

# HEDGE FUNDS

## USA



# Hedge Funds

Consulting editors

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Quick reference guide enabling side-by-side comparison of local insights, including into the market and policy climate; formation and management; regulation, licensing and registration; taxation; offering, selling and trading restrictions; liquidity terms; and recent trends.

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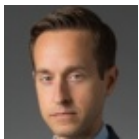
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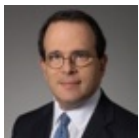
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## MARKET AND POLICY CLIMATE

### Market snapshot

How would you generally describe the state of the market for hedge funds in your jurisdiction?

The United States remains a popular jurisdiction for the formation and operation of hedge funds. The US market continues to provide hedge fund sponsors and managers with access to a wide range of potential investors including, among others, high net worth individuals, pension plans, insurance companies, charitable foundations, university endowments and family offices. Sponsors and managers of hedge funds that seek to attract such capital investments commonly use the state of Delaware as the preferred local jurisdiction for the formation of hedge fund entities. Delaware has a well-developed body of case law applicable to private funds, including hedge funds, that both fund sponsors and managers and the investors they seek are familiar with. This can ease the legal and administrative burden and costs of operating the fund. The two key statutes that typically control fund entities – the Delaware Revised Uniform Limited Partnership Act and the Delaware Limited Liability Company Act – provide a degree of legal flexibility and certainty as they explicitly provide that their intention is to allow the intent of the parties as evidenced in the hedge fund's governing agreements to govern to the greatest extent possible.

*Law stated - 11 May 2022*

### Government and regulatory policy

How would you describe the general government and regulatory policy towards hedge funds in your jurisdiction?

Hedge funds are typically structured to minimise the regulatory burden to which they and their sponsors and managers are subject. Many of the structural and procedural features common to hedge funds are intended to perfect exemptions from some of the most costly and intrusive regulatory requirements and limitations (ie, registration). A common theme underlies most of those exemptions: hedge fund interests offered in the United States must generally be privately offered on a limited basis only to qualifying investors that meet certain financial and sophistication thresholds. While hedge funds are not registered like mutual funds, that does not mean they are not subject to regulation. US-based regulators have regular contact with hedge fund managers and conduct routine compliance examinations and, where applicable, enforcement level investigations. US regulators regularly publish industry guidance on novel or contentious issues and as the hedge fund industry has grown in size and market impact, regulators have proposed new rules to increase the level of industry oversight over hedge funds and their managers and sponsors.

*Law stated - 11 May 2022*

## FORMATION AND MANAGEMENT

### Forms of vehicle

What legal form of vehicle is typically used for hedge funds formed in your jurisdiction? Does such a vehicle have a separate legal personality or existence under the law of your jurisdiction? In either case, what are the legal consequences for investors and the manager?

The form of legal vehicle for a typical US-based hedge fund is either a limited partnership or limited liability company formed in the state of Delaware and operating under exemptions to the US federal securities laws. Limited partners and members are typically passive investors with limited or no voting rights. The form of legal entities limit liability for

investors to the amount of their investment in the fund. These fund vehicles are typically organised as fiscally transparent entities for US federal income tax purposes, which means that the fund itself generally does not pay US federal income taxes. The selection of a limited partnership or limited liability company may in some circumstances depend on non-US tax considerations .

*Law stated - 11 May 2022*

## **Formation process**

**What is the process for forming a hedge fund vehicle in your jurisdiction?**

Hedge fund vehicles are generally formed in the state of Delaware by filing a certificate of limited partnership (for a limited partnership) or certificate of formation (for a limited liability company) with the Delaware Division of Corporations. After the entities are formed, the sponsor or manager will draft the governing and offering documents, including the private placement offering memorandum, subscription documents, investment advisory agreement and the limited partnership agreement or limited liability company operating agreement as applicable. Prior to commencing operations, hedge funds and their sponsors typically engage a number of third-party service providers, including attorneys, fund administrators, placement agents and accountants, and enter into trading agreements with one or more prime brokers and other trading counterparties. The costs and timeline for formation and launch of a hedge fund varies based on the size and complexity of the fund structure and its underlying investment strategy and objectives.

