Investment Property Forum

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Response to HM Treasury's review of the UK funds regime: A call for input

The Investment Property Forum (IPF) welcomes the opportunity to respond to the above consultation.

IPF is a national membership organisation of senior professionals, all active in the property investment and finance market. The organisation has a diverse membership of around 2,000, which includes fund managers, investment agents, accountants, bankers, lawyers, researchers, academics, actuaries and other related professionals.

The IPF's Mission is to enhance the understanding and efficiency of property as an investment, including public, private, debt, equity and derivatives, for its members and other interested parties, including government. The IPF's scope covers direct and indirect routes to investing in property. With regards to the latter, we have an Indirect Property Interest Group that covers issues relating to both the listed and unlisted property sector.

We are not a lobby organisation but one of our key priorities is to identify where legislation or regulation has, or will have, an impact on the market and to alert government and our members to any adverse or beneficial issues.

General observations

The Call for Input sets out several specific tax and regulatory reforms for the UK funds regime and in chapter 4, opportunities for wider reform on issues which cut across the tax and regulatory elements of the UK funds regime, and on aspects of the wider environment. In chapter 3, paragraph 3.6, the Call for Input notes that it will take account of recent and ongoing work by regulators on investment in illiquid assets. This broader review set out in chapters 3 and 4 appears to us to be crucial. The overall objective of reform must be to make available a coherent range of funds for investment in illiquid assets, significant development of the overall investment architecture, in particular increased flexibility in investment platforms and incremental improvements to the UK tax and regulatory regime for funds.

We are concerned that the cumulative impact of regulatory changes is making investment in illiquid assets more cumbersome and costly relative to investment in other asset classes. Despite the long-term benefits for both investors and the broader economy, the deterrent to investing in illiquid assets is becoming significant. Investors are concluding that it is not worth the administrative headache. As discussed further below, we also believe that proposed changes to the fund regimes, under both this and other recent consultations, are highly contingent on changes to the UK investment architecture, particularly the current operational limitations of investment platforms. We understand that this will be a key focus of the recently established Productive Finance Working Group and its associated technical expert group (TEG). We cannot emphasise enough the importance of this.

The ongoing projects referred to in paragraph 3.6 is particularly important. The continuing uncertainty regarding the outcome of the work set out in respect of 'liquidity mismatch' in open-ended funds noted in bullet points 3 and 5 along with the open HMRC consultation on the arrangements for ISAs is causing retail investors to redeem their investments in open-ended property funds.

The IPF publishes "Understanding UK Commercial Property Investments - A Guide for Financial Advisers". It is intended to provide an objective overview of the attributes of UK commercial property as a mainstream asset class and an outline of the commonly available product structures through which retail investors can access the market, should direct property purchase not be the appropriate route. In our response to FCA consultation CP20/15: Liquidity mismatch in authorised open-ended property funds, based on our work for our Guide for Financial Advisers, we highlighted the importance of platform architecture and its ability to accommodate liquidity mechanisms such as deferrals and notice periods. There has been huge increase in investment by clients of independent financial advisers (IFAs) via model portfolios since the Retail Distribution Review (RDR) came into effect on 1st January 2013. In addition to increasing the relevance of the platform architecture, it increases the interdependency of six areas identified in the FCA consultation.

In respect of stocks and shares ISAs, we responded to the consultation published by HMRC that ran until 13h December 2020. Removing the ability of ISAs to make new investments in property funds would be detrimental and remove an important benefit for retail investors. It is difficult to see why this would be regarded as a good idea.

In our responses to these, we strongly suggested that a 'one-size-fits-all' approach will not be appropriate and that liquidity mechanisms in funds for retail investors need to reflect:

- The different routes that retail investors use to invest; and
- The broadening range of types of immovable property that comprise the underlying investments.

In May 2018, the IPF published, "Real Estate Investment in UK Defined Contribution Pension Schemes". This major report looked at the state of property investment in UK defined contribution pensions (DC) at the time and in the future.

