

MOFO BREXIT BRIEFING

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BREXIT: TAX IMPLICATIONS

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The majority has spoken: on Friday 24 June, it was announced that the UK had voted to leave the European Union (the “EU”). The full implications of this decision are largely unknown, given that the UK is navigating uncharted territory and that the withdrawal provisions are brief, and have never before been applied. However, there are a number of likely tax implications and business concerns of which clients should be aware.

The process of Brexit will take time and the implications for our clients’ business will unfold over time. Our MoFo Brexit Task Force is coordinating across all our offices and working with clients on their key concerns and issues, now and in the coming weeks and months. We will also be providing MoFo Brexit Briefings on a range of key issues. We are here to support you in any and every way that we can.

OVERVIEW: THE DOMESTIC IMPACT OF EU DIRECTIVES AND REGULATIONS

EU Regulations, which operate automatically without the need for Member State implementation, will continue to bind the UK until the date of withdrawal. It is difficult to predict a timeline as to when the UK will officially exit the EU but, until such date, all EU Regulations will continue to apply in the UK.

EU Directives, on the other hand, tend to provide a framework, or a legal objective, which needs to be implemented into the domestic law of Member States. The UK therefore has many domestic laws that have been based upon or heavily influenced by EU law (such as the Equality Act 2010, for example). These will continue to bind the UK, unless and until they are formally repealed by Parliament.

The key piece of national legislation in this regard is the European Communities Act 1972 (the “ECA”), which provides the legal basis for the constitutional relationship between the UK and the EU, and grants the EU supremacy over the UK’s domestic law. Many EU

Directives have been implemented in the UK as statutory instruments under the ECA. Accordingly, if the ECA were repealed, all of the statutory instruments passed under its authority would also become ineffective.

TAX IMPLICATIONS

WITHHOLDING TAXES

There are a number of EU Directives in place which were intended to facilitate the freedom of establishment. The key directives for these purposes prohibit the imposition of withholding taxes on intra-group interest, dividend and royalty payments within the EU, namely through the Parent-Subsidiary Directive and the Interest and Royalty Directive.

Companies rely on these Directives to make intra-group dividend, interest and royalty payments, free from withholding taxes. However, by withdrawing from the EU, the protection of these EU Directives is lost. Instead, companies will have to rely on any existing double taxation treaties in order to address withholding tax issues. It should also be noted that not all treaties eliminate withholding tax to a 0% rate, so a UK company that invests overseas could be liable for withholding taxes on dividends received from its subsidiaries. We expect the UK government to address these issues prior to exit from the EU to maintain the UK's attractiveness as a place for global companies to do business and locate their regional holding company.

Businesses should consider any cash flow issues that may arise as a result of the double tax treaties in place between the UK and the jurisdictions of their subsidiaries, as these treaties often allow tax authorities in the paying company's jurisdiction to impose full withholding tax and require recoupment of any reduction in rate only after a demonstration of entitlement to benefits under the applicable treaty. It may be that the withholding tax implications will impact a group of companies so significantly that a restructuring becomes necessary.

It may be worth noting that some double tax treaties may require re-negotiation of certain provisions. For example, the Limitation of Benefits article in the UK/US Treaty (Art. 23, para 7(d) defines "equivalent beneficiaries" in the case of a UK resident to include residents of a Member State of the European Community or of a European Economic Area state. Query whether it will be necessary to amend this definition of the treaty post-Brexit.

THE MERGER DIRECTIVE

The EU Merger Directive was intended to facilitate cross-border re-organisations between companies in different EU Member States. This Directive allows for the deferral of certain taxes that could be chargeable on the difference between the market value and tax value of assets and liabilities on a group re-organisation.

If the UK does not continue to fall within the scope of the Directive post-Brexit, it could result in taxes being imposed on cross-border mergers between UK businesses and EU businesses.

VAT

The EU introduced VAT harmonisation measures through the EU Principal VAT Directive, in order to facilitate trade between Member States. The UK's VAT law is a product of not only EU legislation, but also its own national implementation measures and binding EU-level case law.

The system of VAT is very likely to continue to apply in the UK post-Brexit, but leaving the EU could allow the UK to make desired modifications to its VAT system, most likely by setting its own VAT rates, selecting its own reduced rate supplies and creating its own exemptions. While derogating from the EU VAT scheme grants flexibility, it is also likely to require an overhaul of the VAT-related procedures that businesses have grown comfortable with, for example, the methods of reclaiming VAT from EU tax authorities. Given the potential risk of double taxation, the UK may wish to keep its VAT system in line, as far as possible, with other EU Member States.

However, without knowing the form that the UK's departure from the EU will take (see our summary of the possible approaches in our general [Brexit Briefing](#)), and how negotiations with the European Commission will proceed, it is difficult to speculate on the exact changes that will be seen in the VAT sphere. The most likely repercussion would be the introduction of import VAT on goods entering the EU from the UK, potentially resulting in cash flow issues for businesses due to the delay between the payment of customs charges and recovering the input VAT.

Businesses should be live to the issue of needing extra working capital to address any cash flow issues. They should also consider whether any administrative or structural changes need to be implemented in order to manage VAT registrations throughout the EU.

CUSTOMS DUTY

Again, without knowing the exact form of the UK's relationship with the EU post-Brexit, it is hard to know how much the legal landscape in relation to customs will change. If the UK were to exit the EU's Customs Union, imports from the EU to the UK, and exports from the UK to the EU, could become subject to customs duties. There would also be practical issues to consider, such as the extra time, expense and effort needed to obtain customs clearance on both imports and exports. In such an instance, it would undoubtedly be less attractive for EU companies and consumers to choose UK suppliers when purchasing goods.

Businesses will need to be aware of any increased costs, both in terms of importing from EU suppliers, and exporting to EU customers. They will also need to consider how competitively their goods can be supplied against EU suppliers. Additionally, the size and

scale of sales within the EU will need to be considered, as some businesses may find it more profitable to shift manufacturing operations to an EU site in order to avoid customs duties.

WHAT NOW?

The two year Brexit notice period will give businesses the opportunity to review their international strategies and structures in the light of the terms of exit and the consequential changes made to the UK domestic tax system. A good place to start is perhaps the impact of the Parent Subsidiary Directive and Interest and Royalty Directive no longer being available to UK-based businesses.

MOFO CONTACTS

Please do not hesitate to call with any question or concern you have. We're here to help.

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