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TAX MEASURES TO BE ADOPTED BY THE COMMUNITY IN CONNECTION WITH THE LIBERALIZATION OF CAPITAL MOVEMENTS

(Communication from the Commission to the Council)

Proposal for a

COUNCIL DIRECTIVE

on a common system of withholding tax on interest income

Proposal for a

COUNCIL DIRECTIVE

amending Directive 77/799/EEC concerning mutual assistance by the competent authorities of the Member States in the field of direct taxation and value added tax

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(presented by the Commission)

TAX MEASURES TO BE ADOPTED BY THE COMMUNITY IN CONNECTION WITH THE LIBERALIZATION OF CAPITAL MOVEMENTS

(Communication from the Commission to the Council)

Introduction

1. Article 6(5) of Council Directive 88/361/EEC of 24 June 1988[1] on the liberalization of capital movements states that "the Commission shall submit to the Council, by 31 December 1988, proposals aimed at eliminating or reducing risks of distortion, tax evasion and tax avoidance linked to the diversity of national systems for the taxation of savings and for controlling the application of these systems.

The Council shall take a position on these proposals by 30 June 1989. Any tax provision of a Community nature shall, in accordance with the Treaty, be adopted unanimously."

2. As the Commission pointed out in its communication of 23 May 1986 on the programme for the liberalization of capital movements in the Community[2] and in the communication of 4 November 1987 on the creation of a European financial area,[3] the liberalization of capital movements between Member States, which will be achieved in full with the application of the Council Directive of 24 June 1988,[1] is a prerequisite for the genuine financial integration of the Community. However, this in itself is not sufficient; another two requirements must be met.

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1 OJ No L 178 of 8 July 1988, p. 5.
2 COM(86) 292 final of 23 May 1986.
3 COM(87) 550 final of 4 November 1987.

3. First, a genuine common market in financial services must be created. Some important elements of this market are already in place, including the Directive of 20 December 1985 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS),[1] which will enter into force on 1 October 1989. Others have been proposed by the Commission, the most important being a second directive on the coordination of laws on banking[2] and a directive on investment services in the securities field.[3] All these measures are intended to remove the obstacles which at present impede access by suppliers of financial services to markets and clients in other Member States, thereby preventing genuine cross-frontier competition. At the same time, they are intended to create an environment in which customers and investors are properly protected; the stability of the financial system is strengthened and equal conditions of competition are assured by the harmonization of the essential rules of supervision.

4. Second, appropriate measures must be taken to remove, or at least reduce, the tax obstacles which create difficulties at different levels: unsatisfactory allocation of resources, distortion of competition between suppliers of financial services and, risk of reduced tax revenue for Member States as a result of increased tax evasion.

5. As regards company taxation, a proposal for a directive concerning the harmonization of systems of company taxation and of withholding taxes on dividends has existed since 1975. However, it will need to be reviewed and supplemented at least by instruments aimed at harmonizing the corporation tax base. It will also be necessary to look into how far tax rates should be more closely aligned, in the interests of genuine neutrality of taxation for investment in shares in the Community.

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1 OJ No L 375 of 21 December 1985, p. 3.
2 OJ No C 84 of 21 March 1988, p. 1.
3 COM(88) 778.

6. The proposed measures for bringing tax rates more closely into line concern the taxation of interest. Where the tax treatment of dividends is concerned, the risks of distortion, evasion and avoidance are not comparable. The withholding tax or tax credit systems generally applicable in Member States ensure that the income concerned is declared and taxed.

General observations

7. The two proposals attached to this communication are not intended to bring about complete harmonization of the taxation of savings, something which is neither necessary nor desirable at the moment. They are designed primarily to deal with the increased risks of avoidance or evasion which will be a direct result of the final phase of the liberalization of capital movements, agreed on 24 June 1988. Community residents will be free to transfer their savings into bank accounts in any other Member State. There is thus a risk that, once investors are free to open bank accounts in other Member States, they will not declare their interest income to their national tax authorities and will thus evade payment of tax. The consequences might be a substantial loss of budgetary revenue in many Member States and an unjustifiably favourable treatment of income from capital relative to income from employment.

