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If the UK leaves the EU, this would have immediate consequences for direct taxation.[1] We saw in the first post that the EU fundamental freedoms, EU provisions on State aid and EU directives and regulations (also those on direct taxation) would automatically cease to apply to the UK. Referring back to the second post on future models, the first question is what the UK and the EU will put in place in terms of new treaties. The London financial district is now lobbying for a Swiss model-approach[2], which is a set of separate bilateral agreements with the EU on services, capital and all other areas of interest. This approach gives a lot of flexibility: the UK and the EU will be able to adopt several bilateral treaties in a way that meets all the demands of both parties. At this moment it remains unclear if there will also be an agreement about certain issues regarding direct taxation.

EU Fundamental Treaty Freedoms: stricter anti-abuse rules and more limited consolidation systems

Although there is no harmonization of direct taxation on EU level, all Member States still have to comply with the freedoms as set out in the TFEU.[3] The European Court of Justice (ECJ) has previously judged that domestic tax provisions, also from the UK, infringe upon these freedoms. Now that the UK is leaving the EU, it has become clear that the UK could decide to drop its legislative adjustments that were the result of ECJ judgments. National anti-abuse provisions in the UK could for instance be made stricter for companies now that the UK does not have to follow the EU's requirements regarding abuse developed under the case law of the ECJ (see the *Cadbury Schweppes*-case[4]).The UK could also disregard the outcome of the *Marks & Spencer*-case[5] for their group relief system. Member States could discriminate against UK businesses, except for the freedom of capital that also applies to third countries. This could be relevant at the moment the UK would qualify as a third country. However, it is not clear yet whether under future EU law the UK would qualify as a third country.

It is good to realize that in the field of tax consolidation systems within the EU, (like the fiscal unity regime in the Netherlands), the withdrawal of the UK from the EU could have consequences. It may even lead to dissolutions of group consolidations for tax purposes. Following cases like *Papillon*[6] and *SCA Group Holding*[7], a Dutch holding with subsidiaries in the Netherlands and sub-subsidiaries in another Member State needs to be treated the same as a Dutch company having its sub-subsidiaries in the Netherlands itself. Otherwise the freedom of establishment within the EU would be restricted. If the UK leaves the EU, Dutch national law would no longer be required to treat sub-subsidiaries in the UK as equal to the sub-subsidiaries in the Netherlands. In other Member States, that also have to follow the case law set out in *Papillon* and *SCA Group Holding* (like France, for instance), the same problem would arise. National law of Member States could nevertheless allow such fiscal unities, but under EU law there would be no obligation to do so. The only solution preventing such an outcome would be the UK and the EU to agree that the freedom of establishment is also applicable between the two after the Brexit. The Swiss model (that has been discussed in the second post) would allow for such a separate agreement. Until such an agreement is concluded, companies who benefit from a '*Papillon*-structure' should be prepared for dissolution of their respective tax consolidation structure after the withdrawal of the UK from the EU.

The UK could even grant State aid to its residents

Withdrawing from the EU would make the European primary law State aid provisions no longer apply to the UK. Consequently, the UK could be able to grant State aid and tax reductions to its resident companies. From one side this seems to be attractive for UK businesses, since UK companies would not suffer from State aid investigation by the European Commission regarding their tax position in the UK. State aid problems in cases such as *Starbucks* **[8]** and *Apple* **[9]** would not arise in the UK because Britain could simply act according to its own wishes and could set up its own State aid-programs.

On the other side, providing State aid to a selective number of enterprises (which usually will be the case) would have negative side effects on their competitors that are not being state aided. They would namely be disadvantaged. It is also unclear how the EU would react to the UK granting state aid. In its treaties with the UK, would it include provisions on competition law? Or would it put the UK on the (forthcoming) EU tax blacklist?

EU directives on direct taxation

The EU has no competence in direct tax harmonization but has nevertheless introduced several EU directives to harmonize the application of international tax law in individual Member States. As a result of a UK withdrawal, directives in the field of taxation will cease to apply to the UK (as already pointed out in the first post of this series). Also the Member States won't have to apply the aforementioned directives to the UK (its businesses) any longer.

