

The G30/ISSA Tax Model



In this presentation I intend to outline the advantages of a global model for the delivery of tax relief to cross-border portfolio investors and to bring ISSA members up to date so far as ISSA's proposed tax relief model is concerned. Later we will hear about OECD work in this area. Many members may have some familiarity with the European Union effort in this connection, but perhaps less knowledge of what the OECD is doing in this respect.

Let me start with answering a critical question: Why is a standardized model needed?

Why is a Standardised/Streamlined Tax Relief Model Needed?

- Tax relief systems in many source countries have failed to keep pace with the growing level of intermediation and with the increased volume of cross border investment
- There is a proliferation of different tax relief systems / tax documentation requirements around the world, and sometimes within the same source country!
- It is practically impossible to secure tax relief in certain countries due to impediments such as:
 - Excessive documentation requirements
 - Unreasonable lead times for providing information / documentation
 - Imposition of local advisors
 - Inordinate tax refund delays
- In consequence, the administrative/system resources required to secure relief for eligible investors are substantially inflated; eligible investors are often denied treaty relief or suffer disproportionate costs in securing that relief

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All stakeholders stand to profit from the G30/ISSA tax model. For all parties involved in the process, the

model should provide for greater attractiveness in investing cross-border, and it should improve efficiency in the global capital market.

Benefits of a Standardised/Streamlined Tax Relief Model

- These include:
 - For financial intermediaries, substantial reduction in current administrative costs, simplification of process and elimination of exception processing/risk
 - For investors, enhanced tax relief opportunities (scope and timing), greater certainty of entitlement and reduction in current administrative costs
 - For Government, reduction in current administrative costs of providing tax relief and handling competent authority cases (in relation to residents and non-residents)
 - For all, greater attractiveness of cross-border investment and improved capital market efficiency

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Financial intermediaries have the prospect of a substantial reduction in the administrative cost which they currently incur, simplification of process and, across many countries of investment, elimination of exception processing and associated risk.


For investors, there is the prospect of enhanced tax relief opportunities with tax relief becoming available in far more countries than is currently the case. Also, with the provision of that relief becoming more advanced, generally at the point of income payment rather than retrospectively by way of a tax reclaim application, as is the case in many countries of investment right now. Lastly, there is greater certainty of entitlement and reduction in administrative costs.

Administrative costs are also an issue for governments, particularly where they presently adopt a tax reclaim system or a fairly extensive, demanding relief at source system. There is certainly potential for governments to reduce their costs. There is also the potential for governments to significantly reduce competent authority cases where a person seeks government assistance to resolve treaty issues. This can apply both for local investors investing cross-border and for cross-border investors investing locally.

Background to Development of ISSA Model

- The Group of Thirty (G30) issued its report “Global Clearing and Settlement - A Plan of Action” in January 2003
- Recommendation 8 considered, *inter alia*, the need to automate and standardise tax relief arrangements for cross border investors:
 - “ Market participants and public authorities should work together to minimize the administrative costs to each party involved in tax relief arrangements through standardization and automation of procedures and communication of information and through the use and acceptance of electronic data and documentation”
- During the course of 2004, a putative tax relief model was developed with the aim of converting this high level G30 aspiration into a practical working reality
- The tax relief model was posted to the ISSA website in February 2005, where it has attracted a generally favourable reaction

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The genesis of the model is the Group of Thirty report that was issued in January 2003. Recommendation 8 considered the need to automate and standardize tax relief arrangements. However, the G30 did not articulate a process or a model for converting the very high level aspiration into a practical reality. This led to the development of the tax model during the course of 2004. The model was published in early 2005 on the ISSA website. It was introduced to the public in our ISSA Regional Meetings and at many other occasions. The model attracted many favorable comments. No negative reactions were received but there were a number of comments made and, as I go through the rest of my presentation, I will highlight some of them.

