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Practical cross-border insights into alternative investment funds work

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1 Regulatory Framework

1.1 What legislation governs the establishment and operation of Alternative Investment Funds?

The UK is regarded as one of the leading global asset management centres, with an investment funds industry covering both traditional and alternative asset classes. In the case of funds with alternative investment strategies such as private equity, real estate, alternative credit and infrastructure, UK Alternative Investment Funds are integral to many fund structures. The asset management industry is of vital importance to the UK's economy.

Many Alternative Investment Funds will be "AIFs" for the purposes of UK AIFMD (defined below). An AIF is a collective investment undertaking which raises capital from a number of investors, with a view to investing it in accordance with a defined investment policy for the benefit of those investors, and which is not a UK UCITS.

Even if a vehicle does not fall within the definition of an AIF, it may be categorised as a collective investment scheme ("CIS") under the Financial Services and Markets Act 2000 ("FSMA"). A CIS is similar, but not identical, to the AIFMD concept of a collective investment undertaking. It is also possible for an Alternative Investment Fund to be both an AIF and a CIS or just one of the two. An example of this is likely to be carried interest arrangements structured through a limited partnership, which are unlikely to be AIFs due to the employee participation scheme exclusion from UK AIFMD, but which are likely nevertheless to be unregulated CIS for the purposes of domestic legislation.

The key legislation for AIFs is the Alternative Investment Fund Managers Regulations 2013 with additional measures contained in the Financial Conduct Authority ("FCA") Handbook, particularly the FUND chapter and the on-shored version of the EU AIFMD Delegated Regulation (together referred to here as "UK AIFMD"). UK AIFMD applies to the managers of AIFs ("AIFMs").

Alternative Investment Funds that are solely CIS will be subject to the statutory rules under FSMA and related legislation and also FCA rules applicable to CIS.

Other regimes that could potentially be relevant include authorised funds such as Long-Term Asset Funds ("LTAFs"). However, authorised funds are not the focus of this chapter. Other regimes, which are not discussed further, include the Registered Venture Capital Fund and Social Entrepreneurship Fund.

1.2 Are managers or advisers to Alternative Investment Funds required to be licensed, authorised or regulated by a regulatory body?

The FCA authorises and regulates persons carrying out "regulated activities" in the UK. Acting as the manager of an AIF is a regulated activity, as is establishing, operating (which includes managing) or winding up a CIS. A suitably authorised person must therefore be appointed to carry out these activities on behalf of an Alternative Investment Fund.

It is a criminal offence to breach this requirement. Any agreement entered into by a person carrying on a regulated activity in contravention of this provision is unenforceable against the other party and the other party is entitled to recover any money paid and to compensation for any loss sustained.

UK AIFMD contains a partial exemption for AIFMs whose total assets under management do not exceed certain thresholds. These sub-threshold firms will not have to comply with the full provisions of UK AIFMD, unlike those firms that are "full-scope" AIFMs. The relevant thresholds are: (i) €500 million, provided the AIF is not leveraged and investors have no redemption rights for the first five years; or (ii) €100 million (including assets acquired through leverage). Sub-threshold firms will need to become a "small authorised AIFM" or, in certain limited circumstances, a "small registered AIFM". The latter category imposes the lowest regulatory burden on firms but is only available for certain internally managed AIFs and certain types of real estate scheme.

1.3 Are Alternative Investment Funds themselves required to be licensed, authorised or regulated by a regulatory body?

Generally speaking, under the current UK framework, an Alternative Investment Fund itself is not required to be authorised or licensed by the FCA. UK AIFMD and the regime applicable to CIS broadly support the traditional position that it is the operator or manager (or AIFM), rather than the Alternative Investment Fund, that is subject to regulation. However, to the extent UK AIFMD applies, the AIFM must comply with certain requirements that, in turn, affect the AIF, including: the appointment of a depositary to have custody of certain assets; organisational controls including in relation to risk management, liquidity and valuation; conduct of business rules; and rules relating to companies in which the AIF has a substantial stake.

1.4 Does the regulatory regime distinguish between open-ended and closed-ended Alternative Investment Funds (or otherwise differentiate between different types of funds or strategies (e.g. private equity *vs* hedge)) and, if so, how?

The UK regulatory regime, broadly speaking, does not differentiate between open-ended and closed-ended private funds, although, as noted above, the partial exemption from UK AIFMD for sub-threshold AIFMs will bite at a higher level for non-leveraged, closed-ended funds.

Other regulatory requirements that might apply to a manager of Alternative Investment Funds are linked with the investment strategy being pursued, rather than whether the fund is open-ended or closed-ended (although the relevant strategy might be linked with a particular type of fund). For example, rules relating to market abuse and insider dealing will be particularly relevant to firms investing in listed financial instruments.

1.5 What does the authorisation process involve for managers and, if applicable, Alternative Investment Funds, and how long does the process typically take?

An application for FCA authorisation involves the applicant submitting a considerable volume of information to the FCA. This will include information on the proposed business activities of the applicant, its controllers and individuals who will be undertaking certain core controlled functions, its systems and controls and financial projections. For those applicants applying for authorisation to manage an AIF, the FCA will require further information about the AIF itself as well as details of the depositary arrangements.

The FCA currently has six months to review the application (this is reduced to three months in the context of applications by AIFMs). During the review process, the FCA may raise additional queries in relation to the information submitted.

1.6 Are there local residence or other local qualification or substance requirements for managers and/or Alternative Investment Funds?

A manager applying for FCA authorisation must meet certain threshold conditions. One of these is that, for bodies corporate, the head office or registered office must be in the UK. In certain other cases, the fund manager must carry on business in the UK. Although the FCA will judge each application on a case-by-case basis, a key issue is likely to be the location of its central management and control.

In September 2022, the Economic Crime and Corporate Transparency Bill ("ECCT Bill") proposed the introduction of a number of changes to UK limited partnership law. The reforms include a requirement for UK limited partnerships to have a registered office address at all times in the part of the UK in which the limited partnership is registered (this is in addition to a principal place of business, which need not be in the UK, but often is for UK limited partnerships used in fund structures).

