

Editorial

Savings Taxation: Is Automatic Exchange of Information Becoming a Panacea?

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When one looks at the few legally binding provisions that have been adopted in the field of direct taxation since the first days of the EU common market, there are hardly any of them that could be said to be harmonizing direct taxation as such. They are more simply either preventing double taxation (like the Parent Subsidiary Directive or the Interest and Royalties Directive) or eliminating direct tax obstacles (like the Merger Directive). The Savings Directive itself is most of the time presented as giving back effective means of taxation to Member States, notably by coordinating their possibilities to exchange information so as to better apply their own national tax provisions to income from savings under its different forms. From that point of view, we are still very far away from a transparent and efficient single market when it comes to cross-border investment by individuals given the many different national tax regimes applicable to the different segments of these financial investments.

That said we should not undermine the importance of this Directive: in substance it is certainly the most important achievement in the area of direct taxation until now!

Nevertheless, looking at the, relatively scarce, existing literature on this subject, one quickly get the feeling that it may well have partly missed the target until now. While the theoretical literature deals mainly with the question of whether countries opt for an information exchange or a withholding tax and what are the factors influencing their choice, most of the other articles are concentrating on the different types of loopholes that are effectively weakening the effectiveness of the Directive.¹ In addition, although it is too soon to dispose of any serious empirical evidence, the rare literature in this area² does not reveal, on the whole, a significant impact of the Directive.

No doubt it was time for the Commission to come with an evaluation report³ and an amending Directive.⁴

In fact there is nothing really surprising in this evolution. When this Directive was elaborated it was clear that it would be a very difficult, largely political, exercise with many attempts by some of the interested parties to weaken the legal provisions and consequently the effectiveness of this effort for regulating the most evident source of tax fraud and evasion in the EU. Moreover, this is the first (and only?) 'conditional'

Directive ever adopted: its adoption was dependant on the conclusion of agreements for equivalent measures being adopted by third countries. It also had to be backed up by the application of the same measures by ten dependants or associated territories of Member States. Fortunately its general principles had been agreed in rather clear and straightforward conclusions entered into by the ECOFIN Council on November 2000.⁵ These principles are still the base to which the Commission refers in its amending proposal for justifying the actual scope of the Directive and the elimination of some loopholes that were not envisaged in the initial agreement of the ECOFIN Council on November 2000.

On the whole, many consider the 2003 Savings Directive as a first step, which will have to be completed and updated progressively. The new aspect is that the crisis and the G-20 pressure on tax havens have greatly helped to speed up this process and made it a priority, which was not the case some eighteen months ago. That explains why the Swedish Presidency has invested serious efforts in trying to

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¹ See Frans Vanistendael, 'The European Interest Savings Directive – An Appraisal and Proposals for Reform', *European Taxation* (April 2009).

² The most recent and documented article is Thomas Hemmelgarn & Gaëtan Nicodème, 'Tax Co-ordination in Europe: Assessing the First Years of the EU-Savings Taxation Directive', Taxation Paper No. 18, July 2009; EU Commission – DG TAXUD, <http://ec.europa.eu/taxation_customs/common/publications/services_papers/working_papers/index_fr.htm>.

³ Cf. the Report from the Commission to the Council in accordance with Art. 18 of Council Directive 2003/48/EC on taxation of savings income in the form of interest payments COM(2008) 552 final, Brussels, 15 Sep. 2008 and the Commission Staff Working Document presenting an economic evaluation of the effects of Council Directive 2003/48/EC on the basis of the available data SEC(2008) 2420, Brussels, 15 Sep. 2008.

⁴ Proposal for a Council Directive amending Directive 2003/48/EC on taxation of savings income in the form of interest payments COM(2008) 727 final, Brussels, 13 Nov. 2008.

⁵ See the excerpt of the Council Press Release on the 'essential content' of the then 'future' Directive as agreed at the 2312th Council meeting; ECOFIN – Brussels, 26 and 27 Nov. 2000; as mentioned on the website of DG Taxation and Customs Union, <http://ec.europa.eu/taxation_customs/taxation/personal_tax/savings_tax/savings_directive_review/index_en.htm>.

reach an agreement on the amending Directive or at least its main components.⁶

At the same time it is comforting to see that through the preparatory work, the main loopholes have been well identified and at an early stage. The method followed by the EU Commission helped to reveal the most critical elements and their remedies: through discussions with Member States tax administrations as early as mid-November 2005, just a few months after the entry into force of the Directive, followed by the creation in March 2007 of a group of business experts (Expert Group on Taxation of Savings 'EUSD Group' – EUSD, 'European Union Savings Directive') that was set up to assist the Commission's Services in their review of the functioning of the Savings Directive.

