Alternative Investments

September 8, 2026

Cherry Bekaert
Your Guide Forward

Presenters

Today's Speakers

Two seasoned Cherry Bekaert tax professionals guide this session — drawing on deep experience with securities, funds, and high-net-worth clients.

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Your Guide Forward

Agenda

Introduction

Alternative Investments and Tax Complications

- Passive/Non-Passive
- Trader/Investor
- PTP/MLP's
- 1031 Exchange
- Estates

Recent Developments

- AQR
- Opportunity Zone
- QSBS

Q&A

Introduction

Introduction

About Cherry Bekaert, Legacy Firm – Spicer Jeffries

- History of Spicer Jeffries
- Securities Industry
- Investment Funds
  - Hedge Funds, private equity funds, and fund-of-fund structures
- Registered Investment Advisors
- Broker Dealers
- High Net Work Individuals with Complex Investments

Alternative Investment and Tax Complications

Alternative Investments — Overview

Alternative investments offer diversification, yield, and planning opportunities — but they routinely generate tax reporting complexity that investment summaries do not reveal.

- **Common types:** hedge funds, private equity, real estate funds, PTPs/MLPs, Delaware Statutory Trusts (DSTs)
- **Schedule K-1s:** Investors receive Schedule K-1s containing footnotes, special allocations, and multi-state filing obligations
- **Taxable income:** frequently differs from cash distributions
- **Key tax dimensions:** passive activity limitations, basis tracking, and character of income (ordinary vs. capital)

Passive / Non-Passive

Passive / Non-Passive
IRC Sec. 469

- **Passive activities:** Losses generally cannot offset wages, portfolio income, or active business income.
- **Loss suspension:** Passive losses are carried forward until passive income is generated or the taxpayer fully disposes of the activity.
- **Material participation:** Determines whether trade or business activity is passive or non-passive at the taxpayer level.
- **Rental activities:** Generally treated as passive, even with participation, unless a specific exception applies.
- **Planning point:** Classification affects current deductibility, suspended loss tracking, and timing of tax benefit recognition.

Trader vs. Investor

Trader vs. Investor
IRC Sec. 475 Election Available

- **Trader status:** Activity must be substantial, continuous, and focused on short-term market movements rather than dividends, interest, or long-term appreciation.
- **Tax benefit:** Trader business expenses are generally reported above-the-line; Sec. 475(f) may allow ordinary gain/loss treatment through mark-to-market accounting.
- **Investor status:** Investors hold securities for investment and generally report gains/losses as capital items, subject to capital loss limitations and wash sale rules.
- **Expense limitation:** Investment advisory fees, investment management fees, tax preparation fees, and other miscellaneous itemized deductions remain nondeductible for individuals under current law.
- **Planning point:** Classification affects deductibility, character of income/loss, wash sale exposure, and whether a timely Sec. 475(f) election is available.

PTPs and MLPs — Yield Comes With Complications

⦸ Passive Losses

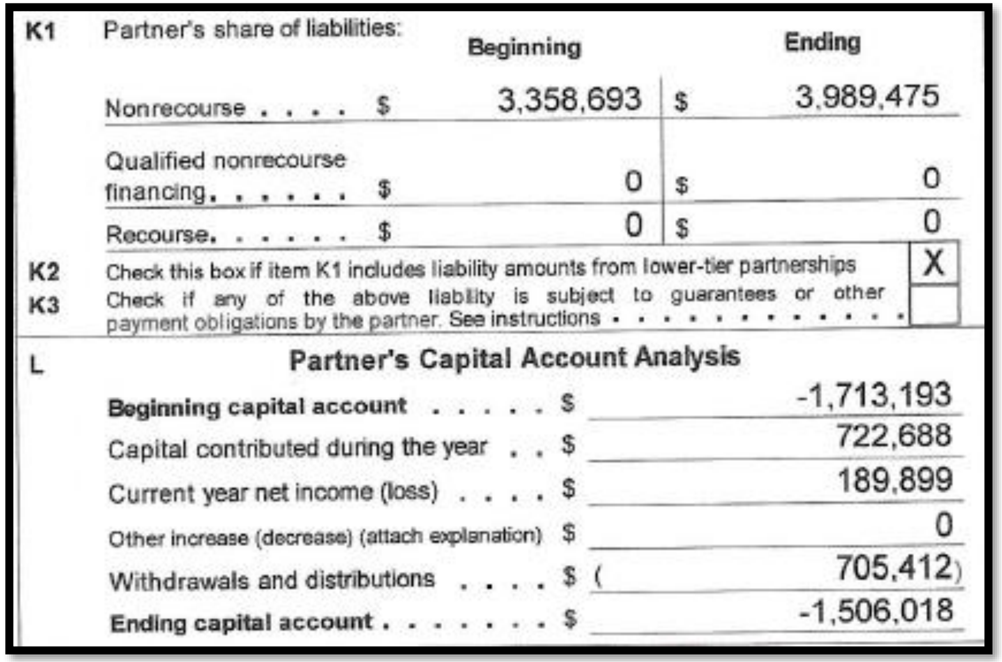
PTPs and MLPs generate passive income and losses. Losses are suspended until the investor has sufficient PTP passive income or fully disposes of the interest — they cannot offset active or portfolio income.

