

Brexit's hidden tax questions for asset managers

August 2018

With increasing urgency, asset managers across the UK and elsewhere in the EU are considering and addressing the possible impact of Brexit: what the loss of passporting means for the products and services they offer; how operating models might need to change; what it means for staff; and much more.

And what's important not to forget is that most steps to mitigate the impact of Brexit will have an impact on the amount of tax firms pay, in both the UK and EU27.

Here are five of the big tax issues we believe asset managers need to tackle as part of their efforts to navigate Brexit:

1. Choice of jurisdiction

The choice of jurisdiction in which an asset manager carries out activities will be driven by regulatory factors. The management company of a UCITS or an EU alternative investment fund (AIF) will need to be established within the EU and so any firm using a UK-based management company will need to relocate it.

What proportion of the underlying activities of the management company needs to be carried out in the EU remains unclear and will be determined as much by any future EU regulations as by any agreement between the UK and the EU on Brexit.

But if a relocation is necessary, deciding where to go may impact an asset manager's tax competitiveness because of the wide variation of corporate and income tax rates across Europe, as shown below:

Headline rates	UK	Ireland	Lux	EU Average
Corporation tax	19% (17% by 2020)	12.5%	26%	21.3%
Personal taxes ^(a)	45%	48%	45.9%	32.5%

Note: (a) not including social security contributions

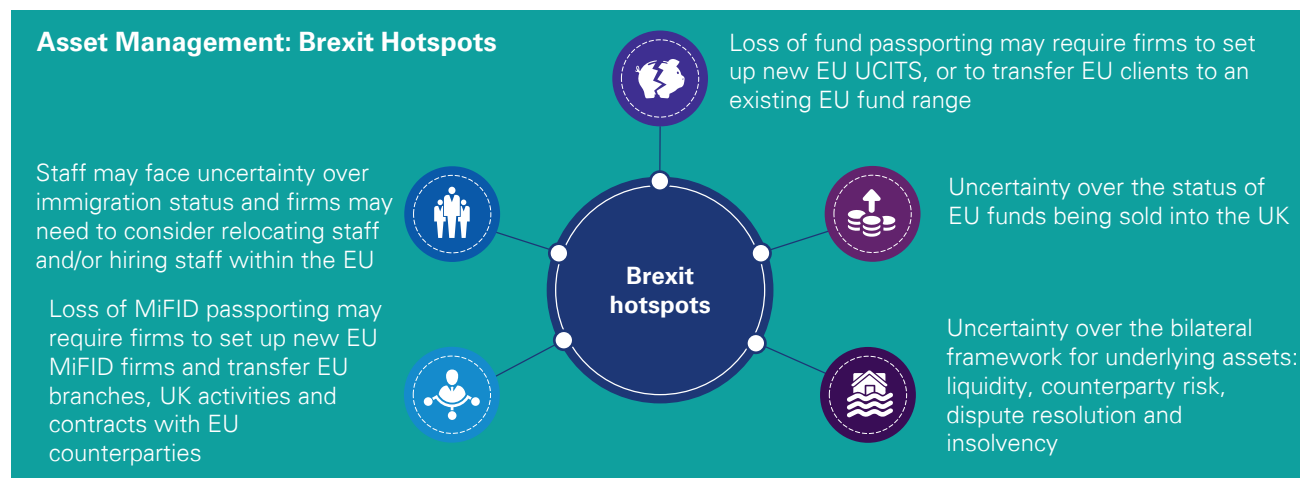
The movement of activities and functions within a group will also have an impact on transfer pricing. Moving people and activities out of the UK and into EU27 entities will mean firms will have to recognise that those EU27 entities are generating more profit.

Any documentation required to support transfer pricing policies will need to be renewed.

Companies will also need to consider other questions relating to their UK tax burden. For example, whether the UK controlled foreign companies rules apply to the new group structure and are they subject to the UK's diverted profits tax?

2. Profits repatriation

Companies need to consider how the way they repatriate profits will alter their tax burden after Brexit. After March next year, the UK will sit outside the EU's Parent-Subsidiary Directive that allows group companies to pay dividends between subsidiaries without being subject to withholding taxes. It's important to ask yourself whether any new structure you set up as a consequence of Brexit will result in any additional tax charges when profits are repatriated at a group level.



3. Moving branches

Be aware of how any moving of a branch from the UK to the EU, or vice versa, might affect your tax position.

