The impact of Brexit on trade, tariffs, and taxes

Charles Yorke, François Renard, Sarah Garvey
Tuesday, 25 October 2016
## Brexit webinar series 2016 – Programme Agenda

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Timeline to Brexit – Article 50

Service of Article 50 notice starts process
- March 2017?
- Parliamentary approval required?

Article 50 gives 2 year period for negotiating terms of withdrawal
- “terms of the divorce”
- Possible transitional arrangements, but not detailed terms for future trade
- Qualified majority of Council and consent of European Parliament required

At end of 2 years (March 2019?) there are three options:
- Negotiation period extended (unanimity of Council required)
- Withdrawal agreement concluded
- UK leaves EU without agreement
1) Any Member State may decide to withdraw from the Union in accordance with its own constitutional requirements.

2) A Member State which decides to withdraw shall notify the European Council of its intention. In the light of the guidelines provided by the European Council, the Union shall negotiate and conclude an agreement with that State, setting out the arrangements for its withdrawal, taking account of the framework for its future relationship with the Union. That agreement shall be negotiated in accordance with Article 218(3) of the Treaty on the Functioning of the European Union. It shall be concluded on behalf of the Union by the Council, acting by a qualified majority, after obtaining the consent of the European Parliament.

3) The Treaties shall cease to apply to the State in question from the date of entry into force of the withdrawal agreement or, failing that, two years after the notification referred to in paragraph 2, unless the European Council, in agreement with the Member State concerned, unanimously decides to extend this period.

4) For the purposes of paragraphs 2 and 3, the member of the European Council or of the Council representing the withdrawing Member State shall not participate in the discussions of the European Council or Council or in decisions concerning it. A qualified majority shall be defined in accordance with Article 238(3)(b) of the Treaty on the Functioning of the European Union.

5) If a State which has withdrawn from the Union asks to rejoin, its request shall be subject to the procedure referred to in Article 49.
Trade
Timeline to Brexit, and beyond

March 2017
- Article 50 process

March 2019: BREXIT
- Full WTO status (hopefully)

2 year period
- “Temporary” or no agreement concluded with the EU
- WTO renegotiation on some aspects

7-8 years (?)
- Negotiation of FTA with the EU (?)

March 2027
- Independent negotiations

Indefinite
- Negotiation of FTA with other WTO members (?)
Trade means trade … and everything else

International trade agreements
• impact international trade
• domestic rules and measures both “as such” (i.e., the rules that will be adopted) and “as applied” (i.e., how those rules will be applied)

Bottom-Up analysis of Brexit:

Per subject (IPRs, competition, tax, passporting, etc)

Goal: identify and assess possible changes to your legal and economic positions

See A&O topic talks

Top-Down analysis of Brexit:

Holistic assessment of Brexit impact

Goal: influence the decision-making process leading to these changes

Our trade talk of today
Few options, all easy to understand…

The UK has three options, not more (Art. XXIV, GATT 47):

<table>
<thead>
<tr>
<th>The fall-back position – being a WTO member</th>
<th>Enter into a <strong>Free Trade Agreement (FTA)</strong> with another WTO member (including negotiating a temporary agreement)</th>
<th>Set up a <strong>Customs Union (CU)</strong> with another WTO member (including negotiating a temporary agreement)</th>
</tr>
</thead>
</table>

The WTO defines FTAs/CUs by reference to (customs) **duties and restrictive regulations of commerce** between RTA Members and with third-party countries:

<table>
<thead>
<tr>
<th>Eliminate internal duties and restrictive regulations of commerce with respect to substantially all the trade between RTA Members</th>
<th>No</th>
<th>Yes</th>
<th>Yes</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Apply</strong> substantially the same <strong>external</strong> duties and regulations of commerce on imports from third countries</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
</tr>
</tbody>
</table>
... but there is an infinite number of possible outcomes

