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2017 Year-End Tax Planning Alert

Be informed, be flexible and be ready to act

With Donald Trump in the White House and Republicans maintaining a majority in Congress comes the real possibility of some dramatic changes in tax law. As of the writing of this alert, however, these and other prospective tax law changes are still uncertain. While both the House and the Senate have passed tax reform bills, differences remain as both chambers meet to try and agree on a single piece of legislation before it is sent to President Trump for his signature. Both the House and the Senate are set to vote on a motion to go to conference. Congress is scheduled to adjourn for its Christmas break on December 15th, but House Speaker Paul Ryan has said that he will keep the House in session beyond that date if necessary to get tax reform passed.

As a result, many taxpayers may be considering a wait-and-see approach regarding tax planning. However, when it comes to year-end tax planning, procrastinating can be costly. Setting aside time to effectively plan requires that you have a good understanding of your current tax situation, as well as a reasonable estimate of how your circumstances might change next year. There's a real opportunity for tax savings but one needs to be informed, to be flexible and to be ready to act before the end of the year, if needed.

As we continue to monitor the prospects of 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.

Stick With Traditional Year-End Strategies?

It is generally always advantageous to push any income you can from one year into the next while pulling deductions into the current year since there is a time value to taxes you can pay next year instead of today. However, with the prospects for a rate cut and substantive tax reform as early as January 1, 2018, the concept of accelerating deductions into 2017, while rates are higher, and deferring income into 2018, when rates may be lower, could prove even more meaningful. Even though both the House and Senate tax reform proposals lower tax rates, some taxpayers could actually see an increase in their tax if the amount of deductions and credits eliminated or minimized will be more than the benefit of lower rates.

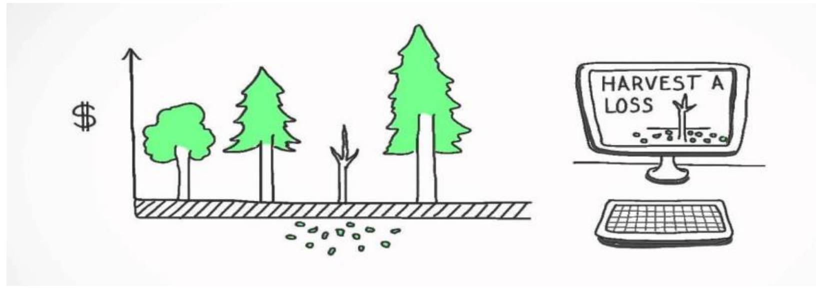
Knowing which areas are subject to change under the tax reform proposals should help taxpayers and their advisors identify where they might need to take action. The following traditional income and deduction acceleration techniques and their reciprocal deferral strategies should be considered:

Income Deferral/Acceleration:

- Defer/Receive bonuses before January
- Hold/Sell appreciated assets
- Accelerate income to use available carryforward losses
- Postpone/Complete Roth conversions
- Minimize/Maximize retirement distributions
- Delay/Accelerate billable services

Deductions and Credits Acceleration/Deferral

- Bunch itemized deductions into 2017 and take standard deduction in 2018 or do the reverse steps
- Pay bills in 2017/postpone payments until 2018
- Pay last state estimated tax installment in 2017/delay payment until 2018
- Watch AGI limitations on deductions/credits
- Watch net investment interest restrictions
- Match passive activity income and losses



Loss Harvesting & Other Planning Opportunities

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. In general, the wash sale 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.

Recall that 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 rules.*** 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 rules 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 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 rules since the ETF will not be deemed substantially identical to the disposed of securities.

- ***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 out-of-the-money call option will suffice) – which triggers the wash sale rules; (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.

- ***(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 rules 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. Since swaps that are marked to market generate ordinary income or loss, we believe that this transaction allows a conversion of a capital loss (via the original stock loss deferred under the wash sale rules) to an ordinary loss (via the mark to market of the swap at year-end). Properly executed basket swaps could also be used to change your economic exposure without causing adverse tax consequences.

- ***Purposely trigger the wash sale rule and postpone loss recognition:*** Assume that you recently sold stock at a loss in 2017 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 2018. If the loss is within the restricted period, simply repurchase the shares so that the loss gets deferred under the wash sale rules; the loss will then get included in the basis of the newly repurchased shares and will not be recognized in 2017.

