AFME's views on Capital Markets Union – Action 10 (Withholding Tax) and Action 12 (Shareholder Rights)

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Executive Summary

AFME, through its Post-Trade division, has a long-standing position of supporting the Capital Markets Union (CMU) project and its objectives, including the creation of a single and fully integrated post-trade ecosystem in the EU.

This paper presents recommendations for the public sector in relation to Actions 10 and 12 of the European Commission's Capital Markets Union Action Plan, that can lead to a more secure and integrated withholding tax system and enhance shareholder rights, providing a major contribution to the creation of a true European CMU.

This paper builds on the foundations of previous initiatives conducted by expert groups convened by the European Commission; notably, the European Post Trade Forum, the CMU High Level Forum, the Advisory Group on Market Infrastructures for Securities and Collateral (AMI-SeCo), and previous papers published by AFME's Post-Trade division.

- **Withholding Tax**

  A high degree of fragmentation is associated with withholding tax (WHT), since WHT relief procedures differ across members states. These procedures tend to be complex, lengthy, cost-inefficient, vulnerable to fraud, and represent burdensome requirements which ultimately may deter foreign investment initiatives. In addition, the absence of a consistent and clearly articulated definition of the term "beneficial ownership" can make it difficult to determine how relief procedures should be applied in practice.

  In order to tackle WHT market fragmentation, policymakers should look to implement an EU-wide WHT regime, focusing on establishing a framework of common definitions under EU law (including a definition of "beneficial ownership" and pragmatic procedures for its determination), along with describing common processes and setting out a standardised relief-at-source single form that would facilitate tax reclaim formalities.

- **Shareholder Rights**

  With regards to shareholder rights, difficulties arise in cases where a shareholder sends a message to the issuer or issuer agent, specifying its preference on how to exercise its rights as holder of the securities. These difficulties may be related to the content of the message, its form (i.e. depending on the communication channel being used), or derived from whether the issuer of the securities recognises the originator or sender of the message as the effective shareholder or as being entitled to the exercise of the corresponding shareholder rights.

  We emphasise the need for a common pan-European definition of 'shareholder', to make it easier for both issuers to meaningfully identify their shareholders, and for investors to exercise their rights.

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Opportunities and challenges

Common objectives shared by CMU Actions 10 and 12 are the creation of legal, regulatory and fiscal frameworks that will allow for the creation of common pan-European processes, particularly those related to the custody chain that connects issuers with investors. A key feature of the custody chain is the ability of intermediaries to hold securities at their securities account provider in omnibus accounts, which helps streamline operational processes and reduces duplicities.

Although the custody chain is a key element of modern capital markets, it faces multiple challenges with regards to the collection, maintenance and transmission of information. Problems in the current processes can be grouped into four categories:

i. Lack of common definitions, particularly in regards to the concept of investor or shareholder;

ii. Differences in the design of corporate events;

iii. Lack of common formats for messages;

iv. Lack of common transmission mechanisms.

Major similarities exist in the process for transmitting information up and down the custody chain, both for processes related to withholding tax refund and those used for the exercise of shareholder rights; firstly, there is an overlap in the information that is required, and secondly, in the identity of the parties sending and receiving the information. These similarities in the current processes provide opportunities for identifying and delivering common solutions, which should be mostly based around setting out common definitions and common design features.

Recommendations

We recommend that actions by European public authorities should aim to strengthen the custody chain, and, to the extent possible, foster integration between withholding tax and shareholder rights processes at operational level.

Public sector actions should also remain consistent with other regulatory objectives, such as improving settlement efficiency, and should aim to deliver benefits for all participants, improving the attractiveness of EU capital markets.

We emphasise that actions at member state level are required, in addition to EU-level initiatives.

Specifically, we recommend that common definitions are developed for key legal and operational concepts, including those of 'investor' and 'shareholder', and are applied across both WHT and shareholder rights processes.

With respect to shareholder rights, the end investor should be identified as the legal shareholder.