*Law stated - 11 May 2022*

## **Custodianship and administration**

**Is a hedge fund vehicle formed in your jurisdiction required to maintain locally a custodian or administrator, a registered office, books and records, or a corporate secretary? If so, how is that requirement typically satisfied?**

For hedge funds formed in Delaware, the entity must comply with local law, including maintaining a local registered agent with a street address at the fund's registered office located in Delaware that is open during normal business hours to accept service of process. Local resident agents act as the point of contact between the Delaware Division of Corporations and the fund entity. Hedge funds typically engage local third-party service providers to act as registered agents. Hedge funds and their sponsors must also maintain books and records in accordance with local law, including complying with local inspection rights for fund investors pursuant to the fund's governing documents.

A typical hedge fund manager that has custody of client assets, even briefly, is subject to extensive regulation pursuant to Rule 206(4)-2 under the Investment Advisers Act of 1940 , commonly referred to as the 'Custody Rule'. When a manager has custody of client securities or funds, it must maintain the client assets with a 'qualified custodian' in a separate account for each client (ie, each fund) under the client's name or in accounts that contain only the adviser's clients' assets in the name of the adviser as agent or trustee for the clients. Qualified custodians are defined in the Custody Rule to include banks, broker-dealers, futures commission merchants and certain foreign financial institutions.

*Law stated - 11 May 2022*

## **Public access to information**

**What access to information about a hedge fund formed in your jurisdiction is the public granted by law? How is it accessed? If applicable, what are the consequences of failing to make such information available?**

Hedge funds generally are not subject to regular public disclosure requirements. Hedge funds are generally structured to operate pursuant to exemptions to the Investment Company Act of 1940, the Securities Exchange Act of 1934 and the Securities Act of 1933. These exemptions typically require the fund to be structured as a limited private offering only to qualifying sophisticated investors. Hedge funds typically provide tax reporting and audited financial statements to investors on an annual basis and some funds may also provide additional information about their investments to investors on a periodic basis, however these reports are not publicly available.

*Law stated - 11 May 2022*

### **Third-party investor liability**

In what circumstances would the limited liability of third-party investors in a hedge fund formed in your jurisdiction not be respected as a matter of local law?

For hedge funds formed in Delaware, investors generally benefit from limited liability as limited partners (if the fund is structured as a limited partnership), or as members (if the fund is organised as a limited liability company). The state of Delaware has a robust body of case law safeguarding the liability of third-party investor limited partners and members. A limited partner's or member's liability is generally limited to the balance of the investor's total investment in the fund. The general partner of a limited partnership has unlimited liability for any unsatisfied obligations of the partnership, however the managing member of a limited liability company does not.

*Law stated - 11 May 2022*

### **Fund manager's fiduciary duties**

What are the fiduciary duties owed to a hedge fund formed in your jurisdiction and its third-party investors by that fund's manager (or other similar control party or fiduciary) under the laws of your jurisdiction? To what extent can those fiduciary duties be modified by agreement of the parties?

Hedge fund managers have a fiduciary duty to act in the best interests of their clients. All hedge fund managers, regardless of whether they are registered under federal or state securities laws, are subject to the prohibition against fraudulent, deceptive or manipulative conduct as set forth in section 206 of the Investment Advisers Act of 1940 (referred to as the anti-fraud provisions). The United States Supreme Court held that section 206 imposes a fiduciary duty on investment managers by operation of law. This fiduciary duty comprises a duty of care and a duty of loyalty and is viewed in the context of the agreed-upon scope of the relationship between the manager and the client.

