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Jeffrey Owens
Director, CTPA
Organisation for Economic Co-operation and Development
2, rue André Pascal
75775 Paris
France

Re: OECD Discussion Draft - Clarification of the Meaning of "Beneficial Owner" in the OECD Model Tax Convention

Dear Mr. Owens:

We write on behalf of the Association of Global Custodians (the "Association")[1] to convey Association members' comments in response to the invitation in the Discussion Draft issued by the Organisation for Economic Co-operation and Development ("OECD") on 29 April 2011. In the Discussion Draft the OECD proposes various changes and additions to the Commentary on Articles 10, 11 and 12 (collectively "the Commentary") of the OECD Model Tax Convention (the "Convention"). The aim of the proposed amendments is to clarify the interpretation that should be given to the concept of "beneficial owner" in the context of the Convention.

As you may know, the Association is an informal group of eleven global banking institutions with affiliates and branches in numerous countries that provide custody services and related securities asset-servicing functions to cross-border institutional investors around the globe[1]. In providing global custody services, Association members routinely seek appropriate tax relief on behalf of their custody clients. The Association also works to eliminate or minimize existing discrepancies in the current tax relief processes and regimes from jurisdiction to jurisdiction, which can be problematic and costly for custodians and their clients. As you will appreciate, the Association has a significant interest in the both the Model Tax Convention and the Commentary. The

[1] Association Members are listed on the letterhead above.

concept of beneficial ownership, particularly in relation to interest and dividends entitlements, is of fundamental importance to the custodian industry. We therefore welcome the OECD's initiative to clarify the concept of beneficial ownership in the context of the Convention.

Overview

Global custodians provide intermediary services to global cross-border securities investors. Services include various asset related operations such as: the safe keeping of the relevant investment; facilitating settlement and clearing; income collection; corporate action processing; and tax related services. Tax services may include the claiming of available withholding tax relief on income from securities investments on behalf of investors, where authorized to do so by such investors. Such claims may require the provision of certain documentation, and the global custodian will typically collect (or complete under power of attorney) such documentation and forward it on to either the local withholding agent or tax authority as appropriate. Custodian banks typically service a diverse client base – i.e., clients from multiple residence countries and clients having differing legal forms and business purposes.

In order to provide these custodian services in multiple markets of investment, the global custodian will typically appoint a sub-custodian network. These sub-custodians may in some cases be affiliates of the global custodian (branches, sister companies, subsidiaries), third party agent banks, or a combination of such entities. Where tax relief at source is possible in a market of investment, i.e. withholding tax relief at point of payment, it is common that tax documentation such as a treaty claim form is required to be submitted to the withholding agent. The withholding agent is typically either the appointed local custodian or the paying agent of the income. As such, the person making the decision whether or not to apply treaty benefits may not necessarily have a contractual relationship with the claimant nor have full knowledge of all client-specific facts and circumstances.

Detailed comments

a) *Domestic law regarding -- or an international fiscal meaning of-- the term "beneficial ownership"*

As you will be aware, it has been a point of debate whether beneficial ownership should be determined with reference to domestic law or to an "international fiscal meaning"[2]. The proposed wording in the Discussion Draft still leaves the alternative open by stating that:

> "Since the term "beneficial owner" was added to address potential difficulties arising from the use of the words "paid to ...a resident" in paragraph 1, it was intended to be interpreted in this context and not to refer to any technical meaning that it could have had under the domestic law of a specific country (in fact, when it was added to the paragraph, the term did not have a precise meaning in the law of many countries). The term "beneficial owner" is therefore not used in a narrow technical sense (such as the meaning that it has under the trust law of many common law countries), rather, it should be understood in its context, in particular in relation to the words "paid ... to a resident", and in light of the object and purposes of the Convention, including avoiding double taxation and the prevention of fiscal evasion and avoidance. This does not mean, however, that the domestic law meaning of "beneficial owner" is automatically irrelevant for the interpretation of that term in the context of the Article: that domestic law meaning is applicable to the extent that it is consistent with the general guidance included in this Commentary."

