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ARTICLE

How Private Funds Can Navigate New FinCEN Reporting Rules

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Fund managers are considering the potential reporting and structural implications that may result from the now-effective Corporate Transparency Act,[1] and the regulations implementing the beneficial ownership information, or BOI, reporting requirements of the CTA issued by the U.S. Department of the Treasury's Financial Crimes Enforcement Network.

Among other things, fund managers are analyzing whether certain reporting obligations apply to entities within their fund structure and whether it is feasible to consider structural changes to simplify or minimize reporting obligations under the BOI reporting rule.

NAVIGATING THE IMPLICATIONS OF THE BOI REPORTING RULE

Private fund structures vary based on a variety of factors, including investment strategies, tax considerations and financial objectives, among others.

Reporting obligations under the BOI reporting rule will also vary depending on a fund's structure. In cases that involve many reporting companies within a fund structure — that is, entities that are created or registered in the U.S. by the filing of a document with a secretary of state and that do not otherwise meet an exemption from reporting — a fund manager may consider structuring alternatives to simplify or minimize the reporting burden associated with the BOI reporting rule.

For example, can any of the entities be formed in a manner that meets a reporting exemption? Can any of the entities be restructured as a wholly owned subsidiary of a qualified exempt entity or as any other exempt entity that may be associated with fund structures?

These considerations require fund managers to strike a balance between what is feasible and what is practical. Additionally, investors may consider structuring alternatives at the investor level, i.e., investments through exempt entities or in a manner consistent with nonreportable thresholds.

Although the BOI reporting rule presents new reporting obligations to the private funds industry and triggers a wide range of disclosure and logistical reporting considerations, such considerations alone may not be enough to cause fund managers to restructure unless a report-mitigating solution will not otherwise affect a fund structure's investment, tax and financial objectives.

KEY EXEMPTIONS FOR ENTITIES IN PRIVATE FUND STRUCTURES

The BOI reporting rule exempts 23 classes of entities that are not considered reporting companies and thus not required to submit BOI reports to FinCEN.

Many of these entities are already subject to a regulatory regime that includes stringent reporting and due diligence standards consistent with the CTA's objectives, e.g., banks and entities registered with the U.S. Securities and Exchange Commission, or are already disclosing beneficial owner information in connection with licensing, registration or monitoring requirements, e.g., state-regulated insurance companies and FinCEN-registered money services businesses.

Of the 23 exemptions, there are a handful of exemptions that are likely to be useful for private funds, advisers, management entities, and operating entities and subsidiaries within a private fund structure.

Investment Advisers Registered With the SEC

Any entity that is (1) an investment adviser as defined in Section 202 of the Investment Advisers Act of 1940 and (2) registered with the SEC under the Advisers Act is an exempt entity that is not subject to the BOI reporting rule.

Notably, while there is an exemption for venture capital fund advisers, described below, there is no similar exemption for exempt reporting advisers that rely on the private fund adviser exemption in Section 203(m) of the Advisers Act or state-registered investments advisers.

Unless another exemption applies, such as perhaps the large operating company exemption or subsidiary exemption, as discussed below, these advisers and any nonexempt funds they manage will have BOI reporting obligations.

General partners and managing members of private funds that are so-called relying advisers included in an umbrella registration of a registered investment adviser, or RIA, using the SEC's Form ADV are also investment advisers registered with the SEC and thus qualify for the RIA exemption.

However, general partners and managing members of funds managed by RIAs that are not relying advisers may qualify for the RIA exemption, as they themselves may be deemed to be RIAs.

Although FinCEN has not specifically provided guidance in its commentary to the BOI reporting rule or through its published FAQs, in certain SEC no-action letters, the SEC has deemed some special purpose vehicles, or SPVs, to private funds as investment advisers registered with the SEC so long as the SPV is established by the RIA and both the SPV and the RIA meet various regulatory and compliance representations and undertakings.

Other entities above and below RIAs, such as holding companies and subsidiaries that are not RIAs, would be subject to BOI reporting obligations unless they meet another exemption, e.g., an entity wholly owned or controlled by an RIA could meet the subsidiary exemption discussed below.

Venture Capital Fund Advisers Exempt From Registration With the SEC

Any investment adviser that (1) is described in Section 203(l) of the Advisers Act and (2) has filed Item 10, Schedule A, and Schedule B of Part 1A of Form AD, or any successor thereto, with the SEC is exempt from BOI reporting obligations.

