Brexit – English Limited Companies at Risk?

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Following the vote on Brexit, companies in the English legal form of Limited Company located in other EU Member States are faced with the question of what impact the withdrawal of Great Britain from the European Union will have for them.

Limiteds under English law have been a model for success in the past and have often been chosen as alternatives to the Gesellschaft mit beschränkter Haftung – GmbH – (German private limited company) and other limited liability companies in other EU countries. In the Centros judgement, the European Court of Justice (ECJ) clarified that the immigration of companies from other Member States should not be restricted. In the subsequent period, numerous limited companies were founded under English law, but their administration and business activities were not carried out from England, but from other EU member states. In Germany it has been possible to register branches of such limited companies in the commercial register.

How will this change?

Following the withdrawal of the UK from the EU and the EEA, English companies can no longer rely on the right of establishment granted by the European treaties.

As a result, according to the “modified real seat theory” represented by the German Federal Court of Justice (BGH), limited companies resident in Germany would no longer be regarded as corporations but as “foreign pseudo-companies”. These are generally subject to the rules for partnerships (BGHZ 151, 204).

This gives rise to serious changes for the liability of the shareholders of such limited companies. While the Limited was previously liable only with the assets of the company, their liability would now – as with a German partnership – be subject to Sec.128 et seq. HGB , with the result that the shareholders are personally liable for the comoany’s debts without limitation.

With regard to taxation, there are no such extensive changes: So far, Limited companies were taxed in Germany like a German GmbH. After Brexit, it would probably be taxed liketo a German partnership.

What to do?

The shareholders of limited companies based in Germany and other EU countries will have to watch the situation carefully. In order to avoid unwanted liability consequences, it may be necessary in the future to change the legal form. A simple transformation of the legal form from a limited company to a GmbH, while maintaining the identity of the company, faces some practical difficulties, but is likely to be admissible until the of the UK from the EU takes effect. On the other hand, the obvious alternative of founding a new company in Germany and liquidating the Limited will, in many cases, lead to undesirable tax consequences because hidden reserves would have to be uncovered. The third, in many cases preferable, option is the merger of Limited with a German legal entity, such as a GmbH. A merger can be implemented without further ado until the withdrawal of the UK from the EU takes effect in accordance with the Companies Cross Border Merger Regulations (CCBMR 2007) or Sec. 122a et seq. UmwG. After a Brexit the regulations of Sec.122a et seq. UmwG will be inapplicable. However, there is reason to believe that even after a Brexit a merger would be considered permissible under the general rules.

Will there be a right of continuence for Limiteds with registered branch in Germany?

The assumption that there will be a right of continuance for UK Limiteds that are already existing in Germany Limiteds, is so far only a hypothesis. The granting of a right of continuance requires a corresponding political will. As far as political decision-making is concerned, we expect that the principle of reciprocity will play a significant role. However, in the current state of affairs, it is unlikely that Britain will retain the right of establishment for all EU citizens and businesses in the UK, as its abolition was one of the main arguments of Brexit advocates. In this respect, it would also be unlikely that the remaining EU member states will be willing to agree to advantageous arrangements for the UK. However, where the freedom of establishment no longer applies, there is no legal basis for exempting limited companies established under English law, but operating exclusively from Germany, from the requirement to use one of the legal forms available under German company law.

Whether the German jurisdiction will recognize the limitation of liability of limited companies already registered with a branch in the German Commercial Register is also open.