A Comprehensive Financial Planning Guide

FOR ATTORNEYS AND LAW FIRM PARTNERS

By Wealthspire Advisors

Welcome to Wealthspire's Comprehensive Financial Planning Guide for Attorneys and Law Firm Partners.

As attorneys, your dedication to the pursuit of justice is unparalleled. Each day, you navigate complex legal terrains, advocate for your clients' rights, and uphold the pillars of fairness and integrity. However, in the midst of your professional commitments, it's crucial not to overlook your own financial well-being. In a prestigious career path such as law, effective financial planning isn't just about accumulating wealth; it's about securing your future, safeguarding your assets, and realizing your long-term aspirations for not only you, but your family and future generations.

In this comprehensive e-book, we'll dive into just some of the intricacies and important details of financial planning for attorneys and law firm partners, with sections written by some of our expert thought leaders, many of whom have their J.D.s but decided to pursue a passion for financial planning stead of law and who have experience in working with attorneys. We'll explore crucial considerations and decisions we've guided other attorneys through from capital accounts and understanding draw accounts, cash flow management, healthcare plan selection, trust and estate planning, charitable giving, and tax optimization strategies. By equipping you with the knowledge and tools necessary to make informed decisions, our aim is to empower you to build a solid foundational plan and help alleviate concerns so you can focus on the things you care about: your family, your career, and your future.

As you navigate the pages of this e-book, remember that financial planning is not a one-time task; it's an ongoing journey that evolves with your life and career. Some sections may be more applicable to certain attorneys than others, but the general concepts are applicable to most all in the legal profession. Whether you're a seasoned attorney or just beginning your legal practice, the principles outlined here will serve as a compass, guiding you towards financial success and peace of mind.

The Path to Law Firm Partnership

If you are fortunate enough to be among the 10% of associates who make partner, your financial landscape may undergo a significant transformation. Understanding the nuances of your new role is crucial for continued financial success. Below are a few other pieces that some colleagues and we have written to help current and future Big Law Partners navigate the complexities of the profession and position.

Considering that less than 10% of associates make partner, some might say that you have already made it to the pinnacle of your profession. Of course, you may believe there is still room for you to raise the ceiling on your career, but considering the above statistic, you are in limited company. If you are fortunate enough to make partner, below are just some of the factors you should consider in your financial plan.

In this comprehensive guide, our contributors will discuss the following topics, and more.

- Capital and Draw Accounts for New Law Firm Partners: As a partner, you will need to understand the financial mechanics of capital accounts and draw accounts. These determine your share in the firm and how you will receive your earnings.
- Healthcare Plan Considerations: Partners often face different healthcare options. It is important to evaluate these choices in the context of your personal and family health needs.
- Trust and Estate Planning: With increased wealth, estate planning becomes even more critical. This may involve managing your legacy and ensuring your assets are distributed according to your wishes.
- Charitable Giving and Tax Planning: With higher earnings, effective tax planning and charitable giving can play a key role in your financial strategy.
- Lifestyle Management: Avoiding lifestyle “creep” is essential to maintaining financial stability and growth, even with a significant increase in income.

Capital Accounts & Draw Accounts

Contributor: Eric Dostal, J.D., CFP®

For those who are embarking on a new and exciting chapter of partnership at a legal firm, it is essential to familiarize yourself with the financial aspects of partnerships, particularly capital accounts and draw accounts. These will be your main sources of income and working capital for your life as you grow into your new role.

The Importance of Capital Accounts

The key to financial success at all stages is controlling expenses and building wealth.

Capital accounts play a crucial role in a law firm partnership and represent your financial stake and equity in the firm. Your initial capital contribution signifies your commitment and investment in the partnership. Understanding the mechanics of capital accounts is key to comprehending how profits and losses are allocated, as well as how your ownership interest in the firm evolves over time.

When an attorney is admitted as a partner at a law firm, they typically are asked to make an initial capital contribution. This contribution can take many different forms depending on the firm’s policies, including cash, debt, or some combination of the two. This initial contribution is to establish the partner’s financial stake in the firm and help demonstrate their commitment to the partnership’s success. Normally, when a partner contributes to their capital account, they will also establish their “book value” in the partnership. Book value is an accounting term that represents the value of a partner’s capital account in a partnership. It reflects the amount of partnership assets that would be distributed to the partner if the partnership were to liquidate or wind up its operations. The higher the book value, the greater the partner’s proportionate ownership in the partnership. Book value is calculated by subtracting the partner’s share of any partnership liabilities from their capital account balance and creating a ration of their remaining capital account to the other partner’s capital accounts in the firm. The book value of a partner’s capital account is important for determining the partner’s equity stake in the partnership and their entitlement to distributions of income.

Below are a few examples of how a newly admitted partner at a law firm makes their initial capital contribution.

EXAMPLE 1
Capital Contribution from Cash

In this example, Partner A joins a law firm as a new partner and makes an initial capital contribution of $500,000 in cash. Partner A's capital account is now $500,000.

