

THE ASSOCIATION OF GLOBAL CUSTODIANS

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VIA E-MAIL

European Commission
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Re: **Consultation on tax problems faced by EU citizens when active across borders within the EU**

Dear Sirs,

The member banks of the Association of Global Custodians (“AGC” or “Association”)¹ appreciate the opportunity to respond to the public consultation recently launched by the European Commission (Directorate-General for Taxation and Customs Union) on tax problems that individuals encounter when they invest or work across borders within the EU.

Perspective of the AGC

In providing global custody services, AGC members routinely seek appropriate withholding tax relief on behalf of custody clients, who include not only direct individual investors but more commonly groups of individuals investing collectively indirectly through investment funds and pension funds. We typically process millions of such relief claims in the aggregate each year, affecting substantial amounts of cross-border portfolio investment

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.

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flows in and out of countries worldwide, including every Member State of the EU. 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. Accordingly, we would like to direct our comments to those problems and to the steps EU Member States could take to alleviate them.

Problems in obtaining withholding tax relief on cross-border investment flows

The problems faced by cross-border investors in obtaining appropriate withholding tax relief are not new, and much thought and effort on the part of the Commission and others has gone into analyzing ways to address them. It has been 13 years since the 2001 Giovannini Report identified national differences in granting withholding tax relief as a problem that should be resolved as a matter of priority. In 2004 the Commission adopted its Communication entitled “Clearing and Settlement in the European Union – The way forward” (ref: COM(2004) 312 final), which set out broad policy guidelines for further Community action in the field of securities clearing and settlement. This led to the formation of the Fiscal Compliance Experts’ (FISCO) group in 2005. In its mandate to the FISCO Group, the Commission noted that:

[D]ifferences exist in the procedures used in the various Member States to collect, or grant relief from, withholding tax. Even if total or partial relief is granted, eligible investors may be required first to suffer the tax and subsequently reclaim it. Procedures applicable to repayment of withholding tax can be very complex and may also differ considerably across Member States. Such complexities and differences significantly increase the cost of cross-border Settlement.

The FISCO Group was directed, *inter alia*, to “examine the fiscal compliance issues ... constituting barriers to efficient cross-border Settlement ..., with a view to reporting on ... whether alternative ways might be found for Member States to secure their tax receipts, while still permitting all financial institutions across the European Union to compete on an equal footing”, and to study whether “the different fiscal compliance procedures in place across Member States ... might be capable of being more closely aligned, so that the existence of a multiplicity of rules, which, among other things, raise the cost of cross-border Settlement, could be eliminated or substantially reduced”.

As early as their First Report published in 2006, the FISCO Group identified a number of issues which are still very common problems today, including the following:

- withholding tax collection and relief procedures vary considerably among Member States and different procedures often even apply to different classes of securities within the same Member State;
- tax rules may require foreign intermediaries to appoint a local agent or fiscal representative in order to be able to offer at source relief from withholding tax;
- relief procedures are not adapted to an environment where securities are held through multiple intermediaries -- problems systematically relate to the requirement that detailed information or paper-based certification on

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beneficial owners must be passed on through one or more intermediaries to the withholding agent prior to the payment of the income, a requirement that makes it practically very difficult to apply for relief at source when securities are held in omnibus accounts through multiple intermediaries on behalf of a large number of beneficial owners;

- the administrative burden associated with such procedures is increased by the fact that each country of investment has its own formal documentation requirements, so basically similar information must be provided in a different format in each of the countries of investment;
- there may be insufficient time between the dividend announcement date and the income payment date to allow the beneficial owner to provide the required certificates through the intermediary chain;
- refund procedures are complicated because, for example, investors (or their authorized representatives) are required to file separate refund claims for each income payment, it is not always easy to identify the appropriate office to which the claim should be sent, and the cost of filing claims may exceed the tax benefits at issue.

The Commission's Recommendation on withholding tax relief procedures

The work of the FISCO Group led to the Commission's adoption of a Recommendation on withholding tax relief procedures (C(2009) 7924 final) in October 2009. The Recommendation called upon Member States to improve and simplify their procedures for granting withholding tax relief on cross-border securities income flows within the EU by, for example:

- granting withholding tax relief at source;
- allowing foreign financial intermediaries to verify investors' entitlement to relief and to pass pooled withholding rate information up the chain;
- allowing withholding agents to rely on the pooled information provided;
- replacing requirements for certificates of residence with self-certifications by the investors, coupled with the application of know-your-customer (KYC) rules by the financial intermediary;
- allowing for the transmission of information and documentation by electronic means;
- requiring the foreign intermediary with the investor information to report that investor-specific information to the source country tax authorities;
- developing common approaches to the above and working in coordination with the OECD on its parallel initiative; and
- ensuring a simplified refund procedure was available in cases where the appropriate relief was not provided at source.

