INREV response to UK Review of the Funds Regime: Call for Input

INREV

19 April 2021

About INREV: the voice of the European non-listed real estate investment industry

INREV is the European Association for Investors in Non-Listed Real Estate Vehicles. We provide guidance, research and information related to the development and harmonisation of professional standards, reporting guidelines and corporate governance within the unlisted real estate funds industry across Europe, including the UK.

INREV currently has more than 450 members. Our member base includes institutional investors from around the globe including pension funds, insurance companies and sovereign wealth funds, as well as investment banks, fund managers, fund of funds managers and advisors representing all facets of investing into unlisted real estate vehicles in the UK and the rest of Europe. Our fund manager members manage more than 500 non-listed real estate investment funds, as well as joint ventures, club deals and separate accounts for institutional investors.

Introduction

INREV welcomes the UK Funds Review Call for Input and the opportunity it presents to make real improvements to the structures available for institutional investors to invest through UK domiciled vehicles. There are unfortunately significant gaps in the current UK funds toolbox that result in many institutional real estate investors using vehicles domiciled outside the UK that are commercially viable, simple and flexible and can be brought to market quickly. To be successful and offer real choice for institutional investors, we believe that any new fund vehicles introduced following the Funds Review need to be no less attractive than familiar fund structures already available in other jurisdictions.

We hope our comments that follow will make a constructive contribution to this important effort.

Questions

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?

We see the top three priorities as:

- The introduction of the Professional Investor Fund unauthorised contractual scheme (**PIF**);
- Continued development of the Long-Term Asset Fund (**LTAF**); and
- Reform of the rules for Real Estate Investment Trusts (**REITs**).

These are explained below:

<u>The introduction of the PIF</u>

We strongly urge the government to make the adoption of the unauthorised contractual scheme referred to in Call for Input (**CFI**) paragraph 4.22 a top priority for implementation. For ease of understanding, we will refer to the unauthorised contractual scheme in this response as the PIF.

The PIF has a significant appeal for both government and industry. A clear gap exists in the UK's fund offering for professional investors in comparison to that offered in several countries in Europe and elsewhere that have successfully attracted investors through their domestic fund structures. In particular, UK fund managers are currently forced offshore if they are looking for a **closed-ended or hybrid fund** ("closed-ended" and "hybrid" for these purposes means not required to be open-ended; the term "hybrid" should not be confused with hybrid mis-matches which could infer tax avoidance) to hold UK real estate investments in a fund that has the attributes of being unlisted, tax transparent and offering **tradable units** ("tradable units" means not inhibited by transaction tax).

The managers' onshore fund choice (with these attributes) is restricted to an open-ended authorised fund. However, an open-ended fund must comply with regulatory operational requirements that erode returns and may be inappropriate for holding illiquid assets, therefore making them less well suited to many institutional investors.

INREV data show that there appears to be a clear unmet need/preference for professional investors to invest via a UK onshore tax-transparent unlisted closed-ended or hybrid real estate vehicle. Based on INREV's Vehicles Database (Q4 2020), only 21% of the unlisted closed-ended vehicles targeting UK and European real estate launched during the last 10 years by fund managers with significant operations in the UK, are UK domiciled funds.

The PIF complements existing UK fund structures and has a particular appeal for UK real estate held through a UK domiciled fund solution which is also enhanced – from manager and professional investor reputational perspectives – by its manager being regulated by the Financial Conduct Authority (**FCA**). Other sectors can also utilise the PIF, given that it is designed to be unconstrained in terms of eligible asset classes and investment strategies. The contractual scheme structure is generally recognised for international treaty purposes. In addition, the PIF offers a speed to market solution without the need for prior regulator fund authorisation: the latter can be a constraint with launching and operating authorised funds.

The PIF will also facilitate the UK government's goals for COVID reconstruction, infrastructure revolution and "levelling-up" the nation by supporting jobs outside of London. In this respect, UK real estate and its funds sector have much to contribute. For example, in the context of attracting capital and re-invigorating town centres, supporting social and affordable housing and developing social infrastructure.

Another advantage of the PIF is its "quick-win" secondary legislative solution such as an amendment of the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (SI 2001/544) (**Regulated Activities Order**) and FCA consultation. In light of its Authorised Contractual Scheme (**ACS**) heritage, the PIF can be delivered swiftly in 2021 with no need for primary legislation.

Continued development of the LTAF

We support the continued development of the LTAF, which has been proposed by the Investment Association. We understand that the LTAF has been designed to be particularly accessible for defined contribution (**DC**) pension schemes but should also be available for certain qualified individual investors. The LTAF has been also 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.

Reform of the rules for REITs

We believe that an attractive REIT regime would result in more real estate investment by institutional investors both in the UK and elsewhere through UK domiciled vehicles, thereby fulfilling an objective of the Funds Review to encourage investment. As indicated in our response to Question 8, we would support more flexibility to the REIT regime by specifically:

- no longer being required to be listed;
- no longer being required to hold at least three properties;
- relaxation of the 10% requirement, i.e., the requirement should not apply to qualifying entities where there would be no risk of loss of UK tax;
- introduction of seeding relief; and
- widening the definition of eligible assets.

We strongly urge that the introduction of the PIF, LTAF and reform of the rules for REITs also take into account HMT/HMRC policy decisions following from responses submitted to HMT's second consultation on tax treatment of AHCs.

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?

We believe that the introduction of the UK REIT regime and the UK PAIF regime have been successful. However, in each case, when the regimes were originally introduced, they were insufficiently attractive, which limited their impact. 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.

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?

Although the question is not relevant for real estate funds, we note that the TEF compares unfavourably to equivalent fund structures available in other jurisdictions.

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.

This issue is not relevant for real estate funds.

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

This issue is not relevant for real estate funds.

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?

The issue is not relevant for real estate 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.

An exempt fund avoids the need for tax to be paid only to be reclaimed by investors (subject to withholding for non-UK corporates) and is therefore more attractive.

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?

We support more flexibility in the REIT regime, including the following features:

- no longer being required to be listed – 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, mean that REIT shares can be held by a small number of qualifying investors;
- no longer being required to hold a minimum of three properties - we do not see a valid policy reason for retaining this restriction. 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;
- relaxation of the 10% requirement, i.e., the requirement should not apply to qualifying exempt entities where there would be no risk of loss of UK tax;
- introduction of seeding relief – seeding relief should be made available in order to make it easier for existing funds or other real estate owners to convert into a REIT; and
- widening the definition of eligible assets – to at least include lending secured by a mortgage over property to allow the establishment of UK mortgage REITs.

