

Tax Withholding News

Page 1 | Issue No. 18a | May 2015

prepared by **GLOBETAX**

In This Issue

A Window into the Future of the Successful CSD	1
Tax: A Problem or an Opportunity?	1
globeSettle – a CSD Case Study	1
Standardizing Corporate Actions Processing	2
The Industry Needs a Golden Record	3
Standardization is Nothing without Automation	3

A Window into the Future of the Successful CSD*

The global custody landscape is changing more rapidly today than ever. The financial services industry is now suffering a tidal wave of new regulations across the world. Many of these regulations are focused on transparency and systemic risk mitigation, others on prevention and detection of tax evasion. All present major technical and operational challenges.

Tax: A Problem or an Opportunity?

Tax, and in particular cross border withholding tax, is one operational issue becoming increasingly substantial. Even though custodians currently rely on the expertise of their network counterparties, these often struggle to provide complete and comprehensive tax relief, reclaim and reporting services. So, is this an inescapable problem that's endemic to the custody model or, is it an opportunity for CSDs to use their centralized position and new technologies to offer a value added service for their Participants?

Given this gap, we suggest that CSDs may be perfectly positioned to offer an outsourced and more efficient tax process than what is currently being done individually. We are now seeing the beginnings of such a centralized approach with initiatives such as T2S. Operating margins for CSDs tend to be very narrow and leveraging technologies such as T2S is one way that a modern CSD can develop its business to remain relevant and profitable. Technological innovation can also create added value and high margin services - without which, CSD core services will become increasingly commoditized and exposed to competitive forces. Amidst the current explosion in the numbers of CSDs, those who look at their customer's challenges and offer services that add value, while reducing their cost and risk, are most likely to succeed in the long run.

globeSettle – a CSD Case Study

The London Stock Exchange Group's Luxembourg based CSD, globeSettle has elected to use ESP - GlobeTax's Electronic Submission Portal - as the backbone for processing withholding tax for their Participants.

ESP allows globeSettle's Participants and their Downstream Intermediary customers to submit claims for tax relief at source, quick refund or post-payable long form, electronically. The system maintains each Participants' positions in each security at the CSD. ESP then manages the tax relief/reclaim processing requirements for each market, automatically flowing out data and documentation

* Abridged compilation of a three-part series published in the WFC 2015 Newsletters



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to Participants in Market Announcements. ESP provides real-time, online reporting, allowing each Participant to see the status and progress of their claims and a full reconciliation to payments made.

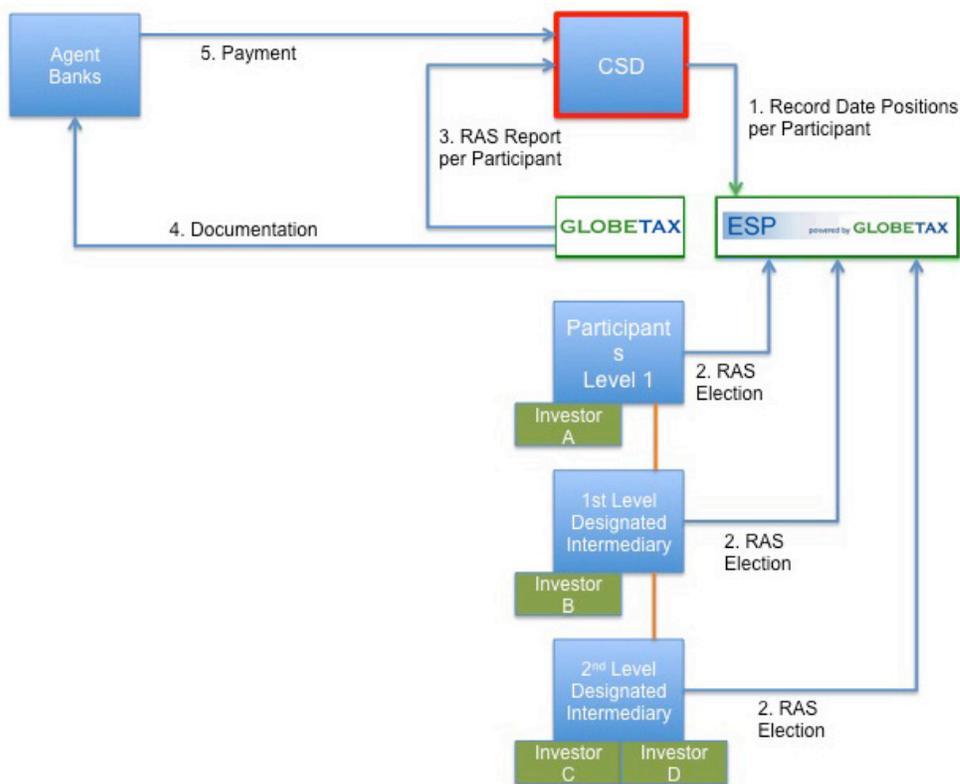


Figure 1: Tax Relief at Source: CSDs using ESP allows multiple levels of investor to claim tax treaty benefits

As a result, each Participant doesn't need to spend time and money on tax reclaim processing, other than maintaining standard books of record and client documentation. The remaining complexity is managed and simplified by ESP at the CSD level.

