Series on International Tax Law
Michael Lang (Ed.)

Limits to Tax Planning

Karin Simader
Elisabeth Titz
(Eds.)

Linde

Anti-abuse concepts in the Savings Directive

Ákos Menyhei

1. Introduction

2. The detailed anti-abuse concepts of the Savings Directive

2.1. Identification of the beneficial owner
- 2.1.1. Definition of the beneficial owner
- 2.1.2. Importance of the anti-abuse measurements
- 2.1.3. Loopholes regarding the BO

2.2. The paying agent
- 2.2.1. Definition and obligation of the paying agent
- 2.2.2. Importance of anti-abuse measurements and loopholes

2.3. Interest payment
- 2.3.1. Definition of the interest payment
- 2.3.2. Importance of anti-abuse measurements and the Commission proposal to close loopholes

2.4. Automatic exchange of information and the anonymous withholding tax, as two competing models

3. Conclusion

1. Introduction

It is difficult to find one general description of "abuse of rights" as its content differs from jurisdiction to jurisdiction in the field of taxation. Additionally, there are even differences in the interpretations within one jurisdiction. The line between what constitutes abusive practice and what qualifies as tax planning is quite flexible. It is better to describe abuse as concepts of abuse, accepting that the content and the terminology may vary from country to country even though the concepts are similar. It seems that the ECJ[1] has been developing a notion of abuse of EU law in a tax context.[2] This activity meets the MSs'[3] aim and the recent developments in the field of EU-level tax legislation. In 2003, the EU legislative body provided for a series of important directives in the field of taxation, creating – among other things – a directive with the ultimate aim of combatting tax avoidance: The Savings Directive[4].

Due to this ultimate aim, the EUSD is unique among the EU directives dealing with taxation, as the EUSD *itself* has to be considered an anti-abuse concept. The ultimate aim of the EUSD is the taxation of all private savings income in the form of interest payments if the payment derives from a business operator established in the territory of the EU – including the Dutch and British dependencies in the Caribbean and the Channel Islands[5] – and is made to BOs[6] who are individuals, being resident of another MS. The BOs are made subject to taxation in accordance with the laws of the state in which they are residents. Selected third countries (the United States[7], Switzer-

[1] European Court of Justice.

[2] J. Freedman, The Anatomy of Tax Avoidance Counteraction: 'Abuse of Law in a Tax Context at Member State and European Union Level', in Rita de la Feria and Stefan Vogenauer (eds.), Prohibition of Abuse of Law – A New General Principle of EU Law? (Oxford University Centre for Business Taxation/Hart Publishing 2011).

[3] Member States.

[4] COUNCIL DIRECTIVE 2003/48/EC of 3 June 2003 on taxation of savings income in the form of interest payments, available at: http://eur-lex.europa.eu/LexUriServ/LexUriServ.douri=OJ:L:2003:157:0038:0048:en:PDF, last visited: 06.01.2013. Hereinafter: EUSD.

[5] The Dutch dependencies: The Netherlands Antilles and Aruba. The British dependencies: Anguilla, British Virgin Islands, Montserrat, Turks and Caicos, Cayman Islands, Isle of Man, Jersey and Guernsey. By geographical mistake or deliberately one British dependent territory The Bermuda is out of the scope of the EUDS as this territory is not in the Caribbean but the Mid-Atlantic. available at: http://www.lowtax.net/specials/std.html, last visited 16.08.2012.

[6] Beneficial Owners.

[7] "The US administration has allowed the Internal Revenue Service (IRS) to force US banks to disclose the amount of bank deposit interest paid to non-resident foreign depositors from 15 countries, including most EU members, but excluding Belgium, Austria and Luxembourg. Thus the Bush administration can continue to maintain to its domestic audience that it is not signing up to the EU proposal, while signaling to Brussels that it is prepared to cooperate." A. Solitander, STATES, MARKETS, THE FINANCE LOBBY AND THE EUROPEAN UNION SAVINGS TAX DIRECTIVE, page 9, http://ethesis.helsinki.fi/julkaisut/val/yleis/pg/solitander/statesma.pdf, last visited 16.08.2012.

land, and the European microstates: Andorra, Liechtenstein, Monaco and San Marino), have adopted similar[8] measures.

Heidenbauer summarizes this topic as follows[9]: "The Saving Directive differs from all other direct tax directives insofar as it does not seek to remove obstacles; rather, it seeks to ensure effective taxation of savings income and to protect national revenue from attempted tax evasion and fraud by EU national individuals."

The EUSD is also not about levying taxes; it only provides for the mechanism and instruments – exchange of information or withholding taxation – to ensure effective taxation of individuals' interest income. The EUSD affects interest payments from savings and bonds, but income from dividends, capital gains, funds' units and insurance policies do not fall within its scope.

To achieve its main aim the EUSD provides for an exchange of information system as the "general rule". Under this mechanism, 25 EU countries[10] and 4 dependent territories[11] automatically report the interest income to the taxpayers' residence state; nevertheless, due to several compromises made whilst MSs and the Commission negotiated the EUSD as well as the connecting treaties, EU taxpayers may choose in Austria, Luxembourg[12] and in some dependent British and Dutch territories[13] as well as in some co-operating jurisdictions[14], most importantly in Switzerland, to pay withholding tax[15], which is deducted directly by their banks when the interest is paid. Another option is that EU taxpayers may choose voluntary disclosure in the above-mentioned jurisdictions by allowing their banks to report the interest they have received to their local tax authority. Thus, EU taxpayers – having a bank account in an MS different than their residence MS – are liable to pay tax in their state of residence according to the rules embedded in domestic law. Both of these mechanisms should assure effective taxation.

---

8 Switzerland and the European microstates that apply equivalent savings taxation measures did not accept the "paying agent on receipt" provisions in the agreements they signed with the EU. COMMISSION STAFF WORKING DOCUMENT Refining the present coverage of Council Directive 2003/48/EC on taxation of income from savings, page 7. Available at: http://ec.europa.eu/taxation_customs/resources/documents/taxation/personal_tax/savings_tax/savings_directive_review/sec(2008)559_en.pdf, last visited: 17.08.2012.

9 S. Heidenbauer, The Savings Directive, M. Lang, P. Pistone, J. Schuch, C. Staringer – Introduction to European Tax Law: Direct Taxation, Linde Verlag 2010, page 169.

10 EU Member States exchanging information: Belgium, Bulgaria, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Malta, the Netherlands, Romania, Poland, Portugal, Slovakia, Slovenia, Spain, Sweden, United Kingdom (incl. Gibraltar).

11 Territories exchanging information: Anguilla, Aruba, Cayman Islands, Montserrat.

12 Previously Belgium also used the withholding tax system, but in 2010 it voluntarily joined MSs who use the information exchange system.

13 Territories levying withholding tax: British Virgin Islands, Jersey, Guernsey, Isle of Man, the Netherlands Antilles, Turks & Caicos Islands.

14 Co-operating states levying withholding tax: Andorra, Liechtenstein, Monaco, San Marino, Switzerland.

15 Hereinafter: WHT.

Development of the EUSD started in 1987 when the European Commission proposed a directive eliminating all capital exchange controls within the European Communities. The free movement of capital was an important step towards a single European market; nevertheless, several MS – particularly France and Italy – became concerned about harmful tax competition, arguing that the liberalization of capital movements would undermine their fiscal position.[16]

A 15-year long negotiation[17] started among the MSs, Switzerland, the European microstates and the US in order to find a suitable solution that would satisfy all countries' interests, but these were several times stopped or suspended, re-launched as countries – mainly Austria, Belgium, Luxembourg and Switzerland – defended their banking secrecy and industries. The Commission suggested, together with several MSs, numerous variations to solve the problem and finally the European Council reached a consensus in Santa Maria da Feira on 19 and 20 June 2000 and the ECOFIN Council continued the deliberations at meetings in November 2000, December 2001 and January 2003. The European Council accepted the Council Directive 2003/49/EC on 3 June 2003 and the MSs began to apply the implementation rules from 1 July 2005 and, for Bulgaria and Romania, from 1 January 2007.

Parallel to the internal agreements,[18] the EU negotiated with Switzerland, in an effort to force it to implement similar measures as the EUSD, and finally offered the "*Bilaterals II*" treaty[19], which encompasses nine separate agreements between the EU and Switzerland including the EUSD, the Schengen agreement on freedom of movement and cross-border cooperation on crime, among other measures. Switzerland agreed to cooperate with the EUSD due to a combination of substantial coercive pressure and important financial incentives[20].

The EUSD is another step in achieving the single market and handling its legal (tax) consequences; nevertheless, it has to be noted that the EUSD is not tax

---

16 Deheija, Vivek H. and Philipp Genschel (1999): 'Tax Competition in the European Union' in Politics & Society, Vol. 27 No. 3, September 1999, pp. 403-430. Sage Publications.

17 See the History of the EUSD: A. Solitander, STATES, MARKETS, THE FINANCE LOBBY AND THE EUROPEAN UNION SAVINGS TAX DIRECTIVE, pages 5-10, http://ethesis.helsinki.fi/julkaisut/val/yleis/pg/solitander/statesma.pdf, last visited 16.08.2012. and also in the Low Tax Library http://www.lowtax.net/specials/std.html, last visited 16.08.2012.

