International
Comparative
Legal Guides

Practical cross-border insights into alternative investment funds work

Alternative Investment Funds 2022

10th Edition

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1 Regulatory Framework

1.1 What legislation governs the establishment and operation of Alternative Investment Funds?

The UK is regarded as one of the leading global asset management centres, with an investment funds industry covering both traditional and alternative asset classes. In the case of funds with alternative investment strategies such as private equity, real estate, alternative credit and infrastructure funds, both the fund manager and the fund itself tend to be domiciled in the UK. The asset management industry is of vital importance to the UK's economy, now more than ever as the economy seeks to recover from the financial impact of the COVID-19 pandemic and is impacted by the uncertainty arising from the ongoing conflict in Ukraine.

The Alternative Investment Fund Managers Directive ("AIFMD"), supplemented by its Level 2 Delegated Regulation ("Delegated Regulation") and guidelines from the European Securities Markets Authority ("ESMA") ushered in a new regulatory environment for many investment fund managers, including private equity firms and managers of hedge funds. AIFMD offers the lofty ideal of pan-European harmonisation of the regulatory and supervisory framework for the non-UCITS ("Undertakings for Collective Investment in Transferable Securities") fund sector, together with the associated freedom to passport management and marketing activities on a cross-border basis.

Following the end of the Brexit implementation period on 31 December 2020, the UK is no longer treated as an EEA Member State; from the perspective of the EEA, the UK is now a third country. Under the European Union (Withdrawal Act) (2018) all EU law in effect as at 31 December 2020 was, broadly, converted and preserved in domestic legislation (known as retained EU law), with amendments made by way of statutory instruments ("SIs") to correct "deficiencies" in retained EU law. These corrections were designed to ensure that the domesticated and on-shored legislation makes sense and operates properly in the UK: the SIs are not intended to make policy changes other than to reflect the UK's new position outside the EEA.

As such, AIFMD was replicated in the UK's post-Brexit AIFMD legislation ("UK AIFMD"), which sits alongside AIFMD, by way of amendment made by the relevant SIs to the existing Financial Services and Markets Act 2000 ("FSMA") and the Alternative Investment Fund Managers Regulations 2013 (SI 2013/1773). The majority of these measures are contained in the FCA (Financial Conduct Authority) Handbook. The "FUND" chapter of the FCA Handbook contains most of the FCA's rules and guidance for UK AIFMs, which adds an additional component to the general regulatory framework set out under FSMA. UK AIFMD applies to UK AIFMs and to the managing and marketing of AIFs in the UK. However, whilst UK AIFMD imposes the obligations set out in AIFMD, it does not include its benefits of the managing and marketing passports.

As noted above, AIFMD applies to the non-UCITS sector. Broadly speaking, UCITS funds have not been used to implement alternative investment strategies in the UK and therefore are generally outside the scope of this chapter. Some hedge fund managers may be able to launch products under the UCITS brand if the proposed investment strategy fits into the framework and the UCITS requirements will offer investors greater regulatory safeguards and protections. However, the fact that UCITS funds are subject to mandated investment and borrowing powers means that they are likely to lack the investment flexibility which is available to private funds.

The European Venture Capital Funds Regulation ("VCF Regulation") provides what is essentially "AIFMD Lite" for EU venture capital fund managers. As with AIFMD, the VCF Regulation formed part of the UK's post-Brexit retained EU law. The new UK regime applies to the new "Registered Venture Capital Fund" (RVECA) and applies to UK AIFMs and venture capital funds domiciled in the UK.

The Regulation on cross-border fund distribution ("Omnibus Regulation") and the Directive on the cross-border marketing of funds ("Omnibus Directive") made a number of important amendments to AIFMD (most notably to pre-marketing) and has applied since August 2021. As the Omnibus Regulation and the Omnibus Directive did not form part of EU law as at 31 December 2020, it does not form part of the post-Brexit EU retained law and does not form part of UK legislation, but UK fund managers seeking to market their funds into certain EU jurisdictions may also be impacted by amended national private placement provisions.

1.2 Are managers or advisers to Alternative Investment Funds required to be licensed, authorised or regulated by a regulatory body?

Many Alternative Investment Funds will be AIFs for the purposes of UK AIFMD. An AIF is a collective investment undertaking which raises capital from a number of investors, with a view to investing it in accordance with a defined investment policy for the benefit of those investors. Even if a vehicle does not fall within the definition of an AIF, it may be categorised as a collective investment scheme ("CIS") under FSMA (a CIS is similar, but not identical, to the European concept of a collective investment undertaking). An example of this is likely to be carried interest arrangements structured through a limited partnership, which are unlikely to be AIFs due to the employee participation scheme exclusion from UK AIFMD, but which are likely nevertheless to be unregulated CISs for the purposes of domestic legislation.

The FCA authorises and regulates persons carrying out specific "regulated activities" in the UK. Acting as the manager of an AIF is a regulated activity, as is establishing, operating (which includes managing) and winding up an unregulated CIS. A suitably authorised person must therefore be appointed to carry out these activities on behalf of an Alternative Investment Fund.

In respect of UK managers of EEA AIFs, UK AIFMs are regarded by the EEA as third-country AIFMs. Therefore, if the local law of the EEA AIF's jurisdiction prohibits AIF management without a licence, a UK AIFM will be unable to manage EEA AIFs. UK AIFMs will be required to comply with applicable national rules and may need to apply to the relevant regulator for authorisation.

In the UK, only appropriately authorised persons can carry on a regulated activity by way of business. It is a criminal offence to breach this requirement. Any agreement entered into by a person carrying on a regulated activity in contravention of this provision is unenforceable against the other party and the other party is entitled to recover any money paid and to compensation for any loss sustained.

UK AIFMD contains a partial exemption for AIFMs whose total assets under management do not exceed certain thresholds. These sub-threshold firms will not have to comply with the full provisions of UK AIFMD, unlike those firms which are "full-scope" AIFMs. The relevant thresholds are: (i) €500 million, provided the AIF is not leveraged and investors have no redemption rights for the first five years; or (ii) €100 million (including assets acquired through leverage). The exemptions do not remove the requirement for authorisation, and sub-threshold firms will need to apply to the FCA to become a "small authorised AIFM" or, in certain limited circumstances, a "small registered AIFM". The latter category imposes the lowest regulatory burden on firms but is only available for internally managed AIFs and certain types of real estate scheme.

A regulated entity which conducts all of its activities in its capacity as the manager/operator of an Alternative Investment Fund – whether an authorised AIFM or not – will be exempt from the EU Markets in Financial Instruments Directive ("MiFID"), as replicated in the UK's post-Brexit legislation ("UK MiFID").

Historically, though, many UK resident managers or advisers of off-shore hedge funds would have been subject to MiFID as the manager/operator of the fund was off-shore and the UK regulated entity was merely its delegate in respect of relevant investment management services. This analysis, however, has been somewhat muddied by the "letterbox" test imposed under AIFMD (and now replicated in UK AIFMD). The consequence of this test is that in some cases the entity which is designated as the manager of an AIF under the fund documentation is not regarded as the AIFM for the purposes of UK AIFMD (because it is a letterbox). The exact analysis of the letterbox test applicable to any situation is very fact-specific, but the risk is likely to arise from one of the tests which provides that a manager of an AIF is likely to be deemed a letterbox if it delegates the performance of investment management functions (i.e. investment management and risk management) to an extent that exceeds by a substantial margin the investment management functions performed by the manager itself. The consequence of this is that an on-shore manager of a hedge fund may, depending on the exact structure and division of powers, now find itself as the AIFM for the purposes of UK AIFMD even if it feeds its services into an off-shore manager.

