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INVESTMENT COMPANY INSTITUTE

MEMO# 16178

June 9, 2003

EUROPEAN UNION FORMALLY ADOPTS DIRECTIVE ON TAXATION OF SAVINGS

[16178] June 9, 2003 TO: INTERNATIONAL OPERATIONS ADVISORY COMMITTEE No. 26-03 RE: EUROPEAN UNION FORMALLY ADOPTS DIRECTIVE ON TAXATION OF SAVINGS At its meeting on June 3, 2003, the European Union (EU) Council of Economic and Finance Ministers adopted a package of measures on tax, including the Directive on the Taxation of Savings (Savings Directive). As previously reported, the Council reached political agreement to adopt the Savings Directive in January. In March, although 14 Member States agreed to the formal text of the Savings Directive, Italy blocked its final adoption because of an issue unrelated to the Directive. This formal adoption concludes 14 years of negotiations to complete the Savings Directive. Member States will be required to apply the Savings Directive by January 1, 2005. A copy of the preliminary text of the Directive is attached. The final text of the Directive will not be available until it is published in the Official Journal of the European Union at which time the Directive will enter into force. Purpose and Approach of the Savings Directive The Savings Directive generally is intended to provide a mechanism for a member state of the European Union to collect tax on income in the form of interest paid on savings products purchased by its citizens in another EU member state. The Savings Directive has significance to collective investment vehicles because it defines reportable interest payments under the Directive to include: (1) income derived from interest that is distributed by a UCITS fund or a fund established outside the European Union, including US mutual funds sold in the European Union; and (2) income realized upon the sale of shares of these funds if a certain percentage of the funds' assets consist of debt instruments. The Savings Directive is based generally on an "exchange of information" approach, whereby each EU member state automatically would be required to report interest paid in that state to individual residents of other EU member states. Three Members States – Austria, Belgium, and Luxembourg – may apply a withholding tax instead of exchanging information for an indefinite period of time until two conditions have been satisfied. First, the Council through unanimity must enter into agreements with Switzerland, Liechtenstein, San Marino, Monaco, and Andorra to exchange of information upon request as defined in the OECD Model Agreement on Exchange of Information on Tax Matters. Second, the Council must agree by 2 unanimity that the United States is committed to exchange of information upon request as defined in the OECD agreement. Austria, Belgium, and Luxembourg will be required to apply a withholding tax of 15% from 2005, 20% from 2007, and 35% from 2011.1 The revenue generated by the tax will be shared between the country of source and the country of residence of the beneficial owner of the interest on a 25/75 basis. Significant Requirements of the Savings Directive The obligations under the Savings Directive are triggered if there is a paying agent in one Member State of the European Union making payments to a resident in another Member State. Payments from a paying agent to a resident in the same Member State would be outside the scope of the

Directive. One of the most significant issues for funds (both UCITS and non-UCITS funds) with paying agents in the European Union is that the term “interest” in the Directive is broadly defined and may be interpreted differently in the Member States. For funds, the definition of interest includes income derived from interest payments and income realized upon the sale, refund, or redemption of shares of funds that invest more than 40% (or 25% from 2011) of their assets in debt. Member States, however, will have the option of including only the income that was derived from interest payments and to exclude from the definition of interest payments any income from a fund established within their territory that has less than 15% of its assets in debt instruments. The Savings Directive provides minimum standards for paying agents in identifying beneficial owners and their residence. The Savings Directive also provides for the minimum amount of information that must be reported by paying agents, including the identity and residence of the beneficial owner and the information on the interest payments. If a paying agent has no information regarding the interest component of a distribution or sales proceeds, the default would be for the paying agent to levy or report the entire distribution or sales proceeds as income. Catherine Barré Jennifer S. Choi Assistant Counsel Associate Counsel Attachment (in .pdf format) 1 These Member States will be required to provide for procedures allowing beneficial owners to avoid the imposition of this withholding tax by either agreeing to have their interest income reported or providing a certificate by the competent authority of the Member State of residence for tax purposes.
