

MEMO# 11663

February 18, 2000

INSTITUTE SEEKS CHANGES TO PROCEDURES FOR WITHHOLDING TAX EXEMPTION FOR JAPANESE GOVERNMENT BONDS

[11663] February 18, 2000 TO: INTERNATIONAL COMMITTEE No. 7-00 SECURITIES
OPERATIONS SUBCOMMITTEE RE: INSTITUTE SEEKS CHANGES TO PROCEDURES FOR
WITHHOLDING TAX EXEMPTION FOR JAPANESE GOVERNMENT BONDS

On September 1, 1999, a tax reform law called the Special Taxation Measures Law took effect in Japan. Among other things, the law provides that individual non-residents of Japan and foreign corporations are exempt from Japanese withholding tax on interest payments on Japanese government bonds (JGBs), provided certain conditions are met with respect to how the securities are held. While US mutual funds are among the investors entitled to claim the exemption, they have not been able to meet these conditions while maintaining custody of JGBs through their global custodians. To qualify for the exemption, a non-resident holder must satisfy three requirements: 1. The non-resident must hold the JGBs in the JGB Book Entry System (BOJ-NET); 2. The book-entry JGBs must be deposited with a Japan operation of a financial institution that is a participant in the BOJ-NET; and 3. The beneficial owner of the JGBs must be certified as a non-resident by the head of the Japan operation where the JGBs are deposited. The requirements are intended to assure that the exemption will only be afforded to non-residents and not to Japanese residents. The practical effect of these requirements, however, is that US mutual funds that maintain custody of JGBs through their global custodians are ineligible for the withholding tax exemption. On January 31, 2000, Institute staff met with senior tax policy officials from the Japanese Ministry of Finance (MoF). In that meeting and in a subsequent letter to the MoF officials, the Institute stressed that US mutual funds are the type of non-resident investor intended to qualify for the withholding tax exemption. The Institute further argued that it should be possible to develop a reporting system that would allow US mutual funds to claim the exemption while providing the Japanese government with enough information to guard against fraudulent claims to the exemption by Japanese residents. A copy of the letter is attached. The Institute has also discussed this issue with senior officials of the US Treasury Department and intends to continue to raise it in discussions with Japanese and US government officials in Tokyo later this month. The Association of Global Custodians (AGC), which represents many of the largest US-based global custodians, also has been active on this issue. The AGC submitted a letter to the MoF, a copy of which is attached, suggesting either that Japanese custodians be permitted to certify non-residency based on documentation received from a global custodian or that global custodians be permitted to

participate in the JGB Book Entry System directly. Robert C. Grohowski Assistant Counsel
Attachments

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