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EUROPEAN UNION'S COUNCIL OF ECONOMIC MINISTERS REACHES NEW COMPROMISE ON THE TAXATION OF SAVINGS

[15589] January 28, 2003 TO: INTERNATIONAL COMMITTEE No. 12-03 TAX COMMITTEE No. 3-03 RE: EUROPEAN UNION'S COUNCIL OF ECONOMIC MINISTERS REACHES NEW COMPROMISE ON THE TAXATION OF SAVINGS On January 21, 2003, the EU Council of Economic Ministers reached a political agreement to adopt the Directive on the Taxation of Savings (Savings Directive), as part of a larger EU tax package. The outcome of the proceedings of the Council meeting is attached. Once the Council adopts the tax package in March, the final text of the Directive will be published in the Official Journal of the European Communities. The implementation date of the Directive is expected to be January 1, 2004. A brief summary of the Council's political agreement is described below. Background The Savings Directive generally is intended to provide a mechanism for a member state of the European Union to collect tax on savings income in the form of interest paid on savings products purchased by its citizens in another EU member state. As we reported earlier, the Savings Directive has significance to collective investment vehicles because it defines reportable interest payments under the Directive to include 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 income realized upon the sale of shares of these funds if a certain percentage of the funds' assets consist of debt instruments.1 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. Council's Political Compromise Although the Council reiterates that the ultimate objective is the exchange of information within the European Union as well as with third countries, the agreement reached by the Council last week would permit Austria, Belgium, and Luxembourg to levy withholding tax on non-resident's savings income instead of engaging in information sharing. The other 12 1 See Memorandum to International Committee No. 11-02 and to Tax Committee No. 5-02 (Feb. 8, 2002); Memorandum to International Committee No. 47-01 and to Tax Committee No. 22-01 (July 31, 2001). For this purpose, it is irrelevant whether an interest payment is from EU or non-EU sources, so long as the distribution is made by a "paying agent" located within the European Union. 2 EU member states would be required to introduce a system of automatic exchange of information from January 1, 2004, on the savings of citizens from other EU member states. Austria, Belgium, and Luxembourg would be required to apply a withholding tax of 15% from January 1, 2004, 20% from January 1, 2007, and 35% from January 1, 2010.2 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. To achieve the ultimate objective of an entirely information sharing regime, the three countries will implement automatic exchange of information when 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 Agreement on Exchange of Information on Tax Matters.3 Second, the Council must agree by unanimity that the United States is committed to exchange of information upon request as defined in the OECD agreement. Significant Issues 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 will likely be broadly defined and include distributions from funds that are invested above a certain percentage in debt instruments. Until systems can be implemented to distinguish reportable income between interest and non-interest income, paying agents may report the total amount of income paid or the total amount of proceeds from a sale, redemption, or refund. In addition, there will be issues with respect to procedures for paying agents to establish the identity of beneficial owners receiving interest payments. * * * The Institute is forming a working group to discuss issues with respect to the Savings Directive. If you are interested in being part of the working group, please complete and return the attached form. If you have any comments or questions regarding the effect of the Directive on US mutual funds, please contact Catherine Barré at (202) 326-5821 or at cbarré @ici.org. If you have any comments or questions for UCITS funds, please contact Jennifer Choi at (202) 326-5810 or at jchoi@ici.org. Catherine Barré Jennifer S. Choi Assistant Counsel Associate Counsel Attachment (in .pdf format) 2 The Directive will likely require member states levying withholding tax to provide procedures to ensure that beneficial owners may request that no tax be withheld. 3 Before exchange of information agreements are reached, the European Union intends to enter into agreements with these third countries, whereby the third countries will apply the same rates of withholding tax (and share the revenue generated by the tax) as Austria, Belgium, and Luxembourg.