Response to HMT Review of the UK Funds Regime Call for Input

20 April 2021

About the Investment Association

The Investment Association (IA) champions UK investment management, a world-leading industry which helps millions of households save for the future while supporting businesses and economic growth in the UK and abroad. Our 250 members range from smaller, specialist UK firms to European and global investment managers with a UK base. Collectively, they manage £8.7trillion for savers and institutions, such as pension schemes and insurance companies, in the UK and beyond. Forty per cent of this is for overseas customers. The UK asset management industry is the largest in Europe and the second largest globally.

Executive summary

- Our response is in four main parts, following the structure of the HMT Call for Input (CfI). Having set out our key prioritisation, we look at the UK's approach to funds taxation, the approach to funds regulation and the opportunities for wider reform. We also provide four appendices with supporting detail:
    - Appendix One looks at detailed options for the taxation of multi-asset funds
    - Appendix Two looks at the potential impact of a move to a tax-exempt regime on access to tax treaties
    - Appendix Three compares UK and offshore fund structures
    - Appendix Four contains the IA's recent response to the HMRC tax treaty network review, listing the priorities for UK funds in respect of the tax treaties

<u>Part One: Key priorities</u>

- Our key priorities in terms of Government and regulatory action focus on three areas: innovation in the UK fund architecture; the need for a fully energised approach to branding and promotion; and significant improvements to the UK direct and indirect tax regime. We emphasise the need to see these priorities as part of a broader strategic ambition, rather than piecemeal areas of change.

- On fund architecture, we stress the importance of developing the Onshore Professional Fund (OPF) regime alongside the Long-Term Asset Fund (LTAF). We also see a need to enhance the existing framework, including an evolved Qualified Investor Scheme (QIS) alongside a rebranded UCITS and NURS regime.

- Innovation such as the OPF can help drive both export growth and the wider UK authorities' objective of increased investment in domestic long-term and productive finance. At the same time, we highlight the potential of using the UK fund regime as an integral way to help the UK become a pre-eminent global centre for responsible and sustainable investment. We also underline the importance of technological innovation in the way in which funds will operate in the future. While large parts of the digital agenda will be driven by industry itself, the policy and regulatory environment will be critical to adoption and adaption.

- The proposals would benefit all types of investors, domestic and international, institutional and retail. Our framework for the future UK fund product range will ensure a compelling offer to professional investors, particularly through the OPF and QIS. The LTAF and targeted changes to the retail fund regime will provide new opportunities for domestic savers in areas such as access to private markets and innovative approaches to retirement income. The IA will also continue to work closely with Government, regulators and other stakeholders on wider measures to ensure that the UK retail market successfully serves millions of savers who increasingly will benefit from better access to long-term investment products.

- Throughout this response, a consistent sub-theme is the need for a policy and regulatory environment that supports the fund and wider investment management industry, a core feature of other successful jurisdictions. This will in turn help to generate jobs in different parts of the UK and contribute to tax revenue.

- Such support can take multiple forms, whether through enhancements to authorisation processes or the approach taken to facilitating innovation. Critically, this does not imply that such support should come without appropriate challenge and, of course, customer safeguards. But we set out an agenda that would benefit from a different kind of dialogue going forward, which has also informed our previous proposals for a new Investment Fund Forum to operate at working level alongside the HMT Asset Management Taskforce.

- At a strategic level, this agenda has added urgency in the context of an increasingly uncertain outlook for the broader UK-EU relationship, including the position of financial services. While the investment management industry strongly supports the continuation of a manufacturing model that can operate successfully across borders, particularly in the context of delegation, the UK needs to ensure that it remains attractive to businesses that may face rising pressures regarding location decisions. This underlines the important of supporting fund as well as investment management activity.

Part Two: The UK's approach to fund taxation

- **The need for greater simplicity and certainty:** The fund tax discussion at the heart of our submission covers both targeted solutions for specific issues and a wider potential shift in approach. One key example is the tax treatment of multi-asset (balanced) funds. In terms of a targeted approach, it could best be enhanced by moving to deemed deductions for distribution at fund level. However, this raises an important broader question of whether the UK should move to a fully tax-exempt regime for funds, thereby solving this - and other issues - in a more systemic rather than incremental way.

There are currently different views within the industry. On the one hand, a move to a fully tax-exempt regime could lead to unintended consequences such as the potential loss of access to some double tax treaties. On the other, if the ambition is for the UK to act as a compelling global fund hub, supporting a wide range of investor needs internationally, then this points to the need for a significant departure from the current approach that is largely driven by UK investor taxation. Our response sets out the advantages and disadvantages of each approach. Overall, irrespective of the approach taken, a key message is that a successful fund tax regime needs to be simple to operate and understand while offering certainty of outcome.

- **Urgent need for a competitive UK VAT Regime:** A competitive UK VAT regime for existing and new UK-domiciled funds, including LTAF and OPF, that eases the VAT burden to the industry, funds and their investors, is critical for their success as suitable alternatives to offshore funds. This could be achieved by applying a zero rate of UK VAT to the management of all UK funds. Extension of zero-rating to all UK funds would ensure that they are placed on the same footing as equivalent funds domiciled offshore and would also have the added benefit of eliminating many of the issues that have arisen as a result of current VAT rules resulting in significant litigation.

  In any event, the UK needs to radically reassess and update its position on the application of VAT exemption to the investment management supply chain in order that a) the purpose of the exemption is respected and b) to ensure that the UK remains a competitive location for investment managers to establish their funds and operations. It is very important therefore that the anticipated indirect tax review, including the VAT treatment of fund management fees, runs in parallel, as was originally announced at Spring Budget 2020, rather than lagging behind the wider UK Fund Regime review. The effect of the VAT changes needs to be considered holistically with other changes to the tax regime in order to make UK funds as attractive and competitive as equivalent strategy offshore funds.

- **Tax Treaties:** Our key asks on the double tax treaty network focus particularly on the need to seek access to levels of relief for UK funds that are equivalent or close to those they enjoyed when previously categorised as EU UCITS. They also include the need to ensure that rights for UK funds are protected and enhanced as part of any future tax treaty negotiations.

Part Three: The UK's approach to fund regulation

- Authorised funds can be attractive to a range of investors beyond individual retail investors, including institutions such as pension schemes, given the range of protections available and levels of governance. Authorisation is also a requirement in certain overseas jurisdictions for marketing funds to retail and professional investors – e.g. Italy, Spain, Portugal and India.

- The general view from members is that both the statutory and voluntary timescales for authorisations are broadly appropriate, but there are features of the process itself that could be enhanced. We have two concrete suggestions: i) initial review – and initial questions at an earlier stage and ii) more guidance for managers, e.g. list of standard questions for a given type of fund. We would also welcome a fast-track process for funds aimed only at professional investors.

- A range of enhancements should be considered for the QIS such that there is much greater flexibility to serve professional investors in ways that meet their specific needs (e.g. options not to distribute income, option of a fund-of-one structure and wider investment powers). Other jurisdictions, notably the Irish QIAIF, have successfully taken this kind of approach.

Part Four: Opportunities for wider reform

- The IA continues to see the major opportunity as being the launch of innovative new vehicles, rather than systematic re-domiciliation of existing funds, hence our emphasis on the LTAF and OPF. At the same time, some firms are looking at how they could more effectively serve UK customers from within the UK. In addition to reform of the QIS, we propose changes to the rules around capital distribution when thinking about the design of retirement income products.

- New opportunities would have been identified even had the UK remained within the EU, but Brexit clearly provides greater impetus. At the same time, the UK requires a full shopfront of funds to meet the needs of UK and international investors, which also necessitates reassurance and clarity on the status and branding of UK UCITS and an opportunity to enhance the NURS.

- We see an opportunity for the UK to strengthen its capabilities in middle and back office functions, which could be located in the regions rather than in London or the South East. There are a range of considerations for firms as they analyse how best to structure this administrative support, and our submission sets out a range of options for facilitating improved employee skill sets.

- In terms of choice of structures for new funds, firms have multiple options, both open and closed-ended, authorised and unauthorised. Good governance would see the key features of the fund open to challenge as part of the approval process, and market demand would also determine whether a given choice of approach was popular with customers. We do not see how a requirement for investment managers to justify why they are using an open or closed-ended vehicle is compatible with such a process, or who they should justify their choice to.

Part One: Key Priorities

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?**

   The UK is a leading global centre of excellence for investment management, currently supporting 115,000 jobs in multiple regions across the UK, generating 4% of net services exports and contributing £4.5bn each year in tax. However, it significantly lags leading fund domiciles.

   The CfI is an important opportunity for the UK to define an innovative, responsive and supportive framework to ensure that we continue to attract both world-class firms and customers from around the world for our fund management and broader investment management products and services.

   The UK Funds Regime Working Group report to the HMT Asset Management Taskforce in 2019 set out a three-part set of proposals based on innovation, incremental change and the importance of a wider support framework. These proposals form the basis of our response to the CfI and our prioritisation below. We emphasise the need to see the steps as part of a broader strategic ambition, rather than piecemeal steps to deliver change.

   Although some firms are looking at where best to locate specific parts of their product set serving UK customers, the industry as a whole is not looking at systematic re-domiciliation of existing offshore ranges. Our focus is on new fund launches; particularly those suited to Green Finance and long-term finance initiatives such as the Long-Term Asset Fund (LTAF) but also extending to attracting more overseas funds and investors through the Onshore Professional Fund (OPF) regime. We set out how this new world would look in Figure One below and discuss the implications in more detail throughout our response. Our priorities also recognise the practical necessity of a coherent approach to the branding of UK funds, including UCITS that are no longer – by definition – UCITS under EU law.

   Fund delivery is a dynamic, not static process, and the UK needs to be innovative and responsive, with support from Government and regulators. In a post-Brexit context, developing a more attractive fund domicile may also mitigate the risk of a more challenging approach to delegation in the EU, should this arise, resulting in relocation of portfolio management capability outside the UK.

EXHIBIT ONE: Potential Future Shape of the UK Fund Regime

Source: UK Fund Regime Working Group Report (2019). Asterisks indicate new additions to the UK fund framework

To achieve these aims, the IA proposes the following prioritisation for the top three areas as part of the UK fund regime work specifically:

- **Develop both the LTAF – already underway - and the Onshore Professional Fund (OPF) regime and enhance the flexibility of the QIS**. The OPF could in turn be prioritised according to areas which are the most straightforward to implement in terms of legislation, notably the Professional Investor Fund (PIF) contractual scheme structure.
- **Work with industry to establish a branding and naming approach** that will aim to provide a coherent and attractive UK framework, from the OPF through to UCITS.
- **Implement a competitive direct tax and VAT regime for funds** that aims at greater simplicity and stability in the longer term, while minimising administration costs.

These priorities should be accompanied by continued implementation of flanking measures, looking at wider regulatory and operational change, including the Direct2Funds model and a single UK rulebook, which will help to enhance UK competitiveness.

Taken together, these areas will help to increase the confidence in the UK which will in turn provide the key ingredients for future success as a fund domicile. In order to be successful, the UK Fund Regime also requires active promotion by the UK government. Other jurisdictions have received extensive, vocal backing from their governments and changes to the UK fund regime are unlikely to be successful unless the UK government provides a similar level of support. As the UKFRWG set out, we also see benefits in the establishment in a new Investment Fund Forum, which at a working level could help to improve ongoing dialogue about the wide range of issues that we cover in this submission. It would not replace the strategic focus provided by the Asset Management Taskforce, nor the formal regulatory processes that must by definition be part of normal business. However, it would help ensure that outside those formal processes, there was a forum which could look at ongoing issues affecting the UK fund management industry.

1. Rationale for prioritising fund structures

For many years, the UK has seen other jurisdictions move rapidly in the area of new fund structures that are attractive to international professional investors. There is a clear gap in the fund range offered by the UK in the professional space, particularly in comparison to overseas jurisdictions. The UK has an authorised structure aimed at sophisticated retail and professional investors: the Qualified Investor Scheme (QIS). The QIS works well in the authorised sphere for some investment strategies and investor types, although some improvements are warranted (see specific comments to questions 15 – 18 below) that will make a tangible different to the ability of investment management firms to use the QIS. However, the current unauthorised offerings, or those subject to light-touch regulation, do not fill the gap in the professional investor space and a new fund structure needs to be created outside of the authorised regime. The IA proposes that the OPF, as a suite of Alternative Investment Funds (AIFs), will provide that structure. We strongly urge the government to prioritise the OPF in its three legal forms, starting with the PIF which should be the most straightforward, in terms of legislative implementation.

Professional investors do not need all of the protections afforded to retail investors under a fully regulated regime, particularly if those protections stifle freedom in employing a particular investment strategy, e.g. the extensive use of illiquid assets and the possible enhanced returns that result. Instead, the flexibility of an unauthorised structure operating under the UK AIFMD Regime could provide benefit to these investors.

Alongside the Long-Term Asset Fund, the OPF can also assist the government's initiative of reinvigorating the economy in a post-COVID world. The funds envisaged will invest in a vast array of assets, including in new enterprises and infrastructure projects and could support the moving away of certain operational processes from the traditional hubs in London and the South East.

In order to be successful and competitive, OPF fund structures need a competitive tax and VAT regime that offers tax neutrality at fund level (specifically through tax exemption for OPF corporate structure) while ensuring that UK management of OPF does not result in increased VAT obligations as compared to UK management of a comparable fund offshore. This could be achieved by applying a zero rate of UK VAT to the management of these funds. . From a VAT revenue perspective, the zero rating would be equivalent to the current position where non-UK fund vehicles are used with the associated benefits of encouraging the associated support functions such as fund administration and other support services to the UK.

2. Importance of a clear brand

Our second priority, which links to the broader question of support and promotion, recognises the need for the new fund architecture (see Exhibit One above) to have a coherent and attractive brand. This does not just apply to the new elements such as the OPF and LTAF. It also applies to UK-domiciled UCITS, which are now third country AIFs from an EU perspective. By necessity, the UK needs to decide what these should be called. That may depend on the future regulatory direction of travel, but arguably whether or not the UK continues to align with the letter of the UCITS regulation, there will be a need to visibly differentiate UK UCITS from EU UCITS.

3. Need for a competitive direct tax and VAT regime

Our third priority area focuses on the wider changes necessary to ensure that the UK offers a compelling fund domicile proposition from a tax perspective. Historically, the UK has lost ground to other jurisdictions by not being sufficiently adaptive to changing product sets and customer needs. This is often seen at the level of tax treatment.

Although we emphasise and welcome the considerable progress that has been made in the past decade, the UK fund tax regime continues to be complex and provides an inefficient outcome for certain strategies. Like other successful international fund locations, UK needs a tax regime that is simple to operate and understand while offering certainty of outcome. The extent of tax changes depends on the Government's ambition. At the very least, the inefficiencies in the current tax regime, notably the treatment of balanced funds, need to be removed without further complicating the tax regime or increasing operational costs. A more wide-reaching, holistic change would be needed if the aim is for the UK to act as a global hub for the setting-up, management and administration of funds supporting a wider range of more efficient investments better suited to investors' needs.

Equally importantly, it is critical for the UK to offer a competitive VAT regime that attracts funds and investment management businesses to locate in the UK. This could be achieved by applying a zero rate of UK VAT to the management of all funds, whether special investment funds (SIF) or non-SIF. Extension of zero-rating to all UK funds would have the added benefit of eliminating many of the issues that have arisen as a result of current VAT rules resulting in significant litigation.

In any event, the UK needs to radically reassess and update its position on the application of VAT exemption to the investment management supply chain in order that a) the purpose of the exemption is respected and b) to ensure that the UK remains a competitive location for investment managers to establish their funds and operations.

Importance of wider context

Our main prioritisation for the UK fund regime is set against a broader set of commercial and policy challenges, which also present major opportunities.

<u>An ambition to be a pre-eminent centre for responsible investing</u>

The UK is at a critical juncture on a journey to honour its commitment to bring about net zero greenhouse gas emissions by 2050 ("Net Zero") and to achieve the Paris Agreement goals this century. The UK's 2050 Net Zero target is one of the most ambitious in the world and the UK Government must continue to display global leadership and to galvanise all industries and other countries to do the same.

These last two years, we have also witnessed a global pandemic bring devastation to communities across the world and disruption to businesses of unprecedented scale. With the UK Government now considering how best to trigger a green, sustainable, and fast recovery from the pandemic, we are facing a once-in-a-generation opportunity to set out a blueprint for the long-term growth of the UK economy, which puts action towards Net Zero, limiting the damage from climate change and delivering social justice at the heart of this recovery and growth. This, of course, is not just a story about managing risk; there is significant economic opportunity to be found in the new industries and technologies that are emerging to tackle climate change and to adapt to its impacts. IA members with almost £5trn of assets under management in the UK have now signed up to the Net Zero Asset Managers initiative and Race to Zero, committing to support investing aligned with net zero emissions by 2050 or sooner.

It is important to note that sustainable and responsible investing is not just a recent trend. It has long been an area of strength for the UK investment management industry. The pandemic has only re-confirmed the centrality of sustainability to our clients and the broader economy: In the UK, the investment management industry has indeed seen a marked increase in demand for sustainable and responsible investments. IA figures show net retail sales to responsible investment funds grew to £11.7bn in 2020.

