BREXIT – TAXATION ISSUES

Tax Strategy Group – TSG 17/09

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Introduction

1. This paper examines the implications of the decision of the UK to leave the EU on the administration of taxation in Ireland. While the full impacts will not be clear until negotiations have been finalised and the details of any agreement between the EU and the UK are made public, it is important to consider the possible scenarios depending on the outcome of these negotiations.

2. Before doing so it is important to acknowledge the steps taken already in the context of making Ireland Brexit ready. Budget 2017 introduced a series of measures to enable indigenous enterprises that are small in scale and have relatively low profit levels to remain competitive and to trade in diversified markets. These measures include:

- Reduced Capital Gains Tax to help entrepreneurs
- An extension and amendment of the Foreign Earnings Deduction to help Irish exporters to diversify their export and import markets
- An extension of the Special Assignee Relief Programme to assist businesses to relocate key staff to Ireland
- An increase in the Earned Income Tax Credit for the self-employed tax payers to encourage entrepreneurs
- The introduction of an income averaging “step-out” in the agriculture sector to help with expected volatility in demand for agri-food products following severe price fluctuations
- The retention of the 9% VAT rate to help tourism and hospitality sector to maintain competitiveness in light of recent current movements.

3. This paper looks at the impact Brexit will have on the administration and collection of individual taxes, as well as the impact on Exchequer revenues. The paper also examines the possibility of a disorderly Brexit, where the UK leave the EU without any agreement in place.

4. The paper is divided into the following parts:

- Direct taxes
- Indirect taxes

- Disorderly Brexit
- Other Issues

Direct taxes

5. Brexit is unlikely to have a significant impact on our direct taxes, given the fact that the double taxation agreement between Ireland and the UK will be unaffected by Brexit.

6. Ireland has always monitored income tax rates in the context of tax competition and in this regard, Brexit will not impose an additional challenge. However, the competitiveness challenge could increase should the UK adopt a policy of aggressive income tax cutting post Brexit.

7. Of potentially more impact could be a future UK unbound by State aid rules and therefore in a position to undercut Ireland in terms of tax incentives and funding aids to enterprise. Some existing schemes provide tax relief for investments in SMEs and relief for entrepreneurs, which Ireland has mirrored to some extent taking account of Ireland specific factors when tailoring design.

8. The benefits of any reduced income tax rates and any additional incentives for UK business, would need to be considered in concert with any new trading arrangements that could involve the imposition of tariffs or levies for goods and services exported from the UK.

9. The Income Tax Reform plan published last year, compared Ireland to a number of other countries, including the UK, with regard to income taxation. The report found that Ireland has a comparatively low tax burden on labour, particularly at low and middle income levels. This has consistently been the case since 2000. At 167% of average earnings, the average tax burden increases above the comparative tax burden in the UK and above the OECD average. However, it is still below the average for the 21 EU Member States within the OECD.

10. The medium-term income tax reform plan is designed to keep the tax base broad, reduce excessive tax rates for middle income earners, and limit the benefit for high earners. Issues of competitiveness, including those related to the evolving income tax

regime in the UK, will continue to be considered in the development of the Irish income tax policy, as part of the annual Budget process.

11. From a corporation tax perspective, Brexit will take the UK outside the scope of EU Direct Tax Directives. Recent Directives require Member States to implement OECD Base Erosion and Profit Shifting (BEPS) recommendations into EU law. While the UK would no longer be bound by these Directives, the UK has been a consistent and strong supporter of the OECD BEPS project and continues to actively implement the BEPS recommendations into domestic UK law. The Great Repeal Bill will transpose all of these EU laws into UK law on the day the UK formally exit from the EU. However, post Brexit the UK can amend this legislation as it so wishes.

12. More longstanding EU Directives regulate the tax rules relating to cross border flows of interest and dividends between Member States. While both countries would have more freedom in this area post-Brexit, domestic legislation and the longstanding Ireland/UK Double Tax Agreement would provide certainty as to the taxation of such flows.

13. There has been speculation around the corporation tax plans of the UK post-Brexit. In this regard it should be noted that the UK's intention to reduce their corporate tax rate (currently at 19% but to be reduced to 17% by 2020) was announced in March 2016 well in advance of the Brexit vote. This was the next step in a consistent strategy to reduce the corporation tax rate. The UK has been competitive on corporation tax in recent years and is likely to remain so regardless of the form Brexit takes. The planned gradual reduction in the UK's corporate tax rate was restated in the UK Spring Budget announcement 2017. From a corporation tax perspective, Brexit would not have any impact on the UK's ability to set its own corporate tax rates. Tax rates remain within the exclusive competence of Member States and all Member States are free to set their corporation tax rate as they see fit.

14. It is also important to remember that EU tax rules can only be changed by unanimous agreement of all Member States, and Brexit does not impact this.

Indirect taxes

15. While it is clear that cross border activity is determined by a combination of elements including exchange rates and pricing strategies of retailers, with the uncertainty created by the UK vote to leave already impacting on the balance of cross

border trade with a fall in sterling against the Euro, there is little doubt that Indirect taxes such as VAT and excise duties will feel the main impact of Brexit.

