Memo: Corporate Transparency Act for Fund Clients

Date: **January 24, 2024**

TO: **Private Investment Fund Clients**

FROM: **Choate, Hall & Stewart LLP**

RE: **Corporate Transparency Act for Fund Clients – Attention Requested**

As described in Choate's recent memo to clients and friends, a new set of federal disclosure requirements came into effect on January 1, 2024. These Beneficial Ownership Information Reporting Requirements (the "***BOIR Rule***") under the Corporate Transparency Act (the "***CTA***") will require companies to identify their beneficial owners, unless the company falls within a list of exemptions. For new entities that are formed on or after January 1, 2024, the CTA filings will be due 90 days following formation. The CTA is intended to combat money laundering and related financial crimes. This memorandum describes in general terms some key factors of the CTA that funds should consider.

Overview

Subject to certain enumerated exemptions, the CTA will require corporations, limited liability companies, limited partnerships, and similar entities that are formed in (or registered to do business in) any of the states of the U.S. to identify their beneficial owners by providing information in an electronic form (a "***CTA Submission***") submitted to the Financial Crimes Enforcement Network of the U.S. Treasury Department ("***FinCEN***").

In general, the CTA will apply to any entity that is formed in the U.S. (or to any foreign entity that is registered to do business in the U.S.) by the filing of a document with the appropriate state governmental office (each, a "***Subject Entity***"). This occurs, for example, when a limited liability company is formed by filing a certificate of formation with a given state's secretary of state.

Beneficial owners include any individual who, directly or indirectly, (i) "exercises substantial control over the entity" (e.g., any senior officer) or (ii) "owns or controls 25 percent of the ownership interests of the entity."[1] These terms will likely be broadly construed.

When entities are formed after January 1, 2024, they will also need to submit information about their applicants. Applicants include a maximum of two individuals: (i) the individual who directly files the formation or registration document of the reporting entity, and (ii) the individual who is primarily

responsible for directing such filing. Entities that were formed prior to January 1, 2024, will not need to provide information about their applicants.

In the absence of an exemption, a CTA Submission must be made by the Subject Entity.

- For Subject Entities that are formed on or after January 1, 2024, the CTA Submission must be completed within 90 days following formation. FinCEN has posted this link for submissions.
- For Subject Entities that were formed prior to January 1, 2024, the CTA Submission must be completed by January 1, 2025.

The CTA provides for civil penalties (up to $500 per day) and criminal penalties (including imprisonment) for willful failure to file.

We would be glad to help our clients assess how to comply with the CTA. In general, however, Choate is not responsible to make CTA Submissions (including updates) unless we discuss this with you expressly.

The CTA provides for twenty-three exemptions.[2] Many U.S. banks, nonprofit entities, and public companies are exempt. In addition, large private companies are exempt if they (A) have an operating presence at a physical location in the U.S., (B) employ more than 20 full-time U.S. based individuals (not counting employees of affiliated entities), and (C) reported more than $5 million of revenue from U.S. sources on a consolidated basis to the IRS for the previous year. However, there are several exemptions likely to be most relevant to private investment fund sponsors, which are summarized below.

Exemptions for Registered Investment Advisers, Venture Capital Fund Advisers and Certain Affiliates Thereof

The BOIR Rule exempts from beneficial ownership reporting any investment adviser (as defined in Section 202 of the Investment Advisers Act of 1940, as amended (the "***Advisers Act***")) that is registered with the Securities and Exchange Commission (the "***SEC***") under the Advisers Act (a "***Registered Investment Adviser***" or "***RIA***").

Venture capital fund advisers that solely manage qualifying venture capital funds and are therefore exempted by Section 203(l) of the Advisers Act from registering with the SEC ("***Venture Advisers***") are also exempted from beneficial ownership reporting under the BOIR Rule.

Subsidiaries of RIAs and Venture Advisers (*i.e.*, any entity whose ownership interests are controlled or wholly owned, directly or indirectly, by an RIA or Venture Adviser) are themselves exempt from beneficial ownership reporting.

Additionally, emerging interpretation within the legal community suggests that certain other management entities may be exempt from beneficial ownership reporting:

Relying Advisers

When an RIA establishes separate, affiliated entities through which it conducts a single advisory business, the RIA may rely on an "umbrella registration" where only one entity registers with the SEC

and that registered entity identifies its advisory affiliates as such on its Form ADV filed with the SEC. Those advisory affiliates are then treated as "***Relying Advisers***" of the registrant. In accordance with the SEC's rules, the Relying Advisers are RIAs in substance (and subject to applicable regulations under the Advisers Act) but need not file separate registrations themselves. It is therefore reasonable to conclude that Relying Advisers may themselves be exempt from beneficial ownership reporting on the same basis as RIAs.

Fund GPs and Managers

Similarly, a general partner or managing member of a private fund (a "***GP***") created by an RIA or Venture Adviser that meets the relevant conditions set forth in the SEC Staff's 2005 and 2012 no-action letters to the American Bar Association is deemed to be an investment adviser registered with the SEC or an exempt reporting adviser, as applicable. Those conditions are: (a) the investment adviser established the GP to act as the general partner or managing member of a private fund; (b) the GP's formation documents designate the investment adviser to manage the private fund's assets; (c) all of the investment advisory activities of the GP are subject to the Advisers Act and the applicable rules thereunder, and the GP is subject to examination by the SEC; and (d) the RIA subjects the GP, its employees and persons acting on its behalf to its supervision and control (any such entity, a "***Relying GP***"). As with Relying Advisers, there is an emerging view that Relying GP entities may be exempt from beneficial ownership reporting under the RIA or Venture Adviser exemptions, as applicable.

