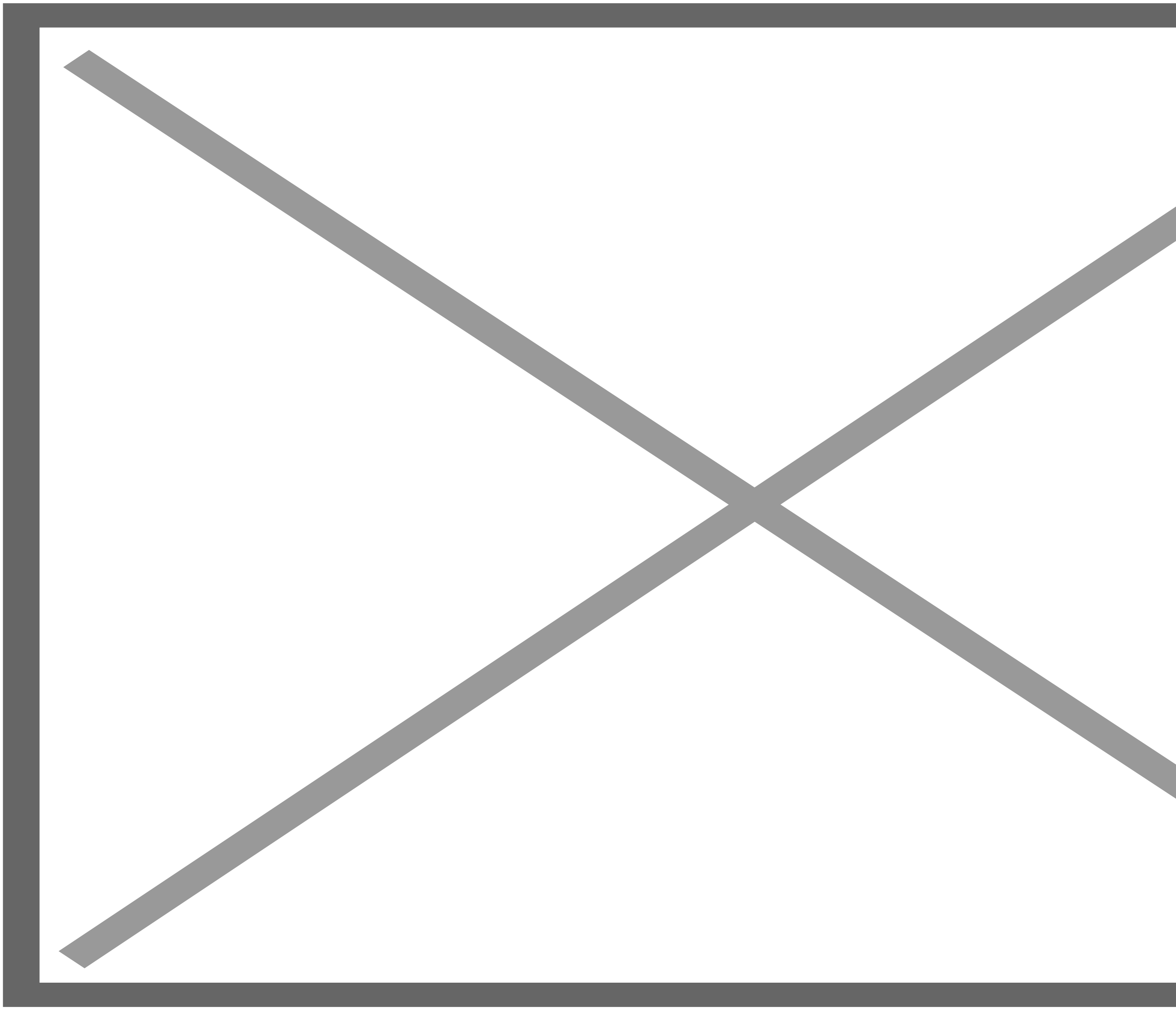
Don't panic!

General Features | Indirect Tax | International Tax | Large Corporate



01 August 2016

Bill Dodwell considers the impact of Brexit on the tax system

The historic EU referendum vote certainly delivered a shock to the country – whichever way you voted. It’s clear that the major issues for the UK will cover market access and the movement of people – but there are some tax issues as well.

The vote will have little immediate impact on direct or indirect taxes. The UK remains an EU member state until a secession agreement is concluded with the EU, and EU laws and treaty obligations will continue to have effect.

