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Alternative Funds

Introduction
Gibson, Dunn & Crutcher LLP

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Contributed by Gibson, Dunn & Crutcher LLP

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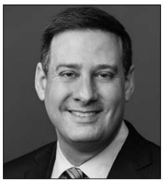
Gibson, Dunn & Crutcher LLP has an investment funds practice that spans its New York, Los Angeles, Washington, DC, London, Hong Kong and Dubai offices. It focuses on the formation of private investment funds, including traditional funds, funds-of-one, separately managed accounts and co-investment vehicles. The firm has significant experience in fund-related transactions, such as fund recapitalisations and minority investments, and it assist clients seeking to raise capital in funds across multiple sectors, including buyout, growth, real estate, infrastructure, credit, and oil and gas. The practice is seamlessly meshed with the firm's transactional practices in these areas, including its private equity, infrastructure and real estate practices. It provides sophisticated advice on tax and regulatory issues affecting funds and sponsors. Drawing on the experience of its renowned enforcement and litigation practices, it also provides advice regarding SEC examinations of, and enforcement actions against, investment advisers, and it conducts significant internal investigations.

Authors



Shukie Grossman focuses on private investment fund formation across all investment strategies, including buyout, growth capital, infrastructure, real estate and credit funds. He has significant experience advising on the acquisition and sale of minority and majority stakes in fund sponsors, and spin-offs of fund businesses and management teams. He also advises investment firms on their operation, regulation and internal governance arrangements. Shukie is a member of the Private Investment Funds Forum, New York Investment Funds Society and adjunct faculty at Columbia Law School. He previously worked in the Division of Investment Management of the US Securities and Exchange Commission.

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1. General

1.1 General Overview of Jurisdiction

The United States serves as a premier destination for the formation of a variety of alternative funds due primarily to its position as the world's largest economy, the presence within the jurisdiction of a multitude of asset managers and institutional investors, a well-established legal system on both the federal and state level, and a host of regulatory regimes that concentrate on investor protection and transparency. According to a report issued by the Division of Investment Management of the Securities and Exchange Commission (SEC) in May 2019, as of the end of September 2018, more than 30,000 "private funds" managed by more than 3,000 advisers, and representing more than USD8 trillion, were reporting to the SEC.

2. Funds

2.1 Types of Alternative Funds

The United States is home to a range of alternative funds, including both open-end products which offer various levels of liquidity and closed-end products which are generally illiquid. The most common open-end products are credit funds, hedge funds, securitised asset funds and, increasingly, certain real asset funds investing in income-yielding assets. The most common closed-end products are private equity-style buyout, growth capital and venture capital funds as well as more traditional credit, infrastructure and real estate funds. These product lines are also divided among those investing directly and those investing in other funds (ie, feeder funds and funds of funds). More recent trends include the introduction of an array of "permanent capital" structures, such as conglomerates and holding companies that are designed for investors with longer-term horizons and platform-oriented exits.

2.2 Fund Structures

A significant portion of alternative funds domiciled in the US are organised as limited partnerships, which afford investors "flow-through" treatment for US tax purposes, meaning that tax is paid only once by the investors and not by the fund. This preference tends to be asset class-agnostic, although, as described in **2.11 Tax Regime**, certain funds or ancillary fund vehicles that cater to US tax-exempt and non-US investors offer an offshore parallel vehicle or feeder vehicle that may invest through entities treated as taxable corporations to address the specific needs of these investors.

Limited Partnerships

In general, a limited partnership affords limited liability to its limited partners, provided that the limited partners do not participate in the management of the limited partnership, which is the domain of the general partner. The general partner is also legally responsible for the debts and obligations of a limited partnership if they exceed its assets. While a limited partner generally will not be responsible for the debts and obligations of a limited partnership in an amount exceeding its funded and unfunded commitment, applicable law may require the return of certain erroneous distributions (eg, distributions that render the limited partnership insolvent), and the agreement governing an alternative fund organised as a limited partnership often contemplates a restoration of distributions under certain circumstances to satisfy the fund's liabilities.

Delaware – Jurisdiction of Choice

Delaware is the jurisdiction of choice for alternative funds investing predominantly in the US because legal entities can be formed and reconstituted efficiently; the Delaware Revised Uniform Limited Partnership Act is clear (and is regularly updated to address shifts in industry practice); and the Delaware courts are well versed in issues pertaining to limited partnerships organised for investment purposes, yielding a wealth of relevant judicial precedent.

2.3 Regulatory Regime

There are numerous regulatory regimes applicable to alternative funds domiciled in the US or offered to US investors. The following is an overview of several key regimes:

Investment Company Act of 1940

The US Investment Company Act of 1940, as amended (Investment Company Act), was among the suite of securities regulations enacted in the wake of the Great Depression. This Act regulates and imposes certain requirements upon the operation of publicly offered investment funds that fall within the definition of an "investment company" under the Investment Company Act. Such requirements include limitations on the use of leverage, the charging of performance fees, and various ongoing reporting obligations, which, in each case, are generally impractical in the context of operating an alternative fund. Consequently, alternative funds typically rely on certain exclusions from the definition of "investment company" to remain exempt from registration and regulation as an investment company under the Investment Company Act. In order to do so, an alternative fund must typically raise capital through a private placement and limit participation either:

- to fewer than 100 beneficial owners (determined according to a "look-through" rule that applies in certain circumstances) in reliance on Section 3(c)(1) of the Investment Company Act; or
- to persons that are "qualified purchasers" (the definition of which includes natural persons who own not less than USD5 million in "investments" or entities that own and invest on a discretionary basis not less than USD25 million in "investments") in reliance on Section 3(c)(7) of the Investment Company Act.

