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Taxation Trends & Topics for High-Net-Worth Individuals

Family Office Space, TCJA Sunset Planning & Wealth Migration

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Impactful Trend – Family Office Space

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Growth In Family Office

- Concentration of wealth and demographic shifts
- Growing trend of direct investments, co-investments and venture capital participation
- Complexity in tax regulations
- Wealth migration
- Competition for talent at single- and multi-family offices increasing demand for outsourced solutions

Common Types of Family Offices

- Embedded Family Office (EFO)
- Virtual Family Office (VFO)
- Multi-Family Office (MFO)
- Single-Family Office (SFO)
- Hybrid Family Office (HFO)

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Increased Complexity

https://www.stlouistrust.com/insights/how-to-decide-what-your-family-office-should-outsource/

High Impact Areas HNW Individuals Face Today

- Liquidity event anticipated
  - Seek immediate guidance
  - Establish team of advisers – identify your "quarterback"
  - Understand tax impact of transaction
  - Understand estate objectives
  - Understand family office goals moving forward
- Educating next generation
- Risk management and cybersecurity

Poll Question #1

- Could you or your clients benefit from working with a private client tax professional who understands the needs of a high-net-worth individual or family office?
  - A. Yes
  - B. No
  - C. Maybe

Serving Family Office Clients

- Function as single point of contact for client
- Build extensive network of external experts
- Develop broad technical skills
  - Tax planning (business and personal)
  - Risk management and insurance planning
  - Charitable and legacy planning
  - Estate planning
  - Retirement planning
- Monitor legislative changes and proactively approach clients with planning opportunities

Tax Cuts and Jobs Act (TCJA) Sunset – Estate Planning

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Estate and Gift Tax Exemption Landscape

- Tax Cuts and Jobs Act (TCJA) passed at the end of 2017 temporarily doubled gift and estate tax exemption from $5 million to $10 million (indexed for inflation)
- Single taxpayer in 2024 can claim a federal estate and lifetime gift tax exemption of $13.61 million ($27.22 million for married couples)
- Legislatively scheduled rollback to pre-TCJA levels at the end of 2025
- 40% tax rate*

**$345,800 base tax 40% on taxable amount*

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Historical Perspective on Rollbacks – 2012 Example

- Congress has not allowed automatic roll backs to previous rates/levels to occur, most recently 2012.
- Exemption was scheduled to be dramatically reduced by operation of law at the end of 2012 (from $5 million to $1 million indexed for inflation).
- January 2013 Congress passed The American Taxpayer Relief Act keeping exemption at $5 million indexed for inflation
- Substantial gifting done in 2012 prior to potential tax law change, drawing attention to the estate planning process

Beyond The Numbers

- Gifting can be emotional, take a step back and help navigate considerations holistically
- Avoiding donors' remorse
  - *Raia v. Lowenstein Sandler*
  - *Jackson v. Calone*
- Goal-based approach to gifting conversations
  - Financial independence
  - Shifting resources to next generation
  - Charitable intent

Gifting Steps

- Understand goals and current plan
- Update personal financial statement
- Coordinate with estate planning attorney and financial adviser
- Present several options
- Understand timing considerations
- Continuously monitor

Popular Gifting Vehicles – Examples

- **Spousal Lifetime Access Trust (SLAT)** – Remove assets from taxable estate while leaving door open for limited access *(beware of reciprocal trust doctrine)*
- **Family Limited Partnership** – Ability to shift wealth to next generation while still maintaining limited control
- **Irrevocable Life Insurance Trust (ILIT)** – Minimizing gross estate and provide liquidity for estate tax

Poll Question #2

- Have you prepared a comprehensive personal financial statement?
  - A. Yes
  - B. No
  - C. Maybe

Estate Reduction Strategies Without Use of Exemption

- Annual exclusion gifting (consider Crummey trusts)
- Paying tuition and medical expenses directly to institutions
- Unlimited spousal transfers
- Pre-funding 529 plans with up to five years' worth of gifts
- Grantor retained annuity trusts (GRATs)*
- Charitable gifting

**Immaterial exemption generally utilized on front end when GRAT is funded. GST exemption applied at end of GRAT term. Consult with attorney and tax professional.*

