

## Brexit and Taxes

Writing about Brexit is not an easy task. I have written articles only to see them go out of date a few moments after I've pressed the send button on the email to the editor. Indeed, I have had articles go out of date while I've been writing them. The challenge for the Brexit writer is compounded by the necessity of trying to write something that amounts to more than a long-winded shrug. I hope that this article amounts to marginally more than a long-winded shrug, even if it is being written in highly uncertain times, and will almost certainly be a little out of date by the time you read it.

This is where, at the time of writing on 16 January 2019, we stand on Brexit and taxes.

As a result of having served notice of its intention to leave the EU on 29 March 2017 under the so-called Article 50 procedure, the United Kingdom (UK) is currently scheduled to leave the EU, as a matter of law, on 29 March 2019.

There are essentially three possible short-term scenarios:

- The UK parliament ratifies the Withdrawal Agreement concluded between the UK government and the EU (see below), in which case the UK enters a transition period (also see below), which will last until at least 31 December 2020.
- The UK parliament does not ratify the Withdrawal Agreement, in which case the UK leaves the EU on 29 March 2019, and does not enter into a transition period.
- The UK government requests an extension of the Article 50 period beyond 29 March 2019, or unilaterally revokes the Article 50 notification.

### I THE WITHDRAWAL AGREEMENT, TRANSITION AND THE BACKSTOP

In respect of the backstop (i.e. the insurance policy designed to ensure that no hard border is created on the island of Ireland), the Withdrawal Agreement broadly provides that, in the absence of an alternative agreement regarding the future relationship between the UK and the EU by the end of the transition period, there would be a single customs territory between the EU and the whole of the UK. This would prohibit all customs duties and

quantitative restrictions between the UK and the EU, and taxes on imports in excess of those applying to similar domestic products. Northern Ireland will be subject to additional provisions: while it will remain part of the UK's custom territory and VAT area, it will also fall within the EU's regulatory union and certain EU VAT and excise rules will apply in Northern Ireland with respect to the movement of cross-border trade in goods.

Neither the UK nor the EU is able unilaterally to terminate the backstop.

It is this aspect of the Withdrawal Agreement in particular which has become the focus of opposition in the UK among a number of Conservative and Democratic Unionist Party (a strongly pro-UK Northern Irish party on which the government relies for its parliamentary majority) MPs. Their fear is that the backstop is a trap for the UK: if triggered, it would mean not only that after transition Northern Ireland would be treated differently from the rest of the UK, but that the UK would not be able to negotiate independent trade deals with, for example, the United States (US).

During the transition period, the EU will broadly treat the UK, and the UK will treat itself, as if it were a Member State, such that the UK will effectively be part of the EU customs union and regulatory framework, subject to the jurisdiction of the Court of Justice of the European Union, still required to accept freedom of movement of citizens from other EU Member States and contribute to the European budget, but all without any participation in EU decision-taking. The EU will request that third countries also treat the UK as part of the EU for the purposes of their free trade and other agreements: it remains unclear to what extent those third countries will agree to do so. It is possible that there may be some changes to international trade even in the event that the Withdrawal Agreement is ratified.

The Withdrawal Agreement does not, as a matter of law, conclude the future trading relationship between the UK and the EU. Instead, the parties have concluded a Political Declaration on the future relationship between the EU and EU, establishing a general but non-binding direction of travel for future negotiations during a transition period. As it currently stands, that Political Declaration is so vague it is

capable of providing the basis of a range of future trading relationship, from a customs union to a looser arrangement similar to the free trade agreement entered into between the EU and Canada. The lack of precision has attracted further discontent from some accusing the Government as leading the country into a 'blind' Brexit.

## 2 A MEANINGFUL VOTE

The UK Government postponed the intended meaningful parliamentary vote on the Withdrawal Agreement that was originally scheduled for 11 December 2018, on the basis that it would result in a heavy three-figure defeat, with over 100 Conservative MPs expected to rebel, with the Democratic Unionist Party, the Labour Party and other minority opposition parties voting against the 'deal'. Despite little (if any) evidence that sufficient numbers of MPs were inclined to vote in favour, the vote was held on Tuesday 15 January 2019.

As expected, Parliament rejected the Withdrawal Agreement in that vote by a historic margin of 230 votes. A range of different scenarios, sketched out in brief below, could now play out. It is not impossible (it may indeed even be the Government's calculation) that after Parliament has failed to agree on any alternative way forward (assuming finding an alternative way forward proves impossible), the Government will bring the Withdrawal Agreement back to Parliament as the only alternative to the consequences of failing to ratify the Withdrawal Agreement (as also described below).

