RS&F

THE FAMILY OFFICE SOURCE

A tax and business reference for family office principals, executives, and advisers

David S. Rosen
and
Jeffrey S. Rosen

By the author of the Bloomberg Tax Family Offices Portfolio and 2023 Bloomberg Tax Portfolio Author of the Year

Citations and Disclaimer

Unless otherwise noted, the material in this report was produced from David Rosen's source material that was used when he wrote the Family Offices Portfolio and all of the underlying citations are contained in the Portfolio. Virtually all of the topics addressed in the Source are addressed in much more detail in the Portfolio. The Portfolio is a primary source for the Source, with the applicable section mirroring the relevant section in the Portfolio. The Source should not be considered an authoritative guide. Rather, all specific questions should be directed specifically to your advisers. Readers should review the Family Offices Portfolio (and the remainder of the Bloomberg Tax library) for more detailed analysis of the underlying issues described in the Source.

The Portfolio is available to subscribers at www.bloombergtax.com and is cited as T.M. 880-1st, *Family Offices*. We encourage all readers to read the Portfolio, which considers the various issues pertaining to family offices in tremendous detail. Feel free to contact us and we will provide additional information about the Portfolio.

DISCLAIMER: Before using any information contained in these materials, a taxpayer should seek advice based on the taxpayer's particular circumstances from an independent tax adviser. Tax advisers should research these issues independently rather than rely on these materials. This book is a reference for educational use for the community and should not be relied upon without independent verification of the underlying law.

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Big-Firm Sophistication, **Boutique Firm Service**

Dear Family Office Owners and Executives,

I am delighted to present The *Family Office Source*. Growing from just a few family office clients as the 2007-08 financial crisis faded to the preeminent family office boutique has been quite a journey. Over the years, we have helped clients create new family offices and restructure old ones, and even combined a few of them as well.

With over 115 professionals and the family office practice encompassing more than half of our business, it is probably safe to say that RS&F is one of the largest family office accounting firms in the United States.

In July of 2023, we took the next step. The *Family Offices* Portfolio was published by *Bloomberg Tax*. The author and RS&F tax partner, David Rosen, was subsequently named as the Bloomberg Tax Portfolio Author of the Year. The publication is a culmination of more than a decade of work by our exceptional team on countless tax returns, business transactions, estate plans, and other matters.

We are now excited to make our next contribution to the family office industry available to all. The Family Office Source includes a broad overview of all matters important to family offices, and will be updated as the world, industry, and laws change. David and I were excited to collaborate on this resource by leveraging David's work on The *Family Offices* Portfolio, joint editing efforts, and tools I had developed for family office clients.

We also wanted to provide a guide for our clients that did not wish to read the 350+ pages of tax analysis in the *Family Offices* Portfolio, but wanted a comprehensive overview focused on business issues. The Family Office Source is the result of our efforts.

RS&F has a proven delivery model of providing best-in-class planning, advisory, tax, and consulting to family offices under a boutique firm model that is tailored to providing excellent client service.

As a full-service firm, we remain committed to providing an extensive array of accounting services for our clients, but never forgetting that our family office clients deserve family office attention along with family office sophistication and resources.

Sincerely,

Jeffrey Rosen

Jeffrey S. Rosen, CPA, CGMA, MBA
Managing Partner

Getting to Know RS&F

RS&F advises sophisticated family offices, ultra-high net worth families, and upper middle market businesses with significant assets, complexities and opportunities. Planning underlies our client service commitment and approach.

WE ADVISE...

Single and Multifamily Offices

Ultra-High Net Worth Individuals and Families

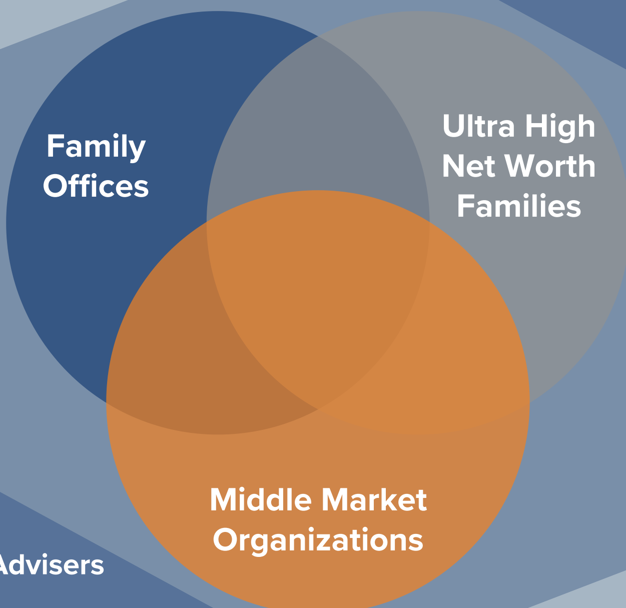
Upper Middle Market Organizations in 15+ Industries

WE ARE...

16 Partners & Directors

100+ Professionals

National Tax and Planning Experts



WE HAVE...

Dedicated CPA and JD Planning Advisers

Family Office Intellectual Property and Thought Leadership

International Resources

The *Family Offices* Portfolio

published by Bloomberg Tax

In July 2023, the first tax treatise on Family Offices was published by Bloomberg Tax (T.M. 880-1st, *Family Offices*), providing a full resource for Family Offices and their stakeholders covering the wide range of tax issues affecting family offices and their owners.

The Portfolio is the primary resource on Bloomberg Tax for many relevant topics, including taxation of family offices, taxation of private aircraft, contributions of complex assets, artwork and collectibles, private trust companies, and tax issues when private foundations hold family investments. RS&F's Chair of Tax, David Rosen, is the primary author of the Portfolio. Following years of devising and executing sophisticated planning for many of the most prominent families in the United States, David focused his second tax treatise on educating family office advisers on nearly every issue that would arise in the family office context, leading to the publication of one of the only texts covering income, estate, and charitable planning in depth.

The Portfolio is available to subscribers of Bloomberg Tax and Accounting and Bloomberg Law, and provides an in-depth analysis of most of the topics covered in this Family Office Report. Please visit www.bloombergtax.com for more information.

Following publication, David Rosen was named Bloomberg Tax Portfolio Author of the Year for the Family Offices Portfolio. The Portfolio is widely regarded as the most comprehensive family office publication to date.

01 Family Offices Overview

Learn the Basics of Family Offices and the Family Office Industry

What is a "Family Office"

A family office may generally be described as an organization that engages in substantial, active management, oversight, and monitoring of a family's business, investment, and personal assets in a purposeful, prudent, and business-like manner. Thus, a family office exists when the family makes an intentional effort to manage their family assets and activities *like a business*. Distinct from merely contributing assets to a holding company, a family office represents a desire for a family to outperform the broader market and provide services to family members that are normally performed by third parties.

Family offices come in all shapes and sizes. Many are quite small, with only one or two full-time personnel, and perhaps only family members. Larger family offices provide investment, accounting, legal, administrative, and concierge services with a team of highly trained and highly compensated personnel. Larger family offices rival hedge funds or private equity funds in complexity.

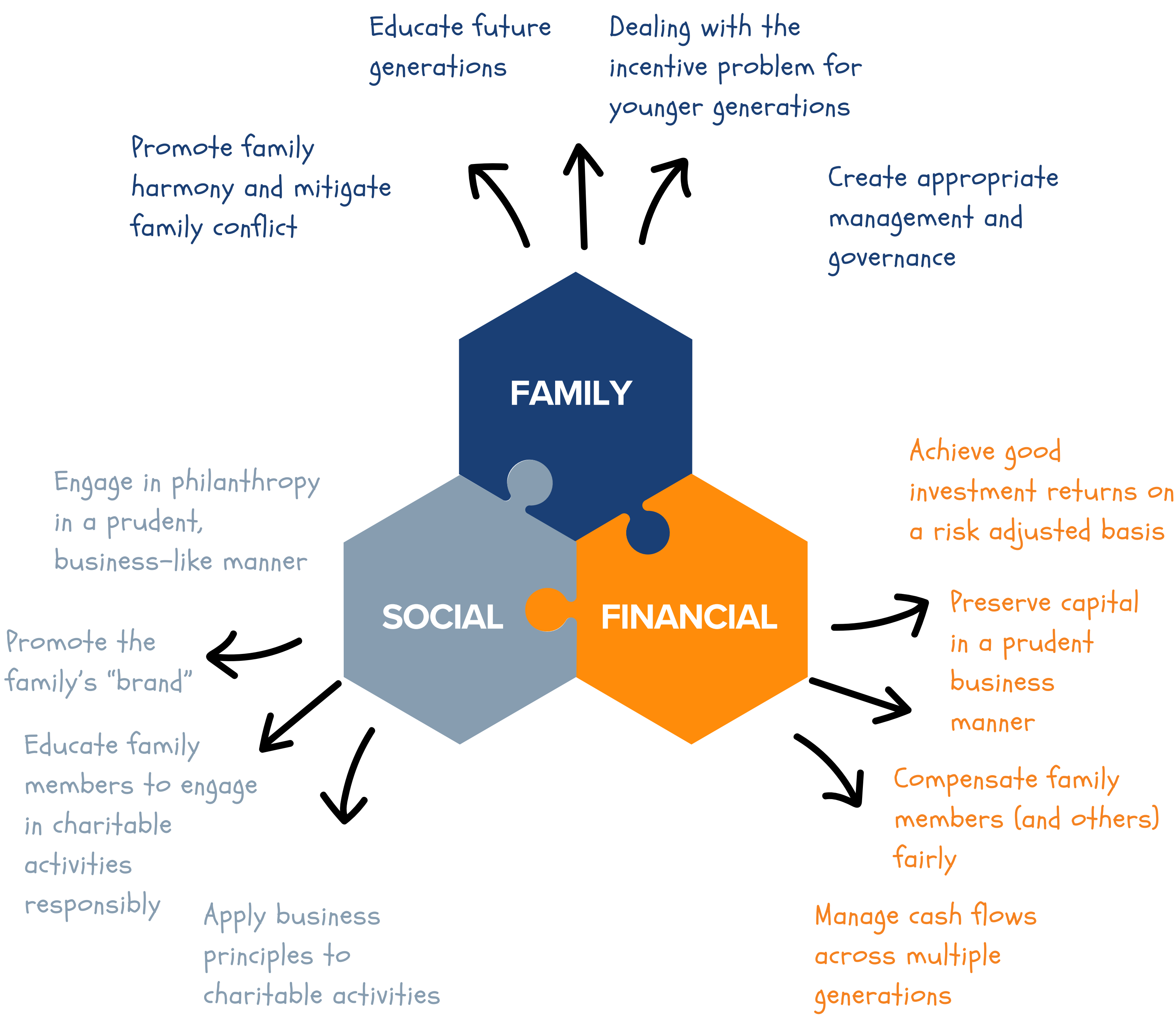
People say "if you have seen one family office, you have seen *one* family office." This statement has a lot of truth. These are very unique organizations. However, at some point, it becomes clear that the organization has become a business.

One way to envision a family office is to think of a private equity fund or hedge fund that is engaged in a full-scale investment business and, on the other hand, think of a family that has a large amount of investments assets that are being wholly managed by a financial adviser with little input or decision-making from the family. At some point, a family's operations and activities begin to resemble the private equity fund much more so than a simple wealthy family.

Once a family achieves this type of organization, we begin to call that business a "family office." The family office may even exist for years, even if the family never uses the term family office. If the family begins to manage their investment assets and devote resources to this purpose as well as other family functions, soon enough a functional family office exists.

We also think two other components are appropriate in defining a family office. First, a family office, even if primarily a wealth management business, maintains committed to a broader set of family goals in addition to its profit-seeking mandate. Second, in referring to a family office, we refer to those organizations in which family members own both the management company overseeing family office services and the fund capital.

The Family Office Framework



Glossary of Certain Terms

FO Manager	Family Office Manager
FO Fund	Family Office Fund
FO Investor	Family Office Investor
FO Family	Family Office Family
Code	Internal Revenue Code of 1986, as amended
Regulations	Treasury Regulations promulgated under the Code
Adviser's Act	Investment Adviser's Act of 1940
Portfolio	The Bloomberg Tax Family Offices Portfolio. Cited as T.M. 880-1st, *Family Offices* (available to subscribers at www.bloombergtax.com)

Benefits of Family Offices
Economic Benefits

Treating a family office as a business leads to substantial positive outcomes. Investment assets are often held in various structures, such as individually, through revocable trusts, or in investment holding companies. While these entities may be operated with appropriate formalities, they may not be run in a manner that maximizes economic performance and achieves business and family goals. A family office, on the other hand, is created to operate as an investment business and outperform mere passive investment holdings.

A well-run family office adopts business practices that lead to better performance, such as employing qualified professionals, implementing disciplined investment processes, and managing cash and financials like third-party investment companies. These practices not only improve performance but also reduce risk. Risk management is crucial for regulatory purposes, as family offices are subject to complex tax and securities law requirements.

Pooling resources through a family office creates efficiencies not available to individual family members. Economies of scale allow access to sophisticated advice, exclusive investments, and favorable business terms with professionals. Family offices can provide personalized investment advice, tax and estate planning services, legal services, concierge services, and general administrative resources. Centralizing services increases the overall service level and reduces costs through volume discounts and consistent service providers. In many circumstances, the family office reduces the costs of required services for family members. The cost to manage investments, for example, may be much lower compared to engaging third-party advisers individually.

Forming a family office creates a positive culture designed to perpetuate good outcomes. By focusing on growing and sustaining wealth and encouraging family members to engage in meaningful and productive endeavors, the family office mitigates wasteful and harmful activities that reduce wealth and create conflict. Developing a family mission and vision statement serves as a foundation for managing family and business activities in a constructive manner over a multigenerational timeframe.

Benefits of Family Offices
Nonfinancial Benefits

Privacy and Security

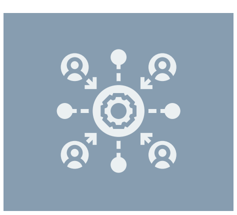
Family offices offer privacy and security for prominent, high-profile families by limiting access to financial information and mitigating risks associated with public disclosure of wealth. They also enhance cybersecurity and serve as a buffer for intra- and extra-familial relationships, handling requests for information through a professional business manager and formal governance structure.

Family Management and Governance

Proper governance and controls are essential for managing family decision-making objectively and professionally. Family summits help share information, foster inclusion, and provide knowledge for family planning needs. Selecting suitable principals for the family office is crucial, as they must work with family members of varying backgrounds and skill sets while handling complex business transactions.

Managing Family Disputes

Family offices can mitigate conflicts through contractual arrangements, such as arbitration, mediation, and cost-shifting provisions, which are incorporated into the operating agreement that binds members under applicable law. These mechanisms help avoid expensive litigation and address intrafamily disagreements effectively.



Centralization of Services

The centralization of services creates efficiencies with shared service providers, reduces costs, tends to create more organization, and allows for higher quality services and talent. Centralization greatly decreases the burden on less sophisticated family members by providing vetted talent to advise family members.

Types of Family Offices

SINGLE FAMILY OFFICE (SFO)

The traditional family office serves a single family. There are believed to be more than 10,000 single family offices throughout the world.

VIRTUAL FAMILY OFFICE

In modern society, the virtual family office allows families to provide support structures and services to family members worldwide, without substantial costs.

MULTIFAMILY OFFICE (MFO)

A multifamily office serves more than one family. Benefits include reduced costs and possibly joining an already successful investment business.

EMBEDDED FAMILY OFFICE

This approach is common with family office functions being housed under a separate operating business with shared employees and resources.

Governance Considerations

Effective governance is critical for a successful family office that can endure across multiple generations. Without structured governance policies and procedures in place, family offices risk mismanagement, lack of clarity around decision-making, and potential family conflicts that can undermine the entire enterprise. When establishing a governance framework, affluent families must carefully consider several key factors.

Family Dynamics: The specific family relationships, communication styles, values alignment, and potential for disagreements or power struggles all shape what governance model will work best.

Complexity of Assets: The more complex the assets and investments under management, the greater the need for professional expertise and clear policies around investment decision authority, risk management, reporting, and compliance.

Long-Term Vision: Governance helps codify and preserve the family's mission, values, and long-term vision for the office across multiple generations of ownership and leadership transitions.

Independence vs. Family Control: Some families want to retain full control, while others are comfortable delegating certain functions to independent boards or advisors. The degree of desired independence impacts governance design.

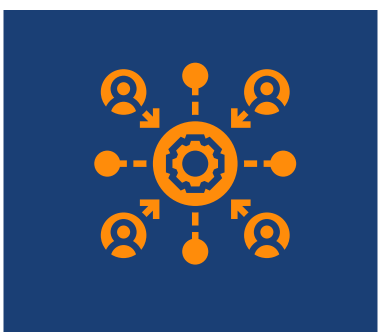
Family Evolution: Any governance model must have mechanisms to evolve and adapt as the family's circumstances, assets, and generational involvement change over decades.

A thoughtful governance design tailored to the specific family situation is crucial for long-term family office success and harmony. Families should take the time to carefully assess their priorities and implement an effective governance model as a foundational element.

Dealings with Family Members
General Considerations

Distributions: Determining the amount, manner and timing - without conflict.

Educating Future Management and Investors: Preparing family members for perpetual stewardship of wealth.

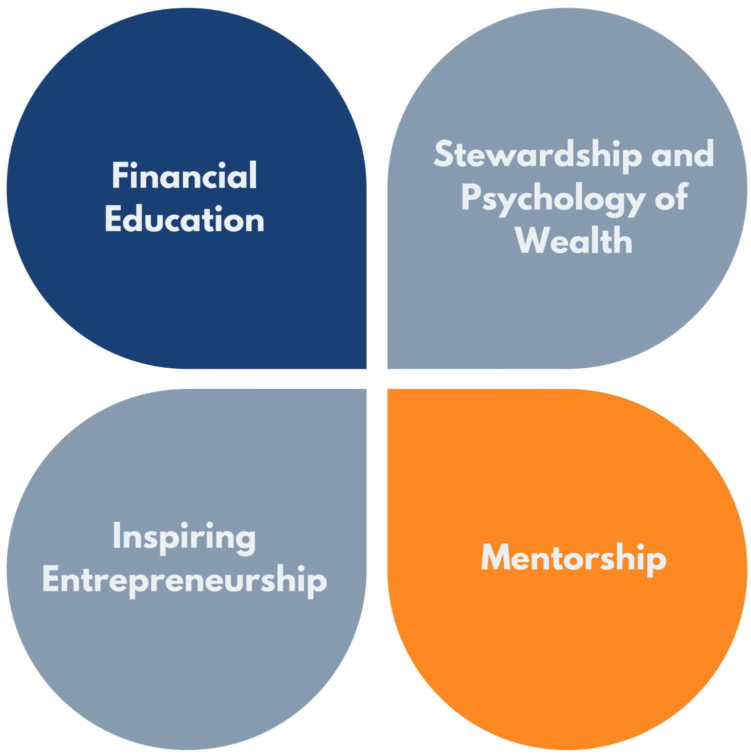


Identifying and Integrating Successor Management: Talent acquisition and integration should mimic for-profit companies.

Holding Family Summits: Adopting formal coordination of family office and family affairs is critical for long term success.

Dealings with Family Members
Coordination with the Family Office

Dealing with family members is a critical aspect of managing a family office, and one of the inherent conflicts is balancing the distribution of funds to family members with the need to retain and reinvest cash for long-term growth. Stewardship of a family office requires managing this balance, and creating a fair, transparent, and mutually agreeable distribution approach is fundamental to its success. The following represents education topics addressed by a typical family office:



Identifying and integrating successor management is critical for the long-term success of a family office. Family office leadership may be found among family members, particularly in the first two or three generations.

However, obtaining buy-in from other family members, willingness of the chosen individual to devote their career to the family office, acceptance by nonfamily employees, and proper training are all important factors. A successful management transition requires cooperation between the board, family council, and management to align the interests of active and passive family members, as well as key employees.

Family meetings or summits are common in later generations, serving purposes such as reviewing performance, sharing information, delivering educational content, messaging changes, facilitating socializing and bonding, showcasing next-generation leaders, providing legal and tax updates, and addressing group-level questions and concerns. These meetings help maintain harmony, mitigate ongoing conflict, and ensure the family office continues to meet the evolving needs of the family.

