THE INVESTMENT ASSOCIATION

Response to consultation

Review of Double Taxation Treaties 2022

About the Investment Association

The Investment Association (IA) champions UK investment management, a world-leading industry which helps millions of households save for the future while supporting businesses and economic growth in the UK and abroad. Our 270 members range from smaller, specialist UK firms to European and global investment managers with a UK base. Collectively, they manage £9.4 trillion for savers and institutions, such as pension schemes and insurance companies, in the UK and beyond. 44% of this is for overseas clients. The UK asset management industry is the largest in Europe and the second largest globally.

Executive summary

The work of HMRC's Tax Treaty Team remains vital to the competitiveness of the UK Fund Industry, and effective and timely management of the Tax Treaty Network (thereafter "the Network") is essential to our continuing success. We welcome the chance to influence the direction of future negotiations and the opportunity to highlight undue administrative hurdles faced by members.

Our response to the Network review replicates many of the asks and issues that we have raised in our previous responses to this annual engagement, amid concerns at the lack of attention that investment fund treaty issues have received in the past few years.

We are mindful of the immense demands of overlapping global and domestic initiatives such as ongoing implementation of BEPS Multi-Lateral Instruments, efforts to replicate benefits of the Parent/Subsidiary Directive and the Interest & Royalties Directive, and the looming spectre of the OECD's BEPS 2.0 project and new MLIs needed to implement these rules, alongside practical challenges still being faced due to the pandemic. With this tsunami of work still to be accomplished, we urge that HMRC Treaty Team is sufficiently resourced to ensure that UK taxpayers enjoy the fullest possible benefits of its extensive Treaty Network.

More recently, we have been encouraged to see the importance of treaty access for UK funds being recognised by HMT and HMRC in the newly published response to the UK Fund Regime call for input and hope that this commitment enables us to work collaboratively to improve treaty access for UK funds.

To support this objective, we have in our response focussed only on the highest priority issues that need urgent attention from the Treaty Team. These include the below:

- **Engage with Competent Authorities in Switzerland to restore treaty access for UK funds**
- **Include access to EU domestic withholding tax exemptions for UK funds (as was the case before UK's departure from the EU) in all ongoing and future EU treaties renegotiations**
- **Protect and enhance treaty access for UK investment funds and unit linked pension schemes by recognising them as tax residents in all UK tax treaties**

The Investment Association
Camomile Court, 23 Camomile Street, London, EC3A 7LL
www.theia.org

Anshita.joshi@theia.org
@InvAssoc @The Investment Association

We have in the annexes to this letter included an expanded list of long-standing issues as part of our 2021 response, which can be addressed on an ongoing basis as and when the opportunity arises, either while negotiating new treaties or renegotiating existing ones.

We look forward to working with HMRC on these issues and will be attending the virtual roundtable on 22 February to discuss the responses. At this event it would be useful to agree a format and timeline for future engagement, including thoughts on how to make the Network Review a two-way engagement. With no published Summary of Responses, in recent years it has been difficult for respondents to gauge which messages have been heard and understood. We request that this meeting act as a forum to understand what can and will be actioned, as well as highlight areas that cannot be progressed, for any reason.

As ever the IA remain committed to supporting your work and we would be very happy to engage with HMRC in detail on the various points raised in this response and provide any additional information that may be helpful in dealing with each of the relevant issues.

Questionnaire

We have included our detailed responses to your specific questions, where appropriate, below:

Q1. How could our existing Double Taxation Agreements (DTAs) be improved? Please refer to specific treaties and, where possible, specific provisions within those treaties.

1.1 Have any of the UK's treaties had an impact on your project(s), investment(s) or other cross-border activity? If so, please provide details.

Switzerland

THE PROBLEM

Switzerland continues to be a significantly problematic market for UK funds seeking treaty relief, due to a variety of issues with the new attestation process (Forms 86A and 86B), which was agreed in 2019 with the Swiss Federal Tax authorities (SFTA) in an effort to support treaty access for UK Funds as part of the 2008 UK/Swiss Memorandum of Understanding (MoU) for investment vehicles. Over the last 12 months, these problems have now degenerated further, and the supposed simplified procedure has been rendered effectively unworkable and is no longer fit for purpose.

