High Net Worth Family Tax Report
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Welcome back to Loeb & Loeb's High Net Worth Family Tax Report, bringing you in-depth articles highlighting important topics and providing practical insights for high net worth individuals, with a focus on trusts and estates, tax, family offices, and tax-exempt organizations.

With the new year almost here, this issue includes articles on year-end planning reminders and 2024 inflation adjustments, summarizing actions that individuals may want to consider as part of their tax planning for the remainder of this year and into the next.

Associate Vanessa Davidson and partner Danielle E. Miller review planning opportunities for high net worth families to maximize the benefits of the higher federal gift, estate and generation-skipping transfer tax exemptions ($13.61 million in 2024) before these increased levels sunset in 2026. In our Family Office Corner, featuring insights on topics of interest to our family office clients, partner Stefan Schick discusses the unique world of Broadway entertainment and the issues family offices and other potential investors should consider before investing in a Broadway production.

Looking at the increasing popularity of directed trusts and corresponding developments in state legislation, partners Camille Lu, Danielle E. Miller, Cristine Sapers and Todd I. Steinberg; senior counsel Jennifer M. Smith; and associates David V. Khanjyan and Erica Stern summarize the rules applicable to settlors and trustees when creating directed trusts in various states, including the recent enactment of the California Uniform Directed Trust Act, which takes effect on Jan. 1, 2024.

Finally, in case you missed it, partner Alyse N. Pelavin and senior counsel Christina Hammervold summarize the reporting requirements taking effect on Jan. 1, 2024, that will require most entities to report beneficial ownership information to the U.S. government in their alert Beneficial Ownership Reporting Under the Corporate Transparency

Act (CTA)—Key Questions Answered, and partners Kimberly Eney and Diara M. Holmes and associate Kensington Wolgamott review recently issued proposed regulations affecting donor-advised funds, including what qualifies as a "donor-advised fund," a "donor" and a "donor-advisor," in their alert Proposed Regulations on Donor-Advised Funds—Part I of the Anticipated Guidance: What Qualifies and What Doesn't.

Year-End Planning Reminders: Last-Minute Action Items

With 2024 looming, individuals should consider the following year-end planning action items.

Corporate Transparency Act (CTA)

Prepare for Beneficial Ownership Disclosure. As discussed in more detail in Loeb's client alert here, filing requirements under the CTA take effect on Jan. 1, 2024, and will require disclosure of the beneficial ownership of most corporations, LLCs, limited partnerships and similar entities to the U.S. Treasury's Financial Crimes and Enforcement Network (FinCEN). Entities in existence before Jan. 1, 2024, have at least one year to file the required beneficial ownership report; entities created in 2024 must file within 90 days of creation, and those created in 2025 or after will have 30 days to file.

For individuals who anticipate forming reportable entities in 2024, creating the entity by Dec. 31, 2023, will allow them to fall under the extended filing deadline for preexisting entities. Existing entities also should be reviewed and consideration given to dissolving unused or defunct entities by year-end to avoid unnecessary reporting.

Gift Tax Planning

Use or Lose 2023 Annual Exclusion Gifts. In 2023, individuals can give up to $17,000 each to an unlimited number of recipients without reducing their lifetime gift or estate tax exemptions, paying gift tax or filing a federal gift tax return. Married couples can give up to $34,000 per recipient by electing to "split" gifts on a gift tax return. Note that gifts made by check must be deposited by the recipient before year-end to qualify for the 2023 annual exclusion, and any unused 2023 annual exclusions will not carry over to 2024.

An annual exclusion gift must be of a present interest, so the donor should make the gift directly to the recipient or, if the gift is made to a trust, the trust must provide Crummey withdrawal powers that allow the intended beneficiary to withdraw the annual exclusion amount. (A notification letter should generally be sent to the beneficiary.) Trusts for grandchildren should be designed to qualify for the generation-skipping transfer (GST) tax exemption annual exclusion or they will use a portion of the donor's lifetime GST tax exemption.

Plan for Use of Higher Gift Tax Exemption. Each U.S. individual also has a federal gift and estate tax exemption of $12.92 million in 2023, increasing to $13.61 million in 2024. This exemption will drop to $5 million (adjusted for inflation) in 2026, absent additional tax law changes. Accordingly, as discussed in the newsletter here, individuals with sufficient assets and a desire to make lifetime gifts should get a head start on planning to maximize this temporarily higher gifting capacity.

Charitable and Income Tax Planning

Offset Capital Gains. Taxpayers can manage their capital gains tax exposure by realizing capital losses to offset other capital gains recognized in the same tax year. Individuals should review their investments for potential capital loss harvesting opportunities or, conversely, their ability to accelerate capital gains to absorb any already-realized losses. Securities should be sold by Dec. 29, 2023, the last trading day of the year, to realize any capital gains or losses. Note that the asset holding period for tax purposes (i.e., long term or short term) is determined based on the trade date, when you initiate the buy or sell order, rather than its settlement date. Also keep in mind the wash-sale rules, which disallow a tax loss on the sale of a security if a "substantially identical" security is repurchased within a 30-day window before or after the sale.