The concepts that underpin the development of the model were as follows:

ISSA Model Concepts

- Designed to fully satisfy G30 criteria by:
 - Standardising tax relief arrangements
 - Providing platform enabling automation of associated procedures and electronic communication of associated data
 - Providing opportunity to minimise associated costs
- Builds on existing technology and best practices

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One point to emphasize, like in the ISSA Mutual Funds and the OTC Derivatives Working Group updates, was the approach to build on existing technology and best practices – things that are already out there in certain markets and which work well. The approach is evolutionary rather than revolutionary. Re-inventing the wheel is not the intention.


The next four slides and the three flow charts that follow summarize the model's key features. We will return to them when we examine the likely future direction of the OECD project. Note there is some external commentary received in respect of the model which is included in the slides.

Key ISSA Model Features - Information Delivery

- Investor completes a single declaration covering all source countries, confirming (i) identity, (ii) residence, (iii) generic category and (iv) eligibility for tax relief
 - Some commentators have suggested that other information held on file (e.g. KYC) may be used in lieu of securing investor declaration
- The information provided by the investor remains with the intermediary acting directly for the investor
- If the intermediary acting for the investor does not have withholding responsibility, pooled tax rate information (rather than investor-specific information) is passed up the intermediary chain to the withholding agent by means of:
 - separate tax rate pools (relevant tax rate information provided at the point of security acquisition - see Flowchart 1); or
 - single pool (relevant tax rate information provided at the point of each income entitlement - see Flowchart 2)

established with each upper tier intermediary or the withholding agent
(Intermediaries may thus operate an optimal “omnibus” account structure)

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Key ISSA Model Features - Tax Deduction/Relief

- The withholding agent applies appropriate reduced tax rates AT SOURCE, based on:
 - Declaration received from direct investor
 - Tax rate information received from intermediary
- Tax deduction responsibility is unaltered under the model, however some commentators have suggested that there should be an option for lower tier intermediaries to elect for withholding responsibility in lieu of passing tax rate information up the intermediary chain

(Flowchart 3 illustrates information delivery and income flow under model)

Key ISSA Model Features - Intermediary Authorisation

- Only authorised intermediaries may benefit from the simplified arrangements set out in the model
- Authorisation is based on standard criteria, to assure consistency and a level playing field
- Model envisages that intermediary is authorised by the taxing authority in the country of operation

There are likely to be significant changes in the field of intermediary compliance verification. Tricia Brown will provide further detail later on in this regard:

Key ISSA Model Features - Intermediary Compliance Verification

- Model envisages that authorised intermediaries are subject to periodic review by the taxing authority in the country of operation
- Review primarily system based, but more granular information may be provided if necessary (to demonstrate that, where appropriate, the intermediary secures proper investor declarations, secures/passes accurate pooled tax rate information and applies correct withholding)
- Some commentators have suggested that intermediaries may optionally elect for review to be performed by external auditor
- A number of commentators have emphasised that the intermediary should not be penalised for acting in “good faith”