In addition, we urge any reform of REIT regime to take into account HMT/HMRC policy decisions following from responses submitted to HMT’s second consultation on tax treatment of AHCs including:

- the interest cover test;
- the three-year development rule; and

- REITs holding overseas properties in a UK company.

As noted in our response to Question 1, we believe that an attractive unlisted REIT regime would result in more real estate investment by institutional investors both in the UK and elsewhere through UK domiciled vehicles.

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

See our response to Question 8.

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.

With effect from 1 January 2021, the EU Directives (in particular the parent-subsidiary directive (**PSD**) and the royalties and interest directive (**IRD**)) no longer apply, which means the UK based entities will have to rely on benefits available under the bilateral double tax treaties with the 27 EU Member States. In the majority of cases, there are no equivalent tax benefits available under those treaties when compared to the benefits available under the PSD and the IRD.

Concerning outflows of income, UK domestic law fully exempt dividends from withholding tax, but this exemption is not extended to interest payments which are not aligned with exemption of interest payments from withholding tax in most key European jurisdictions. Although UK withholding tax on interest payments could be managed via other means, it remains one of the key concerns for an offshore investor when providing debt funding or investing in a debt/credit fund that provides returns in the form of interest payments. Renegotiating double tax treaties with key European countries to extend the exemption of withholding tax on interest payments would be very beneficial for these investors.

We urge any reform and/or renegotiation of the treaties to take into account HMT/HMRC policy decisions following from responses submitted to HMT's second consultation on tax treatment of AHCs.

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.

The following issues act as barriers to using UK LPs in property funds; however, we note that a PIF would not face the same barriers:

- **Stamp Duty Land Tax** (**SDLT**) is applied on transfers of interests in partnerships (Property Investment Partnerships) that hold UK land. This was an anti-avoidance measure following the extensive use of Property Investment Partnerships as SDLT avoidance vehicles. While this anti-avoidance measure was not specifically intended to target genuinely widely held funds, it is applied to all transfers of interests in Property Investment Partnerships and is a significant barrier to setting up property funds in LP form.

- **Statement of Practice** (**SP D12**) results in complex capital gains tax (**CGT**) issues for partnerships whenever there is a change in membership. In particular there can be dry tax charges for the existing partners as a consequence of a deemed transfer of a share of each asset on the admission of a new partner.
- **Corporate filing and disclosure requirements** for UK (English and Scottish) investment partnerships give rise to cost and administrative burdens because a tax return is always required to be filed, whereas a foreign partnership is only required to file a return if HMRC issues a notice to a UK partner.
- **Capital/loan issue**: In a UK LP, but not a PFLP, the partners, including the limited partners, remain liable up to the value of their original capital contribution (but not loans) for partnership liabilities after they have left the partnership. This is typically dealt with by their contributing a small amount of capital and a large proportion of their contribution in the form of a loan.
- **Withholding tax:** While ITA07 s937 provides an exemption from the requirement to withhold tax on interest paid to partnerships, this only applies where every partner is itself entitled to gross payment (and not itself a partnership, even if that higher partnership is itself made up only of gross recipients).

Of the above, the issues regarding SP D12, SDLT and withholding tax apply to both UK and foreign partnerships. SP D12 also applies to overseas CIVs that have made a transparency election under UK non-resident capital gains tax rules.

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?

For funds aimed at professional investors only, the fact that a fund manager is subject to some level of regulation, for example under AIFMD, can be an attractive feature of the fund. Requiring the fund to be authorised offers no added benefit to institutional investors as sufficient comfort is derived from the fund manager being regulated.

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

We have no opinion on this issue.

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?

We understand that the Central Bank of Ireland operates a "Fast Track" authorisation process for QIFs and QIAIFs. Provided all parties have previously been authorised by the Central Bank, the fund's board and legal advisers can certify the documents and file with the Central Bank, which will authorise the fund the following day without review of the documents, its authorisation being based on the certification.

Even more efficiently, the Luxembourg RAIF does not require any pre-authorisation – it simply requires notification to the regulator. This speed to market creates a strong advantage for professional investors when launching funds. As mentioned in our response to Question 12, requiring the fund to be authorised offers no added benefit to institutional investors as sufficient comfort is derived from the fund manager being regulated.

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?

We have no opinion on this issue.

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?

We have no opinion on this issue.

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?

We have no opinion on this issue.

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.

We have no opinion on this issue.

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?

We believe that to enhance the attractiveness of the UK funds regime, the focus should be both on creating new fund structures, particularly the PIF and the LTAF, and on improving current fund structures, particularly the REIT, as we note in our response to Question 1 above, to fill the gap in the current UK fund structuring toolbox.

Question 20: Why do firms choose to locate their funds in other jurisdictions in cases where the UK's 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?

For institutional real estate investment funds, there are no comparable vehicles available in the UK, especially regarding tax treatment. This is the reason that we suggest the creation of the PIF and LTAF, alongside reforms to REITs and more attractive tax treatment of AHCs in real estate fund structures.

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?

Our members include institutional investors such as pension funds, insurers, sovereign wealth funds and family offices in Europe, North America, Asia and the Middle East. Ensuring these investors have viable choices of commercially attractive fund structures and domiciles when deciding to invest in unlisted funds is our priority. Our fund manager members market their funds to these and other investors, and we believe that UK fund managers should not be competitively disadvantaged by a lack of suitable UK fund structures or unattractive tax treatment.

We keep a comprehensive database of unlisted real estate vehicles in Europe. According to this database (Q4 2020), only 21% of the unlisted closed-ended vehicles targeting UK and European real estate launched during the last 10 years by fund managers with significant operations in the UK, are UK domiciled funds. This shows that there appears to be an unmet need for a UK onshore tax-transparent unlisted closed-ended or hybrid real estate vehicle.

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?

We have no opinion on this issue.

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

We have no opinion on this issue.

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?

We have no opinion on this issue.

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?

We believe that institutional investor preferences and needs should drive the decision whether to offer open-ended or closed-ended funds. Fund managers should not have to justify the decision and requiring them to do so offers no advantages and only slows speed to market.

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?

We have no opinion on this issue.

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.

We have no opinion on this issue.

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?

We have no opinion on this issue.

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.

We have no opinion on this issue.

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.

These questions are largely addressed in the PIF submission document of the Association of Real Estate Funds of 23 June 2020: https://www.aref.org.uk/resource/new-fund-vehicle-proposed.html.