From this work, we made two observations in our response to the FCA consultation:

- DC pension schemes are extensive investors via insurance products. This is particularly the case for the DC default fund, which accounts for the overwhelming majority of DC investment. Our report identified that one of the routes that DC schemes use to invest into property is through Non-UCITS Retail Schemes;
- We believe DC pension scheme investment models provide a good example that retail investment could follow. Our report highlights the real estate investment allocation of NEST, the Government's own vehicle for the investment of auto-enrolment DC pension contributions. NEST invests in property via two LGIM funds: The Managed Property Fund and The Global Real Estate Equity Index Fund. By combining the two it provides its liquidity requirements through the latter.

We believe that these points remain highly relevant to the matters addressed in this Call for Input. We also believe that addressing the matters raised in FCA consultation CP20/15 remain as much of a priority as the new points raised in this Call for Input.

Response to specific questions

Our comments on the specific questions are below.

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

The Call for Input sets out that the overarching objective of the review is to identify options which will make the UK a more attractive location to set up, manage and administer funds, and which will support a wider range of more efficient investments better suited to investors' needs. It also recognises the importance of allocating capital to the economy.

The UK government agenda for levelling up across the whole of the United Kingdom, to support local economic growth and employment, to regenerate our town centres and high streets and to improve local infrastructure, will require very significant private sector investment. We believe that lending to finance real estate and infrastructure investment is a key component of this, we therefore welcome the proposals set out in the Call for Input.

We would see the top three priorities as:

- The introduction of the Professional Investor Fund (PIF);
- The introduction of the Long-Term Asset Fund (LTAF); and
- Reform of the rules for Real Estate Investment Trusts (REIT)s

These are explained below:

The introduction of the PIF

The UK funds regime currently suffers from a major gap. The Authorised Contractual Scheme has proved to be popular but it is required to be open-ended and comes with a regulatory regime that is regarded as unduly burdensome by institutional investors. The PIF unauthorised contractual scheme – proposed by the Association of Real Estate Funds (AREF) - will create a new vehicle that:

- Could be used for equity and debt investment in illiquid assets in the UK or overseas. This should also be considered in the context of the LTAF proposals as they would seem to us to be strongly complementary. Funds pooled in an LTAF could be invested in different underlying PIFs managed by specialist managers with expertise in a specific type of asset or investment strategy. The attractiveness of the PIF, particularly for investment in non-UK assets would be enhanced by the proposals separately under discussion for a UK asset holding company regime.

- Would encourage the use of 'onshore' funds for investment in UK real estate and infrastructure. Currently UK investors often hold UK assets through Jersey Property Unit Trusts (JPUTs) and other 'offshore' vehicles due to the absence of a suitable onshore alternative.

- Could facilitate investment by foreign investors. For funds that are only open to tax exempt investors, the exempt unauthorised unit trust is a suitable vehicle. This is not open to most foreign investors, hence the use of offshore vehicles. With the adverse publicity attached to offshore vehicles, some UK institutions are now motivated to invest through exempt unauthorised unit trusts even if this means turning away foreign capital. This is the opposite of the government's policy objective.

The introduction of the LTAF

The LTAF, which has been developed by the Investment Association (IA), is a new fund structure allowing wider access to less liquid assets. It has been designed to be particularly accessible for DC pension schemes but should also be available for certain individual investors. The LTAF is designed to allow investments in a wide range of less liquid assets, but of particular importance is the ability to open up a broader range of options for investment in real assets (real estate and infrastructure) to qualifying investors. Defined benefit pension schemes and life insurance companies have in recent years become major long-term lenders to real estate and infrastructure, some of the larger ones directly and others through specialist funds. The LTAF can facilitate this opportunity for DC and appropriate individual investors. We believe that this is crucial for long-term investment in view of the increasing proportion of retirement capital that is held in DC schemes and individual investment arrangements. The changes introduced in the Pensions Act 2021 will accelerate this trend.

Reform of the rules for REITs

We believe that reform of the REIT regime, particularly a relaxation of the listing requirements, would encourage investment. In addition to the specific points set out in the Call for Input (covered in more detail in our response to question 8, we would advocate:

- The introduction of a seeding relief; and
- Widening the definition of eligible assets.

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?

We believe that the introduction of the UK REIT regime, the UK PAIF regime and the UK Authorised Contractual Scheme (ACS) have been successful. However, in each case the proposals when originally introduced were insufficiently ambitious or included fundamental flaws that made take-up extremely disappointing. It was only after further changes to the legislation that the vehicles have become more widely used. We believe that this is an important lesson for the matters covered by this Call for Input and the associated AHC consultation.

