REPORT

EUROPEAN PARLIAMENT

Policy Department
Economic and Scientific Policy

WORKSHOP

The Savings Tax Directive

Presentations and Briefing notes

IP/A/ECON/WS/2008-21

PE 408.587

This workshop report was requested by the European Parliament's Economic and Monetary Affairs Committee (ECON)

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Table of Contents

EUROPEAN PARLIAMENT

DIRECTORATE-GENERAL INTERNAL POLICIES OF THE UNION
- DIRECTORATE A -
ECONOMIC AND SCIENTIFIC POLICIES

Workshop on the Savings Tax Directive

2 December 2008
European Parliament, Brussels
Room ASP 5E2, 15.00-18.30 hrs
Interpretation - EN DE FR

15.00 - 15.15 Introduction

Chair: Pervenche Berès (MEP, ECON Chairwoman)

Introduction: Benoît Hamon (MEP), Rapporteur

15.15 - 16.30 Session I - The Proposed Savings Tax Regime in the EU

Topics discussed: Presentation of the revision of the Directive and the motives and goals involved; sharing international experiences in the area of savings taxation (OECD); receiving academic input on the issue.

Experts:

Kerstin Malmer
Head of Unit Direct Tax Legislation, DG TAXUD, European Commission

Dónal Godfrey
Head of the Harmful Tax Practices Unit, OECD Centre for Tax Policy and Administration

Frans Vanistendael
Academic Chairman, International Bureau for Fiscal Documentation (IBFD), Member of the Executive Committee of IFA (International Fiscal Association), Professor Emeritus in Tax Law, KU Leuven

16.30 - 18.30 Session II - The Options for the Future in the Light of Different Experiences

Topics discussed: Experiences with the current Directive in Member States; presentation of different (and representative) positions from treasuries, NGOs and the industry. (Where) do loopholes remain in the current and proposed EU regime on Savings Taxes? What direction should the future regime take?

Experts: Christian Comolet-Tirman

Deputy Director of the Tax Policy Directorate, French Ministry of Economy

Accompanied by Irène Juranville, French Ministry of Economy

Richard Murphy

Director of Research, Tax Justice Network

Piet Battiau

Head Public Policy, KBC Bank, Chairman of the European Banking Federation (EBF) Fiscal Committee

Accompanied by Roger Kaiser, Senior Adviser, Tax & Accounting Issues, EBF

Jacques Terray

Vice-Chair, Transparency International France

Milena Hrdinkova

Designated Chairwoman of Council Working Group during Czech Presidency, Czech Republic

Please note that the distinction between the two sessions of this workshop is merely for purposes of organisational ease and structure. All speakers and experts are invited to comment and take the floor in both sessions, independent of their own session. For more information on this workshop, please contact arttu.makipaa@europarl.europa.eu.

Curricula Vitae

Session I - Speakers

Kerstin Malmer

A graduate of business economics and tax law of Lund University, Sweden, Kerstin Malmer started her career in the banking sector and went on to work with the Swedish tax administration, specialising in business taxation and international taxation. In 1997 she joined the European Commission. Since 2005 she is head of the Direct Tax Legislation unit.

Dónal Godfrey.

Mr. Dónal Godfrey is Head of the Harmful Tax Practices Unit at the OECD's Centre for Tax Policy and Administration. He joined the CTPA at the end of 2000. Previously, Mr. Godfrey was Head of International Branch with the Irish Revenue Commissioners.

Frans Vanistendael

Frans Vanistendael ° 1942 studied law, economics and philopsohy at KULeuven (Belgium), Chicago and Yale. He was professor in taxation at KULeuven (1971-2007), member of the Brussels bar (1974-2008), dean of the law faculty (1999-2005). He was and is also cabinet advisor to the Minister of Finance in Belgium, member of the Ruding Committee and consultant to the OECD, the IMF and the EU. At present he is Academic Chairman of the International Bureau of Fiscal Documentation in Amsterdam.

Session II - Speakers

Christian Comolet-Tirman

Christian Comolet-Tirman is Deputy Director of the French Tax Policy Directorate, Head of the "European and International affairs" Department. He is also Chair of the OECD Forum on Harmful Tax Practices and member of the UN Committee of Experts on Cooperation in International Tax Matters. As regards European Union work, he has chaired in 2006 the sub-group on taxable income of the European Commission's CCCTB working group. He is currently Chair of the Working Party on Tax Questions (direct taxation) and first Vice-chair of the Code of Conduct Group.

Richard Murphy

Richard Murphy is a UK based chartered accountant. At one time the senior partner of a London based firm of accountants, he is now director of Tax Research LLP. In that role he is a senior adviser to the Tax Justice Network, the U.K.'s Trade Union Congress and many development NGOs. He is a visiting fellow at the University of Sussex and an external research fellow at University of Nottingham's Tax Research Institute.

Piet Battiau

Piet Battiau is born in 1964 and is living in Ghent, Belgium. He started his career as a tax inspector for the Belgian Ministry of Finance/VAT Administration before moving on in 1995 to KBC Group where he was tax adviser and became head of the International Taxation during January 2006 till April 2007. At the moment he is still working at KBC Group as Head Group Public Policy. Piet is also currently Chairman of the Fiscal Committee for the European Banking Federation. He represents the European banking sector (over 5500 banks) in its contacts with the EU Commission and OECD on policy matters, in direct tax as well as indirect taxes. He has contributed to several seminars for the EU Commission for Governments, professional organisations and at congresses organized by accounting companies and law offices. He has made several contributions to national and international tax publications.

Roger Kaiser

Roger Kaiser is Senior Adviser to the European Banking Federation. He is adviser to the Supervisory Board of the European Financial Reporting Advisory Group (EFRAG) and has been involved in the European Commission's Expert Group on the savings tax. He is a member of the Belgian Institute of Chartered Accountants and Tax Advisers. He studied Commercial Engineering and received a Master's Degree in Taxation and an International Degree in European Tax Lax.

Jacques Terray

Paris Sorbonne School of law, 1961, Columbia law School LLM, 1965, 1965/ 2003 : associate then partner in the Paris law firm "Gide Loyrette Nouel" in charge of banking and finance law (advised Channel Tunnel bank lenders, 1987; Eurodisney Park bank lenders, 1994, Securitisation, 1990/ 2001, Euro, 1999).Presently vice-chair, Transparence International (France).

Milena Hrdinkova

Milena Hrdinkova has been working for the Czech Ministry of Finance for 10 years currently as an adviser to the Deputy Minister for direct tax questions. During this time she has obtained an extensive experience in the direct tax area with particular focus on European community tax law matters and international taxation in general. She was engaged in a number of mutual procedure cases at the beginning of her carrier and contributed to the legislative works of individual and corporate income taxes act afterwards. Between 2004 and 2007 she joined the Directorate General Tax and Custom Union of the European Commission as a seconded national expert and worked in the unit responsible for the comprehensive company tax reform. Her educational background is law; she obtained her degree from the Charles University in Prague in 1998. During the Czech Presidency in the Council in 2009 she is going to lead the team dealing with the direct tax files and chair the Council Working Group on direct tax questions."

