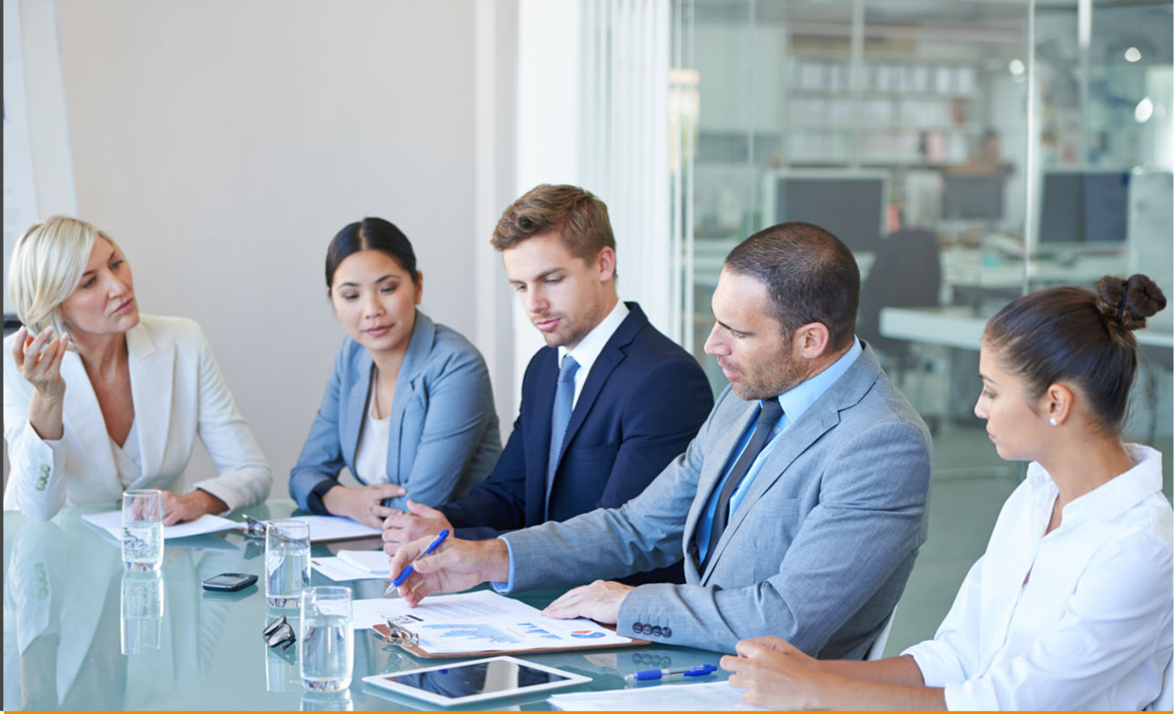


Keeping up with Tax – Asset and Wealth Management

Click to launch

January 2021

Welcome back…

Welcome to our first edition of the new year of Keeping up with Tax – Asset and Wealth Management. We hope you managed to have a restful break over the holidays. Since we signed off for the year in December, there were two significant developments in areas which we highlighted in our last edition.

One of these, the end of the Brexit transition period, was expected, and as promised in December, this edition of Keeping up with Tax includes an article with specific details of the impact on dividend withholding taxes across several key jurisdictions. This is just one of many operational tax issues for investment funds which will rear its head over the coming months as the industry, and the various European tax authorities, adjust to the new regime. With these myriad challenges in mind, we will also be running an EMEA Brexit and Beyond Webinar Series throughout 2021. The first of these will be held on Wednesday 3 February, and will focus on the immediate impact for asset and wealth managers ('AWMs') of the EU-UK Trade and Cooperation Agreement. Proposed future topics for these events include exploring the marketing options for UK AWMs, the AIFMD Review, and the impact of divergence on the UK/EU regulatory relationship. If you have not received an invitation to this webinar, and would like to attend, please get in touch using the email address uk_awm_xlos@pwc.com.

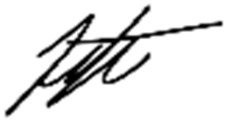
The second development, and a surprise for many, was HMRC's announcement on just before New Year's Eve that the obligation to make disclosure of cross-border arrangements under the DAC6 regime would fall away in the UK, unless these relate to the 'D' hallmarks. As a reminder, these are the hallmarks which relate to CRS avoidance and opaque ownership structures, and we would not expect these to be in play in the vast majority of arrangements entered into by AWMs. This is the case for the MDR transitional period and any future arrangements. The amendments should be treated with caution, as HMRC's change of stance may simply have the result of shifting any reporting requirement to another EU jurisdiction. Given the ramifications of this move, we have included an article in this month's edition covering what AWMs need to think about in relation to EU MDR.

A more forward-looking development which will be of significant interest to AWMs is HM Treasury's launch of a second stage consultation on the taxation of asset holding companies in alternative fund structures. The purpose of this second consultation, the first of which we covered in our June edition, is to explore the more detailed design features of the proposed new asset holding company regime, as well as certain reforms to the REIT regime.

We have a packed edition on a variety of topics to start the year, including the following articles

- Dividend withholding taxes – The impact of Brexit
- EU DAC6 developments following the EU/UK Trade and Cooperation Agreement
- Hong Kong's proposed carried interest concession
- Do tax practitioners need to prepare for the UK version of the Sarbanes-Oxley Act?
- Update on Nudge letters to individuals, One to Many letters, and tax enquiries

As always, please continue to share your feedback with us, and please do get in touch with any of the contacts listed, or your usual PwC contact, if you would like to discuss any of the topics further.



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Dividend withholding taxes – The impact of Brexit

Brexit has now been completed, but the effects will likely be felt for a long time and are just starting to be 'discovered.' The UK is now free to change its laws, depart from EU precedent and change taxation laws where it makes sense (removing tax on Sanitary products from 1 January for example), but equally the EU 27 can now change their laws as applied to the UK.

