News
Latest Finance Bill developments

Cases
Our quarterly pick of the top cases

One minute with...
David Southern QC, Temple Tax Chambers

TAX JOURNAL

Insight and analysis for the business tax community

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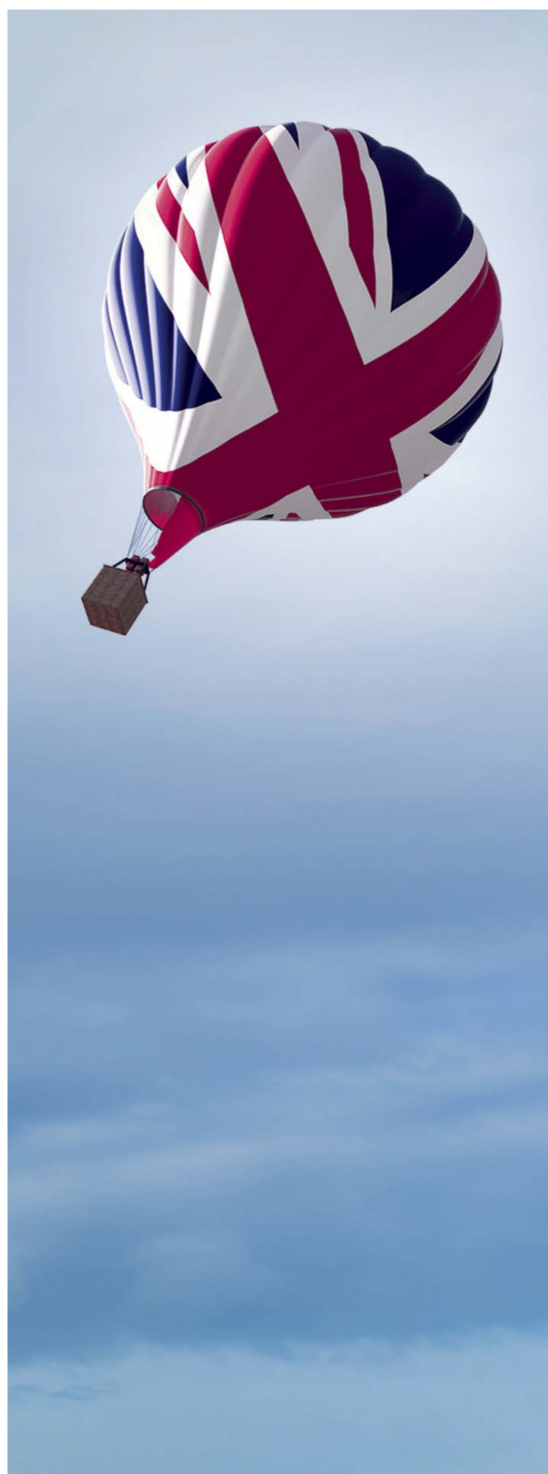

BREXIT

The top 20 tax questions
Darren Mellor-Clark & Andrew Scott | Pinsent Masons

Economics view: Keep calm and carry on worrying
David Smith | The Sunday Times

In-house view: What now for policy makers and businesses?
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Tax on business restructuring
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Considerations for multinationals
Peter Clements | Freshfields Bruckhaus Deringer

The impact on SMEs
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Etienne Wong | Old Square Tax Chambers

Ask an expert: Peak performance or pique performance?

9–10 September 2016
(Magdalen College, Oxford)

IFS Residential Conference

Corporate tax avoidance: where next for policy and practice?

Every two years, IFS holds a residential conference, aiming to facilitate high-level knowledge exchange between practitioners, policymakers and academics on key areas of policy and practice. This year we will consider how anti-avoidance measures are designed, how governments' and businesses' perspectives on tax avoidance are changing, and what we can expect from international efforts going forward.

KEYNOTE SPEAKERS

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Stephen Quest (DG Taxation and Customs Union, European Commission)

Edward Troup (Executive Chair and First Permanent Secretary at HM Revenue and Customs)

OTHER PARTICIPANTS INCLUDE:

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Tracey Bowler *(Research Director, IFS Tax Law Review Committee)*
David Bradbury *(Head of the Tax Policy and Statistics Division, OECD – TBC)*
Ian Brimicombe *(Vice President Corporate Finance, AstraZeneca and Audit Committee)*
John Connors *(Group Tax Director, Vodafone)*
Bill Dodwell *(President, CIOT and Partner, Tax Policy Group at Deloitte)*
Julie Elsey *(Counter-Avoidance Directorate, HMRC)*
Kevin Fletcher *(Chief Economist and Director KAI, HMRC)*
Malcolm Gammie QC *(One Essex Court and Chairman, IFS Tax Law Review Committee)*
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Jon Sherman *(Director, Corporation Tax, International and Stamps, HMRC)*
Kate Thomson *(Group Head of Tax, BP)*
Stef van Weeghel *(Global Tax Policy Leader, PwC)*
John Whiting *(Tax Director, Office of Tax Simplification)*

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Accommodation will be provided on Thursday 8 and Friday 9 September and a drinks reception and conference dinner will take place on Friday evening.

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Day delegate places also available.

From the editor

The tax impact of Brexit may not rank as highly as concerns over the economy or immigration, but it is an important issue all the same. Of course, all we really know at this stage is that nothing has happened yet. And we don't know exactly when something will happen. Or even, with compete certainty, if anything will happen at all. But once Brexit does occur, one thing we do know is that there will be substantial change to the tax rules – whether caused directly by leaving the EU (although such changes probably won't happen until at least late 2018) or whether in response to concerns over the economy (these changes may come much sooner).

In this week's edition, experts at Pinsent Masons answer all the key Brexit tax questions you are likely to be asked. We also have a range of commentaries speculating on particular issues for different types of clients, along with an in-house perspective with considerations for large businesses. And, given the importance of Brexit, we've gone beyond the tax issues to consider the legal mechanisms for the UK's departure and the options for a post-Brexit UK. My thanks to all the authors for their timely contributions. Interesting times.

Paul Stainforth
paul.stainforth@lexisnexis.co.uk

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Editor: Paul Stainforth (tel: 020 3364 4448; **email:** paul.stainforth@lexisnexis.co.uk)

Editorial team
Julia Burns & Nick Raad
Cases: Cathya Djanogly
Production manager: Angela Waterman
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Our pick

No emergency Budget following ‘Brexit’

The chancellor of the exchequer stood up on the Monday following the EU referendum result to deliver a statement designed to reassure the markets. The British economy is ‘fundamentally strong’ and contingency plans are in place to ensure the country is ‘equipped for whatever happens’.

However, he made no mention of the emergency Budget, which during the referendum campaign he had suggested would immediately follow a vote for ‘Brexit’. Instead, the chancellor made clear that any decisions on what action the government should take to address the impact on the economy and the public finances ‘should wait for the OBR to assess the economy in the autumn’. Such action is still likely to involve ‘tax rises and spending cuts’, he confirmed in an interview on BBC Radio 4’s *Today* programme.

John Cullinane, CIOT tax policy director, commented that, ‘it will be important for the government to consult carefully with business, tax professionals and others on the practical implications of policy changes, and for the government to be as clear as possible as early as possible which EU laws they intend to retain and which they intend to repeal’.

On 28 June, the European Parliament passed a resolution concerning the UK’s referendum decision, urging the prime minister to trigger the formal withdrawal process by giving notification under article 50 TEU at the Council meeting on 28/29 June. The prime minister did not do so and has stated his intention to leave this notification to his successor, who is expected to be in place by the autumn.

Business taxes

Large businesses: publishing tax strategy

HMRC has published an overview guide for large businesses (with a turnover above £200m or balance sheet over £2bn), on the requirement to publish their tax strategy before the end of the next financial year commencing after royal assent to Finance Bill 2016, and yearly thereafter. A more detailed draft guide to the Finance Bill legislation was published in March. See www.bit.ly/28YXjgy.

Withholding tax on royalties

HMRC has updated its technical note, first published at the Budget in March, concerning legislation in Finance Bill 2016 to broaden the scope of the rules for withholding tax on royalties arising in the UK. Chapter 5 contains the anti-treaty shopping provision applying to payments made on or after 17 March 2016. Chapters 7, 9 and 11 contain legislation being introduced at the Public Bill Committee stage, to have effect from 28 June 2016. These clauses will: change the definition of a royalty to align with the OECD model tax convention definition; include payments made by non-UK resident persons where those payments are connected with a trade carried out through a permanent establishment (PE) in the UK; and ensure that diverted profits tax will apply to payments that would have been subject to withholding had an avoided PE been an actual PE in the UK. See www.bit.ly/1UT3X8k.

Personal taxes

Non-resident athletes’ income tax exemption

The Major Sporting Events (Income Tax Exemption) Regulations, SI 2016/Draft, will provide for an income tax exemption for overseas competitors (including UK residents in the overseas part of a split year) taking part in the London Anniversary Games 2016 and the World Athletics Championships 2017. The exemption will be available from two days before until two days after each event.

VAT

EU directive on vouchers

The Council of the EU has adopted an amendment to the VAT directive which provides, broadly, for VAT to be charged at the point of issue for single-purpose vouchers and on redemption for multi-purpose vouchers. These new rules will only apply to vouchers issued after 31 December 2018. The directive does not cover discount vouchers, in a departure from the Commission’s 2012 proposals. See www.bit.ly/2931Kne.

TOGCs and VAT groups

Revenue and Customs Brief 11/2016 makes clear that, in a change of policy, HMRC will now accept that the transfer of a business to a company in a VAT group can be the transfer of a going concern (TOGC) for VAT purposes, provided the company intends to operate the same kind of business in supplying services to other group members, who in turn make supplies outside of the group. This follows the Upper Tribunal decision in *Intelligent Managed Services Ltd* [2015] UKUT 341 (TCC). HMRC has also revised its policy on TOGCs involving transfers out of a VAT group. For the TOGC rules to apply where the buyer of a business is not established in the UK, HMRC will take the view that a voluntary registration must be in place at the time of the transaction.

International taxes

New double taxation agreements

Three new double taxation conventions have been signed, but are not yet in force.

- the UK and Turkmenistan signed a new double taxation convention on 10 June 2016, which will replace the 1985 UK/USSR convention;
- the UK and Uruguay signed a new double taxation convention on 24 February 2016; and
- the UK and United Arab Emirates signed a new double taxation convention on 12 April 2016.

Dominican Republic and Nauru

The Dominican Republic and Nauru have become the latest signatories to the OECD’s multilateral convention on mutual administrative assistance in tax matters, becoming the 97th and 98th jurisdictions to join the convention.

Administration & appeals

Finance Bill 2016 developments

The government has tabled another large group of amendments (see www.bit.ly/294otRM) to be considered by the Public Bill Committee, beginning on a date yet to be announced. These are listed below in the order in which the Committee will debate the relevant clauses and schedules.

- cl 5 and Sch 1 (dividend nil rate and abolition of dividend tax credits etc.): amendments concern: discretionary payments by trustees (amendment ensures that the beneficiaries get a credit for the tax so that the income is only taxed once on the trustees); dividends received by estates in administration (amendments ensure that credit given to the beneficiary in relation to dividend income distributed by an estate will reflect tax actually paid, and that tax will be repayable where the beneficiary is a non-taxpayer); and partnerships (amendment ensures that all partnership dividend income continues to be taxable on a tax year basis, rather than by reference to a partnership accounting period).

