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2018 Year-End Tax Planning Alert

Be informed, be flexible, be ready to act, and “be patient”...

With the passage of the Tax Cuts & Jobs Act (the “Tax Act”) in December of 2017, the impact on funds, their owners/managers and investors has been anything but clear. The Tax Act was rushed into law, is extremely complex and still has many unanswered questions to unclear sections of the new law. However, unlike last year at this time, we do not foresee any new tax legislation before year-end 2018 nor is it clear that guidance or technical corrections will be forthcoming to address some of the open questions affecting funds, fund managers and their investors.

While today the tax environment is more stable than at this time last year, we are still dealing with uncertainty in certain portions of the Tax Act. Therefore, right now is the perfect time to meet with your accountants, attorneys and other advisors to make portfolio adjustments with the goal of minimizing your 2018 income tax liability and to position yourselves and your businesses for the future. Of course, economic considerations should be weighed and thoroughly discussed before any tax-motivated planning.

Note that the Tax Act retained the maximum 20% preferential rate applicable to long-term capital gains and qualified dividend income and the 3.8% net investment income tax continues to apply. Long term gains are taxed at rates of 0%, 15% or 20%, depending on your tax bracket, while short term gains are taxed as ordinary income. Under prior law, the 0% rate applied to the two lowest tax brackets, the 15% rate was applied to the next four and the 20% was applied to the top bracket. Under the Tax Act, the three capital gains income thresholds don’t match up perfectly with the tax brackets but are applied at maximum taxable income levels, as follows:

Long-Term Capital Gains Rate	Single Taxpayers	Married Filing Jointly	Head of Household	Married Filing Separately
0%	Up to $38,600	Up to $77,200	Up to $51,700	Up to $38,600
15%	$38,600-$425,800	$77,200-$479,000	$51,700-$452,400	$38,600-$239,500
20%	Over $425,800	Over $479,000	Over $452,400	Over $239,500

This year, as every year, along with the ensuing holiday celebrations, it is again time for some year-end tax planning. As year-end approaches, you should consider the following opportunities as you review your tax picture. However, be wary of quick answers and simple advice. Before taking action with any of these suggested planning ideas and opportunities, taxpayers should completely analyze the proposed transaction(s) and alternative outcomes.

Tax Loss Harvesting (Wash Sale Planning Opportunities)

Given the recent market volatility, 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. 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 at or 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 7clear 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 2018 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 2019. 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 2018.

- ***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.

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 2018 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 2018. 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 2019, the short cover capital losses will be deferred until 2019.

**** 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 2018. Note that the last trading day of the year is December 31, 2018.

Defer

Accelerate

Using Constructive Sales to "Accelerate" or "Defer" Capital Gains

You should consider your tax situation in 2018 as well as your projected tax situation in 2019 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 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 2018 or defer capital gains recognition to 2019 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 2018.

- If the status of your tax picture for 2018/2019 is more clear towards the end of January 2019, you still have time to :
  - o Unwind the constructive gain(s) by utilizing the "short term hedging exception" – thereby continuing to defer the LT unrealized gains to 2019 and beyond.

- If the status of your tax picture for 2018/2019 is more clear by early to mid-March 2019, you still have time to :
  - o Violate the 60-day un-hedged portion of the short term hedging exception in order to recognize the constructive gain(s) in 2018.

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 29-30 for a refresher on the Constructive Sales rules and the short-term-hedging exception.***

Using Qualified Opportunity Zones to Defer / Reduce / Eliminate Capital Gains

An interesting and unique provision of the Tax Act is a new federal incentive called Qualified Opportunity Zones (QOZ). The program is designed to incentivize long-term investment in low income and economically distressed communities by deferring capital gains tax when taxpayers invest those gains in Qualified Opportunity Zone Funds (QOZF).

The new provision allows capital gains that are reinvested in a QOZF to be temporarily deferred from inclusion in the taxpayer's gross income. A QOZF can be organized as a corporation or a partnership for the purpose of investing in Qualified Opportunity Zones:

- ***Qualified Opportunity Zone Business (QOZB):*** if a trade or business meets certain requirements, including maintaining substantially all of the tangible property used by the trade or business within a QOZ, it will be designated a QOZB.

