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Congress, President Deliver $2 Trillion Relief Package, Address Many Horse Industry Concerns

By, Bryan Brendle, American Horse Council

Following a week of intense negotiations, on Friday, March 27 House lawmakers finally passed – and the President signed into law - the Coronavirus Aid Relief and Economic Security (CARES) Act, teeing up approximately $2 trillion in emergency aid to American taxpayers, small business, independent contractors and non-profits and charities. Because most equine enterprises characterize themselves as small businesses and include many non-profits such as state associations and equine rescue operations, the package addresses many challenges facing the horse industry. The following are highlights from the relief package.

Small Business, Non-Profits, Independent Contractors - The CARES Act allocates $350 billion to help bridge payroll, rent and related expenses for small business, non-profits and independent contractors. To expedite delivery of resources to applicants, the new law streamlines processes and increases authorities under two existing SBA programs.

Paycheck Protection Program - The bill bolsters the Small Business Administration's (SBA) Paycheck Protection Program (PPP), establishing a maximum loan amount of $10 million per borrower through December 31, 2020. The law defines eligibility for loans as a small business or 501(c)(3) nonprofit with not more than 500 employees "or the applicable size standard for the industry as provided by SBA." Fortunately for large segments of the horse industry, the law further extends eligibility to sole-proprietors, independent contractors, and other self-employed individuals. The expanded scope of the program should provide assistance to trainers, farriers, and veterinarians, among other solo practitioners. Significantly, the law provides that PPP loans will convert to outright grants in whole or in part in the event the recipient uses funds to make payroll, rent, mortgage, and existing business debt. While SBA has not released details related to revised application processes for PPP at this time, the agency is expected to release guidance during the next several days. AHC will post guidance related to PPP on the COVID-19 resources page as soon as it is available.

Economic Injury Disaster Loan Program (EIDLP) - The new law expands the EIDLP to include "any individual operating as a sole proprietor or an independent contractor during the covered period" from January 31, 2020 to December 31, 2020. Luckily for many breed-specific associations and state groups, for example, the bill extends the program to private non-profits. According to SBA, EIDLs "offer up to $2 million in assistance and can provide vital economic support to small businesses to help overcome the temporary loss of revenue." Recipients can use the loans "to pay fixed debts, payroll, accounts payable and other bills that can't be paid because of the disaster's impact." SBA sets interest rates at 3.75 percent for small businesses and 2.75 percent for non-profits. The AHC COVID-19 Resources web page includes links related to the EIDL program and will post updated information as details unfold.

<u>Tax and Payroll Flexibility</u>

Charitable Contribution Flexibility – The CARES Act reverses some limits placed on charitable contributions within the Tax Cuts and Jobs Act (TCJA). The new law encourages Americans to contribute to charitable organizations in 2020 by permitting them to deduct up to $300 of cash contributions, whether they itemize their deductions or not. This provision should assist equine charities including rescue operations and equine assisted activities and therapies (EAAT) facilities that rely on a high volume of relatively small cash contributions.

As you might recall, by effectively reducing the number of taxpayers choosing to itemize their deductions, a key vehicle for charitable giving, the TCJA created a degree of uncertainty for non-profit organizations. TCJA nearly doubled the standard deduction for taxpayers from $6,500 to $12,000 for individuals and from $13,000 to $24,000 for married joint filers. According to the Tax Foundation, a non-partisan think tank based in Washington, DC, approximately 13.7 percent of taxpayers will itemize in 2019, down from approximately 30 percent under the old law.

Charitable Contribution Increases – In addition to creating a $300 exemption for all taxpayers whether or not they itemize their deductions, the law increases the limitations on deductions for charitable contributions by individuals who itemize, as well as corporations. For 2020 only, the law increases the limit for individuals to a full 100 percent of gross income. For corporations, the new law increases the ten percent limit to 25 percent of taxable income.

