OVERCOMING THE UNRELATED BUSINESS INCOME TAX ON ALTS MAY BE EASIER THAN YOU THINK

Introduced in 1950 by the U.S. Congress, the Unrelated Business Income Tax (UBIT) was designed to address public concerns that the income-generating investments of some nonprofit organizations might have an unfair advantage over for-profit organizations.

By applying a tax to these streams of income, it was reasoned, the playing fields between the two sectors could be made more level.

And ever since, lawyers and accountants aligned with the "avoid taxes at all costs" side of the financial industry have warned against investing in vehicles with potential exposure to UBIT and its related acronyms UBTI (Unrelated Business Taxable Income) and UDFI (Unrelated Debt-Financed Income).

From Steptoe & Johnson's *Planning Techniques for Avoiding UBIT*[1] to Venable LLP's *How to Avoid UBIT Taxes*,[2] the message to institutional and individual investors has been: If a UBIT is involved, invest elsewhere. The result has been predictable: Countless tax-exempt and tax-deferral opportunities to invest in real estate, precious metals, private debt, MLPs and LLCs and other selections in the alternative universe have been overlooked or discarded based on a reflex to avoid to the word "tax."

GETTING THOUGHTFUL ABOUT UBIT: MISSED OPPORTUNITIES ALSO CARRY A COST

When the facts are examined, though, it becomes clear that outright rejection of UBIT may come with a fairly high price tag: a lack of participation in what McKinsey & Company has termed *The Trillion-Dollar Convergence: Capturing the Next Wave of Growth in Alternative Investments*,[3] characterized by statements like this:

> ***As alternatives become increasingly entrenched in portfolios, institutional investors—who control approximately 60% of the money flowing into alternatives—have not only upped their allocations to alternatives over the past few years, but the vast majority intend to either maintain or increase them over the next three years. Retail investors, meanwhile, are moving rapidly into the market, as new product vehicles provide unprecedented access to a broad range of alternatives managers and strategies.***

For investment sponsors and asset managers, the continued rise of alternatives represents one of the largest growth opportunities of the next five years. And, unlike traditional asset management choices, the alternatives market still has ample room to grow, according to McKinsey & Company, and for new category leaders to emerge.

WHAT'S UBIT?

UBIT stands for **Unrelated Business Income Tax.** This is a tax that applies to the profits of an active business owned by an individual retirement account. While most investors never run into UBIT, a few investments are subject to taxation. Also, if a tax-exempt entity, such as a nonprofit organization, invests in an unincorporated active business – the operation of a gas station, dry cleaner or grocery store, for example – then the net profit of the business would be subject to UBIT.

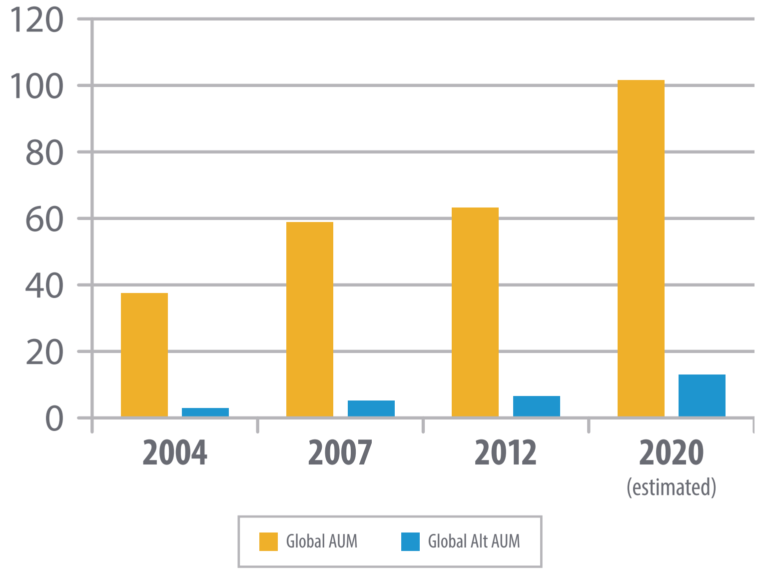
This bullish outlook on alternatives was recently echoed by PriceWaterhouseCoopers (PwC) in its own report, *Asset Management 2020.*[4] The report describes "an extraordinarily positive environment for asset managers through 2020. Worldwide assets under management (AUM) totaled $63.9 trillion in 2012. Our prediction is this will rise to around $101.7 trillion by 2020, a compound growth rate of nearly 6%."

Despite this 40% surge in overall assets, alternative assets, according to PwC will increase at an even faster rate, reaching almost 100% between 2012 and 2020; and, in effect, doubling alternative AUM over an eight-year period.

