The Brexit Papers

Tax Law

Paper 18

Bar Council Brexit
Working Group
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Brexit Paper 18: UK Tax

Summary

Should the UK decide to leave the Customs Union, which would almost certainly increase the costs of trading with the EU, one of the main challenges will be to develop a comprehensive Customs Code. The UK currently benefits from free trade agreements entered into by the EU with third countries which give access to preferential duty rates. Unless and until the UK has its own agreements with such third countries, duty rates faced by UK exports are likely to increase.

In the area of VAT, post-Brexit, decisions of the European Court will effectively remain 'binding' in the UK for so long as the UK's system mirrors that of the EU. The UK courts will however no longer be able to seek guidance from the CJEU nor will the UK have any influence over how EU law is developed by the CJEU.

At present the UK benefits from EU-wide administrative cooperation on exchanging information and tackling tax evasion, in particular in the form of the Mutual Assistance Directive which enables cross-EU border enforcement of tax debts. This will only be able to continue to the extent that the UK has or enters into bilateral agreements replicating this network. There are also a number issues to address on direct taxation, stamp duties, and state aid.

- As with all aspects of Brexit negotiations, the Government's approach to arrangements on tax law will be contingent on other considerations which will reflect the Government's political leadership. We therefore urge the Government to consider the implications of the different approaches, as outlined in this paper.

The Impact of Brexit on UK Tax

1. Taxpayers, particular business taxpayers, need certainty as to the legal and fiscal position in order to make sensible commercial decisions as to investment, jobs, etc. Recent UK Governments have gone some way towards achieving this by outlining a "Business Tax Road Map" which has sought to identify policy goals and broad routes to achieving such goals. That process is now under considerable pressure as a result of the vote to leave the EU, the current debate as to how and when to trigger Article 50 and the absence, as yet, of any published guidance as to how the Government sees the UK tax system developing in a post-Brexit world.

2. There is anecdotal evidence, at least, that some investment destined for the UK has been re-routed elsewhere or deferred and that plans are now well advanced to move businesses (and jobs) out of the UK if greater clarity is not achieved, particularly in the financial services sector. While tax is only one factor in such considerations it is an important one. What follows is an outline summary (no doubt incomplete) of the main issues that will need to be resolved over the next two years or so.

Customs duties

3. At present the UK is a part of the EU customs union which allows free of movement of goods between member states without any customs formalities or duties/tariffs. On leaving the EU the UK will need to decide if it is to remain inside the customs union and, assuming that it does not, the UK will need to introduce its own comprehensive customs code. This will require the UK to determine how it wishes to categorise goods, what goods will suffer what duties and how it is to operate customs formalities (clearance mechanisms, financial security for duties, registration requirements). As it is likely that duties/tariffs will be imposed on trade in goods between the UK and the remaining EU member states, the administrative costs of trading with the EU will increase.

4. Furthermore, the UK currently benefits from free trade agreements entered into by the EU with third countries which give access to preferential duty rates. Unless and until the UK has its own agreements with such third countries, duty rates faced by UK exports are likely to increase.

VAT

5. VAT is an EU tax, derived from (now) the Principal VAT Directive ("PVD"). Post-Brexit, the UK will need to introduce its own VAT system and, in theory at least, the UK has full freedom to design the new UK VAT system as it sees fit, irrespective of the PVD. However, while some 'UK specific features' might be expanded (e.g. an extension in the scope of zero rating or changes in rates), in practice the new UK VAT system will likely have to mirror very closely the EU equivalent so as to ensure that UK business can trade with the EU, and EU businesses can trade with the UK, on an equal footing without the fear of VAT double-taxation or VAT non-taxation.

6. This is likely to mean that decisions of the European Court ("CJEU") interpreting the PVD will, de facto, remain 'binding' in the UK for so long as the UK's system mirrors that of the EU. This is particularly so since the UK courts have to interpret the UK VAT legislation in accordance with the legislative intention of the UK Parliament and the intention of Parliament when enacting the majority of the current UK VAT legislation was to ensure a harmonised VAT system with the rest of the EU. The UK courts will however no longer be able to seek guidance from the CJEU nor will the UK have any influence over how EU law is developed by the CJEU. [1]

7. Other specific issues that will need to be resolved in a new UK VAT system include: (1) whether the UK will continue to benefit from the EU 'one-stop shop' mechanisms that are designed to remove the burden for a business requiring 28 VAT registrations across all member states; (2) whether the UK will continue with the principles of 'triangulation' whereby goods move from (say) a manufacturer in EU member state 1 to the end customer in EU member state 3 without the supplier in EU member state 2 being required to VAT register in either state 1 or 3; (3) in the financial services and insurance sectors, transactions with non-EU counterparts give rise to VAT recovery on costs for UK businesses; it is unclear whether this is to continue post-Brexit and whether it will then apply to transactions with any non-UK counterpart; (4) under the PVD, travel in the EU is taxed under the tour operators' margin scheme whereas non-EU travel is not; how is non-UK travel to be taxed post-Brexit?

