In contrast to the Commission's initial stance, based on its report of 23 July 1998, the regulation of 26 May 1998 abolishes the 'may contain GMOs' option.

Moreover, it establishes a list of foodstuffs not subject to labelling (the list is initially empty, and will gradually be built up on the basis of opinions from the scientific committees) and in the preamble introduces the concept of a threshold for DNA or protein presence, below which labelling will not be necessary. No threshold value is set.

Opinion of the Economic and Social Committee on the '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' (1)

(98/C 284/09)

On 30 March 1998 the Council decided to consult the Economic and Social Committee, under Article 100 of the Treaty establishing the European Economic Community, on the above-mentioned proposal.

The Section for Economic, Financial and Monetary Questions, which was responsible for preparing the Committee's work on the subject, adopted its opinion on 9 June 1998. The rapporteur was Mr Pelletier.

At its 356th plenary session on 1 and 2 July 1998 (meeting of 1 July) the Economic and Social Committee adopted the following opinion by 136 votes to seven, with four abstentions.

1. **Introduction**

1.1. The ESC welcomes the Commission's move to rectify a tax discrepancy which is an obstacle to completion of an integrated single market.

1.2. Abolition of the withholding tax levied by some Member States on interest and royalties has long been recognized as being of major importance for a Community-wide market.

1.3. The Commission's first initiative in this direction dates back to 20 April 1990. In 1992 the Ruding report — broadly approved by the ESC (2) — prioritized this reform. Unfortunately the Commission, in the absence of consensus within the Council, decided in 1994 to withdraw its proposal. Eventually, in December 1997, the Ecofin Council gave the Commission the go-ahead to draw up the proposal on which the ESC is now consulted.

1.4. The ESC acclaims the Commission's persistence, not to say obstinacy. The same persistence should be displayed concerning the plan — approved by the Council and referred to in the explanatory memorandum — for a directive 'to ensure minimum effective taxation of income from savings' while bearing in mind the need to preserve the competitiveness of European financial markets at international level, which presupposes extension to non-EU countries and to the Member States' dependent or associated territories (3).

1.5. The purpose of the draft directive is to exempt interest and royalty payments made by a company of one Member State to an associated company (in which the first company has directly or indirectly a minimum holding of 25 %) of another Member State from any withholding tax in the Member State from which the payments are made. Hence tax on revenue deriving from such payments shall be levied solely by the Member State in which the beneficial owner is located.

2. **Financial justification for the draft directive**

2.1. From the financial angle, the aim is to avoid double taxation — which is undesirable per se — or, at

(1) OJ C 123, 22.4.1998, p. 9.
(2) ESC opinion of 24.11.1992; OJ C 19, 25.1.1993, p. 65.

(3) Conclusions of the Ecofin Council meeting on 1.12.1997 regarding fiscal policy (OJ C 2, 6.1.1998).

best, cashflow problems resulting from the inevitable delays sustained by the final beneficiary in recuperating the amounts withheld.

2.2. The proposal for a directive reflects the concern of the international professional bodies representing the companies concerned: UNICE, European Banking Federation, Association of Chambers of Commerce, etc.

2.3. The tables appended to the draft directive provide a fairly detailed picture of the nature of the problem, in tax terms. It can be seen that, in the absence of a bilateral tax agreement — not the case within the European Union — withholding tax on interest and royalties can be harsh in most States, though rates vary widely (between 45 % and 0 % for interest and between 33 % and 0 % for royalties).

2.4. In the European Union, bilateral agreements reduce such taxation to far lower levels but they do not always make it possible to avoid double taxation completely and the relevant schemes for levying withholding tax in the countries of the beneficial owners of the payments are complicated.

3. **Why has it taken so long to frame a directive?**

3.1. For a long time it has been generally recognized that rules are needed on such an apparently simple matter.

3.2. The difficulties stem from with the complexity of tax rules in the European Union and poor harmonization — except in the VAT sphere.

3.3. In addition, taxation falls within the sphere of national sovereignty because of its vital contribution to national budgetary resources. Hence the Treaty of Rome designated this area as one in which decisions must be taken unanimously.

3.4. The strict financial constraints imposed by the Maastricht Treaty or the Stability Pact make States particularly vigilant when there is any likelihood of loss of revenue, as in this particular instance.

3.5. The Member States' interests differ: some are net importers of capital and technology, viz. their external payments outstrip their receipts. Conversely, others are net structural exporters.

3.6. These difficulties may explain the Commission's cautious, wait-and-see, pragmatic approach; it is regrettable that this attitude is ultimately akin to being afraid to act.

4. **A cautious approach**

4.1. The draft directive hedges implementation with impressive precautions.

4.2. Interest and royalty payments may serve as device for evasion and fraud in the form, for instance, of unduly large payments made by the subsidiary to the parent company in the guise of interest or royalties. This practice, which corresponds to transfer of profits, usually occurs within a group with the intention of ensuring that profits will be taxed in a country where company income tax is low.

4.3. Here the draft directive draws logical conclusions as regards the option allowing Member States to readjust transfer charges when interest or royalties exceed 'arm's length' prices.

4.4. As the financial cost of exemption from withholding tax will hit Greece and Portugal hard, these countries are granted a five-year transition period during which taxes will be scaled down.

