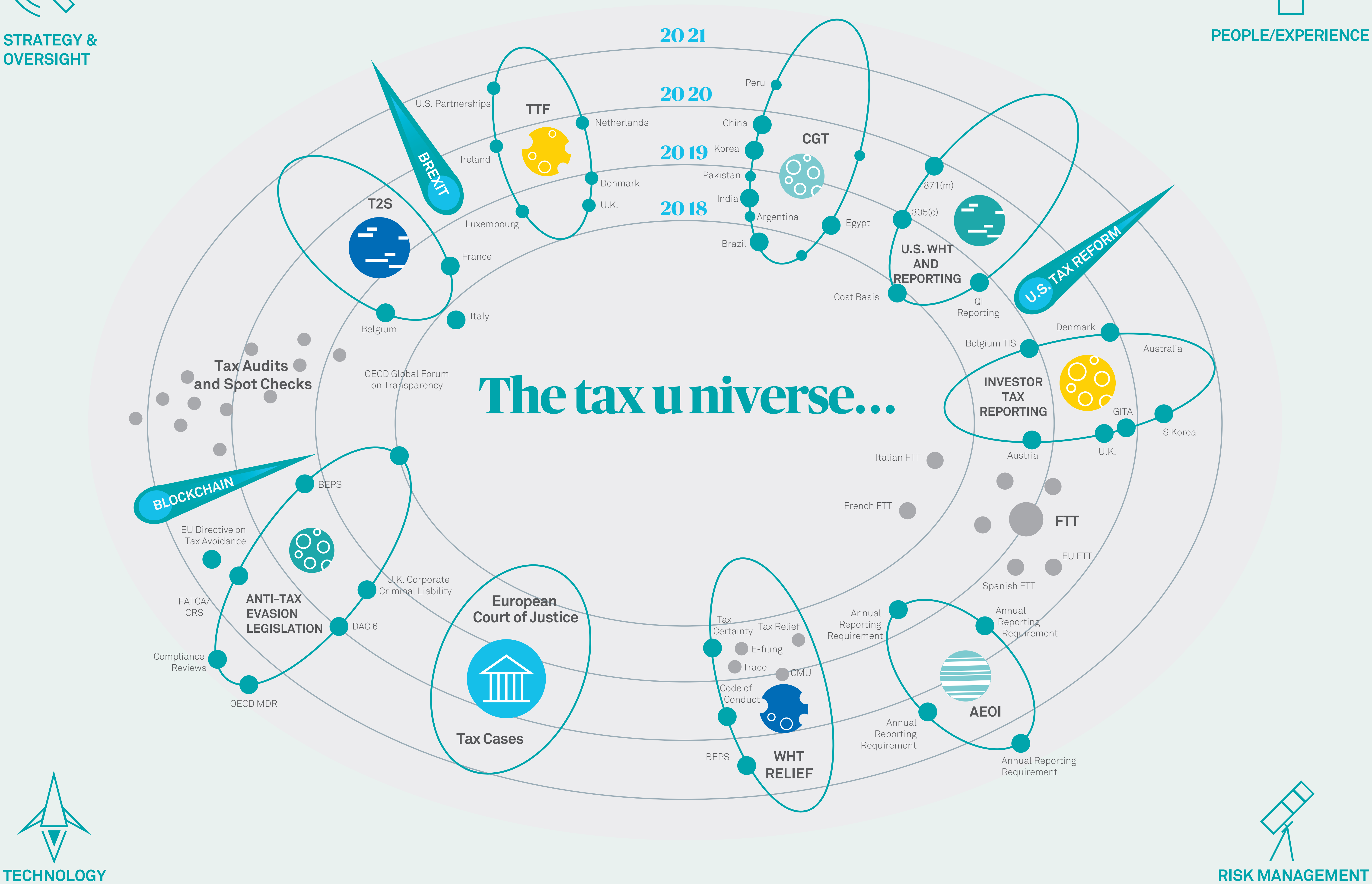
The Tax Universe 2019

AN OVERVIEW OF
CURRENT AND
FUTURE TAXATION

GLOBAL TAX AND REGULATORY SERVICES

BNY MELLON

The future



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The Tax Universe 2019

Fifteen years ago, expansion of the tax universe could have been considered somewhat more gentle, or even inflationary. Fast forward to today, and a superheated big bang of tax change and regulation have created accelerated expansion and a very dynamic new tax environment.

CAPITAL GAINS TAX (CGT)

Capital gains tax (CGT) is a tax on the increase in value of assets during the time they have been owned, and is typically due when the asset is disposed of.

The process of calculating and levying CGT on foreign investors differs widely between jurisdictions. While historically CGT was not a significant concern for portfolio investments, the last decade has seen a significant increase in exposure to CGT for foreign investors (particularly emerging and frontier markets).

