Keeping up with Alternative Investment Funds

December 2020

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Introduction

Welcome to our December edition of Keeping up with Alternative Investment Funds.

As we approach the close of the year, we move towards 2021 with the hope of the first effective COVID-19 vaccination schemes. Aside from the pandemic, the US awaits Biden's inauguration next month, whilst Brexit trade talks again hang in the balance. With it a near certainty that asset management will not be covered by any trade deal, it is ever important for firms to persist with efforts to prepare for the end of the transition period this month and have a contingency in place for a No Deal outcome impact. As always, we hope you and your families continue to remain safe and well in these uncertain times.

To support organisations with their response to the ongoing impact of the Covid-19 pandemic, our **COVID-19 website** will continue to feature the latest guidance, updates, and details of how we can offer help and support to businesses, from crisis scenario planning, to cashflow management and cyber security.

We will be holding more targeted client virtual roundtables in the new year to allow client communities to network and discuss common issues, allowing for a deeper dive into the discussion points. The dates for these virtual roundtable events will be released in due course.

As always, we are keen to hear feedback from clients on the virtual client roundtables held to date regarding frequency (bi-monthly vs monthly), content, format and any suggested topics to be covered at future events. Please contact **richard.madden@pwc.com** or **robert.mellor@pwc.com** if you have any feedback or suggestions.

Our December newsletter covers a wide variety of topics including an overseas deep dive special on the Cayman Islands.

See the full list of articles in this newsletter below:

- AIFMD Review: the European Commission launches a public consultation on the review of the Alternative Investment Funds Managers Directive
- Update on Nudge letters, One to Many letters, and tax enquiries
- COVID-19 - The People Perspective
- Staying Ahead of Governance
- Overseas Deep Dive - Cayman Islands

Please do continue to reach out to your usual PwC contacts if you would like to discuss any of the above, and please do share your feedback with us if there is a particular topic or issue you would like us to cover in the future.

Kind regards,

PwC Alternative Investment Funds team

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News Bulletin

Brexit Update

UK managers ("UK AIFMs") that currently market their funds in Europe under the national private placement regimes implementing Article 36 of the Alternative Investment Fund Managers Directive ("AIFMD") should be aware that their existing marketing notifications will lapse on 1 January 2021.

Following the end of the Brexit transition period, the UK will be considered a "third-country" for the purposes of AIFMD and Article 36 will no longer apply. Instead, UK AIFMs will need to rely on the local regimes established under Article 42 of AIFMD to market their funds, as third-country AIFMs.

Subject to the necessary cooperation agreements being in place between the FCA and the relevant EEA member state regulators (which is expected to be the case following the end of the Brexit transition period), UK AIFMs will be required to make separate notifications under Article 42 in each relevant country if they wish to continue marketing their funds. UK AIFMs should be able to market in the same jurisdictions under Article 42, as currently under Article 36.

As third-country managers, UK AIFMs will also be required to submit Annex IV transparency reports on a country-by-country basis to the relevant member state regulators (in addition to continuing with their AIF001/002 reporting to the FCA).

UK AIFMs that wish to continue marketing their funds after 1 Jan. 2021 should prepare and submit their Article 42 notifications in the relevant EEA countries as soon as possible. No notifications are required if the UK AIFM no longer wishes to market its funds.

Reminder of upcoming reporting deadlines for EU MDR

On 24 June 2020 ECOFIN adopted an amendment to DAC6 which gives EU member states the option to defer reporting under DAC6 for 6 months, with the possibility of extending this for a further three months after that. It's for individual states to decide whether to implement the deferral. The UK is implementing the 6 month deferral. From 1 January 2021 the reporting deadline will be 30 days and it is therefore imperative that reporting obligations are dealt with on a real time basis.

Reporting deadlines will be deferred as follows:

- The deadline for reporting **transitional arrangements** (where implementation started between 25 June 2018 and 30 June 2020) will be deferred until **28 February 2021** (rather than 31 August 2020).
- The full regime came into force on 1 July 2020. However, for arrangements where the **reporting trigger** (normally when advice is given to the taxpayer, or where implementation starts) occurs **between 1 July 2020 and 31 December 2020**, the 30 day reporting window will not start until 1 January 2021 (i.e. **30 January 2021** deadline).
- The 6 month deferral is **optional** for member states - each member state must decide whether to implement the deferral or stick with the original DAC6 deadlines. The UK has implemented the deferral.

The Government is deferring the first reporting deadlines by six months. The International Tax Enforcement (Discloseable Arrangements) (Coronavirus) (Amendment) Regulations 2020 (SI 2020/713) have been laid before parliament and will enter into force on 30 July 2020.

News Bulletin cont'd.

