changes needed to UK tax law to reflect the European Regulation on Insolvency Proceedings—which is already in force having been adopted as long ago as May 29, 2000.

Anthony Davis*

Exchange of information—sections 197–199

Sections 197 to 199 are published in the Finance Act 2003 under the heading "International Matters". Each section relates to the UK's obligations to exchange information to other jurisdictions regarding tax matters. Section 197 relates to the UK's obligations to exchange information with other EU Member States under EU legislation covering tax generally. Section 198 deals with the UK's obligations to exchange information with its tax treaty and tax information exchange agreement partners. Section 199 deals with the UK's obligations to exchange information with other EU Member States in relation to savings income of EU resident nationals.[1]

EU Exchange of Information: Direct Tax

Section 197(1)–(4) consolidates existing legislation relating to the UK's obligations under the Mutual Assistance Directive 77/799/EEC (as amended) to conduct enquiries on behalf and/or provide information to Member States to enable a correct assessment of taxes (including (currently) VAT and Excise Duties). This part of section 197 is obviously a tidying up exercise, and brings together in one place (and that will mean in the same tax handbook) the provisions dealing with the occasions when confidentiality will not prevent and occasions when it will prevent disclosure of information to the tax authorities of another State and with the limitations on the use of any such information. These provisions appear to be for the avoidance of doubt rather than extending the UK's obligations or imposing further limitations. An obligation to keep information secret which is imposed by domestic law would not appear to satisfy any of the exceptions in Article 8 of the Directive to the requirements on Member States to provide information unless either the secrecy obligation would prevent the UK tax authorities from collecting or using the information for its own purposes or if disclosure would be contrary to public policy or if the requesting State would be unable to provide similar information due to practical or legal reasons. Hence, the provision in section 197(1) providing that an obligation as to secrecy imposed by statute or otherwise would not prevent disclosure of information under the Mutual Assistance Directive does not appear to be necessary. (Although the final exception in Article 8 to the requirement to provide information does imply that limitations on the power to obtain or supply information imposed by domestic law (or practice) may take priority over a State's obligations to provide information under the Mutual Assistance Directive. One would expect, however, that any domestic limitations would have to be provided for expressly rather than be inferred from the secret nature of the information at issue.) Moreover, the limitation in section 197(2) on disclosure of information by the UK unless satisfied that the requesting State is bound by or has undertaken to observe no less strict rules of confidentiality than those applying to the information in the UK and the exclusion in section 197(3) of any right by the UK tax

* Cadwalader, Wickersham and Taft LLP.

[1] A more detailed article discussing all aspects of the Savings Directive in its revised form will appear in the next issue of this *Review*.

[2003] BTR: No.5 © sweet & maxwell and contributors 2003

authorities to authorise the use of information disclosed for purposes other than tax purposes are already provided for in Article 7 of the Mutual Assistance Directive.

Section 197 also contains a power in sub-section (5) to amend by Treasury Order the definition of "the Mutual Assistance Directive" as used in subsections (1)–(3) and defined in subsection (4). This power is a new provision and anticipates future amendments to the Mutual Assistance Directive. Imminent changes include the extension of its scope from January 2004 to include the exchange of information on taxes on insurance premiums and the restriction of its scope from the same date to exclude VAT whose administrative co-ordination is to be governed by a new Regulation (which aims to strengthen and modernise the exchange of information rules relevant to VAT which are currently contained in two places namely, the Mutual Assistance Directive and Regulation 218/92/EEC[2]). It is understood that there will also be a separate instrument for administrative corporation in the field of excise duties leaving the Mutual Assistance Directive to cover direct taxes only. Changes have also been anticipated to the Mutual Assistance Directive as it affects direct taxes. According to a speech given by Robert Verrue, Director General of the EU Commission's Information Society at a conference on "Multinational Enterprise Taxation in the EU" on January 25, 2003, the Commission aimed to propose amendments to the Mutual Assistance Directive as it applies to direct tax to make it clearer and to shorten some of the procedures that need to be followed when assistance is requested "together with some new provisions".

