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Brexit and EU Direct tax measures: Keep calm and stumble on

Jonathan Schwarz (Temple Tax Chambers; King's College London) · Tuesday, July 24th, 2018

What the UK government wants by way of Brexit outcome seems to change daily, with the government and political parties in Parliament divided among various factions. The only legal certainty about Brexit is that unless the UK and the remaining member states agree otherwise, EU law will cease to apply in the UK after 29 March 2019. See [Brexit: Transition brings tax-related controversy](#).

Draft legislation, with accompanying policy papers, published by the UK Treasury on 6 July to implement EU directives that give effect to the OECD/G20 BEPS actions may give some clues to the thinking in the UK Treasury on Brexit. Each policy paper states:

“Until exit negotiations are concluded, the UK remains a full member of the European Union and all the rights and obligations of EU membership remain in force.

During this period the government will continue to negotiate, implement and apply EU legislation. The outcome of these negotiations will determine what arrangements apply in relation to EU legislation in future once the UK has left the EU.”

While the Treasury mis-states the legal effect of Article 50 of the Treaty on European Union, does it imply a more optimistic view about the continued UK application of EU tax law during the proposed “transitional period”? The draft withdrawal agreement provides for a 20 month transition with certain EU law applying in the UK until December 2020.

ATAD

The Anti-Tax Avoidance Directive (ATAD) Directive 2016/1164 (Council Directive (EU) 2016/1164 of 12 July 2016 Laying down rules against tax avoidance practices that directly affect the functioning of the internal market) must be given effect by member states from 1 January 2019 (Discussed in *Schwarz on Tax Treaties, 5th Edition*, Chapter 14). The draft legislation and related policy papers identify three areas in which UK rules will be amended from 31 December 2018 to comply with the ATAD:

Hybrid mismatches

The UK enacted hybrid mismatch rules to give effect to BEPS Action 2 in Finance Act 2016 which came into effect on 1 January 2017. The draft legislation is designed to make the UK law comply with the requirements in relation to the exemption of certain regulatory capital in Article 9(4) of

the ATAD and those in relation to the treatment of disregarded permanent establishments Article 9(5).

Provisions relating to ‘reverse hybrids’ in Article 9a introduced by EU Directive 2016/1164 only require implementation by 1 January 2022. No commitment is made on these other than to consider them “in due course”.

CFCs

Two changes to the UK CFC rules are proposed to comply with ATAD. These relate to the definition of control, and the treatment of certain profits generated by UK activity. The UK CFC definition of control does not take into account interests held by non-resident associated parties, unlike Article 7(1)(b) of the ATAD, which requires all associated enterprises to be taken into account for this purpose.

Article 7(2)(b) of ATAD identifies profits that have been generated by significant people functions (SPFs) carried out by a controlling company in a member state as CFC profits. The UK CFC rules bring non-trade finance profits into the scope of the CFC charge where any of the SPFs are carried on in the UK, but these profits may qualify for an elective group finance company exemption. This exemption is also the subject of a [European Commission State aid investigation](#). The elective exemption will not apply to these profits from 1 January 2019.

Exit tax

Deferral of payment of the UK corporate exit tax when companies transfer residence to another EU or EEA member state, or when assets cease to be within the charge to tax of a UK permanent establishment of a company resident in another EU or EEA member state may be by the standard instalment or the realization method. This is to be replaced by a single exit charge payment plan process, adopting the deferral rules in the ATAD. The maximum deferral period will be five years (or less in certain cases).

This deferral will only be available if the EEA state to which residence or an asset is moved is party to the “provisions of the agreement for the Mutual Assistance on Recovery of Debts”. Does the Treasury mean the EU Directive 2010/24 or a treaty to the same effect?

UK law will for the first time provide a step-up in base cost of assets that come within the charge to Corporation Tax in respect of which an exit tax is imposed at market value on the asset by an EU or EEA member state.

Dispute resolution: shoot first, ask questions afterwards

Directive 2017/1852 on double taxation dispute resolution (Council Directive (EU) 2017/1852 of 10 October 2017 on tax dispute resolution mechanisms in the European Union) applies to intra-EU disputes relating to income earned in a tax year commencing from 1 January 2018 for cases submitted from 1 July 2019. Competent authorities of Member States may agree to apply the Directive to cases submitted earlier or to earlier tax years. See [EU sets the standard for international tax dispute resolution](#) and *Schwarz on Tax Treaties* Chapter 21.

UK legislation will allow the Treasury to make regulations for or in connection with the implementation of the directive. This remains in a legislative black box. Nonetheless, most of the

directive is of direct effect and taxpayers may therefore rely on its provisions even in the absence of enacting legislation by member states. Although the UK European Union (Withdrawal) Act 2018 broadly aims to converting EU law at the point of exit into UK legislation, the doctrine of direct effect of directives is excluded by s. 4(1). Taxpayers seeking to rely on the directive may want to consider invoking it anyway with other procedures and then considering its legal effect in due course.

Automatic exchange of reportable cross-border arrangements

The UK was an early adopter of legislation requiring advisers, promoters and users of tax avoidance schemes to disclose their plans before implementing them (Disclosure of Tax Avoidance Schemes, Finance Act 2004, Part 7). EU Directive 2018/822 as regards mandatory automatic exchange of information in the field of taxation in relation to reportable cross-border arrangements amends Directive 2011/16/EU (Examined in *Schwarz on Tax Treaties*, Chapter 22) by imposing additional obligations on member states to exchange information on such schemes that have a cross-border element.

Legislation will authorise the Treasury to enact regulations to require persons to notify certain cross border arrangements to HMRC to implement the Directive by 31 December 2019. As with much of the UK Brexit-related law, extensive use of so called Henry VIII powers (which give the Executive broad law-making powers) is made to shape the post-departure legal environment.

EU Commission: business as usual

The Commission also maintains that the UK remains a full member of the EU. On 19 July the Commission issued two reasoned opinions (letters before legal action) to the UK with respect to non-compliance with EU VAT law rules, one on the lack of administrative cooperation concerning the VAT Mini One-Stop-Shop and the other on VAT treatment of certain commodity markets. It also issued a (precursor) formal notice to the UK to align its rules on income tax relief for losses on disposals of shares with EU law. The UK income tax loss relief in question, applies only in respect of shares in companies which trade wholly or mainly in the UK. The Commission considers that these rules infringe the free movement of capital.

Recent UK opinion polls suggest the most popular view is to remain in the EU rather than have an unsatisfactory exit with only a very small minority backing a hard Brexit.

Whether the UK implementation of the ATAD will only last for less than 90 days in 2019 remains to be seen. Will UK taxpayers benefit at all from the international tax dispute resolution directive or other measures intended for future implementation? There is still plenty of time for common sense to prevail. It is hard to believe that these steps towards compliance with EU law by the UK Treasury are only intended to have a brief transitory life.

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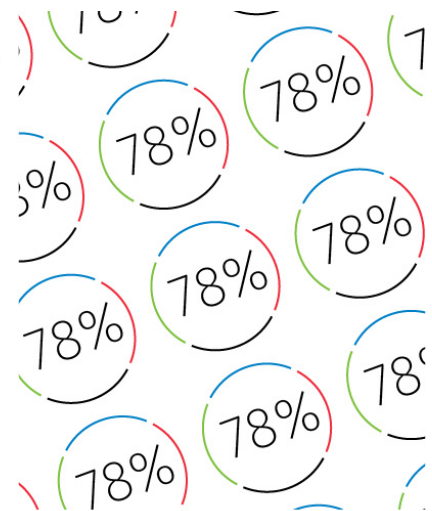
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