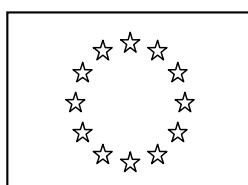


# **SECOND REPORT**

**2007**



## **SOLUTIONS**

**TO FISCAL COMPLIANCE BARRIERS  
RELATED TO POST-TRADING WITHIN  
THE EU**

**THE FISCAL COMPLIANCE  
EXPERTS' GROUP - FISCO**



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# INTRODUCTION<sup>1</sup>

## 1.1. General Background of the FISCO Group

The EU Clearing and Settlement Fiscal Compliance Experts' Group ('FISCO') was created in March 2005 following the Communication "Clearing and Settlement in the European Union – The way forward"<sup>2</sup>. The aim of this Experts' Group is to give advice on the removal of Fiscal Compliance barriers to the post-trading of EU cross-border securities transactions. The key issues considered by the FISCO Group are Giovannini Barriers 11 and 12 on withholding and transaction tax procedures respectively<sup>3</sup>.

This FISCO Second Report on Solutions is based upon the FISCO Fact-Finding Study<sup>4</sup> on fiscal compliance procedures related to EU clearing and settlement, finalised in 2006. The FISCO Fact-Finding Study ascertained the many different fiscal compliance procedures that actually exist within the Member States. This diversity hinders the functioning of capital markets and raises the costs of cross-border settlement with respect to withholding and transaction tax procedures. The aim of this Report consequently consists of highlighting the main problems, analysing the advantages and disadvantages of possible solutions and, whenever possible, indicating solutions.

The present document has been produced by the FISCO Group in line with its mandate<sup>5</sup>. It is important to underline that the solutions proposed in this report are not aimed at any tax (rate) harmonisation, nor are they intended to affect the tax revenues in the Member States. The aim of the proposed solutions is solely to remove fiscal compliance barriers related to EU clearing and settlement and to make local fiscal procedures work more efficiently. - for investors and intermediaries alike. These proposed solutions will also lead to procedures which will be better adapted to the way financial markets operate.

FISCO is composed of 15 high-calibre experts, mainly from private bodies and the academic community. The Organisation for Economic Co-operation and Development (OECD) is represented as observer. To facilitate the work of the group, the Commission provides a Secretariat made up of a

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<sup>1</sup> This Introduction has been prepared by the Secretariat of the FISCO Group and not by FISCO Members.

<sup>2</sup> COM(2004) 312 final

<sup>3</sup> Two other Expert Groups have also been set up for the Giovannini barriers on clearing and settlement: (i) CESAME Group on market-led initiatives to dismantle industry-related barriers to cross-border clearing and settlement and (ii) Legal Certainty Group to tackle legal clearing and settlement barriers.

<sup>4</sup> [http://ec.europa.eu/internal\\_market/financial-markets/docs/compliance/ff\\_study\\_en.pdf](http://ec.europa.eu/internal_market/financial-markets/docs/compliance/ff_study_en.pdf)

<sup>5</sup> Mandate available on the FISCO website: [http://ec.europa.eu/internal\\_market/financial-markets/docs/compliance/mandate\\_en.pdf](http://ec.europa.eu/internal_market/financial-markets/docs/compliance/mandate_en.pdf)

Chairperson, a Secretary and two experts. A list of the FISCO members, secretariat and observers is annexed to this report. The Commission services are very grateful to all the FISCO members and their organisations for making their time and expertise available for the purpose of the present report. The report, however, does not necessarily reflect the views of the organisations to which the FISCO members belong, nor the views of the Commission or its services.

All reports and other FISCO documents are available on the FISCO website: [http://europa.eu.int/comm/internal\\_market/financial-markets/clearing/compliance\\_en.htm](http://europa.eu.int/comm/internal_market/financial-markets/clearing/compliance_en.htm)

The Commission will use the FISCO findings as a basis for discussion with the Member States in line with its established policy of prior consultation on tax issues led by Directorate-General Taxation and Customs Union.

## **1.2. The Giovannini Reports**

The first Giovannini Report of November 2001 identified 15 barriers to the integration<sup>6</sup> of EU securities clearing and settlement systems.<sup>7</sup> Two of these barriers (11 and 12) relate to fiscal compliance procedures. Barrier 11 relates to domestic withholding tax regulations, i.e. that foreign intermediaries cannot sufficiently offer withholding tax relief at source or only under the condition that they have a fiscal agent. Barrier 12 deals with national provisions requiring that taxes on securities transactions be collected via local systems.

The second Giovannini Report of April 2003 called for the following:

- *all financial intermediaries established within the EU should be allowed to offer withholding agent services in all of the Member States so as to ensure a level playing-field between local and foreign intermediaries (Barrier 11); and*
- *any provisions requiring that taxes on securities transactions are collected via local systems should be removed to ensure a level playing-field between domestic and foreign investors (Barrier 12).*

A mandate was given to the EU Clearing and Settlement Fiscal Compliance Experts' Working Group (FISCO) to examine these issues and to propose more efficient alternative tax procedures where possible.

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<sup>6</sup> Integration is defined as "a situation where all obstacles to the use of the different cross-border channels in the post-trading industry are eliminated, so that cross-border operations become equivalent to domestic operations" according to the Document "Integration of Clearing and Settlement in the EU; Regulatory Impact Assessment – Annex 1: Lower Bound; CESAME, 7 March 2005.

<sup>7</sup> Giovannini Group, Second report on EU clearing and settlement arrangements, Brussels, April 2003 page 11. The findings regarding obstacles resulting from tax procedures of this Giovannini report are reflected within the Commission communication on "Clearing and settlement in the EU – The way forward", COM(2004) 312 final, under heading "3.2. Taxation issues".

### 1.2.1. Overview Giovannini Barriers

The matrix below shows the progress reached so far and the expected forecasts on the 15 Giovannini barriers to the integration of EU securities clearing and settlement systems.

<b>Giovannini Barrier<sup>8</sup></b>	<b>Progress</b>	<b>Forecast</b>
<b>1. <u>Diversity of IT platforms/interfaces</u></b>	Common Protocol established by SWIFT, high level message gap analysis finished; detailed analysis under consultation	Support for implementation started; full implementation anticipated only by 2011; potential major impact from TARGET2Securities ('T2S') to be assessed
<b>2. <i>Restriction on location of C&amp;S</i></b>	MiFID rules on choice of settlement location adopted; Code of conduct signed	MiFID rules not sufficient but constitute a step forward; T2S expected to have positive impact on settlement level; implementation of the Code of Conduct will provide additional possibilities on settlement and CCP clearing level; attitude of national supervisors and regulators is important
<b>3. <u>Different rules governing corporate actions</u></b>	Multiple standards and recommendations for many corporate actions adopted and in implementation phase; work to combine them in one set of rules is under way	'Distributions' standards in implementation phase; reorganisations, general meetings and transaction management standards under development; related legal and fiscal issues to be examined
<b>4. <u>Absence of intra-day settlement finality</u></b>	ECSDA standards adopted and largely implemented by CSDs	Practical impediments for CSDs participants remain and are under consideration (with EPDA and ERC); major T2S impact expected
<b>5. <i>Impediments to remote access</i></b>	Non-discrimination rule on remote access adopted in MiFID; positive effect of Code of Conduct; with introduction of T2cash issue of remote access to central bank credit will become irrelevant for T2cash participants	No solution for non-T2cash Member States as regards remote access to central bank credit
<b>6. <u>Differences in standard settlement periods</u></b>	No progress so far; harmonisation of (T+x) standard is not considered a priority	Dismantling of the barrier (through shortening the current T+x period) may become easier with more Straight-Through-Processing and increased same-day confirmation/matching
<b>7. <u>Different operating hours/settlement deadlines</u></b>	ECSDA standards adopted and largely implemented by CSDs	Practical impediments for CSDs participants remain and are under consideration (with EPDA/ERC); major T2S impact expected

<sup>8</sup> Public barriers in *italics*, Industry barriers underlined

<b>8. Differences in securities issuances</b>	Dismantled	
<b>9. Restrictions on location of securities</b>	Under consideration by the Legal Certainty Group ('LCG')	Legal Certainty Group to propose solutions by November 2008
<b>10. Primary dealer restrictions</b>	"collapsed" into barrier 2 by EFC Sub-Committee on EU Government Bonds	Now sub-part of barrier 2
<b>11. Restrictions on withholding agents</b> <b>12. Restrictions on tax collection</b>	FISCO 1 <sup>st</sup> Fact-Finding Report finished; Solutions suggested and promoted by 2 <sup>nd</sup> FISCO Solutions Report, Oct. 2007	Member States and Commission to decide on follow-up
<b>13. Absence of EU-wide framework of laws</b>	Existing Law reviewed by LCG; follow up work in progress	Legal Certainty Group to propose solutions by November 2008
<b>14. Legal treatment of netting</b>	Financial Collateral Directive ('FCD') adopted, implemented and reported on	Issues relating to netting are sufficiently addressed by existing legislation; Commission to monitor whether future developments call for further action
<b>15. Conflict of laws</b>	FCD and SFD provide PRIMA rule for EU; different rule under the Hague Convention currently debated in Council	Discussion on Hague Convention blocked in Council; Commission services exploring way forward



### 1.3. The FISCO Fact-Finding Study

The FISCO Group issued in 2006 a Fact-Finding Study ('FFS') examining EU Member States' fiscal compliance procedures for clearing and settlement of cross-border securities transactions. The Study analyses how these procedures hinder the functioning of capital markets and increase the cost of cross-border settlement, particularly in relation to withholding and transaction taxes. The main conclusions of the FISCO FFS are as follows.

#### 1.3.1. *Withholding Tax Procedures*

The country reports produced by FISCO demonstrate that withholding tax collection and relief procedures vary considerably between Member States and that different procedures often apply even to different classes of securities within the same Member State. In some cases, these variations reflect differences in the substantive withholding tax rules or particular concerns about tax evasion and avoidance. In most cases, however, different approaches are taken to the same practical problems for no specific reason and there is clearly room for rationalisation as regards many fiscal compliance procedures. The complexity and administrative costs resulting from these differences may lead investors to forego the tax relief to which they are entitled, and may discourage cross-border investment for the same reason.

In the view of the FISCO Group, the optimal withholding tax collection and relief procedures should:

- have sufficient audit and enforcement possibilities for local authorities to ensure the proper collection of withholding tax;
- allow for the appropriate tax relief to be applied at source without excessive documentation requirements and without exposing issuers, intermediaries and investors to unnecessary risks and costs;
- work in an equally efficient way, irrespective of where securities are held or where transactions are settled (local versus foreign intermediary or CSD) and irrespective of the investment structure or settlement arrangements chosen by the investors and intermediaries (direct versus indirect access); and
- ensure equal treatment of foreign and local intermediaries.

None of the Member States have tax collection and relief procedures in place that meet all of the above criteria for all types of securities. Several cases have been identified where procedural tax rules *de facto* prevent foreign intermediaries from obtaining direct access to the local CSD, or at least do not allow them to obtain such access under conditions similar to those granted to local intermediaries.

Also, the procedural tax rules do not always take into account the fact that securities transactions may settle outside in the books of a settlement service provider established outside the country of investment. In some cases, the procedures that were identified apply equally to all parties involved. In other cases, procedural tax rules put foreign intermediaries and/or investors at a disadvantage compared to local intermediaries and/or investors and thus may constitute a violation of the EC Treaty.

### **1.3.2. *Other Issues related to Withholding Tax Procedures***

To give an additional description of the current situation in Member States as regards fiscal procedures relevant to the work of the FISCO Group, the following should also be highlighted:

The relief procedures for withholding taxes do not take sufficient account of the often multi-tiered holding environment. It is simply assumed that the market will organise the transfer of information and of documentation on the beneficial owner in paper form up through the chain of intermediaries in order for the entity closest to the "issuer" or the issuer itself to be able to correctly fulfil its withholding tax obligations on behalf of *the source state*. The problems arising from this set-up are treated in Chapter 2, focusing on the withholding tax responsibilities on behalf of the source state.

However, in addition to the source state withholding taxes, there may also exist an obligation to levy withholding taxes on behalf of the *residence state* of the recipient (beneficial owner) of the payment, normally as a prepayment of the tax to be assessed later on the basis of an income tax return. If an intermediary were to be able to take on full withholding responsibilities, the market would have to be organised in such a way as to take into account not only the existence of a source state withholding tax, but also the possible existence of a residence state withholding tax.

### **1.3.3. *Transaction Tax Procedures***

Currently, eleven Member States have some form of transaction tax on the transfer of securities. In most Member States, the responsibility to collect the transaction tax lies with the parties to the trade or their agent. Only very few Member States impose the responsibility to collect transaction taxes on securities transactions on the settlement service providers.

Tax rules that impose tax collection responsibilities on settlement service providers do not always take into account the fact that securities transactions may settle in the books of several local or foreign settlement services providers and do not allow all of the settlement service providers to collect transfer taxes under similar conditions. This issue may put certain settlement service providers at a competitive disadvantage compared to others. These disadvantages may result from:

- the legal uncertainty of whether transactions settling in their books are subject to the transaction tax;
- the absence of a legal framework for such settlement service providers to collect transaction taxes on transactions that take place in their books, and pay and report this to the relevant tax authority;
- the denial of exemptions of transaction taxes, if transactions linked to the one for which exemption is requested are not settled by a settlement service provider with tax collection responsibilities.
- The requirement to appoint a fiscal representative discharging the foreign intermediaries' tax collection obligation.

