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SUMMARY RECORD OF THE 6th MEETING OF THE EXPERT GROUP ON TAXATION OF SAVINGS

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

Held in Brussels on 22 June 2009

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1. INTRODUCTION

The sixth meeting of the Commission Expert Working Group on Taxation of Savings (hereinafter the 'Group') was attended by the appointed experts representing banking, accountants, asset management, insurance, investment funds and professional trustees. The meeting was chaired by Mr Philip Kermode, Director of Analyses and Tax Policies in Directorate General Taxation and Customs Union of the Commission. The Chair presented the agenda for the meeting of the group:

(i) Discussions in the Council (Presidency progress on the Savings Directive and the Council meeting of 9 June)

(ii) Detailed discussion of the Amending Proposal (hereinafter the 'Proposal') of 2 April

2. DISCUSSIONS IN THE COUNCIL

The Chair debriefed the experts in the group on progress made on the Savings Directive since the last meeting of the Group of 3 March. The Chair noted that the OECD and the G20 have emphasised the fight against tax havens and recommended that banking secrecy should be lifted. It was noted that Belgium has decided to apply the automatic exchange of information on interest payments made as from 1st January 2010.. On 9 June in its good governance conclusions, the Council agreed on the following regarding the Savings Directive:

(i) an extension of the scope of the Directive to at least other substantially equivalent income than just interest from savings;

(ii) the introduction of a look-through approach for payments to certain non-EU entities and arrangements and a more systematic application of the paying agent upon receipt responsibilities;

(iii) a broader use of personal identification numbers and the use of the information on actual tax residence, when available, in identification procedures.

In regard to the Savings Directive, the Czech Presidency issued an amending Proposal[1] (the 'Proposal') on 2 April. A technical meeting took place in 26 May to review three areas which Member States still need to resolve:

(i) The extent to which life insurance products should be included in the scope of the Directive;

(ii) Paying agent on receipt responsibilities;

(iii) The concept of 'place of effective management.'

The Swedish presidency will provide an update to the Proposal, in collaboration with the Commission, which will hopefully be issued on July, 2009. This will allow MS to review the Proposal for a Council meeting envisaged for 9 September. Nevertheless, it will still be useful

[1] The Czech Presidency's compromise text on the proposal for the Directive on taxation of savings (2 April 8346/09).

to have the views of experts on the Proposal of 2 April in order to communicate the concerns of market operators to the Presidency.

The Commission intends to start negotiations on the 5 third country agreements within the next month. Contact will be made with the United Kingdom and the Netherlands in regard to the associated and dependent territories for which they are responsible. In particular, it is envisaged that automatic exchange of information should now be included in all these agreements. Consequently, the result of the negotiations on this point will have an impact on whether the withholding tax mechanism will be maintained in the current Directive. Further discussions will continue with other third countries (notably Macao, Singapore and Hong Kong).

3. DISCUSSION ON THE PROPOSAL

The experts were requested to give their comments on the articles of the Proposal.

An expert representing the European Banking Federation (EBF) raised a concern about the 'look-through' approach envisaged in Article 1 of the Proposal where the EU paying agent is obliged to use the AMLD (the Third Anti-Money Laundering Directive) for a non EU legal arrangement/entity listed in Annex I of the Proposal. The expert doubted whether all paying agents in the EU will have the information at their disposable in order to fulfil this requirement. Furthermore, in connection with the negotiations with third countries and associated/dependent territories, the expert questioned what the imposition of exchange of information with these jurisdictions will mean in practice. If they do not already possess the information regarding the beneficial owner in the first place then it is debatable how useful this mechanism will be for tax authorities in the EU.

The Chair advised the Group to wait for the OECD proposal on the content of information on exchange before we decide whether the mechanism will be useful for tax authorities in the EU.

Another expert representing EBF stressed the need to have equivalent measures on exchange of information, as contained in the Savings Directive, in the agreements with third countries.

The Chair noted that it is the intention of the Commission to have measures equivalent to those in the Savings Directive and is encouraged by the positive responses received by the Commission from the initial contacts with third countries.

