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The big read

20 questions on Brexit

From the impact on EU litigation to the future of VAT, experts at Pinsent Masons consider the top 20 questions on the tax issues surrounding Brexit.

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The impact on taxes

1. Can we expect to see any immediate tax changes?

No tax changes will take effect automatically as a result of the referendum vote. The process of leaving the EU does not officially begin until the UK gives notice of its intention under article 50 of the Lisbon Treaty. Once this is triggered, the UK has a two year period in which to negotiate its withdrawal. Extension of this period requires a unanimous vote of all 27 other EU member states.

This means that we should not expect to see major changes to the tax system as a direct result of leaving the EU until late 2018 at the earliest. However, in the meantime we may see tax changes indirectly caused by Brexit, such as increases in tax rates or changes to exemptions or allowances which are needed to enable the chancellor to balance the nation's books.

2. What is the likely effect on corporation tax?

The UK's direct taxes, such as corporation tax, are purely domestic and are therefore not governed by EU law, subject to the requirement not to discriminate against EU nationals and to comply with the fundamental freedoms and state aid rules. If the UK leaves the EU but becomes a member of the European Economic Area (EEA) it will still be obliged to comply with these principles.

Even if the UK did not become an EEA state post-Brexit, it is far from obvious that the government would necessarily rush to alter much direct tax law that has been consciously drafted to comply with EU law. For example, the UK's CFC laws and taxation of foreign dividends (or, more accurately, non-taxation) are consistent with EU law but they also reflect the government's wider policy objectives.

In other areas, the government would undoubtedly have preferred to have done nothing (e.g. cross-border group relief or exit charges). The resulting legislation has tended to have been very narrowly drafted with relatively limited tax loss to the UK, but it would be surprising if the UK did not seek to repeal these measures in due course. Elsewhere (e.g. UK to UK transfer pricing), HMRC has ended up with another tool in its avoidance/compliance armoury, and it is not obvious why it would throw this aside.

Similarly, the diverted profits tax (DPT) is capable of applying to wholly UK structures, which were not the main targets. The government would be free to have a bigger, bolder DPT in a post-EU world (assuming the UK is not part of the EEA), but it is not clear that the government would necessarily want to take a more aggressive stance.

3. What is the likely effect on income tax and capital gains tax?

As with corporation tax, there will be little change to income tax and capital gains tax if the UK is within the EEA. However, if the UK is not constrained by EEA membership, the government is likely to want to repeal the changes it was forced to make to the transfer of assets abroad legislation (ITA 2007 s 742A) and the changes to TCGA 1992 s 13. It would also have the freedom, if it was so inclined, to seek to impose increased taxes on, for example, the holding of residential property by non-UK residents.

4. VAT is an EU tax. What will happen to it once the UK leaves the EU?

The UK will no longer be obliged to maintain a VAT system, but, given its revenue raising potential, it is extremely unlikely that it will be abolished. Since VAT has been incorporated into domestic law, leaving the EU will not automatically abolish VAT and it will not change unless and until Parliament changes our laws.

Even though it is not bound to, it also seems unlikely that the UK would wish to start with a transaction tax that looks radically different to the EU bloc on its doorstep. At least in the early years, it seems probable therefore that there would be large similarity to the EU VAT, although perhaps over time the taxes will drift apart in some of their provisions.

However, leaving the EU will give HMRC the opportunity to reconsider its operation and policy in relation to VAT. In particular, it is likely to increasingly marginalise or ignore EU jurisprudence it dislikes and apply more vigorously its own view that, previously, was curtailed by application of EU law.

Even if the UK continues essentially with its current VAT system (subject to necessary adjustments), there will be a question mark over the precedent value of past CJEU decisions, which will need to be addressed by UK legislation.

Customs and excise

5. What is the impact on customs duty?

Trade agreements and customs tariffs are the tax area probably most affected by Brexit. On leaving the EU, the UK will retain any bilateral agreements to which the UK is itself a signatory but will eventually lose the benefit of the agreements for which the EU is the signatory. As a WTO member, the UK will at least have the certainty of knowing that 'most favoured nation' terms would be available, although this would be limited in scope. It would be then a question of seeking to negotiate better terms country by country or bloc by bloc. The UK might instead seek to join the EEA or EFTA to strengthen its bargaining position.

