ETF taxation report for investors

Kingdom of Saudi Arabia

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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. 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 Kingdom of Saudi Arabia-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 Zakat/tax on trading profits/losses.
4. The distribution from ETFs is considered to be normal dividend and/or distribution (practically subject to local variances).
5. All investors are institutional corporate investors and tax residents and nationals of Kingdom of Saudi Arabia, and subject to standard corporate income tax rate/Zakat, where applicable. 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 is 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:

Investment

1. Withholding tax (WHT) on interest, dividends, capital gains and other income
2. Stamp duty/transaction taxes on investments

ETF

1. Taxation of the ETFs (if any)
2. WHT on distributions by the ETFs

Investor

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

The extent of tax costs will vary widely depending on:
1. Nationality of investors
2. Residency and type of ETF[1]
3. Jurisdiction of the underlying portfolio investments

Illustration using MSCI China Index:

10% WHT on dividends from Chinese equities

WHT on distributions by the ETFs:
0% WHT for HK ETFs
30% WHT for US ETFs

Dividend received by Kingdom of Saudi Arabia investors (UBO is GCC)*:
2.5% tax for HK ETFs
2.5% tax for US ETFs

88% after-tax return for HK ETFs

61% after-tax return for US ETFs

Dividend received by Kingdom of Saudi Arabia investors (UBO is non-GCC)**:
20% tax for HK ETFs
20% tax for US ETFs

72% after-tax return for HK ETFs

50% after-tax return for US ETFs

* 2.5% zakat is applied based on the assumption that the ultimate beneficial owner (UBO) of the Investor is a national of Gulf Cooperation Council (GCC) which consists of Kingdom of Saudi Arabia, Kuwait, Bahrain, United Arab Emirates, Qatar and Oman.

** 20% corporate income tax rate is applied based on the assumption that UBO of the investor is not a national of GCC.

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.**

Kingdom of Saudi Arabia investor after-tax returns compared

Figure 1 below depicts the percentage of expected after-tax returns 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 levels of taxes.[2]

Figure 1. Single-market equity indices[3]

Index	ETF	After-tax return: Dividend received by Kingdom of Saudi Arabia investors (UBO is GCC)	After-tax return: Dividend received by Kingdom of Saudi Arabia investors (UBO is non-GCC)
MSCI China	Hong Kong ETF	88%	72%
	Luxembourg ETF	88%	72%
	Irish ETF	88%	72%
	US ETF	61%	50%
MSCI Hong Kong	Hong Kong ETF	98%	80%
	Luxembourg ETF	98%	80%
	Irish ETF	98%	80%
	US ETF	68%	56%
MSCI Taiwan	Hong Kong ETF	77%	63%
	Luxembourg ETF	77%	63%
	Irish ETF	77%	63%
	US ETF	54%	44%
MSCI Japan	Hong Kong ETF	88%	72%
	Luxembourg ETF	83%	68%
	Irish ETF	83%	68%
	US ETF	61%	50%
MSCI USA	Hong Kong ETF	68%	56%
	Luxembourg ETF	68%	56%
	Irish ETF	83%	68%
	US ETF	68%	56%

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 web page.

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 190 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 a 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 web page **www.hkex.com.hk/etp**.

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

Notes:

1. 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
2. This includes portfolio level, ETF level and investor level, and does not take into account any fees to intermediates.
3. This Report is prepared based on the index constituents data and the applicable tax rates as of 30 June 2024. 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.

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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.

As of June 2024, there are more than 190 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

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