



The EU Saving Directive in the EU and in Switzerland

Luxembourg, 20 May 2003
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- “Interest” under the EU Saving Directive versus the notion of interest under the Agreement between Switzerland and the EU providing for measures equivalent to those laid down in the EU Saving Directive
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- “Paying agent” under the EU Saving Directive versus “the Swiss concept of paying agent”
- Conclusion

Introduction (1)

- Purpose of the proposed EU Savings Tax Directive (“EU Directive”)
 - Measure to tackle harmful tax competition
 - Ensure a minimum taxation on interest payments made to individuals resident within the EU
 - Ensure taxation by (1) exchanging information (“exchange of information”) or (2) applying a withholding tax (“paying agent tax system”)

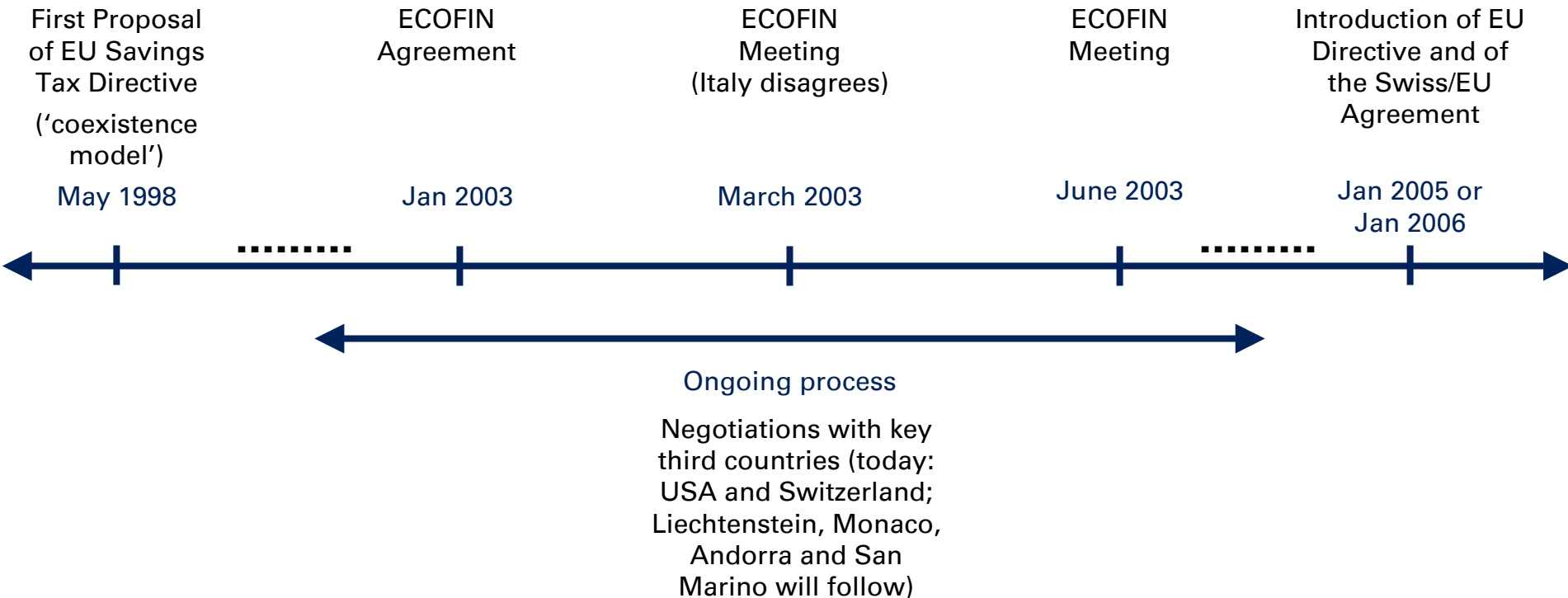
Introduction (2)

- Purpose of the proposed Agreement between Switzerland and EU providing for measures equivalent to those laid down in the EU Saving Directive (“Swiss/EU Agreement”)
 - Equivalent measures to tackle harmful competition in EU
 - Ensure a minimum taxation on non-Swiss interest payments
 - Ensures taxation by (1) applying a retention or (2) exchanging information

Introduction (3)

- Switzerland will adopt the EU Directive and become a collecting agent for the EU
- Focus is: withholding tax and not exchange of information
- Switzerland will not completely adopt the concept of the EU Directive
- However Switzerland will adopt the loopholes of the EU Directive

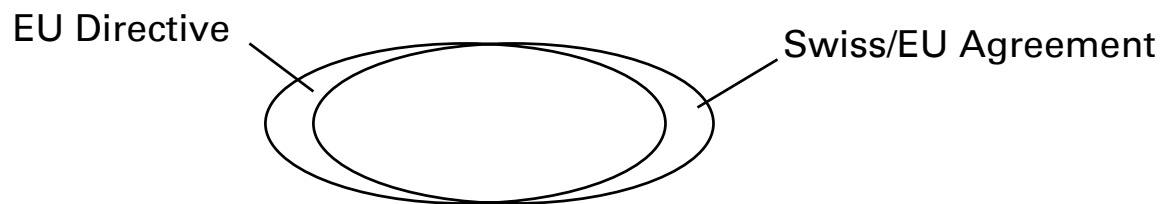
Introduction (4)



