THE IMPLEMENTATION OF THE INTEREST AND SAVINGS DIRECTIVE IN THE UK

SPECIAL REPORT

UNITED KINGDOM

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1) Although the ultimate goal of the interest savings directive is to concentrate taxation of interest in the country of residence, the directive does not propose any measure either to eliminate all withholding taxes in the country of source, or to impose a tax credit for the elimination of double taxation in the country of residence. Do you see from a policy point of view any justification for this omission?

Comment:

As the ultimate goal of the interest savings directive (ISD) is to enable Member States of residence to be able to properly assess their own residents to tax, the ISD achieves this result with minimum interference with the direct tax systems of the Member States; some of whom choose to apply the credit method and others choose the exemption method for the elimination of double taxation under their double tax conventions (DTCs). Equally, when some Member States impose domestic withholding taxes on savings income, such income when taxed in the residence Member State receives the benefit of an exemption or credit. As the ISD does not specify a method for the elimination of double taxation, this allows source States to continue to levy withholding taxes at their normal rates because the ISD does not abolish source State withholding taxes. The ISD is, therefore, ensuring that current Member State and DTC practices are continued. Had the ISD included the abolition of source State taxation, there would have been a considerable impact upon source States’ tax revenues and the balance inherent in source States’ DTCs would have been affected resulting in such DTCs having to be re-negotiated.

If the ISD had specified a tax credit in the State of residence, the question would then arise as to the amount of that tax credit: would it be similar to an “ordinary credit” contained in DTCs or would it be a “full credit”? If the latter, then this would impact upon residence States tax competence because effectively other resident taxpayers would have to subsidise the higher withholding tax rates of the source State. Equally, even if it were only an
“ordinary credit”, this would impact upon those Member States who favour the capital import neutrality (CIN) approach and utilise the exemption method. This would generate a tax requirement in the State of residence of that foreign source income contrary to CIN.

By not specifying – “no taxation in the State of source” and by not imposing a tax credit in the State of residence, the ISD ensures that the status quo is maintained. This could have been a significant factor in ensuring that the ISD was adopted by the Council.

2) By concentrating the taxation of interest in the country of residence the interest savings directive is eliminating tax competition on this category of income between the country of residence and the countries of source. Is the idea of eliminating this type of competition by giving a decisive tax advantage to the country of residence, compatible with the rules of the single integrated market and in particular with the free movement of capital, or could the elimination of this type of competition be justified by the fact that it is harmful tax competition?

Comment:

The ISD does not eliminate tax competition on savings income between the source and the residence State. Source States may still impose withholding taxes. Residence States must still grant a credit or exemption under their DTCs to eliminate double taxation and may choose to tax or exempt their residents as they so wish on interest income earned outside their territory. States that opt to impose a withholding tax during the transitional period instead of exchanging information

Is a decisive tax advantage given to residence Member States?

The choice as to whether or not to tax their residents and at what rate remains with the residence Member State. The exchange of information under the ISD merely ensures that all residents of that Member State can be taxed on the basis that information concerning interest savings
income will be available to the tax authorities of the residence Member State when its resident earns interest savings income in the other Member States and in specified territories and Third Countries (TCs).

Two cases of the Court of Justice may have some relevance in this area. First, in Sandoz,¹ Austrian corporate residents contracted loans in other Member States in order to avoid stamp duty in Austria. Austrian rules designated such loans as taxable in Austria if they were recorded in the borrower’s books and records. Sandoz argued that this constituted a restriction on the free movement of capital between a borrower residing in Austria and a lender established in another Member State “which was likely to deter the borrower from turning to such a lender”.²

The Court said that “legislation such as that at issue ... deprives residents of a Member State of the possibility of benefiting from the absence of taxation which may be associated with loans obtained outside the national territory...Such a measure is likely to deter such residents from obtaining loans from persons established in other Member States”.³ This is an obstacle to the free movement of capital.⁴

Austria contended that the purpose of the national rules was to impose an internal indirect tax which was within the competence of the Member States and the taxing of loans contracted by Austrian residents was justified by the need to observe the principle that residents should be treated equally for tax purposes. Consequently, the rules were “essential in order to prevent infringements of national tax law and regulations, as provided for in Article 73d (1)(b) of the Treaty”⁵.

¹ Case C-439/97 Sandoz GmbH v Finanzlandesdirektion fur Wien, Niederosterreich und Burgenland (“Sandoz”).
² See Sandoz paragraph 14.
³ See Sandoz paragraph 19.
⁴ See Sandoz paragraph 20.
⁵ See Sandoz paragraph 23. Article 73d(1)(b) of the Treaty is now numbered Article 58(1)(b) of the EC Treaty.
The Court agreed, noting that “the main objective of the legislation ...which, irrespective of the nationality of the contracting parties or of the place where the loan is contracted, applies to all natural and legal persons resident in Austria, who enter into a contract for a loan, is to ensure equal tax treatment for those persons. Since the effect of such a measure is to compel such persons to pay the duty, it prevents taxable persons from evading the requirements of domestic tax legislation through the exercise of the free movement of capital”.\(^6\) The Court observed that the Austrian rules were essential in order to prevent infringements of national tax law and regulations pursuant to Article 73d (1)(b) of the Treaty.

The *Sandoz* decision should be contrasted with the second ECJ case involving infringement proceedings brought by the European Commission against Belgium: *Commission v Belgium* (“*Eurobonds*”),\(^7\) where Belgian rules prevented their residents from subscribing for certain Eurobonds issued by the Belgian State which granted a tax-free advantage for subscribers. It was conceded that these rules constituted a restriction on the free movement of capital. However, Belgium tried to justify the rules by arguing that they were necessary to prevent their residents from evading tax and by the need to ensure the effectiveness of fiscal supervision.\(^8\) The Court agreed that these justifications could be relied upon to justify a restriction of the free movement of capital,\(^9\) but had to meet a proportionality test.\(^10\)

The Court noted that in *Leur-Bloem*,\(^11\) that a general presumption of evasion could not justify a tax rule which compromised the objectives of a

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\(^6\) See *Sandoz* paragraph 24.  
\(^7\) Case C-478/98 *Commission v Belgium* (“*Eurobonds*”).  
\(^8\) *Eurobonds* paragraph 32.  
\(^9\) *Eurobonds* paragraph 39.  
\(^10\) *Eurobonds* paragraph 40.  
\(^11\) Case C-28/95 *Leur-Bloem v Inspecteur der Belastingdienst Ondernemingen Amsterdam* [1997] ECR I-4161, paragraph 44.
directive, commenting: “That applies all the more in the present case, where the contested measure consists in an outright prohibition on the exercise of a fundamental freedom guaranteed by Article 73b of the Treaty”. However, the Court recognised that Belgian residents could have subscribed for Eurobonds with issuers other than the Belgian State which also qualified for the tax-free advantage. Consequently, the Belgian rules did not meet the principle of proportionality test and “cannot be covered by Article 73d (1)(b)”. The Court therefore examines the aim and objective of the Member State’s tax rule and measures that rule against the Gebhard formula to determine whether (a) it is a justified on general interest grounds and (b) whether it is proportionate in meeting its aims and objectives. The scheme of the Treaty therefore allows Member States considerable leeway in designing their direct tax systems which are generally focused on “residents” and on “sources” located within their respective territories. One last comment: the ISD provides an opportunity for Member States to re-think their schemes for dealing with the abolition of double taxation. If residence Member States have the necessary information to tax their residents, this may lead to a realisation within the EU/EEA that only residence States should tax this type of income. This should ultimately lead to the realisation that double taxation could be eliminated more effectively by either (a) including such a clause (allocating this type of income to the residence State only for tax purposes) in the relevant DTC; (b) having a multilateral agreement between Member States and others containing this provision; or (c) having a further Council Directive which provides for exclusive taxation in the Member State of residence for interest savings income.

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12 Eurobonds paragraph 45.
13 Eurobonds paragraph 46.
14 Eurobonds paragraph 47.
3) Apart from obvious budgetary reasons for some Member States, what is the justification for exclusive taxation in the state of residence, when many Member States have introduced a dual tax system in which capital income like interest is subject to a proportional rather than a progressive tax?

Comment:

The ISD does not ensure exclusive taxation in the State of residence. But it does try to ensure that residents of a Member State with interest savings income are taxed in that State if that Member State decides to impose taxes on that particular income.

The justification for ensuring that residence Member States receive this information appears to be that this treatment ensures that residents may be properly taxed in their residence State on savings income earned outside the residence State. Once as the appropriate information is received by the residence Member State, it is up to that Member State to tax its residents or not to tax them as appropriate. The exchange of information ensures that non-taxation of residents on interest savings income should be the choice of the residence Member State, and not the choice of its resident.

4) The final objective of the directive is to tax all interest income in the state of residence of the beneficial owner. Now that the state of residence has all the information with respect to foreign source interest income, shouldn’t the directive provide for a mandatory credit eliminating all double taxation, thereby indicating which direction the ECJ should take in cases involving the free movement of capital (either elimination of all taxation at source, or mandatory credit for foreign source interest income)?

Comment:

The ISD appears to maintain the current status quo concerning the methods used for the abolition of double taxation contained in the DTCs of the Member States. As some States follow a CIN\(^\text{16}\) policy

\(^{16}\) Capital Import Neutrality – like the Netherlands.
and others try to achieve the goals of CEN,\textsuperscript{17} the ISD ensures that both concepts of neutrality can continue to exist in the Community and that Member States do not need to alter their DTCs at the present time to take into account a specific method for the relief of double taxation which they may not wish to employ.

The ISD continues to respect the competence of Member States in the direct tax area to tax their residents at a rate of their choosing, including a zero rate, and to allow source States to also impose taxes at a rate of their choosing, including a zero rate. By not providing for a mandatory credit or the elimination of source State taxation, the ISD allows Member States to deal with this issue via their DTCs.

\textbf{(5) In accordance with the OECD model treaty, third countries will maintain their withholding taxes in their relationship with Member States of the E.U. However some Member States grant ordinary tax credits for withholding taxes paid on interest received abroad, whereas for interest received from a Member State under the Interest Savings Directive a full and refundable credit will be available (art. 11 ISD). How will this discrepancy affect E.U. residents in deciding on investment opportunities on third countries compared to investment opportunities within the E.U.?

\textbf{Comment:}

The ISD imposes additional withholding taxes during the transitional period. The ISD provides for an additional tax credit, above that of the normal credit, to be granted by the residence Member State which operates a credit method for the relief of double taxation. These rules are in addition to the normal rules on double taxation, which continue to apply in the normal way to any tax withheld in the territory where the original payer of the income is established.\textsuperscript{18}

\textsuperscript{17} Capital Export Neutrality – like the UK.

