

## THE ASSOCIATION OF GLOBAL CUSTODIANS

THE BANK OF NEW YORK  
BROWN BROTHERS HARRIMAN  
CITIBANK, N.A.  
INVESTORS BANK & TRUST COMPANY  
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MELLON FINANCIAL  
THE NORTHERN TRUST COMPANY  
RBC GLOBAL SERVICES  
STATE STREET BANK AND TRUST COMPANY

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February 22, 2005

Mr. Keiji Aoyama  
Deputy Commissioner (International Affairs)  
National Tax Agency  
3-1-1 Kasumigaseki  
Chiyoda-Ku, Tokyo 100-8978  
Japan

Re: Follow-Up on the Requirements to Comply with the New U.S. / Japan Tax Treaty

Dear Mr. Aoyama:

On September 15, 2004, the Association of Global Custodians ("Association") sent a letter to you concerning requirements related to the exemption-at-source entitlement for U.S. pension funds under the 2004 Income Tax Treaty between the United States and Japan ("Treaty").<sup>1</sup>

In the aforementioned letter, the Association expressed concerns over two domestic administrative requirements --

1. Global custodians operating omnibus securities accounts for U.S. pension funds must provide a beneficial owner breakdown to their Japanese sub-custodian bank for each income payment; and
2. A Japanese Ministerial ordinance requires one original Internal Revenue Service ("IRS") tax residency certificate to be submitted per pension fund per security for each income payment.

In December 2004, the Association learned that some relaxation of item 2., the original tax residency certificate requirements, has been proposed under the upcoming Tax

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<sup>1</sup> A copy is attached for your convenience.

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Reform Act of 2005. We also understand that the proposal is currently pending approval from the Diet.

We await the anticipated positive outcome on tax residency certification requirements under the Reform Act and know that the proposed changes will be positively received by participants and investors. At the same time, we would appreciate your further assistance and support with respect to item 1., regarding beneficial owner breakdown requirements, which we hope may be addressed in concert with residency certification requirements.

### **Current Procedures**

As an industry practice, global custodians typically place the securities holdings of all treaty-eligible U.S. pension funds in a U.S. pension fund omnibus account ("Omnibus Account") on the books of their sub-custodian banks in Japan. Under the current requirements, global custodians must provide a beneficial owner breakdown on the Omnibus Account to their Japanese sub-custodian bank for each income payment. Based on this breakdown, the Japanese sub-custodian bank will prepare the Application Form for Income Tax Convention at the level of each individual U.S. pension fund and submit this to the relevant securities issuer agent.

Severe administrative burdens are placed on all parties under this current requirement, as global custodians, Japanese sub-custodian banks and securities issuer agents are required to secure and/or provide full beneficial owner breakdowns, and reconcile and process the details prior to each income payment.

### **Proposed Procedures**

The Association respectfully submits that the need to furnish beneficial owner breakdowns for each income payment is unnecessarily burdensome for all concerned. While the Association is appreciative of the need to properly validate the treaty eligibility of U.S. pension funds maintaining holdings in the Omnibus Accounts, the Association believes this can be addressed through less cumbersome but equally effective administrative procedures. The Association proposes the following alternative procedures for your consideration:

- The global custodian continues to place the securities holdings of eligible U.S. pension funds in an Omnibus Account maintained by its Japanese sub-custodian;

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- Income accruing on securities holdings held in the above Omnibus Account is paid without deduction of tax, in accordance with Treaty provisions. This is achieved by means of the Japanese sub-custodian completing the Application Form for Income Tax Convention in the name of the global custodian and/or the Omnibus Account;
- Beneficial owner breakdown details and photocopies of IRS tax residency certificates are provided by the global custodian to the Japanese sub-custodian on a limited random sample basis to justify the Treaty relief that has been provided. This process is initiated upon request of the Japanese tax authority.

By decreasing the complexity of the administrative procedures, Treaty relief can be provided to U.S. pension funds in an efficient manner while the correct application of Treaty benefits can still be verified. The current system is overly cumbersome in comparison to the existing systems in a number of other countries. A suitably refined approach, consistent with the above proposed procedures, would address this and enhance the relative attractiveness of investing in Japanese securities.

### Conclusion

The Association would be happy to provide any further information that you may require in consideration of the issues raised in this letter. If the Association can be of any assistance, please do not hesitate to contact the undersigned at 202/452-7045. We look forward to hearing from you.