Basis Erosion

Basis can erode to zero or below through cash distributions and depletion deductions. Suspended losses must be tracked separately per PTP — they cannot be commingled across partnerships.

Recapture at Sale

On sale, ordinary income recapture under Sec. 1245 and 1250 is layered on top of capital gain. All previously suspended losses are released at disposition and offset gain in that year.



	Partner's share of liabilities:	Beginning	Ending
K1	Nonrecourse	$ 3,358,693	$ 3,989,475
	Qualified nonrecourse financing.	$ 0	$ 0
	Recourse.	$ 0	$ 0
K2	Check this box if item K1 includes liability amounts from lower-tier partnerships		X
K3	Check if any of the above liability is subject to guarantees or other payment obligations by the partner. See instructions		

L	Partner's Capital Account Analysis	
	Beginning capital account	$ -1,713,193
	Capital contributed during the year . .	$ 722,688
	Current year net income (loss)	$ 189,899
	Other increase (decrease) (attach explanation)	$ 0
	Withdrawals and distributions	$ (705,412)
	Ending capital account	$ -1,506,018

Estate Planning Tip

Under Sec. 1014, the step-up in basis at death eliminates all suspended passive losses — they vanish rather than carry over to the heir. Decedents holding MLPs with large accumulated suspended losses receive no tax benefit from those losses at death.

1031 Exchanges into a Delaware Statutory Trust (DST)

The DST structure offers a compliant 1031 exchange vehicle for fractional real estate ownership — but illiquidity, investor restrictions, and K-1 complexity are real trade-offs.

A DST can be used as a compliant 1031 exchange replacement property for fractional real estate ownership.
While it can defer taxes, key trade-offs include illiquidity, investor restrictions, and K-1 reporting complexity.

Complete the 1031 Exchange

- Reinvest proceeds into a like-kind property to defer:
  - Capital gain tax
  - Depreciation recapture
- Must meet:
  - 45-day identification period
  - 180-day exchange completion period

DST Qualification Requirements

- DST interests qualify as replacement property under IRS Rev. Rul. 2004-86.
- Investors hold a fractional beneficial interest.
- Asset is managed by a professional sponsor.
- Subject to the DST's "Seven Deadly Sins" operational restrictions. These limitations are designed to ensure that a DST remains a passive real estate ownership vehicle and qualifies as like-kind property for §1031 exchange purposes.

1031 Exchanges into a Delaware Statutory Trust (DST)

K-1 Reporting

- Investors receive pass-through allocations of:
  - Passive income
  - Depreciation
  - Debt

- Investors must track adjusted basis annually.

Exit and Liquidity Considerations

- DST interests are not freely tradable.