Greater risk of withholding tax on dividends, interest and royalties

After the Brexit the *Parent-Subsidiary Directive*[10](*PSD*) will cease to apply to the UK. One benefit of the *PSD* is that dividends within a group can be paid without withholding taxation. Non-applicability of this directive means that Member States can tax dividend payments to the UK. After the Brexit only bilateral tax treaties between the UK and the respective Member States can potentially lower or even completely alter withholding taxation. The best solution in this regard is that the EU and the UK would agree to apply the *Parent-Subsidiary Directive* also after the Brexit. This agreement could find its inspiration in an agreement Switzerland and the EU previously concluded. [11] Under this existing agreement withholding taxation on dividend is not allowed and it is based on the *Parent-Subsidiary Directive*. It is good to realize that the problem of withholding taxation on dividends does not arise when the dividend has its source in the UK, since the UK has no withholding taxation at all on dividend payments.

After the Brexit the *Interest and Royalties Directive*[12] will not be applicable anymore. This means more risk of withholding taxation on intra-group interest and royalties payments to and from the UK. Only tax treaties will protect taxpayers in some cases against withholding tax on interest and royalties. Also in this case the best solution would be that the EU and the UK would agree to also apply the *Interest and Royalties Directive* after the withdrawal from the EU.

No implementation of EU anti-BEPS measures in the UK

Another example links back to the *Anti-Tax Avoidance Directive* (*ATAD*).[13] This directive has recently been adopted by the EU (a few days prior to the Brexit-

referendum) and aims at implementing certain anti-BEPS measures in the EU. This directive has not been implemented yet (the implementation deadline is January 1, 2019). Following withdrawal from the EU, the UK could now create the tax system that it wants. From the side of the UK, its former Chancellor of the Exchequer (Minister of Finance) George Osborne announced on July 2, 2016 (following the Brexit-referendum) that the UK will lower the corporate tax rate from 20 percent to 15 percent, in order to prove to investors that, despite Brexit, the UK is still "open for business". A race to the bottom between the UK and Member States might be the result.[14] European leaders have announced that UK proposals that lower their tax rates and that aim at aggressive tax competition will make the negotiations with the EU on a future agreement more difficult. More specifically linked to provisions of the *ATAD*, this directive often refers to third countries. The UK could be regarded as a third country after it leaves the EU.
For the EU, some decisions will become easier once the UK officially leaves the EU. It brings in a new dynamic to EU decision making. Shortly after the Brexit-referendum, the European Commission already proposed strict rules according to which trusts must identify the owners, a move that for a long time had been blocked by the UK.[15]

Other directives and regulations in the field of direct taxation
Other examples of EU Directives that are no longer applicable are the *Tax Merger Directive*[16] and the *Mutual Assistance Directive*[17] (in conjunction with the *Recovery Directive*[18]). Meanwhile, one of the main implications of the UK's release from EU regulations in the field of taxation will be the lifting of the *Social Security Systems Regulation*[19].

What will the future agreement look like?
How the future agreement(s) will look like is difficult to predict. The Swiss model-approach, however, would allow for a solution in which the UK and the EU would negotiate separate agreements: agreements that would deal with the fundamental freedoms and State aid and more, but also a separate agreement regarding taxation between the UK and the EU would be possible (for instance no withholding tax on intra-group dividends, interest and royalties) .

Another important aspect of this discussion is the way in which the EU will react to the UK changing its national tax legislation in a manner contrary to the current State aid provisions and if the UK will be aggressive in attracting business with lower tax rates. Potentially, the functioning of any new agreements between the

EU and the UK could be made dependent on the UK meeting some EU standards in taxation. Statements by individual Member State ministers indicate that the EU is reluctant to agree with the UK on anything, if at the same time it is introducing aggressive tax proposals. An agreement on the UKs new policy on taxation, maybe in the form of only a political binding code of conduct on harmful tax competition, could be key to the negotiations in the upcoming months.

[1] Following the Brexit-referendum on June 23, 2016, the House of Commons immediately issued a briefing paper titled "Tax after the EU Referendum". This paper gives a brief and not very detailed overview of the direct consequences of the withdrawal from the EU for the UK. Anthony Seely (House of Commons Library), Tax after the EU referendum (Commons Briefing papers CBP-7630) <http://researchbriefings.parliament.uk/ResearchBriefing/Summary/CBP-7630#fullreport> accessed 5 July 2016.

