



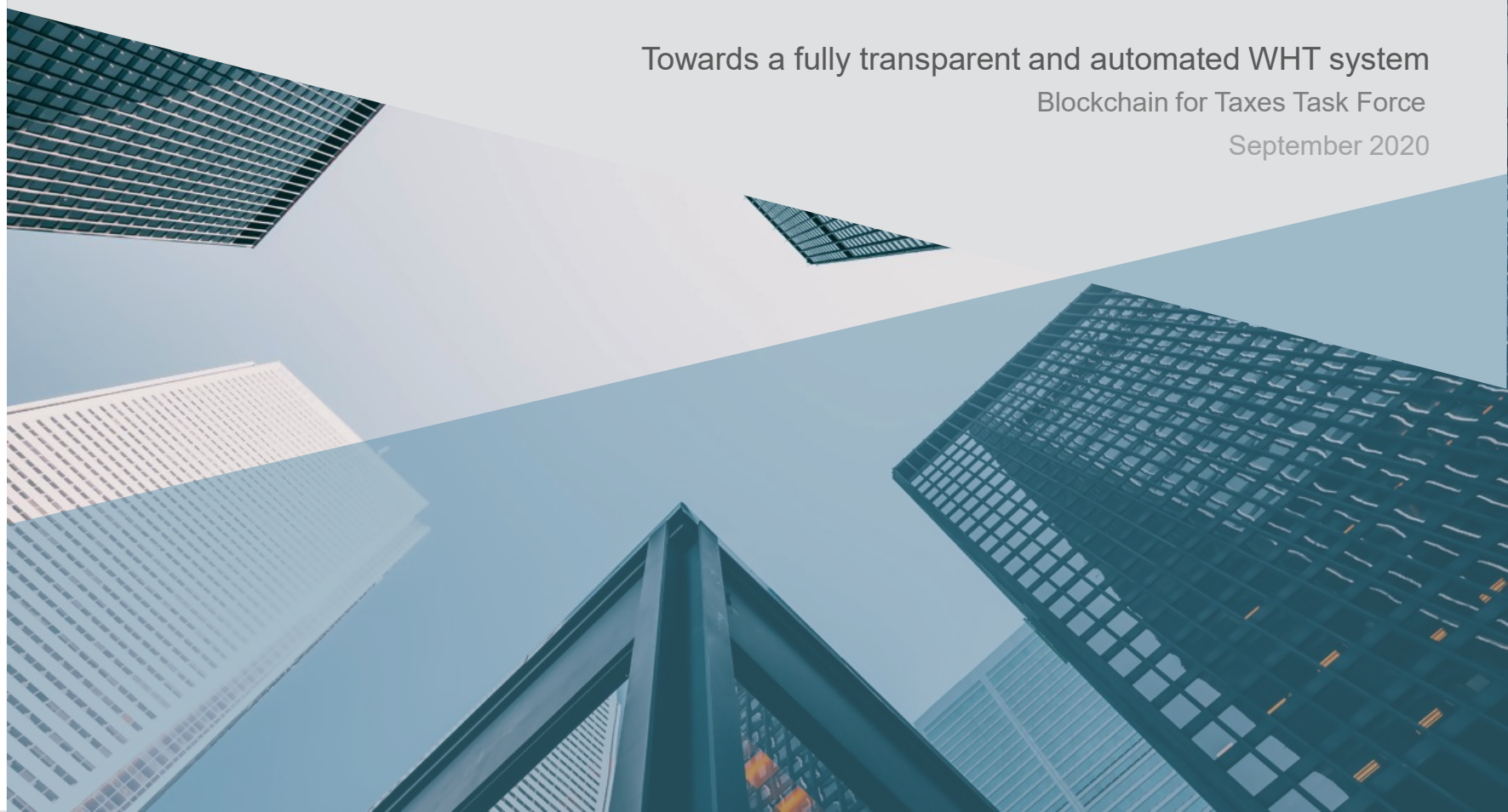
EFAMA

Removing Withholding Taxes barriers

Towards a fully transparent and automated WHT system

Blockchain for Taxes Task Force

September 2020



Executive Summary



Problem Statement

- Within the EU, withholding tax (WHT) for cross-border portfolio investments is not harmonised, is inefficient and creates uncertainty, risk and costs for all participants, including investors and tax authorities.
- The current model is prone to withholding tax fraud (cum-ex fraud of €55bn) and leads to loss of annual entitlement of €8.4bn for small investors ([European Commission withholding tax, 2016, p. 2](#)).
- Significant increase in the practical requirements investment funds have to meet to access WHT relief at source and/or WHT reclaims

Proposal

- We propose the use of DLT technology to provide a WHT Relief at Source model to bring trust and transparency for all market participants including tax authorities.
- Work for Funds will be significantly reduced as no additional disclosures are required.
- Governments will benefit from receiving a single disclosure per filing, providing fully traceable, pre-confirmed evidence of entitlement

Implementation

Identify Tax Authorities who are willing to explore the use of DLT technology in order to test the functionality. The Custodians will administer and manage the Investment Chain and perform the administration on behalf of the funds. We propose to do this in a phased approach:

- Phase 1 – Work with Tax Authorities who only offer Reclaims or have onerous Relief at Source (RAS) requirements and test a RAS DLT solution.
- Phase 2 – Expand to cover RAS markets
- Phase 3 – Deliver the full investment chain in order to verify residency of the Ultimate Beneficial Owners in each market.

