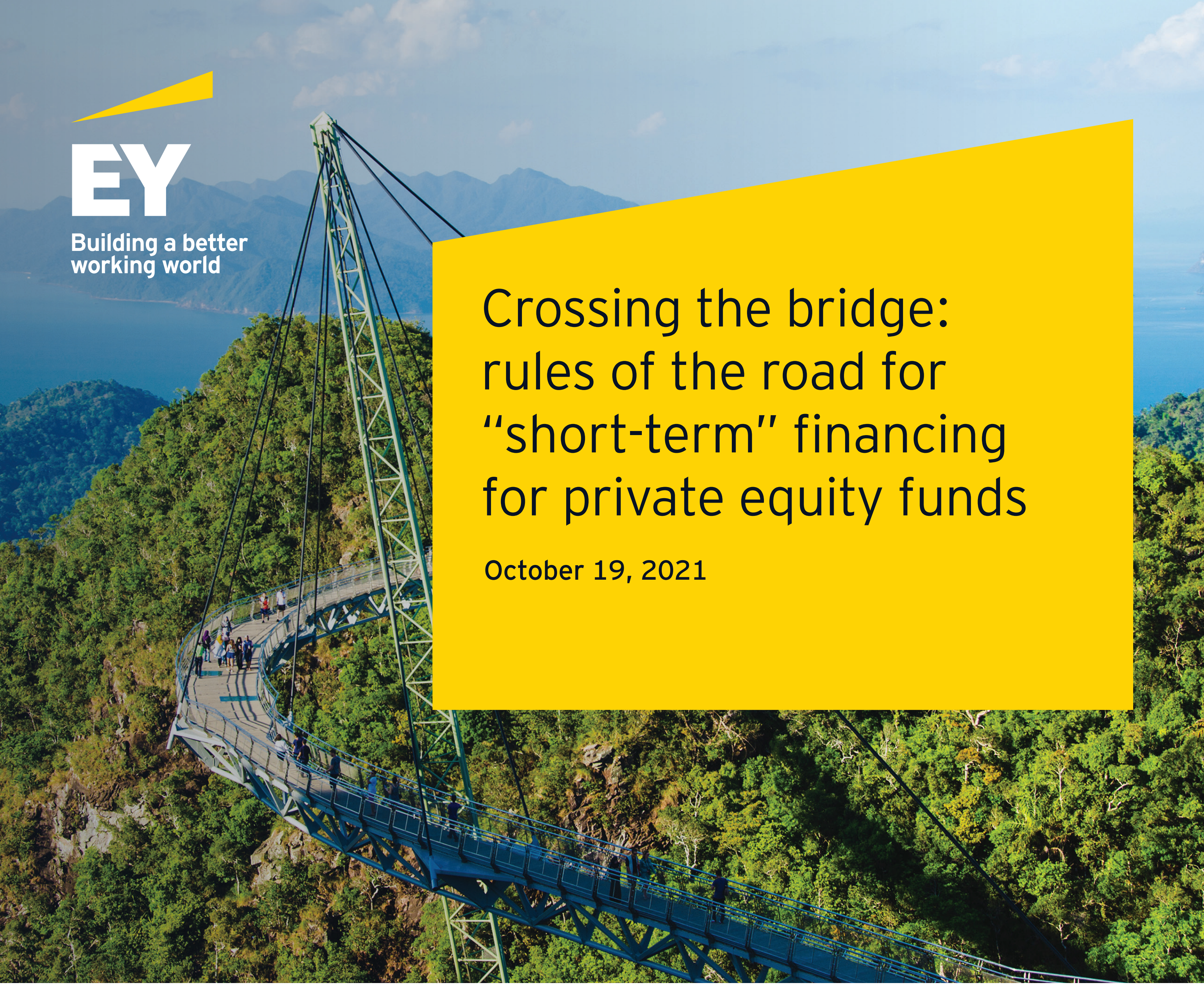

EY
Building a better working world

Crossing the bridge: rules of the road for "short-term" financing for private equity funds

October 19, 2021

Private equity (PE) funds commonly draw down on fund-level "bridge" credit facilities for a variety of commercial reasons, including, most commonly, to fund portfolio investment closings in advance of investor capital calls. As a result, the question arises as to whether or to what extent the use of such fund-level bridge financing may give rise to unrelated business taxable income (UBTI) to the fund's US tax-exempt fund investors. Applying the relevant statutory provisions in a mechanical way can produce undesirable UBTI results. Arguably, there are grounds for excluding short-term fund-level bridge financing from UBTI, depending on the duration of the borrowing. Great controversy exists as to the precise limit on permissible financings for UBTI purposes. Anecdotally, many advisors and lenders suggest that a good deal of commercial leeway exists in this area. Notwithstanding the lack of technical authority, funds often seek to take the position that bridge financings that remain outstanding for 120 days or less do not create UBTI to their investors.

