Tax implications of Brexit

Minds made for shaping Financial Services

April 2019

EY
Building a better working world

The UK's departure from the EU will have several impacts on business, including potential implications for regulation, legal, financing, the operating model, foreign exchange and tax. From a tax perspective, Brexit will give rise to several changes, however, it is also worth highlighting what will remain the same.

What will change?

It is worth noting that, subject to any specific future changes to be made by the UK Government, all enacted UK domestic tax legislation will remain in force post-Brexit, including those pieces of law that were originally designed or amended to be compliant with EU law, such as VAT, transfer pricing, and exemptions from withholding tax on interest/dividends.

Minor amendments

The UK Government will have to address the body of UK tax law that derives definitions, etc., from EU law, e.g., the UK bank levy. However, the current UK Government approach is to maintain the status quo where possible in order to provide as much certainty as possible for taxpayers at a time of significant change.

Limitation on powers to make minor amendments

A cross-party amendment to the Finance Bill prevents the Treasury having the right to spend money on no-deal Brexit arrangements (under clause 89 of the Bill). This right is unless:

- There is a negotiated withdrawal agreement and a framework for the future relationship
- The Government has sought an extension of the Article 50 period
- The House of Commons has approved leaving the European Union without a withdrawal agreement and framework for the future relationship.

The amendment effectively requires the Government to use other legislative means (rather than via the power in the Finance Bill) to make any necessary tax changes in the event of a no-deal exit where Parliament has not agreed to that outcome.

Value Added Tax (VAT)

HMRC has released updates to the Specified Supplies Order, the legislation which sets out a business's rights to recover VAT on financial and insurance services. This legislation will be implemented in the event of a "no-deal" Brexit.

The changes maintain the status quo, meaning that only supplies to non-EU customers (other than UK customers post-Brexit) will carry a VAT recovery right. VAT will not, therefore, be recoverable on financial and insurance services to UK or EU customers. The change in wording ensures that the UK is not accidentally treated as a non-EU jurisdiction.

The treatment of financial and insurance services to EU customers has been the subject of a great deal of interest with many lobbying for supplies to EU customers to carry a recovery right. The fact that they will not is likely to be unwelcome and, furthermore, may put UK businesses at a mismatch with EU businesses. This is because, assuming EU VAT law does not also change, supplies from EU business to UK customers will carry a recovery right whereas supplies from the UK to the EU will not.

What would the post-Brexit impact be on UK tax policy?

In a no-deal scenario, the UK Government would be able to set corporate tax policy free of the constraints of EU law, especially EU State Aid rules. However, the Government has already laid a Statutory Instrument (SI) giving the Competition and Markets Authority (CMA) powers to ensure a domestic State Aid regime would be in place in the event of a no-deal scenario. The SI trans-poses the EU State Aid regime into domestic law and it is intended that there will be no material change to the definition of State Aid or to the general prohibition on giving aid.

There are also a number of practical points that may constrain the UK's freedom of action with regard to UK tax policy:

- The UK has signed up to all of the Base Erosion and Profit Shifting (BEPS), Action Plans, including Action 5 on harmful tax practices.
- The UK will presumably, even in the event of a no-deal Brexit, look to agree a free trade agreement (FTA) at some point in the future with the EU, and such a FTA may well include some "level playing field" requirements around tax (amongst other matters).
- The European Commission has prepared papers setting out proposals for possible counter-measures to take against the UK should the UK engage in what the EU considers to be harmful tax practices.
- The UK's approach to tax policy will also be informed by overall fiscal position and what is affordable from an Exchequer perspective.

Where is the greatest potential impact for change from a tax perspective?

Post-Brexit tax impacts include the loss of application of EU fundamental freedoms and taxation Directives with respect to the UK, amongst other things.

EU Directives no longer applying to UK companies

Post Brexit, the UK will no longer be required to give effect to various EU tax-related directives and this may potentially make the UK a less appealing holding and financing company jurisdiction. Perhaps more importantly, however, UK companies would not post-Brexit be able to rely on such directives. In particular, from a corporate income tax perspective:

