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FEASIBILITY STUDY ON A STANDARDISED “RELIEF AT SOURCE” SYSTEM IMPLEMENTING THE PRINCIPLES OF THE FISCO RECOMMENDATION	

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EXECUTIVE SUMMARY TO THE FINAL REPORT

This report highlights the main findings, conclusions and recommendations arising from the feasibility study on a simplified relief at source system, implementing the principles of the European Commission's FISCO Recommendation (C(2009)7924 of 19 October 2009).

The FISCO Recommendation suggests to the Member States (MSs) possible ways to make their withholding tax (WHT) relief procedures on cross-border securities income simpler and more efficient. In particular, the Recommendation designs the main features of a simplified relief at source system whereby authorised financial institutions (AIs) would be able to make claims on behalf of their investors and on a pooled basis. This would be coupled with the provision of investors' specific information to both the source and the resident countries (SC and RC).

The current trend is towards more exchange of information across borders and there are a series of initiatives taken at international level in that respect: the US Qualified Intermediary (QI) system and FATCA; the EU Savings Directive and some OECD work (in particular, the "TRACE" project, which is similar to the FISCO work).

In the framework of this study, the main question is “how”, in the context of a simplified relief at source system, the international exchange of information should be organised both towards the SC (to ensure correct application of the double tax treaty (DTT) rates) and towards the RC (to ensure correct income tax treatment) with specific consideration to the channels used in this respect. In this regard, the study covers the assessment of two potential Models: the Source Country (SC) Model and the Authorised Intermediary Country (AIC) Model.

The AIC Model largely corresponds to the SC Model, whose main elements and principles are described in the Implementation Package and are being followed up in the TRACE discussions. The major difference between the two Models lies in the communication channels used to have the investors' information reported to the SC and RC: in the AIC Model, the AI reports the information directly to the tax administration of the country where it is established. This variation has an impact on other principles that have been defined in the study (e.g. legal tool to be used to implement the proposed system; recognition process; audit process).

These two approaches have been examined and compared from the following main perspectives: a) Interaction with EU and International Administrative Cooperation Framework; b) Legal tools available in the EU; c) Data Protection Analysis; d) Effectiveness and Tax Compliance; e) Fraud Analysis; f) IT Analysis and g) Cost-benefit Analysis. The findings of the analysis conducted with respect to each of the above-mentioned aspects are as follows:

No Suitability of the EU and International Administrative Cooperation Framework. An analysis of the existing international administrative cooperation framework shows that the Savings, the Administrative Cooperation, the Recovery Directives and other cooperation instruments as they currently stand are not directly suitable to support the exchanges of information that are required as part of the application of a relief at source Model without specific amendments and this, irrespective of the Model used.

From the study, it appears that **a Directive would be the most appropriate binding form of legislation to implement either of the contemplated Models across the EU.** If a Directive were gone for, it would have to be sufficiently detailed (and probably supplemented by regulations) in order to ensure the uniformity required for a relief at source and exchange of information system to be efficient. Various factors (the side effects, within the EU, of the Intergovernmental Agreements MSs are going to sign with the US to improve tax compliance and to implement FATCA; the possibility for MSs to set up enhanced cooperation between themselves; and the “mandatory” spontaneous exchange of information required towards non-participating MSs) could mean faster agreement between MSs.

When interacting with third countries, bilateral agreements would have to be concluded. In order for a country outside the EU to be able to participate in the system, an agreement with specific clauses to enable the different actors to contract on a bilateral basis would have to be signed with that specific country. Specific clauses should be provided for, ideally in the common rules, governing EU MSs' interaction with third countries.

As both Models (AIC and SC) entail the collection and cross-border exchange of personal (tax) information regarding individuals by financial intermediaries and tax administrations, possible data protection concerns could arise from the implementation of one of these Models.

The creation of a legal basis (Directive or other binding legal instrument) is the most appropriate way forward to set a clear legal framework on how personal data could legally and validly be exchanged between countries. This legal basis should ensure the needs of the simplified WHT relief at source system are reconciled with the basic human rights of the data subjects involved (i.e. the Investors).

In terms of effectiveness and tax compliance, both Models offer advantages but, globally, the AIC Model seems more convincing. The AIC Model offers more guarantees to the RC that it will receive the same information as the SC, and in a timely manner, while the SC Model only refers to a memorandum of understanding that will need to be signed on a bilateral basis (between the SC and each RC) and whose terms still need to be set down.

Both Models as they currently stand provide tax administrations of SCs and RCs the opportunity to combat some of the fraud risks existing in the current situation. Given their identical scope, the fraud risks tackled by both Models are similar in substance.

However, the contemplated Models currently present crucial limitations: neither of the two contemplated Models provides for exchange of information to the RC on cross-border securities income payments in the absence of application of a DTT, neither provides for an exchange of information to the RC about the principal and its origin, especially with the option left to the investor not to request DTT application. Although these limitations are inherent to the system and depend on the fact that both Models are mainly aimed at simplifying WHT relief procedures, they should be taken into account in a perspective where more focus is given to the fight against tax fraud/evasion.