#### ***1.3.4. Transaction Tax Procedures and Market Liquidity***

From the literature examined, as well as the collective experience of the FISCO experts, it is clear that there is general agreement that the existence of transaction taxes does affect market liquidity. However, the extent to which liquidity is affected is difficult to determine and controversial. One of the key difficulties is that of isolating the effect of transaction taxes from all the other factors (including a particular country's political and historical context) which can influence market behaviour. The literature and observations from the different country experiences make it clear that liquidity is not the only attribute of a securities market to consider when looking at the effects of transaction taxes. Other important factors (including controlling volatility and transaction tax) play an important role here.

Nevertheless, a number of countries have had adverse experiences related to transaction taxes and their effects upon liquidity, share price fluctuation and transaction execution methods. As a result, in some cases governments have decided to abolish their local transaction taxes or to grant very wide exceptions (e.g. Germany, Netherlands and Sweden).

While the FISCO Group acknowledges that the tax authorities may have their own views on the value of transaction taxes and, in particular, their revenue-raising capability, the Group considers that, in the light of the collective experiences described above, transaction tax procedures are a matter which should be considered at EU level.

### **1.4. The FISCO Second Report on Solutions (SRS)**

In order to provide solutions to the problems identified by the Fact-Finding Study 2006, the FISCO Group, in accordance with its mandate, decided to continue its work by producing this FISCO Second Report on Solutions (SRS) in 2007.

This FISCO Second Report on Solutions (SRS) mainly deals with withholding and transaction tax procedure issues and is structured by the categories of problems identified by the Fact-Finding Study:

The relief procedures which exist in Member States do not at present take sufficiently into account the multi-tiered holding environment. Notably, the responsibilities for collecting withholding taxes on behalf of the source state (in principle, the state of the issuer), are often put on an entity that is not connected to the beneficial owner / final investor. It is thus assumed that the market will organise the transfer of information and paper-based documentation relating to the beneficial owner up through the chain of intermediaries. In reality, this is costly and inefficient and may create confidentiality and data protection/privacy issues. These problems are addressed in Chapter 2.1-2.3 of this report.

Some remaining issues related to withholding tax and relief procedures are described in Chapter 2.4.

Chapter 3 of this report contains proposals connected to transaction tax procedures and the removal of Giovannini barrier 12.

Chapter 4 provides a summary of the conclusions proposed by this report.

Finally, the report includes two annexes. Annex I is a reference to European Court of Justice (ECJ) cases that are relevant to the matters discussed in this report. Annex II is a list of the Members of the FISCO Group.

The FISCO Group considers that any proposal for the removal of barriers associated with the fulfilment of tax obligations and the taxing of securities transactions and preventing the establishment of an internal financial services market must abide to the following general principles:

- Respects the needs of the national tax administrations to receive all the necessary relevant information and does not result in any loss of tax revenues;
- Allows foreign intermediaries remote access to national clearing and settlement systems under the same conditions as local operators, without the level of tax obligations or their limited possibilities for action in this area constituting a barrier to entry for the free cross-border provision of investment services;
- Assures local intermediaries that the remote access of foreign intermediaries will take place on the basis of a level playing field in terms of rights and obligations, so that the removal of the current fiscal barriers does not place them at a competitive disadvantage in terms of the level of responsibility assumed with regard to local tax authorities;
- Ensures that no intermediary will face any tax liability when shortcomings in the information provided or errors in the making of the corresponding withholdings are not the result of negligence

or misrepresentation on the part of the intermediary. There also should be no liability in the case of negligence or misrepresentation on the part of others, particularly the owner of the securities.

The approximation of national laws in order to remove the obstacles to the exercise of fundamental freedoms can take different forms.

When describing the different types of measures and proposals to solve the present problems related to Giovannini barriers 11 and 12, it is relevant to recall the Council conclusions on clearing and settlement taken at the ECOFIN Council Meeting of 28 November 2006.

The Council concluded that the clearing and settlement of securities transactions is a key area for financial integration in the EU, where substantial progress needs to be achieved. The Council highlighted the urgent work to remove legal and fiscal barriers in the context of the Giovannini barriers.

The Council recognised the strategic approach by the Commission based on self-regulation as an attempt to enhance competition and reduce costs for users of post-trading services.

In this context it should also be recalled that, on 19 December 2006, the European Commission adopted a Communication announcing a series of initiatives to promote better co-ordination of national direct tax systems in the EU. The aim is to ensure that national tax systems comply with Community law and interact coherently with each other. The initiatives seek to remove discrimination and double taxation for the benefit of individuals and business, while preventing tax abuse and erosion of the tax base. The Commission regards withholding taxes as an area where co-ordination of tax systems can prove particularly useful, notably in view of removing discrimination and double taxation and reducing compliance costs, and also to prevent inadvertent non-taxation and abuse.

The "box" below describes the policy and market development in the trading and post-trading field.

### **Policy and market developments in the trading and post-trading field**

European securities markets are currently in transition. On the trading side, securities exchanges are merging in order to reap benefits related to economies of scale. This is illustrated by, among other things, the merger between the New York Stock Exchange (NYSE) and Euronext NV/SA, the London Stock Exchange and the Borsa Italiana/Milan Exchange Agreement, and the very recent tripartite agreement between NASDAQ, the Dubai International Financial Exchange Ltd and OMX management. On the central counterparty clearing side, scale economies are equal, if not more important, and as a result consolidation has occurred here as well, e.g. as illustrated by the 2003 merger between the London Clearing House and Clearnet SA to form LCH.Clearnet. As regards settlement, Euroclear has brought together four CSDs under its banner and is currently implementing a single settlement system.

This consolidation process is the result of several forces. Some are market-driven, such as technological change. Other forces are policy-driven, such as deregulation and liberalisation. As a result, long gone is the time when markets were national in scope. Today, the national border is an increasingly meaningless concept for describing a market. In observing these market developments, the Commission's regulatory

approaches as regards trading and post-trading matters will have to evolve in order to continue to effectively promote the general interest.

### Trading

Developments have been particularly rapid in the area of securities trading, where technological innovations have enabled a strong increase in trading volumes and a multiplication of trading methods and trading venues. To ensure that regulatory objectives of efficiency, safety and consumer protection were met in this new market place, the European Union has updated its securities trading legislation by adopting the Markets in Financial Instruments Directive (MiFID)<sup>9</sup>. The MiFID, being a Lamfalussy-type framework directive, is complemented by an implementing Regulation<sup>10</sup> and an implementing Directive<sup>11</sup>. The transposition deadline for MiFID was 31 January 2007. Only a few Member States met that deadline however. Nevertheless, many Member States transposed throughout spring and summer 2007. The deadline for applying MiFID is 1 November 2007. MiFID will facilitate competition across borders and among different types of trading venue through a series of measures. For example, it abolishes the so-called concentration rule that allowed Member States to require trades to be executed on the main regulated market, i.e. the traditional stock exchange. Moreover, it creates a new category of trading venue, the MTF or multilateral trading facility that will be able to compete with regulated markets while being subject to a similar, but not identical, regulatory framework.

To counter the risks to market quality associated with competing trading venues, i.e. fragmented liquidity pools, the directive sets up pre- and post-trade transparency requirements. It also puts in place investor protection rules such as order-handling and best execution rules and governance rules that ensure that firms engaged in securities trading are well organised.

The Commission expects these measures to dramatically increase competition both across borders and among venue types. Ongoing initiatives, started already prior to the implementation date of MiFID, such as the initiative of seven investment banks to set up a competing trading venue (Project Turquoise), support that view.

### Post-trading

While securities trading has rapidly become more global, the market infrastructures supporting trading venues have not followed suit. In Europe, post-trading infrastructures by and large continue to cater for national needs. As a result, while domestic transactions are handled in an efficient and safe manner, cross-border transactions are costlier and riskier. To address this state of affairs, market participants, national governments and the European Commission have all been trying to dismantle the various barriers preventing the emergence of post-trading arrangements that are better suited to serve today's more global markets.

EU legislation plays a role in addressing these problems. MiFID grants investment firms rights of access to post-trading service providers in other Member States (Article 34.1). Article 34.2 grants investment firms a right to designate their settlement system subject to links being in place and supervisory approval. Article 34.3 grants post-trading service providers the right to refuse access on legitimate commercial grounds. Article 46 grants regulated markets the right to use clearing and settlement arrangements from another Member State, stating that supervisors can only block such use if it is demonstrably necessary in order to maintain the orderly functioning of that regulated market. MiFID's Article 35 also grants similar rights in respect of multilateral trading facilities (MTFs).

However, in addition to MiFID, the European Commission is pursuing other regulatory approaches as well.

1. One way is to work with the market in order to dismantle the barriers preventing more efficient post-trading arrangements from materialising. Effort along those lines is being carried out within the context of

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<sup>9</sup> 2004/39/EC, OJ L 145, 30.4.2004, pages 1-44.

<sup>10</sup> (EC) No 1287/2006, OJ L 241, 2.9.2006, pages 1-25.

<sup>11</sup> 2006/73/EC, OJ L 241, 2.9.2006, pages 26-58.

the so-called CESAME group. This group brings together the Commission and market participants and is aimed at dismantling six industry-related barriers of the 15 so-called Giovannini barriers, of which the fiscal barriers dealt with by the FISCO Group and the legal barriers dealt with by the Legal Certainty Group form part.

2. Furthermore, in accordance with the conclusions of the Commission Evaluation Report to the Council and the European Parliament<sup>12</sup> on the Financial Collateral Arrangements Directive<sup>13</sup> (FCD), the Commission is considering proposing amendments to extend the FCD depending on the progress made in respect to the technical issues related to the use of credit claims as collateral.

3. Building on MiFID, the Commission in 2006 forged an agreement among trading and post-trading infrastructures to sign a Code of Conduct on clearing and settlement. The Code improves price transparency, and thus enables customers to compare different service offers more easily. The Code also improves access rights and interoperability between post-trading infrastructures. One has to keep in mind that MiFID does not provide market participants with the right to choose the Central Counter-party (CCP), nor does it cover relations among post-trading infrastructures. Therefore, the Code creates a framework governing such relations. The Code will also enable users to buy unbundled post-trade services. This will bring more competition to the market and hence improve efficiency. On 15 September 2007, the Commission reported to the Economic and Financial Affairs Council (ECOFIN) on the state of post-trading in Europe, notably providing an overview of the current status of the Code of Conduct, its views on dismantling the legal and fiscal barriers and on how to move the stalled negotiations on the draft CESR-European System of Central Banks (ESCB) standards, which are aimed at improving the safety and soundness of EU post-trading arrangements. The report was favourably received.

While these initiatives aim at making national systems operate better together and hence enable competition, the European Central Bank (ECB) has recently proposed to set up and operate a central platform for securities settlement. TARGET2-Securities ('T2S') will centralise settlement activities, with euro-denominated securities transactions in the future being settled on a single platform managed by the Euro-system. If confirmed, it is likely to improve efficiency (higher scale, less duplication), dismantle some of the barriers outlined above and improve safety (it eliminates the need for central banks to outsource the management of cash accounts). On 27 February 2007, the Economic and Financial Affairs Council (ECOFIN) welcomed the ECB's efforts to improve the efficiency of EU post-trading services, stated that the full impact of the T2S project should be properly assessed and asked the ECB to report back to the Council as the project is further developed.

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<sup>12</sup> COM (2006) 833

<sup>13</sup> 2002/47/EC

## 2. RECOMMENDATIONS WITH RESPECT TO WITHHOLDING TAX PROCEDURES

### 2.1. INTRODUCTION

In European Member States, withholding tax is basically withheld either by:

- (1) the debtor of the income, i.e. the issuer, or by
- (2) the - mostly local - intermediary through which the securities are held.

This withholding tax is levied at the national statutory rate of withholding tax. Under double-taxation treaties and also sometimes on the basis of national laws, this withholding tax rate can be reduced or eliminated. This reduction might happen through a refund after the payment of income has taken place or through at source (i.e. at the moment the income is paid).

The FISCO Group is of the opinion that *relief at source* is the preferred method because of the optimized cash flow it offers to investors. Consequently, Chapter 2.2 below describes *the rationale for, and how to shift, tax responsibility* to facilitate relief at source (2.2.1-2.2.7), followed by Chapter 2.2.8 describing measures to *simplify and harmonise* the currently applicable tax relief at source procedures.

Having stated that relief at source is the preferred relief method, there are several reasons why it should ideally be complemented by the possibility to obtain relief through an efficient *quick refund and/or standard refund procedure*:

- It may not always be possible for intermediaries to provide the withholding agent with the required information prior to the payment date, especially where securities are being traded near record dates;
- Market claims are generally processed by clearing organizations and central securities depositories in an automated way and can only be processed at one single rate (generally the amount representing the dividend net of withholding tax at the maximum domestic rate), in which case relief can only be obtained through a refund;
- Intermediaries may not always be in a position to offer relief at source (for instance because their legal status does not allow them to offer such a service or because their market share does not justify the investments in procedures and know-how to offer relief at source).

Chapter 2.3 describes how current quick and standard refund procedures could be made more efficient.

Some remaining issues related to withholding tax and relief procedures are described in Chapter 2.4.



Chapter 2.5 describes the conclusions presented in this chapter.

## **2.2. MEASURES TO INCREASE THE EFFICIENCY OF AT-SOURCE RELIEF PROCEDURES**

Relief at source can be granted only with the help of the entity (issuer or intermediary) that has a formal withholding tax responsibility. The rule of thumb for efficient tax procedures is that they take sufficient account of the way the markets operate. A problem is often that the prescribed relief procedures do not take sufficient account of the multi-tiered holding environment and often put tax collection responsibilities on an entity that is not connected to the beneficial owner / final investor and therefore assumes that the market will organize itself to transfer information and (paper form) documentation on the beneficial owner up through the chain of intermediaries. In reality this is costly and inefficient and may create confidentiality and data-privacy issues. The FISCO group is of the opinion that many of the administrative and efficiency problems identified in the FISCO Fact-Finding Study can best be resolved by allowing all intermediaries in the custody chain to assume withholding responsibilities or to take responsibility for granting withholding tax relief.

