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BUSE HEBERER FROMM

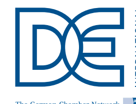
How BREXIT will impact business relationships with the UK in manifold ways

The UK recently notified the European Union of its intention to leave. A two years' period has been triggered by this notification during which the UK and the EU will most possibly try to mitigate the impact that this decision may have on business relationships and individuals. However, as per today, any outcome is possible, from the "hard Brexit" to solutions which would bring the UK's status vis-à-vis the EU close to that of Norway, for example.

Right after the results of the referendum held last year became known, many comments referred to the consequences of the Brexit for UK Private Limited Companies that had been used in the past by quite a few start-ups in Germany to circumvent the relatively onerous rules for setting up a German Private Limited Liability Company ("GmbH"). Many of these "Limited" had no other reason than to serve as a vehicle for start-ups in Germany; typically, they had no physical company seat in the UK, just a letterbox. According to several rulings by the European Court of Justice, these "Limited" have to be considered as validly established companies with the privilege of limited liability for its owner in applying the principle of freedom of movement of individuals and capital under Union law. Once the UK leaves the European Union, these "Limited" will, however, not be considered as legal entities by German law anymore. In consequence, the shareholders and agents doing business in the name of such a "vehicle" can be held liable for obligations and debts of the Limited. Another example of the consequences of the Brexit in corporate law is the Societas Europaea ("SE"), a company form similar to a stock corporation which has been created by lawmakers of the European Union and has found increasing interest in many European countries in recent years, including the UK. In case of a "hard Brexit" there will be no legal basis anymore for the Limited in Germany and the SE in the UK, owners of these entities should react as soon as possible, as long as cross-border transformations between the UK and Germany (and other European countries) are still possible.

Statistically, the above mentioned corporate issues are of lesser importance because the number of affected Limited companies and SE is relatively small. Far more companies will have to watch out for the impact of the Brexit in other business areas. There will be consequences for supply and service relationships, distributorship and agency contracts, franchising systems, only to mention the most significant ones. The Brexit—at least in its hard form—will have an immediate effect on

- how to interpret whether a contractual clause that defines the scope of the agreement as being the "territory of the European Union" will still comprise the UK
- agreed INCOTERMS (due to possible new tariffs and custom duties); there will possibly also be new other trade restrictions



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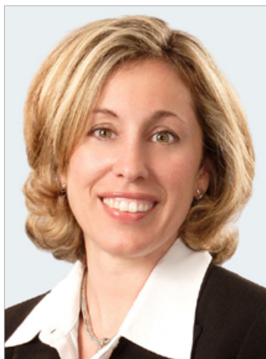
How BREXIT will impact business relationships with the UK in manifold ways

- clauses restricting competition which as per today are permitted pursuant to one of the EU-block exemption regulations
- the applicable law to a given contract
- the place of jurisdiction for disputes on contractual obligations
- the debt collection and enforcement of judgements.

Today, all the above matters are governed by Union law, in particular by Regulations on the applicable law, on competent jurisdiction and the enforcement of judgements. With the UK leaving the Union, these statutory provisions will not be applicable anymore and this will lead to great legal uncertainty. Therefore, the best recommendation to all companies (not only from other European countries but also, for example, from the US) doing business with UK companies is to go through their current contracts and agreements with UK companies—and with companies in other European jurisdictions if the territorial scope is defined as being the "European Union"—and see what kind of action can or should be taken to avoid surprises in the near future. In some cases, agreements will provide for a termination clause which either allows to exit the relationship or start negotiations on the commercial and legal terms of the contract. In other cases, namely when the contract has a longer fixed duration, the question will be whether the Brexit will be sufficient reason for an adjustment based on the principle of "frustration of contract" (*"Wegfall der Geschäftsgrundlage"*).

Manufacturer of products should also have in mind that the EU has set many industrial standards such as for machines, toys, medicinal products, only to mention a few of them, which will also not be applicable anymore with regard to the UK after the Brexit. In a similar way this will be the case of registered EU-trademarks and patents.



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Managing Workforces in the Era of the "Gig" Economy

German companies planning to staff U.S. operations by capitalizing on the "gig" economy—that is, the business environment in which goods and services are provided on an "as needed" or "on demand" basis—must tread carefully. While this new employment model has indisputably changed the American workforce, it has also sparked vigorous debate about its impact, as well as government and legal action.