If we assume the firm has three partners in total, no outstanding debts, and their combined capital contributions are $1,500,000, then Partner A's book value of partnership interest would be: ($500,000 / $1,500,000) x 100% = 33.33%.

EXAMPLE 2
Capital Contribution via Profits

A new partner, Partner X, agrees with the firm that their capital contribution of $500,000 will be made over a period of four years, using a portion of their share of the profits each year:

- **Year 1:** Partner X's share of profits is $200,000, and they allocate $100,000 towards their capital contribution.
- **Year 2:** Partner X's share of profits is $240,000, and they allocate $120,000 towards their capital contribution.
- **Year 3:** Partner X's share of profits is $300,000, and they allocate $150,000 towards their capital contribution.
- **Year 4:** Partner X's share of profits is $260,000, and they allocate $130,000 towards their capital contribution.

By the end of the fourth year, Partner X will have made a total capital contribution of $500,000 ($100,000 + $120,000 + $150,000 + $130,000) from their share of the profits. They are now able to keep all their profit distributions, as they have fully satisfied their capital commitment to the firm.

EXAMPLE 3
Capital Contribution through Borrowing

Partner Y, a new partner, decides to fund their capital contribution of $500,000 by borrowing funds from a financial institution. Partner Y secures a loan of $500,000 from a bank to cover their capital contribution.

- Over time, Partner Y repays the loan, typically through a combination of monthly installments and interest payments, as per the loan agreement. Often this interest is fully deductible by the partner. By obtaining a loan, Partner Y can make their full capital contribution upfront and repay the loan amount over time using their income from the partnership.

Similarly, Partner Z is a newly admitted partner in a law firm that requires a capital contribution of $500,000. However, Partner Z currently does not have the full amount available to make the capital contribution upfront. In this case, the partnership may offer financing to Partner Z, enabling them to fulfill their capital obligation over time.

- The partnership agrees to lend Partner Z $400,000 to cover a significant portion of the capital contribution. Partner Z will repay the loan over an agreed upon period, usually through regular installments, along with any applicable interest as per the terms established in the financing agreement. The remaining $100,000 of Partner Z's capital contribution can be made through other means, such as personal funds or profit allocations from their share of the partnership.

By providing financing, the partnership enables the new partner to fulfill their capital contribution obligation while spreading out the payment over a specified period. This arrangement can be beneficial for both the partnership and the new partner, as it allows for a more flexible financial transition into the partnership while ensuring the partner meets their capital commitment.

Allocation of Profits and Losses

As a partner, your share of the firm's profits and losses will be determined by a predefined formula outlined in your partnership agreement. This formula may consider several factors such as seniority, performance, client origination, and other criteria specific to your firm. Being familiar with this formula and its implications will help you understand how your efforts and contributions impact your financial rewards.

In many partnerships, the distribution of income is based on the partners' capital account balances or on specific profit-sharing ratios outlined in the partnership agreement. The book value of a partner's capital account can influence their share of income distributions. If profit distributions are based on capital account balances, partners may receive income distributions in proportion to their respective capital account balances. Therefore, a partner with a higher book value will generally receive a larger share of the income distribution.

Thinking back to Partner A in our first example above, if the firm's profits for the year were $1,000,000 and distributions were based solely on partnership interest, then Partner A would expect to receive ~$330,000 as an income distribution. Typically, none of Partner A's capital account would be distributed during an annual distribution of profits. This would make the entire amount of the distribution taxable to Partner A. Partner A would typically receive a form K-1 from the partnership outlining their share of profits distributed.

If the distribution is based on profit-sharing ratios, the partnership agreement may specify different profit-sharing ratios for partners based on various factors such as seniority, performance, or capital contributions. While the book value itself may not directly determine the profit-sharing ratio, it can indirectly influence the partner's entitlement to a larger or smaller share of the income distribution.

Alternatively, let's assume Partner A is the junior partner at the firm and, according to the partnership agreement, is only entitled to 25% of income profits during their first five years in the partnership. In this case, Partner A would receive an income distribution of $250,000 even though they have a 33.33% ownership stake in the partnership.

Example 4 shows additional examples of how profits and losses can be allocated among partners in a law firm, along with sample calculations to illustrate the distributions.

EXAMPLE 4
Formula-Based Profit Allocation

Consider a law firm with two partners, X and Y, where profits are allocated based on a formula considering both seniority and performance:

Total annual profit: $800,000

- Seniority counts for 25% of compensation
- Partner X's seniority factor: 40%
- Partner Y's seniority factor: 60%

Performance/origination counts for 75% of compensation

- Partner X's performance factor: 30%
- Partner Y's performance factor: 70%

Partner X's allocated profit:

- Seniority factor:
  (25% x 40%) x $800,000 = $80,000
- Performance factor:
  (75% x 30%) x $800,000 = $180,000
- Partner X's share:
  $80,000 + $180,000 = $260,000

Partner Y's allocated profit:

- Seniority factor:
  (25% x 60%) x $800,000 = $120,000
- Performance factor:
  (75% x 70%) x $800,000 = $420,000
- Partner Y's share:
  $120,000 + $420,000 = $540,000.