Standardizing Corporate Actions Processing

Regulatory change and technological disruption are issues the industry has faced continually over the decades. The difference now is that the pace and volume of those changes are coming too fast to only address one thing at a time. There are some "big ideas" out there which will alter the landscape of securities' clearing, settlement and asset servicing – T2S, KYC Repositories and Tax landscape simplification. While some have been unsuccessful, technology and standards have finally evolved to a point that this time is indeed different. One area that has been left out of this surge of innovation is corporate actions processing.

To illustrate this point, we share an example: Italian debt is subject to one of two tax scenarios. If the beneficial owner of the debt is resident in a 'white list' market, there is no withholding tax. But, if the owner is not in a 'white list' market, the withholding tax has to be calculated and paid on the interest accrued between the buy and sell dates – so called 'pro rata temporis' (PRT). Most cross border tax is calculated based on income. The PRT model requires advance knowledge and documentary evidence of the beneficial owner's residency, intraday trade data (which can be quite voluminous), a credit and debit accounting system between 'first level' and 'second level' banks, and a reporting system that can reconcile everyone's books of record at trade level and reconcile the tax paid to the tax authority. The calculation methodology can also vary between types of bond. It is rumored that one financial institution has over fifty staff employed full time just working on PRT.

If this type of complexity, which is not unique to Italy, can be automated and standardized, then there is hope for the whole corporate actions lifecycle. Enter the partnership between the London Stock Exchange CSD, globeSettle and GlobeTax. One of globeSettle's core requirements was to have a tax services offering for its collateral management service, including Italian PRT. In six months' time GlobeTax analyzed the market requirements, developed the (complex) algorithms and established the operational model for automated transfer of trade data. This was integrated with the existing ESP platform and the reporting engine was upgraded to allow all parties to use a unified system to reconcile and report to tax authorities.

Tax Withholding News

Page 3 | Issue No. 18a | May 2015

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ESP has approximately 250 CSD Participants using it today in both the Investor and Issuer CSD modes and currently covers 15 markets, with more being added.

ESP Claims powered by GLOBETAX

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Select Country Select Security Select Income Event Select Entry Option

COUNTRY OF ISSUANCE REPUBLIC OF KOREA
ISSUE CITIGROUP KOREA INC
CUSIP 999992993

Please select income event:

	ADR Record Date	ADR Pay Date	Elections Open	Dead
SELECT	31 DEC 2012	TBD	01 JAN 2013	23 JAN
SELECT	30 DEC 2011	13 APR 2012	31 DEC 2011	13 JAN
SELECT	31 DEC 2010	05 JAN 1900	30 DEC 2010	13 JAN

	Shares	Beneficial Owners
2013	5.5 Billion	1.8 Million
2014	18.7 Billion*	5.3 Million
2015 YTD as of May	5.0 Billion	3.3 Million
TOTAL 2008 - YTD	39.8 Billion	14.6 Million

*** \$2.8 Billion returned to investors in 2014**

The Industry Needs a Golden Record

One of the most important elements of modern corporate actions processing is the so called 'Golden Record'. Get this right, and everything else should follow; it establishes a data set for a corporate action with the highest degree of accuracy and precision. The problem is that those who have the best information with which to create the Golden Record - the Issuers - have little interest or commercial reason to do the work needed to codify and standardize that record. The real beneficiaries of such standardization would be the downstream financial institutions that form the chain of intermediation between the Issuers and the ultimate investors. In the absence of that Golden Record duplicate research (and cost) is necessary to extract and use reliable corporate actions information.

However, the Golden Record is not enough on its own. At least as important, from a processing perspective, is how that Golden Record is transmitted through the financial chain. At present, even with standardization of some data to ISO 15022 and ISO 20022, in many cases, each recipient in the chain of intermediation currently receives an electronic data set but must then print, review, approve, re-key and re-distribute to the next layer down. Apart from being incredibly inefficient and time consuming, this also injects cost and risk into the process.

Standardization is Nothing without Automation

Acting as Issuers, the four depository banks distribute Important Notices via the US CSD, the DTCC, for American Depositary Receipts (ADRs). These Important Notices provide the Golden Record to everyone in the chain as information is closely controlled by just three entities – the Issuer, the Depository and GlobeTax (as the common processor for all relief/reclaim applications). However, once the announcement is distributed via DTCC, the downstream recipients receive these announcements as PDF files which currently go through an error prone process at each layer of intermediation.

