EU Savings Directive : recent developments

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Author: Antony Seely

Business & Transport Section

Concerns about the level of tax evasion across the EU by individuals concealing savings held in other countries lead to the European Commission publishing proposals in May 1998, to ensure taxpayers paid the tax due on 'cross border' interest payments (interest paid in one state to individuals resident in another).[1] Initially it was anticipated that banks, building societies and other financial institutions would be required to withhold tax at 20% on these payments or, as an alternative, provide the tax authorities with enough information about payments to ensure that they could be taxed on receipt. There was considerable opposition to an EU-wide withholding tax, particularly from the UK, for fear a tax would drive investors to other countries and significantly impact the City of London.

After protracted negotiations, European Finance Ministers reached political agreement in January 2003 on arrangements for the automatic exchange of information between national tax authorities. Three States with particular concerns over their national rules preserving bank secrecy - Austria, Belgium and Luxembourg - would operate a transitional withholding tax, until such time as arrangements for information exchange were agreed with other countries, such as Switzerland.[2] In June 2003 the European Council formally adopted the new Savings Directive (Council Directive 2003/48/EC), though it did not come into force until 1 July 2005 – a delay caused by the difficulties in agreeing equivalent arrangements with other countries where EU citizens were likely to hold savings, such as Switzerland, Liechtenstein and the Channel Islands.

From its inception there have been concerns that the Directive has been far less successful at preventing tax avoidance as first hoped.[3] The Commission is required to assess its operation every three years, and, on completing the first of its reviews, published proposals to amend its scope in November 2008.[4] The Commission had found that it was "relatively easy for individuals to circumvent the rules", having their savings held by interposed legal persons – such as trusts – or put into innovative financial vehicles, instead of classic savings accounts. A second review completed in March 2012 reinforced these findings,[5] but it has

1 EC draft 8781/98, 20 May 1998

2 HC Deb 27 January 2003 cc 607-8W; European Commission MEMO/03/13, 22 January 2003

3 "Offshore investors beat EU directive to avoid tax", *Financial Times*, 8 July 2006

4 European Commission press notice IP/08/1697, 13 November 2008. Details on this ongoing work are collated on the Commission's site.

5 HM Treasury, *Explanatory memorandum on … COM(2012)65 final*, 31 March 2012 para 4

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proved very difficult for Member States to reach unanimity changing the scope of the Directive. In the meantime there has been moves by individual countries, including the UK, to tackle this type of evasion by making separate agreements with the Swiss authorities that, controversially, preserve aspects of Swiss banking secrecy. Some critics have suggested that this type of unilateral action has made it harder to reach agreement on revising the Directive,[6] though the UK Government, for one, has argued that this is a sensible approach, as an international agreement on information sharing is not likely in the near future.[7]

This note looks at these recent developments; a second note provides some background to the genesis of the original directive.[8]

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1 Initial evaluation of the Savings Directive

One year after the Savings Directive had come into force there was considerable speculation that taxpayers were finding it easy to avoid its provisions. Several territories that had agreed to impose a withholding charge – rather than exchange information on bank accounts – reported collecting relatively small sums from EU citizens: Switzerland reported receipts of just £69m, and, as the *Financial Times* reported, 'paltry amounts' had come from other financial centres outside the EU.[9] Apparently many savers had put funds into portfolio bonds, run by insurance companies – putting them outside the scope of the Directive – or into deferred interest accounts – which would accumulate interest during their lifetime, and only pay out at the taxpayer's convenience when they decided to close the account. Other taxpayers had invested in creating discretionary trusts and companies to escape the reporting requirements placed on financial institutions holding their savings.[10]

An editorial in the *Financial Times* argued that these difficulties were due to the fact that the Directive was the creation of an "uneasy compromise": the withholding tax model which underpinned the rules "harks back to the days when the EU's weapons of choice were regulation and harmonisation. In a globalised economy with free movement of capital, this old-think approach is outdated and ultimately futile."[11] Member States had agonised over an agreement that would meet concerns over taxpayer evasion, *as well* as concerns about 'tax competition' between States to attract investment *and* a potential capital flight to centres outside

[6] For example, "Editorial: Arrested progress", *Financial Times*, 5 April 2012
[7] For example, the Exchequer Secretary, David Gauke, when the provisions to establish the UK-Swiss agreement were debated at the Committee stage of the Finance Bill (PBC 26 June 2012 c638).
[8] *EU Savings Directive : background history*, SN522, 16 October 2012
[9] "Loopholes undermine EU offshore tax law", 6 July 2006
[10] "Legal roads you can take to avoid the taxman's net", *Financial Times*, 15 July 2006
[11] "Editorial: A resounding tinkle", *Financial Times*, 6 July 2006

the EU – aims which cut across each other. While the EU had slowly progressed to a final deal, banking centres had innovated aggressively to attract customers:

> Why has the EU largely failed in its objective to catch the tax avoiders? The answer lies partly in the tortuous way in which the law was drafted and partly in the capacity of the offshore banks to develop their business models to deal with new threats. The EU savings tax was conceived in the early 1990s but its gestation was long and painful. It had to be agreed unanimously by all 25 EU member states, with bilateral agreements with non-members such as Switzerland. Gordon Brown, Britain's chancellor of the exchequer, fought for several years against the plan for a withholding tax, claiming it would drive international bond business from the City of London. Instead he pressed for a system based on the exchange of data on offshore savings between governments: the home state of the tax avoider would levy the savings tax ...
>
> Eventually a hybrid deal was reached in which most EU countries agreed to exchange information on income from savings interest. However, countries that cherished banking secrecy - including Luxembourg and non-EU jurisdictions such as Switzerland and Liechtenstein - agreed instead to levy a withholding tax of 15 per cent, eventually rising to 35 per cent. The identity of EU citizens hiding savings in these countries would not be passed on to the taxman in their home country. By the time the tax was put in place in July last year, it was hardly watertight. EU officials speak of "appalling" translation errors as the English version of the text was rendered into French and then back into English. Loopholes were inserted, including the glaring exemption from the tax of trusts and foundations. "The amount raised from withholding taxes in these offshore centres is tiny, but not surprising," admits one EU official.
>
> Meanwhile, countries such as Switzerland were gearing up for the challenge as they had done many times before. They had already been forced to adapt their business models to comply with tougher rules on money laundering. Large cash deposits, for example, would attract considerable suspicion today ... Evidence suggests that the banks have … taken the EU savings tax in their stride. The very wealthy have been counselled on the merits of setting up foundations or creating a company structure to get around the rules. For the merely rather rich, advice has centred on selling investments that would be taxed, such as eurobonds, in favour of other vehicles. "The EU designed this directive," says James Nason of the Swiss Bankers' Association. "Switzerland implemented equivalent measures under its separate agreement with Brussels and these are the results."[12]

