COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 1.4.2004
COM(2004) 243 final

2004/0076 (CNS)

Proposal for a

COUNCIL DIRECTIVE

amending Directive 2003/49/EC as regards the possibility for certain Member States to apply transitional periods for the application of a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States

(presented by the Commission)

EXPLANATORY MEMORANDUM

1. INTRODUCTION

1. The purpose of this proposal is to amend Directive 2003/49/EC so as to incorporate transitional periods, relating to the application of the Directive, following requests by the Czech Republic, Latvia, Lithuania, Poland and Slovakia.

2. Directive 2003/49/EC[1] (hereinafter "the Directive") was adopted at the meeting of the "Economic and Financial Affairs" Council on 3 June 2003 as a part of the "Tax Package".

3. Subsequently, on 30 December 2003, the Commission presented a proposal for a Council Directive amending Directive 2003/49/EC[2]. The intentions of that amending proposal were twofold. First, at the Council meeting on 3 June 2003, the Council set out in the "Statements for entry in the minutes of the Council" that "the benefit of the Interest and Royalty Directive should not accrue to companies that are exempt from tax on income covered by that Directive." It therefore invited the Commission "to propose any necessary amendment to this Directive in due time." Second, given the date of adoption and the fact that it is based on a Commission proposal dating from 1998[3], the Directive did not make reference to the new legal forms of the European Company ("Societas Europaea" – SE)[4] and of a European Cooperative Society ("Societas Cooperativa Europaea" – SCE)[5] and did not reflect the developments in relation to the inclusion of other new entities in the scope of Council Directive 2003/123/EC[6] and the proposal for amending the Merger Directive[7].

4. As the Directive was adopted on 3 June 2003, after the signing of the Act of Accession on 16 April 2003[8], the Directive was not included in Chapter 9 of Annexe II of the Act of Accession. Thus no adaptation, on the basis of Art. 20 of the Act of Accession, was possible.

5. Nevertheless, the Directive constitutes part of the community *acquis* and therefore applies from the date of accession - 1 May 2004. Since, in its present version, the

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1 Council Directive 2003/49/EC on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States. OJ L 157, 26.6.2003, p. 49.

2 Proposal for a Council Directive amending Directive 2003/49/EC on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States, COM(2003) 841 final.

3 COM(1998) 67 final – 98/0087(CNS), OJ C 123, 22.4.1998, p. 9.

4 Council Regulation (EC) n° 2157/2001 of 8 October 2001 on the Statute for a European Company (SE) and the Council Directive 2001/86/EC of 8 October 2001 supplementing the Statute for a European company with regard to the involvement of employees, OJ L 294, 10.11.2001.

5 Council Regulation (EC) n° 1435/2003 of 22 July 2003 on the Statute for a European Cooperative Society (SCE) and the Council Directive 2003/72/EC of 22 July 2003 supplementing the Statute for a European Cooperative Society with regard to the involvement of employees, OJ L 207, 18.8.2003, p. 1.

6 Council Directive 2003/123/EC of 22 December 2003 amending Directive 90/435/EEC on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States, OJ L 7, 13.1.2004, p. 41.

7 Proposal for a Council Directive amending Directive 90/434/EEC of 23 July 1990 on the common system of taxation applicable to mergers, divisions, transfers of assets and exchanges of shares concerning companies of different Member States, COM(2003) 613 final.

8 OJ L 236, 23.9.2003, p. 555.

Directive includes neither the list of companies referred to in Art. 3(a)(i) (reproduced in the Annex to the Directive), nor the relevant taxes of the Acceding States that should be listed in Art. 3(a)(iii), technical adaptations are necessary. For such adaptations, Art. 57 of the Act of Accession provides for a procedure that is regarded as appropriate for the inclusion of the list of relevant taxes and companies in the Acceding States.

6. In May and July 2003, the Acceding States were invited formally to submit their requests for transitional periods.

7. The Czech Republic and the Republics of Latvia, Lithuania and Poland each submitted formal requests for transitional periods. Additional information, requested by the Commission services, was provided by mid-December 2003, except in the case of Slovakia which made its request on 2 February 2004 and provided additional information on 9 February 2004.

8. Taking into account their present economic situations, their status as capital importing countries, the ongoing economic transition and their relatively low level of budget revenues, Acceding States might face budgetary difficulties were they required to abolish withholding taxes on interest and royalties payments. At this stage, these countries would not be able to balance the loss of tax revenues, arising from such abolition, by receipts of additional domestic tax on income from interest and royalty payments received by associated companies from abroad, because they are net importers of capital. Therefore, the Commission proposes granting certain transitional arrangements, where these appear to be justified.