18 See more about the background of the negotiation: C.H. Courtois,THE IMPACT OF THE EUROPEAN COMMISSION ON THE COUNCIL OF MINISTERS' DECISIONS IN THE FIELD OF EUROPEAN TAXATION The Case of the European Savings Directive, available at: http://www.ucl.ac.uk/ippr/journal/downloads/vol2-2/IPPR_Vol_2_No_2-2.pdf, last visited on 20.08.2012.

19 More and detailed information available about the Bilaterals II at: http://www.europarl.europa.eu/meetdocs/2004_2009/documents/fd/deea20050706_1/deea20050706_11a.pdf, last visited 16. 08. 2012.

20 Swiss companies were granted the benefits of the EU Parent-Subsidiary Directive, thereby exempting them from cross-border withholding taxes dividends paid by an EU subsidiary of a Swiss company to its Swiss parent.

harmonization but that it is co-ordination among MS through an exchange of information.

The EUSD is not a single measure in the EU anti-abuse system, as the EU has concluded a treaty with the Swiss Confederation[21] and European microstates regarding savings income in the form of interest payments. These treaties provide similar rules as the EUSD in achieving a partial taxation of the undeclared assets concealed in Switzerland and in other offshore financial centers. The Anti-Money Laundering Directive[22] and the latest FATF Recommendations (2012)[23] support further the anti-abuse efforts taken by the MSs, as these – among other rules – force the identification of the BO, the transparency of the legal entities and legal arrangements, introduce the all-crime approach, the abolition of professional secrecy towards the competent authorities and mutual legal assistance among the States[24].

Parallel with EU developments – like the roadmap of automatic exchange of information for categories of income other than interest[25] – there are bilateral agreements among some MSs (Austria, Germany and the UK) and Switzerland and Liechtenstein providing for a different solution than the exchange of information since these treaties operate with anonymous WHT.

The Commission's point of view is that the EUSD – within its limits – has proven itself to be effective in limiting EU residents' tax avoidance opportunities; further, it has had positive results by enhancing taxpayers' compliance to fulfill their obligations and to declare interest income[26]. The EUSD has limits set by its scope, so the EU tax system currently cannot provide for the effective taxation of

---

21 AGREEMENT between the European Community and the Swiss Confederation providing for measures equivalent to those laid down in Council Directive 2003/48/EC on taxation of savings income in the form of interest payments. Available at: http://eur-lex.europa.eu/LexUriServ/LexUriServ.douri=OJ:L:2004:385:0030:0042:EN:PDF, last visited on 17.08.2012.

22 Directive 2005/60/EC of the European Parliament and of the Council of 26 October 2005 on the prevention of the use of the financial system fort he purpose of money laundering and terrorist financing. Available at: http://eur-lex.europa.eu/LexUriServ/LexUriServ.douri=OJ:L:2005:309:0015:0036:en:PDF, last visited on 18.08.2012.

23 Financial Action Task Force. Hereinafter: FATF. The latest FATF Recommendations were published on 15 February 2012, available on www. FATF.org, last visited on 18.08.2012.

24 No. 3, 10, 24, 25 and 37 FATF Recommendation 2012. www. FATF.org.

25 Council Directive 2011/16/EU, Administrative Cooperation in the Field of Taxation and Repealing Directive 77/799/EEC, 2011 O.J. (L 64).

26 Brussels, 15.9.2008 COM (2008) 552 final, REPORT FROM THE COMMISSION TO THE COUNCIL in accordance with Article 18 of Council Directive 2003/48/EC on taxation of savings income in the form of interest payments {SEC(2008) 2420}, Available at: http://ec.europa.eu/taxation_customs/resources/documents/taxation/personal_tax/savings_tax/savings_directive_review/com(2008)552_en.pdf, last visited on 17.08.2012. More information available about the Commission's activity regarding the EUSD: http://ec.europa.eu/taxation_customs/taxation/personal_tax/savings_tax/savings_directive_review/index_en.htm, last visited on 17.08.2012.

undeclared assets and income other than interest. Independent experts do not seem to be as optimistic as the Commission itself; in relation to the positive effects of the EUSD, these experts emphasize the uncertainties and the lack of a comparative basis of the WHT and the reported income.[27] Reading the Commission's reports and working papers, it seems that the Commission understood the loopholes existing at the time the EUSD was legislated and went into force. One logical explanation might be that the Commission wanted to start the fight against EU-wide tax evasion *somewhere* and the EUSD is a compromise as well as a starting point for further developments in the future. The financial crisis in 2008 has changed several states' perspectives[28] regarding taxation as state revenues decrease and state debt has increased. This change in attitude is apparent from OECD's recent activity regarding TIEA, FATF consultations and recommendations.

The history of the EUSD continues as the Commission reports on the operation of the EUSD every three years and also suggests amending proposals in an effort to seal loopholes. Considering the 22-year history of the EUSD, one can hardly believe that it will be easy to change the existing model. Nevertheless, the recent developments in the field of taxation and the automatic exchange of information may accelerate the debate on the Commission's amending proposal[29] as it has been tabled for discussion in the Council since 2008.

2. The detailed anti-abuse concepts of the Savings Directive

As set forth in the introduction, the aim of the EUSD is to prevent abuse regarding interest payments[30] to individuals who are resident for tax purposes in an MS. The EUSD itself is an instrument to achieve this aim, and there are separate anti-abuse measures contained therein, namely: the definition of beneficial owner (Art. 2); the definition of paying agent (Art. 4); the definition of interest payment (Art. 6); the automatic exchange of information (Art. 9); the withholding tax (Art. 11)

[27] T. Klautke, A. J. Weichenrieder, Interest Income Tax Evasion, the EU Savings Directive, and Capital Market Effects

[37] available at: http://www.uclouvain.be/cps/ucl/doc/core/documents/weichenrieder.pdf, last visited: 17.08.2012.

[28] See this topic in detail in I. Grinber, Beyond FATCA: An Evolutionary Moment for the International Tax System. Available at: http://scholarship.law.georgetown.edu/cgi/viewcontent.cgiarticle=1162&context=fwps_papers, last visited on 02.01.2013.

[29] The Commission of the EU, Brussels, 13.11.2008 COM (2008) 727 final, 2008/0215 (CNS) Proposal for a Council Directive amending Directive 2003/48EC on taxation of savings income in the form of interest payments. Available at : http://ec.europa.eu/taxation_customs/resources/documents/taxation/personal_tax/savings_tax/savings_directive_review/com(2008)727_en.pdf, last visited on 17.08.2012.

[30] Preamble 8, 14 and Article 1 of the Council Directive 2003/48EC of 3 June 2003 on taxation of savings income in the form of interest payments.

Three of these rules also fulfill other functions. The definition of the BO, including the connecting identification obligation, the exchange of information, and the withholding tax are useful instruments for tracking money flows, preventing tax evasion in connection with other types of income, and supporting the combatting of money laundering and criminal activity. The implementation of WHT[31] is an imperfect solution, but it is a compromise among the MSs due to the economic and historical arguments of Belgium, Luxembourg, and Austria.[32] Nonetheless, it fulfills certain anti-abuse functions.

2.1. Identification of the beneficial owner

The notion of BO was introduced in EU law by the parallel implementation of the EUSD and the Interest-Royalty Directive[33]. Although both directives provide a complete definition of the BO, the targets and scopes of these directives are different; therefore their legal solutions defining the BO are also different. The Interest-Royalty Directive borrowed[34] its definition from the OECD Model Convention Commentary;[35] thus, there are similarities between the Interest-Royalty Directive and the OECD Model Convention Commentary[36].

Comparing the Interest-Royalty Directive with the EUSD, it is evident that their scope is different; the first deals with corporations and the latter focuses on individuals and corporations do not fall within its scope[37]. The EUSD defines the BO for different purposes than the Interest-Royalty Directive, and thus, comparing them is outside the scope of this paper.

The identification of the BO is a key factor in achieving the EUSD's aim and it is important from compliance, taxation, and anti-money laundering perspectives, too.[38] MS must comply with the Anti-Money Laundering Directive and they cannot avoid their international obligations to comply with FATF Recom-

[31] Article 11 of the Council Directive 2003/48 EC of 3 June 2003 on taxation of savings income in the form of interest payments.

[32] Preamble 17-18 of the Council Directive 2003/48EC of 3 June 2003 on taxation of savings income in the form of interest payments.

[33] Council Directive 2003/49 EC of 3 June 2003 on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States. Hereinafter: the Interest-Royalty Directive.

[34] J. Petkevica, "The concept of beneficial owner: From international tax law to community law" RGSL Working Papers No. 26. Riga (2005) pp. 7-8.

[35] Commentary to the Articles of the Model Convention with respect to taxes on income and on capital adopted by the Organization for Economic Co-operation and Development.

[36] See 2010 OECD Model Tax Convention on Income and on Capital Condensed Version 22 July 2010, Commentary on Article 10, paragraph 2 (12.1); Commentary on Article 11, paragraph 2 (8-9); Commentary on Article 12, paragraph 1 (4.1-4.2).

[37] Article 1(1) of the Council Directive 2003/48EC of June 2003 on taxation of savings income in the form of interest payments.

