

BREXIT TAX IMPLICATIONS AND OTHER UK TAX ISSUES

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The Tax Implications of Brexit David Sayers, International Tax Partner, Mazars LLP





Fog in The Channel. Continent Cut Off

How on Earth Did This Happen?
...a Series of Unfortunate Events...



Lies, Damned Lies and Statistics..... The Start of Fake News



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So What's Changed so Far?

Well,

- 2% growth forecast for 2017



- backtracks on economic warnings
- Some things that were predicted
- just haven't come true...but some have
- Sterling was close to parity with the Euro
- Has fallen by 12% and inflation has risen to 3%

How has the economy fared since the Brexit vote?

By Tim Bowler
Business reporter, BBC News

© 28 March 2017 Business



Brexit



With Theresa May about to trigger Article 50 and the UK set to start two years of Brexit negotiations with the rest of the EU, how is the country's economy doing?

Before the referendum last June, many economists produced gloomy forecasts which have since been proved wrong. Consumers' confidence has not suffered, and by and large, things have gone on as before.

However, the UK has not actually left the EU yet - the real change may only happen once it does.

The current uncertainty, ahead of talks between the UK and the rest of the EU, over what form Brexit will take is an issue for many firms when it comes to investment planning.

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Voting on Brexit

- In spite of opposition
- Vote supported in parliament
- Scheduled Departure March 2019
- EU withdrawal bill published July 2017
- Customs paper published August 2017
- Possible future models considered
 - Norway (EFTA & EEA)
 - Switzerland (EFTA but not EEA)
 - Turkey (Customs Union)
 - Canada
 - But the UK wants to go its own way....



Membership of European Economic Area (Norway)

- EU would prefer this...however:
- UK unlikely to agree as:
 - Keeps free movement of people
 - Broadly retains sovereignty of European Court
 - Norway pays significant budget contributions
 - UK keeps most of EU legislation with little or no influence

Membership of Customs Union (Turkey)

- Not a lot of people know, this but:
- Turkey is the only non EU state that belongs to the EU customs union
- So what does that mean?
 - Turkey is the 5th largest trading partner with the EU in terms of goods
 - Turkey cannot vote in EU free trade negotiations
 - Still bound by EU trade policy for other countries

Trading Under WTO Rules (Canada)

- Canada's trade minister has been in London a lot recently...
- Under CETA, 98% of tariffs between Canada and the EU will be eliminated
- Signed October 2016, effective March 2019. Took 7 years to negotiate...1634 pages long...
- Possibility of most favoured nation (MFN) status
- However still no access to EU single market on preferential terms
- Possible fall back position?

Or the UK Can Go its Own Way (Most Likely)

- Made to measure with potentially lower tariffs than under WTO?
- Services are very important to the UK (80% of GDP) so it is essential that these are included
- However unlikely to gain EU market access without agreeing to EU law, in particular free movement of people
- However there are precedents – for example Switzerland has in the past had free movement of people, though more restricted now
- Issues over Ireland – the only EU country with which we have a land border

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So, on to The Tax Consequences Direct Taxes

- CJEU influence on UK law
 - Group relief
 - CFC's



No State Aid

- R&D
- Patent Box
- Share schemes
- No equalization tax

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.....Direct Taxes

- European Directives
 - Parent/Subsidiary
 - Interest and Royalties
 - Mergers



- Transfer Pricing Arbitration goes
- No need to adhere to ATAD, so ...
- CCCTB now more remote for UK

Inbound Investment

- For inward investment into UK the directives are less important:
- No UK withholding tax on dividends since 1973
- No UK capital gains tax for disposals of shares by non residents (unless holding real estate)
- UK has the most extensive treaty network in the world with over 130 treaties
- Interest - withholding tax at rate of 20% can normally be reduced via these treaties
- Royalties - withholding tax at 20% can be reduced on the same basis.
- Care needed for holding companies on new multi lateral instrument...

Outbound Investment – a Real Cost?

- If The UK loses access to the EU parent subsidiary and interest and royalties directive, this may lead to a cost when replaced by tax treaties – potentially between 5-10%:
- Dividends - Germany, Ireland, Italy, Iceland, Austria, Croatia, Czech Republic.
- Royalties - Austria, Bulgaria, Iceland, Croatia, Estonia,
- Lithuania, Czech Republic, Portugal, Romania, Slovenia
- Interest – Poland, Italy, Lithuania, Portugal, Romania, Slovenia

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Brexit and ... Indirect Taxes

- ~~EU Customs Union~~

- Increased import/export costs
- Renegotiate trade agreements?



- VAT
 - Here to stay
 - End of EU claims?
 - Flexibility to change
 - Extend zero rate
 - Mini one-stop-shop lost



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Brexit and Personal Tax

- Immigration
 - employee mobility and social security
 - Open letter to EU Citizens Oct 17



- Cross-border property ownership
- EU Mergers with individual owners

- Inbound investment
 - Increased incentives?
 - end of EU claims?