Dealings with Family Members

Governing Bodies Used by Family Offices

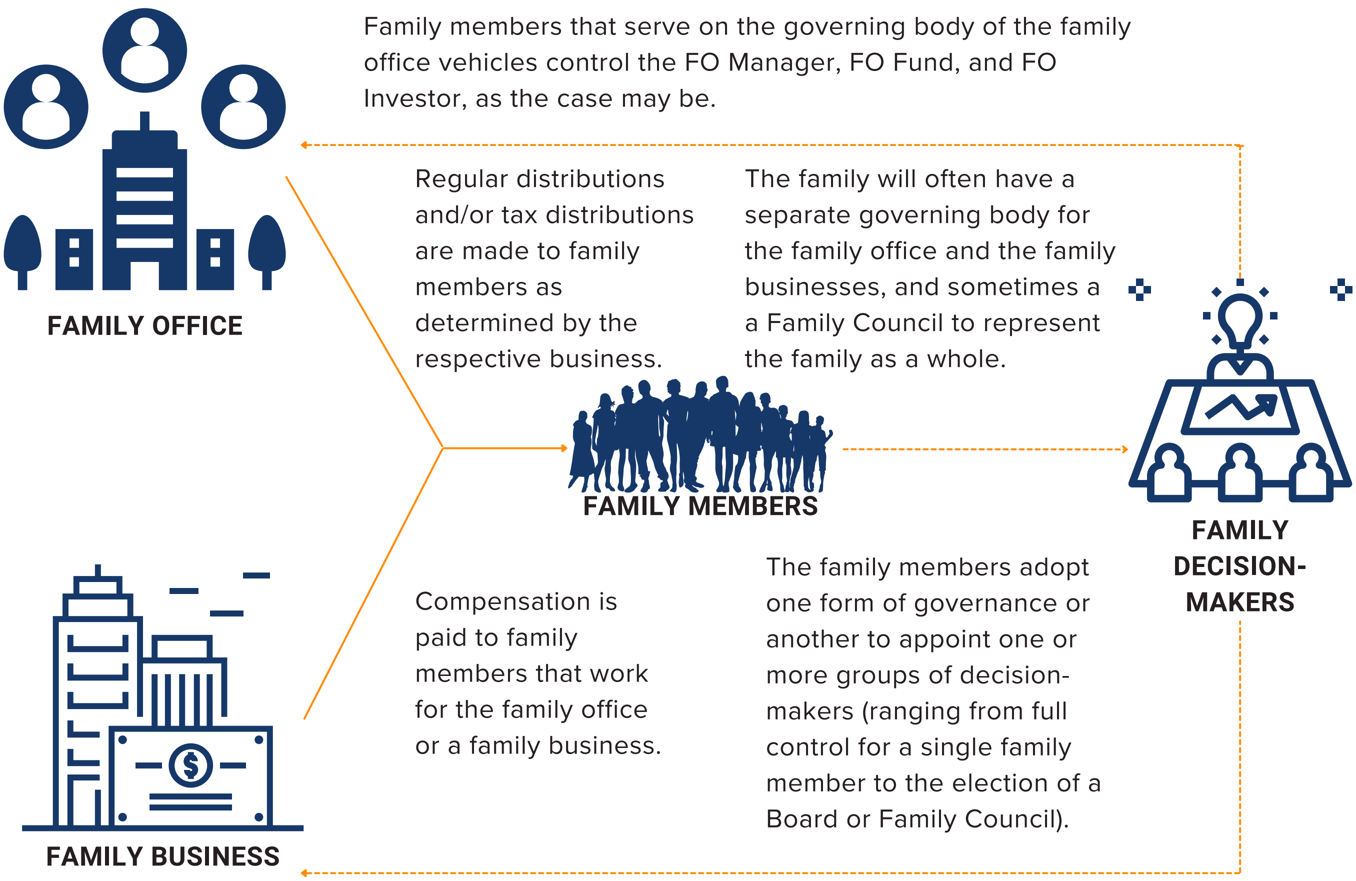
Board of Directors with substantial authority and control.

Board of Advisors often involve sophisticated personnel, but without control vested in a Board of Directors.

Family Council generally represents the interests of family members, similar to a body representing shareholders.

Other management approaches ranging from informal (*e.g.*, founder with full control of the various entities) to formal (*e.g.*, voting trusts,) are used by family offices.

Relationship Between Family Office and a Family Business



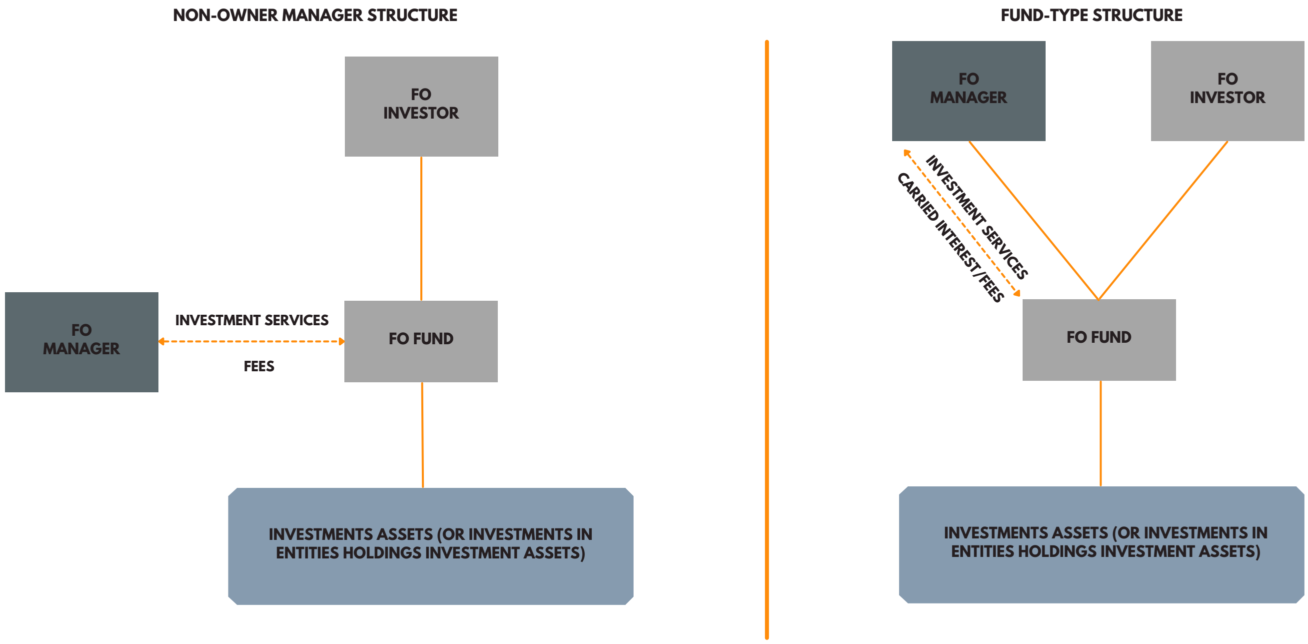
Family members that serve on the governing body of the family businesses (e.g., Board of Directors, Executive Committee, etc.) act on behalf of the underlying businesses. A separate governing body would also exist for any family foundation.

02 Forming the Family Office

Forming a Family Office, Structure the Various Family Office Entities, and Related Tax Issues

Family Office Structure

A basic depiction of family office structures is below:



The basic model for a family office is that it functions as an investment company in which the FO Manager is responsible for managing assets and performing services in exchange for fees or compensation. The owners of the assets enter into a business arrangement with the FO Manager which is intended to pay the manager an agreed upon amount of fees and profits in exchange for services. The family members, as the owners of the assets directly or through entities and trusts, will receive the benefits and bear the costs of the family office arrangement.

- The tax structure of a family office normally utilizes a fund-type structure (similar to the above charts).
- Family office managers provide investment services and may need to be registered as investment advisers. Thus, family office managers are generally formed as corporations, limited liability companies, or limited liability partnerships based on advice of corporate counsel.
- Family office fund entities tend to be formed as limited liability companies or limited liability partnerships in states with robust protections for investors, such as Delaware or Nevada.
- State tax planning is a major consideration for family office structuring, particularly when personnel will work from different states on behalf of the family office.

The Family Office Manager

The Family Office Manager ("FO Manager") is responsible for the management of the family office and is normally a separate entity that functions as the "family office" business. The family office performs investment and management functions and operates as a typical investment business in most respects, hiring employees, leasing office space and equipment, and performing back-office functions.

The FO Manager is normally compensated through either a fee paid pursuant to a management agreement, or is issued a carried interest and receives a combination of a fee and profits interest paid to the FO Manager under a fund operating agreement.

The payment of a management fee is not inherently tax efficient. The payment by a fund to an FO manager is generally allocable to the respective activities (i.e., managing investments). These activities may be nondeductible if the investments are subject to §212 or if the underlying activities are personal in nature. Note, however, that if the underlying activities are trade or business activities, such as real estate or most private equity investments, then the expenses allocable to such trade or business activities are deductible as trade or business expenses.

In exchange for a substantial amount of economic risk in the form of a profits interest, a carried interest structure is much more tax efficient. Similar to the structure used in Lender Management, the allocation of a carried interest has the effect of shifting income to the FO Manager - which has the effect of a deduction - but does not trigger a disallowance of a deduction under §212.

OPERATIONAL RESPONSIBILITIES OF THE FAMILY OFFICE MANAGER

Determine overall investment strategy	Manage existing investments
Financial planning for family members	Negotiate transactions and financings
Tax compliance	Monitor and oversee third party investment managers
Trust and investment administration	Personal concierge services (e.g. travel, household)
Accounting and financing reporting	Managing banking and bills
Estate and insurance planning	Coordination with third party advisers

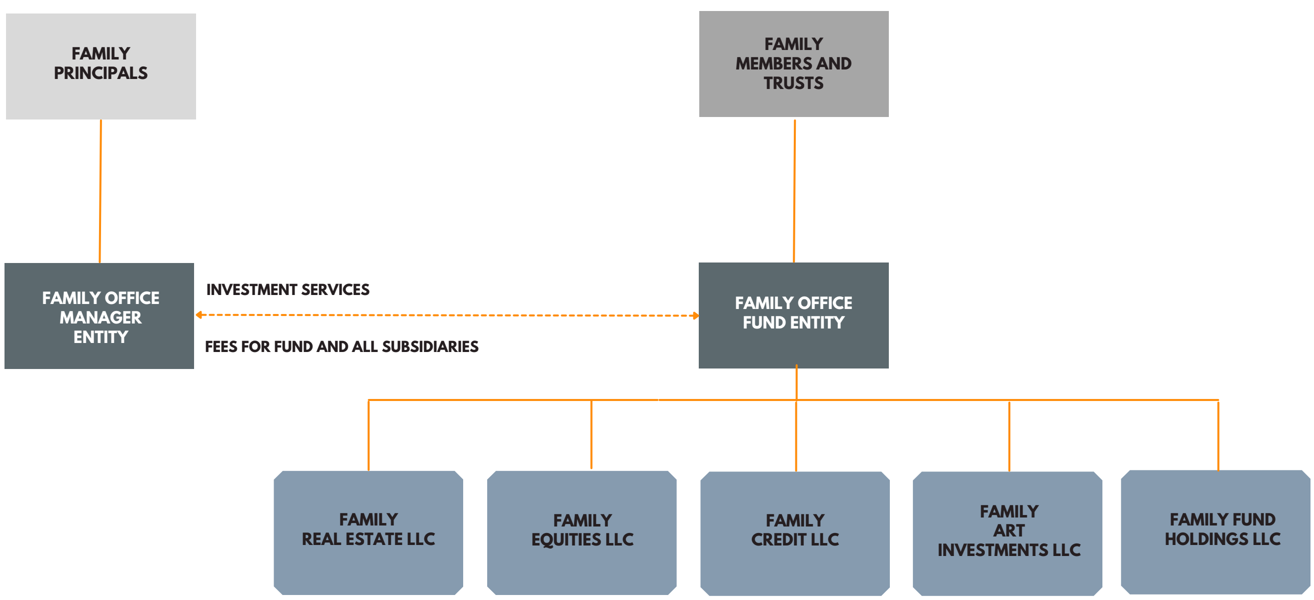
Nevertheless, the FO Manager's direct expenses could be disallowed as investment expenses under §212 if the FO Manager is not in the trade or business of investment. To mitigate this risk, a family office may instead elect to be treated as a C corporation, which is presumed to be a trade or business. Using a C corporation in an investment company structure does, however, risk the implications of the accumulated earnings tax and personal holding company rules.

Ultimately, in a well-functioning family office, a family office manager replicates the efficiency of a third-party fund manager or RIA and is compensated in a similar tax-efficient manner.

Family Office Funds

Generally, two primary models have been used to hold investment assets: corporate holding companies (e.g., Berkshire Hathaway) and the GP/LP/Fund model popularized by the private equity and hedge fund industries. The latter approach - emulating the fund industry - has been adopted by most family offices. Thus, most family offices utilize some version of a "fund" model, typically using a partnership (for tax purposes) to hold assets and a separate third-party entity serving as the manager of the fund, normally in exchange for compensation. The compensation to the manager may be in the form of fees paid by the fund or a carried interest issued to the manager by the fund (which would convert the manager to a partner in the fund).

A typical family office may form one or more funds to hold investment assets. For tax purposes, such funds are typically set up either as separate partnerships or a single partnership with various single member LLCs representing different investment strategies. Below is an example of a family office fund structure in which investments are segregated into different single member LLCs and the family officer manager charges fees.



The fund entity itself has no employees and no operating activity and is itself not a trade or business. Thus, direct expenses borne at the fund level are passed through to its owners and deductible or not deductible based on the tax treatment of its partners (who are normally treated as passive investors for tax purposes).

Family Office Investors

Family office investors are comprised of individuals, trusts, corporations, and pass-through entities owned by these persons. For tax purposes, the use of a pass-through entity as the investor in a family office fund does not generally create any tax savings (the tax attributes of a holding company will pass through to the investors in any event). Nevertheless, many investors use pass-through entities to hold investment in family office funds, for a single person, family, or family branch.

REASONS TO USE INVESTOR ENTITIES TO INVEST IN A FAMILY OFFICE FUND

Selecting Assets to Contribute to the Family Office

When a family decides to form a family office, one if the major questions that arise is what assets should be contributed to the family office fund entities?

In making this decision, families must consider their overall investment and economic objectives, cash flow needs, estate planning goals and existing planning, regulatory concerns, securities laws, and overall family dynamics. Many families, utilize the family office as the mechanism for addressing the range of economic and family issues that arise with respect to family assets. In such cases, the family would contribute most (if not all) of their investment assets to the family office fund entities and agree to be subject to the terms of the family office legal arrangements.

When contributing assets, the family should make arrangements to address potential disparities, variances, or inequities. Examples include potential phantom tax liabilities resulting from sales of contributed property, personal guarantees, personal services provided to underlying entities without adequate compensation, or valuation issues.

Outside Holdings to be Managed by the Family Office

For a variety of reasons, some assets are not contributed to the family office fund and remain outside of the family office ownership structure. Nevertheless, many of these assets are complex and managed by the FO Manager. Examples of these assets include residences and vacation homes, private aircraft, boats and yachts, closely held rental real estate, and closely-held businesses that have limited resources.

A family office should charge management fees for services related to such activities (especially if it is charging profit-making fees through a profits interest). If the expense is allocable to a trade or business activity, the expense is deductible (e.g., rental real estate). However, if the expense is allocated to investments or personal activities, then such expense would not be deductible.

As with all related party fees, such fees should be based on market rates and negotiated at arm's length or established with independent third-party input (the amount of input based on counsel's advice).

Securities Law Considerations
Overview

A family office is subject to substantial securities regulations. These securities laws impact manner in which a family office is structured, its ongoing compliance obligations and the potential investments of the family office. A family office is almost always impacted by the securities laws the United States and jurisdictions in which the family office conducts business. With careful advanced planning, a family office may be structured to comply with applicable securities laws and minimize costs.

INVESTMENT ADVISORS ACT OF 1940

Governs operations of investment advisors.

SECURITIES ACT OF 1933

Governs issuance and sale of securities in the United States.

INVESTMENT COMPANY ACT OF 1940

Regulates organizations and companies that engage in investing and trading.

COMMODITY EXCHANGE ACT

Governs investments in “commodity interests.”

Securities Law Considerations
Investment Adviser's Act of 1940

The Investment Advisers Act of 1940 (Advisers Act) governs the operations of investment advisers, and unless an exemption is available, a family office needs to register as an investment adviser and comply with ongoing reporting and operational requirements. Given the time and expense of registering and operating as an investment adviser, most family offices are purposely structured to qualify for an exemption or exclusion under the Advisers Act.

The Act introduced new exemptions based on whether the family office manages solely private investment funds with less than $150 million of assets under management (Private Investment Fund Exemption) or qualifies under the Family Office Rule.

The Private Investment Fund Exemption exempts a family office from registration if it has assets under management in the United States of less than $150 million. However, the family office still needs to file a short-form Form ADV and test annually for the exemption. Additionally, the family office may be subject to state-level regulation and registration unless an exemption is available.

The Family Office Rule excludes any family office from the definition of investment adviser. To qualify, a family office must (1) have no clients other than family clients, (2) be wholly owned by family clients and exclusively controlled by one or more family members and/or family entities, and (3) not hold itself out to the public as an investment adviser.

A trust company formed and supervised under state law is exempt from registration as an investment adviser under the Advisers Act but is subject to state banking regulation. While some states have attractive banking regulatory structures, the uncertainty and cost of the applicable banking supervisory requirements lead most family offices to avoid relying on the trust company exclusion, with the Family Office Rule generally being a more attractive option if available.

Securities Law Considerations

Family Office Rule

All clients of the family office are a "family client," including family members, former family members, key employees and former key employees, charitable organizations, and certain trusts for the benefit of a family client.

The Family Office is wholly owned by family clients (which may include key employees) and is exclusively controlled by one or more family members and/or family entities.

The Family Office does not hold itself out to the public as an investment adviser.

Tax Issues Upon Formation
Start-Up Costs

The start-up costs associated with family offices can be substantial, including legal fees, accounting fees, office expenses, filing and registration fees, technology, and other costs. These organizational costs are generally not deductible for income tax purposes, but taxpayers may elect to deduct a limited amount and amortize the remaining balance over a 180-month period.

Start-up expenditures are amounts paid or incurred in connection with investigating, creating, or engaging in an activity for profit before the active trade or business begins. Similar rules apply to partnerships and corporations, with limited deductions allowed for organizational expenses if an election is made, and amortization of the remaining balance over 180 months.

Determining when a business begins is a question of fact based on the circumstances. A partnership or corporation begins business when it starts the operations for which it was organized. Courts have held that a business begins when all necessary assets are acquired, and the nature of the business has been established.

For a family office manager (FO Manager), determining when the business begins can be challenging, as it may not be apparent that the operations constitute a trade or business. If an FO Manager operates as an investment activity subject to §212, expenses must be deducted or disallowed under §212 principles rather than treated as start-up expenses. The later conversion to a trade or business does not change the former §212 expenses into start-up expenses.

Tax Issues Upon Formation
Partnership Gain or Loss

When family members contribute investment assets to form a family office, complex tax rules allocate income and deductions to account for the difference between the economic value of each contributor's interest and its tax basis. These rules are crucial for creating an equitable family office structure, especially for assets like real estate, as the tax basis differential is itself an asset (or a liability) at the time of contribution.

Contributions to family office partnerships are generally tax-free. No gain or loss is recognized by a partnership or its partners when property is contributed in exchange for a partnership interest. However, an exception applies when property is contributed to certain investment partnerships, resulting in the recognition of gain, but not loss, if the partnership would be treated as an investment company under §351 if it were incorporated. If a partnership is treated as an investment company, then if is considered to be diversified as a result of the contribution, gain or loss would result on a contribution.

A company is an "investment company" if it holds 80% of its assets in certain categories of investments (generally marketable securities). An investment company is diversified if after the transfer, the owners meet certain tests that reflect their ownership is less concentrated. If that occurs, the contribution is taxable because it is akin to trading liquid assets to the partnership in exchange for a diversified portfolio.

Nevertheless, diversification is typically not a barrier to forming a family office because the aggregate asset holdings tend to have more than 20% of acceptable assets. A more in-depth discussion can be found in the Portfolio.

A contributing partner's basis in their partnership interest equals the sum of money and the adjusted basis of property contributed, increased by any recognized gain under §721(b). The partnership's basis in contributed property is the contributing partner's adjusted basis at the time of contribution, increased by any recognized gain under §721(b). Partners are entitled to basis equal to their share of liabilities, and a contributor's basis is increased by the amount of liabilities deemed contributed under §752(a).

Tax Issues Upon Formation
Section 704(c) Implications (General)

When family members contribute assets to a family office entity, special allocations of income or loss apply to the contributed property to account for the difference between the property's basis to the partnership and its fair market value at the time of contribution. These rules, governed by §704(c) and its corresponding regulations, aim to prevent the shifting of tax consequences among partners for precontribution gains or losses.

Section 704(c) property is property contributed to a partnership with a book value that differs from the contributing partner's adjusted tax basis. The Regulations require that a partnership make allocations in a manner to account for these disparities, generally in a manner to reduce the relative tax basis differential in a rapid manner. In most cases, the main effect of these allocations are to (1) change the amount of depreciation or amortization that is allocated for tax purposes every year, and/or (2) change the amount of gain that is allocated for tax purposes when assets are sold.

- The regulations provide three generally reasonable methods for making allocations related to §704(c) property: the traditional method, the traditional method with curative allocations, and the remedial method. Most family offices choose the traditional method, which allocates deductions relatively slowly to noncontributing partners to make up the basis differential.

- Built-in gain or loss is the difference between the property's book value and the contributing partner's adjusted tax basis upon contribution. When a partnership interest is transferred, the transferee partner must be allocated the share of built-in gain or loss as it would have been allocated to the transferor partner.

To address these disparities, partnerships periodically revalue or "book up" their assets every time certain equity transactions occur, such as contributions, liquidations, and distributions. These revaluations create new §704(c) built-in gains or losses, known as "reverse §704(c) allocations."

The complexity of revaluations lies in the creation of “layers" reflecting an asset's valuation every time these equity transactions occur, requiring the tracking of book and tax attributes for each asset at every layer. This is particularly challenging for family office entities that receive disproportionate contributions on a regular basis.

