Brexit: A Brexit/Corporate Tax Mini Primer - Part 10 [VIDEO]

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Jeff Hay and Doug Wood discuss taxation of U.K. based companies as well as the implications of the U.K. being on the “outside looking in” in terms of tax withholdings for multi-national companies- planning opportunities and pitfalls, in this latest addition to our multi-part video series discussing the U.K.’s decision to leave the EU and the potential challenges and opportunities Brexit poses for businesses on either side of the Atlantic.

Jeff: Cause, that’s why you’re here. What effect is Brexit going to have on the tax system for the UK?

Doug: I think it is helpful to think about taxes, and you’re talking about the taxation of a UK base company. Let’s ignore for the moment that the cross boarder aspects of it, but tax folks tend to put taxes into two broad camps. One is direct tax, one is indirect tax. A direct tax would be things like corporate income tax. Indirect tax would be things like VAT or certain tariffs such as customs. For a direct tax perspective, we don’t see a tremendous amount at stake at least in the interim. I think one of the prior panelists made reference to the fact that the UK’s already got a relatively low corporate tax and if you listen to what’s been talked about publicly, it’s going to trend even lower. That clearly creates a more favorable environment. If you transition to the indirect side, that’s where things arguably could get more interesting quicker. Depending on how individual trade negotiations pan out, you very likely could have a situation where the UK is on the outside looking in and so transactions between the EU and UK are no different absent a trade agreement than the United States or China or another country and there you get into a host of issues around the application VAT, the application of customs, all that is kind of consistent with a little bit of the theme here today. It has a little bit of wait and see.

Jeff: OK, so US multi-national companies who have use the UK for a variety of tax planning purposes can you talk a little bit about how Brexit might change that going forward.

Doug: Sure, it is very common for US based multi-national, even if they don’t have robust operations in the UK, they nonetheless use the UK as a strategic jurisdiction in cross border tax planning so for instance, it’s very common for a UK multi-national to have a UK holding company and that UK holding company in turn will own investment throughout the EU or perhaps throughout the world. The attractiveness of that from a strategic standpoint at least within the EU is the ability to move cash whether that be in the form of a dividend or an interest payment or a royalty payment. Between those borders without the imposition of a withholding tax and that's all by virtue of being a member of the EU. If you transition to an environment where the UK is again on the outside looking in, then whether or not there is a withholding tax is a function or whether or not the UK has an individual bilateral income tax treaty with that other jurisdiction. So if a UK holding company owns a Germany operating subsidiary for instance, today that dividend can go from Germany to the UK, no withholding tax and the way the UK system operates, there's no UK corporate income tax on that dividend either, outside that EU protected zone, there very likely would be a withholding tax and very likely would not be creditable in the UK. So that would a dead cost to moving that cash around. Similarly on using the UK as a finance center, using the UK as a place to own IP and charge royalties or interest streams to the operating companies. That withholding tax could ultimately become a drag that affects the efficacy of the tax efficiency of using the UK in that context.

Jeff: Is that all stuff that will on the table in the negotiation and do you have a view on where that's likely to end up?

Doug: I do, it absolutely will be on the table. The degree to which it becomes a hot button issue, a little bit of that depends on the relative strength of the UK treaty network as it currently exists or it might look years from now. They already have a real bust treaty network so there are not an insignificant but there are a handful of countries where this is going to be problematic so I think you see it coming up in negotiations where there are those specific points of paying.

Jeff: OK, you know Jon talk a lot about effective currency on his business which you know we've seen across the board in terms of companies either exporting to the UK or having operations there. Does that create any planning opportunities or other tax effects?