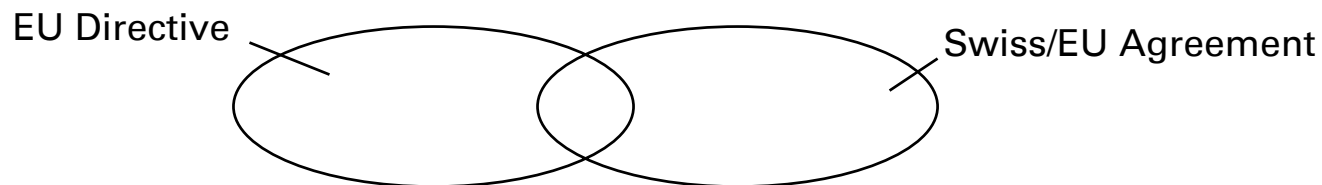
EU Directive has to be converted into national legislation and applied accordingly

Introduction (5)

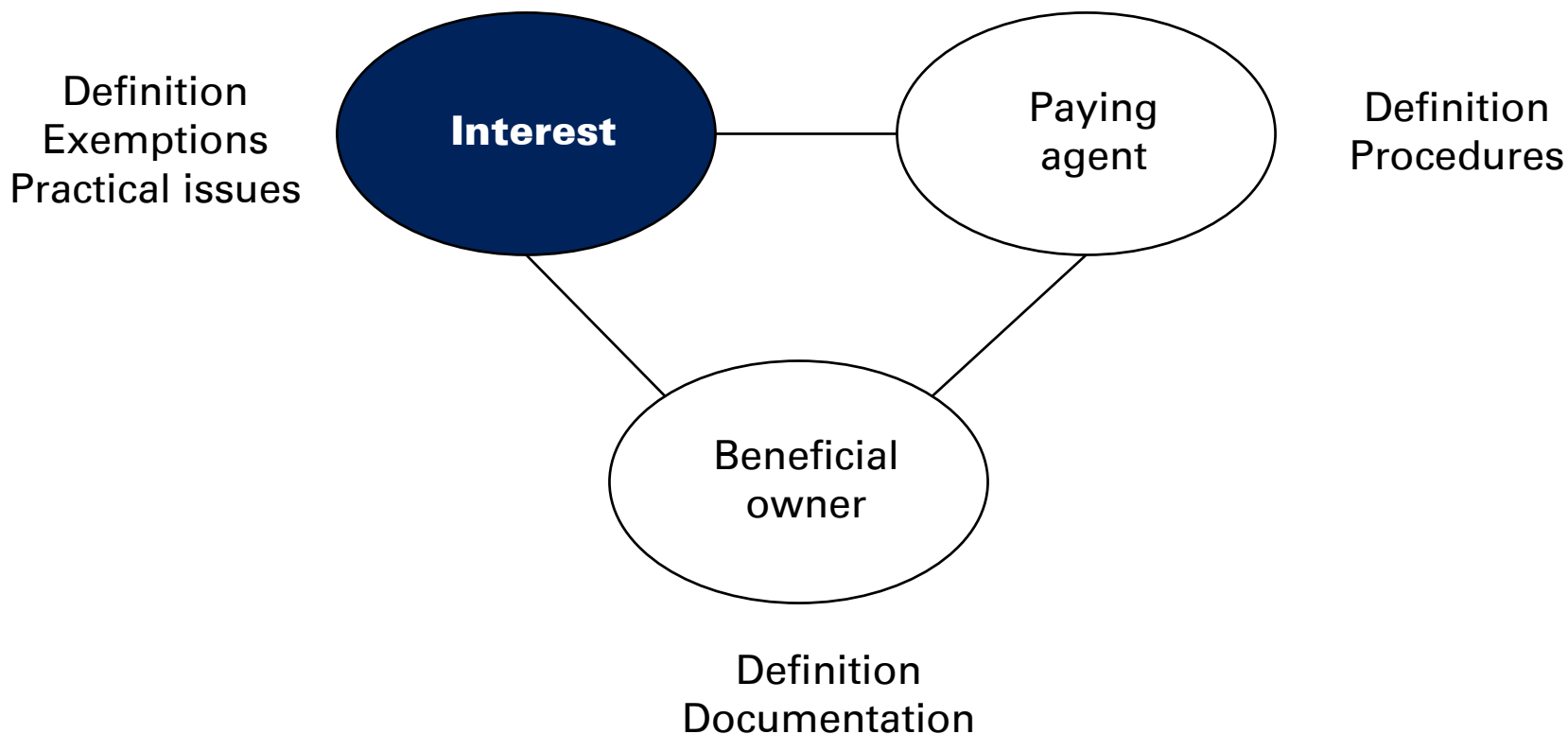
How do they fit together?



or rather?

