

PRIVATE EQUITY PORTFOLIO COMPANY COMPLIANCE UNDER THE CORPORATE TRANSPARENCY ACT

Requirements, Compliance, and Implications

January 18, 2024

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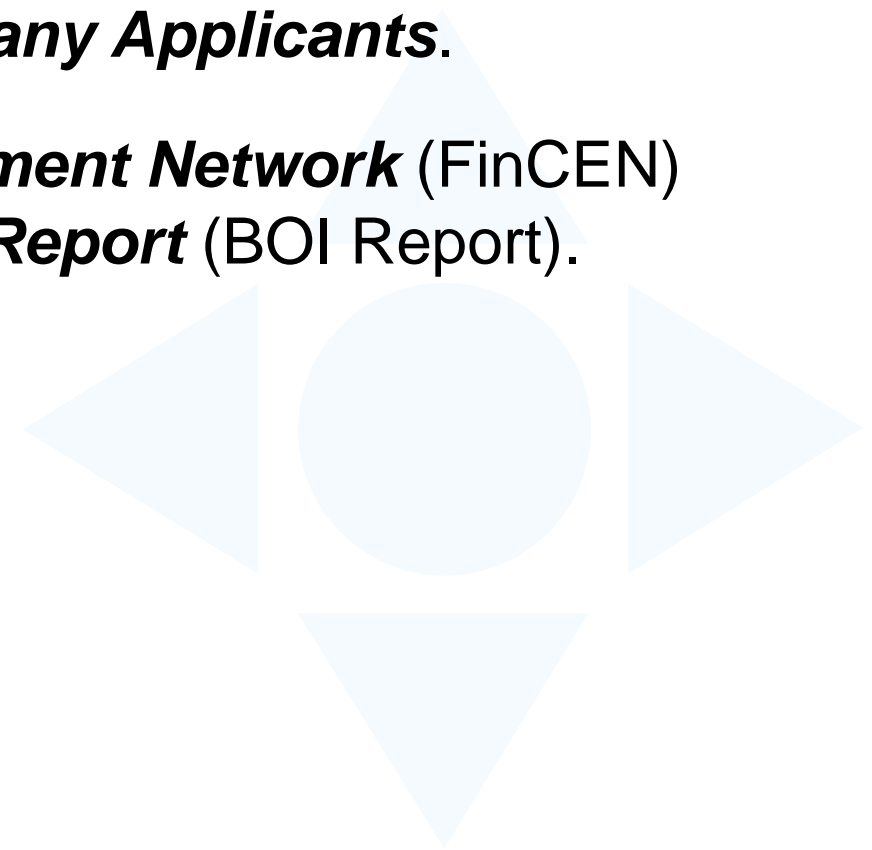
- The General Rule and Timeline
- What is a Reporting Company?
- Which exemptions may apply to PE Portfolio Companies?
- How do we identify the Beneficial Owners of a Reporting Company?
- Next Steps for CTA Compliance – 2024 and Beyond



THE GENERAL RULE

The ***Corporate Transparency Act*** (CTA) requires that all ***Reporting Companies*** provide certain information about their ***Beneficial Owners*** and, for any such Reporting Company formed on or after ***Jan. 1, 2024***, such Reporting Company's ***Company Applicants***.

This information will be provided to the ***Financial Crimes Enforcement Network*** (FinCEN) through an online submission of a ***Beneficial Owner Information Report*** (BOI Report).



SOURCES OF CTA COMPLIANCE INFORMATION: LAW, REGULATORY GUIDANCE AND FINCEN RESOURCES

| Title | Type | Date | Citation |
|-------------------------------|--|------------------------|------------------|
| CTA | Federal Statutory Text | Enacted 1/1/21 | 31 U.S.C. § 5336 |
| CTA Rule | Federal Implementing Regulation (FinCEN) | Effective 9/30/22 | 31 CFR 1010.380 |
| FAQ | FinCEN Interpretive Guidance | Last updated 1/12/2024 | Online |
| Small Entity Compliance Guide | FinCEN Compliance Guide | Last updated Dec. '23 | Online |

TIMELINE FOR COMPLIANCE

| Reporting Type | Reporting Deadline |
|---|--|
| Initial Report for Reporting Companies in existence on Dec. 31, 2023 | No Later than Jan. 1, 2025 |
| Initial Report for Reporting Companies formed after Dec. 31, 2023 and before Jan. 1, 2025 | Within 90 days of formation |
| Initial Report for Reporting Companies formed on or after Jan. 1, 2025 | Within 30 days of formation |
| Amendments, Updates and Corrections* | Within 30 days of the relevant change or awareness of need of correction |

*Does not apply to Company Applicant BOI Report information

WHAT IS A REPORTING COMPANY?

