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Tax policy in the UK post-Brexit

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Abstract: Tax matters figured prominently in the Brexit debate. Current signs are, however, that the UK government is not planning the creation of a post-Brexit 'Singapore on Thames' as some had predicted. In fact, we are seeing increases to the main corporation tax rate in response to broader international tax developments and the fiscal upheaval caused by the pandemic. Prior to Brexit, the UK already enjoyed considerable freedom in respect of direct taxes including income tax and corporation tax, but less so for VAT; it has more freedom to change the VAT now, if desired, and has already introduced some relatively small amendments to reflect the new state of play. At this point, the government has exercised its new-found freedoms on tax in quite limited ways—most notably in creating freeports which will benefit from special advantageous customs and tax rules, refocusing R&D tax relief towards activity conducted in the UK, making relatively minor changes to tonnage tax, alcohol duties, and air passenger duty, and removing some narrow EU-focused corporation tax measures. However, these new-found tax freedoms come with new-found restrictions, costs, and challenges for both taxpayers and the UK government. There are significant changes on the tax administration front, which generally complicates matters for HMRC as it will have to rely on less extensive and less convenient treaty and OECD avenues of cooperation. On VAT, teething issues as well as longer-term complications have arisen post-Brexit for businesses and consumers. Provisions remain to control the extent of fiscal state aid, albeit in a less restrictive way under the new subsidy control mechanism in the UK/EU Trade and Co-operation Agreement. The strong overall message is that financial and international pressures and constraints are more important to the direction of tax policy than the fact that the UK has left the EU.

Keywords: EU, trade, tax, tax law, business tax, value added tax

JEL classification: F15, H20, H25

I. Introduction

Taxation figured strongly in the Brexit campaign. Correctly anticipated issues included increased complexity around VAT for cross-border transactions and the introduction of freeports,[1] but much discussion was in the form of speculation that the UK would become a new tax haven—the 'Singapore on Thames' concerns—despite it being clear

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[1] Even though freeports of some description probably could have been introduced even within the EU (see below).

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for some time that this was an overly-simplistic view, given the international pressures arising around taxation.[2] There were even conspiracy theories around the motivation of Leavers being to escape anti-tax avoidance legislation.[3] Although completely and comprehensively disproved by Full Fact and others (the UK had already enacted much of the relevant legislation and had led the way on much of it), these allegations left their mark (Full Fact, 2019). So strong were the stories about the UK becoming a tax haven that at a hearing of the European Parliament on 26 January 2021, MEPs continued to express their conviction that Brexit would lead to reductions in UK corporation tax, despite being given explanations as to why this seemed unlikely.[4]

On 3 March 2021, the Chancellor removed some of the doubt about project 'Singapore on Thames'. He announced that in the light of the huge costs arising from the Covid-19 pandemic, UK corporation tax would be increased rather than decreased as some had expected. From April 2023 the main UK corporation tax rate will go up to 25 per cent from 19 per cent,[5] the first hike in the headline rate of corporation tax in 50 years. This appears to have been a surprise to some, but the tax and business communities mostly expected an increase, given the need for revenue. It is true that in tandem with the UK corporate tax rises new 'super deductions' were introduced for a 2-year period (deductions at 130 per cent of cost for plant and machinery).[6] These, however, may do little more than balance the pressure that would otherwise exist to defer capital investment until the 25 per cent deduction was available in 2023.[7] It is not impossible that enhanced deductions for investment will continue after this 2-year period, but the UK normally has relatively low investment allowances, so some continuation of enhancement of capital allowances (although not a super-deduction) would not put it out of line with other G7 countries on investment incentives.

The corporation tax rate increase may also be linked to UK expectations around international tax developments, notably the introduction of a global minimum tax rate, which is looking more likely to become a reality following the election of President Biden in the USA.[8] In October 2021, the OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting agreed on a two-pillar approach aimed at addressing some of the tax challenges arising from the digitalization of the economy.[9] Pillar One seeks to adapt the international income tax system through changes to the profit allocation and nexus rules applicable to business profits of very large multinationals. Pillar Two

[2] As discussed in Freedman (2017).

[3] This hinged around the Anti-Tax Avoidance Directive ('ATAD'), Council Directive (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market, https://ec.europa.eu/taxation_customs/business/company-tax/anti-tax-avoidance-package/anti-tax-avoidance-directive_en.

[4] Evidence of Judith Freedman to the European Parliament on 26 January 2021, https://www.europarl.europa.eu/committees/en/the-impact-of-brexit-on-the-level-%20playin/product-details/20210120CHE08142.

[5] Finance Act 2021, s 6.

[6] Finance Act 2021, ss 9–14.

[7] Although see Devereux (2021), who argues that for the next 2 years the super-deduction is likely to have a very strong impact on levels of investment—as much as 50 per cent higher.

[8] Politi *et al.* (2021). Domestic obstacles in the USA remain, however.

[9] See OECD, 'Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy – 8 October 2021', https://www.oecd.org/tax/beps/statement-on-a-two-pillar-solution-to-address-the-tax-challenges-arising-from-the-digitalisation-of-the-economy-october-2021.htm

sets a global minimum corporate tax rate of 15 per cent, establishing a floor on competition over rates. Having obtained the agreement of over 135 countries, the OECD is aiming for implementation in 2023 to 2024, although there is still considerable detail to be agreed and the reaction of the US Congress could be problematic.[10] The impact of USA and OECD tax developments has always been at least as important as EU tax developments for the UK and almost certainly more so, regardless of Brexit.

Taken overall, there is little sign that the UK government is planning the creation of a post-Brexit 'Singapore on Thames' when it comes to taxation policy.