Optimize Charitable Gifts. Individuals who make regular charitable gifts may want to optimize their potential charitable deductions, such as by bundling donations into an expected high tax year. Consideration also should be given to the types of assets donated. For example, making a charitable donation of publicly traded stock that has a low basis (rather than selling it and donating the proceeds) can give the donor a charitable deduction equal to the fair market value of the stock at the time of donation and eliminate the gain recognition that generally would be triggered upon the asset's sale. When reviewing, consider the charitable deduction limitations that may apply based on adjusted gross income (AGI) for the year, the type of charity (public or private) and the asset given (cash, appreciated stock, etc.). A five-year carry forward applies for charitable contributions that are not currently deductible due to AGI limitations.

Donors also should confirm that the charitable donation will take place in 2023. Gifts made by check or credit card are deductible for 2023 if the check is written and mailed or the charge to the credit card posts by Dec. 31, 2023. Charitable gifts of stock are not complete for deduction purposes until the stock certificate is actually delivered to the charity or ownership is changed in the corporation's or broker's records; accordingly, for any recently made or intended charitable donations of stock, it may be wise to confirm with the corporation or broker that will process the ownership change before the new year.

Consider Timing of Other Deductions. Individuals may wish to accelerate or delay other itemized deductions (such as medical costs and certain interest expenses), depending on their tax outlook for this year and next. Bunching available itemized deductions into a high tax year can help manage anticipated income tax liabilities.

Retirement Planning

Take Required Minimum Distributions (RMDs). Individuals who must take RMDs from qualified retirement plans and traditional IRAs should do so by Dec. 31 to avoid penalties.

Consider Qualified Charitable Distributions (QCDs). Charitably inclined individuals who have not yet taken 2023 RMDs (or who have attained age 70 1/2 even if not required to take RMDs) may consider making QCDs from their traditional and/or inherited IRAs. QCDs are IRA distributions of up to $100,000 per year directly to one or more qualifying public charities (not donor-advised funds or private foundations). Thanks to the recently enacted SECURE Act 2.0, as of 2023, donors also can direct a one-time $50,000 QCD to a charitable remainder trust or charitable gift annuity. QCDs do not count as taxable income and cannot be taken as charitable deductions but may count toward satisfaction of an individual's RMD. These QCD limits will be indexed for inflation beginning in 2024.

2024 Inflation Adjustments for Personal Tax Planning

The IRS has announced 2024 inflation adjustments for the following personal tax planning items.

Gift, Estate and Generation-Skipping Transfer (GST) Taxes

The 2024 inflation adjustments for the gift, estate and GST tax exemptions provide an increase of almost $690,000 from 2023:

- **Unified Gift and Estate Tax Exemption:** For gifts made and estates of decedents dying in 2024, the exemption amount will increase to $13.61 million (up from $12.92 million in 2023).
- **GST Tax Exemption:** The GST tax exemption also increases to $13.6 million in 2024 for GSTs (up from $12.92 million in 2023).
- **Gift Tax Annual Exclusion:** The gift tax annual exclusion increases to $18,000 for gifts made in 2024 (up from $17,000 in 2023).
- **Annual Exclusion for Gifts to Non-U.S. Citizen Spouses:** For 2024 gifts made to non-U.S. citizen spouses, the annual exclusion increases to $185,000 (up from $175,000 in 2023).

Income Taxes

Income Tax Brackets: The 2024 tax brackets for individuals as well as trusts and estates also have been adjusted upward.

- **Married Joint Filers:** The top tax rate of 37% applies to taxable income over $731,200 in 2024 (up from $693,750 in 2023).
- **Single Filers:** The top tax rate of 37% applies to taxable income over $609,350 in 2024 (up from $578,125 in 2023).

- **Trusts and Estates:** Trust and estates have a far more compressed tax bracket, and the top tax rate of 37% applies to taxable income over $15,200 in 2024 (up from $14,450 in 2023).

Capital Gains Thresholds: Below are the increased thresholds for application of the 15% capital gains tax rate. The 20% capital gains tax rate applies to adjusted net capital gains in excess of the 15% maximum amounts.

- **Married Joint Filers:** The 15% capital gains tax rate applies to adjusted capital gains of more than $94,050 and up to $583,750 (up from $89,250 and $553,850 in 2023).
- **Single Filers:** The 15% capital gains tax rate applies to adjusted capital gains of more than $47,025 and up to $518,900 (up from $44,625 and $492,300 in 2023).
- **Trusts and Estates:** The 15% capital gains tax rate applies to adjusted capital gains of more than $3,150 and up to $15,450 (up from $3,000 and $14,650 in 2023).

The above are subject to change if Congress enacts any modifications to the current income or transfer tax laws.

Planning for 2026: Opportunities and Drafting Guide

In 2024, the federal lifetime gift, estate and generation-skipping transfer (GST) tax exemptions are $13.61 million for individuals and $27.22 million for married couples through the "pooling" of their exemptions, which are subject to annual inflation adjustments. Absent new legislation, the current exemption laws will sunset on Jan. 1, 2026, and the exemption amounts will drop to an estimated $6 million to $7 million per individual (reflecting a base $5 million exemption, inflation adjusted from 2010 to 2026).

The following provides a general overview of two planning opportunities for individuals who want to use all or part of their exemptions before 2026: (1) a gift and/or sale to a grantor trust and (2) the creation of a spousal lifetime access trust. Each strategy takes time to implement, and individuals must select the assets they plan to transfer with care, taking into account expected income and appreciation, applicable federal and state income and transfer tax rates, state property taxes and personal circumstances. As 2026 nears, implementing these transactions may become increasingly difficult, due to heightened demands on advisors and potential trustees. Accordingly, individuals with sufficient wealth should consider planning now to maximize the benefits of their currently higher exemptions.

