

New EU system for the avoidance of double taxation and prevention of tax abuse in the field of withholding taxes

Contribution to the European Commission's public consultation

AFEP Position Paper

Withholding tax (WHT) is a way of sharing tax rights between the source country and the country of residence. To eliminate double taxation, Member States provide for exemption from WHT or reduced rates of WHT, under certain conditions, in application of European directives (on parent companies and subsidiaries and interest and royalty payments), bilateral tax conventions or national legislation. While it is legitimate to fight against tax evasion, we see too often in practice that Member States rely on this objective to deprive companies of exemptions or relief from WHT.

In practice, European companies bear too often double taxation and are faced with tedious, costly and discouraging procedures to benefit from exemptions or relief from WHT due to national practices.

This situation has long been identified as an obstacle to the proper functioning of the capital market and the attractiveness of the EU. Past non-binding initiatives of the European Commission have not addressed this issue¹ even though quick and simple solutions are available, especially in this era of digitalisation, while also making it possible to fight against tax evasion.

AFEP's member companies therefore strongly support this new initiative from the European Commission on WHT on the condition that it will simplify the life of companies and investors within the European Union and allow for better capital allocation.

Companies established in the European Union must benefit from a competitive advantage in tax matters, thanks to simplified mechanisms and the removal of tax frictions on transactions, including the treatment of WHT. AFEP wishes for WHT to be abolished for payments within the EU, as they are a restriction on fundamental freedoms protected by European treaties, as evidenced by the numerous litigation on the subject.

a) An unsatisfactory current situation for businesses

Regarding the European Commission's questionnaire submitted for public consultation, it should be noted that it focuses on flows between financial intermediaries and natural persons. **However, the topic is broader and also concerns flows between associated companies. The flows between non-associated companies must also be taken into account.**

European directives ("parent companies and their subsidiaries" and "interest and royalty payments") provide for exemption from WHT (when certain conditions are met), but this exemption is far from being achieved. In combination with bilateral tax conventions, companies (or investors in general) are faced with difficulties in benefiting from a reduced rate of WHT or an exemption from WHT. This situation constitutes a real obstacle to market integration, the progress of the Capital Markets Union and the attractiveness of the EU. In comparison, the United Kingdom does not subject dividend distributions paid to non-resident shareholders to WHT.

¹ The subject of simplification in terms of withholding tax within the European Union is not new. However, the so far non-binding European measures have been poorly followed by Member States tax authorities. As early as 2009, the European Commission had adopted a [recommendation aimed at improving the procedures for granting a reduction in WHT](#) for income from cross-border securities received by European residents (promoting rate reductions upon payment of income, introducing rapid and standardized reimbursement procedures, transmission of information and documents in electronic form, etc.). In 2017, the European Commission adopted a [code of conduct on withholding tax](#) which includes a series of measures aimed at improving the efficiency of procedures relating to WHT on cross-border passive income from a Member State paid to residents and non-EU residents.

Intra-group flows are all the more important as they are numerous: the group holding company is generally the one that finances the entire group (interest flows) and the IP can be located in an entity for the needs of the group. In some cases, such as in France, the pooling of dividends at the level of the parent company of the group is a legal obligation: the parent company must have sufficient distributable reserves to be able to distribute dividends to its shareholders (unlike for example the United States).

Schematically, the withholding tax procedures are of two types:

- Procedures aimed at retaining a reduced rate of WHT or an exemption from WHT provided for by the tax treaty and/or European directives when certain conditions are met;
- Reimbursement procedures which involve the return of excess tax levied by the tax authorities of the source country.

In practice, companies are faced with difficulties in benefiting from an exemption or a reduced rate of WHT, especially in a context where rates and procedures differ between Member States. The main difficulties are:

- **The use of “paper” certification procedures and/or the requirement of a signature from the tax authority of the State of residence:** although the COVID-19 crisis has highlighted the unsuitability of this system in the digital age, some countries still use this type of procedure (Bulgaria, Portugal in particular).
- **The obligation to transmit all the documents and information before the payment of the income:** this constraint is difficult to comply with given the additional requests from tax authorities (in paper format) which extend the deadlines and therefore render ineffective the possibility of immediately benefiting from conventional advantages or European directives.
- **The subordination, under cover of the fight against fraud, of the benefit of the WHT exemption or the reduced rate to a long and costly formalism for companies or recourse to an ex-post WHT reimbursement mechanism.**

For instance:

- **The Polish “pay-and-refund system”** aimed at applying domestic law withholding tax (19% or 20%) on passive income is subject to the completion of extremely restrictive formalities engaging the criminal liability of managers, where international tax treaties or European directives provide for an exemption from WHT or a reduced rate of WHT.
- **Austrian law provides that when Austrian dividends are paid to a pure foreign holding company, a withholding tax (27.5%) is levied.** In this case, the company must request reimbursement (“information request”) from the Austrian administration (approximately 18 months to obtain reimbursement). If the Austrian administration considers that the partner qualifies as the beneficial owner of the dividends paid, it reimburses the WHT. This decision allows the Austrian subsidiary to pay dividends to its French parent company without deduction of WHT for the following three years. However, this exemption applies to an amount of dividends equal to that which gave rise to the initial request for reimbursement.
- **Since 2021, German law has introduced (reactivation of a “dormant” law from 1923) a retroactive withholding tax on income generated since 2013 due to the assignment or concession of locally registered industrial property rights** when the parties to the contract are not German residents (the measure also applies for related or non-related parties). **To benefit from the exemptions provided for by European or conventional law, the company must comply with a restrictive and lengthy procedure** (reconstitution of past flows and disposal operations carried out since 2013 even though entities may have been dissolved, translation of contracts, mention of the article of the agreement or of the directive allowing to benefit from the exemption...) and whose methods differ according to the period of payment of the royalties.

- Greek law stipulates that services invoiced by a non-resident company to a subsidiary in Greece are subject to an internal withholding tax of 20 % (services such as consulting, technical services, management fees, ...). The Franco-Greek tax treaty provides for an exemption subject to the application of specific formalities (Greek forms to be signed by the French tax authorities). The service providers concerned are small companies and do not know these procedures and do not send the necessary documents before payment of the services (particularly the certificate of tax residence). Consequently, the Greek subsidiary levies the 20 % WHT and it is sometimes contractually impossible for it to deduct this WHT from the payments and therefore to have it borne by the service providers, resulting in a significant additional cost of the operation.
- The refusal by the French tax authorities to sign an Italian form to benefit from the WHT exemption on dividends as it is considered not compliant with Directive 2011/96 of November 30, 2011.
- As part of a request for WHT exemption on future dividends and capital gains, the German tax authorities required, in 2021, a French company to provide the following information:
 - A German model of tax residence certificate to be signed by the French Direction Générale des Entreprises
 - Communication of the following documents:
 - Current balance sheet and income statement, preferably for 2020, if available already
 - Documents evidencing the exercise of management functions over and above the exercise of company rights relating to XX
 - Commercial register excerpt of XX
 - Current Organizational chart

In addition to the above documents, a standardized questionnaire must be submitted to the German Federal Central Tax Office containing numerous and burdensome information².

² The following questions:

1. Does substantial and regular trading take place on a recognized stock exchange for the main class of shares of XX?
If not:
2. Which shareholders/companies are holding direct and indirect shares in XX?
Please add to the organizational chart the name, address, statutory seat or registered office of the management of all direct and indirect shareholders with the percentage of the shareholding.
3. Does XX and its participating companies exercise an own economic activity? Which?
Please add the balance sheet and income statement of the relevant participating companies for the relevant financial year.
4. For what reasons was xx founded? What functions does it perform within the group
5. Does xx have a business establishment specifically set up for its business purpose in the country of domicile or management, or merely a permanent establishment, an administrative office, or only the formal legal domicile?
Please explain to what extent the business is adequately equipped for the business purpose and since when it has been maintained.
Please provide information on the existing business addresses, if fax, telephone lines and e-mail addresses exist for these addresses and the number of employees and their activities
6. Which persons are responsible for the management of the company and where are decisive decisions made?
Please add the following information about the managing director:
 - Name and address
 - Does this person have any other functions, e.g. at other companies?
 - Is the manager a lawyer, consultant or asset manager?
 - In what amount are annual salaries paid to managing directors?
 - are other salaries paid in addition to management compensation?

The procedure was time-consuming and the company had to use local counsel, while in the end the German subsidiary ultimately did not pay dividends.

Concerning the **cost relating to the processing of WHT by companies**, it is difficult to provide figures.