Non-US domiciled alternative funds must rely on one of these exemptions with respect to investors that are US persons.

Investment Advisers Act of 1940

This statue generally requires that investment advisers who manage assets from a place of business in the US or on behalf of US clients or investors register with the SEC under the US Investment Advisers Act of 1940, as amended (Advisers Act). Managers of private funds may avoid registration if they qualify for one or more of the following exemptions:

- an exemption for advisers to private funds with less than USD150 million in private fund assets under management (private fund adviser exemption);
- an exemption for certain foreign advisers with no place of business in the United States and less than USD25 million in assets under management attributable to US investors and clients (foreign private adviser exemption);
- an exemption for advisers to qualifying venture capital funds (venture capital fund adviser exemption); and
- an exemption for family offices (family office exemption).

Advisers who qualify for the foreign private adviser exemption or the family office exemption are completely exempt from regulation under the Advisers Act. Advisers who qualify for the private fund adviser exemption or the venture capital fund adviser exemption are exempt from most requirements under the Advisers Act, but must still make certain abbreviated notice filings with the SEC as "exempt reporting advisers". Advisers whose principal place of business is located outside of the United States who do not qualify for the foreign private adviser exemption may still qualify for the private fund adviser exemption if the assets it manages from a place of business in the United States are attributable to private funds only and are below USD150 million.

Investment advisers with less than USD100 million in assets under management are generally subject to state, rather than federal, regulation. However, exemptions from registration are available in most states for private fund advisers, venture capital fund advisers, foreign private advisers and family offices.

All investment advisers (whether registered or not) are subject to the anti-fraud provisions of the Advisers Act, which generally make it unlawful for advisers to engage in fraudulent, deceptive or manipulative conduct. These provisions have been interpreted by regulators and the courts to impose a fiduciary duty on advisers towards their clients.

By registering with the SEC, an investment adviser becomes subject to the core provisions of the Advisers Act, including requirements to develop, implement and update a variety of compliance policies and procedures and lengthy record-keeping requirements. Implementing a compliance programme is not a standard process, but rather requires customisation to fit the business of the adviser. Registered investment advisers are also required to designate a chief compliance officer and to assess the adequacy and effectiveness of their compliance policies at least annually. Plus, registered investment advisers are subject to periodic and "for cause" examination by SEC staff.

In addition, the Advisers Act imposes various restrictions on the terms of contracts between advisers and their clients. For example:

- an adviser may not assign the contract without client consent; and
- the contract cannot provide for performance compensation (subject to exceptions, including for contracts with 3(c)(7) funds and contracts with clients who meet certain net worth standards (known as "qualified clients").

Furthermore, the Advisers Act provides that no provision of a contract may purport to waive compliance with the Advisers Act.

Exempt reporting advisers are also subject to certain substantive conduct and compliance obligations. However, these obligations are considerably less burdensome than is the case for registered investment advisers. In addition, while the SEC has authority to conduct examinations for exempt reporting advisers, this authority is rarely exercised unless the SEC has cause to believe that a serious violation of the Advisers Act has occurred.

Securities Act of 1933

The US Securities Act of 1933, as amended (Securities Act), regulates the offer and sale of "securities", which includes interests in alternative funds, by US issuers and by non-US issuers, to investors who are US persons. Under the Securities Act, offers and sales of securities are subject to registration with the SEC unless otherwise exempt. Registration under the Securities Act requires the filing of a registration statement as well as compliance with the reporting requirements of the US Securities Exchange Act of 1934, as amended (Exchange Act). Consequently, the offering and sale of interests in alternative funds must typically remain exempt from registration under the Securities Act. Many alternative funds offered in the US therefore rely on the private placement exemption contained in Section 4(a)(2) of the Securities Act and the non-exclusive safe-harbour exemption from registration provided by Rule 506(b) of Regulation D promulgated thereunder for securities offerings primarily to "accredited investors" (as defined in Regulation D) that do not involve general solicitation or general advertising. Relatively recent revisions to Regulation D also permit issuers to utilise general solicitation or general advertising in an exempt securities offering in reliance on Rule 506(c) promulgated thereunder, but such reliance requires an issuer to notify the SEC that it is engaging in general solicitation or general advertising and engage in a more extensive verification process to ensure that purchasers of securities sold in any such offering are "accredited investors". As such, Rule 506(c) offerings by alternative funds tend to be limited to alternative funds pursuing a significant number of retail investors (and often through an affiliated brokerage arm that is already collecting extensive verification information from such investors). It is also possible to offer interests in an alternative fund to non-US persons pursuant to Regulation S, another safe harbour which provides an exclusion from the registration requirements of the Securities Act for offerings made outside the US. Regulation S is available only for "offers and sales of securities made outside the US" in good faith and not as a means of circumventing the registration provisions of the Securities Act. An issuer may rely concurrently on Regulation D and Regulation S in the context of a single securities offering.