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Subsequent Developments

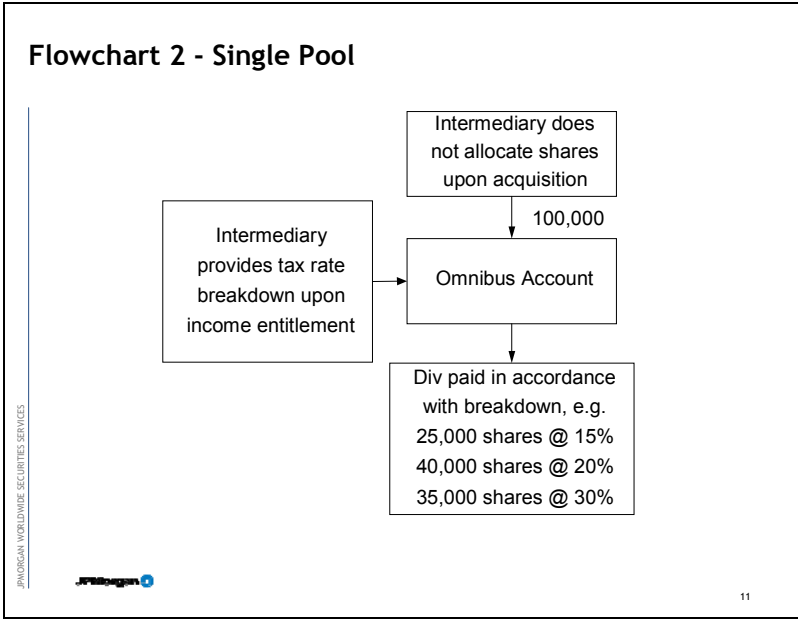
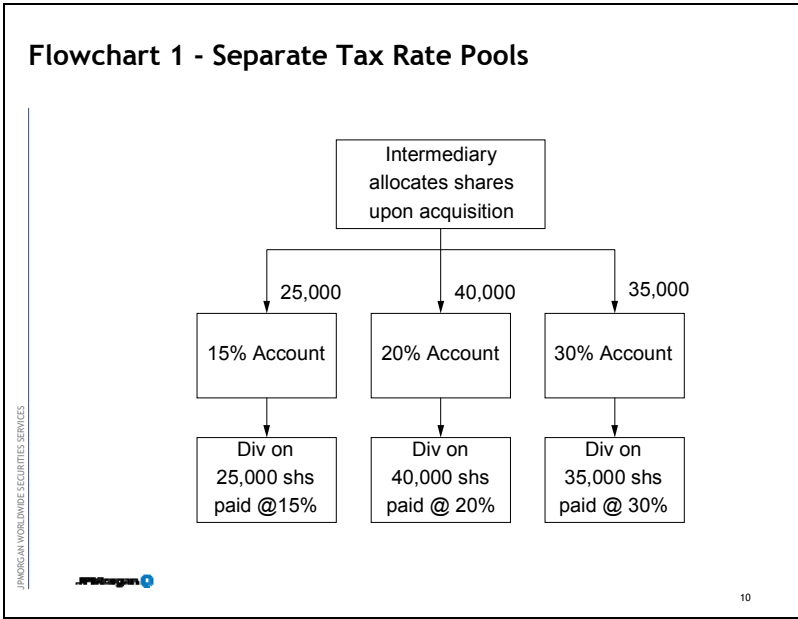
- The model has been presented to various interested parties, including the OECD and EU Commission (FISCO group examining fiscal compliance barriers)
- The model has had a substantial influence on the conclusions announced by the FISCO group in 2007
- In 2006, the OECD established an Informal Consultative Group (ICG) of Government and industry representatives to examine the issues of treaty relief for collective investment vehicles and the general administrative arrangements for providing treaty relief to cross border investors

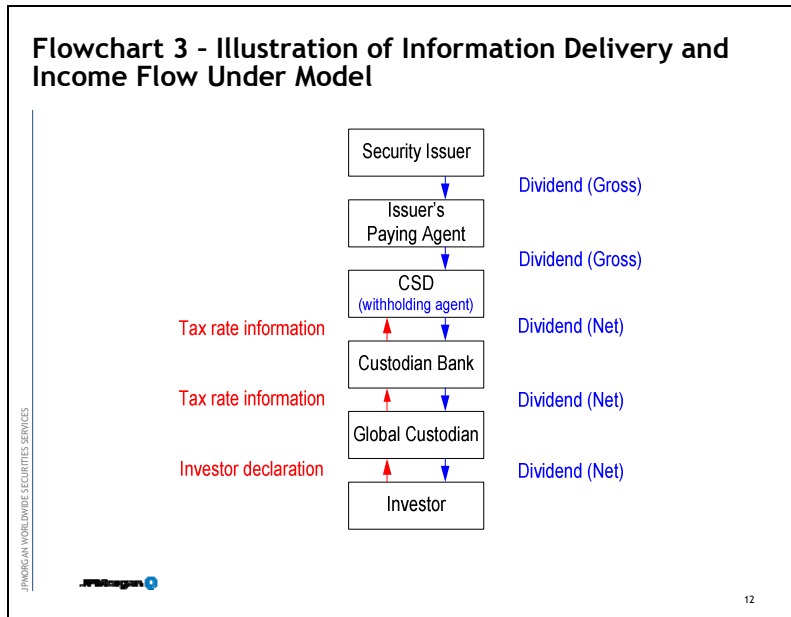
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(FISCO Group = Fiscal Compliance Experts' Group)



