Consultation Response

European Commission Proposal for a Council Directive on Faster and Safer Relief of Excess Withholding Taxes
September 2023

The Association for Financial Markets in Europe (AFME) welcomes the opportunity to comment on the European Commission ('EC') Proposal for a Council Directive on Faster and Safer Relief of Excess Withholding Taxes ('the Proposal') and related documents released on 19 June 2023.

Executive summary

Currently, Member States operate a wide variety of different approaches to the processing of tax reclaims or to applying treaty or domestic law relief at the time of payment. This includes, but is not limited to, variations in the degree to which relief-at-source arrangements are available, different treatment of market compensation payments related to settlement failures, differences in documentation requirements and the use of electronic filing and of IT systems.

More significantly, financial institutions have highlighted widespread uncertainties in the outcomes relating to withholding tax claims. This is in large measure due to varying interpretations of who is the 'beneficial owner' of income from securities who is entitled to make a reclaim of withholding tax.

Against this background, AFME welcomes the EC's plans to simplify and digitise withholding tax processes within the EU. We agree that current processes are slow and complex, and that a simple, fast, and clear system will encourage investment.

Our detailed comments are below. We would like to highlight the following points:

- A single, EU wide portal for reporting transactions and the issue of tax residence certificates would significantly reduce the administrative burden and generate considerable savings for investors, financial intermediaries and governments.
- An effective EU wide withholding tax regime will require a clear and consistent approach to reporting requirements, due diligence obligations and liability rules for financial intermediaries across Member States. It is essential that these requirements take into account the limits of a financial intermediary's visibility of an ultimate investor's activities. It follows that liability should also be commensurate with the level of knowledge available to financial intermediaries.
- Further clarification is needed with respect to the definitions of key concepts such as beneficial ownership, other financial arrangements and holding periods.
- Anti-abuse provisions should be tackled through targeted anti-avoidance legislation. In any case, the Directive must avoid creating conflicts with other pieces of EU legislation, such as the Shareholder Rights Directive.

We hope that these points can support policymakers in their deliberations. As negotiations progress, we look forward to further contributing to the discussion, towards an effective implementation of the proposed framework.

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We set out below our comments on the proposed Directive under the following headings:

- Relief-at source and tax refunds
- Residence certificates
- Registration
- Reporting
- Due diligence requirements
- Beneficial ownership
- Anti abuse provisions – general comments
- Anti abuse provisions – two-day test
- Anti abuse provisions – financial arrangements
- CFI liabilities
- Scope
- Implementation timeline
- Portal access
- Data provision

Relief-at source and tax refunds

We welcome the proposed harmonised relief-at-source ('RAS') and quick refund ('QR') processes, which we believe have the potential to deliver significant value for investors while protecting the interests of governments and tax authorities.

The RAS and QR options should be easy and digital so that investors can intervene in the process and perform the necessary set-up to benefit from the advantages offered by this new route. This configuration should be constant over time and reviewable periodically. If this functionality is established on a single EU wide technology platform, it will allow the application of the advantages in all countries with a single entry, reducing the cost of implementation for all Member States and reducing the technology build required for investors and financial intermediaries.

However, we are concerned that, in its current form, the Proposal will exclude many transactions from these new processes, including transactions that currently benefit from RAS, and therefore narrow eligibility to reclaim in some jurisdictions. For example, Article 11(2)(a) requires CFIs to verify the electronic tax residence certificate ('eTRC') of the registered owner. In some Member States, however, some investment funds are not able to obtain a certificate of tax residency (for example Luxembourg/French FCPs). Nonetheless, they are entitled to relief at source under domestic legislation as they are compliant with UCITS/AIF Directive. We see no reason to modify existing processes which are working well in Member States.

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 as appropriate.

Article 10 para 3(b) permits Member States to exclude securities positions that can benefit from an exemption from withholding tax from the RAS and QR procedures. It should be expected that Member States will use this possibility only very rarely, given that many investors who can benefit from an exemption, such as governmental entities, supranationals, and pension funds are created to achieve particular social goals or to benefit broad classes of investors. Further, it would be important for Member States to clearly outline when and how such exclusions would apply.

The Proposal is silent on the application of treaty rates that require additional documentation (e.g., pension schemes from certain countries may be entitled to the full exemption or reduced rate but need to provide

documentary evidence to confirm their eligibility to the withholding agent/ tax authorities). We recommend that clarification is issued as to whether those additional documentation requirements should be abolished by the Member States or how they will be managed under the new regimes.

