Keeping up with Tax – Asset and Wealth Management

October 2022

pwc

Introduction

Welcome to our October edition of Keeping up with Tax - Asset and Wealth Management. Following what was a well deserved summer break for many of us, the autumn is bringing a number of updates of which asset and wealth managers will need to be conscious over the coming months on the tax and political agendas alike.

Defined benefit pension scheme closure – potential PAYE / NIC reclaim

A recent upper tribunal tax case (E.ON UK plc v HMRC) which may impact employers who have made payments to compensate employees for a detrimental change in their pension funding arrangements at the time of a defined benefit pension scheme closure.

The judgment suggests that in certain circumstances PAYE / NIC is not due on these payments, and therefore an opportunity may exist to seek a significant repayment of PAYE and NICs.

Although this may be subject to appeal, asset and wealth managers who have made changes to pension arrangements and made payments to employees that were subject to PAYE and NIC, it would be appropriate to review the specific fact pattern in line with the case to understand if a reclaim may be possible, and taking into account time limits which might apply to a claim. Alternatively, if a closure is imminent, it may be worth considering the substance of any payments to be made to ensure the correct amount of tax is paid.

Research and development claims coming under increasing scrutiny

Based on recent updates from HMRC, it is clear that research and development ('R&D') claims are coming under increasing scrutiny from HMRC. R&D is seen as a high risk area by HMRC resulting in a robust operational strategy to identify and deal with the risks associated with incorrect claims. As a result, we can expect to see an increase in 'nudge' letters, as well as an increased likelihood of claims being checked after they are submitted.

If you currently claim, or anticipate making a claim for R&D relief, then it is vital that you ensure there are effectively managed processes associated with preparing the claim, ensuring that you are in a position to deal with any post claim questions from HMRC. This includes having appropriate attention to real-time matters such as:

- Evidence that systems and processes relevant to the R&D tax relief claims are documented and robust.
- Documenting the process of preparing a claim and applying that process consistently.
- Ensuring the claim is strongly evidenced and complies with the relevant legislative requirements.

For further information relating to the increased focus on R&D claims, as well as how we can help, please find our Insight here.

Asset & Wealth Management Conference - Wednesday 2 November 2022

With less than a month to go, we're seeing a great uptake for our showcase Asset & Wealth Management conference, 2022: Reacting to Change, Evolving for Success. This conference is a half day in-person event which will be held at our More London office from 1:00 pm.

We will be joined by a leading global economist, former government Chief of Staff, ESG specialists, market leaders and chairs of industry associations to debate and discuss the forces driving change and innovation in Asset & Wealth Management.

The afternoon will feature plenary sessions, panel discussions and elective deep dive breakouts. After the conference, you will get a chance to network with industry colleagues and PwC's AWM team over drinks and canapés.

For more information and to register, please click here.

In the meantime, we hope you enjoy this month's insightful edition which includes articles on the following topics:

- Operational tax update – Germany, Denmark, Switzerland and Brazil.
- Supreme court judgment on manufactured overseas dividends and their recoverability of withholding tax suffered.
- Belgium fine-tunes the tax framework for ELTIFs.

Kind regards,

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Operational taxes update – Germany, Denmark, Switzerland and Brazil

Germany

Fokus bank update

At the end of September our colleagues in Germany attended a meeting with the German tax authorities to discuss the pending Fokus Bank claims for foreign investment and pension funds. In this meeting the German tax authorities laid out their plans on how they want to process the Fokus Bank claims that have been filed over the years.