Sincerely,



Mary C. Bennett  
Counsel to the Association

Attachment --

Letter dated September 15, 2004, to Keiji Aoyama, Deputy Commissioner (International Affairs), NTA, from Margaret R. Blake, Counsel to the Association, regarding Requirements to Comply with the New U.S./Japan Tax Treaty.

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September 15, 2004

Mr. Keiji Aoyama  
Deputy Commissioner (International Affairs)  
National Tax Agency  
3-1-1 Kasumigaseki  
Chiyoda-ku, Tokyo 100-8978  
Japan

Re: Requirements to Comply with the New U. S./ Japan Tax Treaty

Dear Mr. Keiji Aoyama:

On behalf of the Association of Global Custodians ("Association"), we are writing to express our collective concern over the information we have received to date regarding the facilitation of exemption-at-source entitlement for U.S. pension funds under the recently ratified income tax treaty between the United States and Japan ("Treaty"). In particular, we refer to Articles 10(3)(b) and 11(3)(d) of the Treaty.<sup>1</sup>

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<sup>1</sup> Article 10 states,

1. Dividends paid by a company which is a resident of a Contracting State to a resident of the other Contracting State may be taxed in that other Contracting State.
2. However, such dividends may also be taxed in the Contracting State of which the company paying the dividends is a resident and according to the laws of that Contracting State \* \* \*.
3. Notwithstanding the provisions of paragraph 2, such dividends shall not be taxed in the Contracting State of which the company paying the dividends is a resident if the beneficial owner of the dividends is:

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The Association is comprised of nine global custodian banks with affiliates and branches in numerous countries that provide global custody services to cross-border institutional investors.<sup>2</sup> Members of the Association provide global custody services to investors investing in the Japanese marketplace. The Association is very concerned about the application of Treaty benefits to U.S. pension funds based on the administrative and documentation requirements resulting therefrom. We have set forth below the critical challenges we believe U.S. pension funds, global custodians and Japanese custodian banks will face as a result of the proposed application of the Treaty and have proposed an alternative solution to address these concerns.

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\* \* \*(b) a pension fund that is a resident of the other Contracting State, provided that such dividends are not derived from the carrying on of a business, directly or indirectly, by such pension fund. (Emphasis added)

Article 11 states,

1. Interest arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that other Contracting State.
2. However, such interest may also be taxed in the Contracting State in which it arises and according to the laws of that Contracting State, but if the beneficial owner of the interest is a resident of the other Contracting State, the tax so charged shall not exceed 10 percent of the gross amount of the interest.
3. Notwithstanding the provisions of paragraph 2, interest arising in a Contracting State shall be taxable only in the other Contracting State if:

\* \* \* (d) the interest is beneficially owned by a pension fund that is a resident of that other Contracting State, provided that such interest is not derived from the carrying on of a business, directly or indirectly, by such pension fund[.]  
(Emphasis added)

<sup>2</sup> The members of the Association are listed on the letterhead above.

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### Administration and Documentation Requirements

#### Beneficial Owner Breakdown

The administrative arrangements being considered by the National Tax Agency ("NTA") pursuant to the Treaty would require global custodians operating omnibus securities accounts for U.S. pension funds to provide beneficial owner breakdown details to their Japanese custodian bank for each income payment. The Japanese custodian bank would use this information to complete the Application Form for Income Tax Convention for each U.S. pension fund in order to facilitate the exemption payment process through the securities issuer agent. We are concerned about the severe administrative burden that would be borne by:

- Global custodians, in providing breakdown details for each income payment;
- Japanese custodian banks, in reconciling these breakdown details and preparing the Application Form for Income Tax Convention for each U.S. pension fund recipient of each income payment; and
- Issuer agents, in processing this incremental amount of paperwork.

#### Internal Revenue Service ("IRS") Residency Certificate

In addition, the Association understands that the NTA requires an original IRS tax residency certificate to be submitted per pension fund per security, prior to each income payment date. Therefore, in order for U.S. pension funds to be eligible and in compliance they would have needed these documents by the effective date of the Treaty, which was July 2004.