II. A brief overview of the pre-Brexit situation on taxes

The VAT is the most European of UK taxes and thus the one most impacted by Brexit. VAT legislation is adopted under what is now Article 113 of the Treaty on the Functioning of the European Union (TFEU) on the harmonization of turnover taxes, which led to the Sixth Directive imposing a common tax base to VAT throughout the Union, which was subsequently recast as the Principal VAT Directive.[11] The Directives were enacted in the UK in what is now the Value Added Tax Act 1994. The UK was required to implement the VAT rules prescribed by the EU, including on matters such as minimum rates.[12] The entire scheme is premised on special arrangements for members of the internal market. In addition, the EU introduced administrative VAT directives, including a special scheme to reduce burdens on business supplying B2C (business-to-consumer) cross-border digital services known as the MOSS (Mini One Stop Shop). An EU doctrine of abuse of rights is a feature of the UK's VAT following on from the *Halifax* case,[13] though since 2013 the UK has had its own general anti-abuse rule that applies for most other taxes (but not VAT).[14]

In theory, the EU Treaties leave other, direct taxes including income tax and corporation tax as matters for member states under the principle of sovereignty. In practice, there are some important measures and jurisprudence impacting on direct taxation within the EU. Directives to harmonize corporate tax measures can be adopted under Arts 115 and 352 TFEU, but this requires unanimity in the Council with the result that there are very few such measures. However, two important tax Directives were enacted in 1990—the Parent/Subsidiary Directive and the Mergers Directive—designed

[10] Ibid. Under Pillar One, it is claimed that taxing rights on more than US$100 billion of profit will be reallocated to market jurisdictions each year. The global minimum corporate income tax under Pillar Two is estimated to raise about US$150 billion in additional global tax revenues per year.

[11] Sixth Council Directive 77/388/EEC of 17 May 1977 on the harmonization of the laws of the member states relating to turnover taxes—Common system of value added tax: uniform basis of assessment; Council Directive (EC) 2006/112 (OJ L347 11.12.2006, p. 1) on the common system of value added tax ('the Principal VAT Directive').

[12] Principal VAT Directive, Articles 96–101.

[13] Case C-255/02 *Halifax PLC and others* [2006] STC 919 at para 72. The Taxation (Cross-border Trade) Act 2018, s 42(4) expressly confirms that the *Halifax* principle continues to be relevant, in accordance with the European Union (Withdrawal) Act 2018, for the purposes of the law relating to the UK's VAT. On abuse of rights and European tax law, see de la Feria and Vogenauer (eds) (2011) and especially ch. 25 by Judith Freedman.

[14] Finance Act 2013, Pt 5, s 206 *et seq*.

to reduce tax barriers to corporate reorganizations involving EU affiliates and eliminate withholding taxes on dividends paid within corporate groups.[15] Notable others include the Interest and Royalties Directive, the Anti-Tax Avoidance Directive (ATAD), and several directives concerned with tax administration, including the Directives on Mutual Recovery of Taxes, Tax Dispute Resolution Mechanisms, and Administrative Co-operation.[16]

Further, the Court of Justice of the European Union (CJEU) has built up a considerable jurisprudence resulting in constraints on the member states' taxation powers. The CJEU has disapplied the direct tax legislation of member states (including, in the past, that of the EU) on the basis that the law contravened the fundamental freedoms, and in particular the freedom of establishment for businesses (Article 49 TFEU) and the free movement of capital (Article 63 TFEU). UK corporation tax measures that the CJEU found incompatible with the fundamental freedoms include rules on the taxation of dividends,[17] relief for cross-border losses,[18] and controlled foreign companies (CFCs). In the case of the dividends and losses, the issue was essentially that the treatment of groups of companies as a business unit for domestic purposes but not cross border meant that reliefs and advantages were available at a domestic level but not across the EU. This was considered discriminatory and therefore contrary to the operation of the single market. A CFC is a non UK-resident company that is controlled by a UK resident person or persons, and typically benefits from low rates of tax on its profits in its foreign jurisdiction of residence. The CJEU held that CFC legislation must be restricted to wholly artificial arrangements.[19] Setting up in another EU country simply to get a lower tax rate did not in itself constitute abuse. This places limits on the ability of member states to enact anti-avoidance legislation.

[15] Council Directive 90/435/EEC of 23 July 1990, replaced by Council Directive 2011/96/E, OJ L 345, 29 December 2011, on the common system of taxation applicable in the case of parent companies and subsidiaries of different member states, and Council Directive 90/434/EEC [1990] OJ L225/1, replaced by Council Directive 2009/133/EC, OJ L 310, 25 November 2009, on the common system of taxation applicable to mergers, divisions, partial divisions, transfers of assets, and exchanges of shares concerning companies of different member states and to the transfer of the registered office of an SE or SCE between member states, respectively. A Societas Europaea or 'SE' is a public limited-liability company set up within the territory of the EU, as introduced in Council Regulation (EC) No 2157/2001 of 8 October 2001 on the Statute for a European Company. An 'SCE' is a European Cooperative Society which has as its principal object the satisfaction of its members' needs and/or the development of their economic and/or social activities, as introduced in Council Regulation (EC) No 1435/2003 of 22 July 2003 on the Statute for a European Cooperative Society (SCE).

[16] Council Directive 2003/49/EC, OJ L 157, 26 June 2003, on a common system of taxation applicable to interest and royalty payments made between associated companies of different member states; Council Directive (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market; Council Directive 2010/24/EU of 16 March 2010 [2010] OJ L84/1 concerning mutual assistance for the recovery of claims relating to taxes, duties, and other measures; Council Directive (EU) 2017/1852 of 10 October 2017 on tax dispute resolution mechanisms in the European Union; and Council Directive 2011/16/EU, OJ L 064, 11 March 2011 on administrative cooperation in the field of taxation.

[17] Case C-374/04 *Test Claimants in Class IV of the ACT Group Litigation* [2006] ECR I-11673, and Case C-446/04 *Test Claimants of the Franked Investment Income Group Litigation* [2006] ECR I-11753.

[18] Case C-446/*03 Marks & Spencer plc v Halsey* (Inspector of Taxes) [2005] ECR I-10837.

