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Brexit: the Possible Impact for Italy

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There will be numerous effects on customs, direct and indirect taxation between Italy and the United Kingdom as a result of "Brexit", as discussed here. However, it is as yet difficult to predict exactly what the eventual effects will be.

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I. Introduction

Until today, we have been accustomed to analyzing the economic and fiscal effects due to the admission of a state as a new member of the European Union ("EU"). In such cases, we would be discussing solutions to specific operations underway at the time of the requested entry (the last was Croatia in 2013).

For "Brexit", the situation is the opposite; it represents the first case in the history of the EU in which a Member State has decided to leave the EU, and there will be several economic and tax consequences for Italy due to the U.K.'s intention to leave.

As far as the economic consequences are concerned, the Italian finance Minister declared that Brexit would have limited effects on the Italian real economy, but it is undeniable that the U.K.'s exit will have a considerable impact on the European market. Moreover, those effects would certainly be greater if Scotland were to become an independent country within the EU.

Sezione speciale per l'Assicurazione del Credito all'Esportazionedell'Istituto Nazionale Assicurazioni ("SACE") has pointed out that the principal risks for Italian companies after Brexit are mainly related to exports. In particular, according to SACE, the U.K.'s exit could have a significant impact on Italian exports in the range of 200–500 million euros in 2016 and between 600–1,700 million euros in 2017.

As regards the effect on taxes, there will be several effects on customs, direct and indirect taxation that tax planners ought not to overlook. EU Member States have a number of tax benefits which could automatically terminate or be remapped in a way similar to that for non-EU countries and for non-participating countries in the European Economic Area (i.e. Iceland, Liechstenstein and Norway).

The previous U.K. Chancellor of the Exchequer, George Osborne, had already announced a plan to cut the U.K.'s corporate tax rate to under 15%. Osborne expressed the intention to create a "super competitive economy", decreasing the corporate tax rate by more than five percentage points, in order to avoid companies moving their headquarters out of the U.K. This plan has been confirmed by the head of the OECD Tax division Pascal Saint-Amans, who declared that "the negative impact of Brexit on competitiveness would lead the United Kingdom to become more aggressive in its respective tax proposals. A further step in that direction would transform the United Kingdom into a tax haven type economy."

Such a fiscal policy, which anticipates the existing program to reduce the corporate tax rate to 17% by 2017, would place the U.K. closer to the level of taxation of Ireland.

The effects of Brexit will in any event become visible after the U.K. formalizes its exit from the EU. They are not therefore immediate, because the procedure required by the "termination clause" in Article 50 of the EU Treaty involves finalizing a lengthy and complex deal to outline the future economic and political relationship with the EU. As a result, it is possible to assume that Brexit will not immediately affect tax legislation.

II. Tax Impact

A. Indirect Taxation

Brexit will undoubtedly have a greater impact on indirect than on direct taxation, but the respective effects are still not easily identifiable. As far as VAT is concerned, the effects of Brexit will be pronounced for British trade, resulting in major border costs. These costs are difficult to estimate at present, additionally

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because the U.K. may have the power to negotiate a sufficient level of free trade with the other EU Member States. Furthermore, U.K. Governments will now redraft their own rule of law without any reference to the EU Directives.

From Italy's point of view, all operations with the U.K. should be remapped as import/export operations, with the resulting loss of the special regime—the so-called intra-EU operation. This regime currently provides for total VAT exemption of trade between companies settled in the EU (business-to-business ("B2B")).

In a nutshell, the main changes in the actual Italian VAT regime caused by Brexit can be summarized as follows:

- abolition of "Intrastat" fulfillment referred to trade on goods between Italy and the U.K.;
- abolition of the "EC Sales List Model" provided for trade between the U.K. and EU countries;
- introduction of new rules concerning imports and exports between the U.K. and other EU countries;
- the exemption threshold provided for distance selling could no longer be applicable with reference to low-value exports;
- some changes to actual VAT rates.

B. Direct Taxation

With regard to the effects on direct taxation, it is currently difficult to estimate these because they mostly depend on the new international agreements, which remain to be negotiated.