The specific funds treatment under the Non-Resident Capital Gains Tax (NRCGT) rules has ultimately resulted in something that is broadly workable, although again changes have been required to solve problems that were identified early in the process. The NRCGT rules as originally proposed were potentially disastrous for funds to invest in UK real estate and infrastructure. The extensive dialogue with industry organisations allowed the development of a workable regime that investment managers were able to operate whilst delivering the government's broad objectives.

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?

We are not able to comment in detail on this but believe that the IA is responding in more detail. We would, however, note that the property investment conditions for a TEF restrict its attractiveness for a multi-asset fund. A TEF can invest in a property authorised investment fund (PAIF), Real Estate Investment Trust (REIT) or in real estate mortgage debt but cannot invest in property directly or through other vehicles such as partnerships or Authorised Contractual Schemes.

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.

Paragraph 2.8 of the Call for Input sets out the problem and paragraph 2.9 the suggestions as to a solution made by the UK Funds Regime Working Group. These funds were intended to be tax efficient. The fact that they are often not in practice is a flaw rather than a design feature. As HMRC is currently raising revenue from what would appear to be a flaw, we do not see why it is necessary to consider "how a proportionate impact on HMRC could be ensured". Other organisations are better able than us to comment in more detail on this.

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

Other organisations are better able than us to comment on this.

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?

Other organisations are better able than us to comment on this.

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.

We understand that the IA is commenting in detail on this. We would make the general comment that other jurisdictions, particularly for example Luxembourg, successfully offer tax exempt funds alongside tax transparent and taxable vehicles. The introduction of a tax-exempt fund in the UK should be in addition to, rather than instead of, existing options.

Specifically for real estate investment, UK PAIFs typically operate with a feeder Authorised Unit Trust (AUT) to limit the risks of breaching the 10% corporate shareholder limit in the context of an open-ended structure. The effect of investing in such a Feeder AUT is that corporation tax is applied and then has to be reclaimed by investors using the corporate streaming rules. An exempt AUT would avoid the need for tax to be paid only to be reclaimed by investors (subject to withholding for non-UK corporates).

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?

The Call for Input notes the matters raised in the AHCs consultation to which the IPF responded. The IPF was not in a position to comment on the technical aspects of the proposals, but would make the general observation that the requirement for a REIT to be listed or traded on a recognised stock exchange adds cost for limited benefit in many cases. There has been a very significant increase in the number of UK REITs listed on The International Stock Exchange (TISE) in the Channel Islands where no free float is required. This, coupled with changes to the rules in 2012 that mean that REIT shares can be held by a small number of qualifying investors, does raise the question of what the purpose of the listing requirement is in such circumstances.

We also support a change to the excessive rights rules as these simply create a cost and administration burden as investors who would otherwise be caught fragment their ownership to avoid being caught.

In terms of the specific areas discussed in paragraph 2.16 of the Call for Input, we would comment as follows:

- We agree that following subsequent changes to legislation, the interest cover test no longer serves a useful purpose and should be removed.

- We agree the 3-year development rule should be amended or possibly be removed entirely.

- We agree that the requirement to hold three properties should be removed. The rule is in any case widely circumvented in practice as it possible is for a REIT to arrange that 3 floors within the same building, let out to different tenants, are treated as different assets to meet the requirement to hold at least 3 properties. The new IPSX exchange for listed property holding entities is specifically designed to allow the listing of a company owning a single, substantial asset. Allowing such companies to sit within the REIT regime would be a beneficial step.

- As we indicated in our response to the AHCs consultation, we are supportive of making it easier for UK REITs to invest in overseas property but are not in a position to comment in detail.

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

In addition to the specific changes to the REIT regime discussed in question 8, we believe that two further changes would be important in encouraging more widespread use of the regime:

- A seeding relief should be made available in order to make it easier for existing funds or other property owners to convert into a REIT; and

- Expanding the definition of eligible assets to include lending secured by a mortgage over property to allow the establishment of UK mortgage REITs. CREFC has shared with us the details of its proposal for a mortgage REIT, which we would support.

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.

We are not able to comment on this.

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.

We set out our comments below in three broad categories of issue.

