Tax Alert

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Assessing the impact of Brexit on Asia

The United Kingdom's (UK) decision to leave the European Union (EU) on 24 June was an unexpected outcome to many of us.

There remain a lot of uncertainties, and the most commonly asked question is: when will the UK trigger Article 50 of the Lisbon Treaty to officially start the process to leave the EU? It is also unclear how the process will pan out. The uncertainties also extend to the type of alternative economic agreements / treaties that the UK will be able to put in place with the rest of the EU Member States as well as with the rest of world.

The UK has to act fast on Brexit in order to mitigate the negative economic effects as much as possible. Given how much interconnected the UK is with the global economy, there is no doubt that Brexit will have far-reaching economic consequences to businesses operating in the Asia region.

One major impact for businesses in Asia will be the free trade agreements (FTA) that exist between EU and Asia – all of which directly affect businesses operating in Asia. The EU has always been interested and proactive in building a FTA network with various Asia countries in its efforts to boost trade. As it stands, the FTAs that the EU has ratified, signed and awaiting ratification, in midst of negotiations are as follows.

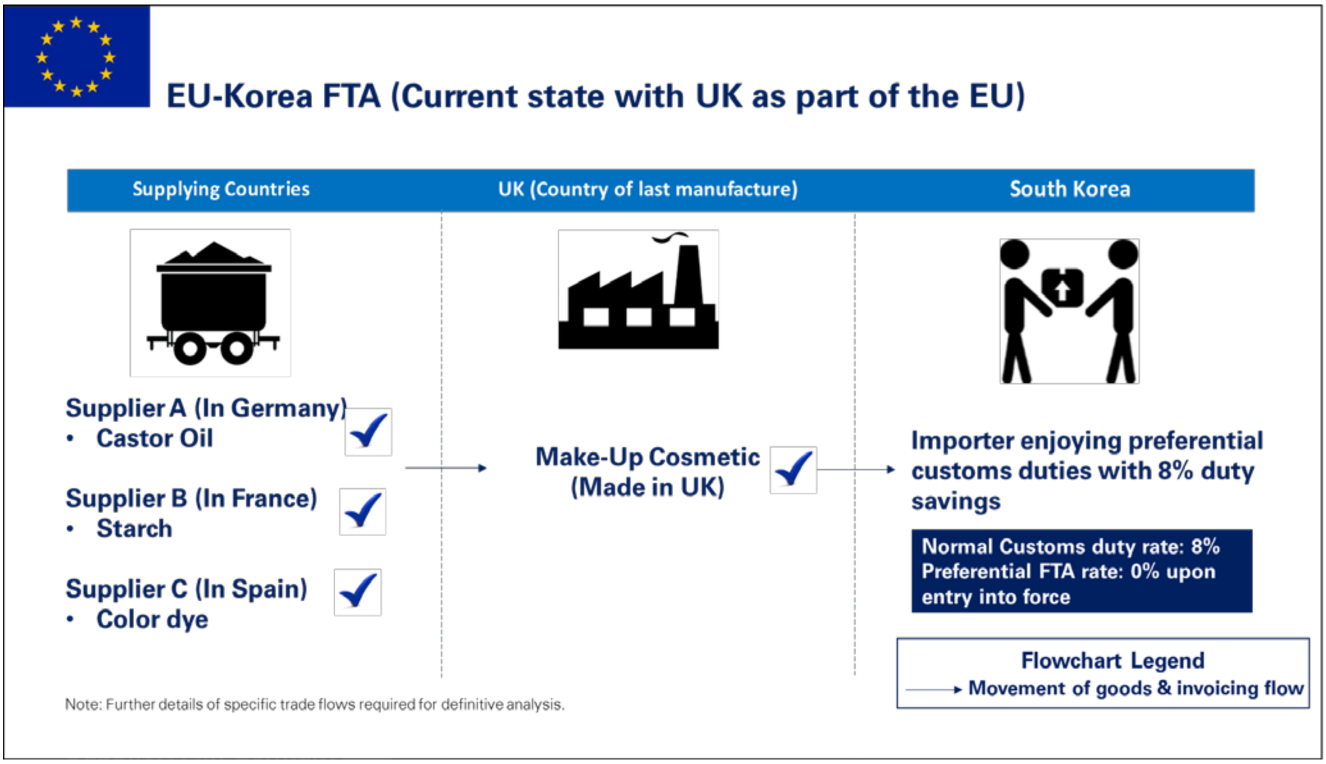
EU FTA Network in Asia (as of June 2016):

