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Inefficiencies of withholding tax relief/refund procedures applicable to portfolio income

EBF Conference achieving tax certainty in a world of uncertainty - 22nd November 2017

Lorraine White – Managing Director – Head of Global Securities Services – BNY Mellon

CROSS BORDER PORTFOLIO INVESTMENT - TAX BARRIERS – A LITTLE HISTORY

Why is Cross Border Portfolio Investment Important

- Portfolio investment is defined as cross-border transactions involving equity or debt securities.
- The characteristic feature of securities is their negotiability. i.e. ownership is readily transferable.
- Seen as efficient, flexible way of raising and investing money.
- Money not tied/locked up.
- On equity securities dividend income is often reinvested.
- For smaller investors the use of collective investment funds (CIVs) enables investors diversify.
- Over $20 trillion worldwide is invested via CIVs
- The importance of cross border portfolio investment has been recognised by the G20, EU Commission, OECD and the IMF and reflected in the EU Commissions CMU plans.

The EU and OECDs Work on Tax Barriers

- The **EU** work commenced following the <u>2001 and 2003</u> Giovannini Reports .15 barriers to efficient cross-border clearing and settlement.
- <u>2005</u> the EU created ('FISCO'). Its key objective was resolution of Giovannini Barriers 11 and 12.
- In <u>2009</u> the EU Commission adopted its Recommendation on Withholding Tax Relief Procedures (COM (2009) 7924 final) forming the T-BAG in June 2010. T-BAG report published in 2013

OECD

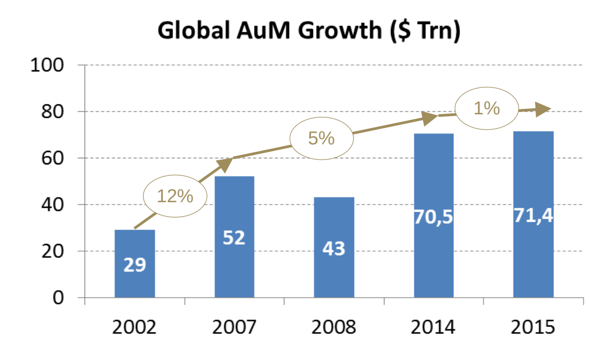
- In December 2006, OECD Committee on Fiscal Affairs (CFA) created the Informal Consultative Group (ICG) on Taxation of Collective Investment Vehicles (CIVs).
- In January 2009, CFA approved creation of a ‘Pilot Group’ to develop standardised documentation to implement best practices as outlined in the report
- In January 2010, CFA created The Tax Relief and Compliance Enhancement Group (TRACE).
- The TRACE group published the TRACE Implementation Package (IP) in <u>2013</u> following the endorsement by the OECD’s Committee on Fiscal Affairs.

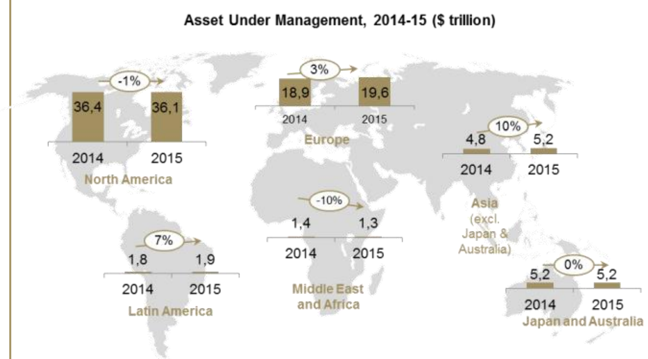
MACRO-ECONOMIC ENVIRONMENT AND IMPACT ON AUM/AUC

Macro-economics

Lackluster macro-economic environment is expected to lead to limited growth.

Even though global AuM growth stalled in 2015, regional differences exist





Source: BCG Global Asset Management Market-Sizing Database 2016; BCG Global Asset Management Benchmarking Database 2016.
Note: Sizing corresponds to AuM professionally managed in exchange for management fees

Trends	Description	AuM/AuC impact
Expansion of private wealth	• Rapid expansion of Asian's private wealth is an opportunity for asset managers to convert more clients to wealth management. Managers are expected to continue focusing on APAC and other burgeoning economies to limit exposure to home markets • Asset managers will look to provide services long-term investments such as insurance and retirement	↑↑↑
Changes in institutional asset management	• It is likely that European insurers will continue considering outsourcing to external investment managers to offset low fixed-income yields through enhanced diversification of assets • Sovereign funds will continue suffering due to volatility in commodities • Pension funds may move investment management	→
Growth in alternative investments	• Due to financial market volatility, alternative investment classes will continue to grow as investors are looking for returns • growing interest in private asset classes (e.g. private equity, real estate, infrastructure …)	→
Low interest rates & quantitative easing	• Historically low interest rates are expected to remain for the foreseeable future. This will continue to push investors to look for higher yields in equity and alternative investments • Quantitative easing programs by major central banks are expected to continue.	↑↑
Pensions	• Pension saving responsibility is increasingly shifting from governments to individuals, entailing a shift from 'Defined Benefit' (DB) provision to 'Defined Contribution' (DC) in pension funds. This results in growth opportunities for pension saving funds	↑
Economic growth perspectives	• According to the World Bank, growth prospects have weakened. Global growth for 2016 is projected at 2.4 % (1.7 % for advanced economies and 2.4 % for emerging markets) • Global growth is projected to pick up slowly to 3.0 % by 2018, as stabilizing commodity prices provide support to commodity exporting developing economies	↓↓↓
(Geo)political uncertainties	• Heightened policy and geopolitical uncertainties result in delayed investment decisions, further slowing down economic growth and hence assets growth	↓↓
Rising debts	• Debts are rising (e.g. student loans in the US, large sovereign debts in some European countries) • This is expected to have a neutral impact on the evolution of AuM as it will be off-set by bank deleveraging	→

