NovioTax

BREXIT – what actions are required for companies doing business with and within the UK

April 2018

More than a year has passed since the UK formally opted to leave the EU. We published our first blog on Brexit shortly after the UK formally triggered Article 50 of the EU treaty (withdraw from the Union). At that time, we discussed the likely scenario of a transitional period after the time-frame to conclude a final withdrawal agreement with the EU within two years. We also discussed the likely tax implications and potential steps that could be taken to mitigate or reduce the tax impact of a Brexit. In this blog, we will assess the latest status in the negotiations between the EU and the UK, and update our views and takeaways.

At the end of March 2018, both the EU and the UK presented a joint text of the Withdrawal Agreement which was perceived as a 'decisive step' in the negotiations. However, the text published illustrates that there remains a lot of work to be done and some significant issues are still to be resolved. One key aspect is the inclusion of a transition agreement to the end of 31 December 2020, which should allow both parties more time to negotiate the entire agreement. Furthermore, the text covering citizens' rights and the financial settlement appeared to be agreed. It is confirmed that citizens arriving in the EU or the UK during the transition period will have the same rights as those arriving before. It should be noted however, that even in respect of areas that are agreed, legal certainty on an agreement will only come with legal ratification, which is scheduled for the end of 2018. Also, the UK Parliament has to approve the Withdrawal Bill once it is final.

What if the UK's departure from the EU would cause too many adverse (tax) implications?

At the start of the negotiations, the UK Government has made clear that its key objective is to ensure that the UK legal system remains to function effectively and that its withdrawal from the EU takes place in a smooth and orderly manner. On this basis, it was already likely that the Withdrawal Agreement would include some sort of transition period. Based on the Withdrawal Agreement, the UK will remain part of the single market and customs union in the period until 31 December 2020, but it may negotiate, sign and ratify international agreements entered into in its own capacity in the areas of exclusive competence of the EU, provided those agreements do not apply during the transition period.

The fact that both the UK and the EU seem to acknowledge that a transition period is necessary may provide sufficient certainty that the UK will remain to be part of the single market until December 2020, however, it should be emphasized that there are still businesses working towards the March 2019 deadline until there is a formal ratification of the transition agreement.

Future relation with the Court of Justice of the EU

Over the past years, UK tax legislation has changed and remoulded in order to comply with EU laws such as the four fundamental freedoms (often following case law by the ECJ). Post-Brexit, compliance with some of the EU laws may not be necessary anymore. This could have an adverse impact on UK companies doing business with other EU companies, as protection for loss relief or the avoidance of double taxation in EU context is not guaranteed anymore. This also brings up, perhaps, the most controversial topic in relation to tax: the jurisdiction of the ECJ and the sovereignty the UK is seeking. What will be the impact of pending EU cases and will the jurisdiction of the ECJ on the UK come to an end?

In contrast to what has been stated early in the process by 'hard' Brexiteers, the UK Government now acknowledges that the ECJ still may play a role in relation to the UK post-Brexit. The position paper on 'Enforcement and dispute resolution: a future partnership paper' states that, where agreements between the EU and third countries replicate language which is identical in substance to EU law, it may be agreed that those terms should be interpreted and applied in line with any relevant interpretations of the ECJ which preceded the agreement. Such agreements may also specify that account is to be taken of post-agreement ECJ (and possibly domestic court) decisions when interpreting those concepts. Furthermore, the UK's aim is – again – to provide certainty for the point at which pending cases have been finally resolved. In this respect we note the following consideration points:

- Cross-border loss offsetting has been one of the most important ECJ case law topics regarding outbound investment and following Marks & Spencer (C-446/03) is limited to narrow cases (i.e. liquidation scenarios). Following the Commission v. United Kingdom (Case C-172/13) this definition seems to be amended (definitive losses). It would be interesting to see what the UK would do following the Brexit.

