MACFARLANES

Macfarlanes' response to HMT's consultation on the UK Funds Regime

1. This call for input on the UK funds regime is necessarily wide-ranging. As the government would not be able to take forward all proposals immediately, what do you think the top 3 priority proposals should be for government implementation and why?

There are three areas of reform that we consider would have the most impact in terms of their benefits to investors and to improving the attractiveness of the UK's funds regime. These are: (i) a series of incremental improvements to the UK's private funds LPs (UKLPs) regime, (ii) the successful implementation of the Long Term Asset Fund (LTAF) and in respect of tax, (iii) improvements to the VAT regime.

We detail improvements to the UK PFLP regime in response to question 30. However, briefly, we believe that the existing UK PFLP regime is well understood by market participants and generally works well. Building on this success is preferable to the creation of an entirely new regime and could yield greater benefits relatively easily and quickly. Specifically, we propose that LPs should have the option to have separate legal personality, to create separate liability cells, should be exempted from the "qualifying partnership" rules, should be exempted from all Gazette advertising requirements and the legislation regarding the position on the death of a partner should be clarified. Furthermore, the legislation should provide for same-day online Companies House filings and BEIS proposals on the removal of LP and PFLP filings from the register once a fund has been wound up should be adopted. Taken together, we think these measures would make the UK PFLP an extremely attractive fund vehicle for an unauthorised fund.

The LTAF has the potential to be a game-changing new fund vehicle by opening up private, unlisted and illiquid investments to certain types of retail investors. Retirement income is an under-utilised source of capital in the UK that could be deployed to drive the economic recovery and improve productivity by investing in infrastructure, SMEs and high growth companies. DC schemes are ideally placed to make long-term investments, but the LTAF should not be solely restricted to this category of investors. Wealth management clients, including "mass affluent investors" and multi-family offices, should be able to invest in the LTAF. This category of advised investors are likely to have the appetite to make riskier investments that have the potential to yield higher returns. The success of the LTAF will be dependent on its being viewed as viable by intermediaries; specifically, the LTAF must be considered a vehicle that is appropriate for retail investors and the higher costs of the LTAF's investments must be deemed acceptable by DC scheme trustees. We touch on the LTAF at various points in this response, but the issues that must be resolved for the LTAF to be a success are detailed at length in response to Question 37.

In respect of tax, post-Brexit there is a significant opportunity to remove the distortive effect VAT has on the operation of asset management businesses. The current VAT exemption for the management of a special investment fund ('SIF') tends to penalise the outsourcing of fund management functions and is subject to frequent litigation.

The recent Blackrock litigation demonstrates many of the downsides of the current regime. Refinement of the VAT exemption for investment management to permit the apportionment of services that are used to manage both SIFs and non-SIFs would to some extent mitigate the current VAT barrier to outsourcing. In addition, further thought should be given to clarifying and widening the concept of "management" for the purposes of the VAT exemption. Again, this could prevent VAT from acting as a barrier to outsourcing functions and encourage innovation in the industry.

Similarly, the current system tends to result in the "tainting" of services supplied to or in respect of individual funds. Examples include non-UK regulated funds which are marketed to UK retail investors, and are therefore treated as SIFs in their entirety regardless of the level of UK retail investment, and combined DB / DC pension funds, where the holding of any DB assets is seen by HMRC as causing the fund to not be a SIF. Such tainting gives rise to arbitrary VAT results with no clear policy objective.

Finally, the current VAT system acts as an incentive for managers to locate AIFs outside the UK (by giving full input VAT credit in the UK with no corresponding VAT charge in the fund jurisdiction). Similarly, the current VAT system encourages the location of retail funds outside the UK by applying a blanket exemption to UK-domiciled funds while the management of non-UK funds gives a right to input VAT recovery (subject to the "actively marketed to UK retail investors" test). An amended VAT system, either through widespread zero-rating, or through a more targeted zero-rating or exemption based on the domicile of underlying investors rather than the fund itself, would be an opportunity to level the playing field in this area. We welcome the forthcoming consultation on the review of fund management fees and hope that the conclusions made during that review can be streamlined with the conclusions made under this consultation.

From a wider tax perspective, we encourage the government to continue its efforts to bring in the new Asset Holding Company (AHC) regime as soon as possible. We are very encouraged by the direction of travel as the regime will have a positive impact and signals that the UK wants to strengthen the asset management industry. An improved UK fund regime in addition to the AHC regime will further support the co-location of funds with the investment holding vehicles, building teams and greater permanence in the UK.

2. How effective were recent reforms to UK funds taxation in achieving their aims? Please explain your answer. Could anything have made these reforms more effective, particularly in terms of increasing the attractiveness of the UK as a location to set up funds?

Each of the reforms set out in paragraph 2.3[1] of the consultation response have served a purpose in their own right and will, to varying degrees depending on the types of investors, asset classes and strategies deployed have been valuable reforms. In our experience, the reforms to the Substantial Shareholding Exemption (SSE) have been particularly welcome, that has meant the regime is simpler to apply and overall created a much enhanced regime. That is not to say that further reforms would not be welcome. We identified some of the remaining challenges with SSE for AHCs in our responses to the separate consultations[2] undertaken for the AHC regime. From a tax perspective, it remains difficult for the UK to increase its attractiveness much more unless the VAT treatment of management fees is addressed. We note the forthcoming consultation, and we have outlined our initial thoughts under question 1 based on our understanding that you are currently undertaking research in this area.

As we explain in response to other questions, tax is not the primary driver in making the UK more attractive as a location to set up funds. There are many other regulatory issues that play into the attractiveness going forward, such as the ability to passport funds into the EU.

6. Where funds are already tax neutral, how would a tax-exempt status for funds influence decisions about how and where to set up funds?

A tax-exempt vehicle would be an attractive vehicle, and clearly is a popular choice in Luxembourg and Ireland but the attraction cannot solely be attributed to a tax exemption provided under the regimes, there are many other reasons (primarily commercial and regulatory) why these jurisdictions are chosen. In our experience a tax-exempt vehicle will suit certain types of investors but may not suit all circumstances.

