Observations on the European Commission's proposal Faster and Safer Relief of Excess Withholding Taxes (COM(2023) 324 final)

I. Background

On 19 June, the Commission published a proposal for addressing major inefficiencies and divergences in national withholding tax (WHT) procedures on dividends and interest payments from securities. The initiative is part of the 2020 Capital Markets Union (CMU) Action Plan and aims at encouraging cross-border investment, but also at tackling tax abuse as observed in the "cum-cum" and "cum-ex" scandals. Under the current patchwork of national WHT procedures, interest or dividend payments may be subject to either excess taxation (i.e. double taxation or a higher tax rate than what the taxpayer should pay based on its tax residency status) – which can prevent investments in securities originating in other jurisdictions – or complex operational processes in the refunding of double taxation. This legislative proposal follows earlier non-legislative measures that were aimed at harmonising WHT procedures – namely the 2009 Recommendation on withholding tax relief procedures and the 2017 Code of Conduct on withholding tax - but did not yield the expected results.

Enhancing and harmonising WHT procedures is one of the harmonisation areas within the T2S harmonisation agenda and hence a an important barrier in post-trade procedures identified by the AMI-SeCo. A harmonised WHT framework would remove very significant barriers preventing today a fully integrated European post-trade services landscape. Inefficient, fragmented and uncertain national WHT procedures are an important barrier in particular in the area of collateral management and collateral mobility in EU capital markets. Accordingly, the AMI-SeCo had provided a response to the Commission's public consultation on WHT procedures, highlighting the main elements for a robust common framework for WHT relief, and had addressed recommendations to the Commission (letters of 2018, 2020).

II. Brief summary of the proposal:

The following are the **key elements** of the Commission's proposal:

Scope: the general scope (e.g. eTRC) of the proposal applies to all taxpayers and all Member States but the mandatory scope of the proposal on national registers and withholding tax relief at source or faster refund procedures concerns only dividends paid on publicly traded equities, while on publicly traded bonds or other instruments Member States may decide to 'opt in' and apply the framework.

Common digital tax residence certificate (eTRC): The Commission seeks to reduce administrative burdens by allowing investors to use only one digital tax residency certificate for tax refunds in the EU. Under the proposal, Member States would have to issue the eTRC for tax residents in their jurisdiction upon the taxpayer's request within one business day through a fully automated system. The proposal also specifies the harmonised elements eTRCs should contain to identify the taxpayer and confirm their tax residency. The eTRC will be based on EUID and LEI and will build on the e-IDAS framework. The details of the eTRC will be elaborated by the Commission via in implementing act (assisted by a committee of experts).

Common reporting: Under the proposal, Member States would establish national registers of certified financial intermediaries (CFIs) that apply WHT relief procedures. CFIs would need to report where their clients' investment takes place to the relevant authorities regardless of their country of residence. This would allow recipients to ascertain the identity of the final investor and their potential entitlement to any WHT rebate. The proposal also introduces reporting requirements to help authorities combat "cum-cum" and "cum-ex" abuse schemes, namely by providing information about the holding period of

underlying securities[1] and information about financial arrangements linked to the securities for which the taxpayer is requesting relief. Here also the communication standards will be set by the Commission via an implementing act (assisted by a committee of experts).

Systems of relief: The proposal contains two procedures to accelerate and harmonise withholding tax processing across the EU. Member States that apply excess tax relief for dividends and, optionally, those that apply excess tax relief for interest would need to choose one of the proposed procedures or apply a combination of both:

- **Relief at source:** The correct tax rate, as per the investor's tax residency, is applied at the time of payment of dividends or interest based on the applicable domestic rules and/or international agreements (such as double taxation treaties).
- **Quick refund:** The payment of a dividend or interest is made taking into account the domestic WHT rate but the excess tax is paid back to the taxpayer within 25 days from the date of requesting the refund (provided all reporting obligations have been fulfilled).

These relief procedures will not apply in cases where the securities were acquired within a period of two days before the ex-dividend date or where there is a financial arrangement that has not been settled, expired or otherwise terminated at the ex-dividend date.