- ***Qualified Opportunity Zone Property (QOZP):*** if an investment in a QOZB is made by purchasing Qualified Opportunity Zone Stock (QOZS), a Qualified Opportunity Zone Partnership Interest (QOZPI) or the tangible assets in a Qualified Opportunity Zone Business Property (QOZBP), such investment will be considered a QOZP.

- ***Qualified Opportunity Fund (QOF):*** a fund that is set up as a corporation or a partnership and invests 90% of its assets in QOZP is a QOF. Such fund is subject to certain testing dates every six months to ensure 90% of its assets remain in the QOZ.

A taxpayer may defer up to 100% of the realized capital gain if the capital gain is reinvested into a QOF within 180 days from the date of the sale of the asset. If the investment in the QOF is held by the taxpayer for at least 5 years, the basis is increased by 10% of the original deferred gain. If held for at least 7 years, the basis is increased by an additional 5%. The deferred gain is recognized on the date on which the QOF investment is liquidated or December 31, 2026, whichever comes first. Post investment gain on investments in QOZFs that are held for at least 10 years are also excluded from the taxpayer's gross income. For the sale of a QOZF investment held for more than 10 years, the taxpayer can make an election to convert the basis of such investment to the fair market value of the investment at the date of sale – thus producing no gain recognition.

***** 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 where possible.

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. 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.

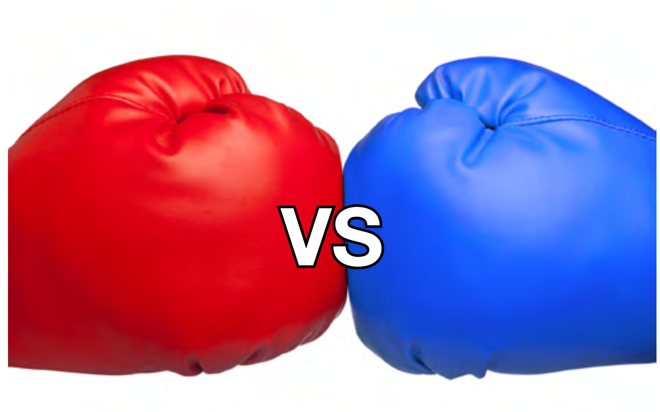
The Section 475(f)(1) election must be filed with a timely filed extension request (or a timely filed unextended tax return) for the previous year. For example, if the election is to be effective for the 2019 tax year, and assuming the taxpayer is an individual, the election would need to be made by April 15, 2019 (March 15, 2019 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 2018 (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 (2019). You could then make the §475(f) election for 2019 and deduct the mark-to-market losses in 2019 as ordinary losses rather than selling the securities in 2018 and recognizing capital losses, which are subject to limitations on deductibility.

475(f) Revocation Procedures: 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.

Trader



Investor

Miscellaneous Itemized Deductions / Trader versus Investor / Planning Opportunities

Under the Tax Act, all deductions subject to the 2% adjusted gross income (AGI) floor are repealed through the year 2025, including those for tax preparation and investment fees and related expenses. The Tax Act did not 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 earlier).

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.

Put another way, a trader regularly and continuously purchases and sells securities with the objective of profiting from short-term fluctuations in market values while an investor seeks to realize profits from the long-term appreciation of securities and/or the earning of interest or dividends. The **intent** of the taxpayer is fundamental to the determination of trader or investor status.

Having established the tax existence of a trader, a review of the available case law reflects that the criteria which are indicative of trader status generally are as follows:

1. Security positions, in general, are held for short periods of time. In other words, there is a **frequent turnover** of the portfolio.
2. There are a large number of buy and sell transactions **on a regular and continuous monthly basis** throughout the year.
3. An office is maintained from which the taxpayer conducts its trading activities.
4. Taxpayer is generally not engaged in other activities but rather trading securities is the taxpayer's sole activity and source of revenue.
5. Purchase and sale decisions are made by the taxpayer, not a financial advisor retained by the taxpayer.

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 alone should not be the only fact taken into account for this analysis.

**** 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 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 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.

**** Other Possibilities:*** Can such miscellaneous 2% expenses be capitalized? Can the manager agree to pay the miscellaneous 2% expenses (not charge a management fee) in exchange for an increased carried interest allocation? Both are potential options but need to be fully discussed and assessed with your service providers.