European Commission's Action Plan

- The [CMU new Action Plan](#) and the [Package for fair and simple taxation](#) are currently being reviewed and monitored by EFAMA's Taxation and Accounting Standing Committee and Blockchain for taxes Task Force.
- The Commission will propose a **legislative initiative for introducing a common, standardised, EU-wide system for withholding tax relief at source**, accompanied by an exchange of information and cooperation mechanism among tax administrations. In addition, the Commission will assess the need for exchange of information and cooperation between tax authorities and financial markets supervisory authorities. Options considered will include both legislative and non-legislative interventions and take into account the OECD Treaty Relief and Compliance Enhancement (TRACE) initiative. EC's action plan seems to be aligned with the tax recommendations made by the HLF on CMU.
- EFAMA stands ready to contribute to an impact assessment and to help the Commission in drafting the suggested legislative proposal.

Main milestones on WHT

- 2013: OECD TRACE package approved
- 2014: First wave of FATCA IGAs
- 2016: CRS comes into law (early adopters)
- 2016: EC published data on excess WHT not reclaimed by small investors: yearly € 8.4bn
- 2017: EC published the EU Code of Conduct on WHT to help remove WHT barriers within the EU (as part of the Capital Markets Union initiative)
- 2018: Public Hearing on Cum-Ex fraud: €55bn loss for tax authorities over the period 2001 to 2012
- 2018: Creation of the European Blockchain Partnership and the European Blockchain Observatory and Forum
- Since 2018: Introduction by tax authorities of some EU countries of more stringent and complex rules for WHT relief at source and/or reclaims as a response to tax scandals (e.g. Austria)
- 2019: ESMA report included considerations on Cum-Ex fraud considered as a potential market abuse practice
- 2019: Proposal for the implementation of TRACE by the Finnish tax authorities

What is EFAMA position on the existing solutions to remove WHT barriers?

- Investment funds issues in accessing double tax treaty provisions have been long standing issues as outlined in particular in the OECD 2010 report
- EFAMA has always supported the idea that investment funds should be given access to double tax treaties and be recognized within the EU as beneficial owners and therefore be able to claim treaty benefits in their own right
- EFAMA reckons that existing WHT procedures may be streamlined if best practices are implemented and is supportive of initiatives taken at EC level (EU Code of Conduct in particular) as well as of the OECD TRACE initiative
- However these best practices only solve problems related to relief at source but not those related to WHT reclaims
- As a consequence of national tax authorities' tension over tax scandals, EFAMA is witnessing a significant increase in the practical requirements investment funds have to meet to access WHT relief at source and/or WHT reclaims.

How can Distributed Ledger Technology (DLT) enhance and secure the WHT process?

- We will use DLT technology to build an integrated process and obtain full transparency for all participants



- DLT technology will streamline and secure the investment process, reduce inefficiencies and risk for all market participants and tax authorities by implementing an end-to-end solution that captures the underlying investors.
- DLT technology will offer a potential real-time solution to both concerns of tax fraud and the excess WHT foregone (see Appendix 2).

What are the benefits of the DLT?

- We will use DLT technology to build a single platform and obtain full transparency for all authorised participants
- 1. DLT technology will streamline the investment process by providing secured information, and as a consequence it will reduce inefficiencies and risks for all market participants and tax authorities
- 2. Both relief at source and reclaim issues may be effectively tackled by using DLT technology (dealing with the challenges resulting from multi-intermediated investment structures) – Appendix 6.
- 3. DLT solutions can provide full transparency on the underlying investors and from there combat BEPS and tax evasion as well as all other topics covered by our technical presentation (Appendix 1)

Action Plan

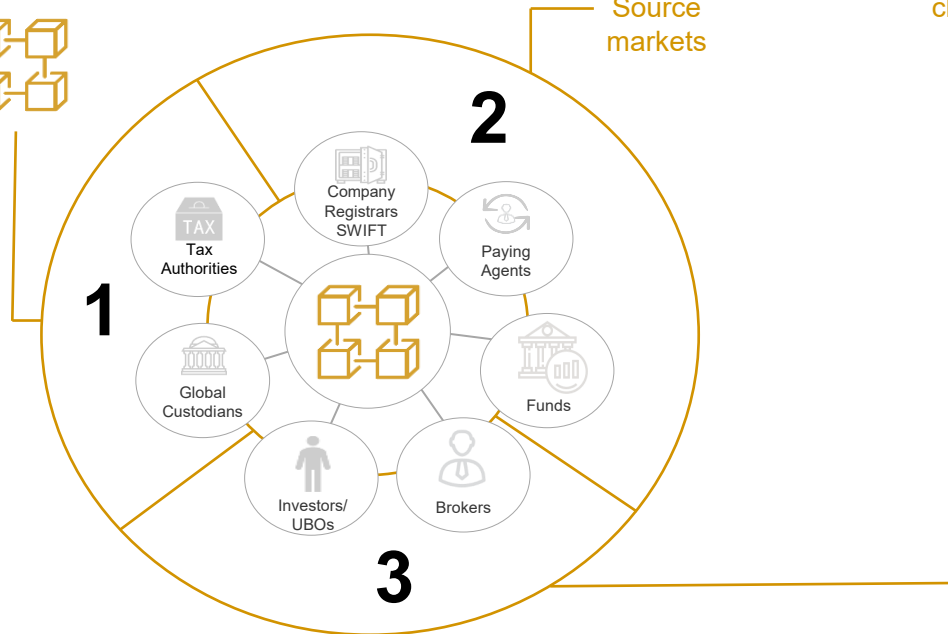
Starting in 2020 – DLT solution implementation in 3 phases

Phase 1
Work with Tax
Authorities
Pilot Test



Phase 2
Expand to
cover
Relief at
Source
markets

Phase 3
Deliver the
Full
investment
chain



How can Distributed Ledger Technology (DLT) enhance the WHT process? (1)

How would we implement this?

