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KEY SERVICE INSIGHTS

FAMILY OFFICE / CLIENT SERVICES NEWSLETTER

STRATEGIC COORDINATION OF ACCOUNTING AND TAX FOR THE FAMILY OFFICE AND DYNASTY TRUST

The typical family office has a sophisticated tax structure that must blend income tax planning with estate tax planning. The structure typically involves a number of business entities that will include owners involving individuals and one or more dynasty trusts for efficient estate and gift tax planning. With the complex tax structure, it is important that the legal, tax, and accounting team are coordinated to ensure proper reporting and avoid potential issues that could occur.

Family offices typically act as an investment vehicle for the family. The family typically has accumulated a lot of wealth over the years and now through the family office the family invests in a number of companies seeking large returns.

The assets held in a dynasty trust are generational skipping transfer tax exempt, so the assets held in the dynasty trust are not subject to estate tax at each generational level. This avoids a haircut of wealth currently at 40 percent at each generational level. For the wealthy family, the dynasty trust allows for the preservation of significant wealth that would otherwise be paid in estate taxes at each generation.

The reason only part of the family office is held in a dynasty trust is that the estate, gift, and generation skipping transfer tax exemption is $13.61 million for 2024 or $27.22 million per married couple (*collectively*, "***Transfer Tax Exemption***"). For those families that have wealth exceeding the Transfer Tax Exemption it is important to strategically plan in order not to lose significant wealth to taxes.

Typically, the dynasty trust will also be drafted as an intentionally defective grantor trust ("**IDGT**") which is a grantor trust for income tax purposes during the grantor's lifetime and a completed gift for gift tax purposes. The IDGT allows the dynasty trust to grow income tax free outside the grantor's estate during the grantor's lifetime, as the grantor will continue to be taxed on the income generated by the IDGT. This is a significant planning opportunity as the grantor's payment of the income tax of the dynasty trust is not considered a gift so there is no use of the grantor's gift tax exemption. This allows significant additional growth of the assets in the grantor's dynasty trust while reducing the grantor's otherwise taxable estate.

The dynasty trust adds complexity to the tax planning of the family office. The benefits of the dynasty trust far exceed the additional complexities, but it is incumbent that the legal, tax, and accounting professionals understand the taxation of the dynasty trust, how the

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dynasty trust operates as an owner of the family office, and how to account for the various levels of trust and individual ownership in the family office.

Very few legal and accounting professionals understand the intersection of corporate, partnership, and estate tax planning involved in these structures. This understanding is essential for reporting purposes and, more importantly, for tax planning to minimize all applicable taxes. Too often, professionals know one of the necessary areas of tax and base the planning on this limited knowledge which leads to additional taxes being due and missed planning opportunities.

Also, important in pulling this altogether is ensuring the accounting is customized to the structure. The typical family office will own a number of investments.With fractional ownership of the family office between individuals and trusts it is important to properly account for each so that there are no compliance issues.

Since trusts are not routine practice for most accounting professionals, it is important to have a specialized team that understands the reporting requirements to handle the accounting. If the accounting is not handled correctly, the Internal Revenue Service could see this as adding additional wealth to the dynasty trust which could lead to the imposition of an additional gift tax and the possibility of a mixed inclusion ratio for generation skipping transfer tax purposes causing significant issues to the tax efficiency of the dynasty trust.

Having the right professionals in place also allows for strategic thinking that will lead to additional planning that will reduce taxes. For example, under the right circumstances the family office may be restructured to allow for significantly more of the value of the family office to be transferred to the dynasty trust with no use of the Transfer Tax Exemption. For this to occur, there will need to be strategic advising among the legal, tax, accounting, and business valuation team to be handled correctly.

Family offices are highly customized to each family and it is important that their legal and accounting advisors understand how to strategically handle and coordinate the tax, accounting, and compliance requirements of the family office. Too often, the legal, tax, and accounting professionals are not coordinating which results in missed opportunities and potential penalties. We have a highly customized team of tax and accounting advisors to structure the family office, handle compliance for tax and accounting, and advise on additional tax planning opportunities.

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