Update on Tax treatment of UK Asset Holding Companies in Alternative Fund Structures Consultation

Following our response to HM Treasury's consultation on the tax treatment of asset holding companies ("AHCs") in alternative fund structures earlier this year, we have been informed by HMT that they are shortly set to publish a response to the AHC consultation and launch a 2nd consultation seeking further views on design of a prospective regime for UK AHCs - timing looks likely w/c 14 December to coincide with the Town Hall events being held by HMT/HMRC on 15 and 17 December.

These town hall events are being held to discuss the direction of travel for the AHC regime, understand views and answer any questions from industry.

We also understand that HMT are to shortly publish an initial call for input on the review of the UK funds regime - we will communicate further updates with you accordingly.

Update on Anti-Hybrids legislation

Following the publication of a consultation document on "hybrid and other mismatches" published in March 2020, HMRC published its response to the consultation on 12 November together with draft legislation proposing changes to the UK anti-hybrid rules. There is a public consultation in respect of the draft legislation which will close on 7 January 2021. Whilst there were several positive and welcome and unexpected amendments to the anti-hybrid rules, some of which apply retroactively back to 1 January 2017 when the rules entered into force, certain proposals may only partly address issues arising for some taxpayers. More detail will be provided in the next edition.

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AIFMD Review

In this article, we take a look at the recently announced consultation by the European Commission (the **EC**) on the review of the Alternative Investment Fund Managers Directive (**AIFMD**) (the **AIFMD Consultation**).

By way of background, the AIFMD is a regulatory framework for alternative investment fund managers (**AIFMs**), including managers of hedge funds, private equity firms and investment trusts, known as Alternative Investment Funds (**AIFs**), which entered into application on 22 July 2013.

The AIFMD required the EC to commence a review of the Directive by July 2017 (the **AIFMD Review**) to establish whether its objectives were being met and, if necessary, to propose appropriate amendments. The first stage of the AIFMD Review was completed last year with the publication on 10 January 2019 by the EC of the report it had commissioned into the operation of the AIFMD, intended to "*provide and assess evidence*" for the EC's review. The EC released its own report on 10 June 2020 (the **EC Report on AIFMD**) which concluded that while the AIFMD had contributed to the creation of the EU AIF market there were also a number of areas where the legal framework could be improved. The European Securities and Markets Authority (**ESMA**) has also written a letter to the EC on 18 August 2020 to provide their own contribution to the AIFMD Review (the **ESMA Letter**).

The next stage of the AIFMD Review now seeks the views of relevant stakeholders and we have set out some of the AIFMD Consultation's key areas of focus below:

Access to markets

The EC Report on AIFMD revealed that although access to national markets had grown due to the AIFMD, in some cases, the time to market had increased. The AIFM passport was declared to have been an "*important factor*" in the growth of the EU AIF market but its impact was also said to have been impaired by some countries choosing to impose additional requirements, divergences in the national marketing rules, varying interpretations of the AIFMD by national supervisors and its limited scope.

Therefore, the AIFMD Consultation seeks views from stakeholders on the scope of the AIFM passport, its potential extension to smaller AIFMs and also level playing field concerns between investment firms and AIFMs providing competing services.

National Private Placement Regimes

National Private Placement Regimes (**NPPRs**) allow AIFMs to market AIFs that are not allowed to be marketed under the AIFM passporting regime (such as third country (i.e., non-EU) AIFMs). Indeed, the role of NPPRs is acknowledged in the EC Report on AIFMD to have been an important factor in the development of the AIF market in the EU given the absence of the AIFM passport for third-country managers. However, as NPPRs differ among member states, it has also created an unequal playing field between EU and non-EU AIFMs. Therefore the AIFMD Consultation seeks views on how best to achieve the equitable treatment of non-EU AIFs and securing a wider choice of AIFs for investors while at the same time ensuring that EU AIFMs are not exposed to unfair competition or are otherwise disadvantaged.

AIFMD Review cont'd

Depositaries

The EC Report on AIFMD noted the lack of a depositary passport as being at odds with the EU's single market approach. ESMA have also stated in the ESMA Letter that the EC should study the benefits and risks further of a depositary passport in the context of the AIFMD Review. Because of the limited choice of service providers in smaller markets, there are fears of concentration risk where a single depositary could hold the assets of all AIFs established in a Member State. Although the AIFMD Consultation states that the introduction of the depositary passport is desirable from an internal market point of view, it also asks stakeholders to propose other potential legal solutions.

Valuation

The EC Report on AIFMD noted that while AIFMD had brought some structure to the AIF asset valuation process, there were still some issues with the binary choice in the valuation rules between internal or external valuation, as well as uncertainty about the liability of external valuers. Therefore, the AIFMD Consultation seeks stakeholders' views on potential improvements to the AIFMD rules on valuation.

