

BACK TO BASICS: PRIVATE FUND LIMITED PARTNERSHIPS

Private fund limited partnerships (“**PFLPs**”) were introduced on 6 April 2017 by the Legislative Reform (Private Fund Limited Partnerships) Order 2017 (SI 2017/514) (“**PFLP Order**”), which made a number of changes to the principal statute governing UK limited partnerships, the Limited Partnerships Act 1907 (“**LPA 1907**”).

A PFLP is a sub-category of the limited partnership, a familiar and popular structure for UK private funds, and both English and Scottish limited partnerships can be designated as a PFLP. Designation as a PFLP allows the limited partnership to benefit from reduced administrative and financial burdens and a clearer regime in relation to the rights that investors can exercise as limited partners without compromising their limited liability status.

Fund managers and investors are becoming more familiar with the designation and the PFLP is swiftly becoming the default option for new UK private fund structures. There are few downsides to applying for the designation where a “traditional” limited partnership is already the preferred structure and the requirements are met. There are, however, certain cases where the intended simplicity of the regime is undermined and imminent reform of limited partnership law may introduce further burdens.

DESIGNATION OF A PFLP

A new limited partnership can apply for designation as a PFLP on registration, and existing limited partnerships can apply for re-designation as a PFLP at any time.

On application for designation or re-designation as a PFLP, the general partner has to confirm that the partnership meets the following conditions (known as the “private fund conditions”):

- the PFLP is constituted by a written agreement; and
- the partnership is a collective investment scheme (for purposes of s235 of the Financial Services and Markets Act 2000).

Once a partnership becomes a PFLP, it will not be able to return to ordinary limited partnership status.

WHAT ARE THE PRINCIPAL FEATURES AND BENEFITS OF USING A PFLP?

The PFLP was designed for private funds and creates a more flexible vehicle, especially for private equity, real estate and infrastructure fund managers. They have a number of advantages over the “standard” limited partnership vehicle, including:

- there is no requirement for a limited partner in a PFLP to contribute capital, meaning a participant in a PFLP can fund its commitment solely by way of loan (or can make no contribution at all);
- should investors in a PFLP choose to contribute capital, there is no requirement to register capital contributions (including increases to capital contributions) on the UK company register and the capital can (except as described below) be withdrawn at any time during the life of the PFLP;
- PFLPs benefit from a statutory “white list” of activities that an investor can undertake without risking their limited liability status (bringing the PFLP regime in line with limited partnership regimes in other jurisdictions, such as Luxembourg and Delaware); and
- PFLPs are exempt from certain statutory and administrative (including filing) duties.

These are expanded on below.

Capital contributions

In a “standard” limited partnership, each limited partner is required to contribute capital at the time of its admission. If any of that capital is subsequently withdrawn, the limited partner becomes liable for the debts and obligations of the limited partnership up to the amount withdrawn. If the limited partners in a “standard” limited partnership were to contribute all amounts by way of capital, this would therefore obviously constrain the ability to repay the equity contributions of investors during the life of the vehicle.

Typically, this has been addressed by structuring limited partners’ contributions to a limited partnership by way of a nominal (e.g. 0.01%) contribution to capital, with the balance being committed by way of loan. In recognition that this nominal capital structure provides limited protection to the creditors of a limited partnership, the PFLP Order confirms that the limited partners in a PFLP are under no obligation to contribute any capital and are not liable for the debts or obligations of the firm beyond the amount of the PFLP’s available assets.

Note that any limited partnership which was registered prior to 6 April 2017 and is subsequently re-designated as a PFLP does however remain subject to the prohibition on withdrawal, to the extent of any capital contributed prior to its re-designation.

If investors do choose to commit capital to a PFLP, there is no requirement for the amount of capital contributed to be registered on the UK company register. This has the benefit of eliminating filing obligations where, for example, an existing limited partner increases its commitment to a PFLP and in doing so is obliged to contribute further capital.

In our experience, while we have seen PFLPs utilise capital only funding structures, a traditional loan capital split is still employed for many PFLPs. This may in part be explained by a reluctance on the part of managers and investors to diverge from the existing model that has become standard in the private funds industry. Furthermore, a memorandum of understanding (MoU) was agreed between the Inland Revenue (the predecessor to HMRC) and the British Venture Capital Association in relation to the income tax treatment of carried interest arrangements in private fund limited partnership structures. In confirming the capital treatment of carried interest proceeds, the MoU referred to a typical fund structure which assumed a 99.99% / 0.01% loan capital split for investor commitments. While the industry is becoming more accepting that this model is not strictly necessary to ensure capital treatment on carried interest, there has been no subsequent guidance from HMRC and a conservative approach is therefore taken in many cases.

