An outreach activity of The University of Akron's
Master of Taxation program (http://MTaxDirect.uakron.edu)

AGENDA

7:55 | **Welcome** | Dr. Thomas Calderon, Professor of Accounting

8:00 – 8:45 | **Putting "Success" Back into Business Succession Planning** | Tom Pauloski, JD, National Managing Director / Wealth Planning and Analysis Group | AllianceBernstein

8:45 – 9:45 | **Planned Giving of S Corporation Stock** | Bryan Clontz, PhD, CFP, CLU, ChFC, CAP, AEP, RICP, CBP, President | Charitable Solutions, LLC

9:45 – 9:55 | Break

9:55 | Remarks | Laura Fink, Senior Director of Development and Professional Advisor Relations | Akron Community Foundation | Dan Brophy, Private Bank Regional Director | Huntington National Bank

10:00 – 11:30 | **Panel: Estate Planning Post COVID-19**
Moderator: Joseph Wojcik, Sr. Vice President – Wealth and Investment Management | Huntington National Bank
Panelists:
Theodore A. Wagner, CPA, CVA, Cleveland Managing Partner – Taxation Services | Bober Markey Fedorovich
Jason Bogniard, MBA, ASA, CVA, EA, Principal – Business Valuation | Apple Growth Partners
Michael Wear, AEP® JD, Partner | Buckingham, Doolittle & Burroughs, LLC

11:30 – 11:45 | Break

11:45 – 12:15 | Keynote Sponsored by Glenmede
Financial Markets and the Economy | Uma Rajeshwar, CFA, CTFA, CFP®,
Managing Director | Glenmede

12:15 – 1:00 | **Tax Consequences To Debtors of a Discharge And Modification of Debt** | Tony Bakale, CPA, MT, Partner & Technical Director, Tax | Cohen & Company

1:00 – 1:45 | **Tax Basis Capital Account Reporting**
Angelina Milo, CPA, Vice President – Tax Services Group | Meaden & Moore and
Brent Thompson, CPA, MT, Vice President – Tax Services Group | Meaden & Moore

1:45 – 2:00 | Break

2:00 – 2:45 | **Maximizing the Benefit of Losses** | Dave Groves, CPA, Principal | CliftonLarsonAllen

2:45 – 3:30 | **Impact of Artificial Intelligence and Smart Technology on the Tax Practice** | Matt Skaletski and Ds Davlyatov | Ernst & Young, LLP

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if you have any questions.

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- **Tim Gerspacher**, B.A., MPAcc Taxation, *Tax Partner*, PricewaterhouseCoopers
- **Julianne Jones**, J.D. MTax, CPA, *Associate Professor*, The University of Akron
- **Robert Malone**, J.D., B.A., *Partner*, Buckingham, Doolittle, & Burroughs, LLC
- **Melanie McCoskey**, Ph.D., CPA, *Associate Professor*, The University of Akron
- **Doron Narotzki**, S.J.D., The University of Akron
- **William Nolan**, BBLS, ACA , *Manager*, Financial Accounting Advisory Services, Ernst & Young, LLP
- **Jonathan Penwell**, M.A., B.A., CPA , *Subject Matter Expert*, IRS
- **Gregory Rosko**, BSBA, MTax, J.D., *Tax Partner*, PricewaterhouseCoopers
- **Carol Szczepanik**, J.D., LL.M., *Senior attorney (Criminal Tax)*, Office of Chief Counsel, IRS, retired
- **Michael Urse**, B.A., J.D., CPA, *International Tax Partner*, PricewaterhouseCoopers
- **Matt Wallace**, BSBA, M.S. Tax, *International Tax Partner*, PricewaterhouseCoopers

Testimonials from Former Students

Pete Underation, CPA, MTax, 2016, *International Tax Director*, Sherwin Williams

“The University of Akron's MTax Program provides students and professionals with the necessary tools to further their career in the field of taxation. The Program addresses all tax disciplines for well-rounded professionals entering the workforce or preparing for the next opportunity. The curriculum and course outline is taught by highly-trained individuals who were in Industry, which adds elements of real-world applicability to the classroom. I highly recommend The University of Akron's MTax program for individuals who are looking to further their career in Tax.”

Pellegrino Piermarini, CPA, MTax, 2017, *Tax In-Charge*, Plante Moran

“I chose to pursue an MTax after I spoke with firm experts during my internship on how to best start my career. I decided to return to The University of Akron because the professors I had as an undergraduate helped me build a great foundation. They are true experts in their field and are often still active tax consultants. This helps bring real life experience to the classroom. The research skills I gained from the program has opened many doors in my career. It introduced me to International Tax and gave me the necessary background to pursue a fellowship with my firm’s International Tax Services Group.”

Sarah Sivic, MTax, 2018, *Tax Consultant II*, Deloitte Tax

“I chose to enter the MTax program as I had interned and committed to a full-time position in federal tax with a Big 4 accounting firm and had been told it would be a very beneficial choice for my career in both the short-term and long-term standpoint. The MTax program not only taught me about the tax code, but also gave me a deeper perspective of tax policies and issues that are present in the world around me. Every class was an undeniably entertaining experience and I truly learned more than I could have ever asked for. I not only gained knowledge of tax law but also obtained life lessons and professional development advice that I will carry with me indefinitely. The professors and my peers made the MTax one of the most influential years of my life and I highly recommend completing the program if you have the opportunity to do so.”

Is A Donor-Advised Fund Right For Your Clients?

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1 Want Maximum Flexibility

Want maximum flexibility to give to multiple charities or change beneficiaries over time.

2 Wish To Involve Their Family

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3 Prefer To Be Anonymous

Prefer to give anonymously and avoid funding appeals.

4 Had An Exceptionally High-Income Year

Have had an exceptionally high-income year in which they need immediate charitable tax benefits, but they prefer to decide which charities to support over time.

5 Do Not Want Burdens Of Fund Management

Would like someone else to handle the administrative work while they focus on their charitable impact.

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For more information, contact Laura Fink at Akron Community Foundation at 330-436-5611 or lfink@akroncf.org. Get more strategic giving tips for your clients at www.akroncf.org/YearEnd.

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Grow Your Charitable Impact

SESSION 1

PUTTING “SUCCESS” BACK INTO BUSINESS SUCCESSION PLANNING

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THOMAS J. PAULOSKI is National Managing Director for Wealth Planning and Analysis, the research division of Bernstein Private Wealth Management's Private Client Group. He works with private clients and their advisors on wealth transfer strategies, focusing on tax-efficient wealth management and asset allocation decisions. Previously, Tom was a partner at the Chicago law firm of Winston & Strawn LLP, where he concentrated his practice in estate, tax, and business planning. Tom also has been a member of the Chicago law firm of Levin & Schreder, Ltd., a Vice President in the Private Client Group of Zurich Life in Long Grove, Illinois, and a partner at the Chicago law firm of Schiff Hardin & Waite.

Tom is a nationally known speaker on estate planning, tax, and insurance issues, and has written numerous articles and continuing legal education materials on estate planning topics. He serves on the faculty of the American Bankers Association National Trust and National Graduate Trust Schools, and has served on the adjunct faculty of the Cannon Financial Institute Schools. Tom has been an adjunct professor at Loyola University Chicago School of Law and has taught estate planning classes at Northwestern University Law School. Tom also has served on the editorial board of *Trusts & Estates* magazine. He retired from the United States Naval Reserve in 2003, after 21 years of service.

Tom received his bachelor of science degree in environmental engineering from Northwestern University, and his juris doctor, *magna cum laude*, from Loyola University Chicago School of Law, where he served as editor-in-chief of the *Loyola Law Journal.*

Putting "Success" Back into Business Succession Planning:

Case Studies

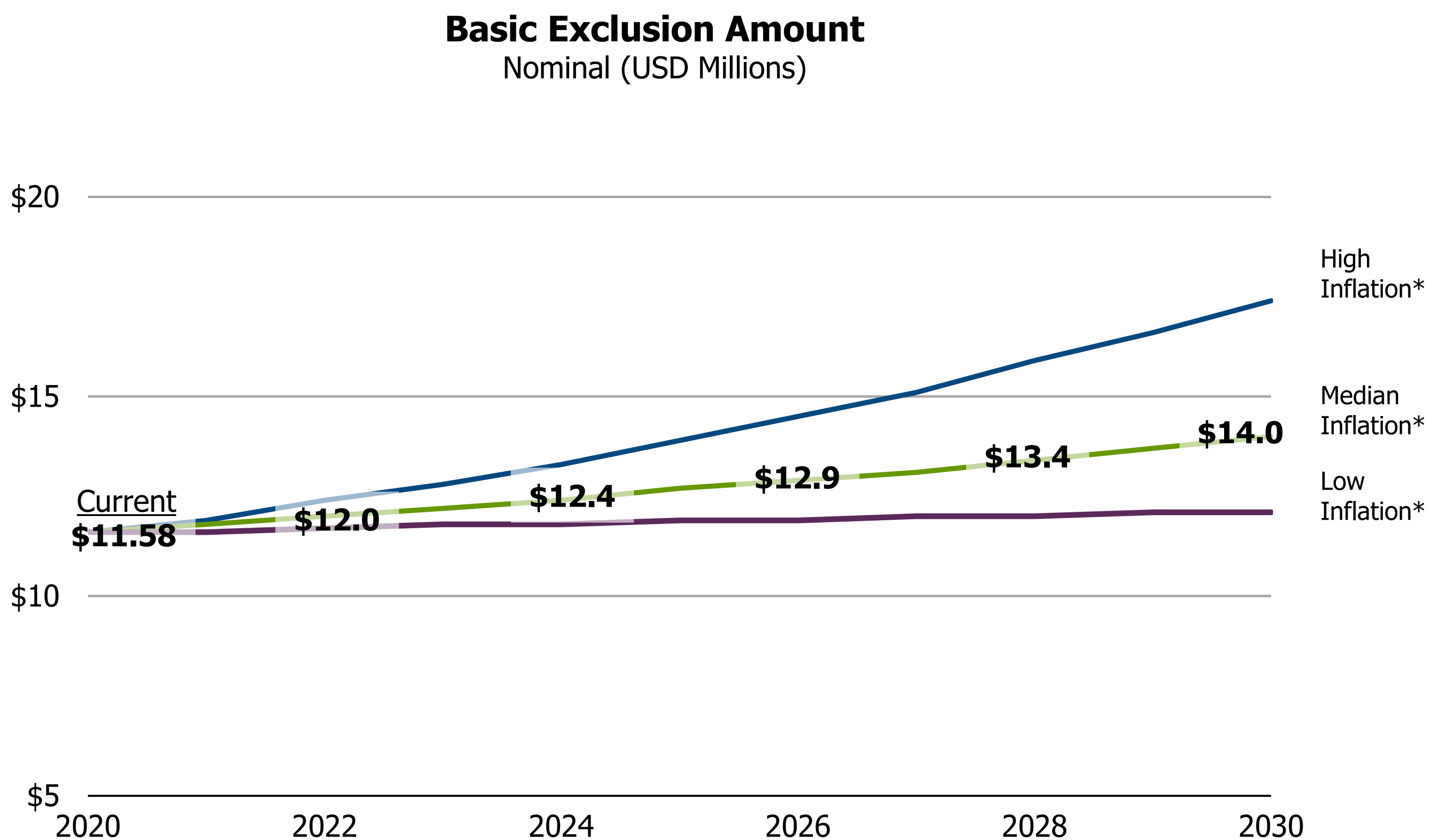
Thomas J. Pauloski, J.D.
National Managing Director
Wealth Planning and Analysis Group

Comparative Highlights of Prior Law and "The Legislation Formerly Known as the Tax Cuts and Jobs Act"

	ATRA, et al.	
	2017	**2020**
Top marginal corporate income tax rate	35%	21%
Top marginal individual income tax rate	39.6%	37%, but up to 20% of domestic qualified business income is deductible
Surtax on net investment income	3.8%	Same
Nonitemizers	Combination of standard deduction and personal exemptions	2x standard deduction; personal exemptions eliminated
Itemized deductions	Subject to "3% cutback"	"3% cutback" and most deductions repealed; state and local tax deduction limited to $10,000 per year
Estate and GST taxes	$5.49M inflation-indexed exclusion; 40% "flat" rate	Same, except 2x prior basic exclusion amount through 2025 (now $11.58M)
Step-up in income tax basis at death	Applies to all decedent's estates	Same

Sources: https://www.congress.gov/congressional-report/115th-congress/house-report/466/1?overview=closed, Rev. Proc. 2019-44 § 3.41 (Nov. 6, 2019), and AB

Projected Effect of Inflation on Basic Exclusion Amount . . .

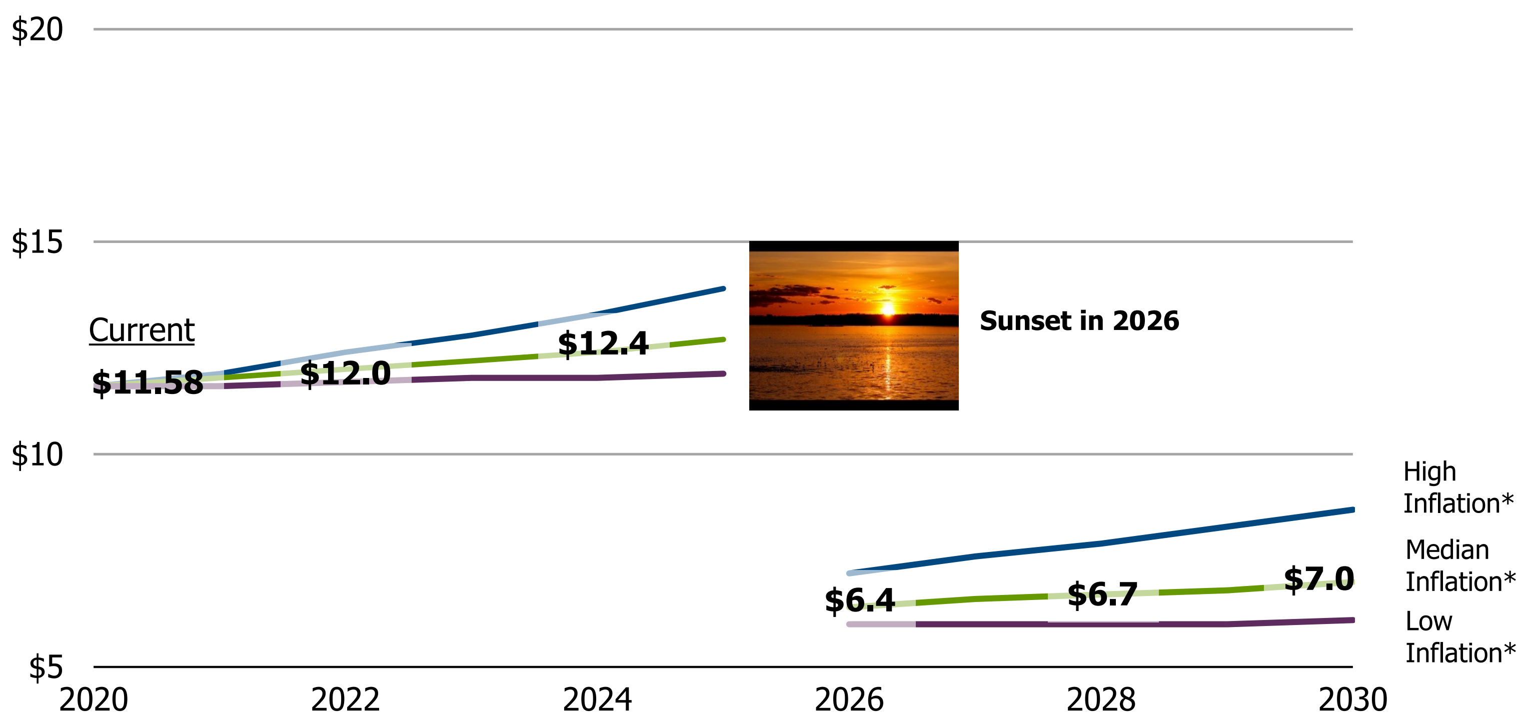


*Based on projected increases in "chained" CPI-U, rounded (except for 2020) to the nearest $100,000 in this display. Basic exclusion amount shown is for an individual, based upon 10th ("high"), 50th ("median"), and 90th ("low") percentile outcomes for the inflation-adjusted basic exclusion amount.
Based on Bernstein's estimates of the range of returns for the applicable capital markets. **Data do not represent past performance and are not a promise of actual results or a range of future results.** See Appendix, Notes on Wealth Forecasting, for details.
Source: AB

. . . Unless We Get This

Basic Exclusion Amount

Nominal (USD Millions)

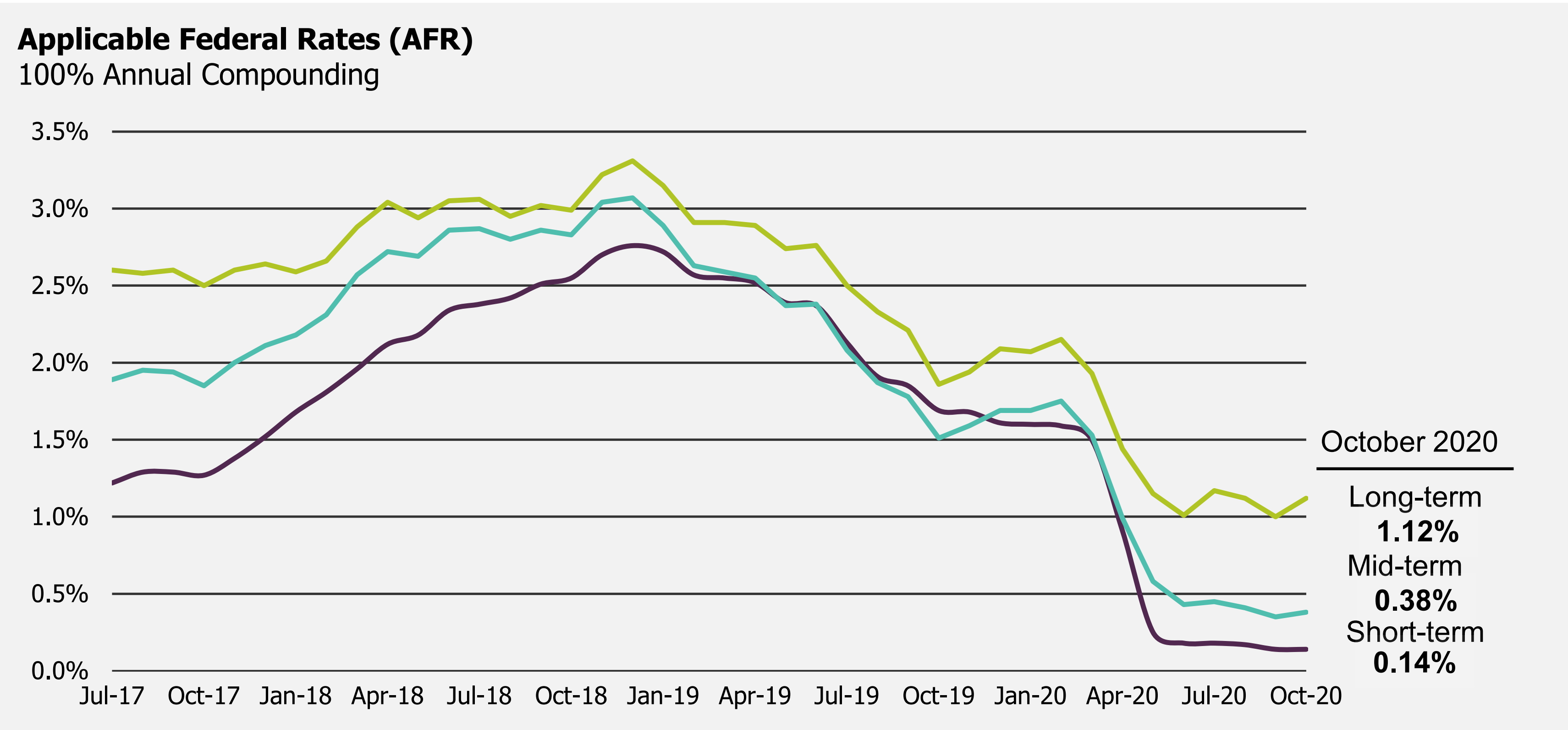


*Based on projected increases in "chained" CPI-U, rounded (except for 2020) to the nearest $100,000 in this display. Basic exclusion amount shown is for an individual, based upon 10th ("high"), 50th ("median"), and 90th ("low") percentile outcomes for the inflation-adjusted basic exclusion amount.

Based on Bernstein's estimates of the range of returns for the applicable capital markets. **Data do not represent past performance and are not a promise of actual results or a range of future results.** See Appendix, Notes on Wealth Forecasting, for details.

Source: AB

Potential Strategy: Lock in Today's Still-Low Interest Rates… But Retain the Option to Complete the Gift Later



Source: www.irs.gov

The Ballot: Top Candidates for Wealth Transfer

Asset category or investment service	Description	Installment sale	Short-term, rolling GRATs	Long-term GRAT	Outright gift
Concentrated, publicly-traded single stock	Stock in a single company that makes up a substantial part of an investor's portfolio.		X		
Diversified portfolio, publicly-traded stocks	A portfolio of companies of different market capitalization, sectors, and geographies.	X	X		X
Responsible US equities	Large cap ,high-conviction portfolio of 80-90 companies. Optimized to minimize exposure to tobacco, defense, guns, fossil fuels, and nuclear power. Selects companies with strong or improving ESG characteristics.	X	X		X
Sustainable international equities	Targets a global (ex-US) universe of companies with strong ESG practices.	X	X		X
Global core equities	High-conviction portfolio of 50-80 companies with high active share and low turnover.	X	X		X
High yield fixed income	Invests primarily in non-investment grade corporate debt.	X	X		X
Securitized assets	Capitalizes on opportunities in securitized assets with a focus on mortgage credit.	X			
Financial services fund	Seeks to capitalize on secular opportunities within the micro-cap bank space.	X	X		X
Energy	Invests across the capital structure in private and public debt and equity of oil producers in the US.	X			
Real Estate	Bernstein real estate portfolios focus on "distressed" opportunities during the early stages of a slow and uneven recover by identifying mispriced assets, restructuring, recapitalizing, and stabilizing.				
High cash flow				X	
Low cash flow		X			
No cash flow		Pair installment sale of real estate with short-term, rolling GRATs funded with marketable stocks			X
Closely held business interests	A business entity whose shares are held by a small number of stockholders, often within just one family. Current valuations of such interests are extraordinarily low due to economic uncertainties.				
High cash flow				X	
Low cash flow		X			
No cash flow		Pair installment sale of business interest with short-term, rolling GRATs funded with marketable stocks			X

Leaning In to Social Distancing: A Perfect Storm for Wealth Transfer

- Environmental factors
  - **Favorable valuations**
  - **Historically low interest rates**
  - Huge applicable exclusion amount
  - **Possibility of adverse tax legislation as early as 2021**
- Current wealth transfer opportunities
  - Grantor retained annuity trust (GRAT) or installment sale to irrevocable grantor trust (IGT)
  - GRAT immunization
  - "Value-shifting" strategy
  - Roth conversion
  - Refinancing intrafamily debt

Bernstein is not a legal, tax, or estate advisor. Investors should consult these professionals as appropriate before making any decisions.
Source: AB

Rumored Provisions of the Biden Tax Plan

Rumored Income Tax Provisions of Biden Plan

- Increase income taxes **for taxpayers with income > $400,000**
  - Restore pre-2018 **top marginal rate of 39.6%**
  - Limit itemized deductions to 28% tax benefit
  - Restore Section 68 3% limitation on itemized deductions
  - Impose 12.4% payroll tax (employee and employer share)
  - **Eliminate Section 1031 exchanges** for real estate investors
  - **Repeal Section 199A deduction**
- Tax capital gains and dividends at ordinary rates for taxpayers with income > $1 million
- **Increase corporate tax rate from 21% to 28%**
- Repeal $10,000 limitation on state and local tax (SALT) deduction

Source: AB

Rumored Transfer Tax Provisions of Biden Plan

- "Back to the Future": Return to 2009
  - $3.5 million estate tax exclusion not indexed for inflation
  - **$1 million lifetime gift tax exclusion not indexed for inflation** (would reduce estate tax exclusion if used)
  - 45% estate, gift, and generation-skipping transfer (GST) tax rate
- Tax unrealized capital gains or eliminate basis "step-up" at death (carried over from Obama-era proposal)
  - Transfers to spouses and charity exempt
  - $100,000 per-person exclusion
  - Tangible personal property excluded
  - Capital gains tax paid is deductible against estate tax

Source: AB

Potential Resuscitation of Obama-Era Transfer Tax Proposals

- Grantor retained annuity trusts (GRATs)
  - Prohibit annuity terms shorter than 10 years
  - Require minimum remainder interest of 25% at inception
- **Grantor trusts**
  - **Prohibit grantors from engaging in tax-free exchanges with trust**
  - **Require property transferred to trust by sale or exchange, increased by appreciation and distributions of such property, to be included in grantor's estate**
- Annual cumulative cap of $50,000 on annual exclusion gifts

Source: AB

Overview: The Path for Enactment

- Democrats would need to sweep the House, Senate, and White House
  - Maintain control of House
  - Pick up four seats in the Senate (simple majority)
  - Win the White House
- What about the Senate filibuster?
  - Can be bypassed using budget reconciliation process
  - Byrd Rule is not applicable because Biden tax proposals would reduce, not increase, deficit
- Two additional obstacles
  - Political capital of Senators in purple states
  - Fragility of economic recovery during ongoing recession and pandemic

Source: AB

Possible Retroactivity of Biden Tax Plan

- Act becomes generally becomes effective on the date of its enactment, unless otherwise provided
- Retroactive tax law is permitted, provided it doesn't create new tax
  - No Constitutional prohibition against retroactivity
  - "A taxpayer has no vested right in the Internal Revenue Code," U.S. v. Carlton, 512 U.S. 26, 33 (1994)
- Example: Deficit Reduction Act of 1993 increased estate tax rate from 50% to 55%
  - Top marginal transfer tax rate decreased from 55% to 50%, effective 1/1/93
  - Act purported to restore 55% rate, retroactive to 1/1/93
  - Congress passed bill, and President Clinton signed into law on 8/10/93
  - Taxpayers lost Constitutional challenges at Federal District Court level

Source: AB

Case Study: Preparing for the *Next* Transaction

Assumptions

- John, age 43, is an Illinois resident, is married, and has four children
- Assets
  - $10 million liquid, assumed to be invested 60% global stocks* and 40% bonds
  - Closely held business interest, with second liquidity event in May 2018 expected to generate between $20 million and $35 million, pre-tax
- Annual pre-tax salary of $250,000, expected to increase 5% each year for the next five years
- Spending
  - We modeled core spending of $125,000 to $250,000 per year, indexed for inflation
  - We assumed that 10% of John's pre-tax salary will be tithed to the church each year for the next five years
- Time horizon: 50 years

*Throughout this analysis, "global stocks" means 21% U.S. value, 21% U.S. growth, 21% U.S. diversified, 22.5% developed international, 7.5% emerging markets, and 7% U.S. small/mid-cap.
Source: AB

Wealth Transfer Framework: Key Questions Post-ATRA

Lifestyle Spending	
Personal Reserve	

Core Capital

- How likely is it that core assets needed to support lifestyle will be *less than* the inflation-indexed applicable exclusion over time?
- Does the inflation-indexed exclusion provide an opportunity to reserve more for long-term care?

Extra Spending	
Opportunistic	
Children Grandchildren	
Charity	

Surplus Capital

- How much (if any) can stay in the estate without estate tax exposure?
- What are the *income* tax characteristics of capital earmarked for wealth transfer?
- What are the income tax consequences to the beneficiary upon liquidation?
- Can grantor trusts be used to facilitate periodic repositioning of assets, based on potential for growth *and* favorable income tax characteristics?

Source: AB

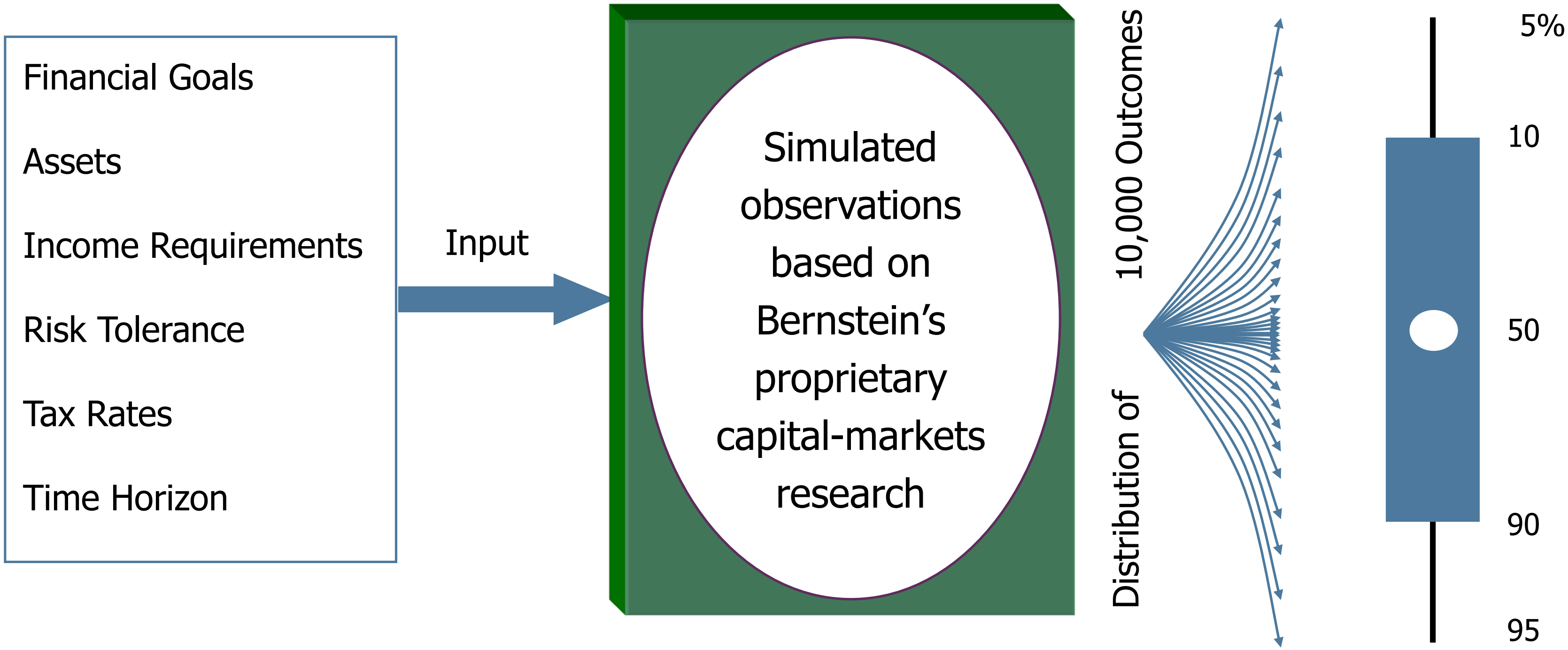
Analytical Model*

Quantifying the Trade-Offs

Personal Profile Data

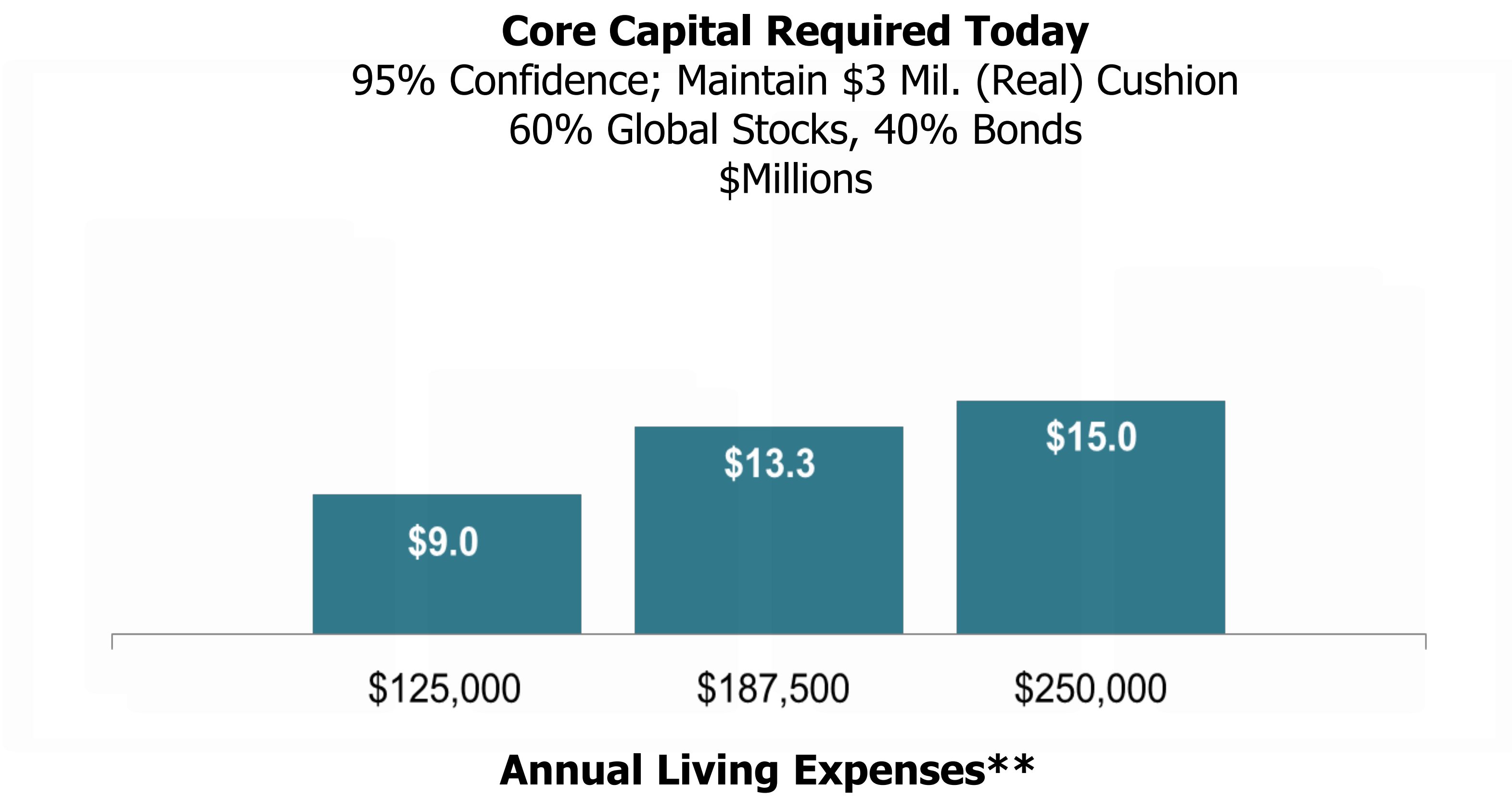
Wealth Forecasting Model

Probability Distribution



*See Appendix, Notes on Wealth Forecasting System, for details.
Source: AB

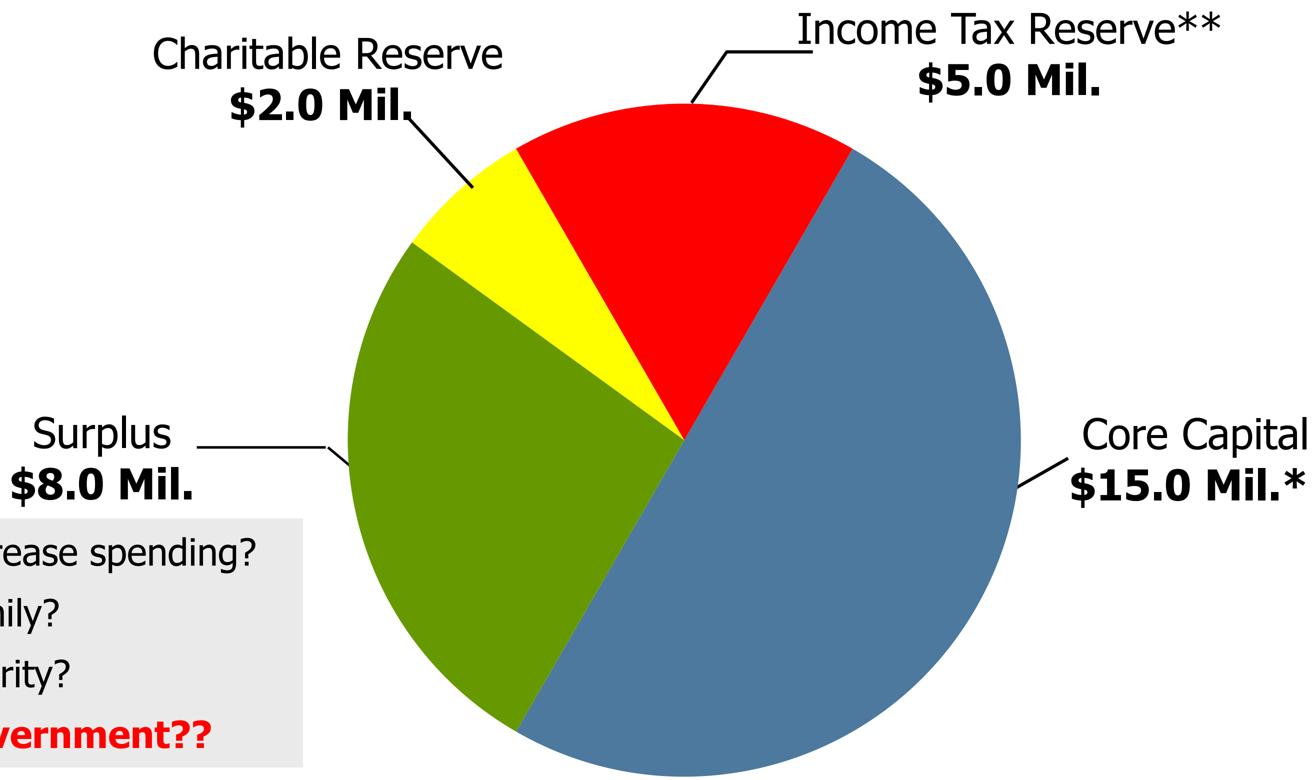
Amount Needed to Fund Core Spending for 50 Years*



Based on Bernstein's estimate of returns for the applicable capital markets for 50 years. Data does not represent past performance and is not a promise of actual or range of future results.
*Core capital calculated at 95% level of confidence with a $3 million (real) "cushion" throughout. Variations in actual income, spending, applicable tax rates, time horizon, and market returns may substantially impact the likelihood that a core capital estimate will be sufficient to provide for future expenses. See Appendix, Notes on Wealth Forecasting System, for details.
**Annual living expenses are indexed for inflation. Computations assume pre-tax income of $250,000 per year, and charitable gifts of $25,000 per year, each grown by 5% annually, for the next five years.
Source: AB

Proposed Allocation of Wealth Today

Total Wealth Today = $30 Mil.
(Assumes $20 Mil. Business Valuation)



- Increase spending?
- Family?
- Charity?
- **Government??**

Bernstein's estimates of the range of returns for the applicable capital markets over next 50 years. Data does not represent past performance and is not a promise of actual or range of future results. See Appendix, Notes on Wealth Forecasting System, for details. Bernstein does not provide legal or tax advice. Consult with competent professionals in these areas before making any decisions.

*"Core Capital" calculated at 95% level of confidence with a $3 million (real) "cushion" throughout. Variations in actual income, spending, applicable tax rates, time horizon, and market returns may substantially impact the likelihood that a core capital estimate will be sufficient to provide for future expenses.

**"Income Tax Reserve "assumes that the pre-tax proceeds of the business sale are $20 million, offset in part by a 10% ($2 million) cash contribution to charity that qualifies for an income tax charitable deduction.

Source: AB

Pre-Transaction Planning: Preserving Wealth for Family

Expected Surplus* if Business Sells for…

…$20 Million

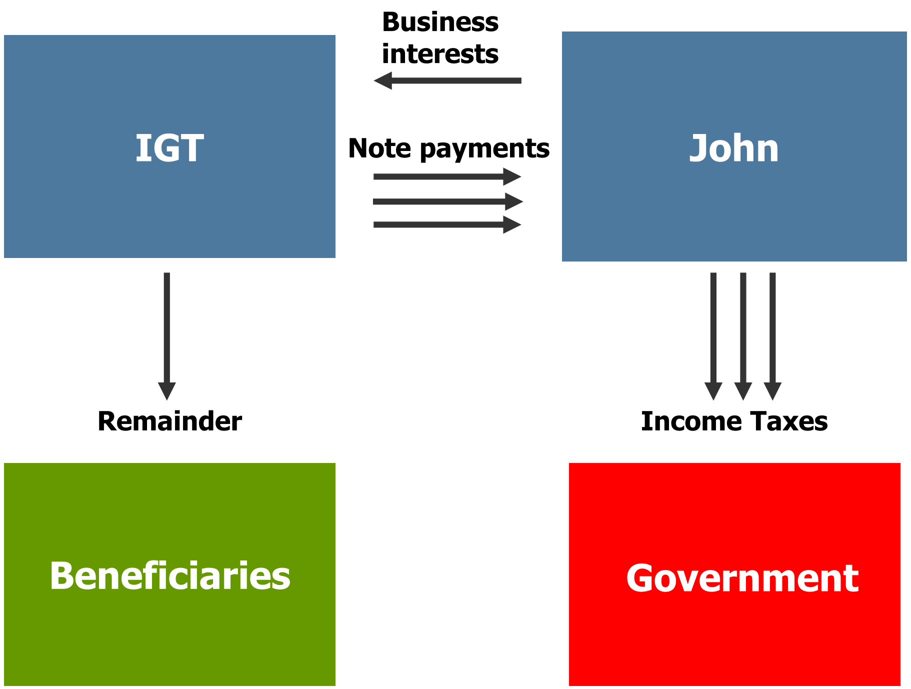
…$35 Million

Bernstein’s estimates of the range of returns for the applicable capital markets over next 50 years. Data does not represent past performance and is not a promise of actual or range of future results. See Appendix, Notes on Wealth Forecasting System, for details.

*“Surplus” means total portfolio post-sale, less core capital, income taxes, and charitable contribution. Core capital calculated at 95% level of confidence with a $3 million (real) “cushion” throughout. Variations in actual income, spending, applicable tax rates, time horizon, and market returns may substantially impact the likelihood that a core capital estimate will be sufficient to provide for future expenses. Income tax computation assumes that the pre-tax proceeds of the business sale are $20 million or $35 million, offset, in part by a 10% ($2 million or $3.5 million) income tax charitable deduction. Bernstein does not provide legal or tax advice. Consult with competent professionals in these areas before making any decisions.

Source: AB

How Installment Sale to Irrevocable Grantor Trust (IGT) Works



Key points:

- **John transfers some or all of his business interests* to IGT**
- **In effect, transaction is treated as part-gift (10%), part-sale (90%)**
- **In exchange for portion of business interest sold, John receives promissory note, principal and accrued interest to be repaid from sale proceeds in May 2018**
- **Until then, John pays all income taxes on behalf of IGT and its beneficiaries**
- **Growth in excess of "mid-term applicable federal rate" of interest (1.65% in December 2013) may avoid gift, estate, and GST taxes****

If transaction is structured properly and John fails to survive note term, value of note (*not assets sold*) will be subject to estate tax at John's death

Bernstein does not opine on the availability or amount of any valuation discount, and does not provide legal, or tax advice. Consult with competent professionals in these areas before making any decisions.