1.7 What service providers are required?

Under UK AIFMD, a depositary is required, which will have responsibilities including custody, cash monitoring and oversight of certain processes such as the issue and redemption of units. Under UK AIFMD, the depositary of a UK AIF must be established in the UK and be a credit institution, MiFID investment firm or the equivalent with regulatory permission to act as depositary of an AIF. Independent valuers may also be appointed pursuant to the provisions of UK AIFMD.

1.8 What rules apply to foreign managers or advisers wishing to manage, advise, or otherwise operate funds domiciled in your jurisdiction?

Managing, advising and operating funds in the UK are all potentially regulated activities under UK financial services legislation. If the foreign manager or adviser is considered to be carrying on these activities by way of business in the UK then it would need be authorised by the FCA to do so, unless an exemption applies.

1.9 What relevant co-operation or information sharing agreements have been entered into with other governments or regulators?

According to the FCA's website, the FCA has entered into memoranda of understanding with each of the EEA competent authorities and also supervisors in a large number of non-EEA jurisdictions including Australia, British Virgin Islands, Cayman Islands, Guernsey, Hong Kong, Japan, Jersey, Singapore, Switzerland and the United States.

2 Fund Structures

2.1 What are the principal legal structures used for Alternative Investment Funds (including reference where relevant to local asset holding companies)?

There are a wide variety of fund vehicles available in the UK. Certain of these are only available for retail funds, such as the authorised unit trust and the open-ended investment company. Others, such as the investment trust company ("ITC"), are likely to be used for closed-ended structures implementing a traditional investment strategy.

A private fund domiciled in the UK and implementing an alternative investment strategy will usually take one of two forms. Closed-ended private funds (in particular, those investing in asset classes such as private equity, real estate and infrastructure) are most commonly structured as limited partnerships. This is a form of partnership governed by statute under the Limited Partnerships Act 1907 ("LP Act"). In April 2017, the LP Act was the subject of extensive reform by the UK government in respect of private funds. The reforms introduced the Private Fund Limited Partnership ("PFLP"), a limited partnership designated as a private fund limited partnership, designed to simplify limited partnership law and reduce uncertainty, administrative costs and burdens. The PFLP regime is not mandatory: it is open to a limited partnership that satisfies the conditions to be a PFLP to choose not to apply to be designated as a PFLP. There are further reforms proposed to UK limited partnership law, which are expected to become law in 2023. This is part of a wider review of the UK funds regime. Almost all new private funds using the UK limited partnership will be PFLPs.

In common with other jurisdictions, the limited partnership (including the PFLP) will have one or more general partners and one or more limited partners. The general partner is responsible for the management of the limited partnership (although whether it fulfils this role will largely depend on the regulatory considerations described above), but has unlimited liability for the debts and obligations of the partnership over and above the

partnership assets. Conversely, the liability of a limited partner will be limited to the amount of capital it contributes to the partnership (and, in the case of PFLPs, there is no requirement for a limited partner to make a capital contribution), provided such limited partner takes no part in the management of the partnership: to the extent the limited partner does take part in management, it will be treated as a general partner and will lose the protection of limited liability. The LP Act contains a white list of matters that limited partners of a PFLP can take part in without jeopardising their limited liability status. A limited partnership (including a PFLP) registered in England & Wales does not have any legal personality separate from its partners and is not a body corporate.

One of the fundamental attractions in the UK of a limited partnership structure for private closed-ended funds is that the limited partnership is a flexible vehicle in terms of internal governance and control. The constitutional document (the limited partnership agreement) is a freely negotiable document between the fund manager and the investors.

The statutory framework in the UK requires that a limited partnership is registered as such. This entails filing an application for registration with the Registrar of Limited Partnerships, providing certain details including the name of each limited partner and for non-PFLPs, the amount of capital contributed by each limited partner. Any changes to these details during the continuance of the limited partnership must be registered within seven days of the relevant change. There are also formalities for non-PFLPs that must be followed on assignments of limited partner interests, such as advertising the transfer in specific Gazettes.

While the focus of this chapter is not on hedge funds, it is worth mentioning that the usual hedge fund structure will generally not include the actual hedge fund being domiciled in the UK, because to set up the fund on-shore would lead to tax inefficiencies since the fund would be treated as "trading" rather than "investing" for UK tax purposes. Instead, hedge fund structures will invariably include a company or limited partnership established in an off-shore jurisdiction.

The LTAF is designed for investing in long-term, illiquid (private) assets and is targeted at defined contribution pension schemes. The LTAF is an authorised open-ended AIF so can be structured as an investment company with variable capital ("ICVC"), unit trust or contractual scheme. There has been some (limited) adoption of the new LTAF structure, but the FCA has introduced new rules to broaden retail access.

Whether a UK Alternative Investment Fund invests in assets via a holding company will depend on a number of issues (including commercial, tax and regulatory considerations). In April 2022, the UK introduced a new tax privileged regime for UK resident qualifying asset holding companies ("QAHCs"). To be a QAHC, a company must comply with a number of requirements including that, broadly, it is at least 70% owned by "category A" investors. Alternative Investment Funds will be category A investors provided certain conditions are met. Please see question 6.1 below for a discussion of tax benefits applicable to QAHCs.

In addition, recent changes to the UK real estate investment trust ("REIT") regime mean that that entity can be unlisted where, broadly, it is at least 70% owned by institutional investors, potentially making it more attractive to such investors as a vehicle for holding UK real estate. An Alternative Investment Fund structured as a limited partnership will be an institutional investor for these purposes provided certain conditions are met. The UK REIT is a corporate vehicle for holding real estate that benefits from a tax privileged regime (see question 6.8 below).

2.2 Do any of the legal structures operate as an umbrella structure with several sub-funds, and if yes, is segregation of assets between the sub-funds a legally recognised feature of the structure?

The LTAF can operate as an umbrella fund with sub-funds, with segregated liability between sub-funds. None of the legal structures outlined above typically operate as an umbrella structure.

