Asset managers and withholding tax: Problems, options and best practices for asset managers on withholding tax processing

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Abstract

This paper presents a detailed analysis of the critical role and complications surrounding withholding tax processing in the asset management industry. The paper first explores the substantial losses incurred by the industry due to a lack of proper attention and expertise in withholding tax matters, demonstrating the urgency of this issue. It then examines the current approach of relying predominantly on custodian banks for managing these issues, highlighting the shortcomings and risks inherent in this practice. The paper further investigates the current state of asset management companies, revealing their limited capabilities in managing withholding tax efficiently due to various factors including cost pressures, technological gaps and lack of awareness. To address these challenges, the paper proposes two primary options for asset managers: increased collaboration with tax advisers, and automation through software solutions. A detailed comparison is made on the pros and cons of these options. Collaborating *with tax consultants, while beneficial in many ways, might fall short due to the complexity and volume of the withholding tax challenges. On the other hand, automation can provide significant benefits in terms of efficiency, accuracy, scalability, compliance and cost-effectiveness, although challenges related to implementation and integration exist. The paper concludes with a checklist of critical success factors for selecting, implementing and operating withholding tax processing software, providing practical guidance for asset management companies seeking to improve their handling of withholding tax matters. These findings underline the importance of a proactive approach and the necessity for asset managers to explore the potential of technology-based solutions in this crucial area.*

Keywords: withholding tax processing, tax consultants, tax automation, asset managers, tax reclaim, tax relief at source

INTRODUCTION

Recently, there has been a growing interest in withholding tax within the financial industry, thanks in part to initiatives such as the European Commission's Fair and Simple Taxation (FASTER) project.[1] The escalating focus from finance professionals and corresponding media coverage has served as a catalyst for the creation of this paper. It has been observed that there is a dearth of content specifically tailored towards asset managers functioning within this intricate landscape. This has underscored the necessity to address this void. Consequently, an initiative has been undertaken to craft material catering to this underserved segment.

It is vital to articulate that the authors of this paper neither assume the role of tax advisers nor claim to be a tax consulting entity. Their specialisation lies in software development at RAQUEST, including the market-leading withholding tax automation engine. Their knowledge base might be less theoretical in terms of international taxation, but they have garnered practical insights into the challenges and potential solutions that asset managers encounter in this arena.

Their objective is to furnish readers with salient arguments, considerations and pragmatic guidance on withholding tax processing, rooted in the expertise amassed over their more than 13-year tenure in the industry. They aspire to empower asset managers by endowing them with the necessary insights and tools to navigate the complexities of withholding tax, enabling informed decision making for their respective organisations.

By disseminating their experiences, addressing prevalent misconceptions and offering pragmatic advice, they intend to contribute to the ongoing dialogue and equip asset managers with the requisite resources for optimising their withholding tax processes.

THE FIRST PROBLEM: LOSSES BECAUSE OF A LACK OF WITHHOLDING TAX PROCESSING ARE HUGE

Withholding tax, a common practice across global jurisdictions, is intended to ensure proper tax collection by imposing levies on cross-border security-based income flows.

Withholding tax has been an underestimated topic, however, and one that has not received the attention it deserves from various stakeholders, including banks, asset managers, tax consulting companies, investors and the media. Indeed, as shown in Table 1, it becomes evident that value stock investments are progressively gaining significance over the years. Between Q1 2022 and Q1 2023, a notable 36 per cent surge in dividend payouts across Europe (excluding the UK) has been observed. Europe has consistently played a pivotal role in cross-border investments due to the modest scale

Table 1: Annual dividends by regions in US$ billions[2]

Region	*2019*	*% change*	*2020*	*% change*	*2021*	*% change*	*2022*	*% change*	*Q1 2022*	*% change*	*Q1 2023*	*% change*
Europe ex UK	\$248.40	−2.1%	\$168.80	−32.1%	\$230.40	36.5%	\$255.60	10.9%	\$44.30	10.6%	\$60.30	36.1%
Japan	\$84.80	7.7%	\$80.50	−5.1%	\$81.80	1.6%	\$73.60	−10.0%	\$4.40	−15.2%	\$5.10	15.9%

of its national capital markets, thereby motivating investors to actively diversify their portfolios. Despite its significance in the financial landscape, withholding tax has often been overlooked, leading to potential challenges such as compliance gaps and missed opportunities for the parties involved.

