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Philip S. Gross, Jeffrey S. Bortnick, James D. McCann and Neil Dubnoff of Kleinberg Kaplan offer a checklist of tax issues and tax planning items that hedge fund managers should give consideration before the end of 2016. Topping the list: The presidency of Donald Trump—the authors say that while ''it is more likely that tax changes or reform will be enacted due to Republican control of the White House and Congress, it isn't clear when tax changes will be enacted or will be effective.''

Hedge Funds—Tax Issues and Planning to Consider Before Year-End

By Philip S. Gross, Jeffrey S. Bortnick, James D. McCann and Neil Dubnoff

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This article briefly highlights certain tax issues and planning that hedge fund managers should consider (or reconsider) before the end of 2016.

1. Trump Presidency

With the election of Donald Trump as president, year-end tax planning is ''business as usual''—that is, generally accelerating deductions and deferring income since rates aren't expected to increase in 2017. Since tax rates may decrease in 2017 and deductions may be limited or eliminated as well, 2016 may be an especially good year for such planning.

While there have been various tax proposals put forth by Trump and the Republican Party, and it is more likely that tax changes or reform will be enacted due to Republican control of the White House and Congress, it isn't clear when tax changes will be enacted or will be effective. There has been speculation that changes to tax rates and the taxation of carried interest aren't expected to be effective until Jan. 1, 2018. But no one knows and tax changes made via legislation or otherwise will need to be monitored.

2. Fund's 2016 Tax Picture

Your fund's tax picture should be evaluated throughout the year, but particularly at year-end.

How does your fund's taxable income compare to book? Any unrealized gains that are almost long term that you should consider holding a little bit longer to realize long-term capital gains rather than selling now

and realizing short-term capital gains? Any unrealized losses that you should realize?

Be aware of the wash sale and straddle rules. There may be ways to realize losses and avoid the wash rules while still economically maintaining exposure to the desired positions.

3. Deferred Fees

It is hard to believe, but 2017 is really (finally!) almost upon us and pre-2009 deferred fees grandfathered until 2017 are almost subject to taxation. For managers with deferred fees, they should consider income and estate tax planning for such fees. We have spent a significant amount of time on this topic.

4. Medicare Contribution Tax

Managers need to be aware of the 3.8 percent Medicare contribution tax (also known as the net investment income tax or NII tax) when determining their individual taxes and considering the taxation of investors in their funds.

5. Self-Employment Tax

Managers should consider the impact of self-employment tax and the structure of their management entities. Investment managers should generally be structured as limited partnerships in order to minimize self-employment tax.

6. Changing Your Incentive Fee To an Incentive Allocation

Most offshore funds have restructured their incentive fee to an incentive allocation. If you haven't, you should consider doing so. Restructuring may be beneficial for tax purposes, although the taxation of carried interest may be changed.

Restructuring can be done as a mini-master or master-feeder structure.

Note, if most of your income is short-term capital gain or ordinary income (for example, because you have made a tax code Section 475 election), it may instead be beneficial to retain the incentive as a fee or restructure your incentive allocation as an incentive fee. See item 5 above regarding self-employment tax. Also, see item 14 below regarding carried interest.

7. Consider the Use of Stock-Settled Stock Appreciation Rights

The Internal Revenue Service issued a ruling in June 2014 confirming that certain stock appreciation rights (SARs) won't be subject to the rules set forth in Section 409A and Section 457A. The use, if any, of SARs by fund managers has still been very limited, primarily due to built-in economic clawbacks, significant complexity and the tax benefits of incentive allocations.

There are a number of issues regarding the use of SARs and it would take a significant amount of time to implement a SARs plan, so considering or implementing SARs for 2017 would need to be done very soon.

Multi-year compensation continues to be a topic of discussion with a number of managers. The possible change in the taxation of carried interest may lead more hedge fund managers to consider the deferral of income through SARs as an alternative.

8. Review Swaps If You Are an Investor

If your fund is considered an investor for tax purposes (as opposed to a trader), has swaps that have decreased in value and marks to market its swaps, consider terminating the swaps and realizing capital losses.

