



COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 04.03.1998  
COM(1998) 67 final

98/0087 (CNS)

**Proposal for a  
COUNCIL DIRECTIVE**

**on a common system of taxation applicable to interest and royalty payments  
made between associated companies of different Member States**

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(presented by the Commission)

# EXPLANATORY MEMORANDUM

## I. General

1. In its Communication of 5 November 1997 entitled "A package to tackle harmful tax competition in the European Union"<sup>1</sup>, the Commission stressed the need for coordinated action at European level to tackle harmful tax competition in order to help achieve certain objectives such as reducing the continuing distortions in the Single Market, preventing excessive losses of tax revenue and encouraging tax structures to develop in a more employment-friendly way. The ECOFIN Council of 1 December 1997 held a wide-ranging debate on the basis of that Communication, highlighting three areas in particular: business taxation, taxation of savings income and the issue of withholding taxes on cross-border interest and royalty payments between companies<sup>2</sup>. Following the debate on this taxation package, the Council and the Representatives of the Governments of the Member States, meeting within the Council, agreed to a Resolution on a code of conduct for business taxation. The Council also approved a text on taxation of savings, considered that the Commission should submit a proposal for a Directive on interest and royalty payments between companies and took note of the Commission's intention to submit rapidly two proposals for Directives on these subjects. This Memorandum deals with the proposal for a Directive to eliminate taxation in the country where they arise of payments of interest and royalties between associated companies in different Member States. The Commission will shortly present a proposal for a Directive to ensure minimum effective taxation of income from savings, in order to facilitate parallel progress on all the elements of the taxation package.
2. In its Communication of 20 April 1990 setting out guidelines on company taxation<sup>3</sup>, the Commission pointed out that one of the aims of the Single Market was to remove tax obstacles impeding cross-border business activity in the Community.
3. One of the measures the adoption of which was considered to be necessary to that end was the proposal presented by the Commission at the end of 1990 to abolish withholding taxes levied on interest and royalty payments, initially those made between parent companies and subsidiaries of different Member States<sup>4</sup>.
4. In March 1992, the Ruding report<sup>5</sup> included this Directive among its priorities for the establishment of the Single Market.
5. As, however, it was not possible to find an unanimous resolution to some problems that arose in the course of the negotiations in the Council, the Commission decided, after several compromises, to withdraw the proposal at the end of 1994. It had become clear at that stage that there was not unanimous agreement in principle on the desirability of such a Directive.

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1 COM(97) 564 final of 5.11.1997.

2 OJ C 2, 6.1.1998.

3 SEC(90) 601 final of 20.4.1990.

4 OJ C 53, 28.2.1991, p. 26.

5 Report of the Committee of independent experts on company taxation, Commission of the European Communities, 1992.

6. The Commission, and international business associations, have always been convinced of the need for a Community instrument in this area, as neither unilateral measures taken by Member States nor the bilateral tax agreements, that have gone some way towards overcoming the problems resulting from the taxes levied on these payments in the Member State where they arise, have provided a satisfactory solution that fully meets the requirements of the Single Market. Bilateral tax treaties do not cover all bilateral relations between Member States, they do not achieve complete abolition of double taxation and, in particular, they never provide any uniform solution for triangular and multilateral relations between Member States.
7. Unilateral measures and bilateral agreements generally allow withholding taxes, often levied at reduced rates, to be set against the tax payable by the recipient companies. However, double taxation occurs wherever it is not stipulated that withholding taxes are deductible from the taxable profits of the recipient company or where that company cannot use or can only partially use the tax credit because the amount of tax payable by it is insufficient or nil. What is more, bilateral agreements generally make the reduction or abolition of the withholding tax conditional on completion of administrative formalities.
8. Application of withholding taxes may also give rise to cash-flow problems, since some time will elapse between receipt of the income from which the withholding tax has been deducted and the setting-off of the tax credit against payment of tax.
9. The application of a withholding tax to interest limits, for the above reasons, the possibilities for flexible intra-group financing arrangements. In such cases financing has to be done locally, often leading to higher costs.
10. Elimination of any form of possible double taxation can best be achieved by allocating the taxing rights to the Member State of residence of the beneficial owner of the interest or royalties. It is important to eliminate not only the tax collected by deduction at source in the Member State where the interest or royalties arise but also any tax liability that is levied by assessment in that Member State.
11. The only satisfactory way to effect this is through a Directive which enshrines the principle that Member States should not impose taxes on interest and royalties arising in their territory but beneficially owned by non-resident companies, in order to ensure that such income is taxed only once in the Member State in which the beneficial owner is established. This will allow companies to take better advantage of the opportunities of the Single Market.
12. The discussions initiated by the Commission at the informal meeting of Ministers for Economic Affairs and Finance in Verona in April 1996 and culminating in the ECOFIN Council Meeting on 1 December 1997 have demonstrated a new willingness among Member States to compromise in order to tackle harmful tax competition and reduce the continuing distortions of the Single Market. In view of this new development, the Commission is now coming forward with a new proposal for a Directive to eliminate source country taxes on payments of interest and royalties.

