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client alert

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BREXIT: WHAT HAPPENS NEXT?

On Thursday 23 June 2016, the United Kingdom voted to leave the European Union.

WHAT HAPPENS NEXT?

The first step is for the UK government to decide whether or not, and if so when, to issue a notice to withdraw under Article 50 of the Treaty on European Union.

Before the Referendum the UK Government stated that, in the event of a vote to leave the EU, the UK would serve its notice to withdraw under Article 50, which triggers a two-year period of negotiation of a withdrawal agreement. However, there was no indication of when the UK would serve such notice and even the “Leave” camp was divided about whether or not it would be appropriate to serve the notice immediately.

The immediate result is therefore a period of uncertainty while the Government decides how to deal with this. This will be coupled with uncertainty about the future of the Prime Minister and the Government itself.

In the meantime, from a legal point of view, the UK remains a part of the EU, EU citizens have the same rights in the UK as before and the "four freedoms" (of goods, persons, services and capital) will be preserved, for the time being.

WHAT IS THE SHAPE OF THINGS TO COME?

The next step would be for the UK to decide on what form of relationship it will try to negotiate with the EU for the future. This will not be easy and the EU countries will of course have their own view.

The Referendum was conducted on a binary "remain or leave" decision and the "leave" campaign did not put forward a definitive alternative proposal to membership of the EU.

The UK could take any one of five models for its future relationships with the EU and the rest of the world:

- **the Norwegian option** - the UK is a member of the EFTA and the EEA
- **the Swiss option** - the UK is a member of the EFTA and negotiates specific bilateral arrangements with the EU, equating to the EEA in some respects
- **the Turkish option** - the UK is a member of the EU customs union, but has no other formal links

- **the South Korean/Canadian option** - the UK negotiates a comprehensive free trade agreement with the EU, similar to those recently concluded with South Korea and with Canada

- **the WTO option** - the UK relies on the World Trade Organisation obligations for its trade with all other countries

Prime Minister David Cameron indicated before the Referendum that neither the Norwegian nor Swiss models were acceptable because they would require the UK to accept EU regulation without having any input in the formation of that regulation.

The Turkish option (customs union) is not much more attractive because although the UK would continue to be able to export goods to the EU without restriction, it would have no contribution to the making of regulations regarding those goods, and would have to negotiate separately in relation to services.

The most likely option is thought to be a free trade agreement similar to those recently concluded with South Korea and Canada. These are notoriously slow to be concluded (the Canadian negotiations took over five years) and in the meantime the UK would have to rely on the WTO arrangements as its only fall-back if, after having served its Article 50 notice, the two year withdrawal period expires before alternative agreements have been reached.

WHAT TO DO IN THE MEANTIME?

There is a great deal of uncertainty about the future of the UK in light of the Brexit vote. But there are a number of areas in which non-UK parties active in the UK can take action to protect themselves.

Financial Services

For at least the next two years (and almost certainly longer), whilst the UK remains within the EU, financial institutions permitted by the UK Financial Conduct Authority to provide regulated products and services in the UK can obtain a "passport" enabling them to provide financial products or services, set up a base or run permitted activities in another country in the EEA.

Firms authorised in the UK may wish to "passport" into other EEA jurisdictions in good time before the departure of the UK from the EU.

Relocating UK Businesses

Companies based in other EU jurisdictions with UK subsidiaries should be aware that although there is no statutory regime for merging two English incorporated companies, the EU Directive on Cross-Border Mergers of Limited Liability Companies will still apply to English companies and they can be merged into other EU affiliates or parent companies, for at least the next two years.

Tax

From the tax perspective, although the UK's departure from the EU means that the UK is no longer bound to ensure that UK tax legislation complies with EU Treaty freedoms, it is unlikely that the Government will wish to reverse or amend previous changes made to comply with EU law, or introduce new rules that do not comply. Compliance with such freedoms has only served to increase the attractiveness of the UK tax regime to international business, and it is clearly not in the Government's interest to risk harming this.

However, one area where multi-national groups may need to take action relates to withholding taxes on dividends, interest payments or royalties flowing between the UK and EU member states.

EU-based rules such as the Parent-Subsidiary and Interest and Royalties Directives will cease to apply to the UK, which could make the UK a less attractive holding company location for European groups.

The UK's network of double tax treaties should, in many cases, make up for this to a large extent by providing an exemption from such withholding taxes, but there may be exceptions and a detailed analysis would need to be conducted for those groups where UK entities receive payments of this nature from EU-based group companies, since the tax treaty may not always fully remove the tax charge (and, in any case, the conditions for entitlement to exemption under a tax treaty will typically be more stringent than in the case of the aforementioned EU regimes). An additional cost may therefore result for some businesses.

On a separate note, a potential area of concern for multi-national groups with an internationally mobile workforce is the question of social security contributions: currently EU resident workers employed to work in another EU member state are only required to pay social security contributions in one member state, avoiding potential double contributions. Brexit means these rules will cease to apply to the UK, potentially causing an additional cost for such businesses unless a similar arrangement can be reached with the EU.

Businesses which may be affected by any of the above are advised to review their structure, and their operations in the UK, in order to determine to what extent these points may be relevant. Our London office will be pleased to assist in conducting any such review.

The use of English Law in Commercial Contracts

English law has been commonly used for centuries in cross border commercial contracts that have no connection with the UK. Non-UK parties can take comfort from the fact that Brexit will not detract from the reasons that English law is so frequently the preferred choice for international contracts: stability, flexibility, predictability of outcome, commerciality and access to the English courts.

The choice of English law to govern international contracts will remain valid even after the full departure of the UK from the EU, and the construction of contracts governed by English law will not be affected at all by the change. Jurisdiction clauses and the enforcement of judgements might be affected in the future if the UK were to remove the Brussels I Regulation on jurisdiction and the enforcement of judgements in civil and commercial matters, but parties can be assured that such a change would be made known well in advance of coming into effect.

For further information, please get in touch with your usual Gide contact.

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