Tax Issues Upon Formation

Section 704(c) Implications (Specific to Family Offices)

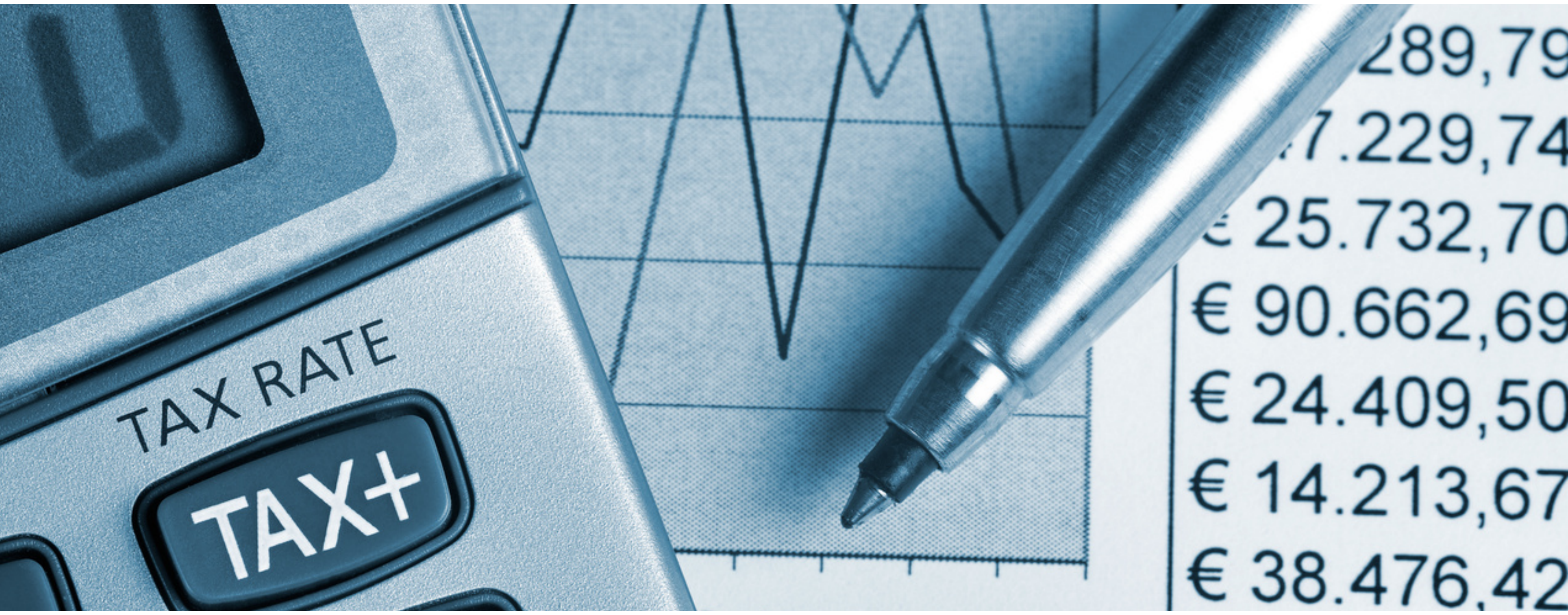
The §704(c) rules are essential for family office entities because they are often formed by taxpayers contributing appreciated assets to newly formed partnerships in exchange for partnership interests, while other taxpayers contribute cash, notes, or other assets. Complying with §704(c) is mandatory and a required feature of family offices, which must plan for tax allocations that may diverge materially from cash flows in a family office fund.

The most obvious consequence of §704(c) allocations is that gain from property disposition is specially allocated to the contributing partner when the property is sold to recognize the built-in gain existing at the time of contribution. This can lead to a contributing partner being allocated a substantially higher proportion of taxable gain compared to the cash distributed to them.

Family offices use various mechanisms to address these tax-cash disparities, such as allowing distributions to pay the tax based on taxable income allocations, permitting redemptions of interests in the family office fund or upper-tier investor, or providing loans to the affected partner that can be repaid out of future distributions.

Family offices that make frequent contributions and distributions face additional complexity in tracking §704(c) layers. Each partner would have §704(c) gain for each period in which they hold an interest, with each period beginning and ending on the date of a contribution, distribution, or other event as set forth in the regulations.

A similar effect occurs in securities partnerships, in which aggregation is generally not permitted for partnerships with fewer than 10 unrelated partners. If the aggregation rules are not allowed, the fund must apply the §704(c) gain or loss to each partner for each period on an asset-by-asset basis, requiring substantial accounting capacity and potentially specialized accounting and tax software.



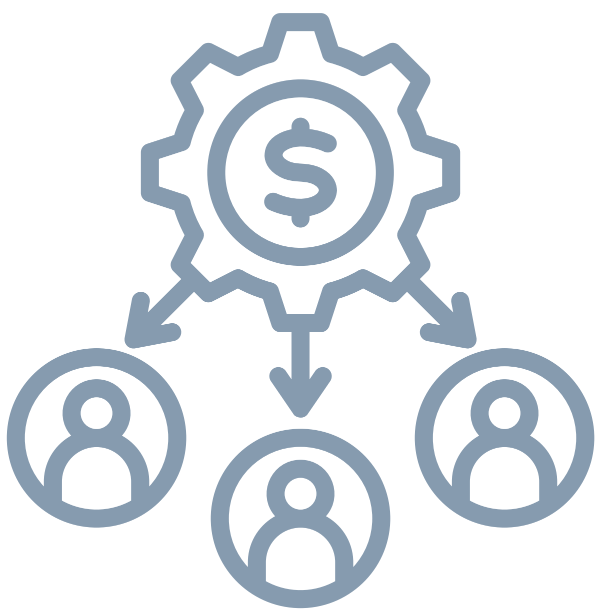
Tax Issues Upon Formation

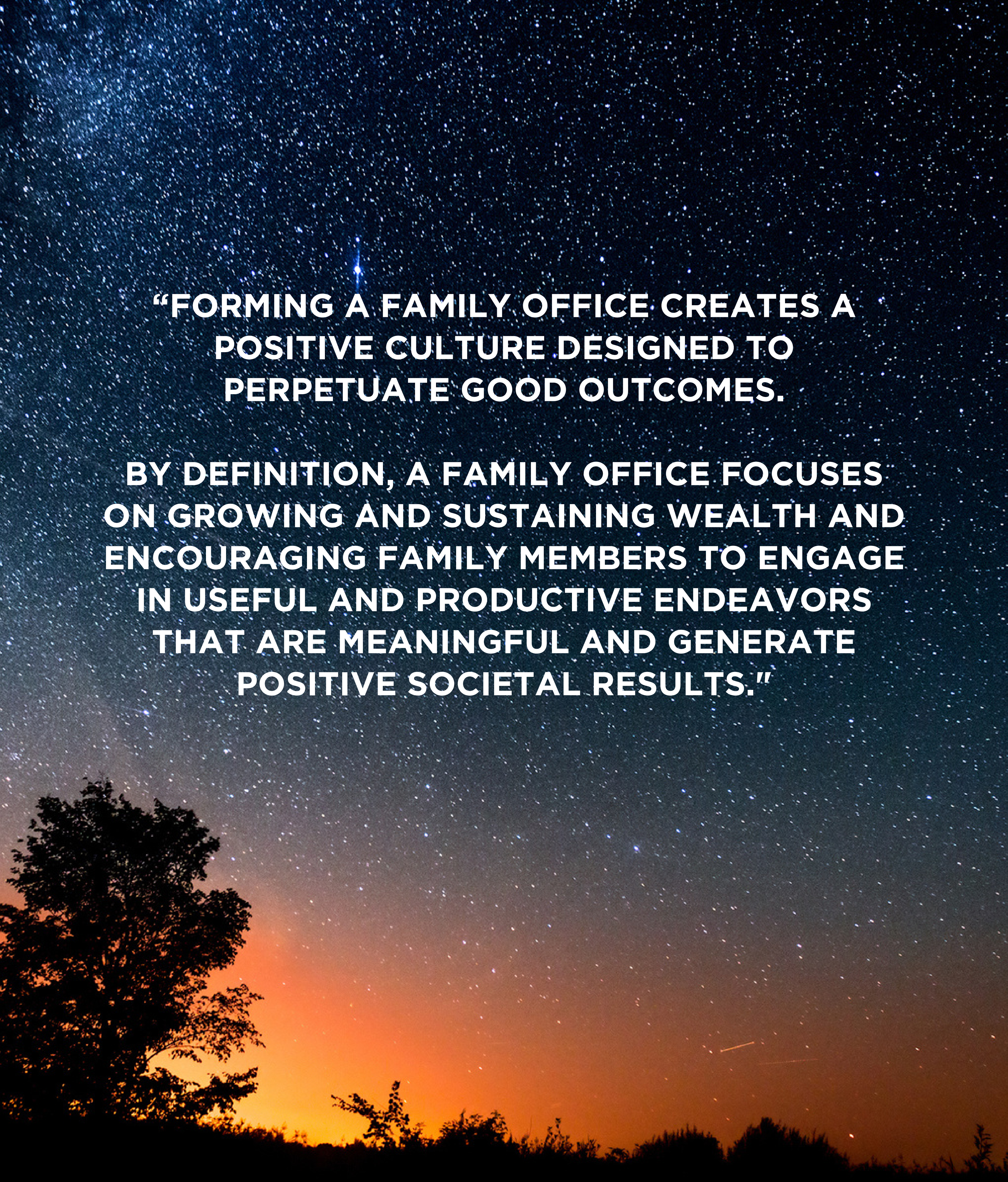
Allocations in the Family Office

In the family office context, the FO Fund is nearly always structured as a partnership, and the allocation rules under §704 apply to determine permissible allocations. A partner's distributive share is generally determined in accordance with the partnership agreement. If the agreement does not provide for allocations or if the allocation lacks substantial economic effect, the partner's distributive share is determined based on their interest in the partnership.

Special allocations of partnership items are permitted, subject to the substantial economic effect test under §704(b). Examples of special allocations that may be used by an FO Fund or FO Investor include preferential allocation of losses to partners who contributed cash or valuable assets, allocating specific expenses or deductions to partners bearing the related obligations, allocating gains for specific property held by the partnership, and allocating gains corresponding to cash flow distributions when partnerships use preferred returns or similar mechanisms to shift economic attributes among partners.

To have “substantial economic effect,“ an allocation must have meet a two-part test under the Regulations. (i.e., each allocation must have economic effect, and must be substantial) Allocations that do not meet these requirements must be allocated according to the partners' interests in the partnership. In a family office, special allocations are most likely designed to shift income to or from an FO Manager to account for the economic arrangement among the partners.





"FORMING A FAMILY OFFICE CREATES A POSITIVE CULTURE DESIGNED TO PERPETUATE GOOD OUTCOMES.

BY DEFINITION, A FAMILY OFFICE FOCUSES ON GROWING AND SUSTAINING WEALTH AND ENCOURAGING FAMILY MEMBERS TO ENGAGE IN USEFUL AND PRODUCTIVE ENDEAVORS THAT ARE MEANINGFUL AND GENERATE POSITIVE SOCIETAL RESULTS."

03 Family Office Operations

Business Operations of the Family Office, Manager Compensation, and Tax Treatment as a Trade or Business

Basic Operations of the Family Office as a Business

A family office is a private wealth management firm that serves ultra-high net worth families by providing a comprehensive suite of services, including investment management, financial planning, tax and estate planning, philanthropic management, and lifestyle management. The primary function of a family office is to manage the family's investment assets in accordance with the family's goals and objectives. This is achieved through a team of investment professionals who conduct research, analyze investment options, and make informed decisions to optimize the family's investment portfolio.

The investment team works closely with family members to understand their individual needs and preferences, providing personalized investment management services or educational guidance to help them make informed financial decisions. The family office also employs a support staff to assist with back-office functions such as accounting, legal services, human resources, and IT, ensuring the smooth operation of the office and its investment activities.

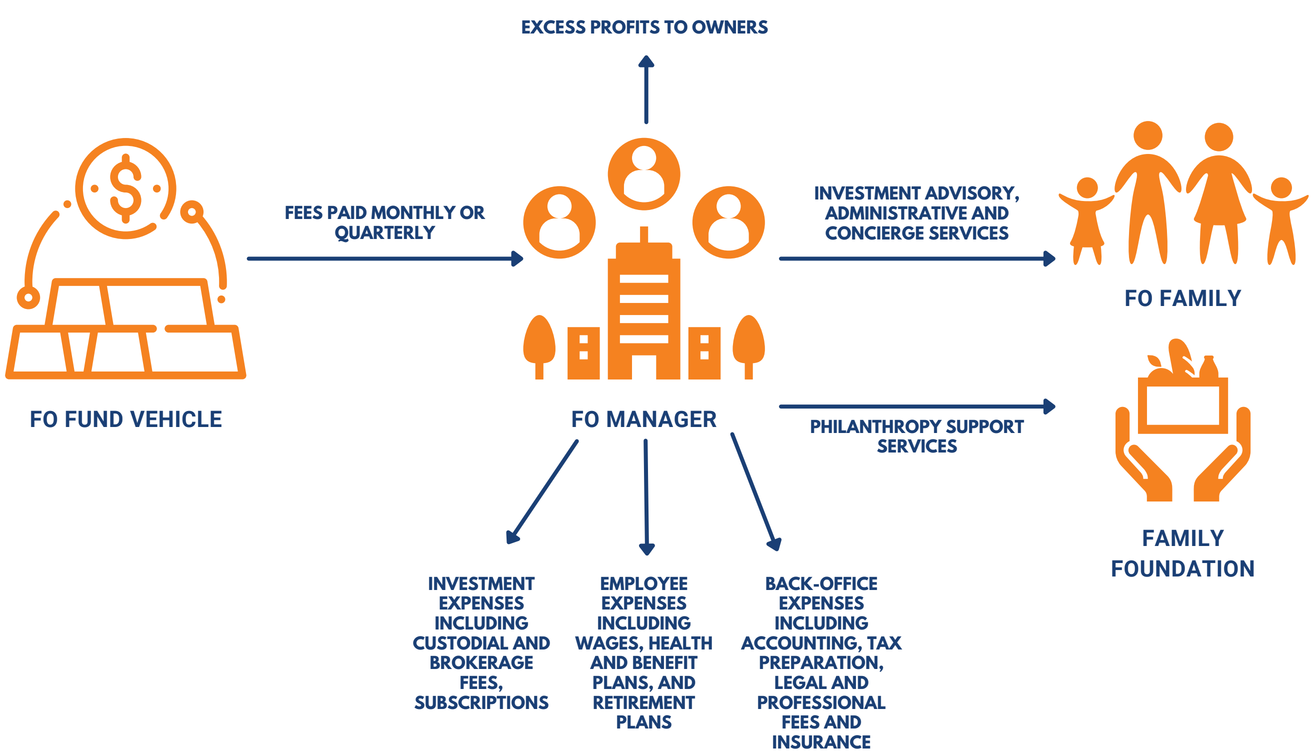
Family office employees are often deeply involved in the management of business and real estate investments, handling transactions such as mergers, acquisitions, and financing. They may also hold board positions or provide strategic advice to these companies. The family office's investment professionals also engage in planning for portfolio companies, offering expertise in areas such as financing, cash flow management, and operational consulting.

Basic Operations of the Family Office as a Business (cont.)

In some cases, the family office directly manages a portion of its investment assets, such as real estate or actively traded securities. This hands-on approach allows the office to maintain greater control over these investments and optimize returns. Some family-owned businesses may be managed by family office personnel, particularly those without back-office support.

Beyond investment management, family offices often play a significant role in the family's philanthropic activities. This may involve overseeing private foundations or donor-advised funds, managing the foundation's investments, and handling charitable activities such as grantmaking, due diligence, and compliance with tax and regulatory requirements.

Family offices also provide a wide range of financial and administrative services to family members, including bookkeeping, bill payment, travel planning, and coordination of personal asset transactions. The office may also offer recommendations for professional services such as healthcare, legal, and accounting. While these services are typically provided at market rates, some family offices may choose to absorb the costs and treat them as nondeductible expenses.



Manager Compensation
Economic Considerations

Family offices often adopt compensation structures similar to third-party investment funds, with a focus on growth and the use of hedge fund-like models to compensate FO Managers. The compensation typically consists of an asset management fee based on assets under management and a performance or incentive fee based on the fund's economic performance.

Asset management fees in the market serve as a guide for determining the appropriate fee in the family office setting. Hedge funds or private equity funds generally charge a fee of 1-2%, with successful funds often charging 2%. Fund of funds typically charge a lower fee of around 1%, while actively managed portfolios charge 50-100 basis points and passive portfolios charge 5-25 basis points.

FO Managers may participate in underlying businesses through direct management of trade or business activities, strategic guidance for closely held businesses, board participation for venture investments, or other active management of business activities. If the manager or management company has expanded responsibilities, they may be entitled to a larger fee.

Incentive fees vary between family offices and are calculated as a percentage of annual profits or net asset appreciation of the underlying FO Funds. The typical institutional private equity or hedge fund model charges a 20% carried interest, while fund of funds usually charge 10-15%.

Determining the profits interest and management fee for an FO Manager is crucial for incentivizing management to generate above-market returns. A properly structured compensation system aligns the interests of the management company's owners and employees with the investors in the fund.

There is no one-size-fits-all compensation model, but existing market-based compensation systems used by funds serve as a guide for family offices. The specific compensation structure depends on the nature of the family office's activities and the level of involvement of the FO Manager in managing the underlying assets.

Engaging a third-party accounting or investment firm to determine the appropriate fee and carry for a family office can help mitigate potential conflicts, tax risks, and economic distortions.

Manager Compensation
Tax Considerations

The concept of a profits interest, also known as a "promote" or "carried interest," dates back to the 16th century and is still used today to compensate investment fund managers for generating investment returns. A profits interest is an interest in the future profits of a venture, which may be a straight percentage of profits or profits above a specified hurdle rate.

The initial capital for a profits interest is $0, meaning the recipient would receive no value if the fund were liquidated before generating profits. This speculative nature led to uncertainty about the tax treatment of profits interests until the IRS issued definitive rulings in 1993 (Revenue Proc. 93-27) and 2001 (Rev. Proc. 2001-43).

For a family office issuing a profits interest to the FO Manager, the transaction is generally income tax-free if it falls within the safe harbor of the revenue procedures. The IRS may challenge the validity of a profits interest allocation if it appears to be a guaranteed payment for services or if the economic arrangement lacks substance. To avoid this, the FO Manager typically makes a small capital contribution to own a small initial capital interest in the FO Fund.

The recipient of a carried interest is generally treated as a partner for tax purposes and must report their distributive share of each class or item of income, gain, loss, deduction, or credit. The character of the tax item flows through from the partnership to the partner's distributive share.

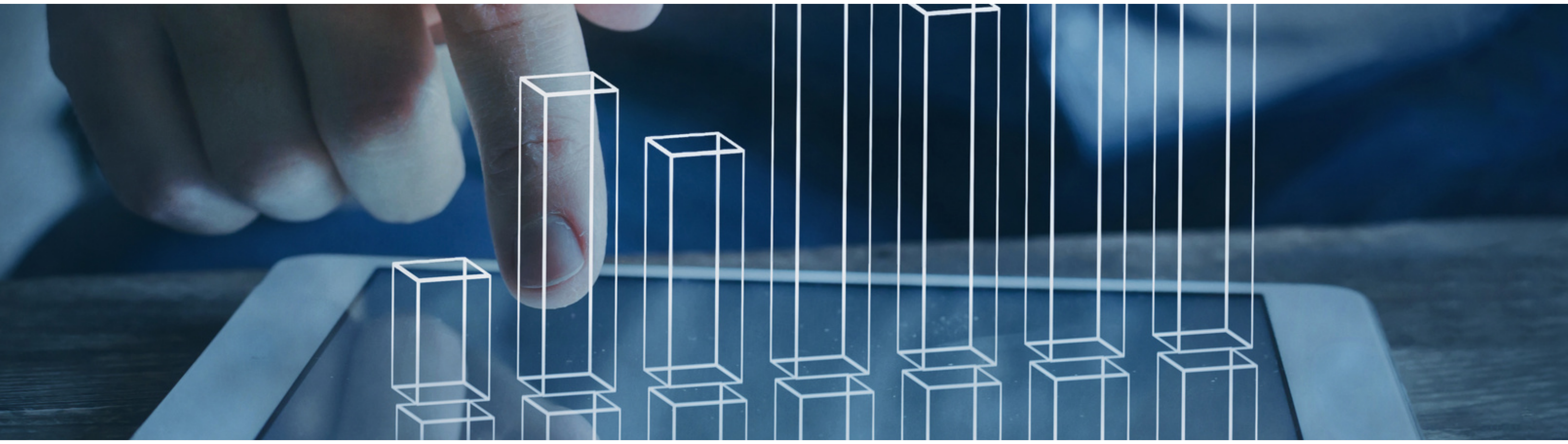
Under §1061, holders of carried interests are generally subject to short term capital gains for dispositions with a holding period of less than three years. Taxpayers treat gains incurred by an "applicable partnership interest" as short-term capital gains if the holding period for the asset creating the gain was less than three years. However, this rule does not apply to income or gain attributable to any asset not held for portfolio investment on behalf of third-party investors, which is intended to exclude family offices. In cases with more distant family member relationships or family offices serving multiple families, the carried interest legislation may still apply, subjecting the FO Manager to short-term capital gain treatment for a larger class of investment assets.

Roles of the Family Office Manager

Making Investments

Family office portfolios blend wealthy family asset allocations with those of hedge funds and private equity funds. Family offices have more portfolio holdings, while hedge funds and private equity funds have more alternative assets and riskier leveraged trading strategies. Lower short-term liquidity needs allow family offices to invest more in illiquid alternatives with higher expected returns.

Despite incremental changes to strategic asset allocation, nearly three-quarters of family offices deviate tactically to capture short-term opportunities (UBS 2021 Global Family Office Report). For example, during 2020's volatile markets, family offices rapidly switched positions, trading nearly a quarter of their portfolios between March and May of that year.



Family offices use an "institutional yet dynamic" approach, hedging risks and maintaining higher risk profiles than the general market. They invest in various industries, focusing on newer technologies like artificial intelligence, health tech, green energy, digital transformation, automation, robotics, smart mobility, and cryptocurrencies. They also invest globally with broad diversification and tactical investments in strategic opportunities.

Private equity investments drive family office performance, with investments in various funds and companies at different stages. Over half of family offices engage in sustainable investing, and they are more likely to integrate ESG factors, constituting over 25% of global family office investments. The family philosophy and the potential for investment upside prompt these investment trends. Family offices' decisions are influenced by their unique goals and values, as well as the desire to generate strong returns while managing risk.

Administrative and Concierge Services

Family offices often provide a wide range of personal and concierge services to family members, setting them apart from traditional fund entities. These services may include:

Accounting and Tax Services

Family offices may oversee personal accounting for family members, ranging from coordinating paperwork for third-party accounting firms to preparing tax returns internally and handling bookkeeping, bill payments, bank accounts, cash management, fund transfers, and household payroll.