6. What about excise duties?

The UK's freedom to impose excise duties is significantly circumscribed by EU directives and fundamental freedoms. Outside the EU, the UK would be free to protect UK industries, e.g. beer, whisky and cider, with low or no tariffs and to impose high duties on French and Italian wine. This could be politically very attractive to the government and demonstrate in a clear way the sort of benefits that come from Brexit. It could be a step too far, though, for Remain supporters in the South.

Multinationals and tax competitiveness

7. What are the key tax considerations for multinationals?

Groups which are currently relying on EU directives such as the Parent-Subsidiary Directive or the Interest and Royalties Directive to reduce withholdings of foreign tax when profits from their subsidiaries are repatriated to the UK could see their overseas tax bill increase, if withholdings are not eliminated by the relevant double tax treaties. Groups need to assess their exposure and in the long term, depending on the result of the Brexit negotiations, they may need to consider restructuring.

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Cross-border tax disputes are likely to increase over the next few years as a result of jurisdictions implementing the BEPS recommendations – probably in slightly different ways and to different timescales. Leaving the EU will mean UK groups lose the benefit of the EU Arbitration Convention in relation to transfer pricing disputes, although this is not used as much as the mutual agreement procedure (MAP).

8. Will the UK become a less attractive tax regime for foreign investment?

The current government has gone out of its way to try to make the UK a competitive regime for corporates with the headline rate of corporation tax scheduled to reduce to 17% in 2020. There is no indication that the current government will seek to reverse or delay this change, but that may depend upon the state of the public finances over the next few years – and (with talk of a possible early general election), the government in power at that time.

The loss of the benefit for UK holding companies of the EU Parent-Subsidiary Directive and the Interest and Royalties Directive will not make the UK as attractive as Luxembourg or the Netherlands if subsidiaries are located in territories where the relevant double tax treaty does not eliminate any tax withholding.

Litigation

9. What will happen for cases before the CJEU?

Until the UK actually leaves the EU, it should be business as usual in terms of the ability to make a reference and for the CJEU to reach judgment. However, litigants would do well to consider whether the judgment handed down would be implemented in a full manner by UK courts, which may well be influenced by wider considerations to interpret CJEU judgments in line with the new political realities.

10. Does this mean the UK would be free to abolish historic EU-law based tax refund claims – and if so, is that likely?

As a member of the EU, the UK has willingly agreed to circumscribe the sovereignty of Parliament: EU law is supreme. Leaving the EU will restore sovereignty to Parliament. So, in strict legal theory, it is arguable that Parliament will be entitled to do whatever it likes, including removing already accrued rights founded on EU law. Whether or not the higher courts would acquiesce in giving effect to provisions of Parliament that were contrary to established views of the rule of law is, perhaps, another thing but would be the subject of an article in itself.

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However, there are two other significant impediments that are likely to act as a brake on the executive bringing forward substantively retrospective legislation. The first is the long-standing internal government requirement for any proposed legislative provision with retrospective effect to be consented to by the government's legal officers, namely the attorney general (AG) or the solicitor general. Their role is to protect legal policy; and the starting point is that retrospective legislation is fundamentally inimical to legal policy. The giving or withholding of AG consent to legislation is clothed in secrecy (because it is subject to legal professional privilege), but it is fair to say that the process is not simply a hoop to be jumped through. However, although long-standing, it is, ultimately, merely a matter of convention.

The second impediment is the European Convention on Human Rights (ECHR). So long as the UK government remains a signatory to the ECHR, it is bound (according to international law) to act in conformity with it. Accordingly, the government is obliged to assess whether any of its acts, including legislation that it proposes to introduce, is consistent with those international law obligations. That will remain the case even if the Human Rights Act 1998 is repealed. And, to put it at its lowest, the interference with rights that have already accrued is likely to give rise to significant ECHR difficulties.