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Brexit and Financial Services

- Short term :
 - Capital and liquidity requirements
 - Key indicator breaches
 - Companies are making plans
 - HMRC giving guidance
- Medium term :
 - EU Passport
 - Permanent establishments?
 - Equivalence?
- Longer term.....?



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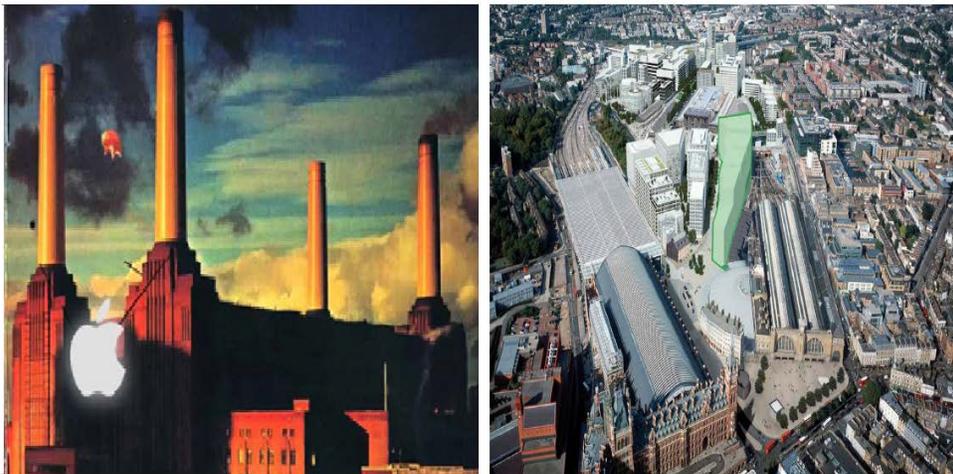
The Future and Multinationals

- Withholding tax – absolute cost
 - dividends, interest....
- UK still popular as location for holdcos
 - administrative burden?
- Transfer pricing
 - UK ‘ahead of the curve’
 - EU Arbitration procedure lost
- Internationally mobile employees
- Still a low tax jurisdiction...



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Conclusion – Signs of Investor Confidence



Google and Apple investing in London.....

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The UK – a Vision of the Post-BEPS World?

Paul Rutherford
Corporate Tax Partner
DLA Piper UK LLP



Where are We Now?

- Disclosure of aggressive tax planning (2004)
- CFC rules (re-written April 2012)
- VAT on business to customer digital services (January 2015)
- **DIVERTED PROFITS TAX (DPT) (APRIL 2015)**
- CbC (accounting periods commencing on or after January 2016)
- Transfer pricing (April 2016)
- Harmful tax practices (i.e. Patent Box) (July 2016)
- **ANTI-HYBRID RULES (JANUARY 2017)**
- **INTEREST DEDUCTIBILITY (APRIL 2017)**
- Treaty abuse (March 2016 (royalties only) / June 2017 (via MLI))



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Diverted Profits Tax (DPT)

DPT Key Features and Scope

- Key Features
- Separate from UK corporation tax
- 25% rate (compared with 19% UK corporation tax rate)
- Not self-assessed – HMRC charging notice require
- No clearance mechanism (but see below re APAs)
- Scope
- Concerned with artificial diversion of profits from the UK
- Two charging cases:
 - Avoidance of a UK permanent establishment
 - Tax mismatch involving entities or transactions lacking economic substance



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DPT Risk Areas



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DPT Impact

Year	2015/16	2016/17
DPT notices received	48	145
DPT collections	£31m	£138m
Transfer pricing adjustments	N/A	£143m
Total Collections	£31m	£281m

Other impacts

- Behavioral change?
- No unilateral APA (and bilateral will likely prompt DPT review)
- Transfer pricing audit – likely to include DPT review



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Anti-Hybrid Rules

Overview

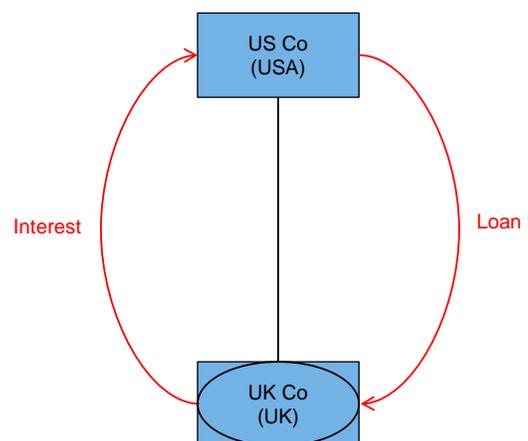
- UK corporation tax payers only
- Applies to a hybrid instrument or hybrid entity that results in a tax mismatch (deduction / non-inclusion or double deduction)
- UK entity is directly involved in the hybrid arrangement or an imported mismatch
 - UK entity not directly involved in a hybrid arrangement
 - a hybrid arrangement exists elsewhere in the group
 - the UK arrangement and the other hybrid arrangement are part of the same over-arching arrangement
- Applies to payments and tax accruals
- Haven entities can be particularly problematic
- Rules counteract the tax mismatch – e.g. deny UK tax deduction



