Legal BRIEF

RECOVERING FOREIGN WITHHOLDING TAX IS WORTH THE EFFORT

Investors putting their money to work abroad are losing out to poor advice in this complex area of tax law. Here's how they can claim back a small fortune in tax

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As certain investors will be aware, most countries levy a withholding tax on returns from investments, usually derived from dividend and interest income. The rate of withholding tax varies but is generally between 20% and 30%, deducted at source by the country's tax authority. In many countries, all or a portion of the withholding tax is recoverable, providing a claim for its recovery is submitted within a specified period of time. With increased financial transparency, more people will be able to recover this tax, arguably imposing an increasing fiduciary duty on asset managers to engage in this reclamation process.

Investment performance is materially affected by the imposition of a withholding tax, as returns are subjected to 'double taxation'. Often, the effect of a withholding tax is not considered at the start of the investment decision making process, leading to reduced effective yields.

TAX MAZE

The ability to recover this tax is dependent upon a number of variables, including where the beneficial owner of the investment is domiciled, where the investment is made and the existence of any double-taxation treaties between the two countries. All of these factors, among others, can affect how successfully you will be able to reclaim a withholding tax.

The recovery process can be complex, time-consuming and highly administrative, involving numerous procedures and reclaim mechanisms, which vary massively from jurisdiction to jurisdiction. The truth is that one tick in the wrong box can result in the claim being queried – at best – or even rejected. Getting the necessary supporting documentation (such as tax certificates and dividend and interest vouchers) can also be challenging. What's more, some tax authorities will only approve refunds where the person submitting the claim has fiscal representation in the relevant country and can communicate in the native language.

Three main claim mechanisms can be employed to recover withholding taxes: double-taxation treaties, legal precedent from the European Court of Justice (ECJ) and domestic tax law exemptions. To add even more variables to the mix, some jurisdictions allow withholding taxes to be 'switched off' – in whole or in part – for a set period of time prior to the imposition of the withholding tax, through the submission of the appropriate forms. This mechanism is usually referred to as 'relief at source'.

Most custodian banks offer a degree of assistance when it comes to recovering withholding tax. However, their ability to do so is limited by some double-taxation treaties and domestic exemption claims, by certain rules in some jurisdictions, and by the custodian bank's service agreement with the client. Custodian banks are not entitled – by law – to dispense tax advice, hence their inability to perform ECJ claims, which are far more technical. This is problematic because only a partial withholding tax refund is then being obtained on behalf of investors.

THE RIGHT ADVICE IS WORTH A FORTUNE

In practice, asset managers are often shocked to find out that withholding taxes can, in some cases, be reduced to zero. Quite simply, investors are often not being advised accordingly, especially when it comes to ECJ claims, which are a relatively new practice in the realm of withholding tax. Fortunately, ECJ claims, as well as all other claims, can be performed by withholding tax recovery specialists and select third-party tax advisers.

Asset managers should ask the following questions:

1. Do I know where withholding taxes have been incurred and at what rate?
2. Do I know where it is possible to reclaim withholding taxes and to what extent?
3. Have claims been submitted in all relevant jurisdictions – to the fullest extent – by the custodian or a third party?
4. Have I received all refunds in all relevant jurisdictions to the fullest extent?

Asset managers who cannot definitively answer 'yes' to all of these questions should seek the advice of an expert service provider in this highly specialised field. When investors' money is being lost, there is, quite simply, no excuse not to.