[38] Commission of the EU, Proposal for a Council Directive amending Directive 2003/48EC on taxation of savings income in the form of interest payments, p. 2.

mendations. Moreover, this is not solely an obligation but an important factor in combating tax avoidance.[39]

2.1.1. Definition of the beneficial owner

Article 2 provides a complex definition of the BO as follows:

"For the purposes of this Directive, 'beneficial owner' means any individual who receives an interest payment or any individual for whom an interest payment is secured, (...)"

It has to be acknowledged first that this definition is limited to the purposes of the EUSD; therefore, this definition does not solve the interpretation problems of double tax treaties regarding beneficial ownership.[40]

Regarding the aim of the directive,[41] the BO's definition is limited to individuals. Although the wording of Article 2 paragraph 1 is misleading, the interpretation of the EUSD clarifies that the personal scope of the definition does not cover third countries' tax residents.[42] This will be decisive when states[43] implement No 36-40 FATF Recommendations, regarding international cooperation.[44]

In accordance with the scope of the EUSD, the BO definition is limited to an individual who receives interest payments or for whom an interest payment is secured. It means that the competent tax authorities cannot use this definition in dealing with other types of income; however, the definition's concept may give guidance for further interpretation.

An individual is not deemed to be BO if, and only if, he or she provides evidence that the income was not received or secured for his or her own benefit. It is important to underline that the EUSD requires evidence. However, the wording does not provide further clarification about which type of evidence is acceptable. Therefore, the paying agent[45] is responsible for making a decision in dubious cases.[46] Based on the concept of free deliberation, the individual fulfills this obliga-

---

[39] See FATF Recommendation No. 3 "all crime approach".

[40] See the dispute about the topic S. Jain, "Beneficial Ownership and Conduit Companies", Research seminar at Institute for Austrian and International Tax Law, Vienna University of Economics and Business, (14 March 2012), 3.

[41] See Article 1 (1) of the Council Directive 2003/48EC of June 2003 on taxation of savings income in the form of interest payments.

[42] See Article 1 (1) and 3 (3) b of the Council Directive 2003/48EC of June 2003 on taxation of savings income in the form of interest payments.

[43] There are more than 180 states in the world implementing FATF Recommendation in their domestic legal systems. Source: www.fatf-gafi.org last visited 08.04.2012.

[44] These are: International instruments, Mutual legal assistance, Mutual legal assistance: freezing and confiscation, Extradition, Other forms of international cooperation.

[45] Hereinafter: PA.

[46] Article 2(2) last sentence of the Council Directive 2003/48EC of June 2003 on taxation of savings income in the form of interest payments.

tion by providing a written statement if other circumstances do not conflict with it. This interpretation of the wording is in accordance with the last section of this article, as the PA is obliged to take reasonable steps to establish the identity of the BO, when the PA has information that the individual who receives an interest payment or for whom an interest payment is secured may not be the BO.

This obligation of the PA is limited, as the PA is obliged to take only reasonable steps in order to establish the identity of the BO. In other words, the PA is not obliged to undertake an investigation in connection with the identification. Article 2 (2) of the EUSD provides an ultimate rule solving any identification disputes: *"If the paying agent is unable to identify the beneficial owner, it shall treat the individual in question as the beneficial owner."*

Article 2 (1) of the EUSD provides further alternative conditions in connection with the previously analyzed verification obligation. These alternative conditions are:

- the individual acts as a PA; or
- the individual acts on behalf of a legal person, an entity which is taxed on its profits under the general arrangements for business taxation, an UCITS[47] or an entity referred to in Article (2) of the EUSD and, in the last-mentioned case, the individual discloses the name and address of that entity to the PA making the interest payment and the latter communicates such information to the competent authority of its MS of establishment; or
- the individual acts on behalf of another individual and informs the PA about the ultimate BO.

The first and last conditions are clear, as these directly or indirectly transfer the BO's obligations to the ultimate BO. If an individual acts as a PA, this person has to fulfill all those obligations which are laid down in Article 3, 8, 11. If an individual acts on behalf of the ultimate BO the PA must identify the latter.

The second section of Article 2 (1) requires further explanation, as this is more complex. If an individual acts on behalf of a legal person, the interest income in question is outside of the scope of the EUSD, as the Directive focuses on individuals who are tax resident in an MS. If an individual acts on behalf of an entity, which is taxed on its profits under the general arrangements for business taxation, the interest income is taxed through profit taxation; therefore, it does not have to be taxed once more.

[47] Collective investments in transferable securities, hereinafter: UCITS Council Directive 85/611/EEC of 20 December 1985 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities.

2.1.2. Importance of the anti-abuse measurements

The importance and effects of the BO's definition and identification procedure[48] can be summarized as follows:

(a) It clarifies the ultimate beneficiary, giving to the tax authorities a precisely identified individual as a taxpayer.
(b) It helps the taxpayers, paying agents, and authorities to fulfill their obligations when dealing with savings.
(c) It limits the possibility of tax avoidance, as in the absence of a precise definition the state of residence of the BO would not be able to tax the dividend income; therefore, it would be able to avoid taxation. Moreover, the PA would not be able to fulfill its obligation and report the interest income to the competent tax authority without a clear definition and rules of identification procedure of the BO.
(d) It indicates that the BO is the owner of the original income; thus, it may create further tax obligations and, moreover, provides clear evidence to the tax authorities about who the taxpayer is.

2.1.3. Loopholes regarding the BO

The EUSD as a whole has achieved positive results[49] since its implementation;[50] however, the EUSD has not fulfilled all of the ambitious expectations of the

[48] Article 3 provides technical rules for the BO's identification procedure. This depends on whether the contractual relation between the PA and BO was entered into before or after 1 January 2004. In the first case the PA must establish the identity of the BO consisting of his/her name and address, by using the information at its disposal, in particular pursuant to the regulations in connection with the prevention of money laundering. In the latter case, the PA must establish the identity of the BO, consisting of the name, address, and tax identification number. The BO must provide official documents to prove the above-mentioned facts. An important rule is that the PA must establish the residence of the BO. It is decisive regarding place of taxation and revenue sharing. The country of residence has the right to tax the interest income. The place of residence is in the country where the BO has his/her permanent address. In the case of individuals, they present an official document issued by an MS, and declare themselves to be resident in a third country, residence is established by means of a tax residence certificate issued by the competent authority of this third country. The ultimate rule solving any dispute is that if the BO fails to present the above-mentioned certificate, the MS, which issued the identity document, must be considered to be the country of residence.

[49] See Commission of the EU, Brussels, 13.11.2008 COM (2008) 727 final, 2008/0215 (CNS) Proposal for a Council Directive amending Directive 2003/48EC on taxation of savings income in the form of interest payments, p.2. http://ec.europa.eu/taxation_customs/resources/documents/taxation/personal_tax/savings_tax/savings_directive_review/com(2008)727_en.pdf; also see the first review and amending proposal of the Commission of the EU. http://ec.europa.eu/taxation_customs/taxation/personal_tax/savings_tax/savings_directive_review/index_en.htm; and the EU Commission's report 04/02/2009 / Taxation and Customs Union DG/ TAXUD A1/2/2009, pp. 4-5. http://ec.europa.eu/taxation_customs/resources/documents/taxation/gen_info/info_docs/tax_reports/report_activities_2008_en.pdf; last visited 08.04.2012

[50] Council Directive 2003/48EC has been applied in the EU Member States since 1 July 2005.

Council of the EU. The definition of the BO is precise but quite narrow, and it contains loopholes. Thus, interposing intermediate tax-exempt structures held by EU tax resident individuals results in these individuals easily being able to circumvent the EUSD. These tax-exempt structures are companies registered in offshore or low-tax jurisdictions, hybrid entities (usually partnerships), trusts, and similar legal arrangements. Neither the payments to legal entities nor a look-through approach is covered by the BO definition; therefore, it cannot prevent abusive practice of intermediate companies or legal arrangements.[51]

Another problematic issue is that the current framework does not require regular updating of the BO's permanent address. Moving between EU Member States results in uncertainty and the PA would not be able to accurately fulfill its obligations. The lack of an obligation to provide regularly updated tax residence certification means that the EU citizens are able to circumvent the rules by providing tax residence certificate issued by a third country and then move back to their original abode within the EU.[52]

Based on the Commission Staff working document,[53] the Commission has detected these problems and reported them to the Council in the first report[54] of the operation of EUSD. Regarding the actual provision of the BO in the EUSD, the Commission admitted that it is easy to circumvent it using shell companies or legal arrangements.

Due to the above-mentioned loopholes regarding the BO, the Commission suggested in its amending proposal[55] a targeted solution, the application of a "*look-through*" approach by PAs, requesting them to identify, as far as possible

---

[51] See the Commission's arguments in the Proposal for a Council Directive amending Directive 2003/48EC on taxation of savings income in the form of interest payments, p.3. http://ec.europa.eu/taxation_customs/resources/documents/taxation/personal_tax/savings_tax/savings_directive_review/com(2008)727_en.pdf; last visited 08.04.2012.

[52] See the Commission of the EU, Brussels, 13.11.2008 COM (2008) 727 final, 2008/0215 (CNS) Proposal for a Council Directive amending Directive 2003/48EC on taxation of savings income in the form of interest payments, p.4. Available at: http://ec.europa.eu/taxation_customs/resources/documents/taxation/personal_tax/savings_tax/savings_directive_review/com(2008)727_en.pdf, last visited 06.01.2013.