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Example – Hybrid Payer Mismatch

- UK Co is a hybrid entity
- UK Co pays interest to US Co
- Interest is disregarded for US tax purposes (tax mismatch - no US income inclusion)
- UK anti-hybrid rules deny UK Co interest deduction



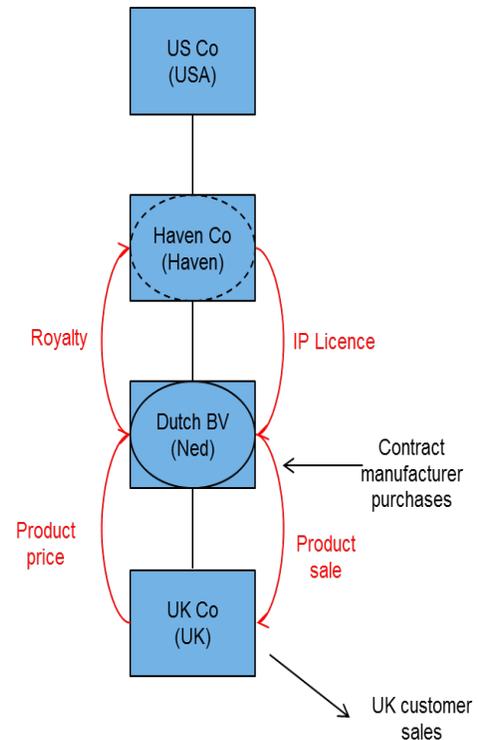
Legend

-  = Corporation for both US and local tax purposes
-  = Partnership for local tax purposes / corporation for US tax purposes
-  = Corporation for local tax purposes / partnership for US tax purposes
-  = Corporation for local tax purposes / disregarded entity for US tax purposes

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Example – Imported Mismatch

- UK Co pays purchase price to Dutch BV
- Dutch BV includes purchase price in income (no direct tax mismatch)
- Dutch BV pays royalty to checked Haven Co (indirect tax mismatch - no US or Haven jurisdiction income inclusion)
- Indirect tax mismatch deemed to arise if Haven Co disregarded
- UK anti-hybrid rules deny UK Co interest deduction



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Other Risk Areas

- Hybrid financial instruments (e.g. Luxembourg preferred equity certificates, PECs)
- Reverse hybrid IP / principal structures (e.g. Dutch BV / CV)
- Non-trading branch structures (e.g. Luxembourg / Ireland)
- "Tower" structures (i.e. double deduction for interest in the UK and the USA)
- Payees in 0% tax jurisdictions (e.g. Channel Islands) or territorial regimes (e.g. Hong Kong, Singapore)
- Targeted anti-avoidance rule (TAAR)



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Anti-Hybrid Impact

- **General review of relevant structures by multinationals (to take account of UK legislation and EU proposals)**
- **Some reorganisation activity to date – often into "placeholder" structures (given uncertainties around US tax reform, BEPS implementation outside the UK, Brexit, etc.)**
- **Achieve similar benefits through low-tax jurisdictions?**
- **Some HMRC clearances sought (only if no avoidance)**
- **Accounting provisions and disclosures (e.g. FIN48) to be considered**
- **Contingency planning for the longer-term – e.g. IP "on-shoring" once EU anti-tax avoidance directive takes effect**

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Interest Deductibility

Overview

Overview of changes	
Application	UK corporation tax paying companies
Scope	Net tax-interest expense
Restriction	Tax deductible net tax-interest expense limited to % of UK Group EBITDA calculated using: <ul style="list-style-type: none"> • Fixed Ratio Rule <i>or</i> • Group Ratio Rule
Fixed Ratio Rule	30% of UK Group's EBITDA
Group Ratio Rule (Election required)	Substitute 30% fixed ratio with % derived from Worldwide Group's interest expense to EBITDA ratio
Debt Cap	Fixed Ratio Debt Cap (Modified Debt Cap)
UK <i>de minimis</i> exclusion	£2 million net tax-interest expense
Exclusions	Public Benefit Infrastructure Exemption
Commencement Date	1 April 2017
Grandfathering for existing loans	None

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Impact

- Other European jurisdictions already have similar rules (e.g. Germany, Spain)
- Greatest focus in highly-leveraged sectors (private equity, real estate, infrastructure)
- Assess cash flow impact on borrower companies
- Must continue to ensure borrowing at arm's length, no equity-like features, no hybrid debt

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So Where Are We Now?