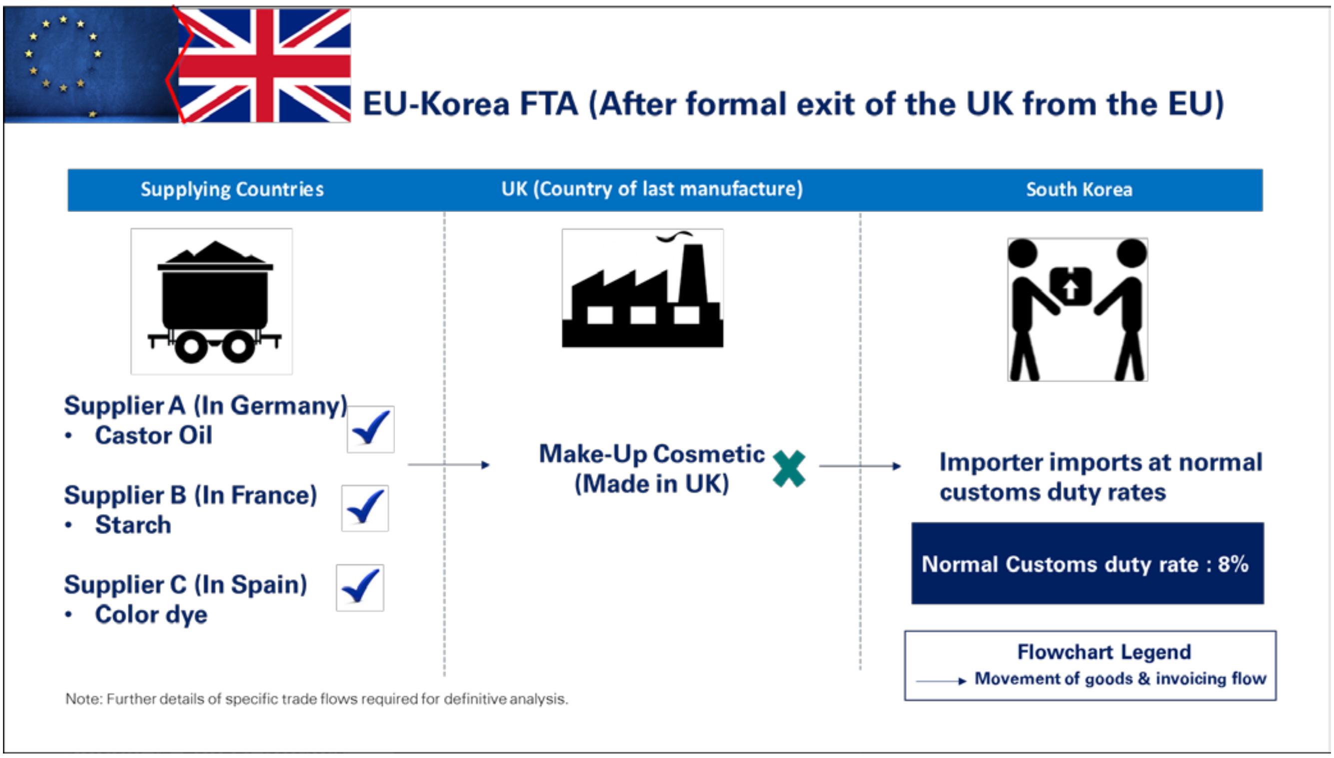
Currently in force	Signed but awaiting ratification / concluded negotiations	Undergoing negotiations at various stages
South Korea	Singapore	Malaysia
Papua New Guinea (Under an Economic Partnership Arrangement (EPA))	Vietnam	Philippines
Fiji (Under an EPA)		Thailand
		Myanmar
		Japan
		India
		Gulf Council Cooperation (Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and United Arab Emirates)

Let us assume that the UK is officially not part of the EU today and the UK has not concluded their bilateral negotiation on the existing EU-Korea FTA.

