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The Tax Impacts of Brexit

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What are the key tax impacts of a 'no deal' Brexit?

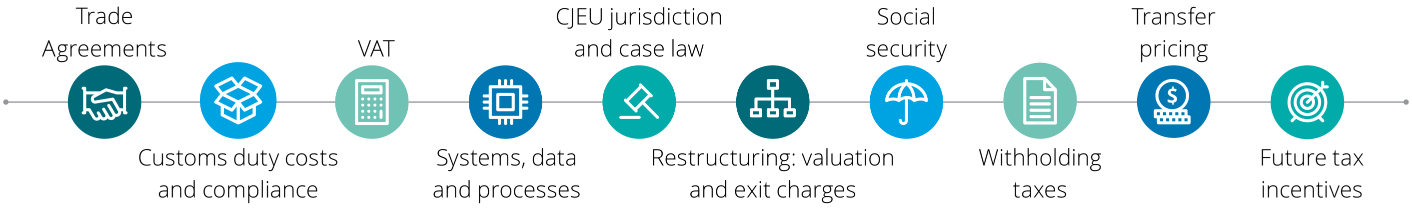
There are a number of tax changes that will arise if the UK leaves the EU without a deal by virtue of the UK no longer being a member of the Single Market and Customs Union. Businesses are also making commercial and operational changes in response to Brexit, including restructuring, changes to supply chain, and setting up in new (or expanding operations in existing) locations, which all entail tax changes. It is important that the tax consequences of Brexit are factored into planning in order to avoid unexpected tax costs arising. As the relationships between the UK and the EU, and between the UK and third countries, evolve, the tax impacts will need to be managed.

The main indirect taxes are harmonised at EU level. The VAT Directive, for example, applies to all EU Member States (although there are differences between countries in how this is implemented), and the Union Customs Code ('UCC') governs the import, export, handling and transit of goods within the EU. Direct taxes, on the other hand, are largely governed by individual Member States although there are some EU Directives affecting corporate tax and social security rules intended to support the functioning of the Single Market. These will no longer apply in the UK, which could lead to additional tax costs for businesses and individuals.

Where the tax changes arising as a result of Brexit have a material impact on the business, consideration needs to be given as to how these are reported to the Board and whether disclosure needs to be made in the financial statements in line with Financial Reporting Council (FRC) guidance.

This paper highlights some of the key tax issues we see commonly arise as businesses prepare for Brexit. Businesses should also reference the no deal guidance published by the UK Government, the European Commission and individual Member States.

Ten Tax Impacts of Brexit



1 Indirect taxes

Supplies of goods

Businesses need to be clear on the role they take in the supply chain and the resulting duty and VAT implications: this is the key starting point for assessing the indirect tax impact. Where a business acts as importer or exporter of record for goods moving between the UK and the EU, it will need to submit Customs declarations and, for the import of goods, account for any duties and import VAT due.

Incoterms govern which party bears risk and costs for the international carriage of goods. In a Brexit context, they will determine the party that bears the risk of border delays, and who is responsible for customs clearance, and for payment of duty. For example, Ex Works (EXW) represents maximum obligations for the customer (but does not remove tax risks for the seller) and Delivered Duty Paid (DDP) represents maximum obligations for the seller. Note that Incoterms are indicative but not determinative of the VAT position. Businesses should review the Incoterms used – and check these are applied in practice – from both a commercial and a tax point of view in light of Brexit.

In order to import and export from the EU and the UK, businesses must have an EORI number. HMRC's analysis indicated that as of February 2019, only around 17% of the estimated 240,000 EU-only trading businesses based in the UK had registered for an EORI number (with reports in early August suggesting this proportion had only slightly increased to just under 30%). Businesses importing and exporting from both the UK and the EU may need two EORI numbers. It is only possible to have one EORI number in the EU, but some Member States are taking a pragmatic approach in the run up to Brexit e.g. the Netherlands is accepting applications and will issue an EORI number on 'day one' once the UK has left the EU.

Many organisations have **quantified the potential additional duty cost on a product-line basis**, and are now taking steps to mitigate the additional duty costs through the use of Customs procedures such as Customs Warehousing and Inward Processing. Lead times to obtain approval for these regimes must be factored in, e.g. Inward Processing is relatively quick to obtain with a c.60 day lead time for authorisation in the UK once an application is submitted; others take longer e.g. c.150 days for Authorised Economic Operator (AEO). Time is limited in order to get approvals in place before 31 October (and has passed for AEO if not already underway), but many organisations are pressing ahead with application for Customs procedures where there is a clear benefit to their business as usual Customs processes.

