Global Tax Update

Germany

Deloitte Tohmatsu Tax Co.

July 2016

Brexit: Majority of British Electorate Votes to Leave EU

On June 23, 2016, the majority of British voters decided to leave the EU, however this will not happen immediately. In the next few months and probably years negotiations will take place between the EU and Great Britain on their relationship after the exit. During this negotiation period, companies should keep an eye on the related fiscal and legal issues.

(1) Yes to Brexit − But When and How?

Although in the referendum on June 23, 2016, the British electorate voted to leave the EU (Brexit) that does not mean that the exit will take place immediately. British voters only gave the starting signal for the process of leaving the EU to begin. Negotiations to leave must first take place before such an exit can take place. Pursuant to Art. 50 of the Treaty of European Union in order to commence the negotiations Great Britain must first make an official written notification to the European Council requesting such an exit. Negotiations can then begin between the EU and Great Britain on the details of the exit. Such negotiations will result in an agreement on the framework of the future relationship between Great Britain and the EU.

Pursuant to Art. 50 Subsection 3 Treaty of European Union Great Britain can leave the EU when the exit agreement takes effect or at the latest two years after the notification to the European Council declaring Great Britain's intention to leave the EU. The two-year period can be extended unilaterally by the Council in consultation with Great Britain. It can currently be assumed that the negotiations will not be completed within the two-year period due to the complicated exit formalities. If the Council does not grant an extension, the European Treaties and the European secondary legislation (EU regulations and directives, for example) would no longer apply to the relationship with Great Britain.

(2) Current Requirement for Action by Companies

Great Britain remains a member of the EU until it leaves. Although there may be immediate economic effects on the financial markets in particular, for the time being there will be no legal modifications. However, possible fiscal and legal changes resulting from an exit should be taken into account with a view to the future when making current corporate decisions. Furthermore it is necessary to plan organizational alterations and to rethink and modify existing structures in the company with a view to negative fiscal consequences in anticipation of the changes after an exit. Insofar it will be necessary to monitor the course of the exit negotiations closely in order to be prepared for the exit scenario.

(3) Possible Effects of an Exit by Great Britain

The exact effects will become apparent only after the exit agreement has been finally negotiated. There are, however, various possible developments in light of the relationship between the EU and Great Britain (see Brexit 2025).[1)] Without claiming to be complete, the following overview should provide initial food for thought in areas where there could be legal and fiscal modifications due to Brexit. The specific effects cannot yet be described in detail.

(4) International Law Agreements (e.g. European Economic Area (EEA)) and National Legislation

Leaving the EU leads to European primary and secondary legislation no longer being applicable and thus decisions by the European courts are not taken into consideration nor are national regulations interpreted in a manner conforming to EU law. However, EU law which has been transposed into national law (e.g. on the basis of EU directives) will continue to apply. British legislation would have to modify such standards deliberately. A certain legal framework which is more or less adapted to the EU legal framework will therefore exist in Great Britain depending on the extent of regulation.

Furthermore the so-called mixed agreements. i.e. international law agreements where the parties to the agreement include individual member states as well as the EU, also continue to exist. The most important treaty is probably the Treaty on the European Economic Area ("EEA"); this will almost certainly also be a subject of the negotiations to leave the EU. However, there are other agreements in the respective economic sectors which will be significant for the economic relationship with Great Britain and which will continue to apply, such as the energy charter agreement. It is doubtful whether Great Britain would also call such agreements into question.

(5) Tax Effects

Effects on Income Tax

There is no longer any protection through the EU directives in the area of direct taxes (Parent - Subsidiary Directive, Interest and Royalties Directive and Merger Directive). This can lead to the following consequences:

- German companies have hitherto been able to benefit from a zero rate withholding tax on profit distributions to a British parent company and were able to make distributions without withholding tax (or the British parent company could have the withholding tax reimbursed in full). The same could apply to an indirect holding of a British parent company − since it was itself exempt from withholding tax, it was not necessary to prove, e.g., for a Dutch intermediate holding company that it was interposed for non-tax reasons. In future there is a risk in such cases that dividends will suffer withholding tax at a rate of 5% which would become a true cost for the company due to the exemption in Great Britain.
- Although Great Britain does not collect any withholding tax on dividends, it does on interest and also Germany collects withholding tax on license fees. In the past it was possible to obtain an exemption from withholding tax in certain structures, but this will no longer apply unless a double tax agreement offers similar benefits, which is particularly not the case in relation to East European countries.
- Within the EU, it is possible to undertake certain restructuring measures (e.g. mergers, demergers, spin-off etc.) on a tax-neutral basis if the companies involved have been established under the laws of an EU member state − this precondition is no longer fulfilled after the end of EU

membership so that pursuant to general regulations comparable restructuring measures would then usually lead to the realization of profits (and therewith taxes).