### **2.2.1. *Why should withholding responsibilities be shifted?***

The main goal of shifting responsibilities to intermediaries is to avoid the need to pass on paper-form certificates and beneficial owner breakdowns through the chain of intermediaries that intervene in the income distribution up to the withholding agent. In addition, the upward forwarding of client information may create problems of confidentiality. Conceptually one could imagine two ways to get rid of the onerous requirement whereby paper-form documentation must be passed on through the chain of intermediaries.

- (1) One solution is to abolish the requirement of paper-form certification and allow intermediaries to make use of modern technology to pass on beneficial owner information to the local withholding agent in electronic format.
- (2) Another solution would be to shift tax collection obligations, or, at a minimum, the associated responsibilities to allow for withholding tax relief at source to the (local or foreign) intermediaries that are closer (or closest) to the beneficial owner.

The FISCO Group considers that these two solutions should be combined. The Group is of the opinion that allowing electronic certification does not, on its own, constitute a satisfactory solution, and this for the following three reasons:

- First, even if intermediaries were allowed to pass on beneficial owner certificates in electronic format, tax relief procedures

would still be costly given the high volumes of information to be passed on through the chain of intermediaries. Experience shows that the cost of passing on and validating such electronic certificates is significant.

- Secondly, electronic certification on beneficial owners does not offer a solution to the confidentiality and/or data privacy issue. Confidential customer information could be disclosed to competitors in the chain of intermediaries. In addition, there is a possible problem regarding the Personal Data Protection Legislation at both European and national level.
- Thirdly, practical experience with existing cross-border relief procedures shows that the procedures are often unworkable. At present, numerous countries provide relief at source for investors residing abroad. The rules of such countries generally stipulate that information about the investor, the securities concerned, the income payment expected, and a certificate of residence issued by the responsible tax office of the investor must be forwarded to the responsible withholding agent in the issuer country. The withholding agent must receive this form by the record date. As illustrated in the Fact-Finding Study there is often insufficient time between the dividend announcement date and the income payment date to allow the beneficial owner to provide the required certificates, through the chain of intermediaries, to the issuer prior to the income payment. For actively-traded securities, transactions around the record date, and particularly after the date the application for relief at source is made until payment date, make it impossible to provide the upstream withholding agent with up-to-date information in time. Such problems and similar difficulties have occurred in practice in connection with the relief procedures for non-residents e.g. in the Netherlands, Portugal, and Hungary. Some procedures have even additional complications that make them unworkable when the information has to transit through a chain of intermediaries.

The removal of the above obstacles will not be achieved by the sole use of electronic systems, but require that the possibility<sup>14</sup> will be offered to shift part or all of the withholding responsibilities to an intermediary in the custody chain that has a direct link with the beneficial owner in such a way that the detailed beneficial owner information no longer needs to be passed on through the chain of intermediaries to the local withholding agents. This includes allowing for pooling of assets into tax-rate pools and passing on beneficial owner information electronically on a non-individual level for those (domestic or foreign) intermediaries that do not opt for a withholding responsibility. Obviously, these electronic systems

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<sup>14</sup> The FISCO Group believes that shifting responsibility would be the preferred solution however, it is evident that any shift of responsibility should be on a voluntary basis rather than imposed.

could be compatible with “traditional” proceedings in the case of individual investors, or when formal requirements have not been properly fulfilled.

### **2.2.2. Which responsibilities could be shifted?**

If the withholding responsibility is shifted cross-border to a (domestic or foreign) intermediary, there is always a bundle of duties or obligations that must be accepted and fulfilled by this intermediary. However, it appears sensible – similarly to the US QI regime – to allow an intermediary either to assume the full tax withholding responsibility, or not to do so, and instead just to act on an informative basis<sup>15</sup>. In the latter case, the intermediary holding an omnibus account either provides withholding-rate pool information to his upstream intermediary or establishes sub-accounts with the upstream intermediary or issuer that is acting as withholding agent.

The intermediary assuming full withholding responsibility shall be referred to hereinafter as “Responsible Withholding Agent”. In contrast an intermediary without assuming full tax-withholding responsibility will be referred to as “Responsible Non-Withholding Agent” – in analogy to the US QI regime.

Section 2.2.2.1 describes in more detail the responsibilities of a Responsible Withholding Agent. Section 2.2.2.2 describes the responsibilities of a Responsible Non-Withholding Agent.

#### **2.2.2.1. The Responsible Withholding Agent**

The Responsible Withholding Agent must assume the tax withholding responsibility “itself”, i.e. the obligation to deduct and deposit withholding tax with the relevant tax authority of the issuer country. In connection herewith, the Responsible Withholding Agent must:

- Collect the prescribed documentation/information evidencing the owner's entitlement to receive the income payment at a reduced withholding tax rate according to an applicable tax treaty or a domestic relief provision;
- Archive the documentation/information obtained on the basis of which the withholding tax relief has been granted;
- Remit the withholding tax deducted to the tax authorities of the issuer country;

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<sup>15</sup> Especially in markets where the primary withholding responsibility is imposed on local agents, foreign intermediaries may want to have the possibility to assume full withholding responsibility as well, in order to compete under similar conditions as local intermediaries.

- File tax returns periodically with the relevant tax authorities of the issuer country (the tax return should be filed electronically; the data to be provided, the formats to be applied, and the deadlines for filing should be harmonized – as explained below);
- Be available, in case of a tax audit, to enable the relevant tax authorities to check compliance with the withholding obligations assumed;
- Be responsible, vis-à-vis the tax authorities of the issuer country, for withholding; however, such responsibility should be engaged only when the intermediary has not used “reasonable efforts”; and
- Be entitled to act as agent of the beneficial owner for refund purposes; this includes the possibility to set off tax amounts to be refunded against taxes to be remitted to the tax authorities.

The individual components of this field of activity must be based on harmonized procedures, ways and means within the EU. It is necessary to provide a level playing-field within the EU and to remove the existing obstacles resulting from the different and versatile conditions currently existing within the EU Member States.

In order to reduce the onerous paper-based administrative burden, efforts should be made to replace paper-based communication, tax returns and deposit obligations by electronic means. In this respect, the Italian system may serve as a good example. At present, foreign intermediaries without a permanent establishment in Italy can opt to assume withholding responsibility, if they *inter alia* activate an electronic connection with the Italian Ministry of Economy and Finance. The adoption of electronic systems would also be helpful for the submission, upon request, of the investor’s documentation to the tax authority, for purposes of examining the investor’s entitlement to tax benefits.

The utilisation of existing systems would avoid setting up completely new installations, which would be costly, especially for smaller banks. To benefit fully from the electronic communication systems, messages used for transferring information should also be standardized.

In some countries (such as Italy) it is a requirement to appoint a local fiscal representative if a foreign intermediary intends to assume withholding responsibility. This requirement, which was clearly identified in the

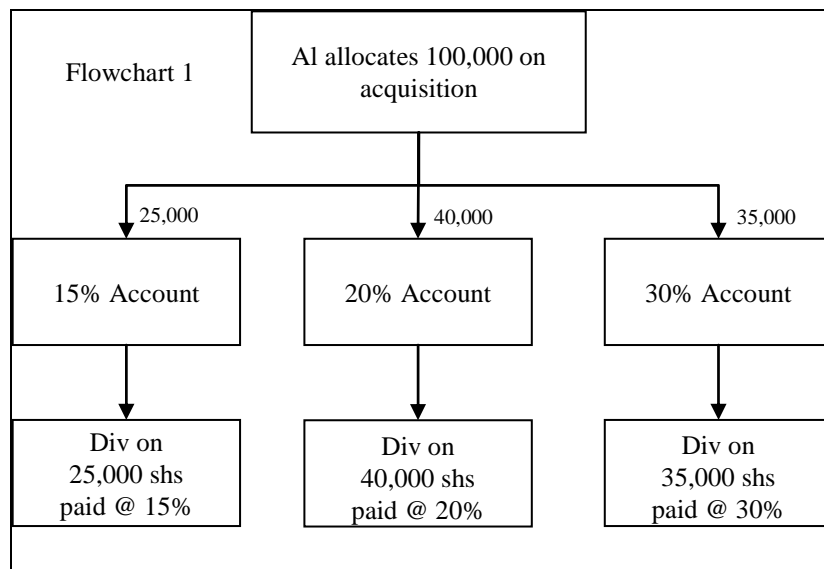
FISCO Fact-Finding Study as an obstacle, must be abolished.

#### 2.2.2.2. The Responsible Non-Withholding Agent

The responsibilities of a Responsible Non-Withholding Agent are similar to those of a Responsible Withholding Agent, but without the requirement to deduct and remit the withholding tax to the tax authorities. Instead it should be allowed to pass the tax-rate information on a pooled basis to the security issuer/agent or any upper tier authorized intermediary (A1) as appropriate.

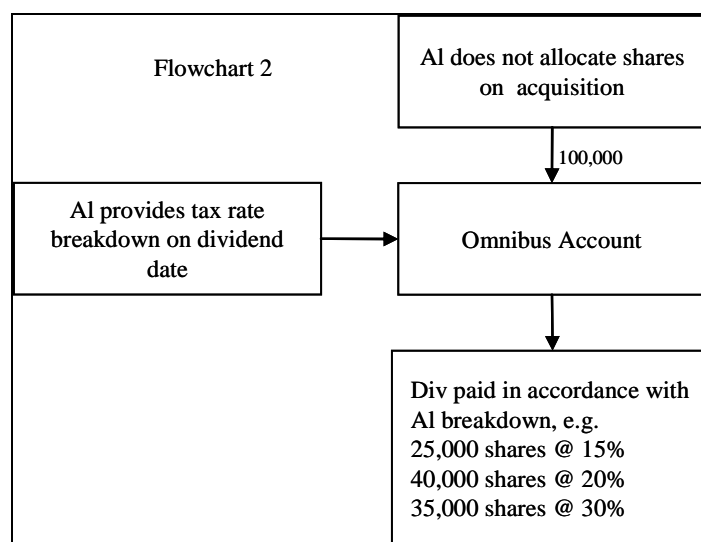
This may involve:

(i) segregation of assets into tax-rate pools on the books of the upper-tier intermediary/issuer (flowchart 1),



OR

(ii) tax-rate breakdown of income entitlements arising on assets held in a single pool on the books of the upper-tier intermediary/issuer in accordance with the tax rates applicable to the underlying investors (flowchart 2)



If the information is provided to an upper-tier authorized intermediary that does not have tax deduction responsibility, this authorized intermediary is responsible for relaying that information to the next upper-tier authorized intermediary or the issuer, in conjunction with one of the methods outlined above (i) or (ii). The reporting to the upper-level intermediary then forms the basis for the tax-withholding by the intermediary/issuer with withholding responsibility.

### 2.2.3. *How: Legal liability and reliance on "Good Faith"*

In the national tax laws, there should be clear provisions regarding the liability of the withholding tax deduction and collection, as well as for collecting beneficial owner information that is passed on and/or reported to other intermediaries. No liability may be imposed on authorised intermediaries acting in “good faith”. This should be the case both for beneficial owner information collection and for tax collection, if any.

If foreign intermediaries may opt for withholding tax responsibility, this must be on equal terms and conditions, with respect to the applicable reporting obligations and legal liability, as for local intermediaries, in order to maintain a level playing-field and to prevent unjust competition. The legal responsibility for tax withholding and reporting, if any, should also be clearly regulated if this option is not utilized by a foreign intermediary. It should be emphasized in the law that there is an obligation for the beneficial owner to pay his or her own tax. The legal remedies to uphold the right to recourse any paid tax on behalf of the beneficial owner should also be closely monitored and reinforced.

The Finnish system is a useful example to illustrate this point:

- Neither the foreign custodian, nor the local account operator nor the issuer can be held responsible for unpaid taxes, if they have

fulfilled their duties laid down in the tax law. The only person who can actually be held responsible, if the account operator and the issuer have fulfilled their obligations, is the beneficial owner.

Consequently, the FISCO Group proposes that it should be clearly stipulated in the tax law that ultimate legal responsibility should not fall upon authorized intermediaries acting in good faith and following the prescribed forms for collecting “sufficient evidence” on the underlying beneficial owners. It is also the opinion and recommendation of the FISCO Group that some general rules and guidelines for all EU Member States should be implemented in this respect. There should also be some guidelines for harmonising the requirements of how long information or documents must be kept by intermediaries and/or withholding agents.

It should be possible to transfer funds to authorized foreign intermediaries in Member States (who cannot opt themselves for withholding responsibilities) net of treaty rates based on information received in "good faith".

The liability of the Responsible (Non-) Withholding Agent should be understood as shifting the standard of care and the connected liability imposed on local intermediaries to foreign intermediaries and not to impose additional liabilities or a stricter standard of care on foreign intermediaries. This affects countries such as France, where the local intermediary remains legally responsible to the French tax authority in addition to the foreign intermediary. A local intermediary must be released from any liability to the extent such liability is assumed by the foreign intermediary.

This proposal is in line with the ISSA Tax Relief Model (see 2.2.8.5. below). However, in contrast to the ISSA model, an option between either assuming withholding responsibility or acting as Non-Withholding Agent appears more favourable than a strict system without any flexibility.

Moreover this proposal, in contrast to the ISSA model, allows for a Responsible Withholding Agent to act partly with primary withholding responsibility and partly without it. Such possibility for combining options is also offered in connection with the US QI regime. Different options are imaginable e.g. with respect to different types of customers or different income types. However, when an intermediary does not opt for withholding tax responsibility, the tax law should clearly state who actually will be legally responsible for the withholding tax collection.

