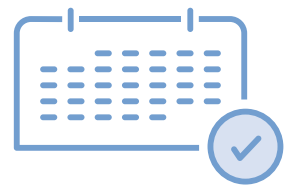
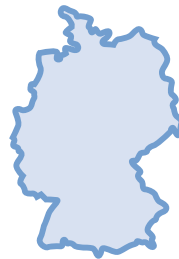


TAX ACT RELATING TO BREXIT (StBG)

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THE TAX ACT RELATING TO BREXIT (STBG) PASSED THROUGH THE BUNDES RAT ON 15 MARCH 2019



The fact that Britain's exit from the EU (Brexit) will not take place on 29 March 2019 is now clear; Great Britain has asked for an extension of the leaving deadline. It is uncertain whether the exit date will be 12 April, 22 May or another future date.

German legislature is already one step ahead, at least as regards preventing the negative tax consequences for German tax payers which could arise as a result of Brexit. The law govern-

ing the tax changes, known as the Tax Act relating to Brexit (Brexit StBG for short) passed through the Bundesrat on 15 March 2019. The Bundestag gave its consent to the Brexit StBG on 21 February 2019. Thus, the major hurdles in the legislative process have already been overcome. No further obstacles are expected to prevent the legislative changes from coming into force on time prior to Brexit, provided that publication in the Federal Law Gazette takes place prior to the exit date.

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The draft bill which has now been passed was based on the recommendations for a decision made by the Parliamentary Finance Committee presented on 20 February 2019. When compared to the Federal Government's original draft bill, the final law also contains a number of amendments to implement proposals made by the Bundesrat during the legislative process. The tax changes that have now been passed essentially involve additions to the German Corporation Tax Act and Income Tax Act, the German Transformation Tax Act and to the Property Transfer Tax and Inheritance Tax Acts as set out below.

NO LIQUIDATION OF A CORPORATION AS A RESULT OF BREXIT (SECTION 12 (3) GERMAN CORPORATION TAX ACT (KStG))

When a corporation relocates its headquarters or registered office thereby withdrawing from unlimited tax liability in an EU state, it is generally deemed to have been dissolved and the liquidated funds become taxable. Due to Brexit, this may affect corporations with their registered offices or headquarters in the UK. Brexit alone will not, however, result in the dissolution and liquidation of a corporation. This is stipulated in the new Section 12 (3), sentence 4 KStG. The provision deems that, despite Brexit, for the purposes of Section 12 (3) KStG, the corporation is still deemed as having unlimited tax liability in an EU state or as being domiciled within the sovereign territory of an EU state. The corporation will only be dissolved and liquidated if the corporation subsequently moves to another third country and is no longer subject to unlimited tax liability in the UK or is regarded as domiciled in another third country as a result of its departure from the UK.

CHANGES FOR A LIMITED COMPANY WITH UNLIMITED TAX LIABILITY IN GERMANY (SECTION 12 (4) KStG)

The Brexit StBG introduces a new Section 12 (4) German Corporation Tax Act (KStG) principally aimed at British limited companies with their administrative office in the Federal Republic of Germany. This aims at preventing the taxation of hidden reserves of these companies as a result of Brexit which could otherwise occur if no action is taken by the taxpayer. Problematic in this respect is company law. Following Brexit, under company law, the "real seat" theory will apply due to the UK's status as a third country. Thus, a limited company, which was previously recognised as a corporation under the European incorporation theory, will now be deemed to be a trading company (OHG), company under civil law (GbR) or a sole trader.

According to the case law of the Federal Court of Finance (BFH) relating to type comparison, even if the limited company remains subject to corporation tax and able to generate its own income that is liable for corporation tax, dissolution of the company cannot be ruled out under tax law. This could result in realisation of the hidden reserves and an implied distribution with corresponding liability for capital gains tax. The new Section 12 (4) KStG creates a legal fiction in order to avoid such a problem. Thus, after Brexit, a British corporation under German management (central administration in Germany) will still be imputed with the business assets that were imputed to it prior to Brexit, without interruption.

TRANSITIONAL ARRANGEMENT FOR CROSS-BORDER MERGERS (SECTION 1 (2), SENTENCE 3 TRANSFORMATION TAX ACT (UmwStG))

A transitional arrangement for British corporations has been created in Section 122m of the German Transformation Act (UmwG) which continues to allow the registration of mergers after Brexit. This is subject to the condition that the merger plan under Section 122c (4) UmwG receives certification by a notary prior to Brexit and registration of the merger takes place without delay, and in any case within two years, with the necessary documents for entry in the register.

