

The background of the slide features a dark blue color scheme with a faint world map. Overlaid on the map are various financial data points, including bar charts, line graphs, and numerical values. The K&L GATES logo is prominently displayed in the upper left corner in white text on a dark blue rectangular background.

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2019 WASHINGTON D.C. INVESTMENT MANAGEMENT
CONFERENCE – November 12, 2019

Organizing an Investment Company, Registering Its Shares and Maintaining a Continuous Offering, and Complying with the Tax Code

Stacy L. Fuller, Partner, K&L Gates LLP

Virginia L. Stevenson, K&L Gates LLP

Jin H. Ahn, Associate, K&L Gates LLP

ORGANIZING A REGISTERED FUND

Time and Responsibility Schedule

- Decide form and content early
- Allow appropriate review time
- Reviewers include:
 - Internal Personnel
 - Portfolio Managers
 - Legal/Compliance
 - Operations
 - Fund Counsel (Tax Counsel)
 - Directors/Independent Director Counsel
 - Independent Accountants (consent required)



ORGANIZING A REGISTERED FUND *(CONTINUED)*

- Possible Forms of Organization
 - Corporations
 - (Maryland)
 - Business/Statutory Trusts
 - Massachusetts Business Trusts
 - Delaware Statutory Trusts
- Federal Tax Implications
 - Must be, or be treated as, a domestic corporation



ORGANIZING A REGISTERED FUND *(CONTINUED)*

- **Governing State Law**
 - Maryland Corporate Law
 - A well-developed and detailed statute
 - Massachusetts Business Trust Law
 - Virtually no substantive statutory provisions
 - Delaware Statutory Trust/Corporate Law
 - Highly developed case law



ORGANIZING A REGISTERED FUND *(CONTINUED)*

- **Organizational and Corporate Documents**
 - Charter (Declaration of Trust, Trust Instrument or Articles of Incorporation)
 - Name
 - Number of Directors
 - Powers Clause
 - Purpose Clause
 - Limitation of Liability & Indemnification
 - Bylaws
 - Election of Directors
 - Board Committees
 - Duties of Officers
 - Conduct of Board and Shareholder Meetings

ORGANIZING A REGISTERED FUND *(CONTINUED)*

- Organizational Meeting
 - Approving the Charter and Adopting the By-laws
 - Formal election of directors and officers
 - Establishing Board Committees (e.g., audit, nominating)
 - Ratification of prior actions
 - Business transactions (e.g., approve arrangements with fund service providers)
 - Authorization to file the fund's registration statement



ORGANIZING A REGISTERED FUND *(CONTINUED)*

- Structure and Distribution
 - Separate Entities
 - Series Funds
 - Multiple Class
 - Master-Feeder Arrangements
 - Fund of Funds
- Federal Tax Implications



SEC REGISTRATION

- **Primary Laws Governing Federal Registration**
 - **Securities Act of 1933 (the 1933 Act)**
 - Section 5 – Registration of Securities
 - Section 10 – Information Required in a Prospectus
 - Regulation C – Rules 421, 480-486 and 495-497
 - Sections 11 and 12 – Liability
 - **Investment Company Act of 1940 (the 1940 Act)**
 - Section 8 - Registration of Investment Companies



SEC REGISTRATION *(CONTINUED)*

- **The Registration Process**
 - Notification of Registration (Form N-8A)
 - Registers entity as an investment company
 - Essential for federal tax treatment as a regulated investment company
 - Registration Statement (Forms N-1A and N-2)
 - Registers the fund and its shares
 - SEC Staff Review
 - Registration Statement ordered “effective” by SEC
 - File definitive prospectus and SAI within 5 days of effectiveness
 - XBRL (15 business days after effectiveness)
 - Registration Under Securities Exchange Act of 1934 (Form 8-A)

REORGANIZATIONS

- Form N-14
 - Combined prospectus and proxy statement
 - Prospectus – acquiring company registers securities to be issued in connection with reorganization
 - Proxy statement – acquiring company solicits votes for approval of reorganization
 - Increased disclosure required



SEC REGISTRATION *(CONTINUED)*

- **Form N-8A: Notification of Registration**
 - Registers entity as investment company
 - Short Form (file concurrent with Form N-1A)
 - Long Form (file Form N-1A within 3 months)



SEC REGISTRATION *(CONTINUED)*

- **Form N-1A: Registration Statement**
 - Facing Sheet
 - Part A: Prospectus
 - Part B: Statement of Additional Information (SAI)
 - Part C: Other Information
 - Signature Pages
 - Exhibit Index/Exhibits
 - Transmittal Letter