<u>General issues for LP funds in the UK</u>

In our response to the first AHC consultation in August 2020, the IPF looked at the example of Luxembourg where there has been a significant growth in the number of managers establishing both the fund and the AHC in Luxembourg. Luxembourg has introduced new fund vehicles such as the SCS (directly comparable to the UK limited partnership) and RAIF to facilitate this.

The increasing tax and other pressures to locate the fund and AHC in the same jurisdiction creates a threat to the UK's current fund industry. An increasing number of managers are setting up funds in Luxembourg that would historically have been established in the UK.

Traditionally, many fund managers would have used a UK limited partnership investing through a Luxembourg AHC. The combined effect of limited partnerships now being available in Luxembourg with no viable AHC regime in the UK has significantly reduced the attractiveness of UK-domiciled LP Funds and PFLPs for international investment. Successful implementation of an AHC regime is the key opportunity.

<u>Specific issues for LP Funds and PFLPs</u>

The filing and administration requirements for UK LP Funds and PFLPs are perceived as more burdensome than for overseas equivalents. One area that provokes particular annoyance is HMRC's requirement that a UK limited partnership needs to file a UK tax return even if there are no UK taxable investors.

<u>Specific issues for LP Funds and PFLPs owning UK real estate</u>

In many circumstances LP Funds and PFLPs are inappropriate for holding UK real estate.

- Statement of Practice D12 sets out the situation in which a deemed gain is deemed to arise to partners when a new partner joins the partnership and cash is withdrawn. The one aspect of this that would seem to be an anomaly that could easily be addressed is where cash is withdrawn temporarily under the operation of an 'equalisation' mechanism for rebalancing partnership interests between first and subsequent closings as is normal in fund formation. We do not believe that this is an intended feature of Statement of Practice D12. For other situations where Statement of Practice D12 potentially gives rise to a charge, this can be better addressed by using a more appropriate vehicle, hence the need for a PIF.

- Stand Duty Land Tax (SDLT) is applied on transfers of interests in partnerships that hold UK land. This has become increasingly of concern to institutional investors who may wish to exit a partnership by selling their interest on the secondary market. As with situations where Statement of Practice D12 potentially gives rise to a charge, this can be better addressed by using a more appropriate vehicle, hence the need for a PIF.

LP Funds and PFLPs are often inappropriate vehicles for owning UK real estate directly. This is a key reason for the need to establish the PIF.

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?

Some investors believe the regulatory oversight of an authorised fund brings additional protections for the investor that justify the additional associated costs. Others may have particular regulatory reasons for investing in authorised funds. Equally, there are institutional investors who prefer vehicles that are not authorised as they do not want the cost and restrictions of rules that are designed to protect less sophisticated investors. We would suggest that Luxembourg is good model to follow. The Luxembourg Part II Fund and Specialised Investment Fund (SIF) are broadly comparable to the UK NURS and QIS regimes. There is a lighter touch regulatory regime in the form of the Reserved Alternative Investment Fund (RAIF) which does not require product approval but is governed by a specific legal framework. It is also possible to have a fund that is simply an Alternative Investment Fund under the AIFMD, such that only the manager is regulated. This range of options allows managers to design a fund with the level of regulatory oversight that the investors want.

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

We are not able to comment on this but understand that other trade organisations in the real estate industry are responding.

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?

We believe that other jurisdictions including Luxembourg have a fast-track process for funds for professional investors. As outlined in our response to question 12, the lighter touch RAIF regulatory regime in Luxembourg does not require product approval.

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?

We are not able to comment on this.

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?

We understand that the FCA will not accept a QIS that only owns a single asset. As with the proposals for REITs discussed in our response to question 8, we believe that investment vehicles that own a single asset are appropriate for sophisticated investors.

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

We are not able to comment on this.

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.

We are not able to comment on this.

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?

There would appear to be two different possible questions here, about new types of funds and about conversion of existing funds. We have answered both.

New types of funds

New fund structures such as the PIF and the LTAF should make the UK fund regime more attractive as a location for fund management businesses and will also help attract inward investment in real estate and infrastructure. Shortcomings in the current regulations also need to be addressed for the UK to compete with other jurisdictions of choice for investment. We have highlighted changes needed to the REIT regime in our response to question 8.