Foundational Tax Concepts

Income Tax Basis. A lifetime gift carries over the donor's income tax basis to the recipient. Accordingly, if a donor makes a lifetime taxable gift of appreciated property that the recipient subsequently sells, not only does the donor use gift tax exemption and/or pay gift tax (40%) based on the gift's fair market value, but the recipient also may pay capital gains tax (20% to 37% plus applicable state taxes) on the difference between the property's tax basis and its fair market value when sold.

In contrast, property inherited from a donor's estate typically receives either a "step up" or a "step down" in tax basis to the property's fair market value as of the donor's death. For spouses with community property, this basis adjustment is made to both the deceased spouse's half and the surviving spouse's half of the community property assets at the first spouse's death, whereas separate property assets receive a basis adjustment only with respect to the deceased spouse's separate property.

For these reasons, deciding whether to make a lifetime transfer of an asset that will carry over its tax basis depends in part on the spread between the projected income or capital gains taxes resulting from a future sale of that transferred property compared to the estate tax exposure applicable to inherited property. A lifetime gift of property with substantial appreciation or potential for growth in value may not generate the greatest overall tax savings.

Retained Interests or Powers. If an individual makes a lifetime transfer of property and retains an interest in or certain powers over that property, it can trigger inclusion in the individual's taxable estate at death. For example:

- If an individual makes a lifetime transfer of a partnership interest and retains the right to receive the income attributable to that interest, the value of the entire partnership interest is considered a part of the individual's taxable estate at death.

- If an individual makes a lifetime transfer of a house and then continues to use the house without paying fair market rent for the usage, the value of the house will be included in the individual's taxable estate at death.
- If an individual makes a gift to an irrevocable trust benefiting descendants but retains the right to receive income from the trust or to control the distribution of trust assets, the value of the trust will be included in the individual's taxable estate.

GST Tax. GST tax applies to transfers to grandchildren (or more remote descendants) and to non-relatives who are more than 37.5 years younger than the donor. As a result, GST tax can apply to a transfer to such a person in addition to any gift or estate tax. For example, if a donor creates a trust for her child for the child's lifetime, after which the donor's grandchild will become the beneficiary, the donor's gift to the trust is subject to gift tax and, at the child's death, may be subject to GST tax.

State Property Taxes. Individuals with real property holdings should consider any relevant state property tax laws when making a transfer of real property interests. For example, with certain exceptions, a transfer of California real property is generally considered a change in ownership for property tax purposes that "resets" the property's assessed value based on its then fair market value. Notably, a transfer of California real property between spouses does not trigger such a reset. Special rules apply with respect to transfers of interests in an entity (such as a limited liability company, partnership or corporation) that owns California real property and whether such a transfer triggers reassessment of the real property held within the entity.

Grantor and Non-Grantor Trusts. A donor can structure an irrevocable trust as a non-grantor trust, so that the trust itself is responsible for the payment of its own income tax liability. If trust income is distributed to a trust beneficiary, the beneficiary, rather than the trust, may be responsible for payment of any income tax. For estate tax purposes, assets held in the non-grantor trust remain outside of the donor's and beneficiaries' taxable estates (absent the retention of certain powers by the donor).

In contrast, a donor may establish an irrevocable trust as a grantor trust by holding certain powers or interests in the trust. The donor, as grantor, is treated as the owner of the trust assets for income tax purposes and must pay the trust's income tax liability. The grantor's income tax payments are not taxed as gifts, even though they could be viewed as constructive additions to the trust. The grantor also can enter into transactions with the trust, such as sales or loans to or from the trust, which are disregarded for income tax purposes. With proper structuring, the grantor will not be treated as the owner of the grantor trust assets for estate tax purposes at death, so any property gifted or transferred to the trust (and any appreciation) will be removed from the grantor's taxable estate.

If the income tax burden of a grantor trust becomes too onerous for the grantor, the trust can include a mechanism to convert to non-grantor trust status, although this conversion typically cannot be reversed. Alternatively, it may be possible for the trust to grant an independent person the authority, on a year-by-year basis, to reimburse the grantor for income taxes paid by the grantor on the trust's income. Such a power should not be exercised with regularity in order to avoid the risk of inclusion of the trust assets in the grantor's estate.

Opportunity 1: Gift and/or Sale to a Grantor Trust

An individual can fund a grantor trust via a gift and/or a sale, which can take advantage of the transferor's available exemption amounts, shift appreciating assets to beneficiaries and remove the value of the assets and future appreciation from the transferor's taxable estate. Thereafter, the trust assets will grow free of additional income, gift or estate tax (and, if applicable, GST tax).

In a typical gift and sale transaction, an individual makes an initial gift of property to the grantor trust, which can serve as "seed money" to support the trust's purchase of additional assets from the transferor. As a general rule of thumb, the gifted property equals at least 10% – 20% of the value of the property to be sold to the trust. The transferor then sells property to the trust in exchange for a promissory note. The sale is not a taxable gift if the assets are accurately valued and the note bears interest at the appropriate interest rate. On a monthly basis, the IRS publishes applicable federal rates (AFRs), which are the threshold rates that these notes should charge. Because transactions between a grantor and a grantor trust are disregarded for income tax purposes, the sale does not trigger capital gains tax, and the tax basis of the property sold carries over to the trust.