The low level of awareness when it comes to withholding tax issues can often be attributed to the inherent complexity surrounding it. What makes the whole matter even more critical is that the combination of complexities and the lack of comprehensive frameworks for managing them has led to a significant loss of investment returns. It is a disheartening reality that billions of dollars are needlessly lost each year:

> 'Of the 1.6 trillion of tax withheld by foreign governments on cross-border investment income less than 7% will, under current conditions, ever get back to the investors to whom it belongs.'[3]

In light of this substantial financial drain, it becomes imperative for all stakeholders to rethink their approach and assume greater accountability in withholding tax management; this is especially valid for asset management companies, since it is their after-tax returns being affected.

THE SECOND PROBLEM: TRUSTING THE BANKS IS NOT ENOUGH

Through conversations with numerous asset managers in recent years, it has become apparent that a significant majority of them expressed a reluctance to engage with withholding tax issues. They often emphasised that they consider this aspect to be solely the responsibility of custodian banks.

This approach of relying mainly on custodian banks for withholding tax matters can be attributed to several factors. First, asset managers rather prioritise their core competencies, such as portfolio management and investment strategies, and prefer to allocate their time and resources accordingly.[4] Second, the perceived complexity and ever-changing nature of withholding tax regulations can be overwhelming, especially if you have in mind that due to cost-efficiency reasons many asset managers do not have big tax teams.[5–7] Third, they trust their custodian banks to thoroughly handle all responsibilities mapped out in service level agreements (SLAs) and contracts.

It is crucial to note that the authors still perceive custodian banks as playing a vital role in tax-related issues, including withholding tax; however, the notion that such institutions should bear the entire responsibility for this is overly simplistic. The complexities associated with these tax-related matters are too significant for a single stakeholder group to manage comprehensively.

Three aspects are driving this challenging complexity. First and foremost:

(1) The regulatory landscape surrounding withholding tax is known for its frequent updates and modifications. As illustrated in Figure 1, tax authorities regularly

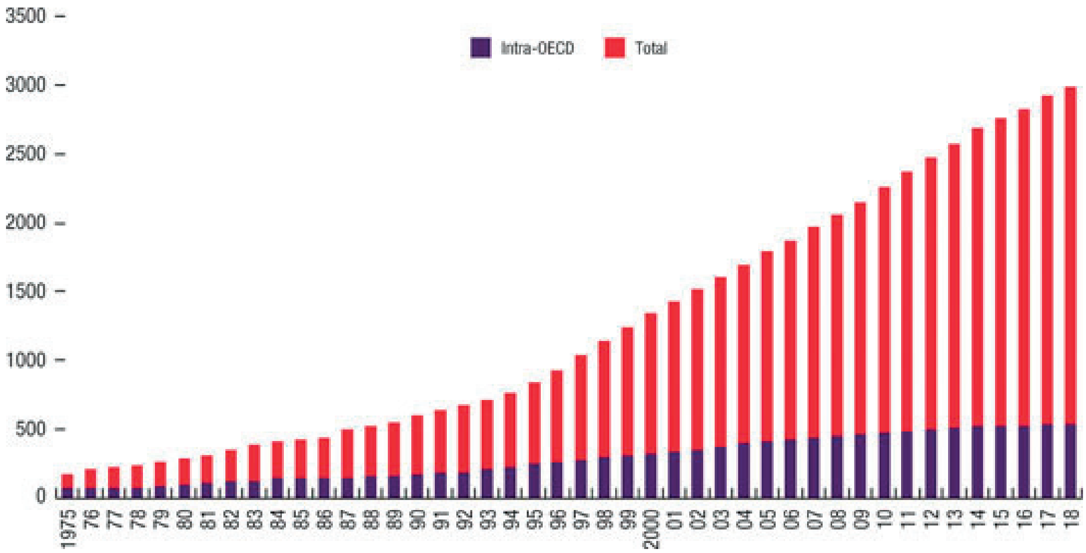

Figure 1 Development of worldwide tax treaty network[9]

introduce new treaties, regulations and rules, aiming to enhance tax compliance and prevent tax evasion. These changes can include adjustments to tax rates, modifications to exemption criteria, or the introduction of additional reporting requirements;[8]

