Navigating Brexit

Debevoise & Plimpton

BABC | BRITISH–AMERICAN BUSINESS COUNCIL

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Introduction

On June 23rd 2016 the UK voted to leave the European Union (EU). The vote is not legally binding but the UK Government has made it clear it intends to deliver on Brexit. For the UK to officially leave the EU, the Government must trigger Article 50 of the Lisbon Treaty. Once this is done there will be a two year negotiating period, during which time the UK will remain a full member of the EU. As the UK begins this new chapter the UK-US relationship will be more important than ever as a source of strength, stability and opportunity. At the British-American Business Council (BABC) we are committed to helping our members navigate this period of change. This briefing is an introduction to some of the issues business are likely to face.

One factor of immediate relevance to business has been the market re-evaluation of the value of sterling, the British currency, against other major trading currencies. At the end of August the pound appeared to be settling at $1.32, a 10% decline. The main effect of the devaluation has been to impact cross border transactions and the modelling for future business activity including capex investment. Members in the UK who export can take immediate advantage of a cheaper invoice price for the future contact prices of goods and services they provide, but also will have to consider their own input costs, and their dependency on imports as part of a necessary currency management review.

The following content was provided by lawyers at Debevoise & Plimpton LLP.

Workforce

There are many EU nationals working in the UK and UK nationals working across the EU. What worries might you have when thinking about your workforce?

Do you have non-UK EU nationals working for you in the UK? Do you have UK nationals working abroad in other EU countries?
There is a risk that EU nationals may no longer be able to work indefinitely in the UK. The government has not given a definitive guarantee about the status of EU nationals currently living in the UK, on the basis that such a guarantee cannot be given in the absence of a similar agreement from other EU members about British nationals living on the continent. Whilst it appears that EU nationals who have lived in the UK for at least 5 years, and therefore have the right of permanent residence, will be eligible to remain in the UK after Brexit, the position relating to others is less clear.

Practical steps to take:
Assess the risk of changes to your workforce: Whilst it should by no means be assumed that those employees will be required to leave the UK or obtain permission to remain, businesses with key personnel or large numbers of (non-UK) EU nationals (or British nationals if employed in Europe) may wish to assess the impact should they no longer have the automatic right to remain in the UK.

Contracts

Rule of law continues to apply but are there detailed considerations that you will need to bear in mind?

Do you have contracts that may be affected by Brexit?
If significant economic uncertainties follow, parties may wish to claim a right to terminate existing contracts or that contracts have come to an end because of force majeure.

Practical steps to take:
Review key contracts: take advice as to whether Brexit or the economic conditions that accompany Brexit could result in breaches of covenants and/or allow you or counterparties the right to terminate or to claim an instance of force majeure. If there are doubts or uncertainties, immediate steps should be taken to clarify the position.

Consider renegotiating existing contracts: in light of fluctuations in the value of currencies and other uncertainties, it may be a good time to renegotiate existing contracts and/or to enter into contractual relationships on revised terms and other opportunities; it may be worth considering whether contracts ought to be renegotiated.

Data

Deploying data across borders is key business tool. What will change and what will not change as a result of the Brexit vote?

Do you transfer data into or out of the EU through the UK?
If the UK diverges its data protection laws from the EU rules (the new General Data Protection Regulation), it will become more difficult to transfer data between the UK and EU countries. This is particularly significant for large multinational companies with branches within the EU.

Practical steps to take:
Assess risk: businesses should take steps to assess the way they conduct internal or external transfers of data, including the way in which data is transferred electronically and online. Businesses should consider whether voluntary compliance with the new rules might be prudent.

Tax

Fiscal sovereignty resided in the UK before the referendum. So what other implications are arising in the tax field?

Do you have group arrangements in place within the EU for intra-group dividends, interest or royalties flowing to or from UK companies? Do you need to make any other arrangements in relation to tax?
Currently there are certain EU directives that ensure that intra-group dividend, interest and royalty payments may move within the EU free of any associated withholding taxes. Following Brexit, if the UK does not negotiate a position with regard to these directives, the UK will have to resort to the default position which is stated in the relevant double tax treaty. A double tax treaty may reduce the withholding tax rate in some cases, but it is not always eliminated. Treaties sometimes allow a tax authority to impose full withholding tax and require recovery of any reduction in rate only after a demonstration of entitlement to benefits under the applicable treaty.