#### **2.2.4. *To whom should the responsibilities be given?***

As mentioned above, the main goal of shifting responsibilities to upper-tier intermediaries is to avoid the need to pass on paper-form certificates and beneficial owner breakdowns through the chain of

intermediaries that intervene in the income distribution up to the withholding agent.

Depending on the type of income, two different models could be adopted to achieve this goal: One model "Model 1 - Dividend and Interest Income" imposes primary withholding responsibilities on the issuer or a local intermediary, with the possibility for other intermediaries to take on all or part of these withholding responsibilities. The other model "Model 2 - Interest Income" imposes withholding responsibilities exclusively on the person established in the source country who pays income for the immediate benefit of the individual beneficial owner in the same source country.

(a) Model 1 - Dividend and Interest Income

(b) Model 2 - Interest Income

#### **2.2.4.1. Model 1 - Dividend and Interest Income**

Under this model, primary withholding responsibility is imposed on the issuer, but each intermediary in the custody chain is given the option to take over part (in the case of a Responsible Non-withholding Agent) or all (in the case of a Responsible Withholding Agent) of the withholding responsibilities. The main *advantages* of this solution are that:

- Intermediaries can grant at-source relief without the need to pass on detailed beneficial owner documentation to the issuers or upstream intermediaries;
- At the same time, relief is only given on the basis of a proper identification of the beneficial owner and a verification of its entitlement to relief (even if such information about the individual beneficial owners is not necessarily passed on to the issuer or upstream intermediaries); and
- All intermediaries are treated equally: In order to ensure a true level playing-field amongst intermediaries, no distinction should be made between foreign and local intermediaries as regards the type of responsibilities they can assume or the conditions under which they can assume such responsibilities.

Intermediaries that are not interested in offering relief at source services are not obliged to take on any responsibilities. In certain jurisdictions, however, the withholding responsibility is legally already imposed upon the last domestic intermediary closest to the beneficial



owner. In such cases there will be no level playing-field within the EU if those intermediaries or CSDs cannot opt out from the responsibility. The FISCO Group recommends to provide for the option rather than for an obligation to assume all or certain withholding responsibilities.

To realize the proposed solution it is required that:

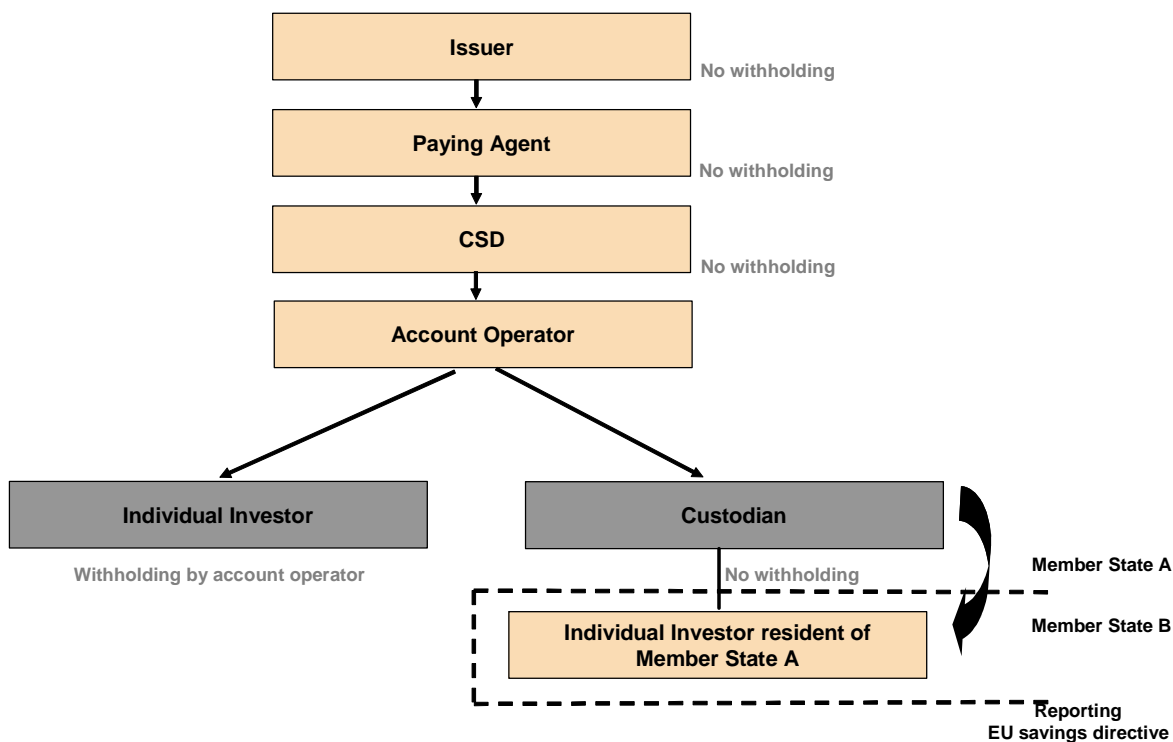
- The legislation of Member States' that currently do not allow the local tax authorities to audit and/or enforce withholding obligations imposed on foreign intermediaries.
- Smaller intermediaries may be discouraged by the compliance cost associated with the assumption of withholding or QI responsibilities in a large number of Member States. This could be addressed by:
  - (i.) harmonizing the withholding tax relief procedures among Member States; and
  - (ii.) foreseeing an efficient and fast standard refund procedure for those intermediaries that do not wish to take on the responsibilities to grant relief at source.

#### **2.2.4.2. Model 2 - Interest Income**

In several Member States the withholding tax on interest payments does not really aim to be a revenue-raising tax on non-resident investors, but it merely serves a tool to ensure that resident non-corporate investors are effectively paying taxes on such income. Where this is the case for domestic source interest, an alternative solution to the one described above could be to impose withholding responsibilities exclusively on the person established in the source country, who pays income for the immediate benefit of beneficial owners that are individuals resident in the same source country.

This model is illustrated in the pictogram below:

## Paying Agent Model (interest)



- If the local custodian is paying interest for the immediate benefit of a resident individual, it must apply withholding tax;
- If the local custodian is paying the interest to an intermediary (in the pictogram the global custodian), it has no withholding obligations, even if the intermediary is holding the securities for a taxable individual investor that is resident in the source country.

Some Member States already apply this principle today with respect to interest payments (cf. Germany, Austria, Luxembourg, Sweden). The main *advantages* of this solution are that:

- It does not impose any new responsibilities on foreign intermediaries outside the country of the beneficial owner, and hence it neither imposes an additional compliance cost on foreign intermediaries nor does it require Member States to develop new rules or procedures to audit and enforce the obligations of foreign entities; and
- Since withholding obligations are only imposed on the intermediary with a direct relationship with the beneficial owner, no beneficial owner information

and/or documentation must be passed on between intermediaries.

The main *disadvantage* of this solution is that:

- It may allow taxable investors to evade taxes by hiding behind a foreign intermediary, since it does not require withholding agents to look behind the payee to which they are paying the income.

However, to the extent payments are made to EU resident intermediaries, the withholding or reporting obligations imposed by the EU Savings Directive on those intermediaries constitute a good safety-net against such potential tax evasion (cf. pictogram). In addition, the beneficial owner generally also has an unlimited tax liability in the residence country for all income and is therefore, in most cases, obliged to file annual tax returns and also pay his or her non-withheld taxes on the income.

#### **2.2.5. *On which legal basis should the responsibilities be assumed?***

The legal basis for the proposed withholding tax relief procedures should be set in accordance with each Member States constitutional or similar provisions. It seems, however, desirable that the relevant (tax) authorities be given the authority to enter into agreements with foreign intermediaries regarding the assumption of withholding responsibilities by the latter on the basis of a model contract – similar to the US QI agreement. One can notice that the principle of contractual agreements is used more and more by the tax authorities and taxpayers for purposes of arrangements of applicable procedures. In addition to the mentioned US QI agreement, this appears typically to advance pricing agreements (“APA”).

Moreover, in contrast to the QI agreement, not only foreign but also domestic intermediaries should be entitled to enter into such an agreement with their local tax authority.

It seems highly desirable to develop a single model contract that would be used by all EU Member States. It would be logical that in the model preparation the industry’s points of view are taken into account. To facilitate this, consideration should be given to the idea of creating a Consultative Group at EU level.

The parties of such an agreement are the intermediary on one hand and the tax authority of the issuer country on the other. Technically it should be possible to enter into such an agreement by signing a “one-pager” that incorporates the various applicable terms and conditions, as amended from time to time, by reference.

The conclusion of such a contract with a domestic or foreign tax authority should not be mandatory but should remain optional.

Intermediaries should be allowed to opt for entering in such a contract on a country by country basis and preferably entitled to make use of the contract. vis-à-vis each downstream intermediary separately. It is expected that the business model adopted by the intermediary will have an effect on such decisions.

Despite the fact that the principle of a contractual agreement is preferred to legal regulations, mainly due to the flexibility offered by such arrangements, some adaptations of the Member States' laws will be inevitable, for at least the following reasons:

- Firstly, in many jurisdictions the withholding responsibility is reserved for those issuers or intermediaries that are residents of the issuer country. Accordingly, shifting the withholding responsibility abroad will require a change of the relevant laws;
- Secondly, the recommended contractual agreement between the tax authority and the domestic and foreign intermediary will, for its part, require a legal basis under the law systems of many Member States. Generally it should be possible to establish such legal bases by way of ministerial regulations or decrees in contrast to formal laws issued by legislative bodies. Thus, the necessary legal adaptations within the Member States should be reasonably limited.

#### **2.2.6. *How to ensure audit and tax assessment***

If the local tax authorities allow for the withholding responsibility to be outside the issuer country, they must also keep it under appropriate surveillance. The question is how such surveillance should be performed:

- (1) directly by the tax authorities of the issuer country;  
or
- (2) by the tax authorities of the relevant intermediary;  
or
- (3) by external auditors; or
- (4) by means of a cooperation of these institutions.

There is already some experience in the cross-border field of shifting withholding responsibility to intermediaries, granting relief at source and simplified refund procedure. That experience should be used for finding an appropriate solution.

- Firstly, under the US QI regime, specific periodical audits have to be performed by external auditors, who submit their report directly to the local tax authorities of the source country, i.e. to the US Internal Revenue Service (IRS). The drawback of this regime is the cost attached to the involvement of external auditors.

- Secondly, in contrast to the US QI regime, the Japanese QFI regime does not contain any audit requirements. Instead the foreign intermediary must have comprehensive documentation about the beneficial owner. Upon request, this documentation must be made available to the Japanese Ministry of Finance. Thus, under this regime, the surveillance by the local tax authorities is undertaken by an information system. The positive effect of this system is that it is not necessary to provide the documentation of all beneficial owners upfront to the local tax authorities, in contrast to a reporting system.
- Thirdly, the mechanism of surveillance via the “Elective Dividend System” (EDS) of the US Depository Trust Company (DTC) should be taken into consideration. This procedure is a simplified collective relief at source or quick refund procedure applied by the DTC with regard to dividends derived by US residents from certain European securities. Under this procedure the DTC-participants notify the DTC of those positions of foreign-sourced dividends that are entitled to tax-treaty relief. The DTC sums up the positions received and submits a collective claim for relief at source or quick refund at the relevant foreign tax authority without disclosing the names of the beneficial owners.

Under the DTC procedure, as agreed e.g. with the German Ministry of Finance, there is no periodical audit provided for. The German tax authority merely has the right to request from the DTC, within 4 years after the refund has been paid to audit the entitlement of the investors to benefits under the US / German tax treaty. In the event of an audit, the German tax authority turns to the DTC and informs them of the scope of the audit and of the investors to be audited. In turn, the DTC forwards the relevant questions to the US intermediaries involved. Those intermediaries then furnish proof of entitlement to relief on the basis of the relevant documentation, e.g. registers showing the names requested and certificates of residence issued by the US IRS (US “Form 6166”).

The principal favourable effect of this method of surveillance is the absence of a complex and costly periodical audit, in contrast to the US QI regime. In this context it seems remarkable that some EU Member States, such as Italy, do not subject local intermediaries to periodical audits. Consequently, the submission of foreign intermediaries to periodical audits could be discriminatory, if local intermediaries are not subject to the same requirements. In view of this, it appears rather doubtful whether there is any need for a compulsory periodical audit within the EU.

Another favourable effect of the DTC procedure, and of the other procedures mentioned, is that they all, as far as possible, avoid disclosing the beneficial owners' names. From a level playing-field point of view, intermediaries should not be required to reveal confidential customer information to competitors, such as other intermediaries or banks, but only to tax authorities and third party

auditors. In any case, where it exists, banking secrecy must be taken into consideration. Consequently, no other intermediaries should be involved in the audit procedures of a Responsible (Non-) Withholding Agent.

The FISCO Group recommends the following audit procedures:

- It seems appropriate to involve both the tax authorities and external auditors in an audit, by means of co-actions. The task of the external auditor should focus on periodical systems checks, and the task of the tax authorities should focus on audit actions as the case arises.
- The decision must be made whether the tax authority of the issuer country or the tax authority of the relevant intermediary's country should be competent. It seems proper that the audit comes from the issuer country, as the revenue of that country is affected. The "distance" between the issuer country and the location of the Responsible Withholding Agent can easily be bridged by use of electronic systems. Moreover, it could be beneficial to involve the tax authority of the intermediary's country by way of mutual administrative assistance. In this sense, the principle of cooperation between (home/host) supervisors, which is based on MiFID, could be considered as an example for the cooperation between fiscal authorities in the case of cross-border operations. This could be appropriate for particular audit measures or in particular situations, e.g. in the event of adverse audit results.
- The external auditors should perform systems checks, as opposed to random sampling of groups of investors, which inevitably would be quite comprehensive. Random sampling based on the "agreed-upon procedures" audit under the QI regime has frequently turned out to be a costly experience.