Securities Exchange Act of 1934

Capital raising

Capital-raising activities by alternative fund advisers may give rise to broker registration issues under the Exchange Act. The definition of a broker under the Exchange Act is quite broad and includes any person "engaged in the business of arranging securities transactions on behalf of others". In general, any person engaged in such activities is required to be registered as a broker under the Exchange Act, unless a specific exemption applies. According to the SEC's staff, an alternative fund adviser's capital-raising activities can fall within this broad definition to the extent that such activities involve:

- marketing securities (ie, interests in the adviser's private funds) to investors; and/or
- negotiating and arranging such investments.

Rule 3a4-1 under the Exchange Act (the "issuer's exemption") establishes an exemption from broker registration for an "associated person" of an issuer, provided that such person:

- is not subject to statutory disqualification (eg, such person has not been found to have engaged in a securities law violation);
- does not receive transaction–based compensation (eg, sales commissions);
- is not an associated person of a registered broker dealer; and
- satisfies one of the following three conditions:
  - (a) the associated person limits the offering and selling of the issuer's securities only to broker dealers and other specified types of financial institutions;
  - (b) the associated person:
    - (i) performs substantial duties on behalf of the issuer other than in connection with transactions in securities;
    - (ii) has not been an associated person of a broker dealer within the past 12 months; and
  - (c) does not participate in selling and offering of securities for any issuer more than once every 12 months; or
  - (d) the associated person limits his or her activities to delivering written communications by means that do not involve oral solicitation of potential purchasers.

Reporting Requirements

Investment Advisers Act

Registered and exempt reporting investment advisers are required to file updates to the information provided in their Form ADV filings with the SEC on an annual basis (or more frequently if certain material changes to the information on file occur). The information provided in an adviser's Form ADV filing is publicly available on the SEC's website. In addition, registered investment advisers with more than USD150 million in assets under management attributable to private funds must file a Form PF providing certain financial and other information with respect to the operations of their private funds. In general, Form PF filings must be made on an annual basis. However, the frequency of the filing obligation and the level of detailed information that must be provided increases for certain "large" alternative fund advisers whose assets under management exceed certain thresholds. The information provided to the SEC on Form PF is not publicly available.

Securities Exchange Act of 1934

Alternative fund advisers whose investment strategies involve trading in public securities may be subject to certain reporting obligations under the Exchange Act. In particular, investment advisers who acquire more than 5% of the outstanding equity securities of a public company may be required to file reports of such ownership positions on Schedule 13G (for certain passive investors) or 13D (for other investors). In addition, "institutional investment managers" who manage more than USD100 million in publicly-traded securities are required to file quarterly reports of their holdings in such securities on Schedule 13F. These reports are typically publicly available, though confidential treatment can be requested under some circumstances.

Commodity Exchange Act

An alternative fund may trade futures contracts (including futures contract options, forward contracts and swaps) as a component of its strategy (or incidental component of its strategy, for example, to hedge certain currency risks). Such activities may require registration with the Commodity Futures Trading Commission (CFTC) as a "commodity pool operator" and a "commodity trading adviser" unless an exemption is available based on the manner in which the alternative fund is offered and whether the alternative fund's commodities-related activities are de minimis within the regulatory regime's purview.

Anti-money laundering, sanctions and anti-terrorism
An alternative fund and/or its sponsor should have policies designed to ensure compliance with the Uniting and Strengthening America by Providing Appropriate Tools to Intercept and Obstruct Terrorism Act of 2001 and any other anti-money laundering and sanctions regulations applicable to an alternative fund and/or the sponsor. Such compliance may require obtaining additional information with respect to the identity of investors and their beneficial owners, if any, and disclosing such information to law enforcement or regulatory authorities.

Additional considerations
Certain investments by an alternative fund that involve the acquisition of a business connected with, or related to, national security or critical infrastructure may be subject to review and approval by the Committee on Foreign Investment in the United States (CFIUS) and/or non-US national security/investment clearance regulators, depending on the beneficial ownership and control of interests in the fund.

Alternative fund advisers that engage in cross-border transactions (including both investments in offshore portfolio companies or offshore investment in their funds) may be subject to various reporting requirements under the US Department of Treasury's Treasury International Capital System or the Bureau of Economic Analysis' direct investment surveys programme.

2.4 Loan Origination
Alternative funds are permitted to originate loans.

Engaging in such lending activity in certain US states (eg, California) may subject the fund and/or its affiliate to licensing requirements. In addition, alternative funds sponsored by banks are subject to bank regulatory restrictions with respect to lending activity.

US tax considerations with respect to originated loans are complex, and typically require careful planning.

2.5 Cryptocurrencies and Non-traditional Assets
US-domiciled funds are increasingly investing in cryptocurrencies and other non-traditional assets. The regulatory landscape at the asset level is still very much evolving in relation to cryptocurrencies. The CFTC, the SEC, the Financial Crimes Enforcement Network of the US Treasury Department (FinCEN) and the Financial Industry Regulatory Authority (FINRA) have all attempted to assert some modicum of regulatory jurisdiction over such assets, rendering the legal environment in which such cryptocurrencies are acquired complex. The tax treatment of cryptocurrencies in the US is evolving, creating additional challenges for alternative funds trading in such assets.

2.6 Regulatory Approval Process
Because a typical US-domiciled alternative fund is outside the definition of "investment company" under the Investment Company Act, no regulatory approval is required to form a fund. The manager of an alternative fund may, however, be required to register as an RIA with the SEC unless it can rely on an exemption. Such registration can take up to 45 days from the date the relevant filing is made and additional lead-time is required to prepare the filing.