We suggest the PIF:

1 Is modelled (in terms of legislation and regulation) on the ACS legislation, and duly revised to reflect that the PIF will not operate – nor is it permitted to operate – as an Authorised Fund, i.e., an open-ended fund. The PIF would be a closed-ended fund or a hybrid fund with flexible redemption windows.

A PIF will be formed by a contract initially made between the PIF operator (also responsible as the PIF AIFM (**PIF AIFM**) for the purposes of the Alternative Investment Fund Managers (Amendment etc.) **(EU Exit**) Regulations 2019 (SI 2019/328) (**UK AIFMD**)) and 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.

Appendix 1 to this Submission sets out an analysis of key legislative and regulatory provisions to facilitate the establishment and operation of the PIF, recognising there will be further technical points that we suggest should be covered through technical working groups.

2 Is limited to a similar category of investors who are permitted to invest in a Qualified Investor Scheme ACS. Direct investment in a PIF is limited to investors who invest a minimum of £1 million and are professional investors. Other investors can only access a PIF through feeder funds that satisfy the professional investor status.

3 Is an Alternative Investment Fund/AIF in respect UK AIFMD, managed by a full scope Alternative Investment Fund Manager, and has a depositary. We envisage the PIF operator being required to act as the PIF AIFM.

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

5 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/risks.

We highlight that the PIF adds value alongside existing authorised and unauthorised UK fund structures as it solves a significant gap in the UK fund offering. It is unfortunate that – in a scenario where the underlying real estate, asset and fund managers and pension fund/other institutional investors are all UK-located – the funds have to be established and operated outside the UK. We do not believe the PIF would bring unnecessary complexity.

As indicated in our response to Question 1, the funds being operated offshore are subject to associated operational costs. In addition, these funds have to address the challenges of multiple legal, tax and regulatory regimes including maintaining sufficient substance offshore, which can add significant cost.

The current available choices:

- Onshore: restricted to an open-ended authorised fund, requiring compliance with regulatory operational requirements that erode returns and may be inappropriate for holding illiquid assets; and
- Offshore: requiring multiple legal, tax and regulatory regimes including maintaining sufficient substance offshore.

As a result, managers incur costs that would be avoided if the PIF were available. These costs are challenges for the establishment and operation of fund, particularly in the context of low yield market conditions. In addition, they represent a barrier to entry to small and medium-sized enterprises (**SMEs**) and aspiring asset and fund managers operating in the real estate and funds sector.

Assuming the PIF legislation is implemented, the PIF would be a solution that provides managers an opportunity to operate funds more efficiently and not to be burdened by such costs. The PIF enhances the prospects for future generations of UK assets and fund managers including those operating in the real estate sector.

In addition, we expect that, adopting Section 261P of Financial Services and Markets Act 2000 (**FSMA**), the PIF legislation would facilitate a sub-fund or protected cell feature, i.e., allow for sub-funds with a legally enforceable segregation of the assets and liabilities of each sub-fund. PIF operators can then manage a large range of funds more efficiently: the sub-funds (or cells) are separately managed, charged, accounted for and assessed for tax, but do not have a separate legal personality.

This submission does not assess the relative merits of other proposals, other than commenting (from a real estate funds perspective) in the context of widening the choice of UK funds:

Unlisted REITs

CFI paragraph 2.15 refers to the government considering the relaxation of the listing requirement for REITs. We take the view that an unlisted REIT can complement an unlisted PIF contractual scheme. The key dynamic could relate to the respective exit scenarios if and when in due course each vehicle looks to attract more capital/IPO, for example, unlisted REITs could efficiently evolve/exit into a listed REIT and unlisted PIF contractual scheme could efficiently evolve/exit into an unlisted ACS.

Managers can provide their prospective investors with a choice of target IPO listed or unlisted fund solutions (when deciding between an unlisted REIT and PIF), and that choice applies within a UK onshore user-friendly tax and regulatory ecosystem.

LTAF – and its relationship with PIF

Two frequent key goals, in the context of professional investors committing into alternative/illiquid funds, are accommodating investor "hybrid" exit expectations (possibly related to "liquidity mismatch" issues); and flexibility, cost and other efficiencies in terms of the establishment and operation of funds particularly given the prospects of market low yield returns.

In the context of these goals, we suggest that the LTAF and the PIF helpfully widen the choice of UK funds, which may involve some overlap in the context of each fund structure involving equivalent investors and underlying investments. Each of these fund structures will have the opportunity to offer investors complementary "hybrid" exit solutions, respectively from:

- an authorised LTAF/open-ended base via dealing at different intervals as well as notice periods, recognising that an authorised "open-ended" fund must comply with regulatory operational requirements that erode returns. We understand that a limited two-year duration is proposed to apply to the LTAF notice period; and

- an unauthorised PIF/closed-ended and hybrid base via redemption windows, where PIF investors can look to balance the investor demand-led with the manager and underlying investment supply-led dynamics, with more flexible redemption windows and other investor exits.

The LTAF and PIF would seem to be designed to achieve similar objectives in terms of liquidity matching, but for slightly different client groups – the LTAF aims at retail investors (subject to marketing restrictions) whereas the PIF is aimed at professional investors. In terms of cost, we understand that the LTAF has been designed to significantly reduce the friction costs currently associated with retail vehicles that invest in private market assets beyond real estate, in particular removing the layer of holding structures currently required to use NURS-FAIF, etc. However, in reality any authorised vehicle for retail investors will require additional investor protections compared with the unauthorised PIF, which will reflect in costs.

We consider that both proposals have the potential to broaden the options available to UK and non-UK investors in alternative assets, and will complement rather than compete – in particular, we anticipate many LTAFs will be looking to offer broad private market exposure to their investors, and are likely to achieve exposures through investing in funds that give them exposure to specified asset classes, so the PIF, with its operational efficiencies, may be an attractive way to give LTAFs exposure to real estate as part of a broader private assets portfolio.

Unauthorised corporate fund proposal

The unauthorised corporate fund would seem to be similar to – and overlap with – an unlisted REIT. CFI paragraph 2.15 indicates that HM Treasury is also considering relaxation of the listing requirement for REITs. We suggest government considers with the proponents of the respective proposals (unauthorised corporate fund and REITs (with a relaxation of the listing requirement)) the justification for this overlap.

