

Brexit: Legal and Tax Implications*

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I. Introduction*

On 23 June 2016, a majority of voters – albeit a narrow one – in the United Kingdom (United Kingdom of the United Kingdom and Northern Ireland, referred to here as the United Kingdom or the UK for the sake of simplicity) decided to have the UK withdrawing from the European Union (“EU”). This, so far, historically unique event will enter the history books under the name of Brexit.¹ Prior to the withdrawal, negotiations on the terms and shape of future relations between the EU and the United Kingdom will take place. So, it could be interesting so summarize the background and the framework of the withdrawal (II). Already now, depending on the various exit scenarios, potential tax and legal consequences (III) are emerging for which preparations should be made at an early stage.

II. Background and framework of the right to withdraw**

This section will cover the unilateral right to withdraw under TEU, the withdrawal process as such, the potential right to re-enter the Union and the consequences of the withdrawal.

1. The unilateral right to withdraw (Article 50(1) TEU)

According to Article 50(1) TEU, any Member State may decide to withdraw from the Union in accordance with its own constitutional requirements. However, the provision does not itself contain an explicitly formulated unilateral right to withdraw. Even if one does not wish to regard the provision as a purely declaratory reference to domestic decision-making abilities, one is nevertheless obliged to infer such from it.² The origins of the provision also argue for such an interpretation, and so it cannot be seriously questioned by either side. Nonetheless, this linguistic imprecision does prove surprising. But it too may be explained by the fact that the constitutional convention from which this formulation stems plainly did not imagine that this provision would play a role in the near future or indeed ever.

a) National constitutional law

In the absence of a written constitution, the United Kingdom does not have any corresponding substantive legal requirements for a withdrawal from the EU, and as a consequence would, in theory, be free to decide on this itself. However, the referendum pursued by David Cameron appears not to be legally binding in this regard. According to the British concept, only the "Queen in Parliament" is sovereign. If the British people decide to withdraw from the EU, this decision would, as in Germany, be

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¹ Legal basis was the European Union Referendum Act 2015, 2015 c. 36.

** A. Thiele, Der Austritt aus der EU. Hintergründe und rechtliche Rahmenbedingungen eines „Brexit“, EUR 2016, 281 (convenience translation of items IV. 1 to 4).

² J. Zeh, Recht auf Austritt?, ZEuS 2004, p. 173, 199.

required to be formally confirmed by Parliament (or indeed be taken for the first time in a legally binding manner). The declaration of withdrawal would then have to be communicated by the head of state (the Queen) or the government to the EU or European Council.

Whether these various domestic requirements are fulfilled, will not, however, be investigated by the EU, provided a declaration of withdrawal effective with regard to external relations is put before it.³ As a unilateral and not directly legally effective declaration of intent,⁴ which must be received by the other party or parties, the declaration of intent may of course be unilaterally revoked at any point before completion of the process set out in Article 50(2) TEU or expiry of the two-year period provided for.⁵ There is no reason, at least in the EU's view, to limit this unilateral right of revocation for a Member State which previously wished to withdraw.

b) Demands on the Union?

The withdrawal provision of Article 50(1) TEU does not attach any specific preconditions to the admissibility of a declaration of withdrawal by a Member State. According to the provision, it does not require either a specific rationale or any preliminary proceedings of any kind. It is also emphasised in the literature that the declaration of withdrawal is not linked to "any further preconditions".⁶ In light of the "unlimited period" for which the Treaty applies (cf. Article 53 TEU) and the aim of "an ever closer union", such a wide-ranging unilateral right to withdraw appears surprising, as it is difficult to reconcile with the separate integration objectives.⁷ It is of course true that a state which no longer favours integration will not be forced to remain in the EU.⁸ However, that does not mean that withdrawal must necessarily be drafted on the part of the union with so few presuppositions – the right to withdraw even lags behind the standard rules of the Vienna Convention on the Law of Treaties in this regard.⁹ Generally speaking, the question of withdrawal will be extraordinarily controversial in the Member State in question, so that an attempt to keep the state in the system of integration is not necessarily doomed from the outset. The British debate confirms this finding. Therefore, at a minimum, a notification process as set out in Article 56(2) VCLT, in which the unilateral declaration of withdrawal is initially announced but can only be formally declared upon expiry of a further period of one year, seems appropriate. This time could be used for renegotiations and consultations in the course of which a formal exit could yet be averted. Both the ultimately averted withdrawal in 1975 and the withdrawal

³ A.A. R. Friel, *Providing a Constitutional Framework for Withdrawal from the EU: Article 59 of the Draft European Constitution*, ICLQ 53 (2004), p. 407, 425, which assumes that the CJEU would, where necessary, be required to monitor compliance with domestic legal requirements. However, the provision could hardly have been intended to be interpreted in this way. The reference to the requirements of constitutional law does not therefore provide the basis of a supervisory power for the CJEU, nor would the latter be in a position to do so.

⁴ Cf. R. Streinz, *Id.*, EUV/AEUV, Art. 50 EUV, marginal no. 6.

⁵ It is evident that J. Herbst, *Observations on the Right to Withdraw from the European Union: Who are the "Masters of the Treaties"?*, German Law Journal 6 (2005), p. 1755, 1758 also assumes this possibility. However, R. Friel (fn. 2), p. 426 is undecided on the matter.

⁶ C. Calliess, *Id./M. Ruffert*, EUV/AEUV, Art. 50 EUV, marginal no. 3; J. Herbst (fn. 4), p. 1756. Likewise R. Streinz, *Id.*, EUV/AEUV, Art. 50 EUV, marginal no. 3.

⁷ See also C. Calliess, *Id./M. Ruffert*, EUV/AEUV, Art. 50 EUV, marginal no. 9.

