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2019 Year-End Tax Planning Alert

Tax planning is complex. Cautious planning involves more than just a focus on lowering your taxes for the current and future years. The various items and planning opportunities discussed in this alert are general in nature and may not apply to each taxpayer's situation. There are many things to think about and rules to navigate when it comes to tax planning. In most, if not all situations, multi-year modelling may be required so as to try and get the best tax result now and in future years. This alert cannot cover every tax planning opportunity that may be available to you and your business. Therefore, we urge you to meet with your tax advisors who should be able to provide you with a comprehensive review of tax-saving opportunities appropriate to you and your business. If you would like to discuss any of these techniques or planning ideas, please contact ***E. George Teixeira*** or any member of ***Anchin's Financial Services Practice*** at your earliest convenience. We stand ready as ***Your Expert Partner*** to help you plan effectively and to navigate through the various tax rules that may apply to you, your family and your fund.

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"Be informed, be flexible and be ready to act"

The Tax Cuts and Jobs Act of 2017 (TCJA) made sweeping changes to income taxation, estate and gift taxation and international taxation. In the year since enactment, the Internal Revenue Service has provided guidance in many areas, some of which still require further clarification. However, there are still many sections of the newly passed law where no clarity has yet been received. This has created many challenges for individuals, businesses and tax professionals in addressing certain tax issues.

Every year, along with Thanksgiving turkey and the ensuing holiday celebrations, comes the time for year-end tax planning. The sooner that one focuses on their tax situation and the available tax planning opportunities, the more likely you are to put yourself in a better tax position. We know that the changes under the TCJA as well as additional changes that may occur as a result of the 2020 elections may be weighing heavily on your mind. While we cannot predict the future, we can assist you with your tax planning.

As we continue to monitor the prospects of regulations, guidance and potential new tax reform and as year-end approaches, you should consider the following opportunities as you review your tax picture. However, before taking action with any of these suggested planning ideas and opportunities, taxpayers should completely analyze the proposed transaction(s) and alternative outcomes.

ONE YEAR LATER

Choice of Entity Considerations Post TCJA – One Year Later: Corporation or Flow-Though Entity?

Choosing the appropriate type of entity is a complex analysis and is generally dependent upon many factors, such as business objectives, type of business, cash needs, and ease of obtaining new capital. The TCJA, enacted at the end of 2017, included many changes that impact this analysis. One of the headline changes was the top C-corporation tax rate being "permanently" decreased from 35 percent to a flat 21 percent. Although many predicted this change would lead to a surge of partnerships and S corporations (flow-through entities) converting into C corporations, such a surge has not occurred. Some of the major factors to consider when making a choice of entity decision post-TCJA are as follows:

Tax Rates:

C Corporation: While the TCJA reduced the federal corporate rate from 35 percent to 21 percent, it did not change the tax rate on distributions from a corporation to its shareholders. Qualified dividends received by non-corporate taxpayers are still taxed at a maximum rate of 20 percent (plus an additional 3.8 percent for taxpayers subject to the net investment income tax). The combined effective federal tax rate for non-corporate shareholders on distributions from a C corporation is 39.8 percent.

Flow-Through Entity: The TCJA also provided a rate reduction for non-corporate taxpayers on income from flow-through entities. Income of flow-through entities is not taxed (federally) at the entity-level, but is instead included by the owners on their respective income tax returns. The TCJA reduced the top non-corporate tax rate on ordinary income from 39.6 percent to 37 percent while also providing a 20 percent deduction (via Section 199A) for certain business income for non-corporate taxpayers that own flow-through entities. This 20 percent deduction reduces the effective federal tax rate on flow-through income from 37 percent to 29.6 percent. To the extent the owners of a flow-through entity have included these amounts as taxable income, the amounts can generally be distributed from the flow-through entity without additional tax. Note that all pass-through income is not eligible for the 20 percent deduction; therefore taxpayers should consult their tax advisors to verify, discuss and analyze.

Individual partners in a partnership may also be subject to self-employment taxes or the 3.8 percent net investment income tax, depending on how the partnership is structured (limited liability company versus limited partnership) and on their involvement with the business. In addition, shareholders of S corporations who work in the business are required to pay themselves reasonable compensation, which is taxable at ordinary income rates. This compensation is not eligible for the 20 percent deduction for certain business income. The S corporation is responsible for paying half of the employment taxes, and the S corporation shareholder pays the other half. Accordingly, the effective rate of tax on income from a flow-through entity will depend on whether the income is subject to self-employment taxes, employment taxes or the net investment income tax.

> **** Practice Tip:*** When modelling this out and comparing different effective tax rates, entity distributions should be considered. If a business plans to reinvest all after-tax proceeds and not make any distributions, a C corporation likely provides a greater opportunity for growth because the after-tax proceeds (which are subject to federal tax at a 21 percent rate) generally are higher than those of a flow-through entity (assuming the flow-through entity makes distributions to enable its owners to pay taxes). Conversely, if a business plans to distribute all of its income, a flow-through entity likely is more efficient.

> **** Caution:*** Major issues can arise under various state and local tax and/or foreign country tax systems that would need to be factored into any choice of entity analysis. It is also important to note that a C-corporation cannot avoid paying shareholder distributions (dividends) without having a reasonable business need to hold onto the cash. Otherwise it risks becoming subject to a 20 percent Accumulated Earnings Tax (AET). Such reasonableness of anticipated cash needs should be assessed based on facts existing at the close of the tax year and, because the burden of proof rests with the taxpayer, proper documentation is recommended.

Tax Reporting:

C Corporation: Income and losses of a C corporation do not flow through to its owners but instead remain at the entity level. If losses cannot be used in a current year to offset corporate income, the losses generally are carried forward as net operating losses and are available to offset income in future years. Under the TCJA, corporations can no longer carry losses back, but can carry losses forward indefinitely, with such losses limited to 80 percent of the corporate taxable income.
Corporations file U.S. federal and applicable state/local income tax returns and pay taxes at the corporate level. The owners of the corporation do not reflect income of the corporation on their personal returns.

Flow-Through Entity: Income and losses of a flow-through entity are reported by its owners, where such losses may be available to offset income from other businesses, subject to existing loss limitations such as basis, at-risk limitations, passive activity rules and new excess business loss limitations imposed by the TCJA. The new excess business loss limitation provides that only $250,000 ($500,000 for taxpayers filing jointly) of net losses from all of a taxpayer's trades or businesses can be used to offset nonbusiness income.

Unlike the shareholder owners of C corporations, owners of a flow-through entity are required to file U.S. federal income tax returns reflecting the operations of the entity. In addition, these owners may also be required to file tax returns in each state and locality in which the entity is deemed to be doing business. This can become complicated and involved for larger companies operating in all 50 states. In addition, non-U.S. persons generally do not want to file a U.S. tax return so a flow-through entity will not be the preferred investment vehicle for such owners/investors.

Raising Capital and Exit Planning:

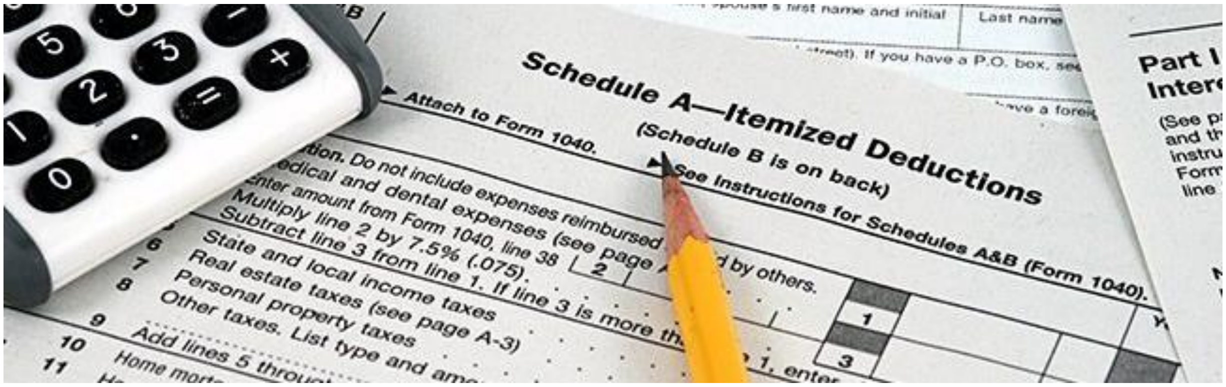
In many cases, the entity structure will be driven by types of investors in the entity as well as where the business investments are made (onshore only, offshore only or some combination of both) or possible buyers in a sale or exit event.

One significant reason many buyers prefer asset acquisitions over stock acquisitions is because of the ability of the buyer to obtain a step-up in the tax basis of the assets upon an asset purchase. Consequently, a flow-through structure that minimizes the impact on the seller with respect to an asset sale may be preferred. The ability to step-up the tax basis of assets upon purchase has increased somewhat as a result of changes made by the TCJA, which added favorable bonus depreciation rules allowing the buyer to immediately deduct 100 percent of the cost of certain assets. Given these incentives to obtain a tax basis step-up and create more immediate deductions, buyers are typically not willing to pay as much for a stock acquisition.

At odds with the buyer's motivations in an acquisition, owners of a corporation prefer to sell stock because it results in a single level of tax on any gain realized upon the sale of their stock. Unless a section 338 election is made by the parties, the sale of stock does not provide a basis step-up in the corporation's assets. For the seller, a sale of corporate assets yields two levels of tax — one at the corporate level and another at the shareholder level when proceeds from the asset sale are distributed. With that being the case, owners of a corporation more times than not prefer to sell stock, which does not provide a basis step-up in the corporation's assets. However, given the potential disadvantages to buyers discussed above, buyers generally pay less for stock than they would for assets.