The UK's draft temporary Tariff published in March would reduce duty rates to nil on 87% of imports to the UK by value for a period of 12 months. Tariffs would continue to apply in a number of sectors, including agriculture, automotive and ceramics.

Companies will need to manage the ongoing Customs compliance obligations that will arise once the UK leaves the EU. For some businesses, this will have more of an impact than the additional duty costs, particularly where there is limited in-house Customs expertise at present. In a no deal scenario, some of the key Customs compliance obligations are:

- Customs declarations will be required including the necessary data on classification, valuation and origin;
- Animal products, products of animal origin and other food and plant material may be subject to sanitary and phyto-sanitary checks at the border;
- Customs brokers may need to be appointed to support with submission of customs declarations (the cost of which increased in the run up to March 2019 in the face of increased demand);
- A Customs Comprehensive Guarantee and Duty Deferment Account may be required in order to defer the payment of duty to the 15th of the month following import rather than paying this at the border;
- Review establishment requirements e.g. the UCC requires the exporter of record (EoR) to be established in the EU, which may entail changes to roles undertaken by counterparties where a UK company is currently EoR.

HMRC has introduced Transitional Simplified Procedures (TSP) for imports via UK ports to help businesses manage customs compliance requirements in a no deal scenario e.g. to allow additional time to submit declarations and pay the duty. TSP is similar to Customs Simplified Freight Procedures (CFSP) but with an accelerated approval process, to allow faster release of goods from Customs, improve cash flow and simplify administrative arrangements. Businesses may want to consider signing up for CFSP given there are still some unknowns about how TSP will work in practice.

Even if the UK entered into a Customs Union with the EU, there would be more friction than compared to now. In such a scenario, whilst there would not be a duty cost on covered goods moving between the UK and the EU, there would be Customs formalities and checks at the border. For example, the EU Turkey Customs Union only covers certain goods (such as industrial products but not agricultural products) and businesses need to submit a declaration and paperwork confirming the origin of the goods. A Customs Union would not apply to services or cross-border procurement, so would only cover a little less than half of the UK's trade with the EU.

The UK is set to remain in the Common Transit Convention (CTC) once it leaves the EU, which will help to simplify cross-border trade for UK and EU businesses. For goods placed under transit that meet all of the necessary conditions, businesses will only have to make Customs declarations and pay import duties when they arrive at their final destination.
This should be particularly beneficial in supply chains where the UK is used as a 'land bridge' for flows of goods between mainland Europe and the Republic of Ireland.

EU VAT simplifications such as triangulation, distance selling, and supply and install rules will no longer apply to UK only VAT registered businesses. This is likely to require additional VAT registrations. In some instances, EU27 Member States are not permitting registrations until much closer to exit day if a registration requirement would only arise once the UK has left the EU. On a similar note, we have also seen some tax authorities refuse to issue rulings on post-Brexit scenarios because the situation is not yet certain. Some Member States e.g. France, Austria and Denmark, require non-EU entities to appoint a fiscal representative. Others require non-EU businesses to appoint a fiscal representative only in certain circumstances e.g. in the Netherlands a fiscal representative is required for import VAT deferment.

HMRC has announced that deferred import VAT accounting will be introduced in the UK for all imports – not just movements from the EU. Some EU27 Member States also allow VAT registered entities to account for import VAT on their returns, and Ireland has also prepared legislation to introduce similar measures in the event of a no deal Brexit. HMRC also released a Brief this year on import VAT recovery. From 15 July 2019, only businesses who own the goods are entitled to recover import VAT as input tax, which means, for example, that toll manufacturers will not be able to recover import VAT on goods when title remains with the client. Whilst this development is not specifically Brexit-related, it is likely to impact many more businesses once the UK leaves the EU as the number of imports made by businesses increases.

There will be changes to UK trade with non-EU countries too. The UK currently benefits from over forty trade agreements between the EU and other 'third' countries. It is not a given that the UK will be able to continue to trade on the same terms as currently exist with these countries post-Brexit. The UK Government is negotiating Trade Continuity Agreements with third countries seeking to replicate existing EU trade agreements as far as possible, but there are some differences e.g. the agreement with Norway and Iceland is goods only and does not cover services trade. So far, the UK has reached agreement with countries that cover 64% of trade currently covered by EU agreements for which the UK is seeking continuity.

