ASSET SERVICING AND TAX

TAX HARMONIZATION IN THE EUROPEAN ASSET SERVICING MARKET

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PREFACE

Celebrities and business magnates leaving their home countries and evading taxes and fiscal scandals such as Luxleaks and the Panama Papers, have become regular subjects in the news. The pressure on politicians is mounting to do something on the issue. Significant changes in the tax domain in the coming 5 to 10 years can be expected.

This study has four objectives. Firstly, to describe the evolution of the tax subject on a European level over the last 20 years. Secondly, to assess the current situation. Thirdly, to analyse in which direction the current environment could evolve. Fourthly, to identify how tax services providers and asset servicers in general should adapt their business model accordingly.

The raising public adversity against income inequality and tax evasion make it highly probable that we will see fundamental changes in the tax environment in the coming decade. As it’s always the case, changes bring threats and new opportunities. This white paper will help you to overcome the challenges and grasp the new opportunities.

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This whitepaper is the result of a great team work. A special and warm thanks goes to the Wavestone team (Sarah Drews, Virginie Ranaivoson, Alain Leclère and Vincent Rousseaux) and our clients who have made this publication possible.

SUMMARY

INTRODUCTION

Over the past decades some of the European Union major concerns focused on tax transparency and tax avoidance topics. This is demonstrated by the following trends:

- Increased responsibility vis a vis the tax authorities of financial institutions to control their clients
- Prevent "grey areas" to avoid tax evasion
- Exchange of information between countries to reconcile, and identify those avoiding taxes
- Pressure on local government to adapt their laws (e.g. FATCA, QI, EUSD, CRS, EU FATCA Flat-tax agreements)

The majority of these global actions are recognized. However, their impact on the market is not always clear. What do these developments mean for European asset servicers? Is tax harmonization compatible with financial market efficiency? Will Member States simplify their documentation procedures to attract investors?

To enable decision makers from financial service providers to reflect on how to create competitive advantages for withholding tax processes in the best ways, including tax relief at source and tax reclaim and in developing a framework for discussion, we have set out a series of potential scenarios and their plausible implications. Our analysis is based on four key questions which have the potential to challenge the withholding tax ecosystem in Europe:

- EU directive or self-organization of the market?
- Pan-European infrastructure or local model?
- Open-field market or restricted access?
- Maintenance of complexity or process simplification?

We used these key interrogations to design three main scenarios:

/ Complete integration of the market through the harmonization of relief at source and exchange of information processes in the EU

/ Integration of the market by concentric circles

/ Status quo: market remains fragmented

Based on Wavestone's knowledge and experiences in this area, and a number of discussions with industry players, we assessed the scenarios (on basis of predictions for the coming five to ten years), and their implications on future tax services models within the asset servicing industry. Through our strategic analysis, by means of desk research and think tanks organized with various experts, we agreed on the key trends in industry changes.

This report focuses on the medium to longer term changes affecting European asset servicers, private and retail banks and specialized services companies acting in the tax services area. A number of drivers are already at work, ranging from the tighter regulation constraints to the competition of newcomers in the market. Some asset servicers have already positioned themselves to profit from this shift.

In order to be of added-value for its audience, this white paper sets the following objectives with the ultimate goal of providing guidance to financial services providers:

/ Understanding of the tax harmonization trends and progress

/ Management of trends uncertainty thanks to scenario planning approach

/ Ideal positioning in the future landscape of the tax services ecosystem

Understanding the drivers of these changes and defining a clear strategy will be key to success. Failure to do so could lead to a suboptimal positioning and loss of market share over the long run.

1.

WHAT YOU NEED TO KNOW ABOUT WITHHOLDING TAX

IS THE EUROPEAN COMMISSION GOING TO ENFORCE SOME HARMONIZATION?

Taxation remains one of the most challenging topics of the globalized world, both for its regulatory and operational complexity, caused by the difficulty of harmonizing local processes and requirements to a multi-national set of rules.

Several attempts towards tax harmonization were made by the EU Commission on a pan-European level, via consultation of representatives from the financial services industry. Coordinated actions to tackle tax obstacles and inefficiencies have already been achieved in tax reporting via Automatic Exchange of Information Agreements (AEOI). However, as of today, there is no legal framework that enforces the removal of tax barriers.

So far efforts to harmonize taxation have been unsuccessful (e.g. Financial Transaction Tax). The rationale behind this resistance can be explained through analysis of all stakeholders' objectives. These include supranational actors (e.g. EU Commission), EU Member States and Third Countries, Interest Groups (e.g. FISCO), Financial Institutions and Investors. A thorough analysis shows a distinct interest from all parties to remove barriers and reduce inefficiencies, but exposes divergences regarding the opportunity costs behind such initiatives.

In the current framework, Directives take extended periods of time to be implemented due to the need for defining not only common simplification policies and procedures, but also protracted negotiations between Member States. This generally results in a 'lowest common denominator' solution that may not be the most effective for the market or for investors. On the other hand, leaving all players in the market to organize themselves will be lengthy in time and may have no significant impact to transform the ecosystem due to the different actors' agendas (see Chapter III).

IS THE TAX PROCESSING GETTING SIMPLER OR MORE COMPLEX?

In today's context, there are many potential enhancement zones in tax processing - such improvements can be internally adopted within financial institutions:

/ Develop a near-shoring/ shared services model to build a competence center within the group (e.g. tax payment collection);

/ Outsource non-core activities to external providers and maintain minimal services to clients (e.g. tax reclaim);

/ Streamline the process (e.g. documentation collection);

/ Automate the manual workload and interfaces with third-parties (e.g. payment of tax reclaim).

Nevertheless, too many brakes still exist within the tax ecosystem to hope for harmonization in the market and productivity gains in a short-term period.

LOCAL LAWS REPRESENT AN IMPEDIMENT TO MARKET SIMPLIFICATION:

- Tax models and responsibilities are divergent amongst countries;
- Financial Institutions can play different roles in the tax ecosystem;
- Tax Reclaim limitation periods remain uneven depending on the market.

The market is fragmented – one country for one process – with the following consequences:

- Excessive documentation;
- Heavy manual workload;
- Lack of streamlining for paperwork and payment processing.

WHAT IS THE COMPETITION DOING?

Four types of actors have been identified within financial institutions: market leaders, niche players, followers and outsiders. Their positioning are defined by the following criteria:

- Transaction Volume
- Market coverage
- Service Coverage
- Product Coverage
- Client type

Our analysis shows that in the studied context, it can be noted that:

Heterogeneity of processes between countries require a panel of human, technical and financial skills which increase with country coverage growth;

- Volumes greatly impact profitability of services and activities;
- Generally, proposed tax services have low added value;
- Tax services activities are not core to all financial institutions;
- Major actors are asset servicers that fully master the value chain.

It can be concluded that the landscape of actors is bipolar:

- On one side, actors that reach profitability thanks to high volumes and a capacity to develop a network covering up to 40 of the most requested markets;
- On the other, small-to-medium actors which directly offer their services to their own clients or that cannot afford to offer such services at all.

In between, there is a spectrum of possibilities that remain unexploited for new entrants in the tax ecosystem working on an innovative business model.

ARE THERE ALTERNATIVES TO THE ACTUAL BUSINESS MODELS?

In the short term, financial institutions will have to deal with operational inefficiencies and distortions caused by a heterogeneous ecosystem. In these conditions, each one of them will need to define a strategic positioning which benefits most from this fragmented environment.

For financial institutions considered to provide tax services as a core activity, here are three strategic approaches:

Contribute to the implementation of a standard model on the European market as defined by the OECD (TRACE) (cf* § Table page 58- 59);

1. DEFINE AN INNOVATIVE BUSINESS MODEL;

2. REINFORCE THE CURRENT POSITIONING AND ACCEPT COMPETITION WITH MARKET LEADERS.

CAN I GAIN MARKET SHARE/ BE MORE PROFITABLE BY HANDLING THE TAX PROCESSING DIFFERENTLY?

No matter what the future may hold, or the level of harmonization that can be reached, financial institutions will have to think about the integration of tax services within their value chain. Today, this activity is costly in terms of human and/or financial resources; moving forward towards harmonization and automation of processes will require considerable further investments. The fact that the provision of tax services is, furthermore, highly sensitive to volumes, does not make the decision any easier.

Therefore, as mentioned previously, there are two different types of financial institutions: those that wish, due to their smaller size, to offer 'direct' tax services to their individual clients; and those that have attained enough volume to propose an infrastructure available to other financial institutions ('indirect' tax services). For both of these institutions, there are four different strategies to choose from:

1. Growth - providing high-volume standardized service offerings and products to other financial service providers, including asset servicers being retail and private banks;

2. Innovation - proposing tailor-made or niche services to the client, the client being any person or organisation that requires the providers' services;

3. Sustainability - delivering tax services to "internal clients" only;

4. Reconfiguration - creating a new offering based on increasing client requests.

Each of these strategies, draw on elements to evaluate and redefine or fine-tune their business model if required.

HOW DO I ADAPT MY STRATEGY IN UNCERTAIN TIMES?

The fact that in general a weak level of tax services is being offered to clients (only limited to large clients or to specific activities) and that no strong environment change trends have broken through, leaves financial institutions to evolve in an uncertain environment.

TRENDS

ECONOMICAL
- Globalisation
- Harmonization of the market

COMPLIANCE
- Exchange of information/ Directive 2011
- EU Directive 2003
- Prevent tax evasion
- Administrative cooperation
- Council Directive 2014/107/EU

TECHNOLOGY
- SWIFT format
- XBRL format

CULTURE
- Tax transparency
- Increase of tax on revenues

Business

SECTOR FORCES

PARTICIPANTS
- FISCO working group
- EU commission

SUBSTITUTE SERVICES OR PRODUCTS
- Relief at source
- Tax reclaim

COMPETITION
-Financial institutions
-Custodians
-CSD/ICSD
-T2S

PROVIDER
- Reduce cost for tax authorities

Hence, it is required to evaluate future situations by means of scenarios in order to measure impacts on the organization and implement an action plan to mitigate uncertainty.

*Cf: Business model – Nouvelle generation, Ed Pearson

model

MARKET FORCES

COSTS
- Reduce cost for investor
- Reduce document management constraints
- Reduce cost opportunity for investor

CLIENT DEMANDS
- Avoid tax refund
- Effective tax refund
- Encourage cross border investment

MARKET SEGMENT
- Individual clients
- Asset servicers
- Financial institution, corporates, etc

ISSUES
- Avoid over taxation
- Avoid tax discrimination

REVENUES
- Distribute more revenues to the client
- Avoid tax refund process

MACRO-ECONOMIC FORCES

ECONOMIC INFRASTRUCTURE
- Efficiency and profitability
- Improvement of technical infrastructure
- Free access to the market for more competition

RESOURCES
- Lack of adapted technical infrastructure
- Reduce WHT process costs
- FI to contribute to the state revenues

ECONOMIC CONTEXT
- Increasing of cross-border investment
- Increasing of state revenues needs
- Increase growth

FINANCIAL MARKET
- Foreign investment
- Competitivity of the market
- Decrease complexity of internal market rules

2.

TO HARMONIZE OR NOT TO HARMONIZE? THAT IS THE QUESTION

TAX HARMONIZATION REMAINS TO BE ACHIEVED

The past decades have seen the rise of globalization with a deep impact for the financial industry. Due to technological progress and financial innovation, financial institutions have seen an ongoing growth in their cross-border activities, requiring harmonization in their processes to remain operationally efficient.

However, due to the distinct objectives of Member States and the fact that taxation is considered to be central to national sovereignty, tax harmonization remains to be achieved. The European Commission addressed the disparities between the Member States tax systems through a communication regarding "Tax Policy in the European Union – Priorities for the years ahead (2001).

This Communication stated that there was no need for "across the board harmonization" of Member States' tax systems. Instead, taxation required better coordination of national policies. The Commission's main concern was that the freedom to design domestic tax systems (from tax rates to tax rises) may lead to unfair tax treatment, tax evasion and additional costs in a cross-border context, highlighting topics such as discrimination or double taxation, with consequences on national growth and market attractiveness.