Even in these uncertain times, it seems unlikely that the government will lightly discard long-standing constitutional norms (the need for AG consent to retrospective legislation) or its international obligations (the ECHR) in retrospectively removing rights that have already accrued. All things are possible, but it would be a bold and controversial thing for any government to do, however tempting the tax yield might be.

11. The compound interest litigation (brought by Littlewoods) is still going through the courts. Could the government litigate to stop these claims?

It is one thing to remove the entitlement to the VAT refund that has already accrued (indeed, in the case of *Littlewoods* itself, has been paid). It is another thing altogether to change the law so that the basis on which recompense is paid to a claimant for the loss of its money is simple rather than compound interest. But, of course, the government has already shown its hand here in enacting CTA 2010 Part 8C, which seeks to impose a liability of 45% on the interest element of any award beyond simple interest. That legislation is being challenged in the courts on EU grounds (among others), and it would seem likely that any challenge in this respect will now fail (if for no other reason than because of the likely timescales involved).

EU protections

12. Should taxpayers 'buy while stocks last' in relation to protections afforded by EU law that might be removed?

In theory, yes, but this will have relatively limited significance in reality for most taxpayers as most of the relevant provisions likely to be removed are in the realm of avoidance, or there are protections against abuse, for example, companies structuring to get the benefit of cross-border group relief.

Tackling perceived corporate tax avoidance

13. What is the impact on the UK's implementation of BEPS?

It is unlikely that Brexit will have any significant impact on the UK's implementation of the OECD's recommendations in relation to BEPS (base erosion and profit shifting). The UK will continue to be bound by its commitment – as a member of the G20 and the OECD – to implement the recommendations. The UK government has been keen to be an 'early adopter' of BEPS, with restrictions on interest deductibility due to come into force in 2017.

A new prime minister and potentially a new chancellor of the exchequer are unlikely to soften the current government's approach to clamping down on tax avoidance by multinationals. Although some may hope that the introduction of the interest deductibility restriction rules may be delayed as a result of Brexit, the £920m the measure is forecast to raise in 2017/18 makes this unlikely.

14. What about the Commission's Anti-Tax Avoidance Directive?

The European Commission's Anti-Tax Avoidance Directive (ATAD), which was agreed in June by EU finance ministers, is intended to force implementation of certain key BEPS recommendations within the EU, including country by country reporting and interest deductibility restrictions. Member states will have until 31 December 2018 to transpose most of the provisions of the directive into their national laws.

Depending on how the negotiations go, the UK may still be within the EU at this point. However, now the controversial 'switchover clause' has been dropped, it should make little difference to the UK as by this stage Parliament will probably have already implemented into domestic law the measures covered by ATAD which are not already UK law. The switchover rule was not an OECD recommendation and would have allowed tax authorities in EU member states to deny EU tax exemptions on dividends, capital gains and profits from permanent establishments which enter the EU from non-EU countries, had that income been taxed at a very low or no rate in the third country.

Harmful tax practices

15. Presumably EU state aid rules would no longer apply. Is that right, and what's the likely practical effect?

The EU's state aid rules prevent the giving of selective tax advantages to certain taxpayers or groups of taxpayers. Once the UK leaves the EU, it will no longer be bound by these rules. Although the UK will still need to comply with World Trade Organisation (WTO) rules on subsidies, the government may have more flexibility on providing state funding to business.

The European Commission has been investigating whether rulings by member countries on topics such as transfer pricing are in accordance with state aid rules. In October 2015, it decided that rulings provided to Fiat by Luxembourg and Starbucks by the Netherlands constituted unlawful state aid and we are still waiting for decisions in relation to Apple in Ireland and Amazon in Luxembourg. As part of their investigations, all member states have been asked to provide copies of previous rulings to the Commission for review.

Although the UK is not currently being investigated for potential state aid breaches, it is clearly on the radar and some commentators have suggested that recent HMRC transfer pricing settlements should be referred to the EU Commission. Leaving the EU would remove this potential avenue, although it would not do anything to allay the lack of trust which the Public Accounts Committee has expressed in HMRC.