⁸ Relevant here is C. Calliess, *Id./M. Ruffert*, EUV/AEUV, Art. 50 EUV, marginal no. 20, who however directs this statement mainly at the critics of a general right to withdraw and not at the drafting in particular.

⁹ Thus Article 56(2) VCLT obliges a Member State that wishes to denounce a treaty to notify the other Member States of this intention a minimum of 12 months in advance. By contrast, a declaration of withdrawal may be given without any advance warning under Article 50(1) TEU. See also J. Herbst (fn. 4), p. 1755.

of the United Kingdom currently under consideration were and will be preceded by such negotiations. In terms of European law, under the provisions of Article 50 TEU the parties are likewise under no obligation in the context of these negotiations to aim for a mutual solution conducive to integration without an official withdrawal.

This normatively somewhat contradictory position¹⁰ – an unconditional unilateral right to withdraw on the one hand and the aim of ever closer union with an indefinite treaty period on the other – has caused some commentators in the literature to apply to the right to withdraw certain unwritten (substantive) limitations. For example, *Juli Zeh* states that the principle of cooperation in the union would give rise to "duties to observe and support the treaty, and an obligation not to take actions that would jeopardise the treaty".¹¹ And: "As the request to withdraw necessarily brings with it an end to Member State loyalty, limitations could arise from the aforementioned principles which, due to the vague wording (...), would have to be taken into account in its interpretation".¹² In a similar fashion, *Peter Gussone* believes a withdrawal should only be permitted "after exhausting all options for compromise, having regard to the principle of solidarity".¹³ This conceptualisation is similar to the German national concept of practical concordance, according to which conflicting treaty provisions must be balanced carefully. In principle, no objection can be made to making use of this dogmatic concept for the interpretation of European law. However, it is questionable whether corresponding normative restrictions for the unilateral right to withdraw can in fact be justified on this basis – even *Juli Zeh* contents herself with just a mere reference to legal doctrine and practice. It is problematic not only because the principle of Union loyalty and the principle of solidarity are extraordinarily vague, but in particular because the Member State is by its withdrawal from the EU seeking a dissolution of those very obligations. However, if the EU explicitly allows the possibility of a withdrawal and consequently the dissolution of obligations under Union law, it seems wholly unconvincing to now attempt to impose restrictions on the right to withdraw based on those same Union law obligations. There is a significant difference in this regard to a Member State remaining in the system of integration which must actually refrain from action that jeopardises the treaties. The withdrawal itself cannot be viewed as jeopardising the treaty if it is expressly provided for. It is not possible to justify in this way placing particular responsibility on the withdrawing Member State for the continuation of the EU, which might even under certain conditions rule out entirely the option to withdraw. The right to withdraw in principle must be maintained at all times. Even the "ultima ratio" solution favoured by *Gussone* does not appear convincing in this respect.¹⁴ What does at most appear conceivable, is a normative obligation on the Member State in question not to ambush the EU and the other Member States with the demand to withdraw and communicate a declaration of withdrawal without any notice whatsoever. The EU must at least be given a chance to influence the decision-making process in the Member State in question and to avert a withdrawal in this way – through renegotiations, for example. As stated, a specific provision would appear thoroughly appropriate in this regard. Without being explicitly mentioned in Article 50(1) TEU, the content of such an obligation would remain necessarily vague. It is also unclear what should happen if the obligation were to be breached. Is the declaration of withdrawal then to be viewed as null and void? Can the defect be cured? Ultimately the CJEU itself would have to rule on these questions. But is it the correct institution to make an ultimate decision on such a highly political question without any

¹⁰ *C. Calliess*, *Id./M. Ruffert*, EUV/AEUV, Art. 50 EUV, marginal no. 9 refers to a "charged relationship".

¹¹ *J. Zeh* (fn. 1), p. 199.

¹² *J. Zeh* (fn. 1), p. 199.

¹³ *P. Gussone*, *Das Solidaritätsprinzip in der Europäischen Union und seine Grenzen*, 2006, p. 218.

¹⁴ In this regard see *P. Gussone* (fn. 12), p. 218.

textual safeguard? And would any such judgment be accepted by a withdrawing Member State? In light of these considerations, the strongest arguments are in favour of treating the unilateral right to withdraw seriously and not placing any further normative restrictions on it.¹⁵ Politically – as the case of the United Kingdom makes clear – an abrupt declaration of withdrawal would be impossible in any case.

2. The withdrawal process – Article 50(2)-(4) TEU

After notification of the declaration of withdrawal to the European Council as (probably) the correct recipient,¹⁶ the latter will first determine "guidelines" on the withdrawal, on the basis of which the Union will subsequently negotiate and conclude an agreement on the details of the withdrawal. As a rule, membership will come to an end as a consequence of such a treaty between the EU and the withdrawing Member State. In light of the complex interrelationships within the European system of integration, such a contractual arrangement appears more than reasonable. This consensual, rule-based procedure does not of course establish a second withdrawal scenario existing alongside the unilateral right to withdraw,¹⁷ as the withdrawing Member State always decides itself unilaterally on the withdrawal.¹⁸ Therefore the subject of the planned agreement is only the "how" and not the "whether" of withdrawal. Consequently, the EU also cannot block the withdrawal by delaying or even refusing to conclude the agreement. According to Article 50(3) TEU, the withdrawal becomes automatically effective if an agreement is not concluded within a period of two years (sunset clause).¹⁹ An extension of this period is possible, but requires a unanimous decision of the Council²⁰ and also the agreement of the withdrawing Member State.

Even if the other Member States are not involved in the agreement, and accordingly are not required to ratify it,²¹ it is hardly likely, in view of the complexity of the material, that such an agreement could actually come into force in much less than two years following the notification of the declaration of withdrawal.²² Even in the case of the British withdrawal, a mutually-agreed extension of this period to

¹⁵ See also *J. Herbst* (fn. 4), p. 1756.

