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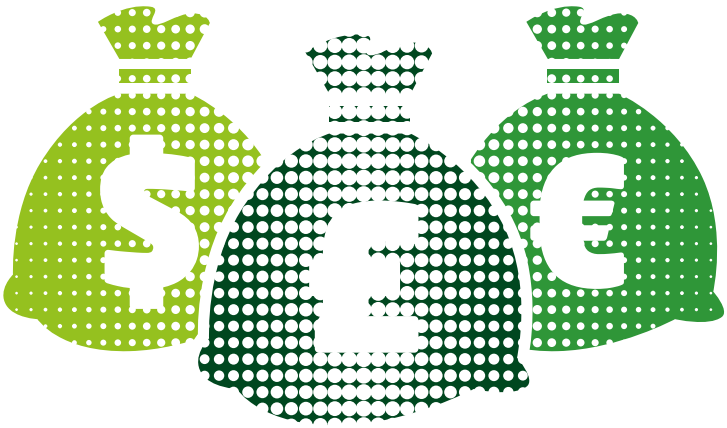

Global withholding tax relief

November **2014**

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Overview

This guide offers an accessible and practical introduction to the world of global withholding tax and tax relief on cross-border securities investments.

The guide explains:

- The general principles of global withholding tax on cross-border securities investments
- Guidelines for full or partial relief from this taxation under regulations or tax treaties
- The practicalities of actually securing the tax relief that investors are legally entitled to

Withholding tax is a levy deducted at source from income, especially from dividends, paid to non-residents of a country. It may be reclaimed if there is a formal treaty – called a double-taxation agreement – between the country in which the income is paid and the country of residence of the recipient. Cross-border investment in this context is when an investor resident in one country purchases a security in another country. Many securities pay periodic income to their investors either in the form of dividends or interest, and local withholding tax regulations often impose a withholding tax on such payments. Investors are often (sometimes to their surprise) subject to withholding tax on the periodic income received from these investments. Pension funds in particular often assume that as a tax-exempt organisation in their home jurisdiction, they should automatically be exempt from tax in a foreign country.

Every year, pension funds around the world earn billions of pounds of dividend and interest income from cross-border securities investment. Recent studies show the average proportion of a portfolio held in foreign shares in 2003 was 24.9% and by 2012 had risen to 33.1%*. However, most dividend income from equity investment and some interest income from fixed income securities are subject to withholding tax in the country of investment. Partial or full relief from this tax is generally secured for these pension funds by their custodians. But this is restricted to whether the pension fund qualifies for such relief and to the extent the custodians file the required reclaim documentation. It is believed that claims for this tax relief have in fact seen a marginal improvement since 2001, but there is still almost 24% of available tax relief being left un-reclaimed. Investors need to be vigilant to ensure they maximise investment returns through effective foreign tax relief strategies

** Source: IMF investment portfolio data and market capitalisation data from the International Federation of Exchanges. The calculation is all foreign shares / total market capitalisation.*

2

The rising importance of the dividend and cross-border investing

Investors worldwide are turning to equity markets for growth, with 80% planning to maintain or increase the amount they invest in 2014. Seventy percent of global investors believe equities will deliver the best returns in 2014 following a strong performance at the end of 2013.

Looking back, a watershed moment arrived in 2003 when Microsoft announced its first ever dividend. Since then, dividend payouts steadily increased in popularity until the financial market crisis. Then came a natural downturn. However, indicators are now showing a major resurgence in dividend payments as the markets grow strongly. Companies in the US Standard & Poor's (S&P) 500 Index paid a combined $311.77bn in dividends in 2013, up 11% from 2012. The increase reflects a restoration of some of the dividend cuts of 2009 and early 2010. Earlier this year, Howard Silverblatt, Senior Index Analyst at S&P Dow Jones Indices, pointed to "a record dividend payout in 2014 of $339bn from S&P 500 companies, topping 2013's $312bn, a far cry from when cash paid out totalled $196bn in 2009."

Interest in cross-border investments is also on the rise. According to statistics from the International Monetary Fund and from global stock exchanges, the market capitalisation of global equities rose 81% between 2003 and 2012. Over the same period, the value of cross-border equities investments rose by 141%. So cross-border shareholdings have risen at something around double the market rate, showing that fund managers have steadily increased the proportion of foreign shares in their portfolio from around 20% in 2001, to 28% in 2009 and 33% going into 2013. In fact, as of 30 June 2012, foreign holdings of US securities had bounced back significantly from $9.641bn in 2009 to $13.261bn.

