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Brexit: highlight of the major potential tax ramifications

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On June 24 the British people voted in favour of the UK leaving the EU. The vote itself does not automatically imply the withdrawal from the EU: indeed, such withdrawal shall take place pursuant to Article 50 of the EU Treaty, which requires in the first place the notification of the intention to leave the EU by the UK to the European Council. The UK will then have to negotiate with the EU the terms and the conditions of its withdrawal. For the time being, the terms of the UK withdrawal from the EU cannot be foreseen and, therefore, the consequences of such withdrawal are still uncertain. Hereby, we highlight some of the main tax consequences, regarding the relationship between the UK and Italy, which might derive from the UK withdrawal, bearing in mind that such consequences will be affected by the outcome of the aforementioned UK-EU negotiations and by the possible permanence of the UK in the European Economic Area (in which case some of the rules below would continue to apply).

In terms of primary EU law, the UK withdrawal will imply that the EU fundamental freedoms laid down in the EU Treaty will no longer apply in relation to cross-border economic activities between the UK and Italy, with the exception of the free movement of capital which will still apply vis-à-vis third (i.e. non-EU Member) States. This implies e.g. that UK companies setting up subsidiaries or branches in Italy will not be protected from discriminations in Italy pursuant to the EU freedom of establishment. Obviously, double tax treaty non discrimination rules will continue to apply and the UK and the EU may agree for the fundamental freedoms to continue to apply in their relations. Again on primary EU law, following its withdrawal, the UK will no longer be bound by the State aid ban embodied into Article 107 of the EU Treaty: this may grant more flexibility to the UK in terms of introducing attractive tax regimes for local businesses.

Given the above it is likely that many domestic tax rules, which apply in the relations with EU Member States, will no longer apply to the UK. This is the case, for example, of the Italian reduced domestic withholding tax on outbound dividends paid to entities that are resident of an EU Member State and subject to corporate income tax therein (and not qualifying for the exemption under the Parent Subsidiary Directive, described below). Another example could regard the Italian deferral of the levy of exit tax upon the transfer of residence to an EU Member State (it is to be investigated whether the UK withdrawal from the EU might lead to the termination of the deferral regime for transfers to the UK occurred prior to the UK withdrawal on the ground of the provisions whereby the deferral regime is terminated when there is a subsequent transfer from the foreign EU Member State to a third State). Also rules on domestic consolidation regimes could no longer apply. For example, Italian rules allowing fiscal unity between resident sister companies controlled by a parent company that is resident of an EU Member State will not apply anymore in the event of

common control by a company resident of the UK.

In terms of secondary EU law, the UK withdrawal will trigger the non-application of the EU Directives and Regulations in the relations between EU Member States and the UK. With particular reference to tax law:

The Parent Subsidiary Directive, which provides for an exemption for inbound and outbound dividends paid between qualifying EU companies of different EU Member States, will cease to apply in the relations between EU Member States and the UK. Therefore, for instance, dividends paid by Italian subsidiaries to UK parent companies will become subject to withholding tax at the domestic tax rate, as reduced by the UK-Italy tax treaty (and, possibly, by the free movement of capital). Furthermore, also the Interest and Royalty Directive, which provides an exemption from withholding tax on outbound interest and royalty payments between qualifying associated companies of different EU Member States, will cease to apply in the relations between EU Member States and the UK, so that previously exempt cross-border interest and royalties will become subject to withholding tax in the State of source. Needless to say, the UK, similarly to Switzerland, may negotiate with the EU the application of a regime, for UK-EU cross-border dividends, interest and royalties, substantially similar to the regime under the aforementioned Directives. Absent this, the structure of corporate groups will need to be reviewed in order to minimize the adverse consequences deriving from the different legal framework.

The Merger Directive, which grants, under certain conditions, a tax-free (neutral) regime to restructuring transactions between qualifying companies of different EU Member States, will cease to apply in the relations between EU Member States and the UK, so that cross-border reorganisations may become more burdensome (aside to this, also the legal framework of cross-border mergers could change since corporate law directives would no longer apply too);

The Directives on exchange of information and assistance in the recovery of tax claims will cease to apply in the relations between EU Member States and the UK. However, information between the Tax Authorities could still be exchanged under the relevant rules of international tax law, including double tax treaties and the Multilateral Convention on Mutual Assistance in Tax Matters.

For the purposes of the Anti-Tax-Avoidance Directive approved on 12 July 2016, which obliges Member States to introduce in their domestic legislations five anti-abuse measures against common forms of aggressive tax planning, it remains to be seen whether the UK should be regarded as a third State. This will depend on the status that the UK will acquire upon the termination of the negotiation. In case Member States will regard the UK as a third State the tax regime of participations in subsidiary companies resident of the UK may be negatively affected by controlled foreign company rules contained in the Directive.

Further and foremost, in terms of indirect taxes, not being bound by the VAT system, supplies of goods from the UK to the EU and from the EU to the UK will not qualify as intra-Community supplies but, rather, as importations (subject to VAT) into the EU or exportations from the EU respectively. This will also have an effect in terms of VAT obligations. For instance, UK established persons will need to appoint a VAT representative in order to exploit VAT rights and comply with obligations whilst, for EU taxable persons, VAT registration can be done directly.
Moreover, the withdrawal from the EU will put the UK outside the single trading area and, therefore, supplies of goods from the UK to the EU will be subject to excise duties upon their import.

The UK withdrawal from the EU will further imply that so called European soft legislation (codes of conduct, recommendations, communications, etc) will not be addressed to the UK anymore. For instance, despite the fact that the UK withdrawal will not affect by itself the application of the Arbitration Convention on transfer pricing adjustments involving companies resident of the UK (since the Arbitration Convention is not EU legislation but it is a multilateral tax treaty signed by individual States, including the UK), the code of conduct issued by the EU Council for the effective implementation of such a convention will not be addressed anymore to the UK. Furthermore, EU Member States will not be addressed anymore by the same code of conduct in relation to transfer pricing adjustments involving companies resident of the UK since the above code of conduct deals with the application of the Arbitration Convention (and tax treaties) to transfer pricing adjustments between affiliated companies resident of different EU Member States. As a further example, the Commission Recommendation of 28.1.2016 on the implementation of measures against tax treaty abuse, part of the Anti-Tax-Avoidance Package together with the aforementioned Anti-Tax-Avoidance Directive, will not be addressed anymore to the UK once outside the EU.

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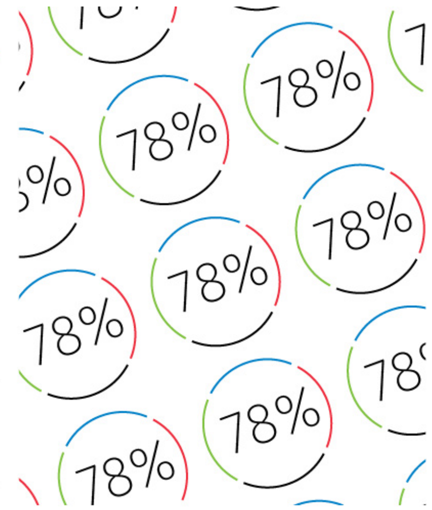

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