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NEXT STOP BREXIT MIND THE GAP

NEXT STOP BREXIT – MIND THE STEP

POSSIBLE IMPACT OF BREXIT
ON FRAMEWORK CONDITIONS
FOR BUSINESS OPERATIONS IN THE UNITED KINGDOM

AUSTRIAN TRADE COMMISSION, LONDON
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INTRODUCTION

In a Referendum held on 23 June 2016 which saw a record turnout, despite a clear majority in favour of "Remain" in London, Scotland and Northern Ireland, a total of 52% of UK voters decided in favour of exiting the EU.

Following the formal withdrawal declaration at the end of March 2017, the two-year "divorce proceedings" laid down in EU treaties began. According to the law, with effect from 29 March 2019 at 11:00 PM GMT (i.e. midnight CET), the United Kingdom will no longer be a member of the EU. However, it is very likely that the UK's withdrawal will de facto only take place following a transition phase which is urgently required for the purpose of negotiation, terminating at the end of the current, multi-year EU financial framework on 31 December 2020 (or indeed later), and that until such date, there will be no change to the status quo.

Indeed, until the UK's actual departure, nothing (or hardly anything) will change in terms of market access for Austrian companies.

However, it is currently entirely unclear how future participation by the UK in the internal market will be structured. From the current perspective, conclusion of a free trade agreement modelled on the Comprehensive Economic and Trade Agreement (CETA) with Canada appears very likely, but even a failure of the negotiations and thus a return to the WTO rules cannot be ruled out, and nor can an "Exit from Brexit" be excluded, although this would however require a realignment of political power relationships in the UK.

The possible consequences of withdrawal for exporters and companies based in the UK are in some areas very serious, even in a best-case scenario, and should be taken into account in a medium-term planning horizon.

Even if WTO tariffs (which are 3% – 5% for most product groups) could be adjusted to zero through a free trade agreement, supplying goods becomes more expensive solely as a result of the extension of transfer times and the necessity of going through customs procedures with a third country. Possible restrictions with regard to the posting of qualified workers to the UK could present providers of assembly and construction services with problems. Above all with regard to rules of origin, tax law, property rights and the recognition of standards, norms or professional qualifications, changes could arise which increase the expense and costs of market cultivation.

The following commentary deals with the most important topics and questions of relevance in the context of a UK withdrawal from the EU which – depending on the structure of future participation by the UK in the internal market – give rise to a lesser or greater requirement for action to be taken on the part of Austrian companies. The commentary is intended to raise awareness with regard to problem areas and assist in promptly making the requisite adjustments in business dealings with the UK and in business relations with British partners and – whenever required – using the assistance of lawyers and tax advisers. Topics such as the enforcement of judgments or investment protection, in respect of which we are confident that the status quo will be preserved, have been included in order to present a complete picture.

With regard to detailed questions and further individual advice, the **Team at the Austrian Trade Commission in London** (see page 2) is here to assist and is also able to put you in touch with legal and tax experts.

If you wish to receive updates on the economic position in the United Kingdom and the course of the Brexit negotiations, we shall be pleased to provide you with these on a regular basis upon request.

Here too is a checklist (only in German) produced by our German sister organisation, the German Chambers of Commerce and Industry and response (in German) to 111 questions on implementation provided by the Federal Association of German Industry (BDI) here.

Please note: This Special Report deals with the most important aspects, but by no means all. Uncertainty as to future framework conditions exists in many other areas: intellectual property rights and EU unitary patents, the Roaming Regulation, anti-trust law, the law on chemicals, the licensing of medicines, or for instance access to aviation markets, the market for transportation of goods by road and passenger transport markets, to name but a few. The specialists working within the **EU Department of the Austrian Federal Economic Chamber** - Christian Mandl (T +43 5 90 900 4316) and Lisa Rilasciati (T +43 5 90 900 4336) - will be pleased to inform you as needed on the respective status of negotiations concerning both these and other areas.

1. BREXIT SCENARIOS

The Referendum, the official handing over of the withdrawal notification and the withdrawal negotiations have not yet had any direct legal consequences. Until the date of **formal withdrawal on 29 March 2019**, the United Kingdom remains a full EU Member. However the legal consequences of Brexit will most likely not arise until the UK's **de-facto withdrawal** following the end of the transition period.

