



**ACCOUNTANCY
EUROPE.**

SIMPLIFYING WITHHOLDING TAX PROCEDURES

Towards lower costs of compliance

VIEWS.

**TAX
MAY 2019**

HIGHLIGHTS

This paper intends to drive public debate on the streamlining of withholding tax procedures. A simplified withholding tax system would incentivise cross-border investment and promote Capital Market Union in the EU.

The current procedures are cumbersome, expensive, time-consuming and inconsistent. The voluntary Withholding Tax Code proposes eight areas for improvement, which we have divided into two threads, legal and tax. On the legal side, Accountancy Europe supports the development of a pan-EU legal framework for harmonising procedures. On the tax side, we offer targeted suggestions towards greater automation.

Ultimately, the EU needs a system that is easy to comply with and has improved audit capabilities. Although the Withholding Tax Code is voluntary, we hope that Member States will take notice and implement its recommendations.

INTRODUCTION

Addressing the current diverse national withholding tax (WHT) procedures and rules will contribute to the objectives of the European Commission's Capital Markets Union (CMU) project. The CMU is not only about introducing new legislation and measures, but also about removing barriers, simplifying rules and streamlining.

Accountancy Europe believes that the CMU project is a positive step towards diversifying financing opportunities in Europe and improving businesses' access to finance, including SMEs.

This paper is a continuation of Accountancy Europe's commitment to integrated capital markets in Europe. It is intended to drive public debate on streamlining WHT procedures and thereby incentivise cross-border investment and promote capital market union in the EU.

WHAT IS WITHHOLDING TAX?

In this paper we will be looking at WHT in the context of cross-border passive income, such as dividends, royalties and interest.

WHT is deducted at source by the payer in the EU Member State where it is generated and is designed to be a payment on account of the recipient's local tax liability. This helps both simplify the tax system – ensuring that many taxpayers do not have to file tax returns – and helps to protect tax revenue by reducing the possibility that tax is not reported and / or paid.

The rates of WHT vary considerably but are usually in the range of 10 to 30%.

WITHHOLDING TAX AND DOUBLE TAXATION

Most corporate and individual income tax systems are based on the residence principle – i.e. a country raises income taxes on persons if they are resident or domiciled in the country, regardless of the location of the source of income. With cross-border investments, WHT can easily lead to double taxation – once in the country where tax is withheld and once again in the EU Member State where the investor is resident.

This is a long-standing issue and various measures have been introduced to mitigate the possibility of double taxation. Double tax treaties seek to minimise the negative impacts by removing WHT in some circumstances and by reducing the rates in others. Governments frequently offer unilateral relief, where the tax deducted overseas at source is allowed as a credit against the domestic tax paid by the investor in the country in which they are resident.

It is also possible for overseas investors to claim a refund of the WHT paid. This is particularly important if the recipient is a non-taxpayer or if the organisation receiving the income is unable to claim treaty relief for any reason (as can often result with collective investment vehicles).

SETTING THE SCENE

The current procedures for investors claiming a refund of WHT are cumbersome, expensive and time-consuming. They are not harmonised across the EU. This is a very significant problem. The European Commission estimates that the total costs of inefficient WHT refund processes is €8.4 billion annually, of which €6.03 billion is tax relief unclaimed by taxpayers.¹ As such, they have been identified by the European Commission's expert groups² as one of the biggest barriers to free movement of capital and thus to an effective capital market. It was concluded that these barriers especially impact on individual and small investors.

¹ Source <http://ec.europa.eu/transparency/regexpert/index.cfm?do=groupDetail.groupDetailDoc&id=28783&no=6>

² For example, the *Project Group on Simplification of withholding tax relief procedures in the Member States* and the *Tax Barriers Business Advisory Group – T-BAG*

Indeed, CMU experts agree that mobilising the net savings from European households into the capital markets, be it directly or via the financial products offered by third parties, is crucial. However, households will be discouraged from making these investments if they lose investment return as a result of unrecovered WHT.

Accordingly, as part of its broader CMU agenda, the European Commission has encouraged Member States to improve the harmonisation and efficiency of national WHT procedures by publishing a Code of Conduct³ (hereafter ‘the WHT Code’).

“The code is a non-binding document which calls for voluntary commitments by Member States and should be considered as a compilation of approaches to improve efficiency of current withholding tax (WHT) procedures, in particular for refund of WHT to which Member States can add or adapt elements to meet national contexts⁴.”