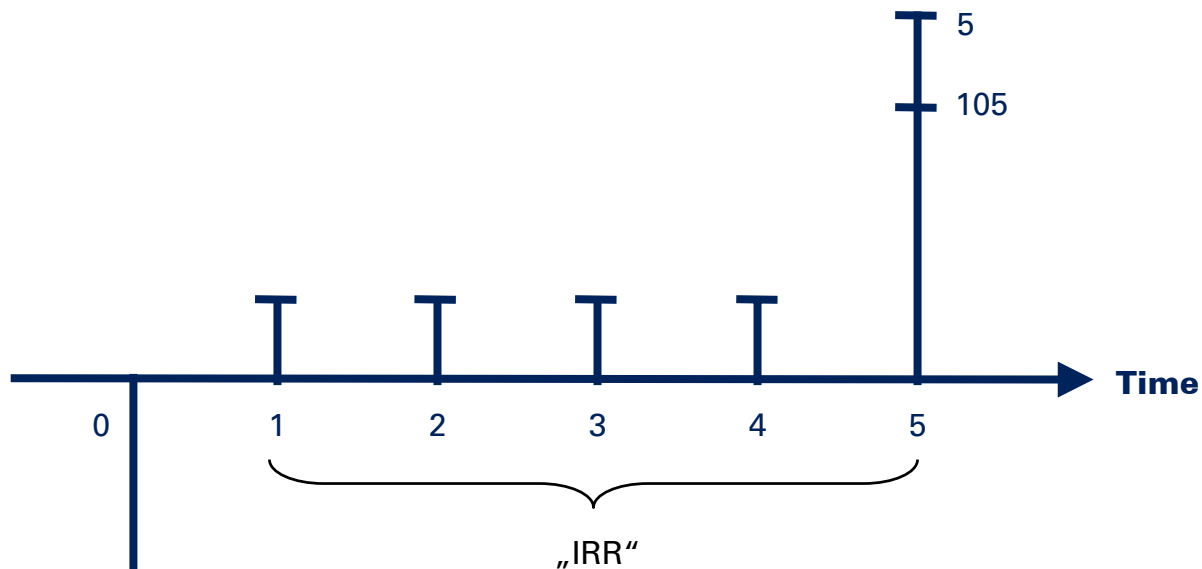


The Bermuda triangle



Interest Financial concept

- Interest = economic return on a money debt



→ **Variables:**

- Issue acquisition price
- Redemption price
- Coupon
- Duration

} IRR = pure interest rate on a money debt

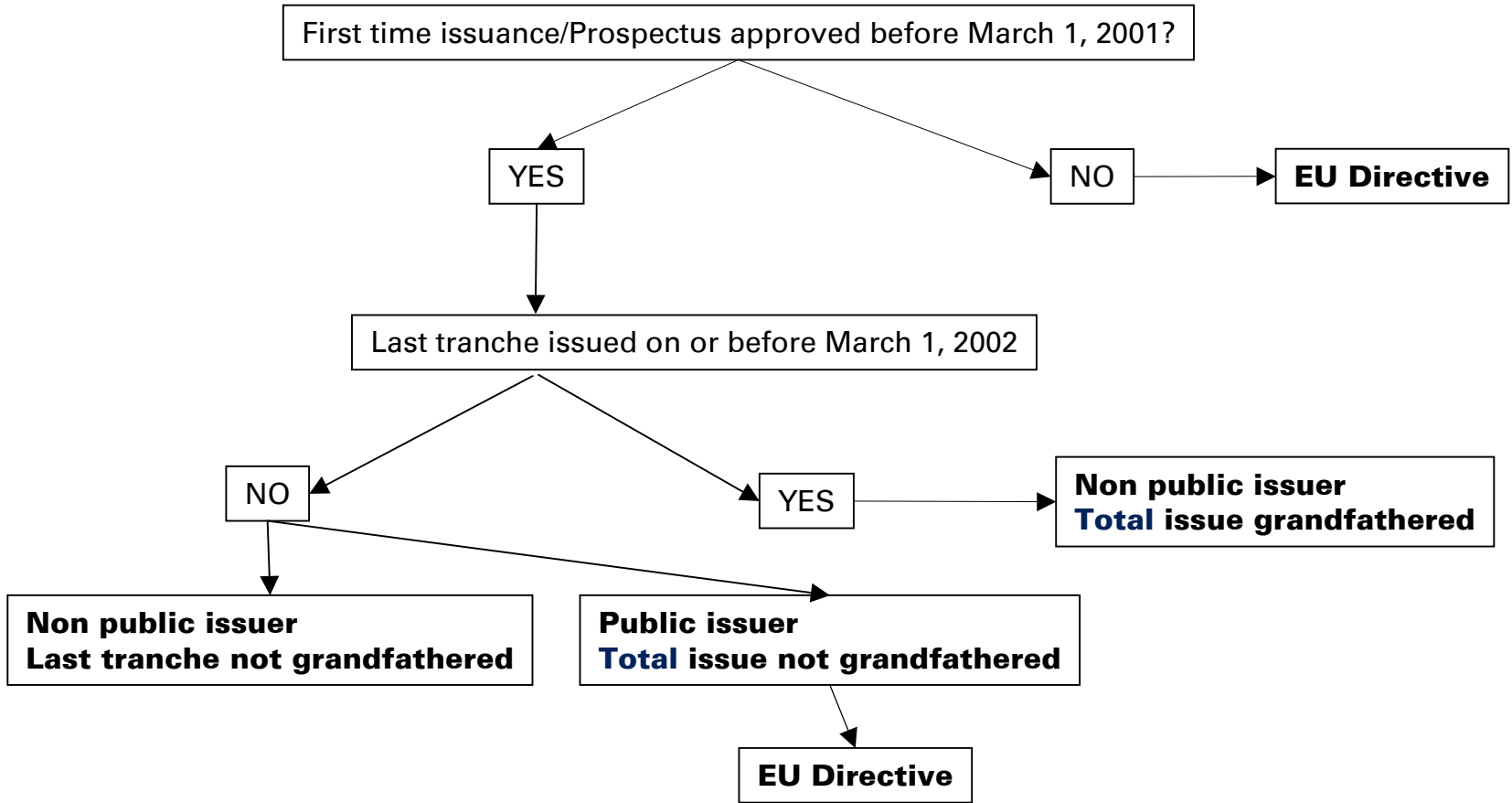
Interest

EU Directive definition of interest



<u>Pure Interest</u>	<u>„Hidden“ Interest</u>	<u>Distributed Indirect Interest</u>	<u>„Hidden“ Indirect Interest</u>
a) What: Interest relating to debt-claims of every kind paid or credited to an account	a) What: Interest accrued / capitalised	a) What: Income deriving from interest payments („look through“)	a) What: Income realised through UCITS or similar entities that invest directly or indirectly more than 40% of their assets in debt-claims of any kind („40/60 rule“)
b) When: When paid or credited to an account	b) When: at sale / refund / redemption of debt-claims	b) When: distributed by UCITS or similar entities	b) When: upon sale / refund / redemption of shares or units in UCITS or similar entities

Interest Grandfathering for bonds



Grandfathering will expire in 2010
except for bonds with gross-up and early redemption clauses

Interest

Interest, „to be or not to be“

Products not covered

- Shares (dividends, capital gains)
- Derivative financial instruments
- Insurance products

Products under discussion?

