

Isle of Man

# Guide To The European Savings Tax Directive



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## A. FREQUENTLY ASKED QUESTIONS

### 1. What is the European Savings Tax Directive (ESD)?

The European Savings Tax Directive is one of three measures relating to tax which together are known as the **EU Tax Package**. In summary, the ESD is an agreement between the Member States of the European Union (EU) to automatically exchange information with each other about customers who earn **savings income** in one EU Member State but reside in another (the **automatic exchange of information option**).

Whilst automatic exchange of information is the ultimate objective of the ESD, three EU Member States (Austria, Belgium and Luxembourg) have opted to apply alternative arrangements during a transitional period. Under these arrangements, tax will be deducted at source from income earned by EU resident individuals on savings held in other EU countries (the **withholding tax option**). However, the Directive specifies that any jurisdiction implementing the **withholding tax option** will also need to provide one or both of the following procedures in order to ensure that a **relevant payee** may request that no tax be withheld:

- a procedure which allows the **relevant payee** expressly to authorise a paying agent to report information to his/her Member State of residence; and/or
- a procedure which ensures that **withholding tax** is not levied where a **relevant payee** presents to his **paying agent** a certificate drawn in the name of a competent authority of his Member State of residence.

### 2. When does the ESD take effect?

The requirements for exchange of information/deduction of withholding tax are currently expected to come into force on 1st July 2005. This is subject to certain preconditions having been met by that date, which are designed to ensure that a “level playing field” is established for those countries and territories affected.

### 3. Which countries and territories are affected?

Once it comes into force, the ESD will apply to all EU Member States<sup>1</sup>. Although the legal scope of the Directive cannot extend outside the EU, its implementation will also affect the UK Crown Dependencies (the Channel Islands and the Isle of Man) and UK Overseas Territories<sup>2</sup>, the Dependent Territories of the Netherlands<sup>3</sup>, and certain other “Third Countries”, which have all voluntarily agreed to apply the same or equivalent measures to those contained in the ESD.

<sup>1</sup> UK, Ireland, France, Germany, Netherlands, Belgium, Italy, Luxembourg, Spain, Portugal, Greece, Austria, Sweden, Finland, Denmark, Cyprus, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovakia and Slovenia

<sup>2</sup> Anguilla, Montserrat, British Virgin Islands, Turks and Caicos Islands and Cayman Islands

<sup>3</sup> Netherlands Antilles and Aruba

<sup>4</sup> Switzerland, Andorra, Liechtenstein, Monaco and San Marino

As noted above, Austria, Belgium and Luxembourg are the EU Member States which have elected for the **withholding tax option**; the other 22 EU States have elected for **automatic exchange of information**. It is currently expected that, with the exception of the Cayman Islands, Anguilla and Monserrat, all of the other countries and territories affected by the ESD will elect for the **withholding tax option**.

The UK Crown Dependencies are meeting their commitment through the implementation of bilateral agreements with each of the 25 EU Member States.

#### 4. So will it affect me?

If you are an individual (natural person) who is resident in an EU Member State and earn bank interest or other **savings income** (as defined for the purposes of the Directive) on deposits or investments held in your own name in another EU Member State, Third Country or territory identified above, then it is probable that you will be affected by the implementation of the ESD. The Directive does not apply to persons (including EU Nationals) who are resident outside the EU.

#### 5. What is the withholding tax option and how will it work?

Under the withholding tax option, banks and other **paying agents** will automatically deduct tax from interest and other **savings income** earned and pass it to their local tax authority, indicating how much of the total amount relates to customers in each Member State. The local tax authority will then keep 25% of the total amount collected and remit 75% to the various tax authorities within the Member States. The receiving Member State receives a bulk payment but does **not** receive personal details in respect of individual customers.

The rate of withholding tax will be 15% from 1st July 2005, 20% from 1st July 2008 rising to 35% from 1st July 2011.

#### 6. What is the automatic exchange of information option and how will it work?

If a customer chooses the exchange of information option instead of withholding tax, details of the customer's identity and residence, their paying agent, the level of savings income received and the period to which it relates will be reported to the local tax authority in the country which the account is held and then forwarded to the tax authority of the country in which the customer is resident.

#### 7. What exactly is the position in the Isle of Man?

The Isle of Man has elected to implement the **withholding tax option**. However, the bilateral agreements entered into by the Isle of Man with the EU Member States also provide for both of the alternative procedures described at point 1 above.

In practice, banks and other **paying agents** in the Isle of Man have therefore been given the option to offer customers the choice between the **deduction of withholding tax** and **exchange of information**. The position is therefore more flexible than in many EU Member States, where no choice will be offered.