Contents

Overview

Certain PE fund investors, such as private pension plans, which are generally exempt from tax, pay tax on UBTI. As such, these investors are sensitive, at varying degrees, to receipt of income that is UBTI. Despite their sensitivities, many such investors increasingly seek to invest directly (and not via what's commonly referred to as a "blocker corporation") in the PE fund because of the "tax drag" associated with a US blocker corporation. Fund agreements often carve out bridge loans from the definition of UBTI for purposes of any UBTI covenants contained in the partnership agreement. As a result, UBTI-sensitive investors may require PE fund managers to use certain efforts (contractually, either in their side letter or operating agreement) to prevent such investors from incurring UBTI solely as a result of their investment in the fund. UBTI can arise as a result of the conduct of a trade or business, or from "debt-financed property" (in both cases either directly or indirectly, as a partner in a partnership).

PE funds may use an "above-the-fund" blocker, which would block UBTI for tax-exempt investors, but more typically, funds utilize "investment-by-investment" blockers, which may reside underneath the fund and would not block leverage incurred by the fund to bridge capital calls.

Against the foregoing background, this summary evaluates the theories for asserting that fund-level bridge financing does not give rise to debt-financed property or UBTI. First, we take a closer look at both the commercial context for such financing and UBTI covenants. Next, we consider the historical development of the debt-financed property rules and the limited authority on this issue.

Commercial context

FUND-LEVEL BRIDGE FINANCING

A typical PE fund is organized as a limited partnership that is fiscally transparent for US federal income tax purposes, does not incur long-term fund-level indebtedness for the purpose of leveraging fund returns and ordinarily invests in corporate targets that generate capital gains and dividends.

Funds and fund managers must constantly manage a variety of cash flows in a way that is administrable for the fund and its investors. For example, the fund manager’s fee is typically paid quarterly, while fund expenses, other than management fees, may be incurred on a current basis. Investigatory expenses incurred in anticipation of an investment (due diligence activity, professional advice, etc.) may be advanced by the manager and reimbursed by the fund either when the relevant investment closes or the transaction is affirmatively abandoned and becomes a broken deal. In some situations, potential targets or portfolio companies (e.g., in the context of an add-on acquisition) may need standby letters of credit where a fund equity commitment will not suffice. Investment closings must be completed and funded in full in time for closing. Also, in some cases a fund may intend to syndicate a portion of the investment to co-investors after closing. All of these moving pieces and the cash flow needs of the fund must be factored into investor capital calls and distributions that minimize inconvenience to investors, whose portfolios contain many alternative fund investments.

Fund general partners (GPs) regularly manage these needs by using a fund-level revolving credit facility, which may be secured by partner subscription obligations (particularly early in a fund’s life cycle) or fund assets (later in a fund’s life cycle) or both. Funds frequently draw on such facilities to close deals and then subsequently call capital to repay the borrowing. This technique reduces risk of investor delay or default on a capital call and allows the fund to effectuate transactions on a short timeline (investors typically are afforded 10 to 15 business days’ notice to deliver called capital). Similarly, a revolving credit facility allows a fund to call capital only for investments that actually close, and only for portions of the investment the fund expects to keep rather than syndicate.

From a commercial perspective, a revolving credit line is typically not attractive in its own right to a lender. Fees on undrawn amounts are less than the margin on funded loans, even though draws can be made on short notice and are outstanding only for a short time. Instead, the value to the lender may be to develop a relationship and gain access to other fund business, such as currency hedging and term-loan borrowing by portfolio companies.