Considerable work has also been undertaken on changes to open-ended funds that will apply to existing funds in the form of a NURS. The Call for Input notes:

- the Financial Policy Committee joint review of 'liquidity mismatch' in open-ended funds, which the FCA and the Bank of England are currently undertaking. This joint work is exploring how the redemption terms of open-ended funds might better align with the liquidity of their assets in order to enhance financial stability and promote funds' ability to invest in illiquid investments, helping to increase the supply of productive finance to the economy through the business and financial cycles.

- the FCA's consultation CP20/15 "Liquidity mismatch in authorised open- ended property funds", which proposed the introduction of notice periods for daily-dealing property funds.

Conversion of existing funds

The Call for Input states that the government has been told by stakeholders that 're-domiciling' existing funds would involve moving assets from an entity in one jurisdiction to a new entity in the UK, which would be expensive for firms and could create tax liabilities for investors, meaning this may therefore be unrealistic. As a result, the government has been encouraged by stakeholders to focus on proposals which would enhance the UK's reputation as a location for the creation of entirely new funds that have not yet been set up.

We think that this would miss a significant opportunity and would undermine some of the key policy objectives of encouraging UK investment. Many real estate and infrastructure assets are currently held in offshore vehicles such as Jersey Property Unit Trusts. The creation of the PIF would allow such assets to be brough onshore, provided that there is a suitable seeding relief. One of the key lessons from the introduction of the PAIF and ACS regimes was that seeding relief was key to ensuring viable funds, by allowing a critical mass of assets to be seeded at the outset. This created funds of viable size that were then able to attract additional capital to make 'new' investments.

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?

As the Call for Input identifies, embedded business practice, industry and investor familiarity, and inertia means that established fund administration hubs will have a significant incumbent advantage over the UK funds regime, even after steps are taken to address UK barriers. Following the UK's departure from the European Union, the loss of the marketing passport for UK funds to institutional investors in the EU is also an additional obstacle. We are aware of fund managers who would have traditionally used UK funds who are setting up funds in Luxembourg specifically to benefit from the passport. We would, however, make two observations:

- As previously noted, the matters addressed in the AHC consultation in conjunction with the proposals in this Call for Input together will address some of the obstacles.

- Even if it is challenging to create funds for international investment, the proposals that we would see as the top three priorities, the introduction of the PIF, the introduction of the LTAF and reform of the rules for REITs would facilitate greater investment in UK real estate and infrastructure, which would address the other broad policy objectives set out by the government.

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?

We believe that the proposals set out as the top three priorities would be attractive to international and UK investors. We think that there would be significant benefits of the PIF in allowing UK pension funds and other institutional investors to invest in UK property through a UK vehicle rather than through a JPUT or other form of offshore fund.

As outlined in our answer to question 1, for funds that are only open to tax exempt investors, the exempt unauthorised unit trust is a suitable vehicle. This is not open to most foreign investors, hence the use of offshore vehicles. With the adverse publicity attached to offshore vehicles, some UK institutions are now motivated to invest through exempt unauthorised unit trusts even if this means turning away foreign capital. This is the opposite of the government's policy objective.

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*?*

A number of fund administrators in the UK are either based outside London or have significant offices outside London. The motivation and the skill set of staff required is the same as for back and middle office financial services staff, so location is often in the same cities.

Policy initiatives to encourage fund administration providers to locate jobs in specific UK regions are, in our view, the same as for financial services more generally.

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

As in our answer to question 21, the policy initiatives to develop expertise are, in our view, the same as for financial services more generally.

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?

We are not able to comment on this.

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?

For funds open to retail investors, the requirement to determine product design and suitability is set out in MiFID II. For funds for institutional investors, the investors will give very detailed consideration to the structure and operation of the fund. It is also important to note that this is not a binary choice between closed-ended or open-ended structures. It is far more complex than this, with funds offering a spectrum of redemption arrangements. Closed-ended funds may be fixed life funds with a relatively short, fixed life, the typical private equity real estate fund in the form of a limited partnership with a fixed life of 7 to 10 years during which assets are acquired, activity undertaken and then the assets are sold so that the capital is returned to investors. Closed-ended funds may also be notionally fixed life funds with the investors voting to continue at the end of the fixed life period, for example every five years. There are also examples of closed-ended funds that are in effect perpetual but with no redemption rights. Investors leave by selling their units. Equally open-ended funds can cover a broad range of liquidity arrangements depending on the nature of the investors and investments. At one end of the spectrum are daily traded funds. At the other end, there are funds with an initial 10-year period before redemptions are allowed with a liquidity window in which redemptions can be made every five years.