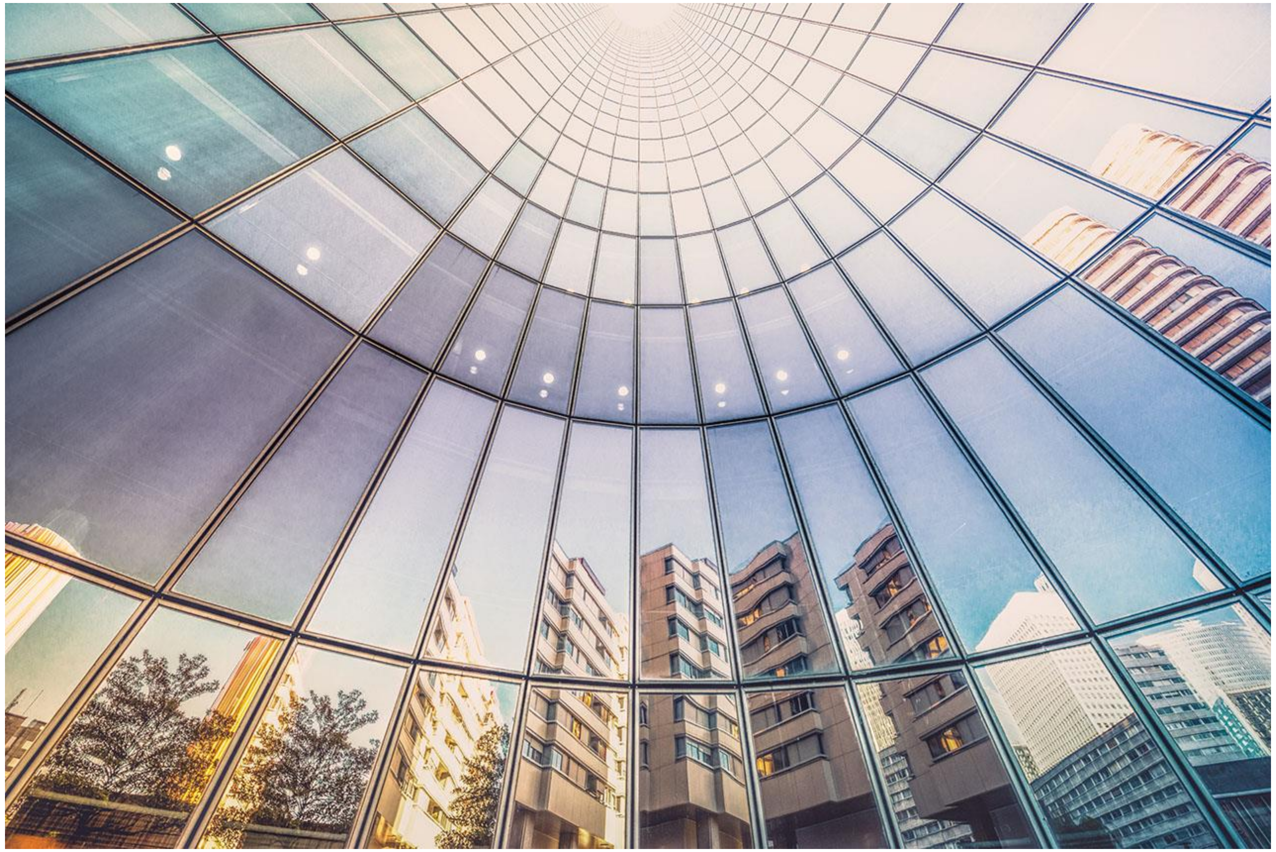
- Liquidity is generally dependent on:
  - Property sale
  - Sponsor refinancing event

- Investors face illiquidity risk.

Investor Cautions

- Investors have no management rights.

- Income character and passive activity rules apply at the investor level.



K-1 and Hedge Fund Estate Issues

K-1s from hedge funds and private funds carry embedded complexities — and when a fund partner dies, the absence of a Sec. 754 election can create a loss that exists only on paper.

K-1 Anatomy — What to Review

- **Income/Loss Lines**
  Ordinary income/loss, Sec. 1231 gains, unrecaptured Sec. 1250, and qualified dividends
- **Special Disclosures**
  Foreign taxes paid/accrued; footnotes flagging PFIC or Sec. 988 (foreign currency) exposure
- **State Sourcing Allocations**
  Multi-state filing obligations may be triggered — each state allocation must be evaluated separately
- **Multiple Activities**
  Activity schedules are provided to account for passive loss for each activity.

⚠ **Footnotes often contain the most material information — PFIC and Sec. 988 items buried in supplemental schedules can alter the entire tax picture.**

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651123

Schedule K-1 (Form 1065)
Department of the Treasury
Internal Revenue Service

2024
For calendar year 2024, or tax year beginning ____ ending ____

☐ Final K-1 ☐ Amended K-1 OMB No. 1545-0123

Partner's Share of Income, Deductions, Credits, etc.
See separate instructions.

Part I Information About the Partnership

A Partnership's employer identification number
[redacted]

B Partnership's name, address, city, state, and ZIP code
[redacted]

C IRS center where partnership filed return:
E-FILE

D ☐ Check if this is a publicly traded partnership (PTP)

Part II Information About the Partner

E Partner's SSN or TIN (Do not use TIN of a disregarded entity. See instructions.)
[redacted]

F Name, address, city, state, and ZIP code for partner entered in E. See instructions.
[redacted]

G ☒ General partner or LLC member-manager ☐ Limited partner or other LLC member

H1 ☒ Domestic partner ☐ Foreign partner

H2 ☒ If the partner is a disregarded entity (DE), enter the partner's:
[redacted] Name [redacted]

I1 What type of entity is this partner? INDIVIDUAL

I2 If this partner is a retirement plan (IRA/SEP/Keogh/etc.), check here ☐

J Partner's share of profit, loss, and capital:

	Beginning	Ending
Profit	9.8835441 %	9.8196639 %
Loss	9.8835441 %	9.8196639 %
Capital	0.6655744 %	0.6005717 %

Check if decrease is due to:
☐ Sale or ☐ Exchange of partnership interest. See instructions.