When the ISD is applied, from a UK perspective, investors may find that two amounts of foreign tax have been withheld from the gross amount of interest savings income:

(a) tax withheld in the territory where the original payer of the income is resident under that territory’s domestic law; and

(b) tax withheld by a paying agent (known in the UK legislation as “special withholding tax”) as part of the new scheme in those countries and territories that opt to withhold tax rather than exchange information.\(^{19}\)

The UK will eliminate double taxation as follows:

- any tax withheld in the territory where the original payer of the income is resident under its domestic law will be credited first against the UK tax payable on the savings income, provided that the credit is allowable under UK law or under the UK’s DTC with that territory. Such tax cannot be repaid if it exceeds the UK tax liability on that income;
- the special withholding tax will be credited against the remaining UK Income or Capital Gains Tax liability;
- any special withholding tax remaining after the UK Income and Capital Gains Tax liability will be repaid to the investor by HMRC.\(^{20}\)

The discrepancy between the credit for TC taxation under a DTC and the withholding tax under the directive during the transitional regime should only have an impact on an investor’s decision as to where to invest from the point of view of a cash flow

\(^{19}\) See “Issues for Investors”, paragraph 15.

\(^{20}\) See “Issues for Investors”, paragraph 16. The Guidance points out in paragraphs 17 and 18 that the tax withheld under the directive can be reclaimed either through the tax return or by submitting a claim to HMRC. Self-assessment returns will allow this withholding tax to be set-off against income and capital gains tax, and any repayment claimed.
perspective as investors investing in territories which levy the special withholding tax under the directive will have an additional withholding tax levied (unless they choose to take advantage of the option to obtain a certificate from the residence State Revenue authority or they authorise the paying agent to exchange information on the payment with the residence State). Also, it should be noted that as the rates of special withholding tax are currently only 15%, it may be in many taxpayers’ interest to simply to pay this additional withholding tax rather than to pay tax at higher rates in their residence State where progressive rates of tax may apply.

6. The interest savings directive introduces the principle that one Member State is somehow responsible for the correct enforcement of the tax law of another Member State, by providing it automatically with the correct information on a particular category of income. Is it a principle of international tax law that one country should be responsible for the correct enforcement of another country’s tax laws? If not, is this a principle that is necessary for the operation for the fully integrated single market in the E.U.?

Comment:

From a UK perspective, the House of Lords decision in Government of India v Taylor\(^2\) specifies a general rule of non-enforcement in UK courts for foreign revenue claims. A number of exceptions have infiltrated this general regime such as assisting in situations involving

- a cross-border insolvency.\(^2\)
- trustees and executors with assets in other States.\(^3\)
- the implementation of bilateral and multilateral conventions.
- recovery of duties within the EU.\(^4\)

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\(^3\) See Insolvency Act, 1986, s. 426; and Re Tucker [1988] 1 W.L.R. 928.

\(^4\) For instance, see: Re Lord Cable, [1976] 3 All ER 417.

• mutual assistance in the gathering of information and collection of taxes.  
• extradition for fiscal offences and tax fraud.  
• money-laundering crimes and legislation.

The ECJ’s attitude on this matter appears to assume that mutual assistance within the EU is available on a wide variety of matters. Whether or not that is actually the case in practice seems to get ignored in its judgments – the Court seems to assume that mutual assistance operates in the way that is necessary for the proper functioning of the internal market.

Thus, in *Bachmann*, the Court said that

“Council Directive 77/799/EEC of 19 December 1977 concerning mutual assistance by the competent authorities of the Member States in the field of direct taxation (...) may be invoked by a Member State in order to check whether payments have been made in another Member State where it is necessary (...) for those payments to be taken into account in order to correctly assess the income tax payable...”

Similarly, in *Halliburton*, the Court stressed that

“Article 1(1) [of Council Directive 77/799/EEC] provides that that system relates to any information which may enable the competent authorities of the Member States to make a

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26 For instance, see: *Article XXVIA U.S.-Canada tax treaty* (added by Third Protocol, 1994)
28 For instance see: *Proceeds of Crime Act, 2002, ss.327-340.*
29 See Case C-204/90, *Hanns-Martin Bachmann v Belgian State*.
correct assessment of the taxes referred to by the directive”.31

The Court dismissed the Dutch administration’s argument that it was unable to check whether the legal forms of entities constituted in other Member States were equivalent to Dutch companies.

This line of thinking is re-echoed in Skandia,32 where it was argued that Community instruments in this area, in particular Council Directive 77/799/EEC, were inadequate. The Court decided that the Directive could be used by a Member State to obtain “all the information enabling it to ascertain the correct amount of income tax...or all the information it considers necessary to ascertain the correct amount of income tax payable by a taxpayer according to the legislation which it applies”.33

Finally, in Manninen, the Court gives us a clue as to its thinking on cross-border mutual assistance not involving the directive 77/799/EEC. In that case it examined a Finnish situation and required that Finland extend the imputation tax credit to residents who had made investments in companies resident in other Member States, namely, Sweden. The Court dismissed the argument that calculating the tax credit corresponding to the corporation tax due from a company established in another Member State was too difficult and had too many practical difficulties.34 It simply said:

“Possible difficulties in determining the tax actually paid cannot, in any event, justify an obstacle to the free movement of capital such as that which arises from the legislation at issue in the main proceedings”.35

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31 See Case C-1/93 Halliburton Services BV v Staatssecretaris van Financien.  
32 See Case C-422/01 Skandia  
33 See Case C-422/01 Skandia paragraph 42.  
34 See Case C-319/02 Manninen paragraph 50.  
35 See Case C-319/02 Manninen paragraph 54.
Therefore, the Court is implying that taxpayers and Member States must find ways of cooperating to resolve these cross-border information problems as otherwise there is a risk that it will find that a restriction of the fundamental freedoms exists. As such, the answer to the question as to whether this “mutual assistance” principle is necessary for the proper functioning of the internal market appears to be affirmative.

**Part II Questions of Implementation**

`Brief overview` on the following aspects:

a. the taxation in your country of interest income earned by resident and non-resident individuals as (i) business income and (ii) income from private investment (withholding, preferential taxation (`dual income system`), taxation on aggregate income, deductions, rates etc.), and

b. an overview of typical special provisions in your country’s tax treaties with respect to interest income (cf. Article 11 (Interest) of the OECD Model)

**The Taxation of Interest in the UK – an overview**

The UK operates a classification system which divides income into different classes. For our purposes, the law is set out in the Income Tax (Trading and Other Income) Act 2005 (“ITTOIA”).

**a. (i)**

The taxation of interest income earned by UK residents is covered by Part 2 Chapter 2 of ITTOIA which charges to UK tax the profits of a trade, profession or vocation. Section 29 of the ITTOIA specifies that “interest is an item of a revenue nature, whatever the nature of the loan”. Under section 6(1) ITTOIA, the profits of a trade,

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36 Until 2005, this was a Schedular system.
37 See section 5 of the Income Tax (Trading and Other Income) Act 2005, (“ITTOIA”)
are charged to UK tax “wherever the trade is carried on”. Income Tax is charged on the full amount of the profits for the year.\(^{38}\) The person liable for the income tax is the person “receiving or entitled to the profits”.\(^ {39}\)

The profits of a trade arising to a non-UK resident are chargeable to tax in the UK only if they arise from a trade carried on wholly in the UK;\(^ {40}\) or in the case of a trade partly carried on in the UK and partly elsewhere, on that part of the trade carried on in the UK.\(^ {41}\)

\textbf{a. (ii)}

Part 4 Chapter 2 of the ITTOIA taxes “interest” which has an extended meaning in certain circumstances to include building society dividends,\(^ {42}\) open-ended investment company interest distributions,\(^ {43}\) authorised unit trust interest distributions,\(^ {44}\) industrial and provident society payments,\(^ {45}\) funding bonds,\(^ {46}\) and discounts.\(^ {47}\) All interest is charged to tax whether from a source within or outside the UK.\(^ {48}\)

There are a number of exemptions for a variety of national savings plans such as SAYE,\(^ {49}\) Peps, ISAs, and National Savings,\(^ {50}\) interest from FOTRA securities,\(^ {51}\) interest arising from repayment supplements, tax reserve certificates, damages for personal injury, the redemption of funding bonds,\(^ {52}\)

\(^{38}\) See section 7(1) ITTOIA.  
\(^{39}\) See section 8 ITTOIA.  
\(^{40}\) See section 6(2)(a) ITTOIA.  
\(^{41}\) See section 6(2)(b) ITTOIA.  
\(^{42}\) See section 372 ITTOIA.  
\(^{43}\) See section 373 ITTOIA.  
\(^{44}\) See section 376 ITTOIA.  
\(^{45}\) See section 379 ITTOIA.  
\(^{46}\) See section 380 ITTOIA.  
\(^{47}\) See section 381 ITTOIA.  
\(^{48}\) See section 369 ITTOIA.  
\(^{49}\) See Chapter 4 of Part 6 of ITTOIA.  
\(^{50}\) See Chapter 2 of Part 6 of ITTOIA.  
\(^{51}\) “FOTRA” securities – see section 713 ITTOIA. “FOTRA” stands for free of tax for residents abroad.”
and the interest on certain foreign currency securities.

Income tax is charged on the full amount of interest arising\(^\text{52}\) in a tax year.\(^\text{53}\) The person liable for the tax is the person receiving or the person entitled to the interest.\(^\text{54}\) The place of payment of the interest is only one of the factors that will be taken into account in determining the source of the interest.

There are special rules for UK residents who are non-domiciled in the UK. This is known as the “remittance basis”, and basically gives an exemption from UK income tax on foreign sourced income which is not remitted to the UK, including interest income earned from sources outside the UK.\(^\text{55}\) The claim is applied for a particular tax year and only the full amount of “relevant foreign income” is charged to tax in the UK.\(^\text{56}\)

Non-UK residents are charged to income tax on interest arising from UK sources if they receive or are entitled to the interest.\(^\text{57}\)

If a person is neither resident nor ordinarily resident\(^\text{58}\) in the UK and carries on a trade, profession or vocation through a branch or agency in the UK, UK capital gains tax (CGT)\(^\text{59}\) may be payable on the disposal of assets in the UK which

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\(^\text{52}\) “Arising” includes “received and credited to a bank account”, but has been given a wider meaning in its interpretation by the UK courts.  
\(^\text{53}\) See section 370(1) ITTOIA.  
\(^\text{54}\) See section 371 ITTOIA.  
\(^\text{55}\) See Part 8 Chapter 2 of the ITTOIA.  
\(^\text{56}\) See section 832 ITTOIA.  
\(^\text{57}\) See section 371 ITTOIA.  
\(^\text{58}\) The understanding of “ordinarily resident” in the UK is resident in the UK year after year. An individual can be absent from the UK for a complete tax year, and hence, non-resident in the UK, but can still be ordinarily resident in the UK. See HMRC Guidance Manuals paragraphs IM35 and IM36; see section 10 Taxation of Chargeable Gains Act 1992 (“TCGA 1992”); and see section 69(2) TCGA 1992 in relation to the residence etc. of trustees.  
\(^\text{59}\) CGT is mentioned in this part of the paper because the definition of interest payment in the Interest Savings Directive (ISD) crosses over into CGT areas in relation to certain types of gains on securities. This is discussed in more detail below.
were used in the trade, profession or vocation, or by the branch or agency. There may also be a liability if the activity ceases and assets are transferred outside the UK.