- Phase 1 - Proof of Concept would be launched to gauge effort and Tax Authority (TA) engagement.
- Phase 2 - Expand to cover RAS markets
- Phase 3 - Deliver full investment chain

Who needs to be represented in the chain?

- Phase 1– Custodians, selected TAs with input from EFAMA members
- Phase 2 – Phase 1 participants, Investment funds, Company Registrars, SWIFT, paying agents.
- Phase 3 – Phases 1 and 2 participants as well as brokers and ultimate beneficial owners

Who is going to build the platform?

- Likely a suitable qualified vendor (Big 4, Microsoft, IBM, VMWare etc)

How can Distributed Ledger Technology (DLT) enhance the WHT process? (2)

Ownership/ Control

- Participants via a tokenized contribution called a “Stake” (see Appendix 4).
- This systemically allows participants to perform the Proof of Stake calculations to update the chain.
- TAs and regulators will be able to witness updates. They will also be heavily involved in the governance of the chain.

Costs structure

- **Cost of Participation:** We need to understand how to cover cost of establishment of the DLTs. This will be estimated when building the POC.
- **Cost of transactions:** Priced by volume + a maintenance fee to pay for changes in the smart contracts, hardware and price inflation

Funding

- Stakes will be distributed via stakeholding membership so **costs will be split by the number of holders of Investment chain stakes**
- **EU funding may be available for the tax authority solution:** the European Commission has been funding Blockchain projects through the European Union's research programmes FP7 and Horizon 2020 since 2013. Until 2020, it will fund projects that could draw on Blockchain technologies for up to €340 million.

How can Distributed Ledger Technology (DLT) enhance the WHT process? (3)

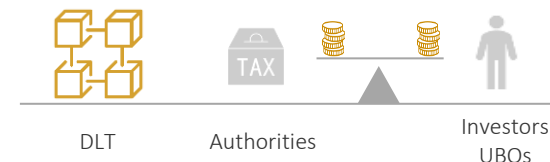
Governance model

- SWIFT / Alternative model – Consortium – Optimal governance still needs to be fully explored
- The European Commission has already implemented similar efforts through the CEF Infrastructure, where services were successfully deployed (see Appendix 5).
- The signatories of the EBP declaration can work with the Commission and with industry to facilitate development, delivery and implementation of a DLT solution for the internal market (see Appendix 7)
- Can we use CEF Building blocks and IT Governance Model?

How can we protect early adopters' investment?

- Additional stakeholding members will pay **cost/new number**

Pilot and proof of technology concept



Which scenarios do we want to tackle as “proof of technology concept”?

To be confirmed within the countries signatories of the European Blockchain Partnership Declaration (Appendix 3). According to a market ranking study (Appendix 7) performed by a large custodian within our industry, the TAs of the following jurisdictions should be approached to run the pilot test:

Country		Desirability RANKING
Denmark		1
France		2
Belgium		3
Finland		4
Germany		5
Spain		6
United Kingdom		7
Austria		8
Netherlands		9
Poland		10



All processes will be **fully transparent** at the time of the transaction and **fully auditable**