Unauthorised partnership/limited partnership fund proposal

The unauthorised partnership/limited partnership fund would constitute a Property Investment Partnership – and hence the Stamp Duty Land Tax would apply to transfers of units in an unauthorised 'partnership'/limited partnership: see: https://www.gov.uk/hmrc-internal-manuals/stamp-duty-land-tax-manual/sdltm34010.

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?

The PIF proposal would support the government's work on facilitating investment in long-term and productive assets, with reference to policy goals as outlined in Chapter 1[1].

We strongly advocate that DC pension schemes – including via Conduct of Business Sourcebook Rules (COBS) 21 Permitted Links – be allowed to invest in PIFs and other unauthorised funds, i.e., not restricted as at present to investments in authorised open-ended funds.

In terms of facilitating investment in long-term and productive assets:

---

[1] Also detailed in the Speech of Alex Brazier, Executive Director for Financial Stability Strategy and Risk and a member of the Financial Policy Committee, Bank of England, on 23 July 2020: https://www.bankofengland.co.uk/speech/2020/alex-brazier-keynote-dialogue-at-the-cfo-agenda; and Bank of England: August 2020 Financial Stability Report (FSR), Box 4 on productive finance: https://www.bankofengland.co.uk/report/2020/monetary-policy-report-financial-stability-report-august-2020.

The PIF is one solution that would facilitate *"*providing a source of diversification and potential for enhanced returns, and for the success of the UK economy, with capital required to fund the post-COVID recovery, modernise and upgrade infrastructure, transition to a carbon neutral economy and support innovation in private enterprise to drive productivity growth". (CFI paragraph 1.13)

We refer to the 23 July 2020 Speech of Alex Brazier, Executive Director for Financial Stability Strategy and Risk and a member of the Financial Policy Committee, Bank of England and the Bank of England: August 2020 Financial Stability Report (**FSR**), Box 4 on productive finance (see footnote 1), which suggest key goals for facilitating investment in long-term and productive assets. We comment:

(i) The PIF could be a structural solution given "Investors need the right structures and platforms to invest in longer-term illiquid assets in a way that is consistent with financial stability*".*

(ii) The PIF should be considered*…"*as closed-ended funds, may be more appropriate vehicles for investing in certain illiquid assets" (albeit the context seems to refer to listed funds) and "are therefore more able to invest in truly illiquid growth capital and additional equity or equity-like finance, particularly for unlisted companies, could support recovery and reduce liquidations in the medium term*".*

(iii) The PIF…could operate as a conduit "for more equity finance to minimise the scarring to the economy*".*

(iv) The target investors for the PIF can include "Financial institutions with longer-term liabilities – pension funds – are the natural investors in growth capital". The PIF allows such pension funds to commit as co-investors with other professional investors (whether from the UK or elsewhere) and utilise attractions of the PIF including that the PIF is tax transparent, unlisted with closed ended/hybrid exits.

(v) The PIF would operate as a closed-ended or hybrid fund: hybrid fund means closed-ended with redemption windows *"*Closed ended funds...might be able to invest in truly illiquid growth capital and offer an even higher return*".*

As we have noted, the PIF will facilitate the UK government’s goals for COVID reconstruction, infrastructure revolution and “levelling up” the nation by supporting jobs outside of London. In this respect, UK real estate and its funds sector have much to contribute. For example, in the context of attracting capital and re-invigorating our town centres, as well as supporting social and affordable housing[2].

---

[2] ***The investment case for social and affordable housing in the UK***, *N Colley & J Fear, Property Funds Research, commissioned by Impact Investing Institute & Housing England, (forthcoming) May 2021, which states that the PIF “could provide an excellent ‘hybrid’ solution that may provide a more tailored fund structure to suit the investors requirements and the risk characteristics of [UK social and affordable housing] sector.”*

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

CFI paragraph 4.22 refers to unauthorised corporate, partnership/limited partnership and contractual scheme fund structures: the last referred to as the PIF in this submission.

We recognise branding attraction and appropriateness of the name “Professional Investor Fund” or “PIF”, and suggest this brand - as an umbrella brand – could be utilised for each unauthorised fund proposal. For legislative purposes, the unauthorised contractual scheme is defined as "Professional Investor Fund (Contractual Scheme)" or "PIF(CS)".

The names "Professional Investor Fund (Contractual Scheme)" or "PIF(CS)" would accommodate any implementing legislation (as government considers appropriate) related to the proposals for the other unauthorised funds i.e., such funds respectively being named:

- "Professional Investor Fund (Company)" or "PIF(Co)", and
- “Professional Investor Fund (Limited Partnership)" or "PIF(LP)".

We understand this solution for consistent branding is acceptable to the main proponent of the unauthorised corporate, partnership/limited partnership proposals, the Alternative Investment Management Association.

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?

Yes: the PIF has significant appeal on account of being "an unregulated collective investment scheme" combined with the PIF AIFM required to be authorised under UK AIFMD. This will have an appeal of flexibility as well as launch and operational efficiencies for PIF managers and investors, not constrained by the alternative fully authorised structure. The latter, which applies in an open-ended fund scenario, has understandable regulatory operational requirements particularly associated with liquidity management.

In addition, by utilising the PIF, professional investors can benefit from attributes (typically available in equivalent professional investor funds in other jurisdictions) including a speed to market launch with no prior regulatory approval of the PIF promotion and scheme documentation.

This is important in a low yield market, where launch and operational costs can have a material effect in eroding investor returns.

Our response to this CFI Question 33 focused on the PIF connects also with issues raised in CFI paragraph 1.12/Fund authorisation and CFI paragraph 1.13/Speed to market.

The term "unauthorised" in the context of “an unauthorised fund” is a misnomer, as such a fund operates within the UK AIFMD authorisation regime. In addition, the term "unregulated” in the context of “unregulated collective investment scheme" is another misnomer, as such a scheme is subject to extensive regulation.

It is unfortunate that these misnomers are currently embedded in the UK legislative regulatory and tax laws and regulations, and also combine with negative "**un**authorised" and "**un**regulated" labels. We assume that these terms were developed for understandable domestic investor-protection policy reasons as relative and binary notions, i.e., respectively as contrasts:

- "unauthorised fund" with an "authorised fund" – and "authorised" signals to investors a fund operates as open-ended fund with units redeemable within a reasonable period at net asset value and "unregulated collective investment scheme" with a "regulated collective investment scheme."

However today, there can be confusion when (as often is the case) these terms are expressed out of context. This includes promoting "unauthorised funds" and "unregulated collective investment schemes", when such terms can lead to prospective investors – particularly from outside the UK – assuming there is simply no authorisation required for an "unauthorised fund" and no regulation applying to an "unregulated collective investment scheme".