Advising Charitably Inclined Clients

- Effective philanthropic planning helps clients feel purpose and connection with gifting
- Helping clients navigate all aspects of the charitable gifting process to ensure gifting programs are in line with goals (philanthropic advisory):
  - Understanding clients' charitable interests and priorities
  - Formalize values, mission and goals
  - Assist in due diligence and research
  - Help facilitate meetings with charities and assist in evaluating the impact of gift

Charitable Gifting Strategies – Examples

Charitable Bunching (in high income years)

- Bunch future charitable contributions to offset income in highest tax brackets
- Gifting appreciated stock
- Donor Advised Fund vs. Private Foundation

Charitable Lead Trust (CLTs)

- “Split-interest” giving vehicle income to charity, remainder to family
- Grantor vs. non-grantor
- Hurdle rate

Charitable Remainder Trusts (CRTs)

- “Split interest” giving vehicle income/annuity to family, remainder to charity
- Deduction when gift is made up front

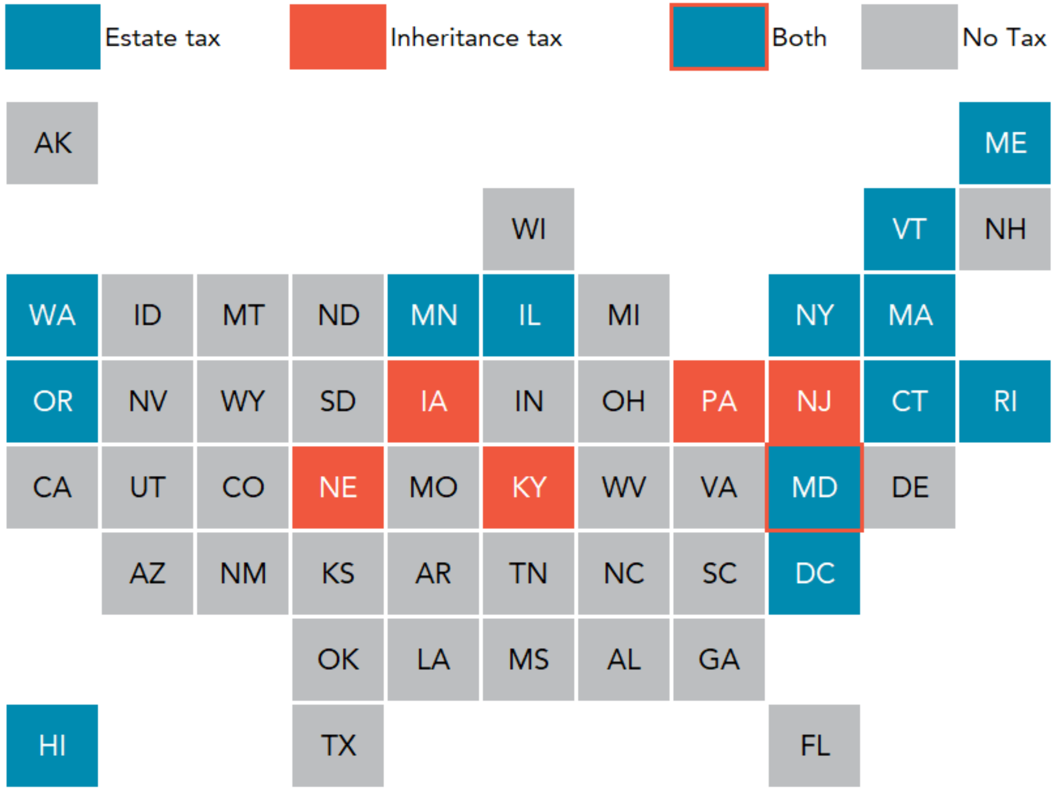
States With Estate and Inheritance Tax

HOW MUCH DO ESTATE TAXES DIFFER ACROSS STATES?

In 2023, 12 states and the District of Columbia levy an estate tax and six levy an inheritance tax. Maryland levies both.

FIGURE 1

State Estate and Inheritance Taxes, 2023



Source: TPC analysis of state tax codes and forms; Bloomberg State Tax Navigator (accessed February 2023).

