



CITY OF PHILADELPHIA

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March 20, 2024

[REDACTED]

Re: [REDACTED] - Management Fees and/or Incentive Fees earned by Advisers from Business Development Companies – Business Income and Receipts Tax & Net Profits Tax – Private Letter Ruling Request

Dear [REDACTED]

This ruling is issued by the Tax Unit of the City of Philadelphia Law Department and the Technical Staff Unit of the Philadelphia Department of Revenue in response to your February 20, 2024 request for a ruling (“Ruling Request”). You have requested an opinion as to the application of the Business Income and Receipts Tax (“BIRT”) and Net Profits Tax (“NPT”) laws and regulations as it relates to the management and incentive fees earned by advisors from business development companies (“BDCs”). This opinion is based on the facts provided to the City of Philadelphia (the “City”) in your letter Ruling Request.

Facts

Founded and headquartered in [REDACTED], [REDACTED] (“[REDACTED]”) is a global alternative asset manager dedicated to delivering innovative investment solutions for its clients. A small group of [REDACTED] founded the firm in [REDACTED] with the mission of democratizing investing by providing individual investors access to alternative asset classes and strategies (e.g., venture capital, private equity, private real estate and private credit) historically available only to large institutions and ultra-high-net-worth individuals.

Novel at that time, the [REDACTED] approach is now widely accepted in the marketplace, and the firm has grown from being an innovative start up to an organization with more than [REDACTED] employees in offices across the globe in [REDACTED], and [REDACTED] now manages more than \$ [REDACTED] for both individual clients and large institutions such as state pension funds, Taft-Hartley funds, hospitals, and universities. To offer its diversified investment platform to its wide range of clients and comply with securities and other federal laws and regulations, [REDACTED] uses a wide variety of

fund structures including BDCs, interval funds, closed-end funds, real estate investment trusts, and traditional “draw-down” private funds.

Within this broad platform, and through limited liability companies (classified as partnerships for federal income tax purposes) that are investment company advisers under the Investment Company Advisers Act of 1940 (the “Advisers”), [REDACTED] administers and is responsible for the investment performance of four BDCs (or entities that will be BDCs):

- [REDACTED]
- [REDACTED]
- [REDACTED]
- [REDACTED]

[REDACTED] has not yet made an election to be a BDC but plans to do so before [REDACTED]. As such, each BDC is (or will be) registered as a BDC under the Investment Company Act of 1940 and is advised by an Adviser. [REDACTED] Advisor, LLC (“[REDACTED]”) is the adviser for [REDACTED] and [REDACTED]. [REDACTED] Advisor, LLC (“[REDACTED]”) is the adviser for [REDACTED].

Each Adviser has an Investment Advisory and Administrative Services Agreement in place with the BDC it advises. Each Adviser is compensated by the BDC through the payment of a base management fee and an incentive fee. The incentive fee is comprised of an income incentive fee and a capital gains incentive fee.

Each Adviser earns the base management fee and has the ability to earn the incentive fee in exchange for managing the investment portfolio and the financial performance of a BDC. As explained in further detail below, both the management fee and the incentive fee are measured by the financial performance of the BDC.

[REDACTED] has waived both the base management fee and the incentive fee through [REDACTED] for [REDACTED] and [REDACTED]. Therefore, the discussion below focuses on the base management fees and incentive fees earned from [REDACTED] and [REDACTED], but the general concepts for these fees from [REDACTED] and [REDACTED] will equally apply to [REDACTED] and [REDACTED] during any time that such fees are not waived.

An Adviser contractually agrees to manage the investment and reinvestment of the assets of a BDC, subject to the supervision of the board of trustees / directors of the BDC, in accordance with:

- (i) the investment objectives, policies and restrictions that are set forth in the BDC’s filings with the Securities and Exchange Commission;
- (ii) other applicable federal and state laws, rules and regulations, and the BDC’s organizational documents (e.g., declaration of trust or articles of incorporation); and
- (iii) investment policies, directives, and regulatory restrictions as the BDC may from time to time establish.