With increasing numbers of investors asking for information on the sustainability characteristics of financial products, as well as for specific products to deliver on their own unique investment goals and preferences (for example, reflecting their different attitudes to climate change), investment managers must continue to innovate – developing new funds and communicating even more clearly and consistently with clients. While the UK is home to considerable expertise in this area, with appropriate Government support, the UK can secure its position as the pre-eminent global centre for sustainable and responsible investing.

We welcome the Chancellor's commitment, made at the first meeting of G7 Finance Ministers under the UK's G7 presidency, to pursuing cooperation on improved climate-related financial disclosures and support for the development of international sustainability-related financial reporting standards. Such financial disclosures are critical in addressing the data gaps that currently limit the accurate measurement and assessment of climate-related risks and impacts of investment portfolios.

IA members would welcome an approach from both UK Government and UK regulators that seeks to encourage and support international harmonisation of standards and reporting of environmental, social and governance (ESG) factors for products and funds, including alignment with the EU sustainable finance rules, wherever this is deemed to be in the best interest of end investors. Fragmented approaches across different jurisdictions run the risk of not treating consumers consistently and fairly, including different regulatory requirements impacting the investable universe of certain consumers more heavily than others.

Notwithstanding our view on global harmonisation of rules and regulation, ultimately, we view as critical the need for the Government to come forward with a UK ESG/sustainable investment framework as soon as possible to ensure good customer outcomes and a well-functioning UK fund market which will help set the UK as a pre-eminent ESG investment centre. IA members are committing significant time and resource not only to the development of new responsible investment products, but also on consistent and clear disclosure of the sustainable characteristics of their products. However, it is critical our members know what regulatory framework they will be working in. The FCA draft Guiding Principles on ESG/sustainable fund design, disclosure and delivery help this but firms need clarity on whether the UK will be adopting a regime similar to the EU Sustainable Finance Disclosure Regulation (SFDR) or alternative frameworks.

At the heart of a UK framework should be the aim to enable and empower consumers to make informed investment choices that are aligned with their needs and preferences.

Harnessing technological change

Technology is changing every aspect of investment management, from front office investment decisions through to back office administration. We stress the need for Government, industry and regulators to work together to understand and support the imminent technological transformation that lies ahead, particularly as the transition to digital or tokenised funds operating using distributed ledger technology (DLT) infrastructure gathers pace, and investor behaviours continue to evolve. This will help to ensure that the UK is in the best possible position to attract and foster innovators, as well as improving efficiency and lowering cost for customers.

The IA has already taken concrete steps in this area with the establishment of the Engine fintech accelerator and is working closely with firms on the potential offered by DLT in the new generation of fund delivery. It will be important that the regulatory arrangements governing funds are flexible to cater for new ways of working and delivering the benefits of collective investment to investors. Areas that we can foresee may need reviewing are around the operation of tokenised funds whose move away from a centralised shareholder register via the DLT may require adjustments to the OEIC Regulations and the COLL rules.

We also foresee an evolution in the distribution of funds as investors take greater control of their financial account information via Open Finance, and potentially partner with organisations not part of the current marketplace to manage the allocation of their savings to specialists. This is likely to accelerate the use of digital account management platforms, as well as putting existing datasets to greater use in providing consumers with outcomes suited to their needs. There will be questions around the boundaries between formal financial advice and guidance and how this can be managed online, and the ethical use of different type of datasets in this context.

Similarly, as societal demands move further towards a digital-first interface with providers, there will also potentially be greater demand for a digital ID for investors to be able to reuse pre-validated identity documentation to satisfy KYC and AML rules. Changes may also occur in the payment process as a future central bank digital currency and/or other digital currencies become used as a form of payment for financial services.

It will be important to see whether the pandemic-related trend of self-directed investing, driven by consumers with more disposable income and more free time, continues longer term. This also presents potentially wider opportunities to democratise the investment culture. Historically, the UK has not had a strong direct investment culture, compared with for example, the US. Recent behaviours have certainly been facilitated by technological change in making direct investing more accessible, which is something that fund providers can learn from. Investment firms are beginning to assess whether there will be a longer-term impact either in terms of greater rates of investment including into funds, and/or whether the future for investing needs complimentary products alongside funds, such as separate accounts where a greater level of customisation of underlying portfolios are made possible. Taken together, these long-term changes in consumer behaviours will require a regulatory environment that is adaptable and reflects technological trends.

Part Two: The UK's approach to funds taxation

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

Over the last decade, significant effort has been invested by Government in addressing specific competition issues, particularly on the UK tax side. This has resulted in a far more positive dialogue between Government and industry, as well as some clear successes. In particular, the creation of Tax Transparent Funds/Authorised Contractual Schemes has helped to ensure that significant institutional asset pools were invested through UK vehicles, rather than being domiciled overseas.

However, while the growth rate of UK-domiciled funds under management has increased in the last decade, this has largely been driven by a combination of domestic demand and market factors, rather than a significant change in international perception and fund exports.

Exhibit Two: Total assets in UCITS and AIFS by domicile[1]

Some of this is due to sunk cost with existing ranges, but also reflects the need for an enduring signal of regulatory and political support for the UK funds industry going forward, which this Call for Input is a very welcome first step towards.

Fund delivery is a dynamic, not a static process. Other jurisdictions are continually innovating, with Ireland and Luxembourg offering a wide range of fund vehicles to match changing customer and industry needs. Vehicles such as the Luxembourg Reserved Alternative Investment Fund (RAIF) and Irish Qualifying Investor Alternative Investment Fund (QIAIF) have demonstrated an ongoing responsiveness. Some initiatives are more successful than others, but success as a jurisdiction is not measured on terms of individual fund vehicles but the collective impact on attractiveness.

Fund managers make decisions on where to establish hubs for fund domiciliation over the long term and hence, for a jurisdiction to be successful it needs to provide a large menu of options for investment managers and investors to choose from based on their

[1] Source: The Investment Association Annual Survey 2019-20

needs. Importantly also, the fund regime needs to cater to a wide range of strategies in order for a fund provider to adopt a particular location – whether equities, fixed income or balanced. Whilst the UK regime technically works for some strategies, it does not work for all strategies and this limits its potential as a fund hub.

Lastly, while it is possible that not all initiatives may be successful either in the short term or even over the longer term, success needs to be measured over a longer period of time across the regime as a whole rather than its individual components.

To conclude, as can be seen from Exhibit Two above, the UK has been left behind when it comes to comparative levels of funds under management, with the tax regime still perceived to be a significant contributor to this lag. Most investors do not understand the UK tax regime but what they do understand is that there is a risk - perhaps remote but a risk nonetheless - of material taxation at the fund level, whether because of trading or a balanced strategy or something else. It is this perception of risk that drives international investors away from the UK. Reforms to date have not done enough yet to alter this perception.

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

The lack of uptake of the Tax Elected Funds (TEF) regime to attract significant market interest when launched in 2008 can be attributed to a number of factors:

- The dividend exemption introduced as part of the Corporation Tax Act 2009, which largely exempted most foreign dividends from the scope of UK taxation thereby significantly removing tax for funds investing in equities and reducing the overall benefit of the TEF regime;
- The reduced benefit of the TEF regime as a result of introduction of the dividend exemption also meant that the investment costs to establish TEFs on fund platforms outweighed the potential benefits resulting in a majority of platforms deciding not to incur the additional set up costs of running a TEF regime;
- Launching the TEF regime in the midst of the financial crisis also had an impact on its immediate use, particularly where any additional spend was required to adopt the regime;
- The ban on holding property, making TEFs less attractive to mixed and balanced asset investors including pension schemes; and
- The complexity and cost for underlying investors of the tax reporting of assets held in a TEF, in effect creating a significant barrier for all but large institutional investors.

Overall, the industry does not think that TEFs or any modified version of TEFs will work as the costs associated with the regime far outweigh the benefits. The costs/benefits are also asymmetric and the number of funds that paid tax became so small in number following the introduction of the dividend exemption from 1 July 2009, that the cost of the complex system requirements to run TEFs could not be justified. Therefore, any solution to addressing deficiencies in the funds tax regime need to be simple, operationally easy and inexpensive to implement, unlike the TEF regime.

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

As the Call for Input highlights, the UK Fund Regime Working Group offered several potential solutions to help resolve the "Mixed Assets/Balanced Funds" problem and tax incorrectly suffered by funds which cannot currently benefit from universal tax neutrality.

On this point, there has been uniformity from our membership on two core messages:

- The current rules offer sub-optimal results in the context of UK Corporation Tax being trapped within the fund structure and there is no appetite for the current rules to remain unchanged without dealing with these inefficiencies.
- Investors, especially those used to the easy-to-understand regimes internationally, want simplicity. The UK has a system that is too complicated with overly burdensome administrative processes as well as placing a drag through the application of Corporation Tax. This perception of complexity and tax cost has a negative impact on the reputation of UK funds outside the UK that far exceeds the relatively small amounts of tax that are paid in practice.

We agree with the importance of tax neutrality for funds as explained in para 2.2 of the Call for Input. The UK, like all other competitive fund domiciles internationally, is committed to the concept of tax neutrality for funds. Any increased tax drag, either in absolute or administration terms, in the investment chain threatens the core advantages of collective over direct investment.

While the question asks *how a proportionate impact on HMRC could be ensured*, we do not agree that this is the right approach to take to matters of agreed Policy. Any tax collected through UK funds is unintentional and a feature of an overly complicated regime which relies on existing mainstream Corporation Tax legislation with various exemptions and reliefs grafted onto it to attempt to achieve effective tax neutrality. It is important to stress that the burden of any fund level tax drag is borne by investors and savers, removing much needed investment from the economy as well as delivering reputational damage on the UK funds industry as a whole.

The burden of this tax is also uneven and arbitrary, differing by manager, strategy and portfolio but the issue is likely greatest for funds which hold portfolios that mix equity and interest-bearing investments, and sit closest to the 60% threshold for qualifying to pay an interest distribution. These strategies are increasingly common as fund managers tilt towards offering solution-based strategies to their clients.

Anecdotal evidence supplied by members suggests that the magnitude of tax loss for solution-based strategies around this threshold is likely to be around 0.18-0.2% of the net asset value of the fund. This also has a significant impact on income yields, an important performance metric used by investors to determine which funds to invest their money. While the offset of management expenses will reduce any taxable income somewhat, we are aware of examples where the tax drag can be as high as 11.67% of a fund's distribution, meaning that a UK fund would under perform an equivalent Luxembourg or Irish fund's income distribution by over a 10th, and likely more when additional costs of compliance are factored in.

These percentages are gross and do not factor in any Corporation Tax reclaimed via Corporate Streaming. In this sense the above represents 'the worst of all worlds' in that the actual tax retained by HMRC will be a fraction of the reported amount while managers have to market the entire fund using the reduced yield figures. It also penalises UK retail investors investing via ISAs, SIPPS and UK pension funds who cannot reclaim the tax suffered by the fund, and international investors to the extent there are any.

The above outcomes are simply for investors who have chosen to consolidate these types of strategies through a single fund. Should they have invested in multiple equity and bond funds which offered the same allocation of ownership in the underlying assets, they would have suffered no tax. The fact that UK Corporates can recover this tax, while other types of investors like pension schemes and ISA policy holders suffer this tax is also completely arbitrary.

Mitigating the loss of tax of such accidental outcomes should not be placed on an industry which has unduly suffered this tax since the rules were introduced and evolved to their current form.

Recommended solution: Deemed deductions for distributions at fund level

The potential solutions presented in para 2.9 of the Call for Input (listed below) were highlighted as part of the UK Fund Regime working Group report in 2019 as examples of tax neutrality for funds in other international jurisdictions.

- Option 1: Changes to the tax rates applied to UK funds, including applying a low rate of tax to authorised funds
- Option 2: Deemed deductions for distributions at fund level
- Option 3: Amendments to the TEF regime
- Option 4: Extension of corporate streaming to individuals

This also links to the broader question of whether the UK should move to a fully tax-exempt regime, thereby solving the issue at a more systemic level. Here, there are currently different views within the industry. We have considered these in further detail in the response to Questions 6 and 7. Overall, a key message is that a successful fund tax regime needs to be simple to operate and understand while offering certainty of outcome.

In the absence of a fully tax-exempt regime discussed in question 7, of the options presented in para 2.9 of the Call for Input, the majority of IA member firms support an approach based on deemed deductions for distributions at funds level, which offers relative simplicity as well as domestic familiarity in achieving tax neutrality. This principle is also used in other jurisdictions for fund regimes targeted at domestic investors. It should be noted that while this approach would help resolve the tax leakage for UK authorised funds, it would not address perceptions from the international investor community that UK funds are complex and risky.

Appendix One sets out the arguments in more detail and also explains why we recommend that the other three options (changes to tax rates applied, amendments to the TEF regime, extension of corporate streaming to individuals) are dropped completely to allow a clear focus on the core discussion.

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

   60% Test

   An additional complication for UK authorised funds is the need to constantly monitor the qualifying investment test or the 60% test (applying to interest-bearing assets) throughout the year under the Authorised Investment Funds (Tax) Regulations 2006 (the AIF regulations) for a fund to be able to make interest distributions.

   The AIF regulations require the 60% test to be met throughout the distribution period for a distribution to be considered an interest distribution. This is a cliff-edge test requiring constant monitoring. In the case of a mixed asset or balanced fund, the daily fluctuations in investment holdings could therefore mean that the fund may have a different status for each distribution period. This gives result to various issues including fund pricing.

   Given the challenges in the monitoring of this test, many balanced funds are treated as equity funds and therefore become less tax efficient for investors for the reasons set out above.

   Any changes to the wider regime, such as the introduction of either a deemed deduction mechanism referenced in Question 4 or a tax-exempt vehicle referenced in Question 6, would need to be assessed in parallel to the 60% test to ensure coherence of the regime while meeting the overall policy objective.

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?**

   Where funds are already tax-neutral, such as most UK authorised equity and bond funds, their tax-exempt status may not itself change anything, as fund location decisions are based not only on the tax regime but also on a number of other factors such as the wider regulatory framework. For balanced funds that currently suffer tax leakage, a tax-exempt status would help address this issue. That said, UK authorised funds have historically been largely domestic and more so since the UK's decision to the leave the EU. The growth of UK authorised funds is not automatically expected to increase purely for the reason of having a tax-exempt status, particularly given the limited marketability of UK funds to EU investors following the UK's withdrawal from the EU.

   That said, some members believe that a tax-exempt status will have an impact on the overall perception and the attractiveness of the UK fund regime for international investors, as explained further in our response to question 7 below. The relative growth of fund AUM in Luxembourg and Ireland evidences the effect that an exemption regime certainly does not act as a disincentive. Indeed, the simplicity of the tax exemption regime in Luxembourg and Ireland offers reduced tax costs, complexity and risk which are key considerations in any discussions on fund domicile, whether in the context of retail funds or professional funds.

The most significant concern raised by members to any potential change to the taxation of UK authorised funds is the effects of such a change on the ability of certain strategies to access double tax treaties internationally. This is because tax exemption may in certain instances have a negative impact on treaty access for funds where the tax residence for the purpose of the treaty is linked to the fund being subject to tax or where the income itself may need to be taxable to benefit from lower rates under the relevant treaty article. These are issues already faced by funds based in locations such as Ireland and Luxembourg and where UK funds currently have an advantage as a result of the UK fund regime. More details on these are included in the detailed response to question 7 below.

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.

Funds are tax-efficient conduits for investors, offering investors the benefits of collective investment and risk spreading while preserving, so far as possible, the tax treatment that an investor would have if investing directly in the underlying assets. This concept of tax neutrality ensures that there is no double taxation. Any tax drag at the fund level undermines the tax neutrality principle and makes funds less attractive for investors.

There are a number of factors that affect competitiveness and the attractiveness of a fund regime. A tax regime that offers certainty, longevity, simplicity, stability, ease of administration and flexibility to cater for a range of investment strategies, asset classes and investors is a key feature of successful fund locations.

Under the current tax regime for UK funds, most UK funds generally do not pay taxes due to the application of UK dividend tax exemption on income from equity investments at the fund level or the deduction for interest distributions by bond funds. This by itself is a complex message to explain to international investors in comparison to the exempt regimes favoured elsewhere. As also noted in the CfI, balanced or multi-asset funds that do not fall within the definition of a bond fund suffer tax on income from derivatives and on any interest income, without a deduction for distribution of such income, which results in a tax drag at the fund level.

Impact of UK fund tax inefficiencies

- **Higher tax and compliance costs for investors:** Tax at UK fund level is not recoverable by retail or exempt investors as streaming of distribution exists only for corporate investors, which results in lower returns for such savers. Any tax drag at the fund level undermines the tax neutrality principle and makes funds less attractive for investors. In addition, there is also considerable compliance cost associated with tax returns and administration of tax by taxpayers.
- **Perception:** The complexity of the UK fund tax regime and tax inefficiency of balanced funds fuels the perception that UK funds are not tax-efficient, unlike the offshore funds based in other popular fund locations.
- **Competitiveness:** All these factors have a disproportionate and unfair tax impact on UK retail and exempt investors by imposing irrecoverable additional costs on these investors. Irish and Luxembourg funds are tax-exempt and do not suffer

comparable leakage. Therefore, offshore fund vehicles have become more attractive for certain categories of domestic investors, as well as foreign investors. This drives fund managers to offshore solutions with consequential impact on UK jobs and the wider support economy.

