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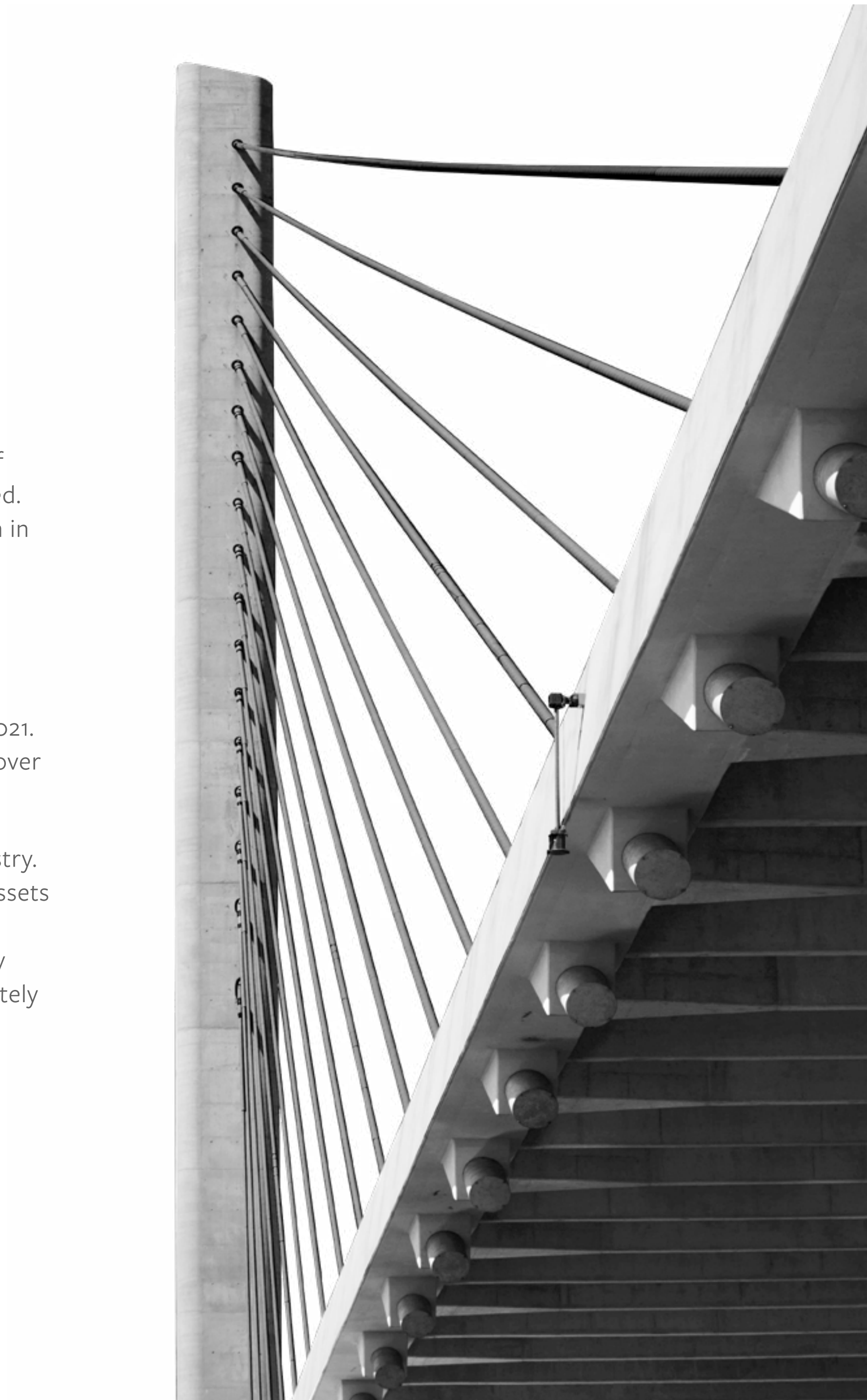
United States

The United States (US) is by far the largest asset management and fund market in the world —in every category, mainstream and alternative. Assets of US funds now exceed USD24tn.

Although US alternative investment funds and their advisers are subject to the laws of the federal government, they are also subject to the jurisdiction of the state in which they are formed and/or are registered. The state of Delaware is the most common jurisdiction in the US for alternative funds and their advisers.