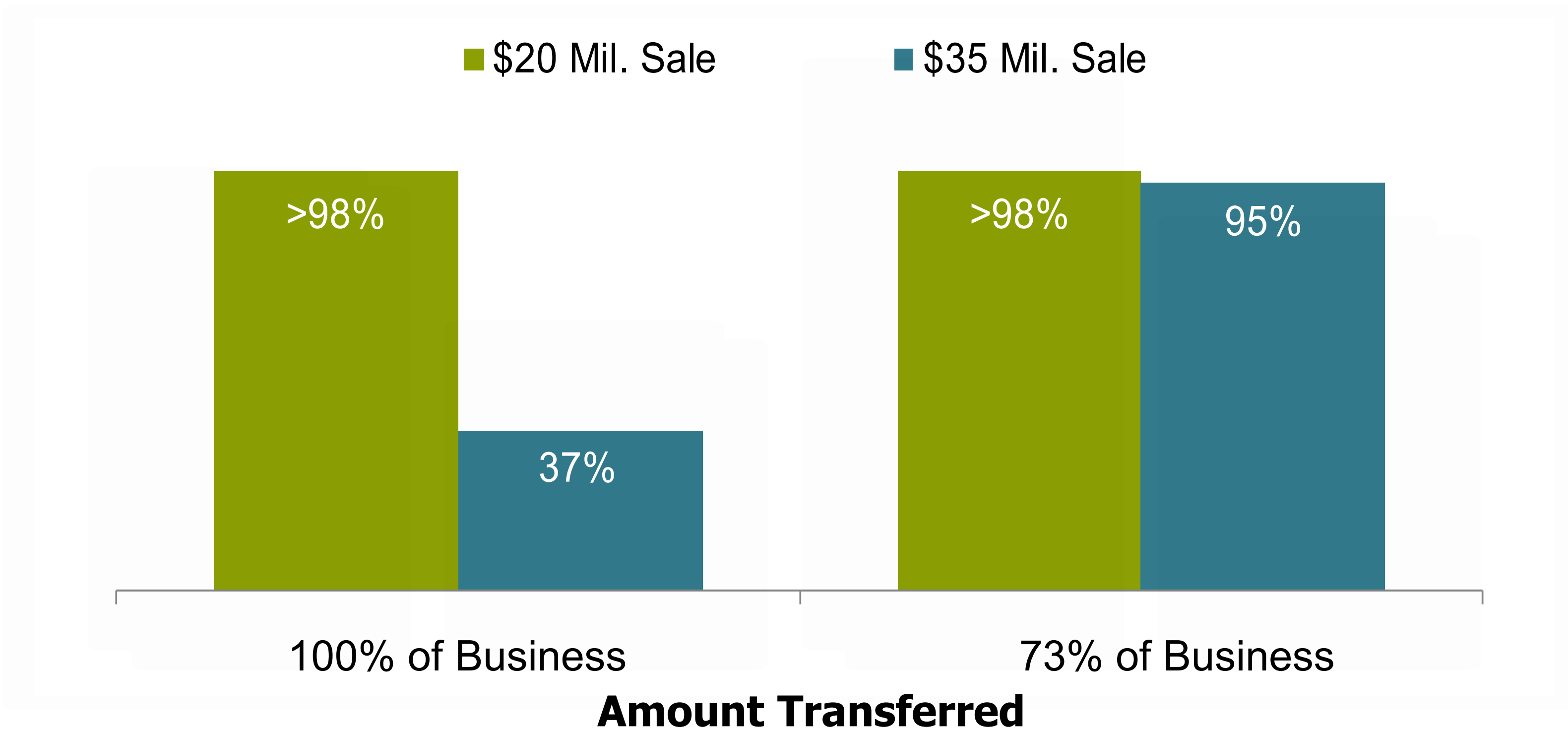
*For purposes of this analysis, we assumed a 20% discount off the expected pre-tax transaction value of $20 million for John's business interests.

**Potential benefit to the IGT and its beneficiaries equals any discount allowed for federal transfer tax purposes, plus IGT's share of sale proceeds in excess of $20 million expected pre-tax transaction value, less 1.65% interest payable on discounted sale price. In this analysis, interest is accrued and added to principal each year; for tax purposes, it may be advisable to pay, rather than accrue, interest annually.

Source: AB

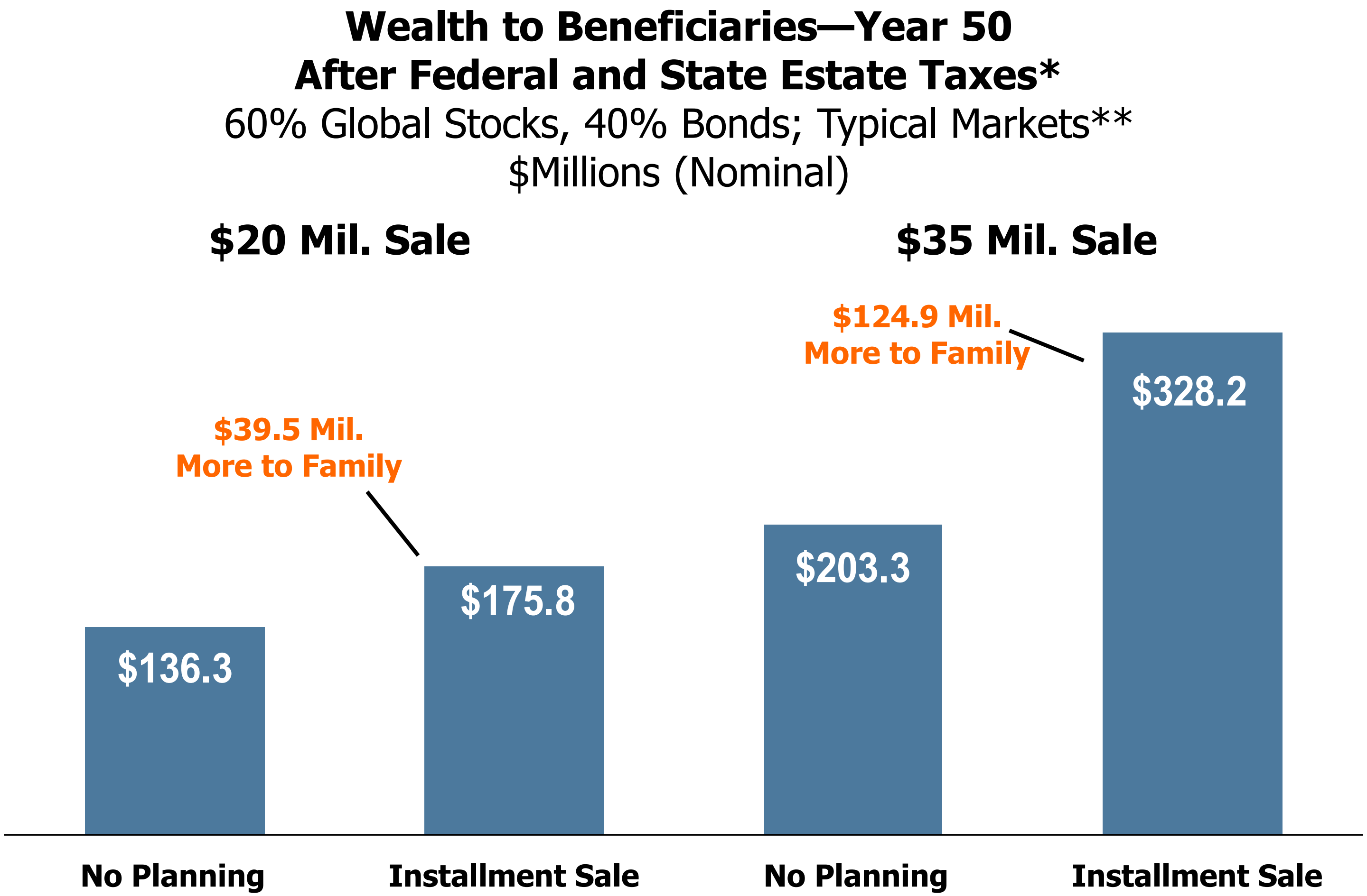
Correctly Sized, Installment Sale Should ***Not*** Affect John's Spending Plan

Probability of Assets Greater than $3 Million (Inflation Adjusted) in 50 Years*
$250,000 (Real) Annual Spending; 95% Confidence; Maintain $3 Mil. (Real) Cushion
60% Global Stocks, 40% Bonds



Based on Bernstein's estimate of returns for the applicable capital markets for 50 years. Data does not represent past performance and is not a promise of actual or range of future results. See Appendix, Notes on Wealth Forecasting System, for details. Bernstein does not provide legal or tax advice. Consult with competent professionals in these areas before making any decisions.
*Calculated at 95% level of confidence with a $3 million (real) "cushion" throughout, assuming John pays income taxes as "deemed owner" of all assets held in the IGT for 25 years after the sale. Variations in actual income, spending, applicable tax rates, time horizon, and market returns may substantially impact the likelihood that a core capital estimate will be sufficient to provide for future expenses.
Source: AB

Pre-Transaction Planning Plus Compounding Wealth Off Balance Sheet Can Provide Huge Tax Savings



Based on Bernstein's estimates of the range of returns for applicable capital markets for 50 years. Data does not represent past performance and is not a promise of actual future results. See Appendix, Notes on Wealth Forecasting, for details. Bernstein does not provide legal or tax advice. Consult with competent professionals in these areas before making any decisions.
*Assumes federal applicable exclusion amount of $5.25 million, indexed for inflation for 50 years, "flat" federal estate tax rate of 40%, and deduction for state death tax paid; assumes Illinois estate tax at rates described in Section 2011(b) of the Internal Revenue Code of 1986, as amended, for taxable estates in excess of $4 million.
**"Typical Markets" means 50th percentile results of 10,000 trials in our Wealth Forecasting System.
Soucrce: AB

Case Study: Preparing for a *Possible* Transaction

Assumptions

- David, age 51, and Anne, age 52, are Maine residents and have four children
- Assets
  - $470,000 million liquid, assumed to be invested 60% global stocks and 40% bonds
  - Closely held business interest, with estimated enterprise value of $35 million (pre-tax)
- Annual pre-tax salary of $342,000, expected to increase with inflation each year for the next three years
- Expenses
  - Core spending of $200,000 per year, indexed for inflation
  - Home purchase for $700,000 in 2025
- Time horizon: 45 years

Source: AB

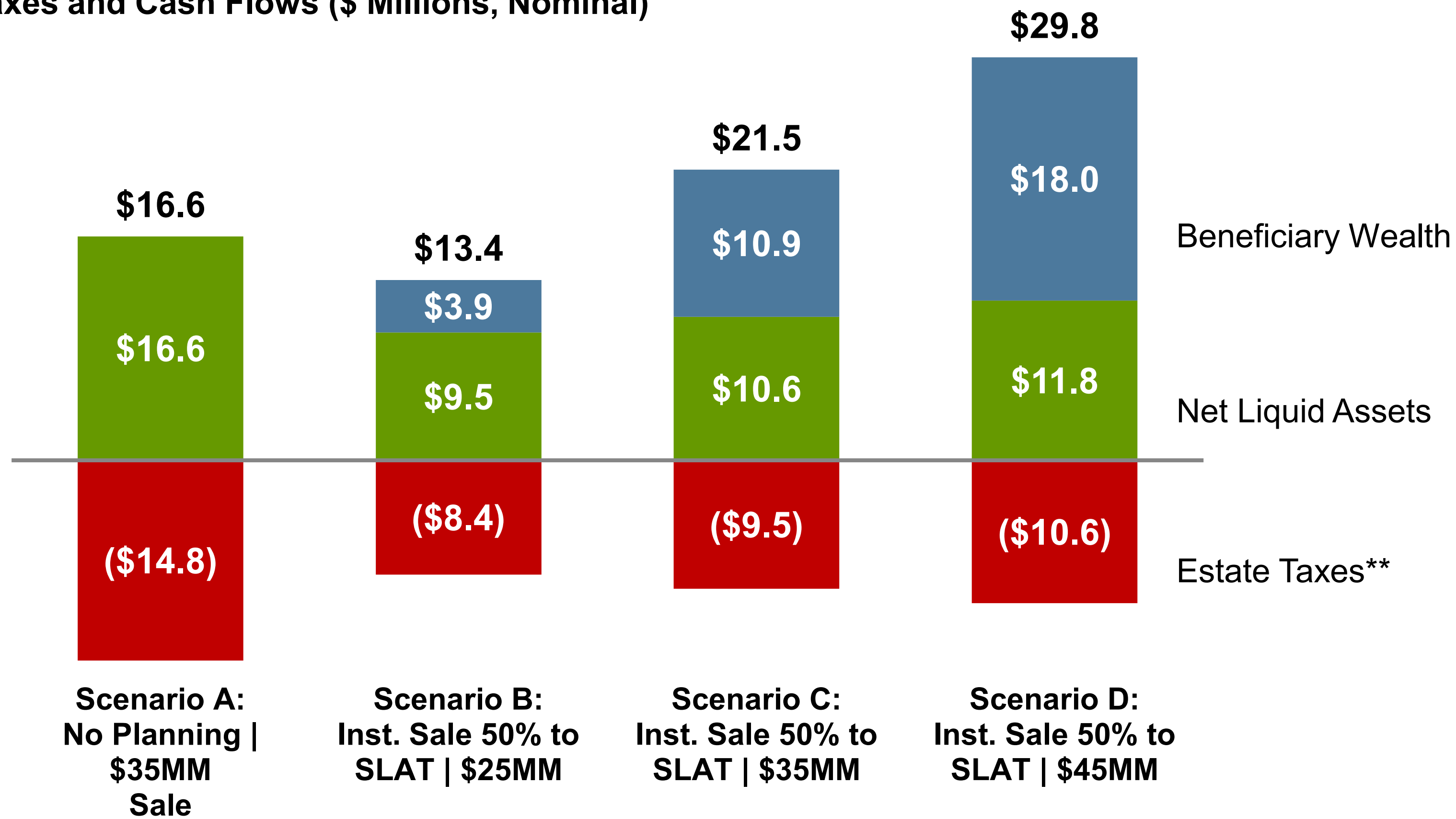
Estate Planning Scenarios

- Scenario A: No pretransaction wealth transfer; David sells 100% of LLC member interests to third-party purchaser for $35 million (pre-tax) in 2023
- Installment sale scenarios
  - Scenario B: David sells 50% of his LLC member interest to spousal lifetime access trust (SLAT) in exchange for a promissory note; 100% of outstanding member interests are sold to third-party purchaser for $25 million (pre-tax) in 2023
  - Scenario C: Same as B, except business is sold for $35 million
  - Scenario D: Same as B and C, except business is sold for $45 million
- Installment sale details
  - SLAT is structured as an irrevocable ("intentionally defective") grantor trust
  - Sale price = $13.1 million (= 50% interest x $35 million enterprise value, less 25% valuation discount)
  - Nine-year note; interest rate = 0.41% (July 2020 mid-term AFR); balloon principal payment at maturity

Source: AB

Potential Estate Tax

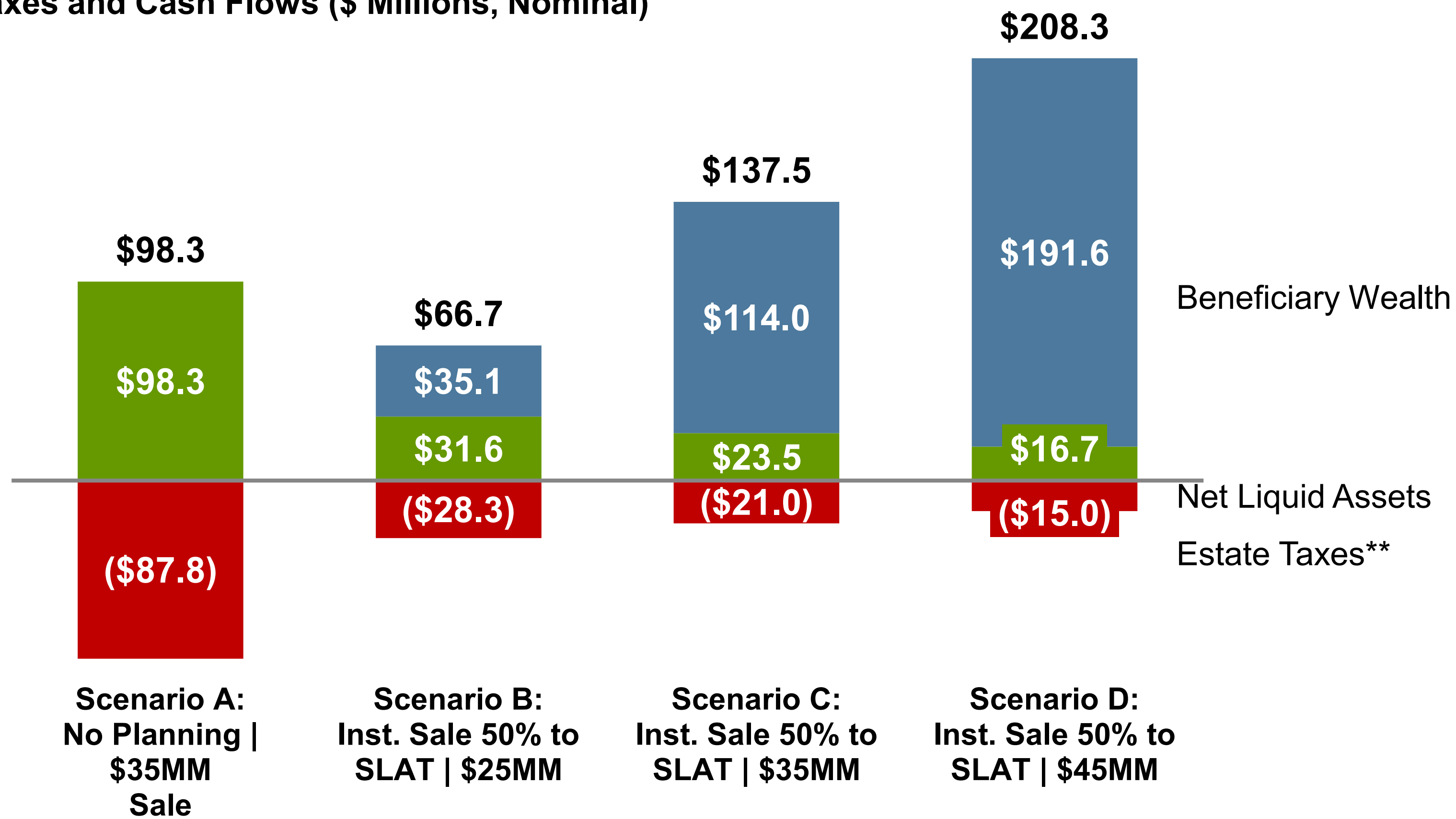
Typical Markets* (Year 9)
After Estate Taxes and Cash Flows ($ Millions, Nominal)



*"Typical Markets" means 50th percentile results of 10,000 trials in our Wealth Forecasting System. Based on AB's estimates of the range of returns for the applicable capital market (as of 3/31/20) over 9 years.
**For illustrative purposes only. Assumes federal estate tax rate of 40% and Maine state estate tax of 12% on all assets, for a combined estate tax rate of 47.2%. For purposes of this analysis, all personal and commercial real estate has been excluded.
Data does not represent past performance and is not a promise of actual or range of actual future results. See Assumptions and Notes on Wealth Forecasting System in Appendix for further details.
Source: AB

Potential Estate Tax

Typical Markets* (Year 45)
After Estate Taxes and Cash Flows ($ Millions, Nominal)



*"Typical Markets" means 50th percentile results of 10,000 trials in our Wealth Forecasting System. Based on AB's estimates of the range of returns for the applicable capital market (as of 3/31/20) over 9 years.

**For illustrative purposes only. Assumes federal estate tax rate of 40% and Maine state estate tax of 12% on all assets, for a combined estate tax rate of 47.2%. For purposes of this analysis, all personal and commercial real estate has been excluded.

Data does not represent past performance and is not a promise of actual or range of actual future results. See Assumptions and Notes on Wealth Forecasting System in Appendix for further details.

Source: AB

Case Study: Real Estate Investor

Real Estate Investor Case Study Assumptions

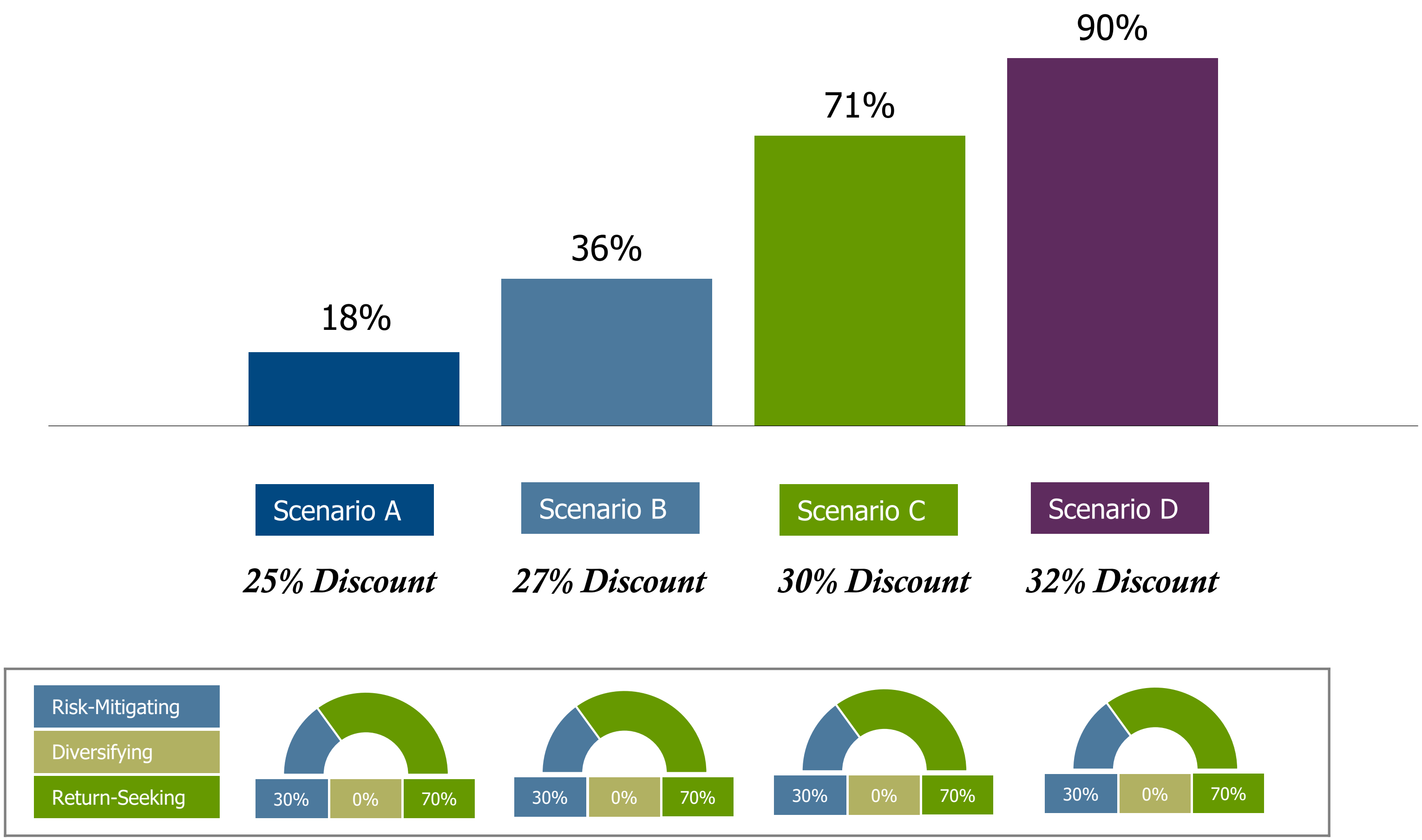
- Real estate entrepreneur, Lando, age 67, owns 45% interest in commercial property
  - Nondiscounted value of interest = $135 million
  - Reduced by 25% valuation discount (base case) = <$33.75 million>
  - Reduced by 45% share of $150 million debt = <$67.5 million>
  - **Net value (discounted) = $33.75 million**
- 45% of annual cash flow (net of debt service) = $3.15 million (9.3% of net value)
- Lando is considering selling his interest to an irrevocable grantor trust

How sensitive is the analysis to the level of valuation discount? Would a long-term sale be preferable?

*At time of this analysis (May 2017), Section 7520 rate was 2.4%; mid-term applicable federal rate (AFR) was 2.04%; long-term AFR was 2.75%. "Installment sale" means annual interest-only payments at mid- or long-term AFR, as appropriate, with "balloon" principal payment at maturity. We assume that guarantees, rather than seed capital, will be used to establish creditworthiness of purchasing trust. Excess cash is invested 70% in global stocks, 30% in intermediate-term bonds; specific portfolio allocation information is available upon request. Bernstein does not provide legal or tax advice, or opine as to the appropriateness or amount of any valuation discount. Consult with competent professionals in these areas before making any decisions.
Sources: www.irs.gov, AB

Debt on Property Enhances Sensitivity to Valuation Discount . . .

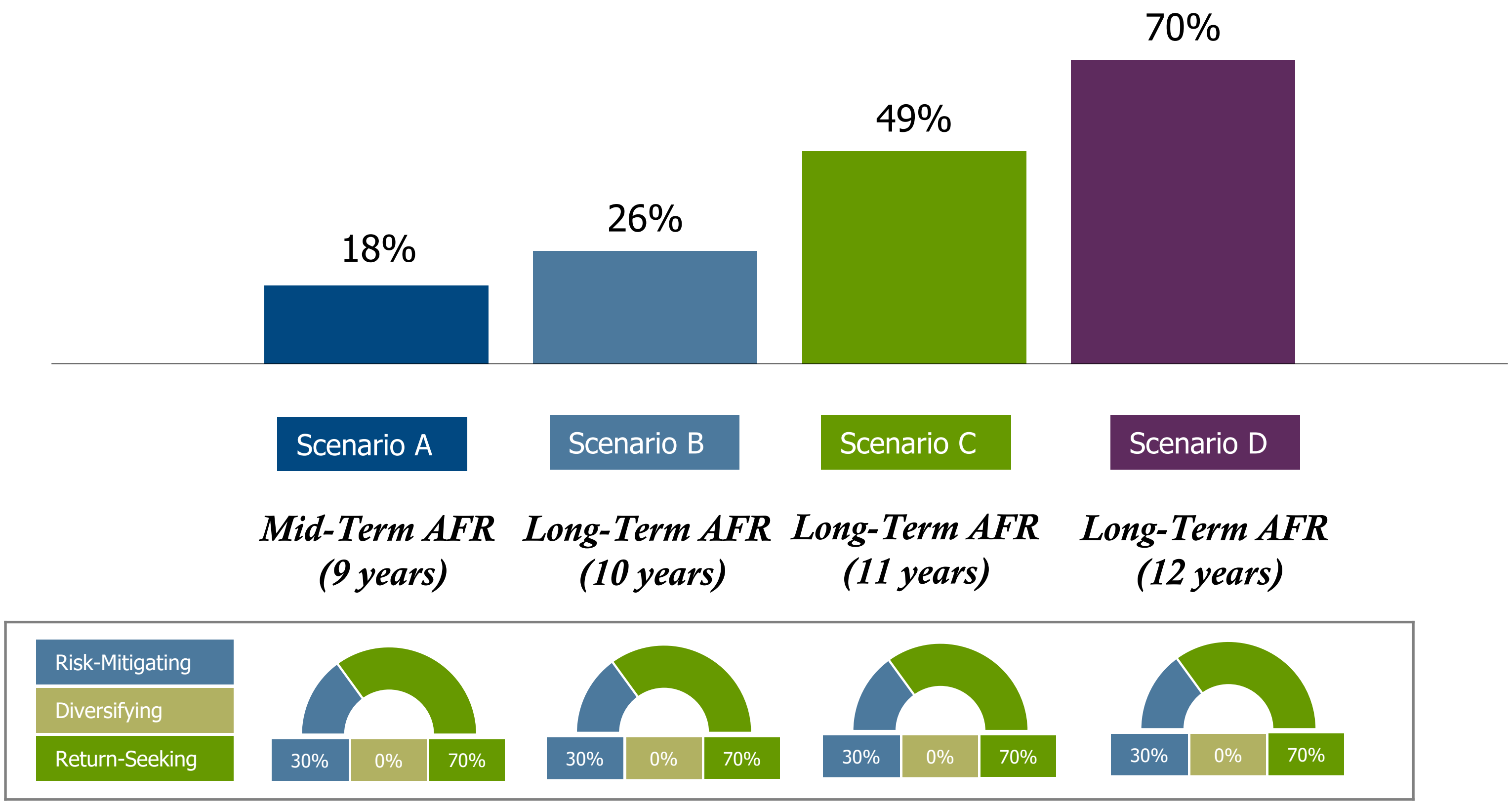
Probability of Success,* Nine-Year Installment Sale



*"Success" means probability of trust remainder of at least $1.
Based on Bernstein's estimates of the range of returns for the applicable capital markets over the periods analyzed. Data do not represent past performance and are not a promise of actual future results or a range of future results. See Appendix, Notes on Wealth Forecasting, for details.

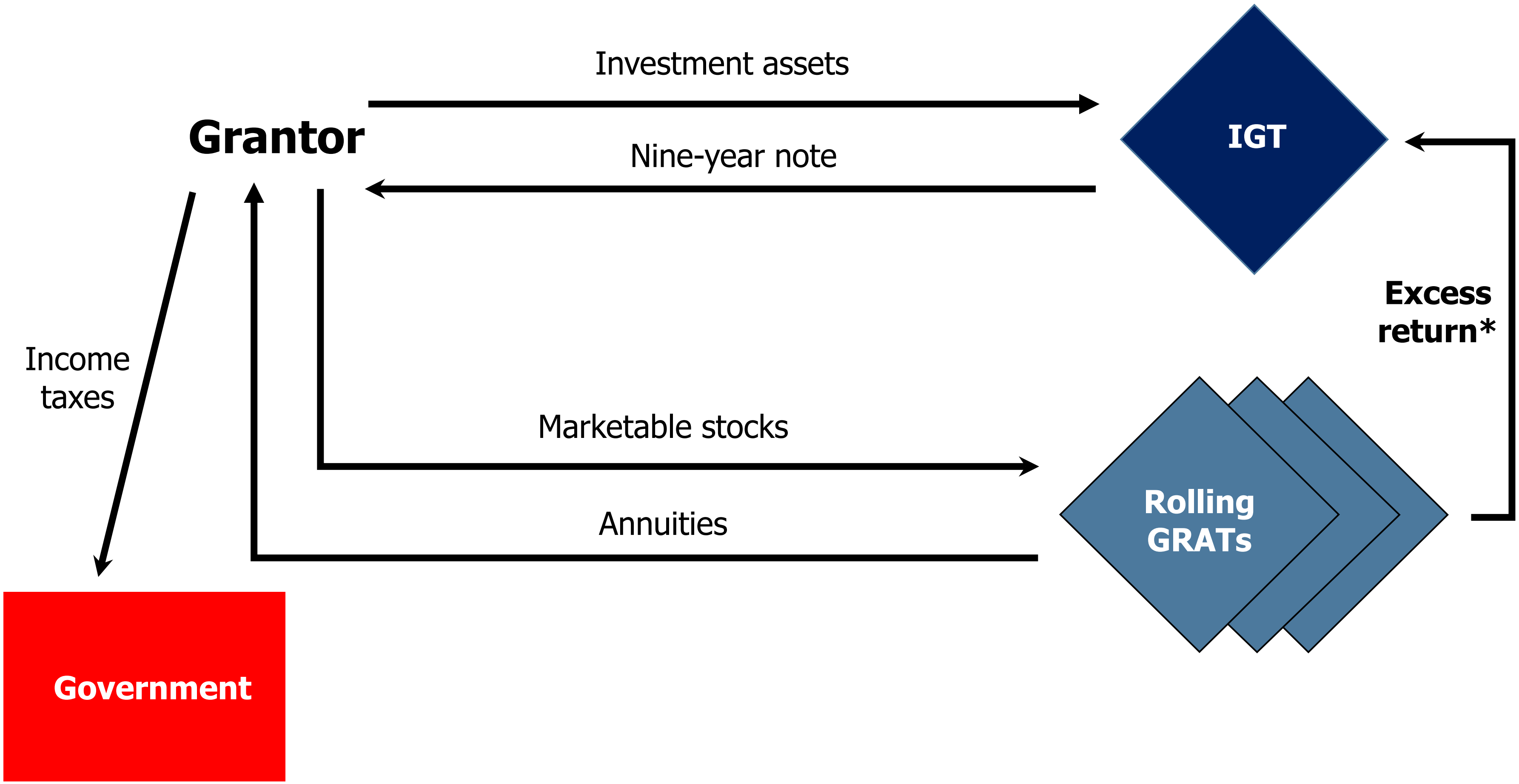
. . . And to Note Term

Probability of Success,* 25% Valuation Discount



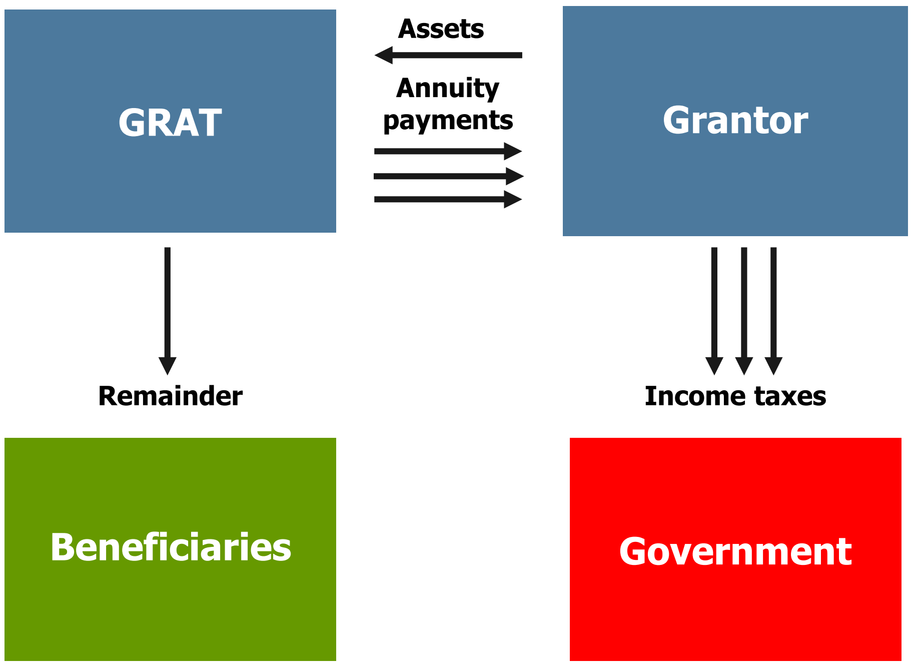
*"Success" means probability of trust remainder of at least $1.
Based on Bernstein's estimates of the range of returns for the applicable capital markets over the periods analyzed. Data do not represent past performance and are not a promise of actual future results or a range of future results. See Appendix, Notes on Wealth Forecasting, for details.

Paired Installment Sale-GRAT Strategy



*Alternatively, excess return from GRATs could be directly to individual beneficiaries, or to separate irrevocable grantor or nongrantor trust for their benefit.
For illustrative purposes only; not an advertisement and does not constitute an endorsement of any particular wealth transfer strategy. Bernstein does not provide legal or tax advice. Consult with competent professionals in these areas before making any decisions.
Source: AB

How Grantor Remainder Annuity Trust (GRAT) Works



Key points:

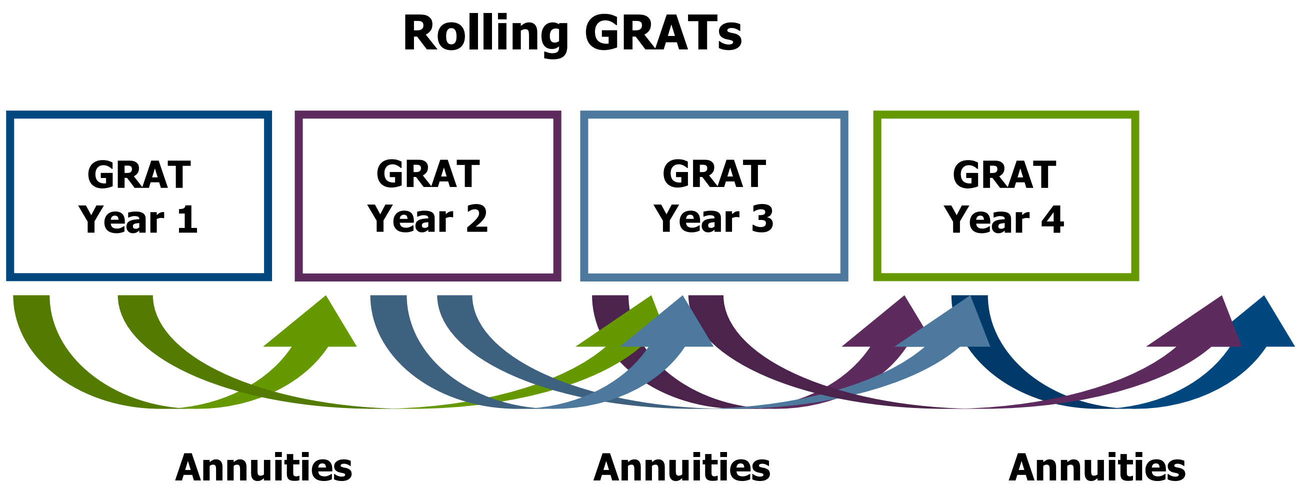
- **Grantor transfers assets to GRAT**
- **Grantor receives annuity payments from trust during annuity term**
- **Grantor pays taxes on trust income**
- **If GRAT assets grow faster than Section 7520 rate (3.2% in April 2018), excess passes to Beneficiaries at end of annuity term free of gift tax**
- **If desired, "Beneficiaries" may be limited to Grantor's spouse or irrevocable trust established for his/her benefit; if properly structured, assets in that trust should avoid estate tax at Grantor's death and at Beneficiaries' deaths**

If Grantor fails to survive annuity term, full date-of-death value of GRAT assets may be subject to estate tax

*If present value of annuity stream retained by Grantor equals value of assets contributed to trust, grantor makes no gift for gift tax purposes; GRAT is said to be "zeroed out."
For illustrative purposes only; not an advertisement and does not constitute an endorsement of any particular wealth transfer strategy. Bernstein does not provide legal or tax advice. Consult with competent professionals in these areas before making any decisions.
Source: AB

Refinement: Short-Term Rolling GRATs

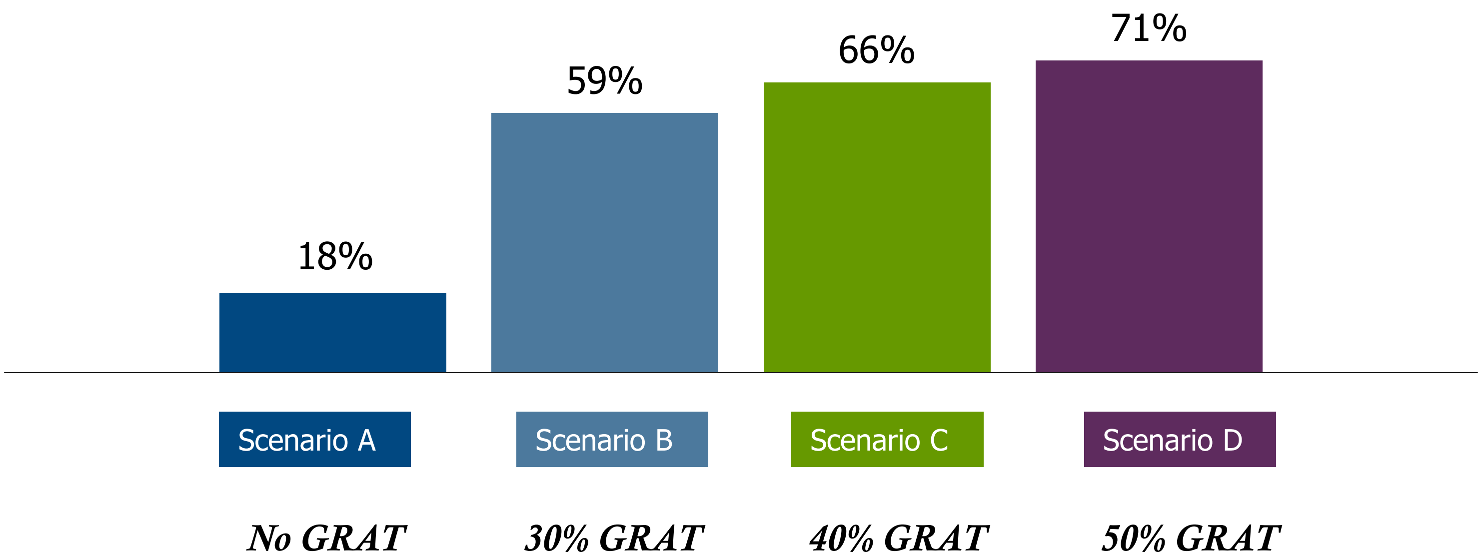
- Contribute initial assets to first of a series of two-year GRATs
- Annual payouts are contributed to new two-year GRAT each year
- Any appreciation above the Section 7520 rate in each trust passes tax-free to or for the benefit of the remainder beneficiaries*

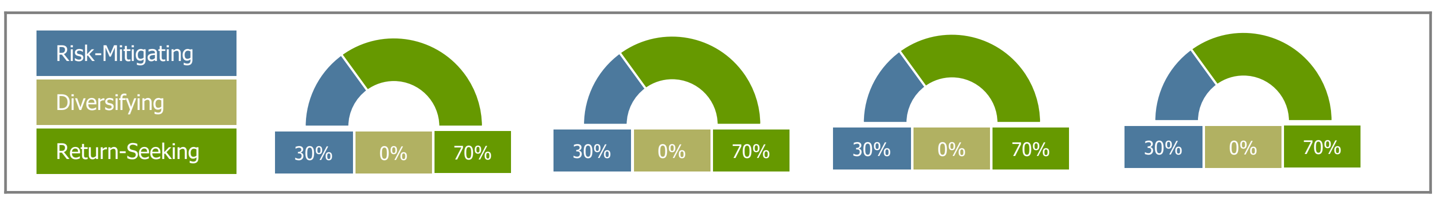


*If present value of annuity stream retained by Grantor equals value of assets contribute d to trust, grantor makes no gift for gift tax purposes; GRAT is said to be "zeroed out." This display assumes each GRAT is zeroed-out.
For illustrative purposes only; not an advertisement and does not constitute an endorsement of any particular wealth transfer strategy. Bernstein does not provide legal or tax advice. Consult with competent professionals in these areas before making any decisions.
Source: AB

"Paired" Strategy Enhances Probability of Success . . . Without Extending Note Maturity or Increasing Discount Percentage

Probability of Success,* Nine-Year Installment Sale at 25% Valuation Discount, plus Nine-Year "Rolling" GRAT Strategy





*"Success" means probability of trust remainder of at least $1. "GRAT" means series of two-year, zeroed-out, "rolling" GRATs funded entirely with globally diversified stocks; specific portfolio allocation information is available upon request. Percentage allocation to GRAT strategy is relative to discounted value of real estate interest sold. Strategy is initiated in May 2017, when Section 7520 rate is 2.4%; rate for subsequent GRATs is determined by Bernstein's wealth forecasting model.
Based on Bernstein's estimates of the range of returns for the applicable capital markets over the periods analyzed. Data do not represent past performance and are not a promise of actual future results or a range of future results. See Appendix, Notes on Wealth Forecasting, for details.