Additionally, in many cases, there is a taxable element to the corporate action commonly known as 'Relief at Source' (from excess taxation) which often can only be mitigated by the provision of documents and/or data between the Record and Pay Date. This window of time is often as short as 3 days. The consequence of not standardizing or automating this process is that investors down the chain of intermediation have almost no chance of getting Relief at Source, because each layer is duplicating a manual process within a short period of time.

Tax Withholding News

ISO standards and the SWIFT network both fall short of being ubiquitous and take lots of time and money to implement, rendering the 'normal' way of solving this problem unfeasible for many. What is needed is a way to satisfy the lowest common denominator in the financial chain and effectively provide an automation solution that allows for 'machine readable Golden Records'. That's where XBRL (eXtensible Business Reporting Language) comes in as an available open language with a taxonomy/dictionary designed and built by those who use it. It is a great common denominator that any intermediary or institutional investor can adopt: it's based on the widely available XML protocols, it's simple, it's quick, it's cheap to implement and it's also compliant with ISO 20022 standards. It is so successful that the US and UK now mandate its use for publicly listed corporations reporting their financials. The underlying XML standard has also been adopted by the G20 and OECD for the Common Reporting Standards being used to expand FATCA principles.

As the central coordinator in the ADR processing model GlobeTax took corporate actions information from various parties, added the withholding tax related data and issued the golden record for the CSD to distribute. Since this project started in 2012 there have been 9,324 dividend announcements issued in XBRL format on 1,850 announcements relating to 445 securities in 22 countries.

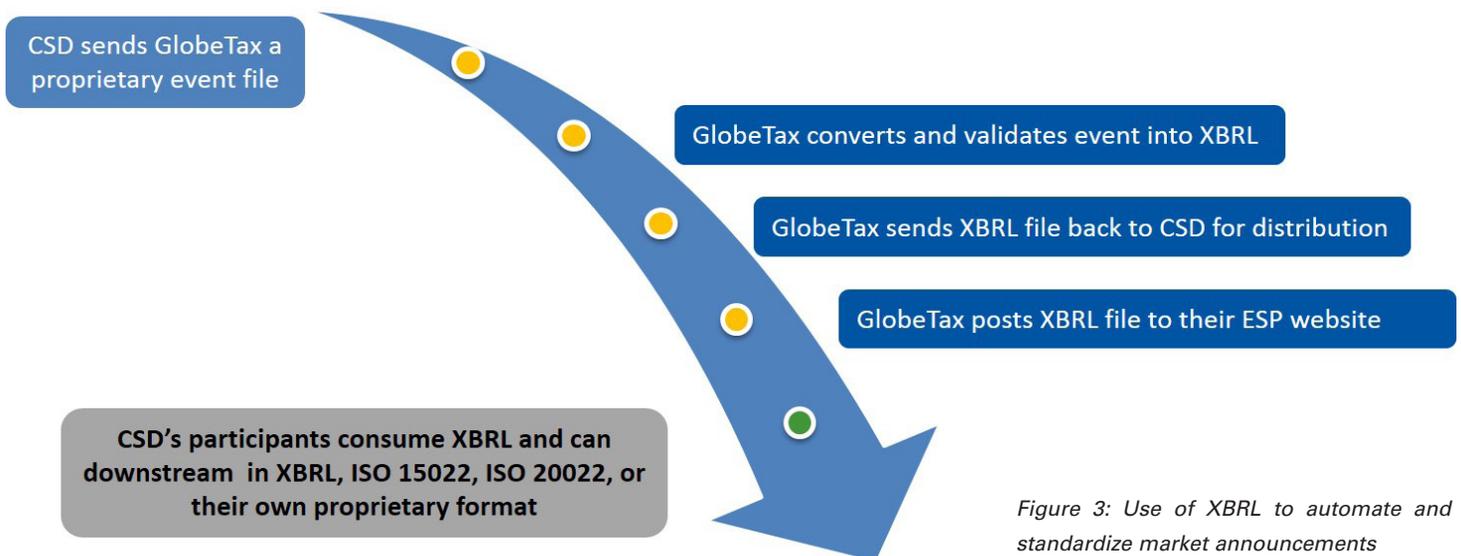


Figure 3: Use of XBRL to automate and standardize market announcements

The special position CSDs have in the investment chain gives them a perfect opportunity to leverage these kinds of technologies and become an entry and exit point for securities processing. Our ESP tax processing platform is built with XBRL announcement tagging in mind. When a CSD chooses to offer inbound tax relief and reclaims processing to its Issuer customers and outbound tax relief and reclaims processing to its domestic Participants, the processing of the announcements that trigger those claims is already standardized and automated. That will allow any intermediary in the chain to rapidly import and integrate information to their systems, giving them more time to meet deadlines for clients, while also reducing the resources needed to process the corporate action.

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