- The CTA rule defines a domestic “Reporting Company” as:
 - Any corporation, limited liability company, limited partnership, or other entity formed under applicable law by filing an organizational document with any state, U.S. territory, the District of Columbia or U.S. Indian tribe, **that does not qualify for an exemption**
- The CTA rule defines a foreign “Reporting Company” as:
 - Any business entity organized outside of the U.S. that is registered to do business in the United States by filing a document with any state, U.S. territory, the District of Columbia or U.S. Indian tribe, **that does not qualify for an exemption**
- Entities whose formation is not contingent upon the public filing of an organizational document with a state secretary of state (or comparable government agency) are ***not*** treated as Reporting Companies under the CTA (e.g. general partnerships, with some exceptions)

EXEMPTIONS

The following 23 general categories of entities are statutorily exempt from any CTA filings and are not classified as “Reporting Companies”:

1. Securities reporting issuers (required to file '34 Act periodic reports)
2. U.S., state and local governments, and instrumentalities, agencies and subdivisions
3. Banks
4. Federal and state licensed credit unions
5. Bank holding companies and savings and loan holding companies
6. Registered money services businesses
7. SEC registered broker or dealers in securities
8. SEC registered securities exchange or clearing agencies
9. Other SEC registered '34 Act entities
10. SEC registered investment companies and SEC registered investment advisers
11. Venture capital fund advisers
12. Insurance companies
13. State-licensed insurance producers
14. Commodity Exchange Act registered entities (e.g., commodity trading advisors, futures commission merchants, and commodity pool operators)
15. Public accounting firms registered with PCAOB
16. Regulated public utilities
17. Financial market utilities
18. Pooled investment funds/vehicles
19. Tax-exempt non-profit entities referenced in IRC 501(c) and exempt from U.S. taxation under IRC 501(a); and political organizations referenced in IRC Sec. 527
20. Entities (owned and controlled by U.S. persons) exclusively assisting a tax-exempt non-profit entity
21. Large operating companies
22. Subsidiaries of certain other exempt entities
23. Inactive entities (formed prior to 2020, inactive and with less than \$1,000 in assets)

Each of these exemptions are subject to specific requirements set forth in the CTA and the CTA Final Rule, and application of each exemption requires an analysis of the specific facts and circumstances of the applicable entity.

WHICH EXEMPTIONS MAY APPLY TO PE PORTFOLIO COMPANIES?

There are **four** primary statutory exemptions that will likely be the most applicable to private equity portfolio companies and their sponsors:

1. Large Operating Company
2. Subsidiary
3. Registered Investment Advisers / Venture Capital Advisers
4. Pooled Investment Vehicle



EXEMPTION: LARGE OPERATING COMPANY

- To be eligible for the “Large Operating Company” exemption, a Reporting Company must:
 - Employ **more than 20 persons** in the US on a “**full time**” basis (30 hrs/week);
 - Generate **more than \$5M of annual revenue** from US operations; and
 - Have an operating presence at a **physical office in the United States**.
- Revenue of “other entities owned by the entity and other entities through which the entity operates” can be aggregated – *note that it remains unclear whether an LLC or LP filing a Form 1065 information return may include the proportionate share of partially owned subsidiary revenue for aggregation.
- Aggregation principles do not apply to the FTE prong – i.e., the reporting company itself must directly employ at least 21 FTEs to be eligible

EXEMPTION: LARGE OPERATING COMPANY, CONT'D

- **M&A Consideration:** Newly formed purchaser entity in an asset purchase or a HoldCo in a stock or equity purchase . . . even if the seller/target meets the Large Operating Company exemption, buyers may not qualify
- \$5M annual revenue for a newly formed entity will not be established until tax return submitted for the prior year
- Employees of lower tier payroll entities will not be attributable to HoldCo for purposes of meeting the Large Operating Company exemption
- Private Equity buyers should therefore take care to identify each entity within the company chain will meet the Large Operating Company exemption **at the time of formation**

