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International Tax Newsletter

BREXIT – The impact on UK business taxes

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BREXIT – What might it mean for UK business taxes?

Although it will soon be eighteen months since the Brexit referendum there is still no certainty as to how the UKs "divorce" from the EU will proceed.

It originally looked like matters were on course for a "hard" Brexit – with ties being cut as quickly and cleanly as possible. However since Teresa May, the UK Prime Minister, lost her overall parliamentary majority in the June 2017 general election there are signs that the EU exit terms may be more gradual - with various "transition periods" being muted. Of course this is all subject to agreement between the UK and the EU and there are a myriad of matters which need to be negotiated. It is true to say that the process is proving to be slow and somewhat fractious.

Taxation is not the most important of the exit issues but it is nevertheless interesting to speculate what impact Brexit might have on business taxes.

Legislation

It is helpful to understand the legal process behind Brexit as this has an impact on tax law. Currently the European Communities Act 1972 enshrines the supremacy of EU law in UK national law. That will come to an end with Brexit. EU law will no longer be applicable in the UK. References from UK courts to the European Court (CJEU) to answer questions of UK law will no longer be applicable in the UK and decisions of the CJEU will no longer be binding.

In order to reflect this the UK will pass a Great Repeal Bill. This will also have two other main functions:

- To transfer EU laws and regulations onto the UK statute book; and

- To give the UK powers to amend laws that would not otherwise function sensibly once the UK has left the EU.

Tax professionals are digesting the draft Bill and are concerned that it does not satisfactorily deal with how some UK tax laws should be interpreted in the absence of the backdrop of EU law.

In time it might be expected that the UK will diverge from EU laws but this will not happen overnight.

Custom Duties

Freedom to move goods within the EU without the imposition of custom duties is a central premise of the EU internal market. Leaving the EU need not necessarily mean leaving the Customs Union but there is a high possibility that it might – although this is one area where "transitional arrangements" might be negotiated.

Whilst the financial implications will vary by sector it will almost certainly be the case that, projecting forward, duties will apply to more transactions and the administrative burden of dealing with this will increase.

Value Added Tax

The UK introduced VAT to comply with its EU obligations, so leaving the EU means, in theory at least, that it could abolish VAT. This is thought unlikely, not least because in the 2015/16 fiscal year VAT receipts were £116 billion, representing 22% of UK tax revenue.

In theory the UK could agree to remain part of the VAT Union and some pundits believe this more likely than remaining part of the Customs Union. If not then the VAT treatment of supplies to and from the EU would revert to those in operation for imports and exports elsewhere in the world. This is potentially a double edged sword. Whilst many businesses might be glad that they no longer have to submit EC Sales Lists and Intrastats, the fact that goods imported from EU suppliers will be subject to the clearance procedures currently in place for non-EU imports might outweigh the advantages. The administrative simplifications arising from recent initiatives like the Mini-One-Stop Shop (MOSS) for the provision of electronic services might also disappear.

In the longer term it is possible that the UK might deviate from EU VAT rules. One area where this might be the case for example, is the introduction of more zero-rated items.

Corporation tax

Although corporation tax is a UK domestic tax, this does not mean that it is not influenced by EU rules. Over the last decades there have been many high profile cases heard by the CJEU which have resulted in the UK having to change its tax policy. In time it is possible that the UK tax code could revert, but this is unlikely to be a short-term priority.

Also EU State Aid Rules have often limited the amount that the UK Government are able to pay out to UK businesses as tax incentives. Research & Development tax credits, the Enterprise Incentive Scheme (EIS) - which provides tax relief for investors in smaller companies - and Enterprise Management Incentive (EMI) share options, widely popular with many businesses, currently have to be approved by the EU. Going forward this will not need to happen and the incentives could become more generous. And what to the corporation tax rate? At 19% the UK already has one of the lowest rates amongst the developed economies and legislation has already been passed to reduce this rate further to 17% by 2020. Although the UK Chancellor of the Exchequer, Philip Hammond, appears to be ruling out further cuts, if, as a consequence of Brexit, international businesses start to reduce investment into the UK then this may have to be revisited. On the other hand the major opposition party stood at the last election on a platform of increasing corporation tax rates significantly – and so the future is anything but certain.

International matters

The UK has a wide range of tax treaties which reduce withholding taxes and avoid double taxation. Many of the treaties with EU countries have not been modernised as EU rules have meant that this has not been necessary. Leaving the EU could mean that withholding taxes might apply where otherwise this might have not been the case. Bizarrely this might not only be limited to EU countries. A good example of this is Article 10 of the UK:US treaty. This allows for 0% US withholding tax on dividends paid by a US company to a UK company that has owned at least 80% of the US company for at least 12 months provided the UK company broadly meets the following conditions;

- It owned the 80% prior to 1 October 1998; or
- It is publicly traded on certain exchanges or;
- It is 95% or more owned by 7 or fewer residents of a country in the EU (or European Economic Area) - which currently includes the UK but will not after Brexit.

Unless the treaty is amended it is possible that, with the UK departing the EU, many companies currently enjoying the 0% rate of US withholding tax will see that increase to at least 5%. This is potentially a real cost to UK companies – as the UK generally doesn't tax US dividends there is no corresponding UK tax saving for the US tax.

BEPS has been master-minded by the OECD and is being enthusiastically adopted across the EU. Although the UK will cease to be required to adopt EU BEPS Directives it has nevertheless been a keen supporter of the project and it is likely that it will implement the changes unilaterally.

Future planning

Tax rules change often and planning for future taxes is never certain. Brexit compounds this. As tax represents a significant cost to many businesses it is hoped that as Brexit progresses more clarity will emerge.

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