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GREAT FUND INSIGHTS

Opportunity and optimism: Review of the UK funds regime – a call for input by the UK government

Background

As part of its March 2020 Budget, the UK government announced that it would undertake a review of the UK's funds regime. Since then, the UK government has gone on to publish a series of consultations and documents, committing to significant reform of both the tax and other regulatory aspects of the current regime. The overarching purpose of the call for input consultation is to identify and implement those reforms that will make the UK a more attractive location to set up, manage and administer funds. The UK considers that there is a clear policy justification for reform in this area and intends to take advantage of its post-Brexit flexibility.

The UK government acknowledges that tax neutrality is a fundamental consideration in fund investment and that tax considerations should not distort the market. That is, investment through a fund structure should not place investors in a disadvantageous tax position, as compared to direct investment in the underlying assets; tax leakage should be minimised, subject to satisfying any anti-avoidance concerns.

Amongst the challenges identified by the UK government are the improvement of the UK's double taxation treaty network, and assessing barriers to the use of UK-domiciled Limited Partnership Funds and Private Fund Limited Partnerships. Portfolio delegation as a model of investment management is also given the stamp of approval by the UK government's commitment to supporting portfolio delegation from and to the UK as a means to promote market efficiency, investor choice and to reflect the international nature of financial markets.

For many institutional investors, re-domiciling existing funds would involve moving assets from an entity in one jurisdiction to a new entity in the UK and would be expensive or could create tax liabilities. 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.

Key proposals

The proposals contemplated (not all of which are proceeding at the same pace) include:

– A wide-ranging and holistic review of the UK investment funds regime, with a view to cementing the UK's competitive position in light of its already robust portfolio management and fund administration strengths. Stakeholders are invited to contribute their views as to prescribed reforms and their respective priorities.

– **New fund structures:**

  – Introduction of the Long-Term Asset Fund (LTAF) with a focus on necessary changes to the wider ecosystem for funds to complement a forthcoming consultation on the vehicle;

  – Array of proposals for new unauthorised fund structures, including UK vehicles for funds targeting only professional investors and investing in alternative asset classes and investment strategies;

  – Tax treatment of new fund structures, covering VAT treatment; reliefs from any other taxes; potential for tax avoidance; and interaction with any other relevant aspects of government tax policy.

– A new, bespoke tax regime for asset holding companies in alternative fund structures. The new regime will seek to ensure both tax neutrality and a streamlined structure. In drafting the detail of the legislation, it will be important to manage the tension between the desire to simplify (which will broaden its appeal) and the need to incorporate anti-avoidance principles (to avoid abuse).

– Reforms to the tax treatment of real estate investment trusts (REITs). Although the REITs regime will also form part of the wider funds review, more immediate, specific changes are anticipated. These include the relaxation of existing requirements for listing and maximum shareholding rules, extension of potential investors, as well as changes to a "balance of business" test.

– Amendments to the VAT treatment of fund management services with a further, specific consultation published later in 2021. Freedom from EU constraints may mean that the UK is now able to simplify and overcome existing rules that occasionally produce disadvantageous VAT outcomes for UK-based funds.

What next?

Although the proposals for wider reform are at a relatively early consultative stage, the timetable (which has an April 2021 deadline for input) is ambitious, and the developments have been widely welcomed by UK asset managers, fund administrators and distributors. Post-Brexit, the UK has swiftly demonstrated that it is keen to progress reform in the funds context, and to ensure that the UK remains competitive in a global context.

Allen & Overy will continue to monitor developments closely and contribute to dialogue and development with the UK government and industry representative bodies.

For further information, please contact your usual Allen & Overy contact.

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