WHITEPAPER: A 'NO DEAL' BREXIT TAX STRATEGY

January 2019
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etc TAX

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INTRODUCTION

Britain's scheduled withdrawal from the European Union (EU) is now merely weeks away.

Almost 30 months of negotiations between London and Brussels following the June 2016 referendum produced a 585-page framework for the future, known as the draft Withdrawal Agreement ("WA").

Before the ink had even begun to dry, however, both 'remainers' and 'leavers' alike were united in claiming that the document failed to live up to how they believe any Brexit should be.

A planned vote by MPs on the Agreement in December was postponed by the Prime Minister, Theresa May, as she did not feel able to marshal the support required to steer it through the House of Commons.

Her fears proved to be wholly justified as, on 15th January 2019, the Government suffered the biggest parliamentary reverse in almost a century when MPs of all parties were finally balloted on the proposals.

In the run-up to the vote, Mrs May had insisted that only two options were possible:

1. The draft agreement struck with the EU
2. No deal

That was despite many respected commentators at home and abroad warning that either outcome would result in the UK economy being considerably worse off.

"the time to talk about tax as an enabler for prosperity is now before any agreement with the EU is signed"

Even that note of caution was criticised because it was predicated on the UK entering the post-EU era almost in a passive manner – simply accepting that Brexit would happen without doing anything other than talk with Brussels in order to mitigate potentially negative consequences.

What, though, if there was a more pro-active response? What if, in the absence of any deal, the UK was to be more positive about the future, perhaps using the tax system as one way of fostering economic growth?

Such a notion is not so far-fetched. It's something which occurred to the Chancellor of the Exchequer, Philip Hammond, almost exactly two years ago[1] in an interview with the German weekly newspaper Welt am Sonntag. His robustly-worded position was that the UK might cut Corporation Tax in order to "regain competitiveness" on the world stage.

Mr Hammond's position was interpreted as a desire to turn the UK in to a 'tax haven' or, as Jeremy Corbyn put it, "a bargain basement"[2] Brexit.

More recently, Theresa May, at an economic forum in New York last autumn[3], stressed the role of taxes as part of her pledge to make Britain "one of the most business-friendly economies in the world".

We should remember that using tax for national economic benefit is nothing which Britain's near neighbours aren't already doing. The Netherlands has, for instance, admitted parading a succession of tax breaks before 250 companies in an effort to have them relocate there from Britain due to the "great uncertainty" of Brexit.

If Britain were also to employ its tax system in a similarly positive fashion, it would not necessarily require wholesale change, as important building blocks are already in place.

Nevertheless, leaving the EU would not automatically present the UK with freedom to do exactly as it wishes. The very WA which the parliament in Westminster is still arguing the merits of includes a requirement that Britain maintains what is described as "a level playing field" in certain key policy areas.

Implementing a tax-led strategy becomes more difficult if the WA is ratified, given that the UK's hands would effectively be tied.

It would have significantly greater leeway to proceed with such a plan if the current discussions fail to produce a deal. Therefore, this White Paper is predicated on that 'no deal' outcome.

Even so, turning ideas about how best to use tax to stimulate the economy into policy will require no little effort.

That is why we believe urgent consideration should be given - now - about what shape such an approach might take rather than waiting to start deliberation until after the UK is outside the EU and possibly tied to an agreement which is ultimately unhelpful to such ambitions.

Having already undertaken the analysis, we believe that our ideas would indeed serve their economic objective, going some way to reinforce Britain's reputation as something of a beacon for innovation, possibly even luring new, dynamic business to the country's shores

[1] www.etctax.co.uk/brexit-tax-thou-shalt-not-make-unto-thee-haven/
[2] www.itv.com/news/2017-01-18/jeremy-corbyn-may-plan-is-for-bargain-basement-brexit/
[3] www.politico.eu/article/theresa-may-pledges-lowest-business-tax-rate-in-g20-post-brexit/
[4] www.thetimes.co.uk/article/dutch-try-to-lure-250-british-based-companies-over-brexit-k3xxx9ghc?shareToken=2413a0152b875d8a309c26b5a5b051ec

HEADLINE RATE OF TAX

General

Corporation Tax (CT) is one of the key elements in our proposed strategy.
According to the most recent figures issued by HMRC, CT amounted to £53.3 billion in the financial year 2017-18 – no small figure in itself but only nine per cent of overall tax income collected by the Revenue.