This provision is now accompanied for tax purposes by a new provision in Section 1 (2), sentence 3 Transformation Tax Act (UmwStG) and ensures that a transferring company, which makes use of the transitional arrangement in Section 122m UmwG, also falls within the personal scope of the UmwStG even though the company's registered office is outside the EU and the EEA after Brexit.

NO TAXATION ARISING FROM BREXIT ON GAINS FROM CAPITAL CONTRIBUTIONS

The Brexit StBG also introduces a new Section 22 (8) UmwStG. This will prevent gains from capital contributions from becoming taxable as a result of Brexit. However, this only applies to transitional cases in which the contribution agreement or transformation resolution (in the case of universal succession) takes place before Brexit. The background to this provision is that the UmwStG permits tax-neutral capital contributions, in the sense of contributions in kind (Section 20 UmwStG) or share swaps (Section 21 UmwStG), inter alia where the receiving legal entity is domiciled and central administration

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within an EU/EEA Member State (Section 1 (4) UmwStG). This EU/EEA-connection within the seven-year blocking period ceases to be met if, as a result of Brexit, the contributing or receiving company is no longer domiciled or has its central administration in the EU or EEA (Section 22 (1), sentence 6 No. 6 in conjunction with Section 22 (2), sentence 6 in conjunction with Section 1 (4) UmwStG). In such cases, the gain on capital contributions would become taxable with retroactive effect. Retroactive taxation of the gain on capital contributions will not however be triggered solely by Brexit in such cases. This is specified in Section 22 (8) UmwStG.

PROPERTY TRANSFER TAX REGULATIONS FOR A LIMITED COMPANY WITH ONLY ONE SHAREHOLDER (SECTION 4 NO. 6, SECTION 6A, SENTENCE 5 PROPERTY TRANSFER TAX ACT (GRESTG))

The Brexit StBG also provides for further changes to the law relating to property transfer tax, aimed at avoiding problems for companies incorporated as British limited companies and under German management. Here too, the classification of a limited company under company law after Brexit poses a problem. According to the settled case law of the Federal Court of Justice (BGH), this may take the form of a trading company (OHG), a company under civil law (GbR) or – in the case of companies with only one shareholder – a sole trader or private individual.

In the case of a limited company under German management, with only one shareholder, various scenarios are possible in which liability for property transfer tax will be triggered solely by Brexit. The introduction of a new tax exemption provision under Section 4 No. 6 Property Transfer Tax Act (GrEStG) ensures that liability for property transfer tax will not be triggered solely by Brexit.

The same applies in the case of the tax exemption under Section 6a GrEStG. In the case of a limited company with only one shareholder, Brexit would result in the sole shareholder taking the place of the limited company. Under the law on property transfer tax, this would terminate the company within the meaning of Section 6a GrEStG with the result that the tax relief, specified under that provision, would no longer apply. This is the case irrespective of whether the Limited is a controlling enterprise or a dependent company. The addition of sentence 5 to Section 6a GrEStG ensures that the tax relief under Section 6a GrEStG does not cease to apply solely due to Brexit.

NO CANCELLATION OF THE BALANCING ENTRY UNDER SECTION 4g INCOME TAX ACT (ESTG) DUE TO BREXIT

When assets are transferred to a permanent establishment in an EU Member State (e.g. UK), the resulting withdrawal gain can be spread over several years, pursuant to Section 4g EStG, by creating an adjustment item. The balancing item under Section 4g EStG must generally be liquidated by 20% in the year of its creation and for four years thereafter, thereby increasing profits. However, if the transferred assets leave the tax jurisdiction of an EU Member State, the residual balancing item must be liquidated immediately, thereby increasing profits. The Brexit StBG stipulates that a withdrawn asset will not be deemed to have left the tax jurisdiction of an EU Member State solely as a result of Brexit. This will principally assist companies that – in preparation for Brexit – have transferred assets to the UK. They can still spread the resulting withdrawal gain equally over five years even after Brexit.

REINVESTMENT IN UK PERMANENT ESTABLISHMENTS AFTER BREXIT (SECTION 6b (2a) EStG)

Profits from the sale of assets eligible under Section 6b (generally land and buildings) can be transferred under Section 6b EStG to assets acquired in Germany. Alternatively, it is also possible to pay off the income tax arising on the profits of sale in five equal annual instalments (Section 6b (2a) EStG). The objective possibility of future cross-border investments is sufficient for the approval of payment by instalments where the corresponding application is filed in the year that the relevant assets are sold. Where no investment is made in another EU country or if the acquisition or production costs of the reinvestment in another EU country fall short of the capital gain, the benefit of deferral is refunded by way of interest due on the portion falling short of the reinvestment. This interest payment applies to profits from the sale of assets from the financial years commencing after 31 December 2017.