K1 Partner's share of liabilities:

	Beginning	Ending
Nonrecourse	$	$
Qualified nonrecourse financing	$	$
Recourse	$ 340,228.	$ 772,883.

K2 Check this box if item K-1 includes liability amounts from lower-tier partnerships ☐

K3 Check if any of the above liability is subject to guarantees or other payment obligations by the partner. See instructions ☐

L **Partner's Capital Account Analysis**

Beginning capital account	$ 117,865.
Capital contributed during the year	$
Current year net income (loss)	$ 121,305.
Other increase (decrease) (attach explanation)	$
Withdrawals and distributions	$(118,949.)
Ending capital account	$ 120,221.

M Did the partner contribute property with a built-in gain (loss)?
☐ Yes ☒ No If "Yes," attach statement. See instructions.

N **Partner's Share of Net Unrecognized Section 704(c) Gain or (Loss)**

Beginning	$ 51.
Ending	$ 42,182.

Part III Partner's Share of Current Year Income, Deductions, Credits, and Other Items

1	Ordinary business income (loss)		49,374.
2	Net rental real estate income (loss)		-12,848.
3	Other net rental income (loss)		319.
4a	Guaranteed payments for services		201,154.
4b	Guaranteed payments for capital		
4c	Total guaranteed payments		201,154.
5	Interest income		125,497.
6a	Ordinary dividends		15,323.
6b	Qualified dividends		365.
6c	Dividend equivalents		
7	Royalties		7,403.
8	Net short-term capital gain (loss)		725.
9a	Net long-term capital gain (loss)		215.
9b	Collectibles (28%) gain (loss)		
9c	Unrecaptured section 1250 gain		-21.
10	Net section 1231 gain (loss)		128.
11	Other income (loss)	A	* 564
		C	1,369
			* STMT
12	Section 179 deduction		
13	Other deductions	A	25
		H	21,571
			* STMT
14	Self-employment earnings (loss)	A	250,528.
15	Credits	J	1.
			* STMT
16	Schedule K-3 is attached if checked ☒		
17	Alternative min tax (AMT) items	A	-86.
		B*	-11.
		*	STMT
18	Tax-exempt income and nondeductible expenses	B*	1.
		C*	248.
19	Distributions	A	118,949.
20	Other information	A	148,787.
		B	16.
		N	* 20,122.
		T	* 5,085.
		Z	* STMT
		AE	* 58,615.
		AF	* 53,052.
		AJ	* STMT
		AM	* STMT
		ZZ	* STMT
21	Foreign taxes paid or accrued		41.

22 ☐ More than one activity for at-risk purposes*
23 ☐ More than one activity for passive activity purposes*
*See attached statement for additional information.

For IRS Use Only

LHA For Paperwork Reduction Act Notice, see the Instructions for Form 1065. 411261 12-08-24 www.irs.gov/Form1065 **Schedule K-1 (Form 1065) 2024**
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K-1 Basic Footnote Examples

GENERAL FOOTNOTES

UNDER TEMPORARY TREASURY REGULATIONS SECTION 1.469-1T(E)(6), NONE OF THE DISTRIBUTIVE SHARE ITEMS REPORTED TO YOU ON SCHEDULE K-1 ARE CONSIDERED TO BE DERIVED FROM A PASSIVE ACTIVITY, EXCEPT AS NOTED BELOW.

ALL OF LINE 1, LINE 2, LINE 3, LINE 10, LINE 12 AND DEPLETION IS DERIVED FROM A PASSIVE ACTIVITY. REFER TO THE SCHEDULE OF ACTIVITIES ATTACHED TO YOUR K-1 FOR THE BREAKDOWN BY ACTIVITY.

INTERNAL REVENUE SERVICE GUIDANCE REQUIRES SCHEDULE K-3 TO BE PROVIDED WITH YOUR SCHEDULE K-1. SCHEDULE K-3 REPLACES, SUPPLEMENTS, AND CLARIFIES THE FORMER LINE 16, FOREIGN TRANSACTIONS, OF SCHEDULE K-1. SCHEDULE K-3 IS AN EXTENTION OF SCHEDULE K-1 AND IS GENERALLY USED TO REPORT TO PARTNERS THEIR SHARE OF INTERNATIONAL ITEMS, INCLUDING FOREIGN TAXES AND RELATED INFORMATION. PLEASE CONTACT THE PARTNERSHIP IF YOU NEED ANY ADDITIONAL INFORMATION.

