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# HMT REVIEW OF THE UK FUNDS REGIME:

# TRAVERS SMITH RESPONSE

## 1. EXECUTIVE SUMMARY

### 1.1 This response

Travers Smith is a leading London based law firm. We advise a wide range of UK, European and global fund managers. We welcome HM Treasury's consultation on how to improve the UK's funds regime, to support existing managers and attract new ones. This response has been prepared by our asset management specialists across our funds, regulatory, tax and transaction teams. Our response has a particular focus on the alternative asset management/private funds sector, covering private equity, debt, real estate, infrastructure and hedge funds. Funds in this sector are principally marketed to institutional investors.

We welcome HM Treasury's call for input on the UK Funds Regime. This response answers a number of the specific questions raised by HM Treasury. It also considers a wider range of topics relating to the UK funds regime.

The ***first part*** of this response sets out our views on improvements which could be made for the sector.

***Annex 1*** lists out the questions from the consultation which we have addressed and sets out where in the first part of the response we have addressed them.

***Annex 2*** sets out some more detailed comments on partnership law reform.

We would welcome the opportunity to discuss our response further with HM Treasury.

### 1.2 Attracting and retaining Global fund managers

The UK is a leading centre for Global private fund managers. This brings highly skilled jobs for asset managers and their service providers, in particular: administrators, lawyers, accountants, ESG consultants, data providers and others. For many asset classes, having global fund managers located in the UK also increases the likelihood of those funds raised from global investors being invested in the wider UK economy. It also means that UK institutional investors have the option of investing with a wide range of local fund managers, rather than needing to seek best in class managers in other jurisdictions.

The global funds market is highly competitive. Managers are able both personally to shift between jurisdictions and to establish funds they manage in different jurisdictions. Factors include:

- Access to investors
- Access to asset manager talent
- Tax neutral fund vehicles
- Access to/ease of dealing with tax, regulatory and legal authorities
- Effective and respected regulation
- Effective anti-money laundering controls
- Private and public market liquidity
- Access to expert service providers
- Competitive personal tax treatment

The UK must be a leader in all of these areas in order to maintain a compelling case for asset managers to maintain and invest in a UK base.

### 1.3 Asset Management Competitiveness Unit

The UK needs to enhance its brand as a jurisdiction for asset managers and fund establishment. The UK Government should outwardly support and market the sector. We recommend there should be a permanent team in Government responsible for monitoring and promoting the competitiveness of the asset management sector. That team should be tasked with maintaining a holistic approach to private funds, monitoring how the UK sector compares to that of other jurisdictions. It should promote the maintenance of a proportionate tax, legal and regulatory regime for the sector. It should have the ability to work (as one) with other departments to review changes which, in the round, could directly or indirectly adversely impact the UK sector. Industry representatives who raise concerns about policies which chip away at the asset management sector regularly find that their concerns are not taken into account by UK policymakers. The effect of this is a series of changes which whilst individually minor, collectively amount to material aggregate incentives for asset managers to move their operations outside the UK. A core purpose of the central unit will be to act as a central check on these types of issue.

### 1.4 Preserving what works

Much of the current UK funds framework is strong and must be maintained. The UK has a strong reputation for robust financial services regulation which is attractive to investors. The UK has strong anti-financial crime controls. UK funds are largely tax neutral, which means that when those funds invest in companies, investors are not subject to double taxation (at fund and investor level) on the profits and capital gains made by the funds.

### 1.5 Attracting and retaining international institutional investors

The UK should establish a regime to allow non-UK headquartered institutional investors to establish in the UK in order to allow UK managers to market funds to them. The UK would need to facilitate this happening without requiring the investors to be separately UK regulated.

**1.6 A flexible funds offering**

The UK needs to maintain a range of funds suitable for different asset classes and investors. We have already responded to and support the proposals for the new asset holding company regime. We welcome the new Professional Investor Fund as proposed by the Association of Real Estate Funds as a new vehicle which could fill a gap in the current UK fund offering and be suitable for international as well as domestic institutional investors. We also support proposals for a modernised REIT.

**1.7 Sustainable investment**

The UK should continue to develop its regime for fund managers to report on their ESG strategies to support the net zero carbon agenda. Permitted categories of types of investments should be reviewed (eg in the REIT regime) to ensure that these align with these.

**1.8 Immigration**

The UK needs to maintain an attractive immigration environment. Global asset managers need the flexibility to move their staff between global fund locations. Service providers need the same flexibility. Consistent messaging about the UK seeking to attract top global talent would support the development and maintenance of this environment.

**1.9 Three main priorities**

Question 1 of the call for input asks for us to identify three main priorities. These are:

**1.9.1** The establishment of an ***asset management competitiveness unit***, to bring a holistic approach to the sector in Government.

**1.9.2** ***Tax:*** The Government should eliminate the current incentives for establishing funds outside the UK. In particular this applies to VAT (see para 3.4). The Government should make clear that it does not intend to introduce further tax changes that specifically target investment managers and which would be expected to have a negative impact on them (see para 3.6). We set out a series of other recommendations on tax reform in sections 3 and 4 of this paper.

**1.9.3** ***Plugging the gaps in the range of available UK funds structures.*** We set out our recommendations in section 6. The UK should offer the full range of fund products that investors may seek which are available in other jurisdictions. In particular we support the proposals for the new Professional Investor Fund in the form of an unregulated contractual scheme (UCS) as proposed by the Association of Real Estate Funds (AREF). This should be an effective onshore UK equivalent to the Jersey Property Unit Trust (JPUT), *Luxembourg Fonds*

*Commun de Placement* and *Irish Contractual Fund*. It should be able to accommodate investments other than just real estate.

### 1.10 Contributors

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## 2. TREATMENT OF UK VENTURE CAPITAL AND PRIVATE EQUITY FUND ENTITIES

### 2.1 Consistent recognition of the rule of venture capital and private equity funds as "investment vehicles" in England and Wales

We suggest that the UK takes a more consistent and coherent approach to the way in which private equity and venture capital limited partnership funds are treated for legal, regulatory and reporting purposes. These funds are investment vehicles. They are not conglomerates or group holding companies and should not be treated as such. This needs to be reflected in a number of areas:

***Preserve the current position of no consolidated accounts at fund level:*** The vast majority of private funds are not required to prepare accounts which consolidate the portfolio investments by UK and International accounting standards, even in cases where the investment fund holds a majority of the shares and/or voting rights in the underlying company. This is appropriate because each of those companies (together with their subsidiaries) are operated independently with their own financing structures and management. It would not make sense to treat them as a single entity for financial reporting purposes.

***Extend this concept to other areas:*** This treatment of private funds as investment entities is not consistently applied across all legal, tax and reporting regimes and the differences frequently give rise to complexity and anomalous results.

For example, ***merger control filings*** require that all assets of a private fund are aggregated when assessing whether or not a filing is required. UK based funds taking majority stake in UK financial entities will be subject to ***regulatory capital consolidation***, acting as an incentive for managers to establish funds outside the UK to invest in UK businesses.

This issue is also relevant to tax: see in particular our comments on the ***partnership aggregation rules*** at paragraph 4.2 below.

Similarly, availability of some Covid-19 Government-backed support schemes was initially in doubt for portfolio companies on the basis that they had to aggregate their turnover with other companies in the same portfolio and were therefore deemed too large to qualify.