A resident or ordinarily resident in the UK who disposes of overseas assets will normally be liable to CGT on any gains arising. However, persons who are not domiciled in the UK are taxed on such gains only to the extent that they are received or remitted to the UK. Where the proceeds of a disposal are remitted, an appropriate proportion of the proceeds is treated as a remittance of the gain. There is no CGT charge on gains remitted to the UK before a person becomes resident in the UK.

Residents of countries with which the UK has a DTC may be able to claim exemption or partial relief from UK tax on income (including interest income) from UK sources and from CGT on the disposal of assets. Some UK DTCs impose a “subject to tax” requirement in the other country on the income in question before relief can be obtained from UK tax. However, if a trade or business is carried on in the UK through a permanent establishment, there may be no relief from UK tax on interest which is connected with the UK permanent establishment.

Banks and building societies, and other deposit-takers normally deduct UK tax at the rate of 20% from interest paid or credited to accounts. For non-residents, this can be paid or credited without tax deducted: this is still liable to UK tax, but persons who are not resident in the UK for a whole tax year (6 April-5 April) have their UK tax liability on interest limited to 20%, unless a trade, profession, or vocation is carried on through a UK branch or agency. Also, special rules apply where foreign interest is paid through a paying agent in the UK, or are received by a collecting

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60 For more information see HMRC Guidance Manuals paragraph CG10700 et seq. See sections 2 and 10 of TCGA 1992. The UK legislation, broadly, aims to charge CGT where there is a connection with the UK. See HMRC Guidance Manuals paragraph CG10900 et seq.

agent in the UK (for instance, a bank). The paying or collecting agent will normally deduct tax but non-residents can arrange for the paying or collecting agent to pay the income without deduction of tax.

UK residents receive personal allowances. Non-residents may claim the same personal allowances if they are (inter alia):

- citizens of an EEA country,
- a Commonwealth citizen,
- a present or former employee of the British Crown,
- a resident of the Isle of Man or the Channel Islands,
- a former resident of the UK living abroad for the sake of his/her health or the health of a member of his/her family living with him/her,
- a national or resident of a country with which the UK has a double tax convention (DTC) which extends the benefits.

Income tax is charged at the lower rate of 20% on “savings income” in the hands of individuals, trustees and personal representatives of deceased persons. “Savings income” includes interest from banks and building societies; interest distributions from authorised unit trusts; interest from gilts and other securities, including corporate bonds; purchased life annuities; discounts. “Savings income” is generally treated as “top slice” income. This means that where the income falls within the lower rate or basic rate bands, it is chargeable at the lower rate; for persons liable to tax at the higher rate on all or the highest part of their “savings income” the charge to income tax will be 40% less a credit at the lower rate (20%) resulting in a further tax liability of 20% (40-20). “Savings income” arising abroad for residents will be taxed at 20% except for income taxed on a remittance basis and

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62 See the following link: http://www.hmrc.gov.uk/pensioners/personal_allowance.htm (last visited 28 February 2006).
63 See the following link: http://www.hmrc.gov.uk/manuals/apmanual/AP41.htm (last visited on 28 February 2006).
any payment from a foreign estate of a deceased person under administration which is treated as income.

UK tax is not charged on interest arising on UK Government “FOTRA” securities if the recipient of the interest is not ordinarily resident in the UK.\textsuperscript{64}

\textbf{b. UK Double Tax Conventions: “Interest Article” - overview}

All UK DTCs entered into since the introduction of the OECD Model Tax Convention (MTC) adopt the format used in the MTC with some variations. The interest article in the UK’s DTCs usually provides that either:

- interest is only taxable in the beneficial owner’s residence State\textsuperscript{65}
- interest arising to a resident of one country may be taxed by that country. It may also be taxed by the source country but at a rate not exceeding a specified percentage if the recipient is the beneficial owner.\textsuperscript{66}

\textsuperscript{64} “FOTRA” stands for “Free of Tax to Residents Abroad”. They are also known as “gilts” or gilt-edged securities. See: \url{http://www.hmrc.gov.uk/cnr/fotra_sec.htm} (last visited 26 February 2006). See also HMRC Guidance Manuals paragraph INTM368000. FOTRA interest payments are made by the Bank of England and include one of the following names on the stock in question – Conversion Stock, Exchequer Stock, Treasury Loan, Index-linked Treasury Stock, or War Loan. See section 713 ITTOIA. Section 715(2) provides in relation to trusts that for the purposes of determining whether the interest is exempt, “it is to be assumed that the security is in the beneficial ownership of a person not ordinarily resident in the UK if none of the beneficiaries of the trust is ordinarily resident in the UK at the time the interest arises”.

\textsuperscript{65} For example, see Article 7 of the UK-Germany DTC \url{http://www.hmrc.gov.uk/manuals/dtmanual/DT8006.htm}.

\textsuperscript{66} For example, see Article 7 of the UK-Israel DTC - \url{http://www.hmrc.gov.uk/manuals/dtmanual/DT10106.htm}.
Some UK DTCs specify that the benefits of the DTCs can only be granted if the recipient of the interest is “subject to tax” in his residence State on that interest. Some early DTCs contain no interest article, allowing each country to tax interest flowing to residents of the other DTC partner State in accordance with their domestic laws. Many interest articles determine in which country the source of interest is found by deeming it to be in the country where the payer is a resident. Special source rules apply, similar to the MTC, where the debt-claim was incurred in connection with a permanent establishment and the interest was borne by that establishment.

1) Did you country implement the interest savings directive, fully or partially?

The directive was fully implemented. See Annex I.

2) In implementing the interest savings directive, did the implementing legislation just refer to the directive and incorporate it into national legislation as a whole, or was specific national legislation developed for the implementation?

The UK adopted specific national legislation for the implementation of the ISD. The ISD was implemented by The Reporting of Savings Income Information Regulations 2003 and by The Reporting

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68 For example, see the UK-Myanmar (formerly Burma) DTC http://www.hmrc.gov.uk/manuals/dtmanual/DT13800+.htm.
69 For example, see Article 11(6) of the UK-Luxembourg DTC -http://www.hmrc.gov.uk/manuals/dtmanual/DT12253.htm.
of Savings Income Information (Amendment) Regulations 2005. See Annex I.

3) When specific national legislation was developed, did the national legislator use identical concepts (interest, beneficial owner, paying agent etc. as in the directive, or are there deviations from the directive? You can answer those questions in detail in one of the other questions below referring specifically to these concepts?

There are deviations from the ISD. See details below.

4) Beneficial ownership is a central concept in the directive. Is there a concept of beneficial ownership in your national tax system and/or tax treaty system and how is it structured? How does it apply to concepts such as trusts (discretionary trusts and other forms of trusts, Stiftungen), foundations and other similar forms of intermediaries?

The UK has a concept of beneficial ownership in its national tax system and in its tax treaty network.

The concept of a beneficial owner may be understood as the person having “the sole and unfettered right to use, enjoy or dispose of the asset or income in question”. Thus, for instance, shares might be held in the name of a particular individual (legal owner) for the benefit of someone else (beneficial owner). UK law understands this distinction between the legal owner, and the equitable or beneficial owner.

The concept also appears in UK DTCs, with the majority of DTCs providing relief for the beneficial owner of the income. If the DTC partner State

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71 See HMRC Guidance International Manual at paragraph INTM332010.
72 For example, see the Explanatory Memorandum to the UK-USA DTC at this link: http://www.hmrc.gov.uk/international/usaem.pdf (last visited 28 February 2006).
does not have the concept of beneficial owner in its domestic system, “beneficial ownership” as a condition for relief may not appear in the DTC, but in such a case, the DTC will usually require the income to be “subject to tax” in the DTC partner State.\textsuperscript{73}

The concept of beneficial owner was discussed in a recent High Court case entitled \textit{Indofood International Finance Ltd v JP Morgan Chase Bank, NA, London Branch,}\textsuperscript{74} and involved the question whether an Indonesian company would be eligible to receive the benefits of the Netherlands – Indonesia Double Tax Convention (DTC). This entitlement depended on whether the Dutch resident company was “beneficially entitled” to the interest payable to it by the Indonesian company within the meaning of the DTC. The High Court determined that the Dutch company was the beneficial owner of the interest payments. “The beneficial owner of interest received under a loan transaction must be the lender”.\textsuperscript{75} It was not a mere nominee, agent, fiduciary or administrator of the income on behalf of another owner. The mere fact that an entity was a conduit did not mean that it was not the beneficial owner.\textsuperscript{76} The Dutch company had the power to dispose of the interest it received as it wished.

\textsuperscript{73} See HMRC Guidance International Manual at paragraph INTM332020.
\textsuperscript{74} Indofood International Finance Ltd. v JP Morgan Chase bank, NA, London Branch, [2006] STC 192.
\textsuperscript{75} Indofood International Finance Ltd. v JP Morgan Chase bank, NA, London Branch, [2006] STC 192, paragraph 50.
\textsuperscript{76} Indofood International Finance Ltd. v JP Morgan Chase bank, NA, London Branch, [2006] STC 192, paragraph 45, where the Court approves a passage from Baker, P., \textit{Double Taxation Conventions} (Sweet and Maxwell, London 2004), paragraph 10B-10.4.
The fact that the concept of “beneficial ownership” is not defined in DTCs or in the OECD Model Tax Convention has generated some debate as to whether domestic law definitions should prevail. Further confusion is caused by the introduction of the concept into European Community directives like the ISD. Interactions between the various norms generate questions concerning which interpretation of the concept of “beneficial owner” will prevail in the event of a dispute.

The concept of beneficial owner also applies in the area of trusts – in certain cases property held by “bare” trustees is treated as if it belonged to the beneficial owners directly. In other situations, there is a deemed disposal by the trustees when a beneficial owner becomes absolutely entitled to the trust assets. If these rules did not exist, the beneficial owner would be able to postpone when a disposal from the trustees takes place. The basic principle is that a person is “absolutely entitled” if he/she/it has the exclusive right to direct the trustee how to deal with the property. There are also special rules to cover situations where the person who created the trust or settlement ("settlor") or the settlor’s spouse or civil partner is entitled or does in fact benefit from the settlement: the chargeable gains of the trustees are treated as the chargeable gains of the settlor. Discretionary trusts do not have a “beneficial owner” or a person

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77 See Oliver, J. David. B., Beneficial Ownership and the OECD Model BTR 2001, 1, 27-68; Field, Thomas F., IFA Conference concludes with focus on beneficial ownership and cross-border services, 19 Tax Notes International Int’l 1605 (October 25, 1999).
78 This matter was examined by The International Fiscal Association at its 1999 Congress in Eilat, Israel.
79 For instance, section 60 of the taxation of Chargeable Gains Act, 1992.
80 See for instance section 71(1) of the Taxation of Chargeable Gains Act, 1992.
81 See HMRC Guidance Capital Gains Tax Manual paragraph CG37010 and Section 60(2) of the Taxation of Chargeable Gains Act, 1992.
82 See HMRC Guidance Capital Gains Tax Manual paragraph CG37400.
with a “right to an interest in possession” as such. Instead, the property in the trust is held on trust to accumulate the income or to apply the income at (usually) the trustees’ discretion, with or without the power to accumulate any surplus.