Pros & Cons

Critics argue that the demise of "traditional" employment is bad for businesses and that non-employee workers suffer from a lack of benefits, stability and consistency in their work, and security for their professional and financial futures. Advocates assert the new paradigm reaps significant benefits for workers, businesses, and the national economy. For example, "gig" workers have flexibility, working when they are able or desire, with the ability to better balance personal and professional lives and pursue new career interests. Businesses, in turn, can be agile in adapting to the changing and competitive workplace and economy, as well as to client and customer needs, by engaging workers to perform only on a project or task basis, allowing businesses to manage cash flow and projects without full-time labor and the attendant costs or the need to reduce overstaffed workforces in times of business downturn. Both sides of the debate agree, though, that engaging workers as independent contractors, freelancers, or vendors, or through third parties or even related entities, can lead to blurred lines.

Main Concerns

Of concern are both ***misclassification*** (*i.e.,* erroneous identification of employees as independent contractors and vice versa) and the potential of a ***joint employment relationship*** with third party entities providing workers. "Independent contractor tests" evaluate whether workers should be classified as employees, while the concept of joint employment considers whether two companies share or co-determine the essential terms and conditions of employment for the same worker, becoming equally responsible for any claims or legal issues. Both misclassification and joint employment have become enforcement targets for government agencies, as clearly articulated by the U.S. Department of Labor:

> Misclassified employees often are denied access to critical benefits and protections they are entitled to by law, such as the minimum wage, overtime compensation, family and medical leave, unemployment insurance, and safe workplaces. Employee misclassification generates substantial losses to the federal government and state

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governments in the form of lower tax revenues, as well as to state unemployment insurance and workers' compensation funds.

German companies are, therefore, well advised to take these issues very seriously.

Risk of Costly Litigation

Even employers trying to properly classify their workers can face confusion, as definitions vary depending on the jurisdiction and which law is applied. And single plaintiff or class/collective actions against entities such as Amazon, Grubhub, Lyft, and Uber filed in recent years have become cautionary tales for employers participating in the "gig" economy. In short, entities wishing merely to engage workers can find themselves embroiled in litigation or government enforcement activity.

Strategic Planning

When deciding how to classify a worker relationship, even with a related entity, a business should consider all aspects of the worker's engagement, including:

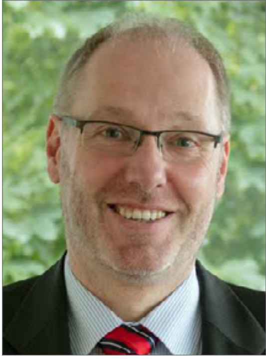
- Various issues from hiring to work location
- Scheduling and supervision
- Compensation and benefits
- Duration and potential conclusion of the relationship, whether predetermined or not

Written Agreements

Setting forth all the terms of the relationship in a comprehensive written agreement is essential. For an "independent contractor" relationship, such an agreement should include terms that divest the company of as much control as possible. When engaging a third party to provide workers, the agreement should place limits on the relationship—that is, it should specifically disclaim joint employer status and clearly delineate responsibility between the parties. Caution: How the relationships will actually work in reality is a crucial consideration, as formalities such as contractual provisions will be disregarded if the real nature of the relationship is not accurately reflected.

Reevaluation

German companies and their U.S. subsidiaries should periodically audit their workforce relationships and determine whether they are functioning as written. And if they are not, or if the laws or regulations have changed, adjustments are needed to avoid costly problems in the future.



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Impact of BREXIT on the Unitary EU Patent

As reported in previous articles, there is an upcoming EU Patent Package containing severeal interlinked instruments. One of them being the European Patent with unitary effect, another one the Unified Patent Court (UPC).

The UPC will comprise a Court of First Instance and a Court of Appeal. The Court of First Instance will be composed of several local and regional divisions in the Contracting Member States to the Agreement and a central division with seat in Paris and two sections in London and Munich. This central division has jurisdiction for combined infringement and invalidation cases and for isolated invalidation cases, the London court being competent for human necessities and chemistry/metallurgy as covered by IPC classes A and C.

