

ETF taxation report for investors

Hong Kong

September 2022



Commissioned by:



Introduction

Exchange Traded Funds (ETFs) continue to gain popularity by investors as an efficient mechanism to gain a broad array of desired market access. While 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, EY teams examine the impact of different types of ETFs on Hong Kong-based investor returns across key markets, ETF types and domiciles.

Types of ETFs compared

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

Hong Kong ETF

Hong Kong unit trust authorized by the Securities and Futures Commission of Hong Kong

Luxembourg ETF

Capital company constituted as a Société d'Investissement à Capital Variable (SICAV)/ Société d'Investissement à Capital Fixe (SICAF)

Irish ETF

Irish Collective Asset-management Vehicle (ICAV) authorized as an Undertaking for Collective Investment in Transferable Securities (UCITS)

US ETF

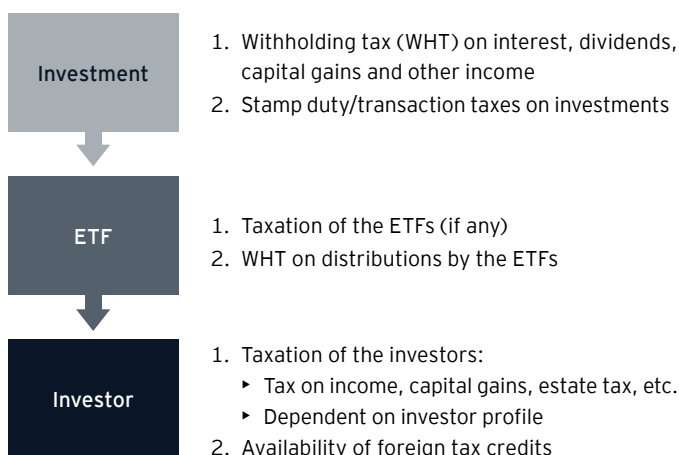
Regulated Investment Company and satisfies specific requirements

General basis of preparation

1. This Report is general in nature.
2. It does not consider any transfer taxes such as stamp duty.
3. It considers only income tax/WHT effect on dividend and interest income received by the ETFs, and excludes capital gains tax or tax on trading profits/losses.
4. The distribution from ETFs are considered to be normal dividend and/or distribution (practically subject to local variances).
5. All investors are institutional corporate investors and tax residents in their domicile location(s), and subject to standard corporate income tax rate. Individual circumstances have not been considered.
6. To the extent domestic unilateral tax credit is available and considered, it is assumed that the necessary criterion are satisfied and the available tax credit will be within the prescribed limit.
7. Some jurisdictions may have regulatory restrictions on cross-border investments. Investors should seek separate legal and regulatory advice in this regard as this Report focuses solely on the potential tax implications of investing into different types of ETFs.
8. It does not consider any EU non-discrimination directives or relevant rules.

Multiple instances of taxation on ETFs

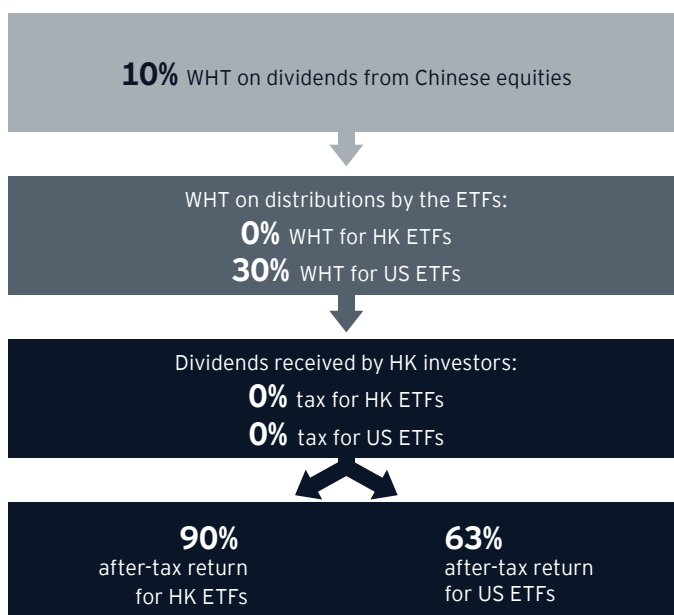
An investor's ETF returns can generally be subject to tax at three levels:



The extent of tax costs will vary widely depending on:

1. Domicile of the investor
2. Domicile and type of ETF¹
3. Jurisdiction of the underlying portfolio investments

Illustration using MSCI China Index ETFs:



This Report is prepared for informational purposes and supported by the ETF Tax Calculator. It sets out the key summary of the preparation basis as well as underlying assumptions. For more details, please visit: www.hkex.com.hk/ETFTaxCalculator.

