GUIDANCE ON THE APPLICATION OF THE AGREEMENTS ENTERED INTO BETWEEN JERSEY AND EACH EU MEMBER STATE IN SUPPORT OF THE EU DIRECTIVE ON THE TAXATION OF SAVINGS INCOME

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Background

1. The European Union on the 3rd June 2003 formally adopted Council Directive 2003/48/EC on the Taxation of Savings Income in the form of interest payments. The preamble to that Directive states that its ultimate aim is to enable savings income in the form of interest payments made in one EU Member State to beneficial owners who are individuals resident in another EU Member State to be made subject to effective taxation in accordance with the laws of the latter Member State.

2. The EU Member States were concerned that so long as the United States of America, Switzerland, Andorra, Liechtenstein, Monaco, San Marino and the relevant dependent or associated territories of the EU Member States did not all apply measures equal to, or the same as, those provided for by the Directive, capital flight towards these countries or territories could imperil the attainment of the Directive's objectives. For this reason the European Union sought to conclude agreements with the countries and territories concerned that provide for the objectives of the Directive to be met within those countries and territories from the same date as within the EU Member States.

3. The Directive allows three Member States to adopt a withholding tax for a transitional period whilst the other twenty-two Member States adopt automatic exchange of information. The same option was extended to the non-EU jurisdictions referred to in paragraph 2 above, including the Crown Dependencies of Guernsey, the Isle of Man and Jersey.

4. The Crown Dependencies worked extremely closely together in reaching agreement with the EU Member States and this cooperation was reflected in the strength of their representations during the negotiations. The negotiations with the EU High Level Group on Taxation and the EU

Presidency also enabled the Crown Dependencies to better establish their international personality in negotiating and concluding such agreements.

5. The outcome of the negotiations was two Model Agreements, one between each of the Crown Dependencies and those EU Member States that have opted for automatic exchange of information and one between each of the Crown Dependencies and the three EU Member States that have opted for a withholding tax (Austria, Belgium and Luxembourg). These two Model Agreements have been approved by each of the Crown Dependencies legislatures and have been the basis for the individual Agreements ("the Agreements") signed between each of the Crown Dependencies and each of the EU Member States and the specific insular legislation required to bring the Agreements into effect.

6. The text of the Agreements follows that of the EU Directive in large part but with appropriate adaptations and the inclusion of additional safeguards in the provisions in the Agreements for the suspension or termination of the Agreements if certain events come to pass. In addition, to distinguish the Island from the EU Member States, to reflect the fact that the Island is not a part of the European Union and is not subject to the EU Directive, the term "retention tax" is used rather than "withholding tax".

What is the purpose of the Guidance Notes

7. The Agreements inevitably leave questions to be answered on points of interpretation. The Crown Dependencies working together therefore have agreed these Guidance Notes to accompany their respective insular legislation that is required to bring into effect the Agreements with each of the EU Member States.

8. It should be emphasised however that this Guidance is intended simply to offer practical assistance to those who are subject to the Agreements. The Guidance is not a legal document and does not replace the need to obtain proper legal advice. The Notes are being issued in the name of the Policy & Resources Committee which has overall responsibility for international matters but will be taken fully into account by the Comptroller of Income Tax who will have responsibility for administering the Regulations required to bring the Agreements into effect (the Taxation (Agreements with European Union Member States) (Jersey) Regulations 2005).

9. The Notes are intended to help the reader answer for themselves questions such as whether they are a paying agent, whether they are a person to whom interest payments are made, and whether the interest payments made or received are subject to the retention tax. Primarily the Guidance Notes are aimed at those who will be considered paying agents within the Island and will have responsibility for deducting the retention tax from interest payments made to individuals resident in an EU Member State. The Notes are not cast in stone and can be expected to be amended and added to in the light of experience.

10. The Guidance Notes should have relevance for banks, registrars, custodians and other financial institutions that make interest payments, or distributions from certain collective investment schemes, to individuals in the EU Member States. They may also be of interest to financial dealers and securities houses which purchase money debts or units in collective investment schemes from individuals subject to the retention tax, businesses which redeem money debts or units in collective investment schemes held by individuals and stockbrokers and others who act for individuals in the sale of such investments. They may also be relevant for those (such as accountants, solicitors or nominee companies) who hold or administer money debts and investments in collective investment schemes on behalf of individuals.

General Guidance

11. In approaching the implementation of the Agreements it should be noted that the Island has agreed to assist the European Union in ensuring that individuals resident in the EU Member States do not escape from a liability to tax, in circumstances where such a liability properly arises in the EU Member States, by moving their funds to the Island. In deciding on whether the retention tax should be applied to interest payments made to an individual resident in an EU Member State it is appropriate that regard is had for the tax status of the individual, if it is known to the paying agent.

12. Individuals resident in an EU Member State who are in receipt of interest payments that are subject to the retention tax may if they so wish avoid the imposition of the tax by opting for voluntary disclosure of information to the relevant authority of the EU Member State in which they are resident for tax purposes, or by obtaining a certificate from their tax authority (see paras 37-44 for further information on these options). To satisfy data protection legislation it is important that the disclosure is voluntary; that is, it is with the express authorisation of the individual.

13. When the retention tax is applied no details of the individual concerned will be received from the paying agent by the Island's tax authorities. No information on the individual tax payer therefore will be passed to the tax authorities of the EU Member State of residence. If an individual who is in receipt of an interest payment that has been subject to the retention tax wishes to obtain credit for that tax from his home tax authority he or she can seek to take advantage of the article in the Agreements that provides for the elimination of double taxation. However, if an individual intends to pursue this course of action a simpler arrangement might be to opt for the voluntary disclosure and avoid the retention tax in the first place (see also paragraph 83 below).

What have the Crown Dependencies agreed to do?