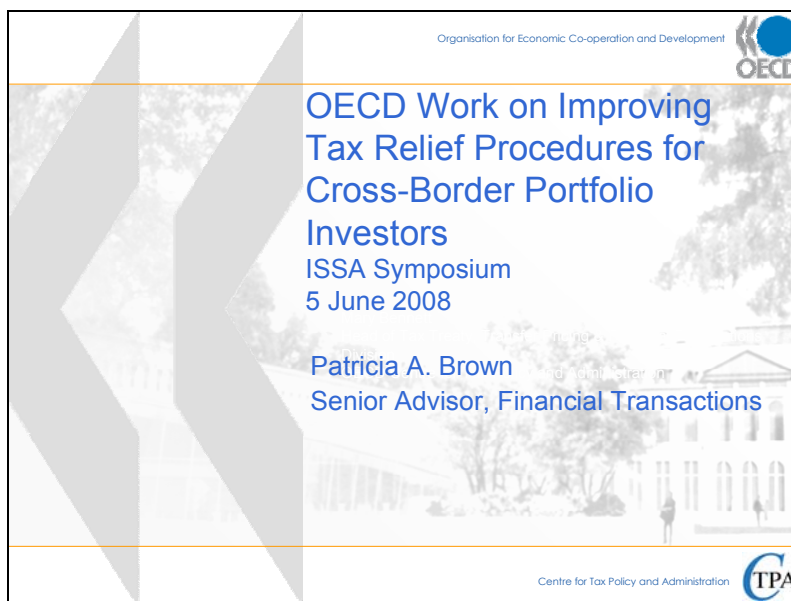


In 2006, the OECD established an informal consultative group of government and industry representatives to examine the issues of treaty relief for collective investment vehicles, which is another important issue for us. And perhaps more specifically, the general administrative arrangements for providing treaty relief to cross-border investors.

It is fair to say that the ISSA model has been very influential in terms of setting the direction of this OECD group.

I am now handing over to Tricia Brown to explain the work of the OECD group to date. In a third part, we will then discuss the likely future development of that work.

The OECD Project




To introduce myself, in 1994 I joined the US Treasury Department where I spent 12½ years negotiating tax treaties. The challenge for me now is how to implement those grand objectives we set out in the tax treaties....


Let me start by giving you some introduction to the role of the OECD, as it is often perceived merely as a

producer of economic data. A large number of economic statistics come from the OECD. But the OECD deals with a broad range of subjects, from agriculture to environment, to travel, to taxes.

Role of the OECD




- One of the OECD's core missions is to promote economic growth through the development of international trade and investment.
- In the tax area, a key aspect of that goal is to:
 - minimise tax obstacles to cross-border activities,
 - by, in particular, eliminating double taxation on income earned by residents of one country from sources in another country.

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The OECD's core mission is to promote economic growth through the development of international trade and investment. The OECD developed out of the Marshall Plan.

In the tax area, we try to minimize tax obstacles to cross-border activities by eliminating double taxation. The primary method that we use to achieve that is through the OECD Model Tax Convention.

OECD Model Tax Convention



- The OECD Model Tax Convention is the template for thousands of bilateral tax treaties between countries around the globe.
- These treaties contain provisions aimed at reducing high source country withholding taxes on cross-border income from investments in securities.
- The objective is to prevent those taxes from distorting investment choices between domestic and foreign securities.

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Currently more than 2500 bilateral tax treaties exist. Within each treaty, different forms of income are addressed: dividends, interest, capital gains, each of which can be treated differently. This results in a huge number of different processes.

The good news is that, in many cases, the substantive rules have been standardized. The standard dividend rates for portfolio investment generally are about 15%. That is coming down from a domestic rate of 20-30% in most countries. For direct investment, the range generally is between zero and 5%. The point is that, we have many different agreements, but there is already a degree of standardization in the substantive rules. We can build on that.