For those of us in the UK who have been very close to EU law and its impact on tax across all 28 States that have been EU Members at some point in the last 20 years, it's time to turn our focus to what it means being a third country nation and to consider the wider impacts of our new relationship with the EU.

To that end, the departure from the EU from 1 January 2021 has impacted the level of dividend withholding tax payable by UK funds on EU sourced income. The potential cost of this across an EU investment portfolio is not insignificant, it is big enough to give a multiple basis points disadvantage to UK funds on performance vs some of their EU counterparts.

Of course the new rules have not been brought in on purpose to punish the UK's departure, however the UK's departure from the EU takes it out of many domestic exemptions that EU territories have introduced over a number years. Most of these domestic exemptions were introduced to ensure compliance with the fundamental freedoms of capital and establishment, as enshrined in EU law.

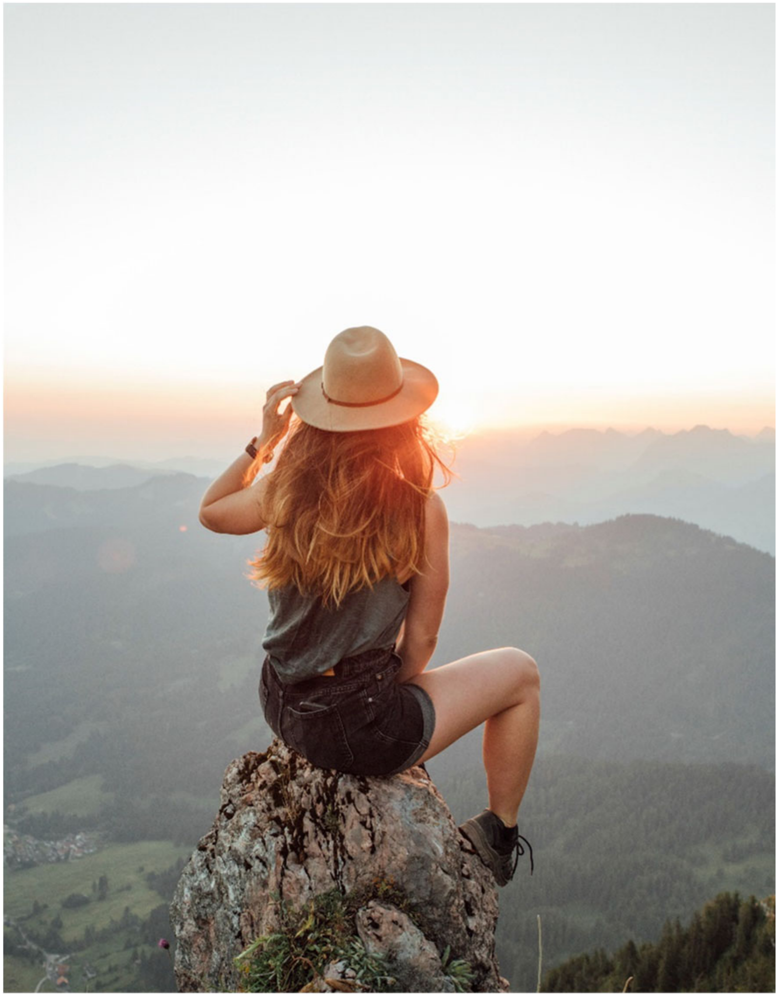
From 1 January 2021, UK funds are no longer established and authorised in the EEA and have therefore lost their legal status as UCITS or AIFs, as applicable and of course they are no longer residents of the EU. Therefore, favourable withholding tax rates for some territories, available only to EU funds, have been lost. Where this is the case and tax exemptions have been lost action is required to obtain relief by alternative methods (if available), such as under double tax treaties (DTTs).

For those UK funds who have pursued EU claims over recent years, any new claims will now have to be filed on a third-country basis and outcomes may be less favourable for some territories (though given the success of the US funds in the area, all is not lost). Managers should therefore conduct an impact assessment across portfolio ranges to determine the expected additional tax cost that will sit within portfolio returns and consider what steps are now needed to obtain any remaining favourable rates in the post-Brexit landscape.

For UK UCITS funds there is the possibility to make an ECJ claim as a 'third country' resident fund on the basis that they are still comparable to domestic UCITS funds. We believe that there remains a strong argument to support the comparability argument as the funds' structures will not have changed. Such funds will merely have lost the formal UCITS designation.

The tables below summarise some of the key market changes to dividend withholding taxes, and suggests actions managers may wish to take to help mitigate the impact Brexit will have on withholding taxes for UK funds.

Funds should pay close attention to the operational aspects for any new reliefs to apply and will have to take action in a timely manner to make sure alternative arrangements are in place (if you have not already done so). This presents an opportunity to undertake a wider review of process flows and performance around withholding taxes across markets and fund ranges.



Dividend withholding taxes – The impact of Brexit (cont'd)

WHT changes post from 1 January 2021

UK (former) UCITS and non-UCITS funds

Country	Statutory WHT rate	Rate to 31 December 2020	Rate from 1 Jan 2021	Comments on fund reliefs available
France	26.5%	0% (under French domestic law)	• 15% under UK/France DTT • 0% under French domestic law • 0% under EU claim	**For DTT rate** • Following Brexit, UK beneficiaries will no longer be entitled to EU tax treatment, and will therefore need to put measures in place, if other reliefs are not available, to obtain the 15% rate under the UK/France DTT • We advise you ensure arrangements are in place with your custodians to obtain relief at source • Due to the requirement for attestation that the withholding entity be 'subject to tax' in order for the French reclaim/relief at source Form 5000 to apply, it is unclear whether relief is available for UK funds via the standard reclaim method **For domestic relief** • For UK CIVs, historically a 0% rate was available as they were deemed to be comparable to French funds. This comparability has fallen away. However, relief may be possible down to 0% under new procedures for third country funds based on equivalence. US claims have been successful on this basis • To date UK funds have benefitted from a domestic relief in France, being held to be comparable to similar French Investment Funds. This relief is not currently available to funds outside of the EU/EEA, however it is likely this exemption will be expanded to include third country funds in the very near future given case law developments on US funds and EU claims. It is likely therefore at some stage UK funds should be able to benefit from domestic relief to 0% – this is not yet confirmed **For EU claims** • Reclaims down to 0% could be considered under 'Fokus Bank' principles for funds as 'third country' entities from 2021. Recent case law developments have been positive for US funds • There is a 2 year statute of limitations for EU reclaims in France

