Keeping up with Tax – Asset and Wealth Management

June 2023

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Introduction

Welcome to our June edition of Keeping up with Tax – Asset and Wealth Management

With this being our last edition before the Summer holidays commence, we come into this ready to unwind and reflect on the year so far. However, this does not mean that we will stop sharing the latest exciting updates for Asset and Wealth Managers. Before we take a deep-dive into the latest updates in the UK Funds space and the European Commission's published proposal referred to as FASTER in relation to withholding tax procedures, firstly we wanted to share some of our other global updates.

Changes to Austrian Investor Reporting

From the 24th May 2023, the Austrian Central Bank Oesterreichische Kontrollbank AG ("OeKB") applied some changes regarding the process of basic data submission for the registration of reporting funds in Austria. The key change in terms of basic data information is that the legal entity identifier of the management company, or the umbrella fund is now required for the registration of a share class as a reporting fund.

Additionally, registrations can only be submitted by tax representatives by uploading the form via a specific portal. The OeKB have stressed they will not accept basic data sent to them via email going forward.

House Republicans introduce bill responding to Pillar Two and unilateral taxes

In the United States, the House Ways and Means Committee Chairman Jason Smith (R-MO) and all Ways and Means Republicans on 25 May 2023 introduced the Defending American Jobs and Investment Act. The proposed legislation would increase income tax and withholding tax rates, initially by 5 percentage points, increasing up to 20 percentage points on certain foreign citizens, foreign corporations, and foreign partnerships of any foreign country that is listed in a report on the extraterritorial taxes and discriminatory taxes of foreign countries ('Report') submitted by the Secretary of the Treasury ('Secretary') to certain Congressional committees.

The bill appears to take aim at the OECD's two-pillar solution and at countries that introduce digital service taxes ("DSTs"), with the extraterritorial tax focusing on the undertaxed profits rule ("UTPR") and the discriminatory tax focusing on DSTs. Further insight can be found **here**.

UAE introduces CIT

The United Arab Emirates introduced its corporate income tax regime on 1 June 2023. For accounting periods starting on or after 1 June 2023, companies with taxable income exceeding 375,000 AED at a rate of 9%. Further information can be found **here**.

Financial Services ESG Report

We are pleased to share that in April 2023 PwC published a survey of financial services businesses across the banking, asset management and insurance sectors to ascertain the current level of maturity regarding ESG (Environmental, Social and Governance) and tax across the industry. This report details the findings from the survey, highlighting areas of significant progress and identifying potential gaps and vulnerabilities. We then look at what a strategy for tax and ESG might look like – and how to turn theory into practice.

Tax is a crucial part of the environmental, social and governance conversation for financial services businesses at a corporate and product level. Tax is both an ESG consideration in its own right and an issue with significant implications for each constituent part of the ESG agenda. However, the survey showed that the financial services sector still has some way to go in understanding and addressing the linkages between tax and an organisation's ESG agenda. The full report can be found **here**.

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

1. The UK Reserved Investor Fund Consultation
2. The UK Long Term Asset Fund
3. Draft FASTER Directive

As always, please do continue to share your feedback, and please feel free to get in touch with one of the contacts listed, or your usual PwC contact, if you wish to discuss anything further.

Kind regards

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The UK Reserved Investor Fund Consultation

In response to the industry's demand for a new contractual scheme fund that is unauthorised and open to all asset classes, the government released a consultation in April on the possibility of introducing the new Reserved Investor Fund ("RIF"). The consultation can be found **here** and our responses to the consultation can be found **here**.

The consultation is particularly relevant for investments in UK Real Estate as the government had received representations from industry that such an "onshore" vehicle could be attractive for such investors and could fill a gap in the UK's current fund offering that has resulted in the use of offshore structures.

The consultation contains 32 questions to help the government understand the industry's views on the following areas:

- The scope of the RIF and whether it should be restricted or unrestricted.
- The eligibility and notification criteria, which would allow the government to monitor the RIF population and give certainty of treatment for investors by requiring the fund to specify the date in which it is expected to be treated as a RIF.
- The branding so that it clearly signals the legal structure and target investors. It was originally suggested that it would be called the "professional investor fund (contractual scheme)" but following discussions with the industry the government felt that it would be more appropriate to name it the "reserved investor fund".
- The design of the tax system as well as the application of the non-resident capital gains tax ("NRCGT") rules and the tax treatment of when an unauthorised contractual scheme ceases to meet the conditions to be within the RIF regime.