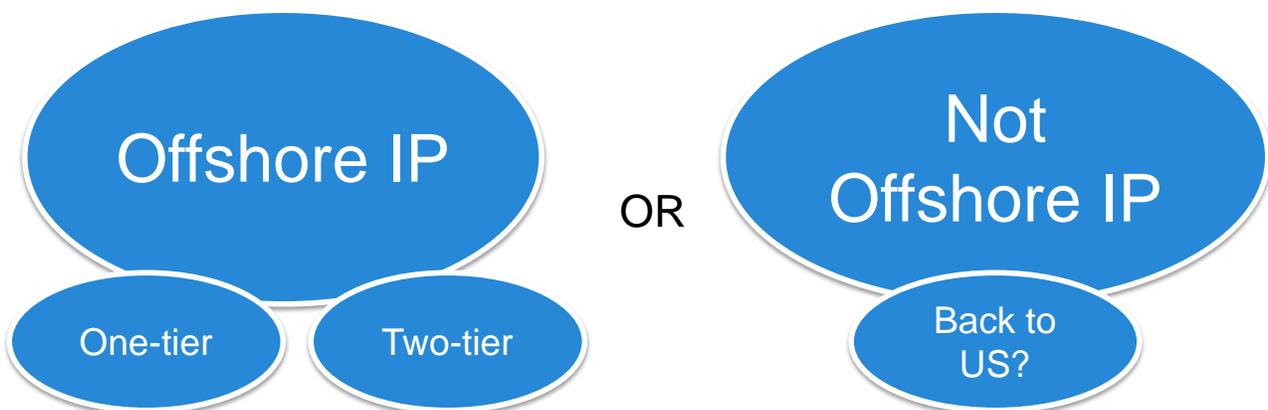
- Is the way forward now a low corporate tax rate (UK 17% by April 2020) and a broad tax base?
- Eroding the tax base through low-tax offshore structures and gearing will be problematic
- Focus on alignment of economic operations and tax outcomes
- And for now, contingency planning abounds
 - Brexit
 - US tax reform
 - EU27 anti-tax avoidance directive (by 31 December 2018)

Restructuring Alternatives – Key Considerations

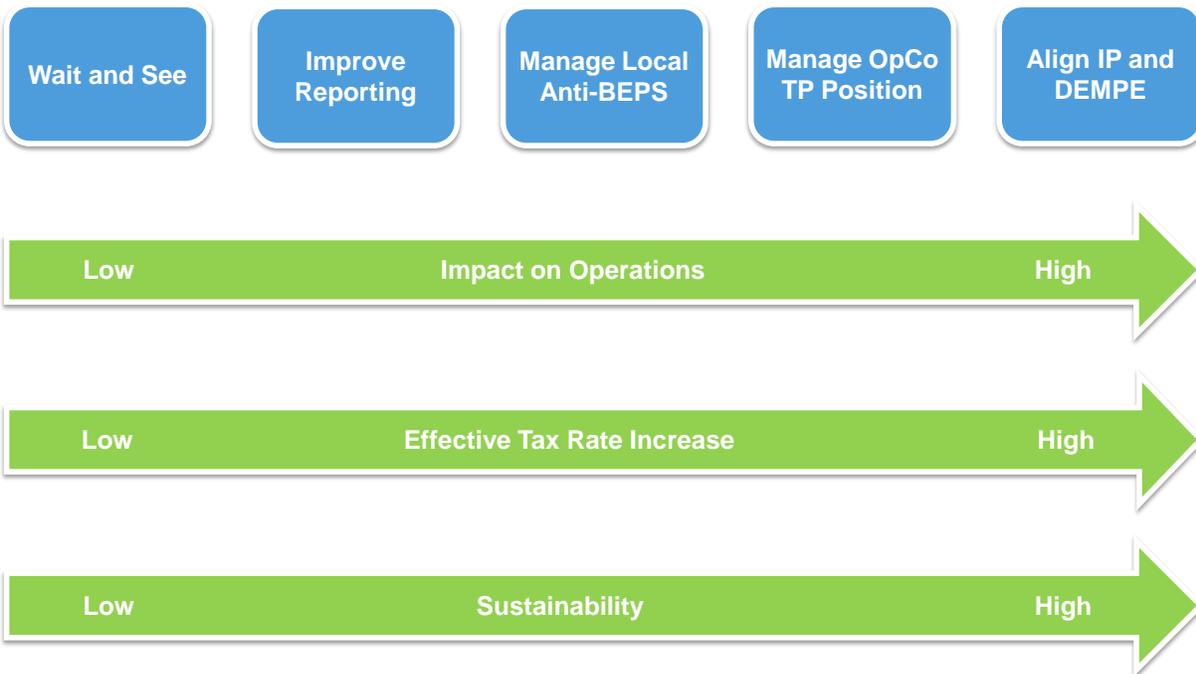
Eric D. Ryan
Of Counsel
DLA Piper - Palo Alto, CA