14. The Crown Dependencies have decided to follow the EU Member States of Austria, Belgium and Luxembourg – in common with the named third countries of Switzerland, Andorra, Liechtenstein, Monaco and San Marino and the dependent or associated territories of British Virgin Islands, Netherlands Antilles and Turks and Caicos – in adopting, during what is referred to as the 'transitional' period (see para 21 below), what is referred to in the EU Directive as a "withholding tax" but which in the Islands is referred to as a "retention tax". For the purposes of the Agreements between each of the Crown Dependencies and the individual EU Member States the two terms "withholding" and "retention" are to be read coterminously and have the same meaning.

How are the Agreements to be brought into effect?

15. The Model Agreements upon which the bilateral Agreements with each Member State are based have been approved by the Island's legislature. The individual bilateral Agreements have been signed by the parties and are brought into effect by specific insular legislation - the Taxation (Agreements with European Union Member States) (Jersey) Regulations 2005

16. Article 17 of the Agreements also provides that their coming into effect is conditional on the adoption and implementation by all the Member States of the European Union, by the United States of America, Switzerland, Andorra, Liechtenstein, Monaco and San Marino, and by all the relevant dependent and associated territories of the Member States of the European Community, respectively, of measures which conform with or are equivalent to those contained in the Directive or in the Agreements, and providing for the same dates of implementation. [The date of implementation is currently the 1st July, 2005.]

What will happen if there is evidence that the playing field is not level after the Agreements come into effect?

17. The Island has agreed to apply a retention tax with effect from the same date as the EU Member States apply the Directive, provided the EU Member States have adopted the laws, regulations and administrative provisions necessary to comply with the Directive, and the requirements set out in Article 17 of the Agreements have generally been met.

18. Article 16 of the Agreements provides for their termination by notice being given in writing specifying the circumstances leading to the giving of such a notice. In such a case the Agreement(s) shall cease to have effect twelve months after the serving of notice.

19. Article 17 of the Agreements provides for their suspension. This can occur should the Directive cease to be applicable either temporarily or permanently in accordance with European Community Law or in the event that an EU Member State should suspend the application of its implementing legislation. Suspension can also occur in the event that one of the third countries, or dependent or associated territories, referred to in the Directive should subsequently cease to apply the measures referred to in the Directive or the supporting Agreements.

What will happen at the end of the transitional period referred to in Article 14 of the Agreements?

20. Article 14 of the Agreements provides that at the end of the transitional period as defined in Article 10 of the EU Directive the Island will cease to apply the retention tax and apply automatic exchange of information in the same manner as is provided for in Chapter II of the Directive.

21. The transitional period does not have a fixed end date. It will only come to an end when the terms set out in Article 10 of the Directive are met. To quote from the Directive –

"The transitional period shall end at the end of the first full fiscal year following the later of the following dates:-

- The date of entry into force of an agreement between the European Community, following a unanimous decision of the Council, and the last of the Swiss Confederation, the Principality of Liechtenstein, the Republic of San Marino, the Principality of Monaco and the Principality of Andorra, providing for the exchange of information upon request as defined in the OECD Model Agreement on Exchange of Information on Tax Matters released on 18th April, 2002 (hereinafter the "OECD Model Agreement") with respect to interest payments, as defined in this Directive, made by paying agents established within their respective territories to beneficial owners resident in the territory to which the Directive applies, in addition to the simultaneous application by those same countries of a withholding tax on such payments at the rate defined for the corresponding periods referred to in Article 11(1) of the Directive;

- The date on which the Council agrees by unanimity that the United States of America is committed to exchange of information upon request as defined in the OECD Model Agreement with respect of interest payments, as defined in this Directive, made by paying agents established within its territory to beneficial owners resident in the territory to which the Directive applies."

22. Although the Island can take full advantage of these transitional arrangements, it is also open to the Island at any time to elect to apply the automatic exchange of information provisions in the same manner as is provided for in Chapter II of the Directive. If the Island so elects it shall no longer apply the retention tax and revenue sharing provided for in Article 9 of the Agreements. A decision to so elect however would not be made without extensive prior consultation with the finance industry and other interested parties.

What will be the rate of retention tax applied?

23. During the transitional period, as defined above, which is due to commence on 1st July 2005, the retention tax shall be levied at the rate of 15% during the first three years of that period, 20% for the subsequent three years and 35% thereafter.

Who will benefit from the proceeds of the retention tax?

24. Of the retention tax to be levied 25% will be retained by the Island authorities and 75% will be transferred by the Island authorities to the EU Member State of residence of the beneficial owner of the interest. That transfer is to take place at the latest six months following the end of the Island's tax year. It is emphasised that the money to be transferred will be a total amount per country and the identity of the individuals from whose savings income the retention tax will have been deducted will remain confidential to the paying agent concerned.

How will the requirements be enforced?

25. The Taxation (Agreements with European Union Member States) (Jersey) Regulations 2005 provide for the retention tax to be applied to those who are to be subject to the tax. Provision is also made for the exchange of information where those subject to the retention tax decide to take advantage of the voluntary disclosure arrangements (see paragraphs 37-44 below).

Who is to be liable to the retention tax?

26. An individual beneficial owner resident in an EU Member State who receives a savings income payment (hereinafter referred to as an "interest payment" but see paragraph 77 for a definition of the savings income that is subject to retention tax) made by a paying agent established in the Island, will potentially be liable to the retention tax.

27. An individual will not be deemed to be the beneficial owner when he or she

(a) acts as a paying agent (see paragraphs 48-56);

(b) acts on behalf of –

- a legal person;
- an entity which is taxed on its profits under the general arrangements for business taxation;
- a UCITS authorised in accordance with Directive 85/611/EEC or an equivalent undertaking for collective investment established in the Island (see paragraphs 84-100);

- an entity to which reference is made in Article 7(2) of the Agreements.

(c) acts on behalf of another individual who is the beneficial owner and discloses to the paying agent the identity of that beneficial owner.

If a paying agent holds information which gives him reason to believe that the individual he pays interest to does not receive the interest payment for his own benefit, because he is acting on behalf of another individual, the agent should take the same reasonable steps to establish who the beneficial owner of the payment is as would be the practice in complying with anti-money laundering and terrorist financing requirements.

