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Business Implications of Brexit

A CMS Tax Analysis

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Foreword

The United Kingdom has triggered Article 50 to leave the European Union, raising more and more questions about businesses and individuals both in the UK and in the EU. With the OECD's Base Erosion and Profit Shifting (BEPS) project already well under way, and stringent new EU anti-BEPS projects being negotiated and voted on, the international tax context for Brexit is more complex than ever. In a series of five articles, our CMS experts have outlined some of these issues and offer you their insights to better understand this unique and unprecedented situation, not only from a UK perspective, but also from the point of view of its European business partners.

In his article *Benefits of Brexit for England and other countries*, Richard Croker (CMS London) analyses what benefits Brexit may bring, both for the UK and EU countries, and presents some new legal opportunities which arise from this situation. Croker's analysis covers both immediate effects such as those linked to political changes, medium-term effects such as possible legislative evolutions – in the UK as well as in the EU – and long-term effects such as the situation in Scotland.

Daniel Gutmann (CMS Paris) tackles the choices facing the UK in his article *Brexit: Options for the UK*. In this article, Gutmann offers an in-depth analysis of the harsh consequences of Brexit from a tax perspective, opening the question of which options the UK could choose to pursue in order to avoid the numerous undesirable effects of its exiting the EU could have, such as double taxation situations or discriminatory tax treatments, and so on.

On a related note, Niels Koene and Staffan Bos (CMS Amsterdam), along with Marie Debruyne (CMS Lyon) and Andreas Hofelich (CMS Cologne) present the challenges for employers and employees in a common article, *UK employees in Europe after Brexit? Be smart and be prepared!.*
In this article, the authors present the difficulties for a non-EU person working in the Netherlands, France or Germany, addressing for each country issues such as work permits and residency conditions. They also reflect on the social security and tax issues such workers would be faced with.

In *Brexit: Groups of Companies and Tax Treaties*, Daniel Gutmann (CMS Paris) and Herman Boersen (CMS Amsterdam) offer their insights on the impact of Brexit on the application of various EU directives, such as the Parent-Subsidiary DIrective, the Merger Directive, the Interest and Royalty Directive, etc. They also analyse such questions as the possibility of forming fiscal unities for groups of companies, cross-border offsetting of losses, and many other questions which will interest international groups of companies with a presence in both the UK and EU countries.

Elisabeth Ashworth (CMS Paris) concludes this series with her article *Brexit and VAT: Challenges and opportunities,* where she offers an in-depth explanation of, on the one hand, the consequences for the UK of being a third-party country with regards to application of VAT, and on the other hand the newfound freedoms in this area for the UK, no longer constrained by the EU VAT Directive. She concludes with her thoughts on the institutional issues which arise from the current situation.

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Benefits of Brexit for England and other countries

Richard Croker, Partner – CMS UK

Many column inches have been devoted to the various forms which Brexit may take and much advice given freely to the UK, other EU Member States and the Commission on what to do about it and when since the UK referendum result. After all that, even though the UK Prime Minister has invoked Article 50 in March 2017, we have now perhaps less certainty about what Brexit will look like than we had on the morning after the UK Referendum on 23 June 2016 due to the recent general election which has eliminated the majority of Theresa May's conservative government. That administration had published a White Paper on legislating for Brexit which set out its intentions which involved contemplating a negotiation which may end in a "hard" Brexit, where as a minimum access of the UK to the single market and free movement of people between the UK and the EU are likely to be curtailed. This means not only that the UK would leave the EU, but also the EEA. If that is to happen and the UK seeks to rely on World Trade Organisation (WTO) rules or negotiate a bespoke trade agreement with the EU in the manner of Canada, this may create some longer-term opportunities for the UK in the tax sphere. Whether what is legally possible in theory will now prove politically achievable domestically or with the EU in practice is, of course, a question for the new minority government – and that is all outside the scope of this analysis.

A new fiscal approach

One of the immediate consequences of Brexit was the end of the administration led by David Cameron and his Chancellor, George Osborne. His successor Philip Hammond has demonstrated a different approach.

Osborne had been in post for six years and was seen as committed to strict monetarist policies including elimination of the fiscal deficit by 2020. Osborne concentrated on reducing public spending through benefit and other cuts rather than on increasing taxation – he had some headline-grabbing policies such as the proposal that corporate tax would reduce to 17%, or more recently, to 15%. Hammond, has already indicated that the latter target is a mere aspiration but has confirmed the proposed reduction to 17% and indications are that following his confirmation in post since the election he may be interested in further fiscal loosening.

Another consequence of the recent election is that the previous 'tax lock' committing the government to no increases in income, tax national insurance or VAT – which arguably affected its approach to other taxes such as the recent increase in insurance premium tax - is now history. Hammond may seek to use these new powers in the medium term to enable tax cuts elsewhere.

Tax changes to benefit the UK

A variety of tax laws which apply to the UK by virtue of its membership of the EU may cease to be binding on it as a result of Brexit, and Brexit may therefore throw up opportunities.

The VAT Directive (which will be looked at in future analysis) will cease to bind the UK. Possible advantages would be that the UK would be free to introduce other consumption taxes, as well as expand the scope of zero-rating or redefine the scope of the VAT exemption for funds.The UK may be tempted to reverse the effect of the long line of Court of Justice of the European Union (CJEU) cases recognising breaches of the fundamental freedoms by domestic rules ranging from group relief for tax losses to transfer pricing legislation. For example, this could mean an end to UK-UK transfer pricing (at least for periods post Brexit).