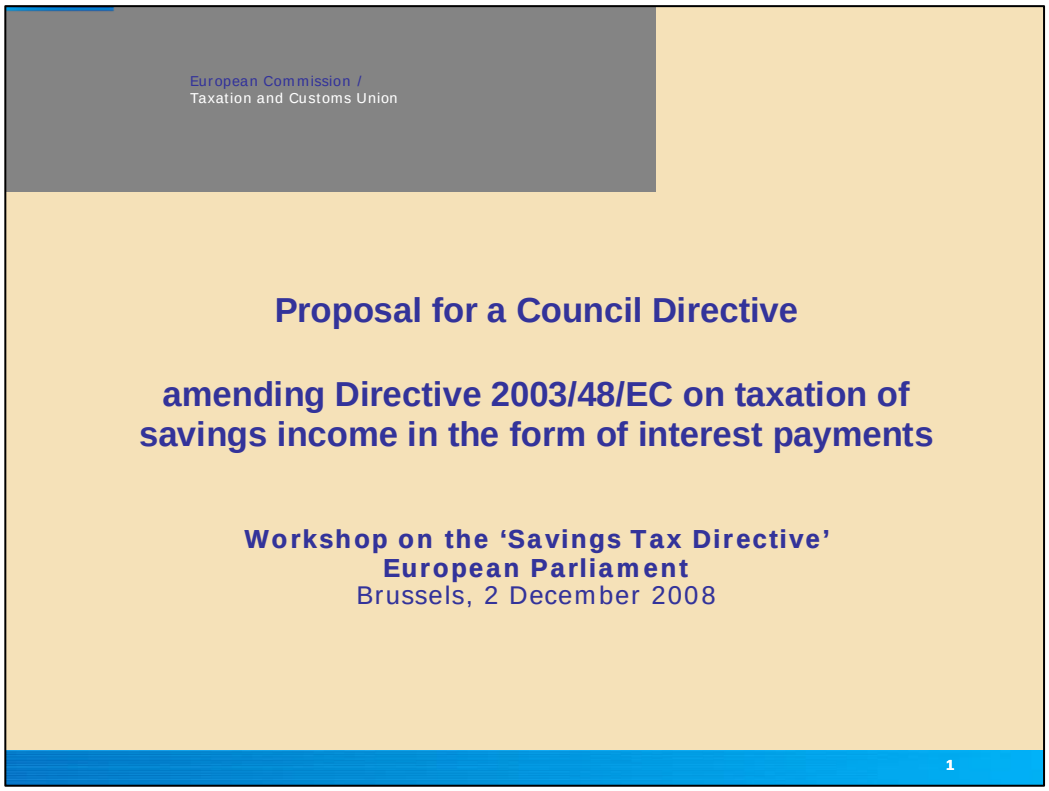
Slides

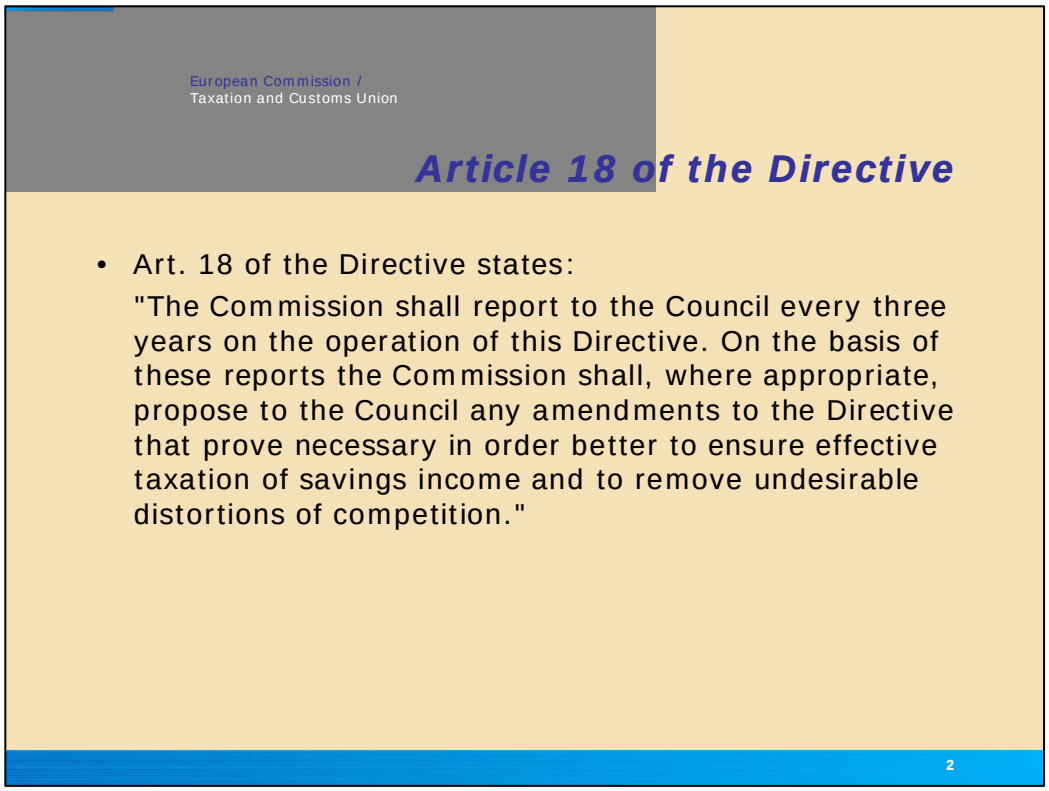
Session I - The Proposed Savings Tax Regime in the EU

Presentation by

Kerstin Malmer

Head of Unit Direct Tax Legislation, DG TAXUD, European Commission





European Commission /
Taxation and Customs Union

Report and Amending Proposal

- Extensive consultation with business expert group and with MS;
- The ECOFIN Council of May 2008 requested the Commission to present the first report on the functioning of the Directive before end September, to be followed by specific proposals based on the report;
- The Commission presented its first Report on 15 September 2008 [COM/2008/552];
- The European Parliament adopted resolutions on 2 September and 22 October 2008, inviting the Commission to present an Amending Proposal;
- On 13 November 2008, the Commission tabled the Amending Proposal [COM/2008/727], accompanied by an impact assessment [SEC(2008)2767] with a summary [SEC(2008)2768].

3

European Commission /
Taxation and Customs Union

The Directive and the Amending Proposal

The Directive covers

- **"interest payments"**
- made by an economic operator, "**paying agent",**
- to a "**beneficial owner"** who is an individual resident in the EU

The Amending Proposal intervenes on each of these three essential elements with the aim of **closing loopholes**, while taking into account the need to **limit the administrative burden** on paying agents

4

European Commission /
Taxation and Customs Union

Beneficial ownership and payments to entities / arrangements established outside the EU

Problem: Individuals can circumvent the Directive by using an interposed legal person (e.g. foundation) or arrangement (e.g. trust) situated in a non-EU country which does not tax it.

Solution proposed in the Amending Proposal:

Look-through approach based on 'customer due diligence'

- Asking EU paying agents to use the information already available to them under the anti-money laundering provisions about the actual beneficial owner(s)
- of certain types of entities and arrangements (Annex I) established in jurisdictions outside the EU, which do not ensure their effective taxation.

5

European Commission /
Taxation and Customs Union

Definition of paying agent inside the EU

Problem: The Directive it is not sufficiently clear about which entities have to act as paying agent already when they receive an interest payment, **"paying agent upon receipt**". This mechanism of the Directive is therefore not fully effective.

Solution proposed in the Amending Proposal:

- A clearer definition of the structures (including trusts, transparent entities…) which have to act as "paying agent upon receipt";
- Definition based on substantial elements [absence of effective taxation] rather than on the legal form;
- A positive list of entities and arrangements which are not taxed on their income under the general rules for taxation applicable in the MS in which the entity or arrangement is established (Annex III).

6

European Commission /
Taxation and Customs Union

Definition of interest payment included in the scope

Problem : The Directive can be circumvented by rearranging one's portfolio of financial products so that income remains outside the legal definition of interest.

Solution proposed in the Amending Proposal:

Extending the scope to income from:

- Securities which are equivalent to debt claims, because virtually all (95%) of the capital invested is protected, and because the conditions of return on capital are defined at the issuing date;
- Life insurance contracts whose performance is strictly linked to income from debt claims or equivalent income, when they provide for very low 'biometric' (mortality or disability) risk coverage (lower than 5%) in relation to the capital insured.

7

European Commission /
Taxation and Customs Union

Interest payments included in the scope: A level playing field for investment funds

Problem:

- The Directive directly covers only income obtained through undertakings for collective investment in transferable securities authorised in accordance with Directive 85/611/EEC ("UCITS");

- Income through other EU investment funds ("non-UCITS") is taken into account only if they do not have legal personality

Solution proposed in the Amending Proposal:

- Replacing the reference to Directive 85/611/EEC with a reference to the registration of the undertaking or investment fund or scheme in accordance with the rules of any of the MS. **=>** application of the same rules not only to all UCITS, but also to all non-UCITS (independently of their legal form).

- Income from all non-EU investment funds is also covered.

8

European Commission /
Taxation and Customs Union

Other Proposed Amendments

On the basis of the consultations with business and MS, the Commission proposes certain other amendments to improve the efficiency and the legal certainty:

- The identification of beneficial owners and the establishment of their residence (incl. Annex II);
- Procedural elements of the definition of interest payments (home country rule to facilitate the activity of paying agents (art 6));
- The information reporting by the paying agents (e.g. additional information on the features of payments to joint accounts);
- Facilitate the access of beneficial owners to the exceptions to the withholding tax procedure (art 13), while ensuring that their Member State of residence is correctly informed.

9

European Commission /
Taxation and Customs Union

The Amending Proposal: Comitology Procedure & Improving Statistics

- New articles to establish a comitology procedure in conformity with Council Decision 99/468/EC,
  in order to
  - allow for swift updates of the Annexes
  - establish a list of data providers as requested by business
  - establish common formats and procedures, if needed

- MS should provide the Commission with relevant statistics on the application of the Directive, in accordance with the Council conclusions of May 2008 (Annex V)

10

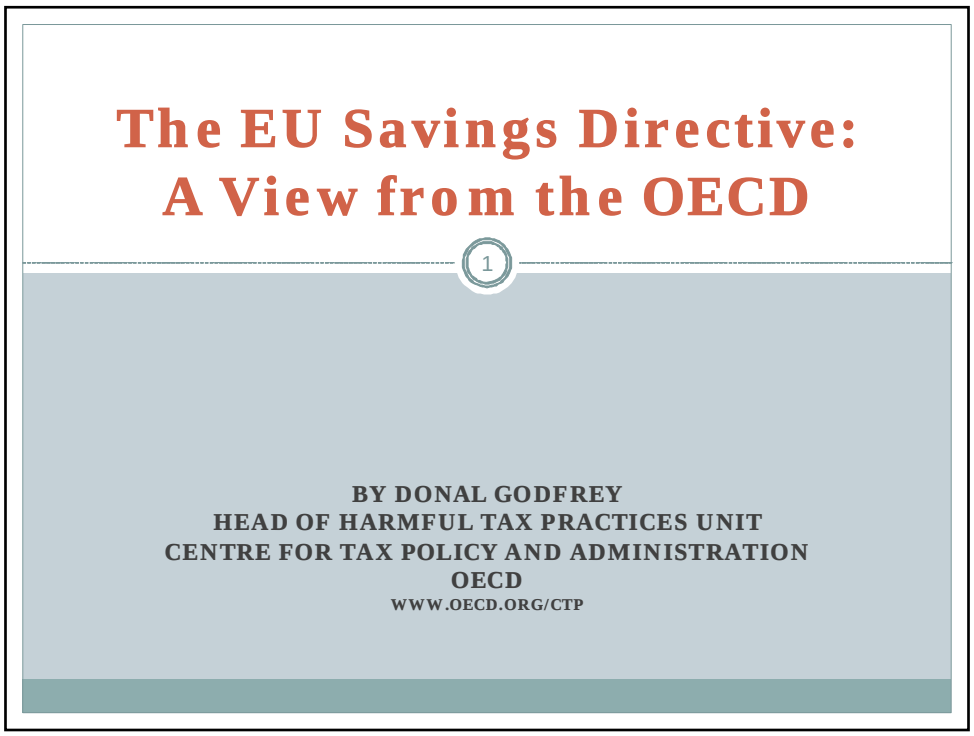
Our Website: The Savings Directive Review