IP Restructuring for US MNE's:

The Same Dilemmas, Except Perhaps in Different
Directions

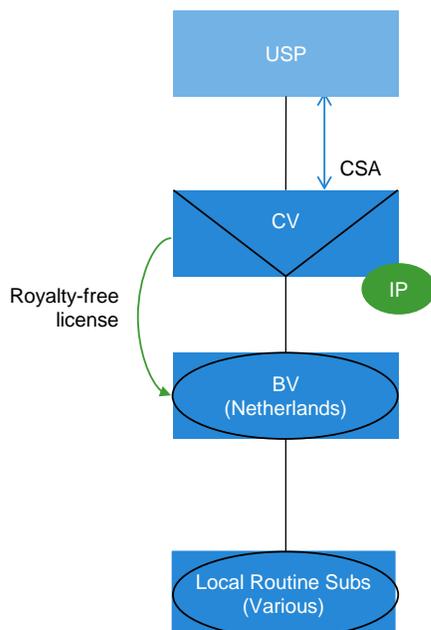


Tiered Structures: What are Companies Doing?



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Option 1: Royalty-free License to OpCo*



Description

- *This option may only work for Dutch CV/BV
 - CV is a US regarded entity in this structure
- CV and BV enter into a royalty-free License and Distribution arrangement

Taxation

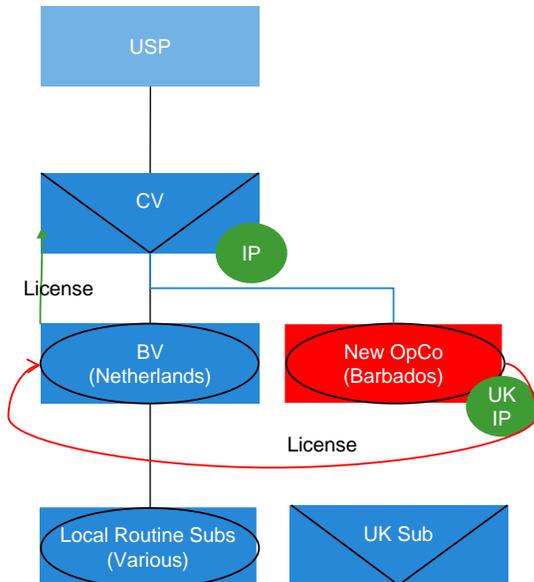
- BV should be entitled to a *deemed income tax deduction* for Dutch purposes
- Dutch tax ruling available (if at upper end of TP range)

Considerations

- Favorable CbC reporting position as CV does not report royalty income in commercial accounts
- CV funded by dividend income (outside of scope of CbC)
- Improves UK imported mismatch anti-hybrid position
- Potentially increases beneficial ownership position of BV by eliminating (back-to-back) payment obligation
- Not invasive to current operating model and does not require change in operational substance...
- ...but likely not a long-term solution

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Option 2: Transfer IP to New OpCo in Barbados



Description

- CV sets up New OpCo in Barbados
- CV carves out UK IP to New OpCo
 - Or, transfers *all* CV IP to Barbados
- New OpCo licenses UK IP to Dutch BV

Taxation

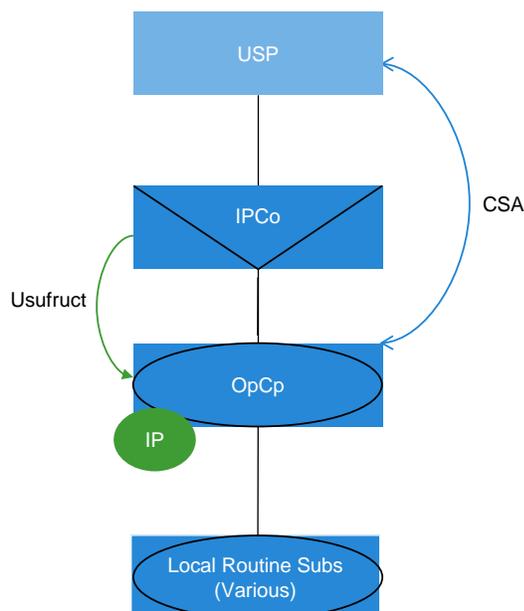
- New OpCo falls under Barbados International Business Company (IBC) regime and is subject to sliding scale of [low] tax in Barbados
- BV situation essentially unchanged

Considerations

- Primary aim to mitigate UK Anti-Hybrid provisions applicable as of January 1, 2017
- IBC classification allows New OpCo to stay outside of scope of UK anti-hybrid rules
- Slightly complicated royalty computations
- No significant assistance for CbC, etc.