(2) Reporting standards, rules, documentation requirements and timelines for withholding tax processes can exhibit considerable disparities among diverse jurisdictions (see Table 2). This variation necessitates custodian banks to have a deep understanding of the specific regulations in each jurisdiction where they operate, further increasing the complexity of the withholding tax processing;[10]

(3) Moreover, the digital transformation of tax authorities has introduced the need for more advanced and standardised digital submission gateways. Many fiscal authorities are transitioning towards electronic filing and require custodian banks to submit tax-related information in a specific digital format.[11,12] Adapting to these digital submission standards and ensuring seamless integration between custodian bank systems and the tax authorities' platforms can be a challenging task, especially considering the diverse array of systems and technologies in use across different jurisdictions.

Given the complexities and challenges associated with withholding tax processing, it is crucial for asset managers to maintain control and monitor their custodian banks rather than relying on blind confidence. By embracing a proactive approach to withholding tax management, asset management companies can unlock significant benefits for their clients and themselves. These benefits include maximising investment returns, minimising compliance risks, strengthening client relationships and gaining a competitive advantage in an increasingly dynamic industry. Below we explore and evaluate various options on how asset managers can implement that. Additionally, we conclude with a

Table 2: Statutes and recovery times

Country of issue	Deadline for filing claims	Indicative times to recovery
Australia	No deadline	9 months
Austria	5 years from end of year div. was paid	6 months
Belgium	3 years from end of year div. was paid	1–2 years
Canada	2 years from end of year div. was paid	14 months
Denmark	3 years from end of year div. was paid	12 months
Finland	3 years from pay date	6–12 months
France	2 years from end of year div. was paid	8–12 months
Germany	4 years from end of year div. was paid	10 months
Ireland	5 years from end of year div. was paid	6 months
Italy	4 years from pay date for div. with record date after 7/1/99; prior div. 1 year from end of year div. was paid	5–10 years
Luxembourg	2 years from pay date	6 months
Mexico	5 years from pay date	6 months
Netherlands	3 years from end of year div. was paid	2 months
New Zealand	8 years from end of year div. was paid	6 months
Norway	4 years from end of year div. was paid	1–2 years
Spain	4 years from pay date	8-12 months
Sweden	5 years from end of year div. was paid	6 months
Switzerland	3 years from end of year div. was paid	3–6 months

Source: Authors

best practices checklist specifically tailored for decision makers at asset management companies.

STATUS QUO: VERY FEW ASSET MANAGERS HAVE INTERNAL CAPABILITIES FOR WITHHOLDING TAX PROCESSING

It seems evident that very few asset managers currently possess the necessary resources and capabilities for efficient withholding tax processing. Several factors contribute to this situation:

(1) *Pressure on cost efficiency and slim organisational structure*: Asset managers often prioritise cost efficiency, resulting in lean tax operations teams with limited resources dedicated to handling withholding tax. Concentrating on primary proficiencies such as the creation of investment strategies may inadvertently result in a deficiency of specialised acumen in tax-related domains;

(2) *Lack of IT systems and tools*: Many asset managers do not have adequate IT systems or technology solutions in place to effectively manage and track withholding tax obligations. The absence of suitable systems hampers their ability to have timely and accurate indications regarding withholding tax requirements and potential risks;

(3) *Limited investor demand or pressure*: In some cases, asset managers may not feel significant pressure from investors to prioritise withholding tax management. Investors may not fully understand the impact of withholding tax on investment returns or may not actively seek transparency and compliance in this area;

