FUNDS

# Are we having funds yet?

The UK has struggled to make its mark in the competitive world of Ucits funds. Stuart Martin argues the case for the jurisdiction

I am asked regularly by investment managers to identify the relative advantages and disadvantages of the UK, Luxembourg and Ireland as potential onshore European domiciles for fund structures.

It is not a new issue. More than 13 years ago I was asked to speak on this topic to an audience of US general counsel at a New York conference. The audience was keenly interested in whether they should be establishing a European Undertakings for Collective Investment in Transferable Securities (Ucits) platform in Dublin or Luxembourg. I suspect my thoughts on the circumstances in which a promoter might consider the UK a potential domicile were largely of academic, as opposed to commercial, interest to the audience.

Nevertheless, no balanced comparison of this kind can be made properly without an appreciation of the circumstances in which a UK domicile may be most appropriate. Over the years I have seen a number of non-UK clients choose the UK as the domicile for their Ucits funds over other onshore jurisdictions, including Dublin and Luxembourg.

The relative advantages and disadvantages of the three domiciles are many and varied, but that said there are some key rules of thumb that every fund promoter should bear in mind.

### The big two

One established – and largely accurate – guideline is that UK-based fund managers with significant UK Ucits retail distribution tend, for marketing purposes, to be attracted to a UK domicile for their funds. Equally, UK fund managers seeking non-UK-based distribution tend to establish their Ucits funds in jurisdictions such as Ireland or Luxembourg instead of, or in addition to, their UK-based ranges.

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There is no doubt that an Irish or Luxembourg domicile remains the market standard for international distributors of Ucits funds.

Aside from market recognition issues, Ireland and Luxembourg have a variety of commercial and structuring advantages. Both offer well-developed systems of law, including segregation of liability between sub-funds and fund structures capable of dealing with the complexities of retail and non-retail share classes and charging structures.

Both jurisdictions offer promoters flexibility in designing tax-efficient products utilising tax-opaque corporate investment vehicles, as well as tax-transparent vehicles operating as contractual funds. Ireland also offers its own version of the semi-tax-transparent unit trust.

There are, of course, some important differences between the jurisdictions. For instance, for both Ucits and non-Ucits funds Ireland requires the promoter to maintain minimum regulatory capital of €635,000 (£530,700). While Luxembourg does not impose such a requirement on its specialised investment fund structures, the regulatory capital requirement for a promoter of a Ucits fund is considerably higher than in Ireland.

### Case for the UK

So, aside from distribution imperatives, when might one consider using the UK as a domicile?

Ireland- and Luxembourg-domiciled funds are, essentially, not subject to tax in their home domiciles. In this sense their tax treatments are simpler than the historical position in the UK, where funds suffer tax on their net income. However, in certain circumstances and for certain strategies and asset classes UK funds can achieve greater tax efficiency in terms of overseas witholding taxes and liabilities through access to the UK's range of double tax treaties. This is a particular advantage for Ucits funds, as neither an Irish nor a Luxembourg fund can utilise tax treaty subsidiaries to invest through.

Indeed, this is one of the primary historical reasons for international promoters to choose a UK domicile for their Ucits funds over and above Ireland or Luxembourg. As promoters consider the adoption of master-feeder structures under Ucits IV, the UK may also offer an attractive tax-efficient location for establishing Ucits master funds.

The UK has taken steps to make its fund ranges and taxation simpler and more attractive to fund promoters. For instance, in addition to UK Ucits it is possible to utilise the less regulated Non Ucits Retail Fund and Qualified Investor Scheme ranges for onshore alternative investment strategies, including funds of alternative investment funds, certain alternative investment and absolute return strategies not permitted for a Ucits III fund and, through the property authorised investment fund taxation dispensation, a form of open-ended real estate investment trust for UK property. Indeed, UK tax rules as they apply to UK non-Ucits funds investing in alternative investment strategies can also offer tax advantages to UK investors over investment in comparable offshore investment vehicles.

As part of this general trend towards modernisation, HM Revenue & Customs now permits UK funds to elect not to be subject to entity-level taxation in a similar way to the rules governing a traditional offshore fund. The Funds Investing in Non-Reporting Offshore Funds regime also offers a simplification of the UK tax rules. Additionally, the UK is considering adopting a regulated, tax-transparent vehicle that may be similar to a common contractual fund.

It is fair to say that there are some good reasons for considering a UK domicile and for the first time in a generation the UK appears to be taking steps to make itself a more attractive domicile for onshore funds. Clearly, however, much more needs to be done by the UK regulatory and tax authorities. It would be helpful to see progress under the new Government on segregated liability between sub-funds of umbrella schemes and also progress on eliminating stamp duty reserve tax on certain types of unit transactions.

In the final analysis, therefore, Luxembourg and Dublin retain the edge over the UK so far as international distribution of onshore Ucits and non-Ucits schemes is concerned. However, a New York audience may be more interested to hear what I have to say about UK funds now than in a cold and snowy January 13 years ago. ■

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