Case study: E-commerce retailers face potential additional duty costs, loss of the VAT distance selling simplification, and changes to the rules on low value consignment relief. Many UK retailers selling B2C to customers in EU27 countries are reviewing their Indirect Tax position in light of Brexit. Acting as importer of record not only allows greater control of the customs duty and VAT position for both sales and returns, but also improves the customer experience by ensuring customers do not have unexpected additional costs or administrative obligations on import. It does however increase administration for the seller.

Supplies of services

Brexit will also impact supplies of services between the UK and the EU27. Many of the VAT reliefs and simplifications applying to services are sector-specific. Some examples are highlighted below:

- **Financial services:** In a no deal scenario, changes would be made to the Specified Supplies Order that would give VAT recovery rights to taxpayers making certain exempt supplies of financial services to EU27 counterparties. This is likely to result in a significantly higher rate of VAT recovery for UK based companies making supplies to EU27 customers. Existing Partial Exemption Special Methods that have already been agreed with HMRC would be overridden where necessary to allow them to continue to operate without renegotiation. There would be adjustments to input tax apportionment for businesses supplying financial services alongside their main business. There are still questions as to how this would be implemented in practice; in particular the Statutory Instrument laid does not include anti-forestalling measures so thought needs to be given to appropriate recovery where (for example) the time of supply falls after Brexit, but the majority of associated input tax was "used" during a time period when the supply was not a specified exempt supply with VAT recovery.

- **UK based tour operators** will be subject to a UK version of the Tour Operators Margin Scheme (TOMS) under which only travel services 'enjoyed' in the UK will be subject to VAT and any non-UK travel services will be zero-rated. Currently, VAT is also accounted for at the standard rate for supplies in the EU, and so the change potentially puts UK tour operators at a competitive advantage to EU companies.

Systems, processes and controls

Managing these tax changes will entail updates to systems and a review of master data, which may require different treatment to be applied in the same tax period if the Brexit date does not align with the end of a reporting period. For example:

- Capturing the data required to complete customs declarations;

- Reviewing the accuracy of product classification to ensure the correct amount of duty is paid;

- Making changes to counterparty information e.g. where a customer has relocated to the EU;

- Making changes to tax codes that determine the VAT liability of supplies.

UK businesses incurring VAT in other EU member states will no longer be able to recover VAT via the EU cross-border refund system ('8th Directive') and will need to file '13th Directive' claims instead. Some Member States, such as France, were encouraging businesses to file 8th Directive claims in advance of 29 March in order to use the EU refund system.

2 Corporate

EU Directives on direct tax matters which provide that Member States do not impose withholding tax (WHT) on intra-EU cross-border payments of intra-group interest and royalties, and dividends paid by a subsidiary company to its foreign EU parent company, will no longer apply. The default position will be to rely on Double Tax Treaties between the UK and each individual EU Member State. Whilst the UK has an extensive treaty network, in some cases the treaty will not reduce the WHT rate to nil as under the Directive (for example, UK/Italy, UK/Poland, UK/Portugal). Furthermore, this may give rise to increased compliance obligations in securing clearances to apply the treaty rates.

A number of Member States have adopted measures to minimise the direct tax impact of Brexit for domestic taxpayers, typically by treating the UK as if it is a member of the EU for a limited time period, even in a no deal scenario. The table below sets out some examples of such measures.

Country	Summary
The Netherlands	A draft decree (Conceptbeleidsbesluit inzake fiscaal overgangsrecht in geval van een terugtrekking van het VK uit de EU zonder terugtrekkingsovereenkomst) was published in early March 2019. This was prepared for a no deal scenario on 29 March to introduce transitional rules to treat the UK as an EU Member State for corporate tax purposes until the end of a Dutch company's fiscal year so that Brexit would not lead to inconsistent domestic tax positions in the same year. It is expected, but not confirmed, that a similar draft decree would be published in advance of a 31 October 'no deal' scenario.
Belgium	Brexit law (Wet betreffende de terugtrekking van het Verenigd Koninkrijk uit de Europese Unie or Loi relative au retrait du Royaume-Uni de l'Union européenne) received Royal Assent on 3 April 2019. The UK is deemed to remain an EU Member State in a no deal scenario for corporate tax purposes for a transitional period, subject to reciprocity. The Belgian Communities (Flanders, Wallonia and Brussels) have adopted similar acts for relevant taxes that the Communities are competent for.
Austria	The 2018 Austria-UK Double Taxation Convention (which is not strictly Brexit-driven legislation) applies to Austrian taxes from 1 January 2020 (Federal Law Gazette III No. 32/2019) and applies in the UK from 1 April 2019 for corporation tax and 6 April 2019 for income tax. Subject to certain conditions, WHT treaty rates for dividend and royalties reduced to 0%.
Italy	Law No. 41 (conversion law) was enacted in May 2019 with retrospective effect from March 2019. This provides for a temporary 18 month transition period starting from a no-deal withdrawal date during which Italian domestic tax provisions currently applicable as a result of the UK's membership of the EU would continue to apply.
Germany	Brexit-Steuerbegleitgesetz (Tax Act relating to Brexit) was enacted in March 2019 and applies in both a deal and a no-deal scenario. It includes rules to prevent triggering an immediate tax charge in relation to historical German-UK company migrations or asset transfers. It aims to prevent legal disadvantages arising solely as a result of Brexit for taxpayers who have completed all essential tax-relevant actions prior to Brexit.