Private equity continues to grow steadily in the US. According to Preqin, there were 3724 private equity funds operating in the US market at the start of 2022, representing a 65.5% increase since the beginning of 2021. In 2021, 1558 private equity investment vehicles raised over $481.54bn in capital commitments.

The US is also dominant in the global hedge fund industry. Preqin reports that 77% of total hedge fund industry assets worldwide are overseen by managers based in the US. The US remains a key driver of the hedge fund industry across the globe, accounting for 77% of the approximately $4.339tn in global assets as of December 2021.



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Fund structures

In the United States, pooled investment vehicles operating in the US that invest in securities and their advisers are subject to the laws of the federal government and of the individual state or jurisdiction in which the entities are incorporated, doing business and/or selling securities. Many pooled investment vehicles operating in the US, including alternative investment funds, are generally subject to the jurisdiction of the Securities and Exchange Commission (SEC).

The SEC's jurisdiction comes by way of the Investment Company Act of 1940, as amended, for the activities of investment companies and the Investment Advisers Act of 1940, as amended, for the activities of investment advisers. The offering and sale of interests in Alternative Investment Funds is regulated by the Securities Act of 1933 and the Securities Exchange Act of 1934, and are also regulated by the Financial Industry Regulatory Authority (FINRA). Alternative funds that invest in futures, options, or swaps also come under the jurisdiction of the Commodity Futures Trading Commission (CFTC).

The majority of alternative funds are structured as limited partnerships (LP) or limited liability companies (LLC). A Delaware LP consists of at least one general partner and one limited partner. The general partner can be either an individual or an entity, such as a corporation. A Delaware LLC is an entity with a legal existence separate and distinct from its owners, referred to as Members. Members and/or managers are not personally liable for the company's debts and obligations.

Alternative funds in the US are often structured as several pooled investment vehicles rather than one vehicle in order to accommodate the tax preferences of different types of investors, reports ICLG. This allows the form and the jurisdiction of the organisation to be varied according to investor type, the most common variation being to house non-US investors within an offshore structure in a tax-neutral jurisdiction.

A parallel fund is a fund through which US tax-exempt investors or foreign investors invest may hold investments through corporations, real estate investment trusts (REITs) or other similar vehicles. These are non-transparent for tax purposes to 'block' income that might otherwise subject them to income tax or reporting requirements in the US.

These parallel fund structures are often used by private equity and other closed-end funds. On the other hand, hedge funds generally prefer a 'master-feeder' structure. In this structure, investors subscribe for interests in 'feeder funds' that in turn invest in one 'master' fund that holds all investments.

US investors also allocate to onshore feeders, and foreign and US tax-exempt investors invest through 'blocker' vehicles (the offshore feeders), classified as corporations for US tax purposes and organised in a tax-neutral jurisdiction such as the Cayman Islands.

The Cayman Islands has become the most common jurisdiction for fund structures domiciled outside the US that are distributed to US tax-exempt investors such as public pension funds and endowments.

Taxation

The overwhelming majority of alternative funds in the US are private funds that are classified as partnerships. They are transparent for US federal income tax.

Hedge fund investors, that are taxable in the US, allocate via an onshore feeder that is classified as a partnership (and transparent) for federal income tax purposes, while foreign and US tax-exempt investors invest through an offshore feeder classified as a non-US corporation for US tax purposes and organised in a tax-neutral jurisdiction.

BEPS

The US has not signed the Multilateral Instrument, unlike the vast majority of countries around the world. It has, however, implemented some parts of the BEPS 15-point actions. For example, the US Treasury is has enacted hybrid mismatch rules as part of the US Tax Reform for certain amounts paid or accrued to related parties, and on BEPS Action 6 (prevention of treaty abuse), the US already satisfies this BEPS standard.

Americans of all political persuasion do not want to see US multinational companies paying more tax overseas. Therefore, it is unlikely that much of the BEPS programme will ever be adopted by the US.

Sources

- Preqin Special Report on Hedge Funds in the US released in July 2019 (Website: https://docs.preqin.com/reports/Preqin-Special-Report-Hedge-Funds-in-the-US-July-2018.pdf)
- The International Comparative Legal Guides (ICLG) to: Alternative Investment Funds released in August 2019 (Website: https://iclg.com/practice-areas/alternative-investment-funds-laws-and-regulations/usa)

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