Funds may convert from closed-ended to open-ended.

Turning this into a binary question and then seeking to regulate it would seem to us to be misguided.

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?

We are not able to comment on this.

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.

We are not able to comment on this.

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?

The suitability of authorised fund vehicles for an LTAF depends on the outcome of the ongoing FCA discussions and the impending FCA consultation on key features of the LTAF regulatory regime including the types of investors that LTAF may be distributed to.

Based on an expectation that LTAF adopts the open-ended structure proposed by the IA and at the initial stage only available to DC investors, initiation feedback from members indicates that a UK Co-ownership Authorised Contractual Scheme (CoACS) may be an appropriate vehicle in the first instance. On the basis that a CoACS is effectively tax transparent, the current tax regime for such funds should be suitable for LTAFs. However, as FCA discussions progress and the nature of investor and investments is expanded, consideration would need to extend to LTAFs taking an OEIC form, and any tax changes will to a large extend be dependent on the permitted investor base. If affluent and/or retail investors are permitted in LTAF then the issue of tax leakage for balanced funds (as already identified as an issue for authorised investment funds in Chapter 2 of the Call for Input) would arise. Additionally, the overall complexity of the UK fund regime would also need to be considered in such a case if an LTAF invests across a range of assets. There would also be issues if there was a need to accommodate UK property. In this regard, member feedback suggests that Property Authorised Investment Funds do not seem to be a solution given the intended long-term nature of an LTAF, and the Government's intention to ensure that effective taxing rights for UK property are maintained. It needs to be ensured that seeding relief, which is currently available for ACS vehicles, would also continue to be available to ACS LTAFs.

As the LTAF is expected to adopt existing authorised fund structures, the UK fund management VAT exemption for management of SIFs the VAT Act 1994 Schedule 9 Group 5 Item 9 would also be available to LTAF set up as existing UK authorised funds.

It is generally anticipated that an LTAF fund vehicle would use underlying holding structures to suit its investment strategies. The current HMT review of Asset Holding Companies (UK AHC review) in Alternative Fund Structures is a helpful step in offering UK holding structures as a potential choice as holding vehicles for LTAFs. The set-up of an LTAF is, however, not dependent on the AHC review and it is anticipated that an LTAF would use non-UK holding structures to hold investments. It is also generally expected that access to tax treaties will be more relevant and possibly managed more often at the level of the underlying fund structure, rather than the LTAF. In any case, where required, treaty access may be available to an LTAF depending on the legal form that it chooses, as is currently the case for UK authorised funds.

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

We are not able to comment on this.

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.

We believe that the various unauthorised funds fulfil different functions. We therefore support the corporate vehicle and limited partnership OPF structures proposed by the IA and AIMA, although as indicated in our response to question 1, we see the PIF as the highest priority.

We support the PIF unauthorised contractual scheme proposed by AREF, a proposal which:

- Is modelled (in terms of legislation and regulation) on the ACS legislation, and duly revised to reflect that the PIF will not be permitted to operate as an authorised fund. The PIF would be a closed-ended or hybrid fund. A PIF will be formed by a contract initially made between the PIF operator (also responsible as the PIF AIFM) and, as applicable, the PIF depositary to which the participants (PIF investors) become parties. The assets of the PIF will be held as legal owner by the PIF operator or PIF depositary, as applicable, on behalf of the participants who are jointly the beneficial owners of the scheme assets which they hold as tenants in common (or in Scotland as common property). The PIF operator must make decisions on behalf of the participants about the acquisition, management and disposal of assets subject to the scheme as permitted by the scheme deed and those decisions will be binding on participants.

- Is limited to a similar category of investors who are permitted to invest in a QIS ACS. Direct investment in a PIF should be limited to investors who invest a minimum of £1 million and are professional investors. Other investors should only be able to access a PIF through feeder funds that satisfy the professional investor status.