An expert representing European Forum of Securities Associations (EFSA) supported the concerns of EBF regarding the competitive position of EU financial centres. The expert also noted that experts from the City Group (which is a member of EFSA) are concerned about the comitology procedure contained in the Proposal and wondered whether this would grant too much power to the Commission.

The Chair stressed that, as restated during the discussions with Ireland on the Lisbon Treaty, there will be no change regarding the taxation rights of Member States.

The Commission services noted that Article 2 of the Proposal has been problematic for some Member States with regard to the concept of 'place of effective management'. This concept was introduced in order that tax authorities can trace beneficial owners who are resident in the

EU but who use a legal arrangement/entity established in a non EU jurisdiction in order to circumvent the Directive. Some Member States do not use place of effective management (as contained in the OECD MTC) to determine residence therefore they are reluctant to have this concept in the Proposal.
Commission services noted that there is an inconsistency in the Proposal: Articles 8 and 11 refer to the state of establishment instead of the place of effective management, as stipulated in Article 2. This inconsistency will be reported to the Swedish presidency. Commission services noted that it is the intention of the Swedish presidency to make reference to the person who primarily holds legal title and primarily manages its property and income rather than the legal arrangement/entity itself.

An expert representing EBF was concerned about the wording in the Directive 'its legal form, the name of the person who primarily holds legal title and primarily manages its property and income **and** the permanent address of that person'. In connection with the word *and,* he wonders what would happen in situations where there are two individuals who are located in two different jurisdictions, one which could be in the EU and the other outside the EU. In this scenario, no individual would be identified by the Directive.

An expert representing the Society of Trust and Estate Practitioners (STEP) agreed that this was a very relevant point. It would be difficult to identify 'the person who primarily holds legal title and primarily manages its property and income.' This would be feasible in a simple fund, however, more often trustees and fund managers will be resident in many jurisdictions, some of which will be outside the EU. The expert agreed with the comment in the Presidency progress report which stipulates that 'place of effective management' is a well know concept. However, it is also important to look at the commentaries to this concept in the OECD MTC which are highly complex. This degree of complexity would need to be introduced into the Proposal in order for the phrase to have any effect. As it now stands, the proposal is far too simplistic and does not lend itself to complex structures.

Concerning Article 2, an expert representing the EBF noted that paying agents do not always have the information available to make these judgements concerning the place of effective management. He recommended that the Proposal should have simple rules for paying agents, for example it would be easier to refer to where the trustee is established.

Another expert from EBF noted that the OECD definition of permanent establishment is used by tax authorities **after** a particular tax year in order to identify whether a beneficial owner is resident in their jurisdiction. In the scenario of the Proposal, the paying agents will be forced to identify this at the time of the transaction and before a decision is taken by the relevant tax authorities concerning possible residence.

The Chair acknowledged that there should be a refinement of this article especially in respect of the word 'primarily'. However, the Chair emphasised that Member States, by the use of the Directive, wish to establish whether the beneficial owners of these legal arrangements and entities are resident in the EU. If there is a simpler way of doing this then the Chair welcomed suggestions from the experts and will put these forward to the Presidency.

The Commission services noted that the Presidency has suggested simplifying the text so that economic operators can rely on representations of the trustees made through the mechanism of the AMLD regarding who manages the legal arrangement/entity. The problem with using the place of establishment of the trust in order to simplify matters is that often this entity is

not taxed and the beneficial owners are located in other jurisdictions. The aforementioned concept of effective management relates more directly to residence for Member States purposes.

An expert representing STEP noted that there is a difference between subject to tax and subject to the Directive. The expert understood the concerns of the Commission but does not think that the present wording will help in ensuring effective taxation. A trustee will irrevocably delegate the powers of management to a fund manager and does not have the power to interfere in the day to day management of a fund. The Proposal should establish specific rules in order to determine the residence of the fund, as the UK currently has, in order to determine where a trust is resident for taxation purposes. In the UK, trusts are taxed and specific detailed rules are given to enable this. It can be done but the current text in the Proposal does not achieve this.

An expert from the International Swaps and Derivatives Association (ISDA): agreed that there should be more clarity for paying agents in the Proposal and that they should not have to make subjective judgements to determine the place of effective management of a trust. It is necessary to provide clear guidelines for paying agents.