The benefit of a tax-exempt vehicle is that it is seen to offer an element of certainty and to global investors the status is easy to understand. As is explained in response to Question 10, there are challenges with adopting a tax exemption in terms of access to tax treaties (or at least the perception of such access). In comparison, tax neutrality can be secured through other UK tax transparent vehicles, but the UK regime (perhaps incorrectly) is seen as requiring greater understanding of the UK tax system and the wider regulatory regime may not support the objectives of the fund/investors. Furthermore, from a real estate angle there is a gap currently filled by Jersey Property Unit Trusts (JPUTs) for funds/JVs that want income transparency and CGT exemption. The proposals endorsed by AREF and others for a professional investment fund that would offer a tax transparent vehicle would be an attractive offering.

In summary, the option to have a tax-exempt vehicle may aid marketing UK fund structures to certain investor profiles but on its own will not solve all the barriers to using a UK vehicle – it will be necessary to ensure the regime works as a whole. Fundamentally, the use of non-UK fund vehicles which have access to full exemption is driven more by flexibility in investment requirements and lighter regulation which make those regimes easier to access in practice, in particular for smaller asset managers

[1] The reforms set out in paragraph 2.3 include: Co-ownership Authorised Contractual Schemes (CoACS); Investment Trust Company (ITC); unauthorised unit trusts; and Substantial Shareholding Exemption.

[2] Tax treatment of asset holding companies in alternative fund structures, HMT, March 2020 and Taxation of asset holding companies in alternative fund structures (second stage consultation), HMT, December 2020.

(including private equity) who have limited resource to take on significant compliance, but only seek investment from sophisticated institutional investors. Whether full exemption, partial exemption (as now) or transparency is followed, the key will be allowing ease of access to the regime without significant regulatory overlay where the fund is not marketed at retail investors (as to which the LTAF should be appropriate to allow access to these vehicles in turn).

7. How would tax-exempt funds affect the competitiveness and attractiveness of the UK funds regime? Please explain your answer providing evidence and international comparisons where possible.

The established principle of tax neutrality - to ensure that duplicative layers of tax are not imposed at the level of the fund and intermediate holding companies so that the investor is taxed as if they had invested directly in the underlying assets - is paramount. A tax-exempt vehicle achieves this aim very easily. UK general partnerships, limited partnerships and most LLPs are 'tax transparent' for UK tax purposes (which means that the partnership is not itself liable to tax) so are already used in certain scenarios. That said, there is a desire for a UK fund vehicle offering professional investors a regime which provides exemption in respect of non-UK property income. The professional investment fund proposal providing an unlisted, tax transparent vehicle offering tradable units would satisfy these calls.

Having said all the above, and bearing in mind that perfection should not be the enemy of the good, there are advantages to a non-transparent fund structure for some investors as an opaque vehicle provides a clear tax filing blocker – for example where there may be investment in UK real estate which could trigger a UK tax filing obligation (or at least withholding taxes). Therefore, there are advantages to opaque and exempt structures as well as transparent and exempt structures. Ideally both would be available (as in Luxembourg with the RAIF structure which can apply to companies or partnerships).

8. What would be the likely impact if changes were made to the REIT regime in the areas discussed in para 2.16 To what extent could investment in the UK be expected to increase, and what would be the drivers for this? Could such changes be expected to impact the extent to which funds with UK and foreign property assets are managed in the UK?

We welcome the consideration to reform the REIT regime within this consultation and the earlier AHC consultations. We made a number of points in our response dated 23 February 2021 to the second stage AHC consultation on the key areas of reform for the REIT regime. These mirror the issues you have identified in paragraph 2.15[3], so we have not repeated these in this response.

In terms of further reform, the items listed under paragraph 2.16 would also be welcomed and without such reform the UK REIT regime may slip behind other jurisdictions that continue to renew and enhance their REIT regimes. Overall, we believe these changes would be viewed positively by the industry and result in greater use of UK REITs.

Interaction of interest cover test and Corporate Interest Restriction (“CIR) ” rules

REITs are required to apply the CIR rules in addition to the interest cover test. A number of calls to exclude REITs from the CIR rules were made at the time of introduction but the Government rejected these demands. It was argued that the REIT legislation already included an interest cover test and overlaying a further restriction on interest deductibility should not be necessary. As such it is not entirely clear from a policy perspective why both tests are required, which in practice are overly burdensome. The UK in some respects is an outlier as other countries, for example, Germany, exclude REITs from their equivalent interest restriction rules. In our view it is not necessary for both tests to exist and therefore the Government should identify which test should be retained. Given the more recent introduction of the CIR and the rejection of earlier calls to exclude REITs from those rules, the interest cover test should be considered for repeal. In practice the interest cover test is rarely if ever breached.

Three-year development rule

[3] The issues set out in paragraph 2.15 include: relaxation of the listing requirement; changes to how the close company test is applied; the application of the holders of excessive rights rules and how the balance of business test operates.

When the three-year development rule is breached, the gain on the property sale is subject to UK corporation tax. This can prevent the sale of development assets and may in some cases affect the liquidity of the REIT if assets are tied up unnecessarily to avoid a gain crystallising. It puts REITs at a disadvantage compared to other corporate entities that can take advantage of the NRCGT exemption election treatment. From a policy perspective we appreciate the rule is trying to identify development activity that might be considered trading in nature without the need to conduct an analysis based on the badges of trade, however it is possible to assess trading v. investment activity via other means. Furthermore, the three-year period is an arbitrary amount of time for this rule. We believe that the three-year development rule should be repealed or if the policy is to retain it, there should be certain circumstances where the rule is waived, for example, to enable assets that are not core to a regeneration programme to be divested. This may occur, for example, when there are requirements to deliver residential developments as part of a regeneration scheme.