On 23 June 2017 the United Kingdom held a referendum on its withdrawal fro the European Union—the BREXIT. As to the above mentioned Patent Package, the BREXIT raises legal questions, especially whether the UK can still participate in the Package and what will have to be done about the London section of the central division.

According to the wording of the Council Decision 167/2011 and the regulations 1257 and 1260 the unitary EU patent applies only to the EU Member States that adhered to the related enhanced cooperation. Thus, the UK as a non-EU Member State-to-be will not have access to the Package, BREXIT makes all EU law inapplicable to the UK.

BREXIT also eliminates the underyling basis for the establishment of the UPC in Great Britain. Far more worse, only citizens of the EU Member States and UPC contracting parties are enabled be judges of the related courts. Thus, the London section of the central division has to be re-located in another EU member state. According the the aforesaid, British Judges will have to be withdrawn from the courts at the moment, the UK leaves the EU. This will cause costs and might lead to a reduced performance of the courts.

In view of that the President of the EPO has stated that it is legally possible for the UK to remain in the Patent Package and to ratify it, especially, since the UK is currently still member of the EU. Others think it is not and that some other kind of legal relationship has to be established, for example a new UK-law extending or validating the effects of the Unitary EU patent to the UK territory. Finally, there are even some of the opinion that the UK-withdrawal requires a re-negotiation of the complete Patent Package since it can not be ratified finally for the UK being required but not allowed to.

Of course, the UK remains party to the European Patent Convention (EPC). It will remain possible to validate granted European Patents in the UK as it was possible ever since the EPC came into force.

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Impact of BREXIT on the Unitary EU Patent

Momentarily, there are no solutions in sight with regard to the Patent Package, no real advise for applicants can be given right now. As soon as there are indications to such a solution, we will update this report.

Personally, I do set hope into the farsightedness and rationality of the British politicians to achieve a feasible solution to these legal problems.

Hashtag With Caution—Or You May Get #Sued

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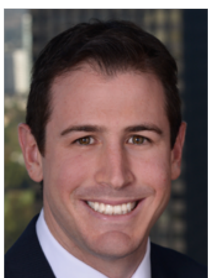

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Hashtags are more popular than ever on social media sites. They frequently are used on Twitter and other social media platforms as part of marketing campaigns and to simply facilitate searches. It is not uncommon for gamers and video game makers to use hashtags in their social media posts. The popularity of hashtags leads us to ask: Are hashtags protectable trademarks or part of the public domain?

Courts and administrative bodies have been adjudicating—albeit inconsistently—whether hashtags can themselves constitute trademarks. A search of the U.S. Patent and Trademark Office shows that there have been more than 400 trademark applications or registrations involving a hashtag. In general, while the mere addition of the hashtag symbol to an otherwise unregistrable mark does not render it registrable, a mark including the hash symbol is registrable as a trademark or service mark if it functions as an identifier of the source of goods or services. However, if a mark consists of the hash symbol combined with a word that is merely descriptive or generic, then the entire mark will likely be refused.

Illustratively, The World Intellectual Property Organization (WIPO) has recognized that hashtags can be trademarks. In Coca-Cola Company v. Whois Privacy Protection Service, Inc./Thien Le Trieu, Le Trieu Thien, 2016 WL 692866, Case No. D2015-2078, at *3 (WIPO Feb. 10, 2016), WIPO held that XOMTU constituted a common-law trademark, because Coca-Cola was using it as a hashtag as part of its "Share a Coke" campaign.

In contrast, U.S. Courts have not consistently recognized hashtags as trademarks. In Eksouzian v. Albanese, No. CV 13-00728-PSG-MAN, 2015 WL 4720478, at *7-8 (C.D. Cal. Aug. 7, 2015), the Central District of California expressed its view that hashtags are merely functional tools, and not actual trademarks in and of themselves. In particular, the court found that the use of the hashtag "#cloudpen" on an online photo-sharing site did not breach the parties' settlement agreement—which, among other things, prohibited the plaintiffs' use of "CLOUD PEN" in association with plaintiffs' vaporizer pens as a mark. The court reasoned that "hashtags are merely descriptive devices" and plaintiff's use of the hashtag "#cloudpen" was merely a functional tool to direct the location of its promotion so that it would be viewed by a group of consumers. See also, AOP Ventures, Inc. v. Steam Distribution, LLC, No. EDCV151586VAPKKX, 2016 WL 7336730, at *13 (C.D. Cal. Oct. 11, 2016) (declining to analyze whether the use of "#DRIPCLUB" caused consumer confusion and reiterating that merely using a trademark as a hashtag does not cause infringement).