We consider that it would be helpful, and would improve the attractiveness of the UK as a place to locate private funds if the UK applied a consistent treatment to investment vehicles and, following the accounting treatment, regarded underlying portfolio companies as separate entities. The limited partnership which sits at the top of the structure should not be considered a 'parent company' for any purpose.

We would be happy to discuss this with you further, and identify specific areas of difficulty in more detail, if that would be helpful.

## 3. APPROACH TO FUNDS TAXATION

**3.1** **A competitive tax regime for asset managers*:*** When considering how tax impacts on the asset management sector, the need for tax competitiveness extends beyond having a tax neutral fund vehicle and is of fundamental importance to all levels of the arrangement i.e. the asset manager level, the fund level and the asset holding level. In this regard, whilst we welcome this call for input as well as the proposals to introduce a tax efficient asset holding company regime proposals, reform should go further and also consider ***the tax position of asset managers***. This is particularly relevant given that, in most cases, a fund will be established by an asset management house and the house's post-tax return, and the post-tax return of its individual team members, will inevitably be an important consideration in deciding the jurisdiction in which to locate the various elements of the fund structure. Accordingly, it is not enough for the UK to have a competitive range of fund vehicles; it should also have an attractive tax regime for fund managers. This issue is considered further below.

**3.2** **Holistic approach to government tax policy*:*** The UK tax regime is subject to frequent changes and reforms. This is unsurprising as economic and political circumstances and technological advances change the fiscal landscape. However, it is important that:

**3.2.1** First, the changes are made in a joined-up manner consistent with the overall strategy that the government has for the asset management sector. In the case of the current call for input, it will be crucial that any reforms fit together with the results of the upcoming ***review of fund management fees*** and the ***asset holding company consultation***.

**3.2.2** Second, when the government makes ***general changes to UK tax***, the specific impact of such changes on the asset management sector should be considered and given more weight than has previously been the case. For example, the introduction of the corporate loss restriction rules in 2017 were not primarily targeted at general partners carrying forward their share of fund losses from the early years of the fund; however, the rules applied to them and resulted in disproportionate problems.

Our proposal for an ***asset management competitiveness sector team*** would address both these issues.

**3.3** **First mover disadvantage:** The UK should strive to remain at the forefront of standard raising, but ***should not be a serial early adopter of international rules***. Being an early adopter leads to the UK being a testing ground for complex new regimes, unable to draw from the experience of others as to what works and what does not, and leaves UK businesses to deal with the resultant uncertainty and ongoing amendments to the rules. In addition, early adoption of restrictive tax rules puts the UK at a competitive disadvantage to other jurisdictions, and this disadvantage lasts beyond the period when the UK has different rules to other jurisdictions. This is because, if a business chooses to use a foreign jurisdiction that has not yet introduced a new regime, it is unlikely that it will relocate an established venture to the UK when the foreign jurisdiction later implements the regime. This is particularly relevant in the context of rules introduced in response to the BEPS project:

**3.3.1** The UK was an early adopter of the ***anti-hybrids rules*** and hurriedly introduced a highly complex regime in January 2017. This meant that there were flaws and shortcomings in the legislation coupled with a lack of definitive and clear HMRC guidance at the outset. Various amendments have had to be made to the anti-hybrids rules since 2017 in order to rectify shortcomings in the legislation including the wide-ranging changes included in the Finance Bill 2021. The "early adopter" approach has inevitably resulted in uncertainty for taxpayers who were generally unprepared for such complex rules. It is worth noting that when other key fund jurisdictions such as Ireland and Luxembourg introduced anti-hybrid rules in January 2020 (three years after the UK) – a more considered approach was adopted to the implementation of the rules in those jurisdictions.

**3.3.2** The ***Base Erosion and Profit Shifting (BEPS) 2.0 Project***: The BEPS 2.0 (Pillar One and Pillar Two) initiative introduces measures to ensure a global minimum level of taxation and focuses specifically on introducing new concepts and rules to address the tax challenges of the digitalisation of the economy and grant new taxing rights to the countries where users of highly digitalised business models are located. Such an initiative has the potential to disrupt the asset management industry. In particular, implementation of Pillar 1 could result in a requirement for large asset management businesses to allocate taxable activities to jurisdictions where they have no permanent establishment. Likewise, implementation of Pillar 2 could result in certain fund structures being subject to GloBE taxes. Whilst the recent blueprints on Pillar 1 and Pillar 2 demonstrate that the OECD have attempted to address these concerns, any changes to domestic tax rules arising as a result of BEPS 2.0 are likely to be extremely significant and complex. It will, therefore, be particularly important that the UK moves in step with other jurisdictions in terms of the timing of the introduction of any new rules, rather than hurriedly introducing them and adopting the "first mover" approach as has occurred previously.

**3.4 Avoiding UK tax incentives to move infrastructure and jobs to other jurisdictions**

***The UK should change the current UK VAT incentives for fund managers to locate funds outside the UK.*** Currently, supplies of fund management services to foreign private equity funds can be made free of UK VAT while allowing the fund manager to recover its related input VAT. An equivalent supply to a UK fund would, however, be subject to UK VAT. This provides managers with a significant incentive to establish funds in other jurisdictions. The same issue arises in relation to some other services.

Whilst VAT grouping the UK fund manager with the UK fund ensures that the fund management services are disregarded for UK VAT purposes, UK fund managers are in a better VAT recovery position if the fund is located offshore. There is, therefore, a VAT incentive for UK fund managers to locate their funds offshore.

It is important that the UK VAT treatment of management supplies to foreign funds is not made less generous as this would erode the UK's competitive position for the location of the asset manager. Instead, the government should also consider ways of improving the position for ***equivalent onshore supplies*** so that they are not comparatively disadvantaged. We look forward to the publication of the Governments consultation on the VAT treatment of fund management fees so that this issue can be addressed.

**3.5** **Provide UK tax incentives to move infrastructure and jobs to the UK:** Currently, the UK tax rules contain a number of special rules targeted at asset managers. However, these rules typically, focus on preventing perceived tax avoidance by asset managers (see further below) rather than seeking to provide incentives for investment in the UK. As discussed further below, competitor jurisdictions are using tax incentives for asset managers to boost their funds industry and we recommend that the government considers a similar approach. In particular:

**3.5.1** If the aim is to encourage asset managers to domicile their funds in the UK, consideration could be given to applying lower capital gains tax rates to carried interest received by managers from funds which are established as UK limited partnerships and which use UK asset holding companies. These rates would be no higher than the normal capital gains tax rates (i.e. 20% rather than the current special higher rate of 28% that applies to carried interest). We note that ***under French rules*** for example, any sums derived from carried interest are treated as capital gains or distributions and taxable at a lower rate provided certain conditions are met. One such condition is that the fund vehicle must be established in the EU. Asset managers with French team members will, therefore, often use Luxembourg or Ireland as the jurisdiction for domiciling their funds.

**3.5.2** Whilst the UK has a beneficial regime for non-UK domiciled individuals, consideration should be given to improving the UK tax position for fund managers who are moving or returning to the UK. We note that some jurisdictions have, in recent, years, introduced tax regimes aimed at attracting foreign individuals to move their tax residency to those jurisdictions. Under the ***Italian inpatriate regime*** for example, individuals who migrate their tax residency to Italy can opt to be subject to Italian income tax on only 30% of their employment income, self-employment income and business income for five years (which can be extended to 10 years in certain situations).