Importantly, these emerging positions with respect to Relying Advisers and Relying GPs, while believed to be reasonable and consistent with policy objectives of the CTA, should be considered in light of the facts and circumstances of each case in which they might apply and, moreover, may need to be reconsidered if FinCEN issues further interpretive guidance or new regulations regarding the CTA that are contrary to these readings of the BOIR Rule. There can be no assurance that regulating authorities will take the positions outlined in this memorandum.

Pooled Investment Vehicle Exemption

The BOIR Rule exempts any pooled investment vehicle ("***PIV***") that:

- is operated or advised by a bank, credit union, broker dealer, registered investment adviser or venture capital fund adviser; and
- is either:
  - a registered investment company (e.g., mutual funds), or
  - a fund that relies on an exemption under sections 3(c)(1) or 3(c)(7) of the Investment Company Act of 1940, as amended (the "***Investment Company Act***") **and** that is identified by name or will be identified by name on its adviser's Form ADV filed with the SEC.

This exemption is likely to apply to most funds managed by private equity and venture capital sponsors, but any 3(c)(1) or 3(c)(7) vehicle that is **not** identified in the RIA's Form ADV (e.g., a below-the-fund holding vehicle or certain SPVs) will not satisfy the requirements for the PIV exclusion and may be

required to file a beneficial ownership report, unless another exemption is available. Each RIA should review its own facts and circumstances to consider the implications of including on its next Form ADV any vehicles that it does not currently include.

GP entities listed on an RIA or Venture Adviser's Form ADV as advisory affiliates may also be eligible for exemption as PIVs to the extent that they rely on the section 3(c)(1) or 3(c)(7) exemptions under the Investment Company Act (which is typically the case for GP entities that issue securities to sponsor officers or employees, including "carried interest" or other profits interests, indirect equity interests in underlying fund, etc.).

Subsidiaries of Pooled Investment Vehicles

Direct or indirect subsidiaries of an exempt PIV (including holding companies, SPVs and other deal-structuring vehicles) **are not** presumptively exempt from beneficial ownership reporting on the basis of being such a subsidiary. Whether they are exempt from the reporting requirements of the CTA depends on whether they themselves meet the criteria of an exemption or, in some circumstances, are subsidiaries of an RIA or Venture Adviser. Therefore, it is important to consider the nature of ownership and control of each SPV or other subsidiary entity owned by a PIV.

Below-the-PIV entities whose ownership interests are controlled, directly or indirectly, by an exempt entity, such as an RIA, Venture Adviser, Relying Adviser or Relying GP, *may* qualify for an exemption from beneficial ownership reporting, but the exempted status of any such entity owned by a PIV must be evaluated on a case-by-case basis to see if the entity's ownership interests could be deemed to be controlled by an exempt entity. This will not be the case for below-the-PIV entities if, for example (1) there are individuals or other non-PIV investors with interests in the entity of 25% or more, or (2) there are individuals or other non-PIV investors with interests of less than 25% **but with** minority rights amounting to "substantial control" over the entity (*e.g.*, the ability to direct, determine or substantially influence important decisions of the entity, including the scope of business, transfers, sales or leases of principal assets, reorganizations or mergers, compensation and incentive programs for senior officers, etc.).[3]

State-Registered Advisers and Exempt Reporting Advisers Relying on the Private Fund Adviser Exemption

It is important to note that the BOIR Rule **does not** include an exemption for:

- state-registered investment advisers or
- advisers relying on the private fund adviser exemption from registration under the Advisers Act (Section 203(m)), which exempts advisers from registering with the SEC if they solely manage private funds and have assets under management in the United States of less than $150 million.

Such investment advisers should prepare to make CTA filings in connection with new entity formations in 2024 and for existing funds, management companies and fund general partner or manager entities by January 1, 2025.

Conclusion

Please contact Kim Kaplan-Gross at kkaplangross@choate.com or Shaun Barnes at sbarnes@choate.com if you have questions. We appreciate the privilege of providing legal services to our clients.

This Memo is for educational purposes and does not establish an attorney-client engagement. Please contact counsel if you need advice in a specific situation.

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[1] The precise language of the requirement at 31 U.S.C. §5336(a)(3) is posted on the FinCEN website at www.fincen.gov/boi/reference-materials [click on Corporate Transparency Act].

[2] The full list of exemptions in the statute at 31 U.S.C. §5536(a)(11) is posted on the FinCEN website at www.fincen.gov/boi/reference-materials [click on Corporate Transparency Act].

[3] The full definition of "substantial control" and related provisions of the BOIR Rule are at 31 C.F.R. §1010.380(d)(1), published in the Federal Register and available online at https://www.federalregister.gov/documents/2022/09/30/2022-21020/beneficial-ownership-information-reporting-requirements#h-119.