However, since its publication in 2017, there has been little concrete action by EU Member States to align WHT procedures in intra-EU situations.

We would like to restart the discussion on how to improve the investment climate in the EU by reducing the costs of compliance for investors and improving the efficiency of WHT procedures within the EU. We fully appreciate the fact that this is only possible with the goodwill and cooperation of all EU Member States.

SIMPLIFYING THE PROCESS

Accountancy Europe believes that lower costs of compliance through a more aligned system of reclaim procedures and relief at source would increase the transparency and effectiveness of EU capital markets and reduce barriers to investors within the EU. Improving the procedures for claiming a refund on WHT requires a 3-fold approach for the assessment of:

- existing legal and/or regulatory approaches
- current processes and controls
- enabling technologies to improve efficiencies

The WHT Code, which considers the first two of the above bulleted points in some detail, proposes 8 areas for improvement, which we have divided into two threads:

- Legal - the possibility of claiming relief from WHT at the time of payment (‘relief at source’) or a refund
- Tax Administrations Systems
 1. Making relief procedures more taxpayer-centric and easier to use
 2. The development of digital tools to ensure compliant behaviour

LEGAL: POSSIBILITY OF CLAIMING A RELIEF AT SOURCE OR A REFUND

Obviously, there must be a legal framework to permit relief at source or a refund. Currently, there is no pan-EU legal framework covering WHT on passive income. This means that investor entitlement to repayment or relief at source is based on double tax treaty provisions that may have been agreed between the Member States involved. Most double tax treaties contain such provisions, but not all and some only grant partial relief or refund. We believe that there must be a common EU legal framework that permits relief at source or a refund.

However, even if a claim for relief or refund is legally valid, the taxpayer must then decide whether the administrative barriers make such claims economically viable. In many cases it is not. Legal barriers creating a non-level playing field for financial intermediaries make it expensive and time consuming for investors to reclaim WHT.

³ https://ec.europa.eu/taxation_customs/sites/taxation/files/code_of_conduct_on_withholding_tax.pdf

⁴ Page 4 of the European Commission’s *Code of Conduct on Withholding Tax*

Even if tax authorities make their reclaim processes more automated and streamlined, they may still struggle to cope with the quantity of claims coming from individual investors. Consequently, there is a strong case for allowing financial intermediaries to play a greater role in the system, particularly in respect of being able to make bulk claims on behalf of large pools of clients. This has been recognised by the OECD, in its 2009 paper on improving the procedures for tax relief for cross-border investors⁵.

To do this, key information, or a statement of facts, must flow to the tax authority in the country of source – primarily:

- whether the claimant is a person for the purposes of the relevant treaty
- where the person is resident
- whether the person is the beneficial owner of the income received

This information would normally be available to the intermediary that deals directly with the investor – typically as the result of know-your-client and money laundering requirements. It is necessary to develop appropriate information systems to pass this information up to the intermediary making the repayment or relief claim to the source country tax authority. These systems would need to be compliant with the requirements of the General Data Protection Regulation (GDPR).

In the short-term, GDPR compliance could be achieved by ensuring that investors were fully informed as to which third parties would receive their personal information, including a specific reference that it would be sent to another country (especially a third country). In the longer-term, it may be possible to use one of the many blockchain identity management systems currently under development to provide tax authorities of the identity and country of residence of investors without the need to transfer personal data.

Increased reliance on financial intermediaries also requires that there be trust inherent in all intermediaries in the chain.

We believe that this trust would be facilitated through the certification of intermediaries.



ACCOUNTANCY EUROPE PROPOSAL

We support the development of a pan-EU legal framework for harmonising WHT procedures.

We believe that there should be a system of certification for EU financial intermediaries so that they can make bulk claims for relief at source or for refunds of WHT on behalf of the investor they represent. This system would allow for a more transparent and open market for financial services providers. A certificate could only be obtained if certain minimum conditions were met. Local or EU authorities should monitor certified financial service providers.

The certification requirements should be sufficiently comprehensive to ensure that the intermediary must verify the country of residence of the investor. The details of this proof would need to be first agreed by tax authorities but would then remove the need for investors to provide proof of residence to the tax authority to secure relief at source and a tax refund. Such proof of residence is required by some Member States and is regarded as a particularly onerous requirement – especially as some countries require this document separately for every refund application made.

