**Appendix C. Hedge Funds**

Background

During 2005, the Foundation Board approved a 15% allocation to hedge funds. This allocation was managed by two consultants, Cambridge Associates and Morgan Stanley. Each portfolio held approximately 20-25 funds. The majority of the funds were invested in foreign blocker funds, funds held overseas, to protect the Foundation from UBTI. A couple of the funds were invested in domestic partnerships, Man-AHL and Farallon, and a Schedule K-1 was received. These two funds were held in the Morgan Stanley hedge fund portfolio. During 2012, the Foundation Board terminated Morgan Stanley and reduced the hedge fund allocation to 10%. Redemption requests were submitted during the second quarter of 2012. The majority of the funds were redeemed by year end. As of December 31, 2012, the Cambridge portfolio held approximately 20 funds.

The following discussion provides a summary of tax reporting received from hedge funds, as well as a summary of the preparation of additional tax forms related to the Foundation’s hedge fund investments.

As indicated earlier, only two of the Foundation’s hedge fund investments provide annual tax information on a K-1. Other hedge fund investments provide no annual tax reporting. K-1 information is entered into the hedge fund tab of the K-1 summary spreadsheet, then included in one adjustment to income reported on the Foundation’s Form 990-PF. Appendix A includes a more complete description of the K-1 process.

During preparation of the tax return each year, the Accountant reviews the year’s Transaction Detail report for the Foundation’s hedge fund account(s). Among other transactions, this report details any additional hedge fund subscriptions during the year as well as redemptions and distributions from the Foundation’s hedge fund investments. This report is used in a number of ways. First, the Accountant notes the subscriptions, listed as purchases on the report. The purchase information includes new hedge fund subscriptions as well as additional subscriptions made during the year. The Accountant prepares a Form 926 or Form 8865 for each hedge fund for which there was a purchase transaction during the year. Which form is filed depends on the structure of the hedge fund investment; partnerships require the filing of Form 8865, while corporations require the filing of Form 926.

For completion of Form 926, standard responses for Parts I and IV are included in the attached form. Information for Part II is collected from the subscription documents. Note that the response to Part II, Question 8 is No, and the wording “See Statement 1” is included. Statement 1 is attached to all hedge fund Forms 926, and a copy is included in Appendix B. The purchases transaction information in the Transaction Detail report is used to complete Part III of Form 926.

Form 8865 has not been required for any of the Foundation’s hedge fund investments to date. However, the form would be completed using the subscription documents for the hedge fund, as well as the purchase information included in the Transaction Detail report. Form 8865, Schedule O would need to be filed to detail the purchase transaction.

Whether or not a hedge fund provides annual tax reporting information, it may provide information indicating that additional forms need to be filed related to the investment. For example, the Foundation filed one Form 8621 for the 2011 tax year related to its investment in Gruss Global Investors (Enhanced), Ltd. Appendix B contains more detailed information regarding the additional forms that the Foundation files.

The Transaction Detail report is also used to identify the distributions and redemptions that occurred during the year. These are reviewed to determine the tax impact, if any, of the redemption or the distribution. In the case of distributions, Foundation staff may need to follow up with the contact at the hedge fund to determine tax treatment. In the cases of a partial or full redemption, the Foundation staff need to determine whether there is any gain or loss to be recognized on the tax return. Depending on the cost basis of the investment and the amount received upon redemption of the hedge fund investment, the Foundation may realize a gain or a loss upon disposition.

Information regarding the cost basis tracking of the Foundation’s hedge fund investments is available at the discussion titled Cost Basis Tracking.