9. This is consistent with the general position that the European Union set out during negotiations with acceding countries, whereby transitional periods should be granted taking account of the interest not only of the Union, but also of Candidate Countries.[9] In an "Information Note" for the European Council, the Commission held that *"…in considering whether transitional measures should be accepted, the Member States should take into account the need to safeguard the functioning of the internal market, as well as the political, economic … implications for the Candidate Countries…"*[10].

10. It should be borne in mind that some current Member States were also granted transitional periods, when the Directive was adopted in June 2003. The Commission assessed the Acceding Countries' requests against this background, taking into account their specific needs. Under these principles, any transitional periods should be of short duration and proportionate to the problem that they seek to address.

11. The Commission's assessment of the derogation requests took account of:

- the current withholding taxes applicable in the requesting countries under their domestic income legislation;
- the rate of the withholding taxes on interest and royalty payments provided for in the Tax Conventions on Income and Capital of the requesting countries, and

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9 Enlargement Strategy Paper, Report on progress towards accession by each of the candidate countries, 2000, p. 26.

10 Communication from the Commission – Information note to the European Council on a mid-term review of the implementation of the enlargement strategy, COM(2001) 553 final, p. 3 and 16 f.

- the budgetary effect of abolishing the withholding taxes, and
- the transitional periods granted to existing Member States.

12. The Czech Republic submitted its request by letter of 16 September 2003. Its domestic rate of withholding taxes, on both interest and royalty payments, is 15 %. However, for interest payments, 12 out of 15 Double Taxation Conventions with present Member States provide for an elimination of withholding taxes. For royalty payments, the Double Taxation Conventions provide, in all cases, for a withholding tax of 5 % or 10 %. Thus, the Commission concludes that derogation could only be justified for royalty payments.

13. The Republic of Latvia submitted its request by letter of 28 May 2003. Its domestic rate of withholding tax, for interest payments, is 10 % (with certain exceptions); and for royalty payments, 5 % (a withholding tax of 15 % applies for literary or artistic work including cinematograph and video films and records). All eight Double Taxation Conventions with present Member States provide for a withholding tax on interest payments at a rate of 10 %; and also 10 % (and exceptionally 5 % under certain Conventions) for royalty payments. The Commission concludes that derogation could be justified for both interest and royalty payments.

14. The Republic of Lithuania submitted its request by letter of 5 December 2003. The domestic rate of withholding tax on both interest and royalty payments is 10 %. All Double Taxation Conventions, with the exception of one, provide for a withholding tax of 10 % on both interest and royalty payments. However, in 12 Double Taxation Conventions (all of them with present Member States) the rate of withholding tax on royalty payments is reduced to 5 % in respect of the use of industrial, commercial or scientific equipment. The Commission concludes that derogation could be justified for both interest and royalty payments.

15. The Republic of Poland submitted its request by letter of 31 July 2003. Its domestic rate for withholding taxes, on both interest and royalty payments, is 20 %. However, nine out of 15 Double Taxation Conventions with present Member States provide for the elimination of withholding taxes on interest payments. However, for royalty payments, the Double Taxation Conventions specify a rate of 10 %, in most cases. The Commission concludes that derogation could only be justified for royalties.

16. The Slovak Republic submitted its request by letter on 2 February 2004. Its domestic rate for withholding taxes is 19%, following its tax reform that took effect from 1 January 2004. However, thirteen out of fourteen Double Tax Conventions with present Member States provide for the elimination of withholding taxes on interest payments. In relation to royalty payments, the Double Taxation Conventions specify rates that vary according to the type of royalties and the country concerned. Currently the rates are 0%, 1%, 5% and 10%. The Commission concludes that derogation could only be justified for royalties.

17. On this basis, the Commission proposes that, with the exception of Slovakia, which only asked for two years, a transitional period of six years should be granted to all requesting states for the application of the Directive regarding the taxation of payments of royalties; and a transitional period of six years should be granted to Latvia and Lithuania regarding the taxation of payments of interest - it being considered that six years should be sufficient to allow appropriate adjustments to be

made. For a period of four years, the rate of tax applied by Latvia and Lithuania, to payments of interest, may not exceed 10% and for the remaining two years, that rate may not exceed 5%.

