THE US CORPORATE TRANSPARENCY ACT: PRACTICAL CONSIDERATIONS FOR PRIVATE FUND SPONSORS AS THE EFFECTIVE DATE APPROACHES

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US Asset Management and Investment Funds Alert

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Earlier this year, the US Congress passed the Corporate Transparency Act (CTA). The CTA will require thousands of privately held US and non-US entities to report beneficial ownership to the US Treasury Department's Financial Crimes Enforcement Network (FinCEN). The CTA was passed to enhance financial transparency and aid in anti-money laundering efforts, and there are significant ramifications for privacy and compliance considerations for a wide range of businesses, including certain private fund sponsors. For a broader view of the CTA, please see our alert dated 15 August 2023.

Starting on 1 January 2024, the regulations and reporting rules promulgated by FinCEN under the CTA (collectively, the Final Rule) implementing the beneficial ownership reporting requirements under the CTA will become effective. The CTA and Final Rule identify which US and non-US entities must report beneficial ownership information (BOI), what information must be reported, and when reports are due:

- Broadly, the CTA and Final Rule require certain US domestic and non-US companies (Reporting Companies) to report BOI to FinCEN with respect to beneficial owners. The collected BOI will be maintained in a confidential database and only made accessible to law enforcement agencies and, with Reporting Companies' consent, certain financial institutions for purposes of conducting customer due diligence;
- There is a phase-in period for Reporting Companies formed (or registered, if applicable) before 1 January 2024, and such companies will need to provide BOI to FinCEN by 31 December 2024;
- However, new Reporting Companies that are formed (or registered, if applicable) in 2024 must report BOI within 90 days[1] of the acceptance of the company's formation or registration filing. New Reporting Companies that are formed or registered on or after 1 January 2025 will only have 30 days to file their initial BOI reports;
- In addition, a change in beneficial ownership or a change in exemption status for any Reporting Company will also need to be reported within 30 days of such change, even for Reporting Companies formed (or registered, if applicable) before 1 January 2024; and
- While the categories of entities that are considered Reporting Companies are broad, the Final Rule exempts 23 types of entities (please see Appendix A below for more details) from the reporting

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obligations, including a number of exemptions applicable to the private fund industry. Private fund advisers should note that certain of their affiliates and entities included in fund structures may be required to submit BOI reports to FinCEN, even if other entities in a particular structure are exempt. In addition, there remain some open questions as to how some of these exemptions will be implemented in the private funds context.

We provide in this alert a brief overview of the CTA and Final Rule,[2] a description of the most relevant exceptions to the BOI reporting requirements for private funds sponsors, and certain practical implications to consider moving forward.

OVERVIEW

Information to be Reported

A Reporting Company will be required to provide certain identifying information about itself, including:

- Its full legal name and any trade name or "doing business as" name;
- Its complete current address;
- Its US state, tribal, or non-US jurisdiction of formation or registration; and
- Its taxpayer identification number (TIN) (*e.g.,* US federal Employer Identification Number or applicable non-US tax identification number).

For each beneficial owner and company applicant (*i.e.*, an individual who filed or was responsible for filing the documents that created the Reporting Company or registered it do business in the United States), the applicable Reporting Company must also submit to FinCEN the individual's BOI: their full legal name, date of birth, complete current address (in the case of a company applicant, a business address may be used, in all other cases a residential address must be used), and a TIN or other unique identifying number from an acceptable identification document, as well as copies of such documents.

Reporting Companies

A "Reporting Company" is a US domestic or non-US entity that is a corporation, limited liability company, or other entity that was either formed or registered to do business in a US state or tribal jurisdiction by filing a document with a secretary of state or other similar office and which does not qualify for an exemption. Certain US domestic entities that are not created by a state filing (*e.g.,* some trusts and general partnerships) are not currently subject to the CTA. Under the CTA, a US state includes any state of the United States, the District of Columbia, or any other commonwealth, territory or possession of the United States (*e.g.*, Puerto Rico, Northern Mariana Islands, American Samoa, Guam, and the US Virgin Islands).

Beneficial Owners

A "beneficial owner" is any individual who, directly or indirectly, controls at least 25% of the ownership of the Reporting Company or, through any contract, arrangement, understanding, relationship, or otherwise either exercises substantial control over the Reporting Company (*e.g.,* chief executive officers, chief operating officers, chief financial officer, general counsel, etc.). A Reporting Company will always have at least one owner with

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substantial control and possibly several owners with such control, even if no individual holds a 25% ownership interest.

