Withholding tax on overseas dividends to UK Shareholders

What is withholding tax?

Most countries with legal systems that support the formation of companies have laws that levy a tax on dividends paid by those companies to overseas shareholders. This tax is called a withholding tax. For example, USA withholding tax is 30% - applied on dividends to shareholders in all countries outside the US.

Most countries have individual agreements with many other countries called Double Tax Agreements (DTAs). These will normally include limits on the withholding tax rates on dividends between the two countries. For example, the USA/UK DTA limits the withholding tax on dividends paid by US companies to individual investors in the UK to 15%, and to zero where the recipient is a UK pension fund. The agreement applies the same (15%) limit to dividends in the other direction – paid from companies in the UK to investors in the US, although this limit is only theoretical since the UK has not had any withholding tax on dividend payments since the early 1970's

What are Double Tax Agreements?

DTAs are not limited to tax on dividends. They may also cover other taxes on transactions or arrangements between the two countries – for example earnings, pensions, royalties and inheritance tax.

UK has DTAs with nearly 150 different countries. Across all countries in the world there are several thousand different DTAs.

Operation of withholding tax agreements

Each double tax agreement set limits on the amount of withholding tax that each of the two parties to the agreement can levy. The maximum rates normally differ for different categories of dividend recipient. The figures below are from the US/UK agreement, and the text also describes how the USA implements these rules in practice. (The text of the treaty almost never describes the actual procedures each country will apply – for example the US/UK agreement does not mention the advance clearance procedure that the USA actually operates).

Each dividend will be paid net of a deduction of 30% WHT (US). The US/UK DTA limits WHT to 15%, (unless the investor is a pension fund in which case there is no tax). The USA will permit the company paying the dividend to apply the treaty rate (rather than the full 30% rate) if the recipient files the appropriate documentation in advance.(If the advance documentation is not filed, the US company will deduct the full 30% and the recipient will need to file with the USA's Internal Revenue Service (equivalent of the UK's HMRC) for a refund.

Many other countries do not have a system for advance application for the double tax treaty rate to apply. Instead, the paying company will always deduce the full overseas country withholding tax rate, and the UK recipient will need to apply to the foreign tax authority afterwards for a refund.

Problems arise because of the different ways in which shares can be held in the UK. We distinguish between:

1. certificated shareholders (shareholders on register),
2. nominee shareholders - typically individuals investing through brokers/platforms that buy shares on behalf of the individual which are held in a nominee account in the broker's name, and
3. investors through SIPPS.

The WHT processes for these are:

1. Certificated shareholders must apply direct to the foreign country for advance application of the treaty rate (where available as with the USA) or file with the foreign country for a refund using dividend vouchers as proof that withholding tax has been suffered.
2. Nominee shareholders are technically owners (though without voting rights) but do not possess dividend vouchers in their name so must ask, through their broker, for the nominee to deal with the equivalent paperwork to (1) above. The broker must have a process to do this. In the case of the USA the relevant form is completed by the individual customer and then sent on via the nominee. Other countries will have different processes for applying for refunds.
3. Although Investors through SIPPS control the investments and are ultimate economic beneficiaries, they are not technically owners. The SIPP is legally a pension fund, and pension funds are trusts. The trustees must apply for the advance application of the treaty rate where available (as with the USA) or seek the refund due to the SIPP. UKSA members have experience of trustees doing this correctly for the USA (probably because US processes are easy and the USA is the most popular overseas investment destination) but failing to act in the case of other countries such as the Netherlands, Germany or Israel, even when asked by the beneficiary.

Consequences

These arrangements are complicated, confusing, and not necessarily well reported by intermediaries. They require expensive administration by third parties which it would be tempting to shortcut.

Individual investors may even be unaware of the overseas status of their investments – the company's country of tax residence is not normally a feature of brokers' lists. Nor is the withholding tax position advised to potential buyers, which one would have thought would be key information for them.

In summary:

1. Individual investors may be unaware of the need to act
2. Individual investors may be unaware of the pricing implications of potential investments
3. Not all foreign tax residence is obvious. Usually, the information given by a broker is the country of quotation, not the country of residence. For example, there are companies listed on the London Stock Exchange which are tax residents of Israel, Chile and many other countries.
4. The SIPP investor is dependent on the administrator of the SIPP trust. Administrators do not report their WHT claims to beneficiaries, and may or may not be acting correctly.
5. Is it possible that indirect investors are being seriously let down by their platform providers, without even being aware of it?

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