28. The retention tax will not apply to payments to residents outside the EU, residents of the dependent or associated territories of the Member States, which will include residents of the Bailiwick of Guernsey, the Isle of Man and Jersey and residents of Switzerland and the other named third countries (Andorra, Liechtenstein, Monaco and San Marino).

29. 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 members of the joint account. However, alternative arrangements at the discretion of the paying agent may well be appropriate. What should be kept in mind is the extent to which a joint account holder who is resident in an EU Member State has the benefit of the interest payments credited to the account.

30. There may be other such complications. Another example is where an individual receives an interest payment for a period of which part is spent as resident outside the EU and part is spent as resident inside the EU. If it is

possible to separately allocate a portion of the interest received for that part of the year during which the person was resident outside the EU, that portion of the interest payment need not be subject to the retention tax. This apportionment, which is at the paying agent's discretion, can also be adopted where the voluntary disclosure option is chosen.

31. Another issue may arise in respect of an interest payment made after 1st July, 2005 in respect of a period covering the whole or part of a period prior to 1st July, 2005. In these cases, on the assumption that it is possible to apportion the interest payments, the retention tax need only apply to the payments that arise in respect of the period after the 1st July, 2005. For example, if interest is paid at the end of August, 2005 in respect of the preceding six month period, the retention tax need be applied on a pro rata basis only in respect of the two months of July and August, 2005; that is, to two sixths of the interest payment. This apportionment, which is at the paying agent's discretion, can also be adopted where the voluntary disclosure option is chosen. If the paying agent's systems cannot provide for any apportionment the full interest payment would be subject to the retention tax.

32. In deciding to whom the retention tax will need to be applied the focus should be on the ultimate aim of the Agreements which is to enable savings income in the form of interest payments made in the Island to beneficial owners who are individuals resident in an EU Member State to be made subject to effective taxation in accordance with the laws of the latter Member State. The emphasis should be on individuals, and also on those individuals who are not only resident in an EU Member State but are persons subject to effective taxation in accordance with the laws of the EU Member State. It is therefore consistent with the aims of the Agreements into which the Island has entered that the retention tax will not apply to interest payments made to –

- a legal person;

- an entity which is taxed under the general arrangements for business taxation;
- a trust (but see paragraph 50 for the position of trustees)

- an unincorporated association or society;

- an individual where the interest payment arises from negotiable securities issued before 1st March 2001 (see paragraphs 73-76);

- an individual where it is known to the paying agent that the individual benefits in their Member State of residence from an exemption from income tax; or where because of non-remittance of interest to an individual's Member State of residence no liability to income tax arises in that country of residence.

33. For the purposes of the implementation of the Agreements domestic partnerships, foreign partnerships and limited partnerships or equivalent entities are considered to be entities which are taxed under the general arrangements for business taxation.

34. The sixth bullet point in paragraph 32 above leaves open the question how the paying agent is expected to know that an individual benefits from exemption from income tax etc. For some existing customers, the paying agent may have an understanding of and/or documentary evidence confirming the customers tax status. Reliance on self-certification by a customer also may be appropriate, where the paying agent has no contrary evidence and where the assertion is consistent with the paying agent's understanding of the customer's circumstances. In other cases the customer may have in their possession documentation from a tax authority or other

source which would assist in confirming their tax status or they might be asked to provide a letter confirming that status endorsed by a professional third party such as a lawyer or accountant. The ultimate responsibility will rest with the paying agent. It will be for the paying agent to decide whether they have sufficient information in order for them to know that no tax liability arises but, unless evidence exists to the contrary, those able to take advantage of the sixth bullet point in paragraph 32 may be considered to have arranged their affairs in a tax efficient manner.

35. Another guiding principle in the application of the Agreements will be the wish to avoid unnecessary bureaucracy and cost to those who are required to implement the Agreements.

36. These Guidance Notes will not cover every case where the retention tax should not apply. In the light of experience, further guidance may be provided but it is important to again emphasise that this guidance will not take the form of legal advice.

Will there be any exceptions to the application of the retention tax?

37. Under Article 3 of the Agreements there is provision for the use of one of the following procedures in order to ensure that beneficial owners may request that no tax be retained.

(a) a procedure which allows the beneficial owner expressly to authorise the paying agent to report information on the interest payments to the appropriate body in the Island. Such voluntary authorisations will cover all interest payments made to the beneficial owner by that paying agent;

(b) a procedure which ensures that retention tax shall not be levied where the beneficial owner presents to his paying agent a certificate drawn up in his name by the competent authority of his EU Member State of residence for tax purposes in accordance with the arrangements set out in paragraph 43 below;

38. Authorisation to report information in accordance with sub-paragraph (a) above can be in such form as the paying agent will require, but can normally be expected to take the form of a written agreement, letter or other document between the parties. Individual beneficial owners will be regarded as giving express authorisation by adopting a course of conduct in accordance with such documents. The collection of retention tax is a legislative requirement that flows from the Agreements and involves no disclosure by a paying agent of personal data about an individual client to the authorities in that individual's Member State of residence. Whilst it is open to any paying agent to decide that they will not, for administrative reasons, collect retention tax it is a requirement of data protection legislation to obtain the consent of the beneficial owner to the information exchange option.

39. For existing investors, the paying agent should notify all beneficial owners that, under the legislation that flows from the Agreements, exchange of information is optional and subject to the express authorisation of the individual client. Such an authorisation should normally take the form of a written agreement [i.e. a positive opt-in] and the paying agent should not infer any such authorisation from a failure to respond to that notification.

40. It is sufficient in the case of new contractual relationships for the paying agent to include a clear notice in the terms and conditions of the account, fund or other relevant instrument that information will be disclosed to the appropriate authorities detailing the interest payments received by beneficial owners resident in an EU Member State from that investment.

41. Where the beneficial owner expressly authorises the paying agent to report information in accordance with paragraph 37(a) above, the paying agent will need to communicate the following information to the Comptroller of Income Tax in accordance with the provisions of the Taxation (Agreements with European Union Member States) (Jersey) Regulations 2005.

