KPMG

The Brexit Strategy

Well-prepared? How Belgian companies can prepare for the upcoming withdrawal of UK from the EU

2017

International Business

The vote for Brexit; what's next?

Whether it was expected or not, several months after the UK voted in favor of leaving the UK, much is still uncertain. We saw the initial shock of the financial markets, the drop of the British pound, and even the Bank of England setting aside GBP 250 billion to keep the banking sector afloat in case of emergency.

In Brussels, meanwhile, the chairman of the European Council, Donald Tusk, tried to moderate reactions by addressing the media: "It is impossible to predict all the potential consequences of this event, especially for the UK. But this is not the time for hysterical reactions." Until the moment the UK officially leaves the EU, all EU rules continue to apply.

Generally speaking, British entrepreneurs seem confident about the development of the UK national economy. The country seems to have overcome the initial shock that followed the referendum. The British economy is picking up once again and in the third quarter even recorded growth of 0.5%. Production in UK industry and manufacturing orders are once again on the rise and the Bank of England has introduced a range of measures to prevent the country from slipping into recession.

And yet the situation remains remarkably uncertain.

— The National Bank of Belgium (NBB) expects Brexit to have a considerable negative impact on the British economy in the longer term. The NBB quotes studies by the OECD and the London School of Economics, which expect British GDP to have declined by 5% to 9.5% in 2030[1].
— KPMG's '100 UK CEOs' survey described the impact of the current development on British C-suite level managers. It turns out that three-quarters of British CEOs are assessing the possibility of moving their head office or part of their business operations out of the UK. The reasons they give for this are the uncertain future and the chance that trade between the member states of the EU and UK will only become more difficult.
— And there is the ruling of the British Supreme Court of 24 January 2017, which concluded, as did the High Court in previous instance, that the government requires permission from UK parliament to initiate the procedures pursuant to Article 50 of the Treaty on European Union (TEU). Triggering Article 50 will launch the exit process. A group of British investors took the matter to the courts and won. The Lord Chief Justice, Lord Thomas of Cwmgiedd, ruled that "the most fundamental rule of the UK constitution is that parliament is sovereign". The Supreme Court's ruling might trigger a long period of debates in the House of Commons. After all, a majority of Members of Parliament (MPs) had been against Brexit, even if there had been a large majority in favor of holding the referendum. Interestingly enough, however, the House of Commons did vote, already before the Supreme Court's ruling of 24 January 2017, in favor of a motion to support Prime Minister May's March timetable (see below), in a trade-off to obtain a degree of scrutiny over the plan for negotiations. This motion was not legally binding on government or members of Parliament, nor did it give Theresa May the authority to trigger Brexit. It does suggest though that the Prime Minister will rather not face stiff opposition in Parliament and thus might be able to keep her March deadline notwithstanding the Supreme Court ruling.

Theresa May has announced that she will submit the application for the exit procedure pursuant to Article 50 TEU to the EU no later than March 2017. The exit procedure is expected to take at least two years. During that time, the EU and UK will remain in uncertainty about the future cooperation between the two parties. This uncertainty will last at least two years and won't be completely removed after that time either. The question remains as to how the negotiations will progress.

Will there be a hard Brexit? Will any cooperation agreement be reached between the EU and the UK? And what will be the effect on elections in France and Germany, for instance, on the position of the EU member states in this process?

[1] NBB Brexit Nota 24/06/2016

What does Theresa May want... What does the new British model entail?

The UK will formally inform the EU before April 2017 that it is invoking article 50 of the European Union Treaty. The negotiations on the exit must be completed within two years, unless all other 27 member states unanimously decide to extend the negotiations. It seems very likely that Brexit will be effected no later than April 2019.

The new British model

Theresa May has indicated there are four key issues she wants to realize for the UK:

— Self-determination on immigration policy
— No judicial power for the European Court of Justice in the UK
— No financial contributions to the EU
— No adoption of rules if the UK has had no influence in the introduction of same

In addition, May will put into effect a Great Repeal Bill in March of 2017, which the UK will use to revoke the European Communities Act (ECA) of 1972. This act confirmed the UK's membership of the EU and ensures that EU legislation prevailed over British national legislation. This will no longer be the case after the annulment of the ECA. The British wish to adopt all EU legislation prevailing at that time and subsequently decide which components of that legislation will remain in force in the UK.

May wants the UK to become a sovereign and independent country again, in her own words: "There will no longer be a mechanism to impose rules on Britain without the consent of our elected representatives."