A common pan-European system for tax relief at source should be established as the default mechanism, with the back-up ability of applying for tax reclaims.

Additionally, a consistent pan-European application of the record date principle is required, in order for tax entitlements to be based on booked securities positions as of record date. Market claims related to dividend payments should be treated as indemnities rather than taxable dividends.

Tax rules should facilitate the provision of securities as collateral, so that, where possible and appropriate, tax processing should be based on the tax status of the collateral giver rather than the tax status of the collateral taker.

Introduction

On 24 September 2020, the European Commission adopted the Capital Markets Union Action Plan, which set out its intention to take 16 Actions with the objective of building a single market for capital across Europe, namely a Capital Markets Union.

The European Commission has already taken several of the actions set out in the Action Plan, including, notably, a package of legislative proposals that were adopted on 25 November 2021 and that cover topics such as long-term investment funds, and a consolidated tape.

However, the European Commission has not yet made proposals with respect to two important post-trade actions: Action 10 on withholding tax procedures, and Action 12 on shareholder rights.

This paper sets out an analysis of these two topics, identifies commonalities between them, and proposes steps that can be taken, that will maximise synergies in the resolution of the underlying problems.

AFME's views on the CMU:

AFME is a strong advocate of the Capital Markets Union (CMU) project and its objectives. Despite significant joint efforts and some notable achievements, it is still a reality that European capital markets remain fragmented. This market fragmentation results in higher costs, prevents economies of scale and hinders investment opportunities.

AFME, through its Post Trade division, supports the creation of a single integrated post-trading process for securities transactions in Europe, to achieve harmonisation, standardisation and consolidation through best practice and regulation.

Critical to the functioning of the post-trade value chain is the involvement of regulated intermediaries to connect securities issuers with investors, and provide core services such as settlement, custody and asset servicing.

The ability of custodians and other post-trade service providers to perform these functions in a safe, efficient and harmonised manner is hindered by barriers, that can be bucketed into three categories: operational inefficiencies; legal uncertainties and regulatory inconsistencies. Delivering Capital Markets Union requires further integration of the post-trading landscape in the EU. There is a need for an ambitious approach, a clear vision of the objectives, along with cross-collaboration between both the public and the private sectors.

Previous initiatives and papers:

The analysis contained in this paper builds on analysis that has previously been conducted by expert groups convened by the European Commission – including the European Post Trade Forum (EPTF)[1] and the CMU High Level Forum[2] – as well as by the European Central Bank, including, notably, the Advisory Group on Market Infrastructures for Securities and Collateral (AMI-SeCo). This paper also builds on previous papers issued by the AFME Post-Trade division.

[1] https://ec.europa.eu/info/publications/170515-eptf-report_en
[2] https://ec.europa.eu/info/files/200610-cmu-high-level-forum-final-report_en

CMU Action 10 – Withholding Tax

CMU Action 10 relates to withholding tax procedures applicable to cross-border holdings of securities.

- **Withholding Tax Challenges**

  Investors who receive income on holdings of securities, namely, dividends on holdings of equities, and interest on holdings of bonds, may be obliged to pay tax on that income both in the country of the issuer of the securities (in the form of withholding tax) and in their country of residence (in the form of income tax). Under the terms of many double taxation agreements (DTAs) between individual countries, investors may be able to benefit from reduced rates of withholding tax. The purpose of such reduced rates is to reduce or eliminate the double taxation that occurs on cross-border investments.

  The main challenges in withholding tax processing are (i) those relating to information management and transmission and (ii) determining in many commonly encountered circumstances who is the "beneficial owner" of the income stream that is subject to withholding tax..

  i. *Information management and transmission*

  In order to ensure that, for a given income payment, the correct amount of tax is withheld, the information that needs to be maintained and transmitted to the relevant party (i.e. the withholding agent and/or the tax authority) falls into four basic categories [3]:

  a) information as to the identity, residency and tax status of the investor;

  b) documentary evidence/proof of this tax status and residency;

  c) information as to the securities held by the investor (and possibly the related information as to the amount of income paid, and the amount of tax withheld);

  d) documentary evidence/proof of these securities positions (and any related payments).

