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Brexit: what might change
Tax

Introduction

On 23 June 2016 the UK population voted for the UK's exit from the European Union (EU). The applicable exit procedure and certain possible tax consequences of Brexit will be discussed below.

In the short term, we do not identify material changes for the legal practice. The European law and regulations will remain in force until the negotiations between the EU and the UK have been completed and the withdrawal procedure has come to an end. To which extent European law and regulations will also apply following the UK's exit from the EU, will largely depend on the outcome of the negotiations. One of the fundamentals of the EU is the internal market, allowing for the free movement of goods, services, workers and capital (Internal Market). In this context we note that in January 2017, Prime Minister May announced that the UK will opt for a "hard Brexit", meaning that the UK will no longer maintain membership of the Internal Market, nor accede to any associated status. Instead, the UK will seek a free-trade deal with the EU outside the Internal Market.

Brexit – background

Since 2007 (Treaty of Lisbon), the EU Treaty offers a Member State an explicit legal basis to leave the EU (Article 50 TEU). Pursuant to Article 50(2) TEU, the UK can start the exit procedure by giving notice to the European Council. The exit agreement will be concluded on behalf of the EU by the Council[1], acting upon a qualified majority[2] and after having obtained the consent of the European Parliament. The agreement must set out the arrangements for the UK's exit and take account of the framework for the UK's future relationship with the EU. The UK cannot participate in the relevant discussions or decisions of the European Council or Council.

The EU Treaties cease to apply to the UK from the date of entry into force of the exit agreement or, if there is no such agreement, 2 years after the date of notice under Article 50 TEU, unless the European Council, in agreement with the UK, unanimously decides to extend this period. The exit procedure has never been called for and the way forward is full of uncertainties. Apart from Article 50 TEU, no further provisions or guidelines apply.

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1 The Council consists of a representative of each Member State at ministerial level, who may bind the government of the Member State in question and cast its vote (Article 16 TEU).

2 The qualified majority shall be defined as at least 72 % of the members of the Council representing the participating Member States, comprising at least 65 % of the population of these States (Article 238(3)(b) TFEU).

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What types of tax are coordinated at EU level?
The EU coordinates and harmonises multiple fields of taxation, including corporate income tax, withholding tax, capital tax and, in particular, VAT & Customs regulations. In addition, EU freedoms and case law of the European Court of Justice (ECJ) have had a significant impact on domestic tax rules. This note mainly deals with the potential consequences of Brexit on corporate income tax and withholding tax. We have described the potential impact of Brexit on VAT & Customs regulations in a separate note.

EU Parent-Subsidiary Directive
The EU Parent-Subsidiary Directive (EU PSD) provides for two benefits. Firstly, the EU PSD abolishes withholding tax on dividend distributions to EU parent companies owning 10% or more in qualifying EU subsidiaries. Secondly, the Member State of the parent company is obliged to provide for double taxation relief in the form of an exemption (of at least 95%) or a tax credit for profit distributions received from such an EU subsidiary for levying corporate income tax. A comparable arrangement applies between EU Member States and Switzerland.

In this respect, Brexit may affect UK parent companies investing in EU subsidiaries, as a consequence of which UK parent companies might have to rely on tax treaties to reduce withholding tax on dividends. The bilateral tax treaties between the UK and respectively Belgium, Luxembourg, the Netherlands and Switzerland may, however, safeguard withholding tax exemptions on profit distributions made by companies resident in said countries to their UK parent companies. To this extent, the impact of Brexit will probably be limited.

As the UK does not levy withholding tax on dividends, EU parent companies of UK subsidiaries should not be affected insofar it concerns dividend withholding tax. On the other hand, the EU parent company's country of residence may no longer be obliged to provide for corporate income tax relief for dividends received from UK subsidiaries. The participation exemption or reduction regimes in Belgium, Luxembourg, the Netherlands and Switzerland do however not (only) rely on the EU residency of the subsidiary. As such, the adverse impact of Brexit for holding companies with UK subsidiaries in the BeNeLux and Switzerland will probably be limited as well.

EU Interest and Royalty Directive
The EU Interest and Royalty Directive abolishes withholding tax on interest and royalty payments made between associated EU-resident companies (i.e. companies with a 25% direct ownership link or through a common parent entity). Because the UK levies 20% withholding tax on both interest and royalties, Brexit may certainly affect intra-group financing and licensing arrangements. The bilateral tax treaties of the UK mitigate this issue only to a certain extent. For example, the Belgium-UK tax treaty allows 10% withholding tax on interest, whereas the Luxembourg-UK tax treaty allows 5% withholding tax on royalties.

EU Tax Merger Directive
The EU Tax Merger Directive provides for the possibility of tax-neutral, cross-border mergers within the EU. This roll-over facility may no longer be available for EU companies that merge with a UK company after Brexit. Hence Brexit may hinder cross-border restructurings.

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EU Anti-Tax Avoidance Directive

In the same week as the Brexit vote, the EU reached political agreement on the EU Anti-Tax Avoidance Directive (ATAD), which is essentially implementation by the EU of part of the OECD BEPS project. Following Brexit, the UK will no longer have to implement the ATAD. However, the UK has introduced unilateral anti-tax avoidance rules by itself, which arguably have a broader scope in some instances than the ATAD provisions.

Further harmonisation: CCCTB

The next level in EU harmonisation of corporate income tax, the Common (Consolidated) Corporate Tax Base (CCTB and CCCTB), has recently been tabled again by the European Commission. With the UK leaving the EU, the changes the CCCTB will become reality arguably increase as the UK has always been one of the main opponents.

Transparency

Alongside the ATAD developments, the EU has been working on increasing transparency on tax matters, including the exchange tax rulings between Member States and (publicly available) country-by-country reporting. The UK would be excluded from these obligations, although following the implementation of the OECD Common Reporting Standards in 2017, comparable information has to be disclosed anyhow.

Impact on domestic legislation

Many domestic tax laws of the BeNeLux apply in a similar way to resident companies as well as to companies resident in another EU/EEA jurisdiction in order to comply with EU freedoms and ECJ case law. In this respect, parent-subsidiary and fiscal unity regimes, roll-over facilities for corporate restructurings and dividend tax exemptions or refunds for EU pension funds, for example, may come under examination. The application of such rules to UK resident companies may differ after Brexit.

Impact on the application of bilateral tax treaties

Despite treaties for the avoidance of double taxation generally apply on a bilateral basis between two countries, Brexit may nevertheless impact the application of some aspects thereof. For instance, the definition of ‘equivalent beneficiary’ - which is part of the ‘limitation on benefits test’ in many tax treaties that Member States have concluded with the US - includes EU/EEA resident beneficiaries. Brexit may therefore impact EU (i.e. non-UK) companies that currently rely on their UK beneficiaries to benefit from tax treaty relief in relation to the US.

What next?

Once the UK invokes Article 50 TEU, the UK and the EU will negotiate the terms of Brexit. It will be a highly political process and the outcome is as yet unclear. Therefore it is of the utmost importance to monitor the developments and the potential impact on your company’s tax position closely. We will keep you informed about further developments.

Please contact your trusted adviser at Loyens & Loeff or send an e-mail to Brexit@loyensloeff.com if you have any queries.