While this risk cannot be quantified with any degree of accuracy, the evidence available from Germany (following the introduction of a 10% withholding tax), from the Netherlands (following the introduction of an automatic obligation on banks to declare interest) and from France (in the Lebègue Report) suggests that the loss of tax revenues could be substantial.

8. Action is also necessary at Community level in order to ensure equilibrium within the integrated financial area that will result from the complete liberalization of capital movements. Without some minimum movement towards alignment of the arrangements in Member States for taxing interest, present tax disparities may trigger undesirable shifts in capital which, because of the national measures that would be taken to counter them, would inevitably jeopardize the removal of controls and lead to renewed market fragmentation.

9. Concerted action in the tax field in the Community will help to strengthen both economic and financial cohesion between Member States and the Community's identity vis-à-vis the rest of the world.

In this connection, the adoption of a modern solution such as the application of withholding tax could pave the way for its introduction at international level as part of negotiations to be held with the Community's main partners (OECD member countries).

10. In considering what measures to propose, the Commission has taken account of a number of factors that have led it to rule out unduly drastic measures:

(a) the risk that savings will be shifted to banks and other financial institutions in third countries;

(b) the possible loss of business for Community banks and financial institutions;

(c) the risk of an appreciable increase in interest rates and hence of a rise in the cost of money for European firms and governments;

(d) the risk of a significant increase in administrative costs for both the public authorities and financial institutions resulting from the measures to be taken;

(e) the need to maintain the internal balance of the systems for the taxation of income in the different Member States, while at the same time encouraging closer alignment of national tax systems.

(i) Measures to be taken at national level

11. There is clearly a primary responsibility on the national tax authorities in Member States to take all reasonable steps within their power to ensure that their residents declare and pay the tax on their interest income from investments held at home.

12. In addition, as laid down in Directive 88/361/EEC of 24 June 1988 on the liberalization of capital movements,[1] any Member State will remain free to obtain information from banks about transfers of capital abroad by residents, either at the time of transfer or at a later date.

(ii) Measures needed at Community level

13. Given the disparities between the tax systems in force, however, the national measures described in paragraphs 11 and 12 above will not be sufficient to reduce the risks of distortion, avoidance and evasion.

14. In its communication of 4 November 1987 on the creation of a European financial area,[2] the Commission indicated that there were three possible ways (not mutually exclusive) of reducing distortion and evasion in this field:

1 See Article 4 of Directive 88/361/EEC: OJ No L 178 of 8 July 1988, p. 6.
2 COM(87)550 final of 4 November 1987.

- the introduction of a system of control based on the requirement that banks disclose automatically to the tax authorities the identity of recipients of interest payments and the amounts received;

- the introduction of a general withholding tax throughout the Community;

- the strengthening of mutual assistance between national tax authorities.

(a) Automatic declarations by banks

15. The Commission has decided not to propose that banks be required to declare automatically to the tax authorities the interest payments they make. While such a system would, in principle, enable the tax authorities in each Member State to obtain information about all the interest received by their residents, there would still be a risk of tax evasion and additional administrative burdens would be placed on banks. Furthermore, the introduction of such arrangements would be likely to encounter serious obstacles in those Member States where banking secrecy is a long-standing tradition and is very often protected under the law or by the courts.

16. Nevertheless, it should be stressed that those Member States which so wished would be free to enter into bilateral arrangements for the exchange of information on interest paid to each other's residents.

(b) Withholding tax

17. The Commission considers that the introduction of a minimum Community-wide withholding tax on interest payments made to all Community residents would be the most appropriate response to the risks of distortion, evasion and avoidance described above. The main features of

this tax are set out in paragraph 18 below. A system of withholding tax would have the following advantages in particular:

- as regards administration, it is efficient in that it guarantees immediate collection of the tax, before the saver receives the income; it thereby reduces the risks of evasion;

- it will fit into the tax system of most Member States, since nine of them already apply withholding tax to payments of interest to residents;

- it would be consistent with the Commission's proposals for a harmonized withholding tax on dividends;

- it would provide a basis for any future international discussions on limiting tax evasion and applying the withholding tax system generally;

- lastly, it would introduce a new tax concept of "Community resident" that is entirely appropriate in the context of the creation of a European financial area.