1977 – 2007: PRE-CRISIS ENVIRONMENT

/ 1977:

"Clear rules ensure fair competition" – defining a taxation framework -
Mutual assistance by the competent authorities of the Member States in the field of direct taxation and taxation of insurance premiums (77/799/EEC)

In 1977, the Commission released the first directive "to combat international tax evasion and avoidance" in the European Union: Member States' competent authorities were required to exchange information relevant for the correct assessment of taxes on income and on capital. Since then, the 1977 Directive has evolved to extend its scope. It remains the juridical basis for taxation laws on a European level.

/ 1996 - 2003:

Identification of tax barriers - *the Giovannini Report*
In 1996, a group of financial market professionals, the Giovannini group, was tasked to identify inefficiencies in the EU financial market and to propose solutions to ensure that any initiatives taken at the national level could be integrated on a pan-European scale. The group released their first report in 2001, which identified a total of 15 specific barriers: these included two barriers specific to taxation, focusing on three types of securities taxes -withholding tax, capital gas tax and transaction taxes.

/ 2003

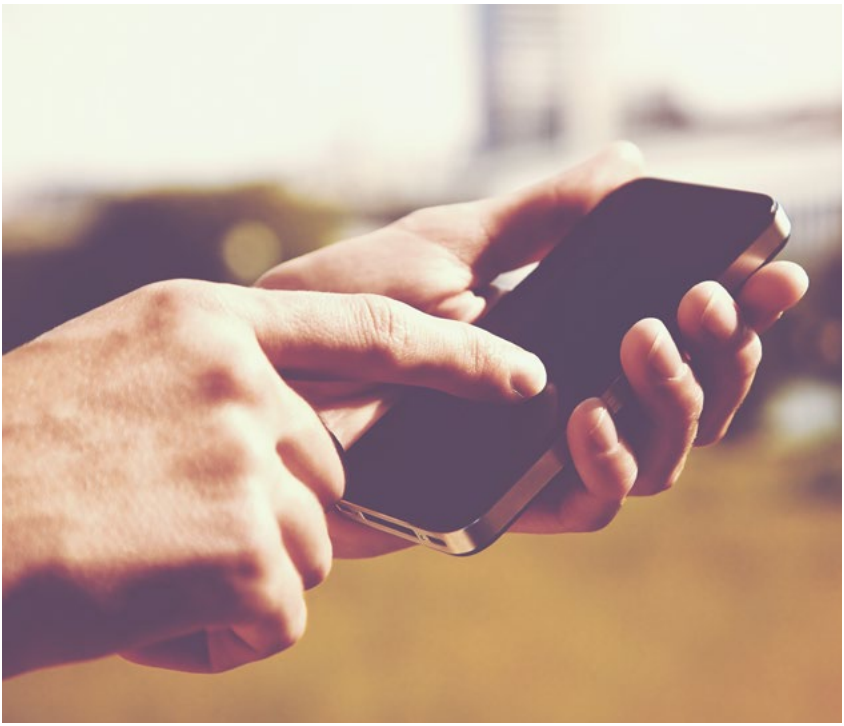
Tackling tax discrimination - *Savings Directive (2003/48/EC)*

In 2003, the “Directive on Taxation of Saving Income in the form of interest payments” was adopted, aiming to tackle harmful tax competition in the EU and to allow Member States to consolidate their tax revenue raising capacities. The European Union Savings Directive (EUSD) is an agreement between the Member States of the European Union (EU) to exchange information about customers who earn savings income in one EU Member State but live in another.

/ 2007

Make the financial sector pay its fair share

Following the 2007 crisis, Member States wanted to ensure that the financial sector is contributing to increasing public revenues. Increasingly, local initiatives were introduced to tax financial institutions. In particular, the idea of implementing a transaction tax was thought to be able to reduce volatility and bring additional tax revenues.



SINCE 2007 – PRIORITIES: TRANSPARENCY AND CO-OPERATION

/ 2008

Limitations of the Savings Directive *- Report from the commission to the council - COM (2008) 552*

These gaps were underlined in a 2008 Commission report, stating that the inconsistency of the tax treatment of similar products was the major limitation of 2003/48/EC.

/ 2009

Withholding Tax Relief procedures *– the FISCO Group*

Following an European Commission initiative, The FISCO (Clearing and Settlement Fiscal Compliance Experts' Working Group) expert group was mandated to tackle some of the tax barriers defined by the Giovannini group by studying the disparities between the fiscal procedures of the different Member States, specifically regarding withholding procedures for securities income (but also regarding financial transaction taxes). The results of the study demonstrated that there were significant differences in withholding tax collection and relief procedures amongst the Member States.

The FISCO group provided recommendations, published by the European Commission in 2009, to apply a "standardised set of rules" for withholding tax relief procedures. However it stated that the best way to implement a harmonized model requires the implementation of a legal instrument (i.e. Directive) due to the need for exchange of personal data between countries.

/ 2010

Europe 2020 strategy

In 2010, the objective of the communication was to explain the importance of "removing cross-border tax obstacles for EU citizens".

/ 2011

Administrative cooperation in the field of taxation

2011/16/EU also completed the 2003 Savings Directive. It provides for the introduction of different mechanisms of information exchange and encourages contribution from Member States by the sharing of best practices. Finally, the Directive requested Member States to be fully transparent. This requirement ensured that tax treatments between all Member States (and third-party countries) were non-discriminatory.

/ 2013

Enhanced cooperation in the area of financial transaction tax - *2011/16/EU*

Aimed to translate these local initiatives and minimize the risks of market abuse and tax discrimination. The main objectives of the proposal were to harmonize the process of indirect taxation on financial transactions via a supranational legislation/directive. However, Member States could not reach a common agreement due to divergent national objectives.

/ 2014-2015

Repealing the Savings Directive and implementing Automatic Exchange of Information - *Council Directive 2014/107/EU*

Fiscal transparency with cooperation between tax authorities through automatic exchange of financial account information.

Changes included upgraded reporting rules and the extension of the financial products scope and the territorial scope. The 2014 Directive also requires a secure electronic system for the information exchange.

On 18 March 2015, the Commission presented a proposal to repeal the Savings Directive with the implementation of Council Directive 2014/107/EU on administrative cooperation in the field of direct taxation which provides for automatic exchange of financial account information between Member States, including income categories contained in the Savings Directive.

Under transitional arrangements, the Savings Directive will continue to be operational until the end of 2015 and is to be replaced by Council Directive 2014/107/EU as of 1 January, 2016.

TOWARDS A HARMONIZED TAX SYSTEM?

The previous overview shows that the harmonization of tax processes and systems has been a topic of interest for the European Commission for decades and has involved stakeholders from the private (via interest groups) to the public sector. The closest attempts to harmonization remain in the hands of expert groups, such as the FISCO group, mandated to study withholding tax rules or in October 2014 the Automatic Exchange of Financial Account Information for Direct Taxation Purposes (AEFI Group), mandated to review and propose efficient models of automatic exchange of information in the EU.

Examples, such as the failure to agree on the Financial Transaction Tax, or the limitations of double tax treaties (e.g. difficulties to apply bilateral treaties on triangular situations), establish that multi-party agreements on taxation topics remain complex. For now, the European Commission relies on the cooperation from all Member States to keep the processes efficient.

For example, in October 2014, 61 jurisdictions have signed a multi-lateral agreement implementing the Standard on automatic exchange as defined by the OECD (Organization for Economic Co-operation and Development) – Common Reporting Standards (CRS). CRS sets out the financial account information to be exchanged, the financial institutions that need to report, the different types of accounts and taxpayers covered, with common due diligence procedures to be implemented and applied by financial institutions.

The harmonization question remains unanswered for now. However, to achieve this goal, different stakeholders will have to collaborate and align their interests. Therefore, to better understand opportunities and threats to harmonization, it is crucial to analyse convergences and divergences of all actors' objectives involved in this process. In the next chapter the results of such an analysis are summarised.

3.

CONVERGENCE AND DIVERGENCE : WHO HAS THE POWER?

THE PRECEDING CHAPTER SHOWS DIFFERENT INITIATIVES AT THE SUPRANATIONAL LEVEL STRIVED FOR A HARMONIZATION OF TAX MATTERS IN THE PAST BUT WITHOUT MUCH SUCCESS. Yet, the following analysis will show that, in the future, numerous public and private actors will collaborate in setting a common agenda (despite diverging interests). Supranational institutions will presumably act as facilitators by implementing a pertinent legal framework, rather than being the driving force pushing for the WHT (Withholding tax).

Wavestone identified five top objectives for each stakeholder group involved in WHT matters to ensure an accurate assessment of these actors' respective (in)direct influence:

ACTOR'S OBJECTIVES

Actors	Objective 1	Objective 2	Objective 3	Objective 4	Objective 5
Supranational Actors	Secure decent taxation	Ensure fair international competition	Reduce inefficiencies	Harmonise international markets	Guarantee viable global growth
EU Member Countries / Third Countries	Secure revenues	Reduce administrative costs	Decide on local legislation (market access)	Maintain/Gain national advantages	Warrant compliance to int. standards
Interest Groups	Maintain/Extend political influence	Change the status quo in its own advantage	Increase member associations' benefits	Secure revenues from assoc.	Ensure alignment with similar interests to create synergies
Financial Institutions	Secure FI revenues	Decrease operating costs for fin. inst.	Avoid over taxation for investors	Maintain high level of services	Ensure compliance to global and local standards
Investors	Increase portfolio performance	Reduce administrative burdens and costs associated	Avoid multiple taxation	Obtain high-level of cross-border services compliant with legal framework	Ensure individual (cash) liquidity

In our approach, a proven simulation tool is used to measure the impact of each actor's objectives on the other actors' objectives.

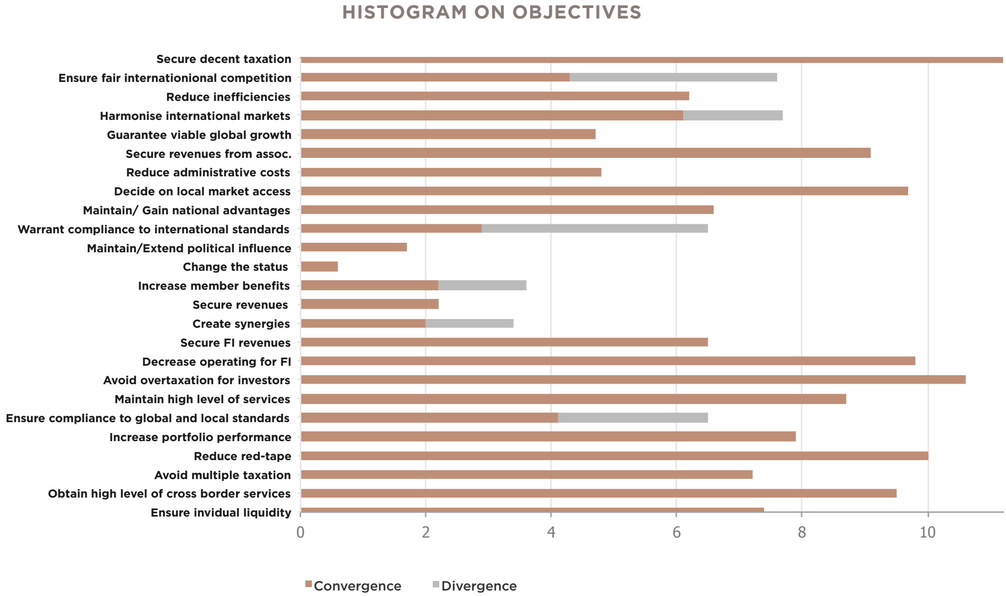
Based on this analysis, we can answer following three key questions:

1. What are the main divergences?
2. What are the main convergences?
3. Who has the power?

By answering these questions it becomes possible to determine forces that will influence future potential situations.

DIVERGENCES

The figure hereafter evaluates the degree of conflictual or consensual "tension" among actors on the objectives identified above. As a result, it allows developing forecasting outcomes based on the actors' positioning.



From a general point of view, one can recognise that the amount of diametrically opposite opinions is rather minor. However, the histogram reveals potential frictions (grey bars) between actors with regards to compliance requirements and fair competition measures or the harmonization of international markets. In other words: any limitation/tightened boundary to their current business models is potentially perceived as a threat (E.g. Ensure fair international competition, harmonize international market, warrant compliance to international standards, increase member associations benefits, ensure alignment with similar interests to create synergies, ensure compliance to global and local standards).