Firms may need to transfer branches into an EU-regulated entity ahead of Brexit if they are currently using a UK-regulated entity to carry out regulated activity in the EU27. The tax issue arises because the transfer of a branch from a UK company to an EU company is a disposal of assets. That could generate capital gains in both the UK and/or in the jurisdiction of the branch.

Companies should review whether any tax reliefs might be available to them for such transactions. For example the EU Mergers Directive or the application of relevant Double Tax Treaties and local law (in the UK, the branch exemption) may all help.

However, asset managers will need to look at these provisions carefully since they operate differently in different EU member states. Some countries, for instance, may have provisions to claw back tax on the application of the EU Mergers Directive if the company that makes the transfer is within a country that subsequently leaves the EU. Such a rule would obviously apply to all UK companies.

In addition, firms will need to consider where it makes most sense, to place the parent entity to an EU branch network. The EU's Parent-Subsidiary Directive can prevent double taxation on branch profits, and many EU countries have national exemptions (e.g. Luxembourg and Ireland). But rules on what constitutes a branch and how the Directive, or local exemption applies, will differ from one EU country to another.

4. Moving contracts to an EU entity

Asset managers might need to move contracts with EU clients for services overseen by regulators to EU27 because the company will no longer have a regulatory passport to provide that service from the UK. Possible examples include investment management agreements and distribution agreements regulated under UCITS or MiFID.

Companies can treat the transfer of contracts like this as a disposal for tax purposes. But that might trigger a capital gains liability. As the contracts are normally transferred within group companies, the asset manager would need to calculate the size of any gain by referring to the market value of the contract. That requires examining the details of every contract and putting a valuation upon it.

Contacts



Jorge Morley-Smith
Director,
Asset Management

T: +44 (0) 7770 678 721
E: jorge.morley-smith@kpmg.co.uk



Peter Dylewski
Director,
Indirect Tax

T: +44 (0) 7900 163496
E: peter.dylewski@kpmg.co.uk



Simon Hart
Senior Manager,
Asset Management

T: +44 (0) 7771678753
E: simon.hart@kpmg.co.uk

kpmg.com/uk



The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavor to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

© 2018 KPMG LLP, a UK limited liability partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name and logo are registered trademarks or trademarks of KPMG International. Designed by CREATE | CRT102845A

5. VAT

VAT is an EU tax, which member states then implement into national law. They are then bound on matters of interpretation by judgments of the Court of Justice of the European Union. There is an exemption for the management of certain funds. However the way different EU countries apply that exemption varies widely in terms of which domestic and overseas funds are in scope, which activities will qualify when outsourcing and what special VAT recovery rules apply to funds and asset managers.

Changes to fund domiciles or group structures will therefore have an impact on an asset manager's VAT position – both at the initial transactional stage (e.g. securing VAT reliefs for business transfers) and in terms of an asset manager's on-going business model (e.g. changes in VAT liability and recovery).

Currently, the UK exemption from VAT for the management of funds applies to the management of UK funds, offshore funds that are actively marketed to UK retail investors and certain listed closed-ended vehicles. Although the UK Government's intention is to leave the jurisdiction of the Court of Justice and no longer recognise the primacy of EU law, it has committed to preserving the existing VAT regime immediately on leaving the EU. Therefore we currently expect the exemption to apply in broadly the same manner post-Brexit as it does now.

One key question in the immediate term will be what happens to the rules on VAT-exempt supplies to non-EU counterparties ("specified supplies"). These can give funds and fund managers the right to recover some of the VAT they incur. However, once the UK itself becomes a non-EU country, the UK government will need to make a decision as to whether to give VAT recovery for VAT-exempt supplies to the EU too or, alternatively, to give no VAT recovery on any exempt supplies. This decision will likely be linked to the level of market access the UK is able to negotiate. Either way it is likely to impact firms' EU business models significantly.

As well as considering the fund management VAT exemption, firms will also need to have regard to other relevant VAT differences across the EU, for instance in relation to intra-entity cross-border transactions following the [Skandia judgement](#) in which the court ruled that services supplied by a head office to an overseas branch can be subject to VAT where one establishment is in a VAT group. Global custody, a key part of the cost base, is VAT exempt in some countries but partly or fully taxable in others – while the rules on VAT grouping, where available, vary significantly and, in some cases, are in the process of being changed or challenged.

How we can help

KPMG is helping asset managers across the industry navigate the tax consequences of Brexit:

- Identifying the risks to business operations
- Building implementation plans
- Creating tax-effective cross border operating models
- Obtaining tax clearances for transactions to adopt new business structures.

Please get in touch if you need some help to manage the impact of Brexit on your tax function.