  We note that the starting point for management and transmission of this information is the investor, as it is the investor that knows its own identity, knows the amounts of securities it has purchased, and can receive certifications as to its tax status from the tax authorities in its own country of residence. The information provided by the investor is corroborated with official certifications by the tax authority in its country of residence and by an intermediary (usually the custodian bank) with documentary evidence/proof of securities holdings and related income payments.

  The application of existing withholding tax (WHT) procedures across most member states is problematic and highly fragmented, thus representing a long-standing issue in terms of achieving European integration.

  These procedures represent a complex and burdensome requirement, both for foreign investors and for tax administrations. Procedures for WHT relief differ across member states, and are lengthy, cost-inefficient and vulnerable to fraud.

[3] This explanation is based in good part on the analysis contained in a November 2016 paper issued by the T2S Advisory Group, and available at: https://www.ecb.europa.eu/paym/groups/shared/docs/a226b-20161130_ag_discussion_note_on_harmonisation_of_tax_processing.pdf

As a result of this, European markets may be seen as less attractive for potential foreign investors, with the second-order effect of negatively impacting markets' liquidity and performance. Many of the problems associated with withholding tax procedures have been reviewed in detail by the EPTF and by the CMU High Level Forum. AFME supports the conclusions of these forums. In its final report, the CMU High Level Forum recommends the implementation of an EU-wide WHT system whereby recognition of immediate relief at source would become the default option for cross-border investment activities. This would imply that reclaim procedures would become the back-up option for cases where foreign investors have not been able to benefit from relief at source.

ii. Beneficial Ownership

The application and outcome of current withholding tax relief processes is fundamentally uncertain. A primary cause of this uncertainty stems from how the beneficial owner test is applied to determine who is entitled to make the reclaim. The beneficial ownership test is normally applied to income derived from securities, namely dividends and interest.

The core problem is that there is in practice no general agreement or clarity on what indicia will decisively convey beneficial ownership to a party.

In practice the specific facts that tend towards providing beneficial ownership vary from country to country, but the issue is that most tests are often vague, imprecise or are applied inconsistently from case to case. In addition, the tests are often applied to determine that a person is not a beneficial owner without confirming who the beneficial owner is.

In fact, AFME members are not aware of a single member state that has clearly defined the term "beneficial owner" in legislation or statute and there is very limited case law on the subject.

With this issue in mind, the OECD sought to remedy the situation with their project of almost a decade ago seeking to clarify the meaning of the term "beneficial owner". However, it is evident from the current situation that in practice the OECD guidance is not clearly or consistently followed in all jurisdictions. Subsequent to the OECD initiative, treaty adherents (both member states and countries outside of the European Union) have taken a broad range of approaches to dealing with the application and consequence of the beneficial ownership requirement (each representing a different balance act involving the sometimes-competing objectives of preventing unintended outcomes, fairness, certainty and administrability).

These approaches include adopting standards for determining whether the beneficial ownership requirement has been satisfied in specific scenarios as well as introducing alternative measures of taxation in situations where they appear to believe a beneficial ownership standard is not delivering results that align with policy objectives.

The lack of consistency in approach is itself a potential source of unfairness and uncertainty (for both tax authorities and investors).

The absence of a clear understanding of what is required to fulfil the beneficial owner test means that in practice it is often necessary for investors or their agents to take a view as to what is sufficient to meet the test. This inevitably means that there is potentially less consistency in the standards applied. It also increases administration of the rules by tax authorities given some interpretations of the test may be at variance with the intended standards of a tax authority or at variance with what a tax authority ultimately decides are the standards it wishes to apply.

There may also be sudden shifts in the requirements imposed by tax authorities before the test is regarded as fulfilled, and there is a chance that these could be applied retrospectively. It is also increasingly common for disputes about the nature of the beneficial ownership test to arise.