The original Directive required the Commission to review its operation every three years, and to facilitate this the Commission established a 'working group' from European trade bodies, to take evidence on possible reforms.[13] Their efforts were galvanised by the efforts of the German tax authorities, who in late 2007 had discovered information on 1,400 anonymous trusts set up by one bank in Liechtenstein, resulting in a series of raids on German account holders; crucially the authorities had been empowered, not by any provisions of the Directive, but by data obtained from a former bank employee-turned-paid-informer.[14]

[12] "Brussels outfoxed as Europe's tax havens stay one step ahead", *Financial Times*, 4 August 2006

[13] PriceWaterhouseCoopers press notice, *Savings Directive review – EC seeing views from expert group and Member States*, 10 April 2007

[14] "Trounced on tax: raids aim to halt Europe's havens", *Financial Times*, 6 March 2008. In light of this, European Finance Ministers welcomed plans by the Commission to bring forward their review of the Directive (HC Deb 3 April 2008 c66WS).

In April 2008 the Commission published interim findings, which found anecdotal evidence that EU residents circumvented the Directive in two ways:

> (1) making use of intermediate investment vehicles leaving them outside the current purely formal definition of beneficial owner, and/or
>
> (2) selecting for their portfolio financial/investment products which do not fall within the scope of the Directive, such as, for instance, products whose income remains outside the definition of interest payment.[15]

Although this diagnosis might seem uncontroversial, given earlier criticisms, the Commission noted that any workable solution would have to meet a number of constraints – with regard to compliance costs, timing, and the limited geographical range of any reshaped Directive:

> The Savings Taxation Directive essentially relies on paying agents for the execution of its provisions … Member States should therefore be prepared to explore solutions whereby any additional administrative burden for making the provisions of the Directive more effective would be placed as far as possible on the tax administrations … or on market operators that are currently less involved, rather than on those market operators (such as banks and asset managers) that already make an important contribution to the functioning of the Directive.
>
> The time constraint should also be mentioned: the rate of the withholding tax levied by the three Member States entitled to the transitional regime of Chapter III of the Directive (as well as by the non-EU territories and countries applying the same or equivalent measures), which is currently 15%, will increase to 20% on interest payments made on or after 1 July 2008, and to 35% on interest payments made on or after 1 July 2011. Any delay in finding an agreement between Member States (and possibly with non-EU territories and countries), on solutions for ensuring fairer and more consistent coverage of the savings taxation measures, could result in increased market distortions between comparable products and vehicles in these withholding tax countries.
>
> Another well-known constraint is the relatively limited territorial coverage of the Savings Taxation Directive as well as of the agreements providing for the same or equivalent measures. In the era of globalisation, the relative ease with which customer relationships can be established and maintained via the internet and the advantage of open markets make Member States' tax systems more vulnerable to tax evasion ... as long as the geographic coverage of the savings taxation measures remains limited, it may also be useful to consider, while having due regard to the free movement of capital laid down in the EC Treaty, whether steps should be included in the review process aimed at tackling the attempts of EU resident individuals to circumvent these measures by channelling interest payments, made in the EU, through "shell" entities or arrangements located outside the territory of the EU and of the jurisdictions cooperating with the EU.[16]

2 The Commission's proposals for reform

In September 2008 the Commission completed its review, in which it stated that while the Directive had proven effective, there were shortcomings in its coverage: specifically, "difficulties with the definitions of beneficial ownership and paying agent, treatment of financial instruments

[15] Commission Staff Working Document SEC(2008)559, 29 April 2008 p5
[16] *op.cit.* pp3-4

equivalent to those already explicitly covered by the Directive and certain procedural aspects that lessen the Directive's effectiveness."[17]

Strikingly, the Commission observed that it had been unable to conduct a robust economic analysis, because Member States had not provided sufficient data on its operation.[18] It made a number of suggestions for possible amendments, and asked for views to inform any final proposals. For its part, the Government expressed its support for the Directive's central aim, though it took the view that, "any extension of the scope of the Directive [must take] … account of the burden on financial institutions and other market operators who are required to provide information under the legislation."[19]

A second analysis of the Directive by Commission officials, published in 2009, found *no evidence* of the legislation affecting the development of different investments – a finding which *could well* be consistent with the view that the Directive had been ineffective:

> The data suggest that the Savings Taxation Directive had no measurable effects on the development of different investments that fall under the scope of the Directive. At a first glance, this is surprising since the expected tax increase due to the Directive should lead to economic reactions. A possible reason for this surprising result is that the existence of loopholes makes it easy for investors to circumvent taxation on foreign-source interest.[20]
>
> Furthermore, the countries where most of the international deposits are held (Switzerland and Luxemburg) did not exchange information, but levied a withholding tax with a relatively low rate of 15 percent in the period surveyed in this paper. Generally, the analysis of the effects of the Savings Taxation Directive faces some shortcomings linked to definitions in the legal provisions of the Directive, to data limitations and to technical issues, all of which make an assessment of the Directive more difficult. The issues linked to the legal provisions include the facts that the beneficial owner may use intermediate structures not covered by the Directive or that the country of the paying agent may be different from the country where the funds are located.
>
> Finally, the analysis is also constrained by the difficulty of separating many concomitant effects. The Directive is aimed at enabling Member States to tax their resident individuals on interest income received in another Member State.
>
> To the extent that the income covered by the Directive previously escaped taxation, there is likely to be an effect on the vehicles that fall within its scope: investors might decrease their savings because of a lower net-of-tax interest rate; investors might reallocate their savings in the same vehicle but in another country (e.g. one not subject to the Directive); investors might reallocate their savings towards other investment vehicles as the relative net-of-tax return has changed; and (or) investors might evade taxation. This and the different data limitations mentioned above must be borne in mind when interpreting the results of the analysis.[21]

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[17] COM(2008)552 final, 17 September 2008. HM Treasury, *Explanatory memorandum: Commission report … on taxation of savings income*, 28 September 2008 para 5

[18] Limited details on the £ amounts raised by withholding tax, and £ amounts of interest payments reported to other tax authorities, were given in a FAQ document, published alongside the Commission's formal proposals two months later (European Commission MEMO/08/704, 13 November 2008).