Dividend withholding taxes – The impact of Brexit (cont'd)

Country	Statutory WHT rate	Rate to 31 December 2020	Rate from 1 Jan 2021	Comments on fund reliefs available
Germany	26.375%	15% with status certificate	• 15% with status certificate • 0% under EU claim	**For DTT rate** • In principle, there is no change to the rate UK funds are entitled to for the German market. However, there are practical considerations, however, to ensure continuation of the 15% rate • In particular, funds should review the certificates in place granting relief and ensure these do not rely on UCITS status • UCITS funds losing their status should instead qualify as an AIF under the German Investment Tax Act, allowing them to qualify for reduced withholding • Due to the loss of UCITS status, funds may wish to apply to the German Tax Authority for a new Status Certificate as an AIF, in order to ensure that there is no disruption in eligibility for relief at source • There can at times be long delays in obtaining Status Certificates, so we recommend taking action quickly to ensure the process is started soon. If relief at source arrangements are not in place by the time income is received, tax will be withheld at statutory rate • If higher tax has been suffered due to a lack of certification, a quick reclaim process should be available if the documentation is in place within 6 months after the pay date, however if this deadline is missed funds will fall back on the standard written application process for reclaims, which is administratively burdensome and takes a longer time to settle **For EU claims** • Reclaims down to 0% could be considered under 'Fokus Bank' principles for funds as 'third country' entities from 2021. There has however not been positive case law for the German market to date and so litigation would likely be required • There is a 4 year statute of limitations for EU reclaims in Germany

Dividend withholding taxes – The impact of Brexit (cont'd)

Country	Statutory WHT rate	Rate to 31 December 2020	Rate from 1 Jan 2021	Comments on fund reliefs available
Italy	26%	1.2% Corporate/15% non-corporate	• 15% under UK/Italy DTT • 0% under EU claim	**For DTT rate** • Following Brexit, UK beneficiaries will no longer be entitled to EU tax treatment, and will therefore suffer the fall-back 15% rate under the UK/Italy DTT • Ensure arrangements are in place with your custodians to obtain relief at source under the DTT in a timely manner. If arrangements are not in place at the time of receipt of income, withholding tax will be suffered at the full statutory rate of 26% • There is a route available to reclaim Italian withholding tax. However in practice the procedure is administratively burdensome and funds have often found the Italian tax authority has taken a significant time to settle reclaims. Funds should therefore ensure arrangements are in place for relief at source before any Italian dividend income is received **Domestic relief** • The new dividend exemption in Italy from 2021 applicable to funds established in the EU/EEA will not apply to UK funds **For EU claims** • There is a possibility to make an ECJ claim as a 'third country', but to date there has not been positive case law supporting third country claimants and thus litigation would likely be required. Rule changes from 2021 onwards as set out above are helpful in supporting EU law arguments but third country status adds complexity for the Italian market • There is a 4 year statute of limitations for EU reclaims in Italy

Dividend withholding taxes – The impact of Brexit (cont'd)

Country	Statutory WHT rate	Rate to 31 December 2020	Rate from 1 Jan 2021	Comments on fund reliefs available
Norway	25%	0% (under Norwegian domestic law)	15% under UK/Norway DTT	**For DTT rate** • New documentation will be required, as the relief mechanism will change from a reclaim under the EU/EEA exemption to relief at source under the UK/Norway double tax treaty • Investors will have to file a pre-approval application to the Norwegian tax authority to obtain the 15% rate. Processing times at the Norwegian tax authority average around 6 weeks and documentation must be in place in order to obtain relief at source. Reclaims should be viable if relief at source is not established **EU claims** • Whilst Norway are in the EEA, they are not in the EU. For those thinking (and long enough in the tooth to remember) that Case E-1/04 Fokus Bank was actually a Norwegian case in the first place, yes it was but that was a case based on the Free Movement of Capital provisions as applicable to the EEA, rather than the EU. They are subtly different and critically the EEA was careful enough not to concede rights to third countries under movement of capital principles unlike the EU tax treaty version of the same principles
Poland	19%	0%	• 10% under UK/Poland DTT • 0% under EU claim	**For DTT rate** • Following Brexit, UK beneficiaries will no longer be entitled to the exemption under domestic law for EU/EEA investment funds, and will therefore need to ensure arrangements are in place with custodians to claim the 10% rate under the UK/Poland DTT in order to avoid suffering the full statutory rate of 19% **For EU claims** • There is a possibility to make an ECJ claim as a 'third country 'resident. Refunds have been received with respect to funds from third countries, notably the US. Process can be relatively intensive re paperwork support needed • There is a 5 year statute of limitations for EU reclaims in Poland

Dividend withholding taxes – The impact of Brexit (cont'd)

Country	Statutory WHT rate	Rate to 31 December 2020	Rate from 1 Jan 2021	Comments on fund reliefs available
Spain	19%	1%	• 10% under UK/Spain DTT • 0% under EU claim	**For DTT rate** • Following Brexit, UK beneficiaries will no longer be entitled to EU tax treatment, and will therefore need to ensure that arrangements are in place to avail of the 10% rate under the UK/Spain DTT, in order to avoid suffering the full statutory rate of 19% **For EU claims** • There is a possibility to make an ECJ claim as a 'third country' resident fund. There has been some positive case law since 2019 supporting claims from third countries but the process remains time consuming and complex • Case law to date supports claims by US funds, however as the DTT between Spain and the UK has an exchange of information clause, and given the legal framework in which UK funds operate should be comparable to the EU framework, there should be a good chance of success for UK funds • There is a 4 year statute of limitations for EU reclaims in Spain