- Customs “duties” are easy to identify, but can vary extensively
- “Restrictive regulations of commerce” can include hundreds of regulations
- And nothing prevents trading partners from combining these trade-related regulations with other non-trade-focused regulation (depending on their respective bargaining power)

<table>
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<tr>
<th></th>
<th>WTO</th>
<th>FTA</th>
<th>CU</th>
</tr>
</thead>
<tbody>
<tr>
<td>Abolish tariffs and import quotas among members</td>
<td>-</td>
<td>√</td>
<td>√</td>
</tr>
<tr>
<td>Establish common external tariffs and quotas</td>
<td>-</td>
<td>-</td>
<td>√</td>
</tr>
<tr>
<td>Allow free movement of goods, services and workers</td>
<td>-</td>
<td>-</td>
<td>Negotiable (e.g., EEA)</td>
</tr>
<tr>
<td>Harmonize competition, structural, fiscal, monetary and social policies</td>
<td>-</td>
<td>Negotiable (e.g., Single Market;</td>
<td></td>
</tr>
<tr>
<td>Unify economic policies and establish supra-national institutions</td>
<td>-</td>
<td>-</td>
<td></td>
</tr>
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Based on progressive levels of integration proposed by Rolf Mirus and Nataliya Rylska (Alberta International and Intergovernmental Relations)
## The Brexit options

While aiming at the same result, the positions from companies and political leaders seem at odds:

<table>
<thead>
<tr>
<th>Access <strong>out of the UK</strong> to the EU <strong>single goods</strong> market, without duties and complex rules of origin</th>
<th>What UK leaders seem willing to negotiate</th>
<th>What Companies want</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Yes</td>
<td>Yes</td>
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</table>

| Access **out of the UK** to the EU **single service** market, with passporting and recognition | Yes | Yes |

| Meaning… | **A sovereign-compliant FTA, at best** | **The most advanced CU** |

– What history tells us: a FTA is the most likely option (only 6% of the trade agreements are Customs Unions)
– So the question for companies: how to manage cost & regulatory changes?
### Options available for the UK

Why none of the existing models can satisfy the UK? A simple (istic) explanation

<table>
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<th>Economic benefits</th>
<th>Political Quid Pro Quo</th>
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<tr>
<td></td>
<td>Acceptable</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Models</th>
<th>Internal Duties</th>
<th>Common External Duties with the EU (2)</th>
<th>Cross-border services allowed</th>
<th>Free movement of people Intra-Members</th>
<th>Need to respect/apply EU laws</th>
<th>Financial contribution</th>
<th>Participation in EU decision making process</th>
</tr>
</thead>
<tbody>
<tr>
<td>EU</td>
<td>No</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes (X)</td>
<td>Yes (X)</td>
<td>Extensive (X)</td>
<td>Yes</td>
</tr>
<tr>
<td>Norwegian (EEA)</td>
<td>No (1)</td>
<td>No</td>
<td>Yes</td>
<td>Yes (X)</td>
<td>Yes (X)</td>
<td>Extensive (X)</td>
<td>Consultation</td>
</tr>
<tr>
<td>No (RoO avoided)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Swiss</td>
<td>No</td>
<td>No</td>
<td>Quite Limited (X)</td>
<td>Yes (X)</td>
<td>Yes when relevant</td>
<td>Partial (X)</td>
<td>Consultation</td>
</tr>
<tr>
<td>Turkish</td>
<td>No (1)</td>
<td>Yes (but trade remedy actions possible)</td>
<td>Very Limited (X)</td>
<td>Limited</td>
<td>Yes (X)</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>No (RoO avoided)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Canadian</td>
<td>No (1)</td>
<td>Very Limited (X)</td>
<td>No</td>
<td>Limited</td>
<td>No</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>No (RoO avoided)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>WTO</td>
<td>High (X)</td>
<td>No</td>
<td>Very Limited (X)</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>NA</td>
</tr>
<tr>
<td>UK wish list</td>
<td>No</td>
<td>No (3)</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>NA</td>
</tr>
</tbody>
</table>

