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SUMMARY RECORD OF A MEETING OF WORKING PARTY IV ON DIRECT TAXATION

Review of the operation of the Council Directive 2003/48/EC on taxation of income from savings

Held in Brussels on 29 May 2008

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1. INTRODUCTION

The meeting of the Commission Working Party IV on Direct Taxation was attended by the appointed experts representing the Member States and was chaired by [redacted] at the Directorate General Taxation and Customs Union of the Commission. The Chair welcomed the delegates of the MS and presented the agenda of the meeting:

- Discussion on the questions raised in the Commission service's working document of 29 May 2008 "List of specific questions on which guidance from delegates is sought (Council Directive 2003/48/EC on taxation of income from savings) ("working document" hereafter);
- Issues relating to the increase in the rate of withholding tax on interest paid or credited from 1 July 2008;
- State of play in negotiations with Hong Kong and Singapore;
- Provision of statistical information.

The Chair informed the Working Party that the Commission services have launched CIRCA for distribution of information relevant for Working Party IV meetings. As from September 2008 any information will only be distributed by CIRCA. The Chair invited the delegations which have not done so to register up to three contact persons. Furthermore, the Chair invited delegations which have not yet done so to submit written contributions on the Commission service's working document of 29 March 2008.

The Chair reminded the Working Party of the ECOFIN Conclusions of 14 May 2008 calling on the Commission to submit the report pursuant to Article 18 of the Directive by 30 September 2008 at the latest, to be followed by specific proposals based on the report. Given this time schedule, it will be the last Working Party IV meeting before submitting the report to the Council. Finally, the Chair informed the Working Party that the next Working Party IV meeting will deal with corporate tax issues, in particular the study on the Merger Directive (Directive 90/434/EEC of 23 July 1990).

2. DISCUSSION ON THE WORKING DOCUMENT

2.1. Article 2: Beneficial ownership

The Commission services briefly outlined question 1 of the working document on the concept of beneficial owner enquiring whether MS wish to go beyond the current definition of beneficial owner for the purposes of the Directive and, if so, which of the four alternatives the MS would support. Option a) is the most comprehensive solution suggesting extending the scope of the Directive to interest payments made to all legal entities and arrangements. Option b) maintains the present scope of the Directive but suggests applying the Directive also to those payments made to legal persons, entities and arrangements for which the beneficial owner identified for anti-money laundering (AML) purposes is an individual resident in another EU MS. Some experts representing market operators have expressed reservations to a broad application of this "look-through" approach. For that reason, option c) suggests applying a "look-through" approach only to payments made to legal entities and arrangements outside the EU territory whereas option d) further limits application of "look-through"

approach to some specific entities and arrangements established in non-cooperative jurisdictions. In regard to the BE question concerning the reaction of market operators, the Commission services responded that option d) has been largely inspired by comments received from some delegations and experts, e.g. the European Banking Federation (EBF) and the European Central Securities Depositories Association (ECSDA).

DE sought clarification on the meaning of "non-cooperative jurisdictions" under option d) noting that it would also be interested in receiving information on payments made to certain legal entities established in Switzerland and Lichtenstein. The Commission services responded that the scope of the measures applied depends on the availability of 3rd countries to cooperate with EU MS. If it is possible to agree on equivalent measures to the amended Directive, it would be unfair to include these countries in the "black" list. Furthermore, it could lead to the duplication of measures applied in respect of 3rd countries.

LU expressed a preference for option d) commenting that even a minimal extension of the scope of the Directive would increase the administrative burden on paying agents as such information is not held on their information systems. LU further noted that the Commission service's proposal should provide countries applying withholding tax system with the possibility of imposing withholding tax on payments made to entities without a "look-through" approach. Finally, LU underlined the necessity of ensuring a level playing field by negotiating equivalent measures in the amendments with 3rd countries. It suggested using a different term for "non-cooperative jurisdictions" as it is not defined at Community level. The Commission services responded that, if the withholding tax system is applied without "look-through" approach, withholding tax would be applied blindly without knowing the MS to which the revenue should be transferred.

EL referred to the consultations undertaken with the market operators noting that industry would favour further exploring the application of a limited "look-through" approach as suggested by option d). EL further agreed that the notion "non-cooperative jurisdictions" should be clarified.