Doug: Sure and again let's talk about it a little bit from the perspective of a UK company and what happens at the UK level and then we could also talk about it a little from a cross border perspective. For the most part and there are some exceptions to this, for the most part, currency gains and the losses are taxable transactions when they happen within that UK corporation. So to the extent you are suffering a business currency gain or loss, it's going to affect taxable income. There is an opportunity there to the extent that some of those transactions are happening in related party context for instance. And so the UK might be the creditor or a debtor in an intercompany lending arrangement. You have an opportunity to affirmatively decide which side of the transaction is going to take the currency risk. And you can make that decision in light of effective tax rates as between those two jurisdictions. I do think there's an opportunity to look at your treasury operations. There's an opportunity to look at where you own a licensed IP with an eye towards putting that currency gain or loss in the tax efficient jurisdiction. If I transition and I look at from a US multi-national perspective, there are a couple of rather unique opportunities associated with the devaluation of the pound that people probably could and should stake a look at at the hearing now. So this kind of falls in the camp of something you might not want to wait any longer to evaluate. To the extent that you are a US based company and you've decided, this is not all that uncommon to treat your UK operation as a tax transparent or flow through entity if you will, treat it as a partnership. And that's an election you can make for US tax purposes and that's not uncommon. You see if very often from the perspective of a start-up operation in the UK and you want to import those losses into the United States. You might very well structure that in a way to tax US money as losses. Well, you know at some point business becomes successful no matter what paying tax. That same structure is actually disadvantageous and it can create a tax liability to get out of the devaluation of the pound. It's actually creating an opportunity for you to get out of that tax transparent structure and do it in a way that's essentially or could be essentially tax free. There are also opportunities associated with organization that own not only a UK operating holding company but also a variety of operating or holding companies in other jurisdictions and you might want to reorganize internally the way you own those. Typically that can also create tax liability for a US based multi-national and the fact that the pound is devalued versus the US dollar as well as other currencies creates the opportunity to do some of that now under the cover that fictitious law if you will. And you can do some of that planning in a way that actually affords you an opportunity to check cash out of the UK or other European operations on a very tax efficient or perhaps even a tax free basis.

Jeff: So you talked about you're seeing this issue from both sides of the English Channel, what's interesting to you, or what's the other side of the coin so to speak on these issues?

Doug: So it is interesting in preparation for today, I actually reached out to a couple my partners in our member firm and their bias is obviously to paint a picture that is favorable as possible. The UK is open for business and I personally happen to believe that strongly. At the same time, if you go talk to a tax professional in the Netherlands or Germany or Belgium, some of the other jurisdictions that compete if you will for headquarters location, you can certainly see friendly sharp elbows perhaps. Some of these other jurisdictions are being a little opportunistic as it relates to going out and playing up, there used to be a sort of objective conversation about the pros and cons. You can line up the tax attributes of doing business in jurisdiction A versus B, you can build data points to make a business decision. Now you've got that added component of the uncertainty or what's going to happen post-Brexit as it relates to the practicableness of the UK. And some of the other jurisdictions I do think are you know designing marketing materials if you will around those opportunities.

Jeff: So in our own region we have a border between us and South Carolina and an economic consent of battle that goes on all the time. You know the UK has been a leader in the EU from a corporate tax reform effort to close tax jurisdiction shopping in tax avoidance. Do you see this changing with Brexit, does it create an opportunity for the UK to forge a different path in these war and tax incentives, to shop for business or how do you see that playing out?

Doug: I do. At the same time it's an admittedly fine line that they need to walk. If you look at the global conversation around international tax reform, the acronym that you'll probably bump into the most is BEPS. That's an OECD led initiative. BEPS is an acronym for Base Erosion in Profit Shifting. And it really is designed at the highest level to suggest a body of wheels to jurisdictions throughout the OECD as a guideline. You adopt this type of rule and it will help us come back if you will, at least the perception that large multi-national companies are able to take advantage of arbitrage, the respect of rules between jurisdictions. And at the same time as your question suggests, is there unhealthy tax competition going on somewhere between North Carolina and South Carolina, Georgia? the UK has been a very strong proponent of BEPS. And they've got some internal rules that are actually out in front of BEPS, the diverted profits tax would be a very good example of that. And I continue to think there's very strong political support in the UK for all things BEPS. At the same time you see this lowering, lowering, lowering of the base line corporate rate. So I do think there's an opportunity for the UK to become a more attractive jurisdiction on the tax planning perspective. But I think it needs to be done with a little bit of an eye on caution about the optics of what that might look like. At the same time there are EU driven perspectives that go well beyond BEPS. ATAD is another acronym that you might hear. It's a set of rules that takes the outline of BEPS and actually adds more rigor to it, in a way that a lot of countries including the UK aren't necessarily on board with. And so a UK outside of the EU would allow them the freedom of flexibility to only pick up the pieces of that global tax reform that they think is a right fit for the UK.

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