[19] European Scrutiny Committee, *Thirty-fifth report*, 24 October 2008 HC 16-xxxi 2007-08, para 7.4

[20] For a discussion of legal loopholes see, Gläser, L. (2007). Taxation of Cross-Border Savings: Options for Reviewing the European Approach. *Intertax*, 35(2): 726-734; and, Jiménez, A.M. (2006). Loopholes in the EU Savings Directive. *IBFD Bulletin*, December: 480-494.

[21] Hemmelgarn et al., *Tax Co-ordination in Europe: Assessing the First Years of the EU-Savings Taxation Directive, Taxation Paper No 18*, European Commission June 2009 pp5-6

In November the Commission published detailed proposals for amending three aspects of the Directive, affecting its scope with regard to taxpayers, interest income, and the legal form in which interest-bearing savings were held:

Determining the effective beneficial owner of interest payments
The first review of the Directive has shown that, at present, it is relatively easy for individuals to circumvent the rules by using interposed legal persons or arrangements (like certain foundations or trusts) which are not taxed on their income.

As far as interest payments are made by paying agents (banks, financial institutions, independent professionals, etc.) established in the EU to certain intermediate structures (listed in the compliance list in Annex I of the proposal) established **outside the EU**, the Commission proposes that paying agents in the EU (who know, under the anti-money laundering provisions that the beneficial owner of the interest payments is an individual resident in the Union) apply the provisions of the Directive (exchange of information or withholding tax) at the time of the payment to the intermediate structure, as if this payment was directly made to the individual.

Concerning payments of interest to certain intermediate structures **established within the EU,** including some non-charitable trusts and foundations, those structures will be always obliged to act as a "paying agent upon receipt". This means that the provisions of the Directive (exchange of information or withholding tax) must be applied by these structures upon receipt of any interest payment from any upstream economic operator (bank, financial institution, independent professional), no matter where they are established and regardless of the actual distribution of any sums to the individual beneficial owners. The suggested definition of "paying agent upon receipt" includes all entities and legal arrangements (trust foundations etc) which are not taxed on their income under the general rules for direct taxation in their Member State of residence/establishment (an indicative list of those entities and legal arrangements will form Annex III of the Directive).

Extending the scope to income equivalent to interest payments
The Savings Taxation Directive can also be circumvented by using innovative financial vehicles instead of a classical savings account in a bank.

Therefore, the Commission proposes extending the scope of the Directive to income from:

- securities which are equivalent to debt claims (of which the capital is protected and the return on investment is pre-defined),
- life insurance contracts whose performance is strictly linked to income from debt claims or equivalent income and have less than 5% risk coverage.

Income from investment funds
In addition, the Commission proposal seeks to ensure a level playing field between all investment funds or schemes (be it undertakings for collective investment in transferable securities authorised in accordance with the UCITS Directive [85/611/EEC] or not), independently of their legal form. This means that income obtained from those investment funds by individuals resident in the EU will be subject to effective taxation.[22]

The Commission also published answers to a number of technical questions gave more detail on the important new concept of a 'paying agent upon receipt' – the Commission's solution to

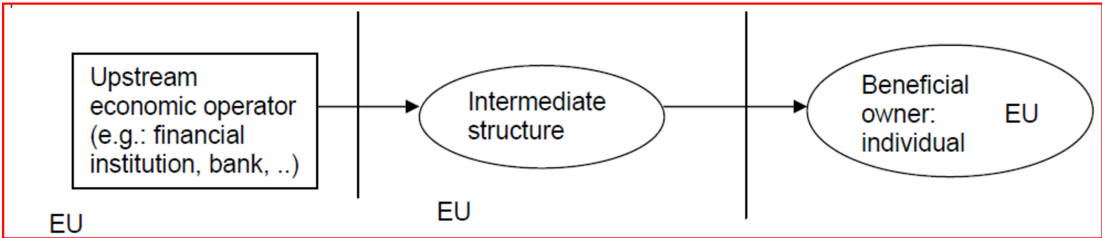
[22] European Commission press notice IP/08/1697, *Taxation of savings: The EC proposes changes to eliminate tax evasion*, 13 November 2008. See also, *Staff working document: Impact assessment* SEC(2008)2767, November 2008

the problem of taxpayers avoiding the reporting requirements of the Directive by having their income channelled through a separate legal structure:[23]

> **What is the concept of "paying agent upon receipt"? Why does the directive contain this concept?**
>
> Paying agents under the directive (every person who pays interest to individuals in the framework of a professional activity such as a financial institution, a bank or an independent asset manager) are ordinarily obliged to report information on the identity of the owner of the interest to their tax authorities, who pass the information to the Member State of residence of the beneficial owner, at the time when the interest payment is made to that beneficial owner (paying agents established in states or territories which apply the withholding tax are obliged to withhold a tax instead of communicating information). These agents could be defined as the normal paying agents "upon distribution" within the framework of the directive.
>
> However, in order to avoid a situation where individuals could circumvent the directive by interposing, between normal paying agents and themselves, certain non-corporate entities such as untaxed associations and investment clubs, the current directive already assimilates those entities to paying agents. It obliges them to act as paying agents at the moment when they receive an interest payment from an upstream economic operator, regardless of the actual distribution of any sum to the individual beneficial owner ("paying agent upon receipt" rule).
>
> The new Commission proposal intends to clarify this provision by establishing a "positive" and clearer definition of the concept of "paying agent upon receipt", by explicitly extending this concept also to entities with legal personality and to legal arrangements and by establishing a list (see Annex III of the proposal) of those entities and arrangements which have to be in any case considered as "paying agents upon receipt".