Initially (*i.e.* before an Opposition amendment was agreed to) the Treasury power was expressed as a power to amend any of subsections (1) to (4) of section 197 (*i.e.* not simply the references to the Mutual Assistance Directive but also the substantive provisions). As noted above the limitation in subsection (2) on the obligation to provide information where the UK standard of secrecy may not be observed and the limitation in sub-section (3) on the power to authorise use of information for non-tax purposes are already provided for in the Directive. Although Robert Verrue gave no indication that changes would be made to these provisions it might, perhaps, have been inferred from the Government's initial intention to be able to amend these provisions quickly by Treasury Order (and without further consent by Parliament) that such changes were in the pipeline. Widening the use of information supplied for tax purposes would be consistent with the Fiscalis 2007 programme (which was adopted by the Council on December 3, 2002 as decision 2235/2002/EC) which aims to improve the functioning of the taxation systems in the internal market by increasing co-operation between participating countries, their administrations and officials, and to identify and remedy areas, such as legislation and administrative practices which make this co-operation more difficult. The Commentary to Article 3 in the Explanatory Memorandum speaks of encouraging exchanges of experience and best practice in the matter of administrative procedures and encouraging the exchange of information, in particular by the formation of networks of national and community agencies. Moreover, widening the use to which information supplied for tax purposes might be put is also, perhaps the logical corollary of a number of recent initiatives where information obtained for non-tax purposes is to be used for tax purposes. A significant example in this respect is the forthcoming Savings Income Directive (see below) which to a certain extent relies on information obtained pursuant to the money laundering regime. In a domestic context sharing of information between government agencies is now possible

[2] See COM(2001) 294 final which was adopted by the Council on February 18, 2003.

[2003] BTR: No.5 © SWEET & MAXWELL AND CONTRIBUTORS 2003

pursuant to, *e.g.* sections 17 to 20 of the Anti-terrorism Crime and Security Act 2001 which allows Government departments to disclose information to other departments and overseas agencies where a criminal investigation is being or could be carried out or even to decide whether such an investigation should be initiated or brought to an end. During the debate of section 197 (then cl.194) in Standing Committee B.[3] Dawn Primarolo, the Paymaster General, did not concede that any changes were anticipated to the "safeguards". She did, however, accede to an Opposition amendment restricting the Treasury amending power to the definition of the Mutual Assistance Directive in subsection (4) only and subjecting this power to a right of annulment by resolution in the House of Commons.

Since then the Commission have published a proposal to amend the Mutual Assistance Directive.[4] This proposal has now been adopted by the Council and issued as a Directive.[4a] The amendments aim to modernise the Directive and also to bring it into closer alignment with the arrangements for indirect taxes. In fact the amendments are even more modest than that description suggests, comprising largely of redrafts of certain provisions to clarify their intended interpretation together with two new provisions: the first, a procedure enabling the requested state on behalf of the requesting state to notify the taxpayer of a request for information, and the second a new procedure enabling two or more States to control jointly the tax affairs of a taxpayer which operates in those States. Any concern that the Directive might be amended in a way which could compromise the confidentiality of the information supplied or extend the purposes for which the information may be used beyond tax purposes have not materialised in this proposal.

Exchange of Information: VAT

Finally, section 197 updates the reference to "the Mutual Assistance Provisions" in section 48(1B) of the Value Added Tax Act 1994 (which enables Customs to require the appointment of another person where a VAT representative does not satisfy certain criteria, including where the representative is established in a territory with whom there are no Mutual Assistance arrangements with the UK similar to the Mutual Assistance Provisions). This reference will now include section 197 and section 134 of and Schedule 39 to the Finance Act 2002 which deal with the recovery in the UK of amounts in respect of which a request for enforcement has been made pursuant to the Mutual Assistance Directive. This latter cross-reference was obviously overlooked last year. To avoid a similar mishap a further power to update these references by Treasury Order has been added into section 148 by subsection (7). This will presumably be invoked to include a reference to the new VAT Regulation described above.

Exchange of Information under Treaties and Exchange Agreements

Section 198, which was heralded in the Explanatory Notes to Finance Bill 2003 as a "minor amendment", changes the standard for supplying information to another State under the UK's double tax agreements and tax information exchange agreements from that which is "necessary" for carrying out the relevant tax laws to that which is

[3] *Hansard*, cols 624-626, June 17, 2003.
[4] See COM(2003) 446 final (2003/0170(CNS)).
[4a] Council Directive 2003/93/EC of October 7, 2003: [2003] O.J. 23 L264/23.