¹⁶ The recipient of the declaration of withdrawal is not entirely clear from the provisions of Article 50 TEU. But Article 50(2) provides that the Member State in question must notify the European Council of its intention to withdraw. In this regard one could likely view the European Council –and not the Commission – as the correct recipient of the formal declaration of withdrawal. Likewise also *R. Streinz*, Id., EUV/AEUV, Art. 50 EUV, marginal no. 6; *J. Herbst* (fn. 4), p. 1757. But see *C. Calliess*, Id./M. Ruffert, EUV/AEUV, Art. 50 EUV, marginal no. 5, who regards the Council as the recipient.

¹⁷ But see *W. Hummer*, *Unschlüssige Austrittsszenarien aus der EU und deren Konsequenzen*, in: K.-S. Stieber, *Brexit und Grexit. Voraussetzungen eines Austritts*, Munich 2015: Hanns-Seidel-Stiftung e.V., p. 15, 16.

¹⁸ For a different view see *M. Pechstein*, *Mitgliedschaftsordnung der EU*, in: A. Hatje/P.-C. Müller-Graff (eds.), *Europäisches Organisations- und Verfassungsrecht* (EnzEuR Bd. 1), 1st edition 2014, para. 15, marginal no. 20, who however ignores the sunset clause. See also *C. D. Classen*, *Zur offenen Finalität der europäischen Integration*, in: A. Hatje/P.-C. Müller-Graff (eds.), *Europäisches Organisations- und Verfassungsrecht* (EnzEuR Bd. 1), 1st edition 2014, para. 37, marginal no. 92, 136.

¹⁹ *R. Streinz*, Id., EUV/AEUV, Art. 50 EUV, marginal no. 3; *C. Calliess*, Id./M. Ruffert, EUV/AEUV, Art. 50 EUV, marginal no. 5 in fn. 15. The term relates solely to this part of the provision and not the entire provision. In this regard *J. Herbst*, (fn. 4), p. 1755 goes too far.

²⁰ The withdrawing Member State is not involved in the decision-making process of the Council in accordance with Article 50(4) TEU, meaning that its approval must be obtained in addition.

²¹ See also *C. Calliess*, Id./M. Ruffert, EUV/AEUV, Art. 50 EUV, marginal no. 5.

²² This would however be legally permissible. The two-year period is not a minimum period. But see in this regard *J. Herbst*, (fn. 4), p. 1756 et seq. *Herbst* too at p. 1757 et seq., loc. cit. views the period of two years as being too short in general.

prevent a legally invalid withdrawal has not been ruled out. However, in terms of the domestic political situation, the pressure on the British government will be extraordinarily high to successfully bring about the withdrawal within two years by concluding an agreement. The period specified in Article 50(3) TEU begins in each case with the notification of the formal declaration of withdrawal to the European Council. In the United Kingdom this requires a formal resolution of Parliament after the referendum and the assent of the Queen. As it must also be assumed that the declaration of withdrawal will be notified at a special meeting of the European Council, the two-year period may only commence some weeks or even months after the referendum.

The guidelines to be determined by the European Council and which are binding on the Council then negotiating the agreement are drawn up in accordance with Article 50(4) TEU without the participation of the withdrawing Member State. That the European Council, as the leading political institution, determines these guidelines appears virtually obligatory. However, Article 50(2) is silent with regard to the specific content of these guidelines. In light of the political explosiveness of a withdrawal, this is of course not surprising. Likewise, due to the variation in possible withdrawal scenarios, any "minimum content" of the guidelines could only be determined with difficulty and in the abstract. Regulation of the "significant withdrawal issues" cannot ultimately be withheld from the European Council from a normative perspective. Accordingly, the European Council is free to determine the nature and scope of these guidelines. All that is required is that it draws up guidelines, deals with the request to withdraw in accordance with them and in this way gives particular democratic legitimacy to the negotiations of the Council.

According to the general provisions of Article 15(4) TEU, the European Council decides on these guidelines by consensus, while according to Article 50(2), final sentence, the withdrawal agreement itself is to be decided on by the Council acting by a qualified majority. Consequently, it is possible that a Member State could prevent the conclusion of an agreement by preventing the adoption of guidelines, as the Council can only commence its negotiations on the basis of these guidelines. In view of the sunset clause, this would of course not block the withdrawal itself. But as a contractually agreed withdrawal is clearly preferable to an unregulated "sunset withdrawal", given the associated legal uncertainties, there is a certain level of risk here for the EU and the withdrawing Member State.

The details of the withdrawal are then set out in an agreement on the basis of these guidelines, with this agreement being negotiated by the Council with the Member State in accordance with the procedure in Article 218(3) TFEU. What emerges as a consequence is a bilateral agreement, which the other Member States do not formally participate in.²³ Article 50(2) TEU is silent regarding the precise content of the agreement, even though the agreement must account for the framework of future relations between this state and the Union. In view of the many possible withdrawal scenarios, the various legal forms of membership (Euro state, non-Euro state, other special rights) and the high political explosiveness of a withdrawal, this is admittedly understandable.²⁴ Abstract determination of the content of such a withdrawal agreement is only possible (if at all) in a very qualified manner. Even the accession agreement in Article 49(2) TEU does not contain specific details in terms of its content. In principle, the withdrawal agreement should attempt to arrange the withdrawal from the Union to be as smooth and legally certain as possible for both parties – the EU and the withdrawing Member State. In view of the

²³ J. Herbst (fn. 4), p. 1758.