3 Impact of withholding taxes

Most countries impose a statutory withholding tax on dividends and interest received by non-resident investors.

The issuer or its agent is generally required to withhold tax on behalf of the taxing authorities. Withholding rates vary by country, and frequently differ within a country depending on the type of income. For example, the statutory rate on dividends in Switzerland is 35%, in Belgium it is 25% and in the Netherlands it is 15%. So, an investor that receives a dividend from a Swiss company of CHF 1,000,000 will actually only receive CHF 650,000 on the dividend payable date. By contrast, on a €1,000,000 dividend from a Netherlands company, an investor will receive €850,000 on the payable date. Using this example as shown on Figure 1 demonstrates to you how a net dividend payment is calculated and the reclaim calculation added.

Figure 1.

EXAMPLE OF A CALCULATION

A Swiss Dividend Company	%	CHF
Dividend payable	100	1,000,000
WHT deducted	-35	350,000
Net dividend	65	650,000
Reclaim calculation	+20	200,000
Total received after reclaim	85	850,000

Obviously, recovering this tax can significantly enhance returns. On the other hand, specific types of securities may be subject to special withholding tax rules. For example many so-called Eurobonds are exempt from withholding tax.

a. Income tax treaties

Referred to by terms such as "double taxation agreements" and "bilateral tax conventions", income tax treaties are formal agreements, usually between two countries, that coordinate the taxation of income that flows between them. A main purpose of income tax treaties is to prevent international double taxation. However, it is important to note that tax treaties have other purposes including:

- Providing for an exchange of information and mutual assistance
- Curbing tax avoidance practices
- Encouraging international commerce and investment
- Increasing educational and cultural exchanges among countries

Tax treaties prevent double taxation by allowing a particular item of income to be taxed by either or both countries based on certain basic principles. The right of taxation may be given to:

- The country which is the source of the income;
- The country of which the recipient is resident; or
- The country of which the recipient is a citizen.

When both countries have the right of taxation under these principles, double taxation may be eased through foreign tax credit allowances in the country of residence or citizenship. To achieve these purposes, tax treaties contain a wide variety of provisions, including income exemption and reductions in tax rates. In recent years, numerous countries have negotiated new treaties or protocols that have extended tax exemptions to pension funds and certain other retirement plans.

b. Domestic tax regulations

In addition to treaty-based tax relief, the domestic tax laws in countries of investment often provide certain types of investors with similar or additional tax relief benefits. In contrast to treaty benefits, which are only available to residents of treaty partner countries, domestic tax law benefits are generally extended to investors without regard to treaties.

Domestic tax law relief is usually a function of:

- Status of an instrument's issuer (eg government vs non-government); and/or
- An instrument's terms (eg stated interest vs original issue discount, date of issuance); and/or
- The status of an investor (eg tax exempt vs taxable entity).

For example, stated interest from virtually all US debt securities (including US Treasuries) is subject to US withholding tax at the rate of 30%. However, under the so-called "Portfolio Interest" rules under domestic regulations, all interest paid on most such securities issued on or after 18 July 1984 to any non-US person that has provided the requisite documentation can be exempt from withholding tax.

In another example, the dividend withholding tax (DWT) rules on Irish equity securities is also a domestic tax law provision. It extends a full exemption from Irish withholding tax to virtually all residents of the EU and its tax treaty network, regardless of whether the tax rate set under a specific treaty is higher.

c. Markets

As discussed, full withholding tax rate, treaty rate, reclaim rate, indicative time-frame and statute of limitation vary by market. The following chart (Figure 2, right) illustrates the range of these variables as a sample of the major markets, taking a UK pension fund as the beneficial owner.

Please note that these rates are subject to change

(A) Full withholding tax rate – full tax deducted

(B) Treaty rate – tax deducted at source under double taxation agreements

(C) Reclaim rate – applicable reclaim rate which may be obtained under double taxation agreement

(D) Indicative time-frame – reclaim submitted to tax authority for period of to receive tax refund

(E) Statute of Limitation – period of availability to submit tax reclaim under tax agreement.

Figure 2.