1.1 SCENARIO 1: Transition phase + follow-up agreement (likely)

In order to create the room for manoeuvre urgently needed for detailed negotiations on a follow-up agreement, and to establish legal certainty for market participants, the parties have agreed on a transition phase from 30 March 2019 until most probably 31 December 2020. While, in formal terms, during this period the United Kingdom will already be a third country, it will continue to participate in the EU internal market and customs union. Thus, until the UK's **de-facto withdrawal on 31 December 2020** (as envisaged by the EU 27, whereby the consent of UK is also required), there will be no change to the status quo:

- Both existing and new EU law will continue to apply in the UK
- EU trade agreements with third countries will continue apply to the UK
- No customs duties or quotas will be introduced
- The European Court of Justice will remain the highest authority with regard to dispute settlement.

Then, on **1 January 2021**, a follow-up agreement will enter into force which will be fairly comprehensive in scope and which will set out the new terms governing economic relations between the UK and the EU 27 (and the content of which should be at least broadly known months in advance).

1.2 SCENARIO 2: WTO rules (unlikely, but not impossible)

If no agreement is reached on a transition phase, or if, during a transition period, no follow-up agreement can be negotiated, then:

- In the first case (no agreement on transition period), on **29 March 2019**
- In the second case (no agreement on a follow-up arrangement during the transition period), on **31 December 2020**

there will be a "disorderly" de-facto withdrawal from the EU by the UK. Exchange relations (goods and services) would thereafter be solely subject to WTO rules (see in particular "Import customs duties and customs procedures").

If the negotiations fail, when it leaves the EU, the United Kingdom will adopt the entire body of EU law one-to-one into its own legal system. Thus, on the first day of the UK's departure, the same legal rules will apply in the UK as in the EU. EU law will continue to apply for as long as the legal rules adopted are not changed by the UK.

2. CONTRACTUAL ARRANGEMENTS

Without doubt, the departure of the UK from the EU will have an impact on the structure of contracts concluded in future which have a connection with the UK.

However, if possible, ongoing contracts should also be checked and, if necessary, renegotiated. In some cases (referred to in the following subparagraphs), the area of application, settlement of disputes or the possibility or terms of modification or termination of contracts will be at issue.

In many cases, the question arises of how to allocate additional costs caused by Brexit. Since these problem areas are relevant not only in terms of contractual arrangements but also with regard to business-model validation, they will be dealt with as separate items.

2.1 Brexit clauses

Having regard to the uncertainty surrounding the future framework conditions, it may be sensible to agree in new contracts a brief phase following the UK's de-facto withdrawal, during which one (or each) party is entitled to terminate the contract if Brexit has a tangible commercial effect on the subject of the contract.

Parties could also contemplate initially entering into short-term contracts which end shortly after the UK's **de-facto withdrawal**, so that the economic impact of Brexit can be better assessed and taken into account in new contracts.

There also exists the possibility of providing for the flexibility of price agreements for the phase after the UK's **de-facto withdrawal** in longer-term contracts (annual price adjustments could for instance be replaced by quarterly adjustments).

In this context, it should always be borne in mind that clauses which provide for rights of termination or a duty of renegotiation in good faith are difficult to enforce under English law.

2.2 Termination of existing contracts

Under normal circumstances, in terms of assessment under contractual law, Brexit should NOT be deemed a case of force majeure removing the foundation of a business transaction and thus establishing a right of extraordinary termination.

However, it could be argued in special cases that the contractual agreements are based to the highest degree on reciprocal free and unhindered market access and the existence of a customs union. In such a case, it could be argued that a disruption to the foundation of the business transaction is given. Under English law, a contract would then be deemed to have failed and could be terminated if circumstances exist which the parties did not foresee and which render contractual fulfilment impossible and thus mean that fulfilment cannot be reasonably expected. Whether contractual fulfilment is impossible or cannot be reasonably expected, must be adjudged according to the circumstances of an individual case and could, under English law, presumably only be successfully argued in very few exceptional instances.