18. The main features of the withholding tax system set out in the Commission's proposal are as follows:

(i) there should be a minimum rate of withholding tax on interest paid by debtors residing in the Community; Member States would be free to apply a higher rate of withholding tax either to their own domestic taxpayers only or to all recipients of interest;

(ii) however, Member States which already had a system of automatic declaration to the tax authorities of interest payments made by banks would be permitted to apply the withholding tax only to residents of the other Member States;

(iii) Member States would be free not to apply the withholding tax to tax-exempt savings income (savings books and other forms of small savings);

(iv) Member States would have the option of not applying the withholding tax to interest payments constituting industrial or commercial income;

(v) they would also have the option of not applying the withholding tax to interest payments made to residents of third countries or to international loans (Eurobonds) - see paragraph 19 below;

(vi) the withholding tax would be levied by the debtor or his paying agent in the case of interest-bearing financial instruments, including bank accounts;

(vii) Member States would have the option either of regarding the withholding tax as fully extinguishing their resident taxpayers' liability to tax or of considering it as a payment on account of personal income tax, in which case the tax paid would be credited against the total amount of tax payable by the taxpayer, with the excess being refunded where appropriate.

19. The Eurobond market enables large companies, governments and other public sector bodies to raise large amounts of capital rapidly and on competitive terms. At present, interest on Eurobonds is not subject to

withholding tax in most Member States. If it were, the effect would be either that major European companies would be placed at a disadvantage compared with their US and Japanese competitors or that Community issuers would set up subsidiaries in third countries to float their bonds and thereby escape tax. Community investors would be likely to follow them. In both cases, harm would be done to Europe as a major financial centre. For these reasons, there would seem to be no alternative at the moment to permitting Member States to exempt interest payable on Eurobonds.

20. Under the circumstances, the Commission considers that the minimum rate of withholding tax should be 15%, a figure which is close to the average of the withholding taxes applied in the Community (0% to 35%).

(c) Strengthening cooperation between tax authorities

21. The exchange of information is currently inhibited by the fact that, under Council Directive 77/799/EEC of 19 December 1977,[1] a competent authority is not required to look for, or to transmit to the competent authority of another Member State, information which it would be prevented by its laws or administrative practices from collecting or using for its own purposes.

22. This provision is a particularly serious obstacle to the exchange of information in the case of income from capital, given the existence of very strict rules on banking secrecy in many Member States and of an even more restrictive administrative practice in some others.

1 OJ No L 336 of 27 December 1977, p. 15.

23. The complete removal of obstacles to cooperation would require harmonization of national laws on banking secrecy. The Commission does not believe that this is feasible at this stage. Where, however, the restrictions stem solely from administrative practice which is more restrictive than legislation, they can and should be abolished.

24. The Commission has accordingly decided to propose that Directive 77/799/EEC be amended to remove purely administrative restrictions and to facilitate the exchange of information in cases where the tax authorities of the Member State of the investor in question can show that there are clear grounds for a presumption of fraud.

The international context

25. In order to reduce the risk of an outflow of capital to third countries as a means of escaping taxation, the Community should open negotiations with the major third countries involved, either bilaterally or within a multilateral framework such as the OECD.

These negotiations should have a twofold objective: approximation of the provisions governing non-residents on the basis of a system of withholding tax, and cooperation between tax authorities.

Discriminatory tax measures

26. As the Commission indicated in its communication of 4 November 1987, the optimum allocation of investment and fair competition in the provision of financial services can be seriously distorted by national tax concessions which give the investor an incentive to invest in financial instruments issued by residents of his own country. Such measures are

incompatible with the creation of a genuinely integrated financial market. Accordingly, the Commission will open discussions with the Member States concerned with a view to ensuring the progressive removal of such sources of discrimination.