2.7 Requirement for Local Investment Managers
A manager need not be domiciled in the US to provide services to a US-domiciled alternative fund.

2.8 Other Local Requirements
As noted in **2.2 Fund Structures**, alternative funds domiciled in the US are typically structured as limited partnerships and do not require a board of directors or similar governing body. The general partner of a limited partnership domiciled in Delaware may be domiciled elsewhere, including outside of the US, but must maintain a registered office and agent for service of process in Delaware, although this requirement is easily met and does not entail having premises or employees in Delaware.

2.9 Rules Concerning Other Service Providers
See **3.6 Outsourcing of Investment Functions/Business Operations**.

2.10 Requirements for Non-local Service Providers
See **3.6 Outsourcing of Investment Functions/Business Operations**.

2.11 Tax Regime
Delaware Limited Partnerships
Alternative funds sponsored by US investment managers are typically organised as Delaware limited partnerships that are classified as partnerships for US federal income tax purposes. Partnerships are flow-through vehicles and are not generally subject to US federal income tax. Partnerships file an annual information return with the US Internal Revenue Service (IRS), which reports the results of the partnership's operations. Each partner of the partnership is required to report separately on its income tax return its distributive share of the partnership's income, gain, loss, deduction and credit for the taxable year of the partnership ending within or with the taxable year of such partner, regardless of whether such partner has received any distributions from the partnership.

Feeder Vehicles
Alternative funds often establish ancillary vehicles known as "feeder vehicles", "parallel vehicles" or "alternative investment vehicles". These are generally organised in Delaware or

an offshore jurisdiction, such as the Cayman Islands. These vehicles are intended to directly or indirectly block non-US investors from direct US federal income taxation on income that is "effectively connected" with the conduct of a US trade or business or ECI and associated tax reporting obligations, and US tax-exempt investors from "unrelated business taxable income" or "UBTI". In the hedge fund or funds of funds context, feeder vehicles organised in the Cayman Islands that elect to be treated as corporations for US federal income tax purposes often do not incur significant US federal income tax liabilities, but serve as a blocker for unexpected ECI (and to minimise the risk of US tax filings) and to reduce the risk of UBTI as a result of the debt financing of investments. For alternative funds that make investments in US real estate or US energy assets, engage in loan origination and/or invest in operating partnerships, US investment managers generally structure investors' capital commitments through one or more entities treated as corporations for US federal income tax purposes. These entities generally incur US federal income tax liabilities and permit investors to invest in ECI and/or UBTI-generating assets without direct US federal income taxation or direct US tax reporting obligations. See **4.7 Tax Regime** for a brief discussion of US federal income taxation of US tax-exempt and non-US investors.

Publicly Traded Partnerships

Alternative funds that are classified as partnerships for US federal income tax purposes must avoid the application of the "publicly traded partnership" rules which, if applicable, cause the partnership to be taxable as a corporation for US federal income tax purposes. A partnership is a "publicly traded partnership" if its interests are traded on an established securities market or are readily tradeable on a secondary market (or the substantial equivalent thereof). Unless the fund satisfies a "qualifying income" test establishing that at least 90% of its income consists of certain types of passive investment income or its interests were issued in private offerings and it has fewer than 100 partners (subject to a look-through rule), the fund generally must monitor or limit redemptions of interests by the fund and transfers of interests by investors, to ensure that the fund is not subject to taxation as a corporation.

2.12 Double-tax Treaties

The US has an extensive network of income tax treaties which provide relief to non-US investors from US federal withholding and income tax on certain items of US source income, such as dividends, interest and business profits, that are not attributable to a "permanent establishment". A non-US investor's ability to qualify for benefits under a tax treaty between the US and its home jurisdiction is generally determined at the investor level and requires, in part, that the investor's home jurisdiction treats the fund as transparent for tax purposes and treats the applicable items of income of the fund as belonging to the investor. Alternative funds organised as Delaware partnerships that are treated as partnerships for US federal income tax purposes, as well as certain offshore entities, may permit a non-US investor to claim tax treaty benefits with respect to items of US source income. Many foreign jurisdictions do not treat Delaware limited liability companies as transparent and, therefore, an alternative fund organised as a Delaware limited liability company may prevent a non-US investor from claiming tax treaty benefits. See **3.4 Rules Concerning "Permanent Establishments"** for a brief discussion of "permanent establishments" in the context of US tax treaties.

2.13 Use of Subsidiaries for Investment Purposes

See **4.7 Tax Regime – Use of US Corporate Blockers**.

2.14 Origin of Promoters/Sponsors of Alternative Funds

Sponsors of US-domiciled alternative funds are themselves typically domiciled in the US or maintain a place of business in the US. Sponsors of alternative funds from across the globe do, however, access private capital from a wide range of investors in the US.

2.15 Origin of Investors in Alternative Funds

Investors in alternative funds established in the US span the globe. Such funds take in capital from Asian, Australian, European, Latin American and Middle Eastern investors as well as from investors in the US and Canada. Such investors include corporations, family offices, funds of funds, high net worth individuals, insurance companies, pension plans, sovereign wealth funds and the wealth management arms of financial institutions.

2.16 Destination of Investments Made by Alternative Funds

Alternative funds established in the US are able to make investments globally, subject to certain tax structuring that may be required.

