



Article 50 is triggered – the countdown begins

With the triggering of Article 50, Prime Minister Theresa May has begun the formal process of withdrawing the UK from the European Union. As the clock begins to tick on the two-year negotiation period, Baker McKenzie answers common client queries and addresses the pragmatic considerations for the business community.

Q **What's the legal position if the UK doesn't manage a deal within two years? What's the WTO deal?**

A If a deal for future trade is not reached between the UK and EU-27 within two years and the two-year period is not extended, then the UK will trade with the EU-27 on the same terms as other World Trade Organisation (WTO) members.

The UK will have no preferential access for its goods and services to and from the EU-27 market.

Goods: A customs border will be reintroduced between the UK and EU-27 and goods will be subject to tariffs and customs controls. WTO Members make individual commitments on tariffs i.e. rate of customs duty that will be applied when a product is imported into a country. Upon leaving the EU, the UK will need to negotiate its own Schedule, which is not a straightforward process.

Services: The default position for access for services from the UK into the EU-27 and vice versa will be set out in the WTO's General Agreement on Trade in Services. The UK will need to agree or negotiate its own Schedule of Specific Commitments, which will set out the limitations on the provision of services from other WTO members into the UK.

Q When can the UK start to negotiate bi-lateral trade agreements with other countries?

A Up to and until the UK formally leaves the EU at the end of the Brexit process, it will remain a Member State and must adhere to the rules of being part of the Single Market and Customs Union.

This means:

- Only once the UK has left the EU and the Customs Union will it be free to conclude its own trade agreements with third countries.
- Up until this time, the UK may have, and in fact has already begun, informal discussions with a number of third countries.
- The Department for International Trade (DIT) has said that their order of priority with third countries is roughly as follows:
 - (i) Australia, New Zealand, US (DIT is beginning to put in place the foundations for new trade agreements with these countries)
 - (ii) Gulf Cooperation Council and India (the DIT is beginning to look at strengthening the trade relationship with these countries and conducting a trade audit re. India);
 - (iii) Norway and Turkey (a dialogue has started here, but UK relations with these countries will be complex and will depend on the UK's relationship with the EU27).

In terms of what the UK can 'discuss' or 'negotiate' with third countries before it leaves the EU, this will likely be limited by the fact that these third countries will want to see what form of deal the EU27 and the UK conclude before finalising any negotiations.

It will therefore likely be a question of sequencing, of the UK leaving the EU, then concluding a trade agreement with the EU27, then concluding trade agreements with third countries.

Several factors may slow down the UK's negotiations with third countries, including:

- Some third countries may want to prioritise an agreement with the EU27 over an agreement with the UK (e.g. Australia)
- Some third countries may want to wait and see what agreement the UK and EU27 reach before negotiating an agreement with the UK; and
- There is a practical limit in the number of trade negotiators the UK has, which will limit the number of trade deals it can discuss/ negotiate at any one time.

Q What benefits are there to UK business from a US trade deal? Is it likely to happen?

A The US is the UK's largest single net export market globally. A US/UK FTA will likely further increase the ability of UK business to sell into the US through the reduction of both tariff and non-tariff barriers.

In light of May's recent trip to the US, the UK and US are likely to pursue negotiations of some form, concurrent to those that the UK has with the EU. It is possible the UK uses such discussions, or the threat thereof, as leverage to help it secure preferential access to the EU single market.

The UK Government will also be assessing potential opportunities for an early trade deal with other countries, given both the political need to show that Brexit is 'working' and the well publicised shortage of trade negotiation expertise in the government. It is likely that the UK will prioritise discussions with countries such as the US, New Zealand, Canada, and Australia – each of which has expressed a concrete desire to negotiate and may represent an 'easy win'.

Irrespective of whether the UK can negotiate deals while still in the EU, the UK and the EU have a two year window in which to negotiate their new relationship. This is widely acknowledged as a very ambitious timeframe, given the length of similar negotiations such as CETA and TTIP. Concluding two parallel trade deals of such magnitude will be an added challenge for the UK.

Q What's the latest thinking on passporting in the financial services sector?

A The debate around access to the Single Market has shifted along with the political sands. In the initial period after the referendum, the focus was on the UK maintaining access to the Single Market through a passporting regime. As it became clear that the UK was actually going to leave the EU and that this would likely take the form of a so-called hard Brexit, most people gave up hope of maintaining a passport and the focus moved to equivalence: the concept that since the UK already has laws on its statute books and its regulatory standards are the same (or even higher) than those in continental Europe, we should be able to continue to access the EU/EEA market on the basis of reciprocity.