For example, **Supranational actors** (e.g. European Commission, European Parliament etc.) are geared towards securing an appropriate level of taxation by harmonizing existing fiscal disparities amongst market participants - whilst reducing administrative costs. The existence of prevailing market disorganizations also ranks high on supranational actors' agendas. Indeed, they have an inherent interest in facilitating trade by reducing paperwork burdens and operational inefficiencies. But these objectives may go against those of **Financial institutions**, who currently leverage on the aforementioned inefficiencies to build their tax services offer.

With regards to the harmonization of international markets, supranational actors do have a pronounced interest in requisitioning Members States' last remaining economic policy instrument, namely the nationally set tax rate. However, a harmonized tax rate goes against **Member States'** objectives, as it does not take into account national specificities and interests.

CONVERGENCES

With regards to convergences, the strongest link is the one between financial institutions and investors. **Financial Institutions** (in this context: custodians and sub-custodians) possess a distinct interest in securing their revenues. Ultimately, **Investors** have a well-marked demand for return on investment generated by increasing portfolio performance without increasing risk per se. Hence, their overall alignment is very pronounced and could be used to build strategic alliances.

However, securing revenue is a common objective for other actors. **Member States** have a pronounced self-interest in maximising their revenues and thereby increasing their respective country's economic performance. From an operational point of view, securing revenues plays an existential role to members of **Interest Groups.**

Another strong – though less pronounced – link is the one between investors and supranational actors. **Investors** wish to reduce red-tape and multiple taxations which might result in severe opportunity costs due to a lack of "liquidity visibility". The same assumption can be made with regards to cross-border services, as investors intrinsically strive for obtaining the highest possible level of services. This objective goes along with the **Supranational Actors** objective of ensuring fair market competition conditions by providing free access to the internal market to all actors involved on the one hand, and to facilitate financial cross-border activities on the other.

One similar objective stands out amongst many different actors, namely "secure decent taxation". Avoiding over taxation that negatively impacts revenues (e.g. by making use of a specific countries' tax treaties) is a major priority for all actors.

The results obtained from this analysis allow for a grouping of identified objectives in accordance to analysed stakeholders relative importance and their respective agreement or disagreement on specific topics. A strong concentration of objectives illustrates a pronounced agreement, whereas mapping distances reveal discrepancies between objectives. As a consequence, one can discern two homogenous groups when analysing mapping positions independently:

The first group contains elements that can be perceived beneficial to certain actors only, such as increasing interest group members' benefits, creating synergy effects for these groups, increasing their political leverage and so on. As a consequence, these isolated objectives could be seen as potentially controversial topics as benefits for individual actors (such as the ones provided to interest groups) easily exceed advantages to the market in its entirety.

The second cluster indicates variables that are of mutual interest to all market members, like the avoidance of multiple taxation, the decrease of operating costs and the achievement of sustainable global economic growth. Hence, these common objectives could serve as a basis to forge future alliances.

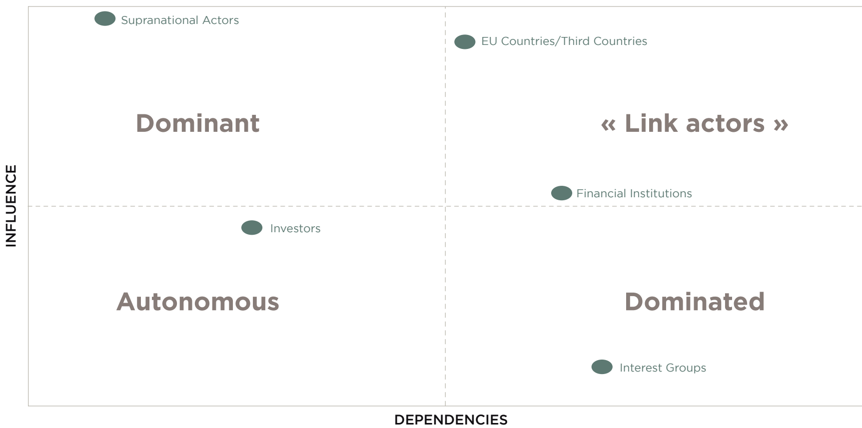
WHO HAS THE POWER?

Above analysis confirms influences and dependencies among actors. Supranational actors act as agenda setters and thus clearly dominate Members States as link actors given their mediating role between superordinate political instances and subordinate national economy actors. Interest Groups are dominated as they have to comply with their members' targets on the one hand and set political/economic boundaries on the other. Investors, on the contrary, can be categorized autonomous due to their relative flexibility in choosing the most beneficial business circumstances. However, in the end they remain dependant on the rules and legislations made by Supranational actors and Members States.

Therefore, it can be concluded that supranational actors dominate the game.

As mentioned before, five actors are deemed to be of major importance in the WHT environment. The diagram below – computed via vector calculations - provides a high-level view of these actors' positioning based on their respective (in)direct influence on- and the relative dependencies among themselves.

INFLUENCES AND DEPENDENCIES AMONG ACTORS



The utilized approach provides further insights on the actors' contextual balance of power, and therefore on the expected behaviour of involved actors. As a result, the following conclusions can be drawn with regards to the actual drivers of the WHT:

1. First, a pronounced degree of alignment concerning the removal of market barriers is to be expected with regards to investors and supranational actors, as both strive for a maximization of growth/profit realisation while reducing opportunity costs. This is especially true as there is no withholding taxation standard yet, and supranational actors possess important incentives to align with investors - albeit the international institutions' dominant (legislative) agenda setting position.

2. Secondly, the analysis reveals well-marked similarities between financial institutions ("link actors") and "autonomous" investors. Hence, it is expected that financial institutions and investors will forge alliances to endorse commonalities such as reducing operating costs to reduce inefficiencies, avoid multiple taxation or maintaining a high level of services. Financial institutions could therefore leverage investors' aims to influence decisions-making bodies as these enjoy a rather cooperative relation with investors.

Nonetheless, frictions are to be expected between financial institutions and supranational actors, as their targets are potentially conflicting. Indeed, fair international competition and the harmonization of markets could be perceived as a threat by financial institutions as these measures severely diminish the exploitation of potential system inconsistencies that doubtlessly facilitate these institutions' revenue generation if exploited. However, certain degree of alignment is ensured as supranational actors possess a vital interest in flawlessly growing financial markets.

Hence, it is beyond dispute that securing decent taxation and thereby safeguarding revenues for all actors involved, while decreasing operating- and opportunity costs will set the agenda for a European Directive regarding WHT.

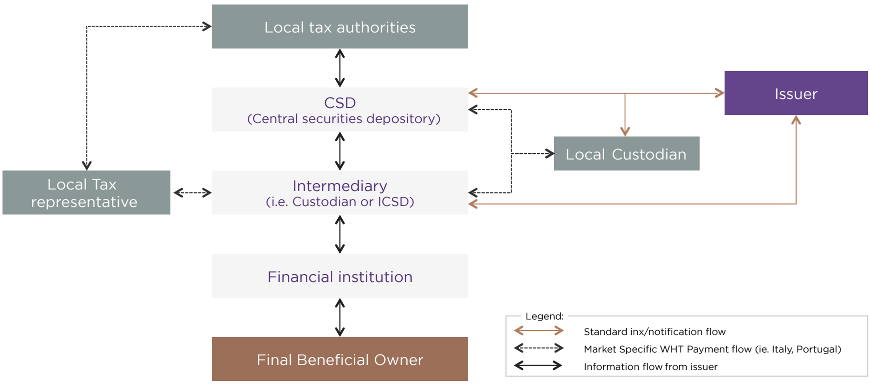
All in all, these advances will most probably end into a consensus among all actors given system-inherent interdependencies. This consensus will translate into changing the tax value chain as a whole, requiring a re-tailoring of operational processes. The upcoming chapter provides a discourse of the changes to be expected.

4.

HOW TO SURVIVE IN AN INEFFICIENT SYSTEM

IN BUSINESS SENSE, AN ECOSYSTEM CAN BE DEFINED AS A NETWORK OF ORGANIZATIONS — INCLUDING ISSUERS, DISTRIBUTERS, CUSTOMERS, COMPETITORS, GOVERNMENT AGENCIES AND SO ON — INVOLVED IN THE DELIVERY OF A SPECIFIC PRODUCT OR SERVICE THROUGH BOTH COMPETITION AND COOPERATION. Given this definition, the withholding tax system can be analyzed as an ecosystem

HIGH LEVEL GENERIC MODEL

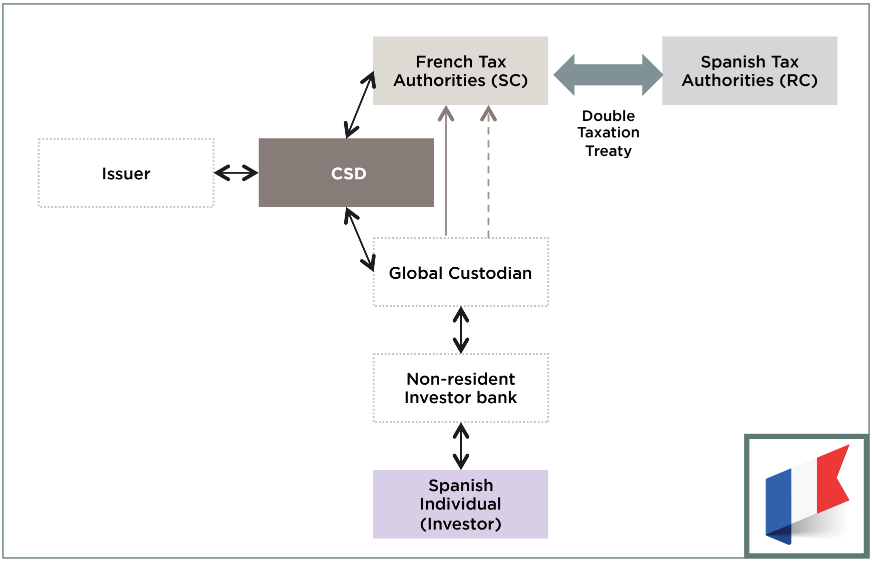


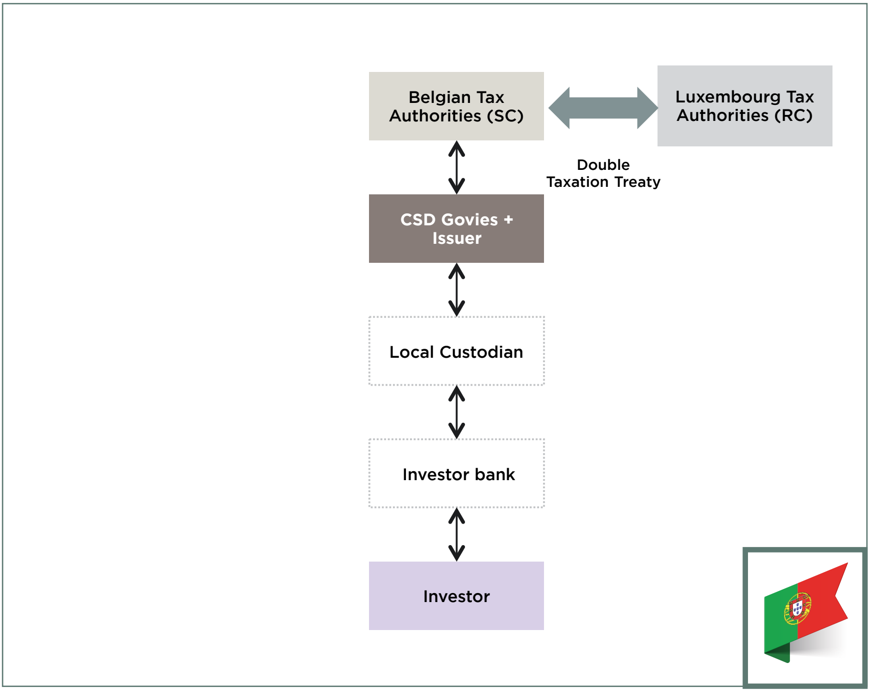
THE FRAGMENTED MARKET HAS LED TO A VARIETY OF KEY ACTIVITIES

