HM Treasury

Review of the UK funds regime: a call for input

Summary of responses

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Introduction

1.1 At Budget 2020, the government announced a wide-ranging review of the UK's funds regime, covering both tax and relevant areas of regulation. This followed several representations from stakeholders which highlighted that there were opportunities to improve the UK's attractiveness for funds and related entities.

Background to the UK funds regime review

1.2 The UK's asset management industry is the largest in Europe and the second largest globally. It has around £11 trillion assets under management[1], and makes a significant contribution to UK Gross Domestic Product and employment. The government is committed to taking steps to bolster and build on this position in relation to both key components of the industry:

- Portfolio management – which involves making decisions on how a fund's assets are invested; and
- Fund administration – which involves setting up and running fund vehicles, including services such as processing statements and managing investors' subscriptions and disinvestments.

1.3 The overarching objective of this review is to identify options which will make the UK a more attractive location to set up, manage and administer funds, as well as support a wider range of more efficient investments better suited to investors' needs. This objective underpinned two key initiatives that the government has already taken forward as part of the review, namely:

- **A new tax regime for qualifying asset holding companies (QAHCs) in certain fund structures** – Following two consultations, the new regime was introduced in the Finance Bill to commence in April 2022[2]. The government is also reforming some tax rules for Real Estate Investment Trusts (REITs) through the Finance Bill to improve their competitive position as real estate asset holding vehicles.
- **Facilitating the introduction of the Long-Term Asset Fund (LTAF) structure** – The industry-led Productive Finance Working Group was convened by HM Treasury (HMT), the Bank of England and the Financial Conduct

[1] The Investment Association, 'Investment Management in The UK 2020 – 2021', page 12.

[2] The government will continue to engage with the QAHC working group established to provide feedback on draft legislation ahead of Finance Bill 2021/22. This will allow for real-time feedback on the effectiveness of the QAHC regime and the identification of further opportunities to enhance it. Tax professionals who are likely to be involved in the creation or operation of QAHCs are welcome to make expressions of interest to join the existing membership.

Authority (FCA) in November 2020, to develop practical solutions to the barriers to investment in long-term, less liquid assets. A high priority and early deliverable for the Group was to facilitate the successful rollout of the LTAF structure. In October 2021 the FCA published rules to allow for the introduction of LTAFs, a new type of authorised fund for investing in illiquid assets. To ensure consistent treatment with similar types of authorised funds in tax legislation, HMT laid a statutory instrument on 16 November 2021 to require LTAFs to meet a genuine diversity of ownership (GDO) condition. The government is continuing to assess the case for any further changes to the way LTAFs are taxed.

1.4 In January 2021, the government launched a call for input on the wider components of the review. The call for input set out the objectives and scope of the review and requested feedback on which reforms should be taken forward and how they should be prioritised. It sought to build on the significant pre-existing body of work, such as the recommendations the Investment Association's UK Funds Regime Working Group made to the government's Asset Management Taskforce in 2019. The call for input therefore sought views on several specific proposals, but also invited new ideas for reform.

1.5 This publication summarises the responses the government received to its call for input. The government received 79 responses from a range of stakeholders including asset management firms, management consultants, institutional investors, accountancy bodies, law firms and trade bodies. Overall, respondents were supportive of the scope and ambition of the call for input.

Looking forward – an enhanced UK funds regime

1.6 This publication also sets out the government's response to respondents' feedback, and the next steps the government will take to ensure that the UK funds regime review delivers on its objectives. Following the call for input the government, and the FCA where applicable, proposes to:

- Make the taxation of funds simpler and more efficient, including in relation to the GDO requirement, REITs and solutions to deal with the tax efficiency of multi-asset authorised funds;
- Expand the range of investment products available in the UK, including in relation to authorised fund structures that are permitted to distribute capital, and a new type of fund structure – an unauthorised contractual scheme – aimed at professional investors; and
- Explore opportunities to support the wider funds environment, including by providing additional information pertaining to the fund authorisation process and by promoting the UK funds regime abroad.

1.7 In taking forward these proposals, the government is clear that any tax reforms will be compatible with its robust approach on tax avoidance and evasion, and with the UK's international commitments. The government will also ensure that the UK continues to exercise its taxing rights effectively.

1.8 Similarly, the government is clear that any changes to regulation will be supportive of the UK's commitment to uphold the highest standards of regulation, supervisory oversight, and investor protection. The government recognised in the call for input that the UK's robust regulatory regime and its commitment to upholding these standards are among its key strengths in financial services, including funds. The responses to the call for input also recognised and reflected the crucial importance of the UK's robust regulatory approach.

1.9 In addition to these reforms, the government, and the FCA where applicable, will also be working to enhance the UK funds regime through:

- A consultation on options to simplify the VAT treatment of fund management fees; and
- Ongoing work to facilitate the rollout of the LTAF, including: the continued work of the Productive Finance Working Group; a planned FCA consultation on potentially changing the restrictions on the promotion of LTAFs to allow distribution to a broader range of retail investors; and continued assessment of the case for any further changes to the way LTAFs are taxed.

1.10 Further consideration has been given to the VAT treatment of fund management fees, which the original Budget 2020 announcement made clear was a key workstream of the UK funds regime review, but which was not in scope of the call for input. The government was also clear that the 'onshored' directly applicable Level 2 regulations under AIFMD and UCITS and the associated Level 1 legislation (hereafter "AIFMD- and UCITS-related legislation") are out of scope of the call for input as the government does not intend to make changes to them at this time[3].

1.11 The government is grateful for the responses received, which have significantly enhanced its understanding of stakeholders' priorities. Following extensive analysis and engagement, this publication highlights specific proposals that will be progressed in the short term, alongside those which require further consideration and those where the government is not currently persuaded by the potential impact or evidence base. As set out below, the government welcomes further representations from industry. If stakeholders wish to contact the UK funds regime review team, they may continue to do so at: ukfundsreview@hmtreasury.gov.uk.

[3] After the 2016 EU referendum the government 'onshored' the existing body of directly applicable retained EU law. This included converting into UK domestic law the directly applicable Level 2 regulations under the Undertakings for Collective Investment in Transferable Securities (UCITS) Directive and the Alternative Investment Fund Managers Directive (AIFMD). The regulations which had transposed EU Directives into UK law before EU exit (Level 1 legislation) were retained in UK law.

Chapter 2
Summary of responses

2.1 The call for input asked 38 questions. Given the wide-ranging nature of the call for input, the first question focused on the relative prioritisation of the proposals. All other questions were split across three areas: those relating exclusively to the taxation of funds; those relating to their regulation; and areas where there may be cross-cutting opportunities for reform.

VAT

2.2 Respondents to the call for input were clear that, although being taken forward in a separate workstream and not within scope of the call for input, the competitiveness of the UK's VAT regime is a necessary condition for the UK to be an attractive location to domicile funds. The government is aware of the importance of VAT for industry. As set out at Autumn Budget and Spending Review 2021, HMT and HMRC are working towards a consultation on the VAT treatment of fund management fees as part of the UK funds regime review. This consultation on VAT will be published in the coming months.

2.3 The upcoming consultation will not look at a VAT zero-rate for fund management fees. The Exchequer impact of such a change would be significant, and therefore this cannot be prioritised in the current fiscal context. However, the government will examine other options to improve and simplify the VAT regime for fund management. Given industry's clear steer that some proposals in the call for input are dependent on a VAT zero-rate, the government has decided not to progress these proposals at this time (see New unauthorised fund structures, paragraphs 2.170 and 2.171). The government will assess whether these proposals would be effective following its consultation on VAT.

Prioritising proposals

2.4 The breadth of proposals and areas covered in the call for input inevitably requires that the government and regulators prioritise which measures should be progressed in the short term. Therefore, the first question asked:

Question 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?

2.5 Across all the responses, the areas most frequently cited as top priorities were:

- The introduction of the LTAF as a new fund vehicle to support investor access to longer-term, less liquid assets such as venture capital, private equity, private credit, infrastructure, and real estate (see Long-Term Asset Fund, paragraph 2.148).

- Addressing gaps in the UK's current offering of fund structures for professional investors, which could be filled by creating an internationally attractive onshore professional investor regime of unauthorised fund structures, available in the key internationally recognised legal forms – particularly corporate vehicles, limited partnerships, and contractual schemes – and with the freedom to be either closed- or open-ended (see also New unauthorised fund structures, paragraphs 2.155 to 2.157).

- A review of the VAT treatment of fund management, specifically to ensure that: the treatment of fund management fees is competitive; uncertainties or complexities are removed; and that the case for zero rating is considered.

2.6 Other areas raised as top priorities by multiple respondents included:

- Reforming the REIT rules. Respondents called for more flexibility in the regime rules and in the types of assets a REIT can hold, to make it easier for UK REITs to be launched on behalf of major overseas and domestic investors.

- Improving efficiencies within the FCA's fund authorisation process, ensuring the speed to market for professional funds is at least comparable with other jurisdictions.

- Simplifying the funds tax regime, ensuring that the tax system is coherent and that any reforms provide certainty for investors and boost the regime's attractiveness.

- Clearer branding and promotion of the UK funds regime, to highlight the UK's offering and its strategic underpinning.

- Seeking to develop an advantage in future growth areas of financial services, especially sustainable investment.

- Strengthening the double tax treaty network, including a focus on accessing relief for UK UCITS, following the discontinuation of access to provisions in the Interest and Royalties Directive and Parent-Subsidiary Directive.

The UK's approach to funds taxation

2.7 The UK's approach to funds taxation seeks to ensure that investor decisions are not distorted by tax considerations. Broadly, the tax outcome for investors in UK funds should be similar to that from investing in the underlying assets of the fund directly. Most UK funds are tax neutral in this way, but the government is aware of areas of tax inefficiency, as well as other aspects of the regime where the UK could be more attractive.

2.8 With these considerations in mind, the government is keen to learn from previous experiences, both in the UK and elsewhere, and to receive fresh ideas from stakeholders. The government therefore asked ten questions about the UK's approach to funds taxation, focusing on: the current funds landscape, multi-asset/balanced funds, tax-exempt funds, REITs, treaty issues, and limited partnership funds.

Current funds landscape

2.9 The call for input set out a number of notable reforms to the taxation of funds over the past 10 years, where the government has sought to ensure that the taxation of UK funds remains competitive.

Question 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?

2.10 **Co-ownership Authorised Contractual Schemes (CoACS)**: Many respondents commented that the introduction of CoACS has been a significant success in providing a domestic fund vehicle for institutional clients. Many respondents said that this vehicle has been valuable in facilitating tax efficient pension pooling and noted its use particularly for Local Government Pension Schemes. Respondents said that industry input when developing the regime, and its similarity to well established regimes in other jurisdictions, have contributed to CoACS being a well understood and attractive regime. Some respondents also stated that Stamp Duty Land Tax (SDLT) seeding relief has meant CoACS have been useful as a vehicle to invest in real estate.

