

INTRODUCTION

Welcome to this edition of UK Inward Investment. In a moment of history the UK has now triggered Article 50 and begun the process of leaving the European Union. With, in addition, an impending general election, it is a time of great uncertainty. As we all know, uncertainty is not a good environment for business but, that said, the message from the government remains clear 'Britain is Open for Business'. At Mercer & Hole, it is very much business as usual; business continues and individuals and their businesses are still setting up and operating in the UK.

In this issue, we cover some topical areas of business interest, looking at some of the pros and cons the current market affords.

Away from Article 50, the UK tax system continues to be updated with "transparency" and "fairness" being the government watchwords. As the UK strives to meet these objectives, it is essential that anyone investing in the UK is aware of the tax implications of doing so. Liz Cuthbertson sets out the main changes for investing in real property and provides an overview of how the tax rules apply in the case of residential property.

'What are the implications for the UK's direct taxes?' asks David Hadley as the UK moves towards what he anticipates will be a hard Brexit. David considers the

UK government's position on a number of issues, which include attracting investment, payments between companies in the EU and anti-avoidance.

Looking at some issues around corporate transactions in the context of Brexit, Ross Lane and Mike Orton seek to make us more informed about those who might plan to invest in the UK.

Brexit has already had a marked impact on currency with the pound losing value, but with that there are also some innovative new opportunities arising for financing cross-border trade. Steve Smith shares some positive observations on current circumstances.

Richard Collier reminds us that VAT is firmly in the Remain camp and looks at the VAT implications of Brexit and some of the unanswered questions which we will be keeping a close eye on in the months and years ahead.

I hope you enjoy the read and, as ever, we look forward to helping you bring your plans to fruition. If there is anything here you would like to discuss further, please do not hesitate to contact any of us.



Lisa Spearman
Partner
+44 (0)20 7236 2601
+44 (0)1908 605552
lisaspearman@mercerhole.co.uk

IN THIS ISSUE:

02: UK Property – still the real deal? **03:** Implications of Brexit for the UK's direct taxes **04:** How attractive is the current UK market for overseas investors? **05:** Financing cross-border trade after Brexit **06:** VAT Implications of Brexit

UK PROPERTY – STILL THE REAL DEAL?

DESPITE POST BREXIT FEARS, REAL ESTATE PROPERTY INVESTMENT CONTINUES ALTHOUGH THERE SEEMS TO BE A CONSENSUS THAT PRIME PARTS OF LONDON HAVE SLOWED DOWN.

Further tax complexity for real estate purchases has not cooled down and, from 6 April 2017, all UK residential property is in the scope of UK Inheritance Tax (IHT), regardless of the vehicle it is held in. The rules apply even if the ultimate beneficial owner is or has even never been resident or domiciled in the UK.

Identifying who is caught and the extent of the exposure is critically important and therefore trustees and directors of non UK structures need to be aware of the new rules and the associated compliance requirements.

The prospect of further tax rules is not over. Consultation is underway as to whether non UK companies should be charged to UK corporation tax rather than income tax. Although this may appear to be just semantics, it would have wider ramifications not least with regard to the way interest on borrowings can be relieved but also the timing and delivery of tax returns.

We have vast experience in guiding our clients through the complexity to find the most appropriate solution for their circumstances and ensuring all reporting obligations are met.

	Related occupation	Third party let		Income Tax	Capital Gains Tax	Inheritance Tax
Individual	Yes	No	▶	None	Possibly main residence exempt	Yes
	No	Yes	▶	Yes	Yes	Yes
Company	Yes	No	▶	Possibly benefit in kind charges Possibly ATED charges	Yes	Yes in estate of shareholder Possible lifetime charges on gifts
	No	Yes	▶	Yes	Yes	Yes in estate of shareholder Possible lifetime charges on gifts
Trust	Yes	No	▶	Yes, probably	Yes	Possibly both in estate of settlor AND 6% charge every ten years AND exit charges
	No	Yes	▶	Yes	Yes	Possibly both in estate of settlor AND 6% charge every ten years AND exit charges

THERE IS PLENTY TO THINK ABOUT, PLEASE CONTACT LIZ CUTHBERTSON OR YOUR USUAL MERCER & HOLE CONTACT IF THERE IS ANYTHING YOU WOULD LIKE TO DISCUSS.