[2003] BTR: No.5 © SWEET & MAXWELL AND CONTRIBUTORS 2003

"foreseeably relevant" thereto. This change applies to existing as well as future agreements although the Revenue deny that the change has retrospective effect in practice.

According to the Explanatory Notes no change in meaning is intended by the change in expression. Indeed, it is said that it has long been recognised in the UK that, in its context, a broad interpretation of "necessary" was required to give effect to the intentions of the treaty signatories. If this is the case then it would seem unnecessary to make the change retrospective (if at all). The Explanatory Notes state that the Government simply wishes, despite this wide interpretation of "necessary", to effect this explicitly in the UK's bilateral double tax agreements and tax information exchange agreements and that to achieve this requires "minor" changes to the wording used in the legislation that enables the UK to exchange information under these agreements. The notes go on to state that in practice the change will not alter the type or scope of information that is exchanged at present. According to the Revenue the reason for the change is that the term "foreseeably relevant" is found in the OECD Tax Information Exchange Agreement of April 2002 and there is a possibility that the terminology of the OECD Model Tax Convention will also switch to "foreseeably relevant" in the future. In dismissing an Opposition argument during the Standing Committee debate of the provision[5] that the new test of what information is appropriate to exchange is both broader and more subjective than the necessary test that it replaces, Dawn Primarolo referred to a UK commitment to keep up to date with OECD developments as the reason for adopting the change. She also referred to the Commentary on the OECD Model Tax Convention on Article 26 ("Exchange of Information") which states that some countries replace "necessary" with "relevant" in their bilateral conventions, regarding this as a better way to express the sense of the provisions. Miss Primarolo does not go on to consider the further questions raised by the Opposition of whether it is lawful for the UK unilaterally to make changes to existing double taxation treaties and whether a degree of retrospection is involved in this provision. However, one might argue that no change is required to domestic law since the change is already effective as a matter of international law. Article 31 of the Vienna Convention on the Law of Treaties of May 23, 1969 provides that for the purpose of interpreting a treaty its context includes any agreement relating to the treaty which was made between all the parties to its conclusion and that in addition any subsequent agreement or practice may be taken together with the context in interpreting a treaty. It would seem reasonable to conclude that the OECD Commentary to the Model Tax Convention is such an agreement for this purpose and that updates to the Commentary are subsequent agreements. In accordance with such an ambulatory interpretation (rather than a static interpretation) of the Convention, the reference in the Commentary to the use of "relevant" as more closely expressing the sense of the provision tends to indicate that the change may already been made applying international law rules of interpreting treaties. This appears to justify still less a retrospective change to domestic law.

Exchange of information: Savings Income Directive

Section 199 provides the enabling power for the introduction of regulations to implement Council Directive 2003/48/EC 3 June 2003 on taxation of savings income in the form of interest payments (the Savings Income Directive).[6] Briefly, the Directive is intended to

[5] *Hansard*, cols 625-627, June 17, 2003.
[6] For further details of the scope of the Directive see n.1 on p.420 and previous articles published in the *Review* at [2001] BTR 261 and [2002] BTR 32.

[2003] BTR: No.5 © SWEET & MAXWELL AND CONTRIBUTORS 2003

counter tax evasion regarding savings income by requiring Member States to provide to the tax authorities of another Member State information regarding payments by a person (a "paying agent" which is either an "economic operator" or a residual entity) within its jurisdiction of interest or similar income to an individual (the "beneficial owner") resident in that other Member State. Exceptionally (and for a transitional period which will end when agreement on exchange of information is reached with certain non-EU countries) Belgium, Luxembourg and Austria will withhold tax from such payments unless the investor authorises disclosure of the payment or presents a tax certificate. The Directive will take effect from January 1, 2005 provided that the Member States agree unanimously that equivalent measures will be applied from the same date by certain non-EU countries and the same measures will be applied from the same date by certain dependencies and associated territories of the Member States.