Hong Kong investor after-tax returns compared

Figure 1 below depicts the percentage of expected after-tax return for institutional corporate investors from investing into different domiciled ETFs which seek to track the investment results of the same selected single market equity index. It is assumed that different domiciled ETFs tracking the same index would generate the same ETF distribution before all level of taxes.²

Figure 1. Single-market equity indices³

Index	After-tax return
MSCI China	Hong Kong ETF 90%
	Luxembourg ETF 90%
	Irish ETF 90%
	US ETF 63%
MSCI Hong Kong	Hong Kong ETF 100%
	Luxembourg ETF 100%
	Irish ETF 100%
	US ETF 70%
MSCI Taiwan	Hong Kong ETF 79%
	Luxembourg ETF 79%
	Irish ETF 79%
	US ETF 55%
MSCI Japan	Hong Kong ETF 90%
	Luxembourg ETF 85%
	Irish ETF 85%
	US ETF 63%
MSCI USA	Hong Kong ETF 70%
	Luxembourg ETF 70%
	Irish ETF 85%
	US ETF 70%

Consider total cost of ownership (TCO) including tax

This Report provides evidence that significant differences can arise in after-tax returns for ETFs domiciled in different jurisdictions. However, tax should not be the only consideration in ETF selection. Investors should evaluate ETF investment costs in the context of the TCO, including but not limited to bid-ask spread, broker commissions, total expense ratio and taxation. For more details about TCO, please read the *ETF Total Cost of Ownership primer* in the HKEX ETF webpage.

Why Hong Kong ETFs?

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 more than 160 ETFs and Leveraged and Inverse Products representing a wide range of global products, investors now have an enhanced ability to use Hong Kong ETFs to achieve their desired market exposures.

Furthermore, Hong Kong's ETF market, as a regional issuing and trading hub of ETFs, is seeing deepening liquidity driven by a continuously enhancing market structure. This translates into narrower bid-ask spread and lower trading cost for investors seeking to gain exposure to Asia and beyond via Hong Kong ETFs.

Investors can also benefit from lower tracking difference, which is a component of TCO, by trading Asia underlyings in the Asian time zone with Hong Kong ETFs as they can react to events occurring in Asia more timely.

Hong Kong ETFs may offer a tax-efficient, low-cost vehicle for investors to access a diverse range of asset classes and markets.

To learn more about Hong Kong ETFs, please visit the HKEX ETF webpage www.hkex.com.hk/etp.

To see the after-tax returns comparison on more indices, please visit: www.hkex.com.hk/ETFTaxCalculator.

Notes:

- 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 ETF level
 - Access to any available tax treaty benefits
- This includes portfolio level, ETF level and investor level, and does not take into account any fees to intermediates.
- This Report is prepared based on the index constituents data and the applicable tax rates as of 30 June 2022. The index constituents data is provided by MSCI. For MSCI indices, the jurisdiction classification is generally determined by the company's location of incorporation and the primary listing of its securities.

Contact EY teams



Elliott Shadforth

EY Asia-Pacific Wealth & Asset Management Sector Leader, Ernst & Young
+61 2 9248 4546
elliott.shadforth@au.ey.com



Rohit Narula

EY Asia-Pacific FSO International Tax & Transaction Services Leader, Ernst & Young Tax Services Limited
+852 2629 3549
rohit.narula@hk.ey.com



Paul Ho

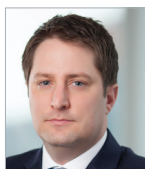
Partner, Financial Services Tax Leader, Ernst & Young Tax Services Limited
+852 2849 9564
paul.ho@hk.ey.com



Ming Lam

Partner, Financial Services Tax Ernst & Young Tax Services Limited
+852 2849 9265
ming.lam@hk.ey.com

Contact HKEX



Brian Roberts

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

HKEX Disclaimer

The information contained in this document is for general informational purposes only and does not constitute an offer, solicitation, invitation or recommendation to buy or sell any securities or other products or to provide any investment advice or service of any kind. This document is not directed at, and is not intended for distribution to or use by, any person or entity in any jurisdiction or country where such distribution or use would be contrary to law or regulation or which would subject Hong Kong Exchanges and Clearing Limited, The Stock Exchange of Hong Kong Limited ("SEHK") (together, the "Entities", each an "Entity"), or any of their affiliates, or any of the companies that they operate, to any registration requirement within such jurisdiction or country.

No section or clause in this document may be regarded as creating any obligation on the part of any of the Entities. Rights and obligations with regard to the trading, clearing and settlement of any securities effected on SEHK shall depend solely on the applicable rules of SEHK and the relevant clearing house, as well as the applicable laws, rules and regulations of Hong Kong.