The grantor trust should make periodic payments on the promissory note, such as debt servicing of the note interest. At the end of the note's term (or earlier), the trust repays the note's outstanding balance in cash or by transferring assets back to the transferor (valued at their then fair market value). Any appreciation in the assets sold in excess of the total note obligations is transferred to the trust gift-tax free. Further, grantor trust assets are not subject to estate tax at the deaths of the beneficiaries or to GST tax if GST tax exemption is allocated to the trust. This plan allows the transferor to retain access to the transferred assets through the trust's payments on the note.

- **Example.** A transferor gives $1 million of interests in Realty LLC (or $1 million of cash) to a grantor trust and then sells an additional $4 million of interests in Realty LLC to the trust in exchange for a promissory note equal to the purchase price. The note has a nine-year term and bears interest annually at 5% (equal to $200,000 per year). The trust receives annual income from the Realty LLC interest of $1.14 million, which it can apply to the annual note payments.

The transferor receives an income stream through the annual note payments but does not recognize the interest payments as taxable income. Although the transferor must continue to pay the income tax on all income from the Realty LLC interest, he or she also can take any depreciation or other deductions allowable to the trust to offset that income. All appreciation remaining in the trust after repayment of the note is removed from the transferor's taxable estate.

Opportunity 2: Spousal Lifetime Access Trust

A common hesitation for donors when considering sizable gifts is uncertainty as to whether they will need the gifted property in the future. Planning with a spousal lifetime access trust (SLAT) can help mitigate such apprehension.

A SLAT is a lifetime irrevocable trust created and funded with the separate property of one spouse (Grantor Spouse) to benefit the other spouse (Beneficiary Spouse) and/or descendants. To remove the transferred assets from Grantor Spouse's estate, Grantor Spouse cannot retain an income interest in or direct access to the trust assets. Beneficiary Spouse, however, can receive trust distributions, which gives Grantor Spouse indirect access to the transferred property and trust income. Beneficiary Spouse also can act as a trustee, although his or her powers to make distributions should be limited to an "ascertainable standard," such as distributions for health, education, maintenance or support.

The trust is a grantor trust due to Beneficiary Spouse's interest, so Grantor Spouse remains responsible for payment of the trust's income tax liability. Any assets remaining in the trust after Beneficiary Spouse's death can pass to descendants or other beneficiaries free of gift or estate tax and GST tax, if GST tax exemption is allocated to the trust.

- **Example.** Grantor Spouse and Beneficiary Spouse, California residents, divide $26 million of community property into equal shares of separate property ($13 million per spouse). Grantor Spouse funds a SLAT for the benefit of Beneficiary Spouse with Grantor Spouse's $13 million separate property. Following Beneficiary Spouse's death, the remaining trust assets pass to trusts for Grantor Spouse's descendants. Grantor Spouse files a gift tax return allocating her lifetime gift and GST tax exemptions to the gift to the trust. If California real property is part of the gift, the property's assessed value will not be "reset" for California property tax purposes because Beneficiary Spouse is the trust's initial beneficiary.

Each spouse may want to create a SLAT for the benefit of the other. If the IRS successfully asserts the "reciprocal trust doctrine," however, both SLATs may be unwound, thus subjecting the spouses' transferred assets to estate tax and defeating the planning. The more similar the terms of the two trusts, the greater the risk, although crafting effective differences intended to permit SLATs to benefit both spouses can be a complex exercise. Accordingly, careful planning and execution are essential in creating dual SLATs.

As noted, a Grantor Spouse generally should not retain a direct interest in the SLAT to prevent inclusion of the trust assets in his or her taxable estate. If Beneficiary Spouse predeceases or divorces Grantor Spouse, Grantor Spouse will lose indirect access to the trust assets. For example, if the SLAT holds a family home, Grantor Spouse would need to pay fair market rent to avoid possessing a retained interest in that asset following the divorce from or death of Beneficiary Spouse.

While there are certain states that allow the creation of "self-settled" trusts with retained interests, known as Domestic Asset Protection Trusts (DAPTs), there are many risks, formalities and constraints that could make a

DAPT an undesirable vehicle. Further, the effectiveness of a DAPT created in one state by a resident outside of that state will depend on applicable state law, and it may be unclear whether a DAPT is effective with respect to a non-DAPT state resident who creates a trust in a DAPT state.

- **Example.** Beneficiary Spouse is able, under the terms of the trust, to add Grantor Spouse as a beneficiary of the SLAT at Beneficiary Spouse's death. Under California law, Beneficiary Spouse's power will be treated as a retained interest of Grantor Spouse. If the trust is created in a DAPT state, there should be no retained interest, but it is unclear whether that determination would govern with respect to California residents.

Key Takeaway

The above is only a sample of the planning strategies that may work for a particular individual's circumstances. The most important takeaway is that, with 2026 around the corner, now is the right time for high net worth individuals to begin evaluating methods for optimizing the benefits of their increased exemptions.

Family Office Corner: The Basics of Investing on Broadway

After nearly tripping multiple times on assorted bags and feet, you squeeze yourself into your human olive press of a seat at a Broadway theater. You open up your *Playbill* to the main billing page, and above the title of the show, you see anywhere from one to 100 names of the people or companies that "present" the show. To pass the time as you wait for the lights to dim, perhaps you find yourself wondering who they are and how the production you are about to see was financed—and how you could get your name in a Broadway *Playbill* (assuming you, like this author, fall somewhat shy of being a world-class actor/singer/dancer).