EXEMPTION: SUBSIDIARY

- Entities whose “ownership interests” are “controlled or wholly owned, directly or indirectly, by one or more” entities described in other CTA statutory exemption categories, except for certain specified types of exemptions, including Pooled Investment Vehicles.
- Although the final rule expressly states that complete equity ownership by an exempt entity is not required to qualify for the subsidiary exemption, recent FinCEN guidance has further clarified that “control of ownership interests means that the exempt entity **entirely controls** all of 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 for the exemption to apply.”
- “Control” of a company’s equity ownership or “control” of a portion of a company’s equity interests combined with ownership of the balance of a company’s equity ownership by the same or another exempt entity may be sufficient, however

EXEMPTION: REGISTERED INVESTMENT ADVISER

- The following Reporting Companies are eligible for the “Registered Investment Adviser” exemption:
 - Investment advisers directly registered with the SEC as a Registered Investment Adviser (“RIA”) under the U.S. Investment Advisers Act of 1940 (“Advisers Act”)
 - “Relying” advisers listed on a filing RIA’s Form ADV umbrella registration
 - Management entities of private funds (e.g., GPs and Managing Members) that are not “relying” advisers listed on an RIA’s Form ADV umbrella registration, if they meet the relevant conditions set forth in no-action letters issued by the SEC in 2005 and 2012, including (among others) that the relevant management entity:
 - Was formed by an RIA as a special purpose vehicle in connection with a private fund;
 - Has designated the RIA to manage the applicable private fund’s assets; and
 - All employees and persons acting on behalf of such entity are “persons associated with” the RIA (and, consequently, subject to SEC examination.
- This exemption is not applicable to “family offices” unless registered under the Advisers Act.

EXEMPTION: VENTURE CAPITAL FUND ADVISER

- Any investment adviser that is exempt from registration with the SEC pursuant to Section 203(I) of the Advisers Act because it:
 - Solely advises one or more venture capital funds

and

 - Has filed Item 10, Schedule A, and Schedule B of Part 1A of Form ADV with the SEC.

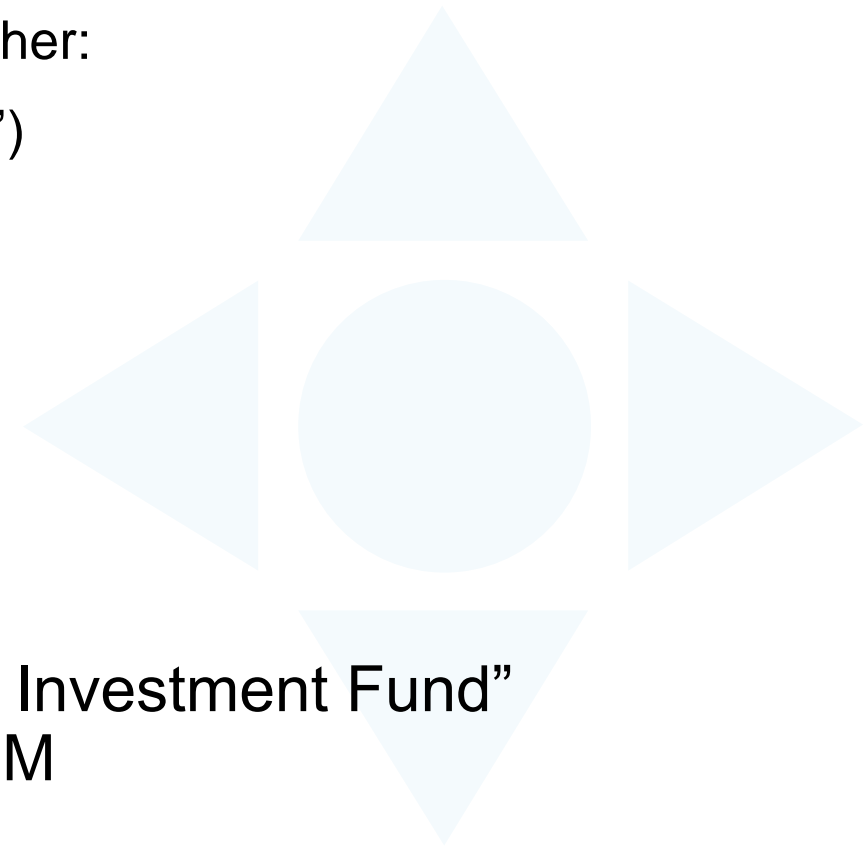


EXEMPTION: POOLED INVESTMENT VEHICLE

- Funds meeting both of the prongs below will be covered by the “Pooled Investment Vehicle” exemption:
 - Exempt from registration by the Investment Company Act of 1940 under either:
 - **Section 3(c)(1)** – i.e., fewer than 100 investors (typically all “accredited”)
 - **Section 3(c)(7)** – i.e., all investors are “Qualified Purchasers”