If, instead, you simply marked to market the swaps at year-end, their decrease in value would give rise to miscellaneous itemized deductions that would potentially not be useable by your investors.

9. Consider Making a Section 475 Election

A Section 475 election to mark to market securities can offer significant tax benefits. For example, if you are a trader and have significant net unrealized losses, you could elect to mark to market for 2017, thus converting unrealized capital losses at the end of 2016 to ordinary losses in 2017.

If you have unrealized gains, you could realize the gains in 2017 and be subject to tax on the income over four years, but you could also be converting capital gains to ordinary income.

A Section 475 election may offer other tax benefits as well.

10. Re-Evaluate Going Over The Benefit Plan Investor Threshold

With the influx of pension plan investments in hedge funds, the ability to exceed the 25 percent benefit plan investor (BPI) test has become even more important. The registration of hedge fund managers (which is generally required for managers with more than $150 million in gross assets under management) eliminates one of the biggest hurdles in evaluating whether to exceed the 25 percent BPI threshold and comply with the Employee Retirement Income Security Act.

One trend for funds in a master-feeder structure is to hard-wire the feeder funds so that they must invest all investable assets in the master fund.

For managers that have registered, registration is no longer a factor to consider in deciding whether to exceed 25 percent BPI. There are still some uncertainties in what happens when you exceed 25 percent BPI, but exceeding 25 percent may be worthwhile and offer substantial opportunities to grow your fund.

One trend for funds in a master-feeder structure is to hard-wire the feeder funds so that they must invest all investable assets in the master fund. This potentially causes the impact of ERISA to mostly be at the master fund level and increases the total that may be invested

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by BPIs without triggering many of the potentially negative implications of ERISA.

11. U.S. FATCA, U.K. FATCA And the Common Reporting Standard

Fund managers need to evaluate their compliance (registration, diligence, documentation and reporting) with the U.S. Foreign Account Tax Compliance Act (FATCA), U.K. FATCA and the Organization for Economic Cooperation and Development's Common Reporting Standard (CRS).

12. Estate and Gift Tax Planning

Consideration should be given to whether a gift should be made before year-end. Interest rates continue to remain low and a low interest rate environment can provide substantial estate and income tax planning opportunities (such as the use of grantor retained annuity trusts (GRATs) or charitable lead annuity trusts (CLATs)).

13. Charitable Contributions

For taxpayers sitting on large unrealized gains, it may be prudent to contribute appreciated shares to charities in lieu of donating cash. Depending on the type of charity and the holding period for the shares, you may be able to get a charitable deduction equal to fair market value and avoid tax on the gain.

Many hedge fund managers with large taxable income (including deferred fees—see item 3 above) reduce their taxes through donations to charity before year-end. If a manager wants a current charitable deduction but wants to defer selection of the public charities, setting up a private foundation or donor-advised fund before year-end should be considered.

Because Trump's current plan limits the deduction for charitable contributions, 2016 is a good year to make charitable contributions.

14. Carried Interest

Both presidential candidates mentioned the taxation of carried interest as an issue. It isn't clear when, if or how the taxation of carried interest would be changed. This is an issue we are following very closely. If the taxation of carried interest is changed, it may affect the structure of manager compensation.

15. New Partnership Audit Rules

New partnership audit rules were enacted in November 2015 and are scheduled to be effective for audits of taxable years beginning on or after Jan. 1, 2018 (unless elected into earlier). Only limited guidance has been issued to date. Fund documents and side letters will need to be revised (or further revised) in 2017 to address these new rules.

16. New DOL Fiduciary Rules

New Department of Labor rules concerning fiduciary standards were finalized in April and are scheduled to go into effect for investments on or after April 10, 2017. These rules could affect new investments in funds by individual retirement accounts and small pension plans.

It is anticipated that fund documents would need to be revised to reflect these new rules, but it has been speculated that Trump will repeal these new rules before they become effective.