It is unlikely that there will be dramatic changes to the VAT system, though the UK will be free to determine how it charges VAT post-Brexit. While derogating from the EU VAT scheme may provide flexibilities, businesses have grown comfortable with the existing system which seems to work well. Businesses may need extra working capital to address cash flow VAT issues after Brexit.

Practical steps to take:

- Conduct a tax audit: You should conduct an internal audit of your business' tax arrangements, particularly if you work within a group structure.
- Assess and plan for additional cash-flow and working capital:
- There may be cash flow issues if a double tax treaty structure is employed so these possibilities should be assessed and planned for as appropriate
- Those making or receiving EU supplies may see changes to their administrative costs and cash flows.
- Consider potential structural changes: You should consider whether administrative or structural changes ought to be implemented in order to manage the different VAT consequences of making/ recovering supplies to/from the EU from the UK and vice versa. For example, depending on the outcome of negotiations.

What is the likely impact of Brexit on the UK's participation in BEPS and other international tax co-operation regimes?

- Post-Brexit, the UK will still be a member of the OECD and will therefore still be held to its commitment to the Base Erosion and Profit Shifting (BEPS) Project and the Common Reporting Standard (the new global standard for the automatic exchange of certain financial account information between tax authorities). The UK is an enthusiastic supporter of the BEPS Project and is expected to continue its leading role in support for this and other international cooperation regimes.
- Departing from the EU will give the UK more freedom over the method and pace of its implementation of the BEPS project. The EU has proposed its own anti-avoidance directive which seeks to implement many of the BEPS proposals as well as others. Post-Brexit, the UK will not be obliged to implement this EU directive, but since it will still be subject to the international regimes that influenced this new legislation, it is likely that the UK will probably adopt a position that is in line with the EU approach.

Mergers & Acquisitions

M&A Activity is a primary vehicle for investment flows, commercial activity and business opportunity. How will Brexit affect the M&A trajectory?

Are you considering mergers and acquisitions or deals within the next year?
The result of the referendum EU has so far had a dampening effect on M&A transaction volume. However, many businesses may stand to benefit from current market conditions: the weak pound makes certain targets appealing to offshore buyers. In addition, if organisations decide to restructure as a result of Brexit, a range of assets could become available to buyers.

Practical steps to take:
Review your future deal pipeline: Do Single Market access issues make certain potential targets or jurisdictions more or less attractive? Does your investment strategy need to be adjusted or adapted? Engage with advisors early as to appropriate deal structures.

Model the risk: For deals that may close following the UK's exit from the EU, consider the effects of the different possible models of the new UK/EU relationship on the business being acquired. Have risks been accounted for in the purchase price, transaction documents and deal structure?

Consider whether merger clearances are required: EU merger regulations, as they apply to parties active in the EEA, are not anticipated to change, however parties may wish to mitigate this risk by running deals to timelines that do not include a "post-Brexit" period.

Deal with due diligence: Due diligence will be crucial for understanding whether Brexit-related risks attach to any target. For sellers, in particular, engaging early with advisors will be key to managing data protection issues. This is further complicated by the fact that the EU Data Protection Directive is being repealed and replaced by a new General Data Protection Regulation which comes into force in May 2018.

Update contractual clauses: Consider whether contractual clauses included material adverse change clauses should be redrafted to account for possible negative outcomes of Brexit negotiations, and whether dispute resolution clauses will be fit for purpose following Brexit.

Purchase price hedging: In light of current volatility in currency prices, choose the currency of your deal carefully. Would hedging be beneficial to avoid suffering from cost increases where the purchase price is in a different currency?

Debevoise & Plimpton LLP
65 Gresham Street,
London
EC2V 7NQ
T: +44 20 7786 9000
E: infoUK@debevoise.com
W: www.debevoise.com

British-American Business Council (BABC)
12 Phillimore Walk, West Wing, 2nd Floor
London
W8 7RX
T: +44 (0)20 7290 9888
E: policy@babinc.org
W: www.babc.org