The difficulty with equivalence is that it does not provide a complete answer to the problem of guaranteeing access. The EU Single Market Directives do not have a uniform equivalence regime and certain Directives do not provide for any special access for equivalent third countries. The equivalence decision making process is political and can take time as well. Therefore, equivalence is no longer regarded as the panacea it once was.

Given that there is little confidence that there will be any special deal on offer post-Brexit – and the fact that passporting and equivalence are not likely to be available – most parties interested in accessing the Single Market are also considering alternatives. Examples include setting up booking entities in Europe, which front trades with European clients which are then back out to the UK entity under a back-to-back trade. There are also various exemptions or local licensing regimes that can still be used particularly for wholesale business into Europe, without the need to obtain a passport.

Q Will the UK stop adopting EU law as of the Article 50 date or only when we have actually left?

A The UK will continue to be bound by EU law until it actually leaves the EU.

Q Is the UK likely to review its tax regime if the Brexit discussions falter?

A No matter the terms of the UK's exit, it will undoubtedly look at its tax regime. Some would view this as an opportunity to lower the UK corporation tax rate still further (the rate is 19% from 1 April, falling to 17% from 2020). A less regulated, lower tax environment has been suggested as a way of allowing the UK to retain its tax competitiveness. A rate of 15% or even lower has been mooted, but the Chancellor has so far made no indication that he will pursue this option.

The UK's priorities would depend heavily on the type of exit agreement that is reached. We would almost certainly retain a VAT system, possibly in the form of a sales or goods and services tax. But the UK might have freedom to develop its own rules, for example, on which services are zero-rated or exempt, in a bid to support certain sectors, such as financial services.

A major issue is customs duties and what trade agreements could be reached with other countries, both inside and outside the EU. In a worst case scenario (although, again, some view this as an opportunity), we would be left with the WTO tariff system.

The current big question in the tax world, however, is what the US is going to do. If it goes ahead with the border-adjusted tax plan, this would completely turn on its head the principles underlying tax law and practice and could prompt radical overhaul not just in the US but in other countries, including the UK, so we are awaiting further announcements on this with great interest.

Q Is the EU within its rights to charge the UK an exit bill?

A This is a point of contention and the legal position is open to interpretation. This will undoubtedly be a key point of negotiation.

Q What should the UK be aiming to achieve in an EU trade deal?

A Ensuring that all new barriers to trade on goods and services are as low and efficient as possible:

a) All goods and services which are supplied today as part of Single Market under a "presumption of conformity" should continue to have access to this rule after we leave, and do not revert to "presumption of non-conformity"

b) All new customs and VAT procedures can be dealt with on the basis of self-certification by traders, and operate under some form of centralised clearance;

Ensuring no persons are repatriated, and UK persons can still use EU-27 immigration principles without having to flip back to immigration rules being dealt with at the Member State level.

Q How well placed is the UK government for trade deal negotiations? Who would lead those discussions?

A The UK Government's Department for International Trade (DIT), headed by Liam Fox, would lead discussions with third countries.

DIT is responsible for:

- developing, coordinating and delivering a new trade and investment policy to promote UK business across the globe;
- developing and negotiating free trade agreements with non-EU countries;
- negotiating plurilateral trade deals (focused on specific sectors or products); and
- providing support for exports and facilitating inward and outward investment.

The DIT is currently recruiting and is advertising posts for chief trade negotiators to help secure trade agreements with third countries. The department was created last July with approximately 50 trade negotiators, and is now up to 200, in preparation for negotiating trade agreements with third countries.

However, there is a practical limit in the number of trade negotiators the UK has, which will restrict the number of trade deals it can discuss at any one time.

Furthermore, the negotiations will be extremely complex, given the ambitions of the UK Government. Having ceded responsibility for trade policy to the EU for such a long time, the UK civil service lacks the capacity to strike major trade deals quickly, and has a great deal of technical and legal information to understand with before it can begin negotiations.

Q If Scotland were to vote for independence and remain in the EU, how would this affect the Brexit negotiations?

A There would be some form of border (whether soft or hard) between the UK and Scotland on goods and persons, and the countries would have to unwind freedom to provide services. Scotland would also have to accept € if it joins the EU, and so that would require significant upheaval in payments systems.

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