Brexit: The Vote Is In

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Introduction

By the early hours of Friday, 24 June, it was clear that history was about to be made and that the voting UK public had decided to end the UK's 41-year membership of the EU. Many reasons were cited as fundamental to the decision, and can probably be reduced to couple of main (perceived or otherwise) issues: disenfranchisement and a dislike for the apparent lack of democracy and independence created by the governing power of the EU. The percentage margin makes the result look a far closer call than the numbers – with some 17.4m voters (a majority of 1.25m) in favour of leaving the EU. Given these numbers and the fact that the new UK Prime Minister, Theresa May has clearly stated that "Brexit means Brexit", it appears to be a very remote possibility that the vote will be put back to the people or indeed that the UK Parliament will seek to overturn the view of the electorate.

Ireland's focus should be on the factual reality that the UK has decided to exit the EU and how Ireland's future – as its closest neighbour, with very significant trade links and intertwined history – will be shaped by the UK's decision to sever ties with the EU. Ireland has a unique and historical relationship with the UK. Indeed, it will feel the biggest impact amongst the remaining EU members with the most immediate concerns being trade, free movement of people and the position of Northern Ireland. The Irish Government have made it clear that Ireland's intention is to preserve our close ties and relationship with the UK in so far as is possible.

Before the result of the referendum was even two weeks old, it felt as though the reverberations of the decision were only just beginning. British politics imploded, with two of the most prominent and vocal "Leave" advocates stepping down (albeit with they both found favour in the subsequent Cabinet reshuffle); the Prime Minister resigning and a new Prime Minister appointed; sterling plummeting to lows against the US dollar not seen for 31 years; billions wiped off UK pensions and stock markets; pre-referendum promises retracted; the stability of the Northern Irish peace process called into question; and echoes of Scotland's politicians calling for another referendum to split from the UK. Some two months on, things have settled somewhat mainly due to the stabilisation of the political situation in the UK when Theresa May stepped up as Prime Minister on 13 July and undertook an immediate and thorough Cabinet reshuffle.

The ultimate effect of Brexit will remain unknown until alternative arrangements have been negotiated. In the interim, contingency planning is made difficult in the absence of any clarity around the timescale or precise arrangements for the UK's exit from the EU or what the new relationship between the UK and EU will be (if any).

Currently no formal exit notification (as required under Article 50 of the Treaty on European Union) has been made by the UK. Early indications from Theresa May were that Article 50 would be invoked in early 2017, however, according to recent newspaper reports, Ministers are now suggesting that there will be no movement on invoking Article 50 until at least autumn of 2017. The delay is thought to be due to the fact that the UK's Brexit and international trade departments will not be ready to begin negotiating any earlier and with the upcoming presidential elections across Europe the UK would like clarity as to who will be sitting at the table to lead negotiations on behalf of the EU.

It should be remembered that, until Article 50 is invoked and the exit process is completed, the UK remains a full EU Member State, with all of the rights, privileges and obligations that this entails. The UK will formally leave the EU on the day the withdrawal agreement enters into force or two years from the date of submission of the Article 50 exit notification. Until such time, there is no change to the free flow of people, goods and services between Ireland and the UK.

Taoiseach Enda Kenny delivered a statement to the Dáil within hours of the referendum result. He outlined that Ireland is to begin early bilateral discussions, with the Government framework centring on Northern Ireland, the border and the Common Travel Area. Any matters capable of being settled bilaterally will be. He went on to confirm that in other crucial matters, such as trade, it is the outcome of the wider EU discussions that will be decisive. This serves as a reminder that, although we have always had our own relationship with the UK, we are now at the negotiation table as a Member State of the EU rather than in our own right – ironically finding ourselves restricted in a manner that is cited as one of the reasons the UK public voted to leave the EU.

Implications for Ireland in the Immediate Interim Period

Trade

Until the UK serves an exit notification and begins the process of leaving the EU, the immediate impacts on Ireland are trade related, the two major issues being market volatility and currency fluctuations.

