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Tax after the EU referendum

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Background

Taxation is very largely a Member State competence. The implications of the UK lying outside the EU are likely to be less significant for taxation compared with other policy areas.

The major exception to this generalisation is indirect tax: primarily VAT – for which there is a substantive body of EU law establishing common rules across Member States – and, to a lesser extent, excise duties. It has long been recognised that the harmonisation of indirect taxes across Member States is an essential element to the achievement of an effective Single Market. Unlike most internal market measures, which use qualified majority voting, the harmonisation of taxation is decided by unanimity.

The consequences of the EU's shared competence in indirect tax is most frequently discussed in the context of the UK's limited discretion in setting the rates of VAT on individual goods and services. In addition many commentators have raised concerns about the UK's ability in the future to maintain its existing range of VAT reliefs (such as the zero rates of VAT which apply to food and children's clothes) from any further harmonisation of VAT law.[1]

However, the relative importance of VAT to the Exchequer – accounting for around 17% of all government receipts – suggests that future governments would be unlikely to substantially increase these reliefs or abolish the tax, even while exit from the EU would give them this power.[2] Writing in the *Tax Journal* before the referendum, Ben Jones, partner at Eversheds LLP, noted, "there is no practical likelihood that VAT will be abolished by the UK following Brexit. It is not even the case that it would be necessary to take significant legislative steps to preserve VAT in the UK, given that the EU VAT rules have been mainly implemented by UK legislation." Mr Jones went on to note, "UK governments would have greater flexibility to use changes to the VAT system to further political objectives ", and it (e.g. by widening zero-rating, exemption rules or the use of lower rates)."[3] Indeed during the referendum campaign it had been argued that Brexit

1 For details see, *VAT : European law on VAT rates*, Commons Briefing Paper SN2683, 20 May 2016.
2 VAT receipts are forecast to be £121 billion in 2016/17 (see, OBR, *Economic & Fiscal Outlook*, Cm 9419, March 2017 p104, Table 4.6).
3 "Brexit: the tax issues at stake", *Tax Journal*, 15 June 2016. Mr Jones concluded, ""the conclusion is that no conclusions can be drawn at this stage."

would enable the Government to introduce a zero rate of VAT on domestic supplies of fuel & power.[4]

There are no equivalent provisions with regard to other taxes, though all national legislation has to comply with the overarching provisions of the Treaty guaranteeing the free movement of goods, persons, services and capital across the single market and prohibiting discrimination. There is a substantive body of case law where the European Court of Justice has ruled that individual provisions of a Member State's tax code fail this test. Member States' powers to act in relation to taxation must also be exercised in accordance with State aid rules.

Finally, there are a number of EU instruments relating to administrative cooperation to exchange information and help tackle tax evasion. In the latter case it seems likely that outside the EU the UK will seek to maintain some form of bilateral agreement akin to these provisions, given the growing consensus between governments that there is a very important international dimension to taxing multinational corporations fairly and effectively tackling tax avoidance.[5]

In July 2013 the Coalition Government published its report on the respective powers of the UK and the EU with regard to taxation, as part of its Balance of Competence Review. This report found that "respondents and interested parties were content with the current balance of competence on taxation, taking account of the protections offered by unanimity voting. Whilst individual respondents suggested areas where existing measures could be updated to reflect modern business practice and development, no respondents identified any major gaps in the existing tax legislation."[6]

Some respondents to the review cited proposals for an EU-wide financial transactions tax as an area "where they questioned the appropriateness and utility of EU-level action." The European Commission had proposed an EU-wide tax on financial transactions in September 2011. As this failed to attract unanimity, in January 2013 eleven countries, excluding the UK, agreed to pursue this option on a smaller scale. Negotiations have continued, although there has never been any question of the UK having to take part.[7]

Details of the areas of EU competence in taxation are given on the site of the Commission's Taxation & Customs Union Directorate.[8]

Writing in the *Times*, some months after the referendum vote, Paul Johnson, director of the Institute for Fiscal Studies, suggested that these tax rules represented "our legal relationship with the EU in microcosm":