2.3 Please describe the limited liability of investors in respect of different legal structures and fund types (e.g. PE funds and LPACs).

In respect of funds structured as limited partnerships, under statute, the liability of a limited partner for the debts or obligations of the partnership is limited to the amount of capital it contributes to the partnership, and for PFLPs is limited to the amount of the partnership property which is available to the general partner to meet such debts or obligations, subject always to the caveat that the investor does not become involved in the management of the structure.

This does not relieve the investor of its contractual obligation to advance money, and therefore Alternative Investment Funds operating "just-in-time" drawdown structures will be able to draw the full amount the investor has committed to advance to the fund, notwithstanding the statutory limitation on liability. The UK limited partnership will generally be structured so that the commitment of investors comprises a nominal amount of capital contribution, with the balance being advanced by way of a loan. This structure should avoid amounts distributed to investors being subject to return in the event of the insolvency of the limited partnership.

In respect of PFLPs, as there is no requirement for a limited partner to contribute any capital, the entire funding to be contributed by a limited partner in a PFLP can be in the form of capital that can be contributed and repaid at any time without affecting the extent of the liability. This removes the need for the capital/loan split described above; however, PFLPs typically do split capital and loans in this way.

The other fund vehicles available will provide for the limited liability of investors, such that they will not be required to contribute more than the amount that they have committed to invest in the fund.

2.4 What are the principal legal structures used for managers and advisers of Alternative Investment Funds?

There are no formal requirements as to the legal structure used for managers and advisers of Alternative Investment Funds. However, the two most common structures seen in the market are the private limited company and the limited liability partnership ("LLP"). LLPs have been seen as the preferred structure for asset managers for some time now, as they offer the tax transparency of a traditional partnership whilst giving limited liability to the members of the LLP. Although an LLP is a body corporate, it is inherently a more flexible vehicle than a limited company and therefore can be adapted to suit the particular circumstances of the fund manager's business and preferred governance structure. LLPs (together with UK unlisted companies) are subject to a requirement to maintain a register of people with significant control ("PSCs"); such register is to be available for public inspection at their registered offices.

The basic position is that each member of an LLP is treated as being self-employed for income tax and national insurance contribution ("NIC") purposes. This means that LLPs do not

need to pay employer's NICs on the remuneration of members, and it also keeps members of an LLP outside of the UK employment-related securities ("ERS") legislation. However, this basic position can be disapplied by the "salaried member" rules. Under these rules, a member of an LLP will be treated as an employee for income tax and NIC purposes if, generally: (a) at least 80% of the amount payable by the LLP for the services they perform for it is "disguised salary" (broadly, remuneration that is not dependent on the firm's profitability); (b) they do not have "significant influence" over the LLP's affairs; and (c) they make a capital contribution to the LLP that is less than 25% of their annual "disguised salary".

Employees are outside of the scope of the income-based carried interest rules (see question 6.2), whereas self-employed LLP members must consider the potential application of these rules to their carried interest returns.

2.5 Are there any limits on the manager's ability to restrict redemptions in open-ended funds or transfers in open-ended or closed-ended funds?

Generally, there are no statutory or regulatory limitations on the ability of managers of private open-ended funds to restrict redemptions or on managers of private open-ended or closed-ended funds to restrict transfers, although contractual restrictions are likely to be imposed.

2.6 Are there any legislative restrictions on transfers of investors' interests in Alternative Investment Funds?

There are no legislative restrictions on the transfer of investors' interests; however, contractual restrictions are standard in the market. In the case of UK limited partnerships, certain filing requirements will need to be met, and for non-PFLPs, details of the transfer advertised, before it is deemed effective.

2.7 Are there any other limitations on a manager's ability to manage its funds (e.g. diversification requirements, asset stripping rules)?

UK AIFMD replicates the substantive requirements of the AIFMD portfolio company provisions, including those relating to asset stripping. The provisions cover situations where an AIF managed by a full-scope AIFM holds a significant proportion of the shares in, or acquires "control" of, a UK unlisted company or an issuer of traded securities, imposing requirements relating to the provision of information to the company or issuer, the shareholders, employees' representatives (or employees) and, for certain acquisitions, the FCA. The asset stripping provisions contain restrictions on distributions, capital reductions, share redemptions and acquisitions by the company or issuer of its own shares for two years after the AIF acquires "control".

2.8 Does the fund remunerate investment managers through management/performance fees or by a combination of management fee and carried interest? In the case of carried interest, how is this typically structured?

A fund's remuneration arrangements differ depending upon its structure. Closed-ended private funds structured as limited partnerships typically have a management fee that will be structured as a priority profit share rather than a fee. The commercial terms vary according to the investment strategy (the market standard in the private equity industry, for example, is 2% of commitments during the investment period, stepping down to 2% of the acquisition cost of unrealised investments following the end of the investment period, but infrastructure and debt strategies are unlikely to support this pricing model). The carried interest will also be structured as a share in the profits of the partnership and typically entitles the executives of private equity funds to 20% of the fund's overall profits after return of drawn commitments and payment of the preferred return to investors in the fund.

3 Marketing

3.1 What legislation governs the production and use of marketing materials?

As a general matter, marketing materials will need to comply with rules around investor protection, including those in the FCA Handbook, for information provided to be fair, clear and not misleading.

Marketing materials relating to fund units or interests will generally be considered financial promotions and will be subject to the UK financial promotion regime. Generally, financial promotions are permitted if they are made or approved by an FCA authorised firm or fall within a statutory exemption. The relevant legislation is the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 and the Financial Services and Markets Act 2000 (Promotion of Collective Investment Schemes) Order 2001. There are also limits on the types of investors to which such units or interests can lawfully be marketed and, in some cases, there will also be certain disclosure or other procedural requirements. Certain types of fund communications will also be subject to conduct of business requirements in the FCA Rules.

Specific marketing restrictions are also imposed by UK AIFMD and there are some exemptions to address the overlap between the UK AIFMD marketing regime and the financial promotion regime.

