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German Tax News

October 2016

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1. BREXIT – Legal and Tax Consequences

On 23 June 2016, the British people have voted for a withdrawal from the EU. The result of the referendum marks a significant change not only for the UK and the EU, but also for their trading partners all over the world. While this decision will affect a range of several legal and tax issues, companies and entrepreneurs should be prepared to confront possible risks and structuring options at an early stage.

The consequences of the Brexit crucially depend on the outcome of the withdrawal negotiations and are therefore not predictable by today's perspective. This uncertainty is unlikely to change any time soon as the negotiations will only begin once the official announcement of the UK's withdrawal intention has been held (see Art. 50 para. 2 Treaty on European Union). Until then, the UK will remain a full member of the EU with all rights and obligations. The procedure schedules that the withdrawal takes effect with the entry into force of the withdrawal agreement or, in the absence thereof, two years after the official announcement of the withdrawal intention (see Art. 50 para. 3 Treaty on European Union).

Apart from political and regulatory implications, Brexit will lead to legal and tax consequences. As several holding companies and EU headquarters are located in the UK, multinational enterprises are able to benefit from many European agreements as of today. It is clear that this is about to change in the future, which is why an overview of potential legal and tax consequences is following:

Legal Consequences:

It is recommended that companies and entrepreneurs should already think about the inclusion of specific clauses on risks arising from the Brexit within any contract negotiations containing an UK party. With regard to current contracts, it is important to consider if any special termination rights and adjustment clauses come into effect due to the legal and economic consequences of the Brexit.

The legal uncertainties, which arise from the Brexit, are complex and concern numerous fields of law. Here are only a few examples:

- Concerning goods deliveries, the Brexit could have consequences on product authorizations and their mutual recognition of import and export regulations.
- In the area of corporate law, there are uncertainties about the recognition of British legal forms in other EU countries (for example Ltd., SE) and several restrictions on the possibilities for cross-boarder transformation transactions, such as mergers and reorganizations.
- From a labor law perspective, restrictions on cross-boarder personnel deployments and co-determination consequences for cross-boarder employee committees are to be considered against the background of the free movement of workers and services.
- More questions arise in relation to industrial property rights. The main issue here is the risk that EU-registered trademarks could loose their legal protection in the UK. Further uncertainties arise in the area of license agreements referring to the EU or EEA.

Tax Consequences:

Against the background that the UK is not able to benefit from several tax advantages arising from an EU membership after the Brexit anymore, it is now to give a brief overview of the tax implications:

- With regard to cross-boarder agreements, the **EU Parent-Subsidiary Directive**, which eliminates withholding tax on dividends between associated EU entities, is no longer applicable to UK companies. The same goes for the **EU Interest and Royalties Directive**, which eliminates withholding tax on interest and royalty payments between EU resident entities, and the **EU Merger Directive**, which permits certain cross-boarder reorganizations.
- To create a European market, the **Value Added Tax Law** (VAT Law) has been harmonized by implementing an intra-Community VAT Law with a uniform basis of assessment and deduction system. The European VAT Law ensures a clear distinction between sales within the EU-Community-area and to third countries. For example, intra-Community supplies are exempted from the VAT within the Community territory. A with-

drawal from the EU will lead to the fact that privileges such as the simplified receipt documentary will be eliminated since the UK would be considered as a third country from a VAT perspective.
- If a person with unlimited tax liability holds shares in a domestic corporation and leaves his/her current residence, the **German Foreign Tax Law** (AStG) provides a so-called exit-taxation, i.e. the taxation of a fictitious capital gain of the holding shares. If the taxable person moves to another member state of the EU, the AStG provides that the tax burden is deferred free of interest and without any securities due to the European fundamental freedoms. In case of a withdrawal of the UK, the deferment option would disappear, which would lead to an immediate taxation. Furthermore, it seems questionable how to handle cases where a taxable person has already moved to the UK and his taxes have hitherto been deferred. One conceivable option is the grandfathering of old cases or even an immediate taxation.