VAT and customs duties are EU taxes. The UK would need to introduce its own customs duty system, even though some models would allow the UK to remain in the customs union with the EU/European Economic Area (EEA) member states. VAT already is a part of UK law and would continue without the EU VAT directive, subject to future changes and new legislation for some minor points. VAT issues will be covered in an upcoming article – but it’s worth noting that for both VAT and customs duties the movement of goods between the UK and the EU is likely to require more complicated administration and some cash and cash flow costs.

Following secession, the UK’s approach to taxation could possibly change, since future governments could have more freedom of choice, subject to future agreements with the EU. However, the UK is unlikely to develop wholly new tax systems. The EU direct tax restrictions are relatively minor and the focus on a territorial system of corporate tax is a common model. Similarly, there is a worldwide focus on VAT systems and many emerging economies are introducing VAT.

Possible alternatives to EU membership

There are a number of different alternatives to full EU membership, such as the European Free Trade Association (EFTA) and most favoured nation (MFN) status. Options used by other countries are shown in ***table 1***.

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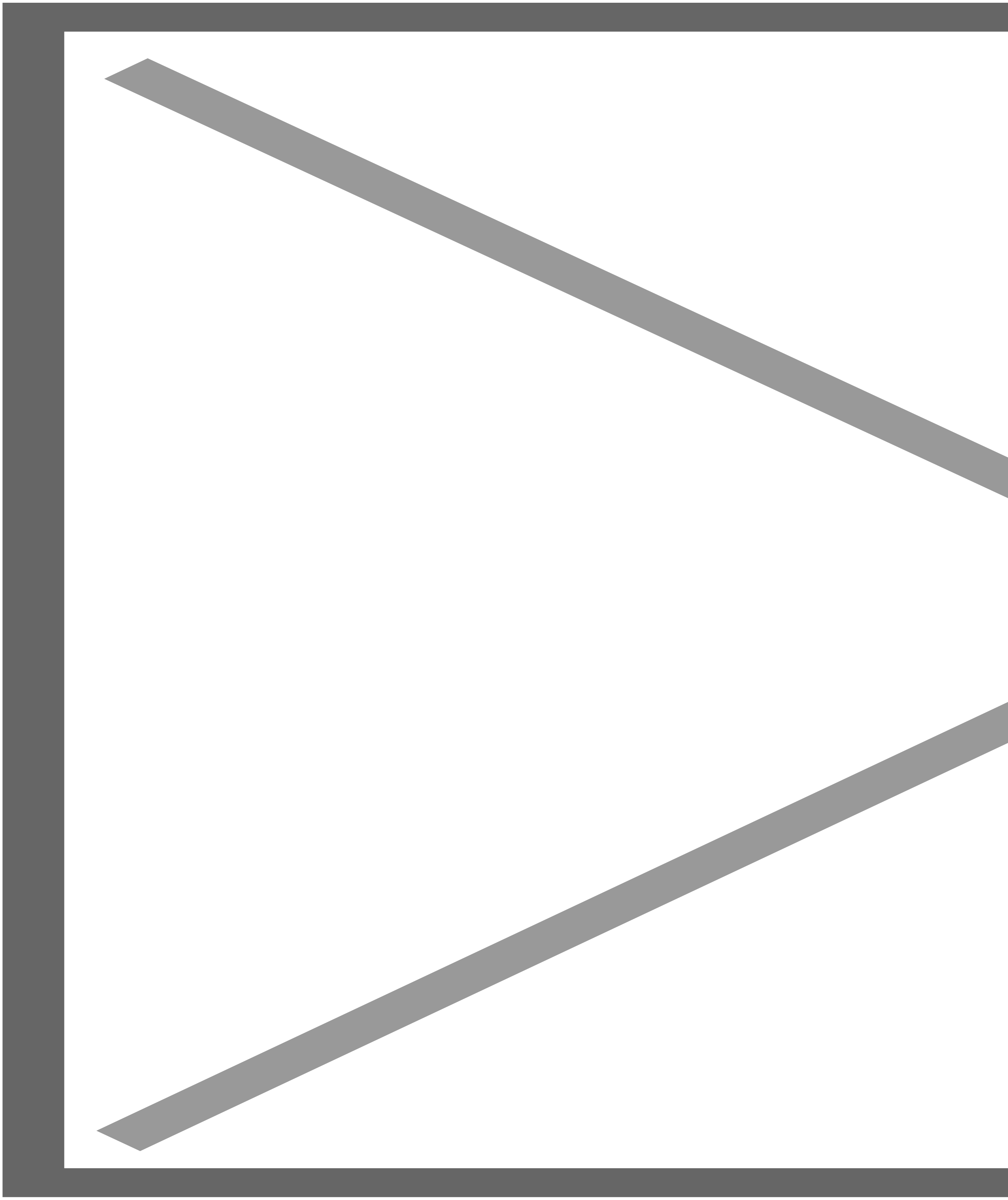

World Trade Organisation (WTO) membership:

The WTO sets out rules governing trade between WTO members (which include the UK). WTO rules do not include any preferential access to the single market, or to any of the 53 markets with which the EU has negotiated free trade agreements. The UK is likely to reactivate its direct membership of the WTO after it leaves the EU.

