The Brexit Strategy

The Impact of Brexit on Non-EU Multinationals with UK Holdings

2016

International Business

On 23 June, the UK voted to leave the European Union. Multi-nationals with a UK holding company structure should therefore be aware of the legal changes which might influence their business after Brexit.

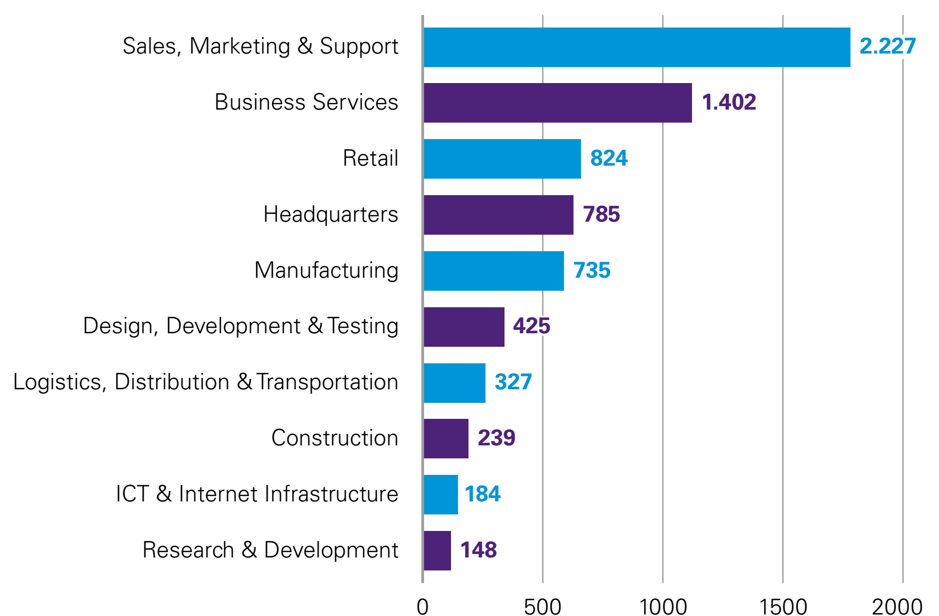
Will the UK Remain a Preferred Location for the European Headquarters of Non-European Multinationals?

Traditionally, the UK has been one of the most attractive destinations in the EU for non-EU companies for establishing a European holding company. Regarding business activities, headquarters have ranked fourth in non-EU greenfield investments to the UK since 2003. The 785 greenfield investments registered as headquarter projects account for more than 10% of all non-EU greenfield projects in the UK during this period. In comparison: Germany reports a fraction of only 6.8%. After Brexit, this will likely change, causing a shift in investments towards the remaining EU member states.

Some of the UK's current advantages might not only disappear, but actually become disadvantageous. The introduction of withholding taxes on dividends, interest, and license fees may result in higher overall taxation in the UK versus EU member states, as EU directives that avoid withholding taxes on dividends, interest and royalties received from EU subsidiaries would no longer be available. Increasing costs for financial services might also put pressure on profits, while restrictions on the free movement of labor could cause additional administrative expenditures in terms of managing European operations and related processes.

Multinationals with a UK-based holding company structure should evaluate whether their current structure makes sense in the post-Brexit world. Relocation of the European headquarters to an EU member state may result in a more efficient organization of their business.

Top 10 of non-EU greenfield investments in the UK since 2003, by business activity