and

 - Managed by either:
 - an **RIA with \$150M+ of AUM**; or
 - a **venture capital adviser** under the Advisers Act- Smaller, non-VC private funds will not be covered by the “Pooled Investment Fund” exemption if they are not managed by an RIA with \$150M+ in AUM



HOW DO WE IDENTIFY THE BENEFICIAL OWNERS OF A REPORTING COMPANY?

- The CTA Rule defines “Beneficial Owners” as:
 - 1) any individual who directly or indirectly “owns or controls not less than 25% of the ownership interests of the entity” **OR**
 - 2) any individual who “directly or indirectly...exercises substantial control over [the] Reporting Company.”
- The CTA ***does not cap*** the number of Beneficial Owners that may be listed on a BOI Report

THREE PART 25% OWNERSHIP TEST

1. **Ownership Interest.** Individuals who directly or indirectly own 25% or more of the ownership interests in a Reporting Company would qualify as Beneficial Owners.
2. **Control of Ownership Interest.** Individuals may also qualify as a Beneficial Owner if they control more than 25% of the ownership interests of a Reporting Company, which may be obtained through contracts, arrangements, understandings, relationships, or otherwise.
3. **Calculation.** Per FinCEN guidance, the 25% threshold of ownership is measurable by including all the ownership interests of a Reporting Company, including convertible securities and options, on a fully diluted “as converted, as exercised” basis.

CALCULATION EXAMPLES

- Corporate Stock
 - An individual's shares **divided by** total number of shares, if all shares have the same voting / value per share
 - If more than one class or series of shares based on voting rights or economic distributions, then the **larger** of the following applies:
 - Voting power percent of all an individual's shares **divided by** the voting power percent of all shares entitled to vote
 - Total "value" of all an individual's shares **divided by** the total "value" of all outstanding shares
- LLC and Partnership Equity Interests
 - An individual's capital and profits interests **divided by** the entity's total capital and profits interest
 - If the above is not determinable because of "waterfall" tiering or otherwise, then separately measure by ownership of any "class or type" of ownership interest

MULTI-FACTOR SUBSTANTIAL CONTROL TEST

1. **Senior Officers.** The CTA expressly includes the president, CEO, CFO, COO, general counsel and “any other officer who performs a similar function.”
2. **Appointment and Removal Authority.** Individuals who have the authority to appoint or remove certain officers or a majority of directors of the Reporting Company.
3. **Important Decision-Maker.** Individuals who have “substantial influence” over “important decisions” made by the Reporting Company, including respecting its business, finances, “major expenditures”, “significant contracts” and structure; which is evaluated on a case by case basis.
4. **Any Other Form of Substantial Control.** Which may be obtained through board representation, financing and other formal and informal contractual arrangements, control over one or more parent companies of a Reporting Company.

INDIRECT BENEFICIAL OWNERSHIP: TRUSTS AND SIMILAR ARRANGEMENTS

- The following parties to ***trusts or similar arrangements*** may qualify as beneficial owners of a Reporting Company with its ownership interests held by such trust:
 - A trustee may exercise substantial control over a Reporting Company
 - A trustee or other individual with the authority to dispose of trust assets
 - A beneficiary who is the sole permissible recipient of trust income and principal or who has the right to demand a distribution of or withdraw substantially all of the trust assets
 - A grantor or settlor who has the right to revoke or otherwise withdraw trust assets

BENEFICIAL OWNER EXEMPTIONS

- A minor child (if the information of a parent or guardian is disclosed)
- An individual who acts on behalf of an actual Beneficial Owner as the Beneficial Owner's nominee, intermediary, custodian, or agent (including ordinary advisory or contractual services)
- An employee whose "substantial control" is derived solely from employment status but is not a "Senior Officer"
- A creditor of a Reporting Company

BENEFICIAL OWNERS EXCLUSIVELY THROUGH EXEMPT ENTITIES

If one or more [of the 23] exempt entitiesha[ve] a direct or indirect ownership interest in a Reporting Company and an individual is a Beneficial Owner of the Reporting Company exclusively by virtue of the individual's ownership interest in such [one or more] exempt entities, the [BOI Report] may include the names of the exempt entities in lieu of the [individual-related] information required with respect to such Beneficial Owner.