> ***Observation:*** Section 1202 should be taken into account when evaluating the benefits of a C corporation in a sale event. Section 1202 allows taxpayers to exclude up to 100% of the gain on sale of qualified small business stock (QSBS) if the stock has been held for more than five years and meets certain other requirements. Therefore, the benefit of the 1202 exclusion needs to be modelled out and considered over the life of the stock rather than just during the sale year.

A flow-through structure may in fact provide more flexibility on exit because owners of a partnership generally are agnostic between an asset sale and a sale of interests in the partnership since both transactions can provide a step-up in the tax basis of the assets for the buyer. In an S corporation flow-through structure, owners may still prefer to sell stock because it generates capital gain. If an S corporation sells assets, there is only one level of tax, but some of the income may be taxed at ordinary income tax rates, depending on the types of the assets that are sold.



Loss of Miscellaneous Itemized Deductions - Planning Opportunities

Under the TCJA, all deductions subject to the 2% adjusted gross income (AGI) floor were repealed through the year 2025, including those for investment fees and related expenses. The TCJA did not, however, change the criteria distinguishing between private funds that are engaged in the trade or business as a securities trader (Trader) and private funds that are investors in securities (Investor). Trader funds are engaged in a trade or business and generate above-the-line deductions while Investor funds are engaged in investing activities and generate below-the-line deductions (or miscellaneous itemized deductions subject to the 2% AGI floor limitation discussed above).

The IRS Code and regulations are silent as to what constitutes engaging in the trade or business of trading in securities. However, the distinction between carrying on a trade or business (and thus being considered a trader), or not (an investor) has been addressed in court cases over the years. The most often quoted passage in case law distinguishing an investment account from a trading account, where the courts have stated:

> ...in the former (investor), securities are purchased to be held for capital appreciation and income, usually without regard to short-term developments that would influence the price of the securities on the daily market. In a trading account, securities are bought and sold with reasonable frequency in an endeavor to catch the swings in the daily market movements and profit there from on a short-term basis.

The trader versus investor decision is one that should be made with full knowledge of topical case law as well as what the current industry standards are. While a predominance of long-term capital gains/losses is generally not the best fact pattern for trader status that fact alone should not be the only fact taken into account for this analysis. Some planning opportunities that should be discussed and considered are as follows:

- **Use of Passive Foreign Investment Companies (PFICs):** Investing through the offshore feeder of a hedge fund rather than the onshore feeder could provide some tax benefits in certain situations. Investor funds (buy-and-hold investment strategy), structured as partnerships, flow through the partnership level expenses to their investors as portfolio deductions, which are non-deductible through the year 2025 at the individual investor level. Investing in the offshore feeder classified as a PFIC and making the qualified electing fund (QEF) election, the taxpayer/shareholder would get an ordinary deduction for these expenses without limitation. A QEF election is an election where an investor includes income from the PFIC on a current basis.

The election is made on an investor-by-investor basis whereby the investor is required to include his/her portion of the PFICs current earnings and profits in income; the income is long-term capital gain to the extent of his/her pro rata share of the PFICs net capital gain (i.e., net long-term capital gain net of net short-term capital losses) and ordinary income to the remaining extent. While current taxable losses would not be allowed, this is certainly an option that should be reviewed as part of an efficient tax planning process.

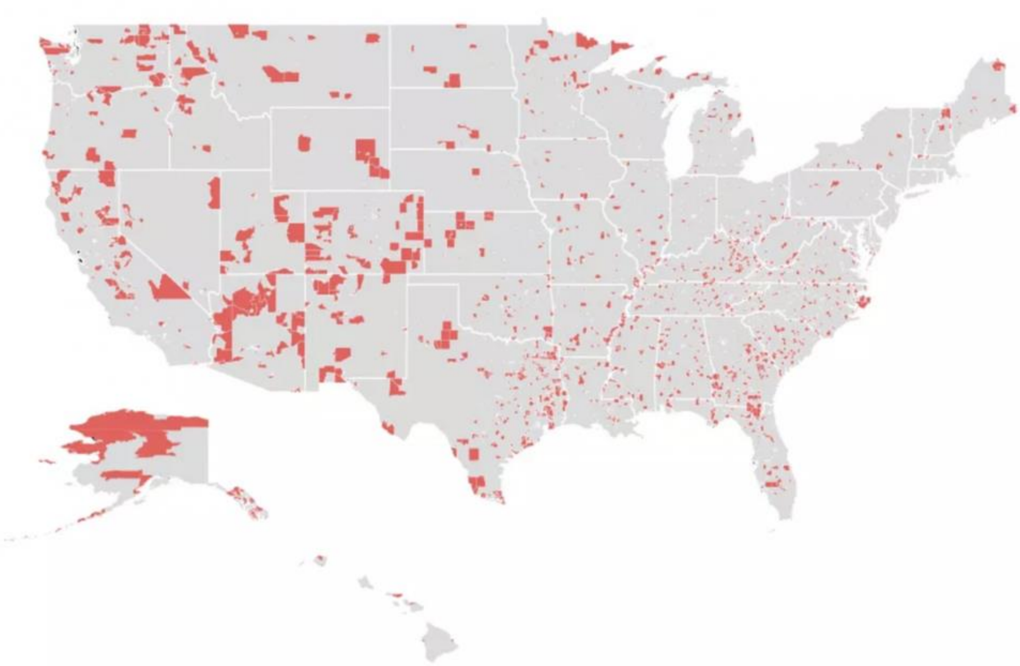
**** Observation:*** There are also certain potential state tax benefits of investing through a PFIC and not making a QEF election. In this scenario, the PFIC income (for which no QEF election has been made and which is allocated to prior years), is not included in federal adjusted gross income ("FAGI") when received. Instead, tax and interest are computed on said PFIC income allocated to prior years and that amount is added to the federal tax computed on the investor's taxable income. Since many states base their tax on FAGI and the PFIC income allocated from prior years would not be included as such, the income may not be taxed at the state level. Note also that not making the QEF election would yield ordinary gain (but a still a capital loss) on the subsequent disposition of such PFIC stock; while PFICs with QEF elections in place would yield capital gain or loss on such dispositions.

- **Take some or all of the management fees as an allocation (instead of a fee):** Doing so effectively allows the deduction of these fees to the investors since less income will be allocated to them.

Fees for investment management services provided to a private investment fund are typically calculated as a percentage of capital commitments or invested capital in the fund and paid to a management entity that is usually affiliated with the general partner of the fund. Management fees are taxed as ordinary income to the investment manager and are often not deductible when computing the taxable income of individual fund investors (unless the fund is deemed a ***Trader*** – discussed above).

A standard management fee waiver arrangement lets a manager elect to not receive all or a portion of future management fees throughout the term of the fund. Instead, the manager would receive an interest in the fund's profits. Converting management fees into profits interests often provides substantial tax benefits to both the investment manager and individual fund investors. If the arrangement is respected by the IRS as a profits interest, all or a portion of the investment manager's income allocated under the profits interest may qualify for a lower tax rate as compared to the highest ordinary income tax rate applicable to management fees.

**** Caution:*** Proposed IRS regulations have been issued in an attempt to curb the use of management fee waivers, particularly those that lack "substantial entrepreneurial risk". These proposed regulations outline standards for determining whether an arrangement, including a management fee waiver, is a disguised payment for services (i.e., a management fee) rather than a profits (or carried) interest. If you are considering such a structure, now or in the future, you should thoroughly review existing and prospective management fee waiver arrangements with your tax advisors.



Qualified Opportunity Zones: *One Year Later*

Although the (long-term) capital gains rates are attractive, some taxpayers prefer to defer paying any tax to a later time. The TCJA added a new way to defer the tax on capital gains for up to seven years by investing in a Qualified Opportunity Zone (QOZ). In order to take advantage of this tax deferral, a taxpayer must roll over a capital gain into a Qualified Opportunity Zone Fund (QOZF) within 180-days of the capital gain being triggered. If the deferred gain is held for five years in the QOZF, taxpayers are entitled to a 10% reduction in the deferred capital gain (via increased basis). If the QOZF is held for seven years, there will be a 15% reduction in the deferred capital gain (via increased basis). The most compelling part of the Qualified Opportunity Zones provision calls for a 100% gain exclusion on any appreciation on the original investment in the QOZF if held for 10 years. Regardless, the roll over gain into a QOZF will be taxed on December 31, 2026, unless it is sold earlier.

In general, the 180-day period begins on the day capital gain is recognized. The party recognizing the gain usually must make the replacement (e.g., if a partnership sells an asset, the partnership can defer the gain at the entity level by investing in a QOZF). If a pass-through entity such as a partnership does not elect to defer gain by reinvesting in a QOZF, each owner has the option to directly reinvest his or her share of gain. In this case, the 180-day period generally begins on the last day of the owner's tax year (rather than the day on which the pass-through entity recognized the gain). The owner can, however, elect to use the same 180-day period as the pass-through entity (unless the property is section 1231 property, where different rules apply).

**** Observation:*** In order to achieve the full 15% exemption referenced above, the investment in the QOZF must be made by December 31, 2019 (unless Congress subsequently extends that date).

**** Planning Opportunity:*** One may be able to use the QOF rules for short-term deferrals; that is, deferring capital gains from one year to the following year. This opportunity, along with all tax planning, should be thoroughly discussed and planned out with your tax advisors.

***** Next Steps***: There are Opportunity Zones in every state with potentially great investment opportunities to deploy capital into underserved areas of the country. While QOFs can offer an array of substantial tax benefits, many taxpayers may still be better off using more traditional tax planning techniques. Please contact someone in Anchin's Opportunity Zone Practice Group as they are ready, willing and able to assist you with your tax planning.

