European Union

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FASTER: The European Commission Publishes a Proposed Council Directive Aimed at Improving the Withholding Tax Process within the European Union

In this article, the authors discuss the European Commission's legislative proposal for a Directive that aims to improve withholding tax processes, reduce barriers to an effective capital markets union and reduce potential fraud and abuse connected with such withholding tax claims.

1. Introduction

On 19 June 2023, the European Commission published a legislative proposal for a Council Directive (the Directive) setting forth rules that aim to make withholding tax (WHT) procedures in the European Union more efficient and secure for investors, financial intermediaries and Member States (the draft Directive is also referred to as FASTER (Faster and Safer Relief of Excess Withholding Taxes).[1] This initiative was announced earlier in the Commission's 2020 Action Plan on the Capital Markets Union.[2]

FASTER was developed in response to the widely recognized need for a new WHT model that could improve processes and reduce fraud.[3] As the Explanatory Memorandum to the Directive states:[4]

> [...] the WHT procedures that allow non-resident investors to benefit from tax treaty or domestic benefits are often burdensome, costly, and lengthy as they vary considerably across Member States both in terms of documentation to be submitted by the taxpayers to obtain the relief from WHT and as regards their level of digitalisation. WHT procedures are also still prone to risk of tax fraud and abuse, leading to revenue losses for Member States, as shown by a series of tax scandals, notably the so called Cum/Cum and Cum/Ex cases. This is due to the lack of accurate information in the hands of tax administrations, which owes to the low level of transparency within the financial chain and to the lack of information on the presence of financial arrangements linked to the underlying security.

There are three core objectives that the Commission sought to address in the proposed Directive:
(i) improve WHT processes in general;
(ii) reduce barriers to an effective capital markets union; and
(iii) reduce potential fraud and abuse connected with such WHT claims.

The draft Directive proposes three key building blocks and seeks to achieve a fair balance between the needs and obligations of the three primary participants, being investors, financial intermediaries and governments. The three building blocks are:

- Common due diligence procedures through:
  - a common EU digital tax residence certificate (eTRC) to be issued by the investor's residence state;
  - a beneficial owner declaration to be completed by the investor; and
  - obligations imposed on financial intermediaries to verify the tax residence of the investor and the presence of pre-defined triggers that could unveil potentially unjust or abusive claims for WHT relief.

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1. European Commission, Proposal for a Council Directive on faster and safer relief of excess withholding taxes, COM(2023) 324 final (19 June 2023), available at https://taxation-customs.ec.europa.eu/system/files/2023-06/COM_2023_324_1_EN_ACT_part1_v3.pdf.
2. European Union, *Capital markets union 2020 action plan: A capital markets union for people and businesses*, available at https://finance.ec.europa.eu/capital-markets-union-and-financial-markets/capital-markets-union/capital-markets-union-2020-action-plan_en (accessed 2 July 2023).
3. For a detailed overview of the background and the initiatives taken in the past two decades to unify and simplify withholding taxes within the European Union, *see* P. Radcliffe & R. Devisscher, *FASTER: The European Commission's Plans to Improve the Withholding Tax Claim Process within the European Union*, 63 Eur. Taxn. 5 (2023), Journal Articles & Opinion Pieces IBFD and P. Radcliffe & R. Devisscher, *European Commission Publishes Inception Impact Assessment on a New EU System for the Avoidance of Double Taxation and Prevention of Tax Abuse in the Field of Withholding Taxes*, 62 Eur. Taxn. 1 (2022), Journal Articles & Opinion Pieces IBFD.
4. European Commission, *supra* n. 1, at p. 1.

- Common procedures by offering Member States a choice to introduce either a "relief at source" or "quick refund" system (or a combination of both). Whilst Member States have the choice of which system to implement, they must ensure that at least one of the two systems is available to all investors and actually activated.
- A standardized reporting obligation that imposes common reporting obligations on all financial intermediaries that are registered in a National Register of Certified Financial Intermediaries (CFIs).

The public can provide input on the proposal until 14 August 2023 through a public consultation process. In the next stage, the proposal will move to the negotiation phase between Member States with the aim of final adoption. Similar to previous Directives on direct taxation, it is expected that the proposal may undergo significant changes during the negotiation process. Consequently, if a Directive is adopted, it may differ substantially from the current text. The adoption of a Directive on tax legislation requires unanimity between all 27 Member States. If unanimity is achieved, the Directive will be published in the Official Journal of the European Union. The Directive currently proposes that Member States bring into force the laws, regulations and administrative provisions necessary to comply with the provisions of the final Directive by 31 December 2026, and that they shall apply these as of 1 January 2027.