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Appendix

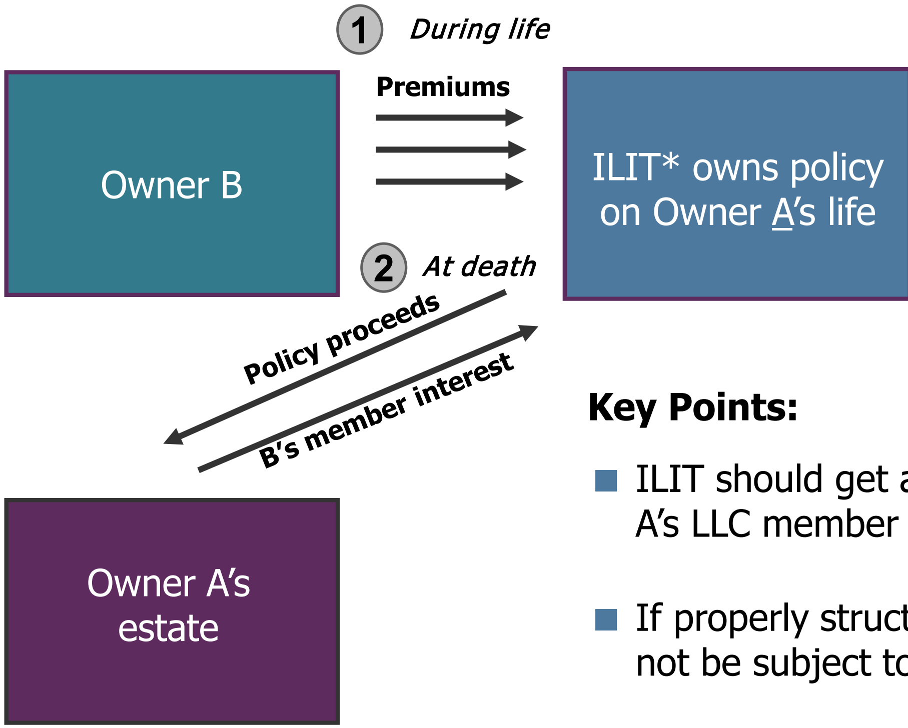
Case Study: Life Insurance Policy Evaluation in Connection with a Buy-Sell Agreement

Assumptions

- Closely held business (LLC) is believed to be worth $30 million as a going concern
- No sale of the business is contemplated
- Two 50 percent owners
  - A: 53-year old male, preferred risk (best underwriting category)
  - B: 55-year-old male, standard risk (3rd best category)
- Buy-sell agreement provides that upon the death of one owner, the survivor will buy the decedent's LLC member interest for $15 million

Source: AB

Financing a Cross-Purchase Buy-Sell Agreement with Life Insurance



Key Points:

- ILIT should get a stepped-up (cost) basis in Owner A's LLC member interest
- If properly structured, death benefit proceeds should not be subject to creditors' claims or estate taxes
- Can be unwieldy if there are multiple owners—not the case here
- *Perceived inequity if there are large disparities in premiums due to age or health differences—an issue here*

*"ILIT" means an irrevocable life insurance trust. In a typical ILIT, trust beneficiaries are given temporary powers of withdrawal (so-called "*Crummey*" powers) over contributions to the trust so that those contributions may qualify for the gift tax annual exclusion. The trustee of the ILIT then uses those contributions to pay annual insurance premiums. If properly structured, the death benefit proceeds of the life insurance policy or policies should not be subject to estate tax upon the death of the grantor or the insured.

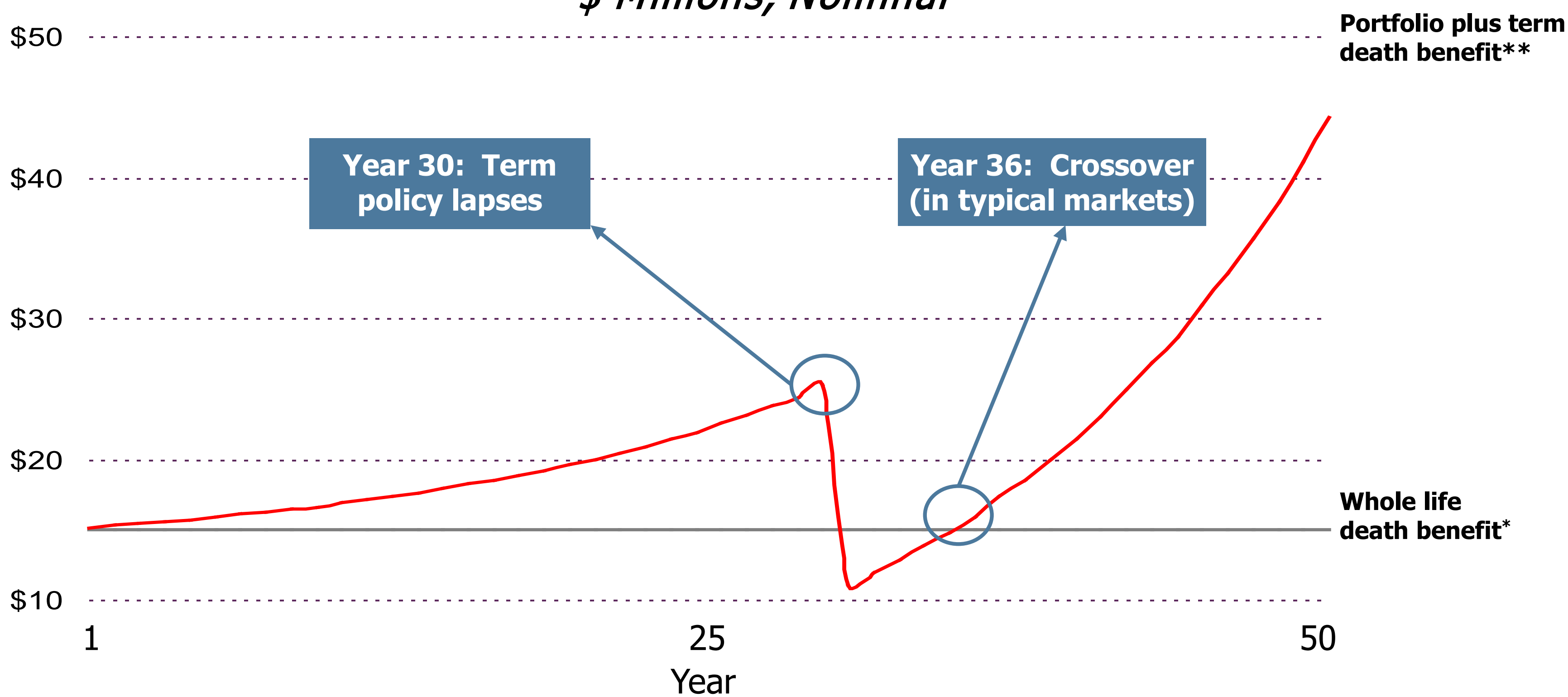
Source: AB

Policy type	Annual premium Owner A	Annual premium Owner B	Total premium outlay*	Revisit in
10-year term	$17,648	$31,719	$493,670	2021
20-year term	33,685	60,219	1,878,080	2031
30-year term	57,963	120,065	5,340,840	2041
UL with guarantee	126,004	200,756	14,704,200	2056**
UL without guarantee	126,004	200,756	14,050,680	2054***
Blended whole life	189,049	280,683	30,532,580	Never†

Problem: In a typical cross-purchase arrangement, Owner B will pay premiums on Owner A's policy (and vice versa)

*Assumes annual premiums are paid through the year listed in the column headed "Revisit in" on the far right-had side of the table. Premium outlays are not adjusted for the time value of money.
**Based on secondary no-lapse guarantee through age 100.
***As illustrated, based on current crediting rate of 5.2% and current policy expenses.
†Based on policy endowing at age 120.
Source: AB (insurance illustrations were provided by a third party and are available upon request)

Whole Life Death Benefit* vs. Projected Portfolio Value Plus Term Death Benefit**
60/40 Portfolio, After Income Taxes, Typical Markets***
$ Millions, Nominal



Portfolio values (not policy death benefits) are based on Bernstein's estimates of the range of returns for the applicable capital markets over the next 50 years. Data do not represent past performance and are not a promise of actual or range of future results. See Appendix, Notes on Wealth Forecasting System, for details.

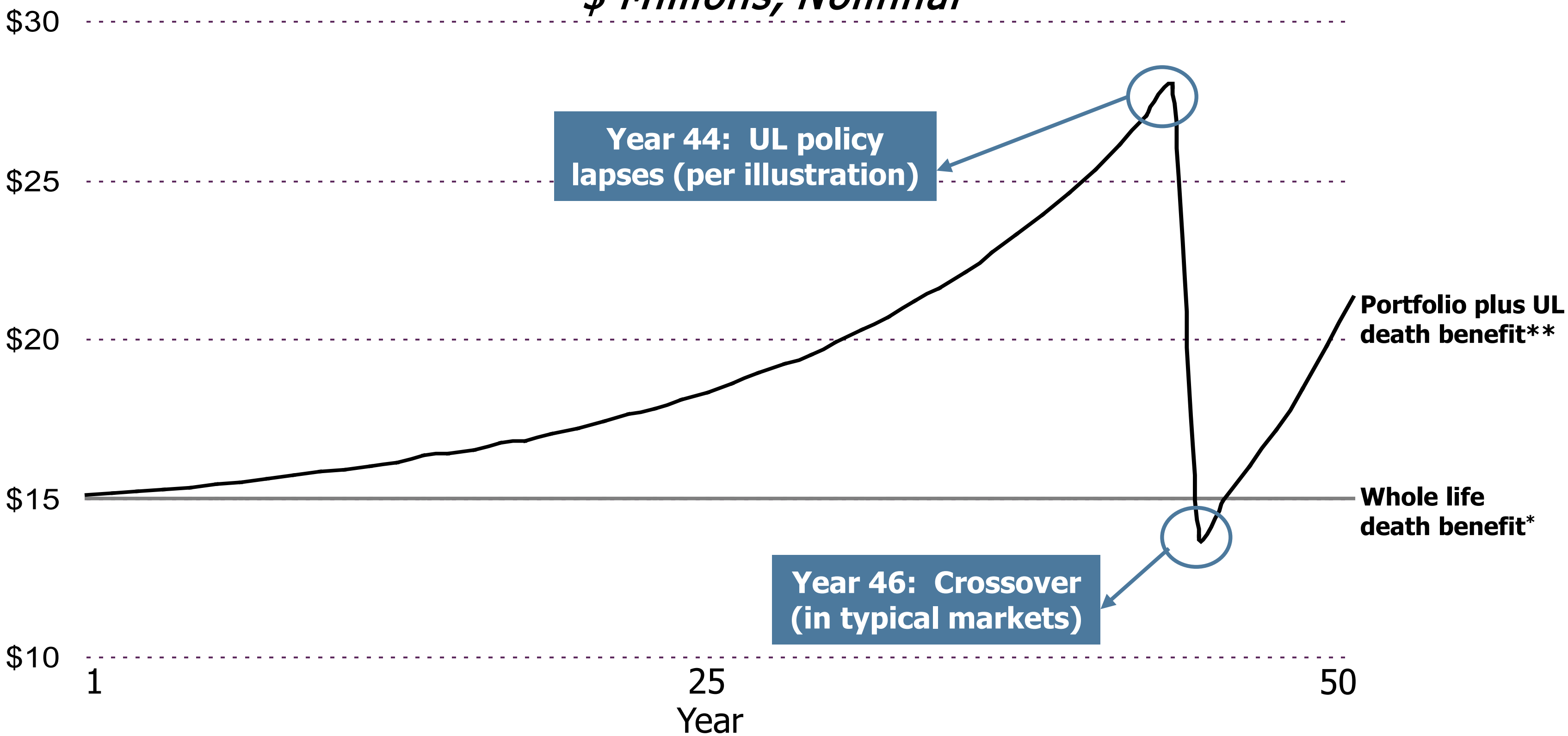
*"Whole life death benefit" scenario is based upon an actual case in which a blended whole life / term life insurance policy was proposed to a healthy, 53-year-old male ("Owner A"). As illustrated, annual premium is $189,049 and death benefit through age 115 is $15M, increasing modestly each year thereafter until endowment at age 120.

**"Portfolio plus term death benefit" scenario is based upon an actual case in which a 30-year term life insurance policy was proposed to Owner A, as defined in the immediately preceding footnote. As illustrated, annual premium is $57,963 and death benefit through age 82 is $15M. In this scenario, the difference between the annual whole life premium and the annual term premium (i.e., $189,049 minus $57,963 equals $131,086) is invested each year in a portfolio of marketable securities. In years 1 through 30, the displayed value is the sum of the term death benefit and the median portfolio value calculated by Bernstein's Wealth Forecasting System; in years 31 through 50, the displayed value is the median portfolio value only.

***"60/40 portfolio" means 60% globally diversified stocks, 40% intermediate-term municipal bonds. "Globally diversified" means 21% US value stocks, 21% US growth stocks, 21% US Diversified stocks, 7% US small and mid cap stocks, 22.5% developed international stocks, and 7.5% emerging market stocks. "Typical markets" means the median result of 10,000 trials for applicable capital markets in Bernstein's Wealth Forecasting System.

Source: AB (insurance illustrations were provided by a third party and are available upon request)

Whole Life Death Benefit* vs. Projected Portfolio Value Plus UL Death Benefit**
60/40 Portfolio, After Income Taxes, Typical Markets***
$ Millions, Nominal



Portfolio values (not policy death benefits) are based on Bernstein's estimates of the range of returns for the applicable capital markets over the next 50 years. Data do not represent past performance and are not a promise of actual or range of future results. See Appendix, Notes on Wealth Forecasting System, for details.

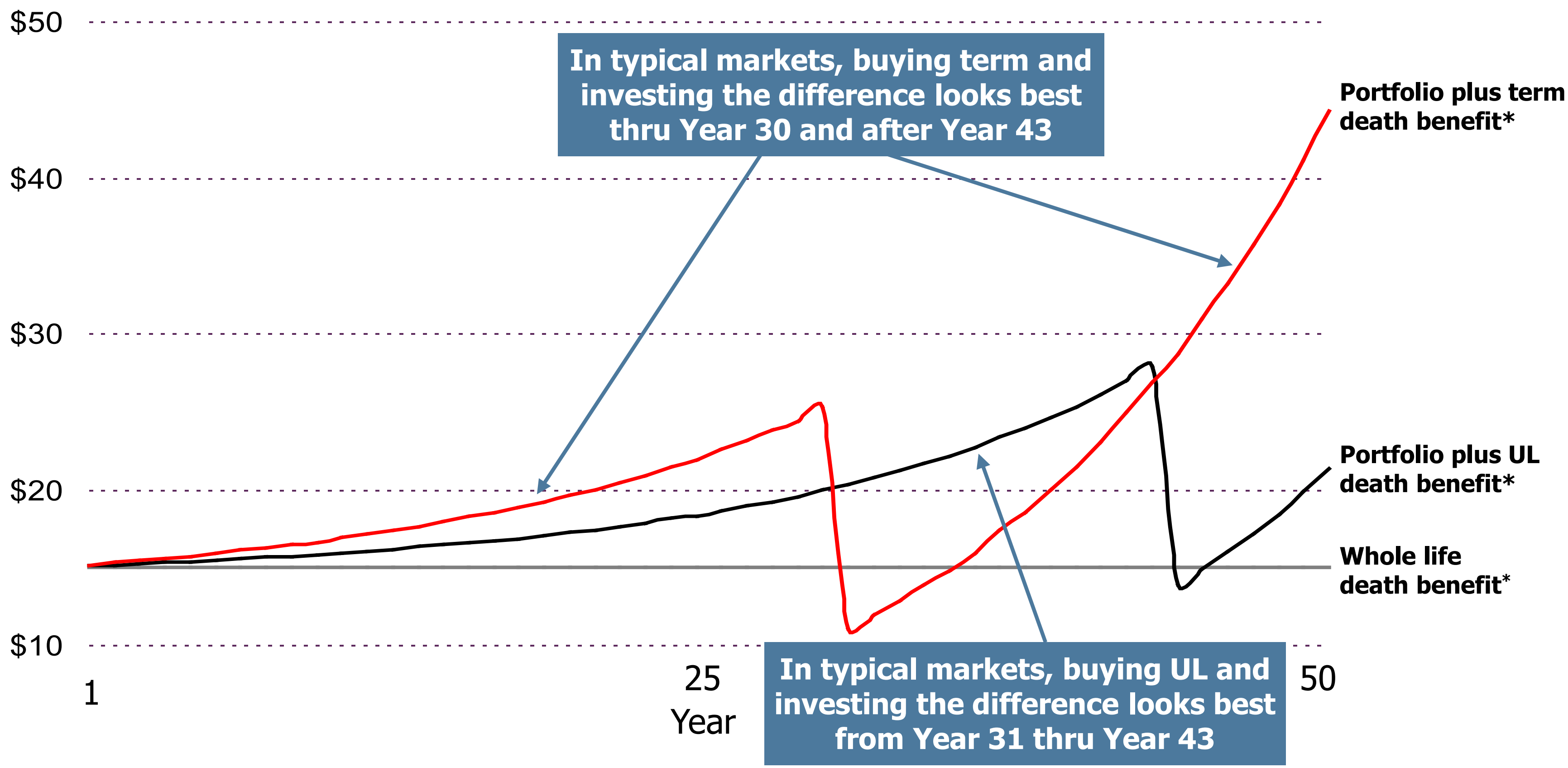
*"Whole life death benefit" scenario is described in a footnote on the immediately preceding display.

**"Portfolio plus UL death benefit" scenario is based upon an actual case in which a universal life insurance policy was proposed to a healthy, 53-year-old male ("Owner A"). As illustrated, annual premium is $126,004 and death benefit through age 96 is $15M. In this scenario, the difference between the annual whole life premium and the annual UL premium (i.e., $189,049 minus $126,004, or $63,045) is invested each year in a portfolio of marketable securities. In years 1 through 43, the displayed value is the sum of the UL death benefit and the median portfolio value calculated by Bernstein's Wealth Forecasting System; in years 44 through 50, the displayed value is the median portfolio value only.

***"60/40 portfolio" means 60% globally diversified stocks, 40% intermediate-term municipal bonds. "Globally diversified" means 21% US value stocks, 21% US growth stocks, 21% US Diversified stocks, 7% US small and mid cap stocks, 22.5% developed international stocks, and 7.5% emerging market stocks. "Typical markets" means the median result of 10,000 trials for applicable capital markets in Bernstein's Wealth Forecasting System.

Source: AB (insurance illustrations were provided by a third party and are available upon request)

Whole Life vs. UL vs. Term*
60/40 Portfolio, After Income Taxes, Typical Markets**
$ Millions, Nominal



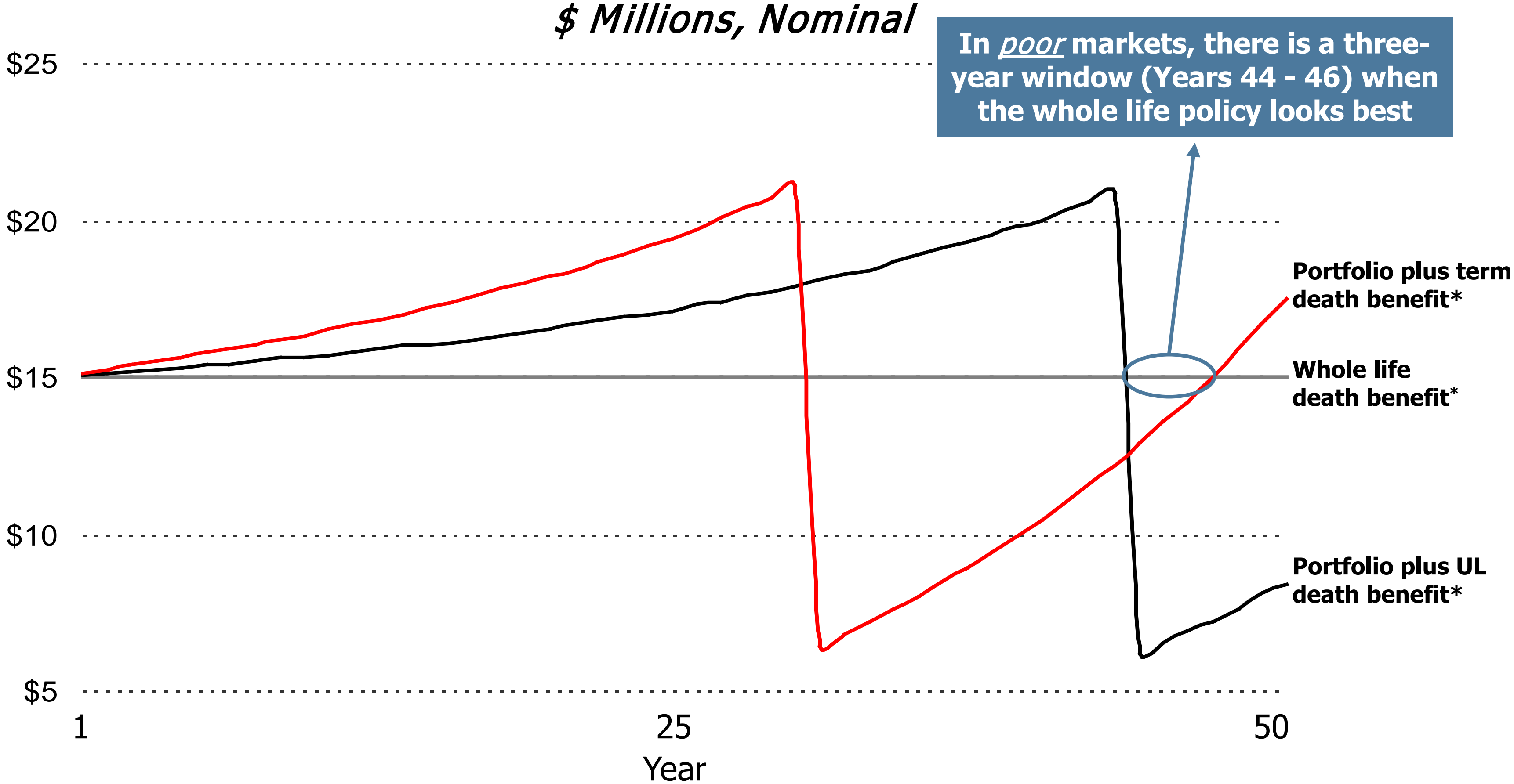
Portfolio values (not policy death benefits) are based on Bernstein's estimates of the range of returns for the applicable capital markets over the next 50 years. Data do not represent past performance and are not a promise of actual or range of future results. See Appendix, Notes on Wealth Forecasting System, for details.

*"Whole life death benefit," "portfolio plus UL death benefit," and "portfolio plus term death benefit" scenarios are described in footnotes on the immediately preceding displays.

**"60/40 portfolio" means 60% globally diversified stocks, 40% intermediate-term municipal bonds. "Globally diversified" means 21% US value stocks, 21% US growth stocks, 21% US Diversified stocks, 7% US small and mid cap stocks, 22.5% developed international stocks, and 7.5% emerging market stocks. "Typical markets" means the median result of 10,000 trials for applicable capital markets in Bernstein's Wealth Forecasting System.

Source: AB (insurance illustrations were provided by a third party and are available upon request)

Whole Life vs. UL vs. Term*
60/40 Portfolio, After Income Taxes, *Poor* Markets**
$ Millions, Nominal



Portfolio values (not policy death benefits) are based on Bernstein's estimates of the range of returns for the applicable capital markets over the next 50 years. Data do not represent past performance and are not a promise of actual or range of future results. See Appendix, Notes on Wealth Forecasting System, for details.
*"Whole life death benefit," "portfolio plus UL death benefit," and "portfolio plus term death benefit" scenarios are described in footnotes on the preceding displays.
**"60/40 portfolio" means 60% globally diversified stocks, 40% intermediate-term municipal bonds. "Globally diversified" means 21% US value stocks, 21% US growth stocks, 21% US Diversified stocks, 7% US small and mid cap stocks, 22.5% developed international stocks, and 7.5% emerging market stocks. "Poor markets" means the 90th percentile result of 10,000 trials for applicable capital markets in Bernstein's Wealth Forecasting System.
Source: AB

Other Buy-Sell Agreement Issues to Think About

- Entity purchase (vs. cross-purchase) agreement
- Qualifying premiums for gift and GST tax annual exclusions
  - Difference in sizes of families
  - Difference in annual premiums
  - Multibeneficiary trusts generally do not qualify for the GST tax annual exclusion
- Whether agreed (fixed) purchase price will be binding for estate tax purposes under Section 2703
  - Bona fide business arrangement
  - Not an impermissible wealth transfer device
  - Comparable to arms' length arrangements

Source: AB

Notes on Wealth Forecasting System

1. Purpose and Description of Wealth Forecasting System

Bernstein's Wealth Forecasting System^{SM} is designed to assist investors in making long-term investment decisions regarding their allocation of investments among categories of financial assets. Our new planning tool consists of a four-step process: (1) Client Profile Input: the client's asset allocation, income, expenses, cash withdrawals, tax rate, risk-tolerance level, goals and other factors; (2) Client Scenarios: in effect, questions the client would like our guidance on, which may touch on issues such as when to retire, what his/her cash-flow stream is likely to be, whether his/her portfolio can beat inflation long term and how different asset allocations might impact his/her long-term security; (3) The Capital Markets Engine: Our proprietary model, which uses our research and historical data to create a vast range of market returns, takes into account the linkages within and among the capital markets, as well as their unpredictability; and finally (4) A Probability Distribution of Outcomes: Based on the assets invested pursuant to the stated asset allocation, 90% of the estimated ranges of returns and asset values the client could expect to experience are represented within the range established by the 5th and 95th percentiles on "box and whiskers" graphs. However, outcomes outside this range are expected to occur 10% of the time; thus, the range does not establish the boundaries for all outcomes. Expected market returns on bonds are derived by taking into account yield and other criteria. An important assumption is that stocks will, over time, outperform long bonds by a reasonable amount, although this is in no way a certainty. Moreover, actual future results may not meet Bernstein's estimates of the range of market returns, as these results are subject to a variety of economic, market and other variables. Accordingly, the analysis should not be construed as a promise of actual future results, the actual range of future results or the actual probability that these results will be realized.

2. Rebalancing

Another important planning assumption is how the asset allocation varies over time. We attempt to model how the portfolio would actually be managed. Cash flows and cash generated from portfolio turnover are used to maintain the selected asset allocation between cash, bonds, stocks, REITs and hedge funds over the period of the analysis. Where this is not sufficient, an optimization program is run to trade off the mismatch between the actual allocation and targets against the cost of trading to rebalance. In general, the portfolio allocation will be maintained reasonably close to its target. In addition, in later years, there may be contention between the total relationship's allocation and those of the separate portfolios. For example, suppose an investor (in the top marginal federal tax bracket) begins with an asset mix consisting entirely of municipal bonds in his/her personal portfolio and entirely of stocks in his/her retirement portfolio. If personal assets are spent, the mix between stocks and bonds will be pulled away from targets. We put primary weight on maintaining the overall allocation near target, which may result in an allocation to taxable bonds in the retirement portfolio as the personal assets decrease in value relative to the retirement portfolio's value.

3. Expenses and Spending Plans (Withdrawals)

All results are generally shown after applicable taxes and after anticipated withdrawals and/or additions, unless otherwise noted. Liquidations may result in realized gains or losses that will have capital gains tax implications.

Notes on Wealth Forecasting System

4. Modeled Asset Classes

The following assets or indexes were used in this analysis to represent the various model classes:

Asset Class	Modeled As…	Annual Turnover Rate
Intermediate-Term Diversified Municipal Bonds	AA-rated diversified municipal bonds with seven-year maturity	30%
US Diversified	S&P 500 Index	15
US Value Stocks	S&P/Barra Value Index	15
US Growth Stocks	S&P/Barra Growth Index	15
Developed International Stocks	MSCI EAFE Unhedged	15
Emerging Markets Stocks	MSCI Emerging Markets Index	20
US SMID	Russell 2000	15

5. Volatility

Volatility is a measure of dispersion of expected returns around the average. The greater the volatility, the more likely it is that returns in any one period will be substantially above or below the expected result. The volatility for each asset class used in this analysis is listed on the Capital Markets Projections page at the end of these Notes.

In general, two-thirds of the returns will be within one standard deviation. For example, assuming that stocks are expected to return 8.0% on a compounded basis and the volatility of returns on stocks is 17.0%, in any one year it is likely that two-thirds of the projected returns will be between (8.9)% and 28.0%. With intermediate government bonds, if the expected compound return is assumed to be 5.0% and the volatility is assumed to be 6.0%, two-thirds of the outcomes will typically be between (1.1)% and 11.5%. Bernstein's forecast of volatility is based on historical data and incorporates Bernstein's judgment that the volatility of fixed income assets is different for different time periods.

6. Technical Assumptions

Bernstein's Wealth Forecasting System is based on a number of technical assumptions regarding the future behavior of financial markets. Bernstein's Capital Markets Engine is the module responsible for creating simulations of returns in the capital markets. Except as otherwise noted, these simulations are based on inputs that summarize the current condition of the capital markets as of March 31, 2013. Therefore, the first 12-month period of simulated returns represents the period from April 1, 2013, through March 31, 2014, and not necessarily the calendar year of 2013. A description of these technical assumptions is available upon request.

Notes on Wealth Forecasting System

7. Tax Implications

Before making any asset allocation decisions, an investor should review with his/her tax advisor the tax liabilities incurred by the different investment alternatives presented herein, including any capital gains that would be incurred as a result of liquidating all or part of his/her portfolio, retirement-plan distributions, investments in municipal or taxable bonds, etc. Bernstein does not provide tax, legal or accounting advice. In considering this material, you should discuss your individual circumstances with professionals in those areas before making any decisions.

8. Income Tax Rates

Bernstein's Wealth Forecasting System has used various assumptions for the income tax rates of investors in the case studies that constitute this analysis. See the assumptions in each case study (including footnotes) for details. Contact Bernstein for additional information.

The Federal Income Tax Rate is Bernstein's estimate of either the top marginal federal income tax rate or an "average" rate calculated based upon the marginal-rate schedule. The Federal Capital Gains Tax Rate is the lesser of the top marginal federal income tax rate or the current cap on capital gains for an individual or corporation, as applicable. Federal tax rates are blended with applicable state tax rates by including, among other things, federal deductions for state income and capital gains taxes. The State Tax Rate generally is Bernstein's estimate of the top marginal state income tax rate, if applicable.

The Wealth Forecasting System uses the following top marginal federal tax rates unless otherwise stated: For 2013 and beyond, the maximum federal ordinary income tax rate is 43.4% and the maximum federal capital gain and qualified dividend tax rate is 23.8%.

9. Estate Transfer and Taxation

The Wealth Forecasting System models the transfer of assets to children, more remote descendants, and charities, taking into account applicable wealth transfer taxes. If the analysis concerns a grantor and his or her spouse, the System assumes that only the first to die owns assets in his or her individual name and that no assets are owned jointly. It is further assumed that the couple's estate plan provides that an amount equal to the largest amount that can pass free of Federal estate tax by reason of the federal unified credit against estate taxes (or, if desired, the largest amount that can pass without state death tax, if less) passes to a trust for the benefit of the surviving spouse and/or descendants of the first-to-die, or directly to one or more of those descendants. It is further assumed that the balance of the first-to-die's individually owned assets passes outright to the surviving spouse and that such transfer qualifies for the federal estate tax marital deduction. Any state death taxes payable at the death of the first-to-die after 2010 are assumed to be paid from the assets otherwise passing to the surviving spouse. To the extent that this assumption results in an increase in state death taxes under any state's law, this increase is ignored. In addition, it is assumed that the surviving spouse "rolls over" into an IRA in his or her own name any assets in any retirement accounts (e.g., an IRA) owned by the first to die, and that the surviving spouse withdraws each year at least the minimum required distribution ("MRD"), if any, from that IRA.
At the survivor's death, all applicable wealth transfer taxes are paid, taking into account any deductions to which the survivor's estate may be entitled for gifts to charity and/or (after 2010) the payment of state death taxes. The balance of the survivor's individually-owned assets passes to descendants and/or charities and/or trusts for their benefit. The survivor's retirement accounts (if any) pass to descendants and/or charities. To the extent that a retirement account passes to more than one individual beneficiary, it is assumed that separate accounts are established for each beneficiary and that each takes at least the MRD each year from the account. In all cases, it is assumed that all expenses are paid from an individual's taxable accounts rather than his or her retirement accounts to the maximum extent possible.

Notes on Wealth Forecasting System

10. Capital Markets Projections (Planning for the Next Liquidity Event Case Study)

	Median 50-Year Growth Rate	Mean Annual Return	Mean Annual Income	One-Year Volatility	50-Year Annual Equivalent Volatility
Cash Equivalents	3.7	4.1	4.1	0.0	13.6
Int.-Term Diversified Municipal Bonds	4.0	4.2	4.0	3.3	10.7
US Diversified	8.2	10.0	3.4	16.3	24.6
US Value	8.5	10.1	4.0	15.8	24.2
US Growth	8.0	10.1	2.7	18.2	25.9
Developed International	8.7	10.8	3.5	18.0	24.8
Emerging Markets	7.0	11.1	4.6	25.8	31.6
US SMID	8.3	10.5	3.0	18.6	26.8
Inflation	3.3	3.6	N/A	0.9	12.3

Based on 10,000 simulated trials each consisting of 50-year periods.

Reflects Bernstein's estimates and the capital market conditions of September 30, 2013.

Does not represent any past performance and is not a guarantee of any future specific risk levels or returns or any specific range of risk levels or returns.

Notes on Wealth Forecasting System

11. Capital Markets Projections (Buy-Sell Agreement Case Study)

	Median 50-Year Growth Rate	Mean Annual Return	Mean Annual Income	One-Year Volatility	50-Year Annual Equivalent Volatility

Based on 10,000 simulated trials each consisting of 50-year periods.

Reflects Bernstein's estimates and the capital market conditions of December 31, 2012.

Does not represent any past performance and is not a guarantee of any future specific risk levels or returns or any specific range of risk levels or returns.

Notes on Wealth Forecasting System (cont.)

12. Capital Markets Projections (Real Estate Investor Case)

	Median 10-Year Growth Rate	Mean Annual Return	Mean Annual Income	One-Year Volatility	10-Year Annual Equivalent Volatility
Municipal Cash	1.4%	1.6%	1.6%	0.3%	3.2%
Cash Equivalents	1.6	1.9	1.9	0.3	4.2
Intermediate-Term Municipals	2.6	2.7	2.8	3.9	3.0
Diversified Hedge Fund Portfolio	4.7	5.0	2.0	11.0	15.1
US Diversified	6.0	7.5	2.3	16.4	15.3
US Value	6.4	7.8	2.8	16.0	15.0
US Growth	5.7	7.6	1.9	18.2	16.7
US SMID	6.4	8.3	1.9	18.7	17.7
US Low Vol Equity	6.3	7.4	3.6	14.2	13.7
Developed International	7.7	9.6	3.1	18.1	16.9
Emerging Markets	5.8	9.6	3.1	26.1	25.6
High-Risk International	8.1	10.9	2.0	22.1	21.0
Inflation	2.3	2.6	—	1.2	5.7

Data do not represent any past performance and are not a guarantee of any future specific risk levels or returns, or any specific range of risk levels or returns.
Based on 10,000 simulated trials each consisting of 10-year periods; contact Bernstein for additional information.
Reflects Bernstein's estimates and the capital market conditions as of December 31, 2016.

SESSION 2

PLANNED GIVING OF S CORPORATION STOCK

Bryan Clontz, PhD, CFP®, CLU®, ChFC®, CAP®, AEP®, RICP®, CBP, ChSNC®

Bryan Clontz is the founder and president of Charitable Solutions, LLC, specializing in non-cash asset receipt and liquidation, gift annuity reinsurance brokerage, actuarial gift annuity risk management consulting, emergency assistance funds, as well as virtual currency and life insurance appraisals/audits. He also serves as Senior Partner of Ekstrom Alley Clontz & Associates – a community foundation consulting firm in Tuscon, AZ.

Bryan is the founder of the Dechomai Foundation, Inc. and the Dechomai Asset Trust - two national donor advised funds focusing on non-cash assets generally and S-corp transactions, respectively. He is also the founder and president of The Emergency Assistance Foundation, Inc.– a global charity that allows employers to create emergency assistance and disaster relief funds for their employees. As of 2020, EAF works with more than 300 employers and 10 million employees. Finally, Bryan created the National Gift Annuity Foundation, the largest national independent gift annuity platform.

In the decade prior to founding Charitable Solutions, LLC in 2003, he served as the director of planned giving for the United Way of Metropolitan Atlanta, national director of planned giving for Boys & Girls Clubs of America and then as vice president of advancement at The Community Foundation for Greater Atlanta. He received a bachelor's degree in business administration from the College of Charleston in Charleston, SC; a master's degree in risk management and insurance from Georgia State University in Atlanta, GA; master's degree in financial services, as well as a Ph.D. in retirement and financial planning from The American College in of Financial Services in Bryn Mawr, PA. (Dissertation: A Study of the Relationship Between Gift Annuity Solvency and Disparate Statutory Insurance Regulation)

He has earned the following designations: Certified Financial Planner, Chartered Life Underwriter, Chartered Financial Consultant, Chartered Advisor in Philanthropy, Accredited Estate Planner, Retirement Income Certified Professional, Certified Bitcoin Professional and Chartered Special Needs Consultant.

From 2000-2005 he served as a graduate adjunct professor for both personal financial planning and life insurance in the Department of Risk Management and Insurance at Georgia State University. He serves on the Editorial Board of the Planned Giving Design Center (2000-current), the Advisory Board for the American College's Chartered Advisor in Philanthropy designation (2001-current), the American Council on Gift Annuities' Rate Recommendation (2003-2010) and Research Committee (2003-current) and the National Association of Charitable Gift Planners Board, formerly NCPG (2007-2009). He also was a partner in a NAPFA-registered fee-only financial planning firm, Tombs Moody & Clontz from 1995-2003.

He has given more than 2,000 presentations on charitable gift planning and community foundation topics (including the National Committee on Planned Giving Conferences, American Council on Gift Annuities and more than 50 speeches at national community foundation conferences – COF, ADNET, FAOG); been published in an international insurance textbook; and authored a book called *Charitable Gifts of Noncash Assets,* a planned giving manual entitled *Just Add Water*, and a dozen articles in financial services and planned giving journals. Bryan chaired the inaugural statewide *Leave a Legacy Georgia!* Campaign involving more than 400 charities. He has served as an expert witness on charitable gift annuity default and reinsurance involving an Arizona charitable bankruptcy and as a donor advised fund expert witness for a Virginia bankruptcy. He is the co-inventor of a proprietary CGA risk management process (LIRMAS- Life Income Risk Management Analytic Suite) based on an actuarial study he co-authored for the Society of Actuaries on CGA Mortality.

He has been quoted by the Wall Street Journal, New York Times, Kiplingers Personal Finance, Bloomberg Wealth and serves as a guest columnist on charitable tax issues for Forbes.

Creative Charitable Options for Sub-Chapter S Shares in 2020

Bryan Clontz, Ph.D., CFP®, CAP®
President, Charitable Solutions, LLC
Bryan@charitablesolutionsllc.com
404-375-5496

Agenda

- UBIT Definition, Overview and Exceptions
- UBIT and S-Corp Stock: A Summary
- Trust Rates vs. Corporate Rates
- UBIT Solution: Trust-form DAF Charity
- UBIT Case Study
- CARES Act Summary and S-Corp Giving
- Limitations
- UBIT Resources/Articles

UBIT Definition and Overview

- Code Section 512 defines UBIT as income derived from an <u>unrelated trade or business</u> – UBIT has existed for nearly 70 years
- Tax is paid at either corporate or trust rates
- Charities must file 990-T and publicly disclose UBIT
- IRS may audit UBIT compliance/accuracy
- Practical applications and compliance of UBIT are particularly complex
- UBIT typically arise with S-Corp stock, real estate with debt or LLC/real estate with active income
- Some charities automatically decline UBIT gifts

UBIT Exceptions

1. Passive Income – rents, interest, gains, dividends, royalties, etc.

Exception #1 – S corporation income/gain

Exception #2 - Debt financed income

Exception to the Exception #1 – mortgage for 5 years and owned for 5 years "old and cold"

Charitable Remainder Trusts are not exempt from UBIT (100% tax rate), **charitable gift annuity contracts are exempt under acquisition indebtedness rules IRC 514(c)5 but the funding asset is not exempt**

UBIT and S-Corp Stock: A Summary

- There are over 4 million S-corporations – more than twice as many as C-corporations – with over 7 million shareholders
- In 1998, Congress allowed charities to be qualified shareholders of S-corporations but not CRTs
- Charities would have to pay UBIT on passive income as well as any pre- and post-contribution gain
- Donor receives a fair market value deduction (less any ordinary income reduction) on stock

Taxation – Trust vs. Corporate Rates

- **Trust Rates** (basically the same as individual rates)
  - 10-37% with the top bracket hit at $12,750
  - Capital gains (Long Term) are taxed at 20%

- **Corporate Rates**
  - Under the 2017 TCJA, a flat 21% federal rate
  - Capital gains are income

UBIT Solution: Trust Donation Flow

Step 1 – California Donor Contributes S-Corp Stock to Trust-Form DAF Charity in Income Tax-Free State

Deduction: $1M of S-corp stock with $0 adjusted basis

Step 2 – Trust-DAF Sells Shares

UBIT at trust rates ($1M @ 20%) = $200K in federal tax

Step 3 – DAF Grants Net Proceeds to Other Charity

Trust receives a 60% of AGI deduction to reduce tax to $80K with $920K to charity; If donor sold asset, gift/deduction would have been $700K (30% tax federal and state)

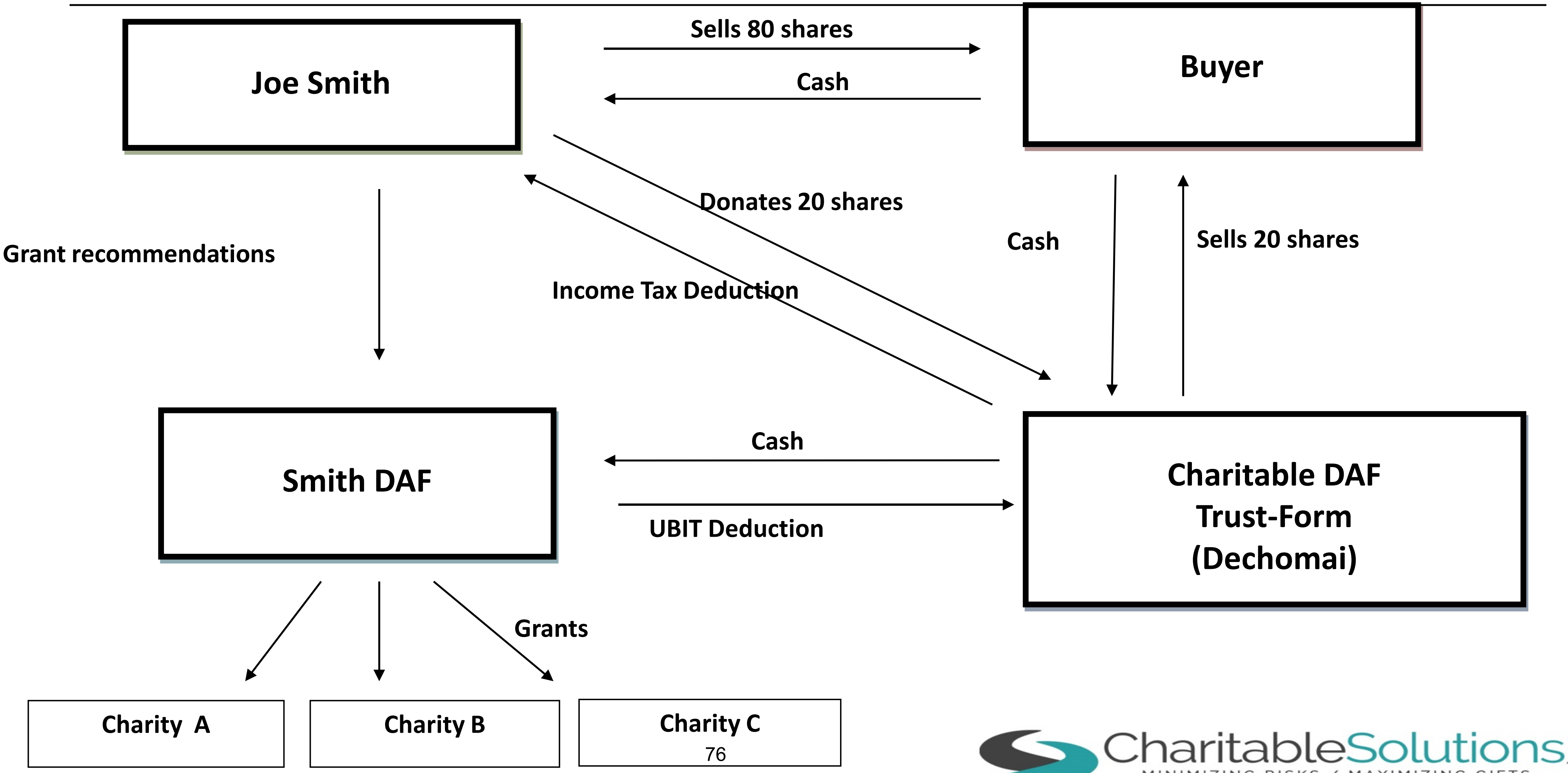
Case Study:
Investment Advisor Selling to Jr. Partner

Donor Contributes S-Corp to Trust-Form Public Charity in Nevada (Income Tax-Free State)

Donor Advised Fund Sells to New Partner/20% Gains Tax Reduced by 60% for Deduction

Donor Receives a 100% FMV Deduction. Donor's DAF Receives Net 92% of Gift as Grant Vs. Sale and Gift of Proceeds Netting 75% to Corporate DAF

S-Corp Donor Schematic:
$5 Million Donation



CharitableSolutions LLC
MINIMIZING RISKS / MAXIMIZING GIFTS

4 Scenario Outcome Summary

Options	1	2	3	4
	Client Sells Shares, Then Gives Proceeds	**Client Gives Shares to Trust DAF, Then Grants Net Proceeds to Corporate DAF**	**Client Gives Directly to a Corporate Form Public Charity**	**Client Gives to a Private Foundation**
Total Donor Tax Savings Less Taxes Paid	250,000	2,000,000	2,000,000	0
Total Amount Left for Charitable Giving	3,750,000	4,600,000	3,830,000	3,820,550

Assumptions:	
S-Corp Shares FMV	**$5,000,000**
Cost Basis	**-0-**
Federal Tax (Ordinary Income)	**35%**
Federal Tax Rate (Capital gains)	**20%**
State Income Tax	**5%**

2020 CARES Act: A Summary

- Act signed into law to provide relief against the impact of COVID-19
- Increased the AGI limitation for cash donations from 60% to 100% for 2020 only
    - Only cash donations to public charities
    - Cash contributions to DAFs and supporting orgs not eligible

CARES Act and S-Corp Giving

- Can the CARES Act eliminate UBIT for S-corp shares in 2020?
- 100% deduction only applies to cash donations
- Donor still limited to a 30% deduction

BUT…

- Charity in Trust-Form receives a deduction for cash grants to other non-DAF charities
- Normally 60%
- Could this be 100% under the CARES Act?