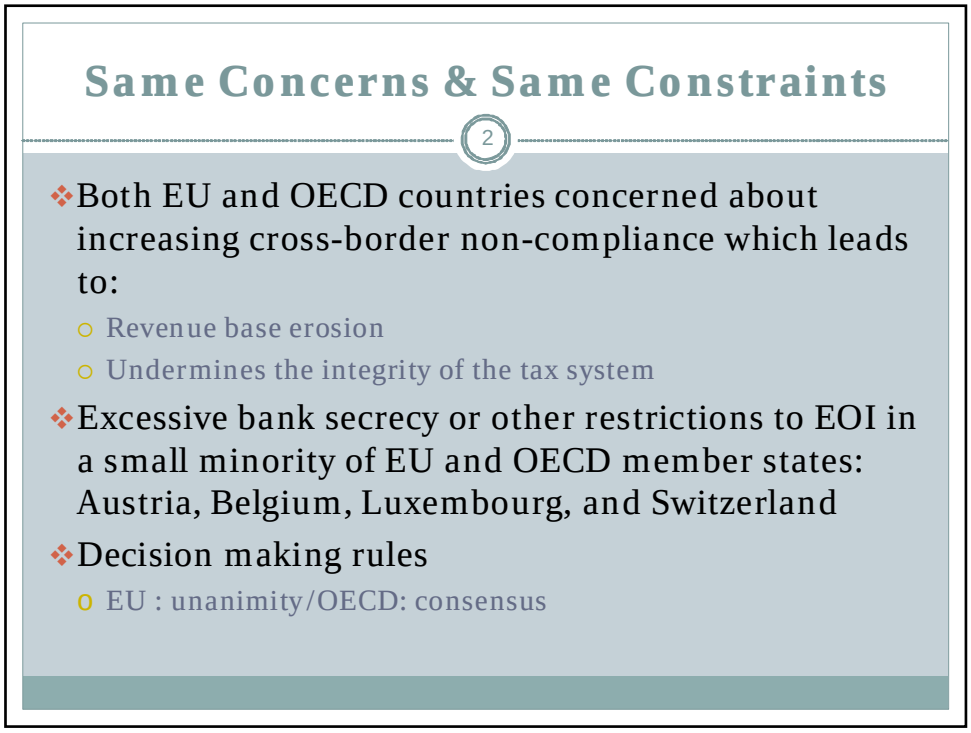
http://ec.europa.eu/taxation_customs/taxation/personal_tax/savings_tax/savings_directive_review/index_en.htm

Presentation by

Dónal Godfrey

Head of the Harmful Tax Practices Unit, OECD Centre for Tax Policy and Administration





Different Responses

3

OECD

- 1998 Report on Harmful Tax Practices and 2000 Report on improving access to bank information
- New Standards on transparency and exchange of information : Model TIEA in 2002/ 2004 version of Article 26 of OECD Model Tax Convention
- EOI on request BUT no restriction on access to information (such as bank secrecy or domestic tax interest)
- Wide scope (all items of income and wealth of both individuals and corporations)
- Global reach essential for level playing field

EU

- EU Savings Directive: political agreement in 2000/ Adoption in 2003/ Entry into force in 2005
- Scope limited to interest earned by individuals
- Transitional co-existence between EOI and WHT
- Growing WHT rate from 15% to 35% (1/7/2011)
- Otherwise Automatic EOI
- Agreements with 10 overseas and dependent territories + 5 non EU members.
- Communications on good governance in tax matters + incentive tranche in 10th EDF.

Achievements to Date?

4

OECD

- 45 TIEAs signed and over 80 under negotiation
- Significant moves in Belgium, Malta, Cyprus, Hong Kong (to be confirmed)
- US Senate Sub-Committee confirms Liechtenstein is negotiating TIEA with the US
- Some progress in Switzerland
- G7, G20, EU and UN endorse new standards
- Up to 2007 progress steady but slow.
- A lot has happened in 2008. New political climate

EU

- Mechanisms in place for automatic EOI or WHT in 42 countries and territories
- Some non EU partners have opted for automatic EOI, e.g. Cayman Islands.
- Witholding has yielded additional tax revenue
- But effectiveness of the Directive weakened by technical issues and scope
- 2008 Review

Similar Environment (1)

5

- Cross-border non-compliance is a growing concern
  - 2008 Heads of G8 governments' statement "*We urge all countries that have not yet fully implemented the OECD standards of transparency and effective exchange of information in tax matters to do so without further delay, and encourage the OECD to strengthen its work on tax evasion and report back in 2010.*"
  - G20 meeting in October 2008 reiterates the basic proposal that "*Lack of transparency and a failure to exchange tax information should be vigorously addressed.*"
  - International context: Liechtenstein scandal / UBS case/ national offshore initiatives/ US Senate Subcommittee hearing

Similar Environment (2)

6

- Level playing field:
  - Cross border non bank deposits in Singapore have tripled since 2002
  - Singapore is positioning itself aggressively as a major player in the market for private wealth management
  - Swiss Bank Chief says Singaporean banking secrecy provisions are probably even stronger than the ones in Switzerland (Financial Times, November 27 2008)

EUSD Challenges (1)

7

- Directive deals only with one aspect of cross-border non-compliance
- Too many loopholes
- Discrepancies between EUSD and non EU agreements
- 90% of savings income from Switzerland in 2005 subject to WHT, only 10% voluntary disclosure.
- Why not use voluntary disclosure if income is reported in residence country? Income not reported
- What impact when WHT rate reaches 35%?

EUSD Challenges - Amendments (2)

8

- Technical issues:
  - Timing issue : how much time to fix the Directive?
  - Whatever the content of the Directive it will be susceptible to planning, avoidance and inconsistencies, e.g. Annex I, Niue no longer has IBC regime? New types of entities can always be created
  - Geographical scope must be expanded but limited outreach so far
  - Complexity = higher compliance costs and makes it harder to expand geographical scope

- Fundamental issues:
  - More LGT/UBS scandals likely so long as WHT remains an option
  - WHT is the price to be paid for tax evasion

One Way Forward

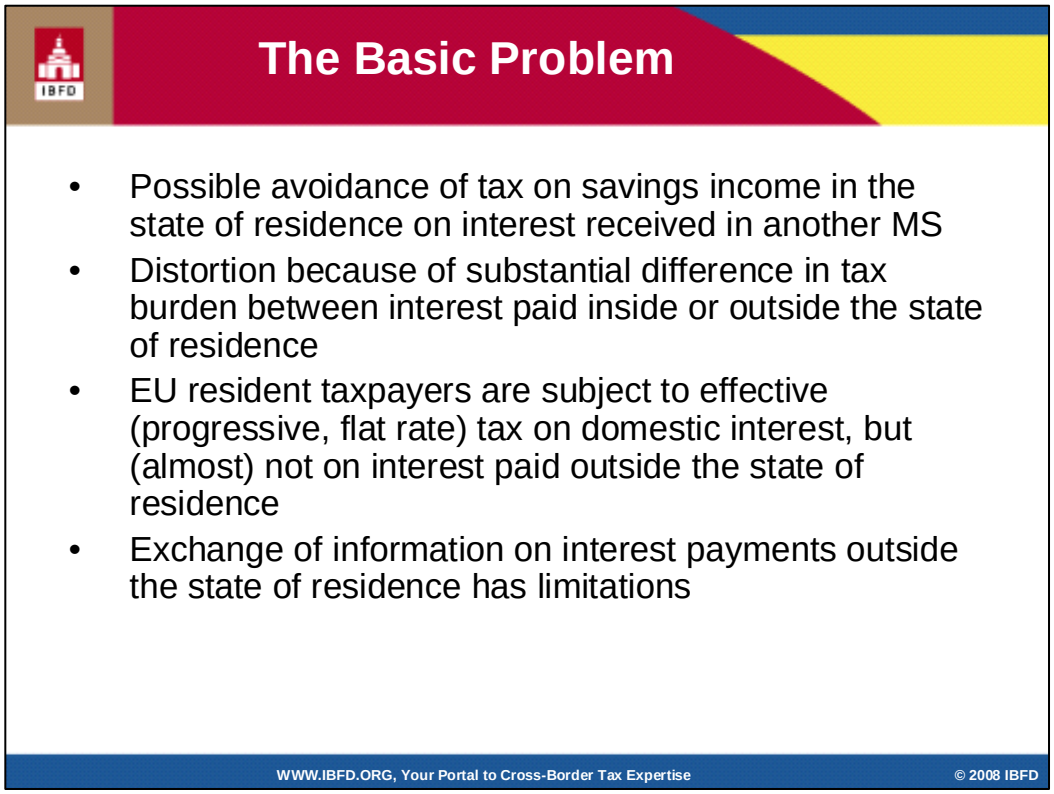
9

- Put the debate in the broader context of good governance in a global tax environment. Process has already begun
- Confirm now that for third countries equivalent measures could be OECD EOI on request standard. Already done for some countries
- Review savings agreements with third countries
- End transitional WHT arrangements for EU countries

Presentation by

Frans Vanistendael

Professor Emeritus in Tax Law, KU Leuven, IBFD Amsterdam, Member of the Executive Committee of IFA



Potential Solutions

- Full and automatic exchange of information for each taxpayer on a standardised basis
- General withholding tax on interest payments to non-residents at an appropriate common rate and sharing of tax revenue

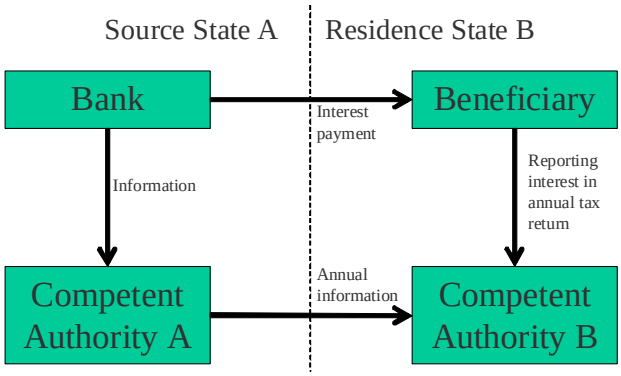
Aim of the Directive – Art. 1

Ultimate aim of the Directive

"…is to enable savings income in the form of interest payments made in one Member State to beneficial owners who are individuals **resident for tax purposes in another Member State** to be made subject to **effective taxation** in accordance with the national laws of the latter Member State"

I.e. - effective taxation
- in the state of residence

ISD Exchange of Information



Transition: withholding tax

- Austria – Belgium –Luxembourg
- WHT: 15%, 20%, 35% on all interest payments subject to exchange of information
- 25% of WHT to source state
  75% of WHT to residence state
- Full and refundable tax credit in residence state

Differences in approach

- Exchange of information **operates ex post**, i.e. relies on **taxpayer compliance** which is enforced by random audits and in depth investigations, backed up by exchange of information
- Withholding tax **operates ex ante** and guarantees effective taxation of every taxpayer **in the state of source**, regardless of compliance by taxpayer in state of residence

ISD problems

- Distortion of competition with third countries and between EOI and WHT countries (WHT 35%)
- Routing of interest through branches in third countries
- Integration of trusts and similar arranegments in the Directive
- Problems of paying agents
- Legality of look through approach
- Discrepancies between directive and non-EU agreements
- Extension of the notion of interest