We have summarised below the key areas of focus:

Eligibility

To enter into the RIF regime certain eligibility criteria would need to be met, which broadly includes:

- The manager must either be authorised or registered with the FCA.
- It is UK based which means that the operator and depository must be body corporates incorporated and with a place of business in the UK.
- Meet the new GDO conditions.

Taxation

The government intends for the tax regime for the RIF to largely replicate the tax rules for Co-ownership authorised contractual schemes ("CoACS") but with some modifications to ensure alignment with the policy behind the NRCGT rules. In particularly, the government is concerned that if the CGT treatment for CoACS is adopted for a RIF there will be a loss of tax as neither the disposals be the RIF (including UK property and UK property rich shares), nor disposals by the non-resident investors of their interests in the RIF in certain circumstances would fall within scope of UK tax.

For example, if the RIF is not "UK property rich" (broadly it derives less than 75% of the value of its gross assets directly or indirectly from UK property) at a time the non-resident investor receives its share of the disposal proceeds or disposes of its interest in the RIF then under the terms of any relevant double tax treaty, it is unlikely that the UK would be able to tax the investor. Therefore, to ensure that the NRCGT regime still applies as intended the government is asking for comments on two alternative regimes.

Restricted regime

It is proposed that the restricted regime would only be available in the following three circumstances:

a. The RIF is "UK property rich" at all times and as such non-resident investors would be subject to the NRCGT. This rule is similar to the current restrictions applicable to Jersey property unit trusts ("JPUTs").

b. The RIF only has investors that are exempt from gains other than by reason of non-residence. This is to ensure no loss of tax at the investor level even if the RIF is UK property rich. This is similar to the existing treatment of a UK exempt unauthorised unit trust ("EUUT") and would include pension funds and investors who have sovereign immunity.

c. The RIF does not invest directly or indirectly in UK property and therefore there is no loss of tax.

If the requirements of the three circumstances are breached, then the RIF would be treated as a partnership for capital gains tax purposes.

The UK Reserved Investor Fund Consultation (continued)

Unrestricted regime

Under the proposed unrestricted regime, no additional restrictions on its investments or investors would be placed on the RIF. To ensure that this regime works, two options have been proposed which broadly includes

a. RIF being treated as transparent for gains only at the point of the disposal of UK property or a change in the RIFs investors.

b. RIF being treated as transparent only during any period when it is not UK property rich, with a deemed disposal by the investors when the RIF ceases to be UK property rich.

Both options are expected to require more complex tax provisions and potentially more frequent tax filings by investors when UK property/ UK property rich shares are sold or there is a change in the investors.

UK tax treatment of income

As a contractual arrangement the RIF itself is not taxable on its income, which is treated as arising directly to its investors. Where investors are exempt from UK tax on the income (e.g. UK registered pensions scheme) no UK tax is therefore suffered.

Also, as in the case of a CoACS, it is proposed that the operator of the RIF would be required to provide a report to its investors to enable them to complete their tax filings, as well as providing certain details to HMRC regarding the investors, within six months of the end of the accounting period (which cannot exceed 18 months).

Other taxes

The ability to transfer units in a RIF free of SDLT and to access seeding relief compares favourably with existing structures for investing into UK real estate. However, unlike an authorised contractual scheme (“ACS”) the management of a RIF is not expected to be VAT exempt and as such may only prove to be attractive for commercial property investment.

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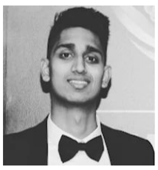
Next steps for Asset and Wealth Managers

RIFs will be of interest to the asset and wealth industry as they will represent the first unauthorised onshore pooling vehicle in the form of something other than a partnership. This means that if the proposals proceed, we will have an onshore version of a Jersey JPUT. Asset and wealth managers may consider if it makes sense for pension pooling vehicles established in the form of a CoACS to continue to exist or whether it would be more cost efficient to convert to a RIF.

If you are interested in discussing the consultation 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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The UK Long Term Asset Fund

Overview

The UK's new FCA authorised fund, the Long-Term Asset Fund ("LTAF"), is designed to promote DC pension investments in illiquid assets whilst providing investors protections around capital and transparency. The FCA's LTAF rules and guidance came into force on 15 November 2021.

