THE INVESTMENT ASSOCIATION

# Response to consultation

## Withholding Taxes – New EU System to avoid Double Taxation

## About the Investment Association

The Investment Association (IA) champions UK investment management, a world-leading industry which helps millions of households save for the future while supporting businesses and economic growth in the UK and abroad. Our 270 members range from smaller, specialist UK firms to European and global investment managers with a UK base. Collectively, they manage £9.4 trillion for savers and institutions, such as pension schemes and insurance companies, in the UK and beyond. 44% of this is for overseas clients. The UK asset management industry is the largest in Europe and the second largest globally.

## Executive Summary

The IA welcomes the opportunity to respond to the Commission's consultation on laying the groundwork for an EU wide system to prevent double taxation.

Investment funds managed by our members invest globally, have extensive experience of European Member State withholding tax (WHT) relief processes and are therefore very interested in helping shape the direction of the Directive that will emerge from this process.

Action 10 of the Capital Markets Union (CMU) Report is the right catalyst for change, coming at the right moment, to reshape 27 different processes in need of both standardisation and digitalisation. The IA has been a supporter of the CMU since it was launched in 2014, having provided a series of submissions over the years.

We are mindful that the Commission are likely to be inundated with a myriad of requests from respondents, some achievable over short term whilst others being part of the Commission's longer-term plan. To cater for this diversity of goals, we urge the Commission to create a pragmatic roadmap for how these improvements can be made, with consideration to timescales both for competent authorities and the financial services community which will have to implement such material scalable changes.

Our response is also unreservedly supportive of Relief at Source (RaS) mechanisms, recognising their benefits both to investors and tax authorities. Uninvested monies, awaiting reclaims, negate further investment under the CMU. Thus, we are strongly against any system which seeks to allocate risk to claims by value or tax rate and disagree with the notion that relief at source is inherently riskier or subject to abuse.

We recognise, and have reflected in our response, the need to balance improvements without unnecessary impinging on Member State sovereignty or tax abuse concerns, and the limitations that

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unanimity through the Council that Article 116 of the Treaty of the Functioning of the European Union (TEFU) brings.

We set out below our views on how such policy changes could pragmatically be addressed, through building blocks in different stages looking to finally achieve a harmonised relief at source system:

**Stage 1:**

- An immediate action to allow for electronic application for Certificates of Residence (CoRs) and any other aspect of treaty or domestic relief processes, crystallising the benefits of recent successes of COVID related easements as part of a wider, permanent move away from paper-based filings.
- Expand the CoR window for entitlement beyond 1 year, allowing for easy refreshes and limiting new documentation to any fundamental changes to the WHT entitlement of the entity or treaty in question (in-line with recent COVID relaxations).

**Stage 2**

*Policy*

- Introduce definitional requirement to action delayed reclaims, pending processing no longer than 1 year after application and for compensatory interest for claims falling out of this time window.
- An EU-wide harmonised approval of intermediaries acting under Power of Attorney agreements to manage and file relief applications.

*Technology*

- Standardised, XBRL Based Application Forms that also allow for automatic translation into all 24 EU languages
- True digitisation of the entitlement process to:
    - Digital standardised CoRs
    - Where Member States seek to be directly and closely involved in the entitlement process, the Commission should seek to deliver a template for a standardised Digital Passport. We would urge this is designed through consultation, learning lessons from Member States which have already implemented their own versions of these passports to allow for timely at source relief processing by paying agents

**Stage 3**

- A fully standardised relief at source process that applies consistently across all Member States
- A centralised technology-enabled hub to process applications and track progress both by tax authorities, taxpayers and their intermediaries

We believe the above strikes the right balance, careful not to encroach on the integrity of Member State's tax systems, their autonomy to tax activity within their own borders nor their sovereignty to act as independent actors and engage in treaties bilaterally with international partners.

We remain available and keen to work with the Commission to provide support in developing these goals further.

## Our Detailed Response

Supplementing our answers to the questions in the Commission's questionnaire, we offer below further comments on some of the important aspects of the consultation as relevant to our industry:

### A. Investment funds and the role of tax in investment decisions

Investment funds provide important funding routes and liquidity for the capital markets. To achieve the overarching objective of end-user taxation, which runs through the product design of all of funds, is the concept of tax neutrality – a simplistic tenet that the tax outcomes of investing collectively should be the same if invested directly. While individual jurisdictions achieve this in differing ways, the goal of tax neutrality is internationally acknowledged and established policy through the OECD, the UN, the EU and individual Members States. Funds play an important role as one of the largest cross-border investors in the EU and worldwide and look to ensure that they or their investors do not suffer double taxation on their underlying investments.

