

Tax

Proposal for a Council Directive on Faster and Safer Relief of Excess Withholding Taxes

Analysis of the most salient aspects of the proposed FASTER Directive, aimed at improving the procedures for levying and refunding withholding taxes on foreign-source dividends and interest.

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1. Introduction

On 19 June 2023, the European Commission published a proposal for a directive - “Proposal for a Council Directive on Faster and Safer Relief of Excess Withholding Taxes” - aimed at laying down rules to improve levying and refund procedures in relation to taxes on dividends and interest withheld at source. The main aim is to establish an agreed, common and standardised system at European level for withholding taxes, addressing the problems that currently arise through inefficient and disproportionately burdensome procedures to relieve excess withholding taxes borne abroad.

It should be noted that payments in the form of dividends or interest associated with investments in securities are subject to withholding tax in most EU countries, when they may be exempt from withholding tax or subject to withholding tax rates higher than those resulting from the application of double tax treaties, which obliges investors to claim a refund of the excess in the country in which the income originates. In many cases, this leads to situations of double taxation when, due to the complexity of the formalities associated with claiming a refund, the refund is waived, with the consequent disincentive for cross-border investments.

In addition, the fragmentation of withholding tax refund procedures between Member States sometimes paves the way to tax fraud, tax evasion and tax avoidance. These are, for example, operations aimed at transferring ownership of securities and/or investment risks, with the objective of obtaining withholding tax refunds when one is not entitled to them, or to increase the amount of such refunds. In this respect, the Commission refers in particular to two types of cases. Firstly, “Cum/Cum” transactions, whereby investors resident in countries with high taxation on dividends transfer or assign their securities in the short term to another person resident in a country with lower taxation, who collects the dividends and subsequently returns the securities to the investor in return for a fee. And secondly, “Cum/Ex” transactions, the purpose of which - bearing in mind that cross-border investments often involve a chain of payments between financial intermediaries - is to enable several persons to obtain withholding certificates in countries where no detailed information is required to track the distributed dividend, thus making it possible to obtain several returns in connection with the payment of a single dividend.

Finally, the lack of digitisation of withholding tax refund procedures in most of the Member States concerned is another major driver for the proposed change.

2. Main measures incorporated in the proposal for a directive

In order to address problems such as those mentioned above, the proposed directive - which has been preceded by several recommendations and actions by the European Commission - introduces the following basic actions.

a) The digital tax residence certificate

The European Commission considers it essential to ensure transparency and certainty on investors' identity for securities' issuers, withholding tax agents, financial intermediaries and Member States, as the case may be.

To this end, it calls for the digitalisation of the certificate of tax residence, so that Member States would use automated procedures for issuing such tax residence certificates for residents in their respective jurisdictions.

According to Article 4 of the proposed Directive, the content of the digital tax residence certificate (eTRC) shall be common to all Member States, incorporating, as set out in paragraph 2 thereof: the first and last name of the taxpayer and the date and place of birth, if the taxpayer is an individual, or its name and its European Unique Identifier number (EUID), if the taxpayer is an entity; tax identification number; address of the taxpayer; date of issuance; the covered period; identification of the tax authority issuing the certificate; and any additional information that may be relevant where the certificate is issued to serve purposes other than relief of withholding tax under this Directive or information required to be included in a tax residence certificate under EU law.

Such certificates shall be considered by Member States as sufficient proof of a taxpayer's residence and shall be issued within one day of the submission of the application through an accessible online portal, provided that the above information has been supplied and unless there

are exceptional circumstances which could justify a delay.

Once issued, the certificate will be valid for at least one calendar year, with Member States being able to provide for a longer period of validity. However, Member States may rescind an eTRC issued where the tax administration has evidence to the contrary of tax residence for that year.

- b) Establishment and maintenance of a national register of “certified financial intermediaries”: reporting obligations of certified financial intermediaries

As cross-border investments often involve a chain of payments between financial intermediaries, these should be identifiable to enable the flow of income from the issuer of the security to the final recipient or investor to be traced.

For this purpose, Member States that levy a withholding tax on dividends from publicly traded shares paid to registered owners resident for tax purposes outside that Member State and that provide relief of excess withholding tax shall establish a national register of certified financial intermediaries which will include the data referred to in Article 5 of the proposed Directive - name of the certified financial intermediary; date of registration; contact details and any existing website of the certified financial intermediary; the EUID or, where the certified financial intermediary has no such number, the legal entity identifier (LEI) or any legal entity registration number issued by its country of residence.