YOUR CAPITAL ACCOUNT PRESENTED IN ITEM L OF SCHEDULE K-1 IS PREPARED USING A TAX BASIS METHOD AS REQUIRED BY THE IRS. IF YOU DISPOSE OF YOUR PARTNERSHIP INTEREST, YOU MAY RECOGNIZE ADDITIONAL GAIN OR LOSS ON LIQUIDATION. CONSULT YOUR TAX ADVISOR.

PARTNER'S SHARE OF PROFIT, LOSS, AND CAPITAL PERCENTAGES

PARTNER PERCENTAGES REFLECTED IN ITEM J ON YOUR SCHEDULE K-1 ARE CALCULATED PURSUANT TO IRS INSTRUCTIONS; TAXABLE INCOME REPORTED ON YOUR SCHEDULE K-1 IS ALLOCATED CONSISTENT WITH SPECIFICATIONS DETAILED WITHIN THE LIMITED PARTNERSHIP AGREEMENT. YOUR OWNERSHIP PERCENTAGE MAY NOT BE EXACTLY THE SAME AS YOUR PROFIT AND LOSS PERCENTAGE. CHANGE IN OWNERSHIP PERCENTAGE DURING THE YEAR IS REFLECTED IN THE PROFIT, LOSS, AND CAPITAL PERCENTAGES REPORTED ON YOUR SCHEDULE K-1, ITEM J.

NET INVESTMENT INCOME - 20Y

UNLESS OTHERWISE INDICATED (FOR EXAMPLE, ITEMS TAKEN INTO ACCOUNT FOR SELF-EMPLOYMENT TAX PURPOSES), THE AMOUNTS REPORTED ON YOUR SCHEDULE K-1 ARE SUBJECT TO IRC SECTION 1411 AND SHOULD BE CONSIDERED IN COMPUTING YOUR NET INVESTMENT INCOME TAX. DEDUCTIONS REPORTED ON YOUR SCHEDULE K-1 MAY BE SUBJECT TO CERTAIN LIMITATIONS IN COMPUTING YOUR NET INVESTMENT INCOME TAX.

INTEREST EXPENSE FOR TRADER / INVESTOR

YOUR SCHEDULE K-1 HAS BEEN PREPARED ON THE BASIS THAT YOU DO NOT MATERIALLY PARTICIPATE IN THE PARTNERSHIP'S ACTIVITIES. YOU ARE ALLOCATED INVESTMENT INTEREST EXPENSE AND INVESTMENT INCOME AND EXPENSE ON LINE 13H, 20A AND 20B PER IRC SECTION 163(D).

SINCE YOU DO NOT MATERIALLY PARTICIPATE IN THE PARTNERSHIP, THE AMOUNT OF INTEREST EXPENSE FROM TRADING ACTIVITIES THAT HAS BEEN ALLOCATED TO YOU SHOULD BE SUBJECTED TO THE INVESTMENT INTEREST EXPENSE LIMITATION. IF DEDUCTIBLE, THE INTEREST EXPENSE SHOULD BE DEDUCTED ON SCHEDULE E, PART II, COLUMN (I).

THE AMOUNT OF INTEREST EXPENSE ON LINE 13H OF YOUR SCHEDULE K-1 INCLUDES BOTH INTEREST EXPENSE FROM TRADING AND INVESTING ACTIVITIES, SEE BELOW FOR A DETAIL OF EACH AMOUNT ALLOCATED TO YOU.

TRADER INTEREST EXPENSE - DEDUCT ON SCH. E	7,737.
INVESTOR INTEREST EXPENSE - DEDUCT ON SCH. A	13,834.

K-1 Basic Footnote Examples

INVESTOR IN SECURITIES

THE PARTNERSHIP HAS TAKEN THE POSITION THAT IT IS NOT ENGAGED IN THE TRADE OR BUSINESS OF TRADING SECURITIES. THE INCOME, GAIN, LOSS, AND EXPENSE REPORTED TO YOU ON SCHEDULE K-1 IS PORTFOLIO INCOME AND EXPENSE.

NON-NEW YORK RESIDENTS

ALL OF THE INCOME OF THE PARTNERSHIP IS DERIVED FROM PURCHASING AND SELLING SECURITIES SOLELY FOR THE TAXPAYER'S OWN ACCOUNT. THEREFORE, A NONRESIDENT PARTNER SHALL NOT BE DEEMED TO CARRY ON A TRADE OR BUSINESS, PROFESSION OR OCCUPATION IN NEW YORK AND SHALL NOT BE TAXABLE ON THE PARTNER'S DISTRIBUTIVE SHARE OF PARTNERSHIP INCOME BY NEW YORK.