The **withholding tax option** referred to above will be known as the “**retention tax option**” within the UK Crown Dependencies (see point 10 below for explanation). References to “withholding” and “retention” in this guide are interchangeable and may be taken to have the same meaning.

It should be noted that whilst banks and **paying agents** in the Isle of Man have the ability to offer a choice to customers, in practice individual organisations may elect not to do so. In this case the **retention tax option** will be applied by default. If in doubt, you should clarify the position directly with your relevant financial services provider.

If a financial institution does elect to offer the **exchange of information** option to its customers, information exchange will only take place at the specific request of individual customers (see also 8 below).

## 8. How do the reporting obligations created by the bilateral agreements between the Isle of Man and the EU Member States fit with the Isle of Man’s data protection legislation and customer confidentiality rules?

The Isle of Man has comprehensive data protection legislation and well-established common law principles concerning customer confidentiality. These will not be affected by the introduction of the bilateral agreements the Island has entered into because the “default” position in the Isle of Man is the **retention tax option**, under which customer confidentiality is fully maintained.

Automatic exchange of information can only be provided at the express request of individual customers.

## B. KEY TERMS

### 9. What is the EU Tax Package?

The **EU Tax Package** comprises three measures relating to taxation which have been agreed by the European Union. The three measures are the **European Savings Tax Directive**, which relates to the taxation of private individuals and which is the subject of this guide, the European Directive on Interest and Royalties, and the Code of Conduct. The latter two measures both relate to business taxation and are outside the scope of this guide.

### 10. I have read about the Isle of Man applying a “retention tax” – what is this?

The withholding tax described above will be known in the Isle of Man, Jersey and Guernsey as a “**retention tax**” rather than withholding tax. This is to distinguish the Islands from the Member States to reflect the fact that they are not a part of the European Union and are not subject to the Directive.

As noted above, the Islands are meeting their political commitment to introduce “same measures” as those contained in the ESD through the implementation of bilateral agreements with each of the 25 EU Member States. For the purposes of these agreements the two terms “withholding” and “retention” are interchangeable and may be taken to have the same meaning.

## 11. Who is a “relevant payee”?

The precise definition of “**relevant payee**” will in fact vary according to whether the impact of the ESD is being considered from the perspective of an EU Member State, a Third Country, or an Overseas or Dependent Territory (including the Crown Dependencies). This is essentially because the agreements between the EU and the Third Countries do not provide for reciprocity whereas those between the EU and the Crown Dependencies do.

From the Isle of Man’s perspective, a **relevant payee** may be considered to be an individual resident in an EU Member State who receives a **savings income** payment from, or for whom a **savings income** payment is secured by, a **paying agent** located in the Island. It should also be noted that, because the bilateral agreements between the Isle of Man and the EU Member States provide for reciprocity, an Isle of Man resident individual who earns **savings income** on deposits and investments held in an EU Member State may also fall within the definition of **relevant payee**.

## 12. What is “savings income”?

There are four main categories of savings income under the scheme. Broadly, these are:-

- a) Interest paid out on debt-claims or credited to accounts
- b) Interest rolled-up and paid out when a debt-claim is repaid or sold
- c) Distributions made by certain unit trusts and other collective investment funds which have invested more than 15% of their investments in debt-claims
- d) Accumulated income paid out when units in certain collective investment funds that have invested more than 40% of their investments in debt-claims are redeemed or sold.

In layman’s terms, savings income is therefore essentially interest earned on bank deposits, interest from, and proceeds on the sale or redemption of, certain bonds and income from certain types of investment funds (principally open-ended money market retail funds). Most other types of income (for example, dividends on ordinary or preference shares of companies, salary and pension payments) fall outside the definition and are therefore outside the scope of the bilateral agreements entered into by the Isle of Man.

## 13. What is a “paying agent”?

A **paying agent** is a person who in the course of his business or profession:-

- makes a savings income payment to; or
  - secures a savings income payment for,
- the immediate benefit of an individual resident in an EU Member State.

In practice, **the paying agent** will typically be the entity that pays the customer the bank interest or investment fund income. For bank interest, this will be the bank where the deposit is held. With regard to income from investment funds, this will be the entity that pays the customer that income.

