Advancing your private wealth goals: 3 focus areas for 2023

Protecting, preserving and growing the family's wealth

Welcome to tax year 2023! Since we last connected, the Inflation Reduction Act of 2022 has settled into law and new retirement protections known as the Secure 2.0 Act of 2022 provided some changes to the retirement savings landscape in late December 2022. Yet, as of the release of this article, many taxpayers and businesses are still awaiting relief on those tighter limitations on business interest expense and research expenditures deductibility, as well as future certainty around bonus depreciation expensing. In April 2023, the Internal Revenue Service released its long awaited strategic operating plan detailing how it intends to spend the roughly $80 billion in new funding it will receive in the coming 10 years. All with the backdrop of a presidential race for 2024 beginning to take shape. While change may be on the horizon, we are still left with certainty in our tax laws, at the moment, stemming from the 2017 Tax Act (P.L. 115-97, known as the Tax Cuts and Jobs Act or "TCJA"). Many of the tax provisions affecting family enterprises and their owners will remain the same through the end of 2025. This certainty allows individuals and their family enterprises to continue to execute planning towards advancing their goals for their family wealth.

Protecting, preserving or growing the family's wealth, while being good stewards to their investments, remains perpetually on the agenda for many families. Depending on the goals for the family's invested assets, different considerations may take priority at any given point in time. In this article, we will explore a few of those considerations that families evaluate over the multi-generational accumulation and stewardship of wealth, such as:

- Setting up the family office to manage and preserve wealth and to protect the family's legacy and investments,
- Planning for the transfer of wealth to family to steward those investments to future generations, and
- Sharing the wealth beyond the family to further their philanthropic goals.

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Setting up the family office

In previous articles, we followed the hypothetical story of Tom's family enterprise and the wealth he created for his family through the successful operation of their chain of grocery stores.

As family businesses surpass major growth milestones, many decide they need help directing the increasingly complex aspects of that flourishing enterprise, which begins to extend beyond the core business. Often, employees from the family enterprise and/or key members of the family handle these new tasks along with their day-to-day responsibilities. As the demands associated with overseeing new investments and wealth generated outside the family enterprise increase, it is essential that families have the appropriate structures and talent in place to address the related risks and opportunities.

Many family enterprises have spent a significant amount of time and energy building their enterprises and growing their wealth. The effort needed to further grow those investments and preserve that wealth outside the business requires similar effort, and a family office can be the mechanism to formalize the future structure for the family. Two common scenarios tend to lead to the formation of a family office: Asset diversification and/or a liquidity event.

Family offices are designed to assist families in a variety of areas, including assistance in managing and investing assets, implementing income, gift or estate tax planning, charitable planning, providing concierge services, and educating family members about their wealth. These activities are generally done in an effort to maintain the family's legacy across generations. There are key tax and financial considerations when establishing a family office, including an analysis regarding how the family office should be structured for income tax purposes and how the family office will be compensated for its services.

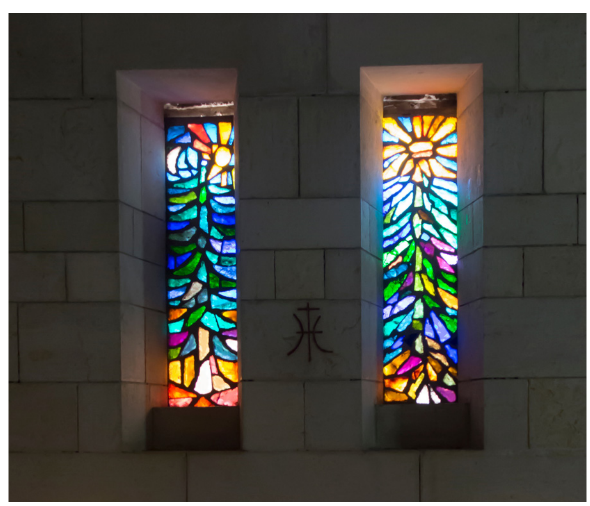
While each family office serves the unique needs of the founders and their descendants, family offices typically work to seek preferential investment access, create economies of scale, manage financial and personal risks for the family, unite the family around philanthropic goals, and maintain the privacy of family affairs. Family offices may bring wealthy families a sense of control, the ability to tap into bespoke services, and a dedicated group of people focused on the family's best interests, all while protecting the family's legacy and investments.

Asset diversification:

The profits from a family enterprise are diversified into new investments. The core family business employees cannot handle the management of those investments, so the family's nonbusiness operations migrate to a family office.

Liquidity event:

A family sells some or all of its interest in the business, triggering the need for a family office to formalize governance and manage the reinvestment of the proceeds.



Planning for the transfer of wealth

While creating and preserving wealth are usually top of mind, planning for the transfer of wealth can sometimes take lower priority. Proactive planning for the transfer of family wealth can help ensure that property transfers (and the related tax issues) align with—and don't distract from —the overarching wealth distribution goals for the family. One critical, yet often overlooked, element of wealth planning is keeping the plans up to date, particularly as investments grow, relationships change, or new descendants are born. With each significant life event, business divestiture, substantial wealth accumulation or tax law change, it's important to review your plans and make proactive changes when the situation calls.