UK-headed groups with US investments could also see an increase in US withholding taxes. The US levies a 30% WHT on most interest, royalty and dividend payments paid out of the US to another country. WHT is often reduced (sometimes to zero) where payments are made to a company based in a territory with which the US has a tax treaty. This benefit is typically available if the recipient company has a substantial operating presence in its country of residence, but the rule is relaxed where the company is a subsidiary of a listed company resident in another EU Member State. When the UK ceases to be an EU Member State, there will be reduced scope to avail of the US treaty rates for payments received by EU subsidiaries of groups headed by UK listed companies, e.g. subsidiaries in third countries such as the Netherlands or Luxembourg which are often used to hold and/or fund investments into the US

In many cases there will be opportunities to alter intra-group arrangements in a way that mitigates the risk of incremental WHT costs. However the appropriate course of action needs to be determined on a case by case basis, and arrangements that are not aligned with a group's substance and commercial reality may fall foul of anti-abuse rules in various countries.

Other corporate tax technical issues – in some cases the local eligibility for certain tax reliefs or regimes may depend on entities being established in EU Member States (e.g. the tax consolidation regime in Italy typically requires entities to have a common EU parent company). Some comfort may be given by the various domestic transitional approaches mentioned above, but a review of material local tax positions is appropriate.

In reality the most significant direct tax considerations in relation to Brexit for many taxpayers will be those arising from commercial changes and reorganisations, rather than from changes to tax law. Any instance where a group changes the location of functions or assets, or the nature of its supply chain, will invariably require analysis of capital gains, exit charges and the appropriate transfer pricing approach for the new arrangements.

Case study: EU regulatory requirements have been a driver for Brexit restructuring, most notably in financial services. This restructuring has resulted in a number of tax issues, including determining whether the activity transitioning to a new EU company is a transfer of a business going concern in order to determine potential exit tax charges and associated valuation issues. Post-restructuring, the tax implications for ongoing operations present different tax challenges. In many regulated industries, substance requirements imposed by regulators in the location of the chosen EU company will have tax consequences. In the financial services sector, new cross-border charges for services provided say by the old UK hub company to the new EU company will have transfer pricing and VAT implications, as will back to back arrangements where the UK company seeks to continue some of the key entrepreneurial risk taking functions in respect of the financial assets that may now be originated and entered into by the EU company with EU customers. The employment tax position for staff moving to new locations will also need to be considered. While the UK remains an EU member state, support for the EU company may be provided by short term business travel of employees of the old UK hub company, which could mean a permanent establishment risk assessment is required.

3 Employment related considerations

Businesses will need to understand the impact of Brexit on their employees. The impact on people could be significant, both personally and professionally. As an employer it will be vital to plan effectively for the upcoming changes and be ready to communicate proactively, support and engage with the workforce in a way that successfully drives the Brexit strategy.

Social security

The social security landscape within the European Union (EU) and the European Economic Area (EEA) is governed by EC Regulation 883/2004. Under this framework individuals are covered by the legislation of one country at a time and have the same rights and obligations as nationals of the country where they are covered.

Whilst the UK does have old bilateral treaties in place with some EU27 Member States and EEA countries (20 in total), whether these would be effective in the event that the UK leaves the EU without an equivalent multilateral arrangement in place remains to be seen. These are limited in scope and coverage and are not necessarily fit for purpose in today's business environment.

The UK Government has published practical guidance on the social security contributions position for UK and EU internationally mobile workers if the UK leaves the EU without a deal:

- UK outbound: It depends on date the individual moves and existing arrangements, but there is likely to be an ongoing UK social security requirement. A potential double charge is possible depending on the host country's approach.
- UK inbound: Individuals assigned from an EU Member State to the UK would generally be exempt from UK social security for at least the first 24 months of their assignment provided they meet certain conditions.

