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Consequences of Brexit for the financial sector

A Dutch tax perspective

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Introduction

Will Amsterdam become the new "City"?

Consequences of the Brexit for the financial sector

After several weeks and months of intense debate the British public has spoken and made clear that it sees the UK's interests best served by leaving the European Union (EU).

Clearly nothing will change in the short term, but the consequences on the medium/long term of the UK's leaving the EU from a taxation perspective are significant.[1] In addition, the Brexit may impact the position of London as one of the key financial centers in the EU.

In that context, this document provides an overview of some of the expected Direct and Indirect Tax consequences for Dutch businesses. Also, we briefly address our viewpoint on the developments that will take place in the near future.

1 Legal Framework

1.1 Secession

The current Brexit vote will trigger a secession process – a negotiation about exit terms – that is likely to take several months at least. Until agreement on secession is reached (or, possibly, for two years in the absence of agreement or longer if there is an agreement to extend the period for negotiation), EU laws and treaty obligations continue to have effect. The UK may elect to remain part of the EEA after the Brexit. This may however not seem likely since, amongst others, the UK will then remain to be faced with the free movement of persons.

1.2 Taxation

Currently, the level of harmonization on EU-level in the field of taxation varies significantly between different types of taxes.

As a consequence of the Customs Union, there are no customs duties within the EU's territory, and Member States share common external tariffs with third countries. As a consequence of the VAT Directive, the Member States share a common VAT system.

Corporate taxes are in principle not harmonized. It was envisaged that corporate income taxes would remain within national competencies. While a handful of Directives target specific obstacles to cross-border activity most important are those regarding withholding taxes.

[1] Certain parts of the UK, e.g. Scotland and Northern Ireland, will perhaps try to remain in the EU.

1.3 Regulatory
If the UK leaves the EU (and the EEA), UK-based banks and investment firms will lose their automatic access to the EU passports. These parties will either have to establish an authorized entity in a Member State to obtain EU passporting rights. This will also apply to third country banks and investment firms that have established UK subsidiaries to obtain EU passporting rights; they will have to re-domicile elsewhere in the EU.

2 Direct Taxes
2.1 Directives
The EU has implemented a number of harmonizing Direct Tax Directives intended to support the internal market. The most important are the Parent-Subsidiary Directive, the Mergers Directive and the Interest and Royalty Directive. Not being able to rely on these directives reduces the protection against withholding tax becoming due on payments vis-à-vis the UK (dividends, interest, royalties). Further, tax neutral cross border (de)mergers, transfers of assets and exchanges of shares with companies in the UK may not be possible anymore once the UK has left the EU.

2.2 Transfer Pricing
Further to BEPS, transfer pricing has become one of the main focus areas of tax authorities. The EU Transfer Pricing Arbitration Convention stipulates a procedure for disagreements in the area of transfer pricing within the EU. Once the UK leaves the EU, companies cannot rely anymore on the protection of the Transfer Pricing Arbitration Convention if they seem themselves faced with transfer pricing mismatches in relation with the UK. The mutual agreement procedure under the double tax treaty between the UK and the Netherlands should however remain available.

2.3 Other
Cross border corporate income tax fiscal unities with UK companies may cease to exist after the UK has left the EU. Parties should therefore be aware that tax neutral transfers within such fiscal unity may result in a taxable event at a later stage (claw back).

3 Indirect Taxes

3.1 VAT

VAT is a supposedly fully harmonized tax that is currently governed by EU VAT Directives and Regulations, decisions from the CJEU, etc.

With effect from the date of secession the consequences would be:

3.1.1 ECJ-court cases would not apply

UK taxpayers will no longer be able to rely on the "direct effect" of certain EU laws and the teleological approach to the interpretation of UK VAT law (which has its origins in the way that EU law is written and interpreted) may be less widely applied. The UK courts will revert to interpreting the UK provisions and not European Court of Justice.

3.1.2 Import VAT – relevant for commodity trading

The most tangible consequence of Brexit would likely be the imposition of "import" VAT when goods enter the EU from the UK, and when EU goods enter the UK. This is relevant for financial institutions that perform commodity trading. For these financial institutions the VAT would often be recoverable – but there may be an unwelcome cash flow cost for the period between import and recovery.

3.1.3 Wider application VAT exemption in UK – Cross border arbitrage

Future governments could consider such changes as the VAT-exempting outsourcing in financial sector or the widening of the insurance intermediary exemption.

3.1.4 Additional VAT pro rata deduction

When UK leaves the EU financial transactions between UK and the EU will from an EU point of view be considered to be VAT-exempt with the right to deduct. This will have a direct benefit for EU (and NL) financial institutions.

3.1.5 Other consequences

A number of other compliance consequences are to be expected, such as changes in Intrastat reporting and mini-one stop shop (MOSS) VAT returns.

3.2 Customs Duty

Perhaps the biggest Customs Duty related change that businesses are likely to see will be the recognition of trade with EU countries as imports and exports. Depending on the outcome of the secession negotiations, this may mean that duty is payable when goods move to and from EU Member States. This, and the related import and export formalities have the potential to result in some impediment to trade.

