Essential tax and wealth planning guide

2024 EDITION

Deloitte.

Welcome

DEAR READER,

As tax year 2023 winds down, we look forward to the exciting possibilities a new year can bring. No matter what time of year, protecting, preserving and growing a family's wealth remains perpetually on the agenda for many individuals and families. Our June release previewed three considerations many families evaluate over the accumulation and stewardship of wealth—setting up the family office, planning for the transfer of wealth, and accomplishing philanthropic goals. In this release, we will dive deeper into some of those areas, while exploring other considerations the family and the family enterprise face as they advance their goals.

Welcome to this year's *2024 Essential tax and wealth planning guide* where we explore the art of protecting the family's wealth while being good stewards to the family's legacy. This year's *Guide* covers:

- **Tax policy:** Explore more about where tax legislation may go next with the backdrop of a presidential race in 2024 beginning to take shape.
- **Setting up the family office: Protecting family legacy:** Learn how the accumulation of significant wealth can open the door for potential opportunities, as well as challenges, that come with overseeing the financial affairs of a family.
- **Furthering the family's philanthropic goals:** The philanthropic goals for a family can be as diverse as the individuals that comprise them. However, with a systematic approach and the possibility of new tools, those goals can be achieved.
- **Pass-through entity taxes: A bold new picture:** States continue to evolve and adopt elective new tax regimes in response to the limitation imposed on the state and local tax deduction. Explore those considerations for owners of pass-through entities.

Remember, at the moment, we have some level of certainty in our tax laws. Many of the provisions of the 2017 Tax Act (P.L. 115-97, known as the Tax Cuts and Jobs Act or "TCJA"), remain with us through the end of 2025. As we've said before, plan with what is known and press forward, consult with advisors, and gain the confidence needed to be good stewards of the family's legacy.

To find a member of the Deloitte Private Wealth practice who specializes in your area of interest, please contact us at ustaxprivatewealth@deloitte.com.

Regards,

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US Private Wealth Tax Leader
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01 Tax policy

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TAX POLICY

Year-end tax bill prospects clouded by House leadership issues, government funding dispute

The House and Senate missed their deadline to fund federal departments and agencies for fiscal year 2024, which began October 1, as lawmakers struggled to reach consensus on topline appropriations numbers. As this publication goes to press, the government is currently operating under a short-term continuing resolution (CR) that keeps the doors open through November 17 at the funding levels in place for fiscal year 2023.

Both chambers of Congress approved the CR on September 30 and President Biden quickly signed it into law, averting a government shutdown that otherwise would have taken place when the new fiscal year began just a few hours later. However, that measure proved to be so divisive within the House Republican Conference that it sparked protests by a handful of the chamber's most conservative members that culminated in Speaker Kevin McCarthy, R-Calif., losing his leadership post on October 3. (For details, see ***Tax News & Views***, Vol. 24, No. 33, Oct. 6, 2023.) McCarthy's ouster as speaker brought legislative action in the chamber to a standstill for more than three weeks as Republican members were unable to coalesce around a new leader. The logjam finally broke when Rep. Mike Johnson, R-La., was chosen as McCarthy's successor on October 25.

With the House's floor agenda interrupted and a full-year spending agreement still elusive, it appears likely that Congress will have to adopt another short-term CR to maintain government operations if it wants to avoid the renewed threat of a shutdown once the current stopgap measure lapses. Just how the spending impasse ultimately will be resolved is uncertain, but there is a growing sense that instead of advancing 12 separate

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appropriations bills to keep the government operating, lawmakers will have to opt for some type of omnibus measure that will be approved late this year or early in 2025.

Normally, tax legislation and spending legislation take distinct paths through Congress, though those trails have often converged in a combined "end-of-year" package. That could turn out to be the case this year, although the likelihood of such an outcome is particularly fraught given the uncertainty we currently face on the spending side.

What a tax deal might look like...

Talks around a possible tax bill thus far have been conducted largely behind the scenes and have been limited to the chairs of the two congressional tax-writing committees. House Ways and Means Committee Chairman Jason Smith, R-Mo., has noted that the American Families and Jobs Act—the formal name for a trio of largely business-focused tax relief measures that the Ways and Means Committee approved in June—should provide the foundation for any agreement on taxes that moves through Congress this year. Smith has also said that he has met several times with Senate Finance Committee Chairman Ron Wyden, D-Ore., to discuss the contours of a potential deal.

Among its more notable provisions, the American Families and Jobs Act would:

- Temporarily mitigate the adverse impact of more stringent rules related to the tax treatment of research expenditures, the deduction for business interest expense, and bonus depreciation that were included in the Tax Cuts and Jobs Act (TCJA, P.L. 115-197) for revenue reasons;
- Pare back clean energy tax incentives that became law as part of last year's Inflation Reduction Act (P.L. 117-169);
- Help US-based businesses remain competitive internationally;
- Spur small-business manufacturing and investment; and
- Offer individuals some relief from the effects of inflation by temporarily increasing the standard deduction.

(For additional details on the legislation as approved by the committee, see *Tax News & Views*, Vol. 24, No. 24, June 16, 2023.)

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Hinting at the broader contents of a potential bicameral tax bill, Smith has specifically cited the urgency of addressing the TCJA's changes to research expenditures, bonus depreciation, and business interest expense, but he also said that lawmakers could take up "traditional" tax extenders, noting that "many of [these] have bipartisan backing." According to Smith, Chairman Wyden is also interested in reforms to the low-income housing tax credit as well as other tax incentives to promote affordable housing.

...And what might keep a deal from coming together

Assuming that Smith and Wyden can agree that a potential tax deal should build on the American Families and Jobs Act, they still would have to sort through a number of inter-party—and intra-party—policy differences to develop a package that could win approval on both sides of the Capitol.

SALT Cap: Although Smith had hoped that there would be a House floor vote on the American Families and Jobs Act this past summer before lawmakers left for their August recess, the legislation remains in limbo as Republicans argue behind closed doors about whether or not to include provisions to repeal or relax the current-law cap on the federal deduction for state and local taxes (SALT) enacted in the Tax Cuts and Jobs Act.

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The House's SALT Caucus includes lawmakers in both parties who represent jurisdictions with high state and local income and property taxes, and there are enough GOP members to prevent the measure from passing if it comes to the House floor without some kind of SALT cap relief; however, there also is a contingent of lawmakers representing lower-tax jurisdictions who are just as adamant about keeping SALT tax relief out of a tax bill. A similar dynamic is at work in the Senate.

Child tax credit: Another potential stumbling block to a deal between the two tax-writing leaders could involve partisan differences over possible enhancements to the child tax credit. Wyden and many Democrats in both chambers have called for expanding the current-law credit—for example, by increasing credit amounts, adjusting refundability thresholds, and making the benefit available in advanceable monthly installments, similar to what Congress did on a temporary basis in the American Rescue Plan Act of 2021 (P.L. 117-2). In the wake of US Census Bureau data released in September showing that child poverty rates increased dramatically after the expiration of the American Rescue Plan provisions, Wyden commented that "[a]ny end of year tax package must include expansions to the child tax credit."

Smith, for his part, has in the past suggested that he could accept enhancements to the child tax credit as long as they were coupled with work requirements. More recently, however, he has appeared to favor narrower changes, stating that he wants to ensure that the credit amount doesn't fall to $1,000 (from its current level of $2,000) after 2025 as currently scheduled under the Tax Cuts and Jobs Act.

Deficit impact, off-putting offsets: Based on estimates from the Joint Committee on Taxation staff, the Ways and Means Committee's American Families and Jobs Act includes a total of $237 billion in tax cuts and $216 billion in revenue increases for a net revenue loss of $21 billion over the 10-year budget window covering 2023-2033. The price tag for the legislation would rise sharply if Smith and Wyden strike a deal that also includes some kind of SALT cap relief and significant enhancements to the child tax credit.

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Republican policy has long been that extensions of current law—for example, restoration of taxpayer-favorable treatment of research expenditures, bonus depreciation, and business interest expense as proposed in the Ways and Means package—should not require revenue offsets. In the current environment, however, the most fiscally conservative Republicans in the House may well balk at any legislation that drives up the deficit.