2. Background to the Directive

The current WHT framework for claims by non-resident portfolio investors is not uniform across the European Union – in that each Member State has its own rules, regulations, processes and procedures - and is often complex, burdensome and expensive for financial intermediaries, investors and tax authorities. The way financial markets operate may mean that the investor (the claimant) has no relationship with the person with the withholding obligation and there is often a chain of financial intermediaries between the investor and that person. This introduces opacity – i.e. makes it difficult for different actors in the chain to identify the beneficial owner – and therefore increases the potential for fraud. In order for a WHT claim at source to be made, a claimant (or their agent) will often have to complete a source market tax form and get that form stamped either by their home state tax authority or provide a certificate of tax residence and then attempt to get that form passed through the financial chain to the person who needs to see that form in order to pay the right rate of tax. When co-mingled client accounts are added into the equation, this can introduce another layer of difficulty, with the result that it becomes difficult to attribute the payment to the beneficiary without a breakdown in the information being provided.

The costs associated with the claim procedure, overlaid with the practical barriers of these procedures, often result in investors refraining from filing a claim or providing the right documentation, and thus foregoing WHT relief, resulting in permanent double taxation. The fragmentation of the procedures, with their lack of transparency and information, also provides a conducive environment for abusive practices and hinders effective measures against evasion. This situation has culminated in the following statistics:

- foregone relief is estimated to be around EUR 5 billion per annum;
- the cost of WHT relief procedures is estimated to be EUR 1 billion per annum; and
- the estimated cost of dividend arbitrage and/or abusive practice is estimated to be EUR 150 billion in the last 20 years.[5]

The European Commission has long had an interest in trying to resolve the WHT issues associated with barriers to a capital markets union. This interest stretches back over 20 years to the Giovannini reports of 2001-2003, which suggested that a common relief at source system, with obligations and liabilities for non-domestic intermediaries, could be a potential solution.[6] In the intervening period, a series of attempts were made to tackle this problem – notably, the 2009 Commission's recommendations for electronic and digital documentation and information and the Commission's 2017 Code of Conduct on WHT. However, whilst it might be argued that these initiatives led to some minor marginal improvements in some countries, they did not achieve their core goals, largely because these initiatives did not have the necessary support; nor did they have force of law.

For completeness, it is also worth noting that the OECD had identified WHT claims as an area of concern and, through an innovative collaborative effort made up of government representatives and experts from the business community, produced the report "Possible Improvements to Procedures for Tax Relief for Cross-Border Investors".[7] The Committee for Fiscal Affairs (CFA) then recommended further work be undertaken that eventually gave rise to the Treaty Relief and Compliance Enhancement (TRACE) initiative – broadly a standardized system for WHT relief procedures for cross-border portfolio income. This was approved by the CFA on 23 January 2013. However, Finland is currently the only country to have adopted TRACE through its introduction of the regime with effect from January 2021. Indeed, it can be argued that TRACE, as proposed by the OECD, may no longer suffice to deal with tax authorities' concerns given the focus on tax fraud and abuse and that its time has come and gone.

5. European Commission, *New EU system for the avoidance of double taxation and prevention of tax abuse in the field of withholding taxes (WHT)*, Commission Staff Working Document, SWD (2023) 216 final (19 June 2023), available at https://taxation-customs.ec.europa.eu/system/files/2023-06/SWD_2023_216_1_EN_impact_assessment_part1_v2.pdf.
6. European Commission, Giovannini Reports (14 Dec. 2016), available at https://finance.ec.europa.eu/publications/giovannini-reports_en (accessed 2 July 2023).
7. OECD, Treaty Relief and Compliance Enhancement (TRACE) – Implementation Package approved by CFA, available at https://www.oecd.org/ctp/exchange-of-tax-information/treatyreliefandcomplianceenhancementtrace.htm (accessed 2 July 2023).

In 2020, the Commission published an "Action Plan for Fair and Simple Taxation to Support the Recovery Strategy"[8] and "A Capital Markets Union for People and Businesses – New Action Plan".[9] As part of these action plans, the Commission outlined its intention to present a legislative proposal for the implementation of a unified and standardized WHT system across the European Union. This system would enable relief at source and would be accompanied by a mechanism for exchanging information and fostering cooperation among tax administrations.