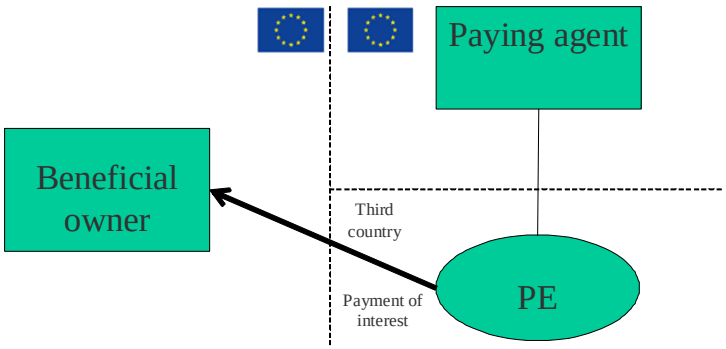
Competition – Level playing field with agreement/third countries

- Anecdotal evidence that savings move to financial centres in third countries not subject to reporting requirements in ISD (Singapore)
- “Equivalent ” agreements with agreement countries do not extend to residual or other entities, resulting in a significant administrative disparity
- EU paying agents are at significant competitive disadvantage compared to paying agents in third countries

Competition - Level playing field between WHT and EOI

- Automatic EOI has a deterrent effect, but it is not clear how strong or how weak it is
- Withholding taxes have an immediate impact that is directly measurable (20% - 35%)
- Even when interest subject to WHT is duly reported, there is a timing disadvantage

Routing interest payments through non-EU branches



Routing interest payments through non-EU branches

- Can a MS impose the obligation on HQ to obtain relevant information from PE in third country?
- Can such obligation be imposed routinely, or only in cases of presumption of abuse? Who decides whether there is abuse?
- Would it not be preferable to deal with these cases through exchange of information on request by the tax administration?
- Could WHT be applied by the HQ to such payments routed through the PE?

ISD – Trusts - General

What is the trust concept?

- Not an entity
- Not a contract (UK and Ireland)
- A (flexible) **fiduciary relationship** between a trustee and beneficiaries

ISD – Trusts - General

Who is entitled to the interest payment?

- Entitlement at the time at which the interest payment arises (e.g. bare trusts)
- Deferment/uncertainty of entitlement (e.g. discretionary trusts)

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ISD – Trusts – Tax rules in the UK and Ireland

Who is taxable?

- Trustees: UK and Ireland tax the trustees on trust income
- Beneficiaries: UK and Ireland generally tax beneficiaries on income to which they are entitled or actually receive
- Measures to eliminate double taxation between trustee and beneficiary via a tax credit (UK and Ireland)

Taxation of Trusts (bare trusts)

If a beneficiary has an immediate entitlement to the income:

- No final tax liability normally exists at the level of the trust or trustee
- The underlying beneficial owner is liable to tax on income
- However, in certain circumstances the trustees may settle the tax liability on behalf of the beneficial owner

Taxation of Trusts (discretionary trusts)

- For income paid to UK discretionary trusts:
  - The trustees are liable to tax on income paid to the trust
  - Income may be accumulated by the trustees; the income becomes additional trust capital
  - The underlying beneficial owner is liable to income tax on income (but not capital) distributions by the trust
  - A tax credit is available on income distributions which may partially or fully cover the beneficiary's tax liability; in certain cases the beneficiary will be able to claim a full or partial refund
- Other **(non-UK) discretionary trusts may not be subject to tax at a trustee or beneficiary level**

Trusts and the ISD

• Paying agents will normally look to the trustees of a trust when determining whether the ISD should apply, as a trust is not considered to be an entity

• For bare trusts, any paying agent responsibility will rest with the trustee, if it is an economic operator or, otherwise, the upstream payor of interest, regardless of the distribution of benefits by the trust

• Distributions by a discretionary trust are generally considered to be trust income rather than savings income and therefore fall outside the scope of the ISD

Trusts in non-trust countries

- Absence of statutory rules on trusts and problems of interpretation
- Use of trusts in which settlor, trustee and/or beneficiaries' connections with common law are non-existent

ISD – Trusts - Problems

- Absence of a tax on trust(ee)s resulting from inadequate legal re-characterisation
- Ex.: Italy treats trusts as entities, subject to tax, independently from distribution
- Absence of taxation when trustee and beneficiaries are non-residents

ISD – Trusts - Are there solutions to the problems?

- Integration of trusts as a separate concept in the ISD (paying agent or beneficial owner)
- No application of ISD if trustee is effectively subject to trust taxation, e.g. for the application of ISD trust taxation is deemed to be equivalent to effective taxation of interest in the country of residence of the beneficiary
- Application of ISD if trustee is not effectively subject to trust taxation (trustee is a non-resident, absence of trust taxation)
- Quid for inadequate legal re-characterisation of trusts in non-common law countries?

Implementation problems for paying agents (individuals)

For individuals:

- It is incorrectly assumed that every individual will have a passport or identity card to verify identity and that it will contain date / place of birth details
- Member states have not articulated whether they look at TINs or date / place of birth
- The ability to secure a certificate of tax residence is very limited where an EU passport holder resides in certain non-EU countries

Implementation problems - payments to paying agents on receipt

- The “negative” evidential standard, whereby paying agents are required to secure “official evidence” that an entity is NOT a residual entity, creates a major administrative burden
- Any “residual” entities arising from this process are usually the result of deficient documentation rather than true “residual” entity status

Implementation problems for paying agents - Interest

There should be formal recognition of the need for paying agents which are not connected to the securities issuer to utilise:

- The **“home country” rule** to determine whether a fund or a particular fund event falls under the Directive and if so, the interest attaching to the fund event
- **External information providers** as a conduit for securing relevant data in relation to securities / interest falling under the Directive

Look-through and abuse

- Discussions to extend the application of ISD to transparent entities is also implicitly related to a situation of abuse
- Is there a **legal basis for these look-through provisions** and should they refer to abuse, or rather refer to money laundering conditions, where there is a presumption or precondition of tax evasion?

Look-through and abuse

- Is abuse relevant in EOI situations?
- Is abuse relevant in WHT situations? WHT is an effective tax
- Are national or treaty concepts of abuse relevant or only the concept of abuse of EU freedoms (movement of capital)?

Discrepancies: directive – third country agreements

- The rules on paying agents on receipt are not the same in the directive and in some third country agreements
- Amending the rules with respect to paying agent on receipts requires amendements in all third country agreements. Will effectiveness of changes between MS be postponed until agreement with all third countries involved?

Extension of the notion of interest

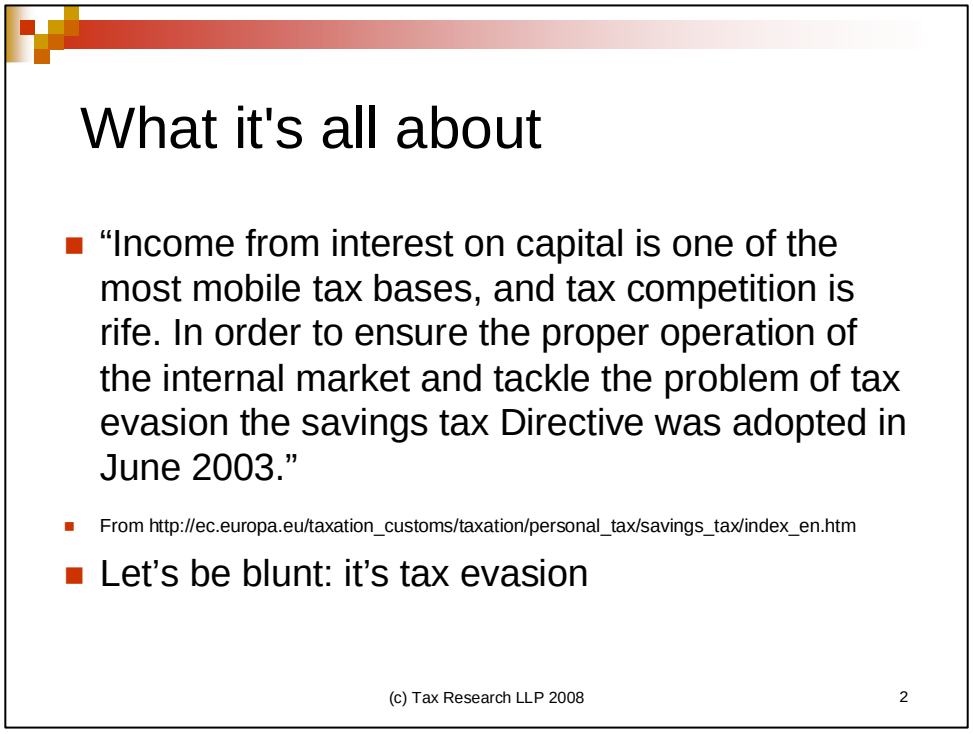
- Extension of the notion of interest to some hybrid investments runs into the problem that the tax regimes of these products in the MS are very different and not harmonised. Some of these products are not taxed as interest, or even when qualified as interest are tax exempt.
- No extension leaves loopholes, but extension may establish useless administrative machinery, due to exemption in state of residence.

Session II - The Options for the Future in the Light of Different Experiences

Presentation by

Richard Murphy

Director of Research, Tax Justice Network



Praise where it is due

- The EU STD has been staggeringly successful:
  - It exists: a considerable achievement
  - It has pioneered bulk information exchange
  - It has included many secrecy jurisdictions: a massive achievement
  - It has opened pathways for extension
- This is a tale of success

How has it been avoided?

- The EU Savings Tax Directive has been easy to avoid.
  - Placing the funds on deposit in the name of a limited company.
  - Transferring the sums on deposit into a trust.
  - Selecting forms of invested specifically excluded by the STD e.g transfer to non-UCITs funds, actively assisted by some territories
  - Moving the investment out of cash or interest bearing deposits and into any other form of investment e.g. shares or bonds.
  - Moving the sum deposited to a non-participating location such as Singapore or Dubai.

What's the impact been?