Legal Services

Family offices commonly coordinate legal services, which may be narrowly tied to family office operations, such as estate planning, or more wide-ranging, addressing personal legal issues, general business and contract matters, operating agreements, real estate and financing transactions, securities filings, and other transactions involving family members.

Trust Administration

Family office managers often handle the administration of various trusts affiliated with the family office, including making distributions, obtaining required documents, completing tax returns and state filings, coordinating with third-party wealth management firms and banks, and ensuring compliance with trust documents and applicable law.

Travel Services

Given the complex travel needs of family members, which may involve private travel, security, insurance, events, business and personal tracking, and visa issues, family offices have evolved to handle these functions internally.

Household and Vacation Homes

Family offices may oversee household finances, maintenance, payroll, capital improvements, projects, and supplies for the family's valuable residential properties and vacation homes, serving as managers for properties used by multiple family members.

Concierge services may be provided to family members at no charge, making them non-deductible for the family office. Alternatively, family offices may allocate a portion of a management fee, directly charge family members, or employ a cost-sharing arrangement to cover the costs of these services.

Tax Compliance Services

Tax returns for individuals, trusts and entities, often including dozens of state returns for many filers.

Estimated taxes for individuals, trusts, corporations, and pass through entities (including for nonresident and elective PTE taxes).

Registrations, notices from taxing authorities, and state franchise or licensing requirements.

Foreign tax compliance, including reporting of foreign holdings, as required.

Family Office as a Trade or Business

Trade or Business in General

One critical issue in the family office arena is whether a family office entity, particularly the FO Manager, is treated as a trade or business. This determination drives various tax matters, including the deductibility of investment expenses, which can be significant as they relate to both third-party investment fees and internal investment expenses, such as family office personnel costs. If deductions are treated as expenses incurred to manage, conserve, or maintain property held to produce income under §212 or as nondeductible personal expenses, the result would be the same under current law: no deduction and no tax benefit.

The term "trade or business" appears over 1,000 times in the tax code but is not defined in either the Code or the Regulations. The Supreme Court addressed this issue in *Higgins v. Commissioner*, one of the first family office cases on the subject. In *Higgins*, the taxpayer had extensive personal investments and devoted considerable time to overseeing them, hiring staff and leasing office space. However, the Court concluded that under the facts presented, Higgins' activities did not rise to the level of a trade or business, and the corresponding deductions were disallowed. Higgins established that merely managing one's own investments, without more, does not constitute a trade or business and that the inquiry is fact intensive.

In 1987, the Supreme Court created a definitive test to define a trade or business in *Commissioner v. Groetzinger*. The Court articulated a two-factor test, stating that to be engaged in a trade or business, one "must be involved in an activity with continuity and regularity and that the taxpayer's primary purpose for engaging in the activity must be for income or profit." This ruling provided a testable and applicable definition of "trade or business," although a factual analysis of each case is still required to determine whether a particular activity is treated as a trade or business.

For family offices, the challenge lies in engaging in an activity regularly and continuously with the intent to make a profit, as opposed to merely managing one's own investments, which is not considered a trade or business. The deductibility of expenses hangs in the balance, and courts have begun to address the issue.

Family Office as a Trade or Business

Trade or Business of Investing Before *Lender Management*

Early court cases - culminating in the Supreme Court's ruling in *Higgins* - addressing the tax treatment of investment activities provided little clarity on when investing would be considered a trade or business. These cases were decided based on the facts, indicating that the taxpayer's investment activities in those cases did not rise to the level of a trade or business but did not preclude the possibility that such activities could be deemed a trade or business under the right circumstances.

Post-Groetzinger, in considering the trade or business of investing, the analysis shifted to focus on (i) taxpayers claiming to be traders rather than investors, (ii) the distinction between investing activities and the trade or business of investing, and (iii) trade or business issues in private equity, hedge funds, and similar vehicles.

Tax law recognizes three categories of investment ownership: dealers, traders, and investors. Family offices are commonly classified as either traders or investors. To be considered a "trader," a taxpayer must be actively involved in trading activities, conducting them to make a living and a major portion of their time and efforts. The courts have looked at various criteria, requiring trading activity to be substantial (i.e., "frequent, regular, and continuous ") and seeking to profit from short-term market swings rather than long-term changes.

In *Moller v. United States*, the court held that a married couple managing their sizable portfolios but holding investments for the long term and making few annual transactions was not in the trade or business of trading or investing. The court noted that merely managing investments seeking long-term gain is not carrying on a trade or business, regardless of the extent or continuity of transactions or the work required in managing the portfolio.

Nevertheless, family offices are structurally and factually more akin to private equity or hedge funds than individual investors. These cases suggest that a fund may be considered a trade or business if it is actively involved in the management and operations of its investments, intervenes in their affairs, and receives direct benefits from the trade or business activities of its agent.

In *Dagres v. Commissioner*, the court determined that a member-manager of several general partner LLCs managing venture funds was in the trade or business of managing venture funds, and a loan made to gain preferential access to deals was proximately related to such activities.

Family Office as a Trade or Business

Lender Management v. Commissioner

In 2017, the IRS challenged Lender Management, LLC, a bona fide operating family office, and the taxpayer prevailed. The case served as a model for family offices across the country to claim trade or business treatment. The court held that the management company of the Lender family office, which managed investments and performed personalized investment advisory services for three generations of family members and trusts, was indeed a trade or business eligible to deduct its investment-related expenses as an ordinary and necessary deduction under §162.

The Lender family office was formed in the early 1990s, following the sale of Lender's Bagels to Kraft in 1984. Lender Management, LLC was the fund manager, providing management services to three investment entities, collectively known as the "Investment LLCs." All the beneficial owners were descendants of Harry Lender, but the connection between the owners varied widely.

Lender Management was a true business in the operational sense, with Keith Lender serving as the Chief Investment Officer, working 50 hours per week. The company rented office space in New Jersey and had three full-time employees. Keith dedicated most of his time to researching and pursuing new investment opportunities and monitoring existing positions. Lender Management also engaged Pathstone Family Office to provide accounting and investment advisory services.

Lender Management received compensation through an asset management fee and carried interest. In 2011 and subsequent years, Lender Management received 2.5% of net asset value, plus 25% of the increase in net asset value annually. This was later changed to a carried interest only without a fee.

Upon examination, the IRS disallowed expenses, including salaries and wages, rent, retirement plans, employee benefits, and guaranteed payments to Keith as §162 trade or business expenses, instead allowing them only as §212 expenses. Nevertheless, the court ultimately determined that Lender Management was a trade or business, as its activities were engaged in for profit, the taxpayer was regularly and actively involved in the activity, and its operations had commenced. The court pointed out that Lender Management's services were comparable to those provided by hedge fund managers and went far beyond those of an investor.

The court also analyzed whether the family relationship between the investors in the Lender family office barred trade or business treatment. Despite transactions within a family group being subject to heightened scrutiny, the court found that the investors could invest in a manner that fit their needs, withdraw investments if they saw fit, had separate employment, and many had no involvement other than as passive investors. The court determined that Lender Management provided investment advisory services and managed investments for its clients individually, regardless of their relationship to each other, and the profits interest was not provided because Keith and Marvin Lender were part of the Lender family.

The court noted that the IRS did not cite any applicable attribution rules that would deem Lender Management or Keith as owning all of the Investment LLCs' interests, which could have derailed the trade or business treatment of the family office entity.

Family Office as a Trade or Business

Hellmann's v. Commissioner

The Hellmann family, known for their mayonnaise brand, also had their family office expenses challenged by the IRS as trade or business deductions. However, their case was settled out of court. The Tax Court issued an Order to the parties, providing the factual background, legal analysis, and necessary facts for a ruling.

The Hellmann family operated a family office called GFM Management, LLC, which provided investment management services for six investment partnerships (the "Hellmann Partnerships"). Each of the four taxpayers owned a 25% profits interest in GFM, which held a 1% interest in the Hellmann Partnerships, while trusts for the benefit of the GFM Owners held the remaining 99%.

Judge Lauber noted distinctions between the Hellmann case and Lender Management, including the ownership structure, geographical proximity and relationships of the family members, and the lack of information about GFM's investment activities. The trade or business determination depends on the facts of each case, and the Tax Court did not have sufficient information to reach a conclusion.

The court listed relevant factors to determine the existence of a trade or business, such as the compensation structure, nature and extent of services provided, expertise and time spent by employees, individualization of investment strategies, and proportionality between ownership and profits.

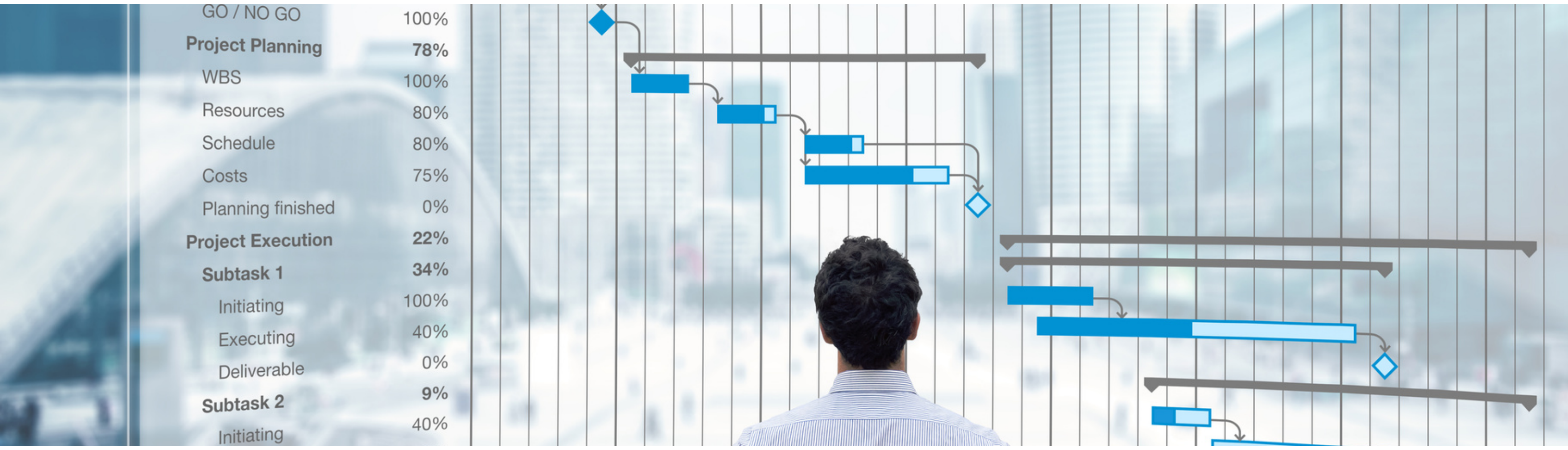
The court ordered the parties to provide facts in response to various inquiries, including the education and professional background of investor-employees, work schedules, decision processes, net asset values, ownership interests, major investments, investment strategies and objectives, and tailoring of strategies to individual family members' needs and preferences. These questions offer insight into factors practitioners should consider when structuring a family office to avoid an IRS challenge.

Family Office as a Trade or Business

Practical and Planning Considerations

The deductibility of a family office's investment expenses depends on whether the family office is considered to be engaged in a trade or business. The Tax Court's ruling in Lender Management and the factual analysis in Hellmann's case provide the most recent guidance for determining if a family office should be treated as a trade or business.

- The manner in which the family office was compensated for its services.
- Nature and extent of the services provided by the family office.
- Relative expertise of employees and time they spent working on family office matters.
- Individualization of investment strategies for different family members with different needs.
- Proportionality between the ownership and profits inuring to such member as an owner of the family office, on one hand, and as an investor in the fund, on the other hand.



Trade or business treatment also impacts the deductibility and character of bad debt expenses. Business bad debts are deductible as ordinary deductions, while nonbusiness bad debts are treated as short-term capital losses. If a family office's lending activities rise to the level of a trade or business, related bad debt deductions would be treated as business bad debts. In some cases, a bad debt may be recharacterized as a gift or capital contribution if there is no realistic expectation of repayment or if the loan is at a below-market rate. To avoid such recharacterization, debts should be treated comparably to commercial obligations, with appropriate interest rates, documentation, and administration.

Unlike partnerships and S corporations, C corporations are generally presumed to be engaged in a trade or business regardless of the level of activity. A family office manager formed as a C corporation that engages in substantial activity, even if mainly investment activities, may rely on a 1978 revenue ruling to deduct expenses as trade or business expenses under §162. If a C corporation's expenses are recharacterized as personal expenses, they are properly characterized as dividends and are not deductible as ordinary and necessary business expenses. If the corporation lacks earnings and profits, the amount would be treated as a nontaxable return of capital up to the shareholder's basis or a distribution in excess of basis.

04 Family Office Investments and Other Holdings

Economic and Tax Treatment of Family Office Investment Holdings

Family Office Investment Holdings (In General)

Family offices hold a wide range of investment assets consisting of marketable securities, alternative investments, closely held businesses, real estate, artwork, and collectibles. Moreover, the family office often manages “luxury business activities” that are held by the family, including private aircraft, yachts, vacation homes and farms. According to the UBS Family Office Report, family offices hold a larger share of their holdings in alternative assets, which is acceptable given a family office’s lower need for liquidity. Thus, many family offices resemble a combination of hedge fund, private equity fund, and fund of funds when we consider their aggregate holdings and complexity.

A family office’s holdings tend to reflect the hybrid nature of the family office as somewhat of a blend between a wealthy family’s portfolio and a complex fund of funds. Most family offices utilize little or no leverage to enhance their investment performance (although this practice is not universal). However, family offices tend to react quickly and efficiently, shifting positions much more rapidly than typical investors in changing markets. Family offices tend have a global perspective, with a relatively larger share of international activity than retail portfolio models. In recent years, family offices have been large proponents of social investing and invest in environmentally conscious investments.

Outside of third-party investment holdings, family offices may own large amounts of controlled businesses. Sometimes this may consist of a large position in public company stock, interests in closely held operating businesses, or self-managed real estate. These types of holdings occupy substantial time from family office personnel.

Portfolio Investments

A family office typically holds the bulk of its diversified asset holdings in core portfolio investments (e.g., marketable securities, bonds and other fixed income instruments). For tax purposes, the term "portfolio income" is defined under the passive loss rules and generally consists of interest, annuities, royalties, and dividends on C corporation stock, as well as capital gains and losses. Most securities generate portfolio income (as well as some alternative investments, which are discussed later).

Interest Income

Interest - income related to loans, bonds, or otherwise classified as interest is very inefficient. Interest income is typically taxed at federal ordinary income tax rates, plus net investment income tax and state tax. Since interest income is portfolio income, it cannot be offset with passive losses.

Dividends

Dividends - distributions from C corporations - are normally treated as qualified dividends and taxed at capital gains rates (and are also subject to the 3.8% NIIT). Certain dividends (mort notably, dividends from REITS) are taxed at ordinary rates since there is no corporate level tax.

Capital Gains

Capital gains are subject to a matching regime in which all gains are categorized as long- and short-term gains, and then these net amounts are netted to determine capital gain and the applicable character.

Planning to obtain long-term capital gains is an annual exercise for family offices. In its most common form, a family office will harvest losses. Sometimes this is done intentionally, using a loss harvesting fund. When available, short-term gains can be offset with long-term losses. More advanced planning to mitigate capital gains used by family offices includes §1202 planning, qualified opportunity zones, and charitable remainder trusts.

Alternative Investments
Overview and Economic Treatment

Family offices often allocate a significant portion of their portfolios to alternative investments, which include financial assets outside of traditional categories like stocks, bonds, and cash. These investments encompass equity interests in various funds, real estate, venture capital, structured investments, and derivatives.

Most alternative investments are structured as direct or indirect investments in partnerships. Many funds allow investing through a "blocker" corporation to simplify tax reporting, potentially avoid certain taxes for tax-exempt investors, and address regulatory concerns. However, investing through a blocker corporation subjects nonexempt taxpayers to double taxation, reducing after-tax returns.

Although alternative investments often provide beneficial after-tax returns, they are frequently illiquid. The potential tax advantages and outperformance are offset by the lack of marketability resulting from illiquidity. Selling these investments often requires substantial discounts, significant time, and fund consent.

Apart from liquidity considerations, investing in an alternative investment is similar to any other partnership investment. The typical FO Fund invests in alternative investments and is taxed on the flow-through income. Alternative investments, except for those treated as C corporations, are generally subject to passive loss rules.

Third-party investment funds aim to generate higher returns than traditional investments, often using leverage to amplify returns. These investments may be tax-advantaged by accelerating and allowing deductions during the early stages of the investment while generating only a single level of tax liability.

Alternative fund investments charge substantially higher fees, typically following a "2 and 20" model. Fees can vary widely, even among investors in a single fund.

Alternative investments are often uncorrelated with the market, and a well-designed alternative portfolio can deliver both higher expected returns and increased diversification. The economic outcome of a private equity fund often follows the traditional "J curve," with an initial decline in value followed by increasing returns. In contrast, hedge funds often do not face the longer investment cycle common in PE and real estate funds.

Alternative Investments

Types of Alternative Investments

Hedge funds generally invest in marketable equity and debt securities. Hedge funds normally permit cash redemptions at regular intervals and are therefore more liquid than other alternative investments.

Private equity funds (and similar fund types) typically make equity investments in operating businesses (or real estate businesses, in the case of real estate equity funds). Investors receive cash flow from future distributions and then, ultimately, from the disposition of the equity position, underlying company, or investment.

Venture capital funds invest in early stage companies with substantial growth potential. Many of the underlying investments are expected to fail (and the funds are therefore diversified). Investors receive distributions from the sale of the underlying equity or in some cases could receive distributions of stock in companies themselves.

Alternative Investments

Taxation of Alternative Investments

HEDGE FUNDS

Most hedge funds invest in portfolio assets, with most income generated as interest, dividends, and some form of capital gains. These items, and related deductions, are reported on the taxpayer's K-1. Most investors are not active and will follow the default reporting positions. However, certain attributes are determined at the investor level (such as whether the investor materially participates as an investor). Hedge funds themselves are either taxed as trader funds (in the business of trading securities) or investor funds (eligible for long-term capital gain treatment).

PRIVATE EQUITY FUNDS

Private equity funds generally invest in profitable operating businesses, which are often structured as partnerships for federal income tax purposes, but also may be C corporations. For partnership investments, all items of ordinary income and deduction are passed through to the investor-partners. Since most private equity investments will be partnership investments in trade or business activities, such activities will almost always be treated as passive activities in which the investor does not materially participate.

VENTURE CAPITAL FUNDS

Venture capital funds generally invest in early stage operating and development businesses. At the institutional investment stage, such investments are usually structured as partnership investments in C corporation portfolio companies. This approach simplifies tax compliance and potentially offers beneficial tax treatment. Many venture capital investments qualify for QSBS treatment, providing for up to $10 million of tax-free gains (or 10x adjusted basis, if greater) for the investor.

Collectibles and Artwork

Family offices tend to own large amounts of collectibles and artwork and sometimes hold artwork and collectibles for investment purposes in a family office environment (although such assets are normally held directly by the family members or entities they personally control). For tax purposes, these assets are classified as collectibles and treated effectively identical to other capital assets with the exception that all collectibles are taxed at a 28% rate. The collectibles category is determined in the same way that other categories (such as long-term capital gain) are determined to categorize gains and losses for tax purposes.

In order to categorize a loss from the disposition of collectibles as a deductible capital loss, such assets must have been held for investment and not personal purposes.

In some cases, a family that regularly buys and sells artwork and collectibles could be treated as a dealer, subjecting all of their gains and losses to ordinary tax treatment.

Residences and Vacation Homes

Family offices are often responsible for maintaining the books and records, coordinating property management, paying bills, and dealing with ownership matters relating to large and expensive residences and vacation homes. Families may own homes with values exceeding $10 million or even $100 million, which are effectively businesses in themselves.

For tax purposes, such homes are treated as a personal residence, subject to normal limits, unless they are rented subject to a bona fide rental agreement.

Residences held out for rent are subject to normal rental rules - including related-party restrictions that may apply in the family office context (e.g., §280A, self-rentals under the passive loss regulations).

Private Aircraft
Overview and Regulatory Environment

The taxation of private aircraft involves a complex interplay of federal income tax issues, federal aviation regulations, and ancillary taxes such as state and local sales and use taxes and federal excise taxes. Family offices often manage the business and personal use of private aircraft for ultra-high net worth families who use these aircraft for convenience, specialized travel needs, productivity, security, and privacy.

The Federal Aviation Administration (FAA) is the primary regulatory agency for aircraft in the United States. Private aircraft must qualify for operations under Part 91 of the Federal Aviation Regulations and may also be operated under Part 135 for liability protection and greater flexibility in collecting payments from third parties.

Operating under Part 91 generally precludes operating the aircraft as an independent trade or business and prohibits commercial transportation arrangements. However, Part 91 operations are generally not subject to federal air transportation excise tax (FET). Part 135 permits the aircraft operator to engage in air transportation for compensation or hire, but these operations are more highly regulated and generally subject to FET.

Aircraft leases can be structured as "dry leases" (without crew) or "wet leases" (with crew). The form of these arrangements can affect qualification for operations under Part 91 or Part 135, the imposition of FET, and potential exemptions from state sales and use taxes.

When acquiring a private aircraft, family offices must decide whether to purchase or lease the aircraft. Purchasing an aircraft allows for depreciation under the Modified Accelerated Cost Recovery System (MACRS) or the Alternative Depreciation System (ADS), while leasing an aircraft under an operating lease generates deductions equal to the annual rent payments. In either case, deduction disallowance rules and loss limitation rules may impact the allowable deductions and losses.

An aircraft can be used as an asset in an operating trade or business or held in a single-purpose entity and leased to related and/or unrelated parties. In the latter case, the aircraft is typically used by an operating business that operates the aircraft under Part 91 incidental to its primary business activities.