Conclusions

27. In the light of the above, the Commission is presenting the Council with two proposals for directives.

28. The first is concerned with the general introduction of a withholding tax on interest payments.

29. The second provides for limited amendment of the 1977 Directive on mutual assistance in order to bring about more effective cooperation between national tax authorities in the fight against tax evasion in the case of investment income.

30. The Commission calls on the Council to examine these two proposals and to reach a decision before 30 June 1989, as required by Article 8 of Directive 88/361/EEC of 24 June 1988.

31. Finally, the Commission will draw up a report on the common withholding tax system and on the use made of the exemptions provided for, once that system has been in operation for two years.

PROPOSAL FOR A COUNCIL DIRECTIVE
ON A SYSTEM OF WITHHOLDING TAX ON INTEREST INCOME

Explanatory memorandum

I. GENERAL CONSIDERATIONS

1. Article 6(5) of Council Directive 88/361/EEC of 24 June 1988[1] on the liberalization of capital movements states that "the Commission shall submit to the Council, by 31 December 1988, proposals aimed at eliminating or reducing risks of distortion, tax evasion and tax avoidance linked to the diversity of national systems for the taxation of savings and for controlling the application of these systems".

2. As explained in the Communication to the Council, to which the present proposal is attached, the Commission believes that the most effective measure for avoiding distortions and fraud is a common system of withholding tax at source on payments of interest income. The present Directive accordingly provides for the introduction of such a withholding tax. Precisely, one characteristic of Member States' national tax systems is that in most cases they make no provision for the taxation of interest to non-residents.

3. This measure will ensure that a minimum level of taxation is applied to all investment income arising within the Community. It will thus discourage Community investors from transferring funds to other Member States solely in order to evade paying tax.

4. Having regard to the range of withholding tax rates at present applied in Member States (0%-35%) and the risk that a too high rate of tax could lead to a diversion of savings outside the Community, the Commission considers that the minimum rate of withholding tax should be 15%.

[1] OJ L 178, 8.7.1988, p. 5.

5. The Commission considers that this withholding tax at source should be designed to fit as easily as possible into the existing domestic tax systems of Member States. It is accordingly proposed that the tax should have the following characteristics :

(i) it should be a minimum rate of withholding tax. Member States would remain free to apply a higher rate of tax either to their own domestic taxpayers or to all Community residents;

(ii) Member States having a system of automatic declaration of interest payments by their banks to their tax authorities would be permitted to apply the withholding tax to Community residents from other Member States only;

(iii) Member States would have the option to disapply the withholding in the case of all interest payments constituting industrial or commercial revenues.

6. In addition it is proposed that Member States would be free to exempt from the withholding:

(i) interest not subject to the income tax (exempted small savings);

(ii) residents of third countries;

(iii) certain international loans (e.g. "Eurobonds") meeting defined criteria. This exemption already applies in a number of Member States. The Community must promote its development as an international financial centre.

7. Finally, the Commission considers that once the common system of a withholding tax at source will be adopted, the Community should enter into negotiations with its major trading partners, either bilaterally or multilaterally to extend at an international standard the scope of the withholding at source.

II. COMMENTS

Article 1

The criterion for levying a withholding tax is that the debtor of the interests should be resident in a Member State.

The withholding will not be levied on the interests distributed by non-resident debtors.

The residence shall be determined on the basis of national legislation. Any disputes will be settled by mean of "ad hoc" measures provided in accordance with the bilateral conventions in force between Member States.

Article 2

Paragraph 1

For the purpose of the tax arrangements established by the Directive, the term "interest" covers all income from claims of any kind, even if those claims carry a profits participation clause. The expression "claims of any kind" of course includes cash deposits and cash guarantees, public debt securities and bond loans. Moreover, claims, and in particular bonds which entitle the holder to participate in the debtor's profits, are still regarded as loans if at least the contract is, overall, clearly one for an interest-bearing loan.