However, in the absence of specific changes of law overturning it, the White Paper indicates that the UK courts will be required to interpret EU deemed law by reference to existing case law of the CJEU, e.g. with regard to VAT. The UK would have the freedom to tax non-resident investors in the UK more heavily than residents, although this would be a major policy change which would run contrary to the UK's historic openness to inward investment and is not thought to have many backers. A more radical approach would see the UK legislating to prevent taxpayer reliance on accrued rights under EU law for historic periods.

Constitutionally such a move would be possible as the UK government would be sovereign following the proposed repeal of the European Communities Act of 1972, but such a move would be appear to have been ruled out in the recent White Paper.

State aid

EU rules concerning state aid have been employed recently by the Commission to attempt to correct the effect of certain tax rulings, giving what are perceived to be selective advantages to certain taxpayers. They have been mentioned in connection with the UK's recent tax settlement with Google, but no finding has been made. In the UK, a number of tax incentive arrangements have been withdrawn or had **6** | Business Implications of Brexit - A CMS Tax Analysis their scope curtailed by the need for state aid approval in the recent past, and it is possible that the UK will look to expand some of these incentives in a post Brexit world as well as considering whether they have more flexibility in the design of the tax system in the future. As an example of other relationships, while EEA states are bound by broadly similar rules to the EU, the Swiss agreement with the EU has limited state aid provisions, including no power to make the state recover historic aid.

Opportunities for other EU member states

Given the potential difficulties thrown up for the rest of Europe as a result of the UK referendum, it may be too early to speak to opportunities for others from Brexit but, if the UK leaves the EU stage, some initiatives which have been held back by UK opposition may be more likely to succeed. Chief among these would be the Common Consolidated Corporate Tax Base (CCCTB), where the UK had opposed mandatory reporting. The UK also brought a premature and unsuccessful challenge to the proposed Financial Transactions Tax (FTT), on the grounds that powers of enhanced cooperation were exceeded by it, but the CJEU did not rule out the possibility of a decision in the UK's favour on this basis if the FTT is finally approved.
This would be in a pre-Brexit world and there will be questions about whether the UK is entitled to object to the operation of enhanced cooperation if it is no longer bound by the EU treaties, should the FTT ever be approved.

Scotland

Scotland is in a difficult position. The country beyond Hadrian's Wall voted clearly to remain in the EU, but also recently had a referendum where it agreed to stay in the UK.

If the rest of the UK wants to leave, what happens? Scotland cannot unilaterally prevent the repeal of the European Communities Act, and there is no clear constitutional path which would entitle Scotland to a second referendum on independence from the UK.

The current Scottish administration continues to aspire to rejoin the EU as an independent state. In that case, what price would the UK and EU exact for that to come to pass? The remainder of the UK is unlikely to want to continue to subsidise the Scottish economy, to let Scotland use the pound as its currency, or to allow freedom of movement via Scotland into the 'remainder of the UK' for the rest of the EU. There is currently no commitment from the UK government to allow separate Scottish representations in the negotiations – although it has said it will consult.
It is unlikely that a Scotland yoked to a UK outside the EU would be reconciled unless the terms of Brexit were very soft indeed.

Brexit: Options for the UK

Daniel Gutmann, Partner – CMS France

The referendum which took place on 23 June 2016 has opened a period of uncertainty in all areas of the law about the actual consequences Brexit is likely to have in the near or more remote future.

The harsh consequences of Brexit from a tax perspective

The UK's exit will give it the status of a third-party state and release it from all obligations under EU legislation. It will also prevent all its nationals, whether natural or legal persons, from invoking the provisions of that legislation. Therefore:

— the provisions of treaties will cease to apply, depriving the UK of access to the internal market;
— EU regulations will no longer apply in internal law;
— in terms of directives, the British Parliament will need to decide whether to retain, amend or repeal implementing laws, but in any case they will no longer be binding from the EU's perspective and their infringement will no longer be able to be invoked in disputes heard by British courts;
— International treaties negotiated by the EU shall also cease to apply in the UK.

From a tax perspective, exiting the EU may certainly bring some benefits to the UK. As described by Richard Croker in an earlier article, a variety of tax laws which apply to the UK by virtue of its membership of the EU would cease to be binding, which means in practice that the UK would gain more freedom in terms of tax policy, particularly in the field of VAT and direct taxes.

The idea that the UK would be "liberated" from any international constraints in tax matters should however be mitigated by the observation that other (non-EU) multilateral instruments would still be binding on the UK. In particular, the UK is a signatory to WTO Agreements and a WTO Member in its own right. If the UK left the EU without any grandfathering of existing EU relationships, its trade relations with the rest of the world would still be governed by WTO rules. This has significant tax effects, as WTO rules governing the prohibition of subsidies are to a large extent comparable to European Union law regarding state aids.

Besides, it is also material that many tax rules laid down by EU law provide UK firms and individuals with tax benefits which would not be available otherwise.

For companies subject to corporate income tax in the EU, the Parent-Subsidiary Directive obliges all EU Member States to abstain from levying withholding taxes on cross-border distributions of dividends within the EU, which is not the case under some tax treaties concluded by the UK with other European Countries. The same point can be made regarding the Interest-Royalty Directive. The Merger Directive provides for the tax neutrality of cross-border mergers within the EU, which is a highly valuable achievement considering the diversity of domestic legislation in this respect.

For individuals, Brexit means that the fundamental freedoms enshrined in the Treaty on the Functioning of the European Union would cease to apply, with the exception of the freedom of capital movement (which would continue to be binding on EU Member States). The UK would therefore acquire the right to apply discriminatory tax treatment to EU residents, but its own residents may reciprocally suffer such treatment in some EU countries (subject, once again, to compliance with freedom of capital movement).

These are the reasons why the UK may wish to neutralise, to a certain extent, the tax consequences of leaving the EU.

Available options

First of all, the UK Government may be interested in securing the benefits of EU directives which are favourable to UK interests.