AT highlighted the change in the Commission service's position in comparison to 2007, noting that the working document presented on 27 March 2008 considers the application of a "look-through" approach to legal entities and arrangements established within EU as too cumbersome. Although AT is still consulting with paying agents on the feasibility of a "look-through" approach, the solution seems quite difficult to apply.

On the question of whether all legal entities either taxable or not are covered under option a), the **Commission services** responded that any measure requiring paying agents to make judgements would be very complicated. For that reason, the Commission services suggested either a broad application of the Directive to interest payments made to all legal entities and arrangements or a targeted approach not requiring substantial changes in the paying agent's reporting systems.

DE, DK, ES, IE, NL, UK and SE expressed preference for an extension the scope of the Directive to interest payments made to all legal persons, entities and arrangements as suggested by option a) of the working document. However, if option a) is not feasible, DK could also support option b) or c). ES, IE and the UK added that option a) is the simplest and easiest to apply and as such is the less burdensome for the industry. The UK is unsure whether options b) to d) are workable due to an additional burden on the paying agent. DE and DK

further noted that it would be difficult to accept option d) due to the lack of uniform measures in respect of 3rd countries and associated and depended territories. Furthermore, DE and NL observed that the Anti-Money Laundering Directive (AMLD) has a different objective from the Savings Directive and as such is not suitable for taxation purposes. The UK noted that AML approach probably would not provide for information on all beneficial owners due to its risk based approach and, for that reason, specially tailored rules on "look-through" would be needed for the purposes of the Savings Directive. DE would like to refine option a) by establishing a list of cases which should not be examined under the Directive e.g. not subject to annual taxation.

With regard to the "look-through" approach, the **Commission services** acknowledged the difficulties underlined by a number of market operators of having a selective approach.

Regarding the suggestion of DE to have option a) but refined with a selective 'look-through' approach which is not based on the beneficial owner but on any tax evasion by the entity or arrangement, the **Commission services** explained that private experts in the EUSD group had stressed how difficult it would be for paying agents to have information available to them in order to be able to judge whether it would fall under a particular criteria as in the case of subject to annual taxation. Indeed, the Member State receiving such information on a 'look-through' approach would still need to ascertain who the beneficial owner is behind an entity for taxation purposes. For option a) Member States should ascertain whether the information received on such a proposal would be beneficial and would outweigh the costs of administering such a system.

FR is in favour of a "look through" approach as suggested by the Commission services, and provisionally, option b). FR could accept option a) only if it is coupled with a "look-through" approach. FR expressed further concerns on multiplying information flows in case the Directive is applied to all legal persons, entities and arrangements.

BE expressed a preference for option b). Nevertheless, BE wants to analyse drafting of the amendments, consult with EBF on the feasibility of the solution and learn the reaction of 3rd countries before giving its final view. With regard to option a), BE expressed its reservation noting that the suggestion is incompatible with the exemption from withholding tax on interest payments made between associated legal persons established in the EU. The Chair responded that withholding tax under the Savings Directive is imposed on behalf of the individual's residence state, which makes it different from the exemption of withholding tax under the Interest-Royalty Directive (Directive 2003/49/EC of 3 June 2003) and the Parent-Subsidiary Directive (Directive 90/435/EEC of 23 July 1990).

IT expressed doubts on using the AML approach for the purposes of savings taxation noting that another option would be to bring the AMLD in line with the Savings Directive. Slight preference for option d). As IT provides for a possibility of introducing both a "black" and a "white" list of non-EU jurisdictions, it would be important to avoid a lack of coordination between different systems if options c) or d) are retained.

EE and PT expressed their preference for a limited "look-through" approach, maybe under option c) or d). Although option a) is the simplest solution, PT was concerned that a generalised approach could be excessive and could not solve the problem.

BG, CZ, MT, LT, LV and PL expressed their preference for option c) whereas LV left the possibility of considering option a) also; PL will explore the issue further and will send its explicit position in writing.