PART A: PROSPECTUS

- **Cover/Back Page**
- **Fund Summary**
 - Objectives, Performance, Fee Table, Summary of Investments, Risks, Fund Management Information, Purchase/Sale Information, Tax Information and Financial Intermediary Compensation
- **Fund Details**
 - Investment Objectives, Principal Investment Strategies, Related Risks and Disclosure of Portfolio Holdings
- **Fund Management, Organization and Capital Structure**
 - Adviser
 - Portfolio Managers
- **Shareholder Services**
 - Shareholder Information including Valuation, Purchase/Sale and Tax Information and Policies about Frequent Purchases and Sales
 - Distribution Arrangements
- **Financial Information**



PART B: STATEMENT OF ADDITIONAL INFORMATION (SAI)

- Detailed description of fund matters (incorporated into prospectus)
 - Investment Policies and Limitations
 - Investment Descriptions
 - Fund Management/Board of Directors/Service Providers
 - Description of the Trust/Corporation
 - Control Persons
 - Portfolio Transactions
 - Valuation
 - Tax Information
 - Performance
 - Portfolio Holdings Disclosure
 - Financial Statements



PART C: OTHER INFORMATION

- Exhibits:
 - Organizational documents
 - Fund contracts
 - Legal opinions and consents
 - Rule 12b-1 Plan(s)
 - Rule 18f-3 Plan
 - Code of Ethics
- Indemnification, Business Connections of Adviser and Underwriter, Recordkeeping and Undertakings
- Signature Pages



SEC REGISTRATION

- Signature Pages (Directors, certain Officers)
 - Powers of Attorney
 - Section 11 of the 1933 Act
 - Civil remedy for purchasers
 - Liability for content of registration statement
 - Liability extends to:
 - Each person that signs the registration statement (directors are required to sign)
 - Each person that provides an expert opinion (accountants)
 - Underwriter
 - Any controlling person

SEC REGISTRATION *(CONTINUED)*

■ SEC Staff Review

- Division of Investment Management
- Selective Review
- Comments
- Responses

■ Order of Effectiveness

- Delaying amendment
- Definitive prospectus and SAI (file within 5 days of receipt of the Order of Effectiveness)
- Summary Prospectus (file before or on day of first use)



POST-EFFECTIVE REQUIREMENTS

- **Maintain good standing with the State of organization**
- **Annual update of registration statement**
 - Update no later than 16 months (stale financials)
 - 120 days for 1940 Act compliance
 - Rule 485(a): Non-routine “material” changes
 - Effective 60 days after filing (75 days for new series)
 - Rule 485(b): Non-material “routine” changes
 - Automatically effective upon filing
 - May use to update 485(a) filing
 - Rule 497 stickers



POST-EFFECTIVE REQUIREMENTS *(CONTINUED)*

- Due Diligence Checklist for Post-Effective Amendments
 - Updated copy of Form N-1A
 - Board materials and resolutions
 - Proxy statements
 - Stickers/Supplements
 - Shareholder reports
 - Exemptive Orders/No-Action Letters
 - Sign-off (portfolio managers, counsel, accountants)

POST-EFFECTIVE REQUIREMENTS *(CONTINUED)*

- Useful Resources
 - Plain English Handbook
 - Proposing and Adopting Releases of Disclosure Rules
 - Generic Comment Letters, “Dear Registrant” and “Dear Financial Officer” Letters
 - Old N-1A Disclosure Guidelines
 - SEC Staff No-Action and Interpretive Letters



POST-EFFECTIVE REQUIREMENTS *(CONTINUED)*

■ Shareholder Reports

- Annual and semi-annual delivered to shareholders within 60 days of period end date
- Rule 30e-3 of the Investment Company Act of 1940
 - Allows for optional “notice and access” method for delivering shareholder reports
 - Effective Date: January 1, 2019 for Large Funds

■ Form N-CSR

- Used to file shareholder reports with the SEC within 10 days such reports are sent to shareholders
- Sarbanes-Oxley Act certifications
- Includes additional information



POST-EFFECTIVE REQUIREMENTS *(CONTINUED)*

■ Form N-Q

- File complete portfolio holdings with the SEC within 60 days of the end of the first and third fiscal quarter
- No delivery to shareholders, but available to shareholders upon request
- Sarbanes-Oxley Act certifications