**3.6** **Punitive tax rules for asset managers**

**3.6.1** Between 2014 and 2017 a number of tax rules were introduced which either specifically singled out fund managers for adverse tax treatment or significantly detrimentally impacted on them. These include the salaried member rules, the mixed member rules, disguised investment management fee rules, the higher rate for carried interest capital gains, income based carried interest rules as well as other partnership tax changes.

**3.6.2** The introduction of any further rules specifically targeting the investment management industry that are not aimed at simplifying the current position or making the regime more internationally competitive could be a disincentive for international management groups to retain UK offices or to carry on any activities from those UK offices which are not strictly related to UK or European funds. In order for the UK to continue to be a leading centre for fund management, it would be helpful if the Government could indicate that ***no further changes specifically targeting asset management are planned for the life of the current Parliament***.

**3.6.3** We recommend that the Government considers applying the normal capital gains rates to carried interest, instead of the current higher rates. The Government could accompany this with an incentive to base those funds and/or fund managers in the UK. Whilst we note the recommendations of the Office of Tax Simplification as regards its review of capital gains tax, any increases to the rates of tax for carried interest will have a significant impact on whether fund managers will choose the UK as the location to operate their business and will most likely place the UK under a detrimental disadvantage.

**3.7** **Establishing a wide range of tax efficient fund vehicles for use for different asset classes:** The UK limited partnership is an attractive fund vehicle for certain asset classes, in particular, for private equity. Whilst technical improvements could be made to improve its attractiveness from a UK tax position, wide-ranging tax reform is not necessary or desirable.

However, having a wider range of tax efficient fund vehicles would allow fund houses to use the UK for different asset classes and therefore make it a more attractive base jurisdiction. For example, an effective unauthorised corporate fund vehicle which could be used as a credit fund would allow a fund house that focuses on both debt and equity investments to use the UK for all its strategies.

**3.8** **CGT and Statement of Practice D12**

It is suggested that HMRC's approach to the capital gains tax consequences of changes in partnership interests as set out in Statement of Practice D12 be reviewed in the context of ensuring that partnerships can function as fund vehicles in an open-ended or quasi-opened ended situation. The current approach of treating any decrease in a partner's partnership interest as a (potentially (unfunded) taxable) disposal, including when a new partner is admitted, can mean that alternative (often offshore vehicles) are used instead. This issue is particularly acute for real estate. We would recommend that the current position is ***reviewed in the context of funds that are either (i) widely held, (ii) not "close companies", or (iii) close companies only because of the presence of institutional investors***. Appropriate definitions could be based on those in the capital gains rules relating to UK property rich collective investment (contained in schedule 5AAA of the Taxation of Chargeable Gains Act 1992).

### 3.9 SDLT

***SDLT on the transfer of interests in UK property investment partnerships*** is one of the main reasons for people seeking to use offshore structures in the context of real estate funds. Notably, there is no such tax on transfers of interests in many other fund structures. It is suggested that this is ***removed for funds within points (i) to (iii)*** of para 3.8 above.

### 3.10 Property Investment LLPs

We suggest abolition of the rule that disapplies, for investments in property investment LLPs, the usual exemption from tax on investment income and gains applicable to pension funds. It is not clear why this rule still exists, though it is understood it revolves around concerns about tax avoidance, as the precise concern has not been articulated. We suggest that, whatever the exact concern is, it should be dealt with by targeted rules rather than the blunt instrument of disapplying the usual tax exemption. The adverse tax implication was abolished for life companies some years ago.

In particular, the restriction on LLPs can impact on the structuring of funds and joint ventures. For example, local authorities are familiar with and often wish to use LLPs but this will hamper pension fund investment. This is problematic for other institutional investors (i.e. not just pension funds) as they will be aware that the LLP structure will reduce the market for their investment on an exit (as they will not be able to sell to pension funds).

### 3.11 Partnership aggregation rules

See paragraph 4.2 below.

## 4. APPROACH TO DEAL TAXATION

### 4.1 Considering the impact on UK investee companies

A review of the UK funds regime should not look at fund-level issues in isolation but should also consider ***the impact of the UK funds rules on UK investee companies*** of those funds. Any reform of and growth in the UK funds industry is an opportunity for a greater amount of capital to be invested in UK investee companies. UK investee companies should not be disadvantaged when invested in via a fund rather than directly by corporate entities/individuals, and the UK tax rules as they apply to investee companies should not adversely impact typical investment models or structures used by the funds industry. These comments also apply in the context of the Asset Holding Company consultation, which should be considered alongside the broader review of the UK funds regime.

### 4.2 Partnership aggregation rules

The various UK tax rules that aggregate the interests of partners in a partnership should also be considered in the funds context. Partnership aggregation rules can result in investee companies of partnerships being treated as controlled, or as being associated/linked with other fund portfolio companies, for tax purposes. This can impact e.g. ***access to SME R&D relief***, the ***ability to use EMI options*** and possibly the ability to benefit from the small companies corporation tax rate that is to be introduced in 2023. Investee companies are effectively penalised because their investors have invested via a fund (usually for regulatory or commercial reasons) rather than directly. We would suggest in particular that the position regarding EMI options is amended to accommodate typical fund structures and note that a separate EMI consultation has been announced, which will hopefully consider this point in more detail.

## 5. UK LIMITED PARTNERSHIP LAW

### 5.1 Ongoing consultation on further changes to limited partnership law

We strongly recommend that the BEIS ***conclude its consideration of proposed reforms to UK limited partnership law*** as quickly as possible because the continuing review is causing uncertainty in the market. The review was triggered by concerns that some UK limited partnerships were being used for anti-money laundering or other criminal purposes. There has been no suggestion that these anti-money laundering concerns have any connection with venture capital and private equity funds but the continuing uncertainty is a concern in the UK private fund sector. Industry engagement with BEIS has led to the development of some workable solutions that we believe would meet any ongoing concerns.

### 5.2 Legal personality

We consider that it would improve the attractiveness of UK limited partnerships in the private fund sector if there was an ***option to establish a UK limited partnership either with or without a separate legal personality.*** Currently, all Scottish limited partnerships have separate legal personality and all limited partnerships established elsewhere in the UK (including in England) do not have separate legal personality. Having a separate legal personality enables the limited partnership itself to hold assets and to contract with third parties in its own name. This would simplify UK fund structures, limited partnership contractual arrangements and the holding of limited partnership assets. Simplification of the structure would also mean the need potentially for fewer vehicles and so lower costs, effectively making the vehicle more competitive commercially in the returns it can offer compared to its offshore counterparts – or at least not at such a disadvantage. It would also simplify financing transactions for limited partnerships, (especially in connection with granting security over assets of the partnership, particularly in the context of real estate with the provisions of section 27 Law of Property Act). It would also be helpful if a limited partnership with separate legal personality had an express power to grant a floating charge over its assets.

We recommend that, as currently is the case for Scottish limited partnerships, ***a UK limited partnership with separate legal personality should not be a "body corporate".*** We also recommend that the option be retained for a UK limited partnership to be established as a ***contractual arrangement without separate legal personality***, because in some cases having separate legal personality might result in the limited partnership suffering adverse tax treatment under the tax laws of some foreign jurisdictions. This is in line with the recommendations of the joint report on partnerships in 2003 of the Law Commission and the Scottish Law Commission (the "2003 LC Report"). It would also match what is offered under the limited partnership laws of other competing jurisdictions including Guernsey, Jersey and Luxembourg which offer forms of limited partnership with or without a separate legal personality.