Source: fDi Markets 2016

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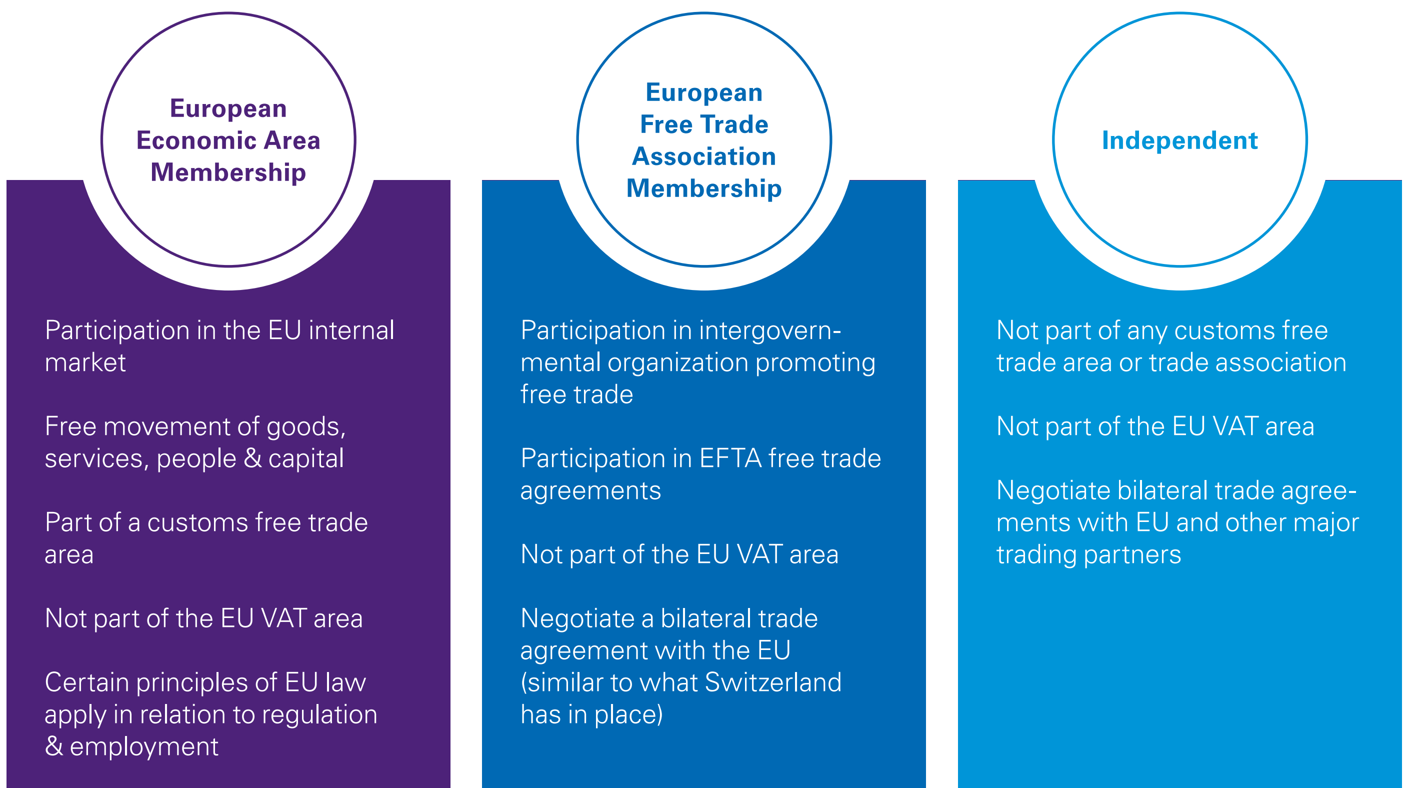
Brexit Will Have a Significant Impact on UK Holdings

Following the UK's Leave vote on June 23, negotiations about the future relationship between the UK and the EU could last for up to two years, according to the Lisbon treaty. The UK would therefore exit the EU in the second half of 2018, and more likely in the beginning of 2019. Additionally, any treaties between the EU and third countries will lose their validity for the United Kingdom and will need to be renegotiated between the UK and those countries. This process could take several years, as has been the case with current negotiations between the EU and Canada regarding CETA and the USA regarding TTIP.

The impact of Brexit on the European operations of non-EU companies will depend on the outcome of negotiations between the UK and the EU. The three most likely scenarios are summarized below.

How the EU-UK relationship may look post-Brexit



Non-EU companies with European headquarters in the UK may be affected by limitations on the free movement of capital and labor as well as goods and services. Above all, changes in tax issues could encourage international corporates to relocate their UK holding companies to EU member states.

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Changes in the Free Movement of Capital

If the United Kingdom exits the EU but remains part of the European Economic Area (EEA), there would not be any restrictions on the free movement of capital. Norway, for example, is not a member of the EU but it is a member of the EEA and is thus allowed free entry to the European capital market. In return, the country accepts the free movement of labor and pays into the EU budget. Additionally, Norway accepts the Single European Market regulations without being able to influence them. As British EU opponents would likely struggle with such concessions, some limitations on the free movement of capital are probable. Switzerland, for example, as a member of the European Free Trade Agreement (EFTA), but not of EEA, is not allowed free entry to the European capital market and is not bound to Single European Market rules.