The second sentence of the first paragraph excludes penalties for late payment from the definition of interest. Such penalties, which are the result of a contract, a practice or a judgement, consist of payments calculated on a pro rata temporis basis or of a fixed sum.

Paragraph 2

In the case of non-interest-bearing securities (e.g. zero bonds) or of a relatively low rate of interest (e.g. deep discount bonds) and whose income are made up exclusively or mostly of a capital gain, the difference between the issue price and the redemption value is regarded as interest subject to withholding tax.

Article 3

Paragraph 1

The debtor of the interest (or its paying agent - financial institution) is required to apply withholding tax at the rate fixed by the Member State in which it is resident. The withholding tax is applied to securities issued inside or outside the Community, before or after the Directive comes into force, irrespective of whether the interest is paid inside or outside the Community and of the currency in which the loan was issued.

Paragraph 2

Where the interest is paid not in the Member State in which the debtor is resident but by an establishment located in another Member State which deducts the interest from its taxable profits, the withholding tax must be applied by the permanent establishment and paid over to the tax authorities in the Member State in which this permanent establishment is situated.

Article 4

Paragraph 1

The obligation of levying a minimum withholding tax of 15% does not preclude application by a Member State of differential rates according to the nature of the financial instrument (e.g. bank deposits, bonds, Treasury bonds).

Paragraph 2

Member States are free to apply higher withholding tax rates to their own residents than to non-residents. This will generally be the case when the withholding tax levied on residents has the effect of discharging of debt.

Paragraph 3

The Directive does not preclude application of bilateral agreements concluded by Member States where a taxpayer wishes to benefit from a lower rate of withholding tax provided for under such an agreement, since he may benefit from such agreements only by declaring the income in question to his national tax authorities. It goes without saying that in such cases the recipient may set against his personal tax (see Article 7) only that amount of withholding tax still borne by him.

Article 5

(a) This sub-paragraph permits Member States not to levy withholding tax where the identity of the recipients is known to them and there is therefore no risk of evasion.

(b) Member States are free not to levy withholding tax where the recipient is one of their residents and does not fall within the scope of the income or profits tax (e.g. undertakings for collective investment in transferable securities, charitable institutions).

(c) Member States are free not to levy withholding tax where the interest paid to their own residents is not subject to income or profits tax. This provision concerns in particular the exemption schemes to promote certain issues. -

(d) This provision aims at permitting Member States not to apply the withholding tax where the interest is paid on small savings accounts subject to a preferential scheme. The application of such schemes is subordinate to particular conditions concerning interest rates or the amount invested.

(e) In order to ensure that a private individual is not required to comply with the formalities laid down by this Directive, particularly as regards the application of a withholding tax and payment of such sums to the tax authorities, Member States are free not to apply withholding tax in such cases (e.g. in the case of a borrowing between private individuals).

(f) This faculty of exonerating is justified because the recipients are subject to complete fiscal control which removes the risk of fraud.

(g) Member States are free not to levy withholding tax on the interest of international loans (Eurobonds), as defined in this sub-paragraph.

(h) In view of the arrangements in force in the Member States and the arrangements applied by non-member countries to Community residents, the Member States must be allowed a degree of flexibility in the provisions to be applied to residents from non-member countries.

Article 6

In the case of undertakings for collective investment in transferable securities (UCITS) there are two possibilities :

- or the withholding tax is not applied or is refunded, in which case the redistribution of interest is subject to withholding tax;

- either the withholding tax is transferred as an allowable credit to the unitholder, in which case the redistribution of interest by the UCITS is exempt from withholding tax;

In both cases, unitholders are entitled to set the withholding tax against their personal tax and to a refund of any amount in excess.

Article 7

Except in the case where the withholding tax has a discharging character for a resident, it makes up simply a payment on account towards the definitive tax payable by the recipient of the interest. It is therefore normal clear that the withholding could be allowable as a credit or be refunded if the recipient is not taxable, or if it exceeds the final tax.

