

Mary Vandenack provides members the transcript from a Legal Visionaries podcast from a series on High Net Worth Estate Planning. You can listen to the podcast at: <https://vwtlawyers.com/family-office/>.

Mary E. Vandenack, J.D., ACTEC, CAP®, COLPM®, Accredited Estate Planner® (Distinguished) Nominee is CEO, founding and managing member of **Vandenack Weaver LLC** in Omaha, Nebraska. Mary is a highly regarded practitioner in the areas of tax, trusts and estates, private wealth planning, asset protection planning, executive compensation, business, business exit and business succession planning, tax dispute resolution, philanthropy and tax-exempt entities. Mary's practice serves businesses and business owners, executives, real estate developers and investors, health care providers, companies in the financial industry, and tax-exempt organizations. Mary is a member of the American Bar Association Real Property Trust and Estate Section where she serves on Council. Mary is a member of the American Bar Association Law Practice Division where she currently serves as Chair. Mary has been named to ABA LTRC Distinguished Women of Legal Tech, received the James Keane Award for e-lawyering, and serves on ABA Standing Committee on Information and Technology Systems. Mary is a frequent writer and speaker on tax, benefits, asset protection planning, and estate planning topics as well as on practice management topics including improving the delivery of legal services, technology in the practice of law and process automation. Mary hosts a podcast called Legal Visionaries. <https://vwtlawyers.com/news-knowledge/podcasts/>

COMMENT:

Mary: On today's episode, I am joined by Cheri Duryea. Cheri owns Duryea Strategic Marketing and has been instrumental in supporting this podcast and helping us put it together. Today we're going to reverse roles and Cheri's going to interview me on the topic of family offices. Thanks for joining me and taking on the role of interviewer today, Cheri.

Cheri: Thanks for asking me to join today. I love these episodes where we reverse roles. First, can you start off by explaining what a family office is?

Mary: Family office can be one of those terms that I like to say is used generically by people similarly to the way the term living trust gets used. When somebody says “I have a living trust”, I ask: “what kind of trust exactly do you have?.” Because it becomes a term that can refer to a lot of different things. We find the same thing with the term family office. When somebody says, I'm thinking about a family office, I ask the question, what exactly do you mean? The term can refer to a large variety of structures. As a generality, the family office is something that is focused on helping a family with wealth management. Usually, this strategy is used by a family that has a significant amount of assets. This often comes up where we have a family who has owned a business for a good portion of their career, has built wealth and then sold the business. That's happened a lot recently. There have been great multiples for clients selling businesses in recent years. A client one moment owns a business, and the next moment has a lot of liquid wealth and is no longer running the business and their life changes. A family office structure can be helpful to a family in making that transition. Many of the family offices focus on managing investments, but there are a lot of different services that can also be involved. Let's say that when you had your business, your bookkeeper took care of your business bookkeeping and your personal bookkeeping and maybe your real estate LLCs. Now you don't have that business anymore, the bookkeeper's working for the company that bought you out and you're needing some assistance with that. Maybe you have various investments, some real estate or maybe you have some art or some specific philanthropic activities that you're focused on. Maybe you have a family foundation, maybe you're trying to help family members learn about financial issues and develop, maybe you're supporting family members with different types of education. These are a variety of the services that will be part of a family office in some cases.

Cheri: What types of structures are common for family offices?

Mary: There's several different types. One is simply what we call a single-family office. Again, that can mean a variety of things, but the single-family office in general means that one family creates a family office. Doing so can be a significant investment. You'll have some advisors that will define the single-family office based on the net worth of a client, which may or may not be right. The number that we hear a lot is, if you want a single-family office you need to have 250 million dollars. In some cases that might be true, but in other cases not so much. Another type of family office is what's called the virtual family office and that's an entirely outsourced model with little or no in-house staff. For the single-family office, you're going to put together a group of people that are going to be your family office - in the virtual, we have people involved but we don't have a physical place. The issue with the virtual family office is that it takes a little more coordination. Another type that you will see is what we call the multi-family

office. When we are in the multi-family office realm, there's a couple subtypes of that. One is the closed family office. In such case, one family founded the multi-family office and decided that the structure would be more cost effective if the founding family brought in four or five other families, but we're going to have this limited number of families participate in this multi-family office. The other type of multi-family office would be more of a commercial multi-family office. Such a family office is in the business of providing multi-family office services and it won't necessarily be the founding family and several of their friends. There's another form and we did a previous podcast on private family trust companies. A private family trust company can also serve as a family office but will in addition have the ability to have trust powers.

Cheri: This sounds complicated. There's a lot of different structures that you can look at. What are the initial considerations for establishing a family office?

Mary: It's important to sit down and have a conversation about exactly what are we trying to accomplish because sometimes the term family office can be this trendy term that gets thrown about and you just sold your business, you should have a family office. The question I ask is, what exactly are you trying to achieve? If all you really need is an accountant and you have a great accountant, you probably don't need a family office. If you have a great investment advisor, a great accountant, all of the services that you need (and a lot of business owners will have a great set of advisors), maybe it's not for you. On the other hand, if you're looking for overall management, you've sold the business, you kind of want to go travel the world and maybe as part of selling the business, some of your advisors retired when the business sold or otherwise decided that they weren't going to be involved anymore and you're left without key advisors. Then maybe looking at a family office structure might be the thing to do. What I typically discuss with clients is what their objectives are and what services are needed. Will those services be better provided through a family office type structure? Does the client need everything done? The bookkeeping? Is someone needed to run the household? Is someone needed to oversee the jet plane or foreign property or whatever the case might be? The needs and objectives drive the structure a, the family office itself can get expensive. There are some other advantages.