Liz Cuthbertson
Partner
+44 (0)20 7236 2601
lizcuthbertson@mercerhole.co.uk

IMPLICATIONS OF BREXIT FOR THE UK'S DIRECT TAXES

NOW THAT ARTICLE 50 HAS BEEN TRIGGERED WHAT ARE THE IMPLICATIONS FOR THE UK'S DIRECT TAXES? UK DIRECT TAXES, UNLIKE VAT, ARE PURELY GOVERNED BY DOMESTIC LAW, NOT EU LAW, APART FROM THE REQUIREMENT NOT TO DISCRIMINATE AGAINST OTHER EU NATIONALS AND TO COMPLY WITH THE FUNDAMENTAL FREEDOMS AND STATE AID REGULATIONS. IF THE UK WERE TO LEAVE THE EU BUT JOIN THE EUROPEAN ECONOMIC AREA (EEA) IT WOULD STILL NEED TO COMPLY IN THESE AREAS. HOWEVER, THE UK JOINING THE EEA LOOKS LESS AND LESS LIKELY AS THE DIRECTION APPEARS TO BE TOWARD A HARD BREXIT.

The government will wish for Britain to appear to be open for business, suggesting a tax system that supports and encourages UK inward investment and entrepreneurship. The UK already has a competitive corporation tax rate at 19% (reducing to 17% on 1 April 2020) much lower than most other Organisation for Economic Co-operation and Development (OECD) countries.

If the UK were no longer required to meet the state aid rules this would allow the UK government to be more generous with tax reliefs for investors. For example, the scope of tax relief under the Enterprise Investment Scheme (EIS) and the Seed Enterprise Investment Scheme (SEIS) could be wider than at present. Whether or not the UK government will take this opportunity remains to be seen.

'THE GOVERNMENT WILL WISH FOR BRITAIN TO APPEAR TO BE OPEN FOR BUSINESS, SUGGESTING A TAX SYSTEM THAT SUPPORTS AND ENCOURAGES UK INWARD INVESTMENT AND ENTREPRENEURSHIP.'

The EU freedoms have meant the UK tax authorities have not always been able to implement anti-avoidance rules against international persons and organisations in the way that they would wish. They have had to restrict their Controlled Foreign Companies legislation, for example. Brexit could enable them to implement that legislation in the way that they would have originally preferred. We wait to see if they will do so.

Following Brexit, the EU Parent-Subsidiary and Interest and Royalties Directives will no longer apply. These directives allow dividends, interest and royalties to be paid between companies within the EU without, usually, withholding tax. The UK does however have double tax treaties with all of the

EU members so most payments will still be able to be paid gross but there will be exceptions (e.g. dividends paid to the UK by a German subsidiary).

It is unlikely that Brexit will have any significant impact on the UK's implementation of BEPS (Base Erosion and Profit Shifting) a general anti-avoidance provision being implemented internationally. The UK is bound by its commitment as a member of the G20 and the OECD and has already introduced restrictions on interest deductibility for large companies and groups.

The European Commission's Anti-Tax Avoidance Directive is intended to implement certain BEPS recommendations within the EU including country-by-country reporting. Members have until 31 December 2018 and the UK is likely to have implemented the proposals before Brexit.

In summary Brexit is unlikely to have any significant impact on UK direct taxation in the short or medium term but in the long term it will give greater flexibility to the UK government on the legislation it implements.

IF YOU WOULD LIKE TO DISCUSS THIS FURTHER PLEASE GET IN TOUCH WITH DAVID HADLEY OR ANOTHER MEMBER OF THE CORPORATE AND BUSINESS TAX TEAM.



David Hadley
Tax Director
44 (0)1727 869141
+44 (0)20 7236 2601
davidhadley@mercerhole.co.uk

HOW ATTRACTIVE IS THE CURRENT UK MARKET FOR OVERSEAS INVESTORS?

WITH THE PRIME MINISTER RECENTLY TRIGGERING ARTICLE 50, THE POTENTIAL IMPACT OF THE BREXIT DEAL TO BE NEGOTIATED COMES INTO SHARPER FOCUS WITH THE NATURE OF THE TRADE DEAL LIKELY TO IMPACT ON FUTURE FOREIGN INVESTMENT IN THE UK. FOREIGN INVESTMENT IS IMPORTANT TO THE FUTURE UK ECONOMIC LANDSCAPE AS IT INCREASES NATIONAL PRODUCTIVITY, AND SUBSEQUENTLY OUTPUT AND WAGES.