The method for calculating and/or collecting CGT differs from country to country, and can be extremely complex and/or uncertain in some markets. Due to these uncertainties, and the potential risks created by CGT, this has been a key area of focus for auditors and investors.

U.S. WITHHOLDING TAX AND REPORTING (U.S. WHT)

U.S. WHT involves the U.S. reporting of income and withholding (if applicable) to U.S. and non-U.S. persons invested in U.S. assets. The Internal Revenue Service (IRS) is seeking to expand withholding into derivative transactions.

IRC §871(m) was recently added, and impacts non-U.S. entities by imposing WHT on certain dividend equivalent payments generated by notional principal contracts, derivatives and other "equity-linked investments" where the payments reference dividends on U.S. equity. IRC §305(c) requires U.S. withholding agents to withhold on deemed distributions associated with convertible debt instruments held by U.S. and non-U.S. entities, where an adjustment is made to the instrument when an underlying U.S. dividend is declared.

U.S. TAX REFORM

Following up on campaign promises, the current administration made tax reform a priority, and in November 2017 passed the Tax Cuts and Jobs Act of 2017 ("TCJA"). The TCJA reduced individual and corporate tax rates, and eliminated or limited many existing deductions. The TCJA also moves the U.S. to a territorial tax system, and imposed a tax on existing repatriated earnings. While the bill passed in November 2017, additional guidance is expected over the course of the year.

INVESTOR TAX REPORTING

Within Europe, effective cross border distribution of funds may require investor tax reporting in certain jurisdictions. With the number of jurisdictions within Europe imposing their own set of rules and restrictions on investments in UCITS and other vehicles the provision of investor tax reporting has become more in demand than ever. Austria, Belgium, Germany, Italy, Switzerland, and the United Kingdom, are countries where investor tax reporting is required.

In addition to European countries, the U.S. has K-1 and PFIC reporting regimes, and in early 2016, South Korea introduced its own investor tax reporting regime.

EU FINANCIAL TRANSACTION TAXES (FTTS)

Following the 2008 financial crisis, the European Commission determined that an EU financial transaction tax would lead the financial sector to "contribute more fairly to the costs of the crisis" and would help address the fiscal imbalance in Europe.

Broadly, the proposed EU FTT directive introduces a tax on transactions involving a wide variety of financial instruments where a Financial Institution party to the transaction is resident in an FTT participating Member State or a Financial Institution is party to a transaction in an instrument issued by an entity in an FTT participating Member State.

France and Italy already have local FTTs and Spain, Portugal and Hungary are expected to enact their respective FTTs should the EU FTT not happen. Financial transaction taxes are not new to markets globally and have been passed in various forms and countries.

AUTOMATIC EXCHANGE OF INFORMATION (AEOI)

With the introduction of the U.S. Foreign Account Tax Compliance Act (FATCA) in 2010, the global tax community has transformed the way in which it exchanges information.

Today, in addition to U.S. FATCA, 150 countries have committed to information exchange of financial accounts by locally implementing the Organization for Economic Co-operation and Development's (OECD) Common Reporting Standard (CRS).

Both FATCA and CRS intend to bring about greater tax transparency. Both regimes require Financial Institutions to identify and report on certain Account Holders who have U.S. citizenship and/or tax residency outside of the Financial Institution's jurisdiction of operation.

Governments will then exchange this information globally, giving tax authorities greater visibility into the location of their taxpayers' financial assets.

WHT RELIEF

When a Government identifies an income event, the withholding tax is levied; in most cases the income event and associated taxation are domestic in nature, however international withholding tax becomes relevant when the income event is paid to a 'beneficiary' who is not tax resident in the country where the income arises. For example, a U.K. investor investing in U.S. securities is subject to U.S. withholding tax on distributions made from these securities.

Income tax treaties (ITT) become important as they are designed to eliminate double taxation. BNY Mellon offers custody services in over 90 countries, and each of these countries implements the collection and corresponding relief from withholding tax differently. Understanding the application of withholding tax in each jurisdiction of investment is a key concern for our clients, and BNY Mellon strives to facilitate the collection and relief of withholding tax. Central to BNY Mellon's service is monitoring and understanding the changes to governments' policies and procedures for the collection and relief of withholding tax and the corresponding impact to our clients.

The introduction by the OECD of the Base Erosion and Profit Shifting (BEPS) project which consisted of 15 actions to combat international tax avoidance is rapidly transforming withholding tax procedures globally. Action 15 introduced a new model Multilateral Tax Convention, or 'Instrument' (MLI). MLI, which entered into force on July 1, 2018, is designed as an efficient method to incorporate the majority of BEPS measures quickly into existing bilateral tax treaties, with the remainder to be implemented into a source country's domestic law. As a result of BEPS, industry must be increasingly vigilant to the changes occurring to reduce the uncertainty that such rapid change creates, and to ensure a quick response to allow clients to continue to obtain relief from withholding tax to avoid double taxation.