Just how lawmakers might make a tax package deficit-neutral is unclear, however. Republicans likely would view most of the potential tax increases that would raise revenue to cover the cost of new tax relief as nonstarters, and the tax increases that likely would be acceptable them—including the rollbacks of various Inflation Reduction Act clean energy credits as proposed in the Ways and Means legislation—would be nonstarters for the White House and congressional Democrats.

A limited supply of 'drivers': In addition to these policy-related obstacles, the relative scarcity of urgent issues that could provide momentum for a tax bill also could prove to be an impediment to a year-end deal. One issue that had been regarded as a significant potential driver for tax legislation in 2023—namely, concerns expressed by retirement plan sponsors about their ability to comply with provisions in last year's SECURE 2.0 Act (Division T of the Consolidated Appropriations Act, 2023 (P.L. 11 7-328)) that require catch-up contributions made by certain higher income participants in 401(k) and similar retirement plans to be designated as after-tax Roth contributions effective for taxable years beginning after December 31, 2023—was recently taken off the table when the IRS announced in Notice 2023-62 that it will provide a two-year administrative transition period to implement the new requirement. The notice also addressed concerns by plan sponsors and participants over perceived ambiguity in the statutory language of the SECURE Act by clarifying that eligible plan participants can continue to make catch up contributions after 2023, regardless of income.

Even without the urgency of a SECURE Act fix, though, lawmakers may feel compelled to address the pending expiration, at the end of this year, of administrative relief that delayed enforcement of the stricter information reporting threshold for third-party payment processors that was enacted in the American Rescue Plan. The reduced reporting threshold—$600 in aggregate payments, regardless of the number of transactions—applied to reporting for returns for calendar years after 2021; however, the IRS announced late last year in Notice 2023-10 that calendar year 2022 would be a transition period for implementing the provision. (The American Families and Jobs Act includes a provision that would repeal the reduced reporting threshold and reinstate the levels in place under prior law—that is, $20,000 in aggregate payments and at least 200 transactions annually.)

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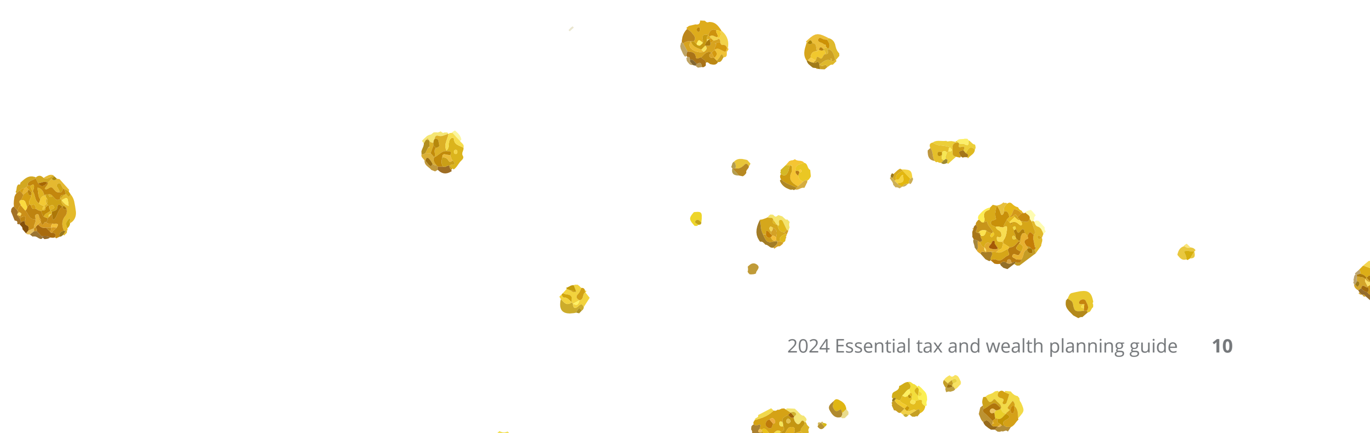
This year, especially, mood matters

Regardless of substantive tax policy differences between the two parties, the mood set by the weeks-long rift among House Republicans over who will lead the chamber, the continuing partisan standoff over spending, and Democratic frustration over the new GOP-led impeachment inquiry against President Biden could sap the energy and political goodwill that House and Senate negotiators would need to reach a compromise on tax code changes.

At the very least, a prolonged and contentious fight over a year-end omnibus spending bill could limit the size and scope of any tax package that lawmakers may try to attach to it.

Stay informed

For continuing coverage of tax legislative developments, see *Tax News & Views* from Deloitte Tax LLP.



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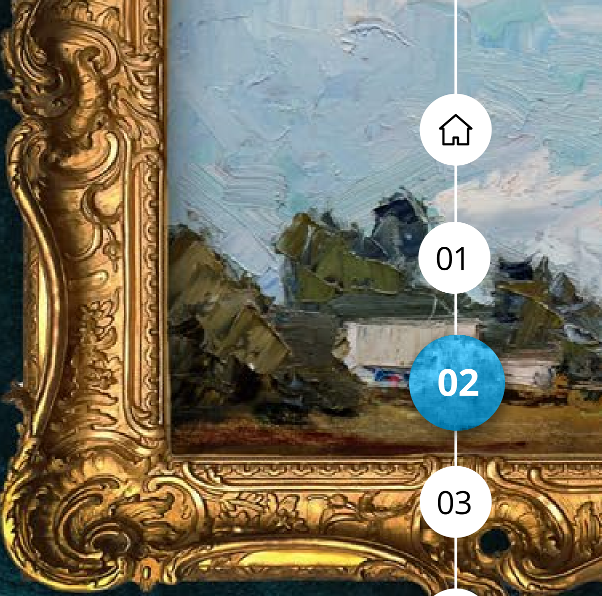
Family office



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FAMILY OFFICE

Setting up the family office: Protecting your legacy

With the creation of significant wealth, new considerations often open for high-net-worth individuals and their families. Exciting opportunities, as well as new challenges, can arise as the family acclimates to the increased complexities of wealth. One important decision may be establishing a family office—or modernizing an existing one—to oversee the financial affairs of the family rather than relying on financial institutions to provide those services.

That is a big step—one that involves many logistical, operational, and even emotional considerations. Yet it is a bold move that many others have made in recent decades. Wealthy families have been taking more hands-on control over investment policy decisions as a result of continued capital market uncertainty and their desire to commit resources to making an impact in the world now and in the future. Also, in this era of business failures, investment fraud, and cybercrime, more families have been adopting an institutional approach to family risk management. This process is aided by the advancement of and growing reliance on technology in family financial affairs.

In such an environment, establishing and operating a family office—or expanding and modernizing the services of an existing family office—requires careful analysis and planning to properly manage, protect, and grow a family's wealth so the legacy a family has built sustains its interests in the future.

In this chapter we will discuss general observations of what a family office is, consider factors that have contributed to the success of other family offices, and help family enterprises understand the considerations that can lead to the creation or revitalization of their own family office.

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Let's start with what a family office is

A family office is a popular concept in the United States, the roots of which extend back to the 1800s when they were established to manage the significant fortunes of successful tycoons. It is generally a private organization established by a family to oversee, directly or indirectly, the financial affairs of the family that is often the result, like wealth accumulation in general, of owning a successful family business. In certain instances, it is formed by a principal of a hedge fund or private equity fund who decides to no longer advise on funds with third-party assets, instead evolving into a standalone family office to solely manage his or her family's wealth. It can be an organization that offers many of the same services as top-tier private banks and investment firms but devoted to the needs of a single family. It is often a highly tailored organization, often reflecting the characteristics and aspirations of the family it serves.

While each family office is as unique as the DNA of its individual founders, there are some common goals that most family offices strive to achieve:

- Provide formal structure for the management and governance of the family's wealth
- Promote the family's legacy, vision, and values
- Coordinate, integrate and consolidate customized services for the family
- Manage economic and personal risks for the family
- Capitalize on economies of scale gained from consolidated family wealth accumulation, such as preferential investment access and fee reductions
- Maintain confidentiality and privacy of family affairs

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When is it time?

