ETF taxation report for investors 2019

Singapore

Commissioned by:

HKEX
香港交易所

EY 安永
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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 access. 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 investment which are normally subject to multiple instances of taxation.

In this report we will examine the impact of different types of ETFs on Singapore 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

- Withholding tax (WHT) on interests, dividends and capital gains
- Stamp duty/transaction taxes on investments

ETF

- Taxation of the fund (if any)
- WHT on distributions by the fund

Investor

- Taxation of the investor
  - Tax on income, capital gains, estate tax, etc.
  - Dependent on investor profile
- Availability of foreign tax credits

The extent of tax costs will vary widely depending on:

1. Domicile of the investor
2. Domicile and type of ETF*
3. Jurisdiction of the underlying portfolio investments

* Especially important because this should have an impact on the following:

- The applicable WHT rate at both the investment and investor levels
- The applicable taxes at the fund level
- Access to any available tax treaty benefits

Types of ETFs compared

Common forms of ETFs compared in this report include the following:

- Hong Kong domiciled fund, listed on the HKEX
- Irish Collective Asset-management Vehicle (ICAV) authorized as an Undertaking for Collective Investment in Transferable Securities (UCIT)
- Luxembourg Société d'Investissement à Capital Variable (SICAV)/Société d'Investissement à Capital Fixe (SICAF)
- US Regulated Investment Company (RIC)
- Singapore Unit Trust (Singapore Fund)

Basis of analysis

1. General in nature
2. Only consider the impact of tax on dividend and interest income
3. Also important to consider the impact of tax on exit giving rise to capital gains and the availability of foreign tax credits

Assumptions

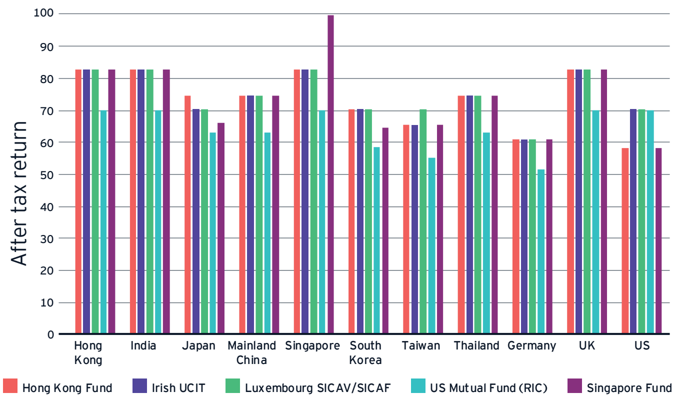
- The US ETF will qualify as a RIC for the relevant year and satisfy the relevant annual distribution requirements such that it should not be subject to US federal income tax on its investment company taxable income distributed to stockholders
- The Irish UCIT's principal class of shares is substantially and regularly traded on a recognized stock exchange
- All funds are eligible to enjoy the portfolio interest exemption in the US
- ETF distributions will be remitted or deemed remitted to Singapore
- The Singapore corporate bonds are Qualifying Debt Securities ("QDS")
- All investors are institutional corporate investors and tax residents in Singapore**
- In making the comparison, it has been assumed that the Singapore 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 Singapore investor or the ETF will depend on their individual facts and circumstances, e.g., whether they can demonstrate to the local tax authority that they are the beneficial owners of such income. These requirements should be assessed in detail.

Singapore investor after tax returns compared

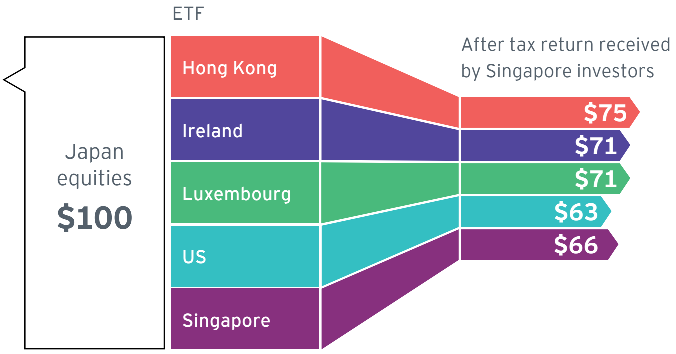
Figure 1. Dividends from equities

(The chart is for illustration purpose only.)