If the free movement of capital is restricted, the UK financial sector in London, as the central market place for assets denominated in euro, would suffer the most. However, a rise in withholding taxes between the UK and EU member countries might also increase capital costs for UK-located holding companies significantly. For example, withholding tax for cross-border payments of dividends between Germany and the UK could rise from zero to five percent according to the double taxation agreement of 2010 between the two countries as the benefits of the EU Parent Subsidiary Directive may no longer be available. Similar effects are possible with other EU member states.

Higher tax levies such as these could be avoided by renegotiating agreements between the United Kingdom and the EU member states, but negotiations would likely take time. In the meantime, UK-based holding companies would suffer increased capital costs.

Changes in the Free Movement of Labor

Limitations on the free movement of labor might affect a company's ability to easily relocate workers from branches located in the EU to the UK and vice versa. Moreover, for non-EU and UK employees, separate work visas for the UK and the EU would likely be required. As a consequence, administrative and processing costs for human resource planning would increase, whereas competitors with headquarters in EU member states would suffer less from these restrictions.

However, restrictions on the free movement of labor are less likely than limitations on free access to the European capital market. Members of EFTA are not subject to restrictions on labor movement. The EU is in fact considering the acceptance of the free movement of labor as one of the major conditions to allow non-EU countries free entry to the European goods market.

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Changes in the Free Movement of Goods and Services

Restrictions on the cross-border movement of goods are not applicable to members of EFTA. It is however quite unlikely that trade between the EU and the UK would face rising customs tariffs as even international customs tariffs based on WTO (World Treaty Organization) agreements are negligible in most sectors. Furthermore, as goods are generally not traded between holding companies and other group subsidiaries, significant impacts arising from changes in the free movement of goods between the UK and the EU are not expected.

In contrast, countries such as Switzerland, which are not members of the EEA, face limitations on the free movement of services. The financial sector in London could experience rising costs for offering financial services in the EU, which banking institutions may pass on to their customers. UK-based holding companies require these financial services to manage their capital flows between branches located in other European countries. They could therefore be significantly disadvantaged compared with competitors who have European headquarters in EU member states, and who would not suffer from increasing costs for financial services.

Germany – the Most Attractive Country for Relocating UK Holding Companies

Germany, the second most attractive country for non-EU investors in the past, offers several advantages over other large, developed European countries such as France, the Netherlands and Spain. It is not only the largest domestic market in Europe, but also provides excellent infrastructure connections to both established Western European markets and dynamically growing Eastern European economies.

Its diverse economy with various clusters of excellence located all over the country, ranging from automotive to biotechnology, makes Germany attractive to enterprises from all business sectors. Additionally, Germany's well-balanced academic and non-academic education system provides enterprises with a highly skilled and very productive labor force, especially with regards to engineering and other technical jobs.

Germany further provides significant tax benefits, which makes it an excellent holding company location. In particular, dividends and capital gains received from foreign and domestic shareholdings are 95% tax exempt.

These favorable economic factors, along with a politically stable framework, give Germany a leading position in Europe in terms of its attractiveness as an EU holding company site location, as KPMG benchmarking reveals.