While a hedge fund manager's fiduciary duty under the Investment Advisers Act of 1940 cannot be disclaimed or waived in its entirety and a manager cannot issue a blanket waiver of all conflicts of interest, the scope of the relationship can be defined and limited by the terms of the contract as long as there is full and fair disclosure and informed consent.

*Law stated - 11 May 2022*

### **Management liability and negligence**

What standard of liability applies to the management of a hedge fund formed in your jurisdiction? Does your jurisdiction recognise 'gross negligence' (as opposed to 'ordinary negligence') in this regard?



The gross negligence standard is recognised in Delaware as a heightened degree of negligence and is the typical standard in a hedge fund manager's or sponsor's investment advisory contract with a hedge fund.

*Law stated - 11 May 2022*

### **Governance and other special issues or requirements**

Are there any governance or other special issues or requirements particular to hedge fund vehicles formed in your jurisdiction? Does your jurisdiction impose any environmental, social and governance (ESG) obligations on hedge funds or their managers?

There are no such governance or other special issues or requirements particular to hedge funds but ESG is an area of steadily increasing regulatory focus in the United States. The US Securities and Exchange Commission's (SEC) Division of Examinations has included ESG as an area of interest for its exams, noting that it was particularly interested in the accuracy and adequacy of disclosures provided by fund managers. The SEC has been focused on 'greenwashing' where investment products are labelled as ESG without providing any metrics on the impact outcomes. The SEC has been focused on questions relating to, among other things, the definition of ESG used by the manager, ESG factors used, ESG scoring systems used, ESG policies and procedures, relationships with service providers that provide due diligence, screening information or other services relating to the selection or recommendation of ESG investments, marketing materials discussing ESG and ESG performance questions.

*Law stated - 11 May 2022*

### **Fund sponsor insolvency or change of control**

With respect to institutional sponsors of hedge funds organised in your jurisdiction, what are some of the primary legal and regulatory consequences and other key issues for the hedge fund and its general partner and investment adviser arising out of a bankruptcy, insolvency, change of control, restructuring or similar transaction of the hedge fund's sponsor?

Under section 205(a)(2) of the Investment Advisers Act of 1940, a manager cannot assign a client's (a hedge fund in this case) investment advisory contract to another manager without the consent of the client. An 'assignment' is defined broadly under the Investment Advisers Act of 1940 to include any transfer of an investment advisory contract by the manager or any direct or indirect transfer of a controlling block of the manager's stock or other equity interests resulting in a change in control of the management of an investment manager. However, the Investment Advisers Act of 1940 excludes from the definition of 'assignment' transactions that do not result in a change of actual control or management of the manager. For example, a transaction where the manager reincorporates to another local jurisdiction. A 'negative' consent may be sufficient to approve an assignment if the hedge fund's advisory agreement does not specifically provide for written consent and if certain procedures, as disclosed in the hedge fund's governing documents, are followed.

*Law stated - 11 May 2022*

## **REGULATION, LICENSING AND REGISTRATION**

### **Principal legislation and regulatory bodies**

What principal legislation governs hedge funds in your jurisdiction? Which regulatory bodies have authority over a hedge fund and its manager in your jurisdiction, and what are their audit and inspection rights?

Delaware is the preferred jurisdiction for organising most hedge funds in the United States. The two statutes that typically control fund entities in the jurisdiction are the Delaware Revised Uniform Limited Partnership Act and the Delaware Limited Liability Company Act.

The principal legislation at the US federal securities law level for hedge funds and their investment managers are the Investment Company Act of 1940, the Investment Advisers Act of 1940, the Securities Act of 1933, the Securities Exchange Act of 1934 and the Commodity Exchange Act.

The primary regulator for hedge funds and their investment manager is the US Securities and Exchange Commission (SEC). Depending on the investment strategy utilised by the fund, the manager may be subject to regulation by the Commodity Futures Trading Commission (CFTC) and the National Futures Association.