The information contained in this document is produced by Ernst & Young Tax Services Limited and MSCI Limited. Neither of the Entities is responsible for the content or guarantees the accuracy, validity, timeliness or completeness of the information or data, and the Entities and the companies that they operate shall not accept any responsibility for, or be liable for, errors, omissions or other inaccuracies in the information or for the consequences thereof. The information set out in this document is provided on an "as is" and "as available" basis and may be amended or changed. It is not a substitute for professional advice which takes account of your specific circumstances and nothing in this document constitutes legal advice. Neither of the Entities shall be responsible or liable for any loss or damage, directly or indirectly, arising from the use of or reliance upon any information provided in this document.

EY | Building a better working world

EY exists to build a better working world, helping to create long-term value for clients, people and society and build trust in the capital markets.

Enabled by data and technology, diverse EY teams in over 150 countries provide trust through assurance and help clients grow, transform and operate.

Working across assurance, consulting, law, strategy, tax and transactions, EY teams ask better questions to find new answers for the complex issues facing our world today.

EY refers to the global organization, and may refer to one or more, of the member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients, nor does it own or control any member firm or act as the headquarters of any member firm. Information about how EY collects and uses personal data and a description of the rights individuals have under data protection legislation are available via ey.com/privacy. EY member firms do not practice law where prohibited by local laws. For more information about our organization, please visit ey.com.

© 2022 EYGM Limited.
All Rights Reserved.

EYG no. 007544-22Gbl

BMC Agency
GA 161947949

ED None

ey.com

About HKEX

HKEX is one of the world's major exchange groups, and operates a range of equity, commodity, fixed income and currency markets. HKEX is the world's leading IPO market and as Hong Kong's only securities and derivatives exchange and sole operator of its clearing houses, it is uniquely placed to offer regional and international investors access to Asia's most vibrant markets.

HKEX is also the global leader in metals trading, through its wholly owned subsidiaries, The London Metal Exchange (LME) and LME Clear Limited. This commodity franchise was further enhanced with the launch of Qianhai Mercantile Exchange (QME), in China, in 2018.

HKEX launched the pioneering Shanghai-Hong Kong Stock Connect programme in 2014, further expanded with the launch of Shenzhen Connect in 2016, and the launch of Bond Connect in 2017. In 2022, the Stock Connect programme is broadened to include ETFs.

There are more than 160 ETFs and Leveraged & Inverse Products listed in Hong Kong, providing access to a range of asset classes, markets and strategies. As Asia's ETF marketplace, HKEX offers diverse, liquid and tax efficient product offerings during Asian trading hours.

www.hkex.com.hk/ETP

EY Disclaimer

This Report has been prepared for general information purpose only and is not intended to be relied upon as accounting, tax, legal or other professional advice. Please refer to your advisors for specific advice. In preparation or updating of the information of this Report, EY has relied upon underlying data on a specific date (as indicated in this Report) and applicable prevailing tax regulations, interpretations and practices of the domicile of investors as at the time the information of this Report is being prepared and updated. Proposed and recently enacted changes or amendments in the relevant local tax regulations, interpretations and practices may not be timely captured and reflected in this Report. EY is not responsible for the accuracy, validity and completeness of other parties' data and the results produced by this Report.

No duty of care is owed by EY to any recipient of this Report in respect of any use that such recipient may make of this Report. No claim or demand or any actions or proceedings may be brought against EY arising from or connected with the contents of this Report or provision of this Report to any recipient. No reliance may be placed upon this Report or any of its contents by any recipient of this Report for any purpose. A recipient must make and rely on their own enquiries in relation to the issues to which this Report relates, the contents of this Report and all matters arising from or relating to or in any way connected with this Report or its contents.

EY makes no representations as to the appropriateness, accuracy or completeness of this Report for any recipient's purposes.

MSCI Disclaimer

The MSCI information may not be reproduced or disseminated in any form and may not be used as a basis for or a component of any financial instruments or products or indices. None of the MSCI information is intended to constitute investment advice or a recommendation to make (or refrain from making) any kind of investment decision and may not be relied on as such. Historical data and analysis should not be taken as an indication or guarantee of any future performance analysis, forecast or prediction. The MSCI information is provided on an "as is" basis and the user of this information assumes the entire risk of any use made of this information. MSCI, each of its affiliates and each other person involved in or related to compiling, computing or creating any MSCI information (collectively, the "MSCI Parties") expressly disclaims all warranties (including, without limitation, any warranties of originality, accuracy, completeness, timeliness, non-infringement, merchantability and fitness for a particular purpose) with respect to this information. Without limiting any of the foregoing, in no event shall any MSCI Party have any liability for any direct, indirect, special, incidental, punitive, consequential (including, without limitation, lost profits) or any other damages. (www.msci.com)