



SPRING 2015

Point of View

*BOOM IN TRUSTS PASSING CARRIED INTEREST TO HEIRS*

Arden Dale of The Wall Street Journal writes about the latest boom in trusts by members of the private equity community passing their carried interest to their heirs. This latest boom has actually been the “Go to Strategy”, that M3 has utilized with their PE clients since 1997.

The illiquidity and enormous potential for appreciation of private equity fund carried interest of our clients created both the need and the opportunity to pursue sophisticated estate planning. In the event of the premature death of a member, their estate may be faced with a liquidity gap for their taxable estate, and over the long term the carried interest can produce significant valuations subject to estate transfer costs.

The solution utilized by M3 and their team of advisors consisted of setting up family LLC’s controlled by the PE member, and gifting or selling the LP interest at a discounted value to a defective trust for the benefit of their heirs. These can even be structured where the member can be the income tax payer on the growth of the carried interest while trust compounds income tax free.

Freeze, Discount and Leverage, are the perfect trifecta for an effect estate arrangement that transfers the future value of carried interest outside of the members taxable estate while providing access to the funds if ever needed by the family.



This presentation is neither an offer to sell nor a solicitation of an offer to buy any securities. The material in this presentation is based on information from sources we consider reliable, but do not represent that the information is accurate or complete. Opinions expressed are current opinions as of the date appearing in this material only. This material is not intended to be used as a general guide to investing, or as a source of any specific investment recommendations, and makes no implied or express recommendations concerning the manner in which any client’s account should or would be handled, as appropriate strategies depend upon the client’s specific circumstances and investment objectives.

SOCHI 2014



ALL MEDALS »

MORE + OLYMPICS

TOP STORIES IN WEALTH MGMT

1 of 12

2 of 12

3 of 12



Boom in Trusts Passing Carried Interest...



Cetera's New Owners Work to Calm Broker...



Saving Retirees From Financial Missteps



Voices: Vincent Barbera, on Technology ...

WEALTH ADVISER

Boom in Trusts Passing Carried Interest to Heirs

Email Print Save 0 Comments [Social icons]

By ARDEN DALE CONNECT

Feb. 18, 2014 9:27 a.m. ET

A new generation of principals in their 30s and 40s at private-equity firms and hedge funds are making their first estate plans, creating a boom in trusts that give their heirs a lucrative slice of the investments they oversee.

- Also in Wealth Adviser:**
- [Cetera Owners Work to Calm Brokers' Concerns](#)
  - [Vonnegut: The Leaky Bucket of Family Wealth](#)
  - [Visit the Wealth Adviser Page](#)

Under this strategy recommended by industry peers and financial advisers, heirs get the right to collect a share of carried interest, a form of compensation that rewards an investment manager for enhancing performance. It could

potentially save a lot in federal gift and estate taxes.

What makes carried interest a popular gifting vehicle is that it typically has a relatively low value initially due to its speculative nature. But, as a hedge fund's returns grow, so does that value of the carried interest.

Dan Schrauth, a wealth adviser in the San Francisco office of J.P. Morgan Private Bank, calls carried-interest planning the "go-to strategy" when working with clients at hedge funds as well private-equity and venture-capital firms.

"It's where you start the conversation,"

said Mr. Schrauth, who brings it up with every one of his client in this niche.

Recently, he introduced the idea to the partner of a Silicon Valley venture-capital firm. The man, in his early 40s, wants to get started on an estate plan that includes gifts to his heirs. He liked the idea of a trust that would hold carried interest from a new fund he plans to raise soon. The client will start modestly, transferring a small percentage of his carried interest.

Carried interest lets the general partner of a private investment fund share its profits. Often, the general partner is a partnership itself, owned by investment managers. It may contribute 1% to 5% of initial capital for the fund. It also manages the fund's assets and gets an standardized annual management fee of 2% of the assets, as well as carried interest.



Enlarge Image

Are you Vanguarding® your clients' portfolios?

Start Vanguarding now

© 2013 The Vanguard Group, Inc. All rights reserved. U.S. Pat. No. 8,879,084 B2; 7,387,138; 7,720,748; 7,825,873; 8,080,646. Vanguard Marketing Corporation, Distributor. Obtain prospectus

Popular Now

What's This?

ARTICLES

1 Forget Medals, Olympians Vie for Puppy Love



[Social icons]

2 A Bitcoin Experiment in Everyday Life



[Social icons]

3 'Candy Crush Saga' Maker Files for IPO



[Social icons]

4 Ukraine Clashes Raise Stakes in Renewed East-West Contest

[Social icons]

5 Opinion: Hurting the 0.3%



[Social icons]

VIDEO

Carried interest typically equals 20% of a fund's profits over a set rate of return. Individual partners in the general partnership, not the partnership itself, pay taxes on these profits. On average, carried interest accounts for about one third of the payments that private-equity general partners get while management fees make up the rest, according to the Tax Policy Center.

Various kinds of trusts are suitable to use for the carried-interest strategy. Some tax attorneys use versions of grantor retained annuity trusts, and others like a strategy known as a sale to a defective grantor trust. Both are widely employed to reduce or eliminate federal gift or estate taxes on gifts to heirs.