Diagram 1: UK as the country of last manufacture

Illustrative Example:



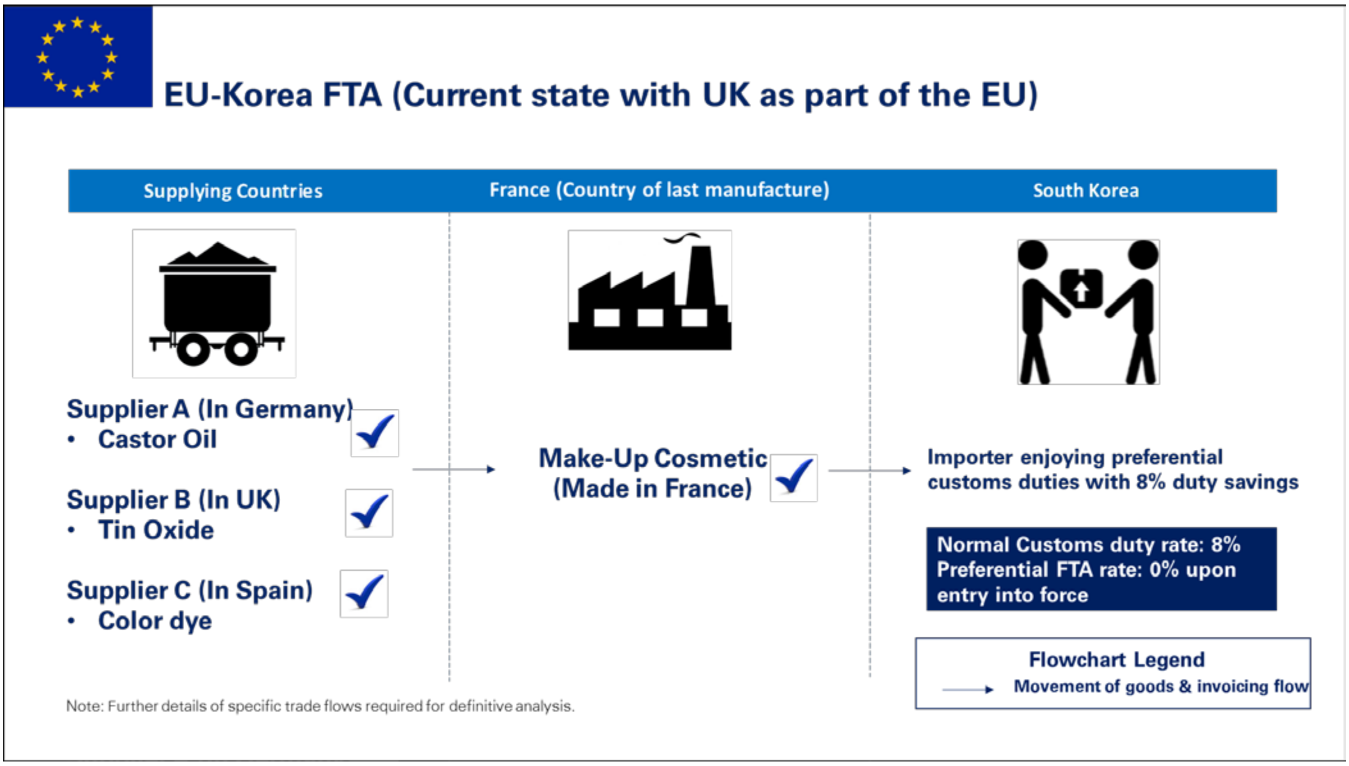


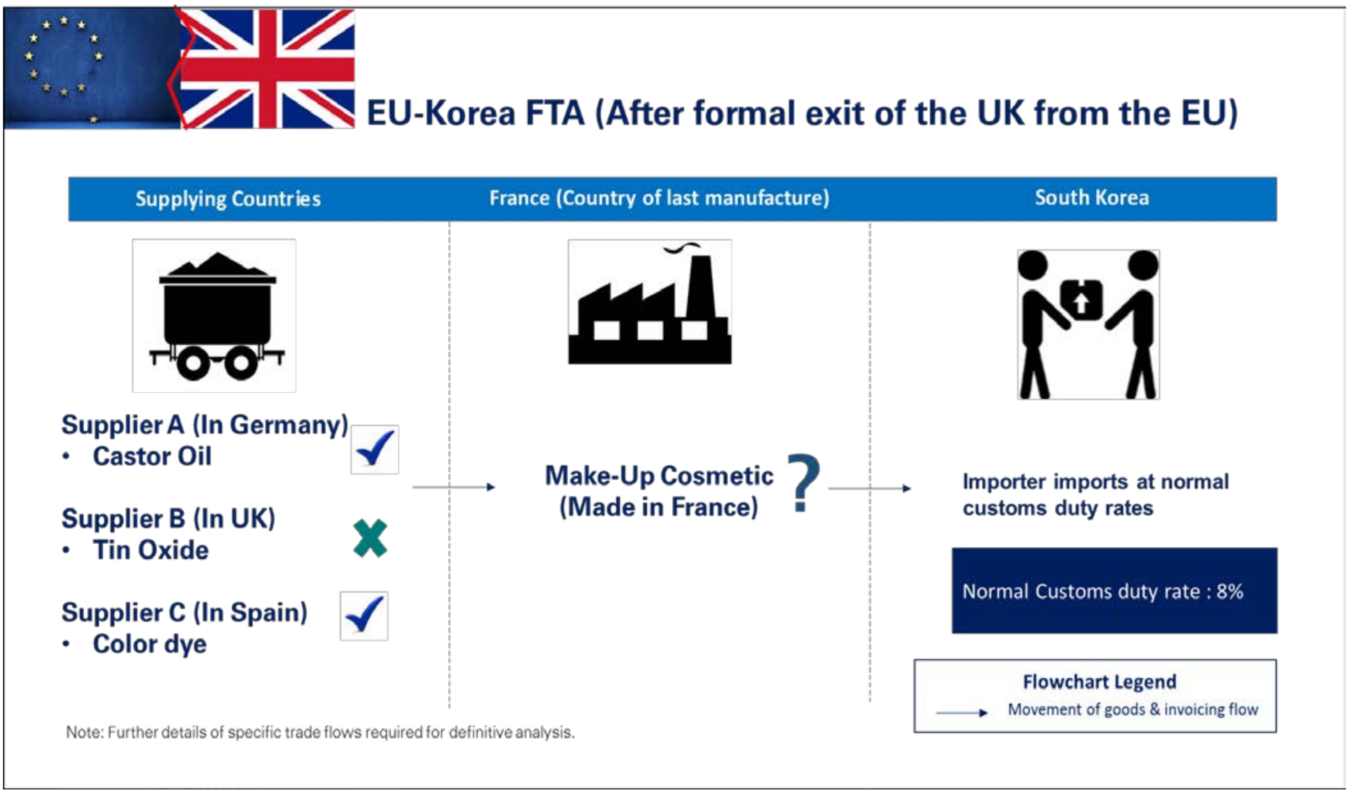
If your last manufacturing country of cosmetic is in UK and the finished product is exported to Korea, the finished product will be subject to full import duty at 8 percent instead of 0 percent. Your landed cost of the cosmetics will increase by 8 percent immediately.

Diagram 2: UK as one of the countries supplying raw materials

If your last manufacturing country is in France and you are sourcing an ingredient from the UK and exporting the finished product to Korea, the ingredient from the UK will be regarded as "foreign" or "non-EU". The final product may fail the origin criteria under the EU-Korea FTA and no longer qualifies for the EU-Korea FTA. The finished product shipped to Korea will subject to full import duty at 8 percent instead of 0 percent.

Illustrative Example:





Given the above simplified examples, there are several observations on Brexit that we deemed important for businesses in Asia.

Reassessment of global supply chain

The reassessment of global supply chains is especially critical in a price-sensitive industry and when utilisation of EU FTAs is a key strategy to optimise customs duty. In the context of the diagrams illustrated above, an 8 percent customs duty savings for the import of cosmetics into Korea is absolutely critical for foreign market players in the cosmetics industry looking to gain greater market access with strong local competition.