III. Observations

A table is provided in the annex with a preliminary assessment of the proposal against the key points highlighted by the AMI-SeCo to the Commission in the context of the 2022 public consultation on withholding tax procedures.

Overall, the proposal (if endorsed by the Council) would be a major step in the right direction of reducing WHT-related burdens and uncertainties of issuers, investors and intermediaries in cross-border transactions. Nevertheless, a lot of procedural details are left for the implementing acts by the Commission and the actual implementation by the Member States so it may be pre-mature to provide a fully-fledged assessment (The text foresees implementing acts relating to (i) issuance of eTRCs (Article 4), (ii) reporting obligations of intermediaries (Article 9), and (iii) the QR request (Article 13)).

The following aims to summarise the key points or questions that would need to be clarified and potentially changed from a post-trade integration perspective:

- **Scope:** The scope of the proposal should be extended to all securities constituted under the laws of the Member States and issued in EU CSDs, if such securities pay income that is subject to withholding tax in the Member States. From a CMU perspective, and to minimise the complexity of EU capital markets, it is important to have common operational processes for all securities that have an issuer CSD in the EU. The arguments in favour of treating dividend paid on equities and interest income paid on debt instruments the same way from a WHT procedures perspective are the following: i) debt markets constitute a large proportion of the EU capital markets. Measuring by the value of amount issued, their share is larger than that of equities[2]; ii) accordingly the overall amount and frequency of distribution of interest income across borders in the EU (depending on the general interest rate environment) may be larger than that of dividends iii) from a post-trade procedures (incl. WHT procedures) perspective the cash distributions related to dividend or interest income do not differ from each other operationally.
- **Definition of a financial arrangement** (Article 3, item 17) **and exclusion of securities positions with financial arrangements from the QR/RAS processes**. The definition of financial arrangements is very broad and would potentially exclude a very substantial number of positions from the QR/RAS processes. Although there is a rationale to exclude some financial arrangements to tackle cum/cum abuse, there is the possibility to tailor the exclusion so that it

[1] Although in Annex II section E of the proposal related to the reporting on the holding period only the amount of securities acquired more than two days before ex-date and the number of securities acquired within two days of the ex-date are requested and both these relate to the trading positions (not applying the record date principle) which implies that the reporting may not give accurate information on holding periods.

[2] According to public ECB statistics the share of debt instruments in the value of all securities issued in EU CSDs at the end of 2022 was 56 % compared the share of 35 % of equities. The amounts on cross-border holdings of different types of instruments reported in the Commission's Impact Assessment also show higher cross-border holdings of debt instruments than equities (although the difference is smaller in that estimation).

does not cover some types of collateral management arrangements. There is a need for a more granular, and more operational definition (so that all parties, including the custodian and its clients, can be certain as to what activity falls within the QR/RAS procedure and what doesn't).