Investment Vehicles, VC Fund Advisers, Broker-Dealers, Banks or Credit Unions

An exempt pooled investment vehicle must be operated or advised by:

- An RIA;
- A venture capital fund adviser;
- A broker or dealer, as defined in Section 3 of the Securities Exchange Act of 1934, that is registered under Section 15 of the 1934 Act;
- A bank, as defined in (1) Section 3 of the Federal Deposit Insurance Act, (2) Section 2(a) of the Investment Company Act of 1940 or (3) Section 202(a) of the Advisers Act; or
- A federal credit union or state credit union, as defined in Section 101 of the Federal Credit Union Act.

To qualify as a pooled investment vehicle for purposes of the BOI reporting rule, an entity must be either:

- An investment company, as defined in Section 3(a) of the Investment Company Act. i.e., a mutual fund; or
- A company that: (1) would be an investment company but for the exclusions under paragraphs (1) or (7) of Section 3(c) of the Investment Company Act, i.e., outstanding securities owned by up to 100 investors or by qualified purchasers, respectively; and (2) is identified by its legal name by the applicable investment adviser in its Form ADV filed with the SEC, or will be so identified in the next annual updating amendment to Form ADV as required.

Notably, private funds that invest in mortgage debt obligations and other liens on and interest in real estate in reliance on the exclusion under paragraph (5)(C) of Section 3(c) of the Investment Company Act do not qualify as private investment vehicles. Therefore, even if operated or advised by an RIA, these vehicles would be subject to BOI reporting obligations unless they meet another exemption.

Additionally, exempt pooled investment vehicles are specifically excluded from the subsidiary exemption. Therefore, other entities below exempt pooled investment vehicles in a private fund structure, such as holding companies and wholly owned SPVs, i.e., portfolio companies, blocker entities, are subject to BOI reporting obligations unless they meet another exemption.

Large Operating Companies That Meet Certain Conditions

Any entity that meets the following three conditions is exempt as a large operating company pursuant to the BOI reporting rule:

- Employs 21 or more full time employees in the U.S.;
- Has an operating presence at a physical office within the U.S.; and
- Has filed a federal income tax or information return in the U.S. for the previous year demonstrating more than $5 million in gross receipts or sales, as reported as gross receipts or sales, net or returns or allowances, on the entity's applicable IRS form, excluding gross receipts or sales from sources outside the U.S.

To determine whether the large operating company exemption is available for any entity within an organizational structure, it is important to consider three factors that may affect the application of this exemption.

First — and a key factor that likely limits the availability of this exemption — FinCEN does not permit companies to consolidate employee headcount across affiliates.

Second, FinCEN allows the tax filing entity to consolidate receipts or sales of other entities owned by such entity and through which such entity operates, as reflected in a consolidated federal tax filing.

And third, absent any contrary guidance from FinCEN, it appears that disregarded entities for federal tax purposes which satisfy the employment, operating presence and minimum gross receipts or sales requirements may not rely on this exemption because they do not file U.S. federal income tax returns.

Wholly owned or controlled subsidiaries of certain exempt entities. An entity whose ownership interests are controlled or wholly owned, directly or indirectly, by one or more exempted entities — excluding dormant entities, FinCEN-registered money services businesses, pooled investment vehicles and entities assisting tax-exempt entities — are exempt from BOI reporting obligations.

Importantly, the term "control" is not defined in the CTA or in FinCEN's implementing regulations. However, FinCEN recently issued guidance that interprets the subsidiary exemption quite narrowly.

Through its published FAQs, FinCEN clarified that, to qualify for the subsidiary exemption, "control of ownership interests means that the exempt entity entirely controls all the ownership interests in the reporting company in the same way that an exempt entity must wholly own all of a subsidiary's ownership interests."

FinCEN's narrow interpretation of control appears to limit the application of the subsidiary exemption to entities that are wholly owned or exclusively controlled by exempt entities.

However, any such control analysis is necessarily fact-specific, and a determination of whether a reporting company is exempt pursuant to the subsidiary exemption may depend on the extent of control that any non-exempt entity can exercise over the reporting company.

HOUSEKEEPING ITEMS

Use of FinCEN Identifiers to Simplify Reporting Company Reporting Obligations

Reporting companies — and not beneficial owners or company applicants — are required to submit BOI reports to FinCEN. Reporting companies are also required to submit updated or corrected BOI reports to FinCEN, as needed.