Three property holding

The stipulation that the REIT must hold at least three 'properties' is again, an arbitrary rule. We have experienced problems with blind pool REITs where the investment properties have not been identified at the outset of setting up the REIT. We are also aware of circumstances where investment in just one property may run into several hundreds of millions of pounds, but the rules act as an obstacle against making this type of investment as holding one property would not qualify. On the one hand, we understand one of the objectives behind this requirement is to ensure that the investors are not exposed to one single asset, however this is not borne out in the way that the rules work at a practical level. For example, a shopping centre with say, 50 titles (and accordingly 50 "properties") would be a qualifying investment but in this scenario the investors are still exposed to one property, the shopping centre (albeit with an exposure to multiple tenants). If it is the government's intention to restrict the regime to three properties or more, we believe that there should be a grace period introduced to allow REITs time to set up and identify appropriate investment properties.

Overseas properties

As the consultation identifies, where a REIT holds overseas property in a UK company it is likely to suffer tax in the overseas jurisdiction as well as UK tax withheld on paying the property income distribution to investors. This is one of a number of issues that have been discussed during the AHC consultation and whilst it can act as a barrier to REITs holding overseas property in a UK company, there are often commercial drivers to using a local overseas company to hold overseas property.

0. Are there any other reforms to the REIT regime that the government ought to consider and why?

Taking on board the issues raised above and those outlined in our AHC consultation responses, we believe these would have a material impact on the attractiveness of the UK REIT regime.

The government should also give due consideration to the VAT treatment of the management of REITs in tandem with the proposed changes. The VAT treatment of the management of a REIT is currently based on that REIT's listing classification. For example, the management of a REIT listed on the Premium (Closed Ended Investment Fund) category will be exempt from UK VAT, whereas the management of a REIT listed on the specialist fund segment of the LSE will be subject to VAT. Changes to the REIT regime around the listing requirement should include consideration of the resulting VAT consequences.

0. Regarding the proposals covered in the call for input, are there any specific considerations that the government ought to take account of in the context of the UK's double taxation treaty network? Please provide as much detail as possible.

Following the UK's withdrawal from the EU, the UK has lost access to the EU parent-subsidiary and interest and royalties directives. This means, that certain payments to and from the UK are now subject to withholding taxes. As a first step, we would recommend that the government prioritises renegotiation with Germany, Italy, Poland and Portugal as these are the EU member states where there is likely to be a withholding tax exposure for asset managers.

One of the proposals covered in this consultation is a tax-exempt vehicle. The tax-exempt status of a vehicle is often a source of debate and can cause issues in terms of accessing double tax treaties. In practice, what creates most debate is defining the term 'resident' of a contracting state which depends on its tax treatment in the contracting state and provides that an entity must be 'liable to tax'. Where an entity is exempt from tax, some tax authorities do not accept that the fund vehicle is liable to tax. There is little guidance on how to interpret what liable to tax means, and there is a tendency for some tax authorities to conflate liable to tax with 'subject to tax'. From a UK perspective, a REIT (a fundamentally taxable entity with access to specific exemptions) is generally seen to meet the condition of being liable to tax for the purposes of double tax treaties, however in introducing a new exempt tax vehicle it would be important for the government to assess and clarify the treatment in key territories. It may become necessary for the UK government to renegotiate the relevant tax treaties recognising funds as 'residents' in their own rights. Furthermore, the UK should follow the Luxembourg tax authority by clarifying whether UK funds are entitled to treaty access and publish a list of territories that recognise UK funds as being resident and therefore entitled to treaty benefits.

11. What are the barriers to the use of UK-domiciled LP funds and PFLPs, and how might tax changes help to address them? Please provide detailed proposals and explain your answers.

Barriers

UK-domiciled limited partnerships (in particular PFLPs) remain attractive options as fund vehicles for UK-domiciled fund managers, particularly in the private equity and venture capital sector. However, several factors contribute to UK managers deciding to use vehicles domiciled in other jurisdictions:

- Brexit and access to EEA-based investors.

For UK managers looking to raise substantial amounts of capital from EEA-based investors, an EEA-domiciled fund structure (e.g. a Luxembourg SCSp managed by a Luxembourg fund manager) offers the advantage of the AIFMD marketing passport, providing ease of access to professional investors across the EEA. This is something a UK limited partnership cannot offer.

Further, some European institutional investors are subject to requirements that prohibit them from investing in non-EEA-domiciled funds. UK managers wanting to develop and maintain relationships with these investors will necessarily need to use EEA-domiciled fund vehicles.

- Legal issues connected with the use of UK limited partnerships.

The legal framework for UK limited partnerships – principally the Limited Partnerships Act 1907 – provides a stable, well-known and widely-understood grounding for managers of, and investors in, UK-domiciled limited partnership funds. That said, issues with UK limited partnerships can place them at a disadvantage when compared to similar vehicles in other jurisdictions. These include:

  - Requirements to publish notices in The Gazette, which are seen as out-dated formalities of no tangible benefit.
  - The lack of separate legal personality for English and Northern Irish limited partnerships, making them unsuitable to act as "feeder funds" or "funds of funds".
  - The potential applicability of the "qualifying partnership" rules, which can result in UK limited partnerships having to prepare and file public statutory accounts.
  - A lack of clarity around the consequences of the death of an individual limited partner and what happens to the deceased partner's interest in the partnership.
  - The lack of a power to remove limited partnerships from the register, once fully wound up.

- Administrative issues connected with the use of UK limited partnerships.

Companies House filings for limited partnerships are paper based (as opposed to being electronic or online filings). This can lead to significant delays in registering new limited partnerships (up to two or three weeks, in the current Covid-affected circumstances). For managers looking to establish vehicles on an expedited basis to take advantage of an investment opportunity (e.g. a co-investment partnership), the lack of a guaranteed same-day registration service can be a significant reason to use a non-UK limited partnership.

Further, Companies House has adopted the practice recently of querying the registration of new limited partners, by asking for confirmation and/or evidence of their having separate legal personality. We are not aware of this practice being undertaken by any other registry in other typical fund jurisdictions. This practice can result in perfectly valid and correct filings being rejected, pending the provision of the requisite confirmation/evidence. As general partners are required under s.9(1) of the Limited Partnerships Act 1907 to give notice of the admission of new limited partners within 7 days of their admission, rejected filings can call into question a general partner's compliance with the Act, even if those filings were correctly made within the 7-day period.