This will be true of the directives which are designed to establish administrative procedures to fight tax avoidance and evasion, for instance the Mutual Assistance Directives which allow the UK to obtain information from other EU Member States and to get assistance in the recovery of tax claims. Whether the UK will try to negotiate an agreement to continue to apply these Directives is uncertain, considering that similar forms of administrative cooperation also exist under double tax treaties and the Multilateral Convention on Mutual Assistance on Tax Matters concluded under the auspices of the OECD. One may observe, however, that the OECD Mutual Assistance Convention permits reservations by contracting states and objections to the reservations of other states, which makes it less effective than existing directives at the EU level.

The UK may also wish to continue to apply – in substance – some tax directives which provide for the elimination of juridical double taxation, such as the Parent-Subsidiary Directive and the Interest Royalty Directive. This could be achieved by a bilateral agreement with the EU, following the Swiss example in this field. Another issue connected to the elimination of double taxation for the benefit of UK companies relates to the applicability of the Arbitration Convention, which is a multilateral convention designed to resolve transfer pricing disputes and to put an end to economic double taxation by mutual agreement between the competent authorities. It also contains a mechanism by which arbitration becomes mandatory if the competent authorities have failed to agree in the course of the mutual agreement procedure. In theory, this Convention should continue to apply to the UK even after Brexit because it is multilateral treaty signed by the EU Member States, but it is not EU legislation strictly speaking. It is a little bit paradoxical, though, that the UK could remain a party to this treaty without being the addressee of the Code of Conduct issued by the EU Council for its effective implementation.

A discomfort with fundamental freedoms protected by the EU seems to account – at least partially – for the popular decision in favour of Brexit. Besides, the UK may be happy to remove the control exercised by the European Court of Justice on its domestic legislation. It therefore seems unlikely that the UK will try to secure the full benefit of these freedoms for the future. However, it is necessary to observe that the freedoms would still apply in whole or in part if the UK, either negotiated a tailored regime of application of selected freedoms under specific conditions in the process of negotiation of the exit, or joined the European Economic Area. This latter option would offer less flexibility than a tailor-made relationship between the UK and the EU and one may wonder whether the UK would be ready to accept legal mechanisms which turn out to be nearly as binding as the EU institutional framework (albeit in a narrower field).

Let us indeed recall that the EFTA Surveillance Authority monitors compliance with the Agreement on the EEA in a way which is comparable to the European Commission, while the EFTA Court is in many respects comparable to the European Court of Justice.

One may therefore predict that the alternative to Brexit will lie in a complex set of very specific provisions regarding the relationship between the UK and the EU.

UK employees in Europe after Brexit? Be smart and be prepared!

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Employers in the European Union may be able to continue to employ UK nationals after Brexit, but they need to consider the legal and tax implications now.

Brexit may cause major problems for British citizens working in Europe, as well as for their employers. Free movement of workers is at risk. However, employers in the EU may be able to continue to employ UK nationals after Brexit if they make use of the possibilities provided for by local law.

I. Consequences of Brexit for employees in Europe

At this stage it is unclear what the actual consequences of Brexit will be for British employees within Europe. Until the UK leaves the EU, free movement of workers will continue. After Brexit, the status of British employees depends on the relationship agreed with the remaining EU Member States.

In this article we provide a brief look at the current routes when hiring a non-European Union/non-European Economic Area national ("non-EU/EEA") employee to work in the Netherlands, France and Germany. These include becoming a recognised sponsor and employing highly skilled migrants (the Netherlands), the introduction request to the *Prefecture* (France) or requesting a permit for qualified and highly skilled workers (Germany). Such methods also allow employers that employ British nationals to be prepared when necessary.

A. The Netherlands

1. GVVA
In order to legally reside in the Netherlands for more than 90 days as a non-EU/EEA worker, one requires a residence permit. Our assumption is that British citizens are likely to fall under the same legal regime as all other non-EU/EEA workers after Brexit. Non-EU/EEA nationals in principle may only work in the Netherlands if a work permit is obtained. Practice shows that it is advisable to combine the two requirements and apply for the Gecombineerde vergunning voor verblijf en arbeid (GVVA), which basically is a combination of a residence permit and work permit.

To successfully apply for the GVVA, the employer in the Netherlands that wishes to employ the non-EU/EEA national must, amongst other requirements, substantiate that the position that will be filled by the non-EU/EEA individual cannot be fulfilled by a Dutch or European employee. Practice shows that it is difficult to obtain a work permit due to this high threshold.

2. Highly skilled migrant
Fortunately there is a possibility that allows non-EU/EEA nationals to work in the Netherlands. In the event that the employer becomes (i) a recognised sponsor (*erkend referent*) of the Dutch Immigration and Naturalisation Service (IND) (Immigratie en Naturalisatie Dienst), and (ii) the employee earns more than the wage requirement (which is currently €4,240 gross per month excluding 8% holiday pay for employees who are 30 years or older), the employee is regarded as a highly skilled migrant and therefore allowed to work in the Netherlands without a work permit/without a GVVA being required.

3. How to become a recognised sponsor
In order to become a recognised sponsor, the employer must apply for sponsorship at the IND. The main conditions are that:

- the employer is registered at the Dutch Chamber of Commerce
- the employer has a Dutch bank account and withholding tax number
- the employer is not bankrupt or in suspension of payment
- the employer, its directors and the persons involved in the organisation are trustworthy (for example, no previous penalties or convictions).

The fee for becoming a recognised sponsor currently amounts to €5,183. Once the employer has been acknowledged as a recognised sponsor, the employer is allowed to request residence cards for other highly skilled migrants, without having to pay the fee for recognised sponsorship again. Also, as a recognised sponsor the procedural times for applications of permits are substantially shorter compared to those applicable to employers that are not a recognised sponsor.