TRADER IN SECURITIES

THE PARTNERSHIP HAS TAKEN THE POSITION THAT IT IS ENGAGED IN THE TRADE OR BUSINESS OF TRADING SECURITIES. THEREFORE, THE PARTNERSHIP'S EXPENSES HAVE BEEN DEDUCTED AS OTHER DEDUCTIONS ON LINE 13ZZ OF YOUR SCHEDULE K-1.

LINE 13ZZ REPRESENTS PROFESSIONAL FEES, MANAGEMENT FEES, AND OTHER DEDUCTIONS WHICH ARE RELATED TO THE PARTNERSHIP'S ACTIVITY AS A TRADER IN SECURITIES, THEY SHOULD BE ENTERED BY AN "INDIVIDUAL" TAXPAYER ON SCHEDULE E, PART II AS NONPASSIVE.

THE EXPENSES REPORTED ON LINE 13ZZ OF YOUR SCHEDULE K-1 SHOULD BE INCLUDED AS INVESTMENT EXPENSES FOR PURPOSES OF THE INVESTMENT INTEREST EXPENSE LIMITATION SINCE THESE EXPENSES ARE GENERATED IN CONJUNCTION WITH THE PARTNERSHIP'S TRADING ACTIVITIES.

*********PLEASE CONSULT YOUR TAX ADVISOR*********

K-1 Specific Footnote Examples

QUALIFIED SMALL BUSINESS STOCK (QSBS)

AN UNDERLYING PARTNERSHIP, SALEM INVESTMENT PARTNERS IV LP, SOLD STOCK ELIGIBLE FOR THE QUALIFIED SMALL BUSINESS STOCK EXCLUSION UNDER SEC. 1202. DETAILS ON THE SALE ARE BELOW TO DETERMINE IF YOU MEET THE HOLDING PERIOD:

STOCK SOLD: US TARP INTERMEDIATE HOLDINGS, INC.	
DATE ACQUIRED: APRIL 12, 2018	
DATE SOLD: AUGUST 9, 2024	
YOUR SHARE OF PROCEEDS ELIGIBLE FOR EXCLUSION:	2,860.
YOUR COST BASIS OF SHARES ELIGIBLE FOR EXCLUSION:	627.
GAIN:	2,233.

PERFORMANCE OR INCENTIVE ALLOCATION

UNDER IRC 1061, EFFECTIVE FOR TAX YEARS BEGINNING AFTER DECEMBER 31, 2017, A 3-YEAR HOLDING PERIOD REQUIREMENT IS IMPOSED IN ORDER FOR CERTAIN PARTNERSHIP INTERESTS RECEIVED IN CONNECTION WITH THE PERFORMANCE OF SERVICES TO BE TAXED AS A LONG-TERM CAPITAL GAIN.

THE FOLLOWING AMOUNT REPRESENTS THE PORTION OF YOUR INCOME ON LINE 9A THAT IS SUBJECT TO SHORT-TERM CAPITAL GAIN TAX RATES: 1,007,628.

*********PLEASE CONSULT YOUR TAX ADVISOR*********

FOR TAX EXEMPT ENTITIES ONLY:

YOUR SHARE OF UNRELATED BUSINESS TAXABLE INCOME IS AS FOLLOWS:

ORDINARY INCOME	15,251.
SHORT-TERM CAPITAL GAIN (LOSS)	66.
LONG-TERM CAPITAL GAIN (LOSS)	-89.
NET RENTAL REAL ESTATE:	-35.
INTEREST:	9,287.
ROYALTIES:	64.
SECTION 1231 GAIN:	381.
OTHER PORTFOLIO INCOME:	282.
DIVIDENDS:	7.
SCETION 179 DEDUCTION:	0.
CHARITABLE CONTRIBUTIONS:	9.
INTEREST EXPENSE:	4,006.
SECTION 59(E)(2) EXPENSE:	5,636.
PORTFOLIO DEDUCTIONS:	13,424.
OTHER DEDUCTIONS:	4,101.

SECTION 163(J) GROSS RECEIPTS

THE SEC. 163(J) INTEREST EXPENSE LIMITATION DOES NOT APPLY TO CERTAIN SMALL BUSINESSES (SUBJECT TO A GROSS RECEIPTS TEST UNDER SEC. 448(C)). GROSS RECEIPTS FOR PURPOSES OF THE SECTION 163(J) LIMITATION ARE AVAILABLE UPON REQUEST. PLEASE CONSULT YOUR TAX ADVISOR.

THE AMOUNTS FLOWING THROUGH ON LINES 20AE, 20AF, AND 13K ARE FROM UNDERLYING PARTNERSHIPS.