2.11 However, several respondents suggested that the attractiveness of CoACS was limited due to the uncertainty of their treatment under double tax treaties, and that the government could do more to improve this. Some respondents also suggested that CoACS had limited attractiveness outside certain classes of the largest institutional investors, due to their authorised nature and administrative requirements. One respondent also noted that the VAT exemption results in irrecoverable VAT at the level of the management supplier, which reduces tax efficiency.

2.12 **Investment Trust Companies (ITCs)**: Respondents suggested that the previous tax changes to modernise the tax treatment of ITCs were successful in reducing administrative burdens, including by allowing income streaming and an easier route to market. However, they also noted that there are some remaining issues. Respondents recommended that further take-up could be encouraged by:

- Reforming the close company rules;
- Removing the Stamp Duty and Stamp Duty Reserve Tax (SDRT) charge from transfers of shares in UK ITCs[1] to level the playing field with open-ended investment companies (OEICs); and
- Disapplying the Corporate Interest Restriction for ITCs which fall outside the de minimis threshold.

2.13 Several respondents also mentioned **Unauthorised Unit Trusts (UUTs)**. Some welcomed the reforms to the rules and recent clarifications to guidance, stating that these have helped to reduce the administrative burden of managing UUTs. They suggested this has increased their popularity with UK tax-exempt investors. However, respondents thought that whilst they are in principle available to eligible non-UK investors, in practice the complexity of the qualification criteria reduces certainty and thereby imposes a barrier. Others suggested that these reforms have not gone far enough, and UUTs remain poorly understood by investors.

2.14 Respondents suggested that the 2016/17 changes to the Substantial Shareholding Exemption (SSE) were helpful, but that it was less ambitious than equivalent regimes in other jurisdictions. Respondents thought that the benefits of the regime should be extended to real estate investment companies, as well as trading companies. Others thought that the SSE has been too restrictive for institutional investors, and that it could be administratively burdensome.

2.15 Respondents suggested that the introductions of REIT and Property Authorised Investment Fund (PAIF) regimes have been successful, but only after amendments were made following their initial implementation. Respondents noted the significant uptake of REITs followed changes to the regime in 2012, since when the total number of REITs has more than quadrupled. The current commitment to review the REIT regime was welcomed.

Multi-asset/balanced authorised funds

2.16 The call for input recognised that multi-asset funds can be tax inefficient, due to the tax paid on income from interest-bearing investments and derivative contracts. It was also acknowledged that there was low take-up of the Tax-Elected Fund (TEF) regime, which was introduced in 2009 to remove tax drag within multi-asset funds by streaming different types of income to investors in an accounting period.

2.17 The call for input sought views on four possible solutions proposed by the UK Funds Working Group, in addition to the consideration of tax exemption for UK authorised funds. Those solutions were: amendments to the TEF regime; extension of the corporate streaming rules to individuals; changes to the tax rates applied to UK funds, including applying a low rate of tax to authorised funds; and a 'deemed deduction' for distributions at fund level.

[1] A similar ask was made in respect of Real Estate Investment Trusts (REITs) and Venture Capital Trusts (VCTs).

Question 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?

Question 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.

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

2.18 Respondents said that, if UK funds are to compete with overseas funds, the government needs to find a simple and operationally inexpensive solution to the tax inefficiency in multi-asset funds.

2.19 Respondents gave several reasons for the low take-up of the TEF regime. The key points raised were that:

- TEFs are not widely available on investment platforms. It was suggested that the number of platforms offering access to TEFs for individual investors could be as low as 30%, and for financial advisors that only half of platform providers offer access to TEFs.
- The TEF administrative requirements for monitoring different streams of income and investor reporting are too burdensome.
- TEFs do not provide a tax efficient way to hold UK and non-UK property.
- The introduction of the TEF regime coincided with the introduction of the exemption from tax on foreign dividends and the introduction of the reporting offshore fund regime, both of which reduced the relative benefits of the TEF regime for funds and investors.
- There is limited investor demand and market awareness of the potential benefits of the TEF regime.

2.20 Overall, most respondents were not in favour of a solution which involves the TEF regime.

2.21 Given the strong likelihood of increased administrative burdens for both investors and HMRC, respondents agreed that extending the corporate streaming rules to individual investors was not a viable solution.

2.22 Some respondents were in favour of a low rate of tax for UK authorised funds. However, most said that this was a partial solution, which could cause difficulties accessing double taxation treaties.

2.23 Most respondents said that, in the absence of tax exemption for UK authorised funds, they would prefer a 'deemed deduction' for distributions, as this would in their view remove tax drag while preserving access to double taxation treaties. Respondents said that the deemed deduction could operate like the deduction for an interest distribution paid by a bond fund. It was also suggested that the deduction should extend to other sources of income beyond income from interest-bearing investments and derivatives. Respondents said that the difficulty with adopting the deemed deduction proposal is that it is unlikely to solve the complexities in the UK funds regime and change the perception of UK funds taxation. One respondent also proposed a portfolio interest income exemption.

2.24 Several respondents highlighted difficulty with the qualifying investments test to determine whether a fund is a bond fund, and consequently can make an interest distribution to investors. An authorised investment fund satisfies the test if throughout the distribution period the market value of its qualifying investments exceeds 60% of all its investments. Qualifying investments include investments that either yield interest or returns whose economic substance is of a similar nature to interest. Responses pointed out that this is a cliff-edge test, which requires constant monitoring. In some cases, responses said that a balanced fund could have a different status in each distribution period, causing issues with fund pricing.

2.25 Respondents said that a solution could either be to remove the qualifying investments test or modify the test. Modifications suggested were an advance clearance process which would require less frequent monitoring, adopting an income-based test, adopting a mechanism for reporting tax information to investors (similar to that used for reporting offshore funds) and giving an allowance for unintentional minor breaches.

2.26 Other suggestions in response to these questions included that the government should: review the approach to taxing derivative income; review the GDO condition for institutional and other investors; and ensure that any changes made to improve the tax efficiency of multi-asset authorised funds are also considered for other types of funds – for example, ITCs – where they might improve their attractiveness.

Government response and next steps

2.27 Having analysed the responses to these questions, the government intends to continue work to address tax inefficiency where it arises for authorised multi-asset funds. As part of this, it will focus on the proposals which hold the greatest potential, considering the impact on tax treaty benefits and any Exchequer cost.

2.28 Respondents raised several reasons for the low take-up of TEFs, and generally respondents were not in favour of TEFs as a solution, citing costs, complexity, and administrative burdens. However, the government will need to better understand the problems raised at administrator and investment platform level.

2.29 The government agrees with the reservations expressed by stakeholders in relation to the proposal to extend corporate streaming to individuals and a low tax rate for authorised funds; the challenges presented by these options outweigh their potential to address the underlying issue.

2.30 The government wishes to further evaluate the case for a deemed deduction for distributions, as well as continuing consideration of tax exemption (see Tax-exempt fund, paragraphs 2.40 and 2.41). Given the currently incomplete evidence base, it will be necessary to undertake further engagement with stakeholders on how these would work in practice.

2.31 The government recognises the points raised in relation to monitoring to determine whether the qualifying investments test has been met and will consider the modifications suggested by respondents further through engagement with stakeholders.

2.32 The government will conduct a review of the GDO condition to consider whether reforms are required.

Tax-exempt fund

2.33 The call for input sought views on tax exemption, both for authorised funds and any new unauthorised fund structures. It acknowledged that tax exemption would be a major departure from current policy and that there is a need to consider the impact that this could have on access to treaty benefits.

Question 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?

Question 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.

2.34 Most responses agreed that UK funds do largely achieve tax neutrality, but many said that the UK tax rules are complex. Respondents suggested that it was difficult to explain to investors how neutrality is achieved, especially for international investors and where the fund is invested in other funds. One respondent thought that institutional investors were more likely to understand that UK funds do not suffer tax in practice but provide access to considerable benefits from the UK tax treaty network. It was also suggested that the growth of multi-asset funds could emphasise any existing tax inefficiency in the future as funds look to use a wider range of derivative strategies.

2.35 Most responses said that tax exemption would make the UK funds regime simpler and give greater certainty. Furthermore, respondents said it would remove tax drag in multi-asset funds. Some felt that a tax-exempt status would have an impact on the overall perception and attractiveness of the UK fund regime and that tax exemption could give the UK a stronger base to capture assets in future.

2.36 Some respondents said that tax exemption for both authorised and unauthorised funds would provide an opportunity to have a single tax regime for funds. They thought the success of overseas funds was largely a result of offering the same tax treatment irrespective of the type of investor and/or strategy. Several respondents said that funds prefer to have an umbrella arrangement with multiple investment strategies held within that structure, which meant choosing a fund domicile that worked for all those strategies.

2.37 However, most responses said that tax exemption would not alone be sufficient to increase the international take-up of UK funds, as decisions are taken holistically considering several other factors. Other factors raised included the regulatory regime and speed to market, available fund structures, the location of target investors and/or investments, location of ancillary services, familiarity and/or existing footprint, and the VAT regime. Respondents also said that no longer having access to the UCITS passporting regime was likely to limit uptake of UK funds. Furthermore, responses also said that where funds are already tax neutral, tax-exempt status would be unlikely to prompt significant change.

2.38 Most respondents also raised concerns with accessing double tax treaty benefits if tax exemption were adopted, either where tax residence is linked to the fund being liable to tax or where the income itself needs to be taxable to benefit from lower rates. Some respondents said that the benefits of tax exemption may be offset by a loss of treaty access, which it was said would not be felt evenly across the sector. Several responses said that access to treaties is an advantage that the UK currently has over overseas funds. However, others said that treaty issues have not affected the growth of tax-exempt overseas funds. Respondents also pointed to the administrative difficulties some UK funds have in accessing treaty benefits; it was suggested that, coupled with the loss of access to reduced rates of withholding tax in respect of certain EU Member States, this UK advantage had already been impacted.

2.39 Some responses said that the UK should instead look at an optional tax-exempt regime, as it could allow existing structures to retain treaty access, and cater for new funds that are not currently attracted to the UK market. Finally, one respondent suggested that the review of the UK fund regime should focus on simplification, rather than tax exemption.

Government response and next steps

2.40 Overall, respondents did not reach a consensus on whether the government should adopt tax exemption for authorised funds, with responses acknowledging that it would likely depend on the investment strategy of the fund and the importance of accessing treaty benefits. The government will explore with stakeholders the case for an elective tax-exemption for authorised funds. Please also see the government response on tax inefficiency in multi-asset authorised funds in paragraph 2.30.

2.41 The policy rationale for exploring this would be similar to that in other relevant jurisdictions. The main drivers for this would be increasing the tax efficiency of 'balanced funds' and simplification of the tax system. Key considerations will include: the impacts on existing tax treaty benefits (bearing in mind UK priorities for renegotiation of double taxation treaties, covered further below); operational complexity; and any associated Exchequer costs.