Section 199 was also considered in Standing Committee B on June 17, 2003 and was ordered to stand part of the Bill without amendment. Amendments proposed by the Opposition which sought to tie in the definitions of paying agent and relevant payees more closely with the definitions of paying agent and beneficial owner in the Directive were withdrawn on the basis of statements by Dawn Primarolo that the amendments were unnecessary given that the regulations are limited in their scope to the matters set out in subsection (1), namely any Community obligation or arrangements with a non-EU state aimed at ensuring the effective taxation of savings income.

On June 30, 2003 the Revenue launched a consultation on the UK's proposals to implement the Savings Income Directive. Helpfully, the Revenue have collected together on their website all the information relevant to this topic including the text of the Directive. In addition they have published a number of discussion papers which deal with discrete parts of the Directive and how the UK intends to implement these in the regulations which will be made under section 199. The discussion papers do not shed much light on the scope of the Directive beyond that which is known already. The following points are worth noting, however:

- The term "economic operator" (which is used in the primary definition of "paying agent" in Article 4 of the Directive) is described as a person who makes or secures savings income payments "in the course of his business or profession".
- Where a payment is made by a paying agent to an individual who is not the beneficial owner then that individual should give details of the beneficial owner to the paying agent and the paying agent will report these details. The papers do not address the issue of nominee receipts directly—except perhaps for this paragraph. In particular the papers do not elucidate on what is meant by "payments secured for the benefit of" an individual (in the definition of beneficial owner in Article 2 of the Directive). Although there are various statements which on balance tend to indicate that nominee receipts may not be within the Directive except where the nominee is a paying agent within the meaning of Article 4(1)—which would require it to be paying the interest in the course of a business—or within Article 4(2)—which would exclude, *e.g.* a company. In either case there would be no requirement to make a report if the nominee is located in the same Member State as that of the beneficial owner.
- UK partnerships should be treated as single entities and as they are subject to business taxation they will not be regarded as paying agents within the residual category in Article 4(2). Moreover, some partnerships (*i.e.* Scottish partnerships

[2003] BTR: No.5 © SWEET & MAXWELL AND CONTRIBUTORS 2003

and limited liability partnerships formed under the Limited Liability Partnerships Act 2000) are also legal persons which is another ground for exclusion from Article 4(2). Non-UK partnerships may be legal persons according to the law of the jurisdiction in which they are established and so would also be excluded from Article 4(2) if they are.

- There are likely to be few "residual entities" established in the UK. The only example given is an investment club. Of more relevance for UK paying agents (and UK investors) is how to determine whether an entity established in another Member State is a residual entity. (NB: an economic operator who makes a cross-border payment to such an entity must make a report to its tax authorities and the residual entity will be under an obligation to report information or withhold tax on *receipt* of payments for any members resident in other Member States rather than when it makes payments to its members.) The papers state that this will depend on the status of the entity under the law of the country in which it is established. The paying agent will need to obtain "official evidence" that the entity is what it says it is which is similar to that required for the know your customer (*kyc*) rules for the purposes of the money laundering regime.[7] (It is highly likely that a person who is considered to be a paying agent under the Savings Income Directive will be subject to the kyc rules under the money laundering regime.) If the paying agent is unable to obtain sufficient evidence to satisfy itself that the entity is not a residual entity then it must assume it is (and report details of the payment to the Revenue). Although rather vague on this the rules will also extend to situations where a UK paying agent makes the payment to a UK residual entity. Article 4(4) of the Directive requires Member States to take necessary measures to ensure that in a situation where an economic operator and an Article 4(2) entity are established in the same Member State that the latter entity complies with the Directive when it acts as a paying agent.
- As trusts have no separate existence in UK law paying agents will need to determine whether the trustee is a "relevant payee". (The term "relevant payee" is used in the papers to describe what are referred to in the Directive as a "beneficial owner" – basically an individual.) It seems unlikely that a trustee would receive a payment for his immediate benefit and therefore such a payment will probably not need to be reported. Again for non-UK trusts reference will need to be made to the law of the jurisdiction in which the trust is established to determine its status and if the paying agent is unsure it should report the payment as if the non-UK trust were a "residual entity". A professional trustee under a settlement to which the beneficiary is absolutely entitled will be a paying agent in respect of any savings income if the beneficiary is a relevant payee. Again, the papers do not go on to say whether a receipt by such a trustee will be regarded as a payment secured for the beneficial owner. If it is not then a "cross-border" payment on to the beneficiary will be required for the Directive to bite.
- Pensions and payments by charities will not be reportable since they will not be savings income. (Pensions are expressly excluded from the scope of the Directive by recital 13. The exclusion of payments by charities ends speculation that they might be considered to be paying agents within the residual category in Art.4(2).)