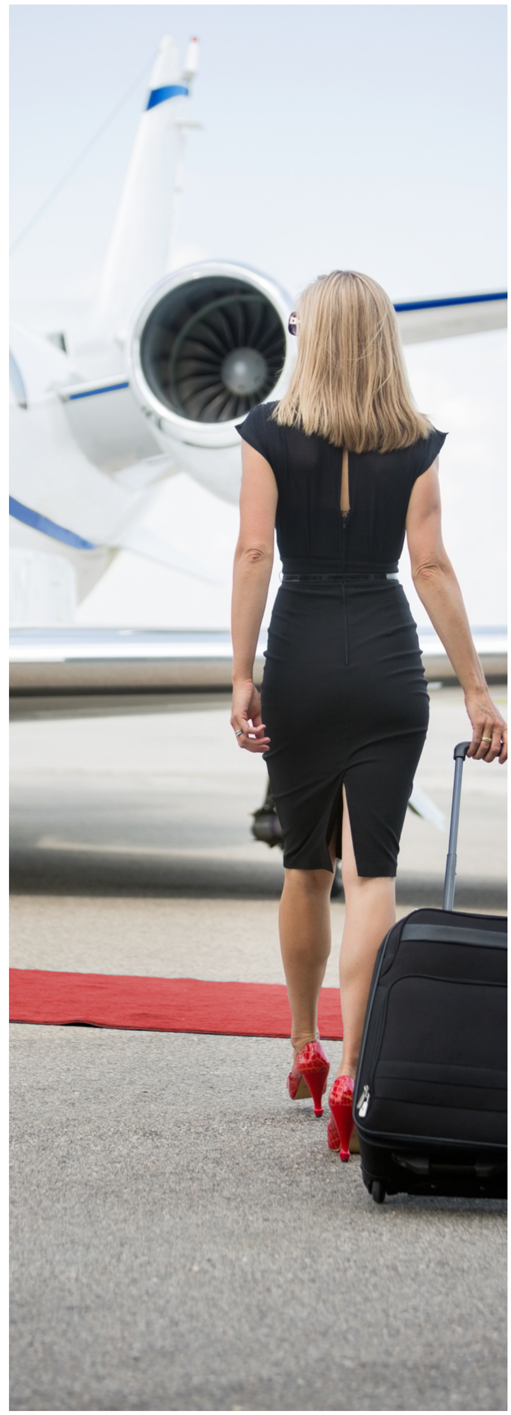
Financing the acquisition of an aircraft has various tax implications, including the deductibility of interest expense under different sections of the Code, the application of interest tracing rules, and potential limitations under the at-risk rules and passive loss rules. Deduction limitations for entertainment and commuting expenses also apply to interest expense.

Private Aircraft

Tax Issues When Operating Private Aircraft

- Treatment of private aircraft operations as part of another trade or business or as a separate trade or business under §162.
- Hobby loss rules under §183.
- Depreciation of private aircraft under §167 and §168, including bonus depreciation under §168(k) and limitations applicable to depreciation under §280F.
- Income inclusion relating to personal use of aircraft under Reg. §1.61-21.
- Deductibility of expenses relating to entertainment and commuting uses under §274.
- At-risk loss limitation rules under §465.
- Passive loss limitation rules under §469.
- Excess business loss limitations under §461(l).
- Business interest limitation under §163(j).

Private Aircraft
Personal Use of Aircraft



The value of an individual's use of corporate aircraft is considered income to the employee under the fringe benefit rules. The determination of whether a flight is business or nonbusiness and whether any persons on the flight are treated as receiving compensation falls under §61 and Reg. §1.61-21.

In general, an employee must include in gross income the fair market value of the fringe benefit over any amount paid for the benefit, minus any amount specifically excluded from gross income under the Code. A special valuation rule applies to noncommercial flights, often referred to as the Standard Industry Fare Level (SIFL) rate method. If the special valuation rules do not apply, the fair market value of the flight is determined under the general valuation rules.

The general valuation rule for a dry lease is the amount an individual pays in an arm's-length transaction to lease the same or comparable aircraft for the same period in the geographic area. For a wet lease, the fair market value is the amount an individual would pay in an arm's-length transaction to charter the same or comparable piloted aircraft for the same or a comparable flight.

The special valuation rule for noncommercial flights utilizes a mechanical formula to determine the value of the flight for compensation purposes based on the SIFL formula, which considers the SIFL cents-per-mile rates, the appropriate aircraft multiple based on the aircraft's weight, whether the employee is a control or non-control employee, and the applicable terminal charge.

The determination of what constitutes a flight, the mileage and weight, who is a control employee, and control employee status to guests are the inputs in calculating the imputed income. Control employees are defined based on their position, compensation, and ownership interest in the employer.

For purposes of the special valuation rules, a flight is the distance, in statute miles, between the place where the individual boards the aircraft and subsequently deplanes. Each flight's value is determined separately, and each leg of a round trip is considered a separate flight. If a flight includes an intermediate stop, the additional mileage is ignored in determining the flight's value.

These rules are very technical and complex. Please refer to the Portfolio for a detailed analysis of these issues.

Private Aircraft
Deductibility of Entertainment Expenses

Since the passage of the Tax Cuts and Jobs Act (TCJA) in 2017, business entertainment expenses are generally disallowed under §274. Taxpayers may not deduct any item for (1) an activity generally considered entertainment, amusement, or recreation, and (2) for a facility used in connection with entertainment, subject to nine exceptions.

An adviser to a family office owning aircraft must be able to (1) classify each flight under the applicable category under §274 and (2) properly allocate aircraft expenses under the allowable methods under §274. The general rule is that no deduction is allowed for certain expenses for entertainment, amusement, or recreation activities, or for an entertainment facility, which includes personal property such as airplanes.

Entertainment includes any activity generally considered to constitute entertainment, amusement, or recreation, even if the expenditure may be described otherwise. An aircraft will not be treated as an entertainment facility if it is used in a trade or business and not for entertainment.

For private aircraft in the family office context, several exceptions to the entertainment expense disallowance rules may generally apply: (1) food and beverages for employees, (2) certain expenses treated as compensation to employees or persons other than employees, (3) expenses for travel to business meetings or business league organizations, and (4) reimbursed expenses. These rules are complex and technical, and readers should refer to the applicable section of the Portfolio for additional information.

Since 2018, four categories of aircraft flights exist: (1) business flights, (2) business entertainment flights, (3) personal non-entertainment flights, and (4) personal entertainment flights. The primary purpose of the flight, on a passenger-by-passenger basis, will determine whether the flight is business or personal.

To calculate the expenses disallowed under the entertainment disallowance rules, a taxpayer may use one of the methods: (1) occupied seat hours or occupied seat miles, or (2) flight-by-flight method. A taxpayer must use the chosen method for all flights of all aircraft for the year. Examples of these methods are found in the Portfolio.

Private Aircraft
Depreciation and Related Issues

Aircraft are depreciated under the Modified Accelerated Cost Recovery System (MACRS) or the Alternative Depreciation System (ADS). Airplanes not used in commercial carrying of passengers or freight, and all helicopters, are depreciated over five years under MACRS or six years under ADS. Airplanes used in commercial and carrying of passengers are depreciated over seven years under MACRS or 12 years under ADS. The primary use of the aircraft determines whether it is subject to a five-year or seven-year useful life under MACRS.

Under the bonus depreciation rules, taxpayers can depreciate most aircraft under §168(k), allowing an additional allowance for depreciation equal to the applicable percentage of the adjusted basis of qualified property.

However, the qualified business use limitations under §280F restrict the depreciation of aircraft with less than 50% qualified business use. If an aircraft is not predominantly used in a qualified business use for any taxable year, it must be depreciated using ADS instead of MACRS. If an aircraft is predominantly used in a qualified business use during the first year it is placed in service but falls below 50% qualified business use in a subsequent year, any excess depreciation must be recaptured and included in gross income for that year. As a general matter, these tests are mechanical in nature and readers should review the Portfolio for an understanding of the detailed application of these tests.

Private Aircraft
Hobby Losses

The hobby loss rules under §183 limit allowable deductions for activities not conducted for profit to the gross income derived from the activity. Determining whether an activity is engaged in for profit is a question of fact, but an activity is presumed to be for profit if gross income exceeds deductions for three out of five tax years.

Aircraft activities are often subjected to IRS examination under the hobby loss rules due to substantial tax losses, particularly when bonus depreciation is claimed. To demonstrate that an aircraft activity is conducted for profit, taxpayers must address the nine factors enumerated in the regulations, including the manner in which the activity is carried out, the expertise of the taxpayer or advisers, time and effort expended, expectation of asset appreciation, success in similar activities, history of income or losses, amount of occasional profits, financial status of the taxpayer, and elements of personal pleasure or recreation.

“To effectively counter a hobby loss claim, family offices advising their clients in aircraft businesses should take the following non-exhaustive steps: (1) set leases at market rates, preferably based on a third-party appraisal or similar independent determination, (2) expand the universe of potential users, ideally including unrelated third parties, to maximize business usage and profitability, and (3) adopt excellent business practices, including maintaining books and records, financial statements, budgets, business plans, maintain meticulous logs and records, and utilize specialized aircraft counsel and consultants.”

FAMILY OFFICES PORTFOLIO

The definition of "profit" for §183 purposes is unclear, as it is not defined in the Code. In the context of private aircraft, courts have considered factors such as unrealized asset appreciation, pre-tax or post-tax analysis, and present value in determining profit. The Supreme Court has stated that a taxpayer may establish an intent to profit even without an expectation of realizing taxable income, as many Code provisions serve purposes other than accurate measurement of economic income.

In some cases, courts have allowed expenses related to owning and operating a private aircraft as ordinary and necessary business expenses under §162 when the expenses were reasonable compared to the cost of leasing private charter planes. However, the IRS has advised that allowing such deductions would not affect the conclusion that an activity is not engaged in for profit under §183.

Private Aircraft
Ordinary and Necessary Business Expenses

Taxpayers can deduct ordinary and necessary expenses incurred in carrying out a trade or business, including travel expenses related to private aircraft. To qualify for the deduction, the taxpayer must be engaged in a trade or business, and the expenses must be both ordinary and necessary.

Expenses are considered "ordinary" if they are regular and arise from common transactions in the type of business involved. They are "necessary" when they are appropriate and helpful, but not necessarily essential. Courts have added another factor, finding that expenses must also be reasonable in amount. The reasonableness of aircraft expenses is a question of fact, and courts have allowed deductions when the use of the airplane was an ordinary and necessary part of the taxpayer's business and generated substantial income.

In the family office context, the line between business and personal activities is often blurred. To determine whether expenses are personal or business, the tax court has held that such expenses must not be primarily for personal purposes and must have a proximate relationship with the taxpayer's trade or business.

Examples of allowed business expenses include company-wide trips where business matters are discussed, using a private plane to serve on a public company's board of directors, and attending educational conferences that make employees more effective. However, expenses for guests and family members may not be deductible, even if the conference has a bona fide business purpose.

Taxpayers have attempted to deduct various personal and nonbusiness expenses, often with poor results. Commuting expenses, including travel by air from a residence to the taxpayer's normal place of business, are generally nondeductible under the §162 and §262 regulations.

Private Aircraft
Other Tax Issues

The ***at-risk rules*** under §465 limit the deduction of losses from private aircraft activities to the amount the taxpayer has invested and the share of liabilities for which the taxpayer is personally liable. These rules apply to aircraft ownership in a manner consistent with other businesses.

The ***passive activity loss*** rules under §469 often treat the use of private aircraft by a family office as a passive activity, resulting in the limitation of losses. Aircraft leasing businesses are almost always considered passive activities. However, if the aircraft is used in a trade or business in which the taxpayer materially participates and the use of the plane is incidental to another trade or business, the passive loss rules may not apply. The IRS has challenged nonpassive treatment of losses from aircraft activities in several key areas, including grouping aircraft activities with nonpassive activities, treating aircraft activities as rental activities, and determining whether an aircraft could be considered an active business.

The ***excess business loss rules*** under §461(l), introduced by the Tax Cuts and Jobs Act, create a two-tier system for deducting business losses. For tax years beginning after December 31, 2020, and ending before January 1, 2026, an excess business loss is not allowed. The limitation is $500,000 for taxpayers filing jointly and $250,000 for all others, adjusted for inflation. Disallowed losses are carried forward as net operating losses under §172(b) for subsequent taxable years. Business losses exceeding the threshold cannot be deducted against investment or personal income.

The ***business interest expense limitations*** under §163(j) impact businesses that own aircraft in the same manner as any other business financing equipment. Private aircraft in the family office context are often operated for both business and personal purposes, and business interest expense is allowed subject to certain limitations.

Boats and Yachts

Family offices own boats and yachts for various purposes, including personal use, entertaining clients or employees, and chartering to third parties. The tax treatment of these vessels is generally similar to private aircraft, with some notable differences. Key tax issues that family offices must consider include treating charter boat operations as a trade or business under §162, depreciation under §167 and §168, hobby loss rules under §183, deductibility of business entertainment expenses under §274, and fringe benefit rules under Reg. §1.61-21.

Boats used in a trade or business may be depreciated under MACRS or ADS, depending on their predominant use. Charter boats are eligible for bonus depreciation under §168(k) if they meet certain requirements. The qualified business use limitations under §280F apply to boats and yachts, potentially limiting depreciation deductions if the vessel is not predominantly used in a qualified business use.

The hobby loss rules may disallow deductions if the boating activity is not conducted for profit, based on nine factors listed in the regulations. Case law instructs how these factors are applied to boat chartering activities.

Entertainment expenses related to boat use are generally disallowed under §274, with limited exceptions for employee expenses and business meetings. Structuring boat ownership as a charter business allows for deductions if it is operated as a bona fide trade or business, since the charter activity itself is not considered entertainment. However, lessees of the boat would only be permitted to deduct rental expenses and related operating costs to the extent otherwise allowed.

Employee and personal use of boats may be subject to fringe benefit rules, with the fair market value of the benefit treated as compensation. The fair market value is determined based on all the facts and circumstances, and none of the special valuation rules apply to boats or yachts.

Family offices should carefully structure boat ownership and activities, maintain proper records, rely on third-party valuations, and consult with experienced professionals to ensure compliance with tax regulations and maritime law. Proper planning and documentation can help optimize tax deductions and minimize the risk of adverse tax consequences related to boat and yacht ownership and use.

Farming Activities

Many FO Families engage in farming activities of one type of another. Some families maintain extensive horse racing and breeding operations, others will grow crops on dedicated farm properties or portions of properties that are otherwise used for residential purposes . . . often, the FO Manager oversees the farming operations. To that end, such FO Manager must operate and structure farming businesses with a focus on the deductibility of related expenses under §162 (trade or business expenses), §183 (hobby losses) and §469 (the passive loss rules).

FAMILY OFFICES PORTFOLIO

Assets Created from Estate Planning Transactions

Family office managers oversee various types of investment assets, including those created as a result of estate planning transactions that were consummated between family members, trusts, and family entities. These assets may include intrafamily promissory notes, partnership interests in family partnerships, receivables from GRATs or private annuities, and life insurance policies. These assets are often held by the respective family member, or a trust created by them, and are administered by the family office manager.

Assets created from estate planning transactions have specific tax attributes and transferring them could result in income tax, gains, or even gift tax consequences. For income tax purposes, transactions between a taxpayer and a grantor trust are disregarded, with the grantor bearing the income tax consequences of the underlying economic investment. The family office must identify appropriate sources of cash to fund tax payments in such cases.

Before transferring any asset created from an estate planning transaction, the family should consult with advisers to understand the ramifications from an income, estate, and gift tax perspective. Transfers could also cast doubt on the validity of the original transaction, especially if they are close in time.

The specific tax consequences of contributing or transferring assets depend on the type of asset and the parties involved. Equity interests in family-owned entities may be subject to the rules of §2701-§2704, and the transfer of life insurance implicates the transfer for value rules under §101(a)(2) and potential inadvertent inclusion under §2035 or §2042.

"A FAMILY OFFICE SERVES THE FAMILY'S BUSINESS OBJECTIVES WHEN IT IS DESIGNED TO COMPLEMENT THE WAY THAT A FAMILY RUNS ITS BUSINESS. IN OTHER WORDS, A WELL-DESIGNED FAMILY OFFICE SUPPORTS THE FAMILY'S BUSINESS OPERATIONS, RATHER THAN CHANGE OR IMPEDE THE WAY THAT THE FAMILY CONDUCTS ITS BUSINESS."

05 Family Office Investors

Economic and Tax Treatment of Family Office Investors (and ultimate owners)

Individuals

The ultimate owners of family office holdings usually include individuals, grantor trusts, nongrantor trusts that distribute income to individual beneficiaries, and partnerships or S corporations that pass-through income to their partners or shareholders, which is reported as individual income tax.

Individuals are subject to income tax on their taxable income, with tax rates based on their filing status. Ordinary income is taxed at rates up to 37%, while capital gains are taxed at rates up to 20% for regular capital gains, 25% for §1250 recapture, and 28% for collectibles gains and recognized §1202 gains. Individuals may also be subject to additional taxes, such as self-employment taxes, net investment income tax, and alternative minimum tax.

Generally, no deduction is allowed for personal, living, and family expenses, but certain expenses are explicitly deductible under the Code. Costs related to family office personnel engaged in a trade or business but also performing personal and concierge services must be allocated between trade or business expenses, costs for the maintenance of property held for the production of income, and personal expenses.

Individual family office investors are ultimately subject to tax liability for their ownership of investment assets held by family office funds, either directly or indirectly. The tax treatment of investment income varies, with some types receiving favorable tax rates, such as long-term capital gains and qualified dividends, while others are treated as ordinary income.

Determining whether expenses incurred in investment management activities constitute trade or business expenses with respect to such individual or expenses for the maintenance and production of income has implications for the deductibility of interest expense, net operating losses, losses, and bad debts.

Trusts
General Tax Treatment

With substantial family office holdings held in trust, the income taxation of trusts and estates is particularly relevant to family offices as they often utilize trusts for various purposes, such as holding investment assets, managing wealth, and facilitating estate planning.

Trusts generate taxable income, loss, deductions, and credits while holding assets for the benefit of beneficiaries. The tax attributes are either borne by the trust or passed out to the beneficiaries, affecting the overall tax liability of the family office structure. The trust's taxable income is computed similarly to an individual's, with certain exceptions.

Family office advisers must be aware of the significant differences between trusts and individual taxation. Special rules under §642 provide for certain credits and deductions specific to trusts and estates, offering planning opportunities for family offices.

The unlimited charitable contribution deduction for trusts and estates under §642(c), subject to certain pitfalls, may be advantageous for family offices with significant charitable goals. Investment expenses for trusts and estates are treated similarly to those of individuals, with deductions falling under either §162 or §212. Certain trust and estate deductions permitted under §67(e) can be beneficial for family offices.

Family offices should consider the tax attributes of future beneficiaries when determining the timing of the termination of a trust or estate, as certain excess deductions and carryover losses are allowed as a deduction to the beneficiaries in the final year.

Family offices utilizing S corporations should be aware of the restrictions on trust ownership, as only Qualified Subchapter S Trusts (QSSTs) and Electing Small Business Trusts (ESBTs) can own stock in an S corporation. QSSTs are treated as grantor trusts, while ESBTs are subject to special rules for S corporation income and are taxed at the highest income tax rate applicable to trusts.

Trusts
Use of Private Trust Companies

High net worth families operating family offices are primary stakeholders in the private trust company marketplace. Private trust companies serve as fiduciaries for a small class of trusts, often for a single family, managing assets over a multigenerational timeframe. Many well-known trust companies, such as US Trust and Bessemer Trust, were originally formed by wealthy families to manage their assets across generations.

Forming a private trust company has become more common in recent years. Several states streamlined legislation allowing for private trust company formation, such as Nevada, South Dakota, Tennessee, and Wyoming. These states offer both regulated and unregulated private trust companies, with varying requirements for physical presence, board meetings, employees, capital, and state examinations.

Non-tax reasons often drive the formation of private trust companies, including:

- Replacing individual trustees with business-like governance subject to a board of directors.
- Flexibility for grantors in creating trusts and for beneficiaries in managing them.
- Trustee protection through broader discretion and reduced liability.
- Formalized business processes inherent in a trust company structure.
- Cost savings compared to using a corporate trustee.
- Private trust company laws create flexibility for grantors, allowing trusts to supersede default rules under state trust laws and emphasize specific objectives without limitation. Beneficiaries also benefit from flexibility, particularly through decanting powers and easier trust reformation.

A private trust company can protect trustees acting in accordance with family goals from liability, since they are not constrained by the conservative approach often taken by outside corporate trustees. The formalization of trust company activities, combined with the flexibility usually reserved for individual trustees, often leads to better outcomes.

For federal income tax purposes, a private trust company is an operating business providing trust services, while the underlying trusts are subject to federal income tax like any other trust. State income tax treatment is a significant tax-driven focus of private trust companies, as forming one in an income tax-free jurisdiction may allow families to avoid state taxes, depending on other nexus factors.

Forming a private trust company aligns the management, governance, and ownership of family office assets with family office operations and management. It can streamline business operations by having a single owner and manager for all trust vehicles and provide a necessary level of formality and strong governance to oversee family investment activities when an FO Manager is run by non-family members.

Trusts
State Tax Issues

A family office often has trusts and estates as owners of FO Fund interests, creating many issues related to state taxation. Trusts formed by wealthy individuals to benefit their descendants over multiple generations may be subject to taxation by a state that no longer has a meaningful connection to current trustees, beneficiaries, or the trust's investment activities.

States generally tax all income of a resident trust and income attributable to the state for a nonresident trust. To determine if a trust is subject to state income tax, it must establish its state of residency, nexus to a specific jurisdiction, and whether income is derived from the state. Each state uses various factors to determine taxability, including the state of formation, decedent's residence, residency of the grantor, trustee, and beneficiaries, location of trust administration, presence of physical assets, and the relationship between the trust's activities and the states.