13. Both this proposal and the text on the taxation of savings income in the Community which was also approved at the 1 December ECOFIN Council meeting are aimed at removing distortions in the Single Market. The directive in the field of savings income will be aimed at eliminating non-taxation of income while this proposal concerning payments of interest and royalties payments is aimed at eliminating the distortions which arise through double taxation.
14. In order to alleviate the budgetary impact of the interest and royalties proposal, particularly for those Member States which are net importers of capital and technology and for which these taxes on such payments represent an appreciable source of revenue, a gradual approach as far as the scope of the Directive is concerned would seem to be appropriate.
15. Initially, therefore, it is only proposed that the taxes collected at source or by assessment on interest and royalty payments made between associated companies, including the permanent establishments of such companies, should be abolished, as such taxes fall most frequently on transactions between associated companies. It will be possible to extend the measure later, as part of the further development of the Single Market, to taxes of this type levied on interest and royalty payments made between companies which are not associated.
16. As well as this limitation in the scope of the Directive, a further step to help those Member States which are net importers of capital and technology would be to include arrangements allowing a gradual, rather than immediate, abolition of these taxes over a transitional period.
17. This Directive does not preclude Member States from taking steps to combat fraud and abuse. In particular, it does not affect the right of tax authorities to adjust transfer prices, where the amount of interest or royalties or the amount of a loan exceeds the amount which would have been agreed upon by the payer and the beneficial owner had they stipulated at arm's length.
18. The Directive allows Member States not to apply the exemption from source country taxation if the beneficial owner of the payments benefits from a special tax rate which is lower than that generally applicable to payments of this kind received by a company or a permanent establishment of the Member State of the beneficial owner.
19. Furthermore, the provisions of the Council Directive of 19 December 1977 concerning mutual assistance by the competent authorities of the Member States in the field of direct and indirect taxation<sup>6</sup> apply to interest and royalty payments. The exchange - and in particular the spontaneous exchange - of information where there appears to be a transfer of profits can enhance the effectiveness of measures to prevent evasion and avoidance in these fields.

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<sup>6</sup> OJ L 336, 27.12.1977, amended subsequently by Directives 79/1070/EEC (OJ L 331, 27.12.1979) and 92/12/EEC (OJ L 76, 23.3.1992).

20. Provision is made for the Commission to report on the operation of this Directive on the basis of the experience of its operation over the first three years, with a view to an extension of its scope. It will be clearer at that stage, in particular in the light of progress on the code of conduct for business taxation, whether it is necessary to continue to allow Member States the option of not applying the Directive to payments which benefit from a special tax rate which is lower than the normally applicable rate. The question of reviewing the definition of interest and royalties in the light of the convergence of the provisions dealing with interest and royalties in national legislation and in bilateral double taxation treaties may also be considered at that stage.

## **II. Commentary**

### **Article 1**

1. The purpose of this Article is to exempt payments of interest and royalties from any taxation at source, whether collected by withholding tax or by assessment, where such payments are made by or on behalf of a company of a Member State, or a permanent establishment situated in a Member State of a company of another Member State, to an associated company of another Member State, or to a permanent establishment situated in another Member State of an associated company of a Member State, which is the beneficial owner of those payments. This provision requires an exemption to be granted at source (i.e. at the moment when the interest and royalties are paid); the beneficial owner does not have to apply for a refund of tax.

When a permanent establishment pays or receives interest or royalties, it is for the purposes of this Directive treated as the payer or the beneficial owner and not its headquarters company, as also provided for in Article 3, paragraph 3.

2. The Directive will not apply in situations which do not in essence involve cross-border payments. This could arise, for example:
  - (a) if the beneficial owner of the interest or royalties is a permanent establishment situated in the same Member State as the paying company or permanent establishment and the debt-claim or right or property in respect of which the payments of interest or royalties are made is effectively connected with such a permanent establishment, even if the interest and royalties are in fact paid to an associated company of another Member State;
  - (b) if the interest and royalties are paid to a permanent establishment in another Member State of an associated company established in the Member State where the interest or royalties arise, whenever such payments made directly between companies of the same Member State are subject to a tax collected by deduction at source, unless the debt-claim or right of property in respect of which these payments are made is effectively connected with the permanent establishment.

## Article 2

1. (a) The term “interest” as used for the purposes of this Directive denotes in general all income from debt-claims of every kind. The definition is based on that used in Article 11 of the 1996 OECD Model Tax Convention on income and on capital, with the exception of income from government securities which is not relevant to this Directive. Penalty charges for late payment do not really constitute income from capital, but are rather a special form of compensation for loss suffered through the debtor’s delay in meeting his obligations. These charges are therefore, as in Article 11 of the OECD Model Tax Convention, not regarded as interest for the purposes of this Directive.
- (b) The term “royalties” as used for the purposes of this Directive denotes in general all payments made as a consideration for the use of, or the entitlement to use copyright, work, patents, etc. as included in Article 12 of the 1996 OECD Model Tax Convention on income and on capital, as well as payments made in consideration for the use of or the right to use industrial, commercial or scientific equipment, in order to cover all payments considered by Member States to be royalties.

