

Hedge Funds Year-End Tax Strategies

TAXES

OUR FEATURED PANELISTS

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Program level : Basic

No prerequisites are required

No advance preparation is required



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ABOUT



AKRAM & ASSOCIATES IS A FULL-SERVICE ACCOUNTING FIRM PROVIDING ASSURANCE, ADVISORY, AND TAX SERVICES FOR THE FINANCIALLY SAVVY, ESPECIALLY HEDGE FUNDS & CRYPTOCURRENCY FUNDS.

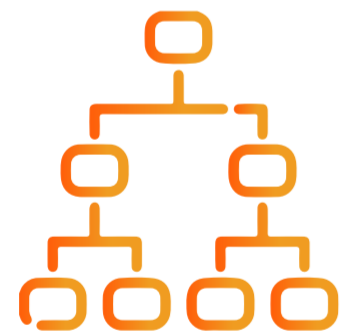
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A MULTI-FAMILY OFFICE AND TAX FIRM SPECIALIZING IN HIGH AND ULTRA-HIGH NET WORTH INDIVIDUALS, WE ARE COMMITTED TO RECOGNIZING AND MEETING THE UNIQUE NEEDS OF OUR VALUED CLIENTS.

AGENDA



Year-end Tax Planning



Investment Structuring Considerations



Legislative Updates

HEDGE FUND CONSIDERATIONS

- Review year-to-date taxable income to book income
- **Wash sales**
 - Loss on sale of security is not allowed if "substantially identical" security is purchased 30 days before or after date of sale
 - Ways to harvest loss while maintaining exposure:
 - Basket swap (long or short position)
 - Doubling down
 - Options
- **Straddles**
 - Holding offsetting positions in actively traded personal property, such as long and short the same stock ("substantial diminution of risk of loss")
 - Holding period termination
 - Timely electing and identifying under the specific identification rules

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. Be aware of Wash Sales rules and sell before STCG to LTCG. Preferential

HEDGE FUND CONSIDERATIONS

■ **Unsettled short positions**

- Covering short positions with losses must be settled in December for loss to be allowed in the current tax year

■ **Constructive sales**

- Recognize gain to extent an unrealized appreciated position is offset by another position effectively "locking" in the gain
- Closed transaction exception

■ **Worthless securities**

- Security becomes wholly worthless during the taxable year. Treated as a sale or exchange on the last day of the taxable year

■ **Trader vs. Investor status**

- Annual test

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

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.



POLLING QUESTION

WHEN CONSIDERING TAX IMPLICATIONS FOR INVESTMENTS, WHAT FACTORS SHOULD BE CONSIDERED TO DETERMINE THE OPTIMAL TIMING FOR RECOGNIZING WINS AND LOSSES?

- a) Current and projected tax situation for the current and next year.**
- b) Phase of the moon and astrological signs.**
- c) Preference for short-term or long-term gains, irrespective of tax implications.**

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 manner.**

PFIC AND FAMILY OFFICE STRUCTURES MAY 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**

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

SECTION 988 (A) (1) (B) ELECTION

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



MANAGEMENT COMPANY CONSIDERATIONS

MANAGEMENT COMPANY AND GP CONSIDERATIONS

- **Bonus depreciation - 80% for 2023**
 - State conformity
- **Business meals 50% deductible for 2023**
- **Self-employment Limited Partner exception**
- **Pass-through entity tax (PTET) state regimes**
 - Ensure payments are made timely to receive federal deduction
- **New Jersey market based sourcing**

INVESTMENT STRUCTURING CONSIDERATIONS

■ **Qualified Small Business Stock (QSBS) - Sec. 1202**

- Eligible shareholder (individual, pass-throughs). Partners of partnerships must be members at the time the partnership acquires QSBS
- Original issuance – must receive stock directly from the company in exchange for cash, property (not stock), or services
- Held for more than 5 years (unless Sec. 1045 rollover)
- The corporation (issuer) must be a C corporation (S corporation does not qualify)
- Gross asset test – assets must not exceed \$50mm (tax basis) before and immediately after issuance
- Active business requirement – for substantially all the holding period, substantially all the assets must be used in the active conduct of a qualified trade or business
- Not all states conform

