

Japan tax alert

Ernst & Young Tax Co.

European Restructuring in the 11 month Brexit Implementation Period

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Brexit confirmed

On 29 January, the European Parliament ratified the Brexit Withdrawal Agreement, confirming that the UK will leave the EU on 31 January 2020. This was the final legal step in the Brexit process. The UK left the EU at 11pm on 31 January UK time. From this date, the UK will enter a transition or implementation period lasting until 31 December 2020, during which it will remain fully obligated to comply with EU rules and laws. There is an option to extend the transition period, but this needs to be agreed by 30 June 2020.

Implications for Japanese Multinationals

The implications of Brexit for Japanese businesses operating in the UK and EU are wide-ranging and many companies have already acted to de-risk their supply chains, legal structures or regulatory affairs in the region. There are some businesses however who have held off acting due to the uncertainty of Brexit proceeding. Others have identified structural issues but have not remedied these due to the lack of certainty as to whether the steps required could be complete before a "Hard Brexit". The current period of 11 months "implementation/transition period" gives these businesses a window in which it is possible to act.

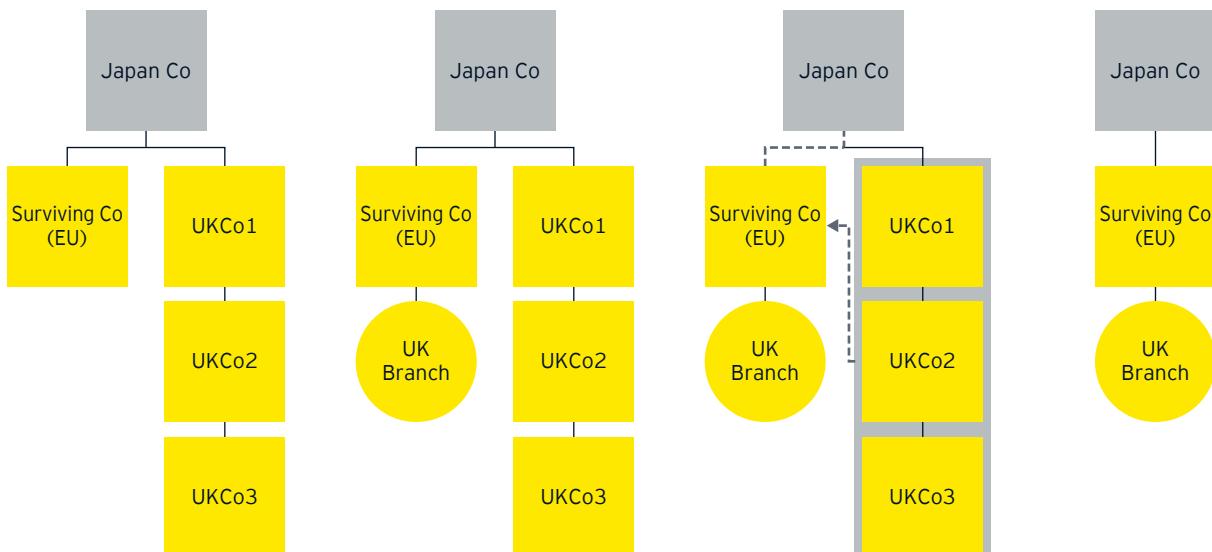
Common regulatory, business and structural issues

Issues that are likely to lead to operational, structural or tax inefficiencies in the face of Brexit are varied and depend on the sector, supply chain and corporate structure of each company. Some of the common structural issues faced by Japanese multinationals who may now wish to use the 11 month implementation period to remedy these issues, are as follows:

- ▶ Withholding tax inefficiencies on payments from countries with old tax treaties to a UK holding company (Italy, Germany and others);
- ▶ Groups in certain industries with EU regulated assets which need to transfer these into a company incorporated in the EU;
- ▶ Groups in industries which require certain entities carrying out regulated functions to be located in the EU;
- ▶ Groups which rely upon an EU brand or wish to portray an EU focused business;
- ▶ Groups which wish to split their business between the UK and the EU markets post-Brexit;
- ▶ Groups which rely on EU funding for certain activities, such as R&D under EU funding schemes into the future;
- ▶ Groups which need to change their supply chains and require an EU incorporated entity to manage the EU side of this supply chain;
- ▶ Groups wishing to establish operations in the UK notwithstanding Brexit

There are many ways in which these groups may restructure in order to achieve their target structure, however 2019 saw an increase in cross-border mergers, especially those carried out by Japanese groups. This is in part due to the acceptance by the National Tax Agency (NTA) and the relevant Tax Bureaus that an EU Cross-Border merger may be treated as a "Tax Qualified" merger for Japanese tax purposes. This means that the merger can be completed without giving rise to Japanese taxation on the merger transaction. This fact is now included along with a redacted clearance at the NTA website: <https://www.nta.go.jp/about/organization/osaka/bunshokaito/hojin/190218/index.htm> (Japanese only)

As stated in the above case, a qualifying merger under Japanese corporate tax law is based on the premise that a "merger activity" in EU is akin to "merger activity" under Japanese tax law. To determine whether a "merger" is a merger under Japanese tax law, it is necessary to consider what legal characteristics the "merger" has and to consider the legal nature of the "merger" activities that take place in each country and to compare this to mergers under Japanese tax law.



EU Merger

The facts of an EU merger may vary, but an example of a simplification of a UK structure collapsing into an EU sister company is set out above. Parent/subsidiary and inbound mergers into the UK are also possible. The EU Merger Directive requires that the merger can be undertaken between companies from different EU Member States without tax. It is important from a merging company tax perspective that a branch, representing the business that has merged from the disappearing entity, remains after the merger.

Merger process

The framework established in the UK's Companies (Cross-Border Mergers) Regulations 2007 for cross-border mergers between UK companies and companies incorporated in EU or EEA jurisdictions other than the UK (for example, Belgium, Germany, Luxembourg and the Netherlands) will remain in place for the duration of the transitional period. The UK Government has already passed legislation repealing the cross border mergers legislation at the end of the transitional period which adds greater urgency to the need to act.

Cross-border mergers require parallel processes to be carried on in the countries where companies are to be merged; whilst there is a high level of harmonisation between member states, there are also significant areas of difference over issues such as retroactivity, the preparation of supporting accounting information, waiting periods, creditors' rights and the approval process itself. Employment law issues also require early consideration. Each cross-border merger requires a customised approach and a composite project plan to manage the merger process in each jurisdiction.

Next Steps

Given the limited timeframe in which to act, groups should analyse the impact of Brexit, the options available in terms of structural issues and if it is necessary to transfer assets, individuals or shareholdings to or from the UK, the cross border merger provides a limited window to achieve that objective in a tax efficient way.

Groups need to have analysis complete and plans in place by the end of June 2020 and have made the decision to merge in order to have a realistic chance of completing the merger prior to 31 December. They should also consider pre-clearance with the relevant tax authorities to ensure certainty of the tax neutrality of the merger. There may be other non-Brexit related benefits which arise from such a structuring exercise, including reduction of entities, tax registrations, compliance filings, exposure to tax audits for certain entities and simplification of both corporate governance and funding complexity.

EY have a team who have executed these mergers from a legal and tax perspective. We are able to commence the first phase analysis with companies in a flexible and efficient way and to proceed through the necessary steps to de-risk Japanese groups from a Brexit perspective.

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