Tax Loss Harvesting: Turn Investment Losses into Tax Savings

2019 has been a volatile year for many stock market investments. Therefore, this could be an ideal time to recognize built-up losses in taxable accounts. Recognizing capital losses is a common strategy to reduce taxable income, but purchases of substantially identical securities can result in the disallowance of those losses via the wash sale rule. In general, this rule disallows a loss resulting from the sale of stock or securities, if, within the restricted period (a 61-day period beginning 30 days before the sale), the taxpayer "acquires", or enters into a contract or option to acquire, ***substantially identical*** stock or securities. In addition, a loss from closing a short sale is similarly disallowed where, within the restricted period, substantially identical stock or securities are sold or another short sale of identical stock or securities is entered into.

***** Reminder:*** Long-term capital losses are used to offset long-term capital gains before they are used to offset short-term capital gains. Similarly, short-term capital losses must be used to offset short-term capital gains before they are used to offset long-term capital gains. Individuals may use up to $3,000 of total capital losses in excess of total capital gains as a deduction against ordinary income and may also carry capital losses forward indefinitely. Below is a list of strategies, ranging in complexity:

- ***Sell long stock at a loss or cover short sale at a loss and wait 31 days to buy back or re-short the same security to avoid triggering the wash sale rule.*** With this strategy (assuming you have not purchased or shorted additional shares within the restricted wash sale period), there is no need to navigate through the complex wash sale rule since you are selling off the position and waiting the applicable 31 days after the sale before repurchasing or re-shorting the same security position.

- ***Sell long stock at a loss and purchase a call option:*** The taxpayer would (1) sell the stock and recognize the loss; (2) the next day, purchase a call option (an at or out-of-the-money call option will suffice) – which triggers the wash sale rule; (3) the following day, repurchase the stock and (4) sell (either later that day or the following morning) the call to recognize the loss. Note that this last step (4) will not trigger the wash sale rule. Therefore, the taxpayer in this example can buy back the shares in less than 31 days as long as they bought a call option on the same stock in between the two transactions.

- ***Sell long stock at a loss or cover short sale at a loss and replace the investment with an exchange traded fund (ETF) tied to the company's industry or sector.*** In this way, the ETF effectively serves as a temporary approximate substitute for sold stock(s) and still enables you to recognize the loss on your original position that was sold at a loss – without incurring the wrath of the wash sale rule since the ETF will not be deemed substantially identical to the disposed of securities.

  ***** Observation:*** This transaction can be further enhanced using index options – which are marked-to-market at year-end for tax purposes. One would sell an ETF that they are holding at a loss and then buy an option on the index the ETF references. As discussed above, the buying of the option triggers the wash sale rule and the losses from the ETF increase the cost basis of the index options. Said losses are then realized through the mark-to-market of the index options.

- ***(Cover) short sale at a loss and purchase a put option:*** Note that the wash sale rule will apply if the taxpayer (within the restricted period) executes another short sale with respect to substantially identical stock or securities. The wash sale rule in this respect (cover a short and buy a put option) is anything but clear with many practitioners believing this is a wash sale while others believing that it is not.

  Therefore, a cautionary best practice would be to employ a strategy similar to the "Purchase a call option strategy" discussed above where the taxpayer would (1) cover the short and recognize the loss; (2) the next day, purchase a put option – which triggers the wash sale rule; (3) the following day, re-short the stock and (4) sell (either later that day or the following morning) the put option to recognize the loss. Note that this last step (4) will not trigger the wash sale rule since the selling of a put at a loss will only be deemed a wash sale if the taxpayer buys another put with the same expiration date as the previously disposed of put within the restricted period.

- ***Sell long stock at a loss and sell a put option (or "write a put"):*** Where a taxpayer sells a long stock at a loss but seeks to remain economically at risk with respect to the stock, the wash sale rule seems to present an obstacle. Not only is the taxpayer barred from reacquiring the stock during the restricted period, the law also forbids the acquisition of a call option within this same period.

  A large degree of exposure can be attained if the taxpayer, within the restricted period, sells (writes) a put option; a transaction not covered by the current wash sale rule.

  **** Caution:*** Some care needs to be exercised in writing the put as IRS guidance states that if a taxpayer sells stock at a loss and within the restricted period sells a put option, the sale of the put option ***"may"*** trigger the wash sale rule. The IRS guidance appears to allow the sale of puts only if they are "not likely to be exercised". Given that there are no clear guidelines for this "not likely to be exercised" standard, most practitioners advise the writing of puts that are either at-the-money or out-of-the-money.

- ***Sell long stock at a loss and enter into a total return swap:*** Where the taxpayer sells a long stock at a loss and, within the restricted period, enters into a total return swap on the same security, we believe that this transaction will trigger the wash sale rule and the loss on the stock sale will be added to the basis of the swap. If the taxpayer or fund is marking to market its swaps, the swap contract in this transaction will be marked to market at year-end and the deferred loss will be recognized.

  ***** Observation:*** Since swaps that are marked to market generate ordinary income or loss, it is conceivable that this transaction allows a conversion of a capital loss (via the original stock loss deferred under the wash sale rule) to an ordinary loss (via the mark to market of the swap at year-end).

  ***** Observation:*** Properly executed basket swaps could also be used to change your economic exposure without causing adverse tax consequences.

Tax Planning using the Wash Sale Rule to your Advantage

As referenced above, the wash sale rule was designed to discourage taxpayers from selling securities at a loss simply to claim a tax benefit. Recall that assets that are not stock or securities (such as gold or gold ETF, currencies, bitcoin) are not subject to the onerous wash sale rule. For example, if you sell bitcoin at a loss, you can buy bitcoin again without running afoul of the wash sale rule. Also, with proper planning and the appropriate facts, the wash sale rule can be used to your advantage, some examples as follows:

- ***Purposely trigger the wash sale rule and postpone loss recognition:*** Assume that you recently sold stock at a loss in 2019 and then realize that the loss is going to offset long-term capital gains (taxed at a preferentially lower tax rate than short-term capital gains) and you want to postpone recognizing the loss until 2020. If the loss is within the restricted period, simply repurchase the shares so that the loss gets deferred under the wash sale rule; the loss will then get included in the basis of the newly repurchased shares and will not be recognized in 2019.

- ***Converting Short-Term Capital Gains into Long-Term Capital Gains:*** Stock that has fallen in value is often sold before attaining long-term holding status in order to benefit from short term capital loss treatment. If you notice that the stock price has risen shortly after a sale at a loss, you can repurchase the stock within the restricted period, and the holding period you had attained on the previously sold shares will be “tacked” on to the holding period of the newly acquired shares. As a result, if you then find yourself with an overall gain on the repurchased shares, you can take advantage of the long-term capital gains rate assuming the combined holding period of the two lots of stock exceeds one year.

- ***Converting Long-Term Capital Losses into Short-Term Capital Losses:*** The taxpayer would (1) sell the stock and recognize the long-term capital loss; (2) within the restricted wash sale period (perhaps the next day), purchase a call option on the sold stock – which triggers the wash sale rule; (3) exercise the call option – sell the stock received through the exercise of the call. As described above, the loss on the initial sale is disallowed as a wash sale due to the purchase of the call option within the restricted wash sale period. The disallowed loss is added to the tax basis of the call option, as is the long-term holding period. The exercise of the call option, however, starts a new holding period of the stock. The tax basis of the call option including the disallowed loss from the original stock sale is added to the basis of the stock received through the exercise of the call. The subsequent sale of the stock, assuming held for less than one year, is a short-term capital loss.

Using Constructive Sales to “Accelerate” or “Defer” Capital Gains

You should consider your tax situation in 2019 as well as your projected tax situation in 2020 in order to determine if it would be best to generate additional realized capital gains this year or next. Varying concerns may prompt some taxpayers to reduce their exposure in some of their stock investments. If planned correctly, the affirmative use of the constructive sale rules may allow a taxpayer to hedge an appreciated position through the end of the year and can give the taxpayer the ability to accelerate capital gains into 2019 or defer capital gains recognition to 2020 and beyond.

Assume that you have substantial unrealized gains in your portfolio which have aged to Long Term (“LT”) and you would like to buy some more time in order to decide when to recognize the capital gain…

- You can enter into an offsetting position and cause a constructive sale and potentially realize the gain in 2019.

- If the status of your tax picture for 2019/2020 is more clear towards the end of January 2020, you still have time to :
    - Unwind the constructive gain(s) by utilizing the “short term hedging exception” – thereby continuing to defer the LT unrealized gains to 2020 and beyond.

- If the status of your tax picture for 2019/2020 is more clear by early to mid-March 2020, you still have time to :
    - Violate the 60-day un-hedged portion of the short term hedging exception in order to recognize the constructive gain(s) in 2019.

In summary, taxpayers seeking to preserve gains in the face of year-end uncertainty may do so in a tax efficient manner without running afoul of the constructive sale rules.

***** Please refer to page 42 for a refresher on the Constructive Sales rules and the short-term-hedging exception.***

Examine Portfolio for "Worthless Security" Positions

For purposes of potential worthless securities deductions, securities include:

- Stocks, including stock options
- Bonds, and
- Notes, commercial paper or debt instruments for debts owed by a corporation or government

Securities do not include stocks or debt instruments that aren't offered to the public for purchase or sale, or those issued by individuals.

A capital loss is available in the year a security position becomes totally worthless or is abandoned. The concept of worthlessness is based on facts and circumstances and could have many interpretations. A taxpayer generally must establish that the security position had a basis, was not worthless before the year worthlessness is claimed and became worthless in the year claimed. One must demonstrate both balance sheet insolvency and a complete lack of future potential value. Balance sheet insolvency entails proving that liabilities exceed assets in the year of worthlessness. Even though the balance sheet may show insolvency, the stock of the corporation could possibly have some value in the future. Therefore, the taxpayer must also demonstrate the destruction of potential future value to establish current worthlessness.