According to the Department of Foreign Affairs and Trade, in excess of €1bn of goods and services move between the countries each week, making the UK our biggest trading partner. The UK currency plummeted to a 31-year low against the dollar in the immediate wake of Brexit with sterling also dropping against the Euro but without the dramatic flair. Currency fluctuations have continued in the months following Brexit with some commentators suggesting that it will continue fluctuating for the foreseeable future. As sterling falls, the cost of Irish goods and services to UK consumers goes up – so they buy less. This causes obvious challenges for Irish exporters to the UK market. Irish retailers that have pre-purchased stock in sterling are also prevented from benefitting from the weakening sterling currency. In general where economic confidence takes a hit, coupled with uncertainty, it affects the decisions of retailers, manufacturers and all involved in the supply chain in-between. The property market is also adversely affected by indecision, with this fed through to property development and construction sectors. Mergers and acquisitions activity slows. The more protracted the exit process is, the greater impact it will have on the trading and investment environment. The biggest challenges in this area are for indigenous SMEs and the agri-food sector.

The Irish Government has developed contingency strategies to counteract these short-term implications, with the Taoiseach's statement to the Dáil outlining some of them:

"Enterprise Ireland is implementing a plan to help exporters and a short term strategy identifying other options and possible instruments will be developed to protect jobs in vulnerable sectors. The impact on enterprise and trade in Border counties will be monitored closely. As part of overall contingency planning a dedicated unit has been established in the Department of Agriculture to work on relevant sectoral issues and the Minister will convene a consultative committee of stakeholders to ensure a full exchange of information as the negotiations proceed. Bord Bia will provide practical guidance to SMEs to assist them in dealing with marketing challenges and the management of volatility arising in the short term."

Budget 2017

Just before the referendum, the Minister for Finance, Michael Noonan, and the Minister for Public Expenditure, Paschal Donohoe, delivered their Summer Economic Statement, in which they outlined their optimistic expectation of having probably more than €1bn to give away in tax cuts and extra spending in the October Budget– subject to the caveat that the impact of the UK referendum may wipe out any anticipated excess. It appears that this caveat may now be the most important part of the Summer Economic Statement.

The Taoiseach has given assurances that the UK's decision to leave the EU should not have any impact on Budget 2017. However, a post-Brexit recession is considered inevitable by some commentators, and one would wonder whether (this time) we should heed the warning of ill winds and temper the planned Government spending in anticipation of future pressure on the Exchequer, rather than continuing with commitments that may no longer make sense in the wake of events in the UK.

Pensions

An anectode suggests that a proportion of the €109bn in Irish pension funds is accounted for in EU and UK stocks and shares. The stock markets have been grossly affected by the Brexit vote. As with all investments, they might recover, but it may take time. The most immediate impact is for anyone retiring during the bottom-through-recovery period.

Pension schemes that are heavily invested in UK assets or in assets that are suffering from currency fluctuations and market volatility will need to review their exposure to risk and consider reallocating those assets.

Implications for Ireland in the Long-Term Period

As noted above, it is impossible to give definitive commentary on the full implications until the negotiations between the EU and the UK are concluded and the exit and continuing terms are known. Theresa May was formally sworn in as Prime Minister of the United Kingdom on 13 July 2016. Despite campaigning for Britain to Remain in the European Union, May has vowed to uphold the wishes of the British people and to secure the best possible deal upon withdrawal with this intention underlined by the appointment of Pro- Brexit campaigners in key Cabinet positions and leading the "Brextraction" team. At the date of writing there has yet to be any formal or rumoured indication from the UK government as to its plans for its future relationship (if any) with the EU.

The following sections cover the potential impacts and, more importantly, the potential opportunities created for Ireland in the wake of Brexit.

Trade

According to the Department of Foreign Affairs and Trade[1] Ireland and the UK's Department for International Trade[2], Ireland is the UK's fifth largest export market and imports more from the UK than any other country. The UK accounts for 30% of imports into Ireland. In 2014, exports of goods and services from the UK to Ireland totalled £27.86 billion. With goods and services valued at €1.2 billion moving through the Anglo-Irish trade corridor every week, it is impossible to see a situation where trade between our two islands will not be affected. As noted earlier, the future trade relationship negotiation process will be lengthy and must be carried out in the context of the EU where Ireland does not have the freedom to negotiate its own trading terms with the UK unless it reaches some prior agreement with the EU in that regard – a highly unlikely prospect.