(4) *Low awareness of the benefits of control*: Some asset managers may have limited

awareness of the advantages associated with having control over withholding tax processing. They may not fully realise that maintaining control in this area can contribute to improved tax compliance. By actively monitoring and managing withholding tax processes, asset managers can ensure accurate reporting, reduce the risk of non-compliance and enhance their overall tax governance. Without a clear understanding of these benefits and the potential impact on tax compliance, however, asset managers may not allocate sufficient resources or prioritise this aspect of their operations;

(5) *Minimal media coverage and awareness*: Withholding tax issues receive minimal attention from the finance media, resulting in a lack of pressure on asset managers to demonstrate proficiency in this area. The media's focus tends to be on other financial topics, such as market trends, Blockchain, investment strategies and regulatory developments (environmental, social and governance [ESG]), leaving withholding tax challenges largely overlooked. As a result, asset managers may not perceive a need to prioritise withholding tax processing or proactively address potential issues since there is little external scrutiny or demand for transparency in this specific domain.

SOLUTION OPTIONS: GIVE MORE OUT TO TAX CONSULTANTS OR GO FOR AUTOMATION

Considering the limited resources on the asset management side and the increasing need for greater control over withholding tax processing, asset managers are faced with two primary options. First, they can choose to collaborate more extensively with tax advisers, entrusting them with the mandate to oversee and manage the withholding tax processes. This approach leverages the expertise of tax professionals who specialise in navigating the complexities of withholding tax regulations and can provide valuable guidance and support. Alternatively, asset managers can opt for automation by implementing software solutions that enable them to monitor and control their custodian banks' withholding tax activities. By leveraging technology, asset managers can gain real-time insights, identify service gaps and take over the processing when necessary, ensuring efficient and accurate handling of withholding tax matters. Both options offer asset managers the means to address the challenges faced by custodian banks while taking proactive steps to safeguard their clients' investments and mitigate potential financial risks.

Pros and cons of using tax consulting companies

The pros

Opting for increased collaboration with tax consultants appears to be a logical choice for asset managers. Tax consultants are already familiar with the systems and processes of the asset management industry, while possessing specialised expertise in tax matters. Their knowledge and experience can prove invaluable, particularly when dealing with the international landscape of withholding tax, where procedures and requirements can change frequently. Moreover, tax consultants often have extensive networks and resources, enabling them to stay updated on regulatory changes and provide timely guidance. Asset managers typically find it easier to pass on the expenses associated with tax advisory services to their investors, making it a feasible and cost-effective solution for gaining access to expert tax support. This approach allows asset managers to leverage the existing capabilities and international networks of tax consultants, ensuring comprehensive and compliant withholding tax management.

The cons

According to what the authors see in the market, it is often not the case that tax consulting companies, even with their expertise, can effectively manage the complex challenges of withholding tax manually. Furthermore, the magnitude of work involved in managing withholding tax challenges renders the option of hiring tax consultants excessively expensive. The sheer volume of transactions, the need for continuous monitoring and adaptation to changing regulations, and the requirement for international expertise make it a resource-intensive and costly endeavour to rely solely on tax consulting companies for withholding tax processing. Moreover, it is not in the best interest of asset management companies to remain overly dependent on external (outsourcing) service providers for critical functions such as tax operations. Relying solely on third-party entities for an essential aspect of their operations introduces a level of vulnerability and dependency that can affect their ability to adapt swiftly to changing market dynamics and maintain control over their processes.

Pros and cons of using automation software

The pros

There are several compelling reasons why asset management companies should consider utilising software automation tools for withholding tax processing. First, these tools enhance efficiency and accuracy by reducing manual errors and streamlining workflows. Through automation, repetitive tasks, data entry and calculations are handled, resulting in time savings and a decreased risk of human error. Furthermore, investing in software automation tools offers long-term cost-effectiveness. While there may be an initial investment, the reduction in manual labour and potential errors can result in significant cost savings over time.

Additionally, these tools provide scalability and flexibility, allowing companies to handle increasing volumes of withholding tax transactions without requiring a proportional increase in resources. They can adapt to changing regulatory requirements and evolving business needs, providing flexibility for future growth. Automation tools also offer real-time monitoring and reporting capabilities. This empowers asset management companies with better visibility and control over their withholding tax processes, enabling them to make informed decisions, identify potential issues proactively and ensure compliance with tax regulations.[13] Moreover, these tools contribute to enhanced compliance and risk management by validating tax data, performing audits and generating accurate reports. This supports companies in meeting their regulatory obligations and reduces the risk of non-compliance.