- cl 22 (pension flexibility): amendment ensures that if an employer tops up any shortfall in funds in a cash balance arrangement in order to pay an uncrystallised funds lump sum death benefit after the member's death, the top-up will be an authorised payment to the extent that it does not exceed the shortfall. The change has effect for uncrystallised funds lump sum death benefits paid on the day after royal assent to Finance Bill 2016.
- cl 37 (income-based carried interest): amendments ensure that the clause operates as intended. The clause introduces a new legislative test to determine when carried interest should be taxed as income or as chargeable gains.
- cl 40 (deduction of income tax at source: tax avoidance): amendments ensure that the clause will apply to all payments of royalties in respect of which there is an obligation to deduct income tax at source as a consequence of new cl 8, which introduces revised definitions to broaden the scope of the UK's domestic withholding rights over royalties paid abroad.
- cl 60 (profits from the exploitation of patents etc.): amendments take account of further comments made on the clause and schedule since publication of the Bill. The clause and schedule revise the patent box rules to implement the 'nexus approach', using R&D expenditure as a proxy for substantial activity, in the context of the OECD's BEPS project.
- cl 82 (inheritance tax: increased nil-rate band): amendments ensure that the new residence nil-rate band for individuals downsizing or ceasing to own a home will apply in certain specific situations, such as where an individual had more than one interest in a former residence, or the former residence was held in a trust, or where an individual gave away a former residence but continued to live in it and subsequently moved out. The amendments will apply for deaths on or after 6 April 2017.
- cl 86 (estate duty: objects of national, scientific, historic or artistic interest): amendments make a number of changes to ensure that the clause operates as intended. This will prevent an unintended dual charge arising when an item is lost, once for the breach of the undertaking to preserve the object and a second charge for the loss itself, and will ensure that the clause applies to objects granted exemptions under FA 1975 provisions.
- cl 88 (charge to apprenticeship levy): amendments have the effect of setting out that the value of the annual levy allowance for employers is £15,000, except where it is split by a group of companies or group of charities.
- cl 90 (apprenticeship levy: connected companies): technical amendment to clarify that the definition of company applies to the whole of Part 6 of the Bill relating to the apprenticeship levy.
- cl 90 (apprenticeship levy: connected companies): amendment allows companies which are connected for the purposes of the apprenticeship levy to share their annual levy allowance of £15,000 between them, instead of only one company being entitled to the allowance.
- cl 91 (apprenticeship levy: connected charities): amendment allows charities which are connected for the purposes of the apprenticeship levy to share their annual levy allowance of £15,000 between them, instead of only one charity being entitled to this allowance.
- cl 109 (apprenticeship levy: general interpretation): technical amendment to clarify that the definition of company in clause 90 applies to the whole of Part 6 of the Bill relating to the apprenticeship levy.
- cl 117 (SDLT: higher rates for additional dwellings etc.): amendments remove liability to the higher rates of SDLT for purchasers of dwellings with self-contained annexes or outbuildings that are themselves dwellings ('granny annexes'), where the annex or outbuilding is the only reason that the higher rates would apply.
- cl 117 (SDLT: higher rates for additional dwellings etc.): amendment has retrospective effect from 1 April 2016 to ensure that the SDLT higher rate will not apply to financial institutions involved in alternative finance transactions used to fund property purchases by individuals, where the purchase would otherwise be exempt from the higher rate.
- cl 117 (SDLT: higher rates for additional dwellings etc.): amendments add a new paragraph giving HM Treasury the power to change the rules as to what is a higher rates transaction for the purpose of removing transactions from the higher rates charge.
- New cl 7 (receipts from intellectual property: diverted profits tax): this includes within the charge to DPT an amount equal to payments of royalties and other sums in respect of intellectual property that would have been subject to withholding tax had an avoided permanent establishment been an actual permanent establishment in the UK. These changes ensure that no advantages accrue to a person within the charge to DPT as a result of other changes to the rules in respect of withholding tax on payments of royalties in the Finance Bill.
- New cl 8 (deduction of income tax at source: intellectual property): this broadens the scope of the UK's domestic withholding rights over royalties, introducing a new definition of 'intellectual property' in order to ensure that payments abroad are taxed in the UK unless the UK has explicitly given up those taxing rights under a double tax treaty or other international agreement.
- New cl 9 (receipts from intellectual property: territorial scope): this broadens the territorial scope of withholding tax on receipts from intellectual property, to include payments made by non-UK resident persons where those payments are connected with a trade carried out by that person through a permanent establishment in the UK.
- New cl 10 (stamp duty: acquisition of target company's share capital): these amendments to the relief in FA 1986 s 77 will have effect in relation to any instrument executed on or after 29 June 2016.

See www.bit.ly/294oOUq.

On 27 and 28 June, a Committee of the Whole House agreed amendments to numerous clauses and schedules, and also passed numerous provisions without amendment (see the longer news item on taxjournal.com for full details). The remainder of the Bill will now go to a Public Bill Committee, to be concluded by 14 July. The government has already tabled a number of amendments for the Public Bill Committee.

For more news, including details of latest HMRC guidance, see www.taxjournal.com.

People and firms

Baker & McKenzie promotes **Alistair Craig** to tax partner in the firm's London office. Worldwide, the firm has promoted 85 lawyers to partnership in this year's round.

CMS promotes **Anna Burchner** to a partner in the firm's London tax team. Burchner's practice covers both international and domestic tax, particularly funds and financial services related work.

KPMG appoints **Alexander Marcham** as a director in the London private client advisory team. Marcham joins the firm from Deloitte.

MHA MacIntyre Hudson appoints **Neil Barry** to tax partner. Based in the firm's Leicester office, Barry's practice covers a broad range of taxes.

Accountancy firm **Milsted Langdon** appoints international tax practitioner **Leon Crane** as a senior tax manager in its tax team. Crane joins the firm from Deloitte.

To publicise tax promotions, appointments and firm news, email paul.stainforth@lexisnexis.co.uk

This week we look back at the tax cases reported during the last quarter and give our pick of five that caught our eye.

1. *Fidex*: unallowable purpose straddling two accounting periods

In ***Fidex v HMRC*** [2016] EWCA Civ 385 (21 April), the Court of Appeal found that HMRC was not precluded from raising a substantive issue by the terms of its closure notice; and that the derecognition of bonds as part of a scheme had not triggered the intended debit under FA 1996 Sch 9 para 19A, as the debit was unallowable under para 13.

The appeal related to a tax avoidance scheme called Project Zephyr. The purpose of the scheme was to create a loss of around €84m, as a result of the derecognition of bonds held by Fidex, which would be available for group relief throughout the BNP Paribas group of companies of which Fidex was a member.

There was both a procedural issue and a substantive issue. The procedural issue was whether HMRC was precluded from raising the substantive issue by the terms of its closure notice. The substantive issue was whether the debits were attributable to an unallowable purpose.

In relation to the procedural issue, applying *Tower MCashback* [2011] UKSC 19, the Court of Appeal found that the scope of the appeal was defined by the conclusions stated in the closure notice but that HMRC was not restricted to the process of reasoning by which it had reached those conclusions; it was free to deploy new arguments in support of them. The conclusion was that the sum of €83,849,399, representing the value of derecognised listed bonds, should not have been included in the change in basis adjustments.

As for the substantive issue, the Court of Appeal observed that the question was whether and to what extent the debit was attributable to the unallowable purpose for which the bonds were held. The court found that the debit arose from and was entirely attributable to Project Zephyr.

Why it matters: Fidex had argued that if, in an accounting period, a company had one or more allowable main purposes for being a party to a loan relationship and one unallowable main purpose, it was not just and reasonable to attribute the whole of the relevant debit to the unallowable purpose. The court accepted that Fidex may have held the bonds irrespective of the unallowable purpose, but that was not the issue. The issue was whether the debit was attributable to the unallowable purpose for which the bonds were held.

2. *Tottenham Hotspur*: payments received by footballers on a transfer between clubs

In ***Tottenham Hotspur v HMRC*** [2016] UKFTT 389 (3 June), the FTT found that payments received by footballers on a transfer between clubs were not 'from' their employment and therefore were not subject to NICs; and were only subject to income tax above the £30,000 threshold.

The appellant was the parent company of the well-known football club. In 2011, Tottenham had paid two of its players, Peter Crouch and Wilson Palacios, for their agreement to leave Tottenham to join Stoke City. The issue was whether, as HMRC contended, the payments were earnings fully subject to income tax and NICs or compensation for early termination and therefore not 'from' the players' employment.

The FTT pointed out that the fact that the parties might have had substantial reasons not connected with the players' employments for making or receiving the payments (for example, Tottenham's wish to secure a transfer fee) was not sufficient to prevent the payments being 'from' employment, provided that there was a 'sufficiently substantial' employment-related reason for making the payments (see *Kuehne + Nagel* [2012] EWCA Civ 34).

There were provisions that would have entitled Tottenham to terminate the players' contracts early if particular circumstances had arisen. However, none of these early termination provisions were engaged, so neither the players nor Tottenham had any operative right of termination. Tottenham had therefore made the payments in return for the surrender of the players' rights under their employment contracts.

As the contracts were not terminated following a breach of contract, the termination was by mutual agreement (although both the players and Tottenham had been under pressure to reach an agreement). Additionally, both the FIFA rules and the employment contracts permitted the parties to terminate the contracts early by mutual agreement. However, payments made following such a mutual agreement were not within the scope of the principle in *EMI Group Electronics* [1999] STC 803, as the contracts had not specifically provided for the payments. The payments under the mutual agreement were therefore not 'from' employment.

Why it matters: The FTT noted that whether or not a contract provided for the possibility to terminate it by mutual agreement was irrelevant, given that any contract could, in any event, be so terminated. However, payments made following such a mutual agreement were not within the scope of the principle in *EMI Group Electronics*.

Commenting on the decision, BKL Tax's Brass Tax observed: 'Although Spurs would probably have happily traded their recent win before the First-tier Tribunal … for a win in the Premier League, we venture to suggest that the decision will prove of even greater and longer-lasting significance than three points at White Hart Lane.' (Tottenham Hotspur and termination arrangements, *Tax Journal,* 23 June 2016).

3. *Project Blue*: sub-sale relief and alternative finance relief

In ***Project Blue v HMRC*** [2016] EWCA Civ 485 (26 May), the Court of Appeal found that FA 2003 s 71A did not apply to a land transaction, so that s 75A was not in point.

The issue was the SDLT payable on the purchase of the Chelsea Barracks from the Minister of Defence (MoD) by Project Blue (PBL), using an Ijara lease, which is a form of Sharia-compliant financing (as opposed to an interest-bearing loan). The sale comprised the following steps:

- MoD contracted to sell the land to PBL for £959m;
- PBL contracted to sell the land to a Qatari bank (MAR). Under leaseback arrangements, PBL was to pay MAR rent (representing instalments of the purchase price); and
- PBL and MAR granted each other put and call options over the land.

The UT had found that PBL was liable to SDLT in the sum of £38m based on a consideration of £959m under s 75A. PBL contended that the party liable was MAR.

Under FA 2003 s 45 (before its 2008 amendments), PBL was not liable to SDLT, as the completion of the contract between the MoD and PBL was 'disregarded' under 'sub-sale relief'. Furthermore, under FA 2003 s 71A, no SDLT was payable on the transfer from the MoD to MAR under the second contract. This was because s 71A ensured that no SDLT was triggered by an Ijara lease transaction. Consequently, both the transfer to MAR and the leaseback by MAR were exempt alternative finance transactions. Finally, s 75A applied to a series of transactions between a vendor 'V' and a purchaser 'P', where the total SDLT payable was less than would have been payable on a direct sale by V to P.

The court observed that the purpose of s 71A was to limit SDLT to a single charge on the acquisition of the property from the third party vendor, whether by the financial institution or its customer. It would therefore be 'strange' for Parliament to have intended that both the acquisition of the property by the customer and its later acquisition by the financial institution should be SDLT

free under sub-sale relief. The court therefore thought that the 'much more obvious construction of s 71A' was that cases falling within s 45(3) were intended to be treated as direct acquisitions by the financial institution from the third party vendor, which triggered SDLT so that MAR was liable.

As to s 75A, the court stressed that there was no reference in the provision to the purpose of the transaction being tax avoidance. Under s 75A, MAR was 'P' and must be treated as such. However, this was only relevant if the court was wrong in relation to s 71A.

Why it matters: The Court of Appeal reversed the UT's decision, finding that s 75A did not apply because s 71A did not apply, so that the notional transaction and the actual transaction were identical for s 75A purposes. Interestingly, the s 71A argument was not run by PBL in the FTT and was given relatively short shrift by the UT.

Commenting on the decision, Patrick Cannon observed: 'The implications of this decision for other types of sub-sale planning done under s 45(3) are interesting. They give taxpayers who undertook such planning grounds for optimism, where their planning did not depend on the intermediate purchaser having a special status so as to confer a statutory exemption on the sub-purchaser.' ('Court of Appeal in *Project Blue*: the fog clears', *Tax Journal,* 9 June 2016).

4. *Airtours Holidays Transport*: recovery of input tax incurred on production of a report

In ***Airtours Holidays Transport v HMRC*** [2016] UKSC 21 (11 May), the Supreme Court found that Airtours was not entitled to recover input tax in relation to a report prepared by PwC and paid for by Airtours.

The issue was whether Airtours was entitled to recover input tax in respect of services provided by PwC and paid for by Airtours. This in turn depended on whether the services provided by PwC had been supplied to Airtours.

Airtours, which had borrowed money from around 80 banks, had been in serious financial difficulties and had sought refinancing. It had commissioned PwC to produce an accountants' report to satisfy the banks that its restructuring proposals were viable.

The first issue was whether PwC had contractually agreed with Airtours that it would supply services to it, such as providing a report to the banks. The Supreme Court found that PwC's obligation to provide its services was owed solely to the banks; and that Airtours was a party mainly for the purpose of agreeing to pay PwC's fees.

The second issue was whether the facts that Airtours had a substantial commercial interest in the services being provided by PwC to the banks, and that it had agreed to pay PwC for the services, led to the conclusion that the services were 'supplied' to Airtours (as well as to the banks). The court found that the benefit which Airtours received was not the services from PwC, but the enhanced possibility of funding from the banks.

Why it matters: Two Lords dissented, observing that the approach taken by Lord Neuberger was too narrow. In their view, the real issue was whether, on the facts, the arrangements between the banks, PwC and Airtours involved the supply of services to Airtours or merely third party consideration provided by Airtours for services rendered to the banks alone. Airtours' future had depended on the report, so that the value of the services provided by PwC was as great to Airtours as it was to the banks. They concluded that a tripartite agreement had been entered into and that PwC had owed a duty of care to Airtours.

Commenting on the decision, Nick Skerrett and Gary Barnett observed: 'it appears that whilst the Supreme Court may have answered the direct question in this case, it may, in doing so, have cast new doubt on the question of whether a taxpayer who is the recipient of a supply can deduct, as input tax, VAT paid by another person as "third-party consideration"' ('Supreme Court in *Airtours: Redrow* redacted', *Tax Journal,* 19 May 2016).

5. *Pattullo*: discovery and the hypothetical officer

In ***N Pattullo v HMRC*** [2016] UKUT 270 (14 June), the UT found that HMRC had made a discovery (TMA 1970 s 29(1)) and that HMRC could not have been aware of the insufficiency of tax at the time the enquiry window had closed (s 29(5)).

