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Subcommittee on Tax Matters (FISC) of the European Parliament
Public hearing on 'A European Withholding Tax Framework'
27 October 2021, 09:00-11:15

The FISC Subcommittee is the specialised body of the European Parliament dealing with tax-related matters, particularly the fight against tax fraud, tax evasion and tax avoidance, as well as financial transparency for taxation purposes.

European Withholding Tax for a Fair Tax System

Abstract:
- Withholding tax on ALL interest and license fee payments.
- Irrespective of the tax residence of the final beneficiary.
- Without any relief at source.
- Tax credit where the income of interest and license fees is declared and taxed.

The political guidelines for the current Commission´s mandate call for fair taxation and fight against tax fraud, as key foundations of an economy that works for people.[1]

A recent EU-initiative calls for a new EU system of withholding taxes to avoid double taxation[2]. It aims to introduce a common EU-wide system for withholding tax on dividend or interest payments. It will include a system for tax authorities to exchange information and cooperate with each other.

In addition, a recent draft report of the European Parliament calls for a new European Withholding Tax Framework.[3]

1 Withholding tax on ALL payments of interest and license fees

In the following we propose a simple withholding tax system[4] which prevents double taxation as well as non-taxation. It guarantees that all income is indeed taxed once within the EU as postulated by the EU-directive on interest and royalties[5]:

- To impede tax evasion via low-tax regimes we propose a withholding tax on **ALL** interest and license fee payments.
- The proposed withholding tax should be levied **irrespective of the tax residence** of the final beneficiary.
- The withholding tax shall be applied **without any relief at source**.
- In return all withholding taxes paid to foreign tax administrations[6] should receive a **tax credit** by that EU Member State **where the income is declared and taxed**. This avoids today´s lengthy, resource-intensive and costly reimbursement procedures.

The proposal can be implemented unilaterally by any individual EU Member State or a group of EU Member States.

2 Relief at source supports tax fraud as well as base erosion and profit shifting

The current refund procedures for withholding tax can be abused for an alleged large-scale tax fraud known as Cum/Ex-scheme and subsequent Cum/Cum-Scheme. In addition, such withholding tax relief mechanisms for cross-border payments have proved to be lengthy, resource-intensive and costly for both investors and tax administrations due to the lack of digitalized procedures and the existence of complex and divergent forms across Member States.[7]

On the other hand the establishment of a fully-fledged common EU relief at source system[8] would support Base Erosion and Profit Shifting (BEPS). Increasingly in the last decades offshore financing from banks and other financial institutions has become one of the favorite tax avoidance strategies for multinational enterprises. The part of their earnings paid as interest for credits or as license fees and going

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[1] Report on financial crimes, tax evasion and tax avoidance. European Parliament resolution of 26 March 2019 on financial crimes, tax evasion and tax avoidance (2018/2121(INI)). https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52019IP0240&rid=7

[2] Withholding taxes – new EU system to avoid double taxation. EC, Initiative, 28 September 2021. https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/13031-Withholding-taxes-new-EU-system-to-avoid-double-taxation_en

[3] European Withholding Tax framework (2021/2097(INI)), draft report. Committee on Economic and Monetary Affairs, European Parliament, 13.10.2021. https://www.europarl.europa.eu/doceo/document/ECON-PR-695241_EN.pdf

[4] For detailed explanations see e.g. Jarass/Obermair: Fair and Efficient Business Taxation – What an individual EU country can do unilaterally to counteract base erosion and profit shifting. Tax notes international, 24 August 2015. Jarass/Obermair: Unilateral Withholding Tax to counteract Base Erosion and Profit Shifting. European Taxation, 11/2015, pp. 509-514. Jarass/Obermair: Tax on earnings before interest and taxes instead of profit – fair, simple and competitive. EC Tax Review, Kluwer Law International, Amsterdam, vol. 17, June 2008, pp. 111-117. Jarass/Obermair: Angemessene Unternehmensbesteuerung. National umsetzbare Maßnahmen gegen Gewinnverkürzung und Gewinnverlagerung zur Unterstützung von international abgestimmten Maßnahmen. 2., vollständig neu bearbeitete Auflage. BoD, 2017.

[5] "It is necessary to ensure that interest and royalty payments are subject to tax once in a Member State." EU-Directive on Interest and Royalties 2003, Whereas, (3).

[6] If they have double taxation agreements with the respective Member State.

[7] Withholding taxes – new EU system to avoid double taxation. EC, Initiative, 28 September 2021.

[8] In contrast withholding tax relief at source has been proposed by Option 2 of Withholding taxes – new EU system to avoid double taxation, ... See also EU-wide system for withholding tax relief. https://ec.europa.eu/jrc/en/page/eu-wide-system-withholding-tax-relief-174656. The Action Plan for fair and simple taxation supporting the recovery strategy proposes to introduce a common, standardised EU-wide system for withholding tax relief at source.

abroad is presently exempt from taxation in the withholding country at least in most relevant industrial countries. Once abroad the payments, using the channels available for large international enterprises, can easily be transferred to a tax haven. Relief at source, therefore, thwarts the basic idea of withholding taxes.