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Option 3: Temporary Onshoring of IP (Usufruct)



Description

- IPCo grants OpCo the right to exploit the IP under a Usufruct agreement for a period of 3-4 years
- USP and OpCo enter into CSA

Taxation

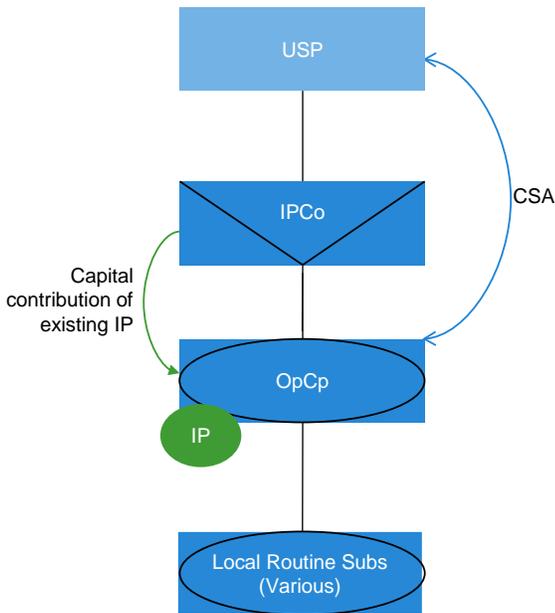
- OpCo accounts for Usufruct as an amortizable asset
- IP income subject to taxation in the IPCo jurisdiction, but offset by OpCo's amortization deduction
- Upon end of Usufruct economic ownership defaults back to legal IP owner without exit taxation*
 - *But under the CSA there is exit taxation to the BV on the newly developed IP

Considerations

- Temporary IP onshoring allowing for flexibility to exit upon end of Usufruct
- Improve CbC reporting position, no income reported in Stateless Entity
- Improve beneficial ownership position of OpCo toward source jurisdictions
- Will require DEMPE functionality in OpCo to increase sustainability
- Will the transaction form be respected

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Option 4: Contribution of IP to OpCo



Description

- IPCo makes a capital contribution of IP to OpCo
- USP and OpCo enter the CSA

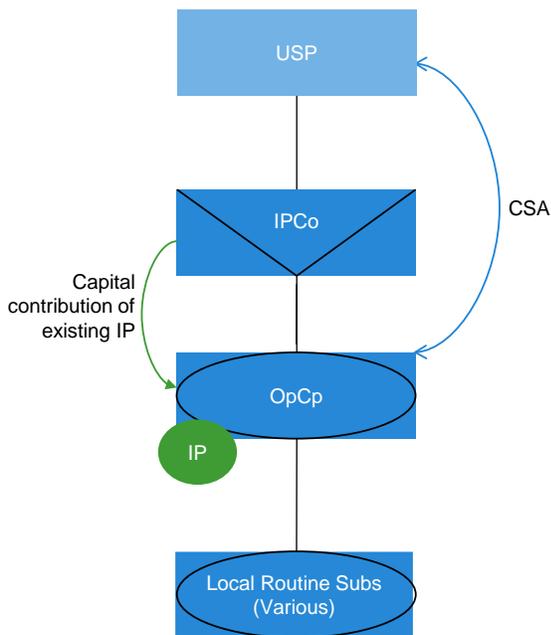
Taxation

- OpCo receives a tax basis in the IP
- Amortization of IP by OpCo
- Favorable CbC reporting position as CV does not report royalty income in commercial accounts
- Improves UK imported mismatch anti-hybrid position
- No US consequences since check-the-box

Considerations

- IPCo funded by dividend income (outside CbC)
- Potentially increases beneficial ownership position of OpCo by eliminating (back-to-back) payment obligation
- No more royalties to IPCo from OpCo
- What happens after the IP is fully amortized?
- What if OpCo wishes to sell the amortized IP?
- Tax ruling in OpCo for FMV of tax basis?

Option 4: (Continued) Valuation Issues



Description

- IPCo makes a capital contribution of IP to OpCo

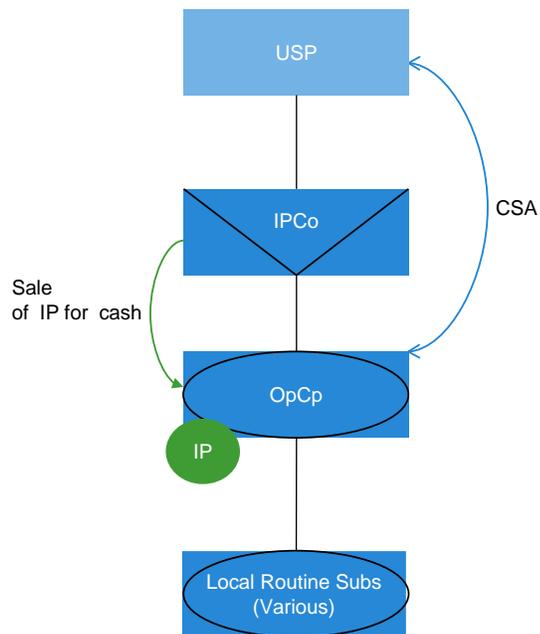
Valuation

- TP Methods:
 - Market Capitalization – perhaps secondary
 - Discounted Cash Flow Methods
 - Residual Profit Split Method
 - Royalty by either CUT or CPM
 - Income Method?

