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2016 Year-End Tax Planning Alert

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

With the election of Donald Trump and a Republican control of Congress, tax reform is expected. While some expect it may be summer for all of this to be on the President’s desk for signature, the proposed tax reductions may be retroactively effective to January 1, 2017 (but possibly not expected to be effective until January 1, 2018, or later). As of right now, timing is uncertain but things should get clearer fairly quickly with the new President’s budget expected in February 2017. In the meantime, the House Ways and Means Committee has been working on new tax legislation with some similarities to proposals mentioned by President-elect Trump during his campaign.

As a result, the tax law could look dramatically different soon into the New Year. Therefore, while year-end tax planning is always important and prudent, as 2016 comes to a close, taxpayers may need to be even more diligent than normal, as you’re not only comparing 2016 to 2017, but you must also compare 2016 to what 2017 might be. 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 December 31st, if required.

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.

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Traditional Year-End Strategies

It is generally always advantageous to push any income you can from one year into the next since there is a time value to taxes you can pay next year instead of today. However, this year, the concept of deferring income and accelerating deductions could be even more meaningful. For 2017, the top rate on ordinary income is 39.6%. Should President-elect Trump's tax proposal become law, the top rate on ordinary income would drop to 33%. However, please also note that President-elect Trump's tax proposal also includes a cap on itemized deductions ($200,000 if married filing a join return and $100,000 if single).

If your business uses the cash method of accounting, you may be able to defer income by delaying invoices until late in the year or accelerate deductions by paying certain expenses in advance. If your business uses the accrual method of accounting, you may be able to defer the tax on certain advance payments you receive this year. You may also be able to deduct year-end bonuses accrued in 2016 even if they aren't paid until 2017 (provided they're paid within 2½ months after the end of the tax year and meet other conditions).

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 2016 and take standard deduction in 2017 or do the reverse steps
- Pay bills in 2016/postpone payments until 2017
- Pay last state estimated tax installment in 2016/delay payment until 2017
- 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 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; not logical, but it is the law. 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, 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 under the proposed swap regulations, 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).

- ***Purposely trigger the wash sale rule and postpone loss recognition:*** Assume that you recently sold stock at a loss in 2016 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 2017. 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 2016.

- ***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 mentioned 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 1 year, is a short-term capital loss.

Short Sales and Losses

If you close a short sale at a loss late in the year in 2016 through the delivery of shares and you have to purchase the shares in the market, you need to allow at least three 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 2016. 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 2017, the short cover capital losses will be deferred until 2017.

* ***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 2016. Note that the last trading day of the year is December 30, 2016.

Examine Portfolio for "Worthless Security" Positions

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.

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 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.

*** New Revocation Procedures**: Securities and commodities traders who have a §475(f) election in place, whether individually or at the entity level, now have the ability to make an automatic revocation of this election. Please contact your tax advisor if this is being contemplated.

- ***Election for existing taxpayers – Prospective Election:*** A statement must be filed no later than the due date (without regard to extensions) of the federal tax return for the tax year immediately preceding the election year and must be attached either to that tax return or the extension for that tax return. For example, if the election is to be effective for the 2017 tax year, and assuming the taxpayer is a calendar year taxpayer, the election would need to be made by April 15, 2017 (March 15, 2017 with respect to S Corporations and Partnerships).
- ***New Taxpayer Elections:*** A statement should be documented in the taxpayer's books and records within 2 months and 15 days of formation and a copy of the statement should be attached to the federal tax return, or extension, for the year of the election. The statement must include the following: (1) that you are making an election under §475(f) of the Internal Revenue Code; (2) the first tax year for which the election is effective; (3) the trade or business for which you are making the election; (4) that the election only applies to securities and not to futures.

***Planning Opportunity**: If you have significant unrealized losses in your trading portfolio in late 2016 (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 (2017). You could then make the §475(f) election for 2017 and deduct the mark-to-market losses in 2017 as ordinary losses rather than selling the securities in 2016 and recognizing capital losses, which are subject to limitations on deductibility.

New Tax Expensing and 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.

- ***Enhanced expensing election.*** The "Protecting Americans from Tax Hikes Act of 2015" (PATH Act) was passed by both the House and Senate and signed into law on December 18, 2015. The bill expanded the Section 179 deduction limit to $500,000 and made it permanent (until further notice). Businesses exceeding a total of $2 million of qualifying asset purchases have the Section 179 deduction phased-out dollar-for-dollar and completely eliminated above $2.5 million. Additionally, the Section 179 cap will be indexed to inflation in $10,000 increments in future years (and until further notice) and the election is limited to taxable income from any of your active trades or businesses.