The markets will continue to react to the uncertainty and may contract as a result and this in turn may constrict supply and demand and affect stock markets and currencies. The longer the uncertainty continues, the more volatile the markets will

1 Joint Economic Study – *'Evaluating the value of the economic relationship between the United Kingdom and Ireland'* 2013, UK ONS, Tourism Ireland, IDA, Enterprise Ireland, Bord Bia, Visit Britain.

2 Doing business in Ireland: Ireland trade and export guide - https://www.gov.uk/government/publications/exporting-to-ireland/exporting-to-ireland.

remain, resulting in potentially longer term damage to our export market.

The other potential trading impact is where the UK is part of a supply chain or a route to market. There may be a reduction in the use of UK service providers as there is no visibility or control over the level of tariffs or duties that may be imposed by the UK. This leaves companies completely exposed to unascertainable costs in the short and medium term.

It is clear that Brexit will affect trade between our two nations – the quantum of that effect and the terms of our future trading rights are the issues. The Economic and Social Research Institute predicts a 20% reduction in trade flows, a value of about €10bn annually, as a result of Brexit.[3]

Other business risks include increased bureaucracy and wider gaps in regulatory regimes, all of which have the effect of increasing costs for businesses.

On the bright side, Brexit also presents the opportunity that more beneficial trading terms may be negotiated with the UK due to the leverage of the EU in determining those terms and also the opportunity to focus on forming new trading alliances with a view to reducing reliance on any one particular market.

Tax

There is a general level of uncertainty hanging over the competitiveness of Ireland's current tax regime if the UK is no longer constrained by the EU's State Aid rules and is free to adjust its tax rates and employ tax policies that encourage both domestic investment and foreign direct investment (FDI). Ireland may need to consider its own tax incentive schemes and tax regime in the context of the UK and other jurisdictions levelling the playing field in competing for FDI and diverting attention from Ireland.

Imports/exports

The UK may no longer be part of the Single Market. This would have a direct impact on imports and exports, where VAT zero rating on business-to-business supplies within the EU is lost. Any exports by the UK to the EU may be subject to tariffs and customs and excise duties at the point of import, making UK goods more expensive in the EU market. Additionally, the UK would be entitled to charge import duties on any EU imports, making EU products more expensive in the UK.

Import duties would mean that businesses are faced with additional upfront costs that may lead to cash-flow problems. Businesses may need to fund what would previously have been a non-existent import duty before taking a corresponding deduction for the expense. Cash-flow is cited as the single biggest reason that start-up businesses fail.

Corporation tax rate

The Minister for Finance, Michael Noonan, has given assurances that there is no threat to Ireland's 12.5% corporation tax rate as a result of Brexit. However, this does not quite fully assuage the fear that our tax rate will once again be brought into focus amongst our EU counterparts.

Group structures

Consideration will need to be given to a group structure that includes a UK company. Most tax relief/reduction or preferential treatment is predicated on group companies being resident in the EU. The presence of a UK company in the group may negate tax neutrality on intra-group transactions, including: withholding taxes on interest and royalties; transfer taxes such as CGT and stamp duty; reorganisation relief; merger relief; transfer of losses; and VAT. In certain circumstances, the provisions of the Ireland–UK double taxation agreement (DTA) will mitigate this effect, and the DTA will need to be consulted for all future transactions between Ireland and the UK.

EU Directives

EU Directives may cease to have effect in the UK. There are many Directives that will have an impact, and each will require consideration in its own right. At first blush, two important Directives for tax purposes that will cease to have effect are:

- the Parent–Subsidiary Directive, which allows dividends between an EU subsidiary and parent free of dividend withholding tax, and
- the Interest and Royalties Directive, which allows interest and royalties to be paid free of withholding taxes between group companies – this will impact on UK-headquartered groups.

Foreign direct investment

It was always anticipated that Brexit would result in announcements of changes to the UK's tax regime in an effort to compete

3 Alan Barrett, Adele Bergin, John FitzGerald *et al.*, *Scoping the Possible Implications of Brexit on Ireland* (Dublin: ESRI, 2015), p. 61.

for FDI. Prior to the appointment of Teresa May as Prime Minister and the subsequent Cabinet reshuffle the then UK Chancellor, George Osborne, had announced a plan to cut corporation tax to less than 15% as part of a plan to give the UK a post-Brexit-vote boost. The newly appointed Chancellor, Philip Hammond has yet to make any official statement but if he were to adopt his predecessor's proposition, slicing more than 5% off the current rate would see the UK close in on Ireland's 12.5% corporation tax rate to make it one of the most competitive global economies.

