WITHHOLDING TAX ON DIVIDENDS BETWEEN MEMBER STATES

Impact assessment of abolition of all withholding tax on dividends between EU-countries

CHALLENGES AND OPPORTUNITIES FOR EUROPEAN COMPANIES

The practice of withholding taxes on dividends on cross-border portfolio investments constitutes one of the main obstacles to an integrated capital market in the EU. This is especially so for institutional investors (Collective Investment Vehicles, CIV). In most cases, such entities cannot qualify for withholding tax relief in their country of residence, as they pay little or no tax themselves against which to claim the relief. For all portfolio investors, however, the procedure of reclaiming excess withholding tax (in the source country) and obtaining credit for paid withholding tax (in country of residence) can be cumbersome, especially considering the relatively small amounts in question.

As the withholding tax is a gross tax (at source, in one Member State) it may in some cases conflict with the net taxation of the taxpayer in another member state (the country of residence). E.g. if the taxpayer's capital income is net negative, but he/she must still pay withholding tax on dividends from another Member State. In such a case, the withholding tax directly conflicts with the free movement of capital, as portfolio investments in another member state is discouraged.

The net effect of the withholding tax on dividends between EU Member States is to increase the cost of capital and hamper cross-border portfolio investments.

Abolishing withholding taxes on cross-border portfolio investments between Member States will remove a significant obstacle to the flow of capital within the EU, thus lowering the cost of capital.

For Member States, the withholding tax is on the one hand a source of income (on dividends paid to taxpayers in other Member States). On the other hand, however, it is an expense (as resident taxpayers claim tax relief for withholding tax paid in other Member States).

To our knowledge, no one has conducted an impact assessment of the effects of an abolition of the withholding tax on dividends between EU Member States, including the net effects on tax revenues in each Member State.

STATUS AND EXISTING EU LEGISLATION

Following the parent / subsidiary directive, there is no withholding tax on the dividends from foreign direct investments (FDI) between Member States. However, in the case of portfolio investments, the "source country" has the option of collecting a withholding tax (WHT) on the payment of dividends to foreign taxpayers (portfolio investors). The size of the WHT is regulated in bilateral tax treaties. In the case of dividends between EU member states, the WHT imposed typically varies between 10 and 15 percent.

In many instances, however, a larger WHT is initially withheld at source, leaving the taxpayer the option of claiming a refund (down to the WHT rate set in the bilateral tax agreement) from the source country. Then he/she may offset the remaining WHT against the capital income tax in the country of residence.

In 2010, the Commission published its recommendations regarding the procedure for claiming relief for withholding taxes.

This issue is also addressed by the Commission's Action Plan on Building a Capital Markets Union.

RECOMMENDATIONS

- The Commission should take steps towards the abolition of all withholding tax on dividends between member states.
- First and foremost, the Commission should conduct an impact assessment of the proposal, including net effects on the tax revenues of each member state.
- The impact assessment should also explore the option of only abolishing the withholding tax on dividends to CIV.

THIS PROPOSAL IS ALSO SUPPORTED BY

The need to remove the withholding tax on dividends from portfolio investments between EU member states was addressed in BusinessEurope's reply to the Commission Consultation regarding the Capital Markets Union, in May 2015.

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