[53] Brussels, 29.4.2008 SEC(2008)559, COMMISSION STAFF WORKING DOCUMENT, Refining the present coverage of Council Directive 2003/48/EC on taxation of income from savings Available at: http://ec.europa.eu/taxation_customs/resources/documents/taxation/personal_tax/savings_tax/savings_directive_review/sec(2008)559_en.pdf, last visited 17.08.2012.

[54] Brussels, 15.9.2008 COM (2008) 552 final, REPORT FROM THE COMMISSION TO THE COUNCIL in accordance with Article 18 of Council Directive 2003/48/EC on taxation of savings income in the form of interest payments {SEC(2008) 2420}, Available at: http://ec.europa.eu/taxation_customs/resources/documents/taxation/personal_tax/savings_tax/savings_directive_review/com(2008)552_en.pdf, last visited on 17.08.2012.

[55] Brussels, 15.9.2008 COM (2008) 552 final, REPORT FROM THE COMMISSION TO THE COUNCIL in accordance with Article 18 of Council Directive 2003/48/EC on taxation of savings income in the form of interest payments {SEC(2008) 2420}, pages 4-5.

on the basis of the information already available to them, the individual beneficiaries behind the legal entities or arrangements which are the immediate recipients of the interest payments.

This "look-through" approach would be based on the existing customer due diligence as financial institutions and professionals are obligated to identify the BO on whose behalf a legal entity or an arrangement concludes a transaction. Parallel with the "look-through" approach the Commission provides clarification of the definition and the obligation of PAs; moreover, it suggests annexing a list of those jurisdictions and their relevant entities and arrangements that are usually used for tax evasion.

On the basis of the Commission's proposal an immediate question arises, namely whether the "look-through" approach is compatible with the separate legal entity's existence and acceptance or whether an appropriate CFC regulation would be able to solve these disputes providing a solution not just to seal the EUSD's loopholes but offering effective solutions to tax other income, too.

There are several problems with the Commission's proposal, using the "look-through" approach and listing the low-tax jurisdictions in an appendix and forcing legal entities established outside of the EU to act as a paying agent. First, this is a very bureaucratic approach and it disregards the separation between the legal entity and its shareholder, which is a worldwide common phenomenon. Generally, if a legal entity receives income, it does not mean immediate distribution to its shareholders; therefore, the company's income without conditions is not equal to its shareholders' income. Taxing the interest income immediately upon receipt would result in a double taxation, once upon receipt and once again upon distribution. Secondly, it disregards the effective activity and place of management of the legal entity. Any approach should take into account the legal entities' real activity. Thirdly, it is a hidden general WHT on companies' income; thus, this would mean a different approach than residence taxation and it is closer to the source taxation approach. Several MSs have concluded DTTs[56] with the listed jurisdictions, which limit their taxation rights; thus, the Commission's amendment suggestion – introducing an effectively company-level WHT – might be in contradiction to the existing DTTs among MSs and low-tax jurisdictions. Panama, Malaysia, Hong Kong, Dubai or Singapore are good examples of low tax jurisdictions having DTTs with MSs.

The MSs could solve the problem and limit the tax evasion practices of their taxpayers by combining EU and OECD level automatic information exchange regime with the introduction of a targeted CFC regulation into their domestic tax systems. In the domestic tax system it is much easier to bespoke personal taxation and create a deemed dividend (without effective distribution) category once the MSs do have information of beneficial ownership and income of foreign legal entities.

---

[56] Double Tax Treaty.

The OECD's recent activity[57], forcing the low tax jurisdictions to accept exchange of tax information treaties (TIEA), and the 2012 FATF Recommendations have created an appropriate basis – which is leading to[58] a complete transparency of legal entities and arrangements – to tax the shell companies incomes as deemed dividends on the domestic level.

2.2. The paying agent

Under the EUSD, economic operators play an important rule by obligating them to act as cross-border tax intermediaries[59]. The EUSD has created a new category in taxation and this is the PA, who is obligated to identify the taxpayer, file and report to its domestic tax authority the required information or calculate, deduct and transfer the amount of WHT. This mechanism differs from the US FATCA[60] system as it takes into account domestic regulations and does not force economic operators to breach their domestic obligation when they report confidential information to a foreign sovereign. Thus, under the EUSD's regime, the PA reports to its domestic tax authority. Due to the compromise among the MSs accepting withholding taxation in selected jurisdictions, the PA can be a cross-border WHT agent or a cross-border information-reporting agent[61]. Therefore, the definition is decisive to precisely clarify those economic operators whose tasks are close to the tax authorities.

2.2.1. Definition and obligation of the paying agent

Identification of the PA is decisive to the operation of EUSD, as the PA must determine whether the provisions of the EUSD apply to a payment of savings income. Article 4 paragraph 1 provides a complex definition of the PA as follows:

57 Model agreement on exchange of information on tax matters, developed by the OECD Global Forum Working Group on Effective Exchange of Information, available at: http://www.oecd.org/ctp/exchangeofinformation/taxinformationexchangeagreementstieas.htm, last visited: 02.01.2013.

58 In The Czech Republic and Panama internal negotiations have started to abolish the bearer shares or at least oblige the company providers to do customer due diligence and keep the records.

59 This name derives from the essay of I. Grinberg, Beyond FATCA: An Evolutionary Moment for the International Tax System, available at: http://scholarship.law.georgetown.edu/cgi, last visited: 12.01.2013.

60 US Foreign Account Tax Compliance Act available at: http://www.pwc.com/en_US/us/asset-management/investment-management/publications/assets/pwc-fatca-proposed-regulations.pdf, last visited: 02.01.2013. Useful information available at: http://www.irs.gov/Businesses/Corporations/Foreign-Account-Tax-Compliance-Act-(FATCA)last visited: 02.01.2013.

61 These terms derive from the essay of I. Grinberg, Beyond FATCA: An Evolutionary Moment for the International Tax System.

> *"For the purposes of this Directive, 'paying agent' means any economic operator who pays interest to or secures the payment of interest for the immediate benefit of the beneficial owner, whether the operator is the debtor of the debt claim which produces the interest or the operator charged by the debtor or the beneficial owner with paying interest or securing the payment of interest."*

Based on this, any economic operator is a PA if it pays interest to or secures the payment of interest for the immediate benefit of the BO, who must be an EU tax resident individual. The economic operator to be deemed a PA can either be directly the debtor of the debt claim or the operator charged by the debtor or the BO with paying or securing the interest. Therefore, the PA is a person who, in the course of a business or profession, makes savings income payments to individuals or residual entities in prescribed territories[62]. The PA is always the last link in the payment chain before the relevant payee or residual entity and actively initiates a payment. From this explanation, the logical next step is that making or securing a payment requires a significant active responsibility for ensuring that the payment is made or secured. Thus, in order to an economic operator to be considered a PA, it should have a more active than a simple passive or supporting role. Business operators conducting essentially passive or auxiliary activity such as transfers, issuing bank guaranties or clearing checks do not by any means create PA obligations. The cross-border financial intermediaries must act as cross-border reporting agents or cross-border WHT agents when they actively pay interest to, or secure the payment of interest for the immediate benefit of, the BO. A question arises as to who is the last link in the chain in complex structures, when two competing business operators play significantly similar roles both claiming to be a PA. The EUSD does not provide a solution for this; therefore, the economic operators should decide by mutual agreement with regard to their locally implemented rules and tax authorities' guidelines.

The definition of the "paying agent on receipt" in Article 4 paragraph 2 is much more complex and requires interpretation, as it provides the following:

> *"Any entity established in a Member State to which interest is paid or for which interest is secured for the benefit of the beneficial owner shall also be considered a paying agent upon such payment or securing of such payment. This provision shall not apply if the economic operator has reason to believe, on the basis of official evidence produced by that entity, that: (a) it is a legal person, with the exception of those legal persons referred to in paragraph 5; or (b) its profits are taxed under the general arrangements for business taxation; or(c) it is an UCITS recognized in accordance with Directive 85/611/EEC."*

---

[62] The legal persons exempted from Article 4 paragraph 2(a) are: (a) in Finland: avoin yhtiö (Ay) and kommandiittiyhtiö (Ky)/öppet bolag and kommanditbolag; (b) in Sweden: handelsbolag (HB) and kommanditbolag (KB).

Once an economic operator is deemed "paying agent on receipt" with regard to the above paragraph it must act as follows based on the Article 4 paragraph 3:

> *"An economic operator paying interest to, or securing interest for, such an entity established in another Member State which is considered a paying agent under this paragraph shall communicate the name and address of the entity and the total amount of interest paid to, or secured for, the entity to the competent authority of its Member State of establishment, which shall pass this information on to the competent authority of the Member State where the entity is established."*

The interpretation of these complex provisions is not easy, and the Commission itself acknowledged[63] that these provisions have not fulfilled earlier expectations thus, causing uncertainties and loopholes in the EUSD' operation. Based on the provisions above, entities registered in the EU mostly lack legal personality, with the exception of certain Finnish and Swedish entities, and are treated as PAs at the moment of they receive the payment instead of at the moment when the interest is distributed to the BO. This regulation limits the geographical scope of the EUSD, as legal entities established outside of the EU's territory do not fall under the category of "paying agent on receipt". The official justification of this "*paying agent on receipt*" approach is that *"the income obtained by the entities concerned is generally allocated for tax purposes to the participants in the entity regardless of the moment of effective distribution by the entities to the participants ("tax transparent" entities)"*[64].