- Tax issues

There are a number of tax issues that act as a barrier, which often means the UK is overlooked in favour of other jurisdictions. Over time this has meant managers have become more established and have sought to co-locate with investment holding vehicles, building teams and greater permanence in those jurisdictions. The UK AHC proposals, together with the reforms under this consultation, will help to make the UK more attractive but as this consultation document identifies the focus should be on attracting new funds rather than chasing what has already been established elsewhere. The main tax barriers on the use of UK-domiciled LP funds and PFLPs are as follows:

- VAT: It is normally preferable from an input VAT recovery perspective for UK managers to manage non-UK partnership funds. Managers of UK partnership funds normally include the general partner of the fund (and by extension the entire fund for VAT purposes) in the UK VAT group of the Manager. The management fee charged by the Manager to the fund is disregarded from UK VAT as an intra-VAT group supply. Input VAT recovery for the VAT group is then based largely on supplies made by the fund, which typically leads to significant input VAT restrictions. Furthermore, the manager finds itself within the partial exemption regime, which gives rise to inherent complication, uncertainty and risk of dispute with HMRC. By contrast, a UK Manager of a non-UK fund will often be able to recover its input VAT in full.

- Tax compliance cost burden on managers and investors: Following the changes made to tax reporting obligations within FA 2018, the tax compliance burden for partnerships has increased. The rules were amended such that there is a requirement to include further information for each of the 'participating' partnerships, the share of the partnership's profit or loss calculated on all four possible bases of calculation (UK-resident individual, non-UK resident individual, UK-resident company, and non-UK resident company), unless details for all partners (and indirect partners) are included in the partnership statement. Furthermore, the requirement for non-UK investors in UK partnerships who file information reporting returns to another CRS jurisdiction (i.e. not the UK) to have a Unique Taxpayer Reference ("UTR") is creating significant tension with important non-UK investors. When these measures were introduced, the nature of investment partnerships distinct from trading partnerships was not considered. It has not been articulated why this information is needed for non-UK partners who would typically not have any UK tax liability (unless they have UK tax nexus separate from their interest in the investment partnership) and seems to be an oversight that has generated huge administrative and compliance cost burdens for managers. Consequently, the UK limited partnership regime is viewed as less attractive than other jurisdictions.

- SDLT: The treatment of SDLT for transactions involving partnerships is complex and has grown more complicated in recent years following a series of anti-avoidance measures. The transfer of an interest in a property investment partnership holding UK land is chargeable to SDLT on a proportion of the market value of underlying property, and so whenever a person acquires or increases a partnership share a transfer is considered to take place. This has a materially detrimental effect on how partnerships are viewed for real estate investment, especially as this anti-avoidance measure was not designed to target widely held funds and in large part drives the use of JPUTs in tandem with partnerships. In reality, there are plenty of other anti-avoidance measures (e.g. section 75A) that would protect against the government's concerns in this regard and a review of this rule would potentially allow many more widely held property investment vehicles to be structured through the UK with no loss of tax.

- Tax changes

The consultation asks how tax changes might help to address the barriers identified. We believe changes in tax are only necessary to address the tax barriers. Overall, we believe that the issues we have highlighted above demonstrate that when new rules are brought in there needs to be active consideration of how the rules will apply to investment partnerships to ensure that new rules do not inadvertently undermine the attractiveness of the UK fund regime. As a starting point, we are anticipating the VAT fund review to set out a clear path on making the UK an attractive place for asset managers. We also believe that HMRC should be alert to the effect additional reporting requirements has on the industry. Finally, on SDLT, we suggest that the property investment partnership rules are disapplied for widely held funds (possibly using the closeness and GDO tests as used for UK property rich collective investment vehicle rules) to bring many more of those structures onshore.

12. What benefit does fund authorisation bring to product providers beyond access to retail investors? Does this benefit vary depending on the specific investor base or investment strategy? What relevance does authorisation of a product have to its appeal to the UK market and to the international market?

As the question identifies, the principal benefit to establishing an authorised fund over an unauthorised fund is the access the authorised fund gives to retail investors. Consequently, managers looking to raise capital from retail investors will typically opt for an authorised fund structure and, conversely, managers raising capital exclusively from professional investors will opt for an unauthorised fund structure.

That said, managers are always sensitive to the individual preferences of their target investor base. As a result, a manager may for example chose an authorised fund structure, even though it is targeting professional investors, because the additional layer of scrutiny and regulation that an authorised fund attracts might be preferable to an intermediary that wishes to choose or to recommend a fund to its clients. For instance, many pension scheme trustees, despite themselves qualifying as professional investors, nonetheless often prefer to invest in authorised funds. This is because those trustees are cautious about the perceived risk of putting their scheme savers into vehicles that might be deemed too complex or risky for ordinary investors (at least in their scheme’s default option).

These concerns are important in the context of the LTAF. In order to achieve the goal of ‘retailisation’, permitting retail investors to invest in private and less liquid assets, the LTAF should be a form of vehicle that is authorised for retail investors such as the NURS. Basing the LTAF on a vehicle that is understood by the market to be designed for professional investors, such as the QIS, could make intermediaries such as pension schemes reluctant to invest in the LTAF on behalf of their scheme members. It would be preferable to base the LTAF on the existing NURS because this structure is already known and understand by the market to be suitable for retail investors.

13. Do you have views on the current authorisation processes set out in legislation and how they could be improved?

We do not have any specific views on the existing UK authorisation processes as set out in legislation. In general, our view is that that FCA fund approval process is far more efficient and transparent than the equivalent processes in other key jurisdictions. As such, we do not perceive the FCA authorisation process to be creating any barriers. However, we set out below some general observations for consideration with a view to further enhancing the experience:

- Some jurisdictions have a more electronic application system e.g. the CSSF in Luxembourg. Such a system may help to increase transparency around tracking the status of the application and provide a portal through which questions and answers can be delivered.