The outcome of such disputes may also be perceived as arbitrary, along with having unintended consequences and tax impacts in other jurisdictions. This means that the absence of any clearly understood interpretation of the beneficial owner test is causing significant problems and leading to undesired outcomes for tax authorities and investors alike.

The existence of these various problems stemming from the beneficial owner test therefore represents a material obstacle to the goals set for the European Commission initiative. It follows that the goal of removing the burdensome and distortionary effects that are caused by withholding tax procedures will be achieved only if the relevant processes as revised deliver both efficiency and certainty.

The efficiency requirement will necessitate the introduction of simplified and universally applied processes that can readily be applied by both investors and tax authorities. Such processes would also need to address the range of issues identified in the European Commission's 2017 Code of Conduct on Withholding Tax.

The certainty requirement will mean that it is essential for the relevant tests and standards comprised in those processes to be completely clear – including the requirements of what tests must be satisfied to meet the beneficial owner test. That requirement will also make it essential that the outcome of applying those processes and tests is delivered with complete reliability. These certainty objectives will enhance the intended efficiency and preclude unfair outcomes.

▪ Withholding Tax Proposals

In order to implement a harmonised EU-wide WHT regime, European Regulators would need to establish a framework of common definitions under EU law, along with the description of common processes and the establishment of a single standardised relief-at-source request form, that would simplify formalities and would facilitate verifications by tax authorities. Such a standardised process would also represent the basis of a more efficient protocol for those cases subject to tax reclaims, where the relief at source would have not been automatically recognised.

Furthermore, the adoption of standardised forms and procedures would be facilitated by a common approach towards digitalisation of the information management and transmission. This approach could be seen as consisting of the following steps:

i. definition of a standard EU form for the certification of residence, in a digital and machine-readable format (thus eliminating paper certificates and wet-ink signatures/stamps);

ii. definition of EU standards for reporting and transmission protocols, to be used by intermediaries in their documentary evidence and proofs to tax authorities for both the relief at source and, when needed, the reclaim procedures (thus greatly simplifying the tax refund requests and the auditing activities);

iii. establishment of a single EU register of official certificates of residency ("file only once" principle), which would be accessible by all EU intermediaries and tax authorities (thus reducing the burden of multiple copies of the same certificates to be used by each investor for securities investments in various EU countries; a single digital register would also increase transparency and facilitate fraud prevention controls).

CMU Action 12 – Shareholder Rights

CMU Action 12 on shareholder rights relates to the question of how investors, who have bought and paid for securities, can effectively exercise the rights associated with those securities.

This question largely relates to the custody chain, as the vast majority of tradable securities are held by investors through a custody chain comprising one or more intermediaries.

For securities held through a custody chain the exercise of some types of shareholder rights is unproblematic. For distributions (cash or stock dividends, interest payment), the process is relatively straightforward. There is a cascade process, whereby each party in a custody chain receives the outcome of the distribution (cash or securities), and passes this outcome to its account holder, until the outcome is received by the last party in the custody chain (i.e. the end investor).

Difficulties in the exercise of rights arise largely in the process whereby the shareholder sends a message to an issuer or issuer agent specifying how it chooses to exercise its rights. There are three main categories of difficulty. There can be difficulties relating to the content of the message, if, for example, the shareholder does not have access to all the necessary information. There can be difficulties relating to the form of the message, depending, for example, on the communications channel used, and whether the message is sent through, or outside, the custody chain. And there can be difficulties relating to whether the issuer or issuer agent recognises the party sending the message as being the shareholder and/or as being entitled to exercise the shareholder rights.

This third category of difficulties is the most fundamental. If a legal regime, and a set of operational procedures, such as, registration procedures, have the effect that an end investor may not (or not immediately) be recognised as the legal owner, then this raises the question of whether the end investor in EU securities has actually acquired the full set of legal rights associated with ownership of those securities.

Important steps have already been taken to strengthen the legal framework for the exercise of shareholders' rights, with, notably, the original Shareholder Rights Directive (SRD) of 2007, and a revised version, Shareholder Rights Directive II (SRD II) in 2017, which sets out a series of operational requirements that have applied since September 2020, and that are designed to improve connectivity between issuers and investors, through the chain of intermediaries.