Employer Payroll Tax Flexibility - The bill allows employers and self-employed individuals to defer payment of the portion of Social Security tax paid with respect to their employees. The law requires repayment of the deferred taxes in two installments: the first half is due by December 31, 2021, and the second half on December 31, 2022. Employers generally pay a 6.2-percent Social Security tax on employee wages. This provision will impact a variety of business entities, large and small. It may apply to equine equipment makers and other manufacturers and merchants that comprise the complex supply-chain for the horse industry.

Modifications for Net Operating Losses - This provision relaxes the limitations on a company's use of losses to offset past and future income. This should prove beneficial to racing and breeding operations, among others. The TCJA limits net operating losses (NOL) to 80 percent of taxable income, and bans a "carry back" to reduce income in a prior tax year. The CARES Act, however, states that a NOL occurring in 2018, 2019, or 2020 can be carried back five years, giving business the ability to amend returns from prior years.

Modification of limitation on business interest - The provision temporarily increases the amount of interest expense businesses are allowed to deduct on their tax returns, by increasing the 30-percent limit to 50 percent of taxable income for 2019 and 2020. Equine businesses which have taken out large loans for infrastructure such as barns and riding facilities should be able to realize more cash-flow through business interest flexibility.

Pandemic Unemployment Assistance – The bill extends unemployment benefits to the self-employed, independent contractors, those with limited work history, and others who are unable to work as a direct result of the pandemic. Self-employed professionals such as trainers and other independent contractors impacted by economic disruptions, including event cancellations, caused by "social distancing" should find this provision helpful.

Individual "Recovery Rebates" - Individuals with adjusted gross income up to $75,000 are eligible for a $1200 cash rebate from the IRS. The amount rises to $2400 for married couples.

While the ink on the 880-page CARES Act continues to dry, lawmakers have wasted no time talking about plans for a "phase four" emergency package. This could include additional tax rebates for individuals, industry-specific aid for "hard hit" businesses, and measures to address unforeseen issues that arise during the next few weeks. AHC will keep you posted on legislative and related administrative developments as they unfold.

"PHASE 2" CORONAVIRUS RELIEF LEGISLATION INCLUDES IMPORTANT TAX PROVISIONS

By, Maddie Schueler, Senior Tax Consultant, Dean Dorton, Lexington, KY

More than one week prior to enacment of the CARES Act, on March 18, President Trump signed legislation providing support to Americans affected by coronavirus. The Families First Coronavirus Response Act, or H.R. 6201, provides for paid sick leave and free coronavirus testing and expands food assistance and unemployment benefits. Notably, H.R. 6201 also provides businesses with tax credits for qualified sick and family leave wages paid to employees.

Paid Sick Leave

Part of H.R. 6201, the Emergency Paid Sick Leave Act, requires government employers and private employers with fewer than 500 employees to provide employees with two weeks of paid sick leave at the employee's regular pay if the employee is unable to work because he or she: is subject to a federal, state, or local quarantine or isolation order related to coronavirus; has been advised by a healthcare provider to self-quarantine due to coronavirus concerns; or is experiencing symptoms of coronavirus and seeking a medical diagnosis.

The amount of paid sick leave per employee is limited to $511 per day and $5,110 total.

The Act also requires these employers to provide employees with two weeks of paid sick leave at two-thirds the employee's regular pay to care for another individual in quarantine or for a child whose school has closed or childcare provider is unavailable because of coronavirus precautions. The amount of paid sick leave for these employees is limited to $200 per day and $2,000 total.

Full-time employees are entitled to paid sick leave for 80 hours. Part-time employees are entitled to paid sick leave for the number of hours they work, on average, over a two-week period.

Paid Family Leave

The Emergency Family and Medical Leave Expansion Act, another part of H.R. 6201, provides certain government employees and employees of private businesses with fewer than 500 employees who have been on the job for at least 30 days with 12 weeks of job-protected leave. Employees qualify for paid family leave if they are unable to work due to a need to care for a child whose school or place of care has closed due to a "public health emergency." A "public health emergency" is defined as a coronavirus emergency declared by a federal, state, or local authority.