## 3 NO DEAL

If the UK fails to ratify the Withdrawal Agreement, it will leave the EU on 29 March 2019, will not enter into a transition period and will immediately be treated by the EU as a third country. It will, as a matter of law, cease to be subject to the rights and obligations under existing EU agreements.

Precisely, how a 'no-deal' Brexit would impact the UK and the EU is impossible to predict, as is the response of the UK government and EU in the weeks and months following such an outcome. Needless to say, should the UK leave the EU without ratifying the Withdrawal Agreement, the potential for the disruption to impact not only the UK and the EU, but to cause contamination in other key global players such as the US, China and Japan, should not be underestimated. The ill will fermenting between the EU and the UK (likely to be exacerbated if the UK government were to decide not to honour what it had previously accepted as the UK financial obligations on leaving the EU) could complicate both the EU-UK relationship and the development of new UK relationships with other countries (including the US) for some years to come.

## 4 ALTERNATIVE DEAL

Although the default legal position is that the UK leaves the EU on 29 March 2019 as described above, there appears to be a very large majority in Parliament opposed to a no-deal outcome. It is therefore highly unpredictable what might happen next after a rejection of the Withdrawal Agreement: the collapse of Theresa May's Government and a General Election cannot be ruled out. Equally, Parliament could form a majority around an alternative exit route (such as, perhaps, the European Economic Area (EEA)/European Free Trade Association (EFTA) 'Norway +' option). Or, Parliament could, conceivably, decide to refer the matter back to the electorate in a further referendum. Any of these alternatives would be very hard – impossible in fact – to complete before the current Article 50 time limit of 29 March. In these circumstances, the UK could ask the EU to extend the Article 50 process. This can only be done by unanimous agreement of all twenty-seven remaining EU Member States. Their interest in doing so will be heavily conditioned by whether their reading of the evolution of UK politics is such that they conclude that they will either get a deal more favourable to the EU through a renewed negotiation, or stand a better chance of avoiding a 'no deal' Brexit, or even securing no Brexit at all.

## 5 No Brexit

At any point until 29 March 2019, the UK can decide unilaterally to revoke its Article 50 notification and remain in the EU on its existing terms of membership. In principle, the UK could unilaterally revoke its Article 50 notification during an extension of the Article 50 period.

It is not clear whether the UK government could unilaterally revoke its Article 50 notification without an Act of Parliament authorizing it to do so and, politically, even more uncertain whether it could do so without first asking the public to reconsider their decision to leave the EU in a second referendum. In practice, there is insufficient time before 29 March 2019 to introduce legislation for, and hold, a second referendum including an option on whether the UK should remain in the EU or not. An extension of Article 50 would, therefore, be required, but there is currently little appetite in the UK government or parliament to legislate for one.

As things currently stand, neither the UK government nor parliament shows an inclination to revoke Article 50, or request an extension. Assuming that sentiment persists following the result of the vote on 15 January 2019, the stark choice for the UK parliament is, then, still between the Withdrawal Agreement and a 'no deal' Brexit.

## 6 WHAT DOES THIS MEAN FOR TAX?

If the Withdrawal Agreement is ratified and comes into force, then nothing changes in the field of tax until (in

likelihood, at least) 31 December 2020. The UK is treated vis-à-vis by and in relation to the EU as if it were still a member. This means that, for example, UK companies with subsidiaries in the EU will continue to benefit from zero withholding tax on interest and dividends under the Parent-Subsidiary Directive, the UK will still be required to keep its VAT regime consistent the principles set out in the Principal Directive and it will still be subject to the jurisprudence and jurisdiction of the Court of Justice.

Because the UK will be a non-Member State in a transition period, it will not have a vote in the formulation of European tax policy. This may have an impact. The House of Commons European Scrutiny committee expressed concern over European Commission proposals to amend the VAT Directive. This proposes a maximum EUR 85,000 (GBP 76,300) turnover threshold for companies. The UK has the highest registration threshold in the EU at EUR 94,146 (GBP 85,000), which it aggressively increased over the last twenty-eight years from a base of GBP 25,400 in 1990. The Chancellor, who reportedly was considering reducing the threshold, has agreed to freeze it until at least 2022. The UK has no right of veto during the transition period. If this new VAT Directive were to come into force during transition, the UK would be required to reduce the turnover threshold. I suspect that secretly the Treasury wouldn't be adverse to this outcome (few think it was an economically sensible policy to raise it so fast and so significantly) but it is a real-life example of the impact that 'vassalage' could have on the UK, particularly if transition is extended beyond 31 December 2020.