The operational requirements set out in SRD II relate to three core processes, namely, financial corporate actions, general meetings, and shareholder identification.

For each of these three core processes, associations representing banks, issuers and market infrastructures have created market standards that give more detailed guidance to parties in the custody chain as to how they should act in order to meet their SRD II obligations, and to achieve efficient end-to-end communication.

The market standards for financial corporate actions and for shareholder identification are subject to an annual compliance monitoring exercise carried out by the Corporate Events Group (CEG) that has been set up by the AMI-SeCo.

In a report published in December 2021, the CEG set out the results of its 2021 compliance monitoring exercise, which covered the standards relating to two SRD II operational processes, namely, financial corporate actions and shareholder identification.

The CEG report published in December 2021 identified substantial compliance with the standards, and noted progress towards increased compliance, but at the same time highlighted some significant gaps and problems.

The CEG report does not cover general meeting processes, but, in addition to the reports from the EPTF and the CMU High Level Forum, other recent documents and reports, including from the Association of Global Custodians[4] and Better Finance[5] , provide insight and perspectives on these processes.

One common factor that all these reports stress is the issue of the definition of the shareholder.

SRD II does not contain a definition of the term "shareholder", instead relying on national corporate and securities laws of the country of issuance of the security in question. This means that, in practice, the party identified as the shareholder differs from country to country.

This is especially problematic from a cross-border investment perspective. Typically, cross-border custody chains are longer and more complex than domestic custody chains – in other words, issuers and investors are separated by more "layers" of intermediaries.

This increases the probability that, under national transpositions of SRD II, and under specific national registration processes, the true 'end investor' is not identified as the 'shareholder'. This makes it more difficult for both issuers to meaningfully identify their shareholders, and for investors to exercise their rights.

Difficulties in the exercise of rights occur most frequently in the exercise of voting rights. Common problems include issues arising out of requirements for the provision of paper-based power of attorney documents, out of badly placed record dates for voting entitlements (i.e.: record dates that are too close to or after the market deadline for voting instructions), and out of difficulties in message formats.

Some of the difficulties in the exercise of rights are exacerbated by the fact that SRD II is a directive, and the key Level 1 requirements of SRD II take effect through transposition into the national law of each member state. Consequently, and despite the fact that the Level 2 requirements have the legal form of a regulation, the Directive falls short of delivering a single pan-European legal or operational framework for delivering its objectives.

[4] http://www.theagc.com/EFC%20SRD%20II%20Position%20Paper%2004-08-20%20FINAL.pdf
[5] https://betterfinance.eu/wp-content/uploads/Barriers-to-Shareholder-Engagement-2.0-SRD2-Implementation-Study-20220106.pdf

Analysis

The common objectives of CMU Actions 10 and 12 are to create legal, regulatory and fiscal frameworks that will allow for the creation of common pan-European operational processes, so that all issuers of European securities, and all investors in European securities, can benefit from these processes in the exercise of their rights associated with securities that they have issued, or that they hold.

The objective of common pan-European operational processes is a fundamental pre-requisite for a Capital Markets Union. Different operational processes across countries, whether by country of the issuer, or by country of the investor, create increased complexity, cost and risk, and have the effect of segmenting markets.

The operational processes covered by CMU Actions 10 and 12 relate to the custody chain that connects issuers to investors.

The **custody chain**, i.e., the use by investors of intermediaries (such as central securities depositories and custodians) to hold securities, is a fundamental building block of capital markets. It is a solution to two separate "many-to-many" problems. These are the problems of, firstly, connecting multiple issuers (tens, if not hundreds, of thousands) to multiple investors (tens, if not hundreds, of millions), and of, secondly, connecting multiple buyers on secondary markets to multiple sellers. It is not an exaggeration to say that, without the custody chain, modern capital markets would not exist.