In this scenario, the allocation is based on a combination of seniority and performance factors, resulting in Partner X receiving $260,000 and Partner Y receiving $540,000 of distributed profits.

Draw Accounts – Accessing Regular Income

While capital accounts reflect your ownership interest, draw accounts are designed to provide you with regular income to cover personal expenses. Sometimes draws are considered an advance against your future profits, while other times they represent dollars already earned/owed but not yet distributed from the partnership. Your draw amount is likely influenced by factors like your capital account balance and firm policies. It's important to strike a balance between taking appropriate draws to meet your financial needs and maintaining a stable capital account.

At the end of the fiscal year, your draws are reconciled with the actual profits allocated to you through your capital account. If your draws exceed your allocated profits, adjustments may be made, either deducting the excess from your share of profits or requiring repayment to the firm. Understanding this reconciliation process will help you plan your finances and avoid any surprises at year-end.

As a newly elected big law partner, understanding capital accounts and draw accounts is essential for managing your financial interests within the partnership. By grasping these concepts and your options, you can make informed decisions, strike a balance between personal needs and firm stability, and maximize your financial rewards. Embrace this new financial dimension of partnership, and congratulations again on your well-deserved achievement!

Click here for additional information on Understanding Capital Accounts and Draw Accounts: A Guide for Newly Elected Big Law Partners.

Understanding Your Healthcare Plans

Contributor: Eric Dostal, J.D., CFP®

As you embark on this exciting chapter of your legal career, it's crucial to make informed decisions regarding your healthcare plan. There are several important factors to consider when choosing the right healthcare plan and using healthcare services in a cost-effective manner.

Understanding Healthcare Costs

The rise in popularity of high deductible health plans has shed light on the way healthcare is provided in the United States and the associated costs. Our current fee-for-service model often leads to a belief that more is better - more tests, more medications, more visits. This, coupled with malpractice concerns and the opportunity for hospitals to charge more for the same procedures than independent doctors, can result in rapidly rising healthcare costs. As a law firm partner, it's crucial to navigate these costs effectively.

Choosing the Right Healthcare Plan

When it comes to deciding which healthcare plan is best for you and your family, it is important to understand a variety of components. No two people are the same, and there is not a one-size-fits-all solution. Below are just a few factors to think about when you become partner and need to choose a healthcare plan that fits your needs.

Coordination with Firm Policies: Familiarize yourself with your law firm's policies regarding healthcare plans. Understand any specific requirements, such as whether you're expected to choose from a pre-approved list of plans or if there are restrictions on changing plans outside of the open enrollment period.

Provider Preferences: As a partner, you may have established relationships with specific healthcare providers or specialists. Ensure that the healthcare plan you choose provides access to the providers you prefer or that you have the flexibility to seek out-of-network care if needed.

Executive Health Programs: Some law firms offer executive health programs as a perk for partners and senior executives. These programs often provide comprehensive and personalized healthcare services, including dedicated medical teams, expedited appointments, and additional wellness benefits. Inquire about the availability and benefits of such programs.

Flexibility and Portability: Consider the flexibility and portability of your healthcare plan. If you anticipate changes in your career, such as transitioning to another law firm or starting your own practice, it's important to evaluate whether the plan can be easily transferred or if it offers coverage options beyond the firm's network.

Cost-Sharing Arrangements: Law firm partnership often involves unique compensation structures. Make sure that the healthcare plan you choose aligns with your specific compensation arrangement and considers tax implications, reimbursement methods, or profit-sharing agreements.

Dependent Coverage: Assess the options for dependent coverage under the healthcare plan. If you have a family or dependents, factor in their healthcare needs and ensure that the plan provides suitable coverage for them as well.

Additional Benefits: Inquire about any additional benefits or perks offered by the healthcare plans available to you. These may include wellness programs, gym memberships, mental health services, telemedicine options, or other value-added services that can contribute to your overall well-being.

Tax Implications: Understand the tax implications associated with your healthcare plan, including the deductibility of premiums and potential tax advantages regarding health savings accounts (HSAs) or flexible spending accounts (FSAs).

Using Healthcare Services Effectively

To make the most of your healthcare plan as a law firm partner, here are some helpful tips.

In-Network Providers: When making appointments with healthcare providers, ask if they are in-network rather than just covered under your plan. Being in-network means that the provider has a fee arrangement with your insurance provider, resulting in lower costs for you. Ensure that the providers you prefer are in-network or that the plan offers flexibility for out-of-network care when necessary.