B. France

1. The work permit
Non-EU/EEA nationals (including non-EU/EEA nationals allowed to reside in France) in principle may only work in France if a work permit is obtained. Nevertheless, the residence permits marked in particular, "employee", "temporary worker", "seasonal worker", "employee on assignment", "European blue card", "cultural and artistic profession", "scientific researcher" and "private and family life" can give the authorisation to work.

The application for the work permit is in principle submitted by the employer in France who wishes to employ the non-EU/EEA national. If the non-EU/EEA national resides in France, the application must be sent to the local administration, the *Prefecture*, for the non-EU/EEA national's place of residence. If the non-EU/EEA national does not reside in France, the application must be sent, if the employer is located in France, to the *Prefecture* for the non-EU/EEA national's workplace or the private individual employer's place of residence.

2. The introduction request
If a French employer wishes to hire a non-EU/EEA national who does not reside in France, they will have to comply with a specific procedure called "the introduction request". This specific work permit application concerns employees who currently reside abroad but who meet the job requirements. Employers can apply for the work permit provided that they are able to provide evidence of their failed search for an applicant already present on the French labor market, unless the law states otherwise.

3. Evaluation of the application
In order to grant or refuse a work permit, the "Prefecture" takes into account in particular:

- the employment situation within the profession and within the geographic area concerned by the application (unless otherwise stated and in particular if the planned job is among a list of occupations established by the Employment and Immigration Ministers or in the event of apprenticeship contract)
- whether the qualification, experience, and diploma match the job description
- the compliance with French labor law and social security law
- the working conditions and salary offered
- if the non-EU/EEA national resides abroad, the measures taken to ensure the accommodation of the individual.

4. The Decision
The decision is issued by the *Prefecture* within two months after submitting the complete application, and is sent to the employer and the non-EU/EEA national. No response from the administration will be considered as a refusal. Nevertheless, the reasons for refusing the permit must be given. An appeal can be filed.

These procedures are long and complex. Consequently, employers who would like to employ non-EU/EEA nationals should prepare their applications well in advance.

C. Germany
To legally reside in Germany as a non-EU/EEA national for longer than 90 days one has to obtain a residence permit (*Aufenthaltstitel*). Unless (i) the UK does not even remain a member of the EEA (so-called Norway Scenario), and (ii) no bilateral agreement between the UK and the EU on the issue of freedom of movement is concluded (so-called Swiss Scenario), British citizens are likely to fall under the same legal regime as all other non-EU/EEA workers after Brexit. In this case, a residence permit has to be applied for with the local German immigration authorities. This residence permit will also show whether or not one is allowed to be employed in Germany (*Aufenthaltstitel zur Ausübung einer Erwerbstätigkeit*).

Such working permits can be issued by the relevant immigration authorities if the following preconditions are met.

1. General
First of all, the applicant always has to account for a specific job offer. Only if an applicant has a concrete prospect of being employed in Germany will the work permit be issued.

Second, the federal employment agency (*Bundesagentur für Arbeit* (BA)) has to agree to the issuing of the work permit. In general the BA will do so if the three following preconditions are fulfilled:

- the position that will be filled by the non-EU/EEA individual cannot be filled by a German or European employee
- no negative effects on the German employment market are to be expected through the issuing of the work permit
- the non-EU/EEA individual will not be employed on less favourable conditions than comparable German workers.

Depending on the individual's qualifications, the preconditions that have to be fulfilled in order for the BA to consent to the work permit can be either augmented or relaxed and – in some cases – the BA's consent is no longer necessary at all.

2. Non-Qualified Workers
Non-EU/EEA workers that do not have a qualified graduation (at least two years of apprenticeship or education) can obtain the BA's consent only if – in addition to the restrictions mentioned above – the BA is allowed by law to give their consent for the specific occupational group in which the applicant wishes to be employed in Germany. Currently this is possible only for au pairs, carnival employees, seasonal workers and household aides; so the possibilities here are limited.

3. Qualified workers
For non-EU/EEA workers that do have a qualified graduation it is much easier to work in Germany:

- if they obtained their qualified graduation in Germany then for these individuals a work permit will be issued without involving the BA as long as their position is related to their field of graduation
- if they graduated in a foreign state then it must be proven that their qualification is equal to a comparable German one and that no negative effects are to be expected on the German employment market.

These restrictions are still easier to fulfil than those mentioned above, especially since it is no longer necessary to prove that no other German or European worker could fulfil the relevant position.

4. Highly skilled workers

For highly skilled workers in some occupational groups it is even easier to obtain a work permit. For certain specific positions the approval requirement of the BA does not apply at all: general managers and executive employees with outstanding responsibility (representatives of a company) or specialist knowledge; scientists working at universities, visiting scientists; and engineers working in the research team of a visiting scientist and teaching staff working at public educational facilities.

In conclusion it can be seen that the German system is geared to the needs and demands of the German employment market. Germany seeks to improve its economy by letting highly skilled workers in and keeping non-qualified workers out. So, the better the qualification of a non-EU/EEA individual the better the chances that they might be allowed to work in Germany.

II. Social security and tax

A. Social security benefits

Entitlement to social security benefits for employees moving between EU Member States is closely linked to free movement rights. Brexit could have significant implications for both EU/EEA citizens living in the UK, and for UK citizens in the EU/EEA. Currently, if an employee works and/or lives in multiple EU/EEA countries, EU Regulation No 883/2004 prescribes the country in which the employee is covered by social security insurance. The objective of the social security regulation is to avoid situations in which an EU employee is not insured, or is insured in more than one country. If the UK leaves the EU, the EU Regulation will in principle no longer apply to UK citizens working or living abroad in EU/EEA countries. In that case, after Brexit the UK may seek to conclude social security conventions with all EU/EEA countries.

