Managed Funds Association
The Voice of the Global Alternative Investment Industry
Washington, D.C. | New York | Brussels

February 3, 2023

Via Electronic Submission: HMTVATandExcisePolicy@hmtreasury.gov.uk

HM Revenue & Customs
100 Parliament Street
London
SW1A 2BQ
United Kingdom

Re: VAT Treatment of Fund Management Services

Managed Funds Association[1] ("**MFA**") appreciates the opportunity to provide feedback to His Majesty's Revenue and Customs ("**HMRC**" or "**HM Revenue & Customs**") and His Majesty's Treasury ("**HMT**" or "**HM Treasury**") on the above-captioned consultation regarding their intention to codify current UK policy for the exempt VAT treatment of certain fund management services into UK law ("**Consultation**").[2] We view the overall proposal as a welcome step in clarifying the scope and application of a comprehensive UK domestic VAT exemption for the management of Special Investment Funds ("**SIFs**") (the "**SIF Exemption**"), particularly in light of the additional complexity and potential uncertainty in relying on EU legislation and case law post-Brexit.

We broadly agree that the proposed approach to refining the current UK law covering the VAT treatment of fund management achieves its stated aims.[3] We do, however, have recommendations on both the proposed approach to the legislative drafting for this SIF Exemption (as outlined in the Consultation) and the broader application of and context for this SIF Exemption (and broader VAT policy reform) as it applies to the majority of MFA members. We believe that our recommendations on the legislative drafting for this SIF Exemption would further "the twin aims of improving policy clarity and certainty for all stakeholders and removing the reliance on retained EU law." We equally believe that our recommendations on the broader VAT policy reform, although beyond the scope of the Consultation, would further support the oft-stated goals of building on the UK's existing strengths as an asset management hub and enhancing the attractiveness of the UK as a funds domicile. Our recommendations are set out in narrative form below, cross-referenced to the specific Questions posed by the Consultation where appropriate.

MFA Member Interest in the Consultation

[1] Managed Funds Association ("**MFA**") represents the global hedge fund and alternative asset management industry and its investors by advocating for regulatory, tax, and other public policies that foster efficient, transparent, and fair capital markets. MFA's more than 150 member firms collectively manage nearly $2.6 trillion across a diverse group of investment strategies. Member firms help pension plans, university endowments, charitable foundations, and other institutional investors to diversify their investments, manage risk, and generate attractive returns over time. MFA has a global presence and is active in Washington, Brussels, London, and Asia. www.managedfunds.org.

[2] "VAT treatment of fund management services," HM Treasury and HM Revenue & Customs, https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1122855/221130_VAT_on_fund_management_condoc.pdf (published 9 December 2022)

[3] ***Question 1***: "Do you agree that the proposed approached to refine UK law covering the VAT treatment of fund management, set out above, achieves its stated aims?"

For context, and with respect to ***Question 3***,[4] regarding current reliance on the domestic VAT exemption, MFA members largely do not manage funds which currently rely on Items 9 and 10 of Group 5, Schedule 9 of the VAT Act 1994 ("**Items 9 and 10**"),[5] nor would they expect to rely on the new SIF Exemption following the proposed change in legislation in the UK. A common structure amongst less liquid, non-retail and non-UCITS-type funds (such as those that constitute the majority of funds managed by MFA members) entails the provision of fund management services from a UK manager or advisor (or sub-manager or sub-advisor) to a manager or advisor or fund vehicle (or general partner thereof) located outside the UK, with such services constituting taxable services supplied outside the scope of UK VAT.

As HMRC is already aware, including from responses submitted by other parties to the January 2021 Call for Input on the UK funds regime ("**Summary of Responses**"),[6] the input VAT recovery position of the UK manager or advisor in this structure relies upon the management services being considered taxable supplies (albeit out of scope) rather than exempt supplies. In response to ***Question 2***,[7] regarding whether the proposed reforms present any issues for the business of MFA members, we submit that if the scope of the existing VAT exemption were to be inadvertently broadened through the proposed codification process so as to result in irrecoverable input VAT for the UK entities used by MFA members (as a result of their being treated as supplying exempt, as opposed to taxable, services), this would constitute a significant business cost that would negatively affect the attractiveness of the UK as a location from which to provide fund management services.