It also provides for the possibility for Member States to opt to use this national register in relation to the relief of excess withholding tax on interest from publicly traded bonds, if applicable; as well as those Member States that levy a withholding tax on the latter, but not on dividends from publicly traded shares.

In view of the above, and given the different types of financial intermediaries that may be involved in payment chains relating to these securities, the proposed directive introduces the obligation to apply for registration in the national registers referred to above for large institutions - as defined in article 5(2) of Regulation (EU) No 575/2013 - and for Central Securities Depositories in the scope of Regulation (EU) No 909/2014 that are providing withholding tax agent services and that as such need to register with those Member States in which securities' issuers are located and where any of their clients have invested in.

Registration will be voluntary for all other entities, including those that are established in a third country jurisdiction when they act as financial intermediaries.

Notwithstanding the above, Member States that do not need to provide relief of excess withholding tax, due to an exemption on withholding tax over dividend payments or in case the relevant domestic tax rate is always lower than or equal to the rate that could be applied under double taxation treaties, do not need to have a national register of financial intermediaries in place.

Apart from the above, once registered, financial intermediaries will be regarded

as “certified financial intermediaries” in the respective Member State and will be subject to the relevant reporting obligations under the proposed directive - Article 9. They will, inter alia, report dividend or interest payments to the relevant tax administration so that the transaction can be traced. In addition, in order to combat abusive transactions, they will also have to provide information on the holding period of the securities or, where applicable, on the fact that the payment of income is related to certain transactions, such as securities lending or swaps.

However, to limit the burden stemming from the reporting, the information to be reported by financial intermediaries has been limited to what is necessary to Member States to reconstruct the payment chain for dividends and interest and to the extent such information is available to reporting financial intermediaries. Moreover, reporting will be done by using standard computerised forms and common requirements for the communication channels to be laid down by the Commission by means of implementing acts. In addition, for the sake of simplification and bringing lighter requirements to the WHT procedures for small investors, a de minimis rule has been introduced for the reporting obligations and due diligence procedure. It consists of not requesting information about financial arrangements or minimum holding period to investors with dividend payments below a threshold of EUR 1000.

- c) Proposed procedures for relief of excess withholding taxes

Another pillar of the proposed directive focuses on the systems envisaged to pro-

vide relief for the problems arising from excess withholding taxes on dividends or interest in the source country, with two types of procedures that Member States may apply any of the two or a combination of both. These are:

- Firstly, the “relief at source system” provided for in Article 12, a system where the appropriate withholding tax rate, in accordance with the applicable domestic rules and/or international agreements, such as the relevant double tax treaty, is applied at the moment of payment of dividends or interest.
- Secondly, the “quick refund system”, regulated in Article 13, a system where a payment of dividend or interest is made taking into account the general domestic withholding tax rate followed by a request for refund of the excess withholding tax within a maximum of 50 days.

As noted above, Member States will be free to introduce either of the two procedures or a combination of the two, as they see fit, but will have to ensure that at least one of them is available to all investors, provided that the requirements of this Directive are met. In order to ensure the proper and timely implementation of these procedures by Member States, Member States shall apply interest in accordance with Article 13(2) at a rate equal to the interest or equivalent charge applied by the Member State to late payments of income tax by registered owners, or, if the national legislation of the Member States does not include such provision, at the Euro short-term rate plus 50 basis points or

the equivalent interest rate used by their Central Bank plus 50 basis points, if they are not part of the European Exchange Rate Mechanism - Article 14-. However, in case of one of the two anti-abuse cases mentioned above, an automatic exit rule towards the standard refund procedure applies.

3. A final note

Together with the proposal for a directive, the Commission has opened a public consultation

period until 14 August 2023, so it is to be expected that the text under analysis will undergo changes during the negotiation for its adoption, which should take place before 31 December 2026, to be applied as of 1 January 2027.

The proposed FASTER Directive is among the priorities of the Spanish presidency (July-December 2023), as well as of the subsequent Belgian presidency, which, together with its eminently procedural nature, could contribute to its adoption in the short/medium term.