The Chair invited the MS expressing support for option a) to elaborate further on the use of information received on payments made to legal entities and arrangements and the application of this particular solution to the countries applying the withholding tax system. In that respect, **IE** noted that the information obtained could be used for auditing purposes. With regard to countries applying the withholding tax system, IE suggested enabling those legal entities and arrangements which do not want to suffer withholding tax to opt for exchange of information. **UK** observed that option a) would enable more effective taxation of legal entities and arrangements. Once the information on legal entities and arrangements is available, tax authorities could, on a case by case basis, request further information on beneficial owners under the Mutual Assistance Directive. With regard to countries applying a withholding tax system, UK assumed that amendments to the Directive could possibly enter into force by 2011, i.e. by the time there was an assumption that the transitional period for the countries applying withholding tax would end due to the rate of 35% (the UK referred to the comments of BE Minister of Finance at the ECOFIN meeting of 14 May). **BE** replied that this is only an intention and not a commitment; the efficiency of the current Savings Directive has still to be determined.

2.2. Article 4: Definition of paying agent

The Commission services briefly introduced question 2 of the working document dealing with the paying agent under Article 4 of the Directive. Option a) suggests extending the scope of obligations as paying agent "on receipt" of Article 4(2) to all transparent entities and arrangements established in the EU; this measure would be coupled with a "positive" list of paying agents on receipt. The Commission services further observed that a "positive" list could facilitate legal certainty required by upstream economic operators making payments to the entities and arrangements concerned and facilitate acceptance of equivalent measures to Article 4(2) of the Directive by 3rd countries, including Switzerland. Option b) suggests extending the scope of the same provisions of Article 4 (2) also to some non-transparent entities and arrangements established in the EU, i.e. foundations and discretionary trusts. In that respect, the Commission services stressed the difficulties of identifying the beneficial owner at the moment a payment is made to the entity or arrangement due to the fact that the beneficiary is not immediately entitled to a payment. For that reason, the Commission services suggested considering a settlor of a trust or a beneficial owner identified under the AMLD as the beneficial owner for the purposes of the Directive. Finally, option c) suggests the alternative "first distribution approach" for the same non-transparent entities and arrangements, i.e. foundations and discretionary trusts. Although the solution would provide for clearer criteria for identifying beneficial owner for tax purposes, it would be still difficult to distinguish between the distribution of interest income and capital. Commission services concluded by asking MS views on a solution based on a combination of options a) and b) or options a) and c).

IT expressed concerns on the feasibility of option c), noting that solution could be difficult to apply and could lead to retroactive taxation. With regard to option a) and b), IT underlined the importance of safeguarding taxation on an annual basis, i.e. an entity and arrangement including a trust shall be excluded from the obligation to report under the Directive if it is

subject to annual taxation according to the rules of the Member State where it is established. Furthermore, IT supported the Commission service's suggestion to establish a "positive" list in order to avoid uncertainty over which entities and arrangements are covered by the Directive.

DE, EE, UK and LT expressed their preference for a combination of options a) and b). **DE, IE and UK** noted nevertheless that if the Directive is extended to all legal persons, entities and arrangements as suggested by option a) of question 1, there would be no need to extend the scope of Article 4(2) of the Directive: **IE** therefore expressed its opposition to any such extension. UK added that, in case discretionary trusts would be covered by the Directive, the beneficial owner for the purposes of the Directive could be the trustee. In that respect, the Commission services commented that the UK's suggestion would make sense only for the Member States which provide for the annual taxation of trustees. However, it would not solve the problem when a trust is set up in accordance with the civil law rules of a country providing for annual taxation of trusts, but the trustee is actually a resident in another country which does not provide for such taxation. For that reason, the Commission services suggested introducing simplified criteria for identifying the beneficial owner for the purposes of the Directive, e.g. the settlor of the trust or the beneficial owner as identified under the AMLD. The UK responded that it is not convinced that the Commission service's suggestion on discretionary trusts is workable as there is a great danger of providing useless information. The MS that are concerned with taxing income from trusts are free to introduce special 'trust tax' and obtain information on income received by trusts. Extending the scope of the Directive to discretionary trusts as suggested by option a) +b), without going further about deemed beneficial ownership, would already be a great concession by the UK and the trust industry. DE further observed that it does not consider problematic cases when a trust is established in the MS that provide for the annual taxation of trusts.

EL supports option a) and further exploration of option c).

BE expressed preference to option b) **without** option a). Nevertheless, BE would like to examine final drafting of the amendments as well as to consult with EBF before giving its final view.