- There are instances of the FCA making policy through its authorisation process, rather than through a formal consultation on new rules, or through publishing industry guidance. A recent example of this is the FCA’s unpublished view on the definition of “UK Equities”. In our view, all FCA policies should be documented so as to be understood fully in the market.

- FCA authorisation applications are typically reviewed by a more junior member of the FCA's fund authorisations team before being passed on to a senior reviewer for sign off. The senior reviewer often follows up very late in the day with an extensive list of new questions. It would be helpful if the senior review could happen, perhaps, halfway through the process to avoid the number of occasions where there are last minute questions which can often require fund applications to be withdrawn and resubmitted in order to "restart the clock".

14. How do the FCA's timescales for fund authorisation compare internationally? Is there value in providing greater certainty about these timescales? Other than by reducing the statutory time limit, how could this be achieved and what benefits would it bring?

The FCA's timescales for fund authorisations compare favourably to those of other regulators and, in particular, the SLAs are very helpful.

However, there have been a number of instances where the SLAs have only been met due to applications being withdraw and resubmitted by the manager, in order to "restart the clock", as described above.

That aside, we do not observe deficiencies in respect of the formal authorisation process and timescales detailed in the legislation and in the FCA's SLAs. However, as described above, there are practical improvements that could be made to make the regime easier to navigate for managers making applications under the regime.

Incremental changes like those suggested above, and perhaps others, could ensure that the existing process can work better. We can certainly provide more granular feedback on the FCA authorisation process if that would be helpful.

19. Do you agree that reforms to enhance the attractiveness of the UK funds regime should focus on appealing to the creation of entirely new funds that have not yet been set up?

Enhancing the attractiveness of the UK's funds regime should not focus solely on the creation of new fund vehicles, although new vehicles and particularly the LTAF, might contribute significantly. Targeted and relatively simple enhancements should also be considered. Furthermore, a pro-growth tax regime underpins the attractiveness of the UK as an investment domicile and reforms to VAT would be a significant improvement.

Existing vehicles are well understood and generally work well for their intended investment purposes and investor groups. As we detail in response to Question 30, there are a series of improvements that can be made to the UK PFLP regime that would make the PFLP an extremely attractive vehicle to managers of unauthorised funds. While the creation of entirely new unauthorised vehicles might have many merits, the Government should not exclude the possibility of pursuing these 'quick wins' that can yield great benefits.

In respect of authorised funds, we agree that the creation of the LTAF, an entirely new fund vehicle, should be the focus of the reforms and would be most likely to enhance the overall attractiveness of the UK funds regime. We welcome the Government's desire to launch the first LTAF by the end of 2021. However, the desire to finalise the regulations quickly should not undermine the necessity to get the rules right. We have seen international examples, such as the ELTIF, that have been unsuccessful so far due to poorly crafted regulations. The attractiveness of the LTAF will be largely dependent on rules that successfully address investors' and their intermediaries' needs. We address these issues in our response to Question 38.

Finally, on tax, it will be important to address issues such as VAT of which more details are set out in response question 1. It will also be important to ensure that asset managers can take greater confidence in the tax system and not be subjected to knee-jerk changes or implicated by wider changes where the impact on the investment management sector has not been properly thought through. Over the next couple of years, the developments arising from this review and the AHC consultation will be seen as very positive, but only in an environment where managers and investors can grow more confident that the UK wants to encourage funds to hold investments in the UK. Going forward, more detailed consideration needs to be given to incremental changes that overtime inadvertently damage the attractiveness of the UK.

25. Should asset managers be required to justify their use of either closed-ended or open-ended structures? How effective might this requirement be, and what are the advantages or disadvantages of this approach?

We assume that the intent behind this proposal is to ensure that managers are appropriately managing the liquidity risks posed by their investments including any potential liquidity mismatches and that managers choose a fund structure that is well aligned with the liquidity of the fund's assets.

The starting point for regulators should be to ensure that investors have clear and meaningful information by which to judge whether an investment strategy is right for their individual needs. In the process of describing a fund's investment strategy, a manager should explain the nature of the fund's investments and the ability of investors in the fund to redeem their investment.

Second, supervisors should consider the extent to which a fund practically achieves the promises that are made in the fund's incorporating documents and disclosures to investors. This might include the extent to which an index fund tracks its reference benchmark or whether a fund is able to achieve the redemption terms offered to investors.

A specific obligation on managers to explain how a fund's structure relates to the nature of its assets and the manager's approach to liquidity management in respect of the fund might be helpful. This is because transparency about liquidity management and redemptions can help investors frame their judgement about the risks inherent in the fund and whether it is right for their needs.

However, it is not clear that requiring managers to 'justify' why a fund is open-ended or closed-ended will necessarily solve the problem of potential investor detriment. Open-ended and closed-ended structures offer different approaches to the problem of liquidity mismatches and neither structure is inherently better than the other.

Closed-ended structures reflect changes in liquidity via changes in fund's unit price. This can benefit an investor because there is little risk that they will not be able to redeem their shares in the fund. However, the investor pays a liquidity premium in terms of the price at which their shares or units trade and, therefore, the price at which the investor can redeem their investment (which is typically at a discount to the fund's Net Asset Value or NAV).

The shares of open-ended vehicles trade at a price that reflects the value of their underlying assets (i.e. at NAV). This can benefit investors that do not wish to be charged a liquidity premium. However, there is a risk that the investor might not be able to redeem their shares or units on demand, either because the fund has a longer term redemption window or notice period or because the manager or a regulator might suspend or gate the fund in exceptional market conditions. Furthermore, some managers might impose a price discount on redeeming investors via an exit charge or swing pricing in some circumstances.

Furthermore, there are an increasing number of funds that adopt a quasi-open ended or closed-ended structure. The LTAF, for instance, could be considered a quasi-open-ended vehicle due to its longer term (non-daily dealing) structure that reflects the liquidity of its assets.

These considerations make clear that investors should be able to choose the vehicle and strategy that best matches their requirements, including their preferences on when they can redeem their shares or units and at what price. The important point is that investors must have clear and sufficient information to enable them to understand the fund's operations.