This leaves UK funds with no meaningful access to Article 10 of the 1977 UK / Switzerland Double Tax Convention.

The reasons for this are as follows:

a. **The attestation process requires Form 86B** to be completed by intermediaries (nominees and platforms) investing in a fund as of December 31 of each year (including both past years of reclaims as well as going forwards) confirming percentage of UK/non-UK investors investing through them in an investment fund. While for the past few years, a small number of funds had limited success in obtaining some such attestations, **more recently major intermediaries and platforms have confirmed their inability to complete these attestations citing a range of issues including risk, resourcing, data, and cost**. This has led to many managers having to scrap the proportion of the reclaim covered by 86Bs in favour of filing partial reclaims only for investors which they themselves can attest through the 86A process in order to meet both their fiduciary responsibilities as well as stay within the 5 years statute of limitation deadline for filings.

b. Even with partial information on investors that fund managers can identify, **SFTA is now no longer honouring partial reclaims** and the number of successful applications has reduced to a trickle. The ultimate driver for the cessation of repayments is unknown but most of the rejections issued have focused on administrative hurdles and there appears to be no consistent approach across the officers or offices dealing with these claims. Rejections have often been followed by unreasonable requests for information and unrealistic deadlines for reply.

The combined effect of these two factors means that **UK funds are no longer able to gain treaty access on their Swiss investments going as far back as 2015 in some instances.**

We understand these refusals are not exclusive to UK funds and other international partners, including the US and Germany, are having similar issues accessing their relevant treaties with Switzerland. This appears to be proving an issue for insurances companies and pension schemes also.

THE EFFECT

The above effectively means that the practical solution that HMRC, the SFTA and the industry spent nearly 3 years developing from 2016 through to 2018, is no longer workable in practice and leading to UK funds losing access to the treaty that they are rightfully entitled to. This loss of access to the treaty will have a material effect on UK investors.

As previously discussed with HMRC, roughly 96% of investment in UK retail funds comes directly or indirectly from UK Resident investors. This should mean that, following the UK Swiss DTA and the MoU which allow for full refund to be claimed where more than 95% investors are based in the UK, UK funds should be entitled to full access to treaty rates. However, to the contrary and much to the industry's frustration, with the increasing trend of the SFTA now not honouring even partial reclaims, the UK fund industry is now suffering 35% withholding tax rate on Swiss dividends instead of the 15% rate that they are entitled to.

The quantitative effect of this issue for UK funds is significant. Using data provided to us by members we estimate that up to £0.9bn of potentially valid claims since 2015 are at risk.

A more detailed analysis of this is provided in **Annex A** of this submission.

OUR ASK

Given that despite engaging in good faith with the Swiss on the new process, UK funds have not been able to access their treaty entitlement in Switzerland, HMRC's immediate intervention is essential. We urge HMRC to engage in bi-lateral discussions with their counterparts in Switzerland to demand fair and equitable treaty access for UK investment funds bearing in mind the commercial and operational realities of providing supporting information.

Potential options for restoring UK funds' entitlement to treaty benefits include:

- The use of an Equivalent Beneficiaries clause to allow for easier attestation
- A reduction in the entitlement threshold from 95% to 50%, as available in the US treaty
- The role that regulatory requirements and documentation could play in demonstrating treaty entitlement
- Consideration of available options via the treaties MAP provisions for individual rejections

While being mindful of the powers of the SFTA to seek necessary information to confirm treaty entitlement, we urge that any process that can be agreed **will only rely on information which is within a fund managers' power to provide**. The IA is keen to engage with HMRC on this topic as soon as possible in order to provide them with any further information needed for opening up lines of dialogue with the SFTA.

Q2. Are there any aspects of recently signed DTAs that could be improved?