1.3 Are Alternative Investment Funds themselves required to be licensed, authorised or regulated by a regulatory body?

Generally speaking, under the current UK framework, an Alternative Investment Fund itself is not required to be authorised or licensed by the FCA. UK AIFMD broadly supports the traditional position that it is the manager (or AIFM), rather than the Alternative Investment Fund, which is subject to regulation. However, whilst historically there have been very few operational requirements imposed at the level of the fund itself, to the extent UK AIFMD applies, the AIFM must now ensure that certain requirements are imposed upon the fund, such as: the appointment of a depositary to have custody of certain assets and/or verify title to privately held assets; organisational controls (relating to risk management, compliance and valuation); conduct-of-business rules (relating to due diligence, execution of orders and reporting); and rules relating to companies in which the fund has a substantial stake.

This will not be the case if the fund manager is looking to implement an alternative investment strategy through a retail fund (meaning those which are approved by the FCA to be marketed to identified categories of investors, including, in the case of UCITS and non-UCITS retail schemes, the general public). In the case of non-UCITS retail schemes, the fund itself, as well as the manager, will require FCA authorisation. Where a closed-ended investment fund is to be launched (such as an investment trust or real estate investment trust ("REIT")) and its shares listed, the listing on the London Stock Exchange of any such fund, as well as the manager, would need to be authorised by the FCA.

1.4 Does the regulatory regime distinguish between open-ended and closed-ended Alternative Investment Funds (or otherwise differentiate between different types of funds or strategies (e.g. private equity *vs* hedge)) and, if so, how?

The UK regulatory regime, broadly speaking, does not differentiate between open-ended and closed-ended private funds, assuming that the fund is domiciled within the UK, although, as noted above in the context of sub-threshold firms, the partial exemption from UK AIFMD will bite at a higher level for non-leveraged closed-ended funds. It should be noted that from 1 January 2021, EEA UCITS funds will fall within the definition of an AIF for the purposes of UK AIFMD, as AIFs are defined as any investment fund that is not subject to the UK UCITS regime.

However, the regulatory categorisation of UK fund managers advising or managing off-shore structures may be different to that which would apply if the entire structure is on-shore.

Other regulatory requirements which might apply to a manager of Alternative Investment Funds are linked with the investment strategy being pursued, rather than whether the fund is open-ended or closed-ended (although the relevant strategy might be linked with a particular type of fund). For example, further requirements of UK legislation which are particularly relevant to hedge funds include: rules relating to market abuse and insider dealing; disclosures of interests in shares and related derivatives above certain levels; and disclosures of net economic short exposures to certain financial-sector companies and companies subject to a rights issue.

1.5 What does the authorisation process involve for managers and, if applicable, Alternative Investment Funds, and how long does the process typically take?

An application for authorisation under FSMA involves the applicant submitting a considerable volume of information to the FCA. This will include information on the proposed business activities of the applicant, its controllers and individuals who will be undertaking certain core controlled functions, its systems and controls including those relating to the manner in which the applicant monitors its compliance with applicable FCA Rules, its group structure and reporting lines and financial projections for the first year of trading. For those applicants applying for authorisation to manage an AIF, the FCA will require further information about the AIF itself (such as details of the AIF's risk profile and its use of leverage).

Once a complete application has been submitted (together with the requisite application fee), the FCA currently has six months to review the application (this is reduced to three months in the context of applications by AIFMs). During the review process, the FCA is likely to raise additional queries in relation to the information submitted.

The FCA has made available a suite of forms for use by UK AIFMs in order to apply for the various permissions and authorisations required from a UK AIFM. Further applications will also need to be made in relation to any "material changes" to the information submitted as part of the authorisation application.

Following authorisation, a successful applicant will need to comply with the applicable conduct of business and prudential rules of the FCA which are relevant to its business. In the context of AIFMs, particular focus is likely to be given to the capital adequacy requirements of, and remuneration principles imposed by, UK AIFMD.

1.6 Are there local residence or other local qualification or substance requirements for managers and/or Alternative Investment Funds?

A fund manager applying for authorisation under FSMA (whether or not as an AIFM) must meet certain threshold conditions. One of these is that the head office of the applicant must be in the UK. Although the FCA will judge each application on a case-by-case basis, the key issue in identifying the head office of a firm is the location of its central management and control.

In December 2018, the Department of Business, Energy and Industries Strategy of the UK Government indicated that it will introduce various reforms in respect of UK limited partnerships, following its consultation earlier in 2018. The reforms include requirements for a proposed "principal place of business" ("PPoB") to be included in the application for the limited partnership's registration. On an ongoing basis, the limited partnership will then need to demonstrate that it maintains an ongoing connection to the UK. The UK Government is still considering what evidence will be required to demonstrate the ongoing connection and how these requirements shall apply to existing limited partnerships. In terms of timing, the UK Government stated in March 2022 that the reforms will be presented in draft legislation to be introduced as early as possible in the next session of Parliament.

1.7 What service providers are required?

Historically, there have been no formal requirements to appoint external service providers to private funds domiciled in the UK (although a manager may have engaged service providers as a matter of choice). However, under UK AIFMD a depositary is required, who will have the responsibilities set out under AIFMD (which include custody, cash movement reconciliations and monitoring certain processes such as issues and redemptions of units and valuations). Under AIFMD, the depositary of an EEA AIF must be established in the home Member State of that AIF. Therefore, EU AIFs will not be able to use UK banks as depositories and UK AIFs will not be able to use EU banks as depositaries. Independent valuers may also be appointed pursuant to the provisions of AIFMD.

1.8 What rules apply to foreign managers or advisers wishing to manage, advise, or otherwise operate funds domiciled in your jurisdiction?

Following Brexit, EEA AIFMs are no longer able to rely upon the AIFMD managing passport for activities in the UK.

Firms (either EEA or non-EEA) wishing to market AIFs in the UK are required to comply with the National Private Placement Regime ("NPPR"), as well as the UK's financial promotion rules.

1.9 What relevant co-operation or information sharing agreements have been entered into with other governments or regulators?

One of the key determinants in the context of a UK manager's ability to market a fund (whether EEA or non-EEA) within Europe, or an EEA manager's ability to market in the UK, will be whether information exchange arrangements are in place between the jurisdiction in which the marketing takes place and the jurisdiction in which the fund manager and the fund itself are established. The FCA confirmed in February 2019 that the text of the memorandum of understanding ("MoU") has been agreed with ESMA based on existing precedents and existing MoUs in place for AIFMD, and meets the requirements under the Alternative Investment Fund Managers Regulations 2013 (covering marketing into the UK under the UK NPPR). In July 2020, ESMA and the FCA announced that the MoU remains valid and took effect from 31 December 2020. Similarly, regulators in Guernsey and Jersey have announced that they signed MoUs with the FCA which allow Guernsey and Jersey funds to continue to be marketed into the UK.

2 Fund Structures

2.1 What are the principal legal structures used for Alternative Investment Funds (including reference where relevant to local asset holding companies)?

There are a wide variety of fund vehicles available in the UK. Certain of these are only available for retail funds, such as the authorised unit trust and the open-ended investment company. Others, such as the investment trust company, are likely to be used for closed-ended structures implementing a traditional investment strategy.