Mr Pattullo had entered into a tax avoidance arrangement in the 2003/04 tax year. The arrangement had involved the use of capital redemption contracts (CRCs) and had sought to take advantage of the wording of TCGA 1992 s 37. Some 925 participants in the scheme had been identified and 909 enquiries opened. However, at the time Mr Pattullo had submitted his return, disclosure of the CRC scheme had not been required by law. It was ultimately held that the scheme did not achieve its purpose.

The first issue was whether a discovery could comprise a series of discoveries. The FTT had found that the threshold had been crossed in the period June to November 2009, when the *Drummond* [2009] STC 2206 case (which concerned a similar scheme) had been decided by the Court of Appeal and leave to appeal had been refused. The UT detected no error of law in this finding.

Mr Pattullo also argued that TMA 1970 s 29(1) required HMRC to make an assessment immediately upon making a discovery. The UT agreed, noting that the requirement for the discovery to be acted upon while it remained fresh arose on the natural meaning of s 29(1) itself. However, the FTT had found that the discovery had been made sometime between July and November 2009 and that the assessment had been made in January 2010. The discovery had therefore not been stale by the time of the assessment.

The second issue was the level of knowledge and expertise to be expected of the hypothetical officer, when deciding whether he should have been aware of the insufficiency of tax (TMA 1970 s 29(5)). The UT thought that the discovery in sub-s (1) found its counterpart in the state of awareness in sub-s (5). The question of reasonableness therefore came not in the need to construct a fictional hypothetical officer, but rather in the test of whether the actual officer ought reasonably to have been aware of the insufficiency.

The UT found that in January 2006 (when the enquiry window had closed), a hypothetical officer would not have had any real understanding of the arcane world of CRCs. Furthermore, the *Drummond* case had only reached the Court of Appeal in 2009. The FTT had therefore been right (although it had erred in law when ascertaining the characteristics of the hypothetical officer) to find that the hypothetical officer could not have been aware of the insufficiency.

Why it matters: The UT clarified what is meant by 'discovery'. It considered that there may be 'hesitation on the doorstep, shifting forwards then back again before finally going in'; 'crossing the threshold' was therefore not like 'crossing the Rubicon'. The UT also refined the notion of reasonableness of 'the hypothetical officer'. It noted that the question of reasonableness should arise as an objective test, by reference to the standards of knowledge and expertise reasonably to be expected of an HMRC officer dealing with tax returns raising 'this kind of question' and giving 'this amount of information'. The question was therefore whether the officer's lack of awareness of the insufficiency as at the relevant date could properly be categorised as unreasonable.

Cases reported by Cathya Djanogly (cathya.djanogly@hotmail.com)

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The big read

20 questions on Brexit

Darren Mellor-Clark
Pinsent Masons
Darren Mellor-Clark is a partner (non-lawyer) in the indirect tax advisory practice at Pinsent Masons. He advises clients with regard to key business issues especially within the financial services, commodities and telecoms sectors. Email: darren.mellor-clark@pinsentmasons.com; tel: 020 7054 2743.

Andrew Scott
Pinsent Masons
Andrew Scott is a legal director in Pinsent Masons' contentious tax practice who advises on all aspects of business tax. Andrew was previously director of business tax at HMRC Solicitor's Office and, as a Parliamentary drafter, was responsible for drafting a significant proportion of the UK tax code. Email: andrew.scott@pinsentmasons.com; tel: 020 7490 6191.

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.

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.

The loss of the benefit of the EU Mergers Directive could impact on cross-border mergers involving the remaining EU member states.

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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.

> Even in these uncertain times, it seems unlikely that the government will lightly discard long-standing constitutional norms

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.

> It may be not until the Autumn Statement when we get an indication of the government's early thinking on the post-Brexit tax landscape

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. ■

Economics focus

Brexit: keep calm and carry on worrying

Speed read

Brexit came as a shock to pundits, the markets, and probably to most voters. Its consequences will be far reaching, and will last for years. In the immediate future, George Osborne's threatened £30bn emergency austerity Budget will not now happen, while the future of the chancellor himself is in extreme doubt.

David Smith
Economics editor
David Smith has been economics editor of *The Sunday Times* since 1989, where he writes a weekly column. He is also chief leader writer, an assistant editor and policy adviser. He is the author of several books, including *Something will turn up*.
Email: david@economicsuk.com.

The deed has been done, and it is not the deed I expected. Until about 11.30pm on referendum night, the picture seemed clear. In the run up to the big day we had both large leads for Remain and large leads for Leave, but the direction of travel was clear. The momentum for Remain was evident, and it was confirmed in polls on the referendum day itself. So-called status quo bias had asserted itself and there would be a narrow, or even a comfortable, vote to stay. The bookmakers were so certain of it that they almost stopped taking bets.

They were wrong, and so was the assumption that the warnings from experts about the economic damage, including those of the saintly Institute for Fiscal Studies (IFS), would persuade people not to take a risk with Brexit. A good guide to a general election outcome is which party is most trusted to run the economy. Given that the Remain camp had a much more convincing economic story to tell, that should also have been a reliable indicator of the referendum result.

The problem was that the two people most associated with the economic message, David Cameron and George Osborne, were those least trusted by voters to tell the truth about Europe. Osborne's threat of a £30bn emergency austerity Budget to follow a Brexit vote was seen as the last straw by many voters, and also by many Tory MPs. In contrast, despite their highly dubious claims, Boris Johnson and Michael Gove were more trusted by voters.

What happens now?

This is not the time to go into the details of when article 50 is triggered – the process by which Britain will have a two-year window for withdrawal from the EU. Cameron, in announcing his intention to step down, said that decision would be for his successor, most probably Boris Johnson, who will not be in place until September. The political chaos the Brexit vote has created – not just Cameron's announcement of his intention to step down, but also the disintegration of the Labour party under Jeremy Corbyn – has been even greater than I would have expected. If you were to characterise this as a vote for anarchy, you would not be greatly wrong.

It is legitimate to ask about Osborne's emergency Budget, and Osborne himself. In his statement on the morning of 27 June, the chancellor made it clear that there would be no rush to reassess the fiscal situation. Any action will await a new Office for Budget Responsibility assessment and the Autumn Statement, once a new prime minister is in place. That makes sense. Not only would it have defied economic logic to inflict additional pain on an economy reeling from the aftermath of the shock Brexit vote, but Osborne would not have succeeded in getting it through Parliament, as Tory MPs made clear.

What about Osborne himself? In his 27 June statement, he said he would talk about his own role in the coming days. It is hard to see him surviving beyond the prime minister's remaining time in office, certainly not at the Treasury. There is talk of him cosying up to Johnson and Gove, which in theory could see him staying on as a continuity chancellor. That would, however, be a hard sell to many Tory MPs, let alone to the rest of the country, following his dire warning of the consequences of Brexit.

> There is talk not of an austerity Budget, but rather of dramatic moves to stimulate the economy

What of those dire warnings?

A wise old economist I used to work with always pointed out that financial markets respond quickly to shocks but the economy takes longer. The economic effects of Brexit – which I think will be negative – will only become clear over months and years. If indeed there is no way back into the EU, we will soon tire of blaming bad news on the referendum and instead regard it as the normal order of things.

Britain's departure from the EU will take years to complete, and involves more parliamentary and constitutional hurdles than bear thinking about. I hope to still have a full head of hair when it is complete but I expect it to be snowy white. In the meantime, what should the chancellor, or his successor, be doing?

The referendum occurred at a time when the public finances appear to be going through another of their periods of slippage. It is early days; however, the Office for National Statistics said on 21 June that the £74.9bn of public sector net borrowing in 2015/16 remains nearly £3bn above the Office for Budget Responsibility's March forecast. Figures for the first two months of the year suggest that the forecast for 2016/17, of a drop in borrowing to £55.5bn, will be very hard to hit. Borrowing in April to May was down on a year earlier, but not by enough.

There is talk not of an austerity Budget, but rather of dramatic moves to stimulate the economy in the wake of Brexit. Could corporation tax be cut to 10%, undercutting even Ireland, to ensure that Britain retains her appeal for foreign direct investors? Maybe, but it would be an expensive move – at a time when the public finances are likely to be hit by a slowing economy – and, perhaps less importantly, would fall foul of EU unfair tax competition rules which, for the time being, we are bound by.

If there are constraints on what the Treasury might do, there are also limits on the Bank of England's freedom of action. Mark Carney, who some in the Brexit camp believe should go for his pre-referendum warnings, could lead a cut in the Bank rate to zero and unveil another round of quantitative easing. Few would see this as doing much to boost the economy, however. As a result of the referendum vote, we have made our bed. We should not be surprised if it is uncomfortable when we lie in it. ■

In-house view

Brexit: what now for policy makers and businesses?

Speed read

There is little doubt that Brexit will result in change, even if at present it is impossible to predict what that will entail. There may be pressure on UK policy makers to offer an even more attractive tax system, although such reform is likely to be constrained by the need to maximise the facilitation for cross-border trade and investment. In the interim, large businesses might wish to consider establishing a cross-functional 'Brexit' committee to monitor developments and plan for risks.

Paul Morton
RELX
Paul Morton is the head of group tax at RELX plc. He leads a team of tax professionals in the UK, Netherlands, US and Singapore which serves businesses operating in more than 90 countries. Paul is deputy chairman of the British branch of the International Fiscal Association, and a member of the Confederation of British Industry and FTSE 100 group tax committees, as well as the Tax Law Review Committee of the Institute for Fiscal Studies and the Council of the Institute for Fiscal Studies.

Many tax professionals will have woken on Friday morning, perhaps after a late night, with something of a Brexit 'hangover'. The mood at the joint HMT/HMRC/International Fiscal Association annual conference was perhaps a little subdued. Clients will be asking their advisers for their first thoughts on the tax implications of Brexit, after reading through the flurry of briefing papers, updates, bulletins and advisories, and the first thoughts will broadly confirm that no one really knows.

It may be that once the dust has settled any changes in the UK tax system will be modest and measured rather than dramatic. Perhaps the VAT system will continue largely in its current form, since it works, with some adjustments to reflect policy preferences but within a broadly unchanged administrative framework. Direct taxes are even less likely to be fundamentally changed as these taxes have been, to a greater extent, within the jurisdiction of domestic policy making. The UK's exceptional network of double tax treaties might ameliorate the impact of losing access to some EU instruments such as the interest and royalties directive and the arbitration convention, at least to some extent.

An initially ebullient policy maker might have visions of dramatically reforming the UK business tax system but, at least for larger corporates, the international business tax system demands close adherence to the consensus developed at the OECD and now even more precisely defined by the BEPS deliverables. The tax system will need to continue to play its part in facilitating cross-border trade and investment so the avoidance of double taxation, the minimisation of withholding taxes and enabling the swiftest possible resolution of cross border disputes will all be critically important. This means keeping well within the lines of the international consensus on application of the OECD Model Double Tax Treaty, the Transfer Pricing Guidelines and other accepted international law and practice.

Having said all of that, there will be change and at present it is impossible to predict what that will be. It might therefore be useful for large businesses to establish a 'Brexit' committee to monitor developments and plan for risks. This should be a cross-functional team, particularly including business representatives, treasury colleagues, government affairs, finance, systems specialists and strategy. Nobody knows yet what impact Brexit will have on cross-border business models, but if changes are required it might be necessary to adjust corporate structures and transfer pricing strategies. It might be useful to undertake a risk assessment exercise, perhaps by way of scenario planning, to explore the possible tax implications of all kinds of changes. This might provide an informed basis on which to brief boards and audit committees on tax risk post Brexit.

Generally, most developments in tax run to a somewhat slower timescale than those in the businesses. First impressions are that the mind bogglingly complex negotiations required to re-engineer the UK's relationship with the EU will take quite some time and could even lead in unexpected directions. Business leaders should be briefed to expect a lengthy, slow and unpredictable process.

Looking a little further into the future, some speculate that a UK outside the EU might choose to compete for investment by offering an even more attractive tax system. Is a corporation tax rate of 15% likely, a rate of 10% or even 5% unimaginable? There has been very little comment from the public regarding the 17% rate so the argument that a very low rate is necessary to attract international investment may prove to be not just acceptable but even compelling after Brexit. Are there other features of the UK regime which could be made more attractive? Perhaps the incentives for R&D and technology might be improved further, within the limitations set by the BEPS deliverables. Could a more attractive regime for short term business visitors or assignees be on the cards?

For some multinational businesses, particularly in the digital economy or in knowledge based industries, the specific location of their activities is rather less important. Technologists can be based anywhere from an operational point of view, at least in some industries and functions, and in the digital economy teams can increasingly work across borders. Proximity to customers is no longer important for some parts of the value chain. In this context it might be that the UK remains as attractive as it is now for the location of digital economy business functions. On the other hand, the EU might follow the lead of many other countries, particularly emerging economies, in introducing higher levels of tax on imported digital services. This might encourage the relocation of digital service providers into the EU. Arguably, however, this would result in it being more expensive for EU consumers to purchase digital services. The UK is, of course, a substantial market so perhaps EU countries will prefer not to put tax barriers in the way of cross border digital services exported from the EU to the UK.

