

# Tax Withholding News

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## Pension Funds

*EU and US Pension Funds must be proactive in obtaining beneficial tax treatment*

Pensions and other tax exempt entities generally are not subject to taxation in their home countries. On the other hand, income from cross-border investments is often taxed by the foreign jurisdiction at the time of the income event, thus subjecting a pension or endowment investor to a level of taxation that they would not otherwise experience. Why is this?

It is often difficult or impossible for a paying agent in one market to verify, through a series of banks and intermediaries, that the ultimate beneficial owner of an investment (and intended recipient of a dividend or interest payment) should not be taxed on that distribution. As a result, beneficial rates of withholding are not always extended, even if the beneficial owner is entitled to exemption from tax. The result is that up to 35% of a foreign source dividend or interest payment can be withheld, significantly impacting the real and perceived returns on investments from those countries that regularly levy withholding tax on non-resident investment income.

This article provides an update on the efforts to perfect tax exemption and recover excess withholding taxes due to EU and US pension funds, thereby increasing investment performance and helping to fulfill their obligations to the beneficiaries. It also should be noted that even where progress has been made, exemption is usually not automatic, and proactive reclaims must still be made on a retroactive basis.

In 2004, then EU Taxation and Customs Commissioner, László Kovács, stated, "The European Commission is determined to tackle tax discrimination against occupational pension funds of other Member States." The principle here is two-fold. First, the sentiment expressed is in agreement with the purpose of double taxation treaties, which is to entice and encourage bilateral investment between two countries. Second, international taxation agents

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## FIN 48

The worldwide trend toward increased regulation of the financial sector is gaining momentum. At the same time, many previously common practices are being re-examined. This includes the new codified Financial Accounting Standards Board (FASB) Interpretation No. 48, Accounting for Uncertainty in Income Taxes (FIN 48) guidelines, now known as ASU 740 (Accounting Standard Update).

FIN 48 is intended to reduce uncertainty in income tax accounting. Issued in 2006, FIN 48 originally applied only to publicly traded companies. Beginning with the 2009 tax year, however, the rule has been extended to LPs and private investment funds. Given the expansion of its coverage, certain income events that did not previously constitute taxable events now must be booked as liabilities pending a review by the IRS or other tax authority. That, in turn, is putting a dent in the net asset values (NAV) of funds.

While a number of countries impose capital gains tax on investors, the withholding mechanism is often unclear or not utilized. Two notable examples of this are the tax treatment of capital gains in Spain and Australia for non-resident investors. Additionally, they don't appear to have the facility to withhold. To date, these taxes have not been applied to non-

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*The European Parliament Building in Brussels, Belgium*

## *Pension Funds...continued from page 1*

have long held that there should not be discrimination against investors of the counterparty country, and they should be treated equally to investors resident in the country of investment.

For example, a pension fund will be treated equally by both countries – if the pension is tax exempt in its home country, then the country of investment should treat the other country's pension funds as tax exempt.

In the EU, higher taxation of foreign pension funds may constitute a restriction on the free movement of capital, which would violate Article 63 of the Consolidated Version of the Treaty on the Functioning of the European Union. In 2007, following complaints by the European Federation for Retirement Provision, the European Commission initiated infringement procedures against nine EU member states based on such violation. The higher levels of withholding levied on outgoing dividend and interest payments to nonresident entities means that many European pension funds have been paying too much tax for years.

Since 2007, additional Member States have had infringement proceedings started against them. Countries that have been targeted so far include **Austria**, the **Czech Republic**, **France**, **Germany**, **Lithuania**, **Poland**, **Portugal** and **Slovenia** for infringements concerning both dividend taxation and interest taxation; **Denmark**, **Estonia**, **Finland**, **Hungary**, **Italy**, **Latvia**, **the Netherlands**, **Spain** and **Sweden** for infringements concerning only dividend taxation; and the **United Kingdom** for an infringement concerning interest taxation. If the Member State reduces the rate of tax applied to the income from dividends or interest received by a foreign pension fund, or exempts the income by way of relief at source or by a reclaim process, pension funds will be encouraged to invest in that Member State. Since 2007, much progress has been made in this area, as can be seen from the examples listed here.

**Austria:** Proceedings were closed on October 8, 2009 as Austria amended legislation to allow EU pension funds to claim exemption.

## *...Pension Funds continued*

**Czech Republic:** Proceedings were closed on March 19, 2009 as the Government amended its corporate income tax act by extending exemption on dividends and interest on bonds to EU and EEA based pension funds

**France:** On February 13, 2009, the Conseil d'Etat (French Supreme Court) decided that the tax treatment of French dividends received by French pension funds under domestic tax law should be extended to EU non-profit organizations of the same nature.

**Italy:** Proceedings were closed on October 8, 2009 following a change in their legislation to apply a reduced rate of withholding on dividends paid to pension funds resident in an EU Member State or Norway.

