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Main tax effects of a 'no-deal' Brexit

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From the perspective of direct and indirect taxation, analysis of the main implications of a no-deal Brexit for UK citizens and companies that have established themselves in our country and for Spanish citizens and companies with residence, establishment or operations in the UK.

1. Introduction

Faced with the increasingly likely scenario of a no-deal Brexit, many are the direct and indirect tax consequences that may be triggered for UK citizens and companies that have established themselves or have interests in our country and for Spanish citizens and companies that have taken up residence, opened an establishment or set up operations in the UK.

It should be borne in mind – regardless of the fact that the UK continues to be bound by the rules laid down by the World Trade Organisation, of which it is a member – that EU tax-related directives will cease to apply in the UK and the freedoms of movement guaranteed by EU treaties will also be affected. However, resulting negative effects may be mitigated both by the application of bilateral treaties – such as the tax treaty for the avoidance of double taxation which is in force – and by the fact that EU freedoms such as those affecting the movement of capital also apply to third countries.

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Bearing this in mind, below follow the most important matters that, in view of the main categories of our tax system, could be affected by the situation described above, some of which would have to be qualified if the UK finally remains within the European Economic Area.

2. Personal income tax

For the purposes of personal income tax, residents in Spain who are taxpayers of this tax must take into account, among others, the following aspects:

— Firstly, in cases of change of residence to the United Kingdom, in relation to *temporary imputations of income pending inclusion* and in accordance with the provisions of art. 14(3) of the Personal Income Tax Act ('LIRPF'), such income must be included in the tax base for the last taxable period to be declared for this tax, filing, where applicable, supplementary self-assessment without any late payment penalty, interest or surcharge, thus losing the possibility of choosing to impute such income as and when earned.

— In addition, in accordance with art. 33(5) LIRPF, in order not to include *capital losses derived from transfers of UK listed securities,* the relevant period for reinvestments in homogeneous securities will no longer be two months but one year.

— In addition, *changes in the value of assets arising from the sale of UK listed securities* may not be calculated in accordance with the specific valuation rule provided in art. 37(1)(a) LIPRF due to the inapplicability of Directive 2004/39/EC.

— Similarly, also because of the impossibility of applying EU legislation - in this case, Directive (EU) 2016/2341 (which has replaced, with effect from 13 January 2019, Directive 2003/41/EC) - contributions to UK pension schemes will not be able to benefit from the reductions in the general tax base provided for in art. 51(1)(2) LIRPF nor shall the special valuation rule provided for in art. 43(1)(1) apply to remuneration in kind for contributions paid by sponsors to UK pension funds.

— The *reinvestment deferral rules provided for shares or units in collective investment schemes* under art. 94 LIRPF, which also applies to members or unit-holders of collective investment schemes governed by Directive 2009/65/EC, will not apply where such institutions are incorporated and domiciled in the UK.

— It should also be noted that the exception in art. 91(15) LIRPF to the application of *controlled foreign corporations (CFC) rules* in relation to undertakings resident in another Member State of the EU will no longer be applicable in the case of undertakings resident in the UK.

— In addition, the special rules applicable to capital gains on change of residence - exit tax - provided for in Art. 95 bis (6) LIRPF cannot be applied where such a transfer is to the UK.

— Lastly, also worth noting is the non-application of the *transitional rules applicable to capital gains derived from assets acquired prior to 31 December 1994* provided for in the ninth transitional provision LIRPF. It would therefore no longer be possible to apply abatement factors to the amounts arising from the transfer of securities traded on UK regulated markets or shares and units in UK collective investment schemes where acquired before that date.

3. Non-resident income tax

With regard to non-resident income tax, it should be noted, firstly, that a no-deal withdrawal of the UK would result in the non-application of some important cases of exempt income under art. 14 of the Recast Version of the Non-Resident Income Tax Act ('TRLIRNR'). In this regard, the exemptions provided for in that provision would not apply to interest and other capital income, or in respect of capital gains from movable property without a permanent establishment where such income was earned by UK residents - art. 14(1)(c) -, or to profits distributed by subsidiaries resident in Spanish territory to their parent companies when the latter reside in the UK - art. 14(1)(h) -, or in respect of dividends and shares in profits earned without a permanent establishment by pension funds or collective investment schemes when resident in the UK - art. 14(1)(k) and (l) -, or in respect of the fees or royalties referred to in art. 14(1)(m) when paid to a UK company.