CharitableSolutions LLC
MINIMIZING RISKS / MAXIMIZING GIFTS

CARES Act and S-Corp Giving

- The CARES Act provisions do not exclude trusts
- If Trust-DAF makes a grant of cash, it should be entitled to a 100% deduction
- This would offset the taxable gain – meaning zero UBIT

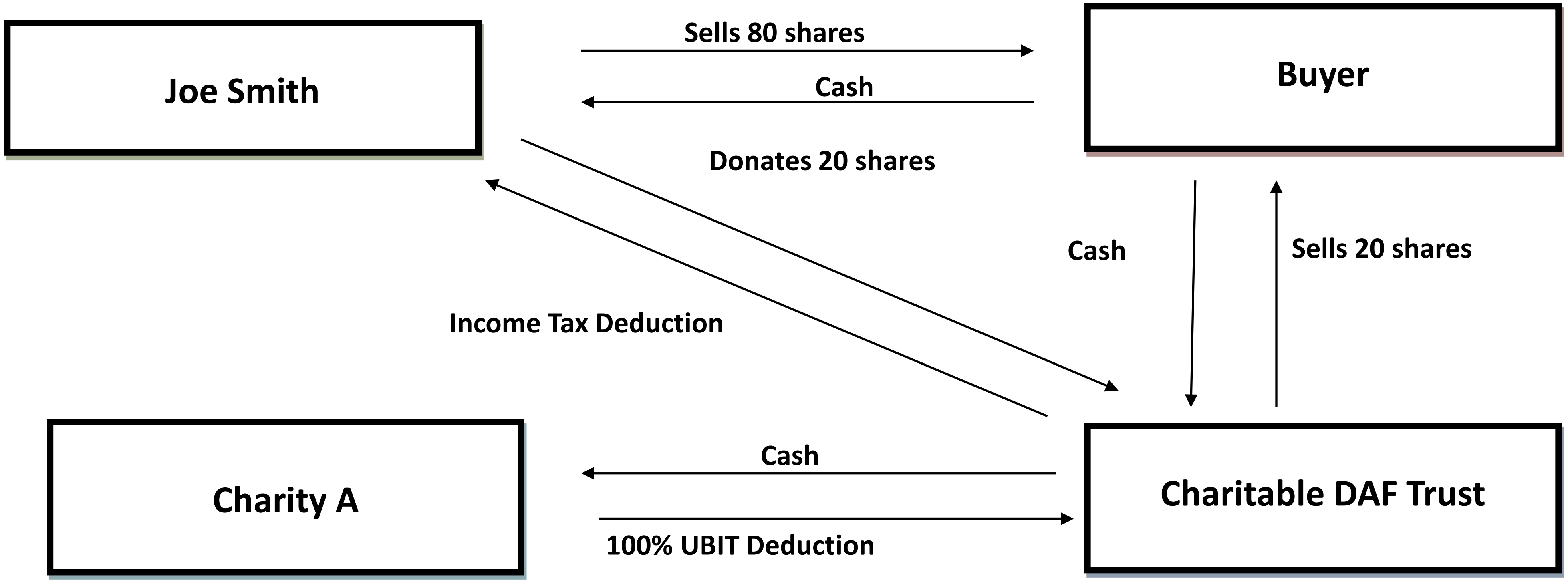
SO…

- The effective tax rate on gains goes from 8% to 0%
- That means increased tax efficiency
- More dollars available for grants
- **ADVANCED IDEA**: Funding a Charitable Gift Annuity (CGA) with S-corp shares during 2020…Less tax = larger net CGA for annuitant

A Cautionary Note

- It is possible the IRS could apply the language of the CARES Act literally
  - Individuals and corporations are specifically mentioned – trusts are not
  - This omission could be a drafting oversight
- The normal UBIT deduction operates by reference
- Spirit of the law is to encourage charitable giving
- IRS treatment will depend on whether they take a practical approach or a literal one

S-Corp Donor Schematic: CARES Act



Limitations

- Some ways this does NOT work:
  - The 100% deduction is triggered only if the charity makes a grant by 12/31/20
  - Dechomai cannot get the 100% deduction if it makes a grant to a new or existing DAF
  - Dechomai cannot get the 100% deduction if it makes a grant to a supporting org
  - Normal limits on grants to private non-operating foundations apply

UBIT Resources and Articles

- *The Tax Law of Unrelated Business for Nonprofit Organizations* by Bruce Hopkins, John Wiley & Sons (2005).

- "Tax Savings Opportunities for Charities Owning Subchapter S Stock," by Laura Peebles – Planned Giving Design Center

- **Charitable Gifts of Noncash Assets** – Chapter 3

Free: https://charitablesolutionsllc.com/new-book-charitable-gifts-of-noncash-assets/ (Funded by the Chartered Advisor in Philanthropy Program at The American College of Financial Services and Leon Levy donation) - https://www.theamericancollege.edu/designations-degrees/CAP

SESSION 3

ESTATE PLANNING POST COVID-19

PRIVATE BANK

4481 Munson Avenue NW
Canton, OH 44718

Joseph Wojcik
Senior Vice President
Wealth & Investment Management

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Cell: 330-571-4147
Email: joseph.wojcik@huntington.com

EXPERIENCE

Joe Wojcik is Manager of High Net Worth Strategy for Wealth & Investment Management at Huntington Bank. Joe has delivered financial, tax, and trust solutions to clients for over 30 years. He has been Personal Trust Officer and Regional Manager for Huntington's Akron-Canton region since 2007. He was a partner in the CPA firm of Brott Mardis and Company, specializing in tax and estate planning for high net worth clients, until he sold his practice in 1994 to join First Merit Bank as Vice President and Trust Officer. He went to Sky Bank in 2004 to manage its newly created trust region and was serving as Senior Vice President for wealth management when Huntington acquired Sky Bank in 2007.

COMMUNITY INVOLVEMENT

Instructor - The University of Akron – Taxation for Financial Planning
Member - Canton Estate Planning Council
Member - Stark Community Foundation Trust and Estate Planning Committee
Former President - Akron Trust and Estate Planning Council
Former Trustee - Beacon Journal Charity Fund
Director - Joseph Wojcik Charitable Fund at Stark Community Foundation
Speaker - on Trust, Tax, Financial Planning, and Investments Topics
Member – Brookside Country Club, Canton

EDUCATION

Certified Public Accountant, Inactive – State of Ohio
Masters in Taxation – University of Akron
B.A. cum laude - Accounting - Kent State University

APPLE GROW+H PARTNERS
Healthy Growth.

JASON BOGNIARD, MBA, ASA, CVA, EA

Work Experience

Jason is a principal in the business valuation and litigation consulting group at Apple Growth Partners (AGP). As an Accredited Senior Appraiser, Jason has been responsible for the development of hundreds of business valuation engagements for interests in closely held companies covering a variety of industries. He has performed valuations and other financial analyses for a number of purposes including litigation support services involving shareholder disputes, asset tracing, bankruptcy, and domestic relations. Non-litigation engagements include estate and gift taxes, Employee Stock Ownership Plans (ESOPs), feasibility studies, mergers and acquisitions, stock options, and bankruptcy. Jason has been engaged to provide expert witness testimony relating to business valuations, lost profits and economic damages, forensic accounting, solvency, spousal and child support and asset tracing matters. Engagements performed include business valuations, economic damage analyses, solvency and fairness opinions for various industries including industrial manufacturing and distribution, professional service, automotive, retail, medical practices, dental practices, real estate development and construction, telecommunications, food and beverage, restaurant, insurance, automobile dealerships, and metal processing among others.

Positions

- Apple Growth Partners, Shareholder, Executive Committee and Past Treasurer (July 2005 – Present)
  Principal in charge of the Business Valuation and Litigation Support Department.
  Responsible for development and preparation of valuations of closely-held business entities, economic damages, and other financial analysis and providing related court testimony.

- CBIZ Accounting, Tax and Advisory Services, Senior Valuation Consultant (1999 – June 2005)
  Responsible for valuations of hundreds of closely-held business entities, and economic damage analyses.

Educational Background and Other

Jason is a summa cum laude graduate of Ohio University with a Bachelor's degree in finance. Additionally, Jason has obtained a Masters of Business Administration at Case Western Reserve's Weatherhead School of Management, receiving the Dean's Academic Achievement Award. Jason is an Accredited Senior Appraiser and member of the American Society of Appraisers, as well as a Certified Valuation Analyst and member of the National Association of Certified Valuators and Analysts. As an Enrolled Agent (EA), Jason is a federally-authorized tax practitioner, who has technical expertise in the field of taxation, and is empowered by the U.S. Department of the Treasury to represent taxpayers before all administrative levels of the Internal Revenue Service for audits, collections and appeals.

Professional Associations

The American Society of Appraisers
- Accredited Senior Appraiser

National Association of Certified Valuators and Analysts
- Certified Valuation Analyst

The Center for Principled Family Advocacy
- Member/completed collaborative divorce training

International Academy of Collaborative Professionals
- Member

The Ohio Society of CPAs
- Affiliate Member

THEODORE A. WAGNER CPA, CVA

Managing Partner, Cleveland Office
Partner-in-Charge, Taxation Services

Specializations
- Mergers and Acquisitions
- Succession Planning
- Business Valuation
- Pass Through Entities
- Trusts and Estates

Certifications
- Certified Public Accountant
- Certified Valuation Analyst

Education
- Bachelor of Science in Accounting, Miami University

CliftonStrengths®
- Relator
- Belief
- Responsibility
- Learner
- Self-Assurance

Tod delivers high-level advisory services to middle market businesses and their owners in the areas of corporate and individual tax planning. In working with high net worth family groups and family offices, Tod helps clients align their personal, financial, charitable and legacy goals. His expertise also includes estate and succession planning, business valuation, and represents clients before taxing authorities.

As Partner-in-Charge of Taxation Services, Tod sets the vision and direction of the firm's tax practice, ensuring that the firm's expertise and resources are aligned with the current and future needs of our clients. Tod's philosophy as a tax advisor extends beyond compliance and reporting to include a broader consultative approach that blends financial and business strategy needs into a tax strategy that aligns with the client's personal and business goals.

Along with tax and financial planning, Tod has extensive expertise with mergers and acquisitions including tax diligence, business valuations, negotiation of deal terms, and innovative transaction structuring strategies.

Tod was with Arthur Andersen for nine years, and Libman, Goldstine, Kopperman & Wolf, Inc. for more than 13 years before merging with BMF in 2014.

Professional Memberships
- American Institute of Certified Public Accountants
- Ohio Society of Certified Public Accountants
- National Association of Certified Valuation Analysts

Civic Service and Activities
- Leadership Cleveland, Class of 2017
- Cleveland Zoological Society, board member
- The City Mission, vice president
- The City Mission Endowment Foundation, president
- Harvest for Hunger, "Kitchen Cabinet" member
- Association for Corporate Growth Cleveland, former board member and past president
- Case Western Reserve University, past adjunct professor, Weatherhead School of Management
- United Way of Cuyahoga County, former member, executive campaign cabinet

MICHAEL L. WEAR

Partner | Akron
330.258.6424
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ASSISTANT
Michele Workman | MWorkman@bdblaw.com

AREAS OF PRACTICE
Trusts & Estates

Mike focuses his practice on estate planning, planned giving, trust and estate administration matters, and business succession planning. With more than 20 years of experience in tax, estate and financial planning, Mike represents individual and corporate fiduciaries in the administration of trusts and estates. He counsels high net worth individuals, families and owners of closely-held businesses in all areas of estate planning with a focus on tax minimization. He offers clear understanding for complex issues surrounding all areas of wealth and business transfers, asset protection and estate administration.

Mike listens carefully to clients to assure he understands their goals and personal wishes to assure he is aligning comprehensive wealth and estate planning strategies with their desired outcomes. He understands the importance of his clients' legacies, helping them create meaningful planned charitable gifts and multi-generational wealth transfers. He guides clients through difficult decisions to offer clarity and peace of mind on sensitive topics.

EXPERIENCE

- More than 20 years of experience counseling high net worth individuals and organizations
- Advises clients on estate planning, business succession planning, planned giving, probate administration and litigation matters, and tax minimization strategies
- OSBA Board Certified Specialist in Estate Planning, Trust and Probate Law
- Designated as an Accredited Estate Planner® (AEP)
- Frequent presenter on estate planning, probate administration, planned giving and tax topics
- Assists nonprofit organizations with planned giving and development strategies

EDUCATION & ADMISSIONS

J.D. / M.B.A. Finance, University of Akron School of Law and College of Business, Cum Laude

B.S. Business Administration Finance, University of Akron, Cum Laude

Admissions

Ohio Bar

U.S. Tax Court

PROFESSIONAL & CIVIC INVOLVEMENT

Member: American Cancer Society, Volunteer Leadership Council

Past Advisory Board Member: Riverfront YMCA

Past Board Member: Big Brothers & Big Sisters of Summit & Medina Counties

Past Member: Summit County Planned Giving Committee of the American Cancer Society

Past Member: Summa Century Club Committee

Past Investment Review Committee Member: United Way of Summit County

Associations

Member: Ohio State Bar Association

Estate Planning, Trust and Probate Law Section Council

Member: Estate Planning Council of Cleveland

Past Chair: Akron Bar Association, Probate Law Section

Past Chair: Cleveland Metropolitan Bar Association, Estate Planning, Trust and Probate Law Section

Moderator & Panelists

Moderator: Joseph Wojcik, Sr. Vice President – Wealth and Investment Management | Huntington National Bank

Panelists:

- Theodore A. Wagner, CPA, CVA, Cleveland Managing Partner – Taxation Services | Bober Markey Fedorovich
- Jason Bogniard, MBA, ASA, CVA, EA, Principal – Business Valuation | Apple Growth Partners
- Michael Wear, JD, MBA, AEP®, Partner | Buckingham, Doolittle & Burroughs, LLC

Current law – Estate & Gift Tax

- Gift, estate & GST tax exemption - $11,580,000 per person, $23,160,000 for married couple
- Scheduled to decrease to $5,000,000 per person, $10,000,000 for married couple, with an inflation adjustment on January 1, 2026
- No claw back for taxable gifts made before 2026
- Flat tax rate – 40% for estate and gift taxes

Year	Amount	Year	Amount
2001	675,000	2011	5,000,000
2002	1,000,000	2012	5,120,000
2003	1,000,000	2013	5,250,000
2004	1,500,000	2014	5,340,000
2005	1,500,000	2015	5,430,000
2006	2,000,000	2016	5,450,000
2007	2,000,000	2017	5,490,000
2008	2,000,000	2018	11,180,000
2009	3,500,000	2019	11,400,000
2010	Repealed	2020	11,580,000

Presidential Candidate Tax Proposal – Estate & Gift

Vice President Biden Proposal:

- Eliminate cost basis step-up at death
- Suggests returning to 2009 levels for gift, estate, and GST tax exemptions - $3,500,000 per person
- Exemption for married couple would decrease from $23,160,000 to $7,000,000
  - $6,464,000 increase in taxes at current 40% rate

President Trump Proposal:

- Make permanent TCJA changes set to expire after 2025

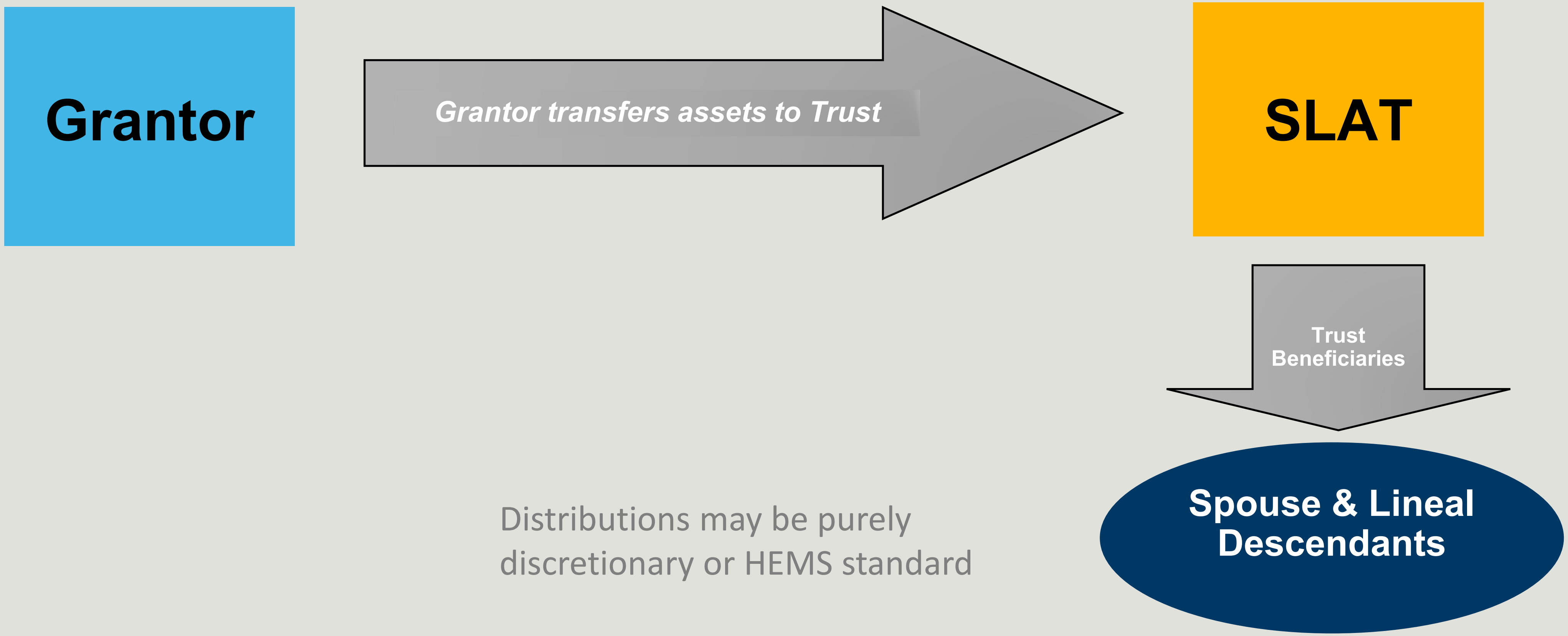
Basic Estate Planning

- Make sure clients have current documents (Wills, Revocable Trusts, Financial Powers of Attorney, Advance Health Care Directives)
- Properly titled assets and beneficiary designations
- Making use of annual exclusion gifts, non-gifts such as medical expenses and education expenses
- Asset protection planning, if appropriate

Planning to Utilize Lifetime Gift & GST Tax Exemption

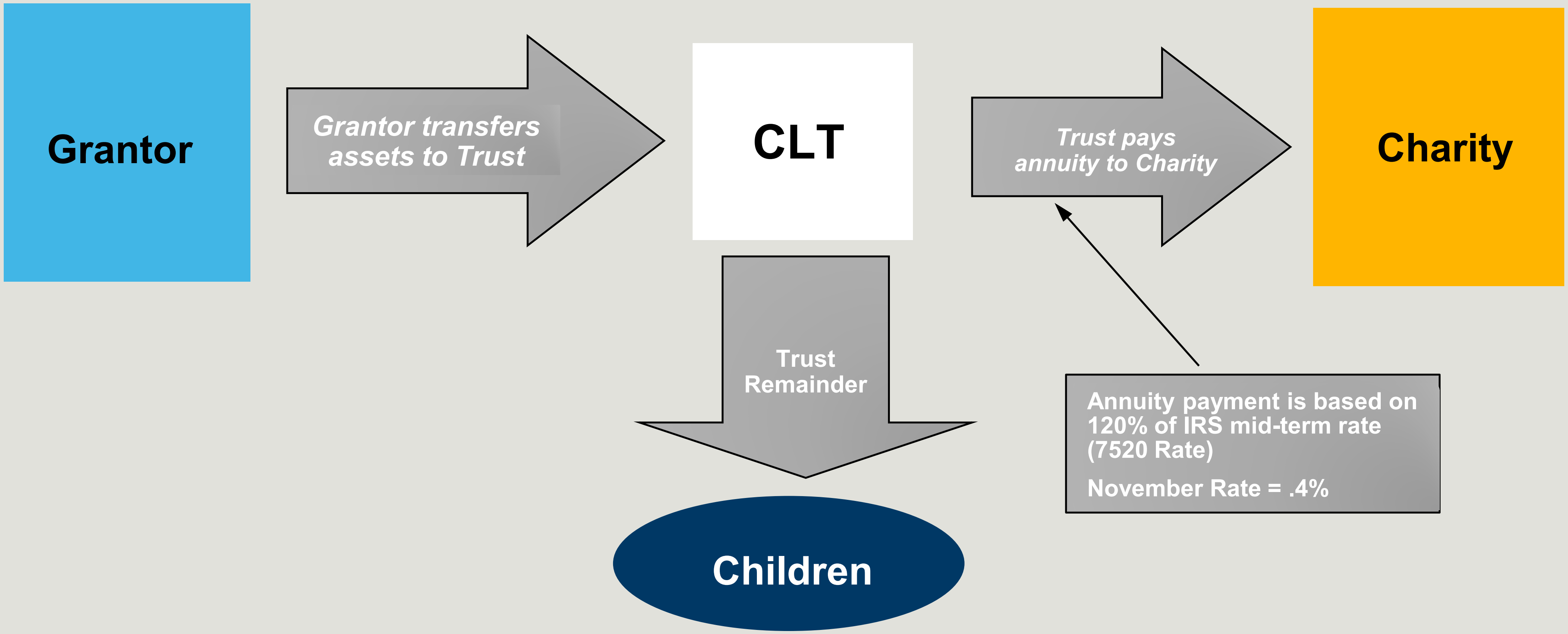
- Outright Gifts
- Gifts in Trust
  - SLAT, ILIT, Dynasty Trust, CLAT
- Estate Freezes (using current low interest rates)
  - Sale to IDGT, Promissory Note, GRAT
- Go big or go home using lifetime exemptions
  - No claw back

Spousal Lifetime Access Trust

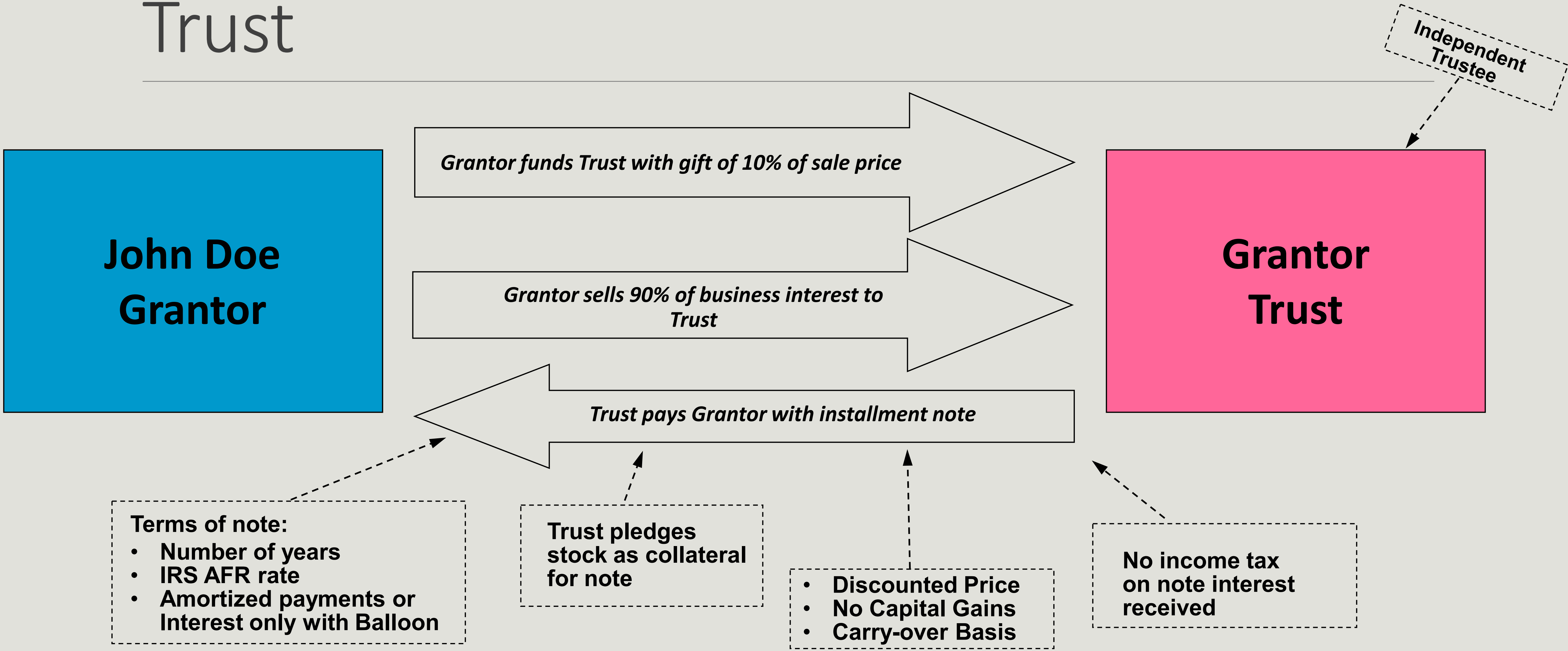


Distributions may be purely discretionary or HEMS standard

Charitable Lead Annuity Trust



Sale to Intentionally Defective Grantor Trust



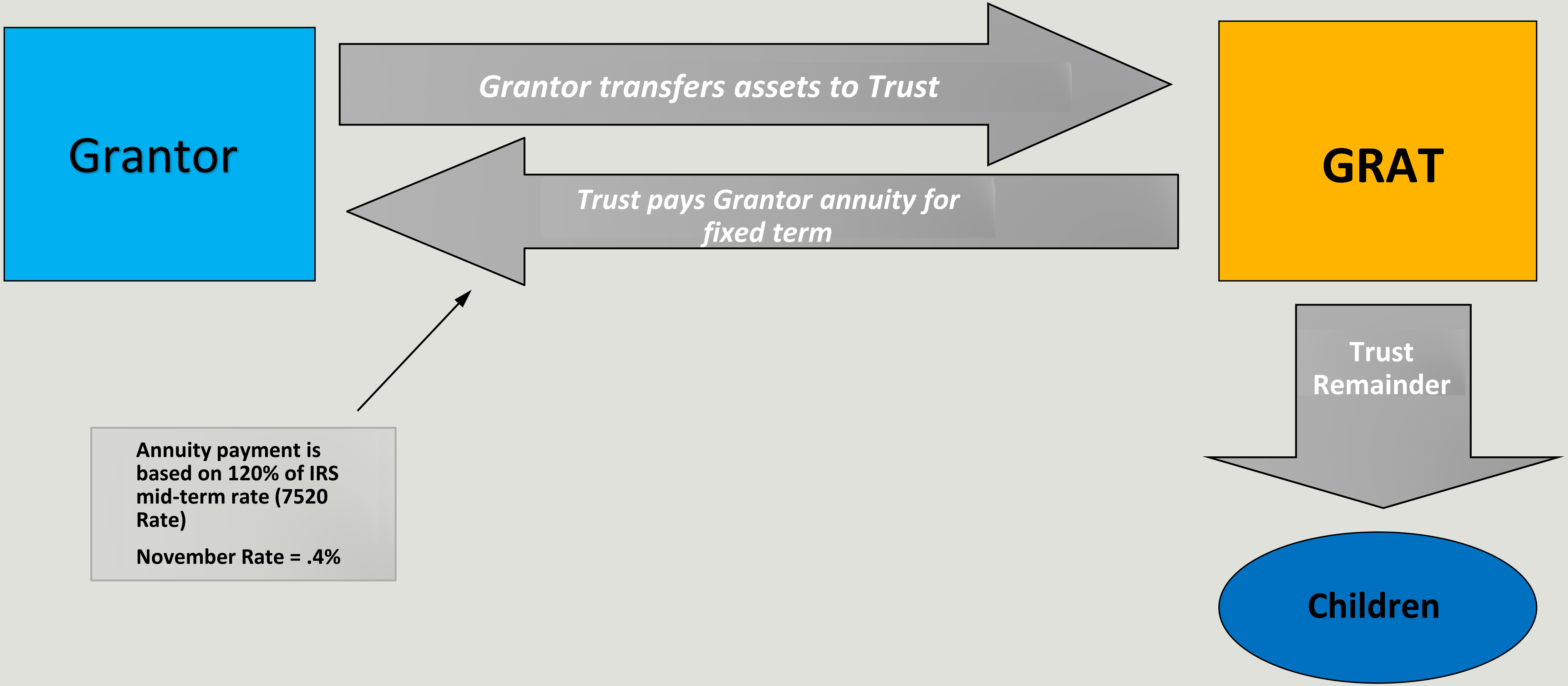
Promissory Note Valuation Example

PROMISSORY NOTE FACE VALUE	10,000,000	
TERM - YEARS	10	
STATED INTEREST RATE		1.12%
ANNUAL PAYMENT	1,062,629	

Market Interest Rate [1]	**3.25%**

Year	Payment	Present Value
1	1,062,629	1,029,181
2	1,062,629	996,785
3	1,062,629	965,409
4	1,062,629	935,021
5	1,062,629	905,589
6	1,062,629	877,084
7	1,062,629	849,476
8	1,062,629	822,737
9	1,062,629	796,840
10	1,062,629	771,758
Total Present Value		**8,949,881**
Discount From Face Value		**(1,050,119)**

Grantor Retained Annuity Trust



Business Valuation Planning Opportunity

- Macro economic uncertainties are the friend of estate planners.
- Market earning volatility has increased.
- Lower private company purchase price multiples.
- Market evidence of higher discounts for lack of control.
- Concept of Fair Market Value vs. Strategic Value.

EBITDA Multiple Trend

MARKET MULTIPLES OF EBITDA

	2019 QUARTER 4	2020 QUARTER 1	2020 QUARTER 2
EBITDA MULTIPLE	4.00	4.70	4.40
% CHANGE		**17.5%**	**-6.4%**

private buyer/private seller transactions

Lack of Control Discount Increasing

CLOSED END FUND DISCOUNTS

	2019	2020	2020	2020
	12/31/2019	**3/31/2020**	**6/30/2020**	**9/30/2020**
CEF DISCOUNTS	11.1%	12.4%	13.9%	13.3%
% CHANGE		**11.7%**	**12.1%**	**-4.3%**

Median discount of trading price from net asset value

Healthy Discounts - Grieve v. Commissioner

- Taxpayer transferred a 99.8% non-voting interest in LLC to GRAT and a second 99.8% non-voting interest in LLC to Irrevocable Trust.
- IRS determined 2013 gift tax deficiency of $4.4 million and Section 6662(a) accuracy penalty of $628,000.
- Assets held by LLCs were largely cash, marketable securities and notes, 70% to 100% of total assets held.
- Taxpayer relied upon closed-end funds and restricted stock studies for discounts.
- IRS Expert assumed the 0.2% voting units would be purchased at a premium and that premium equated to the economic discount of the nonvoting units (1.4% effective discount conclusion).
- Court threw out tiered discounts on small private equity investments valued by taxpayer’s trial expert.

Tax Court Case Update - Grieve

Grieve v. Commissioner - TC Memo 2020-28

	LLC #1	LLC #2
LACK OF CONTROL	13.4%	12.7%
LACK OF MARKETABLITY	25.0%	25.0%
EFFECTIVE DISCOUNT	**35.1%**	**34.5%**

Tiered Discounts - Nelson v. Commissioner

- Taxpayer gifted and sold two separate interests in Longspar Partners Ltd. (holding company) in 2008/2009.
- IRS determined gift tax deficiency of $6.7 million and Section 6662(a) accuracy penalty of $1.3 million.
- Assets held by Longspar Partners consisted of several privately held operating companies, the most valuable of which was a Caterpillar equipment dealership.
- Issue # 1 – Were the interests transferred fixed dollar amounts or percentage interests.
- Issue # 2- The fair market value of the 6.14% and 58.65% limited partner interests.
- Court found no intangible value for dealership (not a franchise) due to restrictive terms of dealership agreement, including sale a Net Asset Value.

Tax Court Case Update - Nelson

Nelson v. Commissioner - TC Memo 2020-81

OPERATING CO. LACK OF CONTROL	15.0%
OPERATING CO. LACK OF MARKETABLITY	30.0%
OPERATING CO. EFFECTIVE DISCOUNT	40.5%
HOLDING CO. LACK OF CONTROL	5.0%
HOLDING CO. LACK OF MARKETABLITY	28.0%
HOLDING CO. EFFECTIVE DISCOUNT	31.6%
TOTAL EFFECTIVE TIERED DISCOUNT	**59.3%**

Consider Income Tax Implications

Current / TCJA:

- Top Individual rates = 37% through 2025
- Long-term capital gain and dividend rates = 20%
- Itemized deductions – deduction for state and local taxes capped at $10,000; no miscellaneous itemized deductions
- Sec 199A deduction of 20% on Qualified Business Income– makes top rate effectively 29.6%
- Corporate Tax rate = 21%
- Net Investment Income Tax of 3.8% on investment income for AGI over thresholds
- No RMDs required for 2020; RMDs required beginning at age 72

Presidential Candidate Tax Proposal – Income Tax

Vice President Biden Proposal:

- Top Individual rates = pre-TCJA; 39.6%
- Long-term capital gain and dividend rates = 39.6% for income > $1 million
- Itemized deductions – repeal TCJA & revert to 2016; deduction for state and local taxes; Pease limitations; maximum rate benefit of 28%
- Sec 199A deduction – phase out for taxpayers with income > $400,000
- Corporate Tax rate = 28%
- Social Security Tax = 12.4% on all earned income (with "hole" for $137k - $400k)

President Trump Proposal:

- Make permanent TCJA changes set to expire after 2025
- 10% "middle class tax cut"; Eliminate Net Investment Income Tax

Consider Income Tax Implications

Optimization of Effective Tax Rates

Maximize Benefits of Losses/Deductions | Minimize Tax on Income/Gains

Environmental Factors | Personal Factors | Estate Factors & Impacts

Consider Income Tax Implications

Examples of Planning Strategies:

- Conversion of Traditional IRA to Roth IRA
- Capital Gain "Harvesting" (includes electing out of installment sale treatment)
- Distributions from Trusts
- Acceleration of Options and Deferred Compensation
- Accounting Method Changes / Election
- RMDs – to defer or not defer
- Loss Carrybacks

Environmental Facts & Assumptions

- Current rates – ordinary / capital
- Prior year(s) rates – for any NOL carrybacks
- Future rates – likely rising
  - Impact of November elections
  - Impact of Stimulus spending
  - Sunset of Tax Cuts and Jobs Act provisions

Estate Impacts / Assumptions

- Basis step-up at death?
- Beneficiary tax rates?
- Inclusion of assets in beneficiaries' estates – inside/ outside trusts

Examples of Planning Strategies

- Roth IRA Conversion
- Distribute funds from trusts to mitigate higher trust tax rates
- Capital Gain “Harvesting”
- Exercise Opinions/ Deferred Compensation
- Accounting method changes / elections
- Loss Carrybacks
- RMDs – to defer or not defer?

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Disclosures

- The information contained herein is for information purposes only and should not be construed as providing investment, tax or legal advice.

SESSION 4

FINANCIAL MARKETS AND THE ECONOMY

A SPECIAL THANKS TO OUR KEYNOTE SESSION SPONSOR

UMA M. RAJESHWAR, CFA, CTFA, CFP®

Managing Director, Portfolio Management

Uma M. Rajeshwar is a Managing Director and Relationship Manager in Glenmede's Ohio office. He is the primary contact on complex relationships and provides investment and wealth advice to the Company's high-net-worth individual clients.

With thirty-one years of investment and trust experience, Mr. Rajeshwar served as Vice President, Society Asset Management, for Society Corp, Cleveland, Ohio, and as Vice President, Finance, Trust & Investment Management, AmeriTrust/Society Corp., Cleveland, Ohio.

Mr. Rajeshwar graduated from the University of Delhi, India, with a B.A. in economics and earned an M.B.A. from the University of Michigan. He also holds the Chartered Financial Analyst® (CFA), CERTIFIED FINANCIAL PLANNER (CFP®), and the Certified Trust Financial Advisor (CTFA) designations.

A resident of Pepper Pike, Ohio, Mr. Rajeshwar is a member of the CFA Institute, the ABA Institute of Certified Bankers, and the Financial Planning Association, and has provided business and market analysis on national and local media channels and events.

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The Covid-19 Crisis - Navigating Market Volatility

Don't Call It a Comeback…Yet

October 29, 2020

Uma Rajeshwar, CFA, CTFA, AEP, CFP®
Managing Director,
Glenmede

- Market indices have recovered most of their losses from earlier this year, but deeper analysis reveals that markets remain far from normal
- Ongoing abnormal market behavior reflects a reopening economy that is finding it difficult to fully recover without a widely-distributed vaccine
- A robust pipeline of vaccine candidates provides opportunity to transition to a full recovery, but timing remains uncertain
- Attention is now turning to the potentially divergent election outcomes, but markets often exhibit very little political bias longer term
- Investors should maintain a neutral equity and risk allocation relative to established investment plans, while seeking opportunity away from the largest U.S. stocks

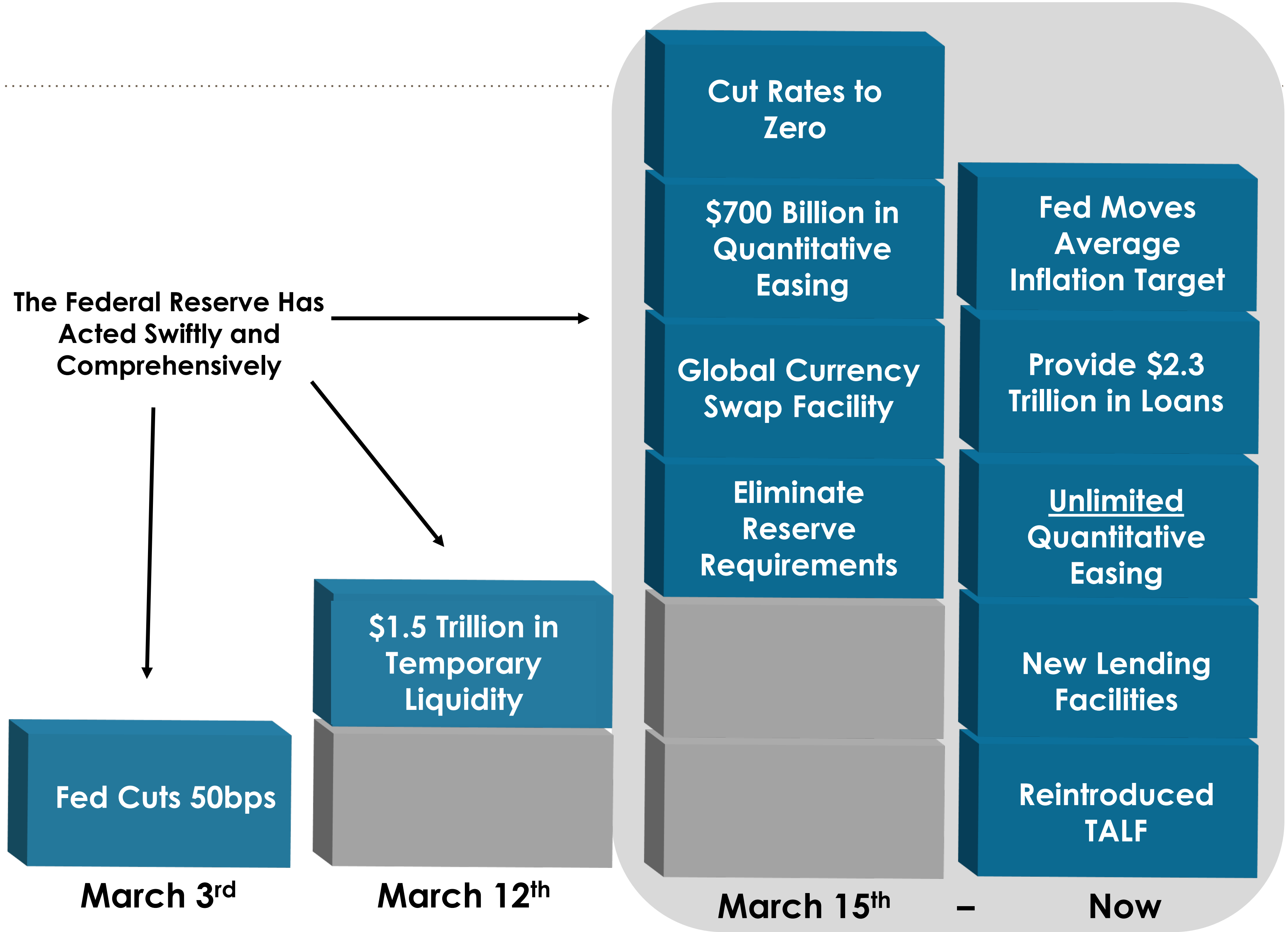
These statements reflect Glenmede's opinions or projections, which may change after the date of publication. Actual future developments may differ materially from the opinions and projections noted above.

