POSITION | EUROPEAN POLICY | BREXIT

Taxation

Challenges caused by Brexit

27 February 2018

Core Recommendations

- Business needs a transitional period to adjust to the new (post-Brexit) situation.

  - The period announced by Michel Barnier until 31 December 2020 is the shortest acceptable duration.
- During this transitional period, all tax-related legislation of the internal market should remain in force

  - The UK's continued full participation in the Internal Market during the transition is absolutely essential.

  - This is the only way to avoid an interim solution; the partners are short of time; additionally, it prevents two consecutive changeovers.
- If no final agreement on future relations is reached and Brexit is still expected to cause major tax-related distortions, the transitional period should be extended.
- The most far-reaching requirement for new regulations in taxation are with respect to value added tax (VAT) and (corporate) income tax (CIT).
- To achieve adequate legal certainty for all conversion and grandfathering rules, business calls for a formal Brexit tax act. As a minimum, the German Ministry of Finance should issue a decree to clarify the application of the tax-related changes caused by Brexit.

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BDI Task Force Brexit

The BDI is committed to supporting the Brexit negotiation teams with in-depth expertise in a number of areas of economic policy. In summer 2017, the BDI set up a Brexit task force together with its member organisations, company representatives and partners including the Association of German Banks (BdB), the German Insurance Association (GDV), the Federation of German Wholesale, Foreign Trade and Services (BGA), the Confederation of German Employers' Associations (BDA) and the Association of German Chambers of Commerce and Industry (DIHK).

The BDI Task Force Brexit has established ten project teams to address specific policy areas: (1) Trade in Goods, (2) Transportation and Logistics, (3) Data and ICT, (4) Taxation, (5) Legal consequences of Brexit in core areas of business law, (6) Energy and Climate Policy, (7) Market Access, (8) Workforce Mobility, (9) Banking, Finance and Insurance, (10) Negotiation Process (including Northern Ireland, Research and Development, Defence, Financial Commitments).

The objective of the project teams is to identify the potential risks posed by the exit of the UK from the EU and to propose constructive approaches to countering these risks. The project teams are looking at the regulatory issues in the individual policy areas on the European and the national level. The BDI is also a member of a similar task force at Business Europe, the umbrella organisation for European business. The work of the BDI Task Force Brexit will progress in line with the official negotiations.

This position paper is based on the background information developed by the BDI Brexit Task Force. The views expressed in this position paper are those of the BDI and do not necessarily reflect those of the other members of the Task Force.

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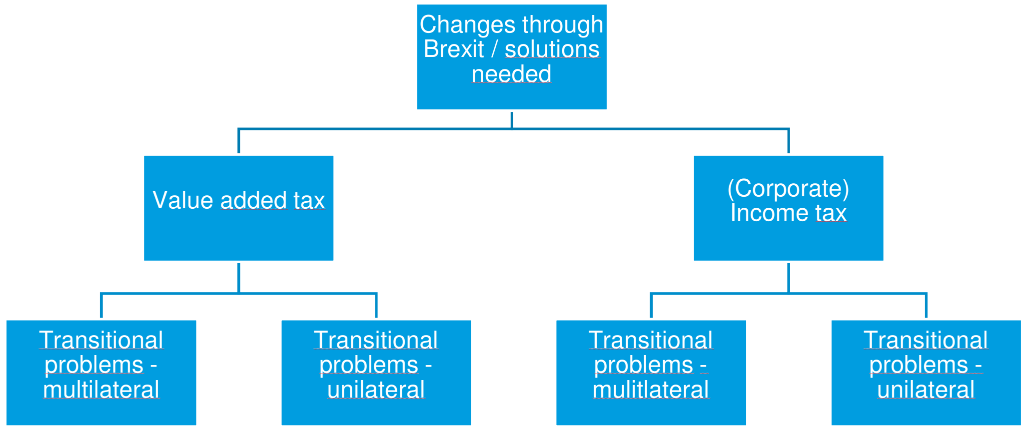
In the field of taxation Brexit will mainly affect value-added tax (VAT) and income tax. In both areas there are various aspects that need to be addressed, some on a multilateral and some on a unilateral basis. Unilateral problems arise due to the differential treatment of EU member states and third countries in national tax codes and because EU directives will no longer apply to the UK. Multilateral problems result from the fact that EU directives and procedures for the internal market will no longer apply to the UK and will need to be replaced by new agreements. In the case of VAT, the problems are largely multilateral, whereas for income tax they are mostly unilateral.