The IRS issues tax residency certificates specifically for the purpose of demonstrating to other tax authorities that the investor is a U.S. resident for tax purposes. Tax residency certificates for U.S. pension funds are issued by the IRS from one service center in the United States. Each member of the Association requests, through this one office, tax residency certificates for U.S. clients for those countries of investment that require them. The Association members' collective experience indicates that the process of obtaining these tax residency certificates from the IRS takes approximately 5-7 weeks. For those countries of investment that require tax

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residency certificates, only one tax residency certificate is generally required for each pension fund in order for relevant treaty benefits to be applied. Examples of such markets are Belgium, Canada, France, Indonesia, Ireland, Italy, the Netherlands, and Poland. This consistent approach allows eligible clients to comply with the documentation requirements and benefit from the applicable double taxation treaties.

Based on the Association's current understanding of NTA tax residency certificate requirements, the Association estimates that there will be a significant negative impact on U.S. pension fund investors, global custodians and the Japanese banking community. Collectively, members of the Association act as custodian for over 800 U.S. pension funds, which currently invest in Japan. These pension funds hold a combined total of over 60,000 lines of stock at Japanese subcustodian banks. The requirement set forth by the NTA is in essence asking U.S. pension funds custodied with the Association to provide 60,000 additional tax residency certificates. To illustrate, one such U.S. pension fund client invests in more than 1,500 Japanese securities. Thus, the global custodian for this pension fund would need to request 1,500 original tax residency certificates from the IRS and then provide 1,500 originals to the Japanese custodian banks.

It is unclear to the Association how original documents versus photocopies will provide reassurance to treaty eligibility, as the IRS will only be generating thousands of duplicate tax residency certificates.

### **Suggested Approach**

From the Association's perspective, while we understand the NTA's need to validate the treaty eligibility of a U.S. pension fund, the requirement for one original residency certificate and one Application Form for Income Tax Convention for each pension fund per security event seems excessive. Moreover, these measures may make the Japanese securities market less attractive to U.S. pension fund investors.

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Due to the above concerns, the Association respectfully recommends that the NTA revise the administrative procedure. In order to assist in this recommendation propose the following administrative procedure:

- The global custodian places the securities holdings of eligible U.S. pension funds in a "U.S. Pension Fund" omnibus account maintained by its Japanese custodian;
- Income accruing on securities holdings held in the above omnibus account is paid without deduction of tax, in accordance with Treaty provision. This is achieved by means of the Japanese custodian completing Application Form for Income Tax Convention in the name of the global custodian or the omnibus account.
- Beneficial owner breakdown details and photocopies of IRS tax residency certificates are provided by the global custodian to the Japanese custodian on a **limited** random sample basis to justify the Treaty relief that has been provided. This process is initiated upon request of the Japanese tax authority.

The benefits of such an approach are that:

- Treaty relief can be provided to US pension funds in an efficient manner;
- Tax residency certificate requests to the IRS are minimized;
- The Japanese tax authority can still verify the correct application of Treaty benefits; and
- The relative attractiveness of the Japanese securities market is preserved.

The Association suggests that the tax residency certificate should be dated within the last three years and that subject to this, it should be valid indefinitely – unless the U.S. pension fund has changed status (e.g., legal name or tax identification number).

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We feel the tax residency certificate language should alleviate the need for the additional questions that are being raised by the Japanese custodian banks such as, for example, 1) Name of applicable law of establishment for the pension fund, 2) Name of applicable law for tax exemption status of the pension fund, and 3) Confirmation that more than 50% of beneficiaries are residents of the United States. Lastly, the tax residency certificate will refer to the relevant sections under the U.S. Internal Revenue Code that will provide confirmation to Treaty entitlement.

**Conclusion**

We hope you find the above comments useful in considering the issues related to the application of the Treaty to U.S. pension fund clients. The Association would like to seek finalization of the proposed administrative process for obtaining reciprocal Treaty benefits for U.S. pension funds. Please let us know how we can assist in moving this initiative forward. If you have any questions or comments in relation to the points raised in this letter, please do not hesitate to contact Patrick C. Costello, Chair of the Association's Tax Issues Committee (617-382-4588) or the undersigned (202-452-7020).

Sincerely,



Margaret R. Blake  
Counsel to the Association

cc: Mr. Robert H. Green  
Director, International  
IRS

Mr. Aziz Benbrahim  
Tax Treaty Group Manager  
IRS