However, a private fund domiciled in the UK and implementing an alternative investment strategy will usually take one of two forms. Closed-ended private funds (in particular, those investing in asset classes such as private equity, real estate and infrastructure) are most commonly structured as limited partnerships. This is a form of partnership governed by statute under the Limited Partnerships Act 1907 ("LP Act"). In April 2017, the LP Act was the subject of extensive reform by the UK Government in respect of private funds by way of the Legislative Reform (Private Fund Limited Partnerships) Order 2017 ("PFLP Order"). The reforms have been introduced with a view to simplifying the pre-existing law, reducing uncertainty and administrative costs and burdens, and ensuring that the UK remains an attractive and competitive location for private funds in comparison to other jurisdictions. The reforms apply only to a limited partnership that is "designated" as a Private Fund Limited Partnership ("PFLP"). The new regime is not mandatory: it is open to a limited partnership that satisfies the conditions to be a PFLP to choose not to apply to be designated as a PFLP, in which case the pre-existing limited partnership will apply.

In common with other jurisdictions, the limited partnership (including the PFLP) will have one or more general partners and one or more limited partners. The general partner is responsible for the management of the limited partnership (although whether it fulfils this role will largely depend on the regulatory issues described above), but has unlimited liability for the debts and obligations of the partnership over and above the partnership assets. Conversely, the liability of a limited partner will be limited to the amount of capital it contributes to the partnership (and, in the case of PFLPs, there is no requirement for a limited partner to make a capital contribution), provided such limited partner takes no part in the management of the partnership: to the extent the limited partner does take part in management, it will be treated as a general partner and will lose the protection of limited liability. The LP Act contains a white list of matters ("White List") which limited partners of a PFLP can take part in without jeopardising their limited liability status. A limited partnership (including a PFLP) registered in England & Wales does not have any legal personality separate from its partners and is not a body corporate.

One of the fundamental attractions in the UK of a limited partnership structure for private closed-ended funds is that the limited partnership is a flexible vehicle in terms of internal governance and control. The constitutional document (the limited partnership agreement) is a freely negotiable document between the fund manager and the investors.

The statutory framework in the UK requires that a limited partnership is registered as such. This entails providing an application for registration to the Registrar for Limited Partnerships, providing certain details including the name of each limited partner and the amount of capital contributed by each limited partner. Any changes to these details during the continuance of the limited partnership must be similarly registered within seven days of the relevant change. There are also formalities that must be followed on assignments of limited partnership interests, such as advertising the transfer in specific publications. In respect of the new PFLP regime, either a new or an existing limited partnership may choose to apply for PFLP status if it fulfils the criteria to qualify as a PFLP. Unlike limited partnerships, there is no obligation to provide details of the partnership's general nature, capital contribution amounts or term of the partnership (or to notify of any changes to such details).

It is also possible for a private closed-ended fund in the UK to be structured as a unit trust. The English law concept of a trust has no equivalent in some other jurisdictions. It is a structure under which title to the fund's assets is held by a person with legal personality (the trustee) for the benefit of the fund's investors (the beneficiaries). The document constituting the trust (the trust deed) governs the relationship between the trustee and the beneficiaries and, in addition, strict fiduciary duties are owed by the trustee as a matter of law.

As noted above, although the UK is the primary European hedge fund centre, the usual hedge fund structure will generally not include the actual hedge fund being domiciled in the UK, because to set up the fund on-shore would lead to tax inefficiencies since the fund would be treated as "trading" rather than "investing" for UK tax purposes. Instead, hedge fund structures will invariably include a company or limited partnership established in an off-shore jurisdiction.

In November 2021, rules for a new UK fund structure – the Long-Term Assets Fund or "LTAF" – came into effect. The LTAF is a UK authorised fund that is designed to be focused on long-term, illiquid assets and is particularly targeted at increasing defined contribution pension scheme investment into alternative assets. The LTAF is an authorised fund so can be structured as an open-ended investment company (ICVC), unit trust or contractual scheme. There is an increasing expectation that the LTAF will play a significant role in attracting long-term capital to the market.

Whether a UK Alternative Investment Fund invests in assets via a holding company will depend on a number of issues (including commercial, tax and regulatory considerations). In April 2022, the UK introduced a new tax privileged regime for UK resident qualifying asset holding companies ("QAHCs"). To be a QAHC, a company must comply with a number of requirements including that, broadly, it is at least 70% owned by "category A" investors. Alternative Investment Funds will be category A investors provided certain conditions are met. Please see question 6.1 below for a discussion of tax benefits applicable to QAHCs.

In addition, recent changes to the UK REIT regime mean that that entity can be unlisted where, broadly, it is at least 70% owned by institutional investors, potentially making it more attractive to such investors as a vehicle for holding UK real estate. An Alternative Investment Fund structured as a limited partnership will be an institutional investor for these purposes provided certain conditions are met. The UK REIT is a corporate vehicle for holding real estate that benefits from a tax privileged regime (see question 6.8 below).

2.2 Do any of the legal structures operate as an umbrella structure with several sub-funds, and if yes, is segregation of assets between the sub-funds a legally recognised feature of the structure?

The LTAF can operate as an umbrella fund with sub-funds, with segregated liability between sub-funds. None of the other legal structures outlined above typically operate as an umbrella structure.

2.3 Please describe the limited liability of investors in respect of different legal structures and fund types (e.g. PE funds and LPACs).

In respect of funds structured as limited partnerships, under statute the liability of a limited partner for the debts and obligations of the partnership is limited to the amount of capital it contributes to the partnership, subject always to the caveat that the investor does not become involved in the management of the structure.

This does not relieve the investor of its contractual obligation to advance money, and therefore Alternative Investment Funds operating "just-in-time" drawdown structures will be able to draw the full amount the investor has committed to advance to the fund, notwithstanding the statutory limitation on liability. The UK limited partnership will generally be structured so that the commitment of investors comprises a nominal amount of capital contribution, with the balance being advanced by way of a loan. This structure should avoid amounts distributed to investors being subject to return in the event of the insolvency of the limited partnership.

The other fund vehicles available will provide for the limited liability of investors, such that they will not be required to contribute more than the amount which they have committed to invest in the fund.

In respect of PFLPs, as there is no requirement for a limited partner to contribute any capital, the entire funding to be contributed by a limited partner in a PFLP can be in the form of capital which can be contributed and repaid at any time without affecting the extent of the liability. This removes the need for the capital/loan split described above.

2.4 What are the principal legal structures used for managers and advisers of Alternative Investment Funds?

There are no formal requirements as to the legal structure used for managers and advisers of Alternative Investment Funds. However, the two most common structures seen in the market are the private limited company and the limited liability partnership (LLP). LLPs have been seen as the preferred structure for asset managers for some time now, as they offer the tax transparency of a traditional partnership whilst giving limited liability to the members of the LLP. Although an LLP is a body corporate, it is inherently a more flexible vehicle than a limited company and therefore can be adapted to suit the particular circumstances of the fund manager's business and preferred governance structure. Since April 2016, LLPs (together with UK unlisted companies) are subject to a new requirement to maintain a register of people with significant control ("PSCs"); such register is to be available for public inspection at their registered offices.

Historically, each member of an LLP was treated as being self-employed for tax purposes. This meant that LLPs did not need to pay employer's national insurance contributions ("NICs") on the remuneration of members, and it also kept members of an LLP outside of the UK employment-related securities ("ERS") legislation.

However, since the introduction of the "salaried member" rules in 2014, the position has not been quite so straightforward. Under these rules, a member of an LLP will be treated as an employee if, broadly: (a) at least 80% of the amount payable by the LLP for the services they perform for it is "disguised salary" (broadly, remuneration which is not dependent on the firm's profitability); (b) they do not have "significant influence" over the LLP's affairs; and (c) they make a capital contribution to the LLP which is less than 25% of their annual "disguised salary". If a member meets all three conditions, they will be deemed to be an employee for income tax and NIC purposes (such that the LLP will need to pay employer's NICs on their remuneration and the member will be brought within the scope of the ERS legislation).