- Cadbury Schweppes (C-196/04) and The Test Claimants in the CFC and Dividend Group Litigation (Case C-201/05) limited the UK controlled foreign companies rules to "wholly artificial arrangements". The BEPS explanation however amend the requirement of "wholly artificial arrangements" in order to achieve a more automatic / quasi-objective provision. Following the leave of the UK we expect that the UK will follow-up on the OECD / BEPS point of view neglecting the concept of artificiality envisaged by the ECJ's case law.

- At this point the UK levies no withholding tax on dividends. If the UK had legislation introduced for a withholding tax on the distribution of dividends, taxpayers might have successfully challenged it (Amurta (Case 379/05), Commission v. Italy (Case C-540/07), et al). We expect that this will not change following the UK's leave out of the EU market.

Tax implications

First and foremost, the most significant impact of the UK's departure from the EU Single Market is likely to be on indirect taxes, as these are already harmonized at the EU level. In addition, the applicable rules in many areas of direct taxation that stem from EU primary or secondary law are also expected to change. Significant developments will also occur in other areas, such as customs, administrative regulations and social security.

In the context of direct taxation, we note that the UK might become less attractive if it does not have the obligation to comply with EU laws, the UK may on the other hand have the freedom to establish a highly competitive tax system. In view of UK's falling corporation tax rate (17% from 1 April 2020), the absence of a dividend withholding tax and a more generous participation exemption (following the latest Finance Bill), the UK already has an attractive tax climate for investors and holding companies. The Withdrawal Agreement, the EU has made it very clear that it demands a 'level playing field' between the two – this includes ways to prevent undercutting on environmental, labour and (most importantly in this context) tax standards.

In terms of direct tax impact which may or may not be mitigated by taking advanced measures, also historic transactions may result in adverse tax consequences as a result of the UK leaving the single market. For instance, it could have an adverse impact on a Dutch fiscal unity, and tax charges could arise accordingly if the Dutch fiscal unity is broken as a result of Brexit. It is worth mentioning that Ireland has (already) acted to remove the de-grouping issue for transfers between Irish group entities on the UK leaving the EU. This is still an issue in the Netherlands and other EU Member States.

In the context of the Dutch fiscal unity regime, it is also worth linking in with the latest developments in respect of the "per element" approach, as established in Group Steria (C-386/14). As described in more detail in an earlier blog, this EU case has resulted in certain benefits for group structures with a Dutch fiscal unity and foreign subsidiaries. These benefits had to be granted by the Netherlands based on EU law. Subsequent to this decision, the Dutch government confirmed retroactive law changes to the Dutch fiscal unity regime, basically cancelling these various benefits. Following Brexit, Dutch law does not have to adhere the four fundamental EU freedoms in relation to UK companies. This illustrates that the UK leaving the EU can have an adverse impact of the tax treatment in the Netherlands.

One other obvious risk that companies should consider is the fact that EU Directives should no longer apply for UK companies. Most notably, this could result in withholding taxes on dividend, interest and royalty payments. UK companies therefore should determine the extent to which relief from interest and royalty withholding is available under any double taxation treaty. The UK has a strong treaty network, but full relief may not always be available. We expect that the most (or at least one of the most) important Directive(s) for companies will become the EU Anti-Tax Avoidance Directive (2016/1164).

The EU Anti-Tax Avoidance Directive introduces five legally binding anti-tax avoidance measures that EU Member States should apply. The areas covered are: interest limitation, controlled foreign companies (CFC), hybrid mismatches, exit taxation and general anti-abuse. The first three rules implement more or less the OECD BEPS-recommendations, while the other two are complementary measures. This Directive aims to ensure a minimum level of protection (and allows states to go beyond the minimum standards provided). EU Member States must adopt the provisions by 31 December 2018 and apply them from 1 January 2019.

The UK will be obliged to implement EU Directives up to the end of the transition period. It is not clear yet what this will imply for the UK's legislation, in particular its CFC regime (which may also have an impact on how businesses are set up in other countries).