    (a) the identity and residence of the beneficial owner established in accordance with Article 6 of the Agreements (see paragraphs 57-66):

    (b) the name and address of the paying agent;

    (c) the account number of the beneficial owner or, where there is none, identification of the debt claim giving rise to the interest payment;

    (d) information concerning the interest payments specified in Article 4(1) of the Agreements. However, the minimum amount of information concerning interest payments to be reported by the paying agent may be restricted to the total amount of interest or income and to the total amount of the proceeds from sale, redemption or refund.

42. The communication of this information to the Comptroller of Income Tax should be automatic and should be conveyed (preferably electronically) in the required format (note: the format is set out in a schedule attached to this Guidance), at least once a year within three months following the end of the tax year for all interest payments within the scope of the Agreements made during that year.

43. Where the beneficial owner opts to present to his paying agent a certificate drawn up in his name by the competent authority of his EU Member State of

residence for tax purposes, that competent authority shall issue at the request of the beneficial owner a certificate indicating:

(a) the name, address and tax or other identification number, or failing such, the date and place of birth of the beneficial owner;

(b) the name and address of the paying agent;

(c) the account number of the beneficial owner or, where there is none, the identification of the security.

In respect of (a) both a tax or other identification number and birth data can be reported if desired. Such certificates shall be valid for a period not exceeding three years. A certificate should be issued to any beneficial owner who requests it within two months following such request.

44. Where such a certificate expires, a period of grace of up to six months may be allowed for the renewal of the certificate before the retention tax should be applied. Customers might also be given the opportunity to agree that if a tax certificate is held, and the tax certificate expires, then in the absence of any information to the contrary the alternative option of voluntary disclosure (see paragraph 37 (a) above) for exemption from the retention tax could be adopted.

When will the payment of retention tax be due?

45. Paying agents will be required to transfer to the Comptroller of Income Tax, as provided for in the Taxation (Agreements with European Union Member States) (Jersey) Regulations 2005, the retention tax retained, with the amount shown separately by the country of residence for tax purposes of those liable to the retention tax. The revenues will be required to be transferred on an

annual basis, and payment for each year will need to be made by the paying agents no later than the end of March in the following year. As stated in paragraph 24, the paying agent is not required to identify individuals' names. Only the total amount of retention tax allocated to the individual EU Member States of residence of the beneficial owners will be required to be notified by the paying agents to the Comptroller of Income Tax.

46. While the retention tax is not required to be paid over to the Comptroller of Inccome Tax other than on the basis above, the paying agent can levy the tax on the customer as and when the interest payment is paid/credited to an account. Thus, where an interest payment is actually paid/credited to an account every six months the paying agent may consider it prudent to levy the tax at the end of the relevant period and retain it in a suspense account until it is required to be paid to the appropriate body in the Island.

47. The retention tax payments made to the Comptroller of Income Tax may be made in Sterling, US Dollars, Euros or Swiss Francs.

Who will be required to collect the tax?

48. The responsibility for applying the retention tax rests with the paying agent. There are circumstances where a paying agent may be called upon to make a judgement on the liability to the tax (for example in respect of joint accounts where one or more of the account holders is resident in an EU Member State and one or more of the others are resident in a jurisdiction outside the EU – see para. 29 for the treatment of joint accounts). It will be for the paying agents to determine what information/evidence they use in making that judgement. All that is expected of paying agents is that they take what are perceived to be reasonable measures to determine the liability to the retention tax. To distinguish between those who make a genuine mistake and those who deliberately evade their obligations the Taxation (Savings

Income) (Jersey) Regulations 2005 state that only a person who knowingly fails to comply with any requirement imposed by those Regulations shall be guilty of an offence.

49. A paying agent is a person who is established in the Island (i.e. has a place of business or is resident in the Island) who makes interest payments in the course of his business or profession and makes those payments for the immediate and absolute benefit of a beneficial owner who is a resident of an EU Member State.

50. **The position of Trustees (other than trustees of unit trusts who are covered by paras 84-100 which deal with the position of collective investment undertakings): p**ayment made by a professional trustee will not be subject to the retention tax unless –

- the beneficiary of the trust concerned has an absolute entitlement to receive the savings income; and

- the beneficiary is an individual resident in an EU Member State; and

- the savings income is that covered by the Agreements.

If it cannot be said for certain that a payment made out of the assets of the trust represents an interest payment it may be assumed that the condition of the third bullet point above is not met.(Note:Trustees or Executors who in this respect are not acting in a business or professional capacity are not paying agents).

51. Any distribution by trustees of a discretionary trust or under any trust arrangement where the beneficiary has no absolute entitlement to such income is out the scope of the Agreements and therefore does not incur any

liability to retention tax. Distributions so made are not interest payments; they are payments from a trust the source of which is the trustees exercising their power of apportionment. Therefore, a trustee of a discretionary trust will not be a paying agent as that term is defined for the purposes of the Agreements. When a payment of interest is made by a financial institution to a trustee of a discretionary trust that financial institution will not be considered a paying agent for the purposes of the Agreements in respect of those payments.

52. In the absence of any evidence to the contrary, an individual trustee resident in an EU Member State may be considered to be a professional trustee for the purposes of paragraph 50, and their paying agents' obligations, if any, can be left to be determined by their Member State of residence; and where there are a number of trustees some of whom are and some of whom are not resident in an EU Member State the body of trustees can be considered to be out of scope for the purposes of the Agreements.

53. The following are further examples of circumstances in which a person would **not** be a paying agent, although this list is not exhaustive –

- a bank which passively makes a payment, for example, by processing a cheque or arranging for the electronic transfer of funds on behalf of one of its customers, or receives payments credited to a customer's account;

- a person who only makes payments other than interest payments, for example, pension, annuity and rental income payments;

- a person not in business who makes interest payments, for example on a personal loan to an individual resident in an EU Member State (i.e. the individual is not borrowing the money for a business purpose);

- a person who does not make interest payments in the course of a business or profession;

- the payments made are not interest payments;

- the person to whom the payments are made is not a person subject to the retention tax facility; that is, the person is not an individual resident in an EU Member State.