- ***Purposely trigger the wash sale rules and tacked on holding period:*** 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 rules; (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

Notwithstanding a strong financial market and the uncertainty of tax reform, a number of taxpayers are sitting on large unrealized gains in their respective stock portfolios. Varying concerns may prompt some taxpayers to reduce their exposure in some of these 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 2017 or defer capital gains recognition to 2018 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…

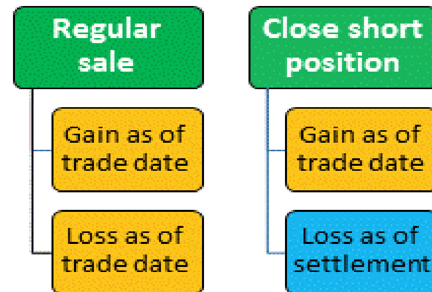
- You can enter into an offsetting position and cause a constructive sale and potentially realize the gain in 2017.

- If the status of your tax picture for 2017/2018 is more clear towards the end of January 2018, 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 2018 and beyond.

- If the status of your tax picture for 2017/2018 is more clear by early to mid-March 2018, 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 2017.

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 21 for a refresher on the Constructive Sales rules and the short-term-hedging exception.***



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 rules (discussed earlier). Investors looking to cover short security positions by year-end should be aware of the trade date rules. 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 2017 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 2017. Therefore, the purchases-to-cover should take place with enough time for them to settle before year-end. Note that if the buy-to-cover positions are purchased too late in the year and settle in 2018, the short cover capital losses will be deferred until 2018.

* ***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 2017. Note that the last trading day of the year is December 29, 2017.

** The SEC changed its rules (effective as of September 5, 2017) to require brokerage firms to cut the number of days to settle stock and bond trades from a maximum of three days to two days, a move to reduce market risk and harmonize standards with other nations. U.S. government securities, such as Treasury bonds and T-bills, are not part of the rule change since they are settled in one day.

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.

Abandoning a Partnership Interest

The economic environment has deteriorated the value of many investments, including partnership interests that do not offer any reasonable prospect of a return. A partner may own a partnership interest that becomes worthless (or nearly worthless) and these may be worth a second look before the end of this year. These partnerships may have little economic value but could produce a significant tax benefit for investors. 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, the abandonment or worthlessness will be treated as a sale or exchange subject to capital loss treatment.

If a partner can show that the partnership interest has been abandoned, the partner can take the loss even if the interest has some value left. A two-part test must be satisfied before a taxpayer can take an abandonment deduction for the investment. First, the taxpayer must show an intent to abandon the property, which is a subjective test. Second, the taxpayer must show an affirmative act of abandonment, an objective test.

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. 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 converts generally 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.

The Section 475(f)(1) election must be filed with a timely filed extension request (or a timely filed unextended tax return) for the previous year. For example, if the election is to be effective for the 2018 tax year, and assuming the taxpayer is an individual, the election would need to be made by April 17, 2018 (March 15, 2018 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 2017 (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 (2018). You could then make the §475(f) election for 2018 and deduct the mark-to-market losses in 2018 as ordinary losses rather than selling the securities in 2017 and recognizing capital losses, which are subject to limitations on deductibility.

New Revocation Procedures: Effective for tax year 2016 onward, new procedures were enacted 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. However, taxpayers revoking this election may not make another mark-to-market election for five years after the revocation.

Foreign Currency Election

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.

Planning for Owners of Passive Foreign Investment Companies

A passive foreign investment company (PFIC) is a foreign corporation that holds an average of more than 50 percent passive income-producing assets (those that generate royalties, rents, dividends, interest, capital gains) ***or*** more than 75 percent of the gross income is passive-type income. This test is applied each and every year, however, the principle "once a PFIC, always a PFIC" generally governs. Cash is included as a passive income-producing asset so sometimes corporations in the first years of raising capital for later investment in machinery or other types of infrastructure can be roped into the definition of a PFIC. This often happens with mining companies and oil and gas ventures. Hedge funds and other individual traders unfamiliar with the corporation's financial condition throughout the year may not be aware of this trap. However, there is some relief for corporations with this predicament in their first year of operation or in the midst of changing businesses.