The UK’s approach in its implementation of the ISD has been to avoid the use of the expression – “beneficial owner”; preferring, instead, to use the notion of “relevant payee”. With some exceptions, a “relevant payee” is an individual who is resident in a prescribed territory and who either receives a savings income payment or is a person for whom a savings income payment is secured.

The exceptions include the situation where a paying agent holds information which gives him reason to believe that the individual he pays savings income to (or secures savings income for) is not the beneficial owner. In such cases, the paying agent should take reasonable steps to establish who the beneficial owner of the payment is. For instance, where a payment is made to a person who is known to act as a trustee of a bare trust, there is reason to believe that the individual (trustee) is not receiving the payment for his own benefit. The paying agent should take reasonable steps to obtain the beneficiaries’ identity and residence details (if they are relevant payees). HMRC Guidance suggests that contacting the trustee and asking whether the beneficiaries are relevant payees, and if so for their details, is a reasonable starting point.

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84 See Regulation 7 of The Reporting of Savings Income Information Regulations 2003, as amended.
85 HMRC Savings Income Reporting Guidance Notes V.4 paragraph 72.
86 HMRC Savings Income Reporting Guidance Notes V.4 paragraph 76.
87 HMRC Savings Income Reporting Guidance Notes V.4 paragraph 77.
88 HMRC Savings Income Reporting Guidance Notes V.4 paragraph 78.
An individual is not a relevant payee if he provides evidence that

- he is a paying agent in the UK or in a Prescribed Territory (called “economic operators” if located in a Prescribed Territory);
- he acts on behalf of
  - a residual entity and he provides the name and address of that entity
  - a legal person
  - a partnership
  - a UCITS or UCITS equivalent
  - an elective UCITS
  - another individual and he provides to the agent details of the other individual’s identity, verified according to the Regulations.\textsuperscript{89}

\textbf{5) Paying agent is a central concept in the directive. Is there such a concept in your national tax system and has it been used for the implementation of the directive, or did your country develop a new concept, or amend the existing concept?}

The UK had the concept of “Paying Agent” in its national tax system\textsuperscript{90} before the ISD and has amended the concept to implement the ISD. Such paying agents report information about interest paid or received under the arrangements set out in section 17 or section 18 of the Taxes Management Act, 1970 (TMA).\textsuperscript{91} These arrangements remain in place but some payments become reportable under The Reporting of Savings Income Information Regulations 2003, as amended.

\textsuperscript{89} HMRC Savings Income Reporting Guidance Notes V.4 paragraph 80.
\textsuperscript{90} See Sections 17 and 18, Taxes Management Act, 1970.
\textsuperscript{91} Under sections 17 and 18 TMA, a HMRC Notice is required before a report is required; if a notice is not served, there is no requirement for a report. See HMRC Savings Income Reporting Guidance Notes V.4, paragraph 10.
6) Interest is a central concept in the directive. Does the concept of interest of the directive coincide with the concept of taxable interest in your country and if not in what way do the two concepts vary?

The concept of “interest payment” in the ISD is similar to the concept of “savings income” in the UK’s implementation rules.92 However, the concept of interest in the ISD includes a number of items which are covered by the UK’s legislation relating to capital gains.93

The UK defines “savings income” (with some exceptions) as being –

(a) interest;
(b) interest accrued or capitalised at sale, refund or redemption;
(c) income distributed by a collective investment fund which is derived directly or indirectly, via other collective investment funds or residual entities, from interest;
(d) income realised upon the sale, refund or redemption of shares or units in a collective investment fund if that fund invests directly or indirectly, via other collective investment funds or residual entities, more than 40% of its assets in money debts.94

The UK defines “interest” in Regulation 8(2) for the above purposes as including –

(i) prizes attaching to money debts (including premium bonds);
(ii) premiums and discounts derived from money debts;
(iii) any dividend derived from shares (including permanent interest bearing shares) in a building society; and

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92 See Regulation 8 of The Reporting of Savings Income Information Regulations 2003, as amended.
93 See the Taxation of Chargeable Gains Act 1992.
94 See Regulation 8(1) of The Reporting of Savings Income Information Regulations 2003, as amended.
(iv) any share interest paid by a registered industrial and provident society.\(^9^5\)

The concept of “interest” in Regulation 8(2) excludes any interest which is not related to a money debt, and any penalty charges for late payment.\(^9^6\)

7) How did the national legislator organize the transfer of information by the paying agent to the competent authority of the national tax legislation? Did the national legislator use existing rules with respect to exchange of information between financial institutions and the national tax administration, or have new rules been developed and if so what rules? Have the concrete administrative procedures to provide the information (forms, channels, dates) already been implemented and if so what are the rules?

To implement the ISD, the UK introduced new rules which built upon existing rules relating to exchange of information by “paying agents”. The rules relating to administrative procedures have also been implemented.\(^9^7\)

When a paying agent makes a savings income payment for the immediate benefit of a relevant payee the following information must be reported to HMRC –

(a) the name and address of the paying agent;\(^9^8\)

(b) the name, address and country of residence of the relevant payee established in accordance with the verification procedures set out in Regulation 9;\(^9^9\)

(c) where contractual relations were entered into with the relevant

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\(^9^5\) See Regulation 8(2)(a) of The Reporting of Savings Income Information Regulations 2003, as amended.
\(^9^6\) See Regulation 8(2)(b) of The Reporting of Savings Income Information Regulations 2003, as amended.
\(^9^7\) See Regulation 10 of The Reporting of Savings Income Information Regulations 2003, as amended.
\(^9^8\) See Regulation 10(2)(a) of The Reporting of Savings Income Information Regulations 2003, as amended.
\(^9^9\) See Regulation 10(2)(b) of The Reporting of Savings Income Information Regulations 2003, as amended.
payee, or transactions are carried out in the absence of contractual relations, on or after 1 January 2004, the tax identification number, or if it is not available, the relevant payee’s date and place of birth, verified in accordance with Regulation 9;\(^{100}\)

(d) the account number of the relevant payee or, where there is none, identification of the money debt or other instrument giving rise to the savings income;\(^{101}\)

(e) the amount and category of savings income made to the relevant payee in accordance with Regulation 13 and the currency in which they were paid.\(^{102}\)

When a paying agent makes a savings income payment to a residual entity established in a prescribed territory the following information must be reported to HMRC –

(a) the name and address of the paying agent;\(^{103}\)

(b) the name and address of the residual entity (including the territory in which it is established);\(^{104}\) and

(c) the total amount and category of the savings income payments made in accordance with Regulation 13 and the currency in which they were paid.

Information must also be reported by receiving agents in respect of each relevant payee when

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\(^{100}\) See Regulation 10(2)(c) of The Reporting of Savings Income Information Regulations 2003, as amended.

\(^{101}\) See Regulation 10(2)(d) of The Reporting of Savings Income Information Regulations 2003, as amended.

\(^{102}\) See Regulation 10(2)(e) of The Reporting of Savings Income Information Regulations 2003, as amended.

\(^{103}\) See Regulation 11(2)(a) of The Reporting of Savings Income Information Regulations 2003, as amended.

\(^{104}\) See Regulation 11(2)(b) of The Reporting of Savings Income Information Regulations 2003, as amended.
savings income is received on their behalf and attributed to them.\textsuperscript{105} The information is –

(a) a statement that the savings income has been received or secured by the receiving agent in his capacity as such;\textsuperscript{106}

(b) the name and address of the receiving agent;\textsuperscript{107}

(c) the name, address and country of residence of the relevant payee verified in accordance with Regulation 9;\textsuperscript{108}

(d) where contractual relations were entered into, or transactions are carried out in the absence of contractual relations, on or after 1 January 2004, the tax identification number, or if it is not available, the relevant payee’s date and place of birth, verified in accordance with Regulation 9;\textsuperscript{109}

(e) the account number of the relevant payee or, where there is none, identification of the money debt or other instrument giving rise to the savings income;\textsuperscript{110}

(f) the amount and category of the savings income received or secured by the receiving agent in accordance with Regulation 13 and the currency in which it is paid.\textsuperscript{111}

Regulations 9 and 13 have been mentioned above. Regulation 9 concerns the establishment of the identity and residence of relevant employees; Regulation 13 concerns the amount of savings income to be reported to HMRC.

\textsuperscript{105} See Regulation 12(1) of The Reporting of Savings Income Information Regulations 2003, as amended.
\textsuperscript{106} See Regulation 12(2)(a) of The Reporting of Savings Income Information Regulations 2003, as amended.
\textsuperscript{107} See Regulation 12(2)(b) of The Reporting of Savings Income Information Regulations 2003, as amended.
\textsuperscript{108} See Regulation 12(2)(c) of The Reporting of Savings Income Information Regulations 2003, as amended.
\textsuperscript{109} See Regulation 12(2)(d) of The Reporting of Savings Income Information Regulations 2003, as amended.
\textsuperscript{110} See Regulation 12(2)(e) of The Reporting of Savings Income Information Regulations 2003, as amended.
\textsuperscript{111} See Regulation 12(2)(f) of The Reporting of Savings Income Information Regulations 2003, as amended.
Regulation 9 provides that where a paying agent makes a savings income payment to an individual whom he believes to be a relevant employee,\(^\text{112}\) or a receiving agent receives or secures a savings income payment for an individual whom he believes to be a relevant employee,\(^\text{113}\) the agent must establish the identity and “country of residence”\(^\text{114}\) of that individual in accordance with this regulation.\(^\text{115}\)

Where contractual relations between the agent and the individual are entered into before the 1\(^{\text{st}}\) January 2004 the agent must verify the name, address and country of residence of the individual by using the information at its disposal, including information obtained under the Money Laundering Regulations 2003.\(^\text{116}\)

Where contractual relations are entered into, or transactions are carried out in the absence of contractual relations, on or after 1\(^{\text{st}}\) January 2004, the agent must obtain and verify –

(a) the name, address and tax identification number allocated by the Member State of

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\(^{112}\) See Regulation 9(1)(a) of The Reporting of Savings Income Information Regulations 2003, as amended.

\(^{113}\) See Regulation 9(1)(b) of The Reporting of Savings Income Information Regulations 2003, as amended.