54. A paying agent is someone who makes an interest payment for the immediate and absolute benefit of an eligible beneficial owner. This means that, if a payment is made through an intermediary or a number of intermediaries the paying agent with responsibility for retaining the tax will be whoever is the last person who makes the interest payment to the beneficial owner. A person is not a paying agent, therefore, if the interest payment liable to the retention tax is made to another person who is a paying agent. The relevant paying agent is always the one that is the "last link in the payment chain" before the individual resident in the EU Member State who is in receipt of an interest payment. Where the last link in the payment chain is outside the Island no retention tax need be deducted within the Island. Whether any retention tax will be levied will then depend on whether the last link in the payment chain is within the scope of the EU Directive or the supporting agreements with the named third countries and the dependent and associated territories of an EU Member State.

55. The Agreements state that "Any entity established in a contracting party to which interest is paid or for which interest is secured for the benefit of a beneficial owner shall also be considered a paying agent upon such payment or securing of such payment". However this provision does not apply to the following entities which are specifically excluded from the definition of paying agent in this instance -

(a) it is a legal person;

(b) its profits are taxed under the general arrangements for business taxation; or

(c) it is an UCITS recognised in accordance with Directive 85/611/EEC of the Council or an equivalent undertaking for collective investment established in the Island.

All partnerships operating in the Island are considered to be covered by (b) – see paragraph 33. For the definition of an equivalent undertaking for collective investment, see paragraph 87 below. Other investment vehicles can be assumed to be covered by either (a) or (b).

56. The Agreements also provide that "An economic operator paying interest to, or securing interest for, such an entity established in the other contracting party which is considered a paying agent [under the above paragraph] shall communicate the name and address of the entity and the total amount of interest paid to, or secured for, the entity to the competent authority of its contracting party of establishment, which will pass this information on to the competent authority of the contracting party where the entity is established". However, the implementation of this provision will not be insisted upon where the administrative burden that this would impose would be disproportionate to the value of the information to be provided.

How is the identity and residence of a beneficial owner to be established?

57. The identification rules to be applied should mirror the "know your customer" ("KYC") rules that already are required to be complied with under the Island's anti-money laundering legislation ("AML"). Paying

agents therefore should be able to cater for the retention tax requirements through their existing KYC systems.

58. The Agreements provide for the application of different requirements depending on whether the contractual relations between the paying agent and the individual commenced before or on and after the 1st January 2004. However, in both cases the requirements will not exceed what is already necessary under AML rules. In most cases it should be clear whether contractual relations exist, and if so when they began. However there will be occasions when it is less clear. It will be for the paying agent to exercise reasonable judgement but, as guidance, pre-1st January 2004 contractual relations can be considered to continue to apply after that date where –

- the underlying contractual basis for the pre-1st January 2004 relationship continues;

- the pre-1st January 2004 customer takes advantage of a new product or service from the same paying agent;

- a business is acquired or merged with another business;

- a pre-1st January 2004 relationship is transferred from one group entity to another.

59. For contractual relations entered into before 1st January 2004 a paying agent can establish the identity of the beneficial owner, consisting of his name and address, by using the information already at his disposal and in accordance with the KYC requirements for anti-money laundering.

60. For contractual relations entered into, or transactions carried out in the absence of contractual relations, on or after 1st January 2004, the paying

agent must establish the identity of the beneficial owner by obtaining his name and address (and as in pre-1st January 2004 contractual relations this can be achieved using information held under existing KYC requirements for AML) and also, if there is one, a tax identification number ("TIN") allocated by the EU Member State of residence for tax purposes. The TIN should be established from the passport or the official identity card presented by the beneficial owner. If the TIN is not mentioned on the passport, on the official identity card or any other documentary proof of identity presented by the beneficial owner, the identity can be supplemented by obtaining their date and place of birth from their passport or official identification card.

61. In practice what this means is that if the copy of the passport or identity card or other documentary proof of identity that is held for AML purposes includes a TIN that information will in consequence be available to the paying agent and should be held on file. There will be no need to ask for a TIN if it does not appear on such documents. Instead the identity should be supplemented by a reference to the person's date and place of birth obtained from the passport, official identity card or other documentary proof of identity which should already be held to meet AML requirements.

62. The place of residence of the beneficial owner is to be established on the basis of minimum standards which will vary according to when relations between the paying agent and the recipient of the interest are entered into. In general the residence of the beneficial owner will be established by using the information at the disposal of the paying agent arising from the AML requirements with which the paying agent has to comply. Again, as with the establishment of the identity of the beneficial owner, where contractual relations are entered into, or transactions are carried out in the absence of contractual relations, on or after the 1st January, 2004, residence is expected to be established on the basis of the address mentioned on the passport, on

the official identity card or, if necessary, on the basis of any other documentary proof of identity presented by the beneficial owner.

63. For those individuals where the "on or after the 1 January 2004" rule applies, and who present a passport or official identity card issued by an EU Member State and who declare themselves to be resident in a jurisdiction other than an EU Member State, residence needs to be established by means of a certificate confirming the jurisdiction of tax residence (see paragraph 64 for an indication of what form that certificate can take) which the individual has received or obtained from a competent authority in the jurisdiction concerned. Failing the presentation of such evidence of residence the EU Member State which issued the passport or official identity document should be considered to be the country of tax residence.

64. The documents which can provide independent confirmation of tax residence and which will be considered sufficient evidence of residence for tax purposes may vary according to the jurisdiction concerned. In general the official documentation that is presently obtained to give proof of address for AML purposes would be considered sufficient to satisfy the requirements referred to in paragraph 63. There would therefore be no standard certificate. It will be left to the paying agents to exercise judgement as to whether the documentation in their possession is sufficient.