Compared that with the sums generated in Income Tax and National Insurance Contributions (NICs). They contributed £186 billion (31 per cent of all tax receipts) and £130.5 billion (22 per cent of HMRC's total tax take) respectively.

That combined personal taxation also grew more over the 12 months in question by 6.8 per cent – far more than the 4.3 per cent increase in CT.

The importance for the UK of creating and keeping jobs is, therefore, fairly obvious and one reason why we would argue that there's a virtue in using CT as a means of fostering innovation and other desirable forms of investment.

"CT amounted to £53.3 billion in the financial year 2017-18"

Rates of tax

The headline rate of tax for EU member states is as follows:

Jurisdiction	Headline Rate %
Malta	35
Belgium	34
France	33.3
Germany	29.79
Greece	29
Luxembourg	27.08
Austria	25
Netherlands	25
Spain	25
Italy	24
Denmark	22
Sweden	22
Portugal	21
Slovakia	21

Jurisdiction	Headline Rate %
Estonia	20
Finland	20
Latvia	20
Czech Republic	19
Poland	19
Slovenia	19
United Kingdom	19
Romania	16
Lithuania	15
Cyprus	12.5
Ireland	12.5
Bulgaria	10
Hungary	9

It should be noted that the UK tax rate is already due to drop to 17 per cent in the coming years. However, even with this in mind, if the UK wanted to be even more ambitious in its use of CT as a spur to growth, then it would have plenty of room for manoeuvre. One only has to look over the Irish Sea and the bold actions of successive governments in Dublin for an example of what can be achieved.

It should also be noted that many of the headline rates of tax are misleading. For instance, most international businesses based in the Malta – the 'highest' rate in the table above – are more likely to pay an effective rate of 5 per due to the ability to claim a substantial credit where profits are distributed to an owner. There are many similar stories once we look at the local details beneath the so-called 'headline' rates.

INNOVATION

The Government has already made clear how much it acknowledges the impact of invention on the UK economy.

Furthermore, former Science Minister Sam Gyimah[4] declared in July last year that he wanted innovation to be "at the heart" of Britain's economic development after Brexit.

A key part of the foundations upon which he wished to build were the various tax relief schemes available to businesses involved in Research and Development (R&D)[5].

Broadly speaking, companies which spend on R&D and meet HMRC's criteria will see their Corporation Tax liabilities reduced and potentially to a significant extent. For example, an SME investing £100k in qualifying R&D may be able to claim relief from Corporation Tax on this amount of up to £230k. In addition, a firm which invests in such expenditure but does not yet turn a profit can actually receive a cash payment from HMRC instead.

The initiative, which was first introduced in 2000, is intended to act as a spur to innnovation investment and figures published in late September would appear to bear that out. A total of £3.5 billion of R&D relief was claimed in 2016-17, an amount which corresponds to £24.9 billion in related expenditure.

Not all of the projects involve manufacturing or require armies of scientists in white coats. In fact, just over half of the 42,855 claims in 2015-16, for instance, related to IT, professional, financial and administrative or support services.

It might also come as a surprise to learn the degree to which the UK economy relies on the service sector.

Data issued recently by the Office for National Statistics (ONS) shows how, despite an increase in exports, trade in goods over the 12 months to August this year generated a deficit of £133.5 billion. That compares with a £118.5 billion surplus in services over the same period.

It should be pointed out that a foreign company can already take part in the R&D scheme as long as it has a UK taxable presence and the R&D is relevant to that UK presence.

However, extending and enhancing the R&D reliefs to new and existing foreign companies might help to attract new and existing innovative businesses to the UK. For example, one could increase the (albeit already attractive) R&D reliefs to, say, 300% of the expenditure for a finite period. There should be clear requirements that the enhanced reliefs only apply to businesses which create a new taxable base in the UK, have plans to employ a certain number of people in the UK and are carrying out substantial activity in the UK.

"a total of £3.5 billion of R&D relief was claimed in 2016-17"

[4] www.gov.uk/government/speeches/britains-new-unique-selling-point-usp-the-go-to-place-for-science-and-innovation
[5] www.etctax.co.uk/knowledge-centre/business-tax-reliefs/r-and-d-relief/

Further, in order to prevent established businesses effectively making a smash and grab on the reliefs, there could be a clawback clause, where if the activity ceases within the five-year period relief is reclaimed either in its entirety or in part.