²⁴ But tending to this view is C. Calliess, Id./M. Ruffert, EUV/AEUV, Art. 50 EUV, marginal no. 7; J.-P. Terhechte, Der Vertrag von Lissabon: Grundlegende Verfassungsurkunde der europäischen Rechtsgemeinschaft oder technischer Änderungsvertrag, EuR 2008, p. 143, 150 et seq.

multiplicity of existing interrelationships, that is clearly no easy task.²⁵ It may, if necessary, include transitional measures, such as are usual in the case of accession, and which are consequently not ruled out by the provisions of Article 50(3) TEU.²⁶ The aim must be to secure a high degree of legal certainty for all participants and consequently for the citizens of the EU and the withdrawing Member State, which reliance on existing association agreements with other states – such as Switzerland, Iceland, Liechtenstein, and Norway – would certainly offer. Accession to the EEA²⁷ would also be attractive, particularly from the perspective of the United Kingdom, but would require the cooperation of the other EEA contracting parties. The normative options for the drafting of the withdrawal agreement are virtually unlimited.²⁸

From a political point of view the EU is of course in something of a bind. On the one hand, particularly with the withdrawal of as significant a Member State as the United Kingdom, it has a major interest in keeping it as close as possible to the EU following withdrawal. This relates especially to maintaining the advantages of the single market for both sides. The future shape of the free movement of goods, persons, services and capital to and from the United Kingdom will likely represent one of the largest sections of the agreement to be negotiated. On the other hand, a withdrawal agreement that is too "generous" could function as a dangerous signal to other Member States potentially seeking to withdraw. If the United Kingdom were put in a position as a result of its withdrawal to, as it were, "cherry pick" its level of integration, it would only be a question of time before other Member States contemplated going the route of formal withdrawal. Sooner or later that would spell the end of the previous European concept of integration – moving to an "à la carte Europe" by the back door. Such a development would obviously not be in the interest of the EU. In order to prevent it, there is little else to do but insist on quite noticeable impairments in the agreement, in particular with regard to the future participation of the United Kingdom in the European single market.²⁹ But there would be economic losers on both sides of such an agreement – a "lose-lose situation" to save integration. A far from happy prospect.

The agreement negotiated in this format would subsequently be concluded by the Council (without the participation of the withdrawing Member State) by qualified majority on behalf of the Union, after obtaining the consent of the European Parliament,³⁰ with the qualified majority being determined in accordance with Article 238(3)(b) TFEU. This rules out an individual Member State preventing the conclusion of the detailed withdrawal agreement following what may be months or even years of negotiations. This would seem reasonable by virtue of the fact that the withdrawal would otherwise become effective simply as a result of the passage of time, but without any regulation, therefore bringing with it considerable legal uncertainty. This does not of course affect the theoretical possibility of a Member State preventing adoption of the necessary guidelines by the European Council by means of its veto.

²⁵ See for example the questions posed in *J. Herbst* (fn. 4), p. 1757.

²⁶ *R. Streinz*, Id., EUV/AEUV, Art. 50 EUV, marginal no. 8. See also *J. Herbst* (fn. 4), p. 1757.

²⁷ On the EEA, see *H. P. Graver*, Der Europäische Wirtschaftsraum (EWR), in: A. Hatje/P.-C. Müller-Graff (eds.), *Europäisches Organisations- und Verfassungsrecht* (EnzEuR Bd. 1), 1st edition 2014, para. 19.

²⁸ But as a bilateral agreement, the withdrawal agreement cannot contain any changes to the Union treaties. If such are required, this would necessitate a formal treaty revision procedure under Article 48 TEU. See also *C. Calliess*, Id./M. Ruffert, EUV/AEUV, Art. 50 EUV, marginal no. 7.

²⁹ To what extent the EU could even implement such "impairments" depends, however, on the Member State in question. Due to its size and its significance for the single market, The United Kingdom finds itself in a relatively good starting position, see also *R. Friel* (fn. 2), p. 427.

³⁰ For the European Parliament there is no provision that excludes from the vote the MEPs of the withdrawing Member State. It must therefore be assumed that they may participate in the vote. However, it is questionable whether this is appropriate. See also *R. Friel* (fn. 2), p. 426.

The withdrawal agreement, as an international treaty, requires ratification in the withdrawing Member State (but not in the other Member States). This is not in fact explicitly addressed in Article 50 TEU, but arises in any case under general provisions.

3. The right of re-entry (Article 50(5) TEU)

Article 50(5) TEU states that even withdrawal does not have to mean withdrawal forever. The Member State which has withdrawn is free to reapply for membership of the EU at any time. What Article 50(5) TEU also makes clear, however, is, that the former member cannot claim any special rights in this regard. It must go through the standard accession procedure under Article 49 TEU and, like other European states, does not have any special right of accession. Therefore it cannot demand that the renewed membership be organised in the same way as it was during the first membership – such as with regard to existing special rights.

4. The consequences of withdrawal

With the entry into force of the withdrawal agreement, or expiry of the period of time specified in Article 50(3) TEU and any extension thereto, the treaties no longer apply to the Member State, which has therefore withdrawn from the EU. This legal consequence is explicitly stated in Article 50(3) TEU, but only in a declaratory manner.³¹ The United Kingdom would as of then no longer be a member of the EU and would not be bound to the treaties or to any other (secondary) EU law. National law which was enacted to implement European directives would continue in force as "ordinary" national law.³² The British legislature would however – unlike before – be authorised to amend or repeal this now-national law in accordance with its own wishes. The British legislature would also be free to transpose existing European regulations into British law. This method might prove useful, particularly for a transitional period. But here too this would be British law, which as a result would no longer be required to be interpreted in accordance with EU law. To that extent there would be no obligation or right to make a reference to the CJEU for a preliminary ruling under Article 267 TFEU.³³ Whether and to what extent individual provisions of European law or single market rules would continue to apply in the withdrawing Member State depends on the specific content of the withdrawal agreement, which generally speaking will probably contain at least some provisions of this kind. This would only fail to be the case if withdrawal was to come into effect due to the passage of time. European rules would then have as little application in a former Member State as they do in a non-European state with no contractual relationship of any kind to the EU. That this is not a serious option for The United Kingdom, should be obvious.