The systems checks recommended should comprise:

- accurate keying of the investors into the intermediary's systems, i.e. customer data and required documentation procedures, whether the system guarantees that the conditions are met for the granting of benefits (such as proof of residence and systems residence codes);
- accurate keying of securities data held in custody and the income derived, particularly correct application of withholding tax rates – regular domestic / benefited domestic / treaty-benefited rate;
- accurate functioning and processing of payment streams of securities income, e.g. its classification and accruals;
- accurate tax deduction, amounts corresponding to correct tax rates, timely remittance.

Cost control should be kept in mind, as the profit margins arising from the securities custody business are rather small. Thus it appears reasonable that the external auditors can make use of the findings of

the internal audit department of the intermediary. For this purpose, and as an example the instrument of the “securities account audit” (“*Depotpruefung*”), which is compulsory on an annual basis in Germany, could be used. This special audit rule provides for the securities custody business and the associated processing systems to be audited annually by an external auditor. The audit comprises the periodical reports of the internal auditors of the bank concerned. The external auditor has to file his statements in a report, which is submitted to the competent supervisory authority of the bank. Eventually Member States' existing audit requirements need to be matched to the requirements of the suggested systems check. The tax authority of the issuer country should be entitled to request such an audit report from the relevant supervisory authority, if the need arises. This right should also be subject to the time limitation of e.g. 4 years. The great advantage of such an audit procedure is that only one audit is performed and the findings could be presented to 26 other Member States.

- The corresponding audit methods of the relevant tax authority (i.e. the tax authority of the issuer country) should be composed of 2 elements:
  - the entitlement to request the relevant audit reports from the competent supervisory authority of the intermediary; and
  - verifying tax relief granted by requesting relevant information from the Responsible (Non-) Withholding Agent about the beneficial owners.

The beneficial owner information to be provided upon request should consist of:

- registers showing the names of the beneficial owners involved;
- self-certificates filed by the Responsible (Non-) Withholding Agent, i.e. copies or electronic versions; and
- know-your-customer ('KYC')-documentation as described in the prior section i.e. copies or electronic versions.

Such audits need not be performed periodically, but only as the case arises. The right to request the audit reports and such verification should be subject to a time limitation. As with the US DTC procedure in respect of some European countries, the entitlement to request an audit of the intermediary with Responsible Withholding Agent-status should be limited to e.g. 4 calendar years after the tax relief has been granted.

Apart from the audit methods mentioned, no additional action or even separate audit seems necessary. It should be carefully borne in mind that the industry must not become overburdened by audit instruments. In this context it should be noted that the European Banking Federation has criticized the “reconciliation” required under the US QI system<sup>16</sup>. It is argued that this instrument imposes too great a burden compared to the benefits that might be derived from it.

#### **2.2.7. *How to ensure recovery of tax and related penalties***

To recover withholding tax that has erroneously not been deposited with the tax authority or to recover penalties, the tax authority of the issuer country could have recourse to the “Council Directive 76/308/EEC of 15 March 1976 on mutual assistance for the recovery of claims relating to certain levies, duties, taxes and other measures”, as amended by the Council Directive 2001/44/EC of 15 June 2001. According to Article 2 of the Mutual Assistance Recovery Directive, it can now be used for the recovery of all claims related to tax on income and on capital interest, administrative penalties and fines, and costs incidental to these claims. At least theoretically, the Mutual Assistance Directive should allow a tax authority to recover the tax and penalties due from foreign intermediaries.

However, there are apparently other reasons in the daily business practice that will avoid recourse to the enforcement methods of the Mutual Assistance Recovery Directive and make the Mutual Assistance Directive (77/799/EEC) the last resort.

The first reason is that the intermediaries which shall be authorized to assume withholding responsibility are financial institutions, i.e. a limited, specific group of economic institutions. Due to their daily business these institutions are aware of the sensitivity of dealing with other people’s money. The experience under the US QI regime, which has been in force since 2001, i.e. more than 6 years, shows that even in the case of non-compliance with the QI Agreement, no recourse to legal enforcement measures has been necessary up to now.

The second reason is that the tax authority will always have the possibility to withdraw the status of the Responsible Withholding Agent. If such action is taken, it will immediately become public through daily business and will seriously affect the reputation of the intermediary heavily. It is therefore anticipated that intermediaries will want to avoid risking their reputation and consequently will avoid recourse to enforcement methods.

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<sup>16</sup> EBF Fiscal Committee circular letter N° C 1512 of 15th November 2006



### **The Mutual Recovery Assistance Directive 76/308/EEC**

When considering the possibility of applying the Mutual Recovery Assistance Directive, it must be observed that this Directive only relates to the taxes that are listed in Art. 2. The Directive consequently applies to "taxes on income and capital" (Art. 2(g)), including those levied by way of a withholding tax. It does not however apply to transaction taxes imposed on the sale, purchase, transfer or registration of financial instruments that require recovery assistance. The Directive stipulates several conditions (Art. 7), confirming mutual assistance with regard to the collection of taxes. The aim of this Directive is to provide assistance between tax authorities of different Member States, for the recovery of claims that remain unpaid. The provisions of this Directive – and of the implementing Directive 2002/94/EC – make it clear that the organisation of the Mutual Recovery Assistance is not adapted to direct contacts (and direct payments) between financial intermediaries and tax authorities in different Member States.

### **The Mutual Assistance Directive 77/799/EEC**

The Court has repeatedly held that effectiveness of fiscal supervision constitutes an overriding requirement of general interest capable of justifying a restriction on the exercise of fundamental freedoms guaranteed by the Treaty<sup>17</sup>. In assessing the proportionality of national measures restricting these fundamental freedoms, the Court tends to take account of the possibilities offered by the Mutual Assistance Directive to check the tax situation of taxpayers. At the same time, the Court repeatedly underlined that there was nothing preventing the tax authorities concerned from requiring the taxpayer to provide such proof as they considered necessary in order to determine whether the conditions provided for in the legislation at issue had been met<sup>18</sup>.

These considerations of the ECJ confirm that the aim of the Mutual Assistance Directive with regard to cross-border situations is not to replace the normal audit rules that each of the Member States applies within its territory. This Directive has been adopted in order to ensure that the Member States exchange information "concerning particular cases" (as confirmed in the 5<sup>th</sup> recital of the Preamble to the directive), where the national control and investigation measures – whose effect does not extend beyond national frontiers – are insufficient.

Consequently, this Directive only deals with collaboration between Member States' competent authorities. It does not provide for any communication of information by taxpayers or financial intermediaries to the tax authorities.

Moreover, the Directive applies to taxes on income and on capital – as defined in Art. 1(2) – including withholding tax, but it does not apply to transaction taxes on the sale, purchase, transfer or registration of financial instruments.

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<sup>17</sup> See, *inter alia*, Case C-250/95 *Futura Participations and Singer v Administration des Contributions* [1997] ECR I-2471, paragraph 31; Case C-254/97, *Baxter* [1999] ECR I-4809.

<sup>18</sup> See, *inter alia*, Case C-136/00, *Danner* [2002] ECR I-8147, paragraphs 50-52; Case C-422/01, *Skandia & Ramstedt* [2003], ECR I-6817.

### 2.2.8. *Simplification and harmonisation of at-source relief procedures*

Harmonisation and simplification of procedural issues cannot be completely achieved due to varying substantial differences in tax laws and regulations. Examples of such issues are differences in tax rates, in the allocation of legal responsibility for the withholding of tax, differences in timing of the withholding responsibility (payment date versus “*pro rata temporis* systems”) and in procedural requirements. Such differences can only be solved by amendments to substantive national tax law provisions or tax treaties and will, in many cases, also require adjustments of national legal systems as well as tax laws.

The FISCO Group finds, however, that the suggestions in this chapter may be used as a basis for the discussion of future harmonised EU Tax Relief Procedures. The suggestions below are based on the conclusions made in the FISCO Fact-Finding Study.

In many countries there is a *formal possibility* of relief at source on payments, but since this may be conditional upon a tax residency proof form or similar being furnished *before* the payment of dividends or interest, this system does not, in practice, allow any tax relief at payment<sup>19</sup>. In other countries, even a receipt of a tax refund after a formal application is made difficult and sometimes a practical impossibility. The FISCO Group finds that such formal possibility is not sufficient and also that, in such countries, certain substantial tax law provisions may need to be amended in order to make relief at source effectively possible and to harmonise tax relief procedures within the EU.

The fact that withholding tax collection and relief procedures differ substantially between the Member States is a serious problem in itself. Intermediaries incur substantial costs to cope with these differences or may forego the relief to which their clients are entitled because of the costs attached thereto. To solve this problem, it is necessary that a harmonised withholding tax relief procedure be introduced.

Consequently, the following features should ideally be harmonized for all EU Member States:

- timing of withholding tax deduction and of the remittance of the tax to the local tax authorities;
- reporting obligations;

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<sup>19</sup> This can often be the case in Belgium, France, Italy and the Netherlands.

- documentation requirements and validity period for documentation;
- statute of limitations for the introduction of refund claims;
- tax authority arrangements for processing refund claims;
- procedures for reviewing compliance by intermediaries with their obligations.

It should be noted that the ambitions of harmonisation and simplification with respect to forms and administrative procedures exist also in the recently-adopted EU Directive on Services in the Internal Market, by the proposal of introducing a One-Stop-Shop in the Member States for non-domestic corporations and businesses, acceptance of forms from other Member States and the exchange of information.

#### **2.2.8.1. Information delivery and proof of tax residency for tax relief**

The Responsible Withholding Agent or intermediary must apply the correct tax rate, i.e. the entitlement to tax relief of each investor corresponding to his residence and the applicable tax treaty or domestic rules of the issuer country. According to the conclusions in the FISCO Fact-Finding Study, there should be no excessive documentation requirements as proof for the applicable tax relief. The currently customary certificates of residence that need to be issued annually by the responsible tax office of the beneficial owner could be abolished. This appears an appropriate step on the road to an Internal European Market.

The FISCO Group recommends that the existing certificate of residence system, when applicable, should be replaced by self-certification of the beneficial owners. However, the experience under the US QI regime, and under the domestic US withholding tax rules, shows that even such a system can become rather bureaucratic and burdensome for intermediaries.

#### **2.2.8.2. Self-Certification and Know-Your-Customer (KYC) rules**

Self-certification will be the optimal way in future to receive the correct investor information, since the complexity of tax residency rules, tax treaties and - above all - the actual circumstances of the investors' presence and activities in a specific state are best known to the investor him-/herself. With respect to individuals it is often sufficient to rely on general know-your-customer rules

(KYC) only. For corporate investors, or in special cases, for instance when the account file contains addresses in different countries, or when it is not clear whether the account holder is acting for his own account or not, it may be needed to request additional information to be provided. In this connection, FISCO has a preference that such additional information be limited to a self-certification. The collection of such self-certification should discharge the liability of the Withholding Agent.

It is to be noted, indeed that several countries – such as e.g. Austria and Germany – currently apply only the KYC-rule for interest payments to non-resident investors. The KYC-rules of these countries provide that a natural person opening an account with a bank has to identify himself by either his passport or identity card (with photo). Based on this document, the bank must determine the customer's full name, date of birth, place of birth, nationality, residence address, type number issue date, and issuing authority of the passport or identity card. Legal persons must be documented by extracts from public registers and/or copies of the certificate of incorporation or other organisational documents. These data must be archived by the bank together with a copy of the passport or identity card<sup>20</sup>.

Generally this means that, if the accountholder is identical to the beneficial owner within the EU Member States, it could in principle suffice that the Responsible Withholding Agent relies on the applicable KYC documentation of his country. However, as stated above, in certain circumstances, it may be desirable to also request a self-certification made under penalty of perjury. It would facilitate tax compliance if such self-certification should be standardised within the EU. If the statement made by an investor is incorrect, this may, in many jurisdictions be a criminal act. Based on the information provided, the CSD or the account operator can decide on a tax code with respect to each customer.<sup>21</sup> The EU Tax Relief Procedure should be based on a common standard of information collection from beneficial owners. We propose that this common standard be included in a single document, valid

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<sup>20</sup> If an accountholder is not the beneficial owner (e.g. transparent investment funds, partnerships, etc), the beneficial ownership must be demonstrated by use of self-certification of the entitled persons. Self-certification is also applied in cases of changes of circumstances with regard to the tax status of the accountholder and in cases of doubt, e.g. conflicting addresses.

<sup>21</sup> In certain countries such as Sweden the information provided by the investors can also be processed against governmental personal record registers. Normally when there is a change of address in such registers (SPAR in Sweden), the CSDs and nominees will be notified and can update their own registers.

in all the EU Member States, presented upon opening an account or deposit.

When accounts are opened, such self-certification should also be able to be handled electronically in the future. There are intermediaries that only operate electronically on the internet. In such cases the customer should be able to identify themselves electronically. In certain jurisdictions, there are already ways for tax payers to identify themselves and file tax returns electronically, e.g. the US, Sweden, Finland and Germany.

### **2.2.8.3. Updating and passing on information**

It should not be necessary to renew information or documentation on a regular basis e.g. yearly. Instead, it should be sufficient for investors to update information when changes occur. Such investor information should be subject to tax audits. Transitional provisions may, however, be necessary for old accounts.

In the EU Tax Relief Procedure, authorized intermediaries without the status of being a Responsible Withholding Agent should be allowed to pass the tax-rate information to the security issuer/agent or any upper-tier authorized intermediary as appropriate.

This may involve:

- (i.) segregation of assets into tax-rate pools on the books of the upper-tier authorized intermediary/issuer (see flowchart 1 in Chapter 2.2.2.2), or
- (ii.) tax-rate breakdown of income entitlements arising on assets held in a single pool on the books of the upper-tier authorized intermediary/issuer in accordance with the tax rates applicable to the underlying investors (see flowchart 2 on Chapter 2.2.2.2).