**** Planning Opportunity:*** In many cases, where facts are not available and future potential value is not clear, many taxpayers sell the security position to an unrelated third party, for a nominal amount, in order to close the transaction, guarantee a capital loss and establish the year of deductibility. Generally, and for this purpose (disallowance of a loss), the IRS defines related parties to be the seller's immediate family: brother or sisters (whole or half-blood), spouses, ancestors and lineal descendants. In laws, for example, are not considered members of the seller's family.

Abandoning a Partnership Interest

Consider the following scenario: an individual has entered into a limited partnership that he/she knows is going bad, and he/she believes the investment will not be recovered. With careful planning, accelerating these losses into the current year to offset ordinary income could provide significant tax savings.

To the extent a partner has remaining adjusted (tax) basis in the partnership interest, the IRS has ruled that a loss incurred in the abandonment or worthlessness of a partnership interest is ordinary if there is no sale or exchange. However, to the extent the partner receives any consideration for the partnership interest in the form of monies or relief from liabilities, no matter the dollar amount, the abandonment or worthlessness will be treated as a sale or exchange subject to capital loss treatment.

The courts have ruled that a limited partnership can be abandoned if the following occur:

- The owner affirmatively intends to abandon the interest;
- There is an affirmative act of abandonment; and
- The intent and affirmative act are communicated to all interested parties.

If a partner determines that abandonment is the best option, there are only a few steps that must be completed within the current tax year. The IRS has made clear that the abandonment of a partnership interest should be accompanied by the partner’s notification of their intent and further documentation that all future rights have been abandoned.

The abandonment of a partnership interest is complex and many facts need to be considered. In determining whether taxpayers have taken sufficient actions so as to abandon their interests, courts have noted facts such as a taxpayer having no further dealings with the abandoned partnership, no expectation to receive anything and not actually receiving anything further in later years.

***** Practice Tip:*** It is a good idea to check the partnership operating agreement to see whether it has a process for giving up the interest and withdrawing from the partnership. If not, a letter to the general partner (and to all other partners, if practical) stating the wish to abandon the interest in the partnership, the intent to have no further dealings with the partnership and that there is no expectation of further benefits from the partnership is a good way to establish abandonment. Although not required, the letter should also ask the general partner to send a confirmation that the abandonment was accepted and that the partnership will no longer treat the taxpayer as a partner.

***** Caution:*** Confirm that state law does not impose any additional requirements upon withdrawing or exiting partners.

Mark-to-Market Election (§475(f))

This election is available to traders in securities and should be considered and discussed where all (or most) of the buying and selling of securities by the taxpayer is short-term. The election generally converts all trading gains and losses (both realized and unrealized) to ordinary income or loss. Funds (or other taxpayers) that elect mark-to-market treatment are not subject to wash sale, straddle, constructive sale and other complex tax rules. However, the election, in general, eliminates the potential significant tax benefits of long-term capital gain treatment and the deferral of any unrealized gains. However, electing traders can still hold a separate investment securities account to age certain securities to long term and which is not subject to the mark-to-market regime discussed above.

The mark-to-market (trader) election must be filed no later than the unextended due date of the tax return for the tax year immediately preceding the election year and must be attached either to that return or, if applicable, to a request for an extension of time to file that return. For example, if the election is to be effective for the 2020 tax year, and assuming the taxpayer is an individual, the election would need to be made by April 15, 2020 (March 15, 2020 with respect to calendar year S Corporations and Partnerships). This, in effect, provides the taxpayer a few months at the start of the year to determine if making the mark-to-market election would be beneficial.

**** Planning Opportunity:*** If you have significant unrealized losses in your trading portfolio in late 2019 (and you qualify as a trader and are therefore eligible to make the §475(f) election), you could benefit by continuing to hold those securities until the following year (2020). You could then make the §475(f) election for 2020 and deduct the mark-to-market losses in 2020 as ordinary losses rather than selling the securities in 2019 and recognizing capital losses, which are subject to limitations on deductibility.

475(f) Revocation Procedures: There are provisions allowing taxpayers to revoke a Section 475(f) election. If you've made a valid election under section 475(f), the only way to stop using mark-to-market accounting for securities is to file an automatic request for revocation under Revenue Procedure 2017-30, Section 23.02. Under that revenue procedure, the request for revocation must be filed by the original due date of the return (without regard to extensions) for the taxable year preceding the year of change. This revocation notification statement must be attached to either that return or, if applicable, to a request for extension of time to file that return.

***** Planning Opportunity:*** Taxpayers may wish to revoke a Section 475(f) election to benefit from any future appreciation of long-term capital gains because the 475(f) election does not affect holding period.

*****Caution:*** However, taxpayers revoking this election may not make another mark-to-market election for five years after the revocation.

Short Sales and Losses

It's the time of year when you should examine your portfolios and seek to harvest built-in tax losses. However, short sellers who wish to harvest losses should keep a close eye on the calendar as well as be wary of the wash sale rule (discussed earlier). Investors looking to cover short security positions by year-end should be aware of the trade date rule. The trade date rule governs whether the gain or loss from the disposition of a security is taken into account on the trade date or on the settlement date. The date that's used for tax purposes depends on whether you have a gain or a loss:

- If you're closing a short position at a profit, the trade date controls the timing for tax purposes.
- If you're closing a short position at a loss, however, the settlement date will control.

If you close a short sale at a loss late in the year in 2019 through the delivery of shares and you have to purchase the shares in the market, you need to allow at least two business days for the settlement of the purchased shares in order to be able to deliver them to cover the short position ***and*** to deduct the capital loss in 2019. Therefore, the purchases-to-cover should take place with enough time for them to settle before year-end. Note that if the purchases-to-cover positions are purchased too late in the year and settle in 2020, the short cover capital losses will be deferred until 2020.

**** Planning Opportunity:*** To avoid running afoul of this settlement rule, be sure to close out your short sales early enough in December to recognize the loss in 2019. Note that the last trading day of the year is Tuesday, December 31, 2019.

Foreign Currency Election - Tax Savings for Some…

The IRS has special rules for "§988 transactions." These are transactions in which the amount the taxpayer is entitled to receive or required to pay is denominated in terms of a nonfunctional currency or determined by reference to the value of one or more nonfunctional currencies. Transactions covered under §988 include entering into or acquiring any forward contract, futures contract, options or similar financial instrument. By default, foreign currency transactions are treated as ordinary income or loss under Section 988. The good news is Section 988 ordinary losses offset ordinary income in full and are not subject to the $3,000 capital loss limitation.

Taxpayers with significant trading in foreign currency forwards should consider making an election under Section 988(a)(1)(B). This election would allow for the treatment of gains (and losses) from these foreign currency contracts as capital gains and losses rather than ordinary income or loss. This election could be especially beneficial for certain foreign currency contracts, which would normally be treated as ordinary income for tax purposes, that now would be taxed at 60% long term capital gain rates and 40% short term capital gain rates, irrespective of how long the foreign currency contract has been held. The 60/40 capital gains tax rates would apply to foreign currency forwards on "major currencies" – currencies for which regulated futures contracts (RFCs) trade on U.S. futures exchanges. This election is required to be made when the foreign currency contract is entered into and cannot be or become part of a straddle.

Business Interest Expense Limitation

The TCJA added new IRC section 163(j), which significantly restricts the deductibility of interest paid or accrued by certain private investment funds that are engaged in a trade or business for tax years beginning after December 31, 2017, including interest paid on existing indebtedness. The term business interest would not, however, include investment interest (as described under §163(d)). The deduction for business interest expense is generally limited to the sum of business interest income plus 30% of adjusted taxable income. For this purpose, adjusted taxable income is determined at the entity level for partnerships and generally is earnings before interest, depreciation, amortization or depletion for tax years beginning before 2022 with no such addbacks for taxable years thereafter.

The law contains certain exceptions as follows:

- A small business exception excludes from this limitation a business whose average gross receipts do not exceed $25 million. However, certain commonly controlled businesses will need to be aggregated to determine if this income requirement is satisfied.

  ***** Caution:*** The business interest expense limitation also applies to tax shelters, irrespective of the $25 million threshold discussed above. For these purposes, a partnership or S corporation that allocates more than 35 percent of its losses for the year to limited partners or limited entrepreneurs is considered a tax shelter.

  ***** Observation:*** There was a problem with the IRS regulations used to determine whether businesses needed to be aggregated for determining whether average gross receipts exceed $25 million. The intention was to use attributions that would provide for constructive ownership between family members, from entities to their owners (and vice versa) and to treat stock subject to an option purchase as being owned by the option holder. Note that the published regulations referred only to the option attribution rule. The IRS then republished the regulations including the full constructive ownership rules. However, the IRS also noted that it "would not upset conclusions reached using the previous regulations for 2018 and 2019 tax filings. This could provide a timely opportunity for 2018-2019 for taxpayers to fall under the $25 million threshold.

- Certain businesses can elect out of this interest limitation such as an electing real property trade or business or an electing farming business. The cost of this election is that the business is required to use the Alternate Depreciation System (ADS) instead of the normal cost recovery rules. ADS requires the use of longer lives and the use of a straight-line method. More importantly, those required to use ADS cannot take bonus depreciation on the acquired assets.

For S corporations, partnerships and LLCs that are treated as partnerships for tax purposes, this limit is applied at the entity level rather than at the owner level. Any business interest disallowed at the entity level in a taxable year is allocated to the partners and may only be deducted by them against excess adjusted taxable income allocated to them from such partnership in a future year. Amounts that cannot be deducted in the current year can generally be carried forward indefinitely.

Carried Interest – All Clear Ahead?

The TCJA added Section 1061 to the Internal Revenue Code and increased the holding period required for long-term capital gains treatment from more than one year to more than three years for an applicable partnership interest (API).

Section 1061 applies to certain items with respect to "partnership interests held in connection with performance of substantial services" in investment management. For carried interest, the holding period for long-term capital gain treatment is more than 3 years (rather than 1 year); capital gain from an asset with a holding period of 1-3 years is re-characterized as short-term capital gain.