[19] Case C-196/*04 Cadbury Schweppes* [2006] ECR I-07995.

UK policy-driven developments led to major changes to the UK taxation of dividends and CFCs that also had the side-benefit of (likely) making these rules EU-compliant. The group relief losses were specifically amended (quite narrowly) to bring those rules into compliance.[20] The CJEU's decisions on dividend taxation have been the most damaging from the UK's perspective, leading to prolonged litigation in the UK courts involving large compensation claims for overpaid tax running into billions of pounds.[21] The UK has also amended its legislation in response to CJEU decisions involving other member states, including on thin capitalization and corporate exit taxes—but these have been relatively minor and have also been overtaken by EU and OECD developments.[22]

Another relevant aspect of EU law is state aid. Under Article 107 TFEU, save as otherwise provided in the Treaties, any aid granted by a member state or through state resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between member states, be incompatible with the internal market. The developing case law in this area, involving some very well-known multinationals, has established that tax provisions which are in substance state aid can fall within these provisions.[23]

[20] Corporation Tax Act 2010, ss 111–128, inserted by Finance Act 2006, s 27 and Sch 1.

[21] See for example *Deutsche Morgan Grenfell Group plc v Inland Revenue Comrs* [2006] UKHL 49, and *Test Claimants in the Franked Investment Income Group Litigation v HMRC* [2020] UKSC 47. The focus of the ACT Group Litigation, including *Deutsche Morgan Grenfell*, is on the UK legislation which prevented UK-resident subsidiaries of foreign parents from making group income elections, thereby obliging them to pay Advance Corporation Tax when paying dividends to their foreign parents. The focus of the FII Group Litigation is on UK-parented groups with foreign subsidiaries, and on the tax treatment of dividends coming into the UK from abroad. A further set of claims arising in Case C-201/05 T*est Claimants in the CFC and Dividend Group Litigation v Inland Revenue Commissioners* [2008] ECR I-02875 also concerns claims that the tax treatment of dividends paid by foreign subsidiaries to UK-resident companies was incompatible with EU law, with a particular emphasis on 'portfolio' holdings of less than 10 per cent of the shares of the relevant companies.

[22] The UK removed an exemption for UK–UK transactions in its transfer pricing rules now found in the Taxation (International and Other Provisions) Act 2010, Part 4, which also applies to thin capitalization, following the decision in Case C-324/00 *Lankhorst-Hohorst GMBH v Finanzamt Steinfurt* [2002] ECR I-11779. Thin capitalization refers to the situation in which a company is financed through a relatively high level of debt, giving rise to tax deductions for interest expense, compared to equity where dividends are typically not tax-deductible. In a cross-border situation the paradigm concern is where the interest-payer is resident in a high-tax country and the recipient of the interest is resident in a low- or no-tax country: see also Case C-524/04 *Test Claimants in the Thin Cap Group Litigation v Commissioners of Inland Revenue* [2007] ECR I-2107. Corporate exit taxes are home-state tax provisions triggered by a change in tax residence of the company, or the move of taxable assets of the company from the home state to another jurisdiction. Such taxes could be a disincentive for companies to move from one EU country to another, but the negative effects can be reduced through administrative measures such as deferring payment of the tax—see Case C-371/10 *National Grid Indus BV v Inspecteur van de Belastingdienst Rijnmond/kantoor Rotterdam* [2011] ECR I-12273 and the Taxes Management Act 1970, Sch 3ZB.

[23] See, for example, Cases T-778/16 and T-892/16 *Ireland v European Commission (Apple Sales International)* ECLI:EU:T:2020:338, in which the General Court annulled the decision of the European Commission that Ireland had granted Apple €13billion in unlawful state aid in the form of tax advantages. The Commission has decided to appeal the General Court's decision to the CJEU. The General Court also annulled the Commission's decision in Cases T-816/17 and T-318/18 *Luxembourg v Commission; Amazon EU Sarl and Amazon.com Inc. v Commission* ECLI:EU:T:2021:252, but upheld the Commission's decision in Cases T-516/18 and T-525/18 *Luxembourg v Commission; Engie, Engie Global LNG Holding Sarl and Engie Invest International SA v Commission* ECLI:EU:T:2021:251.

III. New-found tax freedoms

Following the UK's exit from the EU, the UK will enjoy some new-found freedoms in the field of taxation. This is most clearly the case with respect to VAT, where the UK is free to modify its VAT rules as it sees fit, unfettered by the Principal VAT Directive. The UK could, for example, reduce the standard rate of VAT from its current level of 20 per cent to below the 15 per cent minimum mandated by Article 97 of the Principal VAT Directive. Even a full repeal of VAT is possible, but very unlikely given that VAT is the third-largest source of UK tax revenue, generating £134 billion in 2019–20. Some minor policy changes to VAT have already been made in exercise of the new freedom, most notably the move to a zero rate of tax on women's sanitary products.[24]

UK VAT legislation has been amended to reflect the new state of play, removing special rules formerly related to goods moving between EU member states (e.g. on place of supply and distance selling, acquisition VAT, and cross-border supplies of electronic services).[25] Under the Withdrawal Agreement, however, certain elements of EU law concerning VAT on goods, including the Principal VAT Directive, continue to apply to and in the UK in respect of Northern Ireland; consequently, new VAT rules were required to implement these special arrangements on the movements of goods between Northern Ireland and the rest of the UK, and between Northern Ireland and the EU.[26]

Early indications are that the UK plans to stick closely with its existing VAT regime for now. There are clear advantages to taxpayers in terms of stability and compliance costs from the UK maintaining a VAT regime substantially similar to its current model and the one used by its closest trading partners. On the other hand, the EU VAT was one of the earliest VAT models and looks out-dated and clunky compared to some of its newer counterparts, which tend to have a one rate, broad-base structure with few exemptions. Such a VAT is simpler to comply with and administer, less open to political interference, reduces costly uncertainty and litigation at the boundaries between differently-rated categories, and is less distortive than the EU model.[27] The UK's 'freedom' to reduce rates and provide exemptions may very well become a major burden to politicians as special interest groups press for special treatment. The zero rate on women's sanitary products is a case in point: while political campaigners argued it would promote gender equality and protect lower-income women, the move can also be criticized on tax policy grounds for creating yet another distinct category with the associated administration issues and risks of litigation around the borderline, because prices tend not to fully reflect reductions in VAT, and even on progressivity grounds as richer women are much more likely to benefit from the rate reduction than poorer women.[28]

[24] See VATA 1994, Sch 8 Pt II Group 19, with effect from 1 January 2021.