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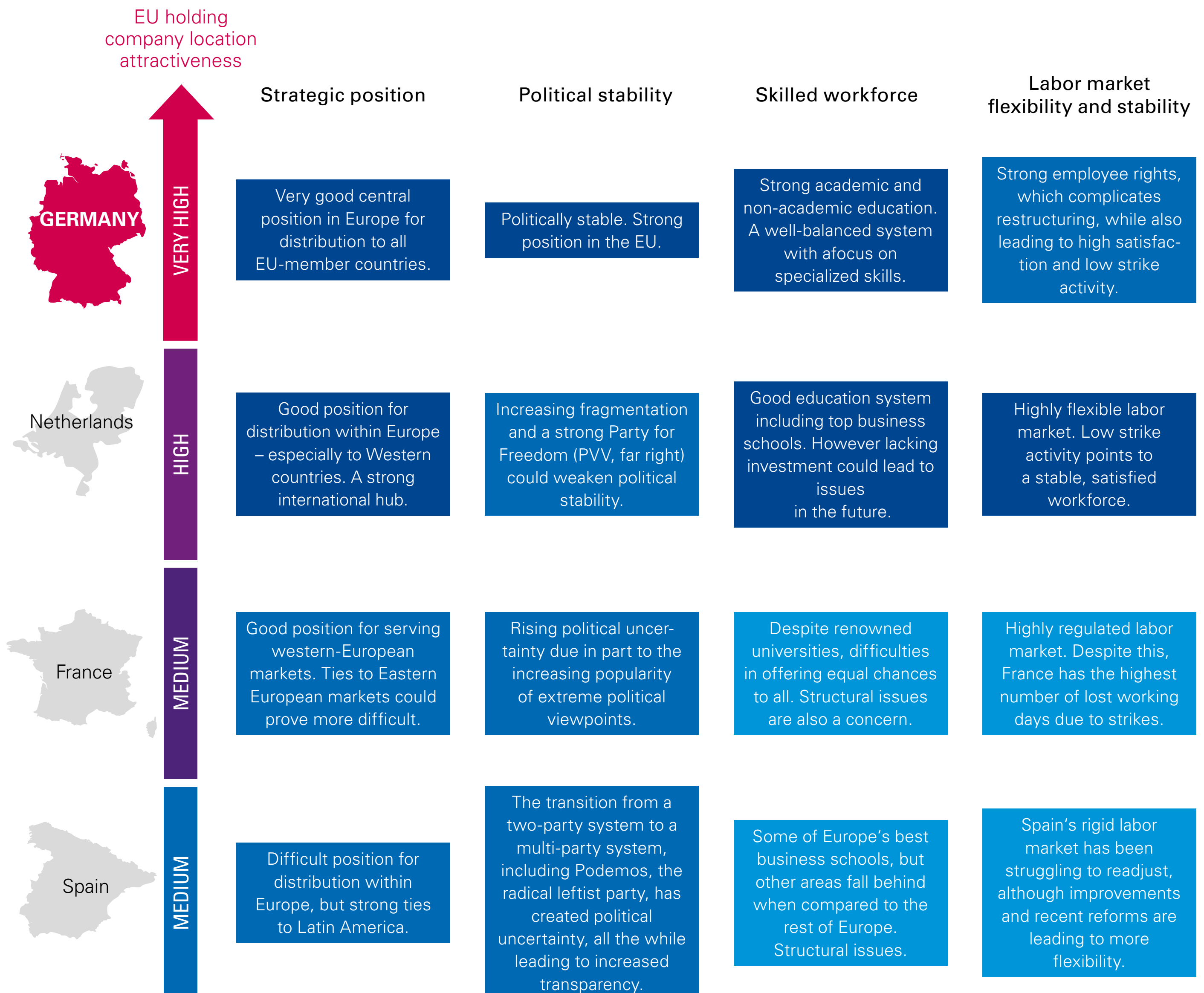
Benchmarking: Germany Compares Very Well to Other Top European Inbound Countries



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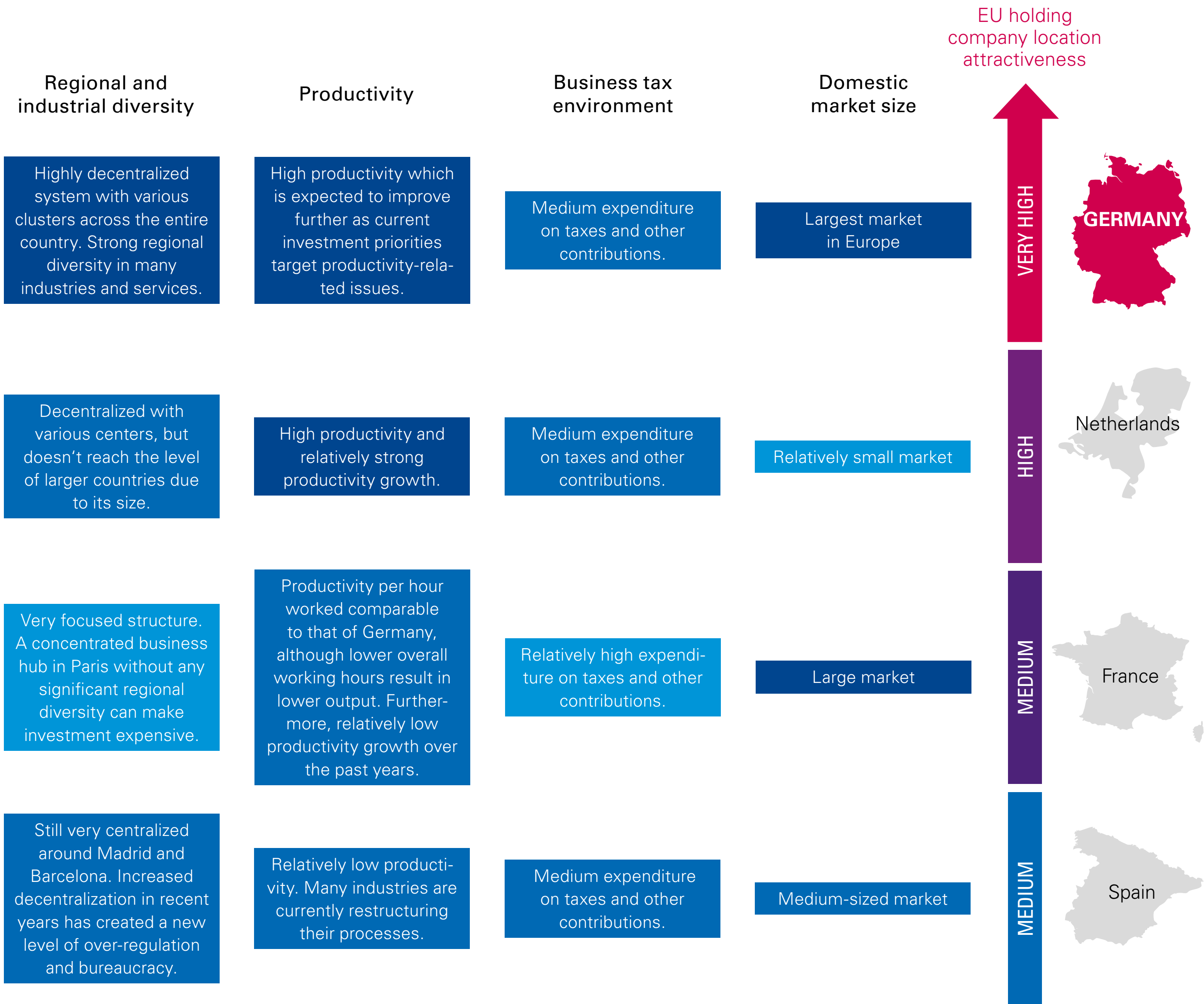

