
Potential tax implications of Brexit on industrial products and services companies

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In brief

The implications of the UK public vote to leave the European Union (EU) for the UK, the EU, and the rest of the world depend to a substantial extent on the agreed withdrawal terms, as well as negotiations with other countries. There are many misconceptions about how the referendum vote impacts taxes, but it causes no major tax legislative changes directly. However, the market volatility that we have seen since the vote could affect some tax-related issues. In addition, tax policy changes may, in time, result from what takes place. This insight covers some areas of uncertainty that may impact multinational companies (MNCs) as a result of Brexit. See our Tax Policy Bulletin [EU and global tax implications of UK public vote to leave the EU](#) for more detailed information.

In detail

The withdrawal process

Article 50 of the Treaty on European Union provides that an EU Member State that decides to withdraw from the EU must notify the European Council of its intention. Given the comments from the new UK Prime Minister Theresa May, it appears that the UK government will, at some point, notify the Council of its intent to leave the EU. This notification triggers a two-year deadline (which can be extended) for concluding negotiations.

Upon withdrawal, EU law would cease to apply to the UK. However, the UK government and Parliament would decide which EU laws, rules, and regulations to keep, amend, or

forego. It also would be necessary to repeal secondary legislation insofar as it implemented EU law or directly applicable EU regulations, but there is no reason why EU-based UK law could not remain part of UK law as long as the law still works without the UK being in the EU.

Choices for alignment

The decisions as to which EU-related law the UK Parliament chooses to keep may be influenced by the nature of the withdrawal agreement and, in particular, whether one of the main routes to continued realignment with the EU is adopted. It has been widely speculated that the UK would wish to enter into some form of free trade agreement (FTA) with

the EU and the remaining EU Member States. Much would depend on the scope and terms of that agreement.

Broadly, there are two main possibilities. First, the UK could negotiate either a customs union or bilateral FTA with the EU, as have Turkey and Switzerland, respectively. Second, the UK could remain a member of the European Economic Area (EEA), but as a non-EU Member.

The EEA currently includes all the EU countries as well as Iceland, Liechtenstein, and Norway. This process also would affect the need for the UK to negotiate trade deals separately with non-EU/EEA countries.

People and tax

Although movements of people and workers from the UK to the EU and vice versa should not be affected before withdrawal, employers should plan for the tax related-changes Brexit may bring. For example, cessation of EU regulations on social security coverage and benefits could lead to increased social security costs, lack of benefit coverage, and fragmentation of pension benefits. In addition, greater freedom from EU regulations could impact UK tax rules as they relate to entitlement to personal allowances as non-residents, pension regulations, and workers' rights.

The possibility of the UK negotiating a form of freedom of movement of labor distinct from the freedom of movement of people could be attractive to those in the UK concerned about immigration issues, but would bring into question the position of temporary arrangements, business visitors and workers when they retire and the need to monitor working arrangements.

See our Global Mobility Insights [United Kingdom: Employer and employee implications of the vote to leave the European Union](#) and [UK: Social Security Implications of the vote to leave the European Union](#) for more information.

Indirect taxes

Of the various consumption taxes, customs duties and the value added tax (VAT) are most directly affected by Brexit as they are directly determined by the EU. The VAT Directive and all EU regulations relating to VAT would cease to apply

on the UK's withdrawal. Barring any agreement to do otherwise, VAT in the UK would become a purely domestic tax and, in the course of time, the rules may diverge from EU rules, with the UK potentially introducing and removing exemptions without regard to EU law.

The potential impact on customs duties is widely regarded as one of the most significant implications of a full withdrawal from the EU. Goods imported into the UK have customs duties set by the EU. If the UK does not join the EEA and there is no agreement on a separate customs union or FTA with the EU, the UK would set its own rates on exports and imports with EU countries and non-EU countries. If the UK joins the EEA, it would still set rates for transactions with non-EEA countries.

Direct taxes

Direct taxes are not within the competence of the EU, but are the prerogative of each Member State. All Member States can agree to Directives that require them to introduce laws on direct taxes into their domestic tax systems. Brexit has no direct impact on provisions that have been made in the UK tax legislation as a result of various Directives, but the UK may choose to keep, adapt, or remove them, subject to any withdrawal or other agreement. However, other Member States will no longer be bound to apply their equivalent domestic rules related to transactions with the UK other than as per the withdrawal agreement, so UK taxpayers could potentially lose various protections.

Most historic Directives relating to direct taxation afford a degree of beneficial treatment, which would not apply under the EEA agreement or if no bilateral agreement is reached. More recent and proposed Directives impose greater obligations on Member States. Potential consequences relating to these various Directives are discussed in our Tax Policy Bulletin [EU and global tax implications of UK public vote to leave the EU](#).

The UK has been keen to encourage and promote particular direct tax policies, which have had to comply with State aid rules. There may be more opportunity for the UK to help particular segments through tax policy following withdrawal, although State aid or similar rules would apply to the EEA agreement or could be part of any bilateral agreement).

The takeaway

MNCs should start assessing factors that will be relevant to their tax position on a UK withdrawal from the EU. In most cases, immediate action is not required to prevent negative tax consequences, but MNCs should be fully informed, show awareness, and address any concerns raised by employees, their supply chain, and other stakeholders. The UK government is reviewing the breadth of issues that need to be considered in withdrawal negotiations and consequential UK policy changes. MNCs are encouraged to engage in the process and make known their concerns and preferences regarding tax issues.

Let's talk

For a deeper discussion of how these issues might affect your business, please contact:

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