The Brexit StBG has now added sentence 7 to Section 6b (2a) EStG which will prevent interest being charged on reinvestments made in permanent UK establishments. This is however subject to the condition that the request for instalment payments under Section 6b (2a) EStG has already been filed prior to Brexit. In this case, there may be a need for companies to take action before Brexit. This applies principally to companies that are still planning to invest in permanent UK establishments in the next few years financed inter alia by the sale of German assets eligible under Section 6b.

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CHANGES TO THE INHERITANCE TAX ACT

Brexit could also have undesirable negative consequences for transfers of companies with a UK shareholding. For this reason, the Brexit StBG provides for a transitional arrangement whereby the UK is deemed to be an EU Member State for inheritance tax purposes. This exception only applies to gifts and inheritances where tax arose prior to Brexit (old cases). For gifts and inheritances after Brexit, the UK is not deemed to be an EU Member State.

This transitional arrangement is particularly helpful for maintaining the wage bill which is crucial for the ultimate retention of inheritance tax relief. Without the new provision, it would not be possible to include the wage bill of UK subsidiaries in the minimum wage bill of the transferred company after Brexit. This would have negative inheritance tax consequences principally for companies with a large UK shareholding and a high UK wage bill.

REVOCATION OF INTEREST-FREE DEFERRAL IN CASES OF RELOCATION

Where, due to relocation in accordance with the requirements of Section 6 (1), sentence 1 German Foreign Transaction Tax Act (AStG), relocation tax arises on shares within the meaning of Section 17 EStG, the tax arising will be deferred without interest or securities. The requirement for this is that the person who is relocating is the citizen of an EU or EEA member state and has unlimited tax liability in the country of destination (para. 5). Under certain circumstances, however, it is mandatory to revoke the interest-free tax deferral pursuant to Section 6 (5), sentence 4 AStG. The requirements for revocation will now be tightened under the Brexit StBG. Among other things, the requirements for deferral (EU citizenship and unlimited tax liability in destination country) must be complied with for the entire deferral period. Thus a subsequent lapse in compliance, which may occur as a result of Brexit, would constitute independent grounds for revocation. Therefore, e.g. a subsequent transfer of shares to a permanent establishment in a third-country - capital contribution within the meaning of Section 6 (5), sentence 3 No. 3 AStG - will also result in revocation of the deferral.

The Brexit StBG now provides for a relaxation of the revocation rules with the new Section 6 (8), sentence 1 AStG which states that there will be no revocation if compliance with the aforementioned requirements lapses solely due to Brexit. This would be the case, e.g. where the relocated person loses their EU citizenship as a result of Brexit.

At the same time, however, this also clarifies the fact that, after Brexit (with application of Section 6 (8), sentence 1 AStG), the subsequent transfer of shares from a UK-resident tax payer to another UK resident may result in revocation of the deferral under Section 6 (5), sentence 4 No. 2 AStG.

At the same time, the Brexit StBG adds to the grounds for revocation under Section 6 (5), sentence 4 AStG with two further cases involving relocation to a third country. Thus deferral must be revoked in the case of withdrawals or other transactions which do not result in the disclosure of hidden reserves but as a result of which the shares can no longer be allocated to any permanent establishment of the tax payer in the UK or the EU/EEA (Section 6 (8), sentence 2 No. 1 AStG). This would be the case where shares were transferred from a permanent establishment in the UK to a third country. Change of domicile or usual residence to a third country also results in revocation of the deferral insofar as the tax payer is no longer subject to an obligation to pay tax in the UK or an EU/EEA country that is comparable to unlimited liability for income tax in Germany.

The new grounds for revocation are also subject to the obligations on reporting and cooperation under Section 6 (7) AStG (Section 6 (8), sentence 3 AStG).

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MAZARS TEAM OF BREXIT EXPERTS

DÜSSELDORF



Birgit Jürgensmann

VAT & Indirect Tax
Attorney, Tax Consultant,
Tax Law Specialist
Partner

Tel: +49 211 83 99-300

birgit.juergensmann@mazars.de

DRESDEN



Jan Kochta, LL.M.

Law
Attorney
Salary Partner

Tel: +49 351 45 15-0

jan.kochta@mazars.de

FRANKFURT AM MAIN



Tobias Mackenrodt, LL.M.

Global Mobility
Attorney, Tax Consultant
Partner

Tel: +49 69 967 65-1215

tobias.mackenrodt@mazars.de

BERLIN



Prof. Dr. Adrian Cloer

International Tax Structuring
Attorney, Tax Consultant
Partner

Tel: +49 30 208 88-1262

adrian.cloer@mazars.de



Christina Vosseler

Private Clients
Tax Consultant
Partner

Tel: +49 30 208 88-1208

christina.vosseler@mazars.de