Payments made in consideration for software may represent royalties if less than the full rights in the software are transferred (no alienation of ownership), i.e. payments made under transactions in software copyrights that allow the transferee to commercially exploit the copyright by using it to reproduce computer software products for sale or by sublicensing the copyright to other parties, but which do not constitute an alienation of the copyright. This Directive will apply to payments made under such transactions.

The term “royalties” does not, however, include so-called “mineral royalties” because such payments have rather the character of income from real estate.

2. The Directive applies not only to the payments of interest or royalties as defined under paragraph 1 but also to all payments regarded by Member States as such, either under a Double Taxation Convention in force between the Member State where the interest or royalties arise and the Member State of the beneficial owner or, in the absence of such a Convention, on the basis of the national tax legislation of the Member State where the interest or royalties arise. This extends to payments made by or to a permanent establishment which would be considered to be interest or royalties if they had been made by or to a company in the Member States concerned.

### Article 3

1. (a) The term “company of a Member State” covers any company as defined in Article 58 of the Treaty and whose activities present an effective and continuous link with the economy of a Member State. The Council adopted on 18 December 1961 (OJ 2 of 15 January 1962) a general programme for the abolition of existing national restrictions on the freedom of establishment. There, an economic criterion has been introduced, that tempers the liberalism of Article 58 of the Treaty. This means that a company which has only its registered office in the Community could only acquire the right of establishment when its activities present an effective and continuous link with the economy of a Member State. It remains, however, excluded that this link could depend upon the nationality of the shareholders or managers of the company. Such a company has moreover to be resident in a Member State and to be subject to tax in a Member State.

(b) The term “associated company” covers as a minimum all companies which are associated with each other by way of a minimum holding of 25% in the capital held either directly or indirectly.

The Directive covers payments of interest and royalties made between a parent company and a subsidiary; between a parent company and a sub-subsidiary; between fellow subsidiaries or sub-subsidiaries; and between subsidiaries and sub-subsidiaries, in so far as the company by, or on behalf of which, the interest or royalties are paid and the company to which these payments are made are both companies of a Member State.

However, Member States who so wish are allowed to provide for a lower, and therefore more liberal, level of holding than 25% in order to determine whether a company exercises sufficient control over another. Furthermore, they can replace the criterion of a minimum capital holding by the criterion of a minimum holding in the voting rights.

(c) The notion of beneficial owner is intended to secure that the exemption applies when an intermediary, such as an agent or nominee or trustee, is interposed between the beneficiary and the payer, only if the true owner of the interest or royalty payments meets the requirements of the Directive.

(d) The term “permanent establishment” as used for the purposes of this Directive denotes in general a fixed place of business in a Member State, through which the business of a company of another Member State is wholly or partly carried on, but that has no legal personality.

(e) As, in principle, interest or royalty payments that are made to or by a permanent establishment are actually made to or by the headquarters company, the fiction that is inherent in this provision ensures that such payments may nonetheless benefit from the Directive, provided all other conditions are met.

2. Member States may also cease (with retroactive effect) to treat a company as an associated company, if the minimum holding requirement set out in paragraph 1(b) is not met throughout a minimum period of up to two years. Member States may

not make the granting of the tax advantage provided for by the Directive subject to the condition that, at the moment of the payment of the interest or royalties, this holding period has already been completed, so long as it is subsequently observed.

#### **Article 4**

Member States are permitted to exclude certain payments which may fall under the notion of interest but which actually have the character of distributed profits, income treated as a return of capital or income from hybrid financing. This could arise, for example, under the provisions of a Double Taxation Convention in force between the Member State where the interest arises and the Member State of the beneficial owner or under the law of the Member State where the interest arises.

Interest that has been re-characterized as distributed profits ought to benefit from the provisions of Directive 90/435/EEC<sup>7</sup> provided all other requirements of that Directive are met, in order to avoid double taxation of such profits.

#### **Article 5**

When the amount of interest and royalties paid exceeds the amount which would have been agreed in the absence of a special relationship between the payer and the beneficial owner or between both of them and another person, the Directive will apply only to the amount which would have been so agreed. This is in line with the principles of Articles 11.6 and 12.4 of the OECD Model Tax Convention on income and on capital.

Moreover, in the case of interest, when the amount of the debt-claim exceeds that which would have been agreed in the absence of such a special relationship, the Directive will apply only to the interest in respect of the amount which would have been so agreed.

#### **Article 6**

1. Member States should be able to prevent and combat fraud or abuse in an appropriate way in accordance with the principle of proportionality.
2. The benefit of the Directive may be withdrawn in the case of a transaction which is established as having as its principal or as one of its principal objectives tax evasion or tax avoidance.