The effective working mechanism of the "paying agent on receipt" approach currently relies on the cooperation of the upstream economic operators making interest payments to these entities when established in another Member State. In practice, the upstream economic operator -who does not know the individual BO – records the payment made to the entity and the entity – who knows the individual BO – must apply the Directive when it receives the payment. The level of this cooperation and the compliance of the "paying agent on receipt" entities may be different in the MSs, and where the "paying agent on receipt" concept is not

---

[63] Brussels, 15.9.2008 COM (2008) 552 final, REPORT FROM THE COMMISSION TO THE COUNCIL in accordance with Article 18 of Council Directive 2003/48/EC on taxation of savings income in the form of interest payments {SEC(2008) 2420}, Available at: http://ec.europa.eu/taxation_customs/resources/documents/taxation/personal_tax/savings_tax/savings_directive_review/com(2008)552_en.pdf, last visited on 17.08.2012.

[64] COMMISSION STAFF WORKING DOCUMENT Refining the present coverage of Council Directive 2003/48/EC on taxation of income from savings ("Savings Taxation Directive") p. 7.

[64] http://ec.europa.eu/taxation_customs/resources/documents/taxation/personal_tax/savings_tax/savings_directive_review/sec(2008)559_en.pdf, last visited on 02.01.2013.

consistently implemented, room is left for abuse and distortions[65]; therefore, further clarification of this provision is advisable.

Once the PA pays or secures interest to, or for the benefit of, the BO, it is obliged to report the minimum amount of information in connection with the BO to the competent authority of its MS if the BO is resident in an MS other than that in which the PA is established. The minimum amount of information must contain the identity and residence of the BO, the name and address of the PA, the account number of the BO, and information concerning the interest payment. In those countries and dependent territories which are entitled to apply WHT instead of an exchange of information, the PA becomes a cross-border WHT agent and it is obliged to levy WHT on the amount of interest paid or credited. It is important to bear in mind that the PA must report the BO's account number; therefore, this information is open to the BO's residence tax authority, which can obtain more information from the competent authority for a further tax audit.

2.2.2. Importance of anti-abuse measurements and loopholes

The definition and the obligations of the PA guarantee the collection and transfer of information to the competent authorities and the levy of WHT at source. The PA's activity is partly similar to the tax authorities' role regarding identification and compliance procedures, and the calculation of the tax base. The costs of these cross-border tax agent activities are transferred to the BOs, as normally the compliance cost is part of the service fee.

The current framework of the EUSD limits the PAs in geographical and economic terms; moreover, the "paying agent on receipt" concept is uncertain and ineffective as there is a lack of any control mechanism.

If we analyze the provisions in more depth from a geographic perspective, it is evident that the EUSD focuses on the EU resident economic operators, and entities established outside the EU are not within the scope of the EUSD. The "paying agent on receipt" provision is much more problematic due to two factors. First, the provision itself limits the scope to entities established in the EU. Secondly, Switzerland and the European microstates, which are obligated to apply equivalent measures regarding interest savings, did not accept the "paying agent on receipt" provision in the agreements they signed with the EU.

[65] Brussels, 13.11.2008 COM(2008) 727 final 2008/0215 (CNS) Proposal for a COUNCIL DIRECTIVE amending Directive 2003/48/EC on taxation of savings income in the form of interest payments {SEC(2008) 2767} {SEC(2008) 2768} (presented by the Commission). pp. 5-6. Available at: http://ec.europa.eu/taxation_customs/resources/documents/taxation/personal_tax/savings_tax/savings_directive_review/com(2008)727_en.pdf, last visited on 17.08.2012.

According to the Commission[66], another problematic area is the activity of multinational financial institutions as these maintain branches outside of the EU's territory. Due to the above-mentioned territorial scope of the EUSD, taxpayers could circumvent it by using interest payments routed through these economic operators' branches outside the EU territory. The lack of precise specification of economic operators' responsibilities[67] in the EUSD results in a possible misuse of the financial institutions' international network in order to circumvent the EUSD.

If we view the provisions from an economic perspective, the current framework provides the possibility of aggressive tax planning to EU taxpayers, who can easily circumvent the provisions using legal arrangements and non-EU legal entities, mainly interposed tax-exempt structures, which are not under the scope of EUSD and are not treated as PA.

Apparently these loopholes are so obvious that the Commission has already acknowledged them in its working document, right after the implementation of the EUSD: *"Experience gained in the first years of application of the Savings Taxation Directive provides anecdotal evidence that the "paying agent on receipt" provisions have been less effective than expected by the Council."* [68]

The Commission Staff Working Document[69] acknowledges the lack of legal certainty for the upstream economic operators, paying interest to the entities; a number of inconsistencies in the definition of the scope of the provisions, including the lack of a reference to legal "arrangements", the exclusion of almost all legal persons, and the exclusion of "transparent" entities.

Based on – among other things – the Commission Staff working document, the Commission submitted an amending proposal[70] to the Council, proposing

66 Brussels, 15.9.2008 COM(2008) 552 final REPORT FROM THE COMMISSION TO THE COUNCIL in accordance with Article 18 of Council Directive 2003/48/EC on taxation of savings income in the form of interest payments {SEC(2008) 2420}, p.5. Available at: http://ec.europa.eu/taxation_customs/resources/documents/taxation/personal_tax/savings_tax/savings_directive_review/com(2008)552_en.pdf, last visited on 03.01.2013.

67 There are situations when financial institutions are aware that an interest payment made to an operator established outside the territorial scope of EUSD is made for the benefit of an individual, known by them to be a resident of another Member State and who can be considered to be their customer.

68 COMMISSION STAFF WORKING DOCUMENT Refining the present coverage of Council Directive 2003/48/EC on taxation of income from savings p.7. Available at: http://ec.europa.eu/taxation_customs/resources/documents/taxation/personal_tax/savings_tax/savings_directive_review/sec(2008)559_en.pdf, last visited on 03.01.2013.

69 COMMISSION STAFF WORKING DOCUMENT Refining the present coverage of Council Directive 2003/48/EC on taxation of income from savings p.7. Available at: http://ec.europa.eu/taxation_customs/resources/documents/taxation/personal_tax/savings_tax/savings_directive_review/sec(2008)559_en.pdf, last visited on 03.01.2013.

70 Brussels, 13.11.2008 COM(2008) 727 final 2008/0215 (CNS) Proposal for a COUNCIL DIRECTIVE amending Directive 2003/48/EC on taxation of savings income in the form of interest payments {SEC(2008) 2767} {SEC(2008) 2768} (presented by the Commission) Available at: http://ec.europa.eu/taxation_customs/resources/documents/taxation/personal_tax/savings_tax/savings_directive_review/com(2008)727_en.pdf, last visited on 03.01.2013.

clarification of this concept to ensure its consistent application. The Commission suggested abandoning the actual approach of the 'paying agent on receipt', proposing a new approach "*based on a 'positive' definition of the intermediate structures obliged to act as a 'paying agent upon receipt'*".[71] The basic element of the proposal – to create a "positive" definition of the structures acting as "paying agent upon receipt" – should be based on substantial elements rather than on their legal forms. With this new approach the Commission suggests to look through the legal entities, disregarding their separate existence and entity.

The Commission explains its proposal as follows: "This approach makes clear that these intermediate structures must apply the provisions of the Directive insofar as any of their beneficial owners is an individual who is resident in another EU MS. This would happen upon receipt by these structures of any interest payment as defined in Art. 6, from any upstream economic operator, not only those established in other MS (Art. 4(2), last sentence) or in the same MS (Art. 4(4)), but also those outside the EU."[72]

The Commission's proposal "paying agent upon receipt" does not seem ideal for two reasons. First, it is burdensome from an administrative perspective. Secondly, the proposal suggests implementing administrative functions and reporting/withholding obligations to legal entities, which are established in another jurisdiction, under the supervision of another sovereign. Without bi- or multilateral-treaties, this initiative might cause resistance among these jurisdictions, as the EU does not have jurisdiction over legal entities registered elsewhere and with regard to geographic and economic diversification of the entities the EU cannot emulate the US FATCA approach.

The Commission's proposal to improve the definition of the PA still contains loopholes. As mentioned in section 2.1.4, the look-through approach and the list of the automatically "paying agent upon receipt" legal entities is a very bureaucratic system. Moreover, the list of the automatically "paying agent upon receipt" legal entities is not broad enough and there are several jurisdictions in which it is possible to establish companies to avoid interest and other income taxation. The proposal generally seems not to be able to affect the territorial tax systems like Hong Kong, Singapore and Panama. In these jurisdictions there is no distinction

[71] Brussels, 13.11.2008 COM(2008) 727 final 2008/0215 (CNS) Proposal for a COUNCIL DIRECTIVE amending Directive 2003/48/EC on taxation of savings income in the form of interest payments {SEC(2008) 2767} {SEC(2008) 2768} (presented by the Commission) p.5., Available at: http://ec.europa.eu/taxation_customs/resources/documents/taxation/personal_tax/savings_tax/savings_directive_review/com(2008)727_en.pdf, last visited on 03.01.2013.