THE MARKET & COVID-19 – A TIMELINE

Source: Glenmede, FactSet *Data through 10/5/2020*

Shown is the S&P 500 Index, which is a market capitalization weighted index of U.S. large-cap stocks. One cannot invest directly in an index. Past performance may not be indicative of future results.

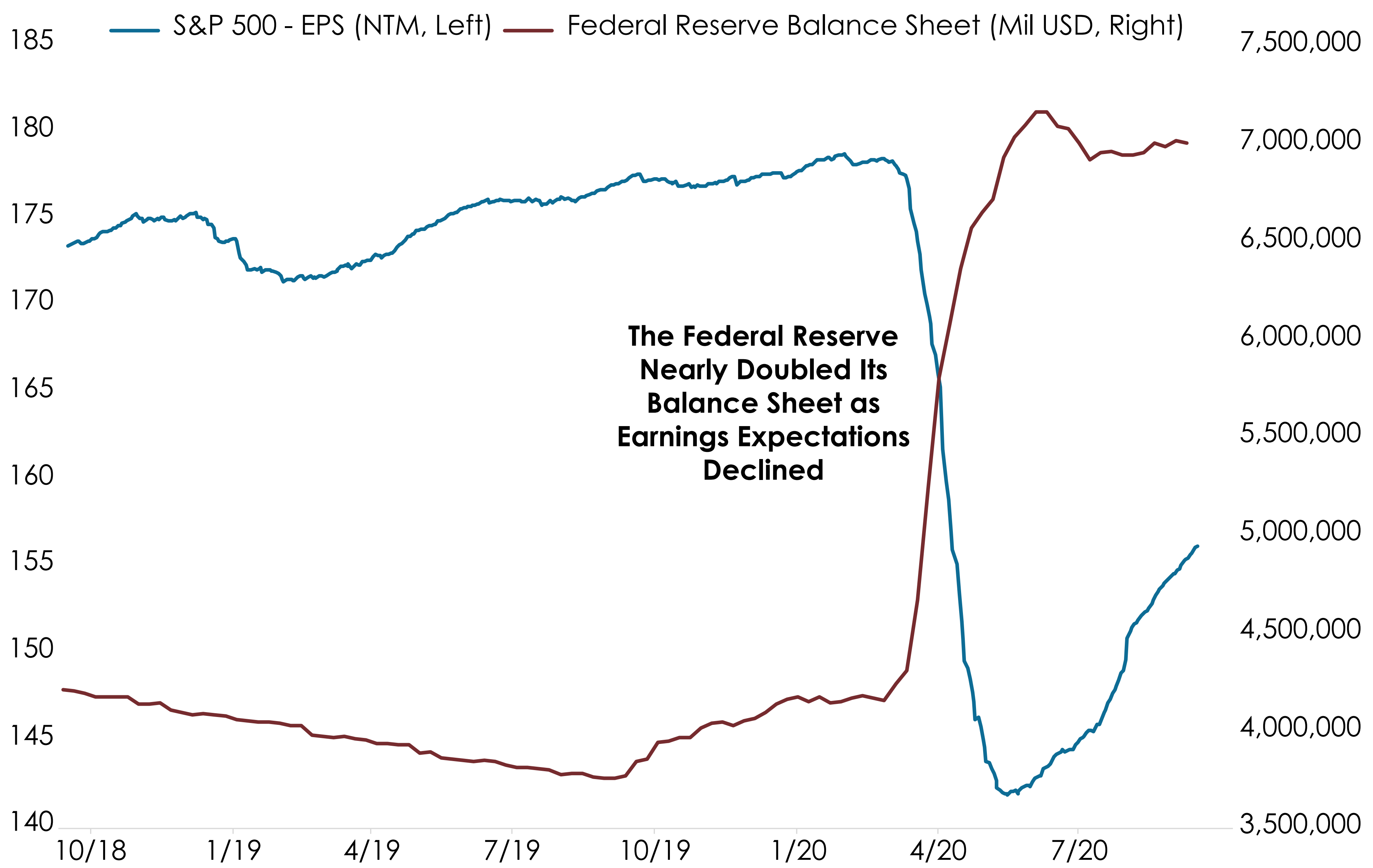
MONETARY POLICY: THE FED'S ACCOMMODATION IS STACKING UP



Source: Glenmede

Data through 09/18/2020

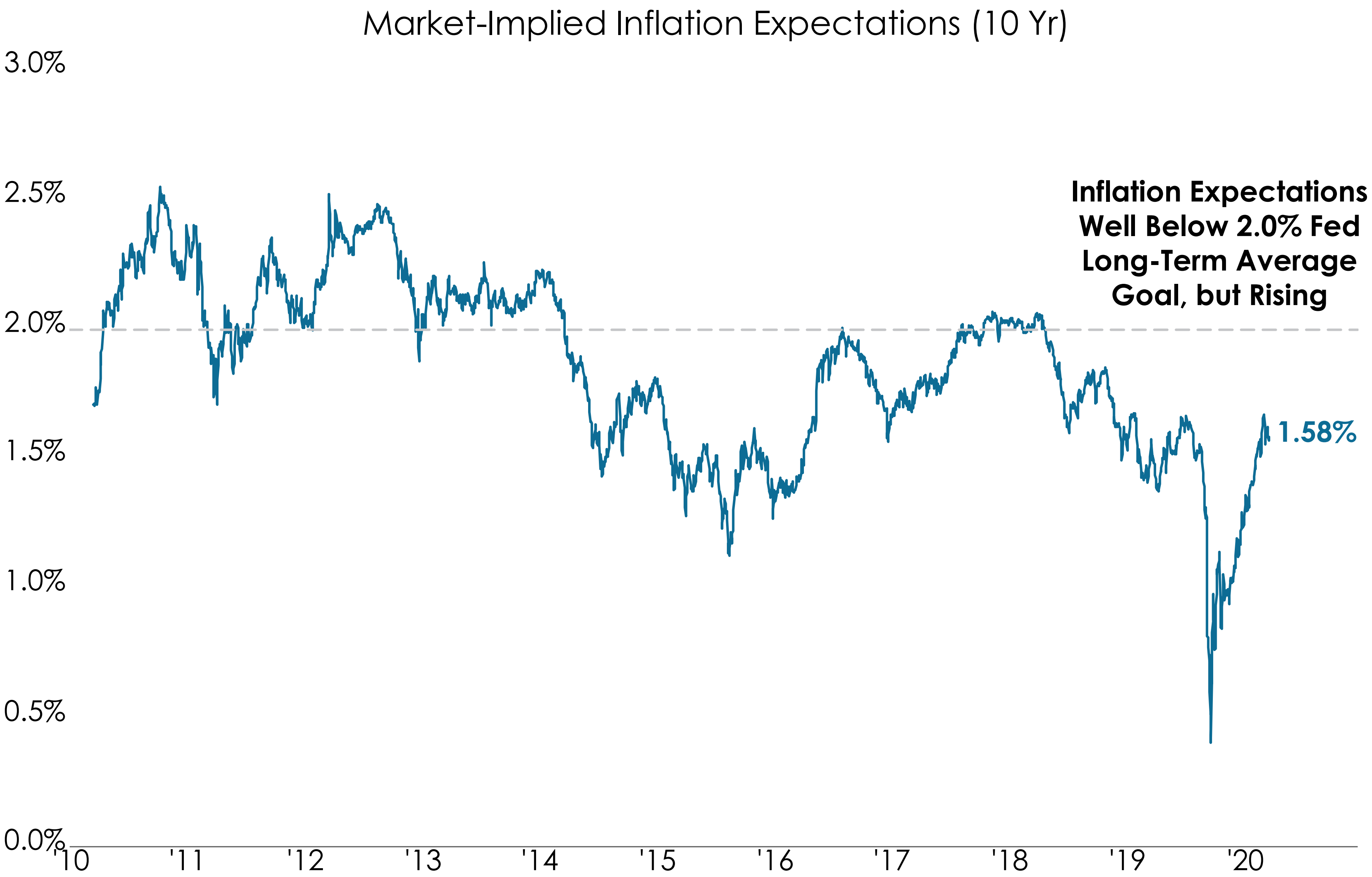
MONETARY STIMULUS BUYS TIME FOR CORPORATE EARNINGS TO RECOVER



Source: Glenmede, FactSet *Data through 09/15/2020*

Data shown in blue is the consensus estimate of 2020 earnings for the S&P 500 index over time and Federal's reserve balance sheet in red. The S&P 500 is a market capitalization weighted index of large-cap stocks in the U.S. One cannot invest directly in an index. Data shown are projections, for which there can be no guarantee of accuracy. Actual results may vary considerably from these projections.

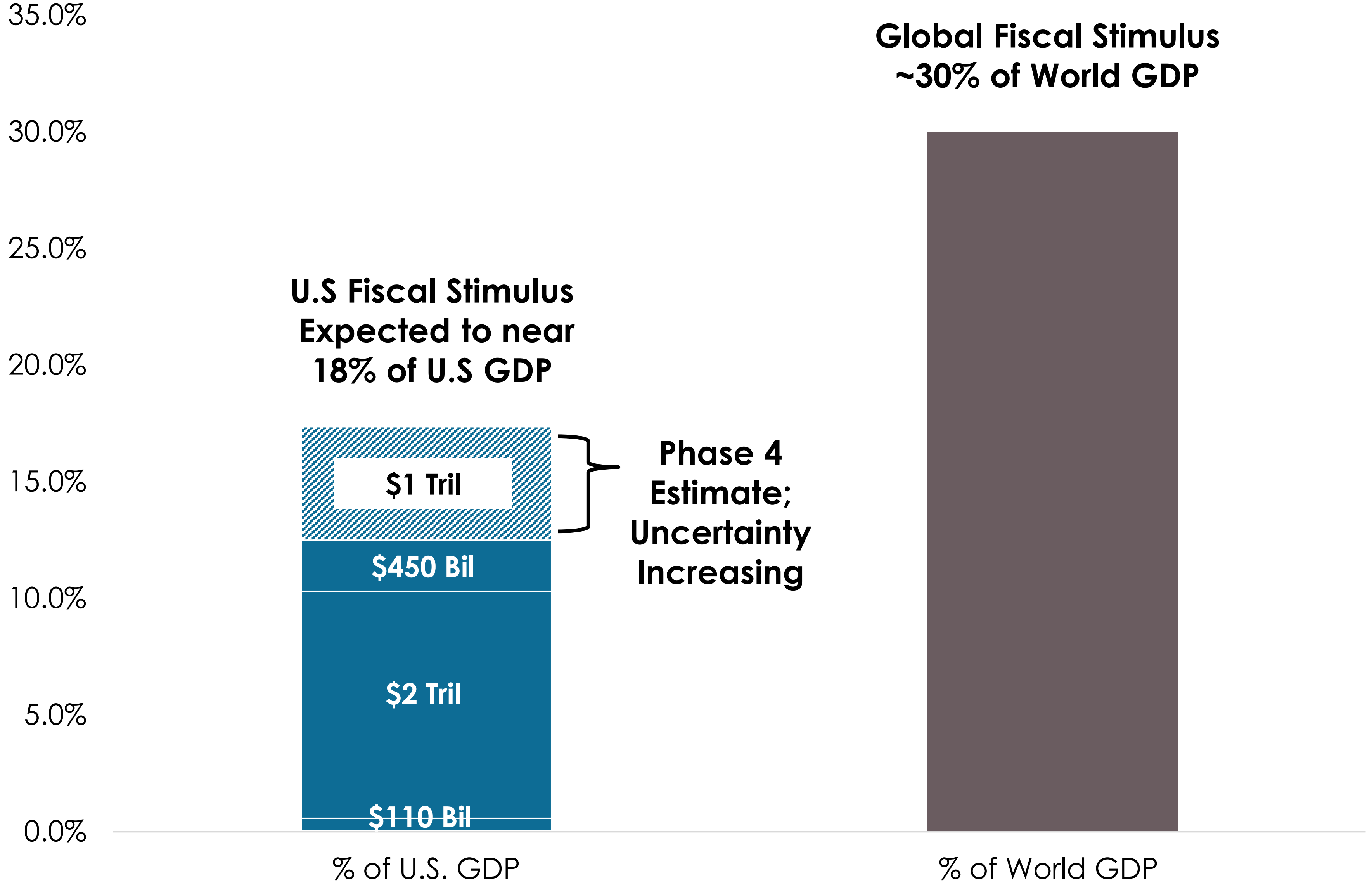
THE FED IS TRYING TO RAISE INFLATION FROM VERY LOW LEVELS



Source: Glenmede, Factset *Data through 09/15/2020*

Market-Implied Inflation Expectations (10yr) are based a equal-weighted average of inflation implied by 10-year inflation swaps and inflation implied by the relative yields on 10-year Treasury Bonds and 10-year Treasury Inflation Protected Securities (TIPS). All inflation expectations are adjusted to reflect Personal Consumption Expenditures Inflation (PCE). Past performance may not be indicative of future results. Actual results may differ materially from market-implied expectations.

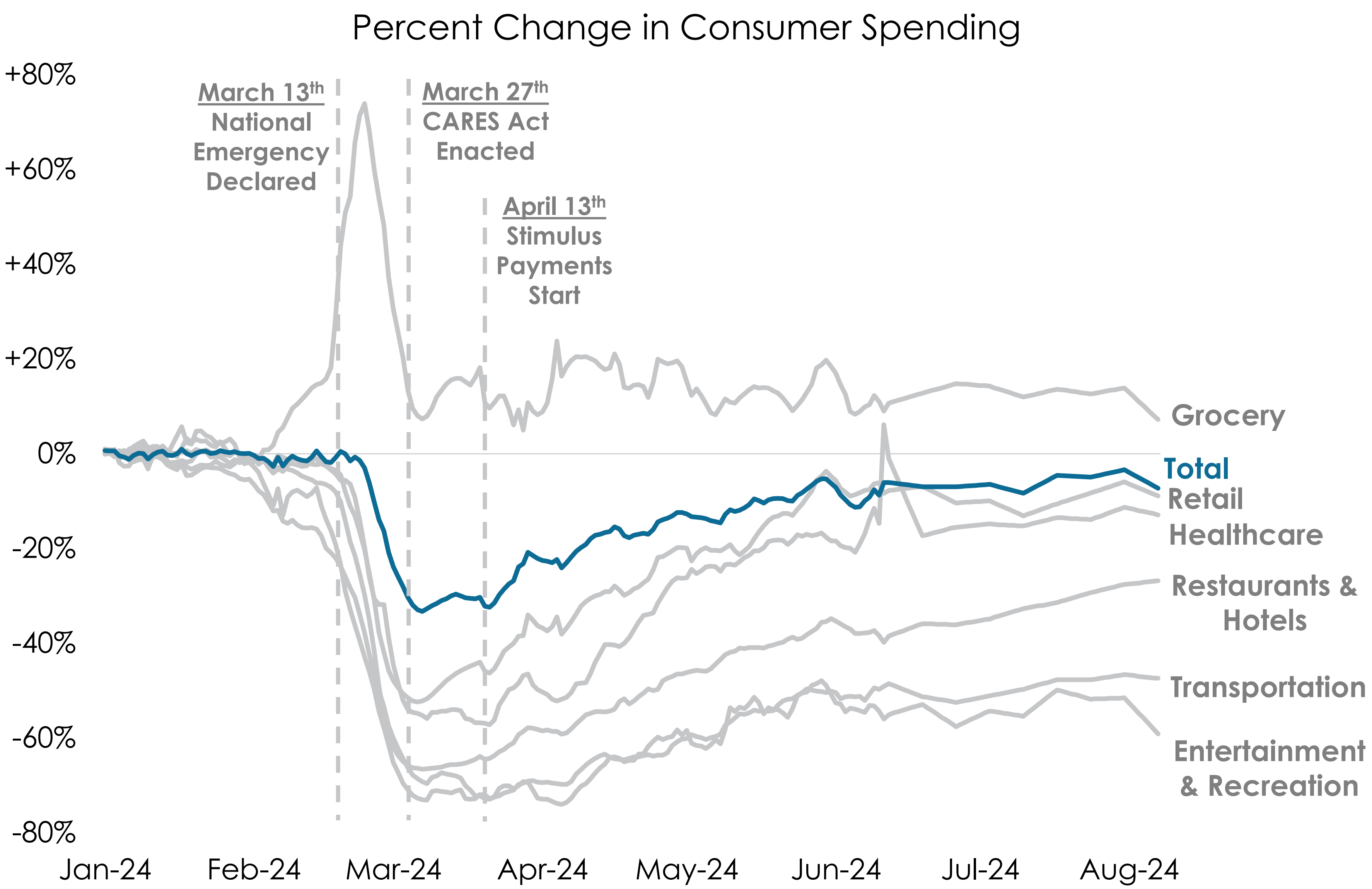
FISCAL POLICY RESPONSE: SIGNIFICANT STIMULUS HAS BEEN INTRODUCED QUICKLY



Source: Glenmede, Cornerstone Macro, UBS

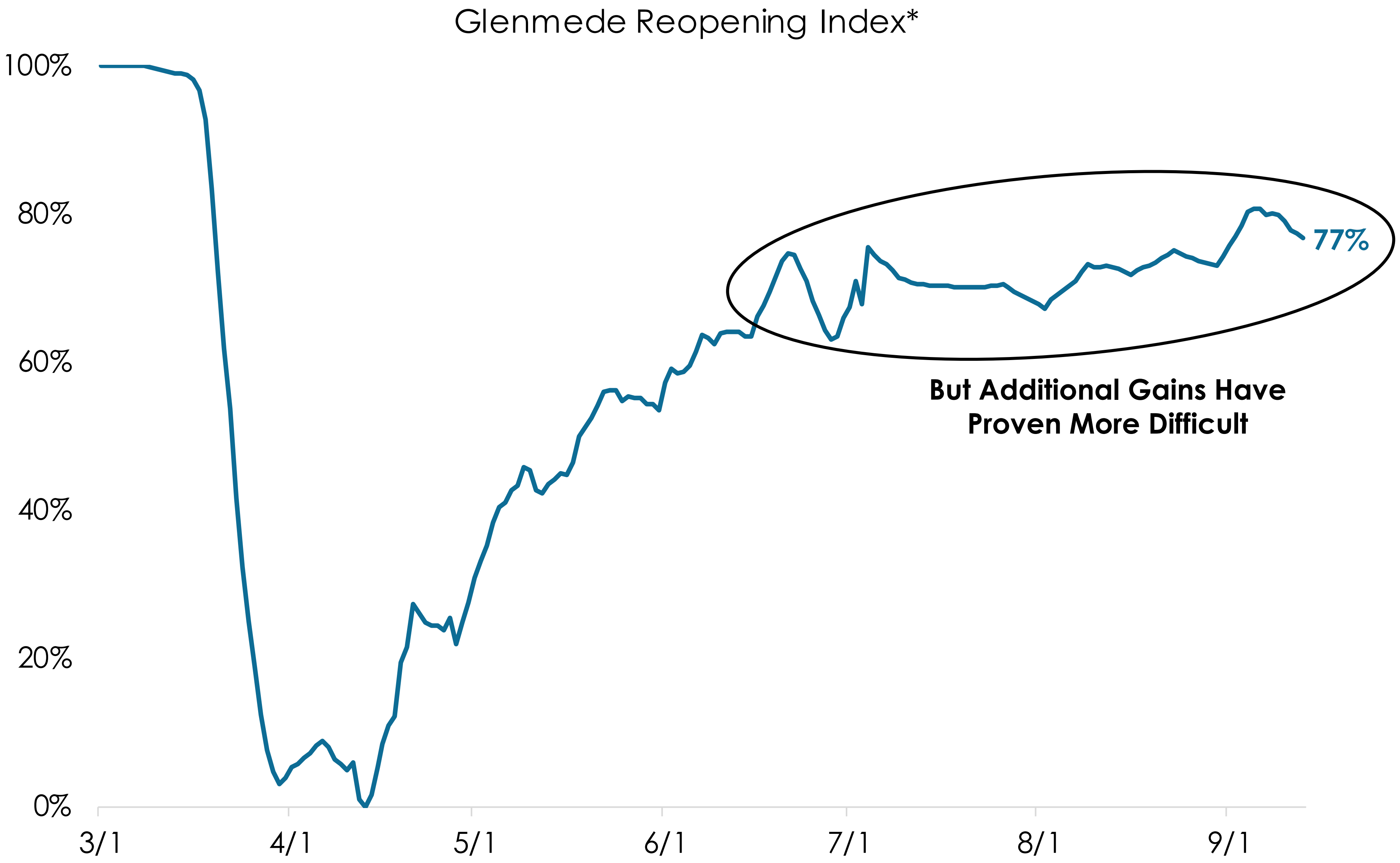
Data through 8/31/20

CONSUMER SPENDING IS REBOUNDING UNEVENLY



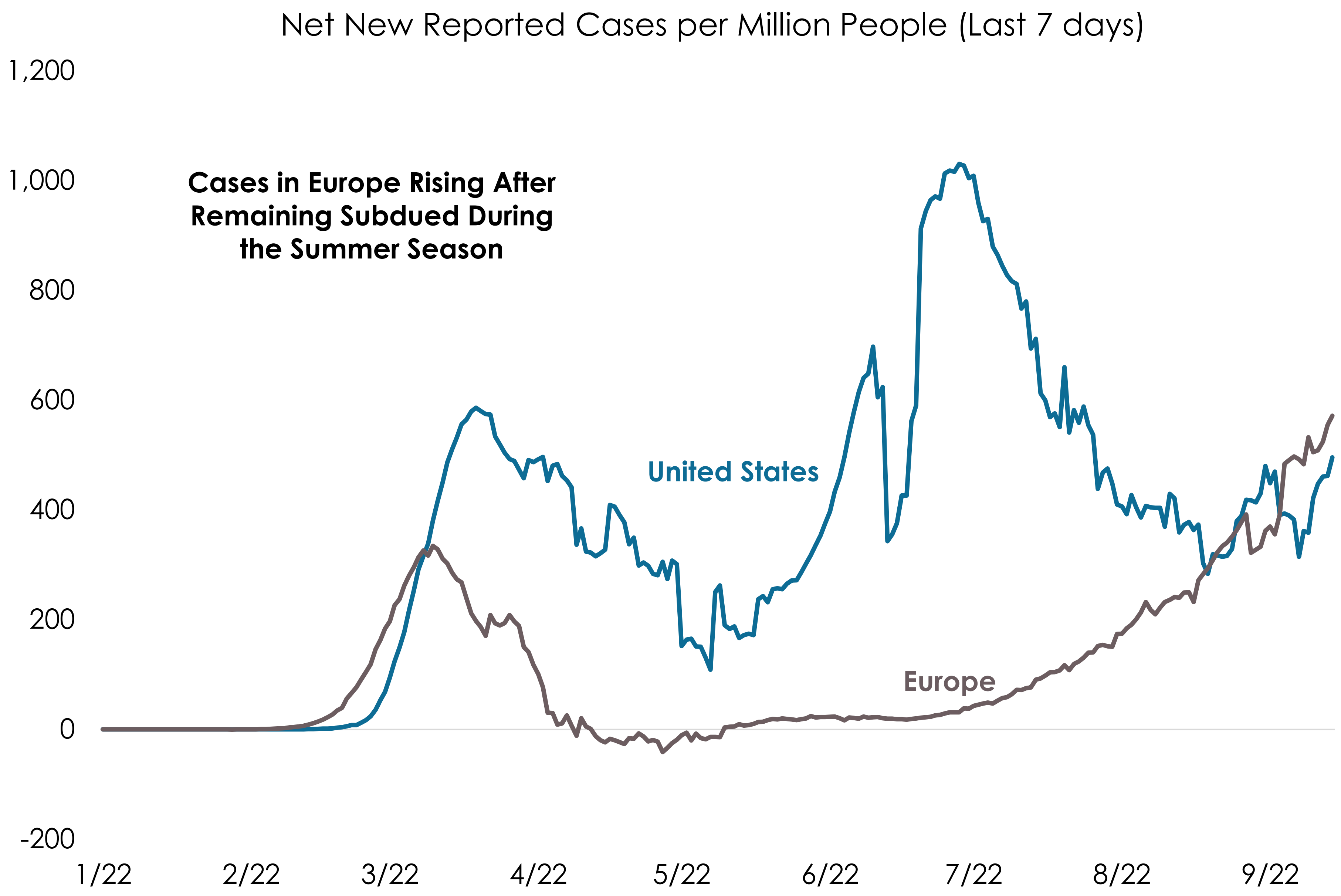
Source: Glenmede, Opportunity Insights *Data through 8/30/2020*

Data shown are components of Opportunity Insight's Economic Tracker for consumer spending in the United States. Figures are percent changes in consumer spending relative to early January levels tracked on a daily basis. Information sourced from third parties is assumed to be accurate, though no guarantees can be made to its accuracy.



Source: Glenmede, Opportunity Insights *Data as of 10/5/2020*

**Glenmede's Reopening Index is a proprietary tool developed by Glenmede. It is a balanced mix of high-frequency indicators meant to estimate the percentage of U.S. economic activity lost during the COVID-19 crisis that has since been regained during the reopening with 100% representing the prior peak level and 0% representing the crisis low. Though created in good faith, there can be no guarantee that these indicators will be accurate.*



Source: Glenmede, Johns Hopkins University, World Health Organization *Data through 10/5/2020*

Net new active cases is the total number of new cases over the last 7days minus the total number of recovered cases and deaths over the last 7 days.

STUDY START DATE	VACCINE CANDIDATES
Jun. 2020	**AstraZeneca & Oxford University** ► 2,000 participants in Brazil; Trial run from the U.K.
Jul. 2020	**Pfizer & BioNTech** ► ~30,000 participants in U.S., Brazil and Argentina
Jul. 2020	**Moderna** ► ~30,000 participants in U.S.
Sep. 2020	**Johnson & Johnson / Janssen** ► ~60,000 participants in U.S. & other counties*
Sep. 2020	**Novavax** ► ~10,000 participants in U.K

Phase III

Phase II: 3
Phase I/II: 10
Phase I: 16
Pre-clinical Trials: 149

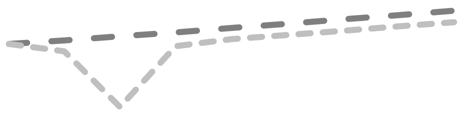
Source: Glenmede, World Health Organization (WHO), U.S. National Institutes of Health (NIH) *Data through 10/2/2020*

Information is based on clinical trial data submitted by each vaccine candidate's organization through ClinicalTrials.gov. Vaccines highlighted are from developed markets. Participants are defined as the target number of participants that the researchers need for the study and the specified countries listed do not mean actual recruitment, only that it is planned.

**Other countries include Brazil, Argentina, Chile, Columbia, Mexico, Peru, Philippines, South Africa and Ukraine*

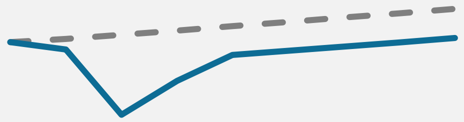
Upside Case
(“V”)

Economic reopening begins in summer
“Reopen” phase lasts through Jan 2021
No longer-term impairment



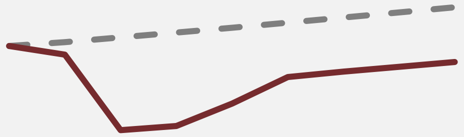
Base Case
(“U”)

Economic reopening begins in summer
“Reopen” phase lasts through Q2 2021
2% longer-term impairment



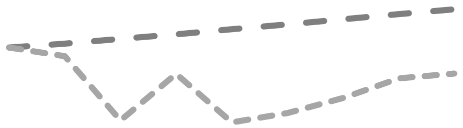
Downside Case
(Long “U”)

Economic reopening begins in summer
“Reopen” phase lasts until Q4 2021
4% longer-term impairment



Downside Case
(“W”)

Economic reopening begins in summer
Second wave of infection & shutdown
Slower recovery through 2021
6% longer-term impairment



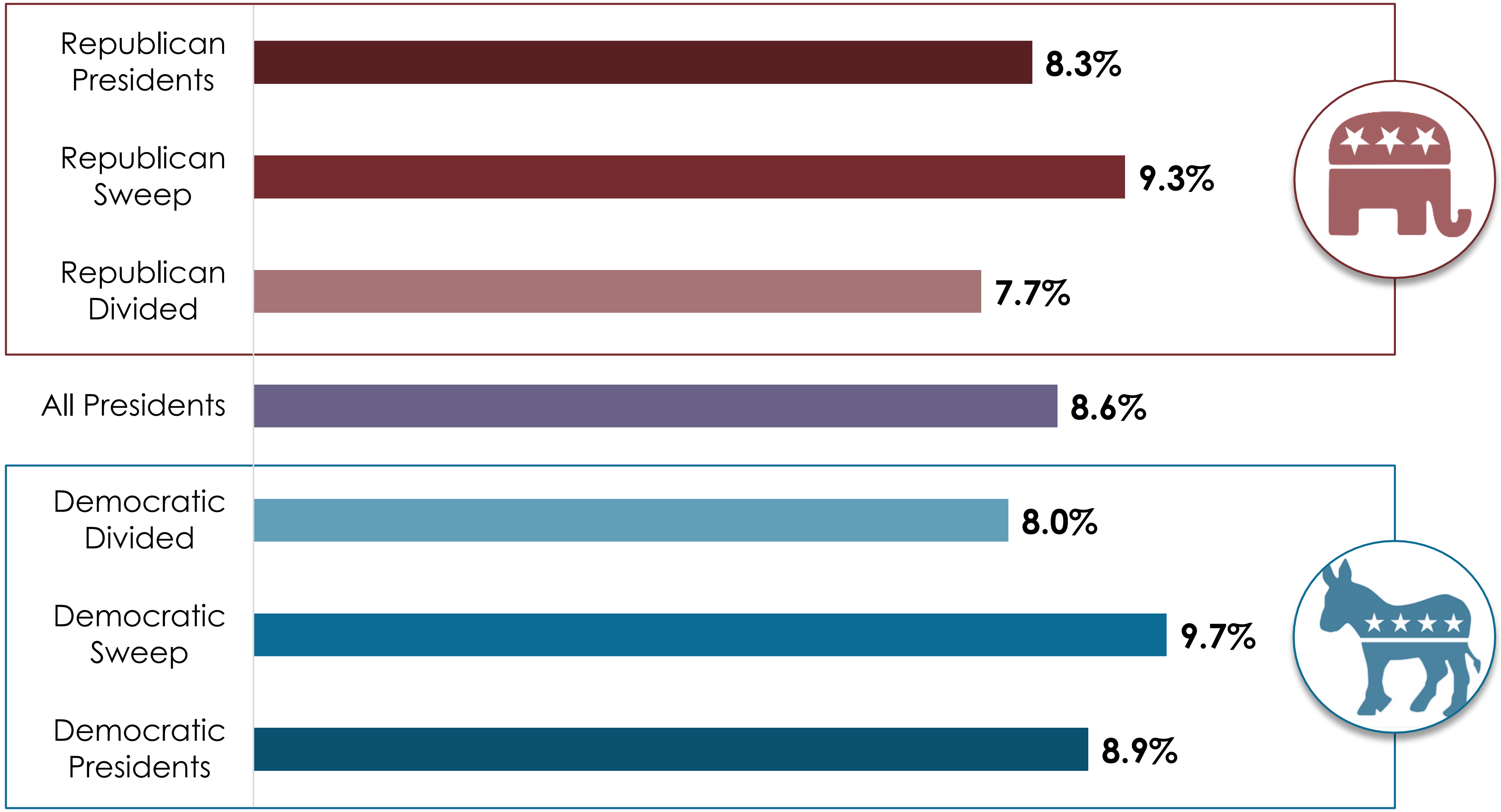
These charts are meant to be generalized representations of how gross domestic product (GDP) may behave in four scenarios outlined. The x-axis show the passage of time and the y-axis for the top panels show the level of GDP, indexed to 100 at t=0. Actual recovery may differ from the scenarios shown.

POLICY SHIFTS COULD BE GOOD FOR GROWTH BUT TOUGH ON SHAREHOLDERS

	Investment Implications
RAISE U.S. CORPORATE TAXES	↓ Corporate Profit Margins ↑ International Stocks
RAISE LONG TERM CAPITAL GAINS RATE TO 37%	↓ Pre-Tax Equity Risk Premiums Rise
INCREASE FISCAL STIMULUS (INFRASTRUCTURE)	↑ Economy
INCREASE LABOR COMPENSATION	↓ Corporate Profit Margins ↑ Average Consumer Income
TRADE COORDINATION WITH ALLIES	↑ Lower Volatility Stabilizes Supply Chains

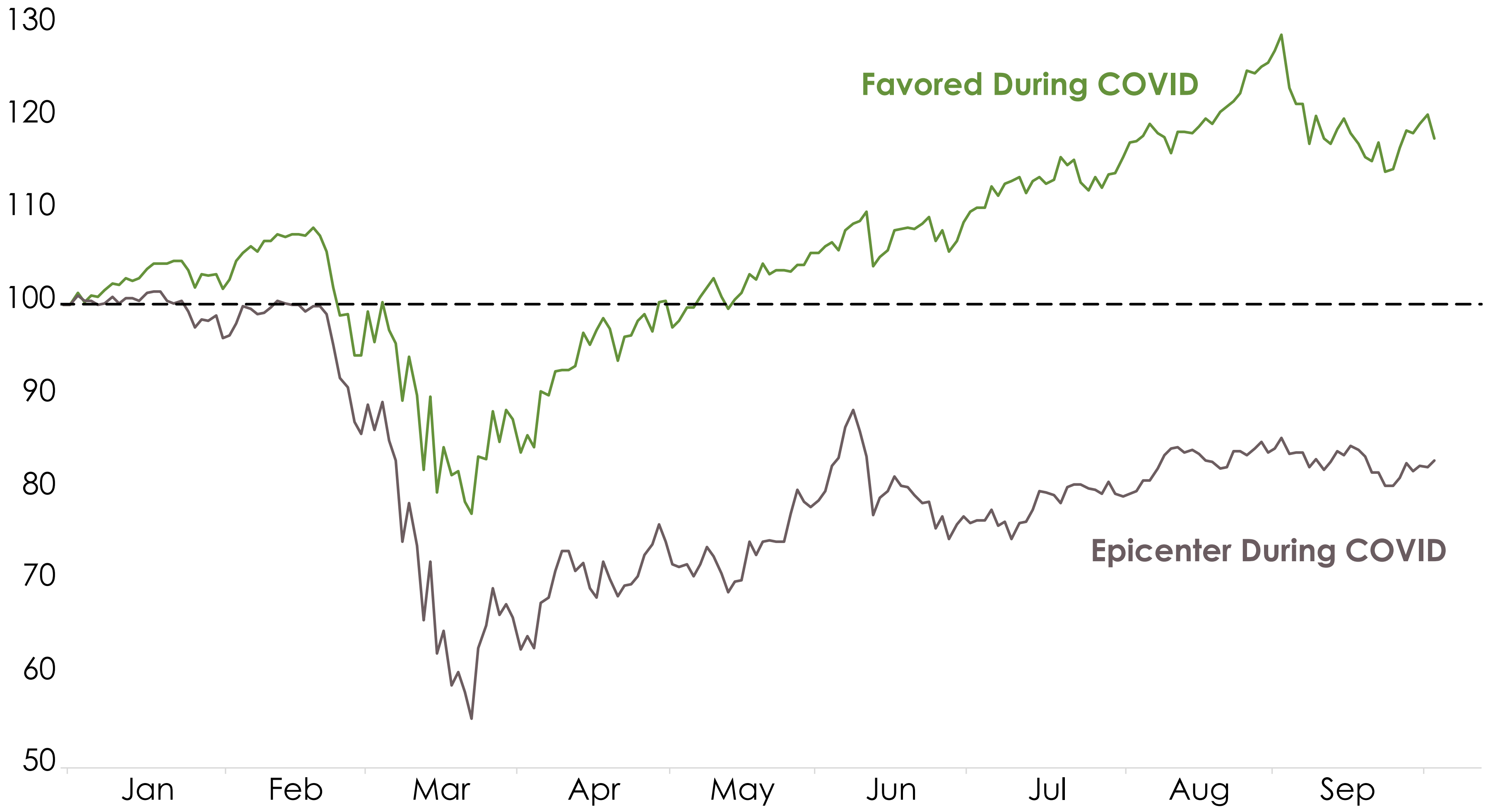
Source: Glenmede
The chart shows potential policy shifts as a result of Democratic control of the White House and Congress. There is no assurance that any of the potential policy shifts shown will occur.

Market Returns (4yrs) Following U.S. Presidential Elections
(1872 – 2016)



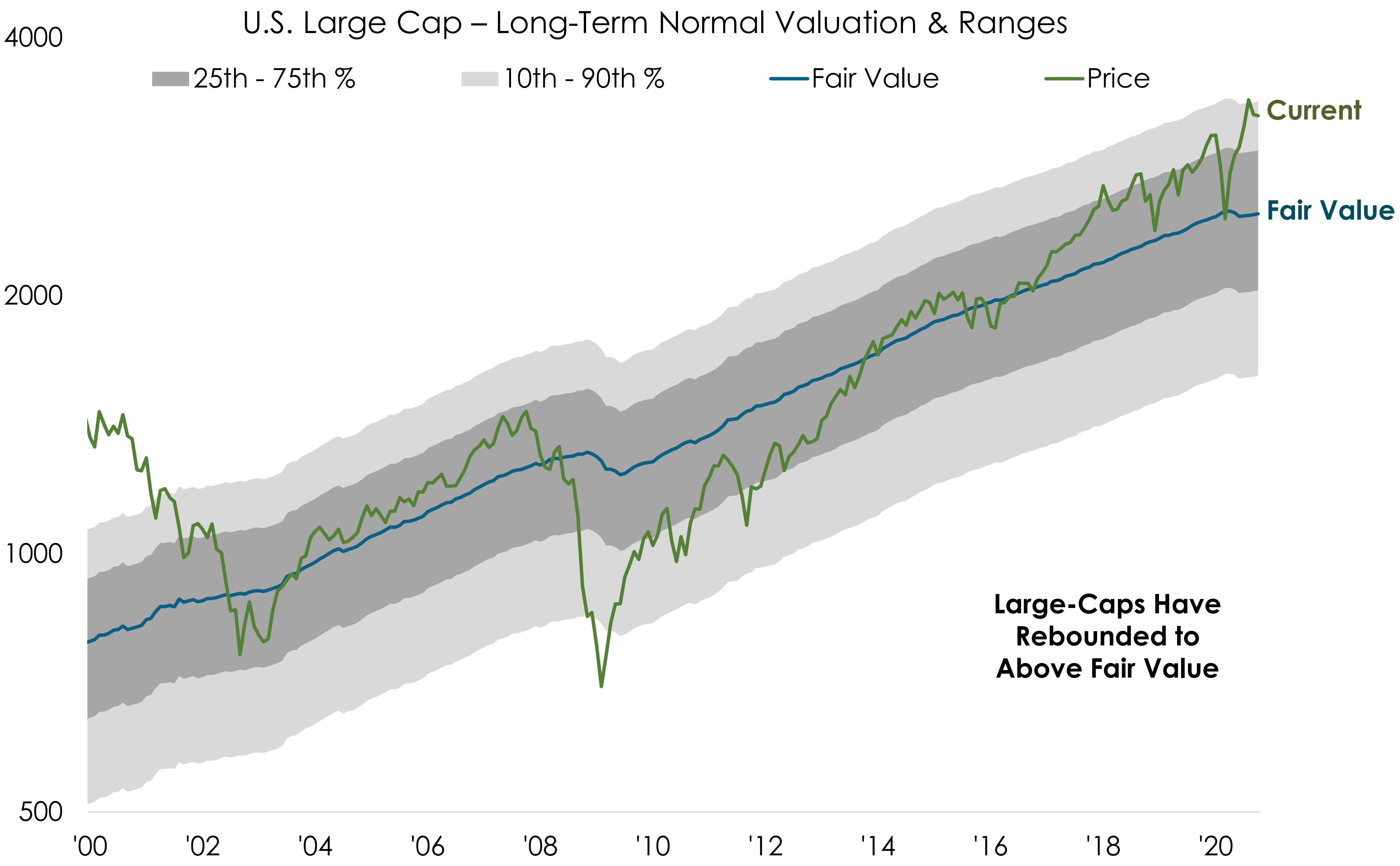
Source: Glenmede, Robert Shiller
Data shown are S&P 500 Index total returns that are inflation-adjusted and include dividend income. The returns are based on monthly data gathered from Standard & Poor's and Cowles & Associates. Returns shown are four-year averages of real total returns since 1872 to 2016. "Republican Presidents" refers to market performance during all Republican presidencies. "Republican Sweep" refers to the four years after an election where Republicans win the White House and both chambers of Congress. "Republican Divided" refers to the four years after an election where Republicans win the White House but do not have control of both chambers of Congress. The same logic applies for the "Democratic" scenarios. The S&P 500 Index is a market capitalization weighted index of U.S. large-cap stocks. One cannot invest directly in an index. Past performance may not be indicative of future results.

Market Value by COVID Impact Cohort (Indexed to 100)



Source: Glenmede, FactSet *Data through 10/02/2020*

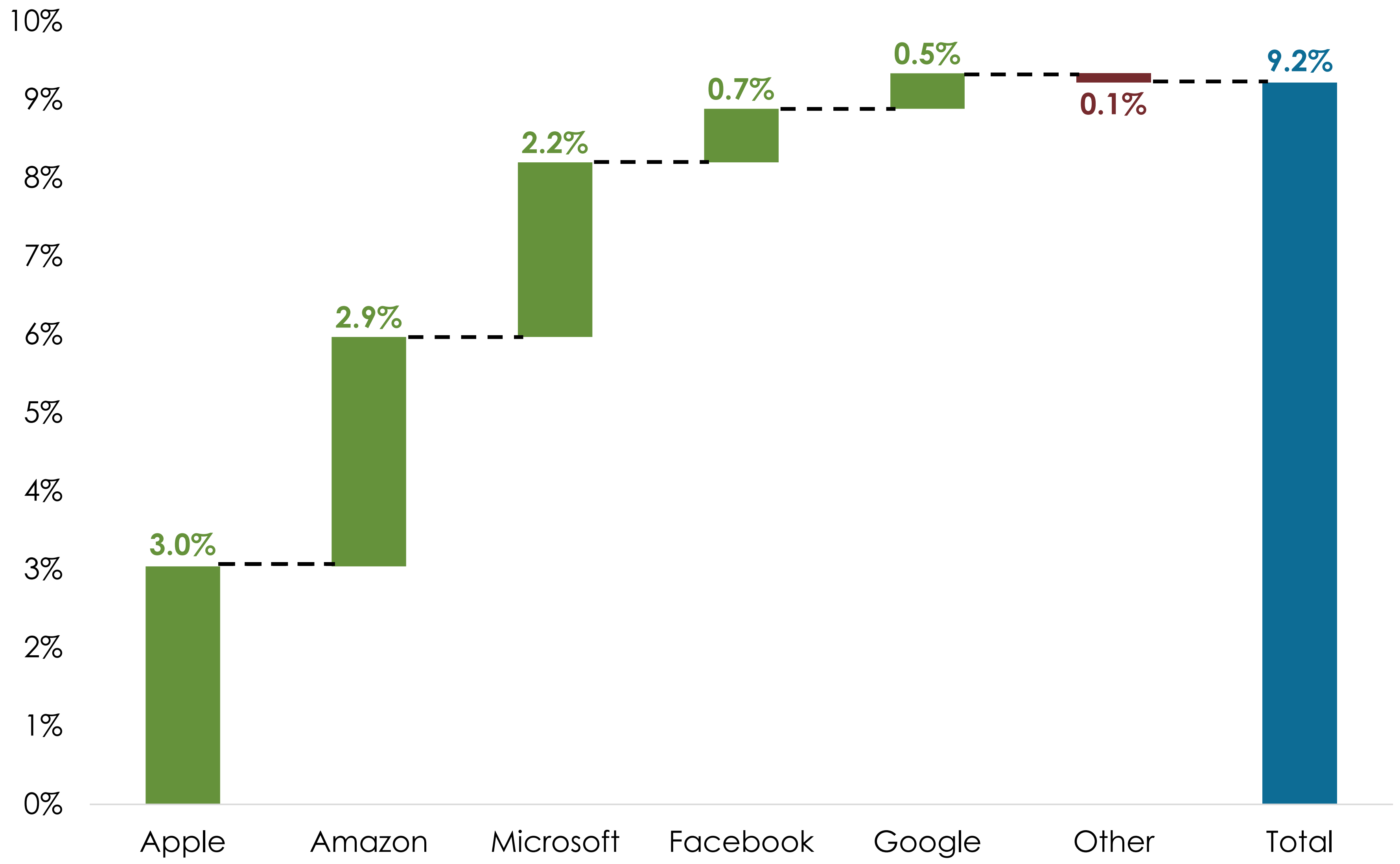
"Favored During COVID" includes sectors that have benefited during the pandemic, and are represented by the information technology, communication services and healthcare sectors in the S&P 500 Index. "Epicenter During COVID" includes sectors that are more levered to the business cycle, and are represented by the consumer discretionary (ex. Amazon), industrials, financials and energy sectors in the S&P 500 Index. The S&P 500 Index is a market capitalization weighted index of U.S. large-cap stocks. Data reflects past performance which may not be indicative of future results. One cannot invest directly in an index.



