Taxation: Commission welcomes adoption of package to curb harmful tax competition

IP/03/787

Brussels, 3rd June 2003

Taxation: Commission welcomes adoption of package to curb harmful tax competition

The European Commission has welcomed the Council's adoption of a package of three measures to tackle harmful tax competition. The Commission proposed the package in October 1997 (see IP/97/830) and the Council has been continuing discussions since then on the basis of an outline that it agreed in December 1997 (see PRES/97/365). The tax package consists of a Council Directive to ensure effective taxation of interest income from cross-border investment of savings that is paid to individuals within the EU; a Code of Conduct for business taxation; and a Council Directive to eliminate withholding taxes on payments of interest and royalties made between associated companies of different Member States. Member States agreed in 1997 that this package was necessary in order to help achieve certain objectives such as reducing the continuing distortions in the Internal Market, preventing excessive losses of tax revenue and re-structuring tax systems in a more employment-friendly direction.

"I am delighted that the Council has finally been able to agree on the tax package to combat harmful tax competition after almost six years of intensive negotiations", said European Commissioner for Taxation Frits Bolkestein. "The agreement reflects the courage and pragmatism demonstrated by all the countries involved, to which I pay tribute. The package will play an essential role in preventing the uncontrolled erosion of certain tax revenues so that the EU can now turn its full attention to tackling remaining tax obstacles to cross-border activity within the Internal Market".

The tax package

The tax package consists of three measures a Code of Conduct to eliminate harmful tax competition in the business taxation area, a Directive and related resolution concerning the taxation of savings income and a Directive on the taxation of interest and royalty payments between associated companies. The Directive on savings taxation is due to take effect from 1 January 2005 and that on interest and royalties from 1 January 2004. The Code of Conduct is in practice already operating, although extensions for limited periods of time have been allowed for certain business tax measures viewed as having harmful features. Member States with dependent and associated territories have agreed to ensure the adoption there of the same measures adopted in the Community concerning savings taxation and to ensure the standstill and rollback of harmful business taxation measures in accordance with the Code of Conduct.

The Member States in question are the United Kingdom and the Netherlands and the relevant dependent and associated territories are the Channel Islands, the Isle of Man and the dependent and associated territories of the UK and the Netherlands in the Caribbean.

Code of Conduct for business taxation

The Code of Conduct requires Member States to refrain from introducing any new harmful tax measures ("standstill") and amend any laws or practices that are deemed to be harmful in respect of the principles of the Code ("rollback"). The code covers tax measures (legislative, regulatory and
administrative) which have, or may have, a significant impact on the location of business in the Union. The criteria for identifying potentially harmful measures include:

- an effective level of taxation which is significantly lower than the general level of taxation in the country concerned
- tax benefits reserved for non-residents
- tax incentives for activities which are isolated from the domestic economy and therefore have no impact on the national tax base
- granting of tax advantages even in the absence of any real economic activity
- the basis of profit determination for companies in a multinational group departs from internationally accepted rules, in particular those approved by the OECD
- lack of transparency.

The EU's Finance Ministers established the Code of Conduct Group (Business Taxation) at a Council meeting on 9 March 1998, under the chairmanship of UK Paymaster General Dawn Primarolo, to assess the tax measures that may fall within the scope of the Code of Conduct for business taxation. In a report of November 1999 the Group identified 66 tax measures with harmful features (40 in EU Member States, 3 in Gibraltar and 23 in dependent or associated territories). The text of this report is available on the Europa website:

http://europa.eu.int/comm/taxation_customs/taxation/law/primarolo.htm

Member States and their dependent and associated territories have now introduced revised or replacement measures in substitution for the 66 measures. For beneficiaries of those regimes on or before 31.12.2000, a "grand-fathering" clause has been provided under which benefits have to lapse no later than 31.12.2005, independently of whether or not they were granted for a fixed period. Some extensions of benefits for defined periods of time beyond 2005 have been agreed for measures in Member States and their dependent and associated territories.

The Council asked the Code of Conduct Group to monitor standstill and the implementation of rollback and report to the Council by the end of 2003.

The Council has agreed to examine favourably a Belgian request for a Decision by the Council of Ministers, under Article 88 (2) third sub-paragraph of the ECTreaty, to authorise as state aid the renewal of approvals granted under the Belgian Co-ordination centres tax regime, and to take a decision as soon as possible.