2.3 Geographical area of validity of contracts

Clauses concerning the geographical area of validity of contracts concluded prior to Brexit must be interpreted based on the circumstances applicable at the time when the contract was concluded. In the absence of any contrary indications (such as, for instance, if a contract explicitly refers to the respective expansion of the EU), and provided the geographical area of validity of the contract comprises the EU at the time of contractual conclusion, the United Kingdom would remain within the geographical area of validity of the contract also following departure from the EU.

In new contracts yet to be concluded, the geographical area of validity should be clearly defined by the parties and it should be explicitly stated and specified whether the United Kingdom is to be included in the area of application.

2.4 International jurisdiction in the event of disputes

For the government of the United Kingdom, clearly, within the framework of the withdrawal negotiations, comprehensive judicial cooperation with the EU 27 is a matter of the utmost importance, also following the UK's withdrawal. At the present time, it is not yet possible to predict whether this objective can be achieved through the continued validity of existing treaties or whether new treaties need to be concluded with the EU. However, in any event, the manifest objective of the negotiations is to ensure that there should be no substantial changes to the existing rules on jurisdiction and the reciprocal recognition and enforceability of decisions in both civil and commercial matters.

3. IMPORT CUSTOMS AND CUSTOMS PROCEDURES

In the event that the withdrawal negotiations, or the negotiations concerning a free trade agreement between the EU and the UK should fail, relations between the UK and the EU 27 in terms of trade policy would fall back on WTO rules (in the case of trade in goods, the terms of the GATT, and with regard to trade in services, the terms of the GATS). In this case, the movement of goods in relation to the UK would need to be transacted as with any other third country; with regard to British imports, the third-country duty rates listed in the EU's Common Customs Tariff would apply; in turn, Austrian exports would incur British third-country duty rates (yet to be agreed by the UK with the WTO).

Even if, as a result of a free trade agreement, customs duties could be reduced to zero, with effect from the UK's **de-facto withdrawal**, each cross-border movement of goods would entail the obligation to submit a customs declaration, which would also lead to additional costs. With regard to long-term supply agreements, clarification should be ensured as to which contracting party must bear the additional costs in such an instance.

Difficulties (and potentially additional costs) could thus arise also in the case of "floating/rolling goods", i.e. with regard to consignments of goods being transported or situated in a customs warehouse or free warehouse on the date of the UK's **de-facto withdrawal**. The same applies with regard to processing the "return transportation" of goods which, prior to Brexit, were delivered either to the UK or to the EU 27 for the purpose of temporary use or processing and which are only returned after the withdrawal date.

Though it is unfortunately only available in German, there is a detailed discussion of the different ways the customs issue could be resolved, along with some useful practical tips, at http://www.wko.at/service/aussenwirtschaft/Brexit-aus-zollrechtlicher-Sicht.html

4. RULES OF ORIGIN

Within the EU internal market, input materials from other EU Member States may be used in production for preferential export in the same manner as own input materials, provided the status of the goods used can be documented as being that of EU preferential originating products by means of a preferential internal EU supplier declaration. This means that, at present, an Austrian supplier can provide a British buyer - which itself does not handle or process enough in order to achieve EU preferential origin status - with input materials for production which have a preferential internal EU supplier declaration. Equally, an Austrian finisher can give a product finished on the instructions of a British customer a preferential internal EU supplier declaration.

In the event of an extension to unhindered access by the "third country" of the UK to the EU internal market within the framework of the anticipated transition period – i.e. **between the UK's formal and de-facto withdrawal** – it is unclear what rules will apply with regard to goods intended for preferential third-country export and which have achieved EU origin through cumulation with input materials from the United Kingdom. Merchandise from the United Kingdom in the EU 27 is equally affected.

Thus, when purchasing British input materials and placing the same in storage, where such materials could sooner or later lose their EU origin, Austrian processors should take account of such uncertainties, plan carefully and seek out alternative sources on a timely basis.

5. PRODUCT NORMS, STANDARDS AND EXPORT LICENCES

Following **de-facto withdrawal** from the EU, the United Kingdom could create its own body of rules concerning product norms and standards (technical safety/health/hygiene/labelling rules, and many other aspects), which could in part differ from those of the EU 27. Such changes could unexpectedly increase the costs of fulfilling performance obligations between contractual partners, for instance as a result of new testing and certification requirements. Additional costs could also arise through licensing obligations applying to third countries for dual-use goods and the supply of military equipment.