In addition, employees remain outside of the scope of the income based carried interest rules (see question 6.2), whereas self-employed LLP members must consider the potential application of these rules to their carried interest returns.

2.5 Are there any limits on the manager's ability to restrict redemptions in open-ended funds or transfers in open-ended or closed-ended funds?

Generally, there are no statutory or regulatory limitations on the ability of managers of private funds to restrict redemptions or transfers in either open-ended or closed-ended funds, although contractual restrictions may be imposed.

2.6 Are there any legislative restrictions on transfers of investors' interests in Alternative Investment Funds?

There are no legislative restrictions on the transfer of investors' interests. However, in the case of UK limited partnerships, certain filing requirements will need to be met, and details of the transfer advertised, before it is deemed to be effective. These filing requirements do not apply to PFLPs.

2.7 Are there any other limitations on a manager's ability to manage its funds (e.g. diversification requirements, asset stripping rules)?

UK AIFMD replicates AIFMD's provisions relating to asset stripping. The provisions cover situations where an AIF managed by an AIFM subject to full authorisation holds a significant proportion of the shares in, or acquires control of, a private company or an issuer of traded securities, imposing requirements relating to the provision of information to the company or issuer, shareholders, employers and employees. The provisions also contain restrictions on distributions, capital reductions, share redemptions and acquisitions by companies or issuers of their own shares for two years after the AIF acquires control.

2.8 Does the fund remunerate investment managers through management/performance fees or by a combination of management fee and carried interest? In the case of carried interest, how is this typically structured?

A fund's remuneration arrangements differ depending upon its structure. Closed-ended private funds structured as limited partnerships typically have a management fee which will be structured as a priority profit share rather than a fee. The commercial terms vary according to the investment strategy (the market standard in the private equity industry, for example, is 2% of commitments during the investment period, stepping down to 2% of the acquisition cost of unrealised investments following the end of the investment period, but infrastructure and debt strategies are unlikely to support this pricing model). The carried interest will also be structured as a share in the profits of the partnership and typically entitles the executives to 20% of the fund's overall profits after return of capital to investors in the fund.

3 Marketing

3.1 What legislation governs the production and use of marketing materials?

Marketing restrictions are imposed by UK AIFMD.

AIFMs wishing to market an AIF to retail or professional investors in the UK are required to apply to the FCA to do so. The FCA permits the marketing of a private fund to a wider group of participants than the category of "professional investors" referred to in UK AIFMD, provided the financial promotion rules referred to at question 3.2 below are complied with throughout the entire marketing process.

3.2 What are the key content requirements for marketing materials, whether due to legal requirements or customary practice?

Under domestic legislation, there are limited content requirements applicable to marketing materials, although there is an overarching obligation to ensure that marketing materials are "clear, fair and not misleading". UK AIFMD requires prescribed pre-investment disclosures which must be made to prospective investors. Whilst many of these disclosures are largely consistent with information that has historically been included in marketing materials for private funds, there are specific components of the disclosure regime which were either new or enhanced the level of detail previously provided.

The requirements of the UK's Prospectus Regulation Rules (which, broadly, replicate the EU Prospectus Regulation) which catch "offers to the public" will generally not apply to the marketing of Alternative Investment Funds on the basis that the requirements can be avoided if the total consideration of offers in the UK, calculated over a 12-month period, is below EUR 8 million or the offer is made to fewer than 150 persons in the UK. The UK's Prospectus Regulation Rules will also not catch open-ended vehicles, so most hedge funds, for example, would not be caught in any event.

3.3 Do the marketing or legal documents need to be registered with or approved by the local regulator?

Outside of UK AIFMD, there is no requirement to register marketing or legal documentation with the FCA. However, an AIFM must submit certain marketing information to the FCA 20 working days prior to marketing and must obtain pre-clearance for any material planned changes to the information provided (the AIFM must give at least one calendar month's notice of the changes). Material unplanned changes must be notified to the FCA immediately. The notification must include a declaration from the AIFM that the management of the AIF complies with the relevant conditions in the UK AIFM Regulations. Notifications must be submitted by the AIFM using the FCA's online system, Connect. AIFMs using the online system for the first time must therefore allow for the time taken to set up its online account with the FCA.

3.4 What restrictions (and if applicable, ongoing regulatory requirements) are there on marketing Alternative Investment Funds?

For the purposes of UK AIFMD, marketing is a direct or indirect offering or placement at the initiative or on behalf of the AIFM to or with investors domiciled in the UK. This is a narrower concept than that of a financial promotion under domestic regulation, which is an offer or inducement to engage in investment activity. The FCA has provided guidance on when it considers an AIFM to be marketing in the UK; neither pre-marketing (as detailed at question 3.5 below) nor reverse solicitation will be regarded as marketing. In respect of reverse solicitation, the FCA guidance states that a confirmation from the investor that the approach was made at its own initiative should be sufficient to rely on this approach. The guidance, however, also states that it must be received prior to making the offer or placement. In addition, "marketing" does not include general public statements, the issuance of capital calls or secondary trading.

Following Brexit, UK full-scope AIFMs wishing to market within the EEA can no longer rely upon the AIFMD marketing passport, and will instead need to identify on a jurisdiction-by-jurisdiction basis whether local law permits the fund to be marketed.

Under the FCA's temporary transitional powers, a UK AIFM can continue to market an EEA AIF in the UK as if it were governed by the provisions contained in AIFMD, as such provisions had effect immediately before 31 December 2020, until 31 March 2022.

EEA AIFMs will no longer be able to use the AIFMD marketing passport to market into the UK and will need to rely on the UK NPPR instead.

Marketing by small AIFMs (i.e. sub-threshold firms) will be subject to a lighter-touch regime; broadly, UK small AIFMs will be able to market all sub-threshold AIFs in accordance with the domestic financial promotion regime.

Off-shore managers of off-shore Alternative Investment Funds may market into the UK on the basis of the financial promotion regime. However, they will be required to comply with the transparency and (if relevant) private equity disclosure requirements imposed under UK AIFMD.

3.5 Is the concept of "pre-marketing" (or equivalent) recognised in your jurisdiction? If so, how has it been defined (by law and/or practice)?

In its guidance, the FCA has stated that pre-marketing is not regarded as constituting marketing by an AIFM for the purposes of UK AIFMD. Pre-marketing will be permissible where it is based on draft documentation and the offer document, or other information, is not sufficiently detailed to enable the recipient to make an investment decision or submit a subscription request; for example, a pathfinder document should not amount to marketing. In the EEA, the Omnibus Directive will for the first time, introduce a new definition of "pre-marketing" into AIFMD. The intention of the proposal is that if a promotional activity does not fall within the definition of "pre-marketing", it should be treated as "marketing". These new requirements mean that the circulation of draft offering documents (e.g. draft versions of a limited partnership agreement) will constitute AIFMD marketing. EU AIFMs will be required to send an "informal letter" to their home State regulator notifying it of the pre-marketing within two weeks. Whilst this represents a significant change to the EEA regime, the Omnibus Directive will not be applicable to activities in the UK.

Pre-marketing activities will be subject to the UK's financial promotion regime. Under FSMA, the communication of financial promotions is restricted. Generally, financial promotions are permitted if they are made or approved by an entity authorised by the FCA. However, in the context of unregulated collective investment schemes (which will catch most private funds), there are further restrictions which limit even the scope for authorised persons to make financial promotions.

Units in unregulated collective investment schemes will, to the extent made by an entity which is not authorised by the FCA, need to be marketed in accordance with the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 ("FPO") or, to the extent made by an entity which is authorised by the FCA, need to be marketed in accordance with either the Financial Services and Markets Act 2000 (Promotion of Collective Investment Schemes) Order 2001 or the provisions of the conduct-of-business rules contained as a component part of the FCA Rules.