**** Planning Opportunity:*** Investing through the offshore feeder of a hedge fund rather than the onshore feeder could provide certain 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 subject to deductibility limitations at the individual investor level. Fund expenses such as management fees and professional fees are further limited when the investors have income in excess of certain limits (Pease limitation) or are subject to the alternative minimum tax (where such deductions are fully disallowed). 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 income 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.

**** Planning Opportunity:*** 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, said income may not be taxed at the state level.

New Partnership Tax Audit Rules

New partnership tax audit rules were enacted in November 2015 and are scheduled to be effective for audits of taxable years beginning on or after January 1, 2018 (unless elected into earlier). These rules significantly alter partnership audit rules 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 existing 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 issues amended Schedules K-1 to the investors that were partners of the partnership during the year under audit. These investors are 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. However, it should be noted that there is still some uncertainty regarding whether an audit adjustment can be pushed out through partnership tiers, such as in Master/Feeder structures.

To prepare for compliance with the new rules, partnerships will need to designate a partnership representative, review ownership structures and 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.

Enhanced Depreciation Rules

For business owners, tax planning is a year-round activity. However, the last several months of the year generally present specific opportunities to minimize taxes on business income. Year-end tax planning for businesses often focuses on acquiring equipment or other qualifying assets to take advantage of enhanced depreciation tax breaks. Careful planning in this area can help you maximize depreciation deductions in the year of purchase.

- ***Section 179 Expensing*.** This election reduces dollar for dollar the amount of qualifying property placed in service exceeding the investment limitation. The PATH Act permanently extended the $500,000 annual cap on the section 179 deduction and the $2 million investment limitation. Starting in 2016, both the annual cap and the investment limitation are indexed for inflation – the expensing limits for 2017 are $510,000 and $2,030,000, respectively.

  ** Eligible Section 179 property includes: new and used machinery, equipment, vehicles and other tangible non-real-estate property, computer software purchased off the shelf, qualified restaurant property, retail improvements and leasehold improvements.

- ***Bonus depreciation*** was extended through 2019 and allows a business to take an immediate write-off for a percentage of an asset's cost. Unlike with Section 179 expensing, the business must be the first taxpayer to use the asset. Businesses of all sizes will be able to depreciate 50 percent of the cost of assets acquired and put in service during 2015, 2016 and 2017. Then bonus depreciation will phase down to 40 percent in 2018 and 30 percent in 2019. Without additional legislation, bonus depreciation expires after 2019. Only certain types of depreciable property can qualify, including tangible property with a recovery period of 20 years or fewer under the Modified Accelerated Cost Recovery System (MACRS).

  Recall that, to take advantage of depreciation tax breaks on your 2017 tax return, you'll need to place assets in service by the end of the year. Paying for them this year isn't enough. Also, because bonus depreciation isn't limited to taxable income, the deduction can contribute to or create a net operating loss (NOL).

  ** ***Caution:*** Despite the many benefits of bonus depreciation, recall that this tool only accelerates deductions. As the percentage of depreciation decreases and with its status unclear after 2019, 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 relatively 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 (per invoice or per item as substantiated on an invoice) 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 Studies.*** 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 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 Planning in Uncertain Times

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. However, uncertainty is in the air this year; repeals of the estate, gift and generation-skipping transfer (GST) taxes have been proposed. Taxpayers should be cognizant of the potential changes but should continue to plan under the current tax system we have while building in flexibility to adapt to any future changes enacted into law.

- **Estate Tax**: For 2017, the tax rate remains at 40% and the exemption has increased to $5.49 million (for married couples splitting gifts the exemption amount is $10.98 million) – increased in 2018 to $5.6 million ($11.2 million for married couples splitting gifts) during life without incurring a gift tax. The exemption is currently scheduled to continue to be adjusted annually for inflation. Any remaining exemption at death may be used to reduce estate tax.
- **Gift Tax**: 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:

- Make ***annual exclusion gifts*** by December 31, 2017. Each person may make annual, gift-tax-free gifts of $14,000 ($28,000 for a married couple splitting gifts) – increased in 2018 to $15,000 ($30,000 for a married couple splitting gifts) -- to any number of individuals. Gifting on a tax-free basis is a great option for reducing (or even eliminating) larger gift and estate taxes in the future. Taxpayers living in states with no current state gift tax may wish to accelerate or focus on additional gifting of assets in 2017. Of course, your financial security and long-term objectives should be assessed and discussed before proceeding with such a gifting strategy.
- Consider ***funding education through 529 plans*** by December 31, 2017 to apply 2017 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 2017, you can transfer $70,000 ($140,000 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. For more information, please refer to Anchin’s “Guide to Education Tax Savings” at http://www.anchin.com/whitepapers/529Edu.