Following the publication of these action plans, the Commission initiated a public consultation on the proposal for a new system. The explanatory memorandum to this Directive states that the Commission concluded, from the feedback received, that there is widespread consensus on the challenges posed and the necessity for EU intervention resulting from the fragmented WHT procedures.[10] However, the Commission observed discrepancies among the primary stakeholder groups regarding potential solutions to rectify these issues (i.e. notably in relation to whether a relief at source or quick refund system would be the most desirable outcome and also in relation to the reporting framework). There was widespread support for the implementation of a unified digital tax residence certificate throughout the European Union.

3. Detailed Discussion

3.1. Introductory remarks

Adoption of the proposed Directive would mark a milestone in the area of taxation within the European Union, as it would represent the first success in harmonization in the field of WHT relief procedures for portfolio investors.

A lot of the operative details will still have to be introduced by Member States as they transpose the Directive into domestic legislation. The Commission also announced that more detail and standardization will be implemented through a series of "implementing acts".[11]

The authors believe that the proposed framework makes a good attempt to find the right balance between equipping governments with the necessary tools to combat tax evasion and enabling faster access to refund procedures for investors. This is achieved by imposing obligations on both investors and financial intermediaries, but the authors believe a clear delineation of the responsibilities and how they link to the liability provisions will be needed in order to ensure the Directive achieves its full intended outcome. Indeed, the success of the initiative is likely to hinge on whether this balance can be maintained so that all parties – investors, intermediaries and tax administrations – benefit from the proposals:

- investors will have to prove their entitlement to claim reduced rates of WHT under treaties or source country legislation by declaring their status as beneficial owner (as the term is defined in the national legislation of the source country) and certifying the absence of certain financial arrangements that are linked to the underlying shares;
- financial intermediaries will have to almost instantaneously report significant amounts of data. They will also have to verify certain claims made by the investor but, at present, it seems they will not have to conduct an independent legal assessment of the beneficial ownership concept as it is defined in the source country legislation; and
- tax authorities will have to set up robust data analytics solutions, allowing them to verify, in real time, the eligibility of registered owners to reduced WHT rates based on the information reported to them that will give insights into the entire securities payment chain.

Whilst the framework seems suitable to achieve the stated objectives, the authors contend that a number of topics remain that require further deliberation at this stage. In the following sections, they present a non-exhaustive analysis of the core components of the Directive and what they perceive to be the most contentious issues that will capture the attention of financial intermediaries and industry groups as they analyse the Directive.

3.2. Certified Financial Intermediaries (CFIs)

Registration will be mandatory for "large financial institutions" (as defined in the Capital Requirements Regulation (EU) No 575/2013)[12] and voluntary for others (including non-EU intermediaries). Such registered entities will be known as CFIs who will appear in a national register maintained by the relevant Member State (i.e. the source state of the relevant income).

Member States will have the ability to remove, from the national register, any CFI who requests such removal or is non-compliant with their obligations. Member States will then have to exchange that information with other Member States, allowing them to consider whether they

8. European Commission, Communication from the Commission to the European Parliament and Council: An Action Plan for Fair and Simple Taxation Supporting the Recovery Strategy, COM(2020) 312 final (15 July 2020), available at https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52020DC0312 (accessed 2 July 2023).
9. European Commission, Communication from the Commission to the European Parliament, the Council, The European Economic and Social Committee and the Committee of the Regions, A Capital Markets Union for People and Business – New Action Plan, COM(2020) 590 final (24 Sept. 2020), available at https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=COM%3A2020%3A590%3AFIN (accessed 2 July 2023).
10. European Commission, Withholding taxes – New EU system for the avoidance of double taxation and prevention of tax abuse: Faster and Safer Relief of Excess Withholding Taxes, available at https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/13031-Withholding-taxes-new-EU-system-for-the-avoidance-of-double-taxation-and-prevention-of-tax-abuse-Faster-and-Safer-Relief-of-Excess-Withholding-Taxes_en (accessed 2 July 2023).
11. An "implementing act" refers to a type of legal act issued by the European Commission to provide detailed guidelines and rules necessary for the implementation of EU legislation. Implementing acts serve to specify and supplement the provisions of primary EU legislation, ensuring consistency and uniformity in its application across EU Member States.
12. European Commission, Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and amending Regulation (EU) No 648/2012, OJ L 176 (27 June 2013), available at https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A02013R0575-20230101 (accessed 2 July 2023).

wish to remove these CFIs from their National Registers as well.

