

What Every Family Business and Family Office Needs to Know

Family Business Best Practices

- Develop consensus and clearly articulate overarching goals and values: what do we seek to accomplish as a family? what principles guide us?
- Develop clear governance policies.
 - Decision-making hierarchy.
 - Develop strategic goals.
 - Ownership eligibility.
 - Maintain business formalities.
- Develop sound operational policies.
 - Employment issues.
 - Financial planning.
 - Selection of advisors.
 - Interpersonal relationships.
- Shareholders Agreement.

Family Business to Family Office?

- Considerations post-liquidity event.
- Role of family members post-liquidity.
- Investment management office: for-profit vs. cost-sharing.

Section 162 vs. Section 212

- Section 162 Elements
 - Ordinary;
 - Necessary;
 - Paid or incurred in the taxable year; and
 - **In carrying on a trade or business.**
- Section 212 Elements
 - Ordinary;
 - Necessary;
 - Paid or incurred in the taxable year:
 - For the production or collection of income;
 - For the management, conservation, or maintenance of property held for the production of income; or
 - In connection with the determination, collection, or refund of any tax.

TCJA - SECTION 212 NO LONGER DEDUCTIBLE

Trade or Business Test

- *Higgins* – Managing own investments ≠ trade or business.
- *Whipple* – Effort does not indicate a trade or business. Taxpayer needs something other than a normal investors return.
- *Dagres* – Investment advisory, financial planning, and other asset management services provided to others may constitute a trade or business.
- *Groetzinger* – Depends on all facts and circumstances.

“...the taxpayer must be involved in the activity with **continuity and regularity** and that the taxpayer’s **primary purpose** for engaging in the activity must be for income or **for profit.**”

Lender – Does A Family Office Qualify?

- Lender Management provides investment advisory and financial planning services to Investment LLCs.
- Investment LLCs compensate Lender Management via a profits interest.
- Investment LLCs, not Lender Management, own investment assets.
- Related family members own Investments LLCs and Lender Management.
- Court rules:
 - Lender Management **provides services to others** in exchange for profits interest.
 - Relationship between Lender Management and Investment LLCs = **business relationship**.
 - Lender Management **meets heightened scrutiny** under family relationship test.
 - **No attribution rule** applies.

“For the tax years in issue, Lender Management was carrying on a trade or business for the purpose of Section 162.”

Most Frequent Dispute – Valuation

- Expert Witness:
 - Google the expert; Special expertise? Do real people rely on the expert? Professional Witness?
 - Likeable? Too flexible or inflexible?
- Expert Report:
 - Tailor the report; Include trial charts; Make the report realistic.
 - The devil is in the details; Avoid hindsight.
- Fair Market Value:
 - State law?
 - Methodologies?
 - Shareholder agreements? → USPAP 9-3.

Key to Winning → All RELEVANT FACTS

S Corporation Tax-Affecting

- Early Tax Court precedent allowed tax-affecting.
- *Gross* – Court rules tax affecting not allowed.
 - Presented with 100% tax-affecting vs. 0% tax-affecting.
 - Court holds no tax-affecting. Other Tax Court cases follow.
- S Corporation Valuation Job Aid (Oct. 2014) – No tax-affecting.
- S Corporation Tax Affecting Models:
 - SEAM/Van Vleet Method.
 - Grabowski Method.
 - Mercer Method.
 - Treharne Method.

***Cecil* may set new standard**

THANK YOU

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