Funds face increasing pressure regarding their internal rates of return (IRRs). Fund IRR determinations typically are keyed to capital call dates rather than to investment closing dates. GPs are incented never to call capital for portions of an investment that will be syndicated, and for anything that will not be syndicated, they are incented to delay calling capital whenever borrowing costs less than the waterfall’s preferred return. Even non-tax-exempt investors often put pressure on the fund to limit the duration of any bridge borrowing, e.g., to 90 days, for IRR-related, non-tax reasons. Where borrowing costs less than the fund’s preferred return to investors (as is the case currently, and has been the case for many years) and where investment returns to investors are measured based on the timing of cash contributions and distributions, long bridge loans increase IRRs. Investors often assert that this IRR inflates the deal IRR and can benefit the GP to the detriment of fund investors. For example, if a fund clears the hurdle rate due to the bridge loan, but doesn’t surpass the catch-up tier in the waterfall to reach full carry, the additional IRR from the bridge loan provides the GP more carry than it would otherwise have received in the absence of the bridge loan.

Commercial context

UBTI COVENANTS

Tension exists between the use and duration of fund-level bridge financing and undertakings to UBTI-sensitive investors who desire to prevent or minimize the incurrence of UBTI. Some funds respond to these sensitivities by implementing covenants that take a wide variety of forms. For example, a basic undertaking may simply be an obligation to use some level of effort to prevent investors from recognizing UBTI (e.g., "commercially reasonable efforts" or "reasonable best efforts").[1] Some funds offer tax-exempts the ability to pre-fund their share of any borrowings so as to reduce the risk of incurring UBTI.

The debt-financed income problem

GENERALLY

The use of bridge financing to close investments before capital is called may at times be adverse to UBTI-sensitive investors, who typically expect minimal UBTI, if any, from their PE fund investments.[2] The baseline rule is that a US tax-exempt generally must treat as UBTI a portion of any income generated by "debt-financed property."[3] Debt-financed property generally includes property that is held to produce income and with respect to which there is an "acquisition indebtedness" at any time during the tax year.[4] Acquisition indebtedness generally includes indebtedness that would not have been incurred "but for" the acquisition or improvement of such property, including indebtedness incurred after the acquisition or improvement that is "reasonably foreseeable."[5] Whether incurrence of indebtedness is reasonably foreseeable depends on the facts and circumstances of each specific case.[6] The portion of income considered "unrelated debt-financed income" generated by debt-financed property in a tax year is generally a fraction equal to the average acquisition indebtedness during the year relative to the average adjusted basis of the debt-financed property.[7]

In many PE funds, which typically have a longer, three- to five-year investment horizon as compared with a hedge fund, and which generate most of their income upon exit, it may be possible to manage the magnitude of debt-financed income from debt financed capital calls as long as the financing is paid off more than 12 months prior to exit. However, any income generated prior to paying off the bridge financing is generally expected to constitute UBTI. Additionally, it may be difficult to trace borrowed funds and their uses — as such, there is the risk that gain from the disposition of other investments could be tainted. Additionally, regardless of how material the UBTI is, the perceived lack of appropriate levels of tax diligence and the absence of tax certainty regarding permissible durations of bridge financing may cause funds that push the envelope on bridge financing durations to run afoul of their investor UBTI covenants or create other investor relations issues.

The UBTI rules generally apply to interests in fiscally transparent partnerships on a look-through basis.[8] An investment by a fund is in property held to produce income, so one may say that the fund-level bridge financing used to close such an investment would not be incurred but for the acquisition of that investment. Accordingly, a mechanical application of the existing rules likely would result in categorizing fund-level bridge financing used to close an investment as acquisition indebtedness with respect to that investment.[9]

There is a general sense in the PE industry that the typical fund-level bridge financing is not among the type of activities that Congress intended to subject to the UBTI rules. Even so, the lack of specificity in the statutory language and the general lack of public guidance make it difficult to assess the risk profile on this issue and reach a high level of certainty that such fund-level, short-term bridge borrowing will not generate UBTI. The leading arguments have their basis both in public policy, and in certain Internal Revenue Service (IRS) private letter rulings (PLRs), which cannot be cited or relied upon as precedential authority, each as further discussed below.