- **Impact on development of new products:** This problem would only be accentuated with the shift in product demand towards more solutions-focused strategies (including liability-driven investment) and alternative asset classes. The UK tax regime has been designed primarily for single strategy funds and as such is unsuitable for solution-oriented products such as multi-asset funds.
- **Impact on choice of UK as a domicile for fund umbrellas:** if the UK regime does not offer optimal results for certain strategies in the UK, then a manager will likely favour a domicile which is suitable for all strategies rather than choosing different locations for different strategies.

Ways to deal with the problem:
There are two ways in which this problem can be dealt with. The industry view is divided on the preferred option on the basis that each option impacts different funds and strategies differently as well as raising a wider question about priority and areas of growth for UK fund industry. We have highlighted below both of these options along with pros and cons of each option, based on member feedback.

1. Removal of tax drag by making amendments to the existing regime

In our response to question 4, we have provided details of the preferred solution that deals with the issue of tax leakage for balanced funds. Amending the existing regime to deal with the issue has the following advantages and drawbacks:

Advantages

- **Removal of tax leakage** at fund level, which is absolutely required in order to remove the irrecoverable tax costs for retail and exempt investors.
- **Less disruption** to existing rules and processes making it operationally easier for existing funds to continue to work broadly in the same way.
- **Less fundamental change** to the tax rules ensuring that the existing framework of UK fund taxation remains broadly the same. Some members believe that the current UK Fund regime is well understood by UK retail investors and as such there is no need for a complete rehaul of the UK fund rules beyond removing the instances of tax leakage for balanced funds.
- **Maintenance of the current treaty position** of UK funds. This is again an argument for those that support maintaining and enhancing the existing UK tax regime on the basis that UK funds have traditionally held an advantage over funds in Luxembourg and Ireland by retaining access to large number of tax treaties. While there are some existing tax treaty concerns in certain circumstances, which we have detailed in the response to question 10 below, the wider access for UK funds to access treaties should be maintained under this option. It should also be noted that the vast majority of fund strategies obtain limited or no treaty benefits. Indeed, with recent developments in domestic withholding regimes, particularly in Europe, for most equity strategies, the UK-US treaty is of most significance.

Drawbacks

- The UK Fund regime retains its complexity, continuing the **perception** that UK funds are not tax efficient unlike the offshore funds based in other popular fund locations.

As UK funds will have access to a smaller domestic pool of capital, they will be relatively speaking more costly to run, generating less scale benefit for managers and investors alike.

- **Retains complexity and cost of compliance.** This option retains all of the complexity and infrastructure, and cost of complying with the regime.
- Retail authorised funds continue to remain domestic as the UK tax regime broadly **retains its complexity** making it difficult to market it to overseas investors.

2. Tax-exemption of funds

As we explore the implications of this option, it is important to highlight that for the corporate legal structure of an OPF referred to in Chapter 4 of the Call for Input, overwhelmingly member feedback indicates that a tax-exempt fund regime would be required in order to be able to compete with other alternative professional fund locations. Please see our responses to question 36 and 37 for further specific details of requisite attributes required for an OPF.

The question that remains then is whether the UK should have two separate tax regimes for UK Authorised Funds and OPFs or a single regime that offers exemption to all funds.

It should be noted that for a tax-exempt regime to be competitive, it must be ensured that tax exemption at fund level does not come at the cost of added complexity of administration either through streaming or in any other way so as to either increase the cost of running and/or distributing the fund to investors.

We have highlighted below, the pros and cons of having a single regime of tax exemption for all funds:

Advantages

- **Removal of tax at fund level**.
- A **single coherent tax regime** which successful fund locations offer without distinguishing between types of investors, retail or professional. It also allows **synergies and economies of scale** of having fund ranges in a single or fewer locations (subject to regulatory requirements).
- **Simplicity** of the tax regime in offering a single easy to understand tax-exempt regime that investors are generally used to seeing in other fund locations.
- **Marketability** and attractiveness to retail and professional investors internationally.
- **Perception.** A simple and straight forward tax-exempt fund regime is likely to help alleviate the perception of the UK tax regime for funds being complex and tax inefficient.

Drawbacks

- **Disruption to existing regime and processes**. Such a significant change to the UK fund tax regime would require time and administrative cost of moving from existing rules.
- **Fundamental change to the UK fund tax regime**. Some members note that the current UK authorised fund regime is well understood for UK retail investors and a fundamental change to UK fund tax regime is therefore not warranted at this stage beyond fixing the specific issue of tax leakage for balanced funds.

- **Impact on Treaty access.** The most significant concern raised by members to any potential change to the taxation of UK funds will be its effects on their ability to access double tax treaties internationally unless the UK takes steps to mitigate this issue. The loss of treaty access will not be felt evenly across the industry by either size or sector. While deeper analysis of all tax treaties and protocols would require us to identify all cases where treaty access for UK funds may be negatively impacted, we have focussed on some of the key territories where treaty access is expected to be an issue based on the current understanding of treaty interpretation as seen for other internationally comparable vehicles – most notably Irish ICAVs/plc and Luxembourg SICAVs, both tax-exempt in local law. It should also be noted that the vast majority of fund strategies obtain limited or no treaty benefits. Indeed, with recent developments in domestic withholding regimes, particularly in Europe, for most equity strategies, the UK-US treaty is of most significance.

Being mindful of this, we have carried out a high-level analysis of key jurisdictions where treaty access for a tax-exempt vehicle may be problematic absent active steps to renegotiate the relevant tax treaties. This analysis is set out in Appendix Two and identifies US, Canada and India as potential locations where current UK tax treaty requirements could make it difficult for an exempt fund to access the treaty benefit. A way to manage these treaty issues is for HMRC to renegotiate the relevant tax treaty recognising funds as "residents" in their own rights.

Other critical factors impacting competitiveness and attractiveness

VAT Regime

Beyond the fund taxation regime, another important factor is the UK VAT regime. A competitive VAT regime that allows businesses to effectively manage their VAT costs and ensure no VAT costs arise at the level of the fund is a vital consideration. VAT can be a significant cost to UK-based fund managers when managing UK funds, disproportionately impacting business decisions. The current VAT regime effectively limits the available onshore fund strategies for investors as VAT cost to a manager is a cost component in higher charges to the funds. On the other hand, countries like Hong Kong and the US do not apply a VAT or a goods and services tax (GST) regime whilst others such as Japan, Singapore, Australia and Switzerland have VAT/GST regimes that work in a way that results in zero or minimal VAT costs for investment management businesses. Taking irrecoverable VAT into account will result in a total effective tax rate for UK businesses in excess of 30% of profit once the new increase in Corporation Tax comes into effect – considerably above the average of G7 nations and far higher than competitors in the asset management space (e.g. HK, Singapore, Switzerland, US).

More consistent and comprehensive application of the current VAT exemption for fund management would be beneficial but, fundamentally**, a competitive UK VAT regime for existing and new funds is critical for their success as a suitable alternative to offshore funds.**

In this regard, key recommendations and asks include:

a. **Competitiveness of the UK VAT Regime for all funds:** Under the current VAT regime, a UK investment manager managing an offshore fund can benefit from full

VAT recovery while no VAT is charged on the fund itself. In contrast, the management of UK funds is either exempt from VAT (if they are qualifying funds) or is subject to VAT (otherwise). Where the fund is exempt from VAT, the input tax recovery of the investment manager is restricted. Where the fund is liable to VAT, there will be full input VAT recovery for the investment manager, but in all probability a significant VAT cost for the fund**. For a UK based fund structure to be comparable to its offshore counterparts, the current VAT treatment available on UK management of offshore funds needs to be extended to management of comparable UK vehicles. This could be achieved, for example, by applying a zero rate of UK VAT to the management of all funds, whether SIF or non-SIF.** Leaving the EU presents an opportunity for the UK to reconfigure its VAT regime in order to make it attractive for funds to be located in and managed from the UK, giving regard to the wider economic benefit of the growth as a fund management location. The Call for Input refers to an opportunity for simplification of the VAT regime which is helpful but not, on its own, sufficient in supporting the UK's agenda to be a leading fund location. Extension of zero-rating to all UK funds would have the added benefit of eliminating many of the issues that rise from the definition of management, which are addressed below.

b. **In absence of zero rating for all funds, the following areas of the UK VAT regime for funds need urgent attention**:

- Funds offer investors many advantages through collective investments over direct investments including access to professional investment managers, diversification and risk spreading, economies of scale, ease of access to certain investments, lower transactions costs, etc. The management of collective investments entails the outsourcing of certain functions necessary for such funds to operate to specialised service providers. The exemption for fund management services provided to special investment funds (referred to as the SIF VAT exemption) under Article 135(1)(g) of the Principal VAT Directive aims to ensure tax neutrality between direct investments (whereby investors do not incur VAT) and indirect or collective investments. A clearly defined interpretation of special investment funds in the UK allows the UK to be a good place for international provision of management and management adjacent services, whilst providing scope for a UK fund range which does not suffer VAT drag.

  The investment management sector is currently undergoing a period of significant operational and structural change, driven by a combination of technological development, commercial specialisation and regulatory changes. As such, the scope of operations undertaken 'in-house' by investment managers and outsourced by them to third-party providers has dramatically changed in the last 15 years or so. **The current UK VAT rules, that are based on the EU VAT directive, have not kept up to date with this pace of change and do not recognise the evolving ways in which services are delivered.**

  For this reason, the definition of what constitutes 'management' has been subject to significant amount of litigation and there is an urgent need to address the approach to the provision of services through outsourced as well as technological means so as to cater for current and future delivery mechanisms. It is also crucial to recognise the importance of outsourcing for small and medium-sized investment management firms. The current application of the UK VAT regime results in a perverse outcome of penalising such firms for choosing to outsource certain functions instead of performing them in-house and urgently needs to be reviewed and addressed. **The UK needs to radically reassess and update its position on the application of VAT exemption to the investment management supply chain in order that a) the purpose of the exemption is respected and b) to ensure that the UK remains a competitive location for investment managers to establish their operations.**

In the recent Budget, the Chancellor announced a number of measures encouraging innovation including a review of the UK's R&D tax credit regime and a super deduction for new investments. The investment management industry is a great consumer of technology and innovation and a regime that supports and encourages it do so adds a very strong dimension to its overall competitiveness. The UK VAT regime also needs to keep up with technological changes in the way in which business is carried out and services delivered so we can truly bring it into the 21st century.

- **Another issue that needs to be addressed is the so called 'tainting' principle regularly applied by HMRC in the context of pension fund management.**

  For example, an investment manager manages a pool of assets for a client and charges a single fee for doing so. Ninety-nine per cent of those assets relate to defined contribution ('DC') pension schemes which are 'qualifying funds' for UK VAT purposes. The remaining 1% relates to a defined benefit ('DB') pension scheme which is not a qualifying fund for UK VAT purposes. HMRC's view is that because the fee does not relate entirely to a qualifying fund, the whole charge must be subject to VAT. In this example, the 1% of DB assets 'taint' the whole pool resulting in VAT being applied to the entire fee.

  This is clearly a perverse outcome which defeats the purpose of the exemption. In this example, DC investors are suffering a 20% VAT cost because a tiny fraction of the asset pool relates to non-qualifying funds. There has been a huge amount of consolidation and aggregation of legacy pension schemes over recent years driven by a number of factors, none of them VAT related, such that this issue is a very real and prevalent one faced by managers and investors alike.

  The UK must recognise the perversity of this position and should allow charges to be apportioned between qualifying and non-qualifying funds thus respecting the purpose of the exemption.

Overall, it is very important to ensure that all aspects of the UK fund regime are looked at holistically and that the anticipated indirect tax review, including the VAT treatment of fund management fees, runs in parallel, as was originally announced at Spring Budget 2020, rather than lagging behind the wider UK Fund Regime review.

Single Investor Funds

Single-investor funds (or fund-of-one) are increasingly popular with investors such as pension funds that require a bespoke solution in a fund structure. This can be catered for in Irish QIAIFs but is currently tax inefficient in the UK QIS regime due to the Genuine Diversity of Ownership (GDO) rules. This would need to be addressed for the UK to be competitive versus offshore regimes and should be allowed with full fund tax 'benefits' with a test that looks at not the GDO but whether the investor is a Qualifying Institutional Investor or similar.

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?

We support changes to areas highlighted in paragraph 2.16 of the Call for Input that will help simplify the UK REIT regime and make it more attractive. In particular, we request the following:

- **Removal or at the very least relaxation of the listing requirement**: the requirement for a REIT to be listed or traded on a recognised stock exchange leads to increased expense and administration and can delay setting up a REIT. Following changes to the rules in 2012, REIT shares can be held by a small number of qualifying investors (subject to the close company test). It is therefore not clear what function the listing requirement serves in these cases. We recommend removal of the listing requirement entirely or at the very least removing the requirement in cases where a proportion of investors are qualifying institutional investors. That said, it is important to ensure that removal or relaxation of the listing requirement does not prohibit REITs from listing should they wish to.

- **Relaxation of 10% requirement**: A holder of excessive rights is, broadly, a company beneficially entitled to at least 10% of distributions paid out by a REIT or to at least 10% of the share capital of the REIT, or who controls 10% or more of voting rights in the REIT. A charge may be triggered in certain cases where a REIT makes a distribution to a holder of excessive rights. These rules could cause some investors to disaggregate their holdings across a number of vehicles and could discourage or prevent use of a UK REIT by certain investors who might wish to invest large sums in real estate via listed vehicles. Holders of excessive rights rules should be retained where they prevent companies with larger stakes in a REIT accessing lower rates of taxation available under double taxation treaties, but the rules should not apply to qualifying exempt entities where there would be no risk of loss of tax.

- **Removal of the interest cover test**: We agree that the interest cover test can be removed, as it is no longer required.

- **Ability of REITs to hold a single property**: The IA agrees with the change in rules to permit REITs to hold a single property.

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

Seeding relief, similar to the SDLT relief for PAIFs and CoACS, could be introduced for REITs. This would give managers wishing to transition existing funds to a new vehicle the flexibility to choose between closed-ended and open-ended fund options to best suit their commercial objectives.

The extension of the range of permissible assets for REITs would bring the regime in line with other overseas REIT regimes.

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

In January 2021, the IA submitted a detailed response listing the priorities for UK funds in respect of the tax treaties as part of HMRC's Tax Treaty Network Review 2020/21 (attached as Appendix 4).

The response listed both strategic and operational areas whether HM Treasury and/or HMRC support is needed in order to ensure UK funds continue to maintain the best possible access to treaties internationally.

We have listed our key asks below:

- HMRC should prioritise seeking **pre-Brexit access to UCITS style/domestic equivalence rates of withholding tax** which UK funds have previously had access to. We believe that loss of domestic EU exemption to UK funds runs counter to the spirit of cooperation which the UK and the EU wish to promote in the future. The Free Trade Agreement includes within it a number of provisions for both parties to ensure that '*treatment no less favourable than the most favourable treatment accorded*'[1]. Whilst further work will need to be done to assess the degree to which this concept will prove to be legally binding, specifically in relation to withholding tax, it speaks to a spirit of reciprocity which we feel should mean UK investors be treated equally to their local counterparts.

  In light of withholding tax losses UK funds will now suffer from funds no longer considered to be UCITS by EU member states, the IA asks that it should be HMRC's stated goal at looking for negotiating opportunities and testing mechanisms which would allow UK funds to get to, or close to, levels of relief when they had previously been categorised and sold as UCITS.

  We also request that HMT and HMRC should:

  - Use France's approach to comparability as a template for reaching out to Competent Authority partners to seek to maintain pre-UCITS withholding tax rates for funds and investors

- Prioritise renegotiation of the Italian, Spanish and other tax treaties which have recently seen loss of withholding tax relief compared to domestic investment funds following the UK's exit from the EU, in order to protect the competitiveness of UK funds for the benefit of savers and investors.

- Renegotiate treaties with Germany, Italy and Luxembourg in order to maintain the zero withholding tax rates that the UK has lost, due to the loss of the EU Interest and Royalties Directive and the Parent Subsidiary Directive.

• **Protect and enhance treaty rights for UK funds** by adopting best practices by other leading fund jurisdictions as part of any future DTAs negotiations including **targeted provisions and exemptions for Collective Investment Vehicles in Treaties.** Treaties contain a number of overrides which allow certain entities to access the treaty regardless of tests for persons, residency or liability to tax.

  - The most obvious examples are for pension schemes and charities which while failing to meet some of these conditions represent entities, and in the case of our industry – investors, which jurisdictions wish to encourage to cross-invest. These clauses often offer the removal of tax altogether and are commonplace. **Specific mention of Collective Investment Vehicles** is less common but can be included, with the OECD offering suggested wording as part of their Commentary on the OCED Model Tax Convention. The US treaties make it clear in their treaties that Regulated Investment Companies (RICs), Real Estate Investment Trusts (REITs) and other vehicles must qualify under the residency condition set out in Question 7, while France includes mention of 'investment vehicles' and how their status applies to the treaty.