Foreign Currency Election (Tax Savings Potential)

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 Deduction

The Tax Act 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.

Certain taxpayers are exempted from the new interest deductibility limitation, including small businesses averaging annual gross receipts of $25 million or less for the three prior taxable years, as well as real property businesses that elect out of the limitation and certain public utilities.

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 shareholders or partners and may only be deducted by them against excess adjusted taxable income allocated to them from such S corporation or partnership in a future year. Amounts that cannot be deducted in the current year can generally be carried forward indefinitely.

Section 199A - New Pass-Through Deduction

Under prior law, net taxable income from pass-through business entities (such as sole proprietorships, partnerships, S corporations and LLCs) was simply passed through to their owners. It was then taxed at the owners' tax rates. In other words, no special treatment applied to pass-through income recognized by business owners.

For tax years beginning in 2018, the Tax Act added new Section 199A, which allows certain business owners to avoid tax on up to 20% of their business profits (referred to as "qualified business income (QBI)). This new tax break is available to individuals, estates and trusts that own interests in partnerships, S corporations or sole proprietorships. The deduction generally equals 20% of QBI, with a cap equal to the greater of 50% of W-2 wages or 25% of W-2 wages plus 2.5% of the cost of qualified property. The deduction expires after the year 2025. Under an exception, the W-2 wage limitation does not apply until an individual owner's taxable income exceeds $157,500 ($315,000 for joint filers). Above those income levels, the W-2 wage limitation is phased in over a $50,000 range ($100,000 range for joint filers).

QBI is generally defined as the net amount of qualified items of income, gain, deduction and loss from any qualified business of the non-corporate owner. QBI does not include investment income, reasonable compensation income or guaranteed payments to the taxpayer from the business. The QBI deduction is not allowed in calculating the non-corporate owner's adjusted gross income (AGI), but it reduces taxable income. In effect, it's treated the same as an allowable itemized deduction.

The 20% deduction is not available for income realized from "specified service trades or businesses" such as health, law, accounting, consulting, financial services firms and other businesses where the principal asset of such trade or business is the reputation or skill of one or more of its employees or owners, unless realized by a taxpayer whose taxable income falls below the thresholds described above.

The Tax Act increases the compliance burden on pass-through entities and their owners, which become even more onerous via tiered-structures. Of greater importance is the large tax rate disparity that now exists between C corporations and pass-through entities which may prompt many businesses to reexamine their entity choice. Even with the second layer of tax on the distribution of corporate earnings as well as a potential accumulated earnings tax on undistributed corporate earnings, the lower 21% rate could be attractive for certain taxpayers. A detailed analysis of entity choice involves many factors and many moving parts and should not be undertaken without fully vetting the pros and cons with your service providers.

Should I Convert My Business to a C-Corporation?
Entity Choice: C Corporation or Pass-Through

Beginning in 2018, the top C-corporation tax rate is “permanently” decreased from 35 percent to a flat 21 percent. As a result, many taxpayers are reassessing their current entity structures to determine if they should switch from being a pass-through entity to become a C-corporation. This assessment however requires careful analysis as there are many factors that must be considered. The tax rate decrease brings into question whether there’s an incentive to convert from a pass-through entity to a C corporation; however, taxpayers should keep in mind the effect of double taxation applicable to C corporations and their owners. Recall that double taxation occurs when C corporation owners are taxed on the dividend income received from the entity—income that’s already been taxed at the C corporation level.

Section 199A (discussed earlier), which potentially allows pass-through entity owners a maximum 20 percent deduction of domestic qualified business income, also is of interest to taxpayers. Not all pass-through income is eligible for the deduction and taxpayers should consult their tax advisor to verify.

Owners of pass-through entities operating in states that do not have an individual income tax should strongly consider the state tax implications of converting their business to a C-corporation. In Florida, for example, the owners of a pass-through entity operating in Florida are not subject to state income tax whereas a C-corporation is subject to a flat state tax rate of 5.5 percent. Considering that state corporate taxes are fully deducted on the federal tax return, the C-corporation would be subject to a combined effective tax rate of approximately 25.4 percent. As this example illustrates, a pass-through entity that qualifies for the Section 199A deduction may only reduce its effective tax rate by approximately 4.3 percentage points if it converts to a C-corporation – not 16 percentage points.

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.