Considerations

- Aggregate or segregate IP elements?
- Future period for DCF – life of IP(s)
- Discount rates?
 - Relevant for industry
 - Consider risk profile of fixed / contingent payments
- Straight line or economic amortization?
- Tax ruling in OpCo?
 - FMV of IP
 - Amortization length / rate

Option 5: Sale of IP to OpCo for Cash



Description

- IPCo sells IP to OpCo for cash
- OpCo is party to CSA going forward
- DEMPE functionality build up in OpCo jurisdiction

Taxation

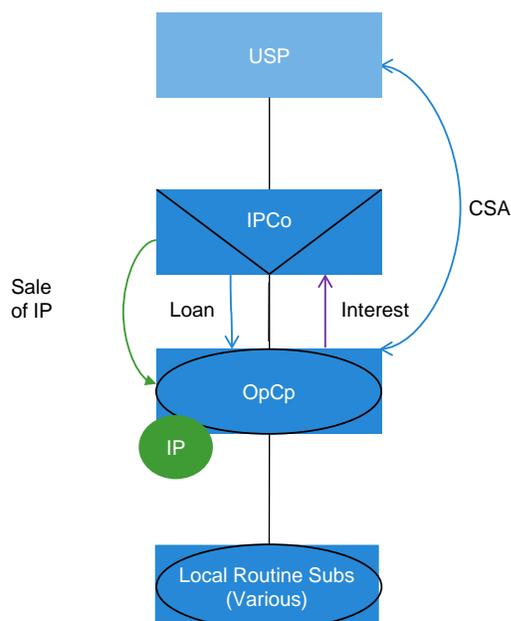
- Step up to FMV of IP in OpCo jurisdiction
- IP is amortizable by OpCo
- Essentially a repatriation of funds via payment from OpCo
- Gain upon exit from OpCo in future likely taxable
 - New IP with zero basis
 - Old IP with potentially some remaining basis

Considerations

- Valuation issues

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Option 6: Cash Sale of IP to OpCo with Loan



Description

- IPCo sells IP to OpCo for loan note or installment payments
- OpCo is party to CSA going forward
- DEMPE functionality build up in OpCo jurisdiction

Taxation

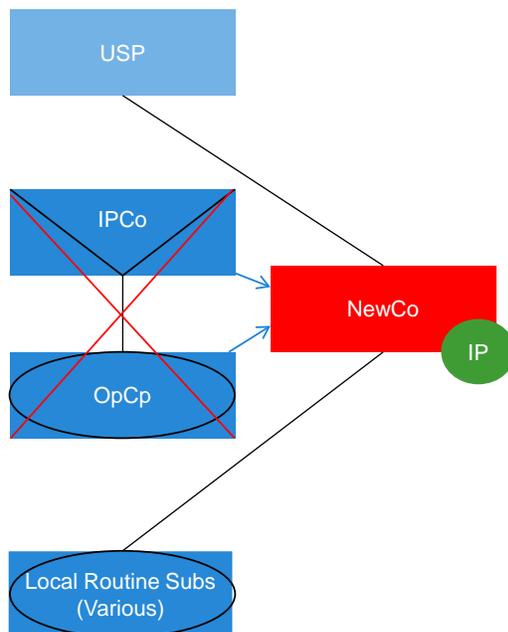
- Step up to FMV of IP in OpCo jurisdiction
- IP is amortizable by OpCo (for a period)
- Essentially a repatriation of funds via payment from OpCo
- Withholding tax implications
- Gain upon exit from OpCo in future likely taxable

Considerations

- OpCo country debt/equity limits on interest deductions
- Can debt be recast by authorities as equity

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Option 7: Collapse IPCo and OpCo into NewSubCo



Description

- IPCo and OpCo contribute their assets to NewCo in exchange for shares of NewCo (e.g., UK) - if IP step up is available
- IPCo and OpCo then dissolve and NewCo is now a wholly owned subsidiary of USP

Taxation

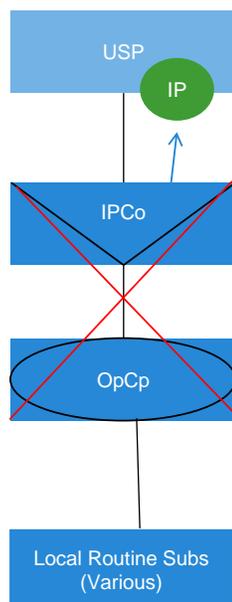
- Step up to FMV of IP in and Credit
- Potential Patent Box benefit
- IP is amortizable by NewCo
- Gain upon exit of IP taxable