(1) excluding some products (fish, agricultural, food)
(2) including one common trade policy, but also a stronger negotiation power with trading partners, no complex Rule of Origin, no “intra” trade remedy actions
(3) applying EU Schedules at WTO, but substantial hurdle: will need to renegotiate agricultural (quantitative) Schedules
## Possible Options for pro-trade Companies

<table>
<thead>
<tr>
<th></th>
<th>After the Art-50 2-year Period</th>
<th>Long Term (normally no more than 10 years)</th>
</tr>
</thead>
</table>
| **Revised EEA/ Norwegian model** | **Option 1**: “An interim [EEA modelled] agreement leading to the formation of [the UK/EUFTA]” – Art. XXIV  
- Economically acceptable (although no more protection against “dumped” /"subsidised” imports), but possibly not acceptable for other WTO members (not to raise barrier – see *DS 34 Turkey-Textile*), e.g.,  
  - how to assess “UK origin”?  
  - how to allocate agricultural products?  
  - Politically difficult for  
    - the UK (“back to square one”)  
    - the EU (encouragement to other potential leavers)  
    - Norway (power sharing with the EFTA countries)  
- Solutions: offering concessions to WTO Members, accepting this Option because it is a temporary solution | **Option 2**  
(polistically untenable?) |
| **WTO model** | **Option 2**:  
- Should not raise any legal issue (willingness of other WTO members), if the UK applies the EU schedules, plus unilaterally decides to apply no duties (HK model) – query: is it acceptable to UK-based companies/ UK Treasury?  
- **BUT** WTO quantitative schedules would need to be negotiated; and substantial uncertainty on Services | **Option 3**  
(commercially too weak?) |
| **FTA (UK Model)** | **No time to negotiate it** | **Option 1** |

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**Will the UK need and be able to negotiate its own separate FTAs with other partners in the Art 50 2-year period (e.g. with South Korea)?**
Priorities for Companies

– Assess impact of Brexit on your UK-EU/other countries trade business
– Regroup yourself by sector (together with pro-trade local companies)
– Team effort (economists, political, lobbyists, legal: understand BOTH side’s rules)
– You and your team must defend your position to:
  – the UK
  – the European Union
  – Norway
  – Others?
– Secure support of your government (USTR)
– Convince the UK and the EU to be pragmatic, not populist
– Obtain compensation for the transitional period
– Do not focus on trade tariffs only – many other matters are at stake, which require a clear understanding of the EU rules. Based on a counterfactual analysis (“what if”), assess the impact of a change/termination in:

<table>
<thead>
<tr>
<th>Mutual recognitions rules</th>
<th>“Technical Barriers to Trade” measures</th>
</tr>
</thead>
<tbody>
<tr>
<td>Private Data, employment rules</td>
<td>“Sanitary or Phytosanitary” measures</td>
</tr>
<tr>
<td>Tax, VAT, competition rules</td>
<td>Trade defence (antidumping) measures</td>
</tr>
<tr>
<td>Rules of Origin rules</td>
<td>Other EU FTAs/bilateral agreements</td>
</tr>
<tr>
<td>Customs clearance processes</td>
<td>Etc</td>
</tr>
</tbody>
</table>
Tax
How does the EU affect tax?

– Common system of VAT
– Harmonisation measures to support the fundamental freedoms (in particularly freedom of movement of capital)
– Challenge to domestic rules if they infringe freedoms
– State aid
– “Mission creep”?
  – Financial transactions tax
  – Common [Consolidated] Corporate Tax Base
VAT – The current position

- EU framework in the Principal VAT Directive
  - National implementation
  - National differences still exist

- Applied and calculated on a national level

- Basic principles
  - Supplier charges VAT on supplies made by it (outputs)
  - Supplier recovers VAT on supplies made to it (inputs)
  - Pays/recovers net difference to/from tax authority