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Headquarter Relocation is Complex and Time Consuming

Companies looking to relocate their European headquarters out of the UK are well advised to prepare now for a full transfer of all relevant functions and design an appropriately-sized future set-up to serve the UK market after Brexit, while securing business as usual. Depending on the size and complexity of the holding structure, it may take anywhere between 6 to 18 months from initial assessment to the final transfer. Ideally, these transfers should be completed before the UK ceases to be a EU member state. Should the UK exit the EU before or during this transfer period, companies would very likely be burdened with additional costs.

Most importantly, EU directives that provide the legal basis for tax neutrality and cross-border reorganizations within the EU may no longer be available. Currently, there are several ways for companies to relocate their UK holding company, for example by merging it with an existing subsidiary in Germany or contributing subsidiaries into a new German holding by way of a share-for-share exchange. However, if the UK follows the Switzerland scenario and also exits the European Economic Area, cross-border reorganizations will no longer benefit from the respective EU directives. Moreover, expats in the UK could require visas and work permits, while additional tax costs such as withholding taxes could reduce profits. As the UK will leave the EU at the latest two years after applying for its exit, there is not much time left.

The table below indicates which further aspects need to be considered to successfully transfer European headquarters from the UK to Germany.

Feasibility of Transfer in Time	Is it possible to transfer all relevant functions, including productive assets? Can we make use of cross-border merger regulations or share-for-share exchange before the UK definitely exits the EU? If not, what are the other options for relocating European headquarters?
Legal & Tax Structure	Design a contractual basis for the transfer of headquarters Consider a new corporate form Take into account exit taxes and tax losses that will be carried forward Consider loss of subsidies received in the UK and possible subsidies in Germany Adapt business to the VAT set-up change Revise the service level agreement regime and transfer pricing set-up
Human Resources	Elaborate a communication strategy to explain the transfer to present staff and increase retention Transfer employee groups to the new headquarter location Secure required resources at the new holding company location (consider lead time of up to 12 months for senior hires) Secure transfer of knowledge where present UK staff is replaced by new staff at the new headquarter location
Assets, Licences and Properties	Transfer all relevant assets, contracts and intellectual property (e.g. registered community designs and EU trademarks could lose their validity in the UK) Transfer or newly apply for any permits, licenses or market authorizations previously granted by UK regulatory bodies to secure their validity for all EU businesses. Adopt local standards in terms of health, security and environment
Operations	Revise invoices & goods flows Adapt IT systems to new organizational structure (e.g. ERP) and legal framework (e.g. data protection) of the new headquarter location country Adopt present set-up to local requirements of headquarter location country (e.g. financial reporting)

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