Preparing for Doctor's Appointments: Before each doctor's appointment, write down relevant information such as symptoms, medications, and questions you have. Send a copy of this document to the doctor's office a few days prior to your visit. Bring another copy to hand to the doctor during your appointment. This increases the likelihood of all your concerns getting addressed, and it helps facilitate effective communication with your healthcare provider.

Evaluating the Necessity of Tests and Procedures: If you are referred to a facility for testing, inquire if the facility and the doctors evaluating the results are in-network. Ask your doctor about the purpose and potential impact of the recommended tests on your treatment. If the necessity or relevance of a test is unclear, discuss alternatives or determine if the testing is truly necessary.

Cost Considerations for Prescriptions: When given a prescription, ask if the drug is covered under your plan and if there is a cheaper generic version available. Compare the cash price of the medication without insurance to the out-of-pocket cost with your insurance. Discuss the benefits, risks, duration of use, and potential alternatives with your doctor.

As a law firm partner, selecting the right healthcare plan and using healthcare services in a cost-effective manner is essential. By having a deep understanding of your healthcare needs, provider preferences, and plan flexibility, you can choose a plan that aligns best with your requirements. Moreover, by selecting in-network providers, preparing for doctor's appointments, evaluating the necessity of tests, and considering cost-saving measures for prescriptions, you can make the most of your healthcare plan while effectively managing costs.

Remember to consult with your law firm's benefits coordinator or human resources department for personalized guidance and to document important conversations throughout the process. Additionally, working with a financial advisor can provide valuable insights into managing healthcare costs and optimizing your overall financial well-being. A financial advisor can help you analyze the available healthcare plan options, review potential tax advantages, and develop a comprehensive financial strategy that aligns with your goals. As a law firm partner, being proactive and informed will empower you to navigate the healthcare system with confidence and make the best healthcare decisions for yourself and your family.

Trust & Estate Planning Considerations

Contributor: Oliver Pursche, AAMS®, CEPA

For many partners at top law firms, their earnings represent the first time in that person's family history that such wealth has been generated. With this first-generation wealth creation comes certain challenges and many opportunities. As a partner in a law firm, they now have additional financial and tax responsibilities that they may not be fully aware of. Many focus on financial planning and investment advice, but often do not spend enough time thinking about how to efficiently transfer newly accumulated wealth to children and grandchildren. Without proper planning, the accumulated wealth that the high-income earner worked so hard for could be taxed at a 40% transfer tax rate before that wealth passes to the next generation. This article will focus on the basics of trust & estate planning, providing specific examples and case studies of how various trust structures can be utilized. Specifically, we will discuss asset protection, probate avoidance, incapacity planning, and estate & gift tax planning.

Utilizing The Right Trust Structure for You

Let's start with the basics – while many are familiar with the terms Revocable and Irrevocable Trust, knowing when to use them and how to best take advantage of them can be tricky and requires more thoughtful planning. The main differences between a revocable and irrevocable trust are as follows:

	Revocable Trusts	Irrevocable Trusts
Benefits	Maintain control of the assets	Tax reduction
	Protection in case of incapacity	Protection from creditors
	Avoids probate	Avoids probate
	Preserves privacy	Preserves privacy
Drawbacks	No estate tax benefits	Reliquish control of assets
	No protection from creditors	Limited flexibility / subject to trustee discretion

Lawyers know that few things are mutually exclusive – this applies to trust structures as well. Taking advantage of both structures for different assets and purposes can be beneficial. For instance, they might want to place a secondary residence in a revocable trust, allowing them to maintain control and for the home to be sold at their passing without the need for probate. However, maximizing tax savings via irrevocable trusts is also important, and should be done in conjunction with other strategies. Of course, as with any tax strategy, limitations apply, and the structures may become undesirable or ineffective if laws change. And, since there are many possible irrevocable trust structures, selecting the appropriate trust for various assets is critical. Below is a list of the most utilized irrevocable trust structures and their primary purposes.

- **Credit shelter trust, also known as a bypass trust or AB trust:** A trust typically used by married couples to avoid estate taxes on certain assets. After the first spouse dies, assets are moved into the credit shelter trust for the use of the surviving spouse. When the second spouse dies, the remaining assets in the trust are passed to the heir of the estate tax-free.

- **Qualified terminable interest property trust, or QTIP:** Divorce attorneys are likely familiar with a QTIP. This type of trust is designed to provide the surviving spouse with an income stream and use of the assets at the trustee's discretion or for limited purposes like health, education, maintenance, and support, and at the surviving spouse's death, QTIP trust assets remaining pass to named beneficiaries. This structure is most often used in second marriages.

- Grantor-retained annuity trust**, or GRAT:** A GRAT is a short-term trust designed to remove asset appreciation from the grantor's estate to benefit heirs (typically children of the grantor) with minimal use of lifetime gift exemption. GRATs work best in low interest rate environments.

- Qualified personal residence trust**, or QPRT:** This structure is similar to a GRAT but is exclusively used for residential real estate. One of the advantages of this structure is that the grantor can live in the home rent-free before it is ultimately gifted to the heirs. QPRTs work best in high interest rate environments.

