COMMISSION OF THE EUROPEAN COMMUNITIES

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98/0193 (CNS)

Proposal for a
COUNCIL DIRECTIVE

to ensure a minimum of effective taxation of savings income in the form of interest payments within the Community

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(presented by the Commission)

EXPLANATORY MEMORANDUM

I. INTRODUCTION

General

1. In its Communication of 5 November 1997 entitled "A package to tackle harmful tax competition in the European Union"[1] the Commission stressed the need for coordinated action at a European level to tackle harmful tax competition in order to help achieve certain objectives such as reducing the continuing distortions in the internal market, preventing excessive losses of tax revenue and encouraging tax structures to develop in a more employment-friendly way. The Ecofin Council of 1 December 1997[2] held a wide-ranging debate on the basis of that Communication, agreed to a Resolution on a code of conduct for business taxation, approved a text on the taxation of savings as the basis for a Directive in this field and considered that the Commission should present a proposal for a Directive on interest and royalty payments between companies. In line with the agreement of 1 December, the Commission adopted on 4 March 1998[3] a proposal for a Directive on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States. This Memorandum deals with the proposal for a Directive to ensure a minimum of effective taxation of savings income in the form of interest payments within the Community.

2. The difficulty of ensuring a minimum of effective taxation of interest payments in the Community has been felt more and more acutely as progress has been achieved in the field of liberalization of capital movements. As provided for by Council Directive 88/361/EEC of 24 June 1988[4], which enabled capital movements to be completely liberalized, the Commission presented on 10 February 1989 a proposal for a Council Directive on a common system of withholding tax on interest income[5]. This proposal, which was aimed at introducing a single system of withholding tax throughout the Community, did not, however, win the unanimous agreement of Member States within the Council. It is being withdrawn at the same time as this new proposal is being presented.

3. The scope for non-taxation of cross-border interest payments in the Community is the cause of economic distortions which are incompatible with the proper functioning of the single market. The European financial area, the creation of which was made possible by the liberalization of capital movements, cannot deliver all its benefits if savers' decisions are determined by the possibility of avoiding tax instead of being taken in the light of a comparison between investment alternatives based on their intrinsic merits. The need for joint action to eliminate these economic distortions is rendered all the more urgent by the start of the third stage of economic and monetary union, which will further facilitate the cross-border investment of savings.

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1 COM(97) 564 final, 5.11.1997.

2 OJ C 2, 6.1.1998, p. 1.

3 COM(1998) 67 final, 4.3.1998, and OJ C 123, 22.4.1998, p. 9.

4 OJ L 178, 8.7.1988, p. 5.

5 COM(89) 60 final and OJ C 141, 7.6.1989, p. 5.

4. The budgetary discipline required of Member States also means that the erosion of tax bases linked to the absence of guarantees concerning a minimum of effective taxation on the cross-border investment of savings is becoming less and less acceptable. Against this background, the absence of guarantees concerning a minimum of effective taxation on the cross-border investment of savings is also hindering Member States' efforts to restore the balance in terms of the burden of taxation between the different factors of production and thereby to achieve a reduction in the level of total taxation on income from employment, something which would be certain to have a favourable impact on job creation and the fight against unemployment.

Coexistence model

5. Having regard to the principles of subsidiarity and proportionality and in accordance with the agreement reached by the Ecofin Council on 1 December 1997, the proposal is based on the "coexistence model", under which each Member State applies a withholding tax at source or provides information on income from savings to other Member States. The advantage of the coexistence model is that Member States which are prepared to apply one of these systems can encounter difficulties in applying the other one and this makes the adoption of a common system for the whole of the Community very difficult.

6. The possibility of allowing those Member States which apply the withholding-tax system to implement, moreover, any information exchange measures which are set in place by national provisions or bilateral agreements concluded with other Member States has also been catered for.

7. The scope of the proposal has been limited to interest paid in each Member State to individuals resident in another Member State. All cross-border interest payments made to individuals within the Community are covered, irrespective of the place of establishment of the debtor.

8. As the objective is to allow a minimum of effective taxation on cross-border interest payments received by residents of each of the Member States, it was necessary to require those Member States which apply the information system to communicate information to all the other Member States, with each of the latter of course receiving only information on its own residents.

9. Given the differences in the level of taxation borne by residents of the various Member States, however, it is difficult to determine a minimum rate of withholding tax which satisfies the requirement of a minimum of effective taxation of income from savings in the case of all the Member States. It would not be appropriate to set the rate of withholding tax at too low a level since, although the withholding tax is not intended to be in full discharge of tax liability, it could become so in practice if the beneficiary does not declare the income in question in his country of residence. Consideration must also be given to the competitiveness of European financial markets and to the risk that setting the rate of withholding tax at too high a level could trigger an outflow of savings from the Community.

10. The Commission has come to the conclusion that a balanced solution to the problem of setting the rate of withholding tax would be to adopt a minimum rate of 20%, together with a corrective mechanism enabling the beneficiary, at his own initiative and without encroaching on the confidentiality of banking information, to be taxed according to the rules of his Member State of residence. This corrective mechanism is based on the issue, by the tax authorities of the Member State of residence, of a certificate proving that the beneficiary has informed those authorities of the amount of interest to be received.