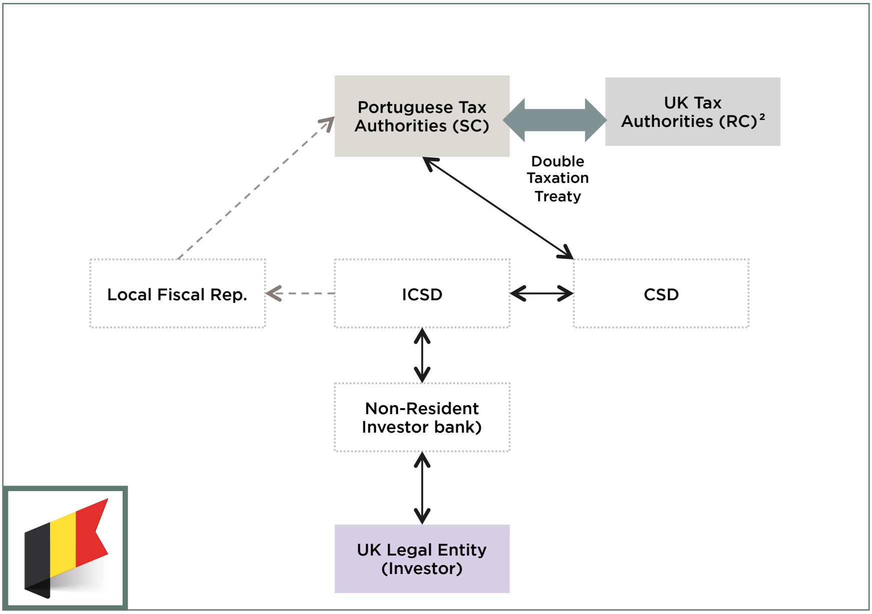
An organization needs to take on different responsibilities

In a large number of Member States, the responsibility for deducting withholding tax from domestic securities income lies exclusively with the issuer of the securities while in others this is the responsibility of the intermediaries involved in the payment of the income. (see models on next page)

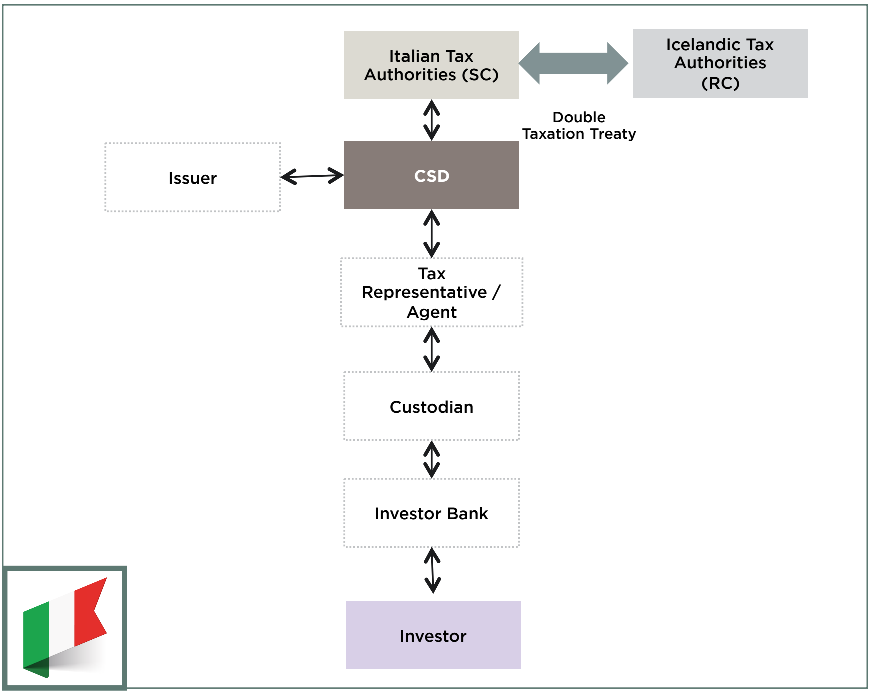
TAX MODELS FOR FRANCE, PORTUGAL, BELGIUM AND ITALY



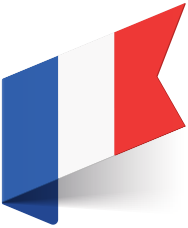




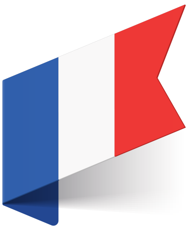
Portuguese Tax Authorities (SC)
UK Tax Authorities (RC)²
Double Taxation Treaty
Local Fiscal Rep.
ICSD
CSD
Non-Resident Investor bank)
UK Legal Entity (Investor)



Italian Tax Authorities (SC)
Icelandic Tax Authorities (RC)
Double Taxation Treaty
Issuer
CSD
Tax Representative / Agent
Custodian
Investor Bank
Investor

Countries	Access to market
	/ Foreign entities appoint a local agent/custodian to act as withholding agent and collect the withholding tax (WHT). For non resident investor, the latter intermediary, is considered as the withholding agent. / For non resident investors, in case of local access to the CSD, the issuer is considered as the withholding agent. Consequently, the CSD needs to be connected with all issuers for who he is the registrar.
	/ Registering and depositary entities act as the withholding agent. / Portuguese entities are subject to registration or deposit under the Portuguese securities code. / Non-resident entities are obliged to appoint a fiscal representative in Portugal. / Resident investor to apply for exemption through resident intermediary.
	/ Depending on eligibility, each custodian holding Belgian government bonds must open an exempt (X) and non-exempt (N) account in the NBB SSS system. / For full exemption, all entities that hold NBB-eligible securities through such custodian must do so exclusively on behalf of beneficial owners (including themselves, if applicable) that qualify for exemption from Belgian withholding tax. / Non-exempted entities (i.e. Belgian residents) must be segregated from exempted entities.
	/ Registering and depositary entities act as the withholding agent. / Non resident entities are obliged to appoint a fiscal representative in Italy.

	Process	Process Issues
	/ Fully automated process in case of French securities and if French intermediary. / In case of foreign intermediary, tax collection via the issuer or a paying agent.	/ Unequal access to the market. / Unequal treatment between foreign. and resident investor. / Process design for the situation where a securities refund of WHT needs local withholding agent intervention. Physical documentation requires to be renewed (per payment and/or annually).
	/ Custodian manually applies tax or exempts certified entities before payment date. Delayed certification can possibly be processed using premium services if available and if requested by underlying investor.	/ Physical documentation requires to be renewed (per payment and/or annually).
	/ Fully automated process in case of declared exempted entities. NBB automatically pays exempt positions gross (held in X accounts).	/ Internal transfers between X and N accounts can cause reconciliation issues for custodians. / Due to the lack of transparency manual circulations may be required. / NBB provides payment notifications only on Payment Date (instead of PD-1). / Physical documentation requires to be renewed (per payment and/or annually).
	/ Once certification is received, pro-rata temporis tax (if any) can be returned immediately (automatically if custodian has a tax tool). / For standard refund, process takes up to four years to receive refunds.	/ Potential delays may be caused during certification retrieval process as required from final beneficial owners. / For standard refund, unless there is an agreement made with the Italian Tax Authorities, the tax may be refunded directly to final beneficial owner – no transparency for intermediaries. / Physical documentation requires to be renewed (per payment and/or annually).

Countries	Documentation
	/ No possibility to provide documentation automatically to apply the tax rate for non residents. / If foreign intermediary uses a CSD, certificate of residence for tax purposes has to be provided for each payment and to all issuers/ paying agents. / For standard reclaim, a certificate of residence (Form5000) and reclaims details (Form 5001) have to be provided for each request.
	/ Foreign investors must declare non-residency (e.g. via a proof of exempted status), normally to be renewed annually or in case of any legal change).
	/ Annual declaration required by custodian to confirm eligibility of exempted underlying entities holding NBB securities. / One-time certificate required by underlying beneficial owners (to confirm exemption to custodian/intermediary).
	/ Certification required down to final beneficial owner level. / For equities and debt securities, certification does not require renewal, except list of beneficial owners for equities and unless there are changes.

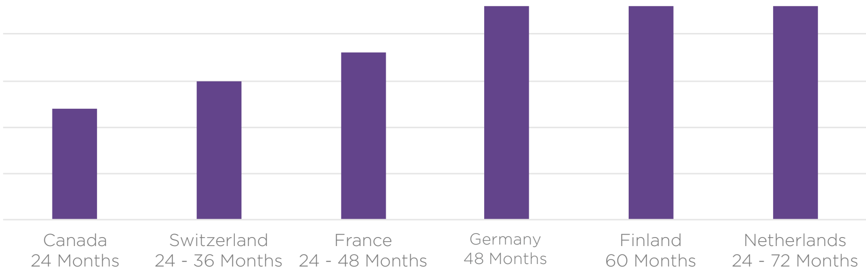
Uneven client documentation requirements

Cross-border withholding tax recovery is a highly complex and often, manual process. Documentation and reporting requirements vary from market to market and are subject to frequent change. (see models in previous page)

Uneven limitation periods and recovery time for tax reclaim

Depending on the country, the limitation period to submit tax reclaim and to receive tax reclaim payment forces to implement as many procedures as there are tax administration authorities

STATUS OF LIMITATION PERIODS



Recovery time varies greatly and depends on numerous factors, including the entity type of the beneficial owner, the nature of income earned and both the investor residency, the category of investor and investment countries (see table below).

Where relief is granted by refund, the long time period investors have to wait to get a refund could additionally imply a decrease of the revenue as money is not being reinvested.

TABLE 7: METRICS OF PERFORMANCE

	Certification Time (weeks)	Status of Limitations (years)	Average Recovery Time (month)
Australia	2-4	7	9
Austria	4-6	5	6
Canada	4-8	2	6
Denmark	2-4	5	4
Finland	3-4	5	12
France	12-24	2	6
Germany	Unknown	4	12
Ireland	1-4	4	6
Italy	8-12	4	84
Netherlands	4-8	5	3
Spain	4-8	4	24
Sweden	4-6	5	3
Switzerland	3-4	3	6
U.S.	8-12	2/3	2

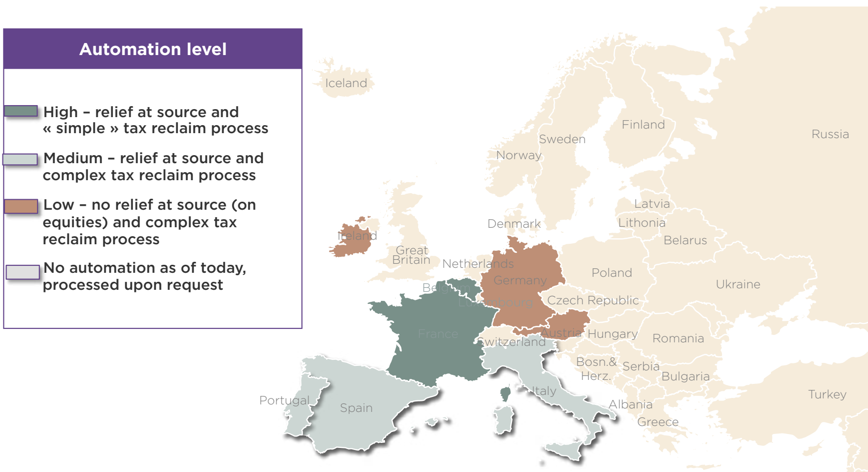
Complex setup for relief at source

In cases where separate paper-form certificates of residence must be signed by beneficial owners for each individual income payment and the certificates must be stamped by the local tax authorities of the beneficial owners' country of residence, there may be insufficient time between the dividend announcement date and the income payment date to allow the beneficial owner to provide the required certificates.

Moreover, for actively traded securities, securities positions held by intermediaries may change on a daily basis which may make it impossible to provide the upstream withholding agent with up-to-date information and certificates on the beneficial owners of the securities by the income payment date.

From this market fragmentation results different maturities of automation level amongst Member States as illustrated in following picture.