Other U.S. district courts, however, recognize that hashtags may be trademarks.

At least two courts have found a likelihood of confusion based on the unauthorized use

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of a trademark within a hashtag. *See,* TWTB, Inc. v. Rampick, No. CV 15-3399, 2016 WL 236313, at *8 (E.D. La. Jan. 20, 2016) (considering former licensee's use of the "Lucy's" mark in a hashtag); Pub. Impact, LLC v. Boston Consulting Grp., Inc., No. 15-13361-FDS, 2016 WL 1048884, at *11 (D. Mass. Mar. 11, 2016) (finding a likelihood of confusion based on the defendant's use of plaintiff's trademark "PUBLIC IMPACT" in defendant's Twitter username, "@4PublicImpact," and its frequently used hashtag, "#publicimpact").

In addition, at least one U.S. federal court has found that "hashtagging" a competitor's name via social media could deceive customers for purposes of a false advertising claim. Fraternity Collection, LLC v. Fargnoli, No. 3:13-CV-664-CWR-FKB, 2015 WL 1486375, at *1-2 (S.D. Miss. Mar. 31, 2015) (acknowledging claim for false advertising under the Lanham Act, based on allegations “that hashtagging a competitor's name or product in social media posts could, in certain circumstances, deceive consumers.")

Even if courts are not uniformly convinced that the use of a hashtag can constitute trademark use, online advertisers should nevertheless proceed with caution. Recent cases concerning social media marketing suggest that the use of a hashtag can form the basis of a successful trademark infringement or false advertising suit. On the other hand, those seeking to protect marks should consider registering hashtags that also serve as valuable source identifiers.

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US estate and gift tax considerations

Whether and how your assets are subject to US estate and gift taxation depends on your domicile status.

Determining domicile for US estate and gift tax purposes is different than determining US income tax residence discussed in the previous section. You are considered to be domiciled in the US for estate and gift tax purposes if you live in the US and have no present intention of leaving. Thus, you may be a resident for income tax purposes, but not US domiciled for estate and gift tax purposes.

To determine whether you are a US domiciliary, the following factors are considered:

- Statement of intent (in visa applications, tax returns, will, etc.)
- Length of US residence
- Green card status
- Style of living in the US and abroad
- Ties to former country
- Country of citizenship
- Location of business interests
- Places where club and church affiliations, voting registration, and driver licenses are maintained

It is possible that two or more countries will consider you a domiciliary, and/or that certain assets may be subject to estate or gift tax in more than one country. As of January 2017, the US has entered into estate and/or gift tax treaties with 16 jurisdictions. Tax treaties may define domicile, resolve issues of dual-domicile, reduce or eliminate double taxation, and provide additional deductions and other tax relief. Countries with whom the US currently has gift and/or estate tax treaties are Australia, Austria, Canada (through the income tax treaty), Denmark, Finland, France, Germany, Greece, Ireland, Italy, Japan, Netherlands, Norway, South Africa, Switzerland and the UK.

You are considered a non-US domiciliary for estate and gift tax purposes if you are not considered a domiciliary under the facts and circumstances test described above. As a non-US domiciliary you are taxed only on the value of your US “situs” tangible and intangible assets owned at death, and on the value of your US “situs” tangible assets gifted during your lifetime, with a maximum tax rate of 40%. An exemption of $60,000 is available, but only for transfers at death. US situs tangible assets generally include real and tangible personal property located in the US and business assets located in the US; US situs intangible assets include stock of US

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US estate and gift tax considerations

corporations. The definition of US situs assets may be modified by an applicable estate and gift tax treaty.

There are additional estate and gift tax considerations when only one spouse is a US citizen. An unlimited amount can be gifted to a spouse who is a US citizen, whereas gifts to a non-US citizen spouse are offset by an increased annual exclusion ($149,000 for 2017, indexed annually). US citizens and domiciliaries can also "gift split," allowing married donors to exclude up to $28,000 per done per year (for 2017, indexed annually). Gift splitting is not permitted if either spouse is a non-US domiciliary.

