

TELEKURS FINANCIAL IS READY FOR EU INTEREST TAXATION

In June 2003, the European Union issued a Directive on the taxation of savings income (Directive 2003/48), which comes into force on 1 July 2005. Telekurs Financial began to address the technical implementation of the new tax regulations at an early stage, and on 22 November 2004 will launch a comprehensive solution for both Switzerland and the EU area to handle the provision of the necessary data.

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The EU Directive on the taxation of savings income regulates the taxation of interest payments made across borders to natural persons within the EU area. The new system will be based primarily on an automatic exchange of information, whereby each financial institution that acts as a paying agent will transfer information on actual interest payments to the authorities in that EU Member State in which the final beneficiary is domiciled. Belgium, Austria and Luxembourg are exempted from this requirement and will instead tax such income at source. Under the terms of bilateral agreements with the EU, Switzerland will introduce the following withholding tax model on the basis of a State Treaty: paying agents domiciled in Switzerland are to deduct withholding tax from interest payments at a level of 15% from 2005, 20% from 2008 and 35% from 2011. This "retention" will then be forwarded to the Swiss Federal Tax Administration which will, in turn, forward two-thirds of total revenue to the EU.

A challenge for financial institutions

Implementing the EU's interest taxation regulations poses a great challenge to financial institutions. Swiss and European paying agents must now get to grips with the new regulations and make the necessary system modifications. This puts a strain on electronic data processing systems, in particular. Firstly, customer management systems must ensure that those customers who are affected by EU withholding tax can be clearly identified. It should be noted at this point that the Directive applies exclusively to natural persons and therefore not to legal entities and institutional investors. A second challenge is to pinpoint those financial instruments which pay out interest income in the sense of the EU directive.

A global solution with a broad foundation

Telekurs Financial began at an early stage to look into the technical implications of this Directive with the aim of modifying Valordata Feed (VDF) structures long before the planned introduction of interest taxation. The goal was to develop a universally applicable solution that could be deployed by customers in the EU area and Switzerland alike. The presently achieved solution is the result of a close and target-oriented cooperation with working groups set up by the Swiss Bankers Association. Contact was also established with a number of specialist bodies abroad, including the Association des Banques et Banquiers, Luxembourg (ABBL), the Association Luxembourgeoise des Fonds d'Investissement (ALFI) and the European Banking Federation (EBF).

The Valordata Feed (VDF) solution

The advent of interest taxation in the EU makes no significant difference to Telekurs Financial's core task, i.e. collecting, processing and distributing descriptive data, corporate actions data and market data. The remit for the project concentrated on flagging the financial instruments concerned using Telekurs's present instrument classifications, and on supplying the data that is required via Valordata Feed (VDF) (see box). These structural modifications will be incorporated in VDF Release 02/04, to be dispatched from 22 November 2004. →

Apart from the general flagging at instrument level, the task will be to determine the **actual tax status of interest payments** made in connection with the financial instruments concerned. A variety of rules must be observed here:

- For example, debt instruments issued prior to the 1 March 2001 cut-off are exempted from the Directive for the time being and will hold “grandfathering” status until 2010.
- Special rules also apply to investment funds: whether or not they are subject to tax depends on the proportion of qualifying interest-paying instruments in the fund assets.

The perspective of paying agents domiciled in Switzerland and the EU alike must also be taken into consideration in applying the new rules. The new VDF structure (see box) covers these differing outlooks.

Thanks to early preliminary work and a close cooperation with both national and international specialist bodies, Telekurs Financial can now offer a comprehensive solution for Swiss and European paying agents, even before EU interest taxation comes into force. **If you would like any further information on the EU savings income tax rules, simply send an e-mail to sales.tkf@telekurs.com** ■

Telekurs Financial's flagging strategy

As a general rule, the financial instruments affected by the new rules will be flagged as *In Scope*, *Out of Scope* or *Unknown*, using the existing instrument categories that are contained in the Telekurs database: bonds (o), floating rate notes (L), money market paper (Q), convertible bonds (V), medium-term notes (z), hybrids and structured instruments (6); participation certificates (G), trust shares (7) and units (C).

The strategy proposes that categories O, L, Q, V and z should automatically be flagged as *In Scope*. Categories 6 and G will be flagged initially as *Unknown*, as a detailed analysis is necessary in order to apply actual *In Scope* or *Out of Scope* status. The remaining categories, 7 and C, will also be marked *Unknown* until Telekurs Financial has received the relevant information from the fund management company and has been able to conduct an accurate assessment. To this end, Telekurs Financial will provide fund management companies with a suitable questionnaire (“self-declaration” principle). Financial instruments that are irrelevant with regard to EU savings income taxation will not be flagged in any way.

New VDF structure

- The new message type TKEUD (EU savings income taxation) supplies the basic information necessary to flag the instruments. This information is essentially a general *In Scope/Out of Scope* categorization, the “grandfathered” status of debt instruments and asset test data relating to investment funds.
- The new message type TKERD (fund self-declaration) contains data from the investment fund's own declaration (details supplied by the fund management company on the proportion of “non-grandfathered” debt instruments in the fund assets, plus the attendant validity data and in-depth information on the investment fund itself).
- The message type TKFAD (instrument administration) provides an additional summary of the most important key data. This attribute states whether or not withholding tax must be levied.
- The remaining information is supplied in message types TKXSD (taxable interest from fund distributions) and TKPRD (qualifying accrued interest on investment funds).