The debt-financed income problem

DEVELOPMENT OF THE DEBT-FINANCED INCOME RULES

The history of debt-financed property and income under the UBTI rules does not reveal a clear policy objective that can serve as a guide when evaluating novel situations not specifically contemplated by the drafters of the debt-financed income rules.[10]

The special tax-exempt treatment of charitable organizations first appeared in the Corporate Income Tax Act of 1909, which exempted from tax any corporation or association operated exclusively for religious, charitable or educational purposes, and no part of whose income inured to the benefit of any private individual. This dispensation continued under the federal income tax and found expression in the "destination of income" cases, in which organizations carrying on charitable activities were exempt from income tax on income derived from commercial activities.[11]

In 1950, Congress set aside the "destination of income" concept in favor of taxing otherwise exempt organizations on their income from business activities unrelated to their exempt purpose, primarily to eliminate the potential for unfair competitive advantage due to tax-exempt status. Congress excepted certain types of passive investment income from the new tax on the theory that such investments were unlikely to create a competition problem. However, in order to target a specific perceived abuse involving sale-leaseback transactions with tax-exempt organizations, Congress carved out from the passive income exception certain rental income derived from property acquired with borrowed funds and leased out for more than five years.[12] The carve-out sought to address three concerns: (1) the exempt organization made no contribution to the transaction other than its exempt status; (2) the tax base could be eroded in the long term if assets and real estate moved to substantially tax-exempt ownership; and (3) tax-indifferent parties could distort prices, e.g., by paying above-market prices or charging lower rentals than a taxable business would, thus "selling" its exempt status (a variation on unfair competition).

Nonetheless, taxpayers continued to use sale-leaseback transactions and avoided the new rules by using shorter-term leases. The IRS challenged both capital treatment for sellers, and buyers' tax exemption, but by 1969 the IRS had suffered losses on both.[13] Congress responded in 1969 by broadening the scope of debt-financed property. The Treasury Department (the Treasury) articulated three reasons for supporting the change: (1) erosion of the tax base, (2) pricing distortions/unfair competition and (3) the potential for diminished accountability if independence from reliance on donors were gained by successful financial management. However, Congress justified its action solely by reference to Brown.

Over time, Congress enacted a series of exceptions to the debt-financed property rules, sometimes over the Treasury's objections, typically justifying each such exception with some version of the theory that unfair-competition concerns were not acute in the particular case.[14]

The debt-financed income problem

IRS DEBT-FINANCED INCOME GUIDANCE

The IRS has not issued regulatory or other binding administrative guidance directly relevant to fund-level bridge financing. However, the IRS has issued a series of PLRs, which may not be cited as precedent but do provide some insight into how the IRS might apply the debt-financed property rules to fund-level bridge financing. As further discussed below, the PLRs were issued to pension funds that borrowed to administratively streamline and expedite distributions to beneficiaries.

The logic of each of these PLRs traces back to a ruling on the UBTI treatment of income from securities lending. In Rev. Rul. 78-88, the Treasury and the IRS concluded that income from securities lending constituted neither income from an unrelated trade or business nor debt-financed income.[15] Setting aside the expansive view of "indebtedness" necessary to consider an obligation to return collateral as an indebtedness, the logic articulated is that the purpose of the securities loan is not to make a leveraged investment in the collateral and, therefore, it presents no debt-financed property concern.[16]

The first of the PLRs[17] concerns a pension fund with a subsidiary that has a revolving loan facility. Were the pension fund to be without immediately available funds to meet its benefit payment obligations and its investment commitment obligations, the subsidiary could borrow and make the investment on its own account until the pension fund could contribute cash to repay the borrowing. The representations provide that such borrowings would be few, would be repaid within days or weeks, and would be de minimis as compared with the pension fund's overall investment assets and cash flow. Citing Rev. Rul. 78-88, the IRS ruled that the transitory indebtedness was not incurred "for the purpose of making and carrying additional investments to which debt-financed property provisions apply." Rather, it would be incurred "solely for convenience in administering [pension fund's] exempt function, and to avoid the cost and inefficiencies of making substantial investments in cash equivalents rather than more productive long-term investments" and thus would not constitute acquisition indebtedness.