18. Granting such transitional periods is regarded as going beyond mere technical adaptations under Art. 57 of the Act of Accession, and therefore, it is proposed to provide for the transitional periods by way of a formal amending Directive of the Council.

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

Article 1

This Article incorporates the transitional periods for the Czech Republic, Latvia, Lithuania, Poland and Slovakia into the provision which governs the already existing transitional periods for Greece, Spain and Portugal.

Article 2

This Article lays down the timetable and the requirements for transposing the Directive into the national law of Member States. Member States are required, forthwith, to inform the Commission of the transposition of the Directive into their national laws and to submit a correlation table between this Directive and the national provisions adopted.

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THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty establishing the European Community, and in particular Article 94 thereof,

Having regard to the proposal from the Commission[11],

Having regard to the opinion of the European Parliament[12],

Having regard to the opinion of the European Economic and Social Committee[13],

Whereas:

(1) Council Directive 2003/49/EC of 3 June 2003 on the common system of taxation applicable to interest and royalty payments made between associated companies of different Member States[14] provides for the abolition of taxation on those payments in the Member State where they arise, but also ensures that these payments are subject to tax once in a Member State.

(2) The application of Directive 2003/49/EC is liable to cause budgetary difficulties for the Czech Republic, Latvia, Lithuania, Poland and Slovakia given the rates of withholding tax applied under domestic law and on the basis of tax conventions on income and capital and the revenue thus collected.

(3) Those Acceding States should therefore be permitted, on a temporary basis, until the date of application referred to in Article 17(2) and (3) of Council Directive 2003/48/EC of 3 June 2003 on taxation of savings income in the form of interest payments not to apply certain provisions of Directive 2003/49/EC concerning, in the case of Latvia and Lithuania, interest and royalty payments, and in the case of the Czech Republic, Poland and Slovakia, royalty payments only.

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11 OJ C …, …, p. …
12 OJ C …, …, p. …
13 OJ C …, …, p. …
14 OJ L 157, 26.6.2003, p. 49.

(4) Since the granting of a transitional period goes beyond mere adaptation within the meaning of Article 57 of the 2003 Act of Accession, Directive 2003/49/EC should be amended accordingly,

(5) Since the Member States are required to grant credit for tax deducted from interest and royalty payments, it is necessary to ensure that this Directive is transposed immediately, after the entry into force of the 2003 Act of Accession.

HAS ADOPTED THIS DIRECTIVE:

Article 1

Article 6 of Directive 2003/49/EC is amended as follows:

(1) The title is replaced by the following:

“**Transitional rules for the Czech Republic, Greece, Spain, Latvia, Lithuania, Poland, Portugal and Slovakia**”

(2) In paragraph 1, the second and third subparagraphs are replaced by the following:

“Latvia and Lithuania shall be authorised not to apply the provisions of Article 1 until the date of application referred to in Article 17(2) and (3) of Council Directive 2003/48/EC of 3 June 2003 on taxation of savings income in the form of interest payments[15]. During a transitional period of six years starting on the aforementioned date, the rate of tax on payments of royalties made to an associated company of another Member State or to a permanent establishment situated in another Member State of an associated company of a Member State must not exceed 10 %. During the first four years of the six-year transitional period, the rate of tax on payments of interest made to an associated company of another Member State or to a permanent establishment situated in another Member State must not exceed 10%; and for the following two years, the rate of tax on such payments of interest must not exceed 5%.

Spain, the Czech Republic and Poland shall be authorised, for royalty payments only, not to apply the provisions of Article 1 until the date of application referred to in Article 17(2) and (3) of Directive 2003/48/EC. During a transitional period of six years starting on the aforementioned date, the rate of tax on payments of royalties made to an associated company of another Member State or to a permanent establishment situated in another Member State of an associated company of a Member State must not exceed 10 %. Slovakia shall be authorised, for royalty payments only, not to apply the provisions of Article 1 during a transitional period of two years starting on 1 May 2004.

These transitional rules shall, however, remain subject to the continued application of any rate of tax lower than those referred to in the first, second and third subparagraphs provided by bilateral agreements concluded between the Czech Republic, Greece, Spain, Latvia, Lithuania, Poland, Portugal or Slovakia and other Member States. Before the end of any of the transitional periods mentioned in this

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15 OJ L 157, 26.6.2003, p. 38

paragraph the Council may decide unanimously, on a proposal from the Commission, on a possible extension of the said transitional periods."