65. When an individual moves during the year there may be more than one country of residence and address for the same retention tax period. The relevant country of residence and address is that at the time the interest payment is made (see paragraph 30 for guidance on the position of an individual who receives an interest payment for a period of which part is spent resident outside the EU and part is spent resident inside the EU).

66. Using existing data to determine whether an individual is resident in an EU Member State and therefore liable to the retention tax is not considered to breach the data protection principle that data should be used for the purpose intended. However, when a new account is opened it is recommended that the customer should be informed of the purpose for which the information on his identity and residence will be used by the paying agent. When the retention tax is applied there is no disclosure of this information by the paying agent. When the customer expressly authorises the disclosure of information, and thus will have given their consent for its use for tax purposes, no problem should arise in respect of data protection.

What savings income is not covered by the requirements?

67. In general, a payment is not an interest payment if:

- it is not interest, or is not derived from interest;
- it is not related to a debt claim;
- the debt claim does not arise from a transaction for the lending of money;
- it is lottery, gaming or betting winnings.

68. More specifically the following are not regarded as interest payments;

- dividends paid on the ordinary or preference shares of companies;
- any other distributions of business or company profits – including distributions made by partnerships .

- distributions out of the assets of a trust other than where a relevant beneficiary has an absolute entitlement to interest payments as defined for the purposes of the Agreements (for example, through a Life Interest Trust) – see also paragraph 50 above;

- employment income and occupational pensions;

- personal pensions, annuities, and payouts from insurance policies;

- returns deriving from derivatives contracts;

- manufactured payments arising during stock loans or under sales and repurchase agreements (including where the underlying security is a money debt).

- trading profits (including the trading profits of a company or partnership);

- rents;

- capital gains (including, without limitation, equalisation payments);

- distributions and other payments derived from investment funds which are not within the scope of the Agreements (see paragraphs 84-100);

69. Most if not all structured products are considered to be covered by "returns deriving from derivatives contracts", and therefore structured products generically can be expected to be out of scope of the retention tax. However, this may not apply if the marketing/prospectus literature refers specifically to the return as "interest".

70. A distribution of income made by a collective investment fund or the proceeds of sale, refund or redemption of units in a collective investment fund is not an interest payment where its investment in debt claims, directly or indirectly, does not exceed 15% of its assets.

71. The sale or redemption proceeds of units in a collective investment fund will not be an interest payment subject to retention tax if the fund has invested 40% or less of its assets in debt claims. This will change from the 1st January 2011 to 25% or less.

72. Examples of instruments which are <u>not</u> debt claims include –

- ordinary or preference shares in companies;
- insurance policies;
- shares in open ended investment companies and units in unit trusts – but there are separate rules which apply to interest payments arising from investments in collective investment schemes which mean that these are reportable in some circumstances (see paragraphs 84-100);
- debts which do not arise from a transaction for the lending of money (for instance where there is a late payment and compensation interest is paid);
- certain debt securities which already existed before the 1st March 2001 – "grand-fathered bonds" (see paragraphs 73-76);
- partnership capital;

- early repayment of loans.

"**Grand-fathered Bonds"**

73. Certain negotiable debt securities are not treated as money debts if they meet certain conditions, for the duration of a transitional period which will end no later than 31 December 2010. These securities ("grand-fathered bonds") do not then count as money debts for all purposes of the Agreements: interest, premiums and discounts derived from these bonds are not savings income; and investment in these bonds does not count when deciding whether the thresholds which determine whether income from certain collective investment funds is savings income have been passed.

74. A security will be a grand-fathered bond if:-

- it was first issued before the 1st March 2001 or the prospectus was first approved by the appropriate regulatory authority before that date, and

- no further issue was made on or after the 1st March 2002.

75. If the bond is a government bond and a further issue is made on or after the 1st March 2002, the whole of the issue (whether made before, on or after 1 March 2002) is not a grand-fathered bond. The whole issue of the bond is then treated as a money debt. On 1st March 2002 the UK Treasury issued additional gilt-edged stock in order to ensure that the transitional protection will not apply to any gilt-edged stocks then in issue. All gilt-edged stock will therefore be treated as money debts and no gilt edged security will be a grand-fathered bond.

76. If the bond is issued by another type of issuer (e.g. a commercial company) and a further issue is made on or after 1st March 2002, only the part of the

issue made on or after the 1st March 2002 is not a grand-fathered bond. This part of the bond issue is treated as a money debt; the rest of the issue (made before 1st March 2002) is not a money debt. A paying agent may not always be able to distinguish between a pre 1st March 2001 and a post 1st March 2002 issue. In such cases, if the original 1st March 2001 issue has been tapped the paying agent may presume that the bond can be treated as a pre 1st March 2001 issue.

What savings income is covered by the requirements?

77. There are four main categories of savings income that will be treated as interest payments to which the retention tax, or the alternative reporting of information (see para 37), will apply. Broadly these are –

- interest paid out on debt claims or credited to accounts;
- interest rolled up and paid out when a debt claim is repaid or sold;
- distributions made by unit trusts and other collective investment funds which have the requisite proportion of their investments in debt claims (see also paragraph 70);
- accumulated income relating to units of a collective investment fund which has invested over 40% of its assets in debt claims when the units are redeemed or sold (see also paragraph 71).

What amount of savings income is subject to retention tax?

78. The retention tax should be levied as follows –

(a) interest payments made or credited to an account, relating to 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 government securities and income from bonds or debentures, including premiums and prizes attaching to such securities, bonds or debentures;

– in this case the retention tax will be levied on the amount of the interest payment made or credited;

[NB – penalty charges for late payment shall not be regarded as interest payments.]

(b) interest accrued or capitalised at the sale, refund or redemption of the debt claims referred to in (a) above

– in this case the retention tax should be levied on the amount of interest or income referred to in this sub-paragraph or by a levy of equivalent effect to be borne by the recipient on the full amount of the proceeds of the sale, redemption or refund;

(c) income deriving from interest payments directly, distributed by undertakings for collective investment where those undertakings are within scope (note: the position regarding these undertakings is dealt with more fully in paragraphs 84-100).