When both spouses are US citizens, an unlimited amount of assets can pass between them without being subject to US estate tax. An election can also be made on a timely filed estate tax return to pass any remaining exemption amount to the surviving spouse for use in addition to his or her own exemption. If your surviving spouse is not a US citizen, the marital deduction is generally not allowed. However, a deferral of US estate tax for assets passing to a non-US citizen surviving spouse may be obtained if US property passes through a qualified domestic trust. Some estate and gift tax treaties also allow for some form of a marital deduction in cases where such a deduction would not normally be available.

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Related Party Transactions—Know Before you Act!

Many German citizens and German entities do business in the U.S. through related entities. This article describes several U.S. tax code provisions that apply to transactions between related parties.

Section 267 – Losses, expenses, and interest with respect to transactions between related taxpayers

Section 267 of the Internal Revenue Code modifies the usual tax result where related parties are involved. Under the general rule in 267(a)(1) losses resulting from related party transactions are disallowed except for losses incurred by a distributing corporation in connection with the complete liquidation of the corporation. Disallowed losses may be allowed at a later time if the related party purchaser later engages in a sale with an unrelated party and realizes a **gain.**

Section 267(a)(2) applies to deductions for expenses and interest and mandates a matching principle in that deductions cannot be taken until the related party includes the corresponding taxable income on its tax return.

Regarding payments to **foreign** related parties, the matching principle goes even further and the Treasury regulations mandate that the expense must actually be paid to the related foreign person before deductions will be allowed (Treas. Reg. Section 1.267(a)-3). This essentially puts the taxpayer on the cash basis for these transactions. There are exceptions and special rules to this requirement; therefore your tax advisor should be consulted to determine the results in any specific situation.

Section 267(b) defines related parties for this section and includes the following among others:

(1) Members of a family;

(2) An individual and a corporation if the individual holds more than 50% (value) of the stock;

(3) Two corporations which are members of the same controlled group; and

(4) A corporation and a partnership if the same persons own—(A) more than 50% in value of the outstanding stock of the corporation, and (B) more than 50% of the capital interest, or the profits interest, in the partnership.

There are other code sections that apply to certain specific transactions that affect related parties:

Like Kind Exchanges – Different requirements for related parties

Another area where the relationship between the parties can affect the tax outcome is found in Section 1031 of the Internal Revenue Code. This section defers the recognition

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Related Party Transactions—Know Before you Act!

of gain if like-kind properties are exchanged and various other requirements are met. However, in order for an exchange **between related parties** to result in gain deferral, an additional requirement exists in that the property exchanged must not be disposed of within two years after the date of the last transfer which was part of the property exchange (with exceptions for death or involuntary conversion).

Therefore, if either party disposes of the property received in the exchange before the running of the two-year period, any gain or loss that would have been recognized on the original exchange must be taken into account on the date that the disqualifying disposition occurs.

Section 1239 – Recharacterization of income for certain sales of depreciable property

This section acts to convert gain into ordinary income where there is a sale or exchange of property between certain related persons. This is important primarily to individual taxpayers because of the preferential capital gain rate which corporations do not receive. Certain corporations, however, might be adversely affected by the ordinary income characterization if they have carryforward capital losses which cannot be used to offset ordinary income.

Interest Expense Limitation under Section 163(j)

When setting up U.S. subsidiaries foreign parents often capitalize the company using both debt and equity. Given that debt produces interest deductions which lower U.S. taxable income while equity does not, this section potentially disallows certain related party interest deductions where mechanical tests lead to a finding of thin capitalization. For this section to apply, the interest expense must be paid to a related payee that is totally or partially exempt from U.S. tax on the interest payment. In addition to debt owed to a foreign related party, interest paid to third parties could also be subject to Section 163(j) if a foreign related party guarantees the interest.

Transfer Pricing – Code Section 482

Given the vast application of transfer pricing to transactions between related parties and the complexities of the transfer pricing rules, this subject is beyond the scope of this article. However, it is important to consider the transfer pricing rules whenever agreements are entered into between related parties as this area is increasingly being examined by the Internal Revenue Service.

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