■ Form 24F-2

- Filing fees
- File notice within 90 days of fiscal year end
- Fees based on shares sold less shares redeemed



POST-EFFECTIVE REQUIREMENTS *(CONTINUED)*

- **Form N-PX**
 - Record of proxy votes for 12-month period ending June 30
 - Due no later than August 31 for all funds
- **Form N-MFP**
 - Applies only to money market funds
 - Shows all portfolio holdings
 - File by the 5th business day of each month



NEW FORMS

- **Form N-SAR was replaced by Form N-CEN**
 - June 1, 2018 for all Funds
 - Filed with the SEC no later than 75 days after the close of the fiscal year

- **Form N-Q was / will be replaced by Form N-PORT**
 - April 30, 2019 for Large Funds
 - April 30, 2020 for Small Funds



FEDERAL TAXATION OF REGULATED INVESTMENT COMPANIES (“RICS”)

- Open-end funds (“mutual funds”)
- Closed-end funds
- Most exchange-traded funds (“ETFs”)

Receive “pass-through” treatment under
Subchapter M



REQUIREMENTS FOR RIC TREATMENT

- Domestic corporation (or entity classified or treated as such)
- Registered under 1940 Act (or BDC election)
- Election to be a RIC – Form 1120-RIC
- Gross Income Requirement – 90% of gross income
 - Passive income
 - Net income derived from an interest in a “qualified publicly traded partnership”
 - Income from commodities – proposed regulations and revenue procedures

REQUIREMENTS FOR RIC TREATMENT

(CONTINUED)

- Diversification Requirements – close of each taxable year quarter (different from 1940 Act requirement)
 - 50% of assets
 - 5% of assets in a single issuer
 - 10% of a single issuer's voting securities
 - Specific instruments (including repos and Government securities)
 - 25% of assets



REQUIREMENTS FOR RIC TREATMENT

(CONTINUED)

- Diversification Requirements (continued)
 - No disqualification for certain failures to comply
 - Exception for market fluctuations and distributions
 - 30-day cure period
 - RIC Modernization Act – “inadvertent” failure (i.e., failure “due to reasonable cause and not due to willful neglect”) and *de minimis* failure



REQUIREMENTS FOR RIC TREATMENT

(CONTINUED)

- Distribution Requirement
 - 90% of investment company taxable income
 - Includes net short-term capital gain
 - Includes net foreign currency gains and losses
 - 90% of net tax-exempt income
 - Net capital gain
 - “Year-end Dividend Rule”



TAX TREATMENT OF SHAREHOLDERS

- Income Dividends
 - Qualified dividend income (individuals) – 15% and 20% maximum tax rates
 - Dividends-received deduction (corporations)
- Capital Gain Dividends
 - 15% and 20% maximum tax rates for individuals
- Undistributed Net Capital Gain
- Exempt-Interest Dividends
 - 50% diversification requirement