2.3. Article 6: Definition of interest payment – Innovative financial products

The Commission services briefly introduced question 3 of the working document on the definition of interest payment. Option a) suggests a broad extension of the definition to all investment income. Option b) closely follows the principle "substance over form" suggesting an extension of the scope of the Directive only to those structured financial products which provide income which may be seen as comparable to debt claims. The Commission services further observed that the solution would require cooperation between paying agents and data providers in order to determine the underlying debt claims of structured financial products. Finally, option c) suggests extending the scope of the Directive to any revenue arising from the investment of capital where capital is totally or almost protected (or there is a commitment to reimburse capital) and the return is defined ex ante, independently from the composition of the product. Under this option it could be necessary to elaborate further on a possible extension of the scope of the Directive to out-payments from life insurance contracts where the mortality or longevity risk covered is merely ancillary.

DE, EL and ES expressed preference for a broad and simple solution as suggested by option a). DE added that from the point of view of its domestic legislation it would favour option a) since it does not distinguish between risk-based products and short-term gains or losses. With regard to possible list of innovative financial products, ES suggested using the Market in Financial Instruments Directive (Directive 2004/12/EC of 21 April 2004) and Annex I of the AMLD as a reference. EL added that it would also be interested in further exploring option c).

BE and PT expressed preference for option c). Nevertheless, BE would like to consult with the banking sector on the feasibility of the solution before giving its final view. As far as insurances are concerned, BE referred to the clear preference for including in the scope of the Savings Directive the contracts under branch 21 and 23 which had been already expressed in its written contribution to the working document of 27 March 2008. With regard to option a), PT commented that the answer, to a large extent, is linked to the answer to question 4 of the working document. The extension of the definition on income without covering dividends and capital gains could lead to further market distortions. Although option b) is more in line with the present objective of the Directive, it would be more difficult to apply by paying agents.

Although at present **IT** would be interested in discussing the method rather than merits of particular suggestions, it would prefer a general clause. IT further observed that in case the definition of income is extended then the rules for paying agents should be simplified.

EE noted that all comparable financial products shall be subject to the same treatment. As a practical matter, EE invited the Commission services to explore further the definition of derivatives used for VAT purposes.

FR noted that it cannot give a final view at this stage. On the question of whether the principle of "substance over form" will be included in the Directive, the Commission services responded that the suggestion to establish a "positive" list of structured financial products has been abandoned. Instead, a list of objective characteristics could be established in the Directive for the convenience of paying agents. The Commission services further referred to comments made by some MS that the Directive applies not only to financial products issued in the EU but also outside the EU, this would make terribly complicated establishing and updating any list. Furthermore, the Commission services noted that both options a) and c) go beyond the present scope of the Directive. Option a) is even broader, as it would mean extending the scope of the Directive also to capital gains derived from any financial products.

LU favours option b) with further specification of 'income comparable to classical debt claims'.

MT favours option b) or c) for question 3.

IE would be interested in having a definition of innovative financial products. In case the "substance over form" approach is pursued by the MS, it shall be provided in the Directive. Furthermore, IE noted that, according to the Life Insurance Directive, an insurance company should comply with the domestic legislation. This could lead to duplication of reporting under the Savings Directive when the domestic legislation already provides for reporting.

2.4. Appropriate forms of cooperation for other products not covered by Article 6 of the Directive

The Commission services outlined question 4 of the working document on appropriate forms of cooperation for other financial products not covered by Article 6 of the Directive. Option a) suggests an extension of the scope of the Savings Directive to all investment income including out-payments from life insurance contracts, capital gains and dividends whereas option b) suggests using a different legal instrument, e.g. the Mutual Assistance Directive for the same purpose. The Chair added that the Commission services are due to present a proposal for amending the Mutual Assistance Directive on October 2008.

DE, EE, ES and SE supports option a). **DE** further underlined that it would also be interested in applying equivalent measures either in a form of information exchange or at least withholding tax to 3rd countries. However, none of the 3rd countries is obliged to apply equivalent measures to the Mutual Assistance Directive. With regard to dividends and how they should be taxed by countries that operate under the withholding tax regime, DE suggested applying the withholding tax of the Directive at a reduced rate when dividends have already been submitted to other withholding taxes under the domestic laws.