> Most parts of the tax system have relatively little impact from the EU. We have plenty of freedom over the design of income tax. The Commission wants to extend its reach over corporation tax but we will have broader multilateral obligations whether inside the EU or not. When it comes to indirect taxes, essentially VAT and excise duties, though, the EU does place some pretty severe restrictions. Here we have our legal relationship with the EU in microcosm. Some of those restrictions force us to do silly and damaging things; some prevent us from creating a mess.[9]

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4 "EU Referendum: Vote Leave wants power to axe fuel VAT", *BBC News online*, 31 May 2016

5 This issue is discussed at length in, *Corporate tax reform (2010-2016)*, Commons Briefing Paper SN5945, 20 June 2016 (see sections 5.3 & 6.2),

6 HMG, *Review of the Balance of Competences between the United Kingdom and the European Union: Taxation*, July 2013 p6

7 For more details see, *The Tobin tax: recent developments*, Commons Briefing Paper, SN6184, 15 May 2014. See also, PQ22411, 18 January 2016

8 European Commission, EU Tax Policy Strategy [accessed 7/7/2017]. The site also provides a full list of EU tax legislation.

9 "Comment: We must seize the chance to rewrite Britain's tax rules", *Times*, 13 December 2016

Reactions

In the days following the referendum vote, there were a number of statements by relevant organisations – such as the Bank of England – as well as some speculation about the possible impact of Brexit on the tax system.[10] However, no immediate changes were made to taxes, as HM Revenue & Customs advised taxpayers on their helpline.[11]

On 27 June 2016 the then Chancellor, George Osborne, suggested that there was likely to be a Budget statement in the autumn. Prior to the vote Mr Osborne had indicated that in the event of a vote to leave the EU, the Government would have to make immediate changes to its tax and spending plans.[12] In a statement Mr Osborne said the following: "as I said before the referendum, this will have an impact on the economy and the public finances – and there will need to be action to address that. Given the delay in triggering Article 50 and the Prime Minister's decision to hand over to a successor, it is sensible that decisions on what that action should consist of should wait for the Office for Budget Responsibility (OBR) to assess the economy in the autumn, and for the new Prime Minister to be in place."[13] Subsequently Mr Osborne argued that as part of its ongoing strategy to attract business investment the Government should aim to cut the rate of corporation tax further to its existing plans for a 17% rate from 2020.[14]

However, on 13 July Theresa May succeeded David Cameron as Prime Minister, and appointed Philip Hammond as Chancellor. In his first interview Mr Hammond ruled out an emergency Budget, while confirming that he would set out the Government's revised economic strategy in the Autumn Statement.[15] Mr Hammond delivered his Autumn Statement to the House on 23 November, though he did not announce any specific tax measures as a consequence of the referendum result. In his introductory remarks the Chancellor simply said, "our task now is to prepare our economy to be resilient as we exit the EU and to be match-fit for the transition that will follow"[16] Similarly the Autumn Statement report did not mention any tax implications arising from the decision to exit the EU, with one small exception.

Since July 2015 the Government has been reviewing options to reform Air Passenger Duty, responding to concerns expressed by regional airports as to the Scottish Government's plans to cut this tax, once it is devolved from April 2018. The review looked at the case for devolving APD within England, varying APD rates in England, or providing direct aid to affected airports or regions. As any of these options would have to comply with EU rules on aviation, State aid and tax devolution, the Autumn Statement announced that the Government would not take specific measures at this point, but would "review this area again after the UK has exited from the EU."[17]

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10 In the latter case see, "20 questions on Brexit", *Tax Journal* , 1 July 2016 & "Breaking away", *Taxation*, 30 June 2016.

11 "EU referendum: HMRC issues 'carry on' message", *BBC News online*, 27 June 2016

12 See, for example, "George Osborne: vote for Brexit and face £30bn of taxes and spending cuts", *Guardian*, 15 June 2016

13 HM Treasury press notice, *Statement by the Chancellor following the EU referendum*, 27 June 2016

14 "Osborne puts corporation tax cut at heart of Brexit recovery plan", *Financial Times*, 2 July 2016. In answer to an urgent question on his plans, Mr Osborne said, "we should aim for a rate of 15% and preferably lower, because if we are pro-business, we are pro-jobs, pro-living standards and pro-working people" (HC Deb 4 July 2016 c622).