Taxation: Challenges caused by Brexit



Companies in all countries – both in EU member states and in the UK – will need a transitional period to adjust to the new post-Brexit regulations. All tax-related legislation of the internal market should remain in force during this transitional period. It is therefore essential that the UK continues full participation in the internal market with all complementary obligations. This is the only viable option as the time window is too narrow to agree on and implement a transitional arrangement and it is the only way to prevent two consecutive changeovers. The resolution of legal disputes would then remain in the competence of the European Court of Justice as it is the only court that can be accepted by all parties.

The transitional period should be at least roughly two years, with the general rule being the longer, the better. The transitional period should preferably end on 31 December. If no agreement on post-Brexit relations is reached within the stipulated timeframe, the transitional period will have to be extended. Furthermore, all transitions in taxes and customs should be synchronized.

To comprehensively deal with all the unilateral problems facing Germany on account of the differential treatment of EU member states and third countries in the German tax code and to provide legal certainty with respect to all changes and possible grandfathering rules, German business underlines the need for a formal Brexit transition tax act. As a minimum, the Ministry of Finance should issue a decree to clarify the application of the tax-related changes caused by the switch of the UK from an EU member state to a third country. However, German business and German taxpayers would much prefer a formal Brexit tax act.

Identified Issues: Background and Measures

1. VAT-related issues

1.1. VAT clearing

Background

The VAT refund procedure for taxable persons not established in the EU member state of refund according to Council Directive 2008/9/EC of 12 February 2008 will no longer apply.

Without a clearing procedure, EU companies not established in the UK for VAT purposes will have to bear the final burden of due British VAT payments.

Measures

Establishment of a VAT refund procedure until the end of the transitional period.

1.2. VAT Information Exchange System

Background

UK companies will no longer be included in the VIES (VAT Information Exchange System). It will therefore no longer be possible to receive electronic confirmation of the VAT number of UK trading partners (confirmation that a recipient of goods and services in the UK is a taxable person for VAT purposes). Exports will be reclassified according to third country regulations. The third country regulations in place are generally considered to be sufficient.

Additionally, EU companies will no longer be able to declare direct sales to consumers in the UK in the EU Mini-One-Stop-Shop.

Measures

The UK should establish a new B2C VAT solution to ensure that direct sales of EU companies to British consumers are not impeded.

1.3. The UK administration system

Background

After Brexit, goods and services supplied by the EU27 to the UK will be classified as imports and will therefore be liable to VAT. Deliveries from the UK to the EU27 will be classified as exports post Brexit.

Measures

HMRC must set up a system capable of administering the additional volume of imports and exports caused by Brexit.

2. Income tax-related issues

2.1. General clarification

Background

The German tax treatment of business relations with EU Member States differs from those with third countries in many respects, e.g. Sec. 4(1) third sentence, Sec. 4g (2) No. 2 *Einkommensteuergesetz* (German Income Tax Act), Sec. 6(5) *Außensteuergesetz* (German Foreign Tax Act), Sec. 12(3) *Körperschaftsteuergesetz* (German Corporate Income Tax Act). In particular, a relocation of residency, assets etc. to a third country is treated differently than a comparable transaction to an EU Member State.

