


# European Commission proposes new rules for harmonized withholding tax procedures in the EU

### European Commission – Fair taxation – Business in Europe – Faster and Safer Relief of Excess Withholding Taxes – FASTER – Withholding Taxes

On June 19, 2023, the European Commission (EC) issued a proposal for a Council Directive providing for the "Faster and Safer Relief of Excess Withholding Taxes (FASTER)" initiative.

The aim of the proposal is to make withholding tax (WHT) procedures in the EU more efficient and secure for investors, financial intermediaries, and local tax authorities. The draft Directive gives Member States a choice between implementing a quick refund system, a relief at source system or a combination of the two, as well as the introduction of additional registration and reporting requirements for financial intermediaries. The proposal is now open to feedback from interested stakeholders.

## Background

The policy effort to design a more efficient WHT system has been high on the agenda of the OECD and EC as well as local tax authorities for more than a decade. Significant progress was achieved at OECD level with the approval of the Treaty Relief and Compliance Enhancement (TRACE) implementation package in 2013, which introduces a standardized system for effective WHT relief procedures for cross-border portfolio income, facilitated by Authorized Intermediary (AI).

On April 1, 2022, the EC launched a public consultation on a new initiative that would introduce a common EU-wide system for withholding tax on dividend and interest payments[1]. The primary objectives of this initiative were

[1] KPMG member firms in EMA submitted a responses to the April 2022 public consultation (see E-News Issue 157 for reference), which followed the submission of a KPMG response to the initial public consultation in October 2021 on the European Commission's roadmap for this file (see E-News Issue 152 for further details).

to (i) shorten the time for relieving and refunding excess WHT, (ii) ensure that financial intermediaries adhere to customer due diligence and related reporting requirements, (iii) prevent abusive WHT practices, and (iv) equip tax authorities with the tools to deal with refund and relief at source procedures in a secure and timely manner.

To achieve these objectives, the EC considered three potential approaches to a harmonized WHT system:

(i) The implementation of a Common EU digital tax residence certificate alongside common reporting for financial intermediaries. This would involve the implementation of standardized due diligence procedures, common rules for liability allocation and the option for financial intermediaries to file requests on behalf of taxpayers.

(ii) The introduction of a relief at source system. This would have built on the elements in the first option while also implementing an EU level relief at source system which would apply the reduced WHT rate directly at the moment of interest or dividend payment.

(iii) The implementation of a quick refund system within a set time frame and/or a Relief at Source system. This would also incorporate the added reporting and due diligence requirements of option one.

According to the explanatory memorandum, the EC compared the various approaches considering effectiveness, efficiency, coherence, and proportionality. Ultimately, it was decided that the third approach was preferable, given that it would be highly effective to tackle the problems identified in the EU in terms of speed, simpler processes, and more digitalized procedures. The proposed Directive has been drafted as such.

## Proposal by European Commission

The proposed Directive is structured into four Chapters that set out the rules, starting with general provisions on scope and definitions, moving to the provisions relating to a digital tax residence certificate, the proposed withholding tax relief procedure and then finishing with provisions covering the transposition of the proposed Directive into the local laws of EU Member States.

### Proposed WHT relief systems

The proposal outlines two systems of relief that Member States may apply. Each Member State may decide to apply either Option 1, Option 2, or both. However, Member States will be required to ensure that at least one of the two systems below are available to all investors.

- Option 1: Relief at source – under this system, the correct amount of taxes will be applied at the time of dividend or interest payment.
- Option 2: Quick refund system – the quick refund system provides that tax is withheld at the higher rate applied in the source country, but the excess tax is refunded within a set time frame of 25 days maximum from the date of request or from the date when required reporting requirements are fulfilled, whichever is latest. In any event, this should take place within 50 calendar days from the payment date.

Where the relief at source and quick refund systems do not apply, a standard refund procedure will be applied whereby the taxpayer or its representative (who does not need to be a Certified Financial Intermediary (CFI)), are able to directly request a refund to the tax authority.

## Requirements to avail of the WHT relief systems

The proposed Directive outlines a number of requirements for investors to satisfy in order to avail of the benefits of the WHT relief systems, including:

*(a) Eligible payments*

The proposed Directive will apply to Member States that provide relief for excess WHT on dividends paid for publicly traded shares. In addition, Member States may opt to apply the provisions of the Directive in respect of excess WHT paid on interest for publicly traded bonds.