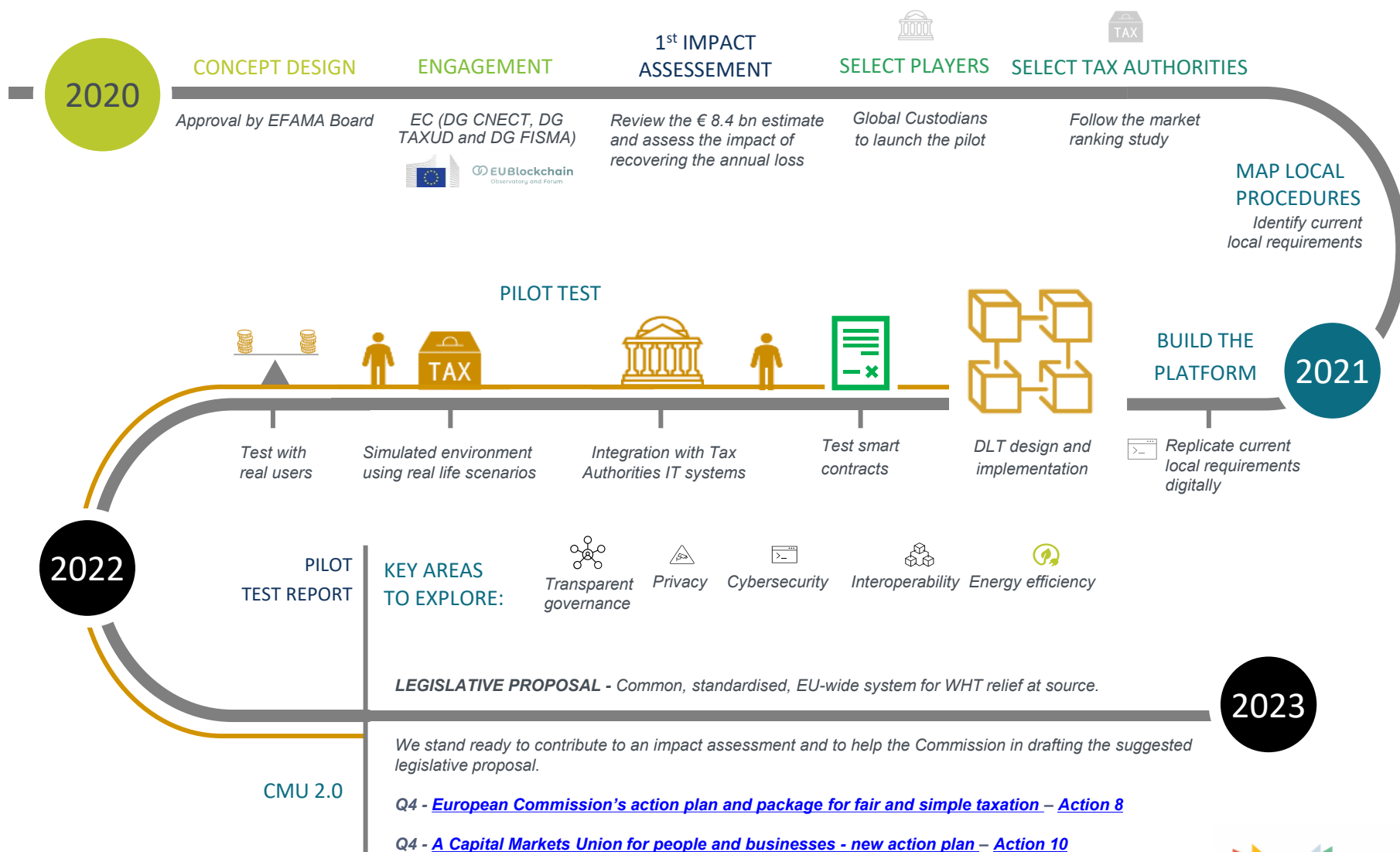


Agreed Smart Contracts will ensure that all market participants treat regulations in the same way. Local regulator/ TA will sign off Smart Contracts before it is implemented.



End-to-end automation will remove the complexity of the process and allow providers to compete only on performance

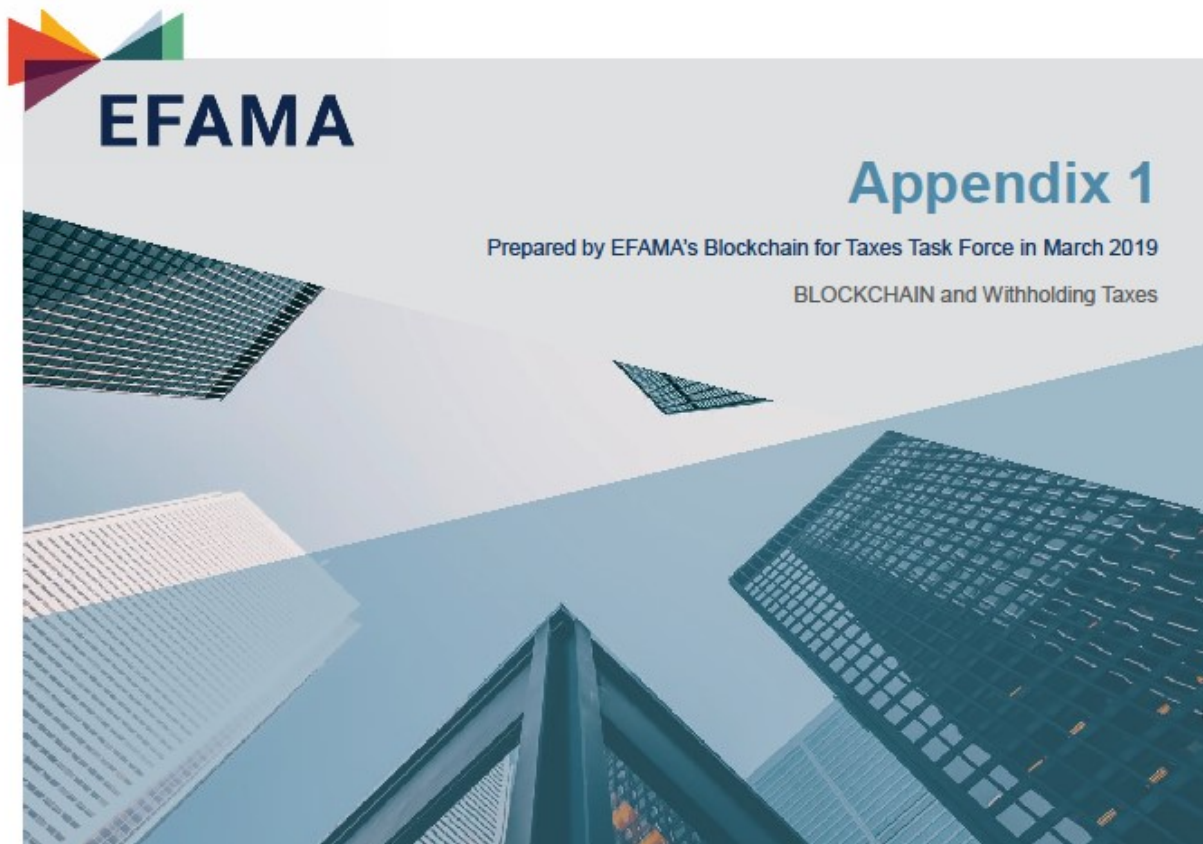
Next steps – Phase 1 (2020-2022)



Appendixes

Appendix 1 – EFAMA Blockchain and Withholding taxes presentation

Presentation available on EFAMA's website ([member's area](#) only)



Appendix 2: Major risks and costs of inefficiency

Facts and figures



Tax law loopholes and tax fraud

€55bn EUR

Dividend tax was reimbursed to multiple parties for more than 10 years. Part of these taxes have never been paid.

55bn

2001 – 2012

Cum-ex / cum-cum scandal

Germany € 31.8bn
France € 17bn
Italy € 4.5bn
Denmark € 1.7bn
Belgium € 201m
Luxembourg € 10m



2018

Public hearing - EP



2019

ESMA Report
Preliminary findings

EFAMA members are against any abusive practice or criminal activity that may be linked to this scandal.

We **strongly support all the EU's initiatives to enhance tax transparency** within the EU with the aim to tackle financial crimes and tax evasion.

