Executive summary

The decision by the voters of the United Kingdom (UK) to leave the European Union (EU) marks a significant change for the UK and EU and will impact other trading partners such as the United States (US). However, as the European Council President Donald Tusk has confirmed, all EU directives and regulations, as well as the treaties themselves, remain in force in respect of the UK until it formally leaves the EU. Therefore, on a legal level, nothing has changed and it is not expected to do so for the time being.

Strictly speaking, the Leave vote is advisory in nature and does not trigger a change in Government. However, the British Prime Minister, David Cameron, has chosen to resign by October 2016 when he hopes a new leader of the ruling Conservative Party will be in place. Mr. Cameron has announced that the negotiation of the UK’s exit from the EU will be under the leadership of the new Prime Minister and it will be his or her choice and that of Parliament when or if Article 50 should be activated. Article 50 is the mechanism in the EU treaties by which a country can leave and provides for two years of negotiations before a country formally exits (unless both sides reach an agreement more quickly).

It is anticipated that the UK and the EU will both wish to ensure tariff-free trading arrangements as far as possible but that discussion will be complicated by the principle of free movement of people. Separately, the UK will wish to seek new trading agreements with other trading partners such as the US. These agreements can typically take years of negotiation.
Detailed discussion

Tax issues

**Treasury tax:** This is an immediate issue. The outcome of the vote was a surprise and has led to volatility in the markets creating risks for companies in foreign exchange, interest rates and commodity prices and may lead to even more active management of these risks by treasury departments. Businesses may therefore, wish to actively review the tax regimes relevant to these activities. For example, they should consider the UK and US tax treatment of their hedging.

In addition, US groups should review functional currency elections for UK entities within the group, as well as the US subpart F rules governing foreign currency and other hedging activities. Finally, market and legal uncertainties, such as decreased liquidity and the impact of an EU exit on UK financial institutions, may impact US groups with UK treasury centers, lending platforms or cash pooling structures.

**Withholding tax:** Longer term UK groups may no longer be able to benefit from the withholding tax exemptions in the Parent and Subsidiary Directive or the Interest and Royalties Directive once the UK leaves the EU. Not all existing UK tax treaties provide for a zero withholding tax and US taxpayers with UK subsidiaries or UK intermediate holding companies may wish to review where they rely on EU directives to mitigate withholding tax.

In addition, many treaties between the US and EU Member States (including the UK) require EU membership for equivalent beneficiary treatment, a test which the UK would no longer meet. US groups reliant on such provisions should review their structures to assess future access to treaty benefits.

**EU law cases:** While the Leave campaign does not determine the actions following the vote, last week it stated that they would seek to prevent further repayments and interest being paid in respect of cases (such as the FII GLO and Prudential cases) where UK tax law was found to be incompatible with EU law. Businesses involved in these and similar cases should urgently review their position.

**EU tax initiatives:** Subject to the terms under which the UK leaves the EU, it is unlikely that the UK will be party to various tax initiatives currently underway in Brussels such as the anti-tax avoidance directive, public country-by-country reporting and the common consolidated corporate tax base. However, where the UK has supported these initiatives, it is expected that the UK will continue to move forward with similar legislation. The UK will also continue to be part of the Organisation for Economic Co-operation and Development's base erosion and profit shifting agenda.

**UK “open for business:”** The UK Government, under a new Prime Minister from September, is likely to want to promote the UK business environment and set out further incentives for companies doing business in the UK. To this end, the UK Chancellor of the Exchequer, George Osborne, has indicated that he would like to cut the main rate of UK corporation tax to less than 15%.

No announcement has been made to date of any delay to major UK tax reforms such as implementing interest restrictions under Action 4 and changes to the corporate loss rules. Legislative changes already announced and draft legislation released, such as the new Anti-hybrid rules, are not expected to be affected by the vote. However, it is too early to say whether the UK Government might reassess the question of tax reform as a result of the need for stability and the need to concentrate on managing the UK’s exit from the EU.

**Immigration:** Given immigration was a key aspect of the debate during the referendum campaign, it is to be expected that the UK will not wish to maintain the free movement of people with the EU after it leaves. However, it has been indicated that EU nationals already in the UK will retain their current status. The UK Government could introduce immigration restrictions for EU nationals from an earlier date by only giving new entrants unconditional leave to remain until the UK formally exits the EU. The UK may also wish to amend social security arrangements that the UK currently participates in for mobile workers in the EU. US nationals working in the UK already benefit from a bilateral social security agreement between the UK and the US and should therefore, not be directly impacted.