Supervisory reporting requirements

The EC Report on AIFMD noted that some of the AIFMD reporting requirements may not be essential, and some may be insufficient or duplicative. Therefore, it suggested further streamlining might be needed with regards to supervisory reporting requirements. This is also picked up on in the AIFMD Consultation which suggests more centralised supervisory reporting and improved information sharing among the relevant supervisors.

Harmonisation of AIFMD and UCITS regimes

The AIFMD Consultation also asks whether rules for AIFs and retail funds should be merged into a single rulebook, including the creation of a single licence for AIF and Undertakings for the Collective Investment in Transferable Securities (**UCITS**) managers, harmonised metrics for leverage calculation and harmonised reporting on the use of liquidity management tools. This is interesting as it also picks up on a point made by ESMA in the ESMA Letter which also raised the possibility of greater harmonisation of the UCITS and AIFMD frameworks which indicates gathering momentum on this issue.

AIFMD Review cont'd

Centralised Supervision

The AIFMD Consultation suggests the potential for more centralised supervision, including entrusting ESMA with the authorisation and supervision of all AIFMs and/or non-EU AIFMs and AIFs. Although contentious (as this would seem to override national competent authorities) and not entirely clear about how it would work in practice it does fit a general theme in the AIFMD Consultation of centralising power and looking to reduce divergences between Member States.

Outsourcing/delegation

The AIFMD Consultation asks whether AIFMD rules on delegation are clear enough to "*prevent the creation of letter-box entities in the EU*", are consistently enforced across the EU and ensure effective risk management. Again, this is also a theme that is raised in the ESMA Letter in which ESMA suggests that further legal clarifications on the maximum extent of delegation would be helpful to ensure supervisory convergence and ensure authorised AIFMs and UCITS management companies maintain sufficient substance in the EU.

The issue of delegation is also intensely wrapped up with Brexit as the EU, will have a very significant new third country on its doorstep. However, there is a vast difference between improving the substance of the oversight of portfolio management delegation (whilst still allowing it to happen) and determining that the portfolio management of EU funds, in which EU investors are invested, should only take place in the EU. Cross border delegation of portfolio management operates across the globe, there is little evidence that it poses risk to investors if the operational oversight of the portfolio management is done correctly.

Next steps for Alternative Investment Funds

- The AIFMD Consultation will be open for fourteen weeks (ending on 29 January 2021) and we would recommend that AIFMs engage with the process.
- For the UK, notwithstanding Brexit, the AIFMD Consultation remains relevant particularly the questions concerning the treatment of non-EU AIFMs and the future of the AIFMD passport.
- One theme that is not picked up by the EC in the AIFMD Consultation (and which may be more relevant for UK firms post Brexit) is greater clarity on reverse solicitation (which is suggested in the ESMA Letter to avoid the divergent practices and interpretation which currently occur at national level).
- However, overall the nature of the questions posed in the AIFMD Consultation show that it will be a serious exercise covering some of the more contentious topics like delegation and supervision.

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Update on Nudge letters, One to Many letters, and tax enquiries

Increasingly, taxpayers and their agents are receiving letters from HMRC as part of dedicated campaigns being run by HMRC designed to encourage taxpayers to review their tax position and ensure their tax affairs are fully up to date.

The two main types of letters we are seeing at the moment are referred to as "nudge" letters and "one to many". Both types of letters can cover a range of different areas, are not uniform and do not all require a response so knowing what action to take on their receipt, if any is required, is very important.

"Nudge" letters

We are aware that HMRC has once again issued letters to some taxpayers requesting information in respect of offshore income and gains.

The letters tell the individual that it is their responsibility to tell HMRC about their UK tax liabilities from offshore income and gains anywhere in the world, and that it is important that taxpayers check that they have declared all their UK tax liabilities.

The letters generally give 30 days to respond and all of them include a "Certificate of Tax Position" form which HMRC ask the individual to complete and return whether they have additional tax liabilities to disclose or not.

On the certificate, the individual is asked to sign and make a declaration to the effect that:

1. The information they provide on the certificate is "correct and complete to the best of their knowledge and belief" and
2. They understand that choosing to make a false statement or complete a false certificate is a criminal offence that can result in investigation and prosecution

Recipients are also asked to tick that either:

1. Their tax affairs need to be brought up to date and they will make a disclosure of irregularities through the Worldwide Disclosure Facility (WDF); or
2. Their tax affairs do not need updating and they do not have additional tax to pay.

There is then a further declaration: "I have declared all of my offshore income, assets and gains which are taxable in the UK".

What should you do if you receive one of these letters from HMRC?

The first point to note is that HMRC is saying that they are aware that you have overseas income, not that your tax return is necessarily wrong. It should also be noted that there is no legal obligation to complete the 'Certificate of tax position' and return it to HMRC. However, it is essential to check whether your tax affairs are correct and complete to the best of your knowledge and belief before responding to the letter.