- Substantial and organised avoidance
- Complete failure of banks to recognise that opting for the withholding option is sufficient to indicate reportable suspicion of money laundering for AML purposes
- Disappointing sums collected
  - Impacted by low withholding rate to date
- But, has had a significant deterrent effect

The proposed changes

- The proposed extension is pragmatic
  - We would wish for a statement of intent to extend to all legal persons and other forms of income in due course
- We welcome changes covering:
  - Legal entities
  - Arrangements
  - UCITs
  - Paying agents on receipt
  - Deemed tax transparent entities
  - The definition of interest

But there are real problems

- Annex 1
- Annex 3
- Interaction with AML
- Other issues

Annex 1

- Annex 1 lists locations and entities outside the EU that are 'looked through' to the beneficial owner to determine application of the STD
- Annex 1 is poorly drafted
- At least 15 jurisdictions are omitted from the Annex including Dubai, New Zealand, Canada, Anjouan and most importantly the USA
- The list of entities covered is seriously deficient.

Annex 1 - continued

- It must be assumed that all entities in every jurisdiction are covered unless the jurisdiction can prove otherwise.
- There is a real risk that if these issues are not addressed there will be a failure of the Directive or a risk of a 2001 OECD style backlash from the secrecy jurisdictions

Annex 3

- Gibraltar is not in Annex 1 or Annex 3
- Annex 3 does not include entities – only trusts, and yet Article 4 does include entities and so Annex 3 is seriously incomplete. Untaxed companies must be included, and there are plenty of them
- Foundations are not specifically included
- The list of countries in which trusts can be managed is incomplete

Dependence on anti-money laundering (AML) rules

- Annex 1 on tax transparency is dependent on AML rules to determine ownership and residence of account holders
- But EU 3rd AML directive does not require proof of address and nor does the FATF
- Rules must be added to STD on proving residence of beneficial owners, and this must be monitored

Other issues

- Singapore, Hong Kong and Dubai remain outside the scope
- Pensions – not in
- Many annuities stay outside the scope
- Unit-linked life insurance with 5% cover – open to abuse, limit should be higher
- Swaps – more work needed

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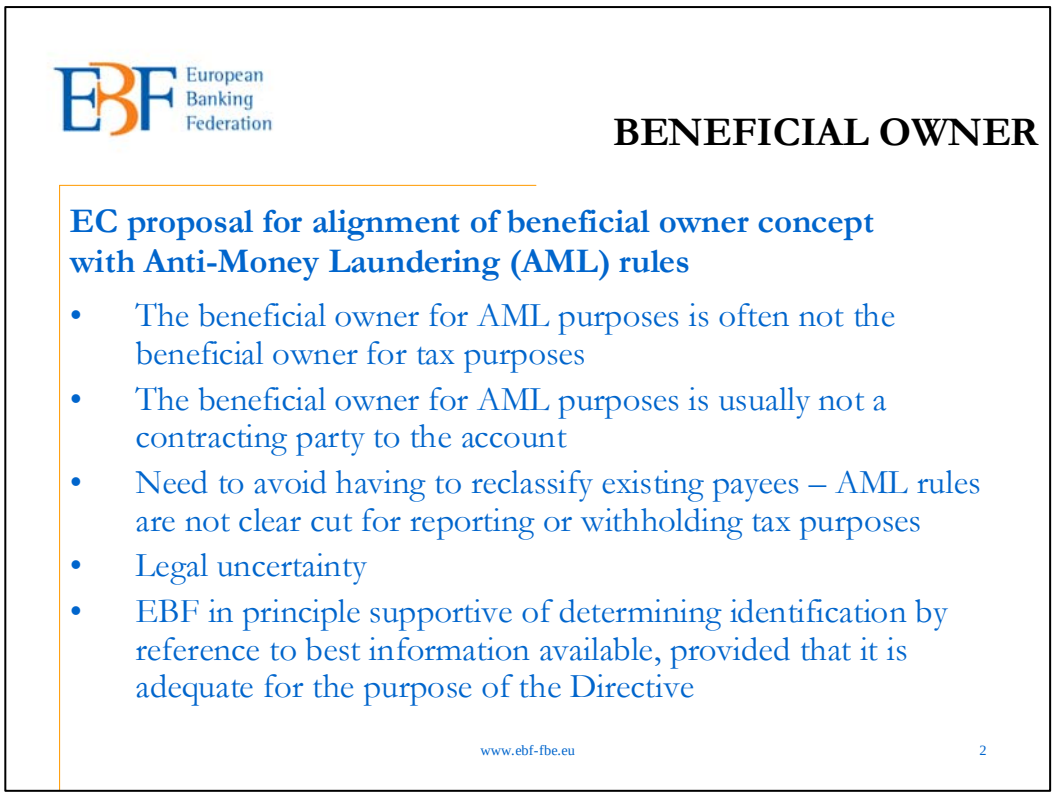
Presentation by

Piet Battiau & Roger Kaiser

Head Public Policy, KBC Bank, Chairman of the EBF Fiscal Committee



European Banking Federation

PAYING AGENT

EC proposal for a positive approach of intermediate structures

- Complexity of the rules of the "paying agent upon receipt" does not play in favor of an extension of their scope
- EBF welcomes the positive approach for residual entities:
- Currently burdensome requirement to secure evidence that an entity is not a residual entity
- Current unlevel playing field within the EU
- EBF emphasizes the unlevel playing field with Third Countries

European Banking Federation

INTEREST PAYMENTS

EC proposal for extension of the scope of the Directive: structured products, non-UCITS, certain non-EU funds and certain life insurance contracts

- Practical difficulties, in particular for paying agents not connected to issuer
- Home country rule

European Banking Federation

CONCLUSIONS

- Need for a level playing field within and oustide the EU
- Need for adapting documentary requirements, notably in the light of the FISCO recommendations

Presentation by

Jacques Terray

Vice-Chair, Transparency International France

POSITION DE TRANSPARENCE INTERNATIONALE SUR LA MODIFICATION DE LA DIRECTIVE EPARGNE

L'objet de Transparency International (TI) consiste à promouvoir la transparence dans les relations entre les différents acteurs sociaux, aux niveaux national et international.
La transparence financière fait évidemment partie de notre champ de préoccupations.
Elle prévient la corruption en dévoilant les paiements illicites des corrupteurs, et elle empêche la constitution de caisses noires dans des territoires où l'opacité est la règle. Elle rend visibles la fraude et l'évasion fiscales qui permettent à des entreprises et à des particuliers fortunés de choisir un lieu d'imposition différent de celui où ils exercent leur activité.

A ce titre, TI attache une grande importance aux efforts déployés par l'Union Européenne pour créer sur son territoire et dans les pays qui lui sont liés une règle commune d'échange d'informations sur les revenus des particuliers.

TI partage l'analyse de la Commission sur les lacunes de la directive qui permettent d'en tourner les dispositions. TI rappelle en outre que l'option ouverte à 3 pays membres (la Belgique, le Luxembourg et l'Autriche) de prélever une retenue à la source lorsque les bénéficiaires de revenus ne veulent pas être dévoilés est un régime temporaire. TI souhaite qu'il soit mis fin à cette exception dans les meilleurs délais, car elle semble légitimer la revendication d'opacité.

TI constate qu'il n'est pas envisagé de supprimer l'option pour la retenue à la source, ni même de rappeler son caractère transitoire, et elle le regrette.

TI approuve la prise en compte des trusts et fondations comme des écrans protecteurs des particuliers qui en sont les bénéficiaires. Elle craint néanmoins que le procédé utilisé pour identifier le bénéficiaire ne soit pas efficace.

En effet, si l'agent payeur a respecté intégralement les prescriptions des lois anti-blanchiment, et identifié le véritable bénéficiaire, celui-ci n'a (ou n'a plus) aucune raison d'opter pour la retenue à la source. Il s'agit vraisemblablement du particulier honnête qui recourt à un trust pour des raisons de droit personnel légitimes. Au contraire le bénéficiaire d'un circuit de blanchiment jouera des ressources qu'offrent les mécanismes de sociétés-écrans pour déjouer aussi bien les règles du GAFI que celles de la directive épargne.

Il nous semble donc qu'il est impératif d'exiger de tous les Etats membres qu'ils instaurent des mesures de publicité effectives lors de la création des trusts et fondations, avec un mécanisme de suivi des évènements ultérieurs.

On pourrait s'inspirer à cet égard des dispositions contenues dans la loi française sur les fiducies, c'est-à-dire, à peine de nullité, l'inscription dans un registre national ouvert aux autorités judiciaires, fiscales et douanières, contenant l'identification du gestionnaire, du donneur d'ordre et du bénéficiaire. Pour renforcer l'efficacité de cette exigence, les Etats membres ne reconnaîtraient les trusts constitués dans des pays tiers que s'ils ont été soumis aux mêmes règles de publicité.

Il faut aussi que l'institution des sociétés ne soit pas dévoyée par le recours à des trusts et à des prête-noms (nominee holders), comme par exemple des "charitable trusts" censés jouer le rôle d'actionnaires, mais masquant en réalité les véritables bénéficiaires des résultats. Une directive devrait énoncer les quelques principes de prévention contre ces abus de qualification.