Other jurisdictions in labelling fund products apply more appropriate and less binary notions, such as "lightly regulated fund". We suggest it is appropriate at some point now or later that these terms are reviewed and reforms implemented. For example, the Department for Business, Energy & Industrial Strategy and then the Law Commission of England and Wales and the Scottish Law Commission review the appropriate terminology to be applied to UK fund products and recommend appropriate legislative reforms – although the findings of such review and implementation of legislative reforms are progressed independently and do not delay progressing reforms arising from the CFI.

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?

The PIF will have a particular attraction for holding real estate and less liquid assets. In the case of real estate indirect investors, they are inevitably focused on liquidity/exit expectations as a key factor in an investment decision making process.

Investors requiring high liquidity may choose to allocate to listed real estate companies (e.g., REITs), but these investors trade-off diversification for liquidity by introducing potentially unwanted correlation to the wider public equities market. Other investors requiring liquidity allocate to unlisted open-ended real estate funds, but these vehicles usually hold cash balances in order to meet redemption requests, which dilute the real estate return from such vehicles.

As an alternative conduit for real estate indirect investment, institutional investors are increasingly attracted to funds with the features of being unlisted closed-ended funds or funds which are not regulated as open-ended funds (and having to offer frequent redemption windows). The PIF is designed to meet these features. For a relatively illiquid asset class such as real estate, holding a longer-term view and investing in a fund with limited liquidity can result in higher returns and track the performance of underlying real estate assets. These types of funds hold little to no cash in order to meet potential redemptions.

To meet this demand, fund management houses look to operate funds that offer flexibility by being closed-ended, semi-closed/open "hybrids" or even "evergreen" funds[3]. These funds particularly appeal to investment strategies focused on:

- real estate sector-specific, alternative and emerging investment sectors such as residential property in various forms including elderly care, social housing, co-living and student accommodation that require specialist asset management skills.
- fund management houses offering core plus/opportunistic returns and/or realising post J-curve returns[4].

However, we estimate that, out of the total number of closed-ended/hybrid vehicles targeting UK and/or European real estate assets launched by fund managers with significant UK operations during the last ten years, only 21% by are domiciled in the UK[5].

Closed-ended funds for institutional investors typically operate with termination dates and can include manager and investor options to extend the termination dates. The life of a fund is typically 7-10 years after fund launch.

In recent years the greater flexibility of fund liquidity windows in the UK has combined with a growing secondary market servicing closed-ended, open-ended and hybrid funds. Institutional investors and fund management houses have benefited from exits via the secondary market, which they have utilised for real estate strategic purposes such as asset allocation changes, rebalancing portfolio risks and satisfying redemption requests.

An alternative exit may be an option for investors in a PIF to elect for conversion of the fund to a Co-ownership Authorised Contractual Scheme (**CoACS**), i.e., as an open-ended structure (and comply with legislative and regulatory provisions applicable to CoACSs).

The UK is currently the global leader in secondary market trading of real estate fund units held by institutional investors. The market operates on a match-bargain basis (not via a listed exchange), with brokerage firms providing pricing transparency in the UK and certain other jurisdictions. The secondary market can be attractive to meet the MiFID II best execution requirements that apply to many institutional investors. However, overall transaction volumes are modest in comparative terms[6] and the secondary market (in the UK or elsewhere) may have liquidity limitations in certain market conditions.

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.

---

[3] *"Evergreen" funds mean funds with an infinite fund term combined with infrequent and qualified liquidity windows.*

[4] *"Post J-curve returns" refers to the reduction in fund returns after launch resulting from capital deployment and associated costs i.e., the returns initially fall, then stabilise and increase as the fund matures.*

[5] *INREV Vehicles Database, Q4 2020.*

[6] *See chart in respect of trades undertaken on the PropertyMatch platform: Appendix 2.*

As indicated in response to CFI Question 1, the PIF provides a "quick-win" legislative solution given its ACS heritage, that is, it can be delivered swiftly in 2021 with no need for primary legislation. We understand that the legislative process would involve:

- Secondary legislation such as amending the Regulated Activities Order, FSMA and/or UK AIFMD; and
- In light of the preference of the FCA, the FCA consulting for the FCA Handbook (Investment Funds sourcebook (FUND), COBS and (maybe) SUP Supervision and the Prudential Requirements).

In terms of legislation, we suggest (as indicated in our response to Question 32) that the unauthorised contractual scheme would be named “Professional Investor Fund (Contractual Scheme)” or "PIF(CS)", given it would only be available to professional investors.

We consider the PIF could be easily recognised within the existing regulatory framework and subject to the same degree of regulation as is extended to UCIS Funds: for example, in light of the preference of the FCA one of two approaches could be adopted:

- PIF specific requirements to be included in a new section 4.2 of FUND to sit in the “specialist fund regime” section alongside the LTIF rules; or
- by specifying the following as regulated activities: “Establishing, operating and winding up a PIF(CS)” by adding a further article to a (new) article 51ZEE Establishing etc. a professional investor fund (contractual scheme): “Establishing, operating or winding up a professional investor fund (contractual scheme) is a specified kind of activity.”

In light of the approach to be adopted by the FCA, the FCA may prefer:

- granting a requisite Part 4A permission to those carrying on these activities and ensure that only those who satisfy the FIT criteria are able to establish, operate and wind up such schemes, but leave the schemes otherwise available to professional investors only; or
- PIF threshold conditions to be set out in Schedule 6 to FSMA.

The limitation on promotion could be easily addressed by a minor modification to the COBS as follows (indicated by underlining): COBS 4.12.3 R (1) A firm must not communicate or approve an invitation or inducement to participate in, acquire, or underwrite a non-mainstream pooled investment <u>or a professional investor fund (contractual scheme)</u> where that invitation or inducement is addressed to or disseminated in such a way that it is likely to be received by a retail client.

Appendix 1 to this Submission sets out an analysis of other key legislative and regulatory provisions to facilitate the establishment and operation of the PIF, recognising there will be further technical points that we suggest should be covered through technical working groups.

The attractiveness of PIFs is not dependent on/interlinked with any other legislative reforms arising from the HMT Funds Review (including the Asset Holding Companies and VAT consultations), albeit such reforms may result in enhancing the attractiveness of PIFs.

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.