If no disclosure is needed, you may wish to consider sending HMRC an explanation by letter. Where no response is received by HMRC, HMRC may follow up. Therefore not responding at all could attract more attention from HMRC. Responding to the initial letter may reduce the risks of further action being taken by HMRC.

If a disclosure is required, the letter advises that this must be made via the Worldwide Disclosure Facility ("WDF"), but using the WDF may not necessarily be the most appropriate method. Depending on your individual circumstances, other approaches may be better.

"One to Many" letters

A One to Many letter represents an approach taken by HMRC to "positively influence customer actions" so that they are more likely to comply with their tax obligations. In effect, these letters are designed to educate taxpayers, alerting them to consider whether there are any issues that they need to review in relation to their historic filing positions.

HMRC have issued these letters recently in relation to a number of different areas. These include:

- Deferred consideration for CGT purposes
- Reporting requirements for deemed domicile individuals
- CGT on residential property disposals
- Statutory Residency Test
- Foreign tax credit relief
- Overseas workday relief

Update on Nudge letters, One to Many letters, and tax enquiries

What should you do if you receive one of these letters from HMRC?

If you receive one of these letters, it is important that you consider your historic position, with a view to confirming that there have not been any tax irregularities. Firstly and fundamentally this is important in and of itself to ensure that all returns are correct and complete.

In addition to this, if any irregularity that relates to the contents of HMRC's letter does emerge, whether or not this issue has been adequately considered could have an impact on your position in the context of any subsequent amendment or enquiry.

HMRC enquiries

Over the last 18 months, we have seen many HMRC enquiries into executive tax returns with a focus on "carried interest" - some involving several executives from the same asset manager, whilst others may only be in relation to one individual.

In order for HMRC to get comfortable with the reporting and disclosure of carried interest, they typically request evidence that:

- The carried interest is qualifying carried interest (i.e. meets the definition of carry as per the legislation);
- Does not meet the conditions of Income Based Carried Interest (i.e. they want to look at the Weighted Average Holding Period and the methodology that has been adopted);
- If foreign tax has been levied on the carry, that the correct foreign tax credit has been claimed; and
- If the recipient is non-UK domiciled, that the carry has been paid into two separate bank accounts and the proportion attributable to UK services is appropriate.

All of these points require some level of information to be provided by the alternative investment fund manager, and in fact, HMRC will expect the them to engage with HMRC to provide this evidence (which makes it even more important for this information to be provided to the executives from the outset - i.e. when preparing their returns).

Next steps for Alternative Investment Funds

The tax affairs of Alternative Investment Fund executives are typically complex, and the reporting of fund related returns can have wide ranging implications for both the individual and the alternative investment fund manager.

To ensure that executives are compliant with their reporting obligations, it is important to seek advice when:

- Dealing with HMRC "Nudge" and "One to Many" letters;
- Reporting carried interest and other fund returns via self-assessment; and
- Dealing with HMRC enquiries.

The Alternative Investment Fund Network within PwC can support you with the above to make sure you get the right result for funds managers and executives. Please get in touch with the below your PwC contact or the authors below if you would like to discuss further.

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COVID-19 - The people perspective

In our previous article in June 2020 we looked at the impact of COVID-19 on the people in your business, most countries around the world were enduring a stringent local lockdown. Several months later, some restrictions have lifted, some restrictions remain, some went away and then came back again, and irrespective of location, many of us continue to work remotely at least the majority of the time. Even for those of us who have spent some time physically present at our usual place of work, the UK government's guidance has varied over time as to whether we are encouraged or discouraged to visit the office and in either case there have been very strict protocols set out by both our national government and our employers to keep people as safe as possible.

By now, many employers have also indicated that even in a post COVID-19 world, as distant a thought as that may seem at the moment, they do not expect that the office buildings will be buzzing with busy-ness in quite the same way as was previously the case and that they will support employees' desires to work from home more frequently in the future. In fact, out of all of the Financial Services organisations that took part in a PwC survey over the summer, only 13% indicated that they did not expect to adopt and embrace international remote working. Importantly, as we edge closer towards the end of 2020, it is also important that we throw Brexit into the mix with COVID to consider more holistically what the future might look like.