3.3. Digital tax residence certificate

The eTRC seeks to inject uniformity into the previously fragmented procedures and is a step forward in the move towards a paperless digital framework.

The eTRC will have to be issued by Member States through an automated process to a person deemed resident in their jurisdiction for tax purposes. The eTRC should be issued within one working day after the submission of a request and cover at least the whole calendar year in which the request for the certificate is made. Member States can nevertheless rescind an eTRC issued where the tax administration has proof to the contrary regarding the tax residence for that year. Member States should recognize an eTRC issued by another Member State as adequate proof of a taxpayer's residence in that other Member State.

The eTRC shall include the following information:
- 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 WHT under the Directive or information required to be included in a tax residence certificate under EU law.[13]

The Commission is expected to adopt implementing acts with standard computerized forms and technical protocols for the issuance of an eTRC.

Whilst the financial industry, as a general matter, is likely to support steps that improve digitalization and speed on issuance, there is a fundamental question as to what true value the eTRC provides in terms of reducing tax risk for the source tax authority. Indeed, the TRACE discussions concluded that:[14]

> the value of a certificate of residence is unclear. There are a number of reasons why they may be of limited value […]
>
> Accordingly, a requirement that a claimant obtain a certificate of residence from the residence country tax administration does not guarantee that the claimant is a resident of that country either on the date of requesting the certificate or on the date of recipient of the income with respect to which it will be used, although it may ensure that the claimant was a resident of that county at some point in the not too distant past […] In summary, then, doubts exist as to whether the information in the hands of the residence country is adequate for satisfying the broad information needs of either the source country or the residence country, and whether under those circumstances source country requirements for the residence country to provide certificates of residence are justified.

The key difference between now and the time of the TRACE discussions is the high level of automation anticipated in the Directive. If that is achieved, it may well be that the proposed solution is less of a burden for the CFIs than an alternative process – e.g. self-certification with checking to anti-money laundering (AML), etc. – that might well be less digitized and more costly.

3.4. Due diligence and liability

In order to benefit from the relief at source or quick refund system, the proposed due diligence procedures impose obligations on investors and CFIs who will be liable for potential under withholding in the event of intentional or negligent non-compliance.[15]

The registered owner (which is defined as any natural or legal person that is entitled to receive dividend or interest income from securities subject to tax withheld at source in a Member State)[16] will have to provide its eTRC and a declaration to the CFI that is seeking relief on its behalf. The declaration will have to include a representation that the registered owner is the beneficial owner of the income according to the law of the source country Member State. In addition, the registered owner will have to declare that it has not engaged in a financial arrangement linked to the underlying publicly-traded share that has not been settled, expired or otherwise terminated as at the ex-dividend date.

The CFI seeking relief on behalf of the registered owner will have to verify the claims made by the registered owner. The due diligence obligation imposed on the CFI consists of three core blocks:
(1) verification of the eTRC or proof of tax residence in a non-EU Member State. Here, the CFI will be expected to verify the existence and veracity of the eTRC[17] or other Certificate of Residence (COR) and also test this by cross-checking information maintained for AML/know your customer (KYC) purposes. It could be anticipated that indicia checks will be imposed similar to what financial institutions are familiar with pursuant to Automatic Exchange of Information (AEOI) regimes;
(2) the CFI will have to check the rates claimed, i.e. whether the registered owner is entitled to a specific reduced rate of WHT as foreseen in a tax treaty or domestic legislation of the source country; and

13. *See* European Commission, *supra* n. 1, at p. 25.
14. OECD, *Report of the Informal Consultative Group on the Taxation of Collective Investment Vehicles and Procedures for Tax Relief for Cross-Border Investors on Possible Improvements to Procedures for Tax Relief for Cross-Border Investors 12 January 2009*, pp. 13-14 (OECD 2009), available at https://www.oecd.org/ctp/treaties/41974569.pdf.
15. *See* European Commission, *supra* n. 1, at p. 31.
16. Generally, that would be the person that appears in the books of the participants in the Central Security Depository as the holder of the income paying security on the record date. Some countries – for example Denmark – look at the AGM date to determine who is eligible to receive the dividend so it will be important to carefully monitor local country variations.
17. *See* European Commission, *supra* n. 1, Appendix 12 contains a number of proposed verification mechanisms.