Article 10 para 3(a) implies 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, provided that a certified custodian provides reporting on the end investor who is serviced by the uncertified custodian. It will be important that full certainty is provided on this reporting, and that the reporting modalities do not differ across Member States. Further clarity should also be provided on the liability imposed on the certified custodians in that situation, as they are expected to have limited means to verify information on the end investors.

Residence certificates

We welcome the proposal for a standardised and automated eTRC issued within one working day of submission, valid for the calendar year of issue.

We agree that a consistent, electronic process for the issuing of eTRCs would be a substantial improvement over paper certificates, both in terms of the process for obtaining these documents and ensuring Member States offer the ability to digitally submit those documents as part of the withholding tax reclaim process.

We strongly urge the EC to develop a common portal used by Member States to receive and process requests for eTRCs, as different technology systems and processes would unnecessarily complicate the withholding tax process. Something as simple as credential rules for access to a portal can become complex when multiplied across 27 countries (e.g., some require individual registration and access, others allow company-level access).

It is important that any system developed allows for bulk uploads/requests, as CFIs may need to request many documents for many entities at the same time.

It is also essential that countries outside the EU will be able to accept eTRCs. If third countries request paper forms, this would complicate the process i.e., one system for the EU and another for other countries. The content of the eTRC needs to be acceptable to non-EU treaty partners.

Some counterparties will only accept tax residence certificates if they reference a specific tax treaty and a specific type of income. We would appreciate flexibility in this regard, with eTRCs being able to include this information upon request.

Registration

We note that large financial intermediaries ('CFI') will be required to register with EU Member States.

We recommend that CFIs should be able to register on a single EU portal, and that a single registration on that portal should be valid in all EU Member States. Any requirement to register separately at the tax authorities of each Member State will dissuade smaller and non-European custodians from registering.

The position of foreign branches needs clarification, in particular as to whether they should register in the location of the branch and/or the head office (i.e., in the case of a branch registered as a CFI). If registration is at branch level, we would appreciate confirmation as to whether this would only cover transactions relating to the branch or also the head office.

Reporting

We note the requirement in Article 9 that CFIs will be required to file reports to tax authorities.

Recent developments with respect to reporting under the EU DAC and FATCA intergovernmental agreements within certain EU Member States suggest an increased focus on the General Data Protection Regulation. Requirements for data privacy must be harmonised with any reporting requirements upfront – in particular, we would reiterate the importance that CFIs can only report information directly within their control. It is the ultimate investor, rather than intermediaries involved solely in brokerage, clearing, settlement and safekeeping, which is likely to have the full information concerning the nature of the underlying transactions.

We include as an Annex to this paper a list of information typically held by CFIs.

We note that CFIs will be required to report information on dividend/interest payments within 25 days from the record date, including information on the payor and payee, plus additional information on equities trades (e.g., if acquired within 2 days of ex-div/financial arrangements are in place). This requirement does not appear practical from an operational and technical perspective, due to the very high volumes of reporting which would be required on a daily basis, particularly during the first six months of the year when most European companies pay dividends, and the complexity of many transactions including late trades, failed trades, market claims and CFI's reconciliation processes. We believe that a longer period will be needed. We would suggest that the minimum period for CFIs to be practically able to report transactions is quarterly. We recommend that all transactions taking place in a calendar quarter should be reported one month after the end of that quarter. Consideration should also be given to making the reporting annual, in line with the current regimes for reporting under the Common Reporting Standard and the US Foreign Account Tax Compliance Act.

A single reporting portal that is used across all Member States would greatly reduce costs of implementation for CFIs and tax authorities, and act as a natural lever to ensure consistent reporting requirements. Incremental or 'gold-plated' reporting obligations across 27 countries would once again overly complicate compliance processes. Further, it is noted that a consistent implementation of the rules across Member States maximises the opportunity for participation by investors and CFIs across all EU Member States. Country-by-country requirements would result in country-by-country assessment of the cost and benefit of participation and would be counterproductive to the stated intention of consistently encouraging investment across the EU.

Any reporting portal must be built to support the volume of filings that will be required. We urge the EC to consult with industry throughout the development process, given that CFIs will be the predominant users of that system.

It is essential that detailed guidance is provided on the reporting requirements. Such guidance should be issued in draft for consultation, to ensure proper involvement of all relevant stakeholders. In particular, any requirements to report holding periods should include the calculation methodology. Given the high volumes of various types of transactions, it is important to provide clear guidance on how to calculate the holding period of a fungible asset, ensure availability of relevant data points in the trading data or instructions and ability to operationalise and automate. This must recognise the complexity of trading activities, where high volumes of buys, sells, repo buys, repo sales, collateral transfers and securities lending transactions may happen within any given period.