- **Generation-skipping trust/dynasty trust:** For attorneys who have amassed a larger amount of wealth, these trust structures can help insure multi-generational benefits. These types of trusts enable the grantor to gift assets to trusts for their children, grandchildren, and/or more remote descendants and keep the trust assets excluded from the taxable estates of the grantor's descendants for multiple generations.

- **Special needs trust:** This trust allows a beneficiary with special needs to maintain eligibility for governmental assistance while ultimately benefiting from the trust to enhance the beneficiary's life.

- Intentionally defective grantor trust**, IDGT or grantor trust:** This strategy helps reduce or eliminate estate taxes but requires the grantor to continue to pay any applicable income taxes on the assets transferred into this trust. As a result of grantor continuing to pay the income taxes, the IDGT grows tax-free.

- **Irrevocable life insurance trust, or ILIT:** This is a trust that owns a life insurance policy and receives the death benefit proceeds of the policy. This can be a useful tool for addressing potential estate tax liability, and subject to limited exceptions, the death benefit is excluded from the grantor's taxable estate.

- **Charitable trusts:** There are trusts set up to benefit charities and gain favorable tax treatment for the grantor. Frequently used charitable trusts include charitable remainder trusts, charitable lead trusts, and pooled income trusts.

As evidenced above, there are many types of trusts that can be set up and incorporated into a comprehensive estate plan, all depending on one's primary concerns and objectives. Working with a knowledgeable professional who is able to coordinate the appropriate resources to address these complex planning matters is critical.

Follow this link for additional information on Estate Planning Considerations for Top Law Firm Partners.

Charitable Giving and Effective Tax Strategies

Contributor: Craig Fasano, J.D.

Charitable giving is an important part of life for many clients. Whether donating money or property, dedicating time and effort, or a combination thereof, giving is a way to promote values and leave a legacy for future generations. Charitable giving can also be a valuable part of the overall financial plan, and understanding some basic ways to give can add significant economic efficiency to benefit the donor and their family for the long-term.

On the strictly financial side, the 2017 Tax Cuts and Jobs Act ("TCJA") reduced opportunities to claim itemized income tax deductions, leaving most individual/joint taxpayers able to report deductions for medical and dental expenses, mortgage interest, state and local taxes paid (capped at $10,000), and charitable gifts. With deduction limitations in place, having a better understanding of different funding sources and ways to give can save money on tax bills, and do so whether one takes a standard deduction or itemizes.

Most clients new to Wealthspire have traditionally made charitable gifts by simply writing a check or donating cash. Cash donations to public 501(3)(c) charities provide a current year income tax deduction up to 60% of adjusted gross income (AGI) with a 5-year carry forward to utilize the full deduction if the client is above the AGI limits. However, using cash is seldom the most efficient way to give. Below we will explore some of the more common and efficient ways to make charitable gifts and how to integrate these strategies into a long-term financial plan.

Common Charitable Gifting Strategies

Donate Appreciated Assets

For high-net-worth taxpayers, managing capital gains adds significant tax-efficiency to the portfolio. We often utilize tax-loss harvesting when markets are volatile and strategic gain harvesting in low-income years. For the charitably inclined, using low basis, long-term capital gain positions to donate also adds tax-efficiency. Appreciated assets can be viewed as charitable currency since asset donations allow for a current year income tax deduction at fair market value and will not trigger a capital gain on the disposition of the asset. So, that stock that a client paid $10k for and is now worth $100k? It can be donated to charity and they will receive a charitable income tax deduction of $100k and avoid paying capital gains tax on the $90k gain since the tax-exempt charity will sell the position.

Most charities can receive direct donations of securities or other appreciated assets and donations of appreciated assets to public charities are limited to 30% of AGI with a 5-year carryforward. And, if the asset is one that a client would like to continue to own, there is no preclusion from purchasing it back with cash (cash that would have otherwise been used to make the charitable gift) which will reset the cost basis to current market value. When using appreciated securities, it is important to make sure that the asset donated is a long-term capital gain holding (i.e., it has been owned for one year or more), as short-term capital gain positions have their deduction limited to cost basis and not current market value.

Use a Donor Advised Fund

What if someone would like a tax deduction this year, but they do not want to give all the funds to the charities they plan to support right now? The donor advised fund (DAF) provides a simple solution. A DAF is a charitable investment account that is itself a public 501(c)(3) charity. DAFs have modest initial funding requirements (Fidelity's DAF has no initial minimums, Schwab's a $5,000 initial minimum) and can be funded with cash, appreciated assets, collectibles, or other investments (real estate/illiquid investments). Funds are donated into one's own designated account within the DAF that can have their name attached to it or remain anonymous.