15 "Philip Hammond: Financial markets 'rattled' by Out vote", *BBC news online*, 14 July 2016; "New Chancellor Philip Hammond to scale back austerity", *Financial Times*, 14 July 2016

16 HC Deb 23 November 2016 c899

17 *Autumn Statement*, Cm 9362, November 2016 para 4.37

Subsequently there has been some speculation as to the possible tax reforms that might accompany Brexit,[18] but no specific Government proposals.

In her speech on 17 January 2017, setting out the Government's negotiating objectives, the Prime Minister said that if the UK were excluded from accessing the European Single Market, "we would be free to change the basis of Britain's economic model" as the UK "would have the freedom to set the competitive tax rates and embrace the policies that would attract the world's best companies and biggest investors to Britain."[19] Similarly, in an interview with the German newspaper Welt am Sonntag the Chancellor noted "if Britain were to leave the European Union without an agreement on market access … we could be forced to change our economic model and we will have to change our model to regain competitiveness."[20] Some commentators suggested that this might encompass substantive cuts in corporation tax, as well as reductions in the regulatory burden placed on businesses.[21]

However, the Government has not published any further details of what this might involve for individual taxes. The Government's White Paper on its strategic aims for exiting the EU, published in February, made no mention of taxation or tax policy,[22] and the issue was not mentioned in either the Spring 2017 Budget prior to the 2017 General Election, or the Queen's Speech on 21 June.

In his Budget speech on 8 March, the Chancellor confirmed the Government's plans to cut the rate of corporation tax to 17% from 2020 "sending the clearest possible signal that Britain is open for business."[23] Mr Hammond also reaffirmed the Government's intention, announced in the 2016 Autumn Statement, to move towards a single fiscal event each year, with the first autumn Budget being delivered in 2017.[24]

In the Queen's Speech, the Government has stated that one of the Bills to be introduced in the 2017-20 Session will be a Customs Bill to ensure that "that the UK has a standalone UK customs regime on exit", and that, "changes can be made to the UK's VAT and excise regimes to ensure that the UK has standalone regimes on EU-exit." The Government has also confirmed that its legislative programme over the two-year session will include "three Finance Bills to implement budget decisions."[25] The timing of the 2017 General Election meant that the Finance Bill introduced after the 2017 Budget being agreed in the short 'wash up' period before the Dissolution of the House. With cross-party support the Government removed a series of clauses from the Bill, with the intention of legislating for these at the start of the new Parliament.[26] The Government's notes to the Queen's Speech simply state that "Summer Finance Bill 2017 will include a range of tax measures including those to tackle avoidance."[27]

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18 For example, "Plan B: May's elaborate bluff?", *Financial Times*, 20 January 2017; Judith Freedman, "Tax and Brexit", *Oxford Review of Economic Policy*, vol 33, no.S1, March 2017

19 10 Downing Street press notice, *The government's negotiating objectives for exiting the EU: PM speech*, 17 January 2017

20 "Philip Hammond issues threat to EU partners", *Welt am Sonntag* (English edition), 15 January 2017; "Hammond threatens EU with aggressive tax changes after Brexit", *Guardian*, 15 January 2017

21 "May to EU: give us a fair deal or you'll be crushed", *Times*, 18 January 2017. See also, ""Hammond's hollow threat", & "Editorial: The PM's transparent Brexit bluff", *Financial Times*, 16 & 26 January 2017

22 *The United Kingdom's exit from and new partnership with the European Union* Cm 9417, 2 February 2017

23 HC Deb 8 March 2017 c811. See also, *Spring 2017 Budget*, HC 1025, March 2017

24 *Spring 2017 Budget*, HC 1025, March 2017 paras 3.1-3

25 Cabinet Office, *Queen's Speech 2017: background briefing notes*, June 2017 p11, p16

26 Treasury Minister Jane Ellison set out the Government's position when the House completed all the remaining stages of the Finance Bill on 25 April 2017 (HC Deb c1013).

27 *Queen's Speech 2017: background briefing notes*, June 2017 p16