2.17 Key Trends

There continues to be a significant increase in fund-raising activity involving larger pools of capital raised and deployed over relatively shorter timeframes. There has also been an increase in the number of fund sponsors raising longer-dated or permanent capital funds to better align the fund structure with the anticipated holding periods of the targeted assets. Such products create additional complexity around issues such as management fee pricing, carried interest crystallisation and secondary liquidity opportunities. The use of fund-level credit facilities has also expanded beyond that of bridging capital calls. In addition, trends involving sponsors raising permanent capital in vehicles that function more like conglomerates or holding companies than alternative funds continue.

2.18 Disclosure/Reporting Requirements

Although alternative funds are not required to file registration statements or detailed business updates with the SEC, they typically do prepare, on a periodic basis associated with their fund-raising cycles, disclosure documents such as private placement memoranda provided to prospective investors. While not routinely reviewed by the SEC, these documents are subject both to the anti-fraud provisions under applicable US securities laws and in the case of an RIA, must comply with rules governing the presentation of historic performance, among other things. Additionally, the managers of RIAs must file, and annually update, a Form ADV, which contains information about the RIA's ownership, disciplinary history, AUM, investment strategy and fee structure. RIAs must also report regulatory assets under management (RAUM) to the Financial Stability Oversight Council (FSOC), an organisation tasked with monitoring risks within the financial sector on an annual basis. Moreover, to the extent that a manager is subject to SEC oversight, it must also provide its clients with full and fair disclosure of all material conflicts of interest in order that a client may provide informed consent.

2.19 Anticipated Changes

While there have not been any recent legislative or regulatory changes targeting US alternative funds, the SEC is considering liberalising certain standards applicable to the types of investors whose participation will not cause alternative funds to become investment companies. Domestic alternative fund managers also take note of the non-binding views of an institutional investor council formed to provide guidance to the industry overall. This council, known as the Institutional Limited Partners Association (ILPA), recently released ILPA Principles 3.0: Fostering Transparency, Governance and Alignment of Interests for General and Limited Partners (ILPA 3.0), which further develops previous guidance on best practices for alternative fund sponsors and investors. ILPA 3.0 recalibrates positions on issues previously addressed, such as the structure of distribution waterfalls, management fees (and related offsets), fund expenses, fund term extensions, time and attention and replacement of key persons, GP removal, fiduciary duties, and investor committees (known as "LPACs") best practices. ILPA 3.0 also introduces new issues for consideration, such as GP ownership and control, GP-led secondary transactions, co-investment allocations, auditor independence and scope of the fund audit, reporting of fees and expenses and disclosure of other financial information, subscription lines of credit, and disclosure of, and compliance with, ESG and other policies that impact the fund and its investors.

While ILPA 3.0 is not binding upon alternative fund managers, ILPA's views are expected to influence the dialogue between managers and investors and to impact the terms of fund agreements.

In addition, the Volcker Rule, a post-financial crisis US regulation that generally prohibits banking entities from engaging in certain types of principal investment activities and limits the ability of banking entities to sponsor alternative funds, was recently amended to modestly liberalise its terms. Such amendments, in relevant part, permit regulated financial institutions to share their names with certain alternative funds if:

- the banking entity in question is an investment adviser to the alternative fund;
- the banking entity is not:
  - (a) an insured depositary institution (IDI);
  - (b) a company that controls an IDI, such as a bank holding company (BHC); or
  - (c) a foreign banking organisation (FBO) that has a US banking subsidiary or operates branches, agencies or commercial lending company subsidiaries in the US, treated as a BHC for certain purposes;
- the banking entity does not share its name or a variation thereof with an IDI, BHC or FBO; and
- the banking entity's name does not include the word "bank".

While this relief is relatively limited, it may facilitate a greater degree of sponsorship of alternative funds by US banking entities.

3. Managers

3.1 Legal Structures Used by Fund Managers

Fund managers in the US are typically formed as limited partnerships or limited liability companies. The limited liability company and limited partnership structures are favoured because they are both flow-through entities from a US tax perspective, and thus not subject to potential double taxation, which in turn is efficient insofar as fund manager entities expect to become profitable. Perhaps equally important, these structures allow wide flexibility with regard to drafting of the governing agreement, enabling the owners to tailor the economic interests of members or partners in a manner which may diverge from ownership and control, while still providing for limited liability as would a corporation. Although they are similar vehicles, a limited partnership requires a general partner while a limited liability company may be member-managed or managed by a managing member or non-member manager, thereby rendering it more attractive from a liability standpoint (a general partner is responsible for the debts and obligations of a limited partnership while a managing member or non-member manager of a limited liability company is not) as well as from an administrative standpoint (due to the liability concern, a general partner is typically organised as a separate legal entity, which requires the creation of an additional entity). There are, however, tax considerations related to the treatment of limited liability companies in certain non-US jurisdictions (to the extent that the manager employs non-US persons) and US self-employment tax considerations that may make a limited partnership more attractive than a limited liability company.

Alternative fund managers often use two vehicles in connection with each fund they manage, one to hold the economic interest that is unique to that fund (ie, the carried interest granted to its general partner), and one (which is often the same vehicle but used across the manager's platform) to manage the day-to-day activities of the funds and receive the management fee stream across the platform. Typically, the management entity would also employ the investment professionals and other employees, lease its offices and so forth.

3.2 Regulatory Regime

See **2.3 Regulatory Regime**.