**State aid:** The EU’s State aid rules may no longer apply to the UK after it leaves. At the moment, HM Revenue & Customs is seeking to recover aggregate levy relief that was found to constitute State aid. The European Commission is also engaged in a State aid investigation into aspects of the taxation system in Gibraltar.

**VAT:** It is likely that the UK will largely retain the current system of Value Added Tax (VAT) on leaving. However, taxpayers would no longer have a right of appeal to the European Court and the UK Government would have additional flexibility in setting the rates and scope of VAT as the VAT system moves away from the EU directives on which it is based. This will provide the opportunity for lobbying for existing VAT treatments to continue or change but, also gives the UK Government the opportunity to change VAT legislation it no longer wishes to follow whereas European Court rulings relating to VAT refunds and interest may be reversed. Any changes would however, be prospective rather than retrospective.
For VAT purposes, trade between the UK and the US (and other non-EU jurisdictions) is unlikely to change. In fact, trade between the UK and current EU Member States is likely to take a similar VAT model to that for current UK/US transactions. However, US businesses with UK or EU operations will need to review the VAT implications and pay close attention to the “Brexit” developments to ensure they can adapt to any changes, in particular:

- Review current supply chains against potential Brexit trade options
- Maximize current reliefs
- Understand potential systems changes
- Model cash flow and cash funding requirements
- Factor in indirect taxes into any business transformation

**Customs and Duties:** As a current member of the EU, the UK is part of a single market, has access to a range of Free Trade Agreements and applies the Common Customs Tariff. The Common Customs Tariff is managed by the EU itself and so, after parting with the EU, the UK would need to legislate for a domestic tariff system. Furthermore, all movements from the UK to the EU and vice versa will become subject to customs declarations and formalities, and the UK will require negotiation of new trade relations with the EU as well as Free Trade Agreements with third countries. While the US does not currently have a Free Trade Agreement with the EU, negotiations are underway. To the extent these progresses, both the UK and US authorities are likely to consider negotiation of an equally favorable bilateral arrangement; the UK may welcome the opportunity to negotiate directly with the US and other important trading partners.

**Capital Duty:** The UK has been required, by EU law, to remove the 1.5% stamp duty and stamp duty reserve tax on securities issued into clearance and depositary receipt services to comply with the Capital Duty Directive. Such issues are common in the case of US listed multinationals. This requirement may no longer apply when the UK leaves the EU.

Notwithstanding that this position arises as a result of EU law, it is not clear whether the UK authorities would seek to reinstate the charge in the event of an exit from the EU.

**Regulatory/Sector considerations:** Many US multinationals trade in goods and services within the EU under EU wide regulatory regimes. This would include the provision of financial services within the EU and also for example, the sale and approvals of pharmaceutical products.

US multinationals should consider which of these non-tariff regimes are applicable to their operations and determine the impact of the UK not being part of these EU wide regulatory regimes and consider the tax implications of any necessary business model change.

**Next steps**

The UK Government has announced that it will now consider its options to leave. For example, on the one hand, the UK could explore joining the European Economic Area like Norway, or at the other extreme, leaving and relying on World Trade Organization rules. EU politicians have so far stressed that no negotiations can begin until the Article 50 (of the Lisbon Treaty) notice has been given. However, substantial progress in the UK position is unlikely until the new British Prime Minister has been installed and can set strategy. He or she may also wish to call a general election to obtain a mandate for their proposed way forward; and while the current Prime Minister has ruled out a Second Referendum, this cannot be excluded as a possibility. As noted above, once Article 50 is triggered, the UK and EU have up to two years to agree on terms for the UK’s exit and this period can only be extended with the unanimous approval all other Member States. It would be anticipated that progressing bilateral agreements with various strategic trade partners, including the US, on a series of issues, including tax, would be a priority for the UK Government during this period.

As businesses prepare for the UK to leave the EU, it is important that they consider the tax implications, including:

- The immediate foreign currency, liquidity and trade impacts that have already and/or will occur
- Dividend and interest flows and associated withholding tax costs that would result from the UK being outside EU and the related impact on group structure
- Supply chains and how EU trade flows and tariffs may impact costs
- The tax impact of any restructuring and relocation
- Issues relating to the cross-border movement of staff

Although one suggested deadline for the UK to leave the EU is not until 2020, businesses will wish to use the intervening period to assess implications and ensure they can effectively manage the transition.
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