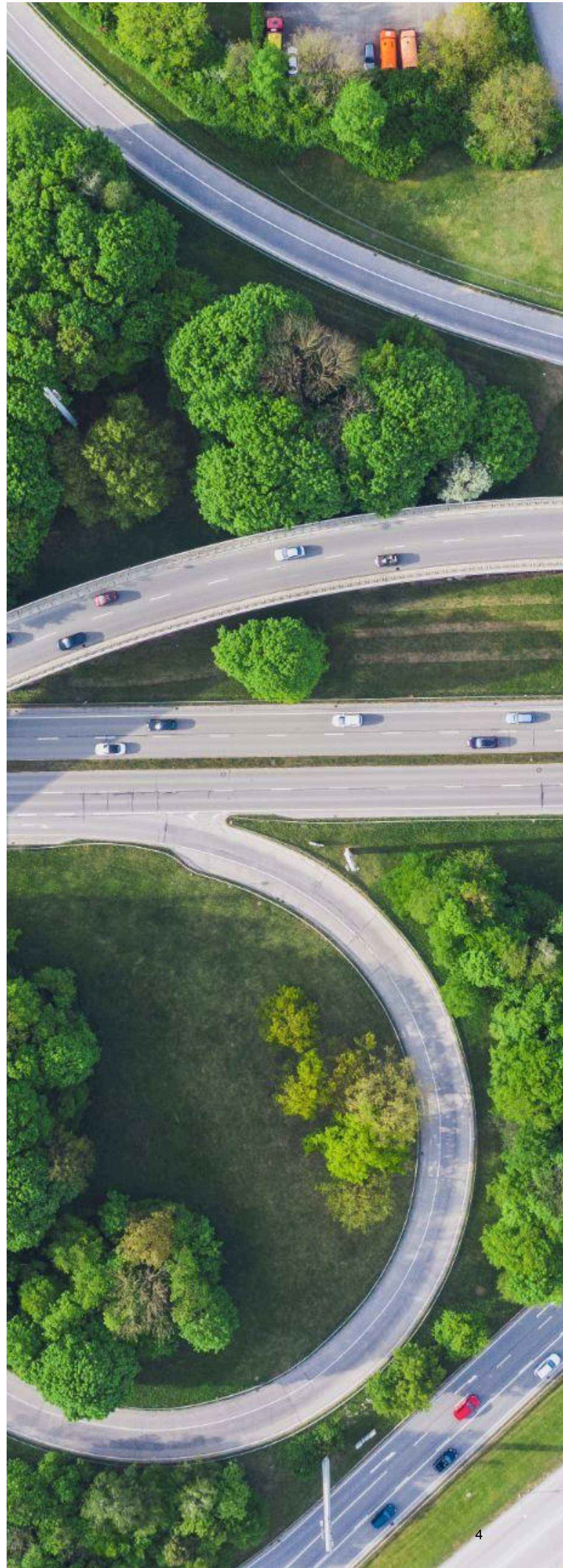
In a nutshell, the Federal Central Tax Office ""FCTO" has now become the competent central tax office to now start processing the applications that have accumulated over the years. The FCTO gave a clear statement in that there will not be a general refund and each case will need to be assessed on a case-by-case basis. At a minimum, the FCTO expects the following as part of the claim:

- Detailed comparison of legal form of the foreign investment fund to that of a domestic fund.
- Explanation as to why foreign investment funds have been discriminated against when compared to domestic funds.
- Information on other withholding tax refunds already obtained / applied (e.g double tax treaty claims) as well as tax credit or tax deduction opportunities outside of Germany.

The FCTO maintains the position that the interest period for any tax refunds would not start until the above information has been provided as in their view, refund claims that have been submitted that do not contain the above details (i.e. three bullet points above), these are considered as incomplete claims.

The FCTO has also not made an official statement specifying whether litigation is required but have indicated that if they are satisfied that foreign investment funds are comparable they have not ruled out making the tax refund without litigation.