  - In respect of UK CoACSs, HMRC **actively negotiates access to either domestic exemptions or treaties for the CoACS participants**, rather than the cost and administrative burden of each CoACS or participant having to pursue their own ruling.

  - In addition, pension backed life company businesses often experience significant difficulties in accessing exemptions from dividend withholding tax as pension schemes under UK tax treaties if there is any comingling of non-pension life money. HMRC should ask to protect treaty benefits for pension schemes to be extended to situations where the fund is almost entirely pension money (say 90% or even 95%).

  - We would ask the UK to seek to future-proof issues regarding interpretation of treaties by clearly setting out the benefits which foreign investment brings through the use of collective investment schemes and the need for certainty of access under treaties through specific clauses within the appropriate Articles.

• In agreeing any future **Memoranda of Understanding (MoUs)** with treaty partners, consult with the wider industry especially where the MoU could have an impact on the processes which taxpayers have to use to ensure that such processes are in fact commercially workable. Additionally, MoUs should have set dates for reviews so as to offer an opportunity to revisit and renew procedures and processes. Importantly also, the UK should withdraw from the Swiss MoU which is not fit for purpose, does not simplify the process and simply denies UK funds access to the treaty that they are entitled to as UK residents.

- With introduction of the BEPS Action 6 provisions such as Limitation of Benefits (LOB) and Principal Purpose Test (PPT) in recent tax treaties, we request HMRC to consider the impact of the tests and requirements for funds and their investors and to ensure that clear guidance and procedures are available to ensure continued uninterrupted access to treaty benefits for genuine residents.

- Looking at the Certificate of Residence (CoRs) process as a whole and determining whether work through existing regulation can help HMRC offer support for side letters, bespoke CoRs and if better utilisation of technology could help the UK compete with other jurisdictions in digital authentication.

- Targeting of specific issues with individual treaties and operations and looking to work with Competent Authorities in India, Switzerland and others to address them within a set timeframe.

- To support a wider COVID-19 'lessons-learned' exercise across all processes to try to crystallise the various relaxations reached with various overseas tax authorities.

- Keep close to international developments on tax administration and where possible support the EU Commission's proposals to look to implementation of a bloc-wide relief at source model based of the OECD's TRACE initiative.

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.

There are a number of key barriers:

- **Legal personality:** a partnership under the laws of England and Wales is not a person in law, rather the legal personality sits with each individual partner. In some jurisdictions, such as the US, there is a maximum number of investors permitted in certain types of fund and the need to consider each investor in the LP as a separate investor in the US fund can make the LP an ineligible investor.

- **Loss of access to EU AIFMD passport:** as mentioned elsewhere in this response, the loss of access to the EU AIFMD passport post-Brexit has made marketing within the EU under the national Private Placement Regime too inefficient.

- **Need for modernisation**: the UK LP regime is outdated and unlike Ireland or Luxembourg does not offer segregation of assets and liabilities through umbrella/sub-fund structure.

- **Complex Tax regime:** the UK tax regime for LPs is administratively complex for open-ended funds with large number of small investors, particularly for capital gains tax purposes.

Part Three: The UK's approach to funds regulation

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?

Fund authorisation is an important tool for ensuring that retail investors are protected when using investment funds. The prescriptive rules relating to, for example, investment and borrowing powers, the appointment of a depositary and investor disclosure ensure that retail investors with little or no investment knowledge and experience can invest in authorised funds, either directly or through intermediaries with the knowledge that their interests are protected.

For funds aimed at professional or sophisticated retail investors only, the fact that a fund is subject to some level of regulation can be an attractive feature of the fund. In addition, some investors themselves subject to regulation, such as pension funds, are limited to the amount they can invest in unauthorised vehicles. The words "unauthorised" or "unregulated" can have negative connotations, largely driven by the negative press surrounding unauthorised fund structures in offshore jurisdictions and can therefore make branding less effective. Investors often like the comfort of oversight of the fund by a regulator, in addition to the manager and depositary of the fund being subject to such regulation. It should be noted that the number of completely unregulated funds outside the UK has been lessening significantly in number over recent years.

In addition, for a number of regulatory or tax reasons, certain overseas jurisdictions, e.g. Spain, Portugal, Italy and India require funds being marketed to retail and institutional investors within the territory to be authorised or regulated.

Furthermore, some professional investors acting on behalf of retail end-investors, such as wealth managers and pension trustees, prefer to invest in authorised products to allow those investors to be subject to the full range of protections available. Regulation in the UK implies a standard of governance, such as board oversight, a committee structure, risk and compliance framework, Treating Customers Fairly (TCF) oversight, etc.

However, managers report institutional investors in some cases expressing a preference for unauthorised funds for investment opportunities. There is a perception that a lack of authorisation would bring greater freedom for managers as regards investment strategy and that such freedom brings greater opportunity for higher rewards, albeit at a higher risk.

The regulatory framework for Alternative Investment Funds ("AIFs") requires AIFs to be registered, to be managed by an authorised operator (the "AIFM") and to be overseen by an authorised depositary. Under this regime, the AIFM is subject to reporting obligations to the regulator. AIFs are currently used by a number of investors, including professional investors such as pension schemes who require a regulated, but flexible regime. This option would be an alternative for managers who wish to establish funds aimed at professional investors that do not need to be fully authorised, as detailed in the responses to questions 30 – 37 below.

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

The IA considers that the statutory authorisation processes and time limits for authorised funds aimed at retail investors are appropriate for more complex funds and would not advocate the time limits being shortened, in part due to the self-imposed voluntary service standards employed by the FCA. The current statutory limits allow for extra time to be taken for applications for particularly complex funds or funds with complex strategies. However, for certain funds aimed solely at professional investors, we advocate a 'light-touch' regime, with FCA approval based on the production of a signed solicitor's certificate and approval within 24 hours. We set this arrangement out further in the response to the questions below.

Members have not expressed a preference for the voluntary service standards to be shortened either, as the one-month and two-month time periods are deemed appropriate and the FCA meets these standards in over 90% of cases. A shortening of these service standards could cause issues with the authorisation of more involved cases, forcing managers to withdraw and resubmit applications. It has also been suggested that provision be added to the legislation allowing the FCA and the applicant to mutually agree an extension, within a specified limit (e.g. the statutory limit originally applied: a one-month application can be extended by a further month, 2 months by a further 2 months etc.).

QIS managers have noted that the FCA authorisation process is relatively simple, although robust. However, there was some comment regarding the regulation of such funds. The FCA appears to view the management of QISs the same way that they do for retail funds. This has resulted in some (and in the view of members, unnecessary) comments in relation to, for example, the language used in the investment objective/policy. Also, the rules around investor relations are identical to those for other funds so, for example, . an introduction of a new type of fee would require an Extraordinary General Meeting (EGM), which is not the case for the majority of offshore professional funds.

Some IA members have commented that initial questions concerning fund applications are not received until late into the process and it is unclear whether the high figure of cases being approved within the time limits set by the voluntary service standards include applications withdrawn shortly before the deadline, due to agreement not being reached. The IA suggests that the process could be improved in two aspects. Firstly, the process could be broken down into stages, with clear communication between the FCA and firms and checkpoints at each stage. The FCA could perform an initial review of applications shortly after receipt, with initial questions and comments being submitted to the manager at a much earlier stage along with a clear plan for subsequent stages. The second suggestion is that the FCA produces guidance for managers, which may include a checklist or list of standard questions for the type of fund in question. This would go some way to ensure that managers anticipate many of the standard questions or requests and provide full responses as part of the original submission.

It has also been suggested that each firm be assigned a case officer within the FCA Authorisations team who would deal with each application, with the aim of reducing inconsistencies in approach.

In addition, for funds marketed only to professional investors, it may be appropriate to introduce a fast-track authorisation process, where authorisation is granted within 24 hours to allow the fund to get to market in the fastest possible time.

Funds subject to the AIF regime would also benefit from a fast-track registration process.

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

The IA is aware that the Central Bank of Ireland operates a "Fast Track" authorisation process for QIAIFs. Provided all parties have previously been authorised by the Central Bank, the fund's Board and legal advisers can certify the documents and file with the Central Bank, which will authorise the fund the following day without review of the documents, its authorisation being based on the certification. The Luxembourg regulator (CSSF), too, has a fast-track authorisation process for professional funds.

We encourage HM Treasury and the FCA to create similar fast-track processes for UK funds marketing to professional investors.

In general, member feedback re Luxembourg has been that the CSSF approves new funds in a speedier manner than the FCA, but that the FCA is faster at approving fund changes than the CSSF.

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 these strategies?**

The regulatory oversight of a QIS is akin to that of UK UCITS and NURS. The IA is of the opinion that regulatory oversight should take account of the type of investors in a fund and provide greater flexibility within a regulated framework for a professional structure, compared to a retail structure. For example, in Ireland, the QIAIF is lightly regulated, requiring the manager to set and adhere to a robust risk framework, which is complemented with a clear regulatory framework and has proved popular with professional investors such as pension funds and insurers.

The QIS already allows an umbrella structure, with sub-funds in a variety of share classes, with different features to suit different investors. Members have stressed the importance of share classes providing them with the ability to subscribe and redeem in different currencies, to provide investors with currency-hedged share classes, while allowing other investors to manage their own broader hedging arrangements. We consider it important to preserve this flexibility and encourage HMT and the FCA to work with service providers to ensure that these features can be offered at an operational, as well as regulatory level.

QISs must distribute all income to investors or provide accumulation share classes in which income distributions are re-invested. Investors are subject to tax on distributions received or re-invested. It has been noted that the majority of the intended investor base (professional investors) are less concerned about receiving income, and funds should be given the option not to distribute. Similar regimes, such as the Irish QIF do not have a requirement to distribute income.

In addition, as explained fully in the responses to questions 26 and 27, the ability to meet and maintain income targets, either by making up any shortfall from income targets from the fund's capital or by smoothing income over more than one accounting year where targets are exceeded, would be an attractive feature for UK authorised funds to be available to offer investors.

Furthermore, QISs cannot accommodate carried interest and are not generally permitted to distribute capital gains. The ability to distribute capital can be a benefit to certain types of investors (see responses to questions 26 and 27 for more detail).

It has also been suggested that flexibility be provided on dealing frequency, such as different subscription and redemption cycles and different dealing cut-offs for subscriptions and redemptions. For those QIS that invest in less liquid or inherently illiquid assets, the option to align the fund's dealing terms to the liquidity of the fund's assets would be welcomed.

The structure should be able to offer individual investors access to standalone fund solutions created purely for them as the single investor in the fund (known as "fund of one" structures) without incurring a negative tax impact. This is a popular structure with investors such as UK pensions funds, as it allows them the flexibility to create a bespoke solution to meet their asset and liability needs while still benefitting from the protections of a UK-regulated fund. Although this is permitted under the QIS regime, we understand that it can lead to unfavourable tax treatment, due to the Genuine Diversity of Ownership (GDO) condition.

Members have also suggested broadening the availability of liquidity tools, including side pockets, although it should be noted that the IA advocates this for all fund types, not just QIS.

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?

The QIS is more flexible than retail authorised funds in relation to permitted investments and is not subject to diversification limits. However, the QIS investment and borrowing powers could be even more flexible and be able to access all major asset classes, including alternative investment strategies, without limits. There should be a review of permitted investments (including a review of the Regulatory Activities Order) and of the level of the cap on leverage.

Members have proposed the broad eligibility of the following asset classes within a QIS:

- Loan origination, including the ability to originate loans directly, or to acquire or dispose of loan participation;
- Derivatives on a speculative basis and loan basis;

- Private credit;
- Structured finance;
- Infrastructure;
- Listed credit.

The ability of a QIS to operate as a loan origination fund under a more integrated, flexible regime could allow the UK to take a competitive advantage over other fund domiciles, which have additional restrictions in other areas.

Firms would need to ensure that the risks of investment in less vanilla asset classes, in particular the lack of restriction of investment in particular asset classes are fully and clearly described in the fund's literature.

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

As above, a review of the level of the cap on leverage would be welcomed and ideally the cap would be removed. Members have suggested that rules similar to those for the Irish QIAIF are adopted, where there are no outright limits to the use of derivatives or borrowing. The manager must set, disclose and adhere to their own limits as part of their fiduciary duties and create a robust risk framework that is monitored and supervised by the regulator.

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

The OEIC Regulations' Protected Cell Regime affords legal and regulatory protection of a sub-fund's assets, which is useful for managers. It would be beneficial if the provisions were replicated in FSMA for Authorised Unit Trusts and Authorised Contractual Schemes.

Part Four: Opportunities for wider reform

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

Broadly, we do agree. While there is room for the enhancement of existing structures, notably the QIS (covered elsewhere in this response), the government's strategic aim should be to both defend the UK's position as a pre-eminent investment management centre and seek to capitalise on the opportunities that Brexit presents by launching innovative new fund vehicles alongside the preservation of the gold-standard UCITS-type offering for retail investors.

The UK requires a full shopfront of funds to meet the wide range of needs of British and international investors. An immediate core message should be one of reassurance that the UK offers an identical vehicle to the EU UCITS – which UK officials and ministers helped to develop while members of the EU – and so, for example, there would be no need for investors to redeem from the existing UK fund and re-invest in a UCITS domiciled in Ireland or Luxembourg. The proposals set out by the IA and others for new fund vehicles such as the LTAF and the OPF will build on that foundation.

We have repeatedly heard from member firms, particularly in the context of the UK's future policy for investment management, that well-established fund ranges in Luxembourg and Ireland are likely to remain there unless potential EU measures hostile to investors, such as the Financial Transaction Tax or changes to delegation rules move them on. However, although mass re-domiciliation is highly unlikely at this stage, we have also heard that some fund managers would consider moving certain capabilities back to the UK with a competitive fund regime, although these would focus on meeting the needs of UK investors, primarily institutional. It would also need to be operationally and cost-efficient to transfer these funds onshore.

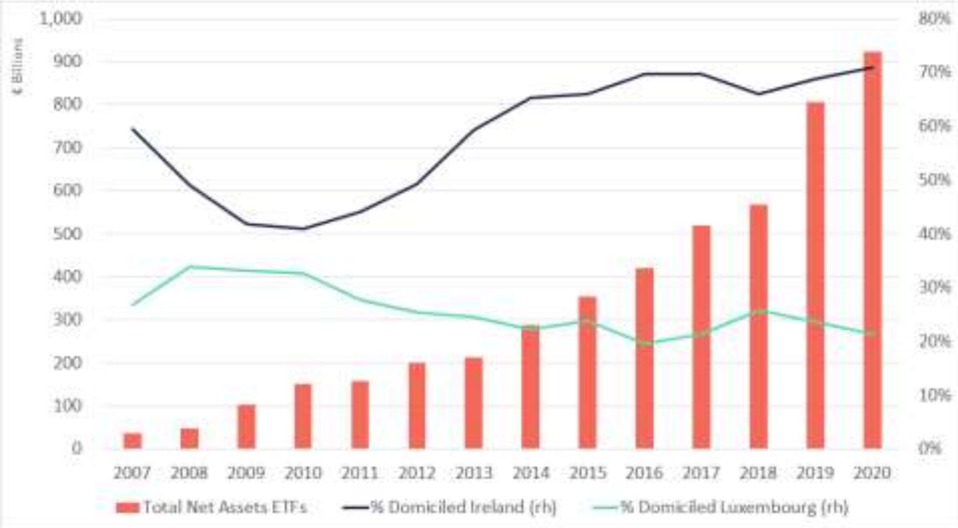
20. Why do firms choose to locate their funds in other jurisdictions in cases where the UK funds regime has a comparable offering, for example ETFs? Are there steps which could help to address this following the potential reforms to the UK funds regime discussed in this call for input, and would the scope to address this vary depending on the type of fund or target investor market?

The UK has lost ground over several decades as a fund domicile across both general UCITS ranges and more specific product sets. Some of these products should arguably have been straightforward to domicile in the UK given their domestic customer base (e.g. sterling-denominated institutional money market funds). Others, notably ETFs, could have served a much broader customer base outside the UK.

There are a range of factors at work. Some relate to tax treatment, some to regulatory approach (e.g. responsiveness to innovation) and some to the wider approach taken by the authorities to support and promotion. In combination and over time, such factors allow other jurisdictions to build momentum and reputation which then becomes self-perpetuating and harder to challenge.

With respect to ETFs, members highlight a number of points as to why more ETFs will not now choose to domicile in the UK, rather than established centres elsewhere in Europe.

Exhibit Three: Total assets in ETFs by domicile



Firstly, as can be seen in Exhibit Three above, much of the ETF industry in Europe has been built up in Ireland and Luxembourg, service providers are also based there, with expertise being focused in those jurisdictions. To create an appropriate ecosystem in the UK, service providers such as administrators and custodians would need to develop expertise and would need incentives to expand or move business to the UK.

While this may be feasible in principle, there is a second set of issues with respect to how to serve both EU and international customers from the UK post-Brexit. The Onshore Funds Regime will allow the free movement of EEA products into the UK but there is no reciprocal agreement regarding UK funds being marketed within the EU. It is neither cost-effective, not desirable for other reasons to create a regime in the UK that could be sold to the UK and rest of the world, while maintaining a main domicile elsewhere. In particular, exchange-traded products need to be of sufficient scale to offer investors benefits and liquidity. Spreading investment over different products fragments liquidity, so investors pay more for the same exposure.