Taxation of savings

The Council agreed that this Directive should be implemented into Member States' national laws from 1 January 2004 and be applied from 1 January 2005. The Council also approved a draft agreement with Switzerland concerning the taxation of savings income including the extension of benefits of the parent/subsidiary and interest/royalty Directives with a derogation for Spain to allow it to negotiate separately with Switzerland on these two Directives. The Council agreed that the four elements (see below) of this agreement with Switzerland should also constitute the basis for agreements between the EU and Liechtenstein, Andorra, Monaco and San Marino. The Council reaffirmed that the exchange of information on as wide a basis as possible is to be the ultimate objective of the European Union in line with international developments.
The Directive

Under the Directive, each Member State will ultimately be expected to provide information to other Member States on interest paid from that Member State to individual savers resident in those other Member States. But for a transitional period, Belgium, Luxembourg and Austria will be allowed to apply a withholding tax instead of providing information, at a rate of 15% for the first three years (2005-2007), 20% for the subsequent three years (2008-2010) and 35% from 2011 onwards. These three Member States will implement automatic exchange of information:

if and when the EC enters into an agreement by unanimity in the Council with Switzerland, Liechtenstein, San Marino, Monaco and Andorra to exchange of information upon request as defined in the OECD Agreement on Exchange of Information on Tax Matters (as developed by the OECD global forum working group on effective exchange of information in 2002) in relation to interest payments, and to continue to apply simultaneously the withholding tax and

if and when the Council agrees by unanimity that the United States is committed to exchange of information upon request as defined in the 2002 OECD Agreement in relation to interest payments.

The Directive has a broad scope, covering interest from debt-claims of every kind, including cash deposits and corporate and government bonds and other similar negotiable debt securities. The definition of interest extends to cases of accrued and capitalised interest. This includes, for example, interest that is calculated to have accrued by the date of the sale or redemption of a bond of a type where normally interest is only paid on maturity together with the principal (a so-called "zero-coupon bond"). The definition also includes interest income obtained as a result of indirect investment via collective investment undertakings (i.e. investment funds managed by a specialist fund manager who places the investments made by individuals in a diverse range of assets according to defined risk criteria).

Agreements with third countries

The Commission is conducting negotiations with key non-EU countries (Switzerland, Liechtenstein, Monaco, Andorra, San Marino) to ensure the adoption of equivalent measures in those countries in order to allow effective taxation of savings income paid to EU residents. The Commission received a mandate to conduct these negotiations from the 16th October 2001 Finance Council (see MEMO/01/330).

The four elements of the draft of the agreement that has been reached with Switzerland are as follows:

Withholding Tax: Switzerland already applies a 35% withholding tax on Swiss source income. Under the agreement, it will commit to withhold a retention tax also on non-Swiss source income at the same rates as Belgium, Luxembourg and Austria under the Savings Directive - 15% during the first three years, 20% for the subsequent three years and 35% thereafter. The scope of the agreement includes, inter alia, the definition of the paying agent, definition of interest, including interest paid on fiduciary deposits and by Swiss investment funds. Switzerland will share the revenue of the tax withheld on non-Swiss source income, transferring 75 per cent of the revenue to the tax authorities of the resident's Member State.

Voluntary disclosure of information. The retention tax on non-Swiss source income will not be applied if the taxpayer authorises the Swiss bank to disclose information on the interest payment to
the tax authorities. In such cases, that interest income should be subject to taxation in the Member State of residence at the same rates as those applied to interest earned domestically.

Review clause stating that the Contracting Parties shall consult with each other at least every three years or at the request of either Contracting Party with a view to examining and if deemed necessary by the Contracting Parties improving the technical functioning of the Agreement, and assessing international developments. On the basis of this assessment, consultation can also take place in order to examine whether changes to the Agreement are necessary to take account of international developments.

Exchange of information upon request - for income covered by the draft Agreement, Switzerland will grant exchange of information on request for all criminal or civil cases of fraud or similar misbehaviour on the part of taxpayers. This part of the Agreement may be implemented through bilateral agreements between Member States and Switzerland.

Interest and royalty payments

The Directive, which is based on a Commission 1998 proposal (see IP/98/212), will, when implemented, eliminate taxes levied at source on payments of interest and royalties between associated companies of different Member States. Taxes levied at source, either by deduction (i.e. withholding taxes) or by assessment, in Member States on interest and royalties paid to companies resident in other Member States can create problems for companies engaged in cross-border business. In particular, such taxes can involve time-consuming formalities, result in cash flow losses and sometimes lead to double taxation.

The Directive is due to enter into force on 1 January 2004.

Transitional arrangements have been provided for Greece and Portugal for both interest and royalties and for Spain for royalties in order to alleviate the immediate budgetary impact of the Directive on those countries. Under these arrangements, Greece and Portugal will not apply the Directive until the Savings Directive takes effect on 1 January 2005 and Spain will not apply the Directive to royalty payments until that same date. Subsequently, Greece and Portugal will for a transitional period of eight years be allowed to apply a withholding tax on payments of interest or royalties that must not exceed 10% during the first four years and 5% during the final four years. Spain will, during a transitional period of six years starting on the same date of 1 January 2005, be authorised to apply a rate of tax on payments of royalties that must not exceed 10%.

The Council agreed that the benefits of the Directive should not accrue to companies that are exempt from tax on income covered by that Directive and that the Commission should propose any necessary amendments to the Directive in due time.