We set out proposals on the implication for the taxation of the PIF. These proposals are not intended to be exhaustive, and they have an "England taxation" focus (recognising that there will be adjustments for the remainder of the UK implementing legislation). We assume that the same regime will apply as would apply in the case of the Co-ownership Authorised Contractual Scheme (CoACS), modified on account of the fund not being an authorised fund.

A PIF will not have its own legal personality and will not be subject to direct tax. Instead, the income received by the PIF will be liable to tax in the hands of each PIF investor as it arises, while their investors will be liable to tax on gains realised on the disposal of PIF units but not on gains realised at the portfolio level. We propose that the PIF will be specifically excluded from the definition of a company for the purposes of s1121(1) of the Corporation Tax Acts in a similar way to a CoACS.

Taxation of UK Investors

Income

PIF investors will be taxable on their share of the PIF's income. This will apply to both corporate and individual investors. Therefore, we envisage investors will require detailed information relating to their share of PIF income in order to fulfil their tax obligations. Any income received will be subject to the normal tax treatment applied to that type of income in the hands of that category of investor. For example, dividend income is likely to be non-taxable in the hands of a corporate investor. Income from real estate and interest received will need to be treated according to the general rules that apply to each stream of income. For some types of income, the computation and the treatment are different for taxpayers within the charge to Corporation Tax and those within the charge to Income Tax.

The PIF will be effectively tax-transparent so it cannot be liable to any tax on income. PIF investors will be taxable on their share of the PIF's income based on their own tax status.

Capital Gains

Capital gains will not be treated as arising on the PIF's share of assets held subject to the PIF but, instead, a unit in the PIF will be treated as if it were an asset purely for the purposes of tax on capital gains. PIF investors will be liable to tax on capital gains made on their interest in the PIF, and the PIF itself is not subject to tax on transactions in the underlying assets held in the PIF.

This means that a gain or loss will not arise when the PIF disposes of assets within the PIF. Instead, PIF investors will need to consider the chargeable gains consequences when they dispose of (or there is a deemed disposal of) their interest in the PIF. The gains of UK resident individuals arising from the disposal of an interest will be liable to capital gains tax (subject to the annual exempt amount and any capital losses), while similar gains arising to corporate investors will be liable to corporation tax. The amount of any gain will be calculated using the normal rules.

Insurance Companies

Insurance companies investing in PIF will be subject to different rules. An investment held in the long-term fund of an insurance company will be subject to s212 of TCGA1992 in the same way as it currently applies to all other holdings in collective investment schemes held by insurance companies (except in partnerships). In addition, this means that if the interests are held in the long-term fund of an insurance company, the company is deemed, for the purposes of corporation tax on capital gains, to have disposed of and immediately reacquired the interests concerned at their market value at the end of an accounting period.

Tax-transparent fund status

We consider that the PIF – particularly on account of being structured as a contractual scheme for professional investors – would have the attraction of being designated internationally as a tax-transparent fund (TTF) like the ACS, Luxembourg's Fonds Commun de Placement (FCP) Dutch Fonds voor Gemene Rekening (FGR) and Irish Common Contractual Fund (CCF). The TTF was designed to facilitate cross-border pension fund pooling: it maximises tax efficiencies for pension funds from multiple domiciles with the benefit of a pooling vehicle. The TTF is also attractive as a fund vehicle for cross-border distribution to tax exempt institutional investors. TTFs are commonly used for a wide range of diverse mandates, allowing investors from single or multiple jurisdictions to invest in a single TTF, subject to any domestic requirements.

Taxation of Non-UK Investors

The fiscal transparency of the PIF means it will not be treated as resident for the purposes of double taxation conventions between the UK and other jurisdictions.

Instead, the availability of double taxation convention reliefs will depend on the convention between the PIF investor's jurisdiction of residence and the jurisdiction where the income or gain arises. Assuming the overseas jurisdiction recognises a PIF as a transparent entity, investors should be entitled to the same treaty benefits as though they had made the investments directly. While it is beyond the scope of UK legislation to prescribe how a PIF contractual scheme is treated by a foreign jurisdiction, it is hoped that the majority, if not all, foreign states will view a PIF as transparent for tax purposes.

PIF investors will need to consult the relevant tax convention in order to establish whether treaty benefits are applicable and, if so, in what circumstances. The treatment of a PIF will need to be discussed with the overseas jurisdiction concerned. Any claim for treaty relief will need to be made using the procedures existing in that state. In practice PIF operators/administrators may offer a service whereby they will submit claims for benefits on investors' behalf. In such cases the PIF operator or administrator will inform investors of the information that they will need from investors in order to establish any claims for treaty benefits.

We expect that non-residents will only be taxable in the UK on investment income arising in the PIF if the income arises in the UK and they would be taxable on it in the UK if they had invested directly into the underlying asset. The main example of this is income from the rental of UK real estate where we would anticipate that they would be chargeable to income tax or corporation tax (as applicable), under the non-resident landlord scheme rules.

Where the PIF meets the UK property richness condition, non-residents will be subject to the non-resident CGT legislation. In addition, we note that individuals, where they are considered to be temporarily non-resident, and corporates where they carry on a trade in the UK through a permanent establishment, would both fall within the UK CGT net.

Capital Allowances

As the PIF will be transparent for the purposes of capital allowances, the PIF investor – not the PIF – may be entitled to claim capital allowances subject to the normal rules.

However, we anticipate the PIF operator will hold the information that investors require to calculate their entitlement to capital allowances. To avoid the need for exchanges of information between the PIF operator and investors, we suggest the government introduce a simplified scheme of calculating capital allowances whereby the operator of a PIF may calculate the allowances and allocate them to investors, i.e., replicating the treatment of CoACSs and having the authority to sign a s198 CAA 2001 election to validly transfer capital allowances upon a disposal of property to a purchaser. The PIF's capital allowances regime should be elective for the same reason as the CoACS regime is, that is, because some PIFs will have only or mainly investors who are exempt investors, and who therefore are not entitled to claim capital allowances.

Combination of a GDO and a non-close test

In the context of the PIF, the nature of closed-ended investment offerings means that a simple Genuine Diversity of Ownership (**GDO**) test would generally be too narrow. HMRC recognised this in the design of the Schedule 5AAA TCGA 1992 requirements for offshore CIVs to benefit from exempt and/or transparent treatment. A similar approach – the combination of a GDO and a non-close test, with exceptions for qualifying institutions, and supplemented with the fallback option of an HMRC direction where necessary to protect the public revenue – may be appropriate here as a way of addressing potential avoidance concerns, and furthermore will ensure a fully level playing field between onshore and offshore equivalent investment vehicles.