We know from our previous discussions that there are some really key aspects that employers need to get on top of with a degree of urgency:

- **Understanding your people** As well as knowing where all their people are and have been, organisations need to understand what their peoples' plans and intentions are in terms of their future working locations;
- **Staying on the right side of the law** - Organisations must satisfy themselves that all regulatory requirements have been adequately managed and met through the COVID period. In particular, we know that many people moved out of the UK as part of planning for the post-Brexit operating model so it is important to assess whether those working arrangements are still sustainable; and
- **Immigration** - Organisations *and* individuals must satisfy themselves that all activities undertaken are covered by appropriate right to work permissions. Whilst COVID-19 has restricted movement across Europe, Irish and UK citizens are still free to travel within the Common Travel Area, albeit with local quarantine measures. In a post-Brexit world, there will need to be greater monitoring of individuals' citizenship and visa statuses.
- **Tax risk now and in the future** - Organisations must take a view on whether any PE risk already exists in other locations (recognising any local relaxations of OECD guidance which may help alleviate this risk) or, if such a risk may exist in the future if individuals are not repatriated to their regular place of work within a certain period of time. For many businesses this is likely to change their emphasis from managing PE risk to recognising PEs and managing attribution and transfer pricing risk.

But what else could all this change mean for us all as individuals within organisations? We have set out below some food for thought which is a compilation of the discussions we have had with many of you, as well as insights we have received from both the global PwC network and from the relevant governing authorities.

Tax Residence

We have all welcomed the news that most countries have announced some form of relaxation around tax residence rules over the COVID period. The UK have indicated that if an individual is unavoidably displaced in the UK as a result of COVID then days spent in the UK may not count towards the day counts used to determine that individual's tax residence which would, in turn, impact that individual's scope of taxation in the UK.

In other locations, France for example, the government has stipulated a specific time period (generally from around March to June) during which days spent in that location might not contribute to tax residence day counts.

COVID-19 - The people perspective cont'd

In the US, a proposal had been put forward some time ago for state tax relief on a temporary basis but so far this proposal has not been mandated so is very much dependent on each individual State's own uptake and interpretation. The political climate and change afoot in the US is almost certainly going to have an impact on the implementation of such initiatives.

Wage Tax Withholding

It is also helpful to know that many European locations in particular do not require a foreign entity to operate wage tax withholding for an employee of a foreign entity who happens to be working in that location, provided there is no permanent establishment of that foreign entity in the European location. Not all locations, however, share this view that the taxpayer can be held responsible for making the appropriate tax filings at the end of the tax year. In the US, for example, many states have a very low (or sometimes no) de minimis before which wage tax withholding should be operated in relation to state tax, and indeed the de minimis for Federal wage tax withholding is also quite low. Further, Brexit will inevitably give rise to an increase in travel, despite the pandemic, and we have seen a sharp increase in the number of commuting and 'dual-hatting' arrangements. As well as considering PE and regulatory risk, the rules regarding obligations to operate wage tax withholding needs to be considered in each location that the individual visits for work, not just those to which they will have contractual ties.

Social Security

This has been a big concern for employers and individuals over the last few months, especially in locations where contributions to social security could impact an individual's access to healthcare. However, we've again had welcome confirmation from many authorities that to the extent that COVID disruption is temporary, it is not expected social security contribution obligations would be impacted as a result of COVID alone.

Note we are starting to see that arrangements to work from home away from the usual country of work are now becoming more permanent and as such social security positions will need to be reassessed. This forward looking assessment will bring about particular challenges between the UK and the EU given that the transitional period will end at the end of December 2020. Similar rules will take effect in the future but these will exist under individually negotiated agreements between two countries and will not easily apply to cases where an individual works across two or more locations. Many sales staff will habitually work across numerous locations because they have coverage over a particular region and so these cases will need to be considered carefully.

In general, it has confirmed that existing A1 certificates will continue to be valid up until their expiry date provided there is no material change to an individual's facts and circumstances ahead of that expiry date. Therefore, it is a good time for employer's to assess where A1s could be applied for now to provide some degree of certainty from January 2021.

Pension Contributions

In June, we talked about the impact of providing certain benefits to employees, and also touched on the need to take labour law advice in case any mandatory benefits provisions arise as a result of a new working arrangement. Another area which will become more relevant as remote working arrangements become more permanent are pension contributions. It is possible that individuals will be accumulating pension funds in numerous locations, all with different contribution limits. In many cases, it will be necessary to consider the pensions rules of every relevant location concurrently.

COVID-19 - The people perspective cont'd

Remuneration Regulation

As we know, many organisations have set up new EU operations in response to Brexit, or enhanced existing organisations with MIFID top up permissions. This brings many alternatives firms in scope of the Investment Firms Regime which applies new remuneration regulations to all firms with MIFID permissions from summer 2021. Large firms will need to think through the technical challenges of delivering variable pay in instruments, deferral of variable pay and implementing formal Remuneration Committees, while all firms will need to consider requirements for their remuneration policy, identification of the individuals in scope of the rules according to prescriptive criteria, disclosure of fixed to variable pay ratios and the implementation of malus and clawback.