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.

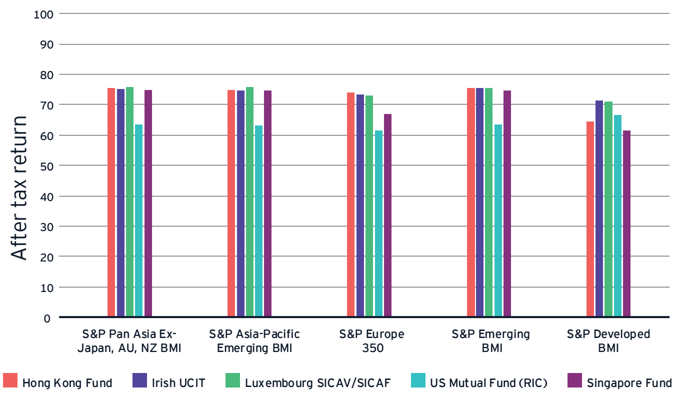
Illustrative diagram for Japan equities (Figure 1)



By investing in Japan equities through a Hong Kong Fund, Singapore investors would receive 75% after tax return for dividends versus 63% using an US Mutual Fund.

Figure 2. Dividends from indices

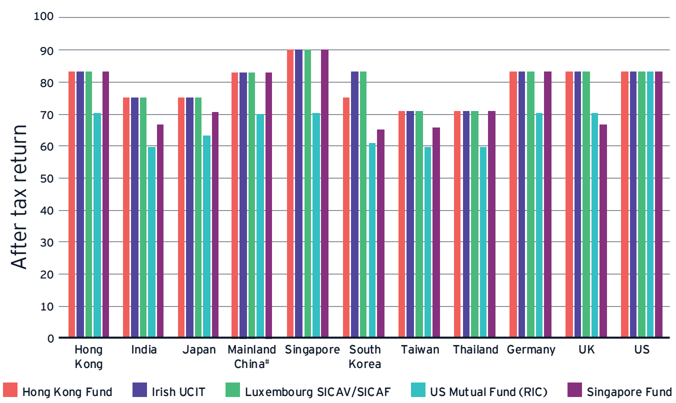
(The chart is for illustration purpose only.)



Based on index constituents' jurisdiction domicile as of 31 December 2018

Figure 3. Interest from corporate bonds

(The chart is for illustration purpose only.)



Non-resident institutional investors are temporarily exempt from WHT with respect to interest income derived from Mainland China corporate bonds (up to 6 November 2021).

Key findings

In general, Hong Kong ETFs offer a tax efficient mechanism for Singapore investors to access popular overseas markets. When investing into Singapore equities, Singapore Fund should be more efficient. Also, when investing into US equities, certain other platforms could be more tax efficient.

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 Singapore based investors seeking to invest via Hong Kong ETFs to gain exposure to other Asian and global markets.

Singapore 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 (March 2019)

Contact EY

Elliott Shadforth
Wealth and Asset Management Leader
Ernst & Young, Hong Kong
+852 2846 9083
elliott.shadforth@hk.ey.com

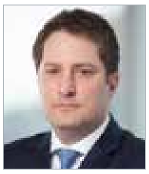
Rohit Narula
Partner, Financial Services Tax
Ernst & Young Tax Services Limited
+852 2629 3549
rohit.narula@hk.ey.com

Desmond Teo
EY Asean Wealth & Asset Management and CRS Tax Leader
Ernst & Young Solutions LLP
+65 6309 6111
desmond.teo@sg.ey.com

May Tay
Director, Financial Services Tax,
Ernst & Young Solutions LLP
+65 6535 7777
may.tay@sg.ey.com

Ming Lam
Senior Manager, Financial Services Tax
Ernst & Young Tax Services Limited
+852 2849 9265
ming.lam@hk.ey.com

Contact HKEX



Brian Roberts
Head of Exchange Traded Products,
Hong Kong Exchanges and Clearing Limited
+852 2840 3396
brianroberts@hkex.com.hk

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