\(^{114}\) “Country of residence” for the purposes of the Regulation means “the country where the individual has his permanent address”. See Regulation 9(2) of The Reporting of Savings Income Information Regulations 2003, as amended. The country of residence is determined on the basis of the individual’s address verified in accordance with Regulation 9(5) and Regulation 9(6). Regulation 9(6) provides that if the address does not appear on the passport or official identity card it can be verified by “any other documentary proof of identity”. Regulation 9(5) provides that this information must be verified by the individual’s passport or official identity card.

\(^{115}\) See Regulation 9(1) of The Reporting of Savings Income Information Regulations 2003, as amended.

residence, or, if it is not available, the date and place of birth of the individual;\textsuperscript{117}

(b) the country of residence of the individual in accordance with Regulation 9(8) and 9(9).\textsuperscript{118}

Regulation 9(9) provides for the situation where an individual declares his country of residence to be in a third country (TC). In such a situation, if he presents a passport or official identity card issued by a Member State, the agent shall establish the country of residence by a certificate of residence for tax purposes issued by the competent authority of the third country which the individual claims to be his country of residence;\textsuperscript{119} otherwise, if the individual fails to present such a certificate, the Member State that issued the passport or other official identity document will be considered as his country of residence.\textsuperscript{120}

The amount of savings income to be reported by the agent to HMRC is covered by Regulation 13.\textsuperscript{121} The agent has to identify the savings income under three categories –

(a) Regulation 8(1)(a) – report the amount of savings income ("interest");\textsuperscript{122}

(b) Regulation 8(1)(b) or (d) – report either the amount of savings income or the full

\textsuperscript{117}See Regulation 9(4)(a) of The Reporting of Savings Income Information Regulations 2003, as amended.

\textsuperscript{118}See Regulation 9(4)(b) of The Reporting of Savings Income Information Regulations 2003, as amended.

\textsuperscript{119}Regulation 9(9)(a) of The Reporting of Savings Income Information Regulations 2003, as amended.

\textsuperscript{120}Regulation 9(9)(b) of The Reporting of Savings Income Information Regulations 2003, as amended.

\textsuperscript{121}See Regulation 13 of The Reporting of Savings Income Information Regulations 2003, as amended. The Regulation provides that savings income which is reported under Regulation 13(2)(a) or (c) does not have to be reported again (Regulation 13(3).

\textsuperscript{122}Regulation 13(2)(a) of The Reporting of Savings Income Information Regulations 2003, as amended.
amount of the proceeds from the sale, redemption or refund;\textsuperscript{123}

(c) Regulation 8(1)(c) – report either the amount of savings income or the full amount of the distribution.\textsuperscript{124}

Part 3 of the Regulations sets out some more details concerning the reporting requirements and fixes some penalties for non-compliance. Part 3 also gives details of some notices which HMRC must send to agents or individuals.

Regulation 14 specifies that an agent who must report information must notify\textsuperscript{125} HMRC within 14 days of the end of the tax year in which the savings income payment was made,\textsuperscript{126} or the savings income was secured or received.\textsuperscript{127} There is a penalty of up to £3,000 for failure to comply.\textsuperscript{128}

Regulation 15 concerns the notices that HMRC must send – to agents who have notified HMRC;\textsuperscript{129} to any persons HMRC considers should have reported;\textsuperscript{130} and to any person who reported in a previous tax year unless that person is no longer an agent.\textsuperscript{131} The agent or person must make and deliver the report in accordance with the requirements set out in the notice.\textsuperscript{132} The notice must contain the following –

\textsuperscript{123} Regulation 13(2)(b) of The Reporting of Savings Income Information Regulations 2003, as amended.
\textsuperscript{124} Regulation 13(2)(c) of The Reporting of Savings Income Information Regulations 2003, as amended.
\textsuperscript{125} Unless the agent has received a notice from HMRC under Regulation 15.
\textsuperscript{126} Regulation 14(1)(a) of The Reporting of Savings Income Information Regulations 2003, as amended.
\textsuperscript{127} Regulation 14(1)(b) of The Reporting of Savings Income Information Regulations 2003, as amended.
\textsuperscript{128} Regulation 14(2) of The Reporting of Savings Income Information Regulations 2003, as amended.
\textsuperscript{129} Regulation 15(1)(a) of The Reporting of Savings Income Information Regulations 2003, as amended.
\textsuperscript{130} Regulation 15(1)(b) of The Reporting of Savings Income Information Regulations 2003, as amended.
\textsuperscript{131} Regulation 15(1)(c) of The Reporting of Savings Income Information Regulations 2003, as amended.
\textsuperscript{132} Regulation 15(5) of The Reporting of Savings Income Information Regulations 2003, as amended.
(a) the information which must be reported;\textsuperscript{133}
(b) all savings income payments for a specified tax year;\textsuperscript{134}
(c) the form of in which the report must be made;\textsuperscript{135}
(d) the address to which the report is to be delivered;\textsuperscript{136}
(e) the date by which the report must be delivered (not earlier than 30 days after the date of the notice).\textsuperscript{137}

8) How did the national legislator organize the transfer from the national competent authority to the competent authorities of the other Member States? Did the national legislator use existing procedures on the basis of bilateral tax treaties or on the basis of the OECD arrangements on exchange of information, or did he develop specific rules and procedures and if so what are these rules?

In implementing the exchange of information provisions of the ISD, the UK used existing procedures and did not need to introduce new domestic rules because such rules were already in place in relation to the implementation of the Mutual Assistance Directive.\textsuperscript{138} The ISD requires the UK to make an automatic exchange of information to the tax authority of the country or territory in which the individual is resident.

\textsuperscript{133} Regulation 15(2)(a) of The Reporting of Savings Income Information Regulations 2003, as amended.
\textsuperscript{134} Regulation 15(2)(b) of The Reporting of Savings Income Information Regulations 2003, as amended.
\textsuperscript{135} Regulation 15(2)(c) of The Reporting of Savings Income Information Regulations 2003, as amended.
\textsuperscript{136} Regulation 15(2)(d) of The Reporting of Savings Income Information Regulations 2003, as amended.
\textsuperscript{137} Regulation 15(2)(e) of The Reporting of Savings Income Information Regulations 2003, as amended. Notices may be combined with those issued under sections 17 or 18, or both, of the Taxes Management Act 1970.
(according to the Directive rules). The provisions of the Mutual Assistance Directive apply, and Article 8 of that directive does not apply to information provided in relation to savings income. Section 197 of the Finance Act 2003 allows the exchange of any information required to be disclosed by virtue of the Mutual Assistance Directive.

9) How is the exchange of information organized from one paying agent to another paying agent within the same tax jurisdiction? Did your country develop new rules, or has use been made of existing rules?

The UK’s approach is, put simply: “You are not a paying agent...in relation to a specific savings income payment if you make that payment to another person who is a paying agent”. The UK Guidance makes it clear that a person is not a paying agent (and does not have to make a report) for the purposes of the UK Regulations if:

(i) savings income payments are not made in the course of a business or profession;
(ii) the payments made are not savings income;
(iii) the person to whom the payments are made is resident in the UK;
(iv) the person to whom the payments are made is not a relevant payee or a residual entity in a prescribed territory.

HMRC Guidance points out that the key term is “paying” and that ties in with the requirement that the paying agent is the last link in the chain.

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139 See ISD, Article 9(1).
140 See ISD, Article 9(3).
141 See Savings Income Reporting Guidance Notes V.4 paragraph 17.
142 See Savings Income Reporting Guidance Notes V.4 paragraph 16.
143 See Savings Income Reporting Guidance Notes V.4 paragraph 18.
“The paying agent is always 'the last link in the payment chain’ before the relevant payee or residual entity and is the person that actively initiates a payment directly to the relevant payee or residual entity or to his or its instructions”.

The UK Guidance also notes that where two competing organisations have a significant claim to the role of paying agent, HMRC will accept the organisation that the relevant parties have agreed will be the paying agent.

10) The directive provides for certain forms of evidence to establish the residence of taxpayers. Are the documents mentioned in the directive available and used in your country to determine residence? Do you think there may be other documents or data, used in your country, enabling the national tax administration to establish the residence of a taxpayer?

The UK does not issue “national identity cards”. Certificates of tax residence and tax identification numbers are used.

Other ways of showing proof of UK residence may require the production or checking of any number of the following items or other sources of information held by national and local government departments, official agencies, credit reference agencies, banks or financial institutions, etc. -

• Landline telephone bills
• UK Driving licences with photographs and addresses
• Credit agency data
• Recent utility bills – gas/electricity/tv/
• Building society or bank statements or credit card bill
• Land Registry search

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144 See Savings Income Reporting Guidance Notes V.4 paragraph 19.
• Third party information such as bank and building society interest, and financial products such as PEPs and ISAs
• Companies House returns – details of registered offices of companies, names and addresses of directors, directorships held
• Vat registration documents and number with address
• HMRC Self-assessment Forms and tax number with address
• National Insurance Number and registered address
• PAYE – Income tax details via employers, payslips with national insurance number
• Recent Council tax bills
• Voters’ Register
• NHS Medical card
• Letter from a bank, solicitor or accountant
• Tenancy agreement
• Mortgage document

The UK Guidance material indicates that copies of documents duly certified are acceptable. For a non-UK national, this means that the copy should be certified by an embassy, consulate or High Commission of the country of issue, a lawyer or an attorney. Copies of documents may also be certified by “a senior official within another reputable intermediary (for example, a copy of documents from an introducing firm).”

146 See Savings Income Reporting Guidance Notes V.4 paragraph 180. the Guidance notes that the “copies should be dated and signed ‘original seen’.
147 See Savings Income Reporting Guidance Notes V.4 paragraph 181. Copies of all documents must be retained for audit purposes for at least two years. See paragraphs 182 and 200.
11) Is there any provision in your national tax system on matching the tax credit for the special withholding tax, with information on the effective withholding of such tax in the country of source? Can the tax credit for the special withholding tax be taken for the tax year in which the tax was withheld in the country of source?

The UK offers a number of ways of dealing with the “special withholding tax” problems encountered by UK residents who have savings income abroad. First, UK resident investors who receive savings income from a paying agent in a withholding country may elect not to have tax withheld via one of two procedures: 148

(1) The UK resident individual may authorise the paying agent to report details of the savings income payment to its tax authority, who will supply it to HMRC.

(2) The individual can ask HMRC for a certificate 149 showing his name, address and a tax identification number (or if none available, his date and place of birth); name and address of the paying agent; the account number or some other means of identifying the security; and the period (up to 3 years) for which the certificate is valid. The individual has to provide HMRC with information about the paying agent and the source of the savings income to HMRC so that the certificate 150 can be drawn up. This is presented to the paying agent and requests them not to withhold tax from savings income.