[25] See in particular amendments to the VATA 1994 introduced by the Taxation (Cross-border Trade) Act 2018, ss 41–43 and Sch 8, with effect from the end of the implementation period at 23.00 on 31 December 2020. Rate freedom that would permit this might be introduced by the EU, but these reforms have been postponed: see https://www.avalara.com/vatlive/en/vat-news/eu-2022-eu-vat-rate-setting-freedoms.html.

[26] See Agreement on the withdrawal of the United Kingdom of Great Britain and Northern Ireland from the European Union and the European Atomic Energy Community (October 2019), Protocol on Ireland/Northern Ireland, art 8 and Annex 3. The Withdrawal Agreement also allows the UK to apply in Northern Ireland exemptions and reduced rates applicable in Ireland: art 8. See also the Taxation (Post-transition Period) Act 2020, ss 3, 7, and Sch 2–3, adding Sch 9ZA and 9ZB to the VATA 1994.

[27] See de la Feria and Krever (2013, pp. 3–35). See also James (2015).

[28] de la Feria (2021). See also de la Feria and Walpole (2020). Equally it will be less easy to argue against removal of exemptions such as that for private schools, given that EU rules cannot be used as a reason against doing so.

There is also the thorny question of how closely the UK will/should track future EU developments. Currently the EU is consulting on modernizing the VAT treatment of financial and insurance services. At present, these services are exempt from VAT, which means businesses are unable to reclaim VAT associated with financial and insurance services. The current rules have been criticized for being non-neutral, uncertain, difficult to apply, creating high administration and regulatory costs, and failing to keep pace with the development of new services in the sector.[29] The freedom to change these rules could be a real positive: the UK is, of course, free to make such changes regardless of the outcome of the EU consultation and will no doubt be watching developments with interest. In fact, post-Brexit, UK banks and other financial institutions have a comparative advantage in financial and insurance service in that they will be able to recover some VAT on supplies to EU recipients under rules formerly restricted to non-EU recipients, whereas EU providers are not able to so recover[30]—as the rules currently stand and pending the outcome of the EU consultations mentioned earlier.

On other taxes, the UK already enjoyed considerable freedom to legislate over matters such as the headline rate of corporation tax—so the post-exit benefits are less substantial and lower rates could have been introduced without leaving the EU had this been the plan. Likewise, the higher corporate tax rate introduced in 2021 (with effect from 2023) was not dependent on Brexit.

One change is that the fundamental freedoms and associated CJEU case law discussed above will no longer apply, leaving the UK free to undo amendments necessitated by those, including the narrowly drafted relief for losses of non-UK subsidiaries of UK companies where there was no possibility of relief in the subsidiaries' jurisdiction and the restrictions on anti-avoidance legislation. Going forward, UK tax law will no longer be subject to compatibility review with the fundamental freedoms by the CJEU, with the uncertainty, instability, and sizeable revenue implications that can have—as seen with the example of the UK's former rules on the taxation of dividends in particular. Removal of the constraints imposed by the four freedoms might actually make it easier for the UK to comply with the OECD/G7 Pillars proposals as it has been suggested that the four freedoms might create difficulties for the EU member states to do so.[31]

The government has already announced plans to establish up to 10 freeport sites as part of its post-Brexit Global Britain vision, and also to help advance its innovation and levelling-up agendas.[32] These designated geographical areas will benefit from special advantageous customs rules including a suspension of import VAT, plus a variety of other time-limited tax incentives including reduced employer National Insurance contributions, business rates relief, enhanced capital allowances, and stamp duty land tax exemptions.[33] The government claims the freedom to do this as an advantage of Brexit, although in practice the UK has had freeports during its time as a member state and a large number

[29] See European Commission, 'VAT rules for financial and insurance services—review' at https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12671-Review-of-the-VAT-rules-for-financial-and-insurance-services.

[30] These supplies will attract the beneficial input VAT treatment available generally on supplies to non-EU persons pursuant to the VAT (Input Tax) (Specified Supplies) Order, SI 1999/3121: see Dickie and Haworth (2021).

[31] Devereux *et al.* (2020). The EU Commission is expected to bring forward proposals to deal with this in December 2021 (https://www.accountancyeurope.eu/tax/tax-policy-211202/).

[32] For more details on the plans for freeports in England see HM Government (2020).

[33] See, for example, Finance Act 2021, ss 113–115 and Sch 22, 23. These incentives are generally available for 5 years, expiring in 2026.

of freeports exist within the EU.[34] On the other hand, EU freeports are subject to some restrictions that make them more limited in scope than their international counterparts, including Single Market regulations in the Union Customs Code and the state aid regime, and these restrictions will cease to apply to the UK post-Brexit (state aid is discussed further below).[35] However, critics point out that freeports give rise to significant risks of fraud and other undesirable activity and may not be as beneficial as claimed economically since they may simply cause activity that would have occurred anyway to relocate.[36]

A further example of freedom to make changes post-exit has been the repeal of the bulk of the legislation enacted in respect of the fifth amendment to the Directive on Administrative Co-operation concerning disclosure of tax arrangements (referred to as DAC 6).[37] This was popular with tax professionals and commentators, since the DAC 6 requirements are very cumbersome and yet the mischiefs aimed at are largely covered already by existing UK disclosure legislation.[38] Nevertheless the gains are limited, since disclosure will be required under DAC 6 by anyone dealing with an EU member state. In any event the UK does intend to legislate to ensure it meets the proposed OECD standards in this area.[39] Claims that this is an example of the UK easing up on tax avoidance are unfounded; this simply provides an early example of the UK preferring the OECD approach to that adopted by the EU.