Given these requirements, it will be virtually impossible for the UK to remain a member of the European Internal Market. The free traffic of people and the judicial powers of the European Court of Justice are indispensable for that. What is more, the difference between European law and British law will only increase over time. The UK will no longer automatically adopt new rules and legislative unity of law is no longer safeguarded by a single highest judicial body.

A complete exit, but what new form of cooperation will there be?

There is a considerable chance that the two-year exit process will be too short a period of time to reach agreement on the new relationship the UK might want with the EU. That means that the UK will leave the EU in April 2019, but that it is highly unlikely that a new cooperative framework will have been agreed. One of the difficult issues, for instance, will be the UK's demand that it retains a say in the creation of European legislation, while it is no longer a member of the EU and does not recognize the judicial authority of the European Court of Justice. That will be difficult to reconcile.

If there is no framework cooperation agreement between the UK and the EU in April 2019, it means that trade between the two will fall back on the rules of the World Trade Organization (WTO). Cooperation with the UK will then be no different than cooperation with a country such as Russia or China.

Unless…. a transitional arrangement is agreed, under which the UK does leave the EU, but many of the de facto relationships as they exist today as part of the EU membership remain in place.

Despite the strong language from Theresa May and demands in terms of sovereignty and independence, the UK is also looking towards reciprocal trade interests of the EU and the UK. In the words of Theresa May: "We must talk to our European partners about a cooperation that is beneficial to both parties. We do not intend to continue the relationship with the other 27 EU countries as if we are a friendly third-party nation, such as South Korea."

All in all, a lot of uncertainty and volatility remains and the UK seems to be heading towards a complete separation from the EU while the new form of cooperation has not yet been decided.

What will Brexit mean to Belgium?

Research has shown that that the UK has a special position for Belgium. As a member of the EU, Belgium will face the harsh reality of the UK's exit. It is our fourth largest export country; 8.8% of our goods exports go to the UK, amounting to € 31.9 billion. And our services sector has also benefitted from exports to the UK. In terms of imports, the UK plays a slightly less important role for Belgium. Imports of goods (€ 17.4 bn) are just over half the value of exports (€ 31.9 bn). Our main imports are mineral products (21.3%), road vehicles (20.5%), chemical products (17.0%) and machinery (13.2%) from the UK.

The Belgian economy has recovered from the crisis in recent years, but the uncertainties surrounding Brexit may have a temporary and negative impact on consumer spending and investments.

If the UK leaves the EU in two years' time without a new cooperation agreement, it will fall back on the agreements of the WTO treaty. The WTO treaty is aimed at encouraging trade between countries across the globe, but even if only WTO regulations apply, Belgium will be affected more severely than other European countries. Belgian exports could be subjected to an average levy of 5.5%, while the EU average is 4.9%.

Economic consequences for Belgium

Brexit will have an impact on the Belgian economy. Belgium is particularly vulnerable because of its close trade links with the UK. On the ranking of European countries' exposure to Brexit Belgium ranks 10th[2].

Import and export

We have established that Belgium has relatively high trade levels with the UK, when compared with the EU as a whole. The short-term weakness of the British pound will have a negative impact on Belgium's competitive position. Imports from the UK will become cheaper for all countries and these imports will continue to access the European market without any obstacles in the next two years.

In terms of Belgian exports, companies will face new obstacles. If the UK is no longer part of the EU Customs Union (depending on the exit scenario), there may be import duties in the future, with extra administrative costs as a result, and VAT payments when goods are crossing the borders between the UK and the EU. The impact of Brexit will be felt most in the industry of motorized vehicles and pharmaceutical sector. They depend on relatively large amounts of exports to the UK.

— For instance, the industry of motorized vehicles constitutes 26.1% of the total Belgian export to the UK, amounting to € 8.3 billion.
— Pharmaceutical products constitute 20.5% of the Belgian export to the UK, amounting to € 6.5 billion. It is expected that the impact on the pharmaceutical sector is less significant, since this area is less price-sensitive[3].

Investments

Brexit will not only have an impact on trading goods and services, but also on the foreign direct investments (FDI). Investments totaling around € 19.4 billion in 2013, which yielded a profit of over € 1 billion in 2013, which is the equivalent of nearly 5% of Belgian GDP[4].

Belgian financial links with the UK are substantial, with Belgian entities owing € 31 billion to UK banks in 2014. It should be noted that this is only one third of the level in 2007, before the financial crisis[5].