The first 10 days of family leave may be unpaid. After the first 10 days, employers must provide employees with no less than two-thirds of their usual pay. Paid family leave per employee is limited to $200 per day and $10,000 total.

Potential Exemption for Certain Employees and Small Businesses

The Act permits the Labor Department to issue regulations allowing employers to exclude certain healthcare providers and emergency responders from paid sick and family leave benefits. The Department also has authority to exempt small businesses with fewer than 50 employees from the paid sick and family leave requirements if complying would jeopardize the viability of the business.

Refundable Payroll Tax Credits for Employers

H.R. 6201 provides for refundable tax credits for employers who provide paid sick or family leave, which can be taken against the employer's payroll or railroad retirement taxes. Employers are entitled to a credit against FICA taxes.

Employers are entitled to a refundable tax credit equal to 100% of "qualified sick leave wages" paid each calendar quarter. "Qualified sick leave wages" are those paid under the provisions of the Emergency Paid Sick Leave Act. The amount of qualified sick leave wages an employer can take into account per employee is capped at $511 per day for employees who are required or advised to self-quarantine or are experiencing symptoms of coronavirus and seeking a diagnosis. For employees caring for another individual in quarantine or a child whose school or place of care is closed, the amount of qualified sick leave wages the employer can take into account is capped at $200 per day. The total number of days an employer can take into account per employee is limited to 10 days for all calendar quarters.

Employers also are entitled to a refundable payroll tax credit equal to 100% of "qualified family leave wages" paid each calendar quarter. "Qualified family leave wages" are wages paid under the Emergency Family and Medical Leave Expansion Act. The amount of qualified family leave wages an employer can take into account per employee is capped at $200 per day and $10,000 for all calendar quarters.

Beyond the wage limits, both the paid sick and family leave tax credits are increased to include amounts employers pay for the employee's health plan coverage while the employee is on leave.

To prevent a double benefit, the law prohibits employers from taking a deduction for the wages paid equal to the amount of any credit received.

Refundable Tax Credits for Self-Employed Individuals
H.R. 6201 also provides for refundable tax credits against the self-employment tax. The sick leave tax credit is 100% of the "qualified sick leave equivalent amount" for self-employed individuals required to self-quarantine or experiencing symptoms of coronavirus and seeking a diagnosis. For these individuals, the "qualified sick leave equivalent amount" is the lesser of their average daily self-employment income or $511 per day.

For self-employed individuals caring for someone else in quarantine or a child whose school or place of care is closed, the sick leave tax credit is 67% of the "qualified sick leave equivalent amount." The "qualified sick leave equivalent amount" for these individuals is the lesser of their average daily self-employment income or $200 per day.

The family leave tax credit for self-employed individuals is 100% of the "qualified family leave equivalent amount." This amount is the lesser of 67% of their average daily self-employment income or $200 per day. Self-employed individuals may receive this credit for up to 50 days.

The provisions of the Emergency Paid Sick Leave Act and the Emergency Family and Medical Leave Expansion Act take effect on April 2, 2020 (15 days from the date of enactment) and expire December 31, 2020. Employer payroll tax credits apply to wages paid beginning on the date selected by the Treasury Department (which must be during the 15-day period beginning on the date of enactment) and ending on December 31, 2020. Likewise, self-employment tax credits apply to the days beginning on the date selected by the Treasury Department and ending on December 31, 2020. Businesses affected by coronavirus should ensure they are complying with the requirements of this legislation and are taking advantage of any associated tax credits that may be available.