On the surface, the lower corporate tax rate and Section 199A deduction both appear to provide tax benefits to entities and their owners; however, further analysis regarding future business environments, exit plans, owner compensation and other factors should be considered to determine the best entity choice.

Carried Interest

Earlier carried interest legislation would have taxed all income from carried interests as ordinary income. The Tax Act took a moderate approach to scaling back the benefits of a carried interest. Section 1061 increases 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 doesn't change the basic favorable treatment of carried interests or other grants of profits interests. Profits interests, including carried interests, continue to be nontaxable at the time of issuance. Subject to the new three-year holding period under Section 1061, the holder of a carried interest continues to enjoy long-term capital gains treatment (not subject to employment taxes) from the sale of partnership assets, or the sale or redemption of the carried interest.

Section 1061 increases the required long-term capital gains holding period of an API from more than one year to more than three years. Understanding what is and what isn't an API is crucial from a planning standpoint.

- **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 (i) the amount of capital contributed (determined at the time of receipt of the partnership interest), or (ii) the value of such interest subject to tax under IRC § 83 upon the receipt or vesting of such 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

- **The portion of a partnership interest that falls within the definition of a profits interest may be an API.** The tax treatment of a profits interest is generally governed by Revenue Procedure 93-27. Under Revenue Procedure 93-27, a "profits interest" is a partnership interest that would not entitle the holder to a share of the proceeds if partnership assets were sold for their fair market value and the net sale proceeds were distributed to the partners in liquidation. If a partnership interest qualifies as a profits interest, the service provider is not taxed upon receipt, the interest is a capital asset in the hands of the service provider, and the service provider is considered a partner and as such will be issued a Schedule K-1. The IRS detailed three exceptions to this general treatment: (1) if the profits interest relates to a substantially certain and predictable stream of income; (2) within two years of receipt, the service provider disposes of the profits interest; and (3) a profits interest in a "publicly traded partnership" within the meaning of Section 7704(b). Of the three exceptions to profits interest treatment, the two-year holding period is a potential planning issue. But from the standpoint of Section 1061, the two-year holding period only matters if the partnership interest is subject to vesting and no Section 83(b) election is made. The greatest risk of a disposition of an unvested profits interest within the two-year period is that the proceeds would be taxable as compensation under Section 83 (so don't take a chance and make the Section 83(b) election). In the pre-Section 1061 era, if the plan included the possible sale or redemption of the carried interest during the first 24 months, a reasonably safe approach would have been to have the service provider contribute $1,000 in connection with the issuance of the interest. The interest would then be a capital interest subject to immediate taxation under Section 83, but the service provider would often take the position that the value of the interest at the time of issuance was only $1,000.

Assuming the interest has vested or the Section 83(b) election has been made, the issue of whether the interest was taxable under Section 83 when issued, or nontaxable under Revenue Procedure 93-27, won't change the analysis for purposes of Section 1061. In either case, Section 1061 potentially treats the portion of the interest that would otherwise be defined as a profits interest (using the Revenue Procedure 93-27 test) as an API subject to the three-year holding period requirement. It is worth keeping in mind that while not all profits interests are APIs for purposes of Section 1061, all APIs will have the economic features associated with a profits interest. A difference between a profits interest and an API is that Revenue Procedure 93-27 doesn't contemplate splitting an interest into separate "capital interest" and "profits interest" components.

- **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.

  The second sentence of Section 1061(c)(1) provides 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 firm's limited partnership, the preceding sentence would appear to take that interest outside the scope of IRC Section 1061.

- **Exceptions.**

  o Section 1061 provides that it doesn't apply to profits interests issued to corporations. But 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.

  o Section 1061(b) anticipates 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." 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.

  o 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. At this time it isn't 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 Tax Act. 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.

- **How Section 1061 works.** If an interest falls within the scope of an API, then gain on the sale of capital assets will be recharacterized as short-term capital gains unless the holder satisfies the more than three-year holding period requirement. This more than three-year holding period requirement appears to apply to both the sale of the capital assets by the partnership and the sale of the partnership interest.

  The more than three-year holding period requirement also appears to apply to APIs issued prior to the enactment of Section 1061.

***** Planning for Section 1061.*** While future corrective legislation may target Section 1061 planning, the statute in its current form provides opportunities for taxpayers to work around the negative consequences of the three-year holding period. Please consult with your tax advisors in order to determine what options (if any) are available.