We note that Article 9(2) provides an exclusion from reporting when the total dividend paid is less than €1,000. We would recommend that this exclusion be made optional to simplify the reporting obligations for CFIs.

We believe that consideration should be given to the requirement to issue tax vouchers following the introduction of the new regime, in light of the detailed reporting obligations set by the Directive.

We would appreciate clarification of the following additional points:

- whether CFIs will be obliged to file nil returns if there are no reportable transactions;

- how partial trades will be reportable; and
- the correct reporting if trades settle over a longer period.

Due diligence requirements

Article 11 of the draft Directive requires CFIs to perform extensive due diligence, with the expectation that CFIs will:

- obtain a declaration from the registered owner of the security that they are the beneficial owner;
- verify the eTRC and the declaration;
- verify the investor's entitlement to the treaty WHT rate; and
- check whether there are any relevant financial arrangements outstanding at the ex-dividend date.

A CFI will only be able to perform due diligence if there is certainty concerning the work they are expected to perform, underpinned by clear guidance, including on the extent to which CFIs can and should be able to rely on information provided to them by investors.

Any guidance concerning due diligence must naturally recognise the limits to a financial intermediary's visibility of an ultimate investor's activities. For example:

- A CFI will have information concerning the transactions entered into by a client but will not necessarily have any information on the rationale or background to specific transactions.
- It is common for investments to be held via a chain of intermediaries. CFIs participating at a particular point in the chain are likely to only have detailed information concerning the party they face directly.
- Clients may well have depots with more than one custodian. CFIs will not know if other custodians are being used.
- Custodians are extremely unlikely to have information on hedging transactions.
- Many financial institutions will have multiple lines of business within the same legal entity, and some will be subject to regulatory restrictions which prevent sharing information across different business lines.

We would also highlight that reliance upon disclosure by CFIs may give tax authorities an incomplete picture of the financial arrangements which may be linked to a particular dividend, which creates a risk that the regime may not fully achieve its objective of tackling tax abuse. The types of financial arrangement which are relevant can be executed in a manner which does not involve, and is not visible to, any custodian or CSD who may be among the chain of CFIs which have a reporting obligation. An investor who is party to a linked financial arrangement is, of course, obliged to disclose it, but the separate disclosure obligation on CFIs is clearly designed to provide a backstop to that. It may not be a reliable backstop, as CFIs will often not have access to the information which would ensure complete disclosure.

We would recommend that clear guidance is provided to confirm that CFIs can rely on information provided by the client, unless they have actual knowledge to the contrary, and examples of such knowledge. Reason to know, as opposed to actual knowledge, would be too subjective a test for this purpose, particularly considering the complexities of the meaning of the phrase 'beneficial ownership.' In other words, the standard for withholding agents should be based on their actual knowledge that their client's claim is incorrect and not indicators that their client's claim may be incorrect.

We would also appreciate clarification as to the level at which ownership should be assessed i.e., as to whether claimants should consider any indirect beneficial ownership if this differs to the legal ownership on which an instrument is traded (e.g., would an investor in a tax transparent vehicle need to consider ex-date criteria against respective interests in the vehicle and/or the asset directly?).

Beneficial ownership

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 different Member States may take different views of what beneficial ownership means. While there is OECD guidance on beneficial ownership, this is not in practice followed by most countries, and countries have taken a wide range of approaches in dealing with the application and consequence of the beneficial ownership requirement.

We call on the EC to provide further clarification and guidance on how the term 'beneficial owner' should be interpreted. It would also be helpful if some standard wording for investor representations on beneficial ownership could be provided.

In the absence of a clear definition, CFIs would have to collect and assess investor documentation with reference to each Member State, and Member States may or may not themselves produce clear guidance on this concept. Such a decentralised approach would be costly and prone to error for CFIs to implement and reduce the usefulness of any representation for tax authorities.

Anti-abuse provisions – general comments

Article 10(2) of the draft Directive states that RAS and QR procedures will not be available to investors where:

- the dividend has been paid on publicly traded shares that the investor acquired within two days before the ex-dividend date; or
- the dividend payment on the underlying security for which relief is requested is linked to a financial arrangement that has not been settled, expired, or otherwise terminated at the ex-dividend date.

These requirements to access RAS or QR would potentially result in dual processes i.e., for 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. We would appreciate confirmation that any partial claims should not preclude access to RAS.