EUROPE – AUTOMATION LEVEL



VARIOUS MARKETS AND THIRD-PARTIES: CONNECTION OVERLOAD

Too many connectivity options

Investors and intermediaries have different options for obtaining access to a foreign market or for making cross-border securities transactions:

- have direct access to a national CSD (Central Securities Depository);
- make use of the services of a local agent, which will be a member of the local CSD;
- use an (I)CSD (International CSD) or a global custodian as a single access point to national CSDs in various countries ((I)CSDs or global custodians may have direct or indirect links with national CSDs);

/ ICSDs or global custodians also have additional constraints where a national investor is supposed to use a national custodian and a national CSD if they want to benefit from reduced tax rate.

Foreign intermediaries can be placed at a disadvantage in their capacity to offer at-source relief from withholding tax. This is based on the following reasoning:

/ relief at source can be granted only with the help of an entity that has formal withholding tax responsibilities (normally a bank or other financial institution);

/ the majority of EU Member States either restrict such withholding tax responsibilities to entities established within their own jurisdiction or require foreign withholding tax agents to appoint a local fiscal representative to carry out their withholding tax obligations;

As a result, foreign intermediaries are required to appoint a local agent or a local representative to be able to offer at source relief, which may represent a significant extra cost for foreign intermediaries vis-à-vis local providers.

Connectivity issues for tax administrations

Each Source Country has its own reporting form with country-specific requirements and different layouts. The provision of tax relief often requires the collection and validation of a large number of certificates or documents with information on beneficial owners which is a very labor-intensive and onerous process.

Useless & ineffective relief at source process due to multi-tiered organization

Relief procedures are not adapted to an environment where securities are held through multiple intermediaries. Consequently, when securities are held through one or more intermediaries without withholding responsibilities, paper-based documentation on beneficial owners and detailed allocation information must be passed on the chain of intermediaries to the upstream withholding agent.

HEAVY WORKLOAD REQUIRES A HIGH NUMBER OF RESOURCES

The cost of the withholding tax process is due to the inefficiencies, complexity and different procedures per country which burden investors with compliance costs. A considerable workload results from the reconciliation of incoming tax refund credit notes with the pending refund claims of the relevant investors and allocating the credit items to the investors' bank accounts (via the intermediaries or directly to the underlying beneficial owners).

For several Financial Institutions, tax reclaim services are not proposed to clients because they consider opportunity costs are too high; this is especially true for complex or specific types of income such as ADR (American Depositary Receipts) or complex Trusts which are deemed transparent. The average costs for customers lies between 10 euros and 35 euros (plus VAT) and in more specific cases goes up to 75 euros (plus VAT) for each refund claim; the industry average threshold seems to approximately be between euros 40 and 50 euros and may even reach 100 euros (Source: Wavestone)

SERVICE AUTOMATION LEVEL

Notification from depositories

- Confirm the taxability event
- Confirm the certification type to be received
- Confirmation of deadline to instruct the depositories

Notification from the custodian to the investors

- Confirm the taxability event
- Confirm the legal and fiscal reference
- Confirm the certification type to be received
- Confirm the deadline to instruct the company

Collection of certificates

- Collection of certificates
- Check, record and reject/validate the documentation
- Forward documentation to depository (if applicable)

Processing of customer instruction

- Ensure the customer has all certificates in place (Extra service: Proactively chase if close to DDL)
- Provide consolidated instruction to the depository

VALUE PROPOSITION

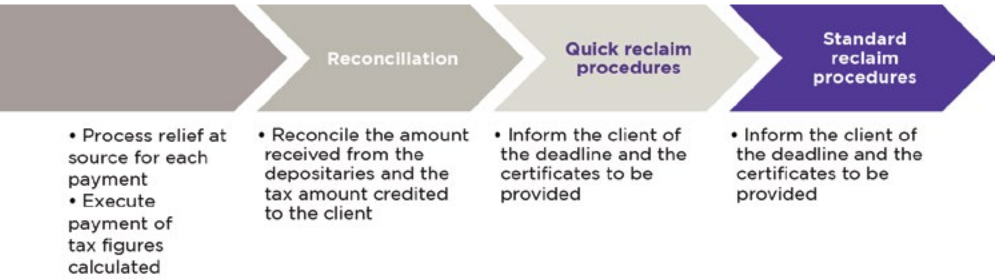
For the WHT client segment, the service providers proposes a combination of products/services:

/ Tax relief at source, in which treaty entitlements or exemptions (reduced rates) are applied is generally only offered by domestic financial institutions in each Member State;

/ Quick refund, in which an intermediary nets off an amount from tax withheld at statutory rate on pay date based on subsequent evidence of treaty entitlement prior to the date on which the intermediary is required to submit tax to its domestic tax authority; and

/ Standard refund reclaims in which entitlements are reclaimed using predominantly manual methods post payment date and within a statute of limitations period.

Automation level	Example of market	
High – Relief at source and« simple » tax reclaim process	France	
	Belgium	
Medium – Relief at source and complex tax reclaim process	Italy	
	Spain	
	Portugal	
Low – No relief at source (on equities) and complex tax reclaim process	Austria	
	Germany	
	Ireland	



SERVICE AUTOMATION LEVEL

	Type of processing	Additional services
	• Relief at Source and Standard Refund	• Electronic certification option (Relief at source)
	• Relief at Source and Standard Refund	• Exemption at source on Debt securities deposited through NBB (ICSD exemption)/ Quick refund depending on local agent/custodian
	• Relief at Source and Standard Refund	• Monitoring of tax reclaim status
	• Relief at Source and Standard Refund	• Electronic certification option (RAS) Quick refund depending on local agent/custodian
	• Relief at Source (complex for Equities) and Standard Refund (complex)	• Electronic certification option (RAS) Quick refund depending on local agent/custodian
	• Standard Refund	• Exemption at source on Debt securities
	• Standard Refund	• Exemption at source on Debt securities
	• Standard Refund	• Relief at Source on Stamp Duty • Exemption at source on Government bonds

The value proposition consists in offering an operational process in order to support Financial Institutions in the reimbursement of withholding tax exceeding amounts, initially paid by the final client to the tax authorities. Financial Institutions leverage on the volume of transactions to propose a lower handling fee, thanks to economies of scale. This is a mass production and industrialized activity, which is why some asset servicers leaders insource activities for third-party clients.

Depending on the number of transactions, a price is allocated (with or without discount – depending on volume) to each type of service. Fixed prices for a specific service or subscription mode are not part of the revenue structure although this approach has the advantage to guarantee a predictable inflow.

The key resources in these administrative activities are people since the operational process cannot easily be automated. Operational profiles must cooperate with tax experts to understand and solve issues or to adapt the process to new regulations and tax laws. Human resources are essential to properly run the process and therefore represent a significant part of the cost.

5.

HOW WILL YOUR FUTURE LOOK LIKE?

CRITERIA INTERPRETATION

Scenario methodology

The scenario methodology aims at defining different possible futures and imagining how the business model could evolve in the context of a new possible future.

The pre-requisite before defining possible scenarios is to define criteria that could have an impact on the transformation of the analyzed ecosystem.

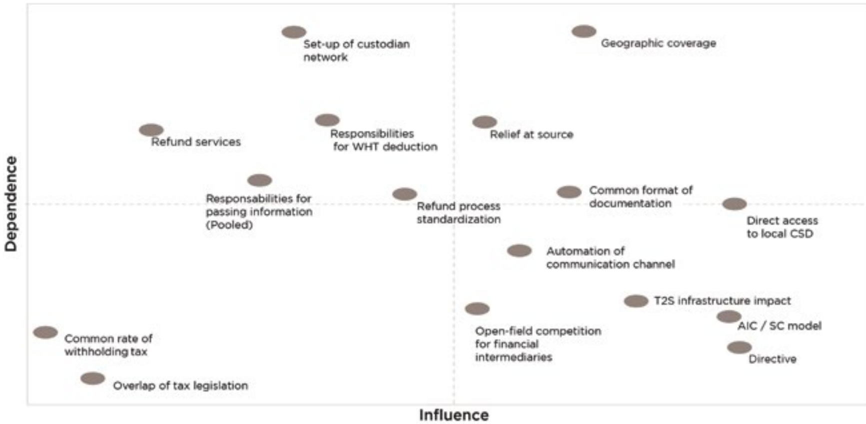
Based on our analysis, we consider the main criteria that could have an impact to be the following:

CRITERIA WITH IMPACT ON SCENARIO

Theme	Variables
Witholding tax ecosystem harmonization	• Directive versus self-organization
	• Open-field competition for financial intermediaries
	• Common rate of witholding tax
	• Overlap of tax legislation
Market infrastrucuture	• T2S infrastructure impact
	• Direct access to local CSD
	• Set-up of custodian network
	• Authorised Intermediary/Source Country model
Role of each player	• Responsabilities for WHT deduction
	• Responsabilities for passing information (Pooled)
	• Relief at source services
	• Refund services
Business and operational rules	• Common format of documentation
	• Refund process standardization
	• Automation of communication channel
	• Geographic coverage

The impact of each variable to define the future of the system are measured by evaluating the degree of influence of the variables. The relative weight of each criterion to transform the withholding tax ecosystem is determined. This analysis can be materialized in the following graph.

INDIRECT INFLUENCE / DEPENDENCE MAP



This graph classifies variables according to their degree of influence and their degree of dependency. In this context, four groups can be identified in the following quadrants, but only three of them are relevant for our analysis:

/ •At the bottom right of the quadrant, a group of variables, the most important drivers of the transformation, represent criteria having a huge impact on the operational process execution (e.g. Directive). Those variables are highly structuring for the overall process, outlining the root-causes of inefficiencies listed in Chapter 3. Without a multilateral, simultaneous and coordinated application by all Financial Institutions regarding these criteria, there is little incentive to harmonize the related processes.

/ On the upper right of the quadrant, a group of variables, important drivers of the transformation, represent criteria explaining stakeholders' main concerns (e.g. Geographical coverage). The analysis shows that the main concern of the stakeholders is to build a harmonized WHT treatment process within the European market, for example through a common format of documentation. The self-organization of the market tends to be based on free access and definition of standard models by Financial Institutions. Private initiatives shape the WHT value chain and allow the creation of the open-field market to increase competition and decrease administrative costs.

/ On the upper left of the graph, a last group of variables are the ones with low driving impact on the ecosystem (e.g. custodian network set up). These variables are influenced by all others. They impact the degree of complexity of the Financial Institution's business model and thus define its positioning within the ecosystem. In practical terms, the description of the current operational process (see chapter 3) highlights how the number of countries covered, mixed to the complexity of the proposed services, increases cost and decreases automation and process streamlining.

This analysis of the current situation highlights that we are in a vicious circle. Structuring changes need the participation of all players to have a quick and deep impact on the process efficiency, but without structural ecosystem changes, there is neither incentive nor financial interest to push the market to change.

Hence these questions could be asked.

1. Do we need political and legal constraints to move forward?
2. Can Financial Institutions gain enough influence to transform the market?

The following paragraph in combination with the next chapter provide some answers to these questions.

POTENTIAL SCENARIOS FOR THE FUTURE

Scenario 1:
Complete integration of the market through the harmonization of relief at source and exchange of information processes in the EU

The overall ecosystem is defined through a European Directive for all market participants. Under this scenario, each intermediary in the custody chain is given the option to take over part (in the case of a responsible non-withholding agent) or all (in the case of a responsible withholding agent) of the withholding responsibilities. No distinction should be made between foreign and local intermediaries in regards to the type of responsibilities they can assume.

The methodology of tax relief at source combined with the possibility of using pooling of assets into tax-rate pool(s) could provide a firm basis for streamlining and simplifying the current tax-relief processes in the EU Member States. Communication processes between Financial Institutions would provide a consolidated vision, irrespective of where securities are held or where transactions are settled (local versus foreign intermediary or CSD) and irrespective of the investment structure or settlement arrangements chosen by the investors and intermediaries (direct versus indirect access).

The benefit of having one form to access multiple markets of investment would reduce complexity within the European Union and should remove a barrier to cross-border investments. Furthermore, standardized documentation would significantly reduce the costs of processing different paper forms and documents. Allowing for self-certifications that are compatible with all onboarding and communication channels (physical, internet, phone...) and that allow for integration in account opening, or other existing processes, would lead to easier processing.