*(b) Engagement with a Certified Financial Intermediary (CFI)*

To avail of either one of the above fast-track procedures, all investors will need to engage with a financial intermediary that is certified to provide services regarding eligible payments. National Registers with details of Certified Financial Intermediaries – CFIs, will be made publicly available for the information of investors. Further details regarding the obligations of CFIs are detailed below.

*(c) Evidence of tax residency with a common EU digital tax residence certificate (eTRC)*

Investors will need to provide evidence of their tax residency in the EU by obtaining an EU digital tax residence certificate – eTRC. The proposed Directive provides that Member States will need to introduce an automated process to issue an eTRC, to enable an efficient administrative process. The key features of the eTRC are:

- The eTRC will be comprised of common content, regardless of which Member State issues it.
- The common content will include information to identify the requesting taxpayer (e.g. name, tax reference number, address, etc.) and confirmation that they are resident in the Member State.
- The eTRC will cover at least the full calendar year in which it is requested. However, should circumstances of the taxpayer change in the period, a Member State may deem the eTRC to no longer be valid before expiry of the period.
- Member States will be required to issue eTRC's within one day if taxpayers have provided all required information.

## Anti-abuse provisions

The proposed Directive has specifically scoped out certain transactions with a view to preventing abusive practices. The benefits of the fast-track procedures would therefore not be available to investors where:

- the dividend has been paid on a publicly traded share 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;
- at least one of the financial intermediaries in the securities payment chain is not a CFI and a subsequent CFI in the chain has not provided the local tax authority the relevant reporting information under this Directive if it were a certified financial intermediary.

## Financial intermediaries: Registration, due diligence and reporting requirements

*Definition of a Certified Financial Intermediary*

The proposed Directive outlines that a financial intermediary is to be considered a CFI on either of the following grounds:

- a compulsory basis for large institutions[2] that handle payments of dividends and interest on securities originating in their jurisdiction and Central Securities Depositories[3] that are providing WHT agent services for the same payments; or
- a voluntary basis for all other entities (including non-EU financial intermediaries) that act as financial intermediaries[4] and satisfy requirements by registering on a National Register set up in accordance with the Directive. It should be noted that it is expected that registration should be with the Member States in which their clients have investments in.

It should also be noted that, where the financial intermediary is established outside the EU, it is required to be subject to legislation in the third country of its residence that is comparable for the purposes of this Directive and the third country of residence is neither on (i) Annex I of the EU list of non-cooperative jurisdictions nor (ii) on the EU list of high-risk third countries (anti-money laundering list).

*Obligations of Certified Financial Intermediaries*

CFIs will be required to register on the National Register of the Member States in which their clients hold investments – as such, it may be the case that CFIs will be required to register on the National Registers of multiple Member States. In addition, it should also be noted that the proposed Directive includes additional obligations for CFIs. A CFI requesting relief on behalf of an investor is required to:

(i) Obtain a declaration that the investor is:

- the beneficial owner of the dividend or interest as defined under the national legislation of the source Member State; and
- has not engaged in a financial arrangement linked to the underlying publicly traded share that has not been settled, expired, or otherwise terminated at the ex-dividend date.

(ii) Verify the following information regarding their client:

- the eTRC of the registered owner and/or appropriate proof of tax residence in a third country;
- the investor's declaration and tax residence against information from the internal control mechanisms used by the CFI in order to comply with anti-money laundering (AML) obligations;

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2 As defined in article 5 paragraph 2 of Regulation (EU) No. 575/2013 of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 (OJ L 176, 27.6.2013, p. 1–337).

3 In the scope of Regulation (EU) No. 909/2014 of 23 July 2014 on improving securities settlement in the European Union and on central securities depositories and amending Directives 98/26/EC and 2014/65/EU and Regulation (EU) No 236/2012 (OJ L 257, 28.8.2014, p. 1–72).

4 According to article 7 paragraph 1 of the proposed Directive, acting as a financial intermediary means that custodial activities are performed by entities such as (i) credit institutions (Directive 2013/36/EU or comparable legislation of a third country), (ii) investment firms (Directive 2014/65/EU or comparable legislation of a third country), and (iii) central securities depositories (Regulation EU 909/2014 or comparable legislation of a third country).