Although resident trusts are entitled to a state tax credit for taxes paid to a non-resident state, the substantial disparity between state tax rates often results in unequal economic outcomes if the trust is subject to tax in a high-tax state. States have a legitimate claim to tax income attributable to their jurisdiction, but a trust's connections with a high-tax state may be tenuous or no stronger than the claim of another state.

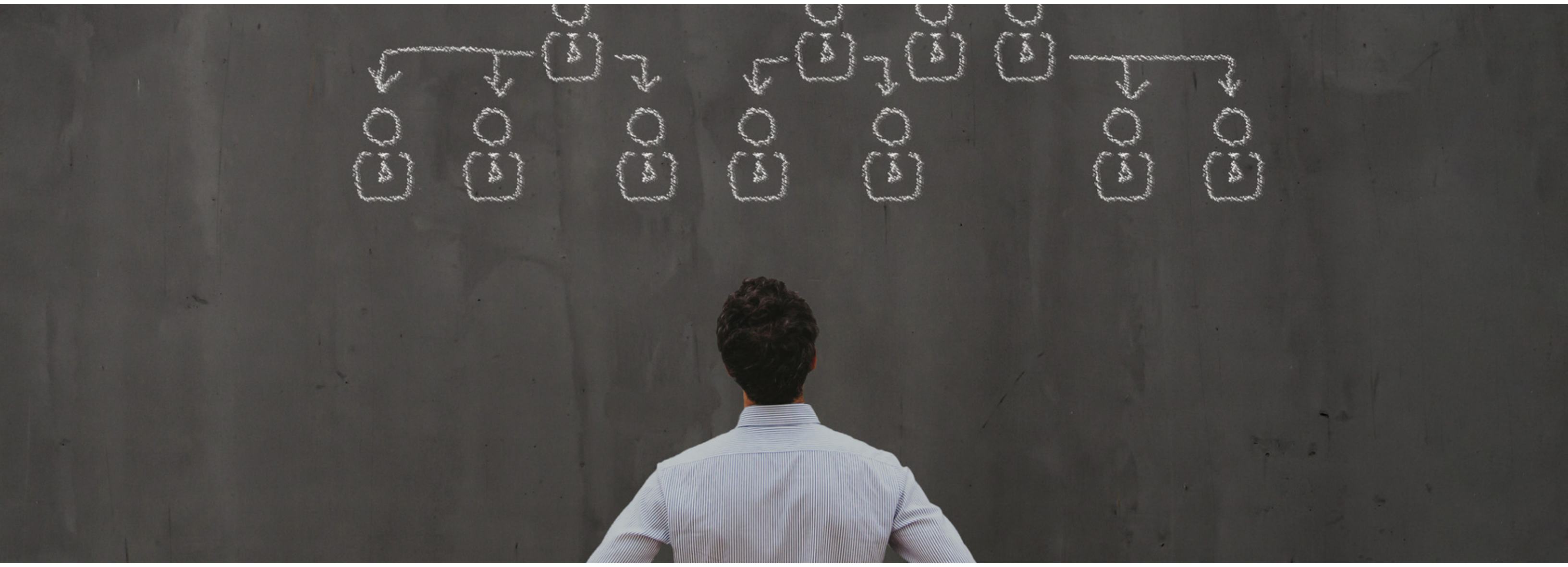
Family offices administering trusts potentially subject to taxes in multiple jurisdictions should examine the impact of state taxation and consider strategies to reduce state tax liability, such as judicial reformation, decanting to a different jurisdiction, replacing trustees, splitting trusts, or changing particular investments.

Pass Through Entities

Family partnerships often serve as FO Investors, using the entity for various purposes such as management, governance, estate planning, compliance with securities laws, regulatory purposes, and asset protection. These partnerships are treated as holding companies and pass-through entities for tax purposes, not engaging in a trade or business themselves. Family partnerships function as conduits for allocations and distributions to owners, and inserting them between the ultimate owners and the FO Investor or FO Fund generally does not change the tax treatment of flow-through income, loss, deduction, or credit.

Family partnerships are ideal vehicles for FO Investors due to their flexibility. They are well-suited for estate planning, allowing for the shifting of benefits and burdens between partners, varying participation in current or future profits, and a step-up in basis under upon a partner's death. Partnerships also allow for cash flow preferences and different classes of equity arrangements in a single entity. They are often formed as limited liability companies under state law, providing maximum flexibility in designing voting, management, and governance structures, dispute resolution methods, and transfer restrictions.

In most cases, an FO Investor is structured as a partnership to maintain tax efficiency without adding negative tax attributes, as would be the case with a C corporation or an S corporation. The basis step-up under is applied at the FO Investor level if family members own interests in the FO Investor directly, maximizing economic results for family members when transfers occur at death or through sales between family members.



S corporations are rarely selected as ideal vehicles for FO Investors in family offices, although they may remain substantial investors in family office investment entities for historical reasons. As pass-through entities, S corporations pass through items of income, gain, loss, deduction, and credit to their shareholders, resulting in a single level of tax, similar to partnerships.

C Corporations
General Tax Treatment

C corporations are treated as separate taxpayers subject to a 21% corporate income tax rate. Distributions from a C corporation are treated as dividends (representing earnings and profits), nontaxable return of capital (up to the shareholder's basis), or capital gains (where distributions exceed basis). Dividends are taxed at dividend tax rates, resulting in a second layer of income tax on distributed earnings.

In the family office context, C corporations are common vehicles for FO Managers, since such entities are operating investment management businesses. C corporations benefit entities that do not intend to make substantial distributions to shareholders.

Using a C corporation for an FO Manager aligns its interests with the FO Fund, as the FO Manager receives its carried interest in cash each year and can either distribute it as a dividend or reinvest it in the FO Fund. Reinvesting avoids additional taxes on dividend distributions and aligns the FO Manager's economic outcomes with the FO Fund's investors. However, retaining assets in a C corporation may implicate the accumulated earnings tax and personal holding company rules.

C Corporations

Accumulated Earnings Tax

The accumulated earnings tax is imposed on a corporation's accumulated taxable income, but unlike most taxes, it is not self-imposed or subject to filing requirements. Instead, it is imposed in connection with an audit. The tax is structured as a penalty, and requires that a corporation with a purpose of accumulating earnings to avoid shareholder income tax is assessed an additional - the accumulated earnings tax - in addition to the dividend tax that would apply if the funds were distributed.

The accumulated earnings tax applies to corporations formed or used to avoid income tax on shareholders by allowing earnings and profits to accumulate beyond the reasonable needs of the business. If the IRS determines that a corporation has accumulated earnings beyond the reasonable needs of the business, it is subject to the accumulated earnings tax.

In the context of family offices, a C corporation owning interests in a family office entity may need to contend with the potential imposition of the accumulated earnings tax. Although illiquid, the accumulated earnings tax may be imposed on undistributed value if the accumulation is not reasonable. The courts have established that tax avoidance to shareholders must be "one of the purposes" for the accumulation of earnings to be subject to the tax. Courts look to a number of factors to determine that the purpose requirement is met, such as the reasonableness of accumulations, treatment as a holding or investment company, dividend history, compensation of shareholder-employees, and loans to stockholders.

The amount subject to accumulated earnings tax is the excess over the reasonable needs of the business. The accumulated earnings tax is equal to 20% of the corporation's accumulated taxable income.

In the family office setting, C corporations are sometimes used as blocker corporations to hold investments in the FO Fund on behalf of non-U.S. citizens, tax-exempt organizations, or for other purposes. The IRS Chief Counsel's Office has advised that a blocker corporation owning hedge fund partnership interests may be considered a holding or investment company and subject to accumulated earnings tax on flow-through accumulated earnings, even if the corporation has no control over distributions from the partnerships in which it invests. This ruling could have negative implications for family offices.

C Corporations
Personal Holding Companies

The personal holding company (PHC) tax is a 20% tax imposed on the undistributed personal holding company income of every personal holding company. It functions as an alternative to the accumulated earnings tax by taxing the accumulated earnings held in certain types of investment assets.

A corporation is considered a personal holding company if (1) at least 60% of its ordinary adjusted gross income for the tax year is personal holding company income, and (2) more than 50% in value of the outstanding stock is owned, directly or indirectly, by or for the benefit of five or fewer individuals at any time during the last half of the tax year. Personal holding company income includes the portion of such corporation's adjusted ordinary gross income that consists of various categories of investment and personal type income.

In the family office setting, a C corporation would often be subject to the personal holding company rules due to its closely held nature and substantial investment income. To determine whether a C corporation is subject to the PHC tax, the corporation must compute its ordinary adjusted gross income and personal holding company income. If the PHC income is at least 60% of the ordinary gross company income and the shareholder test is met, the company is treated as a personal holding company and must compute its undistributed PHC income, which is subject to a 20% tax.

The personal holding company rules are generally mechanical in nature. If a corporation's income meets the definition of PHC income and exceeds 60% of its ordinary adjusted gross income, the PHC rules apply. To avoid the negative impact of the PHC rules, a corporation will either make a distribution to reduce PHC taxable income to zero or make a consent dividend under §565.

Most C corporation family office entities can avoid the negative impact of the PHC rules because their investments often consist of a large percentage of private equity and closely held business investments, generating substantial gross income. A modest concentration of the family office in private equity and similar alternatives would likely generate sufficient gross income to avoid subjecting a corporate family office entity owner to the PHC rules.

Passive Loss Rules
In General

Family offices often maintain a significant portion of their investments in assets such as closely held businesses, private equity funds, real estate, hedge funds, venture funds, oil and gas investments, aircraft, yachts, and farming activities. While these investments can offer attractive returns, they are also potentially subject to the passive activity loss rules under §469, which limit the deductibility of losses and the allowance of credits for passive activities. As a result, family office executives and advisers must be well-versed in how these rules impact the family member-owners of these investments.

Passive Activities and Passive Income and Loss. A passive activity is defined as either a trade or business activity in which the taxpayer does not materially participate during the tax year or a rental activity, regardless of the taxpayer's participation level. Trade or business activities involve conducting a trade or business, an activity conducted in anticipation of a trade or business, or incurring research or experimental expenditures. Rental activities (such as real estate rentals) are considered per se passive, with some exceptions.

Individuals, estates, trusts, closely held C corporations, and personal service corporations are all subject to the passive loss rules. These entities are not allowed to claim a passive activity loss or credit for the tax year. Instead, disallowed losses are carried forward to subsequent tax years and remain subject to the same passive income limitations until utilized.

Passive activity gross income excludes "portfolio income," which includes interest, annuities, royalties, dividends on C corporation stock, and income from certain investment entities. Such income is investment income but is not passive activity gross income.

Grouping Activities. The grouping rules allow one or more trade or business activities or rental activities to be treated as a single activity if they constitute an appropriate economic unit. Factors considered in this determination include similarities and differences in types of trades or businesses, the extent of common control and ownership, geographic location, and interdependence between or among activities.

Disposition of an Activity. When a taxpayer disposes of their interest in a passive activity (or former passive activity) in a fully taxable transaction to an unrelated party, their carryforward passive activity losses are utilized in full for that year. This rule highlights the importance of considering the timing and structure of passive activity dispositions in order to maximize the utilization of accumulated losses.

Passive Loss Rules
Strategies Applicable to the Family Office

Family offices often hold significant investments in closely held businesses, real estate, private equity funds, oil and gas partnerships, and other activities subject to the passive loss rules. Below are tax planning concepts relating to passive losses that apply in the family office context:

Offset Passive Income. FO Investors with passive activity income can offset passive losses from various sources, such as private equity funds, private aircraft, and rental real estate. This leads to improved after-tax returns on passive investments. By strategically replacing portions of the portfolio with assets that generate passive income, family offices can balance the tax-inefficiencies of other investments.

Planning with Non-Grantor Trusts. Family members may also own investment activities through trusts. The trustee's material participation in the trust's investment activities determines whether the trust is subject to the passive loss rules. If trustees materially participate in business activities, the trust's investment income or losses may be treated as nonpassive, allowing for the offset of nonpassive income or the avoidance of NIIT.

Capital Gains as Passive Activity Gross Income. Treating capital gains as passive activity gross income is another strategy family offices utilize when disposing of investments for large gains. Gains from the disposition of property used in a passive activity, such as real estate rental property or private equity holdings in partnerships, can be offset by passive losses from any source. This can be particularly beneficial in years when investments are sold for significant gains, effectively reducing the taxpayer's overall tax rate.

Real Estate Professional Treatment. Family offices with substantial real estate holdings may benefit from having investors qualify as real estate professionals. By meeting the specified criteria, rental real estate activities can be treated as nonpassive, and losses from these activities can be used to offset income from other sources. Family offices focused on real estate investments may work with their investor-owners to achieve real estate professional status and maximize the associated tax benefits.

By carefully navigating the passive loss rules and implementing strategic tax planning, family offices can significantly enhance the after-tax returns of their investment portfolios.

THE FAMILY OFFICE COULD BE DESCRIBED AS A HYBRID BETWEEN AN ULTRA-WEALTHY FAMILY (OFTEN THE OWNERS OF A CLOSELY HELD BUSINESS) AND A HEDGE FUND OR PRIVATE EQUITY FUND.

EVERY SUCH FAMILY LIES ON THIS SPECTRUM, AND AT SOME POINT ON THAT CONTINUUM, THE ULTRA-WEALTHY FAMILY DECIDES TO CREATE, OR EXISTING STRUCTURES TAKE OVER THE ROLE OF, A FAMILY OFFICE.

06 Family Offices and Family Foundations

Relationship Between Family Offices and Charitable Organizations Operated by Family Members

Family Foundations and the Family Office

Family offices often engage in or support significant charitable and philanthropic activities on behalf of themselves, their ultimate owners, and related foundations. Supporting wealth creation to serve charitable and philanthropic objectives is frequently a major goal of family offices. Family foundations commonly become significant FO Investors, and the FO Manager supports these charitable efforts through various operational activities, including:

- Leading charitable activities.
- Assisting with grantmaking and charitable due diligence.
- Providing legal, accounting, and back-office functions.
- Managing cash and investments.
- Offering administrative resources.

Families and their family offices engage in charitable endeavors through one or more family foundations. The relationship between the charitable entity, the family office, and individual family members, as well as the consequences and restrictions on charitable activities, have an effect on the family office’s compliance, economic, administrative, and tax planning functions.

Many of the world's largest private foundations are operated by or affiliated with family offices. Indeed, FO Families are amongst the most charitable families in the world. The income and cash flows from an FO Family's business and investment activities fund their charitable endeavors. The interplay between the benefits of charitable deductions and the family's intrinsic charitable activity enables the FO Family to engage in tax-efficient charitable planning while achieving their philanthropic objectives.

Income Tax Treatment of Charitable Contributions

A taxpayer, whether an individual, corporation, or trust, is allowed a deduction for charitable contributions made within the taxable year. The deduction is generally equal to the amount of money or fair market value of property. When the fair market value is not allowed as a deduction, the contributor's basis is normally deductible, unless the deduction itself is disallowed.

To qualify for a charitable deduction, the contribution must meet several requirements:

- The contribution must consist of money or property.
- The contribution must constitute a transfer for purposes of §170.
- The contribution must be gratuitous, without receiving a corresponding benefit.
- The recipient must be an organization or other recipient permitted to receive tax-deductible contributions.
- The contributor must follow income tax reporting requirements, including substantiation, disclosure by the donee, and tax return compliance.

If the contribution qualifies under §170, the taxpayer may deduct all or a portion of the contribution, potentially reducing their taxable income. The charitable deduction is commonly used by family offices to reduce income taxes. Family office executives and advisers must be aware of the issues raised under charitable deduction rules to ensure that a charitable contribution is deductible, preferably at the asset's full fair market value, even when family office entities contribute complex assets to charities, some of which may be controlled by the donors.

The most relevant charitable contribution deduction issues for family offices include:

- Contribution limitations.
- Valuation of complex assets, such as closely held business and real estate interests.
- Reporting requirements.

Understanding and addressing these issues can help family offices maximize the tax benefits of their charitable contributions while ensuring compliance with the applicable regulations.

Estate Tax Treatment of Charitable Contributions

The charitable deduction under §2055 is the main tool used by FO Families to mitigate estate tax liability. FO Family members often choose a charitable beneficiary, such as a private foundation or charitable lead trust, to "zero" out the estate and reduce estate tax liability to zero. However, this requires transferring property equal to the entire value of the taxable estate to charity.

Section 2055 allows for an unlimited deduction from the gross estate value for bequests or transfers to specified charitable and public organizations, generally encompassing all §501(c)(3) organizations. The estate may transfer all of its assets to charity to reduce estate tax to zero.

The charitable deduction provides specific rules for split-interests in property, such as interests for a term of years, a lifetime interest, or a remainder interest. If the transfer meets the requirements under §2055(e)(2), it will allow a charitable deduction for the transferred interest under a testamentary charitable lead trust or charitable remainder trust.

Charitable Contribution Income Limitations

Charitable contributions made by individuals are subject to limitations based on the type of charitable organization and whether the contribution was made in cash or property. These limitations determine the amount that can be deducted in a given tax year.

Contributions to public charities, private operating foundations, "conduit" private foundations, and certain private foundations pooled in a common fund are allowed up to 50% of the taxpayer's contribution base for the year (the "50% limitation"). For tax years beginning after December 31, 2017, and ending before January 1, 2026, the 50% limitation was increased to 60% for cash contributions. Contributions of qualified conservation easements are also allowed up to 50% of the taxpayer's contribution base.

Contributions of capital gain property to the above-mentioned organizations are allowed up to the lesser of 30% of the taxpayer's contribution base or the excess of 50% of the contribution base over the amount of charitable contributions allowed under the 50% limitation (the "30% limitation"). Cash contributions (or other property eligible for the 50% limitation for public charities) to private foundations, certain semi-public charities, and contributions "for the use of" any charitable organization are also subject to the 30% limitation. However, taxpayers may elect to deduct the basis of capital gain property rather than its fair market value and utilize the 50% limitation for that year.

Contributions of capital gain property to private foundations or semi-public charities are deductible up to the lesser of 20% of the contributor's contribution base or the excess of 30% of the contribution base over the amount of capital gain property subject to the 30% limitation (the "20% limitation").

If a taxpayer cannot use all of their allowable charitable deductions in a given year due to these limitations, the excess deductions can be carried forward for the succeeding five years, subject to the same limitation rules.

Contributions of Complex Assets
In General

Family office stakeholders often contribute complex assets for charitable purposes, which can lead to unexpected tax consequences. The valuation rules applicable to these assets create substantial planning opportunities - but can also lead of very poor outcomes. Moreover, certain tax issues may also arise, potentially causing unintended results, such as gain recognition for the contributor.

Generally, taxpayers can claim a deduction equal to the fair market value of the contributed property, subject to numerous adjustment and disallowance rules. While valuing most assets is relatively simple due to available market data, complex assets like interests in closely held businesses, real estate, collectibles, artwork, nonmarketable securities, and other financial instruments require appraisals.

Charitable donors aim for the highest property value and the smallest discounts for lack of control and marketability to obtain a larger income tax deduction. Conversely, gift donors seek to maximize discounts for a lower value of transferred property, thus moving a greater amount out of the donor's estate. However, the IRS likely expects consistent valuation approaches for similar assets unless there are mitigating factors.

Contributing capital gain property generally results in a contribution equal to the fair market value of the transferred property, with significant exceptions for ordinary income property and certain capital gain property. The allowable deduction may be reduced by the amount of gain that would be ordinary income, short-term capital gain, or long-term capital gain if the property was sold for its fair market value on the contribution date, depending on the type of property and the recipient organization.

Contributions of Complex Assets

Closely Held Business Interests

Contributing closely held interests in businesses and investment holdings to charitable organizations is a common occurrence for family office stakeholders. While a deduction is generally allowed for the fair market value of the contributed stock or partnership interest, additional complexities may limit the allowable deduction or cause current income, particularly in the case of the contribution of interests in pass-through entities.

Valuing closely held business interests for charitable contributions relies on the principles outlined in Rev. Rul. 59-60, which are equally applicable for income, estate, and gift tax purposes. Appraisers must consider various factors, such as the nature and history of the business, economic and industry outlook, book value and financial condition, earning and dividend-paying capacity, goodwill or other intangible value, sales of stock, and market prices of similar businesses.

Family office advisers must recognize several key issues to maximize the benefits of charitable contributions of closely held business interests: contribution limits for private foundations, bargain sale rules, tax rules applicable to charitable contributions of partnership interests and S corporation stock, the assignment of income doctrine, redemption limitations, self-dealing rules, and excess business holding rules.

Careful planning and structuring of charitable contributions of closely held business interests are essential to ensure compliance with the complex rules and restrictions, particularly when involving private foundations.

Contributions of Complex Assets
Real Estate

Family office members sometimes contribute real estate (directly or indirectly) to charitable organizations. The donor's goal is to obtain a deduction for the property's full fair market value, without additional discounts or disallowance. However, such contributions can be complex and may result in significant tax risks due to bargain sale rules, limitations on contributions of partial interests, and special rules for conservation easement contributions.

A taxpayer is entitled to a deduction of the fair market value of unencumbered real property contributed to a charitable organization, subject to adjustments for contributions of ordinary income and capital gain property. Such contributions can be particularly valuable to donors because they effectively monetize an illiquid asset by converting the contribution to a reduction in tax liability. As more fully described in the Portfolio, the following tax matters often arise in the context of charitable contributions of real estate interests: whether a transfer is a complete transfer under applicable state law (rather than the transfer of a partial interest, bargain sale rules applicable on the contribution of encumbered property, and valuation matters.

Family offices must address numerous issues when dealing with such contributions, such as financing and lender issues, as many organizations will not assume liabilities or require the donor to remain a guarantor. Lenders may also require assurances regarding the obligations, collateral, and management of the property post-transfer. State transfer tax considerations should also be taken into account, as transfer tax rates can range from 0.1% to over 5% in some localities, with potential exemptions for transfers to tax-exempt organizations.

