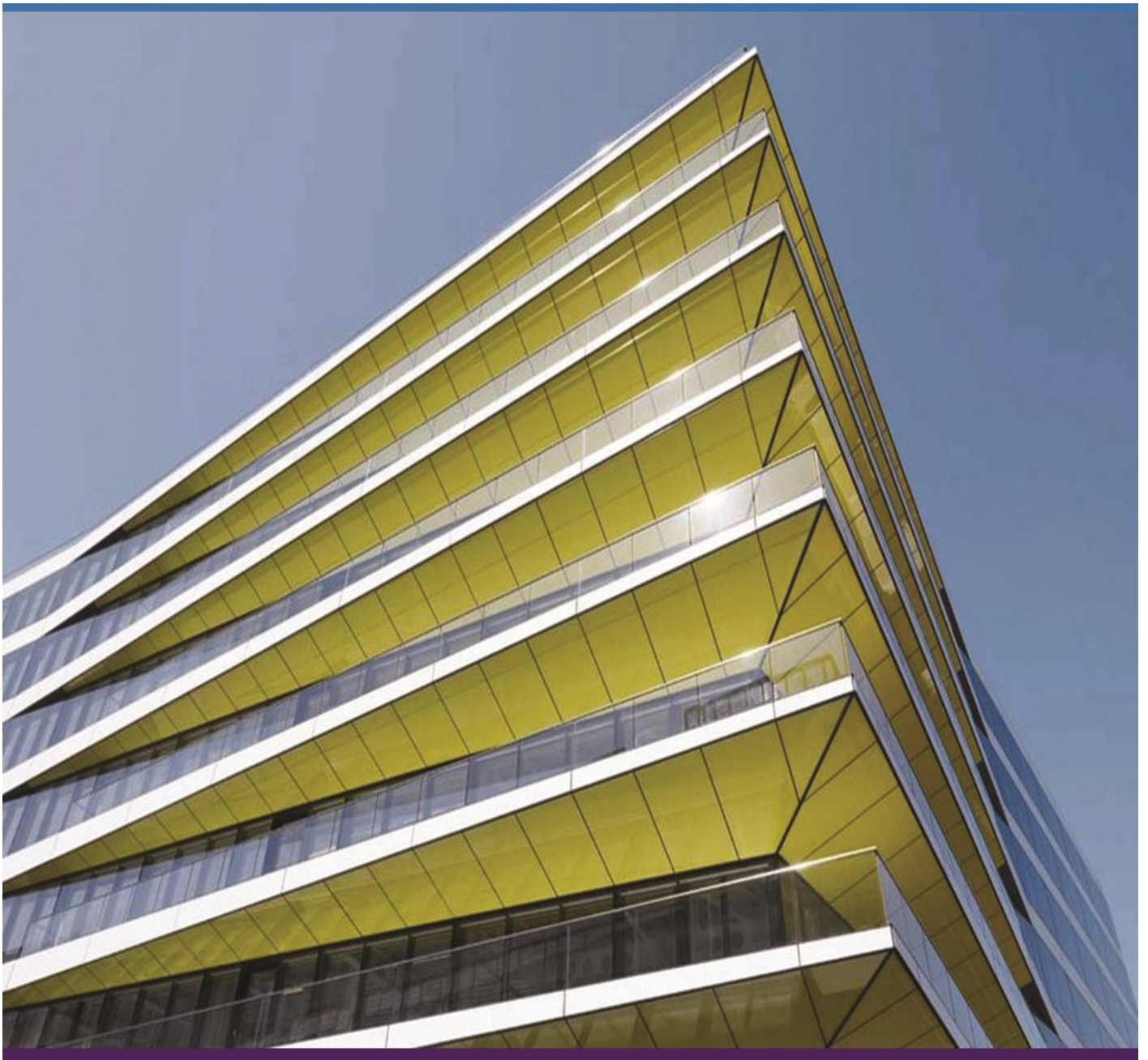


# Authorised Contractual Schemes (ACSs)

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# Authorised Contractual Schemes (ACSs)

*Authorised contractual schemes (ACSs) were established as a new type of legal form of UK authorised fund in 2013 to sit alongside authorised unit trusts and investment companies with variable capital. The benefit of the ACS is that it is a tax transparent fund.*

Authorised contractual schemes are facilitated with provisions inserted in 2013 in the Financial Services and Markets Act 2000 ("FSMA"), Chapter 3A at Sections 261C-Z5. As you will see from these provisions, although introduced with the intention that they would be used as feeder funds in UCITS master/feeder structures, with some of the provisions relating to master/feeder issues, the ACS is a structure to consider for other potential applications, notably for pension products.

Under the FCA Rules now set out in the COLL Rules:

- ACSs may be set up as UCITS, NURS or QIS schemes. They are therefore available for all types of UK authorised fund so consideration should be given to the required investment strategies and the nature of investors to determine which might be most appropriate.
- In general terms, the provisions follow those you would expect to see for an authorised unit trust structure, subject to more specific provisions regarding transfers of units and box management provisions, and arrangements for any winding up.

## Tax drivers

The main driver, both for the setup of ACS and for issues regarding their constitution, concerns tax.

In order to be tax transparent, they require a particular constitution and, in order for the investors to benefit, the relevant investors need to be ready and willing to deal with the information which that entails.