Cheri: When does someone need a single-family office?

Mary: The single-family office does make sense for somebody with significant assets that really wants a comprehensive suite of services. One of the reasons I will look at a single-family office for a client is that it also creates tax planning opportunities. You don't have to know me very well to know how I love tax planning opportunities for clients.

Cheri: Very true.

Mary: But there's going to be cases where even to the extent we can come up with tax benefits, the tax benefits and the tax planning opportunities have to exceed the cost otherwise it doesn't make sense. But one of the significant functions of the family offices is handling investments. You might have a family office with the CIO who's going to oversee the various investment advisors and that can be a great strategy to help you organize and oversee the investments. There are also other factors that may drive the family office, which is the complexity of the overall structure of assets and the priorities of the family. Sometimes the family offices are a great way to keep family connected and involve them. I have clients who are trying to help the next generation understand their values with regarding to wealth, maybe philanthropy, things like that. Sometimes that will lend itself to having the single-family office.

Cheri: With all the things that go into these decisions about structure and if you need one or not, how long does it take to create a family office?

Mary: Technically I could start an entity and to get that in place in 24 hours. You could have a family office tomorrow if you really wanted to. But the fact of the matter is, the real process is what I mentioned earlier, which is being clear about your objectives, deciding what you're going to do, coming up with short-term goals. Maybe you need to identify some mid-term goals and what are the longer-term goals. It's really a process and the process evolves over time.

Cheri: What's the best legal structure for a family office?

Mary: I do always try and make that distinction between legal structure and tax structure because it's not uncommon for somebody to say to me "I have an LLC" as though that means something by itself, which usually refers only to the entity structure pursuant to the state law of formation. Separately, there's the tax issue. So, what is the tax status? Is it a C corporation? Is it going to be an S corporation? Are we going to be partnership tax? Are we going to be some kind of flow through type entity? The other thing that really matters in deciding the best legal structure is who's going to be involved in the family office? Are family members going to be involved? Is it going to be one or two family members kind of looking out for more distant family members or are all the family members going to be involved and in what roles? Because that can really drive the tax efficiency of the structure. Another thing is, can the family office add an element of asset protection? In a lot of cases the answer to that can be yes, and asset protection has become very significant in recent years. The correct state to use varies also based on what the family objectives are. There's this big assumption in a lot of estate planning vehicles to use that you should use the state in which you live in. For example, I live in Iowa so

I should use Iowa law. But the fact is that it might be best to create a structure in Nevada or South Dakota or in Delaware or another state. You have to take a look at which state law is going to make sense for what we are trying to do with our objectives.

Cheri: As you mentioned a minute ago, tax benefits are a passion of yours. What are possible tax benefits for the family office?

Mary: That's one of the fun things in structuring the family office. Often, the clients previously owned a business and it's easy for them to understand. I'll tell a client, "when you own your own business, depending on what the business is, there are lots of tax opportunities. For you Cheri, you're in the marketing industry. Every time you're out in public, you're networking. Everything for you is a marketing expense. As a business owner you get used to that and so you can deduct a lot of things that otherwise you wouldn't be able to deduct. Now you've got that business, you sell it, and then those same things that you eventually attended, all of those become personal expenses rather than expenses you can deduct. In the family office, you can create a different type of business. This business is managing the family's assets and the family structure. It does have to meet the trade and business test to qualify for those deductions to be deductible. But that's one of the things that should be considered in the structure. There's also a case out there referred to as the Lender management. It's referred to you more generically as the Lender Bagel case. This is where the court said that a family office can in fact be a bona fide trade or business, which means that a lot of the things that you do can be deductible. One of the things about the Lender case that I love is that, that we have these rules about the deductibility investment expenses. Under the Lender case, it's possible to structure your family office so that you can deduct some investment expenses that might otherwise be nondeductible.

Cheri: When should a family consider the multi-family rather than the single-family?

Mary: There's that whole concept that is based on the value of wealth, but I don't necessarily think that that's always going to be correct. It is more cost effective generally to do a multifamily office with a little less wealth. But in the single-family office there's more tax deduction and tax planning opportunities and can be more family involvement depending on the structure. It's really looking at those overall things and making that decision based on the overall factors.

Cheri: Does a family office have to be registered with the FCC?

Mary: The general answer is yes, but there is a single-family office exemption and that's probably the subject of almost a whole podcast in itself. I'm just going to mention that, that you have to look at whether there's

any requirements to register under those rules or you know, make sure that you meet the exemption and make a conscious decision about whether it makes sense to qualify for the exemption.

Cheri: So, Mary, any last thoughts?

Mary: I just can't repeat enough that if you're going to go down the path of a family office, sit down with some trusted advisors and develop a clear vision of what your objectives are and what services you're trying to have achieved through the family office so that you create a structure that works in the short term and can evolve in the long term. As we reach the end of our episode, that's all for now, thanks for listening to today's episode and stay tuned for our weekly releases.

HOPE THIS HELPS YOU HELP OTHERS MAKE A *POSITIVE* DIFFERENCE!

Mary Vandenack

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