Contributions of Complex Assets
Artwork and Collectibles

Family office members often own valuable artwork and collectibles, and disposing of such assets through charitable contributions can be consistent with the family's intent while generating substantial tax savings. Donated artwork and collectibles held for personal or investment purposes are subject to the general rules for contributions of tangible personal property, allowing a deduction of the fair market value, subject to the contribution of ordinary income and capital gain rules under §170(e)(1).

The deduction for contributed tangible personal property is reduced by the amount of long-term capital gain that would be recognized if the property were sold, unless the donee's use is related to the purpose or function that is the basis of the donee's exemption under §501. Thus, a donor is entitled to a deduction of the artwork's fair market value if the artwork is donated to an organization with a related exempt purpose; otherwise, the deduction is limited to the adjusted basis of the contributed artwork.

Collectibles such as rare coins, stamps, books, trading cards, rugs, antiques, and memorabilia are treated similarly to artwork. Collectible planes, boats, and cars are also treated as tangible personal property but may be subject to "qualified vehicle" rules. Contributing artwork or collectibles is subject to the 30% AGI limitation under §170(b)(1)(C).

Valuing artwork and collectibles is inherently less certain than valuations based on comparable sales or projected cash flows due to their unique nature. The willing buyer and willing seller standard still applies, but the determination of value is necessarily subjective. Artwork sold shortly after the contribution is likely valued at or near the sales price less costs, while unique works by recognized artists are generally valued by reference to auction sales of similar works with adjustments for buyer's premium and cost of sale.

Donors may obtain a Statement of Value from the IRS for donations appraised at $50,000 or more to provide assurances of acceptable valuation and mitigate the risk of penalties, interest, additional tax, and professional fees associated with an IRS examination or tax litigation.

Contributions of Complex Assets
Qualified Vehicles

Family offices often administer the ownership and operating luxury vehicles, such as automobiles, aircraft, and boats. When disposing of these assets through or charitable contributions, specific rules apply to the charitable contribution of "qualified vehicles," which include motorized vehicles, yachts, aircraft, recreational vehicles, motorcycles, and nonmotorized watercraft.

Contributing a qualified vehicle generally permits a deduction of the donated property's fair market value under §170, subject to certain limitations. For vehicles worth more than $500 but less than $5,000, the contribution is equal to the lesser of the appraised fair market value or the gross proceeds received from the sale by the charitable organization, if sold without significant intervening use or material improvement.

Special acknowledgment and substantiation rules apply for qualified vehicle contributions, requiring the charitable organization to provide a written acknowledgment to the donor with specific information. Advisers assisting with donations of valuable automobiles, aircraft, and boats must ensure compliance with all substantiation requirements and IRS filing requirements to avoid disallowance of the deduction.

A family office overseeing a vehicle contribution must take into account the following planning issues:

- Coordination with the passive loss rules when contributing property with related passive loss carryovers.
- Coordination with ordinary income rules when contributing business property.

Family offices should calculate the economic benefit of a contribution compared to a sale or exchange when disposing of qualified vehicles to optimize the financial outcome.

Contributions of Complex Assets

Planning Considerations

The following planning considerations apply to family offices in the context of contributions of complex assets:

Selection of the Appraiser

When making complex charitable contributions, particularly those involving valuable property, selecting the right appraiser is critical. Appraisers should have experience in valuing the relevant property and a deep understanding of applicable guidelines. Family offices, which are frequently responsible for engaging appraisers to value complex assets, should approach this task with great care from a risk management perspective. Courts have disregarded appraisals for improper methodology or lack of credibility.

Substantiation Requirements

Family offices must be vigilant about the strict substantiation requirements for charitable contributions, as the IRS disallows deductions based on technical noncompliance.

Timing of Contributions

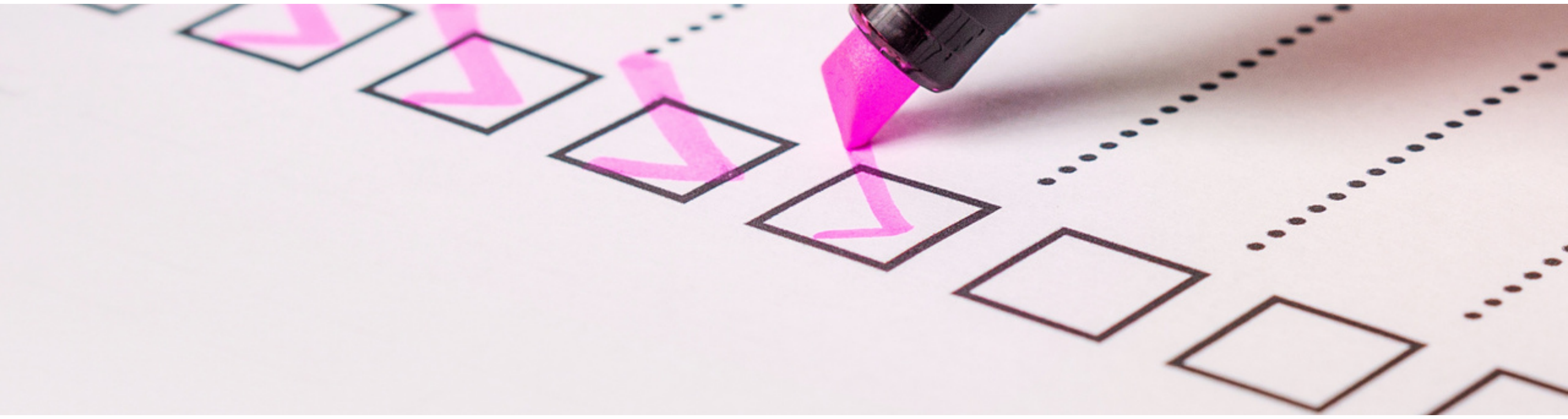
When charitable contributions are made from general family assets, such as an FO Fund, family offices may direct the amount, timing, source, and beneficiary of these contributions.

Nongrantor Trusts

For nongrantor trusts or estates owning interests in an FO Fund or FO Investor, contributing appreciated property through these entities may limit the adjusted basis at the trust level. In such situations, distributing the property to individual owners for them to contribute to charity may maximize the charitable deduction.

Selection of Charitable Vehicle

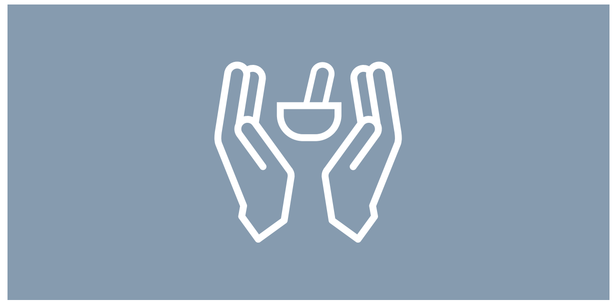
Deduction limits also vary depending on whether the beneficiary is a private foundation, donor-advised fund, or public charity. Private foundations may not be advantageous for contributions other than cash or marketable securities due to reduced deductibility limits and potential self-dealing issues with encumbered property.



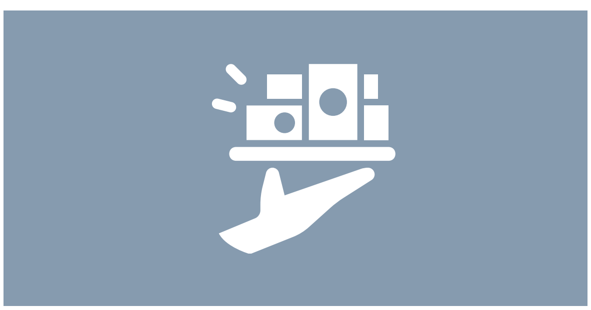
Charitable Contribution Reporting and Substantiation

Complying with these substantiation and reporting requirements is critical for family offices to ensure the deductibility of charitable contributions and avoid potential disallowance or penalties. Proper documentation and recordkeeping are essential for supporting the claimed deductions.

Contributions of money less than $250. The contribution must be substantiated by bank records or a written communication from the donee. Contributions of $250 or more require a contemporaneous written acknowledgment, including the amount of cash and description of property contributed, and a description/estimate of the value of such goods and services.



Contributions of property less than $250. Contributions of property less than $250 can be substantiated with a receipt from the donee or reliable written records. For contributions between $250-$500, a contemporaneous written acknowledgment is required. Contributions between $500 and $5,000 require additional written records and the completion of Section A of Form 8283.



Contributions of property with a claimed deduction greater than $5,000 and not more than $500,000. The taxpayer must obtain a qualified appraisal and attach required information to the tax return. Appraisals are not required for cash, certain publicly traded securities, and certain other property.

Contributions of property with a claimed deduction greater than $500,000. Require the qualified appraisal to be attached to the tax return, along with the substantiation requirements applicable to gifts under $500,000. Certain readily valued property is excepted from this requirement.

Types of Charitable Structures

Family offices utilize various types of charitable structures to meet their philanthropic objectives. Organizations that are organized and operated exclusively for religious, charitable, scientific, and other enumerated purposes, with no net earnings inuring to the benefit of any private shareholder or individual, are treated as tax-exempt organizations under §501(c)(3).

Foundations used by family offices are typically structured as either private foundations or donor-advised funds, although family offices may also support or administer public charities that are not donor-advised funds.

Private foundations are charitable organizations that do not qualify as public charities due to their specific activities, sources of support, or relationships with other organizations. They are subject to various restrictions and potential penalties, including those on managers and possible dissolution.

In addition to traditional tax-exempt organizations, family offices frequently utilize special charitable giving tools such as charitable lead trusts, charitable remainder trusts, or charitable gift annuities, often created for income or estate tax planning purposes.

Private Foundations
In General

Private foundations are subject to the same rules as other §501(c)(3) organizations, but with additional requirements and restrictions not applicable to public charities. Donors to private foundations face greater limitations on contributions compared to public charities, and the Code imposes excise taxes on private foundations for certain impermissible activities.

Contributions to private foundations are limited to 30% of the donor's adjusted gross income for cash gifts and 20% for appreciated securities. The allowable deduction for appreciated property contributions is generally reduced to the adjusted basis, except for most marketable securities.

Private foundations must file Form 990-PF annually to report their activities and determine the excise tax on net investment income. Other excise taxes are reported on Form 4720.

A 1.39% tax is imposed on a private foundation's net investment income, which includes interest, dividends, rents, payments from securities loans, royalties, and capital gain net income, less ordinary and necessary expenses for producing or managing such income. This tax creates a small drag on earnings for foundations with significant investment income.

Private Foundations
Self-Dealing Rules

Congress enacted rules to prohibit or regulate transactions between a private foundation and its controlling persons, known as "self-dealing," to address potential abuse and tax advantages. Excise taxes are imposed on disqualified persons and foundation managers involved in self-dealing transactions.

Self-dealing transactions include:

- Sale, exchange, or leasing of property between a private foundation and a disqualified person.
- Lending money or extending credit between a private foundation and a disqualified person.
- Furnishing goods, services, or facilities between a private foundation and a disqualified person.
- Payment of compensation or reimbursement of expenses by a private foundation to a disqualified person.
- Transfer or use of a private foundation's income or assets by or for the benefit of a disqualified person.
- Agreement by the private foundation to make a payment to a government official.

However, there are exceptions to the self-dealing rules, including:

- Lending money from a disqualified person to a private foundation without interest or charges, if the money is used for tax-exempt purposes.
- Furnishing goods, services, or facilities by a disqualified person to a private foundation without charge, if used for tax-exempt purposes.
- Furnishing goods, services, or facilities by a private foundation to a disqualified person on terms no more favorable than those available to the general public.
- Payment of reasonable and necessary compensation or reimbursement of expenses by a private foundation to a disqualified person for personal services related to the foundation's exempt purpose, if not excessive.
- Transactions between a private foundation and a disqualified person corporation pursuant to a liquidation, merger, redemption, recapitalization, or other corporate reorganization, if all securities of the same class are subject to the same terms and provide for receipt of no less than fair market value by the foundation.

Individuals that are affiliated with a family office are at risk of engaging in self-dealing transactions since it is common for the for-profit family office to actively assist and support foundation operations. While compensating or reimbursing family members for services rendered is permissible, most other transactions, such as sales, exchanges, leases, loans, or furnishing goods or facilities for remuneration, are generally barred under the self-dealing rules.

To avoid potential tax liability and public relations concerns, private foundations should engage independent parties to set compensation for disqualified persons, such as through a compensation study prepared by an independent accounting or consulting firm or a compensation committee comprised of independent board members. Family office personnel who support both family office and private foundation operations must ensure that any compensation received from the private foundation is not excessive to avoid violating the self-dealing rules.

Private Foundations
Excess Business Holdings Rules

The excess business holdings rules, under §4943, limit the ownership stake that private foundations and disqualified persons can hold in a "business enterprise." These rules often apply to family offices, as it is not uncommon for the FO Family to transfer substantial equity stakes in active businesses to private foundations as part of their estate planning.

A "business enterprise" generally includes the active conduct of a trade or business. However, there are two exceptions: (1) a business that derives 95% of its gross income from passive sources, such as dividends, interest, royalties, and capital gains; and (2) a "functionally related business" or program-related investments.

The excess business holdings rules limit a private foundation's ownership in a business enterprise to 20% (or 35% in some cases), reduced by the amount held by disqualified persons. As a result of this rule, the allowable percentage holdings for the foundation is zero since disqualified persons' hold all or most of the remaining holdings. In such circumstances, a private foundation would be limited to the de minimis safe harbor, equal to 2% of the value of the respective business enterprise.

It is not clear whether the allowable percentage applies at the holding company level (e.g., an FO Fund) or the underlying trade or business level. The legislative history and IRS guidance suggest that a holding company would not be counted for purposes of determining the excess business holdings percentage limitations. Therefore, a private foundation could potentially own a larger share of an FO Fund if the §4943 test is conducted at the underlying trade or business level.

If a private foundation owns excess business holdings, it must dispose of the excess interest to a person other than a disqualified person, even if the remaining interest would be permitted under the de minimis rule. This may require transferring the excess interest to an unrelated party, resulting in a loss of control for the family, or transferring it to a disqualified person under the exceptions to the self-dealing rules, such as certain pre-existing business relationships, transactions during estate administration, or certain corporate transactions like redemptions.

Family offices can create FO Funds that only hold passive investments, deriving at least 95% of their gross income from passive sources, to allow private foundations to co-invest without implicating the excess business holdings rules.

The excess business holdings rules are perhaps the largest hurdle to using private foundations for an FO Family. Nevertheless, careful planning allows families to utilize the investment expertise of the family office to grow their private foundations.

Private Foundations

Special Types of Private Foundations

Conduit" or "Distributing" Private Foundations: A conduit or distributing foundation is a private foundation (other than an operating private foundation) that makes qualifying distributions equal to the contributions it received during the year by the 15th day of the third month after the close of its tax year and has no undistributed income for that year. Conduit foundations are eligible for higher contribution limits under §170(b)(1)(A), permitting cash contributions up to 60% and property contributions up to 30% of the contribution limit. The reduction in the value of charitable contributions under §170(e)(1)(B)(ii) does not apply to conduit private foundations.

A family office may use a conduit foundation in tandem with a traditional private foundation to maximize the contribution base. An FO Family could maximize contributions to a traditional private foundation (e.g., appreciated securities up to the 20% limit) and contribute an additional amount to meet the 30% limit to a conduit foundation, which must distribute the contributions by the 15th day of the third month following the close of the tax year.

Private Operating Foundations: A private operating foundation makes qualifying distributions directly in the conduct of charitable activities that fulfill their charitable purpose. The distributions must be equal to the lesser of the foundation's adjusted net income or its minimum investment return. Private operating foundations are eligible for the temporarily increased contribution limits under §170(b)(1)(A), allowing cash contributions up to 60% and property contributions up to 30% of the contribution limit. The reduction in the value of charitable contributions under §170(e)(1)(A) for long-term capital gain donated to a private foundation does not apply to private operating foundations.

The main challenge in utilizing a private operating foundation is meeting the active conduct standard, which requires satisfying one of the three tests described in §4942(j)(3)(B).

Private Foundations
Coordination with the Family Office

Family offices and their stakeholders often prefer using private foundations as their primary charitable vehicle due to the advantages they offer compared to public charities, including donor-advised funds. The main benefit of a private foundation is that the family has control over the assets.

Private foundations have some major disadvantages compared to public charities. The most significant drawback is the lower contribution limits, which restrict the allowable income tax deductions for family members. However, this detriment can be mitigated by using a donor-advised fund, conduit foundation, or private operating foundation in tandem with a private foundation.

For most family offices, the control attributes of a private foundation outweigh the relatively small tax disadvantage of the 1.39% net investment income tax. Excise taxes under §4941–§4945 are not regularly imposed, but act instead as a penalty for noncompliance.

In the family office context, private foundations often serve as the primary vehicle for the family's charitable and philanthropic activities. These foundations may be designed to make gifts over an extended period, with some having a specified time limit and others intended to exist in perpetuity. The purpose of a family foundation is to meet the family's financial, social, and philanthropic legacy.

To meet the family's philanthropic objectives, private foundations fund direct contributions to public charities, donor-advised funds, or direct contributions for operating foundations. These foundations rely on cash flow and funding from family members, often commencing operations with initial funding prior to the formation of the family office. The family office may assist in operating the foundation by providing staff, systems, office space, and professional services, either at no charge or in a manner permitted under the self-dealing rules.

Managing the family's foundations is typically distinct from managing the family office itself. While the family office is managed as a business through the FO Manager, family foundations tend to have a broader social construct involving a more diverse group of family and non-family members. In this model, the FO Manager provides support for formal activities such as cash management, budgeting, accounting, tax and legal advice, due diligence, and oversight of good business practices. The practical management of the foundation and its charitable activities is addressed through a charity-focused group of family and non-family members.

Donor-Advised Funds

Donor-advised funds (DAFs) have become an increasingly popular alternative or supplement to private foundations for family offices engaged in charitable giving. DAFs offer several advantages over private foundations, making them an attractive option for families looking to maximize their philanthropic impact while minimizing administrative burdens and costs.

One of the primary benefits of DAFs is that they are treated as public charities for most purposes, allowing for higher charitable deduction limitations and fewer potential excise taxes compared to private foundations. Donors can claim tax deductions for cash contributions up to 60% of their adjusted gross income (AGI) and contributions of appreciated property up to 30% of their AGI when giving to a DAF. This is significantly higher than the limits for private foundations, which are 30% for cash contributions and 20% for appreciated marketable stock.

While DAFs do not provide as much control as private foundations, donor advisor recommends the charitable distribution and investment of funds for their DAF account. The sponsoring organization ultimately controls the assets, but it typically follows the donor's recommendations as long as they align with the organization's charitable mission.

Family offices can use DAFs in tandem with private foundations to optimize their charitable giving strategy. By contributing the maximum allowable amount to a private foundation and then making additional contributions to a DAF, donors can take full advantage of their AGI limitations for charitable deductions in a given tax year. This approach allows the family to maintain control over the private foundation assets while benefiting from the higher contribution limits and flexibility of a DAF.

By strategically combining DAFs with private foundations and carefully navigating the policies and restrictions of sponsoring organizations, family offices can create a robust and effective charitable giving plan that supports their long-term goals and values.

Unrelated Business Income Tax

Family offices managing assets on behalf of affiliated private foundations must carefully consider the potential impact of the unrelated business income tax (UBIT) on their investment strategies. UBIT can generate significantly different after-tax returns for tax-exempt organizations compared to for-profit entities, making it crucial for family offices to structure their investments in a manner that mitigates tax liabilities and maximizes returns for their private foundation clients.

Unrelated business taxable income (UBTI) is derived from any "unrelated trade or business" regularly carried on by a tax-exempt organization that is not substantially related to its charitable, educational, or other exemption purpose. While certain types of investment income, such as dividends, interest, royalties, and rents from real property, are generally excluded from UBTI, other investments like leveraged real estate, private equity, and hedge funds that utilize leverage can generate taxable UBTI.

To minimize the impact of UBIT, family offices should consider the following planning strategies:

- Structure the private foundation as either a corporation or a charitable trust, depending on which tax rates (corporate or trust) are more advantageous for the foundation's specific investment mix.
- Utilize "blocker" corporations to hold investments that would otherwise generate UBTI. By investing through a C corporation, the private foundation's investment return is received as a dividend or capital gain, avoiding UBTI.
- Tailor investment allocations for private foundation clients to avoid or minimize investments that generate UBTI, considering each foundation's unique tax situation and investment goals.

By proactively addressing UBIT concerns and implementing effective planning strategies, family offices can help their private foundation clients navigate the complex tax landscape, optimize their investment returns, and maintain their tax-exempt status while furthering their charitable mission.

Using Charitable Vehicles to Own Business and Investment Assets

Charitable organizations related to a family office can own various types of assets, but they must be aware of the potential tax implications and restrictions associated with certain investments. Owning interests that generate UBTI, are subject to the excess business holdings rules of §4943, or are considered jeopardizing investments under §4944, and can lead to additional compliance requirements and additional tax liabilities.

When a family wants their related charitable organization own business interests directly, they must consider the impact of UBIT and the limitations imposed by the excess business holdings rules. UBIT lowers the investment returns. However, the tax liability is generally lower than what would be borne by a taxable owner, allowing the business returns to compound at a higher rate and potentially resulting in a larger future charitable gift.

The excess business holdings rules severely limit a private foundation's ownership of business interests, and the self-dealing rules restrict the sale of such interests back to family members, with few exceptions. Despite these restrictions, many families intend to transfer investment company holdings to foundations at death. Such families should consider the following alternatives to holding interests in a private foundation:

- Causing family members or third parties to reacquire the interests from the private foundation under the available exceptions to the self-dealing rules.
- Transferring the business interests to a willing donor-advised fund to hold the interests long-term.
- Transferring the interests to a public charity, although donor-advisor rights will not be available.