The post-BEPS tax world is more inter-connected than ever before and if the G20/OECD project is to succeed it will be based on consensus to an unprecedented extent. The scope for post-Brexit reform seems therefore to be relatively constrained by the need to maximise the facilitation for cross-border trade and investment. Will the immediate aftermath of Brexit, accordingly, involve a huge amount of activity, change and hard work which leaves us, after some time, and with a mild sense of surprise, not that far from where we started? ■

Comment

Brexit: tax implications for multinationals

Speed read

On 23 June 2016, the UK voted to leave the EU. No immediate emergency Budget is expected but the Autumn Statement may provide an indication of future tax policy. Whilst the terms of the UK's future relationship with the EU remain hard to predict, some tax consequences of the UK's withdrawal from the EU can be anticipated. Tax directors should review their existing corporate structures, and any new investment structures, for possible post-Brexit tax inefficiencies. Mitigating action may be possible. Looking further ahead, the UK may have more flexibility in setting UK tax policy, whether to attract investment or otherwise, although radical changes seem unlikely.

Peter Clements
Freshfields Bruckhaus Deringer
Peter Clements is a tax partner at Freshfields Bruckhaus Deringer LLP. He specialises in corporate restructurings, cross-border transactions (including demergers, joint ventures and refinancings) and international public and private mergers and acquisitions. Email: peter.clements@freshfields.com; tel: 020 7785 5750.

On 23 June 2016, the people of the UK voted to leave the EU. The process of working out what that means will now begin, both in terms of what the UK's future relationship with the EU and the rest of the world will look like, and what it means for the UK business landscape and the activities of multinationals in and with the UK.

From a tax perspective, there are perhaps three main phases to consider: the immediate reaction of the UK government; the anticipated consequences of the UK ceasing to be a member of the EU; and the longer term implications for UK tax policy.

Immediate implications

Technically, nothing has changed as a result of the referendum. EU law continues to apply in the UK as it did before, including as regards tax matters, and it will continue to do so until the UK formally exits the EU. The complexity of the withdrawal process means that this is highly unlikely to occur before 31 December 2018 – and may be later.

However, in the face of the immediate uncertainty, the UK government has some near term fiscal policy decisions to make. George Osborne has already confirmed that taxes will need to rise, but businesses will also need to be reassured that the UK remains an attractive place to do business. The prospect of an immediate emergency budget seems to have faded (aside from the unexpected acceleration of the extended royalties withholding tax!), and detailed announcements are likely to be postponed until the Autumn Statement.

It will be interesting to see whether the implementation of major tax reforms, such as the proposed 'interest barrier' and changes to the corporate loss rules, are delayed in light of the need to preserve stability and to focus Treasury resources on negotiating the UK exit.

It will also be interesting to see how the UK courts react to the referendum vote. Will they be more reluctant to refer a question to the CJEU, if it is unclear whether any answer will be obtained pre-Brexit and whether it will be binding?

Looking towards Brexit

It is of course difficult to predict what the future will hold. Assuming the UK does in fact leave the EU, the resulting tax implications will depend on the precise terms of the withdrawal arrangements and the new relationship with the EU going forward. However, there are some known consequences, some likely consequences and some possible consequences that can be anticipated.

The known knowns: EU tax directives

Upon leaving the EU, unless agreed otherwise in the withdrawal agreement, the UK will cease to benefit from (or be bound by) the various European tax directives, including the Interest and Royalties Directive (IRD), the Parent-Subsidiary Directive (PSD), the Cross-Border Mergers Directive and the Capital Duties Directive.

PSD and IRD

The PSD and IRD provide exemptions from withholding tax on dividends, interest and royalties between related parties in the EU. The PSD also provides exemption from tax on receipt of dividends from an EU subsidiary.

The withdrawal of the PSD from UK companies will be mitigated somewhat by the UK's extensive treaty network. However, full protection cannot be assumed. Some 12 out of the 27 member states currently impose withholding tax on dividends, which would not be reduced to nil under a UK double tax treaty. For example, post-Brexit dividends paid by a German subsidiary to its UK parent would suffer withholding tax at 5% versus the nil rate currently mandated by the PSD.

Similarly, inbound dividends received by EU parents from UK subsidiaries may become subject to tax in jurisdictions, such as Ireland, where tax treatment varies as between EU and non-EU source dividends.

The IRD is perhaps less significant in practice, given its narrow scope. However, the extension of the UK royalties withholding tax regime may render it more relevant for groups with UK operations. Also, groups that have activities in Gibraltar, such as the gaming sector, may be disproportionately affected given Gibraltar's lack of double tax treaties.

Tax directors should review their existing corporate structures – and any new acquisition or investment structures – for possible tax inefficiencies resulting from the loss of the benefit of the PSD and IRD. Reorganising corporate structures to benefit from more favourable tax treaties may be desirable; however, they will need to be reviewed against the backdrop of the OECD BEPS work in relation to treaty abuse, recent developments in relation to the 'beneficial ownership' requirement and applicable anti-avoidance rules.

Capital Duties Directive

Brexit could also affect the (non-)application of the 1.5% SDRT charge on share issues into clearing and depositary receipt systems. Technically, this remains on the statute book but it is not enforced by HMRC in light of *HSBC Holdings* [2012] UKFTT 163. The UK's exit from the EU and consequent lapse of the Capital Duties Directive in the UK would open the possibility of the charge being reinstated (subject to free movement of capital arguments). However, it is to be hoped that the UK government would not pursue such an approach.

Other Directives

Following the UK's formal withdrawal from the EU, the EU directives on administrative cooperation and mutual assistance will no longer apply in the UK, including the forthcoming automatic exchange of tax rulings. Overall, however, the impact is likely to be limited, given the broadly similar rights and obligations under the OECD multilateral convention.

Other proposed EU initiatives would also cease to apply upon Brexit, such as public country by country reporting under the Accounting Directive and the Anti-Tax Avoidance Directive. The latter is proposed to come into effect from 1 January 2019 and accordingly may post-date the UK's exit in any event.

The known knowns: VAT and the customs union

Leaving the EU will have significant compliance implications for VAT and customs duties, as supplies that are currently intra-EU become exports and imports. Reporting and cash flow management will need to be reassessed (including having regard to the less streamlined 13th Directive refund process); and existing cross-border supply chains could become unwieldy and inefficient.

Furthermore, depending on the UK's future relationship with the EU, intra-group transfers of goods and services between entities in the UK and the EU may become subject to absolute costs in the form of import/export duties and/or non-tariff trade barriers. This may also extend to transactions between UK and non-EU operations, as the UK ceases to benefit from free trade agreements (FTAs) in place between the EU and third countries.

In some cases, the additional compliance costs and/or tariffs may lead to internal reorganisations and a relocation of activities may become desirable.

The known unknowns: EU fundamental freedoms

As a member of the EU, the UK is subject to the four fundamental freedoms. Members of the EEA are similarly bound.

If the UK ceases to be in the EU and does not join the EEA, then the UK may seek to reinstate domestic rules that have previously been found to be in breach of the fundamental freedoms. For example, the ability to surrender losses to and from non-UK group members following *Marks & Spencer* (Case C-446/03) and *Philips Electronics* (Case C-18/11) may be an obvious target for repeal.

However, it could also work the other way. The loss of EU status for UK resident companies could have adverse implications under the laws of other member states, many of which have developed tax rules that take account of the EU fundamental freedoms in their application to EU resident companies.

For example, France recently amended its fiscal consolidation rules to permit consolidations through EU resident entities, as well as French entities. Groups that rely on consolidating through UK entities may be forced to restructure post-Brexit.

Similarly, in a number of jurisdictions, such as Germany and Spain, CFC rules operate by reference to the high *Cadbury* threshold of wholly artificial arrangements (Case C-196/04) as regards EU resident subsidiaries, but adopt a lower threshold for non-EU subsidiaries. This could lead to the profits of UK subsidiaries becoming subject to taxation under overseas CFC rules.

Again, however, much depends on what is ultimately negotiated with the EU. In particular, accession to the EEA would in effect involve the continuation of the fundamental freedoms (since they are broadly the same in the EEA Agreement as in the EU Treaties); and therefore the prohibition on discrimination as between UK and EU resident companies would continue.

Tax policy making

Looking further ahead, in theory the UK's exit from the EU will allow greater flexibility in setting UK tax policy.

The most obvious example is VAT, where the UK government would be free to amend, extend or repeal VAT laws as it sees fit. In reality, whilst the EU and UK VAT systems would be likely to diverge over time, the expectation is that wholesale changes are unlikely, not least given the global trend towards VAT systems rather than sales tax or GST.

There would also be scope for the UK to introduce additional consumption based taxes (which are currently prohibited by the EU Treaty). These may be politically attractive in light of the continuing furore over the tax treatment of multinationals selling into the UK.

In a similar vein, the UK may find itself freed from EU rules governing state aid and harmful tax practices. This could allow the UK to introduce tax policies designed to attract investment into particular sectors, including investment allowances. However, again it will depend on the model adopted; EEA membership, for example, would carry obligations similar to the EU's state aid rules. And, as regards harmful tax practices, the UK's commitment to the OECD developments in this area would presumably continue outside the EU.

> Group structures should be reviewed to identify areas where a cessation of EU membership could cause tax leakage

The Leave campaign has also made comments about the possibility, post-Brexit, of legislating to prevent the payment of compensation in respect of EU infringement claims, such as those at issue in *Littlewoods* [2015] EWCA Civ 515. The amounts at stake may make this an attractive proposition for any UK government, and is unlikely to be unpopular amongst the general electorate. In the same publication, the Leave campaign also mooted the possibility of reintroducing the CFC regime as it was in force prior to the *Cadbury* decision, although this seems unlikely – at least under the current government.

Final remarks

The immediate impact of the referendum vote for tax directors and professionals is limited. Much will depend on the nature of the UK's future relationship with the EU, which will take shape only over the coming months and years. However, group structures can and should be reviewed to identify areas where a cessation of EU membership could cause tax leakage, and consideration given to the possibility of pre-emptive restructurings before the UK formally exits the EU. Tax directors will also need to be involved closely in wider investment decisions to ensure that the tax implications of the UK being outside the EU are properly factored in. And it will be important that businesses and tax professionals engage actively with government regarding the shape of any future agreement with the EU from a tax perspective. ■

Comment

Brexit: the impact on SMEs

Speed read

At this stage, it is difficult to predict the tax impact for OMBs and SMEs but perhaps we can hope for some positive changes. The EU restrictions on state aid have reduced the availability of venture capital reliefs at a time when finance was needed by SMEs. If the UK is not limited by these rules, perhaps the reliefs can be extended.

Paula Tallon
Gabelle
Paula Tallon is managing partner of Gabelle LLP, which provides independent tax support for accountants and other professionals. Paula's areas of expertise include company reorganisations and reconstructions and other tax issues facing OMBs. Email: paula.tallon@gabelletax.com; tel: 020 3805 7460.

What is the potential tax impact of Brexit for OMBs and SMEs? In terms of business taxes, SMEs have seen these decrease in recent years while personal taxes have increased. The impact of the new dividend tax introduced in April 2016 is already being felt by these businesses, so it is hoped that this tax is not increased as a way of avoiding the tax lock.

The following are relevant to SMEs.

State aid restrictions

The EU state aid rules have restricted the way in which the enterprise investment scheme (EIS) and other venture capital reliefs can offer assistance to growing businesses. In the past few years, EIS has been restricted as a result of EU regulation. The use of such investment as replacement capital has been severely restricted and the age of the company attracting the investment has been reduced to seven years (or ten years in the case of a knowledge-intensive company). Depending on what form Brexit takes, it could mean more flexibility for these reliefs in the future, which in turn would increase the funding available to SMEs.

Both research and development and the patent box relief are caught by the EU state aid rules. These reliefs could be enhanced for SMEs, which would increase the attractiveness of Britain as a place to do business.

Groups

SMEs which have European group structures, and which rely on the Parent-Subsidiary Directive or the Interest and Royalties Directive to benefit from no withholding taxes, will need to review their structures to identify any potential tax leakage. If businesses need to be restructured, this should be done while the EU Mergers Directive still applies. If not, such restructuring could give rise to tax charges on assets which have increased in value.

Employee reward

Brexit is likely to have long-term implications for the design of remuneration structures for finance professionals, which are heavily influenced by rules set out in the Capital Requirements Directive (CRD IV). These rules stipulate that fixed proportions of an employee's variable remuneration (bonuses, etc.) must be directly linked to the financial instruments that they trade in and must also be subject to clawback in certain situations. While it seems unlikely that these rules will be completely scrapped in the short term, it is possible that the UK regulators may choose to scrap elements of them which were designed with market conditions in other member states in mind or to impose new restrictions on remuneration in this sector.

The ongoing market uncertainty will also have a knock-on effect on valuation multiples, used to determine the value of private companies for tax purposes. A fall in those multiples will reduce fiscal valuations of shares. This has a potentially beneficial aspect, in that it makes it cheaper to issue/transfer shares to employees. However, it also increases the risk that employees and founders who sell shares at prices determined before the vote could be seen as having been overpaid for their shares, which could result in charges to both income tax and NICs under the rules in ITEPA 2003 Part 7 Chapter 3D.

Property businesses

In recent years, the UK property market, particularly in London and the South East, has been buoyed up by a huge appetite from international investors. In the run-up to the EU referendum, there was a noticeable slowdown in the property market, particularly in the high end residential sectors. While it still remains to be seen how the market will react as a whole following the EU referendum decision, it seems inevitable that any government will continue to seek to maximise the tax take from this important sector – whether through increasing the rate of transactional taxes such as SDLT; through tackling offshore structures for inheritance tax purposes; or by differentiating and applying higher rates of tax to property transactions, such as the residential property surcharge for capital gains tax.