These enhanced R&D reliefs would not only require evidence of a longer-term commitment but help the economy ride out any turbulence once the post-Brexit transition is over. The period could even be extended if the economy required it.

Ministers could also choose to make amendments to something known as the Patent Box[6], which can be claimed by companies that are both liable to Corporation Tax (CT) and make a profit by exploiting patented inventions which they have had a hand in developing.

For a qualifying business, the benefits can be significant. This allows a 10% rate of Corporation Tax on the income received from these patents. Perhaps the Government could look at further cutting this rate for income from patents created in the UK in - for argument's sake - the next five years?

Of course, promoting substantially reduced rates of CT has caught the eye of the Organisation for Economic Co-operation and Development (OECD). In 2015, it introduced rules designed to combat a process known as Base Erosion Profit Shifting (BEPS), where businesses take advantage of the varying rates in different jurisdictions to manage their tax bills down. One general theme to be taken from the OECD's work in this area is that companies should demonstrate that they have a genuine presence in a low tax country – something known as a 'substance test' - rather than merely engaging in a cosmetic accounting exercise.

We have applied this in our suggestions re R&D above and the same would apply to patent box and also all other suggestions.

In other words, there should be no easily available giveaways to those who might be described as shopping for international tax reliefs.

Successfully encouraging businesses which meet the OECD's rules might not ward off the objections of the remaining EU member states, of course. However, it's hard to see how Brussels might be able to complain too loudly, though, given that a number of countries (the Republic of Ireland, Poland, Cyprus, Hungary and the Netherlands) all have IP tax regimes of their own, offering innovative businesses tax rates as low as two per cent on qualifying projects.

If the Prime Minister follows through on her promise to give Britain "the lowest rate of Corporation Tax in the G20" by tweaking the Patent Box, for example, the country would arguably be on far more competitive footing.

"innovative businesses tax rates as low as two per cent on qualifying projects"

[6] **www.gov.uk/guidance/corporation-tax-the-patent-box**

PEOPLE

Keeping hold of the non-doms.

As we have set out earlier in this document, one essential part of our overall strategy of using tax as a lever to economic growth is encouraging wealthy foreign nationals to come to the UK and invest.

According to the most recent figures published[7] by HMRC, the 91,000 non-domiciles ('Non-doms', to you and I) resident in the UK during the 2016-17 financial year paid just over £9 billion in UK Income Tax, Capital Gains Tax and National Insurance contributions - an increase of £130 million on the amount for the previous year and the highest total since records on such receipts began.

Given those numbers, it's perhaps surprising, then, that - to excuse the pun - the direction of travel in terms of UK taxation of UK resident non-domiciles (Non-doms) has been one-way in recent years: from the departure lounge rather than into the arrivals hall.

Non-doms, of course, can potentially exploit something known as the remittance basis in the UK.

It allows those who resident in the UK but with a permanent home in another territory, to leave their foreign income and gains offshore. However, their UK income (say if they are employed in the City of London) is fully taxable in the UK. In addition, any of that foreign income and gains that are bought to or used in the UK is also subject to UK taxes.

There were substantial changes in 2008 that required longer term non-dom residents of the UK to pay for the privilege of being allowed to take advantage of the remittance basis.

With effect from April 2017, there were further substantive changes which led to a long stop date being placed on use of the remittance basis.

However, other EU member states have been moving in the opposite direction. Italy, Cyprus, Malta, Ireland and Portugal are all EU countries who made their own attempts to lure internationally mobile and wealthy individuals to their own countries.

That said, there is seemingly an inherent problem with the remittance basis in that it encourages wealthy individuals to leave their money outside the UK.

This was recognised by former Chancellor George Osbourne who introduced a relief called Business Investment Relief[8] which provided for foreign income and gains to be brought to the UK and, as long as they were invested in companies that undertook certain UK commercial activities, the remittance would not trigger a tax charge.

