

## Tax-related impacts of a hard Brexit on non-listed real estate investment

- > EU tax directives no longer apply for the UK after 29 March 2019
- > Dividend and interest and royalty rules main focus for non-listed real estate investment
- > UK headquartered groups most affected
- > EU groups with UK subsidiaries also affected, but not as much

After the UK leaves the European Union in March 2019, unless a negotiated settlement approved by all 27 remaining EU Member States determines otherwise, a 'hard Brexit' will occur. In that case, all EU directives, including tax directives such as the Parent-Subsidiary Directive and the Interest and Royalties Directive, will no longer apply for the UK or for EU-source payments to the UK.

In case of a hard Brexit, many technical changes need to be made to UK tax rules that currently interrelate with EU law. Changes will also be necessary in cases where applying UK law currently depends on whether an entity is resident in the EU. For now, there is no clear indication how or when those changes will be made.

### Group headquarters domiciled in one of the 27 remaining EU Member States

The UK does not charge withholding tax on dividends, regardless of the domicile of the parent. However, under the EU Parent-Subsidiary Directive, a dividend paid by a UK

subsidiary to a parent domiciled in another EU country is generally not subject to tax in the parent's jurisdiction.

After the UK leaves the EU, the Parent-Subsidiary Directive will no longer apply and, therefore, a dividend paid by a UK subsidiary to a parent domiciled in another EU country may be subject to tax in the parent's jurisdiction. Many jurisdictions, such as France, Hungary, Luxembourg and the Netherlands, have generous participation exemptions that apply even to non-EU subsidiaries. Others do not.

In EU Member States that do not have participation exemptions, the parent may be subject to tax on its dividends from UK subsidiaries. Credit is available in many cases, but given the relatively lower rate of

corporate tax in the UK, the credit will likely only reduce the tax, but not eliminate it.

Brexit may also impact taxes on capital gains as well as controlled foreign company rules where domestic exemptions and reliefs available in EU Member States depend on the UK's status as an EU member.

### Group headquarters domiciled in the UK

The biggest immediate impacts for UK headquartered groups will likely result from losing the benefits of the Parent-Subsidiary Directive and the Interest and Royalties Directive.

Currently, these directives provide that a UK parent company receives interest, royalties or dividends from subsidiaries elsewhere in the EU free from withholding tax. After the UK leaves the EU in 2019, that may no longer be the case.

EU directives in these areas will be replaced by a network of bilateral UK double tax treaties and unilateral exemptions.

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The treaties will reduce the withholding rates in some cases, but the withholding will not be eliminated on dividends paid by subsidiaries resident in Austria, the Czech Republic, Estonia, Germany, Greece, Italy, Latvia, Lithuania, Malta, Portugal, Romania and Slovakia. The UK double tax treaties will also not eliminate withholding tax on interest and royalties paid by subsidiaries resident in Italy and Portugal.

The benefits of the two EU directives could be duplicated in the terms of a withdrawal agreement, a subsequent agreement between the UK and the EU, or amendments to the UK's double tax treaties with the affected jurisdictions. However, at least now, this seems uncertain.

### What businesses can do now

A fund manager or other real estate business with parent and subsidiary entities on different sides of the Brexit divide should start identifying how its existing group structure may be subject to withholding taxes. If necessary, they should consider whether those taxes can be mitigated.

UK headquartered groups with significant European subsidiaries that expect to be materially exposed to withholding tax risks on intra-group dividends may need to consider taking more far-reaching measures. For example, to maintain the benefits of being

an EU headquartered group, some UK headquartered fund managers may consider shifting the parent company and headquarters from the UK to one of the remaining 27 EU Member States.

Although this mapping exercise is designed to show the impact of a hard Brexit on non-listed indirect real estate investment, the political situation around Brexit remains fluid. Regulations and tax rules, particularly in the UK, could change rapidly in response to a hard Brexit.