³¹ See also *R. Streinz, Id.*, EUV/AEUV, Art. 50 EUV, marginal no. 9.

³² However, British citizens would no longer be able to derive rights in relation to other Member States from such law.

³³ This is not about a kind of "excessive" transposition, for which the CJEU considers itself competent (cf. *A. Thiele, Europäisches Prozessrecht*, para. 9, marginal no. 27). As a non-member, The United Kingdom would no longer be subject to any obligation to transpose whatsoever.

III. Legal and tax ramifications*

This section will cover the legal and tax issues which need to be considered.

1. Legal ramifications

Under legal aspects employment law as a subject matter based on the free movement of workers needs to be covered. Additionally financial supervisory law as a subject matter of freedom of movement, freedom of establishment, freedom of services and free movement of capital as well as a bases of the European passports has to be addressed. The same, praeter propter, holds true for corporate law, data protection, trade mark and pattern law and energy law.

a) Employment law / residency law

In the medium-to-long term, Brexit could also give rise to consequences for German companies in the area of employment and residency law. These are likely to include in particular impacts relating to a restriction or even elimination of free movement for workers. That might make it more difficult in future for a German company operating in The United Kingdom to gain access to skilled labor. Things will also be more difficult for companies when it comes to secondments and short-term foreign assignments in The United Kingdom.

Based on unanimous statements made by British politicians in the Brexit campaign, all EU citizens already exercising a profession in The United Kingdom at the time of its withdrawal from the EU are to enjoy grandfathering protection in the event of the free movement of workers being restricted or eliminated. However, considerable legal uncertainty exists for those EU citizens intending to exercise an activity in The United Kingdom in future. It may turn out that they will no longer enjoy the unrestricted free movement of workers and might have to meet the conditions applicable in The United Kingdom at the decisive point in time – which as things now stand are set to be tightened as at 1 April 2017.³⁴

As a result, German employers in future should carefully review whether their non-British candidates/applicants qualify for naturalization according to the respective residency provisions in force or expected to be in force in The United Kingdom. If this is not the case, employers concerned should prepare themselves by taking appropriate organizational measures to ensure that visas, residence permits and employment permit papers can be obtained within a short time for any non-British employees working in The United Kingdom whom they intend to hire.

The same considerations and precautions should be made by German companies in respect to their British employees working in Germany. Here, too, it is not yet foreseeable what impact the withdrawal of The United Kingdom from the EU will have on residency law.

Moreover, there is legal uncertainty in respect of the future practicability of cross-border transfers of business. After the exit of The United Kingdom from the EU, British rules on transfers of business might be repealed or – in a substantially unforeseeable way – revised, in which case on the one hand the

* "Parting is painful: Brexit and its tax and legal implications", Article published in "Der Betrieb"; DB dated 08.07.2016, no. 26-27, page 1526 - 1530, in German language (convenience translation of items V. and VI.).

³⁴ See <https://www.gov.uk/government/news/migration-advisory-committee-reviews-of-tier-2>.

process of cross-border transfers of business might be impeded and/or slowed and on the other it might become necessary to take account of hitherto unforeseeable consequences of such measures.

b) Financial services regulatory law

Loss of the status of Member State of the European Union and the possible non-participation in the EEA mean that companies having their seat in The United Kingdom will no longer be able to use the hitherto available “European passports”³⁵. “European passports” enable companies, on the basis of a qualified authorization in their home country, to operate in all Member States of the EEA subject to only a low level of residual supervision in the respective host country, whether through branches or by way of cross-border services. These provisions apply on the basis of the EU directives for insurance undertakings, investment services enterprises, management companies and credit institutions.

The end to the option of using the “European passports” will have the following consequences: companies having their principal establishment in the UK will no longer be able to operate via the “European passport”, and thus will have to either discontinue the activity (case 1), continue their activity as a branch of a third country (case 2) or use a subsidiary in a Member State holding the required authorization (case 3).

However, for investment firms³⁶ and those firms which provide collective investment management³⁷ European law offers “equivalence decisions”, which facilitate the access of third country providers to the EEA if their regulatory regimes are equivalent to the European regimes.

The same considerations apply to the product side for which “European passports” were also introduced. UCITS funds and AIFM funds, for example, or also insurance policies, may be marketed throughout the EEA solely on the basis of a home country prospectus and a home country authorization. The same thing applies to other securities whose prospectus could be designed on the basis of the Prospectus Directive implemented in the respective Member States. In addition to the treatment of “new products” after the exit from the EU, the question raised is how the exit will impact the admissibility of the distribution of “old products”, i.e. those issued during The United Kingdom’s membership of the EU.

c) Corporate law

In Germany, Brexit will not be without consequences for corporate law: for example, consequences for British companies in Germany are conceivable, but also for cross-border transformation deals and transnational legal forms.

English limited companies and other British corporate forms – such as limited liability partnerships (LLP) – having their administrative seat in Germany face considerable legal uncertainty. Based on the freedom of establishment laid down in Articles 49, 54 TFEU and the foundation theory applied by the ECJ, the national law provisions of EU-foreign corporations, e.g. relating to limitation of liability or on legal capacity, are also recognized by German courts. However, in absence of EU-influence German

³⁵ With regard to the concept, cf. *Haentjens/Gioia-Carabellese*, European banking and financial law, London/New York 2015 p. 99 et seq.; *Hanten*, ZBB 2000, p. 245.

³⁶ Art. 39, 41 MiFID II (freedom of establishment) and Art. 39 I MiFID II, Art. 46, 54 I MiFIR (freedom of services).