The **Chair** noted that as it would be also very difficult to impose withholding taxes on capital gains; the only practical solution would be taxing full proceeds.

ES noted that further differentiation is necessary between first pillar pensions (social) and second pillar pensions (private). ES considers that the second pillar pensions could fall under the ambit of the Savings Directive or the Mutual Assistance Directive, but not the first pillar. The ECJ has ruled that the Mutual Assistance Directive is subject to the domestic administrative practices of the Member State and as such is not a suitable instrument for first pillar. .

LU objects to both alternatives. LU thinks that the objectives of both Directives are different and should not be confused.

BE expressed its surprise noting that the MS views expressed in their reactions to the working document of 27 March 2008 have not been sufficiently dealt with by the Commission services. BE urged the Commission services to be more responsive to MS views. As out-payments from life insurance products in BE are taxed similarly to interest income, BE repeated that such payments may fall under the Savings Directive. Nevertheless, BE is radically against extension of the scope of the Directive to dividends and capital gains. BE further referred to different levels of taxation in the MS concluding that risk capital is already heavily taxed in the EU.

The **Chair** responded that the aim of the Savings Directive and the Mutual Assistance Directive is not to increase the tax burden but to ensure effective taxation according to MS domestic tax laws.

IT noted that any of the suggested legal instruments could be appropriate. The answer depends on which legal instruments are better suited in technical terms and how long it would take to implement the amendments to the Directive.

NL is in favour of a broad application of the Savings Directive to investment income. Nevertheless, the review of the Savings Directive should be separated from the Mutual Assistance Directive since both directives have different goals.

CZ, DK, EL, LT, LV and UK favours option b). DK expressed concern that an extension of the scope of the Directive to dividends, capital gains, life insurance and pensions could lead to new withholding taxes.

The **Commission services** noted that the UK is interested in solution b) to this question which advocates use of the Mutual Assistance Directive and would like to know the UK position on point a) to question 3 which recommends including innovative financial products in the Savings Taxation Directive. .

The **UK** responded that it has no clear view on question 3 at this stage. It finds solutions under questions 3 and 4 problematic since it currently does not provide for domestic reporting on dividends and derivatives. The UK would be ready to agree on automatic exchange of information for some products, however, the value of the information received on income not covered by the Directive is not fully evident.

The **Chair** further clarified that the review of the Mutual Assistance Directive would probably focus on a broader application of automatic exchange of information.

MT favours option b) for question 4 and option b) or c) for question 3.

PL favours option b) for question 4. However, at this stage PL has no clear position on question 3. PL doubts whether it would be appropriate to cover capital gains partially in the Savings Directive and partially in the Mutual Assistance Directive as suggested under option b) of question 3.

3. INCREASE IN THE RATE OF WITHHOLDING TAX

The **Commission services** noted that the issue on the increase in the rate of withholding tax as from 1 July 2008 has been raised in order to ensure common understanding on application of Article 11 of the Directive. The Commission services recalled the question received from one of the countries applying equivalent measures to the Directive requesting whether the reference to "first three years of the transitions period" could be interpreted as a reference to the end of the tax year concerned and informed Member States that their answer had been that the new rate is applicable from 1 July 2008 onwards, and not only from the end of tax year 2008. The Commission services recalled also the ECOFIN conclusions of 12 April 2005 stating that the Directive applies to all interest payments made from 1 July 2005 onwards, excluding only the portion of that interest which has accrued before that date. As the conclusions have not been modified, the Commission services concluded that 20 percent rate of withholding tax shall be applied on all interest paid on or after 1 July 2008 and accrued after 1 July 2005.

AT, BE and LU confirmed that they share on both points the Commission services' view.

4. STATE OF PLAY IN NEGOTIATIONS WITH HONK KONG AND SINGAPORE

4.1. Hong Kong

The Commission services outlined the state of play in negotiations with HK noting that exploratory talks with HK on taxation of savings were launched at the beginning of 2008. As interest income is not taxed in HK, it has no domestic tax interest in this area and, therefore, there is no information collecting system in place. Although at present HK is unable to cooperate with the Community in the area of taxation of savings, it has indicated that domestic laws could be amended provided that it is in the interests of the business community. Furthermore, the Commission services observed that HK is interested in extending the double tax convention (DTC) network with third countries but the main obstacle is the refusal of HK to accept full exchange of information as provided for in OECD 2005 Model Convention.