Ireland will need to concentrate on continuing to encourage FDI and, given its similarities to the UK, actively competing for FDI with the UK. Ireland should be marketing itself to any investor seeking access to the EU market in the wake of Brexit on the basis that it will be the only native English-speaking EU Member State, with equally strong links to the US, a strong legal and regulatory system and a business-friendly government.

Severance from the EU will have implications that are particular to the regulated financial services sector. Subject to negotiation with the EU, Brexit may result in the UK losing "passport rights" (the right of a UK financial institution to carry out regulated activities in another EU jurisdiction), which could have significant consequences for UK institutions. Since the wake of Brexit, there has been concern voiced by the industry on this particular issue and if the result is an influx of companies and institutions seeking an EU base for operations and to maintain a foothold in the EU market, this may create opportunities for Ireland to promote itself as that EU base.

The asset management sector in the UK may also be significantly affected, and it is reported that the Central Bank of Ireland is preparing for an increase in applications for authorisation from asset management companies due to fears that they would no longer be able sell UK-regulated funds into the EU.

Legal

EU legislation and judicial decisions may no longer be binding in the UK.

There would be no requirement for the UK to abide by decisions of the Court of Justice of the European Union (CJEU). The question also arises of whether this would operate on a retrospective basis, to the effect that the UK may be free to ignore unfavourable historical CJEU decisions.

Another implication for Ireland, a common law jurisdiction where the use of UK case law precedent is frequent, is that UK case law may no longer form precedent, as the UK courts would be free to make decisions without referring to EU law, EU Directives, EU Regulations and CJEU decisions, all of which have overarching reach in Ireland.

EU Directives and Regulations could cease to have effect in the UK. Depending on how the UK approach this issue, there is the potential for an almost insurmountable number of social, cultural, economic and environmental implications, the impacts of which it are impossible to reduce to a few sentences. Suffice to say, the UK may no longer be bound by many of the rules seeking equality across socio-economic and political issues; ironically, most of these were instigated in the EU by the UK in the first instance.

As noted above, tax reliefs, withholding tax exemptions and preferential treatment in our tax and corporate law legislation are particular to companies or individuals located within the EU, or in certain circumstances where there is a DTA in place.

Once the dust has settled and the terms of the EU–UK relationship are determined, the terms of the Ireland–UK DTA will need to be reviewed together with the circumstances in which transactions with the UK are not intended to be penalised. Any such overhaul would have to be carried out in the context of any restrictions imposed on Ireland as an EU Member State on providing preferential treatment to the UK.

There are a myriad of other legal implications, including: governing law clauses; contracts that are overly reliant on EU definitions or principles; service of proceedings; cross-jurisdictional insolvencies, mergers and divisions; the application of TUPE[4] provisions on the transfer of undertakings; competition law; and the enforcement of judgments in the future. The financial services sector will need to be mindful in this regard, particularly by reference to clauses in loan documentation heavily reliant on EU concepts and terminology such as definitions, grossing-up provisions and withholding tax provisions.

4 Transfer of Undertakings (Protection of Employment) Regulations 2006.

Movement of workers

One of the founding pillars of the EU is the free movement of people within EU Member States. The severance of the relationship with the EU by the UK would mean that the free movement of people to the UK from other Member States (including Ireland) may be restricted. Ireland and the UK have enjoyed open borders since the 1920s, but this special relationship may be committed to history, as it is hard to fathom how an open-border policy between our two countries could be maintained where all other EU Member States' borders with the UK would be closed. There are various rumours as to how this issue will take shape in the future but early indicators point to it being very unlikely that we will see the reintroduction of a "hard" border with Northern Ireland.

Any new immigration restrictions introduced by the UK may see working and visiting visa requirements imposed, with the process likely to be similar to the existing regime for non-EU citizens. This would operate in both directions: for EU citizens working and visiting the UK, and for UK citizens working and visiting EU Member States (including Ireland).

Where most businesses are increasing their global mobility, the lockdown of UK borders would create time delays and increase the administrative burden and costs for businesses and tourism. This would serve to make the UK less accessible and possibly less attractive for businesses with a global and fluid workforce.