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?

A successful future for the industry requires three things: (1) the right vehicles to be proposed by the UK; (2) a clear 'open for business' message in the regulatory and tax regime; and (3) a framework for ongoing and timely government and regulatory support and collaboration on promotion.

As part of this, UCITS is a success story in terms of international branding and UCITS are immensely popular in Asia and other countries around the world, including the US. UCITS is often talked about as being a so-called 'gold-standard' fund product. The government should therefore send a strong message to the global fund management community that the UK can still provide UCITS in all but name: these British funds continue to offer clear governance, investor protection, frequent liquidity, and risk diversification, and they should continue to be trusted and supported by managers and investors.

There is discussion in the industry as to what the new brand would look like, with some wanting professional brand management brought in and others preferring a quick change to something that keeps a UCITS flavour, acknowledges the UK's role in bringing the fund type into being in the first place and is clearly British, e.g. UKITS but this would of course need to be carefully considered by marketing professionals and is just presented for illustration at this point. The IA would be happy to convene a working group formed of industry Marketing Directors, with HMT as observers to specifically focus on the branding of the product, along with a rebranding of the NURS.

In addition to ensuring the continued use of a UCITS-equivalent within the UK (UKITS), the UK government should look to improve upon the existing UCITS regime. Consideration should therefore be given to the creation of a separate "UKITS plus" – or whatever the final branding looks like - product, which would resemble the rebranded UKITS product but with enhancements to distinguish it from the EU's vehicle. This could, for example, present a real opportunity to revitalise the Non-UCITS Retail Scheme (NURS) regime and offer an alternative to the UCITS fund for domestic and international investors.

This revitalised NURS regime could offer the investor the protections of UCITS (depositary oversight, asset protection, spread limits, disclosure, valuation procedures etc.) but with more investment flexibility, and potentially greater flexibility around operational features to reflect the asset classes in the portfolios, for example, frequency of redemptions. The NURS already provides the basis for such a regime, allowing investment in a broader range of asset classes than UCITS, including real estate, unregulated collective investment schemes and physical gold, as well as having slightly broader spread limits.

NURS was designed to meet domestic requirements, in particular offering the ability for UK investors to access asset classes not permitted under UCITS, such as real estate, while ensuring investor protection was maintained. As such, it was never intended for an international audience, and NURS have to date not been sold to an international market. Its unattractive branding reflects this. Nonetheless, with investors increasingly seeking to diversify their portfolios into alternative asset classes, with the right branding, the suite of NURS products could appeal to international investors wanting the investor protection offered by UCITS, but with more investment flexibility including exposure to some alternative asset classes, including cryptoassets. The NURS regime is particularly suited to multi-asset funds for retail investors given the greater investment flexibility.

So, looking at AIFS and international markets, the "UKITS plus" product could be promoted as an alternative, more flexible product. The LTAF and the Onshore Professional Fund would each plug a critical gap in the market and, with the UKITS and "UKITS plus" products and other existing UK fund vehicles, enable the UK to present itself as a genuine choice for fund domiciliation, and able to compete with and yet distinguish itself from the likes of Ireland and Luxembourg.

The addition of an attractive funds regime would fill a major gap in the UK's promotional offer. However, unlike Luxembourg or Ireland, fund promotion is only one part of the industry campaign ahead. The priority is to promote the industry's excellence and expertise in portfolio management services. This is the most highly prized link in the investment value chain and it also lends itself very well in promotional terms to some of the key subject areas which attach to portfolio management such as leadership within FinTech, SRI and corporate governance and stewardship, all of which are topics of enormous interest to an international audience. Putting these together would give the UK a formidable platform to base its future campaigns on.

22. Do you agree that new UK fund administration jobs associated with new UK funds would be likely to locate outside London? How could the government encourage fund administration providers to locate jobs in specific UK regions?

We agree that UK fund administration jobs are likely to be located outside of London as there is no requirement for these roles to be based in a high-cost location. Recent experiences with national lockdown have seen fund administrators working from home in the main and it has made no difference where staff are located. Firms have therefore been provided with access to a national resource pool which both increases choice, the number of available resources, reduces average cost of employment, is greener through less travel and provides more disposable income through reduced commuting costs. The UK has the talent and the infrastructure to support an expanded fund administration industry, but needs incentives to do so.

The majority of managers currently outsource fund administration to a number of specialist firms, who may be located anywhere in the UK, if not the world. The government could encourage fund administration providers to locate jobs in specific UK regions through:

- Grants or subsidies for organisations to provide financial services training programmes in the targeted regions – we already see this in Scotland via the Scottish Financial Enterprise.
- Communication with the fund administration industry to understand job skills/capabilities and match these to specific regions (e.g. an area with a high volume of school leavers who have not gone into further education may be well suited to some fund administration roles and knowing this would help the Fund Administrator with recruitment prospects).
- Grants or subsidies for moving operations to certain locations. This should be accompanied by active marketing of the benefits of locating operations in specific locations: cheaper housing, educated resource pools in big universities, work/life balance, etc.
- Ensure the roll out of technical infrastructure is implemented to allow high speed broadband etc in all regions – as we learn that remote working can be viable, this enables Fund Administrators to pick from a wider pool of people in regions across UK.
- Incentives for the UK fund industry to compete with other European jurisdictions who have proved successful as fund administration hubs.

It must, however, be noted that a number of UK jobs in administration have been moved to offshore service centres in places such as Eastern Europe and India in recent years. The primary reason for such a move tends to be cost and although it is becoming more expensive to locate operations in some of these jurisdictions and the cost of oversight is increased where operations are overseas, it may still be more expensive to bring these jobs back to the UK, even if situated outside London and the South East. In such cases, it is likely that the extra cost would need to be passed onto investors through charges to the fund.

Members report that firms and investors prefer to have funds administered in the same, or a similar time zone and by people who understand the local market and there are other benefits to be gained from having all operations in one location. The government will have to ensure that managers have incentives when encouraging firms to move some of the roles back onshore, e.g. the use of relevant tax incentives or grants, such as the corporation tax incentives offered in Ireland, the introduction of UK substance rules, investment in automation (RPA, OCF, machine learning) to negate the labour arbitrage advantage of offshoring.

It should also be noted that some UK fund administration firms already administer offshore funds. The cost of living in other fund administration centres such as the Channel Islands, Luxembourg and Ireland is higher than in many regions within the UK. By setting up fund administration hubs within UK regions outside London, UK expertise may attract fund administration jobs from other jurisdictions.

23. How can the government ensure the UK offers the right expertise for fund administration activity?

In terms of ensuring that the UK offers the right fund administration expertise nationally, the government could consider the following:

- Including financial services modules at secondary education level. These modules could cover financial services infrastructure, the high-level end-to-end process of the investment industry and financial products.
- The creation of Financial Services Apprenticeships, with firms incentivised to offer more of these roles to school-leavers who choose not to attend university.
- University degrees in relevant subjects such as business studies to contain an element of practical studies in financial services. This would include an option for degrees with a year's practical experience in financial services. One fund administration firm has advised that the majority of their new trainees had attended the local university. They enjoyed living in the area and felt that a move to a big city to embark on or progress their career would impinge on their standard of living.
- Firms could offer a similar year's experience for gap-year students yet to embark on a degree. The experience would benefit those students after university, as they would already have practical experience on their CV.
- The government and regulators to work with the industry on a structured training program at all levels that can be rolled out nationally either online or in a classroom.
- Fund administrators providing robust training for the roles. This could involve the creation of training roles, recruited from the huge pool of experience in traditional fund administration hubs.
- Selective recruitment of experienced fund administration staff from the established resource pool, with attractive relocation packages offered to introduce the appropriate level of experience into the business.

- Many of the ongoing initiatives to increase knowledge on initiatives such as digitalisation will provide fund administrators with the expertise needed to evolve and grow their businesses.

Any such initiatives would need to be publicised well by the government to raise the profile of fund administration roles and to attract talent from regional areas and make people aware of the opportunities in fund administration firms for them; most think they have to move to London to get a "good job" in finance.

Opening up the industry to school leavers and students, using an organisation such as Investment 20/20 has so far proved to be a key driver in the Diversity & Inclusion agenda, with the initiative bringing a wide variety of talent from a range of backgrounds into the investment industry.

Fund administration firms can provide an opportunity to train accountants outside the big 4 audit firms in locations with a lower cost of living. Having fund administration firms in alternative locations can lead to opportunities to attract other types of businesses which can offer professional roles such as law and audit firms into those locations.

Finally, an appropriate immigration system, allowing UK investment firms to recruit talent from overseas would be beneficial.

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?

The ITC structure can offer benefits for savers who wish to invest in illiquid assets, whilst having liquidity within the structure to allow disinvestment at short notice. The IA encourages their usage and supports investors holding them as part of a diversified portfolio in line with their investment objectives.

Members have suggested that the fact that ITCs need to trade at a discount, due to factoring in operational costs, such as winding up as one issue which may be causing them to look less attractive. Related to this, price volatility is common in ITCs, which can make them unattractive for investors seeking a stable or more predictable return.

Trading of shares in an ITC must be in whole shares. The ability to fractionalise shares, as is seen with open-ended funds may help with fund liquidity and ease the process of rebalancing model or centralised portfolios.

ITCs, despite the secondary market, can be illiquid where there are a limited number of market makers able to fill orders. In some cases, liquidity comes at a cost, where price discounts or premia are necessary.

As regards disclosure to investors, the overlap between the FCA's Article 25 pre-investment disclosure obligations and those under COLL 4, KIID and PRIIPs regulation should be removed and PRIPs KIDs should be reviewed and revised to make them more user-friendly and less onerous. One specific example of the difficulties of investor disclosure is in relation to gearing: explaining gearing strategies, the benefits of these strategies and the higher costs and charges relating to the costs of gearing can be complicated.

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

As part of the product governance process, when formulating an idea for a new investment funds, both authorised and unauthorised, managers should consider all features of the new fund and discuss what structure would best suit the proposed fund features, including investment strategy, distribution model(s) and proposed investor base. There are a vast number of features to be considered and drawing out this one feature risks oversimplifying an involved and complex process.

Good governance would see a fund proposal going through an approval process, at which point the relevant body should provide challenge around the features of the fund, one aspect being whether the fund is closed- or open-ended.

It is unclear from the question who HM Treasury envisages that managers would have to justify the use of open- or closed-ended structures to. As mentioned above, this should be discussed and challenged within the firm and it is envisaged that such discussions would be documented and this documentation be made available to regulators should they wish to review. The IA does not see what benefit could be gained from any additional justification at this stage. The important point is that managers ensure that full and appropriate disclosure is given to investors, to ensure that they understand the structure's characteristics, its operational aspects and associated risks.

26. Should the distribution out of capital be permitted? What types of products would this facilitate and what investment or financial planning objectives would they meet for investors? What are the possible advantages, disadvantages and risks for investors?

The 2015 pension freedoms have created the need for new retirement income products. With the de facto requirement to use DC pensions to purchase an annuity now removed, FCA data has shown a significant drop off in annuity sales since 2015[2]. However, the need for a secure and stable retirement income remains.

Market developments in the years since 2015 have further created a need for new products. Automatic Enrolment reaches far down the earnings distribution and has created a significant number of new DC investors. Many of these will reach retirement with assets that are significant but not necessarily large enough to be attractive to advisers. We expect a significant advice gap to arise – either because people would not seek it or because it would not always be economic for advisers.

For this large non-advised market, DC master trusts and insured pension schemes are going to be playing an increasingly important role in mass-market retirement income provision and we do foresee opportunities here for investment managers to sell new products to these providers.

---

[2] Detailed information on this trend in declining annuity sales is available via the FCA's Retirement Income Market Data. See https://www.fca.org.uk/data/retirement-income-market-data

The FCA's investment pathways for non-advised customers – which finally came into force at the start of February – accelerate this trend and we are now seeing master trusts adopt equivalent frameworks as they look to build out their retirement propositions.

A range of research has shown that what people want from a pension is a secure and predictable income. What they describe is an annuity, but these preferences are not expressed in annuity sales, with a significant drop in annuity purchase taking place since the pension freedoms came into force. The cost and inflexibility of annuities seems to be the issue here: handing over a lump sum forever, in return for income streams that have become ever smaller as interest rates have fallen and longevity increased has not proven popular in recent years.

We see an opportunity for authorised funds to play a part in addressing this unmet demand for flexible, but predictable, income streams. Ideally a fund would be able to deliver a predictable level of income – much like an annuity. Income funds cannot do this because the level of income will fluctuate.

But if the fund could also distribute capital to make up any shortfall in the targeted income level, it would be possible to deliver a predictable level of income with a high degree of certainty. By constructing a portfolio of high-quality bonds of differing maturity that pay out each year, it would be possible to deliver a stable and relatively secure income stream. But it could be achieved with flexibility that annuities don't give – capital could always be reinvested if not required.

This approach is entirely consistent with certain retirement objectives: current income drawdown approaches can be too cautious. The risk of running out of money can mean that customers end up taking less than they actually need and leaving money on the table. This is inefficient, particularly if there is no customer preference to leave any capital to their estate.

Running down assets is a more efficient way of using a pension, particularly if a customer doesn't have a bequest motive. And there is complete flexibility here because such approaches can be combined with other funds.

The issue is of course that, with the exception of the vehicles listed below, authorised funds cannot distribute capital, so this approach is not allowed under current rules.

There is precedent here: Listed investment companies have had the ability to distribute capital for some time, a feature which has generally been welcomed by the market. Furthermore, Charity Authorised Investment Funds ("CAIFs") also allow for distribution of capital as part of a total return approach, ensuring that charities can receive a consistent revenue from their investment regardless of whether these are obtained from income or capital returns. For example, if investment income is low and capital gains are high, charities investing in CAIFs using a total return approach will continue to receive the same revenue from their investments, giving visibility on their investment revenue for budgeting and planning of their charitable projects and operations. If this flexibility were not available, the risk is that their investment revenue would fluctuate, current income needs would not be met and future needs may be over-provided for.

This situation could apply equally to retirees and the flexibility of capital distribution will facilitate the provision of new products that are entirely in the spirit of the pension freedoms.

We recognise that there are additional risks to investors in capital-distributing funds – the current restrictions exist to prevent the investor's capital being depleted in a manner that may not be fully transparent to them. We therefore suggest that the distribution of capital from authorised funds be subject to specific disclosure requirements, with the product literature needing to be fully transparent on the possibility of distribution of capital. Likewise, each distribution needs to be fully transparent on the amount of capital included in the distribution and the impact on the individual's invested capital.

While the ability to distribute capital is particularly salient in the retirement market, wider consideration should also be given to its' use in other income-based products.

27. How do you consider that such a change might be delivered? Please explain your answer, providing specific examples of rules, how they could be changes, and the effect of the changes.

Our analysis is that the rule prohibiting capital distributions is not explicit but is inferred from COLL:

- COLL 6.8.3 R(3) which requires an authorised fund to have a separate "distribution account" for the purposes of paying out any income generated by assets held via income units.
- This income in turn must be held in a separate "income account" prior to being moved into the distribution account.
- The fund has a "capital account" which is distinct from both the income and distribution accounts and, whose holdings ("capital property") are essentially defined as the residual amount after the income and distribution accounts have been filled as appropriate.
- COLL 6.8.3 R(3A) sets out guidelines for calculating income allocations. While there are specific circumstances under which transfers can be made between the income and capital accounts, the AFM does not have any general discretion in this regard, which is what would be needed for authorised funds to be able to distribute capital as income.

UCITS, NURS and QIS are all required to adhere to these provisions in COLL.

Allowing discretionary transfers from the capital to income account would allow the manager to distribute capital in accordance with the delivery of a specific income target.

As mentioned in our response to Question 26, the CAIF rules on a Total Return Approach (COLL 14.4.5 R and COLL 14.4.6 R) offer a model for application to authorised funds.

Alongside changes to these rules, we also suggest including the ability to not have to pay out all income, carrying forward any excess income over accounting years. This will help the ability to smooth income which is not aligned to underlying dividend payment dates.

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

Member feedback so far indicates that, pending FCA consultation, which is expected to be issued later in the Spring, it is currently difficult to comment on the tax treatment of the LTAF as this will depend upon the type of authorised fund vehicles and what type of investors/investment it may have.

Based on an expectation that LTAF adopts the open-ended structure proposed by the IA and at the initial stage only available to DC investors, some members believe that a UK Co-ownership Authorised Contractual Scheme (ACS) may be an appropriate vehicle in the first instance. On the basis that an ACS is effectively tax transparent, the current tax regime for such funds should be suitable for LTAFs. ACSs however present administrative problems which can limit the investor base that the fund can be distributed to. As FCA discussions progress and the nature of investor and investments is expanded, consideration would need to extend to LTAFs taking an OEIC form. Any tax changes will to a large extent be dependent on the permitted investor base. If affluent and/or retail investors are permitted to invest in an LTAF, then the issue of tax leakage for balanced funds (as already identified as an issue for authorised investment funds in Chapter 2 of the Call for Input) would arise. Any tax leakage would also make it unattractive for institutional investors, non-resident investors and retail exempt investors. Additionally, the overall complexity of the UK fund regime as set out in our response to question 7 would also need to be considered in such a case if an LTAF invests across a range of assets.