TREASURY AND IRS ISSUE GUIDANCE ON DEFERRING TAX PAYMENTS DUE TO COVID-19 OUTBREAK

By Randy Catanese, Esq., Los Angeles, CA

On March 18, 2020, and following President Trump's emergency declaration pursuant to the Stafford Act, the U.S. Treasury Department and Internal Revenue Service issued guidance allowing all individual and other non-corporate tax filers to defer up to $1 million of federal income tax (including self-employment tax) payments due on April 15, 2020, until July 15, 2020, without penalties or interest. The guidance also allows corporate taxpayers a similar deferment of up to $10 million of federal income tax payments that would otherwise be due on April 15, 2020, until July 15, 2020, without penalties or interests. The March 18 guidance did not change the April 15th filing deadline. The Administration, however, subsequently pushed back the filing deadline to July 15, aligning the filing and payment due dates.

CALIFORNIA AB-5 STAKES OUT MAJOR CHANGES IN WORKER CLASSIFICATION

AB-5 is a measure enacted quickly by the California legislature, expressly intended to codify the California's State Supreme Court decision in Dynamex Operations West, Inc. v Superior Court 4 Cal. 5th 903 (2018). Dynamex and AB-5 changed existing law significantly. This new line of authority uses a new test, the "ABC Test" to determine whether workers will be treated as employees or independent contractors. Application of the ABC Test heavily favors findings of employee status instead of independent contractor status, compared to the results of applying California's longstanding Borello test. The Borello test is largely, but not completely discarded by Dynamex and AB-5. Borello remains operative law for some of the exceptions to AB-5.

ABC TEST

The ABC Test provides that unless all three of the following elements are met, the worker is classified as an employee:

A. The worker is free from control and direction of the hiring entity in connection with the performance of the work, both contractually and in fact;

B. The worker performs work that is outside the usual course of the hiring company's business; and

C. The worker is customarily engaged in an independently engaged in established trade or business.

The statute provides for numerous exceptions to the application of the **ABC test**, including the "business to business" exception which small businesses may seek to use to escape the rigid employee-favoring result of The ABC Test. The application of the "business to business" exception to AB-5 remains uncertain. A resolution of the question of the application of the "business to business" exception is doubtless ahead, but there are other challenges ahead of it, as noted below.

Still, the Borello test applies to the exceptions to AB-5's ABC Test, and even within certain applications of the ABC Test.

Borello Test

The overall rule to determine whether the worker is an employee or an independent contractor of the ***Borello*** test is: "*whether the person to whom services is rendered has the right to control the manner and means of accomplishing the result desired*", plus the following nine additional factors:

1. Right to discharge at will, without cause;

2. Whether the one performing the services is engaged in a district occupation or business;

3. The kind of occupation, with reference to whether in the locality the work is usually done under the direction of the principal or by a specialist without supervision;

4. The skill required in the particular occupation;

5. Whether the principal or the worker supplies the instrumentalities, tools, and the place of work for the person doing the work;

6. The length of time for which the services are to be performed;

7. Method of payment, whether by the time or by the job;

8. Whether or not the work is part of the regular business of the principal; and

9. Whether or not the parties believe they are creating the relationship of employer-employee.

The overall rule as well as the nine specific factors in the Borello test are weighed differently, on a case by case basis, depending on the facts and circumstances of the case at hand. In contrast, the ABC Test factors are applied in an *absolute* fashion.

The quick passage of AB-5 left many questions unanswered. Plus, AB-5 caused numerous problems in its application. The answers are being sought, and attempted avoidance of the application of AB-5 have been taking place both by litigation and by numerous legislative efforts to modify and/or replace AB-5.