[7] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/728630/Statistical_commentary_on_non-domiciled_UK_taxpayers.pdf

[8] www.etctax.co.uk/business-investment-relief/

This could be further extended to:

- **Remove the need for investment in companies (why not partnerships or sole traders – which would generally provide greater tax receipts on income generated?);**

- **Although the qualifying activity is quite broad, it should be further extended to include pretty much anything other than the personal use assets (some might go further wanting this to boost the housing market or sales of goods and services however this would pretty much render the remittance basis irrelevant);**

- **Remove some of the technical points which have stymied what, on the face of it, should be a really attractive relief**

One could be even bolder and suspend the remittance basis charge for a period of five years to encourage the internationally mobile to remain in, and relocate to, the UK.

Of course, politically, this would be an extremely brave move.

Attracting new talent

The briefest glance through the ranks of major businesses listed on the Stock Exchange also makes it plain that companies sometimes need capabilities which aren't always readily available in the local market.

There is an international pursuit of talent.

Some of those skilled foreign workers who might have considered a career in London, Cardiff or Edinburgh could decide that Brexit poses too many personal financial uncertainties to uproot themselves and their families and head to the UK.

To overcome those reservations, the UK could consider following the lead of Switzerland and its forfait fiscal. Depending on which canton one chooses to reside in, the system allows individuals to pay an agreed (and, one assumes, amore palatable) lump sum instead of variable rates of Income Tax.

Many wealthy celebrities have taken advantage of the benefits over the years but are limited in that they cannot work locally during their time in the cantons.

Another example, much closer to home, is the Isle of Man.

It's not so strict in terms of qualifying criteria but it does offer a top rate of Income Tax of 20 per cent and a cap on total Income Tax payable per person of £150,000.

Again, isn't this something which a post-Brexit government could consider?

"offer a top rate of Income Tax of 20 per cent"

TAX RELIEF FOR UK COMPANIES WITH / CREATING OVERSEAS TRADING BRANCHES

Of course, the Corporation Tax measures discussed in the preceding sections have covered how we attract businesses to the UK. This enables the UK to create additional jobs, attract the top international talent, encourage innovation and generally enable the economy to survive and flourish after Brexit takes place.

However, as well as enticing foreign companies and entrepreneurs into Britain, ministers should also think how it might encourage home-grown entrepreneurs to expand overseas.

Since the referendum we have seen many SMEs looking to increase foreign sales. A cynic might suggest this was as a result of a sharp fall in the value of sterling.

“encourage home-grown entrepreneurs to expand overseas”

These businesses, which have built - or are in the process of building - genuine overseas trading businesses will often look to create a presence in a tax-efficient EU jurisdiction. They can - and do - set up offices in, say, Malta knowing that they should only have to pay tax at an effective rate of five per cent. It is unlikely that such structures will be caught by anti-avoidance rules as, even if they are not protected by the commercial defence, there is a strong possibility they will be protected by an EU defence.

However, if ministers wanted to foster the cross-border ambitions of Britain's many SMEs, it could opt to reduce the rate of tax suffered on profits derived outside of the UK.

This could even be targeted to support particular industries or any other sizes and shapes of business which the Government wished to encourage.

Outside of the EU, it should be possible to do this without any interventions over State Aid.

It's a measure which would not be unique – with similar systems operating across Europe – but would present an opportunity for some of the small or medium-sized firms which account for 99 per cent of the UK's companies and 51 per cent of all private sector turnover to set their sights further than this country's shores.

But why would we encourage this?

In our view, by allowing registrable overseas branches of these UK firms to benefit from a reduced rate of Corporation Tax, it might assist in keeping company headquarters in the UK and the jobs which go with them.

"create a presence in a tax-efficient EU jurisdiction"

ANTI-AVOIDANCE & TREATY FREEDOMS

We have briefly touched above on how some of the UK's anti-avoidance rules can be disapplied or varied where it involves an entity located in an EU Member state.

Where the EU has made such interventions, the UK has generally been forced to amend its taxing statutes to account for this. This might be seen as hugely frustrating for the taxman and precisely the kind of outside control Brexit is designed to avoid.

Of course, a knee-jerk reaction might be to repeal all of these amendments that relate to EU fetters.

However, our view is slightly different.

Rather than abandon these taxpayer protections, the Government should retain them. This will provide important confidence to those doing cross-border business. Further, the UK could decide to continue in observing some of the EU treaty freedoms. Clearly, there are political difficulties in observing the Freedom of Movement of People. However, there could be advantages in observing other freedoms such as Freedom of Movement of Capital, for instance.