- **Requirement for intermediaries to register separately in each Member State:** This requirement misses a major opportunity to make Europe a simpler and more accessible location for capital markets activity. This requirement will dissuade smaller and non-European custodians from registering. There should be the possibility to register in one Member State and for that registration to benefit from a "passport" valid in all Member States or for a set of practical arrangements whereby an intermediary can achieve registration in multiple Member States through a common application process (e.g. this could be achieved by a single central EU website for CFIs to register).
- **Risk of Member States creating additional/divergent requirements** with respect to the reporting obligation. It will be critical that Member States do not create additional/divergent requirements with respect to the reporting obligation. It will be very important the Level 2 process achieves the objective of common reporting obligations.
- **Process for EU and third country investors** for which at least one custodian in the custody chain is not registered. Article 10, paragraph 3, suggests that end investors for which at least one custodian in the custody chain is not registered can still benefit from the RAS and QR procedures, providing that a certified custodian provides reporting on behalf the uncertified custodian. It will be important that there is full certainty as to how this reporting should be provided including the related liabilities of certified CFIs providing information on behalf of uncertified CFIs, and that the reporting modalities do not differ by Member State.
- **Interpretation of verification obligation and liabilities placed on intermediaries (Article 11, paragraph 2 and Article 16):** It will be important that intermediaries receive consistent guidance as to what exactly "verification" in this context entails, so that the guidance does not differ by source country. The level of liability that might be put on individual CFIs needs to be carefully analysed. The AMI-SeCo points out that CFIs would not have access to all information ("facts and circumstances") in the chain as part of their ordinary course of business and, as a result, they would not be able to verify all information received but would in part have to rely on self-declarations of other parties. With respect to Article 16 (Civil liability) the Directive could be more precise to avoid diverging application by Member States. It could be further specified what "appropriate measures" by Member States may include in this context so that the application does not lead to an un-level playing field and a lack of harmonisation.
- **Legacy reclaim arrangements:** In its current form, the Proposal will exclude many positions from the RAS and QR procedures, even positions that may currently benefit from RAS and QR procedures. Excluded positions will include positions subject to financial arrangements, positions traded within two days of ex-date, positions for which the investor can benefit from an exemption, and positions for which a party in the custody chain has not provided reporting. Accordingly, it will be very important that the legacy reclaim procedures function appropriately. To the greatest extent possible, Member States should improve their legacy reclaim arrangements, by incorporating the eTRC, and elements from the RAS and QR procedures, in these arrangements**.**
- **Use of ex-dividend date instead of record date principle:** The current proposal specifically mandates that Member States do not grant relief under the QR/RAS procedures for shares purchased within two days of ex-date. As a tool to tackle cum/ex abuse, this exclusion is redundant and ineffective, and it will also create a set of new problems. It is redundant as the right tool to tackle cum/ex abuse is to ensure that market claims represent indemnities and not taxable dividends. By ensuring that market claims represent indemnities, there is no artificial creation of taxable dividends, and thus there is no possibility for cum/ex abuse.[3] It is also ineffective, as any market claim (treated as a taxable dividend) creates the theoretical risk of the artificial creation of a taxable dividend. This exclusion may create problems: i) legitimate buyers of securities will not be able to use the relief, ii) different record date positions and different market claims may be subject to different processing. Moving to a T+1 settlement cycle for secondary market outright transactions might alleviate (some of) these issues.
- **Implications for collateral management and corporate actions processes.** The proposal may

[3] A discussion paper by the T2S Advisory Group on tax processing explains this point in detail: https://www.ecb.europa.eu/paym/groups/shared/docs/a226b-20161130_ag_discussion_note_on_harmonisation_of_tax_processing.pdf

raise issues, inter alia, as it explicitly denies the provision of relief to collateral givers, as it does not integrate tax processing with corporate actions processing, and as it does not consistently apply the record date principle, but rather in some places uses a modified version of an ex-dividend date principle. There is a need for a full understanding of the implications of the proposal both for collateral management, and for corporate actions processes.

  - With respect to collateral management, the proposal does not encourage the provision of collateral, as, to benefit from the QR and RAS procedures, the collateral giver will have to end the collateral arrangement. Furthermore, the prohibition on QR and RAS applies to any collateral arrangement (i.e. both title transfer and pledge). This is inconsistent with the approach and objectives of the Eurosystem work on the SCoRE standards and also with the spirit of the Financial Collateral Directive.
  - With respect to corporate actions processes that involve tax processing (not only cash dividends and interest payments, but also stock dividends), there may be considerable complexity, both for corporate actions on stocks and for corporate actions on flows.

  Within a single record date position in a single security part of the position may have one tax status, while a different part of the position may have a different tax status. Similarly, for market claims whose calculation depends on a tax status, some market claims may have one tax status, while other market claims in the same security and for the same investor may have a different tax status, as, for example, they relate to a trade executed less than two days before ex-date, and as they relate to securities transfer that is part of a financial arrangement

- **Lack of harmonisation of definition of beneficial owner for tax purposes.** The proposal leaves the identification of final, beneficial owners to the existing national legal frameworks (the source country definition would apply) and relies on the financial intermediaries to apply the necessary national rules in this regard. Lack of certainty on the identity of beneficial owner in a cross-border investment context is a barrier that may continue to discourage cross-border security investments within the EU, even if more efficient withholding tax processes are applied. The creation of a clear and consistent approach to this definition could provide certainty for tax authorities and investors alike. Article 11(1)(a) of the draft Directive requires that CFIs obtain and verify a declaration that the registered owner is the beneficial owner of the dividend or interest, however, there is no definition of beneficial ownership in the draft Directive and Member States have taken a wide range of approaches in dealing with the application and consequence of the beneficial ownership requirement.