The SEC's oversight of registered investment advisers includes an inspection programme carried out pursuant to the SEC's authority to examine a manager's books and records under section 204 of the Investment Advisers Act of 1940. The SEC is authorised to conduct reasonable, periodic, special or other examinations of all records maintained by investment managers. The examinations may be conducted at any time as the SEC deems necessary or appropriate in the public interest or for the protection of investors. Historically, registered investment advisers were regularly inspected at least every two to four years and a newly registered adviser could be inspected within 12 months of initial registration.

*Law stated - 11 May 2022*

### Reporting and disclosure requirements

What key reporting and disclosure requirements apply to hedge funds in your jurisdiction?

Hedge funds generally operate under exemptions to the Investment Company Act of 1940, the Securities Exchange Act of 1934 and the Securities Act of 1933. Exemptions are typically organised around private offerings and investor wealth and sophistication thresholds. While there is no legal requirement to provide a private placement memorandum (PPM) to accredited investors, many hedge fund managers choose to provide one in light of federal and state anti-fraud provisions, as protection against investor claims that they were misled. The PPM usually describes all material facts about the offering including a description of the fund's investment strategy and associated risk factors, fees and expenses of the fund, including manager compensation; liquidity terms; legal structure and jurisdiction of the organisation; summary of tax considerations; a description of valuation methodology; potential conflicts of interest; and the procedures and eligibility standards to participate in the offering. To the extent a PPM is prepared and provided to prospective investors, it cannot possess any misleading or false information, nor can it omit any information material to the offering. As the fund develops over time, market changes may render its disclosures inaccurate or omit material information. The manager must keep the PPM updated to disclose the current state of the offering. Hedge funds typically provide tax reporting and audited financial statements to investors on an annual basis.

*Law stated - 11 May 2022*

### Fund licensing and registration

What regulatory approval, licensing or registration requirements apply to hedge funds in your jurisdiction? Does it make a difference whether there are significant investment activities in your jurisdiction?

Hedge funds generally do not require regulatory approval or registration with a regulatory body in order to operate. Hedge funds are generally structured to qualify for an exemption under the Investment Company Act of 1940 to avoid regulation as an 'investment company'. An investment company under the Investment Company Act of 1940 is required

to register (like a mutual fund) unless it otherwise qualifies for an exemption. Hedge funds primarily rely on exemptions from registration pursuant to sections 3(c)(1) and 3(c)(7) of the Investment Company Act of 1940. Failing to qualify for an exemption would dramatically increase the hedge fund's and the sponsor's regulatory burden and limit the freedom to operate the fund as intended.

*Law stated - 11 May 2022*

### **Fund manager registration**

**Is a hedge fund's manager – or any of its officers, directors or control persons – required to register as an investment adviser in your jurisdiction?**

The manager of a hedge fund may be required to register under the Investment Advisers Act of 1940 and the Commodity Exchange Act. Investment managers that manage private funds with regulatory assets under management of at least US\$150 million are required to register with the SEC as an 'investment adviser' under the Investment Advisers Act of 1940 unless they can otherwise qualify for an exemption.

Depending on the investment activities of the hedge fund, the manager may also have to register as a commodity pool operator or a commodity trading adviser under the rules of the CFTC unless they otherwise qualify for an exemption.

Investment advisers register with the SEC by filing a Form ADV and have certain annual filing requirements under the Investment Advisers Act of 1940. Each registered adviser must file an annual updating amendment to its Form ADV, which must be filed within 90 days of the adviser's fiscal year end.

*Law stated - 11 May 2022*

### **Fund manager qualifications and other requirements**

**Does your jurisdiction impose any specific qualifications or other requirements on a hedge fund's manager or any of its officers, directors or control persons?**

The SEC does not require registered investment advisers to maintain any particular level of capitalisation, but some local state jurisdictions do have minimum capital requirements. The substantive requirements are generally not substantial, but investment managers must maintain records demonstrating compliance.

