

# THE EUROPEAN POLICY FORUM IS IN FAVOUR OF A WITHHOLDING TAX SYSTEM

In the ongoing debate about the taxation of savings, it is widely assumed that automatic exchange of information systems represent best practice. However, in its report "Challenges to the EU Savings Tax Directive and Taxation of Income from Capital in the EU", the European Policy Forum stresses that an EU wide withholding tax system would be much more efficient. Interview with Graham Mather of the European Policy Forum.

**LFF:** In order to facilitate the taxation of savings, both the European Commission and the larger EU Member States are in favour of an automatic exchange of information between the country where the investor has invested his assets and his country of residence. In much of the debate surrounding the recent G20 Summit it has been assumed, almost without discussion, that automatic exchange of information represents best practice. What is the reason for this apparent attractiveness of an automatic exchange of information system?

**GM:** The debate has become tangled. OECD information exchange is on request. If all is well, there should be few cases where it is necessary to delve into people's financial affairs. Somehow this system has become bracketed together with "Automatic exchange of information" as practised in the EU. But this term is a misnomer. A better description would be "bulk transfer of financial

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data". What it means is the passing of enormous financial data sets between banks and financial institutions in one country and the revenue authorities in another. There is nothing automatic about what happens next. Once received by a revenue authority the data requires a great deal of processing, alignment, matching and calculation to work out what, if any, tax might be due. The system is neither streamlined nor efficient. It is quite different in scale from the OECD model. And it is not automatic. In fact, using a withholding tax is a more automatic way of ensuring that tax gets paid.

**LFF:** The majority of the EU Member States is operating a final withholding tax system for the taxation of their residents. Nevertheless, they are in favour of an exchange of information system at a European level. How do you explain this ambivalent attitude?

**GM:** I think there is a historic wish by revenue authorities to gain as much information as possible about the activities of their residents abroad. Before globalisation this meant a relatively small number of relatively

## Methodology of the survey:

EPF approached EU member states on the operation of savings tax systems and fourteen member states responded, five producing detailed analyses. These were followed-up in discussions with the tax authorities and through examination of responses to questionnaires of paying agents across the EU. Responses were received from paying agents in twelve jurisdictions.

wealthy individuals. The domestic savings market, by comparison, was quite large and a withholding tax was obviously a much more efficient way of collecting tax arising. Given the development of cross-border banking markets, it would now make sense to use withholding tax approaches here too, in the cross border market. But fiscal authorities seem to be stuck in a time warp.

**LFF: You have compared the withholding tax and the exchange of information systems. If you were the European Commission, which system would you opt for to implement at an EU level?**

**GM:** I would adopt a withholding tax approach. The deduction of real cash by a bank and its transfer to the revenue authorities of another Member State is a more concrete act than the passing of large numbers of data files. It is simpler, more efficient, and more capable of audit. The so-called automatic information exchange is seriously affected by the quality of data received, prone



Graham Mather, President - European Policy Forum

to lengthy delays, frequently requires manual follow-up and further enquiries and is prone to confusion on what is taxable. It is disproportionate for small countries without large financial centres and it seems clear that much of the information received under it in the past has gone essentially unused.

## ALL ABOARD AS ALTERNATIVES MOVE ONSHORE TO LUXEMBOURG

The trend for re-domiciliation of off-shore funds started some time ago. As a direct result of a circular issued by the financial supervisory authority, CSSF Circular 02/08 of 2002, which set specific rules for Luxembourg investment funds pursuing alternative investment strategies, many fund of hedge funds re-domiciled to Luxembourg from Cayman, Bermuda and the British Virgin Islands. The recently proposed Alternative Investment Fund Managers' (AIFM) Directive is likely to spur further onshore moves.



Didier Prime, Partner and Alternative Investments Leader at PwC Luxembourg describes this growing trend and the possibilities it brings to the Grand Duchy.

**LFF: As a direct result of CSSF Circular 02/08 many fund of hedge funds moved onshore to Luxembourg. Do you see this continuing?**

**DP:** Yes I do. Although, at the time, the circular was not considered to be flexible enough for hedge fund managers, it represents a good balance between investor