Tax Administration Responses to COVID-19: Administrative Measures to facilitate withholding Tax Relief Claims

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The COVID-19 health crisis has put unprecedented strains on the ability of both governments and taxpayers to carry out normal activities. Cross-border withholding tax relief procedures, frequently reliant on paper-based processes, are one area that has been particularly affected, creating challenges for taxpayers, financial institutions and tax administrations alike. This document contains administrative measures that source and residence jurisdictions may consider adopting to manage withholding tax relief procedures in a co-ordinated manner.

1. Background

The COVID-19 health crisis has put unprecedented strains on the ability of both governments and taxpayers to carry out normal activities. Cross-border withholding tax relief procedures, frequently reliant on paper-based processes, are one area that has been particularly affected, creating challenges for taxpayers, financial institutions and tax administrations alike.

In this respect, this note presents best practice recommendations for administratively feasible measures that source and residence jurisdictions may consider adopting to manage withholding tax relief procedures in a co-ordinated manner.

2. Overview of cross-border withholding tax relief procedures

In most countries withholding tax is levied on dividend and interest payments.[1] With respect to such payments to investors resident in treaty countries, taxing rights are shared between the source and residence country and therefore investors may be entitled to a lower withholding tax rate or exemption in the source country under a double tax treaty. The applicable relief procedures vary between jurisdictions, however most fall into one of two categories (whereby many jurisdictions apply both concurrently):

- ***Relief at source*** *procedures,* where treaty entitlements or exemptions are applied when the underlying dividend/interest payment is made, provided all the necessary information is made available to the withholding agent (often the issuer or the sub-custodian in the source country).
- ***Refund*** procedures, which involve the recovery of over-withheld taxes from the tax authorities in the source country.

The manner in which relief procedures are operationalised also differs between countries. Many countries still rely on traditional paper-based certification procedures, including requiring taxpayers to provide certificates of residence issued by the tax administration of the taxpayer's country of residence as proof of entitlement to treaty benefits. In light of the compliance and administrative challenges associated with such procedures[2] some countries have modernised their procedures, accepting alternative evidence of investors' entitlement to tax relief than certificates of residence (e.g. investor self-certifications and information collected under AML/KYC procedures), and relying on electronic rather than paper-based information. In the same vein, in January 2013 the OECD published the TRACE Authorised Intermediary (AI) system, designed to remove the administrative barriers affecting the ability of portfolio investors to claim treaty benefits.

Notwithstanding, many jurisdictions continue to rely on traditional procedures reliant on the yearly submission and verification of paper-based documentation. While such procedures already result in significant administrative burdens for investors, financial institutions and tax administrations alike, the COVID-19 health crisis has exacerbated the situation and presented additional challenges.

[1] The focus of this note are investors, including portfolio investors, who are most frequently subject to withholding tax procedures in respect of dividend and interest payments. At the same time, it is acknowledged that jurisdictions may also impose withholding taxes on other income streams, including royalty and service payments, whereby the best practice recommendations included in this note could also be applied to such payments.

[2] For a detailed description of the administrative challenges surrounding claims for tax treaty benefits under traditional relief procedures see the 2009 Report of the Informal Consultative Group on the Taxation of Collective Investment Vehicles and Procedures for Tax Relief for Cross-border Investors on Possible Improvements to Procedures for Tax Relief for Cross-border Investors. https://www.oecd.org/ctp/treaties/41974569.pdf

3. Features of cross-border withholding tax relief procedures that raise challenges in the COVID-19 health crisis

Three features of cross-border withholding tax relief procedures present particular challenges in the context of the COVID-19 health crisis:

i. Yearly tax residence certificates and certification of tax relief forms by residence countries

As mentioned above, many withholding tax relief procedures require a certificate of tax residence issued by the tax administration of the taxpayer's country of residence. This can either take the form of a certification on the specific treaty relief form prescribed by the source country or a separate certificate issued by the tax authority. Generally, the certificate of residence must be issued in the tax year in which the relevant dividend or interest was paid. In addition, some countries further require the information (including new certificates of tax residence) to be provided with respect to each payment date and, in the case of at-source relief procedures, prior to the payment date.

As a result of the global reaction to COVID-19, a number of tax administrations responsible for issuing tax residence certificates have implemented measures to protect their employees, leading to closed offices and remote working. This may affect the capacity of tax administrations to issue certificates of tax residence in physical form or to certify reclaim forms.

Further, tax administrations typically may issue residence certificates only to taxpayers that have filed an income tax return for the relevant period. However, during the COVID-19 crisis many tax administrations have extended the filing deadlines for filing tax returns and the processing of income tax returns is often backlogged, leading to consequential delays in issuing certificates of tax residence.

ii. Requirements for paper form tax relief forms by source countries

Current procedures requiring the submission of paper-based tax relief forms result in significant administrative burdens for investors, financial institutions and tax administrations alike. This is because publicly traded securities are typically held through multiple tiers of financial institutions, including local banks, global custodians and central securities depositories. As a result, paper-based documentation on individual investors must be passed on through the chain of intermediaries to the withholding agent in the source country.

The COVID-19 health crisis has exacerbated the situation and presented additional challenges. Indeed, remote working arrangements implemented by financial institutions make it difficult for their employees to receive, verify and process physical paper forms, leading to procedural issues and delays in the chain of intermediaries through which physical documentation must travel before being filed with the source country's tax administration.

iii. Other procedural requirements

There are source countries where certificates of tax residence and other tax documentation not only need to be provided in signed, physical form, but also need to be duly certified by a notary or consular office or display the Hague Apostille stamp. This means that it is necessary for a person to physically sign in wet ink a document and another person in the same place to attest its authenticity and that the document has been signed willingly. Due to restrictions introduced in light of COVID-19, investors may be unable to meet with a notary or access a consular office in order to comply with such procedural requirements.

