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# Avoiding nasty tax surprises

Taking a consolidated view of taxation not only removes compliance headaches for asset managers but can also give them an edge over other industry players

The EU's gaping funding gap post-Brexit amounts to €14bn. From special taxations on digital firms to new environmental taxes, MEPs are in the midst of voting on how to raise money. And not for the first time, the European wide Financial Transaction Tax (FTT) is up for consideration.

The proposed 0.1% tax on shares and bonds, coupled with a 0.01% tax on derivatives, would clearly have a knock-on effect on an investment management community already under increased cost scrutiny from its end investors. Should a European-wide FTT come into play, investors could find themselves paying tax twice on the same product. It could well be, for example, that an EU-structured product with a US equity underlying instrument falls under both FTT and the US 871m rules. If this type of scenario becomes the norm, it would trigger a complete transformation of the thought process around taxes.

The trouble is that, until now, most asset managers have not needed to consider tax efficiency when calculating costs and passing them on to the client. As regulatory deadlines come and go and the potential for new taxes like a European wide FTT up for serious discussion, only now are they realising that closer attention needs to be paid to the tax implications of their investments.

The idea of transparency around costs is the beating heart of recently-implemented regulations such as MiFID II. Clients now have access to a clear breakdown of the costs of their investments, and while the focus has initially been on how fund managers pay for their research, attention is shifting to how tax-efficient they are. It is easy to see why. Since the implementation in January, firms have to disclose tax-related parts of cost and charges. As a result, although it is still a relatively new concept, concerns about tax efficiency have been brought to the fore.

These regulations have not only put pressure on asset managers from a legal perspective, but they have also created pressure from a new generation of cost-conscious investors. Such investors have access to a thorough breakdown of where their money is going. Armed with this new visibility, investors are challenging their asset managers to provide the best costs and charges for them, including when it comes to tax. Instead of just looking at tax from an income perspective, investors are realising that there are other elements which need to be factored into the investment process. These can range from existing security transaction taxes, to the transaction taxes which have already been implemented in countries such as Italy, France and Belgium.

These new demands from rule makers and investors mean one thing for asset managers: the need for a new level of in-depth understanding when it comes to tax.

But this should not be viewed as a burden for asset managers. While this emphasis on transparency may require more complex systems to be put in place, the increase in tax demands means that firms that are proactive about tax efficiency could have competitive advantage. For instance, those with more efficient systems can offer better prices, which is more attractive to investors who want to make sure that their money is put to good use.

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To be prepared for any changes in taxation rules, asset managers need to look at three key aspects of the tax efficiency of any given investment: the tax domicile of the client; how tax efficient the investment process into a given asset is; and what the income tax is on the asset. If asset managers are able to have a consolidated view of these three aspects, they can build an accurate picture of how their performance is affected by tax, and plan accordingly.

Currently, many asset managers do

not take the wider global picture into account when it comes to tax, and tend to look at things on a country by country basis. While this sort of approach can work now, if rules develop which apply across multiple jurisdictions, it could have some serious ramifications. Firms that do not take the time to understand this trend could find themselves in a situation where they are unaware that products they invest in are subject to multiple taxation rules. As a result, they could end up with a surprise from the regulator.

To combat this risk it is essential that firms monitor trading flows and the data underpinning them. Otherwise, it is much harder from a tax perspective to work out what they are being taxed on and where.

Now that a European-wide FTT is back on the table, and other tax rules are possibly coming into play, it is clear that increased focus on tax rules isn't going away anytime soon. Although this may seem daunting, it also presents an opportunity for asset managers that are ahead of the curve when it comes to tax efficiency.

Asset managers should ensure they can meet the demands of their newly-enlightened investors and provide a clear tax efficiency structure with leaner and easier to understand costs. The industry stands to greatly benefit in the long term.

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