This briefing also gave some practical examples of how the proposal would work – for example, where income was siphoned through an intermediate structure, either within the EU, or within the 15 territories party to similar arrangements:

> **What if interest payments are made by financial institutions established within the EU to intermediate structures established within the EU for the benefit of an EU resident individual?**
>
> Two situations can arise. Either the intermediate structure is a **paying agent upon receipt** in accordance with the criteria of the Directive (see indicative list in Annex III of the Directive) or not.



> In the first case, the provisions of the Directive (exchange of information or withholding tax) would apply upon receipt of the payments by the intermediate structure. In the second case, the provisions of the Directive would not apply upon receipt of payments, but might

[23] European Commission, *Amending proposal to the Savings Taxation Directive: technical questions*, November 2008 p1

apply at a later stage when interest payments are attributed by the intermediate structure to individuals resident in another EU Member State. The intermediate structures would then have to act as a normal **paying agent upon distribution.**

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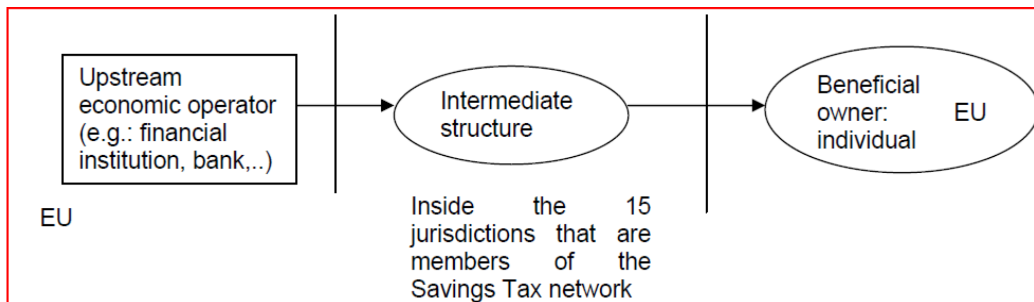
What if interest payments are made by financial institutions established within the EU to intermediate structures established within the 15 other jurisdictions participating in the Savings Tax network for the benefit of an EU resident individual?



Sub-case1): The intermediate structure is established in the 10 dependent or associated territories and is listed in Annex 1 of the Directive: the EU upstream economic operator would have to apply the "look-through" approach on the basis of the information already available to it under the anti-money laundering provisions and determine whether the effective beneficial owner behind the intermediate structure is an individual resident in the EU. In that case, the **EU economic operator would act as paying agent** and apply the provisions of the Directive (exchange of information or withholding tax) as if the payment to the intermediate structure was directly made to this individual. If not, the EU financial institution would not have to act as a paying agent under the Directive.

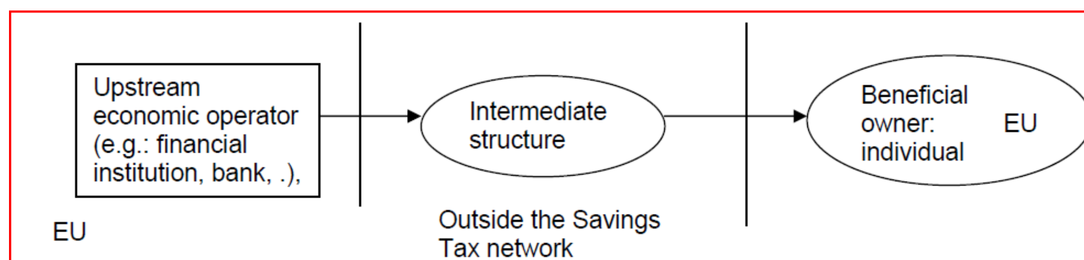
Sub-case 2): The intermediate structure is established in the 10 dependent or associated territories, is not listed in Annex 1 of the Directive but is an entity to which the "paying agent upon receipt" rule already applies at present in these territories: the same provisions as those of the Directive (exchange of information or withholding tax) would apply upon receipt of the payments by **the intermediate structure** that **would act as paying agent** under the responsibility of the territory where it is established.

Sub-case 3): The intermediate structure is established in the 5 non-EU countries. Two situations arise. Either the intermediate structure is listed in Annex I of the Directive or not. If it is not included in the list, the provisions of the Directive will not apply. Should it be included in the list, the **upstream economic operator established in the EU** would have to act as **paying agent** under the directive and to apply the "look-through" approach on the basis of the information already available to it under the anti-money laundering provisions. It would then determine whether or not the effective beneficial owner behind the intermediate structure is an individual resident in the EU. Should it be the case, the provisions of the Directive (exchange of information or withholding tax) would apply on the payment to the intermediate structure. If not, the provisions of the Directive would not apply.[24]

[24] *op.cit.* pp2-3

One other example given was the situation where the taxpayer had routed their savings income through an offshore structure, in a country unaffected by any of the reciprocal arrangements underpinning the Directive:[25]

What if interest payments are made by financial institutions established within the EU to intermediate structures established outside the 42 jurisdictions participating in the Savings Tax network for the benefit of EU resident individuals?



Two situations can arise.

Either the intermediate structure is listed in Annex I of the Directive or not. If it is not included in the list, the provisions of the Directive will not apply. Should it be included in the list, the EU upstream economic operator would have to apply the "look-through" approach on the basis of the information already available to it under the anti-money laundering provisions and determine whether the effective beneficial owner behind the intermediate structure is an individual resident in the EU. In that case, the EU financial institution would act as **paying agent** and apply the provisions of the Directive (exchange of information or withholding tax) as if the payment to the intermediate structure was directly made to this individual. If not, the EU financial institution would not have to act as a paying agent under the Directive.[26]

At their meeting on 2 December 2008 European Finance Ministers welcomed the proposal, and called for 'rapid progress' on further discussions.[27] For its part the UK Government was generally supportive, stating that the draft appeared "to strike a reasonable balance between extending the scope of the present Directive and minimising the burden to the industry." In addition it strongly welcomed the Commission's decision *not* to extend the scope of the Directive to income from all financial products.[28] While some States had argued for this extension, the Commission had ruled it out – as noted in its impact assessment:

Withholding tax (even if transitional for three MS) is a suitable mechanism only if the net income is known. This is rarely the case for forms of income like capital gains. Also, the rules on capital gains taxation vary considerably. The levying of a withholding tax on the full sales proceeds would be disproportionate.