Beneficial Owner: UK Pension Fund					
Country	**Full WHT Rate A**	**Treaty Rate B**	**Reclaim Rate C**	**Indicative Time-frame D**	**Statute of Limitation E**
Austria	25	0	25	1 year	3 years from payment date
Australia	30	15	15	6 months	6 years from payment date
Belgium	25	0	25	9-12 months	5 years from 01 January following payment date
Canada	25	15	10	18-24 months	2 years from 31 December after payment date
Denmark	27	15	12	4 weeks	3 years from payment date
Finland	30	0	30	6 months	5 years from payment date
France	30	15	15	8-18 months	2 years from 31 December after payment date
Germany	26.375	10	16.375	4-6 months	Within 4 years of payment date
Ireland	20	15	5	4 months	Within 4 years from 31 December following payment date
Italy	26	15	11	10 years	4 years from payment date
Japan	15.315	0	15.315	No time-frame	5 years from payment date
Netherlands	15	0	15	3-6 months	3 years from payment date
Norway	25	15	10	4 months	3 years from payment date
Poland	19	10	9	4 months	5 years from payment date
Spain	21	0	21	12-18 months	4 years from payment date
Sweden	30	5	25	2 months	5 years from 31 December after payment date
Switzerland	35	0	35	9 months	3 years from 31 December after payment date

4

Mechanisms for withholding tax relief

a. Relief at source

Whether obtained via a treaty or domestic law provision, tax relief is actually obtained either as a retrospective refund claim ("tax reclaim") or an up-front reduction/elimination of withholding taxes at source ("relief at source"). Available in many countries, sometimes only on certain classes of income or investments in particular countries, relief at source is not automatic and investors are usually required to provide necessary documentation.

Evidence of entitlement and procedures vary by country. In some cases, separate stand-alone certifications of taxpayer and/or residence status, available from an investor's tax authorities, are acceptable or required by the country of investment tax authorities. Alternatively, the country of investment may simply require investors to self-certify that they are entitled to benefits, and in some cases the investors' agents may provide such documentation.

Documentation can often be obtained in advance and attached to or filed separately with sub-custodians as required. (Note; a sub-custodian is an institution providing custody services, with respect to securities traded in a particular market or jurisdiction, on behalf of another custodian such as a global custodian who may not have a presence in that jurisdiction.)

For example, the UK issues "HMRC Certificate of Residency" including a "Pension Fund Reference Number", the US Internal Revenue issues IRS Form 6166, "Certification of Filing a Tax Return", and Revenue Canada issues "Fiscal Domicile Letters".

While some countries grant relief based on the evidence provided to sub-custodians when an account is opened, others require specific forms to be filed periodically with the sub-custodian. Others grant relief on a payment-by-payment basis only if new forms and/or certifications are provided each time a withholding event occurs. Specific forms, are usually issued by the tax authorities of the country of investment, and are often unique for investors from different countries. If required on a payment-by-payment basis, they usually must contain payment details, including the number of units held, the amount of the gross payment, the applicable rate and amount of tax to be withheld. Forms are then filed with the sub-custodian who, if acting as withholding agent, will withhold at the correct rate. If the issuer or its agent acts as the withholding agent, the sub-custodian will submit the forms and/or other documentation to the issuer/agent.

Where relief at source is possible, the manner in which the account is established with the sub-custodian is very important. The global custodian must notify the sub-custodian that the investor is entitled to tax treaty or domestic tax law benefits and should execute all necessary documents when the account is established.

b. Tax reclamation

Tax reclamations must be filed to obtain tax relief benefits when relief at source has not been obtained or is not possible. A tax reclamation is a claim filed by an investor resident in one country with the tax authority of another country to obtain a refund of an excess amount of tax withheld on a previous income collection. The excess amount is the difference between the amount actually withheld at source and the amount to which the investor is entitled under a tax treaty or domestic law provision. For example, tax reclamations are required in Germany, where

dividends are subject to 26.375% withholding tax at source. As a result investors entitled to 15% or 0% treaty rates must file a tax reclaim to secure a refund of the 11.375% or 26.375% respectively that was over-withheld.

Reclaim filing procedures vary by country. Some countries allow custodians to file reclaims on behalf of investor clients if the custodian has been granted power of attorney by the investor. In others, the investor must sign the reclaim form. The statute of limitations within which reclaims must be filed ranges from one to 15 years, depending on the country and/or the type of investment. Forms to file reclaims, generally available from the tax authorities of the country of investment, differ by country and are often unique for each investor's country. The time it takes to receive a refund once a claim is filed also varies by country, but such reclaims can take many months, if not years, to be paid.