As regards a credit for the “special withholding tax”, the UK introduced an additional credit for such tax to accompany its normal double tax credit rules, but the credit for the “special withholding tax” is an additional credit. 151 It operates as

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148 See “Issues for Investors” paragraphs 8-12.
150 HMRC will issue a certificate within two months of receiving the request and it will be valid for up to three years.
151 This is implemented into UK tax law by Sections 107-115 of the Finance Act 2004.
follows\textsuperscript{152} – foreign tax may have been withheld twice – (a) tax withheld in the territory where the original payer of the income is resident under that territory’s domestic rules; and (b) tax withheld by a paying agent (known in the UK legislation as “special withholding tax”) in those countries and territories that opt to withhold tax rather than exchange information.\textsuperscript{153}

The UK eliminates double taxation as follows:

- any tax withheld in the territory where the payer of the income is resident under its domestic law is credited first against the UK tax payable on the savings income, provided that credit is allowable under UK law or under the UK’s DTC with that territory – such tax cannot be repaid if it exceeds the UK tax liability on that income;
- the “special withholding tax” will be credited against the remaining UK Income or Capital Gains Tax liability;
- any “special withholding tax” remaining after the UK Income and Capital Gains Tax liability will be repaid to the investor by HMRC. Either through their self-assessment tax return or by submitting a claim to HMRC.\textsuperscript{154}

The UK rules contained in Finance Act 2004 provide for a match between being charged to tax in the UK in respect of a payment of savings income for a particular year of assessment and any “special withholding tax” levied in respect of that payment.\textsuperscript{155} If the savings income payment is related to chargeable gains, there is a similar matching of the “special withholding tax” and the year of assessment of the chargeable gains in the UK.\textsuperscript{156} However, as the “Year of Assessment” is the UK’s year of assessment, there may be some timing problems between the date of withholding.

\textsuperscript{152} See “Issues for Investors” paragraphs 13-18.
\textsuperscript{153} See “Issues for Investors” paragraph 16.
\textsuperscript{154} See “Issues for Investors” paragraph 16.
\textsuperscript{155} See Finance Act 2004 section 108(1).
\textsuperscript{156} See Finance Act 2004 section 109(3).
and the UK’s tax assessment as these may not always overlap.

**Part III  UNRESOLVED LEGAL QUESTIONS**

1) What is in your opinion the legal status of a taxpayer who has been identified as an E.U. resident under the directive and who proves that he is not a resident of a Member State under the rules of international tax law?

   If such a person is a non-resident of the UK under the rules of international tax law, the person is not taxed in the UK, and will be taxed in his State of residence. The UK will also withhold credit for “special withholding tax” if the individual has obtained relief from double taxation in respect of that “special withholding tax” under the law of a territory outside the UK, or if he was resident in that territory, or was treated as being so resident under any double taxation arrangements, in the year of assessment in question.157

2) If a taxpayer turns out to be a resident of another Member State, than the Member State indicated by the paying agent, what should be done with the information? Should it be forwarded automatically to the authentic state of residence?

   Article 9 of the ISD requires “automatic exchange of information” between the competent authority of the paying agent and the competent authority of the State of residence of the beneficial owner. The information should be forwarded automatically to the correct State of residence.

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3) The directive puts the burden of proof for the residence of the beneficial owner entirely on the paying agent, while under treaty law the burden of proving residence in order to reduce source taxation generally is on the taxpayer. Shouldn’t the directive impose duties on the cooperation of the non-resident taxpayer and provide sanctions in the state of residence if the beneficial owner does not cooperate?

As all ISD payments go through a paying agent, it is the duty and responsibility of each paying agent to act as the control person in the chain. This decreases considerably the number of persons involved in the administration of the ISD procedures and enables such paying agents to become the “frontline” in terms of ensuring that they get detailed information on their clients to whom they will make savings income payments: “paying agents are the last link in the chain”. If the beneficial owner does not cooperate, then the possibility of sanctions will not necessarily make him cooperate either; he is more likely to move his business elsewhere. The administration of the ISD is, therefore, much more efficient from a competent authority’s viewpoint because instead of having to deal with individual taxpayers, it generally deals with “paying agents” which is a much more manageable number.

4) The rules with respect to the identification of the beneficial owner are based on the money laundering directive. Will this, in your opinion, result into a confusion regarding the authority to which the information will have to be sent: competent tax authority or money laundering authority? If indeed indicators of money laundering are established is it a good idea to have a criminal investigation on money laundering for concealing payments in the country of source and a criminal investigation for tax evasion in the country of residence?

The reporting pathways are very clear under UK ISD implementation rules and have been outlined in detail above. Similarly, the reporting pathways under the Money Laundering Regulations\textsuperscript{158} are similarly clear and no confusion should occur. The UK has also published very detailed Guidance on

\textsuperscript{158} See the following link for more information: 
the implementation of the ISD and provided e-mail contacts of senior HMRC officials who will deal with any queries.

If indicators of money laundering are established, generating two criminal investigations in the source and residence countries may be necessary if more than one individual is involved. In relation to only one individual, such appears to be a duplication of time and administrative costs and may result in litigation under the ECHR if two criminal penalties are imposed in different countries relating to the same set of facts.\footnote{See European Taxation Special Issue 2001, Vol 41, Issue 12, concerning Taxation and the European Convention on Human Rights in Domestic Law of the Council of Europe Countries.}

5) Is the information to be provided by the paying agent in art. 8: identity, residence, name and address of paying agent, amount of interest paid and account number or identification of debt claim in your judgment adequate to allow the tax administration in the state of residence to make an assessment? Is there other information that could be useful in this respect?

The information contained in Article 8 of the ISD is the minimum amount of information required for HMRC to raise an assessment.

Other information that might be useful for the competent authority might include:

- Any supporting evidence that the person reported is the actual beneficial owner of the savings income payment;
- The source of the interest payment and the date on which the source commenced; any related transactions;
- whether the beneficial owner is deceased;
- if a trust is involved, more details on the status of the trust
- if a partnership is involved, details on its status
- any payments to residual entities – documents to verify the identity and place of
establishment of a residual entity and when the contractual relationship commenced.

• details concerning the account from which the savings income payment was made – when it was opened/closed;

• any distributions from collective investment funds where the fund’s investments in money debts does not exceed the 15%/40% threshold;

• whether the paying agent been satisfactorily audited, and if so, the audit reference number and the date of that audit;

• Has the paying agent avoided being the subject of any penalties? If so, perhaps the Member State of establishment can issue a "certificate of good standing" or similar reference document/number to demonstrate that compliance is occurring in the paying agent’s territory;

• in relation to making a report concerning accrued or capitalised interest included in the proceeds of the sale, redemption or refund of a money debt, the UK Guidance suggests that paying agents need to know at least:

  • the date on which the person selling (or redeeming etc.) acquired the money debt concerned
  • the price at which it was acquired
  • whether the sale was ex or cum dividend.\textsuperscript{160}

\textsuperscript{160} See Savings Income Reporting Guidance Notes V.4 Appendix 6 and the examples contained therein.

6) The directive organizes the exchange of information in two stages: (a) information transferred from the paying agent to the national competent authority and (b) information transferred for one competent national authority to another. Would it be more effective to transfer the information directly from the paying agent to the competent national authority of the state of residence, and what would be the conditions for such a transfer to become possible from a legal point of view?

The transfer of the information direct from the paying agent to a competent authority of another Member State would not be more effective simply...
because the compliance of paying agents depends upon the auditing carried out by the competent authority of that paying agent. Equally, the information being reported is of use to the competent authority of the paying agent.

For such a transfer of information to take place the UK would have to introduce amending legislation on mutual assistance and would have to take into account its international law obligations under its DTCs to ensure that the proposed actions are not in breach.

7) Although the directive does not mention it, does it allow the information to be transferred directly by the paying agent to the taxpayer concerned? Would your national tax law allow such a transfer?

This seems to pose two questions:

(a) Can a paying agent located outside the UK contact a beneficial owner who is resident in the UK indicating that a report under the savings directive has been/will be made to HMRC?

(b) Can a UK paying agent established in the UK contact a beneficial owner located outside the UK indicating that a report under the savings directive has been or will be made to the competent authority of the beneficial owner?

The answer to (a) will depend on the national law requirements of the State or territory of the paying agent. The answer to (b) depends on UK law, particularly sections 197-199 Finance Act 2003, which covers the exchange of information between HMRC and the competent authority of another Member State. These rules allow HMRC to disclose any information required to be disclosed under the Mutual Assistance Directive. Section 197(2) places some limits on the disclosure of information by HMRC:
“Neither the [HMRC]… nor an authorised officer shall disclose any information in pursuance of the Mutual Assistance Directive unless satisfied that the competent authorities of the other State are bound by, or have undertaken to observe, rules of confidentiality with respect to the information that are not less strict than those applying to it in the United Kingdom”.\(^{161}\)

There appears to be no similar rules in UK legislation covering “paying agents” contacting the beneficial owners and confirming that a report has been made under the ISD to their residence competent authority and disclosing the details of that report.

8) What happens when a Member State would implement the directive, but in fact not deliver any useful information? Does the national law, or the directive, provide for any mechanism of effective enforcement?

The ISD is a piece of secondary Community legislation and automatic exchange of information is specified by Article 9 ISD. Consequently, all Member States are under a Community law obligation to comply under Article 10 of the EC Treaty. This obligation can be enforced by the Commission in the event of complaints from other Member States, or following a Commission investigation. Compliance with Community law implies that the result of the Directive must be achieved by each Member State: this means that the appropriate information specified in the ISD must be collected and passed on to the competent authorities of the other Member States.

\(^{161}\) See section 197(2) Finance Act 2003.
9) For the definition of interest payment, art. 6 of the directive qualifies many hybrid financial instruments as the source of interest. What are in your judgment the accuracy and the effectiveness of these criteria in determining the amount of interest?

In the area of financial instruments, the ISD can only hope to achieve some degree of accuracy concerning the amount of interest that is reported. For example, in the UK, savings income accumulated or rolled-up in some way in the disposal proceeds is reportable. Capital gains are not savings income. However, other types of income and capital gains may be included in the amounts that are reportable under the UK’s Regulations if it is not possible to isolate the amount of savings income in a larger payment and in the case of sale or redemption of shares or units in a collective investment fund, savings income is not restricted to income derived from interest.  

The UK’s Guidance makes it clear that reports are required for all savings income payments within the meaning of the regulations irrespective of

- whether these payments would be taxed in the UK,
- the way in which they would be taxed in the UK, or
- the way in which they would be taxed in the country of residence of the relevant payee or residual entity.

Problems occur in relation to accrued or capital interest. For instance, the situation where a security is purchased “cum dividend” or “ex dividend” is treated differently: if the security is purchased “ex dividend” (without an entitlement to the next coupon payment), there will not normally

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163 See Savings Income Reporting Guidance Notes V.4 paragraph 85.
be any accrued interest in the selling price and so there may be no reportable savings income.\textsuperscript{164}

Further problems are noted in the UK’s Guidance concerning the complex calculations involving the sale, redemption or refund of a money debt. This is why paying agents are given the choice of reporting either the amount of the accrued or capitalised interest or the full amount of the proceeds of sale, redemption or refund of the money debt. Paying agents may require “significant information in addition to certain basic details about the security and the sale or redemption price”.\textsuperscript{165}

Clearly, this aspect of the ISD leaves a number of open questions as to the “accuracy” and “effectiveness” of the criteria in determining the amount of interest when hybrid financial instruments enter the picture.