- **Parent/Subsidiary Directive (PSD)** which prevents withholding tax on dividends paid from one EU company to another EU company and double taxation of parent companies on profits of subsidiaries. Thus, post-Brexit, 8 out of the 27 EU Member States (including, currently, Germany and Italy) would impose withholding tax on dividends paid by local companies to a UK company. The UK will be looking to negotiate revised double tax treaty arrangements with (at least some of) these countries to remove such WHT — but the timing and outcome of any such negotiations is not certain.
- **Interest and Royalties Directive (IRD)** prevents withholding taxes on interest and royalties streams between EU companies. Thus, 5 of the EU27 Member States (including, currently, Italy and Portugal) would, post-Brexit, impose WHT on interest paid by local companies to a UK company. (See above re PSD with regard to possible negotiations to remove WHT.) Another potential point arises because of the way in which the IRD has been implemented into UK law. The enabling legislation in sections 757–767 ITTOIA 2005 makes reference to "companies" as defined in the IRD. This definition applies to a company which "in accordance with the tax laws of a Member State is considered to be resident in that Member State". As the UK will no longer be a Member State, there is an argument that these sections in ITTOIA no longer have an effect.
- **EU Merger Tax Directive (EMTD)** prevents corporate income taxes being crystallized in a number of re-structuring situations, such as mergers, divisions, transfers of assets and exchanges of shares concerning companies of different EU Member States. Where any Brexit related re-structuring is looking to the EMTD to remove the risk of tax being crystallized, particularly in any EU branch jurisdictions, it is imperative that such re-structurings are effected before Brexit to ensure that such tax does not arise.

Restricted application of EU Treaty fundamental freedoms and Court of Justice EU case law

Companies (irrespective of whether based in the UK, the EU27 or anywhere else) will post Brexit no longer be able to rely on EU Treaty fundamental freedoms and CJEU case law when considering their tax position in the UK, or in future disputes with HMRC. Their ability to do so with respect to EU27 jurisdictions, and tax authorities in those countries, may also be constrained compared to the current position (such claims would largely be limited to the application of the free movement of capital provisions of the EU Treaty).

There is also a question as to what impact a no-deal Brexit will have on current disputes with both UK and EU tax authorities that have not yet been determined by a competent court or tribunal.

- **Loss of US double tax treaty benefits for EU subsidiaries of UK owned companies**
  There may be an impact on the eligibility of European entities that are owned by a UK parent to claim relief under double tax treaties between the relevant EU jurisdiction and the US.
- **Restriction on use of EU Arbitration Convention**
  The EU Arbitration Convention establishes a procedure to resolve disputes where double taxation occurs between enterprises of different Member States as a result of an upward adjustment of profits of an enterprise of one Member State.

The Convention is an international treaty rather than EU legislation; however, following Brexit, the UK would not be one of the countries listed in Article 52, and would therefore fall outside the territorial scope of the Convention. This is likely to mean that disputes involving the UK arising pre-Brexit would be dealt with pursuant to the terms of the Convention, but disputes involving the UK arising post-Brexit would not. Consequently, there may be merit in looking to accelerate disputes in order to fall within the terms of the Convention.

Priority activities in a no-deal scenario

Given the challenges mentioned above firms should consider the following activities ahead of Day 1:

- Do you have a plan in place to address the fact that your UK operations, customers and suppliers will no longer be EU established and this may affect access to EU rules including tax directives?
- Have you assessed how your VAT charges, VAT recovery and other taxes will be impacted by the UK leaving the EU?
- Are you able to accelerate initiation of any pending litigation with EU/UK tax authorities that are dependent upon EU Directives or CJEU case law?

How EY can help

EY teams across the UK, key European jurisdictions and the US have been engaged by a number of large financial services firms to support them in fine-tuning their Brexit strategy and assisting in execution. EY professionals have significant experience in providing tax support on Brexit projects, including:

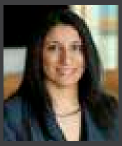
- Advising on corporate tax, VAT and transfer tax aspects of Brexit restructuring
- Tax deductibility of Brexit project costs
- Assisting with tax compliance obligations for new European entities
- Consideration of post-Brexit operating models from transfer pricing and VAT perspective
- Tax valuation of assets potentially impacted by Brexit restructuring
- Advising on personal and employment tax aspects
- Engagement with tax authorities across the EU (and other locations) on Brexit restructuring