Reclaims are usually initiated by custodians after they obtain details of a dividend or interest payment from a sub-custodian. Relevant sections of the form must be completed and certain documents (such as tax vouchers or credit advices) attached, and the claim forms are then signed by beneficial owners, authorised agents, or a custodian if so eligible under power of attorney. Tax authority certifications obtained on behalf of beneficial owners must often also be affixed to reclaim forms. Completed forms are then forwarded to either the tax authority in the country of investment directly or through the sub-custodian.

Certain markets require the reclaim forms to be filed with the sub-custodian. This is often the case where sub-custodians sometimes must sign-off on reclaim forms or they must file the claim with another paying agent. In most cases, reclaims are filed with sub-custodians since they are most familiar with remittance schedules and have established relationships with tax authorities.

c. Variations

Investors should be aware that there are often variations in the customary procedures for tax relief at source and tax reclamations depending on how certain securities are held, where they are held and whether the relevant tax authorities have instituted any special rules.

Securities held at international or local central securities depositories (CSDs) are sometimes subject to alternative procedures for tax relief. Some leading CSDs require special forms and have unique filing requirements. Most non-US securities held at a US depository – such as American Depositary Receipts ("ADRs"), global shares and bonds – are subject to unique procedures as well. In fact, in many cases relief at source is available through an electronic filing system.

A Depositary Receipt (DR) is a negotiable financial instrument issued by a bank, often referred to as a Depositary Bank, to represent a foreign company's public traded securities. Two common forms of DR are the ADR and Global Depositary Receipt (GDR). An ADR is listed and traded on exchanges based in the US, while a GDR can be traded on established non-US markets such as London and Singapore. In either case the depositary bank is the conduit through which dividends are paid, and many of these dividends are subject to withholding tax in the hands of the custodian in the foreign market. As such, the foreign custodian and the Depositary Bank may agree to certain often unique procedures to support tax relief claims for ADR and GDR investors. The electronic dividend filing system for Canadian securities, Japanese and French ADRs are examples of such procedures.

In general, depositary receipts ("DRs") present a unique challenge for tax relief/reclaim filers as the structure of these instruments is not always fully understood. A DR is a negotiable financial instrument issued by a bank to represent a foreign company's publicly-traded securities. A DR trades on a local stock exchange, but a custodian bank in the foreign country holds the actual underlying shares.

DRs are attractive to investors because they offer local investors easy lower-cost access to some of the world's best equity investment opportunities, are quoted and trade like investors' home country securities, attract lower brokerage and custody fees and investors receive dividends and other corporate action entitlements in their home country currencies.

Another variation in the mechanisms created by tax authorities to administer compliance with tax withholding rules has been the emergence of regulations to empower certain financial institutions to administer compliance. For example, the US and Ireland both have a Qualifying Intermediary (QI), while Japan created the Qualified Foreign Intermediary for Japanese Government Bonds ("JGBs").

These entities have generally been designed to:

1. create/promote efficiencies by facilitating withholding tax relief at source;
2. empower the financial intermediary to qualify investors for the associated tax relief; and
3. hold the intermediaries accountable for enforcement of the withholding tax, documentation and reporting regulations for the respective countries.

Recently, the US added its Foreign Account Tax Compliance Act ("FATCA") requirements which now require certain other non-US institutions as well as QIs to report information to the IRS about US account-holders or be subject to FATCA withholding tax. However unlike the QI and QFI regulations, FATCA is designed specifically to detect and deter the evasion of US tax by US persons who hide money outside the US. FATCA in future will have greater global impact.

5 The role of market participants and other providers

a. Custodians

A custodian bank is a financial institution responsible for safeguarding an investor's financial assets. The role of a custodian is to:

- hold in safekeeping assets/securities such as stocks and bonds, including both domestic and foreign
- facilitate settlement of purchases and sales of securities and currency
- collect information on and income from such assets (dividends in the case of stocks/equities and coupons (interest payments) in the case of bonds) and administer related tax withholding documents and foreign tax reclamation
- manage voluntary and involuntary corporate actions on securities held such as stock dividends, stock splits, business combinations (mergers), tender offers, bond calls, etc.
- provide information on the securities and their issuers such as annual general meetings and related proxy votes
- maintain currency/cash bank accounts, effect deposits and withdrawals and manage other cash transactions
- perform foreign exchange transactions
- often perform additional services for particular clients such as mutual funds; examples include fund accounting, administration, legal, compliance and tax support services

Investors generally hold the securities through a registration chain which involves one or more custodians. This is due to the impracticality of registering traded securities in the name of each individual holder; instead, the custodian or custodians are registered as the holders and hold the securities in a fiduciary arrangement for the ultimate security-holders. However, the ultimate security-holders are still the legal owners of the securities. They are not merely beneficiaries of the custodian as a trustee. Therefore, a central role of a custodian is to ensure that security-holders receive all the rights emanating from the security, such as dividends and other payments, and the proceeds of tax relief and tax reclaims. The tax-related responsibilities and associated service level standards are typically set out in a custody or trust agreement with a custodian.