3.6 Can Alternative Investment Funds be marketed to retail investors (including any specific treatment for high-net-worth individuals or semi-professional or similar categories)?

AIFMD effectively left the question of marketing to retail investors to the discretion of Member States. The UK retained provisions which allow marketing to retail investors, and this remains the position post-Brexit, as contained in UK AIFMD. If an AIFM is permitted to market to professional investors, it can also market to certain types of retail investors (effectively qualifying high-net-worth or sophisticated investors), provided it does so in accordance with the UK financial promotion regime. The financial promotion regime has changed recently with the effect that, where the promotion is being made in accordance with the conduct-of-business rules contained in the FCA Rules, in addition to the investors having to fall within the terms of the exemptions themselves, the issuer of the financial promotion must undertake a suitability assessment to ensure that the investment is appropriate for the prospective investor. This suitability assessment needs to be undertaken prior to the point at which the financial promotion is issued.

AIFs being made available to retail investors in the UK must also provide a standardised, short disclosure document – a key information document ("KID") – to investors under the PRIIPs Regulation, as replicated in the UK's post-Brexit regime (the "UK PRIIPs Regulation"). The KID must comply with certain detailed technical standards.

3.7 What qualification requirements must be met in relation to prospective investors?

There are no "across the board" qualification requirements which apply in relation to prospective investors, although certain bases on which marketing is made under the financial promotion regime (or, where applicable, AIFMD) will require an analysis of the circumstances of the prospective investor.

For the purposes of UK AIFMD, a professional investor is one who could be so regarded under UK MiFID. Although most institutional investors are likely to be professional investors *per se*, it may prove difficult to opt people into professional status (it is a higher bar than most UK managers are used to). Investors who are not professional investors will be retail investors.

3.8 Are there additional restrictions on marketing to public bodies such as government pension funds?

Under MiFID II, as replicated in the UK's post-Brexit legislation, local government pension schemes ("LGPS") are classified as retail investors which can lead to certain additional restrictions on marketing and distributing interests in such schemes. Following lobbying by the industry, however, LGPS are able to utilise a standardised opting-up procedure, such that LGPS can be opted-up to an elective professional status in a relatively straightforward manner.

There are no additional restrictions to those which otherwise apply under the financial promotion regime.

3.9 Are there any restrictions on the participation in Alternative Investments Funds by particular types of investors (whether as sponsors or investors)?

Under the current legislative and regulatory regime, there are no firm restrictions on the participation in Alternative Investment Funds – however, there may be regulatory capital costs to financial institutions in respect of their investment positions.

Under UK AIFMD, AIFMs are limited in terms of the additional activities they are able to undertake, and therefore certain financial institutions may need to restructure their operations to ensure that they are compliant with the provisions of UK AIFMD.

3.10 Are there any restrictions on the use of intermediaries to assist in the fundraising process?

There are no restrictions on the use of intermediaries, although if the intermediary is itself carrying on regulated activities for the purposes of the UK regulatory regime, it will need to be authorised by the FCA.

4 Investments

4.1 Are there any restrictions on the types of investment activities that can be performed by Alternative Investment Funds?

Generally speaking, there are no restrictions, although the fund manager will need to ensure that the activities it is carrying out in respect of the Alternative Investment Fund are consistent with the scope of permission it has to carry out regulated activities (and with the contractual investment policy of the Alternative Investment Fund).

However, UK AIFMD does impose certain restrictions relating to asset stripping, as described at question 2.6 above.

In addition, although not restrictions, there are certain deal disclosure requirements under UK AIFMD. From 1 January 2021, UK AIFMs and non-UK AIFMs that have registered their funds for marketing in the UK are subject to UK AIFMD portfolio company provisions only if they acquire a material interest in a UK company (whether listed or unlisted). Prior to Brexit, these requirements would have been engaged on the acquisition of any EEA company. In this regard, an AIFM must notify the FCA when an AIF's voting interest in an unlisted company (being a UK registered company not listed on a UK regulated market) passes through certain thresholds. There are additional disclosure obligations when an AIF acquires "control" of a UK company (the test as to control varies according to whether the investee company is listed or unlisted). Investments by an AIF may also trigger a requirement to make certain information available to the FCA, the investee company and remaining shareholders (including, for unlisted companies, intentions as to the company's future business and the likely repercussions on employees). In the context of unlisted companies, relevant information must be passed to employee representatives (subject to limited exceptions).

4.2 Are there any limitations on the types of investments that can be included in an Alternative Investment Fund's portfolio, whether for diversification reasons or otherwise?

There are no such limitations.

4.3 Are there any local regulatory requirements which apply to investing in particular investments (e.g. derivatives or loans)?

There are no such limitations.

4.4 Are there any restrictions on borrowing by the Alternative Investment Fund?

In the context of private funds, there are currently no statutory or regulatory limitations on borrowing, although contractual restrictions are common. In the context of AIFs covered by UK AIFMD, certain of the pre-investment disclosures relate to the use of leverage. In particular, an AIFM must disclose: the circumstances in which the AIF may use leverage; the types and sources of leverage permitted and the associated risks; any restrictions on the use of leverage and any collateral and asset re-use arrangements; and the maximum level of leverage the AIFM is entitled to employ on behalf of the AIF.

4.5 Are there are any restrictions on who holds the Alternative Investment Fund's assets?

UK AIFMD requires full-scope AIFMs to appoint a depositary to have custody of the Alternative Investment Fund's assets, as described at question 1.7 above.

5 Disclosure of Information

5.1 What disclosure must the Alternative Investment Fund or its manager make to prospective investors, investors, regulators or other parties, including on environmental, social and/or governance factors?

Alternative Investment Funds structured as limited partnerships will need to comply with the registration requirements under the LP Act. Limited partnerships designated as PFLPs need only disclose basic details (essentially the fund's name and address). There may be a requirement on the general partner of a UK limited partnership to file the partnership's accounts on the basis of the Partnership Accounts Regulations.

Where an Alternative Investment Fund is to be marketed in a European Member State under national private placement rules, the pre-contractual disclosure requirements set out in the European Sustainable Finance Regulation ("SDFR") must be complied with in respect of products which promote either environmental or social characteristics. Additional (and material) disclosures are required for those Alternative Investment Funds which have "sustainable investment" as an investment objective.

5.2 Are there any requirements to provide details of participants (whether owners, controllers or investors) in Alternative Investment Funds or managers established in your jurisdiction (including details of investors) to any local regulator or record-keeping agency, for example for the purposes of a public (or non-public) register of beneficial owners?

From July 2017, fund houses that have any Scottish limited partnerships ("SLPs") in their fund structures (commonly used as feeder and carry vehicles) need to make filings under the People with Significant Control ("PSC Regime"). The PSC Regime also applies to SLPs designated as PFLPs, registered under the LP Act. Failure to comply with the PSC Regime requirements carries criminal penalties. The PSC Regime has applied to LLPs since April 2016. English limited partnerships are not affected by these changes and remain outside the scope of the PSC Regime.

The PSC Regime requires SLPs to deliver to Companies House information relating to PSCs in relation to the SLP. The rules are complex but, in broad terms, a SLP's PSCs could include its general partner, any manager/operator and any limited partner whose interest in the partnership represents more than 25% of total interests.

5.3 What are the reporting requirements to investors or regulators in relation to Alternative Investment Funds or their managers, including on environmental, social and/or governance factors?

UK AIFMD requires AIFMs to comply with a range of detailed regulatory reporting obligations. Reporting obligations also apply to AIFMs seeking to market their funds in the UK under its NPPR.