  ** 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. 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 2016 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).

- ***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. Effective for the 2016 tax year, 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.

Deferred Fees – Planning Opportunities

Internal revenue code section 457A applies to amounts deferred that are attributable to services performed after December 31, 2008. Deferred compensation attributable to services performed prior to January 1, 2009 must be included in gross income in the later of:

- The last taxable year beginning before 2018 (2017 for calendar year taxpayers) and
- The first taxable year in which the right to such compensation is no longer subject to substantial risk of forfeiture within the meaning of Section 457A.

Common forms of compensation caught up in the Section 457A net include traditional hedge fund deferred compensation and incentive fees from side-pocket investments and are taxable no later than December 31, 2017 (whether or not paid by December 31, 2017).

Some of the available tax planning strategies by managers for maturing deferrals are as follows:

- Investment in the offshore fund in 2017 and make a qualified electing fund ("QEF") election: The deferred compensation payable in 2017 reduces the earnings and profits of an offshore fund treated as a passive foreign investment company ("PFIC"). A taxable U.S. investor in a PFIC in 2017 should benefit from a QEF election.
- Charitable contributions: The manager makes a charitable contribution and offsets the deduction for such charitable contribution against income from the inclusion of the deferred amount (subject to various limitations on deductions).
    - A **charitable lead annuity trust ("CLAT")** may be used. If structured properly, the CLAT can be used to pay out the initial value of the deferred amount plus an IRS assumed rate of interest to charitable organizations over a set term of years (generally 10-20 years) without making a gift to the remainder beneficiaries who are ordinarily the children of the creator of the CLAT. If the term of years and the annuity to charity are coordinated to equal the full present value of the initial capital at inception of the CLAT using an IRS mandated interest rate, at the end of the charitable term, the remainder of the CLAT assets (i.e., the excess income and appreciation on the deferred amount over the IRS mandated interest rate) would pass to children of the manager free of gift and estate taxes.
- If the deferral is not "back-to-back" with the management company's partners / shareholders, the management company can pay out other expenses (e.g., employee bonuses) by December 31, 2017.
- Relocation of the service recipient (or Fund) to a foreign (treaty jurisdiction) country. If this is being seriously contemplated, please speak to your legal and tax advisors as soon as possible so that you can devise a plan of action.

ESTATE PLANNING

Estate and Gift Planning Considerations

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.

The current political environment has cast doubt on the future of the estate, gift and generation-skipping transfer taxes. Despite the intentions of President-Elect Donald Trump and Republican congressional leaders, there is no clear time frame for any repeal, nor a certainty that these taxes will permanently go away. Taxpayers should continue to plan under the current tax system we have, but build in flexibility to adapt to any changes enacted into law.

Tax implications are an important consideration in the development of any estate plan. The estate, gift and generation skipping transfer (GST) tax exemption amounts are set at $5 million each and are indexed for inflation each year. In 2016, each individual can transfer up to $5.45 million (for married couple splitting gifts, the effective exemption amount is $10.9 million) during life without incurring a gift tax. Any remaining exemption at death may be used to reduce estate tax. The top estate and gift tax rate is 40%.

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

- Make ***annual exclusion gifts*** by December 31, 2016. Each person may make annual, gift-tax-free gifts of $14,000 ($28,000 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 2016. Of course, your financial security and long-term objectives should be assessed and discussed before proceeding with such a gifting strategy.

- ***Grantor Retained Annuity Trusts (GRATs).*** Provides you with a fixed annual amount (an "annuity") from a trust for a term of years (as short as two years under current law). The annuity retained may be equal to 100% of the amount that you use to fund the GRAT, plus the IRS-sanctioned rate of return (known as the 7520 rate) applicable to GRATs. After the trust term ends, the amount of assets (if any) left in the trust after the annuity payments have been made remain in the trust free of gift or estate taxes. Because your beneficiaries will retain the full value of the GRAT assets at the end of the trust's term, if you survive the annuity term, the value of the GRAT assets in excess of your retained annuity amount will then pass to the beneficiaries with no gift or estate tax, either outright or in an additional trust vehicle. If the grantor dies during the term of the GRAT, the entire balance will revert to the grantor as if the GRAT transaction never took place. In addition, if the value of the GRAT assets fall below the amount required for the requisite annuity payments, the GRAT collapses as if the GRAT transaction never took place.

* ***Planning opportunity***: Consider using a "zeroed-out GRAT" - structured so that the value of the gift transferred to the beneficiary is zero.