Article 8

Paragraph 1

In order to ensure that the budgetary cost of crediting or refunding the withholding tax under the items of Article 7 is borne by the Member State in which the income arose, this paragraph provides for financial compensation between the two Member States concerned.

Paragraph 2

The two Member States concerned may arrange, on the basis of a bilateral agreement, to divide the amount of withholding tax between each other, provided that the rights of the recipients of the interest as regards the crediting and possible refund of the tax in their own Member State are not affected.

Article 9

With the aim of reducing the risks of capital flows outside the Community, the Community shall enter into negotiations with its main commercial partners in order to enlarge the geographical scope of the withholding at source.

Article 10

The report provided for in this article shall permit an evaluation of the functioning of the system and particularly of the rate of the withholding tax at source and the use of the exemptions provided for in Article 5.

Proposal for a Council Directive on a common system of withholding tax on interest income

THE COUNCIL OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Economic Community, and in particular Article 100 thereof,
Having regard to the proposal from the Commission,
Having regard to the opinion of the European Parliament,
Having regard to the opinion of the Economic and Social Committee,

Whereas Council Directive 88/361/EEC[1] provides that Member States shall abolish not later than 1 July 1990 restrictions on movements of capital taking place between persons resident in Member States;

Whereas the complete liberalization of capital movements in the Community entails risks of distortion, tax evasion and tax avoidance linked at the diversity of national systems for the taxation of savings and for controlling the application of these systems; whereas in consequence the approximation of these regimes is necessary to ensure that competition in the common market is not distorted;

Whereas the application of a common system of withholding tax meets this objective while at the same time ensuring a minimum taxation of interest paid by a debtor which is resident in a Member State; the institutions of the Communities and the European Investment Bank are not residents of a Member State;

Whereas it is necessary to allow Member States not to levy a withholding tax in cases where the risk of fraud is remote;

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[1] OJ No L 178, 8.7.1988, p. 5.

Whereas provision must be made to ensure that from the interest collected by an undertaking for collective investment in transferable securities a withholding tax could be levied;

Whereas the withholding tax should be simply a payment on account of the final tax liability of the recipient of interest except if it discharges residents from further tax liability; whereas in order to avoid complicated formalities, any possible excess of tax ought to be repaid by the State in which the recipient is resident; whereas Member States must nevertheless be allowed to conclude bilateral agreements on the sharing of budgetary costs resulting from these provisions;

Whereas a withholding tax should be introduced not later than 1 July 1990, at which moment the complete liberalization of capital movements will be achieved,

HAS ADOPTED THIS DIRECTIVE:

Article 1

Member States shall apply, in accordance with the provisions of this Directive, a common system of withholding tax to interest paid by a Member State or a political subdivision, local authority or a resident of a Member State.

Article 2

For the purposes of this Directive, interest means income from claims of any kind, including premiums and prizes linked to public debt securities and bond loans. Penalties for late payment shall not be regarded as interest for the purposes of this Directive.

In the case of securities producing income made up exclusively or partly of a gain, interest means the difference between the issue price and the redemption price.

Article 3

1. The payer of interest (or paying agent) shall deduct from the amount of interest due a withholding tax, the rate of which shall be fixed by the Member State in which he is resident. He shall pay over the sums withheld to the tax authorities of that Member State in accordance with the conditions laid down by that State.

2. Where payment of the interest is effected by a permanent establishment of the payer located in a Member State other than that of the payer, the withholding tax shall be deducted by the permanent establishment, in as much as this interest is a deductible charge for it, and shall be paid over to the tax authorities of the Member State in which this permanent establishment is situated.

Article 4

1. The rate of the withholding tax may not be less than 15%.

2. Member States shall be free to apply a higher withholding tax rate for interest paid to their own residents than for interest paid to non-residents.

3. Paragraph 1 shall not preclude application of agreements concluded between Member States or between Member States and non-member countries providing lower rates of withholding tax when the income is declared.