In this context, we note the comments of Professor Baker in his submission to the United Nations' Subcommittee on Improper Use of Treaties and suggest that a treaty-based definition – i.e. an 'international fiscal meaning' -- would seem a more logical solution. As Professor Baker argues, "the term was introduced into international fiscal usage through the work of the OECD, picked up and inserted into the UN Model, and is employed in double taxation conventions entered into by countries some of which employ the term 'beneficial owner' in their domestic law, others of which do not".[3]

Association members believe that the current wording in the Discussion Draft does not satisfactorily deal with the issue as it is unclear as to when a domestic law meaning would be in point. Members suggest that this paragraph deserves greater

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[2] Refer to Progress Report of Subcommittee on Improper Use of Tax Treaties: Beneficial Ownership, Economic and Social Council Committee of Expert on International Cooperation in Tax Matters, Fourth Session

[3] Ibid, p.9.

consideration and believe it would be appropriate to clarify the draft text or provide examples to illustrate when domestic law would be the applicable standard.

b) *contractual or legal obligation*

The Association is also concerned about the proposed wording that states as follows: "The recipient of a dividend is the "beneficial owner" of that dividend where he has the full right to use and enjoy the dividend unconstrained by a contractual or legal obligation to pass the payment received to another person". This wording is likely to put pressure on a beneficial ownership analysis where income equivalent payments are involved. As a general matter, the Association defers to other financial industry organizations, such as the Capital Markets Tax Committee of Asia and the Taxation Committee of the BIAC; we anticipate that those organizations will comment in detail on the specific difficulties that the Discussion Draft wording will present in financial industry contexts.

Members' narrow concern from a custodial perspective is that without further guidance regarding the extent and interpretation of this phrase it will create uncertainty for withholding agents and intermediaries. The current wording is unclear as to the intended reach and scope of this provision. The lack of clarity may lead different tax authorities to express different interpretative views. Furthermore, withholding agents and intermediaries will often not have full knowledge of the treaty claimant's facts and circumstances. As a result, any withholding tax rate determination will be based on representations made in documentation provided by such a claimant, and in practice, unless they have reason to know the representation is incorrect, the relevant agent or intermediary will have to take any such representation at face value. This may give rise to a greater degree of financial risk for the withholding agent or intermediary in countries that operate under a "strict liability" standard – i.e., the withholding agent or intermediary will be held liable for under-withholding even if it has received all the necessary documentation to evidence a treaty claim and has complied with the source country's procedures.

Association members therefore believe that further examples and explanation are warranted to define the intent and scope of this paragraph. Examples will allow the treaty claimant to make a more considered claim and the recipient of any such claim – i.e. the custodian bank or withholding agent – will be able more confidently to rely on the information provided within such a claim.

c) Liability

Custodian banks greatly prefer to operate in a tax environment that has legal and interpretive certainty. That is, custodian banks welcome clear guidance and regulatory precision governing questions of treaty eligibility and process. As noted above, the current proposed wording in the Discussion Draft leaves degrees of uncertainty regarding practical application of the draft's provisions in financial industry contexts. As such, and as outlined above, examples and explanations concerning the intent and scope of proposed wording are crucial to ensure clarity.

This gives rise to additional Association concerns with respect to work being performed by the OECD through the Treaty Relief and Compliance Enhancement ('TRACE') project. The TRACE project has at its heart a streamlined treaty claim process that would allow authorized intermediaries to provide treaty access to appropriately documented clients. These authorized intermediaries would, if they have taken on withholding responsibilities, withhold tax at the appropriate rate or instruct the relevant withholding agent to do so. In order to become an authorized intermediary, the intermediary will be required to enter into an agreement with the source country. This agreement provides for strict liability – i.e. the authorized intermediary will be held liable for any under-withheld tax. Members note that comment letters sent in by various industry bodies have previously requested that this standard be modified to a 'reason to know' standard. Those comments mirror the Association's concerns outlined above regarding the proposed changes to the Commentary. That is, without a clear meaning of the term beneficial ownership, would-be authorized intermediaries will face interpretive uncertainty and will thus have significant concern regarding the scope of the risk and the potential for liability. In this regard, we refer you to the British Bankers' Association's ('BBA') letter of 24 August 2010 that provided comments to the Report by the Pilot Group.[4] In members' view, the proposed clarification in the Discussion Draft may exacerbate concerns regarding the absence of guidance and the potential for risk. Members therefore fully endorse the noted BBA comments.

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[4] http://www.oecd.org/dataoecd/41/41/46019595.pdf

We hope these comments will be of assistance to you. If we can provide any further information, please contact the undersigned as an initial matter.

Sincerely yours,

Dan W. Schneider
Baker & McKenzie LLP
Counsel to the Association