Full-scope AIFMs wishing to market an AIF to investors in the UK are required to apply to the FCA to do so. For the purposes of UK AIFMD, marketing has a specific meaning and is a direct or indirect offering or placement of units or shares in an AIF by the AIFM to or with investors domiciled in the UK or Gibraltar. Marketing may also be carried out for these purposes by an investment firm acting at the initiative of, or on behalf of, the AIFM. This is a narrower concept than that of a financial promotion, which is an offer or inducement to engage in investment activity. In particular, pre-marketing and reverse solicitation will not be regarded as marketing.

Alternative Investment Funds being made available to retail investors in the UK will also generally need to provide a standardised, short disclosure document – a key information document ("KID") – to investors under the UK Packaged Retail and Insurance-based Investment Products ("PRIIPs") Regulation. The KID must comply with certain detailed technical standards.

The requirements of the UK's Prospectus Regulation Rules, which catch "offers to the public", will generally not apply to the marketing of Alternative Investment Funds on the basis that the requirements can be avoided if the total consideration of offers in the UK, calculated over a 12-month period, is below €8 million or the offer is made to fewer than 150 persons in the UK. The UK's Prospectus Regulation Rules will also not catch open-ended vehicles, so most hedge funds, for example, would not be caught in any event.

3.2 What are the key content requirements for marketing materials, whether due to legal requirements or customary practice?

There are limited content requirements applicable to fund marketing materials. However, UK AIFMD also requires prescribed pre-investment disclosures that must be made to prospective investors (see section 5 below).

3.3 Do the marketing or legal documents need to be registered with or approved by the local regulator?

Outside of UK AIFMD, there is no requirement to register marketing or legal documentation with the FCA.

Under UK AIFMD, a full-scope AIFM must seek FCA approval for marketing a UK AIF at least 20 working days prior to marketing and notify any material planned changes to the information provided at least one month in advance. Material unplanned changes must be notified to the FCA immediately.

Non-UK AIFMs and full-scope AIFMs marketing non-UK AIFs are required to notify the FCA of their intention to carry out marketing, including confirmation that certain UK requirements in respect of the AIF and additional country co-operation requirements are met.

3.4 What restrictions (and, if applicable, ongoing regulatory requirements) are there on marketing Alternative Investment Funds?

Marketing will generally be subject to the UK financial promotion regime and, where relevant, the UK AIFMD marketing requirements.

UK full-scope AIFMs wishing to market UK AIFs in the UK need to comply with the FCA's AIF marketing regime. Non-UK AIFMs and UK full-scope AIFMs marketing non-UK AIFs wishing to market into the UK will need to rely on the UK national private placement regime.

3.5 Is the concept of "pre-marketing" (or equivalent) recognised in your jurisdiction? If so, how has it been defined (by law and/or practice)?

In its guidance, the FCA has stated that pre-marketing is not regarded as constituting marketing by an AIFM for the purposes of UK AIFMD. Pre-marketing for these purposes includes draft documentation, a promotional presentation or a pathfinder version of a private placement memorandum, provided such documents cannot be used by a potential investor to make an investment in the AIF.

Pre-marketing activities will be subject to the UK's financial promotion regime.

3.6 Can Alternative Investment Funds be marketed to retail investors (including any specific treatment for high-net-worth individuals or semi-professional or similar categories)?

Alternative Investment Funds can only be marketed to retail investors if it is possible to do so under the UK financial promotion regime. Effectively, this means that Alternative Investment Funds may only be marketed to largely sophisticated or high net worth retail investors.

The FCA also imposes some limited additional conduct of business requirements for certain fund marketing to retail investors.

Alternative Investment Funds being made available to retail investors in the UK must also provide a KID under the UK PRIIPs Regulation.

3.7 What qualification requirements must be met in relation to prospective investors?

There are no "across the board" qualification requirements that apply in relation to prospective investors, although certain bases on which marketing is made under the financial promotion regime (or, where applicable, UK AIFMD) will require an analysis of the circumstances of the prospective investor.

3.8 Are there additional restrictions on marketing to public bodies such as government pension funds?

Local public authorities or municipalities that do not manage public debt are classified as retail investors but can be opted-up to professional status if certain conditions are met. This includes local government pension schemes, which can lead to certain additional restrictions on marketing and distributing interests in such schemes.

3.9 Are there any restrictions on the participation in Alternative Investment Funds by particular types of investors (whether as sponsors or investors)?

Under the current legislative and regulatory regime, there are no firm restrictions on the participation in Alternative Investment Funds. However as discussed above, there may be indirect restrictions through restrictions in the types of persons to whom an Alternative Investment Fund may be marketed or as a result of the Alternative Investment Fund's own policy. Certain types of investors, particularly regulated financial entities, may also need to consider the regulatory capital implications to their investment positions.

3.10 Are there any restrictions on the use of intermediaries to assist in the fundraising process?

There are no restrictions on the use of intermediaries, although if the intermediary is itself carrying on regulated activities for the purposes of the UK regulatory regime, it will need to be authorised by the FCA.

4 Investments

4.1 Are there any restrictions on the types of investment activities that can be performed by Alternative Investment Funds?

Generally speaking, there are no restrictions, although the fund manager will need to ensure that the activities it is carrying out in respect of the Alternative Investment Fund are consistent with the scope of permission it has to carry out regulated activities (and with the contractual investment policy of the Alternative Investment Fund).

However, UK AIFMD does impose certain restrictions relating to asset stripping, as described at question 2.7 above.

In addition, although not restrictions, there are certain deal disclosure requirements under UK AIFMD. UK AIFMs and certain non-UK AIFMs that have registered their funds for marketing in the UK are subject to UK AIFMD portfolio

company provisions. Such AIFMs must notify the FCA when an AIF's voting interest in an unlisted UK company passes through certain thresholds.

There are additional disclosure obligations when an AIF acquires "control" of a UK listed or unlisted company, including requirements to make certain information available to the FCA, the investee company and other shareholders (and, in some cases, the AIF's investors).

4.2 Are there any limitations on the types of investments that can be included in an Alternative Investment Fund's portfolio, whether for diversification reasons or otherwise?