There would also be issues if there was a need to accommodate UK property. In this regard, member feedback suggests that Property Authorised Investment Funds do not seem to be a solution given the intended long-term nature of an LTAF, and the Government's intention to ensure that effective taxing rights for UK property are maintained.

It needs to be ensured that seeding relief, which is currently available for ACS vehicles, would also continue to be available to ACS LTAFs.

VAT. As the LTAF is expected to adopt existing authorised fund structures, it is anticipated that the UK fund management VAT exemption for management of SIFs provided in the VAT Act 1994 Schedule 9 Group 5 Item 9 would also be available to LTAF set up as existing UK authorised funds. If the VAT exemption status quo approach is taken for LTAFs there would be implied irrecoverable VAT incurred by the LTAF as the manager of the LTAF would suffer input VAT restriction which would need to be included in its cost base for pricing its management fees. Comparing this to a non-UK fund vehicle, the manager would have full VAT recovery (as an exported service) whilst the fund itself would not necessarily incur on VAT on the management fees due to the operation of domestic exemptions or the use of a jurisdiction that does not have a VAT/GST system.

To make the UK domiciled LTAF truly competitive and attractive, zero rating of the management and associated administration fees to an LTAF needs to be considered. From a VAT revenue perspective, the zero rating would be equivalent to the current position where non-UK fund vehicles are used with the associated benefits of encouraging the associated support functions such as fund administration and other support services to the UK. This should be considered alongside fundamental changes to the scope of the VAT exemption for fund management in the UK as detailed in our response to Question 7.

Use of underlying holding structures. It is generally anticipated that an LTAF fund vehicle would use underlying holding structures to suit its investment strategies. The current HMT review of Asset Holding Companies (UK AHC review) in Alternative Fund Structures is a helpful step in offering UK holding structures as a potential choice as holding vehicles for LTAFs. The set-up of an LTAF is however not dependent on the AHC review and it is anticipated that an LTAF would use non-UK holding structures to hold investments.

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

The UK tax regime for makes it unviable for UK resident non-domiciled investors ("resident non-doms") to invest in UK funds and has the effect of encouraging them to invest in non-UK funds. It is important to review this regime to improve the attractiveness of a UK LTAF for potential investors and investment professionals looking to co-invest in such vehicles.

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.

The IA is supportive of introducing the unauthorised fund structures proposed. The UK Fund Regime Working Group Report, submitted in 2019 supported the proposal for an alternative unauthorised corporate fund structure for professional investors submitted by the Alternative Investment Management Association (AIMA) and we would like to reiterate that support here.

Below, we go into more detail about the UKFRWG proposal for an unauthorised fund structure: the Onshore Professional Fund (OPF), which incorporates the AREF proposal for a contractual scheme Professional Investor Fund (PIF). As indicated in our response to Question 1, we strongly urge the government to prioritise the OPF in its three legal forms, starting with the PIF, which should be the most straightforward in terms of legislative implementation.

There is a large untapped appetite from UK, EU and international investors to invest in or through the UK, but the perception of the UK fund regime is that there is no suitable vehicle for meaningful investment in alternative products, and that regulatory and tax barriers make the UK unattractive. UK funds attract strong investment from all types of UK investors, but investment from the global market has traditionally gone offshore. Evidence from successful fund domiciles points to strong investor demand for unauthorised fund structures that facilitate investment in alternative asset classes and investment strategies in a tax-efficient manner.

The aim of the OPF is that it is attractive to professional investors, in the UK and globally. Such a fund would assist in promoting the UK's competitiveness in the alternative funds space and would provide the UK with a growth opportunity.

The UK has for many decades offered unauthorised unit trusts for professional investors, but only the exempt version is used to any notable degree and only by UK pension funds and charities. The prolonged absence in the UK of appropriate alternative vehicles enabled other jurisdictions to establish themselves as leading, innovative jurisdictions for fund domicile and administration.

The UK Qualified Investor Scheme (QIS) was intended to be an attractive export vehicle, but the initial requirements were too restrictive and deterred both managers and investors. The Authorised Contractual Scheme (ACS) has improved the attractiveness of the QIS but only for certain types of UK investors. Other jurisdictions therefore remain dominant as fund domiciles.

As a result of Brexit, the UK has lost access to the EU Alternative Investment Fund Managers Directive (AIFMD) managing and marketing passports. For European investors, the marketing passport allowed them access to UK Alternative Investment Funds (AIFs), but its loss may not be significant for the UK. Research for the European Commission found that the AIFMD has not impacted European investors' appetite for non-EEA funds. They continue to access such funds via national private placement regimes or "reverse solicitation". What the UK lacks is an appropriate fund structure. The current UK fund regime does not provide an adequate fund structure for investing in alternative assets or investment strategies, especially not for non-UK professional investors, with the principal UK fund structures available to professional investors being unauthorised unit trusts, investment trusts, QIS, and ACS. Each of the existing fund structures has its place in the UK professional market but are of limited attraction. The rules for QIS merit some improvements, as discussed in our responses to questions 15 to 18, but this alone would not produce a sufficiently attractive vehicle for non-UK (and for some UK) investors.

Certain jurisdictions, such as the Cayman Islands, Bermuda and Delaware have, for a long time, offered unregulated fund structures that offer investors the opportunity to access alternative assets and investment strategies with relatively few constraints. These fund structures have traditionally been attractive to institutional and professional investors, due to their wide investment powers, innovative investment strategies and attractive tax features. However, ongoing media scrutiny and public perception has increased the attention on tax havens and consequently such structures are slowly becoming less popular with investors, particularly for EU investors. Recent EU-domiciled fund alternatives to the traditional offshore arrangements have been relatively successful. The Irish Qualified Investment Fund (QIF) and the Luxembourg Specialised Investment Fund (SIF) were introduced in the mid-2000s, followed by the UK QIS in 2009. Both the QIF and the SIF had some success, but the UK QIS was rejected at the outset by the industry and investors due to the requirement that investors could not own 10% or more of the fund. This condition was significantly modified sometime later, but QIS (being open-ended investment companies (OEICs) or authorised unit trusts) did not attract much interest until the introduction of the ACS. Even so, they remain of interest only to UK institutions – mainly pension funds.

Implementation of the AIFMD in 2013, which requires the AIF manager ("AIFM") to be authorised but not the AIF, caused key European fund domiciles to review their regimes and to introduce unauthorised AIFs for professional investors, most notably the RAIF in Luxembourg and the QIAIF in Ireland. The QIAIF was designed with the specific aim of securing the benefits of the Ireland/US double tax treaty.

With some development, the ACS QIS could be a suitable vehicle for an onshore alternatives fund for some UK professional investors and possibly for some non-UK investors. However, a world-class domicile requires more than the ACS QIS. It is clear from successful fund domiciles in Europe and globally that both alternative unauthorised corporate fund vehicles, unauthorised partnership structures and unauthorised contractual schemes need to be available for investors, especially in alternative asset classes and investment strategies.

The OPF would not be constrained as regards asset classes or investment strategies, or whether it is (except in the case of the PIF) open or closed-ended, or listed or unlisted. It should be an unauthorised fund that is available to professional investors/semi-professional (e.g. wealth managers) investors. It would be:

- A registered AIF.
- Managed by an authorised UK AIFM.
- Overseen by an authorised UK depositary.

It is important to ensure that there is an appetite in the market to act as depositary for such funds. Reduced choice of options for depositaries of such funds would not be conducive to promoting effective competition and may drive up costs for the funds, and ultimately the investors.

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

The IA's proposal for the OPF is that such funds are unconstrained as to asset classes and investment strategies. It is therefore envisaged that managers of these funds would seek to invest in long-term assets, private assets and productive assets and other types of patient capital. Alongside other solutions proposed, the OPF would, as detailed in paragraph 1.13 of the Call for Input "provide a source of diversification and potential for enhanced returns, and for the success of the UK economy, with capital required to fund the post COVID recovery, modernise and upgrade infrastructure, transition to a carbon neutral economy and support innovation in private enterprise to drive productivity growth.".

As the UK begins the economic recovery from the pandemic, freedom as to the asset classes that would be permitted under the new structure would allow managers to assist recovery by investing in UK businesses. Complete freedom as to asset class and strategy would enable the OPF to drive many of the government initiatives forward, such as sustainable investment, the advancement of the ESG agenda and the road to a carbon neutral economy.

The OPF would therefore facilitate investment by professional investors with a long-term view in long-term and productive assets.

These funds would sit alongside the LTAF structures, which provide an authorised alternative access route to long-term and productive assets, for all types of investor.

Managers would be able to have the full suite of vehicles available: the corporate vehicle, the limited partnership and contractual scheme and investors can choose the structure that most suits their needs.

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

The IA welcomes the plan for consistent branding for UK fund structures. As said earlier (Q.22) there is no preferred style for the branding. For example, throughout this response, we refer to the Onshore Professional Fund (OPF), but are happy to consider alternative labels. We would support a label that refers to the positive features of the fund rather than referring to the fact that a fund is unauthorised or unregulated.

The starting point for consistent branding for UK fund structures targeting only professional investors would be the creation of an overarching brand/label, with an overarching regulatory and tax structure, including requirements on registration and reporting. Under this overarching brand, individual structures, such as OPF, PIF and QIS, in their various legal forms would sit, subject to different legal requirements, depending on the structure. This is similar to the Luxembourg RAIF, which is an umbrella brand under which individual structures sit.

The government would then promote the brand, both at home and overseas. The relative success of other jurisdictions has been driven by an agile regulatory environment combined with strong and enduring political and regulatory support in promoting those jurisdictions' business interests internationally. It will be important to emphasise the safety elements of the UK's proven and highly reputable legal and regulatory sector. Involvement of financial regulators will be key to helping investors from around the world understand the attractions of the UK's funds regime so the FCA will need to reach out to regulators around the globe and ensure they have a sound understanding of the UK's robust regime. We suggest that HMT and the FCA examine the role of overseas offices, following the precedent of other regulators, notably the Monetary Authority of Singapore (MAS).

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

As detailed in the response to Question 12, although we propose that these funds are unauthorised, the funds would be AIFs and be registered as such and would therefore be subject to the AIFM regulatory requirements, including the relevant reporting requirements. In addition, the AIFM of each fund would be required to be authorised, as would the depositary, who would oversee the operation of the fund.

Due to the fact that the AIFM regulatory framework has been in place for some years, the FCA has sufficient and knowledgeable resource available to regulate AIFMs, recognising the difference from other types of fund, authorised or regulated. The FCA should also ensure that authorisation of the managers of such funds is not overly time-consuming or costly.

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

As detailed above the proposal is that the OPF would not be constrained (except in the case of the PIF in some areas) as regards asset classes, investment strategies or whether it is open or closed-ended (or a hybrid) and that this would be driven by investor needs and demands. As the OPF structure is intended to give managers absolute discretion as to investment strategy, it is important that this includes freedom to decide whether the strategy would be best achieved by an open-ended, closed-ended or hybrid structure.

There should also be complete flexibility as to whether structures are listed or unlisted. There may be certain strategies and investors that would find listing attractive for a number of reasons and legislation should give that flexibility. Although listing is a minor consideration, there should not be any barriers put in place to prevent to prevent listing where it is deemed appropriate.

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

The IA proposes a structure akin to the Luxembourg RAIF, which is a brand underneath which a variety of structures can sit. We recommend that the overarching structure, the OPF will introduce all of the vehicle types, as the UK needs as much flexibility as possible to be competitive. The IA supports the introduction of all vehicles, with sufficient flexibility for managers to choose in each case which is most appropriate.

The IA notes that the power in FSMA for ICVCs is currently broad enough to create an OEIC for the OPF and suggests that the partnership vehicle will need primary legislation drafting, but the other vehicles can probably be introduced by secondary legislation.

An attractive, unauthorised partnership regime is essential in order for the UK to be a competitive and world class fund domicile. This would require substantial amendments to partnership law (as well as to secondary legislation and tax law) to create a distinction between investment partnerships and ordinary commercial partnerships. Partnerships are a popular fund vehicle outside the UK, e.g. in Luxembourg for venture capital and private equity investment. Scottish partnerships are preferable to English/Welsh vehicles as they involve less legal administration, e.g.

English/Welsh partnerships are required to list partners at Companies House. Also, Scottish partnerships are "persons in law", so count as one investor, not many. This is of particular benefit in countries such as the US that limit the number of investors in a fund to secure certain treatment under national regulation.

The PIF contractual scheme can be delivered in a relatively short space of time, without the need to amend primary legislation. The IA understands that the PIF could be implemented with, for instance, amendments to the Regulatory Activities Order and an FCA consultation.

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.

While considering the location of a fund and the underlying holding structure, in addition to commercial and regulatory considerations, the availability of a tax regime that offers certainty, longevity, simplicity, stability, ease of administration and flexibility to cater for a range of investment strategies, asset classes and investors is an important factor. The tax regime therefore plays an important part in the attractiveness of a location.

The UK will be competing against well established, simple and well understood regimes internationally and as such it is critical for the UK regime to have certain features that bring it in line with such other regimes. These include:

- Simplicity of application;
- Absolute tax neutrality with no tax leakage at fund level through tax exemption for the OPF corporate vehicle and effective tax transparency for the OPF Limited Partnership and OPF Contractual Scheme vehicle/PIF;
- Certainty and longevity of the regime;
- A competitive VAT regime both at fund level and for managers through zero-rating.

Appendix Three shows a comparison of tax, legal and regulatory aspects of current UK and offshore fund structures for unauthorised funds.

Fund Level Tax

The UK tax regime for any new professional fund vehicles needs to ensure that the fund is tax-neutral. For each of the different types of legal structures being considered, the following tax treatment will be necessary:

- Corporate vehicle – tax-exempt i.e. not liable to tax on any income or capital gains
- Limited Partnership – tax transparent
- Contractual Scheme (PIF) – effectively tax transparent for income purposes applying the existing tax regime for Co-ownership Authorised Contractual Schemes modified on account of the fund not being an authorised fund.

Investor Level Tax

To ensure fair taxation of UK investors in the OPF corporate vehicle while maintaining relative simplicity of the regime, the existing reporting/non-reporting regime for offshore funds could be extended to apply to these funds.

VAT
In addition, a competitive VAT regime for management of such fund vehicles would be critical for their success as a suitable alternative to currently available funds outside the UK. Under the current VAT regime, a UK investment manager managing an offshore fund can benefit from full VAT recovery while no VAT is charged to the fund itself. In contrast, the management of UK funds is either exempt from VAT (if they are qualifying funds) or is subject to VAT (otherwise). Most alternative investment funds are not regarded as qualifying funds and hence suffer VAT on their management charges. Where the fund is exempt from VAT, the input tax recovery of the investment manager is restricted. The current VAT regime effectively limits the available onshore fund strategies for investors as VAT cost to a manager is a cost component in higher charges to the funds.

For a UK OPF (Corporate and Limited partnership structures) to be commercially viable, the current VAT treatment available on the UK management of offshore funds would need to be extended to management of any such new UK vehicles. This can be done, for example, by applying a zero rate of UK VAT to the management of such funds. From a VAT revenue perspective, the zero rating would be equivalent to the current position where non-UK fund vehicles are used with the associated benefits of encouraging the associated support functions such as fund administration and other support services to the UK.

We hope that the anticipated indirect tax review including the VAT treatment of fund management fees will also consider the VAT treatment of the OPF Contractual Scheme structure or PIF as part of the overall improvement of the UK VAT regime for funds.

Single Investor Funds

Single-investor funds (or fund-of-one) are increasing popular with investors that require a bespoke solution in a fund structure. This can be catered for in the Irish QIAIFs but is currently tax inefficient in the UK QIS regime due to the GDO rules. This would need to be addressed for the UK to be competitive versus offshore regimes and should be allowed in the UK with full fund tax 'benefits' with a test that looks at not the GDO but whether the investor is a Qualifying Institutional Investor or similar.

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

UK tax rules for UK resident non-domiciled individuals
The UK tax regime makes it unviable for UK resident non-doms to invest in UK funds and has the effect of encouraging them to invest in non-UK funds. The impact of this preference is then seen on development of new products where demand for non-UK funds by resident non-doms could present two options:

1. Run two funds with identical strategies, one in the UK for UK investors and another outside the UK for resident non-doms; or
2. Offer a single non-UK fund that meets the needs of both resident non-doms and other UK investors.

This often results in a preference from platforms and wealth managers to offer a non-UK fund instead of two parallel UK/non-UK funds and thereby has a knock-on impact on ability of investment managers to offer UK funds. Therefore, it is important that while looking at the broader fund tax regime, the regime for resident non-doms is also reviewed and amended to encourage investment in UK funds. One way of dealing with this issue could be to remove funds from the remittance basis of taxation rules.

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?