Lastly, software automation tools encapsulate a significant amount of knowledge within the tool itself. This eliminates the necessity for asset managers to exclusively hire senior experts or tax specialists to operate the tool. With a well-functioning automation tool, individuals with less expertise in withholding tax can effectively navigate and utilise the tool's capabilities.

The cons

While these are strong arguments in favour of using software automation tools for withholding tax processing, it is important to acknowledge the challenges that asset management companies may encounter. Factors such as communication with upstream systems, the need for departmental training, provision of suitable IT infrastructure, limitations in certain markets and the implementation of data import mechanisms can pose hurdles to companies considering software adoption.

So, it is crucial for asset management companies to carefully evaluate these considerations and assess their ability to address these challenges effectively. By doing so, they can make informed decisions regarding the implementation of software automation tools and ensure a smoother transition towards more efficient withholding tax processing.

CRITICAL SUCCESS FACTORS WHEN SELECTING, IMPLEMENTING AND USING A WITHHOLDING TAX PROCESSING SOFTWARE

The selection of the right software (vendor)

This checklist represents a compilation of questions based on the authors experiences and interactions with various financial institutions during their evaluation of withholding tax processing software. While it provides a valuable starting point, it is important to note that this list is not exhaustive and may not cover all possible considerations. Additionally, Figure 2 provides a general overview of the fundamental functionalities of a withholding tax processing software.

(1) Functionalities, market coverage and regulatory updates:
- Does the software cover the markets and jurisdictions where you conduct withholding tax transactions?;
- Does the software have refund and relief at source capabilities?;
- Is it capable of handling the specific rules and requirements of different tax jurisdictions?;
- Does the software provider have a process in place to stay up to date with regulatory changes and ensure timely updates to the software?;
- Can the software adapt quickly to new regulations and provide the necessary tools to address any changes in withholding tax rules?;

(2) Integration and compatibility:
- Does the software integrate easily with your existing systems and infrastructure, such as accounting or portfolio management software?;
- Is it compatible with the data formats and protocols used by your custodian banks and other relevant stakeholders?;
- Can it easily import and export data to ensure smooth data flow and avoid manual data entry?;