Remote Working Policy

Many of you have told us that you intend to put in place a remote working policy to enhance your existing travel policy. With planning, more formal arrangements can often be structured more efficiently by managing activities and day counts, as well as through advance agreements with tax authorities to mitigate double taxation upfront rather than suffering the cash-flow disadvantage of having to wait until a tax return is filed. Organisations should be guided by the remote working arrangements and requests that have already been brought to their attention when putting together policies, as well as leaving enough flexibility to adapt them in the future as the nature of work evolves.

The pastoral role of the employer

Speaking of evolutions, it seems inevitable that the pastoral role of the employer in the future will become a key differentiator between employers. An employer who can embrace remote working is likely to be looked upon more favourably by most prospective employees. However, individuals and organisations should also be alive to the challenges that come along with a reduction in physical co-location in an office space.

Employers will want to be able to articulate to employees (present and future) how they will continue to upskill their staff, how teams will congregate and how new joiners will be integrated. They will also need to consider how performance will be managed. What if, for example, a member of the workforce does not have a conducive remote working environment? Employers will need to put measures in place to identify issues and tackle them effectively to ensure that employees will feel supported in terms of coming back to an office environment on a more full-time basis. In exchange, there will be a stronger onus on individuals to make themselves known in their organisation not just by getting the job done but by participating in team calls and embracing the new way of working. Is it possible that this expectation on individuals could favour those with certain personalities or character traits and what does that mean for those without those particular attributes? Employers will, therefore, need to ensure they have a strong policy to ensure fair access to work. HR professionals have a key role to play in making the future of remote working successful.

Next steps for Alternative Investment Funds

- As we have set out above, there are some urgent due diligence activities that employers need to undertake as a matter of priority if they have not already done so.
- It is helpful to then combine this with the forward looking perspective so that some of the other considerations that we have touched on here can be fleshed out and any up front actions can be taken.
- Employers should reach out to their regulatory, legal and tax advisors as well as ensuring that remote working is tackled as a combined effort from the business, finance, tax, operations and HR.

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Staying Ahead of Governance: Update to Future Corporate Reporting

Existing and expected regulatory requirements for all companies, as well as businesses' response to the COVID-19 pandemic, have once again sharpened the focus on corporate governance at both parent and subsidiary company level.

The corporate governance statements that must now be published on company's websites and in their annual reports will need to give stakeholders an insight into the decisions that have been made as well as how companies are positioning themselves for the future. The Financial Reporting Council ("FRC") recently published a report outlining how companies could make their governance statements more useful, a report on how companies can improve corporate reporting more generally, as well as updated guides on COVID-19 and reporting in times of uncertainty.

The key point for Alternatives groups to note is that governance reporting is required at an individual legal entity level, rather than Group level. Governance statements must therefore refer to decisions that individual boards have made and the processes that supported those decisions.

The FRC report identified 8 top tips aimed at making governance statements more useful:

- Be specific and genuine, avoid box-ticking;
- Explain the "why" around which stakeholders were identified and engaged with;
- Link the content to the strategy;
- Be open about the challenges the board has faced when making decisions, as well as the positives;
- Reflect the board's oversight;
- Include material KPIs on key stakeholders;
- Address future consequences and planned actions, particularly in response to stakeholder feedback; and
- Be consistent.

In addition to the existing governance reporting requirements, the current audit reform proposals include recommendations that will impact both the content and scrutiny of governance statements, including:

- A new regulator, the Audit, Reporting and Governance Authority ("ARGA"), to replace the existing FRC. The ARGA will focus on subsidiary activities, with the power to impose external "skilled person" reviews, including regarding governance arrangements, amongst other areas.
- A requirement for Auditors' opinions to confirm that governance reporting reflects "observed reality", increasing the focus on and assurance over risk and controls.

Finally, there are some wider considerations impacting governance including:

- The increasing significance of environmental, social and governance ("ESG") matters for businesses and investors, as well as alignment with governance developments in Tax and Pensions regulations. With an ever-changing corporate landscape, companies are expected to consider their societal impact in everyday decision making.
- A focus on costs is requiring a streamlined, strategic approach to governance, supported further by the use of technology.

In summary, investors, stakeholders and regulators will all be scrutinising disclosures around board decision making. A heightened risk of litigation, reputational damage and financial penalties, coupled with the proposed strengthened powers of the regulator, mean that now is the time to review governance arrangements at both parent and subsidiary level and assess readiness against current and future regulations.

Staying Ahead of Governance: Update to Future Corporate Reporting cont'd

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- The increasing significance of environmental, social and governance ("ESG") matters for businesses and investors, as well as alignment with governance developments in Tax and Pensions regulations. With an ever-changing corporate landscape, companies are expected to consider their societal impact in everyday decision making.
- A focus on costs is requiring a streamlined, strategic approach to governance, supported further by the use of technology.