The model itself is reasonably static, because if you have 2500 different treaties, you cannot change the

underlying model too much without upsetting many existing processes and procedures.

OECD Tax Work




- In addition to Model Convention, responsible for other guidance, frequently relating to implementation:
 - Commentaries to the Model Convention, which are interpretations of the provisions;
 - Transfer Pricing Guidelines;
 - Various reports, such as on dispute resolution and best practices notes on tax administration.


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We frequently expand upon the Commentaries on the Model Convention which are interpretations of its provisions. The OECD also issues the Transfer Pricing Guidelines, and we have reports on dispute resolution and best practices notes on tax administration.

OECD Tax Work



- OECD operates on the basis of consensus:
 - Cannot direct a country to do anything;
 - Make recommendations, hope they are persuasive.
- Role of Secretariat is technical – analysis, addressing concerns, helping to forge consensus.

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The OECD, however, is not the EU Commission. We do not have the authority to tell people what to do. We can only issue recommendations and hope they are persuasive.


The Centre for Tax Policy and Administration serves as the secretariat for the Committee on Fiscal Affairs, which is the policy-making body on taxes within the OECD.

We have a technical role. We do analysis, we try to address countries' concerns and we help to forge consensus.

Because the OECD Model Convention is the template for most tax treaties, the OECD is the primary forum to discuss international tax issues. The United Nations are a distant second, and the European Union is concerned with other priorities.


It is important to note that the proposed G30/ISSA tax model Chris introduced, even though it has been

worked on in the European Union and in the OECD, is not limited in application to the EU or the OECD member countries.



From Theory to Practice

- The treaty provisions must work not only in theory but also in practice.
- Have recently refocused our efforts on the implementation of treaties.
- Rules for applying tax treaty benefits to cross-border portfolio income streams have not kept up with recent developments.




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The OECD has begun to recognize that we cannot limit ourselves to discussing a model; we have to deal with implementation issues as well.


For example, the Committee on Fiscal Affairs recently issued a report on dispute resolution, which generally arises in the transfer pricing area. This work on portfolio investors is another step in the process of making sure that the treaties actually achieve their goals.

Until recently, the OECD took a completely hands-off approach to procedures in the area of withholding taxes. It left the issue of the procedures to be used to implement the reduction of withholding taxes up to the source country of an income payment. This has changed. The commentary now says that providing relief at source is the preferred method for providing treaty benefits. So, we have taken at least a baby step forward. That was about six years ago.



From Theory to Practice

- Vast majority of publicly traded securities now held through a complex network of domestic and foreign intermediaries.
- However, few countries recognize this multi-tiered holding environment in their withholding tax collection and relief procedures.
- Many systems based on implicit assumption of direct relationship between issuer and investor.




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Until recently, we had not focused on portfolio investors. Our primary concern was direct investors – the big companies and their subsidiaries who are entitled to much bigger tax reductions than portfolio investors. Portfolio investment was mostly an afterthought in the treaty negotiations, since rates were so standardized. Those procedures, and therefore the treaties, frequently do not work well for portfolio


investors, for the reasons Chris Gilbert described.

The important thing now is that the OECD governments are aware that there is a serious problem. They know that, if the treaties are supposed to fulfill their purpose, they have to do something about it.

From Theory to Practice




- Result: it may be difficult or impossible for a portfolio investor to make an effective claim for treaty relief because of the reality of intermediated financial structures.
- Corporations that hold direct stakes in foreign subsidiaries will make sure they get benefits.
- Same administrative costs may be prohibitive for smaller investors.




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As I said, the reduction for direct investors is typically from 20% or 30% to 5% or even zero. That is a clear incentive for those companies to make sure that they get the treaty benefits they are entitled to. If you are a portfolio investor, your reduction is generally going to be from 20% or 30% to 15%. The cost involved with obtaining those benefits may be prohibitive. The problem has now become obvious and urgent.

