The tax impacts of Brexit

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Zoe Hawes reviews the tax impacts of Brexit and asks how businesses can prepare for the imminent changes

Key Points

What's the issue?
In order to prepare for the changes arising at the end of the transiti on period, businesses will need to consider the tax implicati ons that arise as a direct consequence of the UK leaving the EU Single Market and Customs Union.

What can I take away?
At the end of the transiti on period, many areas will change, irrespecti ve of whether or not a free trade agreement is agreed, including a number of impacts to tax. An

early assessment of these impacts will stand businesses in good stead to prepare for the post-Brexit environment.

What does it mean to me?

There will be a number of key changes across customs, VAT, corporate and personal taxes. How these play out will depend on a business's own facts and circumstances.

Following the UK general election in December, the Brexit questi on facing businesses is no longer one of whether the UK will leave the EU, but what form the future relationship between the UK and the EU will take.

At the time of writing, the Withdrawal Agreement and Political Declarati on are expected to be ratified by the UK and the EU imminently. The transition period will then commence from 1 February 2020. During the transition period, EU law continues to apply in and to the UK as if it were a member state. Therefore, UK/EU operations will – for the most part – continue as now.

The UK government has indicated that it will not seek an extension to the transition period beyond 31 December 2020. This leaves limited time for the UK and the EU to negotiate the details of the future relationship.

The expectation is that the economic partnership will take the form of a free trade agreement (FTA). The ambition is for this to be comprehensive, covering goods and services – albeit outside of the single market and customs union there are likely to be additional barriers to trade and potential for divergence from EU regulati ons. 'No deal' is again a possibility at the end of the transition period (albeit special rules apply to Northern Ireland) if a FTA cannot be agreed.

There are a number of areas that we know will change, irrespective of whether or not a FTA is agreed, and a number of tax impacts fall into this category. An early assessment of these impacts will stand businesses in good stead to prepare for the post-Brexit environment and engage early with government on priority issues.

What do we know about the post-Brexit tax landscape?

The transition period means the status quo is preserved in almost every regard for businesses. There will be some immediate consequences in the relations between the UK and the EU (e.g. the UK is no longer represented in EU institutions), and from a withholding tax perspective there are some complexities relating to the

application of double taxation treaties with non-EU countries where the treaty position relies on the UK being an EU member state.

In order to prepare for the changes arising at the end of the transition period, businesses will need to consider the tax implications that arise as a direct consequence of the UK leaving the EU single market and customs union. Additionally, they also need to deal with the tax changes that arise as a result of commercial and operational changes the business makes in response to Brexit.

As is often the case with tax law, the devil is in the detail. However, some of the key tax changes that we can expect at the end of the transition period (including the specific rules applying to Northern Ireland) are outlined below.

Customs

Some of the most significant tax changes are in respect of customs, arising from the UK's departure from the EU customs union.

Customs duties may become due after the end of the transition period, depending on the terms of the FTA (or, in the event of a no deal scenario, subject to the UK and EU Most Favoured Nation tariff rates). The Political Declaration sets out the ambition to eliminate tariffs, fees, charges and quantitative restrictions on UK-EU trade in goods.

In order to benefit from these arrangements, products will need to meet rules of origin (i.e. the rules that determine where a product is 'from'), which will also be agreed as part of FTA negotiations. Similar considerations apply in respect of the FTAs that the UK negotiates with non-EU countries.

Even if a FTA is agreed, businesses will be required to submit customs declarations and to prove origin. Considerations on how to manage this administrative burden include systems capability, whether declarations will be completed in-house or outsourced, and the use of Customs Freight Simplified Procedures (CFSP) to simplify the clearance process at the border. Note that Transitional Simplified Procedures (TSP) were introduced in the UK as part of the UK government's no deal planning, to simplify the customs clearance process (a 'lite' version of CFSP). However, it is unclear whether TSP would be introduced at the end of the transition period.

Businesses with significant volumes of UK-EU trade may also want to consider applying for Authorised Economic Operator (AEO) status. AEO status may reduce delays at the border, reduce the level of guarantees, and reduce the number of audits by customs authorities – but requires businesses to have robust processes and controls in place.

VAT

Movements of goods between the UK and the EU become imports and exports. Import VAT will become payable, potentially creating a cash flow cost. The UK is expected to introduce postponed import VAT accounting for goods imported from both EU and non-EU countries, and a number of EU member states (e.g. the Netherlands) already operate this.