Dividend withholding taxes – The impact of Brexit (cont'd)

Country	Statutory WHT rate	Rate to 31 December 2020	Rate from 1 Jan 2021	Comments on fund reliefs available
Sweden	30%	0%	• 0% under domestic law • 5% under UK/Sweden DTT • 0% under EU claim	**For domestic exemption** • A UK former UCITS fund which does not change any terms or conditions should likely continue to be subject to the domestic exemption going forward. The former UCITS status should in such case be a strong argument for comparability with Swedish funds. If the fund is contractual, it could also potentially, as before, be out of scope of the Withholding Tax Act if the fund can be deemed to be the recipient of the dividend • A UCITS fund is normally deemed comparable with a Swedish UCITS fund since they are subject to harmonised rules within the EU and should therefore get the exemption • For non-UCITS funds (including non-EU funds) there must be comparability with a Swedish UCITS or a so called Special Fund (Sw. specialfond) for the exemption to apply. Hence, a UK investment fund may, irrespective of legal form, potentially be subject to the domestic exemption • Otherwise, for a non-UCITS, the comparability analysis with Swedish funds is on a case by case basis • The custodian shall withhold tax at source unless it is clear to them that the recipient is exempt or subject to a reduced rate. It is therefore crucial to ensure your custodians are aware of the basis for exemption and all required documentation is in place to obtain relief **For DTT rate** • If exemption under Swedish domestic law is not available, you should ensure arrangements are in place with your custodians to obtain relief at source under the DTT **For EU claims** • Since there is a domestic exemption from withholding tax for foreign investment funds, a claim for exemption is normally based on this rule rather than EU law. However, an argument for the exemption rule to apply can be that it would otherwise be in violation with the EU law principle of free movement of capital which is applicable also in relation to a 'third country' claimant • There is a 5 year statute of limitations for reclaims in Sweden

Dividend withholding taxes – The impact of Brexit (cont'd)

UK Pension Funds

Country	Statutory WHT rate	Current rate	Post-no-deal rate	Remediation steps
Austria	28%	0%	• 15% under UK/Austria DTT • 0% under EU claim	**For DTT rate** • When the UK becomes a third country, the exemption to EU pension schemes will no longer apply. Therefore you should check with your custodian that arrangements are in place to avail of the 15% DTT rate **For EU claims** • There is a possibility to make an ECJ claim as a 'third country' resident pension fund. Refunds have been received with respect to funds from third countries, notably Canada • There is a 5 year statute of limitations for EU reclaims in Austria
Italy	26%	11%	• 15% under UK/Italy DTT • 0% under EU claim	**For DTT relief** • The 11% domestic rate applicable for EU pension funds will no longer apply. Pension funds relying on this exemption should therefore ensure arrangements and documentation are in place to avail of the 15% rate available under the UK/Italy DTT • Action should be taken early to ensure relief at source is obtained at the time income is received, as funds often find a significant time lag between the claim submission and the Italian Tax Authority settling the reclaim **For EU claims** • There is a possibility to make an ECJ claim as a 'third country', but to date there has not been positive case law supporting third country claimants and thus litigation would likely be required. Rule changes from 2021 onwards as set out above are helpful in supporting EU law arguments but third country status adds complexity for the Italian market • There is a 4 year statute of limitations for EU reclaims in Italy

Dividend withholding taxes – The impact of Brexit (cont'd)

Country	Statutory WHT rate	Current rate	Post-no-deal rate	Remediation steps
Norway	25%	0%	0% under UK/Norway DTT	**For DTT rate** • While exemption from dividend withholding tax is available to UK pension funds under the UK/Norway DTT. Funds should ensure they are comfortable with the method of exemption as many funds currently claim a domestic exemption (which will no longer apply) rather than treaty relief • If WHT relief is currently being claimed under the EU/EEA exemption, documentation changes will be required as an application for pre-approval will have to be made to the Norwegian tax authority for DTT relief. This application should state clearly that the special provisions for pension funds is to apply, and residence should be certified by HMRC • The Norwegian tax authority takes approximately 6 weeks to provide this pre-approval, so funds should check applications have been made as soon as possible in order to obtain relief ahead of the early-year Norwegian dividend season

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EU DAC6 developments following the EU/UK Trade and Cooperation Agreement

Following the agreement of the EU/UK Trade and Cooperation Agreement ('TCA') on Christmas Eve, to great surprise HMRC laid some amending regulations on 29 December 2020 which fundamentally changed the application of EU MDR/DAC6 in the UK.

Put simply, HMRC have removed the obligation to make disclosures of cross-border arrangements unless these relate to the 'D hallmarks' (i.e. those which relate to CRS avoidance and opaque ownership structures). This is very significant, as it removes all of the hallmarks which typically impact on normal commercial transactions.Going forward, HMRC intends to implement the OECD MDR regime, which broadly tracks to the 'D Hallmarks' in EU DAC6.

As the change came into force before 1 January 2021, any transitional period arrangements (i.e. between 25 June 2018 and 31 December 2020) will only be disclosable in the UK on 31 January/28 February 2021 to the extent that they satisfied the D hallmarks. This also means that no reliance can be placed on a UK disclosure to satisfy any disclosure obligation in one or more EU27 states.