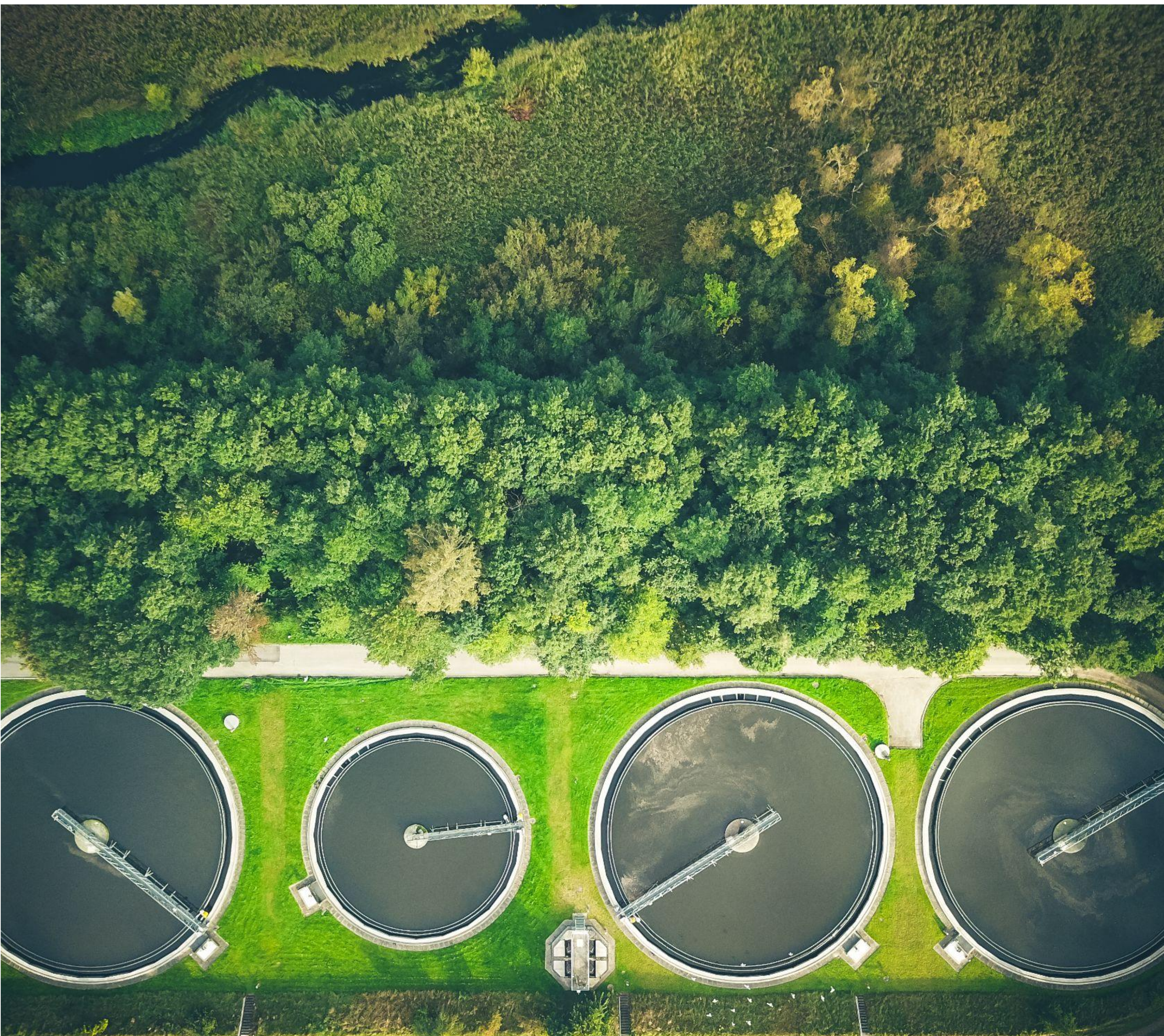
It is the expectation that the FCTO will be sending information requests for detailed justifications in 2023.



Denmark

On 23 September 2022, the Danish government published a draft bill which means that dividends paid by Danish companies to foreign states and institutions such as sovereign wealth funds will be subject to tax at 22%. Under current legislation, foreign states and institutions are exempt from Danish tax on dividends.

Under the proposed draft bill, a withholding tax of 27% will apply and a reduction to 22% or a lower rate under a tax treaty is available through a reclaim procedure. If enacted the new rule will be applicable to dividends paid from 1 March 2023 onwards.



Switzerland

Referendum on abolition of withholding tax on bonds

On the 25th September 2022, the Swiss electorate voted on the Amendment to the Federal Act on Withholding Tax. This referendum asked the question whether the domestic Swiss bonds should be exempt from withholding tax. However, despite the Swiss Parliaments formal approval of the amendment, the Swiss public voted against the exemption from withholding tax for Swiss bonds. As a consequence, a withholding tax of 35% interest will still be levied on Swiss-issued domestic bonds.