International companies operating in Belgium and additional obstacles

Of course numerous international companies will also feel the impact of Brexit. What those consequences will be obviously depends on the exit scenario chosen, but it is already clear that international companies in particular will have to prepare for major changes. And we are referring in particular to companies with subsidiaries in the UK and a parent company in Belgium or vice versa.

You can use the infographic on the next page to determine whether your company is prepared for the effects of Brexit.

[2] BREXIT: the impact on the UK and the EU, Global Counsel, 06/2015
[3] "België bij grootste slachtoffers Brexit", De Tijd, 12 july 2016.

Potential tax implications for Belgium

Will Brexit have direct or indirect tax impacts for your business? Take a look at our below overview of potential impacts that companies in Belgium could experience.

Direct tax implications

- Policy repositioning
- Parent Subsidiary Directive & Interest and Royalties Directive
- Dividends
- Interest and Royalties
- Potential impact on M&A legislation
- Potential for policies favoring UK industries and businesses
- Potential harmonization of direct taxes

Indirect tax implications

- Customs
- Excise duty
- VAT

General tax and legal issues

- Mutual Assistance Directive (AEoI on tax rulings, CBCR)
- Arbitration Convention
- Free movement of persons
- Employment law (e.g. work time directive)

Social security

Below, we provide some examples that will affect the four freedoms of the EU:

Free movement of goods and services

— It is very likely there will no longer be an obligation for the UK to recognize decisions of EU Member States' courts in civil and commercial matters and vice versa, as is currently the case pursuant to article 36, section 1 of Regulation (EU) 1215/2012. In accordance with this article, a judgment given in a member state must be recognized by other member states without any special procedure being required (even if it were incorrect).

— As a result of this, subsidiary companies would no longer be able to appeal to jurisprudence that is applicable in the country of the parent company. The parent company and subsidiary will therefore be subject to different legal systems and that may have a considerable impact on business operations.

— On the other hand, VAT rates in the UK could be reduced to below the minimum rates in the EU (15% and 5% respectively). The same applied to levies on tobacco, alcohol and energy. The extent to which the British government is willing to (partly) forego income from various sectors remains to be seen. It could also decide to reduce corporate income taxes, taking a very direct approach to reducing the burden on companies.

Free movement of capital

— International companies may incur costs for new patents and trademark rights. The UK government is expected to continue to recognize existing EU patents and trademark rights. However, new patents and trademark rights will have to be applied for in different places, separately for the UK and the EU.

— Other costs international companies may face are related to acquisitions, since different regulatory bodies (for the UK and the EU) will have to approve the same deal.

— In addition, a separate withholding tax may also be charged on payments of interest, license fees and dividends from subsidiaries to parent companies.

Free movement of people

— If the exit scenario turns out to restrict freedom of workers, it could mean that EEA nationals will once again need a visa and work permit to live and work in UK. Likewise, UK nationals would need visa and work permits to live and work in EEA countries. While in the past it was possible to second employees to subsidiaries in other EU countries without obstacles, companies would now face additional bureaucracy and a usually time-consuming hurdle in cross-border employment to and from the UK.

— Short term business travel from UK might face an EU electronic authorization system, likely to increase cost and reduce ease of free travel into EU. This might likewise come through for EU nationals travelling into UK.

— In a worst case scenario, UK may seek to impose mandatory visa requirements on EU nationals, or might refuse to exempt nationals of new Member States from visa requirement. Resulting in reciprocity for British citizens needing visa to enter EU.

[4] BREXIT: the impact on the UK and the EU, Global Counsel, 06/2015.
[5] BREXIT: the impact on the UK and the EU, Global Counsel, 06/2015.

In short, the basis for cross-border investments and enterprise models will change on both sides of the Channel. Companies that prepare for possible Brexit scenarios in a timely fashion will be able to adapt more quickly and benefit immediately from the resultant competitive edge.

How can we prepare in Belgium?

Every company and every CEO must decide for themselves which steps they do and do not want to include in the preparations for Brexit and the two-year exit procedure. The impact will be different for everyone. We have seen that our clients are devoting time to the Brexit issue and it also seems that there are still a lot of uncertainties.

It obviously makes sense for Belgian companies to take into account new uncertainties and new risks. Listed companies in particular owe it to their investors to provide insight into the potential impact of Brexit. Companies are currently developing and calculating various potential scenarios for the future.

On the other hand, there are still major uncertainties at this moment about the impact of Brexit and the future cooperation framework between the EU and the UK.