Companies mobilize **significant human and financial resources**:

- **cash advance**: delays in tax refunds are long and they often go up to two years (even 3 years for Italy) given the “paper” process and requests for additional information. In some cases, this impact is worsened by exchange rate effects;
- **the cost of translating** forms, documents requested by tax authorities (particularly contracts), and local regulations;
- **the fees for counsel** to confirm the interpretation of the law and validate requests from the tax administration or local service providers to carry out the procedures;
- **double taxations when WHT is definitively borne by the companies**: prescription of the time limit for requesting reimbursement, impossibility of allocating the WHT to the payments, discouraging of small (but not only) investors from requesting reimbursement of the WHT, failed requests for reimbursement following the judgment from a Member State (for example in Germany and Italy)...;
- **the risk of triggering a tax audit**: some companies have observed that following a request for reimbursement of WHT, a tax audit was triggered giving rise to an adjustment greater than the amount of the request for reimbursement.

b) AFEP member companies’ proposals

The proposals of AFEP member companies to improve the implementation of the provisions resulting from directives, bilateral tax conventions or national legislation concern all cross-border flows likely to support a WHT, i.e. dividends, interest, royalties, other passive income and services rendered. To be efficient, they must be implemented by all Member States in a **coordinated and simultaneous manner**.

The proposals are the following:

- The **standardization of the residence certificate (universal certificate) and reimbursement requests** is a self-evident measure and constitutes a minimalist improvement.
- **Digitization of procedures**: the **request for tax residence certificates** must be digitized (provided online) and accompanied by a digitized verification system. **WHT reimbursement procedures** must also be digitized (electronic filing of reimbursement requests, electronic follow-up of requests, online communication of results, ...). Member States should provide forms in English in addition to the local language version.

Thus, Member States shall no longer require the signature of the residence certificate by the tax authorities of the beneficiary's state of residence (or any other certification) as well as additional information.

- The **use of a single web portal** (one-stop-shop) to which an investor could connect to submit a request for reimbursement regardless of the Member State of the source would be an **element of great simplification for companies**. A single portal would provide an overview of ongoing and past procedures for both businesses and tax administrations.

To be operational, the methods to manage this portal must be specified so that each Member State integrates it into its daily administrative management.

These three measures must at least be implemented within the EU. They must be accompanied by the pooling of useful information to immediately benefit from the advantages resulting from directives, tax conventions or national legislation.

The proposal to issue a **digital passport** attesting to the investor's right to benefit from the advantages resulting from tax treaties for a certain period is interesting but would require a longer implementation period. The measure should be implemented in a second phase.

The proposal to **set up accruing interest** if the refund is not received under a limited period for handling the WHT reclaim is also interesting but this should not lead to an automatic rejection of the request by the tax authorities (due to a delay in the processing of requests) to avoid the payment of accruing interest.

In addition, it would be particularly useful **to relaunch discussions on some consensual aspects of the revision of the "interest and royalties" Directive** (Com 2011/714 of November 11, 2011) in order to reduce the negative impacts of the WHT: the reduction of the threshold of direct participation of 25% to a direct or indirect participation threshold of 10% (similar to the "parent/subsidiary" Directive) and the extension of the benefit of the Directive in France to the "*sociétés par actions simplifiées*" (SAS) (simple update of the list of companies covered).

More generally, the measures provided for in the framework of the OECD's work on the minimum effective global tax (Pillar 2) should lead to the **pure and simple removal of any WHT relating to intra-group flows, at the very least within the EU** (knowing that only companies with a consolidated worldwide turnover of €750 million are concerned).

Finally, the idea of creating **new reporting obligations on companies must, on the other hand, be ruled out**. Member States already have a considerable amount of information (largely unused) subject to automatic exchanges between them (DAC 2 for example on financial accounts, declarations of beneficial owners). The European Commission's initiative in terms of WHT should not lead to aggravating the administrative burden on businesses but rather lighten it.

In conclusion, AFEP member companies **strongly hope that the proposal for a directive which will be presented by the European Commission in the 4th quarter of 2022 will be ambitious** and will make it possible to put an end to the tax frictions resulting from the WHT. The scope of these measures should be extended to all income likely to support a WHT. This measure would be a real improvement in the situation of European companies and investors, the quality of the European market and the attractiveness of the EU. AFEP wishes for WHT to be abolished for payments within the EU, as they are a restriction on fundamental freedoms protected by European treaties, as evidenced by the numerous disputes on the subject.

About AFEP

Since 1982, AFEP brings together large companies operating in France. The Association, based in Paris and Brussels, aims to foster a business-friendly environment and to present the company members' vision to French public authorities, European institutions and international organisations. Restoring business competitiveness to achieve growth and sustainable employment in Europe and tackle the challenges of globalisation is AFEP's core priority. AFEP has [more than 110 members](#). More than 8 million people are employed by AFEP companies and their annual combined turnover amounts to €2,600 billion.

AFEP is involved in the drafting of cross-sectoral legislation, at French and European level, in the following areas: economy, taxation, company law and corporate governance, corporate finance and financial markets, competition, intellectual property and consumer affairs, labour law and social protection, environment and energy, corporate social responsibility and trade.

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