

Taxation of savings income in the form of interest payments

2008/0215(CNS) - 13/11/2008 - Legislative proposal

PURPOSE: to amend Directive 2003/48/EC on taxation of savings income in the form of interest payments.

PROPOSED ACT: Council Directive.

CONTENT: this proposal is intended to amend Directive 2003/48/EC on taxation of savings income in the form of interest payments (the 'EUSD'), with a view to closing existing loopholes and eliminating tax evasion. Experience has shown that the directive can be circumvented. Since 2005, the Savings Directive has ensured that paying agents either report interest income received by taxpayers resident in other EU Member States or levy a withholding tax on the interest income received.

The Commission proposal seeks to **extend the scope of the Directive**, so as to ensure better the taxation of interest payments which are channelled through intermediate tax-exempted structures. It also proposes to extend the scope of the Directive to income equivalent to interest obtained through investments in some innovative financial products as well as in certain life insurances products. Moreover, simplification of the technical operation of the Directive should lead to a more user friendly system and more efficient implementation.

Determining the effective beneficial owner of interest payments: the first review of the Directive has shown that, at present, it is relatively easy for individuals to circumvent the rules by using interposed legal persons or arrangements (like certain foundations or trusts) which are not taxed on their income.

The Commission proposes the following :

- for interest payments made by paying agents established in the EU to certain intermediate structures established outside the EU, the Commission proposes that those paying agents subject to anti-money laundering obligations are required to use the information already available to them within this framework to establish the actual beneficial owner of these payments. When the latter is an individual resident in another EU Member State, the paying agent would consider the payment concerned as directly made to this individual.
- for interest payments made to certain untaxed intermediate structures established within the EU, including some non-charitable trusts and foundations, those structures will be always obliged to apply the provisions of the Directive (exchange of information or withholding tax) upon receipt of any interest payment from any upstream economic operator wherever established.

Extending the scope to income equivalent to interest payments: the EUSD can also be circumvented by using innovative financial vehicles instead of a classical savings account in a bank.

Therefore, the Commission proposes extending the scope of the Directive to income from:

- securities where the investor receives: a) a return on capital whose conditions are defined at the issuing date; and b) a guarantee where, at the end of the term of the securities, at least 95% of the capital invested will be reimbursed. All securities meeting these two conditions will be included in the scope, regardless of whether the underlying assets behind those securities include debt claims or not. Typical examples are structured products like those "index linked certificates" whose

performance is defined ex ante as being a function of the possible positive trend of a market indicator or to the increase in value of a basket of underlying securities, whilst the possible negative results of the market indicator or of the underlying securities has no or minimal influence on the right for the holder to be reimbursed the capital invested;

- those life insurance contracts whose positive performance (beyond the guarantee of reimbursement of the capital invested) is strictly linked to income from debt claims or equivalent income and where the mortality or longevity risk covered under the contract is merely ancillary (lower than 5% of capital insured as an average over the duration of the contract).

Administrative burden: the proposal brings a major reduction of administrative burden for individuals who opt for exchange of information in Austria, Belgium or Luxembourg where they receive interest payments and therefore claim exemption from withholding tax. The proposal asks that the paying agent will directly report information to the tax authorities, at the request of the individual who authorize it, in place of levying the withholding tax.

Income from investment funds: currently, income obtained by individuals through some investment funds (mainly investment funds subject to the UCITS Directive) is already within the scope of the Directive. The Commission proposes to extend the scope of the Directive to all investment funds or schemes, wherever located and independent of their legal form and regulatory regime, having invested in debt claims or other equivalent securities. For this purpose, all the current references to the UCITS Directive for investment funds established in the EU will be replaced by a reference to the registration of the fund in accordance with the domestic rules of any of the Member States. For investment funds established outside the EU, a broad definition of investment funds or schemes based on concepts prevailing at OECD level will be used.

Technical improvements: the proposal contains provisions which are beneficial for the activity of paying agents, such as a clearer treatment of investment funds established in a country different from the one of the paying agent and a clearer guidance for Member States in order to avoid possible cases of duplication of paying agent responsibilities.

Annex: the introduction of the new annex (indicative compliance list) will bring more clarity and legal certainty to paying agents. Annex 1 is based on an analysis of the tax regime of the specific entity or legal arrangement in the corresponding named jurisdiction mentioned. Only those entities and legal arrangements to which EU resident individuals can have access as beneficial owners and which are not subject to effective taxation on their income in that jurisdiction are mentioned in the list. Its purpose is to facilitate the job of the paying agents in executing the application of the Directive. Appropriate procedures are provided to amend the list if the information contained in it needs to be updated.

Money from foundations : the effect of the proposal is as follows :

- if the trust or foundation (or other equivalent entity or arrangement) is established outside the EU in a jurisdiction listed in annex I of the Directive (because it is untaxed), the Commission proposes that the paying agents established in the Union and subject to anti-money laundering obligations would be required to use the information already available to them within this framework to determine the effective beneficial owner of these payments. When the latter is an individual resident in another EU Member State, the paying agent would consider the payment concerned as directly made to this individual, without taking into account the formal transit of the payment through the intermediate structure. For instance, if a bank established within the EU pays interest to a trust established in Switzerland or in Hong-Kong and if it knows, under the anti-money-laundering provisions, that the effective beneficial owner of the trust is an individual resident in the EU, the bank will be required to apply the provisions of the Directive at the time of the payment to the trust as if this payment was directly made to this individual.

- if the trust or foundation (or other equivalent entity or arrangement) is established within the EU and is not taxed on its income under the general rules for direct taxation applicable in the Member State, the provisions of the Directive (exchange of information or withholding tax) should apply upon receipt of the payment by this entity. To facilitate the task of economic operators, the Commission has established a first list of such entities or arrangements established in the EU. This list is to be found in annex III of the directive and will be completed and updated with the assistance of Member States through comitology. For instance, if a trust established within the EU receives interests from an economic operator (bank, financial institution, independent professional) wherever established, it will be obliged to apply the provisions of the Directive (exchange of information or withholding tax) upon receipt of the payment, regardless of the actual distribution of any sum to the individual beneficial owner.