OECD Project on Portfolio Investment




- OECD project is looking at the difficulties that face all portfolio investors when they attempt to claim treaty benefits.
- Convened an informal consultative group consisting of both government and business representatives.
- Includes representatives of countries where the investment is located, where the intermediaries are located, and where the investor is located.



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OECD Project on Portfolio Investment

- Also added the more complicated question of when a collective investment vehicle will qualify for treaty benefits.
- Issue is whether a CIV will be treated as an intermediary or the beneficial owner (ultimate investor) for purposes of claiming benefits.
- Work on technical issues involving CIVs is well advanced.




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As Chris said, the long name of our project is "Collective Investment Vehicles and Procedures for Portfolio Investors". The OECD is also looking at the technical issues about when a collective investment vehicle (CIV) will qualify for treaty benefits. One of the key questions for purposes of the procedures here is "When is the collective investment vehicle treated as a beneficial owner in its own right, so that it can claim benefits without looking through to who the ultimate investors are, and when will it effectively act as an intermediary?"

The work on this particular technical issue is far advanced. There will probably be a recommendation from the CIV Informal Contact Group that will go to the Committee on Fiscal Affairs and from there through the normal process that applies to changes to the model tax convention and the commentaries.

Business Proposals to the OECD Group

- Not surprisingly, very much like the G30/ISSA Model:
 - Relief at source the preferred method for treaty claims;
 - Pooled claims for benefits;
 - Investor self-declaration; no certificate of residence requirement;
 - Investor-specific information to remain with intermediary with the customer relationship



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Now on the side of the business proposals, since Chris is a founding member of the consultative group, it is not surprising that the business proposals look a lot like the G30/ISSA model with these features: relief at source is the preferred method for treaty claims, pooled claims for treaty benefits, investor self-declaration, no certificate of residence requirement, and investor specific information remains with the intermediary at the bottom of the processing chain.

Initial Government Concerns



- Generally relate to compliance issues.
- G30/ISSA proposal assigns oversight responsibilities to local tax authorities.
- Very difficult for source countries to give up oversight.
- Also want to receive investor-specific information at some point in order to determine whether further inquiry is necessary.

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First, the good news: No OECD country in the ICG said "No" to that proposal. Most governments accepted the idea that financial institutions do not want to give their customers' names and investment preferences to intermediaries who may be their competitors.

So, on the basic question – can you make claims based on pooled information? – there seemed to be general acceptance. However, the governments questioned what happens after that. Source countries were very concerned about the idea that they would never see the names of the beneficial owners. Some of them pointed out that they have to respond to internal auditors' requests. The auditors would want to know what the basis was for giving up the domestic withholding tax. They find it hard to accept that they cannot even see who the government gave the benefit to! Most governments now recognize that they cannot get the name of the beneficial owner at the time the payment is made, but they want to get hold of the names at some point.


The business proposal was that the local tax authorities in the countries of the intermediaries would be the ones to examine their intermediaries. That was a big stumbling block. The source countries said that, since they are giving the benefits, they would also have to make sure that the benefits are given correctly. This problem yet needs to be dealt with. The good news is that governments seem to recognize the problem that intermediaries would have if they were presented with the prospect of being audited by tax auditors from dozens of source countries.

The OECD group operates on a consensus basis. Governments can let the best practices "flow through" and not object to them. They have not signed on yet, but they have not objected, either. This is a basis to build on.

Going Forward



- ICG will complete first stage of work, which involves development of “best practices”, by end of 2008.
- Report will go to Committee on Fiscal Affairs in January 2009, which will decide on any future work.
- European Commission is on similar timeframe for follow-up to FISCO report.



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By the end of 2008 we expect to have a set of high level best practices that will go to the Committee on Fiscal Affairs in January 2009.

As Chris mentioned, the EU Commission conducts a parallel project called FISCO. The FISCO Group (Fiscal Compliance Experts' Group) wound up in October 2007 after having issued their second report on recommended solutions for the European Union. We recognize that it does not make sense for the European Union to pursue one set of standards, and for the OECD to pursue a different one. So we had informal meetings and we continue to meet in an effort to coordinate the experts' work.