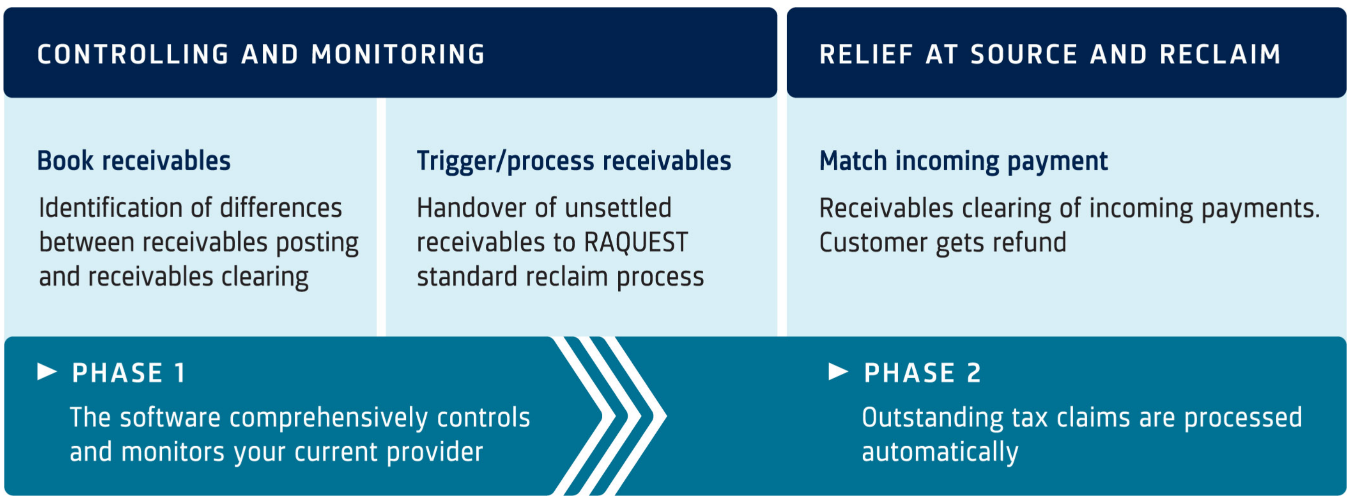

Figure 2 General overview of a withholding tax processing software

Source: Authors

(3) User-friendliness and support:
  - Is the software user-friendly and intuitive, allowing your staff to quickly learn and navigate the system?;
  - Does it offer comprehensive user documentation, training resources and customer support to assist with any issues or questions?;
  - Can the software provider offer adequate technical support and regular software updates to address evolving regulatory requirements and ensure optimal performance?

When implementing the software

After selecting the withholding tax automation software, there are several critical success factors to consider during the implementation phase. These include:

(1) *Clear project planning and management*: Develop a comprehensive implementation plan that outlines the key milestones, tasks and timelines. Assign dedicated project managers and team members responsible for different aspects of the implementation. Regularly monitor progress, address any roadblocks and ensure effective communication among stakeholders;

(2) *Data migration and integration*: Determine the scope of data migration from existing systems to the new software. Ensure that data is accurately transferred and integrated into the automation tool. Validate the integrity of data during the migration process to avoid any inconsistencies or errors;

(3) *Training and user adoption*: Provide thorough training sessions for the users who will be utilising the software. Ensure that they understand its features, functionalities and workflows. Encourage user feedback and address any questions or concerns promptly. Promote user adoption by highlighting the benefits and efficiency gains of the new system;

(4) *Configuration and customisation*: Tailor the software to meet the specific needs of the asset management company. Configure the system settings, rules and parameters according to the organisation's requirements. Customise reports and dashboards to provide relevant insights and monitoring capabilities;

(5) *Acceptance testing and validation*: Implement a structured acceptance and testing process to ensure the software meets the asset management company's requirements and functions as expected. Define clear acceptance criteria and conduct thorough testing to validate the software's performance, accuracy and compliance with regulatory standards. Involve key stakeholders in the testing process and address any identified issues or discrepancies before final acceptance and deployment.

What is important during production operation?

When running and using the software for withholding tax processing, several key aspects are important for asset management companies.

First, regular maintenance of the software is crucial to ensure its continued smooth operation. This includes applying updates, patches (including bug fixes) provided by the software vendor. What is more, having reliable and responsive support from the software provider is vital. The asset management company should have access to a dedicated support team that can promptly address any questions or concerns that arise during the software's use. Clear communication channels and timely resolution of support tickets — especially in the case of time-critical process steps in the context of relief at source — contribute to a seamless user experience. Lastly, establishing regular performance reviews and assessments can help evaluate the software's effectiveness and identify areas for improvement. This includes gathering feedback from users, analysing system logs and conducting periodic audits to ensure compliance with regulatory requirements and industry best practices.

SUMMARY

Prior to summarising the points discussed above, it is fundamental for the authors to underscore their position as providers of the market-leading withholding tax automation engine at RAQUEST. This affiliation certainly contributes a unique expertise to the discourse; however, it is equally essential to recognise that their perspective may not be entirely impartial, given their active role in formulating the software solution that addresses these challenges.

Despite this, they have endeavoured to illuminate the often-underappreciated complexities of withholding tax processing for asset management companies. The aim of this paper is to highlight the extent of the problem and debunk the misconception that it can be entirely managed by banking institutions. The fiscal losses incurred due to insufficient attention to withholding tax are considerable, necessitating a proactive stance and enhanced accountability from all stakeholders.

The authors have put forth two primary alternatives for asset managers: collaboration with tax advisers or the deployment of software automation tools. Finally, they have strived to offer a step-by-step guide for asset managers should they opt to purchase and employ software in this context.

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