[7] See [2001] BTR 261 for a detailed discussion of this regime.

[2003] BTR: No.5 © SWEET & MAXWELL AND CONTRIBUTORS 2003

- An FAQs paper describes what is "savings income" and gives examples of each category in the definition of interest in Article 6 of the Directive. One example given of a payment which is not a savings income payment is a payment on a debt claim which does not arise from a transaction for the lending of money. Indeed, the Government is proposing to limit the definition of "debt claim" to the concept of "money debt" in the loan relationship rules. This apparent limitation does not appear to sit well with the reference to "debt claims of every kind" in the primary definition of interest payment in Article 6 of the Directive and it will be interesting to see how this proposal progresses. There does not appear to be any obvious reason for linking the Savings Income Directive reporting obligations with the loan relationships rules; the domestic reporting obligations in section 17 and section 18 of the Taxes Management Act 1970 for interest payments are not so linked. Further examples given of payments that are not reportable include dividends paid on ordinary or preference shares, although the papers do not refer to other payments such as swap payments. It is thought that for UK purposes such payments will be outside the scope of the Directive but this is not likely to be the case in other jurisdictions (*e.g.* Sweden). The International Swaps and Derivatives Association (*ISDA*) is considering adding in language to its Master Swap Agreement to cater for this eventuality.
- Reports will be required for all savings income payments irrespective of whether the payments will be regarded as "interest" for UK law purposes or whether the payments would be taxed in the UK.
- Grandfathered bonds will not be taken into account when determining whether the thresholds for distributions by funds or proceeds on the sale of shares in such funds respectively are classified as interest payments. (The definition of interest payment in Article 6 includes such payments where a fund or other Undertaking for Collective Investment in Transferable Securities invests more than 15 per cent (distributions) and 40 per cent (proceeds on sale) respectively of its assets in the sort of debt claims to which the primary definition of interest applies.)
- In terms of the mechanics of the reporting obligations and the interaction with the existing obligations under section 17 and section 18 of the Taxes Management Act 1970, a hierarchical approach will be adopted pursuant to which the paying agent will have to consider first whether the payment falls within the scope of the Directive then section 17 then section 18. Where reporting obligations overlap it should be possible to meet these obligations simultaneously. The Government does not, however, consider it necessary or desirable to align the Savings Income Directive and section 17 and section 18 reporting obligations.
- Each subfund of an umbrella fund will be treated as a fund in its own right (as is the case currently under UK tax law). Although some funds may be able to identify the interest element in distributions accurately, the Government considers that many paying agents would prefer the simpler approach of reporting the whole income payment attributable to units in a bond fund rather than the proportion representing interest as defined in the Directive and therefore the Government proposes to require reports of the whole amount. It is not entirely clear on what basis the UK is entitled to make this a requirement. Article 6(2) in fact provides that the total amount of the income shall be

considered an interest payment when a paying agent has no information concerning the proportion of the income which derives from interest payments. This does not appear to give Member States the option to require that the total amount of the income be considered an interest payment in every case. It appears that the UK will avail itself of the option of excluding from the definition of interest payment distributions etc. by funds whose investment in debt claims does not exceed 15 per cent. This threshold will be measured either by reference to the fund's investment policy or by reference to the actual composition of the fund assets. As the latter will require continuous assessment the Government prefers the first option. The same approach will be taken in relation to income realised on the sale, refund or redemption of units in a fund that invests more than 40 per cent of its assets in debt claims. As regards this last type of income, the Government again recognises that some paying agents will be able to report the accumulated income accurately rather than reporting the full sale proceeds but it is not convinced that it will be practicable for most paying agents to report accrued income rather than the full sale proceeds. Notably it does not go on to state that the UK rules will require paying agents to report the full sale proceeds. Again, there is no option for Member States to do this in Article 6. The Government does not expect to exercise the option to annualise accruing interest each year.