One of several scenarios often results in the formation of a family office:

Scenario 1 – Separation:
A successful family business has grown significantly and profits from the business have been diversified into new active or passive investments. The management and administration of those investments has become highly demanding for family business personnel. To mitigate conflicts of interests and other risks, the family's nonbusiness operations embedded within the company are separated into a newly established family office.

Scenario 2 – Liquidity event:
A successful family business or entrepreneur-owned business is monetized through, for example, a minority-interest sale, majority-interest sale, or recapitalization. A family office is established following the liquidity event to provide a formal structure to promote family governance and decision-making around the resulting wealth.

Scenario 3 – Fund redemption:
A hedge fund or private equity fund manager redeems out third-party investors of the fund. Subsequently, the fund manager evolves into a family office, now serving the principal and family members.

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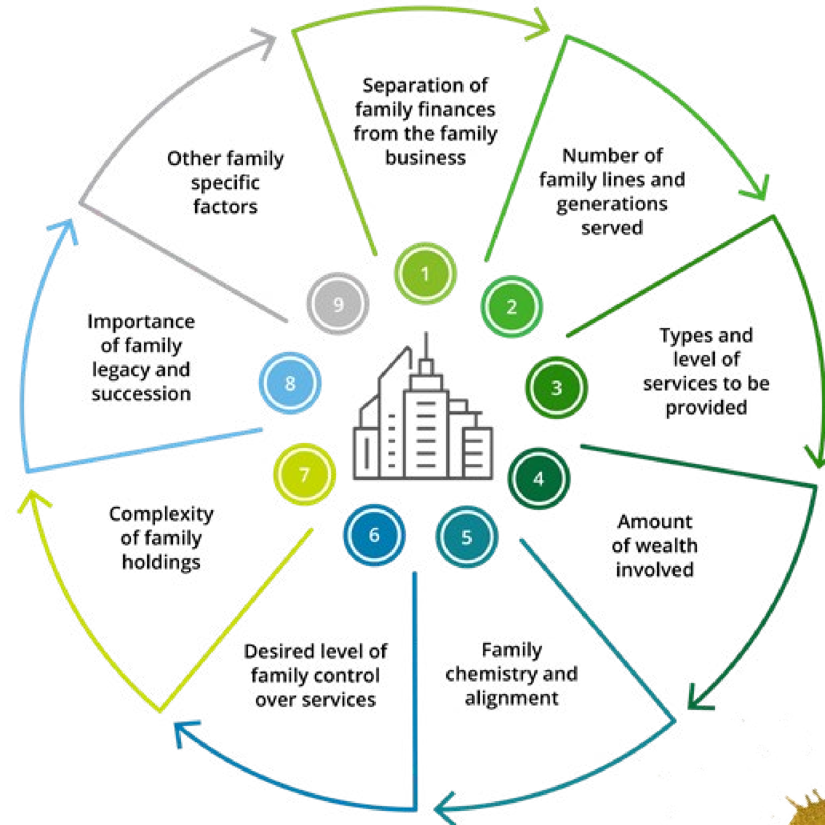
While opinions vary widely, many people in the family office industry believe that a family needs at least $100 million of investable assets to form a family office. Why? In general, it is believed that this amount of wealth is necessary for dedicated resources to provide favorable economies of scale from both a time and money perspective. But the amount of wealth involved is not the only important consideration. There are a number of key integrated, qualitative factors that also should be considered (see figure 1). As more of the factors become relevant, so does the value proposition for the formation of a family office. This due diligence process is an important step in assessing when and how to initiate the formation of a family office. With the guidance of trusted advisers, the diligence process provides a structure for weighing these important factors, which can help a family determine whether and when a family office makes sense.

What services do they provide?

Wealthy families have numerous options for obtaining personal and financial services. A key success factor in forming a family office is to engage the right people to do the right work. For long-term success it is important to establish and periodically reassess the balance between services performed in house by competent family office employees and those outsourced to qualified service providers.

Figure 1. Integrated factors in the decision to form a family office

The amount of wealth involved is only one of many factors that drive the decision to form a family office.



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Many in-house services (see figure 2, items shown in dark gray) address daily activities at a granular level. Keeping these services in house provides immediate access to and control over the information. It is also likely to be more cost-efficient and expedient compared to outsourcing.

Other services (see figure 2, items shown in dark blue) may be performed by family office staff and at other times by outside providers—or some combination of the two. This can offer cost savings on work that involves lower risk or is less complicated, and cutting-edge planning and quality assurance for more complicated work.

The most frequently outsourced services (see figure 2, items shown in light blue) typically require highly specialized skills or significant infrastructure. Few family offices have the appropriate structure or resources to provide these services in house from a risk–return perspective. For those activities that the family office chooses to outsource, the family office executive can build an advisory team and choose third-party providers to deliver those services. Developing a network of resources who are specialists in the respective service offerings is key to putting an effective team in place.

Figure 2. Scope of family office services

Strategic services	Technology	Tax and wealth planning	Investments	Risk management	Philanthropy	Legal	Family	Finance	Operations
Entrepreneur support	Social media	Tax compliance	Investment policy	Insurance	Philanthropic mission	Monitoring and oversight of outside counsel	Concierge services	Bookkeeping and reporting	Talent
Family education	Data analytics and management	Tax planning	Asset allocation	Reputational risk	Family foundation operations	Document preparation	Household help	Cash management	Family communication
Governance	Technology platform and controls	Wealth transfer planning	Manager selection	Fraud prevention and detection	Family foundation oversight	Contractual review	Property management	Budgeting and forecasting analysis	Office policies and procedures
Succession planning	Cloud computing	Investment structure design	Bench-marking	Physical security	Charitable bench-marking	Contract oversight	Collections management		
	Family and business information continuity		Performance reporting	Cyber risk	Due diligence	Litigation oversight	Travel		
			Due dilligence	Financial controls	Miscellaneous philanthropic activities	Regulatory compliance			

- Most often done in house
- Sometimes done in house
- Most often outsourced

Setting up the family office: Protecting your legacy

Operational Considerations: Governance of the family office

Establishing and operating a family office, or expanding the services of an existing family office, requires careful consideration and planning to properly manage and protect a family's wealth so it can flourish over time. As with any organization, the relative success or failure of a family office relies on effective governance. Important considerations include:

Balanced leadership and delegation

Although family offices often are established by the family's senior generation, effective governance hinges on both the experienced leadership of those senior family members and selective delegation to others. Vision and strategy should be set by the family, with tactical decisions and execution left to capable family office personnel and supported by outside advisers.

Effective communications

The family office often serves as the centerpiece for communications to and among family members. The family office often hosts family meetings and organizes retreats, and family office leadership is often tasked with communicating certain messages to younger generations.

Board oversight

A leading practice among family offices is to establish a board of directors to provide oversight and direction. Careful consideration of board composition is imperative. In most cases, the board should include both senior family members and objective outsiders who can offer contrasting perspectives.

Succession and contingency planning

Another leading practice is to safeguard the long-term prospects of the family and family office through succession and contingency planning. For example, developing a plan and educating family members on what will happen after the family patriarch or matriarch passes is an important factor in reducing confusion and averting disagreements over the direction of the family collective.

Continuous operational improvement

Faced with continually evolving operational challenges, many successful family offices and the families they serve thrive on continuous process improvement and innovation.

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Operational Considerations: Talent

A significant factor in determining the success of a family office is the talent it employs. Attracting and retaining quality talent has long been an important pillar of strong and effective family offices. Today, this pillar alone may not be enough. Family offices also need to actively invest in the technical, professional, and leadership development of their employees. In this way, professionals can become multi-faceted, agile, and able to navigate complex interpersonal dynamics within the family office and the family they serve.

The changing mix of family office work puts a premium on these attributes as family offices consider changes to their sourcing models. For example, if a family office keeps services in house, it will likely require new education and experiences for the professionals who lead and deliver those services. Conversely, if services are outsourced, different leadership and oversight skills may be needed to manage external service providers and lead family office staff as the focus shifts to activities that matter most to the family. In the latter scenario, the family office team may need more advisory, innovation, and visioning skills to capitalize on that gift of time.