³⁷ Art. 37, 41 AIFMD (freedom of establishment) and Art. 37, 39, 40, 42 AIFMD (freedom of services).

courts typically determine the status of companies operating in Germany based on the so-called seat theory. If the administrative seat is in Germany, a company must satisfy the requirements of German law for it to, e.g., claim liability law privileges. A British company having its administrative seat in Germany might, post-Brexit, be classified by the German courts as a personally liable partnership (Offene Handelsgesellschaft, OHG), or a civil law partnership (Gesellschaft bürgerlichen Rechts, GbR). The shareholders would then have to assume personal liability for obligations of the company. It is still unclear to what extent a kind of grandfathering might be recognized for already existing British companies in Germany.

Furthermore, cross-border mergers pursuant to section 122a et seq. of the German Transformation Act (Umwandlungsgesetz – UmwG) involving British companies might become impossible since these are also premised on EU/EEA membership. Cross-border changes in company form having a reference to The United Kingdom would also be affected.

Legal forms such as the European company (SE) or the European Cooperative Society (SCE) are affected if they have their seat in The United Kingdom. In this case it will likely be necessary to move the seat or effect a change in legal form.

d) Data protection

A withdrawal of the United Kingdom from the EU will likewise lead to changes in the general conditions particularly relating to the transfer of personal data to the United Kingdom. That is because the United Kingdom, after its exit from the EU, will have to be qualified as a “third country” within the meaning of the EU General Data Protection Regulation (EU GDPR). That means that the transfer of data from the EU to the United Kingdom – also within a company group – in future will require justified grounds (ensuring a reasonable level of data protection). Pursuant to Article 44 ff. EU GDPR, this is based on an adequacy decision of the EU Commission as exists e.g. for Canada, Switzerland, New Zealand, Israel and for U.S. companies that are participating in the EU-US-Privacy Shield³⁸. It is currently not foreseeable whether such justification grounds will be established in future. For that reason, potentially affected companies should prepare themselves to base data transfers to the United Kingdom, at least temporarily, on other mechanisms such as binding corporate rules, EU standard data protection clauses or approved standard clauses or to move the relevant data processing operations to the EU.

e) Trade mark and patent law

For traditional “European patents” prescribing a uniform application and grant procedure before the European Patent Office (which is not an EU institution³⁹) for a bundle of national patents, no material changes are to be expected. However, the package adopted for a unitary EU patent and an EU patent jurisdiction (with a sub-division planned in London) adopted after considerable political wrangling in 2013 will be affected to a lasting extent by Brexit. This particularly holds true since the entry into force of the unitary EU patent is dependent on the introduction of EU patent courts but the EU Agreement

³⁸ http://ec.europa.eu/justice/data-protection/international-transfers/adequacy/index_en.htm.

³⁹ For details please be referred to: <http://www.epo.org/about-us/organisation.html> (status: 22.09.2016).

on a Unified Patent Court to date has not yet been ratified by the United Kingdom and it is hardly conceivable that this will still happen after the referendum.⁴⁰

Without any separate provisions on their conceivable continued application from the date of the concluded Brexit, Union trade-marks will no longer enjoy any protection on British territory. To avoid any potential gaps here, companies should consider at an early stage whether to apply for a national trade mark.⁴¹

f) Regulatory law

Given the pronounced level of integration of the regulated markets existing in some areas, it is not likely that the British market will soon decouple from the EU resulting in high market entry barriers. A complete disintegration, e.g. of the energy markets, is hard to imagine given the existing constructive dependencies, particularly in the area of electricity. Nonetheless, “special approaches” might very well lead to a decoupling of the British market in the medium to long term.

On leaving the EU, the United Kingdom will cease to be a member of the Internal Energy Market. However, the provisions regulating network operation (unbundling, network access, market access, etc.) adopted from the internal market directives (3rd EU Internal Market Package of 13 July 2009) initially will essentially not change fundamentally.

Directly applicable secondary law, such as the Natural Gas Access Regulation (EC) No 715/2009, the Access to Exchanges in Electricity Regulation (EC) No 714/2009 and the Regulation on wholesale energy market integrity and transparency (REMIT) No 1227/2011, would no longer be applicable as of the effective date of withdrawal.

The United Kingdom would moreover “leave” the Energy Community with immediate effect since the Treaty establishing the Energy Community of 25 October 2005 was ratified only by the EU.⁴² Essentially, the objective pursued with the Energy Community is to expand the rules of the Internal Energy Market to a certain extent also to non-EU countries (referred to as *acquis communautaire*). Given the fact that Norway and also Switzerland did not join the Energy Community, it is well likely that the United Kingdom will not rejoin the Energy Community.

In the exit negotiations, one particular subject of discussion is likely to be the United Kingdom’s role in the EEA. Irrespective of that, the United Kingdom, in addition to the rules of the World Trade Organization, is also bound i.a. by the Energy Charter and the Paris Agreement (post-Kyoto convention).⁴³

The Energy Charter Treaty no doubt gives companies a certain measure of security with regard to the investments they have already made and are planning. But this does not shield them from regulatory intervention. Although the United Kingdom moreover would no longer be required to participate in European energy trade, it would nonetheless still be bound by the obligation to cut its CO₂ emissions under the UNF_{CC}, and in particular by the post-Kyoto Protocol “Paris Agreement” of 12 December

⁴⁰ See also *W. Tilmann*, The Future of the UPC after Brexit, *in*: GRUR 2016, p. 753 – 755.

⁴¹ See also *S. Ahrens*, Mögliche Konsequenzen der Krise der Europäischen Union für die einheitlichen europäischen Schutzrechte des geistigen Eigentums am Beispiel des Brexit-Szenarios, *in*: GRUR Int. 2016, p. 548 - 551.

⁴² Background on the Energy Community cf. *T. Woltering*, Die europäische Außenpolitik und ihre Rechtsgrundlagen, Münster, Univ., Diss. 2010, p. 93.

