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2020 Year-End Tax Planning Alert

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

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

As we publish our annual year-end tax planning alert, we are frequently reminded that 2020 is no ordinary year. What began as a normal filing season was extended to July 15, 2020, and came with other ramifications of the COVID-19 pandemic -- quarantine in place, working from home, CARES Act, social and economic turmoil as well as a still-unsettled election and political environment.

The Tax Cuts and Jobs Act of 2017 (TCJA) made sweeping changes to income taxation, estate and gift taxation and international taxation. Since enactment, the Internal Revenue Service has continued to provide guidance in many areas, some of which are addressed in this alert while some require further clarification. This has created many challenges for individuals, businesses and tax professionals in addressing certain tax issues.

All of this has created opportunities as well as areas of caution for taxpayers. In addition to the current second wave of COVID-19 and continuing economic uncertainty, tax rates could change depending on the election results. The prospect for increasing tax rates could hinge on control of the Senate, especially if President-Elect Biden enters the White House in January (as currently appears to be the case). While a change in control of the House of Representatives has not occurred and is not anticipated, control of the Senate is still up for grabs with two Georgia Senate seats due for run-off elections on January 5, 2021.

With many facing difficult and uncertain times, solid financial and tax planning is required now more than ever before. The sooner that one focuses on their tax situation and the available tax planning opportunities, the more likely they are to put themselves in a better tax position. We know that the changes under the TCJA and CARES Act as well as related guidance that we have received to date may be weighing heavily on your mind. While we cannot predict the future, we can assist you with your tax planning.

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

Choice of Entity Considerations – Decisions, Decisions, Decisions…

Choosing the appropriate type of entity is a complex analysis and is generally dependent upon many factors, such as business objectives, type of business, cash needs, and ease of obtaining new capital. The TCJA, enacted at the end of 2017, included many changes that affected this analysis. One of the headline changes was the top C-corporation tax rate being "permanently" decreased from 35 percent to a flat 21 percent. With the TCJA, coupled with the 2020 CARES Act and the possible outcomes of the 2020 elections, there is much to consider when determining the best choice of entity for tax purposes.

C Corporation: While the TCJA reduced the federal corporate rate from 35 percent to 21 percent, it did not change the tax rate on distributions from a corporation to its shareholders. Qualified dividends received by non-corporate taxpayers are still taxed at a maximum rate of 20 percent (plus an additional 3.8 percent for taxpayers subject to the net investment income tax). The combined effective federal tax rate for non-corporate shareholders on distributions classified as ordinary dividends from a C corporation is 40.8 percent.

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

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

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

> **** Caution:*** Major issues can arise under various state and local tax and/or foreign country tax systems that would need to be factored into any choice of entity analysis. It is also important to note that a C-corporation cannot avoid paying shareholder distributions (dividends) without having a reasonable business need to retain 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.

CARES Act 2020. The COVID-19 pandemic added additional factors to consider when making decisions regarding choice of entity. The CARES Act, signed into law on March 27, 2020, provided relief and certain tax benefits for businesses, predominantly businesses structured as C corporations.

Please refer to our Anchin alert for more details.

- **Net Operating Losses (NOLs).** The CARES Act temporarily relaxed rules governing the use of NOLs that were established under the TCJA and that limited the use of NOLs incurred after December 31, 2017 to 80% of current year taxable income. Under the CARES Act, NOLs will no longer be subject to the 80% limitation for tax years beginning before January 1, 2021, and will revert back to the 80% limitation for losses arising in tax years after December 31, 2017. The CARES Act also temporarily modified TCJA rules that had eliminated the ability for NOLs to be carried back to prior years in which a corporation had taxable income by allowing 100% of losses from tax years ending in 2018, 2019 and 2020 to be carried back to the five prior tax years. This potentially creates the opportunity for the C corporation to file for refunds of taxes paid in those prior eligible years by carryback NOLs.

  **** Planning Opportunity:*** As a result of the extended carryback provision, a corporation can carry back its 2018, 2019 and 2020 NOLs to offset pre-2018 income that was taxed at rates of up to 35% and in turn generate current tax refunds at a favorable rate differential. Furthermore, certain taxpayers that anticipate generating losses into 2021 might consider changing their tax year, if possible, to a year ending prior to December 31, 2020, for example, to ensure that some portion of calendar year 2021 is within a tax year that starts prior to January 1, 2021.

- **Alternative Minimum Tax (AMT).** The TCJA eliminated the corporate AMT and allowed corporations to claim any outstanding AMT credits (subject to certain limitations) as refunds for years 2018 through 2020. The CARES Act allowed for this to be accelerated by permitting corporations to elect to claim a refund for any unused AMT credits from 2018 as fully refundable (subject to no limitations).

State & Local Tax (SALT) Updates and Tax Planning Opportunities

As we near the end of the year, uncertainty still remains for businesses and individuals trying to balance between in-person and remote work capabilities.

- **Residency Changes.** This year, more than in years past, inquiries from clients about moving out of high-tax states has increased. The COVID-19 pandemic has thus far proven that we can work remotely and has prompted many to explore and think about where they want to live and work. Moves from high-tax states such as New York, New Jersey and California certainly pose residency audit risks due to the respective state's loss of anticipated tax revenues. Generally, in order to change residency status, taxpayers must change their domicile. Taxpayers who are attempting a domicile change should be aware that a number of factors are taken into account in the determination.

  **** Caution:*** A temporary relocation during the pandemic will not change a taxpayer's domicile. However, statutory residency issues may be triggered due to a temporary relocation during the pandemic. This means that some states will treat taxpayers who exceed a certain in-state presence threshold, such as 183-days and have a place of abode, as a resident in their state for tax purposes. It is therefore possible that a taxpayer can be treated as a resident of two states – one based on domicile and the other based on statutory residency. In most cases, the resident state tax credit will protect the taxpayer from double taxation of wages and other business income, but depending on the state, double taxation could apply to other types of income, such as investment income (i.e., interest, dividends and capital gains) and other intangible income.

  Advanced planning is central to managing and mitigating this risk. Understanding each individual's facts, circumstances and intent are critical factors, as is researching and understanding each state's specific residency and domiciliary laws.

- **Nexus.** States are continuing their attempts to implement and enforce their laws to find nonresident, non-filing taxpayers. Nexus remains a crucial element of managing a business's state tax risk. A nexus is a relationship or connection between two or more entities. In tax law, it is a relationship between a taxing authority, such as a state, and a business. A nexus must exist before a taxing authority can impose a tax on the enterprise, and it requires that there be a definitive link between the jurisdiction and the business. With state budget shortfalls expected to continue into 2021 and beyond, taxpayers should expect to receive nexus inquiries from various state and local taxing authorities.