(3) for dividend payments exceeding EUR 1,000, the CFI will have to verify – based on the information available to it – the possible existence of financial arrangements linked to the underlying publicly-traded share that have not been settled, expired or otherwise terminated at the ex-dividend date.

It is worth noting that the Directive does not seek or attempt to define the term "beneficial ownership". This, in part, is understandable in that the concept itself is difficult and, for the purposes of the Directive, has been reserved to a Member State definition. Indeed, the recent previous attempt by the OECD to further define the term, and to deal with some of the real practical issues in the context of the financial industry, arguably resulted in a less than satisfactory position with a number of issues being left undecided or unclear.[18] The financial industry, during the European Commission's consultation period, identified beneficial ownership as a fundamental issue requiring resolution; for example, the Association of Financial Markets in Europe have argued that:[19]

> 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.

Instead of defining beneficial ownership, the European Commission has introduced two binary tests seeking indicators based on which the entitlement to relief could be challenged. These seem aimed at providing indicia that beneficial ownership is impaired without actually defining what beneficial ownership is. Indeed, one might argue that this may be one route out of the current uncertainty through the production of clear bright-line tests that provide for objective tests with little or no room for subjectivity. These tests relate to the holding period of the income-generating securities and the presence of certain financial arrangements that seem to temporarily transfer ownership of the securities around the ex-dividend date.

Financial intermediaries will be focused on what: "financial arrangement" means and the Explanatory Memorandum to the Directive states that this is about:[20]

> seek[ing] information on whether the reporting financial intermediary is aware of any financial arrangement involving the underlying securities that has not been settled, expired or otherwise terminated at the ex-dividend date, with the objective of helping the tax administration to detect abusive tax arrangements (Cum/Cum schemes). A financial arrangement may be for example a repurchase agreement (repo) or securities lending but also derivatives products such as single stock futures. More specifically, a repurchase agreement involves the sale of securities at a specific price with a commitment to repurchase the same or similar securities at a fixed price on a specified future date. Securities lending involves transfer of the ownership of a security in return for collateral, usually another security, on the condition that the ownership of that security or similar securities will revert to the original owner at a specified future date. The definition is broad in order to allow to comprise different types of arrangements.

As noted, article 11 of the proposed Directive does make it clear that the CFI is required to verify the declaration received "based on information available to the certified financial intermediary" and the recitals to the Directive make it clear that, "[t]o ensure a proportionate approach, reporting on this information should only be required by those certified financial intermediaries that, due to their position within the chain, may have been directly involved in the relevant financial arrangement", i.e. at this point there is no suggestion that the CFI must attempt to take some form of active role to seek such information and it is limited crucially to direct involvement. What "direct involvement" means will no doubt require further clarification and guidance.

The intent and direction of travel of the proposed Directive seems to imply that a CFI who has complied with these verification obligations will not be liable for any potential under withholding. Member States will have to issue clear guidance to address how "available information" should be interpreted and whether this is to be considered at a business line level, legal entity level or at a corporate group level. The guidance should reference what reasonable defence mechanisms are to rebut liability presumptions. It could, for example, be argued that, in large universal banks, custody and investment bank data is hosted in segregated systems and, as such, the custody business would not necessarily be aware nor even have access to information indicating that investment bank business had written derivatives to clients referencing securities upon which WHT relief was being sought. In addition, it should be made clear whether "available information" includes inferred knowledge pursuant to which a person with a reasonable level of knowledge would be expected to identify the "possible" existence of a financial arrangement based on certain patterns or anomalies in trade data (for example, back and forth movement of positions between various accounts in the space of 14 days around the ex-dividend date). It is likely that the problem, in practice, will be imprecise information and, as such, "possible existence" may be a low hurdle giving rise to a lot of false positives. It is expected that there will be detailed debate about what "possible existence" encompasses and exactly which "information" will be considered "available" to the CFI.