Permitted activities for PFLP limited partners

In “standard” limited partnerships, investors may lose their limited liability status and risk becoming liable for the debts and obligations of the limited partnership if they are deemed to become involved in management. As the private funds industry has evolved and investor expectations for controls on governance (particularly in the form of limited partner advisory committees) have become more rigorous, this has given rise to uncertainty as to whether those controls will comprise limited liability status.

The PFLP Order therefore introduced a new statutory “white list” of activities which a limited partner in a PFLP could safely undertake without being considered to be taking part in management. The white list is non-exhaustive, but includes the following activities:

- taking part in decisions to vary or waive the terms of the partnership agreement, to change the general nature of the partnership, to extend its term or to admit or remove partners;
- appointing a person to wind up the partnership;
- providing surety or acting as guarantor for the partnership;

- approving the partnership accounts or valuations of its assets;
- consulting with or advising a general partner or partnership manager or adviser about the partnership's affairs or accounts;
- taking part in decisions about changes to persons responsible for the day-to-day management of the partnership;
- acting, or authorising a person to act, as a director, member, employee, officer or agent of, or a shareholder or partner in, a general partner of, or a manager or adviser to, the partnership (provided that this does not extend to taking part in management of the partnership's business);
- appointing or nominating a person to represent the limited partner on a committee of the partnership (such as an advisory committee), and authorising that person to take any action in that capacity (provided that this does not extend to taking part in management of the partnership's business); and
- taking part in a decision approving or authorising an action proposed to be taken by a general partner or manager of the partnership, such as acquisitions or disposals (although not the selection process for investments); the participation of a limited partner in a particular investment (such as through co-investment rights); or the incurring, extension, variation or discharge of partnership debts.

The activities contained in the statutory white list are not all automatically exercisable by every individual limited partner in a PFLP, as participation in the PFLP will be governed by and subject to its constitutional documents. Where the intention is for limited partners to benefit from the rights in the white list, the partnership agreement should therefore expressly attribute the relevant rights to the limited partners, advisory committee or equivalent.

To file or not to file?

As a sub-category of limited partnership, PFLPs are still governed by the LPA 1907, the Partnership Act 1890 and applicable common law. The PFLP Order acts to exempt PFLPs from some of the applicable statutory requirements.

Limited partners in a PFLP are exempted from the duty to render accounts and information between partners (in section 28 of the Partnership Act 1890) and from the restriction on competing with the partnership (in section 30 of the Partnership Act 1890).

PFLPs also benefit from reduced filing obligations, which are summarised below.

CHANGE TO...	LP	PFLP
Change to be notified to the Registrar		
Name of the limited partnership	✓	✓
Place of business of the limited partnership	✓	✓
Partners or name of any partner	✓	✓
Any partner becoming (i) a limited partner instead of a general partner or (ii) a general partner instead of a limited partner	✓	✓
The general nature of the business of the limited partnership	✓	✗

The term or character of the limited partnership	✓	✗
The sum contributed by any limited partner	✓	✗
Change to be notified by advertisement in the Gazette		
A limited partner assigns its interest in the partnership to another person	✓	✗
A general partner becoming a limited partner	✓	✓

FUTURE REFORM

The UK Government has expressed its intention to reform limited partnership law and, if introduced, the changes will impact the PFLP regime.

In response to concerns that limited partnerships were being misused for money laundering, organised crime and tax evasion, the Government launched a consultation in April 2018. Its response, published in December 2018, set out a range of proposals, including:

- the tightening of registration requirements for limited partnerships;
- requiring limited partnerships to demonstrate a firmer connection to the UK;
- increasing transparency requirements; and
- enabling the Registrar to strike from the register limited partnerships which are dissolved or which are no longer carrying on business.

At the time, the Government's message was that legislation will be developed as and when "parliamentary time allows". While reform may therefore not be imminent at the time of writing, particularly given COVID-19 constraints, the issue of limited partnership reform remains on the Government's radar, with the publication by HM Treasury in January 2021 of consultation paper in which the Government expressed an intention to explore if the introduction of bespoke partnership taxation rules for PFLPs could provide the opportunity for improved tax administration and certainty of tax outcomes for fund managers and investors.

CONCLUSION

Overall, having the additional PFLP option is of significant benefit to the UK funds industry and aligns with other jurisdictions which have developed similar modern fund vehicles to reflect market trends and preferences.

If you would like to discuss whether your existing and future LP structures might benefit by becoming PFLPs and the process for registering or re-designating, please contact a member of the CMS Funds Group.