To make sure that the tax transparency of the partnership whether with or without separate personality is clear, we would suggest that HMRC ensures that this is reflected in its international manual to assist with the understanding of the UK tax implications of the options (ie that there should be none) internationally. This should also assist with the continued view of it being transparent in some (but not all) other jurisdictions.

In summary, we consider that providing fund managers and investors with the option to establish a UK limited partnership with or without separate legal personality would increase the attraction of the UK as a location for private funds by ***reducing costs and complexity***. However, the introduction of separate legal personality would have to be undertaken taking into account any other implications there might be. In particular, it would be important that a limited partnership with separate legal personality did not result in there being an adverse VAT position. Currently, in the case of both English and Scottish limited partnerships, UK VAT law is applied on the basis that it is the general partner of the limited partnership that is the VAT person in respect of the limited partnership. It would be important that that analysis also applied to any UK partnership that had separate limited personality.

There is a more detailed discussion of the issues in the Annex to this note.

## 5.3 The Partnership Accounts Regulation

The Limited Partnerships Act 1907 does not make specific provision for the accounts of a limited partnership. However, under the Partnerships (Accounts) Regulations 2008 (as amended), accounts are required to be prepared and filed in respect of a UK limited partnership (in a similar way to companies) if the partnership is a "qualifying partnership". A qualifying partnership is (broadly) a limited partnership whose general partner is either a limited company or certain other types of entity or association having limited liability. These rules were introduced to implement EU Directive (90/605/EEC). ***We recommend that these accounting rules be disapplied***. Now that the UK is no longer within the EU, the obligation to retain these rules in order to comply with EU Directives is no longer applicable.

Private funds do generally produce and circulate to their investors audited financial statements. However, these are often not prepared according to UK or International GAAP, but apply US GAAP or a different set of accounting standards as required by investors. They are also not generally published. If this obligation to prepare and file UK GAAP accounts applied to private funds (including private equity funds), it would often involve duplication of effort to prepare a second set of accounts and could require potentially sensitive information to be made available to the public. This would be extremely unattractive to the managers of, and investors in, such funds. These accounting rules do not apply to limited partnerships formed in a number of other jurisdictions (including the SCPs in Luxembourg, and limited partnerships in Guernsey, Jersey, the Cayman Islands and Delaware) which can put the UK at a competitive disadvantage.

Not all UK limited partnership private funds are treated as a "qualifying partnership" but the risk that the Partnership (Accounts) Regulations 2008 might apply to private funds is an adverse factor in any decision whether to locate in the UK rather than in another jurisdiction. In the Government's response to the consultation on the reform of limited partnership law dated December, 2018, the Government said it did "not consider the case has been made for all limited partnerships to prepare accounts and reports in line with limited companies". We agree.

## 5.4 Ringfencing of sub-funds of umbrella funds

Private funds sometimes wish to establish "umbrella fund" structures under which separate "pools" of assets and liabilities (or "sub-funds") of a limited partnership are attributed to limited partners holding different classes of limited partnership interest. This can be to enable a single limited partnership to offer investors different investment strategies such as offering (for example) a credit strategy to holders of a Class A limited partnership interest and offering a buyout strategy to holders of a Class B limited partnership interest. It could also be to used avoid the need for separate vehicles in a fund structure when some partners need for tax or regulatory reasons to invest through a "blocker" structure (in which case a "blocker" could be inserted beneath a sub fund). Umbrella fund structures are common in the retail investment fund sector.

The intention is that holders of a particular class of limited partnership interest will only benefit from the performance of the underlying investment strategy being pursued in respect of the sub-fund attributable to that class. The problem is that the segregation of the different assets and liabilities of the limited partnership is achieved by the contractual arrangements in the limited partnership agreement. Whilst this binds the partners, it will not bind third party creditors. This leaves open the possibility that a creditor in respect of one sub-fund may have to be satisfied out of the assets of a different sub-fund if there are insufficient assets in the original sub-fund to satisfy its claim. The risk of any such "cross contamination" presents a serious problem for any investor in an umbrella structure.

In certain other jurisdictions such as Luxembourg and Ireland, there is statutory recognition in limited partnership law that different pools of assets and liabilities of a limited partnership to be "ring fenced" so that a creditor in respect of one pool of assets (sub-fund) cannot claim against a different pool of assets (sub-fund). We consider that this would be an attractive feature to introduce into UK limited partnership law so as to enable private funds structured as limited partnerships to operate as umbrella funds. There may also need to be a clarification that use of an umbrella structure in a UK partnership does not prevent the partnership from being a single partnership for the purposes of UK partnership law.

## 6. UK FUND STRUCTURES

### 6.1 Current gaps in UK domiciled fund structure offering

At present, there are a number of gaps in the UK domiciled fund structure offering which we consider would be vital to improving so as to enhance the UK as a jurisdiction of choice for fund establishment, in particular:

***Tax Exempt Corporate Structure***

A tax-exempt corporate fund structure (or such a structure with a targeted participation exemption) is an obvious gap in the UK's range of structures. The addition of such a structure to the range of UK vehicles would ***allow the UK to compete with equivalent EU domiciled vehicles, including those in Ireland and Luxembourg***. In the investment company context, we would argue such a structure should be in addition to the existing investment trust regime and not a replacement for it.

***Real Estate Funds***

A large amount of investment in UK real estate is made through offshore (commonly Jersey) property unit trusts (JPUTs) and Luxembourg *Fonds Commun de Placement* (FCPs). Many of these funds are invested in by UK investors. This use of an offshore structure gives rise to extra administrative costs and legal complexity as well as diverting associated advisory and support work away from the UK. However, there is no equivalent UK vehicle that provides an equivalent level of UK tax efficiency. While there is an authorised contractual fund, which has proved very popular with certain investors (eg it is commonly used in relation to Local Government Pension Scheme pooling), the practical restrictions arising from being authorised for many institutional investors and managers (not least being open-ended and some of the investment restrictions) has, in practice, driven many away from use of this structure and towards use offshore alternatives. It is for this reason that AREF has recently proposed a new form of flexible onshore contractual fund vehicle for professional investors (the ***professional investor fund (PIF)***) to provide a domestic equivalent to the JPUT. The PIF could be used across asset classes and its structure, as a contractual scheme should make it internationally acceptable. We recommend that the Government give serious consideration to this proposal.

In addition, if the issues discussed in paragraph 3.9 and 3.10 were addressed, the attractiveness of the UK limited partnership as a real estate investment vehicle would be significantly enhanced.

### 6.2 Listed Funds

The investment trust rules for listed investment companies already provide for an effective structure for UK domiciled listed funds. However, in terms of the requirements for listing, the existing Listing Rules, Prospectus Regulation and Disclosure Guidance and Transparency Rules should be revised to further streamline the listing process and documents produced in connection therewith.

In particular, our suggestions are as follows:

- ***Revisions to the PRIIPS rules*** which lead to, in many cases, a false description of future performance to investors and, currently, do not provide for a level playing field between listed investments companies and their open-ended retail competitor funds (this point is also relevant to partnerships in the context of their employee and friends and family participation);

- providing for a ***"shelf prospectus" regime*** whereby secondary offers by investment companies only require the approval of a short form prospectus including the terms of the offer being made and an update on the underlying fund portfolio. This could also be accompanied by a corresponding reduction in approval times by the UKLA for draft prospectuses; and

- a review of the rules on disclosure, in respect of investments representing more than 20% of an investment company's portfolio, to make the ***prospectus disclosure more investor friendly*** rather than formulaic.

