Tax Policy Alert

European Commission FASTER Directive would harmonise withholding tax procedures in the EU

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In brief

The European Commission published the draft Faster and Safer Relief of Excess Withholding Taxes (FASTER) Directive on 19 June to encourage investment in the Single Market by making withholding tax procedures in the European Union more efficient and secure for investors, financial intermediaries and Member State tax administrations. FASTER is a key element of the Communication on Business Taxation for the 21st Century, and the Commission's Action Plan on the Capital Markets Union 2020. The Capital Markets Union (CMU) is a plan to create a single market for capital, allowing investors to benefit regardless of their location. FASTER responds to calls for standardised withholding tax procedures and is estimated to save investors around €5.17 billion per year. The proposal, while promoting 'faster' is also promoting 'safer,' so includes anti-avoidance provisions, as well as new obligations for both financial institutions and tax administrations. Once adopted by EU Member States, the proposal is expected to come into force on 1 January 2027.

In detail

Background

Tax treaties and domestic exemptions aim, amongst other things, to mitigate double taxation that results when a source country taxes investment income that is also taxed in the income owners' country of residence. The administrative processes involved in obtaining an entitlement can be lengthy, costly and cumbersome. At the international level, the OECD Treaty Relief and Compliance Enhancement (TRACE) initiative aimed to address the inefficiency of withholding tax procedures. The TRACE implementation package was approved in 2013 with Finland being the first country to implement it in 2021. TRACE provided a framework for exemptions or reduced rates of withholding taxes to be claimed on behalf of investors. This initiative leveraged the United States Qualified Intermediary agreement.

In most EU Member States, withholding tax relief or reclaim procedures are very different: they may involve more than 450 different forms across the European Union, some of which are only available in national languages. As a result, studies show that close to 70% of retail investors who would be eligible for a reduced withholding tax rate do not claim it and 30% of retail investors have sold their EU portfolios because of this tax barrier. FASTER aims to mitigate these barriers to capital investment by creating digital residence certificates and standardising the Relief at Source and the Quick Refund System. Pursuant to the FASTER relief at source system, the appropriate withholding tax rate is applied at the moment a payment of dividends or interest is made. Alternatively, under the FASTER quick refund procedure, the excess tax paid is refunded in no more than 50 days after the date of payment. Member States will choose which approach to apply. To mitigate potential abuse of the new compliance regime, FASTER includes standardised reporting obligations throughout the value chain so that compliance can be effectively monitored and controlled. These key FASTER proposals are outlined below:

Electronic tax residence certificates (eTRC)

A common EU eTRC is intended to make withholding tax relief procedures faster and more efficient. For instance, the eTRC is issued automatically within one working day after the submission of a request and only one certificate will be required to make several reclaims during a calendar year (and perhaps longer, as this is only a minimum period). This contrasts to the current situation where procedures are paper based with lengthy turnaround times. The eTRC could be available to third countries. The digitalisation of the tax residence certificate is expected to allow financial intermediaries to automate related processes.

Financial intermediaries would be obligated to check the authenticity and content of the eTRC against the customer file through a common verification method, as well as checking the correct applicable WHT rate according to an applicable treaty or domestic rules.

Enhanced relief at source and quick refund procedures

As noted above, two fast-track procedures would complement the existing standard refund procedure. Member States would be able to choose to use either one or a combination of both.

- Under the ‘relief at source’ procedure, the tax rate applied at the time of payment of dividends or interest would be directly based on the applicable rules of the tax treaty provisions.
- Under the ‘quick refund’ procedure, the initial payment would be made taking into account the withholding tax rate of the Member State where the dividends or interest is paid, and the refund for any overpaid taxes would be granted within 50 days from the date of payment (except in rare cases).

Reporting obligation

FASTER reporting obligations would set a common reporting standard of tax information to be shared with tax administrations. Certain financial intermediaries acting as withholding agents would be obligated to register so they can apply exemptions or reduced WHT rates directly on investment income. These registers would help national tax administrations verify and validate eligibility for the reduced rate and detect potential abuse. Large EU financial intermediaries would be required to join and non-EU and smaller EU financial intermediaries could join voluntarily.

Common rules would be introduced to define when financial intermediaries would be held liable for providing incorrect data that could lead to lost tax revenue for the Member State. The liability would be placed at the level of the financial intermediary closest to the investor, who is responsible for performing the due diligence requirements. The intermediary would be liable in case of mis- or under-reporting, subject to certain exceptions.

The takeaway

FASTER is an important development in cross-border withholding taxes, establishing a common, standardised, EU-wide system for withholding tax relief. Whilst a 2027 implementation date may appear distant, investors, financial intermediaries and tax authorities should currently be assessing tax operating and risk models to better understand risks and opportunities. Making withholding tax procedures in the European Union more efficient and fair will support cross-border investment, thus contributing to building the CMU. Financial institutions should consider the benefits of utilising automation and machine learning to bring these benefits to their clients. It will be also interesting to see how this new process may interact with the subject to tax rule (STTR) that is expected to be put forward as part of the G20/OECD Inclusive Framework Pillar Two project and with the potential EU 'Unshell' Directive to the extent it addresses relief for transactions between Member States, as the Unshell Directive may affect the issuance of tax residence certificates or access to treaty reliefs.

Let's talk

For a deeper discussion of how FASTER might affect your business, please contact:

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