A custodian is expected to know the tax rates for each of the countries in which it provides custody, what tax treaties apply to its custody network, whether its customers qualify for relief and how to file tax reclaims. Custodians should also have a process in place to monitor the tax reclaim process over time.

Custodian banks are referred to as global custodians if they safe keep assets for their clients in multiple jurisdictions around the world, using their own local branches or other local custodian banks. These local custodians are often referred to as sub-custodians and are generally responsible for performing the same duties as discussed above.

b. Central securities depositories

A central securities depository (CSD) is a financial organisation structured to hold securities such as shares either in certificated or uncertificated (dematerialised) form so that ownership can be easily transferred through a book entry rather than the

transfer of physical certificates. This allows bank and broker custodians to hold their securities at one location where they can be available for clearing and settlement. This is usually done electronically, making it much faster and easier than in the past when physical certificates had to be exchanged after a trade had been completed.

A CSD can be national or international in nature, and may be for a specific type of security, such as government bonds. Many countries have one domestic CSD that was traditionally associated with the national stock exchange. These organisations are typically heavily regulated by the government and may or may not be separate from the exchanges where trading in securities occurs.

An international CSD (ICSD) is a central securities depository that settles trades in international securities such as Eurobonds, although many also settle trades in various domestic securities, usually through direct or indirect (through local agents) links to local CSDs. Some view the US depository as a national CSD rather than an ICSD, but it does hold over $2 trillion in non-US securities and in ADRs from over 100 nations.

As a result, many cross-border investments are held through ICSDs and CSDs, which often leads to their involvement in the withholding tax relief/reclaim arena. Most offer specialised tax relief mechanisms, including support of tax relief at source for securities of markets where it is legally possible; tax reclaims where necessary; and in some cases very specialised tax relief mechanisms for certain types of securities including Eurobonds, DRs and others.

c. Tax authorities

As noted earlier, most countries have domestic tax laws and regulations that impose a withholding tax on income from securities paid to foreign investors. However, many countries also have income tax treaties in place with dozens of other countries and/or domestic tax law provisions that can eliminate or reduce the actual rate of tax that should ultimately apply.

Therefore, tax authorities have had to implement domestic regulations that define the tax relief mechanism and procedural requirements needed to enforce compliance. These procedural requirements generally include a decision about whether and how relief at source is made available, or how tax reclaims must be filed. As discussed earlier, some of these regulations have created the concepts embodied in the qualified/qualifying or qualified foreign intermediary entities.

d. Third-party tax relief service providers

Over the past 30 years a number of third-party tax relief service models have evolved. These models are based on software solutions, management of complex tax business rules, and outsourcing.

Some providers have developed tax reclaim software that is designed to work in concert with a custodian's custody and income processing platform. This type of solution generally contains functionality to manage final beneficial owner tax status information and tax documentation, to calculate tax relief entitlements, to generate tax reclaim forms, to facilitate the status tracking of filed reclaims, and to process refund payments. Some providers of this type of solution also include in the license and maintenance agreement ongoing maintenance of the expert tax business rules needed to ensure the solution continues to produce the results needed to file successful tax reclaims. The benefit of this solution is that it relieves the custodian from having to build and maintain its own system to keep track of all the periodic changes to tax rates, treaties, domestic regulations, forms and procedures.

However, some providers of this solution do not provide the tax business rules support, in which case the custodian must maintain the business rules themselves and carry the associated risk.

Another type of solution is a tax reclaim outsourcing model. In a typical outsourcing arrangement, the service provider performs all the functions needed to file tax reclamations based on client and payment data provided to the service provider by a custodian or end investor. As in any outsourcing arrangement, the benefit of this approach is that it allows the custodian to focus on its core competencies and moves the burden of performing this highly specialist and fragmented activity into the hands of practitioners with the experience, knowledge and tools to collect tax relief as quickly as possible.