UBTI — Unrelated Business Taxable Income & Offshore Blocker Planning

Tax-exempt investors in private equity and hedge funds face UBTI exposure from debt-financed income and active business activities — offshore blocker corporations are the primary vehicle to neutralize this exposure.

A single UBTI-generating fund investment can result in a tax liability for the tax-exempt entity

Exposure & Affected Entities

What Triggers UBTI

Debt-financed income (IRC Sec. 514), trade or business income not substantially related to exempt purpose, and income from leveraged buyouts in private equity funds.

Who Is Affected

IRAs, pension plans, endowments, foundations, and other Sec. 501(c)(3) organizations investing in alternative investment funds.

Offshore Blocker Structure

Tax-exempt investors invest in a Cayman Islands (or similar) blocker corporation that holds the fund interest. The blocker does not incur any UBTI tax. It would incur tax on Effectively Connected Income (ECI).

Trade-offs: Blocker entities add administrative cost, foreign tax complications, and potential Subpart F or GILTI implications.

Planning Opportunities

Key Planning Strategies

- Use offshore blocker entities (Cayman, Bermuda, BVI) to convert UBTI into exempt dividend income
- Blocker election strategy: C-corp blocker vs. pass-through structures
- Evaluate UBTI at the fund level before commitment — request UBTI estimates from fund managers
- Review partnership allocations — debt-financed income allocations drive most UBTI exposure
- Consider fund structure (parallel fund offerings) that provide a built-in blocker for tax-exempt investors

Offshore Blocker Flow

TAX-EXEMPT		BLOCKER CORP		PE / HEDGE FUND
IRA / Pension / Endowment	Dividend ⇄ Invest	Cayman / Bermuda / BVI	Income ⇄ Invest	UBTI-generating activity

PTET, Real Estate, Startups, Foreign Impacts & PFICs

The pass-through entity tax election (PTET) provides a SALT cap workaround for many business owners — but its interaction with real estate, startup structures, and foreign investments requires careful analysis to avoid unintended consequences.

PTET elections must be made at the entity level — individual partners/shareholders cannot elect in; foreign tax credit implications vary by state.

PTET Basics & Real Estate

- Many states allow partnerships and S-corps to elect PTET, paying state income tax at the entity level and providing partners a credit or deduction
- Real estate partnerships must evaluate whether PTET deduction **reduces QBI** , impacts passive loss calculations, or conflicts with state-level composite filing obligations

PTET & Startup / VC Companies

- S-corps and partnerships used in startup structures can benefit from PTET, but **conversion to C-corp (for QSBS purposes) terminates the PTET election.**
- Founders and VC-backed companies must weigh PTET benefits against the S-corp / C-corp election trade-off carefully

Foreign Impacts

- Partners in foreign partnerships or funds that elect PTET in a U.S. state face cross-border complications — **foreign tax credits may not offset U.S. state taxes** , and treaty positions can be disrupted
- Non-resident alien partners are often excluded from PTET elections, creating **asymmetric results** within the same partnership

PFICs – Passive Foreign Investment Companies

PFIC status triggers a potentially punitive U.S. tax regime — excess distributions may be taxed at ordinary rates plus interest charges, making early identification and election timing critical for tax-efficient outcomes.

⚠ *PFIC exposure is often identified through K-1 footnotes and supplemental schedules rather than the face of the return.*

What is a PFIC?

- Foreign corporation meeting either the 75% Passive Income Test or the 50% Passive Asset Test

75% Passive Income	50% Passive Assets
Income Test	Asset Test

- Commonly encountered through foreign mutual funds, offshore hedge funds, fund-of-funds structures, and certain foreign holding companies

Why Do We Care?

- Potentially punitive U.S. tax regime
- Excess distributions may be taxed at ordinary rates plus interest charges
- Annual reporting requirements can apply even when no distributions are received
- PFIC exposure is often identified through K-1 footnotes and supplemental schedules rather than the face of the return

Key Compliance Considerations

- **Form 8621** filing requirements
- Tracking basis and annual information statements
- Multiple PFICs may require multiple forms
- Significant preparation burden for high-net-worth investors and fund investors

Common Elections

- Qualified Electing Fund (QEF) Election
- Mark-to-Market Election
- Default Excess Distribution Regime (least favorable in many situations)

Planning Points

- Review K-1 footnotes carefully for PFIC disclosures
- Identify PFIC investments early to preserve election opportunities
- Evaluate cost/benefit of QEF or MTM elections
- Consider PFIC implications before investing in foreign pooled investments

Section 754 Election

1 **Death of a Fund Partner**

Decedent's estate receives a stepped-up outside basis to FMV under Sec. 1014 — the standard rule.