Structure

LTAFs are open-ended and may issue new units to new investors which may be formed as a Unit Trust, Open Ended Investment Company ("OEIC"), or Authorised Contractual Scheme ("ACS"). The structuring legal entity decision typically boils down to consideration of the fund's intended investor base and investment returns. LTAFs can be formed as an Umbrella fund with sub-funds.

Distribution and marketing

LTAFs were originally intended to satisfy the demand from the UK Defined Contribution ("DC") Pension market to invest into long-term assets via an authorised pooling vehicle. DC Pensions appear to be the most important investor base for this product still. That said, the demand for the LTAFs was contingent upon changes to the 'permitted links' rules which broadly restrict DC pension schemes' investment in unit-linked long-term insurance products.

Secondly, the rules as they stand consider the LTAF a non-mainstream pooled investment ("NMPI") which means it is effectively an unregulated fund for marketing purposes. As such, its marketing is highly restrictive with respect to who may invest. At present, only professional investors (i.e. institutional investors) and very limited categories of retail clients (i.e. highly sophisticated individuals) are permitted.

The FCA is considering recategorising the LTAF as a restricted mass market investment ("RMMI") given the highly regulated nature of the entity. Should this change come into effect, LTAFs would be able to market to retail investors subject to rules and restrictions.

Investment and borrowing powers

The LTAF largely parallels the investment and borrowing powers of the qualified investor scheme ("QIS") rules with certain exceptions. The differences are namely:

- LTAFs must invest at least 50% of their net asset value ("NAV") in long-term unlisted securities and illiquid assets.
- LTAF must have a "prudent speak of risk"
- LTAFs are permitted to invest in regulated and unregulated collective investment schemes ("CIS") including limited partnerships and fund of funds.
- Specific rules where an LTAF invests more than 20% in unregulated CIS, QIS or other LTAFs.
- Borrowing is permitted up to 30% of NAV with no rules on the aggregate borrowing of underlying investments.

Governance and disclosures

LTAFs are highly regulated entities. The rules only permit Full scope AIFMs with sufficient knowledge, skills and experience and resources to manage the LTAF. In addition, the LTAF regime demands considerable disclosures related to prospectus disclosures in relation to investment strategies, subscriptions, redemptions, fees, and charges, for example. The LTAF manager is required to appoint an "external valuer" unless the manager themselves are able to value the assets of the LTAF subject to depositary oversight where valuations are carried out monthly.

Taxation

The LTAF is required to satisfy the genuine diversity of ownership ("GDO") conditions for authorised funds with additional conditions which are LTAF specific. More precisely, LTAFs will meet the GDO condition where 70% or more of units/shares are held by "relevant investors":

- AUTs/OEICs (or overseas equivalents) which meet the GDO condition.
- Regulated insurers which are not a close company.
- A sovereign wealth fund.
- The trustee, manager or administrator of a pension scheme.

Fund level taxation depends on the legal entity which forms the LTAF. For example, LTAFs structured as ACSs will potentially avail investors of treaty benefits for applicable markets on account of the funds fiscal transparency. This is particularly of interest to the UK DC Pension investor base who would, perhaps significantly, benefit from lower withholding taxes on income streaming through a fiscally transparent ACS LTAF.

The UK Long Term Asset Fund (continued)

Next steps for Asset and Wealth Managers

Interest in LTAFs is growing. There have been multiple LTAFs approved by the FCA in recent months. Asset and wealth managers who have an interest in growing their investor base in DC pensions should consider the LTAF in light of its unique ruleset which marries illiquid and unlisted investments with an authorised open-ended pooling vehicle. The time to go to market on LTAFs is not insignificant; asset and wealth managers will need to negotiate the more burdensome requirements required under the LTAF regime in addition to ensuring readiness of systems and personnel at the asset manager, fund administrator, and depositary. The choice of third party service providers to the LTAF should be carefully considered as LTAF funds may not be able function on BAU operating models.