When the EU Regulation is not applicable and a social security convention has not been concluded, the national legislation of both countries involved will be used to determine which social security insurance schemes are applicable. In that case, there is a risk that an employee will not be (fully) insured, or insured in more than one country. Furthermore, UK residents will not, in principle, be able to apply for an A1/E101 certificate of coverage after Brexit. As a consequence, employers may have to withhold social security contributions even if the employee is also insured in another country. However, an employee who, pursuant to a social security convention, is insured in a country outside the EU can usually apply for a declaration of applicable legislation. In many EU/EEA countries, such a declaration serves the same purpose as an A1/E101 certificate.

Brexit will enable the UK to impose restrictions on access to many social security benefits via immigration law. The entitlement to UK social security benefits could also be restricted by limiting access to employment in the UK for EU/EEA citizens. Of course, this applies vice versa to EU/EEA countries, which may impose similar restrictions and limitations on UK citizens.

B. Tax

Contrary to social security, the right to levy income tax on the wages of an employee who works and/or lives in multiple EU Member States is currently not regulated by the EU but in tax treaties concluded by the individual states. Since the tax treaties concluded by the UK will remain in force after Brexit, no impact is to be expected from an income tax perspective.

The UK currently has tax treaties with all EU Member States. The main rule of these OECD Model Tax Convention-based tax treaties is that income from employment is taxable in the state in which the employment activities were carried out. However, as an exception to the main rule, only the state in which the employee lives is entitled to levy tax when the following three conditions are met:

- the employee spends less than 183 days in a certain period in the state in which the employment activities are carried out. Depending on the tax treaty, this period may be a calendar year, a consecutive period of 12 months or a tax year;
- the employee is paid by or on behalf of an employer who is not established in the state in which the employment activities are carried out;
- the employee does not have a permanent establishment in the state in which the employment activities are carried out.

These three conditions are often jointly referred to as the "183 day rule". If not all of the above-mentioned conditions are met, the main rule applies, i.e. the state in which the employment activities were carried out is entitled to levy tax. Note that sometimes, especially in cases of older tax treaties, different rules may apply. Furthermore, special rules usually apply to income derived by statutory directors, employees in government service (e.g. military or embassy personnel) and airline or seafaring employees.

III. Conclusion

Employers in the Netherlands, France and Germany who would like to prepare for the possible consequences of Brexit may very well wish to consider taking some steps to prepare, now that the status of British employees within the EU after Brexit is insecure.

Brexit: Groups of companies and tax treaties

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Once Brexit occurs, the UK will no longer be bound by the European Union directives concerning tax matters and by the case law of the CJEU: this could have a significant impact on groups of companies that include British subsidiaries. This article provides an analysis of the possible consequences (and solutions) with regard to direct taxes.

I. Brexit Background

On January 17, 2017 the Prime Minister of the UK gave a comprehensive speech at Lancaster House in which she informed the British people and the rest of the world about the intended objectives and consequences of Brexit. One of the most important objectives of Brexit is to take control of British laws and to bring an end to the jurisdiction of the Court of Justice of the European Union (CJEU) in the UK The UK wishes their laws to be made within the UK and interpreted by British judges rather than a European court.

II. EU directives and tax treaties

When the EU directives cease to apply to British companies, the tax treaties that are concluded by the UK will regain their relevance in situations where the directives used to apply. Most of the directives, however, are already implemented in British tax law, and therefore it remains unclear whether the rules which have transposed the specific EU directives will stay in force after Brexit, or whether they will be included in the Great Repeal Act.

It is however also possible that the UK and the EU will negotiate a deal in which part of the directives stay in force, or a new regulation with similar effects comes into force. The most relevant EU directives are:
— the Parent-Subsidiary Directive (2015/121)
— the Merger Directive (2009/133)
— the Interest and Royalty Directive (2003/49)
— the Anti-Tax Avoidance Directive (2016/1164).*

**This directive is not yet implemented but the UK might be obliged to implement it before Brexit takes place.*

A. The Parent-Subsidiary Directive

Pursuant to the Parent-Subsidiary Directive, all EU Member States have to refrain from levying a withholding tax on dividends that are paid by a subsidiary to its parent company if certain requirements—with regard to place of business, minimum interest and legal form—are met.

Since the UK will cease to be part of the EU and thus the internal market, the EU Member States will no longer be obliged to apply the Parent-Subsidiary Directive to dividends that are paid to a parent company in the UK Conversely, the UK will also no longer be bound by the Directive. The EU Member States and the UK will have to determine the dividend withholding tax rate pursuant to the relevant tax treaties. Some EU Member States – such as the Netherlands and France – levy a zero percent withholding tax rate under some conditions. From a British perspective, the EU Member States with the lowest dividend withholding tax rate will be the most competitive after Brexit.

B. The Merger Directive

Pursuant to the Merger Directive, capital gains that derive from cross-border mergers between companies – that are both situated in an EU Member State – are exempted from corporate income tax if certain requirements are met. Similarly to the Parent-Subsidiary Directive, the tax exemption from the Merger Directive will no longer apply to mergers with companies that are located in the UK after Brexit is completed.

C. The Interest and Royalty Directive

The Interest and Royalty Directive provides for an exemption of withholding tax on interest and royalties that are paid to an affiliated entity also located in an EU Member State.

Similarly to the Directives mentioned above, the withholding tax exemption will no longer be applied to interest and royalties that are paid to the UK The EU Member States and the UK will have to determine the interest and royalty withholding tax rate pursuant to the relevant tax treaties. EU Member States with the lowest or no interest and royalty withholding tax – such as the Netherlands and Luxembourg – will have the most favourable position after Brexit.