#### **Article 7**

1. In order to ensure that the interest and royalty payments are subject at least once to taxation in a Member State at a level which is normally applicable to these items of income in the Member State of the beneficial owner, Member States can, by way of derogation, choose not to apply the provisions of Article 1 if the beneficial owner of these payments in respect of the interest or royalties is subject to the tax mentioned in Article 3, paragraph 1(a)(iii) at a rate which is lower than the rate which is normally applicable to such income received by a company or permanent establishment of the Member State of the beneficial owner.

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<sup>7</sup> OJ L 225, 20.8.1990, p. 9.



Member States have the same possibility to derogate when the beneficial owner, while being subject to the aforementioned tax, benefits from a reduction in the tax base (e.g. by way of the creation of a tax base deductible provision or reserve implying specially favourable rules for the calculation of taxable income on interest or royalty income), and which is not generally applicable in relation to interest or royalties received by companies or permanent establishments of the State of the beneficial owner.

2. As in certain circumstances it can happen (e.g. on the basis of a ruling) that the beneficial owner is subject to the tax mentioned in Article 3, paragraph 1(a)(iii) in respect of part of the interest or royalties under the conditions as provided for in paragraph 1, Member States are permitted not to apply the provisions of this Directive to that part of those items of income. Member States shall have to apply the provisions of this Directive at least to the other part of those items of income.

### **Article 8**

1. The Directive should in principle be applied by all Member States without delay. It is, however, appropriate to introduce arrangements for the gradual abolition of the taxes in those Member States which are large net importers of capital and technology and for which these taxes represent an appreciable source of revenue, namely Greece and Portugal.

Provision is made for a transitional period of five years during which the rate of tax is to be reduced progressively (10% during the first two years and 5% during the final three years).

The Council may decide, on a proposal from the Commission, on a possible extension of this derogation beyond the period of five years.

2. In order to avoid potential double taxation, the Directive requires the Member State of the beneficial owner to give a credit for the tax that is levied in Greece or Portugal on the basis of paragraph 1.
3. The deduction need not exceed the lower of the tax levied in Greece or Portugal on the basis of paragraph 1, and the tax due on the interest and royalties in the Member State of the beneficial owner.

### **Article 9**

Member States are required to implement the Directive not later than 1 January 2000. As indicated in the Commission's strategic programme of 1993<sup>8</sup>, Member States are required to refer in their implementing legislation to the Community Directives to which the legislation relates, and, in addition, to provide implementation tables showing the correspondence between the Community and national measures, in order to improve transparency and to assist the Commission in its task of monitoring the quality of implementation.

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<sup>8</sup> Communication of 22.12.1993 "Making the most of the internal market: strategic programme" COM(93) 632 final, page 12.

## **Article 10**

It is important that, in time, not only associated companies can benefit from the removal of taxes on interest and royalty payments as provided for in the Directive. Other, non-associated companies, are also confronted with the tax obstacles that this Directive is intended to remove, as are non-incorporated undertakings. It is therefore foreseen that the Commission will report on the operation of this Directive on the basis of the experience of its operation over the first three years, with a view to an extension of its scope and to assessing the application of Article 7, particularly in the light of progress on the code of conduct for business taxation.

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THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty establishing the European Community, and in particular Article 100 thereof,

Having regard to the proposal from the Commission<sup>9</sup>,

Having regard to the opinion of the European Parliament<sup>10</sup>,

Having regard to the opinion of the Economic and Social Committee<sup>11</sup>,

Whereas, in a Single Market having the characteristics of a domestic market, transactions between companies of different Member States must not be subject to less favourable tax conditions than those applicable to the same transactions carried out between companies of the same Member State;

Whereas this requirement is not currently met as regards interest and royalty payments; whereas national tax laws coupled, where applicable, with bilateral agreements do not ensure that double taxation is completely eliminated, and their application often entails burdensome administrative formalities and cash-flow problems for the companies concerned;

Whereas it is necessary to ensure that interest and royalty payments are subject to tax once in a Member State;

Whereas the abolition of taxation on interest and royalty payments in the Member State where they arise, whether collected by deduction at source or by assessment, on interest and royalty payments is the most appropriate means of eliminating the aforementioned formalities and problems and of ensuring the equality of tax treatment as between national and cross-border transactions; whereas it is particularly necessary to abolish such taxes in respect of such payments made between associated companies of different Member States as well as between permanent establishments of such companies;

Whereas the arrangements should only apply to the amount of interest or royalties or to the amount of the debt-claim which would have been agreed by the payer and the beneficial owner in the absence of a special relationship;

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<sup>9</sup> O J C

<sup>10</sup> O J C

<sup>11</sup> O J C

Whereas Member States should be permitted not to apply the provisions of the Directive if such payments are made to a beneficial owner who, in the Member State where he is situated, is not subject to taxation in respect of those items of income at a level which is normally applicable to interest or royalties received by a company of that Member State;

Whereas it is moreover necessary not to preclude Member States from taking appropriate measures to combat fraud or abuse;