11. In brief, the coexistence model, as presented in the proposal, foresees that each Member State has the choice between two systems, the information system (provision of information to all other Member States in which the beneficiary is resident) and the withholding-tax system (levying a withholding tax of 20%). Each Member State may choose one, but only one, of the two systems and apply that system to all payments of interest in its territory to residents of all other Member States. Moreover, it is possible for the beneficial owner receiving a payment in a Member State which has chosen the withholding-tax system, to obtain a modification of this system by the certificate process; the beneficiary can ensure that he is taxed exclusively in the Member State where he is resident for tax purposes as if he were receiving a payment in a Member State which had opted for the information system.

12. The efficacy of any measure intended to ensure effective taxation of savings income cannot be guaranteed without the cooperation of market operators. In the context of this Directive, in which the withholding-tax system and the information system coexist and the scope of the provisions is limited to interest paid to non-resident individuals, the paying agent is clearly the market operator most capable of implementing effectively the measures required by the Directive.

13. The paying agent can check, using simple procedures and at little cost, whether the interest is paid to an individual and to request that he provides proof of his residence for tax purposes. Except in the case of interest produced by bank accounts and deposits, the debtor is rarely in contact with the beneficiaries and would have difficulty in distinguishing between them. The lack of contact with beneficiaries would also make the role of the debtor more difficult and costly in Member States opting for the information system.

14. The allocation of tasks to the paying agent has, furthermore, the effect, if payment is made in one Member State to an individual resident in another Member State, of including in the scope of the Directive interest from securities issued by debtors who are established outside the Community. The issuing activities of European businesses, in competition with issuers outside the Community, are thus much less affected than if the determinant role was assumed by the debtor as was the case in the Directive presented by the Commission on 10 February 1989. The new approach based on the responsibility of the paying agent, and the application of the Directive only to payments destined for individuals resident in other Member States, strongly limits the impact of the proposed measures on the Eurobond Market. It should be noted that this Market appears principally to be sustained by institutional investors and the part sustained by individual investors by those who are not resident in the Community. The Commission believes that this new direction of the Directive no longer justifies the exclusion of Eurobonds from its scope, as was an option in the 1989 Directive.

15. The Council, in its conclusions of 1 December 1997 on the taxation of savings, considered that the provisions of the Directive should take into account the need to preserve the competitiveness of European financial markets and indicated that the basic principles should be adopted as widely as possible. To this end, the Community should enter into negotiations with its main third country commercial partners, either bilaterally or multilaterally, to allow it to ensure the effective taxation of savings income covered by this Directive paid to residents for tax purposes in the Member States by paying agents established in those third countries. Moreover, Member States must undertake, towards the same ends, to promote the application of provisions equivalent to those of the Directive in territories which do not fall within the scope of the Directive. In particular, Member States which have dependant or associated territories or which have particular responsibilities or taxation prerogatives in respect of other territories must undertake, where appropriate within the framework of their constitutional arrangements, to ensure that measures equivalent to those of the Directive may be applied in those territories. These undertakings should be effected by means of the adoption, in parallel with the discussion of this Directive, of a decision of the Representatives of the Governments of the Member States meeting within the Council on the basis of the model proposed jointly with the proposal for a Directive (see Annex).

II. COMMENTARY ON THE ARTICLES OF THE PROPOSAL FOR A DIRECTIVE

Article 1

1. This Directive is aimed at allowing a minimum of effective taxation of income from savings. It applies to interest received by individuals who have their residence for tax purposes within the Community, but in a different Member State to the one where the interest is paid.

2. The Directive applies to interest paid in the territory of Member States, regardless of the place of establishment of the capital debtor. Each Member State must take measures to ensure that agents established within its territory which pay interest perform the tasks which have been assigned to them for the purpose of implementing the Directive.

Article 2

The Directive is based on the coexistence of two systems, namely the information system and the withholding-tax system. Each Member State in which the interest is paid must opt either for one system or the other and the system chosen be applied to all interest paid in its territory to residents of all other Member States.

Article 3

(a) Definition of *beneficial owner*

The beneficial owner is any individual who receives interest in his own right. This excludes from the scope of the Directive interest payments made for the benefit of legal persons or companies, as well as those made to individuals who receive them in a professional capacity as agent, trustee or nominee for another person.

(b) Definition of *paying agent*

The object of this definition is to guarantee the identification of a single paying agent in the following situations:

- where the interest payment for the benefit of the beneficial owner is made directly by the debtor, he is identified as the paying agent;

- if, on the other hand, the debtor charges another economic operator with making the payment to the beneficial owner, that operator is identified as the paying agent;

- Any party which, in connection with a business or professional activity, pays its customers interest arising from management of their property is also identified as a paying agent.

Where the interest payment is made via a number of intermediaries, possibly established in different countries or territories, "interest payment" means only the transaction whereby the interest is paid for the immediate benefit of the beneficial owner, and "paying agent" means only the last party established within the territory of the European Community which carries out that transaction.

(c) Definition relating to *residence for tax purposes*

To allow the resolution of any dispute between two or more Member States in determining the residence for tax purposes, the Article foresees the application of successive criteria for identifying tax residence for the purposes of the Directive.