** ***Caution***: Although no changes to the GRAT rules have yet been made, various proposals have been set forth over the years that, if enacted, would make GRATs less beneficial. Among other things, some of the proposals would have required a 10-year minimum term for GRATs and a remainder interest greater than zero, effectively eliminating the "zeroed-out" GRAT. For this reason, and because interest rates are currently at low levels, it may be wise to consider establishing a GRAT sooner rather than later.

* ***Planning opportunity***: Instead of setting up one GRAT containing all transferred assets, why not set up multiple GRATs for different assets types – some conservatively invested and others with more risk? The winners, or appreciated GRATs, do their job of transferring wealth to the next generation; the losers collapse, as if the GRAT for these assets never took place.

- Consider ***funding education through 529 plans*** by December 31, 2016 to apply 2016 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 2016, 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.

  ** ***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***: Family members can extend long-term loans to each other at interest rates less than 2.26% -- 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.

  ** ***Caution:*** In August 2016, the IRS issued proposed regulations intended to eliminate perceived abuses in the valuation of gifts between family members. Currently, taxpayers often reduce the value of interests transferred to family members by taking valuation discounts based on various restrictions associated with these assets. The IRS is seeking to eliminate taxpayers' ability to adjust values in this manner. However, the proposal as drafted has been interpreted as being excessively broad in scope. The regulations are not final, and it is not clear if or when they will be become final. Your estate and gift planning should be flexible enough to adapt to any required changes if the rules are put into effect.

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 2016, 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.

*** Planning opportunity***: Gifts made by credit card on or before December 31 can be deducted in 2016, even if the credit card bill is paid in January 2017.

- ***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 1.8% in December 2016).

  *** 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 new 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.

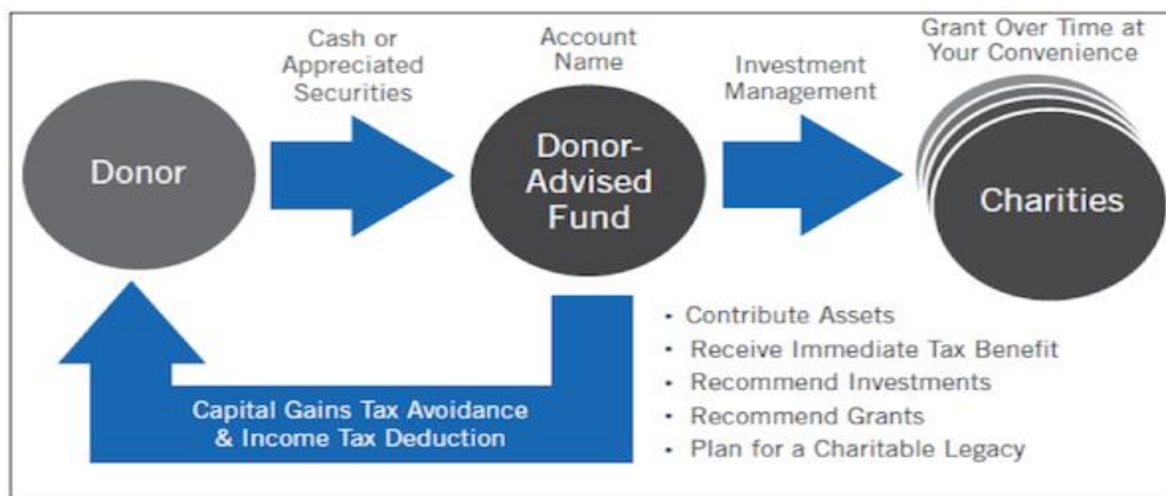
*** ***Caution & Reminder***: If you are planning on donating a non-publicly traded stock to a charity, you are ***required*** to get a qualified appraisal to establish its value. Otherwise, you will only be entitled to a charitable deduction equal to your basis in the stock.

*** ***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 2016, 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, 2016 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 2016 even though the taxpayer has not sold a position and is still holding both the long and short position at December 31, 2016. If the transaction is unwound utilizing the "short term hedging exception" described below, then the gain is not taxable in 2016.

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 2016, 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 2016	Net appreciation at date of delivery	2016
Short closed by purchase in market in 2016, 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	2016 Date of disposition of long position
Short closed by delivery of long position by January 30, 2017	Gain on long position at date of short sale	2016
Short closed by purchase in market to settle by January 30, 2017, 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	2017 Date of disposition of long position
Both long and short positions still in place post January 30, 2017	Appreciation on long position at date of short sale	2016

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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