Following its departure from the EU, the UK is now in a transition period until the end of 2020 (referred to in the European Union (Withdrawal Agreement) Act 2020 as the “implementation period”). During this period, EU law continues to apply in and to the UK and the UK continues to participate in the EU Single Market and Customs Union.

**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 beyond the transition period, the terms of which are to be negotiated during that period (see our Brexit blog for details of the EU’s negotiating directives and the UK’s proposed approach to the future UK/EU relationship). Although this still presents much uncertainty, the Government’s high-level aims, insofar as they will have an impact on taxation, include:**

- ceasing membership of the Single Market;
- ceasing full membership of the EU Customs Union; and
- ending the jurisdiction of the Court of Justice of the European Union in the UK.

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, has been 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 (in practice, from the end of the transition period). 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 arrangements beyond the transition period will depend on the terms of the future relationship to be negotiated with the EU.

**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 Value Added Tax Act 1994. In theory, following the transition period, UK VAT could be repealed in its entirety but the Government intends to retain it. This is unsurprising given the significant UK tax revenue generated by VAT and the administrative upheaval for taxpayers and the Government alike caused by repealing a long-standing tax. 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.

Under the terms of the Withdrawal Agreement, the principal VAT Directive will 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 of goods with a cross border element which are made during the transition 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).

Unless an alternative is negotiated, following the transition period, the current rules for importing and exporting goods from and to non-EU countries will also apply to post-transition 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 will be introduced for imports, meaning that import VAT, which will replace acquisition VAT in relation to EU supplies, can 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 Withdrawal Agreement, the UK’s customs position remains, during the transition period, as it was beforehand. There is no requirement for customs declarations to move goods between the UK and the EU and no imposition of customs duty. The UK is required to maintain its current customs tariffs on third country goods in order to remain aligned with the EU.

Unless an alternative is negotiated, following the transition period, 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, in particular with the EU’s fundamental freedoms.

Such changes have included extending the UK’s transfer pricing rules to transactions between related enterprises (including where all parties are resident in the UK) and 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. It also includes 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. This has had a positive impact by reducing the tax burden on IPOs (HMRC has now confirmed that this SDRT charge will not be reintroduced post-Brexit).

Following the transition period, if there is no agreement to the contrary, the UK will no longer be bound to comply with these EU fundamental freedoms. It is not certain to what extent (if any) the UK would amend these areas of tax law to revert to its former positions, 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 fundamental freedoms set out in the Treaty on the Functioning of the European Union, continues to apply in the UK until the end of 2020,

- any attempts post-transition to remove certain regulatory burdens on business which were previously derived from EU legislation may be impacted by any such future relationship/trade deal.

**At the end of transition – will there be elements of no deal?**

- At the end of the transition period, if the new trading relationship is not in place, there could be a no-deal at that point. It is more likely that this will be modified by the introduction of agreed elements of the future relationship or some other temporary set of rules, even though the UK Government has ruled out extending the transition period. There will be no clarity as to what will happen until towards the end of 2020 and the adage “plan for the worst, hope for the best” continues to apply and no-deal guidance therefore remains relevant. See the accompanying section: Leaving the EU – The process and preparations.

  - The body of EU law in force at the end of 2020 will be imported into UK law (with necessary amendments) under the European Union (Withdrawal) Act 2018 and the UK legislation made to implement EU law will be retained, with suitable amendments – this will be called “retained EU law”.

  - A lot of the secondary legislation to make such amendments has already been made but further adjustments may be required by the terms agreed for the future relationship. See the accompanying section: The UK’s new legal order post-Brexit: A new class of UK law.

  - The Government has published a series of 100+ practical no-deal notes with advice for companies, including guidance on Changes to deduction of tax from interest, royalties and dividends from 1 January 2021 and Import, export and customs for businesses.
maintain the UK’s attractiveness as a place for multinationals to do business and as a holding company jurisdiction. 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 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. The EU Parent-Subsidiary Directive and the EU Interest and Royalties Directive have provided a "blanket" exemption from withholding tax for payments of dividends, interest and royalties between associated companies resident in different Member States. The UK’s departure from the EU means that, absent any agreement to the contrary, these exemptions will not apply after the transition period. 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 tax. 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 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, UK regulations have now been made which amend the various UK tax provisions implementing the Directive, ensuring that these provisions continue to apply to the UK when it is no longer a Member State and preserving the status quo.

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

AURELL TAUSSIG