POTENTIAL IMPACT OF THE TRADE DEAL WITH THE EU

Approximately half of the foreign investment in the UK comes from the EU single market and higher trade costs are likely to depress it. Any decline might be moderate as many EU investors are primarily seeking access to UK markets and customers. Some experts suggest that a comprehensive trade deal, akin to the European Free Trade Association whose members participate in the EU's single market, would significantly reduce the impact. However, such a trade deal seems unlikely unless the UK compromises on issues such as immigration.

The Brexit impact on investments from outside the EU could be more varied, with Asia demonstrating this best. Chinese and Indian investment is expected to remain strong as demand is mainly driven by their own domestic markets, coupled with UK investment opportunities being cheaper due to favourable exchange rate movements. In contrast, Japan and Korea are concerned about the UK not having access to the EU single market in the future, with Korea already relocating operations out of the UK and postponing or eliminating the UK as a location option.

CURRENT VIEW

It was anticipated immediately after the Brexit vote that transactional activity would decline but we continue to see a relatively buoyant market. The weakening of the pound has made and continues to make UK businesses cheaper for foreign investors.

It is inevitable that some countries will pull back on their investment into the UK. Sectors that rely on collaboration with the EU will become less attractive, but the exact terms of the future trade deal will be key.

So what can the UK do to continue to make itself attractive to overseas investors? There should be a focus on markets and sectors that will continue to offer the strongest proposition to foreign investors. In addition, enhancements can be made as to how UK businesses can become aware of companies that are planning on investing in the UK.

We have experience of cross-border transactions, both on the buy side and the sell side, and we can provide services to support vendors and acquirers. Such services can range from providing UK vendors with assistance when selling to overseas investors to providing bid support and due diligence services to overseas acquirers.

IF YOU WOULD LIKE TO DISCUSS THIS FURTHER PLEASE GET IN TOUCH WITH ROSS LANE, MIKE ORTON OR ANOTHER MEMBER OF THE CORPORATE FINANCE TEAM.



Ross Lane
Partner
+44 (0)1727 869141
+44 (0)20 7236 2601
rosslane@mercerhole.co.uk



Mike Orton
Director
+44 (0)20 7236 2601
mikeorton@mercerhole.co.uk

FINANCING CROSS-BORDER TRADE AFTER BREXIT

The devaluation of sterling since the Brexit referendum has had a significant impact on all businesses trading with overseas customers and suppliers or with financial interests outside of the UK.

Importers and exporters of goods and services will be well experienced in using financial derivative products and trade finance solutions to protect their business from fluctuations in currency exchange rates and movements in commodity prices. After all, it is hard work for most businesses to retain margins without leaving that hard earned profit exposed to foreign exchange and commodity price markets over which they have no control.

Securing fixed currency exchange rates covering future trade is commonplace and the market is well served by banks and others providing competitive and flexible arrangements. However, those forward foreign exchange contracts became much more expensive in June 2016 creating a cost and predicament for management. Should they hold off continuing to buy forward currency or in anticipation (and hoping) for an uptick in the value of sterling after the currency markets have settled? Foreign exchange contracts do have fixed periods of cover and most businesses buying forward foreign exchange contracts will have seen by now, or will soon see the benefit of those contracts come to an end. The outlook for importers of products and services is clearly an increase in costs. These costs will have to be carefully managed.

There continues to be an increase in focus on finding certainty of price and many businesses are talking with their offshore suppliers about trading in sterling to eliminate exchange rate risk. There are innovative solutions on the market and banks and others are providing advice and products to try and ease the cost impact. Inevitably, however, importing goods and services is now more costly.

How importers and exporters organise their trade finance may open opportunities to either make some cost savings for importers or otherwise greatly assist exporters in capturing and expanding their offshore business.

Financing trade finance typically involves Letters of Credit which represent a guarantee of settlement, usually reducing cash or borrowing facilities. Leaving the operation and administration of dealing with the paperwork required in the trade finance process for another time, businesses are finding themselves with plenty of orders from overseas customers but are short of the funding facilities to fulfil those orders.

Trade finance is an area of special expertise. The major banks have designated specialist teams to deal with this. There are, however, many other independent specialist trade finance houses who are experiencing an increase in activity and tailor financial arrangements, which may involve debt insurance to cover a shortfall in financial facilities. These arrangements, can be put in place for both importers and exporters and are particularly relevant to those businesses with seasonal trade where large stock orders need to be placed months in advance. Without doubt, the current foreign exchange climate makes overseas business transactions challenging. It is a challenge that UK managers will relish and adapt to successfully.