(d) Definition of *competent authority*

The competent authorities are those defined in Article 1(5) of Council Directive 77/799/EEC[6] of 19 December 1977 concerning mutual assistance by the competent authorities of Member States in the field of direct and indirect taxation.

Article 4

In keeping with the principle of subsidiarity, it is for Member States to choose the most suitable practical arrangements for identifying beneficial owners and determining their place of residence for tax purposes. The identification procedures laid down by each Member State are to be applied by market operators: it is therefore desirable that - at least for the most common transactions and those which are least open to abuse - these identification procedures should not be too cumbersome, while retaining a level of effectiveness that enables the objective pursued by the Directive to be achieved.

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[6] Published in OJ L 336, 27.12.1977, p. 15 and subsequently amended by Council Directives 79/1070/EEC of 6.12.1979 (OJ L 331, 27.12.1979, p. 8) and 92/12/EEC of 25.2.1992 (OJ L 76, 23.3.1992, p. 1) and most recently by the Act of Accession of Austria, Finland and Sweden (Decision 95/1/EC, OJ L 1, 1.1.1995, p. 1).

Article 5

(a) The term "debt-claims of any kind" clearly encompasses cash deposits and cash guarantees. Bonds which carry a right to participate in the debtor's profits are to be regarded as producing interest and not dividends, unless the funds loaned actually bear a share of the risks incurred by the debtor.

(b) Although the extremely broad definition in point (a) leaves no doubt that income from zero-coupon bonds and similar debt-claims is included in the scope of the Directive, it is useful to emphasize that any increase in the value of these debt-claims constitutes income for the purposes of this Directive. This increase in value comes within the scope of the Directive when it is paid by the paying agent on reimbursement of the debt-claim or of the corresponding security.

(c) This point provides similarly that savings income received indirectly, via collective investment undertakings, from securities representing debt-claims is to be regarded as interest for the purposes of the Directive. In order to identify the collective investment undertakings involved, a uniform criterion has been laid down, in terms of the composition of the assets invested, for defining the collective investment undertakings that produce income which is regarded as interest when received by unit-holders.

(d) In order to prevent distortions of competition between comparable financial instruments, the capitalized income of collective investment undertakings which have invested more than 50% of their assets in bonds and similar securities is also regarded as interest of which unit-holders can receive the benefit when their units are redeemed.

Article 6

The scope of the Directive is the territory to which the provisions of the EC Treaty apply, having due regard to Article 227 of that Treaty.

Article 7

1. When applying the information system, a Member State must communicate the information provided for in the Directive, without there being a need for reciprocity, to any other Member State in which the beneficial owner has his residence for tax purposes.

2. This paragraph indicates the type of information which must always be given by Member States which apply the information system. These Member States are also free to communicate other information.

3. The provision of information on request only would not be compatible with the aim of the Directive, since it would not give the assurance that the interest in question could be taxed.

4. It is stipulated that Article 8 of Directive 77/799/EEC does not apply to information which must be supplied under this Directive. The fact is that any reliance on that Article by Member States applying the information system would be certain to undermine achievement of the aim of this Directive. The provision of information on a reciprocal basis only (a possibility allowed by Article 8(3) of

Directive 77/799/EEC) would in particular enable residents of certain Member States (those which are unable to communicate information) to escape any form of taxation on cross-border interest payments they receive.

Article 8

1. The fact that a minimum rate of 20% is set does not prevent Member States from applying a higher rate if they so wish. The prohibition on any other withholding tax on interest payments covered by the Directive applies to all Member States (including those which have opted for the information system under this Directive).

2. From the point of view of this Directive, the withholding tax levied by the Member State in which the interest is paid is not normally a definitive deduction and does not fully discharge the beneficiary's tax liability in his country of residence. The deduction of withholding tax is regarded as a practical means of allowing a minimum of effective taxation of cross-border interest payments in the Community. That objective is also achieved when the beneficiary can prove, by means of a certificate, that he has informed his own tax authorities of the income he is receiving in another Member State: the deduction of withholding tax is not considered necessary in such cases, as it is possible that the income will be taxed in the beneficiary's Member State of residence.

3. Those Member States which apply the withholding-tax system are allowed to arrange for information on the payment of interest subject to withholding tax also to be made available to the Member State in which the beneficiary is resident for tax purposes. The provision of such information, which may be based on national provisions or bilateral agreements, is not regulated by this Directive, although its compatibility with the Directive is explicitly recognized.

Article 9

This Article is intended to specify the information which must feature in the certificate to be issued by the tax authorities of Member States to a beneficial owner of interest who requests it. The beneficial owner can, of course, request more than one certificate from his authorities, not only when he has invested in a number of Member States which apply the withholding-tax system, but also when interest payments are made to him by several different entities within the same Member State.

Article 10

1. Paragraph 1 recalls, within the Directive, the obligation to eliminate double taxation on the interest received.

2. Paragraph 2 lays down the basic principle that each Member State must, when establishing the income tax liability of its residents, take account of any withholding tax which has been applied in another Member State pursuant to this Directive.

   The basic approach adopted is the "normal imputation" system, which involves granting tax relief not exceeding the lower of the following two amounts:

   - the amount of withholding tax which the beneficiary can demonstrate that he has effectively incurred in the Member State where the interest was paid;

- the portion of the beneficiary's income tax liability, which, in accordance with the national law of the Member State in which the beneficiary is resident, corresponds to the interest in respect of which the withholding tax was deducted.