The foregoing provision relieves a Reporting Company from any obligation to identify any individuals whose “indirect” ownership of 25% or more of the Reporting Company derives solely from that individual’s ownership 23 exemption categories that are upstream of the Reporting Company on the rationale that the upstream interest in one or more entities of the type described in the exempt entity is sufficiently regulated and subject to certain ownership disclosure independent of the CTA.

BOI REPORT DISCLOSURES: BENEFICIAL OWNERS

- Full legal name
- Date of birth
- **Residential** street address
- Unique identifying number from acceptable identification document, including –
 - Non-expired driver's license
 - Non-expired identification document issued by a U.S. state or local government (for the purposes of identifying the individual)
 - Non-expired passport issued by the U.S. government
 - *If none of the three forms above are applicable, non-expired passport issued by a foreign government*
- **Image** of the identification document
- Name of the state or jurisdiction that issued the identification document

Beneficial Owners may obtain a **FinCEN Identifier** to streamline BOI Reporting – individuals who have a FinCEN Identifier may provide that number in lieu of the above information for inclusion on BOI Reports

COMPANY APPLICANT IDENTIFICATION

- Reporting Companies formed on and after January 1, 2024 are required to include information regarding their Company Applicant(s) in their BOI Report
- Each such Reporting Company must have ***at least one and not more than two*** Company Applicants
- The CTA Rule defines “Company Applicants” as the individual who “files” the document that creates a U.S. domestic business entity or registers a non-U.S. business entity to do business in the U.S.
- If more than one individual is involved in the filing of the document – the Company Applicant is the individual who is “primarily responsible” for directing or controlling such filing
- BOI Report ***Exceptions*** for Company Applicants
 - Company Applicants *may use a business address* if they work in corporate formation (e.g. attorneys and formation agents)
 - Company Applicants *are not required to update* BOI Report information upon changes

NEXT STEPS FOR CTA COMPLIANCE: 2024 AND BEYOND

- For entities formed prior to Jan. 1, 2024, complete each of the following ***prior to Dec. 31, 2024***:
 - Ascertain whether such entity is a Reporting Company
 - If such entity is a Reporting Company, identify its Beneficial Owners
 - Obtain relevant BOI Report information for each Reporting Company and its Beneficial Owners
 - File BOI Report using FinCEN's online portal
- For entities formed between Jan. 1, 2024 and Dec. 31, 2024, complete each of the following ***within 90 days of formation***:
 - Ascertain whether such entity is a Reporting Company
 - If such entity is a Reporting Company, identify its Beneficial Owners and its Company Applicants
 - Obtain relevant BOI Report information for each Reporting Company, its Beneficial Owners and its Company Applicant(s)
 - File BOI Report using FinCEN's online portal

NEXT STEPS FOR CTA COMPLIANCE: 2024 AND BEYOND

- For each entity within a private equity organizational structure:
 - Ascertain whether such entity is a Reporting Company
 - If such entity is a Reporting Company, identify its Beneficial Owners and its Company Applicants (if applicable)
 - Obtain relevant BOI Report information for each Reporting Company, its Beneficial Owners and its Company Applicant(s) (if applicable)
 - File BOI Report using FinCEN's online portal
- Establish one or more of the following to support ongoing CTA Compliance:
 - Maintain internal records of BOI Reports delivered and entities determined to be exempt by statute
 - For Reporting Companies, require each Beneficial Owner provide prompt notice of applicable changes to BOI Report information (e.g. residential address changes, ID update, legal name changes)
 - For exempt entities, establish protocol for re-evaluation of exemption upon personnel and ownership changes

REFERENCES

- Corporate Transparency Act – [31 U.S.C. § 5336](#)
- Final Rule Text – [31 CFR 1010.380](#)
- [FinCEN Small Entity Compliance Guide \(Dec. '23\)](#)
- [FinCEN FAQs \(last updated 1/12/24\)](#)
- [BBS White Paper \(as of January 2024\)](#)
- BBS Client Alerts ([General Summary](#), [Small Businesses](#), [PE Funds](#))