In summary, investors, stakeholders and regulators will all be scrutinising disclosures around board decision making. A heightened risk of litigation, reputational damage and financial penalties, coupled with the proposed strengthened powers of the regulator, mean that now is the time to review governance arrangements at both parent and subsidiary level and assess readiness against current and future regulations.

Next steps for Alternative Investment Funds

- With regulatory developments in mind, they should review their current governance strategy and arrangements to understand compliance with existing and future regulation, identify potential risks and any areas for improvement, taking a future proofed approach.
- Start thinking about the content for the FY20 corporate governance statement including employee and stakeholder engagement arrangements, and alignment to the company strategy and purpose, bearing in mind the FRC top tips referred to above.
- Consider how technology is being, or could be used to support, corporate reporting requirements (amongst other governance activities), for example tracking decision making.

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Overseas Deep Dive - Cayman Islands

This month's contribution provides an overview of the alternative investment industry in the Cayman Islands and the key factors driving it's success as being a global financial hub.

Overview of the Cayman Islands Alternative Investment Funds Industry

The Cayman Islands was the first international financial centre to implement alternative investment fund specific legislation and this laid the foundation for its status as a leading fund domicile in 1993 with the introduction of the Cayman Islands Mutual Funds Law.

The Cayman Islands has long been established as a popular domicile for alternative investment managers when creating offshore alternative investment funds and currently has more than 11,000 mutual funds and 12,000 private funds registered with the Cayman Islands Monetary Authority ("CIMA"). Recently the total net assets managed by Cayman Islands regulated funds exceeded $4 trillion, a number which continues to grow significantly with the implementation of the new laws mentioned below.

Whilst Cayman is a chosen jurisdiction by the non-US market, it is a popular choice for the US market with 70% of non US-domiciled alternative investment funds managed by US Securities and Exchange Commission registered investment advisors being domiciled in the Cayman Islands.

Regulatory Updates - Private Funds Law, 2020 and Mutual Funds (Amendment) Law, 2020

In early 2020 the Cayman Islands enacted new and revised legislation for alternative investment fund vehicles. This legislation includes revisions made to the existing Mutual funds Law for open ended funds and the passage of a new Private Funds Law for closed ended funds. Aside from strengthening investor confidence in the Cayman Islands, these laws also sought to address EU concerns regarding oversight as set forth in a report dated May 27, 2019, from the EU Code of Conduct Group (Business Taxation).

The Cayman Islands had been added to the EU's list of non-cooperative jurisdictions for tax purposes (often referred to as the "EU Blacklist") on February 4, 2020, having not taken sufficient steps to address certain EU concerns pertaining to collective investment vehicles by that date. The enactment on February 7, 2020 of the above legislation, and its subsequent implementation, prompted the EU to remove the Cayman Islands from this list in October 2020.

Choosing a Cayman Islands Alternative Funds Structure

The Cayman Islands has company, trust and partnership laws that allow a high degree of flexibility for establishing different types of fund vehicles. The four prominent vehicles commonly used are the exempted company, including the segregated portfolio company, the exempted limited partnership, the unit trust and the limited liability company.

Overseas Deep Dive - Cayman Islands cont'd

1. Exempted Company

A Cayman Islands Exempted Company is a corporation with separate legal personality and perpetual succession. Exempted companies are the most popular entity type amongst offshore funds as it provides limited liability while allowing 100% foreign ownership.

An exempted company may redeem or purchase its own shares and may therefore operate as an open-ended corporate fund. The rules governing the return of capital are flexible and allow for distribution to be by way of dividend or redemption of shares.

Closed-ended corporate funds can also be established using the exempted company and it is a relatively straightforward procedure to convert from one to the other.

Exempted companies may also register as a *Segregated Portfolio Company* ("SPC").

SPCs can create protected cells or portfolios to legally segregate assets and liabilities from other portfolios or the general assets and liabilities of the company. The SPC makes it possible to provide a means for different groups to protect their assets and the manager to operate a range of products when carrying on business through a single legal entity.

SPCs can have an unlimited number of portfolios and, if it meets the registration requirements with the Cayman Islands Monetary Authority, only the SPC needs to be registered instead of each individual portfolio.

Exempted companies are commonly used in master-feeder and side-by-side structures for the Master and Offshore Feeder funds.

1. Exempted Limited Partnership

An exempted limited partnership ("ELP") provides an unincorporated (no separate legal personality) vehicle and it can be formed as easily as an exempted company or a unit trust. This is a popular structure with private equity funds and offers speed-to-market that makes it efficient and effective.

3. Unit Trusts

Unit trusts are registered as Exempted Trusts. A unit trust is usually established under a trust deed with the investors' interest held as trust units and may be established as a stand-alone trust (single investment strategy) or umbrella unit trust (multiple investments allocated to separate sub-trusts).