Only the Member State of the paying agent is required to refund any amount of withholding tax in excess of that which can be utilized in this way by the beneficial owner in the Member State in which he is resident.

3. Paragraph 3 indicates the special rules to be followed, both in the Member State where the interest is paid and in the beneficiary's Member State of residence, in order to take account of withholding taxes and other direct taxes already levied on the income of collective investment undertakings corresponding to the same interest. These special rules are aimed at ensuring neutrality in treatment as between the direct investment of savings and investment via a collective investment undertaking. It is for Member States to establish the criteria - which should not too onerous - to allow beneficial owners and paying agents established in their territory to prove the effective taxation borne, through collective investment undertakings, by income corresponding to interest paid.

   (a) Subparagraph (a) concerns payments of interest in Member States which have opted for the information system;

   (b) Subparagraph (b) provides specific rules for payments made in Member States which have opted for the withholding-tax system. Having regard to the fact that the taxes which have already been paid are taken into account by the Member State of residence according to the system of "ordinary imputation" (see the description in paragraph 2 above), application of the withholding tax at the normal rate, added to the taxes borne by the collective investment undertakings, would have the effect of multiplying cases where taxes paid could not be wholly deducted in the Member State of residence.

4. Paragraph 4 recognizes that bilateral conventions for the avoidance of double taxation often grant a right to levy tax, in the form of a withholding tax, to the State where the debtor is established, which is not necessarily the Member State where the interest is paid. While Article 8 prohibits the levying of withholding taxes on such a basis in relations between Member States, the same situation does not apply to relations with non-member countries with regard to securities issued in their territory. In order to avoid cases of double taxation, a mechanism has been devised for taking account of withholding taxes already incurred when calculating the amount of withholding tax to be deducted under this Directive. It is for each of the Member States applying the withholding-tax system to specify, as far as interest payments made in its territory are concerned, the proof to be presented by the beneficiary so that the paying agent can take account of withholding taxes already incurred.

Article 11

The Community shall enter into negotiations with its main third country commercial partners either on a bilateral or on a multilateral basis, in order to ensure the effective taxation of income from savings covered by this Directive which is paid to residents for tax purposes of the Member States by paying agents established in such third countries.

Article 12

Paragraph 1 lays down the timetable for transposing the Directive into Member States' national laws. In view of the need to allow paying agents time to adapt their procedures in line with the arrangements adopted by Member States pursuant to the Directive, it was deemed appropriate to stagger the deadlines for the adoption and the entry into force of national measures. The obligation to communicate to the Commission the national provisions adopted, prior to their entry into force, is intended to ensure correct implementation of the Directive.

Paragraph 2 confirms the standard requirements regarding the communication by Member States of the national provisions they adopt for the purpose of transposing the Directive.

Article 13

The Commission considers that, as established in the conclusions of the Ecofin Council on 1 December 1997, the coexistence model constitutes a first step towards effective taxation of savings income throughout the Community and that a review of the situation should be planned with the aim of determining to what extent further progress would be conceivable.

Proposal for a
COUNCIL DIRECTIVE

to ensure a minimum of effective taxation of savings income in the form of interest payments within the Community

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty establishing the European Community, and in particular Article 100 thereof,

Having regard to the proposal from the Commission[7],

Having regard to the opinion of the European Parliament[8],

Having regard to the opinion of the Economic and Social Committee[9],

(1) Whereas Council Directive 88/361/EEC of 24 June 1988 for the implementation of Article 67 of the Treaty[10] has allowed the complete liberalization of capital movements, including direct investment, taking place in the Community between residents of Member States since 1 July 1990; whereas the free movement of capital has, since 1 January 1994, been enshrined in Articles 73b to 73g of the Treaty;

(2) Whereas savings income, in the form of interest payments, from direct investment is taxable income for residents of all Member States;

(3) Whereas, by virtue of Article 73d(1) of the Treaty, Member States have the right to apply the relevant provisions of their tax law which distinguish between taxpayers who are not in the same situation with regard to their place of residence or with regard to the place where their capital is invested, and to take all requisite measures to prevent infringements of national law and regulations, in particular in the field of taxation;

(4) Whereas, in accordance with Article 73d(3) of the Treaty, the provisions of Member States' national tax law designed to counter abuse or fraud should not constitute a means of arbitrary discrimination or a disguised restriction on the free movement of capital and payments as established by Article 73b of the Treaty;

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7 OJ C

8 OJ C

9 OJ C

10 OJ L 178, 8.7.1988, p. 5.

(5) Whereas, in the absence of any coordination of national systems for the taxation of savings, particularly as far as the treatment of interest received in each Member State by non-residents is concerned, residents of Member States are currently able to avoid any form of taxation on interest they receive in a Member State other than the one in which they are resident;

(6) Whereas this scope for tax avoidance is creating, in capital movements between Member States, economic distortions which are incompatible with the existence of the internal market;

(7) Whereas, at the Ecofin Council meeting of 1 December 1997 concerning taxation policy[11], the Council in its conclusions relating to the taxation of savings approved the objective of guaranteeing a minimum of effective taxation of savings income within the Community and preventing undesirable distortions of competition; whereas to that end it agreed on a certain number of points which form the basis for this Directive;