For Broadway plays and musicals produced by independent producers, and even most produced by larger entertainment companies such as film studios, the producers raise much of the financing needed to mount their shows from individuals and family offices. At a time when the Broadway industry is still rebounding from the COVID-19 pandemic, established producers are looking to widen their investor base, and a crop of newer producers is pushing to expand the traditional Broadway audience by presenting stories from historically underrepresented communities, more and more individuals and family offices are being offered the opportunity to invest in Broadway shows. Anyone contemplating an investment in a Broadway show should consider several important issues and questions.

Mixed Reviews

Before the COVID-19 pandemic shut down Broadway productions from March 2020 to September 2021, total gross box office revenues had increased in most recent Broadway seasons: from $1.367 billion in 2016–17 to $1.637 billion in 2017–18 and $1.8 billion in 2018–19. The 2018–19 season saw an all-time record in total Broadway attendance, reaching 14.77 million (see Broadway season statistics from The Broadway League here). In the 2022–23 season, the first full Broadway season following the shutdown, those numbers slipped to just under $1.6 billion and a total attendance of around 12.28 million, attributable in large part to changing theatergoing and work habits and continued health concerns as a result of the pandemic. For the most part, the shows that were strong box office performers before the pandemic have continued to do well, while newer shows have had a harder time building and sustaining box office momentum.

Even in the pre-pandemic "boom times," only 20% to 30% of Broadway shows fully paid back their investors (see "No Business Like Show Business" here). This percentage varies somewhat depending on the category of show (all shows, just musicals, just plays, etc.). To understand why, it is necessary to have a general knowledge of Broadway economics.

Broadway Economics

Evaluating the economics of a Broadway investment means understanding the typical costs and revenue streams associated with a Broadway production. Although the following focuses on new Broadway musicals, the economics of nonmusical plays are similar, but simpler and smaller, and many of the same issues and considerations apply to investing in off-Broadway, touring and overseas live stage productions.

Costs

Production Costs. The production costs (or mounting costs) of a Broadway show are the expenses incurred until the start of performances. Most new major commercial Broadway musicals currently have production costs, including a reserve for unanticipated expenses, in the range of $17 million to $23 million. A musical with a smaller cast and simpler sets, or a revival (a new Broadway production of a musical that has been produced on Broadway at least once before), can be mounted for significantly less—under $10 million in some cases. Broadway plays are significantly cheaper than musicals, with production costs for new plays often ranging from $3.5 million to $5 million. Production costs include fees to creative and production personnel, including authors, directors, designers and general managers; expenses for workshops, out-of-town tryouts and other developmental steps; physical production costs like those for scenery, props and costumes; advertising and promotion; and administrative expenses such as legal, accounting and insurance. These costs and the operating costs described below have all increased since the pandemic due to COVID-19 testing protocols, supply chain issues, increased labor costs and other factors.

Weekly Operating Costs. The weekly operating costs (or running costs) of a Broadway show are the expenses incurred to run the show each week once performances start. The "fixed" weekly operating costs of a Broadway show include many of the same categories mentioned above, along with fixed theater costs such as the wages of theater and box office staff and musicians. On top of those costs, the theater will charge weekly rent calculated as a percentage (usually 6% or 7%) of the gross weekly box office receipts discussed below. For a major Broadway musical, fixed weekly operating costs excluding theater rent usually range from $650,000 to $800,000 a week.

Royalties. A show also will pay weekly royalties to the various royalty participants, such as authors (the book writer, composer and lyricist for a musical or the playwright for a play); the director and choreographer; the designers; the owner of any underlying novel, film or other work on which the musical is based; and the lead producer, as discussed below. These royalties can be a percentage of gross weekly box office receipts, but far more often for a Broadway musical they are a percentage of weekly operating profits, representing the gross weekly box office receipts less the weekly operating costs described above. They are usually around 40% of weekly operating profits before the show pays back its investors, increasing to approximately 45% after that point.

Revenues

Gross Weekly Box Office Receipts (GWBOR). The primary source of revenue for a new Broadway show is the GWBOR, or the gross, which consists of ticket revenues less certain customary deductions like credit card fees and remote box office fees (such as those charged by Ticketmaster). A Broadway show with a GWBOR of at least $1 million is generally considered a solid success. The grosses for Broadway shows are publicly available information; for example, see here.

Merchandise. A Broadway show also will receive some income from merchandise and (possibly) cast album sales, but these revenues are usually quite small compared with GWBOR.

Licensing of Subsidiary Rights. Revenue also is generated from the licensing of subsidiary rights in the show. These are licenses that the author(s) of a show grant after the commercial producer's rights to produce the show expire (generally once the producer stops presenting productions of the show), for example to schools, community theaters, and professional theaters in the U.S. and elsewhere. Subsidiary rights licensing generates income, and the company formed to finance the Broadway show, and thus its investors, will often receive a share of that revenue for a number of years (though it can take several years for that revenue to start coming in). Also, if a Broadway production spawns a U.S. tour or London production, those additional productions will often pay license fees to the Broadway financing entity.