Finally, at the autumn Budget 2021 the Chancellor announced a set of tax measures under the headline 'Seizing the opportunities of Brexit'. Despite the dramatic sounding headline, these changes were relatively modest and some, although not all, could have been achieved at least in part while still in the EU. The most notable ones were to refocus research and development tax reliefs towards activity conducted in the UK, and to abolish special corporation tax reliefs in respect of European Economic Area cross-border losses including those referred to in section II above. Other measures related to lower-profile taxes, including to the tonnage tax on shipping 'to encourage shipping companies to move to the UK', reforming alcohol duties 'to best suit national priorities', and decreasing air passenger duty on domestic flights 'to bolster UK air connectivity', but increasing it on long-haul travellers.[40]

The UK government is also consulting on a new regime for corporate redomiciliations into the UK.[41] Unlike many other jurisdictions, the UK has no regime allowing for a non-UK entity to redomicile in the UK nor for a non-UK entity to redomicile outside the UK. There are work-arounds used in practice, but one of them involved using the EU cross-border merger regime, now no longer available.

[34] Ward (2018). According to Ward (para 1.3), seven freeports operated in the UK at various points between 1984 and 2012 and there are currently 83 freeports operating in the EU.

[35] Ward (2018).

[36] See Forrest *et al.* (2021) and Morris (2019).

[37] International Tax Enforcement (Disclosable Arrangements) (Amendment) (No. 2) (EU Exit) Regulations, SI 2020/1649, repealing large parts of Council Directive 2011/16/EU on administrative cooperation in the field of taxation as implemented in the UK by International Tax Enforcement (Disclosable Arrangements) Regulations, SI 2020/25.

[38] Disclosure of Tax Avoidance Schemes ('DOTAS'), Finance Act 2004, Pt 7.

[39] HMRC, Draft Regulations: Mandatory Disclosure Rules Consultation, 30 November 2021, https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1037442/HMRC_consultation_Mandatory_Disclosure_Rules.pdf

[40] HM Treasury, *Autumn Budget and Spending Review 2021* (HC 822, 27 October 2021), paras 2.170–2.191.

[41] BEIS, HMRC, and HMT, 'Corporate re-domiciliation: consultation on the Government's proposals' (October 2021), https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1028386/Corporate_Re-domiciliation_-_Consultation_on_the_Government_s_proposals_25102021.pdf.

IV. New-found restrictions and challenges

Undeniably, these new-found tax freedoms come with new-found restrictions, costs, and challenges for both taxpayers and the UK government. There are significant changes on the tax administration front as well, which generally complicates matters for HMRC as it will have to rely on less extensive and less convenient treaty and OECD avenues of cooperation.[42] There are also very large administrative costs, not to mention the compliance costs that have arisen from leaving the single market and becoming a third country *vis-à-vis* the EU for VAT purposes. Government resources have been diverted to making new arrangements around these issues, away from badly needed modernization and digitalization of UK taxation more generally.

(i) Direct tax

The relatively few Directives on direct tax matters cease to apply to UK companies, which will create tax problems for both UK companies and their EU-affiliates. The UK legislation enacting the Interest and Royalties Directive was repealed in the Finance Act 2021,[43] but the effect will be mitigated by domestic law and bilateral tax treaties, which may already provide comparable tax relief, for example by eliminating withholding taxes on interest payments, or which could be amended over time through bilateral negotiation with the UK's treaty partners. Because the UK does not impose withholding taxes on outbound dividend payments, the loss of the Parent-Subsidiary Directive is more of concern for UK companies receiving dividends from EU member states than for those UK companies paying them. Companies in receipt of dividends from the EU will need to rely on the member state domestic legislation and the relevant treaty between the member state and the UK, which may not currently offer the former complete relief, for example, the UK treaties with Germany and Italy, but, again, could be renegotiated over time. Importantly, the state aid rules will also cease to apply to the UK but are replaced by domestic rules (discussed below).

(ii) State aid and tax governance

The key new restrictions for the UK come in the form of the tax related aspects of the UK/EU Trade and Co-operation Agreement (TCA).[44] Many are based on provisions commonly found in other trade agreements, including those concluded by the EU and, recently, the UK. These include the prohibition on customs duties on imports unless otherwise specified and also restrictions on duties, taxes, etc. on exports,[45] along with familiar carve-out protections provided to domestic tax law measures ensuring the equitable or effective imposition or collection of direct taxes and to double tax

[42] Collins and Robins (2021).

[43] Finance Act 2021, s 34 repealed ITTOIA 2005, ss 757–767 (exemption from income tax for certain interest and royalty payments) and ITA 2007, ss 914–917 (discretion to make royalty payments gross).

[44] Trade and Cooperation Agreement between the European Union and the European Atomic Energy Community, of the one part, and the United Kingdom of Great Britain and Northern Ireland, of the other part [2020] OJ L444/14.

[45] TCA, Art.GOODS.5 and Art.GOODS.6. See also Pirlot (2021, pp. 2–3).

conventions.[46] Two others chapters in the TCA, however, are more novel and impose important restrictions on the UK's taxation powers post-exit: (i) subsidy controls[47] and (ii) tax standards and good governance.[48]

First, as discussed in detail in the paper in this issue by Crafts,[49] the TCA introduces new 'subsidy controls' in Title XI, Chapter 3 to replace the EU state aid rules discussed above with a bespoke and detailed new regime modelled on the state aid rules, but also departing from them in significant ways in relation to taxation. It is a softer regime than the pre-Brexit EU regime, yet more than would have been required had the UK been subject only to World Trade Organization rules.