  **** Practice Tip:*** For those employers considering or already allowing employees to continue working remotely going forward, nexus implications need to be thought out not only for income, non-income and sales taxes but also for state payroll withholding taxes and unemployment insurance. Both physical presence and economic presence must be thoroughly analyzed for all potential state taxes when undergoing a nexus study in order to understand and better manage risk.

  **** Caution:*** Due to significant fiscal constraints as result of the pandemic, all signs point to an increase in state audit activity. State letters with an intention to audit as well as nexus questionnaires and notices should be taken seriously and should be addressed timely. We stand ready as your expert partner to assist you in handling such communications and to help you proactively plan.

- **COVID-19 SALT Updates.** The pandemic has forced many employees to telecommute, thus resulting in the widespread relocation of many U.S. employees across state lines throughout the country. Under general SALT rules, the presence of a remote working employee in a state where a business's employees do not usually work is sufficient to create nexus in that state for an employer – thereby potentially exposing the employer to additional state tax liabilities.

  **** Anchin Observation:*** Some states have issued guidance stating that they would not seek to impose nexus as a result of employees working in their state temporarily due to the pandemic. However, the states' leniency appears to be limited with some states starting to issue additional guidance including expiration dates for this treatment. The most common dates that we have seen so far are the end of 2020 or 90 days after the state's state of emergency is lifted.

  The pandemic has also caused some notable concerns for individual taxpayers who have either temporarily or permanently relocated to different states. Generally, individuals are subject to tax withholding based on the state in which they work. Even if taxes are not withheld by the employer, the employee may nevertheless be liable for state income taxes.

Caution & Observation: As a result of COVID-19, some states have chosen to accommodate individual taxpayers thereby allowing wage income to be sourced to the individual's normal work location rather from the state from which they are actually working (their remote work state or resident state). However, not all states have taken this position, potentially raising double state taxation issues for individual taxpayers.

- **SALT Pass-Through Entity (PTE) Taxes.** States and cities imposing entity-level taxes on PTEs are not new and have been around for years (e.g., NYC Unincorporated Business Tax). However, in response to the TCJA, some states have been exploring options to help their residents manage the federal SALT cap deduction limitation. To date, Connecticut, Louisiana, Maryland, New Jersey, Oklahoma, Rhode Island and Wisconsin have enacted a state-level PTE system. While Connecticut's PTE tax is mandatory, the other states have an elective tax whereby the PTE has the option to be taxed at the entity level. The PTE structure allows for the shifting of tax from the individual partner to the PTE thereby reducing the state tax owed by the individual.

  Until recently, there were concerns with the uncertainties of the federal tax treatment of these new regimes enacted by various states, both at the PTE and individual owner levels. The IRS released Notice 2020-75 on November 9, 2020, and announced that proposed regulations will be issued to clarify that state and local taxes imposed on and paid by a partnership or S corporation (i.e., pass-through entities) on its income are allowed as a deduction by the PTE in computing its federal taxable income or loss for the taxable year of payment. As a result, state and local income taxes will be payable and deductible at the PTE level and the tax burden will not be passed through to the individual partners or shareholders of the PTE who are subject to the federal SALT cap deduction limitation discussed earlier.

  Anchin Observation: Now that the validity of these PTE taxes has been confirmed by the IRS via Notice 2020-75, it is probable that more states may look to enact some form of the PTE tax. However, the rules may vary significantly in these jurisdictions and, in some cases, are still evolving, as state tax authorities continue to develop and revise their own guidance. Therefore, taxpayers should carefully examine the laws and the implications for owners before electing to treat PTEs as taxable entities or making estimated income tax payments on behalf of PTEs.

Tax Loss Harvesting: Turn Investment Losses into Tax Savings

2020 may yet turn out to be the perfect year for tax loss harvesting. This tactic, which is used to mitigate or avoid capital gains taxes, proves more useful in years when there is a jolting market downturn followed by a strong rebound. With the market's plunge in March 2020, and its subsequent recovery to record highs, tax loss harvesting should be an integral part of your year-end tax planning strategy. Recognizing capital losses is a common strategy to reduce taxable income, but purchases of substantially identical securities can result in the disallowance of those losses via the wash sale rule. In general, this rule disallows a loss resulting from the sale of stock or securities, if, within the restricted period (a 61-day period beginning 30 days before the sale), the taxpayer "acquires", or enters into a contract or option to acquire, ***substantially identical*** stock or securities. In addition, a loss from closing a short sale is similarly disallowed where, within the restricted period, substantially identical stock or securities are sold or the taxpayer enters into another short sale of identical stock or securities.

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

Below is a list of strategies, ranging in complexity:

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

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

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

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

- ***(Cover) short sale at a loss and purchase a put option:*** Note that the wash sale rule will apply if the taxpayer (within the restricted period) executes another short sale with respect to substantially identical stock or securities. The wash sale rule in this respect (cover a short and buy a put option) is vague, 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, but 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 Basket Swap:*** In this scenario, the taxpayer holds stock with a market value that is lower than the tax basis of the stock and seeks to deduct a capital loss on the sale of the stock while still maintaining economic exposure with respect to the disposed of stock. The following transaction may allow the taxpayer to maintain economic exposure to the stock and to deduct a capital loss without disallowance under the wash sale rules.

  In a proposed transaction, the taxpayer sells (at a loss) the stock in the open market and simultaneously enters into a swap agreement with counterparty with respect to a ***basket*** of securities that includes the sold stock. The swap will terminate on the 35th day following the date on which the swap is entered into (the "Maturity Date"). The swap will provide that on the Maturity Date, (1) the taxpayer will pay the counterparty an amount equal to the depreciation in the value of the basket over the term of the swap and (2) the counterparty will pay the taxpayer an amount equal to the appreciation in the value of the basket over such term. In addition, the swap will provide that the counterparty will pay to the taxpayer an amount equal to dividends paid during the term of the swap on stocks that comprise the basket. The taxpayer also will make LIBOR-based payments to the counterparty determined with reference to the initial value of the stocks comprising the basket on a weekly basis over the term of the swap.

  The basket should be comprised of 20 or more stocks of unrelated issuers, including the stock(s) sold. On the date the swap is entered into, the fair market value of the stock(s) sold should represent less than 70% of the fair market value of all the stocks comprising the basket. We believe that such a basket will not be deemed substantially identical to the shares sold.