This scenario promotes an approach driven by institutions which would define all required information and processes, as it has already been done on the US market, which to this point remains the most successful example of harmonized tax.

Key success factors for Scenario 1:

/ Coverage of the overall European market

/ Relief at source services

as a standard product

- Adoption of standard communication channel
- Adoption of the authorized intermediary status
- Recruiting of key resources (tax expert and operational tax profile)

Scenario 2:
Integration of the market by concentric circles

The concentric circle concept means mature countries (with high level of automation) and financial institutions are progressing together towards the integration of the market in line with the EU recommendations made on simplified WHT.

Under this scenario, the role of each intermediary in the custody chain would still depend on the market organization rules defined in each country.

This scenario relies on strong initiatives of value chain transformation by leading market actors. Due to their weight in the sector, they can leverage on their available resources (i.e. high volume and extended geographical coverage). Such initiatives would start with the structuration of the local markets in the first phase:

- Definition of range of standard tax services for different segments of beneficial owner (e.g. relief at source and exchange of information as defined by the FISCO or OECD working groups);
- Standardization of communication flows and formats between Financial Institutions;
- Set up of close relationships with sub-custodians and local tax authorities to simplify procedures.

In a second phase, these local initiatives could be deployed on a European scale, encouraging less mature actors and countries to adopt these practices and facilitating the convergence towards a standardized model:

- Tax relief at source and possibility of using pooling of assets into tax-rate pool(s);
- Promotion of simplified and harmonized documentation required for both relief at source and tax reclaim process.

The intervention of key players to facilitate the adoption by the Tax Authorities of a simplified document and procedure could be useful but remains a hypothetical result. Indeed, the fact to have high volumes could provide an incentive to lobby the Tax Authorities for harmonization and as such to reduce the overall processing costs (comparative advantage against competition).

This scenario promotes an approach driven by main market actors who see change as an opportunity. On one side, they will federate actors who will benefit from market transformation, but will be confronted to further strong resistance (see chapter 3).

Key success factors:

- Coverage of the main relevant markets for its clients
- Relief at source tax reclaim services proposed for a limited number of relevant markets for its client
- Recruiting of key resources (tax experts and operational tax profiles)
- Management of complexity (Documentation type, local rule,

communication format)

/ Creation of an innovative /specialized business model.

Scenario 3:

Fragmented market

Under this scenario, the ambition is to improve the process and the business model of the internal organization without trying to transform the overall ecosystem. The constraints imposed by Tax Authorities and local laws are accepted by the Financial Institution. This scenario takes the assumption that the market will not change and will remain heterogeneous due to lack of public or private sector initiatives.

But even if this scenario doesn't anticipate transformation of the ecosystem, some leaders in the market will try to improve their positioning as the activity of tax processing is a value proposition element in their chain or is a source of revenues.

This scenario keeps and faces the overall complexity of the process. Tax relief at source and tax reclaim services are not standard services offered by all Financial Institutions to investors. Only key players will be able to provide a complete range of tax offerings. The access to the market remains restricted due to local laws.

Securities positions to be managed are held at different sub-custodians. Having no aggregated view implies managing the same demand of an investor several times. As there are different Tax Authorities and different sub-custodians to reach, the process will remain time and resource consuming. Financial institutions will try to enhance the existing process by developing some technical process improvement. The scenario will not allow for major development of documentation management and will require a high number of employees. Such costs may not offset the benefits. Smaller participants will go for simpler and cheaper processes. However over time, as the volume grows, the client will request Financial Institutions to offer relief at source or tax reclaim services.

Even if some quick wins can be developed, the benefit of the automation will be limited. Working more efficiently would be industrious.

Key success factors:

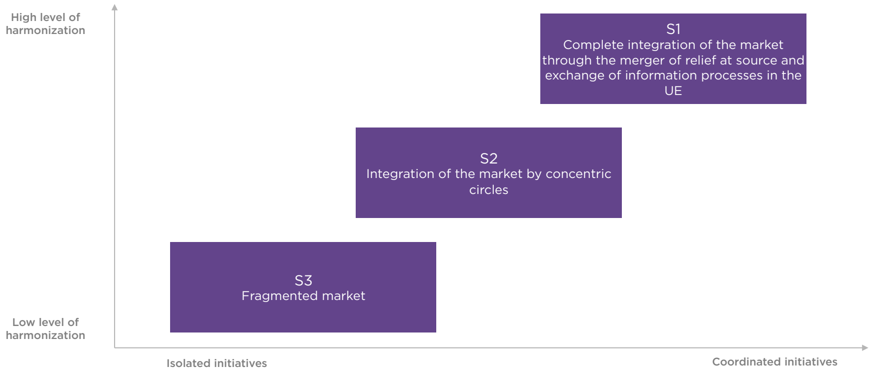
/ Coverage of the main relevant market for its clients

/ Tax reclaim services proposed for a limited number of relevant markets for its client

/ Recruiting of key resources (Tax expert and operational tax profile)

/ Collect and pass the information up in the custodian value chain

POTENTIAL SCENARIO FOR FUTURE



6.

PREPARING FOR THE FUTURE: DO YOU HAVE A STRATEGY ?

TOWARDS A NEW BUSINESS MODEL?

Strategic grouping of financial institutions business models

In order to get perspective on the current landscape of withholding tax services operating models and their supporting technical architecture, Wavestone uses four quadrants to describe the "sharing" dimension:

Quadrant 1: Market leader

A market leader can be defined by its capacity to handle high volumes from various markets and execute a large panel of services with a high level of efficiency:

/ This model regroups the main asset servicers in the market who have decided to develop securities tax services to manage relief at source and tax reclaim;

/ Companies in this model cover as many markets as required by their in-house business and/or third-party clients. This model usually offers a larger array of services (tax relief, quick refund, standard refund....) and tends to cover a large range of products (shares, bonds, investment funds,...). The value chain covers all activities necessary to serve their clients such as collection of certificates, reconciliation of tax reclaim amounts;

/ The companies usually end up offering their services to third parties (institutional, corporate, and private...).
- They propose mass-production and standardized services that allow the automation of their processes in main markets and to be price competitive.

Quadrant 2: Niche player

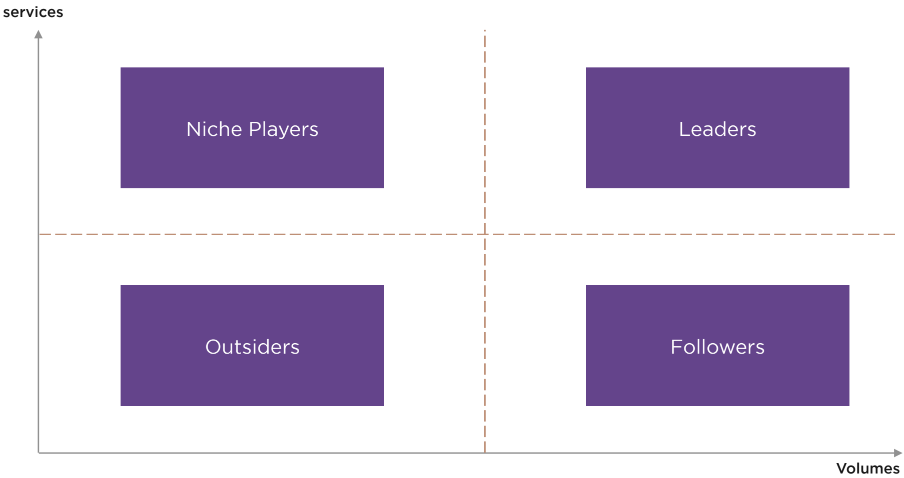
Niche players provide tailor-made services with a high level of quality and low volume or execute a sub-part of the overall value chain:

This model regroups medium asset servicers or companies dedicated to the offering of tax services. They cater to asset servicers, and their offering includes relief at source and tax reclaim but also value-added activities such as portfolio return calculation for asset managers or mutual funds;

There are two different types of value chains for niche players. In the first case, the company's value chain contains the full package of tax services. In the second case, the company's value chain specializes in one activity;

/ Companies in this model usually offer a larger array of services (tax relief, historic reclaim, portfolio analysis....) and tend to cover a large range of complex products (ADR, GDR, Bank debt...). Depending on the company's strategy (as described in the previous point), the offering package could include:
- Full-fledged services
- In-Sourcing
- Particular

PLAYERS TYPE QUADRANT



Services are offered to third parties or smaller Financial Institutions such as asset managers, investments funds, family offices, prime brokers.... Financial Institutions are then able to customize their offering according to client segmentation (institutional, corporate, private...).

- Companies in this quadrant cover as many markets as required by their in-house business and/or third-party clients.

Quadrant 3: Followers

Followers are organizations with sidelined medium volume activities but with a low level of automation focused on the main markets of internal clients:

- This model regroups medium / small asset servicers who provide specific tax services for their in-house activity;
- Companies in this model are able to provide tailor-made services and usually offer a thin range of services (Tax relief, tax reclaim), and tend to cover standard products (shares and bonds) only;
- These companies provide services to internal individual clients or internal fund structures;
- Companies in this model are covering mainly key markets where the threshold of volume allows profitable activities. These services cannot be considered as a real independent value proposition taking into account the contribution to their global revenue and number of resources involved.

Quadrant 4: Outsiders

Outsiders are either organizations with low volumes, or whose clients are not interested in the benefits of tax services, or who do not propose tax services at all. In addition, their withholding tax amount per transaction to refund is too low to be in scope of tax reclaim:

- This quadrant regroups medium / small companies where the tax activities on securities are marginal. Often, they provide no specific services except standard relief at source;
- Companies in this model only cover client residence countries to withhold tax on domestic markets;
- Main clients of these companies are individual clients or corporate clients with low knowledge regarding withholding tax and double tax treaties and who invest only a limited amount of their capital abroad; these clients often have no interest to claim overtaxed payment.

HOW THESE STRATEGIC GROUPS CAN BE IMPACTED BY IDENTIFIED SCENARIOS

In order to get perspective of the future landscape of withholding tax services operating models, the quadrants tend to show what could be the impact of potential scenarios of the future.

Quadrant 1: Leader,
force of market integration

- This group of Financial Institutions possesses internal resources and the sufficient volumes in the most important markets to ensure means to envisage all future scenarios. The current volume, the operational knowledge and their global network would give the possibility to reinforce their current position in scenario S1 and S2.
- In Scenario 1, the organization can leverage on its current resources to reinforce its leading position. It already has all resources needed to comply with the model proposed by the Directive.
- In Scenario 2, the organization can decide to further invest in order to become one of the "integration market makers". The presence in different countries and the process already in place with a custodian network and tax authorities leads to the creation of a more integrated sub-market. Each major player is constantly trying to streamline its processes by asking its local custodians to provide similar information. Therefore, harmonization exists, and if those major players tend to have similar processes, the market will slowly move toward something similar.

Quadrant 2: Niche Player,
force of value chain deconstruction

- This group of Financial Institutions is already positioned as a niche player in asset management. As they are not looking for market coverage to get volume but focus on tailor made and value-added services, this strategic group can benefit from a huge potential of opportunities for the future.
- In Scenario 1, the strategic positioning can be reinforced thanks to the open-field market. The market entry process is facilitated and they can compete with local players based on their competitive advantage without constraints anymore (the niche player will most likely have to face competition of new entrants. In fact, the barriers of entry have been removed completely)

- In Scenario 2 or 3, the company has to preserve its positioning by leveraging tailor made and value-added services. Indeed, inefficiencies in the market are source of value proposition for the client and the company. For those niche players, paradoxically the more specific the process the better for them. They should do what others cannot do because it is too far from the more common process or requires special setup. In both cases, their current original positioning can be a force to transform or restructure the current WHT value chain

Quadrant 3: Followers, keep it simple

- This group of Financial Institutions does not consider tax activities as strategic in their value chain. They offer basic services at a low cost.
- In Scenario 1, the organization has to invest the minimum resources to be compliant with the Directive recommendations. They should keep their standard services to avoid the complexification of their activities which would generate additional costs. This strategic group should have a limited geographical coverage and use the services offered by competitors. More ambitious initiatives would force them to reconsider their positioning and shift to a different quadrant.
- In Scenario 2 and 3, this organization has to deal with the fragmented market. The organization should manage their business in order to remain profitable and provide a minimum level of services to their clients

Quadrant 4: Outsiders, too small to be accounted for

- This group of Financial Institutions has very low volume of relevant transactions eligible for tax reclaim or has no department to manage relief at source or tax reclaim. Often, these services are not provided to the client.
- In Scenario 1, the organization has neither the business motivation, nor the sufficient means to invest in order to comply with the Directive requirements, even though minimum investment in automatic exchange of information would be mandatory.
- In Scenario 2, for the same reasons, the organization is not a market maker who can contribute to modify deeply the structure of the tax ecosystem.
- In Scenario 3, the viability of this activity is questioned internally. If the activity already exists, it is necessary to study how profitable it is to the organization. If it does not exist and a client requests it, the organization can question whether or not it is necessary to develop it internally or partner with another player in order to provide this service.