(8) Whereas, in accordance with the principles of subsidiarity and proportionality set out in Article 3b of the Treaty, the objective of this Directive, which is that of the effective taxation of savings income within the Community, cannot be sufficiently realized by the Member States and can therefore be better achieved by the Community; whereas this Directive, as a first step towards such an objective, limits itself to the minimum required and does not go beyond what is necessary to achieve this objective, inasmuch as it applies only to interest paid by a paying agent established in one Member State to individuals who are resident in another Member State;

(9) Whereas, in the same way, the scope of this Directive should be limited to interest from the investment of capital; whereas the problems relating to the taxation of pensions and insurance benefits will consequently be the subject of separate consideration leading, where appropriate, to specific legislative initiatives;

(10) Whereas the objective pursued can be achieved thanks to the coexistence model, whereby Member States would choose either to operate a withholding tax on interest paid in their territory to non-residents (withholding-tax system) or to allow the Member State of residence for tax purposes of the beneficial owner of the interest to tax that interest through the communication of relevant information by the Member State of the paying agent (information system);

(11) Whereas, in the interests of legal certainty and transparency, Member States should be required to apply one and the same system to all interest paid within their territory to non-residents for tax purposes;

(12) Whereas, when opting for one of the two systems envisaged by this Directive, Member States should take the necessary measures to enable paying agents established within their territory to carry out the tasks required by this Directive;

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[11] OJ C 2, 6.1.1998, p. 1.

(13) Whereas it should be specified that, when interest is not paid direct to the beneficial owner by the debtor of the capital which produces the interest, the paying agent of the Member State responsible for carrying out the tasks envisaged above is the economic operator responsible for the payment of interest for the immediate benefit of the beneficial owner;

(14) Whereas 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 and indirect taxation[12], as last amended by the Act of Accession of Austria, Finland and Sweden already allows Member States some opportunity for securing appropriate taxation through a procedure for exchange of information;

(15) Whereas the automatic provision of appropriate information between Member States on the interest payments covered by this Directive constitutes a *conditio sine qua non* for the establishment of an information system; whereas it should be stipulated that Member States applying that system cannot rely on the right to limit the exchange of information referred to in Article 8 of Directive 77/799/EEC;

(16) Whereas it is important to ensure that Member States having opted for the withholding-tax system apply that withholding tax at a minimum effective rate, and to ensure that withholding tax is charged only once in the Community;

(17) Whereas when interest is paid by a paying agent established in a Member State which has opted for the withholding-tax system, the beneficial owner of the interest should, where he is resident for tax purposes in another Member State, be allowed the possibility of presenting a certificate to the paying agent so that the latter does not withhold tax;

(18) Whereas, to that end, the competent authorities of the Member States should be required to provide such a certificate within a reasonable period of time;

(19) Whereas the objective of allowing the effective taxation of interest paid between two or more Member States places a corresponding obligation on Member States to eliminate any double taxation of that interest;

(20) Whereas, where a withholding tax has been applied to interest, the Member State of residence for tax purposes of the beneficial owner should take account of that withholding tax up to the level of the tax due in its territory on such interest; whereas any difference should be reimbursed by the Member State where the paying agent is established;

(21) Whereas the same principle should be applied with regard to interest from certain collective investment undertakings; whereas it would be advisable to provide suitable procedures to ensure the elimination of all double taxation borne by the interest concerned;

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[12] OJ L 336, 27.12.1977, p. 15.

(22) Whereas the Council, in its conclusions of 1 December 1997 regarding the taxation of savings, emphasized the need to preserve the competitiveness of European financial markets, and stated that the basic principles of any Directive on the subject should be adopted as widely as possible; whereas, to this end, the Community must enter into negotiations with its main third country commercial partners, either on a bilateral or on a multilateral basis, in order to ensure the effective taxation of income from savings covered by this Directive which is paid to residents for tax purposes of the Member States by paying agents established in such third countries;

(23) Whereas provision should be made for a review of the situation by the Council, on the basis of a report by the Commission, three years after the date by which Member States are required to transpose the Directive, with the aim of determining to what extent further progress would be conceivable in order to ensure better effective taxation of savings income,

HAS ADOPTED THIS DIRECTIVE:

Article 1
Aim

1. Member States shall take the necessary measures to allow a minimum of effective taxation of interest paid to individuals who have their residence for tax purposes in a Member State other than the one where payment is made by a paying agent.

2. Member States shall take the necessary measures to ensure that the tasks necessary for the implementation of this Directive are carried out by the paying agent paying the interest established within their territory, irrespective of the place of establishment of the entity which is the debtor of the capital producing the interest.

Article 2
Coexistence model

1. Member States shall opt either for the transmission of information to the Member State of residence for tax purposes of the beneficial owner of the payment (hereinafter referred to as the "information system") or for the levy of a withholding tax (hereinafter referred to as the "withholding-tax system") in accordance with the rules set out in Articles 7 and 8.

2. Each Member State shall apply one and the same system to all interest payments made by a paying agent established within its territory to individuals who are resident for tax purposes in other Member States.