Direct taxes

8. The UK's direct tax legislation (corporation tax, income tax etc.) is made by the UK Parliament and, in the main, not based on EU law. Such taxes are, however, subject to the principles of EU law which require, e.g. freedom of establishment and free movement of capital. Such principles have therefore shaped and adapted the UK direct tax code. It is currently unclear whether such principles will continue to influence the courts in the UK as regards future, post-Brexit, periods. In particular, in the context of group reliefs (for e.g. losses) it is EU law principles that have required the concept of a group to be traced through international and not just one member state entities; it remains to be seen whether the UK will return to defining groups by reference only to UK entities. Similarly, the scope and content of the UK's controlled foreign companies regime has been heavily influenced by freedom of establishment principles and, again, it is to be determined how such rules might be applied going forward where such freedoms have (let's assume) no further role to play.

9. In addition, there are some areas of direct tax where EU Directives require particular legislative regimes in the UK. To take three main examples:

10. The Parent-Subsidiary Directive provides that a parent company in one EU member state which receives distributions from a subsidiary company in another member state cannot be taxed in the member state of the parent company. Post-Brexit a group of companies with a parent company in the UK and subsidiaries in an EU member state (or with a parent company

[1] The CJEU is continuing to hear UK cases which were referred prior to the referendum and new VAT cases are still being sent from the UK. It is unclear what will happen to references in the pipeline at the CJEU as Brexit approaches.

in a member state and subsidiaries in the UK) may become subject to double taxation in respect of profit distributions unless a double tax treaty or similar arrangement prevents this.

11. The Merger Directive is designed to remove fiscal obstacles to cross-border reorganisations. In the case of mergers involving a company transferring assets and liabilities to one or more companies in a different EU member state, the Directive provides for a deferral of the taxes that could be charged on the difference between the real value of such assets and liabilities and their value for tax purposes, subject to certain conditions.

12. The Interest and Royalties Directive ensures that interest and royalties can be paid free of withholding taxes from one EU country to another. This freedom from withholding taxes will disappear unless a given payment is protected by the network of the UK's bilateral double tax treaties.

Stamp duties

13. At present the UK is subject to the Capital Duties Directive which prevents, in some instances, EU member states charging indirect tax in respect of the raising of capital by companies (for example, by issuing shares or other securities). UK legislation currently imposes a 1.5% SDRT charge on issues of shares and securities to depositary receipt issuers and clearance services in certain circumstances. However, as a result of the Capital Duties Directive and decisions of the CJEU and the UK courts the UK no longer imposes this charge. Post-Brexit the UK would be free to impose this SDRT charge and also to impose a new capital duty.

Administration

14. At present the UK benefits from EU-wide administrative cooperation on exchanging information and tackling tax evasion, in particular in the form of the Mutual Assistance Directive which enables cross-EU border enforcement of tax debts. This will only be able to continue to the extent that the UK has or enters into bilateral agreements replicating this network.

Other issues

State aid

15. Assuming the UK is no longer part of the EU, the EEA and does not join EFTA, it will no longer be subject to EU law restrictions when seeking to grant state aid. The corollary of that, however, is that it will no longer have any recourse through the EU against member states introducing state aid that disadvantages UK businesses. The EU may well, however, in that situation seek to introduce some form of State aid or subsidy control in any trade agreement that is negotiated with the UK.

"Abuse of law" and anti-avoidance

16. The decision of the CJEU in *Halifax & Others* (Case C-255/02) introduced into English law, at least for the purposes of VAT, the concept of abuse of law, a principle relied on heavily by HMRC in recent years. The concept presupposes an attempt to achieve as result contrary

to the purpose of the PVD which will not work, or work as well, once the UK adopts its own VAT system. One solution, not without some difficulty where the UK adopts a model based on the current, EU derived, VAT system, would be to extend the GAAR regime to include VAT.

Grandfathering and transitional rules

17. Taxpayers, particularly businesses, will need to know well in advance of the post-Brexit new world becoming operational, when and in what circumstances there will be grandfathering and/or transitional rules.

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