Whilst this removes most of the burden in the UK going forward, it should be noted that:

- The rules are now fully live in all EU Member States
- Many EU territories are taking differing approaches to implementation and interpretation of DAC6, particularly for alternatives. Many ordinary transactions will continue to be disclosable
- Due to the wide scope of legal professional privilege / professional secrecy in many EU Member States, it is frequently a taxpayer obligation to make disclosures

Practical considerations

As asset managers and alternatives have digested the technical updates, thoughts have quickly turned to practical implications, the common of which are set out below:

a) Firms where previous EU MDR interactions were through the UK business only.

The change is, in most cases, good news as most transactions will now be excluded. As a matter of good internal housekeeping, most firms are reviewing their previous technical impact assessments to ensure no unconsidered EU27 elements are in point, given the prior focus on the UK technical position.

(b) Firms with EU MDR interactions through both UK and EU27 member states

Previous analysis needs to pivot to whether any of the EU27 states are relevant now the UK is no longer an intermediary. There are practical challenges here, including:

- Differing interpretations of the Directive across the EU27 meaning that time consuming local technical analysis can be required.
- Legal professional privilege / professional secrecy rules differ between countries and often limit the extent to which advisors will take on filing responsibilities. This means engagement with local advisors before the first filing deadline is key as any filings (and associated penalties) may fall upon the taxpayer.
- Differing administrative procedures across the EU27. Care needs to be taken to ensure that any flings are timely and accurate to mitigate penalty risks. MDR 'trigger' dates for reporting differ or are poorly defined, adding practical complexity and risk.
- Disconnects between UK led structuring processes and MDR compliance. Where the UK office takes the lead role on transactions, that team will most likely need to retain a lead role in overseeing MDR analysis and reporting, even if the UK is no longer relevant, to ensure filings are made on a timely basis in all relevant territories..

A wider issue arises for transactions where a UK based asset manager is involved with EU transactions and there is no local EU asset manager establishment. As this is now not reportable in the UK, this brings in complex considerations over the definitions of 'intermediary' and 'relevant taxpayer' in local legislation and the level of reporting that may be required. Again, the role of advisor intermediaries and legal privilege needs to be considered to identify who may have the reporting obligation in any relevant EU jurisdiction..

Action: firms should review all transactions with an UK / EU nexus and consider whether intermediary status may have changed. Engage with local advisors to confirm filing responsibilities and whether there are any legal privilege issues.

EU DAC6 developments following the EU/UK Trade and Cooperation Agreement (cont'd)

Next steps for asset and wealth managers

With the withdrawal of the UK from the DAC6 regime there are ongoing practical points to consider. AWMs are now focusing on the following 'no regrets' decisions:

- **Update technical assessment**. Review and update previous technical impact assessments to ensure that all structures and transactions are considered in light of the new status. This may result in having to conduct local territory technical analysis and consider the practicalities of local filing obligations
- **Refresh advisor engagement and compliance strategy**. Engage with local advisors to ensure that any new filings are being picked up, especially where 'relevant taxpayer' status may apply in the case of legal privilege being claimed and filings potentially needing to be made by the taxpayer. Obtain confirmation that all required filings have been flagged, and that there is a clear compliance roadmap in place
- **Document technical and operational approach**. Documenting how transactions have been assessed from a technical perspective in a policy document has been a core element of most firms' MDR implementation process. Refreshing this to pick up the changes will help in clearly setting out any changes. It will be equally important to set out how MDR is being managed across the organisation operationally. This provides clarity across Tax, deals teams, advisors, and other counter parties around transactions are undertaken and DAC6 aspects managed. A clearly articulated DAC6 policy is already being seen as important for responding to audit or investor queries and also support internal training and control mechanisms
- **Ongoing tracking and management**. With UK tax teams likely to have a more oversight and risk management focused role over DAC6 compliance, consideration should be given to how this is to be achieved. A wide range of options are being assessed; from spreadsheet tracking, to more comprehensive management tools, to co-sourcing models with external advisors. Now the regime is live and filings are imminent, many firms are now looking to put an appropriate solution in place. Whichever approach is most appropriate, the change in the UK's status is unlikely to take away the need for, and in some cases increases the importance of, the tax teams of asset managers and alternatives to have a clear understanding of any DAC6 filings being made in the EU27

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Hong Kong's proposed carried interest concession

Over the past few years, PwC, together with industry players, have asked for clarity and certainty on the tax treatment of carry. The proposed carry tax concession is a big step towards alleviating the industry's concerns on the taxation of carry, and ensures Hong Kong remains an attractive and competitive location for fund managers. We outline the details behind the proposal below.

What is 'eligible carried interest' or 'carry'?

A sum received by or accrued to a person by way of profit-related return subject to a hurdle rate. A profit-related return must fulfil all of the 3 following conditions:

- Carry must arise only if there are profits for a period on the investments, or on particular investments or from disposal of the investment(s)
- Carry paid would vary with reference to the profits
- The return to external investors is also determined with reference to the same profits

What are the specified conditions?

Qualifying carry payer

A 'fund' as defined under the Inland Revenue Ordinance ('IRO') under the unified tax exemption for funds regime ('UTE') requirements is:

- Certified by the Hong Kong Monetary Authority ('HKMA')
- For non-resident funds – appoint an authorised local representative

The Innovations and Technology Venture Fund ('ITVF') Corporation is also a qualifying carry payer

Qualifying carry recipients

Persons providing investment management services to a qualifying carry payer in Hong Kong or arranging such services to be carried out in Hong Kong. They include:

- An SFO licenced corporation or an authorised financial institution
- A person, not included in (1), providing investment management services or arranging such services to be carried out in Hong Kong to a certified investment fund, which is a 'qualified investment fund' defined under the UTE regime
- An individual deriving assessable income from the employment with qualifying persons in (1) and (2), or their associated corporation or partnership, by providing investment management services in Hong Kong to the certified funds on behalf of the qualifying persons

Qualifying transactions

The concessionary tax treatment would be ring-fenced to eligible carry arising from qualifying transactions in private equity only. These are

- Share, stocks, debentures, loan stocks, funds, bonds, or notes of, or issued by, a private company specified under Schedule 16C to the IRO
- Shares of comparable interests of a special purpose entity ('SPE') or interposed SPE solely holding and administering one or more investee private companies
- Share, stocks, debentures, loan stocks, funds, bonds, or notes of, or issues by an investee private company held by an SPE or interposed SPE from (2)
- Incidental to the carrying out of the qualifying transactions from (1) to (3), subject to a 5% threshold

The qualifying transactions also have to meet all the relevant tax exemption conditions under the UTE before the eligible carry is eligible for the tax concession.