In this post-EU referendum era, the government may wish to be seen as promoting enterprise and innovation. Could we therefore see the creation of a net wealth tax, if necessary, to help balance the books? Such a tax is likely to significantly impact those businesses within the property sector.

As a capital-intensive industry, property is also particularly susceptible to rises in interest rates. The impact of any such interest rate changes would be felt more acutely where these coincide with the introduction of the new rules restricting income tax relief for interest on buy-to-let portfolios under ITTOIA 2005 s 272A; and with any new corporate tax restrictions introduced in line with the BEPS programme. Both of these are likely to apply from 2017 onwards.

Like the rest of the economy, property businesses, small and large, are now having to deal with a period of uncertainty while a clear way forward is negotiated and agreed upon. In the meantime, therefore, property businesses and their tenants are likely to be more cautious, particularly in making any commitment to new acquisitions, developing new projects or agreeing the terms of a tenancy agreement. In the short term, it must be expected that the number of transactions will fall. Until the exact terms of Brexit are apparent, it is difficult to predict the ramifications and the associated tax impacts. The only thing that remains certain at the moment is uncertainty.

What now?

Despite the unsettling nature of the EU referendum, the reality at this moment in time is that from a tax perspective, nothing has changed and it is business as usual. ■

Comment

Brexit: implications for private clients

Speed read

At this stage, we can only speculate about what other changes may eventually affect private clients. Brexit uncertainties could discourage wealthy individuals from moving to the UK. Policy makers may, for instance, be attracted to restricting the personal allowance for inbound non-doms. Assuming the CJEU would no longer have authority over UK taxes, the UK's transfer of assets abroad legislation will no longer need to be EU compliant.

Wendy Walton
BDO
Wendy Walton is the head of global private client services at BDO. She is a senior tax partner within BDO's London tax group and advises high net worth individuals on their worldwide tax position, with an emphasis on non-domiciled individuals. Email: wendy.walton@bdo.co.uk; tel: 0207 893 2252.

Although there is an immediate impact on the personal finances of individuals from the volatility in stock markets and the value of sterling, the immediate impact of the referendum vote on the tax affairs of individuals is expected to be minimal. However, in the longer term, there could be substantive impacts if the UK tax legislation no longer has to comply with EU law. It could, though, potentially be five years before the negotiation is successfully concluded and there is certainty in the post-Brexit world.

Considerations for non-doms

For wealthy individuals considering a move to the UK, these uncertainties, together with the previously outlined future changes in the tax law for non-doms, could discourage them from moving to the UK. In addition, we also wait to see what changes to immigration law will follow. Commentators are suggesting that property prices may fall, which may initially discourage but later encourage investment from overseas. However, it would be good to have clarity over the proposed changes to these rules too.

Having ruled out an emergency Budget before the summer parliamentary recess, it will be interesting to see if the government pushes ahead with ongoing consultations or shelves them pending cabinet changes.

The next stage of the consultation on non-doms is expected before the summer recess. If there is no progress, the delay may be seen as signalling a change of approach or a deferral in the introduction of the rules. A new chancellor could take a different view on the deemed domicile proposals if he or she is concerned to maintain the UK's attractiveness to internationally mobile business generators – be they internet start-up entrepreneurs or hedge fund managers.

The UK's transfer of assets abroad legislation

As regards changes to UK legislation, which no longer has to comply with EU law, a clear example arose from the UK's transfer of assets abroad (TOAA) legislation. Although this is anti-avoidance legislation, it was found to inhibit both freedom of establishment and the free movement of capital enshrined in the EU treaty; and was the subject of EU infringement proceedings taken against the UK in 2012.

Aiming to make the legislation EU compliant, in FA 2013, the government created an exemption for 'genuine' transactions (i.e. those without a tax avoidance purpose). Some leading commentators have suggested that this legislation was still not EU compliant; but we may no longer need to concern ourselves with such arguments. Similar amendments had also been made to the provisions of TCGA 1992 s 13 (attribution of gains to participators in certain non-resident companies).

Assuming the eventual Brexit settlement removes the CJEU's authority over UK taxes, the TOAA rules (and other exit or cross-border taxes) will no longer need to be EU compliant. I am not suggesting that the UK will create a broad range of exit taxes or quasi capital controls – that would probably be counterproductive. They would, however, be possible.

Assuming the eventual Brexit settlement removes the CJEU's authority over UK taxes, the transfer of assets abroad rules (and other exit or cross-border taxes) will no longer need to be EU compliant

Further reflections

The idea of removing UK personal allowances from non-UK residents was considered in 2014 but was shelved because of the complexities of applying it under EU law. This could be revived as a way to raise tax revenue. It may also prove attractive to restrict or reduce the personal allowance for inbound non-doms for an initial qualifying period (perhaps four years, as with the state benefits proposals).

Going forward, our treaty network will be of importance to international families and their businesses.

Offering a specific offshore avoidance amnesty only to those who bring the capital back to the UK and invest it here (with some minimum retention period) may also be seen as a desirable way to raise both tax revenue and boost UK investment.

Finally, it will be interesting to see what happens with those cases that are heading towards the CJEU. For example, *Fisher v HMRC* [2014] UKFTT 804 (TC) (involving the TOAA provisions) was on its way and presumably this will still be heard, but the position going forward is far from clear.

At this stage, we can only speculate about what other changes may eventually affect private clients, as we live in this period of uncertainty. This year's Autumn Statement may prove to be more interesting than that of 2015. ■

VAT focus

UK VAT post-Brexit: initial thoughts

Speed read

The nation has spoken. We are leaving the EU. VAT is a creature of the EU, defined by regulations, Directives and CJEU rulings. Does it still have a place in the UK? The government and HMRC have yet to address this, but abolition is not expected (it is projected to yield more than £100bn in the current tax year, after all). Nor is wholesale replacement by a domestic goods and services tax. But change is inevitable. This article looks at some of the areas that will be impacted and hazards a sketch of the shape of the changes to come.

Etienne Wong
Old Square Tax Chambers
Etienne Wong has been advising on VAT since 1989, with particular focus on finance, real estate, M&A, private equity, funds, e-commerce, outsourcing, renewables and new media. He is a barrister with Old Square Tax Chambers at 15 Old Square. Email: ewong@15oldsquare.co.uk; tel: 020 7242 2744.

'Here's one we made earlier.'

If only someone had shown up with those words and an exit strategy in hand the day we voted to Brexit. Even if that had happened, I doubt this miracle strategy would have extended to a comprehensive explication of what happens with UK VAT.

The key thing to note is that nothing has happened yet. And nothing will, until we actually leave the EU. And actual exit is a protracted process. The UK will first need to notify the European Council of our intention to withdraw in accordance with article 50 of the Lisbon Treaty. Negotiations will then commence on the withdrawal arrangements. Actual exit will occur on the day the UK and the EU (acting by a qualified majority) agree the withdrawal agreement or two years after negotiations commence, whichever is the earlier (unless the UK and the EU, acting unanimously, agree to extend the two-year period). Current events would suggest we will not actually exit before 2019. Until then, question marks hang over UK VAT.

Not all is unknown, however. When we leave, acquisitions and dispatches (concepts that refer exclusively to the movement of goods within the EU) will no longer be relevant. All movements of goods into or out of the UK will simply be imports and exports. Anyone who has so far escaped having to consider triangulation (the rules that govern acquisitions where there are three parties) can breathe a sigh of relief as they will now never have to grapple with this wondrous concept.

The mini-one stop shop

Unfortunately, the same cannot be said about the mini-one stop shop (MOSS) (the regime applicable to business-to-consumer supplies of electronically supplied, telecommunication and broadcasting services, or 'MOSS-covered supplies' for convenience). From actual exit, the UK will become a non-union country, and will no longer be able to offer MOSS. Non-EU businesses that have registered in the UK to account for MOSS-covered supplies they make across the EU will need to register for MOSS in another (i.e. EU) country, as will UK businesses selling MOSS-covered services to EU consumers (unless, perversely, they wish to register for VAT in every EU country to which they sell).

As for MOSS-covered services supplied to UK consumers from outside the UK, we will be free to introduce a new registration regime – perhaps one that deals not only with these services, but also inbound distance sales from outside the UK. This would be a welcome simplification. The question is whether we would do this.

And that is the big question.

Which part of the existing UK VAT regime will stay, which part will go and which part will change (and how)?

> Fun as a brand new goods and services tax sounds, it will be too disruptive, and the experience to date with the son of stamp duty – SDLT – is hardly inspiration for more fiscal reinventions

VAT will survive

Like the country itself, VAT as a tax will go on after Brexit; it will survive. Although it is a wholly EU construct, VAT is worth too much to the Treasury to abolish. It will not be completely rewritten. Fun as that sounds – a brand new goods and services tax! – it will be too disruptive, and the experience to date with the son of stamp duty – SDLT – is hardly inspiration for more fiscal reinventions. The odd nip and tuck are, however, inevitable. Although it is in theory possible that, as part of our withdrawal agreement, we agree to continue applying EU VAT, it is inconceivable from a political perspective, and thus, practically impossible.

So what will UK VAT look like when it finally flies from the nest of its EU progenitor?

The 'umbilical cord' that links UK VAT to the EU is made of three prime components: regulations, Directives and CJEU rulings.

The impact on regulations

Regulations have direct effect, and do not need to be implemented by way of domestic legislation. Electronically supplied services, for example, are not defined in UK legislation; there is a non-exhaustive definition in Implementing Regulation 282/2011 article 7. If we want article 7 (and similar provisions) to have continued currency, we would need to incorporate them in UK law by legislation. The question is whether we want to do this, and it is particularly pertinent with immovable property and services connected with immovable property, new definitions for which are contained in articles 13 and 31 of Implementing Regulation 282/2011. These are close, but not identical, to how we currently understand these concepts in the UK. They come into effect on 1 January 2017. We will still be part of the EU then, and will have to them. It is not clear, however, whether that will be for the short term only or if it will all change again on actual exit (through replacement by domestically-produced definitions, for example), and it would be helpful if the government or HMRC could indicate what their intentions are as regards

regulations and UK VAT law. That is, unfortunately, unlikely in the immediate future.

The impact on Directives

Unlike regulations, Directives do need to be implemented by way of domestic legislation. For VAT, we have VATA 1994. It is common now for discussions on VAT (whether in practice or in tribunal or court) to refer to the provision in the Principal VAT Directive (PVD), and not the one in VATA 1994.

This will change, and instead of 'transactions concerning payments' within PVD article 135(1)(d), for example, we will go back to referring to 'dealing with money' within VATA Sch 9 Group 5 item 1 (as we did in the 1990s). This will take time, if only because old habits die hard.

Some deviations from EU VAT law are likely to be more immediate. The spectre of the CJEU ruling in *Andersen* (C-472/03), for example – which HMRC has always acknowledged meant the insurance exemption in VATA Sch 9 Group 2 was wider than the PVD allowed – which has hung over the insurance industry since March 2005, can finally be laid to rest. The CJEU ruling in *Skandia* (Case C-7/13), which suggests that the territorial scope of the UK VAT grouping rules may be too extensive, may be similarly disregarded. These are both examples of changes both taxpayer and HMRC would welcome. By way of a more one-sided example: query whether, instead of trying (and consistently failing) to give proper effect to the CJEU ruling in *PPG* (Case C-26/12) (on the extent to which an employer is able to deduct input tax on pension-related services), HMRC might be tempted to use its newfound freedom to deviate to revert to the pre-*PPG* position (i.e. its old policy).

Claims based on the direct effect of Directive provisions (where domestic legislation has failed to fully implement), as in the *BFI* referral to the CJEU, for example, will no longer be available. The UK will be free to set its own rates, its own exemptions. The press may be focused on sanitary products, but for the practitioner, there are more intriguing possibilities, such as whether we bring zero-rating back for the grant of a major interest in commercial buildings, to name but one. Or to treat the supply of financial services to EU persons in the same way as where they are supplied to non-EU persons, i.e. as outside the scope supplies with the right to recover related input tax. These will no doubt be welcome changes to the affected sectors, but too many taxpayer-friendly changes will undermine the very purpose of retaining the tax (i.e. healthy revenue generation).

The common EU VAT system will continue to evolve. We will not be bound to follow, but it is likely we will keep a close watch, and where appropriate, carve our own parallel path. One reason we would not want to deviate too much, at least where fundamental principles are concerned, is because it would be in no one's interest – in the case of cross-border transactions especially – for double or non-taxation to arise.

... and on CJEU rulings

The European Communities Act 1972 (ECA) is expected to be repealed on actual exit, and we will no longer be bound by CJEU rulings. What this means precisely is not entirely clear. CJEU rulings on VAT are already part of UK VAT law through incorporation in UK decisions. One would be hard pressed to find a significant 21st century UK VAT decision that does not refer to a CJEU ruling or an applicable European principle. CJEU rulings delivered post-actual exit can be ignored, but that may not always be sensible, especially with rulings that clarify or further develop previous rulings we have adopted. We will undoubtedly pick and choose, but on what basis? What defines a cherry? In *Colaingrove* [2015] UKUT 2, after holding there was no dichotomy between the principles on single composite supplies as laid down by the CJEU in (and since) *CPP* (C-349/96) and the principles that were developed in the same area in the UK before *CPP*, the UT said: 'There is never any need to have recourse to the pre-*CPP* approach of the domestic courts, and in doing so the FTT erred in law'.