2.42 The government recognises that any decision on whether to take forward tax exemption for unauthorised funds will rest on the range of relevant vehicles that will be available. Given the government's position on VAT on fund management fees, and its implications for the unauthorised corporate vehicle proposal (see New unauthorised fund structures, paragraph 2.169), the government has not considered tax exemption for unauthorised funds, since other proposals are for vehicles that would in any case be tax transparent for income.

Real Estate Investment Trusts

2.43 The call for input recognised that, whilst a key element of the UK funds regime is investment in property, there is a perception that there are unnecessary barriers and complexity within the rules for REITs, one of the two UK vehicles aimed specifically at investment in real estate. The document set out that the government was considering a number of changes to the rules. This has now resulted in several changes introduced in Finance Bill 2021/22, namely:

- Removing the requirement for REIT shares to be admitted to trading on a recognised stock exchange in cases where certain types of institutional investor hold at least 70% of the ordinary share capital in the REIT;
- Amending the definition of an overseas equivalent of a UK REIT so that the overseas entity itself, rather than the overseas regime to which it is subject, needs to meet the equivalence test;
- Removing the 'holders of excessive rights' charge where property income distributions (PIDs) are paid to investors entitled to gross payment;
- Amending the rules requiring at least 75% of a REIT's profits and assets to relate to property rental business (the 'balance of business test') to disregard non-rental profits arising because a REIT has to comply with certain planning obligations, and to ensure the items specified are disregarded in all parts of the test; and
- Introducing a new simplified balance of business gateway test.

2.44 Many respondents supported these changes, which had not yet been confirmed when the call for input closed, suggesting that such changes could remove complexities and in some cases barriers to using REITs.

2.45 The call for input also set out a number of possible further changes that had been raised in response to the AHCs consultation. These changes were:

- Removing the requirement for REITs to be subject to both the Corporate Interest Restriction test and the interest cover test at section 543 of the Corporation Tax Act (CTA) 2010;
- Amending the 3-year development rule at section 556 CTA 2010;
- Removing the requirement for a company to hold at least 3 properties, and allowing REITs to hold a single property to make the UK regime more attractive to investors; and
- Amending the rules so that where a REIT holds overseas property in a UK company and suffers tax in the overseas jurisdiction, withholding tax should not be applied when paying relevant property income distributions to investors.

Question 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?

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

2.46 In addition to those changes considered through the AHCs consultations, respondents supported further amendments to the REIT rules, on the grounds that such changes would simplify REITs, reducing some administrative burdens and increasing the attractiveness of the regime.

2.47 Respondents supported removing the requirement for larger REITs to be subject to both the corporate interest restriction test in part 10 and schedule 7A of the Taxation (International and Other Provisions) Act 2010, and the interest cover test at section 543 of CTA 2010, suggesting that the combination of these creates unnecessary complication. Those that responded recommended that one test should be applied and several thought that the CIR test should take precedence, as it is more comprehensive.

2.48 While respondents generally supported the principle behind the 3-year development rule, many suggested changes to make this work better in practice. There were a number of proposals for different amendments that could be made, including:

- Providing exceptions to the provisions, subject to a cap, to allow REITs and REIT investors to benefit from above-market offers;
- Recognising the inflation in property values over time, for example taking into account the fair value of the property immediately prior to the development, or the highest of: that value, the fair value of the property when it joined the REIT regime, or the cost of acquisition; and
- Excluding disposals where they are required in order to meet statutory requirements.

2.49 Respondents welcomed the suggestion of removing the three-property requirement and thought this had the potential to make UK REITs more attractive to investors owning large single assets in the UK. It was suggested that the rule requiring that no single property represents more than 40% of the total value of the properties in the property rental business should also be removed. Respondents noted that the application of the rule in practice was not always coherent. For example, a large warehouse leased to one tenant could be treated as a single property, whereas different floors of the same building leased to the same tenant could count as three properties, regardless of overall property value.

2.50 Respondents stated that removing tax inefficiencies for UK REITs holding non-UK property would make the REIT regime more internationally competitive, stating that this was a current barrier. Suggested changes included:

- Overseas property rental business profits and gains arising to UK REITs should, where taxed in the overseas jurisdiction, be exempt from UK tax and where distributed by the REIT to its shareholders should be treated as ordinary dividends rather than PIDs; and

- Extending the UK branch profits exemption to the income and gains arising from a non-UK property rental business.

2.51 In responding to other areas of potential reform for REITs, many respondents supported broadening the definition of qualifying assets for the REIT regime, to bring it in line with overseas regimes and reflect the evolution of the real estate investment industry. Assets suggested for inclusion are: property backed debt (to allow UK mortgage REITs); operational income from infrastructure assets; and renewable energy assets and the technology and other infrastructure needed to enable the transition to net zero.

2.52 The other suggestion made by many respondents was to introduce a seeding relief from Stamp Duty Land Tax (SDLT) for REITs (similar to those available for PAIFs and CoACS), to ease transition into the REIT regime. This would give existing pools of assets looking to transition to a new vehicle the flexibility to choose between closed-ended and open-ended onshore fund structures, depending on which best suited their commercial objectives.

2.53 A number of respondents recommended a review of the operation of the capital allowances regime for UK REITs, stating that capital allowances reporting did not interact cleanly with PIDs as capital allowances reporting often lags behind PIDs. Respondents recommended making the requirement to calculate capital allowances optional and allowing flexibility to allocate PID payments across accounting periods.

2.54 Respondents also said that the proportional basis on which the capital gains exemption applied to disposals of rights in UK property rich companies could be overly restrictive, leading to small gains being taxable due to sundry balances on a company's balance sheet that do not qualify as related to its property rental business, even in cases where all the company's activities are in fact part of its property rental business.

2.55 Respondents recommended that the changes made to remove the 'holders of excessive rights' charge in respect of payments of PIDs to certain investors should be taken further and extended to qualifying exempt entities, in cases where there would be no risk of loss of tax.

Government response and next steps

2.56 Given the strong stakeholder support for further reform to the REIT regime, the government will establish a new workstream as part of the UK funds regime review to further evaluate the options. This workstream will determine which of the specific proposals in the call for input will be taken forward and set out a timetable, as well as considering any wider suggestions. Discussions on the interaction of REITs with the new QAHC regime will form a part of this. The government will also consider whether any of these changes, where applicable, should be made in respect of other types of relevant fund vehicle (e.g. PAIFs).

2.57 The government will explore whether some of the reforms that are taken forward as a result of this workstream, including in relation to the interaction between REITs and QAHCs, can be delivered in the next Finance Bill. Where it is considered that more detailed and/or lengthy consultation is required, the timetable for any legislative change will be longer.

Consideration of other points raised by respondents to the consultation on QAHCs, such as a review of the institutional investor list at s528(4A) CTA10, and the non-close condition more generally, will also be to a longer timetable.

Treaty issues

2.58 The call for input sought views on the UK's double taxation treaty network, and any features of the treaty network that stakeholders consider could be improved or enhanced for funds.

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

2.59 In responding to this question, many stressed upfront the value of the UK's tax treaty network, and its importance to the attractiveness of the UK as a location for funds. Respondents stated that innovation in the funds space should take this into account.

2.60 Many respondents noted concerns around UK funds no longer having access to provisions under the EU Parent-Subsidiary Directive (PSD) and the Interest and Royalties Directive (IRD), which eliminate withholding tax (WHT) on some dividend and interest payments between EU Member States, and WHT exemptions in Member States based on UCITS status.

2.61 Respondents suggested bilateral agreements that should be prioritised in this context. These include the Italian, Spanish and other tax treaties – which have seen loss of withholding tax relief compared to domestic investment funds following the UK's exit from the EU – and treaties with Germany, Italy and Luxembourg in order to restore the withholding tax benefits that the UK enjoyed under the PSD and IRD. Some respondents also stated that a solution should be sought quickly to allow UK UCITS to continue to demonstrate comparability with EU UCITS.

2.62 Many respondents stated that the UK should seek certainty of treatment for specific UK fund types, and therefore more clarity around the availability of treaty benefits. This was raised in the context of a mismatch between funds treated as opaque or transparent. Respondents suggested this should be explicitly agreed in amendments to existing tax treaties, when negotiating new treaties, or by Memoranda of Understanding (MoU) or Competent Authority Agreements (CAA).

2.63 Specifically, a number of respondents said that the UK should seek to agree the treatment of unit trusts and funds that aren't taxable persons, such as LPs and ACS, with foreign jurisdictions to remove any ambiguity as regards the ability of funds, and certain investors, to access treaty benefits.

2.64 Many respondents also raised the proposal to introduce a tax-exempt fund in their answer to this question, following on from their responses to questions 6 and 7, noting the potential detrimental impact on access to treaty benefits.

2.65 Others commented that burdensome relief procedures and documentation requirements for treaty access should be addressed, and that the UK should seek to influence other jurisdictions to eliminate onerous requirements to prove entitlement to treaty benefits. As part of this several respondents suggested that HMRC should review the Certificates of Tax Residence process, and that the UK generally keep close to international developments on tax administration, including implementation of the OECD's TRACE initiative.

Government response and next steps

2.66 As part of its ongoing negotiation programme, the UK is already looking actively at the UK's tax treaties with EU Member States, and will seek certainty and clarity for funds. While renegotiation of treaties inevitably takes time and negotiated outcomes cannot be guaranteed[2], the government will always advance the interests of UK businesses.

2.67 The government will be considering all of the points made by stakeholders as part of its ongoing tax treaty negotiation programme and will seek to engage further with stakeholders as necessary to bolster its understanding. It has also been noted that tax treaty issues are relevant in the context of other possible reforms, such as the proposed elective exemption for balanced funds.

2.68 It has been UK tax treaty policy over many years to seek to reduce withholding taxes to zero or as close to zero as is possible. The UK also seeks to ensure that the UK funds industry can utilise the tax treaty network effectively by agreeing their status and procedures for making claims with other countries so far as possible. This includes utilising Memoranda of Understanding (MOUs) and Competent Authority Agreements (CAAs) where appropriate.

2.69 Whether a country classifies a fund as opaque or transparent, or equivalent to or comparable with an EU fund, can to an extent depend on the domestic system of that country. The UK will seek to clarify the status of particular fund structures with partner countries where necessary. The UK will seek to agree procedures alongside treaty obligations which will assist funds to make claims for treaty relief, including updating existing procedures where it appears that they may no longer be working as well as they could.

2.70 As set out in Tax Administration and Maintenance announcements in November 2021, HMRC is planning to improve the systems and processes relating to the issuing of Certificates of Residence, including further digitalisation, following stakeholder engagement.