Litigation

One of the problems is whether or not AB-5 would be effective on a nationwide basis. The U.S. District Court for the Southern District of California issued an injunction against applying AB-5 to motor carriers, including truckers operating in California, until courts had an opportunity to rule on whether AB-5 is pre-empted by federal law. An excerpt from that opinion provided:

> "FAAAA [Federal Aviation Administration Authorization Act of 1994] preemption is broad but not so broad that the sky is the limit: states retain the ability to execute their police power with laws that do not significantly impact rates, routes, or services. Here however, there is little question that the State of California has encroached on Congress' territory by eliminating motor carriers' choice to use independent contractor drivers, a choice at the very heart of interstate trucking. In so doing, California disregards Congress' intent to deregulate interstate trucking, instead adopting a law that produces the patchwork of state regulations that Congress sought to prevent. ***With AB-5, California runs off the road and into the presumptive ditch of the FAAAA. Accordingly, Plaintiff's motion for a preliminary injunction is granted."*** [emphasis added]

Other challenges to AB-5 have been brought in courts. Another federal court case disputes the applicability of AB-5 to journalists and photographers. Still another seeks to challenge the applicability of AB-5 to Uber drivers and Postmates.

The California State Supreme Court has agreed to hear appeals of two cases which seek a determination whether Dynamex applies retroactively. If it does, there will be hundreds of millions in California tax due. The wording of AB-5 states that it is declaratory of existing law, and therefore, if the express wording is upheld, AB-5 would appear to be applicable retroactively.

Legislation

Legislatively, two bills have already been introduced, which if enacted would repeal AB-5's ABC test and replace it with the Borello test. More repeal bills are expected, as well as modification bills. AB-5 places difficult burdens on many businesses, particularly small businesses who staff up for each job. However, knowledgeable observers believe that a legislative repeal of AB-5 has little to no chance.

Other bills have been introduced which would expand the list of exemptions from AB-5 to include small businesses, interpreters and translators, musicians and music industry professionals, freelance journalists without regard to content submissions, and another bill would extend the exemption for newspaper carriers/distributors.

Ballot Initiative

A ballot proposition is being planned for the November 2020 election by Uber, Lyft and Postmates to exempt their workers from AB-5

Other States

Other states such as Illinois, New Jersey and New York are considering adopting laws similar to AB-5. In California, AB-5 is in force, but it is subject to a restraining order issued by a federal court, numerous other court challenges and multiple legislative challenges. California is a left-leaning state with a large Democrat majority in its voter base, and overwhelming Democrat majorities in both houses of its legislature, which enacted the bill. Thus, AB-5 seems likely to continue, subject to the possibility of expanding exceptions.

Business to Business Exception

As it exists, the most promising path to avoidance of AB-5's ABC Test is the "business to business" exception; It provides:

(e) Subdivision (a) and the holding in *Dynamex* do not apply to a bona fide business-to-business contracting relationship, as defined below, under the following conditions:

(1) If a business entity formed as a sole proprietorship, partnership, limited liability company, limited liability partnership, or corporation ("business service provider") contracts to provide services to another such business ("contracting business"), the determination of employee or independent contractor status of the business services provider shall be governed by Borello, if the contracting business demonstrates that all of the following criteria are satisfied:

> (A) The business service provider is free from the control and direction of the contracting business entity in connection with the performance of the work, both under the contract for the performance of the work and in fact.

(B) The business service provider is providing services directly to the contracting business rather than to customers of the contracting business.

(C) The contract with the business service provider is in writing.

(D) If the work is performed in a jurisdiction that requires the business service provider to have a business license or business tax registration, the business service provider has the required business license or business tax registration.

(E) The business service provider maintains a business location that is separate from the business or work location of the contracting business.

(F) The business service provider is customarily engaged in an independently established business of the same nature as that involved in the work performed.

(G) The business service provider actually contracts with other businesses to provide the same or similar services and maintains a clientele without restrictions from the hiring entity.

(H) The business service provider advertises and holds itself out to the public as available to provide the same or similar services.

(I) The business service provider provides its own tools, vehicles, and equipment to perform the services.

(J) The business service provider can negotiate its own rates.

(K) Consistent with the nature of the work, the business service provider can set its own hours and location of work.

(L) The business service provider is not performing the type of work for which a license from the Contractor's State License Board is required, pursuant to Chapter 9 (commencing with Section 7000) of Division 3 of the Business and Professions Code.