- Manufactured payments as a result of securities lending or similar transactions
- Guaranteed products

Interest Swiss/EU Agreement

- Definition of interest will generally be taken over
 - Including:
 - Fiduciary deposits
 - Swiss Affidavit funds
 - But excluding:
 - Interest from Swiss sources
 - Interest on private loans
 - Interest on loans between associated companies
(*Directive on interest and royalty payments between associated companies*)

Interest

Practical issues (1): accrued interest

- Double taxation if WHT is due on the accrued interest and on the coupon (?)
- Accrued interest where the acquisition date is not known (e.g. there is a transfer from another account) (?)
- Accrued interest where the acquisition date is not precise (e.g. FIFO, LIFO) (?)
- Separation of „interest“ and „capital gains“ (?)
- Gain as a result of variation of interest free rate is perceived as a „taxable interest income“ (?)

Interest

Practical issues (2): specific rules for investment funds

- “Look through” for distributing funds only
 - Determine the interest income received by the fund
 - Same proportion used to qualify distributed income as interest
 - Only the portion of interest income is subject to WHT
 - If no information is available: 100% distribution deemed to be interest

Interest

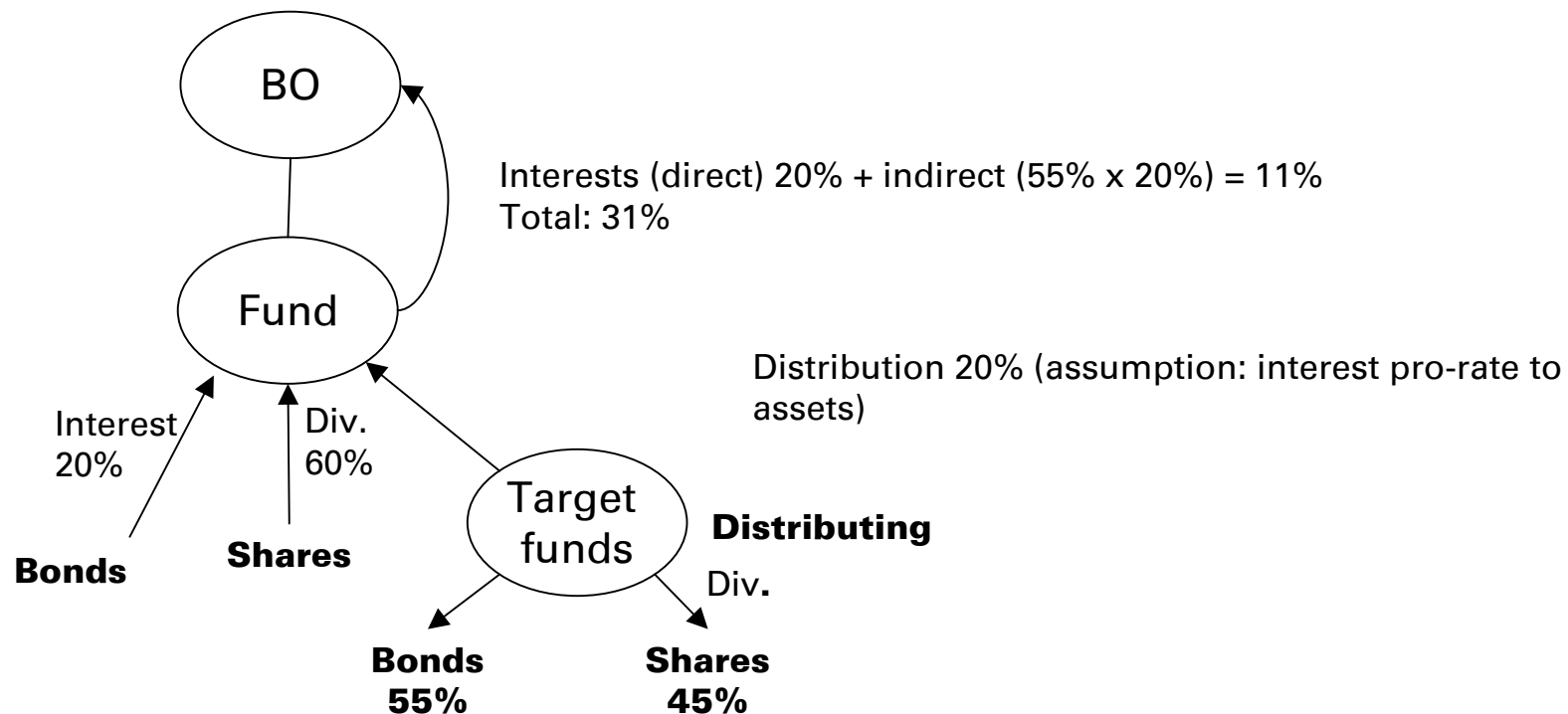
Practical issues (3): specific rules for investment funds