Broadly, AIFMs will be required to make periodic reports to the FCA in accordance with UK AIFMD (which replicate those required under AIFMD). In addition to the annual reports in respect of each managed AIF, an AIFM will need to provide periodic reports relating to the AIFM itself and in respect of each AIF that it manages (including information in relation to investment strategies, main instruments traded, principal exposures, risk profiles and (where relevant) leverage).

The FCA has published various guidance papers and Q&As on periodic reporting, setting out what information is required and how, and when, it should be reported. The FCA has an online reporting system, GABRIEL, which assists UK AIFMs with meeting their requirements. The FCA is in the process of phasing out the use of GABRIEL, which is being replaced by a new data platform, RegData.

The UK Government has indicated, as part of reforms to the UK limited partnerships regime, that it will introduce a requirement for an annual confirmation statement to be filed, confirming that all information on the register at Companies House is correct. A transitional period will be included for existing limited partnerships to provide additional information to cover all relevant requirements. An original proposal made in April 2018 to require limited partnerships to file annual reports and accounts has been dropped and replaced by the less onerous requirement for an annual confirmation. In terms of timing, the UK Government stated in March 2022 that it will be introducing legislation as early as possible.

Where an Alternative Investment Fund has been marketed in a European Member State under national private placement rules, the website and periodic product disclosure requirements set out in the SDFR must be complied with in respect of products which promote either environmental or social characteristics. Additional (and material) disclosures are required for those Alternative Investment Funds which have "sustainable investment" as an investment objective.

5.4 Is the use of side letters restricted?

There are no firm restrictions on the use of side letters. However, UK AIFMD requires disclosures as to how an AIFM ensures the fair treatment of investors and, if side letters are used to provide preferential treatment to investors, a description of the preferential treatment and the type of investors to whom the treatment is made available will need to be disclosed. If the AIFM operates a general most-favoured nations ("MFN") mechanism, this is unlikely to be an issue; however, if no or a limited MFN process is in place, an AIFM will need to consider its use of side letters in the light of the disclosure requirements under UK AIFMD.

6 Taxation

6.1 What is the tax treatment of the principal forms of Alternative Investment Funds and local asset holding companies identified in question 2.1?

UK limited partnerships are not taxable entities for UK direct tax purposes (although they do submit tax returns) and are instead fiscally transparent. This fiscal transparency means each limited partner is treated for UK tax purposes as owning its proportionate share of the assets of the partnership and is subject to tax on the income and gains allocated to it under the limited partnership agreement (whether or not they are distributed).

The tax treatment of the LTAF will depend on what legal form it takes. Broadly, if it is an open-ended investment company or unit trust, it is subject to corporation tax but potentially enjoys certain tax privileges (such as an exemption from tax on capital gains) provided (i) it is sufficiently widely marketed, (ii) its prospectus was published on or before 9 December 2021, or (iii) at least 70% of its shares or units are held by certain categories of institutional investor (which do not include unauthorised Alternative Investment Funds) or the manager of the fund (in its capacity as manager). If the LTAF takes the form of a co-ownership authorised contractual scheme, broadly, (i) it is transparent for the purposes of income taxation and not subject to tax on its capital gains, and (ii) for capital gains tax purposes, a unit in the LTAF is treated as an asset of the investor (with the investor's interest in the underlying assets of the LTAF being disregarded). If the LTAF takes the form of a limited partnership authorised contractual scheme, the tax rules for limited partnerships discussed above will be relevant.

Broadly, a UK tax resident holding company will be subject to corporation tax in the same way as for other UK tax resident companies unless it falls within a special tax privileged regime. If the holding company is a QAHC, then a number of tax benefits will apply, including (i) complete exemption from tax on gains on qualifying shares (broadly, all shares apart from those deriving at least 75% of their value from UK land) and on overseas land, (ii) complete exemption from corporation tax on income profits of an overseas property business, broadly, to the extent they are chargeable to tax abroad, and (iii) potentially being able to reduce the other income on which the QAHC is taxable to a very low margin (by the use of profit participating debt). In addition, there are tax benefits for investors, with normal tax rules disapplied to make it easier for returns from a QAHC to be passed to investors in capital form. Please see question 6.8 below for a discussion of the tax position of REITs.

6.2 What is the tax treatment of the principal forms of investment manager/adviser identified in question 2.4?

The tax treatment of the manager or adviser will depend on whether it is constituted as a company or an LLP. If a company, it will be subject to corporation tax on the fees paid by the fund (currently at 19% but the main rate is rising to 25% in April 2023). The management team takes its remuneration in the form of salary (taxed at the highest applicable income tax rates, with NICs (and, from April 2023, Health and Social Care Levy) due too) and the excess profit can be extracted as dividend income. If the manager is an LLP, it is fiscally transparent, so the profit arising from the fees paid to the manager is automatically taxable in the hands of its members. As noted above, the salaried member rules will be used to ascertain whether a member should be taxed as a self-employed person or an employee. The apparatus of an LLP is likely to mean that it constitutes a UK permanent establishment of its non-resident members such that all of the members, regardless of where they are resident, must pay UK tax on their share of the LLP's profits arising from its UK trade as an investment manager/adviser.

Under anti-avoidance rules, amounts arising to an individual involved in fund management are taxed as trading income, unless such amounts are already taxed as trading income or employment income or fall into exceptions for carried interest or co-investments. Where amounts from the fund arise to another person – such as a priority profit share/fee income arising to the general partner or manager – these amounts can be potentially imputed to the individual fund managers and taxed in their hands if certain conditions are met.

In terms of funds structured as limited partnerships, where the general partner appoints a manager to manage the partnership, the fee payable to the manager will in principle attract value-added tax ("VAT"). This is most often managed by ensuring that the manager and the general partner are in the same VAT group. The Court of Justice of the European Union ("CJEU") in the *Fiscale Eenheid X* case (C-595/13) outlined broad criteria for what constitutes a "special investment fund" ("SIF") for the purposes of the VAT exemption applicable in relation to SIF management services. It was also strongly suggested by the CJEU that AIFs which satisfy certain qualification criteria can be SIFs. This is a changing area of law and, in March 2020, the UK Government announced that it would undertake a review of the VAT treatment of fund management fees. It is therefore possible that the UK's current position on the VAT treatment of management services supplied to AIFs will change.

The UK is not typically used as a domicile for hedge funds, but it is a popular location for investment managers of hedge funds, and this is in part because of the Investment Manager Exemption ("IME"). Provided certain conditions are met, the IME ensures that a UK investment manager managing a non-UK fund will not constitute a permanent establishment of the fund in the UK. The IME enables a non-UK resident fund that is trading for UK tax purposes to appoint a UK-based investment manager without the risk of that part of the fund's profit that is attributable to the activity of the investment manager in the UK becoming subject to UK tax.

In relation to the taxation of carried interest the general "tax transparency" principle is overlaid with: (i) a minimum charge of 28% for carried interest (compared with 20% for most other types of gains); and (ii) rules which can recharacterise carried interest receipts as trading income, taxable at the highest marginal rates, where the fund in question has a short average holding period (the "income based carried interest" rules, or "IBCI"). The IBCI rules are complex, but broadly, where the average holding period of fund investments is less than 36 months, the carried interest returns will be treated as trading income. Where the average holding period is 40 months or more, the returns will be treated as investment gains or income. Where the average holding period is at least 36 months and less than 40 months, the returns are treated as a mix of investment return and trading income. There is an exception from the IBCI rules for carried interest awarded to employees. These rules relating to the taxation of carried interest do not affect the taxation of the fund itself or external investors.

6.3 Are there any establishment or transfer taxes levied in connection with an investor's participation in an Alternative Investment Fund or the transfer of the investor's interest?