Whereas Greece and Portugal should, for budgetary reasons, be allowed a transitional period in order that they can gradually decrease the taxes, whether collected by deduction at source or by assessment, on interest and royalty payments, until they are able to apply the provisions of Article 1;

Whereas it is necessary for the Commission to report to the Council on the operation of the Directive three years after the date by which it must be transposed, in particular with a view to extending its coverage to other companies or undertakings, to reviewing the application of Article 7, and to reviewing the scope of the definition of interest and royalties in pursuance of the necessary convergence of the provisions dealing with interest and royalties in national legislation and in bilateral double taxation treaties;

Whereas, in keeping with the principle of subsidiarity and the principle of proportionality as set out in Article 3b of the Treaty, the objectives of this Directive cannot be sufficiently achieved by the Member States and can therefore be better achieved by the Community; whereas this Directive is confined to the minimum required to achieve those objectives and does not go beyond what is necessary to achieve that purpose,

HAS ADOPTED THIS DIRECTIVE:

#### Article 1

1. A Member State shall exempt interest and royalties from liability to any taxes levied on such income in that Member State, whether collected by deduction at source or by assessment, where such interest or royalties are paid by or on behalf of a company of that Member State, or by a permanent establishment situated in that Member State of a company of another Member State, to an associated company of another Member State or to a permanent establishment situated in another Member State of an associated company of a Member State, where that associated company or that permanent establishment of the associated company is the beneficial owner of those payments.
2. Paragraph 1 shall not apply in situations which do not, in essence, represent cross-border payments. In particular:
  - (a) it shall not apply to interest and royalties paid by a company of a Member State, or by a permanent establishment situated in that Member State of a company of another Member State, if the beneficial owner of the interest or royalties is a permanent establishment situated in the first-mentioned Member State and the debt-claim or the right or property in respect of which the interest or royalties are paid is effectively connected with such a permanent establishment;

- (b) it shall not apply to interest and royalties paid by a company of a Member State to a permanent establishment situated in another Member State of an associated company of the first Member State, where the payment of such interest or royalties to the associated company otherwise than to a permanent establishment of it situated outside the first Member State would be subject to a tax collected by deduction at source in that Member State, unless the debt-claim or the right or property in respect of which the interest or royalties are paid is effectively connected with the permanent establishment.

## Article 2

1. For the purposes of this Directive:
  - (a) "interest" means income from debt-claims of every kind, whether or not secured by mortgage and whether or not carrying a right to participate in the debtor's profits, and in particular, income from bonds or debentures, including premiums and prizes attaching to such bonds or debentures. Penalty charges for late payment shall not be regarded as interest;
  - (b) "royalties" means payments of any kind received as a consideration for the use of, or the right to use, any copyright of literary, artistic, scientific work or software, including cinematograph films, any patent, trade mark, design or model, plan, secret formula or process, or for the use of or the right to use industrial, commercial or scientific equipment, or for information concerning industrial, commercial or scientific experience. Variable or fixed payments as consideration for the working of, or the right to work, mineral deposits, sources and other natural resources shall be excluded, as well as payments for the use of, or the right to use, software when ownership is transferred.
2. In addition to the income and payments referred to in paragraph 1, any income or payments which are considered to be interest or royalties, or which would, but for the nature of the payer or the beneficial owner, be considered to be interest or royalties either by virtue of a Double Taxation Convention in force between the Member State where the interest or royalties arise and the Member State of the beneficial owner or, in the absence of a Convention, by virtue of the tax legislation of the Member State where the interest or royalties arise, shall be treated as interest or royalties for the purposes of this Directive.

## Article 3

1. For the purposes of this Directive:
  - (a) "company of a Member State" means:
    - (i) any company formed in accordance with the law of a Member State and having its registered office, central administration or principal place of business within the Community and whose activities present an effective and continuous link with the economy of that Member State; and

(ii) which according to the tax laws of that Member State is considered to be resident in that Member State and is not, within the meaning of a Double Taxation Convention concluded with a third country, considered to be resident for tax purposes outside the Community; and

(iii) which moreover, is subject to one of the following taxes without being exempt, or to a tax which is identical or substantially similar and which is imposed after the date of entry into force of this Directive in addition to or in place of those existing taxes:

- *impôt des sociétés/vennootschapsbelasting* and *impôt des non résidents/belasting der niet-verblijfhouders* in Belgium,
- *selskabsskat* in Denmark,
- *Körperschaftssteuer* in Germany,
- *Φόρος εισοδήματος νομικών προσώπων* in Greece,
- *impuesto sobre sociedades* in Spain,
- *impôt sur les sociétés* in France,
- *corporation tax* in Ireland,
- *imposta sul reddito delle persone giuridiche* in Italy,
- *impôt sur le revenu des collectivités* in Luxembourg,
- *vennootschapsbelasting* in the Netherlands,
- *Körperschaftssteuer* in Austria,
- *imposto sobre o rendimento da pessoas colectivas* in Portugal,
- *yhteisöjen tulovero/inkomstskatten för samfund* in Finland,
- *Statlig inkomstskatt* in Sweden,
- *corporation tax* in the United Kingdom.