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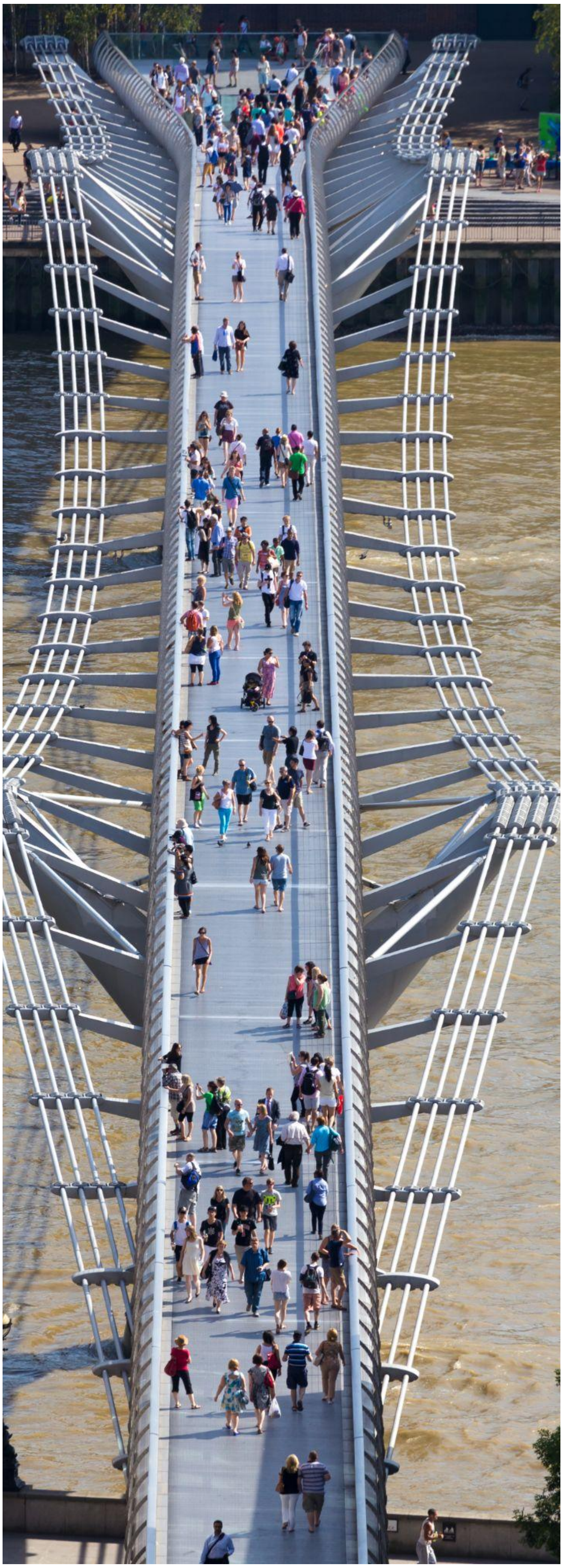


Draft FASTER Directive

As you are no doubt aware, the European Commission published the draft Faster and Safer Relief of Excess Withholding Taxes ("FASTER") Directive on 19 June 2023 (click here for the draft Directive). It has the laudable aim of making withholding tax ("WHT") procedures in the European Union more efficient and secure for investors, financial intermediaries and Member State tax administrations. So, is this aim achievable and does the draft Directive enable this?

Background

The draft Directive itself highlights that the European Commission ("EC") and international organisations have been trying to address the inefficiencies and the risk of fraud or abuse associated with WHT procedures for decades:

- **2009** - EC Recommendation to the Member States on simplifying WHT procedures.
- **2013** - OECD Treaty Relief and Compliance Enhancement ("TRACE") Implementation Package aimed to address the inefficiency of WHT procedures.
- **2017** - EC Code of Conduct on withholding tax, which called for a voluntary commitment by Member States.

Regardless of these measures, the draft Directive concedes that even though this has resulted in some improvement, cumbersome WHT procedures still discourage cross-border investment with the overall costs of WHT procedures estimated to be EUR 6.62 billion.

The Problem

In most EU Member States, withholding tax relief or reclaim procedures are lengthy, costly and cumbersome, causing frustration for investors and discouraging cross-border investment within and into the EU.

A March 2023 survey[1] identified that close to 70% of retail investors who would be eligible for a reduced withholding tax rate do not claim it, citing as the main reasons lengthy, costly and too complicated procedures, which led to 31% of them to decide to sell their foreign EU stocks.

The (proposed) Solution

FASTER aims to mitigate these barriers to capital investment by creating digital residence certificates ("eTRCs") and standardising the Relief at Source and the Quick Refund System.

Pursuant to the FASTER relief at source system, the appropriate withholding tax rate is applied at the moment a payment of dividends or interest is made. Alternatively, under the FASTER quick refund procedure, the excess tax paid is refunded in no more than 50 days after the date of payment.