€8.4bn EUR Money left on the table- yearly

According to the EC* these are the estimated total costs of WHT refund processes, including:

€6.03 bn in foregone tax relief (i.e. investors not claiming their tax refunds due to prohibitive compliance costs)

€ 1.21 bn in costs related to the procedures

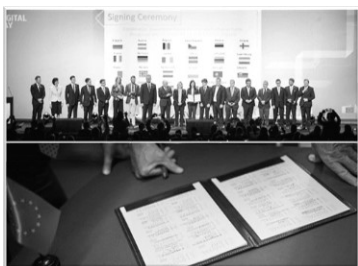
€ 1.16 bn in opportunity costs (due to the impossibility to use the money not yet refunded for other purposes).



* Numbers to be revisited by the EC – “*Non-paper on the withholding tax for discussion*” – EC Expert Group on barriers to free movement of capital – 28 September 2016

Appendix 3: The digital single market policies and initiatives from the Commission and the Parliament

Blockchain Partnership
Observatory & Forum
International standardization



- **European Blockchain Partnership** – [Link](#) – declaration signed by 28 countries (*). The ambition of the Partnership is to make this **trusted infrastructure** accessible to support digital services deployed by **public** and eventually in the future also **private actors**. The aim is to develop a **trusted, secure and resilient** European Blockchain Services Infrastructure (**EBSI**) meeting the highest standards in terms of **privacy, cybersecurity, interoperability** and **energy efficiency**, as well as **fully compliant with EU law**.



EUBlockchain
Observatory and Forum

- **European Blockchain Observatory and Forum** – [Link](#) – acts as a **stakeholders engagement platform**, an initiative to accelerate Blockchain innovation and uptake, by featuring **community engagement, project mapping, working groups** on use cases and the **regulatory framework**, production of thematic reports and delivery of training. It hosts lively **debates**, organises **workshops** and produces **reports** with the help of many European and international stakeholders.



- **INATBA - Public-private cooperation is essential to progress forward and ensure uptake** – [Link](#) – is a **multi-stakeholder organisation** based in Brussels. It brings together suppliers and users of Distributed Ledger Technologies with representatives of governmental organisations and standard setting bodies from all over the world. They share the common vision of **promoting transparent governance, interoperability, legal certainty** and **trust** in services enabled by Blockchain and DLT.

Appendix 4: Platform Ownership and Governance

Inclusive industry-level platform – Private investment chain.

Split governance model - Commercial Board + Audit Board



Concerns	Proposal	Implementation
<p>Members are concerned about <u>platform governance</u> and <u>ownership</u> for the Industry utility:</p> <ul style="list-style-type: none"> • Concern 1 - What can be done to eliminate the free-rider problem where the early adopters pay for the platform and the latecomers use it? -tokenise membership ✓ • Concern 2 - How do we optimise the governance of the platform in order to ensure maximum buy-in by all parties? – solve common problems ✓ • Concern 3 - How do we entice tax authorities and regulators to trust the platform and encourage its adoption? – Provide full visibility and sign-off ✓ • Concern 4 - How do we ensure that members are correctly billed? –billed by volume via the custodian ✓ 	<ul style="list-style-type: none"> • We propose the use of DLT technology to provide an inclusive industry-level platform for all users who can gain assurance that the data is reliable whilst privacy is fully obscured from actors who should not be able to identify them. • The cost of adding data will be billed by volume and we will have to add a maintenance fee to ensure we cover the cost of updates and any changes in operational costs of the platform. • We will split governance from ownership of the utility. Governance will include both members and witnesses but ownership will be restricted to members. 	<ul style="list-style-type: none"> • Integrate governance directly into the DLT solution. Only members will be able to verify and update the chain. • Witnesses (like tax authorities and regulators) are able to view-only both the transactions and the filings. • Billing for members would be performed on periodic basis, via their Custodian (to be confirmed). • Governance of the utility will have a commercial board and an audit board. Members will be on the commercial board. Witnesses will chair the audit board (on a rotating basis- tbd) but the board will also include members who are responsible for any actions.

Appendix 4: Platform Ownership and Governance

How do we optimize buy-in?



How do we optimize buy-in?	How does it work?	Participants
<ul style="list-style-type: none"> The more buy-in we receive from tax authorities, the more successful we will be in bringing in Custodians, Funds and other participants Conversely, tax authorities may reject a second method of filing so we will have to entice both parties We will therefore have to closely involve both sets of participants from the outset <p>Tax Authority</p> <ul style="list-style-type: none"> Replicate current local requirements digitally Create the Ultimate Beneficial Ownership confirmation chain for Tax Authorities [EU Funding available?] 	<ul style="list-style-type: none"> Registered holders on book-closed date in the market are confirmed by market participants A file is submitted to the local tax authority The local tax authority automatically confirm the locally registered entities A file listing confirmed and unknown entity percentages is listed out per client type and broadcast the network. A full file is combined and added to the submission queue 	<ul style="list-style-type: none"> Funds: Funds will likely join where the TA/Broker/ Paying agents are already members. [EU Funding available for their module?] Global Custodians: GCs are a key player. We will need at least 3 major custodians (in order for the technology to work- we have 2. Once we have the minimum number other custodians will be at a disadvantage if they do not join. Registrars: There are a small number of registrars. There is an existential threat if they do not join early [EU Funding available?] TAs, brokers, Paying Agents: There are a small number of major players. There is an existential threat if they do not join early [EU Funding available?]. Smaller nominees will likely be absorbed and consolidated.

Appendix 4: Platform Ownership and Governance

How would the ownership and Governance work?