2.71 The UK will also continue to play a full and active role at the OECD to reach international consensus in relation to administrative procedures in cross-border taxation.

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[2] Any negotiated outcomes will reflect a balanced trade-off of interests, reflecting the domestic position of both countries. Although taxpayers within EU Member States have access to the provisions of directives which regulate withholding taxes within the EU/EEA internal market, this does not necessarily reflect each Member State's domestic policy with respect to withholding taxes.

Limited partnership funds

2.72 The call for input recognised that the number of registrations of UK-domiciled limited partnership funds (LP Funds) has declined over recent years, despite the introduction of the new Private Fund Limited Partnership (PFLP) regime in 2017. The call for input sought to understand the factors leading to this decline, and invited suggestions for improvements.

Question 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.

2.73 Respondents generally cited a mixture of tax and non-tax factors that may impact the attractiveness of UK-domiciled LP Funds and PFLPs to some investors. Many responses highlighted the importance of administrative simplicity and tax certainty for LP Funds.

Non-tax barriers

2.74 A number of respondents suggested that the attractiveness of LP Funds could be improved by allowing English[3] LP Funds to elect to have a separate legal personality. These respondents said that this would allow these LP Funds to enter into agreements, hold assets in their own name, and take action against counterparties to protect their assets. This approach would align with the status of Scottish LPs.

2.75 Several respondents argued that the UK's limited partnership regime should accommodate protected cell structures. This would allow firms to use one limited partnership structure as an "umbrella" legal entity encompassing multiple distinct protected sub-funds, thereby ring-fencing the assets and liabilities from each other. Respondents suggested that this would benefit investors by allowing them to participate in the same pool of investments on distinct terms without the firm having to set up a separate limited partnership vehicle, and that these sub-funds would be faster and easier to set up than separate limited partnerships because they require less legal administration. It was noted that 'protected cells' are common in the retail investment sector under the OEIC protected cell regime as well as in other jurisdictions, and that permitting this structure in UK LP Funds would make the UK regime more attractive (see Qualified Investor Scheme (QIS), paragraphs 2.106 and 2.110).

2.76 Several respondents suggested that no longer having access to the Alternative Investment Fund Managers (AIFM) marketing passport complicated the marketing of Alternative Investment Funds (AIFs), such as LPs, into the EU.

2.77 Some respondents also highlighted that the removal of the reporting requirements introduced by the Partnership (Accounts) Regulations 2008 and modernising the requirement to advertise the transfer of LP Fund interests in the Gazette would reduce the administrative costs for LP Funds. Some of these respondents said that the public disclosure requirements of

[3] Respondents' references to English LP Funds would apply to LP Funds registered in England and Wales, and Northern Ireland.

the Partnership (Accounts) Regulations 2008 discourages fund managers from using LP Funds if they consider there to be a competitive sensitivity.

Tax barriers

2.78 Many respondents suggested tax barriers included administrative obligations introduced by the partnership reporting requirements in the Finance Act 2018. The key obligations identified were the requirement that partners obtain a Unique Tax Reference number (UTR) and the requirement for the partnership to file on four separate tax bases.

2.79 Several respondents also highlighted complex tax considerations caused by the application of Statement of Practice D12, Stamp Duty and Stamp Duty Land Tax (SDLT) to transfers of interest in LP Funds and Property Development LPs. It was suggested by some that LP Funds should be treated as opaque for Capital Gains purposes, so that tax charges are based upon the consideration given by and paid to partners. Some respondents pointed to the anti-avoidance purpose of SDLT charges on transfers of partnership interests and suggested that these should only apply in cases where the partnership share is not widely held. Some respondents suggested that the application of Stamp Duty on transfers of interests in LP Funds should be abolished.

2.80 Other suggestions to reduce potential tax barriers included:

- Modifying Withholding Tax (WHT) obligations in respect of LP Funds, so that the rules are applied to investors rather than the investment fund;
- Providing access to an equivalent of the 'investment transactions list' which sets out the circumstances in which UK LP Funds may be treated as trading, so that there is certainty on whether a UK Permanent Establishment has been created for overseas investors; and
- Exempting general partners of an LP Fund from the 2017 Corporate Loss Reform rules.

Government response and next steps

2.81 The UK's limited partnership regime is internationally recognised and respected. Within the UK funds regime, these structures play a key role in facilitating investor access to alternative investment opportunities – particularly for private equity and venture capital firms.

2.82 The government is therefore keen to support this structure and will continue work to ensure that this vehicle operates efficiently for investors. The government has recently reviewed legislation on limited partnerships and intends to introduce measures that will increase the level of transparency[4] around the ownership and activities of these structures, when parliamentary time allows.

2.83 Respondents were aligned on several non-tax related concerns about the use of LP Funds and PFLPs, for example that 'English'[5] LP Funds cannot elect to

[4] Please note that transparency here does not refer to tax transparency.

[5] Respondents' references to English LP Funds would apply to LP Funds registered in England and Wales, and Northern Ireland.

have separate legal personality, and that the system for legally transferring fund interests could be modernised. These issues, while important, were not raised as a top priority by most respondents. The government therefore intends to consider these issues further before taking forward any specific proposals for reform in this area. As it continues its consideration, the government welcomes any additional representations from industry on these issues.

2.84 The government considers that the current guidance and practice in relation to the taxation of LP funds is robust and is consistent with the tax treatment of UK partnerships, but will keep the points made in relation to tax barriers under review.

2.85 Where new legislation impacts upon LP Funds, the government seeks to work in consultation with industry. For example, the 2017 Corporate Loss Reform rules were explored with industry immediately after introduction. In addition, following discussions with industry, the partnership reporting requirements introduced by the Finance Act 2018 have been subject to exemptions and administrative simplifications that benefit LP Funds. The obligation for partners to obtain a UTR is removed for non-trading partnerships under the circumstances outlined in s12ABZA TMA70, and where partnerships have no members falling within one of the four bases then s12AB TMA70 provides that the basis does not need to be completed. The government will consider how further simplification may be achieved.

2.86 The government notes that there may be advantages to the creation of a bespoke taxation regime for LP Funds, such as providing simplicity and certainty for investors. However, given that several other issues in the call for input were raised as a higher priority by respondents, the government does not currently intend to progress any reforms in this area. The government welcomes engagement and any further representations from stakeholders on this issue.

The UK's approach to fund regulation

2.87 The call for input set out the existing UK funds regime – which consists of authorised and unauthorised, open-ended and closed-ended collective investment vehicles, each with a variety of different regulatory treatments and potential legal structures – and recent reforms taken forward by the government and regulators.

2.88 The government had received representations from stakeholders suggesting that there is further scope for change to regulation of the UK funds regime and its broader funds environment. The call for input therefore asked seven questions about the UK's approach to fund regulation, focusing on: fund authorisation, speed to market, and the FCA's Qualified Investor Scheme (QIS) regime.

Fund authorisation

2.89 The call for input noted that professional investors and sophisticated retail investors often prefer to use authorised products, despite being able to invest in unauthorised collective investment vehicles. To better target potential regulatory reforms, the call for input sought to identify the drivers behind the attractiveness of authorised fund structures to professional and sophisticated retail investors.

Question 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?

2.90 The majority of respondents suggested that the main benefit of fund authorisation is that those products offer a greater level of regulatory oversight and therefore imply a higher degree of investor protection. In particular, respondents referenced the following as benefits of fund authorisation:

- Access to retail investors;
- Minimum standards of governance, due diligence, and risk management;
- An additional layer of supervisory oversight beyond the regulation of the fund manager and depositary; and
- The ability of the FCA to intervene if necessary.

2.91 Several respondents suggested that fund authorisation is undesirable and unnecessary for professional investors. This is because – given the sophistication of the investor base – the associated regulatory requirements create unnecessary additional costs for the firm, which drag on returns. However, other respondents suggested that fund authorisation is still attractive for some professional investors because the robust governance and due diligence standards implied by fund authorisation are attractive to their investors despite the added cost, and can reduce the pressure on the firm and investors to meet some of those demands and costs themselves.

2.92 Some respondents highlighted that whether a fund is authorised or not is pertinent to its market access and treatment in certain international markets. In some instances, the fund's authorisation will determine its regulatory and tax treatment, and in some jurisdictions a fund can only be marketed to professional and retail investors in that jurisdiction if it is authorised by its home state regulator.

Government response and next steps

2.93 The government was interested to see respondents' perceptions of the benefits and costs of a fund's authorised status. The government incorporated these views into its assessment of the proposals for a "fast-track" authorisation process for QIS structures (see Speed to market, paragraphs 2.99 and 2.105) and the new unauthorised fund structures (see New unauthorised fund structures, paragraph 2.173).

Speed to market

2.94 Stakeholders had emphasised to government the importance of speed, clarity, and predictability in the fund authorisation process – particularly for funds for professional and sophisticated investors – in considering where to set up their funds. The call for input therefore set out the existing legislative requirements and the FCA's voluntary service standards for authorising UCITS schemes, Non-UCITS Retail Schemes (NURS), and QIS within certain timeframes.

2.95 The call for input highlighted that the FCA has been historically successful in meeting its voluntary service standards, and that the government considers that the FCA's standards for authorisation of QIS structures are appropriate given that these products can be both complex and marketed to sophisticated retail consumers. However, the call for input also clearly set out the government's desire to identify ways to further refine, improve and clarify the authorisation process and its timelines.

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

Question 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?

2.96 Many respondents observed that they felt the FCA's fund authorisation timeframes were appropriate and did not suggest shortening either the legislative or voluntary service standard time-limits. Some of those respondents noted that this is especially true for more complex funds, such as QIS funds. However, a small number of respondents suggested that the FCA's time-limits be shortened.

2.97 On the fund authorisation process, respondents suggested areas where the FCA could make changes to benefit firms, most notably by producing guidance. They argued that the purpose of this guidance would be to better inform and prepare firms for what is required of them in their application. Respondents suggested several forms this guidance might take, ranging from a checklist of "standard questions" for specific fund structures, to an annual update on the issues the FCA is focusing on at a given time.

2.98 Respondents noted that FCA comments can occasionally be received quite late in the application review process and can be challenging to respond to quickly. They observed that it would be helpful to receive the FCA's comments on the proposed fund early in the application review process. Respondents suggested that late comments can create concerns that the firm may need to re-submit its application, which can sometimes generate uncertainty on the overall authorisation timescale for firms.

2.99 Many respondents suggested that the FCA introduce a "fast-track" process for professional-only AIFs. These respondents noted that professional-only funds do not need the same level of scrutiny as retail investor funds, and therefore the UK process could be made more competitive by allowing these types of funds to be launched more quickly. Several of these respondents referenced the 24-hour approval process for professional-only funds employed by some other jurisdictions as a possible model for the FCA to consider.