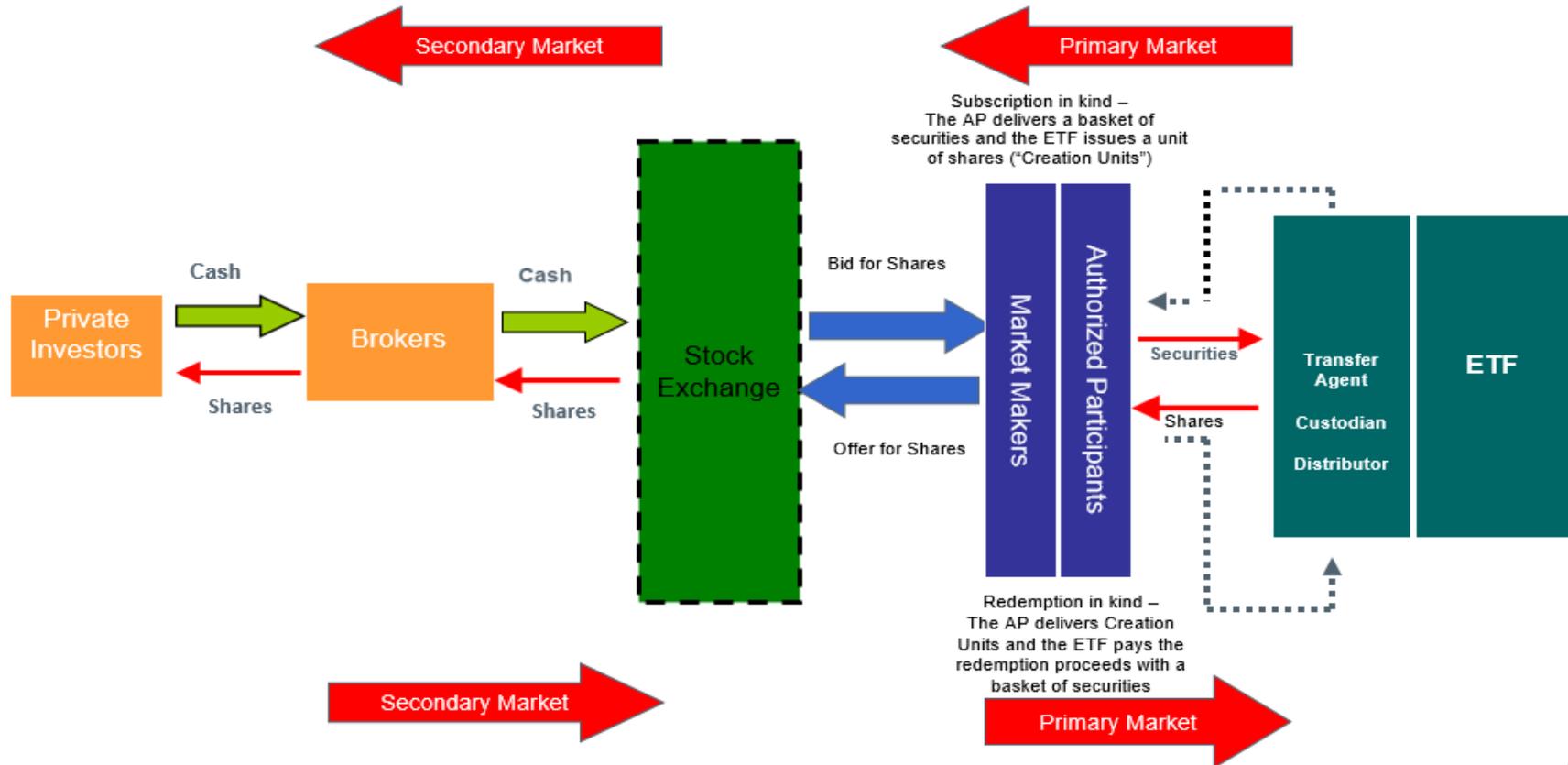
TAX TREATMENT OF SHAREHOLDERS

(CONTINUED)

- Dividends paid to foreign shareholders
- Pass-through of Foreign Taxes Paid
- Disposition of Shares
 - 15% and 20% maximum tax rates for individuals
 - “Wash” sales
 - Basis election/reporting
- 3.8% tax on “net investment income”



TAX TREATMENT OF ETF SHAREHOLDERS



TAX TREATMENT OF ETF SHAREHOLDERS

The ETF Arbitrage Mechanism

- ETFs sell and redeem their shares at NAV directly to unaffiliated broker-dealers with whom the ETF has entered into an agreement (the APs)
- These “primary market” transactions occur in large blocks of shares called “Creation Units”
- APs purchase and sell individual ETF shares on the stock exchange and purchase and redeem Creation Units in-kind for ETF portfolio securities



INCOME TAX TREATMENT OF A RIC

- Investment Company Taxable Income – taxable income with adjustments
 - Net capital gain excluded
 - No net operating loss or certain other deductions
 - Dividends-paid deduction
 - Dividends paid during the taxable year
 - Year-end Dividend Rule
 - “Spillover dividends”



EXCISE TAX ON UNDISTRIBUTED INCOME AND GAINS

- 4% Tax
 - Measured by calendar year, not taxable year
 - 98% of ordinary income
 - 98.2% of capital gain net income
 - 100% of “prior year shortfall”
 - Include dividends deemed paid under Year-end Dividend Rule but not spillover dividends



TAX CUTS & JOBS ACT (DECEMBER 2017)

- No provisions specifically addressed to RICs
- Three provisions of interest to RICs and their shareholders
 - 20% deduction for “qualified publicly traded partnership income” and “qualified REIT dividends” – unlike pass-through of QDI, the DRD, capital gain and exempt-interest dividends, and foreign taxes, only 20% deduction for “qualified REIT dividends” is available to a RIC to pass through to its shareholders; no express pass-through of 20% deduction for QPTPI
 - Limitation on business interest deduction
 - Repatriation of deferred foreign income



Questions?



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