As the UK is an OECD member country, however, it has already made progress in implementing the BEPS-recommendations. A considerable number of domestic rules against tax avoidance have already been implemented. As such, the implementation of the EU Anti-Tax Avoidance Directive, and a possible cessation of the application of the EU Anti-Tax Avoidance Directive after the UK's exit, might not have significant tax consequences. In this respect, proposals from the Commission on the taxation of the digital economy are also likely to be implemented by the UK. It is worth noting that the Commission is foreseeing its draft Directives on this matter to be ready for implementation before the end of the transition period, however, from the outset there appears to be some way to go before the Directive can be fully agreed. These topics should be carefully monitored.

Takeaways

- Key point from the Withdrawal Agreement is that "nothing is agreed until everything is agreed", which means that legal certainty on the agreement only comes with ratification later this year.

- The EU wants to have as close a relationship as possible, based on a free trade agreement with no tariffs on goods and a close partnership on security and defence, but the depth of this future partnership is limited by the UK's "Brexit red lines".

- The EU demands a 'level playing field' between the two, in particular in the field of taxation. This should prevent the UK from becoming a "tax haven" for multinational companies. The application of the EU Anti-Tax Avoidance Directive (offering binding anti-tax avoidance measures for EU Member States), controlled foreign companies legislation and general anti-abuse provisions should be monitored. Further developments on the implementation of EU Directives (such as taxation of the digital economy) need to be closely monitored where relevant.

- The transition agreement leaves open how third countries will treat the UK and whether they will agree to roll-over the benefits of agreements reached with the EU and apply them to the UK. This leaves a risk that particular benefits, such as a reduction of the withholding tax rate, may not be available on certain transactions / money flows involving the UK.

- Adverse tax impact may arise on historic transactions as a result of the UK leaving the single market. For instance, it could have an adverse impact on a Dutch fiscal unity, and tax charges could arise accordingly if the Dutch fiscal unity is broken as a result of Brexit.

- The European Court of Justice will still be relevant during the transitional period, and even may still play a role in relation to the UK post-Brexit. In particular, the application of landmark cases as Marks & Spencer (loss relief) and Cadbury Schweppes (anti-avoidance) could be impacted if, for instance, the Court of Justice would further specify certain interpretations at a later stage.

- International groups may want to review their international strategies and determine to what extent they use UK group companies as a gateway to the EU. It is likely that they can also use the time of the transition period (until 31 December 2020) to arrange a solid post-Brexit structure.

Businesses relying heavily on EU Single Market legislation, for instance within the financial services industry, pharmaceuticals, chemicals and aviation sectors, may already need to take action on short notice to safeguard their position. In particular, these types of businesses would be impacted by changes on customs duties, indirect taxes and EU trade benefits.

ABOUT NOVIOTAX

NovioTax is a Dutch research-oriented tax consultancy firm with offices in Amsterdam and Nijmegen. Our employees are members of the Dutch Association of Tax Advisers (NOB) and the International Fiscal Association (IFA), have many years of experience and some are much sought-after guest speakers on tax policy and other topics that fall within their field of expertise. We typically serve midsized and large MNE clients, coordinate discussions with the DTA and closely cooperate with international law and tax law firms.

DISCLAIMER

The information contained in this blog is of general nature and does not address the specific circumstances of any particular individual or entity. Hence, the information in this blog is intended for general informational purposes and cannot be regarded as advice. Although we endeavor to provide accurate and timely information and great care has been taken when compiling this blog, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation. We do not accept any responsibility whatsoever for any consequences arising from the information in this publication being used without our consent.

Patrick Schrievers
+31(0) 6 10 24 61 40
patrick.schrievers@noviotax.com

Gert-Jan Hop
+31(0) 6 27 32 86 47
gert-jan.hop@noviotax.com

Yoran Noij
+31 (0) 6 38 27 23 92
yoran.noij@noviotax.com