What happens next? Best practices could be implemented in many different ways by many different countries!

The idea is to develop standardized forms, procedures and agreements for everything from the investor certification that goes to the intermediary at the bottom of the chain, to the format for an intermediary to report the names of the beneficial owners to the source country, to the standardized auditing procedures for the intermediaries' external auditors that would go to the source countries, so that the source countries would not feel a need to do substantial additional audits.

Not all governments have bought in to the "Good Faith" principle. However, there seems to be a relationship between setting out very specific standards for what an intermediary has to do, and the intermediary liability issue. This discussion is ongoing. Some Governments say that, if you give investors the ability to check a few boxes on some certification form, and the intermediary does not have to exercise any judgment, that is problematic. So we are addressing that by trying to find the right balance. We are working on a set of fairly explicit procedures that an intermediary can follow, coupled by a good faith standard that says if the intermediary has information which contradicts or undermines the information provided by the investor, then the intermediary cannot rely on that information.

That is where we are. Let's now discuss some specific issues.

Select Discussion Points and Likely Future Development

Gilbert: Let's start with giving you a sense of understanding on what the OECD view is on what the recommendations are likely to be, compared to what the G30/ISSA model is proposing right now. What are the issues the OECD has with the points mentioned in the slide below?

Key ISSA Model Features - Information Delivery

- Investor completes a single declaration covering all source countries, confirming (i) identity, (ii) residence, (iii) generic category and (iv) eligibility for tax relief
 - Some commentators have suggested that other information held on file (e.g. KYC) may be used in lieu of securing investor declaration
- The information provided by the investor remains with the intermediary acting directly for the investor
- If the intermediary acting for the investor does not have withholding responsibility, pooled tax rate information (rather than investor-specific information) is passed up the intermediary chain to the withholding agent by means of:
 - separate tax rate pools (relevant tax rate information provided at the point of security acquisition - see Flowchart 1); or
 - single pool (relevant tax rate information provided at the point of each income entitlement - see Flowchart 2)

established with each upper tier intermediary or the withholding agent
(Intermediaries may thus operate an optimal “omnibus” account structure)

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Brown: The use of Know Your Customer (KYC) information (as advocated by some external commentators) is an issue. It is unlikely that the tax authorities are going to agree to rely completely on the KYC procedures completed by the intermediaries. At a minimum, they will insist on getting a least an investor declaration that says that the person is entitled to treaty benefits. And as we explore the Anti Money Laundering rules in more detail, we see the divergences between the tax and the AML interpretations of beneficial ownership and things like that. We will try to standardize that investor declaration as much as possible.

Gilbert: We move on to tax deduction and the application of tax relief. The G30/ISSA model proposes to grant tax relief at source. It also says that the tax deduction responsibility would not be altered. Some commentators have suggested that the withholding responsibility could be transferred. What are the OECD's views on this?

Key ISSA Model Features - Tax Deduction/Relief

- The withholding agent applies appropriate reduced tax rates AT SOURCE, based on:
 - Declaration received from direct investor
 - Tax rate information received from intermediary
- Tax deduction responsibility is unaltered under the model, however some commentators have suggested that there should be an option for lower tier intermediaries to elect for withholding responsibility in lieu of passing tax rate information up the intermediary chain

(Flowchart 3 illustrates information delivery and income flow under model)

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Brown: As you know, we have a number of countries that like to stay with the refund system. We are trying to deal with this. This is one of those areas where best practices will *recommend* that the relief at source, rather than the refund system, should be used. If we just said that the best practice *is* relief at source, we run the risk that some countries will veto the entire report and we would not have anything. So we will recommend the relief at source, but will also make a few recommendations for making the refund system more efficient. We recognize that this project will take some time.

On the withholding responsibility, the European Union may have some issues of its own. If you look at the Giovannini Barriers, one of the recommendations was to allow foreign intermediaries to take on withholding tax responsibility. This might still float around as an option and there are some countries that may want to have that option. This is not a focal point of the OECD work. In real life, not many intermediaries will want to take that responsibility, and nobody anticipates this becoming a big issue, at least as part of the OECD project.