The SEC does not impose examination or licensing requirements on the manager's personnel, but some local state regulations may require investment-level personnel or principals to pass certain examinations administered by the Financial Industry Regulatory Authority. Certain principals and other employees of registered commodity pool operators and commodity trading advisers must pass certain examinations administered by the National Futures Association.

*Law stated - 11 May 2022*

### **Political contributions**

**Are there any rules – or policies of public pension plans or other governmental entities – in your jurisdiction that restrict, or require disclosure of, political contributions by a hedge fund's manager or investment adviser or their employees?**

The United States enforces 'pay-to-play restrictions' pursuant to Rule 206(4)-5 under the Investment Advisers Act of 1940. The pay-to-play restrictions are designed to prevent investment managers from seeking to influence government officials' awards of advisory contracts by making or soliciting political contributions to those officials. The pay-to-play

restrictions prohibit a manager from receiving compensation for providing investment advisory services to a government client within two years of any contribution (other than certain de minimis contributions, as permitted by the rule) made by the manager or a 'covered associate' to an elected official in a position to direct or influence the investment activities of the government client. The rule generally applies to contributions at the state or local level, and not with respect to federal officials as such, although the rule does apply to contributions to candidates for federal office if those candidates are in a position to direct or influence local government investment activities.

Individual states and municipalities also often have their own regulations relating to political contributions as well.

*Law stated - 11 May 2022*

### **Use of intermediaries and lobbyist registration**

Are there any rules – or policies of public pension plans or other governmental entities – in your jurisdiction that restrict, or require disclosure by a hedge fund's manager or investment adviser of, the engagement of placement agents, lobbyists or other intermediaries in the marketing of the fund to public pension plans and other governmental entities? Are there any rules that require a fund's investment adviser or its employees and agents to register as lobbyists in the marketing of the fund to public pension plans and governmental entities?

Pay-to-play rules, including regulations pursuant to local laws of some states, place restrictions on the use of placement agents, lobbyists or other third-party intermediaries by hedge funds for facilitating investment in the funds by local pension funds. Any placement agent or other third-party intermediary retained by a hedge fund manager to solicit government clients must be a 'regulated person' as defined in the Investment Advisers Act of 1940. The SEC has brought a number of enforcement actions against investment managers that violate the pay-to-play restrictions and the penalties can be severe.

*Law stated - 11 May 2022*

### **Anti-money laundering regulations**

What anti-money laundering rules and requirements apply to hedge funds in your jurisdiction?

Certain US federal laws (including the Bank Secrecy Act (BSA) and the USA PATRIOT Act of 2001 ) and regulations (such as the US Treasury Department Office of Foreign Assets Control (OFAC) prohibitions on transactions with certain persons) are designed to combat money laundering activity and the funding of terrorist or criminal activities. The BSA requires that 'financial institutions', including investment companies registered under the Investment Company Act of 1940, commodity trading advisers and commodity pools, establish anti-money laundering (AML) programmes and comply the AML provisions thereunder. Neither investment managers nor unregistered private funds, including hedge funds, are expressly subject to the AML provisions of the BSA as they are not covered by the current definition of financial institution.

Even though there is no specific requirement for hedge funds and their managers to implement AML programmes under the BSA, since many market participants including banks, broker dealers and futures commission merchants are subject to the rules and may require representations from counterparties that they have AML policies in place, most hedge funds and their managers do develop their own AML programmes as a matter of best practice. In addition, all US persons and entities, including hedge funds and their managers, must comply with rules prohibiting dealings with governments, individuals, foreign countries and entities designated by OFAC on the 'Specially Designated Nationals and Blocked Persons List' (also referred to as the SDN list).

**Data security and privacy regulations**

What data security or privacy rules and regulations apply in your jurisdiction regarding the protection and handling of private data about a hedge fund or its investors?