Covering dividends and all investment income payments to corporate recipients, as suggested by at least one MS, could lead to multiple reporting and to multiple layers of withholding tax.

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[25] In 2009 the BBC reported that Lloyds Bank had been selling schemes that evaded the reporting requirements of the Directive by routing transactions through a subsidiary established in Hong Kong ("Tax inquiry into Lloyds offshore", *BBC News*, 22 September 2009)

[26] *op.cit.* p2

[27] ECOFIN press notice 16231/08, *2911th Council meeting*, 2 December 2008 p12

[28] European Scrutiny Committee, *Second report*, 2 January 2009 HC 19-ii 2008-09 para 9.7

> The general framework for administrative cooperation (Directive 77/799/EEC and its possible amendments), based only on information exchange, would seem more appropriate for these income payments.[29]

Discussions on the Commission's proposals continued during 2009, and in a letter to the European Scrutiny Committee in December that year, the then Financial Secretary, Stephen Timms, summarised progress, first in relation to the scope of the draft:

> - the scope of the draft Directive remains broadly as proposed by the Commission, capturing income substantially equivalent to savings interest while avoiding disproportionate burdens on industry;
> - the Government particularly welcomes inclusion of certain grandfathering provisions, which should reduce reporting burdens;
> - in the important area of income from life insurance contracts, which the proposal would bring into the scope of the amended Directive, the Government has successfully argued for an approach that gives greater flexibly to Member States to tailor reporting requirements to their domestic reporting arrangements — this should help to reduce the potential burdens on the UK insurance industry;

and second, in relation to negotiations with other countries and territories, included in the broader framework of the Directive:

> - the Commission has begun consultations with Switzerland, Liechtenstein, Andorra, Monaco and San Marino, with a view to revising their respective savings agreements to bring them into line with the amended Directive;
> - all appear to be willing to enter negotiations once the Savings Directive has bee adopted by the Council;
> - the Government anticipates that the Crown Dependencies and Overseas Territories that participate in the Savings Directive framework will also revise their respective agreements in line with the new Directive;
> - the draft Directive allows a period of three years between entry into force and the date on which its provisions take effect;
> - this period should be long enough for the revised agreements to be concluded — as in the case of the original Directive, the amended Directive and associated agreements could then be brought into effect at the same time;
> - the Commission has continued to encourage Singapore and Hong Kong to participate in the Savings Directive framework — while both are reluctant to make such a commitment they have, over the past year, made firm commitments to meet international standards of exchange of information on request under bilateral agreements …
> - in addition there have been informal consultations with Bermuda and there is every prospect that further discussions will take place with that jurisdiction.[30]

The Committee cleared the draft, without raising any further questions, and there has been relatively little comment since then in the House, or in the wider press.[31] At the time the Minister anticipated that Member States would try to conclude a political agreement on the draft by the end of the year. This was too prove optimistic. Negotiations between States appear to have ground to a halt for over a year. At a ECOFIN meeting in February 2011,

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[29] *Commission Staff Working Document: Impact Assessment Summary*, SEC(2008)2768, November 2008 p8

[30] *Second report*, 4 December 2009 HC 5-ii 009-10 para 11.6.

[31] One exception is the blog written by Mark Morris, a financial consultant based in Switzerland, who has written extensively on the Directive at: http://www.the-best-of-both-worlds.com/

Ministers simply held an 'orientation debate' on the proposals,[32] while later that year, the UK announced a controversial new agreement with Switzerland that, for critics, threatened to derail any further progress.

3 The UK-Swiss tax agreement

In August 2009 HMRC announced a disclosure scheme, to encourage those with undeclared assets held in accounts in Liechtenstein to settle their outstanding tax liabilities, underpinned by a 'memorandum of understanding' with Liechtenstein:

> The Liechtenstein Disclosure Facility (LDF) runs from 1 September 2009 to 31 March 2015. All Liechtenstein financial intermediaries will have to review all clients identifying those who need to confirm their tax position with HMRC and advise them to do so within a specific time frame. Where a UK investor confirms to the intermediary that they are cooperating with HMRC the financial intermediary can continue to provide financial services to that person. Where a UK investor cannot confirm that they are cooperating with HMRC the financial intermediary must withdraw financial services in Liechtenstein or apply various sanctions. The Liechtenstein Government will introduce new laws to ensure audit of the process.
>
> To take part in the programme, investments must either be held in Liechtenstein on 1 September 2009, in which case the person can participate from the start of the facility on 1 September, or, if the investments or assets are moved into Liechtenstein after that date the person can participate from 1 December 2009 at the end of the registration period for the New Disclosure Opportunity. The penalty on unpaid tax will be limited to 10% in most cases on the same basis as the New Disclosure Opportunity operated by HMRC. The recovery of earlier years' tax lost will be restricted to a maximum of 10 years up to 5 April 2009. The taxpayer can elect to apply a special Composite Rate of 40% to cover all taxes on an annual basis without the benefit of any relief or deduction. Both HMRC and the Liechtenstein authorities expect that by the end of the facility all UK taxpayers holding assets and investments in Liechtenstein will be meeting all their UK tax liabilities.[33]

Writing in the *Tax Journal*, two practitioners noted that this new facility was controversial "because, to a certain extent, it is a true amnesty":

> Under its terms HMRC is giving up the right, for up to a 10 year period, to collect tax that is properly due. One would imagine that HRMC would have been reluctant to enter into such an agreement … but presumably the decision was taken on the pragmatic basis that this represented the best chance of collecting any tax in respect of assets located in Liechtenstein. HMRC has estimated that up to 5,000 people liable to UK taxation may have assets in Liechtenstein worth £3 billion … although the compromises HMRC has made to get the agreement with Liechtenstein have considerably muddied the waters, one thing is clear: HMRC is serious about making sure that anyone with undeclared UK tax liabilities connected with offshore accounts comes clean now.[34]

In the wake of the agreement there was considerable speculation as to what action might be taken with regard to UK residents holding undeclared Swiss bank accounts, and, following several months of negotiation, in October 2011 the details of a new agreement with the Swiss authorities were announced.[35] Subject to ratification by Parliament,and the Swiss authorities, from 2013 a new withholding tax would be charged at 48% on investment income and 27% on

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[32] HC Deb 28 February 2011 c1WS

[33] HM Revenue & Customs press notice, 11 August 2009. Details of the agreements made with Liechtenstein are on HMRC's site.