By investing through an ACS, investors are directly investing for tax purposes and so should be able to benefit directly from the UK's extensive double tax treaty network. Exempt investors such as pension schemes can currently, of course, invest in authorised funds but an ACS would have an advantage over other authorised schemes because the exempt investor would be treated as a direct recipient of income in the ACS. It may be necessary to review how double tax treaty relief is claimed and to confirm that overseas jurisdictions also regard the ACS as transparent but it is expected that the majority of overseas jurisdictions do regard an ACS as transparent.

In outline:

- An ACS is tax transparent for the purposes of income. This means that any income arising arises directly to the investors. As a result, participants need detailed information regarding income so they can meet their tax obligations – which of course has an associated cost.

- In relations to gains, capital gains arise when a gain is made on disposal of a unit. The chargeable asset for participants is the co-ownership interest – i.e. a unit. There are no capital gains when the ACS disposes of an asset.
- The ACS itself is not subject to UK corporation tax, income tax or capital gains tax and does not have to make a tax return.
- Special rules apply to insurance company participants in contractual schemes.

The tax effects of seeding a new scheme require review – it should be efficient but needs proper structuring.

## A co-ownership scheme

Although there are two forms of an ACS, a co-ownership scheme or a limited partnership based scheme, it is the former which have proved more practical and this note therefore focuses on those.

Aside from operational reasons, an additional advantage of a co-ownership scheme is that it may be established as an umbrella structure (in the same way as you were familiar with in relation to ICVCs) whereas a partnership scheme may not. For an umbrella scheme, note the specific segregated liability provision in section 261P of FSMA, which is slightly different from the one for ICVCs, although to the same effect: so there is no cross contagion between sub-funds.

There is a clear statement in FSMA that investors have limited liability: section 261O FSMA provides that the debts are payable by the operator (authorised fund manager) out of the property of the scheme, Participants are not liable.

The definition of a contractual scheme is either a co-ownership scheme or a partnership scheme meeting certain conditions. Focusing on the co-ownership scheme option for the reasons mentioned above, its relevant conditions are:

- that the arrangements constituting the scheme are contractual;
- that they are set out in a deed that is entered into between the operator (the authorised fund manager) and a depositary. That deed must:
  - contain a statement that the arrangements are intended to constitute a co-ownership scheme as defined in Section 235A of FSMA;

- make provision for the issue and redemption of units;
  - must prohibit the transfer of units and allow units to be transferred only if specified conditions are met;
  - authorise the operator (authorised fund manager) to deal in the property of the scheme; and
  - make provision for winding up the scheme in specified circumstances;
- that the scheme does not constitute a body corporate, partnership or a limited partnership;
  - the property to the scheme is held by, or to the order of, a depositary; and
  - that the property is beneficially owned by participants as tenants in common (in other words, investors have an undivided share in the assets) or, where there is an umbrella fund, each party is beneficially owned by participants in that part as tenants in common.

## Available to eligible investors

There are particular provisions under Section 261E of FSMA relating to holdings of units in an ACS.

First, investors must be entitled to have their units redeemed in accordance with the scheme that applies to the net value of the property to which the units relate and determined in accordance with the scheme.

Secondly, the scheme must not allow units in the scheme to be issued to anyone other than:

- a professional investor, or
- a large investor – meaning a person who makes a payment or contributes property with a value of not less than £1 million, or
- a person who already holds units in the scheme.

The operator must be obliged, under the terms of the scheme, if it becomes aware that units have been invested in a person who is not so eligible to redeem those units as soon as practicable.

## Authorised by the FCA

As an FCA authorised fund, the usual FCA application process for authorisation applies. There is though a specific type of application form for establishing an authorised contractual scheme – a Form 261C.

## Specific documentation

Before applying, the draft of the proposed contractual scheme deed constituting the contractual scheme will need to be prepared instead of the Instrument of Incorporation which you are used to seeing for ICVC fund structures.

The Prospectus will generally look very similar to any existing ICVC Prospectus document but it will record the key differences and appropriate administration arrangements would need to be devised to suit the tax transparent nature of an ACS. There will be substantive changes to the wording of the Prospectus document in order to meet the ACS requirements.

In other respects the document is very similar although there will need to be flow through of the particular administration requirements involved.

## Specific administration

The manager must supply the necessary information to investors in an appropriate form and in a timely manner so that investors may deal with their liability to tax on their proportionate share of the net income of each fund – and be able to take advantage of the benefit from their proportionate share of the attached tax credits for any UK and foreign tax withheld at source or paid by or on behalf of the relevant fund.

Reduced rates of withholding tax and foreign source income will be claimed at source and generally this means that separate unit classes are devised, which are dependent on the applicable rate of withholding tax. Investors may supply the appropriate forms for particular income types but, if this is not possible, then the unitholders may, in circumstances, be able to make their own tax claims.

Detailed tax liability and indemnity provisions will be incorporated given the tax transparent nature of the Fund.

**This paper seeks to provide an introduction to the required form and specification for an ACS. Any detailed proposal for any particular investment proposition would need to be discussed in the light of the nature of the potential investors and the particular investment proposition. We will be happy to assist with regard to any particular proposal which might be formulated.**

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