It is after transition ends that the UK may, if it so chooses, be able to diverge its VAT system from the EU's (see commentary in J. Cape & M. Schofield, *VAT and Brexit: The Past, Present and Future*, 27(6) EC Tax Rev. 290–302 (2018) on how it might choose to do so). However, should the Northern Irish backstop kick in, it will only be able to do so in Great Britain, as Northern Ireland will be required to align with EU rules in order to keep an open border with Ireland.

In the event of a no-deal Brexit, the UK and the EU are taking different approaches.

For most purposes, the UK, through the auspices of the European Union (Withdrawal) Act, effectively takes a snapshot of its legislation on 29 March 2019, and preserves that position unless and until the UK parliament explicitly repeals it. Certain changes to tax law are, for example, made under the Taxation (Cross-border Trade) Act 2018 available at <http://www.legislation.gov.uk/ukpga/2018/22/contents/enacted> (accessed 14 January 2019).

This means that on 30 March 2019, the Parent-Subsidiary Directive will still apply in the UK such that payments of interest can still be made by a UK subsidiary to its EU parent free of withholding tax. If the UK imposed withholding tax on dividends, the same position would have applied. The UK VAT Act

will still be required to be interpreted in accordance with historic Court of Justice judgments delivered on or before 29 March 2019, including such non-UK specific concepts, like 'abuse of rights' (again until the UK decides to legislate otherwise).

The Government also intends to make legislative changes in the event of a no-deal Brexit, such as effectively abolishing import VAT and replacing it with acquisition VAT. This will apply not only in relation to imports from the EU, but from anywhere in the world, perhaps because of concerns that differentiating between the EU and non-EU would give rise to WTO issues. The main reason for this change is to reduce friction at the ports, as acquisition VAT moves compliance away from the border at the time of physical import.

On 8 January 2019, MPs, including six former Conservative Cabinet minister, inflicted a defeat (303 votes to 296) on the government by forcing an amendment to the current Finance Bill. The amendment curtailed the ability of the government to make certain technical changes (such as changing references to GBP from EUR) to the UK's tax code to ensure that it could still function in the event that Parliament had not expressly consented to a no-deal Brexit. It's not apparent which provisions the Government expected to need to change under this power, and the defeat was more symbolic than real.

The EU intends to take a different approach. On 30 March 2019, the UK will under a no-deal Brexit be a third country outside transition. The Parent-Subsidiary Directive will not apply which means, depending both on whether the relevant EU Member State imposes withholding tax on interest and dividends, and whether there is a relevant double tax treaty reducing the rates of withholding tax to zero, a subsidiary may now need to start deducting tax on payments to its UK parent. (There is nothing in EU law to prevent the Member State from amending its double tax treaty to eliminate such withholding tax although the absence of dividend withholding tax and the relative ease with which UK withholding tax on interest can be avoided through the Quoted Eurobond Exemption means that such a treaty amendment may not be near the top of the priority list for such Member States).

There are practical issues too, such as what happens to tax cases currently pending in the Court of Justice, or awaiting judgment, on referral from the UK courts. One such example is *Blackrock Investment Management (UK) Limited*, [2018] UKUT 0415 (Tax and Chancery Chamber TCC), available at [https://assets.publishing.service.gov.uk/media/5c1b8313ed915d0b7268ef4d/BlackRock\\_Investment\\_Management\\_UK\\_Ltd\\_v\\_HMRC.pdf](https://assets.publishing.service.gov.uk/media/5c1b8313ed915d0b7268ef4d/BlackRock_Investment_Management_UK_Ltd_v_HMRC.pdf) (accessed 9 January 2019), a case involving the VAT exemption of supplies of the management of special investment funds, which was referred to the Court of Justice by the Upper Tribunal on 20 December 2018. If the Court of Justice does not decide a case until after 29

March 2019 (and it's not clear whether it would decide it at all in the event of a no-deal Brexit), that judgment would not be binding upon the UK court that referred it.

At the point at which the UK leaves the EU or, if later, exits a transition period, a more interesting question is the extent to which it decides to use the opportunity and newly found freedom to reform its tax system more fundamentally. A point that is often made (not least by me) is that the EU does not generally restrict a Member State's tax policy other than in relation to VAT and, to the extent it has done so, the intervention has tended to result in more business-friendly tax laws: the UK's dividend exemption, relaxed grouping rules and soft Controlled Foreign Corporations (CFC) regime

largely emerged as responses to Court of Justice judgments. So if the UK wanted to reduce its tax as a proportion of GDP while a member of the EU, it could have done so. 15% rate of corporation tax? No problem! 30% flat rate of income tax. Sure! Abolish inheritance tax? Bring it on!

Nonetheless, Brexit may provide a catalyst for social and economic change that facilitates the UK attempting to become more like low-tax Singapore than Sweden. There are certainly those who advocate that it should. But almost certainly a greater than a 52% majority who think that it should not.

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