The subsequent PLRs in this line present minor variations on the original factual theme, and analytically each returns to the same proposition — the debt in question is not incurred for the purposes of making and carrying additional investments.[18]

Guidelines

Ernst & Young LLP (EY US) has developed tax guidelines regarding the use of fund short-term transitory bridge financing. As any such analysis is heavily facts and circumstances specific, please consult with your tax advisor on your specific fact pattern. Certain illustrative factors our guidelines generally focus on include, among others:

- Whether bridge borrowings are used exclusively to facilitate an equity investment in a portfolio company in conjunction with a capital call
- Whether the fund has identified a particular investment prior to drawing on any credit facility
- Whether the capital call and the identified investment are clearly documented in a transaction memo, step plan or other contemporaneous documentation in every instance the credit line is accessed
- Whether bridge borrowings are repaid with the planned capital call proceeds within 20 to 30 days. At varying levels of certainty, we have considered whether leaving the borrowing outstanding for 30 to 45 and 60 to 90 days can be supported, depending upon other factors.
- Frequency of credit facility access. Thought should also be given to whether overlapping drawdowns on the credit facility remain open at the same time.

Guidelines

OTHER COMMON UBTI ISSUES

Private equity funds can face a wide variety of UBTI issues beyond the treatment of fund-level bridge financing. For example:

- Back leverage. Back leverage may be incurred after the acquisition of portfolio-company shares, such as a post-acquisition margin loan or a leveraged loan on appreciation related to a specific portfolio company. There is a question as to whether or to what extent this may constitute acquisition indebtedness for purposes of the UBTI rules.
- Fund-level guarantees. Fund-level guarantees of portfolio-company obligations may raise a number of issues, including whether such a guarantee may constitute acquisition indebtedness. Analysis may tend to start with whether the portfolio company could borrow on its own without the guarantee, even if stand-alone borrowing might be on less favorable terms.[19] The IRS has issued a series of PLRs holding on specific facts that a debt guarantee did not constitute acquisition indebtedness.[20] Portfolio companies often tap a fund-level credit line out of administrative convenience.
- Post-repayment taint period. Uncertainty regarding the timing of a potential sale or dividend often forces funds to grapple with whether those events will occur outside of the 12-month period following repayment of acquisition indebtedness.[21]
- Blocker leverage. There are a number of issues related to the use of fund blockers to ring fence UBTI from tiering up the tax-exempt investors, including the interest limitation rules under Section 163(j) and the debt equity rules under Section 385. It is also helpful to perform credit scoring analysis to support blocker leverage.

Conclusions

There are clear commercial reasons for using fund-level bridge financing, but the use of such financing may create some tension with UBTI covenants made by fund managers and may impact an unblocked UBTI-sensitive investor’s after-tax IRR. The unrelated debt financed property rules responded primarily to specific transactional abuse situations that are decidedly unlike fund-level bridge financing. Similarly, fund-level bridge financing does not create any of the competitiveness or similar concerns articulated by Congress and the Treasury in the tax-exempt area. The PLRs that are most on point concern administrative borrowing that is infrequent, de minimis in amount and outstanding for essentially 30 days or less, but they cannot be relied upon. Accordingly, it is difficult to identify a basis for anecdotal claims that fund-level bridge financing may be outstanding for longer periods, such as 120 days, without creating acquisition indebtedness.

Please do not hesitate to consult your EY US tax engagement team or any of the following EY US PE professionals with any questions you may have.

Contacts

Petter Wendel
Global/US Private Equity
Tax Leader
Ernst & Young LLP
petter.wendel@ey.com

Andy Froberg
US Private Equity
Thought Leadership
Ernst & Young LLP
andy.froberg@ey.com

Morgan Anderson
US Private Equity
Thought Leadership
Ernst & Young LLP
morgan.anderson@ey.com

Gerald Whelan
Private Equity Tax Technical Leader
Ernst & Young LLP
gerald.whelan@ey.com

Stephen Clarke
Tax-Exempt Organizations —
National Tax
Ernst & Young LLP
stephen.clarke@ey.com

ENDNOTES

[1]As a practical matter, fund lawyers may tend to interpret "commercially reasonable efforts" as requiring the manager/GP to act only under advice with at least a "more likely than not" level of confidence, and "reasonable best efforts" as requiring advice at a "should" or "will" level of confidence. Delaware corporate law does not recognize contracting parties' attempts to distinguish levels of reasonableness and instead reads all such clauses as requiring "all reasonable efforts." See Akorn, Inc. v. Fresenius Kabi AG, C.A. 2018-0300-JTL (Del. Ch. October 1, 2018).
Undertakings may be further modified by a variety of carve-outs, e.g., for common fund activities that may carry a degree of UBTI risk (such as fund-level bridge financing and management fee offsets), or for safe harbor mitigation techniques (such as the use of a blocker corporation

[2]UBTI determinations can also be relevant to the availability of treaty-reduced withholding. See, e.g., Convention between the United States of America and the Kingdom of the Netherlands for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income (1992), Art 35; and Joint Committee on Taxation Staff Explanation thereof [JCS-15-93] (October 26, 1993).

