Brexit Tax Accompanying Act and its effects on international estate succession planning

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The Brexit Tax Accompanying Act (**Brexit-StBG**) adopted on 21 February 2019 generated transitional regulations for cases in which taxpayers had already initiated taxable transactions in the past.

The Brexit-StBG intends to only defuse those tax problem cases which are solely caused by Brexit. However, it does not regulate the burden of taxable transactions after Brexit.

The tax provisions of the law, which apply both in the case of a hard Brexit without a withdrawal agreement and in the case of a withdrawal agreement with an interim phase (Soft Brexit) after its expiry, are intended to prevent disadvantageous tax consequences arising solely as a result of Brexit and without any further action on the part of the taxpayer with regard to facts realised in the past. This has only been achieved to a limited extent. The United Kingdom will not be treated as a third country until a possible transitional period has elapsed. The entry into force, beginning and duration of this interim period are currently unclear.

Below, a few examples from the areas particularly relevant to asset succession planning in tax law will be presented briefly.

Inheritance tax aspects

While the lack of regulations on Brexit in the draft of the Inheritance Tax Guidelines published at the end of 2018 was still painfully missed by everyone, such regulations can fortunately be found in the Brexit-StBG.

The treatment of business assets which are subject to inheritance tax receives a catch-all circumstance under Section 37 Subsection 17 of the ErbStG through the Brexit-StBG.

By way of fiction, the United Kingdom is to be treated as a member of the EU until its withdrawal is completed.

Example:

One year ago, entrepreneur U gifted his German GmbH to his son living in Germany. In doing so, the son made use of the preferential treatment for family businesses. When determining the prerequisites for the preferential treatment, it was taken into account that the German GmbH holds stakes in a British company with many employees.

The transfer of family businesses in Germany is – subject to further conditions – exempt from inheritance tax, provided that jobs are maintained within a certain period of time. However, only jobs in the EU are taken into account. In the above example, jobs in Great Britain were taken into account at the time of the donation. Due to the departure of Great Britain, the jobs there would no longer be taken into account after the expiry of the seven-year period, as they are no longer in the EU. The son will then – even without de facto job cuts – violate the conditions for the benefit and will have to pay inheritance tax on the family business received

Section 37 Subsection 17 Inheritance Tax Act is expected to prevent this exit taxation for operations taken place in the past. However, the United Kingdom will have to be treated as a third country after its departure.

Exit taxation

If the taxpayer has made use of the possibility of deferring exit taxes, further developments should be monitored carefully. It is true that the newly introduced Section 6 Subsection 8 Foreign Tax Act (AStG) clarifies that Brexit alone leads to a revocation of the deferment.

However, actions of the taxpayer following the Brexit may trigger a withdrawal, possibly also by a transfer of shares to a third country permanent establishment following the contribution; thus caution is required.

Example:

The successful entrepreneur U holds an interest in a German GmbH. His adult daughter is currently studying in Great Britain and would like to stay there long term. If U dies after the departure of Great Britain from the EU and he bequeaths

his GmbH participation to his daughter living in Great Britain in accordance with the German statutory succession, the so-called exit tax is triggered in Germany because of the treatment of Great Britain as a third country, i.e. the GmbH participation is deemed to be subject to income tax.

In this case, Section 6 Subsection 8 AStG prevents the deferment from being revoked; however, the income tax liability remains unrestricted in this non-optimised constellation.

Aspects of corporation tax

Among other things, when transferring the registered office or management of a corporation (i.e. also foundations and trusts) as well as corporations, the taxpayer should pay attention to any changes in tax treatment.

In particular, liquidation taxes and the disclosure and taxation of hidden reserves might be probable.

For this purpose, the Brexit-StBG provides tools which should be utilized in the respective individual cases.

Aspects of real estate transfer and transformation tax law

Classification of a Limited after Brexit is (without further action of the shareholders) unclear[RH1]. Depending on the specific individual case, it can be regarded as a general partnership (OHG), a partnership under civil law (GbR) or, in the case of sole shareholders, even as a sole trader or private individual.

This is to be prevented by a timely conversion of the legal form.

For real estate transfer tax, too, there are regulations which avoid taxation of real estate acquisition solely due to Brexit. However, several irregular scenarios which have not been taken into account, would trigger retention periods.

Abolition of the benefits of the Parent-Subsidiary Directive

The European Parent-Subsidiary Directive provides for complete exemption from capital gains tax or withholding tax on dividend payments within a European group of companies in order to avoid double taxation of these dividends. The prerequisite for this is that the parent company has a direct interest of at least 10% in the subsidiary and that the respective interest has been held for at least two years.

However, the Brexit-StBG does not contain any easements in this respect.

> **Example:**
> The family business holds interests of more than 10% in a British company. Previously, dividend payments were tax-exempt. With the Brexit, the withholding tax reduction to 5% contained in Article 10 Subsection 2 a) of the UK double taxation treaty (DBA UK) between Great Britain and Germany would then have to be considered, thus reducing the net dividend.

The to be feared tax burden regarding the taxpayer is not avoided by the Brexit-StBG. This can solely be achieved by appropriate arrangements.

Conclusion

The Brexit-StBG tries to prevent the most serious tax disadvantages regarding the withdrawal of Great Britain and Northern Ireland in regards to already realised tax issues.

Although the legislator has sought to regulate at least the most typical constellations of already realised facts, the complexity of tax law means that the Brexit-StBG cannot cover all constellations.

As shown, some areas have been neglected.

The Brexit-StBG is therefore not designed as a response to all the tax problems in the context of Brexit, but as a short-term response to a regrettable political event aimed at avoiding catastrophic effects.

It gives the tax obligations a grace period to adapt to the changed tax facts; however, it would have serious consequences to assume that in the future no further initiatives need to be taken by the individual itself.