Further, it is important to consider the unintended consequences this provision could have in Member States that have inoperable tax reclaim procedures. For example, if the anti-abuse measures apply and RAS and QR are not possible, then it will be the case that a standard refund process must be followed. It is important to note that the draft Directive as currently written does not require Member States to provide for a functional standard refund system (Article 15 only mentions that they must receive information on the anti-abuse questions as a minimum for the standard reclaim process). Under the current wording, investors could therefore lose their opportunity to claim withholding tax relief if they buy within two days or have a legitimate financial arrangement open at the time of the ex-date.

We would also like to highlight a possible misalignment between the Proposal and the Shareholder Rights Directive II Implementing Regulation (Regulation 2018/1212) and, in particular:

- Article 1 where 'entitled position' means the position of shareholding as of the 'record date', to which the rights flowing from the shares, including the right to participate and vote in a general meeting, are

attached. Rules need to ensure the record date principle is consistently applied and avoid implying the acceptance of a modified version of an ex-date principle.

- Article 8 stating that "the payment date shall be set as close as possible to the record date, issuer deadline or the deadline set by the third party initiating a corporate event, as applicable, so as to allow for the processing of payments to the shareholders as swiftly as possible" – if this principle is followed, as it is the case today in various EU countries, the pay-date is set by issuer as the day after record date (currently set one business day after ex-date but due to become equal to ex-date if Europe moves to T+1).

The requirement in Article 10(2)(a) and (b) is in contradiction with this practice, because the issuer and their withholding tax agents would not have sufficient time to be made aware of the positions/transactions to be excluded from relief at source ahead of pay date. As a result, unless changes are made to the European corporate actions standards (i.e., asking for more time between record date and pay date), relief at source will no longer be granted, in contradiction with the spirit of the Proposal.

Accordingly, we would recommend that the anti-abuse provisions be tackled through targeted anti-avoidance legislation, or issuers will need to review their calendars, especially for mandatory/choice distributions, with the risk of no longer being compliant with Shareholder Rights Directive II.

Specifically, we would appreciate clarification of the following:

- What are the relevant criteria/indicia to determine whether an 'arrangement' (as opposed to a 'contractual obligation') to transfer ownership exists?
- To what extent must CFIs proactively look at the information they may have access to, directly or indirectly across different legal entities within the same business unit, group, or organisation (bearing in mind the restrictions on information sharing explained above)?
- Which transactions does the EC consider benign and, as such, to be processed in the ordinary course of business?

Anti abuse provisions – two-day test

We believe that the exclusion from RAS/QR processes of securities positions purchased two days (or less) before ex-date should be removed. We think this is an ineffective tool to tackle abuse, which would create the following problems:

- Legitimate purchasers, including those whose trades settle on or before record date, will be unjustifiably disadvantaged.
- Different parts of record date positions may be subject to different processing.
- There is a potential for an impact on trading two days before ex-date, as trades executed three days before ex-date will have a different status from trades executed two days from ex-date.

We understand the desire to limit relief on certain transactions but think that this can be more effectively dealt with through targeted anti-avoidance legislation.

Anti abuse provisions – financial arrangements

The definition of a financial arrangement in Article 3(17) is very broad.

The scope of 'financial arrangements' must be defined in order for CFIs to confirm their awareness of the existence of such arrangements. This must be done precisely and with clear examples of common financial instruments or agreements and whether they fall within scope. These should include examples of hedged transactions, securities lending, repurchase agreements and collateral transfers.

The proposed definition focuses on arrangements with respect to the security itself but does not appear to consider arrangements with respect to the dividend or interest payment or the value of the security (e.g., cash settled derivatives). We would appreciate confirmation as to whether such arrangements are considered outside the scope.

The proposed exclusion of positions with financial arrangements would exclude a very substantial number of positions from the QR/RAS processes. While we understand the rationale for excluding some transactions in order to tackle abuse, we would recommend that this be better targeted.

CFI liabilities

We would appreciate further clarity on the obligations and liabilities of CFIs, including the circumstances under which CFIs may be liable to tax authorities for lost tax revenues in accordance with Article 16.

In our view, liability must be commensurate with the level of knowledge available to the CFI. Strict liability without regard to the actual role played by the CFI would be inappropriate. In addition, we recommend that compliance with published due diligence guidelines should provide a safe harbour from penalties or fines. A CFI that has performed the clearly set out due diligence tasks in good faith should not be subject to penalties, even if a client's claim of beneficial ownership subsequently turns out to be incorrect.

We would further suggest that the term 'civil' should be removed from Article 16. CFIs should be liable under administrative law rather than civil law.