Article 5

Member States shall be free not to levy withholding tax on interest where:

(a) the recipient is one of their own residents and his name and his address and the amount of interest paid are automatically notified to the tax authorities;

(b) the recipient is one of their own residents and does not fall within the scope of the income or profits tax;

(c) the recipient is one of their own residents and the interest is not subject to income or profits tax;

(d) the interest is not subject to income or profits tax following incentives in favour of small savings;

(e) the payer of interest is a private individual;

(f) the interest is made up of commercial and industrial income of the recipient;

(g) the interest is payable on an international loan ("Eurobond"), which is defined for the purposes of this Directive as a transferable security in the form of a bond, which :

- is to be underwritten and distributed by a syndicate at least two of the members of which have their registered offices in different States,

- is offered on a significant scale in one or more States other than that of the issuer's registered office and

- may be subscribed for or initially acquired only through a credit institution, as defined in Article 2 of Council Directive 77/780/EEC[1], or other financial institution.

[1] OJ No L 322, 17.12.1977, p. 30.

(h) the recipient is a resident of a non-member country.

Article 6

Where interest redistributed by an undertaking for collective investment in transferable securities within the meaning of Council Directive 86/566/EEC[1] has not been charged withholding tax in the hands of that undertaking or where withholding tax has been refunded to it, that interest shall be subject to withholding tax if such tax would have been chargeable if the interest had been paid directly by the payer.

In the contrary case, such interest shall be exempt from withholding tax.

However, withholding tax charged on interest in the hands of an undertaking for collective investment in transferable securities shall be allowable against the amount of income or profits tax payable by the unitholder. It shall be refunded to him in the cases referred to in the second paragraph of Article 7.

Article 7

Withholding tax on interest shall be allowed as a credit against the amount of income or profits tax payable by the recipient in respect of such interest.

It shall be refunded to the recipient by the Member State which levies the tax referred to in the preceding paragraph if it exceeds the amount of that tax or if the recipient is not taxable.

Article 8

1. Where the withholding tax levied by a Member State is allowed as a credit or refunded in another Member State, the Member State which levied the withholding tax shall refund it to that other Member State.

[1] OJ No L 332, 26.11.1986, p. 22.

2. Notwithstanding paragraph 1, Member States may divide the amount of the withholding tax between each other on the basis of a bilateral agreement, provided that that agreement in no way affects the rights of the recipients of the interest as established by this Directive.

Article 9

The Community shall enter into negotiations with its main commercial partners either on a bilateral or on a multilateral basis, in order to enlarge the scope of the withholding at source to an international level.

Article 10

The Commission shall present to the Council before 1 July 1992 a report on the functioning of the common system of withholding tax at source.

Article 11

1. Member States shall bring into force, not later than 1 July 1990, the laws, regulations and administrative provisions necessary to comply with this Directive. They shall forthwith inform the Commission thereof.

   The provisions adopted pursuant to the first subparagraph shall make express reference to this Directive.

2. Member States shall communicate to the Commission the main provisions of national law which they adopt in the field governed by this Directive.

Article 12

This Directive is addressed to the Member States.

Done at

For the Council

The President

PROPOSAL FOR A COUNCIL DIRECTIVE OF AMENDING DIRECTIVE 77/799/EEC CONCERNING MUTUAL ASSISTANCE BY THE COMPETENT AUTHORITIES OF THE MEMBER STATES IN THE FIELD OF DIRECT TAXATION AND VALUE ADDED TAX

EXPLANATORY MEMORANDUM

I. General Considerations

1. As explained in detail in the communication to the Council to which this proposal for a directive is annexed, the liberalization of capital movements should be accompanied by measures to eliminate or reduce the risk of distortion, tax avoidance and evasion, linked to the diversity of national systems for the taxation of savings and for controlling the application of these systems.

2. One way of doing this is to step up the cooperation between national tax administrations introduced by Directive 77/799/EEC of 19 December 1977[1] and based primarily on the exchange of information. Of course, this exchange is limited and, in particular, a Member State is not obliged to have enquiries carried out or provide information if its own laws or administrative practices prevent it from carrying out the enquiries or collecting or using the information for its own purposes.