- Changes to these rules would also further enhance the use of real estate investment trusts (REITs), potentially triggering further investment into UK real estate.

**6.3 REITs**

There are now over 100 UK REITs and more coming. This is an excellent example of how suitable improvements to a regime can enhance its attraction to managers and to investors and bring more business onshore. We welcome the proposals in the Asset Holding Company consultation to remove further barriers to entry and outmoded tax and other obstacles (in particular the ability to have unlisted REITs to reflect the commercial fact that they are now a popular joint venture vehicle for appropriate institution investors) and the fact that the current call for input is seeking views on other improvements that could be made to the REIT Regime. We support the ***British Property Federation proposals in relation to the development of the REIT regime***.

In particular, the REIT rules should be amended to facilitate investment in more ESG related assets and infrastructure – a move that would reflecting the government's support for such investment and growing investor demand.

**6.4 Qualifying Investor Scheme (QIS)**

This already is popular in certain cases in the open-ended, regulated environment where the relevant investors (usually institutional) appreciate that some flexibility is required around redemptions for particular assets and indeed where they do not wish for or need daily dealings. We note that a number of questions have been raised, but we only comment on those issues that we have most commonly seen as putting off investors – who, as a result, have commonly sought alternative (often offshore) structures. We support the proposals made by AREF in relation to QISs.

There should be ***more publicity around the one month time frame for obtaining FCA approval.*** Not all investors are aware of this, leading them to dismiss the use of the QIS due to the mistaken belief that the time frame will be six months. There also needs to be more public awareness of the ability of the FCA to offer a more ***flexible approach to redemptions*** etc, which can make a huge difference to the viability of the fund. In addition, more published guidance on timings relating to redemption (e.g. to obtain relevant waivers etc) would be helpful.

The ***limited and constraining investment criteria*** is also a key issue. The criteria can pose practical issues. Given the sophisticated investor base aimed at we believe these restrictions are not necessary and should be amended allowing managers more discretion.

One of the main operational issues is however the ***ban on a Property Authorised Investment Fund from holding UK property through a wholly owned vehicle***. We recommend that is it removed. The ban puts the PAIF commercially at a disadvantage when sale of an entity may be the property vendor's preferred exit (as it means the PAIF can't acquire commercial interest in the property via this route, thus excluding it from some potential transactions). While FCA waivers have been obtained to acquire the vehicle where the vehicle is to immediately be wound up, getting certainty that this can be done in a tax efficient matter is timely and adds cost and, ultimately, can mean the loss of a good asset acquisition to those who can be more nimble. This means PAIFs miss out on potential revenue streams. This is an anomaly as such constraints do not operate for other types of property investment vehicle (eg the REIT).

In addition, although a QIS can (subject to certain conditions) hold interests in collective investment vehicles, what counts as such a vehicle is given an unduly narrow interpretation in the context of an entity that holds a property that comprises of a number of separate units, for example a shopping centre. An issue here is that (notwithstanding the number of separate units) in our experience the property can be seen by the FCA as a single asset (such that it is insufficiently diversified to constitute a collective investment scheme). This interpretation ignores the economic and business reality that the vehicle has a number of different assets constituted by the different units in the property. The REIT regime does not take this approach and ***we recommend that the FCA approach for QISs is changed to align with that regime***.

**6.5 Use of UK/Channel Islands funds by EU holding structures**

In addition to the points above, the UK should closely monitor how the UK's new relationship with the European Union impacts on the use by UK or Channel Islands funds of EU holding company structures (which will also interplay with the implementation of the BEPS substance requirements).

**6.6 Long Term Asset Funds (LTAFs)**

We note the proposals currently being considered in respect of LTAFs. We support the initiative to facilitate investment by defined contribution pension schemes into private/patient capital in a manner that provides appropriate flexibility to both managers and also investors. That said, we do think additional clarification needs to be provided in respect of how the potential LTAF may work, including in respect of the following:

- We note that a number of the features proposed by the Investment Association for the LTAF overlap (in terms of permitted investments/portfolios) with the existing ***investment trust*** regime. We note that there are limitations with the investment trust regime (in particular relating to the practical difficulties of launching new funds rather than as a result of issues with the legal or tax rules) but they are open to DC Pension Schemes for investment and care needs to be taken to ensure that the ***two structures are complimentary to each other*** *(reflecting their different liquidity, pricing, regulatory and asset allocation characteristics*)

- In particular, ***investment trusts offer daily liquidity*** to investors in a closed-ended structure (albeit at a price that may be a discount to the prevailing net asset value per share). Listed investment companies in a number of sectors (including private equity and private credit) have regularly traded at discounts to net asset value meaning it has been difficult for managers to launch new funds in those asset classes. Even so, these funds do offer a daily exit for investors, thereby minimising any risk that they are "stuck" in a fund.

- For asset classes that are unable to be launched in an investment trust structure owing to market demand or sentiment, the LTAF may have significant benefit, in particular for defined contribution pension schemes that want access to those asset classes. Defined contribution pension schemes are able to understand the risks associated with investment in different structures and manage their liquidity requirements accordingly. The recent events associated with the Woodford Income Fund and various gated property funds demonstrate that care would be needed before making these structures available to retail investors.

- With this context we believe there is a risk to the reputation of the UK funds sector in applying an "authorised fund" badge to an LTAF that has very limited redemption rights (potentially once every two years). As such, we would strongly argue that the ***ability to invest in an LTAF be restricted*** to an investor class that is properly able to understand the risks associated with its investment (i.e. predominantly based around DC Pension Schemes). Further, if the LTAF structure overlaps too significantly with the investment trust, there is a risk that DC Pension Schemes only invest in LTAFs which may make new investment trust launches for private capital assets less likely and, therefore, deny retail investors direct access to those funds and strategies. It is key that the fund structures available in the UK are complimentary to one another, address different needs and do not "cannibalise" demand which may result in less choice for consumers for products that are appropriate for investment by them.

## 7. FINANCIAL SERVICES REGULATION OF FUNDS

### 7.1 A UK base for international investors

We welcome HMT's acknowledgement that the loss of European passporting rights for funds has been a factor in selecting jurisdictions other than the UK as the European fundraising jurisdiction for fund managers. We also agree that it makes sense to focus on promoting UK AIFs to investors in other jurisdictions, rather than UCITS/retail funds.

However, the continued existence of the passport in EU jurisdictions, coupled with the difficulty of using national private placement regimes/the patchiness of this as an alternative, makes the job of targeting European investors with UK AIFs challenging.

One potential solution to this is to bring global investors to the UK.

We recommend that Government establishes ***a new regime to attract international institutional investors to the UK***. Amendments could be made to the Regulated Activities Order and Financial Promotions Order which would have the effect of allowing overseas investors to establish UK representative offices to deploy capital without requiring full FCA authorisation. The UK could run a "plug and play" International Financial Centre, allowing non-UK investors to establish a UK representative office to which UK fund managers can market their funds under UK laws. If the registration mechanism works, registrants could give an indication of the approximate level of capital they have to deploy. When global managers are contemplating establishment of a global base, having such an international financial centre with a publishable amount of capital to deploy could help tip the balance in favour of the UK as the go-to destination for capital. For smaller investors not looking to establish their own office, the UK could explore a third-party agency regime. The regime would need to include appropriate checks and balances to preserve the integrity of the UK system e.g. in relation to financial crime and money laundering prevention.