In general, there are no specific regulatory restrictions on the types of investments that can be included in an Alternative Investment Fund's portfolio. Nevertheless, they will need to comply with their investment policy, which may include some restrictions.

4.3 Are there any local regulatory requirements that apply to investing in particular investments (e.g. derivatives or loans)?

There are rules in respect of investment in securitisation positions and, as mentioned below, some limits on leverage may apply.

Alternative Investment Funds will, however, need to comply with any rules applicable to trading and holding such investments as well as their own investment policy.

4.4 Are there any restrictions on borrowing by the Alternative Investment Fund?

Under UK AIFMD, the FCA may impose limits on leverage on a particular AIFM if it considers it necessary to ensure the stability and integrity of the financial system.

4.5 Are there are any restrictions on who holds the Alternative Investment Fund's assets?

Under UK AIFMD, a full-scope AIFM is required to appoint a depositary to have custody of the AIF's assets. For other Alternative Investment Funds, where the assets include financial instruments, these will generally need to be held by an entity authorised for safekeeping, such as a global custodian.

5 Disclosure of Information

5.1 What disclosure must the Alternative Investment Fund or its manager make to prospective investors, investors, regulators or other parties, including on environmental, social and/or governance factors?

Alternative Investment Funds structured as limited partnerships will need to comply with the registration requirements under the LP Act. PFLPs need only disclose basic details (essentially the fund's name and address). However, proposed reforms will require all UK limited partnerships (including PFLPs) to provide additional information about the partners, some of which will be public. There may be a requirement on the general partner of a UK limited partnership to file the partnership's accounts on the basis of the Partnership Accounts Regulations.

Under UK AIFMD, AIFMs must make pre-investment disclosures of certain information relating to the relevant AIF as well as any material changes to that information.

A manager of Alternative Investment Funds with assets under management over £5 billion must make annual climate-related financial disclosures in respect of the manager itself and the Alternative Investment Funds it manages.

5.2 Are there any requirements to provide details of participants (whether owners, controllers or investors) in Alternative Investment Funds or managers established in your jurisdiction (including details of investors) to any local regulator or record-keeping agency, for example, for the purposes of a public (or non-public) register of beneficial owners?

Fund houses that have any Scottish limited partnerships ("SLPs") in their fund structures (commonly used as feeder and carry vehicles) are required to make filings under the persons with significant control regime ("PSC Regime"). The PSC Regime also applies to SLPs designated as PFLPs. Failure to comply with the PSC Regime requirements carries criminal penalties. The PSC Regime also applies to LLPs. English limited partnerships remain outside the scope of the PSC Regime.

The PSC Regime requires SLPs to deliver to Companies House information relating to PSCs in relation to the SLP. The rules are complex but, in broad terms, an SLP's PSCs could include its general partner, any manager/operator, and any limited partner whose interest in the partnership represents more than 25% of the surplus assets on winding up or of the voting rights or who holds, directly or indirectly, the right to appoint or remove the majority of those involved in management.

5.3 What are the reporting requirements to investors or regulators in relation to Alternative Investment Funds or their managers, including on environmental, social and/or governance factors?

UK AIFMD requires AIFMs to comply with a range of detailed regulatory reporting obligations. Reporting obligations also apply to AIFMs seeking to market their funds in the UK under its national private placement regime.

Broadly, AIFMs will be required to make periodic reports to the FCA both in respect of the AIFM itself and in respect of each AIF that it manages (including information in relation to investment strategies, main instruments traded and principal exposures). Additional reporting is also required for funds that employ leverage on a "substantial basis" (broadly where the exposure of an AIF exceeds three times net asset value).

Annual reports containing certain specified information must also be provided to investors in an AIF (and also the FCA).

As part of proposed reforms to the UK limited partnerships regime, all UK limited partnerships (and not just SLPs, as is currently the case) will have to file an annual confirmation statement, essentially confirming that all information relating to the partnership on the register at Companies House is up to date.

A manager of Alternative Investment Funds with assets under management over £5 billion must make annual climate-related financial disclosures in respect of the manager itself and the Alternative Investment Funds it manages.

5.4 Is the use of side letters restricted?

There are no firm restrictions on the use of side letters. However, UK AIFMD requires disclosures as to how an AIFM ensures the fair treatment of investors and, if side letters are used to provide

preferential treatment to investors, a description of the preferential treatment and the type of investors to whom the treatment is made available will need to be disclosed. If the AIFM operates a general most-favoured nations ("MFN") mechanism, this is unlikely to be an issue; however, if no or a limited MFN process is in place, an AIFM will need to consider its use of side letters in light of the disclosure requirements under UK AIFMD.

6 Taxation

6.1 What is the tax treatment of the principal forms of Alternative Investment Funds and local asset holding companies identified in question 2.1?

UK limited partnerships are not taxable entities for UK direct tax purposes (although they do submit tax returns) and are instead fiscally transparent. This fiscal transparency means each limited partner is treated for UK tax purposes as owning its proportionate share of the assets of the partnership and is subject to tax on the income and gains allocated to it under the limited partnership agreement (whether or not they are distributed).

The tax treatment of the LTAF will depend on what legal form it takes. Broadly, if it is an ICVC or unit trust, it is subject to corporation tax but potentially enjoys certain tax privileges (such as an exemption from tax on capital gains) provided (i) it is sufficiently widely marketed, (ii) its prospectus was published on or before 9 December 2021, or (iii) at least 70% of its shares or units are held by certain categories of institutional investor (which do not include unauthorised Alternative Investment Funds) or the manager of the fund (in its capacity as manager). If the LTAF takes the form of a co-ownership authorised contractual scheme, broadly, (i) it is transparent for the purposes of income taxation and not subject to tax on its capital gains, and (ii) for capital gains tax purposes, a unit in the LTAF is treated as an asset of the investor (with the investor's interest in the underlying assets of the LTAF being disregarded).