IV. Recommendations by the AMI-SeCo

Based on the observations made above with the caveat that significant details are left for the implementing acts by the Commission or the Member States, the AMI-SeCo wishes to highlight the following recommendations for considerations by the Commission and the Council in relation to the proposal:

a) **Scope:** The AMI-SeCo recommends that the scope of the proposed Directive is extended to all securities constituted under the laws of the Member States and issued in EU CSDs, if such securities pay income that is subject to withholding tax in the Member States. In particular, this would imply extending the mandatory scope of the proposal to debt instruments in addition to equities, i.e. to cover WHT on interest income, if applicable. This would have the potential to unlock significantly higher integration and efficiency benefits of the proposal than keeping the scope restricted to equities and dividend income only.

b) **Definition of financial arrangement and exclusion of securities subject to financial arrangements:** The AMI-SeCo recommends that a more sophisticated definition of financial arrangements is provided in the proposal which could give a more restricted interpretation of those arrangements for which the beneficial owner cannot benefit from the RaS and QR procedures. The more sophisticated definition of financial arrangement should be based on actual and concrete experience related to the use of cum / cum tax abuse and should target specifically those types of arrangements which have been and can be used for the purpose of such tax abuse. In particular, the definition of such excluding financial arrangements should not cover tri-party collateral management operations and collateral operations with central banks.

c) **Use of the record date principle and treating market claims as indemnities:** The framework

could leverage the record date principle, the concept used in post-trade processing of corporate actions (to which the withholding tax procedures on holdings also belong) rather than the trading concept of the ex-date. It could require Member States that the date regarding the date on which the holder of a security is recorded for tax purposes (i.e. the 'tax record date') is based on the settlement date of securities in CSDs' and custodians' books. This would have the major benefit of aligning dates of the tax record date with those of other corporate actions relevant for the income on securities. In addition, and consistently with this, Member States could consider treating market claims (i.e the reallocation of securities proceeds in case the beneficial owner of the security on the record date is different from holder of the security in settlement systems or custodians' books) as indemnities rather than 'manufactured' income which would eliminate the mechanisms used in the past for cum / ex tax abuse.

d) **Treatment of global investments:** With a view to attracting global capital flows to the EU, the AMI-SeCo recommends that the EU-framework created by the Directive allows for third-country investors to benefit from the faster and more efficient RaS and QR procedures (provided that such third countries follow all requirements of the framework and, where applicable, have a relevant agreement with the EU) by i) allowing that third countries issue e-TRCs to their residents; ii) allowing third-country intermediaries to act as CFIs under the framework iii) allowing investors using non-CFI intermediaries to have access to the more efficient procedures provided all required information is made available to competent authorities on these investors.

e) **Harmonised definition of beneficial ownership**: the AMI-SeCo is of the view that harmonising the definition of beneficial owners of securities (at least) for tax purposes is a key ingredient to an efficient EU framework on the processing of withholding tax. Therefore, the AMI-SeCo recommends that Member States align these definitions and, where necessary, clarify the application of such definitions in a cross-border context.

Assessment of the European Commission's proposal Faster and Safer Relief of Excess Withholding Taxes (COM(2023) 324 final) against the points made by the AMI-SeCo in its 2022 letter on WHT procedures

Legend: Blue: fully in line with AMI-SeCo request; Green: broadly in line with AMI-SeCo request; Yellow: At least partly not in line with AMI-SeCo request