III. Tax treaties and withholding tax rates

As mentioned above, the tax treaties will regain their relevance in order to determine the rate of withholding tax on dividends, interest and royalties. Obviously the EU Member States that apply the lowest withholding tax rates will have the most favourable position after Brexit. This may have an impact on strategic decisions such as the location of subsidiaries of UK companies, the attribution of intangibles and the financial structuring of their use between companies of the same group, and the financing structures used by UK groups.

The chart below contains the applicable tax rates for a number of EU Member States. Please note however that the UK does not levy withholding tax on paid interest and royalties: the tax rate that is mentioned in the chart will only apply to interest and royalties that are paid to British companies.

Treaty	Dividends		Interests	Royalties
	Normal tax rate	When a % of the capital is held		
Belgium	10%	0%*	10%	0%
France	15%	0%*	0%	0%
Germany	15%	5%*	0%	0%
Italy	15%	5%*	10%	8%
Luxembourg	15%	5%**	10%	5%
Portugal	15%	10%**	10%	5%
Netherlands	10%	0%*	0%	0%
Spain	10%	0%*	0%	0%

**The recipient of the dividends controls at least 10% of the voting power/capital*

*** The recipient of the dividends controls at least 25% of the voting power/capital*

IV. Brexit and groups of companies

EU tax law is not only composed of the tax directives which have been described above. A large part of the impact of EU law on domestic tax systems is attributable to the case law of the CJEU, which has issued numerous decisions based on the fundamental freedoms protected by the Treaty on the Functioning on the European Union (TFEU), such as the freedom of establishment or the freedom of capital movement. UK legislation itself has been considered inconsistent with EU primary law in several circumstances, with the effect that domestic legislation has been changed in order to take into account the consequences of the Court's judgments. When Brexit takes place, the UK will gain more freedom to legislate, since it will not have to abide by the fundamental principles of EU law.

A drawback of this evolution however, will be that other EU Member States will no longer be obliged to implement some freedoms in their relationship with the UK (with the exception of the freedom of capital movement which is the only one to apply to third countries). This will certainly impact groups of companies in the following situations:

- cross-border offset of losses
- possibility to form fiscal unities
- treaty access for permanent establishments.

A. Cross-border offset of losses

One of the doctrines that derives from the case law of the CJEU is the possibility of cross-border offset of losses. Based on the Marks & Spencer case (December 13, 2005, C-446/03) EU Member States – under very strict conditions – should allow a parent company to offset losses that are suffered in other EU Member States by its subsidiaries if the foreign losses cannot be set off against any profits locally (due to, for example, termination of the entity). It is well known that the UK legislation, which was at stake in this case, had to be modified after 2005, and the question of whether this modification was itself consistent with EU law gave rise to a second decision of the CJEU. After Brexit, this kind of endless scenario will no longer have to occur, since the UK will be relieved from the obligation to allow cross-border offset of losses. On the other hand, though, the losses of British subsidiaries will not have to be offset in EU Member States, which may turn out to be to the disadvantage of foreign groups acting in the UK through local subsidiaries.

B. Fiscal Unity Legislation

The CJEU has ruled that EU Member States must allow the formation of a fiscal unity between companies that are both owned by the same EU/European Economic Area (EEA) parent company, based on the SCA Group Holding BV case

(June 12, 2014, C-39/13). The CJEU also ruled in the Société Papillon case (November 28, 2008, C-418/07) that the formation of a fiscal unity between the parent and the sub-subsidiary must be allowed if the subsidiary is established in another EU/EEA Member State.

If the UK remains a member of the EEA, the possibility to form such fiscal unities will remain in force in EU Member States. If the UK leaves the EEA, EU Member States will no longer have to allow such types of fiscal unities if the subsidiary or shared parent is located in the UK Another practical issue arises for existing groups based on an "SCA Group Holding BV" or "Papillon" structure. Where the UK exits the EU/EEA area, these groups will not be eligible for domestic benefits connected to the existence of a group unity. The effect of this could be disastrous for a number of consolidated groups throughout Europe, which raises the question of whether UK companies serving as intermediate companies in these groups should not consider transferring their head office to another EU Member State while they still enjoy the benefit of fundamental freedoms protected by the TFEU.

C. Treaty benefits for permanent establishments

Based on the Compagnie de Saint-Gobain case (September 21, 1999, C-307/97) permanent establishments that are located in EU Member States can request certain tax benefits from the tax treaties that are concluded by these States. Note that this case law is – in principle – only applicable if the head office and permanent establishment are all located in EU Member States. The permanent establishments can therefore make use of reduced withholding tax rates and some treaty rights that are awarded in tax treaties that the EU Member State where the permanent establishment is located has concluded with other EU Member States or even third states (as in the Saint-Gobain case). After Brexit, permanent establishments of British companies will no longer be able to make use of this possibility.

D. Non-discrimination clause in tax treaties

The UK and the EU Member States have concluded tax treaties which are based on the OECD Model Tax Treaty. Article 24 of this Model Tax Treaty contains a non-discrimination clause which could provide for an alternative to the principle of non-discrimination established by the case law of the CJEU regarding the fundamental freedoms, such as the freedom of capital or the freedom of establishment. Based on the anti-discrimination clause, permanent establishments and groups of companies will still be able to claim some of the tax benefits that derive from the case law of the CJEU.