Great Britain is a third country from a German perspective so that certain benefits no longer apply:

- Great Britain has been considered low taxed for the purposes of the German Foreign Tax Act for a long time since the rate for corporate income tax is less than 25%. Accordingly, non-distributed income of British subsidiaries would generally be subject to taxation in Germany under the German controlled-foreign-companies rules (CFC rules). However, it was hitherto usually possible to rely on an exemption from the CFC rules based on sufficient substance (§ 8 Subsection 2 Foreign Tax Act (Ausensteuergesetz - AStG)) since companies in Great Britain[2)] usually have considerable substance. This protection does not apply to third countries; in future interest income earned by British subsidiaries, for example, may therefore be subject to taxation under the CFC rules even if the company is otherwise economically active.
- The simplified dividend exemption for trade tax (§ 9 No. 7 Trade Tax Law (Gewerbesteuergesetz - GewStG)) for distributions from EU companies (Parent - Subsidiary Directive) no longer applies. In future dividends of British subsidiaries would only be exempt from trade tax under much stricter preconditions. Especially if British companies exercise holding functions, there is a risk that profits from second-tier subsidiaries could no longer enjoy exemption from trade tax in future since exemptions for so-called functional or country holding companies are not easy to fulfill.
- If a corporation migrates to Great Britain, including a British Ltd. With place of effective management in Germany, this triggers a liquidation for tax purposes pursuant to § 12 Subsection 3 Corporate Income Tax Code (Korperschaftsteuergesetz − KStG). Not only the built-in gains in assets which were moved to Great Britain are therefore taxed, but the entire company would be deemed liquidated even if industrial premises remain in Germany.
- There are aspects to be noted for individuals too. Persons who have moved to Great Britain and who were subject to an exit tax pursuant to § 6 AstG are particularly affected. The exit tax was previously deferred without collateral and does not bear interest. The deferral could now be revoked and the exit tax will become due.

Customs/VAT/Foreign Trade Law

- Customs law will apply to trade with goods since Great Britain no longer belongs to the common economic area of the EU, i.e. intra-Community supplies and acquisitions subject to value added tax ("VAT") become imports and exports.
- Custom duties may apply to trade with goods between Great Britain and the EU. A sales transaction will therefore become more expensive. Such transactions may need to be recalculated.
- The common VAT system for intra-Community supplies and acquisitions will no longer apply to trade with goods and services (see above). It therefore remains to be seen how a respective transaction is to be treated in Great Britain in the future.
- Various regulations to register for VAT may apply.
- The common excise tax system (and the EMCS IT system) will no longer apply to goods subject to excise tax. In future it must therefore be reviewed in detail how

deliveries to Great Britain are to be treated in Great Britain in order to avoid any tax becoming due.

- Supplies of goods to Great Britain which are subject to excise tax will be linked to the customs export procedure. The systems must be aligned in this respect.
- Supplies of goods to Great Britain will be considered as exports under foreign trade law and can therefore be subject to stricter authorization requirements than before.

Transfer Prices and Administration

- Tax payers will have to meet higher burden of proof requirements since the directive on
3) administrative cooperation in the area of taxation no longer applies.
- Although based on a separate multilateral agreement (no EU Directive), the UK may be inclined to terminate the EU Arbitration Convention because of its strong reference to the EU. However, the UK-German already includes in Art. 26 para. 5 an arbitration clause.
- There may be exit taxes for relocation and restructuring measures.
- It should generally be noted for restructuring measures which are
4) undertaken due to the imminent Brexit that a so-called relocation of a business function should be avoided.

Other Tax Topics

- Great Britain leaving the EU could lead to the Pound Sterling suffering lasting exchange rate losses compared with the Euro. German tax payers with receivables in GBP should examine whether tax unit value depreciation to the current value should be made on such receivables. This will particularly depend on the term of the respective receivables.
- Tax questions arise with possible corporate law consequences of Brexit. It could be, for example, that companies under English law (e.g. a UK Limited C) with place of management in Germany will no longer be recognized legally in Germany as limited liability company from the time when the EU exit becomes effective. This could lead to a change in the legal form from a fiscal point of view and thus to hidden assets of the company being taxed. Corporate law developments should therefore be observed so that fiscally advantageous restructuring measures can be taken in due time.
- There is also the question whether Great Britain leaving the EU increases the probability that a Financial Transaction Tax is being introduced in the remaining EU states. This could be concluded from the fact that Great Britain was a major opponent of this tax. However, even before the Brexit vote Great Britain did not belong to the circle of ten member states that are currently in consultation about the introduction of such a tax. Therefore, a lot speaks for the fact that the introduction of a financial transaction tax will essentially depend on whether these ten member states can agree on framework conditions for such a tax.

Newsletter Archives

To see past newsletters, please visit our website.

www.deloitte.com/jp/tax/nl/eu

Contacts

Deloitte Tohmatsu Tax Co. (Tokyo)

Fumiko Mizoguchi, Director fumiko.mizoguchi@tohmatsu.co.jp

Deloitte GmbH (Düsseldorf)

Mitsutoshi Sato, Senior Manager misato@deloitte.de

Issued by

Deloitte Tohmatsu Tax Co.

Tokyo Office

Shin-Tokyo Building 5F, 3-3-1 Marunouchi, Chiyoda-ku, Tokyo 100-8305, Japan

T e l: +81 3 6213 3800

email: tax.cs@tohmatsu.co.jp

Corporate Info.: www.deloitte.com/jp/en/tax

Tax Services: www.deloitte.com/jp/tax/s/en