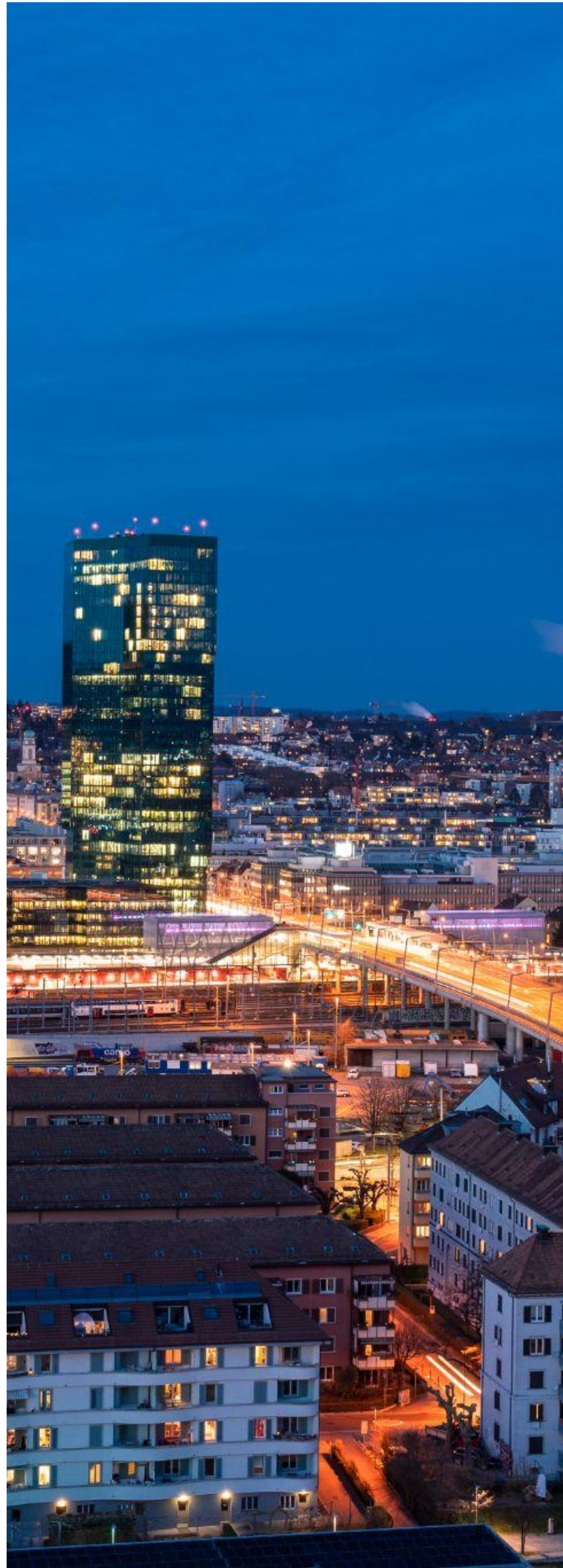
Clarification on statute of limitations issued by SFTA

On the 13th September 2022, the Swiss federal tax authority ('SFTA') published information in relation to the statute of limitations for claiming withholding tax. In essence, there are two statutes of limitations ("SOL") that apply together.

The first SOL is the three years statute of limitations. This is the 'forfeiture item' for filing a claim of Swiss withholding tax with the SFTA, and is essentially the SOL that applies to lodging the claim with the SFTA. As a result, it has been clarified that the three year statute of limitations runs from the end of the calendar year where the taxable payment of withholding tax becomes due.

The second statute of limitation starts a new five-year statute of limitations anew, which begins when the claim for the refund arises above. This statute of limitations is interrupted by any act of the person entitled to the refund that is directed towards asserting the claim. However, the important factor in restarting the 5 year statute of limitation period is that the claim must be asserted by an act of the claimant. For example, the filing of the refund request interrupts the 3 year statute of limitations, causing a new statute of limitations of 5 years to begin the day after filing. The same applies to the subsequent submission of requested information and/or documents in connection with the submitted refund application, as this is also an action by the person entitled to refund aimed at asserting his or her refund claim.

As a consequence, any actions by the SFTA, such as requesting further information or requesting further documentation, will not interrupt the limitation period.



Brazil

Changes to fund taxation

On 22 September 2022, the Brazilian government issued provisional measure PM 1,137, resulting in 0% withholding tax on gains derived from the disposal and amortisation of FIP (Brazilian share investment funds). The rules are expected to take effect from 1 January 2023, but require being confirmed into law by the brazilian congress.

Of importance here is that:

- Portfolio rules have been equalised with the regulatory requirements, eliminating the limitations related to 67% S.A. shares (Brazilian corporation), and 5% of debt.
- Elimination of the 40% cap test.
- Applicability of the 0% rate to sovereign funds located in tax havens or privileged tax regimes.
- There is no benefitting from the 0% rate for structures using US LLCs with non-US shareholders.

Next steps for asset and wealth managers

For asset and wealth managers that have filed any Fokus Bank claims in Germany (irrespective of who did the initial filing), we would recommend reviewing the initial claims that were submitted to ensure that these are complete and inline with what the FCTO now expects. It is our expectation that a proactive approach should be taken with the FCTO, as a substantiation of the claims will be required in many cases, and there is an increased chance of the FCTO prioritising the claims if the claim is proactively submitted. Please do get in touch with one of the authors or your usual PwC contact and we will happily discuss next steps.