Article 24 section 3 of the OECD Model provides that taxation on a permanent establishment which an enterprise of a Contracting State has in the other Contracting State shall not be less favourably levied in that other State than the taxation levied on enterprises of that other State carrying on the same activities. The Netherlands has included this anti-discrimination clause in Article 24 section 2 of the tax treaty between the Netherlands and the UK

Article 24 section 5 of the OECD Model may also have an impact on the tax treatment which will be applied to UK subsidiaries of parent companies established in another Member State, or conversely, to the EU subsidiaries of parent companies established in the UK It may, for instance, be argued that Article 24 section 5 has relevance with regard to the formation of an SCA Group Holding BV fiscal unity. Based on this provision, two companies established in an EU Member State might be allowed to form a fiscal unity where their common parent company is located in the UK, provided that all the other conditions required by domestic legislation for the formation of such a consolidated group are fulfilled.

Interesting precedents may be quoted in this respect. In the Netherlands, the court of appeal Arnhem-Leeuwarden (April 26, 2016, nr. 15/00206) has ruled that four subsidiaries with a common Israeli parent company are allowed to form a fiscal unity. Since the anti-discrimination clause in the tax treaty between Israel and the Netherlands is similar to the anti-discrimination clause in the tax treaty between the UK and the Netherlands, it is possible to assume that the Dutch courts will draw a similar conclusion. There is also case law in Sweden (Supreme Court, SE: RA 1996 ref. 69 et SE: RA, September 24, 1998, 4676-1997, 1998 ref. 49), Finland (Supreme Court, FI: KHO, May 10, 2000, Decision KHO 10.05.2000/864) and the UK (Court of Appeal, October 17, 2012, [2012] EWCA Civ 1290, FCE Bank plc) which seems to share the interpretation of the anti-discrimination clause. Similar questions are also raised before tax courts in France.

V. Conclusion

Brexit may undeniably have severe consequences for groups of companies with entities in the UK All EU directives with regard to direct tax and subsequently the case law of the CJEU will cease to have legal force in the UK The bilateral tax treaties will regain their relevance with regard to the determination of withholding tax rates. A major impact of Brexit is therefore to trigger tax competition between Member States in their relationships with the U.K, with the effect that reorganizations may be anticipated in order to enjoy the best possible treatment on international payments involving UK companies.

Another impact of Brexit will be to raise interesting questions concerning the applicability of the non-discrimination provision enshrined in Article 24 of the OECD Model Tax Treaty with a view to securing that part of the *acquis communautaire* deriving from the case law of the CJEU remains applicable thanks to Treaty law.

Brexit and VAT: Challenges and opportunities

Elisabeth Ashworth, Partner – CMS France

Once the UK has left the European Union it will no longer be part of the harmonised VAT system. This will present challenges, but also opportunities to change aspects of current VAT rules. This article looks at potential effects on businesses in the UK

The UK's exit from the European Union will lead to its immediate exit from the common value added tax (VAT) system.

The harmonised VAT system, currently governed by the provisions of Directive 2006/112/EC ("the VAT Directive") dated November 28, 2006 (in existence since 1970 and reinforced from 1979), sets out only two types of status around which the VAT system for economic transactions is organised: that of EU Member State and that of non-EU state. In that sense, the functioning of the VAT system would not be influenced by any agreement between the EU and the UK to ease the movements of goods or the providing of services.

Once the UK has left the VAT system, on the one hand, the EU budget will immediately lose the British contribution in proportion to its VAT base. (For the record, VAT is one of the three types of EU own resources and its annual amount is equal to 0.3 percent of the harmonised base of each Member State, but the UK benefits from a specific discount to correct excessive contribution.) On the other hand, the UK will take on the status of a non-EU state for the implementation of this tax.

However, the tax itself will not automatically cease to apply, as the VAT Directive is transposed into UK national law. It would seem reasonable to us to set aside the hypothesis under which the UK would choose to remove the tax, which is one of its main sources of tax revenue and would for this very reason need to be replaced by another consumption tax. If we take the example of Switzerland, it is interesting to note that this country – that has always been a non-EU state – does however apply a VAT legislation very similar to the EU system, which of course facilitates application of the tax to economic transactions between Switzerland and EU countries.

However, the UK might be tempted to take advantage of leaving the harmonised system imposed by the VAT Directive to change some aspects of the VAT rules.

I. The effects of third-party country status for application of VAT

Even if it decides to keep the VAT as it is under the EU system, the UK will need to adapt its laws to account for its new status as a third-party country in relation to the EU.

Let's take a concrete example: British regulations currently state (as imposed by the VAT Directive) that deliveries of goods to a taxpayer established in another EU Member State are taxable in the UK, but are exempt from paying the tax if the vendor can prove that the goods moved to another EU Member State and have been delivered to a taxable (business) purchaser. On its side, the purchaser must apply VAT on the same transaction as a so-called intracommunity acquisition of goods. After the UK exits the EU, the same transaction will become an export by the British seller and an import by the purchaser. The procedures for declaring and paying the VAT are different from those for intracommunity deliveries.

All similar changes resulting from the new non-EU status of the UK regarding the EU VAT system will require amendments to British law.

For economic transactions in general, third-party country status in relation to the EU would in fact have the primary effect of changing the tax regime for deliveries of goods between the UK and the EU Member States, which thus become export/import transactions both for business-to-business ("B2B") and business-to-consumer (B2C) transactions, with all the consequences associated with losing the intra-EU cross-border VAT regime and that of distant sales in B2C transactions. (VAT is paid in the Member State of consumption by the seller who needs therefore to be identified in the concerned EU country except if its turnover in that country remains below a threshold fixed between €35,000 and €100 000 by the Member State of consumption.)

Consequently, on the one hand, VAT must be paid for introducing a good into the territory of an EU Member State and vice versa, and, on the other hand, customs formalities will replace the declaration requirements applicable to deliveries made between two EU Member States. Both systems involve an administrative burden but of a different kind, and it would be difficult to say that one might be preferable to the other. In any event, businesses are usually familiar with both import/export and intra-EU delivery of goods transactions.

