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The taxing bit of Brexit

Banks need to consider tax impact if they switch location

November 2016

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At a glance:

- Banks need to consider the tax impact of changing their operating model
- Employment costs and personal tax obligations may impact decision making across EU27
- Tax teams will need to be proactive while also taking a more strategic view

Since the Brexit vote, debate in financial services has raged about whether banks will need to relocate operations to preserve their ability to service EU27 based customers. What has been less discussed is how tax rules, and possible changes to them, will become an important element in that decision. Quite apart from the effect it would have on Britain's position as a global financial centre, questions around tax will play a major part in banks' ability to attract and retain staff, keep a handle on staff costs, determine their exposure and readiness for new global tax rules and ultimately affect profitability itself.

We can broadly break the tax implications of Brexit for banks into two buckets:

First, banks will have to think about the tax consequences of changes to their operating model – moving assets and people for example – and all that will have to be studied to assess the risks and opportunities.

Second, EU legislation has a major influence on UK taxes. For example, indirect taxes such as VAT and customs duties flow directly from the European Union. The UK will potentially have have the opportunity to change these. But what changes are we likely to see?

Banks will want to ensure their operating structures are as adaptable as possible to cope with a possible loss of their passporting privileges – the rules that give banks and other regulated businesses the ability to distribute products across mainland Europe. Banks may need to address structural and capital shortcomings in order to deliver the greatest flexibility to their trading models.

	UK	France	Germany	Ireland	Luxembourg	Poland
Base salary	100,000	100,000	100,000	100,000	100,000	100,000
Company cost	112,473	147,339	112,382	110,750	112,670	110,137
Change in company cost compared to the UK	–	31.00%	(0.08%)	(1.53%)	0.18%	(2.08%)
Employee cost	33,152	37,673	44,057	39,482	39,219	34,097
Change in employee cost compared to the UK	–	13.64%	32.89%	19.09%	18.30%	2.85%
Total contribution	145,625	185,012	156,439	150,232	151,889	144,234
Change in contribution cost compared to the UK	–	27.05%	7.43%	3.16%	4.30%	(0.96%)

The above table is provided for illustrative purposes and only reflects the income tax and social security costs of employing an individual in a given location. It is based on a notional employee with a salary of €100,000 and does not incorporate wage differentials or fact specific allowances or reliefs.

In evaluating an optimal structural solution, banks will need to look at where they encounter least tax friction. Right now, banks and other companies in the UK and across the EU can carry out transactions such as re-organisations and payments of interest and dividends in a tax-efficient way thanks to European directives. What will happen to these guarantees for those outside the EU? For example, will tax treaties provide adequate relief? At the same time, banks' tax departments may need to interpret new approaches to VAT, transfer pricing and other operational taxes.

Continental drift

It is around workforce that some of the biggest tax issues will arise should banks transfer operations to mainland Europe. We know that London's rivals are seeking to smooth the process. Le Parisien reported French Prime Minister Manual Valls as saying recently: "We are working on measures that could help strengthen our attractiveness. I think notably about taxation or the status of expatriates."

Companies shouldn't overlook what could be a significant additional cost however. The cost of employment and those individuals' personal tax obligations will vary hugely across the EU27. There are significant variations in income tax, national insurance, social security, wealth and other tax costs across EU member states. They may also need to consider whether tax equalisation arrangements are appropriate or necessary.

That means banks will need to do a quantitative analysis of what this means for their own costs and for their employees. Banks not only need to understand their cost of operating but their relative attractiveness for their employees. The following table provides a high level comparison across major EU jurisdictions.

Taxing times

To cope with all of this tax departments have their work cut out. First, they need to help their organisations understand the consequences of possible changes to their operating model so that tax costs can be factored into that decision. And second, they need to make their own assessment of changes to the UK tax legislation depending on the precise deal the UK makes in exiting the EU.

And all of this comes as tax departments are straining under the weight of new reforms such as the OECD's Base Erosion and Profit Shifting (BEPS) initiative, which seeks to recalibrate the international tax framework.

And as we have seen recently, the EU is happy to intervene where there is a perception that favourable regimes or 'sweetheart deals' have been implemented. It will be interesting to see how the UK Government responds to both EU and non-EU multinationals – especially in financial services after Article 50 is invoked. Tax incentives might be an option to shore up the UK's attractiveness. Conversely, the EU might seek to head off this possibility with its own measures.

Tax departments will need to be proactive to meet these challenges while continuing to deal with their day-to-day filing and governance obligations – and the rapid pace of legislative change. Now is a moment to take a step back, ensure operations are as tax efficient as possible and review the organisation's readiness for a period of significant change.

A ten point to-do list

1. **Entity and capital restructuring due to required reorganisation:** model tax implications of any required reorganisation; evaluate potential exit charges, indirect taxation implications and transfer pricing.
2. **Staff relocation:** model tax implications on payroll, social security and personal tax costs.
3. **Proposed alternatives to EU membership:** monitor implications of emerging exit terms.
4. **Possible revision to EU tax directive requirements:** assess impact of EU and UK policy revisions.
5. **Changing UK landscape:** action any tax changes and evaluate opportunities arising from competitive policy revisions.
6. **EU competitive initiatives:** monitor EU and global policy revisions for opportunities.
7. **Impact on indirect taxation:** monitor EU and UK legislative revisions.
8. **VAT process:** monitor EU and UK legislative revisions.
9. **Loss of binding arbitration:** monitor EU and global policy revisions.
10. **Non-applicability of EU tax developments:** monitor developments – especially in areas such as the EU anti-avoidance tax package and BEPS.

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CREATE | CRT069352D | November 2016.