(2) This subdivision does not apply to an individual worker, as opposed to a business entity, who performs labor or services for a contracting business.

(3***)*** ***The determination of whether an individual working for a business service provider is an employee or independent contractor of the business service provider is governed by paragraph (1) of subdivision (a)."*** [which is the ABC Test – emphasis added].

The foregoing exception is narrow, particularly when one bears in mind that ***all 12*** elements must be met.

On one hand, on its face, AB-5 does not appear to be either a Democrat or Republican issue, although it was enacted by a heavily Democrat California Legislature. An argument has been made that independent contractors enable employers to avoid paying FICA and FUTA taxes, and the application of some labor laws, particularly overtime and hourly wage laws. On the other hand, taxes are paid by the independent contractors, and a counter argument is that with independent contractors able to take part in the labor force, more work is done, more money is earned and therefore more taxes are paid.

It is true that when all workers are classified as employees, the employers become the government's tax collectors. And it is also true that employers have a higher percentage of tax compliance than independent contractors, at least in part due to severe penalties which are levied against employers if they do not pay over the withholding taxes promptly. Thus, a rationale for AB-5 could be enhanced tax compliance.

Worker classification is an aspect of law that is very much in play and evolving. AB-5 is a controversial law whose future is uncertain. The California Legislature is likely to keep it. But businesses who use independent contractors can be expected to continue to seek to avoid or loosen its inflexible application in the courts, in the legislature and at the ballot box.

IRS ISSUES NEW FINAL AND PROPOSED REGULATIONS REGARDING BONUS DEPRECIATION DEDUCTION

By Randy Catanese, Esq., Los Angeles, CA

The Tax Cuts and Jobs Act ("TCJA") enacted in late 2017 increased the amount of Bonus Depreciation from 50% to 100% of the purchase price for property placed in service after September 27, 2017 and before January 1, 2023, so long as the property is eligible. Generally, horses which are eligible property include racing prospects, racehorses, broodmares and stallions. To qualify, these horses must be used predominantly within the United States. Other property to be eligible must have a recovery period of 20 years or less under the Modified Accelerated Cost Recovery System. The asset must be "placed in service" during the tax year where the bonus depreciation is claimed by the taxpayer. Under the TCJA the IRS was directed to promulgate regulations related to Section 168(k) of the Internal Revenue Code, as amended.

In August 2018, the IRS issued proposed regulations (REG-104397-18) related to Section 168(k). On September 13, 2019, the IRS issued final regulations and new proposed regulations governing the 100% bonus depreciation deduction under Section 168(k). [T.D. 9874 (https://www.irs.gov/pub/irs-drop/td-9874.pdf); REG-106808-19 (https://www.irs.gov/pub/irs-drop/nprm-reg-106808-19.pdf)] The new proposed regulations have included new proposed rules. The regulations have been posted at IRS.gov prior to their official publication in the *Federal Register*.

The final regulations adopt the August 2018 proposed regulations with some modifications. They include operational rules and address how to compute additional bonus depreciation. They also address how to make elections under Section 168(k). The regulations also provide guidance on requirements for property to qualify for the deduction, including used property.

The final regulations are effective for qualified property placed in service. Taxpayers may elect to apply the final regulations to qualified property placed in service after September 27, 2017, during tax years ending on or after September 28, 2017. The taxpayer, however, must consistently follow the rules in the final regulations. IRS provided guidance in the proposed regulations. It related to certain property which is not eligible for additional first-year depreciation, *de minimis* use of used property, components acquired after September 27, 2017 for larger property where construction started before September 28, 2017 and other aspects which were not addressed in the original August 2018 proposed regulations.