Considerations

- High impact on operations now, but a viable long-term solution
- Must have some DEMPE functions in NewCo for most tax benefits

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Option 8: Collapse IPCo into USP



Description

- IPCo sells IP to USP
- IPCo and/or OpCo then dissolve and USP is Principal for US and ROW

Taxation

- Step up to FMV of IP in USP
- Use 1.482-7 to value IP
- IP is IRC Sec. 197 asset – 15 year amortization
- Gain upon sale of IP should be free of Subpart F

Considerations

- Impact of US tax reform legislation
- Will the form of the transaction be respected
- High impact on operations now, but a viable long-term solution
- DEMPE functions likely fully satisfy all requirements

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Bio



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Paul Rutherford advises on all aspects of UK corporate taxation with a particular focus on transactional work.

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Eric D. Ryan concentrates in international tax planning, transfer pricing, post merger integration of legal entities and operations and tax controversy. He has over 25 years of experience, both as a tax partner advisor and an internal corporate tax director, on key international tax structuring issues. His clients are primarily in the high technology industry, including software, hardware, semiconductors and life sciences companies.

His experience includes advising clients in choice of location for their operations; conducting direct negotiations for tax holidays in countries such as Switzerland, Singapore and others; advising on intercompany arrangements that minimize Subpart F and similar tax issues; and advising on intercompany economic terms that seek to maximize profits in appropriate jurisdictions. He advises on the use of holding companies, the valuation of transfer of tangible and intangible property and the establishment of cost-sharing operations. Mr. Ryan is experienced in developments of advice pricing agreements (APA's) and intercompany debt and equity.

On behalf of the Government of the United States Virgin Islands, Mr. Ryan worked to obtain the favorable guidance from the US Treasury and Internal Revenue Service ultimately contained within Notice 2006-76, relating to the qualification of certain e-commerce business models for income tax exemptions in the USVI.

As tax director for Apple Computer, Inc., Mr. Ryan was responsible for the worldwide tax planning, compliance and audit defense activity for this Fortune 100 company operating in more than 30 countries. He led that company's efforts to respond to the IRS at the exam, appeals and Tax Court levels. Mr. Ryan was responsible for the efforts which led to the favorable Tax Court decision regarding Apple's inclusion of stock option compensation in the qualifying base for R&E credits (Apple Computer, Inc. v. Commissioner, 98 T.C. No. 18 (1992)). He was also the architect of the world's first APA in 1991, between the US and Australia, and later for others with Japan and Canada.

Mr. Ryan is listed as one of the pre-eminent practitioners in the Guide to the Worlds' Leading Transfer Pricing Advisors, published by Euromoney. In 2006, he was recognized as one of the top tax lawyers in the Bay Area in a study published by Bay Area Lawyer magazine. He is a frequent speaker on international tax matters for several organizations, including the California Bar Association Tax Section, the Asia Tax Executives Forum, and the Council for International Tax Education (CITE).

Mr. Ryan is a Pro Bono Coordinator for the East Palo Alto office.

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David is a Chartered Tax Advisor of the Chartered Institute of Taxation and heads up Mazars' International Tax practice in the UK. He is also a member of the International Tax Board for the global firm, where he is responsible for development of large corporate tax work

David sits on the European Branch Committee of the Chartered Institute of Taxation.

Since joining Mazars in 1998, David has concentrated on international tax planning for Mazars' European client base, which includes 15% of the FTSE Eurofirst 100 companies, and acts for many inbound and outbound investors. His areas of expertise include cross border corporate structuring, mergers and acquisitions, thin capitalisation and transfer pricing. David lectures frequently on international taxation issues both in the UK and abroad.

David is Chairman of Mazars' Global Transfer Pricing Group and has 18 years' experience in transfer pricing assignments in a wide range of areas including financial services, retail and consumer goods. He has led multi-jurisdictional project teams on a number of occasions and has helped many businesses with transfer pricing issues across Europe, including several CAC 40 and Fortune 500 companies. David is fluent in French and spends a good deal of time working in France

David acts for many businesses of US origin and frequently acts as a bridge for their EU inbound operations, where coordinates work on their behalf in many different countries.

As part of his work on Mazars International Tax Board, David also has responsibility for oversight of Mazars Asia Pacific Tax practice. In the course of this he had a good deal of contact with the region on international tax issues and has advised many inbound and outbound clients on tax treaty interpretation and transfer pricing.

David has also acted as court appointed expert witness on a number of occasions relating to transfer pricing and international tax issues.

Mazars' UK transfer pricing team was nominated for "UK Transfer Pricing Team of the Year 2013" by International Tax Review. David was the author of Tolley's International Tax Planning for 2012/13 and 2013/2014