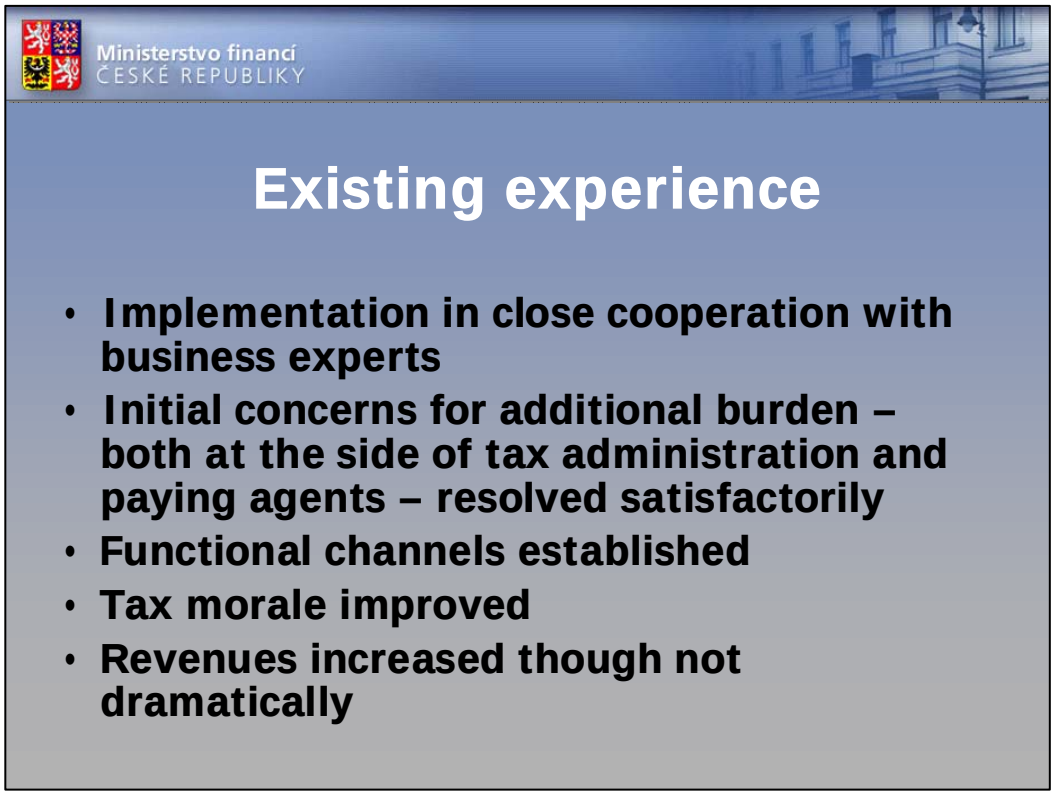
Il n'est plus possible d'attendre le bon vouloir des Etats qui comptent sur la garantie d'opacité qu'ils offrent aux investisseurs pour assurer la prospérité de leur place financière.

Il faut au moins énoncer les principes d'éthique universellement partagés et recommander leur application à la transparence financière sur le territoire de l'Union.

Presentation by

Milena Hrdinkova

Designated Chairwoman of Council Working Group during Czech Presidency, Czech Republic



Ministerstvo financí
ČESKÉ REPUBLIKY

Exchange of information and WHT

- Only area with AEI on multilateral basis sofar
- No tax withheld in CZ
- Gradual volume increase:

	2005	2006	2007
Records received	28,268	38,979	n/a
Records sent	85,096	58,621	115,221
WHT received (approx. in EUR)	1 mil.	3.2 mil.	3.75 mil.

Ministerstvo financí
ČESKÉ REPUBLIKY

Objectives and constraints for future

- Comparable products and structures to be covered – positive impact on tax neutrality
- No excessive burden for paying agents
- Increased efficiency at administrative level
- Flexible tool for updates
- Enhanced territorial scope necessary

Briefing paper by Richard Murphy

Plugging the gaps
Reform of the EU Savings Tax Directive

Briefing Paper for the Committee on Economic and Monetary Affairs of the European Parliament

Richard Murphy FCA[1]

Summary

This report has been prepared by Richard Murphy on behalf of Tax Research LLP and the Tax Justice Network International Secretariat (collectively 'we' in this report).

We welcome the planned revisions to the EU Savings Tax Directive (STD) announced on 13 November 2008 subject to the observations made in the report.

We recognise that the STD has one objective, which is to reduce tax evasion. That is the criteria we use for assessment of the proposed changes.

This report notes the often overlooked success of the existing STD. Despite its deficiencies, many of which have been accurately noted in the documentation supporting the proposed changes, it has made a significant contribution to the process of tackling tax evasion, most notably by being a multilateral agreement on that issue, by pioneering bulk information exchange and by including a number of recognised tax havens and third party states in the agreement.

We broadly welcome the proposed changes to the STD. They are targeted at the most flagrant existing abuses of the STD. They are pragmatic.

We accept that at this stage it would be difficult to extend the STD to all legal persons and to all forms of capital income. That said, a commitment to do so in the future would seem to be an important part of the process of reform and should therefore be included in the revised STD.

The proposed changes to include legal entities and arrangements (mainly trusts) in the scope of STD, to broaden the definition of interest income, to restrict the use of non-UCIT[2] structures, to change the definition of 'paying agent on receipt' (PAOR), to consider certain structures as 'tax transparent' and to therefore treat them as agents for their beneficial owners and to positively identify those structures that will be treated as PAORs and as tax transparent are all particularly welcomed.

All this being noted, we have significant concerns about some aspects of the proposed reform of the STD. These particularly relate to Annexes 1 and Annex 3 to the proposed STD. As currently drafted they are incomplete, failing to list all relevant jurisdictions and a significant number of entities that should be automatically considered as either PAORs or as tax transparent, and they create the possibility for significant political tension both prior to adoption of the proposed STD and after its implementation whilst providing ample opportunity for future tax avoidance and evasion, so undermining the objectives for which they were created. As a result we make suggestion in this report for additions to the list of jurisdictions to be covered, demonstrate the weaknesses in he drafting of Annex 3 and suggest an entirely different approach to defining entities to be considered tax transparent in Annex 1 which is likely to result in substantial enhancement in the effectiveness of the proposed STD.

[1] Thanks are noted to Markus Meinzer of the Tax Justice Network for comment and input into this paper

[2] Undertakings for Collective Investment in Transferable Securities

We also note that the effectiveness of many of the arrangements proposed are dependent upon the anti-money laundering (AML) 'know your client' (KYC) procedures used to determine the residence of the beneficial owners of entities and arrangements now to be included within the scope of the STD. We have doubt about the reliability of those AML KYC procedures when used for this purpose. This is because the risk based approach to KYC rules permitted by the 3rd European Money Laundering Directive and under Financial Action Task Force rules has resulted in some jurisdictions considering the opening of some interest bearing deposit accounts as a transaction carrying low risk, for which purpose only a single document KYC identification process is required. When a passport is used for this purpose the regulated organisation that might for STD purposes become either an upstream economic entity or a paying agent may hold insufficient information to determine the place of residence of the taxpayer to whom a payment is made, so undermining a critical element of the STD. For this reason we recommend a revision to the rules on client identification to be used by paying agents for STD purposes to avoid doubt arising.

Finally, whilst noting that it was not the intention to extend the STD to all capital income, it is clear that some extension of the definition of interest to include a broader range of life assurance products, annuities, swaps and some pensions may have been helpful and if none can be included in this version of the STD then we recommend that extension to these types of income must be indicated as areas for future attention as part of a programme of ongoing work of revision of the STD.

Introduction – tax evasion is the issue

As the European Commission notes on its own website:

> Income from interest on capital is one of the most mobile tax bases, and tax competition is rife. In order to ensure the proper operation of the internal market and tackle the problem of tax evasion the savings tax Directive was adopted in June 2003[3]

As this makes clear, tax evasion undermines the proper operation of markets and as a consequence we will assess the proposed changes to the STD, announced on 13 November 2008 [4], with regard to their likely effectiveness in reducing tax evasion.

It is important to note that the STD has enjoyed some success in achieving this objective since it became operational on 1 July 2005. In particular, it is important to note the following significant successes that can fairly be attributed to it:

- It is a rare multilateral agreement with the primary intention of tackling tax evasion, which is a notable achievement;
- It has pioneered bulk information exchange between nation states and whilst problems remain its success in doing so should be noted;
- A significant number of third party states and secrecy jurisdictions (tax havens) participate in the STD, which has considerably enhanced its effectiveness;
- Tax has been collected and data has actually been exchanged as a result of the STD: the process it has pioneered has been proven to work;

[3] http://ec.europa.eu/taxation_customs/taxation/personal_tax/savings_tax/index_en.htm accessed 21-11-08

[4] http://europa.eu/rapid/pressReleasesAction.do?reference=IP/08/1697&format=HTML&aged=0&language=EN&guiLanguage=en accessed 21-11-08

- It has opened pathways for the current planned extension of the STD. In itself this makes it useful.

We think it important that these achievements be recorded.

Weaknesses in the existing STD

As the main report introducing the proposed STD notes [5]:

> when the EUSD became applicable in 2005, it was apparent that further refinements were advisable to take account of developments in savings products and in investor behaviour.

This is oblique reference to significant avoidance of the requirements of that Directive by some jurisdictions, many 'economic operators' (which is the term the STD uses for financial institutions, banks and other persons making payments of interest) and by taxpayers.

Most particularly the requirements of the STD have been avoided by:

- Placing funds on deposit in the name of a limited company, which along with other legal entities are not covered by the existing STD;
- Transferring the sums on deposit into a trust arrangement, which like legal entities are not covered by the existing STD;
- Selecting investments specifically excluded by the existing STD e.g. transferring funds to non-UCITS[6] funds, a process that was actively assisted by some territories both in and outside the EU and the economic operators that work within those places by proactively creating and promoting these funds for this purpose. Hedge fund investments also fell outside the scope of the existing STD;
- Moving the investment out of cash or interest bearing deposits and into any other form of investment e.g. shares. In addition, a wide range of 'wrappers' were created to move assets outside the scope of the STD, such as Certificates on Bonds, Structured Notes and some International Pension Plans and annuities offered in some participating tax havens which did little more than disguise the nature of interest payments.
- Moving the sums deposited to a non-participating location such as Singapore or Dubai.

The success of the proposed STD needs to be appraised in relation to these abuses of the existing STD.