The capital interest portion of a partnership interest is not an API. Under Section 1061, a capital interest is defined to include "any capital interest in the partnership which provides the taxpayer with a right to share in partnership capital commensurate with the amount of capital contributed (determined at the time of receipt of the partnership interest). If a hedge fund professional is issued a capital interest, his pro rata share of profits based on invested capital is not an applicable partnership interest.

> ***** Open Questions***: Is prior years' carry, not withdrawn from the fund, subject to the new carry rule? If so, what about prior taxed carry left in the fund?

In order for a partnership interest to be an API, it must be issued in connection with the performance of substantial services in an "applicable trade or business". An applicable trade or business is an activity that consists, in whole or in part, of (a) raising or returning capital, and (b) either (1) investing in or disposing of "specified assets," or (2) developing specified assets. Specified assets include securities, commodities, real estate held for rental or investment, options or derivative contracts with respect to the foregoing assets, or an interest in a partnership to the extent of the partnership's interest in the foregoing assets. This brings most profits interests issued to financial professionals in deals involving investors within the potential scope of Section 1061.

> ***** Open Question:*** It is implied that a profits interest is not subject to Section 1061 if it is "held by a person who is employed by another entity that is conducting a trade or business (other than an applicable trade or business) and only provides services to such other entity." If George is the CEO of a private equity firm's portfolio company and is rewarded with the grant of a profits interest in the private equity fund (a limited partnership), the preceding sentence would appear to take that interest outside the scope of IRC Section 1061.

Carried Interest Exceptions

Held on behalf of third-party investors: It is anticipated that the IRS will issue regulations addressing the circumstances under which the provision would not apply to "income or gain attributable to an asset not held for portfolio investment on behalf of third party investors."

> ***** Open Question:*** It's unclear what this exception is intended to address, but presumably the exclusion could apply to a hedge fund or private equity firm's ownership of investment or business assets in LLCs that don't include outside investors.

Does Section 1061 apply all capital gains or income taxed at preferential tax rates? Section 1061(a)(2) implements the increase in the required long-term capital gains holding period by referencing paragraphs (3) and (4) of IRC § 1222 and substituting 3 years for 1 year in those provisions. However, this change doesn't appear to directly affect or apply to the separate one-year holding period requirement for Section 1231 property.

> ***** Open Question:*** At this time it is still not clear whether this failure to bring Section 1231 property, Section 1256 or qualified dividends within the scope of Section 1061 is intentional, but there are numerous glitches and drafting errors and oversights in the TCJA. Therefore, unless Section 1061 is amended or the IRS takes some other step to extend the scope of Section 1061 to the above-referenced provisions, it appears that Section 1231 property, Section 1256 and Qualified Dividends are excluded.

Corporation: Section 1061 provides that it doesn't apply to profits interests issued to corporations.

> ***** Open Question:*** Does this mean that a profits interest held through an S corporation escapes Section 1061? The IRS has indicated that it will issue administrative guidance answering this question by confirming that S corporations are not a workaround for avoiding Section 1061. However, whether the IRS can be successful without a technical corrections bill, is far from clear.

> ***** Caution:*** A thorough discussion and analysis should be undertaken with your tax advisors if you are contemplating the use of an S corporation to hold your carried interest allocations. Also, as we go to press with this alert, the Treasury Department recently announced that is it planning to issue carried interest regulations in early 2020. It is likely that they will attempt to address and bar fund managers from using S corporations to take advantage of this exception.

***** Section 1061 Planning Opportunities:***

- At the Portfolio Company (PC) level, use dividends in order to reduce the exit proceeds that will be subject to the new 3-year carry rule.
- At the Fund level, distribute the PC stock to the carry vehicle; whereby the carry vehicle will hold the stock until the gain is eligible for the preferred tax rate.
- Adjust carry allocations (i.e., hard-wired waiver) whereby no carried interest is earned from assets with a holding period that is not greater than 3 years. Should include a catch-up provision for future allocations from assets with holding periods of more than 3 years.
- Structure the carry vehicle as a Corporation – either U.S. or non-U.S.

International Tax Focus – Private Investment Funds

The TCJA continues to have an impact in the international tax arena in 2019. Thus far, the year has brought forth IRS notices and regulations (both final and proposed) that expanded on provisions of the TCJA and provided clarity on a variety of topics. Two of the major TCJA provisions related to international taxation are the Global Intangible Low-Taxed Income (GILTI) and Foreign-Derived Intangible Income (FDII) regimes.

The following represents a brief discussion of these provision as well as planning opportunities that should be considered for 2019 and future years.

- ***Global Intangible Low-Taxed Income (GILTI):*** Originally introduced under TCJA on the heels of the section 965 repatriation tax, with additional regulations released this past year in hopes of providing clarity to those U.S. taxpayers that were caught up in the TCJA's revamped international tax regime. This provision was designed to deter the deferral of offshoring earnings and basically functions as a current income inclusion on undistributed foreign earned income, equal to the income earned by certain foreign corporations with U.S. shareholders that exceeds 10% of that foreign corporation's depreciable tangible property. Although the word "intangible" is part of the GILTI acronym, this provision can potentially apply to all offshore operating income. Currently, only domestic corporations are generally allowed a deduction of 50 percent of their GILTI inclusion and can additionally claim a foreign tax credit of up to 80 percent of foreign income taxes paid or accrued on GILTI inclusions.

    ***** Observation & Caution:*** A GILTI high-tax exception was proposed in June of 2019 and, if finalized, may provide relief to taxpayers conducting business in foreign high-tax jurisdictions in future tax years. Under this proposed exception, income subject to tax in a foreign country at an effective rate greater than 18.9 percent would not be included in GILTI, at the election of the taxpayer. The election would apply indefinitely and generally can be changed at any time after the initial election and then once every five years thereafter. Planning into structures that can take advantage of the Subpart F high-tax exception may be an option.

    ***** Observation:*** Final regulations issued in June 2019 only require partners to pick up their portion of GILTI if they have more than 10% ownership. Prior to the final regulations, there was uncertainty as to whether or not all partners had to pick up their share of GILTI regardless of ownership percentage.

Note, however, the discussion above by which taxpayers can minimize the effect of the GILTI inclusion are generally only available to domestic C corporations. For pass-through entities and ultimately individual taxpayers that own controlled foreign corporations (CFCs), who would otherwise be subject to ordinary tax rates on their GILTI inclusions and potentially double taxed due to disallowed foreign tax credits, making a §962 election provides a path through which they may reduce the effect of their GILTI inclusion, but also lower their effective tax rate on the whole until distributions from the CFC are made.

- ***IRC Section 962 Election:*** This election allows certain U.S. individuals to elect to be treated as a domestic C corporation for federal income tax purposes with respect to Subpart F and GILTI income. Treatment as a domestic C corporation through a §962 election allows U.S. individual shareholders to be taxed at corporate rates on their GILTI inclusions, and to take advantage of the 50% GILTI deduction, while affording them the ability to utilize foreign tax credits. The election can lessen the U.S. tax on GILTI inclusions if the foreign income tax rate on such income is at least 13.125%. This result can be achieved by election, without the need to interpose a corporation in the structure.

  ***** Observation & Caution:*** When a distribution is made from the CFC to the U.S. shareholder, it will be taxed as an ordinary dividend with no ability to claim foreign withholding tax credits. Thus, any reduction in taxes as a result of the 962 election are temporary until a distribution is made. The timing of the distribution may result in a mismatch of foreign withholding tax credit usage which ultimately may increase the overall tax burden, thus planning for deferral of distributions may be a key element to managing cash taxes appropriately.

- ***Corporate Shareholder:*** Certain U.S. individual shareholders owning shares of foreign entities operating in non-treaty countries, may find that interposing a domestic C corporation to own their foreign entities may provide a more attractive tax-planning alternative than the §962 election discussed above. While both the §962 election and use of a C corporation intermediary grant taxpayers the ability to lessen the effect of GILTI inclusions, using a C corporation provides taxpayers with an important benefit that the §962 election does not → the ability to be taxed at qualified dividend rates (capped at 20%) on dividend distributions from foreign non-treaty entities. Without interposing a domestic corporation in the structure, dividend distributions from non-treaty corporations would not be eligible for qualified dividend treatment and thus would be taxed at ordinary individual income tax rates.

  - ***Dividends Received Deduction (DRD):*** Under the TCJA, domestic C corporation shareholders are entitled to a DRD for dividends received from foreign corporations that are greater than 10% owned and for which certain holding period requirements are met. U.S. taxpayers utilizing a domestic corporation in the ownership chain can have such corporation receive dividends from its foreign subsidiary without U.S. tax by virtue of the DRD. Additionally, once income is distributed from the corporation to its shareholders, such income will be taxed to the U.S. individuals at qualified dividend rates, which potentially reduces the income tax rate imposed on foreign subsidiary income from ordinary tax rates to a maximum (qualified dividend) rate of 20%.

    ***** Caution:*** Careful planning and analysis should be undertaken to determine the viability of this alternative since the use of a domestic holding corporation may involve various state corporate taxation issues as well as added foreign tax consequences.

- ***Foreign-Derived Intangible Income (FDII):*** Also introduced under the TCJA, a U.S. C corporation that provides services and makes sales to foreign customers located outside of the U.S. now has the ability to take a deduction on its foreign-derived intangible income ("FDII"). FDII was intended to encourage on-shoring of intellectual property (IP) by providing an incentive for U.S. entities to develop their intangibles inside the U.S. rather than in foreign localities. While mechanically the FDII deduction can be quite complex, the framework for calculating the deduction amount generally works as follows:
    - FDII-eligible income constitutes net income earned by domestic C corporations from the sale of property or provision of services to foreign persons or entities over a certain threshold.
    - The threshold is 10% of the corporation's U.S. depreciable tangible property. The excess income over the threshold is multiplied by the applicable current year rate of 37.5%, and the result is the corporation's FDII deduction.
    - The FDII deduction can effectively reduce the corporate tax rate on applicable earnings from 21% to 13.125%. Notably, this deduction is available only to domestic entities taxed as C corporations, and is effective for tax years beginning on or after January 1, 2018 (and the effective rate will change from 13.125% to 16.4% in 2026).