10) What is in your view the role of the interest definition of the directive with respect to the effective taxation of such interest in the Member States? Does it impose an obligation to tax such interest?

The “interest definition” in the ISD does not guarantee effective taxation of such interest in the Member States. It is still within the competence of each Member State to decide whether or not to tax such savings income, and at what rate. This rate can be a zero rate. The ISD does not impose an obligation to impose tax on such interest: the Preamble to the ISD notes that - “The ultimate aim of this Directive is to enable savings income in the form of interest payments made in one Member State to beneficial owners who are individuals resident in another Member State to be made subject to effective taxation in accordance with the laws of the latter Member State”.\textsuperscript{166} As such the determination of the taxation of such interest still

\textsuperscript{164} See Savings Income Reporting Guidance Notes V.4 paragraph 100.
\textsuperscript{165} See Savings Income Reporting Guidance Notes V.4 paragraph 237.
\textsuperscript{166} See Recital 8 of Council Directive 2003/48/EC.
rests within the competence of each Member State. This also implies that source States can continue to impose withholding tax on interest sources in their State. This seems clear from the UK’s approach to the implementation of the double tax relief mechanism discussed above.

Part IV Questions of Tax Planning and Tax Avoidance

1) What is in your national tax law the relationship between your national tax system and the tax systems of your dependencies: for the U.K. the Channel Islands, Man, the crown colonies and crown dependencies, for the NL. The Netherlands Antilles, for France Andorra and Monaco, for Switzerland and Austria: Liechtenstein and for Italy San Marino? Are residents with income sourced in these countries subject to tax? Are there special rules with respect to the taxation of interest on behalf of the residents of those countries?

The Channel Islands and the Isle of Man are not part of the UK for tax purposes and Acts of the UK Parliament do not normally extend to the Islands. The constitutional arrangements relating to the Islands have been built up over a number of centuries, but generally speaking they are “self-governing” dependencies. The UK is responsible for their international relations and defence, and it retains a residual prerogative power of the Crown. The Channel Islands and the Isle of Man are not EU Member States, nor are they part of the UK Member State. The relationship of the Islands to the Community is governed by Article 299(6)(c) of the EC Treaty and by Protocol 3 to the UK’s Act of Accession to the Community. The Islands are not subject to Community measures on taxation, nor are they within the EU’s fiscal territory. The Isle of Man and the UK form a common customs area – customs and excise duties and VAT. The Channel Islands operate a separate customs area from the UK.

Gibraltar entered the European Community as a dependent territory at the time of the UK’s
accession. The UK has issued a statement concerning Gibraltar which may be found at the following link: [http://www.hmrc.gov.uk/news/uk-gibraltar.htm](http://www.hmrc.gov.uk/news/uk-gibraltar.htm).

Tax exchange information agreements with British Virgin Islands, Montserrat, Cayman Islands, Turks and Caicos may be found at the following link: [http://www.hmrc.gov.uk/international/tiea_inforce.htm](http://www.hmrc.gov.uk/international/tiea_inforce.htm).

The UK’s overseas countries and territories are covered by Part Four of the Treaty, more specifically, those mentioned in Annex II of the EC Treaty. The EC Treaty does not apply to any other overseas countries and territories having a special relationship with the UK which are not included in that list.

Residents of the UK receiving income from the Channel Islands, the Isle of Man, Gibraltar, or any of the overseas territories are taxed on that income in the UK. There are no special rules in relation to the taxation of interest from those countries: normal UK tax rules apply.

Persons who are “domiciled” in those countries and territories (and other third countries), but who are resident in the UK, benefit from special rules of assessment called the “remittance basis”. If the interest income is not remitted to the UK, such persons, even though they are resident in the UK do not pay income tax on that income in the UK – resident but non-domiciled exception.

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167 See Article 299(4) EC Treaty which specifies that “The provisions of this Treaty shall apply to the European territories for whose external relations a Member State is responsible”.

168 Last visited on 28 February 2006.

169 Last visited on 28 February 2006.

170 Namely, Anguilla, Cayman Islands, Falkland Islands, South Georgia and the South Sandwich Islands, Montserrat, Pitcairn Islands, Saint Helena and Dependencies, British Antarctic Territory, British Indian Ocean Territory, Turks and Caicos Islands, British Virgin Islands and Bermuda.

171 See Article 299(3) of the EC Treaty.

2) The Channel Islands, Man and the British Crown colonies and dependencies have submitted draft treaties literally incorporating the rules of the directive in these treaties? How should these treaties be interpreted if litigation arises with respect to such treaties in one of those territories, in accordance with their national law, or on appeal with English law, or in accordance with the principles of E.U. law? Quid when litigation on such treaties occurs in a Member State? Is E.U. law applicable and could a tribunal or court refer a preliminary question to the E.U. Court of Justice?

The Treaties are international agreements and should be interpreted as such if litigation arises. They also contain mutual agreement clauses which will apply in the event of a dispute arising. If the particular treaty is interpreted in one of those territories by a national court, such a court will apply international law. However, the Agreements with the Channel Islands, Isle of Man etc. all provide that automatic exchange of information or a withholding tax will apply in the same manner as set out in the ISD; consequently, any national court should take this factor into account when interpreting and giving effect to the agreement. If the mutual agreement procedure is invoked, there is no guarantee that a solution will be reached.

On appeal, if there is an appeal, and if the matter comes before a UK court, or if the matter originates in an EU Member State, such a court may be obliged to apply Community law. In Gottardo, the Court pointed out to Member States that

“when giving effect to commitments assumed under international agreements, be it an agreement between Member States or an agreement between a Member State and one or more non-member countries, Member States are required, subject to the provisions of Article 173

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173 See, for instance, Article 8 of the Agreement between the UK and the Cayman Islands.
174 There is no appeal from a mutual agreement procedure. However, a different form of litigation may be envisaged by the question, in which case there may be some procedure for an appeal to the Judicial Committee of the Privy Council. See this link for more information on the Court’s jurisdiction: http://www.privy-council.org.uk/output/Page32.asp.
175 The untried issue is whether the UK Privy Council, sitting as an appeal Court, is a UK Court for the purposes of Community law.
307 EC, to comply with the obligations that Community law imposes on them. The fact that non-member countries, for their part, are not obliged to comply with any Community-law obligation is of no relevance in this respect”. 176

Also, as the international agreement has a Community legal background, the UK appeal court, 177 and the national courts of an EU Member State, could ask the ECJ for a preliminary ruling to assist its interpretation of any aspect of the Community’ ISD legislation if such an interpretation were necessary to assist its understanding of the international agreement. In such circumstances, the ECJ is not interpreting the international agreement it is merely interpreting the ISD. In Bouanich, which involved the free movement of capital, for instance, the ECJ said–

“Since the tax system under the Franco-Swedish agreement, as interpreted in the light of the commentaries on the OECD Model Tax Convention, forms part of the legal background to the main proceedings and has been presented as such by the national court, the Court of Justice must take it into account in order to give an interpretation of Community law that is relevant to the national court. It is not for the Court to interpret national law or to assess its application in the present case (see, inter alia, Case C-435/93 Dietz [1996] ECR I-5223, paragraph 39, and Case C-136/95 Thibault [1998] ECR I-2011, paragraph 21)”.

3) The same question arises when litigation would occur in the Netherlands Antilles, Monaco, Liechtenstein, Andorra or San Marino or in a member State in relationship with these countries?

N/A

176 See Case C-55/00 Gottardo paragraph 33.
177 Perhaps. The matter has not been decided to date.
178 See Case C-265/04 Bouanich v Skatteverket paragraph 51.
4) Does the directive apply to income payments from discretionary trusts or from collective investment funds under the laws of the Channel Islands, Man or British Crown colonies and dependencies? If not is there any equivalent local tax on such income payments?

In relation to the status of foreign trusts generally, this is determined by the law of country in which the trust is established.\textsuperscript{179} The normal rules of the ISD apply to payments made by foreign trusts where the person to whom the payment is made is a relevant payee or a residual entity in a prescribed territory. If the payee is such a person, a report may be required. The normal rules also apply to determine whether the payment made from the foreign trust is savings income.\textsuperscript{180} The UK’s Guidance notes that distributions made by trustees of discretionary or accumulation and maintenance trusts are not savings income and are not reportable.\textsuperscript{181} Thus, in relation to discretionary trusts located in any of the aforementioned jurisdictions the ISD does not apply.

In relation to collective investment funds, each of the aforementioned territories has legislation deemed to be equivalent in its effect to the ISD.\textsuperscript{182}

5) Same question with respect to Stiftungen or foundations in Liechtenstein, Andorra, Monaco or San Marino?

N/A

\textsuperscript{179} See Savings Income Reporting Guidance Notes V.4 paragraph 224.
\textsuperscript{180} See Savings Income Reporting Guidance Notes V.4 paragraph 225.
\textsuperscript{181} See Savings Income Reporting Guidance Notes V.4 paragraph 220.
\textsuperscript{182} See for instance, Recital 5 of the Agreement on the Taxation of Savings Income between the Cayman Islands and the UK, 17\textsuperscript{th} March 2005 and Recital 7 of the Agreement on the Taxation of Savings Income between Jersey and the UK, 19\textsuperscript{th} November 2004.
6) What is the legal status for the application of the directive of the British Crown colonies and dependent territories in the light of the case Cayman Islands C-8530R decided on 26.03.2003?

The ISD only applies in the UK’s dependent territories to the extent that it has been implemented by an international agreement between the UK and such a territory. The ISD itself has no direct impact on the countries and territories associated with the UK.  

"the Community legislature has no competence to adopt an act on the basis of Article 94 EC whose geographical scope extends beyond the territory of the Community as defined in Article 299(1) and (2) EC".  

7) What is the status of ordinary residents, domiciled residents and non-domiciled residents in the U.K. with respect to interest income sourced in the Channel Islands, the Isle of Man and the British Crown colonies and dependencies? Is there a distinction on whether this income is remitted to the U.K.? What about interest income of such taxpayers sourced in other Member States?

Ordinary residents of the UK and UK domiciled residents are taxed on interest income sourced in the aforementioned territories. UK residents who are not domiciled in the UK are taxed on such interest income in the UK on a “remittance basis”. The “remittance basis” is explained above in more detail. The “remittance basis” also applies to interest income sourced in other Member States by UK residents who are not domiciled in the UK. For UK resident but non-UK domiciled individuals, if the interest income is not remitted to the UK, it is not taxed in the UK.