Measures

As the UK is leaving the EU, there is no relocation carried out by the taxpayer in this case. German business and German taxpayers need general confirmation that Brexit is not equivalent to a relocation to or a transfer to or with a third country. As already mentioned in the general comments above, German business calls for a formal Brexit tax act to clarify this – and all other – issues.

2.2. Foreign Tax Act / CFC rules

Background

According to Sec. 8(2) *Außensteuergesetz* (AStG / German Foreign Tax Act) substance carve-out for the application of CFC rules is only feasible for EU member states. Additionally, according to Sec. 8(3) the UK will be a low-tax country as its corporate income tax rate is below 25 percent. However, the German Foreign Tax Act is designed to prevent the abuse of low tax jurisdictions for profit-shifting purposes. Brexit must not be allowed to trigger tax avoidance through subsidiaries or permanent establishments in the UK.

Measures

German business calls for a permanent grandfathering of all sufficiently substantial investment carried out before Brexit comes into effect. Any future legislative changes to the German Foreign Tax Act should avoid discriminating against the grandfathered investment in the UK in favour of investment in EU Member States.

2.3. Trade tax / correction of taxable profits

Background

According to the second half of the first sentence of Sec. 9 No. 7 *Gewerbesteuergesetz* (GewStG / Trade Tax Act) an automatic correction of taxable profits for dividends received from the UK will no longer be possible (no participation exemption). Distributed profits from the UK may thus risk being subject to trade tax after Brexit.

Measures

As a minimum, German business calls for a grandfathering of profits generated before Brexit. A general exemption for profits distributed from the UK by companies already established before the effective date of Brexit would be favourable.

2.4. Conversion Tax Act 2006

Background

In line with Sec. 20(1) and (2) *Umwandlungssteuergesetz* (UmwStG 2006 / Conversion Tax Act 2006) restructurings between associated enterprises within EU member states can be carried out by maintaining the book value of assets. However, according to Sec. 22(1) Sentence 6, No. 6 the difference between the book value and the market value becomes taxable if either the transferring or the receiving company is no longer located in the EU. With respect to Sec. 22(1) UmwStG taxes are due retrospectively if such a change occurs within seven years after restructuring.

Measures

German business strongly calls for the grandfathering of all restructurings prior to Brexit.

2.5. No more freedom of establishment

Background

British Ltd., Ltd. & Co. KG, plc & Co. KG and LLPs effectively managed in Germany but established in the UK will no longer be acknowledged in the remaining EU27.

Societates Europaea (SE) in the UK will no longer be acknowledged (SE must be based in the European Union).

Measures

The change in legal status will lead to a taxation of the difference between the book value and the market value of assets. A long transition period – longer than the general transition period – will be needed here. Full grandfathering would be the best option.

2.6. Council Directive on Double Taxation Dispute Resolution Mechanisms in the European Union and EU Arbitration Convention will no longer apply

Background

On 10 October 2017, the Ecofin Council adopted Directive (EU)2017/1852 on tax dispute resolution mechanisms in the European Union. The directive is to be implemented into national law by 30 June 2019 at the latest, which is after the date of Brexit of 29 March 2019. However, in view of the intended transitional period after Brexit, the directive may still be implemented into the UK tax code depending on the legal arrangements of the transitional period.

The directive sets out a framework for dispute resolution. Which taxes are covered by this framework depends on the treaties and arrangements concluded by a country. Particularly relevant here are, double taxation agreements and the EU Convention on the elimination of double taxation in connection with the adjustment of profits of associated enterprises (90/436/EEC, Union Arbitration Convention). After Brexit, UK will also fall out of the scope of the EU Arbitration Convention.

Measures

German business calls for multilateral agreement that both the Directive on tax dispute resolution mechanisms in the European Union and the EU Convention on the elimination of double taxation in connection with the adjustment of profits of associated enterprises will remain in force for the UK after Brexit. This is of the utmost importance as, despite Brexit, the volume of cross-border trade and services will remain high so the change in the UK's legal status to third country may well lead to an increasing number of disputes.

Imprint

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