OPTIMIZING CHARITABLE GIVING

By Marsha Heinke, DVM, EA, CPA, CVPM, Grafton, OH

2018 Tax Law changes impacted the strategy for annual charitable giving, since the standard deduction increased substantially. The Tax Cuts and Jobs Act increased the standard deduction from $6,500 to $12,000 for individuals (adjusted annually for inflation) and from $13,000 to $24,000 for married joint filers. The change resulted in many more taxpayers taking the standard deduction. The Tax Foundation estimates only about 13.7% of taxpayers will itemize in 2019, down about 17 percentage points from years prior to 2018.

The increase in the standard deduction directly impacts the value of certain taxpayer expenditures that could be deductible through itemization, including donations to charitable organizations. One effective strategy to continue your support of favorite charities and optimizing deductions involves bunching donations into a single year and itemizing, followed by a year or two of no donations and taking the standard deduction. Another attractive option is to establish a donor advised charity fund.

The Donor Advised Fund is an increasingly popular way to obtain a charitable contribution deduction and continue to support your favorite organizations. Financial institutions such as Vanguard, Fidelity, and Charles Schwab have made this a cost-effective option. They provide low-cost, non-profit arms that allow you to establish and irrevocably contribute a larger sum of money to a philanthropic account. Your contribution funds the account and provides a tax deduction for the entire amount, in the year of contribution.

While the gift is irrevocable, you retain control of how and when funds are dispersed from it to qualified non-profit organizations. In future years, you advise the financial institution when and where to make future annual gifts. In those future years, you may opt to only gift through the fund, and take the standard deduction (assuming your other deductions fall below the annual inflation-adjusted limits). You also direct the institution how the funds are invested until you make their disbursement. The funds can be invested in a variety of options: stock funds, bond funds, money market accounts, etc. The investments continue to grow tax free through value increase and interest and dividend returns.

Plan how you will fund the donor advised account. One of the best approaches is to identify appreciated non-retirement fund stock investments you currently own. A direct transfer of appreciated stock to the charitable fund avoids taxable gain in most cases. You are able to itemize a deduction for the full value of the stock thus directly transferred. What is the process for executing this strategy?

- Examine your 2018 or 2019 return, to determine the total itemized deductions you were allowed or would have been, had you not taken the standard deduction. Generally, these are for home mortgage interest expenses and state and local taxes.
- Plan how much you perceive you would like to annually donate to the organizations you support... this can be based on what you have done in the recent past.

- Plan how many years in future you would give these donations. For example, if you typically give $6,000 per year in total to a variety of organizations and plan on doing so for the next 5 years, then a starting point for contribution to a donor advised fund would be, say, $25,000, assuming some growth in the fund annually.
- Compute (or ask your tax accountant for an assist) how this would play out on a tax return, with itemization of deductions including the $25,000 funding transfer and what the tax savings would be as compared to taking the standard deduction.
- Refine how much you wish to initially fund, titrating total funding amount with tax savings.
- Investigate different donor-advised fund offerings on-line, such as those with Vanguard, Schwab, Fidelity and others. Evaluate fees and expenses for these different options, as the costs will be deducted from the fund and reduce the amount available for disbursement to charities.
- Each investment group states minimum initial investment amounts and the minimum account balance to keep the fund open.
- Identify appreciated stock you own in your non-retirement portfolio that has been owned greater than a year. You may wish to work with your advisor, if you are in a managed fund arrangement, to identify specific stocks to transfer and keep your residual portfolio "balanced".
- The appreciated stock must be directly transferred to the charitable fund. Do NOT liquidate your stock holdings. This is a direct transfer of the existing stock. The receiving financial institute will assist you with the details of the transaction.
- Allow enough time before year end to accomplish the foregoing. Paperwork and instructions, as well as stock or other asset transfers require five or more business days to accomplish.

Even if you decide not to use a donor advised fund, do consider supporting favored charities with contribution and direct transfer of appreciated stock. This is an effective strategy for mitigating taxes that would eventually be incurred on the gain realized when long-held stock is redeemed.

International Corner: The Sourcing Rules Often Provide Surprising Tax Results

By Robert Misey, Esq.