Generally, a UK tax resident holding company will be subject to corporation tax in the same way as for other UK tax resident companies unless it falls within a special tax privileged regime. If the holding company is a QAHC, then a number of tax benefits will apply, including (i) complete exemption from tax on gains on qualifying shares (effectively, all shares apart from those deriving at least 75% of their value from UK land) and on overseas land, (ii) complete exemption from corporation tax on income profits of an overseas property business, broadly, to the extent they are chargeable to tax abroad, and (iii) potentially being able to reduce the other income on which the QAHC is taxable to a very low margin (by the use of profit participating debt). In addition, there are tax benefits for investors, with normal tax rules disapplied to make it easier for returns from a QAHC to be passed to investors in capital form. Please see question 6.8 below for a discussion of the tax position of REITs.

6.2 What is the tax treatment of the principal forms of investment manager/adviser identified in question 2.4?

The tax treatment of the manager or adviser will depend on whether it is constituted as a company or an LLP. If a company, it will be subject to corporation tax on the fees paid by the fund (the current main rate of which is at 25%). The management team takes its remuneration in the form of salary (taxed at the highest applicable income tax rates, with NICs also due) and the excess profit can be extracted as dividend income. If the manager is an LLP, it is fiscally transparent, so the profit arising from the fees paid to the manager is automatically taxable in the hands of its members. As noted above, the salaried member rules will be used to ascertain whether a member should be taxed as a self-employed person or an employee. The apparatus of an LLP is likely to mean that it constitutes a UK permanent establishment of its non-resident members such that all of the members, regardless of where they are resident, must pay UK tax on their share of the LLP's profits arising from its UK trade as an investment manager/adviser.

Under anti-avoidance rules, amounts arising to an individual involved in fund management are taxed as trading income, unless such amounts are already taxed as trading income or employment income or fall into exceptions for carried interest or co-investments. Where amounts from the fund arise to another person – such as a priority profit share/fee income arising to the general partner or manager – these amounts can be potentially imputed to the individual fund managers and taxed in their hands if certain conditions are met.

In terms of funds structured as limited partnerships, where the general partner appoints a manager to manage the partnership, the fee payable to the manager will in principle attract value added tax ("VAT"). This is most often managed by ensuring that the manager and the general partner are in the same VAT group. However, the Court of Justice of the European Union in the *Fiscale Eenheid X* case (C-595/13) outlined broad criteria for what constitutes a "special investment fund" ("SIF") for the purposes of the VAT exemption applicable to the management of such funds, and, in doing so, strongly suggested that AIFs that satisfy certain qualification criteria can be SIFs. This is a changing area of law, and in December 2022, the UK government launched a consultation on the VAT treatment of fund management fees. In the document containing the issues on which it was seeking feedback, the UK government set out its view of the qualification criteria for SIF status. It was clear from this that it currently takes a narrow approach to these criteria, such that fund management supplies to AIFs structured as limited partnerships would not be exempt from VAT. Under the consultation, the government is proposing to enshrine this narrow approach more clearly in UK legislation. The consultation closed in February 2023, and at the time of writing, the government's response is still awaited.

The UK is not typically used as a domicile for hedge funds, but it is a popular location for investment managers of hedge funds, and this is in part because of the Investment Manager Exemption ("IME"). Provided certain conditions are met, the IME ensures that a UK investment manager managing a non-UK fund will not constitute a permanent establishment of the fund in the UK. The IME enables a non-UK resident fund that is trading for UK tax purposes to appoint a UK-based investment manager without the risk of that part of the fund's profit that is attributable to the activity of the investment manager in the UK becoming subject to UK tax.

In relation to the taxation of carried interest the general "tax transparency" principle is overlaid with: (i) a minimum charge of 28% for carried interest (compared with 20% for most other types of gains); and (ii) rules that can recharacterise carried interest receipts as trading income, taxable at the highest marginal rates, where the fund in question has a short average holding period (the "income based carried interest" rules, or "IBCI"). The IBCI rules are complex, but broadly, where the average holding period of fund investments is less than 36 months, the carried interest returns will be treated as trading income. Where the average holding period is 40 months or more, the returns will be treated as investment gains or income. Where the average holding period is at least 36 months and less than 40 months, the returns are treated as a mix of investment return and trading income. There is an exception from the IBCI rules for carried interest awarded to employees. These rules relating to the taxation of carried interest do not affect the taxation of the fund itself or external investors.

6.3 Are there any establishment or transfer taxes levied in connection with an investor's participation in an Alternative Investment Fund or the transfer of the investor's interest?

There are no establishment taxes levied in connection with an investor's participation in an Alternative Investment Fund. Stamp duty may be payable on the transfer of limited partnership interests if the partnership property includes stock or marketable securities, although there are a number of methods of mitigating the effect of such duty. This position may change as, at the time of writing, the UK government is considering wide-ranging reform to stamp duty. As part of this, it has proposed that no stamp duty will be payable on transfers of partnership interests but that anti-avoidance legislation will be introduced to prevent such interests being used as a method of transferring share ownership in order to avoid stamp taxes on shares.

A separate tax, stamp duty land tax, may be payable where the partnership property includes land in England or Northern Ireland (with similar taxes potentially applying in relation to land in Scotland or Wales).

6.4 What is the local tax treatment of (a) resident, (b) non-resident, and (c) pension fund investors (or any other common investor type) in Alternative Investment Funds?

The use of tax-transparent limited partnerships as the primary vehicle for Alternative Investment Funds means that income and gains received by the fund are treated as if they had been received by the fund's investors directly. The taxation of the returns depends on whether the fund is treated as trading or investing.

The question of whether or not a fund is carrying on a trade in the UK is largely a question of fact. In practice, this is often determined by applying various criteria derived from case law – often referred to as "badges of trade" – to a fund's transactions. For example, churning investments and investing and divesting opportunistically would be likely to be indicative of a trading activity, whereas holding long for income and capital would be more likely to be considered as an investment activity.

Private equity funds (the main users of the limited partnership structure) usually intend to buy and hold securities for the medium to longer term in order to achieve long-term capital appreciation. Consequently, they are more likely to be considered as investing rather than trading.