Tax, like any other positive or negative economic factor, has an effect on investment decisions, potentially hindering cross-border investments. The value of the tax at stake as well as the amount of due diligence, tax expertise and administrative cost required to maintain investments in a particular market, are important considerations.

WHT, whether it applies to dividends, interest, royalties or capital gains will ultimately be a drag on potential absolute investment returns. Accessing relief from excessive WHT therefore should not be designed around any one form of income or gain but should be built around the treaties which provide for such relief.

### B. Relief at Source (RaS) System

Investors, including investment funds, seek a single, standardised model for WHTs where to benefit from relief a claimant must, to a satisfactory standard, prove that:

- They are who they say they are;
- They are entitled for relief under the relevant treaty and;
- They are beneficially entitled to the income and have or will suffer the tax for which they seeking relief

All of the above needs to achievable at the lowest possible cost to the investor, whilst allowing ease of administration to tax authorities.

Implicit within the questionnaire appears to an assumption, that RaS systems are inherently riskier than their Reclaim equivalents. This is manifestly untrue, especially when it is clear that archaic Reclaim systems untethered to the dividend payment process have been demonstratable susceptible to abuse in the past.

To this point, our members are unreservedly positive on RaS as a system for relief. It offers a superior result for taxpayers and tax authorities, minimising both risk of abuse and opportunity cost of investment. We do however appreciate that a single RaS model is likely to take time to agree and develop and as such have, where possible, endeavoured to engage with the Commission's questions on refund procedures.

In return, we would stress that Commission should not be looking to incentivise one system over another by imposing different administrative burdens on either system, but present a standardised framework for entitlement for Member States to implement as they see fit, where all investors who participate in the capital markets have, as a matter of right, equal entitlements. Any fractionalised administrative process which would seek to unduly inhibit one system of relief over another should be avoided.

## C. Need for Digitisation

Understanding that rates of WHT are solely the domain of Member States and the treaties they sign with international partners, our response seeks to focus on the administrative cost that the WHT processes generate for investors.

There is wholehearted agreement across the investment industry that the best way to build a European WHT system is through the CMU and Action 10 has come at an incredibly opportune time as individual Member States are, individually, looking to bring their WHT procedures into the 21st century.

Relief procedures across Europe remain almost unchanged from how they looked at the end of the 20th century. Digitisation is sparse, even in areas such as delivery of papers. Many European tax authorities still only accept hand signed, paper-based claims. Within the investment industry custodian banks, responsible for the bulk management and submission of relief claims, are colloquially known as 'paper factories'.

These antiquated processes clash starkly with wider European goals in respect of ESG. Alongside increased efforts to hold businesses responsible on this important agenda, the Commission also urgently needs to review and challenge Member States tax authorities that still mandate paper-based filings.

In recent times there have been sporadic domestic European initiatives in various areas including electronic CoR systems and the introduction of 'Digital Passports' for paying agents. Finnish TRACE (though having proven incredibly difficult to implement and has seen only limited success in engagement) is also an indicator that tax authorities are beginning to think bigger – holistically considering how WHT relief has to operate in an increasingly intermediated and cross-border investment world.

We are however concerned that Member States' processes will continue to diverge operationally and there is no sense in having 27 different versions of a TRACE-like regime, 27 different CoRs or 27 different sets of applications forms when the goal of the process is the same – to ensure those who are entitled to WHT relief are provided access to that relief. For this reason, the single EU wide initiative that the Commission is consulting on is necessary and welcomed.

While in the immediate term, digitisation could simply start with extending and making permanent the reliefs offered to tax payers during the COVID-19 pandemic (electronic filing of CoRs and application forms), in the medium term, introduction of a standardised XBRL Based Application Forms that also allow for automatic translation into all 24 EU languages and fully digitised CoRs would offer much needed refresh and boost to the EU's WHT processes.

In the longer term, the aim should be to achieve a fully digitised RaS system that applies consistently across all Member States including a centralised technology-enabled hub to process RaS applications.

Done right, this would also assist in the Commission's obligation around communicating to its citizens in their own language as well as be aligned with its sustainability agenda and increase the attractiveness of the EU as an investment location.

## D. Standardisation of Processes

Terms like harmonisation and standardisation are banded around relatively loosely, often applied interchangeably. We want to be clear however that in a WHT context they are very different.

EU Members States approach to WHTs policy are already relatively harmonised. Almost all EU Members States:

- Utilise a form of the OECD Model Tax Convention
- Default to a post relief rate of dividend WHT of between 0% and 15%.
- Default to an interest WHT rate of 0%
- Default to no capital gains tax for portfolio investment
- Offer some form of concessional rates of WHT for pension schemes, UCITS schemes, etc
- Have signed up to the BEPS 2017 MLI

The time has now come to make the next step to truly standardise the administrative procedures for accessing relief across the EU.