To balance these simplifications and potential benefits for the participants and ultimate beneficiaries, the EC is keen to mitigate potential abuse of the new compliance regime, therefore the draft Directive includes extensive standardised reporting obligations throughout the value chain so that compliance can be effectively monitored and controlled by national tax authorities.

The Details

A Common digital tax residence certificate (eTRC)

The simplest and probably the most welcomed development is the proposal for a common electronic tax residence certificate. Although some tax authorities have already moved towards electronic and digitally "signed" certificates, a transition that was expedited by the Coronavirus pandemic, many still require printed, signed, stamped and even notarised certificates of residence from the investor.

The draft Directive even goes as far as to require that Member States shall issue the eTRC within one working day (i.e. automatically) from the submission of a request. This eTRC should also cover the minimum period of one calendar year, although it is highlighted that longer periods are permitted.

This would be a notable departure for some Member States who currently only provide confirmation of entitlement retrospectively due to concerns over prospective confirmation of eligibility. This is dealt with in the draft by stating that:

"if the circumstances at the end of the year do not support the content of the eTRC issued during the year, such eTRC can be deemed not valid by the issuing Member State and any other Member State concerned".

[1] Withholding tax on dividends, survey for investors in the European Union, Better Finance, March 2023.

Draft FASTER Directive (continued)

This neatly solves the problem of prospective eligibility but would then create a complicated withholding tax reversal for the ultimate beneficiary and the custody value chain.

Enhanced relief at source and quick refund procedures

Member States would be able to choose to use either one or a combination of both; (a) relief at source system; and (b) a quick refund system.

- Under the 'relief at source' system, the correct amount of tax is applied by the WHT agent at the time of payment of dividends or interest based on the applicable domestic rules and/or international agreement.
- Under the 'quick refund' system, the tax is withheld at the higher rate applied in the source country but the excess tax is then given back within a set time frame of maximum 25 days from the date of the request or from the date when the required reporting is fulfilled, whichever is the latest. This should take place within 50 calendar days from payment date.

It is important to note that in both cases, the relevant actors in the procedures would be Certified Financial Intermediaries ("CFIs") acting on behalf of their investors. This neatly brings us onto the associated reporting obligations.

Reporting obligation

As indicated above, to provide these benefits the draft Directive proposes a common reporting standard of tax information to be shared with tax administrations to mitigate potential abuse. Theoretically, this reporting requirement should only apply to a subset of the existing financial intermediaries, those acting as withholding agents, within the value chain. These entities would be obligated to register so they can apply exemptions or reduced WHT rates directly on investment income.

The draft Directive even states:

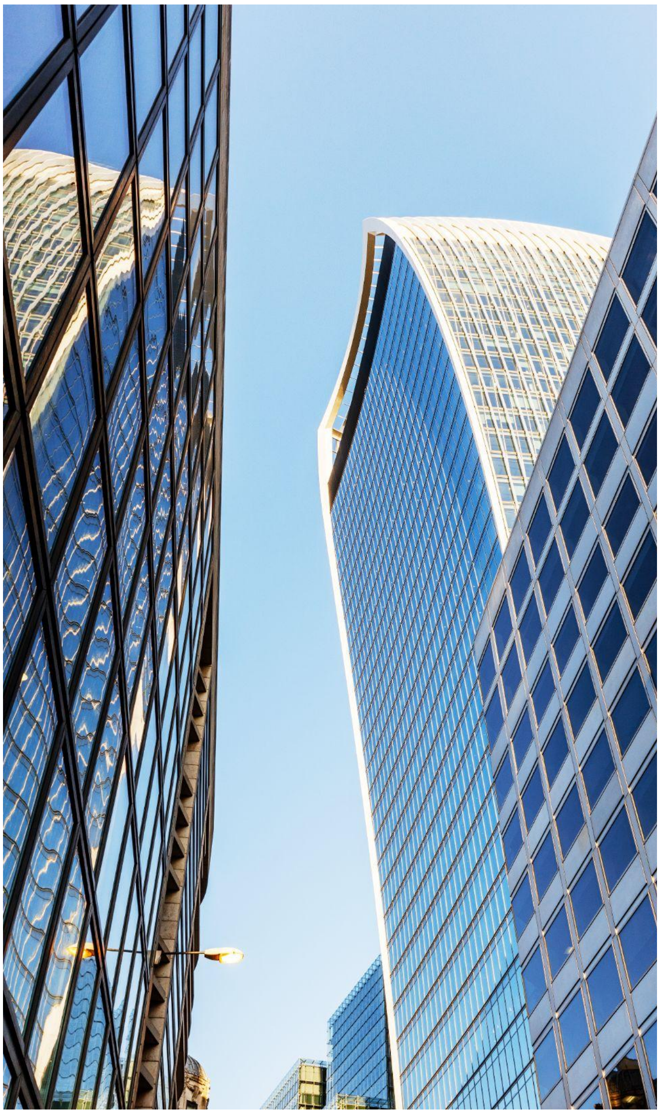
"Member States that do not need to provide relief of excess withholding tax, due to an exemption on WHT over dividend payments or in case the relevant domestic tax rate is always lower than or equal to the rate that could be applied under DTTs, do not need to have a National Register in place."

