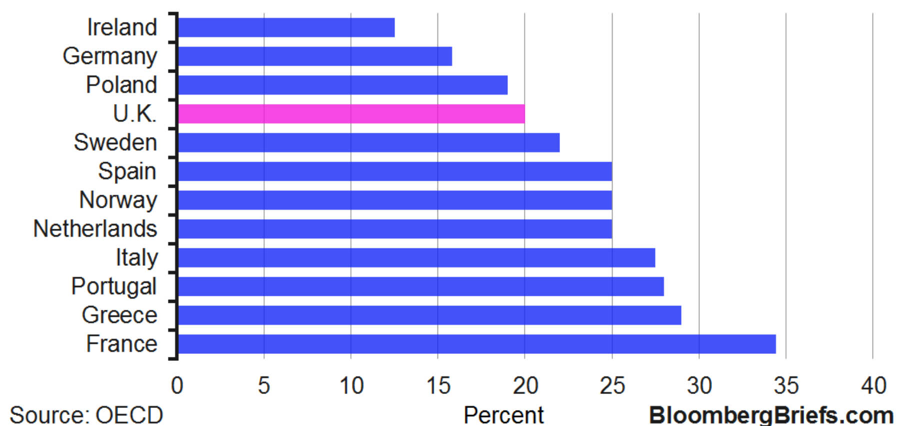
COMMENTARY

How Brexit Might Affect U.K. Companies' Tax Bills

Gianni Bitetti, principal at consultancy firm Bernoni Grant Thornton takes a look at the tax implications of the U.K.'s decision to leave the EU. Bernoni Grant Thornton is a member firm of the Grant Thornton network, with the latter showing combined global revenues of $4.6 billion for the financial year ended Sept. 30, 2015.

U.K. Has One of the Lowest Corporate Tax Rates in the EU



While U.K. Prime Minister Theresa May has said she will begin the process of taking the country out of the EU by the end of March 2017, the nature of what kind of subsequent trade deal May might agree with the EU remains undetermined.

The potential scenarios that may emerge from the Brexit negotiations will have varying impact on the current tax system.

Direct Taxation:

The U.K. may no longer be able to benefit from EU Directives governing its tax relations between itself and the other EU member states once it leaves the bloc.

A Brexit could have a direct impact on the **Parent Subsidiary Directive**. This provides an exemption from withholding taxes for inbound and outbound dividends. This means dividends paid by EU member states' subsidiaries to U.K. parent companies could become subject to a withholding tax charged at the domestic tax rate, as reduced by the relevant tax treaties.

The EU's **Interest and Royalty Directive** will also be affected. This directive gives companies an exemption from withholding taxes on outbound interest and royalty payments between associated companies within the EU. If the U.K. leaves the EU, that exemption could potentially be lifted, meaning that payments will become subject to withholding taxes in the state of source, as reduced, if applicable, by the relevant tax treaties.

The **Merger Directive** grants companies, under certain circumstances, a tax neutral regime to cross-border reorganizations such as mergers, divisions, transfer of assets and exchange of shares between companies of different member states.

Right now current capital gains realized by a reorganization are deferred. If a Brexit occurs during the deferral period, a specific provision for these "outstanding" gains should be identified.

The **EU Directives on Exchange of Information** could cease to apply as well, although tax treaties and the **Multilateral Convention on Mutual Assistance in Tax Matters** will still be applicable.

The **Anti-Tax-Avoidance Directive** which obliges member states to introduce specific anti-abuse measures against aggressive tax planning, may not apply to the U.K. post Brexit. This directive was adopted by the European Council earlier this year to strengthen measures against corporate tax avoidance.

With regard to multinationals, it's key to note that Brexit will not affect the application of the **Arbitration Convention on Transfer Pricing Adjustments** involving U.K. companies.

Customs and VAT:

The U.K.'s withdrawal from the EU will mean that the country will no longer be bound by the EU's VAT system and the flow of goods between the bloc and Britain will no longer be qualified as intra-community supplies. Currently, intra-Europe supplies of goods (and sometimes services) are treated differently from supplies moving in and out of the EU.

Moreover, Brexit will put the U.K. outside the common trading area and, therefore, supplies of goods from the EU might be subject to excise duties upon their import. The U.K. may eliminate customs duty on imports from some or all of those countries, but it does not necessarily follow that those countries will reciprocate. Rules pertaining to VAT identification for non-resident entities and procedures to recover VAT incurred by non-resident entities, and not VAT registered in the country where purchases or imports take place, should change.

Corporation Tax:

Corporation tax is not governed by EU law, so will not be directly affected by a Brexit.

Various European heads, such as Swedish Prime Minister *Stefan Loefven*, have warned the U.K. against drastically cutting corporate taxes post-Brexit in an effort to maintain competitiveness against its European peers.

Indeed, an aggressive tax policy adopted by the U.K. could encourage negative reactions in other countries if they see the U.K. trying to get a competitive edge through promoting itself as a tax haven.

It is important to emphasize that it is unlikely that Brexit will have any major impact on the UK's implementation of the OECD's recommendations in relation to **Base Erosion Profit Shifting** project. The U.K. will continue to be bound by its commitment, as a member of the G20 and the OECD, to implement the recommendations.