A critical feature of the custody chain is the ability of intermediaries to hold securities at their securities account provider in omnibus accounts (i.e. accounts that can hold securities of multiple underlying investors). Without such an ability, the "many-to-many" problems described above are not solved, as the individual accounts of all investors would have to be replicated up the custody chain[6].

Another critical feature is that the custody chain comprises bodies that are regulated and supervised. These are essentially the central securities depositories, that are regulated under the Central Securities Depositories Regulation ("CSDR", EU No. 909/2014) and other international prudential regulations such as the CPMI-IOSCO Principles for Financial Market Infrastructures, and the custodian banks, that are regulated and supervised under a large body of national and international banking laws, prudential requirements and supervisory controls.

Although the custody chain is necessary, it is also faced with an important challenge of information management and transmission. More specifically, the challenge is the collection, maintenance and transmission of information by and through the intermediaries in the custody chain, so that information from the issuer is passed on down to the end investor, and that information from the end investor is passed up the custody chain to the appropriate recipient, whether that be the issuer, or a withholding agent, or the tax authorities in the country of the investment.

One important principle is that data should be stored and maintained in one place only, and not stored in multiple locations, so that – if the data changes – there is not a requirement that the update be effected in multiple locations, with the associated risk that not all updates are effected in the same manner, or at the same time.

The practical impact of this principle is that most core information relating to an end investor should be stored and maintained by the last intermediary in the custody chain (the intermediary in the chain that provides securities account to a party that itself does not provide securities account, i.e.: the end investor). Core information stored by the last intermediary will include the identity of the end investor, its security holdings, and, in most cases, its tax status. Given that this information is stored at the level of the last intermediary, requirements to store this information also higher up

[6] Further information is contained in the 2012 AFME paper on securities account structures: https://www.afme.eu/portals/0/globalassets/downloads/consultation-responses/afme-ptd-csd-acct-structure-final-report-for-publication-19-mar-2012.pdf

the custody chain should be minimised. The use of omnibus accounts up the custody chain is an example of a practical implementation of this principle, as from an operational perspective an account is a tool to store information, and omnibus accounts allow for only the minimum necessary information to be stored.

The reality that core information is stored at the level of the last intermediary is the source of a common perception that security holdings in custody chains are insufficiently transparent.

As regulated entities, intermediaries in the custody chain are subject to existing regulatory obligations to provide transparency on holdings, including, notably, the SRD II obligations on shareholder identification. There have also been self-regulatory initiatives to improve the security and transparency of the custody chain, including, most notably, the "ISSA Financial Crime Compliance Principles for Securities Custody and Settlement"[7].

The critical acid test as to whether a custody chain is transparent is whether, if a party higher up the custody chain is entitled and needs to access the information, that the information is actually transmitted to the party in a reliable and timely manner.

There are major similarities between the process for transmitting information up and down the custody chain for withholding tax purposes, and the process for transmitting information up and down the custody chain for the purpose of shareholder rights.

A first similarity is in the content of the information, as there is a major overlap in the key information that is required.

A second similarity is the identity of the parties sending and receiving information, as for most individual transmissions of information the parties are the same.

These similarities in the current processes provide the opportunity for common solutions.

The problems in the current processes can be placed into four categories:

i. Lack of common definitions
ii. Differences in design of corporate events
iii. Lack of common formats for messages
iv. Lack of common transmission mechanisms

The fundamental building blocks for common solutions, and for delivering the synergies that exist between common solutions, are common definitions, and common design features. These are needed with relation both to the same process that takes place across different countries, and to different processes.

Once there are common definitions, and common design features, across different processes, it will be possible to take steps to integrate these activities into a single common process. In today's world, the payment of a cash dividend is a separate process from the process to ensure that an investor pays the correct amount of withholding tax on that dividend. Integrating these two functions so that there is a single process for the payment of a taxable dividend will deliver major benefits to all parties.

Critically, the most important concept for which there is a need of a common definition is the concept of the investor or the shareholder.