Hedge funds and their managers are subject to a number of privacy requirements under federal and state securities laws. Managers that are registered with the SEC are subject to the privacy rules and regulations under Regulation S-P. Managers may also be subject to CFTC privacy requirements if they are regulated as a commodity trading adviser or a commodity pool operator. Hedge funds that are exempt from registration pursuant to sections 3(c)(1) and 3(c)(7) of the Investment Company Act of 1940 that are not commodity pools and investment managers that are not registered with the SEC and that are not regulated as commodity pool operators or commodity trading advisers are generally subject to Federal Trade Commission (FTC) privacy regulations, enforced by the Consumer Financial Protection Bureau.

Regulation S-P and FTC privacy regulations are mostly aligned and generally require registered investment advisers and hedge funds to adopt written policies and procedures for the protection of customer records and information against anticipated threats or hazards to the security or integrity of customer records, and information and against unauthorised access to or use of customer records or information that could result in substantial harm or inconvenience to any customer. In addition, they have an obligation to ensure proper disposal of such information to ensure confidentiality and protect against unauthorised access or disclosure. Managers and hedge funds must provide a privacy notice to clients and fund investors who are natural persons describing the entity's privacy policies and practices (as a matter of best practice, privacy notices are generally sent to all clients and investors even if they are not natural persons). The regulations prohibit managers from providing non-public personal customer information to unaffiliated third parties, other than service providers that need access to that information in order to permit the manager to conduct its business, unless customers first have been provided with an initial 'privacy notice', offering the client the option of withholding consent to such information sharing (an 'opt out').

Law stated - 11 May 2022

**TAXATION****Hedge fund structuring**

What tax considerations are relevant to the form of organisation and initial structuring of a hedge fund in your jurisdiction?

The typical structure for a US hedge fund is a 'master-feeder' structure consisting of one or more US (onshore) feeder funds, one or more non-US (offshore) feeder funds and one or more master funds (typically formed outside the United States). Typically, only the onshore feeder fund is formed in the United States. The onshore feeder fund typically is only offered to US investors. Non-US and US tax-exempt investors typically invest through offshore feeder funds, which are typically formed in low-tax jurisdictions such as the Cayman Islands.

Law stated - 11 May 2022

**General tax liabilities and available exemptions**

Is a hedge fund vehicle formed in your jurisdiction subject to taxation there with respect to its income or gains? Is the fund required to withhold taxes with respect to distributions to investors? Under what conditions may a hedge fund qualify for applicable tax exemptions?



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A US fund vehicle that is fiscally transparent for US federal income tax purposes generally is not subject to US federal income tax at the entity level but may be subject to state and local taxes at the entity level. In addition, such vehicles may be required to withhold US federal, state or local taxes on their investors' share of the income of the entity, as well as in the case of certain distributions.

US fund vehicles that are classified as corporations for US federal income tax purposes are subject to US federal income tax and, depending on the jurisdiction in which they are formed and the nature of their income, may be subject to state and local taxes at the entity level. Dividends paid by funds that are classified as corporations may also be subject to US withholding tax.

*Law stated - 11 May 2022*

### **Local taxation of non-resident investors**

Are non-resident investors in a hedge fund subject to taxation or return-filing requirements in your jurisdiction?

The taxability of a non-US investor in a hedge fund depends on the tax classification of the fund vehicle through which the non-US investor invests, as well as the nature of the fund's investing and trading activities. Non-US investors that invest in a US fund that is classified as fiscally transparent for US federal income tax purposes may be subject to taxation and return filing requirements if the fund is engaged (or deemed) to be engaged in a US trade or business. As a result, non-US investors will typically seek to invest through non-US vehicles that are classified as corporations for US federal income tax purposes (the offshore feeder fund). But if the fund's investment activity is expected to generate effectively connected income, non-US investors may instead seek to invest through a US vehicle that is classified as a corporation for US federal income tax purposes. Special considerations may apply to non-US sovereign investors.

*Law stated - 11 May 2022*

### **Local tax authority ruling**

Is it necessary or desirable to obtain a ruling from local tax authorities with respect to the tax treatment of a hedge fund vehicle formed in your jurisdiction? Are there any special tax rules relating to investors that are residents of your jurisdiction?

