

## Legal Alert



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## Brexit: What it means for UK tax

### Overview

On 23 June 2016, voters in the United Kingdom came out marginally in favour of ending the country's membership of the European Union. The 'Leave' (or 'Brexit') campaign obtained a 51.9% share of the vote, compared to the 'Remain' campaign's 48.1%.

The vote for the UK to leave the EU will bring in tax changes. The nature and extent of these will depend on the terms of the UK's continuing relationship with the EU, but possibly the most significant impact will be on customs duties.

### Tax Implications of Brexit

Broadly speaking, the EU tax rules that have been incorporated into UK law are intended to create a level playing field and to remove tax obstacles to cross-border activity. EU member states are required to exercise their power to tax consistently with EU law (and the fundamental freedoms enshrined in EU law). For example, on that basis, the UK has previously been required to amend its domestic tax laws (regarding, notably, controlled foreign companies and loss relief) to ensure consistency with EU law. In the short term, the vote for Brexit is unlikely to have any material impact on the UK tax environment, because these EU rules and freedoms will continue to have effect.

The UK's tax system will also continue to be subject to other international influences. In particular, the Organisation for Economic Co-operation and Development (OECD) is becoming increasingly influential in various aspects of tax policy. Indeed it is expected that there will be further efforts to align the tax regimes of most economies (including those of the UK and EU) with the recommendations made by the OECD's Base Erosion and Profit Shifting Project (BEPS).

### Direct Tax

In the longer term, the UK's eventual exit will mean that it will not be bound by, but will no longer benefit from, the EU's initiatives in relation to direct taxation.

There are various ongoing EU initiatives in the field of direct taxation, including: the European Commission's (EC) investigation into tax rulings and State Aid issues, the EC's transparency package (which requires, amongst other things, exchange of rulings between tax authorities), the EC's Action Plan on Corporate

Taxation (which includes a proposal for a mandatory Common Consolidated Corporate Tax Base), and the recently agreed Anti-Tax Avoidance Directive (which includes provisions that relate to controlled foreign company regimes, interest deductibility rules, exit taxation, and hybrid mismatches, alongside a general anti-abuse rule).

In addition, the UK may no longer benefit from the EU's Interest and Royalties Directive (which removes the obligation to withhold tax on payments of interest and royalties to related companies in other member states) or the Parent-Subsidiary Directive (which has the same effect for dividends). Although, under the UK's extensive network of double tax treaties, the interest withholding obligation is reduced or even eliminated, and the UK does not apply withholding tax to dividends as a matter of domestic law, losing the benefit of these EU Directives may reduce the UK's attractiveness as a holding company location in certain circumstances. Conversely, it is also possible that Brexit enables the UK to adopt business friendly measures (not only in relation to taxation, but also, for example, in terms of corporate law and financial regulation) to a degree that it could not achieve whilst a member state of the European Union (in light of the need to comply with EU law).

## Indirect Tax and Customs Duties

Value Added Tax (VAT) is a significant source of revenue for the UK Government and, as such, the UK will almost certainly retain a VAT system (possibly in the form of a sales or goods and services tax). Nevertheless, post-Brexit, the UK will have the freedom to develop its own rules (for example, on which services are 'zero-rated' or 'exempt', in order to support certain sectors).

One area which could see significant change in the longer term, however, is customs duty on the cross-border transfer of goods.

Subject to what trade deal (if any) the UK is able to negotiate with the European Union and with other countries with which the EU currently has trade deals, this could result in:

- a) customs duty (and import VAT) being payable for imports into the UK from the EU and vice versa (coupled with the administrative burden of filing import and export declarations etc.); and
- b) customs duty being payable for imports into the UK from countries with which the EU has trade deals and vice versa (import VAT is already payable and import / export declarations already need to be filed for such movements).

## Implications for multinational groups

Multinational companies with operations in the UK and other EU member states will need to consider whether their current structures are viable if, for example, they are dependent on trade between the UK and the rest of Europe. Restructuring, particularly for supply chains, and the renegotiation of UK to EU contracts, will

almost certainly become necessary.

## Other Resources

The London office has a dedicated website ([www.bakermckenzie.com/brexit](http://www.bakermckenzie.com/brexit)) where you can find the most recent materials in relation to Brexit.

In addition, the London office has produced a [checklist](#) that outlines the core questions that an organisation should be asking itself in order to understand the implications of Brexit.

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