The adaptability of the Models to integrate these adjustments is an important factor. In that respect, the AIC Model seems more robust than the SC Model. Nevertheless, even when “adjusted”, the Models would not be “fraud-proof”.

From an IT architecture point of view, the AIC Model appears to be the most cost-efficient for the tax administrations of the MSs and the FIs. Besides that, the AIC Model requires a lesser implementation and operation effort, for both tax administrations and AIs, as the required IT solution bears greater similarity to the IT systems used by the current Savings Directive. Tax administrations would not need to communicate with non-resident AIs (required under the SC Model). Hence the implementation and operation efforts related to these cross-border transfers would be avoided. In addition, the SC Model would force AIs and tax administrations to cope with the different national data transfer and encryption standards of other MSs as there is a lack of pan-European standards for the exchange of data between AIs and tax administrations. Furthermore, these cross-border data exchanges would significantly increase the total number of connections needed as each tax administration would have to be able to exchange data with all AIs of all participating MSs.

In addition, the study identifies the low quality of data sent by financial institutions under the current Savings Directive as a still prominent concern for all participating MSs. The introduction of structured formats and common rules of procedure helped to increase the quality of data compared to that exchanged under DTTs. However, the quality of the data sent by financial institutions to MSs still needs particular attention. This study therefore suggests incorporating data-quality-improvement activities within the implementation programme for the simplified relief at source system.

A cost/benefit analysis per stakeholder shows that the new relief at source procedure will be relatively costly. However, there are also clear benefits, depending on the type of stakeholder. Even if these gains have not been expressed in monetary value, they should wholly or partially offset the costs. More importantly, the new situation will allow all investors to benefit from a right which has been formally awarded to them via DTTs but which in practice they cannot exercise at present due to the many obstacles and barriers existing across the EU. Considering the reduced tax rate granted via the DTTs, the new procedure should implement an efficient, secure process to ensure that the WHT rate is applied correctly.

There exists a clear preference for the AIC Model. Where some MSs appear to be in favour of the SC Model, others prefer the AIC Model. Be that as it may, the selected model will need to demonstrate its ability to easily integrate third countries.

Stakeholders are against the two Models coexisting, one within the EU (AIC Model) and the other concerning third countries (SC Model). Coexistence is perceived as negative by the MSs and especially by the FIs, which are often located in different countries and on different continents due to the increased level of complexity it will impose. Special attention should be paid to the recent developments in the framework of FATCA.

It is very important to ensure that the financial sector across the EU is globally interested in whatever Model proposed. As they currently stand, both Models rely on voluntary participation by the AIs in the system. In this respect, we recommend the European Commission to conduct an in-depth consultation process which would involve not only the business representatives that have been involved, so far, in the FISCO work, but business representatives from all Member States, from different sectors and of different size. Otherwise, there may be a risk that the system as implemented could be adopted only by a limited number of financial institutions across the EU.

The implementation of a WHT relief at source system is a Trans European project involving different stakeholders (Tax administrations, financial intermediaries, Commission, Investors, etc). Risks and Interdependencies will need particular attention to ensure a successful delivery. The need to reach unanimity should a proposal for a Directive be tabled by the Commission, the need to obtain the buy-in from all stakeholders, and the political priorities are all aspects that will have a significant impact on the timing for the implementation of a Simplified Relief at Source System. Besides a proper project and change management, the efficiency of the system will also depend on the data quality and on the willingness from various stakeholders to implement a new relief at source system.

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EXECUTIVE SUMMARY TO THE ADDENDUM

This report updates the main findings, conclusions and recommendations of the final report to the feasibility study on a standardised relief at source system, implementing the principles of the European Commission’s FISCO Recommendation (C(2009)7924 of 19 October 2009).

The content of this addendum focuses on three main aspects:

- Analysis of the Most-Favoured Nation clause included in Art. 19 of the EU Directive on Administrative Cooperation (2011/16/EU) and its potential impact in terms of compliance in residence Member States.
- Review of the conclusions of the final report to the feasibility study with regard to implementation of the relief at source system laid down in the Implementation Package from three points of view: functionalities; information channels (routing); and practical implementation.
- Interactions and potential synergies between existing and upcoming exchange of information systems (residence-country reporting and source-country reporting systems).

1. Most-Favoured Nation Clause

Entering into an intergovernmental agreement with the United States (either based on Model 1, reciprocal or not, or based on Model 2) to implement the Foreign Account Tax Compliance Act (FATCA) should trigger application of the Most-Favoured Nation clause: from a legal point of view, the Directive on Administrative Cooperation, with the aid of that clause, creates a right for each Member State to request an equivalent level of cooperation on tax matters from other Member States that have signed an intergovernmental agreement on FATCA with the United States (and even without an intergovernmental agreement in the case of unilateral cooperation on tax matters granted by a Member State to the United States). Having said that, it is important to note that the Most-Favoured Nation clause only applies in the European Union and not with regard to third countries.

There would most probably be a difference in terms of the cooperation that a Member State could require from another Member State depending on the type of intergovernmental agreement entered into (Model 1 or Model 2) and on the actual needs of the Member States participating in the wider cooperation (in terms of the content of the information provided in particular). For instance, the channels of information used could be different, the exchange of information could either be automatic or on request, etc.