- The residence of a beneficial owner is determined by his permanent address (and not his tax residence). Presumably these will be the same in most cases. Operating the Directive may be quite difficult in cases where they are different. For example, it does not seem to make sense for 75 per cent of the tax withheld by a paying agent in say Luxembourg to be returned to the State where the investor has his permanent address rather than the State which will tax the savings income.
- In establishing the identity and residence of the beneficial owner, the rules will mirror the kyc rules (as noted above) although unlike the kyc rules the Savings Income Directive applies to every reportable claimant and there is no de minimis rule. For non-face-to-face business, properly notorised or certified copies of, *e.g.* a passport or identification card may be used as sufficient evidence.
- A UK investor will be able to opt not to have tax withheld from a payment of savings income by a paying agent in Austria, Belgium or Luxembourg by either: authorising the paying agent in accordance with the procedures prescribed by the latter's Member State to report the payment to its tax authorities (which will then provide this to the Revenue); or by presenting a certificate from the Revenue which indicates the same level of information which would be required to be reported if a reporting obligation had been imposed. The Revenue will issue such a certificate within 2 months of receiving a request.
- A hierarchical approach will be adopted with respect to claims for double tax relief under a double tax treaty or the UK's unilateral code and credit for tax withheld pursuant to the Directive in respect of the same payment. In brief the former will be allowed first with tax withheld under the Directive being credited against the remaining UK tax liability and to the extent that credit for this tax cannot be given because it exceeds the remaining UK liability the excess will be repaid to the investor. The paper does not shed any light on whether tax withheld

[2003] BTR: No.5 © SWEET & MAXWELL AND CONTRIBUTORS 2003

by a non-UK paying agent in respect of savings income paid to a UK investor which is returned to the UK under revenue sharing arrangements should be regarded as UK tax. This is a point which is relevant to *e.g.* gross-up provisions in bond prospectuses and in other contracts where commonly the obligation to gross-up will be restricted to taxes imposed by the jurisdiction of the issuer only. The references in the Revenue papers to allowing credit for such tax against the investor's UK tax liability would seem to suggest that the Revenue do not consider that the tax withheld is UK tax. On the other hand, the tax is withheld pursuant to a Directive to which the UK is a party and which is aimed at ensuring effective taxation in the State of residence of investors. Moreover, the fact that it is the State of residence (in this case, the UK) which must repay any excess between the amount of tax withheld and the investor's tax liability would indicate that the tax is a tax of the State of residence of the investor.

- The rules regarding the identification of relevant payees differ slightly for contractual relations entered into pre- January 1, 2004 from those entered into post- January 1, 2004 (with slightly more onerous requirements applying for the latter). Where there is no contract between the paying agent and the relevant payee the post- January 1, 2004 rules apply. The papers recognise the practical difficulties for paying agents who have an ongoing non-contractual relationship in place (*e.g.* where the debtor has outsourced the task of administering a debt claim) and state that provided such paying agents obtain and verify the required information at the first reasonable opportunity and report as much information as they can establish from their records in the interim then they will have a reasonable excuse for failure to comply with their obligations. A similar approach is to be applied to paying agents, such as registrars, who have little direct contact with the relevant payee. All paying agents who have put in place an adequate system and update their records as soon as practicable (and report such required information as they hold in the interim) will have met their obligations under the scheme, notwithstanding that individuals may not always reply straight away or that there may be unavoidable delays in updating their systems.

Draft regulations have now been published as part of the second round of consultation.[8] In accordance with Article 17 of the Directive, Member States must adopt and publish the laws, regulations and administrative provisions necessary to comply with the Directive before January 1, 2004 notwithstanding that, as noted above, such provisions will only apply from January 1, 2005 at the earliest.

SUSAN BELL*

Controlled foreign companies—sections 200–201 and Schedule 42

SECTION 200 and Schedule 42 of the Finance Act 2003 significantly expand the scope of paragraph 11, Schedule 25 to the Taxes Act 1988 "wholesale, distributive, financial or service business" provisions for accounting periods of controlled foreign companies

[8] Draft Statutory Instrument published on September 22, 2003 as a consultation draft—The Reporting of Savings Income Regulations 2003.

* Freshfields.

[2003] BTR: No.5 © SWEET & MAXWELL AND CONTRIBUTORS 2003