- Intra-EU supplies treated differently from supplies to third countries
  - BUT overall effect for importer/exporter is mostly the same
  - Biggest area of difference is where the supplier is partially exempt—supplies to third countries may improve its VAT recovery position
VAT example – supplies of goods

**Inputs**
- Non-EU
  - Import VAT: 10 + VAT
- UK
  - Pay VAT: 10 + VAT
- EU
  - Acquisition VAT: 10

**Outputs**
- Non-EU
  - No VAT: 0
- UK
  - Charge VAT: 20 + VAT
- EU
  - Acquisition VAT: 20

**Recovery?**
VAT – Position post-Brexit

VAT legislation is already part of UK law – will stay in place unless changed

UK government would be free to scrap VAT
– BUT – important revenue raiser, efficient collection mechanism
– More likely to make detailed changes eg to rates/classification of supplies in politically sensitive areas

Detailed review is required to work out implications of EU being “third countries” for the UK and vice versa
VAT – UK as “third country”

- For most supply chains, no significant overall tax impact
  - Import VAT generally recoverable unless onward supplies are exempt
  - Exports to third countries are generally zero-rated
  - B2C supplies may be treated differently

- Possible cashflow impact
  - Import VAT from non-EU member states payable on import unless deferment arrangements agreed/use customs warehouse
  - Acquisition VAT from EU member states payable through normal VAT return process

- Biggest issue likely to be compliance and unavailability of certain simplification measures
EU tax harmonisation measures

Capital duties directive
- Opportunity for UK to reintroduce stamp duty on issues of shares into clearing systems/depositaries?

Parent-subsidiary directive
- Permits certain dividend payments without withholding tax
- Largely covered by UK’s treaty network, but some significant exceptions

Interest and royalties directive
- Permits certain interest and royalty payments without withholding tax
- Largely covered by UK’s treaty network, but some significant exceptions

Mutual assistance directive
Where would this leave the UK as a holding company jurisdiction?

Main advantages of the UK as a holding company jurisdiction remain

<table>
<thead>
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<th>Issue</th>
<th>Treatment</th>
</tr>
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<tr>
<td>Receipt of dividends</td>
<td>Usually exempt</td>
</tr>
<tr>
<td>Payment of dividends</td>
<td>No withholding tax</td>
</tr>
<tr>
<td>Capital gains on disposals</td>
<td>Broad exemption for share sales of trading companies</td>
</tr>
<tr>
<td>CFC rules</td>
<td>Limited</td>
</tr>
<tr>
<td>Corporation tax rate</td>
<td>20% reducing to 17%</td>
</tr>
<tr>
<td>Interest deductibility</td>
<td>Generous</td>
</tr>
<tr>
<td>Treaty network</td>
<td>Very large</td>
</tr>
</tbody>
</table>

Some European dividends may attract withholding tax

UK has better treaty provision with the US than other typical holding company jurisdictions
State aid and other EU mission creep

- Aim to reduce tax competition between member states (except rates)
- Appeal to public opinion over heads of member states
- Using other avenues (e.g., state aid, enhanced cooperation procedure) to bypass unanimity
- Increased Commission activism

Tax matters need unanimity
EU Commission approach

State Aid decision in Fiat case

“the arm’s length principle that the Commission applies in its State aid assessment is not that derived from Article 9 of the OECD Model Tax Convention … but is a general principle of equal treatment in taxation falling within the application of Article 107(1) of the TFEU, which binds the Member States”

Pierre Moscovici (EU Commissioner)

There are three political factors in play today which allow us to move forward, **despite unanimity**. First, there is political space to create a European fiscal area … Second, there is political will to secure stable tax revenues for Member States… Finally, there is public pressure to ensure genuinely fair taxation and to put an end to tax fraud and evasion. The combination of all of these factors provides us with a unique opportunity. We have to seize it! We have to start a revolution of transparency, but also of one of efficiency, competitiveness, justice – just as Europeans expect. This is the challenge that I have signed up to and we are now poised to win on several key proposals. At the European Parliament hearing, which I attended today with President Juncker, we gave a clear signal that **this Commission is determined to ensure that our tax projects succeed**.