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Many family offices also exercise those leading practices to ensure the management of talent stays on course. Those leading practices can entail:

- Identifying near and long-term talent and leadership requirements to meet the family office's strategy and mission
- Inventory talent and identify any high-potential high performers and gaps in their capabilities, and how to fill those gaps by building, recruiting, or borrowing talent
- Establish a formal hiring process, including due diligence and background investigations, as well as comprehensive onboarding procedures, such as putting in force appropriate legal documents—employment agreements, confidentiality provisions and privacy commitments
- Develop an employee handbook with policies and procedures for talent programs
- Define clear roles, responsibilities and lines of reporting
- Create long-term succession and development plans
- Establish employee goals that directly tie to the family office's short- and long-term objectives, and tie rewards to those goals, while setting up a formal performance review process that includes meaningful feedback
- Institute compensation arrangements that include long-term incentives to promote retention of key employees
- Create a work environment that emphasizes employee well-being and provides flexibility

Not surprisingly, compensation and benefits are by far a family office's largest annual cost, representing 50 to 75 percent of the annual budget. When the family office is established or undergoes modernization, the family should therefore invest significant time in attracting, incentivizing, and retaining its workforce and understanding how the talent market impacts these.

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Executing the family's vision: Investing and managing family wealth

How the family wealth is invested typically defines the family office. Investment services provided by or coordinated through family offices often include developing investment objectives for each family office client, including drafting of investment policy statements, assessments of risk tolerance, and creation of appropriate target asset allocations. It can include selecting appropriate investments based on the family office clients' short- and long-term needs, and periodically rebalancing or making adjustments to the portfolio. The family office may select, engage, and manage the relationships with investment advisers. Reviewing asset holdings, overseeing investment performance, and managing cash and liquidity, while providing periodic account statements and performance reporting, are all key services provided or coordinated by the family office.

Family investment partnerships (FIPs) can help families address their collective and individual investment goals while offering significant benefits, which may be absent when family members invest separately. Each FIP can be tailored to meet the short- and long-term investment and liquidity needs of its investors. Before forming a FIP, it is important to understand the key considerations of structuring and maintaining one or more FIPs for the family.

Did you know?

- Family office staff size can range from one or two employees to more than 100, depending on family size and type, the services provided, and relative financial holdings and activity.
- The most common family office leadership positions include a chief executive officer (CEO), chief financial officer (CFO), and chief investment officer (CIO). Recently, many family offices have added a chief technology officer (CTO) due to the expanded role and integration of technology.
- As the business demands of the family office change over time, so do the expectations of employees. It is important for family members and family office leaders to recognize these changes and respond to them to attract and retain talent.

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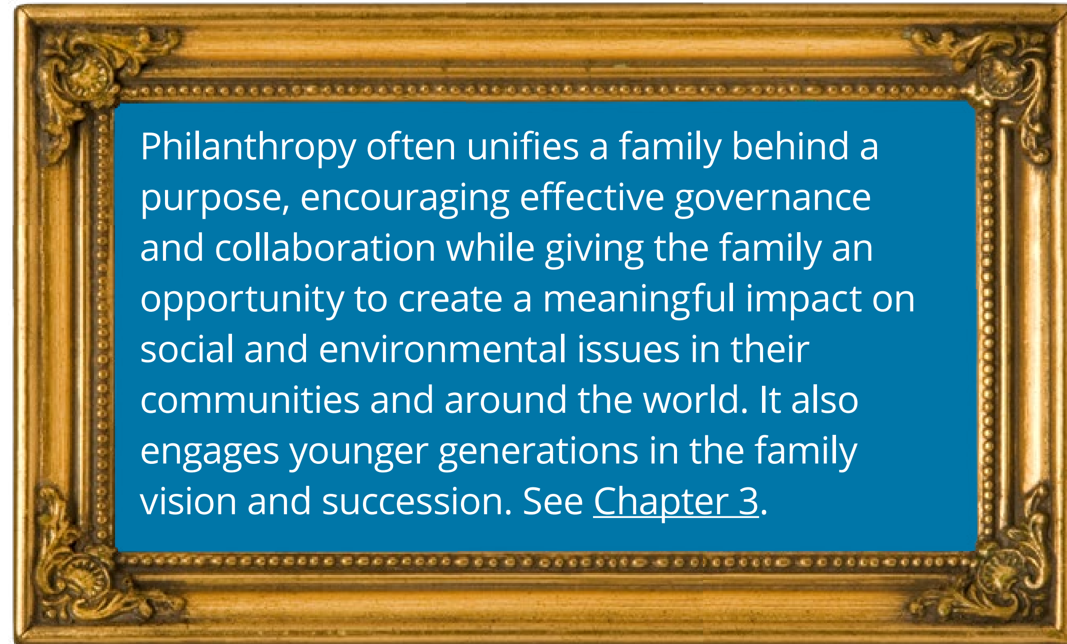
Some additional common themes and trends for family office investing are:

- A long-term investment horizon, perhaps spanning generations
- They are unencumbered by regulatory constraints placed on institutional investors
- Diverse and nontraditional asset allocations
- Significant interest in private equity direct-invest and co-invest opportunities
- Focus on wealth preservation vs. growth—the more generations served, the stronger the focus on preservation
- Liquidity preferences driven by the relative cash needs of the family
- Use of family pooled investment vehicles to promote co-investment
- A more recent emphasis on social impact investing and venture philanthropy



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Transforming your family office

Every family office has its own DNA, so the approach taken to modernize operations should be customizable and scaled to match the family's needs. One of the goals is to identify an operating model that makes the best use of family office resources and helps the family office better align with the family's goals and expectations.

Transformation efforts can range from minor incremental tweaks to more in-depth, involved process modernization, such as:

- Improvement of data-gathering processes
- Implementation of new technologies or tools
- Identification of resource models that refine the balance of internal and external support
- Modernization of an entire area of the family office, such as the tax function

In a transformation project, it is important to understand the family office's operating and talent models, including how executive and staff time is currently spent on tasks by activity across the organization. Surveys and interview tools can shed light on areas that are most time-consuming and repetitive, as well as least value-additive. Once the analysis of survey and interview results is completed, existing processes can be assessed, areas of improvement identified and prioritized, and a roadmap created to show what the family office can achieve in a realistic transformation time frame.

No matter the scope or duration, each transformation project should follow an actionable plan that helps the family office reshape operations and identify where time is spent so everyone involved can move in lockstep toward becoming a more strategic, efficient, automated, and modernized organization.

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Looking Ahead

The family office industry continues to evolve and become more sophisticated in response to the demands of the families they serve. Several emerging trends are reshaping the focus of family offices and how they will operate and serve families in the future:

- **Technology.** The adoption of new technologies is encouraging family offices to look critically look at how existing processes and activities might be improved to reduce or eliminate repetitive, manual, time-consuming tasks. This introspection extends to the skills required of family office personnel going forward as modernization initiatives refine existing processes and enable staff to refocus on other value-added activities. So, rather than hiring individuals to input large amounts of data, family offices can seek to hire individuals with enhanced data analytics skills or other specialized skills necessary to deliver new value-added services to the family.

- **Future of Work.** Historically, the family office talent model and real estate footprint reflected the importance of in-person interactions. However, the pandemic forced many to pivot toward staying connected through virtual solutions. Family office leaders have re-evaluated their service and talent models, as well as their technology infrastructures. Some noticed that increased technology utilization improved connectivity with family members who otherwise did not regularly engage. Others chose to invest in necessary safety measures to create environments where employees could return to the office with some regularity. Moving forward, family offices will need to find a balance between traditional and flex work arrangements to remain competitive in the marketplace. This may lead to a reduction in office space as their talent pool may no longer be restricted to working in-person. With that in mind, it's anticipated that family offices will review their technology platforms to ensure information is exchanged securely and is readily available to those who need access, and that family members can interact confidentially. This financial investment fosters family office modernization and interactivity with each generation served.