Where the information is provided to an upper-tier authorized intermediary who is not a Responsible Withholding Agent, the authorized intermediary is responsible for relaying that information to the next upper-tier authorized intermediary or the issuer, in conjunction with one of the methods outlined above (i) or (ii).

The reporting to the upper-level intermediary then forms the basis for the tax withholding by the Responsible Withholding Agent.

Intermediaries should be allowed to pass on information and withhold tax based on the reliance on information received in “good faith” between authorized intermediaries in the Member State, and provided that self-certification principles are respected. This should be done without the requirement to provide or receive evidence of the beneficial owners' tax residency ahead of each payment. This model should be defined in EU guidelines and applied in domestic tax laws/guidelines, and be monitored and audited by local tax authorities.

#### **2.2.8.4. Domestic investors**

When pools are used it is necessary to take care of domestic investors holding securities through foreign intermediaries in order:

- (i.) to be able to ensure that domestic taxes will eventually be paid;
- (ii.) to prevent the deduction of withholding tax at the highest “non-treaty country” rates.

The need for withholding could be questioned here, since there generally are ways to collect taxes from domestic investors, who have an obligation to submit annual income tax returns. Such potential delay of cash flow for the tax authorities might instead be solved by imposing interest charges on payments after a certain time-limit. It could also be considered whether or not it may be possible to implement reporting obligations for the foreign intermediary. This must however be in consistency with EC law and principles<sup>22</sup>.

#### **2.2.8.5. The ISSA Model**

The Group of Thirty, (“G 30”)<sup>23</sup> issued its report “Global Clearing and Settlement –A Plan of Action” in January 2003. In this report, Recommendation 8 considered, *inter*

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<sup>22</sup> See recent Swedish issue in a press release on June 29, 2006. The Commission found it to be a hindrance according to article 49 and 56 in the EC Treaty to require extensive tax reports from foreign intermediaries without establishments in Sweden, according to which the foreign financial institutions had to reveal customer information to the Swedish Tax Agency. Sweden has recently made an exemption from the reporting obligations for those foreign intermediaries that are prohibited to provide certain information according to legal provisions (such as bank secrecy provisions).

<sup>23</sup> It is an industry group made up of senior representatives from international private and public financial institutions that is focused on increasing understanding of international economic and financial issues, one such goal being to formulate recommendations towards the implementation of widespread reform relating to the global clearing and settlement of securities trades.

*alia*, the need to automate and standardize tax relief arrangements.

In 2004, a tax relief model was developed and proposed. The tax relief model was endorsed both by the G 30 and by the International Securities Services Association, ISSA, and was posted on ISSA's website in February 2005. The model, (hereafter named the "ISSA Model") based on optimal relief-at-source methodology, builds on existing technology and best practices and anticipates a phased implementation approach. The model is presently subject to review and comments by other industry groups and interested parties.

The ISSA tax relief model is designed to fully satisfy the G 30 criteria by:

- standardizing tax relief arrangements;
- creating a platform that facilitates the automation of associated procedures and the electronic communication of associated data;
- providing each party involved in the tax relief process with an opportunity to minimize associated costs.

The ISSA Model is based on the optimal relief-at-source methodology. Accordingly, it envisages that appropriate tax relief will be secured on dividend and interest income arising from securities at the point of income payment and that it will not normally be necessary to file (electronic or physical) tax reclaim applications to secure this relief. Moreover, the model does not envisage any radical changes to existing practices and system capabilities. Rather, it largely builds on existing technology and best practices that are already used to secure tax relief in a number of countries of investment<sup>24</sup>. According to the model which builds on self-certification, investors complete a standardized declaration confirming their:

1. identity;
2. residence;
3. generic category (individual, corporation, pension fund etc.); and
4. tax relief eligibility.

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<sup>24</sup> The countries of investment in this context are not limited to EU Member States.

If the investor fails to complete a declaration, the investor will not be entitled to any tax relief under the model. Instead, a tax relief may be claimed by the general refund procedures. According to the ISSA Model, the declaration is provided to the issuer/agent or any authorized intermediary acting for the investor (depending on the national legal systems of responsibility for the correct withholding).

#### **2.2.8.6. Other “Best practices” building on a system of tax relief at source**

As concluded in the G 30 report and in the FISCO Country Studies made in relation to the FISCO Fact-Finding Study, a number of countries already operate (wholly or partially) a relief at source tax system in a way that is essentially compatible with the ISSA Model, such as the AWA and QI systems in Ireland and US as well as the Japanese QFI system for bonds. Also certain Nordic country systems, such as the Swedish system and the newly reformed Finnish withholding tax system, make tax relief at source generally available. In these systems a relief at source is generally available based on pooling of assets into tax-rate pools in the books of the upper tier intermediaries. It also builds on self-certification and does not require that individual beneficial information passes through the chain of intermediaries ahead of the payment. In Sweden, tax relief can be obtained on payments to foreign intermediaries, but the withholding responsibility lies mandatory on domestic intermediaries only.

Based on the fact that there are already systems in place in certain jurisdictions allowing for tax relief at source and that those systems are also often well-functioning for withholding tax collection, the FISCO Group proposes, in accordance with its findings, that a harmonised EU Tax Relief Procedure be implemented in order to create a level playing-field within the EU.

The methodology of tax relief at source and the availability of using pooling of assets into tax-rate pool(s) combined with standardisation/centralisation of investor tax documentation and requirements, could provide a firm basis for streamlining and simplifying the current tax-relief processes in the EU Member States.



## **2.3. MEASURES TO INCREASE EFFICIENCY OF QUICK AND STANDARD REFUND PROCEDURES**

Even in a system with at-source relief as the normal and preferred method for applying treaty rates and even with a fairly long time-period before taxes must be forwarded to the tax authorities, there is still a clear need for efficient refund procedures. A supplementary refund procedure should be standardised throughout the Member States by using a similar form for application and by implementing a harmonised time-limit for the application of refund. Such refund procedures should consist of both a quick and a standard method.

### ***2.3.1. Quick refund procedures: Time limit or offsetting possibilities for tax to be paid to local tax authorities***

Late transactions near record dates and standardized procedures for corrections in withholding of taxes require a certain period of time before the tax actually has to be paid to the local tax authorities. In some countries many corrections can be administrated without the need for a formal refund application with the tax authorities due to the fact that the collectors of the tax (CSD and the nominees) have a certain amount of time before the taxes must be paid to the Tax Agency (e.g. 4 months in Sweden). Some “quick refund” methods in certain jurisdictions are also based on such concepts. The FISCO Group therefore suggests that the time limit for intermediaries and withholding agents to forward the taxes collected to the tax authorities be harmonised throughout the Member States and extended e.g. to 3-5 months. The cost of such deferred tax payment may often be compensated due to less administration and fewer costs for handling errors in reported and withheld taxes. In some countries the tax administrations have acknowledged this and therefore support the keeping of such extended time limits in national tax law. It seems however, that many countries today have shorter time limits for the payment of withholding taxes. As an alternative, if tax is collected on a current monthly basis, it might instead be possible to offset any tax corrections from tax payments during subsequent months.

### ***2.3.2. Simplifications in standard refund procedures***

The FISCO Group recommends the following simplifications in respect of refund procedures.

- One-Stop-Shop

Standard refund procedures should be centralized in each country to one tax authority or tax office only. As the refund procedure currently works in many Member States, the local tax office responsible for the area where an applicant lives, is liable for the “stamping” of forms confirming the tax residency of that applicant. If there are many local tax offices it can be very time-consuming to

find the right office especially if intermediaries are involved and acting on behalf of many applicants.

- One Form

Standardised forms for application throughout the Member States should be implemented. It may be necessary to consider varying requirements in different tax treaties in this respect. However, such standardisation might build on the proposed beneficial owner declaration according to the model described previously. There could be, for example, certain boxes to fill in for different categories of tax payers (individual, corporation, pension fund etc).

Standardised forms for tax-residency certificates used in all EU Member States should be introduced in order to greatly facilitate the refund procedures. Such forms must be able to be filed electronically.

- One Time-Limit

The time-limit for a refund application should be harmonized throughout the Member States, e.g. 4-5 years after the year of distribution. This would assist investors in different jurisdictions, as well as intermediaries acting on behalf of their customers, to safely meet those time-limits.

## 2.4. SUBSTANTIVE RULES THAT CONSTITUTE A BARRIER

Countries where withholding tax is levied and/or relief from withholding tax is granted on a “*pro rata temporis*” or on a transaction-by-transaction basis raise particular problems which are described in section 2.3.1.2.1. of the FISCO Fact-Finding Study.

One substantial feature of a “*pro rata temporis*” or “transaction-by-transaction” withholding tax on income from fixed debt securities is that the collection of tax is not postponed until the moment of the coupon payment by the issuer, but can take place immediately at the moment of the transaction on the secondary market. The problems identified in the FFS were twofold:

- In cases where only local settlement service providers or CSDs are allowed to collect the withholding tax, foreign settlement service providers that are holding the securities with a local CSD may be precluded or discouraged from settling taxable transactions on their own books. This is due to the fact that the local settlement service providers need to intervene in the settlement on individual transactions in order to be able to collect that tax. This problem could be resolved by allowing foreign CSDs or settlement service providers to assume responsibility for tax collection and relief, without needing to appoint a local fiscal representative, and thus ensuring a level playing-field between local and foreign settlement service providers.
- The remaining problem with such a tax regime is the fact that it requires complex and costly procedures to be developed to track all changes of beneficial ownership. This represents relatively high costs for foreign CSDs or settlement service providers, compared to local CSDs/settlement service providers, as the development cost can only be spread out over a small number of players in the case of a foreign CSD. The FISCO Group is of the opinion that this latter problem cannot be resolved without touching on the substance of tax rules, and since the legitimate concerns of this group are limited to procedural tax barriers, this issue is not further discussed in this report.

## 2.5. CONCLUSIONS ON WITHHOLDING TAX PROCEDURES

The withholding tax relief procedures which exist in Member States do not, at present, take sufficient account of the multi-tiered holding environment. The present procedures are therefore costly and inefficient. The FISCO Group is of the opinion that *at-source relief procedures* are the best method to improve the present situation because of the optimized cash flow they offer to investors.

Many of the present administrative and efficiency problems can only be resolved by *shifting withholding responsibilities* to intermediaries, and by allowing all intermediaries in the custody chain to assume withholding responsibilities or to take responsibility for granting withholding tax relief.

The withholding tax relief procedures differ substantially between the Member States. This is a serious problem, since intermediaries incur substantial costs to cope with these differences or may forego the relief to which their clients are entitled because of the costs attached thereto. To solve these problems, it is necessary that a *harmonised withholding tax relief procedure* be introduced.

Even though relief at source is the preferred relief method, there is a clear need also for efficient *refund procedures*.

### 2.5.1. *Conclusions on at-source relief procedures*

#### 2.5.1.1. **Shifting withholding responsibilities**

- Many of the administrative and efficiency problems identified in the FISCO Fact-Finding Study can be resolved by eliminating the need to pass on detailed information on beneficial owners through the custody chain up to the local withholding agents. This can be best achieved by allowing any intermediary in the chain to either assume full withholding responsibilities or to take responsibility for granting withholding tax relief by sending pooled withholding rate information to the upstream intermediary.
- This possibility would be enhanced by the abolishing of the requirement of paper-form certification and the permission to allow intermediaries to make use of modern technology to pass on beneficial owner information to the local withholding agent in electronic format and to allow the use of pooling of assets into tax-rate pools.
- The Responsible Withholding Agent must assume the tax withholding responsibility “itself”, i.e. the obligation to deduct and deposit withholding tax with the relevant

tax authority of the issuer country as well as collecting beneficial owner information that is passed on and/or reported to other intermediaries.

- In national laws, there should be clear provisions of the legal responsibility of the withholding tax deduction and collection.
- Withholding agents or other intermediaries should only be responsible for non-compliance with their own obligations. No liability may be imposed on authorised intermediaries acting in "good faith". This should be the case both for beneficial owner information collection and for tax collection, if any. The concept of "good faith" should also be defined clearly in law.
- Some general EU rules and guidelines for the concept of acting and relying on information received in "good faith" should be implemented. There should also be some guidelines for harmonising the requirements of how long information or documents must be kept by intermediaries and/or withholding agents.
- It should be possible to transfer funds to authorized foreign intermediaries in Member States (who cannot opt themselves for withholding responsibilities) net of treaty rates based on information received in "good faith".
- In some Member States' jurisdictions, the withholding responsibility is reserved for those issuers or intermediaries who are residents of the issuer country. Accordingly, shifting the withholding responsibility abroad may require a change of the relevant laws.
- However, the shifting of responsibility may be done on the basis of a contract. The recommended contractual agreement between the tax authority and the foreign or local intermediary will, for its part, require a legal basis under the law systems of many Member States. Such legal bases should be generally established by way of ministerial regulations or decrees in contrast to formal laws issued by the legislative bodies.
- Involving both the tax authorities and external auditors in an audit, by means of co-actions is the option preferred by the FISCO Group. The audit of the external auditor should focus on periodical on-site systems checks. The tax authority of any issuer country should have access to the external auditor's report; they should also have the possibility to verify the tax relief granted by the Responsible Withholding Agent or the

Responsible Non-Withholding Agent in individual cases. Besides the audit methods mentioned, no additional action or even separate audit seems necessary.