The responsibilities of the Advisers include:

- (i) determining the composition and allocation of the BDC's investment portfolio, the nature and timing of any changes therein and the manner of implementing such changes;
- (ii) identifying, evaluating and negotiating the structure of the investments made by the BDC;
- (iii) executing, monitoring and servicing the BDC's investments;
- (iv) placing orders with respect to, and arranging for, any investment by the BDC;
- (v) determining the securities and other assets that the BDC shall purchase, retain, or sell;
- (vi) performing due diligence on prospective portfolio companies; and
- (vii) providing the BDC with such other investment advisory, research, and related services as the BDC may, from time to time, reasonably request or require for the investment of its funds.

The management fee is earned based on a percentage of the average weekly value of gross assets of each BDC. The values of those assets are determined quarterly and so are "measured by or otherwise based on the financial performance" of the BDCs' portfolio of investments. Note 2 to the Form 10-K audited financial statements of each BDC describes the valuation process used to determine the amount of the management fee:

Securities that are publicly-traded with readily available market prices will be valued at the reported closing price on the valuation date. Securities that are not publicly-traded with readily available market prices will be valued at fair value as determined in good faith by [as appropriate, ██████████ or ██████████]. In connection with that determination, [each ██████████ or ██████████] will prepare portfolio company valuations which are based on relevant inputs, including, but not limited to, indicative dealer quotes, values of like securities, recent portfolio company financial statements and forecasts, and valuations prepared by independent third-party pricing and valuation services.

With respect to investments for which market quotations are not readily available, a multi-step valuation process is undertaken each quarter, as described below:

- [the] quarterly fair valuation process begins with [the Adviser] facilitating the delivery of updated quarterly financial and other information relating to each investment to an independent third-party pricing or valuation service;
 - the independent third-party pricing or valuation service then reviews and analyzes the ██████████ information, along with relevant market and economic data, and determines proposed valuations for each portfolio company or investment according to the valuation methodologies in [the Adviser's] valuation policy and communicates the information to [the Adviser] in the form of a valuation range for Level 3 assets (defined as unobservable inputs for which little or no market data exists, therefore requiring an entity to develop its own assumptions);
- [the Adviser] then reviews the preliminary valuation information for each portfolio company or investment and provides feedback about the accuracy, completeness and timeliness of the valuation-related inputs considered by the independent third-party pricing or valuation service and any suggested revisions thereto prior to the independent third-party pricing or valuation service finalizing its valuation range;
- [the Adviser] then provides the valuation committee with its valuation determinations and valuation-related information for each portfolio company or investment, along with any applicable supporting materials; and other information that is relevant to the fair valuation process...;

- the valuation committee meets with the Adviser to receive the relevant quarterly reporting from [the Adviser] and to discuss any questions from the valuation committee in connection with the valuation committee's role in overseeing the fair valuation process; and
- following the completion of its fair value oversight activities, the valuation committee (with the assistance of [the Adviser]) provides the [BDC's] board of [trustees or directors] with a report regarding the quarterly valuation process.

Fees Earned from [REDACTED]:

[REDACTED] earns a base management fee of [REDACTED]% annually on the average weekly value of gross assets, excluding cash holdings, of [REDACTED]. To the extent that [REDACTED] utilizes leverage that brings its leverage ratio under [REDACTED]% of asset coverage, [REDACTED] earns [REDACTED]% annually on the marginal amount of assets resulting from the use of the additional leverage.

[REDACTED] earns an income incentive fee on the net investment income of [REDACTED] equal to [REDACTED]% of net investment income (prior to the calculation of the fee). Such fee is subject to quarterly hurdle rate of [REDACTED]% of the on the value of [REDACTED]'s net assets ([REDACTED]%), such that [REDACTED] must earn [REDACTED]% on its net assets quarterly, prior to [REDACTED] earning any income incentive fee. Once the hurdle rate is met, [REDACTED] is entitled to a "catch-up" fee equal to the amount of [REDACTED]'s pre-incentive fee net investment income in excess of the hurdle rate, until [REDACTED]'s pre-incentive fee net investment income for such quarter equals [REDACTED]%, or [REDACTED]% annually, of net assets.