It is important to be reminded that under the TCJA, the applicable exclusion amount (AEA)—the amount that can be left to others by gift or bequest without incurring a gift or estate tax—was increased from $5 million to $10 million, indexed for inflation. In 2023, the AEA is $12.92 million. This increased exclusion will only be in place until the end of 2025, at which time it will revert to the previous $5 million limit indexed for inflation on January 1, 2026. Under current law, the increased AEA is a "use it or lose it" proposition. Once it sunsets, it will be as if it had never existed. Those in a position to make gifts should consider whether to make gifts that absorb part or all of the AEA before the closing of tax year 2025.

As a family evaluates the distribution of family investments and the proactive transfer of wealth to the next generation, consideration must be given to the type of investment that is the target of the wealth transfer plan. A family's wealth can consist of many types of investments, from cash, marketable securities, the business itself, to more exotic assets, such as carried interests in partnerships, cryptocurrency, or art, just to name a few. Assessing the impact to the donor's AEA is just the first consideration. Other concerns to be analyzed when transferring an investment by gift include:

- What is the value of the investment today? Will it require an appraisal to ascertain its value? Will this investment appreciate in the future?
- What are the income tax implications to the donor and/or the donee as a result of the change in ownership?
- What is the impact to the cash flow of the donor or the donee if an asset is transferred?
- Are there any transferability limitations and/or other restrictions related to the investment?

While many families tend to focus on those larger, strategic transfers of wealth, don't forget about the tried and true basic planning, which can include annual exclusion gifts ($17,000 per donee for 2023), gifts to 529 plans or paying medical and education expenses directly to an institution. These can be effective annual actions that allow families to continually share and steward their wealth to the next generations.

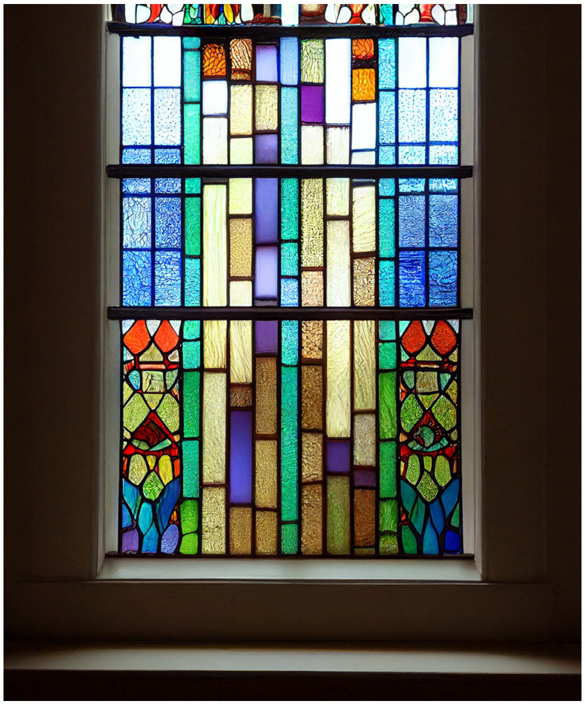
Accomplishing philanthropic goals

Individuals, including the core family business or their family foundations, are increasingly taking a more strategic approach to philanthropy. Many view the family business and its steady income streams as an ideal way to fund the family foundation—either as a lifetime gift or through their estate plan. While it can be done, due to excise tax considerations, this has been an area fraught with subtleties and nuances that make a seemingly easy choice into one that requires careful planning that should be undertaken.

Beyond the family business as the investment to transfer by gift, for many families, the "control" of the donated property continues to be an area that prompts consideration. This often gets framed up as a binary choice between a private foundation and a donor-advised fund, or DAF. This may be too narrow of a decision paradigm ignoring all the other potential charitable options available to donors. Other options may include medical or agricultural research organizations, privately funded schools, supporting organizations, and split-interest trusts.

For those concerned with diminishing privacy and perceived restrictions, the focus often shifts to social welfare organizations—501(c)(4), or "(c) (4)," entities— and single-member LLCs formed for a charitable purpose. These organizations may enhance privacy and provide fewer government restrictions on charitable activity relative to other charitable organizations, yet understanding there are some drawbacks, including the potential for the inclusion of the transferred assets in the donor's estate should the donor directly or indirectly retain control over the organization. Understanding the donor's goals first helps to determine the vehicle with the fewest barriers and most benefits.

Charitable contributions, while they are a means to further philanthropic goals, are often the largest controllable tax deduction for an individual. For those seeking tax efficiency, there are many areas that require thoughtful consideration: the type of asset to donate, the timing of the gift, the vehicle used to fund the gift, and the type of organization to receive it. It is critical to work with an adviser specializing in this area to navigate your way through these decision points effectively for the sake of both your family's philanthropic goals and your overall tax planning.



Conclusion

As we move through the second half of 2023, whichever of these considerations you find taking priority for your family enterprise this year, continue to consult with your team of advisers. This collaboration can provide you the confidence you need to protect, preserve and grow your family's wealth, and be good stewards to your legacy.

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