However, certified intermediaries should not be liable for any tax losses arising out of the provision of incorrect information provided by the investor - where there was a reasonable expectation by the intermediary that the information was correct.

TAX ADMINISTRATIONS SYSTEMS

Inconsistent and opaque procedures are major causes for taxpayer irritation and frustration in the tax system. Procedures are often unnecessarily intricate, unclear and heavily paper-based. This causes uncertainty,

⁵ <http://www.oecd.org/ctp/treaties/41974569.pdf>

additional costs of compliance and cash flow disadvantages. Additionally, existing procedures are difficult to audit for both external and internal auditors, including tax administrations.

Such issues are prevalent within EU Member States when it comes to WHT relief and refund procedures. Quite apart from the cost of changing existing procedures, Member States will be reluctant to change current practices unless they are sure that the new processes proposed would secure proper compliance, reduce chances of fraud and make the system more efficient.

A WHT relief and refund system should be both easy to comply with and easy to audit

To achieve this, tax administrations and taxpayers must understand that transforming paper and manual processes into digital processes via user-friendly portals that are assessable by users is a necessity. This should be combined with continuous monitoring and automated auditing by tax administrations based upon generally accepted audit principles. For larger tax payers - however defined - automated testing of tax and business controls related to WHT protocols could be considered, ideally fitting within the context of responsive regulation models, such as *cooperative compliance*⁶. Real time reporting and auditing could seriously minimise the risk of errors and fraud.

However, it should also be understood by Member States that since the transactions are 'cross-border', tax administrations within the EU should align their digital initiatives towards an effective and efficient WHT system.⁷ Interoperable systems and shared databases could greatly improve the swift and safe exchange of information between member states. Additionally, it would give tax administrations easier access to information for audit purposes.

Exchange of information between tax payers and tax administrations and between tax administrations should be built upon a reliable, easy to access platform. We suggest that a European digital transformation task force be incorporated, to look into technologically enhanced systems for sharing data. Cloud based solutions should not be excluded due to the belief that tax is 'too data sensitive' for the cloud. There are good reasons to assume cloud-based solutions for the exchange of information are more secure than a system based on exchange of information via (local) data centres.

When it comes to changing processes, it needs, in addition to the legal framework, willingness and resources to change national legislation and tax administrations. We are dealing here with multiple aspects of change management.

Besides the procedural aspects, digital transformation of processes and administrations requires sufficient time and budget. However, current developments in global trade and the digital transformation of society make it an absolute necessity, for the sake of efficiency and credibility, for governments and tax administrations to transform into more digitalised organisations.



ACCOUNTANCY EUROPE PROPOSAL

In line with the WHT Code we would like to make some additional suggestions for discussion purposes.

- online forms should be made available on taxpayer platforms in mainstream international business languages in addition to the local languages (English, Spanish, other)
- there should be a legal obligation for tax administrations to decide on the request for relief or refund within 6 months. Failure to meet the deadline would result in a meaningful financial penalty being imposed upon the tax administration
- a 'statement of facts' to be included in any relief or refund request by certified financial intermediary. This statement can only be provided by the certified financial intermediary after having assessed that the facts as provided by the claimant are correct. If the 'statement of facts' appears to have been provided unjustified, the financial intermediary will lose its certificate

⁶ <https://www.accountancyeurope.eu/wp-content/uploads/Draft-tax-assurance-paper-04-2018.pdf>

⁷ We would encourage the OECD to do the same at a global level.

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- a European digital transformation task force will monitor progress and alignment in the field of digitising relief and refund procedures for WHT within EU member states. Support can be provided upon request.
 - a simple categorisation per investor type into, for example, private individual, institutional investor, etc. Such categories are not harmonised between Member States and common definitions would assist in the automation of WHT processes. This would also enable easier benchmarking throughout the EU.
 - development of an EU-wide accepted audit standard for WHT
 - a feasibility study on automated controls and automatic testing of tax and business controls at the level of larger tax payers

CONCLUSION

From a legal, procedural and technological point of view, simplifying relief and refund procedures for WHT is possible. It is up to the Member States to take these proposed steps to break the deadlock and tear down the unnecessary existing barriers especially for individual and small investors.

A system that is easy to comply with whilst assuring compliant behaviour and improved audit capabilities will have a positive impact on the European Union's capital market. Although the WHT Code is voluntary, we hope that many Member States will take notice and prioritise implementation of its recommendations.



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