Poll Question #3

- How likely are you to consider relocating to avoid estate and inheritance tax?
  - A. Very likely
  - B. Somewhat likely
  - C. Not likely

Wealth Migration and Residency

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Wealth Migration and Residency

- Migration trends and remote work
- Impact of state tax reforms
- Population migration data
- Domicile and residency audits
- Taxpayer preparation and defense

Migration Trends and Remote work

- Americans are relocating
- Influence of economic and lifestyle factors
- Pandemic accelerated relocation trend
- People can choose to live where they *prefer*

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Impact of State Tax Reforms

- Increased tax burdens due to state tax reforms in high-tax jurisdictions, leading many to relocate
- Notable tax legislation changes in high-tax states resulting in higher tax rates for high-net-worth individuals

Population Migration Data

- Clear link between tax policies and population migration
- States like California, New York, Massachusetts and New Jersey among top 10 outbound migration
- States without income tax, such as Florida, Texas and Tennessee, experiencing inbound migration
- Pursuit of tax dollars from high-net-worth individuals has led to a migration of wealth, causing challenges related to revenue shortfalls and resident retention in high-tax states

Domicile and Residency Audits

- Migration has led to increased residency audits
- Consult with tax advisers *before* moving and significant liquidity events
- Changing domicile requires more than simply physical relocation
- “Six months and one day" in a new location is NOT always sufficient to establish a change in domicile

Domicile and Residency Audits – What is a Domicile?

- Place where an individual establishes their fixed and permanent home
- One domicile vs. many residences
- *Intent and motive* critical to domicile change
- Two crucial elements to prove a change of domicile:
  - Change of residence
  - Abandonment of former domicile; acquisition of another
- Burden of proof is on YOU
- Domicile continues until demonstrate clearly/prove change to a new location

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Domicile and Residency Audits – Domicile Factors

- Specific factors, tests and/or criteria to assess change in domicile
  - Ex. home, active business involvement, time spent, items near and dear, family connections, etc.
- Assessment of factors varies between states; contingent on specifics of each case
- All factors considered in determining domicile, but single factor can be pivotal

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Domicile and Residency Audits – Statutory Residency

- Multiple states enforce statutory residency provisions
- In some states, an individual is a statutory resident if maintaining a personal place of abode (PPA) in the state and spending in aggregate > than 183 days of the taxable year there
- If statutory resident, required to pay tax as a resident in that state regardless of domicile state

Domicile and Residency Audits - PPA

- A permanent place of abode (PPA) = house, co-op, apartment, condo or other dwelling
- Two key concepts when determining whether a dwelling is considered a PPA
  - Physical attributes
  - Nature of the relationship

Domicile and Residency Audits – Day Count

- Prepare a "day count" to track your days during that year
- Any part of a day spent in a state usually = entire day
- Provide documentation to prove location for every day within 365-day period (cell phone records, credit card statements, airline itineraries, EZ pass, etc.)

Poll Question #4

- What challenges would you anticipate facing if you were to undergo a residency audit?
  - A. Proving physical presence
  - B. Maintaining thorough records
  - C. Understanding complex tax laws
  - D. Communicating with the auditor

Taxpayer Preparation and Defense

- Advances in technology have significantly eased day count tracking (historical cell site data, cell phone statements, location-tracking apps)
- Electronic records have improved accuracy and reduced costs
- Difficult to document physical presence, constructing detailed day counts
- Strategic approach to documenting physical presence crucial; effective use of technology and meticulous record-keeping can strengthen defense

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Taxpayer Preparation and Defense

- Proactive preparation is essential as states intensify audit efforts
- Residency audits can be invasive and emotionally taxing, often involving scrutiny of personal records and credibility
- Auditors require extensive documentation, including residence details, employment history, financial transactions, travel patterns and social connections
- Meticulous and contemporaneous documentation is crucial

Taxpayer Preparation and Defense

- Burden of proof on you and can be onerous
- Use a comprehensive checklist to cover various factors/tests/criteria states consider
- Critical to have in-depth discussion with your adviser about specific circumstances

Thank You!

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What's in Store for Private Company Financial Reporting

Wednesday, August 7
11 a.m. to Noon EDT

Staying Ahead of State & Local Taxation

Wednesday, August 14
11 a.m. to Noon EDT

What You Should Know – Now – About Beneficial Ownership Information Reporting

Wednesday, August 21
11 a.m. to Noon EDT

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