Commercial Board

Members

- Holders of Utility stakes (Global Custodians), Funds/ entities, registrars and Transfer Agents, Brokers/ Paying Agents

Responsibilities

- Ensure that the utility is ethically run and well governed and that stakeholders' views are taken into account. ESG will likely be a major focus too.
- Ensure that the utility is run on behalf of stakeholders, is on commercially sound footing and

Governance

- A Chair should be elected by members on a 3 year term in order to ensure stability of governance for the utility.
- A permanent Head of Operations and a Head of Finance should be employed by the utility. Other positions can be appointed by the board.
- The Commercial Board will be chaired by the chairman and each member will have an equal vote

Audit Board

Members

- Tax Authorities and Regulators (including EU and other trans-national bodies), plus at least once of each of the member categories.

Responsibilities

- Ensure that Smart Contracts for each country are correctly compiled and digitally signed by the relevant tax authority/ regulator
- Perform audits on the investment chain and related disclosure mechanisms
- Report compliance to the commercial board and highlight any identified risks and desired improvements

Governance

- The board should comprise of three revolving Tax Authorities/ Regulators, plus at least once of each of the member categories
- In the European context, it is suggested that the three Tax authorities should be the immediate past, current and immediate future country holding the presidency of the European Council. This would align the goals of the utility with that of the European Union.

Appendix 4: Governance – rejected blocks

What happens when a block is rejected?



Commercial Board

Members

- The member calculating the erroneous block will temporarily be excluded from the process- their stake will be frozen. **They will therefore not be able to perform any updates until their erroneous algorithm is fixed.**

Actions

- The member with the erroneous algorithm will have to reach out to someone able to audit their system and help them to update and verify that their algorithm is now correct.
- A test with blank data will be run and verified by the rest of the members to ensure this is correct

Audit Board

Members

- Any errors are reported to the board who will assess whether further remediation is required.

Responsibilities

- Issues will be reported in a periodic report to provide full transparency

Appendix 5: Technology resources

Connecting Europe Facility's (CEF) Digital Services Infrastructure



Success stories:

eID, eProcurement, eHealth, Online Dispute Resolution (ODR) or Electronic Exchange of Social Security Information (EESSI)

Other examples of online services and databases for taxation

[SEED - System for Exchange of Excise Data](#) - Database to check the validity of an excise number

[TEDB - "Taxes in Europe" database](#) - On-line information tool covering the main taxes in force in the EU Member State

[TIC - Taxation Information and Communication](#) - Member State information on invoicing rules, VAT refunds and the standard VAT rate

[TIN - Taxpayer Identification Number](#) - TINs are used by EU countries to identify taxpayers. There are different national TIN formats and descriptions

[VIES - VAT Information Exchange System](#) - Database for checking the validity of a VAT number issued by an EU Member State

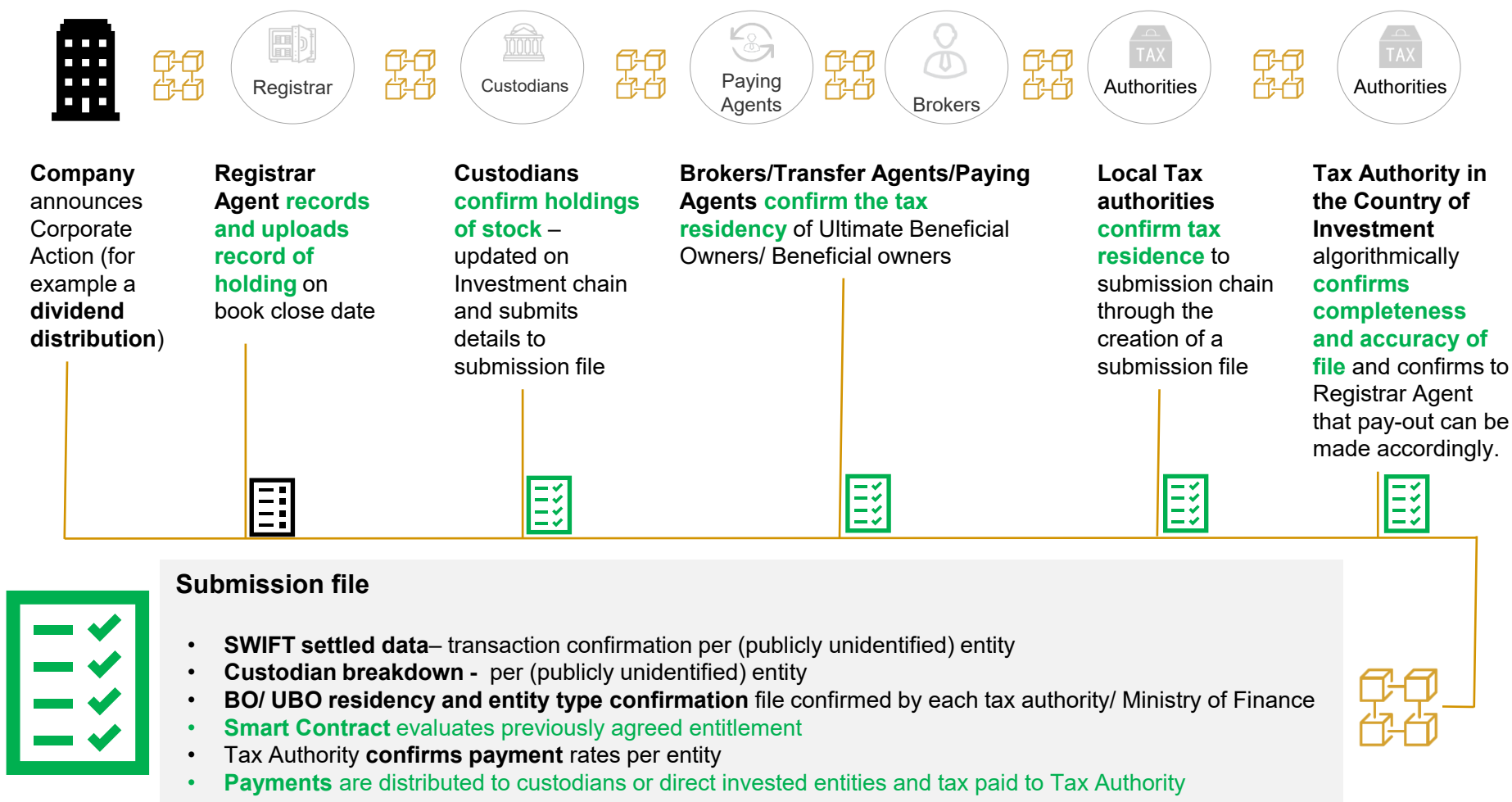
[SAMANCTA - Sampling manual for customs & taxation authorities](#) - Manual on sampling for laboratory testing