[7] The text of the Principles, and additional information of the work on ISSA, are available at: https://issanet.org/working-groups/compliance-transparency/

Recommendations

As set out in the analysis above, AFME believes that the custody chain is a fundamental building block of capital markets and is especially relevant and important for cross-border capital market investments.

With respect to public sector actions to improve and facilitate withholding tax processing and the exercise of shareholder rights, AFME has the following high-level recommendations:

1. Public sector actions should be compatible with, strengthen, and build on the custody chain, which should continue to operate as the key tool for efficient information and communication across all relevant stakeholders.

2. Public sector actions with respect to withholding tax processing should to the greatest extent possible be compatible with public sector actions with relation to shareholder rights. The objectives should not be to create separate operational processes, but rather to integrate the withholding tax process to the greatest possible extent in the process of the exercise of shareholder rights.

3. Public sector actions should be consistent with other regulatory objectives, including, for example, facilitating the use of collateral as a tool to mitigate risk, and achieving a high rate of settlement efficiency.

4. Public sector actions should deliver benefits for all participants, both European and non-European, in European capital markets. Both European and non-European investors should be able to benefit from harmonised processes relating to investments in European securities.

5. Public sector actions should not be limited to the European level. There is also a need for action at a member state level.

AFME also has the following more specific recommendations:

6. European authorities should ensure that common pan-European definitions of key legal and operational concepts, including the concepts of investor and of shareholder, apply for the purposes both of withholding tax processing and of shareholder rights.

7. For the purposes of shareholder rights, the end investor (i.e. the last party in the custody chain, and holding a securities account with the last intermediary) should be identified as the legal shareholder.

8. As it is working well, the SRD II process for shareholder identification can be reused in order to provide transparency for other purposes, including, potentially, for tax purposes.

9. Systems of WHT relief at source and of WHT reclaim are complementary. If there is just the possibility for relief at source, then there is the risk that not all entitled holders will be able to benefit from the correct tax rate. AFME believes that there should be a common pan-European system of relief at source, with, as a back-up for investors, the ability to apply for reclaims.

10. For the calculation of tax entitlements, there should be a consistent pan-European application of the record date principle, so that tax entitlements are based on booked securities positions as of record date, as set out in the November 2016 paper from the T2S Advisory Group[8]. In consequence, market claims relating to dividend payments should be treated as indemnities, rather than as taxable dividends.

[8] https://www.ecb.europa.eu/paym/groups/shared/docs/a226b-20161130_ag_discussion_note_on_harmonisation_of_tax_processing.pdf

11. Tax rules should facilitate the provision of securities as collateral, so that, in general–subject to appropriate conditions– WHT reclaim processing should be based on the tax status of the collateral giver rather than the tax status of the collateral taker[9].

12. Digitalisation of all WHT procedures should be pursued across all EU member states, with certifications in digital form, reporting and transmission protocols that foster automation, and a centralised EU repository for all digital certifications and other WHT-related information.

13. In line with the legislative proposal for a European Single Access Point (ESAP), a single common repository should be established for all corporate information that is relevant for the exercise of shareholder rights (details of corporate events, agendas of general meetings, methods of participation in general meetings, etc.).

AFME believes that action by the public sector is necessary, but will not be sufficient, to deliver all the benefits that can be achieved. The private sector also has an important role to play, in particular in developing pan-European market standards and best practices.

[9] Exceptions may apply with regards to the general recommendations outlined in this paper. AFME welcomes any regulatory guidance onto which party is to be treated as the tax owner of the securities collateral title that has been transferred to the collateral taker.

Conclusions

The future proposals of the European Commission in relation to CMU Actions 10 and 12 will be an important opportunity to take action on major obstacles to integrated capital markets in Europe.

There are important similarities in the operational processes covered by the two Actions, so that there is the potential for major synergies if the legal and regulatory changes to be proposed by the Commission are coordinated and aligned.

This paper sets out 13 Recommendations for public sector action that can lead to a more secure and more integrated withholding tax system, that can enhance shareholder rights, and that can make a major contribution to building a true European Capital Markets Union.