HERBERT SMITH FREEHILLS

Tax

SEPTEMBER 2019

The precise impact on UK tax law of the UK's exit from the EU will depend on a number of factors, not least the nature of the UK's future relationship with the EU, which at this stage presents much uncertainty. However, what is clear is that the UK's membership of the EU has had a considerable effect on UK tax legislation and policy, such that the cessation of application of EU law may have potentially significant implications for the UK tax code.

Indirect taxation

Indirect taxation, particularly VAT, excise duties and customs duties, is heavily influenced by EU membership.

The Taxation (Cross-border Trade) Act 2018 provides a framework for a new standalone customs regime, as well as allowing for the amendment of the UK's VAT and excise regimes following the UK's departure from the EU. The Government's stated aim is to keep the VAT treatment of supplies as close as possible to what they are now, in order to provide certainty and continuity, and to minimise additional administrative burdens on business. The precise nature of the post-Brexit arrangements will depend on the terms of any negotiated withdrawal from the EU or the possible option of a no-deal Brexit.

VAT

EU law provides the framework for VAT and excise rules across the EU. The majority of these rules are set by EU Directives, which are not directly applicable in the UK, and which have therefore been implemented in the UK by domestic legislation, such as the VAT Act 1994. In theory, following Brexit, UK VAT could be repealed in its entirety, but this is unlikely; the Government has not indicated that this is its intention and repeal would be surprising given the significant UK tax revenue generated by VAT. The UK will however gain increased flexibility in determining the scope of UK VAT, including setting rates (for example, determining the goods and services which are to be zero-rated) and defining exemptions. The UK will become a "third country" from the perspective of other member states, which will have implications for the imposition of VAT on cross-border supplies involving the UK. VAT will need to be charged on some transactions where it is currently not charged and UK businesses may need to be registered for VAT in EU countries where they are currently not required to do so.

The section is part of our Brexit Legal Guide.

No Deal

- If the Withdrawal Agreement endorsed by the EU Council on 25 November 2018 or the Political Declaration, or some version of both, are not approved by 31 October 2019 and there is no change to the exit date, the UK will cease to be a member state on that date without any transitional period
- The body of EU law in force at that time will be imported into UK law (with necessary amendments) under the European Union (Withdrawal) Act 2018 and UK legislation made to implement EU law will be retained, with suitable amendments – this is called 'retained EU law'
- A lot of the secondary legislation to adjust retained EU law for the post- Brexit world has already been made, see the accompanying section: The UK's new legal order post-Brexit
- See main body of this note for implications of a no-deal for VAT, customs and direct taxation

Deal/transitional period

- If approved by the UK Parliament, the Withdrawal Agreement, or some

Under the terms of the draft Withdrawal Agreement, the principal VAT Directive should continue to apply during the transition period. The Directive will, for a period of five years after transition ends, continue to determine the VAT treatment of supplies with a cross border element which were made during the transitional period. There is also specific provision in the Agreement that the Directive will apply to supplies of goods which span the day the transition period ends (ie the transport began before that date).

No deal

In the event of a no-deal Brexit, HMRC's technical notes and published guidance for businesses provide that the current rules for importing and exporting goods from and to non-EU countries will also apply to post-Brexit imports and exports from and to the EU. To alleviate a potentially significant cash flow impact for UK businesses, the Government has conceded that postponed VAT accounting would be introduced for imports, meaning that import VAT, which will replace acquisition VAT in relation to EU supplies, could be dealt with through the UK VAT return, rather than at the time of entry into the UK. This treatment will apply equally to imports from non-EU countries.

Customs

Most of the law governing the administration of the EU Customs Union is contained in the Union Customs Code, which is directly applicable in the UK (therefore having automatic legal effect in the UK without the need for domestic legislation); existing domestic legislation is therefore limited.

Under the terms of the draft Withdrawal Agreement, the UK's customs position will remain, during the transition period, as it is pre-Brexit. There will be no requirement for customs declarations to move goods between the UK and the EU and no imposition of customs duty. The UK will be required to maintain its current customs tariffs on third country goods, in order to remain aligned with the EU. In the event of the 'backstop' solution coming into force, the UK will essentially remain in a single customs territory with the EU, which will cover all goods (apart from fish and other sea products).

No deal

In the event of a no-deal Brexit, the UK will cease to be a member of the EU Customs Union. Customs declarations will be required in relation to goods moving between the EU and the UK, as well as the payment of customs duties where relevant. Some costs and administrative obligations may be mitigated by the various 'facilitations' available to businesses, such as the adoption of Authorised Economic Operator status or the use of customs warehousing.

Direct taxation

Direct taxation, including corporation tax and income tax, is generally regarded as an area of competence for member states, but whilst a member of the EU, the UK has been required to exercise its power to tax in accordance with EU law, which has resulted in a number of changes being imposed on areas of UK tax law which were deemed incompatible.