3.3 Tax Regime

Managers typically form Delaware limited partnerships or limited liability companies treated as partnerships for US federal income tax purposes to serve as an alternative fund's investment manager and carried interest recipient. Typically, separate entities are formed to serve as a fund's investment manager and carried interest recipient (which is typically the general partner), sometimes for state and local tax purposes. As a result of investing through partnerships for US federal income tax purposes, the beneficial owners of the investment manager and carried interest recipient, but not the entities themselves, are subject to US federal income tax on management fee income and carried interest allocations.

Management fee income is subject to US federal income tax at ordinary income tax rates, while individual carried interest recipients may be subject to US federal income tax at reduced rates applicable to long-term capital gains and "qualified dividend income" to the extent that the fund's underlying allocations of income and gain qualify for such preferences. Recently enacted legislation substitutes a three-year holding period in lieu of a one-year holding period (which is generally applicable to investors), in order for a carried interest recipient to qualify for long-term capital gains rates on carried interest that would otherwise qualify as capital gains. Incentive fees are subject to US federal income tax at ordinary income tax rates and are, accordingly, less desirable for the manager's beneficial owners (as well as individual US investors, since incentive fees and management fees paid by a fund are not deductible at the investor level under current law and, for taxable years beginning in 2026, will be deductible subject to various limitations). Additionally, because partners in a partnership may receive allocations of the partnership's taxable income without a corresponding distribution of cash, it is customary for funds to provide for annual tax distributions to persons entitled to carried interest in amounts sufficient to enable such individuals to satisfy the tax liabilities attributable to carried interest income allocations.

3.4 Rules Concerning "Permanent Establishments"

Taxes on Non-US Persons

In general, non-US persons that invest in the United States are not subject to tax on capital gains from the sale of corporate stock (unless more than 50% of the value of the corporation's assets consist of US real property interests, a so-called "FIRPTA company"). Therefore, non-US persons are not generally subject to US federal income tax on gains from the sale of stock by an alternative fund that is treated as a flow-through entity for US tax purposes. Non-US persons are, however, subject to US tax on capital gains from the sale of interests in flow-through entities, such as partnerships or limited liability companies that are taxed as partnerships, that are engaged in a US trade or business, or that own US real property interests, but only to the extent of the income generated by such trade or business or US real property interest. Therefore, non-US persons are generally subject to US federal income tax on any such gains recognised by an alternative fund that is treated as a flow-through for US tax purposes. These taxes on non-US persons may be required to be collected, in the first instance, through withholding by an alternative fund. In addition, the United States generally imposes a withholding tax of 30% on interest and dividends paid to a non-US person, unless the interest is treated as "portfolio interest" (as discussed in **4.7 Tax Regime** under Non-US Investors) or the rate of withholding is reduced under an applicable income tax treaty. Such withholding generally applies on a flow-through basis to a non-US person who is an investor in an alternative fund that is treated as a flow-through entity for US tax purposes.

US federal income tax law and tax treaties generally do not attribute an alternative fund manager's activities to the alternative fund for purposes of determining whether the alternative fund or the investors in such fund have a "permanent establishment" in the US, provided that the manager is properly characterised as an independent agent. However, the activities of the fund's general partner would usually be attributed under US federal income tax law to the alternative fund and its investors for such purpose.

Tax Treaty Benefits

Certain alternative funds that may otherwise be treated as engaged in the conduct of a US trade or business, form investment structures that enable limited partners to claim reduced rates of, or exemptions from, US federal withholding taxes on investment income, such as interest and dividends, by avoiding the creation of a "permanent establishment" in the US. These funds generally rely on the fund manager being properly characterised as an independent agent and limit the activities of the fund's general partner to avoid attribution of a "permanent establishment" to investors in the fund. As explained above, the fund generally must be treated in the investor's home jurisdiction as transparent and the investor must generally be treated as recognising the income for the purposes of its home jurisdiction's taxation in order to be eligible for tax treaty benefits. Tax treaty benefits are generally not available with respect to US tax incurred in connection with real estate assets.

3.5 Taxation of Carried Interest

Individual carried interest recipients may be subject to US federal income tax at reduced rates applicable to long-term capital gains and "qualified dividend income", both of which are currently subject to US federal income tax at a maximum rate of 20%, to the extent that the fund's underlying allocations of income and gain benefit from such preferences. In order for the carried interest recipient to qualify for such capital gains rate, the fund must have held the asset for more than three years at the time of disposition (rather than one, as is the case for other investors, including those in the fund).

The taxation of carried interest is constantly under review by the US Congress, the US Department of the Treasury, and candidates for the US presidency. Future legislation or administrative guidance may significantly impact the taxation of carried interest.

3.6 Outsourcing of Investment Functions/Business Operations

Managers of alternative funds are increasingly likely to outsource administrative functions (such as administering capital calls, maintaining records and providing interface mechanisms and data to investors). These administrative services permit managers to scale up resources in an efficient way as their investor bases, assets and funds, and related vehicles under management grow. They do not normally entail an outsourcing of any investment discretion, however.

From a regulatory perspective, the manager remains responsible for, and oversees, the activities of the firm to which it has delegated responsibility for the relevant activities. In addition, to the extent that the administrator engages in activities that are themselves regulated (such as holding funds), it must also comply with applicable anti-money laundering and similar regimes that govern these activities.

The Adviser's Act also contains substantive requirements in regard to custody of the assets of alternative funds, and provides for enhanced scrutiny of firms that elect to maintain custody of the securities in which they invest. As a matter of practice, and separate from the administrative functions described above, the responsibility for physical custody of securities is frequently outsourced to a significant financial institution that contracts with the manager to maintain custody of the fund's securities.