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

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

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

Tax Planning using the Wash Sale Rule to your Advantage

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

- ***Purposely trigger the wash sale rule and postpone loss recognition:*** Assume that you recently sold stock at a loss in 2020 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 2021. If the loss is within the restricted period, simply repurchase the shares so that the loss gets deferred under the wash sale rule; the loss will then get included in the basis of the newly repurchased shares and will not be recognized in 2020.

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

- ***Converting Long-Term Capital Losses into Short-Term Capital Losses:*** The taxpayer would (1) sell the stock and recognize the long-term capital loss; (2) within the restricted wash sale period (perhaps the next day), purchase a call option on the sold stock – which triggers the wash sale rule; (3) exercise the call option – sell the stock received through the exercise of the call. As described earlier, 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.

Qualified Small Business Stock (QSBS) Tax Exemption

One of the significant changes included in the TCJA was the reduction in the C corporation tax rate to 21%; thus making C corporations more prevalent in use for various business owners. In addition to the lower tax rate, C corporation stock can potentially qualify as QSBS under Section 1202 of the Internal Revenue Code (IRC). The QSBS tax exemption may allow you to avoid part or all of the capital gains taxes incurred when you sell a stake in a startup or small business. The requirements to be eligible for this exclusion are as follows:

- the stock was issued by a domestic C corporation after August 10, 1993,
- the C corporation must be a qualified small business with a max of $50 million of gross assets when the stock was issued and immediately after the date of issuance,
- the stock must be ***original issue stock*** as opposed to having been acquired from an existing shareholder,
- the corporation must be an active business that uses at least 80% of its assets in a ***qualified trade or business.***

  - ***Complexities around Original Issue Stock***. When does original issuance occur? The answer appears to be straightforward – when the C corporation issues shares directly to the investor. However, determining original issue proves more complicated when the corporation grants stock options, restricted stock or restricted stock units or when the invested capital is structured as a convertible note or as a simplified agreement for future equity (SAFE). All of these methods are quite common in venture capital and start-up businesses. Therefore, determining when the five-year holding period begins varies (see chart below) and is relevant for QSBS exemption purposes.

Type	QSBS Qualification Test	QSBS Holding Period Test
Stock Options	Upon date of exercise for vested options *(1)*	5 years from the date of exercise
Restricted Stock	Upon §83(b) election *(2)* or vesting date	5 years from the date of the §83(b) election or vesting date
Restricted Stock Units	Upon vesting date	5 years from the date of vesting
Convertible Preferred Stock	Upon date of preferred investment *(3)*	5 years from the date of preferred investment
Convertible Debt	Upon date of conversion *(4)*	5 years from the date of conversion

(1) For unvested options, the company must allow these to be exercised early and the taxpayer must make an §83(b) election within 30 days of exercise.

(2) §83(b) election to be made within 30 days of restricted stock grant or option exercise into restricted stock.

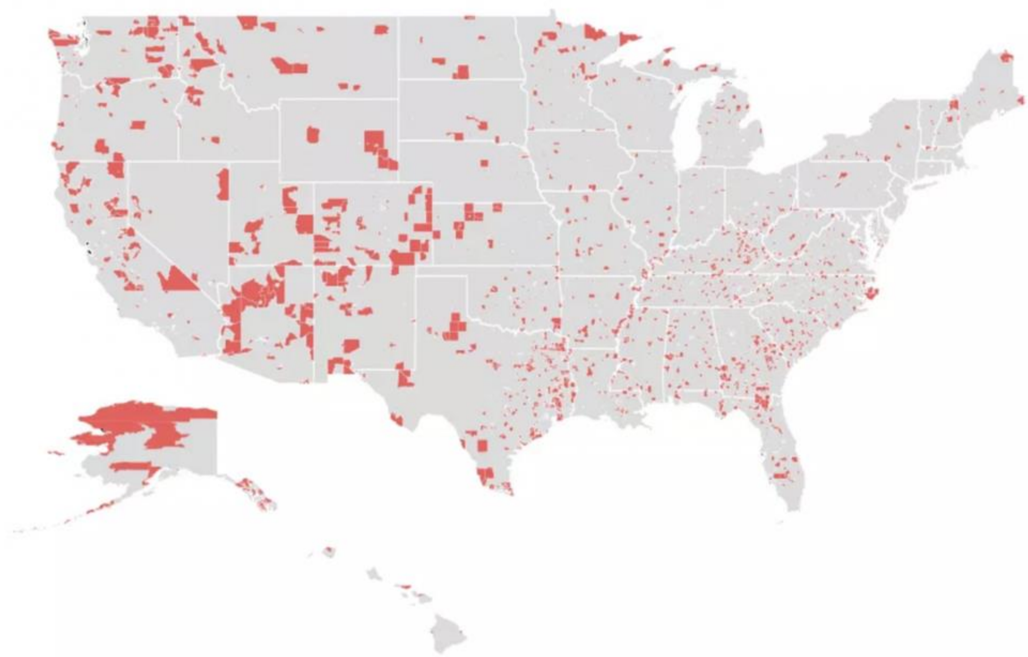
(3) §1202(f) – if any stock in a corporation is acquired solely through the conversion of other stock in such corporation which is QSBS in the hands of the taxpayer – (1) the stock so acquired shall be treated as QSBS in the hands of the taxpayer and (2) the stock so acquired shall be treated as having been held during the period which the converted stock was held

(4) §1202(i)(1)(A) – in the case where the taxpayer transfers property (other than money or stock) to a corporation in exchange for stock in such corporation – (A) such stock shall be treated as having been acquired by the taxpayer on the date of such exchange

For those who qualify, the amount of gain eligible for exclusion - from 0% to 100% - depends on the acquisition date and the holding period. QSBS acquired between August 9, 1993 and February 17, 2009 is eligible for a 50% exclusion, increasing to 75% for QSBS acquired between February 18, 2009 and September 27, 2010 and 100% for QSBS acquired on or after September 28, 2010. To qualify for any of these exclusions, the stock must be held for at least 5 years. The gain eligible to be taken into account for purposes of this exclusion is limited to the greater of $10 million or 10 times the taxpayer's basis in the stock.

**** Anchin Observation:*** If you own a stake (or plan to invest) in a startup or small business, you need to know about the QSBS exemption as it is an important tax planning tool. We often advise clients to think about these provisions if and when they are initiating a startup or small business investment. The QSBS exclusion is most commonly applied in situations when an entrepreneur sells his or her company, or when investors in a private equity fund receive an in-kind distribution of post-IPO shares after a portfolio company in the fund goes public. Note that there are many dimensions to this rule and to any startup or small business owner's situation. We frequently work with our clients and their advisors to develop plans that make sense for each client.