We will no longer be bound by CJEU rulings. But what this means precisely is not entirely clear

Will the reverse now be the norm, with domestic decisions regaining primacy and CJEU rulings being only of (possibly diminishing) persuasive value? It is inconceivable that, after actual exit, the CJEU will be to us what the Privy Council is to the Commonwealth. Will there still be a place for inherently European principles such as fiscal neutrality or the abuse of rights? Would even HMRC want to extend the GAAR (general anti-avoidance rule) to VAT? Or would they instead unearth and reanimate the original *Halifax* test (LON/00/977) before the case was referred to the CJEU? Sadly, these are not academic questions, but live ones with real world consequences. Should the Court of Appeal decide in *Longridge* (heard in April) that the CJEU ruling in *Commission v Finland* (Case C-246/08) meant that *Yarburgh* [2001] EWHC 2201 and *St Paul's Community Project* [2004] EWHC 2490 (two domestic decisions) were no longer good law would actual exit affect how this issue would be considered on appeal? What about *Bookit*, where on 26 May 2016, the CJEU (C-607/14) overruled the Court of Appeal judgment [2006] EWCA Civ 550? The case was only in the FTT when the referral was made. Does the final outcome now depend on whether appeals can outpace the clock on the ECA? And what about that glorious 800lbs gorilla – or the £1.2bn question – *Littlewoods*? The Court of Appeal [2015] EWCA Civ 515 held that the taxpayer's restitution claims were barred under domestic law, but that exclusion was contrary to EU law. The case is on appeal to the Supreme Court. Actual exit is unlikely to happen before the appeal is heard, but the notion that the result may be different pre- and post-actual exit can hardly be satisfactory. Will there be a transitional period? Will taxpayers have accrued rights?

These are some initial thoughts. And loath as I am to end on a raft of unanswered questions, a cliffhanger is perhaps the most appropriate ending given the general uncertainty in the country at large. Let's hope the coming weeks will bring greater clarity and firmer guidance from the government. ■

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Analysis

Brexit: tax issues on business restructurings

Speed read

It is highly likely that one result of Brexit will be a shake up in the operations of many UK businesses operating cross-border in the EU, especially in the financial services sector, where the loss of passporting rights may require businesses to move to or establish a presence in the remaining EU member states. Such business restructurings will inevitably give rise to tax consequences, which will need to be factored into the decision making process. The provisions of the EU Mergers Directive currently facilitate cross-border restructurings with the EU, but in the absence of co-ordinated action, many of the tax benefits of this Directive will be lost when the UK exits the EU. However, in the absence of any detailed information concerning the nature of and arrangements for the UK's exit, much uncertainty will remain over the consequences of business restructurings taking place post-Brexit. As such, businesses should be considering their options at an early stage and whilst the current legal framework remains in place.

Darren Oswick
Simmons & Simmons
Darren Oswick is a partner at Simmons & Simmons. He advises on a wide range of corporate tax and VAT issues, with a focus on private equity and employment tax related matters. He has extensive experience in the corporate and individual tax issues which arise in such areas. Email: darren.oswick@simmons-simmons.com; tel: 020 7825 3546.

Gary Barnett
Simmons & Simmons
Gary Barnett is a senior professional support lawyer in the corporate tax group at Simmons & Simmons. Before becoming a professional support lawyer, he qualified at another major international law firm as a transactional lawyer, advising on a wide range of corporate tax and VAT matters, with a particular emphasis on M&A transactions. Email: gary.barnett@simmons-simmons.com; tel: 020 7825 3313

The exit of the UK from the European Union will have very direct implications for many parts of the UK's tax code. Customs duties and VAT are, in effect, EU taxes; and many other parts of our tax rules are directly impacted by various EU Directives and the fundamental freedoms. However, quite apart from the direct implications for UK taxation, Brexit will most likely result in a great deal of business restructuring, which will in itself give rise to significant tax implications.

In particular, membership of the EU provides a 'passport' to carry on certain regulated business within other EU member states in a range of industries. These include UK based banks and other financial service providers. In the wake of Brexit, UK firms will in principle cease to benefit from the ability to provide services cross-border or to establish branches under relevant passports. At the very least, new licences are likely to be required and businesses may in some cases need to be restructured. The tax implications of any such restructuring will need to be carefully considered.

Restructurings resulting from Brexit are likely to involve the setting up of operations, including subsidiaries and/or branches, in remaining EU member states; and the transfer or migration of existing UK businesses to those member states. The transfer of assets, services and people to any such newly incorporated subsidiaries or branches may have significant tax consequences. In particular, the transfer of assets to a new entity will, in principle, result in a disposal of those assets for tax purposes.

Mergers Directive

At present, the EU Cross-Border Mergers Directive (Council Directive 2009/133) provides for tax relief for mergers between companies incorporated in different EU member states, provided that certain conditions are satisfied. The regime, whilst enacted into English law, derives from EU legislation. When the UK ceases to be a member state, references to 'member states' in the legislation of other EU members will cease to include the UK, meaning relief for such mergers in other member states will, in principle, no longer be available.

The particular tax implications of any restructuring will depend on the exact nature of that restructuring. However, restructurings may generally give rise to a number of different tax considerations, including the following situations.

> Brexit will most likely result in a great deal of business restructuring

Transfer of a UK trade/business

The transfer of a UK business to a new EU entity in return for an issue of shares would currently take place on a no gain, no loss basis, by virtue of the UK's implementation of the EU Mergers Directive (TCGA 1992 s 140A). However, the result of Brexit will be to leave the UK outside the EU. Whilst the provisions of this Directive are enacted into UK law, the UK will cease to be an EU member state when Brexit is effected and s 140A will, in principle, cease to apply on such a merger. Accordingly, any such restructuring taking place after Brexit has become effective may potentially give rise to tax charges on the assets involved in such a transfer which have risen in value. However, it should be noted that TCGA 1992 s 171 may also provide for a no gain no loss transfer in many such cases.

Transfer of a non-UK trade/business

The transfer of a non-UK business by a UK company to a new company in another member state may equally cease to benefit from the current advantageous treatment under the Mergers Directive. References to 'EU member states' in the legislation of other EU members will cease to include the UK. Therefore, any mergers involving assets in other member states will, most likely, no longer benefit from tax relief under the existing framework in that member state following Brexit.

From a UK tax perspective, TCGA 1992 s 140C together with TIOPA 2010 s 122 implements the Mergers

Directive; and this provision gives the UK transferor double tax relief for notional tax which would have been payable in the local member state. Confusingly, the existing provisions of s 140C do not explicitly depend on the UK being part of the EU and so may, technically, continue to apply in the absence of amendment. This serves to exemplify how difficult it may become to apply these provisions following Brexit; and how, in practice, new UK rules will be required.

More generally, TCGA 1992 s 140 provides for a general CGT deferral on the transfer of assets of a non-UK trade to a non-resident company in return for an issue of shares. As such, deferral of gains on the incorporation of an overseas branch should still be possible from a UK tax perspective, even if the Mergers Directive provisions do not survive Brexit. The conditions for the relief are stringent, however, and deferral only applies where the UK company carries on a trade through a permanent establishment, so that relief would not be available for non-trading branches or for assets not used in the trade of the branch.

Furthermore, where an election has been made for the permanent establishment (PE) or branch to be treated as UK tax exempt under CTA 2009 s 18A, then the transfer of the branch assets to a new local subsidiary would also be outside the UK tax provisions.

Where an election has been made for the PE to be treated as UK tax exempt, then the transfer of the branch assets to a new local subsidiary would also be outside the UK tax provisions

Migration

If a business sought to relocate outside the UK following Brexit, then the UK tax rules on corporate migrations will be relevant to consider. For example, a company which ceases to be resident in the UK is deemed to have disposed of and reacquired all of its assets at market value immediately before ceasing to be UK tax resident. This may result in a chargeable gain arising, which would be subject to UK tax.

At present, it may be possible for a company to postpone tax payable, if it becomes resident in an EEA member state and meets a number of other conditions (TMA 1970 Sch 3ZB), but it is far from certain that such relief will continue to apply following Brexit.

Other tax consequences of a transfer/merger

The physical movement of goods from the UK to a remaining member state may give rise to a number of tax issues. Customs duties may be relevant, since the UK will no longer be part of the customs union of the EU in the absence of a new customs agreement. Equally, import VAT may become chargeable on the importation of goods into the EU from the UK.

Tax consequences of the new arrangements

The tax consequences of a reorganisation would not end with the taxation of the actual transaction effecting the reorganisation. There will also be the tax implications of the new arrangements between the UK and other parts of the business going forwards to consider.

For example, it may well be that whilst the business has been transferred to or created in another member state for regulatory purposes, many of the functions, including people functions, might remain in the UK. Clearly, at the very least this would give rise to transfer pricing considerations, with the UK business required to charge an arm's length fee for such services. It is also possible that the diverted profits tax (DPT) provisions may have some impact in this situation were HMRC to consider that the arrangements lacked economic substance.

A UK parent with a new non-UK subsidiary might also have to consider the implications of the UK's controlled foreign companies (CFC) rules, as well as tax issues associated with funding its subsidiary and repatriating profits to the UK. In particular, the payment of dividends and interest free of withholding taxes from EU subsidiaries to a UK parent may no longer be possible without the benefit of the EU Parent Subsidiary Directive (Council Directive 2011/96) and the Interest and Royalties Directive (Council Directive 2003/49), except where the UK's bilateral treaties provide for 0% withholding tax.

In addition, services provided to a new EU subsidiary would be subject to VAT (assuming VAT continued in a form similar to the present rules). In this case, the B2B rules would apply in most cases, however, such that VAT would continue to be charged where the recipient belongs under the reverse charge mechanism. Supplies to EU branches might fall outside the scope of VAT, unless the EU branch was VAT grouped locally, in which case considerations arising from the decision in *Skandia America Corporation USA v Skatteverket* (Case C-7/13) would be relevant.

Brexit may well also have tax consequences for individuals working cross-border in subsidiaries and branches in the UK and other member states. As a member of the EU, the UK is a signatory to the EU Social Security agreement (Regulation (EC) No 883/2004), which essentially provides a mechanism for EU individuals who work in different EU countries to only be subject to the social security regime of one of those countries. Following Brexit, the UK would need to re-sign the agreement in its capacity as a non-EU member (as Switzerland has done, for example) for such arrangements to continue.

Where does this leave us?

It is possible that Brexit will lead to a significant amount of business reorganisation, particularly in the field of financial services, where the benefits of current passporting rules are likely to be lost. The possible tax implications of such business reorganisations should not be underestimated in the absence of the protections currently afforded by the Mergers Directive.

As is the case in all areas of business, the effect of Brexit will, in very large part, depend on the nature of the UK's arrangements to exit the EU and the form of any replacement rules and agreements. In practice, it seems certain that the UK will need to amend or replace the existing UK tax provisions dealing with EU mergers. Nevertheless, in the absence of EU wide action, adverse tax implications may arise in other member states on the incorporation of existing businesses. As a result, whilst much depends on the nature of the post-Brexit relationship between the UK and the EU, businesses likely to be affected should consider their options sooner rather than later, before Brexit actually becomes effective and whilst the current beneficial rules remain in place. ■

Analysis

Brexit: the legal mechanisms for a UK exit from the EU

Speed read

Article 50 of the Treaty of the European Union sets out the broad mechanism for withdrawal of a member state from the EU. The effect of its provisions is that, if the UK notifies the Council of an intention to withdraw and no withdrawal agreement is reached within a two-year period, nor an extension agreed, the UK would, in effect, exit the EU automatically at the expiry of the period and would cease to be bound by the Treaties. The Treaties provide very little guidance about the legal consequences of withdrawing from the EU or what the post-exit world would look like for a departing state. Options for the UK's post-Brexit relationship with the EU would appear to include: a 'Norwegian model'; a 'Swiss model'; a customs union (along the lines of the EU's current relationship with Turkey); a free trade agreement (e.g. of the type negotiated with Canada); or simply remaining a member of the World Trade Organisation (WTO). Whichever model is adopted, the legal landscape post-Brexit would change. The extent of the change would depend not only on which model is adopted, but also on the way in which particular EU laws have been implemented in the UK. Businesses should follow developments closely so that, as matters begin to become clearer, appropriate steps can be taken to mitigate any risks and take advantage of any opportunities.

Sarah Garvey
Allen & Overy
Sarah Garvey is counsel in Allen & Overy LLP's London litigation practice. Sarah has worked on a wide range of commercial matters, and she has been heavily involved in advising clients in relation to the legal consequences of Brexit. She is also incoming chair of the Law Society's EU Committee. Email: sarah.garvey@allenovery.com; tel: 020 3088 3710.

Karen Birch
Allen & Overy
Karen Birch is counsel in Allen & Overy LLP's London litigation practice. She has particular expertise in advising on cross-border governing law and jurisdiction issues and dispute resolution clauses in the context of complex international transactions. She has also been heavily involved in advising on the legal consequences of Brexit. Email: karen.birch@allenovery.com; tel 020 3088 3737.

The European Union is governed by two Treaties, the Treaty on the Functioning of the European Union (TFEU) and the Treaty of the European Union (TEU). In this article, we analyse three aspects of the Brexit debate which involve the EU's legal foundations under these Treaties.