- the investor's entitlement to a specific reduced withholding tax rate in accordance with a double tax treaty between the source Member State and the jurisdictions where the registered owner is resident for tax purposes or specific national legislation of the source Member State;
- in case of a dividend payment, the possible existence of any financial arrangement that has not been settled, expired or otherwise terminated at the ex-dividend date, unless the dividend paid to the registered owner for each group of identical shares held does not exceed EUR 1,000.

(iii) A CFI would be subject to additional reporting obligations, including:

- information regarding the identity of the CFI, recipient and payor of the dividend or interest payment (e.g. name, address, tax reference number, etc.);
- the legal basis of the applicable withholding tax rate and total amount of excess tax to be refunded;
- the tax residence of the registered owner;
- the registered owner's declaration as referred to at (ii) above;
- in the case of dividends, further information will also be requested regarding the holding period of investments and the financial arrangements linked to the investments for which the taxpayer is requesting relief – with a view to reducing the risk of abusive practices. It should be noted that, if the total dividend paid to the investor on a shareholding in a company does not exceed EUR 1,000, CFIs will not be required to report this additional information.

The timeline of the reporting obligation is proposed to be 25 days at the latest from the record date.

*Penalties and civil liability for non-compliance*

Non-compliant CFIs (including those that do not comply with registration requirements), will be subject to removal from the National Registers and/or penalties. In addition, the proposal provides that if a CFI does not comply with its obligations under the Directive, the CFI can be held liable for all or part of the loss of WHT for the Member State.

**Next steps**

The EC has launched a public consultation seeking feedback from interested stakeholders on the proposed revisions. The public consultation will run for an eight-week feedback period starting from June 19, 2023, but extended every day until the proposal is available in all EU languages. For more information, please refer to the public consultation webpage.

Considering that the legal basis for the EC's proposal is Article 115 of the Treaty on the Functioning of the EU (TFEU), the Directive requires unanimous approval in the Council. In addition, the Council would only be allowed to adopt the text once the Parliament and any relevant Committees have given their (non-binding) opinions.

Where the Directive is adopted by Member States, it is expected that the proposal will come into force on January 1, 2027.

## ETC comment

The FASTER initiative has long been a point of interest for stakeholders in the EU. Notably, the EC received approximately 1,700 responses to the initial public consultation (92 percent from EU citizens), including 51 valid position papers. In their feedback, stakeholders highlighted their strong support for an EU-wide framework, as well as the need for a harmonized interpretation and approach to WHT within the EU.

The preamble to the FASTER proposal acknowledges that (i) the current disparity in WHT procedures, and (ii) the cumbersome rules, discourage cross-border investment and negatively impacts the functioning of the EU capital market. Furthermore, the Impact Assessment prepared by the EC estimates the overall cost of WHT procedures to amount to EUR 6.62 billion. The magnitude of these issues was previously explored in a 2022 survey undertaken by EU Tax Centre across the EU/EEA jurisdictions (for more details please refer to a dedicated KPMG blog post).

By providing for a relief at source system and a quick refund procedure with fixed deadlines, the current proposal represents a significant step forward in the pursuit of developing a streamlined WHT procedure and additional support for investors in their efforts to benefit from reduced treaty WHT rates. With this in mind, we also note that the simplified processes – in terms of related verification and reporting requirements to be undertaken by CFIs, for small investors (for dividend payments below the EUR 1,000 threshold), would in principle also be beneficial.

A digital standardized eTRC is also a welcomed development, in particular in the Member States that still requested TRCs completed based on local templates or other forms that have to be completed and stamped by the tax authorities in the jurisdiction of the investor. However, it should be flagged that the FASTER proposal misses a key point, by not tackling the potential mismatches across the EU with respect to the definition of the concept of beneficial ownership.

The proposal goes further than the Finnish TRACE-like regime, by imposing mandatory registration for certain large institutions and certain Central Securities Depositories – registration is voluntary for all financial intermediaries under the Finnish system. The text of the proposal leaves up to Member States to determine certain features, such as penalties for non-compliant CIFs and related civil liability.

Member States that choose to apply both relief options should carefully analyze how to structure the penalty system, in order not to create discrepancies between the two. For example, a stricter liability applicable to WHT reliefs could lead to the refund process being the norm. In addition, the safeguards implemented by Member States around the CIFs liability should be addressed proportionally, so that smaller intermediaries are not discouraged from applying for AI status.

Should you have any queries, please do not hesitate to contact KPMG's EU Tax Centre, or, as appropriate, your local KPMG tax advisor.


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