The goal is to find an asset that's likely to increase sharply in value, and pass the appreciation on it to heirs with no tax due. Carried interest, like real estate, art, partnership interests and other assets, has to be valued by a professional before it goes into a trust.

"If it explodes in value, you've hit a home run," said Tye Klooster, an attorney and partner at Katten Muchin Rosenman in Chicago who specializes in carried-interest transfers. A trust set up at the outset when a fund is new is more likely to succeed, because of the carried interest's low value, he said.

However, caution is required when making a carried-interest transfer. The Internal Revenue Code includes various provisions which could trip up the planning, Mr. Klooster pointed out.

Tax planners make use of what they call the "vertical slice" exception to Section 2701 of the tax code--which spells out how to value partnership interests in trusts--to transfer a derivative tied to the performance of the carried interest. The derivative planning allows growth on the carried interest to be passed along without actually transferring the interest itself.

Vertical-slice planning is one of the more straightforward forms of carried-interest planning, said Christine Quigley, an attorney in the Chicago office of law firm Holland & Knight. It tends to be more attractive to younger principals who are doing significant planning for the first time, for that reason, she said.

Ms. Quigley said the term "vertical slice" is used because the strategy essentially involves taking a slice out of each class of ownership or interest that a principal has in a fund. It gives away a proportional share of each of those interests.

Given their financial sophistication, adviser Joseph W. Spada's clients in this niche often know a little bit about the strategy when they come to him.

"They have heard about this because their peers have done it, and we sit down, say 'what are your goals?' and explain how these work," said Mr. Spada, a senior principal at Summit Financial Resources Inc. in Parsippany, N.J., which manages around \$3.5 billion.

He recently talked with one client, a private-equity partner worth about \$70 million, about creating a trust to gift carried interest in a new fund to his children. A gift of \$1 million to the trust now could be worth as much as \$10 million in seven years, according to estimates.

Write to Arden Dale at [arden.dale@wsj.com](mailto:arden.dale@wsj.com)

[Email](#) [Print](#) [Save](#) [0 Comments](#) [Order Reprints](#) [f](#) [t](#) [+](#) [in](#)

## WSJ In-Depth



### 1 The State of Love and Sex in Single America



### 2 You Bought What With Bitcoin?



### 3 Search for Japanese Diver Continues



### 4 U.N. Reports "Unspeakable Atrocities" in North Korea



### 5 How Target Managed an Historic Data Breach



## Content From Sponsors

What's This?

### Why You Should Max Out Your Retirement Accounts

Betterment



### A Reliable Source of Retirement Income

YouTube



### Why 65% of executives believe the global economy is improving

EY



### Hiring? Market Your Job Opening to Attract the Best Candidates

Fox Business



**High-Speed Traders Turn to Laser Beams**



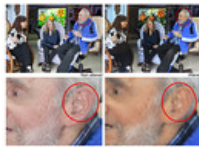
**Social Network Built for Two**

**Germany to Press Search for Looted Art**



**The Season of the Shoe**

**Smart Hubs: A Brain for Your House**



**Altered Photos of Fidel Castro Removed**

**SPONSORED LINKS**

[10 Best Mutual Funds](#)

[Credit Cards For Excellent Credit](#)

[Dividend Income Funds](#)

[Credit Cards For Miles](#)

[Fixed Income Funds](#)

[Best Mortgage Rates](#)

[High Yield Savings Account](#)

[High-Yield CDs](#)

[Best Bond Funds](#)

[Top Minivans](#)

**Add a Comment**

**JOURNAL COMMUNITY**

[Community rules](#)

All comments will display your real name. Start typing your comments here...

Track replies to my comment

**CLEAR**

**POST**

**THE WALL STREET JOURNAL.**



[Back to Top](#)

**Customer Service**

[Customer Center](#)

[New! Live Help](#)

[Contact Us](#)

[WSJ Weekend](#)

[Contact Directory](#)

[Corrections](#)

**Policy**

[Privacy Policy](#)

[Cookie Policy](#)

[Data Policy](#)

[Copyright Policy](#)

[Subscriber Agreement & Terms of Use](#)

[Your Ad Choices](#)

**Ads**

[Advertise](#)

[Place a Classified Ad](#)

[Sell Your Home](#)

[Sell Your Business](#)

[Commercial Real Estate Ads](#)

[Recruitment & Career Ads](#)

[Franchising](#)

[Advertise Locally](#)

**Tools & Features**

[Apps](#)

[Emails & Alerts](#)

[Graphics & Photos](#)

[Columns](#)

[Topics](#)

[Guides](#)

[Portfolio](#)

[Old Portfolio](#)

**More**

[Reprints](#)

[Content Partnerships](#)

[Conferences](#)

[SafeHouse](#)

[Mobile Site](#)

[Price & Volume](#)

[Keyword & Symbol](#)

[News Archive](#)

[Jobs at WSJ](#)

Copyright ©2014 Dow Jones & Company, Inc. All Rights Reserved.