⁴³ An overview on the relevant treatise in *T. Woltering*, pg. 79 et seq.

2015. In this context, the United Kingdom initially is not expected to fundamentally change its legal framework on avoiding CO2 emissions.

2. Tax ramifications

Under tax aspects income taxes with all its specifications, transfer prices, indirect taxes and foreign trade law have to be dealt with.

a) Income taxes

On termination of EU membership, the benefits in the relationship to the United Kingdom conferred by the Directives in the area of direct taxes (Parent-Subsidiary Directive, Interest and Royalties Directive and Merger Directive) will cease to apply. In addition, primary law no longer applies, as a consequence of which corresponding national rules by which tax benefits were extended to the EU/EEA territory are no longer applicable.

- (aa) Parent-Subsidiary Directive and dividend exemption (Schachtelprivileg) for trade tax no longer applicable

Dividends of German companies paid to a British parent company are currently subject to the prohibition on withholding tax pursuant to section 43b of the German Income Tax Act (Einkommensteuergesetz – EStG). Upon the end of EU membership, German subsidiaries of UK-based parent companies will have to rely on the DTC with the United Kingdom that provides only for a reduction of withholding tax to 5% (Article 10(2)(a) DTC the United Kingdom). This reduced level of protection may have adverse consequences also in the case of multi-tiered holding structures, since for British companies the personal entitlement to relief is reduced and any shareholders up in the chain are no longer able to claim their own entitlement to relief.⁴⁴

Conversely, dividends of British companies will continue to be subject to national (section 8b (1), (4), (5) German Corporation Tax Act (Körperschaftsteuergesetz – KStG)) and DTC dividend exemption rules (Article 23 (1)(a) DTC the United Kingdom), but here, too, the protection conferred by the Parent-Subsidiary Directive would cease to apply. For that reason, the more stringent activity requirements of the DTC (Article 23 (1)(c) DTC the United Kingdom) and of the German Trade Tax Act (Gewerbesteuer-gesetz – GewStG) (section 9 no. 7 sentence 1, sentence 4 ff. of the GewStG) would have to be met in order to claim exemption from German trade tax.⁴⁵

⁴⁴ *Herbst/Gebhardt*, DStR 2016, 1705 (1710).

⁴⁵ See *Linn*, IStR 2016, 557 (558).

(bb) Interest and Royalties Directive no longer applicable

In individual cases, the end to the Interest and Royalties Directive⁴⁶ is likely to bring disadvantages, for example if a British company is a common parent to the debtor and creditor company and the DTC here does not result in exemption from withholding tax for interest/royalties.⁴⁷

(cc) Merger Directive no longer applicable

Upon the end of the Britain's membership in the EU/EEA, numerous restructuring measures will no longer enjoy protection by the Merger Directive,⁴⁸ nor will it be possible any longer to rely on the tax-neutrality in accordance with the German Reorganisation Tax Act (Umwandlungssteuergesetz – UmwStG).⁴⁹ That means that, for example, a British corporation would no longer be able to contribute its German branch to a subsidiary on a tax-neutral basis. It may therefore make sense for operational reasons to perform any required restructuring measures prior to the effective date of the United Kingdom's EU exit. However, it has to be noted that the Brexit might constitute a violation of a lock-in period for certain restructurings.

(dd) CFC taxation

Upon the end of EU/EEA membership, there will be a risk that passive income of British companies will be picked up under German CFC-rules unless the low taxation threshold is significantly reduced by then. Whereas hitherto it has normally been possible to invoke the genuine economic activity exemption ("Cadbury-Schweppes exemption") within the meaning of section 8 (2) of the Foreign Transaction Tax Act (Außensteuergesetz – AStG), this protection will no longer apply when EU/EEA membership ends. As a result, e.g., interest income and most types of royalty income would become subject to CFC-taxation, even if the British subsidiary pursues other commercial activities.⁵⁰

(ee) Relocation of corporations

The relocation of a corporation to another EU/EEA country merely results in exit tax (Entstrickung) pursuant to section 12 (1) German Corporation Tax Act (German Corporation Tax Act (Körperschaftsteuergesetz – KStG) according to which assets for which the German taxation right is lost or restricted, are deemed sold at fair market value. In the case of a relocation of a corporation to a third country, however, the corporation is deemed to have been dissolved, and section 11 KStG is to be applied analogously with the consequence of all hidden reserves subject to taxation in German being taxed.

⁴⁶ Council Directive 2003/49/EC.

⁴⁷ See *Linn* (fn. 45) p. 559.

⁴⁸ Council Directive 2009/133/EC.

⁴⁹ See *Herbst/Gebhardt* (fn. 41) p. 1709.

⁵⁰ *Linn* (fn. 45) p. 560.

(ff) Drop in exchange rate of British pound

As expected, the Brexit vote has resulted in a significant drop in the exchange rate of the British pound to the euro. Should this drop in the exchange rate continue, that will raise the question of whether this will have tax consequences for corresponding foreign currency liabilities and receivables. Liabilities in pound sterling in this case would see a fall in value and thus result in unrealized profits which are not taxed.

In the case of receivables in pound sterling, the question that would be raised is whether for tax purposes a profit-reducing write-down to fair value (Teilwertabschreibung) is possible. This would require the probable existence of a permanent impairment. Whether that exists will depend on the circumstances of the individual case and particularly on the residual term of the respective receivable. For example, where there is a residual term of ten years it may be assumed that the fluctuation in the exchange rate will rebalance, with the result that no probable permanent impairment exists; however, it appears doubtful whether this can be applied to the hitherto unprecedented case of an exit from the EU. In the case of receivables with shorter residual terms, the conditions for a write-down to fair value (Teilwertabschreibung) can be met, with the result that, subject to section 8b (3) sentence 4 ff. KStG the impairment is tax deductible.