[ARC follow-up – Administrative Reference Code](#) - Application to track goods under excise duty suspension via an Administrative Reference Code



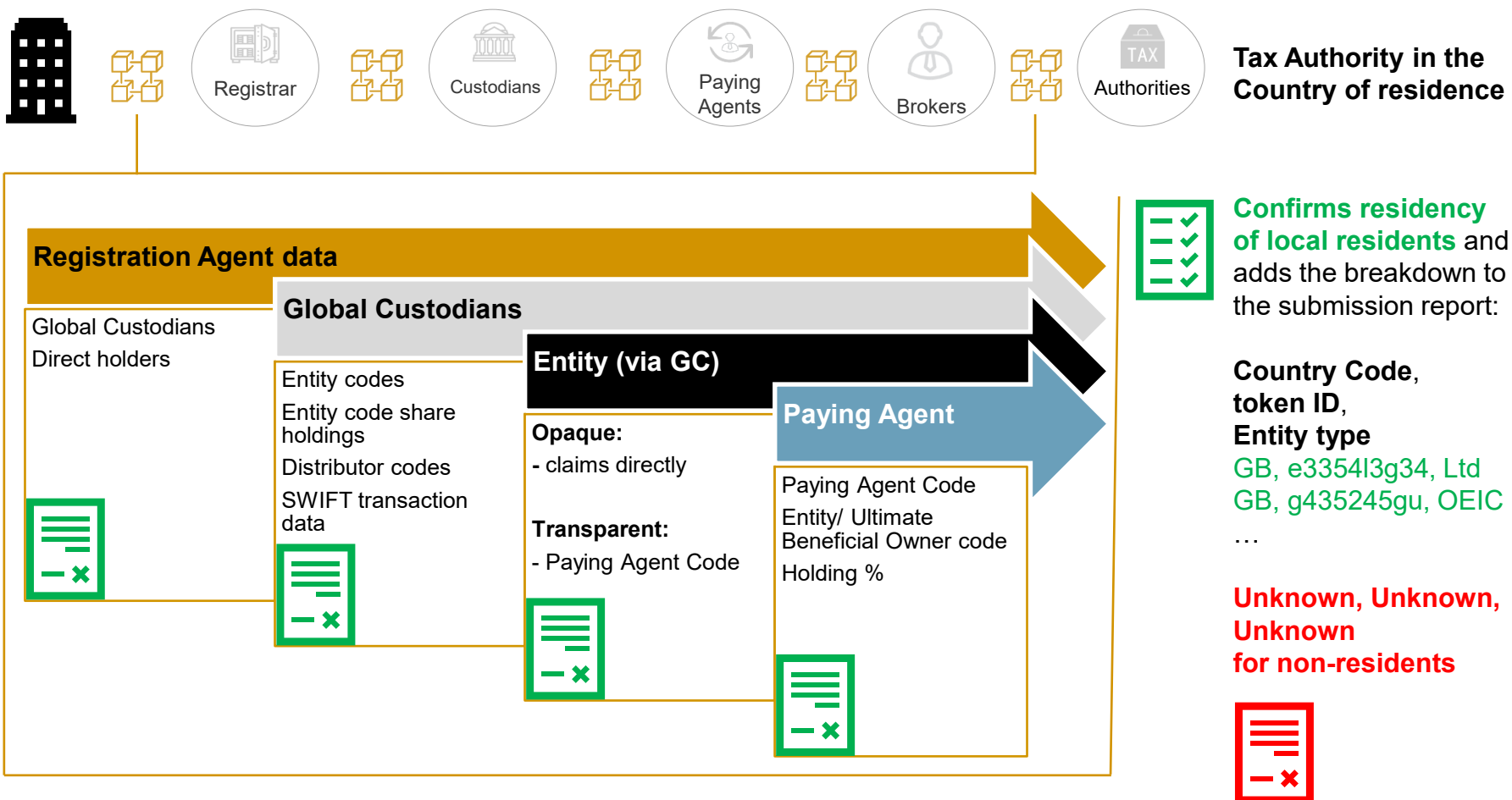
Appendix 6: How do we envisage that this will work?

