# Global tax and investor reporting
# **Converting risk into investor value**


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In the previous article of our "Global Tax and Investor Reporting" series for *Performance Magazine*, we discussed the opportunities for and drivers of operational model changes for fund tax departments. The significant increase in fund complexity and rapid global growth of the asset management industry continues to stretch the capacity of the fund tax teams and expose vulnerabilities, leaving the door open for potential investor and regulatory risk.

An in-depth look at how a fund tax department operates and an assessment to identify and close any gaps may be highly beneficial, not only to mitigate risk, but also to add the value that the benefits arising from planning and continual reassessment can provide.

The regulatory environment has changed significantly since the independent market research that Deloitte commissioned in 2013 to explore certain areas of the asset management industry, and change continues to be the norm. Regulatory bodies and tax authorities across the globe are attempting to close revenue gaps by putting significant enforcement mechanisms in place, such as the Foreign Account Tax Compliance Act (FATCA) in the United States and regulations stemming from the Base Erosion and Profit Shifting (BEPS) project in the Organization for Economic Co-operation and Development (OECD). Meanwhile, asset managers are struggling to implement technology and operational changes to keep investor and regulatory risk to a minimum.

There is a clear duality when thinking about the asset management industry: the dichotomy between actions taken for value creation and those arising from regulatory requirements.

Investors challenge their asset managers to expand their services into new markets and launch creative products, so how can asset managers find the right balance between meeting the demands of their investors by expanding into new markets and products while also containing the cost of risk mitigation measures required as a result of more oversight? Moreover, how can asset managers turn the cost of risk mitigation into a benefit for their investors?

**Case study: utilizing the data required for the Global Exchange of Information**

In 2012, the United States introduced the new tax regulation FATCA, which requires non-US financial institutions to report profits earned by their US account holders. The US government reportedly stands to receive up to US$8 billion over the next 10 years[1] by reporting from US taxpayers who earn income abroad but fail to report and pay tax on that income.

The implementation of US FATCA can cost large multinational financial institutions millions of dollars: costs that may be passed along to investors. However, non-compliance is not an alternative.

The financial penalties and tax withholding would be significant and the reputational cost may be immeasurable. Some foreign financial institutions have indicated that they are not willing to take on the risk and costs associated with having US investors and have closed accounts belonging to such investors to minimize the possibility of compliance mishaps.

*1 Joint Committee on Taxation, JCS-6-10, Estimated Revenue Effects of the Revenue Provisions Contained in an Amendment to the Senate Amendment to the House Amendment to the Senate Amendment to H.R. 2847, the Hiring Incentives to Restore Employment Act.*

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However, US FATCA is only the start. In 2017, a global exchange of investor information from financial institutions in nearly 100 countries will commence under the OECD's Common Reporting Standards (CRS) regime. The OECD has drawn inspiration from the FATCA Model 1 Intergovernmental Agreement in the development of the CRS, and the approach was developed to maximize efficiency while minimizing implementation costs for financial institutions by leveraging the work already done for FATCA compliance.

Investors are challenging their asset managers to find new market opportunities and the result is often that asset managers are becoming responsible for meeting compliance requirements in more countries. This is a new era of cross-border information sharing and, as asset management companies grow, they need to be prepared to meet requirements that involve sharing more data with global tax authorities.

Controlling the risks associated with global information reporting involves a great deal of preparation. For example, process and procedure documents need to be put in place and due dates and reporting requirements need to be tracked. Perhaps the most significant element in reducing risk comes from reviewing systems and data. Ideally, global investor demographic data is stored in one system so that data can be leveraged across the products in which they invest, reducing both the need for multiple client on-boarding documentation requests and the likelihood of a data conflict.