There are two sets of priorities for the UK funds regime that are not covered in the Call for Input. The first relate to broader themes, notably sustainable and responsible investment and digitalisation. We cover these in the first part of the response. The second relate to specific proposals made by the UK Fund Regime Working Group to enhance UK fund regulation: notably, creation of a single rulebook and cross-border master-feeder structures.

Single rulebook

Authorised funds are regulated by the FCA and must adhere to the regulatory requirements set out in the FCA's Handbook. These include, inter alia, detailed rules in various different parts of the Handbook, knowns as Sourcebooks, including:

- Collective Investment Schemes Sourcebook (COLL) which covers matters relating to authorised funds such as operating duties and responsibilities, investment and borrowing powers, and investor relations.
- Investment Funds Sourcebook (FUND) which applies to all UK Alternative Investment Fund Managers (AIFMs).
- Product Intervention and Product Governance Sourcebook (PROD) rules centre on making firms, including Authorised Fund Managers (AFMs) prove the products they recommend deliver good outcomes, meet the needs of an identifiable target market and are sold to the right clients.

In addition, the FCA Handbook includes eleven key Principles for Business, one of which requires managers of authorised funds to pay due regard to the interest of their customers and to treat them fairly.

The main focus of a fund selection by an international investor will be the investment strategy rather than the structure of the investment vehicle. An international investor will therefore usually opt for a structure and domicile they are familiar with. For a fund domicile to be attractive to overseas investors, it is important they are able to quickly understand and familiarise themselves with the legal structures, legal requirements, regulatory requirements and tax positions of the domicile. The difficulties in having to navigate any complexity in these areas can be enough to deter international investors, even where the outcome is beneficial, for example a more advantageous tax position or more robust regulatory protections. It is therefore important that laws and regulations are reasonably straightforward for international investors, who will not be familiar with local customs and conventions, to understand.

Instead of having many regulatory Sourcebooks for funds, particularly COLL and FUND, the UKFRWG recommended the Regulator focuses, post-Brexit, on creating a single rule book for funds as this will ultimately add to the competitiveness of the UK, especially for overseas investors navigating the UK regulatory landscape.

Cross-border master-feeders

Master-feeder fund structures have been widely used in the alternative fund space for a number of years as a means of providing gateways for investors to access alternative funds through local or more efficient structures. More recently, UCITS, NURS and QIS have been permitted to adopt master-feeder structures. Although UCITS IV introduced master-feeder fund structures for UCITS, take up of these has been limited to date. This is partly due to restrictions on UCITS being able to invest in feeder funds as second schemes. While intended to avoid layering and circularity of investment in second schemes, the restriction within UCITS fundamentally misunderstands the nature of a feeder fund as conceptually a gateway into the master, rather than a fund of funds.

The UCITS restriction has hampered the development of master-feeder fund structures within UCITS, and thus prevented the realisation of the potential of master feeder fund structures. Master feeder fund structures enable investors to benefit from increased economies of scale at the level of the master, the efficiencies of a tax transparent vehicle at master level and cross border pooling of assets, while being able to access these through a familiar local retail friendly vehicle. As the fund is nearly wholly invested in the assets of the master, save for a small proportion that is retained for liquidity or hedging currency risk, an investment in the feeder fund is to all intents and purposes an investment in the master fund, but through a familiar gateway fund structure.

The UKFRWG recommended that master-feeder fund structures might be used more widely to allow investors to benefit from increased economies of scale and increased investment choice through being able to access funds domiciled in other jurisdictions (in EU and third countries) through familiar local fund vehicles, i.e. UCITS, NURS or QIS. In the context of post-Brexit international treaties, master-feeder fund structures could also be a key component in mutual fund recognition treaties – funds domiciled in the Far East for example, are unlikely to be attractive to UK retail investors, but these investors may be willing to invest in a UK-domiciled fund that invests in a Far East master fund. The master-feeder rules for NURS already provide that NURS feeder funds can invest in master funds that are recognised schemes (under section 272 of the FSMA). The UKFRWG proposes that this structure should be more heavily promoted as a gateway to opening up funds in other jurisdictions.

APPENDIX ONE: Tax efficiency of multi-asset funds – Consideration of different options (in response to Question 4 of the CfI)

The Call for Input in para 2.9 lists the following options to address the issue of tax leakage for balanced funds:

- Option 1: Changes to the tax rates applied to UK funds, including applying a low rate of tax to authorised funds
- Option 2: Deemed deductions for distributions at fund level – where the government is keen to explore how investors would be taxed on different types of income.
- Option 3: Amendments to the TEF regime
- Option 4: Extension of corporate streaming to individuals

Each of these options need to be looked at through the lens of simplicity and any proposals that would increase complexity in a regime which is already too complicated, could further harm the UK's attractiveness as a fund domicile.

One notable advantage of each of these options would be to keep UK funds within the scope of UK Corporation Tax. This potentially offers some benefits in respect of access to current double tax treaties but it will mean that the administration costs will likely remain unchanged, with these funds still having to follow all future changes to Corporation Tax legislation. These options also do not address perception issues of the complexity of the UK tax regime which limit the promotion of these funds outside the UK.

Each option will also need to consider additional anti-avoidance measures with regard to UK property income which we understand HMRC are keen to ensure remains a taxable item even when invested through a collective vehicle.

We have considered each of the 4 options presented in para 2.9 below highlighting member feedback on each of these. Overall, keeping tax exemption to one side (see our response to question 7 for details), of the 4 options, there is a clear preference for deemed deduction for distributions at fund level (option 2), which offers relative simplicity as well as familiarity in achieving tax neutrality.

Understanding that that in para 2.10 and 2.11 of the CfI the Government is also considering the relative merits of an exemption regime and, to the extent that Questions 6 and 7 are considered separate from the 4 options above, we have set out the advantages and drawbacks of each of the options, starting with the preferred option of deemed deduction.

Option 2: Deemed deductions for distributions at fund level

Advantages:

Domestic familiarity. This approach to tax neutrality is already part of the UK fund regime for interest distributing funds and Property Authorised Investment Funds (PAIFs).

Maintains access to tax treaties. Allowing funds to nominally be 'subject to tax', such entities have a proven history of treaty access and are likely to maintain the access that they currently have.

Can use existing legislation infrastructure to implement. While not being as easy to implement compared to a reduced Corporation Tax rate, much of the legislative infrastructure is already present elsewhere in the tax framework and can be integrated with moderate ease. The adoption of a deemed deduction would also likely see the use of the Unfranked Income – Foreign stream retired as it would be expected that all taxable foreign dividends would fall under the deemed deduction.

Also works as a solution for other instances of tax leakage. In addition to balanced funds, some UK funds with significant synthetic equity strategies can also potentially suffer tax leakage as the taxable income from these strategies cannot benefit from the UK dividend exemption that is available on the dividend income from direct investments in the underlying. A deemed deduction for distributions at fund level would also help address this problem without needing to look at other alternative solutions.

Drawbacks:

Administrative complexity. A deemed deduction, while simpler than the current regime, is not administratively simple. Mirroring the interest distribution deduction, this comes at the end of a Corporation Tax calculation which means funds, and those who administer them, still need to be mindful of the breadth of UK Corporation Tax legislation (e.g., offshore funds rules, trading, taxable income in capital) to ensure accurate and complete compliance. While this reduces the risk of penalties it does not reduce the risk of compliance failures or cost of compliance with the regime.

Perception and International Competitiveness. In retaining the broader UK fund regime intact, this option does not address perception issues of the complexity of the UK tax regime, which limit the promotion of these funds outside the UK.

The adoption of a deemed deduction would also likely see the use of the Unfranked Income – Foreign stream retired as it would be expected that all taxable foreign dividends would fall under the deemed deduction.

Other options

For the sake of completeness, we have also assessed the other options and offered comments as to why these are not as effective as the deemed deduction option. We recommend that all three be dropped from further consideration.

Option 1: Changes to the tax rates applied to UK funds, including applying a low rate of tax to authorised funds

Advantages:

Uses existing UK tax regime. Mirroring an approach taken by Spain's *fondo de inversión inmobiliaria (FII)*, the UK already has a special rate for OEICs and Authorised Unit Trusts which aligns to the domestic basic rate for Income Tax rather than a low rate to promote the vehicle as being mostly tax efficient.

Drawbacks:

Does not address the fundamental issue. While a lower tax rate of say 1% for funds would have the benefit of reducing the magnitude of loss suffered by investors in UK funds, it would not address the root policy shortcoming of a regime which unintentionally sees tax charges on certain strategies but not others.

Potential impact on treaty access. It is also possible that an extremely low rate may create problems for UK funds obtaining treaty benefits in certain locations which automatically trigger when Corporate Income rates drop below certain thresholds.

Retains complexity and cost of compliance. This option retains all of the complexity, infrastructure, and cost of complying with the regime.

Perception and international competitiveness. In retaining the broader UK fund regime intact, this option also does not address perception issues of the complexity of the UK tax regime, which limit the promotion of these funds outside the UK.

Option 3: Amendments to the TEF regime

Advantages:

Addresses the tax leakage at fund level. This option has limited benefits other than to address the issue of the tax leakage at fund level but arguably does so with significant disadvantages discussed below.

Drawbacks:

Increases complexity of the UK fund regime. This option would add to the overall complexity of UK funds and would in all likelihood damage the already limited ability of fund providers to market funds abroad even further. Income streaming as a concept is largely unique to the UK and its approach to taxation and both the mechanics and need is poorly understood by international investors - used to simple products which do not require such complexity or cost to administer.

Increase administration and compliance cost. With TEFs failing to take off any drive to re-promote this regime would also necessitate significant additional IT spends to facilitate the tax reporting through the investment chain, a cost which was never borne at the point this product was initially launched. Almost no fund houses, banks, administrators, transfer agents, or platforms have any off-the-shelf solutions for TEFs currently and forcing the industry to adopt such an approach risks adding significant complexity and fundamentally misunderstands the explosion of financial intermediation which the industry has seen over the last decade.

Potential tax drag for investments in UK REITs. TEFs are also poor vehicles for investment in UK property and have no recourse for reclaim of Income Tax suffered on Property Income Distributions. Should the TEF regime be applied to existing UK funds which pay dividend distributions, any investments in UK REITs would see additional tax drag. This would have the effect of solving the ‘balanced fund’ issue at huge additional cost in industry transformation and further reputational damage in complexity.

Perception and international competitiveness. In making the UK fund tax regime more complex and costlier to comply with, this option is likely to further aggravate the perception issues of the complexity of the UK tax regime, further limiting the promotion of these funds outside the UK.

Option 4: Extension of corporate streaming to individuals.

Advantages:

Addresses the tax leakage at fund level. This option has limited benefits other than to address the issue of the tax leakage at fund level but arguably does so with significant disadvantages discussed below and also implied in the question asked around this option in the call for input.

Drawbacks:

Significant administrative complexity. Implicit in the question, the Government obviously recognises the administrative issues and industry disruption such a proposal will likely create. While this solution may theoretically solve the "balanced fund" issue it would spawn a series of additional concerns which would need to carefully considered. We believe the additional cost would far outweigh what limited gains this approach would have and unless overseas investors opted to file UK tax returns they would in all likelihood still suffer tax, thus only solving this problem for UK residents.

Increase administration and compliance cost. This option will increase costs including cost of developing new systems to cater for reporting.

Perception and international competitiveness. In making the UK fund tax regime more complex and costly to comply with, this option is likely to further aggravate the perception issues of the complexity of the UK tax regime and create confusion at the investor level.

APPENDIX TWO: Considerations of the potential impact of a move to a tax-exempt regime on access to tax treaties (in response to Question 7 of the CfI)

The issues arising with respect to tax-exempt funds and treaty access can be divided into two categories:

Category one: Where a fund does not meet the residence test under Article 4 of the relevant tax treaty.

Commonly treaties, including the OECD and UN models, define the term 'resident" to mean a person who is "liable to tax" in their home jurisdiction. 'Liable to tax' is a nebulous term and can cause issues with regards to its interpretation for entities that are not subject to tax in their home jurisdiction.

In discussions with members, we have identified the following key countries where access to treaty for tax exempt funds could be problematic, along with possible solutions to deal with these problems:

USA –Article 4(1) of the UK-USA tax treaty defines "residence" as

Except as provided in paragraphs 2 and 3 of this Article, the term "resident of a Contracting State" means, for the purposes of this Convention, any person who, under the laws of that State, is liable to tax therein by reason of his domicile, residence, citizenship, place of management, place of incorporation, or any other criterion of a similar nature. This term, however, does not include any person who is liable to tax in that State in respect only of income from sources in that State or of profits attributable to a permanent establishment in that State.

Further article 4(3) of the UK-USA tax treaty states:

The term "resident of a Contracting State" includes:

a. a pension scheme;

b. a plan, scheme, fund, trust, company or other arrangement established in a Contracting State that is operated exclusively to administer or provide employee benefits and that, by reason of its nature as such, is generally exempt from income taxation in that State;

c. an organization that is established exclusively for religious, charitable, scientific, artistic, cultural, or educational purposes and that is a resident of a Contracting State according to its laws, notwithstanding that all or part of its income or gains may be exempt from tax under the domestic law of that State; and

d. a qualified governmental entity that is, is a part of, or is established in, that State.

Initial analysis suggests that like Luxembourg SICAVs and most Irish mutual funds, a tax-exempt vehicle would not qualify as a resident under the treaty, unless the tax treaty is amended (see below).

India – Article 4(1) of the UK-India tax treaty defines "residence" as

For the purposes of this Convention, the term "resident of a Contracting State" means any person who, under the laws of that State, is liable to tax therein by reason of his domicile, residence, place of management, place of incorporation, or any other criterion of a similar nature, provided, however, that:
a) this term does not include any person who is liable to tax in that State in respect only of income from sources in that State; and
b) in the case of income derived or paid by a partnership, estate, or trust, this term applies only to the extent that the income derived by such partnership, estate, or trust is subject to tax in that State as the income of a resident, either in its hands or in the hands of its partners or beneficiaries.

Initial analysis suggests that like Luxembourg SICAVs and some Irish mutual funds, a tax-exempt vehicle would not qualify as a resident under the treaty and under a worst-case scenario could be subject to 23.92% withholding tax (instead of 10% under the UK/India tax treaty).

Canada – Article 4(1) of the UK-Canada tax treaty defines "residence" as

For the purposes of this Convention, the term "resident of a Contracting State" means any person who, under the laws of that State, is liable to taxation therein by reason of his domicile, residence, place of management, place of incorporation or any other criterion of a similar nature. This term also includes that State and any political subdivision or local authority thereof, or any agency or instrumentality of that State, subdivision or local authority. But this term does not include any person who is liable to tax in that Contracting State in respect only of income from sources therein.

Member feedback indicates that Canada requires the relevant revenue to be subject to local/UK tax for the fund to be considered resident for the purpose of the treaty. Initial analysis suggests that like Luxembourg SICAVs and most Irish mutual funds, any Canadian revenue would not be subject to tax in the UK for a tax-exempt fund and thus it would not qualify as a resident under the treaty.

France – UK-France tax treaty also has similar wording around "liable to tax". However. French tax treaty may not be an issue in the future if and when the comparability of UK funds to access French domestic withholding tax relief is established. UK funds were able to access this relief until 31 December 2020 (until the end of the transitional period with the EU) due to their UCITS status. Recently the French Tax Authorities have confirmed exceptional measures to allow UK funds to continue to benefit from domestic withholding tax exemption on French sourced income in 2021 if these have submitted a valid RPPM form to the French paying agent prior to 1 January 2021 and submit a new original valid Form 000089 to the French paying agent. It is unclear whether these measures will extend beyond this year. We would ask HMRC to reach out to the French Authorities to continue to support this case having been comparable UCITSs funds for years previously.

Is there a possible solution to this?
Many of these issues can be mitigated by HMRC renegotiating the relevant treaties to ensure UK funds continue to be viewed as tax resident in the UK. This need not necessary be through formal renegotiation and ratification but through other established mechanisms such as Memorandums of Understanding and Exchange of Notes. This could allow HMRC and relevant competent authorities to agree positions for investment funds through delegated responsibility. Further, we would note that to the extent that a "tax-exempt" fund was still taxable on UK rents, it would seem appropriate to view such funds as persons eligible for treaty benefits, in which case there is potentially no problem to address.

Category two: where the income is required to be subject to tax under the relevant income article of the tax treaty, which a tax-exempt fund is unable to meet.

Article 10/11 - Dividends
The third leg of the test above, revenue is subject to tax, can also be included within the Dividend Article itself. This condition is rare and now no longer present in the standardised texts. Currently for UK funds three treaties have this condition:

- Russia
- Ukraine
- Portugal

Currently UK funds manage access to lower withholding tax rates under the relevant treaty articles by electing for the corresponding income to tax in the UK (disapplying the UK dividend exemption) where the overall cost/benefit analysis of the treaty benefit outweighs the potential tax charge at fund level. This may not be possible to do where a tax-exempt regime were to be applied to funds generally. Based on our discussions, the list of countries where this may be an issue is limited mainly to those set out above, none of which are significant investment jurisdictions for UK funds generally.