In existing contracts, the objective and purpose of the contract is often an aid to interpretation as regards the question of which contracting party must bear such additional costs. Many contracts are very clear in terms of specifying cost coverage. If a contractual text is unclear, in the event of dispute, interpretation will need to be sought from a court of law.

With regard to the drafting of new contracts, it is necessary to ensure that the parties allocate those costs already known and anticipated as precisely as possible and moreover incorporate a "catch-all" clause allocating additional unforeseen costs.

6. TRADE-MARK PROTECTION

At present, there exists a single industrial property right in the EU. In the absence of any separate provision on its continued existence following the transition phase, EU trade marks or community designs will no longer be protected. While it may be assumed that the UK will introduce an adequate system to protect industrial property, there does not however exist any legal certainty in this regard. Business entrepreneurs wishing to play it safe should therefore file national trade marks for registration in the UK in parallel to EU trade marks.

7. CE MARKING

CE marking demonstrates that a product (including electrical appliances, toys, medical products, cosmetics, batteries, construction-industry products or machines) fulfils the safety, environmental and health requirements laid down in various European Directives. Only then may such a product be introduced onto the market in all Member States of the EU. Many companies dispense with the self-verification which would be possible in many instances, but instead arrange to have a Declaration of Conformity issued by licensed testing institutions. With regard to particularly sensitive product groups, such as medical products, indeed referral to a testing agency is compulsory for the purpose of a conformity evaluation.

The testing agencies must have their registered office in a Member State and have been authorized by the competent authorities of the Member State ("notified body"). If the retention of applicable product standards and continued reciprocal recognition of Declarations of Conformity is not regulated in a follow-up agreement, upon the **de-facto withdrawal** of the United Kingdom from the EU, British institutions will lose their status as "notified body" and could no longer undertake in conformity assessments with validity across the EU. At the same time, moreover, certificates of British institutions already issued would lose their validity in the other 27 EU Member States. Companies which introduce products certified in the United Kingdom onto the market in the EU would then have to ensure that either a new conformity assessment is applied for with a certification institution in one of the remaining EU Member States, or that the existing dossier is transferred to another EU Member State.

8. DATA PROTECTION

On 25 May 2018, the EU General Data Protection Regulation ("GDPR") will become operative. Its aim is the harmonisation of data processing within the EU. Many principles of the British Data Protection Act 1998 are reflected in the GDPR. Companies operating in the United Kingdom cannot ignore the requirements of the GDPR – above all in view of the threat of criminal sanctions of up to EUR 20 million or 4% of global turnover – purely for the reason that, on 25 May 2018, the UK will still be a member of the EU. With effect from such date, companies will have to observe the provisions of the GDPR in business dealings with the UK.

Following the UK's withdrawal from the EU, the rules are not likely to substantially change, since it should be in the interests of the UK to continue ensuring that data protection rules applicable in the UK are recognized by the EU as being adequate, so that personal data can continue to be transferred between the United Kingdom and the EU without barriers and formal requirements. Moreover, the GDPR will apply

directly to British companies if they have business contacts with customers from EU Member States, even if they have no physical presence in the EU.

9. VALUE ADDED TAX

Value added tax is the only tax which is harmonised across the EU. Member States are required to implement the provisions of the VAT Directive in national law. Conversely, when the UK leaves the EU, it must also revoke some parts of the Directive which it has already incorporated into domestic law. This relates in particular to the provisions concerning place of taxable transaction as well as the rules on intra-Community supply and acquisition. Other provisions which have no impact on other States, such as for instance the definition of a taxpayer or indeed the structure of VAT rates, which may of course be determined by the UK independently following Brexit, could be retained.

The withdrawal of the UK has a direct impact on the record-keeping obligations of companies and correct representation for tax purposes of the movement of goods in VAT returns. Following the UK's de-facto withdrawal from the EU, Austrian exporters may no longer deliver goods to the UK on an intra-Community basis tax-exempt, and Austrian importers may not receive from British exporters any tax-exempt intra-Community goods. Therefore, when the UK leaves the EU, following the end of the transition period, it will be necessary for every British business to have a British tax reference (which will differ significantly from the current VAT number).

