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July 14, 2016

What Does Brexit Mean for UK Tax?

Once the formal procedure under Article 50 of the Lisbon Treaty is initiated by the United Kingdom, the government will negotiate the terms of its exit from the European Union. Whilst we must accept that this is a period of dynamic change, we can forecast that the Brexit-related UK tax changes will fall into two main categories. First, there will be changes that necessarily and directly flow from the constitutional and legal changes under Brexit. Second, some tax changes may be more indirect, being inspired by the perceived need for the government to respond to economic uncertainty arising from Brexit by making the UK more tax competitive. This advisory summarises some of the broad areas of tax changes post-Brexit.

Corporation Tax

Earlier this month, in an interview with *The Financial Times*, the then-UK Chancellor stated that he would seek to reduce the UK corporation tax rate to below 15 percent in order to attract and retain business investment. This follows the UK Government's Budget 2016 commitment to reduce corporation tax to 17 percent by 2020. If achieved, a corporation tax rate of 15 percent (or lower) would bring the UK's rate very close to the Irish headline rate of 12.5 percent. However, business optimism about this rate should perhaps be tempered with a degree of caution for a few reasons. The first reason is that Philip Hammond, the new UK Chancellor (appointed on 13 July by Theresa May, the new Prime Minister, who took office on the same day) will need to be of like mind and be willing to adopt the same policy. Secondly, it is possible that, as a political matter, any proposed reduction in UK corporation tax could become part of the broader Article 50 negotiations. Finally, if the reduction in corporation tax is expected to reduce overall tax receipts, the Treasury might need to make other tax changes in order to balance its books.

Withholding Tax

Under certain circumstances, the EU Parent Subsidiary Directive and the EU Interest and Royalties Directive provide for no withholding tax to apply to dividends, royalty and interest payments between associated companies in different Member States. Whilst the benefit of these Directives is likely to be lost post-Brexit, the UK will not necessarily become less attractive as a jurisdiction for EU holding companies because the UK has a very extensive network of bilateral double tax treaties (including double tax treaties with all current Member States), resulting in little or no real change in many cases. Some difficulties may be encountered though, for example, where the relevant treaty does not provide for zero percent withholding tax (Germany and Italy being notably difficult).

VAT

As a Member State, the UK has been bound by the value added tax (VAT) rules embodied in the EU VAT directives and regulations. Following Brexit, the repeal or a wholescale reduction seems unlikely for the foreseeable future because VAT is a significant source of tax revenue. Over time, however, it seems likely that VAT in the United Kingdom will diverge from EU VAT, as the UK begins to exercise its freedom to define the scope of its own VAT rules, including setting its own rates and exemptions. The UK should have the opportunity to make some favourable or popular changes, for

For more information, please contact the following member of Katten's **Tax Planning** practice.

Sanjay Mehta
+44.0.20.7776.7623
sanjay.mehta@kattenlaw.co.uk

example, reintroducing zero-rating for the grant of a major interest in commercial buildings or certain changes to the VAT rules applying to financial services. One side effect of divergence may be that businesses face increased compliance burdens or costs due to the need to adhere to an additional VAT regime when operating multinationally.

Customs Duties

The UK will need to negotiate continued membership of the customs union in order to avoid customs procedures and duties for goods sold into the European Union. The fall-back position is likely to be the World Trade Organization's (WTO) "most-favoured nations" duties, which, whilst still low in many cases, would represent a disadvantage for UK companies when compared with those in the EU.

State Aid

EU Member States are prohibited from giving unlawful state aid and subsidies to particular businesses or sectors. This rule extends to tax competition, especially in relation to tax rulings given by Member States to multinational enterprises. Going forward, the ability of the UK to provide state aid to entities will depend on the relationship it has with the EU. Members of the European Economic Area (EEA) (such as Norway) still need to adhere to state aid rules. However, if the UK leaves behind the EU state aid rules altogether, EU Member States might be free to disadvantage the United Kingdom (as it would no longer be a Member State), whilst the UK also would be able to disadvantage EU Member States, through the use of state aid.

European Case Law

Initially, at least, it is likely that the decisions of the European Court of Justice (CJEU) relating to common areas will be followed. This applies especially in relation to VAT (see above)—whilst EU and UK rules remain similar—even if the CJEU judgments will not necessarily be binding on the UK.

One area of difficulty that the UK and other EU Member States have encountered in recent years has been the need to reconcile the potential conflict between fundamental freedoms of the European Union (especially the freedom of establishment and the free movement of capital) and national tax legislation. In a number of instances (for example, the controlled foreign companies rules), the judgment of the CJEU has resulted in the United Kingdom having to amend UK tax legislation in order to give full effect to the fundamental freedoms. It remains to be seen whether and to what extent the judgments of the CJEU will be either binding or persuasive in relation to this body of law post-Brexit.

EU Anti-Tax Avoidance Initiatives

The recently agreed EU Anti-Tax Avoidance Directive (being part of the wider EU Anti-Tax Avoidance Package) is set to come into effect on 1 January 2019, by which time the full legal effect of Brexit may have taken place. The Directive includes anti-tax avoidance rules on interest deductibility, hybrid mismatches, controlled foreign companies, general anti-avoidance rules and exit charges to prevent assets or residence being shifted to low tax jurisdictions. The provisions of the Directive are largely derived from the Organisation for Economic Co-operation and Development's (OECD) Base Erosion and Profit Shifting (BEPS) project, although in some respects go further. The overall effect of the Directive should be to ensure broad implementation across the European Union. As the UK has strived to be an early adopter of such international tax standards, it is likely that the Directive will already have been implemented prior to its start date, irrespective of Brexit.

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Katten Muchin Rosenman UK LLP

www.kattenlaw.co.uk

Paternoster House, 65 St Paul's Churchyard • London EC4M 8AB
+44 (0) 20 7776 7620 tel • +44 (0) 20 7776 7621 fax

7/14/16