** ***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 $14,000 ($28,000 for a married couple splitting gifts) will result in taxable gifts.

- ***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.

  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 less than 2.64% * -- 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 basis. Please check with your Anchin relationship partner before pursuing such loans.

Charitable Contributions

Take note of limitations on the charitable income tax deduction:

- Gifts to public charities. Contributions of cash can be deducted up to 50% 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.

In order to obtain an income tax charitable deduction for 2017, gifts must be made by December 31. If the gift consists of property that will require an appraisal (generally required for gifts of property in excess of $5,000, other than publicly traded securities), you should start the process as soon as possible.

* ***Reminder***: Gifts made by credit card on or before December 31 can be deducted in 2017, even if the credit card bill is paid in January 2018.

- ***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 2.6% in December 2017).

* ***Planning opportunity***: CLATs can be used to offset current income with charitable deductions, with the possibility of the remaining assets to return 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.

CLATs can be useful tools for offsetting large income payments from offshore deferral income payments for taxpayers with a charitable intent.

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.

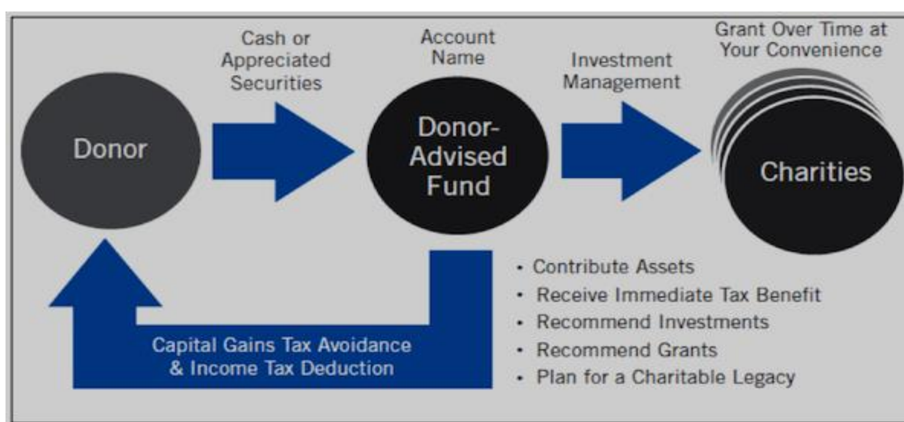
*** ***Caution & Reminder:*** If you are planning on donating a non-publicly traded stock to a charity, you are ***required*** to get a qualified appraisal to establish its value. Otherwise, you will only be entitled to a charitable deduction equal to your basis in the stock.

*** ***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.

Donations can be made to public charities, private foundations, and donor advised funds. Transferring assets to a donor advised fund can allow you to receive an immediate charitable income tax deduction at the maximum amount allowed for gifts to public charities while affording you time to decide on the ultimate charitable beneficiaries. If you would like to create a donor advised fund in 2017, 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 they are interested in employing this tax saving technique.



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, 2017 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 2017 even though the taxpayer has not sold a position and is still holding both the long and short position at December 31, 2017. If the transaction is unwound utilizing the "short term hedging exception" described below, then the gain is not taxable in 2017.

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 2017, 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 2017	Net appreciation at date of delivery	2017
Short closed by purchase in market in 2017, 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	2017 Date of disposition of long position
Short closed by delivery of long position by January 30, 2018	Gain on long position at date of short sale	2017
Short closed by purchase in market to settle by January 30, 2018, 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	2018 Date of disposition of long position
Both long and short positions still in place post January 30, 2018	Appreciation on long position at date of short sale	2017

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.

The 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. 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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