(b) One company is an “associated company” of a second company if, at least,

- (i) the first company has directly or indirectly a minimum holding of 25% in the capital of the second company, or
- (ii) the second company has directly or indirectly a minimum holding of 25% in the capital of the first company, or

- (iii) a third company has directly or indirectly a minimum holding of 25% both in the capital of the first company, and in the capital of the second company.

However, Member States shall have the option of:

- applying this Directive in circumstances where the level of the holding concerned is less than 25%;
  - replacing the criterion of a minimum holding in capital with that of a minimum holding of voting rights.
- (c) the “beneficial owner” of payments of interest or royalties is a company of a Member State or a permanent establishment which holds those payments for its own benefit and not as an agent, trustee or nominee for some other person.
  - (d) “permanent establishment” means a fixed place of business situated in a Member State through which the business of a company of another Member State is wholly or partly carried on.

A permanent establishment shall be treated as paying interest or royalties in so far as such payments represent a tax-deductible expense for that establishment in the Member State in which it is situated; it shall be treated as the beneficial owner of interest or royalties in so far as such receipts represent income in respect of which it is subject in that Member State to one of the taxes mentioned in paragraph 1(a)(iii).

- 2. Member States may withdraw the benefit of this Directive from companies of that Member State in circumstances where the conditions set out in paragraph 1(b) have not been maintained for an uninterrupted period of a minimum of two years.

#### Article 4

By way of derogation from the provisions of Article 2(1)(a) and (2), the Member State where the interest arises may exclude from the application of this Directive payments purporting to be interest such as any of the following:

- (a) income which is treated as a distribution of profits or as a repayment of capital;
- (b) income from debt-claims which carry a right to participate in the payer's profits;
- (c) income from debt-claims which entitle the creditor to exchange his right to interest for a right to participate in the payer's profits;
- (d) income from debt-claims which contain no provision for repayment of the principal amount.

Interest that has been re-characterized as a distribution of profits shall accordingly be subject instead to the provisions of Council Directive 90/435/EEC<sup>12</sup>, where it is paid between companies to which the present Directive applies.

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<sup>12</sup> OJ L 225, 20.8.1990, p. 6.

## Article 5

Where, by reason of the special relationship between the payer and the beneficial owner of interest or royalties, or between both of them and some other person, the amount of that income or those payments exceeds the amount which would have been agreed by the payer and the beneficial owner in the absence of such a relationship, the provisions of this Directive shall apply only to the latter amount; and, in the case of interest, where by reason of such a relationship the amount of the debt-claim in respect of which the interest is paid exceeds the amount which would have been agreed by the payer and the beneficial owner in the absence of such a relationship, the provisions of this Directive shall apply only to interest in respect of the latter amount, if any.

## Article 6

1. This Directive shall not preclude a Member State from taking appropriate measures to combat fraud or abuse.
2. A Member State may withdraw the benefit of or refuse to apply this Directive in the case of any transaction which has as its principal objective or as one of its principal objectives tax evasion or tax avoidance.

## Article 7

1. In addition to the situations covered by Article 6, Member States shall be authorized not to apply the provisions of Article 1 to any payments of interest or royalties made to an associated company of another Member State or to a permanent establishment situated in another Member State of an associated company of a Member State which, in respect of that income and by virtue of a provision made for its benefit or for the benefit of certain companies or permanent establishments or certain activities:
  - (a) is subject to the tax mentioned in Article 3(1)(a)(iii) at a rate which is lower than the rate of tax which would otherwise normally be applicable to such income received by companies of, or permanent establishments situated in, that other State; or
  - (b) benefits from a reduction in the tax base which would not otherwise normally be available to companies of, or permanent establishments situated in, that other State.
2. If the circumstances referred to in either of points (a) or (b) of paragraph 1 apply only to a part of the interest or royalties referred to in paragraph 1, Member States shall be authorized not to apply the provisions of this Directive to that part of the interest or royalties.

## Article 8

1. Greece and Portugal shall be authorized not to apply the provisions of Article 1 during a transitional period ending five years after the date of entry into force of this Directive. In such a case the rate of tax on payments of interest or royalties made to an associated company of another Member State or to a permanent



establishment situated in another Member State of an associated company of a Member State may not exceed 10% during the first two years and 5% during the final three years. Before the end of the fifth year, the Council may decide, on a proposal from the Commission, to extend the term of the transitional period provided for in this paragraph.

2. Where a company of a Member State, or a permanent establishment situated in that Member State of a company of a Member State, receives interest or royalties from an associated company of Greece or Portugal, or from a permanent establishment situated in Greece or Portugal of an associated company of a Member State, the first Member State shall allow an amount equal to the tax paid in Greece or Portugal on that income as a deduction from the tax on the income of the company or permanent establishment which received that income in accordance with paragraph 1.
3. The deduction provided for in paragraph 2 need not exceed the lower of:
  - (a) the tax payable in Greece or Portugal on such income on the basis of paragraph 1; and
  - (b) that part of the tax on the income of the company or permanent establishment which received the interest or royalties, as computed before the deduction is given, which is attributable to those payments under the domestic law of the Member State of which it is a company or in which the permanent establishment is situated.