28. Do you foresee any issues with the LTAF adopting the current tax rules for authorised investment funds? Would the nature of an LTAF's investments, and the tax treatment of the income it receives in respect of those investments, mean that the current rules for authorised funds lead to tax efficient outcomes?

The tax treatment will largely depend on the nature of the vehicle that is adopted however the primary aim will be to ensure that there is no additional tax leakage at a fund level as a result of using a UK vehicle. If existing rules for authorised investment funds are adopted, then it will be key to ensure that VAT issues are addressed and that there is no SDLT or other Stamp Duty on transfers of units. To the extent that treaty benefits need to be accessed then the interaction of the LTAF with the UK AHC regime should have a positive outcome.

In respect of VAT, we assume that the adoption of the current tax rules would involve the inclusion of LTAFs in the exemption under Item 9 Group 5 Schedule 9 VATA. The advantages and disadvantages of this treatment (discussed above) would be the same as for other regulated funds and are not specific to LTAFs.

If the QIS model is adopted for the LTAF regime, it is important to note that it currently requires genuine diversity of ownership (GDO), otherwise investors are taxed on dividend distributions and gains in the same way as distributions from other companies. Ordinarily there are good reasons for adopting a GDO condition, however it would prevent wealthy families/family offices from using the LTAF regime. Given the objectives of the LTAF are to encourage investment in long-term investments linked to infrastructure the government might consider making an exception for the GDO condition for particular asset classes (i.e. a white list of good investments) where without the private investment funding it would fall to the government.

29. Are there any other tax considerations, outside of those that follow from the adoption of the current tax rules for authorised funds, that will be important to the success of the LTAF? Please explain your answer.

We do not have particular views on this, but inevitably there will be other tax issues to address, for example, consideration of whether there should be incentives for investors using LTAFs. As a first step we believe it is important to focus on the structure of the fund vehicle and ensure that is workable from a tax perspective before wider consideration is given to incentivising investors.

30. How would each of the proposed unauthorised fund structures add value alongside existing authorised and unauthorised UK fund structures, including the QIS? Would they bring value alongside each other? Would they bring unnecessary complexity? What would each structure allow fund managers and investors to do that they are unable to do currently in the UK regime? Please address each proposed unauthorised structure separately, and indicate which of the proposed unauthorised structures you consider most important.

Limited partnerships – whether UK, Cayman, Delaware, Luxembourg, Guernsey or Jersey – remain the vehicle of choice, for both managers and investors alike, in the private equity, venture capital and private credit sector. Given the familiarity of managers and investors with limited partnership structures, we suggest focusing on developing and improving on the UK's existing PFLP offering, as opposed to creating a new structure with which managers and investors may be unfamiliar.

We consider that an improved UK PFLP would bring considerable value and, by developing an existing fund structure, would not add any complexity to the UK funds landscape. The improved UK PFLP would not be a "new" structure; instead, it would be implemented by making changes to the existing PFLP legislation. We suggest that the following changes could significantly enhance the attractiveness of the PFLP:

- PFLPs should have the option to elect to have **separate legal personality**. A number of benefits would flow from this. First, for PFLPs that elect for separate legal personality, this could result in simpler operating arrangements, with those PFLPs being able to enter into contracts their own names, own assets in their own names, hold rights in their own names and enforce those rights in their own names. It would also allow English and Northern Irish PFLPs that opted for separate legal personality to be used as "feeder funds" or as "funds of funds". For UK managers needing a fund vehicle with separate legal personality, this change would enable them to set up a PFLP in their own part of the UK, simplifying their structures and minimising cost. For such an option to be tax neutral, PFLPs electing for separate personality should still be able to enter into a VAT group with their manager (similar to the current accepted treatment for Scottish limited partnerships).

- PFLPs should also have the option to create **segregated liability cells**, where the assets and liabilities of a particular cell are segregated by law from those of the other cells. The ability for a single "umbrella" PFLP to have multiple cells could significantly simplify a fund manager's operations, by reducing the number of entities involved in fund structures. For example, instead of establishing two "parallel" PFLPs for a fund structure, a manager could have a single PFLP with two cells. If the same manager then wanted to establish a co-investment vehicle to bring co-investors into a particular transaction alongside its primary fund, it could add a third cell to its existing PFLP. Rather than running three different partnerships (as would currently be the case), the manager would instead be running just one. Further, managers who, in addition to managing pooled funds, also manage segregated mandates for certain investors, could use an "umbrella" PFLP as their investment platform: each new segregated mandate could be added as a new cell. Consideration should also be given to whether one cell should be able to invest in another cell, potentially allowing a manager to replicate a "master-feeder" structure within one "umbrella" PFLP.

- PFLPs should be **exempted from the "qualifying partnership" rules** altogether, so that there is no potential requirement for them to prepare and publicly file statutory accounts. The financial reporting and audit requirements for a private fund are negotiated and agreed between the manager and its investors, and there should be no further or duplicative requirements imposed merely because the fund vehicle is a UK PFLP.

- PFLPs should be **exempted from all Gazette advertising requirements**. The original PFLP reforms made considerable improvements in this area, but there remains a requirement to advertise a notice in the Gazette where a general partner of a PFLP ceases to be a general partner (s.10(1A) Limited Partnerships Act 1907). Interestingly, s.10(1A) does not require the notice to be advertised for the change to have effect – this contrasts with the requirements under s.10(1) for non-PFLP limited partnerships, where the transactions which must be advertised under that section are "deemed to be of no effect" until advertised. As a result, the purpose of s.10(1A) seems to be purely to give notice of the change in general partner(s). We suggest this requirement is removed, and instead third parties should rely on the filings made with respect to the PFLP at Companies House for notice of any changes in the general partner(s) of a PFLP. Having to advertise the change in the Gazette and file notice of the change at Companies House is duplicative, with the Gazette advertisement adding nothing to the Companies House filing.

- The PFLP legislation should **clarify the position on death of a limited partner**. We suggest that the legislation state that, unless the partners agree otherwise, on the death of a limited partner, the deceased's interest in the partnership continues to exist and passes to the deceased's estate, to be dealt with by the deceased's personal representatives. This would significantly simplify contractual arrangements, provide certainty and allow investors in particular to plan for the future in confidence. This will particularly valuable for PFLPs used as "friends and family" vehicles, carried interest vehicles, and team co-investment vehicles, as well as for venture capital and other funds in which natural persons form a significant investor base.