#### 14. My bank has recently asked for a TIN. What is this and why has it been requested?

A "TIN" is a Tax Identification Number – basically your tax registration number in your country of residence. The bilateral agreements require banks and other **paying agents** to obtain customers' TINs where possible. However there is no obligation placed on banks or other **paying agents** to request this information and **paying agents** can rely on whether the TIN is available from a passport or identity card, or other documentary proof of identity that is in their possession. Where there is no TIN available, **paying agents** may accept details of your date and place of birth, which can be obtained from your passport or identity card.

### C. SPECIFIC EXAMPLES & SCENARIOS

#### 15. I am resident in an EU Member State but have a bank account in the Isle of Man - will I have tax withheld?

Unless you specifically opt for automatic exchange of information or show to the satisfaction of your **paying agent** that you are exempt from tax on your **savings income** or that you are not liable to tax unless the interest is remitted to your country of residence, interest income on your Isle of Man bank account will be received net of the **retention tax** once the bilateral agreements come into force. As noted above, the initial rate of **retention tax** applicable will be 15%.

#### 16. I am an EU National but am not currently resident within the EU. Will my bank account / other investments in the Isle of Man fall within the scope of the bilateral agreements entered into between the Isle of Man and the Member States?

As long as you continue to reside outside the EU, **savings income** arising on your bank deposits and/or other investments held in the Isle of Man will fall outside the scope of the bilateral agreements. However, you may be asked to provide proof of your residence to your **paying agent** in the Isle of Man.

#### 17. I am resident in an EU Member State but am a non-taxpayer in my country of residence - can I reclaim the tax withheld on my Isle of Man bank account?

If you can show to the satisfaction of the bank that you are exempt from tax on your interest, the bank will not withhold the tax. This may be achieved by presenting to your **paying agent** a certificate drawn up in your name by the tax authority of your Member State of residence for tax purposes.

Alternatively, by electing for automatic exchange of information, you will be able ensure that no tax is withheld in the first place. However, if it is, you may well be able to reclaim it but would need to clarify this point with your domestic tax authorities or professional advisors.

18. I am resident in an EU Member State but am currently exempt from tax in my country of residence or I am currently taxed on interest received from a foreign source (including interest received in the Isle of Man) only to the extent that the interest is remitted to my country of residence - what do I need to supply to the paying agent to show that the retention tax doesn't apply?

The information required by the paying agent to show that you are exempt from tax or liable on the interest payments only to the extent that they are remitted to your country of residence will differ from paying agent to paying agent. You should discuss this matter directly with your relevant service provider.

19. I am resident in an EU Member State and hold a joint bank account in the Isle of Man with a non-EU resident. How will that be treated under the bilateral agreement between the Isle of Man and the EU Member States?

Where an interest payment is credited to a joint account and where one of the joint account holders is a resident of an EU Member State the latter will normally be liable to the **retention tax**. The **retention tax** may be applied on the basis that interest is allocated equally among the holders of the joint account. However alternative arrangements may well be appropriate and you should discuss this matter with your service provider.

20. What happens if I elect for exchange of information?

In future the tax authority in your country of residence will receive information about savings income you receive from abroad. This will be supplied by the tax authority of the country in which the person who pays you (or who collects the income for you) is based. The information may then be compared with the returns you provide to your domestic tax authority.

21. What is the position with companies?

Legal entities whose profits are taxed under the general arrangements for business taxation and similar entities (e.g. companies, partnerships and limited partnerships) are not relevant payees and payments to such persons fall outside the scope of the Directive, which only applies to individuals.

22. What is the position with trusts?

An Isle of Man trust has no separate legal personality in Isle of Man law and accordingly all payments to a trust are made to the trustees.

If a professional trustee receives savings income and, under the terms of the settlement, the beneficiary has an absolute entitlement to that savings income (for example, through a life interest trust), the trustee would need to consider whether the beneficiary is a **relevant payee**. If so, the trustee would be viewed to be a **paying agent** in respect of that income and would need to consider whether exchange of information or **retention tax** should be applied (i.e. is the beneficiary resident in an EU Member State, and if so, has that beneficiary elected for exchange of information?).

Conversely, if a trust beneficiary does not have an absolute entitlement to receive the **savings income** (for example, through a discretionary trust arrangement), then the trustee is the **relevant payee** and not the **paying agent**. Providing the trustee is a corporate trustee, or not resident within an EU Member State, the payment of **savings income** would not be subject to **retention tax** or exchange of information requirements.

Whether payments to trusts established other than in the Isle of Man are reportable will depend on the status of the trust under the law of the jurisdiction concerned.

### 23. How can I find out more?

Your financial services provider in the Isle of Man will be able to provide specific information concerning its plans for meeting the ESD requirements. For enquiries of a general nature, please contact:

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