

#### **Issue 4 – Extending the Directive to payments between unrelated undertakings**

We would like to submit a response on this issue on behalf of the Loan Market Association. The Loan Market Association is Europe's trade association for participants in the syndicated loan markets.

Historically, the Council Directive has been of limited relevance to our members because the exemption from withholding tax is restricted to payments of interest (and royalties) between associated companies. The type of transactions that we see instead involve payments of interest between unrelated undertakings. (For this reason, we are not in a position to comment on other elements of the consultation.)

The absence of a universal exemption from intra-EU interest withholding tax can lead our members to suffer double taxation, and is often cited by our members as a significant deterrent to lending. We therefore greatly welcome the willingness of this consultation to revisit the scope of the Council Directive.

We recently submitted a response to the European Commission on its consultation on double taxation problems within the EU. We feel that the representations we made with respect to that consultation are equally relevant here and would therefore like to use this opportunity to repeat the key points in the context of this consultation. In our view, the only workable solution is an intra-EU exemption from interest withholding tax that extends to independent parties, and we believe this consultation provides an excellent opportunity to create such an exemption.

#### **Approaches to interest withholding in the EU**

By way of background, there is no single, consistent approach to interest withholding in the EU; rather, different EU Member States apply a variety of withholding tax regimes.

- *No withholding tax*

Some EU Member States do not impose any withholding tax on interest payments made by residents irrespective of the status of the recipient of the interest, for example Luxembourg, the Netherlands, Austria, Sweden and Denmark (subject to limited exceptions). France has recently amended its withholding tax system and now only imposes interest withholding on payments made by its residents to certain "blacklisted" countries.

- *Intra-EU exemptions*

Some EU Member States have incorporated into their domestic laws an exemption from withholding tax on interest payments made by residents to all residents of other EU Member States. These include Spain and Ireland. Accordingly, any bank (or other lender) resident in the EU can lend to a borrower in Spain or Ireland free of local withholding taxes. This will sometimes be subject to the completion of certain procedural formalities, for example the lender may be required to produce to the borrower a certificate of tax residence issued by its home tax authorities evidencing that it is EU resident.

- *Full treaty exemptions*

In the majority of EU Member States, domestic exemptions are of limited application. Foreign lenders must therefore look to any double taxation treaties to which that EU Member State is a party. Double taxation treaties will typically require lenders to meet various conditions, subject to which a full exemption from interest withholding may be available. Many EU Member States, for example the UK, Ireland, the Czech Republic and Hungary, have wide networks of double taxation treaties that eliminate interest withholding paid to lenders in other EU Member States.

In our experience, cross-border lending within the above three categories makes up the vast majority of EU cross-border lending.

- *Partial treaty exemptions*

There are some EU Member States which do not generally negotiate double taxation treaties with full exemption from interest withholding, but only allow for a partial reduction in the rate of interest withholding. In some cases, for example Spain, this is of academic interest only in view of the domestic EU exemption. However, in other EU Member States, principally Italy, Portugal, Greece and Belgium, the treaties generally only provide for a reduction in interest withholding and there are no domestic exemptions applicable to cross-border lending. These jurisdictions typically have a limited number of treaties providing for full exemption and those that do were generally enacted for historic or political reasons (for example the Italy/Hungary treaty and the Greece/UK treaty).

Accordingly, a German lender to an Italian borrower for example, would receive interest subject to 10 per cent. withholding tax. As a commercial matter, no lender is willing to bear this cost and therefore, such lenders will in our experience only lend if the borrower bears the cost of the withholding tax by "grossing-up" its interest payments to such lenders. This would have the effect, for example, of increasing the Italian borrower's funding costs by 10 per cent. when lending from a German bank, compared to when lending from an Italian bank.

### **Potential for double taxation**

When a lender receives a payment of interest, it will be subject to corporate income tax on that interest in its home jurisdiction. If it additionally experiences withholding tax imposed by the borrower jurisdiction, it will have suffered double taxation.

In some cases, a lender's home jurisdiction may recognise this and grant the lender a partial credit against the income tax due. However, the credit rarely covers the cost of the withholding; for understandable policy reasons, most jurisdictions do not wish to bear the cost of another jurisdiction's withholding taxes.

### **Effects on cross-border lending**

The feedback from our members is that the unfavourable withholding tax regimes in some EU Member States acts as a strong disincentive to lending. It also reflects clear discrimination in the tax treatment of resident lenders and foreign branches as compared with foreign lenders. The fact that commercially the cost is passed to the borrower means that the double taxation has a protectionist effect; the business of lending to, for example, Italian, Greek, Portuguese borrowers is dominated by local banks.

In our view, genuine free movement of capital throughout the EU in respect of cross-border lending could be achieved by extending the scope of the Council Directive to cover independent parties.