It is important for fund managers to recognize that they can seek to simplify reporting requirements in certain instances. For example, a reporting company may request that a beneficial owner obtain a FinCEN identifier for the reporting company to report a FinCEN identifier in lieu of reporting such beneficial owner's personal identifiable information, e.g., name, date of birth, residential address, unique identification number, issuing jurisdiction and related document image.

Under this approach, any change to the information previously reported by the beneficial owner to FinCEN would not trigger a reporting obligation by the reporting company but would instead require the beneficial owner to file an updated application with FinCEN within 30 days of a change to update the personal information previously reported.

In such case, the change in beneficial owner's personal information will be reflected in the FinCEN identifier, and the reporting company will not have to file an updated report with FinCEN.

Important Reporting Deadlines

Compliance dates for BOI reports vary depending on when (1) a reporting company is created or registered; (2) an entity becomes a reporting company after losing an exemption from reporting; and (3) updates or corrections to information previously reported to FinCEN are required, as follows:

Initial BOI report due within 90 calendar days of creation/registration	Initial BOI report due by January 1, 2025	Initial BOI report due within 30 calendar days of creation/registration	Initial BOI report due within 30 calendar days of losing exemption	Updated/Corrected BOI report due within 30 calendar days of change/awareness of inaccuracy
▪ Domestic reporting companies incorporated or formed anytime between Jan. 1, 2024, and Dec. 31, 2024 ▪ Foreign reporting companies registered anytime between Jan. 1, 2024, and Dec. 31, 2024	▪ Domestic reporting companies incorporated or formed before Jan. 1, 2024 ▪ Foreign reporting companies registered before Jan. 1, 2024	▪ Domestic reporting companies incorporated or formed on or after Jan. 1, 2025 ▪ Foreign reporting companies registered on or after Jan. 1, 2025	▪ Entities that no longer meet the criteria for any exemption	▪ For updates or corrections to information previously reported to FinCEN about the reporting company or a beneficial owner

KEY TAKEAWAYS

While investment strategies, tax consequences and financial considerations may continue to drive private fund structures, due consideration should be given to reporting obligations that result from the creation of nonexempt entities and the timing of their creation.

Because initial BOI reports are due within 90 days of a reporting company's creation, formation or registration in 2024 — noting that this deadline decreases to within 30 days beginning in 2025 and thereafter — and updated BOI reports reflecting beneficial ownership changes are due within 30 days of any such change, planning around the creation, formation or registration of entities within a fund structure can simplify BOI reporting obligations.

For example, when multiple entities must be created for a leveraged buyout transaction, BOI reporting obligations can be simplified if the entities are created closer to the closing of the transaction.

Such adjustments in timing could permit each reporting company to file only one BOI report to reflect its beneficial ownership post-closing.

If a new reporting company is created in 2024 more than 90 days before the transaction closes — or created on or after Jan. 1, 2025, more than 30 days before the transaction closes — such reporting company would need to file both an initial BOI report reflecting preclosing ownership and an updated BOI report to reflect changes in beneficial ownership resulting from the transaction closing.

Additionally, due consideration should be given to matters concerning contractual disclosures and representations that may be required for reporting companies within private fund structures to comply with BOI reporting obligations.

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[1] At the time this article was written, a federal judge in the U.S. District Court for the Northern District of Alabama held the CTA unconstitutional. Pending an appeal or further developments, the CTA remains in effect except as to members of the National Small Business Association and, arguably, reporting companies in the Northern District of Alabama.

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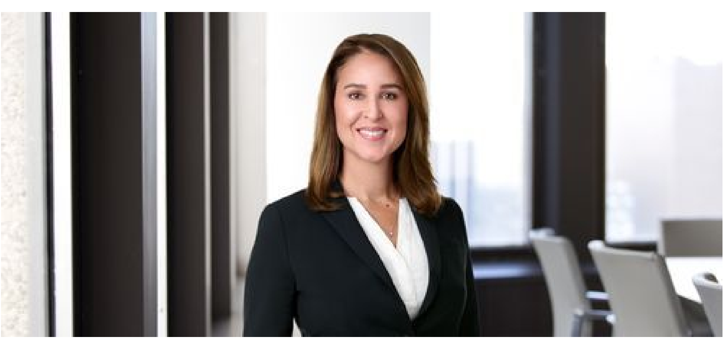

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