***** Observation:*** The interplay between the corporate GILTI deduction and FDII is deliberate and has its own set of ordering rules when calculating how much deduction is available under both regimes. Thus planning into FDII vs. GILTI needs to be done from a holistic point of view.

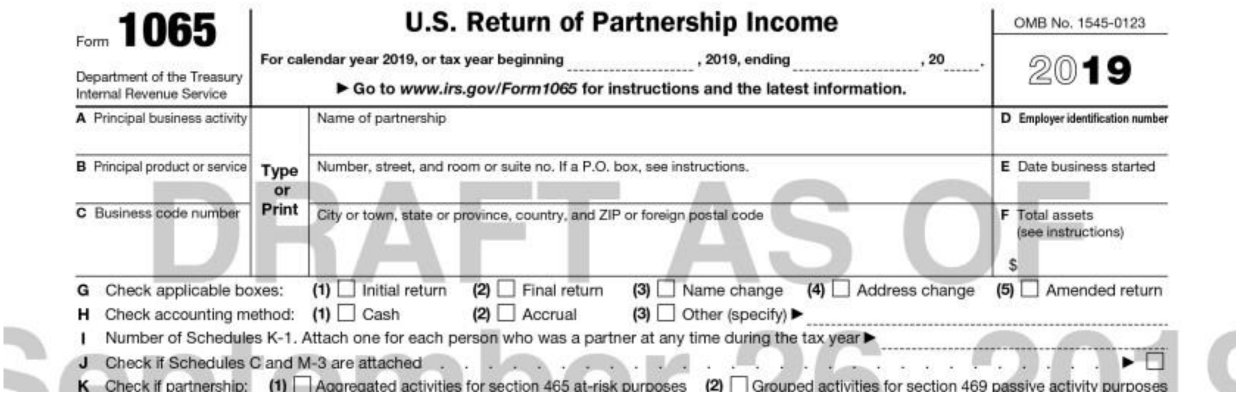
Complying with the *New* Partnership Audit Rules

Effective for audits of tax years beginning after December 31, 2017, new rules significantly altered partnership audits by transferring liability for payment of audit adjustment assessments from the partners to the partnership itself (assuming the partnership does not elect out of these rules or make a push-out election).

Under the old partnership tax audit rules, in the event that an item of partnership income or loss is adjusted in an IRS audit, an entity that is treated as a partnership for U.S. tax purposes issued amended Schedules K-1 to the investors that were partners of the partnership during the year under audit. These investors were then required to amend their own tax returns for that year and pay any tax, interest and penalties on the shortfall resulting from their allocable share of the audit adjustment.

Under the new partnership tax audit rules, in the event that an item of partnership income or loss is adjusted in an IRS audit, an entity treated as a partnership for U.S. tax purposes will be liable for a tax (plus any interest and penalties) equal to the amount of the adjustment multiplied by the highest marginal tax rate). The partnership can then either pay the amount or make a push-out election to push the audit adjustment out to the investors. If the partnership decides to pay the amount, the partnership may be able to reduce the audit adjustment by demonstrating to the IRS that a portion of its current investors either would be exempt from tax or taxed at lower rates or by having the investors voluntarily agree to amend their tax returns to include their share of the audit adjustment. If the partnership decides to make a push-out election, the audit adjustment would be "pushed out" to investors that were partners of the fund during the year (or years) under audit. Such investors would be liable for the tax, interest (at a higher rate than the standard underpayment interest rate) and penalties directly at their tax filing level.

To comply with these new rules, partnerships need to designate a partnership representative, review ownership structures and, if they have not already done so, amend partnership and operating agreements. In addition, partnerships may want to obtain indemnification agreements from partners leaving the partnership in order to maintain the ability to recover the portion of any tax paid at the entity level upon audit for years in which those individuals were partners. Also, while it is always good to assess risk on tax positions taken, it is recommended that you review and assess any and all tax positions with your service providers going forward. The new partnership audit rules will make it easier for the IRS to audit partnerships so the consensus seems to be that there will be an uptick of partnership audits in the foreseeable future.


Form **1065**
Department of the Treasury
Internal Revenue Service

U.S. Return of Partnership Income
For calendar year 2019, or tax year beginning , 2019, ending , 20 .
▶ Go to *www.irs.gov/Form1065* for instructions and the latest information.

OMB No. 1545-0123
2019

A Principal business activity
B Principal product or service
C Business code number
Type or Print
Name of partnership
Number, street, and room or suite no. If a P.O. box, see instructions.
City or town, state or province, country, and ZIP or foreign postal code
D Employer identification number
E Date business started
F Total assets (see instructions)
$

G Check applicable boxes: (1) ☐ Initial return (2) ☐ Final return (3) ☐ Name change (4) ☐ Address change (5) ☐ Amended return
H Check accounting method: (1) ☐ Cash (2) ☐ Accrual (3) ☐ Other (specify) ▶
I Number of Schedules K-1. Attach one for each person who was a partner at any time during the tax year ▶
J Check if Schedules C and M-3 are attached . . . . ▶ ☐
K Check if partnership: (1) ☐ Aggregated activities for section 465 at-risk purposes (2) ☐ Grouped activities for section 469 passive activity purposes

DRAFT AS OF September 26, 2019

New Draft of 2019 Form 1065 K-1

The IRS recently released a draft of the 2019 Form 1065 schedule k-1. Some of the important changes to note are as follows:

The partner's capital account must be reported on a tax basis. In prior years, the partner's basis could be reported as tax basis, GAAP, §704(b) book or other. Requiring tax basis reporting will help the IRS to target potential losses claimed and/or withdrawals in excess of basis.

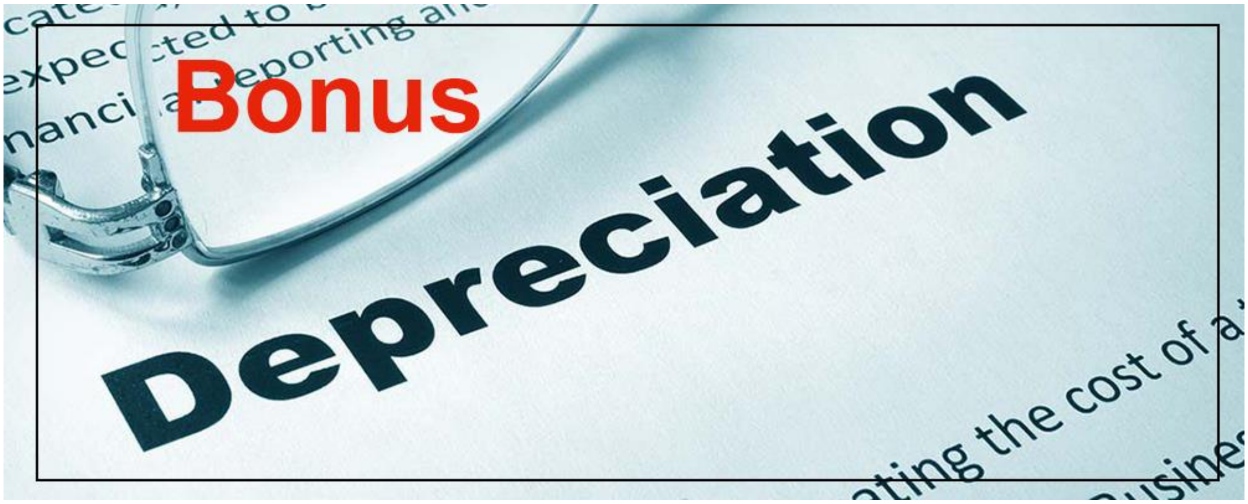
- The partner's beginning and ending §704(c) gain (or loss) must be entered at Part II, N. If the basis of contributed property differs from its FMV at contribution, §704(c) requires gain (or loss) with respect to such property to be allocated to the contributing partner. The purpose of §704(c) is to prevent taxable gain or loss inherent in property at the time of contribution from being shifted to another partner.

- Separate lines have been added for guaranteed payments for services and guaranteed payments for capital (Part III, lines 4a and 4b).

- Lines 21 and 22 have been added to Part III to report "more than one activity for at-risk purposes" and "more than one activity for passive activity purposes."

- Section 199A information will be reported on a supplemental schedule, instead of being detailed on the K-1 itself. Part III, line 20, code Z will direct the partner to the attachment. The supplemental schedule will report (1) qualified business income, (2) W-2 wages, (3) unadjusted basis (UBIA), (4) REIT dividends and (5) PTP income. In addition, the supplemental schedule will report if the qualified business income is from a specified service trade or business (SSTB).

Please refer to our earlier alert (Recently Released Draft Partnership Instructions and Schedule K-1 Raise Questions) for additional information on these changes and how they can affect you and your business.



Bonus Depreciation & Section 179 Expense

All businesses should benefit from the rules increasing the amount of fixed/capital assets that can be expensed. There are specific rules for both §179 and bonus depreciation that should be considered during tax planning.

For assets acquired after September 27, 2017, and before January 1, 2023, bonus depreciation of 100% is allowed. The percentage of bonus depreciation is scheduled to be reduced in 2023 and later years. Property qualified for the bonus depreciation includes computer software, water utility property, qualified film, television, and live theatrical productions. Additionally, used property is now eligible for bonus depreciation.

In general, asset acquisitions that are new **or** used with a recovery period of 20 years or less qualify for bonus depreciation. Unlike the §179 deduction, bonus depreciation can create a net operating loss (NOL) and, therefore, doesn't have a carryforward period.

