

# ***TRACE Implementation Package announced by the OECD***

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*After years of technical discussions, the Committee on Fiscal Affairs of the OECD approved the TRACE Implementation Package (“TRACE”) at its meeting of 23 January and presented it at the OECD conference on TRACE/FATCA in Paris on 12 February 2013. TRACE, which stands for “Treaty Relief and Compliance Enhancement”, is a regime to allow for automated tax withholding by Authorised Intermediaries who agree to the automatic exchange of information.*

*This marks an important development in the exchange of information across governments and in the mechanics of treaty relief systems. It is a further development in what are now global moves to ensure better tracking and ownership checks on transactions flowing through the world’s financial systems. FATCA is the biggest enacted example of new law in this area but it can be expected that other initiatives will follow and TRACE is one of these.*

*FS Groups should be monitoring these developments because there are significant implementation issues likely to be associated with each change but also economies to be gained by linking the various initiatives in what we now call “global information reporting”.*

## ***Overview – what is TRACE?***

With world-wide portfolio investments estimated at greater than USD 35 trillion the OECD has, since 2006, been striving to facilitate cross-border investment.

TRACE is an international business and government initiative intended to streamline procedures for claiming reduced rates of and exemptions from withholding tax, pursuant to tax treaties, domestic law and the exchange of information.

Approximately 3,000 tax treaties are currently silent on methods of granting treaty benefits, so the typical method for granting relief on portfolio investments is through *ex post* refund procedures. These refund procedures are cumbersome for all governments involved, for the financial institutions and for the ultimate investors

and as a result they typically lead to a “home bias” in investing.

In developing its TRACE implementation package, the OECD has given close consideration to the mechanics of the well-established US Qualified Intermediary Regime (“QI”). Through the QI regime, foreign banks can automatically grant US-treaty relief to foreign beneficial owners provided they sign up to a model agreement with the US-Internal Revenue Service (IRS) thereby subjecting themselves to certain due diligence, documentation, audit, reporting and withholding requirements.

Governments of OECD countries were assisted in the development of TRACE by comments from experts of the financial industry through the Business and Industry Advisory Committee to the OECD (“BIAC”).

## ***The OECD, the EC and OECD countries***

Whilst the OECD has reached formal agreement on the TRACE implementation, there is not yet final agreement on what form the TRACE system will take and discussions are ongoing.

In the European Union in particular, the EU Savings Directive and the new EU Directive on administrative cooperation on tax matters are already helping to bring automatic exchange of information a step closer in the EU. While the EC has not yet taken a final formal position on TRACE itself, it may be recommending that EU member states endorse the package.

We understand that a number of countries may be planning to adopt TRACE, including the UK, Denmark, Finland, Slovenia and possibly Germany.

## ***Next phases***

The next phase is adoption by national governments. Similarly to the US QI, TRACE is an optional regime for both governments and financial institutions.

It will therefore be down to the financial institutions to assess whether adhering to a TRACE regime will give it a competitive advantage over its peers and facilitate cross-border investments for the financial institution's custody account-holders. A clear understanding by the financial industry and tax administrators of the benefits of an automated withholding regime with automated exchange of information is therefore important.

Going forward the "TRACE Group" and a separate "TRACE IT Expert Group" will continue to work on the practical aspects of TRACE and FATCA.

By its nature, the TRACE implementation package constitutes an OECD recommendation which requires implementation into national laws by the respective local governments. Some governments have already announced that they are considering the adoption of TRACE legislation during 2013.

## ***What you should do now***

TRACE would greatly simplify withholding tax procedures and clarify custodian and paying agent responsibilities. However, with more burdensome reporting requirements on intermediaries who would be required to report beneficial ownership information to source countries, this could come at price.

It is vital that affected financial institutions take an active part in the design of the new TRACE system to minimise duplication and streamline processes.

Banks acting as global or regional custodian for cross-border investors of countries considering TRACE legislation should be aware of the importance of TRACE, express their support for TRACE legislation and evaluate the impact of TRACE for their business strategy.

The TRACE announcement marks a turning point in the application of international treaty law. While the practical benefits will depend on the willingness of governments to adopt TRACE legislation, these proposals will influence FATCA, QI, automatic exchange of information systems and the other mechanics of treaty relief systems.

The TRACE implementation package is available in full at:

[http://www.oecd.org/ctp/exchangeofinformation/TRACE\\_Implementation\\_Package\\_Website.pdf](http://www.oecd.org/ctp/exchangeofinformation/TRACE_Implementation_Package_Website.pdf)

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