#### **2.5.1.2. Simplification and harmonisation**

- An EU Tax Relief Procedure is proposed in order to facilitate the clearing and settlement of securities within the Member States by simplifying and harmonising the tax relief procedures. The EU Tax Relief Procedure should be built on a model allowing for the appropriate tax relief to be applied at source without excessive documentation requirements and without exposing issuers, intermediaries and investors to unnecessary risks and costs. The Procedure should work in an equally efficient way, irrespective of the location in which securities are held or transactions settled and irrespective of the investment structure or settlement arrangements chosen by the investors and intermediaries and ensure equal treatment of foreign and local intermediaries.
- With respect to individuals it is often sufficient to rely on general know-your-customer rules (KYC) only. For corporate investors, or in special cases, it may be needed to request additional information to be provided. In this connection, FISCO has a preference that such additional information be limited to a self-certification.
- The EU Tax Relief Procedure should be based on a common standard of information collection of beneficial owners, mainly based on self-certification by the beneficial owner. This common standard should be included in a single document, valid in all the EU Member States, presented upon opening an account or deposit. It should be possible to pass this document to authorities electronically, without the need for it to be renewed on a regular basis.
- Intermediaries should be allowed to pass on information and withhold tax based on the reliance on information received in “good faith” between authorized intermediaries in the Member State, and provided that self-certification principles are respected. This should be done without the requirement to provide or receive evidence of the beneficial owners' tax residency ahead of each payment. This model should be defined in EU guidelines and applied in domestic tax laws/guidelines, and be monitored and audited by local tax authorities.

- Besides the aim of tax relief at source in the EU Tax Relief Procedure, the proposed harmonisation and simplification of certain information collection of forms for self-certification, and of the refund procedures, is also a very important goal in itself. Although the complete EU Tax Relief Procedure is the primary proposal and goal of the FISCO Group, the harmonisation and simplification work in other respects such as harmonising forms and other procedural issues is also very important. This work – which is already similarly conducted by other groups and bodies, such as the IFA/OECD PATT Project and the Group 30 ISSA Model Project - could start immediately, preferably by forming an EU group to review these issues. This group should be composed of participants from interested Member States, and should include representatives from both private bodies and tax authorities.

### **2.5.2. *Refund procedures***

- A supplementary refund procedure should be standardised throughout the Member States by using a similar form for application and implementing a harmonized time-limit for the application of refund.
- *One-Stop-Shop*. Standard refund procedures should be centralized in each country to one tax authority or tax office only.
- *One Form*. Standardised forms for application throughout the Member States should be implemented.
- *One Time-Limit*. The time-limit for a refund application should be harmonized throughout the Member States, e.g. 4-5 years after the year of distribution.

### **2.5.3. *Substantive rules that constitute a barrier***

- In cases where only local settlement service providers or CSDs are allowed to collect the withholding tax, foreign settlement service providers that are holding the securities with a local CSD may be precluded or discouraged from settling taxable transactions on their own books due to the fact that the local settlement service providers need to intervene in the settlement on individual transactions in order to be able to collect that tax. This problem could be resolved by allowing foreign CSDs or settlement service providers to assume responsibility for tax collection and relief without needing to appoint a local fiscal representative, and thus ensuring a level playing-field between local and foreign settlement service providers.

### **3. RECOMMENDATIONS WITH RESPECT TO TRANSACTION TAX PROCEDURES**

#### **3.1. INTRODUCTION**

The Giovannini reports recommended the removal of any provisions requiring that taxes on securities transactions be collected via a functionality that is integrated into a local settlement system. Such provisions require foreign investors to link up with the local settlement system that operates the tax functionality and thus reduce the foreign investor's choice of provider for securities settlement.

In its Fact-Finding Study, the FISCO Group concluded that two Member States impose a tax on securities transactions under which the responsibility for collection is imposed on settlement service providers: the UK, which charges Stamp Duty Reserve Tax (SDRT) on transactions in chargeable securities held in electronic form; and Ireland, which charges stamp duty (SD) on instruments which effect transfers on the sale of registered securities in Irish companies or equitable interests in Irish securities.

Both UK and Irish rules require the entity that is approved as an operator of an electronic system enabling title to units of a local security to be evidenced and transferred under local securities legislation<sup>25</sup>, to collect the tax. So far, the only approved system under UK and Irish rules is Euroclear UK & Ireland Limited (former CREST).

The Fact-Finding Study focused principally upon whether the relevant rules of both countries allow all EU-based settlement service providers (including those that are not operating an approved system under UK and Irish rules) to assume tax collection responsibilities under equal conditions. The underlying view supporting that approach is that transaction taxes collected by settlement service providers do not reduce the choice of provider for securities settlement as long as all settlement service providers are allowed to ensure the collection of the tax under equal conditions. In this respect, the FISCO group concluded that, while the UK SDRT rules allow settlement service providers that are not approved as an operator of a relevant system, but are considered a clearance service, to enter into an election and account for SDRT as operators of a relevant system, the Irish stamp duty rules do not contain any specific provisions relating to transfers of interests in Irish shares within systems that are not a relevant system within the meaning of Companies Act 1990 (Uncertified Securities) Regulations 1996. Section 3.2 contains a summary of this issue and proposed solutions.

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<sup>25</sup> In Ireland the operator of a relevant system under the Companies Act 1990 (Uncertified Securities) Regulations 1996; in the UK the operator of a relevant system.



Since the FISCO Fact-Finding Study was presented, comments have been made that even if UK SDRT rules allow operators of a clearance service, within the meaning of Section 96 FA 1986, to enter into an election to collect SDRT, the rules do not contain a clear definition of who should be considered as such an operator of a clearance service. This may not ensure a level playing-field between settlement service providers that are, and those that are not, considered an operator of a clearance service. A more detailed description of this issue and proposed solutions can be found under section 3.3 below.

Certain CSDs have expressed their concern about the fact that, even if the relevant rules allow them to collect transaction taxes and cater for a level playing-field between all settlement service provider, irrespective of the residency or legal status of the operator of the settlement system, the mere requirement for such CSDs to collect transaction taxes imposed on clearance service providers constitutes a significant hindrance for the efficient cross-border clearance and settlement of securities, and exposes the CSDs to considerable operational risk. This problem will be described in further detail in section 3.4.

### **3.2. THE IRISH STAMP DUTY (SD) RULES**

The factual position is described in the FISCO Fact-Finding Study (Chapter 3.2.1.4.on Ireland, pages 38-39). The crux of the problem is that Irish Stamp Duty rules do not really take into account the fact that securities transactions may settle in the books of several local or foreign settlement service providers which do not necessarily have the status of approved operators of a relevant system. This leads to the following issues:

- legal uncertainty as to whether transactions settling in the books of such settlement service providers are subject to Stamp Duty;
- the absence of a legal framework for such settlement service providers to collect transaction taxes on transactions that take place in their books and to pay and report this to the tax authorities; and
- the denial of exemptions of Stamp Duty, if transactions linked to the one for which the exemption is requested are not settled in a relevant system.

This issue may in the first place be important for the tax authorities whose concern is lost revenues. However, it may also put settlement service providers that are not approved as an operator of a relevant system at a competitive disadvantage.

A possible solution would be for Ireland to clarify by legislation whether transactions in securities interest taking place in the books of a settlement service provider that is not an operator of a relevant system are taxable. Such legislation could provide that such transactions are not taxed<sup>26</sup>, in which case

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<sup>26</sup> Current rules already foresee an exemption for transfers of depository receipts representing Irish or non-Irish shares where the receipts are traded on a stock exchange in the USA or Canada.

the issue disappears. However, such exemption would risk creating an uneven playing-field between approved and non-approved systems as well as an incentive for settling transactions in non-approved systems.

Alternatively, such legislation could make it clear that transactions with securities interest in the books of non-approved systems are also taxable. In order to create a level playing-field in such cases, the legislation should also allow an operator of a non-approved system to collect the tax under conditions similar to those granted to operators of an approved system.

It should be noted, however, that even if Irish rules were to foresee a level playing-field between approved and non-approved systems in this respect, the mere requirement to collect stamp duties on transactions in their books would constitute a significant commercial barrier for accepting Irish chargeable securities (cf. *infra*) and most likely not achieve the goal of allowing investors to choose the service provider they prefer for the settlement of their transactions.

### **3.3. UK STAMP DUTY RESERVE TAX (SDRT): DEFINITION OF CLEARANCE SERVICE UNDER SECTION 96 FA 1986 (UK)**

Under Regulation 4A of the Stamp Duty Reserve Tax (SDRT) Regulations 1986, operators of a “relevant system” under the Uncertificated Securities Regulations 2001 are required to:

- (i.) give notice to the Board of Her Majesty's Revenue & Customs (HMRC) of each charge to tax arising in respect of transactions carried out through the relevant system; and
- (ii.) to pay the SDRT due on those transactions.

The UK Uncertificated Securities Regulations permit any person who satisfies requirements as to security, resources, practice and systems to operate a system under which shares in UK companies can be transferred through the system. So far Euroclear UK & Ireland Limited is the only system which is approved, but there is no national barrier to approval. Operators that are approved fall under the SDRT Regulations for such operator systems and must comply with the obligations imposed by the Regulations and, more particularly, Regulation 4A.

The UK SDRT rules also foresee a specific regime for securities transactions settling in the books of settlement service providers that are not an approved operator of a “relevant system”, namely the special regime for so-called “clearance services”. Under this regime there is a 1.5% season ticket charge on entry into the system, but once into a clearing system the basic 0.5% charge on transfers is not payable. Under Section 97A FA 1986, the operator of a clearance service can elect that the clearing service charge does not apply, provided they enter into appropriate arrangements with HMRC under

which they will account for the 0.5% charge arising on transfers within the clearance service.

In practice, the clearing system that considers doing so needs to contact the HMRC in order to agree upon:

- (i) how SDRT will be accounted for, paid and reported to HMRC;
- (ii) how higher rates and relief are applied;
- (iii) appropriate audit information and material;
- (iv) how to deal with clearing service clients; and
- (v) the termination arrangements.

Once agreement on the above items has been obtained, the clearing system needs to document all the above items in a document – a so-called “97A election” which is then reviewed and approved by the Board of the HMRC.

If the clearing system is not resident in the UK, the HMRC may request the appointment of a tax representative.

HMRC in the UK provides some general guidance as to the issues on which they will require to be satisfied before agreeing to such an arrangement. These include things like compatibility with accounting for SDRT through Euroclear UK & Ireland Limited, ensuring all chargeable transactions are reported and duty paid, ensuring a flow of audit information which is accessible in the UK and the need for a non-UK clearance service to appoint a UK representative. Certain details of those practical requirements may be discussed with HMRC to ensure that no barrier is created by the imposition of local requirements such as maintenance of information in the UK and the need for a UK representative.

The FISCO Group considers that the definition of a clearing system is unclear in relation to Stamp Duty Reserve Tax (SDRT) purposes, which may prevent a level playing-field between settlement service providers that are considered a clearing service (such as CSDs) and those who are not.

One feature of the concept of clearance service as envisaged by the UK legislation seems to be the ability to internalise settlement. It has been argued that the ability to internalise settlement is not limited to CSDs. Any Euroclear UK & Ireland Limited member, for example, can settle a transaction on its own books without the need to forward settlement instructions to Euroclear UK & Ireland Limited, provided both contracting parties use the services of the same member. This is correct, but looking at the terms of the UK legislation, the higher rate charge applies where a person enters into an “arrangement” to provide clearance services and it is possible that one reason why Euroclear UK & Ireland Limited member custodian/nominees are not generally regarded as such is that they do not enter into such arrangements. It is likely that these kinds of movement occur where a client may have given an instruction to purchase and another instruction to sell and the custodian can generate a match internally rather than a case of actually setting out to provide

that type of service. There may well be instances where these services are being provided without notifying HMRC or indeed accounting for the tax either at the standard or higher rates. It is certainly the case of transfers of beneficial ownership which are internalised and within the scope of the charge to SDRT at 0.5% under Section 87 FA 1986. There is a mechanism for reporting such transactions via Euroclear UK & Ireland Limited and for accounting for the SDRT due. This is known as a non-settling on account transaction (NCOAT). The Euroclear UK & Ireland Limited blue book gives an example of this (on page 39 of the blue book).

The FISCO Group recommends that the uncertainty as to what a clearing system is for UK Stamp Duty and Stamp Duty Reserve Tax (SDRT) purposes be addressed by UK legislation or by HMRC, clarifying what the criteria are for maintaining that an organisation provides a clearance service. Such criteria would have to distinguish the situation of a clearance service from the functions that Euroclear UK & Ireland Limited perform, otherwise Euroclear UK & Ireland Limited itself would need to elect for the alternative 0.5% charge instead of the 1.5% charge on entry. There is a need for a coherent and consistently applied test for what is a “clearance service”. The concept should not be applied in a convenient way by the tax authorities merely as a tool to enable them to collect a compensatory amount of tax whenever they envisage that, on future dealings, it may be practically inconvenient for them to collect the 0.5% dealing charge. If there is not a consistently applied concept, then there could be an argument that the legislation is being applied in a way which results in unequal treatment between settlement service providers.

#### **3.4. PROVISIONS REQUIRING SETTLEMENT SERVICE PROVIDERS TO COLLECT TRANSACTION TAXES AS A BARRIER PER SE**

Since the publication of the First FISCO Fact-Finding Study (FFS), several CSDs have expressed their concern about the fact that, even if the relevant rules allowed them to collect transaction taxes under conditions similar to those granted to any other settlement service provider, the mere requirement on CSDs to collect transaction taxes still constitutes a significant obstacle and creates operative risk exposure preventing them from accepting securities subject to such transaction taxes (and hence reduces the choice of settlement service providers for such securities).

As a matter of fact, such a requirement will often not be compatible with the business model under which foreign CSDs operate:

- many CSDs do not have access to information on individual trades at the level of beneficial owners. This is due to the fact that the settlement instructions, that they are receiving from clearing organizations and their members, relate to netted transactions which result after the mutual obligations of the buyers and sellers trades are offset by the clearing organization. Access to such individual transactions at the level of the beneficial owners is a prerequisite to ensure the collection of transaction taxes;

- not all CSDs have access to a cash account of their members, which prevents them from collecting the tax through a simple debit instruction to such an account.