Such changes have included extending the UK's transfer pricing rules to transactions between all related enterprises (including where all parties are resident in the UK), extending the UK's group relief rules so that a non-UK resident company acting other than through a UK permanent establishment can, in certain circumstances, surrender losses to a UK company, adjusting the UK's controlled foreign company (CFC) legislation to exempt CFCs which carry on a genuine economic activity within the EU or EEA, and the UK ceasing to impose a 1.5% Stamp Duty Reserve Tax (SDRT) charge on issues of shares and securities to clearance services and depositaries, which has had a positive impact by reducing the tax burden on IPOs (HRMC has now confirmed that this SDRT charge will not be reintroduced post-Brexit).

No deal

When the UK leaves the EU, if it is then no longer bound to comply with EU law and the fundamental freedoms, it is uncertain to what extent (if any) the UK would amend these areas of tax law to revert to its former position - ie distinguishing between UK and non-UK taxpayers and conversely whether the tax systems of EU member states would discriminate against UK businesses. Any temptation to restore the UK tax system to one which favours domestic companies might be counterbalanced by an incentive to maintain the UK's attractiveness as a place for multinationals to do business and as a holding company jurisdiction. The UK has stated its intention to transpose the current EU state aid regime into domestic law and to give the Competition and Markets Authority the function of regulating the regime in place of the European Commission. In some areas of law (for example, the CFC regime) the UK would in any event be constrained by international pressures, in particular, the OECD's Base Erosion and Profit Shifting (BEPS) project, which aims to combat tax avoidance and aggressive tax planning on a global scale and which has produced proposals for

version of it, will set out arrangements for the UK's withdrawal from the EU – when the UK will cease to be a member state

- A transition period will follow the date of the UK's EU exit up till at least the end of 2020, possibly the end of 2021 or 2022
- During transition, EU law will continue to apply in and to the UK and the UK will continue to trade as part of the Single Market
- The Withdrawal Agreement will be accompanied by the Political Declaration on the future relationship between the UK and the EU. This will comment on the future trading relationship between the EU and the UK
- Whether or not the Withdrawal Agreement or the Political Declaration, or some version of both, are approved by 31 October 2019, the UK will cease to be an EU member state on that date, unless the date for the UK to leave the EU is extended again by agreement between the UK and the EU27 or the Article 50 notice is withdrawn. If there is an approved deal and the UK enters transition, as explained above, the legal position during transition will be very similar for businesses as if the UK were still an EU member state

"Brexit may lead to the UK having greater autonomy to create and shape its own tax regime"

AURELL TAUSSIG

anti-avoidance legislation which are recommended for implementation by all participating nations (including the UK).

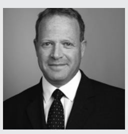
Membership of the EU has also impacted the taxation of payments made between UK companies and associated companies that are resident in other EU member states. EU Directives have provided a 'blanket' exemption from withholding tax for payments of dividends, interest and royalties between associated companies in different member states. The UK's departure from the EU would mean these exemptions would no longer apply. Companies making payments from the EU to the UK would need to rely on the terms of any relevant double tax treaty to reduce or eliminate withholding. In theory, this may make the UK a less attractive option as the location for a European holding company, but in practice, the UK has an extensive network of tax treaties, including with all current members of the EU, which will generally reduce or eliminate any withholding tax. Payments of interest, royalties and dividends from the UK to the EU should remain free of withholding tax by virtue of existing provisions of UK domestic legislation.

The UK's exit from the EU could, in principle, have led cross-border reorganisations to become more complex and less attractive from a UK tax perspective. At present, the EU Cross-Border Mergers Directive provides for tax relief for mergers and transfers between companies incorporated in different member states, provided certain conditions are satisfied. In order to preserve the effect of the Directive in the UK following Brexit, regulations have now been made which amend the various UK tax provisions which implement the Directive, ensuring that these provisions continue to apply to the UK even when it is no longer a member state.

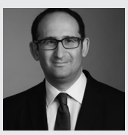
In the event of the UK leaving the EU under the terms of the current draft Withdrawal Agreement, EU Directives will continue to apply to the UK during the transition period.

HMRC has published various guidance notes on trading with the EU post-Brexit (including importing and exporting goods in a no-deal Brexit), as well as the wider tax implications of Brexit (including guidance on changes to the deduction of tax on interest, royalties and dividends in the event of a no-deal Brexit).

Key contacts



Isaac Zailer
Partner, Head of Tax
T +44 20 7466 2464
isaac.zailer@hsf.com



Aurell Taussig
Partner
T +44 20 7466 2451
aurell.taussig@hsf.com