Tax implications of Brexit on the pharmaceutical industry

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Developed by FTI Consulting with input from the BIA

This Guidance Note outlines some key tax implications of Brexit on the pharmaceutical industry. The EU and UK agreed the terms of a future economic partnership in the EU-UK Trade and Cooperation Agreement, with only days left before the end of the transition period. The agreement provides some clarity and certainty on VAT, customs, and excise duty in relation to trade between EU and UK. The changes to indirect tax for UK/EU trade are of upmost significance but the impact on Corporation Tax are also of importance. This Note does not cover every aspect of UK and international taxation that could be affected but draws out those considered to be of greatest significance for the Life Sciences sector.

Customs Duty Overview

It is important to appreciate that despite the UK and the EU agreeing a trade agreement, the UK has left the EU Single Market and the Customs Union, with the exception of Northern Ireland for the time being. This means that Customs borders apply to the movements of goods and various Customs administrative processes and procedures apply that businesses must get used to.

The trade agreement itself confirms that there should be no Customs tariffs or quotas on UK/EU trade. However, it should be noted that this applies to goods originating in the UK/EU and, where goods originate in third countries, tariffs can still apply even under the agreement. In the life sciences sector, many products including finished pharmaceuticals and medical devices are, in any case, free from Customs Duties, although duties may apply to other products purchased.

Even where tariffs do not apply, additional costs arise as a result of appointing Customs Agents to undertake the relevant Customs requirements.

While the UK remained part of the EU, the standard terms of trade were less relevant as the main consideration for the indirect tax treatment was which party in a chain arranged the transport of the goods outside of that territory. However, now the movements are imports and exports, it must be determined who is the correct importer of record and has the responsibility for the Customs obligations. The importer of record is also important for determining the correct party to recover import VAT as detailed below.

Other implications include:

- Potential delays as a result of the Customs border;
- New and additional administration for export controls and licensing;
- Duty reliefs (e.g. Customs warehousing, inward processing relief, goods sent for testing etc.) continue after Brexit;
- Introduction of simplified declaration procedures where businesses can delay the submission of full Customs declarations up to 6 months in certain instances;
- Exporter of record issues – the Customs legislation requires the exporter of record to be established in the UK for UK exports and the EU for EU exports. If this is not the case, a person involved in the supply chain (e.g. the logistics company) will need to act as the exporter of record on an indirect representative basis (which gives them joint and several liability);
- The requirement to obtain UK EORI and/or EU EORI numbers in order to import into and export from the UK and the EU respectively.

VAT Overview

The VAT changes impacting Brexit mainly concern the movement of goods between the UK and the EU and vice versa.

The changes to the VAT treatment of services remain largely unchanged except in certain specific sectors (e.g. financial services and insurance). For the life science sector, this means:

- UK VAT will continue to not be due on services (e.g. licensing, milestone payments, toll manufacturing) to business customers in other EU Member States;
- UK companies will continue to need to account for the reverse charge for services received from the EU (EU VAT should not apply).

In respect of the movements of goods, import VAT will apply. However, the Government has introduced a postponed VAT accounting mechanism, whereby the import VAT can be accounted for on the VAT returns rather than paid upfront and recovered later. No authorisation is required for the use of this mechanism and it is "applied for" on the Customs declaration itself.

The use of postponed VAT accounting significantly improves the cash-flow impact of importing and can mean that duty deferment accounts are no longer necessary.

As detailed above, for movements of goods post Brexit, it is important to understand who is the correct importer of the goods. The standard terms of business (incoterms) may set out who will be responsible for the customs clearance. However, following a change in HMRC policy, only the owner of the goods at the time of import can be the importer. Where the incorrect importer is used, this may result in recovery issues with regards to the import VAT. Therefore, this change in policy has significantly reduced flexibility in supply chains and is likely to result in many more businesses being required to register for VAT in the UK as they will remain the owner of the goods at the point of import.

Other implications include:

- The loss of certain VAT simplifications – in particular, the Triangulation and call-off stock simplifications which allowed businesses that were intermediaries in three party supply chains in having to register for VAT in the destination country for the goods;
- The cessation of the requirement to complete EC Sales Lists;
- The requirement to continue to complete Arrivals Intrastat declarations for 2021 only (but not Despatches declarations unless movement is Northern Ireland to EU);
- The requirement to appoint fiscal representatives in certain EU countries where a UK company is VAT registered.

