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# A Brexit from the EU – Better or Worse from a Tax Perspective?

## Overview

Last week's historic vote by the United Kingdom (UK) to leave the European Union (EU) has caused us all to ponder the wide-reaching implications that will flow from this decision. Here, we provide an overview of the potential tax issues that multinational companies will have to address in connection with the UK's withdrawal from the EU, including indirect taxes, interest, royalty and dividend flows, and the overarching OECD/EU BEPS project. We also address potential implications of using the UK as a holding company jurisdiction in a post-Brexit world.

## Indirect Taxes

### Customs Duties

Upon the UK's withdrawal from the EU, the UK will cease to be a party not only to the EU Customs Union, but also to the free trade agreements the EU has struck with third-party states. Depending upon the types of new trade deals the UK is able to negotiate with the EU and third-party states after it has left the EU, UK suppliers (including global enterprises that have used the UK as an entry point to the EU) may face increased customs duty costs. UK suppliers will need to decide whether to absorb these costs or pass them on to their customers as a business matter. In addition, the terms of commercial contracts will need to be carefully reviewed to determine whether existing "boiler plate" clauses drafted at a time when customs duties were irrelevant due to the EU Customs Union and free trade agreements will now result in an unanticipated economic burden of duties being allocated in a way that is detrimental to the supplier.

Some media reports have commented on the possibility of the UK entering into a European Economic Area (EEA) style arrangement with the EU, similar to the Norwegian model. It should be noted that, although the EEA states have access to the European single market, they are not part of the EU Customs Union. Therefore, even under an EEA style arrangement, goods exported from the UK to the EU would have to clear customs at port, which may give rise to increased supply chain costs as described above.

### Value Added Tax (VAT)

In contrast to the potential negative effects from a customs perspective, there may actually be wins for UK companies that have relatively low sales volumes of goods to the EU. If existing VAT principles are applied, otherwise VATable supplies of goods to EU non-business customers will now be treated as being zero rated exports from a UK standpoint. The ability to zero rate a supply (rather than charging UK VAT under the current rules) to non-business customers may provide a price advantage to UK suppliers of goods who are not required to register for VAT under the distance selling rules of the customer's state.

Electronic services are, unfortunately, less straightforward. EU rules require the supplies of electronically supplied services to non-business customers to be subject to local VAT in the customer's jurisdiction. Even after a Brexit, those EU rules will continue to apply (because the customer will continue to be in the EU and so continue to be subject to EU VAT rules). Unfortunately, the VAT rules applicable to electronically supplied services throws up a new problem after a Brexit. As an administrative simplification, so as to avoid the need to VAT register in every customer's state, EU suppliers of electronically supplied services can rely on the MOSS procedure. In short, this means they can make a single EU VAT registration and account for the relevant local VAT through that registration. As a non-EU member, post-Brexit UK suppliers will be able unable to use MOSS. As a result, UK suppliers will have the choice of either having a series of local VAT registrations or incorporating a subsidiary in an EU member state so as to access MOSS.

## Interest, Royalty and Dividends Flows

The UK is fortunate to already have an extensive, pre-EU, tax treaty network in place that includes all of the EU member states. Therefore, UK companies should be able to rely on this existing tax treaty network to mitigate withholding taxes even when the UK can no longer rely on the EU Parent-Subsidiary Directive and the EU Interest and Royalties Directive as a consequence of its withdrawal from the EU. However, the UK's tax treaty network does not provide blanket protection from withholding taxes on dividends paid to the UK. For example, a number of the UK's older double tax treaties, such as those with Germany and Italy, do not reduce the rates of withholding taxes on dividends to zero. There are similar issues with the UK's tax treaties with the Baltic States, the Czech Republic and Slovakia.

In addition, several tax treaties with EU member states do not reduce the withholding tax on interest and/or royalty payments to zero. Multinationals will need to consider whether these costs can be mitigated through an appropriate group restructuring, the use of foreign tax credits and/or the use of intermediate holding companies. This raises a further implication of a Brexit. If multinational groups can no longer rely on the Parent-Subsidiary Directive or the Interest and Royalties Directive, what will the application of any new anti-BEPS provisions (in the form of limitation on benefits clauses applicable through the BEPS multilateral instrument being negotiated at the moment) have on withholding taxes that are mitigated by reliance on double tax treaties rather than the EU Directives? At best, this creates more uncertainty. In some circumstances, it may lead to withholding taxes being applicable where that would not have been the case if the UK remained a member of the EU. These withholding tax considerations are among the many potential impacts that a Brexit will have on the ownership and use of intellectual property in the UK and the EU. Please see our discussion of the key intellectual property issues.

There is good news, at least under current law, with respect to UK sourced dividends to EU payees. Fortunately, the UK does not impose withholding tax on dividends. However, UK subsidiaries may need to be held by an EU company that can rely on a participation exemption for dividend income to minimize payee-country tax costs, because the payee will no longer be able to rely on the EU Parent-Subsidiary Directive to eliminate income tax on UK-sourced dividends.

## OECD/EU BEPS

The EU Commission recently announced the introduction of The Anti Tax Avoidance Package, which is an effort to have a coordinated EU approach to tax avoidance and implementation of the recommendations in the OECD's BEPS reports. It should be noted that the UK is already among the "best in class" on OECD BEPS implementation (e.g., it has implemented diverted profits tax and anti-hybrid legislation and has a proposed consultation on an interest cap). As a result, the impact of this EU package being inapplicable to a post-Brexit UK will likely be minimal. At the same time, the UK would no longer be constrained by the EU's initiatives to implement the OECD/EU BEPS recommendations on timing and terms for implementation. As a result, the UK may welcome this greater flexibility to go at its own (perhaps faster) pace.

## UK Holding Companies

In recent years, the UK has been promoting itself as a beneficial holding company location (both for group holding companies and IP holding companies) with an effective participation exemption, low corporate tax rate (which will reduce to 17% in 2020), competitive IP development incentives such as R&D tax credits and a patent box regime, and a well-educated workforce. It is often the first location outside the home country for many multinationals, particularly those from the United States. While many of these benefits will likely remain after the UK's exit from the EU, the less certain shelter from withholding taxes currently provided by the EU directives could give some companies reason to avoid the UK as a suitable holding company regime or a need to restructure what is already in place. On the other hand, the BEPS project may itself limit the effectiveness of other jurisdictions compared to the UK for setting up holding companies.

## Conclusion

The full impact of the UK's vote to withdraw from the EU is obviously not yet fully known and will unfold over the next several months and years as negotiation of the terms of exit are decided. Fortunately, many of the tax issues associated with the exit should be manageable for multinationals, provided such companies understand today how the changes will potentially affect various transactions, so that modifications can be made as needed. Multinational groups of companies are already addressing the implications of the BEPS recommendations, many of which have been turned into law in several parts of the world and will now need to overlay the changes that a Brexit will require. Hopefully, as the negotiations progress, there will be ever increasing amounts of clarity on what a Brexit will mean from a tax perspective to give multinational groups the time they need to adjust to even more change in an already fast-moving world of international tax.

## Additional Information

Please check our Brexit Legal blog: http://www.brexitlegal.com

We are setting up a series of client briefings to discuss the consequences of Brexit in more detail and will communicate relevant dates and details shortly. In the meantime, if you have specific concerns arising from the Brexit vote or otherwise, please contact your usual Squire Patton Boggs contact or any of the contacts below.

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