In addition, the maintenance of an IT-environment with the capacity necessary to compute, collect and pay transaction taxes is costly. The cost of developing such systems is economically relevant for a local provider. Compliance by remote settlement service providers, with the legislative requirements of the jurisdiction of incorporation of the company whose shares are traded, would mean that such service providers would have to build systems and incur expenses of compliance which they could not justify commercially.

The only logical recommendation which can ultimately be made to address the above, unless changes in local legislation or non-commercially justifiable changes in business model were made, would be not to impose the tax collection responsibilities on local settlement service providers. However, the FISCO Group acknowledges that it may be difficult to find an alternative tax collection mechanism that would give sufficient tools to local tax authorities to enforce the collection of the transaction tax, especially for transactions between non-resident counterparties.

### **3.5. CONCLUSIONS ON TRANSACTION TAX PROCEDURES**

- As regards Ireland, it is necessary to clarify the treatment of transactions in the books occurring in those settlement systems that are not an operator of a relevant system. At a minimum, the rules should cater for a level playing-field between all settlement service providers and between investors.
- As regards the UK, it is necessary to clarify the definition of clearance system and the criteria used. Then it is possible to consider why some systems are regarded as meeting the definition and others are not. Again, the definition should result in a level playing-field amongst all settlement service providers.
- In general, any regime requiring transaction tax to be collected by settlement service providers, even without discriminating as regards the legal status of residency of such a provider, will constitute a significant obstacle, dissuading or preventing foreign CSDs from accepting securities subject to such transaction tax. The SDRT gives comparable audit and enforcement powers to the relevant tax authorities to collect the tax (in particular for transactions between non-resident counterparties) however, it does not ensure a level playing-field between all settlement service providers irrespective of their residency or legal status, and it is not compatible with some of the business models for trading, clearing and settlement of securities transactions.
- The only logical recommendation which can ultimately be made to address the above would be not to impose the tax-collection responsibilities on local settlement service providers. However, if the tax is maintained with settlement service providers, the FISCO Group could not identify another

tax collection mechanism that would give comparable audit and enforcement powers to tax authorities and would ensure a level playing-field and compatibility with various business models.

## 4. CONCLUSIONS

### 4.1. CONCLUSIONS ON WITHHOLDING TAX PROCEDURES

The withholding tax relief procedures which exist in Member States do not, at present, take sufficient account of the multi-tiered holding environment. The present procedures are therefore costly and inefficient. The FISCO Group is of the opinion that *at-source relief procedures* are the best method to improve the present situation because of the optimized cash flow they offer to investors.

Many of the present administrative and efficiency problems can only be resolved by *shifting withholding responsibilities* to intermediaries, and by allowing all intermediaries in the custody chain to assume withholding responsibilities or to take responsibility for granting withholding tax relief.

The withholding tax relief procedures differ substantially between the Member States. This is a serious problem, since intermediaries incur substantial costs to cope with these differences or may forego the relief to which their clients are entitled because of the costs attached thereto. To solve these problems, it is necessary that a *harmonised withholding tax relief procedure* be introduced.

Even though relief at source is the preferred relief method, there is a clear need also for efficient *refund procedures*.

#### 4.1.1. *Conclusions on at-source relief procedures*

##### 4.1.1.1. **Shifting withholding responsibilities**

- Many of the administrative and efficiency problems identified in the FISCO Fact-Finding Study can be resolved by eliminating the need to pass on detailed information on beneficial owners through the custody chain up to the local withholding agents. This can be best achieved by allowing any intermediary in the chain to either assume full withholding responsibilities or to take responsibility for granting withholding tax relief by sending pooled withholding rate information to the upstream intermediary.
- This possibility would be enhanced by the abolishing of the requirement of paper-form certification and the permission to allow intermediaries to make use of modern technology to pass on beneficial owner information to the local withholding agent in electronic format and to allow the use of pooling of assets into tax-rate pools.

- The Responsible Withholding Agent must assume the tax withholding responsibility “itself”, i.e. the obligation to deduct and deposit withholding tax with the relevant tax authority of the issuer country as well as collecting beneficial owner information that is passed on and/or reported to other intermediaries.
- In national laws, there should be clear provisions of the legal responsibility of the withholding tax deduction and collection.
- Withholding agents or other intermediaries should only be responsible for non-compliance with their own obligations. No liability may be imposed on authorised intermediaries acting in "good faith". This should be the case both for beneficial owner information collection and for tax collection, if any. The concept of “good faith” should also be defined clearly in law.
- Some general EU rules and guidelines for the concept of acting and relying on information received in "good faith" should be implemented. There should also be some guidelines for harmonising the requirements of how long information or documents must be kept by intermediaries and/or withholding agents.
- It should be possible to transfer funds to authorized foreign intermediaries in Member States (who cannot opt themselves for withholding responsibilities) net of treaty rates based on information received in "good faith".
- In some Member States' jurisdictions, the withholding responsibility is reserved for those issuers or intermediaries who are residents of the issuer country. Accordingly, shifting the withholding responsibility abroad may require a change of the relevant laws.
- However, the shifting of responsibility may be done on the basis of a contract. The recommended contractual agreement between the tax authority and the foreign or local intermediary will, for its part, require a legal basis under the law systems of many Member States. Such legal bases should be generally established by way of ministerial regulations or decrees in contrast to formal laws issued by the legislative bodies.
- Involving both the tax authorities and external auditors in an audit, by means of co-actions is the option preferred by the FISCO Group. The audit of the external auditor should focus on periodical on-site systems checks. The tax authority of any issuer country



should have access to the external auditor's report; they should also have the possibility to verify the tax relief granted by the Responsible Withholding Agent or the Responsible Non-Withholding Agent in individual cases. Besides the audit methods mentioned, no additional action or even separate audit seems necessary.

#### **4.1.1.2. Simplification and harmonisation**

- An EU Tax Relief Procedure is proposed in order to facilitate the clearing and settlement of securities within the Member States by simplifying and harmonising the tax relief procedures. The EU Tax Relief Procedure should be built on a model allowing for the appropriate tax relief to be applied at source without excessive documentation requirements and without exposing issuers, intermediaries and investors to unnecessary risks and costs. The Procedure should work in an equally efficient way, irrespective of the location in which securities are held or transactions settled and irrespective of the investment structure or settlement arrangements chosen by the investors and intermediaries and ensure equal treatment of foreign and local intermediaries.
- With respect to individuals it is often sufficient to rely on general know-your-customer rules (KYC) only. For corporate investors, or in special cases, it may be needed to request additional information to be provided. In this connection, FISCO has a preference that such additional information be limited to a self-certification.
- The EU Tax Relief Procedure should be based on a common standard of information collection of beneficial owners, mainly based on self-certification by the beneficial owner. This common standard should be included in a single document, valid in all the EU Member States, presented upon opening an account or deposit. It should be possible to pass this document to authorities electronically, without the need for it to be renewed on a regular basis.
- Intermediaries should be allowed to pass on information and withhold tax based on the reliance on information received in "good faith" between authorized intermediaries in the Member States, and provided the self-certification principles are respected. This should be done without the requirement to provide or receive evidence of the beneficial owners' tax residency ahead of each payment. This model should be defined in EU

guidelines and applied in domestic tax laws/guidelines, and be monitored and audited by local tax authorities.

- Besides the aim of tax relief at source in the EU Tax Relief Procedure, the proposed harmonisation and simplification of certain information collection of forms for self-certification, and of the refund procedures, is also a very important goal in itself. Although the complete EU Tax Relief Procedure is the primary proposal and goal of the FISCO Group, the harmonisation and simplification work in other respects such as harmonising forms and other procedural issues is also very important. This work – which is already similarly conducted by other groups and bodies, such as the IFA/OECD PATT Project and the Group 30 ISSA Model Project - could start immediately, preferably by forming an EU group to review these issues. This group should be composed of participants from interested Member States, and should include representatives from both private bodies and tax authorities.

#### **4.1.2. *Conclusions on refund procedures***

- A supplementary refund procedure should be standardised throughout the Member States by using a similar form for application and implementing a harmonized time-limit for the application of refund.
- *One-Stop-Shop*. Standard refund procedures should be centralized in each country to one tax authority or tax office only.
- *One Form*. Standardised forms for application throughout the Member States should be implemented.
- *One Time-Limit*. The time-limit for a refund application should be harmonized throughout the Member States, e.g. 4-5 years after the year of distribution.

#### **4.1.3. *Substantive rules that constitute a barrier***

- In cases where only local settlement service providers or CSDs are allowed to collect the withholding tax, foreign settlement service providers that are holding the securities with a local CSD may be precluded or discouraged from settling taxable transactions on their own books due to the fact that the local settlement service providers need to intervene in the settlement on individual transactions in order to be able to collect that tax. This problem could be resolved by allowing foreign CSDs or settlement service providers to assume responsibility for tax collection and relief without needing to appoint a local fiscal representative, and thus ensuring a level playing-field between local and foreign settlement service providers.

## 4.2. CONCLUSIONS ON TRANSACTION TAX PROCEDURES

The FISCO Group recommends the following as regards transaction tax procedures:

- As regards Ireland, it is necessary to clarify the treatment of transactions in the books occurring in those settlement systems that are not an operator of a relevant system. At a minimum, the rules should cater for a level playing-field between all settlement service providers and between investors.
- As regards the UK, it is necessary to clarify the definition of clearance system and the criteria used. Then it is possible to consider why some systems are regarded as meeting the definition and others are not. Again, the definition should result in a level playing-field amongst all settlement service providers.
- In general, any regime requiring transaction tax to be collected by settlement service providers, even without discriminating as regards the legal status of residency of such a provider, will constitute a significant obstacle, dissuading or preventing foreign CSDs from accepting securities subject to such transaction tax. The SDRT gives comparable audit and enforcement powers to the relevant tax authorities to collect the tax (in particular for transactions between non-resident counterparties) however, it does not ensure a level playing-field between all settlement service providers irrespective of their residency or legal status, and it is not compatible with some of the various business models for trading, clearing and settlement of securities transactions.
- The only logical recommendation which can ultimately be made to address the above would be not to impose the tax-collection responsibilities on local settlement service providers. However, if the tax is maintained with settlement service providers, the FISCO Group could not identify another tax collection mechanism that would give comparable audit and enforcement powers to tax authorities and would ensure a level playing-field and compatibility with various business models.



## ANNEX I.

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### REFERENCE TO EUROPEAN COURT OF JUSTICE (ECJ) CASES

**This Annex gives a non-exhaustive list of ECJ cases that are relevant to the matters discussed in this report.**

#### **Reference to ECJ cases:**

##### **1. ACCESS TO FISCAL RELIEF SUBJECT TO DIFFERENT CONDITIONS – PRECLUDED**

- Svensson and Gustavsson in C-484/93, ECR (1995), p. I-03955, Para 19 (making the grant of housing benefit subject to the requirement of domestic residence – precluded);
- Futura Participations in C-250/95 ECR (1997), p. I-02471, Para 43 (making the carry forward of losses for tax purposes, subject to the requirement that accounts must be kept in compliance with the relevant national rules – precluded);
- Safir in C-118/96, ECR (1998), p. I-01897, Para 34 (filling the fiscal vacuum arising from the non-taxation of savings in the form of life assurance policies taken out with non-Swedish companies by introducing a special tax – precluded);
- Société Baxter in C-254/97, ECR (1999), p. I-04809, Para 19 (preventing the taxpayer from submitting evidence for the expenditure relating to research carried out in another Member State – precluded);
- Bent Vestergaard in C-55/98, ECR (1999), p.I-07641, Para 25 (preventing the taxpayer from submitting evidence for the deduction of the costs of training courses, taking place in another Member State – precluded) - Skandia in C-422/01, ECR (2003), p. I-06817, Para 56 (pension insurance premiums are deductible, still subject to the condition that the insurance company must be established in Sweden – precluded); and
- Commission v Denmark in C-150/04 (judgment of 30 January 2007), Para 58 (the mere fact that a taxpayer makes contributions to a pension scheme taken out with an institution established outside Denmark cannot form the basis for a general presumption of tax avoidance or justify a fiscal measure which prejudices the enjoyment of a fundamental freedom guaranteed by the EC Treaty).

## **2. NON-JUSTIFIABLE RESTRICTION ON PROCEDURAL RIGHTS**

- Bruno Barra in case 309/85, ECR (1988), p. 00355, Para 17 (the citizen's right to enforce the repayment of amounts charged by a Member State in breach of Community law is the consequence and complement of his/her substantive rights);
- Metallgesellschaft and Hoechst in joined cases C-397/98, C-410/98, ECR (2001), p. I-01727, Para 107 (restriction by the national public authority on a claim on the grounds that the taxpayer did not get involved in burdensome administrative proceedings to seek remedy first -- precluded);
- Fokus Bank in E-1/04 (judgment of 23 November 2004), Para 43 (in the absence of fiscal nexus, non-resident shareholders are denied procedural rights and cannot be a party to tax administrative proceedings – precluded).

## **3. EQUIVALENCE OF THE TREATMENT ACCORDED IN DIFFERENT MEMBER STATES**

- Société Baxter in C-254/97, ECR (1999), p. I-04809, Para 17 (national tax authorities are not prevented from benefiting from the harmonized company law directives on annual accounts);
- Bent Vestergaard in C-55/98, ECR (1999), p.I-07641, Para 26 (the EC Assistance Directive can be invoked by tax administrations);
- Skandia in C-422/01, ECR (2003), p. I-06817, Para 42 (the EC Assistance Directive can be invoked by tax administrations).

## ANNEX II.

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*(List updated September 2007)*