Company Applicants

A “company applicant” is the individual who directly files the document that creates the Reporting Company or registers the company to do business in the United States, and the individual who is primarily responsible for directing or controlling such filing. A Reporting Company may have more than one company applicant.

EXEMPTIONS FOR PRIVATE FUND SPONSORS

The CTA exempts 23 categories of entities from the definition of Reporting Company and, accordingly the CTA's reporting requirement. Of these, the most likely relevant exemptions for private fund sponsors are the exemptions for:

- Investment advisers registered with the Securities and Exchange Commission (SEC) pursuant to the Investment Advisers Act of 1940 (Advisers Act) (such advisers, RIAs);
- Venture capital fund advisers exempt from registration pursuant to Section 203(l) of the Advisers Act (Venture Capital Fund Advisers);
- Controlled or wholly-owned subsidiaries of certain exempted entities; and
- Large operating companies that satisfy certain conditions.

Notably, while the CTA offers exemptions for RIAs and Venture Capital Fund Advisers, there is no similar blanket exemption for private fund advisers (PFAs) or state-registered investment advisers and, unless another exemption applies, such advisers (and certain funds they manage) will be subject to BOI reporting. Similarly, real estate fund managers and single-family offices that are exempt from registration as investment advisers will also need to comply with the CTA with respect to themselves and the certain funds they manage, unless a different exemption is available.

While FinCEN has not expressed a view on whether general partners and managing members of private funds managed by exempted advisers are similarly excused, there are other potentially applicable exemptions for such management entities. Notably, general partners and managing members of funds managed by RIAs may themselves be deemed to be RIAs in accordance with certain SEC staff no-action letters and therefore qualify for the RIA exemption. At the same time, other entities that are typically part of a private fund sponsor's firm, such as holding companies at the top of the corporate hierarchy, and vehicles such as special limited partner vehicles and employee carried interest vehicles, are not deemed to be RIAs. Therefore, such entities would not qualify for the RIA exemption and, unless they fall into another category of exemption, would be subject to CTA reporting obligations.

Pooled Investment Vehicles

As noted above, the BOI reporting does not apply to pooled investment vehicles operated or advised by certain exempted sponsors. The term “pooled investment vehicle” under the CTA is (i) any investment company, as defined in Section 3(a) of the Investment Company Act of 1940 (Investment Company Act) or (ii) any company that (A) would be an investment company under that section but for the exclusion provided from that definition by

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Section 3(c)(1) or Section 3(c)(7) of the Investment Company Act and (B) is identified by its legal name by the applicable investment adviser in its Form ADV (or successor form) filed with the SEC or will be so identified in the next annual updating amendment to Form ADV required to be filed by the applicable investment adviser pursuant to Rule 204-1 under the Advisers Act. Pooled investment vehicles that are not operated or advised by exempted advisers may still qualify for a different exemption from CTA reporting obligations, but any such determination will require a facts and circumstances analysis of the particular entity.

Notably, the foregoing definition does not include investment vehicles that rely on Section 3(c)(5)(c) of the Investment Company Act, such as private funds that invest in mortgage debt obligations. Accordingly, even if such vehicles are operated or advised by and RIA, such vehicles will be subject to BOI reporting unless another exemption applies. For instance, an investment vehicle relying on Section 3(c)(5) of Investment Company Act may qualify for the subsidiary exemption if its ownership interests are controlled or wholly owned by one or more exempt entities.

The Final Rule contains a limited reporting exemption whereby a non-US pooled investment vehicle must report the BOI of an individual that exercises substantial control over it (as opposed to all beneficial owners). If multiple persons meet these criteria, then the non-US pooled investment vehicle must report the information with respect to the individual with the “greatest authority over the strategic management of the entity.” Note, however, that such non-US pooled investment vehicles must be registered to do business in the United States in order to be subject to the CTA.

Subsidiaries

Under the CTA's subsidiary exemption, most controlled or wholly-owned subsidiaries of one or more exempted entities are also exempt from BOI reporting.

Notably, subsidiaries wholly-owned or controlled by an exempt pooled investment vehicle do not qualify for the subsidiary exemption, and the Final Rule requires such subsidiaries to complete BOI reporting (limited to the identities of their exempt beneficial owners) unless a separate exemption applies. This will include portfolio companies as well as blocker entities and other fund structuring vehicles. For example, if a fund that qualifies for the pooled investment vehicle exemption acquires a portfolio company, such portfolio company will not be exempt from reporting on the basis of the subsidiary exemption. However, it may qualify for another exemption, such as the large operating company exemption described below.

