THE ASSOCIATION OF GLOBAL CUSTODIANS

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SUBMITTED VIA E-MAIL
Mr. Ian DeSacia
Director
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Re: DTC Withholding Tax Services to its Member Organizations

Dear: Mr. DeSacia,

The Tax Committee of the Association of Global Custodians ("AGC" or "Association")[1] is committed to working on behalf of its member organizations to identify opportunities to overcome challenges in the pursuit of equitable tax services to its clients and to ensure its members are meeting the requirements of the local tax authorities. In our review of services provided by DTC we would appreciate the opportunity to discuss the expansion of two of the services The Depository Trust Company (DTC) is tasked with based on its role as a central securities depository. The services which we would like to address with DTC pertain to tax service on Canadian and Puerto Rico securities.

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[1] The Association is an informal group of 12 member banks that provide securities safekeeping and asset servicing functions to cross-border institutional investors worldwide, including investment funds. In providing global custody services, AGC members routinely seek appropriate withholding tax relief on behalf of custody clients by processing millions of such claims in the aggregate each year, affecting substantial amounts of cross-border portfolio investment flows in and out of countries worldwide.

Canada

Issue:

DTC offers a tax service on Canadian securities. Under the current service, an exemption from the dividend withholding tax is provided in certain circumstances and generally only when an entity has been issued a six-digit exemption number by the Canadian Revenue Agency (CRA). Canadian source interest is not subject to withholding tax. The CRA does not necessarily require a foreign tax-exempt entity to obtain a CRA exemption number in order to claim an exemption from withholding to which the entity is entitled under the terms of a tax treaty. This means that entities that do not, and are not required to, obtain a CRA exemption number may not benefit from an exemption from withholding to which they are entitled where they hold Canadian securities through DTC. Custodians would like to see an expansion of the service so all entities eligible for an exemption are able to secure the exemption if the securities are held at DTC.

Background:

An Elective Dividend Service (EDS) is provided by DTC as outlined in DTC's Canada – US TaxInfo Version 4.9.5. (TaxInfo) issued October 20, 2014. The TaxInfo document identifies relief opportunities for United States (US) and Canadian residents with a CRA identification number and non-US residents from any treaty jurisdiction where the applicable rates of Canadian withholding tax are the same as the rates specified in the United States-Canada Income Tax Convention of 1980. According to TaxInfo, an exemption from the dividend withholding tax is available to eligible Canadian residents with a valid CRA-issued identification number, eligible US entities with a valid CRA-issued number, and foreign governments, foreign governmental agencies and international organizations exempt from Canadian non-resident withholding tax by virtue of sovereign immunity that have received identification numbers from the CRA. No other entities are currently eligible for the exemption under the EDS procedure even when a lower dividend withholding tax rate may apply under the applicable Canadian tax treaty, and the AGC would like to see EDS amend its procedures to give these other entities access to their exemption through relief at source, notwithstanding the absence of a CRA-issued number.[2]

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2 Affected entities may include Danish pension funds eligible for an exemption on Canadian dividends under the Canada-Denmark Income and Capital Tax Treaty (1997), Irish pension funds eligible for an exemption on Canadian dividends under the Canada-Ireland Income Tax Treaty (2003), Swiss pension funds and the Swiss Central Bank eligible for an exemption on Canadian dividends under the Canada-Switzerland Income and Capital Tax Treaty (1997, as amended through 2012), UK pension funds eligible for an exemption on Canadian dividends under the Canada-United Kingdom Income Tax Treaty (1978, as

As a result of the above-mentioned limitations, the EDS service contrasts unfavorably to the relief provisions available to non-resident investors investing directly in the local market. The CRA allows eligible non-resident investors to benefit from a tax relief at source (RAS) service at the exempt withholding tax rate on Canadian securities held locally. To compensate for the lack of a RAS process for securities held at DTC by exempt investors, reclaims must be filed on behalf of each investor. Reclaims are a costly processing burden for the CRA as well as being burdensome to treaty-eligible holders of Canadian equities and to the custodians. The variance in tax relief procedures for local Canadian securities versus securities held at DTC also presents challenges for custodians needing to explain the differences in processing to clients holding securities both locally and at DTC. Issues also arise when fund accounting and cash projection reports generated using withholding tax tables based on the exempt rate do not reconcile with custodial "cash received" reports.

Recommendation:

The AGC recommends that DTC work with the CRA to update its EDS service to offer consistent relief procedures to all investors qualifying for an exemption with or without an exemption number. We believe this will benefit all entities involved. DTC will benefit as investors will continue to invest in Canadian securities offered at DTC versus on the Canadian market. The CRA would benefit significantly as paper reclaims will not need to be filed for dividends. Custodians will also benefit in that their clients will not be negatively impacted based on where they purchase their securities. Lastly, the reclaim process in Canada is paper-intensive and costly, and the AGC believes the CRA will agree that reclaims are not a good solution, whereas a simple change to add a 0% rate without the requirement of a CRA identification number should not be difficult to institute. Separate conversations with the CRA by custodians indicate that the CRA may be open to this change.

amended through 2014), and UAE governmental entities eligible for an exemption on Canadian dividends under the Canada-United Arab Emirates Income and Capital Tax Treaty (2002).

Puerto Rico

Issue:

DTC offers a tax service on Puerto Rican companies' stocks. Under the current service, upon distribution of a Puerto Rico (PR) dividend a custodian must quantify in the EDS process the portion of the income payment subject to a 10% or 0% withholding tax rate although part of the distribution may technically be subject to a 15% withholding tax rate. The lack of a 15% withholding tax election results in payments received through the depositary not being sufficient to settle the Puerto Rican tax authorities' requirements.

Description:

Under Act 77-2014, effective June 30, 2014, non-resident individuals, estates and trusts investing in Puerto Rican ADRs became subject to a 15% dividend withholding tax rate, increased from a previous tax rate of 10%. PR source interest is not subject to a withholding tax. Operationally, the local agent or issuer would be required to perform the withholding and remit the taxes withheld to the Puerto Rican Treasury (PRDT). In this case, the income from the PR companies' stocks is paid through DTC. Generally, DTC provides an EDS process where the participant bank can elect the applicable withholding tax rate based on the tax attributes of the underlying client. In the case of PR companies' stocks, DTC does not provide an "EDS election" to enable participants to elect the appropriate 15% withholding tax. As a result of this operating model, it is not possible for participants to facilitate the appropriate withholding tax rate where dividends are paid to holders of PR common stocks, and it is possible that the PRDT is not collecting tax sufficient to cover the liabilities of holders that are subject to the higher rate of PR tax.

Recommendation:

The AGC recommends DTC follow its own recommendation and require withholding at the 15% maximum tax rate unless a lower rate is elected by the participant under the EDS procedure.[3] We believe this will benefit all entities involved. The PRDT would benefit as they will collect sufficient levels of tax on PR dividends paid through DTC. DTC should

[3] In most markets, DTC enables dividend withholding to be applied at the maximum tax rate applicable to non-resident holders. In fact, page 8 of the DTC's Puerto Rico-United States Document issued March 12, 2015 states "the absence of a certification by the Participant will result in DTC applying the highest withholding rate, generally the tax jurisdiction's statutory rate."

initiate discussions with the PRDT to enable a mutual industry-level resolution of this issue.

The AGC appreciates the opportunity to discuss the issues and solutions highlighted above with you. Please do contact the undersigned if you have any questions concerning our positions.

Sincerely yours on behalf of the Association,

Mary C. Bennett

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