Plus Ça Change ... Reframing the Tax Influences of the European Union

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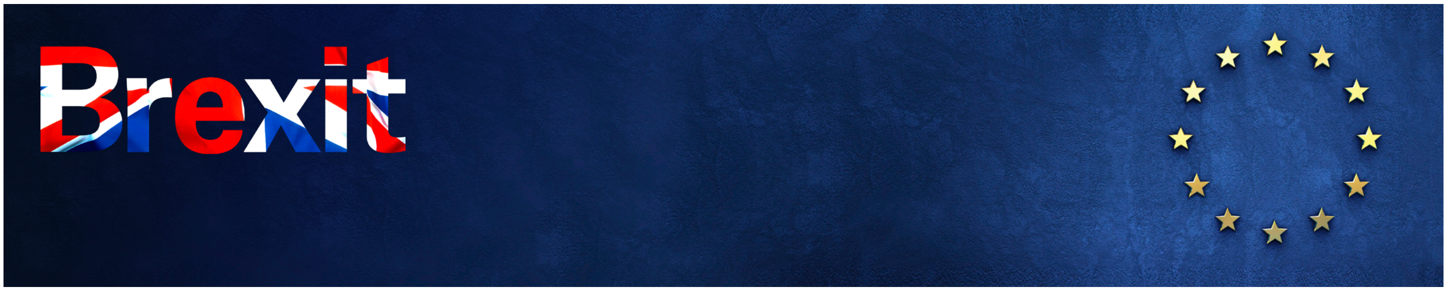

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Takeaways

- While the Trade and Cooperation Agreement (TCA) includes new commitments by the parties on tax, certain EU-derived tax rules will remain relevant in the UK.
- That is actually a good thing in one respect: UK issuers equity will not face new stamp costs on issuances.
- State aid rules have given way to state subsidy rules, but with significant flexibility on both sides and aid recovery not possible if either side passes primary legislation in support of the subsidy.

Though the United Kingdom and the European Union have separated, through the TCA they have agreed upon a very long rulebook with some tax pointers on how to coexist. As well as new tax policy being set out within the TCA, some EU-derived tax rules set prior to Brexit will also still need to be observed by both parties.

Since the UK joined the EU in the 1970s, its tax rules have been framed to comply with specific European directives as well as the fundamental freedoms contained within the EU treaties. Some tax cases involving UK taxpayers have famously been decided by the Court of Justice of the European Union in Luxembourg. The legacy of those cases in the UK has largely been preserved as EU case law, though the senior English appellate courts are empowered to depart from that case law in the future.

That legacy includes cases of particular relevance to UK issuers listed outside the UK and, most notably, listed in the United States. Securities issued directly into the Depositary Trust Company (DTC) by a UK issuer raising new capital have for some time now, thanks to a judicial view of the EU freedoms, excluded the 1.5% stamp duty reserve tax originally imposed on issuance, and have also been tradeable without the friction of stamp duty otherwise due on certificated trades or on dematerialised trades on the London Stock Exchange.

Despite this position being an easy target for reversal by a British government looking for tax revenue, the UK tax authority has, in our view, correctly agreed that this outcome would be preserved in UK tax law beyond 31 December 2020. Practical challenges remain in giving effect to this, not least because new tax clearances and DTC practices will need time to settle. However, UK issuers should be comforted that, for now, they will not face these additional tax costs on future new issuances thanks to the retention of legacy EU case law.

Looking at the new policy enshrined in the TCA, tax largely falls within Part 2, Title XI of TCA in the same way as other issues relevant to the "level playing field," such as workers' rights. (See "Level Playing Field Obligations: Insurance Policy or Tinderbox for Future Trade Disputes?") There are three targeted tax treatments worth noting:

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1. There is an attempt to codify what financial assistance by way of subsidy looks like in the field of tax. Article 3.2 sets out qualifications to the general definition of subsidy in Article 3.1 by identifying tax measures that are not to be considered as specific and therefore not a subsidy. For example, a measure is not specific if it is justified by reference to principles inherent to the design of the general system of taxation for either party, and a special purpose levy is not specific if required by noneconomic public policy objectives. Inclusion of these principles is helpful, although as recent tax state aid cases at the EU level have shown, their interpretation can be debated.
2. Publication of subsidies in the form of tax measures have a different time frame than other subsidies, with publication required within a year of the tax declaration becoming due. What a tax declaration comprises is not defined, but it certainly seems to allow a longer period than other measures, which require publication within six months from the grant of the subsidy. It is of note that where the subsidy is granted by a UK act of Parliament or EU directive, remedies in relation to aid that are found to be inconsistent with the TCA do not include recovery of any prior aid.
3. Both sides felt it necessary to spell out a commitment to anti-tax avoidance measures established by the Organisation for Economic Co-operation and Development (OECD) in recent years, particularly as part of the base erosion and profit shifting project. The UK and EU would presumably have felt bound by such commitments in any event, so their specific inclusion in the TCA is also noteworthy. As part of the measure, both sides have now committed to continue their implementation of exchange of information rules, as well as regulations covering interest deductibility, controlled foreign companies and hybrid mismatches.

Given the above, it appears the EU was sincerely concerned about the UK's ambition to assist its economy in recovering from the pandemic by granting tax-related subsidies, or diverging from international norms, and this is borne out by the reference to credit institutions and investment firms, a sector in which the UK is a clear leader.

Despite that, as a clear statement of intent to immediately help UK businesses, the UK tax authority already has indicated its desire to deploy new flexibilities allowed by the TCA, by announcing on 31 December 2020 it was cutting back its implementation of a flagship tax EU Directive, commonly known as DAC6 or CD (EU) 2018/822, to conform solely to the OECD mandatory disclosure rules, which are in many ways narrower than DAC6.

This may just be the starting point for other measures that the UK intends to relax where possible, whilst still strictly observing the terms of the TCA. Value-added tax, a European tax regime that is considered close to the heart of the EU project from a single market perspective, and certain regulatory rules with tax consequences — including in particular rules governing remuneration within the financial services industry — may also become a focus if the government's ambition is to retain the primacy of London as the financial centre of Europe. This immediate action on DAC6 did not, therefore, go unnoticed by the European Parliament, during what is only an interim implementation period for the TCA and prior to its ratification. An extension to the interim period has now been requested by the European Parliament, until April 2021. An interesting period of discussion on the evolution of tax policy between the UK and the EU lies ahead.