**** Caution:*** As discussed above, the stock must be original issue stock. Therefore, the conversion of an S corporation to a C corporation will not meet this definition since the stock was originally issued by an S corporation. However, converting a partnership to a C corporation could qualify since a partnership does not issue stock.



Qualified Opportunity Zones: Where are we now?

The opportunity zone (OZ) sector is among the numerous sectors of the economy that have been adversely impacted by COVID-19. Reservations of potential investors, liquidity concerns and questions about the viability of certain projects are just a few of the uncertainties in this space that abound. In an effort to alleviate some of these concerns, the IRS released Notice 2020-39 in June 2020.

In Notice 2020-39, the IRS provided investors and qualified opportunity funds (QOFs) extensions to comply with many rules that require time-sensitive actions to take advantage of the OZ tax benefits such as:

- Allows taxpayers until Dec. 31, 2020, to invest eligible gain in exchange for a QOF investment if their 180-day investment period otherwise would have ended on or after April 1, 2020, and before Dec. 31, 2020.

- Deems a QOF's failure to meet the requisite 90% asset test standard to be due to ***reasonable cause*** and, consequently, no penalties will be due if the QOF's: (1) last day of the first six-month period of its taxable year or (2) the last day of its taxable year falls between April 1, 2020, and Dec. 31, 2020.

  **** Caution:*** Despite requests by taxpayers and practitioners to detail what constitutes ***reasonable cause*** for this purpose, the IRS and Treasury declined to do so when finalizing the OZ regulations. As a result, once Notice 2020-39's automatic relief period ends on December 31, 2020, taxpayers run afoul of this requirement will need to determine whether their specific facts and circumstances will present an adequate defense to penalty assessment.

- "Stops the clock" on any 30-month substantial improvement period being utilized by a QOF or qualified opportunity zone business (QOZB) to qualify its property as QOZB property (QOZBP) from April 1, 2020, through Dec. 31, 2020. For example, if as of April 1, 2020, a QOZB was two months into its 30-month period over which it plans to renovate a building, the third month would not start until Jan. 1, 2021.

- Confirms that the national emergency declaration issued in reaction to COVID-19 triggers the availability of the federal disaster relief included in the OZ regulations. Specifically, a QOZB will have more time to acquire or construct property, or start a business within an OZ pursuant to a working capital safe harbor (WCSH).

**** Anchin Observation:*** QOZBs generally can apply up to two consecutive 31-month WCSH periods to carry out a written plan for the aforementioned purposes, but the OZ final regulations allow for "not more than an additional 24 months" in light of a federally declared disaster. It is unclear based on the wording of the final regulations and Notice 2020-39 whether the additional 24 months is automatic or if QOZBs must demonstrate they need the extra time based on facts and circumstances. Due to this uncertainty, we strongly recommend that QOZBs utilizing this relief provision maintain proper documentation to support its need to do so, should it be questioned or challenged in the future.

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

**** Caution - Post-election Uncertainty:*** President-elect Biden has proposed to reform QOZB requirements by:

- Incentivizing QOFs to partner with non-profit or community organizations
- Requiring the Treasury Department to review the QOZB benefits to ensure these tax benefits are only being allowed where there are clear economic, social, and environmental benefits to a community
- Requiring recipients of the QOZB tax break to provide detailed reporting and public disclosure on their QOF investments.

**** 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 a member of Anchin's Opportunity Zone Practice Group as they are ready, willing and able to assist you with your OZ tax planning.

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

You should consider your tax situation in 2020 as well as your projected tax situation in 2021 in order to determine if it would be best to generate additional realized capital gains this year or next. Varying concerns may prompt some taxpayers to reduce their exposure in some of their stock investments. If planned correctly, the affirmative use of the constructive sale rules may allow a taxpayer to hedge an appreciated position through the end of the year and can give the taxpayer the ability to accelerate capital gains into 2020 or defer capital gains recognition to 2021 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 2020.

- If the status of your tax picture for 2020/2021 is more clear towards the end of January 2021, you still have time to:
    - Unwind the constructive gain(s) by utilizing the "short term hedging exception" – thereby continuing to defer the LT unrealized gains to 2021 and beyond.

- If the status of your tax picture for 2020/2021 is more clear by early to mid-March 2021, you still have time to:

    - Violate the 60-day un-hedged portion of the short-term hedging exception in order to recognize the constructive gain(s) in 2020.

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 the Constructive Sales – Rules and Reminder section later in this alert *****

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. Taxpayers generally can only write-off worthless securities in the year they become worthless. A worthless security loss must be evidenced by a closed and completed transaction, fixed by an identifiable event and actually sustained during the taxable year. One must demonstrate both balance sheet insolvency and a complete lack of future potential value. Balance sheet insolvency entails proving that liabilities exceed assets in the year of worthlessness. Even though the balance sheet may show insolvency, the stock of the corporation could possibly have some value in the future. Therefore, the taxpayer must also demonstrate the destruction of potential future value to establish current worthlessness.

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

Abandoning a Partnership Interest – Capital v. Ordinary Loss

Consider the following scenario: a taxpayer has invested in a limited partnership that he/she knows is going bad, and he/she believes the investment will not be recovered. With careful planning, accelerating these losses into the current year to offset income could provide significant tax savings. For tax purposes, losses are characterized as either ordinary or capital. Ordinary losses are generally more beneficial because they can be deducted against regular income without limitation. Capital losses, however, are restricted in use and generally can only offset capital gains.

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

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

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

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

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

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

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

Mark-to-Market Election (§475(f))

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

The mark-to-market (trader) election must be filed no later than the due date of the tax return (without regard to extensions) for the tax year immediately preceding the election year and must be attached either to that return or, if applicable, to a request for an extension of time to file that return. For example, if the election is to be effective for the 2021 tax year, and assuming the taxpayer is an individual, the election would need to be made by April 15, 2021 (March 15, 2021 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 2020 (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 (2021). You could then make the §475(f) election for 2021 and deduct the mark-to-market losses in 2021 as ordinary losses rather than selling the securities in 2020 and recognizing capital losses, which are subject to limitations on deductibility.

**** Anchin Observation:*** Bond or credit funds should consider making the §475(f) election (assuming they qualify as a trader and are therefore eligible to make the election). This election helps to equalize or match income and expenses since interest income earned and losses recognized upon sale are all treated as ordinary for tax purposes.

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

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

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

Short Sales and Losses

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

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

If you close a short sale at a loss late in the year in 2020 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 2020. 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 2021, the short cover capital losses will be deferred until 2021.

