

**MEMO# 14413**

February 8, 2002

## **AMENDED PROPOSAL BY THE COUNCIL OF THE EUROPEAN UNION ON THE TAXATION OF SAVINGS INCOME**

[14413] February 8, 2002 TO: INTERNATIONAL COMMITTEE No. 11-02 TAX COMMITTEE No. 5-02 RE: AMENDED PROPOSAL BY THE COUNCIL OF THE EUROPEAN UNION ON THE TAXATION OF SAVINGS INCOME The Council of the European Union recently approved an amended proposal (EU Council Proposal) for a directive on taxation of savings income (Savings Directive), which modifies and generally is consistent with a prior Savings Directive proposal issued by the Commission of the European Union on July 18, 2001 (EU Commission Proposal).<sup>1</sup> This memorandum summarizes the several changes proposed by the Council to the EU Commission Proposal. Background As you know, the Savings Directive generally was designed to provide a mechanism for a member state of the European Union (EU) to collect tax on savings 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 income derived from interest that is distributed by a UCITS fund or an “undertaking for collective investment” 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. 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. Under the “exchange of information” approach adopted by the Savings Directive, each EU member state automatically would be required to report interest paid in that state to individual residents of other EU member states.<sup>2</sup> In order to prevent avoidance of the Savings Directive (e.g., through the use of paying agents located in non-EU countries), the European Union intends to negotiate with third 1 See Memorandum to International Committee No. 47-01 and to Tax Committee No. 22-01 (July 31, 2001). 2 During a seven-year transitional period, paying agents located in Austria, Belgium, and Luxembourg generally would be permitted to withhold tax at prescribed rates under the Savings Directive, in lieu of applying an exchange of information system. 2 countries for implementation of similar measures. It is expected that the final adoption of the Savings Directive, in large part, will depend on whether third countries, including Switzerland and the United States, agree to adopt exchange of information measures similar to those proposed under the directive. The European Union presently intends to complete its third-party negotiations and unanimously approve the final text of the Savings Directive by December 31, 2002 and to have member states implement the Savings Directive by January 1, 2004. Identification of Beneficial Owner<sup>3</sup> The EU Commission Proposal would require member states to adopt and enforce minimum standards for paying agents to

establish the identity of beneficial owners receiving interest payments. The EU Council Proposal would provide more detailed procedures for this purpose that would apply to contractual relationships or transactions entered into after January 1, 2004.<sup>4</sup> In particular, the EU Council Proposal would require the identity of the beneficial owner to be established on the basis of a passport or an official identity card presented by the beneficial owner. If the beneficial owner's address does not appear on these documents, the paying agent would establish the address based on other documentary proof of identity presented by the beneficial owner. In addition, the paying agent would be required to establish the date and place of birth of the beneficial owner by reference to a passport or official identity card if the beneficial owner's tax identification number did not appear on the required documentation.

**Definition of "Interest Payments"** The EU Commission Proposal would include within the definition of "interest payments" income realized upon the sale, refund, or redemption of shares in UCITS funds and non-EU funds if these funds invested more than 40% of their assets in debt instruments. This threshold level of investments in debt instruments would be lowered to 15% after the seven- year transitional period. The EU Council Proposal would raise the threshold level of investments in debt instruments after the seven-year transitional period from 15% to 25%. The Council also has amended the text to require explicitly a fund's indirect investments in debt instruments made through investments in other funds to be included in computing a fund's level of debt investments. Therefore, "funds of funds" would be required to consider debt investments made by the funds in which they invest for determining whether the income realized upon the sale of "funds of funds" shares would qualify as "interest payments" under the directive. For income realized upon the sale of fund shares, the Council's proposal also would permit EU member states the discretion to include as "interest payments" only income attributable to gains directly or indirectly derived from interest payments.

**3 Reporting obligations under the Savings Directive** generally do not arise where interest is paid to a separate legal entity or a UCITS fund. Paying agents acting as financial intermediaries would be required to report interest receipts that are attributable to beneficial owners.

**4 Prior to this date,** paying agents generally would be permitted to rely on existing customer information.

**3 Information Reporting by the Paying Agent** The EU Commission Proposal would specify the minimum information that must be reported by EU member states under the directive. The EU Council Proposal would permit EU member states to restrict the amount of reportable information under the directive to (1) the total amount of interest or income paid and (2) the total amount of proceeds from a sale, redemption, or refund.

Jennifer S. Choi  
Deanna J. Flores  
Associate Counsel  
Associate Counsel  
Attachment  
Attachment (in .pdf format)