"Follow the Money and See Where It Goes" (With Thanks to *Hamilton*)

The lead producer of a Broadway show raises financing from investors to pay for production costs and to establish a reserve. Once the show starts performances, box office and other revenues are first used to pay the show's weekly operating costs and royalties. What's left are the weekly profits, which are distributed 100% to the investors until the investors are fully paid back, a point known as "recoupment." When a show achieves recoupment, a few things happen. First, the producer and investors metaphorically (and probably at least once literally) run out into the middle of Times Square for an extended kick line of jubilation. Second, there is a change in how the show's profits are allocated. Upon recoupment, the show's weekly profits are referred to as "net profits," and after a share is paid to certain customary creative and production team members, the remaining net profits are referred to as "adjusted net profits" (ANP). ANP is split evenly—50% to the investors and 50% to the lead producer.

One can begin to see why the economics of Broadway can be so challenging. If a show's weekly operating costs are on the high side, then even a show that is grossing $800,000 or $900,000 a week may be making little profit each week, especially after royalties have been paid. At that rate, it can take a long time to pay back the investors, and the longer a show runs, the more it becomes susceptible to competition from other, newer shows that may grab more of the public's attention and dollars. For most shows, there is a natural decline in audience attendance over time. Shows face other challenges as well; for example, a show playing in a smaller theater has a lower maximum GWBOR potential, and a show with prominent stars who help attract attention may lose those stars if they are only available for a limited number of performance weeks.

Private Offerings

Producers raise their financing for shows through private securities offerings under Regulation D of the Securities Act, which avoids the registration and reporting requirements of a public offering. For Broadway, a limited liability company (LLC) is by far the most common financing vehicle. The producer distributes offering documents to prospective investors, consisting of an LLC operating agreement and subscription agreement, typically including summary production and operating budgets and an estimated recoupment schedule that shows how long the producer estimates it will take the show to recoup its investment at different levels of box office performance. A long-standing rule of thumb for a Broadway musical is that the show should be able to repay its investors in roughly 52 weeks, running at an average of 80% of the maximum GWBOR potential at the theater where the show is performed. Post-COVID-19, however, that 52 weeks has crept up to 60 weeks or more for many new musicals. These offerings are almost always "min/max" offerings, with a stated minimum total financing that the producer must hit to proceed with the production and a stated maximum total financing so the investors know their investment will not be diluted beyond a certain point. Nearly all producers require that their investors be accredited investors under Securities Act regulations to avoid needing a private placement memorandum and to minimize the risk of claims under securities law.

Lead Producer vs. Co-Producer vs. Investor

Before proceeding, let's discuss the terminology around the producers and investors in a Broadway show, which can be somewhat confusing.

Lead Producer. The lead producer, also often referred to as the Managing Member or General Partner, or simply "the producer," is responsible for raising the financing for the show and has final authority over all producer decisions. This article mostly refers to "producer" in the singular, but it is not unusual for a show to have two to four lead producers. On the title page of a Broadway *Playbill*, the lead producers are listed on the top line of all the names above the title (just below the Broadway theater information).

Co-Producer. A co-producer is a large investor or someone who introduces a number of smaller investors to the show, or both. A co-producer receives certain special entitlements that "regular" investors do not, as discussed below. On the title page of the *Playbill*, the co-producers are all the names listed above the title but below the top producer line reserved for the lead producer. The lead producer may consult with the co-producers but has no obligation to do so, and the co-producers do not have approval over producer decisions.

Investor. An investor is anyone who directly invests in a show. The minimum investment for most Broadway shows is $25,000. Investors who are not also co-producers or lead producers do not receive billing or many of the other co-producer entitlements.

Co-Producer Entitlements

Co-producers are entitled to receive some or most of the following special entitlements, which are set forth in a side letter to the offering documents between the lead producer and the co-producer:

Kicker. A share of the lead producer's 50% of ANP is known as the co-producer's "kicker." The kicker is usually based on the percentage of the capitalization that the co-producer invests and/or introduces (by way of smaller investors) to the show. For example, let's take a co-producer who invests and/or introduces $1 million to a musical that is capitalized at $10 million, representing 10% of the capitalization. The investors who actually provide the $1 million will collectively receive 10% of the show's profit distributions until recoupment and then 10% of the investors' 50% (or 5% of 100%) of ANP thereafter. Under a typical deal for a co-producer at that level, the co-producer might receive an additional share of ANP payable out of the lead producer's ANP equal to 2.5% of ANP (which is half of the 5% of ANP on the investors' side attributable to the $1 million investment, also known as a "one for two" deal) or, if the producer is driving a harder bargain, 1.67% of ANP (which is one-third of the 5% of ANP on the investors' side, also known as a "one for three" deal).

Billing. Billing as a producer above the title, as well as eligibility to receive a Tony Award if the show wins the Tony Award for Best Play or Best Musical.

Opening Night Tickets. Tickets to the official press opening or opening night performance and the opening night party, plus preferred access to the producer's pool of house seats for post-opening performances.

Future Investment Rights. The right to invest in future productions of the show.

Meeting Participation. The right to attend marketing meetings and certain other producer meetings.

Financial Information. Enhanced financial reports about the show.

Similar Treatment. The right to be treated no less favorably than any other investor or co-producer who invests and/or introduces an equal or lesser amount of total financing (subject to a customary list of exceptions).