> ***** Caution:*** Commercial real estate qualified improvement property was supposed to be eligible for 15-year depreciation and 100% bonus depreciation. However, due to a TCJA drafting error, the language including this type of improvement as 15-year property was never written into the statute. Therefore, for qualified improvement property placed in service after 2017, the current law does not permit bonus depreciation, and 39-year depreciation applies.

As of January 1, 2018, Section 179 expensing increased to $1 million for tax years 2018 to 2022, with a phase-out threshold when acquisitions of section 179 property exceed $2.5 million for the tax year. These dollar amounts are indexed for inflation after 2018 (for 2019, Section 179 expensing increases to $1,020,000 and the phase-out purchase limit is now $2,550,000). Property eligible as section 179 property includes property used to furnish lodging and qualified real property improvements including roofs, heating, ventilation, air conditioning, fire, and security systems.

The immediate expensing of qualified assets may create current-year tax savings, but as part of tax planning discussions with your tax advisors, taxpayers should determine if immediate expensing is the right answer, especially considering the effects of other tax reform changes as well as from states decoupling from federal bonus depreciation rules and states that have not yet conformed to all aspects of the TCJA.

> ***** Caution:*** Despite the many benefits of bonus depreciation, recall that this tool only accelerates deductions. As the percentage of depreciation decreases, future taxable income would be higher as a result of taking bonus depreciation in current and prior years.

- ***Expense Lower Cost Purchases.*** In addition to Section 179 and bonus depreciation elections, also consider the new election that is available for "de minimis" asset purchases if certain requirements are met. With this election in place, your business may simply expense costs that fall below a specified level to the extent that the amounts are deducted for financial accounting purposes or in keeping with your books and records. The de minimis threshold can be up to $5,000 if your business has financial statements audited by an independent certified public accountant (CPA) or issued to a state or federal agency; the threshold is $2,500 for businesses without such financial statements.

  ***** Safe Harbor Election:*** Eligible small businesses can currently deduct the cost of repairs, maintenance and improvements to a building by taking advantage of an IRS "safe harbor" election. Note that this is an annual election that can be made on a building-by-building basis. To be eligible for the election:

  - The property owner's average annual gross receipts for the three prior tax years must be $10 million or less;
  - The building's cost or other unadjusted cost basis must be less than $1 million; and
  - The annual total cost of repairs, maintenance, or improvements to the building may not exceed the lesser of (1) $10,000 or (2) 2% of the building's unadjusted cost basis.

- ***Cost Segregation.*** Allows companies that recently built, renovated, expanded or purchased a building to identify, segregate and reclassify building-related costs that are currently classified as real property to shorter, depreciable lives. A cost segregation study identifies the portion of the building's cost that can be considered personal property or a land improvement and depreciate it over a shorter period of time than the standard depreciation life or 39 years (commercial building) or 27 ½ years (residential building). This could afford business owners several benefits, including larger tax deductions, accelerated depreciation options and increased cash flow.

Estate & Gift Tax Planning Reminders

Thoughtful estate and gift planning helps you preserve your wealth and pass it on to your designated beneficiaries. Proper planning can result in your family and other beneficiaries receiving what you had intended. Several provisions of the TCJA unlock new opportunities for gifting and estate planning. While tax reform retained the maximum federal estate tax rate of 40%, it doubled to $22.8 million the amount married couples can exempt from estate and gift taxes (adjusted annually for inflation). Like most individual tax provisions of the TCJA, this joint exemption amount will sunset to half the exemption in place after 2025 without additional legislative action. The gift tax continues to follow the estate tax exemption and rate. Any gift tax exemption used during life reduces the estate tax exemption available at death. Using up your exemption during life can be tax-savvy, depending on your specific situation and goals.

A few planning techniques you may want to consider are as follows:

- ***Annual Exclusion:*** The 2019 annual gift exclusion is $15,000. This exclusion is the amount that can be gifted per person per year tax-free. In addition, married couples can elect to split gifts. Utilizing this strategy, married taxpayers can gift up to $30,000 to an individual in 2019 before a gift tax return is required. Annual Exclusion gifting is an excellent way to reduce the value of a taxpayer's gross estate over time (without utilizing one's lifetime Exemption), thereby lowering the amount subject to estate tax.

- ***Lifetime Exemption:*** The 2019 lifetime gift exemption is $11,400,000 (indexed for inflation), which has increased significantly from the $5,490,000 exemption amount in 2017. This exemption is the total amount that can be gifted over the course of a donor's entire lifetime tax-free. The TCJA more than doubles the lifetime exemption, but it is scheduled to sunset at the end of 2025 unless Congress renews this provision. If not, the prior exemption amount will be restored, as indexed for inflation. Taxpayers living in states with no current state gift tax may wish to accelerate or focus on additional gifting of assets in 2019. Of course, your financial security and long-term objectives should be assessed and discussed before proceeding with such a gifting strategy.

***** Caution:*** Year-end 2025 is not the only deadline to consider. The 2020 presidential election could change the landscape for estate planning and reduce the lifetime exemption prior to 2025. For those considering using the increased exemption now, the IRS has issued regulations which confirm that gifts made utilizing the enhanced gift tax exemption will not be clawed back if the exemption is reduced.

- ***Portability Election:*** This election remains under the TCJA. It is a vital planning tool for taxpayers, especially if the death of a spouse occurs while the increased exemptions are in place. Portability allows the second spouse to have the benefit of the deceased spouse's $11.4 million exemption, even if the second spouse dies when a lower exemption amount is in effect.

  ***** Caution:*** An estate tax return will need to be filed when the first spouse dies in order to make the portability election, even if the gross estate is under the filing threshold. States may have different rules related to portability; therefore it is important to consider these rules as well to avoid wasting this election.

- ***Basis Step-up:*** No changes were made under TCJA to these provisions, which allow a step-up in tax basis for most inherited appreciated assets (excluding retirement accounts and annuities). Generally, basis is the amount paid for an asset. Upon death, the beneficiaries are allowed to increase the tax basis of an inherited asset to the fair market value at the date of the decedent's death. This is a taxpayer friendly provision that allows beneficiaries to be taxed on a much smaller capital gain, or none at all, should the inherited assets be greatly appreciated and the new owner desires to sell.

- Consider ***funding education through 529 plans*** by December 31, 2019 to apply 2019 annual gift tax exclusion treatment to the contributions. You can "front-load" 529 plans by making five years' worth of annual exclusion gifts to a 529 plan. In 2019, you can transfer $75,000 ($150,000 for a married couple splitting gifts) to a 529 plan without generating gift tax or using up any of your gift tax exemption. Also note that front-loading 529 plans may limit available state credits.

  ***** Caution***: Contributions to 529 plans are gifts to the beneficiary of the plan. Cash gifts and 529 contributions to the same beneficiary which total more than $15,000 ($30,000 for a married couple splitting gifts) will result in taxable gifts. Similarly, front-loading 529 plans limit the available tax-free gifts to that beneficiary for 4 additional years.

- ***Loans to Family Members***: Intra-family loans can be a solution for parents who'd like to help a child achieve specific goals, such as buying a home or starting a business, but would also like to child to have some "skin in the game" rather than simply gift the funds to the child. Note that the loans could also be from the child to the parents or between other family members or family trusts.

The minimum interest rate charged between family members is known as the Applicable Federal Rate (or AFR) where long-term (more than 9 years) loans to each other can be made at rates as low as 2.07% * -- and rates on loans for shorter periods can be even lower. It is a simple and effective estate planning mechanism for transferring wealth to children or grandchildren without gift tax. Note that when you make a loan to a family member, you must charge interest in order to avoid making a gift. To the extent that the family member earns a higher rate of return on the borrowed funds than the very low interest rate being paid, the excess or difference is effectively transferred free of gift taxes.

* This rate conveys a monetary/monthly basis. Please check with your Anchin relationship partner before pursuing such loans.

***** Observation:*** A family loan ideally creates a win-win situation for the borrower and the lender. However, if the family loan goes sideways, it may hurt your relationships as well as your credit scores. Before borrowing from or lending to family members, think through all of the possible consequences. If the loan still makes sense for both parties, be sure everyone is on the same page by putting the loan in writing and carefully tracking the repayments.

- ***Trusts and IRC Section 199A:*** The TCJA created a new Section 199A deduction (discussed earlier), which allows certain taxpayers a 20% deduction on qualified business income (QBI). The 199A deduction has taxable income limitations, based on the taxpayer's total income. In order to maximize the 199A deduction, taxpayers should consider utilizing non-grantor trusts, which are separate taxpayers, each eligible for the 199A deduction. The goal would be to create as many different non-grantor trusts as necessary so that each trust received the maximum amount of income before the phase-out threshold, thus allowing each non-grantor trust to qualify for a Section 199A deduction. Therefore, even if the grantor would not qualify for a Section 199A deduction against his or her total income, each trust would individually qualify for the Section 199A deduction.

  ***** Caution:*** The regulations under Section 199A prevent a taxpayer from establishing multiple trusts with the same grantor and beneficiaries for the principal purpose of avoiding income tax. For this purpose, a husband and wife will be treated as one person. Also carefully consider the administration issues of creating multiple trusts, maintaining separate bank or brokerage accounts, and filing additional tax returns which offset the potential 199A tax benefits of several trusts.

Charitable Contributions: Tax Strategies

The charitable deduction continues to be a flexible and beneficial option for philanthropically minded people to support the causes they hold dear and reap tax benefits for doing so. The tax rules governing charitable contributions remained largely intact under the TCJA with limitations on the charitable income tax deduction as follows:

- **Gifts to public charities**. Contributions of cash can be deducted up to 60% of the taxpayer's adjusted gross income (AGI), and the full fair market value (FMV) of appreciated property held over one year can generally be deducted up to 30% of AGI.
- **Gifts to private foundations**. Contributions of cash can be deducted up to 30% of AGI, and the full FMV of publicly traded securities (if owned for over a year) can be deducted up to 20% of AGI. The deduction for gifts of other appreciated property may be limited to the taxpayer's cost basis.