[5] http://ec.europa.eu/taxation_customs/resources/documents/taxation/personal_tax/savings_tax/savings_directive_review/COM(2008)727_en.pdf accessed 21-11-08

[6] Undertakings for Collective Investment in Transferable Securities

The proposed STD

This is not the place to summarise all the changes that the proposed STD would make. However, for the sake of setting the comments that follow in context it is worth noting that the press release announcing the proposed revision of the STC said [7]:

> The first review of the Directive has shown that, at present, it is relatively easy for individuals to circumvent the rules by using interposed legal persons or arrangements (like certain foundations or trusts) which are not taxed on their income.
>
> As far as interest payments are made by paying agents (banks, financial institutions, independent professionals, etc.) established in the EU to certain intermediate structures (listed in the compliance list in Annex I of the proposal) established outside the EU, the Commission proposes that paying agents in the EU (who know, under the anti-money laundering provisions that the beneficial owner of the interest payments is an individual resident in the Union) apply the provisions of the Directive (exchange of information or withholding tax) at the time of the payment to the intermediate structure, as if this payment was directly made to the individual.
>
> Concerning payments of interest to certain intermediate structures established within the EU, including some non-charitable trusts and foundations, those structures will be always obliged to act as a "paying agent upon receipt". This means that the provisions of the Directive (exchange of information or withholding tax) must be applied by these structures upon receipt of any interest payment from any upstream economic operator (bank, financial institution, independent professional), no matter where they are established and regardless of the actual distribution of any sums to the individual beneficial owners. The suggested definition of "paying agent upon receipt" includes all entities and legal arrangements (trust foundations etc) which are not taxed on their income under the general rules for direct taxation in their Member State of residence/establishment (an indicative list of those entities and legal arrangements will form Annex III of the Directive).
>
> Extending the scope to income equivalent to interest payments
>
> The Savings Taxation Directive can also be circumvented by using innovative financial vehicles instead of a classical savings account in a bank. Therefore, the Commission proposes extending the scope of the Directive to income from:

- securities which are equivalent to debt claims (of which the capital is protected and the return on investment is pre-defined),
- life insurance contracts whose performance is strictly linked to income from debt claims or equivalent income and have less than 5% risk coverage.
- Income from investment funds

> In addition, the Commission proposal seeks to ensure a level playing field between all investment funds or schemes (be it undertakings for collective investment in transferable securities authorised in accordance with the UCITS Directive[1] or not), independently of their legal form. This means that income obtained from those investment funds by individuals resident in the EU will be subject to effective taxation.

This statement provides a useful summary of the objectives of the reform.

[7] http://europa.eu/rapid/pressReleasesAction.do?reference=IP/08/1697&format=HTML&aged=0&language=EN&guiLanguage=en accessed 21-11-08

Matters to be welcomed

Many aspects of the proposed reforms are to be unambiguously welcomed and in particular:

- The extension of the STD to legal entities (companies, corporations and their like);
- The extension of the STD to arrangements (trusts, settlements, foundations and their like)
- Reform of non-UCITS arrangements so that many more structures will now included within the STD, including some hedge funds;
- The revised obligations on paying agents with regard to tax transparent entities;
- The substantial clarification on the nature and obligations of PAORs;
- The broadened definition of interest and its extension to some products such as life assurance with limited mortality cover.

Issues of concern

The above being noted, there are issues of concern to which we think attention must be drawn, which are listed here and then noted in more detail in the sections that follow. These are:

- The decision not to extend to all legal entities and all forms of capital income;
- The drafting and scope of Annex 1;
- The drafting and scope of Annex 3;
- The interaction with AML rules;
- Some aspects of the treatment of discretionary trusts and foundations;
- Other issues;
- Potential problems in securing political support.

Limitation in scope

As the Impact Assessment and its useful summary[8] make clear, the course of action adopted for reform of the STD was the third of four options considered. Since the first two are less desirable than that adopted they are not considered here, and the Commission is to be applauded for taking a more progressive line than those options suggested were possible.

However, the dismissed option 4 for reform would have extended the STD to payments to all legal persons and to all types of investment income (dividends, capital gains, "out payments" from genuine life insurance contracts and pension schemes, etc). Whilst we are inclined to agree that it may not be pragmatic to undertake this exercise now, it is clear that the STD will evolve and develop over time and we believe that in that context it would be desirable to include a statement of intent to extend the STD to cover these issues in due course if alternative automatic information exchange arrangements relating to these sources of income and gain are not created in the meantime. As such we ask the Commission to consider recording this intent as part of the process of reform of the STD at this time.

[8] http://ec.europa.eu/taxation_customs/resources/documents/taxation/personal_tax/savings_tax/savings_directive_review/SEC(2008)2767_en.pdf and http://ec.europa.eu/taxation_customs/resources/documents/taxation/personal_tax/savings_tax/savings_directive_review/SEC(2008)2768_en.pdf accessed 21-11-08

Annex 3

For convenience we consider Annex 3 and its drafting before Annex 1.

In principle we support the proposals in Annex 3. We believe it appropriate that an entity or legal arrangement which is not taxed on its income or on the part of its income arising to its non-resident participants, including on any interest payment, under the general rules for direct taxation applicable in the Member

State in which the entity or legal arrangement has its place of effective management, shall be considered a paying agent upon receipt of an interest payment or upon securing of such payment.

We do however note that Annex 3 does not appear to fulfil this objective.

First, we note that Gibraltar is not included in either Annex 1 or Annex 3. We suspect it should be included in Annex 3 because of its special relationship with the United Kingdom for the purposes of the STD, but its omission from either is a serious oversight and should be corrected.

We approve of the notion inherent in Annex 3 that the list refers to trusts and similar legal arrangements whose place of effective management of their movable assets is in these countries irrespective of the laws under which these trusts and similar legal arrangements have been set up. There do, however, appear to be surprising omissions from the list of jurisdictions in which it is presumed that this can occur in a tax transparent fashion. We believe that trusts and other similar legal arrangements should be listed in Annex 3 for all EU countries. As a result would suggest that their individual specification is not required.

The countries for which a reference to trusts is omitted at present are Germany, Malta, the United Kingdom and Ireland. We think these are omissions and oversight for these reasons:

- Whilst Germany has no trust law its residents are allowed to administer foreign law trusts: therefore, Germany should be listed with regard to trust arrangements;
- The United Kingdom, Malta and Ireland all have extensive trust industries and very large numbers of trusts, none of which have to be registered with a taxation authority to have legal effect. As such we think the omission with regard to these territories particularly serious precisely because those who wish to evade tax might now create trust structures in these locations which are then not registered with the relevant taxation authority but which could receive gross interest without being deemed a PAOR under the terms of the proposed STD. To prevent this possibility arising we strongly recommend that the inclusion of trusts and similar arrangements on the listing of each member state in Annex 3.

We also note that foundations are not specifically referred to in Annex 3, but we are the opinion that foundations could be managed within any EU member state. We think that foundations are sufficiently dissimilar from trusts to not fall within the description of 'other similar legal arrangements' and would therefore suggest that the phrase 'Trusts or other similar legal arrangements' be amended and be specified as 'Trusts, Foundations and other similar legal arrangements' within this annex so that doubt is avoided.

We note that the Annex 3 listing for Ireland appears to omit a number of structures which might be tax transparent, or are not taxed upon receipt of interest income. These might include general partnerships, limited partnerships, investment limited partnerships and non-resident limited liability companies (which remain in existence in Ireland and are not subject to its taxation as a result) and Irish Common Contractual Funds[9].

[9] See http://www.deloitte.com/dtt/alert/0,1002,cid%253D206393,00.html accessed 21-11-08

Their equivalents (if they exist) in the UK are listed and as such the exclusion of these entities in Ireland is surprising. We do therefore suggest that a more thorough review of the entities listed in Annex 3 is required and that it is not at present complete. We have not been able to undertake a review of this data for all EU jurisdictions in the time available to prepare this report.

We are however concerned to note that in general Annex 3 does in fact only relate to trusts and similar legal arrangements despite the fact that Article 4 (2) which will give its legal status quite specifically refers to entities and legal arrangements which are not taxed on their income or part of their income arising to non-resident participants. There appears to be a serious error or omission in Annex 3 as a consequence because there are a substantial number of entities, including those noted above with regard to Ireland, which are not taxed on their income or on that part of their income arising to non-resident participants and as such a major re-drafting of Annex 3 to include these corporate structures would appear to be necessary.

Annex 1

We believe that there are a number of significant problems in the current drafting of Annex 1 to the report.

We confirm that we do think the underlying logic of treating entities listed in Annex 1 as being tax transparent, with information disclosure or tax deduction at source being required as a consequence is appropriate. We do, however, think the list of jurisdictions to which Annex 1 refers is incomplete whilst the listing of entities considered tax transparent within each jurisdiction appears substantially incomplete, and the process for their listing appears inappropriate. We refer to these issues in turning the following paragraphs.

Based upon our research we believe that the following additional jurisdictions should be referred to in Annex 1:

- Alderney (in Part 2), which can in some circumstances be considered a different jurisdiction from Guernsey;
- Anjouan, which is now actively promoting its financial services industry;
- Canada, because of its non-resident trust laws;
- Dubai, which is widely known as a financial services centre;
- Ghana, which is now promoting itself as a new tax haven;
- Grenada, which is widely recognised as a tax haven, for example by the OECD in 2000 and in the draft US legislation for the Stop Tax Haven Abuse Act,
- Liberia, not least for activities related to its shipping registry;
- Macedonia, which is now promoting itself as a new tax haven;
- Montenegro, which is now promoting itself as a new tax haven;
- New Zealand because of its trust laws;
- Ras Al Khaimah, UAE, which is now promoting itself as a new tax haven[10];
- Sao Tome e Principe which has promoted some tax haven style activities;
- Sark (in Part 2), for the same reasons as Alderney, noted above;

[10] http://www.gulfnews.com/uae/rak/sub_story/10068322.html accessed 24-11-08

- Somalia, which some have sought to promote as a new tax haven;
- USA, see below.

The omission of the USA is difficult to justify. It is widely known, and it is recognised in draft legislation before the US Senate, that a great many tax transparent corporations are created in the USA about which the US government has no information as to beneficial ownership. Many of these are in practice tax neutral with the income of the corporation being taxed upon its membership if they can be identified. In the circumstances it appears important that the USA, or certain designated states of the USA such as Delaware, Nevada and Wyoming where incorporation of such entities is commonplace, be added to Annex 1. If this is not done then we are fearful that the reaction of those states listed will be similar to that which gave rise to significant, and to some degree successful opposition to the listing of states promoting harmful tax competition produced by the OECD in 2000. This would be unfortunate and should be avoided by making reference to the necessary states in Annex 1.

The omission of necessary jurisdictions from Annex 1 is important. As important is the omission of significant numbers of relevant tax transparent entities that are available in many of the locations that listed. The significance of this is apparent from reading the Technical Questions note[11] issued by the Commission to support the proposed changes to the STD. In that note it is said that:

> Question: What if interest payments are made by financial institutions established within the EU to intermediate structures established outside the 42 jurisdictions participating in the Savings Tax network for the benefit of EU resident individuals?
>
> Answer: Two situations can arise. Either the intermediate structure is in listed in Annex I of the Directive or not. If it is not included in the list, the provisions of the Directive will not apply.