- The PFLP legislation should provide for **same-day online Companies House filings**. These changes would allow for swifter establishment of new UK PFLPs, and a more reliable and accurate register (with changes – e.g. admission or withdrawal of partners – appearing on the same day as the filing submitted by the general partner). The current system of paper filings means that it can take days, sometimes more than a week, for changes to a partnership to appear on the register.

- The current BEIS proposals to provide for the **removal of LPs and PFLPs from the register once fully wound up** should proceed. In addition to the benefits outlined in the BEIS proposals, managers and investors alike will benefit from the certainty of knowing that long-terminated funds no longer appear on the register.

- As mentioned in response to Question 37, a change to the way that fund partnerships are treated for **remittance basis users** would also remove an unnecessary push factor in fund managers establishing their funds offshore.

Taken together, we think these measures would make the UK PFLP an extremely attractive fund vehicle for an unauthorised fund.

31. Would these unauthorised structures support the government's work on facilitating investment in long-term and productive assets, as outlined in Chapter 1?

Limited partnership funds are frequently used to invest in longer-term, illiquid assets; increasing the attractiveness of the UK PFLP would, we believe, increase the use of UK-domiciled funds for investment in these assets.

32. ***How do you think the government could best achieve consistent branding for UK fund structures which target only professional investors?***

We do not have strong views on this. That said, as the PFLP already exists and already has a degree of name recognition, it makes sense to us to make use of the term "UK PFLP".

33. ***Do you think that these unauthorised structures should be unregulated collective investment schemes? If you consider any "light-touch" authorisation necessary or desirable, what do you understand this term to mean and what form could it take? Why would it be beneficial for investors, and how could it be explained to them in a way that avoid confusion with the regulatory assurances of fully-authorised structures?***

No, the UK PFLP should not be authorised or subject to any kind of "light-touch" authorisation. Managers and investors alike are used to funds of this type being unauthorised, and for regulatory supervision to be via supervision of the fund managers themselves. We see no advantage to requiring the fund itself to be authorised; on the contrary, any kind of authorisation would imply additional time and cost in establishing and operating the fund, which would not appeal to managers or investors.

34. ***Do you think these structures should have flexibility on whether they are open-ended or closed-ended? Should they have flexibility on whether they are listed or non-listed? How important is this?***

As a general principle, it is critical that structural decisions such as these are left to managers and investors to decide. Unauthorised funds of these kinds are often the product of significant negotiations between managers and investors, and they should have complete flexibility to negotiate liquidity and dilution provisions (including whether the fund should be open- or closed-ended) as well as the availability of liquidity on the secondary market (listing). We do not believe that these structural options should be prescribed or proscribed in the relevant legislation.

35. ***Do you think these vehicles should or could be implemented as part of existing structures set out in legislation? Please provide details. If not, please explain why not.***

As noted above, we consider the best approach would be to update the existing UK PFLP legislation. The PFLP already exists, is known to many managers and investors alike, and is familiar to tax and legal advisers and other professional fund service providers.

36. ***Are there any specific tax treatments that would be either necessary or desirable to support the successful introduction of new unauthorised fund vehicles in the UK? Please provide detail of how and where this is the case.***

The combination of a new unauthorised fund vehicle and the AHC regime means that the UK will be an attractive location not only from a fund perspective, but also for the underlying holding structure. As explained, the fund regime needs to have the flexibility to be attractive to a range of strategies, assets and investors, and furthermore it needs to be simple to administer and easy to explain to prospective users.

The key tax principles for a new unauthorised fund vehicle can be summarised as follows:

- The vehicle should be tax neutral, with minimal (if any) taxation at the level of the fund with the income / gains liable to tax in the hands of each investor. The professional investment fund, if structured as a contractual scheme as proposed by others, would have the attraction of being designated as a tax-transparent fund.

- Some form of VAT zero-rating for unauthorised fund vehicles would be required to ensure a level playing field between UK and non-UK unauthorised funds. Without any amendments to legislation, the management of any new unauthorised fund vehicles other than limited partnerships will be subject to UK VAT. Based on the current VAT legislation we would expect that in many cases this

VAT would not be recoverable by the fund (or would only be recoverable in part). This would be a significant cost compared with the management of comparable non-UK funds.

- No SDLT or other Stamp Duty should be imposed on transfers of units.
- To the extent that treaty benefits need to be accessed, it will be necessary to ensure that the fund and / or the UK AHC can access relevant double tax treaties.
- There should be minimal regulatory and investment/liquidity oversight where the fund is aimed at sophisticated institutional investors. Investor protection should ideally be through marketing and investor eligibility requirements rather than investment restriction or requirements for liquidity.
- Overall, cross-party support is needed to ensure managers and investors have confidence that the changes being made will have some permanency.

31.Are there any interactions with wider tax policy that the introduction of new unauthorised vehicles would need to navigate, in order to avoid unintended consequences?

Remittance basis users

A further area to navigate is how a UK fund regime will interact with remittance basis users where income from non-UK sources and gains arising on the disposal of non-UK assets are currently not immediately taxable until or unless they are remitted to the UK. A UK fund would (a) cause amounts to be remitted when invested in the fund and (b) taint those non-UK source income and gains that are realised through that fund structure, so the remittance basis rules have the effect of encouraging UK resident non-domiciled individuals to invest in non-UK funds and managers who target high net worth investors to use non-UK fund structures to accommodate them (or at least to ensure they do not close off that portion of the market). This can be a major issue when the choice of fund jurisdiction is otherwise neutral, and a large remittance basis user investor would otherwise not invest.

We propose that the business investment relief provisions which apply to permit investment by remittance basis users in UK trading companies should be extended to UK funds (both companies and partnerships) to remove this issue.