Hedge funds formed in the United States typically do not seek special tax rulings from the US Internal Revenue Service or other state or local tax authorities.

*Law stated - 11 May 2022*

### **Organisational taxes**

Must any significant organisational taxes be paid with respect to hedge funds organised in your jurisdiction?

Hedge funds formed in the United States may be required to pay state or local organisation fees and expenses.

*Law stated - 11 May 2022*

## Special tax considerations for sponsors

What special tax considerations are relevant with respect to a hedge fund's sponsor?

Sponsors are generally structured as fiscally transparent entities to avoid incurring tax at the entity level. Sponsors may structure incentive compensation either as a fee or as an allocation of income from a fund. The structure of a sponsor's incentive compensation depends on the nature of the underlying investing and trading activity as well as the tax profile of the sponsor's owners.

*Law stated - 11 May 2022*

## Tax treaties

Are there any relevant tax treaties to which your jurisdiction is a party? How do such treaties apply to hedge fund vehicles?

Non-US investors typically do not invest through US fund entities. However, the United States is party to numerous income tax treaties, and in certain cases, a fund may be structured in a manner that is intended to provide non-US investors with the benefit of an income tax treaty between the United States and the jurisdiction in which such investors are located.

*Law stated - 11 May 2022*

## Other significant tax issues

Are there any other significant tax issues relating to hedge funds organised in your jurisdiction?

The Foreign Account Tax Compliance Act (FATCA) imposes registration and reporting requirements on foreign financial institutions and certain non-financial foreign entities. US withholding tax at a rate of 30 per cent may apply to payments to such entities unless such foreign entities enter into an agreement with the US Department of the Treasury or otherwise satisfy their FATCA-related obligations under local implementing legislation.

*Law stated - 11 May 2022*

## OFFERING, SELLING AND TRADING RESTRICTIONS

### Marketing restrictions

What principal legal and regulatory restrictions apply to offers and sales of interests in hedge funds formed in your jurisdiction, including the types of investors to whom such funds may be offered without registration under applicable securities laws?

To avoid the time, cost and administrative burden of registration under US federal and state securities laws, hedge fund interests are often sold solely by way of a private offering. Hedge fund interests are typically offered pursuant to a private placement exemption under section 4(a)(2) of the Securities Act of 1933 and Rule 506 of Regulation D.

*Law stated - 11 May 2022*



## Investor restrictions

Are there any restrictions on the types and number of investors that may participate in hedge funds formed in your jurisdiction (other than those imposed by applicable securities laws)?

To qualify for exemption from registration under section 4(a)(2) of the Securities Act of 1933 and Rule 506 of Regulation D, hedge fund investors generally qualify under minimum suitability thresholds as accredited investors. To qualify for exemption from registration as an investment company under section 3(c)(7) of the Investment Company Act of 1940, hedge fund investors generally qualify under minimum suitability thresholds as qualified purchasers. To rely on section 3(c)(1) to avoid registration under the Investment Company Act of 1940, the hedge fund may not have more than 100 beneficial owners at any one time. If the hedge fund's strategy involves trading in commodity interests, investors may need to meet qualified eligible person status under the Commodity Exchange Act.

*Law stated - 11 May 2022*

## Bank participation

Are there any legal or regulatory restrictions that specifically affect banks with respect to investing in or sponsoring hedge funds?

The Bank Holding Company Act of 1956 (BHCA) provides for limitations on investments in hedge funds by banks. Restrictions added to section 13 of the BHCA, popularly referred to as the 'Volcker Rule', that were included as part of the Dodd-Frank Wall Street Reform and Consumer Protection Act placed new constraints on proprietary trading by banks and bank investment in or sponsorship of hedge funds and other private investment funds.

*Law stated - 11 May 2022*

## Trading activities

Are there any regulatory restrictions or disclosure obligations with respect to a hedge fund's trading activities?