10. WORKING IN THE UNITED KINGDOM

Common market access is based on exercise of the four fundamental freedoms anchored in EU law governing persons and businesses in all EU Member States. This also includes the free movement of persons, which permits EU citizens to work in another EU Member State without an entry visa or work permit.

Until the UK's **de-facto withdrawal** – i.e. also in any transition phase – the free movement of persons will continue to apply in full. EU citizens may work at any time in the UK without a residence or work permit. The posting of workers continues to be possible based on the validity of the "Posting of Workers" Directive (as envisaged by the EU 27, whereby the consent of the UK is also required).

After the UK's **de-facto withdrawal**, a distinction must be made between two "stakeholder groups". Those EU citizens (and their family members) who, at the time of the UK's **formal withdrawal** on 29 March 2019, are lawfully resident in the UK, are entitled to a permanent right to remain as well as largely unchanged rights to healthcare provision and social-welfare and pension benefits in the UK. In this case, the withdrawal treaty does not state that, on the date of Brexit, it will be necessary to be personally present in the host country; a temporary absence which does not impact upon the right of residence is permitted.

It is not yet clear how the citizenship rights of EU citizens who enter the country following the UK's **formal withdrawal** (i.e. with effect from 30 March 2019) will be structured after the UK's **de-facto withdrawal** (i.e. with effect from 1 January 2021). The end of free movement of persons between the United Kingdom and the EU could mean that such persons will require residence and work permits.

However, temporary stays in the context of postings could also be restricted. As in the USA, the right to enter the country for work purposes could be time-restricted or be linked to the existence of specific preconditions (assembly only upon delivery of goods).

Companies which regularly post staff to the United Kingdom, for example for the purpose of commissioning plant or to render assembly work, should incorporate "catch-all" clauses into new contracts concerning the assumption of any additional costs thereby arising. In addition, removal of the automatic reciprocal recognition of professional training and qualifications could lead to additional costs in relation to the posting of workers. One way out of this could be to establish a British subsidiary which would operate in future as a local employer for posted personnel.

No serious direct effects of the UK's withdrawal are anticipated on existing employment relationships or on English employment law.

11. EXCHANGE RATE

The greatest uncertainty and thus the highest economic risk to business will arise during the negotiation and withdrawal phase as a result of volatility in the exchange rate between the pound (GBP) and the euro (EUR).

Companies can minimise this risk through currency hedging or – where they are in a strong negotiating position – through the contractual agreement of threshold clauses. This consists of an agreement on exchange-rate thresholds which, if reached, either trigger particular price-adjustment mechanisms or give rise to termination rights. As already mentioned, contractual clauses which only comprise a renegotiation obligation in good faith are ineffective since, under English law, they are difficult to enforce.

12. DIRECT INVESTMENTS AND BUSINESS ESTABLISHMENTS

In legal terms, and in the absence of any follow-up provision, Brexit would mean for Austrian investors that the (already minimal) EU protection for European investors would no longer apply. This protection comprises the general precept of non-discrimination, guarantees concerning market access and the prohibition on restricting the free movement of capital and payments. Neither is there any bilateral investment protection agreement (BIT) between Austria and the United Kingdom, which usually offers similar guarantees.

Since, however, all of this also applies vice versa to British investments in the EU 27, it may be assumed that, in all probability, the withdrawal agreement will incorporate investment provisions including a dispute-settlement mechanism, similar to the provisions contained in the CETA or the Commission proposal relating to TTIP, or that at least, as part of a follow-up agreement between the EU 27 and the United Kingdom, an investment protection agreement will indeed be concluded.

13. CORPORATE TAXATION

Other than is the case with regard to the taxation of sales, the European Union does not prescribe any common framework for the taxation of corporate profits. Within the EU, there are currently 28 different systems of corporation tax, with a sharp variation in the corporate tax burden. The United Kingdom has one of the most attractive corporate tax systems in Europe, with a tax rate of 19% (with effect from 1 April 2020, 17%; moreover, the UK does not levy any trade tax), and a broad network of bilateral double taxation agreements.