It is apparent as a result of the answer given that the Annex 1 listing is meant to be authoritative and binding in determining whether the intermediate structure is outside the savings tax network, or not. The Commission have admittedly said that they would expect there to be a relatively simple mechanism for adding and delisting entities in both parts one and two of Annex 1, but this does not seem to justify the publication of a substantially incomplete list at this time.

Taking just a limited range of jurisdictions into account, and considering as a result only Guernsey, Jersey and the Isle of Man (in Part 2 of the Annex) it is very apparent that the lists are incomplete and inconsistent. For example, something called a ‘zero tax company’ is referred to in Guernsey but there is no equivalent mention in Jersey or the Isle of Man. In fact, all companies in Guernsey are now subject to zero tax, a situation replicated in both Jersey and the Isle of Man. However, there is no such thing as a zero tax company in any such location, meaning that the definition is wrong for Guernsey, let alone Jersey and the Isle of Man. A full list for these places might include limited companies, exempt companies (which still exist), international business corporations (which likewise still exist) protected cell companies, incorporated cell companies, limited partnerships, international limited partnerships (Isle of Man only) and general partnerships which can be treated as non-taxable in respect of non-resident owners, and all this in addition to trusts in a variety of forms together with foundations in the case of Jersey, who is now introducing legislation for these structures.

[11] http://ec.europa.eu/taxation_customs/resources/documents/taxation/personal_tax/savings_tax/savings_directive_review/technical-questions.pdf accessed 21-11-08

What this makes clear is that the listing in Annex 1 is dangerously incomplete as a list of structures to be recognised as tax transparent, especially when taking into account the status that it is given in the technical questions briefing. If the list is published in the final STD as drafted at present substantial opportunities to tax evasion will continue to exist and will be exploited. This possibility must be avoided.

There appear to be two potential solutions to this problem. The first is to commission a detailed review of all those jurisdictions and structures that should be included in Annex 1. Alternatively or additionally, a principles based approach to the listing could be adopted so that a generic listing of those entities likely to be considered as tax transparent is published and applied to all jurisdictions in the first instance with an onus of proof resting on a jurisdiction if they wish to have an entity of the type name excluded from list in their jurisdiction.

If this second alternative were adopted, and we strongly recommend that it is, then there should be in existence a mechanism for adding newly identified generic entities to the listing, with potential applicability to all jurisdictions. There must also be the facility to add jurisdictions to the list if any is discovered creating tax neutral structures of any of the types noted. In combination this will prevent the creation of a process, at which many jurisdictions are adept, of developing new forms of structure to facilitate tax abuse.

We would propose that the following types of entity should be listed as being automatically deemed tax transparent for STD purposes in every jurisdiction referred to in Annex 1, without differentiation between parts 1 and 2 of that annex:

- Limited liability company, however otherwise described and however limited, whether it be by shares, guarantee or some other mechanism;
- Limited liability corporations, however otherwise described and however limited, whether it be by shares, guarantee or some other mechanism;
- International companies or corporations;
- International business companies or corporations;
- Exempt companies or corporations;
- Protected cell companies or corporations, however otherwise described;
- Incorporated cell companies or corporations, however otherwise described
- International banks, including corporations of similar name;
- Offshore banks, including corporations of similar name;
- Insurance companies or corporations, however described;
- Reinsurance companies or corporations, however described;
- Co-operatives, however otherwise described;
- Credit unions, however otherwise described;
- Partnerships of all forms, however described, including (without limitation) general partnerships, limited partnerships, limited liability partnerships, international partnerships and international business partnerships;
- Joint ventures, however otherwise described;
- Trusts of all forms, however otherwise described;

- Settlements of all forms, however otherwise described;
- Foundations of all forms, however otherwise described;
- Estates of all forms or the estates of deceased persons, however otherwise described;
- Funds of all forms, however, otherwise described;
- Branches of any of the entities and arrangements listed here, however described;
- Representative offices of all sorts;
- Permanent establishments of all sorts.

This list is not meant to be authoritative: it is a first suggestion. We stress that in each and every case we are suggesting that a jurisdiction should have the right to make application to have a particular structure removed from the list for its jurisdiction, but only on submission of evidence that it cannot be relevant within its domain.

We believe that unless this approach is adopted there will be substantial risk that some relevant structures will be omitted from Annex 1 with the result that increased opportunity for tax avoidance or tax evasion will arise. This is the sole motivation for our recommendation. We do not believe this recommendation will place an onerous burden of administration upon the jurisdictions listed and will, in contrast, provide them with a clear incentive to reduce as far as is possible the number of entities to which the STD will refer within their domain, so giving them the opportunity to indicate their compliance with internationally accepted standards, a process which we believe will provide them with a valuable incentive to reform the structure of their financial services sectors.

We are aware that the listing we have produced might appear cumbersome. This is, however, necessary because jurisdictions have proved themselves adept at marginal innovation using mildly differing names to produce as a consequence what appear to be new entities. The style of drafting used is intended to discourage this tendency.

Dependence upon Anti-Money Laundering Records

We have a further issue of concern to go to the process proposed with regard to structures listed in Annex 1.

We note that the STD proposes:

> to ask paying agents subject to the anti-money laundering (AML) obligations to use the information already available to them under these obligations, insofar as it relates to the actual beneficial owner(s) of a payment made to some legal persons or arrangements ('look-through' approach). The EU paying agents should only focus on legal persons and arrangements established in selected jurisdictions outside the EU, where appropriate taxation of interest income paid to these legal persons or arrangements is not ensured. When the beneficial owner identified for AML purposes is an individual resident in another MS of the EU, the payment should be treated by the EU paying agent as made directly to this beneficial owner.

In principle this appears reasonable, but it would appear that a significant development in AML 'Know Your Client' procedures authorised by the 3rd EU Money Laundering Directive and the equivalent FATF rules has been ignored.

Under these arrangements a risk based approach to AML KYC rules is adopted. This was neatly summarised in a Jersey Financial Services Commission paper which said of the new requirements[12]:

> A risk-based approach to customer due diligence is set out, that permits reduced or simplified measures in the case of "lower" risk relationships, and requires enhanced customer due diligence in the case of "higher" risk relationships. …..
>
> Much more emphasis is placed on customer due diligence measures other than identification and verification of identity, and, in particular, on ongoing monitoring of unusual, complex, and "higher" risk activity and transactions.
>
> More "customer friendly" ways of verifying the identity of applicants for business or customers, including scope for greater reliance on a single document to verify identity in "lower" risk circumstances. In the case of an applicant for business that is an individual and is assessed as presenting "lower risk", identity will consist of just name, address, and date of birth, and just name and date of birth need be verified. This means that it will be possible to verify the identity of such applicants using just one document, e.g. a passport.

This approach is confirmed in the following section of the UK's new Money Laundering Regulations 2007, which says[13]:

> **Meaning of customer due diligence measures**
>
> 5. "Customer due diligence measures" means—
>
> (a)identifying the customer and verifying the customer's identity on the basis of documents, data or information obtained from a reliable and independent source;
>
> (b)identifying, where there is a beneficial owner who is not the customer, the beneficial owner and taking adequate measures, on a risk-sensitive basis, to verify his identity so that the relevant person is satisfied that he knows who the beneficial owner is, including, in the case of a legal person, trust or similar legal arrangement, measures to understand the ownership and control structure of the person, trust or arrangement; and
>
> (c)obtaining information on the purpose and intended nature of the business relationship.

It is obvious from this regulation that there is now no requirement that a paying agent regulated for AML purposes prove the address of their customer, a fact made equally clear by the observation in Jersey. They need only prove their identity. Of course, very often this will include data on a person's residential address, but it cannot be assumed that this will be the case in low risk situations. Since deposit paying bank accounts of the type most commonly targeted by the STD will, even when held by trusts or legal entities, almost certainly be considered low risk investments for AML purposes there is a very high chance that STD regulated paying agents will not know the address of the beneficial owner of the structures listed in Annex 1 to the proposed STD. In that case the 'look through' arrangements proposed will not work because the evidence that the beneficial owner is resident in the EU may not be available, and it is possible that some paying agents will wilfully exploit this fact.

We believe that urgent action is required to ensure that this loophole is not exploited, a possibility that we think the current drafting of the proposed Article 3 (2) might permit.

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[12] http://www.jerseyfsc.org/pdf/hbk_consultation%20paper_04.pdf accessed 24-11-08
[13] http://www.opsi.gov.uk/si/si2007/uksi_20072157_en_3#pt2-l1g5 accessed 24-11-08

In particular we would propose that all paying agents be required to assume the following unless they hold evidence to the contrary:

- That their customer is resident in their country of citizenship if their passport has been used to prove their identity;
- That their customer is resident in the country issuing them with an identity card if that has been used for the purpose of proving their identity;
- That their customer is resident in the country issuing them with a driving licence if that has been used for the purpose of proving their identity.

There is, however, risk inherent in each of these processes and we therefore strongly recommend that the STD be amended and that each EU member state be required to issue any person who is tax resident within their domain with a certificate of tax residence, specifying the address to which it has been sent, on demand and that paying agents be required to secure such certificates from their customers annually as evidence of their tax residence for the purposes of correctly applying the provisions of the proposed STD. Agencies then responsible for monitoring AML compliance should be encouraged to review paying agent compliance with this requirement.

Unless such arrangements are adopted we are very concerned that considerable tax evasion may be possible as AML requirements might be exploited by those wishing to inappropriately record their place of taxation residence.

Other issues

A range of other issues do require consideration. For example, there are many pension 'wrappers' now available in locations such as Guernsey which barely disguise the receipt of an income stream derived from interest. The treatment of such arrangements needs careful consideration, as do annuities which are presented in a similar way.

The proposed arrangements would regard a life assurance also pose problems: the proposed requirement that no more than 5% of the invested fund be dedicated to life assurance related risk provides clear opportunity for avoidance activity since the suggested limit is very low and allows 95% of the product to be solely investment related. We suggest that a much requirement with not less than 20% of the funds being dedicated to life assurance related risks would be substantially more appropriate and would significantly reduce the opportunities for tax avoidance using such mechanisms.

Finally, interest swap arrangements are not adequately dealt with in the proposed STD and it would seem that more work is required in this area or abuse is likely.

Conclusion

We have identified issues and concerns with regard to the proposed STD. We do, however, wish to make clear our support for the extension of the STD and the broad approach that the Commission has adopted. We wish them well in their work and offer our support if it might facilitate progress.