Large Operating Companies

Fund entities that do not otherwise qualify for a reporting exemption may qualify for the exemption for “large operating companies” that:

- Maintain an operating presence at a physical office in the United States;
- Have more than 20 full-time employees in the United States; and
- Have filed a US tax return in the previous year reporting over US$5 million in US-source gross receipts or sales.

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PRACTICAL CONSIDERATIONS

The BOI reporting will be held confidentially by FinCEN. However, the regulations provide for Reporting Companies to consent to allow financial institutions to retrieve such information for customer diligence purposes. As the market adjusts to this new rule, we may see banks, broker-dealers and other financial institutions require such consents as a condition to doing business.

Whether an entity within a private fund sponsor's structure (such as holding companies, operating companies, and carried interest vehicles) will need to report BOI will largely be determined by the facts and circumstances of the particular structure, and the potential disclosure of BOI for fund investors will likely impact structuring considerations going forward. The complexity of the CTA and Final Rule as well as the variety of fund structures necessitates that each entity in a structure be examined carefully to ensure compliance. Middle-market and emerging managers whose fund structures include closely-held vehicles may have more privacy considerations and, going forward, should take into consideration the BOI disclosure requirement when structuring their funds and related vehicles.

We also note that the penalties for willfully violating the CTA are significant. Failing to report or update a Reporting Company's BOI or providing false or fraudulent BOI can result in a daily US$500 fine, up to a maximum of US$10,000, and two years' imprisonment.

While the information provided pursuant to the CTA will remain largely confidential, it is nonetheless a significant shift for private fund sponsors from the historical privacy accorded to ownership information of most limited partnerships, limited liability companies, and other entities within a private fund's structure. As noted, there remain some gray areas as to the scope of the CTA that will need to be addressed as the compliance dates approach. Please contact our Asset Management and Investment Funds practice group lawyers for more information on how to prepare for this upcoming change in law.

Appendix A

Each of the following entities is exempted from the definition of a Reporting Company.

1. *Securities Reporting Issuer*

Any issuer of securities that is (A) an issuer of a class of securities registered under Section 12 of the Securities Exchange Act of 1934 (the Exchange Act); or (B) required to file supplementary and periodic information under Section 15(d) of the Exchange Act.

2. *Governmental Authority*

Any entity that: (A) is established under the laws of the United States, an Indian tribe, a US state, or a political subdivision of a US state, or under an interstate compact between two or more US states; and (B) exercises governmental authority on behalf of the United States or any such Indian tribe, US state, or political subdivision of a US state.

3. *Bank*

Any bank, as defined in (A) Section 3 of the Federal Deposit Insurance Act; (B) Section 2(a) of the Investment Company Act; or (C) Section 202(a) of the Advisers Act.

4. *Credit Union*

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Any federal credit union or US state credit union, as those terms are defined in Section 101 of the Federal Credit Union Act.

5. *Depository Institution Holding Company*

Any bank holding company as defined in Section 2 of the Bank Holding Company Act of 1956, or any savings and loan holding company as defined in Section 10(a) of the Home Owners' Loan Act.

6. *Money Services Business*

Any money transmitting business registered with FinCEN under 31 U.S.C. 5330 and any money services business registered with FinCEN under 31 C.F.R. 1022.380.

7. *Broker or Dealer in Securities*

Any broker or dealer, as those terms are defined in Section 3 of the Exchange Act, that is registered under Section 15 of the Exchange Act.

8. *Securities Exchange or Clearing Agency*

Any exchange or clearing agency, as those terms are defined in Section 3 of the Exchange Act, that is registered under Sections 6 or 17A of the Exchange Act.

9. *Other Exchange Act Registered Entity*

Any other entity not described in items 1, 7, or 8 above that is registered with the SEC under the Exchange Act.

10. *Investment Company or Investment Adviser*

Any entity that is: (A) an investment company as defined in Section 3 of the Investment Company Act, or is an investment adviser as defined in Section 202 of the Advisers Act; and (B) registered with the SEC under the Investment Company Act or the Advisers Act.

11. *Venture Capital Fund Adviser*

Any investment adviser that: (A) is described in Section 203(l) of the Advisers Act; and (B) has filed Item 10, Schedule A, and Schedule B of Part 1A of Form ADV, or any successor thereto, with the SEC.

12. *Insurance Company*

Any insurance company as defined in Section 2 of the Investment Company Act.

