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German Tax and Legal News

MOF publishes first draft of Brexit Tax Implementation Act

Draft law includes measures to protect taxpayers from disadvantageous consequences resulting from Brexit.

On 9 October 2018, Germany's Ministry of Finance (MOF) issued a draft law that would introduce tax measures to protect German taxpayers from potential negative consequences of the UK leaving the EU (Brexit Tax Implementation Act).

The UK is scheduled to withdraw from the EU on 29 March 2019. This withdrawal date can be extended only by unanimous vote of the EU member states. Such an extension, the conclusion of a withdrawal agreement and the relationship between the UK and the EU following a withdrawal currently are being negotiated between the UK and the EU. The outcome of these negotiations is still unclear.

After the UK leaves the EU without a transition period or a withdrawal agreement ("hard Brexit"), the UK will be treated as a country outside of the EU and no longer will be able to benefit from certain German tax measures that are available only to EU-resident taxpayers. In addition, the withdrawal could have the consequence that certain tax-neutral reorganizations/transfers that take place before Brexit and that require the involvement of EU resident companies or permanent establishments (PEs) and result in blocking periods/tainted shares would become taxable on a retroactive basis. To mitigate the most disadvantageous tax consequences resulting from Brexit, the draft law clarifies that Brexit itself will not constitute a "harmful event" for purposes of certain German tax law provisions.

The measures included in the draft law provided by the MOF can be summarized as follows:

- Capital gains from the transfer of an asset out of Germany to a PE of the same taxpayer in the EU would be able to be spread over a five-year period. However, if the asset is no longer part of a PE located in the EU (i.e. the asset is being transferred out of the PE), the capital gains would become taxable immediately. The draft law clarifies that Brexit would not constitute a harmful event for purposes of the five-year period and it would not lead to immediate taxation of the capital gains triggered in the asset transfer.
- Share-for-share exchanges and certain asset contributions in return for (newly issued) shares are possible on a tax-neutral basis provided the entity that receives the shares/assets is an EU resident company. The shares received in the tax-neutral transaction are tainted for a seven- year period during which, inter alia, the receiving entity must qualify as an EU resident entity. Again, the draft law clarifies that Brexit would not constitute a harmful event that would result in retroactive taxation of the share-for-share exchange or the relevant asset contribution. If the transaction was carried out on a tax-neutral basis before Brexit, the withdrawal of the UK from the EU should not trigger the clawback provision and, therefore, make the transaction taxable on a retroactive basis. All other conditions that apply during the seven-year period, however, still would need to be fulfilled.
- To qualify for certain retirement plan benefits (i.e. allowances and tax benefits) under the German "Riester scheme," certain condition must be fulfilled to withdraw amounts from the scheme before retirement age is reached. It generally is possible to invest the funds withdrawn into real estate for personal use, and such an investment is not considered harmful to benefit from preferential tax treatment of the contributions, but the real estate must be located within the EU. The draft law clarifies that investments in real estate for personal use that are made before the Brexit effective date would not constitute a harmful event and, therefore, should not impact the tax beneficial treatment under the scheme.
- For VAT purposes, the special rules governing the status of the Isle of Man as part of

the UK would be repealed.
- The explanatory notes of the draft law also provide that, for purposes of the German controlled foreign company rules (deferral of exit tax for certain reorganizations/transfers within the EU) and for purposes of the deemed liquidation of a company as a result of the migration out of the EU, the withdrawal of the UK from the EU would not constitute a harmful event that triggers immediate exit taxation.
- The draft law does not include any statement or provisions relating to the estate tax rules and related clawback provisions.

If approved, the draft law would become effective on 29 March 2019. Germany's upper house of parliament is expected to discuss/vote on the draft law on 19 October.

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