[3]See US Internal Revenue Code (IRC) §514(a)(1).

[4]See IRC §514(b)(1). For property disposed of during the tax year, the test is whether there was any acquisition indebtedness at any time during the 12-month period ending with the date of disposition. Id.

[5]There is also some uncertainty regarding the scope of the term "indebtedness." For example, a variety of financial instruments and transactions involve what might be viewed economically as embedded leverage (e.g., futures, options, notional principal contracts). Congress and the IRS have identified some not giving rise to a trade or business absent dealer status, but there is little direct guidance about the UBTI treatment of embedded leverage. See, e.g., PLR 201434026 (August 22, 2014), PLR 201434024 (August 22, 2014) and PLR 201418061 (May 2, 2014). For example, Treasury and the IRS have ruled in Rev. Rul. 95-8 that short sales do not give rise to "indebtedness" for UBTI purposes, which may signal a narrower view of "indebtedness" for UBTI purposes than embedded economic leverage. See Walker, Investments in Derivatives Could Face Tax as an Unrelated Business, 13:6 Tax'n Exempts (2002). See also Deputy v. du Pont, 308 U.S. 488 (1940).
Although the economic leverage in certain financial instruments commonly is not treated as giving rise to acquisition indebtedness, any appeal to this practice as support for excluding fund-level bridge financing from acquisition indebtedness invites the question whether permanent fund-level indebtedness can be distinguished.

[6]US Treasury Regulations Section (Treas. Regs. §)1.514(c)-(1)(a) (flush language).

[7]IRC §514(a)(1); Treas. Regs. §1.514(a)-1(a)(1)(ii).

[8]See IRC §512(c). For UBTI purposes, the IRS observes no relevant distinction between general partner or limited partner status. Rev. Rul. 79-222. Cf. Prop. Regs. §1.892-5(d)(5)(iii) (distinguishing certain limited partner interests from general partner interests for commercial activity determinations).

[9]Allocation of indebtedness to particular assets is provided for under IRC §514(e).

[10]Following overview adapted from McDowell, Taxing Leveraged Investments of Charitable Organizations: What is the Rationale? 39 Case W. L. Rev. 705 (1989).

[11]See, e.g., Trinidad Segrada Order de Predicadores, 263 U.S. 578 (1924); Roche's Beach, Inc. v. Comm'r, 96 F. 2d 776 (2d Cir. 1938); C. F. Mueller Co. v. Comm'r, 190 F. 2d 120 (3d Cir. 1951).

[12]In the archetypal problem case, the owner of a corporation would sell the corporation to a tax-exempt organization in exchange for a nonrecourse installment note. The exempt buyer would then liquidate the corporation (General Utilities had not yet been repealed) and as a condition of the sale would lease the property/assets back to a corporation seller controlled. Seller would claim capital gain treatment, and the operating corporation would continue the business while deducting rental payments as an expense. Buyer would apply the rental payments to its nonrecourse installment obligation and thus would acquire the property and receive the excess of the rentals over its purchase price with no material economic risk.

[13]Comm'r v. Brown, 380 U.S. 563 (1965) (capital gain treatment of seller); University Hill Foundation v. Comm'r, 51 T.C. 548 (1969), rev'd 446 F. 2d 701 (9th Cir. 1971), cert. denied, 405 U.S. 965 (1972) (UBTI treatment of exempt organization buyer).

[14]See IRC §514(c)(7)-(9); McDowell, supra note 12.

[15]In a typical securities loan, the owner of a security lends it to a broker, which deposits collateral against the return of the security, makes substitute payments equal to any payments made on the security while loaned and pays for the use of the security (e.g., a fee, or earnings on the collateral, or both). In this case, "[a]lthough the organization has the obligation to return the collateral, it has not incurred an indebtedness for the purpose of making additional investments. Rather, the collateral is posted to secure the broker's obligation to deliver identical securities, and the organization is allowed to retain the income from investment of the collateral as compensation for entering into the transaction."