Key ISSA Model Features - Intermediary Authorisation

- Only authorised intermediaries may benefit from the simplified arrangements set out in the model
- Authorisation is based on standard criteria, to assure consistency and a level playing field
- Model envisages that intermediary is authorised by the taxing authority in the country of operation

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Gilbert: With regard to intermediary authorization, we already mentioned that the source countries say that *they* need to authorize the intermediary, rather than the local tax authority in the intermediary's country of operation.

Question from the floor: Authorization is one thing. Financial liability that goes along with that authorization is another. Is the recommendation that you get authorized and then are subject to standards of having performed adequate due diligence; or does authorization come along with a financial liability for the intermediary? What is the intent?

Brown: Most governments understand that intermediaries have to be able to rely on the information that they receive from other intermediaries.

However, they seem to have more trouble giving up liability when the intermediary is dealing directly with the beneficial owner. An example given by one government: they had several hundred claims from Liechtenstein Trusts that were owned by residents of the source country. It is that sort of anecdote that makes source countries reluctant to say "As long as you fill out your investor declaration form, we are fine". They want some form of exercise of good faith beyond that. So we need to boil the different standards I described down into a basic concept that addresses all needs. The relevant question for intermediaries is "Do I have any information suggesting that what the investor told me is not correct?" We are exploring a solution under which intermediaries that follow the specified procedures and do not have such information, are then not liable.

Question from the floor: Can we get to a level of criteria that are not the lowest common denominator but that are workable in practice?

Brown: I think so. Governments are supportive of the idea of standardization. The flip side is that some Governments will get more information than they do now. But there is acceptance on both sides that we have to do something reasonable.

Gilbert: We move on to the last slide for discussion, which is the most important one.

Key ISSA Model Features - Intermediary Compliance Verification

- Model envisages that authorised intermediaries are subject to periodic review by the taxing authority in the country of operation
- Review primarily system based, but more granular information may be provided if necessary (to demonstrate that, where appropriate, the intermediary secures proper investor declarations, secures/passes accurate pooled tax rate information and applies correct withholding)
- Some commentators have suggested that intermediaries may optionally elect for review to be performed by external auditor
- A number of commentators have emphasised that the intermediary should not be penalised for acting in “good faith”

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I mentioned earlier that there will be some significant divergence between what the G30/ISSA model is proposing and what we are likely to see. Crucially, the model did not raise the prospect of reporting. As Tricia mentioned, reporting however *will* be an element of intermediary compliance. Intermediaries will be subject to some sort of review, but not by the tax authority in their country of operation. Hopefully, the review will concentrate on confirming that the structure that the intermediary has in place, achieves the intended results. Tricia already mentioned the possibility that the external auditors of an intermediary could be doing this work.

Brown: We have a chicken and egg problem here. Governments are being asked to adopt an entirely different system from anything they have ever known before. And at the same time, they are being asked to limit auditing. It will take some time for the system to be operational and then we believe that the governments will see that they may not need to audit to the extent that they now think they do. The two fundamental questions that the governments need answered are:

1. Is the person who is claiming treaty benefits from us actually entitled to them?
2. Are the benefits we agree to grant actually reaching the person claiming them?

The second question is not really an issue because, if the money was not reaching the investor who expected it, then his intermediary would quickly be out of business.

The real question is around the account opening issues. If you can get the governments satisfied on them, then not much should be required in addition on the second issue. And random checks on the account opening issue should be sufficient, in the same way random checks are being done today in the US Qualified Intermediary system. Getting the governments to sign on when the system is new may be difficult. They may be reluctant to agree not to look beyond what they receive from the external auditing firms. Over time, they should however realize that looking beyond that will not yield any useful additional information. Over time, I believe they will get there, but it may be a long process.

For some discussion points relating to this presentation, see also the summary of **Q&A, Member Feedback, Floor discussion**.