**** 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 2020. Note that the last trading day of the year is Thursday, December 31, 2020.

Foreign Currency Election - Tax Beneficial?

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). Foreign currency forwards are often used and entered into when trading foreign securities in order to offset currency fluctuations in the price of the securities. This election would allow for the treatment of gains (and losses) from these foreign currency contracts as capital gains and losses rather than ordinary income or loss. This election could be especially beneficial for certain foreign currency contracts, which would normally be treated as ordinary income for tax purposes, that now would be taxed at 60% long term capital gain rates and 40% short term capital gain rates, irrespective of how long the foreign currency contract has been held.

The 60/40 capital gains tax rates would apply to foreign currency forwards on “major currencies” – currencies for which regulated futures contracts (RFCs) trade on U.S. futures exchanges. This election is required to be made when the foreign currency contract is entered into and cannot be or become part of a straddle.

Business Interest Expense Limitation Update

The TCJA added new IRC section 163(j), which significantly restricted 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. Being that this provision is one of the most complicated sections of the TCJA as well as a major revenue raiser, the IRS and the Treasury Department have issued some significant guidance during the past year.

CARES Act (March 27, 2020). Prior to the CARES Act, the business interest expense deduction was limited to the sum of the taxpayer's business interest income, plus 30% of adjusted taxable income (ATI), plus floor plan financing interest expense. The CARES Act added several special rules, which should be taken into account for 2020 tax planning, including:

- For taxpayers other than partnerships, the CARES Act retroactively increased the section 163(j) limitation to 50% of ATI (up from 30%) for 2019 and 2020 with taxpayers have the option to elect out of this rule and use 30% instead of 50%.
- For partnerships, the increase to 50% only applies for 2020. Partners allocated excess business interest expense (EBIE) from 2019 can deduct 50% of that amount as an interest deduction in their 2020 tax year, without limitation.
- Allowing taxpayers to elect to use their 2019 ATI to calculate the 2020 section 163(j) limitation. This election will be helpful for taxpayers experiencing losses in 2020 due to current economic conditions.

**** Anchin Observation:*** This election may be helpful to taxpayers that experienced losses in 2020 due to the pandemic and the related economic environment.

Final Regulations and Proposed Regulations (July 28, 2020). Both sets of regulations provide guidance on the business interest expense limitation under section 163(j) as well as further clarification on the application of section 163(j) to private investment hedge funds classified as trader funds for tax purposes.

Prior to the release of these regulations, trader funds (hedge funds whose activity in trading securities is regular, continuous and substantial and considered to be engaged in a trade or business for tax purposes) were subject to the section 163(j) limitation on business interest expense at the partnership level. Any interest not limited at the partnership level was allocated to investors as investment interest expense and, for those who did not materially participate in the trading activity, was subject to limitation at their level under section 163(d). A section 163(d) limitation, in general, limits the amount of deductible investment interest expense for any taxable year, for taxpayers other than a corporation, to the net investment income of the taxpayer for the taxable year.

The Proposed Regulations solve the problem for non-materially-participating investors in a trader fund in that the trader fund's interest expense will now be bifurcated. Interest expense allocable to partners that materially participate in the trader fund's activities would be subject to Section 163(j) and interest expense allocable to the other (non-materially-participating) partners would not be subject to Section 163(j).

**** Anchin Observation:*** This guidance and clarification is welcome news for investors in trader funds. However, the proposed regulations generally are not retroactive, although taxpayers may choose to apply them to tax years beginning after Dec. 31, 2017. Trader funds or investors in trader funds with significant disallowed interest expense under §163(j) may want to consider revising 2018 & 2019 tax returns.

Carried Interest – All Clear Ahead?

The TCJA added Section 1061 to the Internal Revenue Code to address carried interests. Section 1061 applies to certain items with respect to “partnership interests held in connection with performance of substantial services” in investment management. For carried interest, the holding period for long-term capital gain treatment is more than 3 years (rather than 1 year); capital gain from an asset with a holding period of 1-3 years is re-characterized as short-term capital gain. On July 31, 2020, the IRS and Treasury Department issued proposed regulations (see our earlier Anchin alert here) which addressed many of the open questions but still left some unanswered.

**** Planning Opportunities:***

- At the Portfolio Company (PC) level, use dividends in order to reduce the exit proceeds that will be subject to the new 3-year carry rule.
- At the Fund level, distribute the PC stock to the carry vehicle; whereby the carry vehicle will hold the stock until the gain is eligible for the preferred tax rate.
- For add-on investments to portfolio companies, consider making such investments through loans rather than through equity or, if debt needs be avoided or is not a viable option, consider a special class of preferred equity in order to limit potential future appreciation to the newly issued stock, thus minimizing the potential exposure to section 1061.
- Adjust carry allocations (i.e., hard-wired waiver) whereby no carried interest is earned from assets with a holding period that is not greater than 3 years. Should include a catch-up provision for future allocations from assets with holding periods of more than 3 years.
- Structure the carry vehicle as a Corporation – either U.S. or non-U.S.
- Change your incentive allocation to and incentive fee. There are many factors to consider in making this change so be sure to plan this out with your service providers and to model out the tax effects over multiple years in order to determine the viability of this change.

International Tax Focus – Private Investment Funds Update

The TCJA continues to have an impact in the international tax arena in 2020. Thus far, the year has brought forth IRS notices and regulations (both final and proposed) that expanded on provisions of the TCJA and provided clarity on a variety of topics. Two of the major TCJA provisions related to international taxation are the Global Intangible Low-Taxed Income (GILTI) and Foreign-Derived Intangible Income (FDII) regimes. Additionally, Proposed Regulations under the current Subpart F rules are also something to consider.

The following represents a brief discussion of these provision as well as planning opportunities that should be considered for 2020 and future years.

- ***Global Intangible Low-Taxed Income (GILTI):*** Originally introduced under TCJA on the heels of the section 965 repatriation tax, with additional regulations released this past year in hopes of providing clarity to those U.S. taxpayers that were caught up in the TCJA's revamped international tax regime. This provision was designed to deter the deferral of offshoring earnings and basically functions as a current income inclusion on undistributed foreign earned income, equal to the income earned by certain foreign corporations with U.S. shareholders that exceeds 10% of that foreign corporation's depreciable tangible property. Although the word "intangible" is part of the GILTI acronym, this provision can potentially apply to all offshore operating income that is not subject to Subpart F rules. Currently, only domestic corporations are generally allowed a deduction of 50 percent of their GILTI inclusion and can additionally claim a foreign tax credit of up to 80 percent of foreign income taxes paid or accrued on GILTI inclusions. Final regulations issued in June 2019 only require partners to pick up their portion of GILTI if they have more than 10% ownership.