Firstly, it should be noted that Brexit might not have an effect on some legislation. We are referring here to many tax provisions that have been adopted by the U.K. under several EU Directives, many of which concern indirect taxation. In addition, the tax provisions adopted according to the international Directives laid down by the OECD should not be affected.

The principal effect on direct tax will refer to the probable disapplication of Directive 90/435/EEC on dividends (the "Parent Subsidiary Directive"), according to which it may be possible to exempt dividends paid by a company settled in Italy to another company settled in a country within the EU, shareholder of a minimum stock of 10% of its capital, if the other conditions required by Article 27-*bis*, D.P.R. n. 600 of September 29, 1973 are fulfilled. After Brexit, the subjective conditions provided by the above-mentioned article are not satisfied.

Furthermore, Brexit could probably lead to the disapplication of Article 27, co. 3-*ter*, D.P.R. n. 600 of September 29, 1973, on the application of the favorable tax rate of 1.375% on dividends paid by Italian companies to U.K.-resident shareholders.

As a result, in such cases, the provision contained in Article 10 of the U.K./Italy Double Taxation Convention (according to which dividends paid from a resident company of a contractor country to a resident company of another contractor country should be taxed in the latter one) would be applied.

However, such dividends could also be taxed in the country where the dividends are paid according to its own legislation, but, if the recipient is the beneficial owner, taxation must not exceed:

- 5% of the gross total amount of the dividends, if the beneficial owner is a company which directly or indirectly controls at least 10% of the voting power of the company which pays the dividends;
- 15% of the gross total amount of the dividends in all other cases.

In addition, Brexit probably will lead to the disapplication of Directive 2003/49/EC on interest and royalty payments, which exempts the payment between subsidiary companies within the EU of the Italian tax.

Consequently, there will be a return to the application of the withholding tax provided by Article 26, comma 1, D.P.R n. 600/1973, on interest and other similar payments paid to holders of bonds and similar financial assets issued by non-EU companies. Moreover, withholding tax will be applied to medium- and long-term loans granted by U.K. banks to Italian companies.

Furthermore, Brexit could affect the specific tax regime provided for extraordinary corporate transactions, leading to the loss of the respective fiscal neutrality, when those relate to U.K. companies, or in the case of transfer of company headquarters to the U.K.

Other tax questions could arise in connection with the legislation concerning controlled foreign companies ("CFCs"), especially if the U.K. goes ahead with the above-mentioned plan to reduce the corporate tax rate of U.K. companies. In this case, in fact, the U.K. would be considered a tax haven for the purpose of the CFC legislation.

This condition could also imply consequences for dividends and capital gain taxation, with the consequent application of Articles 47 comma 4, 68 comma 4, 89 comma 3 and 87 comma 1 of D.P.R. n. 917 of December 22, 1986, according to which dividends and capital gains from states or territories with a favorable tax regime are considered fiscally relevant.

Lastly, the tax regime concerning revenues from U.K. OICRs[1] (collective investment undertakings) could abandon the actual taxation system based on withholding tax in favor of a different one based on withholding tax with advance payment under Article 10-*ter*, commas 6 and 7 of Law n. 77/1983.

C. Tobin Tax, Ivafe[2] and Ivie[3]

While Brexit would not affect the actual legislation on Tobin Tax and Ivafe, it certainly involves the current rules for determination of Ivie. In particular, after Brexit the tax base related to U.K. real estate will no longer be determined with reference to the respective cadastral value, but according to the purchase cost.

D. Inheritance Tax

With regard to inheritance tax, after Brexit it will probably be impossible to exclude the corresponding sum of government bonds from the inheritance tax base.

E. Finance

There will also be effects on the financial front since, at present, a loan from an English bank is not subject to mandatory taxes (12.5%). However, this is a privilege reserved for EU Member States only. After Brexit, this will no longer be the case.

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NOTES

[1] *Organismi di investimento collettivo del risparmio* (OICR).

[2] The "imposta sul alore dei rodotti finanziari" (Ivafe) is a model of a financial products tax.

[3] The "imposta sul valore degli immobili all'estero" (Ivie) is a model of a foreign real estate tax.

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