TAX JUSTICE **BRIEFING WITH POLICY RECOMMENDATIONS**

EUROPEAN UNION SAVINGS TAX DIRECTIVE

1. What is it?

1.1: The **EU Savings Tax Directive** was adopted to ensure the proper operation of the internal market and tackle the problem of tax evasion. It was approved in 2003 and came into effect on July 1st, 2005.

2. In what countries does it apply?

2.1: All EU member states

2.2: Dependent or associated territories of EU member states, being **Anguilla**, **Aruba**, **British Virgin Islands**, **Cayman Islands**, **Gibraltar**, **Guernsey**, **Jersey**, **Isle of Man**, **Montserrat**, **Netherlands Antilles**, and the **Turks and Caicos Islands**.

2.3: Other jurisdictions that have agreed to participate are **Andorra**, **Liechtenstein**, **Monaco**, **San Marino** and **Switzerland**.

2.4: **Singapore**, **Hong Kong**, **Macao**, **Bermuda** and **Barbados** have been asked to participate and have so far declined to do so.

3. How does it work?

3.1: The main method is exchange of information between tax authorities. However, an alternative has been allowed for some countries, which is intended to be provisional.

3.1.2: The automatic exchange of data on interest paid has been agreed by all member states except **Austria**, **Belgium** and **Luxembourg**. This means that details of interest paid to a person who is resident in another EU member state is automatically sent to that other member state annually. This enables tax declarations by the person receiving the interest to be checked for accuracy, and allows each state to collect its own taxes appropriately.

3.1.3: As a temporary measure, the option of a withholding tax is allowed, and has been agreed for Austria, Belgium, Luxembourg and in all the non-EU jurisdictions that participate. This allows the taxpayer to choose either to have data on the interest paid to them sent to their country of normal residence, or to have tax deducted at source from the interest payment made to them. If they choose to be taxed at source, details of the interest paid are not exchanged with their usual country of residence. The tax collected this way is shared between the country collecting it (25 per cent) and the country where the person earning that interest resides (75 per cent).

3.2: These options are significantly different. The first option ensures that the correct tax should be paid by the resident of a country in that country. The second option ensures only that a withholding tax is paid, which is likely to be lower (the rates are given below) than the full liability due in the recipient's country of residence. In addition, part of the benefit also goes to the country where the account is held, rather than that in which the recipient resides. For these reasons, the second option is not an effective measure to stop tax evasion, and has only been accepted as a temporary measure by the EU, which does eventually need to eliminate this option if the prevention of tax evasion is its objective.

4: Whom does it apply to?

4.1: Any individual who is resident in one EU country who has interest paid to them in another EU country or participating state. The **Paying Agents** (usually banks) are required to verify the residence of the **beneficial owner** of any interest they pay, under the regulations enacted by the country where the account is held, which must comply with the general principles of the EU law.

5: What does it apply to?

5.1: Interest paid to individuals resident in EU and other participating countries.

6: What are the tax withholding rates?

6.1: Tax is deducted at 15 per cent from 1st July 2005 until 30th June 2008.

6.2: Tax will be deducted at 20 per cent from July 1st 2008 until June 30th 2011.

6.3: From January 1st 2011 tax will be deducted at 35 per cent.

7: What has the impact been?

The impact of the EU STD has been modest to date. For example, in 2006 Jersey collected just £21.9 million of tax under the EUSD. Some £67 billion was on deposit from the EU in December 2006. Interest paid on those deposits probably exceeded £2.7 billion in that year and it is claimed that 50 per cent of all relevant accounts were subject to information exchange. A withholding of £21.9 million in that case suggests that only 11 per cent of all EU resident owned cash on deposit in Jersey is subject to the Directive, giving some indication of how easy it is to avoid. Some of the ways that this has been avoided is outlined below.

8: How has it been avoided?

8.1: The EU Savings Tax Directive has been easy to avoid. It is easy to avoid because `beneficial owner' in the EU law is defined as an individual.

8.2: It can be avoided by:

8.2.1: Placing the funds on deposit in the name of a limited company.

8.2.2: Transferring the sums on deposit into a trust or foundation. In these arrangements the funds on deposit are usually held by professional nominees on behalf of the beneficial owners. These arrangements are not covered by the Directive.

8.2.3: Moving the investment out of cash and into any other form of investment e.g. shares.

8.2.4: Putting the investment into an insurance "coat" or "wrapper": popular in many European countries.

8.2.5: Moving the sum deposited to a non-participating location such as Singapore or **Dubai**.

9: What is needed now to put it right?

9.1: Four actions are needed to remedy the defects in the EU Savings Tax Directive:

9.1.1: The withholding tax option should be removed so that information exchange is required in all cases;

9.1.2: The Directive should be extended to all legal entities, especially private companies and trusts;

9.1.3: The income covered should be extended to include all forms of investment income and insurance based products and not just interest on bank deposits;

9.1.4: The provisions of the Directive should be extended to places like Hong Kong, Singapore and Dubai which are currently marketing themselves on the basis of being outside this scheme and so available for use by tax evaders.

9.2: These actions should be taken immediately without waiting until the current transitional arrangements are supposed to expire in 2011. The EU should make it clear that it cannot accept economic cooperation with countries that refuse to accept these standards of disclosure. So far, the EU has been trying persuasion, although acceptance of the Directive has also been proposed as a condition in the current EU negotiations for an economic agreement with Singapore. Non-cooperating countries have far more to lose from a worsening of economic relations than the EU. It is time to take a strong line and insist that financial liberalisation also requires cooperation to enforce regulations, including taxes.

9.3: If these changes are made the resulting standard should be considered the template for negotiation of international agreements to help tackle tax evasion on a global basis.

10: What are the likely benefits from this?

10.1: The tax that might be recovered as a result of these changes is hard to estimate. However, for the UK alone, and based on data for investments held denominated in sterling in Jersey, Guernsey and the Isle of Man alone, the total tax loss from tax evasion is likely to be at least £3.6 billion a year.

10.2: This indicates the enormous scale of tax recovery likely from full reform of the EU Savings Tax Directive, and the ending of the cloak of secrecy provided by tax havens for banking, investment flows and the beneficial ownership of assets.

Suggested Further Readings

Tax Analysts, Offshore Explorations Project, available at www.taxanalysts.com