INVESTMENT STRUCTURING CONSIDERATIONS

■ **Qualified Small Business Stock (Sec. 1202)**

- Gain eligible for exclusion is limited to greater of \$10 million (lifetime limit), or 10 times adjusted basis in stock sold
- Holding period can tack in certain scenarios (transfer by gift or at death, tax-free exchange under Sec. 351 or 368, distribution to partner)
- If stock is owned by a pass-through entity, owners may exclude pro rata share of gain
- Contribution of stock to partnership will lose QSBS status
- Carried interests may qualify depending on the facts
- Opportunity to rollover gain under Sec. 1045

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**

INVESTMENT STRUCTURING CONSIDERATIONS

■ Contributions of property to a partnership

- Generally, tax free under sec. 721(A)
 - Exception to nonrecognition when a partner contributes property to a partnership classified as an investment company under Sec. 721(B)
 - Disguised sale considerations may apply if related distributions from partnership under Sec. 707(A)(2)(B)
- Holding period and tax basis of property carries over to partnership
- Tracking of built-in-gain or loss (FMV less tax basis) on contributed property for tax allocations



POLLING QUESTION

WHAT IS THE DEDUCTIBLE PERCENTAGE FOR BUSINESS MEALS IN 2023 UNDER CURRENT TAX LAW?

- a) 80%**
- b) 50%**
- c) 100%**

INVESTMENT STRUCTURING CONSIDERATIONS

■ Distributions of property from a partnership

- Generally tax free
- Current distributions
 - Tax basis and holding period in distributed property carries over from partnership to partner
 - Tax basis of the distributed property reduces the partner's tax basis in the partnership but not less than zero
- Liquidating distributions
 - Tax basis in distributed property is adjusted to equal the partner's tax basis in the partnership interest, reduced by any cash received
 - Similar to current distributions, holding period of distributed property carries over from partnership to partner
- Distribution of marketable securities treated as money (at FMV)
 - This does not apply to investment partnerships

- **Potential 734 basis adjustments**
- **Consider partnership mandatory basis adjustments under Sec. 734**
 - **Example: Partner A receives securities with a \$10,000 tax basis in a liquidating distribution from an investment partnership. Immediately before the distribution, Partner A has a \$300,000 outside tax basis in the partnership. This would cause the partnership to reduce the tax basis of the remaining assets by \$290,000**
- **Distribution of Sec. 751(B) hot assets**
 - **Could be taxable upon distribution**
 - **Prevents the reclassification from ordinary to capital gains**
- **Careful with property distributions occurring within 7 years related to the following:**
 - **Distributing property previously contributed by a partner with a built-in-gain to a non-contributing partner**
 - **Distributing property to a partner who had contributed other property with a built-in-gain to the partnership**
- **Consider disguised sale rules when a partner receives a distribution of property within 2 years from making a cash contribution to the partnership**

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 manner. Conversely, investors should consider whether investing in a fund via private placement life insurance or private placement variable annuities is potentially a more tax-efficient way to invest. Investing in an IDF can eliminate income and estate taxes if done properly.

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**

CONTD.

- **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**

IRC SECTION 461 (I) - 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 income includible in excess business loss calculation pass-through entity tax deduction considerations**



POLLING QUESTION

HOW ARE DISTRIBUTIONS OF MARKETABLE SECURITIES TREATED IN A PARTNERSHIP DISTRIBUTION?

- a) As cash at FMV
- b) As non-taxable
- c) As hot assets under Sec. 751(B)

LEGISLATIVE UPDATES

A close-up, high-angle shot of a business meeting. Several people are gathered around a table, examining various documents and charts. One person in the foreground is pointing at a chart with a pen. The documents feature various data visualizations, including line graphs, bar charts, and pie charts. The scene is lit with warm, golden light, creating a professional and focused atmosphere. The text 'LEGISLATIVE UPDATES' is overlaid in large, white, bold letters on the left side of the image.

LEGISLATIVE UPDATES

- **Prospect for tax package before year end**
 - Restoring expensing of R&D expenditures
 - Permanently allowing 100% bonus depreciation
 - Restoring more generous allowance for interest expense deduction (limiting interest on earnings before amortization and depreciation)
- Wash sales and digital assets
- FinCen beneficial ownership information reporting under the corporate transparency act
- Increase in large partnership audits



THANKS FOR LISTENING



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