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Brexit: immediate international tax issues

The Conservative party has won a large majority in the House of Commons which sends a clear message for the direction of travel for Brexit. Prime Minister Boris Johnson has ruled out any extension of the transition period. This means that:

- there is little doubt that the UK will legally leave the EU on January 31, 2020 and begin its transition period, during which the UK will continue to participate in the single market, customs union and all EU policies; and
- the deadline for reaching a comprehensive future trading agreement, or facing a "no deal" outcome is now to be locked in as December 31, 2020, when the transition period will end.

The prominent international tax impact of these deadlines is as follows:

31 January 2020

EU Tax Directives continue to apply

Where the UK leaves the European Union with the transition deal as proposed, the Parent/Subsidiary Directive and the Interest and Royalties Directive should continue to apply during the transition period. This means that the position regarding cross border withholding taxes from an EU company to a UK company should remain the same as it is today. This is due to specific notice that the application of the Directives should remain during this period. While foreign domestic law has of course then imported these Directives into local law, it is expected that the EU27 will respect this notice as it relates to these Directives and taxation at source (withholding taxes).

UK entities may fall outside the scope of some domestic tax law provisions in individual EU countries, creating potential exposure

There are of course other areas of domestic law in the EU27 which reference an EU or EEA Member State, but where such reference is not imported from a Directive. There is no requirement for the EU27 to treat the UK as an EU/EEA state from January 31 as it relates to these matters. Examples of such references could be:

- an EU member state providing an exemption from Controlled Foreign Companies rules for EU/EEA resident companies (ie a white list)
- an EU member state allowing for tax consolidation, simplified reporting or tax groupings including domestic and EU/EEA resident companies
- rules allowing for tax neutral transfers of tangible or intangible assets between domestic and EU/EEA resident companies
- specific reliefs or benefits for eg R&D activity performed domestically or in an EU/EEA member state.

January 31 therefore may provide a hard close for such topics.

There is of course the possibility that an EU27 state may change its domestic law to alter provisions referring to an EU/EEA Member state such that they also include the UK – and this could be in formal change of law or potentially via statutory concession of some sort. This is likely to be case by case and could be unlikely, depending on the provision.

Action to take now

Multinational groups should act now to review current and historic treatment of their EU companies and transactions for any reliance on provisions which reference an EU/EEA Member State, where such provision has been or is applied with reference to the UK.

EU-US tax treaties may cease to apply in certain cases

Further, there may be broader international tax impacts of the UK's loss of EU/EEA status. Several double tax treaties between EU Member States and the US contain references to Member States in determining whether an entity is capable of qualifying for treaty benefits. It is therefore easy to envisage an example where eg a US increased tax burden could occur as a result of the January 31 events.

Action to take now

Multinational groups should review their wider tax profile including treaty positions for any reliance on EU companies or EU based tests with reference to the UK.

31 December 2020

The status of the UK's position on December 31, 2020 will of course depend on the nature of the free trade agreement between the EU and the UK, if indeed such an agreement is reached at all. Multinational businesses should now plan for the most disruptive scenario: a no deal exit on December 31.

Further to the impacts discussed above as they relate to the start of the transition period, a no deal exit would also then remove the application of the EU Directives as they relate to the UK. Cross border payments from an EU resident company to a UK resident company which previously relied on either the Parent/Subsidiary Directive or the Interest and Royalties Directive to reduce or eliminate withholding taxes would no longer qualify for benefits under these provisions.

The impact of such a move is as follows:

- double tax treaties between the EU Member and the UK should be reviewed to determine whether the payment could qualify for treaty benefits, and the rate obtain by the treaty
- this could mean an increased withholding tax imposed by an EU Member State on such a payment
- this would mean new compliance and administration – treaty reliance may include new applications and formalities
- consideration would need to be given to the ability for the UK recipient to credit any withholding taxes suffered.

HMRC released guidance on March 21, 2019 stating that the UK intends to continue to apply the provisions of the Directives to outbound cross border payments. There should therefore be no increased burden as a result of Brexit on UK payments to EU Member States.

The matters discussed above are not an exhaustive list and there will no doubt be other international tax considerations as a result of the Brexit dates for many multinationals. Any business model changes driven by Brexit leading to transfers of functions or new business decisions would of course have tax considerations and secondary tax impact too – ie impact on transfer pricing and cash extraction. A 'whole tax' approach should be taken to review options and plans.

Actions

Identify potential exposure to withholding tax on EU payments to the UK from December 31, 2020.

Review 'whole tax' implications of Brexit legal changes and your Brexit plans, with both January 31 and December 31 events in mind.

Contact us to discuss how we can help

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