If the limited partnership is treated as investing then, as a result of its tax transparency, profit distributions from the limited partnership retain their character as capital gains or investment income and are taxed accordingly. The tax payable by a particular investor will depend upon its own tax profile. For example, if the fund receives dividend income, this would be taxed in the hands of a UK-resident individual but a UK pension fund investor should not be subject to UK tax on such investment income. Most non-resident investors will only be subject to UK tax on UK-source investment income to the extent that it is subject to withholding tax or relates to UK land. Withholding taxes are potentially relevant to both UK interest and UK rental income (but generally not dividends), but there are reliefs from withholding. Generally, non-resident investors should not be subject to UK tax on capital gains unless: (i) they hold their interest for the purposes of a UK trade; or (ii) they fall into specific rules relating to UK property (and property-related) holdings (see below).

If the limited partnership is treated as trading for UK tax purposes, UK resident investors and non-UK resident limited partners will be subject to income tax (or corporation tax on trading income) on their share of the partnership's trading profits. This will be of particular concern for UK pension fund investors (who are only exempt from UK tax on investment income and gains). Non-UK resident investors will be caught because the partnership (or the fund manager) will constitute a taxable presence in the UK through which the non-resident is carrying on a trade, but in many cases the IME may be applicable.

The UK regime for taxation of gains arising to a non-resident from interests in UK land has expanded in scope significantly from 6 April 2019. Before that date, the UK only taxed non-residents on gains from UK residential property (subject to important exemptions in the context of investment funds). Broadly, the general position is now that non-resident investors are subject to tax on gains arising from disposals of UK land and also on the disposal of substantial interests in relevant entities that derive at least 75% of their market value from UK land. However, the general position is significantly modified by complex specific provisions relating to collective investment vehicles.

Investors should also be aware of the annual tax on enveloped dwellings, which should be considered carefully when a fund invests in UK residential property.

Where a UK limited partnership receives income from non-UK jurisdictions that levy withholding tax, or receives capital proceeds from the sale of an asset situated in a jurisdiction that might tax that gain, then limited partners may seek to rely on the terms of a double tax treaty in order to obtain relief. Whether such relief is available will depend, in part, upon whether that non-UK jurisdiction treats a UK limited partnership as fiscally transparent.

6.5 Is it necessary or advisable to obtain a tax ruling from the tax or regulatory authorities prior to establishing an Alternative Investment Fund or local asset holding company?

Generally speaking, it is not necessary to obtain tax rulings prior to establishing an Alternative Investment Fund or UK asset holding company, although a company entering the ITC regime must be approved by His Majesty's Revenue and Customs ("HMRC") and a company entering the QAHC or REIT regimes must have notified HMRC in advance.

6.6 What steps have been or are being taken to implement the US Foreign Account Tax Compliance Act 2010 (FATCA) and other similar information reporting regimes such as the OECD's Common Reporting Standard?

The UK entered into a Model 1 Intergovernmental Agreement with the US in September 2012 in relation to FATCA and subsequently introduced domestic legislation to implement FATCA reporting. Relevant Alternative Investment Funds established in the UK therefore have to carry out the required due diligence procedures and report prescribed information about relevant investors to HMRC.

In addition, the OECD Common Reporting Standard for Automatic Exchange of Financial Account Information ("CRS") has also been implemented into UK law.

Accordingly, UK funds will need to consider these information reporting rules in order to ensure that they are compliant.

6.7 What steps have been or are being taken to implement the OECD's Action Plan on Base Erosion and Profit Shifting (BEPS), in particular Actions 2 (hybrids/reverse hybrids/shell entities) (for example, ATAD I, II and III), 6 (prevention of treaty abuse) (for example, the MLI), and 7 (permanent establishments), insofar as they affect Alternative Investment Funds' and local asset holding companies' operations?

Following the publication of the OECD's final BEPS reports on 5 October 2015, the UK has taken the lead in the development and implementation of new rules relating to BEPS. For example, legislation having effect from 1 January 2017 was introduced in order to neutralise the effect of hybrid mismatch arrangements and legislation to restrict the tax deductibility of corporate interest came into force from 1 April 2017. In addition, the UK has implemented Country-by-Country Reporting and committed to implement Pillars One and Two.

The UK signed the multilateral instrument ("MLI") in June 2017 and it entered into force for the UK on 1 October 2018. As expected, the UK adopted the principal purpose test in relation to its covered treaties, but did not narrow its definition of an independent agent or extend the definition of permanent establishment, other than adopting the provisions that prevent a permanent establishment being avoided by means of the fragmentation of activities.

As the UK is no longer a member of the EU, ATAD III will not be implemented in the UK. In addition, the government has not indicated that it will introduce measures equivalent to those contained in ATAD III.

6.8 Are there any tax-advantaged asset classes or structures available? How widely are they deployed?

If there is appetite to establish a listed fund, then an ITC or REIT should be considered. As discussed in question 2.1, a REIT can now also be an unlisted vehicle where, broadly, it is at least 70% owned by institutional investors.

Provided certain conditions are met, ITCs are exempt from corporation tax on capital gains, can benefit from the general corporation tax exemptions from dividend income and can potentially deduct dividends paid to investors that represent interest income from their interest receipts. Provided certain conditions are met, REITs are exempt from corporation tax on the income profits of their property rental business and on gains arising on disposals of assets used in such business (potentially including interests in certain entities that are UK real estate rich) and can benefit from the general corporation tax exemptions from dividend income.

6.9 Are there any other material tax issues for investors, managers, advisers or AIFs?

The tax position of an investor in a UK Alternative Investment Fund will inevitably depend upon its own tax profile – accordingly investors should always seek independent advice on the tax implications of participating in the fund, and managers should advise investors of this fact.

6.10 Are there any meaningful tax changes anticipated in the coming 12 months other than as set out at question 6.6 above?