6 Tax relief industry trends

a. Organisation for Economic Cooperation and Development (OECD) – TRACE tax relief

In reaction to ongoing encouragement and pressure from the financial community, the OECD's Committee on Fiscal Affairs (CFA), recognised that valid legal questions and administrative barriers existed which negatively impacted the ability of portfolio investors. This in effect identified the benefit of income tax treaties and domestic tax law provisions and formed the Informative Consultative Group (ICG) in 2006 to address these issues. This effort has led to a number of recommendations to streamline the process for cross-border tax relief and to clarify the conditions under which certain collective investment vehicles should/can obtain tax relief benefits.

The ICG was comprised of the tax administrations of some OECD member countries as well as representatives from the financial services industry including global custodians, international central securities depositories, tax and accounting firms, and trade organisations for the international fund industry. After years of discussions among its members a number of key concepts and recommendations emerged, and in January 2013 the CFA endorsed an Implementation Package: this is a self-contained set of agreements and forms to be used by any country that wants to implement the so-called Authorised Intermediary ("AI") system.

The AI system, also referred to as the "TRACE" or Treaty Relief and Compliance Enforcement service, is a standardised system for claiming withholding tax relief on portfolio investments. It aims to reduce the administrative barriers that currently affect the ability of portfolio investors to claim tax relief benefits.

Its key features are:

- Tax relief would be provided at source as the primary means of obtaining withholding tax relief, plus quick refunds in some cases
- Use of investor self-declarations (ISDs) instead of certificates of residence issued by investor tax authorities
- The system would allow AIs to claim exemptions/reduced rates of withholding tax on a pooled basis
- The concept of "contractual intermediaries" ("CI") for downstream intermediaries
- It is aimed at enhancing the ability of both source and residence countries to ensure proper compliance with tax obligations through the exchange of information between countries
- Rules on the extent of AIs' liability for under-withholding
- Independent review of AI compliance activities
- Special rules for investment funds/CIVs

On a practical level, this is designed to produce a number of tangible cost saving benefits. These include:

- Tax relief at source on the basis of pooled withholding tax claims at the time of payment
- Retention of investor information by the AI rather than being passed up the chain of intermediaries
- Elimination of time and expense of paper-based tax reclaims
- Clear and easy-to-understand procedures
- Five-year validity of self-declaration forms
- No need for certificates of residence from domestic tax authorities

On the other hand it is also expected to carry substantial costs. These include costs for:

- IT systems modifications
- New internal procedures
- Potential liability for errors on under-withholding
- New annual information reporting to multiple source country tax authorities
- Independent reviews

The OECD TRACE Group is now working on a plan for country adoption of the AI system, and is assisting countries considering implementing the system. In addition, work is continuing to try and ensure that the reporting requirements under TRACE are aligned with those of other emerging reporting regimes including FATCA. It is not clear if any countries have adopted this to date. Moreover since adoption will need to occur country-by-country over time, it is not likely that this will transform the cross-border tax relief landscape in the near future. Rather, it is likely to lead to yet another level of complexity over time.

b. European Court of Justice ("ECJ") withholding tax claims

In the European Union a significant number of entities such as pension funds, corporations, investment funds, life insurance companies and charities are challenging the withholding tax rules applied to dividend payments arising from various Member States. There are potentially thousands of claims to recover withholding tax on dividend income suffered in other EU Member States to be lodged with tax authorities.

All of these claims are possible due to the rules applied by some Member States, under which domestic and overseas recipients of dividends are treated differently for tax purposes. As an example the so called 'Aberdeen' or 'Santander' Claims are pan European claims by EU or third country resident claimants to recover withholding tax on dividend income suffered in other EU Member States.

The claims made to date could materially enhance a corporation's pension funds or investment funds, life insurance company's or charity's asset base, investment returns and in case of pension funds, go some way to addressing any funding deficit.