2.100 Relatedly, a number of respondents suggested that the process for professional-only funds could be improved if it were possible to submit a certificate of compliance provided by the fund's lawyers, rather than the FCA having to approve the fund documentation itself. Several of these respondents noted that this is the system employed by some other jurisdictions.

2.101 A small number of respondents suggested that increases to the FCA's operational capacity would be beneficial. Some of these respondents suggested the FCA increase its workforce, with a few recommending that the FCA have dedicated case officers for individual firms to create a stable point of contact across that firm's different applications. Some respondents noted that the fees for fund authorisation applications may not cover the costs of higher service levels, but that raising fees would be unpopular. Some other respondents suggested the FCA increase the automation of these processes, such as through machine-readable documentation.

Government response and next steps

2.102 The government was pleased to see that many respondents agreed that the FCA's fund authorisation timeframes are appropriate. The government does not therefore intend to review the legislative time-limits or recommend the FCA to review its voluntary service standard time-limits. The government acknowledges the view that the FCA's authorisation process provides value for money.

2.103 The government would also like to acknowledge that in most cases the FCA responds to firms with questions early in the application period. However, the FCA also recognises that at times – and particularly for complex cases – there can be questions for firms asked throughout the process. Where issues that the FCA has previously raised are not satisfactorily addressed in initial responses, or where responses to initial questions raise new issues, the FCA may ask further questions right up to the end of the process. The FCA is considering how it can limit the number of questions that come to firms late in the process, and therefore welcomes the views provided by respondents.

2.104 The government and the FCA noted the support for additional guidance from the FCA regarding the application process. The FCA will engage with industry to explore further what authorised fund managers would find helpful in terms of additional information regarding the application process. Please e-mail the FCA at ukcis@fca.org.uk providing further details and ideas.

2.105 Based on the evidence provided by respondents to the call for input, the government is not convinced of the merits of a 'fast-track' authorisation process – potentially supported by solicitor-certified authorisation documents – for professional-only AIFs. This relates to the government's response to the question of whether proposed new unauthorised fund structures should be subject to a form of 'light touch' regulation, authorisation, or registration (see New unauthorised fund structures, paragraph 2.162).

- Under the existing regulatory framework, authorised AIFs in the form of NURS can be marketed to professional and retail investors, and other more flexible forms of authorised AIFs, such as QIS, can be marketed to both professional investors and sophisticated retail investors.

- Key benefits associated with fund authorisation by respondents are certain minimum standards, a higher degree of regulatory oversight, and greater investor protection (see Fund authorisation, paragraphs 2.90 to 2.92). It is not clear the degree to which a 'fast track' or 'light-touch' approach to fund authorisation or fund registration is compatible with these benefits.

- Such an approach could create confusion for professional and sophisticated retail investors about what benefit and protection is associated with a fund's authorised status, thereby potentially undermining trust in the benefits of fund authorisation or exposing investors to risks of which they may not be fully aware (see also New unauthorised fund structures, paragraphs 2.162 and 2.173). For example, a key stated benefit of fund authorisation is the ability of the FCA to intervene if necessary. But this depends on the FCA's ability to supervise the fund, which in turn depends on the fund being required to report to the FCA – a requirement which some respondents suggested would be reduced under a 'light-touch' regime.

- The government acknowledges the suggestion below that QIS structures, particularly if made more flexible, should not be marketable to sophisticated retail investors (see Qualified Investor Scheme (QIS), paragraph 2.111). Although in theory this could partially address the government's concerns above, it would take significant further work by both the government and FCA to determine whether the potential benefits of the proposal are proportionate to the potential costs given: (i) the additional complexity and potential risk to investors that might be introduced; and (ii) the restriction of the QIS structure to a narrower set of investors.

- Given that this was not raised as a top priority for firms, the government will therefore not consider this area further in the short-term. The government does however welcome further industry representations on this matter.

Qualified Investor Scheme (QIS)

2.106 The QIS was developed to be a flexible, authorised fund structure aimed at professional investors and sophisticated retail investors. It is regulated as an AIF and can be established as an authorised unit trust, authorised open-ended investment company (OEIC), or authorised contractual scheme (ACS). The QIS therefore offers a broader, more flexible investment vehicle to a narrower set of suitable investors when compared to the UCITS and NURS structures.

2.107 However, previous stakeholder representations to the government and the FCA were clear that the QIS could be made a more attractive structure. Therefore, the government and the FCA asked several questions in the call for input to better understand the limitations of the QIS and how it could be enhanced.

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

Question 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?

Question 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?

Question 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.

2.108 A number of respondents said that the existing QIS structure creates impediments that make the QIS less attractive. In particular respondents noted that the existing QIS structures are perceived to limit the investment products and strategies that can be pursued in the UK, that their target investors for QIS structures – often professional investors – should be allowed a more flexible authorised vehicle, and that fund structures for professional investors that do not have these restrictions and which have some degree of authorisation can be found in other jurisdictions.

2.109 To make the QIS regime more appropriate for the professional investors that will likely be the ones to invest in a QIS, and to make the regime more attractive, respondents suggested that the QIS should:

- Expand the range of QIS permitted investments, to include for example single asset vehicles, loan origination, private credit and infrastructure;
- Relax the QIS borrowing and derivatives constraints, for example by increasing the maximum borrowing limit, removing the maximum

borrowing limit, or removing the maximum borrowing limit but requiring funds to set their own leverage constraints which could then be monitored by the FCA;

- Permit the distribution of capital (see Distribution of capital, paragraphs 2.142 to 2.147);
- Be able to carry over income, rather than being required to distribute it;
- Provide greater flexibility on dealing frequency and subscription/redemption cycles; and
- Accommodate carried interest.

2.110 Some respondents agreed that the QIS sub-fund structure could be improved. Respondents noted that the benefits of a clear sub-fund structure are that it can improve the speed at which firms bring products to market, that it provides legal and regulatory protection of a sub-fund's assets, and that it reduces operational costs. Respondents suggested that the QIS sub-fund structure could be improved through greater clarity. Although segregation of assets and liabilities between sub-funds can currently be achieved by contractual means, some respondents noted that it would be clearer if the segregation of assets and liabilities between sub-funds were specified in legislation. Some respondents suggested that the OEIC Regulations' Protected Cell Regime highlighted by the government in the call for input be replicated for authorised unit trusts and authorised contractual schemes. Beyond specifying the segregation of assets and liabilities between sub-funds in legislation, respondents did not specify another form of clarity that may be helpful to industry.

2.111 Some respondents suggested that QIS structures – particularly with the increased flexibility or 'fast-track' authorisation process discussed above (see Speed to market, paragraph 2.99) – may not be suitable for sophisticated retail investors. Instead, some suggested that the QIS could be limited to only professional investors.

2.112 Several respondents argued that the government and the FCA should not focus on enhancing the QIS. Some suggested that enhancements to the QIS would only benefit the UK market, rather than increasing the UK funds regime's international attractiveness. Others suggested that the government focus instead on creating and implementing the LTAF or the unauthorised contractual scheme.

Government response and next steps

2.113 The government and the FCA welcome respondents' views on how the QIS can be made a more attractive structure and the government will keep this evidence in mind as it considers its approach to funds regulation. Since much of the detail of the QIS regime is contained within FCA rules, respondents' feedback has been shared with the FCA where applicable. The government and FCA would note that, although some respondents' feedback focused on the professional investors that can invest in QIS structures, it is important to remember that these vehicles can also be distributed to sophisticated retail investors for whom the same considerations may not necessarily be appropriate.

2.114 The newly launched LTAF structure (see Long-Term Asset Fund, paragraph 2.148) addresses some of the feedback received on the QIS. In particular the LTAF provides broader investment powers, such as enabling investment in loans. The FCA are considering what, if any, of the additional proposals concerning the QIS they will take forward while taking into account their wider organisational priorities, including consulting on broadening the distribution of the LTAF to a wider subset of retail investors.

2.115 The government was interested to see respondents' views on the benefits provided by a statutory segregation of assets and liabilities between sub-funds and the support for extending to other legal forms, such as unit trusts. This proposal was not raised as a top priority and the government will therefore not prioritise it in the short term. However, the government will consider this further and welcomes any further representations from firms on the issue.

Opportunities for wider reform

2.116 There are several areas covered by the review that cut across and extend beyond tax and regulation. Many of these areas are central to the review's overall objectives, and so they were a particular focus of the call for input and the questions it posed to stakeholders. The government asked 19 questions about cross-cutting opportunities for wider reform, focusing on: the areas of opportunity, spreading the benefits of fund administration jobs across the UK, investment trust companies, distribution of capital, the LTAF, new unauthorised fund structures, and any other areas the government should consider.

Defining areas of opportunity

2.117 The call for input looked to define the areas of greatest opportunity when considering any reforms to be taken forward as part of the UK funds regime review. In order to do so, the government was keen to seek views from stakeholders on which types of funds and which markets should be the focus of any policy changes. In addition to this, the call for input explored instances where the UK is not typically chosen as a domicile despite having an equivalent offering to other jurisdictions.

Question 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?

Question 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?

Question 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?

2.118 A majority of respondents agreed that the government's focus should be on attracting prospective new funds to set up in the UK. In making this case, they pointed to the costs (many of which are operational and could not be addressed unilaterally by the UK) attached to re-domiciling existing funds, as well as the incumbency advantage enjoyed by an existing fund's host jurisdiction. Responses to this question also covered many of the specific areas of potential reform, including in relation to the tax and regulatory environment, that are considered in more detail in the sections of this document relating to other questions.

2.119 A small number of respondents considered that the government should not dismiss the prospect of attracting existing funds. It was noted that occasionally funds need to restructure and that this could involve changing their location. However, it was also noted by some of those stakeholders that such re-domiciliation may only be a realistic prospect once the UK addresses existing complexities and distortive outcomes within the wider regime (many of which were explored through the call for input) and therefore should not be an immediate priority. These include the range of fund vehicles currently available, the pool of relevant expertise, and the tax regime.

2.120 Broadly, respondents agreed that the focus of the review should be global, and that emerging markets in particular presented noteworthy opportunities. There was also a consensus that there was considerable scope for the UK to improve its positioning in respect of alternative investment funds (AIFs) targeting international markets. However, a number of respondents argued that this should not be at the expense of worthwhile reforms to authorised funds which may be primarily targeted at domestic investors (including the LTAF). Some respondents also encouraged the government to demonstrate flexibility in its approach to ensure that reforms reflect the needs of both domestic and international markets.

2.121 It was noted that many existing fund domiciles have over time developed an incumbency advantage through good reputation, established pools of expertise, and through increasing economies of scale that have resulted in lower costs for firms. This partly explains why previous initiatives, including in relation to ETFs, have not been as successful as hoped.

Government response and next steps

2.122 The government has incorporated these views into its assessment of which proposals will be taken forward in the short term, and will continue to assess which areas of opportunity offer the greatest benefit as the UK funds regime review progresses.