Stamp Taxes

We set out our proposals for PIFs, which are based on the assumption that they may hold UK real estate. This assumes both vanilla transactions and that all consideration is for cash, as well as the application of various anti-avoidance provisions and rules for redemptions in specie.

We recognise that our proposals below relating to Stamp Duty Land Tax (**SDLT**), SDLT seeding relief, Stamp Duty (**SD**) and Stamp Duty Reserve Tax (**SDRT**) involve government foregoing tax, the effect of implementing these proposals is crucial to ensure that the PIF will be a successful vehicle of choice. UK managers are currently attracted to operate offshore fund structures where there is nil transaction tax on an agreement to transfer or an actual transfer of fund units and would expect an equivalent "nil transaction tax" scenario for the PIF if they are to utilise the PIF in preference to such offshore fund structures.

We consider that if government were to implement these proposals (and thereby ensure that the PIF will be a successful vehicle of choice), this success will also combine with a resultant positive multiplier effect including far greater revenue receipts than the foregone tax. The multiplier effect would be reflected in employment and other benefits arising from facilitating the UK government's goals (see our response to Question 1) and investment in long-term and productive assets (see our response to Question 31).

We should reiterate that – as indicated in our response to Question 34 – the secondary market trading of real estate fund units held by institutional investors operates on a match-bargain basis: overall transaction volumes are modest in comparative terms[7]. Hence, we suggest that forgone tax – on account of a "nil transaction tax" scenario for the PIF – would also be modest.

[7] *See chart in respect of trades undertaken on the PropertyMatch platform: Appendix 2.*

Stamp Duty Land Tax (SDLT)

SDLT will not apply on transfers of units in a PIF – utilising the framework in s102A FA 2003 applying to CoACSs.

We consider that if a PIF (holding UK real estate) were deemed to be a property investment partnership, it is unlikely that the PIF would provide an attractive onshore option. The imposition of SDLT on any transfers of units in property investment partnerships (which include limited partnerships) was a significant catalyst that resulted in many UK real estate funds moving offshore.

SDLT Seeding Relief

The PIF regime would be more attractive if the CoACS SDLT seeding relief were to apply to the PIF. This would assist launching new products. However, in assessing the merits of the new PIF, the government should consider it primarily a vehicle for new funds and should not assume a significant amount of conversion of existing fund structures (given that conversion is a complex legal exercise). Where SDLT seeding relief has been claimed, we would expect a similar clawback mechanism to apply as for CoACSs to limit the scope for tax avoidance.

Stamp Duty (SD)

We suggest no SD will apply on a transfer of unit in a PIF (based on FA 99 Sch 13 Para 25A(1)(c) applying to CoACSs) and no SD on the issue or surrender of PIF contractual scheme units.

Stamp Duty Reserve Tax (SDRT)

We suggest no SDRT will apply on an agreement to transfer units in a CoACS (based on FA 1986 s90(7B)(b) applying to CoACSs). In addition, there would be no SDRT on the issue or surrender of units.

VAT

We welcome that HMT's Funds Review is considering the VAT treatment of fund management fees and other aspects of the UK's funds regime (**VAT Consultation**). We hope the VAT Consultation will also consider the VAT treatment of the PIF as part of the overall improvement of the UK VAT regime for funds. The same VAT regime that applies to the CoACS should apply to the PIF.

Tax Returns

The PIF will be required to submit a return of income and capital gains, the PIF's allocation to its investors, details of expenses and capital allowances. This requirement ensures that HMRC receives this information for tax collection purposes, even though the PIF will not be liable to any tax on income and on capital gains.

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?

Tax Avoidance

INREV is a strong supporter of the OECD's Base Erosion and Profit Shifting Programme and recognises that appropriate anti-avoidance rules should be included to prevent the use of structures, including newly introduced vehicles such as the PIF and LTAF, as well as AHCs, from being used in a way that is not intended. Such rules should recognise the need for certainty of treatment of the PIF and include appropriate clearance mechanisms.

Further Technical Points

There will be further technical points that we suggest should be covered through technical working groups. These will include the treatment of holdings of PIF units for inheritance tax purposes.

We welcome that the HMT UK Funds Review includes the consultation relating Asset Holding Companies (AHC Consultation). We hope that the AHC Consultation will favourably consider the PIF. The attractiveness of PIFs is not dependent on any legislative reforms arising from the AHC Consultation, although such reforms may result in enhancing the attractiveness of PIFs.

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?

As we have noted earlier in our response to the CFI, we strongly urge that introduction of the PIF, LTAF and reform of the rules for REITs will take into account HMT/HMRC policy decisions following from responses we and others submitted to HMT's second consultation on tax treatment of AHCs. The scale of the UK's asset management sector, its good infrastructure and skilled workforce would make it an attractive and compelling location for attractive investment structures; however, barriers in the UK tax system must also be addressed.

We consider that additional issues can be identified which are also relevant to a broad examination of the UK's regime for funds and asset management. While not central to the Funds Review, we have identified these here for completeness:

- In addition to the consideration of the tax treatment of UK-domiciled LP Funds (and PFLPs), we consider that the legal structure of the UK's limited partnership legislation could benefit from revision. Questions which can be considered in this regard are whether English or other limited partnerships should or should not have legal personality, and whether English limited partnership structures might viably be permitted to create compartments which are legally insulated from liabilities. The objective in this regard would be to update the legislative infrastructure of the still widely-used English limited partnership regime, to complement similarly modernised regimes in other jurisdictions.

- We also consider that a review into the viability of a UK corporate protected cell company regime might usefully complement the changes being considered as part of the Funds Review.

INREV and our global membership base very much welcomed the AHC consultation's aims "to deliver an appropriately targeted, proportionate and internationally competitive tax regime for AHCs that will remove barriers to the establishment of these companies in the UK". In addition, we welcome the forthcoming VAT Consultation and hope that it will address the unfavourable VAT treatment of management fees and other aspects of the UK funds regime.

For the UK to be successful, we stress that the outcome of this Funds Review must also be closely combined with a new tax regime that is simple, commercially viable and, furthermore, no more complex or costly than, for example, the established regimes in Luxembourg, Ireland and the Netherlands that are already familiar, easily accessible and widely used by our industry. Anything less would, regrettably, result in a regime that would simply not be commercially attractive or widely used in practice.