At present, the so-called EU Parent-Subsidiary Directive facilitates the cross-border payment of profits between affiliated undertakings. Here, the EU Directive states that the paying undertaking may not be subject to deduction at source, and no minimum taxation should apply with regard to the receiving undertaking.

In the event that, following the United Kingdom's **de-facto withdrawal**, the Parent-Subsidiary Directive should no longer apply to the UK, with regard to cross-border planning of profit distributions, reference will have to be made to a replacement arrangement between the United Kingdom and the EU in order to avoid any unnecessary additional tax burden. The same will apply with regard to the payment flows between affiliates governed by the Interest and Royalties Directive.

14. PROTECTION AGAINST ECONOMIC DISCRIMINATION

Even though the national systems of personal and corporate taxation in the EU are not harmonised through Directives, the national tax laws – having regard to the four fundamental freedoms – may not lead to economic discrimination against market participants. In practical application, this means, for instance, that a tax law in an EU Member State may not in terms of taxation make the use of capital and economic goods in another EU Member State, e.g. within the framework of a cross-border expansion, more disadvantageous than would be the case within the framework of a domestic expansion.

The departure of the United Kingdom from the EU could mean that this protection against economic discrimination is not retained and the "disjunction" of some tax cases will be required. If a company from the EU 27 has transferred assets at book value to a British subsidiary, to date, there has been no disclosure or taxation of any hidden reserves. However, in many tax jurisdictions, this potential tax burden is only deferred for an unspecified period. If such economic assets are no longer situated in the internal market protected by European law following the UK's **de-facto withdrawal**, this tax burden could be triggered.

15. BRITISH "LIMITED"

The British designation "Ltd." (similarly to the case with a PLC/Public Limited Company or LLP/Limited Liability Partnership) refers to a company limited by shares under British law, the shareholders of which – similarly to an Austrian GmbH – are not personally liable. The British model is attractive because – de facto – a limited company can be formed with minimum capitalisation of £1.00.

On the basis of the freedom of establishment for companies (and the rulings derived therefrom of the European Court of Justice), this legal form and the applicable company-law rules under British law are also recognized by the Austrian courts if the company's administrative seat is situated in Austria. Approximately 1,000 domestic Austrian companies have been able to make use of this business structure.

If the obligatory reciprocal recognition of business structures ends following the UK's de-facto withdrawal without any follow-up provision, it is not certain, but it is by no means inconceivable, that Austrian courts will treat a "Limited" company – which after all does not per se fulfil the stricter requirements of a GmbH – in the same way as a "*Gesellschaft bürgerlichen Rechts*" (private partnership) or an "*Offene Gesellschaft*" (general partnership), in which the partners bear personal liability for the debts of the company.

In order to create legal certainty, it is necessary to form a new Austrian GmbH – possible, but complicated, alternatives could consist of formation of a "Limited" company in Ireland or Malta – generally followed by the cross-border merger of both companies limited by shares under applicable EU law by which the disclosure and thus taxation of hidden reserves can be avoided. Transfer of the business of a "Limited" company to a GmbH with subsequent liquidation of the "Limited" company by way of a classic "asset deal" is possible, but regularly entails considerable tax disadvantages.

The prevailing legal opinion is that a merger must be fully completed by the time of the United Kingdom's de-facto withdrawal (worst-case scenario: 29 March 2019) in order to be valid. The mere initiation of the process at this point in time is not likely to be adequate. With the process for cross-border mergers taking on average approximately 4 – 6 months, the negotiations on agreement of a transition period must be precisely monitored.

While this document does not deal with all problem areas of business operations in the United Kingdom, it does deal with those important areas of difficulty where, as a result of Brexit, there could be legal consequences and additional costs for Austrian companies. In our analyses and recommendations for action, in most cases the assumption is made that no new rules will be negotiated on a particular matter in a follow-up agreement. However, since it is entirely unclear whether and to what extent any follow-up agreement could "alleviate" such problems, it will be necessary to carefully observe the course of the negotiations in order, if necessary, to set the required course at the right time based on reliable professional advice from lawyers and tax consultants.

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