13. *State-Licensed Insurance Provider*

Any entity that: (A) is an insurance producer that is authorized by a US state and subject to supervision by the insurance commissioner or a similar official or agency of a US state; and (B) has an operating presence at a physical office within the United States.

14. *Commodity Exchange Act Registered Entity*

Any entity that: (A) is a registered entity as defined in Section 1a of the Commodity Exchange Act; or (B) is (i) a futures commission merchant, introducing broker swap dealer, major swap participant, commodity pool operator, or commodity trading adviser, each as defined in Section 1a of the Commodity Exchange Act, or a retail foreign

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exchange dealer as described in Section 2(c)(2)(B) of the Commodity Exchange Act; and (ii) registered with the Commodity Futures Trading Commission under the Commodity Exchange Act.

15. *Accounting Firm*

Any public accounting firm registered in accordance with Section 102 of the Sarbanes-Oxley Act of 2002.

16. *Public Utility*

Any entity that is a regulated public utility as defined in 26 U.S.C. 7701(a)(33)(A) that provides telecommunications services, electrical power, natural gas, or water and sewer services within the United States.

17. *Financial Market Utility*

Any financial market utility designated by the Financial Stability Oversight Council under Section 804 of the Payment, Clearing, and Settlement Supervision Act of 2010.

18. *Pooled Investment Vehicle*

Any pooled investment vehicle that is operated or advised by a person described in items 3, 4, 7, 10, or 11 above.

19. *Tax-Exempt Entity*

Any entity that is: (A) an organization that is described in Section 501(c) of the US Internal Revenue Code of 1986, as amended (the Code) (determined without regard to Section 508(a) of the Code), and exempt from tax under Section 501(a) of the Code, except that in the case of any such organization that ceases to be described in Section 501(c) of the Code and exempt from tax under Section 501(a) of the Code, such organization shall be considered to continue to be described in this item for the 180-day period beginning on the date of the loss of such tax-exempt status; (B) a political organization, as defined in Section 527(e)(1) of the Code, that is exempt from tax Section 527(a) of the Code; or (C) a trust described in Paragraph (1) or (2) of Section 4947(a) of the Code.

20. *Entity Assisting a Tax-Exempt Entity*

Any entity that: (A) operates exclusively to provide financial assistance to, or hold governance rights over, any entity described in item 19 above; (B) is a United States person; (C) is beneficially owned or controlled exclusively by one or more United States persons that are United States citizens or lawfully admitted for permanent residence; and (D) derives at least a majority of its funding or revenue from one or more United States persons that are United States citizens or lawfully admitted for permanent residence.

21. *Large Operating Company*

Any entity that: (A) employs more than 20 full-time employees in the United States, with “full-time employee in the United States” having the meaning provided in 26 C.F.R. 54.4980H-1(a) and 54.4980H-3, except that the term “United States” as used in 26 C.F.R. 54.4980H-1(a) and 54.4980H-3 has the meaning provided in 31 C.F.R. § 1010.100(hhh); (B) has an operating presence at a physical office within the United States; and (C) filed a federal income tax or information return in the United States for the previous year demonstrating more than US$5 million in gross receipts or sales, as reported as gross receipts or sales (net of returns and allowances) on the entity's IRS Form 1120, consolidated IRS Form 1120, IRS Form 1120-S, IRS Form 1065, or other applicable IRS form, excluding gross receipts or sales from sources outside the United States, as determined under US federal income

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tax principles. For an entity that is part of an affiliated group of corporations within the meaning of Section 1504 of the Code that filed a consolidated return, the applicable amount shall be the amount reported on the consolidated return of such group.

22. *Subsidiary of Certain Exempt Entities*

Any entity whose ownership interests are controlled or wholly owned, directly or indirectly, by one or more entities described in items 1, 2, 3, 4, 5, 7, 8, 9, 10, 11, 12, 13, 14, 15, 16, 17, 19, or 21 above.

23. *Inactive Entity*

Any entity that: (A) was in existence on or before January 1, 2020; (B) is not engaged in active business; (C) is not owned by a non-US person, whether directly or indirectly, wholly or partially; (D) has not experienced any change in ownership in the preceding 12-month period; (E) has not sent or received any funds in an amount greater than US$1,000, either directly or through any financial account in which the entity or any affiliate of the entity had an interest, in the preceding 12-month period; and (F) does not otherwise hold any kind or type of assets, whether in the United States or abroad, including any ownership interest in any corporation, limited liability company, or other similar entity.

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