Apart from that, implementation of the Most-Favoured Nation clause may entail numerous issues. In particular, it has not been designed to trigger a brand new comprehensive administrative cooperation system such as that provided for in the intergovernmental agreements (covering various aspects on top of the mere exchange of information, from due diligence procedures to penalties in cases of non-compliance to withholding in specific circumstances). Moreover, if applied bilaterally, the Most-Favoured Nation clause will ultimately lead, at best, to an uncoordinated framework.

As a result, the Most-Favoured Nation clause will be very difficult to apply on a large scale if no coordinated approach is taken at the level of the European Union.

At a minimum, since Member States know that there is the potential for application of the Most-Favoured Nation clause in each and every bilateral relationship between Member States that have entered into an intergovernmental agreement with the United States (potentially all of them), their concluding intergovernmental agreements should be understood as a clear political agreement to move towards wider cooperation with each other in terms of residence-country reporting.

The focus in the European Union should consequently move from mere “conceptual” questions (Do the Member States want to improve residence-country reporting, in particular for dividends for instance? etc.) to “practical” questions (How do you further extend residence-country reporting in the European Union? Are the existing channels of information still suitable? How do you leverage on and align with the existing exchange of information systems? etc.).

2. Relief at Source System (Functionalities, Routing and Practical Implementation)

The particulars expected to be exchanged under the Most-Favoured Nation clause are likely to be sufficient to meet the policy objective of ensuring compliance in the residence country. As a result, in the European Union, the reporting from source country to residence country in the framework of the relief at source system proposed in the Implementation Package does not appear to be as necessary as before. More importantly, the gap in terms of tax compliance created by the absence of residence-country reporting when double tax treaty benefits were not requested by the taxpayer, which was the major issue identified previously, is now filled given that such residence reporting should apply irrespective of the claim of treaty benefits pursuant to application of the MFN Clause. When considering the interaction with third countries, however, the residence-country reporting provided for under the Implementation Package nevertheless continues to be required in the absence of a generalised residence-country reporting system on its own (the Most-Favoured Nation clause not being applicable). For the sake of consistency, it may therefore be considered also keeping the residence-country reporting provided for in the Implementation Package within the European Union (at least for a certain period of time).

It is not really opportune to simplify the source-country reporting provided for in the Implementation Package by not requiring the Authorised Intermediary (AI) to send the Annual Information Report to the source country. The source country might indeed require such reports from time to time anyway in order to carry out spot checks. Besides, it is quite possible that third countries that intend to implement a standardised relief at source system would follow the Implementation Package (presumably) so that consistency again pushes in favour of having similar reporting within the European Union.

As far as residence-country reporting is concerned, the Savings Directive, the intergovernmental agreements concluded and under negotiations by Member States with the United States (under Model 1), the Most-Favoured Nation clause and the Directive on Administrative Cooperation already provide for reporting of information by financial institutions passing through the tax administrations of the countries where they are established (“indirect” routing). In addition, in the European Union, such “indirect” routing to the Source Country presents some valuable advantages (number of information flows, IT, data protection, etc.). There are therefore strong arguments in favour of “indirect” routing, also for source-country reporting purposes. However, such routing will be harder to implement vis-à-vis third countries, so that it might well be that direct and indirect reporting by financial institutions will coexist, which should not as such be a problem, however.

Finally, the administrative cooperation framework existing within the European Union offers solid grounds for practical implementation of the relief at source system amongst Member States, to be coordinated with a view to making it more efficient (joint audits, etc.).

3. Interaction and Potential Synergies

Residence-country and source-country reporting systems are very different, so that they could be aligned in only a few regards.

However, the situation is different when only considering residence-country reporting systems, where the alignment possibilities are much broader. Within the European Union in particular, it is highly advisable to avoid ending up with several residence-country reporting systems: the current reporting arrangements under the Savings Directive, the automatic exchange of information provided for under Art. 8 of the Directive on Administrative Cooperation (automatic exchange of information on some categories of available information) and any new arrangements required as a result of the Most-Favoured Nation clause should be aligned. International developments will have to be closely monitored at that stage in order to ensure the greatest possible interoperability of residence-country reporting systems in the European Union and with third countries.

As a result, it is preferable to have two different systems for two different purposes: this would indeed be much more straightforward and clearer to all stakeholders, including the businesses and citizens of the European Union, and, provided it were aligned to international developments, it could prove efficient and not too burdensome for businesses and tax administrations.

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On the one hand, we should thus have a Source-Country reporting system for treaty relief purposes, which could be based on the Implementation Package, irrespective of the routing of the information exchanged (direct reporting by the Authorised Intermediary to the Source Country or indirect reporting through the Authorised Intermediary Country).

On the other hand, we should have Residence-Country reporting focusing only on compliance in the residence country. This reporting should take into account international developments in the area of information exchange (including FATCA and the Model intergovernmental agreement that the U.S. has developed to implement it), to the extent these developments do not contradict EU law.

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