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BREXIT – Tax Q&A

1 How will the UK tax regime change?

It is too early to say. There are many policy options open to the Government. As the Government must give two years notice to terminate membership of the EU (which period could be extended), it is likely that those parts of the UK tax system which must operate in an EU compliant manner will not change until after the UK has formally left the EU.

2 Examples of where the UK tax system has been framed to be EU compliant are the tax rules which deal with cross-border taxation. These are designed so as not to discriminate and to preserve free movement of capital, services and people and the freedom to establish businesses anywhere in the EU. My company based in the UK has investments and businesses in Europe and elsewhere. Will it have a higher tax burden?

The UK has over 160 double tax treaties with countries around the globe. These treaties were entered into independently of EU membership. The treaties are broadly designed to avoid double taxation and, in many instances, reduce or eliminate local withholding tax on income such as interest, royalties and dividends. The treaties in many cases contain non-discrimination articles to prevent, for example, a UK company being taxed unfairly in a way that discriminates between it and a local company in the country in question. Brexit should not affect these double tax treaties.

It is possible, however, that other countries may wish to renegotiate their treaties with the UK.

3 Corporation tax rates have been reducing over the last few years and are set to drop to 17% by 2020. Will Brexit change this?

No, not directly. The reduction in corporation tax rates has been part of the Government's policy of making the UK an attractive business competitive environment both domestically and internationally. Since the Brexit vote, George Osbourne has been reported as wanting to reduce the corporation tax rate further to 15%.

It is possible that the economic impact of Brexit may mean that the Government delays further reductions in the tax rate and it might even increase them in the short or medium term to replace tax revenues that it may lose from other sources.

4 Does Brexit mean that it will be easier to avoid tax?

No. Although the EU Commission actively opposes tax avoidance and has published an action plan to be implemented by all member states, most of the current initiatives to stop multinationals and businesses operating cross-border in ways that artificially reduce their tax liabilities, come from the OECD which is carrying out the Base Erosion and Profit Shifting Project (BEPS) at the request of the G20 Governments. For example, it is very unlikely that Brexit will result in the proposed new interest restriction or the anti-hybrid rules being dropped. We will still have Country by Country Reporting and all of the exchange of information bilateral treaties which the UK has concluded with many territories including tax havens across the globe.

The new Diverted Profits Tax (DPT) in the UK was not really a BEPS proposal or an EU proposal but there is little chance of the UK abolishing DPT as it is essentially aimed at taxing profits that ought to be taxed in the UK but are artificially diverted elsewhere (whether within the EU or outside it).

However, the EU supports the OECD BEPS initiatives but wants to go further in various respects[1]. For example, the EU Council proposes an EU General Anti Abuse Rule[2] which appears broader than the UK GAAR. Brexit may mean that the UK does not have to go further than BEPS; however, the UK will undoubtedly continue to invest in Europe and trade with it and will be affected directly or indirectly by whatever tax avoidance and transparency measures the EU member states implement.

5 My company is about to set up a fund structure using Luxembourg. Should it use a vehicle in another jurisdiction outside the EU for the same purpose?

It is too early to say but Luxembourg is a popular vehicle through which to invest into other EU territories as well as elsewhere. Luxembourg has a wide treaty network and also is able to access the benefits of the EU parent/subsidiary directives removing withholding tax on interest dividends and royalties within the EU. That position will not change but the UK will lose the benefit of those directives and UK companies will need to rely on the UK double tax treaties instead.

6 My company has been considering a group reorganisation involving a cross border merger between a UK company and an EU company or migration of a UK company to an EU member state. What should we do?

The UK has special tax rules that either grant reliefs from tax charges that would otherwise arise on intra-EU reorganisations or defers exit taxes on migrations within the EU and the European Economic Area (EEA) (excluding Switzerland). The EEA Agreement, which entered into force on 1 January 1994, enables Iceland, Liechtenstein and Norway to enjoy the benefits of the EU's single market without the full privileges and responsibilities of EU membership.

It is possible that these special rules will drop away following Brexit and will not be replaced with anything similar. It may, therefore, be sensible to review whether your reorganisation or migration should occur before the UK leaves the EU. If the UK announces it will join EFTA and become part of the EEA, this may not be needed.

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[1] It may be noted that on 21 June 2016 a special committee of the European Parliament recommended an EU public register of beneficial owners of companies, a tax havens blacklist, sanctions against non-cooperative tax jurisdictions, action against abuse of "patent box" regimes, a code of conduct for banks and tax advisors, tax good governance rules in all EU trade agreements and a withholding tax on profits leaving the EU. This is due to be discussed by the European Parliament in July this year.

[2] Article 7 of draft Council Directive on tax avoidance practices affecting the functioning of the internal market (January 2016).

7 My company engages in financial transactions. Will leaving the EU mean that we will not be subject to the EU Financial Transactions Tax?

The EU FTT is in fact supported only by about ten member states[3]. It has not yet been introduced by them in the form proposed in February 2013 in their own countries. There remain disagreements between these countries and it is very possible the FTT project could be abandoned. The UK strongly opposes the FTT and that will be the case whether the UK leaves the EU or not.

However, if your company operates in any of the countries in question directly or through subsidiaries or joint ventures, you will be affected by the FTT if it is ever introduced. Moreover, the design of the February 2013 proposal for the FTT has extra territorial impact and a UK financial institution could find itself bearing the cost of FTT on some of its trades in financial instruments with counterparties in the countries which introduce the FTT or in instruments originating in those countries. The UK will be affected whether it is in or out of the EU.

Contact details

If you would like any further information on the issues covered in this article, please get in touch.

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[3] The countries who remain supporters are Austria, Belgium, France, Germany, Greece, Italy, Portugal, Slovakia, Slovenia and Spain. Estonia has dropped out.

Getting in touch

If you have any questions about what Brexit means for your business, please get in touch.

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