However, it is likely that all large financial ntermediaries that have a significant role in the payment chain, will be required to register and report information available to them about the dividend or interest payments that they process.

This is due to the fact that cross-border investments usually involve a payment chain of financial intermediaries and the directive requires that relevant procedures should allow for the tracing and identification of the chain of intermediaries and hence of the income flow from the issuer of the security until the final recipient, i.e., the sole investor or registered owner.

These registers would help national tax administrations verify and validate eligibility for the reduced rate and detect potential abuse.

Common rules would be introduced to define when financial intermediaries would be held liable for providing incorrect data that could lead to lost tax revenue for the Member State. The liability would be placed at the level of the financial intermediary closest to the investor, who is responsible for performing the due diligence requirements. The intermediary would be liable in case of mis- or under-reporting, subject to certain exceptions.



Draft FASTER Directive (continued)

Further thoughts

Within the article there are a number of interesting comments or issues mentioned that will require more detailed consideration over the coming months and years. A short subset of those comments that have been identified within the last 24 hours is provided below:

- **De minimis -** a de minimis rule has been introduced for the reporting obligations and due diligence procedure. It consists of not requesting information about financial arrangements or minimum holding period to investors with dividend payments below a threshold of EUR 1000.
- **2 day holding periods** - Heading E of Annex II provides for two reporting requirements that are aimed at helping to combat WHT abuse, mainly Cum/Cum abuse schemes… The first element seeks information on whether the underlying securities have been bought within 2 days before the ex-dividend date, with the objective of helping prevent further fraudulent/abusive schemes for multiple reclaim of the same WHT when only one single reclaim should apply (Cum/Ex schemes).
- **UID required -** In order to allow for an efficient identification of EU companies, the certificate should include information on the European Unique Identifier ("EUID").
- **Securities lending** - It is acknowledged that financial arrangements can be used to shift the economic ownership, in whole or in part, of a security and/or relevant investment risks. It has also been evidenced that such arrangements have been used in dividend arbitrage and dividend stripping schemes such as the Cum/Ex and Cum/Cum schemes, with the sole purpose to obtain refunds when there was no entitlement thereto or to increase the amount of refund to which an investor was actually entitled. Information on such financial arrangements, which encompass ordinarily legitimate securities transactions such as repurchase agreements or securities lending, and also derivative products such as single stock futures, is therefore necessary for tax administrations to fight tax abuse. To ensure a proportionate approach, reporting on this information should only be required by those certified financial intermediaries that, due to their position within the chain, may have been directly involved in the relevant financial arrangement. Such reporting is not required in the case of bonds and interest payments.

Next steps

FASTER is an important development in cross-border withholding taxes, establishing a common, standardised, EU-wide system for withholding tax relief.

However, it is clear from the draft Directive itself that there are significant operational costs and challenges anticipated for all stakeholders with implementing the electronic tax residence certificate and establishing the formats and communication channels to be used by financial intermediaries to report to the national tax authorities.

Furthermore, the differences between member states on establishing investor residency are ignored and the operational mechanisms are not defined, nor could they be, by an EC Directive and therefore there are still likely to be notable differences in how the relief is provided in each member state or by each Certified Financial Intermediary.

FASTER appears to benefit the ultimate beneficiaries the most while moving the burden of compliance towards the Custodians (CFIs) in the value chain.

However, until 1 January 2027, the cumbersome and complex patchwork of different WHT reporting requirements will remain a challenge for all participants.

Please reach out to me if you would like to discuss further.

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Thank you

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