- 40/60 rule for capitalising and distributing funds upon sale or redemption
 - Based on investment policy defined in the prospectus (or portfolio composition)
 - Look at the assets in the fund
 - Direct or indirect investment in debt claims $>$ or $=$ 40%
 - Income realised on sale, refund or redemption = interest
 - Grandfathered bonds are excluded for 40/60 rule*
- If no information is available: fund deemed to invest more than 40% in interest bearing products
- Option for the “look through” upon sale available to EU members states

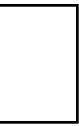
Interest

Practical issues (4): distributing funds

- 40/60 rule does **not** apply, **except in case of sale/redemption**
- „Look through” (part of interest included in the distribution of the fund)



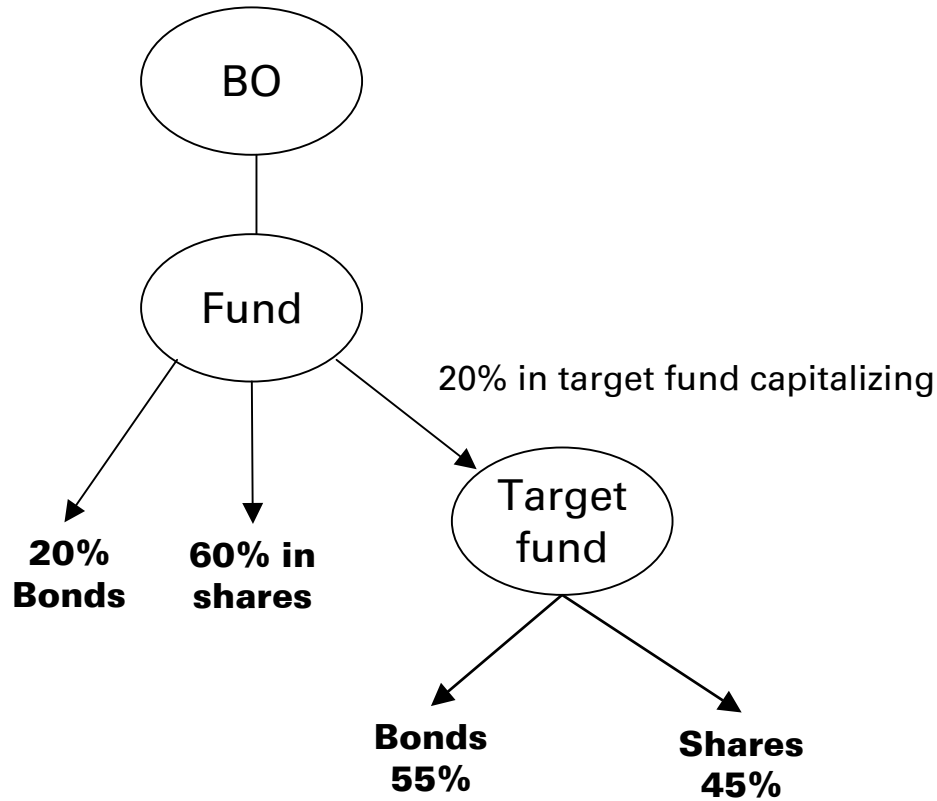
- 31% of the distribution is interest (if information available)
- **Full amount is interest if target fund sold (Bonds > 40 %); but option**



Interest

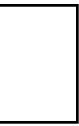
Practical issues (5): capitalising funds

- 40/60 rule applies



Is the fund investing more than 40% of its assets in debt-claims? Directly 20% bonds
 Indirectly 20% x 55% bonds = 11% \Rightarrow The 40% threshold is not met!

