SIMPLIFYING EU RULES ON DIRECT TAXATION – OMNIBUS

JOINT PAPER

The Association of Financial Markets in Europe ('AFME'), the International Swaps and Derivatives Association ('ISDA') and the International Securities Lending Association ('ISLA') welcome the opportunity to comment on the Commission's 'Have Your Say' consultation on the proposed Tax Omnibus Directive ("**Tax Omnibus**").

Executive Summary

We welcome the European Commission's Tax Omnibus which offers opportunity to deliver meaningful simplification, coherence, and legal certainty across EU direct tax rules. We strongly support efforts to reduce administrative burdens, enhance tax certainty, and ensure a fair and efficient tax environment to ensure that EU businesses remain competitive.

We particularly welcome the proposed abolition of withholding taxes ('WHT') on cross-border payments of dividends, interest and royalties between EU companies. The proposed changes to the Parent-Subsidiary Directive ('PSD') and the Interest and Royalties Directive ('IRD'), would promote cross border investment and reduce administrative burdens for businesses. These changes would make it easier to invest across Europe and strengthen the EU's competitiveness.

We encourage Member States ('MS') to support the ambition of the Tax Omnibus and build upon its objectives to embed tax reform in the EU's Savings and Investment Union agenda.

The proposed withholding tax changes need to be fully integrated with the FASTER Directive. It is critical that concepts such as beneficial ownership and financial arrangements are fully addressed and appropriate guidance provided by the Commission and/or MS, to ensure that companies can apply the exemption. However, the proposed implementation date of 1 January 2037 unnecessarily delays these reforms. We recommend that the start date is changed to 1 January 2030 in line with FASTER.

Advancing the Savings and Investments Union: The Case for Withholding Tax Reforms under the PSD and IRD

Although the IRD and the PSD harmonise the tax treatment of interest, royalty, and dividend payments between associated companies within the EU, the procedures for obtaining the tax exemption are determined by the Member States.

Procedures for obtaining exemption or refund of withholding taxes under the PSD and IRD are often lengthy and complex. Administrative processing times can sometimes extend up to 24 months and, combined with complex procedural requirements for obtaining the benefit, cause significant inefficiencies[1]. In some cases, the costs and administrative burden associated with claiming relief may outweigh the benefits, creating a deterrent effect and discouraging eligible claims.

[1] EC Impact Assessment

These challenges exist against the backdrop of broader WHT refund systems across Member States that remain cumbersome and costly for investors, creating frictions and undermining capital market efficiency[2].

Beneficial ownership

We have long supported a more ambitious and harmonised approach to reclaim processes across the EU. We also advocate for a common definition of beneficial ownership that is consistent and easy for taxpayers to apply across all Member States. This would give taxpayers more certainty with respect to how investments in European fixed income and equity securities will be taxed by Member States. A clear definition with safe harbours would also enable EU businesses to know at the point of payment of dividends and interest whether the benefits of the PSD and/or the IRD are available.

We note that certain Member States have, in the context of the elimination of the minimum shareholding threshold for the PSD and the IRD (discussed below), requested the European Commission to provide greater clarity on the meaning of beneficial ownership.

Divergent approaches by different Member States, sometimes with retroactive effect, have caused difficulties and posed obstacles to investment into the EU capital markets. Recent case law of the Court of Justice of the European Union, e.g. the Danish cases and Neo Group, have further reduced taxpayer certainty by identifying situations where the recipient of a payment was not entitled to the benefits of the PSD/IRD. What is needed is a clear definition which details what does constitute beneficial ownership for these purposes.

Our recent joint paper[3] sets out a proposal for an EU-level, principles-based definition of beneficial ownership building on basic OECD commentary. In our view, the Tax Omnibus is the best means for the European Commission to alleviate the concerns of business and Member States alike by providing a workable definition of beneficial ownership, providing clarity and certainty to and tax authorities alike. This definition could then be consistently applied to other legislation, such as the FASTER Directive and the Directives on Administrative Cooperation.

Proposed changes

The Tax Omnibus proposes the removal of the current 25% minimum holding requirements required to access withholding tax exemptions in the PSD and IRD. All dividends, interest and royalty payments between EU companies would be exempt from withholding tax.

The current requirement to obtain advance clearance from tax authorities will be replaced by self-assessment, with FASTER or domestic refund procedures applying where eligibility cannot be confirmed at the time of payment. The FASTER link is a derogation from the standard refund mechanism, improving legal certainty on which procedure takes priority.

The scope of the PSD is also extended to cover pension funds, and both directives would cover an updated list of eligible corporate entities. The IRD is amended to confirm that the withholding tax exemption includes payments attributable to permanent establishments.

[2] Study by Better Finance

[3] Response to the call for evidence and beneficial ownership paper

Benefits to business

The Commission's impact assessment estimates that removing withholding taxes on all cross-border payments of interest, royalties and dividends within the EU would lead to significant annual cost savings for taxpayers of €5.34 billion. This is the cost of foregone tax relief (investors not claiming), the opportunity costs of delayed claims and payments of tax refund and administrative costs. In addition, there will be benefits for companies through improved cashflow and greater certainty around cross-border payments.