We note that the codification process is not intended to result in a significant policy change in UK VAT treatment for the fund management industry, and that the status quo allows for fund managers to choose to rely on either the "direct effect" of the EU VAT Directive 2006/112/EC (the "**VAT Directive**") or on Items 9 and 10. Our understanding of the Consultation is that the SIF Exemption will (mandatorily) apply where a fund is either of a type listed in Items 9 and 10 or falls within the new criteria to be considered a SIF. It is therefore essential that the new criteria are not overly inclusive in defining a SIF for the purposes of the domestic SIF Exemption.

We set out in the following paragraphs observations on the current proposal for the SIF Exemption and recommendations that HMRC and HMT may wish to consider as the legislative process progresses to further support the stated goal of building on the UK's existing strengths as an asset management hub.

Comments on Proposed SIF Exemption

In response to ***Question 4***,[8] we consider that the adoption of the Financial Services and Markets Act 2000 ("**FSMA**") definition of "collective investment scheme" for the purposes of the SIF Exemption is appropriate and should not result in any new issues of interpretation or certainty in applying the SIF

[4] ***Question 3***: "Do you currently rely on Items 9 and 10 of Group 5, schedule 9 of VATA or exempt any transactions using that law?"

[5] Items 9 and 10 set out the current list of fund types of which the management is exempted, including, among others, authorised open-ended investment companies, authorised contractual schemes, and authorised unit trust schemes.

[6] "Review of the UK funds regime: a call for input - Summary of responses," HM Treasury, https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1053909/Final_UK_Funds_Regime_Review_-_Call_for_Input_Summary_of_Responses.pdf (February 2022)

[7] ***Question 2***: "Do the proposed legislative reforms present any issues for your business?"

[8] ***Question 4***: "Would the legal definition for 'Collective Investment' in FSMA 2000 meet the intended aim of providing much greater certainty over correct application of the associated qualifying criteria?"

Exemption. It is principally criterion (d) of the proposed SIF definition which we believe would benefit from greater certainty through the legislative process (as outlined below).

As HMT and HMRC are aware, the UK presently does not treat an EU-domiciled UCITS as a SIF unless, broadly, it is marketed to the public in the UK, which – absent reliance by the EU UCITS on the UK Temporary Marketing Permissions Regime post-Brexit – requires FCA authorisation. Similarly, a UK-domiciled UCITS requires FCA authorisation in order to be marketed to the public in the UK. The Consultation proposes that the requirement for "State Supervision" (which currently appears in the guidelines to the VAT Directive) be dropped as part of the new SIF Exemption, on the basis that the SIF Exemption will include the criterion contained in paragraph 2.3(d) of the Consultation, *i.e.*, that "*the fund must be subject to the same conditions of competition and appeal to the same circle of investors as a UCITS*." In response to ***Question 5***,[9] whilst we agree with this approach in principle, we consider that it will be important to specify the applicable definition of a "UCITS" in order to better achieve the aim of providing greater certainty over the correct application of the qualifying criteria.

We recommend that the natural definition to use in this context is that set out in section 236A of FSMA (not least because this definition is equally applicable to EU- and UK-domiciled funds). Using this definition would properly import to the new SIF Exemption the concept that the potential SIF must be a fund that has been established to raise capital from the public (which would require FCA authorisation, where the members of the public are in the UK) which would allow for the removal of the requirement for State Supervision, without changing the status quo. For completeness, the carve-outs to the definition of a UCITS in sections 236A(5)(b) and (c) and 236A(6) of FSMA should also be retained since, in our view, the geographic location of the investors is relevant to determining whether a potential SIF appeals to the "*same circle of investors as a UCITS*." Without such a geographic limitation, the SIF Exemption could *prima facie* apply to a non-UK-domiciled fund (which would otherwise be outside the scope for UK VAT purposes) that is intended for retail investors but only marketed to the public outside of the European Economic Area or the UK, which would represent a fundamental change to the existing VAT treatment.