There are no establishment taxes levied in connection with an investor's participation in an Alternative Investment Fund. Stamp duties may be payable on the transfer of limited partnership interests if the partnership property includes stock or marketable securities, although there are a number of methods of mitigating the effect of such taxes. Stamp duty land tax may be payable where the partnership property includes land in England or Northern Ireland (with similar taxes potentially applying in relation to land in Scotland or Wales).

6.4 What is the local tax treatment of (a) resident, (b) non-resident, and (c) pension fund investors (or any other common investor type) in Alternative Investment Funds?

The use of tax-transparent limited partnerships as the primary vehicle for Alternative Investment Funds means that income and gains received by the fund are treated as if they had been received by the fund's investors directly. The taxation of the returns depends on whether the fund is treated as trading or investing.

The question of whether or not a fund is carrying on a trade in the UK is largely a question of fact. In practice, this is determined by applying various criteria derived from case law – often referred to as "badges of trade" – to a fund's transactions. For example, churning investments and investing and divesting opportunistically would be likely to be indicative of a trading activity, whereas holding long for income and capital would be more likely to be considered as an investment activity.

Private equity funds (the main users of the limited partnership structure) usually intend to buy and hold securities for the medium to longer term in order to achieve long-term capital appreciation. Consequently, they are more likely to be considered as investing rather than trading.

If the limited partnership is treated as investing then, as a result of its tax transparency, profit distributions from the limited partnership retain their character as capital gains or investment income and are taxed accordingly. The tax payable by a particular investor will depend upon its own tax profile. For example, if the fund receives dividend income, this would be taxed in the hands of a UK-resident individual but a UK pension fund investor should not be subject to UK tax on such investment income. Most non-resident investors will only be subject to UK tax on UK-source investment income to the extent that it is subject to withholding tax or relates to UK land. Withholding taxes are potentially relevant to both UK interest and UK rental income (but generally not dividends), but there are reliefs from withholding. Generally, non-resident investors should not be subject to UK tax on capital gains unless: (i) they hold their interest for the purposes of a UK trade; or (ii) they fall into specific rules relating to UK property (and property-related) holdings (see below).

If the limited partnership is treated as trading for UK tax purposes, UK resident investors and non-UK resident limited partners will be subject to income tax (or corporation tax on trading income) on their share of the partnership's trading profits. This will be of particular concern for UK pension fund investors (who are only exempt from UK tax on investment income and gains). Non-UK resident investors will be caught because the partnership (or the fund manager) will constitute a taxable presence in the UK through which the non-resident is carrying on a trade, but in many cases the IME may be applicable.

The UK regime for taxation of gains arising to a non-resident from interests in UK land has expanded in scope significantly from 6 April 2019. Before that date, the UK only taxed non-residents on gains from UK residential property (subject to important exemptions in the context of investment funds). Broadly, the general position is now that non-resident investors are subject to tax on gains arising from disposals of UK land and also on the disposal of substantial interests in relevant entities that derive at least 75% of their market value from UK land. However, the general position is significantly modified by complex specific provisions relating to collective investment vehicles.

Investors should also be aware of the annual tax on enveloped dwellings ("ATED") and this should be considered carefully when a fund invests in UK residential property.

Where a UK limited partnership receives income from non-UK jurisdictions that levy withholding tax, or receives capital proceeds from the sale of an asset situated in a jurisdiction which might tax that gain, then limited partners may seek to rely on the terms of a double tax treaty in order to obtain relief. Whether such relief is available will depend, in part, upon whether that non-UK jurisdiction treats a UK limited partnership as fiscally transparent.

6.5 Is it necessary or advisable to obtain a tax ruling from the tax or regulatory authorities prior to establishing an Alternative Investment Fund or local asset holding company?

Generally speaking, it is not necessary to obtain tax rulings prior to establishing an Alternative Investment Fund or UK asset holding company, although a company entering the QAHC or REIT regimes must have notified Her Majesty's Revenue and Customs ("HMRC") in advance.

6.6 What steps have been or are being taken to implement the US Foreign Account and Tax Compliance Act 2010 (FATCA) and other similar information reporting regimes such as the OECD's Common Reporting Standard?

The UK entered into a Model 1 Intergovernmental Agreement ("IGA") with the US in September 2012 in relation to FATCA and subsequently introduced domestic legislation to implement FATCA reporting. Relevant Alternative Investment Funds established in the UK therefore have to carry out the required due diligence procedures and report prescribed information about relevant investors to HMRC.

In addition, the Organisation for Economic Co-operation and Development ("OECD") Common Reporting Standard for Automatic Exchange of Financial Account Information ("CRS") has also been implemented into UK law.

Accordingly, UK funds will need to consider these information reporting rules in order to ensure that they are compliant.

6.7 What steps have been or are being taken to implement the OECD's Action Plan on Base Erosion and Profit-Shifting (BEPS), in particular Actions 2 (hybrids/reverse hybrids/shell entities) (for example ATAD I, II and III), 6 (prevention of treaty abuse) (for example, the MLI), and 7 (permanent establishments), insofar as they affect Alternative Investment Funds' and local asset holding companies' operations?

Following the publication of the OECD's final BEPS reports on 5 October 2015, the UK has taken the lead in the development and implementation of new rules relating to BEPS. For example, legislation having effect from 1 January 2017 was introduced in order to neutralise the effect of hybrid mismatch arrangements and legislation to restrict the tax deductibility of corporate interest came into force from 1 April 2017. In addition, the UK has implemented Country-by-Country Reporting and committed to implement Pillars One and Two.

The UK signed the multilateral instrument ("MLI") in June 2017 and it entered into force for the UK on 1 October 2018. As expected, the UK adopted the principal purpose test in relation to its covered treaties, but did not narrow its definition of an independent agent or extend the definition of permanent establishment, other than adopting the provisions which prevent a permanent establishment being avoided by means of the fragmentation of activities.

As the UK is no longer a member of the EU, ATAD III will not be implemented in the UK. In addition, the government has not indicated that it will introduce measures equivalent to those contained in ATAD III.

6.8 Are there any tax-advantaged asset classes or structures available? How widely are they deployed?

If there is appetite to establish a listed fund, then a UK investment trust ("ITC") or REIT should be considered. As discussed in question 2.1, a REIT can now also be an unlisted vehicle where, broadly, it is at least 70% owned by institutional investors.

Provided certain conditions are met, ITCs are exempt from corporation tax on capital gains, can benefit from the general corporation tax exemptions from dividend income and can potentially deduct dividends paid to investors which represent interest income from their interest receipts. Provided certain conditions are met, REITs are exempt from corporation tax on the income profits of their property rental business and on gains arising on disposals of assets used in such business (potentially including interests in certain entities that are UK real estate rich) and can benefit from the general corporation tax exemptions from dividend income.

6.9 Are there any other material tax issues for investors, managers, advisers or AIFs?

The tax position of an investor in a UK Alternative Investment Fund will inevitably depend upon its own tax profile – accordingly investors should always seek independent advice on the tax implications of participating in the fund, and managers should advise investors of this fact.

6.10 Are there any meaningful tax changes anticipated in the coming 12 months other than as set out at question 6.6 above?

In March 2020, the UK Government announced that it would undertake a review of the UK funds regime, including from a tax perspective. The review is very wide ranging and has already led to various changes, including the introduction of the QAHC regime and amendments to the REIT rules. As the review is still in progress, the full extent to which it will lead to further tax developments is not currently known. However, it is expected that further amendments will be made to the REIT regime to increase its attractiveness.

7 Trends and Reforms

7.1 What have been the main trends in the Alternative Investment Funds space in the last 12 months?

The UK's Brexit transition period ended on 31 December 2020. The UK now has its own AIFM and PRIIPs regime which sit alongside the European regimes. Whilst the UK and EU rules remain largely aligned, there may be divergence in the longer term.