### 7.2 International competitiveness considerations for the FCA

The original version of the Financial Services and Markets Act 2000 required the Financial Services Authority to have regard to the "international character of financial services and markets and the desirability of maintaining the competitive position of the United Kingdom". That provision was removed following the financial crisis. It ***should now be reinstated***. The existing provision relating to sustainable growth of the UK economy is welcome and should be maintained. This objective could be supported by the work of the asset management competitiveness unit which we recommend.

### 7.3 Regulation of remuneration

The UK should ***preserve its largely proportionate approach to pay regulation for asset managers***. Pay regulation was introduced for banks and investment banks following the financial crisis. Its purpose was and remains to prevent adverse incentives for increasing bank balance sheet risk through large bonus payouts. The system was extended to asset managers, based on the bank rules. One argument used to support this has been the idea of a "level playing field" in financial services. Another is the idea of aligning the interests of investors with those of the fund managers who they appoint to run their money. The first of these justifications is simply a disguised form of competition prevention. Asset managers do not pose the same regulatory risks as banks. Regulation should be tailored to the risks posed by the institution. The second idea makes regulatory sense, but any regulation needs to take into account existing market structures which already perform this function and not duplicate or undermine them. The carried interest and co-investment models in private equity and venture capital, for instance, already deal with this issue.

**7.4 Regulatory subject matter expertise**

The UK must ***preserve and continue to invest in its subject matter experts at the FCA and elsewhere***. International managers regularly comment on how this is a distinguishing factor in the UK's favour. Managers want to deal with regulators, tax authorities and others who understand their business. That doesn't always guarantee the answer that the manager wants to achieve, but it saves time. In the commercial world business moves quickly and needs Government authorities to do so also.

**7.5 Increased operational efficiencies**

We strongly support the British Private Equity and Venture Capital Association's comments in relation to ***increasing operational efficiencies at the UK FCA***.

We also agree that there is some ***legislative reform*** which could help the FCA refocus its efforts towards its most important functions and avoid resources being diverted inappropriately. For instance, the change of control regime for consumer credit businesses for decades followed the approach of the Office of Fair Trading under the Consumer Credit Act 1974. This was effectively replaced by a revised version of the regime designed for the acquisition of controlling interests in banks and insurers in FSMA, when FCA was appointed to take over responsibility for supervising this sector. It is wholly disproportionate. It results in large delays in M&A and capital funding activity in a wide range of businesses which refer customers to credit providers as an ancillary part of their businesses. White goods retailers, caravan parks, educational suppliers and a wide range of others are all impacted by this. It creates unnecessary work for regulators and industry. It should be scrapped.

**7.6 AIFMD**

HMT has indicated that at this stage, it will not revisit AIFMD authorisation. Should it do so in future, a range of options should be considered, including allowing firms who choose to do so to maintain the current AIFM standards.

**7.7 Semi-professional Investors**

The UK should keep its "professional investor" definition under review. Very significantly high net worth investors with investment experience in alternative investment funds should be permitted to invest as "semi-professional" investors.

## 8. IMMIGRATION

The UK needs to maintain an attractive immigration environment. Global asset managers need the flexibility to move their staff between global fund locations. Service providers need the same flexibility. Consistent messaging about the UK seeking to attract top global talent would support the development and maintenance of this environment.

## ANNEX 1
## MAP OF RECOMMENDATIONS TO CONSULTATION QUESTIONS

| Consultation question | Response summary/paragraphs of this response |
|---|---|
| 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? | 1.9.1 ***Establishment of an asset management competitiveness unit***<br><br>1.9.2 ***Tax:*** eliminate the current incentives for establishing funds outside the UK<br><br>1.9.3 ***Funds structures:*** Plugging the gaps in the range of available UK funds structures |
| 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? | 6.1 ***Tax Exempt Corporate Structure*** filling this obvious gap in the UK's offering would allow the UK to compete directly with equivalent EU domiciled vehicles, including those in Ireland and Luxembourg. Such a structure should be in addition to the existing investment trust regime and not a replacement of it. |
| 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. | 6.1 ***Tax Exempt Corporate Structure*** please see question 6 above. |

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| 8. What would be the likely impact if changes were made to the REIT regime in the areas discussed in paragraph 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? | 6.3 ***REITs*** We support the British Property Federation proposals in relation to the development of the REIT regime and consider that further removing barriers will allow for more REIT to come onshore to the UK. |
| 9. Are there any other reforms to the REIT regime that the government ought to consider, and why? | 6.3 ***REITs*** we consider in particular that REIT rules should be amended to facilitate investment in more ESG related assets and infrastructure. This would satisfy both the appetite of UK government and investors for more of this sort of investment. |
| 10. Regarding the proposals covered in this 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 as possible. | 1.4 ***Preserving what works*** we have not covered such proposals in detail, however we consider that this element of the UK funds framework is strong and must be at the very least maintained. |
| 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. | 5 ***UK Limited Partnership Law*** we consider that there are a number of potential barriers to the use of UK domiciled LP funds an PFLPs:<br><br>i. Slow nature of the BEIS consideration of proposed reforms to the UK limited partnership law is causing uncertainty in the market; |

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| | ii. the lack of an option to select, for English and Scottish limited partnerships, whether to have legal personality;<br><br>iii. the requirement to prepare and file accounts under the Partnership (Accounts) Regulations 2008; and<br><br>iv. the lack of statutory recognition of the segregation of sub-funds of an umbrella fund.<br><br>In respect of tax changes, a natural follow on from point (ii) above is that some limited partnerships would face adverse tax consequences in overseas jurisdictions where the limited partnership has legal personality. Maintaining the option for a contractual agreement without separate legal personality will ensure that a new potential barrier is not erected.<br><br>3 ***Approach to Funds Taxation*** this section proposes a number of tax changes which could make the UK more attractive for LP and PFLP establishment, whilst not advocating for wide-ranging tax overhaul. Please also see below the response to question 36. |
| 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? | 6.1 ***Current gaps in UK domiciled fund structure offering*** in relation to real estate funds, we note that authorised contractual funds have been popular with certain investors but ultimately, practical restrictions arising from being authorised has driven many away from using the structure and towards the use of offshore alternatives. |
| 13. Do you have views on the current authorisation processes set out in legislation and how they could be improved? | 6.1 We support the AREF proposal for a ***professional investor fund***. |

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| 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? | 6.4: There should be ***more publicity around the one month time frame*** for approving a QIS.<br><br>7.6 We support the BVCA's comments on operational efficiencies at the FCA and reducing regulatory timescales generally. |
| 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? | 6.4 ***Qualifying Investor Scheme*** we put forward a number of proposals at 6.4 which show what could be doe with the QIS to make it more attractive. We support the proposals made by AREF in relation to QISs and have these comments on them:<br><br>i. there should be more publicity around the one month time frame for obtaining FCA approval rather than the belief that it will be six months;<br><br>ii. the currently limited and constraining investment criteria should be liberalised; and<br><br>iii. the ban on a Property Authorised Investment Fund from holding UK property through a wholly owned vehicle should be removed. |
| 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? | 6.4 ***Qualifying Investor Scheme*** we put forward a number of proposals at 6.4 which show what could be done with the QIS to make it more attractive. Please see question 16 above. |
| 18. Do you agree that the QIS sub-fund structure could be improved? If so, how? Would greater clarity for the segregation of | We agree that statutory recognition of segregation would be helpful in fund structures more generally. See 5.4 |