The donation is complete and tax deduction received once the funds are inside the DAF, and since the DAF is a public charity, assets can then be sold inside the DAF account with no tax consequence. While the donation is irrevocable, the donor will have the ability to 1) direct investment of the funds, tax-free, inside their DAF account, and 2) nominate other public charities to receive grants from their DAF account. Grants are then sent out by check from the DAF to the end-charity. The is no legal deadline to send funds out of a DAF; however, many DAF sponsors require at least a $50 grant to a public charity every three years.

Given the TCJA's limitation on itemized deductions discussed above, "bunching" gifts often makes sense. This technique involves making multiple years' worth of charitable gifts into the DAF to take a deduction in the current year and then spreading out grants to end-charities over time. Then in the following year(s), the taxpayer takes a standard deduction before bunching to itemize again in a future year.

Make Qualified Charitable Distributions from Traditional IRA Accounts

A qualified charitable distribution (QCD) is a donation from a Traditional IRA to a qualified charity. While required minimum distributions (RMDs) of Traditional IRA funds are not mandated until age 73, IRS rules allow for those 70½ or older to donate up to $100k ($200k for a couple) directly to public charities without taking the distribution as taxable income. Itemizing deductions is not necessary to take advantage of a QCD and one does not have to be of RMD age – 70½ is the magic age. If taking RMDs, the QCD can reduce the amount that must be taken in as taxable income (e.g., a 2023 RMD is $200k and a $100k QCD is made, so tax is only paid on $100K). In addition, under the recently enacted Secure Act 2.0, the annual QCD of $100k is scheduled to be indexed for inflation going forward. One important note is that QCDs must go directly to end-charities and cannot be made to a DAF or private foundation.

Other Charitable Gifting Methods

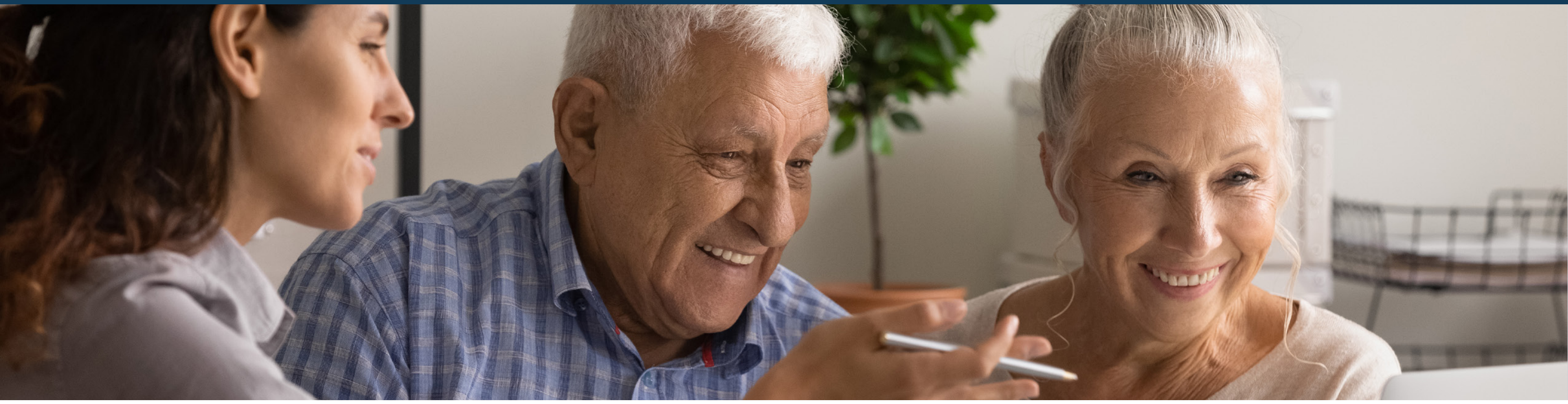
Charitable giving can also be coupled with the donor's desire to retain an income stream from donated assets while also supporting charity. The techniques below are more complex but can be useful for high-net-worth individuals with both philanthropic and income goals in mind.

Charitable Gift Annuity

Many larger charities offer charitable annuities which allow donors to support the organization, receive a partial charitable income tax deduction up front, and receive a fixed income stream from the charity for a single or joint life with the remainder interest reverting to the charity. A gift annuity is a contract between a donor and a single charitable organization. It can be funded with cash, property, or appreciated securities. The terms of the agreement lock in the annuity rate and amount/timing of payments back to the donor. The annuity payment is based on several factors including the donor's age when making the initial gift. Annuitants receive an income tax deduction at the time of the original gift with the deduction based on the estimated amount that will eventually go to the charity after all the annuity payments have been made. Assuming long-term capital gain assets are gifted, the capital gains tax will be spread out for a period of time based on the donor's statistical life expectancy as the donor receives the income payments. If the donor outlives their statistical life expectancy, income payments moving forward are taxed as ordinary income.