4. Limited Liability Company

Cayman Limited Liability Companies ("LLCs") are similar to Delaware Limited Liability Companies and were introduced in 2016 as a hybrid between exempted companies and exempted limited partnerships.

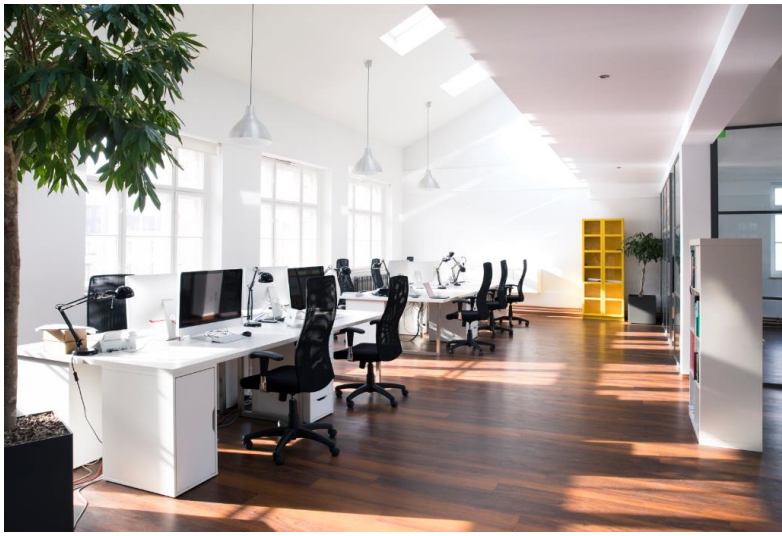
A Cayman LLC is a corporation with separate legal personality that can provide limited liability to its members and more flexibility around the management and structuring of the business.

Members of the LLC acquire LLC interests similar to partnership interests, so the profits and losses of the LLC are allocated in a manner similar to a partnership and as agreed by the members in the LLC agreement.

Tax Considerations

Taxation in the Cayman Islands

The Cayman Islands do not impose taxes on profits, income or gains. There is also no withholding tax on dividends, interest, royalties, or other tax obligations of companies.



Overseas Deep Dive - Cayman Islands cont'd

Cross-border Tax transparency

The Cayman Islands were part of the first set of jurisdictions that committed to improving transparency, eliminating harmful tax practices, and establishing effective exchange of information. Since their commitment in 2000, the Islands have enacted local laws and regulations and entered into various exchange agreements to improve cross-border transparency.

The Cayman Islands are a member of the OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting ("BEPS") and also have 32 bilateral arrangements and agreements in force for the international exchange of tax information.

Foreign Account Tax Compliance Act ("FATCA")

The governments of the Cayman Islands and the United States entered into an intergovernmental ("IGA") agreement in 2013 to improve international tax compliance and implement FATCA based on a Model 1B (non-reciprocal) IGA. The initial annual exchange of financial account information was in 2015.

The Common Reporting Standard ("CRS")

As a member of the OECD's Inclusive Framework on BEPS, the Cayman Islands is a party to the CRS Multilateral Competent Authority Agreement and was an early adopter of the CRS. The initial annual exchange of financial account information took place in 2017.

Country by Country Reporting ("CbC")

The Cayman Islands are also a signatory of the CbC Multilateral Competent Authority Agreement. CbC has also been implemented into domestic law and applies to multinational enterprises (MNE) with annual revenue of more than US$850 million (€750 million).

CbC reports filed with the Tax Information Authority ("TIA") provide a breakdown of the amount of revenue, profits, taxes and other indicators of economic activities for each tax jurisdiction in which the MNE Group does business. The data is then automatically exchanged with each participating jurisdiction in which the MME Group does business. Data collection and exchange with participating jurisdictions started in 2018.

Economic Substance

As a member of the OECD BEPS Inclusive Framework, the Cayman Islands enacted *The International Tax Co-operation (Economic Substance) Law* ("ES Law") at the beginning of 2019 in response to work of the OECD and the European Union.

The ES Law Imposes reporting obligations on "relevant entities", which generally excludes domestic companies, investment funds, or entities that are tax resident outside of the Cayman Islands. *As such, the ES Law is not applicable to most alternative investment funds*.

Starting in 2020, every legal person registered in the Cayman Islands must provide an Annual Substance Notification to the TIA, and relevant entities carrying on a relevant activity will also be required to submit an Economic Substance Return.

Next steps for Alternative Investment Funds

- The Cayman Islands have various types of vehicles that are commonly used for Alternative Investment Fund structures. The Islands also continue to evolve their regulatory regime to align with the ever changing regulatory environment.

To discuss this in more detail, please get in touch with your PwC contact or one of the authors below.

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