A NEW SOLUTION FOR UBIT COMPLIANCE

Against the market meltdown of 2008-2009, the role of alternative investments in a portfolio has evolved from performance-centric novelty to a valued tactical way to pursue specific, crucial outcomes which are uncorrelated to the market.

Global AUM Likely to Expand 40% by 2020, while Alternative Investments Double in Size



Source: PwC analysis. Past data based on Hedge Fund Research, ICI, Preqin, Towers Watson and The City UK. Note: Differences in sums are due to rounding. Mandates exclude alternatives. This information does not constitute professional advice. No representation or warranty (express or implied) is given as to the accuracy or completeness of this information.

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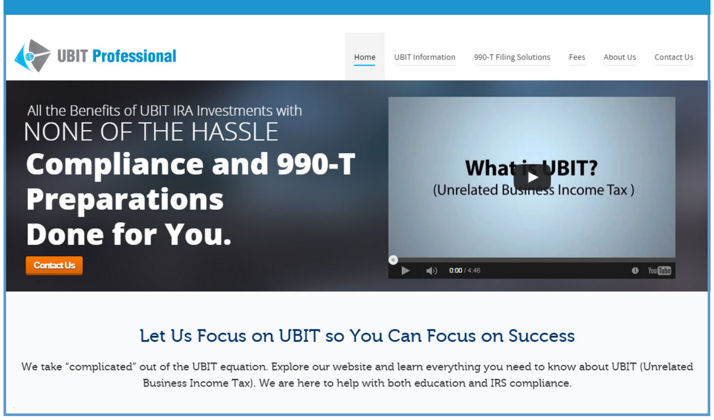

Fortunately, a powerful new solution provider called **UBIT Professional** is intent on meeting the needs of a broad number of institutions and individuals for IRS compliance with UBIT requirements:

- Real estate investors with debt financing
- CPAs, financial professionals and tax advisors
- Entity investors in MLPs, LLCs, LPs, etc.
- Investment sponsors and fund managers

An affiliate of Equity Trust Company, a leading custodian of alternative investment IRAs, **UBIT Professional** offers a full array of educational and tax preparation services to minimize UBIT's impact in a convenient, carefree way in order to allow greater access to alt investments.

The site and its accompanying white papers provide visitors with a streamlined roadmap for assistance in preparation and filing the all-important UBIT-related document, IRS 990-T, too.

If advisors, investors and tax-exempt organizations are looking for a short-cut through the thicket of IRS information related to 990-T – which the IRS states requires some 140 hours of preparation to master – they would do well to start with **www.UBITProfessional.com**.

ADVANTAGE: UBIT

Many are often surprised to learn that when UBIT is calculated it may be very minimal or even result in carrying forward a loss which can then off-set future gains. Even if an IRA is not going to incur any tax, it may be advantageous to file the form to carry a tax loss forward to offset future profits.

While no one likes to pay taxes, UBIT can almost be considered the price of admission to gain access to a universe of alternative investments which could amplify buying power or sharpen investment outcomes.

CONCLUSION

The alt universe cannot help it. These vehicles are going to bump against UBIT, UBTI and UDFI from time to time. These tax technicalities do not have to stand in the way of a good investment idea, however. While the going can get rough for "do-it-yourselfers" who may not have 140 hours or so to prepare their documents, the cost of paying a tax advisor for assistance in keeping current on UBIT isn't prohibitive. The resources at **www.UBITProfessional.com** offer person-to-person contact as well as referrals to tax preparers.

How Do I Know if a Self-Directed IRA Is Subject to UBIT?

There are two scenarios that trigger unrelated business income tax for retirement accounts:

1. **Profits generated from a business or trade**
2. **Leveraged Real Estate (or other real property) Investments**

UBIT PROFESSIONAL: FOCUSED ON UBIT SO INVESTORS CAN FOCUS ON SUCCESS

UBIT Professional offers a full array of educational and tax preparation services to help investors and their tax advisors take advantage of new opportunities to generate potentially higher investment returns. **UBIT Professional** can also point you to experienced non-recourse lenders that may be able to help finance property in your IRA. Please visit **www.UBITProfessional.com** for more information.

[1] *Steptoe & Johnson* https://www.google.com/webhp?sourceid=chrome-instant&rlz=1C1CHTV_enUS525US525&ion=1&espv=2&ie=UTF-8#q=avoiding+ubit&spell=1

[2] *Venable LLP* https://www.venable.com/files/Publication/db6984af-91c9-4010-873f-9ee111b0b70a/Presentation/PublicationAttachment/1166ca81-3c2a-4b48-981a-a7c006bff83a/UBIT_Pitfalls.pdf

[3] *McKinsey & Company* The Trillion-Dollar Convergence: Capturing the Next Wave of Growth in Alternative Investments

[4] *Asset Management 2020, A Brave New World* http://www.pwc.com/gx/en/asset-management/publications/asset-management-2020-a-brave-new-world.jhtml

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