First, we consider possible mechanisms under the EU Treaties for the UK to exit the EU. Notwithstanding the EU Treaties anticipating 'ever closer union' between members, they do expressly contemplate a member state leaving. As has been widely reported, under the terms of the relevant Treaties, the UK would have to give two years' notice of its intention to exit, during which period the terms of its departure would be worked out.

Secondly, we explore the possible shape of the UK's relationships with the remaining member states following an exit from the EU. There is uncertainty as to what regime a UK government might ultimately be able to put in place. In part, this is because those in the 'leave' camp advocate a variety of models. But it is also because it is unclear whether the UK government will be able to reach agreement on its preferred model with the EU (and, potentially, others). If the UK wishes to join another club, it will need the consent of that club's members. Whether this will be achievable against the backdrop of the political fallout that the vote to leave the EU has created depends in large part on the political will and negotiating power (or perceived negotiating power) of the relevant parties.

The options would appear to include a 'Norwegian model', a 'Swiss model', a customs union (along the lines of the EU's current relationship with Turkey), a free trade agreement (e.g. of the type negotiated with Canada), or simply remaining a member of the World Trade Organisation (WTO). Given the uncertainty as to which model will be adopted, we outline the key features of each of the main options, rather than providing an in-depth analysis of every possible arrangement.

Thirdly, we explore what the legal landscape may look like following a UK exit from the EU. In doing so, we seek to assess the extent to which a vast array of EU legislation would be binding on the UK if it chooses to leave the Union.

> Neither the Treaties nor the UK legislation governing the referendum specify the timing for its delivery … This would essentially be a political decision

What do the EU Treaties say about exit?

Although the member states have expressly ceded certain competences to the EU, the Treaties recognise that those member states must be free to 'reclaim' those competences and leave the Union.

Article 50 of TEU contains an express provision allowing a member state to exit from the EU. It provides, in part, that: 'Any member state may decide to withdraw from the Union in accordance with its own constitutional requirements'.

Article 50 also sets out the broad mechanism for withdrawal. In particular, it provides that:

- within two years of a member state notifying the European Council (the Council) of its intention to withdraw from the EU, the EU 'must negotiate and conclude an agreement with that member state, setting out the arrangements for its withdrawal and taking account of the framework for its future relationship with the EU' (article 50(2)(b));
- that withdrawal agreement is to be signed by the Council, acting by a qualified majority, and after obtaining the consent of the European Parliament, acting on a majority vote basis (article 50(2)(c)); and
- the Treaties would cease to apply to the withdrawing state from the date of entry into force of the

withdrawal agreement or, failing that, two years after the notification of the state's intention to leave unless the Council, in agreement with the withdrawing state, unanimously decides to extend this period (art 50(3)).

- An exit from the EU under article 50 would not therefore necessarily require the consent of all member states, although in practice such consent might be necessary if the withdrawal arrangements went further than simply dealing with how the UK extracts itself from EU membership and covered matters in relation to which unanimity is necessary and which may potentially require compliance with member states' constitutional rules (e.g. a new free trade agreement).

The effect of these provisions is that, if the UK notifies the Council of an intention to withdraw and no withdrawal agreement is reached within the two-year period, nor an extension agreed, the UK would, in effect, exit the EU automatically at the expiry of the period and would cease to be bound by the Treaties.

The timing of the delivery of any withdrawal notice to the Council will therefore be important if the UK wants to avoid a unilateral exit, given the fact that the negotiation of the withdrawal agreement is likely to be complex and time consuming. The UK government may wish to lay the groundwork for these important negotiations before delivering such a notice. Neither the Treaties nor the UK legislation governing the referendum specify the timing for its delivery (indeed, the referendum is strictly advisory so there is no formal requirement under the UK rules to deliver a withdrawal notice following a 'leave' vote). This would essentially be a political decision, and one that may require the approval of Parliament.

Whenever a withdrawal notice is given, the UK would, at least in theory, continue to be bound by EU law during the period between delivery of the notice and Brexit itself, unless a different arrangement was agreed. The UK government may be unlikely to be in a hurry to implement new EU laws passed during this period, however, and its ability to influence the negotiation of legislation may be significantly diminished.

> The Treaties provide very little guidance about the legal consequences of withdrawing from the EU or what the post-exit world would look like for the departing state

What are the possible post-Brexit models?

Significantly, the Treaties provide very little guidance about the legal consequences of withdrawing from the EU or what the post-exit world would look like for the departing state (and remaining members). Existing models for the EU's relations with non-member states suggest that there are a range of arrangements that could be agreed if the UK decided to leave the EU, from the 'EU-lite' precedent set by Norway, with its EFTA and EEA membership, through various levels of economic integration and cooperation with the EU, to the UK 'going it alone' at the other end of the spectrum. The principal options are discussed in further detail below.

There are a number of general points to note in relation to what the existing models might be able to tell us about the likely shape of the UK's post-Brexit relationship with the EU. In particular, these models show a clear correlation between the level of access that non-member states have to the EU's single market and the extent to which they are required to comply with EU law, agree to free movement (of people, goods, capital and services) and contribute financially to the EU budget.

What is the European Economic Area?

The European Economic Area (EEA) brings together the 28 EU member states plus Iceland, Norway and Liechtenstein (i.e. all EFTA states minus Switzerland) in a single market. The EEA agreement provides for the adoption of EU legislation covering the four freedoms – the free movement of goods, services, persons and capital – throughout the 31 EEA states. In addition, the EEA agreement covers cooperation in other important areas such as research and development, education, social policy, the environment, consumer protection, tourism and culture, collectively known as 'flanking and horizontal' policies. Each EU member state must be a party to the EEA agreement and EFTA members may accede to it. For the UK to re-join the EEA post-Brexit, all members would need to agree.

What is the European Free Trade Association?

The European Free Trade Association (EFTA) has four states as members: Switzerland, Iceland, Norway and Liechtenstein. EFTA is an intergovernmental organisation set up for the promotion of free trade and economic integration, originally intended as a way to achieve the benefits of trade with the (then) EEC without full membership. EFTA manages a network of worldwide free trade agreements and is governed by the Convention Establishing the European Free Trade Association. Any state can accede to the EFTA Convention upon approval of the EFTA Council and with the consent of all EFTA member states.

There are various ways in which a post-Brexit model could be documented. For example, the agreement as to the UK's withdrawal from its existing relationship with the EU could be documented separately from any agreement(s) as to its future relationship. Alternatively, a single agreement could be put in place covering both the withdrawal agreement and any further agreement as to the new relationship.

1. EEA: the Norwegian model

Assuming the necessary agreement/approvals could be obtained (and the UK becomes an EFTA member as required under the EEA agreement), the UK could leave the EU but join the EEA as a non-EU member state member, like Norway.

This option would be closest to the UK's current relationship with the other EU member states and would retain the UK's place within the single market. Therefore, it would minimise the practical consequences of Brexit to the greatest extent. However, it may be the least politically appealing option as it would not allow the UK to disengage itself from some aspects of the EU legal regime that are unpopular among many in the Brexit camp (e.g. it would require the UK to permit free movement of people). It would also require a significant financial contribution from the UK.

If this approach was followed, the UK would be bound to apply a significant volume of EU law in a range of fields including in relation to financial services, employment and certain consumer protections. While remaining bound by EU law, however, the UK would not have a formal seat at the table when EU law is drawn up.

There would be some EU legislation that the UK would no longer be required to apply if it followed this model, which may mean that the UK would have to enact domestic legislation in its place. Notably, as an EEA member, the UK could set its own rules in areas such as agriculture and fisheries, transport and energy.

2. The Swiss model

The UK might alternatively seek to adopt a model along the lines of the current Swiss model (albeit that this model was initially intended as a transition to full EU membership), with its many bilateral agreements with the member states and limited access to the single market in specifically defined areas. The UK may also seek to become an EFTA member, like Switzerland.

This model would require more detailed negotiation than the Norwegian model as bespoke terms for access to the single market would have to be agreed. It may well also require the UK to accept at least some of the EU's rules on freedom of movement and to comply with EU rules when trading within the market, again without a formal seat at the table when those laws are drafted. Also, if the Swiss model was adopted literally, freedom of movement of services would be limited. This model would also require a financial contribution from the UK. It is understood that the Swiss arrangement is not a popular model in Brussels due to its complexity and so there may be limited enthusiasm for agreeing to a similar arrangement for the UK.

> The Norwegian model would minimise the practical consequences of Brexit to the greatest extent. However, it may be the least politically appealing option

3. Customs union: the Turkish model

It may be that the UK will have little appetite for joining any new 'club' along the lines described above. However, it is unlikely that the UK would not try to retain at least some form of arrangement with the EU.

One such arrangement currently in existence is the customs union between the EU and Turkey. Under this model, which applies only to trade in goods and not services, no internal tariffs are applied to trade between Turkey and the EU and there are common external tariffs for trade with third states.

If the UK adopted this model for trading with the EU, it would not have to make a financial contribution to the EU budget and would not be bound by the majority of EU law and would therefore have to legislate to fill the significant gaps in its national legislation that would be left upon exit. Nor would it have access to the market in services via such an arrangement. However, a formal customs union would not, in practice, be likely to achieve a total break from the EU legal regime. The EU and the UK would have to agree rules on trade which would in reality be highly likely to require the UK to adopt the relevant EU rules (e.g. on the standards applicable to goods entering the single market) without any ability to influence the setting of those rules or their interpretation by the EU courts.

4. Deep free trade agreement: the Canadian model

Alternatively, the UK may seek to negotiate an extensive free trade agreement and may look to the EU/Canadian free trade agreement, which has been agreed but is not yet in force. The Canadian deal (which took over seven years to negotiate) allows tariff free trade in goods (subject to complex country of origin rules) and provides for the removal of certain non-tariff barriers in relation to both goods and services, including financial services. Under such a model the UK would retain control over tariff arrangements with other (non-EU) countries.

5. WTO membership: UK alone

This model would simply lead to:

- the application of caps on tariffs applicable to goods traded between the UK and the EU; and
- limits on certain non-tariff barriers in relation to goods and services.

It would therefore represent the greatest change from the status quo. It would not apply to services and may well require substantial amounts of new legislation to replicate EU legislation that would fall away on Brexit. The UK would not be required to make any financial contribution to the EU, however, nor would it be bound by EU laws.

The UK's legal landscape on Brexit

The UK's domestic affairs

Whichever model is adopted, the legal landscape post-Brexit would change. As noted above, this change would be most stark if a WTO model was followed, but even adopting the Norwegian model would mean significant areas previously occupied by EU law (such as agriculture) would need to be addressed.

As well as being dependent on the model that is adopted, the extent of the change in the legal landscape on Brexit (and the mechanism by which it will be achieved) will depend in part on the way in which particular EU laws have been implemented in the UK. For example, where EU laws (broadly, European Directives) have been implemented via primary legislation in the UK, that legislation will remain part of English law on Brexit, unless it is amended or repealed. Conversely, EU laws that have direct effect in the UK without the need for implementing legislation (broadly, European regulations) would fall away on Brexit unless legislation was passed transposing those laws into UK law. There have also been over 5,000 statutory instruments (SIs) made pursuant to the European Communities Act 1972 (the Act). If the Act is repealed upon Brexit then, without more, those SIs would also fall away (although in practice the UK government may seek to legislate to retain any SIs it considers beneficial to the UK).

There would be a number of difficult issues that the UK government would have to grapple with when legislating for Brexit, including:

- **Transitional arrangements**: Although there will be a two-year (or longer) transitional period between any vote to leave the EU and Brexit itself, unless the post-Brexit model is agreed far enough ahead of Brexit to allow the UK government to make all necessary legislative changes, it is likely that the UK government

will need to put in place additional transitional arrangements in the run-off period immediately post-Brexit, for example allowing EU law to continue to apply for a limited period while the UK government takes steps to fill the legislative gaps. (Greenland and the (then) EC had such a transitional period when Greenland exited in 1985.) However, while a seemingly neat solution in theory, it does raise questions regarding how these obligations would be policed during the run-off period (and, indeed, as to who would police the law as it applied pre-Brexit).
- **Filling the legislative gaps**: The UK government would need to legislate to fill the gaps in the legal regime created by Brexit, either by adopting pre-existing EU measures into domestic law (and amending them where necessary) or by introducing wholly new measures (the latter option in itself may be considered to be a further source of uncertainty).
- **Managing logistics**: If the UK wished to ensure that some but not all existing EU legislation forms part of UK domestic law on Brexit, it might carry out a pruning exercise, considering each piece of EU legislation separately to decide whether it should continue to apply and, if so, whether any amendments should be made. This would inevitably be a complex and time-consuming exercise. Alternatively, the government may decide to legislate in bulk, for example by introducing a single statute which would incorporate all EU regulations into primary UK law. But even this approach would not be straightforward. For example, consideration would need to be given to how references to European institutions and courts should be construed and how to deal with instruments that cannot be adopted unilaterally (e.g. those predicated on reciprocity).
- **Vested rights**: It may be that some parties will seek to argue that certain EU-law derived rights have vested in them as a matter of national or international law, such that those rights cannot fall away on Brexit. Conceivably, reliance may also be placed on arguments under investment treaties between the UK and other member states or on human rights legislation.

On any assumption, it is clear that significant transitional measures and domestic legislation will be required to clarify the position post-Brexit. However, while the UK government is in a position unilaterally to decide upon the UK's domestic law, the impact of Brexit upon the UK's external relations with other member states will be more complex to address.