APPENDIX 1

OTHER LEGISLATIVE AND REGULATORY PROVISIONS TO FACILITATE THE ESTABLISHMENT AND OPERATION OF THE PIF

Authorised Contractual Schemes (ACS)s were introduced in 2013 by the Transferable Securities (Contractual Scheme) Regulations 2013 (SI 2013/1388), structured either as authorised co-ownership schemes or as authorised limited partnership funds (in each case being available as UCITS, NURS or QIS). We request that the government consider the introduction of the PIF as an unauthorised contractual scheme.

As indicated in our response to CFI Question 35, we suggest the PIF could be easily recognised within the existing regulatory framework and subject to the same degree of regulation as is extended to UCIS Funds: for example, in light of the preference of the FCA one of two approaches could be adopted:

- PIF specific requirements to be included in a new section 4.2 of FUND to sit in the "specialist fund regime" section alongside the LTIF rules; or
- by specifying the following as regulated activities: *"Establishing, operating and winding up a PIF(CS)"* by adding a further article to a (new) article 51ZEE Establishing etc. a professional investor fund (contractual scheme): *"Establishing, operating or winding up a professional investor fund (contractual scheme) is a specified kind of activity."*

We also suggest that the FCA grants a requisite Part 4A permission to those carrying on these activities and ensure that only those who satisfy the FIT criteria are able to establish, operate and wind up such schemes but leave the schemes otherwise available to professional investors only. The limitation on promotion could be easily addressed by a minor modification to the Conduct of Business Sourcebook Rules as follows (indicated by underlining): COBS 4.12.3 R (1) A firm must not communicate or approve an invitation or inducement to participate in, acquire, or underwrite a non-mainstream pooled investment <u>or a professional investor fund (contractual scheme)</u> where that invitation or inducement is addressed to or disseminated in such a way that it is likely to be received by a retail client.

The purpose of this Appendix is to identify other key primary and secondary areas of legislation which would potentially require amendment or (at least) consideration if PIFs were to be fitted into the current regulatory landscape. The suggested areas identified are not exhaustive and can be appropriately adopted in light of the preference of the FCA. We suggest that the further technical points should be covered through technical working groups.

<u>Regulatory issues</u>

1 The PIF would fall within the existing definition of a co-ownership scheme as specified in the FSMA s235A (2)-(5). We would suggest the insertion of a definition of a PIF in FSMA s237 (3):

"*professional investor fund (contractual scheme)*" means a contractual scheme which satisfies the requirements of section 235A (2) – (5) and is not the subject of an authorisation order in force under section 261D".

2 s237 of FSMA should be amended to take a PIF clearly outside the definition of a unit trust scheme.

3 The provisions in ss261M – 261P of FSMA (grouped under the heading *"Co-ownership schemes: rights and liabilities of participants"* and comprising: s261M/Contracts, s261N/Effect of becoming or ceasing to be a participant, s261O/Limited liability and s261P/Segregated liability in relation to umbrella co-ownership schemes) should be extended to PIFs.

4 The PIF should be prohibited from operating as a small, registered UK AIFM (for the purposes of UK AIFMD) by adding "*or a PIF(CS) [as defined in [ ]*" to UK AIFMD regulation 10(3)(b)(ii).

5 If the FCA adopts this approach, the activities of: "*Establishing, operating and winding up a PIF(CS)*" can be specified as regulated activities by adding a further Article to the current Financial Services and Markets Act 2000 (Regulated Activities) Order 2001/544 as a (new) art. 51ZEE Establishing etc. a professional investor fund (contractual scheme): "*Establishing, operating or winding up a professional investor fund (contractual scheme) is a specified kind of activity*."

6 "*managing a PIF(CS)*" will fall within Article 51ZC of the Regulated Activities Order and Article 51ZF and the Schedule 8, paragraph 2 exclusion for small, registered UK Alternative Investment Fund Managers (AIFMs)s will not be engaged.

7 "*acting as a depository of a PIF(CS)*" can be brought within Article 51ZD of the Regulated Activities Order by amending "*(1)*" to include "*Acting as — … [(a)(a) the depositary of a Professional Investor Fund (Contractual Scheme)]* and specifying in "*(5)*" that "*[In paragraph 1(a)(a) "depository" has the meanings given by section 237 of the Act]*.

<u>Operational issues</u>

8 The disqualification of auditor regime in s249 and discipline of auditors in s261K of FSMA might be applied to auditors of a PIF.

9 A PIF should be required to be subject to corporate governance mechanisms equivalent to those applied to companies, as envisaged by the COLL Rules, in particular 5.2.7CR(2): "(a) it is subject to corporate governance mechanisms equivalent to those applied to companies; and (b) it is managed by a person who is subject to national regulation for the purpose of investor protection". This will require amendment to the COLL Rules.

10 FUND 3.2.5R to the effect that "*an AIFM must, for each UK AIF it manages, and each AIF it markets, disclose to investors periodically: (1) the percentage of the AIF's assets that are subject to special arrangements arising from their illiquid nature; (2) any new arrangements for managing the liquidity of the AIF; and (3) the current risk profile of the AIF and the risk management systems employed by the AIFM to manage those risks*" will apply to a PIF.

11 FUND 3.3.2 R requiring that an AIFM of any UK AIF it manages and for each AIF it markets in the UK (1) make an annual report available to investors for each financial year; (2) provide the annual report to investors on request; and (3) make the annual report available to the FCA and will apply to a PIF.

12 As indicated in our response to CFI Question 30, the PIF legislation should facilitate a sub-fund or protected cell feature akin to that applying to UK OEICs in view of the Open-Ended

Investment Companies (Amendment) Regulations 2011 (SI 2011/3049), i.e., allow for sub-funds with a legally enforceable segregation of the assets and liabilities of each sub-fund.

Promotion of PIFs

We suggest regulations which treat a PIF as an unregulated collective investment scheme combined with applicable rules that apply to QISs:

13 The operators of PIFs should be prohibited from contracting out of liability for negligence as with ACS pursuant to s261T of FSMA.

14 Specifying that COBS Rule 4, 12.3R (prohibiting promotion of non-mainstream pooled investments to retail clients) applied to PIFs.

15 The Financial Services and Markets Act 2000 (Promotion of Collective Investment Schemes) (Exemptions) Order 2001 (SI 2001/1060) should be amended to specify that PIFs can only be promoted to high net worth and sophisticated investors/professional clients.

APPENDIX 2

<u>CHART - TRADES UNDERTAKEN ON THE PROPERTYMATCH PLATFORM</u>