Benefits to Member States

The abolition of withholding tax on intra EU payments is likely to have a short-term fiscal impact for EU Member States. This is estimated at 0.027% of GDP in the Commission's impact assessment.

This needs to be seen in the context of the benefits to business described above and the broader macroeconomic impacts in terms of investment and growth. The Commission's impact assessment estimates that the withholding tax exemption will increase EU GDP by 0.043%, capital by 0.07% and wages by 0.16%. This appears to be a conservative estimate. Another study found that removing the costs of the withholding tax reclaim process would increase average GDP in the EU by 0.10% and increase capital and wages would rise by 0.21% and 0.06%, respectively.[4]

Removing withholding taxes will also have a positive impact on investment. The above study estimated that simply removing the barriers to attaining the correct rate of withholding taxes could boost foreign portfolio investment by more than 7%; removing withholding tax altogether would be expected to have a greater impact.

Our recommendations

Our objective is to support a strong, competitive, and well capitalised European banking sector that can fund the economy effectively. In this context it is essential to modernising and simplifying the regulatory environment so that European banks can remain globally competitive, deliver on Europe's strategic investment needs, and continue to serve households and businesses effectively.

The Commission Savings & Investment Union (SIU) strategy recognises the importance of removing barriers to cross border investment. The abolition of withholding tax on intra EU payments would substantially reduce a source of double taxation and administrative friction for cross-border investment in Europe.

We understand the proposed changes would not eliminate the need for reporting and compliance as required under the EU FASTER Directive. Given the burdensome nature of that reporting and the present lack of consistency in the understanding and application of critical concepts such as beneficial ownership and financial arrangements, we would highlight the need to address those points before any broad exemption could in fact be operationally implemented. I.e. failure to achieve clear definitions materially increase the risk that applications for exemptions will be delayed or defeated.

It is essential that consideration is given to the feasibility of successful implementation. Guidance will be needed with respect to whether and to what extent there is any difference between different types of transaction in relation to which shares may be held in the same equities account (and will be fungible). This

[4] Economic Effects of Simplified Procedures for Claiming Cross-Border Tax Reliefs (JRC Working Papers on Taxation and Structural Reforms No 09/2023) - Fatica, S., Pycroft, J., Stasio, A.L. and Stoehlker, D. https://publications.jrc.ec.europa.eu/repository/handle/JRC136232

will ensure that the proposals are operable for CFIs (who will have to determine eligibility for relief) and deliver the estimated benefits for taxpayers and MS. This is particularly important given that relief is proposed through self-assessment. For example:

- Intra-group transactions: dividends, interest and royalties paid between clearly identified EU corporate recipients.
- Capital markets transactions: e.g. securities financing, repos, transfers of collateral, derivatives hedges, manufactured payments/market claims.
- Clear ownership chains: listed equities and bonds held directly by eligible investors through short, FASTER-certified custody chains.
- Other ownership chains: e.g. pooled funds, omnibus accounts, transparent entities

We also note that the abolition of such withholding taxes on any intra EU payment between EU domiciled corporates may trigger third country corporates to seek the same treatment on the basis of comparability. Such legal ramifications should be clarified ahead of the introduction of such rules to minimise legal friction and challenge.

The proposed implementation date of 1 January 2037 unnecessarily delays these much-needed reforms. In our view, the start date should be 1 January 2030 in line with FASTER.

Appendix

AFME

AFME represents a broad array of European and global participants in the wholesale financial markets. Its members comprise pan-EU and global banks as well as key regional banks, brokers, law firms, investors, and other financial market participants. We advocate stable, competitive, sustainable European financial markets that support economic growth and benefit society. AFME is the European member of the Global Financial Markets Association (GFMA), a global alliance with the Securities Industry and Financial Markets Association (SIFMA) in the US, and the Asia Securities Industry and Financial Markets Association (ASIFMA) in Asia. AFME is registered on the EU Transparency Register, registration number 65110063986-76.

ISDA

Since 1985, ISDA has worked to make the global derivatives markets safer and more efficient. Today, ISDA has over 1,000 member institutions from 76 countries. These members comprise a broad range of derivatives market participants, including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks. In addition to market participants, members also include key components of the derivatives market infrastructure, such as exchanges, intermediaries, clearing houses and repositories, as well as law firms, accounting firms and other service providers.

ISLA

The International Securities Lending Association (ISLA) is the leading industry association for the securities financing industry, representing more than 280 institutions including beneficial owners, institutional investors, asset managers, insurance companies, custodial banks, lending agents, prime brokers, fintechs, and service providers, spanning the breadth of the global market across 35 jurisdictions. ISLA's role in today's evolving financing ecosystem is to ensure the market, legal, regulatory, and operational foundations are aligned to stakeholder expectations, to support growth that is credible, transparent, and resilient. ISLA works with our members, global regulators and policymakers, to drive clarity, certainty, and best practice. ISLA is the custodian of the Global Master Securities Lending Agreement (GMSLA), together with its related annexes and legal opinions, providing the legal framework and certainty that support securities lending activity globally.