For many stage investors, such nonfinancial benefits, together with the satisfaction of supporting a project that they consider artistically and culturally important and laudable, outweigh (or at least balance out) the financial risks inherent in investing in the theater. One entitlement that a co-producer never receives (absent some truly extraordinary circumstance), however, is any approval or vote over the lead producer's decisions or any ability to remove or change the lead producer.

Key Questions to Ask, or "Why Oh Why Oh Why Oh?...." (With Thanks to *Wonderful Town*)

There are several important questions to ask before investing in a Broadway show. Below is a representative list; it is not meant to be comprehensive.

- What is the minimum and maximum amount for the offering? Is the spread between them unusual?
- What do the production and operating budgets and recoupment schedule reveal? How long will it take the show to recoup at different levels of gross capacity? How big is the reserve?
- What are the lead producers paying themselves?
- Do the producers have a commitment for a Broadway theater yet? (The answer is often no.)
- For co-producers, which of the entitlements above is the lead producer offering?

Funds

Rather than invest in individual shows, some investors prefer to invest in theatrical investment funds that invest in multiple live stage projects. These funds are often established by experienced Broadway insiders (often producers in their own right) who have developed relationships with various producers, theaters and artists over years of working in the Broadway industry. Investing in a fund provides an investor with a more diversified portfolio of stage investments than if the investor invested the same amount of money in only one or two shows. The fund investor also gets the benefit of the fund manager's expertise in selecting the shows for investment and access to potentially "hot" upcoming shows. The fund's ability to aggregate smaller investments into one larger investment can offer better kicker terms from a show than any of the smaller investments would receive on their own.

There are potential downsides to investing in a fund, however. The fund manager typically will take a management fee and a share of fund profits, and the investors typically have no say in the selection of shows their money is used to support. Since the fund may invest its money over multiple Broadway seasons, the timeline for the return of capital to the fund's investors also may extend well into the future. In addition, fund investors may not receive the same nonfinancial benefits (such as Tony Award eligibility) they would receive by direct investment in a show.

Final Curtain

There is no question that investing on Broadway is a high-risk proposition, but it also offers nonfinancial benefits that, for many investors, are more important than the potential financial benefits or risk of losses. One producer client, acknowledging this dynamic, has observed, "You should not invest in a Broadway show unless you love it." Another producer client, discussing his own initial forays into Broadway investing, noted that "it is hard to make money on Broadway, but if you are smart about it and surround yourself with smart people, it is possible." An attorney with expertise in the live stage industry can advise potential investors not only on the offering documents, side letters and other legal aspects of a potential investment in a show, but also on the financial and business aspects of the investment. We might return to that seat in the theater as a good metaphor for investing on Broadway: It's difficult to feel comfortable, but if you get yourself a seat, you might end up being part of an amazing show.

Using Directed Trusts to Create More Customized Estate Plans: Legislative Developments in California and Other States

So-called directed trusts have become increasingly popular in trust planning as a "team" approach to trust administration. These trusts allow designated persons to share some of the trust management responsibilities that traditionally have been reserved solely to a trustee. Many states, including most recently California, have enacted legislation specifically to address directed trusts. These state laws vary as to the ability to form directed trusts and the liability protection afforded to the trustees and others by the division of trust duties, potentially creating unexpected exposure for any friends, family members or other "nonprofessionals" acting in these roles.

When considering directed trusts, trust settlors, trustees and others given powers to provide directions should understand the responsibilities and liabilities applicable under state laws and which rules, if any, can be modified or waived by the trust agreement. Below is a brief overview of directed trusts and the rules that apply in the following states (click on a link to go directly to a specific state summary for California, District of Columbia, Illinois, Maryland, New York and Virginia).

What Is a Directed Trust?

With a traditional trust, a trustee is appointed to administer the trust and manage trust assets. The trustee owes fiduciary duties to the trust beneficiaries to act in their best interests and in accordance with the trust's terms and purposes. A directed trust allows the settlor, through the terms of the trust, to divide and assign various trust powers among persons other than the trustee. These power holders (we will call them "directors," but they also may be referred to as advisers or protectors) direct the trustee as to the exercise of the specified powers.

For example, a directed trust may appoint an investment director solely responsible for directing the trustee on trust investments. It also may name a distribution director solely responsible for directing the trustee regarding trust distributions and/or give a trust protector a variety of other powers under the agreement, such as the power to remove and replace trustees or other directors, to terminate an uneconomical trust, to amend the trust for more tax efficiency and/or to resolve disagreements regarding the trust's terms. The trustee remains responsible for complying with the directions of the trust directors and for ministerial duties, such as the custody of trust assets, maintenance of trust records and filing of tax returns.

Why Use a Directed Trust?

A directed trust provides the flexibility to choose people to act in the roles for which they are best suited. A financially savvy friend may be appointed as the investment director, while a trusted family member who best understands the family dynamics may be appointed as distribution director, leaving the trustee to deal with administrative tasks. For trusts that will hold difficult-to-manage or illiquid assets, such as real estate or closely held business interests, directed trusts may incentivize desired corporate or professional trustees to serve, on the basis that they act only at the direction of another person as to those assets. Appointing beneficiaries as directors or co-directors also can empower them with respect to the trust without providing them complete authority over trust distributions or burdening them with administrative complexities.

How Is a Directed Trust Created?