An expert from EBF noted that under the AMLD, banks and other similar operators are supposed to identify beneficial owners above a 25% ownership threshold, however, trustees are not obliged to know the beneficial owners of a trust or the settlor (only the trust company needs to provide this information).

An expert from the Alternative Investment Management Association (AIMA) supported the aim of having a positive list in Annex I in order to help paying agents identify situations where paying agents should report interest payments. Inserting the concept of 'effective management ' only confuses matters.

The Chair noted that the look-through approach has been introduced in order to prevent circumvention of the Proposal. It is important to have a flow of information back to the EU jurisdictions where the beneficial owner may be resident. Naturally there should also be a mechanism for tax refunds in the case of Member States which levy withholding tax.

An expert representing FEE (Fédération des Experts Comptables Européens) did not understand the virtue of replacing the permanent address concept in the Directive with the place of effective management. The concept of place of effective management as it now stands in the Proposal is not clearly defined. Furthermore, the concepts of the legal arrangement/entity are not defined.

An expert representing STEP considered that Annex I as it currently stands could be misleading. It lists countries and the categories of companies, including trusts, which would be considered as coming within the scope of the Directive and where the look-through approach would be applied. However, it is important to explain in the Annex to which country we refer: where the trust is established and governed as a matter of law or where the trust is deemed to be resident. In order to introduce clarity he prefers that the text should make reference to 'Trusts defined by whichever jurisdiction'.

The Commission services agreed that this should be clarified in the Annex I by referring to where the trust or entity is resident *or* where the trust or entity is established.

An expert from STEP suggested that we apply the wording of the present Proposal to entities/legal arrangements in certain third countries in order to see whether these would be included within the scope of the Directive.

The Chair explained that this is why the Proposal is being scrutinised by the Council. The Chair then referred to pages 10 & 11 of the Proposal and wanted to know whether the certificate procedure established under Article 3 'Identity and residence of beneficial owner' is acceptable?

An expert representing the European Association of Cooperative Banks (EACB) stated that he was in disagreement with paragraph 2 (b) where it states that the tax identification number should be identified for clients as from 1 January, 2004. This requirement should not be retrospective.

An expert representing EBF was concerned about the retrospective nature of the sub paragraph of Article 2 (b) when it refers to information regarding date of birth etc. The expert explained that often paying agents will not have this information available to them and it is therefore debatable whether these requirements should be retrospective as from 1 January, 2004. Furthermore, he wondered what is meant by 'other official documentary proof of identity'.

The Commission services replied that 'official' applies to the identity of the beneficial owner while 'other official documents' refers to the permanent address. The Commission services then referred to page 13 where the Presidency removed the phrase: 'Member States shall take appropriate measures to ensure that there is no overlap of paying agent responsibilities in respect of the same interest payment'. If the reference is to be reinstated in the Proposal we require better drafting in the text. The Presidency would be grateful if market operators could come up with a better wording.

An expert representing EBF commented that the problem of the original wording was that it left it up to Member States to have bilateral negotiations between themselves as to what constitutes an overlap.

On article 3) 3°, another expert representing EBF stated that it could be problematic to track tax residence certificates that have been issued after 1 January, 2004.

An expert representing STEP wondered why 'information' has replaced 'evidence' in Article 4 (b). On Article 4 (2) paying agent on receipt, the reporting of a distribution from a paying agent on receipt to the beneficial owner could relate to capital instead of interest income. Furthermore, there is a concern that the anti-avoidance measures can be circumvented with the phrase 'immediately entitled to assets'. What period does immediately entitled cover: six months or three years? In addition, under the current Proposal, the tax authorities may receive information they do not require.

The Commission services then presented the new wording on Article 4(2) and Article 6(4) (paying agent on receipt provisions) that was presented in the tax working group of the Council by a Member State. The main difference between the new wording and that already contained in the Proposal is that it obliges the paying agent to track when an individual is entitled to the assets producing such interest payment or other assets representing the interest

payment for a period of 10 years from the date of the last interest payment received or secured by the entity or legal arrangement or the last date that an individual becomes entitled to such assets, whichever date is the later. The reaction to this wording from Member States was broadly favourable. Under the Proposal the paying agent on receipt was obliged to track the interest income indefinitely. The Member States agreed that this was not proportional and indeed ECJ jurisprudence limits the amount of time in which tax payers are liable for tax evasion.