  **** Update:*** GILTI high-tax exception Regulations were finalized in July 2020, which provides retroactive (to 2018) and prospective relief to taxpayers conducting business in foreign high-tax jurisdictions. Under this exception, income subject to tax in a foreign country at an effective rate greater than 18.9 percent would not be included in GILTI, at the election of the taxpayer. The election must be made annually and when elected would apply to all CFCs of the US shareholder making the election.

  **** Anchin Observation:*** Although this is a welcome rule to taxpayers, the number of companies the exception will apply to could be reduced as a result of the recent Presidential election. Under a Biden-led White House, a proposal to increase corporate taxes to 28% would push the foreign effective tax rate needed to pass the high-tax exception threshold to 25.2%. This change in legislation will hinge on the special Senate election in Georgia to determine if Democrats will take control of both chambers of Congress.

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

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

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

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

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

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

**** Planning Opportunity:*** If a U.S. Shareholder has mostly foreign sourced low/no taxed income from a direct CFC, then through the use of a C corporation it may be possible to pay an effective tax rate that is less than the rate if applied to a U.S. Shareholder making a §962 election.

- ***Proposed Subpart F Regulations:*** While most Taxpayers welcomed the GILTI Final Regulations, the proposed Subpart F Regulations came as a bit of a surprise to many. These Regulations would conform the historic Subpart F high tax exception rules to the GILTI high tax exception rules and co-ordinate the two in a unified way so that Taxpayers cannot receive any undue benefit by planning into one set of rules versus the other.

- ***Foreign-Derived Intangible Income (FDII):*** Also introduced under the TCJA, a U.S. C corporation that provides services or makes sales of tangible property to foreign customers located outside of the U.S. now has the ability to take a deduction on its foreign-derived intangible income ("FDII"). The FDII deduction is not eligible to financial services companies and is intended to encourage onshoring of intellectual property (IP) by providing an incentive for U.S. entities to develop their intangibles or export sales operations inside the U.S. rather than in foreign localities. While mechanically the FDII deduction can be quite complex, the framework for calculating the deduction amount generally works as follows:

    - FDII-eligible income constitutes net income earned by domestic C corporations from the sale of property or provision of services to foreign persons or entities over a certain threshold.
    - The threshold is 10% of the corporation's U.S. depreciable tangible property. The excess income over the threshold is multiplied by the applicable current year deduction rate of 37.5%, and the result is the corporation's FDII deduction.
    - The FDII deduction can effectively reduce the corporate tax rate on applicable earnings from 21% to 13.125%. Notably, this deduction is available only to domestic entities taxed as C corporations and is effective for tax years beginning on or after January 1, 2018 (and the effective rate will change from 13.125% to 16.4% in 2026).
    - The FDII deduction may be reduced if a GILTI deduction or NOL deduction is being used against Taxable Income.

  **** Planning Opportunity:*** The allocation of expenses to FDII eligible income may present an opportunity for some companies to maximize the deduction. Performing an FDII allocation study akin to an R&D study can yield substantial benefit while also ensuring that the documentation standards for taking the deduction are being met in the event of an audit.

2020 Instructions for Form 1065

Department of the Treasury
Internal Revenue Service

U.S. Return of Partnership Income

DRAFT AS OF October 21, 2020

Section references are to the Internal Revenue Code unless otherwise noted.

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eligible employer claims against payroll taxes for the new employee retention credit may not be taken into account for purposes of determining other credits.

Request for section 754 revocation. Use new Form 15254, Request for Section 754 Revocation, to request revocation of a section 754 election. See *Elections Made by the Partnership*.

Partner's capital account analysis. The reporting requirements for certain partnerships regarding partners' capital accounts have been clarified. See *Item L. Partner's Capital Account Analysis*.

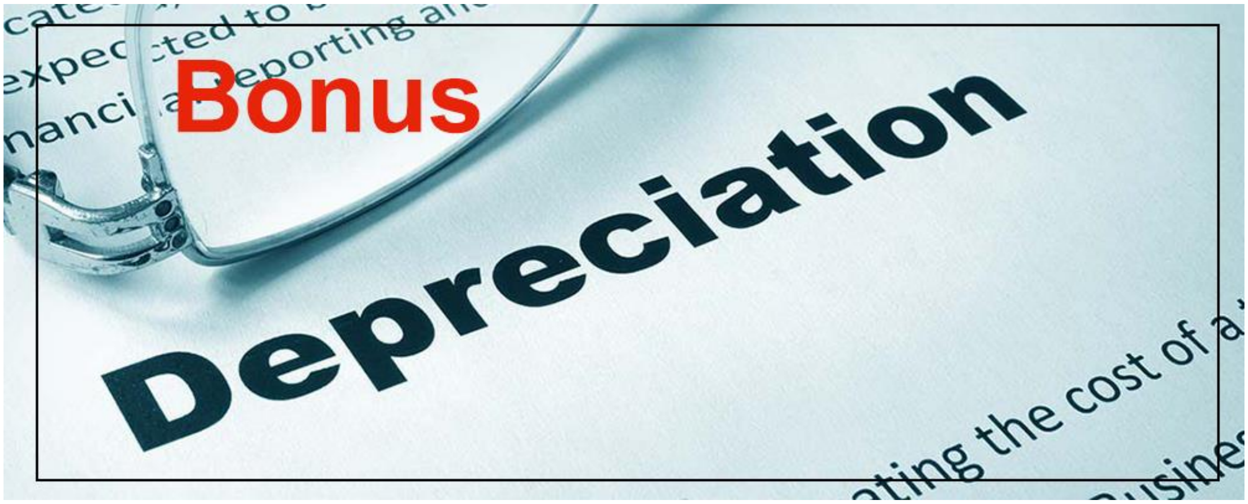
Tax Basis Capital – 2020 Reporting Requirements

After providing a year-long reprieve, the IRS recently released a draft of the 2020 Partnership instructions which once again include the requirement to report partners' capital on the Tax Basis Method. Similar requirements were included in the original draft of the 2019 Partnership instructions, which the IRS back tracked on in Notice 2019-66. The IRS agreed with commentators and practitioners alike that the requirement would be burdensome or that the requisite information did not exist in certain cases, and that partnerships would not have sufficient time to recreate the information in time to include on their 2019 partnership tax returns. The notice did indicate that the requirement to report partners' shares of partnership capital on the tax basis method will be effective for the 2020 tax year.