Scope

The Proposal only covers publicly traded shares and bonds. The scope of the Proposal should be extended to all shares and bonds that are deposited at an issuer CSD located in the European Union. 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.

In addition, domestic investors do not fall within the scope of the Proposal. However, it may be the case that elements of the Proposal, such as the eTRC and the RAS procedure, would also be of benefit to domestic investors. It will therefore be appropriate to investigate and to develop synergies with the processes applicable to domestic investors.

Implementation timeline

Article 22 of the draft Directive states that the Proposal should be adopted by Member States by 31 December 2026 with implementation from 1 January 2027. Given the complexity of the issues involved, we would suggest a period of at least 18 months between adoption of the Directive and its implementation.

Portal access

We recommend that credentials for accessing the portal should be at organisational rather than individual level, which would enable all members of a team working on the reclaim process from end to end to access the system. This will mitigate operational risk due to staff absences or turnover.

Data provision

We note above that data protection regulations and regulatory constraints may prevent sharing of information across different business lines. These constraints may operate differently in non-EU countries, as financial institutions may not be able to rely upon disclosures being legally mandatory (which would override some obligations) because signing up as a CFI is voluntary for non-EU based financial institutions. This may prevent CFIs in non-EU countries from registering as CFIs.

About AFME

AFME represents a broad array of European and global participants in the wholesale financial markets. Its members comprise pan-EU and global banks as well as key regional banks, brokers, law firms, investors, and other financial market participants. We advocate stable, competitive, sustainable European financial markets that support economic growth and benefit society.

AFME is the European member of the Global Financial Markets Association (GFMA), a global alliance with the Securities Industry and Financial Markets Association (SIFMA) in the US, and the Asia Securities Industry and Financial Markets Association (ASIFMA) in Asia.

AFME is registered on the EU Transparency Register, registration number 65110063986-76.

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Annex - Information typically held by custodians:

- Client Name
- Legal Entity Type / subtype
    - Individual
    - Financial Institution
        - Bank – US Banks and non-US banks; US intermediary banks, non-US intermediary bank; securities broker dealer; securities broker dealer non-US, non-proprietary assets; commodities trading firm; designated clearing organization
        - Non-bank Financial Institution – Futures Commission Merchant; insurance companies/ underwriters; investment advisor; management company/ fund manager; other free text
    - Collective Investment Scheme
    - Charitable Organization / NFP / Foundation
    - Trust/ Estate
    - Non-Operating Company
        - Private Investment Company (PIC)
        - Corporate Entity (SPV/SPE/AV/Holding Company/SA/SCA/SARL/SCSA)
    - Operating Company
        - Commodities, logistics, import/ Export company
        - Business enterprise/ operating company
    - Government entity
- Country of formation
- Country of parent's headquarters
- Country of primary physical presence
- Is the entity regulated for AML purposes?
- If yes, list regulator
- Ownership type
    - Private, publicly traded, subsidiary of publicly trade, government
- Type of legal structure
- Does the client have underlying domiciled in certain jurisdictions (restricted)?
- Does the customer derive 25% or more of its overall revenues from any one of these countries in the aggregate?
- Primary line of business
- Servicing offices
- Primary relationship manager
- Secondary line of business
- KYC Coordinators
- Interested persons
- Address
- Is mailing address same as physical address?
- Type of government issued identification number
- Is the legal entity's business subject to negative public opinion (human rights, environmental issues etc.)?
- Are you aware of any material risk relative to the information who owns controls or manages the legal entity beyond the results of the due diligence search?

- Does the foreign financial institution customer operate in an OFAC sanctioned country, or a county determined to be very high risk or non-cooperative with international anti-money laundering principles?
- Does the foreign financial institution customer operate under an offshore banking license?
- Brief description of client's business and/or investment companies
- Will the client engage in any of the following activities: funding payment; service provider payment; subscription and redemption activity; third party beneficiary payment; trade processing related payment?
- Types of payment methods client will use; check; ACH; remote deposit capture; letter of credit; doc/direct collection; wires
- Describe anticipated security activity and money movements (e.g., equities, fixed income, derivatives)
- Describe the type of security activity expected to be in the account: security settlement free of payment; securities settlement versus payment; unannounced free receives
- Will securities in custody be US or non-US securities?
- Systems track entitlement based on market prescribed entitlement date, which is usually traded position on record date / ex-date
- Fund quantity on loan, borrower, days on loan, shares recalled/ outstanding, market quantity on loan, marker inventory quantity remaining, market cap, loan start date, loan end date

The above list is provided for illustrative purposes only. It should not be assumed that CFIs would have access to all the above items for every client.