  ***** Caution:*** Deduction of contributions subject to the 30% and the 20% limitations are first reduced by the amount of cash contributions subject to the 60% limitation. Excess amounts not currently deductible can by carried forward for 5 years.

Understanding the tax strategies related to charitable contributions can help you decide how much to give, what asset to give and when to give, so you can provide the maximum amount to charity—and receive the maximum tax advantages for yourself. Some viable strategies are outlined below.

- ***Bunching Charitable Donations***: Prepaying charitable contributions on an alternating or every few years basis allows taxpayers to itemize deductions in the year contributions are made and use the standard deduction in years featuring little or no donations.
  - A **Donor Advised Fund (DAF)** is a vehicle that could be used and makes it easy for taxpayers to bunch donations. With it, the taxpayer is able to claim the charitable deduction in the year of funding the DAF, and can make grant requests to desired charities over a period of years.
    - If you would like to create a donor advised fund in 2019, you can establish one as late as December 31st; however, additional time may be required if you are planning on funding the account with anything other than cash. Our firm has established a donor advised fund as a simple accommodation to our clients and friends if you are interested in employing this tax saving technique.

- ***Charitable Lead Annuity Trusts (CLATs).*** CLATs are charitable trusts designed to pay an annual annuity to charitable beneficiaries, and then at the trust's termination the remaining assets are returned to the grantor or are assigned to family members. CLAT creators can enjoy a current income tax deduction for the present value of the payments expected to go to charity over the term of the trust. The discount rate is the IRS 7520 rate (currently 2.0% in December 2019).

**** Planning opportunity***: CLATs can be used to offset current income with charitable deductions, with the possibility of the remaining assets returning to the taxpayer or to family members. The CLAT can be designed to reduce current income tax, and have little or no gift tax (depending on who gets any remainder and the terms of the trust). The value of the remainder depends on the performance of the CLAT's assets. Performance returns in excess of the IRS prescribed rate (the 7520 rate) result in remainder assets that can be returned to the taxpayer or be assigned to family members.

- **Qualified Charitable Distribution (QCD) from an IRA.** If you are at least age 70½, have an IRA, and plan to donate to charity this year, another consideration to make a QCD from your IRA. This action can satisfy charitable goals and allows funds to be withdrawn from an IRA without any tax consequences. A QCD can also be appealing because it can be used to satisfy your required minimum distribution (RMD)—up to $100,000 for tax year 2019.

  QCDs may be appealing if you have few other deductions or if you are already close to your charitable deduction limitations. Because the tax-free QCD is never reported as a deduction, it is not counted against the charitable limits and does not require itemization to be effective.

  Alternatively, if you are subject to an RMD and have a desire to contribute to a charity, you could take the RMD proceeds as a taxable distribution and use them to make a charitable donation. Your IRA distribution would then be reported as income, but the subsequent charitable contribution using the proceeds from the RMD would generally offset the tax consequences—to the extent that the limits allow it.

What about Securities?

If you are contemplating making charitable contributions before year end, the most tax-efficient way to do this is to give appreciated publicly traded stock that has been held for more than a year. Doing so, donors receive a charitable contribution deduction equal to the fair market value of the securities contributed and escape paying capital gains tax (and the 3.8% surtax on net investment income) on their built-in appreciation. Also, the donation of appreciated, publicly traded securities does not require you to get a qualified appraisal to establish the value of your deduction. Note that this is a much better result than selling the stock, paying a capital gains tax, and then deciding to use the proceeds to make cash contributions to charity.

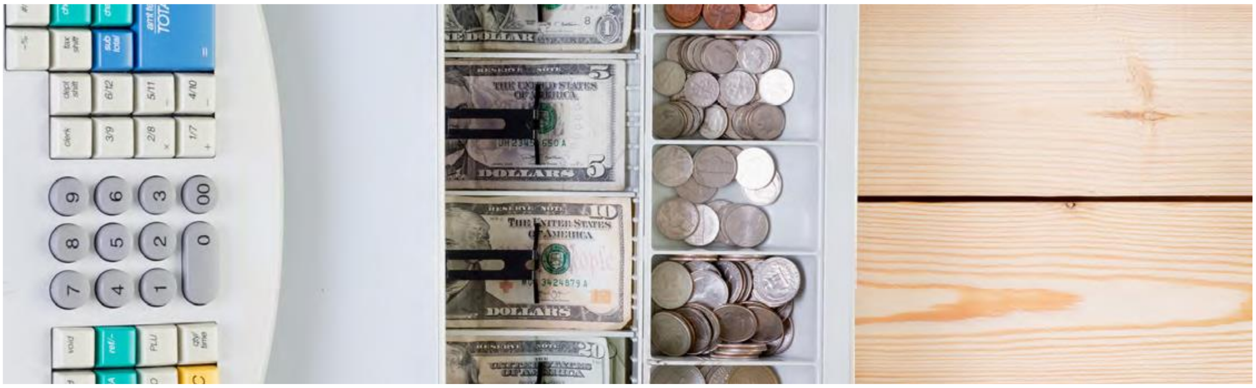
****** Caution & Reminder:*** Do not donate depreciated securities to charity. If this is the case, sell the securities first and then donate the proceeds to charity so that you can take the capital loss on the sale and get a charitable deduction for the donated cash.

****** Caution & Reminder:*** If you are planning on donating a non-publicly traded stock to a public charity, you are ***required*** to get a qualified appraisal to establish its value. Otherwise, you will only be entitled to a charitable deduction equal to your basis in the stock.

****** Caution & Reminder:*** The value of a donation of publicly traded securities held for a year or less is limited to the donor's cost basis.

**** Planning opportunity:*** Consider a partial non-liquidating distribution from investment partnership interests consisting of long-term appreciated securities in order to make charitable contributions.

Before undertaking any of the above giving strategies, you should consult your legal, tax or financial advisor. Nonetheless, each of the strategies, properly employed, represents a tax-advantaged way for you to give more to your favorite charities.



Constructive Sales – Rules and Reminder

Prior to the enactment of §1259 of the Internal Revenue Code by the Taxpayer Relief Act of 1997, taxpayers could lock in gains on appreciated financial positions, without the immediate recognition of income, by using such hedging strategies as short sales against the box. Effective for transactions entered into after June 8, 1997 such a transaction is deemed to be a constructive sale and the taxpayer must recognize gains (not losses) as if the position was sold, assigned or otherwise terminated at its fair market value.

> For example, assume a taxpayer holds a long (appreciated) security position. On July 1, 2019 the taxpayer shorted the same security ("short against the box"). If the transaction is a constructive sale, the gain is deemed to have arisen on July 1st and is taxable in 2019 even though the taxpayer has not sold a position and is still holding both the long and short position at December 31, 2019. If the transaction is unwound utilizing the "short term hedging exception" described below, then the gain is not taxable in 2019.

A short against the box will **not** be considered a constructive sale provided:

1. the offsetting position (in our example above, the short sale) is closed within 30 days after the year-end and
2. the appreciated long position is held "naked" for an additional 60 days (after the short offsetting position is closed).

Note: In order to avoid the constructive sale rules **both** tests must be met.
Caution: The closing of a short sale requires delivery. Accordingly, the short sale must be delivered or settled, and not just covered by January 30th of the succeeding year. When a short sale occurs in 2019, against an appreciated long position – the table on the following page illustrates the tax result.

Transaction	Amount Taxable	Year Taxable
Short closed by delivery of long position in 2019	Net appreciation at date of delivery	2019
Short closed by purchase in market in 2019, and long position held for an additional 60 days	Gain or loss on closing of short position Gain or loss on long position is deferred	2019 Date of disposition of long position
Short closed by delivery of long position by January 30, 2020	Gain on long position at date of short sale	2019
Short closed by purchase in market to settle by January 30, 2020, and long position held "naked" for at least 60 additional days	Gain or loss on closing of short position Gain or loss on closing of long position	2020 Date of disposition of long position
Both long and short positions still in place post January 30, 2020	Appreciation on long position at date of short sale	2019

Holding Period of Capital Assets – *A Refresher*

The holding period begins on the day after the acquisition date and ends with the date of sale. The dates on which securities are traded control, not the settlement dates. There are numerous transactions that will either terminate or suspend the holding period of a capital asset. These are summarized in the following table:

Long Position Held	Offsetting Transaction (1)	Effect on Holding Period
Short-term	(a) Short the stock	Terminated (2)
	(b) Buy put option	Terminated (2)
	(c) Sell deep-in-the money call option (5)	Terminated (2)
Long-term	(a) Short the stock	No effect (6)
	(b) Buy put option	No effect
	(c) Sell deep-in-the money call option (5)	No effect
Short or long term	Sell qualified call not in-the-money (3)	No effect
Short or long term	Sell qualified call in-the-money (3)	Suspended (4)

Notes:

(1) The effect of an offsetting transaction described above only applies to the extent of an equal amount of shares held long.

(2) The holding period of the long position terminates on the date of the specified transaction. A new holding period of the long position begins on the date the offsetting instrument expires or is sold.

(3) A qualified covered call must meet the following criteria: exchange traded, term of more than 30 days, not an ordinary income or loss asset, and not "deep-in-the-money."

(4) The holding period of the long position is merely suspended on the date of the specified transaction. The holding period begins to toll again once the offsetting instrument expires or is sold. There is a tack on of the holding period - the new holding period includes the old holding period.

(5) A deep-in-the money call option is generally where the call price is significantly less than the current market price of the underlying stock.

(6) A loss on the short position should be reclassified to long-term.