Agreements with Asia

Under the current umbrella of the EU-plus FTAs that are either in force, currently awaiting ratification or under negotiations (for example, the EU-Singapore FTA, EU-Vietnam FTA), all importing Asian countries (as indicated in the table above) will be affected by the future exclusion of the UK out from the EU which may have an impact on the businesses sourcing decisions and supply chain set ups within the countries affected within the EU, the UK and Asian countries. It is critical for the UK to keep its origin cumulation and ensure that the various trade agreements signed by the EU can also be duplicated as far as possible once the UK leaves the EU.

Potential knock-on impact on VAT and duties for inbound UK investments

The UK being a part of the EU has also meant simplified VAT treatment for cross-border movement of goods between the UK and other EU member states, rather than being treated as exports and imports which have additional compliance requirements and affects the businesses' cash flow. As such, it has been possible to set up distribution hubs in the UK for products originating from Asia for access to the rest of Europe.

With Brexit, Asian businesses looking to grow or expand into Europe may find the UK less attractive as a regional distribution hub. Businesses operating in the UK and Europe also have to re-evaluate existing supply chains. Current EU VAT simplifications need to be assessed for the distribution of goods to ensure their availability going forward.

For businesses continuing to operate in the UK after Brexit, the additional challenges will likely arise from changes to ERP systems to set up new VAT and duty treatments and related compliance requirements. The cross-border physical trade between the UK and the rest of EU member countries would be classified as imports and exports, leading to potentially increased duty outlays depending on the specific goods traded as well as the VAT cash flow impacts which can be significant as a result of the current 20% UK VAT rate. All these will translate to higher landed costs of products imported as well as higher operating expenses for businesses choosing to continue operating and investing in the UK.

In addition, where companies provide B2C digital services and VAT registered through the UK, it will no longer be possible to use the simplified single VAT return scheme which covers all EU Member States. The options will be to register for VAT in individual EU countries or registration through another EU Member State. Though this impact currently may not be significant, it is anticipated that with future increased utilisation of this scheme for online sales of goods, the downside of operating through the UK will be accentuated.

Important play out in the coming months and/or years

As the impact on supply chain sourcing is significant, potential limitations of procuring or manufacturing in the UK will be accentuated at the ASEAN level with the EU's intention to integrate its various FTAs on the individual ASEAN member states (i.e. Singapore, Malaysia, Vietnam, Philippines). This allows regional ASEAN cumulation (and hence supply chain flexibility) for businesses with suppliers and/or manufacturing operations in the various FTA member states.

If FTA considerations trigger potential migration of their global or regional business functions (e.g. procurement, manufacturing, distribution hub) out from the UK to other countries such as Singapore, businesses should adopt a more holistic approach in managing its global footprint to consider a wider corporate tax and indirect tax (both value-added taxes (VAT) and customs) perspective to ensure that all related implications, risks and opportunities as well are considered and properly managed as well.

For example, from a corporate tax perspective, if your company is keen to relocate or scale up global / regional business functions you might consider negotiating for a more attractive corporate tax incentive package with certain jurisdictions.

From a VAT perspective, if business functions do get relocated to other countries, whether within the EU or outside of the EU, businesses will need to reassess their VAT registration statuses and obligations to ensure proper VAT treatments for the selected jurisdiction(s) as well as re-configure their in-house system requirements to fulfil the VAT compliance requirements. For intra-EU trades, businesses will also need to take into account the potential inability for UK distribution hubs to use cross-border trade VAT simplifications going forward.

From a trade and customs perspective, obtaining the appropriate customs bonded facilities and trade licenses and bandings for new / scaled up business functions are also important areas to consider to ensure continued global supply chain efficiencies as well.

With the political and economic uncertainties surrounding Brexit, the UK is expected to take some time to negotiate its bilateral economic and trade agreements with various countries. It is important for businesses to closely monitor the developments and be ready to provide inputs to the authorities negotiating the various agreements. To be well prepared, you should evaluate the potential impacts on your business and put in place an appropriate response plan.

If one is to take an optimistic perspective, there are perhaps silver linings to the Brexit cloud. This could be a trigger for your business to reassess your global operational footprint and supply chain in terms of enhancing cost optimisation in tax and duty outlays across multiple jurisdictions.

We will release further analysis to support our clients over the coming months. The full picture is unlikely to become clear for some time. With every twist and turn, brace yourself for further volatility.

How we can help

As a committed tax advisor to our clients, we welcome any opportunity to discuss the relevance of the above matters to your business.

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