16. When the UK leaves the EU, it becomes a third country for VAT purposes and all supplies to and from the UK will change from intra-Community supplies/acquisitions to exports/imports. This will involve a substantial initial administrative burden for businesses with systems development issues to deal with changed practices, the review of existing legal contractual arrangements, business models, etc. EU simplifications, such as consignment stock and triangulation, which assist compliance in more complex supply chains will no longer be available to the UK and this could have a significant impact on the operations of Irish businesses engaging with UK businesses depending on the outcome of negotiations.

17. In addition, the UK will have a great deal more flexibility in relation to what level of VAT to charge on supplies as it will no longer be bound by the restrictions on rates under the EU VAT Directives. Reduced VAT rates in the UK could in turn lead to increased cross-border shopping, particularly if combined with weaker sterling. All of this could lead to pressure to move on VAT rates here.

Disorderly Brexit

18. A disorderly Brexit would arise through a failure of the EU-UK negotiations to reach an agreement in line with the article 50 two year timeline. The Article 50 negotiating guidelines state that the Union 'will prepare itself to be able to handle the situation also if negotiations fail' and that it will 'seek to prevent a legal vacuum once the Treaties cease to apply to the United Kingdom and, to the extent possible, address uncertainties'.

19. In the absence of an extension of the Article 50 process, the EU treaties will cease to apply to the UK two years after the Article 50 notification, there would be no transition period and the UK would exit the EU with no successor agreement in place – 'a cliff edge'. The headline taxation and customs administration implications of 'no deal' would include:

- Immediate imposition of tariff and non-tariff barriers
- Immediate imposition of customs controls at ports and airports including a 'hard border on the island of Ireland
- Immediate border infrastructure and transit requirements
- EU tax legislation no longer applying to UK

20. Under a disorderly Brexit, the UK would immediately become a third country, outside the customs union, with immediate imposition of tariffs and customs controls and requirements for full documentation, including safety and security, no arrangements for

transit through the UK and no customs cooperation or mutual assistance framework. The impact on traders and hauliers would be huge. In particular, food supplies would need a system of producer and processor certification backed up by comprehensive inspection at Ireland's borders. Reciprocal arrangements might be applied by UK. Apart from the more onerous legal requirements it is most unlikely that the administration could be fully in place by 30 March 2019, with the result that delays and gaps would arise. There would also be an incentive to criminality arising from the high tariff barriers that would apply. Duty free shopping would probably be an option for travellers to/from the UK/NI, with related loss of Excise duty, VAT, etc. to the Irish exchequer.

21. In relation to taxation generally, it is more difficult to differentiate disorderly impacts from impacts which would arise under an agreed Brexit. The EU acquis on taxation is limited, with direct taxation largely a national competence and limited harmonisation in indirect taxation. Examples of issues which will arise when the EU acquis no longer applies to the UK include:

- The loss of deferred accounting procedures for VAT adding to the administrative burden and cost for companies;
- Less/no co-operation or exchange of information between the UK and EU leading to significant opportunities for fraud and VAT loss;
- UK residents/activities will potentially not meet current business tax definitions. Some impacts already identified include: Interest from UK securities will be subject to tax; CGT relief will not be available for property purchased in the UK;
- Stamp duty on share sales is currently collected through the Central Securities Depository - Euroclear UK, which will no longer have an EU passport after Brexit. This collection method will need to be reviewed;
- Tax Competition on rates in respect of cross border taxes such as excise, VAT & CT may arise;
- UK no longer subject to EU State Aid rules.

Obviously these impacts will be amplified in the case of a 'disorderly Brexit'.

Other issues

Transit of goods through UK and NI

22. At present, excisable goods transiting through member states use the Excise Movement and Control System (EMCS). The EMSC is a computerised system for monitoring the movement of excise goods under duty suspension in the EU, to ensure that the duties are properly levied at the final destination. Post Brexit, the UK will no

longer be a member of the EMCS, an alternative to the control of the movement of excisable goods through the UK will be required. In this regard it is important for Ireland that the UK becomes part of the Common Transit Area. Otherwise, businesses transiting excisable goods through the UK may incur additional financial costs in terms of UK duties.

Duty Free allowances and personal consumption

23. At present a person is free to bring goods into the state from another Member State without having to pay Irish VAT and excises, provided the goods are duty paid in the member state of purchase. There are currently significant notional allowances in regard to excisable products – 800 cigarettes, 90 litres of wine, 110 litres of beer. Post Brexit, this will no longer apply to goods purchased in the UK and brought into Ireland. However, unless the EU-UK agreement provides otherwise, consumers will be permitted to bring goods from the UK to Ireland free of duty, provided their combined value does not exceed €430. In addition to this overall limit, there are specific limits for excisable products such as 200 cigarettes, 4 litres of wine and 16 litres of beer. Duty free allowances could have significant negative impact on indirect tax revenues in the state.