Conclusion

It is uncertain at this stage what status the UK will have in future time with its EU trading partners. The UK could join the EEA like Norway or stay out of the common market. In any case, companies should consider the effect of the UK’s eventual departure from the EU.

2. New Inheritance Tax Law

Having passed all legal hurdles the long awaited Inheritance Tax Reform has finally come to an end after a long dispute between political parties could be settled. On 21 September, 2016, the conciliation committee of Germany reached a compromise on changing the country’s inheritance tax rules, which has both been approved by the German Bundestag on 29 September, 2016 and just recently by the German Bundesrat on 14 October, 2016.

The German Federal Constitutional Court had asked for changes to the current Inheritance Tax Law in December 2014. According to its ruling, the existing system violates the principle of equal tax treatment in its scope and application inter alia due to existing alleviation regulations (Verschonungsregeln) for company assets. These regulations imply that company heirs of medium-sized firms are widely exempted from inheritance tax given that the business is carried on and workplaces are maintained.

The conciliation committee agreed that people inheriting family-owned companies will continue to enjoy a preferential tax treatment, but conditions for enjoying tax breaks have been tightened. An agreement on the controversial aspects has been reached, whose main elements will be summarized in the following:

Valuation Discount for Family-Owned Businesses

A valuation discount of up to 30% of the preferential assets will be granted for “typical” family-owned companies provided that disposal, withdrawal and settlement restrictions are observed. In fact, withdrawals must be limited to 37,5% of the after-tax profit. It is also required that the mentioned restrictions exist two years before and 20 years after the inheritance or gift has been conducted.

Realistic Asset Valuation

Within the capitalized earnings method, the company value will be determined with a capitalization factor of 13,75. Compared to the current factor of 17,85, this will result in more realistic market values of small- and medium-sized companies.

Demarcation of Preferential Assets

The basic structure of the alleviation model (Verschonungsmodell) for preferential assets remains in effect, i.e. the taxable person can choose between the regular exemption model (85% - tax exemption) and the optional exemption model (100% - tax exemption) provided that the wage bill and retention regulations are observed. However, for the granting of the optional exemption model, a maximum limit will be reintroduced according to which the preferential assets must not consist of more than 20% administrative assets.

Wage Bill Regulations

In order to make use of the preferential tax treatment, wage bills will be maintained on a constant level for a certain period after the acquisition. A novel element is that the amount of the wage bill will be dependent on the number of employees. The examination of the wage bill regulation will leave companies with up to 5 employees behind. Another new amendment states that the minimum wage bill increases by the number of the employees.

Limitations on the Transfer of Large Assets

In the future, the tax exemption of the transfer of business assets will depend on the amount of the respective acquisition. In fact, large companies will be subject to a so-called economic needs test (Bedürfnisprüfung) which applies if the tax value of the business assets amounts to more than 26 million per heir/donee. If the value of the preferential assets exceeds the amount of the threshold, the taxable person can choose between a reduction of the preferential treatment discount and a preferential economic needs test (Verschonungsbedarfsprüfung).

Administrative Assets

Although a redefinition of the preferential assets has been asked in the light of last year's government draft, the current systematic remains essentially unchanged. Yet, the administrative assets catalogue will be extended by leisure and luxury items. Administrative assets will be considered as preferential assets unless a maximum permissible value of 10% is exceeded. Cash and cash equivalents will be treated as preferential assets insofar as the amount does not exceed 15% of the company's fair market value.

Deferment

The payment of the inheritance tax arising from the preferential assets can be deferred for seven years. However, while the first year is free of interest, the following six years are subject to 6% interest.

Conclusion

The new Inheritance Tax Law will come into force retroactively, with effect from 1 July, 2016. In general, all transfers carried out up to 31 June, 2016 enjoy the right of continuance. However, the newly introduced valuation provision is to be applied to all valuation dates starting after 31st December 2015, hence with retroactive effect. It remains to be seen whether the new regulations meet the expectations of the German Federal Constitutional Court.

One thing is certain: the enactment of the reform will not make company successions any easier. This is why it will become even more necessary for tax reasons to plan a succession on a long-term basis.

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