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- **Philanthropy.** For decades, family offices have been created to oversee the financial affairs of the family and to implement planning to sustain and pass on wealth to future generations. Many families created family offices after the sale of a business that had been in their family for generations with the intent that future generations would be cared for financially. Today, an increasing number of individuals desire to pass a meaningful portion of the wealth generated by the sale of their businesses to philanthropic pursuits instead of to perpetual trusts for the benefit of family members and future generations. This trend may necessitate different skills and experience among family office employees as the family's wealth is transferred during lifetime and at death to charitable vehicles to achieve their philanthropic goals.

- **Direct private equity.** As more families consider investing in direct private equity, family offices are tasked with evaluating how this will impact the family's overall investment allocations. In addition, families may need to evaluate whether they will acquire talent with a private equity background to source transactions aligned with the family's investment strategy. Direct private equity often requires more active involvement with respect to ongoing business decisions. Accordingly, it will be important for families to agree on the governance with respect to these business investments and whether family members will be allowed to actively participate in the acquired companies.

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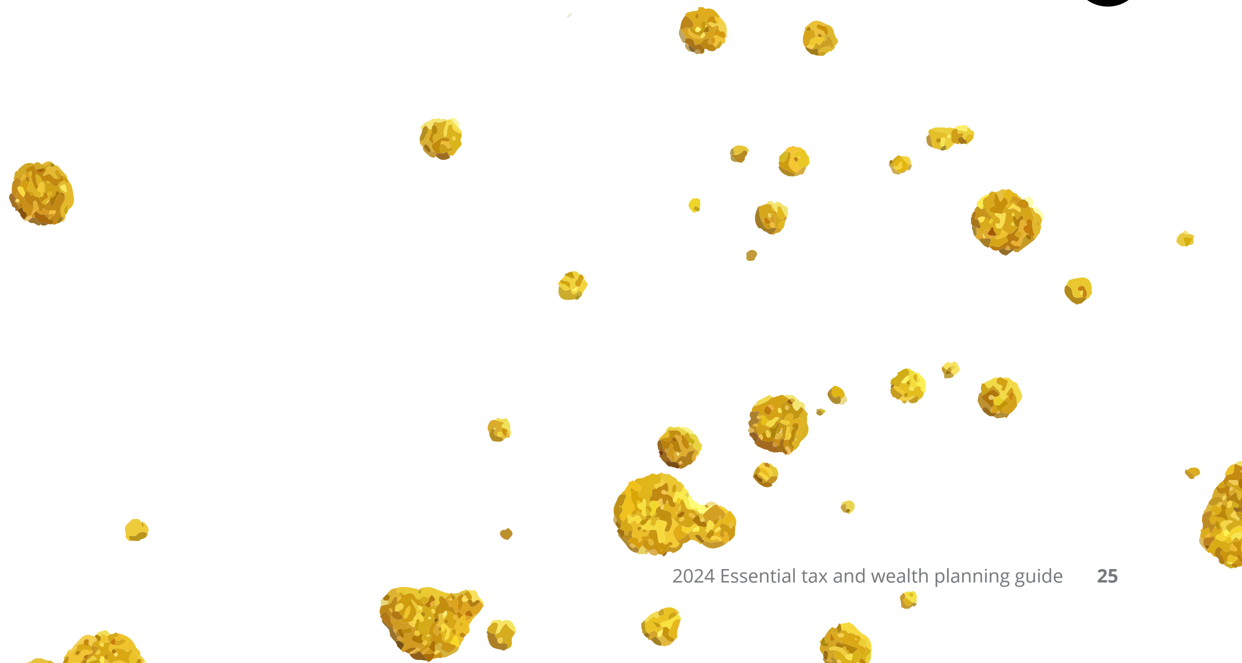
Each of these trends could have significant considerations for the family office and the families it serves. Addressing them will require thoughtful analysis and planning to align decisions and resulting changes with the families' expectations and the family office strategy.



03 Philanthropy

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Furthering the family's philanthropic goals

Families are comprised of individuals, and their philanthropic goals can be as diverse as their individual beliefs. Even when there are divergent interests, we see families benefit through strategic alignment, similar to the alignment used when they pursue business or investment goals together.

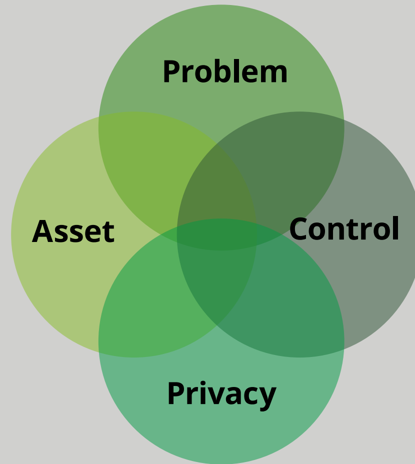
Family enterprises can benefit if they utilize strategy and philanthropy together in a more systematic way. Historically, "drive-by philanthropy," in which high-net-worth individuals gave to causes simply because they received a solicitation, was more common. Today, families and their enterprises are carefully considering their reasons for giving, developing a mission and creating focus areas for their giving. Only after that do they consider going all-in and begin to evaluate the tools to accomplish their goals, including those that may not have been considered common or perhaps were used solely by the mega-wealthy a decade (or even a few years) ago..

When donors become more motivated by strategic philanthropic goals and objectives versus pure income or estate tax savings, other philanthropic tools come into consideration. These alternatives to the traditional philanthropic tools, (i.e., giving cash or securities to public charities), donor advised funds, even private foundation, may spark new thoughts for the charitable motivated reader. We will explore some of these alternative philanthropic giving practices and address the associated tax issues.

Furthering the family's philanthropic goals

Gifting commonly hinges on a few strategic choices:

- What is the problem the donor hopes to solve?
- What assets are available for deployment?
- How much control is the donor willing to cede?
- How much privacy does the donor desire?



Public-Private Partnerships: "If you build it, they will fill it." Andrew Carnegie and the Public Library

Some of the most well-known (but lesser-thought-of) public-private partnerships in American history are the 1,500+ public library buildings constructed between 1886 and 1919. This was initiated by $40 million donated to the cause by Andrew Carnegie. Many of these buildings are still in use today. The gift was comprised only of the buildings, where the use of the gifted property was restricted to free public lending libraries. Each local community, whether large or small, was responsible for filling the library with books the community deemed appropriate. This was a grassroots literacy and access project. Today, a public library is a primary access point for many Americans to gain free Internet services. Andrew Carnegie was a notable philanthropist for many reasons, including the fact that he gave away nearly 90 percent of his accumulated wealth to charitable purposes during his lifetime. This charitable giving happened mostly during a period which pre-dates charitable contributions being deductible by individuals. This charitable deduction was not codified into the Internal Revenue Code until 1917.

An Offer He Couldn't Refuse

Before he was *The Godfather*, a young Marlon Brando was a mutineer in the movie *Mutiny on the Bounty*. During the filming of *Mutiny on the Bounty*, Brando first spied the atoll of Tetiaroa while hiking in Tahiti in the early 1960s. He was able to secure the purchase of the atoll and visited it often over the years. Marlon Brando had a substantial estate and extended family. Like many high-net-worth individuals, his estate contained complicated assets including the Tetiaroa Atoll.