It is clear that more guidance is needed to delineate these obligations and the liability associated with it. In the absence of such clear guidance, there is a risk that CFIs

18. *See* OECD, *Clarification of the Meaning of "Beneficial Owner" in the OECD Model Tax Convention: Discussion Draft – 29 April 2011 to 15 July 2011*, available at https://www.oecd.org/ctp/treaties/47643872.pdf.
19. European Commission, Feedback from: Association for Financial Markets in Europe (AFME), p. 3 (26 Oct. 2021), available at https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/13031-Withholding-taxes-new-EU-system-for-the-avoidance-of-double-taxation-and-prevention-of-tax-abuse-Faster-and-Safer-Relief-of-Excess-Withholding-Taxes/F2745571_en.
20. European Commission, *supra* n. 1, at p. 14.

will focus on mitigating their liability by eliminating the unknown and not offer services to the full range of investors by, for example, only focussing on portfolio retail investors with limited holdings (i.e. below the EUR 1,000 limit).

3.5. Relief systems

The draft Directive introduces two systems of relief, with a requirement that a Member State offer at least one of the systems. The systems as noted above are:

– Relief at source – this would allow a CFI to request the lower rate of WHT at the point of payment (i.e. at source) on behalf of a registered owner through providing, to the WHT agent, information as to the tax residence of the registered owner and the applicable WHT rate to apply.

– Quick refund – this would allow a CFI to request from a Member State a quick refund of excess WHT and for that refund to be provided broadly as soon as possible and, at the latest, within 25 days from the date of payment of the dividend or interest.

Part of the reason that two systems have been proposed is a recognition that some Member States believe that a refund type regime that allows the tax authorities to review and question a refund application provides for more protection than that under a relief at source system, i.e. a Member State can deny a refund application until satisfied that the conditions are met whereas, in a relief at source system, a Member State would need to retrospectively claim against a financial intermediary or claimant to recover any WHT erroneously claimed.

The Directive further suggests that Member States may not provide relief under these two systems where the dividend has been paid on a publicly-traded share that the registered owner acquired within a period of two days before the ex-dividend date; and/or where that dividend on the underlying security is linked to a financial arrangement that has not been settled, expired or otherwise terminated at the ex-dividend date.

The draft Directive proposes, in the case of the quick refund system, that the Commission adopt implementing acts "laying down standard computerized forms, including the linguistic arrangements, and requirements for the communication channels for the submission of requests".[21] This appears to be a suggestion that the Commission envisage a standardized form capable of operating at a pan-European Union level and, if that is true, this would eliminate one of the major issues that investors and intermediaries currently experience – the multiplicity of forms. It will be interesting to see how this is achieved as currently forms, whilst thematically similar, do have variation. It is also worth noting that there does not appear to be a similar provision that would apply to the relief at source system and it is unclear whether the CFI will be required to obtain a source country level form. The alternative would be that either a standardized "above the market" form is required or potentially it may be sufficient for the CFI to just have the declaration of beneficial ownership – the eTRC – and a declaration from the registered owner that they are not engaged in a financial arrangement, etc. More clarity is required here and will be an area of discussion. Furthermore, it seems that the CFIs will not be required to pass the declarations up to the withholding agent. It could be envisaged that a system of segregated accounts, withholding rate pool allocation or withholding statement breakdowns could be used to replace the current cumbersome and paper-heavy process. To the extent that this is true, this will be a simplification of process and thus eliminate what broadly happens in today's financial markets, with the withholding agent being required to have possession of the relevant claim forms. If this is the final result, this represents a significant improvement in process for investors and financial intermediaries but again financial intermediaries will be focused on understanding their liability in this regard.

3.6. Standard refund system

The Directive recognizes that there is still a need for registered owners or their authorized representatives to be able to make a refund application in situations in which relief at source or a quick refund application cannot be made but the anti-abuse information, i.e. the holding period and information about financial arrangements, will still need to be reported. As such, the Directive also seeks to inject uniformity into the standard reclaim procedures, which is a welcome initiative, as there is currently no real alignment between the data that tax authorities are asking from claimants following the submission of reclaim requests. To the extent that this introduces certainty, it is to be welcomed, but it is likely that further work will be required in this area and that this may become unwieldy in practice.

3.7. Reporting

The Directive introduces a standardized reporting obligation that imposes common reporting obligations on all CFIs in the chain. The aim of the reporting obligation is to equip Member States with sufficient information to reconstruct the securities payment chain and identify the final investor. The Directive acknowledges the need to limit the burden on financial intermediaries and has limited the reportable information to information strictly needed to achieve the stated purpose. Reporting will be done by using standard computerized forms and common requirements for the communication channels to be laid down by the Commission by means of an implementing act and this will likely be XML format.