Partnership Tax Audit Rules

New partnership tax audit rules were enacted in November 2015 and are 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 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 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.

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. 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.

Asset Acquisitions & Cost Recovery Provisions

Beginning January 1, 2018, the deduction allowed under Internal Revenue Code Section 179 is increased from $500,000 to $1 million and qualified asset purchases made after September 27, 2017, may qualify for 100 percent bonus depreciation under §168(k). There are specific rules for both §179 and bonus depreciation that should be considered during tax planning.

The allowable deduction under §179 now begins to phase out, dollar for dollar, once total asset purchases reach $2.5 million. Any allowable §179 expense in excess of taxable income is carried forward to the succeeding tax year. The increased expense amount and limitation threshold could prove valuable to small business taxpayers seeking to expand.

In general, asset acquisitions that are new or used—which is a significant change from prior bonus depreciation rules—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. Unless there is a technical correction, you will not receive bonus depreciation on a 15-year property.

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 Tax Act.

***** 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 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:

- o The property owner's average annual gross receipts for the three prior tax years must be $10 million or less;

- o The building's cost or other unadjusted cost basis must be less than $1 million; and

- o 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 & Gift Planning

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 Tax Act unlock new opportunities for gifting and estate planning. While tax reform retained the maximum federal estate tax rate of 40%, it doubled to $22.4 million the amount married couples can exempt (adjusted annually for inflation). Like most provisions of the Tax Act, this joint exemption amount will sunset to half the exemption in place in 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:

- Increased gifting: Assuming that the federal estate tax exemption will revert back to the 2017 level of $5.49 million (per individual) after 2025, tax reform affords individuals a limited window between 2018 and 2025 in which to make significant, estate-tax-free gifts directly to family members or into trusts.

  - Make ***annual exclusion gifts*** by December 31, 2018. Each person may make annual, gift-tax-free gifts of $15,000 ($30,000 for a married couple splitting gifts) – remaining at this level in 2019 -- 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 2018. 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, 2018 to apply 2018 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 2018, 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.

- ***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.

- Trusts and IRC Section 199A: The Tax Act added new Section 199A (discussed on page 14), which allows certain taxpayers a 20% deduction on qualified business income (QBI). The Section 199A deduction has taxable income limitations based on the taxpayer's total income. In order to try to maximize the Section 199A deduction, taxpayers should consider utilizing non-grantor trusts (which are separate taxpayers) and each eligible for the Section 199A deduction. Note that the Section 199A proposed regulations issued earlier this year prevent a taxpayer from establishing multiple trusts with the same grantor and beneficiaries for the "principal" purposes of avoiding tax.

Note that the Tax Act did not alter the portability of a deceased spouse's unused exemption or the step-up in basis on inherited property. Although the increased exemption discussed earlier will reduce the number of estates subject to transfer tax, there are still many considerations that make estate planning important, such as asset protection and family business succession. Therefore, please discuss these and other priorities with your advisors.

Charitable Contributions

The charitable deduction has always been 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 Tax Act 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.

Despite the deductions for charitable giving being largely unchanged, there is concern expressed by charities that charitable giving may be adversely impacted due to the doubling of the standard deduction and changes to other allowable itemized deductions. While very true, charitably-inclined taxpayers must therefore identify optimal timing and methods of donation to ensure maximum tax savings for their charitable giving. 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 2018, 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.

- ***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 3.6% in December 2018).

**** 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.

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, 2018 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 2018 even though the taxpayer has not sold a position and is still holding both the long and short position at December 31, 2018. If the transaction is unwound utilizing the "short term hedging exception" described below, then the gain is not taxable in 2018.

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 offsetposition 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 2018, 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 2018	Net appreciation at date of delivery	2018
Short closed by purchase in market in 2018, 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	2018 Date of disposition of long position
Short closed by delivery of long position by January 30, 2019	Gain on long position at date of short sale	2018
Short closed by purchase in market to settle by January 30, 2019, and	Gain or loss on closing of short position Gain or loss on closing of long position	2019 Date of disposition of long position
Both long and short positions still in place post January 30, 2019	Appreciation on long position at date of short sale	2018

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 Pattern
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
	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 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. 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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