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Current Issues in Making Alternative Investments

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Agenda

- Introduction to alternative investments
- Basic non-tax issues
- Basic tax issues
- Specific tax topics
- Alternative investments at the University of California System

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Introduction to Alternative Investments

What are Alternative Investments

- Depends who you ask

- One definition:

An investment that is not one of the three traditional asset types (stocks, bonds and cash). Most alternative investment assets are held by institutional investors or accredited, high-net-worth individuals because of their complex nature, limited regulations and relative lack of liquidity.

Source: www.investopedia.com.

- Typical types of alternative investments:

- Hedge funds
- Private equity
- Real estate
- Commodities

Why Alternative Investments?

- Higher returns
- Diversification

College and University Asset Allocations

U.S. College and University Endowments and Affiliated Foundations, Fiscal Year 2012

Size of Endowment	Domestic Equities %	Fixed Income %	International Equities %	Alternative Strategies* %	Short-term Securities/ Cash/ Other %
Over \$1 Billion	12	9	15	61	3
\$501 Million to \$1 Billion	18	12	17	48	5
\$101 Million to \$500 Million	25	16	18	36	5
\$51 Million to \$100 Million	31	22	18	24	5
\$25 Million to \$50 Million	35	24	16	19	6
Under \$25 Million	39	29	14	11	7

Source: NACUBO-Commonfund Study of Endowments

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Tax Treatment of Alternative Investments

Unrelated Business Income Tax

- Unrelated business income tax (UBIT) imposed on unrelated business taxable income (UBTI). §511 *et seq.*
- UBTI
 - Colleges and universities: net income from a trade or business, regularly carried on, not substantially related to organization's exempt purposes, subject to exceptions and modifications.
 - Private pension trusts: net income from any trade or business regularly carried on by trust or partnership of which it is member, subject to modifications.
 - Modifications exclude from UBTI dividends, interest, rents, royalties (including overriding royalties), gains from the sale of property (other than inventory or dealer property), certain other types of "passive income".
- Alternative investments typically made in partnership form.
 - College and university partners take into account distributive share of UBTI. § 512(c)

Unrelated Debt-Financed Income

- Passive income exclusions don't apply to extent property is debt-financed. §512(b)(4); §514.
- Unrelated debt-financed income = debt/basis % x net income from debt-financed property.
- Debt/basis % = average acquisition indebtedness ÷ average adjusted basis of property.
- Debt-financed property = property held to produce income with respect to which there is acquisition indebtedness.
- Acquisition indebtedness – "but for" test.