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Tax Alert

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Brexit: Key Tax Implications for Alternative Investment Funds and Investment Managers

The result of the UK's referendum of 23 June 2016 was announced today as a victory for 'Brexit' - in other words, for the UK to exit the European Union. This decision is expected to have significant ramifications for the future of the UK's fiscal and tax policy. We highlight below the key tax implications that are likely to be of particular significance to the investment funds industry, and the likely time frame for any changes.

So 'Brexit' has won the referendum. What happens next?

Nothing will change immediately. The process for leaving the EU is likely to take a number of years, and the exact date of exit will depend on various factors.

As a formal matter, the UK would first need to notify the European Council of its intention to leave the EU. There is then likely to follow a period of negotiation of a withdrawal agreement covering the UK's exit and its future relationship with the EU. Exit would occur on the earlier of (i) the date of the agreement and (ii) the date falling two years - unless an extended period is agreed - after the notification.

This means that the EU tax rules will continue to apply to the UK for the immediate future.

Key UK tax implications

The impact of Brexit on the UK's tax landscape could be significant. The UK will potentially be free to set its own tax rules and rates, without regard to EU frameworks (but subject to the terms of any negotiated agreement with the EU). However, following withdrawal the UK would also no longer be able to benefit directly from EU Directives that eliminate withholding tax on certain payments between Member States. Some of the key UK tax implications that are likely to be of particular interest to the investment funds industry are as follows.

Value Added Tax

Following Brexit, the UK will no longer be bound to impose VAT in accordance with the existing EU rules, or even impose VAT at all, although an abolition of VAT in the UK is very unlikely, given the amount of revenue it generates for the government. The UK would, however, be free to change VAT rates, and exempt or zero-rate different types of supply (such as potentially extending the VAT exemptions for fund management and other financial services).

Withholding tax on cross-border payments

Currently, cross-border payments of dividends, interest and royalties between entities in the UK and EU Member States can qualify for exemption from withholding tax under the EU Parent-Subsidiary Directive and the Interest and Royalties Directive. Following the UK's formal withdrawal from the EU, these directives will no longer apply to the UK. It is conceivable that equivalent agreements will be put in place (as is currently the case with Switzerland) to achieve a similar practical effect. But if that does not happen, UK companies receiving dividends, interest or royalties from EU entities will need to rely on double tax treaties, where applicable, to reduce or eliminate the rate of withholding tax in the payer jurisdiction. In some cases, this could cause an increased withholding tax exposure as compared with the position under the Directives. Fund structures should be reviewed with this in mind.

Stamp taxes

Currently, the UK's 1.5% stamp duty reserve tax charge on the issue of shares to a clearance service or depository receipt issuer is not enforced in view of recent case law finding that the charge is incompatible with the EU Capital Duties Directive. Following the UK's formal withdrawal from the EU, the UK will be free to reimpose such charge.

Direct tax

The UK will be free to set its own tax laws – for example, with regard to group relief of tax losses, that has previously been subject to the approach of the EU courts - without needing to have regard to the EU fundamental freedoms (although indirectly this may still be a relevant consideration under any negotiated agreement).

State aid

Member States are currently prohibited from granting beneficial tax treatment to certain taxpayers, in a way that constitutes state aid and therefore distortion of EU trade and competition. Following Brexit, the UK could, in principle, extend beneficial tax treatment to particular industries, including the investment funds industry, if it were considered politically or commercially beneficial to do so, although the EU state aid rules might indirectly remain a relevant consideration under any negotiated agreement.

Other EU tax measures

EU tax laws, intended to move toward a harmonisation of the Member States' corporate income tax codes, such as the EU's proposed Anti Tax Avoidance Directive, would not apply to the UK following the UK's withdrawal from the EU (again, subject to any negotiated agreement).

The proposed EU financial transaction tax (FTT) on certain financial transactions involving an EU financial institution should not directly impact the UK in any event, since it is currently in the enhanced co-operation procedure for those Members States wishing to participate, which does not include the UK.

These are just some of the tax highlights to look out for as this unique situation unfolds over the coming months and years. Also, prior to the referendum, George Osborne had raised the prospect of an emergency Budget and increased taxes in the event of Brexit, so this will be one to watch in the short term.

Contact Information

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