In terms of Brazil, the PM represents a significant change to the tax law for funds in Brazil and although the PM is to be approved, asset and wealth managers with investments in Brazil should assess the impact and opportunities that the PM offers. With regards to Denmark, although the legislation is in draft, it is important that sovereign wealth fund managers monitor the proposal closely and to understand how the proposed tax changes will have an impact on the investments in Denmark.

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Supreme court judgment on manufactured overseas dividends and their recoverability of withholding tax suffered

Background

On 27 April 2022, the UK Supreme court allowed an appeal by HMRC in the coal staff superannuation scheme case – determining that the UK regime for taxation of 'manufactured overseas dividends' ("MODs") does not entail any restriction on the free movement of capital under Art.63 TFEU. The Supreme Court is the UK's final appellate court.

This judgment is relevant as some asset and wealth managers had made claims to recover withholding tax suffered on MODs under the EU law principles.

As a background, the MODs regime ceased to apply in 2014, meaning that the MODs withholding tax suffered relates to historic amounts pre-2014. The MODs regime saw the payment of a manufactured dividend ("MD") on a stock loan of UK shares not subject to tax, but a payment of MODs is subject to UK withholding tax.

The argument of the respondent was that as the tax treatment of the manufactured dividend differed due to origin of the dividend, that this amounted to a restriction on the free movement of capital under article 63 (et seq) of the Treaty on the Functioning of the European Union (TFEU).

Summary of the case

The case raised a novel issue regarding compatibility of the UK rules with art.63 TFEU. Had this arisen for determination prior to Brexit, the Supreme Court would have been obliged to refer the issue to the CJEU under Art.267 TFEU, third indent (Case C-283 / 81, CILFIT, para 11). Under s.6(1)(b) of the European Union (Withdrawal) Act 2018, however, no further reference to the CJEU by a UK court is permitted after 31 December 2020, and so the supreme court had to determine the issue itself.

The case relates to the taxation, in periods up to 2013, of manufactured overseas dividends received under stock lending agreements by a tax-exempt pension fund. MDs and MODs are contractual payments due under (inter alia) stock lending agreements relating to, respectively, UK and non-UK shares or securities. The contractual payment is designed to preserve for the stock lender the same income benefit as the dividend which it would have derived from the shares if it had not lent them.

The pre-2014 tax regime was designed to achieve the same tax result for the stock lender as if it had received the actual dividend on the shares. In the case of MDs (in relation to UK shares), the pension fund enjoyed exemption (as an exempt fund). In the case of MODs (in relation to non-UK shares), however, the regime required the stock borrower to withhold UK tax equal to the foreign withholding tax that would have been due on the actual dividend.

The pension fund argued that this tax – which was UK tax, not foreign tax – entailed a difference in treatment (compared to MDs) which was an unlawful restriction on the free movement of capital.

The supreme court noted first that there was in any event a disincentive for an exempt pension scheme to invest in non-UK shares as compared with UK shares. Actual dividends on UK shares were exempt. Dividends on non-UK shares would suffer foreign withholding tax, which the pension scheme could not recover. However, this was juridical double taxation resulting from the absence of harmonisation of national tax systems, which did not entail any breach of Art.63: (**Case C-436 / 08 Haribo**, paras 167-172).

Therefore, the special tax regime for MODs would not breach Art.63 TFEU unless it created a disincentive to the acquisition of foreign shares (as compared with UK shares) additional to that which arose already from the juridical double taxation of actual dividends. There was clearly no direct additional disincentive, as the UK withholding tax suffered on the MODs was the same amount as the foreign withholding tax which would have been due on actual dividends. Whether there was an indirect additional disincentive depended on whether the stock borrower's obligation to account for the UK withholding tax was likely to have reduced the amount it was prepared to pay the stock lender (the pension fund) by way of stock lending fee. There was no evidence about this, but HMRC put forward unchallenged evidence that the stock borrowers would typically have more than enough withholding tax credits available to soak up the withholding tax liability by way of set-off, and that those tax credits were otherwise unavailable for use for any economically beneficial purpose. On that basis it was unlikely that the MOD withholding tax would have reduced the amount the stock borrower was prepared to pay by way of stock lending fee.

Supreme court judgment on manufactured overseas dividends and their recoverability of withholding tax suffered (continued)

Hence it was no more than speculation whether the MODs tax regime added to the existing disincentive for tax-exempt investors to acquire foreign rather than UK shares, constituted by juridical double taxation. Such speculation fell short of the logical inferences which the court might draw under the Art.63 case law. Therefore, the MODs tax regime did not entail any restriction on the free movement of capital contrary to Art.63.