As the definition of the term 'subsidy' in Article 3.1(1)(b) specifically includes 'the foregoing of revenue that is otherwise due', it is clear that tax measures are within the scope of the controls. Three further elements of the definition need to be satisfied for the subsidy control regime to apply, which are that the measure confers an economic advantage, is specific in its benefit in that it benefits certain economic actors over others in relation to the production of goods or services, and affects trade or investment.[50] In the particular case of a tax measure, the benefits provided are determined by reference to the tax liability borne under 'the normal taxation regime' by those in a comparable position,[51] which codifies the reference system approach adopted by the European Court and the Commission in state aid cases involving taxation.[52] The identification of the 'normal taxation regime' involves an assessment of the regime enacted by an autonomous authority in light of the regime's objectives and features (including tax base, tax unit, taxable event, and tax rate).[53]

Importantly, tax measures can be justified as not specific

> by principles inherent to the design of the general system... [including] the need to fight fraud or tax evasion, administrative manageability, the avoidance of double taxation, the principle of tax neutrality, the progressive nature of income tax and its redistributive purpose, or the need to respect taxpayers' ability to pay.[54]

As Baker highlights, although many continental European countries have written constitutions which incorporate tax principles including ability to pay, the UK does not; consequently the attention paid to developing these principles in the UK context will be

[46] TCA, Title XII 'Exceptions', and especially Art EXC.2 'Taxation'. See also Pirlot (2021, pp. 3–5) and Lyons (2021).

[47] TCA, Title XI 'Level playing field for open and fair competition', Chapter 3 'Subsidy control' and Subsidy Control Bill 2021. At the time of writing, the Subsidy Control Bill has received its first reading in the House of Commons. See also Baker (2021*a*,*b*).

[48] TCA, Title XI 'Level playing field for open and fair competition', Chapter 5 'Taxation' and in particular Articles 5.1 'Good governance' and 5.2 'Taxation standards'. See also Pirlot (2021, pp. 5–13) and Baker (2021*a*). It should also be noted that Art 5.3 excludes Ch 5 from dispute settlement under Title I [Dispute settlement] of Part Six [Dispute settlement and horizontal provisions].

[49] Crafts (2022, this issue).

[50] TCA Title XI, Chapter 3, Art 3.1(1)(b).

[51] TCA Title XI, Chapter 3, Art 3.1(2) and Subsidy Control Bill, cl 4(4).

[52] Baker (2021*a*, 19–20).

[53] TCA Title XI, Chapter 3, Art 3.1(2)(a)(ii) and Subsidy Control Bill, cl 4(5). See also Baker (2021*a*, pp. 19–20).

[54] TCA Title XI, Chapter 3, Art 3.1, para 2(b). The listed examples are reproduced in Subsidy Control Bill, cl 4(3).

interesting to follow.[55] Special purpose levies will also be considered not specific if they are aimed at non-economic policy objectives such as limited negative environment or health effects.[56] Pirlot notes that the language used in the TCA closely resembles that used in Commission notices on the application of state aid to direct taxes issued in 1998 and 2016.[57] Baker also rightly questions whether any difference in practice exists between 'specific benefits' for this purpose and the concept of selective advantage in EU State aid law.[58] There are clear differences on oversight between the subsidy control and state aid regimes, however. For example, unlike the European Commission on state aid matters, the UK's Competition Market Authority that is charged with administrating the subsidy controls has no investigative role.[59] Although it is early days, Baker concludes that the subsidy control regime is 'significantly softer' than the EU state aid regime,[60] which suggests that UK companies will find the new regime less restrictive in relation to taxation measures. If the EU considers that a UK tax measure amounts to a subsidy that causes negative effects on trade or investment, its main option will be to adopt remedial measure unilaterally.[61]

Second, the TCA Title XI, Chapter 5 contains tax standards and tax good governance provisions, pursuant to which both the EU and UK agree to maintain a commitment to adhering to certain OECD standards, including some arising from the OECD's work aimed at addressing Base Erosion and Profits Shifting (BEPS).[62] Importantly, compliance with the OECD standards is measured according to the standards as they existed at 31 December 2020; the UK is not bound to adhere to future developments.[63] The UK's quick post-exit repeal of the bulk of the legislation enacted in respect of DAC 6 was in line with the relevant OECD standards,[64] and thus provides an early example of the effect of the UK ditching EU standards in favour of those of the OECD. The TCA's requirement for adherence to BEPS-related measures—including limits on the deductibility of interest, CFC rules, and anti-hybrid mismatch rules[65]—are unlikely to be problematic for the UK because the UK played a lead role in developing these measures and was an early adopter in legislating them into UK law.

Since the requirement on the UK is now to have standards of good tax governance and fair taxation rather than EU standards, this may appear to increase the UK's freedom from the EU, although international standards are increasing and are a real control. In addition, as Lyons points out, '[t]he corollary of this increased legal freedom

[55] Baker (2021*a*, p. 22).

[56] TCA Title XI, Chapter 3, Art 3.1, para 2(c).

[57] [1998] OJ C384/3 (10 December 1998) and [2016] OJ C262/1 (19 July 2016). The similarities in language are considered further in Pirlot (2021, pp. 9–10).

[58] Baker (2021*a*, pp. 14, 19).

[59] Baker (2021*a*, pp. 14, 19). See also Baker, (2021*b*, pp. 361, 363).

[60] Baker, (2021*b*, pp. 361, 362).

[61] Pirlot (2021, pp. 2–3).

[62] For more on BEPS see OECD, 'International collaboration to end tax avoidance', https://www.oecd.org/tax/beps/

[63] TCA Title XI, Chapter 5, Art 5.2, para 1.