An expert representing STEP welcomed the suggested amendment to the paying agent on receipt provisions in the Proposal, but wanted to highlight some reservations over the concepts contained in both the Proposal and the amendment:

(i) The amendment refers to 'assets' instead of 'income' received by the beneficial owner. The assets producing the interest income may have nothing to do with the trust and be located elsewhere;

(ii) It is not certain whether there is a link between the assets and the interest income that this produces for the beneficial owner. Apart from the most simple of trusts, it would be difficult to link any interest payment from the fund to the beneficial owner with the assets of the fund and as such it would be impossible to accurately report the interest payment received by the beneficial owner;

(iii) There is a mix up of the concepts of residence – in the amendment reference is made to place of administration while in the Proposal a reference is made to the place of effective management;

(iv) Regarding the 10 year provision, there are doubts about whether Member States will have all this information available;

(v) When the beneficial owner is entitled to the assets then the trust no longer exists.

An expert representing EBF noted that the definition of beneficial owner in the amendment is different from that in the AMLD. Secondly, sub point (i) refers to the person legally entitled to the assets, but it is the trustee and not the beneficial owner who is legally entitled to the assets. A situation could therefore arise where the paying agent and the beneficial owner are one and the same.

The Chair wondered whether it would be more effective to refer to income rather than assets in the paying agent on receipt provisions in the Proposal.

An expert representing STEP agreed that reference should be made to the interest income rather than assets. As it now stands, the income reporting would relate to the trustees and not the beneficial owners. In terms of Article 4 (2), the expert stated that we should direct attention to income arising under the arrangement rather than the assets/capital itself.

The Commission services acknowledged that neither the beneficiary nor the settlor has entitlement to assets in a trust. There are situations when a trust receives an interest payment, but where the beneficial owner is not immediately entitled to the interest income but will become entitled to the income at a later stage. It is therefore important to make this link. It is intended that the Proposal should make reference to the beneficial owner and not the trustee.

Furthermore, the Commission services noted that Annex I is a compulsory list using the look-through approach. Annex III is not an exhaustive list and does not limit the Member States to where the entity/legal arrangement has its place of effective management. There could be other entities that fall under Annex III therefore the state of paying agent on receipt should not be restricted by having a list that is claimed to be definitive. It would be difficult to make an exhaustive list especially if a comitology procedure is not accepted

An expert representing EBF noted that the Proposal obliges paying agents to determine the place of effective management of the beneficial owner and wonders whether this extra burden on paying agents justifies the benefit that may arise from this amendment. The expert strongly advised that the Proposal should flag the actual interest payment. Annexes I and III should operate on the basis of the country of establishment of the legal arrangement/entity rather than the place of effective management. Furthermore, the expert considered that the most effective way for Member States to achieve their objectives is to 'follow where the money goes' from the foundations/trusts using the mechanism of information on request under the Mutual Assistance Directive.

The Commission services replied that the problem with a request for information on exchange is that the request needs to be targeted for it to be accepted by the other party.

An expert representing STEP considered that the Proposal allows too much flexibility for Member States to define what is meant by 'charitable'. Guidance should be sought from ECJ jurisprudence.

An expert representing EFAMA stated that it could be confusing for a paying agent to judge whether an entity or legal arrangement is excluded from Annex III due to its charitable status.

The Commission services emphasised that upstream economic operators are not required to make judgements about the status of the paying agent on receipt. This is only relevant for Annex III where the entity (a charity for example) has its place of effective management.

The Commission services then presented Article 6.1 (aa). It noted that some Member States preferred the original wording in the Commission proposal and not the word 'guarantee' as in 'where the conditions of a return of capital defined at the issuing date guarantee that the investor, at the end of the term, receives at least 95% of the capital invested'. It could be confused as only referring to debt claims and not to structured securities.