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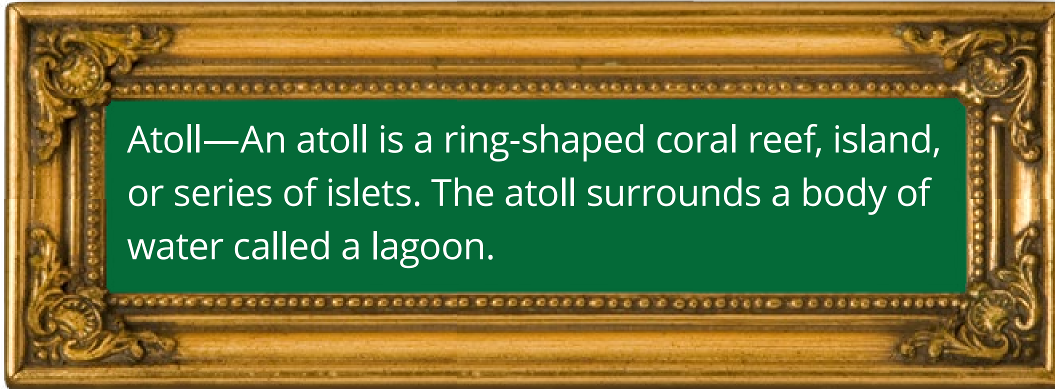

The atoll needed protection in perpetuity, but Brando had long dreamed of sharing its beauty through a sustainable eco-tourism resort that would be a model for stewardship in the industry. In 2009 the Brando Estate and Pacific Beachcomber formed Tetiaroa Society to operate a research station on the atoll. The atoll, now owned by the Brando Trust, leases a portion of the atoll to a resort which operates on one of the islands of the atoll. By allowing the resort to lease its portion of the atoll, the Tetiaroa Society is provided cash flow to further its exempt purpose, which is to contribute to the understanding and wise management of tropical island socio-ecosystems through education, conservation, and research related to Tetiaroa.

Take it out of storage

Seize the opportunity to assess all family assets, from art and real estate to vacation homes, planes, and sporting event tickets. Next, evaluate those assets that may be unused or under-utilized. In the purest of economic terms, there are opportunity costs and real costs associated with these types of assets. The opportunity cost would be the loss of the use of the asset, while examples of real costs are the insurance, maintenance, storage, and other related costs to maintain and protect the asset. For the owner of these sorts of family assets, these types of costs could be borne by a charitable organization if a donor wanted to loan the asset to the charity on a temporary basis for a charitable purpose. Although there is little to no charitable income tax deduction from the lending of assets, the donor and their family have the absolute right to pull the asset back for private use at the end of the agreed-upon term.

Some common examples of assets that may benefit from this arrangement are as follows:

Art and collectibles: Many families have art or other collectables for which they pay storage and insurance but do not display regularly. Loaning art or other collectibles to a museum and allowing the museum to pay the insurance may accomplish several goals. It puts the asset to work for a charitable purpose, it reduces the cost of ownership if the museum pays for insurance (we find most collectors maintain some additional insurance even when art is on loan to a museum), it provides savings on storage while the art/artifacts are on loan, and it may increase the collection's value given the public display and

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corresponding provenance update. While there is no deduction for the value of allowing a charity to use assets for its charitable purpose, the donor may be able to deduct reasonable out-of-pocket expenses while providing volunteer services associated with the donated assets.

Buildings: Empty buildings may be put to use for charitable purposes by the donated use of the otherwise unutilized facilities. The value of donated facilities is nondeductible for income tax purposes, however, out-of-pocket expenses incurred in providing the building for the benefit of the charity may be a qualified charitable deduction. In addition, from an economic standpoint, an occupied building is likely more secure than one that is vacant. Finally, by providing space to a charity to fulfill its exempt purpose, the donor is providing a public service, whether that occurs on a free or reduced rent basis.

Vacation homes: Vacation homes are very popular charity auction items. Similar to other real estate described above, the only tax deduction allowed for donating the use of vacation property to a charitable auction is any out-of-pocket costs incurred (e.g., the cleaning fee). However, economically, the charity benefits from any cash raised from the bidder for the vacation property that was likely to sit unused during the relevant timeframe.

Sporting event tickets: Sporting event tickets, amongst other event tickets, can be another popular charity auction item, but is more complex than the use of vacation homes. A donor is actually allowed a charitable income tax deduction for the value of the tickets and no appraisal is required, assuming the fair market value is less than $5,000. If the fair market value of the tickets is more than $5,000, a tax-qualified appraisal is required, which surprises some donors—especially when the tickets have a price printed on the face of the ticket that is less than that fair market value. As many season ticket holders know, what you pay for the ticket may not be the fair market value of the ticket—especially when the team is winning at the end of the season. So, a qualified appraisal may be a good investment as the value can be substantially higher than the face value of the ticket. However, a qualified appraisal also has a cost which must be borne by the donor. Whether the tax deduction is perfected or not, the charity receiving the ticket is receiving something that might otherwise have gone to waste.

Use of aircraft: Some high-net-worth individuals have private aircraft, yachts, and other types of motorized vehicles in their inventory. The use of these vehicles may be donated to or used by a charitable organization to accomplish its mission. For example, in the case of a natural disaster, a donor's plane may be used to transport much needed supplies for disaster relief. The donor needs to consider whether they are willing to donate the use of a private aircraft for free. There may be little to no tax benefit to the donor for providing such access, but the use of a plane in a time of natural disaster may

be very valuable to a charity providing supplies, services, and other assistance in a time of need. The only income tax deduction allowed to the individual for donating the use of the vehicle to a charitable organization for use in its exempt activities is any out-of-pocket costs incurred by the donor unrelated to the vehicle's ownership (e.g., fuel, crew costs, port taxes).

Social Welfare Organization (SWO)—Charitable-Adjacent Activities with fewer restrictions

We find many high-net-worth donors have given generously during their lifetimes. They have established foundations, created donor-advised funds, and endowed public institutions. Often times, their giving exceeds the allowable charitable deduction afforded under federal and state tax laws. Tax benefits are not necessarily the primary driver for continued investment in change. Investment in change is often the intrinsic goal. This investment in change is one reason why the Internal Revenue Code (IRC) section 501(c)(4) social welfare organizations are rising in popularity among this population of donors. There is no immediate external reward. A 501(c)(4), SWO provides another philanthropic tool for driving change in the system when an income tax deduction is not a driving factor for the donor. Income and gain recognition on asset disposal inside the organization may be taxed at corporate rates depending upon the activities of the organization during the year. However, if the organization engages exclusively in charitable social welfare activities, income is entirely exempt. Lobbying and limited political activities in furtherance of their primary purpose as established by their founder are allowed but must be closely monitored in order for the organization to avoid being treated as a political organization under IRC section 527. This and other tradeoffs discussed below are manageable and worthwhile if this is the right vehicle for a philanthropist to accomplish their charitable goals.

The tax details

In these examples, we have not mentioned the specific tax laws and regulations that must be considered. The examples discussed here are structured using a variety of charitable vehicles, including:

- Public charities and private foundations exempt under IRC section 501(c)(3),
- Donor Advised Funds sponsored by a public charity, and
- charitable limited liability companies or trusts, and
- social welfare organizations exempt under IRC section 501 (c)(4) ("social welfare organizations").

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A note of comparison between IRC section 501(c)(3) and 501(c)(4) entities should be discussed. Both (c)(3) and (c)(4) organizations operate to achieve charitable purposes. However, there are a number of different benefits a 501(c)(4) offers over other charitable vehicles for accomplishing a family's charitable goals. Social welfare organizations must be operated at all times exclusively for the promotion of the social welfare, while a 501(c)(3) organization must meet be exclusively for charitable purposes (specifically the organizational and operational tests). While this may sound similar, some illustrative examples of this difference are:

- **Lobbying capabilities.** A 501(c)(4) may engage in unlimited lobbying expenditures which further the organization's exempt purposes while a 501(c)(3) public charity may engage only in insubstantial lobbying activities which further its activities; and further, a 501(c)(3) private foundation is forbidden from both direct and indirect lobbying activities.

- **Purpose-based investments.** A 501(c)(4) may afford more flexibility than a 501(c)(3) charity in making purpose-based investments. Similar to a public charity, a 501(c)(4) needs to avoid transactions which could result in private inurement to an individual who has a close relationship to the organization as a donor or member of governance or management group. However, there is no restriction on the percentage of ownership a 501(c)(4) may hold in a for-profit business, which gives the 501(c)(4) a large advantage over a private foundation. Private foundations are subject to the excess business holding prohibition, which disallows a private foundation from owning more than 20% (or in some cases 35%) of a business enterprise (when combined with all related individuals and organizations).