2 **Sec. 754 Election — Frequently Not Made**

Hedge funds routinely decline to make the Sec. 754 election. Without it, the fund's inside basis stays low — no corresponding step-up inside the fund.

3 **The Mismatch**

Outside basis (heir's) is stepped up to FMV; inside basis (fund's) remains at historical cost — creating a permanent divergence.

! On full redemption, the loss recognized outside the fund may offset gains allocated from the fund. When a partner fully redeems from a fund, they may be allocated a significant amount of capital gains.

Recent Developments

Recent Developments — Capital Loss SMAs and Tax-Efficient Hedge Funds

Two AQR strategies — Flex and Delphi — represent the frontier of tax-aware investing, but each carries reporting complexity and risks that advisors must understand before recommending them.

AQR Flex

Separately Managed Account

- **Structure:** Long/short equity SMA with systematic tax-loss harvesting designed to generate capital losses that shelter gains elsewhere in the portfolio
- **Book:** Levered long/short (e.g., 145% long / 45% short); expected first-year short-term capital loss of ~32% of basis
- **Scale:** AQR's tax-aware product suite exceeded $68 billion in AUM as of 2026

~32% Expected first-year short-term capital loss of basis (published strategy)

AQR Delphi

Hedge Fund

- **Structure:** Hedge fund designed to produce long-term gain rate income, Sec. 1256 gains, alongside ordinary losses — complex character shifting of income and expense
- **Reporting risk:** K-1 items must be reported in the correct category — if misclassified, loss limitations apply and the tax benefit is forfeited entirely
- **Regulatory risk:** Both strategies are drawing IRS and industry scrutiny; advisors should monitor developments

LT Gain Targets long-term gain character income with offsetting ordinary loss treatment

Regulatory Watch

IRS and industry scrutiny is active on both strategies; ongoing monitoring is essential

Recent Developments — Opportunity Zone Deferrals Due in 2026

Investors who deferred capital gains into Qualified Opportunity Zone funds face a hard December 31, 2026 recognition date — with tax due in April 2027 whether or not the investment is liquid.

2017
TCJA Enacted

Within 180 Days
Gain Reinvested

Dec. 31, 2026
Recognition Date

April 2027
Tax Due

Jan. 1, 2027
OZ 2.0 Begins

QOZ Program (TCJA 2017)
Gains reinvested within 180 days deferred until earlier of disposition or Dec. 31, 2026.

Dec. 31, 2026 — Phantom Income
Deferred gain recognized as taxable "phantom income" — even without a cash event.

2026 Planning Actions
Harvest capital losses, evaluate charitable strategies, assess QOF value decline to reduce taxable gain.

OZ 2.0 — One Big Beautiful Bill
Signed July 4, 2025: Opportunity Zones made permanent; second tranche begins Jan. 1, 2027.

10-Year Hold — Crown Jewel
OZ 1.0 investments held 10 years: all appreciation excluded from federal capital gains tax.

Recent Developments — QSBS (Sec. 1202) and VC Investments

Section 1202 remains one of the most powerful tax benefits available in 2026 — enabling up to 100% exclusion of capital gains — but qualification rules are strict and the planning window must be established at the time of investment.

100%

Gain Exclusion — Qualified Small Business Stock (Sec. 1202)

$10M
Exclusion cap per taxpayer per issuer

10×
Basis alternative cap (if greater than $10M)

$75M
Max gross assets at issuance (raised from $50M under OBBBA)

5 yr
Minimum holding period required for exclusion

Non-corporate taxpayers only

For stock issued after July 4, 2025. The One Big Beautiful Bill Act created a graduated exclusion schedule:

- Held 3 years or more: 50% exclusion
- Held 4 years or more: 75% exclusion
- Held 5 years or more: 100% exclusion

Qualification Requirements & Planning Notes

Domestic C-Corporation Issuer
Stock must be original issuance from a U.S. C-Corp — S-corps, partnerships, and LLCs do not qualify.

Active Qualified Trade or Business
Service businesses (law, health, finance, consulting) are generally **excluded** . Technology, manufacturing, and certain other sectors qualify.

VC Fund Context
QSBS-eligible gains flow through to individual partners; qualification must be tracked at the fund level. Advisors must confirm eligibility per issuer.

Gifting and Stacking Opportunity
Prior to a liquidity event, make gifts of stock to individuals and to separate non-grantor trusts for descendants.

Estates & Trusts Eligibility
QSBS exclusion available to certain trusts and estates — confirm eligibility at the entity level before assuming the benefit passes through.

Q&A

Thank you!

Contacts

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