Euro Tax Flash from KPMG's EU Tax Centre

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Brexit update – Trade and Cooperation Agreement formally signed

Brexit – Trade and Cooperation Agreement – Mobility – Direct Tax – Tax Transparency – Mandatory Disclosure Rules – State Aid

On December 30, 2020, the EU and the UK signed the Trade and Cooperation Agreement ("EU-UK Agreement"), which sets out the terms of their future cooperation. The agreement reached comes as a result of nine rounds of formal negotiations, which started back in March 2020.

The EU-UK Agreement consists of three main pillars:

- a Free Trade Agreement ("EU-UK FTA"), covering, *inter alia,* the trade of goods and services, competition, state aid, tax transparency and social security coordination;
- a partnership on citizens' security, establishing a framework on law enforcement and judicial cooperation;
- a horizonal agreement on Governance, providing clarity on how the agreement will work and control mechanisms. It also sets up a body – Joint Partnership Council – tasked to ensure that the terms of the agreement are properly applied and interpreted.

Applicability and next steps

The EU-UK Agreement is applicable on a provisional basis starting January 1, 2021. In terms of next steps for ratification on the EU side, as the agreement was concluded under article 217 of the Treaty on the Functioning of the European Union, the European Parliament has to provide its consent and the Council has to adopt the decision on the conclusion of the agreement.

Impact of the EU-UK Free Trade agreement

The transition period for the EU withdrawal ended on December 31, 2020, which means that, from an EU perspective, the UK is now formally a third country and the EU principles of free movement of goods, capital, workers and provision of services are no longer applicable. The sections below provide a high-level summary of what has been agreed in the EU-UK FTA in these areas.

1. Trade of goods

As a result of leaving the EU, the UK is no longer part of the Single Market and Customs Union. This means, *inter alia*, that customs formalities and regulatory checks and controls on goods traded between the EU and the UK are now required, which represents a fundamental change for business.

The EU-UK FTA sets out the basis of a free trade agreement which provides zero tariffs or quotas on goods traded, as long as agreed rules of origin are met (i.e. the EU and UK traders have to meet rules of origin comparable to those which the EU and the UK have with other trading partners).

The agreement includes several measures targeted at helping business comply with the rules of origin requirements and certain lighter customs formalities (e.g. the mutual recognition of Authorised Economic Operators).

The EU-UK FTA also includes two protocols, as follows: i) one on mutual assistance to combat customs fraud, and ii) a protocol allowing the EU and the UK to cooperate on VAT matters, the recovery of claims relating to indirect taxes and duties.

On a separate note, the agreement does not cover the trade of goods between the EU and Northern Ireland, which is governed by the Protocol on Ireland and Northern Ireland included in the Withdrawal Agreement.

2. Provision of services

Starting January 1, 2020, UK service suppliers lost their automatic right to offer services across the EU. Among others, this means they no longer benefit from the 'country-of-origin' approach or 'passporting' concept, which enable automatic access to the entire EU Single Market, and thus are required to comply with the host-country rules of each Member state.

Under the EU-UK FTA non-discrimination clauses, service suppliers / investors from the EU are to be treated no less favorably than UK operators by the UK, and vice-versa. The agreement also includes a "most-favored nation" clause that would allow the EU and the UK to claim any more favorable treatment granted by the other party in future agreements on trade in services and investment with other third countries (except in the area of financial services).

As an exception, no agreement has been reached in the field of financial services and the aim is to negotiate and sign a framework for regulatory cooperation by March 2021.

3. Mobility of employees

The EU withdrawal brought an end to the free movement between the UK and the EU. Therefore, all movements after January 1, 2021 are subject to EU / UK existing immigration rules, as applicable to third countries. Cross-border cases already in place before that date are governed by the withdrawal agreement, which allows covered individuals to stay and protects their social security rights.

The UK opted to not include a chapter on mobility in the EU-UK FTA. The agreement does include provisions on the coordination of some social security benefits, as well as facilitations for short-term business trips and temporary secondments of highly skilled employees.