TAX REGULATIONS

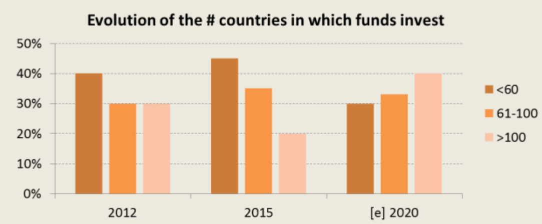
Tax regulations are gaining in importance and complexity over the years, requiring custodians to provide a more expert-based tax services offering

Increasing cross-border tax information exchange

- The world's tax authorities increasingly work together to combat tax avoidance and boost tax revenues
- Far-reaching reforms such as the Foreign Account Tax Compliance Act (FATCA), Common Reporting Standard (CRS) and the OECD's focus on Base Erosion and Profit Shifting (BEPS) require more detailed and transparent reporting
- As a result, tax information exchange between authorities will increasingly be the norm

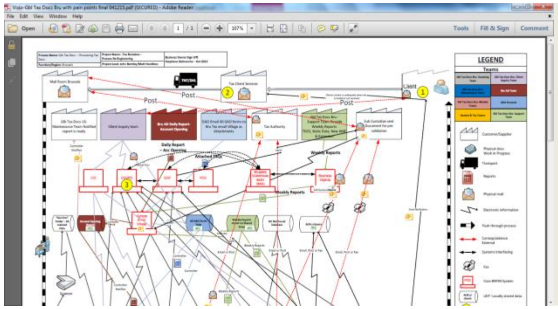
BUT THEY DON'T SEEM TO WORK TOGETHER TO ADDRESS TREATY ISSUES ON WITHHOLDING TAX

Increasing number of tax rules and complexity to comply with



- Number of countries in which asset managers invest increased over the last years and is expected to continue growing.
- Tax changes lead to operational changes impacting personnel or systems. (budgets, training, hiring of new staff);
- Simplification of administrative procedures becomes even more critical

Increasing client expectations



- Investors don't want the 'spaghetti junction' that is the paper flow today
- Obtaining paperwork for customers 'by post' seen as archaic
- Investors want simplification and digitisation
- **<u>Investors demand tax certainty</u>**

- Lack of awareness by Local Tax Authorities of the issues faced by investors
- Lack of communication between Tax Authorities
- Treaty procedures slow to be implemented
- Unclear and non-standard procedures
- Governments slow to change/invest in technology. Not keeping pace with the future.
- Over 500 people in industry working on tax relief processing

Source: PWC - Operational Tax Survey 2016, Own analysis

INVESTOR NEEDS

Client needs

What investors want

- In order to increase their profitability, clients search for yield and increasingly consider alternative asset classes and emerging markets.
- To invest and diversify that want ease of administration.
- Status and updates
- Paperless solutions
- Tax Certainty

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Tax barriers affecting investors

- Average withholding tax drag on an investment return can be more than 3 basis point.
- The tax treatment of collective investment funds becomes increasingly unclear.
- Tax authorities unable to cope with reclaim volumes.
- Globally over 1200 different tax forms are required.
- Process entirely paper based
- Current forms contain over 32 separate declarations (but all share common language).
- Average refund times exceed a year.
- Relief at source becoming increasingly impossible to implement.
- Tax certainty almost impossible to achieve.
- Excessive cost for all actors – Tax authority, client & industry cost.

Source: PwC Asset Management 2020, PwC / Strategy& analysis

Source: From big to great The world's leading institutional investors forge ahead, McKinsey, 2016

WITHHOLDING TAX RELIEF = A COUNTRY BY COUNTRY OVERVIEW

Source of Country of Income	Number of forms /Documents required	Digitisation	Relief Method	Refund Timeframe
Austria	8	No	Reclaim	>10 months
Bulgaria	5	No	RAS & Reclaim	> 12 months
Belgium	6	No	RAS & Reclaim	18-24 months
Croatia	4	No	RAS	
Czech Republic	18	No	RAS & Reclaim	>18 months
Denmark	6	No	Reclaim	>18 months
Finland	31	No	RAS & Reclaim	6-9 months
France	18	No	RAS & Reclaim	>12 months
Germany	11	No	Reclaim	> 12 months
Ireland	3	No	RAS & Reclaim	< 6 months
Italy	28	No	RAS & Reclaim	Most institutions don’t submit reclaims.
Netherlands	4	Yes	Reclaim	New digital process being implemented – Expect 4-6 weeks
Norway	6	No	RAS & Reclaim	6-9 months
Poland	30	No	RAS & Reclaim	12-18 months
Portugal	38	No	RAS & Reclaim	18-24 months
Spain	6	No	RAS & Reclaim	12-18 months
Sweden	4	No	RAS & Reclaim	6-9 months
Switzerland	12	No	Reclaim	12-18 months

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