(3) Paragraphs 2 and 3 are replaced by the following:

"2. Where a company of a Member State, or a permanent establishment situated in that Member State of a company of a Member State:

– receives interest or royalties from an associated company of Greece, Latvia, Lithuania or Portugal,

– receives royalties from an associated company of the Czech Republic, Spain, Poland or Slovakia,

– receives interest or royalties from a permanent establishment situated in Greece, Latvia, Lithuania or Portugal, of an associated company of a Member State, or

– receives royalties from a permanent establishment situated in the Czech Republic, Spain, Poland or Slovakia, of an associated company of a Member State,

the first Member State shall allow an amount equal to the tax paid in the Czech Republic, Greece, Spain, Latvia, Lithuania, Poland, Portugal, or Slovakia in accordance with paragraph 1 on that income as a deduction from the tax on the income of the company or permanent establishment which received that income.

3. The deduction provided for in paragraph 2 need not exceed the lower of:

(a) the tax payable in the Czech Republic, Greece, Spain, Latvia, Lithuania, Poland, Portugal or Slovakia, on such income on the basis of paragraph 1, or

(b) that part of the tax on the income of the company or permanent establishment which received the interest or royalties, as computed before the deduction is given, which is attributable to those payments under the domestic law of the Member State of which it is a company or in which the permanent establishment is situated."

Article 2

1. Member States shall bring into force the laws, regulations and administrative provisions necessary to comply with this Directive by 2 May 2004 at the latest. They shall forthwith communicate to the Commission the text of those provisions and a correlation table between those provisions and this Directive.

When Member States adopt such provisions, they shall contain a reference to this Directive or be accompanied by such a reference on the occasion of their official publication. Member States shall determine how such reference is to be made.

2. Member States shall communicate to the Commission the text of the main provisions of national law which they adopt in the field covered by this Directive.

Article 3

This Directive shall enter into force subject to and as on the date of the entry into force of the Treaty of Accession of the Czech Republic, Estonia, Cyprus, Latvia, Lithuania, Hungary, Malta, Poland, Slovenia and Slovakia.

Article 4

This Directive is addressed to the Member States.

Done at Brussels,

For the Council
The President

FINANCIAL STATEMENT

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

IMPACT ASSESSMENT FORM

THE IMPACT OF THE PROPOSAL ON BUSINESS WITH SPECIAL REFERENCE TO SMALL AND MEDIUM-SIZED ENTERPRISES (SMEs)

TITLE OF PROPOSAL

Proposal for a Council Directive amending Directive 2003/49/EC of 3 June 2003 on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States

DOCUMENT REFERENCE NUMBER

THE PROPOSAL

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

   This proposal updates an already existing Council Directive (2003/49/EC of 3 June 2003 on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States). This Directive will incorporate the request from Acceding States for a transitional period for the application of the Directive.

THE 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.

   This Directive will have the effect that the Acceding countries requesting a transitional period for the application of Council Directive 2003/49/EC may continue to apply their existing tax law on the payments of interest and royalties and that the benefits of the Directive 2003/49/EC only will be available to businesses in these Acceding Countries after termination of the transitional period. The proposal does not affect particular sectors or sizes of business. By the nature of a transitional period, the businesses in the Countries requesting such a transitional period will not be able to benefit from the Council Directive 2003/49/EC until the termination of the transitional period.

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

No new obligations or tax compliance burdens are imposed on business. However, until the end of the transitional period companies in the requesting Member States with interest or royalty payments to companies of other Member States will have to apply the existing rules concerning the taxation of interest and royalty payments and thus will not be able to fully benefit from the advantages from the Directive.

4. What economic effects is the proposal likely to have?

– on employment

– on investment and the creation of new businesses

– on the competitiveness of businesses

The positive effects on cross-border investment which will reinforce the competitiveness of companies and employment from the application of Council Directive 2003/49/EC will be applicable after the transitional period. This not immediate positive effect of the Directive is seen as necessary because of the economic and budgetary consequences of the implementation and application of the Directive in the respective Member States.

5. Does the proposal contain measures to take account of the specific situation of small and medium-sized firms (reduced or different requirements etc)?

There are no specific measures for small and medium-sized firms proposed.

CONSULTATION

6. List the organisations which have been consulted about the proposal and outline their main views.

Due to the technical nature of the proposal for an amendment of a recent adopted Directive it was not considered useful to consult again the organisations, which commented on the original Directive. However, there were discussions between technical representatives of Member States' tax administrations and the Commission services.