4. Direct taxation and tax transparency

From January 1, 2021, the UK can no longer benefit from EU directives, including those in the area of direct tax:

- the Parent-Subsidiary Directive – aimed at exempting dividends and other profit distributions paid by subsidiary companies to their parent companies from withholding taxes and eliminating double taxation of such income at the level of the parent company;
- the Interest and Royalties Directive – aimed at ensuring fair taxation of interest and royalty payments made between associated companies in different EU countries, while avoiding double-taxation between EU countries by abolishing taxes levied at the EU country of source, while the EU country of receipt taxes the same payment;
- the Merger Directive – aimed at removing fiscal obstacles to cross-border reorganizations involving qualifying companies situated in two or more Member States;
- the Directive on Administrative Cooperation (DAC) – the framework for, among others, automatic exchange of information among Member States on certain categories of income and assets, on cross-border tax rulings, advance pricing arrangements and reportable cross-border arrangements
- the Anti-Tax Avoidance Directive (ATAD), which contains legally binding anti-abuse measures, which all Member States apply, including controlled foreign company rules, exit taxation, interest limitation provisions and anti-hybrid rules; and
- the Directive on tax dispute resolution mechanisms in the EU, which has the objective to establish an effective and efficient procedure to resolve disputes in the context of a well-functioning EU internal market.

The EU-UK FTA includes a good governance clause, under which parties commit to uphold the taxation standards on exchange of tax information, anti-tax avoidance, and public tax transparency agreed upon at the level of the OECD, as well as reiterate their support for the OECD Base Erosion and Profit Shifting (BEPS) Action Plan. Taxation standards specifically mentioned include those related to exchange of tax information on financial accounts, cross-border tax rulings, country-by-country reporting, potential cross-border tax planning arrangements, as well as rules on interest limitation, controlled foreign companies and hybrid mismatches.

The parties also re-affirmed, in a separate joint-declaration, their commitment on countering harmful tax regimes and set out the principles that would apply in this matter. An annual dialogue will take place on the application of these principles.

Mandatory Disclosure Rules

In the specific case of mandatory disclosure rules ("MDR"), the UK no longer subscribes to the provisions of the Directive on Administrative Cooperation (DAC6) and will apply the OECD standard going forward.

UK legislation will be amended to reflect this change. In order for the UK to comply with its commitments under the FTA, as an interim step , domestic legislation was amended so that reporting will be restricted only to those arrangements that meet hallmarks under Category D of DAC 6 and which are considered to be equivalent to the OECD's MDR standard.

Category D hallmarks refer to:

- arrangements which may have the effect of undermining the reporting obligation under agreements on the automatic exchange of information or which take advantage of the absence of such legislation or agreements (hallmark D.1.);
- arrangement involving a non-transparent legal or beneficial ownership chain with the use of persons, legal arrangements or structures (hallmark D.2.).

Reporting under D hallmarks only will be required for a limited period of time, according to the deadlines set out in DAC6, i.e. 30 days from the relevant trigger point as of January 1, 2021, January 30, 2021 for the deferral period and February 28, 2021 for the "look-back" period.

No disclosures will be required with respect to arrangements that fall into one of the other hallmarks, i.e. categories A, B, C and E of DAC6. This also applies to "look-back" period arrangements, i.e. where the first step in implementation was made on or after June 25, 2018 and before July 1, 2020, and arrangements for which the reporting trigger(s) was met during the deferral period (July 1 to December 31, 2020).

Once the UK has implemented the OECD MDRs, the remaining UK regulations related to DAC6 (i.e. those referring to D hallmarks) will be repealed. The timeline for adoption of this legislation is currently unknown.

5. Level playing field and state aid

Though the UK is no longer subject to existing EU State aid rules, both parties committed to ensuring a level playing field for open and fair competition. The EU-UK FTA also includes a "rebalancing mechanism" to manage future divergences in specific areas. Both sides can diverge from aspects of the agreement but also have the power to impose temporary measures if they believe there are distortions to trade or investment.

In respect of state aid, the EU-UK FTA introduces a form of subsidy control, replacing the EU State aid rules.

For more further details on the impact of the Brexit deal on business please refer to a tax alert prepared by the KPMG member firm in the UK. Should you have any queries, please do not hesitate to contact KPMG's EU Tax Centre, or, as appropriate, your local KPMG tax advisor.

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