The more global a firm is, the more critical it is that their systems and data are centralized. The centralization of the data into a refined, streamlined system not only helps to address the current global information exchange requirements, but also facilitates a quicker response to requirements encountered in future growth and reduces the risk of incorrect information being reported.
Given the increased regulatory burden to which asset managers are currently subject, and the large volumes of data being collected to meet these requirements, consideration must be given to how best to utilize this information to generate value for investors through other opportunities. Data analytics can play a large role in creating value for clients. For example, the proliferation of data in respect to products and investors may enable an asset manager to determine the incidence of withholding tax leakage on investment income. Tax may have arisen due to treaty claims as well as other deductions. Clearly, fund structuring may be relevant to mitigate tax costs but funds should consider which taxes could potentially be reduced at the source or reclaimed under domestic, treaty, or other provisions.

### Case study: embracing the compliance obligations of the European Union member states

One area which has seen significant developments in the last few years is the potential to reclaim previously irrecoverable withholding tax levied on dividends paid by companies in the European Union.

One of the primary objectives of the EU is the establishment of the common market—an area in which the free movement of goods, services, persons, and capital is enabled. On joining the EU, member states commit to adhering to the principle of the supremacy of EU law.

There are a number of case law examples from the Court of Justice of the European Union which indicate that, in principle, when the investment vehicles of two EU member states are comparable, it is contrary to the principle of the free movement of capital for the non-resident investor to be subject to a higher overall tax burden than a resident in receipt of the same income. Significantly, the territorial scope of the free movement of capital extends to third-country (non-EU) nationals by virtue of the European Treaty. The court has confirmed that, in principle, funds based in third countries can rely on the free of movement of capital principle in the same manner as funds based in the EU. In addition, it is important that adequate exchange of information and mutual assistance provisions are in place between the two countries.

The opportunity for global investment funds to consider filing refund claims is far reaching. To date, many funds have submitted claims to various European tax authorities seeking repayment of withholding tax that has been paid contrary to EU law.

As a result, European governments have responded in various ways:

- A number of member states have already amended their legislation in order to remove the difference in treatment between certain resident and non-resident investors.
- Some countries, such as Sweden and Finland, have made withholding tax repayments to European Collective Investment Vehicles (UCITS) entities for some time now and have recently commenced repayments to US Regulated Investment Companies.
- France, Poland, and Spain are routinely making repayments to UCITS entities, yet, despite positive case law developments elsewhere, they have been slower to recognize the comparability of US mutual funds to the relevant domestic entities.
- In other markets such as Germany and Italy, the claims process is not as developed and litigation may be necessary in order to settle claims.
- Further opportunities for potential cost synergies include the possibility of applying for relief at the source in various markets.

It is not only UCITS and US mutual funds that have received repayments of withholding taxes. Third-country sovereign wealth funds were also able to submit claims and have been successful in receiving refunds in a number of markets.

Aside from the legal developments across the EU there are other initiatives affecting this area. The OECD Treaty Relief and Compliance Enhancement (TRACE) project, which was devised to create a uniform mechanism for claiming withholding tax relief by authorized intermediaries on behalf of portfolio investors in funds, is expected to attract more attention in light of recent developments on global information exchange (FATCA/CRS). Separately, the European Commission is currently reviewing the process and the time limits for European governments to settle withholding tax reclaims.By leveraging existing available information, asset managers may have the opportunity to provide increased returns to their investors, as well as demonstrate effective governance and stewardship for managing investment portfolios.

An asset manager's ability to move from risk containment to adding value and demonstrating due diligence in finding increased shareholder return is key to investor satisfaction in a very competitive industry

### Conclusion

Taking on risk mitigating measures, particularly to meet regulatory compliance requirements, can be a daunting, costly, and time-consuming task with no clear benefits for investors. However, the quality and volume of the data that has been collected as a result of these efforts can be beneficial to asset managers in identifying opportunities to reclaim withheld tax or offer a new product in a new jurisdiction quickly and efficiently. An asset manager's ability to move from risk containment to adding value and demonstrating due diligence in finding increased shareholder return is key to investor satisfaction in a very competitive industry.

**To the point:**

- Investors are pushing their asset managers to be more global in their product offerings and investment opportunities
- There is risk associated with the increased tax authority oversight as a result of the asset managers distributing their products in new jurisdictions
- Risk mitigation measures, like collecting more data on investors, can be costly with no perceived benefit
- However, a forward looking investment manager may use this to identify opportunities to increase shareholder return