Fees Earned from [REDACTED]:

[REDACTED] earns a base management fee of [REDACTED]% annually on the average weekly value of gross assets of [REDACTED]. [REDACTED] may receive structuring or other upfront fees from portfolio companies in which [REDACTED] has caused [REDACTED] to invest. [REDACTED] has agreed to offset the amount of any structuring, upfront or certain other fees received by [REDACTED] against the management fees payable by [REDACTED] under the [REDACTED] investment advisory agreement.

[REDACTED] earns an income incentive fee on the net investment income of [REDACTED] equal to [REDACTED]% of net investment income (prior to the calculation of the fee). Such fee is subject to quarterly hurdle rate of [REDACTED]% ([REDACTED]%) of the adjusted capital of [REDACTED], such that [REDACTED] must earn [REDACTED]% on its capital quarterly, prior to [REDACTED] earning any income incentive fee. Once the hurdle rate is met, [REDACTED] is entitled to a "catch-up" fee equal to the amount of the [REDACTED]'s pre-incentive fee net investment income in excess of the hurdle rate, until [REDACTED]'s pre-incentive fee net investment income for such quarter equals [REDACTED]%, or [REDACTED]% annually, of adjusted capital. [REDACTED] has not in recent years earned the income incentive fee, and [REDACTED] does not expect to earn such fee in the foreseeable future.

Question Presented

Does the BIRT and/or the NPT apply to the management fees and/or incentive fees earned by the Advisers from the BDCs?

Conclusion

The activities conducted by the Advisers generate management and incentive fees that are “measured by or otherwise based on the financial performance” of the BDCs. The activities detailed within this ruling do not meet the definition of “Business” as outlined in the Philadelphia Code and regulations. As such, neither the BIRT nor the NPT will apply to the management fees and incentive fees earned from BDCs by Advisers.

Discussion

Philadelphia Code § 19-2603(1) imposes the BIRT upon every person engaged in any business in the City. The BIRT is imposed on the gross receipts and the net income of every person engaged in a taxable business in the City.

Philadelphia Code § 19-1502(2) imposes the NPT on the net profits earned in businesses, professions, or other activities conducted by residents of the City or conducted by nonresidents within the City.

Philadelphia Code § 19-2601 provides that the definition of “Business” for BIRT purposes does not include the following (emphasis added):

(7) For tax year 2012 and thereafter, the activities of (i) an investment company (no matter how organized) as defined in subsection 3(a) of the Investment Company Act of 1940, without regard to the exceptions set forth at subsections 3(c)(1), 3(c)(3) with respect to common trusts or similar funds, 3(c)(5)(C), 3(c)(7), 3(c)(9), 3(c)(10), 3(c)(11), or 3(c)(14) of said Act; and (ii) an entity or natural person directly or indirectly owning a general partnership interest or a managing member interest in a limited liability company in an entity described in subparagraph (i) that is not publicly traded, to the extent that the activities consist of the exercise of management responsibilities of a general partner or of a managing member in a limited liability company and result in income, gross, net or otherwise, that is measured by or otherwise based on the financial performance of the entity. Except as otherwise provided by law, the activities of any such entity or natural person other than the activities described above shall not be excluded from the definition of “business”. The Revenue Department may, by regulation, apply the provisions of subparagraphs (i) or (ii) to the activities of an entity or natural person that are substantially the same as those described in subparagraph (i) or (ii) whether or not the investee entity is publicly traded.

Similarly, the NPT law provides that the NPT “shall not apply to any net profits from any activity described in [Philadelphia Code § 19-2601] ‘Business’, subsection (7) (relating to certain investment companies and investment company managers).” Phila. Code §§ 19-1502(2)(e), 19-2803(5).