**The Netherlands:** Legislation has been amended so that a beneficial owner being a corporate or non-corporate entity resident in an EU Member State (other than the Netherlands), not subject to tax on profit in its country of residence and who, if it were resident in the Netherlands, would not be subject to corporate tax, is entitled to a full refund from the tax withheld on dividends (15%) paid from January 1, 2007.

Following the principal of non-discrimination, the US has renegotiated, over the last several years, a number of treaties and protocols that now extend tax exempt status to US pensions investing into certain of those markets. **Sweden** changed its treaty with the US in 2006 to exempt US pension funds and other tax exempts from withholding.

Effective in 2008, **Germany**, **Finland** and **Denmark** all extended tax exempt status to US pensions on interest and dividends. **The Netherlands** and **Ireland** already extended full tax exemption to US pensions and **Switzerland**, though not an EU member, also gives US pensions tax exempt status. We expect these trends to continue. Continued updates can be seen by subscribing to GlobeTax's RSS feeds available at [www.GlobeTax.com](http://www.GlobeTax.com)

## *FIN 48...continued from page 1*

resident investors. Given the "accounting for uncertainty" principle of in FIN 48/ASU 740, funds are now having to maintain reserves for their potential calculated tax liability. This directly impacts NAV and returns to investors, even though historical precedent is that the tax is never assessed or collected by either Australia or Spain.

Further to this, the new Foreign Account Tax Compliance (FATCA) provisions contained in Title V, Subtitle A of the recently passed, HIRE Act (H.R. 2847) will further impact the performance and asset valuation of alternative investment funds. A mandatory 30% withholding on all US dividend payments to undocumented ultimate beneficial owners would significantly impact the returns of any fund that invests in this asset class.

The extension of ASU 740 along with FATCA augurs for similar movements globally, as other tax authorities move toward more uniform standards of enforcement. The global trend, recently witnessed, toward mandating that "uncooperative" jurisdictions sign Tax Exchange-of-Information Agreements (TEIAs) shows that when certain influential countries implement a new standard of regulation, the rest are not far behind. The introduction of FATCA has acted as a catalyst for a slew of similar initiatives worldwide through the summer and fall. Also driving this initiative are related activities occurring at the Organization of Economic Cooperation and Development (OECD) which has been issuing guidance on the construct of double taxation treaties and the TEIAs that have proliferated over the last 12-18 months.

In 2009, over a hundred TEIAs were signed by previously opaque "tax haven" jurisdictions, far more than in previous years. In parallel, investigations into the identities of private account holders at UBS and other Swiss banks continue. Already, 2010 has seen an increasing number of funds that were previously domiciled in offshore tax havens, such as the Cayman Islands, moving to more regulated onshore jurisdictions. This not only assuages investor's concerns about transparency, but is also viewed by many as a risk averse move ahead of tougher treatment of these tax havens going forward.

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...FIN 48 continued

As global tax issues are increasingly on the radar of regulators and tax authorities, the common use of swaps to avoid international investment withholding tax will be brought into question. FATCA already made this case in the U.S. in addition to other historically common practices surrounding tax reporting. As withholding tax can have a significant effect on investment performance (rates of withholding vary, but may range between 25-35%), it will be increasingly important for investment managers to find ways to ensure that they receive this portfolio income. Engaging in withholding tax recovery is an important step towards mitigating these losses, as it allows beneficial owners and their investment managers to benefit from favorable withholding tax rates available to them under double taxation treaties. Since most markets mandate a Statute of Limitations under which historical entitlements may be claimed, initial multi-year recoveries can represent a windfall for the fund.

On an ongoing basis, withholding tax reclamation can add between 50 and 150 basis points to the average cross-border portfolio. As regulatory and compliance pressures increase on funds worldwide, it is even more important that private fund managers obtain these benefits in order to best serve their investors.

## Asia-Pacific Update

As growth continues in the Asia-Pacific region, both internally and through foreign investment, these countries are seeing the development of more robust market infrastructures and regulatory frameworks. China is now the single largest originator of IPOs in the world, raising more than US\$55bn last year alone. At the same time, smaller Asian economies such as South Korea, Taiwan and Singapore have steadily grown stronger.

The economic development in the Asia-Pacific region follows increased regulation, and an increased awareness of international taxation issues. Within the region, tax authorities are taking a more aggressive role in negotiating and approving treaties. The Chinese State Administration of Taxation (SAT) recently issued official guidance imposing compliance requirements on foreign persons claiming tax treaty benefits. Effective October 1, 2009, entitlement to tax treaty benefits requires pre-approval or registration by the Chinese tax office.

A three year Statute of Limitations for non-Chinese resident taxpayers to reclaim overpaid tax has been declared. However, the current process is unproven, potentially arduous, and will certainly require cooperation with the issuing companies and their respective local tax authorities. GlobeTax is currently working with local agents to address these challenges and implement relief / reclaim processes.