[16]See G.C.M. 37313 ("Although the organization's obligation to return the collateral might be considered indebtedness in a technical sense, it seems clear that [securities lending] is not the type of transaction to which section 514 was intended to apply. What the organization receives is compensation for entering into the securities 'lending' transaction rather than income from debt-financed property.") See also Walker, supra note 7.

[17]PLR 8721107 (February 27, 1987). See also PLR 200320027 (May 26, 2003) (similar facts involving short-term borrowing to redeem units, but such borrowing was made by a tax-exempt common trust fund rather than a pension fund or profit-sharing fund).

[18]PLR 9644063 (November 1, 1996) (borrowing once or twice annually, normally for not more than 20 trading days, in amounts less than 1% of assets or cash flow, to facilitate orderly liquidation of securities for monthly redemptions); PLR 200010061 (infrequent borrowings normally outstanding no more than 20 trading days in de minimis amounts relative to overall fund assets or cash flow); PLR 200233032 (infrequent borrowings outstanding no more than 30 days in de minimis amounts relative to overall fund assets or cash flow); PLR 200235042 (same as PLR 200233032).

[19]Cf. Plantation Patterns v. Commissioner, 462 F.2d 712 (5th Cir. 1972) (recasting guarantee of a non-creditworthy entity's obligations as a loan to the guarantor followed by an equity contribution to the purported borrower).

[20]See, e.g., PLR 9404029 (November 3, 1993), PLR 9204048 (October 30, 1991), PLR 9204029 (October 28, 1991), PLR 8706044 (November 12, 1986) and PLR 8614051 (January 1, 1986)).

[21]See supra note 4.

EY | Building a better working world

EY exists to build a better working world, helping to create long-term value for clients, people and society and build trust in the capital markets.

Enabled by data and technology, diverse EY teams in over 150 countries provide trust through assurance and help clients grow, transform and operate.

Working across assurance, consulting, law, strategy, tax and transactions, EY teams ask better questions to find new answers for the complex issues facing our world today.

EY refers to the global organization, and may refer to one or more, of the member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. Information about how EY collects and uses personal data and a description of the rights individuals have under data protection legislation are available via ey.com/privacy. EY member firms do not practice law where prohibited by local laws. For more information about our organization, please visit ey.com.

Ernst & Young LLP is a client-serving member firm of Ernst & Young Global Limited operating in the US.

What makes EY distinctive in financial services
Over 84,000 EY professionals are dedicated to financial services, serving the banking and capital markets, insurance, and wealth and asset management sectors. We share a single focus — to build a better financial services industry, one that is stronger, fairer and more sustainable.

© 2021 Ernst & Young LLP.
All Rights Reserved.

SCORE no. 14054-211US
2108-3842428 BDFSO
ED None

This material has been prepared for general informational purposes only and is not intended to be relied upon as accounting, tax, legal or other professional advice. Please refer to your advisors for specific advice.

ey.com

Definitions
A "blocker corporation" refers to the common private equity market practice, whereby a fund uses an entity classified as a C corporation for US tax purposes to hold certain portfolio investments (e.g., to protect US tax exempt investors from being directly engaged in an unrelated trade or business or to protect investors from direct US state and local tax filings, etc.).

"Tax drag" — refers to entity level tax imposed.

"Back leverage" is generally defined as borrowing incurred by a portfolio company post acquisition.

Fund-level guarantee — this refers to the common practice of a private equity fund providing a guarantee or credit support of debt incurred by a portfolio company.

Post-repayment taint period — if acquisition indebtedness is outstanding with respect to property at any time during the 12-month period before the disposition of such property at a gain, the property is treated as debt-financed property, which is subject to tax as UBTI.

"Blocker leverage" generally refers to capitalizing a fund blocker corporation with shareholder or third party debt. The blocker corporation is classified as a C corporation from a US tax perspective and is used to hold a portfolio company investment (e.g., a flow-through portfolio company).

"Waterfall" refers to the part of a fund agreement that dictates the manner in which returns from portfolio investments are shared by a fund's investors.