Carry from hedging transactions may also be eligible for the tax concession, subject to conditions.

Other conditions/notes to be aware of

Substantial activities requirements for qualifying carry recipients for each year of assessment for the period from the date when the qualifying carry recipient begins to perform investment management services to the certified investment fund to the date when the carry is received or accrued to the qualifying carry recipient.

- Average of 2 or more full-time employees in Hong Kong who carry out the investment management services
- HK$2 million or more operating expenditure incurred in Hong Kong for the provision of investment management services

HKMA's certification and ongoing monitoring mechanism

- Certification and application process with the HKMA
- In the year of carry interest distribution, external auditors verify relevant substantial activities requirements are met and that the distribution fulfils the requirements under the tax concession regime

Observations

- **Reference to UTE**. The proposals continue to reference the UTE provisions and implicitly suggests that the UTE should be considered
- **Allows flexible private equity strategies**. The proposals appear to allow the fund to take different investment strategies (e.g. buy private companies and exit by trade sale or IPO, take private a listed company etc.) – recognising that there is no 'one size fits all' in the industry. However, investments in Hong Kong real estate are excluded/carved out. Multi-strategy funds should seek tax advice to determine how the carry tax concession might apply to them
- **HKMA's role**. The HKMA is heavily involved in this regime – with the application and certification process under their purview

Hong Kong's proposed carried interest concession (cont'd)

Observations (cont'd)

- **A broad-based carry tax concession?** While on the surface the tax concession seems to apply primarily to private equity (PE) funds, there is no reference to the type of eligible funds. Instead, the concession makes reference to the type of PE transaction only. This suggests that so long as the specified conditions are met, other funds e.g. hedge funds with side pockets of private equities, are not restricted from making use of the tax concession. This seems to widen the applicable scope of the tax concession
- **Uncertainties on eligible individual carry recipients**. It is still unclear if non-investment professionals would be qualifying carry recipients or not. Although the list of investment management services is not exhaustive, the quoted examples are mostly applicable to investment professionals. It remains to be clarified whether legal, finance, HR, or middle office support functions would be eligible to participate
- **Changes to existing carry flow may be required?** Given different firms adopt different carry structures (e.g. SLP or offshore GP to be the carry recipient), clarifications should be sought if any change to existing carry flow is required to satisfy the qualifying carry recipient and substantial activities requirements

Insights and what's next?

The carry tax concession follows the various measures the government has already implemented to bolster Hong Kong's position as a leading international AWM centre, including the UTE for funds, the open-ended fund company regime, and the limited partnership regime. We expect the industry would be eager to see the fruition of a practical carry interest tax concession.

We are pleased to see that the legislative proposals have taken on board industry comments, including removing the 6% hurdle rate (from the initial proposals) and extending the tax concession to carry from hedging transactions.

While the legislative proposals provide a high-level summary of the proposed tax concession regime for carry, the detailed legislative provisions that govern the implementation of the regime will be set out in the tax amendment bill. The amendment bill is targeted to be introduced into the Legislative Council in late January 2021. We hope the amendment bill will provide further refinements to the regime and clarify the uncertainties before it becomes legislation.

Subject to the passage of the bill, the concessionary tax treatment will apply retrospectively to eligible carried interest received by or accrued to qualifying carry recipients on or after 1 April 2020. We would also highlight an anticipated change to the current UTW rules. Currently, SPEs of an investment fund are restricted to invest in private companies only, and not in public securities and other asset classes that the investment fund is allowed to directly invest in under the UTE regime.

To address the industry's concerns on the above restriction. The Government also proposes to allow SPEs to invest in the full range of asset classes as the investment fund under Schedule 16C of the UTE, and tax exemption can equally apply to the gain derived by the SPEs. The amendment bill is expected to be introduced to the Legislative Council by early February 2021 with effect from the year of assessment 2021/22. As such, investment funds (including hedge funds) should be able to use SPEs to hold listed and marketable securities going forward, without jeopardising the tax exemption status under the UTE.

Next steps for asset and wealth managers

The carried interest tax concession regime is a long-awaited development and key to bolster Hong Kong's position as an international asset and wealth management centre. We are pleased to see that the legislative proposals have been refined to consider industry comments to make the regime more business friendly. In particular, the eligible carried interest will be taxed at 0% profits tax and excluded from employment income for salaries tax purposes. The tax amendment bill is anticipated to be introduced to the Legislative Council in late January/early February 2021. Once enacted, the tax concession will apply retrospectively to eligible carried interest received by or accrued to qualifying carried interest recipients on or after 1 April 2020.

Whilst the legislative proposals provide a high-level summary of the key features of the regime, there are a number of questions to be clarified in the proposals. We hope the tax amendment bill will provide further clarity and refinements before it becomes effective. AWMs may wish to start looking into their existing carry structures to revisit the current tax positions and assess the possibility of being eligible for the tax concession regime. This includes the evaluation of any change to the carry structure and carry flow, as well as changes to other non-tax factors such as legal and commercial considerations. Managers are recommended to keep abreast of the development in this area.

If you would like to understand more details and explore the opportunity of how you may enjoy the regime, please contact us via the details below.

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Do tax practitioners need to prepare for the UK version of the Sarbanes-Oxley Act?