Separately, we note that directly importing the wording of the guidelines to the VAT Directive that "*the fund must be subject to the same conditions of competition and appeal to the same circle of investors as a UCITS*" does not, in our view, eliminate the current uncertainty under the VAT Directive as to the exact meaning of these tests (which, as HMRC and HMT will be aware, has required interpretation by the Court of Justice of the European Union ("**CJEU**") on multiple occasions). We appreciate, however, that changing the underlying tests as part of the codification process could result in a change in the principles on which fund managers have been applying the VAT exemption to date and that this is expressly not the aim of the reform process. We do welcome the fact that, post-Brexit, the UK courts will be entitled to interpret the meaning of these terms for the purposes of the new domestic SIF Exemption, rather than deferring to the CJEU. We surmise that the circle of investors to which a UCITS is intended to appeal for these purposes is "the public" (as referred to in the UCITS definition in section 236A of FSMA mentioned above, including the geographic limitations within that definition). To the extent that HMRC and HMT are also of this view, we recommend that HMRC and HMT set this out explicitly in the new legislation (which would, in our view, be assisted by adopting the FSMA definition of a UCITS as suggested above).

<u>Comments on Broader VAT Policy</u>

[9] ***Question 5***: "If the answer to 4 is no, how might the government improve the definition to attain that aim?"

In response to ***Question 6***,[10] we understand from the Summary of Responses that there may be reluctance from a policy perspective to zero-rate *all* fund management fees. As an alternative, we urge HMRC and HMT to consider applying a VAT zero-rate to fund management fees charged to UK entities (or general partners of such entities) established within the UK's Private Fund Limited Partnership and Qualifying Asset Holding Company ("**QAHC**") regimes. This would further advance the stated goal of enhancing the attractiveness of the UK as a funds domicile by incentivizing the uptake and usage of these newer regimes by simplifying the UK VAT considerations for UK fund managers. Indeed, UK fund managers currently face the choice of establishing an offshore fund which is, on first principles, outside the scope of UK VAT, or establishing an onshore vehicle and then being required to VAT-group the relevant recipient entity of UK onshore fund management services in order to maintain overall VAT neutrality.

The process of VAT-grouping may be unattractive in some cases due to obligations to prepare and file consolidated accounts. In the case of fund managers which are headquartered outside of the UK, VAT-grouping may not be possible to achieve since the UK manager and the fund (or general partner) may not necessarily be under common control in the same way as might be expected with a "traditional" UK-headquartered fund manager. More generally, fund managers which are headquartered outside of the UK have grown accustomed to the market practice of supplying relevant taxable fund management services offshore (outside the scope of UK VAT). It is likely that, on a comparative basis at the structuring stage of a new fund, such fund managers would perceive it to be simpler to maintain this status quo rather than undertake a "new" VAT-grouping process. In addition, a VAT zero-rate would encourage the flexible use of, in particular, QAHCs by larger fund managers for portions of their portfolios, by allowing for the apportionment of fees between funds or investments without being concerned about VAT leakage.

Accordingly, we continue to recommend that HMRC and HMT consider the case for a VAT zero-rate on fund management fees charged to UK entities established within the UK's Private Fund Limited Partnership and QAHC regimes, given its importance to the lasting success of these vehicles.

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We appreciate the opportunity to submit feedback to HMRC and HMT, and we would be pleased to meet with the VAT and Excise Policy Team to discuss our comments. If the VAT and Excise Policy Team have questions or comments, please do not hesitate to contact Joseph Schwartz, Director and Counsel, or the undersigned at (202) 730-2600.

Respectfully submitted,

/s/ Jillien Flores

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cc: Rachel Stirrat, Head of VAT and Financial Services, HM Treasury
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[10] ***Question 6***: "Are there any further VAT related modifications the government might introduce under these or future reforms to improve the fund management regime for taxpayers?"