All these problems can be avoided by our proposal which ensures for all withholding taxes paid to foreign tax administrations a tax credit by that European Member State where the income is declared and taxed.

3 (Re)introduction of withholding taxes needs adaptation of double taxation agreements

For a (re)introduction of withholding taxes the double taxation agreements would have to be adapted step by step. Action 15 of the OECD action plan provides a multilateral instrument for a consensus to be achieved between the participating countries on a simultaneous change of all respective double taxation agreements.

When discussing the double taxation agreement it is solely up to the foreign country to decide

- whether it introduces a withholding tax for interest and license fee payments to the respective EU Member State and
- whether it reimburses payees located in its country for withholding taxes paid abroad.

Compared with the complex, time-consuming and costly present practice for the imputation of withholding taxes, this rather radical step towards the practice now will eventually make taxation much simpler and more efficient. For the initiation this measure would, however, require those double taxation treaties to be renegotiated which do not allow adequate withholding tax rates.

4 Withholding taxes can be implemented in accordance with all EU directives

Such a withholding tax concurs with all EU directives and complements the EC tax proposals. An unilateral withholding tax is explicitly allowed with some minor restrictions in the relevant EU directive on interest and royalties. In contrast to a common opinion, taxation at source of all earnings produced by an enterprise, whether declared as profit or transferred to another enterprise, domestic or abroad, as payment for interest or license fees, was and is not generally forbidden by the EU directive on interest and royalty payments. Quite the reverse: As clearly stated in the directive its aim was to prevent double taxation, while guaranteeing that all income was indeed taxed once within the EU[9].

The directive applies only to payments between associated companies with a direct minimum holding of 25%[10]. The EU directive provides for an exemption only on request for every contract:

- For exemption the source state may require for every payment an attestation to substantiate the fulfilment of the directive´s requirements[11] and the legal justification for the payments (e.g. loan agreement or licensing contract)[12].
- The source state may make it a condition for exemption that it has issued a decision currently granting the exemption following the attestation. If the paying company or permanent establishment has withheld tax at source to be exempted ... a claim may be made for repayment of that tax at source[13].

Résumé: Withholding taxes can be implemented by an individual EU Member State; in very rare cases withholding taxes have to be repayed on individual request.

To avoid these very rare cases thereby decreasing the administrative burden of tax payers a clarification in the directive on interest and royalties could be helpful.

9 "It is necessary to ensure that interest and royalty payments are subject to tax once in a Member State." EU-Directive on Interest and Royalties 2003, Whereas, (3).

10 EU-Directive on Interest and Royalties 2003, art. 1 par. 7 in connection with art. 3 par. 1b. Note that a minimum holding of 10% holds only for the EU parent subsidiary directive which is relevant for dividend payments.

11 EU-Directive on Interest and Royalties 2003, art. 1 par. 11 in connection with art. 1 par. 13.

12 EU-Directive on Interest and Royalties 2003, art. 1 par. 13, last sentence: "Member States may request in addition the legal justification for the payments under the contract (e.g. loan agreement or licensing contract)."

13 EU-Directive on Interest and Royalties 2003, art. 1 par. 12.

5 Withholding tax increases tax revenues of participating countries

The proposed withholding tax increases the tax burden only for those EU Member States who make use of tax havens or low tax regimes. The treasury of a EU Member States that enforces such reforms, if necessary unilaterally, will tendentially get increased tax revenue. E.g. Germany would have an additional net revenue of several billion annually, even if the foreign withholding tax on payments going into Germany would be completely refunded by the German tax administration.

Even if in the beginning the revenue increase would be less, the reform would counteract the trend of ever growing tax avoidance:

- The growing tendency of double non-taxation would be reversed, the advantage of tax avoidance countries would be reduced and tax havens would become less attractive.
- The tax advantage of multinational enterprises over small and medium enterprises and the resulting unfair competition would be reduced.

6 Unilateral withholding tax supports international tax harmonization

Without powerful measures an ever growing share of the earnings of big business will no longer be taxed anywhere and many normal tax EU Member States will lose more and more revenue in the longer run. Holdings still residing in a normal tax EU Member State would be forced to move their head quarters (and the respective high paid jobs) to low tax countries within and outside the EU. All these tendencies can be reversed with the implementation of the measures sketched above.

Once a group of EU Member States takes the initiative for a withholding tax it becomes easier for other countries to follow and join the struggle against tax avoidance, thereby enabling, step by step, a de facto international harmonization by an increasing number of countries.

7 Résumé

(7a) Withholding tax on ALL interest and license fee payments.

(7b) Irrespective of the tax residence of the final beneficiary.

(7c) Without any relief at source.

(7d) Tax credit by that EU Member State where the income of interest and license fees is declared and taxed.