In March 2020, the UK government announced that it would undertake a review of the UK funds regime, including from a tax perspective. The review is very wide ranging and has already led to various changes, including the introduction of the QAHC regime and amendments to the REIT rules. As the review is still in progress, the full extent to which it will lead to further tax developments is not currently known. However, it is expected that further amendments will be made to the REIT regime to increase its attractiveness, and the VAT consultation mentioned in question 6.2 is a further tax element of the review. A more general development arising from the review is the consultation, discussed in question 7.1 below, on the possible introduction of an unauthorised contractual scheme, the "Reserved Investor Fund (Contractual Scheme)". A significant element of that consultation is the tax position of the scheme and its investors.

As mentioned in question 6.3 above, the UK government is considering wide-ranging reform to UK stamp taxes on shares.

7 Trends and Reforms

7.1 What have been the main trends in the Alternative Investment Funds space in the last 12 months?

The UK has sought to take advantage of so-called "Brexit freedoms" and make changes to areas of fund regulation that were previously mandated at EU level. These include amendments to the UK PRIIPs regime, including clarifying the scope of PRIIPs and amending the information to be provided in the KID, which came into effect on 1 January 2023.

New strategies for Alternative Investment Funds and specialisms have been emerging, including growth, healthcare, natural capital and bolt-on acquisitions, and more fund managers are launching GP-led strategies.

In the last 12 months, there has been an increasing trend in investors needing more liquidity, driving demand for GP-led liquidity. This is due to a number of market factors, including slower distributions, a tough fundraising market and the so-called "denominator effect" causing more investors to become overallocated to alternative strategies and therefore needing to obtain liquidity to modify their strategy. Another trend is the increasing maturity of the GP-led market. There is more scrutiny of the deal by investors and due diligence is becoming more sophisticated, and on single asset deals (which have grown considerably), the due diligence and terms are expected to increasingly look like third-party M&A. The Institutional Limited Partners Association ("ILPA") issued Guidelines on GP-led Secondary Fund Restructurings Considerations for Limited and General Partners in April 2019 and new guidance on Continuation Funds Considerations for Limited Partners and General Partners in May 2023 following the increase in these types of secondary transactions and the reportedly growing frustrations from limited partners around these deals. Also, fund managers have turned to fund finance debt providers for innovative, debt-based liquidity solutions as a result of challenging market conditions.

The UK continues to introduce new fund vehicles and adapt existing models to attract the increasing retailisation market. The FCA has introduced new rules to broaden retail access to the UK's rival to the ELTIF: the open-ended fund vehicle introduced in the UK in 2021, the LTAF. In April 2023, the UK government launched a consultation on the possible introduction of an unauthorised contractual scheme, the "Reserved Investor Fund (Contractual Scheme)", aimed at professional investors, high net worth investors and sophisticated investors.

7.2 What reforms (if any) in the Alternative Investment Funds space are proposed?

A number of future initiatives in respect of fund regulation or affecting Alternative Investment Funds are proposed.

The UK's Future Regulatory Framework is intended to repeal retained EU financial services legislation and, effectively, move it from the statute book into the UK financial services regulators' rulebooks. This will include legislation such as UK AIFMD and the UK PRIIPs Regulation. It is currently unclear to what extent there will be changes to the original legislation as part of that process. However, the FCA has published a discussion paper on updating and improving the UK regime for asset management, which seeks views on the current UK regulatory regime for funds and sets out some possible changes, including amending the criteria for sub-threshold AIFMs.

Significant changes are also expected in the case of PRIIPs and retail disclosures. In December 2022, HM Treasury published a consultation on PRIIPs and UK Retail Disclosure setting out plans to repeal the UK PRIIPs Regulation and asking for views on a new framework to replace it. The FCA also published a complementary discussion paper seeking feedback on how the FCA can design and deliver a good disclosure regime (particularly in respect of PRIIPs and UCITS) with a particular focus on the delivery, presentation and content of retail disclosures.

The UK government has also been looking at post-Brexit measures to ensure that the UK remains a competitive and attractive place to list a business as compared with other major stock markets. A number of proposals have been published over the past 12 months and are currently being consulted on to completely overhaul the listing, prospectus and secondary fundraising regimes in the UK and represent a departure from the current EU-based regime.

Sustainable finance also remains a key area of development. The FCA is proposing new sustainability disclosure requirements and a set of consumer-friendly sustainability labels as well as an anti-greenwashing rule.

Reforms to UK limited partnership law are expected to become law in 2023. The ECCT Bill was introduced in Parliament in September 2022 and proposed the introduction of a number of changes to the LP Act aimed at tackling the abuse of limited partnerships by strengthening transparency requirements. However, the proposed changes in the ECCT Bill seem to go further than this. They will apply to all UK limited partnerships (new and existing) registered under the LP Act, including PFLPs and SLPs, and essentially require more information about the limited partnership's partners to be filed with the Registrar of Limited Partnerships (although it will not all be publicly available) and will put in place controls on who can file the information (documents are to be delivered by an "authorised corporate service provider"). The ECCT Bill proposed the introduction of a number of new provisions into the LP Act, including the requirement for limited partnerships to maintain at all times a registered office address in the part of the UK in which the limited partnership is registered, for general partners to have a named "registered officer", and potential criminal offences for limited partners in certain limited circumstances. It also proposed the introduction of a new power on the Registrar of Limited Partnerships to publish a "dissolution notice" in the Gazette where it has reasonable cause to believe that a limited partnership has been dissolved, which has the effect of dissolving the limited partnership if it was not already dissolved. The ECCT Bill also enables the voluntary deregistration of a limited partnership by its partners (safeguarding the limited liability of limited partners after concerns were raised by the industry). While there is no change to the existing rules on partnership accounts, the ECCT Bill conveys powers on HMRC to require a general partner to prepare and deliver accounts to it. There will be a six-month transitional period for existing limited partnerships. The ECCT Bill also proposed the introduction of changes for companies.

The UK Consumer Duty rules are coming into force in July 2023 and will change the way many FCA authorised firms are expected to deal with their customers and investors. The Consumer Duty will apply to all firms that deal with "retail customers" either directly or through distribution chains in respect of "retail market business" – the scope of the new definitions could mean that fund managers that consider their business as institutional may be caught.

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