APPENDIX THREE: Comparison of UK and Offshore Fund Structures – Unauthorised Funds

	UK Exempt Unauthorised Unit Trust	Luxembourg Reserved Alternative Investment Fund	Irish Qualifying Investor Alternative Investment Fund	Cayman Exempted Limited Partnership
Jurisdiction	United Kingdom	Luxembourg	Ireland	Cayman Islands
Legal Structure	Unit Trust	Common Fund (FCP) or investment company/partnership (SICAV or SICAF)	Investment company, unit trust, limited partnership or common contractual fund.	Limited Partnership (exempted limited partnership (ELP)), limited company (exempted companies and segregated portfolio companies (SPC)) or unit trust (exempted unit trust).
Regulatory Authority	Must be approved by HMRC	Commission de Surveillance du Secteur Financier (CSSF) approval not required. RAIFs are established by notarial certification. Manager must be an AIFM, authorised by the CSSF or other EU authority.	Central Bank of Ireland	Cayman Islands Monetary Authority
Basic Structure	Unit Trust	Corporate vehicles need to be formed before a notary public and usually issue shares to investors, representing a proportion of the net assets of the fund. Shareholder liability is limited to the shareholding.	QIAIFs may be open or closed-ended. An investment company is incorporated and investors hold shares in the company.	Licensed Mutual Fund. Administered Mutual Fund – a fund for which the principal office is provided by a licensed mutual fund administrator in the Cayman Islands.

	UK Exempt Unauthorised Unit Trust	Luxembourg Reserved Alternative Investment Fund	Irish Qualifying Investor Alternative Investment Fund	Cayman Exempted Limited Partnership
		Shares can be issued in different classes with different management fees, investment level and charges and different lock-up periods / liquidity terms. Corporate vehicles (with the exception of the corporate partnership limited by shares, or SCA) will not have a general partner. For SIFs formed as partnerships, two types of limited partnerships are available in Luxembourg: the société en commandite simple (SCS) and the société en commandite spéciale (SCSp). The only difference between the two types of partnership is that the former has legal personality while the latter does not. These limited partnerships are formed between one or more general partners and at least one limited partner through execution of the limited partnership agreement (before a notary public	A unit trust is constituted by a Trust Deed, entered into by the Manager and the Trustee. Units/shares are issued to investors, representing a proportion of the net assets of the fund. Shareholder liability is limited to the shareholding. A CCF is an unincorporated body established under a deed where investors are "co-owners" of underlying assets. The ILP is a regulated partnership structure, constituted by a Limited Partnership Agreement (LPA). General Partners are liable for the debts of the ILP where assets are insufficient to cover. Limited Partners have limited liability. Assets and liabilities belong jointly to	Registered Mutual Fund which also includes master funds. Exempt Mutual Fund – exempt from licensing or registration.

	UK Exempt Unauthorised Unit Trust	Luxembourg Reserved Alternative Investment Fund	Irish Qualifying Investor Alternative Investment Fund	Cayman Exempted Limited Partnership
		or under private seal) and the contribution to the partnership. Investors can hold capital accounts or interests in the partnership and the interests may be issued as securities (titres). The general partner is liable (beyond the limited partnership's assets) for the debts and obligations of the limited partnership and limited partners' liability is limited to the extent of their capital contributions.	the partners in the proportions agreed in the LPA.	
Legal Personality	None	FCP has no legal personality. SICAV or SICAF has a legal personality, other than for Special Limited Partnerships.	Yes for investment company. No for unit trusts, ILPs and CCFs.	No. Day to day actions are conducted by the general partner.
Ownership of Assets	Trustees hold legal title of the assets, for the benefit of unit holders.	Corporate vehicles: assets are owned by the fund vehicle or subsidiaries. Partnerships – determined in partnership agreement. Assets are generally held by the Depositary, or ownership must be verifiable.	For investment companies, the assets are the property of the company. For unit trusts, the Trustee is the legal owner, on behalf of investors. Investors are co-owners of the assets held by a CCF.	Assets are owned by the partners on a proportional basis to their capital account unless set out otherwise in the partnership agreement.

	UK Exempt Unauthorised Unit Trust	Luxembourg Reserved Alternative Investment Fund	Irish Qualifying Investor Alternative Investment Fund	Cayman Exempted Limited Partnership
			The partners co-own the assets of an ILP, in the proportions agreed in the LPA.	
Regulatory Status	Unregulated.	Unregulated, although the manager must be an AIFM, regulated in Luxembourg or any other EU State.	Authorised by the Central Bank of Ireland.	ELPs may be subject to registration or regulation as a mutual fund by CIMA under the Cayman Islands Mutual Funds Law depending on their characteristics. Closed ended funds are generally outside scope. The most common category of regulation for mutual funds is as a "registered fund". To be eligible for registration, a mutual fund must have a minimum aggregate equity investment of CI$180,000 ($100,000, or its equivalent in any other currency), or have its equity interests listed on a recognised stock exchange approved by CIMA. Registered funds

	UK Exempt Unauthorised Unit Trust	Luxembourg Reserved Alternative Investment Fund	Irish Qualifying Investor Alternative Investment Fund	Cayman Exempted Limited Partnership
				are required to file an offering document with CIMA and notify CIMA following material changes to the fund and are also required to appoint CIMA approved and Cayman based auditors. Otherwise, there are minimal compliance requirements for registered funds.
Diversification Requirement	None.	No restriction in terms of eligible assets. Principles of risk spreading apply, unless the constitutional documents provide for exclusive investments in risk capital. Loan origination permitted, although it is unclear whether lending activities can be the main objective without falling foul of Financial Sector law. Flexibility as to distribution of income. Management regulations must include a distribution policy.	None. Not subject to borrowing restrictions. If structured as an investment company, then risk must be spread. ICAVs, unit trusts, CCFs, ILPs have no requirement for diversification. For a PLC, company law requires diversification of investment risk. Loan origination not permitted, unless the fund	None. No rules on risk spreading. Loan origination permitted in principle. No requirement to distribute income, unless stipulated in the fund's offering document or disclosed to investors.

	UK Exempt Unauthorised Unit Trust	Luxembourg Reserved Alternative Investment Fund	Irish Qualifying Investor Alternative Investment Fund	Cayman Exempted Limited Partnership
			is specifically organised to do so and subject to specific rules. No requirement to distribute income.	
Regulatory Wrappers and Marketing Passports	If authorised as an AIF, then the AIFM may market under the private placement regime.	Under AIFMD, the fund can be passported if managed by an EU-based AIFM.	Under AIFMD, the fund can be passported if managed by an EU-based AIFM. If managed by a non-EU AIFM, private placement available.	Possibility of marketing under private placement.
Umbrella/Series Structure and Segregated Liability	None.	Umbrellas with segregated liability permitted.	Umbrellas with segregated liability permitted.	No. The limited partnership can, however, have separate classes to which different portfolios of assets could be allocated, but there would be no segregation of liability between portfolios.
Management	Trust is managed by one or more trustees.	The RAIF must be managed by an external AIFM, authorised in the EU. The RAIF must appoint a depositary.	QIAIFs must be managed by an authorised AIFM.	The general partner is required to be either an individual resident in the Cayman Islands, a company incorporated or registered as a foreign company in the Cayman Islands, an ELP in the

	UK Exempt Unauthorised Unit Trust	Luxembourg Reserved Alternative Investment Fund	Irish Qualifying Investor Alternative Investment Fund	Cayman Exempted Limited Partnership
				Cayman Islands or a registered foreign limited partnership. The general partner is typically not subject to regulation. Investment Managers may appointed from almost all jurisdictions to manage the assets of an ELP.
Directorship Requirements	No directors needed. Trustees must be UK resident.	**Will depend on the legal form the RAIF will adopt:** 1) Corporate SICAV => *minimum 3 directors* (additionally, clear allocation of functions between the directors: portfolio management, risk management, distribution, administration, legal and compliance. The board of a SICAV should not be predominantly composed of the same persons as the board of the AIFM and in case of same persons sitting on both boards, conflicts of interest should be prevented).	Board of Directors, with at least two Irish-resident directors.	No residential qualifications necessary. Corporate directors acceptable. CIMA requires a minimum of two individual directors for registered funds or one corporate director (itself having a minimum of two directors).

	UK Exempt Unauthorised Unit Trust	Luxembourg Reserved Alternative Investment Fund	Irish Qualifying Investor Alternative Investment Fund	Cayman Exempted Limited Partnership
		2) Contractual "Fonds Commun de Placement" (Common Contractual Fund equivalent) => *no board of directors* at the level of the fund 3) Special Limited Partnership (SLP): unregulated flexible tax transparent investment vehicle used for AIFs and their managers (Luxembourg SLP is relatively similar to the Anglo Saxon LPs) => management by a GP or a board as defined in the Limited Partnership agreement (more info on Lux SLP: https://www.pwc.lu/en/private-equity/docs/pwc-private-equity-lux-limited-partnership.pdf).		
Tax Transparency	No, opaque	No for SICAV Yes for FCP and LP	Yes, where formed as an investment limited partnership or common contractual fund.	Generally yes.
Tax treatment	Fund tax exempt on gains and income. No withholding tax.	Subject to a reduced subscription tax on 0.01% p.a. of NAV, unless tax exempt. If a RAIF invests exclusively in risk capital, it is subject to the SICAR tax	Exempt from Irish tax on income and gains, irrespective of investors' residence.	No taxes in the nature of income tax, corporation tax, capital gains tax or inheritance tax are payable in the Cayman Islands.

	UK Exempt Unauthorised Unit Trust	Luxembourg Reserved Alternative Investment Fund	Irish Qualifying Investor Alternative Investment Fund	Cayman Exempted Limited Partnership
	Risk of tax on accounting mismatches of over 20%.	regime, meaning there is no subscription tax, but the fund pays the ordinary income tax, unless a tax exemption applies.	No withholding tax on income distributions and redemption payments made to non-Irish investors. Exit tax of 41% applies to distribution or redemption payments made to Irish resident investors, unless exemptions apply.	An exempted company is entitled to apply for an undertaking from the Governor of the Cayman Islands that it will be exempt from any local tax (if any should be introduced) for up to twenty years. An Exempted Limited Partnership/ Unit Trust is entitled to apply for an undertaking from the Governor of the Cayman Islands that it will be exempt from local tax (if any should be introduced) for up to 50 years.
VAT treatment where managed from the UK	Subject to UK VAT at the standard rate of 20%	Outside the scope of UK VAT with recovery. Exempt from Luxembourg VAT	Outside the scope of UK VAT with recovery. Exempt from Irish VAT.	Outside the scope of UK VAT with recovery. No Cayman consumption tax.
Service Providers	Trustees must be UK resident.	Must be managed by an authorised AIFM.	For QIAIFs not internally-managed, external, authorised AIFMs must be appointed. QIAIFs must have a Board of Directors, with at least	No specific requirements. ELPs are subject to anti money-laundering requirements and in practice compliance with such rules is often achieved

	UK Exempt Unauthorised Unit Trust	Luxembourg Reserved Alternative Investment Fund	Irish Qualifying Investor Alternative Investment Fund	Cayman Exempted Limited Partnership
			two Irish-resident directors. Investment management may be delegated. The QIAIF must appoint an independent depositary, located in Ireland. Accounts must be audited by an auditor.	through delegation to an administrator, which must be subject to the AML regime of the Cayman Islands or an equivalent jurisdiction.
Reporting	An EUUT must prepare an annual self-assessment tax return, audited accounts and a statement confirming that during the period all investors were “eligible investors”.	The RAIF (SICAV) or its management company (FCP) must prepare an audited annual report.	A QIAIF must prepare annual accounts, independently audited.	Registered mutual funds are required to appoint a CIMA approved and Cayman based auditor and file audited financial statements yearly.
Establishment Time	Comment needed.	No CSSF approval required before launch, therefore time-to-market is dependent on the manager.	A QIF can be authorised within 24 hours of submission of the relevant documentation, provided parties to the fund are previously approved.	Same day incorporations possible. Start to finish indicative timing: 4-12 weeks for Licensed Mutual Funds; and 2-4 weeks for Administered Funds, Mutual Funds, Registered Mutual Funds and Exempt Mutual Funds.

	UK Exempt Unauthorised Unit Trust	Luxembourg Reserved Alternative Investment Fund	Irish Qualifying Investor Alternative Investment Fund	Cayman Exempted Limited Partnership
Carried Interest Considerations	-	1) The Luxembourg AIFM law defines “carried interest” as a share in the profits of the AIF accrued to the AIFM as a compensation for the management of the AIF and excluding any share in the profits of the AIF accrued to the AIFM as a return on any investment by the AIFM into the AIF. 2) The Law permits the taxation of carried interest realized by certain physical persons that are employees of the AIF or their management company as "speculative income under Luxembourg's Income Tax Law provided that certain conditions are met. The applicable tax rate is 25% of the average tax rate applicable to the taxpayer's adjusted income - i.e., a maximum of 11.44%. In addition, dependence insurance (1.4%) would also be due. 3) To benefit from the tax regime, physical persons must not have been Luxembourg tax residents, or subject to tax in Luxembourg	There is no specific legislation dealing with carried interest. It is possible to structure funds such that carried interest can be treated for Irish tax purposes as a CGT receipt subject to take at the standard rate in the hands of an individual manager.	-

	UK Exempt Unauthorised Unit Trust	Luxembourg Reserved Alternative Investment Fund	Irish Qualifying Investor Alternative Investment Fund	Cayman Exempted Limited Partnership
		on their professional income, during the five years before the year of implementation of the Luxembourg AIFM Law. The physical persons must, furthermore, establish their tax domicile in Luxembourg during the year of implementation of the AIFM Law or during the following five years. The favorable tax treatment will no longer be applicable after 31 December 2018. Developments around a new regime are expected. However, it is not yet known when it will be enforced. 4) Provided that the carried interest is considered as compensation for the management of the AIF, the remuneration falls within the scope of VAT but should benefit from the VAT exemption scheduled for the management of UCIs.		
Status of the Jurisdiction and Court System	England & Wales and Scotland have separate legal and court systems.	Luxembourg (civil law).	Subject to Irish law and court systems.	The Cayman Islands is a British Overseas Territory which is self-governing and part of

	UK Exempt Unauthorised Unit Trust	Luxembourg Reserved Alternative Investment Fund	Irish Qualifying Investor Alternative Investment Fund	Cayman Exempted Limited Partnership
				the Commonwealth. The head of state is HM the Queen of England and the UK is responsible for the appointment of the Cayman Islands' governor, national security and the administration of the courts. The Cayman Islands has its own independent court system. The Privy Council in London.
Derogation from regulation	Not regulated.	A RAIF does not need to be authorised and is not subject to the direct supervision of the CSSF, but it is required to be managed by an authorized AIFM (the AIFM being supervised by the CSSF).	Possible, in limited circumstances, after discussion with the CBI.	(a) funds with a minimum investment of US$100,000 (or currency equivalent) or are listed on a stock exchange approved by CIMA and have paid the prescribed fee and registered certain required documentation with CIMA are exempt from holding a mutual funds licence and

	UK Exempt Unauthorised Unit Trust	Luxembourg Reserved Alternative Investment Fund	Irish Qualifying Investor Alternative Investment Fund	Cayman Exempted Limited Partnership
				(b) funds with fewer than fifteen investors, the majority in number of whom have the right to appoint and remove the directors are exempt from holding a mutual funds licence.
Investment Restrictions	Investors must be exempt from CGT or Corporation Tax on capital gains, for reasons other than residency. This must be confirmed annually.	Investors must be "well informed", which comprises institutional investors, professional investors and other investors who confirm that they adhere to the status of "well informed" investors and who either invest a minimum of €125,000 or are certified by a credit institution, investment firm or management company.	Qualifying investors must invest at least €100,000 and: • Certify they are an informed investor and provide certain written confirmations; or • Be a professional client, as defined by MiFID; or • Receive an appraisal from an EU credit institution, MiFID firm or UCITS management company that they have the appropriate expertise,	No restriction other than a minimum initial investment of $100,000.

	UK Exempt Unauthorised Unit Trust	Luxembourg Reserved Alternative Investment Fund	Irish Qualifying Investor Alternative Investment Fund	Cayman Exempted Limited Partnership
			experience and knowledge. CCFs only permit institutional (not individual) investors.	
Shareholder Meetings	N/A	At least one per year (at the level of the fund or of the ManCo for FCPs (CCF equivalent).	No requirement for unit trusts to hold an AGM. A PLC must hold an AGM, and ICAV does not need to.	No requirement for annual meeting save as may be provided in the articles of association.
Bylaws/Constitutional Documents	Trustees must prepare and enter into a trust deed.	Offering document must contain all information necessary for investors to make an informed judgement and must indicate on the first page that the fund is not subject to supervision in Luxembourg.	Investment companies must have a Memorandum and Articles of Association. Unit trusts are created by a trust deed entered into by the trustee and the manager. The ILP is constituted pursuant to a limited partnership agreement (LPA) entered into by one or more General Partners and any number of Limited Partners. A CCF is constituted under contract law by means of a	Memorandum and articles of association. May be amended by shareholders only.

	UK Exempt Unauthorised Unit Trust	Luxembourg Reserved Alternative Investment Fund	Irish Qualifying Investor Alternative Investment Fund	Cayman Exempted Limited Partnership
			deed of constitution, executed by the management company. QIAIFs must have a prospectus.	