2.1 If so, what are they? Please specify the provision(s) concerned.
2.2 Why are they problematic? Please provide evidence of material impacts these have had where possible.
2.3 Please state if this issue applies across multiple DTAs (and if so, list those DTAs).

In general, we are keen to understand HMRC's opening negotiating stance when engaging with treaty partners and explore whether it would be possible to consult on the UK's Tax Treaty template ahead of any future negotiations, particularly to the extent that it affects investment funds.

The UK relies heavily on a variety of Model Tax Conventions which act as a base template for engagement while then utilising a range of equivalent and interchangeable texts to augment and agree bi-lateral treaties. While we obviously appreciate the UK's commitment to "*always advance the interests of UK businesses*"[1], a greater degree of transparency in how these texts are finalised would help make treaties more user friendly and future proof their application.

It is stated UK Government policy to promote open and sustainable investment. In support of this the UK imposes no dividend withholding, limited interest withholding and a capital gains tax regime which in the main exempts securities and portfolio investment. It is encouraging that this approach is mirrored in HMRC's negotiating stance internationally, and that as part of treaty negotiations the UK stresses the need for reciprocity and a willingness to promote fair and equitable investment with our international partners.

More specifically, as we have mentioned in last year's response, the recent loss of the UCITS brand and the negative impact this has had on withholding taxes suffered across the EU has meant UK funds are now materially less competitive that they were before the UK's departure from the EU.

Country	EU Current Rate	Treaty rate
Italy	0%	15%
Spain	1%	10%
Norway	0%	15%
Sweden	0%	5%
Greece	0%	5%

[1] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1053909/Final_UK_Funds_Regime_Review_-_Call_for_Input_Summary_of_Responses.pdf

Poland	0%	10%
Slovenia	0%	15%

The 2021/22 Network review acknowledges that HMRC Treaty Team are seeking to prioritise the renegotiation of European DTAs to attempt to replicate benefits offered under the Interest & Royalty and Parent/Subsidiary Directives. **We ask that these renegotiations must also include replication of the beneficial treaty rates available to EU-based Collective Investment Vehicles to UK funds.**

This then links to Q3.1 and instances where UK protocols may be uncompetitive compared their peer group. Members have offered a few examples of issues experienced.

Japan	**Article 22(2)(e)**	**Limitation of Benefits**
The Japanese Authorities going beyond the 50% provision to ensure every member of Linked Pension Scheme is UK resident		

Switzerland	**Article 18 DTA & MoU - Pensions b)**	**Pensions**
The Swiss Authorities using the 2008 MoU to ensure every member of Linked Pension Scheme is UK resident		

India	**Article 4**	**Residence**
The Indian authorities refuse to consider an Authorised Unit Trust as a body corporate and are therefore unable to access the reduced 10% withholding rate		

Details of these problems are covered in greater detail in Annex B.

These provisions are not necessarily uncompetitive in of themselves. They are merely replications of generic text from Model Conventions but because of their imprecision allow international tax authorities the freedom to interpret these provisions either unhelpfully or incorrectly under the relevant Articles.

In these examples, the loss of treaty access for Linked Pensions and Authorised Unit Trust is merely a symptom of treaties not being tailored for the jurisdictions utilising them, and the texts need to work hand in glove with the legal definitions of the users.

In answer to this issue, the most obvious improvement would be specific wording of named vehicles within a treaty. This would be the best place to lock in benefit entitlement and can help avoid disagreements of understanding and interpretation between taxpayers and tax authorities at later dates.

We warmly welcome the commitment made as part of the UK Fund Regime Summary of Responses that the Treaty Team will, where possible, "*seek to clarify the status of particular fund structures with partner countries where necessary*"[2]. Ideally this should include specific mention for a range of investment vehicles and their entitlement as both a Person and a Resident under the treaty.

[2] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1053909/Final_UK_Funds_Regime_Review_-_Call_for_Input_Summary_of_Responses.pdf

Included below a list of provisions and template wording in other treaties and conventions which the UK could seek to replicate within the Network:

REITs	US Model Tax Convention
CIVs	Various, OECD Model Tax Convention
Transparent Entities	Various recent Irish treaties
Unit Linked Pensions	USA / UK Competent Authority Agreement

This list is obviously not exhaustive but is reflective of other tax authorities seeking to protect treaty entitlement for their taxpayers through incontestable text.

There are also generalised provisions HMRC could seek to make to the UK's Treaty Network. One such area could be to place less onerous limitations on access to relief, moving away from terms like "wholly" or "exclusively" and to focus on more reasonable phrases like "majority", "predominantly" or de minimis percentages. We note this is a particularly challenging area for unit-linked pensions and instances where providers are required to prove the entirety of schemes are for UK residents.

These are just some of the ways that UK conventions could be made materially more competitive, and we would be keen to consult further with the Treaty Team on setting out standardised, but still customisable text for UK fund structures. HMRC could then be confident they were deploying a best-in-class version of their own hybridised Model Convention, suited to the UK's needs, offering superior access for taxpayers and likely preventing many already avoidable treaty disputes.

Q3. Are there aspects of our existing DTAs that are un-competitive compared with agreements our treaty partners have made with other countries?

3.1 If so, please provide specific provisions in other countries' DTAs that provide more favourable treatment than the equivalent UK DTA.
3.2 Has this affected your decision to undertake a project, investment or other cross-border activity in a specific country? Please provide specific examples of where this has impacted on commercial decisions to the detriment of the UK.

Our answer to this question is included within the response to Q2.

Q4. Are there any gaps in our DTA network?

4.1 If so, to what extent is activity in this country/these countries inhibited by the lack of a DTA? Please provide specific examples where projects, investments or other activities were impeded or did not go ahead because of the lack of a DTA and why the lack of a DTA was a major factor in this.
4.2 Are you able to forecast what level of cross-border activity would likely be facilitated by an agreement?

The IA is supportive of the UK negotiating a double tax agreement with Brazil. We do however note that the Brazilian Government has announced its intention to introduce a new 15% withholding tax on dividends paid to non-residents.

While the date of this new regime has yet to be finalised any treaty negotiation should as part of the DTA attempt to bring this rate lower, ideally to 0%, as a comparable level to what our government offers to Brazilian investors investing in the UK.

Annex A

Switzerland WHT Analysis

5 Year Dividend Yield

	Name	Market Cap	5 Year Dividend Yield	Reference
1	Nestlé	$355.93bn	2.55%	
2	Roche	$331.70bn	2.99%	
3	Novartis	$192.99bn	3.46%	
4	Chubb	$86.72bn	2.04%	
5	Richemont	$81.78bn	1.92%	
		Average	2.59%	

	Investment in UK Regulated Products (ex Fund of Funds)	Switzerland Investment	
2021	£1,386,582,237,546	£31,174,504,569	Actual
2020	£1,248,269,465,448	£28,064,820,896	Estimated
2019	£1,163,672,978,908	£26,162,839,546	Estimated
2018	£1,046,979,594,024	£23,539,224,183	Estimated
2017	£1,160,588,718,633	£26,093,496,175	Estimated
2016	£1,021,600,610,841	£22,968,628,941	Estimated
2015	£901,964,195,326	£20,278,845,471	Estimated*
		£178,282,359,780	
	Estimate Dividend Yield	2.59%	*Included as some members had not filed these claims before issues manifested in 2016
	Cumulative Dividend Estimate	£4,621,078,766	
	Withholding Tax @ 35%	**£1,617,377,568**	
	Potential Reclaim @ 20%	**£924,215,753**	

We have also been provided individual member data on the £ value of their outstanding Swiss reclaims. These amounts have been shared confidentially but the £924m estimate above falls firmly within the high vs low range when modelled on manager-by-manager exposure.

Annex B

Attached separately to this document is our 2021 submission and a link to the file can be found here.