The Commission services further informed the group on the Bauhinia Foundation Research Centre survey with the business community to assess the effectiveness of the HK tax system from a business perspective. The survey, released on 14 May 2008, enquired whether business operators consider important to extend DTC network with third countries and, if so, are they in favour of amending domestic laws to that end. The survey recommends extending DTC with third countries giving priority to Asian countries which generally do not insist on full exchange of information. In addition, it states nevertheless that it would be a low price for HK to amend its domestic legislation in order to extend its DTC network further to other countries. Amendments of the domestic laws would be in line with the commitments undertaken by HK at the OECD Global Tax Forum in Melbourne.

Further consultations between the Commission services and HK will continue at technical level and, for that reason the next technical meeting has been scheduled for September 2008 in Brussels. The Commission services concluded by underlining the strong link between endorsing full exchange of information under any DTC negotiation with HK and obtaining progress in cooperation from HK in the area of savings taxation. Finally, the Chair strongly encouraged the MS not to conclude further DTCs with HK without a provision on full exchange of information.

4.2. Singapore

The Commission services briefly outlined the state of play in negotiations with SG noting that SG has no domestic tax interest as it does not tax interest income and, therefore, there is not an information collecting system in place. At the meeting of 2 February 2008, the SG remarked that it may allow exchange of information in case of qualified criminal tax matters even in the absence of domestic interest and that SG has ratified UN Convention against transnational organised crime (UNTOC). Following the request by Mr Verrue to explore further in which cases SG would be able to exchange of information even in the absence of domestic interest, the Commission services have received a letter from the SG providing for a summary on possibilities for exchange of information for criminal tax matters as communicated to the OECD in January 2008.

The Commission services briefly summarised the reply from SG noting that 54 out of 58 DTCs provide for exchange of information in civil and criminal tax matters but subject to domestic interest and banking secrecy. UNTOC applies only to organised criminal groups (3

or more people) and certain offences and serious crimes (at least 4 years of deprivation of liberty or more serious punishment) that generally do not include tax fraud or the like. The Commission services concluded that response received from SG and an analysis of the Mutual Assistance in Criminal Matters Act does not provide clear guidance on a definition of tax fraud in SG and cases where SG would be ready to exchange information even in the absence of domestic interest. For that reason, the Commission services will respond to SG by asking for more information. The Commission services further invited the MS to provide any information on practical experience in the exchange of information with SG.

Finally, the Commission services recalled ECOFIN conclusions of 14 May 2008 on tax issues in agreements with third countries recognising the need to include a provision on good governance in tax area in relevant agreements to be concluded with 3rd countries. The Commission services observed that the issue of good governance will be raised by DG RELEX in the next meeting on PCA negotiations with SG.

BE enquired whether ECJ ruling "Skattverket v. A" of 18 December 2007 on free movement of capital would have impact on exchange of information with 3rd countries. The Chair responded that the notion of free movement of capital does not necessarily have the same ambit in relation to third countries; however, in-depth legal analysis is needed to assess implications on the agreements with 3rd countries.

5. PROVISION OF STATISTICAL DATA

The Commission services recalled ECOFIN conclusions of 26 of May calling the MS to provide Commission services with the relevant statistical data which is necessary for preparing a report on the operation of the Directive. The Commission services underlined the importance of providing statistical data - even if incomplete - as soon as possible, by mid June at the latest. The Commission services are particularly interested in receiving information on amount of interest concerned by the exchange of information and on the number of beneficial owners concerned by the exchange of information or the withholding tax. With regard to this element of information requested by the Commission services, **AT** underlined that it is impossible for it to provide for information on the number of beneficial owners concerned by the Directive.

6. FINAL REMARKS

Before concluding the meeting, the Chair thanked the delegations for their contribution and invited the MS to make their best efforts in order to ensure that any additional comments are received by the Commission services by 6 June 2008 at the latest. Furthermore, the Chair invited the MS to provide for statistical data on the operation of the Directive even if incomplete as soon as possible as well as any relevant information on practical experience in exchanging the information with SG. Finally, the Chair reminded that the next Working Party IV meeting will deal with corporate tax issues, in particular the study on the Merger Directive.