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I have never met Bob Baffert and I do not know his tax advisor, but whenever the Triple Crown races occur this year, I look forward to watching him on television with the King from Burger King. Nevertheless, I have always wondered how his tax advisor sources the income he receives from Burger King for being seen with the King.

U.S. persons, such as Baffert, pay tax on their worldwide income. As a result, U.S. persons pay tax on their income regardless of whether that income is foreign-source or U.S.-source.

However, a U.S. person who pays foreign taxes receive a foreign tax credit that is limited by the amount of U.S. taxes on what the Code defines as foreign-source income. Accordingly, these U.S. persons would prefer to see the Code source their income as foreign-source instead of U.S.-source.

Example 1: Winston, a U.S. person, races his horses in France where he earns $10 million of foreign-source income and pays $2.5 million of foreign income taxes. Winston may take a foreign tax credit of $2.5 million against his pre-credit U.S. tax of $3.7 million (37% of $10 million of foreignsource income) and pay only the residual $1.2 million of U.S. tax. However, if the Code characterizes only $5 million as foreign-source income (with the other $5 million being U.S.-source income) and Winston still pays $2.5 million of foreign taxes, the foreign tax credit limitation is only $1.85 million (37% of $5 million). Winston will have paid $650,000 of uncreditable foreign taxes.

The Code's sourcing rules do not have anything to do with whether the income incurs tax in the foreign country. Likewise, a foreign country's taxing rules do not have anything to do with the Code's sourcing rules.

The Code's sourcing rules focus on where the economic activity occurs that produces the income. The Code sources income from personal services based on the location of the services performed. This seems intuitive as the economic activity producing the income occurs at the location of the service. In contrast, the Code's sourcing rules source royalty income from the use of intangibles by the location of the intangibles' use.

Example 2: Skippy, a U.S. individual that rode three winners at the Breeder's Cup, licenses his image to a paper towel company in Argentina for $1 million. Skippy's image appears in print advertisements and on labeling and packaging of the paper towels. Because Skippy is licensing intangibles – his image and likeness – for use in Argentina, Skippy has earned foreign-source income. If Skippy pays any foreign taxes – to Argentina or any other country – he can use that $1 million of foreign-source income to increase his foreign tax credit limitation by $370,000 (37% of $1 million).

So Bob Baffert must determine the character of his income from being seen with the King to determine the applicable sourcing rule. If the character is compensation for personal services, Baffert has U.S.-source income because he performs the service at a racetrack in the United States. However, is Baffert really performing a service, or is he providing intangibles – his image and likeness – by being seen with the King? If we focus on the intent of the parties, my guess is that Baffert intends to perform the services a trainer normally conducts on race day and does not care what the King does as long as the King does not interfere. Similarly, Burger King probably wants Baffert to conduct his usual work as long as Baffert does not denigrate the King. It is easy to conclude that the payment Baffert receives is a royalty because Burger King is not paying Baffert to perform any service beyond what Baffert normally performs on race day.

Baffert must source the royalty by the use of the underlying intangibles. Because the Triple Crown races are broadcast worldwide, Baffert uses the intangibles of his image and likeness both in the United States and in foreign countries (Burger King is not paying a large fee for the few people who see Baffert with the King live at the track). Accordingly, Baffert should source his royalty income between U.S.- and foreign-source income by a reasonable methodology.

Baffert should allocate his royalty to foreign-source income based on the percentage of television viewers outside the United States to those viewers worldwide, a methodology that the IRS has endorsed. In IRS Field Service Advice 1150, a foreign person participated in a famous sporting event while wearing the patch of a U.S. company. The Field Service Advice determined that the payment for wearing the patch was a royalty and recommended apportioning the royalty between U.S.- and foreign-source income based on the percent of the worldwide television viewers located in the United States. This methodology will source some of his income as foreign-source income and increase Baffert's foreign tax credit litigation.

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