The amending Directive is notably aiming at resolving problems in situations where:

- Interest payments are made from a non-EU paying agent.
- Interest payments are made to interposed legal entities and arrangements (trusts, etc.) situated within or outside the EU and held by individuals, notably when appropriate taxation of interest paid to these entities or arrangements is not ensured.
- Interest payments are made from Non-Ucits, or the income paid is equivalent to interest payments like securities or innovative financial products equivalent to debt claims (capital is protected and return is pre-defined), or the income is paid from life insurance contracts whose performance are strictly linked to debt claims and have less than 5% risk coverage.

Some of the amendments⁷ are based on the existing obligations resulting from the Anti-Money Laundering Directive so as to avoid creating new obligations and administrative burdens on banks and financial institutions. For example, a mechanism is introduced that obliges paying agents for payments made to some legal persons and arrangements established in some jurisdictions (outside the EU, listed in an annex) to look through these persons or arrangements when they already have information indicating that the payment is for the ultimate benefit of an individual beneficial owner! Along the same line, Tax Identification Number will be used where available for the identification of the beneficial owner, and for its residence, paying agents will have to report on the 'best information available to them at a payment date'.⁸

In addition, the mechanism of 'paying agent upon receipt', which was introduced in the Directive in order to include trusts and similar intermediation in the scope of the Directive but failed to do so, has been clarified (with a positive list of such arrangements placed in an annex) and extended so as to ensure a more consistent application in the future.

Other amendments are proposed, either to improve the quality of the information reported or to facilitate voluntary disclosure by taxpayers. Finally, a procedure is established for adapting the lists in the annexes and a Committee on Administrative Cooperation for Taxation is created to assist the Commission in the exercise

of implementing powers as provided for under the Comitology decision of 1999. This in itself is quite an innovation in the field of direct taxation!

On the whole, this well-prepared amending Directive has been generally well received, judging on the reactions of the other EU institutions⁹ and market operators who participated actively through the abovementioned EUSD Group.

One important additional aspect for judging this initiative is the objective of the Commission to limit as much as possible the administrative burden on market operators.

Having said that, the general efficiency of this kind of approach for fighting tax fraud and evasion remains questionable.

In this respect, the adoption and implementation by an increasing number of jurisdictions of the OECD standard of exchange of information upon request without restrictions through TIEAs, and in particular the five third countries having signed agreements with the EU for the application of equivalent measures (Switzerland, Liechtenstein, Monaco, Andorra and San Marino) is in principle a very positive evolution for the future of the Savings Directive. This is rendering possible that the explicit condition that was placed in the Directive for the three Member States (Austria, Belgium and Luxembourg) to change to automatic exchange of information instead of applying a withholding tax (and consequently for dependants and associated territories to apply the same measure!) will be fulfilled in the near future.

Nevertheless, many are still questioning the exchange of information as the main instrument for ensuring appropriate taxation in a field where Member States have so different taxation schemes for interest income but also for dividends, capital gains and also for insurances and pensions. Will the tax administrations be able to cope with such a flow of information? Will the quality of the information improve so as to make it easier for tax administrations to use it in the most effective way? To what extent will the financial markets be able to innovate in new mechanisms that will once again permit some investors to escape their obligations? Finally, is the future of the single market for financial products compatible with the future of residence taxation for individuals? Many questions are open on which experts will have to pursue the analysis.

⁶ Without success as a link was established by some delegations between the Savings Directive and the other pending Directives on recovery, on administrative cooperation and with the draft mandates for initiating the negotiation of anti-fraud agreements with third countries.

⁷ A dynamic presentation can be found in: Dr Christiana HJI Panayi, 'The proposed amendments to the Savings Directive', *European Taxation* (April 2009).

⁸ Echoing once again the information collected for the application of the Anti-Money Laundering Directive (2005/60/EC).

⁹ The ECOFIN Council welcome the proposal and called for rapid progress in December 2008 (Press 342 No. 16231/1/08 Rev1) and June 2009 (Press: 168 No. 1073736/09), the EU Parliament expressed its opinion on the proposal on 24 Apr. 2009 and the European Economic and Social Committee expressed its full agreement with this initiative when adopting its opinion on 13 May 2009 (Opinion No. 884).