07 Estate Planning for the Family Office

Coordinating Family Office Estate Planning for Family Members from Multiple Generations

Estate and Gift Taxation in the Family Office

Estate and gift tax planning is a crucial aspect of a family office's responsibilities, and advisers within the family office should have a thorough understanding of these concepts to provide guidance that aligns with the family's business and investment goals. The estate tax, gift tax, and generation-skipping transfer tax (GST tax), along with the basis adjustment under §1014, form the core of the U.S. wealth transfer tax system. These taxes are imposed on asset transfers from an individual to their heirs, with the intent to tax each transfer.

Not all transfers are subject to transfer tax, as most transfers to a spouse and charity are deductible, and transfers below the applicable exclusion amount are not taxed. The family office manager often supports estate and gift planning and administration, overseeing gifting transactions, estate administration, and coordinating with outside advisers.

The death of a wealthy family member triggers a series of transactions, including estate administration, business and investment entity arrangements, trust transfers, and dealings with charitable organizations. The net effect is to shift assets from the decedent to family members, trusts, and charities while paying tax liabilities to federal and state authorities.

Most family office families take steps to reduce estate tax liability, such as maximizing discounts on retained assets, gifting assets during lifetime at lower values, using "defective" grantor trusts, selling assets outright or in trust, transferring assets to split-interest trusts, and utilizing other vehicles like grantor retained annuity trusts and qualified personal residence trusts.

The key vehicle in modern estate planning for high net worth families is one or more well-funded GST-exempt trusts, which aid in tax-efficient planning during lifetime and become the ultimate owner of family office assets. Engaging in sophisticated estate planning is critical for most family offices to retain and grow wealth across generations.

Impact of Estate and Gift Taxes on Family Office Stakeholders

With federal estate tax rates at 40% and most family office families with assets over the lifetime exemption amount, the estate and gift tax impact on family office entities and related structuring issues is a critical consideration for family offices. In general, assets are included in a decedent's estate when the decedent has retained certain rights or powers over those assets, as outlined in §2036 and §2038.

Under §2036, a decedent's gross estate includes the value of transferred property subject to a retained interest if the decedent retained the use, possession, right to income, or other enjoyment of the property, or the right to designate the persons who shall possess or enjoy the property or its income. In the family office context, §2036 may apply to the FO Fund and FO Investor. To mitigate this risk, family offices should limit the senior generation's control over distributions, avoid granting the senior generation the right to amend partnership documents, detail non-tax purposes for forming entities, obtain appropriate valuations, and make cash distributions in accordance with fund agreements.

Under §2038, the gross estate includes certain revocable interests in assets where the decedent made a transfer and retained the power to alter, amend, revoke, or terminate the property interest. If a §2038 power is included in a partnership agreement for an FO Fund or FO Investor, it could cause estate inclusion even if the decedent owns no partnership interests at death.

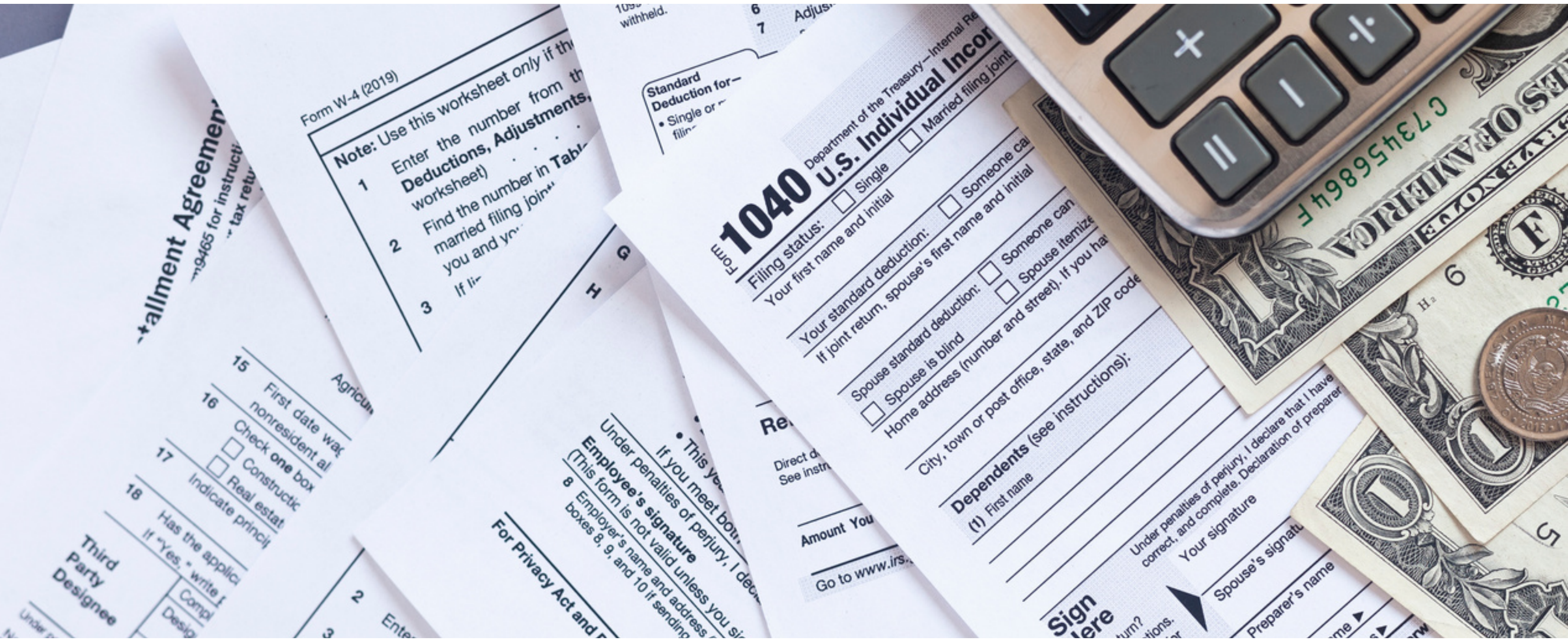
Estate taxes are assessed on the *fair market value* of the decedent's assets. Thus, the fair market value of a decedent's holdings - including family office fund interests - may be included in the taxable estate. Valuing closely held business interests for estate and gift tax purposes follows the rules under Reg. §25.2512-3 and Rev. Rul. 59-60. Interests in family office entities are valued similarly to interests in a family limited partnership, with discounts for lack of control and lack of marketability.

Tax Returns for Estates, Gifts and Generation Skipping Transfers

The family office often administers gifts and estates for FO Family members, including filing gift and estate tax returns.

An **estate tax return (Form 706)** is filed by an estate within nine months from the decedent's date of death (subject to a six-month automatic extension) for estates with a gross estate plus taxable gifts exceeding the applicable exclusion amount (*i.e.*, taxable estates) or if the executor elects to transfer the deceased spousal unused exclusion amount to the surviving spouse. The federal estate tax payment is due by the return's due date, excluding extensions. The return includes information necessary to calculate the estate tax, such as asset listings, valuations, and other required details. Decedents may also need to file state estate tax returns.

A **gift and generation-skipping transfer tax return (Form 709)** must be filed annually by individuals making gifts exceeding the annual exclusion amount, giving future interests, or consenting to split gifts with a spouse. The return reports taxable gifts, applicable exclusion amount used, generation-skipping transfers, GST tax exemption allocation or opt-out elections, and valuation information.



Insurance in the Family Office Environment

Life insurance is a major asset holding for wealthy families and family offices often lead the acquisition, financing, and strategic planning of life insurance for the FO Family. With very large estates, complicated assets, and the need for multigenerational wealth planning, life insurance is almost always a major consideration for FO Families. Life insurance serves multiple purposes in this context, including funding estate tax payments, replacing income for cash flow purposes, providing an investment class generally uncorrelated with most family office investments, funding buy-sell arrangements, and repaying debt obligation.

Life insurance proceeds are generally received tax-free under §101 when payable due to the insured's death. However, life insurance premium payments are generally not deductible for income tax purposes. Although life insurance would be included in the estate of the insured when it is owned by the insured, it is easy to hold life insurance outside of the insured's estate and avoid estate tax. To maximize the benefits of life insurance and remove the proceeds from the insured's estate for estate tax purposes, life insurance policies are often owned by an irrevocable life insurance trust (ILIT) or a similar trust structure.

Unlike other assets transferred to trusts not includible in the taxable estate, which may involve a trade-off between an income tax basis step-up under §1014 and estate tax savings, life insurance held in an ILIT offers a unique advantage. The ILIT receives life insurance proceeds tax-free, and because the proceeds are in the form of cash, the trust has a basis in the proceeds equal to their value. Consequently, the efficiency of life insurance for estate planning purposes is measured solely against the potential return that the premium dollars paid and gift tax exemption used could have generated if invested elsewhere on an after-tax basis.

Family offices have two primary roles in managing ILITs: trust administration and tax planning. Family offices can utilize life insurance in various sophisticated ways, such as creating a systematic approach to acquire life insurance on young, healthy family members to enhance economic returns and reduce premiums, using the cash value of life insurance as a financing tool or "family bank," and managing estate planning risks with term life insurance to cover potential estate inclusion or loss of basis step-up.

Family offices help their clients optimize wealth transfer, minimize estate taxes, and ensure long-term financial security for future generations.

Private Placement Life Insurance

Private placement life insurance (PPLI) has gained popularity in recent years, and PPLI is become more and more common in the family office landscape. PPLI is, in effect, a self-constructed life insurance contract that enables the insured to design the investment criteria, and benefit from the investment return. These policies are typically funded with front-loaded premium payments and are structured to generate substantial investment returns, often as variable universal life policies using separate accounts. The insurance contract will pay out a death benefit that captures most or all of the appreciation.

Like any commercial insurance policy, PPLI investments grow tax-free, and the reduced tax liability increases the relative size of the asset base compared to investments held in a taxable account. An FO Family can customize a PPLI policy to meet its needs, with the underlying investments selected by the family, subject to criteria that ensure the family does not retain investor control and is diversified. PPLI policies often include alternative investments, such as private equity funds, hedge funds, credit and multi-strategy funds, and other vehicles that qualify as insurance dedicated funds.

PPLI policies are subject to state insurance regulation, taxes, and fees, including the federal deferred acquisition cost tax, state premium taxes, and potentially federal excise tax for offshore PPLI policies. A significant detriment of PPLI is its cost. The costs and expenses of PPLI policies are typically higher than those of traditional insurance policies due to regulatory requirements, professional fees, fees for third-party investment funds, and policy administration charges.

“MANY OF THE LARGEST PRIVATE FOUNDATIONS IN THE WORLD ARE OPERATED BY OR AFFILIATED WITH FAMILY OFFICES. THE FO FAMILIES ARE MANY OF THE MOST CHARITABLE FAMILIES IN THE WORLD. THE INCOME AND CASH FLOWS FROM AN FO FAMILY'S BUSINESS AND INVESTMENT ACTIVITIES FUND THEIR CHARITABLE ENDEAVORS. MOREOVER, THE INTERPLAY BETWEEN THE BENEFITS OF CHARITABLE DEDUCTIONS AND THE INTRINSIC CHARITABLE ACTIVITY OF THE FAMILY ENABLES THE FO FAMILY TO ENGAGE IN TAX-EFFICIENT CHARITABLE PLANNING WHILE MEETING THEIR CHARITABLE OBJECTIVES.”

08 Family Office Toolbox

Resources for Family Offices to Assist with Operations, Compliance and Planning

Should You Establish an SFO?

For families who have not established a single-family office or are part of a multifamily office, multiple factors should be considered prior to investing time and resources in a single-family office.

Net Worth and Investable Assets	What is your family's total net worth? What is the approximate value of your family's investable and liquid assets? Does your net worth warrant the cost and complexity of setting up a family office?
Financial Affairs Complexity	How complex are your family's financial affairs, including investments, real estate holdings, business interests, and charitable endeavors? Do you have a diverse range of asset classes and investments that require specialized management?
Generational Wealth Transfer	Do you plan to transfer significant wealth to future generations? Do you require comprehensive estate planning and wealth management strategies across multiple generations?
Family Dynamics and Engagement	How involved do family members want to be in managing their wealth and family matters? Are there multiple branches or generations of the family that need to be coordinated? Is there a shared vision and set of values among family members regarding wealth management and family legacy?
Professionalism and Control	Do you desire greater control, oversight, and customization over the management of your family's wealth? Are you seeking a higher level of professionalism, expertise, and dedicated resources than what traditional wealth management firms can provide?
Privacy and Confidentiality	Is maintaining a high level of privacy and confidentiality regarding your family's financial affairs a priority and/or requirement? Are you concerned about potential conflicts of interest or information leaks when working with third parties?
Succession Planning	Is there a need for a formalized succession plan to ensure the smooth transition of wealth and leadership within the family? Are there family members or trusted individuals who can take on leadership roles to carry out family affairs?
Charitable Endeavors	Does your family have significant philanthropic goals or charitable foundations that require dedicated resources, oversight, and strategic planning? Is there a desire to involve future generations in philanthropic activities and decision-making?
Cost and Resource Considerations	Are you prepared to invest the significant costs and time associated with establishing and maintaining a family office? Do you have access to the necessary resources, including personnel, technology, and infrastructure to support a family office?
Long-Term Commitment	Is your family committed to the long-term investment and effort required to establish and maintain a successful single-family office? Are you prepared to dedicate the necessary time and resources to ensure the family office's effectiveness and run the family's affairs like a business?

Charitable Foundation Checklist

- [ ] Determine the mission and goals of the foundation
- [ ] Choose the legal structure
- [ ] Draft the founding documents
- [ ] Obtain necessary registrations and approvals
- [ ] Establish governance and management
- [ ] Determine funding sources and strategies
- [ ] Develop grantmaking processes
- [ ] Create an investment policy statement
- [ ] Develop a communications and branding strategy
- [ ] Comply with ongoing reporting and filing requirements
- [ ] Evaluate and refine operations periodically

THE DEATH OF A WEALTHY FAMILY MEMBER TRIGGERS A CASCADE OF TRANSACTIONS RELATING TO ESTATE ADMINISTRATION, VOLUNTARY AND CONTRACTUAL ARRANGEMENTS FOR BUSINESS AND INVESTMENT ENTITIES, TRANSFERS TO AND FROM NEW AND EXISTING TRUSTS, AND DEALINGS WITH PRIVATE FOUNDATIONS, DONOR-ADVISED FUNDS, AND PUBLIC CHARITIES. THE NET EFFECT OF THESE TRANSACTIONS IS TO SHIFT ASSETS FROM THE DECEDENT TO FAMILY MEMBERS, TRUSTS, AND CHARITABLE ORGANIZATIONS WHILE PAYING ANY TAX LIABILITY TO FEDERAL AND STATE TAXING AUTHORITIES FROM SUCH ASSETS.

FOR MOST FAMILY MEMBERS ASSOCIATED WITH FAMILY OFFICES, ESTATE PLANNING TRANSACTIONS OFTEN BEGIN DECADES PRIOR TO DEATH.

09 Resources

Additional Resources for Family Office Advisers, Executives and Principals.

Who is RS&F?

Not Your Typical Advisory Firm

WHO

RS&F is a boutique business advisory and accounting firm focused on sophisticated family offices, ultra-high net worth families, and closely held businesses

STRATEGIC ADVISORY

MERGERS AND ACQUISITIONS | CAPITAL AND DEBT FORMATION
BUSINESS AND STRATEGIC PLANNING

BUSINESS AND TAX CONSULTING

BUSINESS STRUCTURING | EXECUTIVE COMPENSATION
OPERATIONS | HUMAN CAPITAL | SYSTEMS

ACCOUNTING, TAX AND REPORTING

TAX COMPLIANCE | AUDITS AND FINANCIAL REPORTING | VALUATIONS
FORENSIC ACCOUNTING | CLIENT ACCOUNTING SERVICES

WHAT

Our team **partners** with clients to support them through opportunities and challenges.

We **value** accountability, compassion, commitment, innovation, empowerment, and team spirit.

Clients benefit from our strong **network** of business owners, professional advisors, partners, and centers of influence.

Our **platform** combines international resources with special attention to efficient and impactful client service.

Industries

Real Estate | Healthcare | Construction | Manufacturing
Distribution | Nonprofits | Government Contractors
Business Services | Technology | Mortgage Banking
Retail

Specialty Services

Family Office Advisory | M&A Transactions
Estate Planning | Qualified Opportunity Zones
Succession Planning | State & Local Taxes
Healthcare Consulting | Aviation Tax Services

Who is RS&F?
Leader in Sophisticated Tax Services

FAMILY WEALTH PLANNING

ESTATE TAX PLANNING | MULTIGENERATIONAL WEALTH TRANSFER STRATEGIES | ASSET PROTECTION | FAMILY OFFICE STRUCTURING

BUSINESS TAX PLANNING

ACCOUNTING METHODS

TAX DEFERRAL STRATEGIES

EXECUTIVE COMPENSATION

BUSINESS TAX CREDITS

BUSINESS RESTRUCTURING

TRANSACTIONAL

MERGERS AND ACQUISITIONS
REAL ESTATE STRUCTURING
FUND FORMATION

STATE TAX PLANNING

PTE TAX PLANNING
RESIDENCE/DOMICILE PLANNING
NEXUS AND APPORTIONMENT
STATE TAX CREDITS

SPECIALTY TAX MATTERS

AIRCRAFT/BOAT TAX PLANNING
COST SEGREGATION
FEDERAL AND STATE TAX AUDITS
PLANNING WITH OPPORTUNITY ZONES AND LIKE-KIND EXCHANGES

FAMILY TAX PLANNING

FAMILY INVESTMENT VEHICLES

CHARITABLE PLANNING

RETIREMENT PLANNING

PERSONAL TAX CREDITS

MAXIMIZING DEDUCTIONS

Who is RS&F?

Leader in Family Office Advisory Services

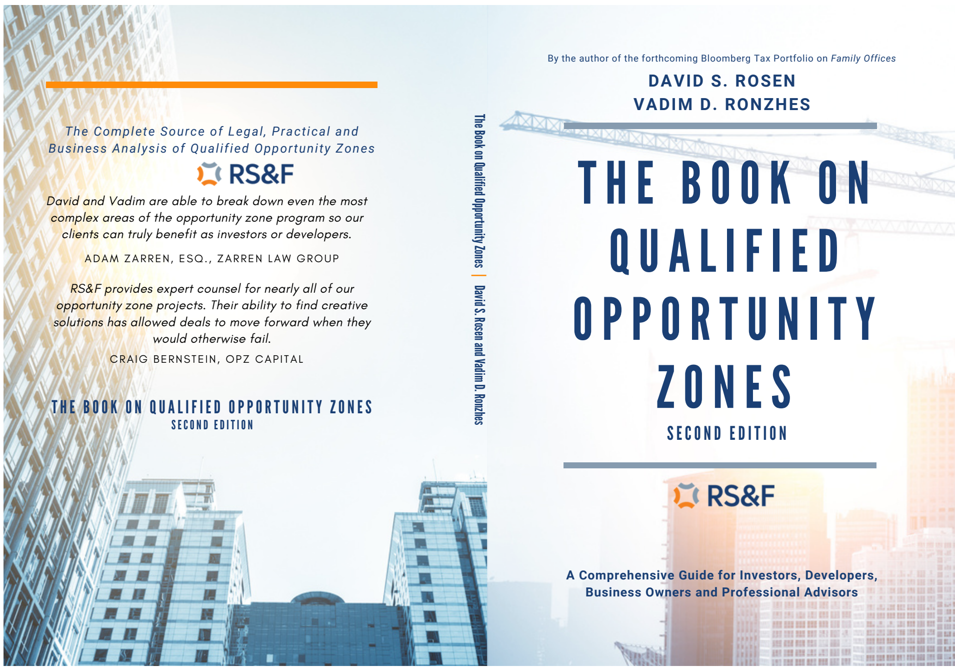
FAMILY OFFICE CONSIDERATIONS

- STRUCTURE OF THE FAMILY OFFICE AND REGULATORY MATTERS
- FAMILY OFFICE OPERATIONS
- INCOME TAX MATTERS AFFECTING THE FAMILY OFFICE MANAGER AND FUND ENTITIES
- TAX TREATMENT OF FAMILY OFFICE INVESTMENTS
- TAX TREATMENT OF FAMILY OFFICE OWNERS AND EMPLOYEES
- CHARITY AND PHILANTHROPY IN THE FAMILY OFFICE
- ESTATE AND GIFT TAX PLANNING FOR FAMILY OFFICE STAKEHOLDERS

FAMILY OFFICE PROFILE

- FAMILY NET WORTH GREATER THAN $250 MILLION (OFTEN IN EXCESS OF $1 BILLION)
- COMMITTED TO MANAGING COORDINATED INVESTMENT AFFAIRS LIKE A BUSINESS OVER A MULTI-GENERATIONAL TIME FRAME
- WILLING TO ACCEPT COMPLEXITY AND COST IN EXCHANGE FOR GOOD LONG TERM OUTCOMES

Thought Leadership
Qualified Opportunity Zones



The development of the Book on Qualified Opportunity Zones (Second Edition) arose following dozens of real-life transactions (many of which have culminated in the creation of qualified opportunity funds that are currently developing real estate and business projects under the program). Over the past four years, we have prepared detailed transaction memos, researched every component of the statute and regulations and developed practical tools for stakeholders. Ultimately, we felt that combining our work into a comprehensive “book” will benefit our team, our clients, and other participants in the new industry focusing on the opportunity zone program.

David Rosen (from the Forward of the Book on Qualified Opportuniyt Zones, Second Edition)

RS&F HAS LED THE TAX STRUCTURING FOR OVER $10 BILLION OF OPPORTUNITY ZONE INVESTMENTS AND DEVELOPMENT PROJECTS

Contact Us.

Advising and supporting family offices to ensure multigenerational success.

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