[34] "Tax amnesty?", *Tax Journal*, 31 August 2009

[35] HC Deb 10 October 2011 c1WS

gains, unless a full disclosure of these assets had been made by the taxpayer before this date – a summary of its provisions was given in a press notice issued at the time:

> Accounts held by individual UK taxpayers in Switzerland will be subject to a one-off deduction in 2013, as long as the account was open on 31 December 2010 and is open on 31 May 2013. This deduction will settle income tax, capital gains tax, inheritance tax and VAT liabilities in relation to the funds in the account. The deduction will not be applied if the account holder instructs the bank to disclose details of the account to HMRC. Following that disclosure, HMRC will seek unpaid taxes with relevant interest and penalties.
>
> From 2013, income and gains arising on investments held by individual UK taxpayers in Swiss banks will be subject to a new withholding tax. The rates of this withholding tax will be very close to the top rates of UK tax. Payment of the withholding tax will satisfy UK tax liabilities on the income and gains. Again, the withholding tax will not apply if the account holder authorises disclosure of details of income and gains to HMRC and pays any associated taxes here.
>
> The agreement contains specific provisions covering the position of resident but non UK domiciled individuals. In order to qualify as a non-UK domiciled individual, a person must claim the remittance basis, and their domicile status must be certified by a professional (a lawyer, accountant or tax agent).
>
> The Agreement contains a wide range of exclusions from tax clearance for the past. These include:
>
> - those who are under enquiry by HMRC at the time the treaty enters into force
> - those who have been successfully prosecuted as a result of an HMRC criminal investigation
> - those who have relevant assets arising from the proceeds of crime including those from attacks on the tax system, such as MTIC fraud. Where a person comes within an excluded category any levy paid to the UK will be treated as a payment on account.
>
> A powerful new provision will allow HMRC to discover whether an individual UK taxpayer has an account in Switzerland. This power is in addition to, and goes further than, the provisions for information exchange under the UK-Switzerland Double Taxation Agreement.
>
> The Agreement contains an anti-abuse provision which ensures that if banks promote schemes for avoiding the withholding tax due under this agreement, the bank itself will become liable for the tax avoided.
>
> The Swiss authorities will give HMRC information about the top 10 destinations which they identify as places where money is moved to. This will help HMRC target future compliance activity.
>
> A joint commission will be established to oversee the Agreement and to make recommendations for future changes. Aggregated data on the outcomes and main findings of audits undertaken by the Swiss authorities will be made available for publication.[36]

One practitioner writing in *Taxation* suggested that “on any view, the agreement represents a ground-breaking achievement for the Swiss and UK authorities and its significance should not be underestimated”:

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[36] HMRC press release (NAT) 79/11, *Swiss tax deal signals beginning of the end for offshore evasion*, 6 October 2011. Further details are collated at: http://www.hmrc.gov.uk/taxtreaties/ukswiss.htm

> While the agreement allows clients to retain banking confidentiality in Switzerland, it effectively signals the demise of banking secrecy as an effective means of facilitating tax evasion. It would also seem to represent a new watershed in what can be achieved by political negotiation in relation to issues that were previously thought to be intractable; and it may well open the floodgates for discussions with other tax havens.
>
> Indirectly, it is also likely to act as an incentive for other countries to accelerate their tax compliance initiatives, whether by way of automatic exchange of information or the effective implementation of OECD standards, tax treaties or tax information exchange agreements. In short, it is clear that the world is fast becoming a considerably smaller place within which to conceal undeclared funds and that the risks of doing so have increased noticeably.[37]

The department have suggested that the projected yield to the UK Exchequer could be in the region of £4 to £7 billion – as Dave Hartnett, Permanent Secretary at HMRC, explained, when he gave evidence to the Treasury Select Committee at this time:

> It may be helpful for me to say that as we have taken forward our work with Switzerland, we have approached the calculation in three different ways. First, HMRC analysts looked at it on the basis of publicly available information and came up with a range of £5 billion to £7 billion. Secondly, the Swiss banks looked at it and came up with a best estimate—this was done through a major accounting firm—of £4 billion, and then we used another external organisation ourselves, which came up with a figure of just over the £7 billion that we came up with. I do not know what the right number is, but it is interesting that, roughly, these three calculations are in the same ballpark.[38]

Mr Harnett went on to explain the timing of the new arrangements, and the risk this could pose for further evasion:

> Why the lead-in time? The Swiss have to build a system to make this happen. This is a novel arrangement among states; it is the first time, I think, any tax administration will have created something that sees withholding against capital. Withholding against income is normal in taxation, but withholding against capital is not …
>
> We recognise that [people can move their money], and the Swiss recognise that, but the Swiss have pledged that they will not be complicit in helping people to take money out of the scope of this … The world is getting a smaller place. First it was Liechtenstein, now it is Switzerland, and other tax administrations with which we are working are focusing on other so-called tax havens, and we will be approaching them in due course.[39]

For its part the Treasury Committee expressed concern over the rate of withholding tax to be imposed, and the time lag between this announcement and the new rules taking effect:

> Under the agreement, Swiss banks will be required from 2013 to impose withholding taxes of 48% on interest and other income, 40% on dividends and 27% on capital payments to anonymous UK clients. In addition, under the agreement Swiss bankable assets held by those liable to UK tax will be subject to a one-off levy ranging between 19% and 34% of their bankable assets in accounts held at 31 December 2010 …The rates of tax to be withheld from income and capital are lower than the top rates of tax in the UK. This seems to reward those who have deliberately avoided tax over those who have not …

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37 "A wolf in sheep's clothing", *Taxation*, 3 November 2011

38 [The Office of Budget Responsibility have not certified this costing, given the "significant uncertainties" involved, such as "the amount of UK funds in Switzerland that would be subject to the deal and the assumed level of compliance" (Cm 8218 November 2011 p118)].