The OECD's recommendations on CIVs and on withholding tax relief procedures

The OECD had begun parallel work on the problems of cross-border withholding tax relief in 2006. Its Informal Consultative Group (ICG) on the Taxation of Collective Investment

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Vehicles (CIVs) produced a report in 2009 which contained proposals for an “Authorised Intermediary” (AI) regime which was closely consistent with the EC’s Recommendation. It also produced a series of recommendations on treaty provisions and withholding procedures countries should use to specifically clarify and streamline the issues surrounding the application of treaty benefits to income paid to CIVs. The latter recommendations were adopted through amendments to the OECD Model Tax Convention in 2010.

The OECD’s Committee on Fiscal Affairs (CFA) continued the general work on improving withholding tax procedures in the form of the TRACE (Treaty Relief and Compliance Enhancement) project, through which government representatives, working in close consultation with industry, developed an Implementation Package which could be used to implement the TRACE recommendations for the AI regime. The CFA approved the Implementation Package in January 2013, pledging further TRACE work to help countries adopt the AI system and to exploit synergies between the TRACE reporting rules and those being developed under FATCA and the more recent multilateral standard on automatic exchange of information (AEOI), the Common Reporting Standard (CRS). The latter standard was presented by the OECD to the G20 in February 2014 and has already achieved the endorsement of dozens of countries worldwide.

Our recommendations

Notwithstanding all the good effort that has gone into laying the theoretical groundwork for improved withholding tax relief procedures, little concrete progress has been made since these issues first became the subject of active intergovernmental discussion. Indeed, our experience is that the problems have become even more severe during the interim, as individual countries have introduced more and more diverging and onerous requirements for the processing of treaty relief claims.

We therefore have the following recommendations.

1. *Encourage the adoption of TRACE in conjunction with the AEOI initiative*

The most important step the EC could take to alleviate the withholding tax relief procedure problems would be to actively encourage the early and widespread adoption of the TRACE regime by Member States and other jurisdictions. The globalization of investment portfolios and financial service providers means that simplification and efficiency benefits from a coordinated regime can only be fully realized if the regime itself is globally applicable, so solutions to the European single market issues in this context must coincide with global solutions. Moreover, the EC should encourage the implementation of TRACE in conjunction – and contemporaneously -- with the AEOI initiative.

Pursuing these two goals simultaneously would provide several benefits. First, the simplification benefits from TRACE 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,

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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.

2. *Encourage adoption of the OECD's CIV recommendations*

As indicated above, the OECD in 2010 introduced into the OECD Model Tax Convention a number of optional approaches countries could adopt in their bilateral treaty relationships (e.g., through treaty amendments or competent authority agreements) to simplify and clarify the application of treaty benefits to investment income paid to CIVs. Model language for some of these proposals was further developed as part of the TRACE Implementation Package. These approaches allow countries to identify the criteria they will apply in granting benefits to CIVs established in their treaty partner countries and to agree upon reasonable procedural approaches to the actual application of those benefits. Unfortunately, there has been very little action on the part of governments to implement these proposals in their bilateral treaty relationships, with the result that investors are continuing to experience serious obstacles to the application of appropriate treaty benefits to the income they earn through CIVs (including, e.g., investment funds and pension funds).

3. *Encourage publication of guidance on issues relevant to claims of withholding tax relief*

One rather straightforward issue which arises in the context of claiming withholding tax relief is ensuring that the taxpayer has the appropriate information to determine whether relief is applicable and how it can be claimed. For example, an initial question is typically whether the taxpayer is a "resident" of a country to which relief has been granted by a treaty partner. Because residency criteria differ from country to country and because

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the residency determination requires familiarity with the legal standard, this determination can often be difficult for taxpayers to make. It would be very helpful if governments would publish guidance on this issue. Similarly, it would greatly lessen costs and difficulties for cross-border investors if governments made easily available necessary information on what withholding tax relief benefits are available and how those benefits can be claimed.

* * * * *

Once again, the Association members appreciate the opportunity to participate in this consultation. We fully endorse the consultation's stated goal of reducing the tax obstacles to cross-border activity and investment by individuals within the EU. 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