3.7 Local Substance Requirements

In the US, an entity must be formed under a state's law, most typically that of Delaware. As noted in **2.8 Other Local Requirements**, there is no state or federal requirement as to the presence of employees or other resources in Delaware (or other states) in order for entities to exist under their laws. Similarly, as described in **2.3 Regulatory Regime**, a foreign manager is not necessarily required to register in the US, but if its activities warrant registration, it would notbe required to establish a physical presence in order to register (nor would the lack of such presence, of itself, exempt it from registration).

3.8 Local Regulatory Requirements for Non-local Managers

As indicated in **2.3 Regulatory Regime**, an alternative manager is subject to registration under the Advisers Act if its activities on behalf of US-based investors meet the regulatory threshold, regardless of its physical location, unless it qualifies for the exemptions described in 2.3. The application of exemptions to foreign or exempt private advisers makes it feasible for some non-US managers to maintain a limited scope of activities in the US without full registration being necessary, though an "exempt reporting adviser" filing may be required.

4. Investors

4.1 Types of Investor in Alternative Funds

The United States is a global leader in the alternative funds industry, serving as a common jurisdiction for private fund formation and a significant source of investor capital. Typical US investors in alternative funds include public and private pension plans, foundations and endowments (such as universities and museums), family offices, insurance companies, funds of funds and other institutional investors.

4.2 Marketing of Alternative Funds

The offering of interests in alternative funds is primarily discussed in **2.3 Regulatory Regime** under Securities Act of 1933, above, and is referenced in **4.3 Rules Concerning Marketing of Alternative Funds**.

4.3 Rules Concerning Marketing of Alternative Funds

The combined effect of reliance upon the exemptions from registration as an investment company and from registering alternative fund interests as securities, discussed in the preceding sections, means that the securities offerings of alternative funds are subject to investor suitability criteria (which are currently based primarily on financial wherewithal) and private placement restrictions. Also, as discussed in **2.3 Regulatory Regime**, managers of alternative funds are subject to the anti-fraud provisions of the Advisers Act and other federal securities laws in connection with the offering of fund interests, which generally make it unlawful for advisers to publish, circulate or distribute advertisements that contain any untrue, or otherwise false or misleading, statement of a material fact. The Advisers Act Rule 206(4)-1 also restricts the use of past performance data, including testimonials, past recommendations, and graphs, charts and formulas without sufficient disclosure.

4.4 Local Investors

Local investors are allowed to invest in alternative funds in the US, subject to meeting the relevant suitability restrictions discussed in **2.3 Regulatory Regime**.

4.5 Regulatory Regime

As discussed in **2.3 Regulatory Regime**, offering of alternative fund interests is generally done in reliance on Regulation D, the private placement safe harbour, which requires a notice filing, SEC Form D, to be filed with the SEC no later than 15 days after the first sale of securities in an alternative fund. An annual amendment filing is required if the offering remains open for a year or more, and periodic amendments are required upon the occurrence of specified events. Many states also require the filing of Form D notices and amendments, and may charge a modest filing fee.

4.6 Disclosure Requirements

The identity of investors is not required to be disclosed under US law, however, the Form ADV filed by an RIA does disclose the different types of investors who are advised by the RIA by category. Furthermore, because public bodies are subject to various disclosure obligations in their capacity as public agencies, many state pension funds disclose the alternative funds in which they invest and certain key metrics relating to those investments.

4.7 Tax Regime

Taxation of US Investors in Alternative Funds

US taxation of investors in alternative funds generally depends on the investor's residence for US federal income tax purposes and the activities of the alternative fund itself. US citizens or residents for US federal income tax purposes, as well as corporations organised under the laws of the US, are generally subject to US federal income tax on their worldwide income. The highest rate of US federal income tax applicable to ordinary income of individual US investors is currently 37%, although individual US investors may benefit fromreduced rates of taxation applicable to "qualified dividend income" and long-term capital gains, which are currently subject to US federal income tax at a maximum rate of 20%. In addition, a 20% deduction temporarily applies to individual taxpayers in respect of "qualified business income" attributable to a US trade or business and certain other items of income. US corporate investors are subject to US federal income tax at a rate of 21% on capital gains and ordinary income, although a dividends received deduction may apply to the receipt of certain dividends.

State Income Tax

US states that impose a state income tax, which include New York and California, generally tax their residents on all of the resident's taxable income, starting with a resident's taxable income for US federal purposes and making state-specific adjustments. These US states also generally tax non-residents, whether residents of other US states or non-US countries, that are engaged, or are deemed to be engaged, in trade or business activities in such state. If an investor is subject to tax on the same income in more than one state, the investor may be entitled to a credit in one state for tax paid to the other state.

US Tax-exempt Investors

US tax-exempt investors are generally not subject to US federal income tax on dividends, interest, gains from the sale of property, qualifying rents, and certain other items of investment income recognised by an alternative fund, provided that neither the investment activities nor the investor's fund interest is, or has been during a specified look-back period, debt-financed. A specific exception to the debt financing rule applies to real estate funds in compliance with the so-called "fractions rule". US tax-exempt investors, however, are subject to US federal income tax on trade or business activities conducted by an alternative fund directly or indirectly through flow-through entities.