– the retention tax should be levied on the amount of income referred to in this sub-paragraph (but see paragraph 81);

(d) income realised upon the sale, refund or redemption of shares or units in undertakings for collective investment, where those undertakings

are within scope, if they invest directly or indirectly, via other undertakings for collective investment more than 40% of the assets in debt claims as referred to in (a) above

– in this case the retention tax would be levied either on the amount of interest or income referred to in this sub-paragraph or the full amount of the proceeds from the sale, redemption or refund (but see paragraph 81).

79. From the 1 January 2011 the percentage referred to in sub-paragraph (d) above shall be 25%.

80. For the purposes of sub-paragraphs (a), (b) and (d) of paragraph 78, the retention tax shall be deducted on a pro rata basis to the period during which the beneficial owner held the debt claim. If the paying agent is unable to determine the period of holding on the basis of the information made available to him, the paying agent shall treat the beneficial owner as having been in possession of the debt claim for the entire period of its existence unless the latter provides evidence of the date of the acquisition.

81. In connection with sub-paragraphs (c) and (d) of paragraph 78 the option is available of excluding any income or proceeds, as applicable, from undertakings for collective investment established in the Island where the investment and debt claims of the type referred to in (a) above held by such entities, directly or indirectly, does not exceed 15% of their assets. This minimum threshold option will be exercised.

82. In the case of life interest and similar trusts (see paragraph 50) it will be acceptable, subject to the trustees' power to allocate trust expenses between capital and income, to offset a just, reasonable and proportionate element of the income expenses first against investment income for each period prior to

accounting to the Life Tenant. Trustees therefore will have discretion to decide whether to apply the retention tax to the relevant savings income gross or net of a set fee for the services rendered on the understanding that where a net payment is made only a just, reasonable and proportionate element of the overall trust fee should be applied against the savings income identified.

83. **Avoidance of Double Taxation**

The Agreements provide for the avoidance of double taxation. However, as this involves the tax authority of the jurisdiction in which the beneficial owner is resident for tax purposes, the beneficial owner may prefer to avoid any retention of tax by a Jersey paying agent by choosing a voluntary disclosure option (see paragraph 37). Alternatively, double taxation can be avoided, and the benefit of the decision of the Island authorities to adopt the retention tax rather than engage in the exchange of information retained, by the paying agent exercising discretion in taking advantage of the following courses of action –

- Where the relevant savings income that is to be paid to an individual resident in an EU Member State is itself received from an EU Member State and is net of withholding tax which is at a rate equal to or higher than the rate of retention tax, the paying agent may treat the Member State's withholding tax already paid as satisfying the retention tax liability (such that no further retention tax is required to be deducted).

- Where relevant savings income that is to be paid to an individual resident in an EU Member State is received after the deduction of withholding tax from a jurisdiction other than an EU Member State the retention tax should be applied to the interest payment net of the withholding tax deducted (e.g. US source savings income that has

suffered US WHT of 30% would be liable to the retention tax on the remaining 70% and not the original 100%). However, if the practice of the EU Member States applying the withholding tax is shown to be to give full credit for the WHT paid so that no retention tax liability arises if the former is greater than the latter, the same practice may be adopted by Jersey paying agents.

The position of collective investment undertakings

84. **Exclusion from the definition of paying agent:** the Agreements provide that certain types of entity established in a contracted party to which interest is paid or for which interest is secured for the benefit of the beneficial owner shall not be considered the paying agent upon such payment or securing of such payment (see paragraph 55 above). This includes an entity that is a UCITS recognised in accordance with Directive 85/611/EEC of the Council or is an equivalent undertaking for collective investment established in the Island.

85. There may be certain circumstances where a UCITS or an equivalent undertaking is the last link in the chain in the payment of eligible interest (see paragraph 78) in which case such an undertaking might be a paying agent as defined for the purposes of the Agreements (see paragraph 49). However, where eligible interest payments received from a UCITS or equivalent undertaking that is within the scope of the retention tax are made by a bank (but see paragraph 53 for when a bank would not be the paying agent), registrar, custodian or other financial institution and not by the collective investment undertaking itself the latter will not be the last link in the chain and will not be called upon to retain tax.

86. **What is meant by established in the island when applied to collective investment undertakings (see also paragraphs 55 & 84 above)? i**t is not

intended that "established in the Island should restrict the exclusion of a collective investment undertaking from being a paying agent to collective investment undertakings formed in the Island. Collective investment undertakings formed elsewhere that are being "administered" in the Island would also be covered; that is, the word "established" in the Agreements should, where it refers to an undertaking for collective investment, be read as including "administered".

87. **What is an "equivalent" undertaking?** The position on collective investment undertakings established in the Island is complicated by the fact that the Directive refers to a UCITS which is an undertaking for collective investment in transferable securities authorised in accordance with the UCITS Directive (Council Directive of 20th December, 1985 (85/611/EEC) on the Co-ordination of Laws, Regulations and Administrative Provisions Relating to Undertakings for Collective Investment and Transferable Securities). The recitals to the Agreements confirm that the Island has legislation that is equivalent in its effect to Directive 85/611/EEC. The equivalent legislation in the Island is that governing "recognised" funds and other retail funds that are regulated effectively to the same standard as "recognised" funds. This is what is to be interpreted as an "equivalent" undertaking.

88. In respect of a retail fund which is marketed in Europe but which is not a recognised fund there can be a further test to apply in determining whether such a collective investment undertaking established in the Island should be considered within the scope of the Agreements. Attention should be first focussed on the equivalent legislation in the Island and then (if the collective investment undertaking is within that legislation) the focus moves to determining whether the collective investment undertaking would be considered (by the law, regulation or practice of any EU Member State or competent regulatory body in any such Member State) to be outside of the scope of Directive 85/611/EEC. The Agreements will not be applicable to a

collective investment undertaking established (as defined in paragraph 86) unless the collective undertaking concerned would be regarded as within Directive 85/611/EEC in each and every Member State.