Spreading the benefits of fund administration across the UK

2.123 The government was clear from the outset of the UK funds regime review about its desire that the benefits of any reforms, including any resulting additional employment, should be felt across the UK. Two-thirds of existing financial services jobs are already based outside of London, including many within the funds and asset management industry. Therefore, the call for input sought views on how best to build on that, with a particular focus on future fund administration roles.

Question 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?

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

2.124 Many respondents noted that fund administration functions were already being conducted outside of London, with decision-making on location driven by factors such as cost, the availability of relevant expertise and infrastructure provision (e.g. high-speed broadband and transport networks). Examples given of locations where successful sites had already been established were Leeds, Newcastle, Cambridge, Horsham, Cardiff and Edinburgh.

2.125 Some respondents suggested that the government might consider offering financial incentives to firms considering locating fund administration functions in particular regions. Proposals included both a targeted use of the tax system and the provision of grants or subsidies. There was limited support for the use of regulatory levers to realise this ambition, with a small number of respondents highlighting that some other jurisdictions had opted to do so. It was also suggested that the government should consider potential synergies with existing measures to develop and incentivise economic activity outside of London and the South East, such as Freeports and enterprise partnerships.

2.126 Many responses also focused on the importance of educational opportunities – especially within schools, colleges and the workplace – in order to ensure a pipeline of relevant talent. Ideas included the provision of financial services modules and qualifications within academia, better-tailored apprenticeships, and more training roles within industry. It was acknowledged that firms would have a significant role to play in this, along with clear direction from government.

Government response and next steps

2.127 Given respondents' focus on the availability of relevant expertise and infrastructure (e.g. high-speed broadband and transport) as key factors, the government is pleased to be able to highlight the investments made in these areas at Spending Review 2021. In particular, the Spending Review committed to:

- **Building skills** by investing a total of £3.8 billion in skills by 2024-25. This includes: equipping hundreds of thousands of people with maths skills with a new UK-wide adult numeracy programme; boosting high quality technical and further education with £1.5 billion investment in further education college estates across England; and quadrupling the scale of employer-led Skills Bootcamps.

- **Improving connectivity** by rolling-out gigabit capable broadband and extending 4G coverage across the UK, through Project Gigabit (UK-wide) and the Shared Rural Network (UK-wide).

- **Improving transport** by transforming local bus services with over £3 billion investment across the Parliament; and over £8 billion investment between 2020 and 2025 in local roads maintenance and upgrades. The Integrated Rail Plan set out £96 billion of investment in our railways to deliver reduced journey times and improved capacity in the North and the Midlands. There is over £35 billion of rail investment over the Spending Review period for High Speed Two, rail enhancements and vital renewals to boost connectivity across the country.

2.128 On 2 February 2022, the government published its Levelling Up White Paper, which sets out its plan to level up every corner of the UK, underpinned by 12 ambitious "missions" over 10 years, including on skills, digital infrastructure and transport connectivity. Delivery of the missions will be tracked by an annual report which will monitor progress and allow the government to be held to account.

2.129 The government is grateful for respondents' views and suggestions. The government hopes that the measures set out above will pave the way for more fund administration jobs and clusters to be generated outside of London, further spreading the benefits of the UK's asset management sector across the country. The government encourages industry to seize these opportunities, and as the UK funds regime review progresses the government will continue to assess whether its policies are sufficient to encourage the development of existing and new fund administration clusters.

Investment Trust Companies

2.130 As part of assessing the case for cross-cutting reforms to existing aspects of the UK's Funds regime, the government was keen to receive stakeholder views on ITCs. As well as wanting to understand if there are barriers to using ITCs, the government sought views on whether there was a case for further requirements upon managers in respect of their choice of fund structure, in order to ensure consideration of both open- and closed-ended vehicles.

Question 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?

Question 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?

2.131 A number of respondents observed that ITCs are a successful component of the UK's offering on funds. In particular, ITCs deploy permanent capital which benefits savers by facilitating investment in illiquid assets without the vehicle needing to sell assets at short notice to fulfil redemption requests. This still enables investors wishing to realise their investment to sell in the secondary market at relatively short notice. However, respondents noted that there was still scope to consider improvements to the ITCs regime.

2.132 Some respondents highlighted barriers managers face when considering whether to use ITCs:

- They noted that there are greater perceived costs to setting up ITCs than there are for open-ended funds, particularly the cost of listing such as producing an FCA approved prospectus.
- They highlighted that the Key Information Document (KID) ITCs are required to produce under Packaged Retail Investment and Insurance Products (PRIIPs) regulations impacts on the competitiveness of ITCs compared to UCITS, which instead produce UCITS Key Investor Information Documents (KIIDs). Some also argued that the PRIIPs KID requirements are not aligned with the structure of ITCs and therefore result in misleading documents.
- Several suggested that there is a lack of knowledge and education in this area, particularly among independent financial advisers. This seems to arise from the perception that ITCs are more complex and riskier products relative to open-ended funds, such as through their use of gearing and that their share prices are subject to a discount/premium dynamic because they are listed on a public market.

- Some noted that a barrier for managers wanting to use ITCs is the critical mass of investors that is required for the fund to be launched. This can be exacerbated by the fact that ITCs are not widely used outside of the UK.

2.133 Other respondents raised issues with some of the ongoing requirements for an ITC to maintain HMRC's approval of the vehicle. Respondents raised issues with the close company test to add more flexibility to the regime, for example, by introducing a look through for institutional investors. Respondents also suggested the £30,000 de minimis threshold for income distribution be increased and reviewed annually to minimise administrative burdens. Finally, one respondent suggested that the minor breach rules should apply to the ITC eligibility conditions, for example, the requirement to be admitted to trading on a regulated market.

2.134 Meanwhile, some responses considered barriers from the perspective of the investor. This includes the level of investor understanding around how ITCs operate. Similarly to the barriers facing managers, it was suggested that investors perceive ITCs as more complex and riskier investments than funds given share price discount/premium dynamics and the use of gearing strategies. Respondents also suggested that a lack of promotion by independent financial advisers – possibly due to the reasons noted at paragraph 2.132 above – and limited availability on investment platforms served as barriers to investor access to investment trusts.

2.135 Responses around the possibility of asset managers having to justify their use of either closed-ended or open-ended structures were mixed. Some were in favour, highlighting that it would require considered evaluation by senior management and directors at management firms, and increase transparency. Others were against, on the grounds that robust internal scrutiny of the appropriate fund structure is already carried out as part of the product design and liquidity risk management process. One respondent suggested that existing regulations already effectively require firms to justify their choice of fund structure. Some against this idea also argued that introducing additional burdens in this respect would run counter to the UK funds regime review's focus on enhancing the attractiveness of the regime.

Government response and next steps

2.136 The government is clear that ITCs are an important part of the UK's fund offering and recognises the fact that the UK is a world-leader in this area, with over £270 billion assets under management in investment companies overall in the UK (Nov 2021)[6].

2.137 Respondents were clear that the burdens faced by ITCs – notably the regimes they operate under for issuing prospectuses and KIDs – are barriers to the use of investment companies compared to open-ended investment products such as OEICs. The government recently consulted on proposals to make the UK's prospectus regime simpler, more agile and more effective. That consultation proposed giving the FCA responsibility for making detailed rules in this area, including on when a prospectus is required and the content of a prospectus. The FCA has confirmed that it stands ready to develop and

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[6] See Association of Investment Companies, here. The AIC's membership includes ITCs, REITs, and venture capital trusts.

consult on further rules to underpin any changes to the existing prospectus regime to better align documentation requirements with the type of transaction being undertaken. The government has also committed to conducting a wholesale review of the disclosure regime for UK retail investors, and will consider respondents' feedback on the PRIIPs KID as it does so.

2.138 The government is committed to ensuring that consumers can access high-quality, affordable and suitable financial advice, as well as free-to-access guidance, when they need it. The government and the FCA note some respondents' concerns that financial advisers and investment platforms may not sufficiently promote or offer ITCs. In its 2020 evaluation of the 2016 Financial Advice Market Review the FCA found that although there have been improvements in the UK's financial advice market, some policy challenges remain. Since last year's FAMR evaluation, the FCA have published their 2021/22 business plan and their consumer investment strategy to set out their priorities in this area. HMT and the FCA are continuing to work closely to address the remaining policy challenges in the financial advice market.

2.139 The government is committed to ensuring that the tax rules for ITCs remain competitive and so welcomes engagement with, and additional representations from, industry to further understand the difficulties raised related to the ongoing requirements to maintain HMRC approval as an ITC. Any such discussions could cover the specific issues raised above.

2.140 The government and FCA have considered whether there is merit in requiring firms to justify the use of closed-ended or open-ended fund structures. In practice, any such requirement would need to be embedded in FCA rules. While existing FCA product governance rules do not require a specific consideration of this topic, the government acknowledges respondents' feedback that considering whether to employ a closed- or open-ended form is already part of the product governance decisions made by asset managers. Moreover, the FCA is currently consulting on the introduction of a new Consumer Duty. This would strengthen and enhance the responsibility of firms to meet retail consumers' needs when designing products, which may influence the form of fund that firms decide to utilise.

2.141 Given that the government and FCA are already pursing policies that address the key points raised by respondents – such as prospectus reforms, addressing challenges in the financial advice market and emphasising the needs of retail consumers – the government and FCA do not plan to take forward additional policy measures at this time. However, the government has shared the feedback on this issue with the FCA where appropriate and welcomes any further representations from industry relating to ITCs.

Distribution of capital

2.142 Reflecting prior representations from stakeholders, the call for input considered the case for permitting authorised funds to pay distributions out of capital.

Question 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?

Question 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 changed, and the effect of the changes.

2.143 A significant number of respondents supported the principle of authorised funds being able to distribute sums out of capital. It was noted that a change of policy in this space could provide additional flexibility versus the status quo, which would be welcomed. Specifically, it was suggested that this would allow fund managers to develop new products that offer investors a long-term, sustainable, and predictable level of income. Investors would be able to receive a regular payment from the income generated by the fund. Those payments could be supplemented by the fund's underlying capital in the event of a shortfall in the fund's target income during lower-yielding market conditions, and the fund would be able to reinvest its gains when market conditions are good. This product would promise a regular level of income, similar to an annuity, and would likely be popular for wealth management, pension and retirement solutions.

2.144 Nevertheless, respondents cautioned that, if such a reform were to go ahead, well-considered safeguards would need to be put in place to protect against excessive capital drawdown. It was highlighted that there would need to be a strong emphasis on disclosure, with some respondents suggesting that fund documentation should be explicit about this practice.

2.145 In terms of implementation, respondents pointed to specific sections of the FCA's Collective Investment Schemes sourcebook (COLL) that they considered would need to be amended to allow distributions out of capital to be permitted. The pre-existing mechanism that allows this practice in respect of Charity Authorised Investment Funds was referenced as a viable precedent. Tax issues would also need to be worked through in order to accurately reflect that distributions could be part income, part capital.