This tax basis capital reporting requirement is no small undertaking and may require a review of all prior year tax returns and Schedule K-1s starting from the partnership's inception. It could also require the partnership to more accurately reflect transfers, assignments and sales of partnership interests in that time period. Many businesses, private investment funds such as hedge funds, private equity funds and funds of funds will undoubtedly be adversely affected since they have largely maintained partners' capital accounts using generally accepted accounting principles (GAAP) basis and were normally not required to keep track of each partner's tax basis.

In prior years, partnerships had the option to report partner's capital on Schedule K-1 on either the tax basis, GAAP basis, 704(b) book basis or other basis. The draft 2020 instructions eliminate these options and require the partnership to report each partner's capital account on the tax basis. If you reported the partners' capital account on the tax basis method for 2019, you will be able to use the ending 2019 amounts as your starting point for 2020. If you did not report on the tax basis method, you will be required to refigure the beginning tax basis capital under one of four methods prescribed in the instructions. Whichever method is selected, it must be used for each partner and only used for the 2020 beginning tax basis amount.

**** Caution:*** While we remain hopeful that the IRS will issue a notice to supplement the draft 2020 Partnership instructions to provide more clarity and guidance on computing tax basis capital, we need to be ready for what could be a significant undertaking. Recalculating these amounts and creating tax capital schedules from inception will take time as well as gathering all of the historical information required for this undertaking. Therefore, we strongly encourage you to reach out to your Anchin relationship partner to discuss and plan this out accordingly as soon as possible.



Bonus Depreciation & Section 179 Expense

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

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

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

> **** Update – Bonus Depreciation on Qualified Improvement Property (QIP):*** The rushed legislative process for the TCJA produced a drafting error that impacted commercial real estate and bonus depreciation on qualified improvement property, which was supposed to be eligible for 15-year depreciation and 100% bonus depreciation. However, due to the drafting error, the language including this type of improvement as 15-year property was never written into the statute thereby leaving qualified improvement property placed in service after 2017 not eligible for bonus depreciation and subject to depreciation over 39-years. The CARES Act fixed the TCJA drafting error and allows QIP to be treated as 15- year property and therefore eligible for bonus

depreciation. This fix is retroactive to the enactment of the TCJA (QIP placed in service after December 31, 2017). The CARES Act created a number of planning issues with respect to 2018 and 2019 tax returns. If QIP was placed in service in 2018 or 2019, you may need to file an amended tax return or file a change in accounting method for 2020 in order to benefit from the change in law.

As of January 1, 2018, Section 179 expensing increased to $1 million for tax years 2018 to 2022, with a phase-out threshold when acquisitions of section 179 property exceed $2.5 million for the tax year. These dollar amounts are indexed for inflation after 2018 (for 2020, Section 179 expensing increases to $1,040,000 and the phase-out purchase limit is now $2,590,000). Property eligible as section 179 property includes property used to furnish lodging and qualified real property improvements including roofs, heating, ventilation, air conditioning, fire, and security systems.

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

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

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

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

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

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

Estate & Gift Tax Planning Reminders & Opportunities

The COVID-19 pandemic and current economic conditions are resulting in some unique estate planning opportunities that should be taken advantage of before the end of this year. Well thought out estate and gift planning help 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.

Before describing specific strategies, a recap of the current law with respect to the annual exclusion and lifetime exemption is in order. Recall that the current federal gift and estate tax rate maxes out at 40%.

- ***Annual Exclusion:*** The 2020 annual gift exclusion is $15,000. This exclusion is the amount that can be gifted per donee per year tax-free. In addition, married couples can elect to split gifts. Utilizing this strategy, married taxpayers can gift up to $30,000 to an individual in 2020 before a gift tax return is required. Annual Exclusion gifting is an excellent way to reduce the value of a taxpayer's gross estate over time (without utilizing one's Lifetime Exemption), thereby lowering the amount subject to estate tax.

- ***Lifetime Exemption:*** The 2020 lifetime gift exemption is $11,580,000, is indexed for inflation and is currently scheduled to sunset at the end of 2025, where it will revert back to $5,000,000 (indexed for inflation). This exemption is the total amount that can be gifted over the course of a donor's entire lifetime tax-free. The exemption amount, however, may change sooner than 2026 given the current political and economic environment. For those considering using the increased exemption now, the IRS has issued regulations which confirm that gifts made utilizing the enhanced gift tax exemption will not be clawed back if the exemption is reduced.

  **** Anchin Observation:*** Taxpayers living in states with no current state gift tax may wish to accelerate or focus on additional gifting of assets in 2020. Of course, your financial security and long-term objectives should be assessed and discussed before proceeding with such a gifting strategy.

  - ***Portability Election:*** This election remains under the TCJA. It is a vital planning tool for taxpayers, especially if the death of a spouse occurs while the increased exemptions are in place. Portability allows the second spouse to have the benefit of the deceased spouse's $11,580,000 exemption, even if the second spouse dies when a lower exemption amount is in effect.

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

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

Some gift and estate tax planning strategies to consider:

- ***Funding education through 529 plans*** by December 31, 2020 to apply 2020 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 2020, you can transfer $75,000 ($150,000 for a married couple splitting gifts) to a 529 plan without generating gift tax or using up any of your gift tax exemption. Also note that front-loading 529 plans may limit available state credits.

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

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

  The minimum interest rate charged between family members is known as the Applicable Federal Rate (AFR) where long-term (more than 9 years) loans to each other can be made at rates as low as 1.31% ***** -- and rates on loans for shorter periods can be even lower. It is a simple and effective estate planning mechanism for providing capital 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.

  > **** Anchin Observation:*** A family loan ideally creates a win-win situation for the borrower and the lender. However, if the family loan goes sideways, it may hurt your relationships as well as your credit scores. Before borrowing from or lending to family members, think through all of the possible consequences. If the loan still makes sense for both parties, be sure everyone is on the same page by putting the loan in writing and carefully tracking the repayments.
  >
  > **** Planning Opportunity:*** With interest rates at historic lows, one should consider refinancing existing notes. This is relatively simple to do and a strategy that can help to preserve additional principal of a trust and therefore allows more trust assets to grow for future generations.

- ***Spousal Lifetime Access Trusts (SLAT).*** Married taxpayers may want to make lifetime gifts to use the balance of their exemption but may be wary of not having access to the gifted funds. The SLAT is an irrevocable trust which has the benefit of removing assets by gift from the estate, but allowing the spouse and other beneficiaries to have access to the assets and their related income. The income from a SLAT is taxable to the creator of the trust (a "grantor" trust), whether or not there are distributions to beneficiaries. The creator's payment of the trust's tax might seem like an additional gift to the trust, but IRS rules do not count it as such, making this feature an added benefit as it allows the trust assets to grow without being depleted through the payment of taxes.