89. **What is a collective investment undertaking?** A non-EU fund, which will include a fund which is not an equivalent fund established in the Islands, should only be regarded as an undertaking for collective investment if the following features are present:

- the fund is operated by way of business;
- investments in the funds are pooled;
- investors are not involved in its day to day management; and
- the fund is open ended (i.e. its capital varies with investments and withdrawals by investors like that of an authorised unit trust or an authorised open ended investment company) not closed ended (i.e. its capital is fixed like that of an investment trust).

Paying agents resident in the island making relevant payments, including for example in a nominee capacity, in respect of a collective investment undertaking established in an EU Member State, one of the named third countries or one of the relevant dependent or associated territories, may apply the 'home country rule'. That is, the paying agents may determine whether the undertaking is within or without the scope of the Agreements according to the treatment of the undertaking in the jurisdiction in which it is established.

90. **What is meant by a payment of interest?** In considering what is meant by a payment of interest reference should be made to paragraphs 78 to 82 above.

With specific reference to collective investment undertakings a payment of interest for the purposes of the Agreements will include –

- income deriving from interest payments directly, distributed by

    (i) a UCITS authorised in accordance with EC Directive 85/611/EEC of the Council; or

    (ii) an equivalent undertaking for collective investment established in the Island; or

    (iii) entities which qualify for the option under Article 7(3) of the Agreements; or

    (iv) other undertakings for collective investment established outside the territory to which the Treaty establishing the European Community applies by virtue of Article 299 thereof and outside the Islands;

- income realised upon the sale, refund or redemption of shares or units in the following undertakings and entities if they invest directly or indirectly via other undertakings for collective investment or entities referred to below more than 40% of their assets in debt claims as defined for the purposes of the Agreements –

    (i) UCITS authorised in accordance with Directive 85/611/EEC; or

    (ii) an equivalent undertaking for collective investment established in the Islands; or

(iii) entities which qualify for the option under Article 7(3) of the Agreements; or

(iv) other undertakings for collective investment established outside the territory to which the treaty establishing the European Community applies by virtue of Article 299 thereof and outside the Islands.

However the option exists of including the income above in the definition of interest only to the extent that such income corresponds to gains directly or indirectly deriving through interest payments within the meaning of paragraphs (1)(a) and (b) of Article 8 of the Agreements. This option is exercised at the discretion of the fund manager.

91. In respect of the bullet points in paragraph 90 above the option is available of excluding any income or proceeds, as applicable, from undertakings for collective investments established in the Island where the investment and debt claims of the type referred to in paragraph 78 (a) held by such entities, directly or indirectly, does not exceed 15% of their assets. As already stated in paragraph 81 above this minimum option threshold will be exercised.

92. The Agreements state that –

- when a paying agent has no information concerning the proportion of the income which derives from interest payments, the total amount of the income shall be considered an interest payment;

- when a paying agent has no information concerning the percentage of the assets invested in debt claims or in shares or units as defined above, that percentage shall be considered to be above 40%. Where the paying agent

cannot determine the amount of income realised by the beneficial owner, the income shall be deemed to correspond to the proceeds of the sale, refund or redemption of the shares or units.

93. However, where insufficient information is available to enable judgement to be exercised, it is to be expected that the paying agent in exercising that judgement will give the greater weight to the interests of the beneficial owner. Thus, if a paying agent has made proper enquiries and there remains an element of doubt as to whether the retention tax should be applied, it is reasonable to presume that a liability does not arise.

94. The Island Authorities will not exercise the option of requiring paying agents to annualise interest and treating such annualised interest as an interest payment (even if no sale, redemption or refund occurs during that period).

95. In determining whether a funds investment in debt claims exceeds 15%, or 40% of its total assets, attention should be focused on the fund's investment policy as set down in its rules or constitution unless the actual composition of the fund's total assets is less than 15% or 40%, measured at the time the last debt claim investment was acquired. Cash awaiting investment should be ignored for these purposes.

96. Where a fund operates equalisation arrangements, the capital element paid on the first distribution following a subscription will not be treated as an interest payment, subject to the discretion of the fund management or the paying agent.

97. In the case of an umbrella fund the 15% and 40% percentages referred to above can be applied to either the fund as a whole or to its constituent sub-

funds, at the discretion of the paying agent or the fund, as long as this is applied consistently year on year.

98. In practice it is probable that for some collective investment undertakings there will be occasion when the percentages referred to above fluctuate one side or the other of the 15% and 40% thresholds. This may be dealt with by focusing on what can be considered the normal course of events. Thus if at one point in time, the percentages suggest the application of the retention tax but this is not the norm, and the investment policy set down in the fund's rules or constitution is such that the retention tax would not ordinarily apply, it will be acceptable for the paying agent to decide that the retention tax should not be applied. A similar approach applies to the sale of units of a collective investment scheme.

99. In computing the 15% and 40% thresholds, provision can also be made for set off of borrowing against debt claims. Bonds and other negotiable debt securities falling within paragraphs 73-76 which are not regarded as debt claims also can be excluded from the assets of collective investment schemes for the purposes of calculating the amount of debt securities owned by that fund (for the purpose of the 15% and 40% threshold).

100. Some general points regarding Funds

- it will be for the paying agent to determine whether or not interest purchased should be deducted but this should be done on a consistent basis;
- it will be for the paying agent to determine the taxable element on redemption but this should be done on a consistent basis;

- interest does not include discounts arising in the secondary markets as opposed to original issue discount;

- limited partnerships are not included in the definition of undertakings for collective investment;

- the return on capital introduced by way of loan is not regarded as interest.

Conclusion

101. This guidance does not cover every aspect of the arrangements being entered into through the Agreements. In some cases this is because the Agreements are considered to be sufficiently clear in themselves. In other cases it is because it is considered any issues arising would need to be dealt with on a case-by-case basis.

102. Any queries concerning these guidance notes should be directed to the Policy & Resources Department (Telephone number: 603400 Fax number: 870755, Cyril Le Marquand House)

27th May 2005