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183 See Case T-85/03 R, Government of the Cayman Islands v European Commission paragraph 66.  
184 See Case T-85/03 R, Government of the Cayman Islands v European Commission paragraph 66.  
185 See response to Q1 in Part VI.
8) Interest income paid to legal entities subject to business or corporate income tax is outside the scope of the directive. In that respect what is the position of the Channel Islands, Man, the British Crown Colonies, the Netherlands Antilles, Andorra, Liechtenstein, Monaco and San Marino with respect to partnerships located in other Member States?

The UK’s treatment of a partnership in a prescribed territory depends upon its legal status under the law of that territory. A partnership is only treated as a residual entity where it is not possible to obtain official evidence that it falls into one of the categories which are excluded from being residual entities.\(^{186}\)

9) In this respect how should the construction be viewed whereby companies on the Isle of Man would be subject to a corporate income tax between 0 and 10%? Should such companies be disregarded, or should they be accepted as entities subject to a business tax for the application of the directive?

Such companies cannot be disregarded. They should be accepted as entities whose “profits are taxed under the general arrangements for business taxation”.\(^{187}\)

10) The directive is not applicable to interest payments made to legal entities subject to general business taxation. What do we do with the problem of interest payments to hybrid entities (such as partnerships) which in the country of source are subject to business tax, but subject to personal income tax in the country of residence? Should there be a rule on uniform interpretation under the directive and what would be the impact of such rule in non E.U. jurisdictions like CH, Andorra, Liechtenstein, Monaco and the British and Dutch dependencies?

The UK Guidance pertaining to partnerships in prescribed territories states that the treatment of a partnership in a prescribed territory depends on its legal status in the country in which it is established. Such a partnership is treated as a residual entity only if there is no official evidence available to

\(^{186}\) See Savings Income Reporting Guidance Notes V.4 paragraph 228.

\(^{187}\) See ISD article 4(2)(b) and Regulation 4(1)(b) of The Reporting of Savings Income Information Regulations 2003.
show that it falls into one of the categories which are excluded from being residual entities.\textsuperscript{188}

A uniform rule specifying whether a partnership is transparent or not would have deeply impacted upon Member States’ competence in the area of direct taxation. Clearly, the ISD’s achievement has been the implementation of a minimum standards harmonisation directive in an area of where the Member States’ ability to tax their residents can be better achieved as a result of the implementation of the ISD, but where the Member States retain the capacity to choose their tax rates and design their tax systems in the way they choose, subject to compliance with Community law. Similar problems of “matching” would occur if there was a single rule determining the status of partnerships in the specified third countries where domestic rules differed as to partnership treatment from the domestic rules of the beneficial owner’s Member State of residence. Having a single “uniform” method of interpretation might have proved too difficult to obtain the agreement of the Member States to the ISD. A uniform approach of some kind however, might provide a better solution at some stage in the future but it is questionable whether the Member States will be likely to agree to such a solution given the disparities in their respective tax systems on this issue.

\textbf{11)} Unlike the other directives, the interest savings directive neither contains a specific anti-abuse clause nor a reference to national or treaty anti-abuse provisions. Does this in your view mean that Member States are not entitled to apply their normal anti-abuse provisions in particular to tax jurisdictions with low or no taxation outside the E.U., like the Channel Islands, Man the British Crown colonies and all the other small tax jurisdictions?

The ISD is a minimum standards directive concerning exchange of information which will enable residence States to have a better picture of their residents’ cross-border interest savings income. The question whether Member States can or cannot apply their normal anti-abuse provisions

\textsuperscript{188} See Savings Income Reporting Guidance Notes V.4 paragraph 228.
does not enter the picture – because the directive merely concerns exchange of information or withholding of tax in its absence. The ISD merely seeks to establish a framework that will allow Member States to tax the interest savings income of their residents that originates in certain prescribed territories. The lack of an anti-abuse clause in the ISD does not result in Member States being unable to apply their normal anti-abuse provisions.

12) In the above case would the withholding tax countries still be entitled to tax the interest in the source country, when paid to such entity in a non- or low tax jurisdiction outside the E.U., on the basis of its national anti-avoidance provisions?

N/A

13) In that respect, what is the exact impact of the recently concluded treaty between the Isle of Man and the Netherlands? Presumably it would mean that dividends form a (0-10%) Man company would benefit from the participation exemption and that interest paid to a Man company would not be taxed in the Netherlands and not be subject neither to source tax nor to “automatic” exchange of information formalities. What is the purpose of this arrangement in connection with the “arrangement” (Rijksregeling) between the Kingdom of the Netherlands and the Netherlands Antilles?

The Netherlands and the Isle of Man entered into a Mutual Understanding on the Application of the Participation Exemption on the 12th October, 2005 (“Mutual Understanding”). Under that Mutual Understanding, the Competent Authorities of the Isle of Man and the Netherlands have agreed that for the application of the participation exemption with respect to an Isle of Man subsidiary of a Dutch parent company, the “subject to tax clause” shall, “if all other conditions are met, be considered fulfilled, regardless of the applicable tax

189 Details are found on the following links:
http://www.gov.im/lib/docs/treasury/incometax/politicaldeclaration12oct05.pdf and
rate in the Isle of Man Income Tax Act 1970". Paragraph 3 of the Mutual Understanding notes that this mutual understanding will terminate on 31 December 2006.

\[190\] See paragraph 1 of the Mutual Understanding on the Application of the Participation Exemption between the Netherlands and the Isle of Man dated 12th October 2005.
## ANNEX I

Table showing the implementation of the ISD in the UK by The Reporting of Savings Income Information Regulations 2003 as amended by The Reporting of Savings Income Information (Amendment) Regulations 2005.

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191 This Table is substantially reproduced from Annex C of XXXX.
192 SI 2003 No. 3297.
193 SI 2005 No. 1539.
<p>| Article 4.4 | Handling of Residual Entity by Member State | Transposition not necessary |
| Article 4.5 | Entities in Sweden and Finland excepted from being a legal person | Reg 4(2) |
| Article 5(a) | Definition of Competent Authority | Transposition not necessary |
| Article 5(b) | Definition of Competent Authority | Reg 9(11) |
| Article 6.1 | Definition of Interest Payment | Reg 8(1) |
| Article 6.1(a) | Definition of Interest Payment | Reg 8(1)(a) Reg 8(2) |
| Article 6.1(b) | Definition of Interest Payment | Reg 8(1)(b) Reg 8(2) Reg 8(3) |
| Article 6.1(c) | Definition of Interest Payment | Reg 8(1)(c) Reg 8(2) Reg 8(11) |
| Article 6.1(d) | Definition of Interest Payment | Reg 8(1)(d) Reg 8(11) |
| Article 6.1(last para.) | Option to separate rolled up interest from rolled up income | Option not exercised |
| Article 6.2 | Regarding Article 6.1(c) agents handling lack of information on proportion of income deriving from interest | Reg 8(4) |
| Article 6.3 | Regarding Article 6.1(d) agents handling lack of information concerning percentage of assets and amount of income realised | Reg 8(6) |
| Article 6.4 | Definition of Interest Payment | Reg 4 Reg 6 Reg 12 |
| Article 6.5 | Option to annualise Interest Payments over time | Option not exercised |
| Article 6.6 | Option of exclusions from Definitions of Interest Payments | Reg 8(5) Reg 8(8) Reg 8(9) |
| Article 6.7 | Amendment of 40% to 25% from 01.01.2011 | Reg 8(7) |
| Article 6.8 | Determination of percentages referred to in Article 6 | Reg 8(10) |
| Article 7 | Territorial Scope | Transposition not necessary |
| Article 8.1 | Information required to be reported by agent | Reg 10(1) Reg 12(1) Reg 13(1) |
| Article 8.1(a) | Information required to be reported by agent | Reg 10(2)(b) Reg 10(2)(c) Reg 12(2)(d) |
| Article 8.1(b) | Information required to be reported by agent | Reg 10(2)(a) Reg 12(2)(b) |
| Article 8.1(c) | Information required to be reported by agent | Reg 10(2)(d) Reg 12(2)(e) |
| Article 8.1(d) | Information required to be reported by agent | Reg 10(2)(e) Reg 12(2)(f) |
| Article 8.2 | Information required to be reported by agent | Reg 13(1) |
| Article 8.2(a) | Income information required by Paying Agent | Reg 13(2)(a) |
| Article 8.2(b) | Income information required by Paying Agent | Reg 13(2)(b) |
| Article 8.2(c) | Income information required by Paying Agent | Reg 13(2)(c) |
| Article 8.2(d) | Income information required by Paying Agent | Reg 12(2)(a) |
| Article 8.2(e) | Option not to exercise | Option not exercised |
| Article 9.1 | Automatic Exchange of Information | Transposition not necessary |
| Article 9.2 | Automatic Exchange of Information | Not transposed in these Regs. |
| Article 9.3 | Automatic Exchange of Information | Not transposed in these Regs. |
| Article 10.1 | Transitional Period | Transposition not necessary |
| Article 10.2 | Transitional Period | Transposition not necessary |
| Article 10.3 | Transitional Period | Transposition not necessary |
| Article 11.1 | Withholding Tax | Transposition not necessary |
| Article 11.2(a) | Withholding Tax | Transposition not necessary |
| Article 11.2(b) | Withholding Tax | Transposition not necessary |
| Article 11.2(c) | Withholding Tax | Transposition not necessary |
| Article 11.2(d) | Withholding Tax | Transposition not necessary |
| Article 11.2(e) | Withholding Tax | Transposition not necessary |
| Article 11.3 | Withholding Tax | Transposition not necessary |
| Article 11.4 | Withholding Tax | Transposition not necessary |
| Article 11.5 | Withholding Tax | Transposition not necessary |
| Article 12.1 | Revenue Sharing | Transposition not necessary |
| Article 12.2 | Revenue Sharing | Transposition not necessary |
| Article 12.3 | Revenue Sharing | Not transposed in these Regs. |
| Article 12.4 | Revenue Sharing | Transposition not necessary |
| Article 13.1 | Exceptions to Withholding Tax Procedure | Transposition not necessary |
| Article 13.1(a) | Exceptions to Withholding Tax Procedure | Transposition not necessary |
| Article 13.1(b) | Exceptions to Withholding Tax Procedure | Transposition not necessary |
| Article 13.2 | Exceptions to Withholding Tax Procedure | Not transposed in these Regs. |
| Article 13.2(a) | Exceptions to Withholding Tax Procedure | Transposition not necessary |
| Article 13.2(b) | Exceptions to Withholding Tax Procedure | Transposition not necessary |
| Article 13.2(c) | Exceptions to Withholding Tax Procedure | Transposition not necessary |
| Article 14.1 | Elimination of Double Taxation | Not transposed in these Regs. |
| Article 14.2 | Elimination of Double Taxation | Not transposed in these Regs. |
| Article 14.3 | Elimination of Double Taxation | Not transposed in these Regs. |
| Article 14.4 | Elimination of Double Taxation | Not transposed in these Regs. |</p>
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