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VIA E-MAIL

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Re: Multilateral AEOI Initiative and Interaction with TRACE

Dear Achim and Philip,

The member banks of the Association of Global Custodians ("AGC" or "Association")¹ have been keenly following (and in some cases actively participating in) the work of the Organisation for Economic Co-Operation and Development ("OECD") with respect to the Foreign Account Tax Compliance Act ("FATCA") Model 1 Intergovernmental Agreement ("IGA") and the recent developments to create an effective and standardized global model of automatic exchange ("AEOI") of financial account information. Whilst the AGC welcomes this standardization initiative, we are writing to urge the OECD to ensure that the initiative also advances the goals of the OECD's TRACE (Treaty Relief and Compliance Enhancement) project in relation to improved procedures for granting withholding tax relief on cross-border investment income.

In providing global custody services, AGC members routinely seek appropriate withholding tax relief on behalf of custody clients. We typically collectively process millions of such relief claims each year, affecting substantial amounts of cross-border portfolio

¹ The Association is an informal group of 11 member banks that provide securities safekeeping and asset serving functions to cross-border institutional investors worldwide. Members provide custody-related services to most types of institutional investors, including investment funds, pension funds, and insurance companies.

investment flows in and out of countries worldwide. As such, we experience on a daily basis the costs, inefficiencies, and excessive withholding that arises when the procedures for claiming lawful relief are unduly burdensome or complicated for the investors involved. As the OECD launches its important new AEOI initiative, we therefore wish to emphasize the need to ensure that work in the AEOI area does not overshadow the work to improve and harmonize cross-border portfolio tax relief. Indeed, the Association views the AEOI initiative as a valuable opportunity for governments and business alike to achieve significant efficiencies by advancing both goals *simultaneously*.

As the OECD is aware, in 2006 the OECD's CFA created the Informal Consultative Group (ICG) on the Taxation of Collective Investment Vehicles (CIVs). The ICG was asked to report on:

- Technical issues relating to the granting of treaty benefits with respect to the income of CIVs
- Possible improvements to current procedures for claiming treaty benefits by all cross-border portfolio investors

In January 2009 the ICG's report on withholding tax procedures made a number of "best practice" recommendations, including the allowance of relief at source, based upon pooled claims made by authorized financial intermediaries for their customers, coupled with detailed information reporting obligations on those intermediaries. The CFA approved the creation of a Pilot Group to take forward the work of the ICG and develop standardized documentation to implement the best practices outlined in the ICG's report.

The resulting output was the TRACE project aimed at finalizing the documentation and developing the IT solutions to support the system, and in January this year the CFA endorsed the TRACE Implementation Package (IP). It agreed that the next steps were to work towards multi-country adoption of the TRACE system and to continue work to align TRACE with emerging reporting regimes such as FATCA, "in order to reduce implementation costs for all stakeholders".

When the TRACE project started it was widely acknowledged that, in practice, claiming withholding tax relief under Double Taxation Agreements and/or a country's domestic tax laws is often cumbersome and time and resource intensive for governments, financial institutions, and foreign portfolio investors. As a result, end investors often are effectively forced to forego the tax relief due them. This has adverse effects, not only on the investor, but also on the source country (due to its reduced ability to attract investment) and the residence country (due to its lack of information about the income of its resident or the excessive foreign tax credits it may end up having to give).

Whilst TRACE is regarded by the AGC, and the wider financial community, as a major step in streamlining processes, reducing costs, and giving investors their rights while improving tax compliance, sadly, no member countries have begun to move forward with actually implementing the IP, no doubt due in significant part to the resources they currently have to devote to address FATCA and related developments.

In our experience the process for claiming withholding tax relief has deteriorated in the interim in many countries, resulting in increased costs and protracted delays for cross-border portfolio investors to collect the tax relief due them. The types of burdensome

procedures increasingly faced by investors include: extensive, non-standardized documentation requirements, often for each income payment; the need to hire local counsel to pursue relief procedures; requirements for residence country tax administrations to provide certificates tailored to requirements of the source country; unclear or unreasonably complicated requirements for withholding tax relief on payments to CIVs, contrary to the OECD's recommendations; and lack of an effective refund procedure.

Where the complexity and cost of obtaining the tax relief to which an investor is legally entitled are too great, anonymous withholding is often the outcome. Even though the financial intermediary has access to accurate customer information and is subject to high compliance regulation standards, obtaining tax relief to which its customers are entitled is often not practicable. This undermines the objectives of treaties to reduce disincentives to cross-border investment, but it also can contribute to erosion of the investor's residence country tax base in the absence of some mechanism to ensure information about the investor's income is conveyed to his home country tax administration.

Reporting of financial account information under an AEOI initiative will go some way to address residence country taxation, at least where investors utilize financial intermediaries that are subject to reporting obligations. But implementation of TRACE, in conjunction – and contemporaneously – with an AEOI initiative can bring several benefits.

First, the simplification benefits from TRACE described above would of course be realized. Without TRACE, investors and intermediaries will continue to face the increasingly costly administrative burdens of varying domestic procedures, excess tax will often be withheld, source countries will be less attractive to investors, and residence countries will see their base eroded and will continue to face costs in the form of processing certificates of residence, underreporting of income, and/or overreporting of foreign tax credits. Source country governments who continue to operate tax reclaim systems will continue to bear the costs associated with such a system, such as the stamping and certification of tax reclaim forms and processing refund payments. Information aligning the implementation of an AEOI system with TRACE would reduce, and in some instances eliminate, many of these costs.

Second, the AEOI initiative implies a very substantial investment of money and resources on the part of governments and the financial industry to put into place the systems necessary to achieve the objectives of that initiative. If the elements necessary to implement TRACE are not built into the systems from the outset, the natural result will be resistance to reopening that design effort at a later date. Significant efficiencies could be achieved for both business and governments by covering both AEOI and TRACE simultaneously in the current initiative. This means taking into account the information requirements of both residence and source countries, but the issues related to doing that in the TRACE context have already been identified and resolved, so implementation of AEOI would not be delayed by the added focus.

Third, combining TRACE with AEOI has the potential to contribute to the objectives of the AEOI initiative itself. For example, the simplification benefits of TRACE would likely have the effect of attracting financial institutions that might not otherwise be subject to the reporting obligations relevant to the AEOI system (e.g., because of the jurisdiction in which they are located), thereby improving the chance that information about the customers of those institutions will be conveyed to their residence countries. Indeed, an explicit link between TRACE and AEOI (e.g., by conditioning a financial institution's participation in

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TRACE on its country's participation in the multilateral AEOI regime) could create the incentives needed to spur more countries to participate in that regime.

It would seem therefore that simultaneous implementation of the TRACE system with AEOI would not only represent an offset for many of the additional compliance costs that would be associated with any information reporting requirements but would also reduce administrative tasks within governments and a worldwide AEOI tax compliance system. In addition, the implementation of TRACE would ensure that correct information based on the investors' entitlement to mitigate or eliminate withholding taxes through double tax treaties would be reported to the country of residence.

We therefore strongly suggest that TRACE implementation be imposed in connection with a move toward broader automatic exchange of financial account information.

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The Association members appreciate any consideration that the OECD and Member countries may give to the comments provided above. We would be pleased to provide further information upon request in relation to any of the points raised.

Sincerely yours on behalf of the Association,

A handwritten signature in black ink that reads "Mary C. Bennett". The signature is written in a cursive style with a long horizontal flourish extending to the right.

Mary C. Bennett
Baker & McKenzie LLP
Counsel to the Association