Source: Glenmede, MSCI *Data through 10/5/2020*

Glenmede's estimate of long-term fair value for U.S. large-cap is based on normalized earnings, dividend yield and book value using MSCI's USA Index, an unmanaged total return index with dividends reinvested. Past performance may not be indicative of future results. One cannot invest directly in an index.

S&P 500: Contribution to 2020 Total Returns

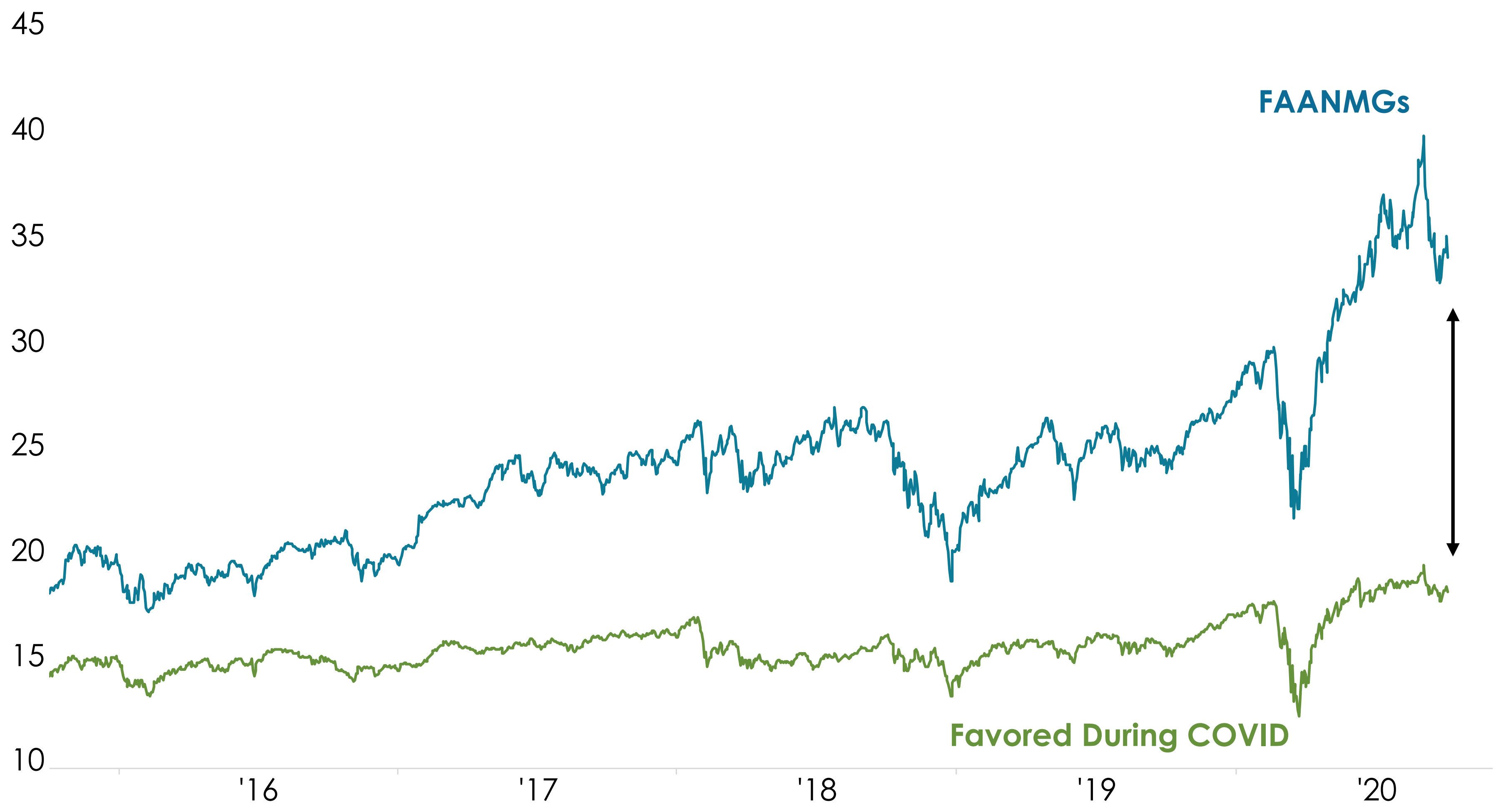


Source: Glenmede, FactSet *Data through 10/11/2020*

Data shown are contributions to total returns for the S&P 500 Index, which is a market capitalization weighted index of U.S. large-cap stocks. One cannot invest directly in an index. Past performance may not be indicative of future results.

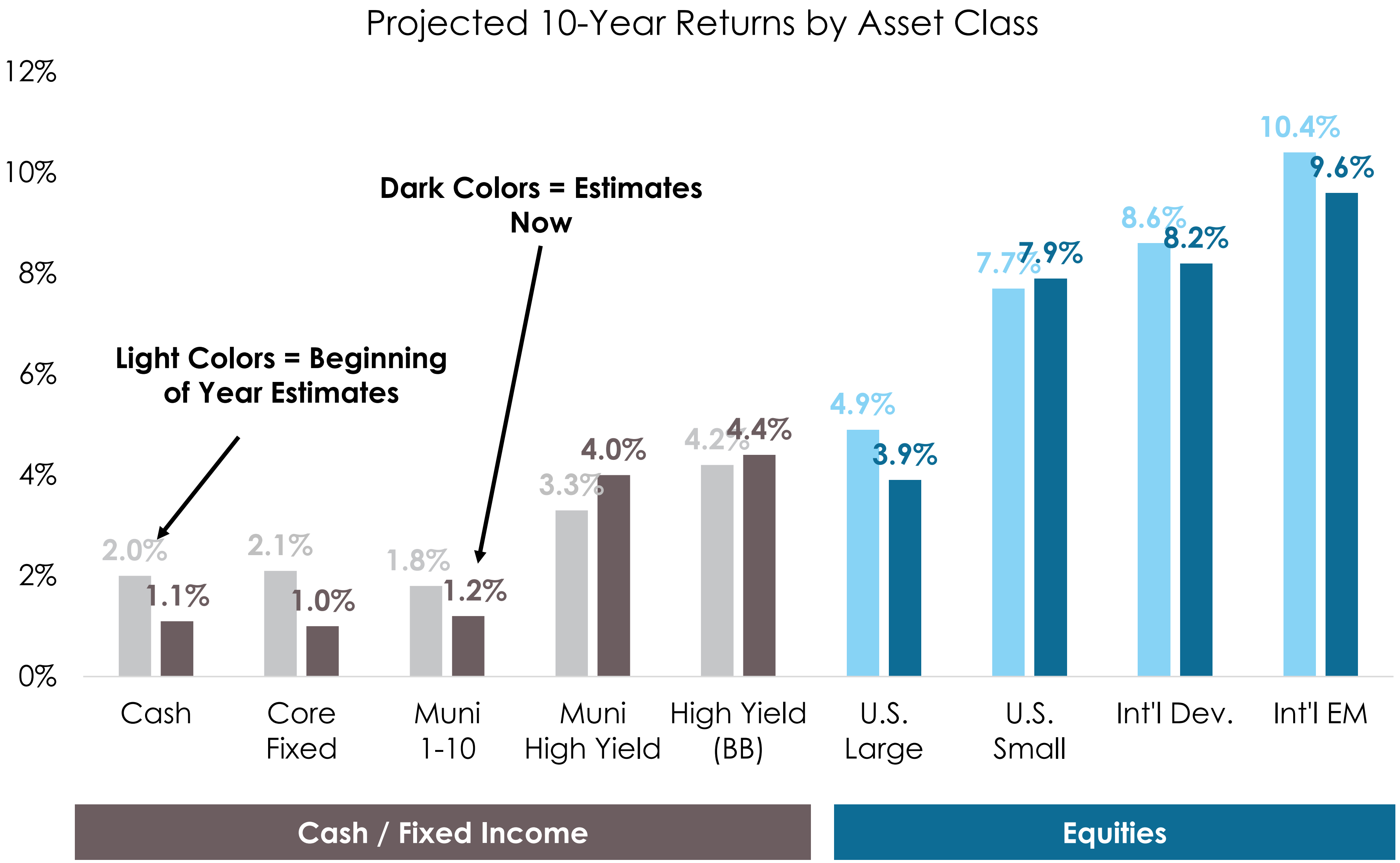
DO NEAR TERM PROFITS JUSTIFY THIS DISPARITY IN VALUATIONS?

Price/Earnings (Next 12 Months) by COVID Impact Cohort



Source: Glenmede, FactSet *Data through 10/02/2020*

Data shows the trend in price-to-earnings (next-twelve months) ratios for various cohorts of stocks, including the FAANMGs (Facebook, Amazon, Apple, Netflix, Microsoft, Google) and a number of sectors that have fared relatively well during the COVID-19 pandemic (Information Technology, Communications Services and Healthcare excluding Facebook, Apple, Netflix, Microsoft and Google). Past performance may not be indicative of future results.



Source: Glenmede *Data as of 10/5/2020*

Data shown are Glenmede's proprietary estimates for 10 year expected returns for a number of asset classes. Proxy indexes for each asset class are as follows: Cash (Bloomberg Barclays Treasury Bellwethers 3M), Core Fixed (Barclays US Aggregate Index), Muni 1-10 (Bloomberg Barclays Municipal Bond 1-10 Index), Muni High Yield (Bloomberg Barclays Muni High Yield 2% Issuer Cap), High Yield (BB) (Bloomberg Barclays U.S. Aggregate Credit Corporate High Yield BB Index), U.S. Large (MSCI USA Index), U.S. Small (Russell 2000 Index), Int'l Dev. (MSCI EAFE Index), Int'l EM (MSCI EM Index). These figures are projections which, though arrived at in good faith, are not guaranteed. One cannot invest directly in an index.

PORTFOLIO ALLOCATION TO ACHIEVE A RETURN OF AT LEAST 7.5%

1995

Core Bonds

2005

U.S. Large Cap Equity

U.S. Small Cap Equity

International Equity

Private Equity

Real Estate

Core Bonds

2019

U.S. Large Cap Equity

U.S. Small Cap Equity

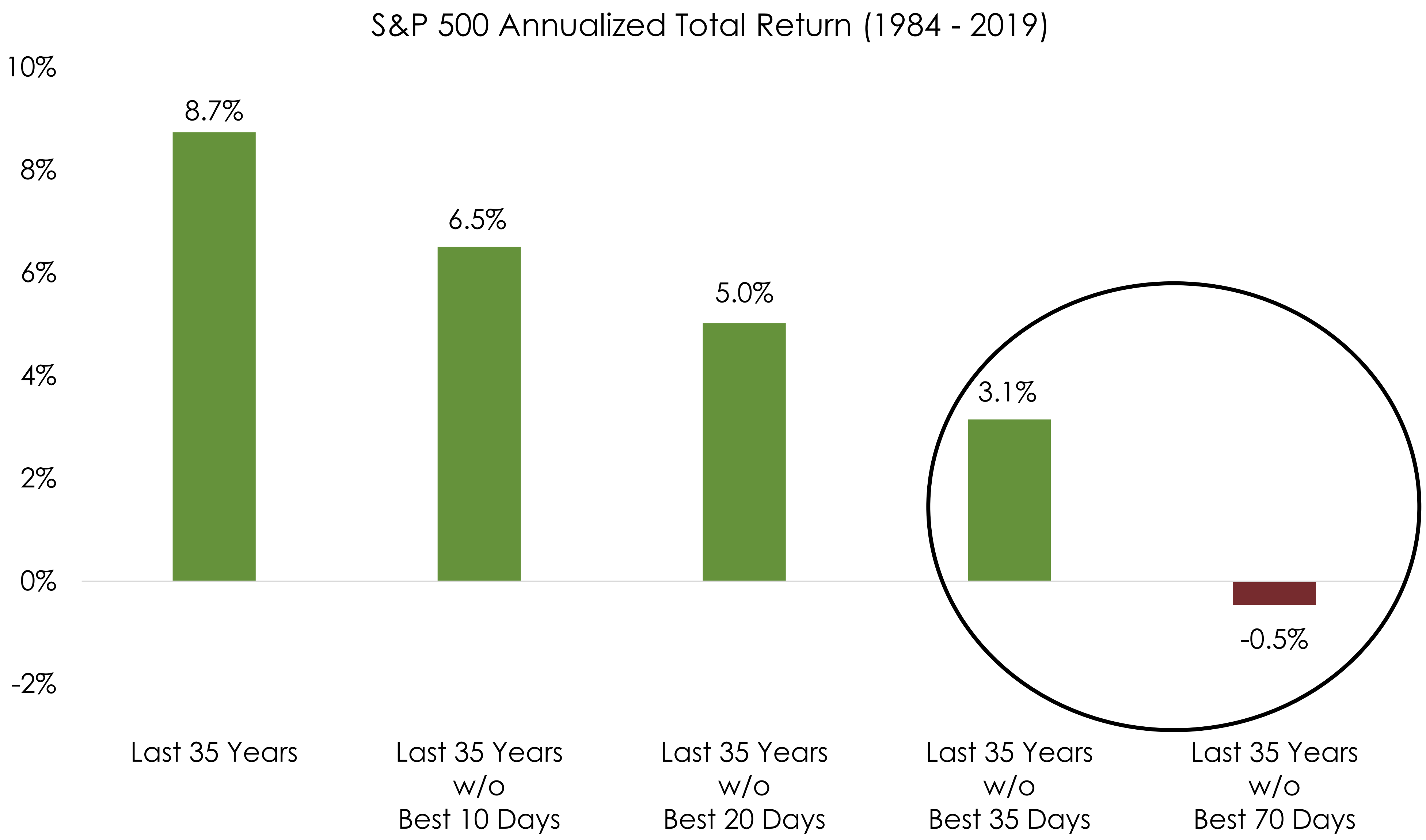
International Equity

Private Equity

Alternatives
Real Estate (1%)
High Yield Bonds (2%)
Core Bonds

Source for 1995 and 2005: Wall Street Journal, Callan Associates
Source for 2019: Glenmede
The allocations shown for 2019 are based on Glenmede's Global Expected Returns Model, which projects estimated future returns for various asset classes based on historical returns of those asset classes. Past performance may not be indicative of future results. Future returns cannot be guaranteed and may not be predicted with accuracy. Glenmede's Expected Return Model assumes valuations converge from a starting point to a future fair value estimate based on target valuation parameters.

PENALTY FOR BEING OUT OF THE MARKET



Source: Glenmede, FactSet *Data through 12/31/2019*

Data shown is the historical annualized total return for the S&P 500 over the span of approximately thirty-five years. The data points reflect the annualized return if an investor were to miss the best ten, twenty, thirty-five or seventy days over the period specified. The time period reflects the first data available beginning 11/01/1984. Data reflects past performance which may not be indicative of future results. One cannot invest directly in an index.

REACT

Shut-downs helped contain COVID-19, but have had a significant impact on the economy and profits

1

REOPEN

Economies are reopening, but absent a widely distributed treatment or cure, remain at risk

2

RECOVER

An eventual recovery is likely, but uncertainty regarding longer-term impacts remains

3

INVESTMENT STRATEGY

- Equity markets reflect an economic rebound, but not entirely
- Investors should maintain a neutral equity and risk allocation
- Better opportunities can be found away from the largest stocks
- Near-term risk remains, but investors should follow longer-term plans

4

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SESSION 5

TAX CONSEQUENCES TO DEBTORS OF A DISCHARGE AND MODIFICATION OF DEBT

Tony Bakale | CPA, MT

Partner & Technical Director, Tax

Tony is one of the firm's senior technical "tax gurus" consulted when the most complex issues are up for interpretation. He uses his deep knowledge to educate his colleagues and his clients, distilling extremely technical and difficult concepts so a layman or fellow tax guru can understand and apply them. Tony's knack for educating clients in a way that's comfortable for them empowers them to make well-reasoned decisions for their businesses.

Tony specializes in research and planning related to federal taxation of partnerships, limited liability companies and S Corporations; mergers and acquisitions; federal tax accounting methods; and incentive credits, such as new markets, historical and advanced energy tax credits. His 30-plus years of expertise are most often applied to the real estate, private equity and hedge fund, and manufacturing and distribution industries. Tony also has spent his career focused on lowering the tax liabilities of closely held companies and their owners, including both partners and passive owners. Additionally, Tony's tenure as a professor of federal tax accounting methods has provided him with an in-depth knowledge of public company accounting issues that can be applied to many private, middle-market clients.

Tony loves sports and is a committed Browns and CSU Viking basketball fan. He's also a regular in the shark-diving circles of the Caribbean Islands (and recommends night diving to discover the best creatures). Tony and his wife live in Broadview Heights, Ohio, but secretly hope to someday retire to an island with Jimmy Buffet as their neighbor.

Leadership Activities and Recognitions

- Cohen & Company Board Member; Partnership Tax Technical Group
- Cleveland State University (CSU) Foundation (Audit Committee, Past Chair)
- CSU Alumni Association (Past-President)
- CSU Accounting Department Advisory Board (Past Chairman)
- CSU Master of Accountancy Program (Adjunct Professor)
- American Institute of CPAs and Ohio Society of CPAs
- August edition of AICPA *Tax Adviser's* "Tax Clinic" since 2001 (Editor)
- Frequent speaker at various CPE qualified technical forums, including the Cleveland Tax Institute, The University of Akron's National Tax Institute and OSCPA programs
- Author of various articles on taxation and tax planning
- Former board member and/or officer of the Tax Club of Cleveland and International Fiscal Association

(Over, please)

Cohen & Co

Credentials & Education

- Certified Public Accountant (Ohio)
- Master's of Taxation, The University of Akron
- B.A., magna cum laude, Cleveland State University

Areas of Focus

- Private Company Services
- Business & Individual Taxation
- Estate & Wealth Transfer
- Tax Credits & Incentives
- Investment Industry Services
- Real Estate & Construction
- Transaction Services
- Accounting Methods
- Management Advisory Services
- Wholesale & Distribution
- International
- State and Local Taxation

Contact Tony: tbakale@cohencpa.com | 216.774.1147

Tax Consequences to Debtors of a Discharge and Debt Modification

Anthony S. Bakale, Partner, Cohen & Company

Cohen & Co

Cohen & Co

Introduction

- Inclusions & Exclusions
- Cash for Debt Exchanges
- Debt for Debt Exchanges
- Related Party Acquisition of Debt
- Special Rules for Partnerships & Partners

Inclusion

- General Rule – Gross Income Includes COD
- COD difference between adjusted issue price of debt and reacquisition price
- Reacquisition Price Equals
  - Money paid
  - Issue price of new debt
  - FMV of equity

Inclusion

- Reacquisition price where property is transferred
  - Recourse Debt
    - Price equals FMV of property
  - Non-Recourse Debt
    - Price equals the "adjusted issue price" of the retired debt
  - Gain/Loss calculated on the transfer of property in retirement of debt

Section 108 Exclusions

- Bankruptcy
- Insolvency
- Qualified Farm Indebtedness
- Qualified Real Property Indebtedness
- Qualified Principle Residence Indebtedness

Exclusion - Bankruptcy

- Title 11 of the US Code
- Taxpayer must be under Bankruptcy Courts Jurisdiction
- Discharge must be:
  - Granted by the court
  - Pursuant to a plan approved by the court
- Partnerships – exclusion determined at partner level

Exclusion - Insolvency

- Liabilities exceed FMV assets
- Non-recourse debt only counted to extent of FMV of secured asset, plus the amount of non-recourse debt discharged
- Individuals – assets only include non-exempt assets

Exclusion - Qualified Farm Indebtedness

- Applicable to debt incurred directly in connection with the business of farming
  - 50% or more of Gross Receipts attributable to farming business
  - Measure on prior 3-year average
- Discharge must be by a Qualified Person
- Exclusion limited to tax attributes and basis in property

Exclusion – Qualified Real Property Business Indebtedness

- Debt incurred in connection with Real Property used in business
- Qualified acquisition debt or incurred prior to January 1, 1993
- Provision is elective
- Does not apply to C Corporations
- Limited to excess over net FMV of real estate and limited to basis in real estate

Exclusion - Qualified Principle Residence Indebtedness

- Expires after 12/31/2020
- Indebtedness must be Acquisition Debt under IRC section 163(h)(3)(B)
- 163 limits increased to $2,000,000/1,000,000
- Applicable to principle residence
- Discharge applied to non-qualified debt first
- Limited to discharges related to decline in value or financial condition

Exclusions – Coordination

- Title 11 takes precedence
- Insolvency over farm and real property
- Farm over real property
- Principle residence over insolvency
  - Can elect out of principle residence exclusion

Cost of Exclusion

- Reduction of Tax Attributes
  - Net Operating Losses
  - General Business Credits
  - Minimum Tax Credits
  - Capital Losses
  - Basis of Taxpayer's Assets
  - Passive Activity Loss or Credit Carryforwards
  - Foreign Tax Credit Carryforwards

Cost of Exclusions

- Attributes are reduced in the order listed until fully absorbed
- Effect of attribute reduction is deferral of income rather than exclusion
- COD in excess of attributes is permanently excluded

Timing of Attribute Reduction

- Attributes reduced after year of discharge tax liability is determined
- NOL's, Capital losses & Credits are reduced year of discharge first, then order in which they arose
- Basis is reduced as of first day of subsequent year
- Special rule for real estate debt
  - Reduction limited to basis in real estate
  - Limitation of basis in excess of liabilities does not apply
  - Basis reduced immediately prior to a sale

Election to Reduce Basis

- Taxpayer may elect to Reduce Basis of Depreciable Property Before other Attributes
  - Applicable to any portion of the exclusion under:
    - Title 11, Insolvency or Farm exclusions
  - Taxpayer can elect to include real estate held for sale as depreciable property
  - Liability limitation under the general rule does not apply

Other Limited Exclusions

- Lost Deductions
  - Applies to accrued expenses or payables that if paid would result in a deduction to taxpayer
  - Mostly applicable to cash basis taxpayers
  - Accrual basis applicable to limited items
- Purchase Price Reduction
  - Applicable to seller financing
  - Not applicable to
    - Title 11 Cases
    - Purchaser is insolvent
    - COD would be excluded under another provision

Election to Defer Recognition of COD

- No longer effective – could be revived
- Discharges of applicable debt after 2008 and before 2011
- Allows a 5-year deferral for 2009 discharges
- Allows a 4-year deferral for 2010 discharges
- Deferred income is included pro rata over 5 succeeding years after deferral period

Election to Defer Recognition

- Applicable debt
  - Issued by a corporation
  - Or other "person" in connection with the active conduct of a trade or business
- Requires deferral of OID Deduction
- Deferral accelerated in certain cases
- Special rules for pass-through entities
- Election

Cash for Debt Exchanges

- Allocation of Payments
  - Consideration should be given to how payments are allocated between principle and interest
  - Judicial Doctrine provides agreement between Payer and Payee decides
  - Reg. Section 1.446-2(e) would overrule long standing judicial precedent

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Cash for Debt Exchanges

- Example 1
  - Loss Corporation discharges $500 liability for $50 cash payment, resulting in COD. Loss has other assets with $50 FMV and a tax basis of $600 and an NOL carryover of $20. Loss is not in Bankruptcy at the time of discharge.
  - **Result**: Loss has $450 of COD Income. Under the insolvency exception Loss can exclude $400 of COD. Loss will use $20 NOL to reduce the remaining $50 of TI. Loss reduces the basis of its assets by the $400.

Cash for Debt Exchanges

- Example 2
  - Same as example 1 except that loss is in bankruptcy and its asset is depreciable.
  - **Result**: Loss has $450 of COD income, all of it is excluded. Loss reduces its NOL to zero and the basis of its assets by $430. Bankruptcy avoided tax on $30. Loss can elect to reduce basis first and preserve the NOL.

Cash for Debt Exchanges

- Example 3
  - Loss is not in bankruptcy. Loss has an NOL of $20. Loss has $250 of liabilities of which $130 are retired for a $10 cash payment. Loss has assets with $50 of tax basis, FMV $90 and remaining liabilities of $120.
  - **Result**: Loss excludes all the COD under the insolvency exception. Loss reduces its NOL to zero. Loss does not reduce its basis in assets due to liability limitation. If loss elects to reduce basis first, the asset basis would be reduced to zero and the NOL would be reduced to zero.

Debt For Debt Exchanges and Debt Modifications

- Actual vs. Deemed Exchanges
  - Actual Exchange
    - Physical exchange
    - Doesn't always result in an "exchange"
  - Deemed Exchange
    - Modification of the debt
    - Modification is significant under the section 1.1001-3

Debt For Debt Exchanges And Debt Modifications

- Modification Defined
  - Alteration of any legal right or obligation of the issuer or the holder of the debt
  - Alteration can be evidenced by:
    - Amendment of the debt
    - Conduct of the parties
    - Or, otherwise:
      - Does not include an alteration which occurs by the original terms of the agreement, e.g. variable rate debt
      - Exceptions: Change in Obligor, change in nature, no longer debt
  - Temporary failure to perform is generally not a modification

Debt For Debt Exchanges and Debt Modifications

- Significant modifications result in exchange
- Five classes of modifications to determine if significant
  - Facts and Circumstances
  - Change in Yield
  - Change in Timing or Amount of Payments
  - Change in Obligor or Security
  - Change in Nature of Instrument

Debt For Debt Exchanges and Debt Modifications

- Facts & Circumstances
  - Alterations of terms are economically significant
  - Other than changes under the other 4 classes, all changes are considered collectively

Debt For Debt Exchanges and Debt Modifications

- Change in Yield
  - Scope
    - Fixed payment debt
    - Alternative payment debt under 1.1272-1(c)
    - Fixed yield debt
    - Variable yield debt
  - Significant if change exceeds, greater of
    - 25 basis points
    - 5% of prior yield
  - Yield determined under Yield to Maturity Method
    - Issue price includes payments to issuer/holder for modification

Debt For Debt Exchanges and Debt Modifications

- Change in Timing
  - Significant if change results in a material deferral of scheduled payments
  - Materiality depends on:
    - Length of deferral
    - Amount deferred
    - Original Term of Debt
  - Safe Harbor – lesser of 5 years or 50% of original term

Debt For Debt Exchanges and Debt Modifications

- Change of Obligor
  - Recourse Debt – substitution of obligor is significant
  - Exceptions:
    - 381(a) transactions
    - Asset acquisitions
  - Addition of Co-obligor if change in payment expectations is significant
  - Non-recourse debt - substitution of obligor is not significant

Debt For Debt Exchanges and Debt Modifications

- Change in Security
  - Recourse Debt – change in collateral or credit enhancement is significant if it changes payment expectations
  - Non-Recourse Debt – change in collateral or credit enhancement is significant
  - Exceptions
    - Fungible collateral
    - Similar credit enhancement
    - Improvements to collateral

Debt For Debt Exchanges and Debt Modifications

- Change in payment expectations
  - Substantial enhancement in Obligor's capacity to make payments
  - Substantial impairment in Obligor's capacity to make payments

Debt For Debt Exchanges and Debt Modifications

- Change in nature of Instrument
  - Change results in instrument not being considered debt is significant
  - Change from recourse to non-recourse is significant
  - Change from non-recourse to recourse is significant
  - Exceptions:
    - Defeasance
    - Recourse to Non-recourse where payment expectations do not change

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Debt For Debt Exchanges and Debt Modifications

- Accounting and financial covenants
  - Generally not significant
- Rules of Application
  - Modification tested under each applicable provision separately
  - Debt subject to substantial contingency tested under general rule
  - Multiple modifications of same term tested cumulatively
  - Multiple modifications of different terms tested separately

Debt For Debt Exchanges and Debt Modifications

- Tax Consequences Triggered by Exchange
  - Cancelation of Debt Income
  - Amount of COD is based on "Issue Price" of new debt versus adjusted principle amount of old debt
    - Non-publicly traded then generally "Issue Price" equals principle amount unless the debt lacks adequately state interest
    - Publicly traded debt then "Issue Price" is FMV
    - If Issue Price is less then FMV, then OID results

Debt For Debt Exchanges and Debt Modifications

- OID in Brief
  - Under 1273(a)(1) OID is the excess of the Stated Redemption Price over the Issue Price
  - In general Stated Redemption Price includes all payments except, qualified periodic interest payments
  - If “publicly traded” issue price is FMV
  - If non-publicly traded issue price is:
    - With Adequate stated interest principle amount of debt
    - Without Adequate stated interest all payments present valued at applicable AFR

Debt For Debt Exchanges and Debt Modifications

- Example 1
  - Loss Corporation exchanges Old Debt having an adjusted issue price before exchange of $100 for New Debt with a principle amount and issue price of $75. Both Old and New have an FMV of $75. Transaction constitutes an exchange under reg. section 1.1001-1(a)
  - **Results**: Loss Corporation realizes $25 of COD income on the exchange.

Debt For Debt Exchanges and Debt Modifications

- Example 2
  - Facts are the same as Example 1, except New Debt has a face amount of $100 and is publicly traded debt.
  - **Result**: Since New Debt is publicly traded its issue price is equal to FMV of $75. Loss Corporation has $25 of COD income and the New Debt contains $25 of OID.

Acquisition of Debt By Related Parties

- In General
  - Direct acquisition - Acquisition by related party treated as acquisition by debtor.
    - Acquisition must be from an unrelated party holder
    - Related Party is defined under section 267(b) or 707(b)
      - Family expanded to include spouses of children and grandchildren

Acquisition of Debt By Related Parties

- Consequences
  - Debtor realizes COD income to extent related party's adjusted basis in debt is less than Adjusted Issue Price
  - COD triggered on the Acquisition date by the Related Party
  - Contrast this rule to 108(e)(10) debt for debt exchange where publicly trade debt uses a FMV standard to calculate COD income

Acquisition of Debt By Related Parties

- Consequences (cont'd)
  - Debtor's is treated as issuing new debt to related party at an issue price equal to its adjusted basis
  - This generally results in OID equal to the COD realized
  - A loss on a subsequent disposition by the related party will be deferred until the debt is retired.

Acquisition of Debt By Related Parties

- Indirect Acquisitions
  - Applicable in situation where a holder of the debt becomes related to the debtor after acquisition of the debt
  - Acquisition must be in anticipation of becoming related
  - Factors to consider:
    - Intent of the parties
    - Pre-existing contracts
    - Time between acquisition and relationship
    - Significance of debt to the holder

Acquisition of Debt By Related Parties

- Indirect Acquisitions (continued)
  - Certain Deemed Indirect Acquisitions
    - Acquired less than 6 months before relationship
    - Acquired 6 months or more but less than 24 months and acquisition not disclosed
    - Debt constitutes more than 25% of holder's assets and acquisition not disclosed
  - Consequences are similar to those of direct acquisition

Acquisition of Debt By Related Parties

- Exceptions
  - Debt retired with in 1 year of acquisition date
  - Certain Acquisitions by security Dealers

Partnerships & Partners Special Rules

- Section 108(a)(1) exclusions apply at the partner level
  - Bankruptcy Partner must be a party to Bankruptcy Case Debt Cancelled
  - Insolvency Measured at Partner Level
    - Limitations on Pass-Through Liabilities
    - Non-Recourse Debt limited to FMV of secured property plus cancelation

Partnerships & Partners Special Rules

- Example 1:
  - ABC, LLC owns Real Estate – FMV $1,000
  - Real Estate subject to recourse mortgage of $2,500
  - Mortgage debt reduced to $1,000
  - A's a 1/3 partner in ABC is allocated $500 of COD income
  - A's Insolvency Calculation:

FMV Other Assets	$100	
FMV Interest in ABC before debt	$333	
Other liabilities		$ 50
Share of ABC Liabilities Limited to FMV	-$333	
Share of ABC Liabilities Cancelled	-$500	
A's insolvency before Cancelation		-$450

  - A must include COD of $50 in income and can exclude the remaining $450
  - Attribute reductions are determined at A's level

Partnerships & Partners Special Rules

- Qualified Real Property Business Indebtedness
  - Qualification is determined at the Partnership Level
  - FMV Limitation determined at the Partnership Level
  - Election to exclude COD under 108(c) is made by partner
  - Basis reduction is determined and applied at partner level
  - Partnership must consent to look through adjustment to depreciable real estate
  - Partner can reduce basis in other real estate including pass-through real estate from other partnerships

Partnerships & Partners Special Rules

- Debt for Equity Exchanges
  - Section 721(a) not applicable to partnership
  - Debt is considered satisfied for Cash = FMV of partnership interest transferred to creditor
  - COD recognized by partnership
  - No gain recognized for transfer of interest
  - Section 721(a) applies to creditor:
    - Creditor gets carryover basis under 722
    - Potential for change in character of loss by Creditor

Partnerships & Partners Special Rules

- Partner Contribution of Debt to Capital
  - Exception under 108(e)(6) does not apply
  - Consider utilizing Preferred Interest in lieu of Partner Debt
    - Section 385 case law should be reviewed
    - Section 385 provides Taxpayer bound by Characterization
  - Consider Implications of Partner Debt under 163(j) interest limitation rules

Partnerships & Partners Special Rules

- Allocation of COD and Other Considerations
  - Income allocated to pre-COD partners
  - Allocations based on distributive share under 704
  - Consider impact of debt reductions
    - Allocation of liabilities under 752
    - Impact on minimum gain calculations
    - Deemed distributions under 731
    - Calculations of basis and At-Risk amounts

Questions?

Thank you for your attention!

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Tax Consequences To Debtors of a Discharge And Modification of Debt

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1) **Introduction**
   a) General Rules for Inclusion and Exclusions of Cancelation of Debt (COD) Income
   b) Cash for Debt Exchanges
   c) Debt for Debt Exchanges and Debt Modifications
   d) Related Party Acquisitions of Debt
   e) Special Considerations for Partnerships and Partners
2) **Inclusions and Exclusions**
   a) General rule -Income inclusion.
      i) Under Code Section 61(a)(12), gross income includes income from the discharge of indebtedness.
      ii) Reg. Section 1.61-12(c)(3), states an issuer has COD income if it repurchases its debt at a "price" less than its "issue price" plus/minus any OID/premium previously taken into income.
      iii) Where debt is retired for cash, the "price" is the amount of money given.
      iv) Where debt is retired in exchange for the issuance of new debt, the "price" is the issue price under Section 1273(b) or 1274.
      v) Where the debt is retired in exchange for the issuer's equity, the "price" is the fair market value of the equity issued,
      vi) Where debt is retired in exchange for property, the determination of "price" depends on whether the debt is recourse or nonrecourse.

(a) Recourse - The price is the fair market value of the property transferred. Gain or loss is calculated on the property transferred as if sold at its fair market value.

(b) Nonrecourse - The price is the principal amount of the debt retired when the mortgaged property is transferred.

(i) Generally, no COD income is realized. Gain or loss is calculated on the property transferred.

(ii) However, where the face amount of nonrecourse debt is reduced without a transfer by the debtor COD income results, Rev. Rul. 91-31, 1991-2 C.B. 19.

(iii) Or where property other than the encumbered property is transferred COD income results *Gershkowitz* vs. *Commissioner,* 88 TC 984 (1987).

b) Exclusions under Section 108.

i) Under Section 108(a), COD income is excluded from gross income if the debt discharge occurs in a Title 11 case, the debt discharge occurs when the taxpayer is insolvent, the discharged indebtedness is “qualified farm indebtedness”, the discharged debt is “qualified real property business indebtedness” or the discharged indebtedness is “qualified principle residence indebtedness.

(1) A ’Title 11 case” refers to a case under Title 11 of the U.S. Code (the Bankruptcy Code), but only if the taxpayer is under the court’s jurisdiction and the discharge is granted by the court or pursuant to a plan approved by the court.

(2) The insolvency exception applies only to the extent the debtor is insolvent. Insolvency occurs if the debtor’s liabilities exceed the fair market value of its assets, measured immediately before the discharge. To the extent a taxpayer is solvent post-forgiveness the non-excluded discharge would be equal to the amount of solvency. For this purpose “insolvency” is a tax concept unrelated to bankruptcy and/or debtor/creditor laws.

(a) Nonrecourse liabilities are taken into account only to the extent of the fair market value of their encumbered property plus the amount of the nonrecourse liability in excess of fair market value, which is part of the discharge. [Rev. Rul. 92-53, 1992-27, I.R.B.7.]

(b) Individuals - fair market value of assets only includes those assets, which are not, exempted assets under Resident State Creditors Law,(e.g., fair market value of accrued pension benefit would generally be excluded).

(3) Qualified farm indebtedness is debt incurred directly in connection with the business of farming and 50% or more of taxpayer's aggregate gross receipts are from such business for the prior three tax years.

(a) Discharge must be by a qualified person or governmental unit.

(i) Qualified Person as defined under Code Section 49(a)(1)(D)(iv) is a person actively and regularly engage in the business of lending money and which is not
1. a related person
2. a person the taxpayer acquired the property from
3. a person who receives a fee with respect to the taxpayer's investment in property

(b) Exclusion limited to adjusted tax attributes and basis in business or income property.

(4) Qualified real property business indebtedness is:

(a) indebtedness incurred or assumed in connection with real property used in a trade or business and is secured by such property,

(b) was incurred prior to January 1, 1993 or is qualified acquisition indebtedness, which is debt incurred or assumed to acquire, construct, reconstruct or substantially improve real property used in a trade or business, and

(c) taxpayer elects the application of the rules with respect to such indebtedness

(d) Provision does not apply to C corporations

(e) Exclusion limited to excess of principle amount of discharged debt over fair market value of property securing debt reduced by any other qualified real property indebtedness secured by such real property

(f) And the amount excluded can not exceed the aggregate adjusted basis of depreciable real property held by the taxpayer immediately before the discharge

(i) depreciable real property acquired in contemplation of the discharge would be excluded

(ii) basis reduced under the attribute reduction rules would be excluded.

(5) Qualified principle residence indebtedness means acquisition indebtedness (within the meaning of section 163(h)(3)(B).

(a) Applicable to discharges occurring prior to January 1, 2021 or subject to a written agreement entered into prior to January 1, 2021.

(b) $1,000,000/$500,000 limitations are increased to $2,000,000/$1,000,000 respectively

(c) Applicable only to the taxpayer's principle residence as defined in section 121.

(d) Ordering rules would apply discharge first to non-qualified debt with any excess considered discharge of qualified principle residence indebtedness,

(e) Would not apply with respect to discharges not directly related to a decline in value of the residence or the financial condition of the taxpayer.

(6) Partners and Partnerships, unless specifically stated otherwise the 108(a) exclusions apply to the partner not the partnership. To be discuss further below.

ii) Coordination of exclusions.

(1) Title 11 exclusions take precedence over all others.

(2) Insolvency exclusion takes precedence over farm and real property indebtedness exclusions.

(3) Qualified farm indebtedness exclusion takes precedence over real property indebtedness exclusion.

(4) Qualified principle residence exclusion takes precedence over insolvency exclusion unless elected otherwise

c) Cost of exclusion - Reduction of attributes.

i) To the extent COD income is excluded under Section 108(a), the taxpayer must reduce certain tax attributes. The effect of this is to postpone the impact of COD income. To the extent COD income exceeds the reduction, the income is permanently excluded. The attributes to be reduced are listed in Section 108(b)(2) and are reduced in the following order and amount:

(1) Net operating losses (NOLs) for the year of discharge and then any carryovers to such taxable year are reduced dollar for dollar.

(2) General business credits carryovers to or from the taxable year of discharge, 33 1/3 cents for each dollar of excluded income.

(3) Minimum tax credits available as of the beginning of the year following year of discharge, 33 1/3 cents for each dollar of excluded income.

(4) Capital losses for the year of discharge and any capital loss carryovers to such taxable year are reduced dollar for dollar.

(5) Basis of the taxpayer's assets, reduced dollar for dollar, but not below aggregate liabilities remaining after discharge. [Code Section 1017(b)(2).

(6) Passive activity loss or credit carryover from the taxable year of discharge.

(7) Foreign tax credit carryovers to or from the year of discharge, reduced 33 1/3 cents for each dollar of excluded income.

ii) The debtor reduces these attributes only after it has determined its tax liability for the year of discharge. [Code Section 108(b)(4)(A).] The order of the reduction of NOLs, capital losses and credits is current year first then carryovers in the order in which they arose. [Code Section 108 (b)(4)(B) & (C).] Reduction in basis is applied to property held by the taxpayer as of the beginning of the year following the year of discharge. [Code Section 1017(a).]

iii) In lieu of the above ordering rules, the taxpayer may elect to reduce the basis of depreciable property and certain inventory prior to other tax attributes. [Code Section 108(b)(5)(B).)

(1) In this case, the aggregate liabilities limitation under Section 1017(b)(2) does not apply

(2) Such election makes sense in cases where the taxpayer can absorb NOLs faster than depreciation could be claimed and the taxpayer does not have significant liabilities remaining which would otherwise limit the reduction of this attribute under normal ordering rules.

iv) Special rules for excluded real property indebtedness.

(1) No reduction in tax attributes other than basis in depreciable real property.

(2) Basis reduced as of beginning of the year succeeding year of discharge for property held immediately before discharge.

(3) If qualified property is disposed of prior to end of year of discharge, basis is reduced immediately before disposition.

(4) Limitation of basis in excess of liabilities under general rule does not apply.

d) Other limited exclusions under Section 108.

i) Under Section 108(e)(2), COD income does not include any forgiveness, which, if paid, would have resulted in a deduction to the debtor.

ii) Under Section 108(e)(5), no income results from the reduction of a debt between the purchaser of property and the seller of property, if the debt arose out of the purchase of such property. The reduction will be treated as a purchase price adjustment to the purchased property. This provision does not apply if:

(1) The taxpayer is in a Title 11 case;

(2) To the extent the purchaser is insolvent; or

(3) The COD income would be excluded under any other provision of the Code.

(4) Under this exclusion, the debtor purchaser would reduce the basis in the property. If the property is depreciable, depreciation deductions are adjusted on a go forward basis to take into account prior depreciation and purchase price reduction. If basis is less than price reduction previously claimed depreciation or other write-offs are recaptured.

iii) Under section 108(e)(6), a shareholder’s contribution of debt to the capital of a corporation is not treated as COD, unless the shareholders basis in the debt is less than the adjusted issue price of the contributed debt.