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| assets between sub-funds via legislation or rules be helpful? Please provide details. | |
| 21. Do you agree that reforms to enhance the attractiveness of the UK funds regime should focus on appealing to AIFs targeting international markets? Which markets would be most valuable and what would be the key obstacles to overcome in each? | 7.1 ***A UK base for international investors***: We recommend that Government establishes a new regime to attract international institutional investors to the UK. |
| 23. How can the government ensure the UK offers the right expertise for fund administration activity? | 1.2 ***Attracting and retaining Global fund managers*** and 1.9 ***Immigration*** an attractive immigration environment coupled with a holistic view on the talent required for effective asset management is key in getting the right expertise to the UK. The UK must offer flexibility to global asset managers so that they are able to move staff between their global fund locations. The same analysis applies to service providers, including administrators, lawyers, accountants, ESG consultants, data providers and others – the UK must make known its desire to attract top talent. |
| 24. Are there specific barriers to the use of ITCs, either from the perspective of firms creating fund products or from the perspective of investors seeking to access them? Are there specific steps which could address these? | |
| 25. Should asset managers be required to justify their use of either closed-ended or open-ended structures? How effective might | |

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| this requirement be, and what are the advantages or disadvantages of this approach? | |
| 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 inefficient outcomes? | 6.6 ***LTAFs*** we note the proposals being considered in respect of LTAFs and whilst we do not have specific comment on the tax treatment proposals, our general comments will have knock-on tax consequences. |
| 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. | **Section 5** of our note makes a number of proposals in relation to limited partnership reform. Some of this may be relevant to the structures addressed in question 30.<br><br>1.4 ***Preserving what works*** we consider that much of what is available in the UK is strong and must be maintained. We do not consider that wide ranging reform is necessary but that the establishment of the option for limited partnerships with a legal personality in England and Wales (as is available in Scotland), would go a long way to improving the attractiveness of the UK as a whole for the establishment of funds. |

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| 31. Would these unauthorised structures support the government's work on facilitating investment in long-term and productive assets, as outlined in Chapter 1? | 1.2 ***Attracting and retaining Global fund managers*** we identify that fund managers being in place in the UK greatly heightens the likelihood that UK investments will be focussed on and by retaining but sharpening up the UK's current offering, this will only improve attractiveness and therefore associated investment. |
| 32. How do you think the government could best achieve consistent branding for UK fund structures which target only professional investors? | 1.3 ***Asset Management Competitiveness Unit*** we consider that such a unit would allow for the UK brand for fund structures to be best marketed and also made consistent. That team should be tasked with maintaining a holistic approach to private funds, monitoring how the UK sector compares to that of other jurisdictions. It should promote the maintenance of a proportionate tax, legal and regulatory regime for the sector. It should have the ability to work (as one) with other departments to review changes which, in the round, could directly or indirectly adversely impact the UK sector. |
| 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. | 3 ***Approach to Funds taxation*** please see this section for a full breakdown of recommendations relating to tax policy for investment funds more generally. Much of this is relevant to the proposed new funds. We consider these particular points to be most important:<br><br>i. a competitive tax regime for asset managers (3.6 and 3.6 in the response)<br><br>between 2014-2107, many rules were introduced which had a negative impact on the tax treatment of asset managers. The introduction of any further rules targeting the industry which do not simplify nor make more internationally competitive the position could be a disincentive for international management groups to retain UK offices or to carry on any activities from the UK offices not specifically related to UK or European funds. We therefore consider that a commitment by the government should be made that no further changes specifically targeting asset management are planned for the life of the current parliament.<br><br>ii. all tax policy change should be approached holistically (3.2 in the response)<br><br>we consider that the government must ensure that all reviews and proposals fit together in one fiscal landscape which matches the overall strategy that the government has for the asset management sector. In |

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| | this regard, it will be crucial that any reforms fit together with the results of the upcoming review of fund management fees and the asset holding company consultation. Further, the government must consider the impact of general changes to UK tax law on the asset management sector when looking at such changes.<br><br>iii. Change of the UK Vat incentive for fund managers to locate funds overseas (3.4 in the response)<br><br>the UK should change the current UK VAT incentives for fund managers to locate funds outside the UK. Currently, supplies of fund management services to foreign private equity funds can be made free of UK VAT while allowing the fund manager to recover its related input VAT. An equivalent supply to a UK fund would, however, be subject to UK VAT. This provides managers with a significant incentive to establish funds in other jurisdictions. The same issue arises in relation to some other services.<br><br>It is important that the UK VAT treatment of management supplies to foreign funds is not made less generous as this would erode the UK's competitive position for the location of the asset manager. Instead, the government should also consider ways of improving the position for equivalent onshore supplies so that they are not comparatively disadvantaged.<br><br>iv. Provide UK tax incentives to move infrastructure and jobs to the UK (3.5 in the response)<br><br>consideration could be given to applying lower capital gains tax rates to carried interest received by managers from funds which are established as UK limited partnerships and which use UK asset holding companies. These rates would be no higher than the normal capital gains tax rates (i.e. 20% rather than the current special higher rate of 28% that applies to carried interest).<br><br>Consideration should also be given to improving the UK tax position for fund managers who are moving or returning to the UK. We note that some jurisdictions have, in recent, years, introduced tax regimes aimed at attracting foreign individuals to move their tax residency to those jurisdictions. |

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| | v. CGT and Statement of Practice D12 (3.8 in the response)<br><br>It is suggested that HMRC's approach to the capital gains tax consequences of changes in partnership interests as set out in Statement of Practice D12 be reviewed in the context of ensuring that partnerships can function as fund vehicles in an open-ended or quasi-opened ended situation. The current approach of treating any decrease in a partner's partnership interest as a (potentially (unfunded) taxable) disposal, including when a new partner is admitted, can mean that alternative (often offshore vehicles) are used instead. This issue is particularly acute for real estate. We would recommend that the current position is reviewed in the context of funds that are either (i) widely held, (ii) not "close companies", or (iii) close companies only because of the presence of institutional investors. Appropriate definitions could be based on those in the capital gains rules relating to UK property rich collective investment (contained in schedule 5AAA of the Taxation of Chargeable Gains Act 1992).<br><br>vi. SDLT (3.9 in the response)<br><br>We recommend that SDLT is removed for funds which are: either (i) widely held, (ii) not "close companies", or (iii) close companies only because of the presence of institutional investors. This is because SDLT on the transfer of interests in UK property investment partnerships is one of the main reasons for people seeking to use offshore structures in the context of real estate funds.<br><br>vii. Property Investment LLPs (3.10 in the response)<br><br>We suggest abolition of the rule that disapplies, for investments in property investment LLPs, the usual exemption from tax on investment income and gains applicable to pension funds. |
| 37. Are there any interactions with wider tax policy that the introduction of new | 3 ***Approach to Funds taxation*** please see the response to question 36. In addition please see 4 ***Approach to Deal Taxation*** of the response. A review of the UK funds regime should not look at fund-level issues in |