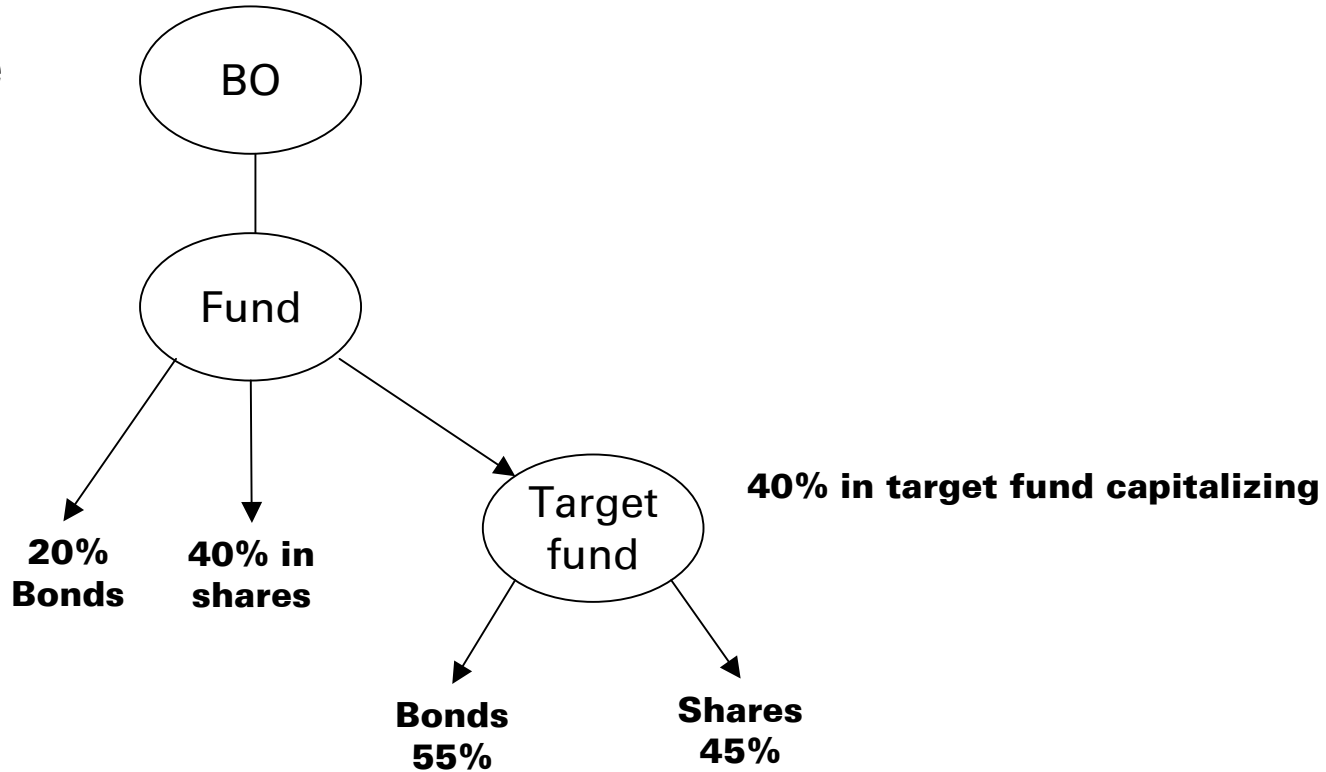
} 31%



Interest

Practical issues (6): capitalising funds

- 40/60 rule

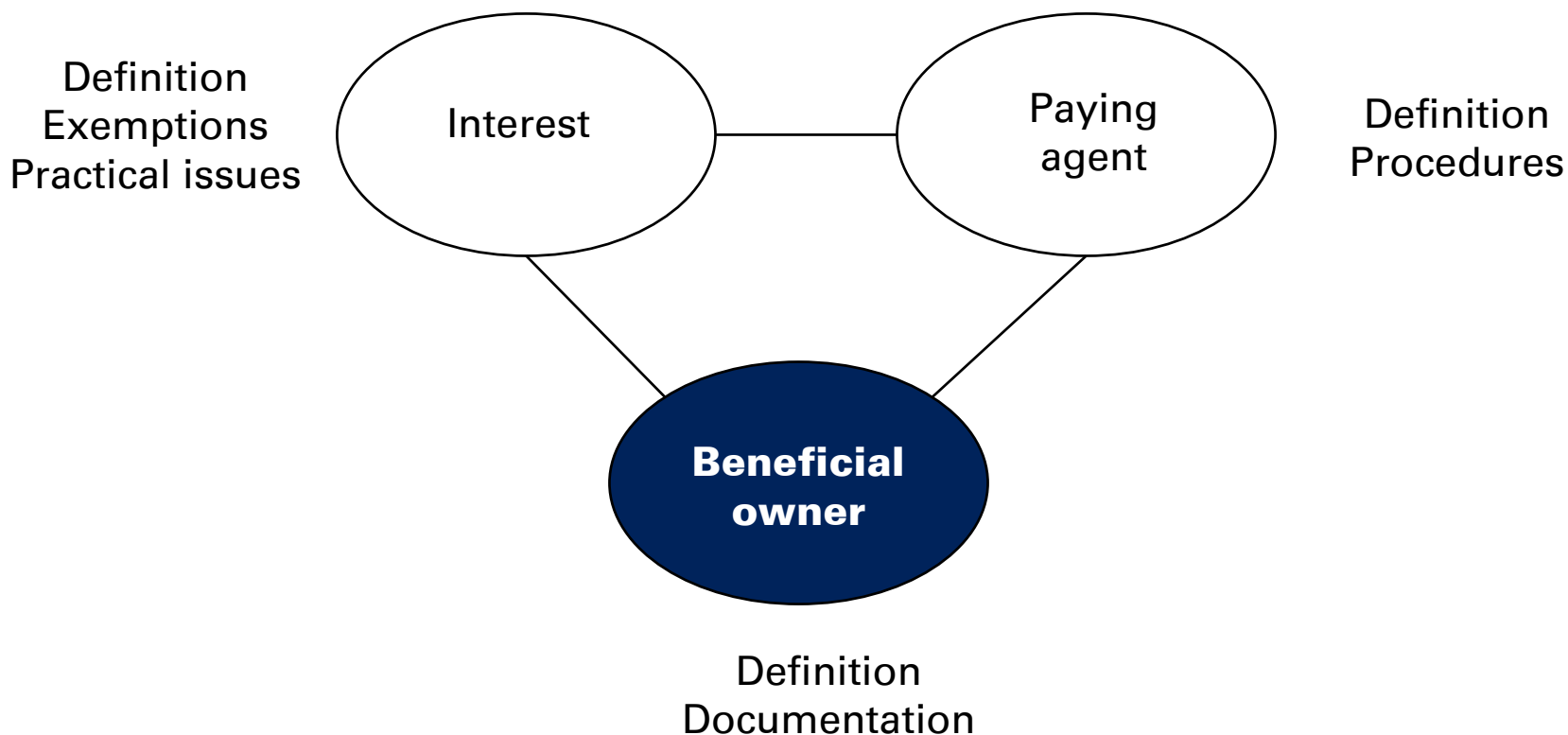


Is the fund investing more than 40% of its assets in debt-claims? Directly 20% bonds

Indirectly 40% x 55% bonds =22% \implies The 40% threshold is met!

42%

The Bermuda triangle



Beneficial owner Definition under the EU Directive

- For the purpose of the EU Directive „beneficial owner“ means:
 - ⊕ Individual
 - ⊕ Receiving an interest or to whom a payment of interest is secured
 - ⊖ An individual is not the beneficial owner if he can provide evidence that the interest received or secured is not for his own benefit



Beneficial owner

Identification and documentation requirements under the EU Directive (1)

- An individual account holder receiving an interest is the beneficial owner if:
 - ⊖ The paying agent does not have „information suggesting that the individual may not be the beneficial owner“
 - ⊕ If the paying agent is unable to identify the beneficial owner, the individual in question is the beneficial owner

- ⚠ Treatment of Trusts, Partnerships and Joint Accounts?



Beneficial owner

Identification and documentation requirements under the EU Directive (1)

- For accounts opened **before 1 January 2004**
- Identification and documentation requirements rely on the EU and **local KYC rules** (i.e. „information at its disposal“)



Beneficial owner

Identification and documentation requirements under the EU Directive (2)

- For contractual relations entered **on or after 1 January 2004** :

- ⊕ Passport, ID (Name and address)

- Other documentary proof if the passport/ID does not include an address

- ⚠ Certificate of residence for EU nationals resident outside the EU

- ⊕ TIN

- Date and place of birth of the individual if TIN not available

Beneficial owner Definition under the Swiss/EU Agreement

- Beneficial owner under the Swiss/EU Agreement should have the same meaning as it has under the EU Directive
 - „Economical owner“ as stated on Form A is basically not relevant

⚠ Information included on Form A may be perceived as being an „information suggesting that the individual is not the beneficial owner“

⚠ Treatment of Trusts, Partnerships and Joint Accounts?