  > **** Anchin Observation:*** This type of trust can be structured to benefit multiple generations while not being subject to estate tax in subsequent generations.

- ***Sale of Assets to an Intentionally Defective Grantor Trust.*** Whereby the taxpayer sells assets to a grantor trust in exchange for a promissory note. The use of a grantor trust allows the sale(s) to not trigger a gain or income tax on the sale. In addition, the grantor will continue to pay the income taxes on the trust income, thereby allowing the trust assets to grow tax-free. This strategy is perfect for assets with high appreciation potential.

- ***What about Grantor Retained Annuity Trusts (GRAT)?*** With market volatility and many assets (particularly real estate) trading at depressed values, a GRAT may be a great option for certain assets. It 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 through a continuing 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.

Charitable Contributions: Tax Strategies

The charitable deduction continues to be a flexible and beneficial option for philanthropically minded people to support the causes they hold dear and to also reap tax benefits for doing so. The tax rules governing charitable contributions remained largely intact under the TCJA with certain changes addressed under the CARES Act in March of 2020 as follows:

- **Gifts to public charities**. Contributions of cash can be deducted up to 100% of the taxpayer's adjusted gross income (AGI) (increased from 60% of AGI in 2019), and the full fair market value (FMV) of appreciated property held over one year can generally be deducted up to 30% of AGI (unchanged from 2019).

  **** Caution:*** Cash donations to a Donor-Advised Fund (DAF) are not eligible for the 100% AGI limitation and are still subject to the 60% AGI limitation.

- **Gifts to private foundations**. Contributions of cash can be deducted up to 30% of AGI, and the full FMV of publicly traded securities (if owned for over a year) can be deducted up to 20% of AGI. The deduction for gifts of other appreciated property may be limited to the taxpayer's cost basis.

  **** Caution:*** Deduction of contributions subject to the 30% and the 20% limitations are first reduced by the amount of cash contributions subject to the 100% limitation. Excess amounts not currently deductible can by carried forward for 5 years.

  **** Anchin Observation:*** Under the CARES Act, up to $300 of charitable contributions can be taken as a deduction in arriving at AGI and applies only to individuals who do not itemize deductions.

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

- ***Bunching Charitable Donations***: Prepaying charitable contributions on an alternating or every few years basis allows taxpayers to itemize deductions in the year contributions are made and use the standard deduction in years featuring little or no donations. For 2020, consider bunching donations to take advantage of the tax deduction limits reduced by the CARES Act (discussed above).

- 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 2020, you can establish one as late as December 31st; however, additional time may be required if you are planning on funding the account with anything other than cash. Our firm has established a donor advised fund as a simple accommodation to our clients and friends if you are interested in employing this tax saving technique.

- ***Charitable Lead Annuity Trusts (CLATs).*** CLATs are charitable trusts designed to pay an 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 1.31% in December 2020).

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

- **Qualified Charitable Distribution (QCD) from an IRA.** If you are at least age 70½, have an IRA, and plan to donate to charity this year, another consideration to make a QCD from your IRA. This action can satisfy charitable goals and allows funds to be withdrawn from an IRA without any tax consequences. A QCD can also be appealing because it can be used to satisfy your required minimum distribution (RMD)—up to $100,000 for tax year 2020.

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

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

  **** Caution:*** Please note that the CARES Act suspended required minimum distributions (RMDs) for 2020. As a result, there may be less incentive for an IRA owner who is 70 ½ or older to make a qualified charitable distribution directly from the IRA to a charity.

What about Securities?

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

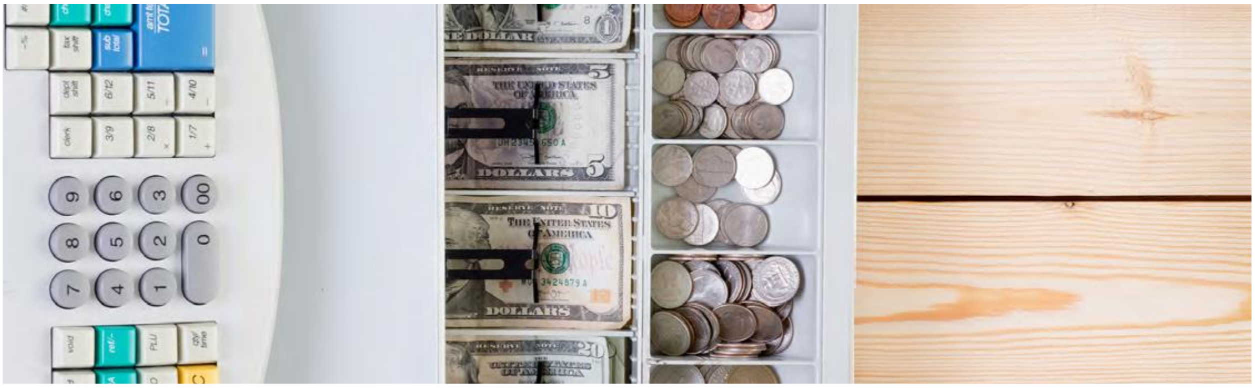
****** Caution & Reminder:*** Do not donate depreciated securities to charity. If this is the case, sell the securities first and then donate the proceeds to charity so that you can take the capital loss on the sale and get a charitable deduction for the donated cash.

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

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

**** Planning opportunity:*** Consider a partial non-liquidating distribution from investment partnership interests consisting of long-term appreciated securities in order to make charitable contributions. This planning opportunity may also be advantageous for securities received from an investment partnership subject to the carried interest rules discussed earlier.

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



Constructive Sales – Rules and Reminder

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

For example, assume a taxpayer holds a long (appreciated) security position. On July 1, 2020 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 2020 even though the taxpayer has not sold a position and is still holding both the long and short position at December 31, 2020. If the transaction is unwound utilizing the "short term hedging exception" described below, then the gain is not taxable in 2020.

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 2020, 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 2020	Net appreciation at date of delivery	2020
Short closed by purchase in market in 2020, 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	2020 Date of disposition of long position
Short closed by delivery of long position by January 30, 2021	Gain on long position at date of short sale	2020
Short closed by purchase in market to settle by January 30, 2021, 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	2021 Date of disposition of long position
Both long and short positions still in place post January 30, 2021	Appreciation on long position at date of short sale	2020

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.

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