Government response and next steps

2.146 The government supports the development of a wider range of investment products better suited to investors' needs and will explore further how the distribution of capital from authorised funds could be permitted. This will require a co-ordinated approach between HMT, HMRC and the FCA, so the government will establish a cross-agency working group to progress the proposal.

2.147 The working group will consider options for future consultation, ensuring that these offer sufficient consumer protection and apply an appropriate tax treatment to the distribution of capital.

Long-Term Asset Fund

2.148 From May to June 2021, the FCA consulted on new rules to allow for the introduction of the Long-Term Asset Fund structure (LTAF)[7]. The LTAF rules came into force in November 2021[8]. These rules outlined that the LTAF could be distributed to professional investors, high net worth individuals and sophisticated retail investors. The FCA plan to consult in 2022 on potentially changing the restrictions on the promotion of LTAFs to allow distribution to a broader range of retail investors. Prior to the FCA's consultation on the LTAF rules, the call for input considered the tax implications of this new fund vehicle.

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

Question 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.

2.149 Some respondents noted that it was not possible to offer comprehensive views on the tax treatment of the LTAF until further detail was available on the regulatory rules, although respondents thought that the existing rules for Co-ownership Authorised Contractual Schemes (CoACS) were likely to be sufficient for an LTAF CoACS. Respondents also noted that LTAFs were likely to be multi-asset funds and so the issues raised generally for authorised funds in questions 4 and 5 were likely to be relevant for the LTAF. Furthermore, respondents thought that consideration should be given to the taxation of an LTAF that holds real estate.

2.150 A number of responses also made a link between the LTAF and wider tax policy issues. These included comments on the work on the hybrid rules and asset holding companies being conducted as part of this review. While not essential, it was felt that the UK QAHC regime could be complementary.

Government response and next steps

2.151 Since the call for input period, both during and following the FCA's consultation, the government has been engaging further with stakeholders on this issue. Currently, an LTAF comes within scope of the existing tax rules for authorised funds. This is subject to an amendment to the Authorised Investment Funds (Tax) Regulations 2006 (SI 2006/964) made through a statutory instrument laid on 16 November 2021, which requires an LTAF that is an open-ended investment company (OEIC) or authorised unit trust (AUT) to meet the GDO condition for it to be subject to the tax rules generally applicable for OEICs and AUTs. The GDO condition ensures that the fund is widely marketed – and cannot be set up to give a limited number of investors a beneficial tax treatment. If the GDO condition is not met, then it can be treated as met where either the LTAF published its prospectus on or

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[7] CP21/12 - A new authorised fund regime for investing in long term assets.

[8] PS21/14 - A new authorised fund regime for investing in long term assets.

before 9 December 2021, or 70% of the units or shares in the LTAF are held by specified institutional investors.

2.152 Further engagement has suggested that additional tax changes may be needed to accommodate an LTAF OEIC or AUT. For example, it has been suggested that the government should consider reviewing, for the purpose of an LTAF, the income distribution requirement that applies to all authorised funds, given the investment strategies that an LTAF will pursue.

2.153 Following the call for input, and now that the regulatory detail is available to industry, the government is continuing to explore any further changes to the way that LTAFs are taxed, and will conduct further discussions with funds industry representatives. Additionally, the government would invite any further representations on possible tax changes to accommodate the introduction of the LTAF.

2.154 The government believes that the LTAF has the potential to help foster a long-term investment culture and thereby deliver good outcomes for investors, aid the economic recovery, and support the government's wider productive finance agenda. The success of the LTAF will be supported by the work of the Productive Finance Working Group, whose recommendations were published in September 2021, with implementation ongoing[9].

New unauthorised fund structures

2.155 Prior to the launch of the call for input, the asset management sector made representations to the government pointing out that there is a gap in the range of unauthorised fund structures offered by the UK. Stakeholders argued that there is demand for flexible, tax-efficient, unauthorised fund structures that can invest in alternative asset classes and are aimed only at professional investors, and that these funds cannot currently be set up in the UK.

2.156 In particular, industry stakeholders made representations to the government to create three fund structures that are available in the following legal forms but subject to the same regulatory treatment:

- **Unauthorised limited partnership** structures that can be open- or closed-ended, and listed or non-listed;
- **Unauthorised corporate** structures that can be open- or closed-ended, and listed or non-listed; and
- **Unauthorised contractual schemes** that are closed-ended and non-listed.

2.157 These structures were proposed as being marketable only to professional investors, and it was therefore suggested that they be unconstrained in terms of eligible asset classes and investment strategies. Stakeholders' original representations argued that the flexibility of structure, legal form, listing status and liquidity profile would make the UK funds regime more competitive by allowing managers greater freedom to tailor their investment products to their investors' demands.

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9 https://www.bankofengland.co.uk/report/2021/a-roadmap-for-increasing-productive-finance-investment.

Question 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.

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

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

Question 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 avoids confusion with the regulatory assurances of fully-authorised structures?

Question 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?

Question 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.

2.158 Respondents noted that creating the unauthorised fund structures listed above would add value to the UK funds regime by enabling the UK to offer a full suite of onshore structures for managers to choose from. This would increase the UK's attractiveness as a fund domicile because managers wanting to launch certain investment products currently have no choice but to domicile them offshore because the UK lacks a suitable vehicle. It was also noted that:

- These structures add value alongside one another by ensuring that managers have flexibility over the legal form for their unauthorised fund.
- There are additional legal, tax and regulatory costs associated with domiciling a fund overseas – especially for small and medium-sized investment managers – that can be avoided if the fund could be domiciled in the UK.
- Of the three proposed unauthorised fund structures the unauthorised contractual scheme was the highest priority.

2.159 Some respondents believed that these unauthorised structures would support the government's work on facilitating investment in long-term and productive assets. For example, respondents outlined that such structures could appeal to the professional investors (including some DC pension schemes) that prefer to invest through unauthorised structures given the level of flexibility this provides. They suggested the proposed structures could act in conjunction with the LTAF which appeals to those professional investors who prefer to invest through authorised vehicles.

2.160 Respondents noted that successful branding of the proposed unauthorised fund structures would require a consistent approach to each vehicle that makes clear: (i) that the fund is aimed at professional investors; and (ii) that each of the three different legal structures are subject to the same regulatory treatment. Respondents also suggested avoiding the terms 'unauthorised' and 'unregulated' in the promotion of such funds; they suggested this risks confusion – particularly among international investors – by obscuring the fact that both the fund managers and depositaries are regulated by the FCA under AIFMD. Several respondents argued that industry, regulators, and government should build on their existing, combined work to ensure that the UK funds regime is promoted effectively.

2.161 Most respondents believed that these proposed fund structures should not be regulated beyond AIFMD. They noted that any fund-level regulation for structures aimed at professional investors would be unnecessary and incur additional costs. Many respondents noted that – as AIFs – these fund structures would be managed by FCA-regulated AIFMs and subject to the requirements of AIFMD and would therefore be subject to an appropriate degree of oversight.

2.162 Some respondents noted that the new fund structures could be subject to 'light-touch' regulation (see also related comments in Speed to market, paragraphs 2.99 and 2.100). Some of these respondents suggested that this 'light touch' regulation would require the fund to be registered with the FCA, but not fully authorised. Other respondents, however, suggested that the notion of being 'lightly regulated' would be confusing to investors.

2.163 Respondents strongly supported new fund structures having flexibility in terms of both whether they are established as closed-ended, open-ended or hybrid structures, and whether they are listed or unlisted.

2.164 Respondents generally thought that these new unauthorised fund structures could be implemented through amendments to the existing structures set out in legislation, rather than the creation of an entirely new legislative regime. Some respondents highlighted that the UK's existing limited partnership regime is already internationally recognised and well used, although they and others pointed to several areas where that regime could be improved (see also Limited partnership funds, paragraphs 2.72 to 2.80).

Question 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.

Question 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?

2.165 Respondents made several general points about the tax regime for new fund structures. In particular they highlighted that a new tax regime for unauthorised fund vehicles should be simple and stable, should offer equivalent investor benefits to those offered by overseas alternative funds and that it was important to have a competitive VAT regime.

2.166 For a new unauthorised contractual scheme, it was suggested that the tax rules should be similar to those applying to Co-Ownership Authorised Contractual Schemes (CoACS). For example, respondents have suggested that:

- The vehicle should not be a legal person or be directly within the charge to tax;
- Income should arise directly to investors and retain its character – that is, the fund should be tax-transparent like a CoACS;
- An investor should be chargeable on gains on disposal of their units in the contractual scheme, not when the fund disposes of assets, similar to the position for CoACS. Also, as is currently the case for CoACS, non-resident investors will be subject to the Non-Resident Chargeable Gains rules if the fund is UK property rich;
- Tax filing and reporting rules for providing information to investors and HMRC should apply, as with CoACS;
- The unauthorised contractual scheme should be excluded from the definition of a company;
- An investment held in the long-term fund of an insurance company should be subject to similar rules to holdings in other collective investment schemes, i.e. they will have an annual deemed disposal of units in the fund; and
- The unauthorised contractual scheme should have simplified capital allowance rules, similar to those for CoACS.

2.167 Responses said that transaction taxes, such as Stamp Duty or Stamp Duty Reserve Tax should not apply on a transfer of units. Many responses called for the fund to be treated like a CoACS for SDLT purposes so that no charge applies upon transfers taking place at the unit level. Some responses suggested that a seeding relief for SDLT would be desirable but differed on whether relief should be given just for the conversion of existing funds or whether it should also include the transfer of property from new investors into the fund. Respondents also said consideration should be given to withholding taxes, inheritance tax and the application of a GDO condition.

2.168 Some respondents commented on tax rules relating to a new unauthorised partnership vehicle. Most respondents raised similar points to those raised in response to question 11 of the call for input, such as a simplified reporting regime for investment partnerships (see Limited partnership funds, paragraphs 2.78 to 2.80).

2.169 Respondents also commented on the taxation of a new unauthorised corporate vehicle. For example, respondents suggest that:

- The vehicle should be tax-exempt on all income and gains;

- The tax exemption could be optional to allow certain funds to access treaty benefits;
- UK investors' taxable position could be determined through a reporting regime, similar to UK investors in offshore funds. It was also suggested that tax reporting for the fund be kept to a minimum;
- A 'look through' should be considered for institutional investors when applying the GDO condition;
- There should be an exemption from Stamp Duty and Stamp Duty Reserve Tax on a transfer of shares in an unauthorised corporate vehicle;
- A new unauthorised corporate vehicle should be able to make capital distributions; and
- A VAT zero-rate on fund management fees would be important for the success of this vehicle.