- **Privacy.** A 501(c)(4) organization also provides a higher level of privacy not otherwise afforded a 501(c)(3) charitable organization. The 501(c)(3) entity has to disclose its contributors each year in its federal and state filings (including its public disclosure versions). Not only is a 501(c)(4) exempt from disclosing this information to the public, but it also does not file the information with the government unless the donor information is requested by taxing authorities under an examination.

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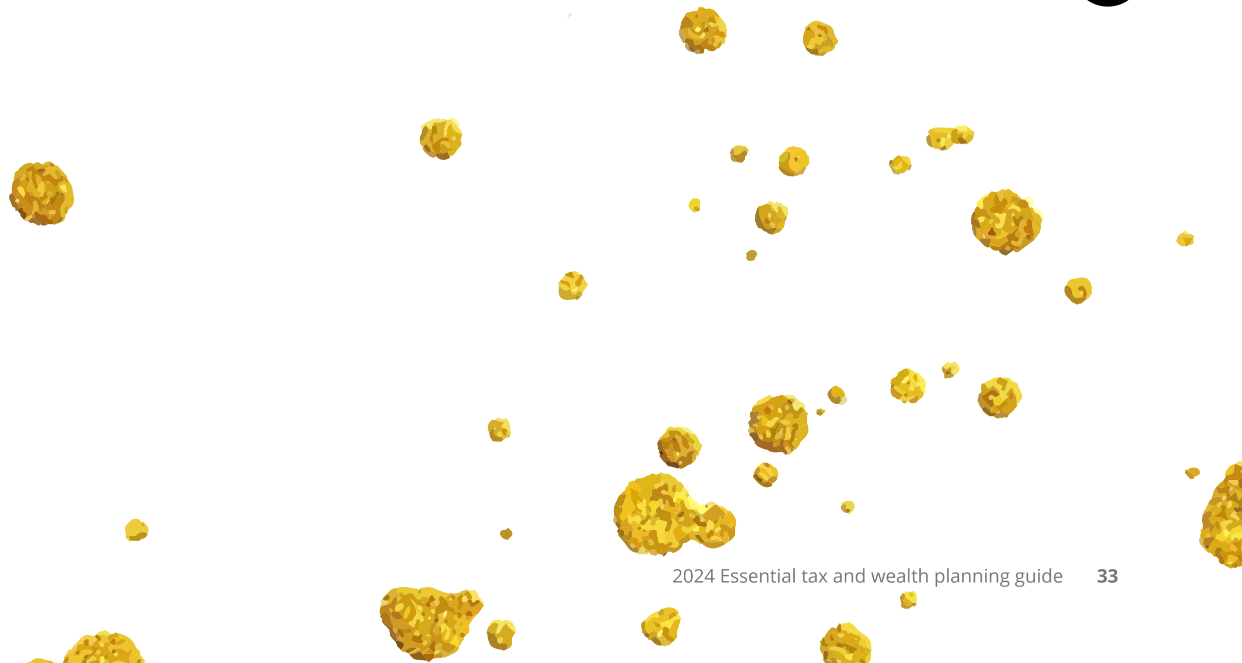
Overall, for families with complex assets and diverse philanthropic goals there are philanthropic vehicles beyond direct cash gifts, donor advised funds and grant-making private foundations. Although these are all tools for certain types of philanthropy, they may only provide partial solutions. When there are complex assets or complex family enterprises with varying objectives, it's best to start with the basics, grounding the discussion in goals, available assets, and greatest desired impact. This is the first step on the path to philanthropic success.

For more information on Deloitte's philanthropic services and the Global Center for Excellence in Philanthropy, visit **Philanthropic Advisory Services | Deloitte US**



04 Pass-through entity taxes

State pass-through entity taxes

What are state pass-through entity taxes?

Pass-through entity taxes ("PET") evolved as state-specific responses to the limitation imposed on the state and local tax deduction for individuals by IRC section 164(b)(6) (added by the Tax Cuts and Jobs Act of 2017), wherein individuals may only deduct $10k or $5k (if married, filing separately) of state and local taxes (the "SALT Cap") for tax years 2018 through 2025.

Generally, without a PET, an individual partner, member, or shareholder ("partner") of a pass-through entity would pay state and local income tax on their allocated share of income generated by the pass-through entity. The partner would only be able to deduct the amount of state and local tax as provided in IRC section 164(b)(6) for federal income tax purposes, which may be significantly less than the amount of state and local tax actually paid by the partner.

Many states have since adopted elective PET regimes as a way for partners to receive the benefit of deducting state and local income tax indirectly through their pass-through entity interest(s). A PET regime would subject the pass-through entity itself to an income tax in the state where the partners would receive a corresponding credit of their shares of the PET tax or a deduction of the income included in the PET in the electing state.

In computing federal taxable income at the pass-through entity, the PET paid by the pass-through entity would be reported as a deduction such that the partners of the pass-through entity would ultimately receive less federal income. Accordingly, partners could report a smaller amount of federal income because of the PET deduction, which in turn reduces the partner's federal income tax liability. The PET effectively converts all or a portion of the state income tax relating to the partner's share of the pass-through entity income to a federal tax deduction, thus circumventing the SALT Cap.

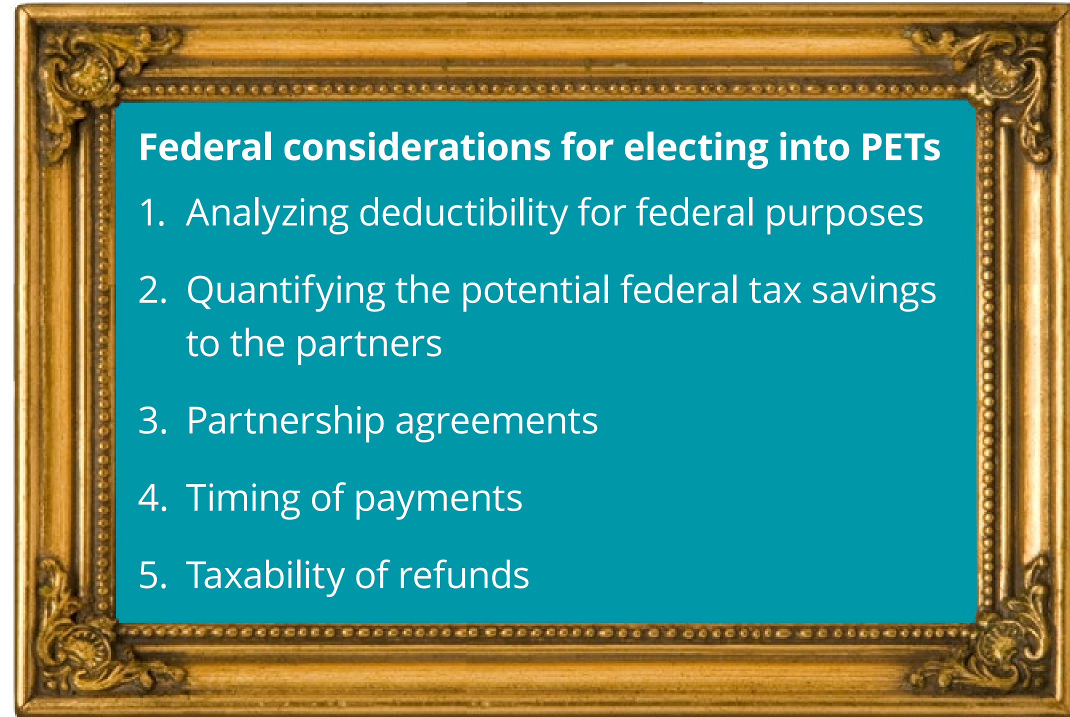
State pass-through entity taxes

As a general note, most PETs are neutral from a state and local tax perspective as to the state which enacted the PET regime (i.e., because the individual is not paying more state tax as a result of the pass-through entity electing into a PET).

The Internal Revenue Service ("IRS") issued Notice 2020-75 on November 9, 2020, which indicates that the IRS intends on issuing proposed regulations to clarify that pass-through entities can deduct specified income tax payments ("SITPs") paid by a partnership or S Corporation to a state or local jurisdiction. Notice 2020-75 also clarifies that SITPs are deductible regardless of whether the PET is mandatory or elective.