What is the impact on Fundamental Rights and Human Rights?

The Charter of Fundamental Rights forms part of the EU Treaties and would cease to apply to the UK upon exit from the EU. It applies to member states when implementing EU law and is enforced by the EU courts in Luxembourg.

Separately, the European Convention on Human Rights is an international treaty which the UK signed up to as a member of the Council of Europe. It is not an EU instrument and is enforced by the European Court of Human Rights in Strasbourg. It was incorporated into domestic law by the Human Rights Act 1998 and will not be affected by the UK exiting the EU.

The other important point to bear in mind is that if an exit is agreed between the member states, it may be that supplementary EU law is passed dictating the approach that member state courts should take to the UK post-Brexit.

The UK's non-EU external relations

The UK is currently bound by a number of international agreements concluded on its behalf by the EU. What would happen to those agreements post-Brexit?

Since the Lisbon Treaty (TFEU article 216(2)), the EU has had express competence to enter into, and has in fact entered into, a number of agreements with non-EU states on behalf of member states. Whether the UK will remain bound by international agreements with non-member states is likely to depend on how the agreement was signed (i.e. whether it was signed by the EU or the UK or both) and whether the subject matter was within the EU's exclusive competence. If the agreement covers a matter which is within the exclusive competence of the EU (either expressly or impliedly – see article 3(1) and 3(2) TFEU) and was signed solely by the EU, then the UK would no longer be bound on Brexit. If the UK wanted to be a party in its own right it would have to sign itself or alternatively make its own arrangements. The EU's exclusive competence covers substantial areas such as the common commercial policy, i.e. trade with third states, and competition law.

> The extent of the change in the legal landscape on Brexit … will depend in part on the way in which particular EU laws have been implemented in the UK

The UK government would need to assess which international obligations have been assumed by the EU, identify the gaps that would arise post-Brexit and then take steps, where appropriate, to negotiate replacement agreements. This is likely to be a complex exercise. Moreover, it will not be a purely legal exercise – international instruments cannot be negotiated in a vacuum. To replace existing free trade agreements that the UK may not benefit from upon any Brexit, the UK would have to persuade other governments that it is worth the effort.

Final thoughts?

This article provides a high level overview of EU exit mechanisms and the range of potential post-Brexit regimes. We have highlighted the core areas of uncertainty and flagged some areas where there may be a post-Brexit legislative overhaul. Understanding these issues will assist commercial parties in their contingency planning. However, the fact that there are significant uncertainties as to the post-Brexit regime emphasises the difficulties of making any firm assumptions or taking concrete steps at this stage. It also highlights the importance to commercial parties of following developments closely so that, as matters begin to become clearer, appropriate steps can be taken to mitigate any risks and take advantage of any opportunities. ■

With acknowledgement to the contribution from Maeve Hanna, associate at Allen & Overy.

Peak performance or pique performance?

Thomas Dalby
Gabelle
Thomas Dalby is an associate director at Gabelle LLP. He is a barrister and chartered tax adviser with nearly 20 years in the profession. Prior to joining Gabelle, Thomas worked at Deloitte where, for the last 14 years, he was a member of the specialist employer consulting and opportunities team. Email: thomas.dalby@gabelletax.com; tel: 020 3815 8999.

My client is interested in granting share options to a number of employees under the rules on enterprise management incentives (EMI). My client plans to make the options exercisable on the eventual sale of the business, but wants to link the options to the employees' performance. Are there any issues with attaching performance conditions to the options?

Linking the right to exercise a share option to employee performance is commonly discussed in the context of quoted companies, where investors are very keen to ensure that employees' share awards will not pay out unless targets are met. The types of performance conditions used by public companies are unlikely to be relevant in a private company context and, on the whole, do not measure individual performance. Instead, they compare indicators like total shareholder return (TSR) or earnings per share (EPS) against those of other companies in the same industry.

Designing performance conditions

It is possible for employers to make the exercise of a qualifying EMI option conditional on the achievement of performance objectives. However, there are a number of issues that the employer will need to have considered:

- The performance conditions need to be comprehensible – employees need to clearly understand how to meet the conditions.
- In setting the targets, the grantor needs to have fully thought through what behaviours the exercise conditions will be rewarding and ensure that the conditions do not act as a perverse incentive to, say, hold up a sale or resist a transaction.
- The grantor also needs to be clear that the performance conditions can be achieved – unachievable targets are likely to be a disincentive.

The leading case of *CIR v Burton* 63 TC 191 sets out the key legal constraints on the design of performance conditions for use in tax-advantaged share schemes. The *Burton* case specifically dealt with an application to amend company share option plan (CSOP) options, but HMRC takes the view that the case is of general application (see *Employee Tax Advantaged Share Scheme User Manual* ETASSUM47250 and ETASSUM54070).

The case illustrates that an option must actually confer a right to acquire shares on an employee. This condition will be met if, at the date of grant of the option, either:

- the number of shares that can be acquired under the option is clearly stated; or
- a mechanism is set out, which can be used to definitively ascertain the number of shares that can be acquired at the time that the option can be exercised.

In practical terms, this means that performance conditions must be objective and clearly measurable; an option that can only be exercised on the whim of the grantor will not meet this requirement. This constraint means that individual performance indicators that are essentially subjective, like annual review ratings, are unlikely to be acceptable. HMRC or, more likely, a future purchaser could argue that options with such performance conditions are not qualifying EMI options, leading to potential claims for PAYE and NICs when they are exercised.

Directors' discretion

A further point that comes out of the *Burton* case is that there are limits on the discretion that grantors are able to exercise over share options.

Any discretion must be exercised fairly and reasonably and it must respect the rights that an employee has to acquire shares. A discretion that allows a grantor to reduce the proportion of a share option that an employee is entitled to exercise will not be acceptable for either EMI or CSOP. In practice, this means that a grantor's discretion will be limited to a 'positive discretion', meaning that it is generally permissible for a grantor to be able to improve the position of an option holder (usually by waiving performance conditions).

Trouble ahead

Like all legal agreements, an option has characteristics that are defined by the documents setting out the option. This gives rise to a fundamental question: if a person exercises an option in a way that was not envisaged by the original option agreement and/or option plan rules, were they exercising the original option or a new option?

Similarly, if the terms of an option are changed, can the changed option be treated as a continuation of the old option, or should it be seen as an entirely new one? This question was considered in two key cases: *IRC v Eurocopy Plc* [1991] STC 707; and *IRC v Reed International Plc* [1995] STC 889.

Eurocopy established the principle that an alteration to an existing option could create new rights, which were tantamount to the grant of a new option. The decision in *Reed* clarified the earlier case by drawing a distinction between an alteration that creates new rights for an employee to acquire shares and an alteration intended to preserve rights that an employee already enjoys. This means that a de minimis enhancement of an employee's rights can be overlooked, but a new right to acquire shares will be treated as the grant of a new option.

In the context of an EMI option, both of these questions are critical: the tax reliefs under EMI only protect growth in the value of the option shares from the date of grant to the date of exercise. If a 'new option' is treated as having been granted because the option is exercised in a way that contravenes the terms on which it was granted or the terms of the option are varied, the option will be treated as a non-qualifying option and the entire value of the option shares will be treated as taxable employment income.

This tends to create issues where a company is coming up to a sale, but the performance conditions attaching to employees' options restrict their ability to exercise them. Very often, performance conditions that were seen as important to a business can seem less relevant in the context of a transaction. For practical reasons, it is strongly recommended that there is a mechanism in the terms of an option for the grantor to waive exercise conditions.

In a private company context, especially where share awards will crystallise on an exit, employers should think carefully about whether they actually need performance conditions. In reality, underperforming employees will usually have moved on and lost their options long before an exit takes place. ■

One minute with...

David Southern QC

Temple Tax Chambers

David Southern QC is a barrister in Temple Tax Chambers. He undertakes all forms of tax litigation and specialises in business taxation, financing, debt restructuring and VAT. He is currently conducting numerous judicial review proceedings of accelerated payments notices. The tenth edition of his *Taxation of loan relationships and derivative contracts* will be published later this year. Email: david.southernQC@templetax.com; tel: 020 7353 7884.

What's in your in-tray?
The latest episode in the Homeric tale of NHS VAT; the question whether payments which you never receive because they arise from a tax planning scheme which failed can be still taxable as income; and whether you can be required to sit an exam without seeing the question paper, i.e. whether it is right for HMRC to start COP9 enquiries without indicating their reasons for doing so.

What attracted you to the Tax Bar?
I joined the Inland Revenue out of fascination with the technicalities of tax; I wanted to be an advocate, not a tax adviser; having sat behind (unfailingly excellent) Revenue counsel for years, I thought, why not me?

What recent tax case caught your eye?
The Upper Tribunal's decision in *Volkswagen Financial Services (UK) Ltd* caused surprise to VAT practitioners. The judgment of Patten LJ in the Court of Appeal has put matters right, set out the principles of VAT in lapidary form and finally explained how *BLP* fits into the subsequent line of cases.

You are conducting numerous judicial review proceedings of accelerated payments notices. On which points are JR proceedings likely to prevail?
The accelerated payments rules were put into primary legislation, with the aim of making payment notices alike unappealable and unchallengeable by judicial review. They have been issued on an industrial scale, including cases which do not constitute tax avoidance in any shape or form. Those are the cases where JR proceedings stand the best chance of prevailing.

If you could make one change to UK tax law or practice, what would it be?
Abolition of the phasing out of personal allowances where income exceeds £100,000. This imposes a marginal rate of tax of 60%, and so makes the headline rates of tax deceptive and misleading. If we are going to increase rates of tax, let us do so transparently and honestly.

The tenth edition of your *Taxation of loan relationships and derivative contracts* will be published later this year. Please comment on a key change.
The key changes revolve around the wholesale rewriting of the legislation in CTA 2009 by F(No. 2)A 2015 and of the Disregard Regulations. This was in part to take account of the introduction of FRS 102, but the changes extend much further than was required for this purpose. There is also the BEPS project.

Aside from your immediate colleagues, who in tax do you most admire?
Michael Avient of UHY Hacker Young handles difficult and demanding cases and clients with matchless professionalism, tireless energy, firmness and good humour.

What will the UK tax system look like post-Brexit?
UK businesses which have expanded abroad will collapse. International businesses will withdraw from the UK. The only way to stop the haemorrhaging of investment and jobs will be to make the UK into a tax haven, and remove all the special charges on the ownership of property in the UK by companies. This will be a curious climax to the last government's campaign against tax avoidance. VAT will continue as a national tax, but without the framework of the Directives or the guidance of the CJEU, so it will diverge ever more from EU principles.

Finally, you might not know this about me but…
I spent two years studying the Anglo-Saxon epic Beowulf. The great moral of that poem is that it is sometimes better to be on the right side and lose, than on the wrong side and win. That reflection affords some consolation for those in practice at the Tax Bar, and for participants in the recent referendum. ■

What's ahead

July

1
Consultation: Comments due on reforms to the gift aid small donations scheme setting out specific proposals for simplifying the scheme rules to help ensure as many eligible charities as possible can benefit. See www.bit.ly/1qDElz6.
Legislation: The Banking Surcharge (Information) Regulations, SI 2016/566 comes into force.

4
PAYE: Last date for employees to reimburse employers for PAYE on notional payments arising in 2015/16 to avoid charge under ITEPA 2003 s 222.
TAXE 2 committee: European Parliament due to vote on the committee report in a plenary session giving support for proposals relating to increased transparency, effective taxation and a common consolidated corporate tax base.

5
PAYE: Last date for agreeing PSA where the employer wishes to settle the tax & NICs due on a grossed up basis.

6
Employment taxes: Last day for various submission deadlines to HMRC (see www.bit.ly/1ToJZjc).
Regulation: The Social Security (Contributions) (Amendment No 3) Regulations, SI 2016/647 come into force, correcting an error in the new legislation restricting the NICs disregard for travel and subsistence for those working through an employment intermediary.

10
Consultation: Comments due on revised draft legislation and first draft of guidance for the new corporate criminal offence of failure to prevent facilitation of tax evasion (see www.bit.ly/1VCqtSJ0).

12
Directive: Text for Anti-Tax Avoidance Directive due to be submitted to ECOFIN meeting for formal adoption.

13
Consultations: Comments due on proposals to strengthen the regimes for disclosing information on tax avoidance schemes to HMRC (see www.bit.ly/1Vj1zYc).
Comments due on whether companies with non tax-advantaged share schemes require the continued availability of a NIC election (see www.bit.ly/1WRKV1r).
Comments due on possible alternatives to the current tax rules for part surrenders and part assignments of life insurance policies (see www.bit.ly/23L6Z3g).

For a 'what's ahead' which looks further ahead, see taxjournal.com (under the 'trackers' tab).

Coming soon in Tax Journal:
- Patent boxes in key jurisdictions.
- Review of *Tottenham Hostpur*.

Annual Golf Day 2016

This year, our corporate golf day saw some of the most influential people in UK tax congregate at Burhill Golf Club, Surrey for a day of golf, good company and great food.

The day began with bacon rolls, a hearty breakfast for the 18 holes that awaited our guests, and proceeded to a fantastic show by Geoff Swain, international trick shot champion.

Find out more...
www.pro-tax.co.uk/golfday2016

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FS Tax Manager
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In-house Tax Manager
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Transaction Tax Specialist
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