This has already been indicated in the case of the PRIIPs regime. In 2022, HM Treasury introduced amendments to the UK PRIIPs regime to improve its functioning in the UK. The changes include clarifying the scope of PRIIPs, giving the FCA power to clarify what information should be provided in the key information document and replacing the "performance scenario" section with "appropriate information on performance", with the FCA amending what information to provide in this section. The changes come into effect from 1 January 2023, with early voluntary compliance permissible. HM Treasury also intends to conduct a more wholesale review of the disclosure regime for UK retail investors in the longer term.

AIFMD now sits alongside its UK counterpart and remains relevant to UK managers managing EEA AIFs, or to marketing in the EEA. The publication in November 2021 of the consultation by the European Commission of proposed amendments to be made to AIFMD, commonly referred to as "AIFMD 2", together with proposed amendments to the existing EU European Long-Term Investment Funds Regulation (ELTIF Regulation) is therefore of interest to UK fund managers. There is currently no indication that the UK is planning to make similar changes.

The UK is not required to implement EU legislation that was not in force before 31 December 2020 but in some instances has adopted a similar regime. For example, while the UK is no longer required to implement the EU's prudential regime for MiFID investment firms due to Brexit, the UK has introduced a new UK Investment Firm Prudential Regime ("IFPR") which came into force in January 2022. The IFPR is a very similar regime to MiFID and introduces a new prudential regime for UK MiFID investment firms with new requirements in respect of regulatory capital, internal governance, remuneration, and disclosures and reporting.

Other regimes have not been adopted, however; for example, the EU cross-border distribution of investment funds legislation, which came into force in the EU in 2021. That is not to say that such European legislation is no longer applicable; UK fund managers may find that they are affected by consequential amendments that individual EEA Member States may decide to make to their NPPRs.

The FCA made changes to the Listing Rules relating to special purpose acquisition vehicles ("SPACs"), which came into effect in August 2021. The FCA's aim is to provide a more flexible regime potentially resulting in a wider range of SPACs listing in the UK, as well as increased choice for investors, and its proposals will put the UK regime on a similar footing to the regulatory regimes of competing financial centres.

The new open-ended fund vehicle introduced in the UK in 2021 – the Long-Term Assets Fund (LTAF) – is primarily aimed at defined contribution pension schemes but is also available to retail clients, though only if such clients are sophisticated investors or certified high-net-worth individuals. The FCA plans to consult in the first half of 2022 in relation to broader retail access.

The publication of the GBP and JPY settings of the London Interbank Offered Rate ("LIBOR") ceased at the end of 2021. In the build-up to cessation, the FCA encouraged market participants to transition their LIBOR-referencing contracts to "risk free" reference rates (often referred to as "RFRs"). The Bank of England's Working Group on Sterling Risk-Free Reference Rates (the "RFR Working Group") ultimately recommended Sterling Overnight Index Average ("SONIA") as its preferred replacement rate for LIBOR in sterling markets though, in some circumstances, the Bank of England Bank Rate has also been deemed an appropriate alternative. The FCA has reported that this transition has largely been successful, but has acknowledged that there are still many agreements that reference LIBOR such that, in order to avoid disruption to the market, the FCA has exercised its powers to require publication of six GBP and JPY LIBOR settings on a changed or "synthetic" methodology ("Synthetic LIBOR") for at least 12 months following 1 January 2022.

In short, practitioners within the industry will need to ensure that they keep abreast of developments and consider whether they should be engaging with the industry in lobbying to try and ensure that any proposed regulatory excesses can be curbed.

7.2 What reforms (if any) in the Alternative Investment Funds space are proposed?

The UK's exit from the EU on 31 December 2020 has created an opportunity to look at the regulation and tax framework of the UK asset management and funds industry in order to create a legal, regulatory and tax regime that remains attractive to fund managers, advisers and other market participants. The UK Government is in the middle of a wide-ranging tax and legal review of the UK funds regime with the aim of identifying options which will make the UK a more attractive location to set up, manage and administer funds, and which will support a wider range of more efficient investments better suited to investors' needs. This has already led to several significant developments, including the introduction of the LTAF and QAHC regimes, with various other workstreams in the development stage. In particular, in February 2022, the UK Government confirmed that it will explore options for a new form of unauthorised fund in the form of a contractual scheme aimed at professional investors.

A number of short-term and longer-term initiatives are underway. This includes the Financial Services Act, introduced to ensure that the UK's regulatory framework continues to function effectively for the UK after leaving the EU. Included in this new piece of legislation is the introduction of a new Overseas Funds Regime to allow overseas domiciled retail funds (and money market funds) to be marketed to investors in the UK. The regime came into effect in February 2022 but before it can be utilised, HM Treasury now needs to assess and make positive equivalence decisions that another country's regulatory regime for a specific type of investment fund is deemed equivalent.

Developments are also underway which should make it easier for pension funds – and potentially other investors – to access longer term, illiquid investments. That could be excellent news for alternative asset managers, who have been looking hard at ways to widen their investor base. It is also good news for the growing pools of "retail" capital that would like to access the more diversified – and frequently high-performing – funds that have previously been the preserve of institutional investors). In October 2021, the Bank of England published a report by the Product Finance Working Group (PFWG), which considers the key barriers to investment in long-term, less liquid assets, summarising the practical solutions that they have developed, specifically focusing on UK workplace defined contribution pension schemes. Separately, the UK government published reform proposals in 2022 relating to the defined contribution pension scheme "charge cap", which can affect the ability of DC schemes to invest in a broader range of assets (including private equity and illiquid infrastructure), that would exempt some performance fees from the charge cap.

Also in 2021, proposed new UK financial promotions rules were published, including additional rules in respect of high-risk investments, new rules on the approval of financial promotions of unauthorised persons and amendments to certain of the financial promotion exemptions.

The UK government has also been looking at post-Brexit measures to boost the UK's reputation as a destination for IPOs. This includes the publication in March 2022 of final proposals to replace the current prospectus regime inherited from the EU Prospectus Regulation. So as to ensure that the UK remains a competitive and attractive place to list a business as compared with other major stock markets, the FCA is also planning to introduce wide reform to the UK listing regime with a series of small but welcome changes brought into force in January 2022 (most notably, in relation to certain eligibility requirements).

In March 2022, legislation came into effect which introduces a register of beneficial ownership information for overseas entities that own or buy UK property, as part of the government's package of sanctions against Russia and in order to progress its longer-term strategy of combatting economic crime.

As to English limited partnerships, relatively minor reform proposals for all UK limited partnerships are to be introduced following a response paper published by the UK government in December 2018. The proposals are designed to build in effective controls into the life cycle of a limited partnership to combat such vehicles being used for illegal activities. The UK government stated in March 2022 that the reforms will be introduced in draft legislation to be introduced as early as possible in the next session of Parliament.

Sustainable finance remains a key area of development. Following Brexit, the UK did not implement the EU Sustainable Finance Disclosure Regulation regime (which started applying in the EU in March 2021) and had only "onshored" the most skeletal elements of the EU Taxonomy Regulation (a classification system to identify sustainable investments). Instead, the UK has sought to tailor a wide-ranging, domestic disclosure regime, albeit one based on international standards and with more than a nod to the EU regime. The UK regime is still evolving, although the cornerstone has been laid and the rules governing the mandatory Taskforce on Climate-related Financial Disclosures (TCFD) disclosure requirements are now in force for some of the very largest asset managers, with the first disclosures required in 2022. Most other UK asset managers will be subject to the regime from 2023.

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