For some time now, we have been talking about the fact that a change is coming which could seriously jolt our corporate governance model. Over the next few months, the Government will examine the many detailed recommendations for audit, corporate reporting and governance arising from the recent Kingman, Brydon and CMA reviews. Of particular interest to the tax community will be the recommendation for the UK to adopt a toughened internal controls regime – something perhaps similar to US SOX is on the horizon?

There is of course a discernible distinction between the approach of those who are subject to SOX and those who are not. In the US, it is widely recognised that SOX has driven a much greater sense of accountability in management for ensuring the effectiveness of the company's internal controls and, as a consequence, has enhanced them. Other benefits have arguably included an increase in investor confidence, more reliable and resilient financial reporting and increased oversight obligation for the audit committee. Companies that do this well are able to leverage their work to better understand their processes, drive efficiencies and make better use of their technology investments.

We need to be clear what the objective of a reinforced UK regime is. If it is to improve financial reporting quality and mitigate large scale financial fraud, then a US SOX style regime is potentially an attractive solution. But if the aim is to reduce the risk of corporate collapse then, the requirements are probably going to have to look beyond pure financial reporting and more towards an organisation's principal business risks.

A full US SOX regime in the UK?

Some in the industry perceive that there is an increasing pressure for the UK to adopt a US style system and there should be a requirement for assurance over the internal controls regime to ensure it is robust enough and does not lead to inconsistencies in approach. (One can only hope that such a regime, if introduced, included more pragmatism around the depth of controls and documentation requirements!)

If we want to look to an alternative model with less stringent requirements than the US, we could perhaps look to South Africa. Companies listed on the Johannesburg Stock Exchange will be required to comply with a CEO/CFO SOX style controls attestation for the first time for 31st Dec 2020 year ends. Their experiences will provide an interesting reference point for us in the UK.

There are a number of big questions for how such a regime could work in the UK.

Five key questions for a UK SOX regime

- **Scope** – There needs to be deliberate study of the scope of any enhanced UK regime. Should it cover only internal controls over financial reporting, as it does in the US, or should it cover broader operational and non-financial controls?
- **Application** – To which companies should it apply? It could be limited to the very largest companies, for example the FTSE 350, or it could apply to all companies where there is a significant public interest, including large private companies.
- **Standards** – How deep should the framework go? And how rigorous is the documentation, testing and evidence gathering that supports the CEO/CFO attestation expected to be?
- **Assurance** – Should assurance over the attestation be mandated? In the US there is an auditor attestation – is that the model we'd use here in the UK?
- **Framework** – What framework should be used? COSO is tried and tested or there is the option to develop a new framework or adapt an existing one.

However, once these questions are answered, it is clear that any bolstered UK framework for internal controls over financial reporting would have an impact on companies. But we can learn lessons from the way SOX was implemented in the US.

In its proposal for how a UK regime should be developed, the ACCIF has already gone a long way towards responding to a number of the key questions. The question now is how will the government take this forward.

If a toughened UK internal controls regime does feature in the government's proposals for the corporate governance system, it is important that companies and their stakeholders respond and share their views.

Tax Internal Controls in an Era of Transparency and Disclosure

Asset and Wealth Managers' Heads of Tax should be following the proposals closely, as many will recall (perhaps as a distant memory from time as a junior on audit rotation(!)) the amount of work that went into adopting SOX for tax in the US back in 2002. Moreover, tax controls are hard to get right and a recent survey by the PCAOB as recent as 2016 found that tax accounting in the US was the second leading cause of 2016 financial restatements; ninety-eight percent of financial restatements were tax related; an average of thirty-six hours was spent on each key control (including design, documentation, and testing); and almost sixty percent of reported tax material weaknesses were attributed to insufficient tax accounting expertise, insufficient review, and lack of general procedures.

These findings clearly indicate that tax accounting is a high risk area, but why is this? There are a number of factors that contribute to the heightened level of inherent risk relating to accounting and financial reporting for tax. These include

- Nature and volume of transactions undertaken e.g. certain taxes like VAT are operational in nature and impact nearly every transaction the organisation enters into
- The combination of automated and manual processes

Do tax practitioners need to prepare for the UK version of the Sarbanes-Oxley Act? (cont'd)

Tax Internal Controls in an Era of Transparency and Disclosure (cont'd)

- Complexity driven by the interaction between tax law and accounting rules
- High level of management judgement involved in the process
- Complexity driven by tax reporting processes straddling multiple systems and functions across the organisation

Given the level of risk and complexity faced, firms should implement a robust framework to identify tax reporting risks, design, implement and test key controls, ensuring identified issues are appropriately remediated and which should be integrated as much as possible with the firm's wider tax risk management framework. The key steps that should be followed include

- **Scoping** – This involves defining materiality thresholds, identifying material locations and processes which impact tax reporting processes and confirming roles and obligations between the tax team, finance and other areas
- **Risk assessment –** This involves reviewing end to end processes to identify where material tax reporting risks arise. Key areas to focus on include processes that are manual or straddle alternative systems or functions as well as where material management judgement is applied
- **Process design and mapping –** This should highlight key steps in the end to end tax reporting processes, identifying where key risks and related controls as well as roles and obligations lie
- **Controls design effectiveness testing –** The focus here is to ensure that the controls that are in place are designed effectively, mitigate the risks they aim to, and that the processes are adequately documented
- **Controls operating effectiveness testing –** The objective here is through, the testing of controls and other assurance activity, to determine whether controls operate as designed, are documented effectively and that any control issues are identified
- **Issue evaluation and remediation –** This activity involves assessing identified control issues so that they can be prioritised for mitigation, remediation and where required escalation and reporting

A key factor to contemplate in delivering on these steps, informed by the introduction of SOX for Tax in the US, is to ensure that the work is done in a proportionate manner to ensure that processes that are put in place are effective but also can be managed in an efficient manner, avoiding excessive administrative overheads.

Where is it all at?