The Federal securities laws impose disclosure obligations on certain trading activities. These include the filing of various forms with the US Securities and Exchange Commission (SEC), some of which may be publicly available (ie, Forms 13D/G/F) and others are available only to regulators (ie, Form PF).

The derivatives market is regulated under Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act under dual regulatory authority of the Commodity Futures Trading Commission (CFTC) and the SEC. The Dodd-Frank Act imposes mandatory clearing, trade execution and margin requirements on many types of commonly used swaps and security-based swaps as well as record-keeping and real-time reporting requirements.

Managers of hedge funds that invest in 'commodity interests', including commodity options, futures contracts and swaps, are subject to the regulations under the Commodity Exchange Act and the rules of the CFTC.

*Law stated - 11 May 2022*

## Side letters



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Are hedge funds or their general partners permitted to enter into side letters with investors? Are there any limits on the contents of side letters?

Side letters have long been a part of the hedge fund industry in the United States. The terms of an investment in a hedge fund are governed by the fund's governing documents (limited partnership agreement or limited liability company operating agreement as applicable) and may be modified by separate written agreement. Investors (typically institutional investors with significant relative economic bargaining power) may seek preferential terms including favourable fees, information rights or most favoured nation status. Side letters are also frequently used to address legal, tax or regulatory issues that are specific to an individual investor, but do not necessarily apply to other fund investors.

*Law stated - 11 May 2022*

## LIQUIDITY TERMS

### Redemptions

Are there any regulatory or other limitations on hedge funds' liquidity terms? Are there any limits on lock-up periods, frequency of redemption dates or length of redemption notice? Are withdrawal 'gates' permissible? Are 'side pockets' permitted? Can different liquidity terms be offered within the same hedge fund structure?

Unlike open-end registered investment companies (mutual funds), hedge funds are not required to provide daily liquidity of fund shares. The redemption terms and policies for hedge funds are set out in the fund's governing documents. Hedge funds frequently include in their governing documents restrictions on liquidity including required notice periods, 'gates', side pockets or special investments, lock-ups, early withdrawal penalties or fees and the ability to suspend redemptions.

*Law stated - 11 May 2022*

### Suspensions

Are there any legal or regulatory issues associated with a suspension of redemptions, payment of redemption proceeds or net asset value?

Hedge funds generally include the ability to suspend redemptions or withdrawals during periods of market turmoil in the fund's underlying governing documents.

*Law stated - 11 May 2022*

### In-kind distributions

Are there any legal or regulatory limitations or disclosure issues related to a hedge fund's ability to make in-kind distributions to its investors?

Most governing documents for hedge funds permit the investment manager to distribute securities in-kind to investors to meet redemption or withdrawal requests so long as the transfer thereof is not prohibited or so limited under applicable law.

## UPDATE AND TRENDS


### Recent trends and developments

What are the most significant recent trends and developments relating to hedge funds in your jurisdiction? What impact do you expect such trends and developments will have on global hedge fundraising and on hedge funds generally?

The hedge fund industry is the subject of impending or proposed rules by federal regulators that may have an impact on fundraising and other matters. Specifically, new marketing rules imposed by the US Securities and Exchange Commission (SEC) will change how promotional materials and performance information will be presented to prospective investors. Moreover, the SEC has recently proposed new substantive and disclosure rules that would apply to hedge fund sponsors generally. These new rules are subject to ongoing comment and may be revised. There also continues to be ongoing regulatory developments relating to ESG and digital assets strategies and disclosures.

Law stated - 11 May 2022

## Jurisdictions

	<b>Hong Kong</b>	Sidley Austin LLP
	<b>Ireland</b>	Maples Group
	<b>Singapore</b>	Sidley Austin LLP
	<b>South Korea</b>	Bae, Kim & Lee LLC
	<b>United Kingdom</b>	Sidley Austin LLP
	<b>USA</b>	Sidley Austin LLP