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Comment Letter on Tax Treaty Benefits to Cover U.S. Mutual Funds, December 2001

September 27, 2001

Barbara M. Angus, Esq.
International Tax Counsel
Department of the Treasury
1500 Pennsylvania Avenue, N.W.
Room 1000
Washington, DC 20220

Re: Withholding on Dividends Paid by RICs to U.K. Pension Plans

Dear Barbara:

As you know, the Investment Company Institute (the "Institute")[1] strongly supports updating and expanding the U.S. income tax treaty network. Most immediately, we support approval of the income tax convention between the United States and the United Kingdom signed on July 24, 2001 (the "Convention").

One issue of concern has arisen, however, regarding application of the Convention to regulated investment companies ("RICs"). Specifically, the Convention's exemption from US withholding tax for certain dividends paid to U.K. pension plans[3] does not apply to dividends from RICs.[3] A dividend paid by a RIC to a U.K. pension plan is instead subject to U.S. withholding tax at a 15 percent rate.[4]

The Institute respectfully submits that dividends paid by a RIC to U.K. pension plans should be exempt from U.S. withholding tax. No policy rationale appears to support exempting U.K. pension plans from U.S. withholding tax on dividends received directly but not on dividends from RICs investing in the same corporations. Moreover, imposition of a 15 percent withholding tax on dividends paid by a RIC to a U.K. pension plan could, in the competitive world of managed investment, create a significant incentive for a U.K. pension plan otherwise planning to invest in a RIC to invest instead directly or through another investment structure.

The Institute would like to work with you to find an expeditious resolution of this issue that will not delay the adoption of the Convention. I will call you to discuss how the Institute may assist you in this regard.

Thank you for your consideration.

Sincerely,

Keith Lawson
Senior Counsel

cc: Patricia Brown

ENDNOTES

[1] The Investment Company Institute is the national association of the American investment company industry. Its membership includes8,730 open-end investment companies ("mutual funds"), 481 closed-end investment companies and 7 sponsors of unit investment trusts. Its mutual fund members have assets of about $6.864trillion, accounting for approximately 95% of total industry assets, and over 83.5 million individual shareholders.

[2] Article 10(3)(b) provides that "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 a resident of the other Contracting State and . . . a pension scheme, provided that

such dividends are not derived from the carrying on of a business, directly or indirectly, by such pension scheme." Although drafted to be a reciprocal benefit, there is no similar issue with regard to the treatment of dividends paid by a U.K. mutual fund to a U.S. pension plan, because the United Kingdom does not have a withholding tax on dividends.

[3] Under Article 10(4), the exemption does not apply "in the case of dividends paid by a pooled investment vehicle which is a resident of a Contracting State."

[4] See Articles 10(2)(b) and 10(4).