In terms of timing, at the moment we are still awaiting the Department for Business Energy and Industrial Strategy (BEIS) super consultation to be released. It is expected early January, but in light of the further recent lock down announcements, this could be pushed to February or March. The work wraps up all of the market reviews over the last two years (Brydon, Kingman, CMA) and proposes the various measures that the government is proposing to implement. This has been jointly written by the FRC and BEIS and a position on UK SOX will be part of this. We anticipate that stakeholders (investors, companies, accountants etc) will then likely be given 3 months to provide feedback against this, which will then lead to some tweaks to the proposed course of action and a legislative timetable – Again quickest scenario would see this become legislation this year with staggered implementation timetables for all the various measures going out a few years.

Next steps for asset and wealth managers

AWMs should be following the audit proposals very closely, as many will remember the amount of work that went into adopting SOX for tax in the US back in 2002. In the meantime, groups may want to look at reviewing their tax internal controls and governance procedures in any case given the general direction of travel and the fact that we know that tax claims and disputes are set to arise as a result of governments seeking to plug black holes in their balance sheets.

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Update on Nudge letters to individuals, One to Many letters, and tax enquiries

Increasingly, individual taxpayers and their agents are receiving letters from HMRC as part of dedicated campaigns being run by HMRC designed to encourage taxpayers to review their tax position and ensure their tax affairs are fully up to date.

The two main types of letters we are seeing at the moment are referred to as 'nudge' letters and 'one to many'. Both types of letters can cover a range of different areas, are not uniform and do not all require a response so knowing what action to take on their receipt, if any is required, is very important.

'Nudge' letters

We are aware that HMRC has once again issued letters to some taxpayers requesting information in respect of offshore income and gains.

The letters tell the individual that it is their responsibility to tell HMRC about their UK tax liabilities from offshore income and gains anywhere in the world, and that it is important that taxpayers check that they have declared all their UK tax liabilities.

The letters generally give 30 days to respond and all of them include a 'Certificate of Tax Position' form which HMRC ask the individual to complete and return whether they have additional tax liabilities to disclose or not.

On the certificate, the individual is asked to sign and make a declaration to the effect that

- The information they provide on the certificate is 'correct and complete to the best of their knowledge and belief'
- They understand that choosing to make a false statement or complete a false certificate is a criminal offence that can result in investigation and prosecution

Recipients are also asked to tick that either:

- Their tax affairs need to be brought up to date and they will make a disclosure of irregularities through the Worldwide Disclosure Facility (WDF)
- Their tax affairs do not need updating and they do not have additional tax to pay

There is then a further declaration: 'I have declared all of my offshore income, assets and gains which are taxable in the UK'.

What should you do if you receive one of these letters from HMRC?

The first point to note is that HMRC is saying that they are aware that you have overseas income, not that your tax return is necessarily wrong. It should also be noted that there is no legal obligation to complete the 'Certificate of tax position' and return it to HMRC. However, we recommend checking whether your tax affairs are correct and completing to the best of your knowledge and belief before responding to the letter.

If no disclosure is needed, you may wish to consider sending HMRC an explanation by letter. Where no response is received by HMRC, HMRC may follow up. Therefore not responding at all could attract more attention from HMRC. Responding to the initial letter may reduce the risks of further action being taken by HMRC.

If a disclosure is required, the letter advises that this must be made via the Worldwide Disclosure Facility ('WDF'), but using the WDF may not necessarily be the most appropriate method. Depending on your individual circumstances, other approaches may be better.

'One to Many' letters

A One to Many letter represents an approach taken by HMRC to 'positively influence customer actions' so that they are more likely to comply with their tax obligations. In effect, these letters are designed to educate taxpayers, alerting them to consider whether there are any issues that they need to review in relation to their historic filing positions.

HMRC have issued these letters recently in relation to a number of different areas. These include

- Deferred consideration for CGT purposes
- Reporting requirements for deemed domicile individuals
- CGT on residential property disposals
- Statutory Residency Test
- Foreign tax credit relief
- Overseas workday relief

What should you do if you receive one of these letters from HMRC?

If you receive one of these letters, it is important that you consider your historic position, with a view to confirming that there have not been any tax irregularities. Firstly and fundamentally this is important in and of itself to ensure that all returns are correct and complete.

In addition to this, if any irregularity that relates to the contents of HMRC's letter does emerge, whether or not this issue has been adequately considered could have an impact on your position in the context of any subsequent amendment or enquiry.

HMRC enquiries

Over the last 18 months, we have seen many HMRC enquiries into executive tax returns with a focus on 'carried interest' – some involving several executives from the same asset manager, whilst others may only be in relation to one individual.

In order for HMRC to get comfortable with the reporting and disclosure of carried interest, they typically request evidence that

Update on Nudge letters to individuals, One to Many letters, and tax enquiries (cont'd)

HMRC enquiries (cont'd)

- The carried interest is qualifying carried interest (i.e. meets the definition of carry as per the legislation)
- Does not meet the conditions of Income Based Carried Interest (i.e. they want to look at the Weighted Average Holding Period and the methodology that has been adopted)
- If foreign tax has been levied on the carry, that the correct foreign tax credit has been claimed
- If the recipient is non-UK domiciled, that the carry has been paid into two separate bank accounts and the proportion attributable to UK services is appropriate

All of these points require some level of information to be provided by the fund manager, and in fact, HMRC will expect the them to engage with HMRC to provide this evidence (which makes it even more important for this information to be provided to the executives from the outset – i.e. when preparing their returns).

Next steps for asset and wealth managers

The tax affairs of AWM executives are typically complex, and the reporting of fund related returns can have wide ranging implications for both the individual and the AWM..

To ensure that executives are compliant with their reporting obligations, it is important to seek advice when:

- Dealing with HMRC 'Nudge' and 'One to Many' letters
- Reporting carried interest and other fund returns via self-assessment
- Dealing with HMRC enquiries

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