3.3 Excise Duty

Following Brexit EU level influence on Excise Duty would be released. However, since Excise Duty rates are not fully harmonized at present this is unlikely to result in material changes to rates in the UK market.

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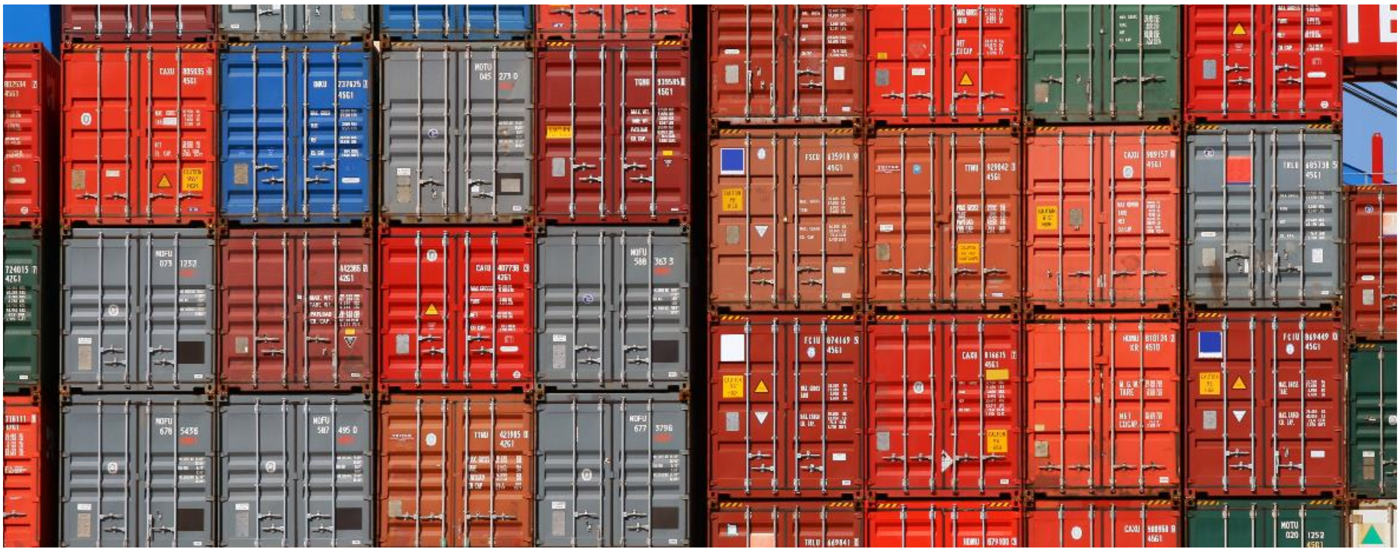
Transactions with UK customers will be considered VAT-exempt with right to deduct.



As with Customs Duty, movements of excise goods between the UK and EU Member States will be treated as imports or exports. Subject to any agreements reached during the secession negotiations, this is likely to mean that such movements will be subject to different procedures than the current "intra-EU trading" rules.

3.4 FTT

It is not anticipated that the UK leave will have an impact on the likelihood of the introduction of a European Financial Transaction Tax (FTT). The possible introduction of such FTT may nevertheless be relevant in this context. Parties that are considering to establish an authorized entity in another Member State to secure EU passporting rights (see also 1.3) may deem relevant whether or not that specific Member State already has an FTT or is in favor of introducing an FTT. Under the current European proposal, the Netherlands are not in favor of introducing an FTT. Further, the Dutch Government has expressed that if an FTT were introduced in the Netherlands, it wants to abolish the Dutch bank tax.

4 Systems and controls

It may require considerable planning and resource to implement the changes described above within the ERP systems and compliance processes currently used by businesses to account for VAT. For example, tax codes and client reference data may need to be thoroughly reviewed and updated and compliance procedures, as well as spreadsheets or automated tools used in the VAT return preparation process, would need to be amended.

5 Expectations for EU financial centers

For a long time, London has arguably been the most relevant financial center of the EU and perhaps the world. A Brexit could impact that leading position as financial institutes may consider relocating their headquarters to another city to maintain easy access to the European market. Main contestants are Frankfurt and Paris, but also Amsterdam. Amsterdam is an attractive alternative due to its central geographical location, its good IT infrastructure, highly educated staff and relative low cost of living. In addition

Amsterdam has positioned itself as a center for innovation which is one of the major challenges facing the financial services industry in the coming years. In the period to come, the Dutch government will likely consider its ambitions for the city of Amsterdam.

6 Conclusion

Time will tell us what exactly will happen and what the scope of the changes will be. In the short term the Brexit may not yet have that many immediate tax consequences and a model similar to Norway or Switzerland seems to limit short term adverse consequences.

However in the long term, especially looking at Indirect Tax which is almost fully harmonized on an EU level, it may very well be so that countries such as the Netherlands will gain importance as a financial hub into Europe. International companies that need to be close to their transactions and these gateways in a physical sense may for example again consider these countries as favorable.

This may yet again put some emphasis on the administrative and practical trade enhancing measures that certain EU countries have or have not implemented in their national legislation. All in all these could be a major competitive considerations that multinationals operating internationally should take into account.

It goes without saying that it will be important to prepare for the changes, especially the systems changes that often require quite some advance planning.

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