EU tax proposals

16. Will Brexit affect the common consolidated corporate tax base (CCCTB)?

The CCCTB is a proposed single set of rules that companies operating within the EU would use to calculate their taxable profits. The UK was a strong opponent of the CCCTB being mandatory for member states and so Brexit could therefore make it easier for the Commission to introduce the CCCTB for the remaining EU members.

17. What happens now to the EU financial transaction tax?

The ten member states that are proposing to introduce a financial transaction tax under the enhanced cooperation procedure have apparently given themselves until September to reach agreement. If introduced, the tax would be levied on all transactions on financial instruments between financial institutions when at least one party to the transaction is located in the EU. The UK challenged the legality of the use of the enhanced cooperation procedure in the CJEU. Its application was rejected, but the court did not rule out a challenge to the tax if it is eventually approved. The UK has always been against an EU-wide financial transaction tax (FTT), on the basis that any such tax would have to be global to stop traders simply routing their deals to New York and other financial centres outside the EU. The UK's main objection to the current proposals is that there are several elements of the tax which make its reach much wider than just the FTT zone.

Brexit will not affect whether or not FTT is introduced and financial institutions operating in London's financial market will still be concerned about the effect of the tax when they are involved in transactions with counterparties in the FTT zone.

Private client perspective

18. How will non-doms moving to or living in UK be affected?

From a UK tax perspective, Brexit will have little impact on non-doms moving to or living in the UK. The UK's tax rules on residence and domicile focus on whether an individual is resident or domiciled in the UK alone and make no distinction between whether an individual is resident inside or outside the EU. Indeed, the UK's tax system for individuals who are UK tax resident but not UK-domiciled, known as the remittance basis of taxation, is unique and differs from other countries in the EU. Under the remittance basis of taxation, subject to an annual charge, UK resident but non-domiciled individuals are only liable to UK tax on their non-UK source income and gains to the extent that those amounts are brought into the UK. In contrast, UK resident and domiciled individuals are liable to UK tax on their worldwide income and gains. By the time the UK's departure from the EU is finalised, changes to the remittance basis of taxation are likely to be in force, whereby individuals who have been resident in the UK for at least 15 out of the last 20 tax years will no longer be able to benefit from the remittance basis.

Brexit may affect the ability of non-doms to move to the UK. If the UK leaves the EU single market, it is likely that there will no longer be free movement of workers from the EU to the UK. However, it is currently unclear whether Brexit will result in the UK's departure from the single market. The UK may seek to remain in the EEA and adopt a position similar to countries such as Norway and Iceland, to ensure that it continues to benefit from the single market. In such circumstances, it is likely that free movement of workers from EU member states to the UK will continue and Brexit will not affect EU non-doms seeking to move to the UK. Brexit will not affect the current immigration position of non-EU non-doms seeking to move to the UK.

Cross-border tax collection

19. There are EU directives which help in the cross-border collection of taxes. Will Brexit make this more difficult?

The Recovery Assistance Directive and the Administrative Cooperation Directive require EU member states to cooperate with each other in relation to the collection of tax across borders, including by exchanging information and assisting in the recovery of tax claims. Leaving the EU would mean that the UK would cease to benefit from these arrangements. However, the UK is one of almost 100 jurisdictions which have signed the OECD Multilateral Convention on Mutual Administrative Assistance in Tax Matters, which has similar effect.

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In addition, the increased international focus on preventing tax evasion and the introduction of the common reporting standard, which will provide for automatic exchange of information about non-residents with offshore accounts, coupled with the UK's extensive network of double tax treaties and tax information exchange agreements, should mean that Brexit will not prejudice HMRC's ability to collect tax on cross-border transactions.

And finally...

20. Can we expect an emergency Budget?

During the course of the referendum campaign, the chancellor threatened an emergency tax increasing budget, should the UK vote for Brexit. However, since the referendum result he has said that there will be no Budget until a new prime minister takes over from David Cameron in the autumn. This may mean that in the Autumn Statement we will get an indication of the government's early thinking on the post-Brexit tax landscape. ■