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| unauthorised vehicles would need to navigate, in order to avoid unintended consequences? | isolation but should also consider the impact of the UK funds rules on UK investee companies of those funds. Any reform of and growth in the UK funds industry is an opportunity for a greater amount of capital to be invested in UK investee companies. UK investee companies should not be disadvantaged when invested in via a fund rather than directly by corporate entities/individuals, and the UK tax rules as they apply to investee companies should not adversely impact typical investment models or structures used by the funds industry.<br><br>In addition, the Partnership Aggregation rules should be considered too in the funds context. Partnership aggregation rules can result in investee companies of partnerships being treated as controlled, or as being associated/linked with other fund portfolio companies, for tax purposes. This can impact e.g. access to SME R&D relief, the ability to use EMI options and possibly the ability to benefit from the small companies corporation tax rate that is to be introduced in 2023. Investee companies are effectively penalised because their investors have invested via a fund (usually for regulatory or commercial reasons) rather than directly. We would suggest in particular that the position regarding EMI options is amended to accommodate typical fund structures. |
| 38. 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? | Please see the remainder of our response |

**ANNEX 2**
**PARTNERSHIP LAW**

**Background**

The limited partnership has been the vehicle of choice for most the of the private fund sector, including particularly the venture capital and private equity fund sector for many years. The common law version of the limited partnership that originated in the UK/USA has now been copied in many jurisdictions including many "offshore" jurisdictions such as Guernsey, Jersey and the Cayman Islands, as well in civil law jurisdictions like Luxembourg.

Its key attraction is the flexibility it offers to investors and managers to decide how they wish to regulate their affairs and their investment activity. Therefore, we consider that it is likely to remain the vehicle of choice for those sectors which currently actively use it, such as private equity and venture capital funds.

UK limited partnership law derives from the Limited Partnerships Act 1907 and the Partnership Act 1890 and was not originally developed with current private funds in mind. Other jurisdictions have tended to update their limited partnership laws to accommodate the needs of the investment fund sector. The UK has also introduced reforms to its limited partnership laws, most recently in The Legislative Reform (Private Fund Limited Partnerships) Order 2017 (S.I. 2017/514) which introduced the "private fund limited partnership". This has already made the UK limited partnership a more attractive vehicle to private fund managers and investors.

The further changes which could be made to enhance the attractiveness of the UK limited partnership to the private fund sector are discussed in section 5 of the response. In relation to the legal personality of UK legal partnerships, further details on why we consider our proposed changes necessary are explained here.

**Particular Issues**

As discussed in section 5 of the response, we consider that it would improve the attractiveness of UK limited partnerships if they could be established with separate legal personality. Currently, UK limited partnerships (other than Scottish limited partnerships) have to act through their general partner(s). The general partner will enter into contracts on behalf of itself and all the limited partners, and any partnership assets will be held by a partner (commonly the general partner) or by a third party for the benefit of the limited partnership. UK limited partnerships have successfully carried on business for many years without legal personality but these agency and nominee relationships add complexity to the contractual and property holding arrangements of limited partnerships. The 2003 LC Report set out a number of technical problems largely concerning the doctrine that where there is a change in the partners of a UK partnership, that results in the automatic dissolution of the "old" partnership and the creation of "new" partnership composed of the new/remaining partners (for example, problems as to the position of creditors of the "old" partnership and how assets of the "old" partnership are transferred to the new partnership). The LC Report considered that these concerns could be removed if UK partnerships had a separate legal personality.

On a more practical level, the lack of separate legal personality complicates the analysis when a limited partnership "invests" in another limited partnership (such as in the case of a "fund of funds" structure) or where the carried interest in a venture capital or private equity fund is held by a limited partnership or where the general partner is itself a limited partnership. In such cases it seems that each partner in the "investing" partnership becomes a partner in the "investee" partnership. That can create complications, for example, if changes in the partners in the investee partnership have to be notified by it to, for example, the registrar of limited partnerships, the investee limited partnership must be informed of and notify any changes in the partners of the investing limited partnership. It is common in a UK context for the carried interest vehicle or the general partner of an English venture capital or private equity fund limited partnership to be established as a Scottish limited partnership which does have a separate legal personality so that it is clear that the Scottish limited partnership is the partner in the English venture capital or private equity fund limited partnership.

In a relatively simple case where an English limited partnership ("A") is used as, for example, a general partner of an English private fund limited partnership ("B"), and B wishes to enter into a contract, the lack of legal personality complicates the legal analysis and increases costs. In such a case the contract must be executed by the general partner of A, acting in its capacity as the general partner of A, and A must be acting in its capacity as the general partner of B. The counterparty needs to be confident that the agency chain is in place and that appropriate authorisations have been obtained in respect of A and B. If A had separate legal personality, it could execute the contract as the general partner of B and its authority would derive from the limited partnership agreement of B. The counterparty would only need to be confident that appropriate authorisations had been obtained in respect of A.

This removes one complication, but it adds a new complication and increases costs by introducing an additional jurisdiction into the structure. There can be other disadvantages such as where there are limits on the number of partners in a partnership or where having more than a certain number of partners introduces complications (such as treatment as an "investment company" for the purposes of the US Investment Company Act where the number of investors exceeds 100).

**Other Jurisdictions**

A number of other jurisdictions offer limited partnerships that have a separate legal personality. For example, in Holland and the USA limited partnerships have a separate legal personality, and Delaware limited partnerships are commonly used as investment fund vehicles. In Luxembourg, the *societe en commandite par actions ("SCA")* and the *societe en commandite simple* ("SCS") are limited partnerships that have a separate legal personality and the *societe en commandite speciale ("SCSp")* is a limited partnership that does not have separate legal personality. In the Channel Islands, Jersey permits limited partnerships to be set up either without a separate legal personality or with a separate legal personality. That separate legal personality can either be a body corporate (the "incorporated limited partnership") or not be a body corporate (the "separate limited partnership"). In Guernsey, a limited partnership can elect to have a separate legal personality. Not all jurisdictions that are popular locations for investment funds permit limited partnerships to have a separate legal personality. For example, in the Cayman Islands and in Ireland limited partnerships do not have separate legal personality. However, in an increasingly global investment funds market, there is competition between jurisdictions to attract investment fund business and we consider it is important that the UK is able to offer a limited partnership vehicle that meets, as far as possible, the common needs of the international community.

**Conclusion**

The proposal that it should be possible for partnerships established in any part of the UK to have separate legal personality is not a new one. For example, as discussed in section 5 of the response, the LC Report recommended that all UK partnerships (both general and limited partnerships) should have separate legal personality (but should not be a "body corporate"). The LC Report also recommended that a new category of "special limited partnership" should be created that did not have separate legal personality. This was in response to concerns that in the venture capital industry the use of UK limited partnerships as investment funds would be adversely affected if limited partnerships had to have separate legal personality because this could result in some foreign jurisdictions no longer regarding them as tax transparent.

We consider the ability to establish English limited partnerships with a separate legal personality (without being a body corporate) would in many cases simplify the structure and operation of English limited partnerships used as investment funds and accordingly reduce costs and uncertainties. This would increase the attraction of the UK as a location for investment funds, particularly as it would align UK limited partnership law with the equivalent laws of a number of other jurisdictions that attract investment funds. Accordingly, we recommend that UK partnership law be altered to permit all limited partnerships (or possibly just limited partnerships that are private funds) established in England and Wales to be established either with or without a separate legal personality (without being a body corporate) as recommended by the LC Report. The LC Report did not consider there was a need to enable Scottish limited partnerships to be established without a separate legal personality and we make no recommendation concerning Scottish partnerships.