



Problems with a European Tax Directive

by Charles-Henri Taufflieb, Partner of Trésofi by Sidetrade

The Directive 2003/49/CE of the European Council (3 June 2003)¹ defines the fiscal regime applicable to interests and royalty payments between "associated companies" of different countries of the EU. Under some restrictive conditions, it puts an end to the withholding tax on intra EU interest payments in cash pooling structures within groups. This Directive has been implemented in the domestic law of 16 European countries.

In 2003, this Directive widened to intra-EU interests and royalties the exemption of withholding tax on dividends. The aim of this European regulation was to abolish all fiscal obstacles on intra-group interest payments within the framework of cash pooling structures inside the EU.

As this Directive was drawn up without preliminary consultation with corporate treasurers' associations, the main conditions to fulfil in order to comply with these exemptions are restrictive and limited and do not fit with current cash pooling practices:

1. interests payments are only related to intra EU ones;
2. the group must have its effective headquarters in the EU;
3. to be regarded as "associated companies", three scenarios only are defined:
 - a) the company which pays interest has at least a direct

summary

In this article the author outlines the provisions of the Directive 2003/49/CE of the European Council, which was passed in June 2003 and is due for revision by the end of 2006, and some of the subsequent additions and emendations. The article identifies specific problems which are associated with it, such as the fact that it does not fully abolish all withholding tax on interests payments related to cash pooling operations within the EU. Finally the author makes a series of practical suggestions of ways in which the Directive might be revised to make it more workable and acceptable to European treasurers.

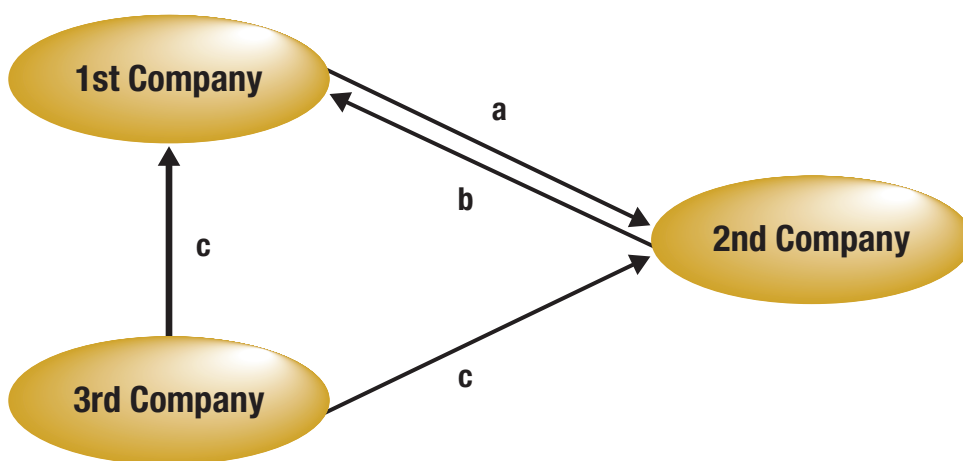
- share capital of 25% of the company which receives the payment;
- b) the company which receives the interest has at least a share capital of 25% of the company which issues the payment;
- c) a third company has at least a share capital of 25% in the company which issues the payment and in the company which receives it;
4. the legal form for each eligible company must be included in the Directive.

As a result, this Directive does not fully abolish all withholding tax on interests payments related to cash pooling operations within the EU.

Consequently, our various experiences in implementing cash pooling organisations proves it is necessary to analyse – case by case – the organisation of each group to check if each interest payment on borrowings is compliant with the Directive and with its transposition into each UE countries regulations.

More specifically, the definition of "associated company" for this Directive is too restricted when one considers many cash pooling structures where affiliated companies

1. The current situation





are not closely linked through share capital, especially when groups have, as a specific central treasury company, a subsidiary of the mother company and among others which are cash pooled with sister or daughter companies.

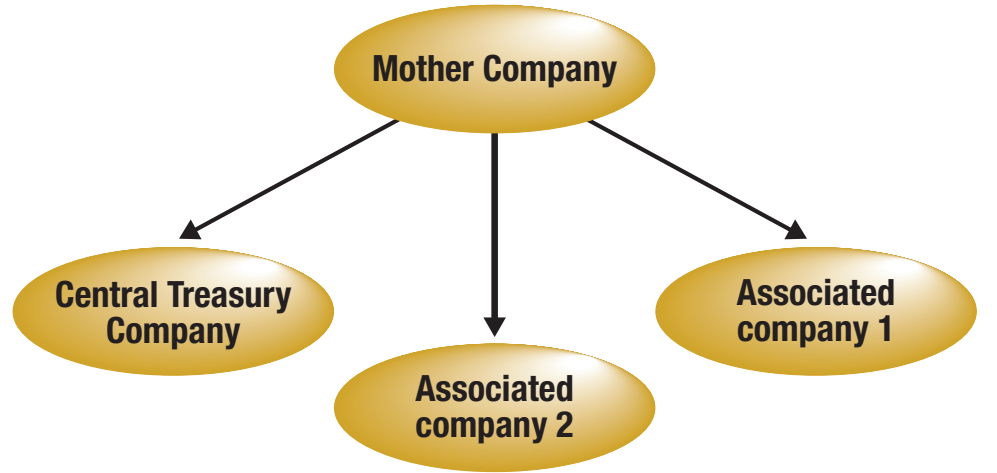
Suggested revisions

As the Directive might be reviewed by December, 31, 2006, we suggest widening its definition of "associated company" to cover all treasury operations within a group where one company has an "effective control"² over all the others independently of the share capital held, i.e. when a company has directly or indirectly more than 50% of the voting rights on an affiliated company. For example, the French *code monétaire et financier* authorises cash pooling transactions "with companies that have direct or indirect capital links with it that confer on one of the linked companies effective control of the others"³. The French code of commerce notably⁴ specifies that a company should be regarded as controlling another if "it directly or indirectly holds a percentage of the capital conferring on it the majority of the voting rights which it holds in the general meetings of the company".

We also suggest modifying the current regulation by:

1. defining "associated companies" as companies where one single and

2. The proposed alterations



common company holds jointly more than 50% of the voting rights of the associated companies or when one of these associated companies holds more than 50% of the voting rights of the other one;

2. extending the legal form of the companies covered by the Directive, taking a wide definition as the UK one which is "companies incorporated under the law of the United Kingdom". Such a definition could for example allow European company (SE) and French general partnership⁵ opting to pay the corporation tax to be eligible to the Directive;
3. considering the constraints of the location of the headquarters in the Directive. Currently, it doesn't allow non-EU groups which wish

to establish a euro cash pool structure within the EU to use this Directive. □

Footnotes:

1. Council Directive 2003/49/EC of June on a common system of taxation applicable to interest and royalty payments between associated companies of different Member States, Official Journal of the European Union, June, 26, 2003.
2. This definition is often taken into account for the appreciation of the exemption to the banking monopoly in the banking laws.
3. Article L 511-7
4. Article L 233-3
5. Société en Nom Collectif

Trésofi by Sidetrade

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1. Consulting and expertise in optimisation of working capital;
2. Operational organisation in cash pooling and implementing central treasury units, assistance in negotiations with banks etc.;
3. Internal control and reporting: internal procedures, securing payments and financial risks (foreign exchange, interest rate, counterparty etc).

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