AMI-SeCo point (from 2022 letter to EC and input to EC's public consultation)	**Traffic light assessment**	**Remarks, explanations**
The single capital market of the EU would benefit greatly from a robust, common framework for withholding tax relief at source based on fully harmonised definitions, procedures and reporting / information exchange (e.g standardised electronic, machine-readable forms).[2] Such common framework should rely on authorised intermediaries which are regularly audited and which should be allowed to provide WHT services with respect to all source countries and all countries of residence within the EU. The framework should provide for the possibility of (auditable) self-certification by beneficial owners and pooled beneficiary information to be passed up the custody chain.		The proposal is a major step towards a more harmonised and integrated cross-border WHT processing landscape in the EU. The proposal includes harmonised forms which is also conducive to applying harmonised definitions. These elements are expected to be elaborated in the EC's implementing acts (at level 2). With the proposed national registries operated by source countries the proposal creates the building ground for a level playing field across intermediaries regardless of the residence of such intermediaries. With regards to self-certification and pooled beneficiary information these do not seem to be included in the proposal. The proposal is based on the information concerning all investors to be communicated / reported to the competent authorities or the designated withholding tax agent. The scope of the proposal is dividends paid on publicly traded equities, while on publicly traded bonds or other instruments Member States may decide to 'opt in' and apply the framework. Such a limitation of scope may lead to preserving

		fragmentation of processes related to debt instruments / debt financing which is a key pillar of the EU's economy.
WHT reclaim / refund procedures should be used as an exception, i.e. only where relief at source is not feasible or has not worked. Such reclaim / refund procedures should be based on a fully harmonised framework within the EU building on fully electronic processing and communication (standardised reclaim forms and messaging, common processing deadlines)		The proposal explicitly allows for Member States to opt for 'quick refund' framework (either exclusively or in combination with a relief-at-source system). Nevertheless, the refund framework would use the same or similar forms and harmonised procedures (to be elaborated via level 2 legislation) across the Member States that opted to use it.
The EU should have a harmonised framework for tax-payer identification based on existing international (ISO) standards (e.g. Legal Entity Identifier - LEI) and allowing a fully digital identification leveraging the e-IDAS framework. Such framework could be created on the basis of, and complemented by, the existing national tax payer identification frameworks.		The proposal includes a common and harmonised Digital tax residence certificate (eTRC) the details of which will be elaborated by the Commission (assisted by a Committee of experts). The eTRC will be based on EUID and LEI for and builds on the e-IDAS framework.
Creating a common EU standard for the certification of residence for tax purposes (CoR) would greatly improve processing efficiency of withholding tax (together with also processing of other types of tax in a cross-border context).		See above, eTRC is expected to cover the needs for a common / standardised CoR.

Clarification and a common EU approach are warranted with regards to the definition of 'beneficial owner' for tax purposes (covering also situations where the legal and economic definition might differ) and with regards to the effect of market transactions other than outright purchases / sales of securities on the identity of the beneficial owner for tax purposes (e.g. impact of securities financing transactions on the taxable entity and the taxable income). Such clarification should take into account, and leverage on, the existing framework of the market harmonisation standards for corporate actions. In particular, there needs to be full consistency with the 'record date' principle similarly as applied for corporate actions, i.e. clear rules regarding the date on which the holder of a security is recorded for tax purposes.		The proposal leaves the identification of final, beneficial owners to the existing national legal frameworks (the source country definition would apply) and relies on the financial intermediaries to apply the necessary national rules in this regard. When it comes to situations / transactions which would result in the holder of the security at the final financial intermediary being different from the beneficial owner (e.g. repos, securities lending or pending outright transactions etc.) the proposal includes a high-level requirement for financial intermediaries to indicate whether there is "…evidence of any financial arrangement involving underlying publicly traded shares that has not been settled, expired or otherwise terminated at the ex-dividend date". Furthermore, the proposal explicitly excludes from its scope dividends / income paid on instruments acquired within a period of 2 days before the ex-dividend date.
Whenever corporate actions on pending securities transactions, such as for example market claims, are necessary due to the beneficial owner being different from the holder of a security on the record date, such claims could be treated by national tax laws as indemnities rather than 'manufactured' income.[3] Such approach could help eliminating the need for ex / cum indicators and could contribute to preventing tax abuse.		The proposal does not include any guidelines for Member States on how they should treat income on pending transactions in their framework but explicitly excludes from its scope dividends / income paid on instruments acquired within a period of 2 days before the ex-dividend date. (see above). Furthermore, the proposal does not consistently apply the record date principle (but rather focuses on the ex-date as a tool to reduce or eliminate the possibility of tax abuse)