Non-US Investors

Non-US investors are generally only subject to US federal income tax on two types of income. First, non-US investors are subject to US federal income tax at regular graduated rates, as if they were US investors, on income that is, or is treated as, ECI. The Foreign Investment in Real Property Tax Act, or FIRPTA, generally treats gain from the sale or exchange of non-creditor investments in US real property or corporations that predominantly hold US real property as ECI. A safe harbour for non-US investors generally protects trading in stocks and securities by a fund that is not treated as a dealer in stocks and securities from recognising ECI as a result of such activities. For the purposes of determining whether a partner is engaged in the conduct of a US trade or business, the activities of a partnership are attributed to the partners. As explained in **2.11 Tax Regime** and in the next paragraph, alternative funds typically offer investment vehicles to non-US investors designed to prevent the non-US investor from being directly subject to US federal income taxation and tax reporting obligations. Second, non-US investors are subject to a 30% US federal withholding tax on US-source dividends, interests, rents, royalties and other similar items of income that are not ECI, unless an exemption (such as "portfolio interest" exemption) or an income tax treaty applies. The "portfolio interest" exemption generally exempts non-US investors that are not banks and own less than 10% of a borrower's equity, actually or constructively, from US federal withholding tax on non-contingent interest that is not ECI. Non-US investors that are an "integral part" or "controlled entity" of a foreign government, such as sovereign wealth funds, are eligible for an exemption from US federal withholding tax on US-source dividends and interest that is not attributable to "commercial activities". "Qualified foreign pension funds" are not subject to the FIRPTA provisions of US federal income tax law.

Blocking Structures for US Tax-Exempt Investors and Non-US Investors

Funds sponsored by US investment managers typically offer structures for US tax-exempt investors and non-US investors seeking to minimise their direct US federal income tax obligations, and associated tax reporting obligations, by establishing subsidiaries, feeder vehicles, parallel vehicles, and/or alternative investment vehicles that are or invest through entities treated as corporations for US federal income tax purposes. These are organised either in the US or an offshore jurisdiction to block the recognition of UBTI or ECI, as applicable, and to bear any resulting US federal income tax and to satisfy any US tax reporting obligations.

US Corporate Blockers

As a general matter, a US corporate blocker will prevent a direct or indirect investor from recognising UBTI and non-FIRPTA ECI (eg, operating income and/or income from loan origination activities). A non-US corporate blocker will generally be used to prevent recognition of debt-financed income that constitutes UBTI and, in certain cases, FIRPTA income that constitutes ECI. Real estate investment trusts (REITs), whether formed as a fund subsidiary or as the fund itself, often present a tax-efficient opportunity to make certain qualifying US real estate debt and equity investments. A REIT is a US corporation that is permitted to deduct from its taxable income the dividends that it pays to its shareholders in a taxable year, provided that it satisfies a variety of technical requirements related to its organisation, assets, income and distribution levels. Individual US investors may deduct from taxable income, until taxable years beginning in 2026, 20% of REIT dividends subject to taxation at ordinary income tax rates. US tax-exempt investors are generally not subject to US federal income tax on any income attributable to a REIT, unless the investment in the shares is debt-financed. Non-US investors are not subject to FIRPTA tax in the case of gain from the sale or exchange of a "domestically controlled" REIT. Non-US investors that are an "integral part" or "controlled entity" of a foreign government are not generally subject to tax on gain from the sale or exchange of REIT shares if they own less than 50% of the REIT's stock. REIT dividends not subject to tax as FIRPTA income may be eligible for tax treaty benefits, although tax treaty benefits often apply differently to REIT dividends than regular dividends. Mortgage REITs generally offer non-US investors the opportunity to engage in real estate loan origination without recognising ECI, incurring US tax reporting obligations or bearing US corporate federal income tax. Specialised vehicles for other types of lending activities may be formed by US investment managers, such as real estate mortgage investment conduits (REMICs), to acquire interests in mortgages, and collateralised loan obligations or CLO structures may be used for other types of debt investments. Although less common for alternative fund sponsors because of the requirement to register under the Investment Company Act of 1940 and other significant regulatory requirements, a regulated investment company (RIC) also offers the opportunity, like a REIT, to avoid US federal corporate income tax by making annual distributions to shareholders, generally prevents investors from recognising ECI or UBTI, and permits certain distributions to be made free of (otherwise applicable) 30% US federal withholding tax.

4.8 FATCA/CRS Compliance Regime

In order to comply with FATCA, Delaware limited partnerships treated as partnerships for US federal income tax purposes are generally required to report and withhold on certain US source payments or distributions to non-US investors. Offshore fund vehicles formed by US investment managers, whether as a subsidiary, feeder vehicle, parallel vehicle or alternative vehicle, are generally considered to be "foreign financial institutions" (FFIs), and must comply with a reporting regime or be subject to a 30% US federal withholding tax on certain US payments, including interest and dividends. The reporting obligations imposed under FATCA require FFIs to enter into agreements with the IRS to obtain and disclose information about certain investors to the IRS, or, more commonly, if formed in jurisdictions that have an intergovernmental agreement with the United States (a Model 1 IGA), such as the Cayman Islands, to disclose such information to the tax authorities in their jurisdictions of formation, which will then share the information with the IRS.

The US is not currently a party to the Common Reporting Standard (CRS), although offshore vehicles established by US investment managers in jurisdictions that are a party to the CRS, such as the Cayman Islands and Bermuda, must comply with the CRS.

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