Certain jurisdictions (e.g., D.C., New York City, and Texas) imposed mandatory entity level taxes on passthrough entities even before the TCJA and related SALT Cap. Most of the PETs are elective regimes; however, some jurisdictions (e.g., Connecticut) impose a mandatory PET. The number of states considering the imposition of a PET may continue to increase provided the SALT Cap remains in place. However, if the SALT Cap is repealed, many of the PETs may also be repealed.

As noted, the decision of whether to make a PET election in states where it is elective is dependent on each pass-through entity's facts and circumstances. Below are a few of the pertinent federal and state considerations to be aware of.



Federal considerations for electing into PETs

1. Analyzing deductibility for federal purposes
2. Quantifying the potential federal tax savings to the partners
3. Partnership agreements
4. Timing of payments
5. Taxability of refunds

State pass-through entity taxes

State considerations for electing into PETs

1. Determining the eligibility of pass-through entities
2. Determining the tax impact in the partner's resident state—credit for taxes paid to other states.
3. Quantifying the PET base
4. Determining the impact to specific partners
5. Analyzing the impact on composite returns

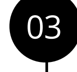
Other considerations

1. Determining the eligibility of pass-through entities

Not all pass-through entities may qualify to make the election based on state-specific guidance. For example, in certain jurisdictions pass-through entity may not qualify for the pass-through entity election if it has a non-qualifying owner, partner, or member. Accordingly, certain pass-through entities with non-qualified partners may want to analyze the impacts of restructuring alternatives. For example, a partnership may be owned 92% by individuals and 8% by other entities. However, by restructuring the partnership, the non-eligible interests may be eliminated, allowing the pass-through entity to qualify for the election.

2. Determining the tax impact in the partner's resident state—credit for taxes paid to other states

Most states tax residents on all income, including income sourced to other states. To avoid double taxation, most states allow a resident taxpayer a credit for taxes paid to other states. However, several states do not allow a resident taxpayer to claim a credit for their share of taxes paid by a pass-through entity. Partners who are residents of these states may be worse off if the pass-through entity makes a PET election. Pass-through entities considering making a PET election need to consider the cost to these partners when analyzing the overall benefit or detriment of the election.



3. Quantifying the income base

In determining whether to make a pass-through entity election, taxpayers must be aware of the pass-through entities' income base (i.e., taxable income) to which the pass-through entity tax may apply. For example, in New York, taxable income for partnerships is defined as all income from New York sources included in the taxable income of a non-resident partner and all income included in the taxable income of a resident partner. The income referred to above would consider New York addition and subtraction modifications, as applicable. With different specific regimes, the income base can vary by jurisdiction.

4. Determining the impact to specific partners

- While the electing pass-through entity is liable for the entity level tax due, partners may be severally liable for the entity level tax to the extent not paid by the electing pass-through entity for the partner's share of the pass-through entity.
- In several states the income attributed to tax-exempt partners is included in the tax base, even though the partner may not be taxed on the income.
- In several states the income attributed to retired partners is included in the tax base, even though the retired partner may not be taxed on the income.
- In several states guaranteed payments are included in the tax base, which could create a change in economics between the partners if the PET cannot reduce the guaranteed payment.
- In California, the credit is not refundable; instead, it is carried forward for up to five years. Furthermore, the credit cannot reduce the partner's tax below the tentative minimum tax. The PET election could result in a reduction of after-tax cash for certain partners.

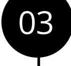
5. Analyzing the impact on composite returns

Most states allow pass-through entities to file composite returns (i.e., a single return) on behalf of non-resident partners providing certain administrative advantages. In several states, the PET election does not satisfy the non-resident partners' filing requirement. However, a state may not allow a pass-through entity that has made a PET election to also file a composite return (e.g., Rhode Island). Other states may not allow the PET credit to be claimed on a composite return (e.g., New York). As a result, non-resident partners may need to file individual income tax returns in these states, increasing the administrative costs associated with the PET election.

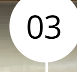
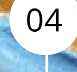
PASS-THROUGH ENTITY TAXES

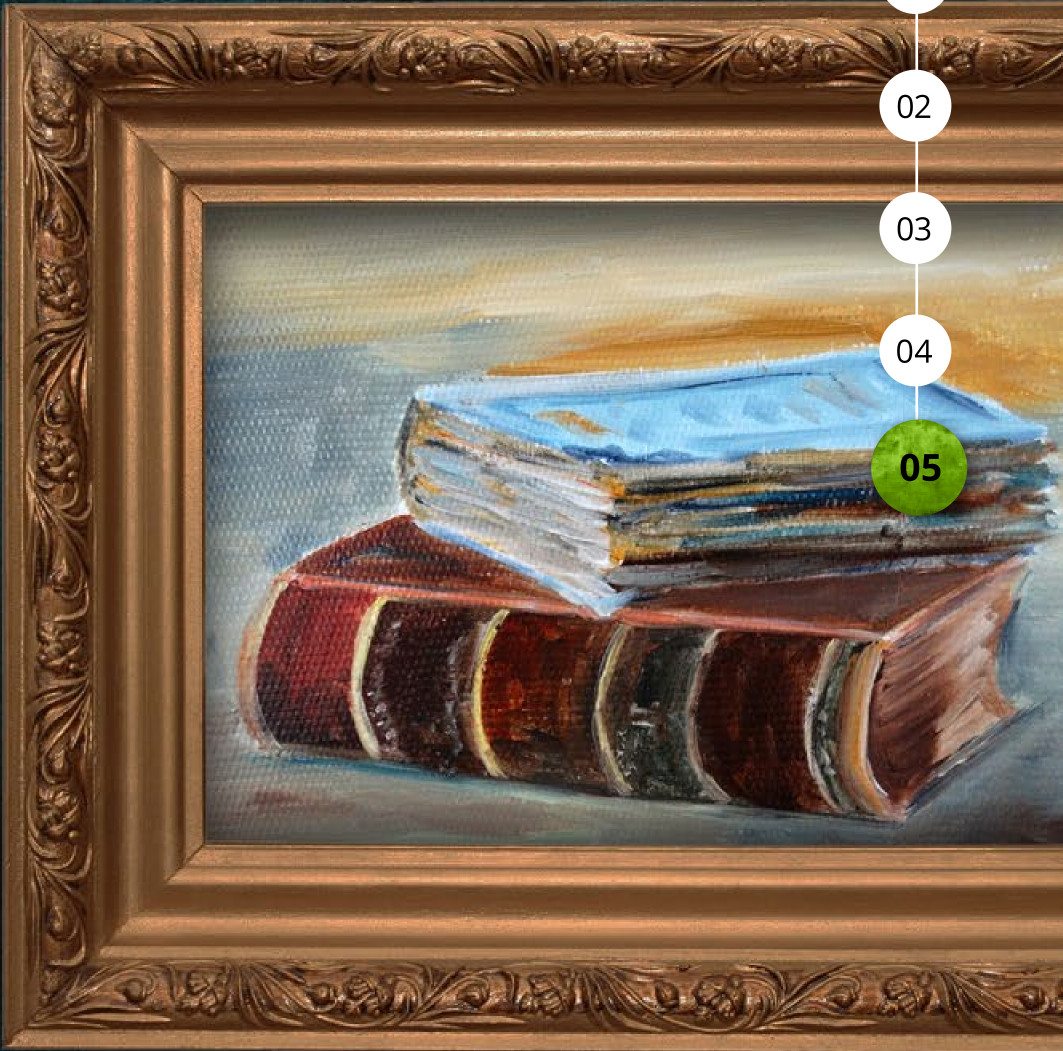
State pass-through entity taxes

Taxpayers should consider the federal and state income tax consequences in the state(s) in which they intend to make a PET election. However, in making an election, or deciding the series of states in which to elect or not, there are other costs that need to be considered, including tax consequences to the partners in their resident state, increased tax to certain partners, cash flow issues, and administrative costs associated with an election.



05 Resources



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05

RESOURCES

Useful links

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Family Office

Philanthropic Advisory Services

Private Wealth Tax Services

Tax News & Views

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