POSSIBLE STRATEGIES

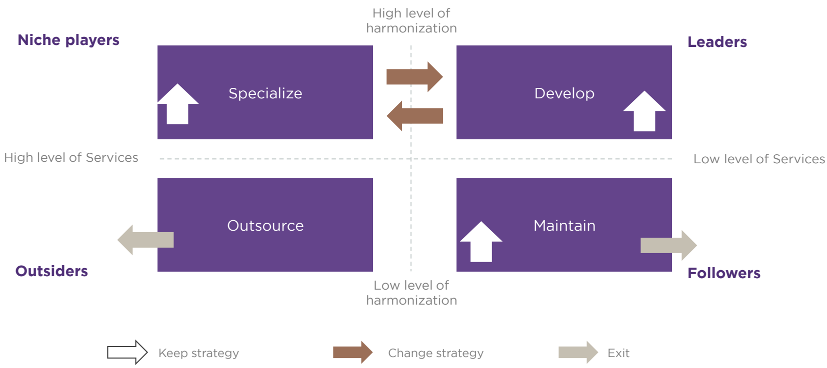
In order to get perspective of the future landscape of withholding tax services operating models, the quadrants tend to show what could be the impact of potential strategies.

Quadrant 1 (upper right): investment and growth

/ This group of financial institutions should continue to invest in this activity to ensure their role of a market leader in tax services:
• They should continue to invest to get volume and to develop the most efficient way to cover 60 markets around the world, specifically in Europe;
• The other possible strategy, in case of lack of resources, is to focus on niche segment to deliver value added services (see second quadrant);

/ For these organizations, the success strategy can be assured through high volumes and industrialized tax services by leveraging the huge number of clients and their presence in various markets due to their position as asset servicing leaders.

PLAYERS – IMPACT DEPENDING ON SCENARIO



Quadrant 2 (upper left): Investment and specialization

/ This group of Financial Institutions should continue to invest in this activity to maintain their competitive advantage based on tailor-made services in the market in tax activities. Possible strategies are:

/ Propose high level services for niche clients who have complex processes and products;

/ Try to get volume if the presence in different markets is increased. After a certain time, the organization could have sufficient resources to be able to compete with asset servicing leaders;

/ For these organizations, the key success factors are based on quality targeted services, through a well-designed and innovative value chain.

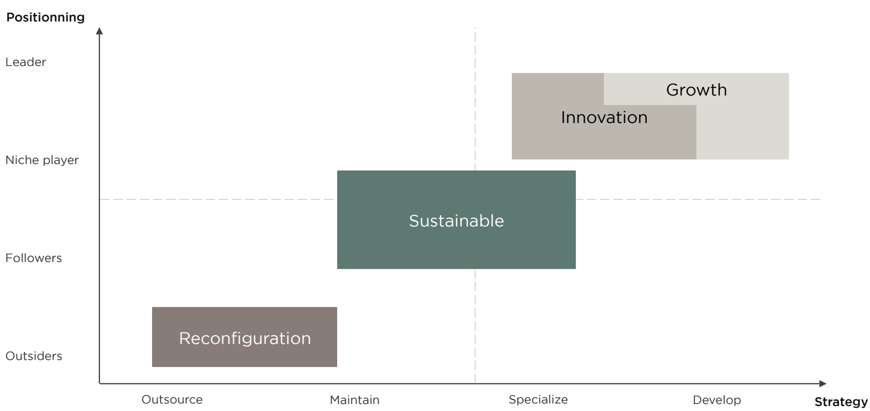
Quadrant 3 (bottom right):
Propose a minima services to keep clients

- / This group of financial institutions has to determine if the provision of tax services is key in their organization and for their clients. Tax services should be at minima profitable except if it is a one-off request by key clients or specific clients who have an imperative need of tax services (tax reclaim or tax relief at source);
- / The organization has to maintain streamlined processes and a basic range of services close to its client needs to avoid extra costs, as for those clients, the margin of the profitability is low;
- / But for this category, as in the next one, the question is also if this activity should be outsourced?

Quadrant 4 (bottom left):
Exit the activity

- / In this group, there are two different possible configurations:
  • The first one is that the volume is too low to maintain profitable services (or clients are not interested in obtaining tax services);
  • The second one is that the financial institution wants to propose the services to its clients but does not have adequate resources to execute those processes properly;
- / In the first case, the activity performed internally is not sufficiently profitable to provide relief at source and tax reclaim services and should be outsourced to a third-party provider;
- / In the second case, taking the entry barriers (Resources, tax expertise…) into account, the outsourcing solution allows the proposal of ad interim services with in parallel the consideration of internal developments.

POSSIBLE STRATEGIES



TRANSFORMATION OF THE BUSINESS MODELS

Business model: Growth

The value proposition of the "growth" business model consists in providing standardized service offerings and products to the client. The competitive advantage consists in proposing low prices obtained thanks to the consolidated volume of its clients on a large market scope. The client accepts basic services and has to fit with the operational model proposed by the organization. This is why these services primarily target clients with the minimum volume necessary to allow the covering of fixed costs.

Business model: Innovation

The value proposition of the "innovation" business model consists in proposing tailor-made or specialized services to the client. In addition to the standard offer proposed by the benchmark actors, these organizations develop solutions or operational models defined by the "voice" of the customer. An "innovative" organization supports its clients by adapting its services and model to the new needs.

The inconvenience of such an approach is the increase in the complexity of the operational model, due to the specificities of client requests and the necessity to mobilize costly resources to be able to cover a high number of countries and products.

Business model: Sustainable

The value proposition of the "sustainable" business consists in delivering tax services to "internal" clients – clients existing only within one of the organization's entities. The service setup is focused on basic relief-at-source, and mostly on tax reclaim services. There is no specific effort to produce specialized reports or to serve a large scope of countries: only punctual needs are covered, avoiding the complexity of tax processes. The organization must define the setup of its operational model based on how to remain the least costly by providing the service itself actively on the markets where volumes are the most important and delegating the rest of the activities to the main actors. This requires a partnership approach to be put in place in order to allow the establishment of a cost structure that isn't based solely on numbers of executed transactions, but also on fixed and recurrent revenues. On the other side, this approach forces the focus towards the most relevant activities of the value chain for the client and the organization. This choice implies assisting client segments that already have complex tax services demands, on a limited market scope.

Business model: Reconfiguration

The "reconfiguration" business model consists either in stopping to offer tax services internally, or to want to create a new offer.

In the first case, the organization has considered that the costs of necessary resources to execute tax reclaim and relief at source services were too high in comparison to the benefits it can reap from it. Therefore it decides to outsource this model, mostly of tax reclaims, to a third-party provider – the middle office is the point of contact with the external service provider. This allows the financial institution to significantly decrease costs, while maintaining a minimum level of services for the client.

In the second case, an organization can decide to put in place a service that didn't previously exist. It is unlikely for such organization to organize to decide to develop the entire value chain of services internally from scratch; instead, in a first step, they mandate a third-party provider to execute operational tasks in order to familiarize with the new activity. As such they gain the time and experience to acquire the skilled resources internally.

In both cases, the organization can negotiate a trailer fee with the third-party in order to cover its costs and to remain profitable on this activity. Generally, third-party providers maintain the major part of revenues which is a percentage of revenues collected from tax authorities.

TOOLS FOR TRANSFORMATION

TOOLS FOR TRANSFORMATION

KEY SUCCESS FACTORS		GROWTH
A. MODULAR SERVICES	Propose relief at source	✓
	Propose value added and tailor-made services	☺
	Propose	☺
	Propose very specialized services	👎
B. NEAR SHORING, SHARED SERVICES AND OUTSOURCING	Outsource part of the value chain	👎
	Mirroring and centralization of all the beneficial owner positions	✓
	Become a hub for the overall market	✓
	Near-shoring and shared services	✓
C. PROCESS STREAMLINING	Streamlined Tax Processing	✓
	Cope with OECD or European Commission model	✓
D. INFORMATION TECHNOLOGY	Develop electronic interface with client	☺
	Automated end to end process	✓
	Use of dematerialized technology to pass through the information	✓

✓ Mandatory ☺ Nice to have 👎 Exclude

Offer modular services

Propose relief at source

The relief at source process enabling investors to get taxed at the correct rate on their cross border investment income should be proposed whenever possible to all investors (The information is not always available. Historically maintaining segregated accounts has been quite costly.)

Proposing those services to the client requires accurate data and documentation often through several intermediaries to the paying agent and is highly time sensitive.

INNOVATE	SUSTAIN	RECONFIGURATE
✓	☺	👎
✓	👎	👎
✓	👎	👎
✓	👎	👎
👎	👎	✓
✓	👎	👎
✓	👎	👎
✓	☺	👎
✓	✓	👎
✓	👎	👎
☺	👎	👎
✓	☺	👎
✓	👎	👎

It also requires to put in place data and document delivery mechanisms to allow the maximum number of customers of a firm to access tax relief at source without increasing proportionally administrative costs for the company.

Propose value added and tailor-made services

Value added services can be proposed to the investors to increase revenues and retain clients. These kind of services position the company on high level services such as analysis of portfolio positions to identify scale and scope of any refund entitlement, historic reclaims (Statutes of Limitations offer potential recovery of over-paid tax on income received in previous years, often resulting in a windfall payment)... These tailored made services are priced on a higher rate.

Propose packaged services and focus on niche clients

The financial institution should develop a specific service offering toward niche clients such as hedge fund, pension fund, ICSD.... This is an especially important consideration when it comes to withholding tax recovery. Recovering excess withholding tax is very valuable service for niche clients and can be extremely complex.

Propose specialized services

Financial Institutions may remain active in tax services even without the required resources by proposing very specific services through a client relationship based on the peer-to-peer model:

- Specialized by market (e.g. focus on Austrian market only)
- Specialized by tax services (e.g. tax reclaim only, or tax relief only, ...)
- Specialized by tax products (e.g. reporting only)

Adopt a new operating model: Near shoring, shared services and outsourcing

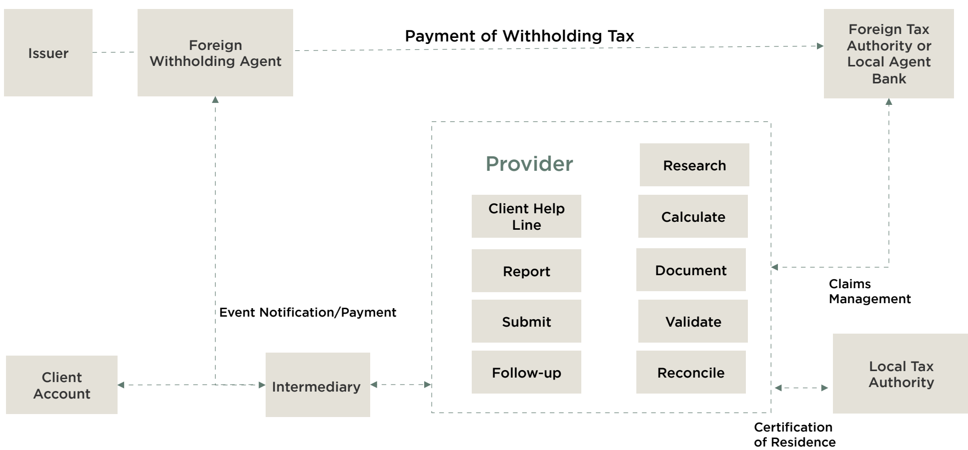
Near shoring and shared services

Over the past 10 years, the first step for financial institutions to make tax services more profitable was to offshore the tax department in a low-cost entity within the financial institution's group. Other actors, lacking locations in countries with low cost resources, have chosen to bring together and to regroup skills linked to tax services in one of the group branches. If this process is outdated for the main asset servicers, as already implemented by main institutions since one decade, it remains an economic lever for medium-sized financial institutions.