Northern Ireland Trade

As a result of the Northern Ireland Protocol, additional complexities for VAT and Customs have resulted and should be carefully examined. However, the general treatment is as follows:

- Sales of goods from GB to NI are subject to UK VAT;
- Sales of goods from GB to NI require Customs declarations and could result in duties;
- Sales of goods from NI to UK are subject to UK VAT (with no Customs formalities);
- Sales of goods from EU to NI remain intra-community supplies and the NI customer accounts for acquisition VAT;
- Sales of goods from NI to EU remain intra-community supplies and the EU customer accounts for acquisition VAT.

It should also be noted that for goods moving from EU to NI, the NI customer needs to obtain a new "XI" VAT number from HMRC in order to ensure EU VAT does not apply.

The future of VAT

As a result of the UK Government no longer being constrained by EU law, it will have more freedom to decide whether it wishes to apply new reduced rates (including zero-rates) to goods and services. This has already applied to sanitary products which were amended to a zero-rated product from 1 January 2021.

It is expected the VAT will continue to not be a cost to the pharmaceutical sector with the exception of over-the-counter products (i.e. products without prescription) to the NHS and individuals. However, Brexit may provide an opportunity to engage with the UK Government to discuss the application of reduced and zero rates to certain pharmaceutical products and thereby reducing the cost of healthcare in the UK.

Corporation Tax

Leaving the EU has limited impact on corporation tax as the UK has discretion over setting its own corporation tax policy and more recent changes have predominantly been driven by the OECD's BEPS project. The current Government appears to remain committed to ensure the UK has a low corporation tax rate in order to maintain the most competitive tax system in the G20.

R&D Relief and Patent Box

From 1 January 2021, the EU State aid rules no longer apply to subsidies granted in the UK. Instead, the UK is to introduce a new regime on subsidy control under the UK-EU Trade and Cooperation Agreement.

The agreement includes some broad principles which shape the design of the systems, aiming to ensure that the granting of subsidy does not have detrimental effects on trade between the UK and EU. As a result, it is unlikely that any changes will be made to the SME R&D tax regime. However, the Government may review the rules following the guidance published by BEIS but no changes have been announced.

The Patent Box is only narrowly impacted by EU law. Nevertheless, with the reducing headline corporation tax rate the relative benefit of the patent box is diminishing. This would therefore provide opportune timing to lobby for a reduction in the Patent Box rate.

EU Directives

There is no direct impact on the EU Directives that have already been incorporated into the domestic UK tax legislation.

The UK implementation of the Interest and Royalties Directive remains in UK law and continues to apply on payments of interest / royalties from UK companies to EU companies in the same manner as prior to Brexit. This point has been acknowledged by HMRC in their guidance and there is currently no intention to repeal this legislation. However, the position in other EU member states may depend on how their domestic implementing legislation has been drafted and, in most cases, it is anticipated that it will be necessary to rely on double tax treaties going forward.

The UK legislation is also compliant with the Parent-Subsidiary Directive. The UK has not imposed a withholding tax on dividends since 1973 and has either provided relief for underlying tax or, since 2009, an effective exemption from tax on foreign dividends received by parent companies. Given that the UK has drafted its tax policy in this area seemingly independently of its obligations under the Parent-Subsidiary Directive, it is unlikely that the UK will make changes purely because of exiting the EU.

As with interest and royalty payments received from associated companies in other member

states, UK recipients of dividends from subsidiaries in EU member states may need to review their existing structures and arrangements.

The UK implementation of the Merger Directive remains in place (with minor amendments to ensure it continues to be effective) and provides additional reliefs for reorganisations where a UK company transfers the business of an EU permanent establishment to a company.

Following Brexit, the UK amended their implementation of DAC6 to narrow the scope of transactions being reported to only those where beneficial ownership is obscured, or Automatic Exchange of Information is being undermined. These changes are retrospective to 25 June 2018 and should reduce the reporting obligations for most UK tax resident companies. However, consideration of the implementation of DAC6 should still be required where there are operations in EU member states.

Double Tax Treaties

With Brexit, the UK's ability to compete effectively in international trade becomes ever more important. Certain treaties will need to be addressed as a consequence of leaving the EU to avoid the increased incidence of double taxation for UK companies. Furthermore, it is hoped that Government would use this impetus to improve terms in a number of other key treaties such as Germany, Italy and Luxembourg

For further guidance please contact Richard Turner, Senior Managing Director at FTI (Tel: 020 3727 1506). FTI works closely with the BIA to make representations on behalf of companies in the Life Sciences industry to the Treasury or HMRC.