Article 3
General definitions

For the purposes of this Directive:

(a) "beneficial owner" means any individual who receives an interest payment for his own benefit;

(b) "paying agent" means any economic operator who is responsible for the payment of interest for the immediate benefit of the beneficial owner, whether he be the debtor of the capital which produces the interest itself or the operator charged with the payment of interest by the debtor or by the beneficial owner, in cases where the economic operator is established within the Community outside the Member State in which the beneficial owner is resident for tax purposes;

(c) Where there is a difficulty between two or more Member States in determining the "residence for tax purposes" of a beneficial owner, the following criteria shall apply:

(i) the beneficial owner is deemed to be a resident of the Member State where he has his permanent home; if he has a permanent home in several Member States, he is deemed to be a resident of the Member State with which his economic and personal links are closest (centre of vital interests);

(ii) if the Member State where the beneficial owner has his centre of vital interests cannot be established, or he does not have a permanent home in any Member State, he is deemed to be a resident of the Member State where he usually resides;

(iii) if the beneficiary usually resides in several Member States or if he does not usually reside in any Member State, he is deemed to be a resident of the Member State of his nationality;

(iv) in the event of difficulty in determining the residence for tax purposes of a beneficial owner between two or more Member States on the basis of the criteria set out in points (i), (ii) and (iii), the Member States concerned shall agree, within a reasonable period of time, on a single place of residence;

(d) the "competent authority" of a Member State means one of the authorities referred to in Article 1(5) of Directive 77/799/EEC.

Article 4
Identification of beneficial owners

Each Member State shall, within its territory, adopt and ensure the application of the procedures necessary to allow the paying agent to identify the beneficial owners and their place of residence for tax purposes for the purpose of Article 1.

Article 5
Definition of interest

For the purposes of this Directive, "interest" means:

(a) income from debt-claims of any kind, whether or not secured by mortgage and whether or not carrying a right to participate in the debtor's profits, and in particular income from public debt securities or bonds, including premiums and prizes attaching to the latter. Penalty charges for late payment shall not be regarded as interest;

(b) the increase in value of debt-claims in respect of which the income, by contract, consists, wholly or partly, of that increase in value, irrespective of the nature of that increase. The interest to be taken into consideration in such circumstances is the difference, paid by the paying agent on redemption, between the capital reimbursed and the issue price of the corresponding securities;

(c) income distributed by undertakings for collective investment in transferable securities within the meaning of Council Directive 85/611/EEC[13] which invest directly or indirectly more than 50% of their assets in debt-claims or corresponding securities;

(d) the difference between the redemption price of units in undertakings referred to in point (c) and the issue price of those units or, if the units are purchased by the beneficial owner after issue, the purchase price.

Article 6
Territorial scope

This Directive shall apply to interest paid by a paying agent established within the territory to which the Treaty applies by virtue of Article 227 thereof.

Article 7
Information system

1. The Member State of the paying agent shall, where it has opted for the information system, communicate to the Member State in which the beneficial owner of the interest is resident for tax purposes the information referred to in paragraph 2 which is necessary to establish the amount of the beneficial owner's income tax liability with regard to that other Member State.

2. The information transmitted by the competent authorities of the first Member State to those of the second Member State shall include at least the amount of interest paid, the date of payment, and the identity of, and residence declared by, the beneficial owner of the payment.

3. The provision of information shall be automatic and shall take place at least once a year, within six months of the end of the preceding calendar year, for all interest payments made during that calendar year.

4. Article 8 of Directive 77/799/EEC shall not apply to the information to be provided pursuant to this Directive.

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[13] OJ L 375, 31.12.1985, p. 3.

Article 8
Withholding-tax system

1. Where the Member State of the paying agent has opted for the withholding-tax system, it shall apply a withholding tax at a minimum rate of 20% to interest paid by that paying agent to the beneficial owner. No other withholding tax shall be levied within the Community on interest paid to beneficial owners.

2. The withholding tax shall not be levied where the beneficial owner concerned presents to the paying agent a certificate drawn up in his name by the competent authority of the Member State in which he is resident for tax purposes, in accordance with the provisions of Article 9, attesting that the beneficial owner has informed that authority of the interest to be received. Where the amount of interest paid exceeds the amount mentioned in the certificate, withholding tax shall be deducted from the difference between the two amounts.

3. This Directive shall not prevent Member States which have opted for the withholding-tax system from also providing information in accordance with national provisions or bilateral agreements with other Member States.

Article 9
Issue of certificates

The competent authorities of each Member State shall issue a certificate based on the information provided to them by their residents for tax purposes who are the beneficial owners of interest to be paid by a paying agent. The certificate shall indicate the identity of the beneficial owner and of the paying agent, the amount of the interest to be received and the date of payment. This certificate shall be issued to any beneficial owner who has requested it, within two months following such request.

Article 10
Elimination of double taxation

1. Member States shall take the necessary measures to eliminate all double taxation on the interest covered by this Directive.

2. If interest received by a beneficial owner has incurred withholding tax in the Member State of the paying agent, the Member State of residence for tax purposes of the beneficial owner shall grant him a tax credit equal to the amount of the tax withheld up to the amount of tax due on such interest in its territory. Where the amount of tax withheld in the Member State of the paying agent is higher than the tax credit granted to the beneficial owner by his Member State of residence for tax purposes, the Member State of the paying agent shall reimburse the difference direct to the beneficial owner.