In January of this year, Indonesia released new guidelines for relief at source or quick refunds for beneficial owners in countries with which it has double taxation treaties in place. As is the case with China, the provision of eligible documentation early in the process is key.

Currently, the post-payment reclaim process in Indonesia is somewhat ambiguous, and requires cooperation on the part of the Indonesian issuer to lodge a claim with the tax office.

In the Philippines, the Bureau of Internal Revenue (BIR) has proposed new guidelines for claiming overwithheld funds. At

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### Market Updates

*These updates reflect changes made from December 2009 through February, 2010.\**

### Statutory Rate Changes:

**Lithuania:** Lowered its withholding tax rate for corporations to 15%, from 20%

**Spain:** Raised its withholding tax rate from 18% to 19%

### New Treaties for 2010

Armenia - Croatia  
Bahrain - the Netherlands  
Bangladesh - Switzerland  
Belarus - Italy  
Brazil - Peru  
Brunei - Japan  
Chile - Colombia  
Cyprus - Czech Republic  
Denmark - Serbia  
Estonia - Isle of Man

France - United Kingdom  
Georgia - Malta  
Isle of Man - Malta  
Italy - United States  
Latvia - South Korea  
Luxembourg - Moldova  
Luxembourg - UAE  
Malta - Montenegro  
Malta - Qatar  
Mexico - Germany  
the Netherlands - Qatar  
Singapore - Ukraine  
Slovak Republic - Syria  
Spain - Trinidad and Tobago  
Sudan - Romania  
Ukraine - Libya

*\*Please note that the list published here is not an exhaustive list. For more information on our data services please email:*

[eTaxDataOnline@GlobeTax.com](mailto:eTaxDataOnline@GlobeTax.com)

*Asia-Pacific....continued from page 3*

this time, these guidelines involve foreign investors lodging Certificates of Residency as well as obtaining certain local certifications in the Philippines. The focus here is again on the relief at source process. The reclaim process will involve the individual issuers and their interpretation of the regulations and related documentation requirements.

In future newsletters GlobeTax will continue to highlight issues and developments in individual Asia-Pacific markets, as our activities in the region continue to grow. In our position as the largest global processor of relief at source and reclaims, GlobeTax is committed to improving the efficiency of withholding tax relief for its clients in these emerging markets.

## ADR Reclaim Update

**Belgium:** New in 2010 there is a relief at source and a quick refund procedure available for holders of AB InBev (NYSE symbol: BUD). The process requires that an election be made through DTC's EDS service and will also pay through DTC. Financial Institutions wishing to facilitate relief at source for clients holding this issue may file through GlobeTax's ESP system.

**Denmark:** New in 2010, elections may now be made through DTC for holders of Novo Nordisk A/S (NYSE symbol: NVO) to obtain a 'quick refund', which will now be paid through DTC's EDS system.

**Finland:** New in 2010, expansion of the availability of DTC's EDS service to non-US beneficial holders of all Finnish ADRs.

**Philippines:** New in 2010, the Philippines has implemented a relief at source process available through DTC's EDS system for Individuals who beneficially own Philippine ADRs. A quick refund process is also available (refer to [DTC Notice B#6329-10](#)).

Refer to the Important Notices for details on the developments described above.

## Upcoming Events

GlobeTax staff will be participating in these exciting events in the coming months. We hope to see you there.



*Boston's Back Bay*

**DTC Annual Tax Seminar**  
**April 23, 2010**  
**New York, NY**  
[www.dtcc.com](http://www.dtcc.com)

**Boston Hedge Fund Group**  
**Symposium**  
**May 10, 2010**  
**Boston, MA**  
<http://bhfg.com>

**Global Tax Withholding and**  
**Regulation Seminar**  
**May 13, 2010**  
**New York, NY**  
[www.cmconsortium.com](http://www.cmconsortium.com)

## Education

### Upcoming Webinars

**April 29 - 11:00 am ET**  
**Pension and Endowment Focus:**  
**Ensuring Tax-Exempt Treatment on**  
**Global Investments**

For a complete list and copies of past webinar presentations please visit the Education page of [GlobeTax.com](http://GlobeTax.com)

If you would like to be added to the webinar notification distribution list please email [Education@GlobeTax.com](mailto:Education@GlobeTax.com).

## Seminars

Ross McGill will be presenting courses on **US Withholding Tax** and **International Withholding Tax**. Upcoming courses will be held in:

### US Withholding Tax

London: 23-24 March  
Sydney: 27-28 April  
Copenhagen: 16-17 November

### International Withholding Tax

Netherlands: 22-23 June  
London: 12-13 October

For further details on these seminars, please visit TConsult's website.  
[www.tconsult-ltd.com](http://www.tconsult-ltd.com)

## Tax Withholding News

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