(gg) Individuals

Individuals may also be affected in many different ways. One of the numerous conceivable scenarios is the fictitious unlimited tax liability (fiktive unbeschränkte Steuerpflicht) pursuant to section 1a EStG, the deduction for donations pursuant to section 10b (1) EStG, the exit tax pursuant to section 6 AStG (in future: immediately due instead of interest-free deferral), as well as the preferential treatment given to EU/EEA business assets in German inheritance tax.

b) Transfer prices

The restructuring measures to be expected in the wake of Brexit also have to be assessed in terms of transfer prices.⁵¹ On the basis of the OECD Transfer Pricing Guidelines,⁵² the realistically available options of the group entities concerned are to be examined in a first step. In a second step it has to be clarified whether, among third entities at arm's length, compensation would have been paid, on the merits and on quantum, for the loss of activities previously performed. Assuming that customs duties were re-introduced: for companies with production activities in the United Kingdom having their main sales territory in continental Europe, a shift in production to continental Europe would be inevitable in the context of price competition and otherwise globally identical cost structures. Despite the lack of alternatives to the shift in production, the second analysis step does not become obsolete. It would be conceivable that the European group companies would enter into competition amongst themselves and would be prepared to make a payment to the British corporation for the transfer of production.

In the case of permanent establishments it has to be examined whether the transfer of economic assets to Germany results in those assets becoming subject to taxation (Verstrickungstatbestand) within

⁵¹ See also *Busch*, *Der Betrieb* 2015, p. 1548.

⁵² See para. 9.59 ff. of the Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations, OECD, 2010.

the meaning of section 4 (1) sentence 8 half-sentence 2 EStG or whether changes in business procedures lead to an attribution of assets resulting in a dealing within the meaning of section 16 (1) no. 1 of the German Regulation on Profit Allocation to Permanent Establishments (Betriebsstättengewinnaufteilungsverordnung – BsGaV).

The EU Arbitration Convention⁵³, which is established as a multilateral treaty, should also remain in force after a Brexit. Moreover, the DTC the United Kingdom, in its version as amended on 30 December 2010, provides in Article 26(5) for an independent arbitration clause, with the result that complete abolishment of double taxation in UK-German transfer pricing matters continues to be safeguarded.

c) Indirect taxes / foreign trade law

Brexit will also have a noticeable impact on the movement of goods between Germany and the United Kingdom in several respects.⁵⁴ How exactly the specific changes will play out, however, will depend to a decisive extent on the intensity of the later relations between the United Kingdom and the EU.⁵⁵ The United Kingdom might e.g. become an EEA member, an EFTA member (European Free Trade Association) or a party to a preferential agreement.⁵⁶ A relationship without preferences/benefits is also conceivable.⁵⁷

(aa) VAT

VAT treatment of cross-border flows of goods between the EU and the United Kingdom will change. The common VAT regime, as the basis in Union law hitherto in force, will no longer be applicable to the United Kingdom. What are now tax-exempt intra-Community supplies from and intra-Community acquisitions in the EU will then turn into imports and exports.⁵⁸ These changes in VAT assessment will require adjustments in the companies' accounting systems and in the reporting of turnovers in VAT declarations.⁵⁹ Any changes in registration requirements in the United Kingdom should also be examined.

(bb) Customs duties

With its leave the EU, the United Kingdom will also presumably withdraw from the Customs Union. For the import of goods from the United Kingdom, therefore, customs law – as with all third countries – will have to be applied. What have hitherto been transfers within the Internal Market will turn into imports and exports with relevance for customs regulations. That might result in the levying of customs duties on (certain) goods. The extent to which that will happen, however, will depend on the future

⁵³ Convention on the elimination of double taxation in connection with the adjustment of profits of associated enterprises (90/436/EEC).

⁵⁴ Schäfer, Brexit und die Wiederkehr des Zolls, Foreign Trade 3/2016, 38-40 (38).

⁵⁵ Mayer/Manz, Der Brexit und seine Folgen auf den Rechtsverkehr zwischen der EU und dem Vereinigten Königreich, BB 2016, 1731-1740 (1731).

⁵⁶ Bode et al., Brexit – Tax it?, BB 2016, 1367-1372 (1367 et seq.).

⁵⁷ Mielken, Großbritannien nach dem Referendum, AW-Prax 2016, 267-279 (268 et seq.).

⁵⁸ Masuch, Aus aller Welt- aktuelle Entwicklungen zu VAT/GTS – 2/2016, MwStR, 2016, 646-654 (652).

⁵⁹ Bode et al. (fn. 56) p. 1370 et seq.

relationship with the EU in terms of trade policy.⁶⁰ At any event, duties on imports in the EU will make it much more expensive to acquire or supply goods from the United Kingdom. As a mirror image to this, the export of goods to the United Kingdom is also expected to be subjected to duties (in the United Kingdom). In the calculation of origin it has to be noted that British goods will presumably no longer qualify as EU goods. Calculations of customs value will also have to be reviewed since i.a. add-back criteria will then also apply to the United Kingdom as a third country (e.g. licenses from the United Kingdom for import goods)⁶¹.

(cc) Excise taxes

The cross-border transport of goods subject to excise taxes will also no longer be possible on the basis of the common excise tax regime under Union law. It will no longer be possible for the IT process EMCS to apply to the entire transport from and to the United Kingdom. Instead, the provisions of the import and export process under customs law in conjunction with excise tax criteria will have to be applied.

(dd) Foreign trade law

In the area of foreign trade law, supplies to the United Kingdom presumably will no longer be qualified as transfers but instead as exports. It is true that past transfers in some cases were already relevant for export controls, but the expenditure with regard to the possible authorization requirements will rise as a result of their qualification as exports.

⁶⁰ *Mielken* (fn. 57) p. 268 et seq.

⁶¹ *Schäfer* (fn. 54) p. 39 et seq.