Government response and next steps

2.170 In responses to the call for input and in subsequent industry engagement, stakeholders have argued that – in light of the decision not to apply a VAT zero-rate to all fund management fees – unauthorised limited partnership and unauthorised corporate structures are unlikely to be commercially attractive. The government will therefore not proceed with these proposals in the short term. The government will consider the case for these vehicles again following the forthcoming consultation on VAT.

2.171 Conversely, industry stakeholders have argued that the case for an unauthorised contractual scheme that invests in real estate is commercially attractive within the existing VAT framework. The responses to the call for input are persuasive that an unauthorised contractual scheme would strengthen the UK's fund offering. It has the potential to lower the barriers for SME asset managers to launch new products, to increase the number of unauthorised closed-ended investment vehicles domiciled in the UK and to support the government's work to promote investment in longer-term, less liquid assets. The government is also conscious that professional investors have – both in their responses to the call for input and previously – highlighted the value of the option for an onshore structure. The government will therefore conduct further work to explore options to include unauthorised contractual schemes in the UK's funds offering.

2.172 To ensure that there is consistent branding for the proposed new fund range, the government recognises that reference to the 'UK' and 'Professional' would provide clarity on the fund offering. The government also recognises and accepts the importance of working with industry to ensure that the UK funds regime is promoted effectively. The government is already working closely with the Investment Association and City of London Corporation on the Global Investment Futures campaign to promote the UK's fund offering abroad and looks forward to continuing this collaboration with industry.

2.173 The government and the FCA do not believe there is currently a good case for introducing a new 'light touch' form of authorisation for new unauthorised fund structures (see Speed to market, paragraph 2.105). Several respondents were clear that any form of authorisation for unauthorised fund structures is inappropriate because it would add additional and unnecessary costs that drag on investor returns (see also related comments in Fund authorisation, paragraph 2.91). Moreover, it is not clear how compatible this concept would be with the benefits of fund authorisation set out by respondents (see Fund authorisation, paragraphs 2.90 to 2.92) and the government believes that a 'lightly authorised' approach would create confusion for investors over what protection is offered by a fund's authorised status. While the government acknowledges that a 'lightly authorised' status might enable products to be marketed in other jurisdictions (see Fund authorisation, paragraph 2.92) and could appeal to some types of professional investor, the government and FCA do not believe that the likely benefit would outweigh the potential costs. These costs include the creation of uncertainty around the benefits associated with fund authorisation and the potential to expose investors to risks of which they may not be aware. The responses to the call for input did not suggest widespread support for this approach, and there would be significant further work to determine its viability. The government and FCA do not therefore currently intend to progress this proposal, although both welcome further industry representations on the matter.

2.174 It is expected that the tax rules for a new unauthorised contractual scheme would largely replicate the tax rules for CoACS. However, the government would need to consider how best to take this forward.

Other proposals

2.175 The government was clear at the outset of the call for input that this was a wide-ranging exercise, covering tax and relevant areas of regulation. While the call for input asked questions about specific ideas or areas of the UK funds regime, the government was keen to invite comment on other points too.

Question 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?

2.176 A number of responses considered the government's ongoing work on the VAT treatment of fund management fees (see VAT, paragraphs 2.2 and 2.3).

2.177 Some respondents also suggested that a review of the 'investment transactions list' (Investment Transactions (Tax) Regulations 2014) may be needed to widen the list of permitted transactions in line with changing market trends to keep UK funds competitive.

2.178 There were proposals to simplify the UK fund regime by introducing a single rule book for funds. While there was no consensus view on how this might operate in practice, respondents noted that there was scope for the government to streamline both the regulatory framework and the tax code, such that industry did not have to navigate a number of different regimes. It was suggested that this would make selling UK-based funds into overseas markets easier, as managers would find the system more straightforward to explain to boards and investors.

2.179 While changes to AIFMD- and UCITS-related legislation were out of scope of the call for input, a number of responses nevertheless made the case for revisiting this. It was felt by some that the government should begin the process of assessing whether any retained EU law ought to be reviewed. Examples given included the threshold for a small alternative investment fund manager (AIFM), and whether LP Funds and publicly listed ITCs should be within scope of the legislation.

2.180 Although the call for input highlighted that work to deliver net zero and support green and sustainable finance is being taken forward separately, a series of respondents highlighted the growing importance of ESG (environmental, social and governance) investment across the industry. It was suggested that the UK should promote and support internationally harmonised ESG and disclosure standards, that the government should combat the risk of 'greenwash', and that the government might consider putting in place incentives, such as a preferential tax regime, for ESG funds.

2.181 Finally, a few responses focused on digitalisation as another relevant industry trend. Comments here varied but included: suggestions that the government could take steps to foster speedier development of technological capabilities within fund administration; the need to encourage funds to invest in companies that were themselves harnessing worthwhile digital innovations; and the continued importance of the modernisation of the tax system, including in relation to stamp taxes and, more broadly, Making Tax Digital.

Government response and next steps

2.182 The government welcomes respondents' views on additional proposals that could enhance the UK's funds regime. Where applicable, the government will incorporate these suggestions into its ongoing work on the UK funds regime review. Where feedback relates to an area of FCA competence, the government has shared the appropriate feedback with the FCA to consider further.

2.183 Although some areas – notably VAT, AIFMD-related and UCITS-related legislation, and ESG considerations – are out of scope of this call for input, the government notes the points that respondents have raised in relation to these areas.

2.184 Delivering net zero and supporting green and sustainable finance are key priorities for the government. These priorities are being progressed through other workstreams but the feedback provided by respondents will help inform how the outputs of UK funds regime review can support these ambitions. The Chancellor of the Exchequer announced at COP26 that the UK will be the world's first net zero-aligned financial centre. This means UK financial institutions having robust firm-level transition plans, and strong government oversight of the financial sector as a whole to ensure that financial flows shift towards net zero. The government set out further detail on its green finance agenda, including incoming Sustainability Disclosure

Requirements, in the October 2021 publication "Greening Finance: A Roadmap to Sustainable Investing".

2.185 In addition to transitioning to net zero themselves, the UK's asset management firms have a crucial role to play in the transition of the wider economy. The UK funds regime review will help to facilitate this transition by improving the routes through which UK funds and capital can be committed into long-term investments in the companies, technology and infrastructure which support and will prosper from the transition.

Chapter 3

An enhanced UK funds regime: conclusions and next steps

3.1 The government is keen to take full advantage of the opportunities that respondents have identified. However, as set out above and in the call for input, it is not possible for government to take forward all proposals immediately. The responses to the call for input have been valuable in allowing the government to identify those that should be prioritised, based on their likely impact on the government's objectives for the UK funds regime as well as considerations about Exchequer cost.

3.2 The government, and the FCA where applicable, therefore propose to take forward:

- A review of the genuine diversity of ownership (GDO) condition;
- Further consideration of options to improve the tax efficiency of UK authorised funds, and in particular multi-asset funds;
- A workstream focusing on further reforms to Real Estate Investment Trusts (REITs), which will also consider the interaction of REITs with the new AHC regime;
- Further engagement with industry to explore what authorised fund managers would find helpful in terms of additional information regarding the application process. Please e-mail: ukcis@fca.org.uk providing further details;
- An HM Treasury, HMRC and FCA working group to progress work on permitting the distribution of capital by authorised funds;
- Promotion of the UK's fund offering abroad, including working with industry on further opportunities where possible; and
- Further work to explore options for the introduction of a new unauthorised contractual scheme fund structure.

3.3 In addition to these workstreams, the government, and the FCA where applicable, will also be working to enhance the UK funds regime through:

- A consultation on options to simplify the VAT treatment of fund management fees; and
- Ongoing work to facilitate the rollout of the LTAF, including: the continued work of the Productive Finance Working Group; a planned FCA consultation on potentially changing the restrictions on the promotion of LTAFs to allow distribution to a broader range of retail investors; and

continued assessment of the case for any further changes to the way LTAFs are taxed.

3.4 The government welcomes further representations and engagement from stakeholders on the proposals that are not being taken forward in the short-term, and on broader issues or new ideas that affect the UK funds regime. If respondents or other stakeholders wish to contact the UK funds regime review team, they may continue to do so at: ukfundsreview@hmtreasury.gov.uk.

Annex A

List of respondents

The government is grateful for the contributions of those who responded to the call for input, who have been listed below:

- Aberdeen Standard Investment (now abrdn)
- Addleshaw Goddard LLP
- Association of British Insurers (ABI)
- Association of Investment Companies (AIC)
- Alternative Investment Management Association (AIMA)
- AJ Bell
- Alvarez & Marsal LLP
- Apex Group
- Association of Real Estate Funds (AREF)
- Aviva
- Baillie Gifford
- BDO LLP
- BlackRock
- BNY Mellon
- Border to Coast
- British Property Federation (BPF)
- Brian Shearing and Partners Limited
- Brunel Pension Partnership Ltd
- Bryan Cave Leighton Paisner LLP
- British Private Equity and Venture Capital Association (BVCA)
- Confederation of British Industry (CBI)
- CFA Society United Kingdom
- Commercial Real Estate Finance Council
- Depositary And Trustee Association (DATA)

- Deborah Lloyd Consulting Limited
- Deloitte UK
- DTZ Investors
- Elite Commercial REIT
- EY
- Financial Service Consumer Panel
- Grant Thornton UK LLP
- Great Portland Estates plc
- Hargreaves Lansdown
- Hearthstone Investments Limited
- Herbert Smith Freehills LLP
- Hogan Lovells International LLP
- HSBC
- Inflection Real Estate
- European Association for Investors in Non-Listed Real Estate Vehicles (INREV)
- Insight Investment
- Investment Association (IA)
- Invesco Ltd
- Investment Property Forum (IPF)
- IPSX UK Limited
- Jersey Finance Ltd
- John Forbes Consulting LLP
- John Raisin Financial Services Limited
- Jones Lang LaSalle
- KPMG LLP
- Legal & General Investment Management
- The Law Society
- Local Pensions Partnership Investments Ltd (LPPI)
- Listed Private Capital (LPeC)
- London Stock Exchange Group (LSEG)
- Marshall Wace LLP

- M&G Plc
- Macfarlanes LLP
- Maitland Institutional Services Ltd
- Melville Rodrigues Consulting LLP
- NatWest Trustee and Depositary Services
- Newcore Capital Management LLP
- Northern Trust
- Osborne Clarke LLP
- PricewaterhouseCoopers LLP (PwC)
- Royal Institution of Chartered Surveyors (RICS)
- RSM UK
- Sanne Group
- Schroders
- Simmons & Simmons
- SS&C
- State Street Corporation
- Thesis Asset Management Limited
- Thompson Taraz LLP
- The Investing and Saving Alliance (TISA)
- Travers Smith LLP
- Vanguard
- Vauban Technologies Limited
- Venture Capital Trust Association (VCTA)

HM Treasury contacts

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