Areas untested following the Supreme Court decision

As the Supreme Court is the highest UK authority, the options available for existing claimants are limited. While a UK court can no longer refer to the CJEU, as the MODs regime was in effect while the UK was an EU Member State, there are avenues for the European Commission to bring the matter before the CJEU within 4 years of the end of the transition period if they wished to do so.

Given the test applied by the Supreme Court, it is likely to be difficult to evidence any material disadvantage within the parameters set out in this case.

Instead, it may be possible to bring an alternative set of facts to HMRC such that these facts would need to be evaluated separately outside of remit of the above judgment.

For example, it may be possible to demonstrate a disadvantage in instances where the MODs received relate to shares in companies resident of the EU or EEA. There has been extensive national and European case law assessing the compatibility of EU law in respect of dividends paid by EU companies to non-resident shareholders **(Fokus Bank, Aberdeen, Santander etc.).** Generally, these cases have held that dividends paid to a non-resident recipient should not be subject to foreign withholding tax where a comparable resident entity would not have been subject to withholding on the dividend.

It follows that there should not have been juridical double taxation on the equivalent EU / EEA dividends, while tax would have been withheld on MODs under the MODs regimed. Such arguments should also include clear evidence of economic disadvantage suffered by the lender.

Finally, even if subsequent case law in respect of the economic disadvantage is more positive, agreeing the precise remediation with HMRC may be a lengthy and challenging process.

Next steps for asset and wealth managers

For existing claimants, while the UKSC judgment is not positive, there are some potential avenues which could be explored either as a means of further challenge or to present alternative lines of argumentation.

If you are interested in discussing how the above has impacted you further, please reach out to one of the contacts below and they will happily discuss any potential next steps going forward.

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Belgium fine-tunes the tax framework for ELTIFs

On 15 July 2022, the tax framework for the European Long-Term investment funds (' ELTIFs') was completed with the necessary exemptions of Belgian withholding tax ('WHT').

As a reminder, the law of 21 January 2022 on various tax provisions provides a tax framework for ELTIFs that operates under three principles:

- Corporate tax neutrality of the investment company.
- Avoidance of economic double taxation for resident corporate investors (under the dividend-received deduction regime).
- Avoidance of economic double taxation for non-resident corporate investors (exemption of Belgian WHT) under similar circumstances to those of Belgian resident corporate investors. For the remainder (taxation of individual investors, legal investors, subscription tax, stock exchange transaction tax, access to double tax treaties, etc.), the usual tax rules applicable to other regulated investment funds apply.

The Royal of Decree of 5 July 2022 (here) supplements the measures taken so far with some Belgian WHT exemptions according to two principles:

- Internal consistency.
- EU compliance.

Details

- Movable income (other than Belgian source dividends) paid to Belgian regulated investment companies are exempt from Belgian WHT (art. 116 RD / BITC).

This Belgian WHT exemption also applies to Belgian ELTIF (to ensure internal consistency) and to foreign corporate ELTIF (ensuring EU compliance).

- Dividends distributed by a Belgian company to a Belgian ELTIF (with a shareholding of at least 10% in the Belgian distributing company) are exempt from Belgian WHT (under conditions), hence of Belgian corporate income tax (art. 106, §6 RD / BITC).

This Belgian WHT exemption also applies to dividends distributed by a Belgian company to a foreign corporate ELTIF in similar circumstances (ensuring EU compliance).

- Dividends (other than those derived from income from Belgian real estate income or from dividends of Belgian origin) distributed by Belgian regulated investment companies to non-resident savers are exempt from Belgian WHT (art. 106, §7 RD / BITC).

This Belgian WHT exemption, which is of a general nature, has a double objective:

- Exemption from Belgian WHT on all income with foreign origin which may be received by a Belgian regulated investment company and which are redistributed by the latter to non-residents savers,
- Exemption from Belgian WHT on all Belgian source movable income which would have been granted such an exemption if they had been received directly by non-resident savers (i.e. without the intermediation of the investment company).

This Belgian WHT exemption would also apply to dividends distributed by Belgian ELTIF (ensuring internal consistency).

Next steps for asset and wealth managers

The advantages of ELTIF are not insignificant. In addition to the advantage of an efficient structure and access for investors to a wide range of assets (including infrastructure assets, digital transformation projects, ecological transition projects and investments in SMEs), they benefit from an EU marketing passport, allowing them to raise funds from Belgian investors as well as from investors from other member states.

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