- Is an Alternative Investment Fund (AIF), in respect of the Alternative Investment Fund Managers (Amendment etc.) (EU Exit) Regulations 2019 (SI 2019/328) (UK AIFMD), managed by a full scope Alternative Investment Fund Manager (AIFM), and has a depositary. We envisage the PIF operator being required to act as the PIF AIFM.

- Constitutes an unregulated collective investment scheme (UCIS) for UK regulatory purposes, and accordingly would be marketed under the UCIS regime.

- Is established and operated via a registration of the PIF and its investors at a registry (PIF Registry) maintained by Companies House, which we assume will operate electronically. The PIF AIFM will be required to register with the PIF Registry details about the PIF including its registered office, the PIF investors and any changes in the PIF investors. The PIF Registry will issue upon completion of the registration process a PIF certificate of registration. The PIF certificate of registration will be conclusive evidence that a PIF came into existence on the date of its registration (equivalent to s8C of the Limited Partnerships Act 1907 (as amended)). We suggest certain information in the PIF Registry (such as its registered office) is publicly available. However, other information (such as details of the PIF investors) is only available to HMRC and the FCA, respectively, for tax collection issues and addressing concerns about harms or risks.

- As set out in our response to question 1, the PIF will create a new vehicle that:
  - Could be used for equity and debt investment in illiquid assets in the UK or overseas. This should also be considered in the context of the LTAF proposals as they would seem to us to be strongly complementary. Funds pooled in an LTAF could be invested in different underlying PIFs managed by specialist managers with expertise in a specific type of asset or investment strategy. The attractiveness of the PIF, particularly for investment in non-UK assets would be enhanced by the proposals separately under discussion for a UK asset holding company regime.
  - Would encourage the use of onshore funds for investment in UK real estate and infrastructure. Currently UK investors often hold UK assets through Jersey Property Unit Trusts (JPUTs) and other offshore vehicles due to the absence of a suitable onshore alternative.
  - Could facilitate investment by foreign investors. For funds that are only open to tax exempt investors, the exempt unauthorised unit trust is a suitable vehicle. This is not open to most foreign investors, hence the use of offshore vehicles. With the adverse publicity attached to offshore vehicles some UK institutions are now motivated to invest through exempt unauthorised unit trusts even if this means turning away foreign capital. This is the opposite of the government's policy objective.

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

As set out in our response to question 1, we believe that this is very much the case.

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

We believe that the regulatory regime can be separated from the legal form, so that it would be possible to have a PIF that is a limited partnership, a PIF that is a company and a PIF that is a contractual scheme. This would be directly comparable to the Luxembourg RAIF, which can be in the form of a limited partnership (SCS), an open-ended or closed-ended investment company (SICAV or SICAF) or a co-ownership contractual scheme (FCP). Equally in the UK, the ACS is available as a partnership or co-ownership form.

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?

The Luxembourg RAIF 'light-touch' regime that provides for registration without authorisation is a suitable model but, as in Luxembourg, should be an option rather than an obligation. For funds such as the PIF marketed to professional investors, regulation of the manager under the AIFMD should be sufficient.

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?

We have set out in detail in our response to question 25 the complexity and risk of trying to set binary tests. Since these vehicles are intended for sophisticated, professional investors, we believe that managers should be given the flexibility to decide. Specifically:

- Funds could be anywhere on the spectrum of closed and open-endedness, although institutional investors generally do not want the volatility and liquidity risk associated with the most open-ended end of the spectrum where the underlying assets are illiquid.

- If investors want a fund that is listed, then managers should be able to offer this. This could encourage the development of new products, such as funds that have periodic liquidity events where redemptions take place with a listing that provides trading in the meantime.

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.

We believe that the PIF can use the existing ACS rules.

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.

AREF has shared its tax analysis with us. We do not have anything to add to AREF's comments on this.

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?

It is recognised that appropriate anti-avoidance rules should be included to prevent the use of structures such as this from being used in a way that is not intended. Such rules should recognise the need for certainty of treatment of the PIF contractual scheme and include appropriate clearance mechanisms.

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?

Other than the broad issues regarding the overall environment and investment infrastructure set out in our introductory comments, we have nothing further to add.

Please do contact me should you wish to discuss any of the above in further detail.

Sue Forster

Sue Forster
Chief Executive, Investment Property Forum