Customs duty

Following secession, the UK would cease to be part of the EU customs union. Control of customs duty, including rates, would revert to the UK. UK legislation would be needed to replace the EU directives, regulations and council decisions that currently govern customs duty. While the UK could replicate the current EU provisions, the fact that the UK has raised objections to some of those provisions suggests that changes might be made.

Customs and international trade programs (e.g. the authorised economic operator programme) are likely to continue unchanged in effect, as are other customs processes, such as temporary importation, duty suspension, etc.

Perhaps the most significant customs duty-related change affecting businesses would be the recognition of trade with EU member states as imports and exports. Depending on the outcome of the secession negotiations, duty may be payable when goods move to and from EU member states, and this, and the related import and export formalities, could create extra costs.

Excise duty

Following secession, EU-level influence on excise duties would cease. Excise duty rates are not fully harmonised (maximum and minimum rates are governed by EU guidance, as are the holding and movement of excisable goods) and so this is unlikely to result in material changes to UK rates.

Other indirect taxes

Following secession, the UK no longer would be bound by the EU capital duty directive – but is unlikely to reintroduce duty. Indirect taxes such as air passenger duty, landfill tax, climate change levy and aggregates levy would not be affected since they are not governed by EU law (other than perhaps state aid rules).

Direct tax implications

Direct taxes are solely a national competency, which must be exercised in accordance with the EU treaties.

The EU treaties authorise the European Council to issue directives. Member states have implemented a number of tax directives to aid intra-EU trade and investment, as well as administrative cooperation, including:

The parent/subsidiary directive, which generally eliminates withholding taxes on dividends paid to ‘parent companies’;

- The interest and royalties directive, which eliminates certain withholding taxes on certain interest and royalties;
- The mergers directive, which allows the deferral of tax on gains that become due at a company or shareholder level for certain cross-border mergers, divisions, transfers of assets and exchanges of shares within the EU;
- The mutual assistance directive on administrative cooperation between tax authorities (including recent amendments requiring the exchange of rulings within the EU as from 2017 and the intra-EU exchange of country-by-country (CbC) information to tax authorities for accounting periods starting on or after 1 January 2016);
- The mutual assistance directive in connection with the recovery of tax, etc.
- The four EU treaty freedoms—freedom to provide services, free movement of people, free movement of capital and freedom of establishment—are relevant for direct tax purposes. The CJEU has found infringements related to certain aspects of the UK corporation tax legislation. In some cases, the UK legislation has been changed so that the infringement is no longer relevant. In other cases – in particular, group relief for cross-border losses – the UK legislation has been changed, but there are open challenges to the application of the legislation.

In principle, the directives would no longer apply after the UK leaves the EU. If the UK remains within the EEA or a similar arrangement, though, national law would need to continue to comply with the treaty freedoms, since they are broadly the same in the EEA agreement – and the benefits of the directives would still apply.

The UK has a wide double tax treaty network, including treaties with the other 27 EU member states. The UK's treaty policy is to eliminate withholding taxes. Under double tax treaties, there would be dividend withholding tax on dividends from Austria, Czech Republic, Germany and Italy to the UK and interest/royalty withholding tax on payments to the UK from Italy, Portugal and Romania.

Farewell CJEU

Upon secession, the jurisdiction of the CJEU would cease completely in relation to UK matters. Open claims would be decided by the UK courts.

State aid and harmful tax practices

The EU's state aid provisions could still be relevant as these are sometimes included in agreements with non-EU states. Although the UK would not be subject to the EU code of conduct for business taxation, it is a party to the OECD's Forum on Harmful Tax Practices, which has a similar remit.

Tax law of other member states

Some UK and other country tax reliefs are offered only in relation to EU member states. These will need to be considered individually.

Social Security

There is an EU-wide social security directive, which essentially provides that individual on short-term moves would remain liable to home country social security. On secession, domestic law would apply, subject to any social security agreements.

Conclusion

Businesses will naturally wish to start assessing the implications of secession on supply chains and employee moves. It is clear that there will be substantial notice before any changes could occur – don’t panic!