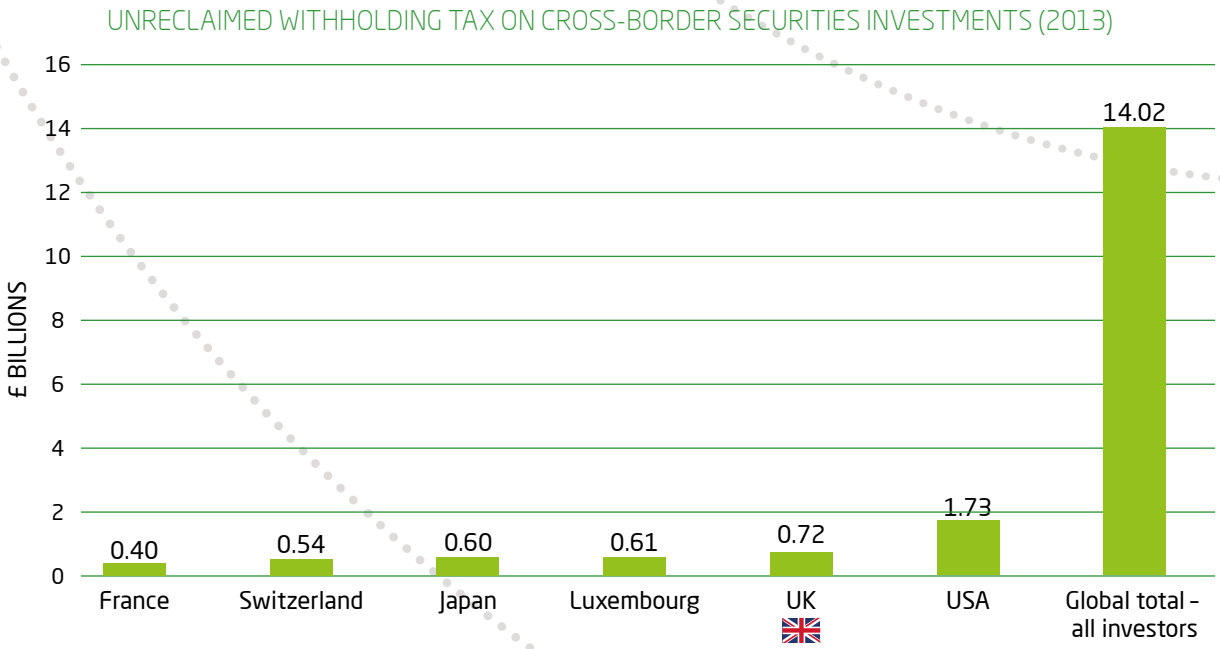
As to whether any of these claims will ultimately be agreed by the EU countries' tax authorities on a wide-spread basis is yet to be determined. Meanwhile, the tax and accounting firms have indicated that so-called "protective claims" should be lodged as soon as possible to remain within any relevant statute of limitations.

7
Related statistics

Assets under management of the world's largest pension funds totaled £9.2 trillion in 2013. This is up 6.2% from 2012, which was up 9.8% from a year earlier. This increase, coupled with an increasing trend toward cross-border investment and rising dividend rates, indicates an increasing value of unclaimed withholding tax relief.

Goal Group's research reveals that almost 24% of reclaimable tax is left unclaimed. Based on recent estimates, this amounts to more than £14bn of shareholder returns that are being lost or left unclaimed. The following (Figure 3) lists estimates on a per country basis.

Figure 3.



8

Pressure on fund managers and custodians

With the increasing popularity of both dividend payments and cross-border investment, the unreclaimed tax will continue to rise unless fund managers' service providers – often custodian banks – improve reclamation levels. In markets where high yield investments are harder to come by, increasingly savvy investors are putting the fund management community under growing pressure to maximise their investment returns. Some investors and fund managers are even making this duty a specific contractual clause.

As a result of all these factors, dividend yields have become a far more highly scrutinised element of the investor's portfolio, with consequent pressure on fund managers to devote greater attention to widen this element of return in the portfolios they are managing. The significance of unreclaimed withholding tax on cross-border securities holdings has therefore risen to a prominence it has not enjoyed since the nineties and early noughties. However, at this time there was no sophisticated technology available to automatically perform the highly complex task of reclaiming withholding tax, a process which has to incorporate up-to-date information, formats and procedures from a multiplicity of different tax authorities around the globe.

In contrast to the last period of attention enjoyed by the faithful dividend, technology solutions are now widely available to automate the process of withholding tax reclamation, making it an economic – indeed profitable – process for custodians, and a must-have for fund managers under pressure from their investor clients.

9 FAQ

Q: How can a pension fund obtain tax reclaim services?

A: Custodians often provide tax reclaim services on securities they hold in custody for clients. However, these services can also be provided by third-party tax reclaim specialist firms. These specialist firms often have many years of experience. They operate sophisticated tax reclaim platforms with the ability to effectively manage investor tax documentation, perform complex tax calculations and track filed tax reclaims. Additionally they have strong relationships with tax authorities around the world and with local sub-custodians.