#### Article 9

1. Member States shall bring into force the laws, regulations and administrative provisions necessary to comply with this Directive not later than 1 January 2000. They shall forthwith inform the Commission thereof.

When Member States adopt these provisions, these shall contain a reference to this Directive or shall be accompanied by such reference at the time of their official publication. The procedure for making such reference shall be adopted by Member States.

2. Member States shall communicate to the Commission the text of the main provisions of national law which they adopt in the field covered by this Directive. In this communication Member States shall provide a correlation table showing the national provisions which exist or are introduced in respect of each Article of this Directive.

#### Article 10

Three years after the date referred to in Article 9(1), the Commission shall report to the Council on the operation of this Directive, in particular with a view to extending its coverage to companies or undertakings other than those covered by this Directive, and to reviewing the application of Article 7.

Article 11

This Directive shall enter into force on the twentieth day following that of its publication in the *Official Journal of the European Communities*.

Article 12

This Directive is addressed to the Member States.

Done at Brussels

For the Council  
The President

## Withholding tax rates on INTEREST (%)

Situation in September 1997

Residence state of the debtor →	B (1)	DK	D (2)	EL (3)	E	F (6)	IRL	I (7)	L (8)	NL (9)	A (10)	P	FIN (11)	S	UK
Residence state of the beneficiary ↓															
Country without a tax treaty	15	0	45.15 26.87	40	25	15	26	30 15	25	0	34	20	28	0	20
B	-	0	15/0 15/0	15	0	15 10	15	15	15	0	15	15	10	0	15
DK	15	-	0 0	8	0	0	0	15	0	0	0	xxx	0	0	0
D	0/15	0	-	10	0	0	0	10	0	0	10	15	0	0	0
EL	10	0	10 10	-	xxx	10 0	xxx	10	0	0	34	xxx	10	0	0
E	15	0	10 10	xxx	-	10	0	12	10	0	5	15	10	0	12
F	15	0	0 0	10	0	-	0	10	10	0	0	12	10	0	0
IRL	15	0	0 0	xxx	0	0	-	10	0	0	0	15	0	0	0
I	15	0	10 10	10	0	10	10	-	10	0	10	15	15	0	10
L	0/15	0	0 0	8/10 (4)	0	10	0	10	-	0	0	xxx	0	0	0
NL	0/10	0	15 15	10	0	10	0	10	0/15 /2.5	-	0	xxx	0	0	0
A	15	0	45.15 26.87	0/10 (5)	0	0	0	10	0	0	-	10	0	0	0
P	15	xxx	26.8/ 15 15/10/ 0	xxx	0	12 10	15	15	xxx	xxx	10	-	15	0	10
FIN	10	0	15 0	10	0	10	0	15	0	0	0	15	-	0	0
S	10	0	0 0	10	0	0	0	15	0	0	0	xxx	0	-	0
UK	15	0	0 0	0	0	0	0	0/10	0	0	0	10	0	0	-

- (1) Normally no withholding tax on interest paid by a Belgian bank on deposits and registered bonds to non-resident company.
- (2) Non-residents only taxed on interest deriving from loans secured by immovable property (first figure) and interest deriving from jouissance rights and profit-sharing bonds. (second figure). Interest on over the counter banking transactions: 35%.
- (3) Exceptions, Greek Government bonds: 7.5%, bank deposits in Greek currency and bonds issued by private banks and companies: 15%, bank deposits in foreign currencies: 0%.
- (4) 8% if paid to bank or other institution.
- (5) 0% if Austrian company owns 50%+ of Greek company.
- (6) Numerous exceptions to general rate, e.g. interest exempt when paid to non-resident on loans contracted abroad, state bonds issued after 1/10/1984, corporate bonds issued after 1/1/1987 and certain negotiable debt instruments.
- (7) Different rates depending on source. Maximum rates shown in this table.
- (8) No withholding tax on ordinary interest. However, interest on profit-sharing bonds taxed - these rates shown here. Interest on loans secured by Luxembourg-situs immovable property taxed by way of assessment at normal corporate tax rate.
- (9) No withholding tax on interest, except on interest from profit-sharing bonds, treated in the same way as dividends.
- (10) Interest derived by non-residents not taxable, except interest deriving from a loan secured by a mortgage on Austrian-situs real estate, these rates shown here.
- (11) No tax generally withheld on interest payments to non-residents. This chart shows the tax withheld in exceptional cases, e.g. permanent loans in lieu of contribution of capital.