Therefore, the BIRT and NPT ordinances exclude from tax gross receipts and net income derived by certain general partners or managing members from certain investment companies. The BIRT ordinance further provides the City of Philadelphia Revenue Department (the “Department”) with regulatory authority to

apply the exclusion to the activities of any person whose activities are substantially the same as such general partner or managing member of those certain investment companies.

Consistent with this authority, the Department promulgated BIRT and NPT regulations implementing the exclusion. BIRT Regulation § 101(D)(9) provides that the following is excluded from the definition of “Business” (emphasis added):

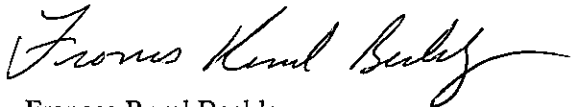
the activities of (i) an investment company (no matter how organized) as defined in subsection 3(a) of the Investment Company Act of 1940, without regard to the exceptions set forth at subsections 3(c)(1), 3(c)(3) with respect to common trusts or similar funds, 3(c)(5)(C), 3(c)(7), 3(c)(9), 3(c)(10), 3(c)(11) or 3(c)(14) of said Act; (ii) an entity or natural person directly or indirectly owning a general partnership interest or managing member interest in a limited liability company in an entity described in subsection (i) that is not publicly traded, to the extent that the activities consist of the exercise of management responsibilities of a general partner or of a managing member in a limited liability company and result in income, gross, net or otherwise, that is measured by or otherwise based on the financial performance of the entity; and (iii) an entity that managers [sic] the investments of an investment company described in subsection (i), which investment company has made an election under section 53(a) of the Investment Company Act of 1940 to qualify as a business development company, to the extent that the activities of the managing entity result in the receipt by such entity from the investment company of income, gross, net or otherwise, that is measured by or otherwise based on the financial performance of the investment company, including such income conditioned upon such financial performance. Such performance-based income shall not be included in the gross receipts or net income taxable under these regulations of a person or entity with an ownership interest in an entity described in subsection (iii). Except as otherwise provided by law, the activities of any such entity or natural person other than the activities described above shall not be excluded from the definition of “business.”

Similarly, Income Tax Regulation § 101(b) provides that the NPT “shall not apply to any net profits from any activity described in [BIRT Regulation § 101(D)(9)] (relating to certain investment companies and investment company managers).”

Within the regulatory authority granted by the BIRT ordinance (and incorporated by reference in the NPT ordinance), the regulations specifically exempt a managing entity from taxation to the extent its activities result in the receipt from a BDC of income (gross, net or otherwise) that is “measured by or otherwise based on financial performance” of the BDC. As described above, the amount of the management fee and the incentive fee earned by each Adviser from BDCs is directly “measured by or otherwise based on the financial performance” of the assets held by each BDC. Consequently, because the Advisers have nexus with the City and otherwise are subject to BIRT and NPT, the BIRT and NPT law and regulations exclude the management fees and incentive fees earned by Advisers from the BDCs from BIRT and NPT.

This ruling was based on the facts provided to the City and is dependent on the accuracy of those facts. This ruling can only be relied upon by the entities named in it and is not to be treated as a precedent in any other context. It is not intended to have, nor does it have any precedential value. The City expresses no opinion as to any matters not expressly set forth herein. The ruling will remain in effect as long as the facts presented in this ruling remain unchanged, until a change in the law dictates a different treatment or until the Revenue Department or the Law Department informs the taxpayer in writing that the ruling is no longer applicable. The City retains the right to audit the entities named in this ruling.

Kind regards,

A handwritten signature in black ink, reading "Frances Ruml Beckley". The signature is written in a cursive style with a long, sweeping tail that extends to the right.

Frances Ruml Beckley
Chief Counsel to the Revenue Department

cc: Laurice Smith, Revenue Policy Director
John F. Martin, Deputy City Solicitor