Q: Are custodians obliged to file tax reclaims and/or obtain withholding tax relief at source for investor clients?

A: Custodians may provide tax reclaim and tax relief services under the service agreement where applicable. Pension funds should review their agreements with custodians to assess the service levels that have been agreed.

Q: Are pension funds entitled to reclaim 100% of any tax withheld in foreign markets?

A: Not always. While tax relief opportunities in many markets provide for a full exemption from withholding tax either under a domestic regulation or under an income tax treaty, this is not the case in all markets for all pension funds. Pension funds need to be vigilant to ensure that their tax status for withholding tax relief has been determined in every market of investment to enable optimal tax relief entitlement.

Q: How does a pension fund know what the withholding tax rates and relief opportunities are in each market?

A: Custodians or tax reclaim service providers should provide clients with this information on a regular basis as tax treaties, rates and tax relief procedures are subject to periodic change.

10

Glossary of commonly used withholding tax and tax relief terms

Beneficial Owner

The beneficial owner is the ultimate beneficiary of income paid. A person is not the beneficial owner of income if that person is receiving income as a nominee, agent or custodian. Since a customer's assets are often registered in the name of the brokerage firm or the central depository, the customer does not have legal ownership title, but is the real owner.

Withholding Tax

Withholding tax is a tax deducted at source, a tax levied by some countries on interest or dividends paid to a person resident outside that country. Many jurisdictions require withholding tax on dividends/interest and there are additional withholding tax obligations if the recipient of the income is under a different jurisdiction.

Central Securities Depository (CSD)

A financial organisation structured to hold securities such as shares either in certificated or uncertificated (dematerialised) form so that ownership can be easily transferred through a book entry rather than the transfer of physical certificates. This allows bank and broker custodians to hold their securities at one location where they can be available for clearing and settlement. This is usually done electronically, making it much faster and easier than in the past when physical certificates had to be exchanged after a trade had been completed.

Double Taxation Agreement (DTA)

In many markets, Double Taxation Agreements (DTAs) exist between the country of investor and the country of investment, providing for a reduction of the applicable withholding tax. The amount of tax relief afforded under a DTA is generally dependent on the asset and investor type.

Depositary Receipts (DRs)

A DR is a negotiable financial instrument issued by a bank, often referred to as a Depositary Bank, to represent a foreign company's publicly traded securities. A DR trades on a local stock exchange, but a custodian bank in the foreign country holds the actual underlying shares. DRs can be sponsored or unsponsored depending on whether the company that issued the shares enters into an agreement with the Depositary Bank that issues the DR. Two common forms of DR are the American Depositary Receipt (ADR) and Global Depositary Receipt (GDR). An ADR is listed and traded on exchanges based in the United States, while a GDR can be traded on established non-US markets such as London and Singapore.

International Central Securities Depository (ICSD)

A CSD that settles trades in international securities such as Eurobonds, although many also settle trades in various domestic securities, usually through direct or indirect (through local agents) links to local CSDs.

Organisation for Economic Cooperation and Development (OECD)

An international organisation focused on economic and social issues. The OECD was created in 1961 from the reorganisation of a Europe-only predecessor organisation. The OECD coordinates international efforts related to cross-border problems affecting member states such as money laundering, tax evasion, and corruption. The OECD has in recent years joined forces with various business groups and government tax authorities to develop and promote recommendations to reduce the administrative barriers that currently affect the ability of portfolio investors to claim tax relief benefits.

Reclaim Filing

This is the physical lodging of tax reclaim forms with the foreign tax authority or, for certain countries, the agent who lodges them with the foreign tax authority.

Relief at Source

The term "Relief at Source" means that a high statutory withholding tax rate is reduced or eliminated at the same time that dividend or interest income is collected, pursuant to a tax treaty or domestic law entitlement.

Statute of Limitations

These generally are written laws passed by legislative bodies that dictate the time period within which an investor has to file a tax reclaim for any excess tax that may have been withheld on securities income. These periods usually run from the date income is paid for a number of years after this date, and vary in length for different countries.

Sub-Custodian

An institution providing custody services, with respect to securities traded in a particular market or jurisdiction, on behalf of another custodian such as a global custodian who may not have a presence in that jurisdiction.

Tax Reclamation

A claim filed by an investor that is resident in one country with the tax authority or agent of another country to obtain a refund of an excess amount of tax withheld on a previous income collection. The excess amount is the difference between the amount actually withheld at source and the amount to which the investor is entitled under a tax treaty or domestic law provision.

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