(1) Special rules apply in the case of S Corporation shareholder debt contributed to capital. Reduction in basis due to pass-through losses and deductions is added back to determine if shareholder basis is less than adjusted issue price of the contributed debt.

e) Special Deferral of COD Income (Section 108(i)) (NO LONGER APPLICABLE EXPIRED FOR CANCELLATIONS OCCURRING AFTER DECEMBER 31, 2010, COULD BE RESURRECTED AS PART OF PANDEMIC STIMULUS PACKAGE.)

i) Applicable to discharges (reacquisition) of "Applicable Debt Instruments" occurring after December 31st, 2008 and before January 1st, 2011

(1) Allows for a five year deferral for acquisitions in 2009, and

(2) Allows for a four year deferral for acquisitions in 2010,

(3) Deferred COD is includible in income over the five tax year period following the deferral period.

ii) Requires deferral of deduction for any OID resulting from the reacquisition,

(1) Defers the deduction of OID accruing during the deferral period, to the extent it does not exceed the amount of income deferred

(2) The aggregate deferred deductions are deductible ratably over the five year income pick-up period.

iii) Applicable Debt Instruments is any debt instrument issued by:

(1) A Corporation

(2) Any other person in connection with the active conduct of a trade or business

iv) Election

(1) Must be made with the return for the year in which the cancelation of debt income arises.

(2) Election once made is irrevocable

(3) Pass-through entities make the election

v) Deferral election will take precedence over general exclusions under section 108(a)(1)

vi) The deferred COD income (and OID deductions) will be accelerated into the taxable year in which one of the following events occur to the extent not previously included in income

(1) Death of the taxpayer

(2) Liquidation of the taxpayer

(3) Sale of substantially all of the assets of the taxpayer

(4) Cessation of the trade or business in which the COD arose or similar circumstances

(5) In the case of a subsequent Title 11 (or similar filing) the income will be recognized on the day before such filing.

vii) Special Rule for pass-through entities

(1) Sale or other transfer by the owner/beneficiary of their interest in the pass-through entity will trigger the acceleration.

(2) In the case of a partnership the income will be allocated to those partners immediately before the discharge in accordance with their respective income sharing ratios.

(3) In the case of a partnership the reduction in liabilities will not be taken into account to the extent they would create income to the partner. In that case the reduction will be recognized as the income is recognized under the deferral provision.

3) Cash for Debt Exchanges

a) In general - Numerous issues and planning possibilities are raised under Section 108 where debt is retired at a discount. The outcome of Section 108 often depends on whether the debtor is insolvent or in a Title 11 case (bankruptcy). The application of Section 108 in various cases is discussed below. The goal of the debtor in each case is to minimize COD income and preserve tax attributes.

b) Allocation of payments to principle and interest. In a debt restructuring, consideration should be given to how the proceeds received by a creditor will be allocated between principal and interest accrued on the debt.

i) Proceeds that are allocable to accrued but unpaid interest will be deductible by the debtor.

(1) In the case of a cash basis debtor, more COD income could be generated to the extent that proceeds are allocated to interest rather than principal.

(2) The debtor would have more COD income to the extent accrued interest was attributable to the year of discharge, unless Section 108(e)(2) would apply to prevent the recognition of the income. See also Rev. Rul. 67-200, 1967-1 C.B. 15 where the Service ruled no COD income is recognized to the extent no prior tax benefit was obtained.

ii) Although in most circumstances the net effect on taxable income is the same an increase in interest expense is offset by a greater amount of COD income. In certain circumstances, the allocation can be significant to the debtor.

(1) In a situation where the principle amount of the debt is nonrecourse, there is a direct trade-off with respect to the debtor between an ordinary deduction and capital gain income.

iii) Under regulation 1.446-2 (Method of Accounting for Interest) payments to a creditor are applied first to interest accrued prior to the date of payment and then to principal. [Reg. Section 1.446-2(e)]. It is unclear whether this rule would withstand judicial scrutiny, since it is contrary to the long-standing judicial doctrine as outlined below which allows for the designation of payments between the payee and payor.

iv) Prior to the promulgation of the aforementioned regulation an agreement between the debtor and creditor as to the allocation of payments generally was respected. If such an agreement is not present, however, payments prior to maturity generally are applied, to interest and then to principal, and payments made at or after maturity are allocated pro rata between principal and interest.

Example 1: Impact of Title 11 Filing.

Loss corporation (L) has two assets: cash of $50 and an asset worth $50 (having a basis of $600). L also has a liability of $500 owed to a single creditor, and a $20 NOL carryover. The creditor has agreed to accept $50 in cancellation of the debt. L's noncash asset is nondepreciable, and L has no other tax attributes.

Corporation L Before		**Corporation L After**	
Assets	$100	Assets	$50
Liability	$500	Liability	$ 0
NOL	$ 20		

Assuming L is **not in bankruptcy**, L has $30 of taxable income computed as follows:

$450	(Potential COD income ($500 - 50)
400	(Insolvency exception)
50	
20	NOL absorbed
$ 30	Taxable income

L's NOL carryover is totally absorbed by L's income under Section 108 (b)(4)(A), and L must reduce the basis of its asset by $400, to $200. [Section 108(b)(2)(E).]

If L were in bankruptcy, L would have $450 of potential COD income, which would be excluded in full;

$450	(Potential COD income ($500 -50)
450	(Bankruptcy exception)

$ 0 Taxable income

However, under Section 108(b)(2), L would be required to reduce tax attributes by $450, allocated as follows: $20 NOL and $430 basis reduction.

Here, bankruptcy is advantageous because it avoids $30 of current taxable income (albeit, at the cost of an additional $30 in attribute reduction).

> *In bankruptcy the COD income is fully excluded without regard to the debtor's insolvency. Indeed, the debtor may be solvent and COD income would be excluded in bankruptcy.
>
> *Bankruptcy also avoids the uncertainty that surrounds any calculation of a debtor's insolvency.

Example 2: Making a Section 108(b)(5) election.

The facts are the same as in Example 1 above, except that L's noncash asset is depreciable (with a basis of $600), and L is in bankruptcy. L retires the $500 debt for $50.

As above, since L is in bankruptcy, L has no COD income, but its tax attributes must be reduced by $450.

- Under the normal attribute reduction rules, L must first reduce the NOL carryover by $20 to $0 and the basis must be reduced by $430 to $170.
- If L made the Section 108(b)(5) election, however, the basis of L's asset would be reduced by $450 to $150. The NOL would remain intact.
- As a result, L's $20 NOL would be preserved and the asset basis would be reduced by an additional $20.
- L should make the election if the NOL can be used more rapidly than the depreciation related to the $20 of foregone basis.

If L were not in bankruptcy, the Section 108(b)(5) election would not change the result from that in example 1 above.

- In example 1 above, the taxable income for the year fully absorbed the $20 NOL anyway, and the only remaining attribute to reduce was the asset's basis. Accordingly, an election to reduce basis first would have no effect.

- However, the result would be different if L's NOL carryover were $200 instead of $20.
- In such a case, in the absence of a Section 108(b)(5) election, L's NOL carryover would be eliminated and basis would be reduced by $250 to $350.

- However, The Section 108(b)(5) election would preserve the remaining $150 NOL carryover ($200 - $50) at the cost of reducing the asset basis by an additional $150. Thus, L would be left with a $150 NOL carryover and an asset basis of $200.

Example 3: Using the aggregate liabilities limitation.

Assume that L is not in bankruptcy. L has cash of $10, an asset worth $90 (having a basis of $50) and $250 in liabilities. L has an NOL carryover of $20. L retires $130 of liabilities for $10.

Corporation L Before		Corporation L After	
Assets	$100	Assets	$ 90
Liability	$250	Liability	$120
NOL	$ 20		

Assuming L is not in bankruptcy, L has no taxable income computed as follows:

$120	(Potential COD income ($130 - 10)
120	(Insolvency exception)
0	Taxable income

- L's NOL carryover is totally eliminated under Section 108(b)(2). L's only remaining attribute is basis. However, L'S basis cannot be reduced below the $120 of liabilities remaining after the discharge[Code section 1017(b)(2)].

- Since L’s asset basis is already $50, no further basis reduction is required.
- Thus, $100 of COD income is eliminated without income or attribute reduction.
- If L retired $160 of debt for $10, L could exclude $130 of COD income without income or attribute reduction.

4) Debt for Debt Exchanges (And Debt Modifications)

a) A debt restructuring often contemplates the alteration of the terms of an existing debt instrument. For example, a lender may agree to reduce the interest rate, to postpone the payment date or change the security—all in the hope of ultimately being repaid.

b) Actual or deemed exchanges.

i) A debt-for-debt exchange can be accomplished by an actual exchange of an old debt instrument for a new one, but it is not required for the exchange rules to apply.

(1) A deemed exchange of a debt instrument may occur if the terms of the debt are modified and this modification is significant. [Reg. Section 1.1001-3(a).]

(2) Conversely, an actual exchange of one debt instrument for another should be ignored for tax purposes if the terms of the new instrument do not materially differ from those of the old debt instrument. In such cases, the new debt instrument should be viewed merely as a new evidence of a pre-existing obligation.

ii) A modification is defined as any alteration of a legal right or obligation (including the addition or deletion of a right or obligation) of the issuer or holder of a debt instrument, whether the alteration is evidence by amendment of the instrument, conduct of the parties or otherwise. [Reg. 1.1001-3(c)(1).]

(1) An alteration of a legal right or obligation is not a modification if it occurs by operation of the original terms of the instrument. An alteration that occurs through one party’s exercise or waiver of a right under the instrument is by operation of the original terms, provided that the exercise or waiver is unilateral. [Reg. 1.1001-3(c)(1)(ii) & 1.1001-3(c)(2)(iii)]

(2) The following alterations would be considered modifications even if they occur under the terms of the original instrument [Reg. 1.1001-3(c)(2)(i) & (ii)]:

(a) a change in obligor/co-obligor (addition or deletion)

(b) a change in the nature of the instrument from recourse to non-recourse or vice versa (in whole or in part)

(c) an alteration that results in the instrument no longer being debt (except for a conversion to equity under the terms) [Prop. Reg. 1.1001-3(c)(2)(ii)].

(3) A temporary failure of the issuer to perform its obligations under an instrument, including a delay in payment, is not a modification. An agreement *by* the holder to temporarily stay collection or waive an acceleration clause or similar default right is not a modification [Reg. 1.1001-3(c)(4)].

iii) Modifications will result in an exchange if the modifications are considered significant modifications. The regulations provide five classes of modifications that will be considered significant

(1) Under the general rule a modification is considered significant if based on the facts and circumstances, the legal rights or obligations that are altered and the degree to which they are altered are economically significant. All changes to the debt instrument other than those under subparagraphs (e)(2) though (e)(6) of the regulations are considered collectively.

(2) Change in yield [Reg. Section 1.1001-3(e)(2).]

(a) Scope: Applies to debt instruments

(i) that provide for fixed payments

(ii) with alternative payment schedules subject to Reg. Section 1.1272-1(c)

(iii)that provide for a fixed yield subject to Reg. Section 1.1272-1(d), and

(iv)variable rate debt instruments

(b) A change in the yield of debt instrument is considered a significant modification if the yield varies by more than the greater of:

(i) ¼ percent (25 basis points), or

(ii) 5 percent of the annual yield before the modification

(c) Yield of an instrument is computed under the yield to maturity method of the OID rules, as follows:

(i) Issue price is equal to the adjusted issue price immediately before modification

1. Plus accrued but unpaid interest

2. Minus bond premium not yet taken into account

3. Plus/minus payments made to issuer/holder as consideration for the modification

(ii) payments will equal the total payments to be made on the modified debt instrument from the date of modification forward

(iii) Prepayment penalty is not included in "payments" for modification if it is a commercially reasonable penalty.

(3) Change in timing [Reg. Section 1.1001-3(e)(3)]

(a) A change in the timing of payments due under a debt instrument is a significant modification if it results in the material deferral of scheduled payments. The deferral may occur through

(i) The extension of the final maturity date or

(ii) A deferral of payments due prior to maturity

(b) The materiality depends on all the facts and circumstances, including

(i) Length of the deferral

(ii) Original term of instrument

(iii) Amount deferred

(iv) Time period between modification and actual deferral of payments

(c) Safe Harbor Period – the regulations provide for a safe harbor period where the deferral of payments within the period will not result in a significant modification.

(i) The safe harbor period equals the lesser of five years or 50% of the term of the original debt instrument.

(ii) The safe harbor period begins on the original date of the first scheduled payment that is deferred.

(iii) Original term is determined without regard to any option to extend the original maturity.

(iv) Deferral of deminis payments are ignored

(v) Unused safe harbor period can be used on subsequent modifications.

(4) Change in obligor or security [Reg. Section 1.1001-3(e)(4).]

(a) The substitution of a new obligor on a recourse debt instrument is a significant modification except in the case of:

(i) A transaction to which Section 381(a) applies and the new obligor is the acquirer and the transaction does not result in a change in the payment expectations, and the transaction does not result in a significant alteration.

(ii) An asset acquisition where the new obligor acquires substantially all the assets of the original obligor, the transaction does not result in a change in payment expectations and it does not result in a significant alteration.

(iii) The new obligor on a tax-exempt bond is related to the original obligor under section 168(h)(4)(A) and the collateral remains the same.

(iv) Significant Alteration is a change in the terms of the instrument that would be a significant modification except for the fact the change occurs by operation of the instrument.

(b) The substitution of the obligor on a non-recourse instrument is not a significant modification.

(c) The addition or deletion of a co-obligor on an instrument is a significant modification if it results in a change in payment expectations.

(d) A modification of the collateral or other credit enhancement for a recourse debt is a significant modification if it results in a change in the payment expectation.

(e) A modification that changes the collateral or other credit enhancement of a non-recourse debt is a significant modification.

(i) Substitution of fungible collateral is not significant.

(ii) Substitution of commercially similar credit enhancement is not significant

(iii) An improvement to the collateral property is not significant

(f) A change in payment expectations occurs if, as a result of the transaction

(i) There is substantial enhancement of the obligor's capacity to make payments under the obligation and that capacity was speculative before and is adequate after.

(ii) There is a substantial impairment of the obligor's capacity to make payments under the obligation and that capacity was adequate before and speculative after.

(5) Change in the nature of the instrument [Reg. Section 1.1001-3(e)(5)]

(a) A change in the instrument which causes it not to be treated as debt is significant modification.

(i) A change in obligor's financial condition between issue date and modification is not taken into account unless there is a substitution of a new obligor or the addition or deletion of a co-obligor.

(b) A change in the debt from recourse to non-recourse is a significant modification.

(c) A change in the debt from non-recourse to recourse is a significant modification

(d) Where the debt instrument is only partially recourse and non-recourse a changed is tested under the general facts and circumstances rule.

(e) Exceptions
  (i) Defeasance of tax-exempt bonds is not a significant modification, if
    1. Defeasance occurs by operation of instrument, and
    2. Issuer places government securities or tax-exempt bonds in trust that are reasonable to cover payment on the original bonds
  (ii) Changes from recourse to non-recourse is not significant if
    1. original collateral is not changed
    2. there is not a change in payment expectations
    3. special rule for fungible collateral

(6) Accounting or Financial Covenants [Reg. Section 1.1001-3(e)(6)]. A modification that adds, deletes, or alters customary accounting or financial covenants is not a significant modification.

iv) Rules of Application

(1) In determining whether a modification is significant it should be tested under each applicable provision and if not addressed specifically then under the general rule

(2) If a modification is subject to a substantial contingency then it is tested under the general rule rather than any of the specific rules

(3) If a modification to obligor, security or nature of the debt instrument is effective on a substantially deferred basis then it is tested under the general rule rather than the specific rules.

(4) If multiple modifications done over a period of time would result in a significant modification if done as a single change then the modifications are significant.
  (a) The significant modification occurs at the time the cumulative modification would result in a change under this rule.
  (b) In testing a change in yield under this rule, changes more than 5 years past are not considered.

(5) Modifications of different terms none of which separately constitutes a significant modification, do not collectively constitute a significant modification.
  (a) Where simultaneous modifications occur in testing any single modification all others are considered to have occurred.
  (b) Modifications that are tested separately are not tested under the general rule.

v) Tax consequences to the Debtor triggered by an exchange of debt.

(1) COD Income

(a) From the debtor's perspective, the main concern in a debt-for-debt exchange is usually COD income. This income can be excluded by the debtor only under Section 108(a). Therefore, a solvent debtor should consider filing a petition for a Chapter 11 reorganization with the Bankruptcy Court.

(b) The amount of COD income the debtor realizes is determined under Section 108(e)(10), which was enacted as part of the Omnibus Budget Reconciliation Act of 1990 (OBRA 90). Under Section 108 (e)(10), the OID principles must be used to determine the amount of the COD income.

(i) If neither the new debt nor the old debt are publicly traded, then the issue price of the new debt would equal the principal amount. However, if the new debt does not have adequate stated interest as determined under Section 1274(c)(2) then the issue price must be calculated in accordance with Sections 1273(b) and 1274.

(ii) If either the new debt or the old debt are publicly traded and the fair market value of the publicly traded debt is less than the principal amount of the new debt then the issue price of the new debt is the lower fair market value.

(c) A lower issue price would increase COD income and OID. This result is generally not beneficial to a solvent debtor. However, an insolvent debtor with expiring NOLs can extend the life of these NOLs through higher interest deductions in the future attributable to the OID.

(2) Original issue discount in brief.

(a) Definition. Section 1273(a)(1) defines OID as the excess of the stated redemption price over its issue price.

(b) The stated redemption price is generally the amount to be paid at maturity. However, interest payments which are not qualified periodic interest payments must be included in the stated redemption price.

(c) The issue price, as previously stated, is in the case of debt which is publicly traded or issued for publicly traded property the fair market value of the instrument.

(d) In the case of non-publicly traded debt, the issue price is the principal amount of the debt if it has adequate stated interest. If not, then all payments on the obligation, principal and interest, are present valued to the issue date at the applicable federal rate (AFR). This present value amount is then the issue price.

(e) A debt has adequate stated interest if the net present value of all the payments at the AFR is more than or equal to the debt's principal amount.

(3) Accounting for OID: Once the total OID is calculated It is generally accounted for as follows:

1. Under Section 163(e)(1), the issuer may claim an interest deduction equal to the aggregate daily portion of the OID accruing during the taxable year.

2. Under Section 1272(a)(1), the holder must include a corresponding amount of OID as interest income. However, no OID is required to be included if the OID yield to maturity is less than ¼ of a point.

Example 1: Old debt exchanged for new debt of lesser face amount.

Loss corporation (L) issued debt (Old Debt) having a stated principal amount of $100, a 5-year term. and interest at 15%. The Old Debt was issued at par for cash and has an adjusted issue price (AIP) of $100. L exchanges the Old Debt for new debt (New Debt) having a face amount of $75, a 5-year term, and interest at 10%. The Old Debt and New Debt both have a fair market value of $75. The New debt has an issue price (IP) of $75. All the interest on the New Debt constitutes qualified periodic interest payments (QPIP). The creditor is an accrual method taxpayer.

Old Debt		New Debt	
Face	$100	Face	$75
AIP	100	FMV	75
FMV	75	IP	75

- This example reflects the fairly common case where Old Debt has depreciated in value and is exchanged for new debt with a face amount that matches the lower value. The transaction should constitute an exchange under Reg. Section 1.1001-1(a).

- Under Section 1001, the creditor would realize a loss of $25 ($100 basis of Old debt less $75 amount realized) and would have no reportable OID, since the stated redemption price $75 equals the issue price.

- Under Section 108(e)(10), L has COD income of $25 ($100 AIP Old Debt less $75 IP New Debt). This income would be excludable by L under Section 108(a), if L were insolvent or in bankruptcy or another exclusion applies.

Example 2: Old debt exchanged for new debt with equal face amount.

Assume the same facts as above, except that the New Debt has a face amount of $100 and a fair market value of $75. The New Debt is, also, publicly traded and, therefore, its issue price is $75.

Old Debt		New Debt	
Face	$100	Face	$100
AIP	100	FMV	75
FMV	75	IP	75

- In this case, L has retained the same principal amount for the New Debt but has reduced the interest rate by more than 1/4 point, therefore, it will be treated as an exchange under Reg. Section 1.1001-3(b).

- Under Section 1001, the creditor would realize a loss of $25 ($100 basis of Old Debt less $75 amount realized FMV of New Debt). In addition, the creditor would have $25 of OID to be included in income over the term of the debt ($100 stated redemption price less $75 issue price).

- Under Section 108(e)(10), L has COD income of $25 ($100 AIP Old Debt less $75 IP New Debt). This income, again, would be includable unless one of the exclusions of Section 108(a) apply. In addition, L would now have an interest deduction for the OID which is equivalent to the COD income, In this situation, L has accelerated the benefit realized by the reduced interest cost into taxable income in the year the transaction is consummated even though the actual benefit is derived over the term of the debt.

- If neither the Old Debt nor the New Debt was publicly traded, the issue price of the New Debt would be equal to its face amount and L would have no COD income or OID. A much more equitable treatment.

5) Related Party Acquisition of Debt

a) In General –

i) Section 108(e)(4) provides that, for purposes of determining COD income, the acquisition of debt by a person related to the debtor from a person unrelated to the debtor is to be treated as an acquisition of the debt by the debtor itself.

ii) Section 108(e)(4) was enacted as part of the Bankruptcy Tax Act of 1980. It was intended to curb perceived abuses of prior law whereby a related party could acquire the taxpayer's debt at a discount and thereby eliminate it as a real liability to outside parties, yet the debtor would avoid income recognition. See H.R. 5043, 96th Cong., 2d Sess. 9 (1980).

iii) Section 108(e)(4), however, applies only to the extent provided in regulations. Which were not released under this section until the proposed regulations were released on March 21, 1991. The Service released the final version of these regulations on December 28, 1992.

iv) The final regulations are effective on December 28, 1992 and apply to direct or indirect acquisitions of indebtedness on or after March 21, 1991. However, it is the Service's position that Section 108(e)(4) is effective for any transaction after December 31, 1980, subject to the rules of Section 7 of the Bankruptcy Tax Act of 1980.

b) Direct Acquisitions.

i) As indicated, the regulations provide that Section 108(e)(4) applies if indebtedness is acquired in a "direct" acquisition.

(1) Definitions.

(a) Reg. Section 1.108-2(b) defines a "direct acquisition" as an acquisition of outstanding indebtedness by a person related to the debtor from a person who is not related to the debtor.

(b) A person is "related" to the debtor if the acquirer and the debtor bear a relationship that is describe in Section 267(b) or 707(b)(1). [Reg. Section 1.108-2(d)(2).]

1. For this purpose, the definition of family, under Section 267(c)(4), has been expanded to include spouses of an individual's children or grandchildren. [Reg. Section 1.108-2(d)(2)(i).] Some of the relationships described in Section 267(b) include generally: (1) An individual and a corporation where the individual owns more than 50% of the corporation. (2) Two corporations which are members of a controlled group under Section 1563(a), substituting a "more than 50%" test for the "at least 80 %" test. (3) A corporation and a partnership if the same persons own more than 50% of the entities.

2. Section 707(b)(1) includes a partnership and a partner owning more than a 50% interest or two partnerships in which the same partners own more than a 50% interest.

3. In addition, two entities which are treated as a single employer under Sections 414(b) and (c) will be treated as related.

(2) Consequences of a direct acquisition.

(a) In a direct acquisition, the debtor will realize COD income to the extent the related party's (acquirer/holder) adjusted basis is less than the debtors adjusted issue price on the "acquisition date." [Reg. Section 1.108-2(f)(1.)]

(i) This is a change from the proposed regulations, which adopted fair market value as the standard.

(ii) In a direct acquisition the "acquisition date" is the actual date in which the related holder acquires the debt.

(iii) COD income would be excludable to the extent provided in Section 108(a), [Reg, section 1.108-2(a).]

(b) This treatment contrasts with Section 108(e)(10), which provides that a debtor's COD income is measured by the issue price of the new debt. In a situation where a related party acquires publicly traded debt in an exchange for its debt of equal face amount which is more than the fair market value, the cancellation of debt income realized would be less than if the debtor issued its own new debt.

(i) Reg. Section, 1.108-2(f)(4) contains an anti-abuse rule, which requires the amount of COD income to be measured by the fair market value of the acquired debt in transactions where a principal purpose of which is the avoidance of federal income tax.

(ii) A taxpayer attempting to avoid COD income in this manner will have to establish a substantial business purpose for structuring the transaction as a related party acquisition.

(3) Treatment after the acquisition.

(a) Section 108(e)(4) states that the regulations thereunder must provide for "such adjustments" in the treatment of any subsequent transaction involving the indebtedness as may be appropriate as a result of the application of Section 108(e)(4). The final regulations carry out this mandate, although somewhat contrary to the legislative history.

(b) Under Reg. Section 1.108-2(g)(1), the debtor is treated as issuing new indebtedness at an issue price equal to the amount used in determining its COD income under Reg. Section 1.108-2(f), (i.e., holder's adjusted basis or FMV at the acquisition date).

(i) All remaining terms of the old debt carry over to the new debt.

(ii) To the extent the stated redemption price at maturity exceeds the issue price of the new debt the amount constitutes OID under Sections 1272 and 163. It is, therefore, subsequently deductible by the debtor and includable in income by the holder.

(iii) The deemed new indebtedness will be treated as such *new* debt for all purposes of the federal income tax law. However, the Secretary has reserved the right for the Commissioner via revenue procedure to designate provisions of the tax laws in which the debt will not be treated as new1y issued.

(c) The related holder of the debt instrument will not recognize gain or loss on the deemed issuance. The deemed issuance is treated as a purchase by the related holder at a price equal to its adjusted basis. Any premium over the deemed issue price would then be amortizable against the related holders OID income under Section 1272 (a)(7).

(d) Under Reg. Section 1.108-2(g)(3), any loss realized by the holder on a subsequent disposition is deferred until the debtor retires the indebtedness, if

i. The related holder acquired the indebtedness in exchange for its own debt; and

ii. The issue Price of the related holder's indebtedness was not determined based on FMV.

iii. The loss deferral would apply in any situation in which the holder is to have been considered to have disposed of the debt either directly or indirectly (e.g. a subsequent transfer to a subsidiary followed by a sale of the subsidiary's stock.)

c) Indirect Acquistions.

i) The regulations also apply Section 108(e)(4) to "indirect acquisitions", even though there is no apparent authority within the code section. According to the regulations, an indirect acquisition is essentially equivalent to a direct acquisition of the debtor's indebtedness by a related party.

(1) Definitions.

(a) An "indirect acquisition" is a transaction in which the holder of the outstanding indebtedness becomes related to the debtor, if holder acquired the indebtedness in anticipation of becoming related to the debtor. {Reg. Section 1.108-2(c)(1)]

(b) In determining whether indebtedness was acquired in anticipation of becoming related, all relevant facts and circumstances will be considered, including

(i) The intent of the parties at the time of the acquisition;

(ii) The nature of any contracts between the parties or affiliates before the acquisition;

(iii) The period of time for which the holder held the debt; and

(iv) The significance of the debt in relation to the holder's other assets.

(c) However, if the holder acquired the debt less than six months prior to becoming related, the acquisition will be treated as made in anticipation of becoming related and therefore, an indirect acquisition.

(d) Finally, certain acquisition unless disclosed on the holder's tax return will be deemed to be an indirect acquisition. See Reg. Section 1.108-2(c)(4). Disclosure is required, if

(i) The holder becomes related in the period 6 to 24 months after the acquisition of the debt; or

(ii) The indebtedness represents more than 25% of the FMV of the acquirer's assets on the date the holder becomes related.

(2) Tax consequences

(a) Treatment of the debtor. As in a direct acquisition, the debtor will realize COD income based on the difference between the holders adjusted basis and the adjusted issue price of the debt on acquisition date.

(i) If the holder acquired the debt more than six months before the acquisition date, the debtor's COD income is measured by the FMV of the indebtedness at the acquisition date.

(ii) For purpose of an indirect acquisition the "acquisition date" is that date on which the holder becomes related to the debtor under Reg. Section 1.108-(d)(2).

(iii) The COD income is excludable to the extent provided in section 108.

(b) Treatment of the holder. The tax consequences to the holder in an indirect acquisition are the same as those in a direct acquisition.

d) Exceptions.

i) Indebtedness retired within one year. Under Reg. Section 1.108-2(e)(1), Section 108(e)(4) does not apply to a direct or indirect acquisition, if the maturity date of the acquired indebtedness is one year or less after the acquisition date, and in fact the indebtedness is retired on or before its maturity date.

ii) Acquisitions by security dealers. Under Reg. Section 1.108-2(e)(2), Section 108(e)(4) does not apply to a direct or indirect acquisition of indebtedness by a security dealer that acquires and disposes of such indebtedness in the ordinary course of business and the dealer does not dispose of or otherwise transfer the indebtedness to a party related to the debtor.

6) Special Considerations for Entities Taxed as Partnerships and their Partners

a) Section 108(a) Exclusions: For entities taxed under subchapter K, the bankruptcy exception of 108(a)(1)(A) and the insolvency exception under section 108(a)(1)(B) do not apply at the entity level. These provisions are applied at the Partner level.

i) For purposes of the bankruptcy exception the partner must be a party to the bankruptcy case in which the debt is cancelled or reduced. Generally, this would require that the partner be personally liable for some portion of the debt which is relieved as part of the Title 11 case.

ii) For purposes of the insolvency exception, determined at the partner level, pass-through partnership debts, if non-recourse to the partner are only counted to the extent of the FMV of partnership assets included in the partner's insolvency calculation.

(1) Most entities taxed as partnerships under subchapter K are organized under state law as limited liability companies and therefore the debt allocated to the partner is generally considered to be non-recourse, barring personal guarantees and certain deficit restoration agreements.

(2) Partner can still include the amount of “non-recourse” debt from the partnership in its insolvency calculation that is considered cancelled.

(3) Example 1: ABC, LLC a typical real estate partnership owns a building FMV $1,000 subject to a recourse mortgage at the entity level of $2,500. Due to an economic downturn ABC, LLC is no longer able to make payments on the mortgage, it negotiates with the lender and has the mortgage principle successfully reduced to $1,000 with certain guarantees from ABC’s members. ABC, LLC recognizes $1,500 of COD income which is passed out to the partners on schedule K-1. Partner A is a 1/3 owner of ABC, LLC and is allocated $500 of COD income. A must determine if he is insolvent immediately prior to the cancelation of debt in order to determine the 108(a)(2) excluded amount. A has other assets of $100 and other debt of $50 outside of his interest in ABC, LLC.

A's solvency calculation:

Other Assets	$100
Interest in ABC assets before debt	$333
Other Liabilities	-$50
ABC liabilities limited to FMV Assets	-$333
A’s Share of Cancelled ABC Debt	-$500
A’s insolvency before COD event	-$450

A can exclude $450 of the COD income passed out from ABC, LLC. The remaining $50, would be taxable as A is solvent by $50 after the debt is forgiven. Attribute reduction of $50 will be determined at the partner level.

b) Under Section 108(a)(1)(D and 108(c), the qualified real property business indebtedness (QRPBI), takes a hybrid approach with certain provisions applicable at the partnership level and other provisions applicable at the partner level.

i) The determination of whether or not indebtedness is QRPBI is made at the partnership level, and the FMV limitation on the amount excludable under section 108(c) is determined at the partnership level.

ii) The election to exclude the COD under 108(c) is made at the partner level. Also, the required basis reduction is made at the partner level and reported to the partnership.

(1) The basis reduction must be consented to by the partnerships with respect to which the partner seeks to reduce the basis of depreciable real estate.

(2) The partner in turn must reduce its outside basis in the partnership interest equal to the reduction in basis of the depreciable real estate to which the 108(c) reduction applies.

(3) Basis reduction in depreciable real estate should first be applied to the real estate securing the QRPBI (assuming the partnership consents to the reduction), then proportionately to the remaining depreciable real estate holdings of the electing partner, including other consenting partnership holdings.

c) Debt for Equity Exchanges under section 108(e)(8) for partnerships is similar to the rule applicable to corporations.

i) Section 721(a) is not applicable to the exchange from the partnership standpoint.

ii) The partnership is treated as satisfying the exchange debt for an amount of money equal to the FMV of the partnership issued in the exchange.

(1) COD income is realized by the partnership to the extent the FMV is less than the issued price (principle amount) of the debt exchanged

(2) Partnership does not recognize gain or loss on the issuance of its equity interest.

iii) Section 721(a) applies to the contributing creditor and therefore prohibits the recognition of loss by the creditor on the exchange.

(1) The creditor receives carryover basis with respect to the partnership interest under section 722.

(2) Creditor may end up with a character shift in a debt-equity swap due to the carryover basis rule, since a subsequent sale of the partnership equity interest would be a capital transaction.

iv) Reg. Section 1.108-8(b)(2), provides a safe harbor which allows the partnership and creditor to value the partnership interest received in the exchange at its calculated liquidation value based on the partnership agreement.

v) Partner contribution of debt to capital or exchange for additional partnership interest is problematic.

(1) Exception under 108(e)(6) for indebtedness contributed to capital does not apply to Partner debt contributed to capital of a partnership whether on not additional equity is exchanged.

(2) Consider utilizing preferred units with specified annual returns and distributions should alleviate problem.

(3) Case law under section 385 should be reviewed, to be sure Preferred Equity is respected and not subject to re-characterization as debt.

(a) Section 385 is a corporate provision but provides certain guidelines for distinguishing debt vs equity in the partnership area.

(b) Section 385 provides taxpayers are bound by the characterization they pick at the outset of the transaction.

(c) IRS will generally be unreceptive to taxpayers' attempts to recharacterize debt as equity in years subsequent to the issuance of the debt/equity

(4) Consideration should also be given to the impact of the interest limitation rules under section 163(j).

vi) Allocation of COD income and other considerations.

(1) Income from COD is allocated to the partners, who were partners immediately before the cancellation.

(2) Allocation must be consistent with the partners distributive share as determined under section 704 rules.

(3) Consideration should be given to the impact of the debt reductions on partners allocation of liabilities under section 752, including impact on minimum gain and minimum gain chargeback rules, deemed distributions under section 731 and calculation of basis and at-risk amounts.

SESSION 6

TAX BASIS CAPITAL ACCOUNT REPORTING

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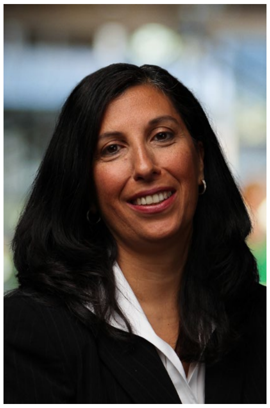

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Angelina's principal area of expertise is in the real estate industry. She also has significant experience in in construction, manufacturing, private equity, private office, and professional services. Her broad technical expertise includes taxation of partnerships, limited liability companies, S Corporations, trusts, and individuals.

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- American Institute of Certified Public Accountants
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- The Tax Club of Akron
- Author & Lecturer of various topics on taxation and tax planning

Community/Philanthropic Pursuits

- Board of Directors - Chicago Title Insurance Company Commercial Advisory Board
- Board of Directors – Akron Roundtable – President Elect
- Akron Children's Hospital Hope Ambassador Program
- Akron Community Foundation – Professional Advisor Council
- Past Board of Directors - Leadership Akron Alumni Association – Past President, Past Vice-President & Past Treasurer
- Past Board of Directors - The University of Akron Master of Taxation Governance Board
- Past Board of Directors - George W. Daverio School of Accountancy
- Past Board of Directors Women's Endowment Fund of the Akron Community Foundation Board -Past Treasurer, Past Grant Committee Chair,
- Past Board of Directors -Women's Network
- Past Board of Directors - International Institute of Akron
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Experience

Brent is a Vice President in our Tax Services Group with almost 20 years of experience in public accounting. He routinely meets with clients in a variety of industries and advises on operational and tax matters.

Brent has proven himself as a trusted and creative resource in managing the sale and acquisition of client organizations. In addition, he has an exceptional record of sustaining client audit positions in federal, state and local income tax audit matters. He adds value to client relationships through continuous communication and analysis of client tax planning opportunities, employee benefits, entity structure and compliance matters.

Brent has presented to professional and civic organizations including The University of Akron National Tax Conference, The Cleveland Tax Institute and the Akron Bar Association.

Areas of Specialization

- Tax Planning & Compliance
- Entity Structure
- Transaction Advisory
- Employee Benefits Consulting

Community/Philanthropic Pursuits

- Community Leadership Institute, Leadership Akron
- Goodwill Industries of Akron, Past Treasurer

Tax Basis Capital Account Reporting
October 29, 2020

Brent Thompson, CPA, MT & Angelina Milo, CPA

MEADEN & MOORE

AKRON I BEACHWOOD I BOSTON I CHARLOTTE I CHICAGO I CLEVELAND I COLUMBUS
LONDON I LOS ANGELES I MIAMI I NEW YORK I ORLANDO I PITTSBURGH I WOOSTER

Tax Basis Capital Account Reporting

History:

- **Prior to 2018**: Partner capital account reconciliations could be reported on the tax basis, GAAP, 704(b) book or another method.

- **2018**: 1065 form instructions introduced a new requirement for partnerships to report when a partner's "tax basis" was negative at either the beginning or end of the year. Exemption for certain small partnerships (<$250K in assets and $1M assets)
  - The term "tax basis capital" was a new term, previously undefined in published guidance and created by the IRS for the purposes of the 2018 reporting requirement.

  - Notice 2019-20: Penalty relief for missing Negative Tax Basis Capital Account information
    - Provided relief from the $195 penalty per partner per month. Allowed partnerships who did not comply with the new 2018 reporting to correct the Schedule K-1 filings without needing to amend the tax returns. To correct the filings, practitioners needed to mail a statement to the IRS disclosing the negative tax basis capital of partners by March 15, 2020. The statement must contain the wording that it is being "Filed Under Notice 2019-20"

Tax Basis Capital Account Reporting

- **2019:** Initial draft instructions to the 1065 would have required all partners' capital accounts to be reported exclusively on the tax basis capital method.
  - Notice 2019-66: In response to practitioner comments highlighting the difficulty of complying with the new requirements, this notice delayed the requirement to report all partners' capital accounts using their tax basis *until the 2020 tax year.*
    - Effectively, same rules in 2019 as existed in 2018. Only required to report those partner's who had negative tax basis on the first or last day of the year.
    - Stated that additional guidance on the definition of partner tax basis capital would be published in the future.

Tax Basis Capital Account Reporting

- **2020:** Partnerships are required to report Tax Basis Capital Accounts to all partners, whether negative or positive.
  - Purpose of Requirement (presumably):
    - Allow the IRS to quickly arrive at an estimate of a partner's outside tax basis in a partnership to identify potential issues related to distributions in excess of basis and ability to recognize losses.
      - i.e.; If tax basis plus partners' share of liabilities nets less than zero….gotcha!
    - The "tax basis capital account" information is not relevant information to either the partnership or the partner. That is, neither the partnership or it's partners should use the computation in determining recognized income, gain, deduction or loss.

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Tax Basis Capital Account Reporting

- **Calculation of Tax Basis Capital As Provided in IRS Instructions and FAQ's:**
  - (i) the amount of cash plus the tax basis of property contributed to a partnership by a partner, minus the amount of cash plus the tax basis of property distributed to a partner by the partnership, net of any liabilities assumed or taken subject to in connection with such contribution or distribution, plus;
  - (ii) the partner's cumulative share of partnership taxable income and tax-exempt income, minus;
  - (iii) the partner's cumulative share of taxable loss and nondeductible, noncapital expenditures.
- Note: this definition is neither a true "inside" or "outside" basis that practitioners are more accustomed to.

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Tax Basis Capital Account Reporting

2018 K-1	**GAAP (K-1)**	**New IRS Tax Basis**	**Outside Tax Basis**	**At-Risk Basis**
Beginning capital	-	-	-	-
Contributions	100,000	100,000	100,000	100,000
Income (loss)	(110,782)	(83,824)	(83,824)	(83,824)
Distributions	-	-	-	-
Inc (dec) in nonrecourse debt	-	-	-	-
Inc (dec) in recourse debt	-	-	661,909	661,909
Ending capital	(10,782)	16,176	678,085	678,085

2019 K-1	**GAAP (K-1)**	**New IRS Tax Basis**	**Outside Tax Basis**	**At-Risk Basis**
Beginning capital	(10,782)	16,176	678,085	678,085
Contributions	15,889	15,889	15,889	15,889
Income (loss)	(9,220)	(47,951)	(47,951)	(47,951)
Distributions	-	-	-	-
Inc (dec) in nonrecourse debt	-	-	42,644	-
Inc (dec) in recourse debt	-	-	3,039	3,039
Ending capital	(4,113)	**(15,886)**	691,706	649,062

* Nonrecourse debt provides tax basis for distributions, but does not provide at-risk basis for purposes of deducting losses.

Tax Basis Capital Account Reporting

IRS Notice 2020-43 – June 5, 2020

- In response to partnerships that may not be able to comply using the historical transaction method because they have not historically maintained partner tax capital account
- “Tax Basis Capital” not defined – as indicated in Notice 2019-66
- Barred the use of the transactional approach
- Proposed two new approaches
- If adopted, the proposed methods are the only methods by which partnership may comply to meet the tax capital reporting requirement for taxable years ending on/after December 31, 2020
- Partnerships may change between methods by attaching a disclosure describing the change to each partner’s beginning and ending capital account balance
- IRS Requested comments

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Tax Basis Capital Account Reporting

- **IRS Notice 2020-43**

  - In lieu of providing "additional guidance" on the definition of tax basis capital, the IRS issued Notice 2020-43 proposing two permissible methods for partnerships to comply with the tax basis capital reporting requirement.

- Two Permissible Methods:
  1) Modified Outside Basis Method
     - the partner's basis in its partnership interest, reduce by the partner's allocable share of partnership liabilities, as determined under §752
  2) Modified Previously Taxed Capital Method
     - The partner's share of previously taxed capital, as calculated under a modified version of §1.743-1(d)

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Tax Basis Capital Account Reporting

IRS Notice 2020-43 – Public Comments

- Administratively burdensome
- Reporting will result in amendments to partnership agreements
- Reporting should be focused at the partner level
- Questioned if IRS has statutory authority to implement new reporting requirements
- Defer effective date
- ***Identified issues and proposed changes to the two permissible methods***
- ***Retain the Transactional Method***
- ***Unfair penalties***

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Tax Basis Capital Account Reporting

IR 2020-240 – October 22, 2020

1. Comments requested: 30-day comment period

2. IRS Released early draft of instructions to 2020 Form 1065, US Return of Partnership Income

- Provide a preview of the changes and information that software developers would need to start updating their system

- Final version of instructions anticipated to be released in December 2020.

3. The IRS intends to issue a notice providing penalty relief for the transition in tax year 2020.

Tax Basis Capital Account Reporting

General Penalties Imposed on a Partnership

- IRC Section 6698 – Partnership fails to show all the information required, unless such failure is due to reasonable cause:
    - 2019 - $195 per non-complying partner, per month up to a year
    - 2020 - $210 per non-complying partner, per month up to a year (Per draft instructions)
- IRC Section 6722 – Failure to furnish correct payee statements
- IRC Section 6038 – Failure to furnish information with respect to foreign partnerships

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Tax Basis Capital Account Reporting

IR 2020-240 – October 22, 2020 – Penalty Relief

- To promote compliance with the tax-basis method, the IRS intends to grant penalty relief for the transition to the new rules.
- The relief will provide that solely for the 2020 tax year (for partnership returns due in 2021), the IRS will not assess a penalty for any errors in reporting a partnership's partners' beginning capital account balances on Schedules K-1 if the partnership takes ordinary and prudent business care in following the form instructions to calculate and report the beginning capital account balances.

