AKRAM | ASSURANCE, ADVISORY & TAX

TAX EFFICIENT HEDGE FUND STRATEGIES & MANAGEMENT CO. TAXATION

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A boutique CPA Firm in Cary, NC, Raleigh, NC, Newport Beach, CA, New York City, NY, and Singapore. A full-service accounting firm providing assurance, advisory, and tax services for the financially savvy, especially hedge funds, cryptocurrency funds, investors, traders, family offices and ultra high net-worth individuals.

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A boutique law firm focused on delivering unmatched value for investment managers and entrepreneurs. We strive to provide first-class legal services and advice that adds value.

Our team leverages the substantial experience of our partners as attorneys, investors, and business owners to provide practical insight to our clients.

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POLLING QUESTION

TAX EFFICIENT HEDGE FUND STRATEGIES

Planning for changes to the taxation of carried interests. Consider changing the carried interest allocation to a fee or the management fee to an allocation.

When to recognize wins and losses; Loss harvesting

- consider your current tax year situation and your projected tax situation for next year to determine in which year it would be preferable to recognize wins and losses for tax purposes. Beaware of Wash Sales rules and sell before STCG to LTCG.

Miscellaneous itemized deductions

- under the TCJA, individuals can no longer deduct miscellaneous itemized deductions for 2018-2025.
- evaluate whether your fund is a trader or an investor and whether that may change. Alternatively, it may be possible to see if such expenses can. be capitalized, otherwise recharacterized or paid in a different manor.

PFIC and Family office StructuresMay Be Utilized

- Passive Foreign Investment Company (PFIC) may be utilized to get the benefit of portfolio deductions.
- Family office Structures- Creating a management company to manage family wealth, using incentive allocation to reduce partners income and management Co. can deduct expenses against revenue

POLLING QUESTION

Consider making a Section 475(f) market-to-market election

- A Section 475 election may offer significant tax benefits, mitigates wash sales, straddles etc – for high volume traders

Section 988 (a) (1) (b) election

- Section 988(a)(1)(B) election – converts Forward gain loss from ordinary to capital/1256

Consider the use of stock-settled stock appreciation rights

- If a substantial portion of the carried interest will now be taxable as short-term capital gains, you might want to consider the use of stock appreciation rights (SAR's). SAR's allows the defferal of income but there is a built in claw-back, they are very complex and no, or very few funds have actually implemented SAR's. There are a number of issues regarding the use of SAR's and it might take a significant amount of time to implement a SAR's plan.

Private Placement Life Insurance/Insurance Dedicated Funds

- Hedge fund managers should consider offering insurance dedicated funds ("IDFs") as a way for investors to invest in their fund strategy in a more tax-efficient manor. Conversley, investors should consider whether investing in a fund via private placement life insurance or private placement variable annunites is potentially a more tax-efficent way to invest. Investing in an IDF can eliminate income and estate taxes if done properly.

Opportunity Zones

- If you have recognized capital gains, consider whether it makes sense to reinvest some or all of your capital gains in opportunity zone funds. Opportunity zone provisions were enacted in the TCJA and offer significant tax benefits including deferral of income tax on future appreciation.

POLLING QUESTION

Section 1256 Contracts

- IRC Section 1256(b)(1) - The term "section 1256 contract" means :

1256 (b)(1)(A) - any regulated future contracts
1256 (b)(1)(B) - any foreign currency contracts
1256 (b)(1)(C) - any nonequity option
1256 (b)(1)(D) - any dealer equity options
1256 (b)(1)(E) - any dealers securities option

- IRC Section 1256 Tax Treatment

Mark to Market : each $1256 contract held at the close at the taxable year should be treated as sold for its FMV. Basis in the contract is adjusted for any mark inclusion.
60/40 Treatment : any gain or loss attributable to a $1256 contract will be treated as 40% short term and 60% long term capital gain or loss

Exception -Foreign Currency Contract - Mark to Market as ordinary treatment unless election is made.

MANAGEMENT COMPANY CONSIDERATIONS

PTE Tax -IRS Notice 2020-75

- Address the state workaround for the pass-through entity (PTE) tax, the IRS announced in Notice 2020-75, on November 9, 2020, its plan to issue regulations on the deductibility of payments by partnerships and S corporations for certain state and local income taxes.
- To date, the IRS has not issued these proposed regulations.

Key provisions of Notice 2020-75:

- "Specified Income Tax Payments" are deductible by partnerships and S corporations in computing their non-separately stated income or loss.
- The term Specified Income Tax Payment means "any amount paid by a [PTE] to a State, a political subdivision of a State, or the District of Columbia (Domestic Jurisdiction) to satisfy its liability for income taxes imposed by the Domestic Jurisdiction on the [PTE]."
- The guidance applies for tax payments made on or after November 9, 2020. Further, taxpayers can rely on the notice and apply it to a PTE's tax payments made after December 31, 2017.
- Notice 2020-75 does not mention any state(s) and/or its tax computation mechanics.

PTE Tax -Taxpayer Consdierations

- Continual evolution of PTE tax regime landscapes, regulations, and applications
- Impact on an owner's resident state tax credit for taxes paid to other states
- Deciding, in the case of a multi-tiered partnership structure, which entity should make the election
- Complications with guaranteed payments
- Treatment of part-year partners
- How to best address the risk of multi-state resident credit concerns
- Treatment of certain separately stated income (e.g., passive activity losses, capital losses), which would normally be subject to partner-level limitations as applied to the state PTE tax base
- Cash flow issues, such as duplicative state tax payments that may result upon election
- Estimated payment requirements
- Mechanisms and systems in place to fulfill online filing requirements and data management

QUALIFIED SMALL BUSINESS STOCK - LEVERAGING THE BENEFIT

- Gain exclusion = Greater of $10M or 10X basis, lifetime limit per issuer which applies to both married and single taxpayers
- Gain more than lifetime limit? – Consider transfer of stock to an irrevocable trust to maximize QSBS tax benefit

QUALIFIED OPPORTUNITY ZONE FUNDS

- Defer income from liquidity events when net proceeds are invested into a QOZ fund, if certain criteria are met
- Investment deadline = 180 days
- Gain from direct investment vs. pass-through
- entity?
- Income inclusion event – Deferred amount included in the gross income of taxpayer upon the earlier of December 31, 2026, or when the QOZ investment is sold
- Additional tax benefits - If the investment is held for 10 years, 100% of the appreciation from the fund is tax free.

IRC SECTION 461 (l) - EXCESS BUSINESS LOSS LIMITATION

- Limits amount of trade/business losses noncorporate taxpayers can utilize to offset nonbusiness income
- Effective for tax years 2021 through 2028
- 2022 business loss limit = $270,000 ($540,000 for joint
- returns)
- Limit application – After outside basis, at-risk and passive activity loss limits
- Trader vs. investor fund considerations
- Net operating loss vs. non-deductible expense oIncome includible in excess business loss calculation oPass-through entity tax deduction considerations

POLLING QUESTION

BONUS DEPRECIATION

- New or used property with a useful life of 20 years or less will qualify
- Federal first year depreciation limits on eligible property

2022 – 100% of purchase price
2023 – 80% of purchase price
2024 – 60% of purchase price
2025 – 40% of purchase price
2026 – 20% of purchase price
2027 and beyond – 0% of purchase price

THANK YOU FOR LISTENING

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