For services, there would be fewer changes to affect the taxation rules, since, with only a few exceptions, the taxation regime of services is determined by the place where both provider and consumer are established. In other words, the rule to apply is the same whether both parties are established in an EU Member State or in a non-EU country. One of the exceptions to this principle concerns "B2C" intangible services, which are taxable in the place where the service provider is established when the client is a EU resident, while they are not subject to EU VAT if the client resides outside the EU.

Electronic services are always taxable in the place where the consumer is established for both business or individual consumption and wherever the provider of the services is established. Since 2015, providers of such services may either declare and pay VAT in each EU Member State of consumption (in that case they need to be identified in each EU Member State of taxation) or apply for the Mini One Stop Shop (MOSS) arrangement, according to which the taxpayer for electronic services declares and pays VAT through a single VAT identification in one EU Member State which is responsible for the dispatching of VAT owed to each EU Member State of consumption. This special scheme applies to both EU and non-EU providers of electronic services, but according to slightly different formalities for non-EU companies than those that apply to EU companies. In this area, at least for British companies providing electronic services to EU consumers, the exit of the UK from the EU should not have significant consequences.

One interesting point to note concerning services is that the new status of the UK as a third-party country would be a real advantage for companies in the banking and insurance sector: these companies cannot in principle recover the VAT they pay on their expenditures, as most of the services they provide to their clients are VAT-exempt. However, there is an exception to this rule: input VAT is recoverable when the recipient of the service is established outside the EU.

For some VAT reporting obligations in EU Member States, British companies may be required to appoint a tax representative, unless the UK maintains a level of cooperation with its former partners that is similar to what exists among the EU Member States according to the administrative cooperation regulation (Council Regulation (EU) 904/2010 of October 7, 2010).

Finally, British companies would no longer apply for reimbursement of the VAT paid in EU Member States through the electronic procedure set out by Directive 2008/8, but would be required to make an application through the more traditional framework of the 13th Directive (potentially with longer delays).

II. A new legislative freedom for the UK

Even if the UK decides to maintain most of the rules of the EU VAT system, it would be free to change some aspects of the system in relation to its own interests.

It is difficult to identify the rules that might be affected, particularly as the UK has not so far faced really significant condemnation by the Court of Justice of the European Union (CJEU) for incorrect implementation of the VAT Directive.

Indeed, the UK appears a "model student", in terms of the quantity and type of CJEU case law related to decisions of the CJEU concerning the conformity of UK law to the VAT Directive. On the one hand, the UK is one of the less frequently condemned EU Member States for violations of the VAT Directive, and on the other hand, the British courts decide more often (or hesitate less) than those of some other EU Member States to stay proceedings and make reference to the CJEU, regarding the number of preliminary rulings they have brought before the Court over the past 30 years. This allows us to assume that the UK has not, to date, sought to avoid EU VAT rules.

However, the UK might be tempted, for example, to apply rates different from those set out by the VAT Directive. Within the EU, the standard rate cannot be less than 15 percent, and EU Member States can only apply two reduced rates at least equal to 5%, and only to a limited list (Appendix III of the Directive) of goods and services.

Upon joining the EU, the U.K was able (like other EU Member States) to maintain different rates, under the condition they previously applied to some goods and services. The UK did so concerning specific products considered as essential that are still subject to a "zero percent rate" (VAT does not apply to the goods or services concerned, but the provider is nevertheless allowed to deduct the VAT paid at the preceding stage). Under the EU VAT legislation, such derogation may however not be extended to any other goods and services than those for which such a standstill clause applies. Depending upon its economic policy, the UK, "freed" from EU constraints, might decide to apply rates lower than 5% to goods and services other than those that currently benefit from such rates.

However, nothing would lead us to think that the UK will adopt a general reduction in rates, in so as far as this would reduce its tax revenues. In addition, it should be underlined that such a decrease in the VAT rate would have a limited impact on the competitiveness of UK products in the EU market, where the VAT rate applicable is currently the one that applies at the place of consumption for most types of economic transactions. A reduction of the VAT rate merely impacts the domestic market, and benefits national consumers more than national businesses.

In any event, it is still too early to have a clear idea of how the UK might modify its VAT regulations.

III. Two institutional issues

It is important to note that within the EU, the VAT legislation, as for all tax issues, can only be amended by a unanimous vote of the EU Member States.

Article 50 of the EU Treaty does not specify how this legislative process applies between the time a Member State has notified its decision to exit the Union and the exit becoming effective.

However, in 2011, the European Commission initiated important discussions to modernise the VAT system, and in April 2016 made proposals for a process of deep amendment of the current rules (COM (2016) 148, 7.4.2016, titled "Time to decide"). Based on those proposals approved by the EU Council, the European Commission has already published a set of three draft directives and we expect more in the coming months.

Once discussed and adopted by the Member States, these changes should make the system more modern, robust, and less exposed to fraud, which is of critical importance. In the current schedule proposed by the European Commission, the entry into force of the most structural parts of this VAT Action Plan would take place by the beginning of the next decade.

We can therefore legitimately wonder what will be the impact of the UK's exit process on this discussion of strong structural reform, and on its adoption.

Finally, jurists must consider another interesting question: how the CJEU jurisdiction to interpret the VAT Directive will apply when, after the exit of the UK from the EU, a British judge hears a dispute concerning the application of VAT in a prior period. We believe nothing would preclude that a British judge might refer for a preliminary ruling to the CJEU for interpretation of the provision in question as part of settling the dispute, despite the UK's having exited at the time when the question arises. This would also mean that such a finding rendered in a case concerning a country that would no longer be bound by EU law would however bind all the EU Member States. An interesting and strange situation…

Jurists will follow these new questions with great attention in the coming months.

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