3. As far as payments of interest within the meaning of Article 5(c) and (d) are concerned:

   (a) where the Member State of the paying agent has opted for the information system, the Member State of residence for tax purposes of the beneficial owner shall grant him, up to the amount of tax due on such interest in its

territory, a tax credit equal to the effective level of taxation incurred by the collective investment undertakings on the income corresponding to the interest paid to the beneficial owner;

(b) where the Member State of the paying agent has opted for the withholding-tax system, the paying agent shall reduce the withholding tax provided for by Article 8 by the effective level of taxation incurred by the collective investment undertakings on the income corresponding to the interest paid to the beneficial owner. In that event the Member State of residence for tax purposes of the beneficial owner shall grant him a tax credit which covers the entire taxation effectively borne by the interest, up to the amount of tax due in its territory on such interest.

4. If a withholding tax has already been deducted, without there being any possibility of its being refunded, in a third country from interest paid via a paying agent established in a Member State to a beneficial owner resident for tax purposes in another Member State, the Member State of the paying agent shall, where it has opted for the withholding-tax system, reduce the amount of the withholding tax on that interest by the amount of tax which has already been withheld.

Article 11
Negotiations with third countries

The Community shall enter into negotiations with its main third-country commercial partners either on a bilateral or on a multilateral basis, in order to ensure the effective taxation of income from savings covered by this Directive which is paid to residents for tax purposes of the Member States by paying agents established in such third countries.

Article 12
Transposal

1. Member States shall adopt and publish no later than 31 December 1999 the laws, regulations and administrative provisions necessary to comply with this Directive. They shall forthwith inform the Commission thereof.

They shall apply the provisions from 1 January 2001.

When Member States adopt the provisions as envisaged in the first subparagraph, these shall contain a reference to this Directive or shall be accompanied by such reference at the time of their official publication. The procedure for making such reference shall be adopted by Member States.

2. Member States shall communicate to the Commission the texts of the main provisions of national law which they adopt in the field covered by this Directive. In that communication they shall provide a correlation table showing the national provisions which exist or are introduced in respect of each Article of this Directive. Member States shall also provide the details of their competent.

Article 13
Review

The Commission shall report to the Council on the operation of this Directive before 1 January 2004. On the basis of that report, the Commission shall, where appropriate, propose to the Council any amendments to the Directive that prove necessary in order to ensure better effective taxation of savings income and to remove undesirable distortions of competition.

Article 14
Entry into force

This Directive shall enter into force on the twentieth day following that of its publication in the *Official Journal of the European Communities*.

Article 15

This Directive is addressed to the Member States.

Done at Brussels,

For the Council
The President

DECISION OF THE REPRESENTATIVES OF THE GOVERNMENTS OF THE MEMBER STATES, MEETING WITHIN THE COUNCIL
of
on the taxation of savings

THE REPRESENTATIVES OF THE GOVERNMENTS OF THE MEMBER STATES, MEETING WITHIN THE COUNCIL,

CONFIRMING that, in order to take account of the necessity to preserve the competitivity of financial markets in a global context, it is advisable that the elements agreed in the text on taxation of savings in the conclusions of the Ecofin Council of 1 December 1997 be adopted as widely as possible;

RECALLING that the proposal for the Directive presented by the Commission on 20 May 1998 to ensure a minimum of effective taxation within the Community of savings income in the form of interest is based on such elements;

CONFIRMING the agreement reached in the Ecofin Council of 1 December 1997 on the fact that the Member States should undertake, at the same time as discussions are taking place on this Directive, to promote the adoption of measures equivalent to those of the Directive in third countries as well as in their dependent or associated territories or the territories in which the Member States have particular responsibilities or fiscal prerogatives, which do not fall within the scope of the Directive,

ADOPT THE FOLLOWING DECISION:

Article 1

Member States undertake, in accordance with their own and the Community's respective competences, at the same time as discussions are taking place on the proposal for a Directive presented by the Commission on 20 May 1998 to ensure a minimum effective taxation within the Community of savings income in the form of interest, to promote the adoption in third countries of equivalent measures relating to payments of interest to Community residents.

Article 2

Member States which have dependent or associated territories or which have special responsibilities or taxation prerogatives in respect of other territories are committed to taking appropriate measures, where appropriate within the framework of their constitutional arrangements, to ensure that provisions concerning interest payments to Community residents, equivalent to those contained in the Directive once adopted, may be applied in those territories.

FINANCIAL STATEMENT

This proposal for a Council Directive has no financial implications for the Community budget.

IMPACT ASSESSMENT FORM

Impact of the proposal on business, with special reference to small and medium-sized enterprises (SMEs)

Title of proposal: Proposal for a Council Directive to ensure a minimum of effective taxation of savings income in the form of interest payments within the Community

Business impact assessment reference number: 98006.

The proposal:

1. Given the principle of subsidiarity, why is Community legislation required in this area and what are its main aims?

The aim of this proposal for a Directive is to allow a minimum of effective taxation of interest paid in each Member State to individuals who are resident for tax purposes in another Member State.

In the absence of any coordination of national systems for the taxation of savings, individuals who are residents of Member States are currently able to avoid any form of taxation on interest paid to them in a Member State other than the one in which they live. This is causing distortions in the operation of the single market and losses in tax revenue for the Member States.