Charitable Remainder Trust

Like the Charitable Gift Annuity, the Charitable Remainder Trust (CRT) also provides an upfront charitable income tax deduction and tax-advantaged income stream for a period of years or life. CRTs can be created during life, or as part of the estate plan after death. They can also be created directly with a charitable organization (mostly larger organizations offer CRTs) or by the donor directly, in which case multiple charities or a DAF can be named as remainder trust beneficiaries.



CRTs are often used as a low-basis stock diversification strategy since, similar to the strategies discussed above, donations to a CRT are valued at current market value and assets are sold and diversified once inside the CRT with no current capital gain consequence. The funds are then invested in a diversified manner inside the CRT and an annual/quarterly income stream is paid to the donor or another named beneficiary. CRTs can have fixed payments (known as a Charitable Remainder Annuity Trust (CRAT)) or varying payments that are a fixed percentage rate of the CRT value each year (known as a Charitable Remainder Unitrust (CRUT)). There is also a CRT variation typically used when immediate income is not the goal or when illiquid assets that do not generate an income stream are used for the initial funding. This is called a Net-Income Make-Up Charitable Remainder Unitrust (NIM-CRUT). Donations to a CRT provide a current year charitable income tax deduction. Payments made to an income beneficiary are taxed in a tiered system which typically allows for deferral of the long-term capital gains tax that would have been due upon the sale of the asset(s) used to fund the CRT.

After the end of the CRT term or death of the last income beneficiary, the remaining CRT assets are distributed to designated charitable beneficiaries. Depending on how the CRT is drafted, the trustee may be given the power to change the charitable remainder beneficiaries during the term of the trust.

There are more complexities and costs with CRTs. If creating a CRT on your own, the trust must be drafted by legal counsel. A CRT will also generate a K1 for the income beneficiary's tax reporting. To learn more about CRTs, please check out our previous post here.

Charitable Lead Trusts

The inverse of the CRT is the Charitable Lead Trust (CLT). CLTs can have a fixed (known as a CLAT) or varying payment (known as a CLUT) and a term of years or lifetime term. They can be created during life or as part of the estate plan at death. Unlike the CRT, the CLT makes its annual payment to one or more charities and has its remainder interest either revert to the grantor or more commonly, pass to designated beneficiaries as a longer-term discounted gift. The CLT is also a more complex strategy that requires both legal and accounting considerations. Depending on how the CLT is set up, it can also provide a large upfront income tax deduction. Learn more about CLATs here.

Beneficiary Designations / Naming Charities in your Estate Plan

Leaving assets to charity through an estate plan should also be a consideration. An estate plan often lists specific charitable bequests and may designate one or more charitable organizations as the taker-in-default (e.g., who receives the estate if all other beneficiaries are deceased). While such provisions are common, naming a charity (which can also be a DAF) as contingent beneficiary for a Traditional IRA or other retirement plan may make sense for some. Under the Secure Act 2.0, Traditional IRA funds passing to a non-spousal beneficiary are given a 10-year deferral period before the total account must be distributed out and the inherited IRA may have RMD requirements for the beneficiary over the 10-year period. All distributions are taxable as ordinary income to the beneficiary. For those with a potentially taxable estate (for 2023, greater than $12.92MM for an individual / $25.84MM for a married couple), naming a charitable contingent beneficiary for Traditional IRA dollars will reduce the amount of the taxable estate by donating an account that may be tax-inefficient for a non-charitable beneficiary.

Charitable giving is an important part of the overall financial plan, not just something to think about near year-end. Well, considered sources and methods of donations can lead to a greater impact for the charity and better tax outcomes for the donor. We are here to help you sort through the options and make decisions that are best for you and your family.

Click here for additional information on Charitable Giving for High-Net-Worth Individuals.

Avoiding Lifestyle Creep

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Lifestyle creep, or lifestyle inflation – when expenses rapidly rise to match newfound income – ensnares countless newly minted partners. Often there are underlying social pressures from peers or colleagues to keep up with new levels of conspicuous consumption. New indulgences and one-time splurges quickly become everyday necessities. It may begin innocently enough with a new car, a small remodel to an existing home, or a generous contribution to one's alma mater, but it can quickly snowball into completely spending bonus checks before they have even been deposited.

So, who cares? After all, you have sacrificed a lot to get where you are today and rewarding yourself for a job well done is your right. However, many junior partners have not considered what they are giving up by having their expenses match their income – namely, true financial freedom or the ability to say no. It is difficult to downshift your lifestyle, especially if you have no resources to fall back on other than your future earning potential. Make sure you do not find yourself in this situation by following these tips.

Prepare for Lumpy Cash Flow

It is important to be fiscally prepared for lumpy cash flow – expenses like estimated tax payments, firm capital commitments, and new firm sponsorship contributions, just to name a few, can potentially catch you off-guard. Without adequate planning and forethought, you can find yourself flat-footed at a very inopportune moment.

The first step to addressing lifestyle creep is to be prepared. Create a short-term cash strategy to help you avoid common cashflow missteps. Start by identifying what your major outstanding liabilities will likely be for the next 12 months. After you have identified these cash needs, find a ready source of liquidity to cover them.