Northern Ireland

In the words of the Taoiseach in a Dáil statement on 27 June: *"many people in Northern Ireland are deeply concerned that Northern Ireland will be outside of a project that has delivered so much for political stability, reconciliation and economic prosperity"*.

As discussed above, one of the biggest initial concerns was the re-introduction of a border in Northern Ireland with passport and customs controls. However, all early indicators are suggesting that a "hard" border is extremely unlikely. If this were to happen, it could roll back the years of integration efforts in Ireland, with risks to peace; to cross-border businesses; and to all EU-funded projects between the UK and Ireland, including scientific, arts and cultural programmes, as well as transport links. There have even been some murmurings that *Game of Thrones* will no longer be filmed in Northern Ireland due to the absence of future EU funding.

The Taoiseach has stated that the Irish Government will continue to work urgently and intensively with the UK Government and the Northern Ireland Executive to see how they can collectively ensure that the gains of the last two decades are fully protected in whatever post-Brexit arrangements are negotiated with all three administrations sharing the objective of wanting to preserve the Common Travel Area and an open border on the island of Ireland.

Focus during the Negotiation Process

- Adequate assistance and support must be provided to Irish businesses dealing with sterling fluctuations.
- All efforts to support integrated relationships between the North and South must be continued.
- Irish government agencies (e.g. Central Bank, the Companies Registration Office, and the Revenue Commissioners) must be sufficiently prepared for any increased volume in inquiries and/or new business.
- Government commitment to investment in infrastructure should be prioritised.

Brexit Opportunities for Ireland

It is difficult to take a benefit from a friend's loss, much less to seek actively to capitalise on that loss. However, Ireland must have no qualms about taking every opportunity arising in the wake of the Brexit vote.

There is no question that the UK intends to shape itself and its tax regime post-Brexit to increase its attractiveness and to compete with Ireland in the race for FDI.

A number of potential opportunities for Ireland are presented by Brexit:

- It should be possible to encourage and secure a greater share of FDI, as Ireland is set to become the only native English-speaking country in the EU.
- It should be possible to promote Ireland as an alternative EU base in circumstances where companies are looking outside of the UK for an EU base.
- The headquarters of financial services operations may be moved from the UK to another jurisdiction in the EU from which to "passport" their financial services. Ireland provides a similar economic and cultural landscape to the UK

and will be the only native English-speaking member of the EU. It needs to market itself as the obvious jurisdiction for relocation, with all requisite State agencies adequately prepared to deal with the added pressures and activity (i.e. Revenue, the Central Bank and the Companies Registration Office).

- It is likely that the UK will look to other jurisdictions, such as the US, for closer ties. Given our existing close connection to the US, this is an economic relationship that we are uniquely positioned to contribute to and benefit from.
- Ireland has the opportunity to concentrate on and develop the EU and other markets offsetting any over-reliance on any one market.
- It is a timely opportunity to review our tax regime to ensure that it is competitive and attractive, with particular reference to securing FDI. A detailed review and possible overhaul of our existing investment incentives – such as the Special Assignee Relief Programme (SARP), share schemes, the R&D credit, the knowledge development box and the start-up company exemption – should be considered, bearing in mind that our biggest competitor will have the freedom to incentivise FDI through its tax regime without restriction by the EU.
- Ireland should ensure that any individuals seeking to reclaim their Irish heritage are encouraged to do so, with information readily provided on the process involved.

Conclusion

This article reflects the position as at mid-September 2016 and given the pace at which the landscape has changed in the two months since the Brexit result we should expect continued developments in the immediate and not so immediate future. We are living through a significant moment in history, and certainly the most important time in the EU since its inception. However much anyone may have wanted a different result on the morning of the 24 June, what is done is done, and this should be seen only as an opportunity for all parties to renegotiate the terms on which they want to do business and to reframe themselves in that context. Change brings about change, and with change comes opportunity.

The initial shock is over and it is only when the dust settles and the real negotiations begin to determine the future of the UK and its relationship with the EU that we will know the true implications of Brexit, in economic, cultural and social terms.

Read more on taxfind Brexit: threat or opportunity for Ireland, Tim Sarson and Sinead Murdock, *Irish Tax Review*, Issue 2, 2016