[2] Martin Arnold and Caroline Binham, 'UK financial sector targets Swiss-style deal for EU market access', *Financial Times* (London, 18 August 2016) <http://www.ft.com/cms/s/0/5cebe746-655a-11e6-8310-ecf0bddad227.html#axzz4IC3CeuO0> accessed 23 August 2016.

[3] Ibid., p. 2.

[4] C-196/04 – *Cadburry Schweppes.*

[5] C-446/03 – *Marks & Spencer.*

[6] C-418/07 – *Société Papillon v. Ministère du Budget, des Comptes publics et de la Fonction publique*, p. 63.

[7] C-39/13, C-40/13 and C-41/13, *SCA Group Holding and Others*.

[8] SA.38374, *State aid implemented by the Netherlands to Starbucks* <http://ec.europa.eu/competition/elojade/isef/case_details.cfm?proc_code=3_SA_38374> accessed 31 August 2016.

[9] IP/16/2923 *Press release decision on 30 August 2016.* http://europa.eu/rapid/press-release_IP-16-2923_en.htm 31 August 2016.

[10] Council Directive 2011/96/EU of 30 November 2011 on the common system of taxation applicable in the case of parent companies and subsidiaries of different

Member States [2011] OJ L345/8 <http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32011L0096> accessed 7 July 2016.

[11] Council Decision 2004/911/EC of 2 June 2004 on the signing and conclusion of the Agreement between the European Community and the Swiss Confederation providing for measures equivalent to those laid down in Council Directive 2003/48/EC on taxation of savings income in the form of interest payments and the accompanying Memorandum of Understanding. [2004] OJ L385/28 <http://eur-lex.europa.eu/legal-content/EN/ALL/?uri=CELEX:32004D0911> accessed 7 July 2016.

[12] Council Directive 2003/49/EC of 3 June 2003 on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States [2003] OJ L157/49 <http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32003L0049> accessed 7 July 2016.

[13] Proposal for a Council Directive laying down rules against tax avoidance practices that directly affect the functioning of the internal market [2016] <http://data.consilium.europa.eu/doc/document/ST-10426-2016-INIT/en/pdf> accessed 6 July 2016.

[14] George Parker, 'George Osborne puts corporation tax cut at heart of Brexit recovery plan' *Financial Times* (London, 3 July 2016) <http://www.ft.com/cms/s/0/d5aedda0-412e-11e6-9b66-0712b3873ae1.html#axzz4DXrHBYJj> accessed 5 July 2016.

[15] Francesco Guarascio, 'After Brexit, EU proposes tougher tax rules on trusts' (*Reuters*, 4 July 2016) <http://www.reuters.com/article/us-britain-eu-tax-trusts-idUSKCN0ZK1ER?utm_campaign=trueAnthem:+Trending+Content&utm_content=577ab35e04d3011771ef237b&utm_medium=trueAnthem&utm_source=twitter> accessed 5 July 2016.

[16] Council Directive 2009/133/EC of 19 October 2009 on the common system of taxation applicable to mergers, divisions, partial divisions, transfers of assets and exchanges of shares concerning companies of different Member States and to the transfer of the registered office of an SE or SCE between Member States [2009] OJ L310/34 <http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32009L0133>

accessed 7 July 2016.

[17] Council Directive 77/799/EEC of 19 December 1977 concerning mutual assistance by the competent authorities of the Member States in the field of direct taxation [1977] OJ L336/15 <http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:31977L0799> accessed 7 July 2016.

[18] Council Directive 2010/24/EU of 16 March 2010 concerning mutual assistance for the recovery of claims relating to taxes, duties and other measures [2010] OJ L84/1 <http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32010L0024> accessed 7 July 2016.

[19] Regulation (EC) No 883/2004 of the European Parliament and of the Council of 29 April 2004 on the coordination of social security systems (Text with relevance for the EEA and for Switzerland) [2004] OJ L166/1 <http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32004R0883> accessed 7 July 2016.