3. As regards legislation, the rules on banking secrecy, which are the main ones involved in the case of income from capital, vary considerably from one Member State to another and their harmonization is a long proces which raises complex problems and is politically highly sensitive.

   This is not true of administrative practices, which can be modified without any change in legislation and without obliging a Member State to obtain and pass on to another Member State information which its laws do not permit it to obtain for the purpose of calculating correctly the tax payable by its own residents. Accordingly, the Commission considers that a Member State should not be permitted to invoke its administrative practices but should exhaust every legal possibility when the Member State making the request cites specific

[1] OJ No L 336, 27.12.1977, p. 15.

grounds for supposing one of its taxpayers has transferred abroad significant funds and has not declared all, or has declared only part, of the income derived from them.

II. Particular comments

Article 1

Where a tax administration suspects one of its taxpayers of tax evasion on the grounds that funds have been transferred to another Member State without the corresponding income having been declared, and the taxpayer's explanations do not appear satisfactory, it may request information from the tax authorities of the other Member State. These authorities may, however, be unable to collect or supply the information requested because of an administrative practice which restricts their powers of investigation of financial institutions, even for their own tax purposes.

The amendments made by this Article to Article 8(1) of Directive 77/799/EEC are designed to overcome this obstacle.

PROPOSAL FOR A COUNCIL DIRECTIVE OF
AMENDING DIRECTIVE 77/799/EEC CONCERNING MUTUAL ASSISTANCE
BY THE COMPETENT AUTHORITIES OF THE MEMBER STATES
IN THE FIELD OF DIRECT TAXATION AND VALUE ADDED TAX

THE COUNCIL OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Economic Community, and in particular Article 100 thereof,

Having regard to the proposal from the Commission,

Having regard to the opinion of the European Parliament,

Having regard to the opinion of the Economic and Social Committee,

Whereas Council Directive 88/361/EEC [1] stipulates that restrictions on capital movements between persons resident in the Member States must be abolished no later than 1 July 1990;

Whereas that Directive requires the Commission to submit to the Council proposals aimed at eliminating or reducing risks of distortion, tax evasion and tax avoidance linked to the diversity of national systems for the taxation of savings and for controlling the application of these systems;

Whereas under Council Directive 77/799/EEC [2], as last amended by Directive 79/1070/EEC [3], Member States are required to provide mutual assistance to combat tax evasion and tax avoidance in respect of taxes on income and on capital; whereas under Article 8 of that Directive, however, a Member State is not

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[1] OJ No L 178, 8.7.1988, p. 5.
[2] OJ No L 336, 27.12.1988, p. 15.
[3] OJ No L 331, 29.12.1979, p. 8.

obliged to provide information following a request from another Member State if its laws or administrative practices prevent it from collecting this information for its own purposes;

Whereas the restriction on the exchange of information arising from administrative practices should be abolished in cases where the Member State making the request has specific grounds for supposing that one of its residents has transferred significant funds to another Member State without declaring the corresponding income,

HAS ADOPTED THIS DIRECTIVE:

Article 1

The following subparagraph is added to Article 8(1) of Directive 77/799/EEC:

"However, where the appropriate authority of the Member State making the request shows specific grounds for supposing that one of its residents has transferred, either directly or through another country, significant funds to the Member State to which the request is made without declaring the corresponding income, the appropriate authority of the Member State to which the request is addressed may not rely on the fact that its administrative practices do not permit it to carry out these enquiries or to collect or use this information for the purpose of correctly establishing the taxes due by its own residents."

Article 2

Member States shall bring into force the necessary laws, regulations and administrative provisions in order to comply with this Directive not later than 1 July 1990. They shall communicate them forthwith to the Commission.

The provisions adopted pursuant to the first paragraph shall make express reference to this Directive.

Article 3

This Directive is addressed to the Member States.

Done at Brussels,

For the Council

The President

Commission of the European Communities

COM(89) 60/3/Revision final

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