**Withholding tax rates on ROYALTIES (%)**  
(the possible value added tax applied is not included in these rates)

Situation in October, 1997

Residence state of the debtor →	B	DK	D	EL	E	F	IRL	I	L	NL	A	P	FIN	S	UK
Residence state of the beneficiary ↓															
Country without a tax treaty	15/25	30	26.87	20	25	33.3	26	30 <sup>3</sup>	10/12	0	20	15	28	28	23
B	-	0	0	5	5	0	0	5	0	0	10 <sup>1</sup> 0	5	0/5	0	0
DK	0	-	0	5	6	0	0	5	0	0	10 <sup>1</sup> 0	xxx	0	0	0
D	0	0	-	0	5	0	0	0/5	5	0	0	10	0/5	0	0
EL	5	5	0	-	xxx	5	xxx	0/5	5/7	0	10 <sup>1</sup> 0	xxx	0/10	5	0
E	5	6	5	xxx	-	6	8/10/ 5	4/8	10	0	5	5	5	10	10
F	0	0	0	5	6	-	0	0/5	0	0	0	5	0	0	0
IRL	0	0	0	xxx	8/10/ 5	0	-	0	0	0	10 <sup>1</sup> 0	10	0	0	0
I	5	5	5/0	0/5	8/4	5	0	-	10	0	10 <sup>1</sup> 0	12	0/5	5	8
L	0	0	5	5/7	10	0	0	10	-	0	10 <sup>1</sup> 20 <sup>2</sup> 0	xxx	0/5	0	5
NL	0	0	0	5/7	6	0	0	5	0	-	10 <sup>1</sup> 0	xxx	0	0	0
A	10 <sup>1</sup> 0	10 <sup>1</sup> 0	0	10 <sup>1</sup> 0	5	0	0	0/10	10 <sup>1</sup> 0	0	-	10 <sup>1</sup> 5	10	10	10 <sup>1</sup> 0
P	5	xxx	10	xxx	5	5	10	12	xxx	0	10 <sup>1</sup> 5	-	10	28	5
FIN	5	0	5/0	0/10	5	0	0	0/5	0/5	0	10 <sup>1</sup> 0	10	-	0	0
S	0	0	0	5	10	0	0	5	0	0	10 <sup>1</sup> 0	xxx	0	-	0
UK	0	0	0	0	10	0	0	8	5	0	10 <sup>1</sup> 0	5	0	0	-

<sup>1</sup> If the receiving company owns more than 50% of the voting stock of the paying company.

<sup>2</sup> If the payee is not a Luxembourg holding company.

<sup>3</sup> 30% generally applied to 75% of gross payment, effective rate 22.5%.

## FINANCIAL STATEMENT

This proposal for a Council Directive has no financial implications for the Community budget.

## **BUSINESS IMPACT ASSESSMENT**

### **The impact of the proposal on business, with special reference to small and medium-sized enterprises (SMEs)**

Title of proposal: Proposal for a Council Directive on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States

Business impact assessment reference number: 97006

The proposal:

1. One of the aims of the Single Market is to enable companies to operate throughout the Community without frontiers or obstacles.

One obstacle is caused by the tax levied on cross-border interest and royalty payments in the Member State where they arise.

The proposal therefore provides for the abolition of these taxes, initially on interest and royalty payments made between associated companies and their permanent establishments of different Member States.

This objective can be better achieved by the Community in order to meet the requirements of a Single Market. Neither unilateral nor bilateral measures taken by Member States have been able to provide a solution to the problems of such cross/frontier payments that fully meets the requirements of the Single Market.

The impact on business:

2. The proposal is initially restricted to payments made between associated companies and their permanent establishments that are subject to corporation tax in a Member State. This covers parent companies and subsidiaries; parent companies and sub-subsidiaries; fellow subsidiaries or sub-subsidiaries; and subsidiaries and sub-subsidiaries. All sectors of business will be able to benefit from this measure, whatever the sizes of the businesses or their geographic location within the Community.

The scope can subsequently be broadened on the basis of the experience of the first three years.

3. All companies falling within the scope of the Directive will benefit from it. They will avoid possible double taxation. Moreover, they will no longer have to comply with burdensome administrative formalities which currently exist if they wish to benefit from the reduction or abolition of withholding taxes foreseen in bilateral tax treaties. No other compliance conditions are provided for.

4. The proposal will have a positive effect on cross-border investment and improve the competitive position of Community companies, as it will improve their financial situation. It will therefore also have a positive effect on employment.
5. The proposal does not provide measures to take account of the special situation of small and medium-sized enterprises, because these enterprises will be able to benefit from the provisions of the Directive under the same conditions as other companies, in as much as they comply with the conditions of this Directive.

Consultation:

6. The views of business associations on this proposal have been received. They have all expressed strong support for the removal of source country taxes on cross-border interest and royalty payments in order to remove obstacles to financial flows.

For example:

- UNICE;
- European Association of Cooperative Banks;
- Association of European Chambers of Commerce and Industry;
- European Mortgage Federation;
- Banking Federation of the European Union.

ISSN 0254-1475

COM(98) 67 final

# DOCUMENTS

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Catalogue number : CB-CO-98-145-EN-C

ISBN 92-78-31887-6

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Office for Official Publications of the European Communities

L-2985 Luxembourg