Tax Basis Capital Account Reporting

IR 2020-240 – October 22, 2020

- Special rules for publicly traded partnerships
- IRS plans similar revisions to Form 8865, Return of US Persons with Respect to Certain Foreign Partnerships

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Tax Basis Capital Account Reporting

Draft Instructions – Item L Partner's Capital Account Analysis

Non-publicly traded partnerships that are required to complete item L on Sch K-1:

1. **Must use the tax basis method to report the "Beginning Capital Account"**

2. **Must use the transactional approach to calculate a partner's capital account following the computation of the 2020 Beginning Capital Account**

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Tax Basis Capital Account Reporting

Draft Instructions – Item L Partner's Capital Account Analysis

Partnerships that completed item L using the tax basis method in 2019

- Continue using the transactional approach to report the 2020 "Beginning Capital Account" for each partner
- Partnership may recalculate beginning tax basis capital account
- If reported negative ending tax basis capital account to a partner in 2019 and recalculation results in a different amount reported for 2020 "Beginning Capital Account", an explanation must be provided for the difference

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Tax Basis Capital Account Reporting

Draft Instructions – Item L Partner's Capital Account Analysis

Partnerships that did not complete item L using the tax basis method in 2019 but, maintained tax basis capital accounts in their books and records, must report each partner's 2020 "Beginning Capital Account" using the tax basis method.

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Tax Basis Capital Account Reporting

Draft Instructions – Item L Partner's Capital Account Analysis

IRC Section 743(b) Basis Adjustments

- Not taken into account in calculating tax basis capital accounts
- If IRC Sec. 743(b) adjustment was included in 2019 tax basis ending capital account, must remove amount from partner's 2020 capital account
- Remove by reporting amount as an other increase(decrease)

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Tax Basis Capital Account Reporting

Draft Instructions – Item L Partner’s Capital Account Analysis

IRC Section 734(b) Basis Adjustments

- Are included in partner’s beginning capital account
- Report adjustments as an other increase(decrease)

Note: IRC Sec 734 adjustments are internal to the partnership while IRC Sec. 743 are not

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Tax Basis Capital Account Reporting

Draft Instructions – Item L Partner's Capital Account Analysis

Partnerships that did not complete item L using the tax basis method in 2019, or did not maintain tax basis capital accounts in their books and records, may determine each partner's beginning tax basis capital account balance for 2020 using one of the following methods:

1. **Modified Outside Basis Method**
2. **Modified Previously Taxed Capital Method**
3. **Section 704(b) Method**

****One-time only calculation****

Same method must be used for each partner

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Tax Basis Capital Account Reporting

Draft Instructions – Item L Partner's Capital Account Analysis

Modified Outside Basis Method

A partner's adjusted tax basis in the partnership determined under the provisions of Subchapter K **(outside basis) <u>less</u>:**

- The partner's share of liabilities under IRC Section 752 and
- The sum of the partner's IRC Section 743(b) Adjustment (Net IRC Sec. 743(b) adjustment)

Partnerships may rely on the adjusted tax basis information given to the partnership by the partners

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Tax Basis Capital Account Reporting

Draft Instructions – Item L Partner's Capital Account Analysis

Instructions provide that each partner continues to be responsible for maintaining a record of the adjusted tax basis in its partnership interest (outside basis).

Tax Basis Capital Account Reporting

Draft Instructions – Item L Partner's Capital Account Analysis

Modified Previously Taxed Capital Method

The amount of cash a partner would receive if the partnership were to liquidate after selling all of its assets in a fully taxable transaction for cash equal to the fair market value (FMV) of the assets.

Tax Basis Capital Account Reporting

Draft Instructions – Item L Partner's Capital Account Analysis

Modified Previously Taxed Capital Method

Increased by the amount of **tax loss** determined **without taking into account**:

- Any IRC Section 743(b) basis adjustments
- Any remedial allocations under Regulations Section 1.704-3(d)

and

Treating all liabilities as nonrecourse

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Tax Basis Capital Account Reporting

Draft Instructions – Item L Partner's Capital Account Analysis

Modified Previously Taxed Capital Method

Decreased by the amount of **tax gain** determined **without taking into account**:

- Any IRC Section 743(b) basis adjustments
- Any remedial allocations under Regulations Section 1.704-3(d)

and

Treating all liabilities as nonrecourse

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Tax Basis Capital Account Reporting

Draft Instructions – Item L Partner's Capital Account Analysis

Modified Previously Taxed Capital Method

Instead of using Fair Market Value may use:

- Bases of assets determined under IRC Section 704(b)
- Bases of assets determined for financial accounting purposes
- Basis set forth in the partnership agreement

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Tax Basis Capital Account Reporting

Draft Instructions – Item L Partner's Capital Account Analysis

Modified Previously Taxed Capital Method

A statement must be provided to each partner, including the method used to determine the partnership's net liquidity value (FMV, GAAP, IRC Sec. 704(b) etc.)

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Tax Basis Capital Account Reporting

Draft Instructions – Item L Partner's Capital Account Analysis

IRC Section 704(b) Method

The partner's IRC Section 704(b) capital account

- Minus the partner's share of IRC Section 704(c) built in gain in the partnerships assets
- Plus the partner's share of IRC Section 704(c) built in loss in the partnerships assets

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Tax Basis Capital Account Reporting

Draft Instructions

Reconciliation of Schedule L (Balance Sheet) Partners' Capital Accounts

Unless Schedule L is prepared on a tax basis, the sum of the capital accounts of Schedule K-1s will not agree with the partners' capital accounts reported on Schedule L.

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Tax Basis Capital Account Reporting

Draft Instructions

Reconciliation of Schedule L (Balance Sheet) Partners' Capital Accounts

The sum of the capital accounts on Schedule K-1s should agree with the partners' capital accounts reported on Schedule M-2, Analysis of Partners' Capital Accounts

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Tax Basis Capital Account Reporting

THANK YOU FOR PARTICIPATING!

Questions? Contact:

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SESSION 7

MAXIMIZING THE BENEFIT OF LOSSES

CliftonLarsonAllen

David L. Groves, CPA

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Profile

Dave is a principal with CLA. He has more than 25 years of public accounting experience in taxation. Dave provides tax advice and consulting services to privately owned businesses, private-equity-owned businesses, publicly traded companies, nonprofit universities and hospitals, and individuals.

Technical experience

- Experience includes
  - Mergers and acquisitions (including significant experience with private equity transactions)
  - International tax planning and compliance
  - Internal tax reorganizations and legal entity simplification
  - Tax accounting methods
  - Inventory planning (including LIFO)
  - Transaction cost analysis
  - IRS examination representation
  - State tax planning and reorganizations
  - ASC 740 – Accounting for Income Taxes
  - S-corporation planning and taxation
  - Partnership taxation
  - Expatriate and foreign national planning and compliance
- Dave is a member of the firm’s Manufacturing and Distribution industry group and serves as the firm’s IC-DISC practice regional leader.

Education/professional involvement

- Bachelor of science degrees in finance and accounting, *cum laude*, from Miami University
- American Institute of Certified Public Accountants
  - Served as an instructor for the AICPA on topics such as international tax, S corporations, accounting for income taxes and partnerships
- Ohio Society of Certified Public Accountants
- Greater Canton Area Business Excellence Awards Committee

Civic organizations/awards

- Stark State College Advisory Board for Finance and Accounting
- Malone University Business Advisory Board
- Former trustee of the Stark Development Finance Corporation
- Akron Chamber of Commerce “30 for the Future” award recipient

University of Akron – National Tax Conference

Maximizing the Benefit of Losses

October 29, 2020

David L. Groves, CPA
Principal, Tax

WEALTH ADVISORY | OUTSOURCING | AUDIT, TAX, AND CONSULTING

Investment advisory services are offered through CliftonLarsonAllen Wealth Advisors, LLC, an SEC-registered investment advisor

Create Opportunities

Disclaimer

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About CLA

- A professional services firm with three distinct business lines
  - Audit, Tax and Consulting
  - Outsourcing
  - Wealth Advisory
- More than 120 offices and 6,200 employees
- 8th largest professional services firm
- Offices coast to coast

Learning Objectives

- At the end of this session, you will be able to:
  - Understand the types of losses available to corporation and individual taxpayers
  - Understand the various restrictions applied to losses
  - Understand potential disclosure requirements when claiming deduction from loss transactions
  - Understand the CARES Act changes related to losses

Maximizing the Benefit of Losses – Overview

- The Importance of Planning for Losses
- Net Operating Losses (NOLs)
- Excess Business Loss Limitations (EBLs)
- CARES Act Changes to NOLs and BLLs
- Maximizing the tax benefit of losses
- Disclosure Requirements

The Basics – Why We Plan for Losses

Incurring a loss is never the goal of a profitable business. If you don't receive a tax benefit for the loss, the consequences are even worse!

C Corporation		Individual	
Amount of loss	$100,000	Amount of loss	$100,000
Tax Savings	($21,000)	Tax Savings	($40,000)
Net cost of loss	$79,000	Net cost of loss	$60,000

The Basics – Character is Important

C Corporation	Individual
• Ordinary losses offset all types of income	• Ordinary losses (generally) offset all types of income (passive activity losses and business losses)
• Capital losses only offset capital gains	• Capital losses only offset capital gains ($3,000 per year limit)
• Net operating losses can be restricted (SRLY, Sec. 382) or limited (80% limitation)	

The Basics – Tax Planning 101

C Corporation	Individual
• Prefer ordinary losses	• Prefer ordinary losses and capital gain income
• Avoid or increase NOL limitations	• Avoid or increase NOL/EBL limitations
• Tax rate is the same for ordinary and capital gain income	• Tax rate is up to 12% lower on capital gain income (election impact?)
• Historically, top tax rate is 35%	• Historically, top tax rate is 39.6%

Net Operating Losses

- 2017 Tax Act NOL Rules
  - Eliminated Carryback
  - Unlimited Carryover
  - Limits Utilization to 80% of current taxable income
- CARES Act Modifications
  - 5 year c/b for NOLs from 2018, 2019, or 2020
    - Can waive c/b but can't modify c/b period
  - 80% of TI limitation suspended through 2020
  - No change to 90% limit for AMT
  - NOLs generated in '18, '19, and '20 subject to 80% of TI limit starting in '21
- 2 year c/b for NOLs from year starting in '17 and ending in '18

Excess Business Losses (EBLs)

- 2017 Tax Act EBL rules
  - Limits deduction for business losses to $250,000 ($500,000 for MJF)
  - Limitation is applied after basis limitation, at-risk limitation and passive activity loss limitation
  - Treated as NOL and carried forward
- EBL suspended for 2018-2020
  - Amended return opportunity/obligation
- Starting in 2021, wages will be non-business income

Planning Opportunities for 2020 – Accelerated Deductions

- 100% Bonus Depreciation
- Qualified Improvement Property (“QIP”)
  - QIP is improvement to interior of building but not:
    - ◊ Enlargement
    - ◊ Escalator/elevator
    - ◊ Internal structural framework
  - Eligible for 100% bonus retroactive to 2018
    - ◊ N/A if elected out of bonus for 15 year property
    - ◊ N/A if elected or forced to use ADS (e.g., real prop T/B)
  - 3115 or amended return opportunity/obligation

Planning Opportunities for 2020 – Accelerated Deductions (con't)

- Accrual to cash method of accounting conversion ($25 million gross receipts limitation)
- IC-DISC commission producer loans/delayed dividends
- Section 163(j) CARES Act changes
  - Limit increased from 30% of ATI to 50% of ATI for 2019 and 2020
    - ◊ Amended return opportunity for '19 returns
  - Partnerships
    - ◊ Limit remains 30% of ATI for '19 – 50% for '20
    - ◊ 50% of '19 excess interest treated as paid in '20
  - Election to use 2019 ATI in computing 2020 limit
  - Election to continue to use 30% of ATI

Comprehensive Case Study

Lucky Corp. manufactures teeter totters, which is a very cyclical business. Over the past several years their taxable income has been up and down as summarized below:

Year ended	Taxable income (loss)
12/31/14	$300,000
12/31/15	$30,000
12/31/16	$20,000
12/31/17	$50,000
12/31/18	$20,000
12/31/19	($30,000)

Comprehensive Case Study (con't)

During 2020, Lucky is projecting a breakeven year with no taxable income. The Company received a PPP loan for $250,000 and expects it to be fully forgiven. During 2019, Lucky incurred $100,000 in costs related to a building improvement which is depreciated over 39 years and meets the requirements of QIP. Lucky was able to deduct $30,000 in interest expense in 2019 (based on the 30% of ATI limitation) and has a 163(j) carryover of $15,000.

Comprehensive Case Study (con’t)

Key questions/considerations:

1. What is the tax impact of the PPP loan forgiveness?
2. How should we approach the QIP and interest deductions?
3. What is the game plan with the 2019 NOL in light of the CARES Act NOL carryback revision?

Comprehensive Case Study (con't)

Option 1 – Amend 2019 to claim the additional deductions for QIP and interest.

- Increases NOL to $145,000
- NOL can be carried back to 12/31/14
- Refund rate for the carryback would be at 34%

Option 2 – Maximize 2020 NOL

- File Form 3115 to report QIP deduction of $100,000 (less 2019 depr.)
- Pick up additional interest expense from 2019
- Delay filing for PPP loan forgiveness
- Refund rate would be at 15% based on graduated C corp. historic rates
- 2019 NOL would need to be carried back unless elect to forgo carryback

Disclosure Requirements

- Reportable Transactions
  - Listed Transactions
  - Confidential Transactions
  - Contractual Protection Transactions
  - Section 165 Loss Transactions
  - Transactions of Interest
- Form 8886


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Thank you
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SESSION 8

IMPACT OF ARTIFICIAL INTELLIGENCE AND SMART TECHNOLOGY ON THE TAX PRACTICE

DS Davlyatov is a Manager in Tax Technology and Transformation practice at EY. DS is a client facing entrepreneurial trailblazer with a proven track record in developing tax technology strategy, analyzing and defining current/future state operating models and implementing leading tax practice operations. DS' primary focus is technology and business enabled process improvement, TFOs, intelligent automation, data analytics / visualization, and artificial intelligence. DS supports some of the largest accounts in the US developing a wide array of solutions across the entire tax lifecycle to meet analytical, management, reporting and regulatory needs of the Tax function. DS is a CPA in the State of Indiana and holds a dual Master's Degree in Information and Communication Sciences and Accounting from Ball State University. DS is originally from Dushanbe, Tajikistan.

Matt Skaletski is a Senior Manager in Tax Technology and Transformation practice at EY. Matt is a client facing transformation strategist with a proven ability to help organizations transform their tax function and re-think their operating model for the digital age. Matt has assisted large multi-national organizations conduct comprehensive assessments focused on developing tailored global tax operating model strategies enhancing the effectiveness of their tax function. Additionally, Matt has experience leading workshops in all major regions of the world and the design and implementation of shared service centers focusing on streamlining operational activities. Matt has also led the design and development of multi-million dollar business cases, supported through ROI identification and transformation roadmap development. Matt has more than 8 years of tax function performance improvement experience as well as extensive project management and operations management experience and is a licensed project management professional (PMP).

Impact of Artificial Intelligence and Smart Technology on the Tax Departments

October 2020

Presented by

Matt Skaletski
Senior Manager, Tax Technology and Transformation

DS Davlyatov
Manager, Tax Technology and Transformation

EY
Building a better working world

About your presenters

Matt Skaletski
Senior Manager, Tax Technology and Transformation

Matt is a client facing transformation strategist with a proven ability to help organizations transform their tax function and re-think their operating model for the digital age. Matt has assisted large multi-national organizations conduct comprehensive assessments focused on developing tailored global tax operating model strategies enhancing the effectiveness of their tax function.

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Manager, Tax Technology and Transformation

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DS supports some of the largest accounts in the US developing a wide array of solutions across the entire tax lifecycle to meet analytical, management, reporting and regulatory needs of the Tax function.

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Agenda

- Market trends
- Artificial Intelligence (AI)
  - What is AI ?
  - AI benefits
  - AI trends
  - AI use cases in Tax
- Other smart technologies impacting Tax
  - Role of data in Tax
  - Need for data strategy in Tax
  - Data visualization and data analytics tools
  - Data visualization use cases in Tax
- Q&A

Market trends
Organization issues

Legislative change

The volume of local legislation, the speed at which it is changing, the need for greater transparency and the risks and consequences of non-compliance all continue to accelerate.

1

Finance transformation

Many companies are initiating a second wave of investment in their SSCs and ERP in order to centralize the last elements of their local finance function.

2

Digital disruption

Tax authorities around the world are shifting to digital reporting creating opportunity and risk for our clients. At the same time, digitization of company records make it possible to centralize more information, activities, and processes.

3

Business agility

As business transactions increase, we see a demand in supporting companies as a result of the impact on their finance and tax staff.

4

Market trends
Operating model challenges

Operating model challenges

Technology	• Digital disruption • Lack of investment • Sustainable technology solution
Regulatory	• Greater transparency requirements • Increased enforcement activity • Legislative change
Risk	• Risk management challenges • Lack of global transparency • Inconsistent positions
Talent	• Aging workforce and succession challenges • Attracting and retaining professionals
Value/cost	• Finance as a business partner driving value and cost reduction

Market trends

How are companies responding in the current environment?

99% are taking action due to deficiencies in their current operating model.

Talent

83% stated technical competencies are being augmented with process, data and technology skills.

62% spend their time focused on compliance activities.

Technology

65% cited the lack of a sustainable plan for data and technology as their biggest barrier to delivering the tax function's purpose and vision.

Regulatory

57% will spend at least $5m to comply with emerging digital tax filing requirements over the next 5 years.

Cost

79% have a plan to reduce the costs of their tax and finance function over the next 2 years.

COVID-19 is amplifying these pressures

1,013 tax and finance executives around the world responded to the 2020 EY Tax and Finance Operate survey, conducted by Euromoney Thought Leadership Consulting.

EY

What is Artificial Intelligence?

In theory …

Human intelligence is the ability to perceive or deduce information, retain it as knowledge and apply it to make decisions. Artificial intelligence simply puts these abilities in machines.

In practice …

A broad set of technologies that solve real problems now–including computer vision, natural language processing, speech recognition, and machine learning. These technologies can be combined to create new capabilities or solve existing problems.

The benefits of AI

Continuous improvement

Through machine learning, AI learns and improves upon the tasks it’s been asked to perform.

Phenomenal speed

The technology is available 24/7, with processing speeds far beyond human capability.

Frees up time

AI carries out repetitive and monotonous tasks, so people can focus on activities that require judgement, creativity or deep thought.

How does AI work?

Get Data

- Trial Balances
- Invoices
- Contracts

Prepare Data

- Data is split into ‘question’ and ‘answer’ sets

Train the model

- Apply AI framework to identify patterns in data

Validate/Adjust the model

- Evaluate model accuracy
- Adjust the model

Use the model

- Apply the model to new data

$$aX*b=Y$$

Trends: AI in the marketplace

By 2020, insights-driven leaders will steal **US$ 1.2T** from data-aware firms.[4]

By 2020, AI will be a priority for more than **30% of CIOs.**[1]

By 2021, AI-related services will enter mainstream adoption, with **30%** adoption by large companies.[1]

Service providers that do **not embrace** intelligent automation will **not be competitive** and will be displaced from their installed base.[1]

Service providers that embrace intelligent automation have **first-mover advantage** in capturing new deals as well as protecting and expanding share of wallet.[1]

IDC forecasts worldwide spending on cognitive and AI systems to reach **US$ 57.6b by 2021.**[2]

Gartner proposes that through **2021**, the majority of service providers will use intelligent automation service techniques, thus lowering the cost of commodity services by **15% to 25% annually.**[1]

Gartner estimates that the consulting and implementation service opportunity to help enterprises assess, select, implement, adapt talent and change IT and business processes to successfully **adopt AI technologies for business** benefits will drive global spending to nearly **US$ 29b in 2021.**[1]

- Linking data management strategies with **advanced AI tools** is on the cusp of intelligent automation.[3]
- Intelligent automation is the next chapter of **transformation for industries** with defined automation strategies emerging and testing and implementation of myriad use cases.[3]
- Business problems need integrated solutions and organizations need delivery structures that allow **multiple value-creation levers to come together** holistically.[3]

With many **industries** aggressively **investing** in cognitive and AI solutions, spending is expected to achieve a CAGR of **50.1%** over the **2016-2021**.

Source: Gartner[1], IDC[2], HfS[3], Forrester[4]

Use cases: Research tax credit

The challenge

The client enters into hundreds of Statements of Work (SOWs) each year with third-party contractors who assist in designing, developing and testing the client's proprietary software. The client spends a significant amount of time reviewing these SOWs to determine if the contract terms allow claiming a Research Tax Credit for the software developed under SOWs.

The solution

AI model can be used to automatically classify each SOW into two categories – "eligible for credit" and "not eligible for credit" while also assigning a probability factor

The outcome

Potential benefits of this approach is that all SOWs (no matter the number) can be reviewed thus potentially increasing the amount of credit. Additionally, efforts and cost are reduced as many tasks are automated

Use cases: Indirect tax compliance

The challenge

As indirect tax compliance becomes more complex with increased regulatory and reporting demands, many organizations are struggling to keep up with the amount of information they have to review and process. 100K+ lines of Excel data is common place. Many organizations spend hours and hours on manual compliance processes. Additionally, risk of inconsistencies and non-compliance is heightened.

The solution

Problems like these are a perfect fit for AI driven solutions.

The outcome

In practice, we've seen compliance submission processes shortened from 10-15 hours a month to just 3-5 hours. Additionally, errors and risk of incorrect submissions are reduced, and the elimination of most manual processes allows the indirect teams to focus on higher value work, improving internal job satisfaction.

Use cases: Correct item classification for tax purposes

The challenge

Tax departments typically perform tasks that involve reading text descriptions of transactions or assets, and inferring the correct classification of the item for tax purposes. These could be income (e.g., dividend distributions), expenses (e.g., meal & entertainment) transactions, or equipment descriptions.
Currently, tax professionals read lists of these items and manually record the proper classification of the items which is used in downstream tax processing. This consumes many hours of routine and tedious work. The challenge is to train an algorithm to perform the work with comparable accuracy to the human.

The solution

AI model can be trained to determine the proper classification of items

The outcome

AI approach was piloted across various clients where monthly transaction volumes ranged from 250 to 30,000. Accuracy (i.e., level of agreement between the models' recommended classifications and the human experts were in the 90%-99% range).
In side-by-side evaluation of 45,000 transactions, the processing time of the AI solution was 120 hours, compared to the status quo process time of 450 hours, a 73% reduction in effort.

Role of data in Tax

The drive to learn more about customers, markets, and internal operations is not new. Companies have been investing in data and advanced analytics for decades

What’s different today?

The stakes are higher than ever. Business leaders are using data to become more competitive, increase revenues and profits, reduce risk, and guide them to new initiatives.

Tax is no exception.

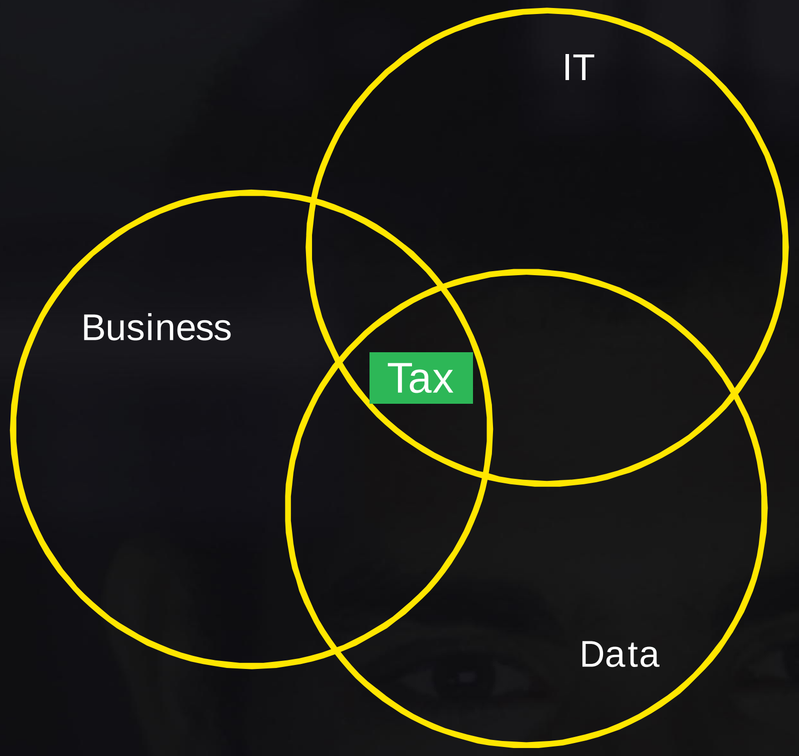
Tax must have an optimal data strategy

What is tax data strategy?

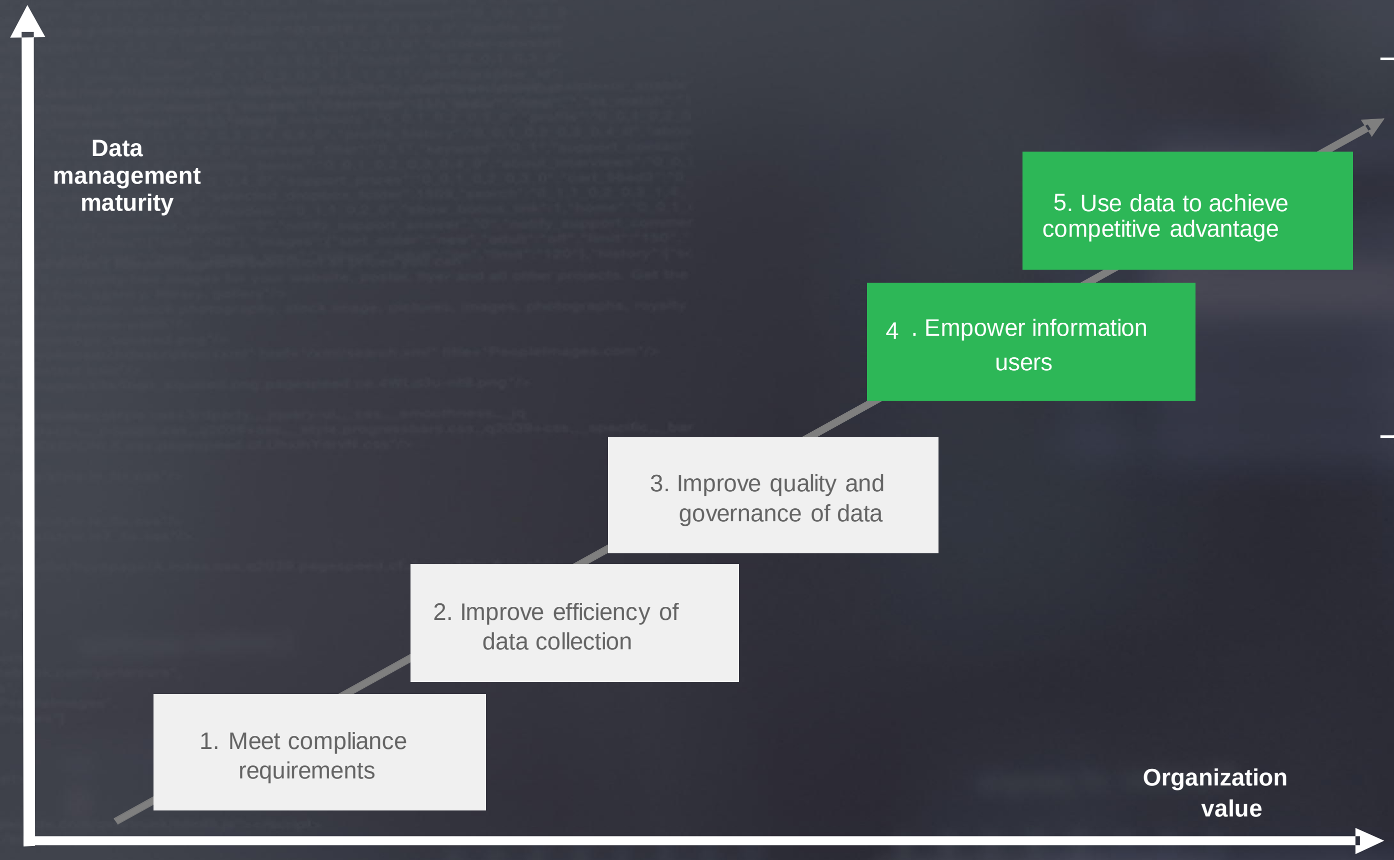
- A comprehensive vision that outlines how data, information and technology are used to meet business objectives
- An actionable foundation for Tax to utilize its data-related capabilities
- A holistic view of how tax data is used and considered and communicated across an organization

Why does Tax need a data strategy?

- There are significant pressures on executives to maintain focus on enterprise data
- Increased regulatory burden around the world raise the risk of non-compliance



Tax data strategy maturity path



This is where we focus

Data processing automation

Data Visualization

Data visualization: Dashboards

Dashboard is a form of data visualization. It is a graphical tool that allows users view and interact with data

Strategic

- Monitors progress against long-term strategic success factors.
- Audience is usually senior management

Operating

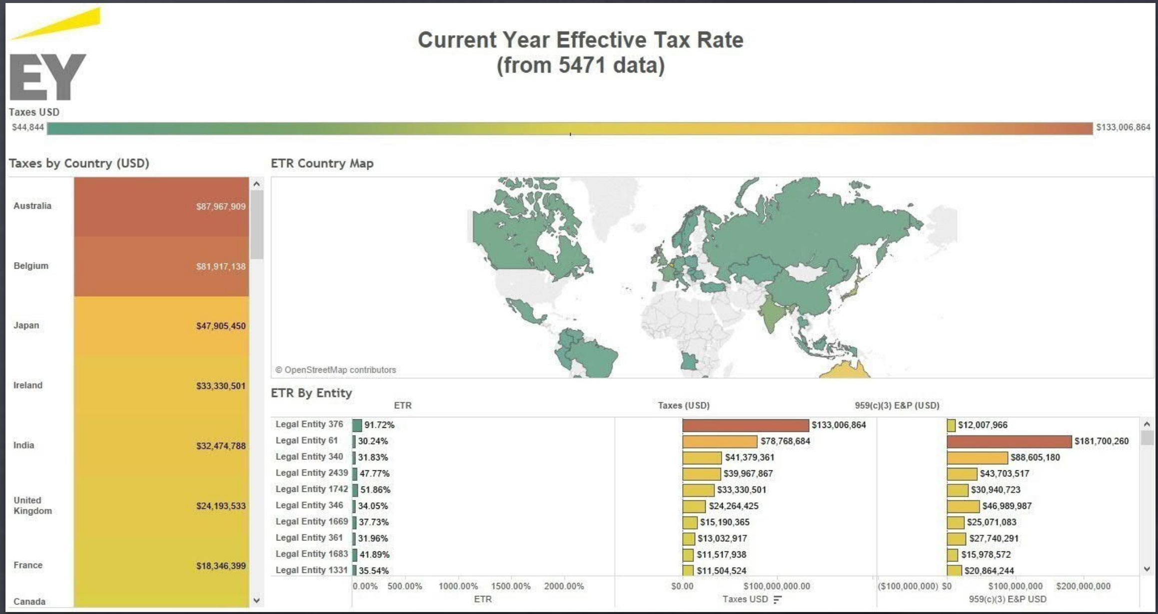
- Focuses on monitoring performance that frequently changes.
- Some can be built with a live feed of data to give real time information

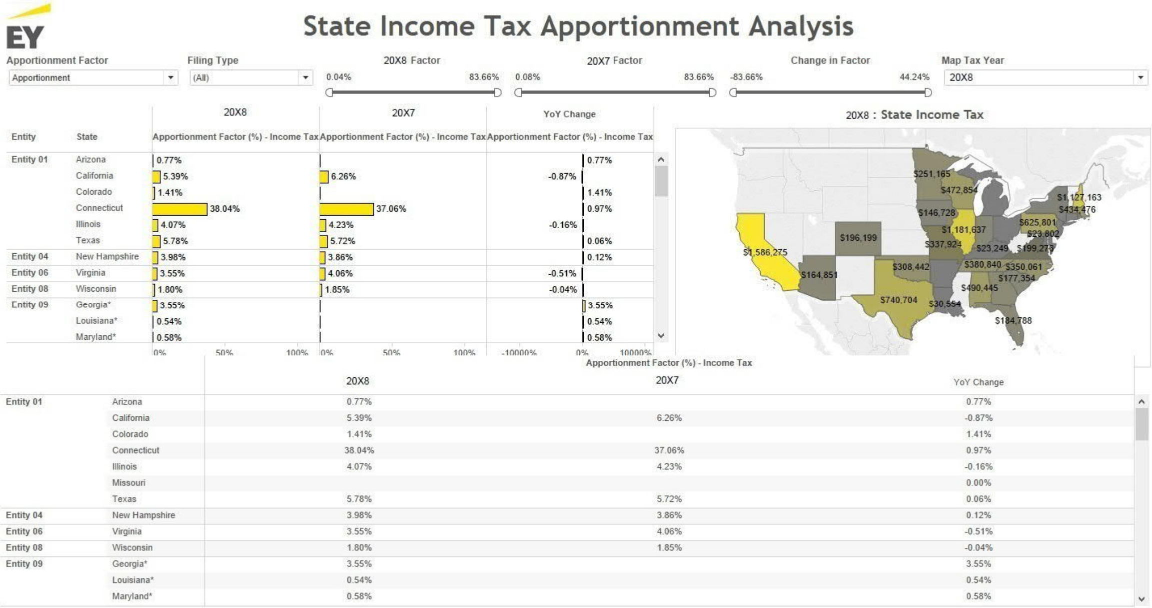
Analytical

- Invites the audience to investigate trend, discover correlations and predict the future.
- Audience is typically a domain specialist with detailed and deep contextual knowledge

Tax Specific Use Cases: Direct Tax

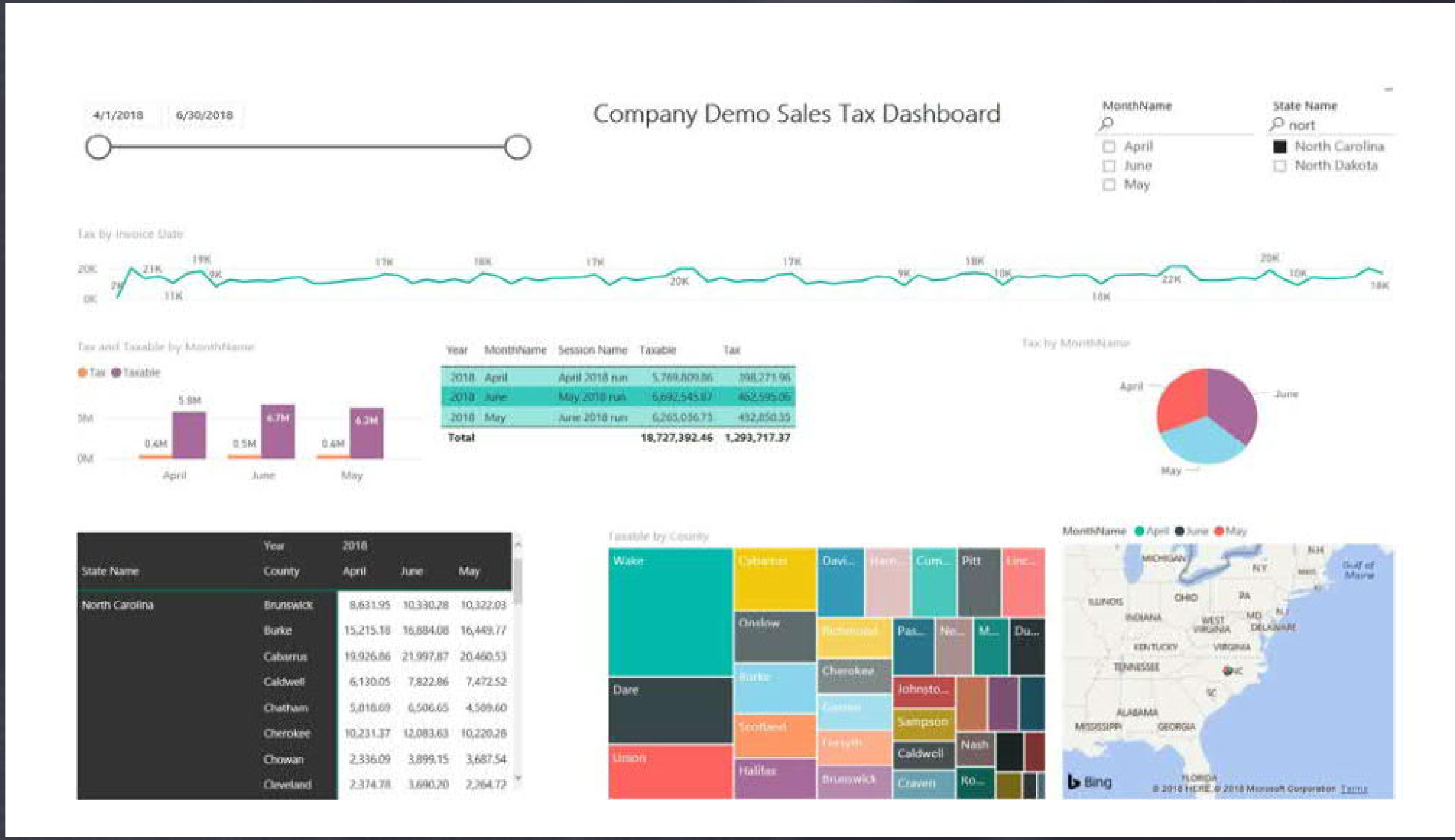
Descriptive visual analytics can add significant value for direct tax. For instance, you can generate strategic tax insights by analyzing domestic tax return data to produce content-rich tax visualizations to drive decisions





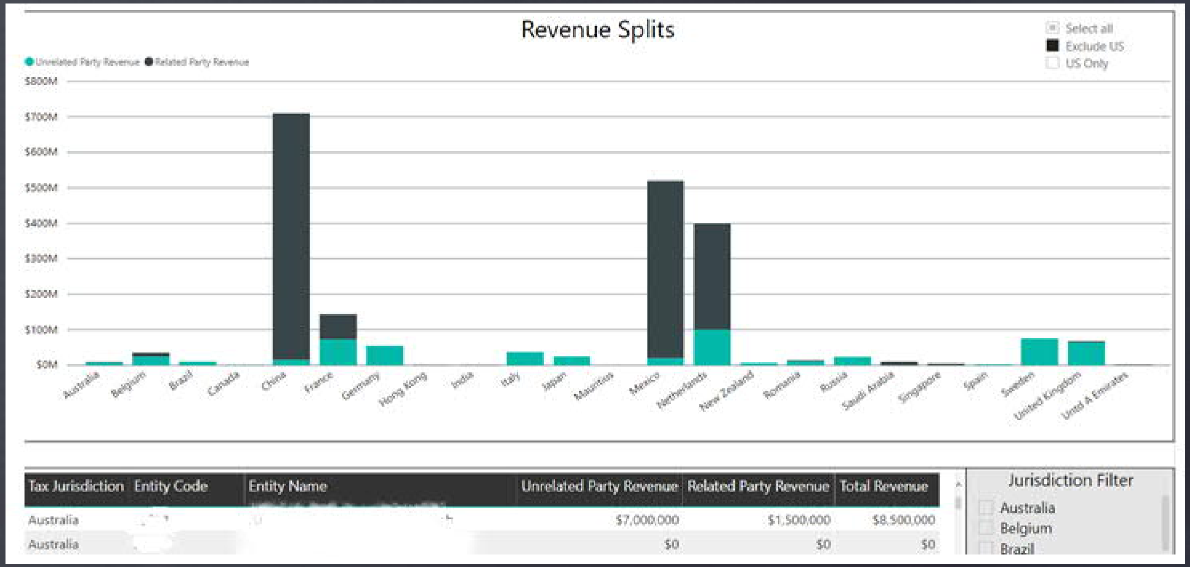
Tax Specific Use Cases: Indirect Tax

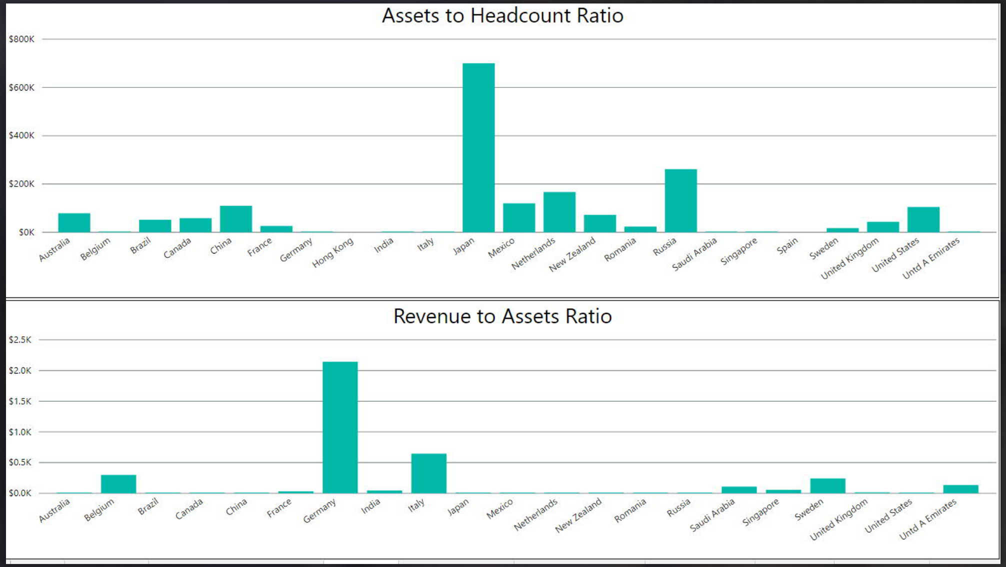
Indirect tax offers considerable opportunities to leverage analytical visuals. The transactional nature, large volume of data, and frequent and complicated reporting make it especially challenging for large companies to manage their indirect tax processes.



Tax Specific Use Cases: Transfer Pricing

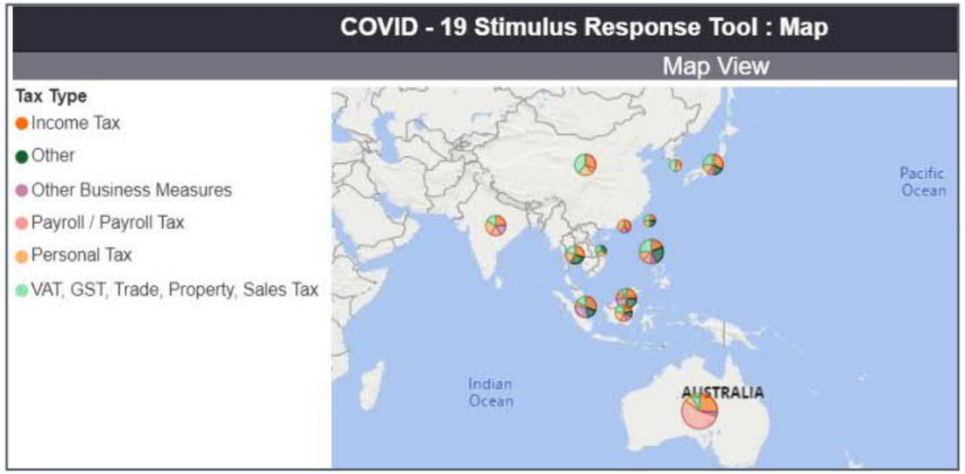
Transfer Pricing Dashboards flag potential outliers and identify risk areas that are likely to be the interest of tax authorities and provide an opportunity to take corrective action where necessary





Tax Specific Use Cases: COVID-19 Stimulus Response Tool

COVID-19 Stimulus Response Tool helps enable an efficient evaluation of the current landscape as it applies to company's unique global footprint. This Tool provides jurisdiction-level visibility, helping companies identify relevant policy and legislation



Within the map you can drill down to a jurisdiction to view the specific incentive details.

Data can be portrayed as the estimated benefits (financial value) or the total number of incentives.

Q&A

Building a better working world


Thank you!
Building a better working world