[64] Council Directive 2011/16/EU on administrative cooperation in the field of taxation, implemented in the UK by International Tax Enforcement (Disclosable Arrangements) Regulations, SI 2020/25. The UK will also add to its existing disclosure requirements in line with new OECD requirements. See HMRC, Draft Regulations: Mandatory Disclosure Rules Consultation, 30 November 2021, https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1037442/HMRC_consultation_Mandatory_Disclosure_Rules.pdf

[65] TCA Title XI, Chapter 5, Art 5.2, para 1(b).

for the UK is, however, increased legal freedom for the EU', so that the EU is also free of some of the constraints it had formerly on its dealings with the UK.[66]

(iii) VAT

On VAT, teething issues as well as longer-term complications have arisen post-Brexit for businesses and consumers. The UK is now a third country for VAT as far as the remaining member states are concerned, with the result that goods exported from the UK will be subject to VAT in the destination country, and goods imported into the UK from the EU will be subject to UK VAT. VAT on sales directly to consumers is treated much differently post-Brexit. Previously, until the distance-selling threshold was crossed, EU retailers would charge VAT at their local rate and remit to their local tax authority. Now, with no distance-selling threshold applicable in the UK, in relation to goods worth less than £135, VAT should be charged by the EU retailer and remitted to HMRC, requiring registration in the UK, thus introducing a new compliance burden that will be particularly unattractive for small EU retailers. If the goods are worth more than £135, VAT and customs duties apply on import and should be paid on delivery by the consumer.[67] The former Low Value Consignment Relief, which relieved import VAT on goods valued at £15 or less, has been abolished.[68] Further, UK businesses will no longer be able to use the administratively simpler Union MOSS system for telecommunications, broadcasting, and electronic services and the EU-wide VAT threshold for supplies of digital services to consumers will cease to apply to UK businesses.[69] Compounding these challenges is the EU's introduction, from 1 July 2021, of an extension to MOSS by way of a revised one-stop-shop (OSS) system for e-commerce businesses, aimed principally at reducing VAT fraud by non-EU based sellers but also to simplify compliance.[70] The new EU system involves three one-stop schemes—a Union scheme, a non-Union scheme, and an import scheme. The OSS allows businesses registered in an EU member state to avoid multiple registrations in other states (upon crossing the new pan-EU distance-selling threshold) by accounting for VAT through a single return via the OSS. The import scheme (IOSS) facilitates the monthly payment of import VAT on low-value goods by suppliers outside the EU, requiring registration or a representative. It is estimated that approximately 26,000 UK-based ecommerce sellers, around 10 per cent of the UK sector, will need to register for VAT for the first time

[66] Lyons (2021, pp. 26–9).

[67] HMRC, 'Changes to VAT treatment of overseas goods sold to customers from 1 January 2021', available at https://www.gov.uk/government/publications/changes-to-vat-treatment-of-overseas-goods-sold-to-customers-from-1-january-2021/changes-to-vat-treatment-of-overseas-goods-sold-to-customers-from-1-january-2021. The £135 threshold for VAT aligns with the customs duty threshold.

[68] HMRC, 'Changes to VAT treatment of overseas goods sold to customers from 1 January 2021', available at https://www.gov.uk/government/publications/changes-to-vat-treatment-of-overseas-goods-sold-to-customers-from-1-january-2021/changes-to-vat-treatment-of-overseas-goods-sold-to-customers-from-1-january-2021.

[69] HMRC, 'Accounting for VAT on services between the UK and EU Member States from 1 January 2021' available at https://www.gov.uk/government/publications/accounting-for-vat-on-goods-moving-between-great-britain-and-northern-ireland-from-1-january-2021/accounting-for-vat-on-services-between-the-uk-and-eu-member-states-from-1-january-2021

[70] Janering (2021), and see https://ec.europa.eu/taxation_customs/business/vat/vat-e-commerce/oss_en.

under the new system, at a cost of at least €8,000 a year each or roughly €208m (£180m) in total, with smaller sellers paying postal services or selling platforms to handle the VAT instead.[71]

All of these VAT changes, on top of customs, excise, and other Brexit-related changes, undoubtedly will make EU–UK trade in goods and services, and in particular business-to-consumers trade, more expensive, more complicated, and less attractive for both businesses and consumers. Some businesses have responded by setting up separate operations in the EU to serve European markets, which has led to additional costs and reductions in the UK workforce.[72] The extent to which these shifts are driven by tax factors is difficult to disentangle from other factors, including new regulatory and customs requirements and also the effects of the pandemic. However, in a recent survey of businesses with trading links between the UK and Germany, 45 per cent of respondents identified new or additional duties and tariffs as one of the three biggest operational challenges encountered post-Brexit, along with additional administrative burdens (76 per cent) and rising freight rates (38 per cent).[73] Further, 51 per cent of surveyed companies expected the importance of UK–German business to decline in the long run. The survey also indicates most of these businesses are not expecting 'Singapore on Thames' either: only 24 per cent of respondents were hopeful for more favourable tax rates or a more advantageous tax system, while 49 per cent considered this somewhat or extremely unlikely.

(iv) Other areas

Finally, a myriad of other issues are starting to emerge. For example, Italian residents who own property in the UK are apparently finding themselves subject to unexpected increases in wealth taxes.[74] There are also worries about high-income taxpayers in the finance industry in particular relocating out of the UK to Amsterdam, Frankfurt, and Dublin. Bearing in mind the top 1 per cent of taxpayers (around 350,000 people) pay nearly 30 per cent of income tax, that is a significant concern. Another disadvantage of Brexit, it has been suggested, might be that the UK will have no influence over the EU's list of non-cooperative jurisdictions, leading to consequential disadvantages for those jurisdictions.[75] This may occur, but equally there is pressure on the EU to recognize the methodology for selecting these jurisdictions is flawed.[76]

[71] Barnes and Foster (2021), citing estimates from the consulting firm Avalara.

[72] Thomas and Foster (2021). A survey conducted for the *Financial Times* and carried out by the Institute of Directors found that nearly a quarter of businesses that trade with the EU have had to relocate some operations or staff.