Outsource part of the value chain

Financial institutions can provide back-office tax processing services to other actors, enabling them to offer enhanced tax services to all counterparties, including central registrar to many issuers, investor disclosure and tax relief, recovery and reporting.

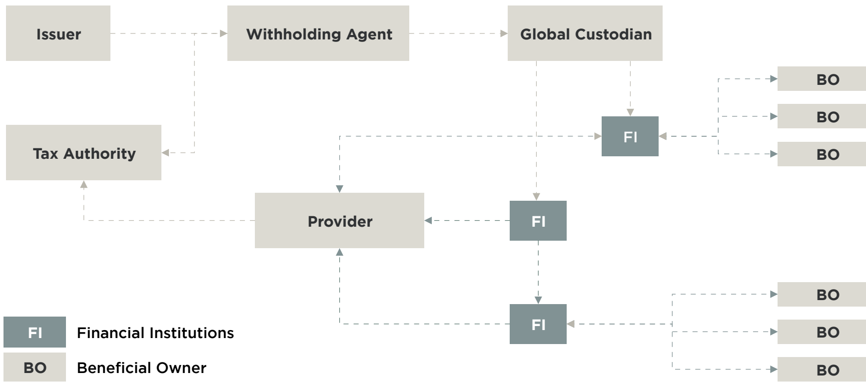
OUTSOURCING SOLUTION



Mirroring and centralization of all the beneficial owner positions

Financial institutions can propose omnibus accounts structures to centralize all positions from different banks and brokers, especially when operating in different jurisdictions. It is an efficient way to bundle customer trading activity into a single account, saving money through economies of scale, and allowing for trades executed at many brokers to be consolidated at a single global custodian or its own affiliate in another jurisdiction.

OMNIBUS ACCOUNT PROCESS



Become a hub for the overall market

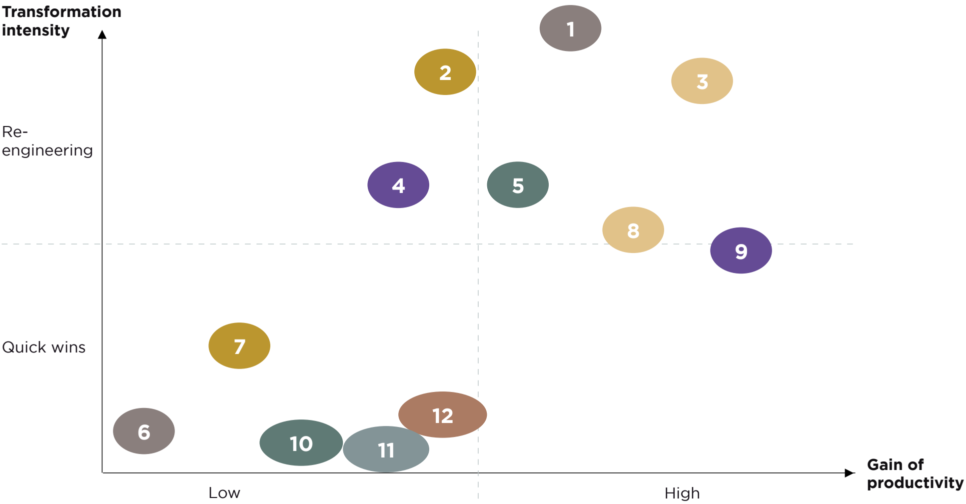
The objective is to create an important market notice of tax-related corporate actions, processing information and requirements through custodian intermediaries in favor of those holding positions on record date. That allows the building of an interface with CSDs to corroborate positions held by CSD participants to ensure valid claim filings, to develop special relief and reclaim processes with tax authorities as the Depositary's agent.

To streamline processes

Streamlined Tax Processing

The following table proposes different potential enhancements of tax processing. Working on internal processes and focusing on creating lean processes is probably the less productive option, as most of the process inefficiencies result from external constraints.

STREAMLINE PROCESSES



Cope with OECD or European Commission model

Treaty Relief and Compliance Enhancement (TRACE) is intended to improve cross-border tax-relief procedures by means of a standardized system for the claiming and reporting of withholding tax relief, under both a treaty and a source country's domestic law reliefs. The system outlines the documentation and due diligence procedures that the financial institution must follow, and the information reporting that is required.

TRACE is the tool which, if used by the main market actors, will strongly contribute to the harmonization of the WHT ecosystem, even in the absence of a political decision pushing for harmonization (see scenarios 2).

Reconciliation → Quick reclaim procedures → Standard reclaim procedures

1 / **Notification timing** from depository is agreed at SLA level.
Real time should become the norm.

2 / **Notification process** could be fully unless there is a late notification of payment from Depository or Issuer when manual intervention is required.
When the security enters the client security account, this triggers several notifications including tax notifications (i.e. taxability, documentation requirements, deadlines, holding, ISIN,etc).
Taxability and legal reference is flagged by New Issues department once securities enter. Certification type is linked directly with taxability country.

3 / **Acceptance of digital documentation** (take UK as an example where electronic Certificates of Residences can be issued via online request).

4 / **Automated alerts o**nce digital certification has been received, inserted, accepted/ rejected to ensure no follow up is required.

5 / **Reconciliation** currently requires FTEs to check each file. Recommendation: build macro to compare data of Depository with actual amount paid to clients.

6 / **Improvement of notification timings** to be escalated during due diligence visit with depository.

7 / **New Issues dept** must ensure clear communication channel with Tax/Fiscal department to ensure correct tax flag is applied.

8 / **Abolishment of «paper» or physical certification**.

9 / **Less FTE** required if collection of certification is automatic - processing of instructions becomes more automated as a result.

10 / **Increase controls** on processing of customer instruction to avoid reconciliation issues.

11 / **Notification** to be trigged when investor position is taxed.

12 / **Notification** to be trigged when investor position is taxed.

SC MODEL

The Authorized Intermediary closest to the beneficial owner reports the information to the Source Country, which then provides this information automatically to the residence country

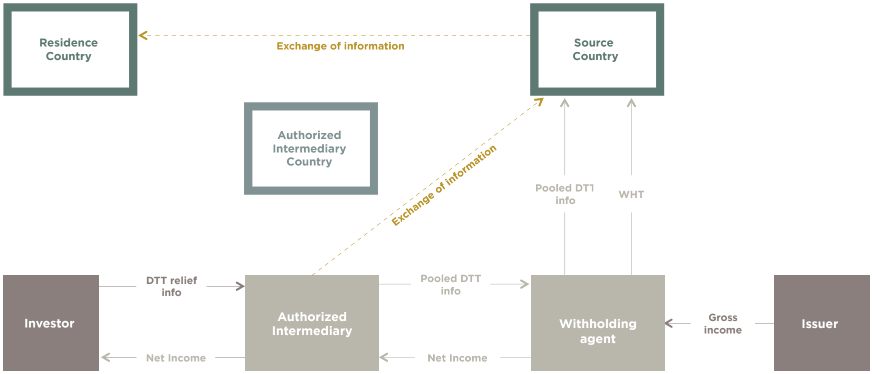
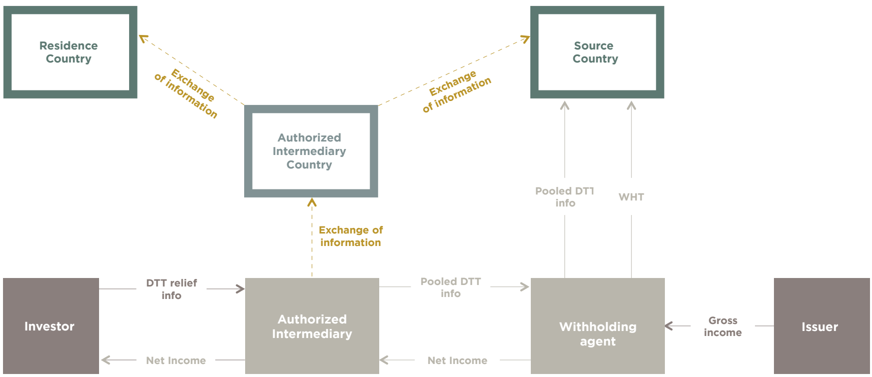


TABLE 22: AIC MODEL

The Authorized Intermediary closest to the beneficial owner reports the information to the country where it is established, which then passes the information automatically to both source and residence countries



To automate

Develop electronic interface with client

An electronic interface accepts submissions of beneficial owner data by manual entry or Excel spreadsheet upload and to file tax reclaims for each of them. This information can be handled through a document management tool.

Automated end to end process

The organization can implement an end-to-end transactional operating process to allow custodians or CSDs and their downstream counterparties to securely provide tax documentation and receive data related to corporate actions in a timely manner. Most countries require proof of residency in order to recover withheld tax. The certification of Tax Residency can be completed electronically and therefore can be used to file for favorable rates of withholding tax guaranteed under double taxation treaties.

Use of digital technology to pass information through

This solution abolishes the requirement of paper-form certification and allows intermediaries to make use of modern technology to pass on beneficial owner information to the local withholding agent in electronic format, therefore eliminating the paper intensive process.

CONCLUSION

Tax transparency and tax avoidance have been a major concern and focus of the European Union during the past decades. Notwithstanding, little progress has been made in this arena. Main cause is the fact that countries within the European Community continue to see taxation to be central to their national sovereignty.

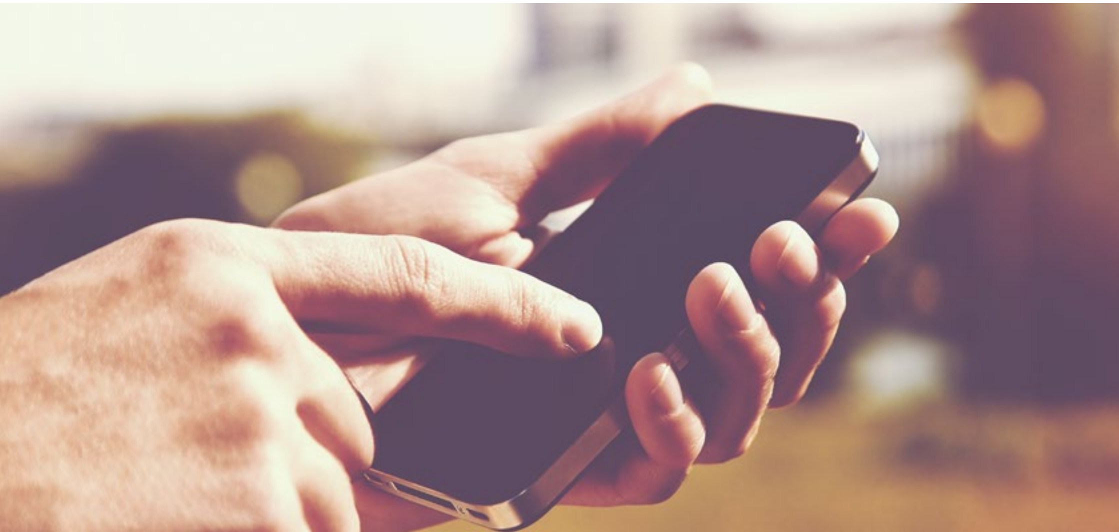
The raising public disapproval of income inequality and tax evasion could lead to a structural change, as pressure on politicians is mounting.

Supranational actors will set the agenda and will play a mediating role between investors, financial institutions, interest groups and member states.

A complete harmonization of the market is not the most likely scenario in the short term, but the current market fragmentation could very well evolve towards an integration by concentric circles.

Hence, whatever your position as market leader, niche player, follower or outsider, there exist some market threats but also very nice opportunities to invest in innovation and growth or to reconfigure your business model and establish win-win partnerships in the tax domain.

We look forward to discuss this further with you.



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