39 *Closing the Tax Gap: HMRC's record at ensuring tax compliance*, 9 March 2012, HC 1371 2010-12 Qs 201-2 Ev 37-8 (Evidence given on 12 September 2011).

> The principle of the UK-Swiss agreement may turn out to be a step forward in reducing opportunities for individuals to avoid tax by concealing assets offshore. However, we are concerned that the rate of tax which will be withheld from anonymous Swiss bank accounts will be lower than the highest rate of income tax payable in the UK, and that the long delay before withholding begins will allow those with Swiss bank accounts to remove their assets before withholding is applied. We recommend that HMRC, when publicising the UK-Swiss tax agreement, explains clearly the reasons for the lower rates of tax being withheld from Swiss bank accounts. If there are to be similar agreements in future with other jurisdictions, the Government should seek agreement for the same effective tax rates that apply to UK taxpayers.[40]

In turn the Government responded to these concerns, noting that the rate of withholding tax was actually higher than that imposed by the Savings Directive:

> The withholding tax element of the agreement will operate in a similar way to tax deducted from interest arising on an ordinary UK bank account balance, but will actually be at a much higher rate and on a broader base (for example, it includes Capital Gains) than is the case for bank accounts in the UK. The effective rate of taxation on interest is higher than the 35% withheld under the European Union Saving Directive. Because of the link to the highest marginal rate of tax and because some reliefs and allowances available (in respect of Capital Gains Tax for example) cannot be taken into account, a person who chooses not to disclose may pay a higher effective rate of tax then they would otherwise do.
>
> As a result, the tax implications of not disclosing income and gains on funds held in a Swiss bank account are now very much less attractive. Combined with the money being received earlier than would be the case under Self Assessment, the withholding tax arrangements provide a fair outcome for the UK Exchequer and the taxpayer. HMRC will work to ensure that this reasoning is clear in publicity associated with the agreement.[41]

In its report the Committee also noted that the European Commission had raised concerns that the deal could be open to legal challenge,[42] and in an editorial, the *Financial Times* argued that “the shortcomings” to the deal “are greater than the advances”:

> The greatest risk in the UK-Swiss deal is that it will undermine the EU’s newly revampled agreement with Bern on tax withholding and information exchange … united EU negotiating pressure can plainly achieve more than unco-ordinated efforts, which make it too easy for Switzerland – or other havens that profiteer from tax cheating – to play EU member states off against one another.[43]

Provision to give effect to the agreement was included in the *Finance Bill 2012*; when debated in Committee the Exchequer Secretary, David Gauke, set out the Government’s case for the deal:

> Swiss banking secrecy has been a thorn in the side of tax administrations for generations. Billions of pounds have been deposited in Switzerland, and until now that money has remained stubbornly beyond the reach of even our finest tax investigators. The tax agreement puts an end to that exploitation for good, and in doing so it will raise billions of pounds for the Exchequer. It will resolve existing tax liabilities and put in place arrangements to ensure the effective future taxation of Swiss investments.
>
> Some have objected to the agreement on the grounds that we should have pushed for full and open access to Swiss bank records, but we fear that there was, and is, no

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40 *op.cit.* paras 52-3, para 57

41 *First special report*, 18 May 2012 HC 124 2010-12 p8

42 “Writ looms over Swiss tax deal”, *Financial Times*, 28 November 2011

43 “Editorial: Tax evasion fight needs united front”, *Financial Times*, 29 November 2011

> chance of that happening in the near future. Banking secrecy is enforced by law in Switzerland. Although this Government are a strong supporter of the automatic exchange of information, we also recognise that it will take some time to achieve it. Doing nothing to address the problem of tax evasion in the meantime is not a credible option. We recognise that, as do Germany and Austria—which is why they have struck similar agreements with Switzerland—and several other European countries. I would not be surprised if other such agreements are made in the future.[44]

The Minister went on to summarise the central features of the agreement:

> The agreement addresses tax evasion through Swiss bank accounts via three tough measures. First, a one-off levy on existing accounts held by UK residents will settle past tax liabilities. Liability to income tax, capital gains tax, inheritance tax and, if applicable, VAT in respect of the account will be cleared, as long as a payment worth between 18% and 34% of the assets is made. That, in the experience of Her Majesty's Revenue and Customs, is comparable with the amounts recovered in offshore investigations. If the account holder wishes to avoid the payment, they may authorise disclosure of the account to HMRC, or they must close their Swiss accounts and move their money elsewhere.
>
> The second measure is a new withholding tax, which will ensure the effective future taxation of investment returns. All income and gains arising on investment held through Swiss banks will be subject to a tax set by reference to the UK top rates. In certain circumstances, inheritances will be subject to a tax worth 40% of the assets in the account. Again, these significant taxes can only be avoided if the account holder authorises disclosure to HMRC.
>
> The third measure introduces a powerful new provision that allows HMRC to discover Swiss bank accounts. The power, which operates alongside and in addition to our existing powers to request information, allows HMRC to discover whether any named individual has a Swiss account, without having to provide any evidence suggesting that any such account is open. This provision and that on inheritances will, over time, act as strong drivers towards tax transparency, because they significantly raise the consequences for those who continue to hide money in Switzerland.
>
> What of those who try to dodge the agreement by moving their illicit funds to another secretive jurisdiction? They will gain no tax clearance and will still be liable for all unpaid taxes, but that is not all. They will also be liable for significant penalties, worth up to 200% of the tax evaded, and they could face criminal investigation and prosecution.[45]

Mr Gauke went on to explain the purpose of amendments to the provisions as first tabled, to comply with a similar tax agreement that the German authorities had agreed with the Swiss in April:

> The one-off payment to settle past tax liabilities is determined by a formula specified in the agreement. The amount payable was, under the terms of the original agreement, to range between 19% and 34% of the value of the account. Germany, which concluded a similar deal with Switzerland, agreed the same rates for the one-off payment.
>
> In March of this year, the UK and Switzerland signed a protocol amending the agreement, which introduced a powerful new provision to safeguard inheritance tax and clarified the relationship between our agreement and the EU-Swiss agreement on the taxation of savings. When we signed the amending protocol, we knew that Germany was still negotiating its own changes, so we obtained legal assurances from the Swiss that, should Germany secure any increases to the rate of the one-off payment, the UK may demand equivalent changes. In concluding a further mutual agreement with Switzerland,

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[44] PBC (Finance Bill), 18th Sitting, 26 June 2012 c638

[45] *op.cit.* cc 638-9

> in April, we did just that. The minimum rate of the one-off payment has risen to 21% of the account balance, and there is a new provision to increase the top rate for accounts holding more than £1 million, up to a maximum of 41% for accounts holding more than £7 million. It should be noted, however, that the new maxima only apply where the person would previously have been liable to the maximum 34% rate.
>
> The amendments make changes to the enabling legislation for the Swiss agreement to acknowledge the new mutual agreement, which is necessary to recognise those higher rates. We do not expect the changes to have a significant impact on the revenue raised by the agreement, but they reinforce an important principle: that we will always secure the best possible outcome for the UK.[46]

Grahame Morris MP argued that the deal was flawed, as the delay in its implementation, and the maintenance of Swiss banking secrecy, meant, in effect, that the Government had "strengthened the sustainability of the Swiss tax haven system." Mr Morris was particularly concerned about the position of those who moved money to other jurisdictions before 2013:

> The UK and Swiss authorities are obviously anticipating [this trend], and the Swiss authorities have indicated that they will give details of the top 10 destinations—alternative tax havens, some of which may well be British dependent territories. Incredibly, there is no requirement on the Swiss to give any more details than that. They will not have to say precisely how the money is being moved around or what sums are involved, but simply the destinations.[47]

Similarly, Catherine McKinnell, shadow Exchequer Secretary, raised concerns about the likely impact on capital flight, and the question of obtaining information on Swiss accounts held by UK residents where individuals had not disclosed details to HMRC. Ms McKinnell also asked about the provision for information sharing, which allows for the UK authorities to make a request for information about named individual, provided they have 'plausible grounds'. The agreement puts a cap of 500 requests of this type a year, and Ms McKinnell noted that under its equivalent deal, the German authorities would be able to make double this number. The Exchequer Secretary responded to these points as follows:

> Of course, there are ways in which HMRC can acquire information [on anonymous transactions]. HMRC acquires information from time to time, and at the moment those individuals are anonymous and have Swiss bank accounts. Were they to leave Switzerland, the agreement would have essentially chased them out of the Swiss jurisdiction … As they move their accounts around, the opportunities increase for HMRC to acquire more information. Without the agreement, those individuals could continue to have their Swiss bank accounts, and nothing would particularly threaten their anonymity…
>
> The new information exchange provision is in addition to, rather than instead of, existing information exchange provisions. It has been agreed that 500 requests for information may be made each year under the new provision. If those requests are generally successful, more requests may be made in the following year. Regarding the comparison with Germany, it is generally accepted that far more accounts in Switzerland belong to German residents than to UK residents, so this is a much bigger issue for the Germans. I do not accept that the Germans have a better deal. In proportionate terms, I suspect that the UK has done much better.[48]

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[46] *op.cit.* c 639
[47] *op.cit.* c644, cc643-4
[48] *op.cit.* cc658-9

4 Recent developments

In March 2012 the Commission published a second review of the operation of the current Directive, which generally reinforced its earlier findings.[49] The Commission reported significant decline over 2007 to 2009 both in the amount of income reported under the arrangements, and the amount of tax deducted by countries applying withholding tax,[50] though part of this trend would be attributable to the financial crisis in late 2008. In addition data from a number of sources on savings products suggested that taxpayers had responded to the proposed extension to the Directive's scope:

> The Commission provides an economic evaluation of the development of key EU and non-EU markets for savings products. The data is drawn from a number of sources including EUROSTAT, Bank of International Settlements (BIS), the European Central Bank (ECB) and the Swiss National Bank (SNB). The BIS and SNB data revealed that a significant share of non-bank deposits are held in offshore jurisdictions. The Commission states that the 2008 proposal to extend the scope of the Directive by requiring paying agents to supply information on routing of interest payments through offshore jurisdictions support the above findings.
>
> The report highlights that the Directive has not deterred investors from investing in securities in member states that exchange information. Data from EUROSTAT indicates that there has been no shift in the source of savings income to products outside the scope of the Directive. The Commission's analysis does however indicate an increased use of structured products similar in substance to bank deposits. The Commission suggests that this supports the amending proposal of November 2008 to cover such products within the scope of the Directive.[51]

However, this appears to have had no impact on the progress of negotiations, and there are no indications that an agreement is likely in the near future. Apparently Austria and Luxembourg have consistently opposed any amendment which would see either nation introducing automatic information exchange – on the grounds that this should only occur if Switzerland agreed equivalent provisions.[52]

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[49] COM(2012)65 final, 2 March 2012. Prior to this, in June 2011 the Commission also published a survey of how States had implemented the Directive which suggested considerable variation in national approaches, with concomitant risk of taxpayers evading its provisions (COM(2011)775 final, 14 June 2011).

[50] From £32.8bn to £8.4 bn, and from £591m to £419m respectively (HM Treasury, *Explanatory memorandum on … COM(2012)65 final*, 31 March 2012 paras 5,6).

[51] *Explanatory memorandum*, 31 March 2012 paras 8-10. The European Scrutiny Committee cleared the document, as neither politically nor legally important (HC 428-lvii 2010-12 p120)

[52] "Total impasse on savings taxation" & "Under pressure, Luxembourg & Vienna continue to block progress", *Europolitics*, 18 May & 12 September 2012