An expert representing the International Swaps and Derivatives Association (ISDA) noted that their association had not been able to circulate the new definition among their members in time for this meeting. The expert was concerned that using the word 'guarantee' could let innovative financial problems circumvent the Directive. Under paragraph 2 of article 6, paying agents have the option of just reporting the interest element of a payment. However, some paying agents will report both income and capital together giving rise to a potential problem of their correct taxation. The expert believed that the issuers of the instruments should be given the option of disclosing which part of the payment relates to interest and which to capital. Grandfathering is also important in order to give a lead time for paying agents to get their reporting in place. Furthermore, the expert was concerned that genuine structured products like swaps which have a high percentage of their assets in debt claims (related to collateral) will be included in the scope of the Directive. The expert also believed that the articles related to securities and funds are also brought into the agreements.

An expert representing the Alternative Investment Management Association (AIMA) agreed with the comments of ISDA. Furthermore, he was concerned that the definition brings all hedge funds into the scope of the Directive, although they have not been set up to return interest income –the Directive should take into account the objectives of the investment and as well as the composition of the assets.

The Commission services explained that there is no definition of interest payment in the Directive as the intention of the Directive is to cover equivalent income forms, whether they arise from capital or interest. It was acknowledged that tax authorities would tax capital and income differently, but the underlying point of the Directive is to identify and exchange information on equivalent forms of income.

The expert representing ISDA noted that when paying agents report it to the tax authority, they will include everything together, both capital and income. The tax authorities will not know whether the reported income relates to debt claims or income from structured products.

The Commission services noted that, according to Article 8 of the Proposal, income from debt claims is reported separately from structured products.

An expert from the Association of Life Offices (AILO) was against life insurance being included in the Directive. Furthermore, the expert wanted to know what the word 'predominantly' meant in the context of the Directive? Both income and capital will be reported. The proposal should refer to insurance products that are fully linked to debt claims and fully linked at all times. Furthermore, the expert thinks that death benefits should not be included in the Proposal and that grandfathering is essential.

The Chair wanted to know the reaction of the experts to the new wording on Article 6 as submitted by a Member State to the Council tax working group?

The expert from AILO replied that as long as life insurance is defined well then there is no need to have a definition for biometric risk. Different states may define it differently. There already exists extensive reporting obligations in the EU and this Proposal will duplicate work for life insurance operators. If we have an option in the Proposal for non-duplication we can go further and Member States could say that they do not want reporting of interest payments.

An expert representing the Comité Européen des Assurances was in agreement with the elimination of the definition of biometric risk in the Proposal. For insurance operators, it will be burdensome to assess the composition of assets in a life insurance fund therefore it is preferable that life insurance is 'fully linked'. The expert agreed with the comments given by life insurance operators that if there is not a good definition of life insurance then it should be excluded from the scope of the Directive.

An expert representing EFAMA considered that the definition, including that of biometric risk, is too vague and is not known and used in some countries. Fully linked would mean that too many insurance products would be outside the scope of the definition. The asset test should assess the contract during its whole duration. Grandfathering is not applicable to the fund industry as it is not possible to make a distinction between shares acquired before 1/12/2008 or after, therefore the same cut off date for funds, securities and life insurance in order to ensure a level playing field.

On Article 6 (6), an expert representing EFAMA was concerned that there was no reference to accumulating funds only distributing funds. The 'de mnimis rule' is only applied for target investments for distributing funds. The expert considered that this is unfair for accumulating funds. The 'home rule' should be integrated and inserted in the text as far as the calculation of the composition of funds is concerned. We will make available a paper that exists for the group after the meeting.

Another expert representing EFAMA expressed their concern that REITS[2] will be within the scope of the Directive as they are often held by special purpose vehicles which have significant amounts of debt claims.

The Commission that REITS are neither excluded from the Proposal nor the current Directive. It is the intention of Member States to include REITS in the Proposal if they are deemed to fall within the scope of the Directive as structured products. The Commission services are not aware of any Member State objecting to including REITS in the Proposal. It is the intention that REITS are also included in the agreement with Switzerland.

3. Conclusion

The Commission welcomed written comments from experts in particular for the three subjects that were discussed in depth today: life insurance, paying agents on receipt and place of effective management.

The next meeting of the group will be in October in which the new Proposal from the Presidency will be discussed.

[2] REITS: Real estate investment trusts