[73] KMPG and British Chamber of Commerce in Germany (2021). Ninety-three BCCG member organizations and other companies 'with a German–British business relationship' were surveyed between 23 March and 12 April 2021. Notably, 77 per cent of surveyed companies reported difficulties moving goods from Germany to the UK, and 72 per cent moving goods in the other direction.

[74] Rowlinson (2021).

[75] European Parliament (2021).

[76] Enache (2021).

V. Future EU developments

The EU tax programme continues to be active, with a current focus on raising so-called own- resource taxation to provide revenue for the European Recovery and Resilience Plan, the aim being to mitigate the economic and social impact of the coronavirus pandemic. Initially it was proposed to do this by way of a new EU digital levy. Given that the UK already has a digital services tax, participation in this new levy would have been problematic had the UK remained an EU member. In any event, the OECD/G7 Pillar I and Pillar II plans discussed above are conditional on removal of the digital services taxes as far as the USA is concerned and the UK would comply with this.[77] The EU has deferred its discussion of its digital levy while negotiations on an international plan continue, but some suggest that it could still attempt to create a levy that is consistent with the OECD proposals.[78] If the EU tries to do this, it is likely to be an area of friction with the USA, and the UK will be pleased not to be part of this discussion.

An alternative source of own resource revenue for the EU was suggested: the proposed EU carbon border adjustment measure (the 'CBAM proposal').[79] The UK was a frontrunner in emissions trading schemes (ETS) adopting a scheme in anticipation of the EU ETS scheme. On exit from the EU it left the ETS and considered two options—a carbon emissions tax or a UK ETS.[80] Legislation was introduced to cover both options. The Finance Act 2021 repealed the provisions introducing a carbon emissions tax and a standalone UK ETS was introduced in January 2021.[81] The TCA requires the UK to maintain carbon prices to provide the same level of protection or more than before exit.[82] This reduces UK concerns about an EU CBAM and, in any event, there are reports that the UK is also considering such a mechanism.[83] It seems that revenue raising is now secondary to the climate mitigation objective, which makes more sense from an environmental perspective.[84]

The EU has also published a communication entitled 'Business in Europe: Framework for Income Taxation' (BEFIT).[85] This is an ambitious programme that includes dealing

[77] OECD, 'Statement on a two-pillar solution to address the tax challenges arising from the digitalisation of the economy', https://www.oecd.org/tax/beps/statement-on-a-two-pillar-solution-to-address-the-tax-challenges-arising-from-the-digitalisation-of-the-economy-july-2021.pdf.

[78] Euronews (2021). But see *Bloomberg Tax*, 'EU Digital Tax Must be Scrapped after Global Deal, Lawmaker Says', 27 October 2021.

[79] European Commission, Proposal for a REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL establishing a carbon border adjustment mechanism COM/2021/564 final. See also https://ec.europa.eu/taxation_customs/green-taxation-0/carbon-border-adjustment-mechanism_en. Although referred to as a tax in the media and elsewhere, the European Commission takes the position that the CBAM is not a tax nor a tariff (the adoption of which requires unanimity in the Council under Art 192(2) TFEU, but an environmental policy tool that is in line with and compliant with international trading rules: see *Financial Times*, 'EU plan for world's first carbon border tax provokes trading partners', https://www.ft.com/content/de7d12e2-0d04-43d4-b38c-cf795854a4a2 (July 16,2021).

[80] Pirlot (2020, pp. 490–7).

[81] BEIS, 'Participating in the UK Emissions Trading Scheme (UK ETS)' https://www.gov.uk/government/publications/participating-in-the-uk-ets.

[82] Pirlot (2021).

[83] 'Financial Times, 'Tory pressure mounts for cross-border carbon levy' https://www.ft.com/content/514058ab-fd27-4318-82e0-dd5501356ebc.'.

[84] Pirlot (2022, forthcoming).

[85] See https://ec.europa.eu/taxation_customs/communication-business-taxation-21st-century_en.

with shell companies and reducing the debt-equity bias, with a major plank being a regime building on the OECD work on the pillars. This document recognizes that the implementation of the OECD Pillar 2 proposals would have implications for existing rules under the ATAD, and specifically for the Controlled Foreign Company (CFC) rules so that it is necessary to 'explore how to best accommodate the interaction between the two rules'.[86] As discussed above, this conflict between international tax law reform and freedom of movement is a problem for the EU: one the UK no longer has to face. Arguably the OECD/G7 changes are of greater long-term significance in any event.

VI. Conclusion

Brexit already has had an impact on VAT administration and burdens for businesses involved in UK–EU trade. Businesses are adapting to these changes, at some cost, but the combination of more burdensome VAT, customs, and regulatory rules looks set to have a sustained negative effect on trade. Brexit may open up the possibility of radical VAT reform, but so far the UK government has not shown an inclination for this. On the direct tax side there are few immediate major impacts, and the loss of benefits under the relatively few EU tax Directives may be offset over time by the UK negotiating similar benefits in its bilateral tax treaties.

The only new tax reliefs we have seen to date on the direct tax side are temporarily increased capital allowances, and freeports that could probably have been introduced without Brexit. Increased subsidies may be a feature of post-Brexit UK, but provisions remain to control the extent of fiscal state aid, albeit in a less restrictive way under the new subsidy control mechanism. As UK tax law will no longer be subject to compatibility review with the fundamental freedoms by the CJEU, this should enhance the stability and predictability of the UK tax legislation. It also may be easier for the UK than for EU member states to introduce any international tax legislation agreed at a global level if those developments aim to limit freedoms in the interests of prevention of tax avoidance. Ironically, in view of the fears that Brexit would assist the UK to become a tax haven, it may actually make it easier for the UK to participate in the reduction of global base erosion and profit shifting. In any event, at the moment there is no sign of a move towards turning the UK into a tax haven. The revenue from companies is needed and the UK has been a key supporter of the OECD international tax reform programme; there is no reason to believe that this is about to change.

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