3 concerns:

1) “The Commission has advanced several previously unarticulated theories as to why its Member States’ generally available tax rulings may constitute impermissible State aid in particular cases. Such a change in course, which has required the Commission to second-guess Member State income tax determinations, was an unforeseeable departure from the status quo”

2) Retroactive effect

3) Contrary to international norms

The U.S. Treasury Department continues to consider potential responses should the Commission continue its present course. A strongly preferred and mutually beneficial outcome would be a return to the system and practice of international tax cooperation that has long fostered cross-border investment between the United States and EU Member States. The U.S. Treasury Department remains ready and willing to continue to collaborate with the Commission on the important work of ensuring that the international tax system is fair, efficient, and predictable.
### Direction of UK corporation tax policy

<table>
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<th>UK is “open for business”</th>
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<tr>
<td>HMRC generally helpful to inward investors – accessible and (broadly) sensible</td>
</tr>
<tr>
<td>Rates low and getting lower – might they go further?</td>
</tr>
<tr>
<td>But… structuring to reduce taxes further is being closed down</td>
</tr>
<tr>
<td>Early adopters of BEPS proposals to counter</td>
</tr>
<tr>
<td>– Hybrid debt</td>
</tr>
<tr>
<td>– Excessive interest deductions</td>
</tr>
<tr>
<td>– Avoidance of UK taxable presence</td>
</tr>
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What can you do?

- Identify areas of supply chain that are likely to be affected
- Contingency plan for worst case outcome
- Lobby in the UK and the EU-27 for a rational outcome
What lies ahead?
Interview with Jonathan Hill – UK’s former EU Commissioner

It’s important that we work at building as many relationships – whether that’s in business or in politics – as we possibly can. This process will be hard enough without misunderstanding and mistranslation.

We do have, because of the nature of British politics, a much more transactional, rational, economic based approach to life. And people here, I think, forget that for the Europeans their project is an emotional project, it’s a political project, that actually it’s quite a romantic project. So if we think in the UK that ultimately economic rationalism will win out in terms of the negotiation, that is to misread how the Europeans will approach this negotiation.

If we approach it in a sensible way, because the European system is a deal based system, there is more scope for resolving it intelligently than if we go at it in a way where we all end up shouting at each other. And I think we have this false choice in the UK between “hard Brexit” and “soft Brexit”. I think the choice is between “stupid Brexit” and “more intelligent Brexit” and that is what we need to go for.
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François has assisted companies throughout the world in anti-dumping and trade sanctions proceedings, as well as in various international trade matters, including WTO-related matters. He has represented in this field from various jurisdictions, including China, Germany, Korea, The Netherlands, New Zealand, Poland, Thailand, Ukraine, the UK and the U.S. François has been listed in the Expert Guide as one of the world’s leading international trade lawyers.

François is also listed as a leading lawyer in PLC’s antitrust cross-border category in China, International Who’s Who of Competition Lawyers, Global Competition Review (GCR), Chambers APAC and IFLR 1000, respectively. He was the winner of the *ILO Client Choice Award 2015* for the Competition and Antitrust category in China.
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Sarah is an experienced litigator with particular expertise in conflict of laws, state immunity issues and EU laws. She regularly advises clients on topics such as governing law, jurisdiction, immunity and arbitration. Sarah is part of Allen & Overy's core Brexit team and has been heavily involved in advising clients on the legal implications of Brexit. Sarah is Chair of the Law Society's EU Committee and sits on the Lord Chancellor's Advisory Committee on Private International Law. Sarah edits the Forum Chapter of Butterworths' Encyclopaedia of Banking and is secretary to Allen & Overy's Global Legal Opinions Committee. Sarah is a Board Member of the London Women's Forum.
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Questions?

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