A number of EU VAT simplifications – such as triangulation, distance sales and call-off stock – will no longer apply in the UK, potentially creating additional EU registration and reporting requirements. Some EU member states may require UK established taxpayers to appoint a fiscal representative.

Supplies of services by UK businesses to EU customers will likely be treated in the same way as supplies to non-EU recipients. This will lead to a number of VAT accounting changes for suppliers of digitised services, financial services, tour operators and businesses in other sectors; for example, where use and enjoyment rules apply. (The use and enjoyment rules ensure that services are taxed where the service is used and enjoyed.) For example, assuming the no deal measures previously announced apply at the end of the transition period, VAT relating to supplies of many financial services by UK companies to EU counterparts will be recoverable.

Other administrative changes will take place. For example, UK businesses will need to use the overseas refund procedure for non-EU established businesses (‘13 th Directive’), rather than using the EU VAT refund mechanism (‘8 th Directive’).

Corporate

There will be a number of changes as a result of EU Directives no longer applying to the UK. For example, withholding tax (WHT) may become due on EU/UK interest or royalty payments (albeit certain principles relevant to UK to EU payments are directly legislated in UK law), and on EU to UK dividend payments (the UK does not

levy WHT on dividends).

The default position will be to rely on double taxation treaties (DTTs) between the UK and individual member states. Whilst the UK has an extensive treaty network, a treaty will not always reduce the WHT rate to nil. Businesses may need to secure clearances to apply the treaty rates.

Local eligibility for certain tax reliefs or regimes may depend on entities being EU-established. For example, the tax consolidation regime in the Netherlands typically requires local entities to have a common EU parent company.
For many taxpayers, the most significant direct tax Brexit impacts will be those arising from commercial changes and reorganisations. Where a group changes the location of functions or assets, or the nature of its supply chain, this will invariably require analysis of capital gains, exit charges and the appropriate transfer pricing approach.

Personal

From a people perspective, the change to immigration rules is a key impact for many businesses. EU nationals living in the UK will need to confirm their residency status under the EU Settlement Scheme.

The UK’s new immigration system is expected to come into force from 1 January 2021, which would align the rules applying to EU and non-EU nationals (potentially along the lines of the Australian points-based system).

Each EU member state sets its own immigration laws for third-country nationals. UK nationals who have no residency rights in those countries (with the exception of the Republic of Ireland) will likely face new immigration processes from 2021.

The personal tax and social security position will need to be considered for mobile employees. Uncertainty remains around what the social security framework will be at the end of the transition period. Under EU regulations, individuals are covered by the legislation of one country at a time and have the same rights as nationals of the country where they live.

At the end of the transition period, the UK will no longer be party to these regulations; and so, absent any agreement between the UK and the EU or individual member states, dual social security liabilities could arise.

Whilst the UK has old bilateral agreements with some EU countries, these are limited in scope and not necessarily fit for purpose in today's business environment. There could also be an impact on individual state benefit and healthcare entitlement, and additional administrative burden on employers.

Ireland/Northern Ireland Protocol

The Ireland/Northern Ireland Protocol is designed to avoid a 'hard border' on the island of Ireland, and will apply as long as it has the democratic support of the Northern Ireland Assembly – regardless of whether or not the UK and EU agree a FTA.

Northern Ireland remains in the UK customs territory, but EU customs rules apply to Northern Ireland. No border checks will take place on the island of Ireland. Goods moving between Northern Ireland and the EU will not be subject to customs duty at the Irish border. However, goods coming from another part of the UK or the rest of world to Northern Ireland will be subject to EU customs duties where they are 'at risk of' entering the single market, although the practical details are yet to be defined.

Northern Ireland will remain subject to EU VAT rules for goods, but not services. The UK will have discretion to align VAT exemptions and reduced rates to those in the Republic of Ireland for goods sold in Northern Ireland. The precise details of how the arrangements in the Protocol will operate will need to be agreed by a Joint Committee during 2020.

What might the future hold?

The UK's judicial landscape for tax will also change post-Brexit. Once the transition period ends, there will be no new references to the European Court of Justice (CJEU) and the UK's Supreme Court will be the final court of appeal for UK tax litigation.

It is possible that we will see changes to UK tax law to encourage investment into the UK. One example is the government exploring free ports and could look at the tax incentive landscape. However, it is worth remembering that the Political Declaration provides for 'robust commitments to ensure a level playing field', including in relation to state aid and relevant tax matters.

Businesses need to monitor developments and engage with government. This is important both during the transition period and in future years, as the UK's post-Brexit tax and trade policy landscape takes shape.