[72] Brussels, 15.9.2008 COM(2008) 552 final REPORT FROM THE COMMISSION TO THE COUNCIL in accordance with Article 18 of Council Directive 2003/48/EC on taxation of savings income in the form of interest payments {SEC(2008) 2420}, p.6. Available at: http://ec.europa.eu/taxation_customs/resources/documents/taxation/personal_tax/savings_tax/savings_directive_review/com(2008)552_en.pdf, last visited on 03.01.2013.

among the companies registered by resident or non-resident individuals; therefore, there is no double standard; moreover, these jurisdictions comply with the OECD and FATF standards[73].

Instead of listing the low tax jurisdictions and trying to force legal entities registered in non-EU countries to act as "paying agent upon receipt", a much more flexible approach would be advisable. A targeted CFC regulation might close this loophole if it is combined with automatic exchange of information. The key factors are not the place of registration and the legal form but effective activity and effective place of management (like stuff, offices, premises). Legal entities with real economic activity and an effective place of management in the place of registration should not be treated as "paying agent upon receipt". In contrast, the BOs of legal entities – registered in low tax jurisdictions without real economic activity or lack of effective place of management in their original jurisdictions – should be treated as if they received a deemed distribution from the legal entity and tax on this deemed distribution should be levied in their place of residence according to their domestic personal income tax rules.

To achieve this objective, information technology is ready and the information is accessible in the financial institutions. These institutions have collected the BOs' information since the FATF changed its recommendation in 2001 and the EU introduced the Anti-Money Laundering Directive[74].

2.3. Interest payment

The essential aim and target of the EUSD as expressly stated in its title and preamble, is ensuring taxation of savings income in the form of interest, which is taxable under a rather homogeneous criterion in all MS.

The EUSD gives important roles to economic operators; therefore, it is decisive for the operation of EUSD and fulfillment of PAs' obligations to precisely define the notion of interest. In the EUSD, interest is defined as income from debt claims in conformity with Article 11 of the OECD Model Tax Convention on income and capital.

During the ECOFIN meetings in 1999 and 2000, the MSs agreed that innovative financial products are excluded from the scope of the EUSD. This decision has opened the door to abusive practice, as by using basic building block

[73] See OECD's List of Unco-operative Tax Havens, Available at: http://www.oecd.org/ctp/harmfultaxpractices/listofunco-operativetaxhavens.htm, last visited on 12.01.2013. Also see: FATF's list of high risk and non-cooperative jurisdictions (19.10.2012.), Available at: http://www.fatf-gafi.org/topics/high-riskandnon-cooperativejurisdictions/documents/improving globalamlcftcomplianceon-goingprocess-19october2012.html, last visited on 12.01.2013.

[74] Directive 2005/60/EC of the European Parliament and of the Council of 26 October 2005 on the prevention of the use of the financial system fort he purpose of money laundering and terrorist financing. Available at: http://eur-lex.europa.eu/LexUriServ/LexUriServ.douri=OJ:L:2005:309:0015:0036:en:PDF, last visited on 18.08.2012.

instruments[75] it is entirely possible to re-wrap debt claims and avoid interest taxation without setting up costly intermediate structures.

Due to the well-known loopholes in the definition of interest, MSs expressly stated at the time of the first report that further refinement is necessary in connection with the definition of interest, but since then no action has been undertaken.

2.3.1. Definition of the interest payment

Article 6 paragraph 1 provides a sophisticated, long definition of 'interest payment' for the purposes of the EUSD, which can be summarized as follows:

- Interest paid or credited to an account, relating to debt claims of every kind;
- Interest accrued or capitalized upon the sale, refund or redemption of the debt claims;
- Income deriving from interest payments either directly or through a paying agent on receipt distributed by: an investment fund, technically defined as a UCITS; entities which qualify for the option being treated as a UCITS; investment funds established outside the territorial scope of the EUSD;
- Income realized upon the sale, refund or redemption of shares or units in the following undertakings and entities if they invest directly or indirectly, via other undertakings for collective investment or entities referred to below, more than 40 % of their assets in debt claims: a UCITS; entities which qualify for the option being treated as UCITS; investment funds established outside the territorial scope of the EUSD.

Although the definition of interest income is extended to interest income obtained through interposing certain investment vehicles, the present provision provides for the possibility of distortions of competition between direct and indirect investment in debt claims.

The current wording of Article 6 of the EUSD covers only income obtained through UCITS funds while – according to the Commission- other collective investment schemes – "non-UCITS" – authorized under national regimes of MSs are not fully captured by the Directive. The treatment of non-UCITS with legal personality (incorporated funds) differs from non-UCITS, which lack of legal personality (unincorporated or "contractual" funds and trusts). The "paying agents on receipt" provision covers unincorporated non-UCITS while the incorporated non-UCITS do not fall within the scope of the EUSD. This different regulation results an asymmetry in treatment between UCITS and unincorporated non-UCITS, on the one hand, and incorporated non-UCITS, on the other[76]. It

[75] T. Edgar, The Income Tax Treatment of Financial Instruments: Theory and Practice, Canadian Tax paper NO. 105, Canadian Tax Foundation.

[76] Brussels, 13.11.2008 COM(2008) 727 final 2008/0215 (CNS) Proposal for a COUNCIL DIRECTIVE amending Directive 2003/48/EC on taxation of savings income in the form of interest payments {SEC(2008) 2767} {SEC(2008) 2768} pp. 6-7.

must be noted that pension and insurance benefits are also excluded from the notion of interest; therefore, these do not fall within the scope of the EUSD.

2.3.2. Importance of anti-abuse measurements and the Commission proposal to close loopholes

The definition of the interest payment is essential to achieve the aim of the EUSD. On the one hand, it gives a guideline to everyone to understand their obligations, while on the other hand it defines the basics and tries to limit tax avoidance. Its loopholes have been apparent since its legislation; therefore, the current regulation of the scope of the interest payments seems much more like the beginning of an unfinished process than a finished regulation.

Despite the Council's effort to create a complex definition of interest payments, this definition excludes from the scope of interest payments innovative financial products, pension, and insurance benefits. This leads to distortions among the different types of investment vehicles and creates abusive practices among taxpayers, who can easily circumvent the EUSD without interposing intermediate structures. By using the services of the financial service sector, taxpayers can create income – enjoying limitations of risk, flexibility and agreed return on investment – which is equivalent to debt claims, but nevertheless remain outside the definition of interest payment provided by the EUSD.

Understanding the need to amend the definition, the Commission proposed a modification in 2008[77]. In this amendment proposal the Commission suggests extending the scope of the EUSD to those securities which are equivalent to debt claims. In the new extended-scope definition, securities are deemed to be equivalent to debt claims when the investor receives a return on capital whose conditions are defined at the issuing date, and also receives, at the end of the term of the securities, at least 95% of the capital invested, regardless of whether the underlying assets behind those securities include debt claims.

The Commission also suggested refinements regarding investment funds, as the current definition only covers income derived from 'UCITS' and unincorporated non-UCITS. Due to the asymmetrical treatment of non-UCITS entities mentioned above, the Commission proposed a new reference instead of Directive 85/611/EEC. This newly proposed reference is the registration of the undertaking or investment fund or scheme in accordance with the rules of any MS. Under the

[77] Brussels, 13.11.2008 COM(2008) 727 final 2008/0215 (CNS) Proposal for a COUNCIL DIRECTIVE amending Directive 2003/48/EC on taxation of savings income in the form of interest payments {SEC(2008) 2767} {SEC(2008) 2768} (presented by the Commission) pp. 6-8. The description of these amending proposals is based on the justification of the Proposal for a Council Directive amending Directive 2003/48/EC on taxation of savings income in the form of interest payments. Available at: http://ec.europa.eu/taxation_customs/resources/documents/taxation/personal_tax/savings_tax/savings_directive_review/com(2008)727_en.pdf, last visited on 03.01.2013.

new definition, the same rules would be applicable to all non-UCITS, irrespective of their legal form.

Regarding funds established outside the EU, the Commission proposed refining the EUSD definition according to the existing OECD definition of 'collective investment fund or scheme'. The Commission perspective is that *"This definition can be shared with countries outside the EU and can ensure that interest income channeled through these vehicles is treated appropriately."*[78]

The Commission admitted in the justification of the amending proposal that *"In relation to the current EUSD definition of interest payment, some MS have called for a radical extension to cover any kind of investment income, but those views are currently not widely shared."*[79]

This shows the dispute around the topic and the different interests of the MSs, even in the field of passive income taxation. It seems that some MS severely protect their financial industry although their standpoint is much more complex than it seems at first sight. There are several other economic, social and political components of this question so it is difficult to answer without an in-depth analysis.

The Commission represents a consensual approach as it stated: *"[...] the EUSD may not be the most suitable framework for improving cooperation between tax authorities on dividends or on capital gains from speculative financial instruments [...]. Solutions based exclusively on exchange of information would also seem more appropriate for ensuring that neither double taxation nor avoidance of any taxation arise [...]. However, until such purely information-exchange-based solutions become fully operational [...] in the field of direct taxation, it seems necessary to extend the scope of the EUSD [...]."*[80]

Based on the Commission's arguments, a conclusion can be draw and summarized as follows. First, the Commission shares the widely accepted tax-professional

[78] Brussels, 13.11.2008 COM(2008) 727 final 2008/0215 (CNS) Proposal for a COUNCIL DIRECTIVE amending Directive 2003/48/EC on taxation of savings income in the form of interest payments {SEC(2008) 2767} {SEC(2008) 2768} (presented by the Commission) P.7. Available at: http://ec.europa.eu/taxation_customs/resources/documents/taxation/personal_tax/savings_tax/savings_directive_review/com(2008)727_en.pdf, last visited on 03.01.2013.

