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Benefits of Brexit for the U.K. and Other Countries

Richard Croker,
CMS London

Amidst the uncertainty surrounding the effects of Brexit there is a possibility it may create some longer-term benefits for the U.K. in the tax sphere. In the first of a series of articles on Brexit the potential benefits are considered.

More than three months on, and with no meaningful progress on the road to Brexit, it may seem strange to be looking for benefits from the process. Many column inches have been devoted to the various forms which Brexit may take and much advice given freely to the U.K., other European Union ("EU") Member States and the European Commission on what to do about it and when. After all that, and even though the new U.K. Prime Minister has recently indicated that the Article 50 process will begin in March 2017, we have no more certainty about what Brexit will look like than we had on the morning after the U.K. Referendum on June 23, 2016.

With that major caveat, it does seem clear that the U.K. Government is contemplating a negotiation which may end in a "hard" Brexit, with a minimum access of the U.K. to the single market, and free movement of people between the U.K. and the EU likely to be curtailed. This means not only that the U,K, would leave the EU, but also the European Economic Area ("EEA"). If that is to happen and the U.K. to seek 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 U.K. in the tax sphere. Whether what is legally possible in theory will prove politically attractive or desirable in practice is, of course, a different question—and outside the scope of this analysis.

I. Advantages of Brexit: a New Chancellor

Richard Croker is a Partner, CMS London

One of the immediate consequences of Brexit is the end of the administration led by David Cameron and his Chancellor, George Osborne. The latter had been in post for six years and was seen as committed to strict monetarist policies including elimination of the fiscal deficit by 2020. Whether or not you think balancing the nation's books necessarily required the degree of austerity imposed by the last government, Osborne undoubtedly 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%. His successor, Philip Hammond, has already indicated that the latter target is a mere aspiration: he does seem inclined however to a relaxation of fiscal policy post the referendum. His Autumn Statement in November should be the first real indication of whether there is to be any major change of government tax policy.

II. Tax Changes to Benefit the U.K.

A variety of tax laws which apply to the U.K. 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 in this series) will cease to bind the U.K.. Possible advantages would be that the U.K. 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 U.K. may be tempted to reverse the effect of the long line of Court of Justice of the European Union ("CJEU") cases recognizing breaches of the fundamental freedoms by domestic rules ranging from

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group relief for tax losses to transfer pricing legislation. For example, this could mean an end to U.K.-U.K. transfer pricing (at least for periods post Brexit). The U.K. would have the freedom to tax nonresident investors in the U.K. more heavily than residents, although this would be a major policy change which would run contrary to the U.K.'s historic openness to inward investment and is not thought to have many backers.

Another area where the U.K. may see a Brexit dividend is in regard to the impact of the so-called compound interest litigation concerning U.K. legislation to curtail compensation payments in connection with EU infringement claims. The taxpayer's claim in the *Littlewoods* case, in reliance on general EU principles, may now fail when it comes to the U.K. Supreme Court. A more radical approach would see the U.K. legislating to prevent taxpayer reliance on accrued rights under EU law for historic periods. Constitutionally such a move would be possible as the U.K. Government would be sovereign following the proposed repeal of the European Communities Act of 1972, but such a move would be highly controversial.

III. 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 as selective advantages to certain taxpayers. They have been mentioned in connection with the U.K.'s recent tax settlement with Google, but no finding has been made. In the U.K., a number of tax incentive arrangements have been withdrawn or had their scope curtailed by the need for state aid approval in the recent past and it is possible that the U.K. 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.

IV. Opportunities for Other EU Member States

Given the potential difficulties thrown up for the rest of Europe as a result of the U.K. referendum, it may be too early to speak to opportunities for others from Brexit but, if the U.K. leaves the EU stage, some initiatives which have been held back by U.K. opposition may be more likely to succeed. Chief among these would be the Common Consolidated Corporate Tax Base, where the U.K. had opposed mandatory reporting. The U.K. also brought a premature and unsuccessful challenge to the proposed Financial Transaction Tax ("FTT"), on the grounds that powers of enhanced cooperation were exceeded by it, but the CJEU did not rule out a decision in the U.K.'s favor on this basis if the FTT is finally approved. This was in a pre-Brexit world and there will be questions about whether the U.K. 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.

V. Scotland

Scotland is in a difficult position: the country beyond Hadrian's Wall voted clearly to remain in the EU, but also recently held a referendum where it agreed to stay in the U.K. If the rest of the U.K. wants to leave, what happens?

The members of the U.K. Parliament who represent the Scottish National Party and their allies may be unable to prevent the repeal of the European Communities Act and the triggering of Article 50, and if so there is no clear constitutional path which would entitle Scotland to a second referendum. On the other hand, Scotland may be likely to aspire to rejoin the EU as an independent state. In that case, what price would the U.K. and EU exact for that to come to pass? The remainder of the U.K. 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 U.K." for the rest of the EU. There is currently no commitment from the U.K. 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 U.K. outside the EU would be reconciled unless the terms of Brexit were very "soft" indeed.

Richard Croker is a Partner with CMS London
He may be contacted at: richard.croker@cms-cmck.com