5. **An over-wary approach**

5.1. The scope of the proposed directive seems too restricted.

5.2. It limits exemption from withholding tax to payments between associated companies, despite the fact that this measure is fully justified where such payments are made between companies which are not in a dependent relationship.

5.3. The status of associated company is recognized only in the case of companies with a minimum shareholding of 25 % in another company although, under bilateral tax agreements, the preferential rules applicable to associated companies usually require a shareholding of 10 %.

6. **General comments**

6.1. The Commission reserves the right to propose at a later stage, as work progresses on the single market, an extension of this exemption to royalty and interest payments between non-associated companies.

6.2. The Committee does not grasp the logic of this restriction, which is designed to alleviate the proposal's financial impact on Member States that are net importers of capital and technology, when it is proposed in the case of the countries concerned (Greece and Portugal) to introduce a five-year transitional period over which the tax rate will be gradually scaled down. The general principle is that interest and royalty payments eligible for exemption from withholding tax must be 'arm's length' payments made between independent companies. When payments are made between associated companies, application of the 'arm's length' principle results in any surplus component being regarded as a distribution of profits eligible to benefit under Directive 90/435/EEC.

6.3. The general rule is therefore that interest and royalty payments are made between independent parties; in such circumstances, there are no particular grounds, as in the case of intra-group dividends (where the aim is to ensure tax neutrality, so as to avoid penalizing offices set up within the EU in the form of subsidiaries or controlled companies compared with permanent establishments), by restricting the scope of exemption from withholding tax solely to interest and royalty payments made between associated companies. On the contrary, it is vital to extend such exemption to all payments made between independent undertakings so as to avoid distorting terms of competition in such a way that national suppliers enjoy an unfair advantage.

6.4. The reasons given in paragraphs 6.2 and 6.3 above justify — once the five-year transitional period (possibly extended) has expired — the automatic extension of exemption provisions to interest and royalty payments between associated companies. The Committee therefore calls for Article 10 to be worded as follows:

> '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 reviewing the application of Article 7. Extension of the directive's coverage to companies or undertakings outside its scope may not be delayed beyond the transitional period of five years (possibly extended) stipulated in Article 8(1).'

6.5. Under Article 7 of the draft directive, Member States may choose not to apply the exemption from withholding tax where interest or royalties paid are subject to preferential corporation tax arrangements in the Member State in which the beneficiaries are registered. On this point Article 10 provides that the report to be made to the Council within three years of the Directive's entry into force shall particularly review the application of Article 7. The Commission specifies that it will be easier at that stage, especially in the light of progress on the code of conduct for business taxation, to ascertain whether it is necessary to continue to grant Member States the derogation provided under Article 7.

6.6. As the Commission points out in the explanatory memorandum accompanying the draft Directive, the Ecofin Council of 1 December 1997 gave its agreement to the framing of a code of conduct on company taxation, to provide for the freezing and dismantling of detrimental tax measures on the part of States. Zero taxation, or substantially lower tax rates than those normally applied in the Member State concerned, come into the above category.

6.7. The Committee would point to the importance of ensuring consistency between the common action envisaged under the code and the derogation provided for in Article 7 of the draft directive, viz. not to apply exemption from withholding tax when interest or royalty payments in the State where the beneficiary company is established are not normally taxed and hence are covered by the above code. Member States may not be authorized to take unilaterally new steps such as levying withholding tax on interest and royalty payments in retaliation against prejudicial tax measures subject to the code of conduct without compromising the consensus on which this code is founded and thereby seriously undermining it.

6.8. The beginning of the first sentence of Article 7(1) must therefore read:

> '1. In addition to the situations covered by Article 6, Member States shall be authorized to retain any existing taxes specified in Article 1 which are applicable to any payments of interest or royalties ...'

and Article 7(2) as follows:

> '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, the authorization for which the said paragraph provides shall be applicable to that part of the interest or royalties.'

7. Specific comments

7.1. *Level of holding (%) required for the status of associated company*

Since the aim is ultimately to do away with any withholding tax on interest and royalty payments made within the EU between companies, a reduction in the level of holding from 25 % to 10 % is recommended, which would tally with the limit set in most bilateral agreements for purposes of eligibility to benefit from the reduced rate of withholding tax applicable to dividends paid between associated companies.

Accordingly, in Article 3(1)(b), '25 %' should be replaced by '10 %'.

7.2. *Timespan for maintaining the level of holding*

To highlight the fact that Member States may not delay application of the directive until such time as the two-year timespan for maintaining the level of holding expires, 'subsequently' should be inserted before 'withdraw' in Article 3(2).

7.3. *Definition of 'royalties'*

Payments made by way of contributions to a group's central research expenditure must specifically be covered by the exemption from withholding tax. The OECD Fiscal Affairs Committee has clearly stated that no withholding tax should be levied on payments that do not represent royalties but result from agreements on contribution to a group's central expenditure. Hence Article 2(1)(b) should read: '... or for information concerning industrial, commercial or scientific experience which has been, or is in the process of being, acquired. Variable ...'

7.4. *Interest or royalties within the meaning of Article 5*

Insert the following sentence under Article 5:

> 'The provisions of Council Directive 90/435/EEC therefore apply to interest or royalty payments reclassified as distribution of profits if these are made between companies covered by the present directive.'

Reason: this clarification, and the attendant explanation, are the same as for Article 4.

Brussels, 1 July 1998.

The President

of the Economic and Social Committee

Tom JENKINS