However, the harmful effects of the above would be mitigated to a large extent by the application of the existing Convention between the United Kingdom of Great Britain and Northern Ireland and the Kingdom of Spain for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income and on Capital, signed on 14 March 2013. It should be recalled that such convention provides for exemption from taxation at source in respect of interest and royalties and, subject to certain requirements, also in respect of certain dividends and capital gains.

Apart from the foregoing, in view of the legislation governing non-resident income tax, it should also be borne in mind that a no-deal withdrawal of the UK from the EU will: (i) lead to the non-application of the exemption provided for in the seventh additional provision of the aforementioned recast act to cases of r*einvestment in habitual residence* in Spain; (ii) prevent, for the purposes of determining the tax base, the possibility *of deducting expense*s directly related to earnings in Spain with a direct and inextricable link with the business activity carried out in our country (referred to in art. 24(6) TRLIRNR); set the *tax rate* applicable to UK residents at the general rate of 24 % - in substitution of the reduced rate of 19 % -; and, finally, eliminate for UK residents the possibility of electing into *the optional scheme provided for in art. 46 of the recast act,* by virtue of which taxpayers resident in other EU Member States may, subject to certain conditions, be taxed as taxpayers of non-resident income tax.

4. Corporate income tax

With regard to corporate income tax, it is also worth highlighting some of the relevant effects that a no-deal withdrawal by the UK could have:

— Firstly, this would make it impossible to apply the *tax neutrality rules* to corporate restructuring operations where such operations are conditional on the acquiring or controlling company, its shareholders or the element subject to transfer being resident in a Member State of the EU. Nor could such tax rules be applied when European companies or co-operatives change their domicile from the UK to Spain or vice versa.

— On the other hand, and also in the case of a change of residence of an organisation to the UK, it would not be possible to *defer the payment* as provided for in art. 19(1) LIS in relation to tax arrears from the transfer of residence when the assets are not attached to a permanent establishment located in Spain.

— Moreover, where different resident companies have as their parent company a UK undertaking, there would be no possibility of applying a *horizontal tax consolidation.*

— The tax credit provided for in art. 35 LIS in relation to *research and development or technological innovation activities* would not apply either if such are carried out in the UK.

— Finally, it is also worth mentioning the non-application of the exception provided for in art. 100(16) LIS with respect to *CFC rules.*

5. Indirect taxation

Within the scope of indirect taxation, a no-deal withdrawal of the UK from the EU will have consequences, on the whole, in customs matters and in relation to value added tax (VAT).

In this regard, the Spanish Tax Agency - specifically the Customs and Excise Department - has issued a communication, dated 26 December 2018, in which it refers to some of the aspects that will derive from what ultimately translates into the UK's exit from the single market and the customs union.

From the customs point of view, the Tax Agency points out that this exit will involve, among other things, that the flows of goods between Spain and the UK will no longer be regarded as intra-Community transactions and will be subject to customs formalities - such as the submission of an import/export customs declaration or attachment to another customs regime for each dispatch, the undergoing of customs controls, the payment of customs duties and other charges that may accrue, or the need to obtain sanitary, phytosanitary, quality or other certificates in order to be able to dispose of their goods.

It also states that the entry or dispatch of goods from the Iberian Peninsula, the Balearic Islands or the Canary Islands to the UK will require the submission of a declaration at normal customs.

It also points to the need for all economic operators to be identified for customs purposes with a registration and identification number (EORI number), valid throughout the EU.

As far as value added tax is concerned, the Tax Agency recalls that shipments to the UK will be exempt from value added tax as exports, the customs export declaration being one of the means of proof accepted for the purpose of supporting such exemption.

On the other hand, imports from the UK will be subject to the payment of this import tax, which must be assessed in the customs declaration and paid within the relevant time limits, although - subject to certain conditions - payment of deferred value added tax may be chosen.

Since the transactions carried out between Spain and the UK are no longer classified as intra-Community, they should not be reported through the summary declaration of Form 349.

Apart from the above, the aforementioned communication also refers to the consequences of a no-deal withdrawal in relation to excise duties. The Tax Agency points out that such a scenario would mean, as from the actual withdrawal of the UK, that shipments or receipts of products subject to excise duty would become exports or imports and, therefore, the EU's customs legislation would be fully applicable to them.

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