Standardisation entails uniformity and longevity, only being amended as changed circumstances arise or at mandated intervals. It ensures consistency and certainty for both governments and taxpayers. Done correctly it can transform 27 different relief procedures into a common single process, much like the W8-BEN process which ensures easy, consistency access for portfolio investment across the USA.

### *Refund Timeframes*

Where Members States insist on a Reclaim system for providing WHT relief, this is a prime opportunity for the Commission to set minimum standards in respect of set timeframes for repayment of excess WHT paid. This as a proposal would require any Directive to be imposing on Member States, in some instances requiring legislative amendment of local law. However, we do not believe it represents an undue imposition nor any material loss of sovereignty or control over access to relief. On the contrary, it is entirely consistent with the CMU's objectives and fair to all parties.

Suggested timeframes are offered in the table below:

| Activity | Timeframe | Justification |
|---|---|---|
| | | |
| Legal requirement for Tax Authority to honour a valid Reclaim | 1 years from point of application | Most European countries offer taxpayers a period of 1 year, either from the financial or calendar year, to finalise their tax affairs and file a tax return. In the spirit of reciprocity, tax authorities should have a similar amount of time to validate and pay a relief application. |

There will however be instances where tax authorities will be unable to meet these turnaround times. In such cases we suggest that it prudent and respectful of investor capital and time to be mandated to pay restitutive interest.

To be clear, any imposition of interest on delays to paying valid claims is not intended to be punitive, merely an incentive to ensure that Members States treat their obligations to investors seriously. Interest payments made by tax authorities are already common across Europe and the Commission is free to investigate whether it would be prudent to adopt a standard approach or align this with local policies on compensatory interest.

In addition, it is equally important to consider the opportunity cost of any delay in applying relief. To illustrate, in the case of funds which accumulate income into capital or pay distributions in the form of additional shares, we can estimate the potential opportunity cost of delaying WHT repayments to investors by looking to the MSCI Europe (excluding the UK) Index – a popular index underpinning many passive investment strategies which targets the largest and most successful European companies.

| **MSCI Europe (ex UK)** | |
|---|---|
| Year | Annual Performance |
| 2021 | 25.36% |
| 2020 | 2.43% |
| 2019 | 28.22% |
| 2018 | (10.10)% |
| 2017 | 12.27% |
| 2016 | 3.31% |

Depending obviously on the buoyancy of the market and timing, this general drag on reinvestment will also have a corresponding drag on productivity gains from this lost funding and so it is imperative that refunds are accelerated back to taxpayers as soon as possible.

We would also highlight that opportunity costs related to delays in repayments are not an issue for effective and efficient RaS models.

### *Power of Attorney*

In many instances, investors delegate the responsibility for the entire relief process, including populating, signing and filing of claims (both relief at source and reclaims) via a Power of Attorney agreement. This is incredibly common in an investment fund context where outsourcing is deployed to keep costs to investors in a fund to an absolute minimum.

We suggest that there is little value in forcing investors into simply signing documents when, through a contractual agreement between the investor and the POA holder, all responsibility for the claim is covered by the POA holder including where the POA holder is prepared to take responsibility for any liability covered by filing the claim.

We suggest that the Commission should look at pressing Members States to offer a consistent approach to allowing the use of POAs. To state the obvious, there is little merit in trying to make the process more difficult for certain businesses which use outsourcing models, a common industry practice in the highly regulated investment management industry.

***Standardised Forms***

In respect of the applications themselves, the Commission has successfully rolled out standardised schemas over the years. However WHT procedures differ from the likes of DAC6, Common Reporting Standards and others, in that it will require replacement of existing procedures already in place in Members States. This should however not be an impediment to achieving a WHT process that is consistent with the aims of the CMU.

To achieve this, we would urge the Commission consult with tax authorities on the form and format of the information they require in order to authorise relief.

This will give Members States the chance to justify their rationale for needing this information and help build the leanest possible, but still robust and effective, system for proving entitlement relief.

In return investors would generally be accepting of standardised anti-abuse provisions – such as minimum holding periods – but only if they were proportionate, targeted, clear and uniform across the EU.

If the Commission is able to achieve true standardisation it will unlock the potential for digitisation and the efficiencies that it brings.

## E. Member State Unanimity

Understandably, Article 116 of the TFEU and the need for Member State unanimity over a binding pan-European WHT system makes a project such as this materially more difficult, as the Commission needs to juggle the competing priorities of stakeholders.

For areas where unanimity is hard to achieve, we would urge 'soft standardisation' over a period of time through adoption of general international standards.