Key contacts

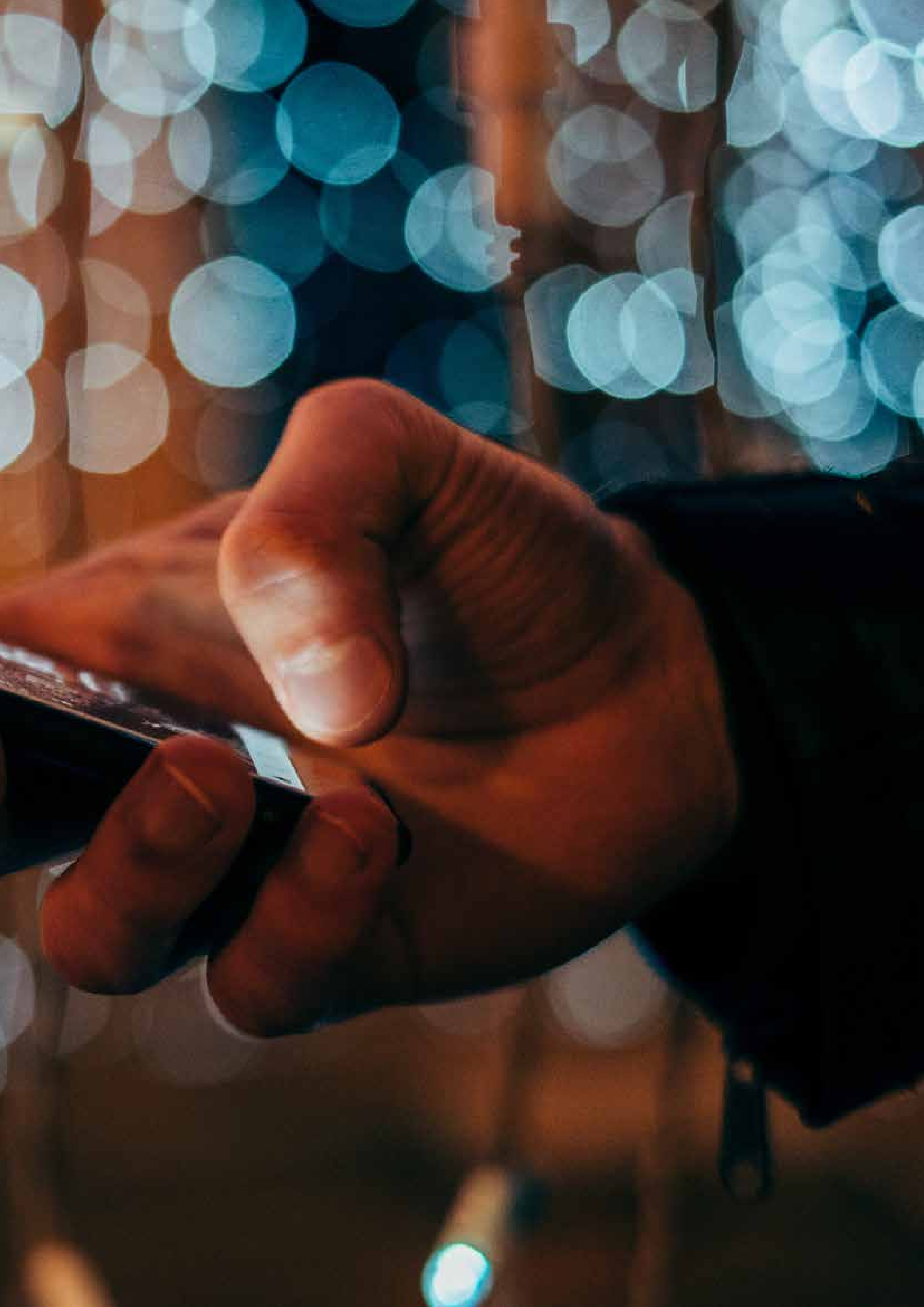
Liam McLaughlin
Partner
EY EMEIA Brexit Lead
lmclaughlin@uk.ey.com

Mark Persoff
Partner
International Tax Services
mpersoff@uk.ey.com

Jenny Coletta
Partner
International Tax Services
jcoletta@uk.ey.com



Tina Ganatra
Executive Director
Transaction Tax
tganatra@uk.ey.com



EY | Assurance | Tax | Transactions | Advisory

About EY
EY is a global leader in assurance, tax, transaction and advisory services. The insights and quality services we deliver help build trust and confidence in the capital markets and in economies the world over. We develop outstanding leaders who team to deliver on our promises to all of our stakeholders. In so doing, we play a critical role in building a better working world for our people, for our clients and for our communities.

EY refers to the global organization, and may refer to one or more, of the member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. For more information about our organization, please visit ey.com.

EY is a leader in shaping the financial services industry
Over 30,000 of our people are dedicated to financial services, serving the banking and capital markets, insurance, and wealth and asset management sectors. At EY Financial Services, we share a single focus — to build a better financial services industry, not just for now, but for the future.

EYG No. 001360-19Gbl

EY-000088811.indd (UK) 02/19.
Artwork by Creative Services Group London.

ED None

In line with EY's commitment to minimize its impact on the environment, this document has been printed on paper with a high recycled content.

ey.com/fsbrexit