The European financial area, the creation of which was made possible by the liberalization of capital movements, cannot deliver all its benefits, which are linked to keener competition between service providers, if savers' decisions are determined by the possibility of avoiding tax instead of being taken in the light of a comparison between investment alternatives based on their intrinsic merits.

Impact on business:

2. Who will be affected by the proposal?

- *Which sectors of business?*
- *Which sizes of business (what is the concentration of small and medium-sized firms)?*
- *Are there particular geographical areas of the Community where these businesses are found?*

No increase in the burden of taxation on business income is to be anticipated, for all business sectors, as a result of the introduction of this Directive. To avoid any obstacles to cross-border economic activities which would be incompatible with the single market, interest flows between banks and more generally between parties that are not private individuals are excluded from the scope of the Directive. As far as sole proprietorships are concerned, the cross-border interest payments they receive fall within the scope of the Directive, but the existence of a corrective mechanism enabling them to avoid withholding tax being deducted from income notified to the tax authorities of their Member State of residence shields them from any double taxation.

The impact of the proposal is thus centred on the cost of the supplementary administrative responsibilities asked of paying agents who are generally financial businesses.

The implementation of the measures is entrusted to paying agents, who are established within the territories of all the Member States of the Community. All those who, not acting as an individuals in a private capacity, make payments in respect of their own debt or the debt of a third party, might, in theory, fall within the category of paying agent. In practice, however, paying agents are very rarely small or medium-sized enterprises.

For the purposes of this Directive, the role of paying agent is assumed only by businesses or professionals who pay interest to individuals: the majority of issuers of securities and of market operators will suffer no additional administrative costs.

3. What will business have to do to comply with the proposal?

The parties which will be regarded as paying agents are normally already under an obligation to identify the beneficiaries of their payments and often also have to discharge tax collection or declaration responsibilities on behalf of their own national tax authorities. The extra obligations placed on them for the purpose of carrying out the measures introduced by this Directive will probably require them to adapt their administrative procedures and computer programs, but the measures have been devised in such a way that the cost of these adaptations and the additional administrative burden should be relatively limited. When transposing the Directive into their national law, Member States should take account of the need to keep costs and extra burdens to a minimum.

4. What economic effects is the proposal likely to have

- *On employment,*
- *On investment and the creation of new businesses,*
- *On the competitive position of businesses ?*

The fact that all interest paid in the Community is taken into consideration, irrespective of the place of establishment of the debtor, will mean that businesses established in the Community are not placed at a disadvantage in relation to their competitors in non-member countries when borrowing funds. The risks of relocation of the debt-issuing activities of European businesses to countries outside the Community, with the sole aim of escaping tax, are thus reduced.

The scope of the Directive is limited to interest payments made to individuals who are resident in Member States other than the one in which the interest is paid. Businesses' financing costs should therefore be only marginally affected by the withholding tax on interest.

As far as dividends are concerned, Member States' legislation is already up to the task of ensuring a minimum of effective taxation, irrespective of the place where the dividends are paid. The fact of allowing a minimum of effective taxation of cross-border interest payments too cannot but help remove distortions of competition between the different instruments used by businesses to raise the finance they need, namely equity capital and

debt financing. The financing of businesses by means of equity capital will furthermore be placed on an equal footing with financing of the public sector through the issue of debt securities.

The non-taxation of cross-border interest payments not only results in a direct loss of tax revenue from those interest payments but also forces some Member States to reduce their rate of taxation of domestic interest payments to below the level they would otherwise have chosen, in order to avoid the risk of a massive outflow of savings.

Allowing a minimum of effective taxation of savings invested across borders can also contribute to Member States' efforts to restore the balance between the burden of taxation on the different factors of production and thereby to achieve a reduction in the level of total taxation on income from employment, something which would be certain to reduce businesses' operating costs and to have a favourable impact on job creation and the fight against unemployment.

5. *Does the proposal contain measures to take account of the specific situation of small and medium sized firms?*

The impact of this proposal on business is predominantly on paying agents who are very rarely small and medium-sized enterprises.

Consultation

6. *Organizations which have been consulted about the proposal and outline of their main views.*

The principles underlying the proposal were agreed by the Ecofin Council at its meeting on 1 December 1997 and published in Official Journal C 2 of 6 January 1998. No organization has reacted to that publication. However, in May 1997 the *Conféderation Fiscale Européenne* (CFE) published a study identifying major differences in the taxation of interest and dividend income, and concluded that the elimination of such differences is indispensable for the creation of a uniform European capital market. The *European Mortgage Federation*, in response to the Commission's report "Taxation in the European Union"[14], feared that harmonizing capital income taxation at European level could prove problematic and might divert capital to areas outside the EU where the tax regime is more favourable. In May 1997 the *Banking Federation of the European Union*, in reaction to the same Commission report, expressed its fear about a relocation of deposits and investments to outside the European Union as a result of the introduction of a common minimum withholding tax. The *European Savings Banks Group*, in June 1997, recognized the need for harmonization of the taxation of income from savings and favoured a smooth transition to a common withholding tax with final effect at a moderate tax rate.

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[14] COM(96) 546 final, 22.10.1996.

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