Beneficial owner

Identification and documentation requirements under the Swiss Agreement

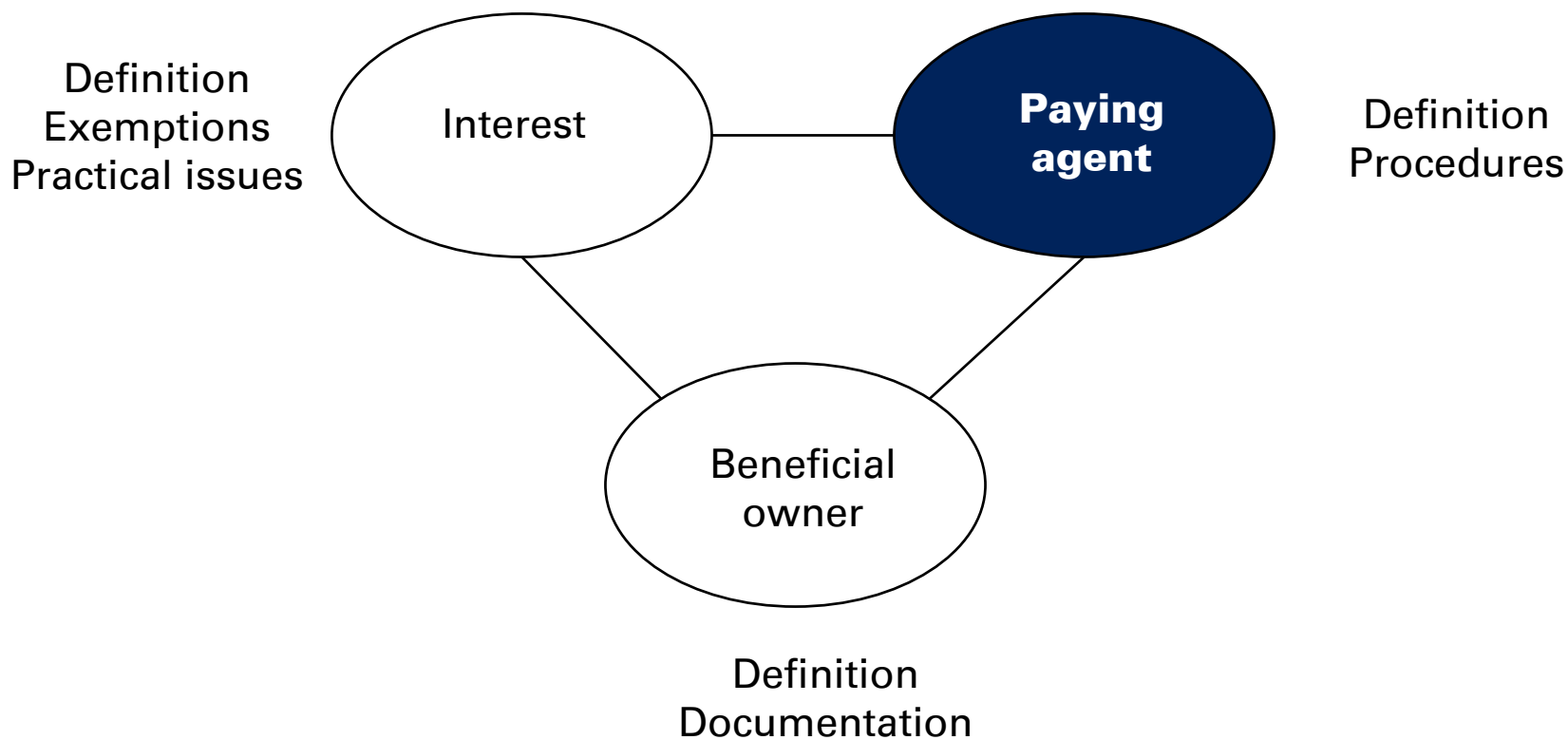
- For accounts opened **before 1 January 2004** and **on or after that date**,
- The paying agent should rely on the **Swiss KYC rules**:

→ No collection of TIN

→ No due diligence of addresses for „EU Expatriates“

→ No „curing requirements“ for „personally known accounts“

The Bermuda triangle



Paying agent

Definition under the EU Directive (1)

Who will have to apply WHT / exchange of information?

- The paying agent has a “double” definition
- The one who **pays** the interest income to the ultimate beneficial owner

And (exceptionally)

- The one who pays the interest income to another paying agent, being qualified as a **residual entity**
 - i.e. a **collective investment vehicle** which is not
 - a legal entity,
 - subject to corporate taxation or
 - compliant with UCITS III

Paying agent Swiss/EU Agreement

- Broad definition of the EU Directive likely not to be taken over into the Swiss/EU Agreement
- Definition restricted to Swiss banks, securities dealers and persons acting “in the course of their business”
- No “Back up” control for residual entities by the higher level paying agent

Paying agent Practical issues (1)

- Implementation will create expenses for Swiss paying agents:
 - Separation of retention / exchange of information
 - Systems changes
 - Client identification and documentation
 - Client mailing
 - Staff training
 - Administration
 - Country reporting (?)

Paying agent Practical issues (2)

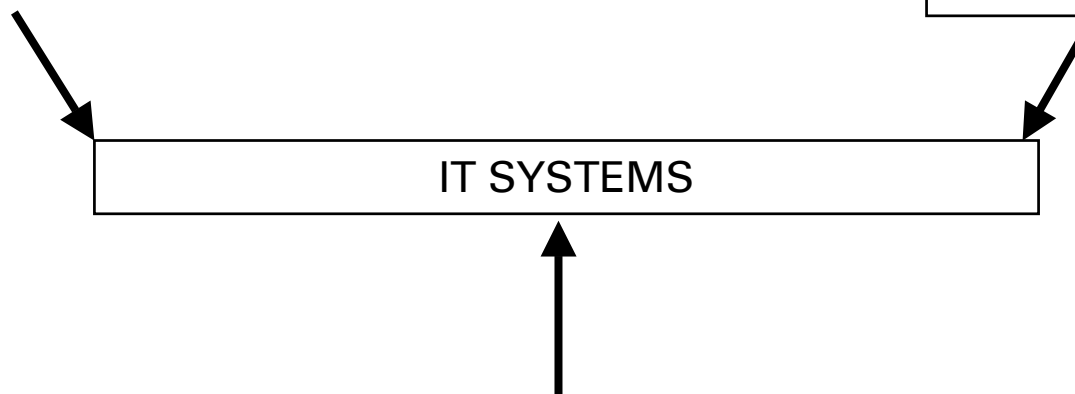
- Levying of the retention
 - Calculation
 - Declaration to federal tax authorities (self declaration and handing over of tax withheld)
 - Confirmation duty to clients
 - Additional duties for audit purposes (journal)?

- No retention if individual reporting is chosen
 - But administration and control

Paying agent Consequences

- Separation of individual/EU/beneficial owner
- Individual reporting / retention
- Declaration of retention
- Certificate / Reporting

Duties to identify
+
Duties to document



Tax rates of

- 01.01.05-31.12.06: 15%
- 01.01.07-31.12.09: 20%
- 01.01.10-?: 35%

Conclusion

What we anticipate:

