ETF taxation report for Thailand investors 2018

Commissioned by:

HKEX

香港交易所

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Introduction

Exchange Traded Funds (ETFs) continue to gain popularity by investors as an efficient mechanism to gain a broad array of desired market exposure. Whilst return on investment (ROI) is a key priority, costs play an important role in maximizing ROI. One significant yet lesser understood cost with investing in ETFs is taxation. This is especially true for any cross-border investments which are normally subject to multiple instances of taxation.

In this report we will examine the impact of different types of ETFs on Thailand based investor returns across key markets, ETF types and domiciles.

Multiple instances of taxation on ETFs

An investor's ETF returns can generally be subject to tax at three levels:

- **Investment level –** Withholding tax (WHT) on interest, dividends and capital gains in the source jurisdiction of investment
- **Fund level –** Taxes applied at the fund level including direct taxes, net asset taxes and stamp duty/transaction taxes
- **Investor level –** WHT on ETF distributions to the investor and tax on exit

The extent of tax cost impacting an investor's returns will vary widely depending on the domicile and type of ETF, domicile of the investor and jurisdiction of the underlying securities within the ETF.

Of these factors, the domicile and type of ETF will be especially important because this will dictate:

- The rate of WHT applied at both the investment and investor levels
- The taxes applied at the fund level (if any)
- The requirements that must be satisfied for treaty access where available

Key ETF markets

Thailand investors have typically sort out exposure to the following markets: Hong Kong, India, Japan, Mainland China, South Korea, Singapore, Taiwan, Germany, the United Kingdom and the United States.

Investors may seek out both single jurisdiction ETFs as well as broader regional or global ETFs to meet their exposure needs.

Types of ETFs compared

Common forms of ETFs include the following:

- Hong Kong domiciled funds, listed on the HKEX
- Irish Collective Asset-management Vehicle (ICAV) authorized as an Undertaking for Collective Investment in Transferable Securities (UCITs)
- Luxembourg Société d'Investissement à Capital Variable (SICAV)/Société d'Investissement à Capital Fixe (SICFs)
- US Regulated Investment Companies (RICs)
- Thailand mutual funds (Thailand Funds)

In order to demonstrate the potential differences in after tax returns on interest and dividends for Thailand residents investing through these types of ETFs, we have prepared the following analysis. Please note, this analysis is general in nature.

The following analysis considers only the impact of tax on dividend and interest income. It will also be important to consider the impact of tax on disposals of shares giving rise to capital gains and the availability of foreign tax credits.

Assumptions

The requirements to obtain treaty benefits are complex and varied and may include the ability of the fund to obtain a certificate of residency or demonstrate to the local tax authority that it, or persons who could claim similar benefits, are the beneficial owners of such income. These requirements may be more difficult to satisfy in particular jurisdictions.

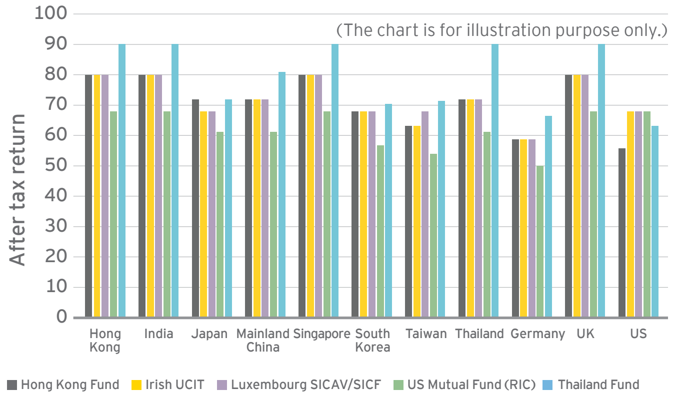
In preparing our analysis, we have made the following specific assumptions:

1. The US ETF will qualify as a RIC for the relevant year and satisfy the relevant annual distribution requirements such that it should not be subject to US federal income tax on its investment company taxable income distributed to stockholders
2. The Irish UCIT's principal class of shares is substantially and regularly traded on a recognized stock exchange
3. All investors are non-listed institutional corporate investors and tax residents in Thailand and are eligible for the partial exemption of domestic corporate income tax in respect of distributions received from Thailand Fund
4. In making the comparison, it has been assumed that Thailand Fund will not be able to obtain a certificate of residency for the purpose of enjoying tax treaty benefits

Ultimately, the ability to claim treaty benefits by the ETF or Thailand investor will depend on their individual facts and circumstances. These requirements should be assessed in detail before making any investment decision.

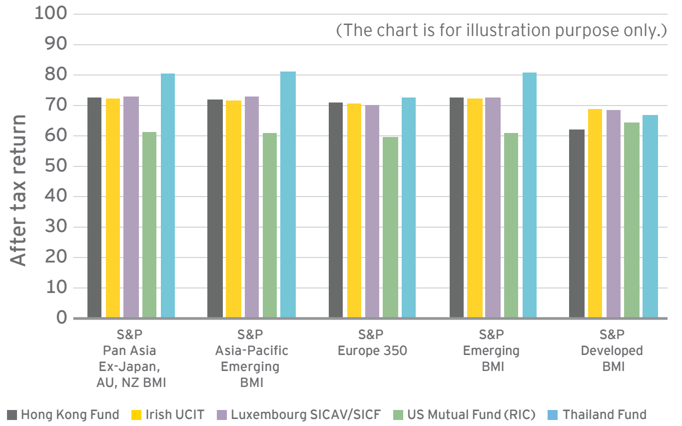
Thailand investor after tax returns compared

Figure 1. Thailand investor after tax return for dividends



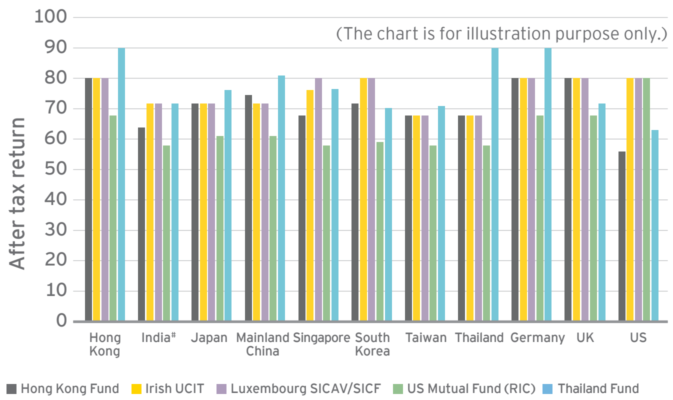
The German dividend withholding tax rate reflected above is the statutory withholding tax rate at source, i.e., 26.4%. A better outcome may be achieved where tax treaty relief can be availed.

Figure 2. Thailand investor after tax return for dividends from indices



Based on index constituents' jurisdiction domicile as of 31 December 2017 provided by the HKEX

Figure 3. Thailand investor after tax return for interest from corporate bonds



#Please note that Hong Kong and India recently signed a double tax avoidance agreement (DTAA) on 19 March 2018 which is pending ratification. A reduced withholding tax rate may be available for interests arising from corporate bonds in India invested via Hong Kong Funds after the tax treaty enters into force.

Key findings

Our analysis demonstrates that Thailand Funds are the most tax efficient ETF vehicles for Thailand investors across all jurisdictions (with the exception of the US assuming that the Fund will not be able to obtain a certificate of residency for the purpose of enjoying tax treaty benefits).

Notwithstanding the above, Thailand investors may seek to invest into ETF vehicles domiciled outside of Thailand for a number of non-tax reasons. For example, potentially lower fees for investing into ETF vehicles offered in larger markets (such as Hong Kong, US, Ireland and Luxembourg) and the wider range of underlying investments in these markets (e.g., access to China A shares through investing into Hong Kong domiciled ETFs).

When comparing ETF Funds offered in these other markets, our analysis demonstrates that Hong Kong domiciled funds are tax efficient for Thailand investors compared to other popular vehicles except when investing into US and Taiwan listed equities. Our analysis also demonstrates that US RICs generally offer the highest rate of withholding taxes for Thailand investors, with the exception of investing into underlying US equities. Both conclusions are broadly consistent when comparing popular indices*.

Similarly, from a corporate bond perspective, Hong Kong Funds generally remain competitive, especially in respect of Mainland China, with a few key exceptions (Indian, Singaporean, South Korean and US bonds).

*Based on index constituents' jurisdiction domicile as of 31 December 2017 provided by the HKEX.

Conclusion

Hong Kong domiciled ETFs have traditionally been recognized for their unique access to the domestic market of Mainland China. However, with the HKEX now carrying over 130 ETFs[1] representing a wide range of global markets, investors now have an enhanced ability to use Hong Kong ETFs to achieve their desired market exposures.

Furthermore, Hong Kong's expanding treaty network and domestic tax rules offer significant benefits for Thailand based investors seeking to invest via foreign domiciled ETFs to gain exposure to other Asian and global markets.

Thailand investors should however be aware of the potential costs of investing into certain markets through a Hong Kong domiciled fund, such as the US.

1 Source: HKEX official webpage (May 2018)

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HKEX launched the ground-breaking Shanghai-Hong Kong Stock Connect programme in 2014, allowing international investors to connect easily with Mainland China's stock market for the first time. The scheme was expanded with the launch of Shenzhen Connect in 2016 and extended to another asset class with the launch of Bond Connect in 2017.

There are over 130 ETFs and Leveraged & Inverse Products in Hong Kong providing access to a world of asset classes, markets and strategies. Quickly becoming Asia's ETF marketplace, HKEX has a diverse, liquid and tax efficient product offerings during Asian trading hours.

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