SHOULD YOU WISH TO DISCUSS MANAGING OR SECURING FOREIGN EXCHANGE RATES ON TRADE FINANCE, DO NOT HESITATE TO CONTACT STEVE SMITH OR YOUR USUAL PARTNER.



Steve Smith
Partner
+44 (0)1727 869141
+44 (0)20 7236 2601
stevesmith@mercerhole.co.uk

VAT IMPLICATIONS OF BREXIT

INVESTING IN THE UK WAS TRADITIONALLY BOTH AN INVESTMENT IN A LARGE MODERN ECONOMY AS WELL AS A SMOOTH GATEWAY INTO THE EU, ONE OF THE WORLD'S FOREMOST TRADING BLOCKS. FOR THOSE OUTSIDE THE EU THE BEMUSEMENT AT THE BRITISH PEOPLE'S DECISION TO LEAVE WILL NOW BE TEMPERED WITH A COLD HARD LOOK AT WHAT THE UK CAN STILL OFFER. INWARD INVESTORS WILL HAVE TO CONSIDER WHETHER THE UK IS THE BEST BET OR WHETHER A SPLIT APPROACH IS REQUIRED.

Within the government, there are contrary opinions of the future of the UK's economy with or without a free trade deal.

Much has been said about World Trade Organisation rules and free trade. This is an important issue as customs duty tariffs will increase trade costs and need to be factored into future business models. However, the VAT changes that will occur as of the first day of Brexit are not so frequently debated and are probably less well understood, maybe even within certain parts of the government.

Many businesses though are waking up to the disruptive effect of these changes as they realise just how tied into the EU VAT regime the UK is. UK VAT rules are based on the EU model set out in the VAT Directive which applies a standard set of VAT rules across the current 28 countries. More importantly, these rules, which regulate and ease trade between the member states, will change immediately and significantly upon Brexit.

The services sector will be impacted, in some specific cases significantly, but the greater impact will arguably be felt by those trading in goods. The EU VAT rules currently make trading with other EU countries simpler, VAT is less of a cash-flow item and there are specific easements and simplifications to address complex trading patterns (triangulation, temporary movement of goods etc.) and to keep goods and deals moving. Granted, there are some nuisance reporting requirements (EC Sales Lists, Intrastats) that will disappear, but it is likely some similar form of trade reporting will be needed by the post-Brexit Treasury and Trade and Industry departments, as well as EU countries on the other side.

From large businesses with EU-wide supply chains to smaller players operating online the effects will be felt widely. The new rules will need review on both sides of the new UK-EU border. The financial industry already faces a strong incentive to relocate at least some functions to the EU. Will there be a similar VAT incentive for other businesses? Can this be avoided? What contingency plans will permit businesses to best ride out the looming VAT and customs duty issues? Will such plans themselves have other tax and business consequences?

There is much to consider over the next two years and as yet there is no certainty, except one; the time will pass all too quickly.

IF YOU WOULD LIKE TO DISCUSS ANY VAT OR INDIRECT TAX MATTERS FURTHER, PLEASE GET IN TOUCH WITH RICHARD COLLIER OR YOUR USUAL MERCER & HOLE CONTACT.



Richard Collier
VAT Senior Manager
+44 (0)1727 869141
richardcollier@mercerhole.co.uk

London

t +44 (0)20 7236 2601 e london@mercerhole.co.uk

St Albans

t +44 (0)1727 869141 e stalbens@mercerhole.co.uk

Rickmansworth

t +44 (0)1923 771010 e rickmansworth@mercerhole.co.uk

Milton Keynes

t +44 (0)1908 605552 e miltonkeynes@mercerhole.co.uk



Newsletter Disclaimer:

This newsletter is a short selection of items extracted from complex legislation. Further specific advice on any matters referred to must be taken at all times. The information is given for general guidance only and publication is without responsibility for loss occasioned to any person acting or refraining from acting as a result of the information given. No part of this publication may be reproduced without the prior permission of Mercer & Hole.

Firm Disclaimer:

Mercer & Hole is registered to carry on audit work in the UK and Ireland and regulated for a range of investment business activities by the Institute of Chartered Accountants in England and Wales. M&H Financial Planning Ltd is authorised and regulated by the Financial Conduct Authority and is a subsidiary of Mercer & Hole Group Limited. Registered in England and Wales No. 9585846. All Rights Reserved.

www.mercerhole.co.uk