This approach could result in dual social security liabilities, but the UK Government is working to protect UK nationals in the EU in a no deal scenario by reaching reciprocal arrangements with the EU or individual Member States to maintain existing coordination arrangements until 31 December 2020. Individuals in scope of these arrangements would pay social security contributions in one country at a time during this transitional period. To date there has been a mixed response. For example, we understand that Belgium and Spain have indicated that they are prepared to offer reciprocity in these types of scenarios whereas the Netherlands and Cyprus are not.

Case study: Assignment from the UK to France. Assuming the existing UK/ France Bilateral Social Security Agreement does not enter back into force, the individual and their employer would remain liable to pay to UK National Insurance contributions (NIC) for 24 months, and could also have a social security liability in France. This could lead to double employer and employee social security charges, and the need for the UK employer to register with the social security authorities in France and meet the associated payroll obligations etc. A UK inbound assignee from France would be exempt from UK NIC for up to 24 months. The social security treatment in France would depend on French domestic social security legislation and approach.

Mobile employees

Where businesses are moving their operations into the EU and as a result, moving employees to an EU27 country, there are a number of considerations for employers e.g. identifying which employees to move, the cost implications for the business, the need to revise policies such as remuneration, pension etc., the support that may need to be provided, and managing the potential increase in business travellers between UK and EU locations.

When moving employees into a particular location, these employees will be concerned about how their net pay position will be impacted. Employers may need to compare the net position for these individuals depending on which country they are relocating to. There may be some favourable regimes in certain locations, such as the impatriate regime in France, the Special Assignee Relief Programme in Ireland, and the 30% expatriate ruling in the Netherlands.

Careful consideration needs to be given as to how Brexit will impact employees and the support provided by the employer throughout this transition.

4 What does Brexit mean for future tax policy?

The outcome of negotiations on the future relationship between the UK and the EU will have implications for the UK's future tax policy. The current draft framework on the future economic relationship commits to a level playing field for open and fair competition, covering relevant tax matters and state aid. It remains to be seen how these principles will be implemented and how such commitments would be altered in a no deal scenario.

Once the UK leaves the EU, the European Court of Justice (CJEU) will no longer rule on UK taxes.

There are numerous other international tax developments that are leading companies to re-examine their legal and operational structures (e.g. US tax reform, implementation of G20/BEPS actions and program of work on the tax challenges of the digital economy, and the European Anti-Tax Avoidance Directive II across various countries). In all cases, assessing the best course of action needs to factor in the post-Brexit tax landscape as well as the status quo.

5 Actions businesses can take between now and 31 October

There are a number of actions that businesses can take in advance of 31 October to manage the tax impacts of Brexit. A number of measures are now back on the table given the Article 50 extension, and businesses should refresh and re-engage with their no deal planning.

Key actions Tax teams can take before 31 October

Understand how to complete and submit a Customs declaration.	Register for Transitional Simplified Procedures in the UK.	Obtain a UK and / or an EU EORI number as necessary.
Speak to Customs brokers to agree process for submission of Customs declarations.	Quantify the potential duty cost in both the UK and the EU, taking account of the UK's draft no deal Tariff (which would apply for one year).	Apply for a Customs Comprehensive Guarantee and Duty Deferment Account, or increase the limits on existing ones.
Determine which Customs regimes can be applied for in advance of 31 October to mitigate the additional duty costs.	Submit EU overseas refund ('Eighth Directive') claims in advance of 31 October.	Assess the benefits of applying for AEO.
Review contractual clauses from a tax perspective, including the Incoterms used.	Review the supply chain to identify the impact of loss of EU VAT simplifications.	Submit VAT registration applications where possible and where a fiscal representative is required enter into discussions with service providers.
Quantify additional potential WHT liabilities (including in relation to the US) and consider bringing payments of interest, royalties and dividends fully up to date, and actions to mitigate future WHT risk where appropriate.	Remain close to any business-led reorganisations so that tax sensitivities on transition as well as ongoing tax and transfer pricing profile are fully understood.	Identify short term business travellers between the UK and EU27 Member States and understand the applicable immigration rules in relevant jurisdictions.
Quantify cost implications of moving employees.	Determine whether remuneration, pension and related policies need updating.	Continue to monitor announcements by UK and EU Member State tax authorities.
Assess social security impact for mobile employees.		

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