End-to-end process



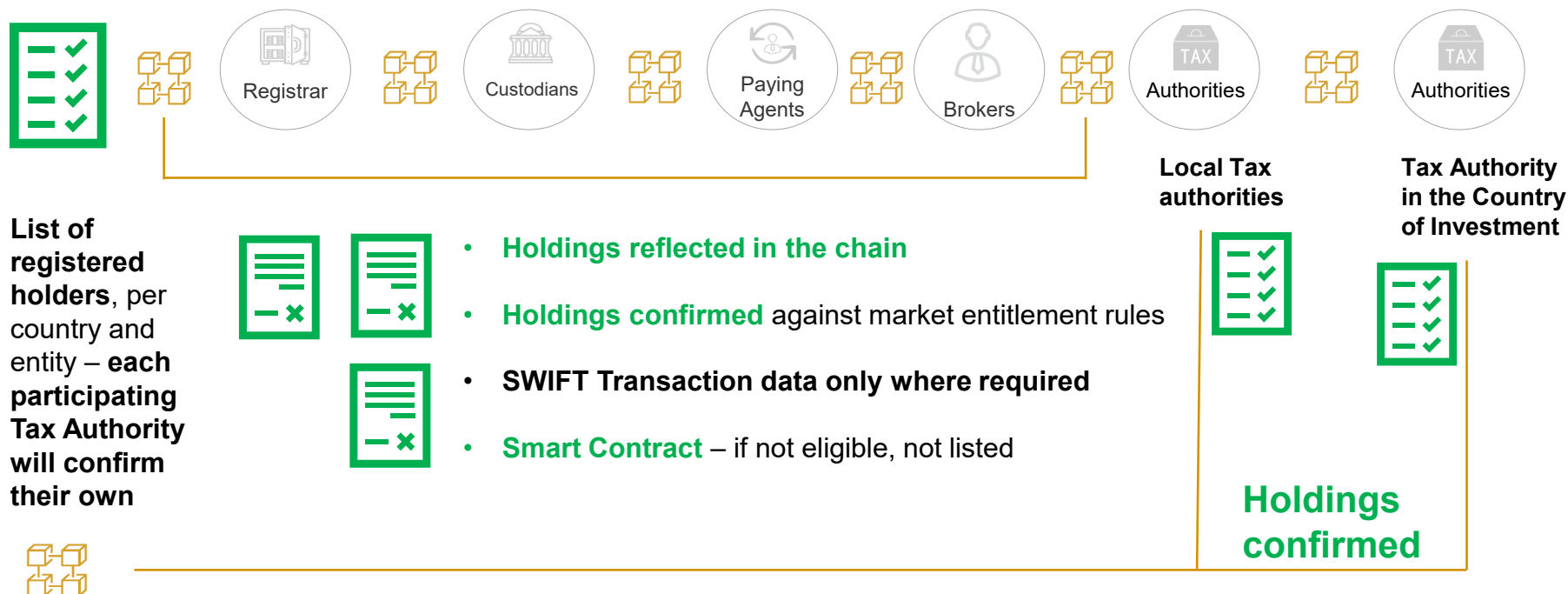
Appendix 6: How do we envisage that this will work?

Tax Authority Layer



Appendix 6: How do we envisage that this will work?

Tax Authority Submission Report



Unknown or unconfirmed holdings can confirm eligibility but **will have to be recovered by reclaim**

Appendix 7: Market ranking study- desirability and suggested phases

Service	RAS available only - Phase 2	RAS and Reclaim - Phase 2	Reclaim only - Phase 1	Desirability Ranking	Service	RAS available only - Phase 2	RAS and Reclaim - Phase 2	Reclaim only - Phase 1	Desirability Ranking
Switzerland			Y	1	Taiwan		Y		25
Denmark			Y	2	Luxembourg			Y	26
France		Y		3	Latvia	Y			26
Germany		Y		4	Malaysia	Y			26
Finland		Y		5	Singapore	Y			26
Belgium		Y		6	Slovenia		Y		26
United Kingdom			Y	7	Australia	Y	Y		31
Japan		Y		7	Colombia	Y			31
Spain		Y		7	Greece		Y		31
Austria			Y	10	Indonesia	Y			31
Netherlands	Y			10	Israel		Y		31
Poland			Y	12	Mexico	Y			31
South Korea	Y			12	Russia		Y		31
Sweden		Y		12	Hungary	Y			38
Italy	Y*			15	Iceland	Y			38
Portugal		Y		15	Lithuania		Y		38
South Africa		Y		15	New Zealand	Y			38
Estonia			Y	18	Philippines	Y			38
Bulgaria			Y	19	Romania		Y		38
Canada		Y		19	Slovak Republic	Y			38
Czech Republic				19	Tunisia	Y			38
Ireland		Y		19	Turkey	Y			38
Norway		Y		19					
United States	Y*			19					

* - Effectively

EFAMA's Blockchain for Taxes Task Force

Mariano Giralt (BNY Mellon) – Chair

António Frade Correia (EFAMA)

Max Ridder-Patrick (BNY Mellon)

Anne-Cecile Collot (BNP Paribas Investment Partners)

Anshita Joshi (The Investment Association)

Camille Neveu (Association Française de la Gestion Financière)

Christian Anger (BVI Bundesverband Investment und Asset Management e.V.)

François-Victor Adam (PricewaterhouseCoopers Lux)

Hans Stamm (DECHERT LLP)

Inga Nitsche (Credit Suisse Asset Management (Schweiz) AG)

Lauri Luukkonen (Finance Finland)

Lene Schönebeck (Danish Investment Association)

Miguel Baptista (APFIPP - Associação Portuguesa de Fundos de Investimento, Pensões e Patrimónios)

Pat Convery (Irish Funds, PricewaterhouseCoopers)

Paul Radcliffe (ERNST & YOUNG)

Phillip Caldwell (J.P. Morgan Asset Management)

Quentin Warscotte (KPMG)

Richard Austin (BlackRock)

Serena Fanali (ASSOGESTIONI)

Thomas Zibuschka (Vereinigung Österreichischer Investmentgesellschaften)

Vilma Domenicucci (Association Luxembourgeoise des Fonds d'Investissement)

Vincent Dardenne (Amundi Asset Management)



EFAMA

THANK YOU



NEW! Rue Marie-Thérèse 11

1000 Brussels

+ 32 (0)2 513 39 69

info@efama.org

www.efama.org