When reviewing your cash strategy look for potential mismatches between liabilities and cash flow, consider all your options. Be prepared to cover an unexpected expense in addition to the ones you identified. Remember alternative sources of potential liquidity that you could use to smooth over any cash crunches, such as:

- A margin loan against assets held in investment accounts.
- A cash reserve built up over the course of time specifically for these types of surprise liquidity events.
- Short term financing solutions offered by the firm.

If you do not research your options in advance, it is difficult to know in the moment what your best options are. Sometimes the terms of short-term margin loans are equal or better than terms offered to new partners from other sources, sometime not – having options in place and knowing what they are is paramount to helping you address your need when it arises. Preparing a short-term cash strategy will give you a better sense of what to hold in reserves for future expenditures, what you can spend on your current lifestyle needs, and what to invest for long-term growth – allowing you to avoid the trap of lifestyle inflation.

Identify Your Goals and Values

Making conscious decisions about what is important to you is one of the most crucial steps in combating lifestyle inflation. You may really like the idea of:

- Having the option to slow down when you want to.
- Buying a vacation home to spend quality time with family.
- Providing meaningful philanthropic support to a cause you believe in.
- Being able to offer monetary support to aging parents.

There are no right or wrong choices, but you should make a choice. One of my favorite Yogi Berra quotes is, "If you don't know where you are going, you might wind up someplace else." Not having your long-term goals well-defined makes it easier to succumb to lifestyle creep, potentially leaving you someplace you didn't intend to be. Balancing short-term needs with long-term goals is a lifelong pursuit, so it is vital not to focus solely on one or the other at any given time. Clearly outlining your goals and having a financial plan in place to achieve them will help you feel comfortable living the life you want today, knowing you are going to end up where you truly want to be.

Create a Financial Roadmap

Without knowing what you are aiming at, you can miss your target and let other seemingly pressing things drain your ability to accomplish what you really want. After identifying what matters most to you, the next step is to create a financial roadmap to help guide you to your destination.

This is done through a comprehensive financial plan that considers not only your resources and liabilities, but also incorporates an in-depth cash flow and investment return projection as well. Having your plan in place will help guide you towards your goals and remind you to maintain focus on them.

To create a financial roadmap, you should gather and review information regarding:

- Partner Benefits: 401(k), deferred compensation plans, etc.
- Investment Assets: taxable and retirement accounts, physical assets, etc.
- Liabilities: existing mortgages, home equity lines of credit (HELOCs), credit cards, student loans, etc.
- Insurance: personal and group benefits – disability, life, property & casualty, etc.
- Estate Plan: current wills, Powers of Attorney (POAs), revocable and irrevocable trusts, etc.
- Tax Returns: recent returns from your accountant for reviewing income, expenses, deductions, etc.

These data points allow you to create a more meaningful individual guide to help you stay on track to reach your financial goals. As assets and income projections change, risk profiles are modified, and other aspects of your personal and financial life develop with time, you should revisit and adjust your financial roadmap to reflect your new situation and goals. Your financial roadmap is a living document that will always be there to reorient you, helping to combat lifestyle creep.

Some level of lifestyle inflation is inevitable and necessary, continuing to live like you are a first-year associate is not the answer to preventing lifestyle creep. As with most things in life, the key is moderation. The transition to partner can be a challenging one – creating a comprehensive financial roadmap that takes your personal and professional situation and goals into consideration is the best way to develop and implement a plan that will help you avoid the kind of overextension that could materially impact your ability to achieve what you really want – whatever you decide that is.

Click here for additional information on 3 Tips to Help Junior Partners Avoid Lifestyle Creep.

Conclusion

There are other factors that an attorney might want to consider in their comprehensive financial plan such as Cash Flow Management, Investment Strategies, and Retirement Plans and other Benefits. Our team at Wealthspire Advisors has helped many attorneys and law firm professionals through these challenges and more.

At Wealthspire Advisors, we recognize the unique challenges and opportunities that attorneys encounter in their financial journeys. With years of experience working closely with law firms and individual practitioners, we understand the nuances of your profession and the intricacies of your unique financial landscape. Our dedicated team of advisors is committed to providing personalized solutions that align with your specific needs and aspirations.

From structuring capital accounts and optimizing draw accounts to crafting comprehensive estate plans and maximizing tax efficiency, we can offer a holistic approach to financial planning tailored to you, your family, and the legal industry.

Beyond offering financial advice, we strive to be your trusted partners, supporting you at every stage of your journey towards financial security and success. By leveraging our expertise and resources, you can focus on what matters most – serving your clients and making a meaningful impact in the legal arena.

If you're ready to take control of your financial future and unlock new possibilities, we invite you to schedule a consultation with us today. Together, let's embark on this journey towards a brighter financial future, one where your goals and aspirations become a reality.