Interaction with AHC

The consultation recognises the desire to locate AHCs in the same jurisdiction as the funds themselves. We are very supportive of the work undertaken so far to develop the AHC regime to make the UK more attractive for these intermediate companies that hold assets. It will be important to ensure that the reforms to UK funds will mean that the AHC eligibility criteria can be satisfied by a UK non-authorised fund. Furthermore, and related to the point above regarding remittance basis users, the AHC regime will need to ensure that the proceeds of UK AHCs retain their non-UK source to the extent they relate to non-UK situs assets when used in conjunction with a UK fund vehicle.

Anti-avoidance and Genuine Diversity of Ownership ("GDO) " with a non-close test

We understand that the government will want to consider the parameters for new fund vehicles (whether authorised or non-authorised), and there will be a desire to distinguish a genuine pooled fund vehicle from something that might have been set up to avoid tax. The combination of a GDO and a non-close test (with exceptions for qualifying institutions) is familiar to the industry following the changes to NRCGT and is also under discussion in relation to the qualifying criteria for the AHC regime. As highlighted previously under Question 28 the GDO requirement would limit the pool of investors from family offices, and we suggest that the government considers whether this is appropriate for the LTAF regime where post-Covid, the LTAF regime could support long-term infrastructure investment that would otherwise need to be funded by the government.

32.Are there other things government should consider as part of this review of the UK funds regime, or proposals for enhancements to the UK funds regime which the government has not included in this call for input? If so, how important are they and how would you like to see them prioritised in relation to the proposals explored in this call for input?

In our view, the creation of the LTAF is the most wide-ranging and potentially beneficial proposed reform to the UK fund regime. It is essential that policymakers achieve the right design for the LTAF first time. We have seen in respect of the EU's ELTIF that poor regulations can hamper the launch of a new fund type, perhaps fatally, making it very difficult to enact subsequent reforms that can rescue its standing with managers and investors. The Government's ambition to launch the first LTAF by the end of 2021 is laudable, but it is important that the rush to complete the rules does not result in avoidable mistakes.

First, achieving the aim of 'retailisation' means that the LTAF must be considered by retail investors and their intermediaries to be a viable and safe instrument for their investment. We are confident that the proposed features of the fund should help achieve that. However, we are concerned that not basing the fund structure on the NURS, as proposed by the UK Fund Regime Working Group, could undermine the perception of the LTAF as a fund that is right for retail investors.

It is currently unclear in regulatory terms whether DC scheme trustees, for instance, can invest their scheme members' savings in funds that are eligible for professional investors. Regardless of the regulatory position, many scheme trustees believe that they cannot or should not invest in funds that are not designed for retail investors.

If the LTAF is based on the QIS (for professional investors), DC scheme trustees might feel reluctant to invest in the LTAF given the regulatory, reputational and legal risks that the trustees bear as fiduciaries of their scheme members' savings. Consequently, we suggest that the LTAF should a variant of the NURS (eligible for retail investors) to overcome any possible issues around branding and reputation.

Related to this, it is important for the launch of the LTAF that the fund's intended investor base is not only DC scheme members, but also wealth management clients and potentially multi-family offices. Some DC pensions schemes (such as NEST) are gradually increasing their allocation to private assets. The introduction of the LTAF might accelerate this process. However, it is still likely to take some time for pension schemes to increase their asset allocation to the LTAF. For an LTAF to build sufficient scale in investment, it will be necessary to have diversified sources of funding from the outset. Wealth management clients, as advised (often retail) investors with relatively large amounts to invest, are likely to have the appetite to seek investments in riskier assets to increase their yield as part of a diversified portfolio. A requirement to have a minimum investible amount could also provide an additional layer of investor protection.

Second, DC scheme trustees are understandably price conscious. In some respects, the regulatory focus on ensuring only the lowest cost investments, often to the exclusion of considerations about risk and potential returns for investors, has contributed to this preference. The illiquid and unlisted investments that the LTAF will invest in are by nature more expensive to access than listed equities, for example. DC scheme trustees will need to feel comfortable that the higher price attached to these investments can be justified in terms of the generally superior returns for their scheme members.

Part of making DC scheme trustees comfortable with the costs will need to be a change in tone from policymakers. An example is the focus on 'value' as being primarily equated with 'the lowest cost' investment (such as in respect of active management compared with other investment strategies). Rather value should be treated in a multi-faceted way comprising investment returns, price, diversification and the ability to achieve a range of investment aims including for non-financial and ESG reasons. This change in tone would be reflected in regulations. We welcome the DWP's consultation on the charge cap and their desire to address issues related to performance fees and to the look-through to facilitate DC scheme's investments in private assets. The current considerations provide an opportunity to demonstrate unambiguously to DC scheme trustees that policymakers support investment in assets that can drive economic growth, so long as these investments are made with due consideration of the risks, as part of a DC scheme's diversified portfolio and with consideration to price among other relevant factors.

Consultation questions not addressed in this response

3 Why has uptake of TEFs been limited? Please explain any operational or commercial factors that have influenced their uptake. How could these be addressed?

4 How would the proposals in paragraph 2.9 improve tax efficiency of multi-asset authorised funds? Please explain how the proposals would work in practice and how a proportionate impact on HMRC could be ensured.

5 Are there are any additional changes the government could consider to reduce tax leakage in multi-asset/balanced authorised funds?

15 What would you like the QIS structure to enable you to do that is not currently possible? What are the existing impediments to your suggested strategies, and why would the QIS be the preferred UK structure for those strategies?

16 Do you think that the range of QIS permitted investments should be expanded? If so, in what way should it be expanded, what impact would this have, and would it still be appropriate for sophisticated retail investors?

17 Do you think that the QIS borrowing cap should be raised or QIS constraints on derivatives exposure should be relaxed? If so, to what magnitude and why? Would this be appropriate for sophisticated retail investors?

18 Do you agree that the QIS sub-fund structure could be improved? If so, how? Would greater clarity for the segregation of assets between sub-funds via legislation or rules be helpful? Please provide details.

25 Should asset managers be required to justify their use of either closed-ended or open-ended structures? How effective might this requirement be, and what are the advantages or disadvantages of this approach?

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