EUROPEAN COURT OF JUSTICE TAX CASES (ECJ)

Since 2005, global portfolio investors have filed "ECJ claims" under European Union (EU) Law to recover withholding tax (WHT) suffered on dividend income received from companies resident in other EU Member States.

A number of these ECJ claims have been successful with the respective EU Member States refunding the WHT to EU comparable resident entities. Some EU Member States have also paid out 'third countries' resident entities (i.e. a non-EU resident that satisfies the comparability criteria of the source state).

Other Member States however, reject these claims (for both EU and non-EU). Depending on the legal route the claims may follow (within their domestic legal system and/or referral to the Court of Justice of the European Union), it is likely that a final outcome can take many years.

ANTI-TAX EVASION LEGISLATION

Governments continue to fight Tax Evasion through the introduction of new and stronger measures. The OECD introduced Mandatory Disclosure Rules to address CRS avoidance arrangements and opaque offshore structures, to ensure the efficacy of the CRS regime. The European Union introduced even broader rules as part of a reform package to address CRS avoidance arrangements, as well as, cross-border tax avoidance schemes. DAC 6 requires "intermediaries" those who design, market, organize, manage, aid, assist, or advise on tax arrangements to disclose the arrangement with characteristics that are prevalent in arrangements to avoid tax. Any transaction conducted post 25 June 2018 is in-scope with the first reporting to take place in 2020. Reporting is ad-hoc and must be completed 30 days within identification of the transaction. The intended aim is to quickly close down such schemes through the introduction of legislative changes.

The United Kingdom in the Criminal Finances Act 2017 introduced two new strict liability corporate criminal offenses for a corporation's failure to prevent the facilitation of tax evasion. This has resulted in firms worldwide reviewing their existing financial crime control framework to ensure appropriate controls are in place. Whilst U.K. legislation, the rules have a very broad territorial reach capturing both the evasion of U.K. and non-U.K. taxes.

TAX AUDITS AND SPOT CHECKS

In recent years, tax authorities worldwide have and continue to strengthen their enforcement provisions, including increasing focus on transparency, disclosure and imposing more onerous requirements in connection with administering their tax systems. As tax authorities focus on tackling perceived abuse of tax rules, the result has been an increase in the number of both formal tax audits and spot checks on relief arrangements by many jurisdictions. In many instances spot checks focus on confirming the beneficial ownership of the recipient of the income. Tax audits can result in significant tax penalties and interest, reputational damage as well as time costs associated in responding to them. Appropriate controls, procedures and training with the implementation of an effective tax risk management programme reduce the risk of an audit, and the risk of adverse audit findings.

TARGET2-SECURITIES (T2S)

T2S is the new European securities settlement platform which offers centralized delivery versus-payment settlement in central bank funds across the European securities markets. The purpose of T2S is to harmonize and integrate the fragmented securities settlements in Europe. BNY Mellon is connecting directly to the key central security depositaries (CSDs) in major Eurozone markets including: Belgium, France, Germany, Italy and the Netherlands. This will reduce the custody chain between investors and the market, and will, in certain cases, extend BNY Mellon's tax services on securities providing "closer-to-market" services support.

BREXIT

Following the U.K. referendum on Europe Union membership in June 2016, the U.K. is expected to leave the EU on March 29, 2019, as a consequence of triggering Article 50 in March 2017. There may be a transitional period to December 2020 (to be agreed). There are a number of tax implications likely to arise out of the negotiations between the U.K. and the EU. These tax implications are likely to fall into the following categories:

a. Cross-border relationships between the U.K. and the EU;
b. Changes to U.K. domestic tax policy;
c. Other EU and international tax implications.

The EU/U.K. negotiations and their likely implications will need to be monitored closely in order to ensure that businesses are ready to address these challenges as and when they arise.

TAX TRANSPARENT FUNDS (TTF)

Pooling is the term used to describe the aggregation of various investors assets into a single fund vehicle in order to benefit from a diversified portfolio, a centralized administration, an enhanced governance and risk management as well as cost savings from economies of scale. Tax Transparent Funds (TTFs) allow investors to access the same double taxation treaty benefits which would have resulted from investing directly in the fund's underlying assets, as well as benefit from the advantages listed above. A TTF may appeal to asset managers, pension funds, life companies, charities and sovereign wealth funds.

BNY MELLON GLOBAL TAX AND REGULATORY SERVICES

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LEARN MORE

If you would like to receive further information, please contact your BNY Mellon Relationship Manager or a member of the BNY Mellon Global Tax and Regulatory Services team.

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