One such avenue, an obvious and welcome initiative, would be to shepherd Member States into adopting OECD interpretations and commentary of the very OECD Model Tax Conventions which they have used as a basis for their bilateral treaties. The Commission could also seek to build up consensus through weight of opinion and we would be supportive of illustrative matrices showing where relief is proving difficult for certain claimants either administratively or through disagreements over their legal form and associated entitlement.

Elsewhere, the Commission could look to leverage common European regulatory definitions, such as UCITS, AIFs, insurance companies, pensions schemes, etc to simplify access to relief. The recent UNSHELL Directive offers an extensive list of '*regulated financial undertakings*' which could act as a starting point for a more unified approach to automatic WHT entitlement in the future.

## F. Size of reclaims or location of investors

We understand that EU Member States are concerned about the possibility of abuse of treaties and the questionnaire seeks feedback on ways in which WHT risk can be attributed to certain mechanisms of relief, forms of income, types of investors or magnitude of investment. We strongly disagree with the assumption that any of these criteria attract a higher degree of risk and our membership is not prepared to entertain any bifurcation of investor entitlement based on perceived risks.

To be clear all abuse of tax systems, regardless of the abuser or the magnitude of the abuse, should be combated equally.

The value of the WHT suffered, which is linked to the size of the investment, does not bare any correlation to the risk of potential abuse. Some of the largest investment positions are taken by insurance companies and pension schemes, both heavily regulated businesses. Barriers should be removed for all investors, large or small, by reducing the administrative cost of investment and we see no valid cause to make access to relief for larger investors more burdensome.

Nor are abusive practices solely the domain of investors or intermediaries located outside of the EU. Treaties signed by Members States with either EU or non-EU countries are equally valid and do not provide for any means to discriminate between them. The standard Model Tax Conventions may vary in terms of specifics but are independent bilateral agreements. For the Commission to artificially differentiate between EU and non-EU based investors risks establishing a two-tier relief system, creating 1st and 2nd class claimants while diminishing the wider objectives of the CMU.

## G. Fraud and Automatic Exchange of Information (AEoI)

On the issue of abuse, obviously we completely support the Commission's drive to eliminate evasion and safeguard Member States' tax bases.

The CumCum and CumEx scandals have both cast a debilitating shadow across WHT relief processes. It should however be stated that abuse remains at the margins and investment is, by and large, an area which offers limited opportunities for abuse. Anti-abuse measures need to be proportionate and not unnecessary punish, nor drive away much needed inbound investment into the EU.

Furthermore, since 2000, the EU (and most of the world) has enacted highly effective cross-border tax reporting regimes, like the Common Reporting Standard under the rubric of the AEoI and other information exchange mechanisms, such as Country-By-Country Reporting and DAC6. These regimes should provide additional comfort to Member States that information exchanges which are standardised and digitised can be effective from the vantage point of governments, industry and investors alike.

On the proposals to expand AEoI between Members States, the consultation lacks substance and the Commission needs to actively consider its necessity and set out exactly how additional reporting can meaningfully help combat abuse.

Though not explicit, mentioned as part a footnote to Question 29, one such idea appears to be to expand the reporting of payment information to cover additional detail on the WHT process. That being said it is not entirely clear what the Commission's plans are in this space and we note the suggestion in the recent response to the European Court of Auditors special report on *Exchanging tax information in the EU*[1] that an impact assessment in this area may emerge from the July 2021 Action Plan. As such we reserve any in-depth commentary until further detail is available.

We would however comment that in general we strongly disagree with reporting for reporting's sake and urge that where necessary it should be:

a) genuinely automatic
b) proportionate

[1] https://www.eca.europa.eu/Lists/ECADocuments/SR21_03/SR_Exchange_tax_inform_EN.pdf

c) designed to be done at minimum cost and
d) only for existing datasets already in the hands of the reporting agent responsible

To the extent that additional reporting can be justified through further active public consultation, existing reporting mechanisms (e.g. DAC) should be considered over any additional reporting requirements and evolution over revolution would be preferable, particularly if the technology involved remains the same.

## Conclusion

Clearly, there is a lot to ponder as the Commission sets out on what will be a mammoth undertaking of crafting a functioning and standardised WHT system across the EU.

Our ask is that the ultimate goal of this exercise should be development of a robust, efficient, effective and technology-enabled Relief at Source model for the benefit of the tax authorities as well as investors. The building blocks to achieving that final outcome are standardisation and digitisation of certain aspects of the tax relief system, that also carry potential benefit for Reclaim processes, ensuring fairness to all investors.

We applaud the Commission once again for this initiative and remain keen to provide further input, support and engagement on this important matter for the investment fund industry.