[79] Brussels, 13.11.2008 COM(2008) 727 final 2008/0215 (CNS) Proposal for a COUNCIL DIRECTIVE amending Directive 2003/48/EC on taxation of savings income in the form of interest payments {SEC(2008) 2767} {SEC(2008) 2768} (presented by the Commission) P.7. Available at: http://ec.europa.eu/taxation_customs/resources/documents/taxation/personal_tax/savings_tax/savings_directive_review/com(2008)727_en.pdf, last visited on 03.01.2013.

[80] Brussels, 13.11.2008 COM(2008) 727 final 2008/0215 (CNS) Proposal for a COUNCIL DIRECTIVE amending Directive 2003/48/EC on taxation of savings income in the form of interest payments {SEC(2008) 2767} {SEC(2008) 2768} (presented by the Commission) P.7. Available at: http://ec.europa.eu/taxation_customs/resources/documents/taxation/personal_tax/savings_tax/savings_directive_review/com(2008)727_en.pdf, last visited on 03.01.2013.

opinion that a pure information exchange system would be a much better solution in the field of taxation in order to limit tax avoidance opportunities than the existing mixed model. Secondly, tax harmonization among the MS in the field of direct taxation is not in the pipeline and it seems that currently it is unrealistic. Third, the Commission follows a 'cautious development' approach regarding direct taxation, trying to find the commonly acceptable compromises among the MSs.

Until the MSs cannot create a harmonized direct tax system or at least a pure automatic information exchange-based system in the field of direct taxation, it is hardly possible to create a complex and unavoidable definition of interest payment.

2.4. Automatic exchange of information and the anonymous withholding tax, as two competing models

The essence of the EUSD is the automatic exchange of information[81] and the WHT[82], as these provide for the fulfillment of the EUSD's aim. The automatic exchange of information and the anonymous WHT are two parallel competing models[83] and these have been competing for years. Obviously, the anonymous WHT model is supported by the financial offshore centers, mainly by Switzerland, which often acts as a leader[84] for offshore asset management centers. The exchange of information[85] is one the most effective weapons combating tax evasion and the key element of the EUSD. It is supported by information technology and the recent co-operation developments[86] propelled by international organiza-

[81] Art. 9 of the EUSD.

[82] Art. 11 of the EUSD.

[83] See on this topic in detail: I. Grinberg , Beyond FATCA: An Evolutionary Moment for the International Tax System, pages 21-25, available at: http://scholarship.law.georgetown.edu, last visited on 05.01.2013.

[84] Switzerland is the world's most important offshore asset management center, managing approximately 27% of the world's offshore wealth. Boston Consulting Group, GLOBAL WEALTH Report 2011, supra note 21, at 13.

[85] See on the topic in detail: M. Meinzer, Policy Paper On Automatic Tax Information Exchange Between Nortern And Southern Countries, available at: http://www.taxjustice.net/cms/upload/pdf/AIE_100926_TJN-Briefing-2.pdf, and M. Brown, B. Döbeli, P. Sauré Swiss Bank Accounts available at: http://www.eui.eu/Personal/JMF/PhilipSaure/SwissBankAcc.pdf, and I. Grinberg, Beyond FATCA: An Evolutionary Moment for the International Tax System, pages 21-25, available at: http://scholarship.law.georgetown.edu, all last visited on 20.08.2012. OECD, Convention on Mutual Administrative Assistance in Tax Matters pmbl., May 27, 2010, available at http://www.oecd.org/dataoecd/63/49/48980598.pdf.

[86] Model agreement on exchange of information on tax matters, developed by the OECD Global Forum Working Group on Effective Exchange of Information, available at: http://www.oecd.org/ctp/exchangeofinformation/taxinformationexchangeagreementsticas.htm, last visited: 02.01.2013. The latest FATF Recommendations were published on 15 February 2012, available on www. FATF.org.

tions such as OECD and FATF. The Commission's original proposal was to implement a pure automatic exchange of information system, instead of the existing dual – exchange of information and WHT – system, but this failed due to the resistance of Austria, Belgium and Luxembourg. The EU also missed the historic opportunity to force Switzerland to sign the automatic exchange of information clause in the agreement with the EU in 2004; however, the 'Bilaterals II' treaty contains such elements as the access to the Parent-Subsidiary Directive[87], which is extremely important to Switzerland. The current compromise is far from a flawless framework, but the exchange of information indicates the right direction, forcing taxpayers to comply with their domestic obligations.

The working mechanisms of these parallel systems are simple. As regards the exchange of information, the financial institutions as cross-border tax intermediaries collect the data of the BO and interest payments, then transfer these to their domestic competent authorities and the competent authorities exchange the information at least once a year[88]. The system is based on technically harmonized IT platforms and the MSs have not reported any technical problems[89] regarding the exchange of information since the implementation of the EUSD. As regards the WHT, in the transitional period in Austria and Luxembourg[90] PAs must levy 35%[91] WHT on income from interest payments and transfer it to their domestic competent tax authority. Those states, which apply WHT, transfer the WHT collected to the taxpayers' residence countries. The MSs agreed that whenever this transitional period ends[92], Austria and Luxembourg must move to an exchange of information system, too.

[87] COUNCIL DIRECTIVE 2011/96/EU of 30 November 2011 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States (Recast) available at http://www.gsis.gr/ddos/st_egkyklios_&_parartimata_English/EC-SWISS_CONFEDERATION_AGREEMENT.pdf, last visited on 04.01.2013.

[88] Art. 9 (2) of the EUSD.

[89] REPORT FROM THE COMMISSION TO THE COUNCIL in accordance with Article 18 of Council Directive 2003/48/EC on taxation of savings income in the form of interest payments. Available at: http://ec.europa.eu/taxation_customs/resources/documents/taxation/personal_tax/savings_tax/savings_directive_review/com(2008)552_en.pdf, last visited on 04.01.2013.

[90] Belgium joined the automatic exchange of information system in 2010.

[91] Since 2010 this is the current rate of the withholding tax.

[92] Under Article 10 paragraph 2 of the EUSD, the transition period ends whenever (1) there is an agreement between the European Community and the last of Switzerland, Liechtenstein, San Marino, Monaco, and Andorra providing for the exchange of information upon request as defined in the OECD Model Agreement with respect to interest payments, (2) the USA is committed to exchange of information upon request as defined in the OECD Model Agreement with respect to interest payments, and (3) the European Council unanimously agrees that conditions (1) and (2) have been met.

In February 2011, the European Union adopted a Directive on Administrative Cooperation in the Field of Taxation[93] for automatic information exchange among EU Member States for categories of income other than interest. This Directive provides[94] that the Commission must submit proposals to the Council before 1 July 2017 regarding the categories of capital and income that MSs should be mandated to report to one another, with the aim being to extend that list to other passive income categories such as capital gains, dividends, and royalties.

A growing number of states have called for an automatic exchange of information and according to *Grinberg's* findings[95] there are four competing exchange of information and WHT systems in the world. These are; the OECD's TIEA, the EU's Directive on Administrative Cooperation in the Field of Taxation, the US's FATCA, and the Swiss anonymous WHT approach. The EUSD operates with a limited form of automatic information exchange among MSs with the exception of Austria and Luxembourg and the Commission has proposed to further develop the automatic exchange of information in the field of direct taxation[96]. The US enacted "FATCA," in 2010, requiring foreign financial institutions to report financial information about accounts held by US persons; otherwise all of their transfers from the US are subject to a 30% WHT. In 2011, the OECD created a platform for automatic information exchange with the revision of Convention on Mutual Administrative Assistance in Tax Matters[97]. Finally, Switzerland developed its own approach, the anonymous withholding taxation, supported by other offshore financial centers. Instead of information exchange, the Swiss approach provides anonymity for non-resident account holders in combination with a WHT regime.

[93] Council Directive 2011/16/EU, Administrative Cooperation in the Field of Taxation and Repealing Directive 77/799/EEC, 2011 O.J. (L 64), Available at: http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2011:064:0001:0012:En:PDF, last visited on 04.01.2013.

[94] Council Directive 2011/16/EU, Administrative Cooperation in the Field of Taxation and Repealing Directive 77/799/EEC, 2011 O.J. (L 64), Art. 8 (5).

[95] I. Grinberg, Beyond FATCA: An Evolutionary Moment for the International Tax System, available at: http://scholarship.law.georgetown.edu, last visited: 12.01.2013.

[96] Proposed amendments of EUSD and Council Directive 2011/16/EU, Administrative Cooperation in the Field of Taxation and Repealing Directive 77/799/EEC,

[97] Text amended by the provisions of the Protocol amending the Convention on Mutual Administrative Assistance in Tax Matters, which entered into force on 1st June 2011.

[97] Available at: http://www.oecd.org/ctp/exchangeofinformation/Amended_Convention_June2011_EN.pdf, last visited on 04.01.2013.