4. Impact on investors and tax administrations

In light of the above constraints, investors may have to forego their withholding tax relief, in particular in a relief at source setting. Alternatively, investors who in normal circumstances would be able to claim treaty benefits at source may now be obliged to claim such benefits through a refund procedure. This may lead to unusually high numbers of refund claims which tax administrations in source countries may not be equipped to handle. In addition, refund requests may be left unopened until office-based services are resumed. This creates a level of uncertainty in the tax relief procedure, in particular where receipt of the refund claim is not acknowledged by the tax administration. Indeed, in such cases, the financial institution or the investor may have to assess whether to re-send the reclaim package, with the risk of inadvertently filing a duplicate tax relief claim, which may give rise to double tax relief, fraud investigations and result in potential revenue losses to governments. This uncertainty in reclaim procedures may further result in the launching of resource-intensive MAP requests between the source and residence jurisdictions.

5. Best practice recommendations

The COVID-19 health crisis is likely to still take time to be fully resolved. In this light, and considering the growing backlog of refund claims to be addressed by tax administrations and the potential permanent loss of relief for some taxpayers, it could be considered to adopt measures to ensure the ongoing effectiveness and integrity of the withholding tax relief claim processes, to the benefit of both tax administrations and investors.

Against this background, this section sets out some temporary measures that residence and source countries may consider adopting to address the issues identified above. It is of course acknowledged that the mix of measures for a country will depend on the type of withholding tax procedures it has in place, and whether the temporary measures can be put in place through administrative procedures, or require a change to the law.

i. Grace periods for tax residence certificates

Source countries which ordinarily require certificates of residence issued in the year of the relevant payment, could consider introducing grace periods that would allow investors to make claims for relief at source or reclaims using the most recent certificates of residence that they have, until such time as the adverse effects of the COVID-19 health crisis on the tax administration have passed and the backlog in certificate requests has been evacuated.

A number of countries have already put in place temporary grace periods during 2020 to allow foreign investors to make claims using their most recent prior year residence certificates. In order to mitigate potential risks of abuse, jurisdictions could complement such measures with additional conditions. For example, jurisdictions could prescribe the duration for which a tax residence certificate is valid to certify tax residence for withholding tax relief purposes, require that a tax residence certificate for the relevant tax year is lodged in due course, or require evidence that such certificate was already requested based on a reasonable expectation that it should be granted. Further, some jurisdictions have instructed caseworkers to exercise discretion and increased flexibility if the applicant is unable to deliver the required documentation on time due to the pandemic.

ii. Reasonable reliance on account information

Source countries which ordinarily require withholding agents to be in possession of a current residence certificate in order to reduce withholding rates to those set out in an applicable tax treaty could consider allowing withholding agents in their jurisdiction to apply the treaty rate of withholding where they had done so for a particular taxpayer in the prior year, the financial institution with whom the taxpayer holds its investments certifies that there is no material change in the account related information (e.g. AML/KYC information) which would indicate a change of tax residency and the tax payer self-certifies their tax residency or that there has been no such change. In many instances the financial institution with whom the taxpayer is holding the securities will already have much of this information, for example where it is a Reporting Financial Institution under the Common Reporting Standard.

iii. Electronic documentation

Source countries could consider accepting digital tax residence certificates, as well as digitally-signed and certified tax relief claim forms, either as a temporary or a permanent measure.[3]

Some countries have already introduced digital alternatives to the acceptance of physical (paper) for the claiming of withholding tax relief, including scanned or electronically-signed relief forms and tax residence certificates, on either a temporary or permanent basis. In rolling-out such procedures, many have also introduced security-enhancing measures to prevent fraud and provide comfort to their counterparty tax administrations. Others have committed to accepting electronic documentation pending the receipt of the original documents.

In addition, some residence jurisdictions have relied upon or expanded the use of existing e-services portals to facilitate the streamlined issuance of tax residence certificates, including in electronic form.

Box 1. Issuance of secure digital tax residence certificates

- In Spain, taxpayers can request electronic tax residence certificates issued in PDF format, containing a Secure Verification Code (CSV) that guarantees the integrity of the document. To encourage the use of electronic tax residence certificates during COVID-19, Spain informed source countries about the system and added to the certificates an explanatory document in Spanish and English explaining in detail the guarantee offered by the CSV, as well as the stages of the procedure to confirm the veracity of the tax certificates issued by the Spanish Tax Agency (AEAT) and presented by taxpayers to other tax administrations.
- In Indonesia, taxpayers can request electronic tax residence certificates online. A residence certificate is issued in under five days if the taxpayer has filed an annual tax return for the preceding two fiscal years and meets certain administrative requirements. Treaty partners and withholding tax agents can verify a tax residence certificate’s validity by scanning a barcode included on the certificate.
- In Mexico, tax residence certificates are issued electronically and can be verified by means of a QR code.

Source : Spanish Tax Agency (2021), Indonesian Tax Authority (2021) and Mexican Tax Authority (2021).

iv. Suspending apostilisation and other similar requirements

Source countries that require apostilisation, notarisation, or legalisation of documentation for the application of withholding tax relief could consider suspending this requirement.

[3] It should be taken into account that accepting digital certificates of tax residence may not be a complete solution in all circumstances, in particular where a residence jurisdiction is not in the position to issue documentation in such form.

v. External communications

Countries implementing any measures to alleviate the impact of COVID-19 on the withholding tax relief process should announce these publicly to ensure that withholding agents, custodians and investors are aware and thus able to apply the applicable rules on a timely basis.

Contact

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