

ESMA broadens scrutiny of multiple withholding tax reclaim schemes

Some EU Member States allow for a WHT on the dividends of listed companies, which under specific circumstances can be reclaimed. This can be abused by aiming to obtain multiple repayments of a single WHT paid upon distribution of dividends, ESMA analysed the incidence of these schemes and whether they result in a violation of the Market Abuse (MAR) or Short Selling Regulation (SSR), while identifying potential supervisory responses. To identify these schemes, ESMA analysed EU cash trading and securities lending volumes that showed increased trading activity around dividend dates.

Overall, the Report found, among other things, that the execution of these schemes do not necessarily imply a breach of the provisions of MAR or SSR. However, there could be concerns about compliance with share trading reporting obligations. In addition, the Report found that:

- dividend arbitrage trading can be carried out through a wide range of sophisticated and complex trading methods giving the impression that a series of genuine claims have taken place;
- the schemes involve high volumes of trading in the outstanding shares of large capitalisation EU index stocks, since the schemes are more profitable when carried out on a large scale;
- the schemes appear to be aimed mainly at obtaining multiple repayments of a single WHT paid upon distribution of dividends (i.e. potentially involving a tax fraud) often using a short selling transaction; and
- some national tax laws allow for the issuance of tax certificates that do not contain any reference to the underlying distribution of dividends, making it difficult to identify multiple fraudulent requests.

In relation to the MiFID II framework, based on the information that has emerged so far, these tax schemes do not necessarily imply a violation of MiFID II. Information on the illegality of a given practice and on the degree of involvement of the supervised entities and their directors in specific cases should be the basis to determine whether certain MiFID II requirements have been breached.

Steven Maijoor, ESMA Chair, said:

“ESMA has looked into multiple withholding tax reclaim schemes from a securities markets perspective. While these schemes do not necessarily imply breaches of the market abuse or short selling regimes, they may affect the integrity of securities markets and individual firms.

“ESMA has identified best practices that could be used by NCAs to detect and investigate multiple withholding tax reclaim schemes. In addition, we have

launched a formal inquiry to further collect evidence on NCAs' supervisory experiences."

Strengthening supervision and cooperation

ESMA has identified best practices that could be used by NCAs to detect and investigate multiple WHT reclaim schemes. These include:

- setting up calibrated alerts in surveillance systems to detect cases where the percentage of traded shares of an issuer reaches a significant level, or perform selective analysis around the dividend distribution dates for possibly relevant issuers;
- using central securities registers data on settlement, transactions and short selling data on short positions to check matching transactions;
- liaising with central securities registers and tax authorities to understand the totality of available data; and
- conducting further firm-specific investigations if need be.

However, as NCAs have different legal mandates, responsibilities and powers it may not be possible for all practices to be adopted uniformly. In addition, further cooperation and mutual assistance between NCAs, tax authorities and other law enforcement bodies could help to prevent the continuation of these schemes and a clear legal basis is required for such cooperation. There is currently no legal basis in EU financial law, namely MAR, MiFID II and MiFIR, for NCAs receiving relevant information under these pieces of legislation to transmit it to the tax Authorities.

Formal Inquiry

ESMA, to build on its preliminary findings, has launched a formal inquiry under Article 22(4) of the ESMA Regulation, to gather further evidence from NCAs on:

- potential threats to the integrity of European financial markets;
- the nature and magnitude of actors in these schemes;
- whether cases were found of breaches of either national or EU law;
- the actions taken by financial supervisors in Member States, and
- potential recommendations for action and reform to the competent authorities concerned.

Next steps

ESMA will report on the results of this formal inquiry to the European Parliament.