Article 63(1) of the Treaty on the Functioning of the European Union prohibits restrictions on capital movements:

(1) Unsurprisingly, between Member States; and
(2) Between Member States and Third Countries

The UK would become a Third Country under a no deal Brexit. This would mean that:

(1) Someone in the UK could invoke this freedom if a Member State restricted capital movement to the UK; and
(2) A person resident in the EU could invoke the freedom against national restrictions on capital transactions either in to or out of the Third Country

To further buttress these freedoms, and provide confidence to international business, the UK could make laws explicitly preserving these freedoms in to UK law.

"provide confidence to those doing cross-border business"

(LITERALLY) BUILDING BRITAIN'S FUTURE

General

Even after Britain formally detaches itself from the EU, there is no sign that the rate at which its population is increasing is going to slow down.

According to the latest estimates, the country is home to 66.57 million people and growing by just over half a per cent every year, a rate which places an ever-greater premium on available quality housing stock.

Just as bold thinking is needed to solve that problem, radical solutions might also, though, energise the housing sector in a way which other countries have embraced.

In the past, France, the United States, Australia and Austria have all give builders or property developers tax breaks in return for helping improve the social infrastructure.

Most recently, Kenya halved the rate of Corporation Tax payable by developers who agreed to construct a proportion of low cost homes, while last year in Malaysia, the government waved a 'Sales and Services Tax' of six per cent on materials for the building of homes below a certain value.

That approach would provide evidence of tax breaks serving both a social and economic purpose and is the sort of multi-faceted venture which a post-Brexit Britain may well need.

In Post-Brexit Britain, then it would seem this could be done without any accusations of State Aid.

"the country is home to 66.57 million people and growing"

Social Housing Investment Relief?

Could the UK tax system be used to provide impetus for the construction of social and affordable housing?

Of course, new housing developments are generally required to provide some affordable housing. However, where this prejudices the profitability of a development, the developer is often allowed to make a different contribution to the surrounding area.

But what if such development could be made more attractive financially through the tax system?

It is strange that this does not seem to have been attempted by any Government.

As we have outlined earlier in this paper, relief is thrown around for investment in innovation (up to 230% relief) by Companies. We have also seen attractive relief provided to individuals investing in growth companies (EIS and Seed EIS) and also by Companies making similar investments (anyone remember the Corporate Venturing Scheme). In the past, there was also something called the Business Property Renovations Allowance ("BPRA"), which aimed to bring back into use vacant commercial property.

So why could a similar investment relief not be introduced for investment in social housing?

This could take a number of forms:

- **Housebuilders: One could provide quite a simple relief where a housebuilder who invests at least, say, £1 million in constructing social housing can get tax relief of 200% of those costs against their other trading profits. The amount of relief could be capped.**

- **Other Companies & Individuals: You could also provide tax reliefs for non-housebuilder Companies and individuals who invest in developers who are active in social housing above a specified threshold.**

For example, at least 30% of the properties they build are social housing projects. The Company and the individual will get a tax credit based on a percentage of their investment. The investee company would need to maintain its qualifying status for a minimum period otherwise the relief which it obtained could be clawed back.

Again, outside of the EU institutions, this could be done without the threat of an intervention over State Aid.

"£1 million in constructing social housing can get tax relief of 200%"

CONCLUSION

The predicament facing the UK is one which is unprecedented in living memory and, unsurprisingly, many people fear that the economy will be subject to turbulence.

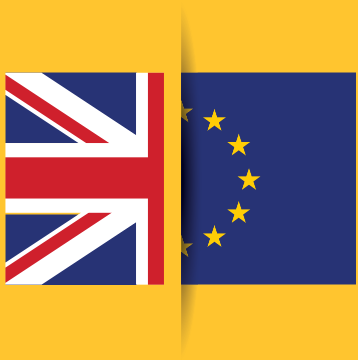
A continued lack of resolution to the negotiations adds to the uncertainty.

That can only be overcome by examining all the possible consequences of the various outcomes and coming up with effective policy responses to each in advance of such eventualities occurring.

It is the fundamental reason why we believe the time to talk about tax as a potential enabler for properity is now and not after either a negotiated or 'no deal' exit.

The onus is the same for Brexiteers and Remainers alike. After all, the desire for a stable economy is surely the same, regardless of how individuals voted in the 2016 referendum.

“the continued lack of resolution to the negotiations only adds to the uncertainty”



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