In 2011 Germany[98] and the UK[99], and in 2012 Austria[100], signed bilateral treaties with Switzerland and the latter also with Liechtenstein[101] in 2013, to the effect that instead of automatic exchange of information these would provide anonymous WHT. Under these agreements, Swiss financial institutions impose WHT and the Swiss government transfers the WHT anonymously to the countries of residence of the investors. The emerging tax information exchange models compete with the anonymous WHT model.

Austria and Luxembourg's standpoint rejecting automatic exchange of information, the Swiss anonymous WHT approach and the ratified Swiss agreements with Austria and the UK represent a "blow" to the expanded exchange of information system. Anonymous WHT supported by Art. 11 of the EUSD and the new bilateral agreements are incompatible with a broadly multilateral automatic exchange of information system. The anonymous WHT is not a sufficient solution to provide fair taxation and improve the taxpayers' voluntary tax compliance because the existing WHT solution still allows covering up the origin of the funds, which are usually untaxed.

3. Conclusion

The EUSD shows clearly the Commission's and the Council's perspectives as regards EU law development: to cautiously improve tax co-operation among the MSs to solve the negative taxation consequences of the unified EU market.

Nevertheless, the improvements have been going on slowly partly due to the counter-interest of some MSs and room is left for further developments. The EUSD provides several anti-abuse measures – including its most important measure the exchange of information – which improve the tax compliance of the market players. The standpoint of Austria and Luxembourg, together with some cooperative jurisdictions, most importantly Switzerland, to support the anonymous WHT solution, however weakens the effectiveness of the EUSD. Thus, the competition between the exchange of information system and the anonymous WHT approach is not over yet and it seems – recent developments taken into consideration – the two systems will remain in parallel for the foreseeable future.

[98] Agreement of 21 September 2011 between the Federal Republic of Germany and the Swiss Confederation on Cooperation in Regard to Taxation and the Financial Market, as amended on 5 April 2012, More information available at: http://www.bundesfinanzministerium.de/Content/EN/FAQ/2012-09-13-tax-agreement-with-switzerland.html, last visited: 05.01.2013.

[99] Agreement between the Swiss Confederation and the United Kingdom of Great Britain and Northern Ireland on cooperation in the area of taxation, available at: http://www.hmrc.gov.uk/taxtreaties/swiss.pdf, last visited: 05.01.2013.

[100] Abkommen zwischen der Schweizerischen Eidgenossenschaft und der Republik Österreich über die Zusammenarbeit in den Bereichen Steuern und Finanzmarkt.

[100] The treaty enters into force on 01.01.2013,available at: http://www.news.admin.ch/NSBSubscriber/message/attachments/26559.pdf, last visited: 05.01.2013.

[101] Federal Ministry of Finance press release. Available at: http://english.bmf.gv.at/Press/07B17B23146C41A4B51D4ED8048724B2.htm, last visited: 18.02.2013.

List of Abbreviations

Art./Arts.	Article/Article
BAO	Bundesabgabenordnung (Austrian Federal Tax Code)
BB	Betriebs Berater
BFH	Bundesfinanzhof (German Federal Tax Court)
BGBl	Bundesgesetzblatt (Federal Law Gazette)
CCCTB	Common Consolidated Corporate Tax Base
CFC	Controlled Foreign Company
CSTI	Cadbury Schweppes Treasury International
CSTS	Cadbury Schweppes Treasury Services
DB	Der Betrieb (periodical, Germany)
DStR	Deutsches Steuerrecht (periodical, Germany)
DTC	Double Tax Convention
DTT	Double Tax Treaty
EC	European Commission
ECJ	European Court of Justice
ECR	European Court Reports
ed./eds.	editor/editors
EEA	European Economic Area
EEC	European Economic Community
EStG	Einkommensteuergesetz (Austrian/German Individual Income Tax Act)
et seq.	and the following
EU	European Union
EuGH	Europäischer Gerichtshof
FJ	Finanz Journal (periodical, Germany)
FR	Finanz Rundschau (peridical, Germay)
GAAR	General Anti-Avoidance Rules
IFA	International Fiscal Association
IfSt	Institut Finanzen und Steuern
IP	Intellectual Property
IStR	Internationales Steuerrecht (periodical, Germany)
LOB	Limitation of Benefits
m.no.	Marginal number(s)

MC	OECD Model Convention
MNE	Multinational Enterprise
MS	Member State(s)
MSISt	Münchner Schriften zum Internationalen Steuerrecht
OECD MC	OECD Model Convention
OECD	Organization for Economic Co-operation and Development
p./pp.	page/pages
para./paras.	Paragraph/paragraphs
RdW	Recht der Wirtschaft (periodical, Austria)
StuW	Steuern und Wirtschaft (periodical, Germany)
SWI	Steuer und Wirtschaft International (periodical, Austria)
Taxlex	Taxlex (periodical, Austria)
TEC	Treaty establishing the European Community
TFEU	Treaty on the Functioning of the European Union
Vol.	Volume

He received his PhD from Moscow State Law Academy.

Sergey is focusing his practice on advising Russian and foreign-based multinational corporations on capital market tax issues (corporate stocks, bonds, derivatives and other financial instruments, securitization, syndicates loans), international tax structuring, as well as representing multinationals in tax disputes.

Prior to joining Liniya Prava, Sergey was a Senior Associate at Berwin Leighton Paisner LLP (Moscow office) and Manager at Deloitte (Moscow office).

Stepan Karas

Stepan Karas graduated with merit in economic theory and logic from the Charles University in Prague in 2003. He also holds a master degree in public finance from the Prague School of Economics. He has been working in various positions within Deloitte since 2003 and is now a senior manager specializing in indirect taxes in the Prague office of Deloitte Czech Republic. He is a member of the Czech Chamber of Tax Advisors since 2007.

Brigitte Leitgeb

Brigitte Leitgeb graduated in Law at the University of Vienna, Austria. After a legal apprenticeship at court and a year as university assistant she joined the Austrian civil service and has worked for the Austrian Ministry of Finance ever since, either in Vienna and or at the Austrian Permanent Representation to the European Union in Brussels. Currently she is specialized in European Union tax law.

Valery Manokhin

Valery Manokhin is a Fellow of the Association of Chartered Certified Accountants (UK) and received his MA (Economics) from the New Economic School in Moscow, Russia and his MBA from Warwick Business School in the United Kingdom. He qualified with a Big Four accounting firm and worked both in practice and in various industries in finance, internal audit, risk management and corporate finance and banking.

Dr Menyhei Ákos TEP

Dr Ákos Menyhei TEP was educated at Eötvös Loránd University of Science Faculty of Law in Budapest, and additionally has participated in the courses of the Central European University organized by the Cardozo Law School (New York) and the University of Ghent Faculty of Law in Belgium. A short time after obtaining the doctoral degree in 1995, he joined Hajdu Attorneys at Law, where he became partner following the bar exams in 1997. In the first few years he gained extensive experience in corporate law, commercial law, banking and finance, and in his latest endeavours has taken an active interest in M&A and tax law. As his professional career advanced he decided to acquire comprehensive knowledge of tax- and estate planning, and since 2004 this has been his main ac-

tivity. As the head of the tax- and estate planning department of Hajdu & Menyhei Attorneys at Law in association with International Practice Group and Society of Trust and Estate Practitioners (STEP), he is highly experienced in establishing structures in a variety of jurisdictions and combining the features of double taxation agreements between different countries to provide an optimal tax result. He is a member of STEP and chairman of Association of Hungarian Trust and Estate Practitioners.

Margit Michlits, MMag.

Margit Michlits received a degree in Business Administration in 2002 after an exchange period at the University of Alberta, Canada, and a degree in Commerce in 2005, both from the Vienna University of Economics and Business. From 2002 until 2004, she was working with Bank Austria (HVB Group) in the field of central controlling. In 2004, she left Bank Austria to join FM Steuerberatung GmbH, since that time specializing in the area of Austrian and international tax law. Margit Michlits has been admitted as a certified tax advisor in Austria in 2008. Currently, she is a tax advisor and partner at FM Steuerberatung GmbH, advising Austrian and international clients in the fields of direct and indirect taxation, company law and social security law.

Margit Michlits has also been working as a lecturer at the Academy of Tax Advisors and Auditors (Akademie der Wirtschaftstreuhänder) in Vienna since 2006, teaching tax-related courses in all parts of Austria.

Mag. Jur. Penka Ivanova Nachkova

Following graduation from Sofia University, Bulgaria with a Master's degree in law, Pepa Nachkova completed her apprenticeship at the Sofia District Court in 1994 and worked as an associate in a Sofia law firm. Since becoming a member of the Sofia Bar Association in March 1995, she has established her own legal practice in the fields of real estate law, administrative law, commercial law, company law, international law, EU law and contract law. She is specialized in a domestic and international civil litigation and arbitration proceedings and experienced in a CEE consulting.

Karri Nieminen

Karri Nieminen graduated in 1995 from Aalto University School of Economics in Helsinki, Finland with a master's degree in accounting and taxation. He has been advising on taxes since 1997. He is currently tax advisor at Fiscales Oy in Helsinki, Finland.

Věra Pazderová

Věra Pazderová holds a degree in law from the Masaryk University in Brno, the Czech Republic. She has been working at the Supreme Administrative Court of the Czech Republic since 2009. Previously, she worked as a legal advisor of the