Most important in these uncertain times: keep an eye on the news
We are looking forward to the moment when the negotiations on Brexit start. Elements that are already seeping out via various British news sources and especially Theresa May speech on the 17th of January seem to indicate a hard Brexit. And as Donald Tusk has indicated, he believes there is only one alternative to a hard Brexit: no Brexit.

We will have to see what happens.

Is there anything organizations can already do today?

Try to create (broad outlines of) long-term scenarios that reflect the impact of Brexit on your company. For instance, consider what happens when the British pound's exchange rate falls, if import levies rise, what effect do interest rates have, etc. Developing different scenarios at this early stage will make it easier to make an effective assessment of the consequences of Brexit.

Take into account fluctuations in valuations and the volatility of the market. This can be translated into an adjustment of the discount rate and changes in the valuation of, for instance, companies, real estate and pension moneys. An IPO will be riskier.

Determine the risk of exchange rate changes. We can see now that the British pound exchange rate will be subject to more volatility in the coming years. If there is 'good' news, the exchange rate increases, and vice versa. A company that is sensitive to fluctuations in the British pound's exchange rate will want to hedge against that risk.

Higher transaction costs can already be taken into consideration. KPMG took stock of the impact of Brexit on 14 large clients and concluded that even without increased levies transaction costs in trade could increase by as much as 22%.

Take into account higher costs for customs duties. Without free trade agreement, Belgian exporters seeking to export to the UK will face customs duties.

Financial environment
How would the uncertainty after the referendum affect your capital costs?

Would your investment financing still be secure?

Would it be necessary to adjust your financial forecasts?

Image
Would EU consumers be more likely to avoid your British brands and vice versa?

Markets
Will there be less trade between Great Britain and the EU?

How would such a decrease impact trade with third countries?

Customer relations
Will your British customers prefer more local suppliers?

Can your company cope with the loss of key customers?

Will you have to modify your pricing policy due to new tax and customs regulations?

Company structure and legal form
Should you adapt your company structure and legal form in order to better take advantage of opportunities? Are changes required by law?

What costs will be incurred by restructuring?

Information
Do you have access to sufficient information for the constant evaluation of your company's stability?

How should you improve monitoring in order to be able to anticipate developments in an even more targeted way?

Are you able to predict the consequences of potential changes in the tax regulations relating to value added tax and withholding tax?

Employees and company structure
How would limited freedom of movement for workers influence the employee structure at your British subsidiary?

How high are the administrative costs of continuing to employ EU workers already working at your British subsidiary?

How will your employee and company structure change in Belgium?

How will your employment policies change, in case the future labor laws in Great Britain deviate considerably from the regulations in the EU?

Core processes
Should you rethink your market development processes?

Are your supplier and distribution networks appropriately positioned for the future?

Are you able to recognize potential risks along your supply chain in time? Are you linked to regional locations?

Infrastructure
Will it be necessary to plan for additional capacity for administrative tasks as a result of trade restrictions?

Is it necessary to adapt IT systems?

Are your structures and processes capable of handling increased fiscal and logistical demands?

> "Every company and every CEO must decide for themselves which steps they do and do not want to include in the preparations for Brexit and the two-year exit procedure.

© 2017 KPMG Central Services, a Belgian Economic Interest Grouping ("ESV/GIE") and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. Printed in Belgium.

What can KPMG do for you?

We are happy to keep our eyes on the news for you, but we can also help your company with a customs scan or advice from one of our Brexit experts.

Tax advice and data analysis
KPMG's Tax teams are closely following developments. They can provide insight and analysis, e.g. around customs and statistical data to determine your company's risks and opportunities.

By analyzing the effects of Brexit (additional customs duties and handling costs) we can help companies to reduce risks and identify opportunities at an early stage. This is an analysis that can be conducted for trade activities from the UK to the EU and vice versa.

KPMG countries desk and Brexit experts

KPMG in Belgium maintains a continuous dialogue with companies from countries such as Japan, Korea and the US about their Brexit strategy. Our Countries desk teams in Belgium have the know-how of the culture and language of the country of origin, and are well equipped to provide these foreign-based companies with advice and guidance on their choice of location and implementation.

© 2017 KPMG Central Services, a Belgian Economic Interest Grouping ("ESV/GIE") and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. Printed in Belgium.

Contact

René Philips
Partner
T +32 2 708 38 07
E rphilips1@kpmg.com

Jeroen Gobbin
Partner
T +32 2 708 37 67
E jgobbin@kpmg.com

Erik Clinck
Partner
T +32 3 821 18 55
E eclinck@kpmg.com

www.kpmg.com/be