Whilst the volumes of reportable data will be significant and timelines relatively short, financial intermediaries do have experience in reporting vast amounts of data, sometimes on an almost real-time basis, for example, pursuant to European market infrastructure regulation, securities financing transactions regulation, various automatic exchange of information regimes, etc. This is not to say

21. Id., at p. 30.

that this will not be a significant system build and it will certainly give rise to costs for the financial industry.

The contentious point in relation to the reporting obligation centres around the reportable data elements included under "relevant dates" per Annex II, heading D to the proposed Directive. Every CFI in the chain will have to report "relevant dates", such as the ex-dividend and the record date but also the settlement date. Whilst the first two data attributes should be relatively easy to obtain, it is currently not entirely clear what is envisaged by "settlement date" reporting.

Institutional investors will regularly trade, which means that their position will have been built up over time with various buy and sell transactions. There will not be one singular settlement date but multiple settlement dates that, over time, have led to the position that generated the income for which WHT relief is sought.

4. Conclusion

The Commission has been tasked with finding a balance between the often-combating needs of investors, financial intermediaries and governments. This task has been further complicated by recent media reports regarding the estimated losses incurred by governments due to Cum/Ex and Cum/Cum transactions (now estimated to be EUR 9 billion and EUR 144 billion, respectively).

Governments want to be in control of the WHT relief procedures to tackle abusive transactions. They need more insights into the chain of transactions and want visibility of the end investor. They are, therefore, looking to impose obligations on financial intermediaries to provide more, better and faster data. Governments are also seeking clear liability provisions ensuring that not only the claimant or registered owner is liable but also the CFI that has intentionally or deficiently not complied with its due diligence or reporting obligations.

At the same time, investors want easier access to recover excessive WHT amounts they have suffered. Whether the proposals make life easier for an investor will depend on the investor's investment profile, e.g. buy and hold investors will have a different risk profile than an investor who has entered into a "financial arrangement".

Financial intermediaries providing WHT services to clients want to limit their role to the provision of services and not assume liabilities for independently assessing complicated tax concepts, such as beneficial ownership. Financial intermediaries will need to maintain a watching brief on these proposals as they go through the consultation phase and into potential transposition. As it becomes more certain whether or not the Directive has support, financial intermediaries will need to mobilize to think through fundamental business model questions as to how they will operationalize the requirements and manage their responsibilities under the law, deal with issues regarding potential liability and consider what impact this may have on client servicing.

Costs should not be underestimated for financial intermediaries and governments. Financial intermediaries will need to build, buy and enhance systems to comply with their obligations, which will be costly. The Explanatory Memorandum references implementation costs and annual recurring costs of EUR 75.9 million and EUR 13 million, respectively. Tax administrations will also incur development costs for implementing the eTRC, estimated in the range of EUR 4.9-54 million of development costs and EUR 0.97–10.8 million recurring costs, with the reporting systems estimated at a one-off cost of EUR 19.2 million and EUR 3.5 million per year.[22] Financial intermediaries and tax administrations will no doubt be looking hard at how the Commission came up with these costings and put the assumptions under scrutiny.

Against this background of competing objectives, the authors believe that the current proposed framework presents a good starting point for both tackling the known issues with WHT claims and with the allocation of obligations across all the actors in the chain. There will no doubt be some disappointment that the beneficial ownership concept has not been addressed but, on balance, this is probably a step too far at this point in time. For completeness, it should be noted that there are still some wider issues around tax treaty entitlement – e.g. in the collective investment fund space – that still give rise to uncertainty, and again this proposal does not deal with that.

However, Member States will now have the difficult task of ensuring that their domestic regulations (including interpretative guidance notes) consider the reality of the capital markets and the often complicated chain of intermediaries. More specifically, clear guidance will be needed in relation to the due diligence and reporting obligations to ensure that CFIs will feel comfortable to assume liability when offering the proposed relief systems to a wide range of investors.

The big question is whether the draft Directive will receive unanimous support from the Member States – a number of Member States are working on changing their WHT regimes (e.g. Germany) – and the question is whether or not such countries will support this initiative. An outcome leading to even further fragmentation and the resulting disadvantages will not be an outcome that the financial industry will want to see. The answer to the question may turn on whether the Commission can make the Directive accommodate the needs of all the Member States and this, in itself, may require further optionality to be introduced into the Directive in order to get the necessary support.

22. Id., at p. 9.