Many states have enacted statutes dealing with directed trusts, but they differ significantly as to their effectiveness in dividing fiduciary responsibilities and liability protection among the trustee and directors. For example, California and Virginia have adopted comprehensive statutes based on the Uniform Directed Trust Act, model legislation issued in 2017 that generally permits the bifurcation of fiduciary responsibilities, limits the liability of any one trustee or director for acts of the others and expressly limits a trustee's duty to monitor decisions or identify breaches of trust by directors. Other jurisdictions, such as Washington, D.C., have far simpler statutes that offer less liability protection to directed trustees in taking direction from others.

Where there is no or a less-comprehensive directed trust statute, a state's general trust laws may still permit a settlor to designate specific roles and duties within a trust agreement that will govern the trust's administration. But the rules must be checked, as not all these states permit or sufficiently provide for the division of fiduciary duties and liabilities (see New York, discussed below). Further, many states, including those with directed trust statutes, impose minimum liability thresholds, even for trustees required by the trust agreement to comply with the directions of another fiduciary.

California

The California Uniform Directed Trust Act (CUDTA), under California Probate Code Section 16600 et seq., takes effect Jan. 1, 2024. Modeled after the Uniform Law Commission's Uniform Directed Trust Act, CUDTA provides a welcome upgrade to the California Probate Code (CPC), allowing greater flexibility and potential to tailor California trusts.

Technically, absent an applicable directed trust statute, a settlor may nonetheless designate specific roles and duties within a California trust instrument, and unless such terms conflict with California law, they generally will govern the administration of the trust. Prior California law, however, did not adequately address the legal implications of implementing a directed trust in California, particularly its impact on the duties of each fiduciary to oversee the acts of the others and their corresponding liability for any breach committed by other fiduciaries. In addition, before CUDTA, a trustee's ability to delegate its powers to third parties was limited, and the trustee would continue to have oversight responsibilities over such third parties. The trust agreement also could not exculpate a California trustee for acts of gross negligence or more culpable conduct, even if, for example, the trustee simply acted at the direction of another fiduciary pursuant to the terms of the trust. Under these relatively rigid prior rules, settlors were generally limited in their ability to create California trusts with distinct fiduciary roles and to protect those fiduciaries by limiting their powers and duties within the trust agreement.

CPC Section 16608 now provides that the terms of a trust may grant a power of direction to a trust director. The term "power of direction" broadly includes any power over a trust granted to a person that is exercisable while such person is not serving as trustee, including powers over the investment, management or distribution of trust property or other administration matters.

Director as Fiduciary. A trust director is generally subject to the same fiduciary rules applicable to trustees or co-trustees in a like position. However, certain powers set forth in CPC Section 16606 are expressly carved out of CUDTA, and accordingly should be exercisable in a nonfiduciary capacity, including (1) powers of appointment to enable a person to designate a recipient of trust property, (2) powers to appoint or remove a trustee or trust director, (3) powers of a settlor over a trust that is revocable by the settlor and (4) powers of a beneficiary to the extent that they affect the beneficial interest of that beneficiary (or another beneficiary represented by the beneficiary).

Trustee's Compliance With Directions. CPC Section 16614 sets forth the duties and liabilities of a trustee taking direction from a trust director. The directed trustee is required to take reasonable steps to comply with the direction of a trust director unless, in complying with such direction, the trustee would engage in willful misconduct. This willful misconduct standard is prevalent in many states' directed trust statutes, including those states that have adopted legislation based on the Uniform Directed Trust Act, but it does not go so far as to fully exculpate a directed trustee, as under Nevada's directed trust statute. While we have yet to see how California courts will interpret the willful misconduct standard, CUDTA provides greater protection to trustees taking directions from others compared to prior law, which prohibited exculpation for acts of gross negligence, a lower threshold than willful misconduct.

Duties To Monitor and/or Inform Others. Another important feature of CUDTA is found in CPC Section 16618, which relieves a directed trustee and a trust director from any duty to monitor the actions of the other or to inform or give advice to the settlor or the beneficiaries with respect to the actions of the other. Unlike prior law, CUDTA makes a trustee and trust director responsible only for the powers and duties granted to them under the trust agreement, without requiring that they oversee others' actions. CPC Section 16620 permits the settlor, through the terms of the trust agreement, to extend this rule to co-trustees so that co-trustees can be relieved from the duty to monitor one another to the same extent that a directed trustee is relieved from monitoring a trust director. Pursuant to CPC Section 16616, directed trustees and directors have a duty to share information with one another to the extent such information is related to both of their powers and duties and will not be liable for a breach of trust for acting in reliance on information provided by the other unless such action amounts to willful misconduct.

CUDTA will apply to any trust, whenever created, that has its principal place of administration in California. If any such trust was created before Jan. 1, 2024, CUDTA will apply only to decisions or actions occurring on or after that date.

District of Columbia

Washington, D.C., has a fairly limited directed trust statute (D.C. Code Section 19-1308.08), which does not offer complete liability protection to a directed trustee.

Director as Fiduciary. The D.C. Code provides that any person other than a beneficiary who holds a power to direct the trustee is a fiduciary who must act in good faith as to the purposes of the trust and beneficiaries' interests and is liable for any breach of fiduciary duty. Although the statute provides a carve-out from this fiduciary standard for beneficiaries, a settlor may want the trust agreement to treat a beneficiary-director as a fiduciary, at least with respect to other current or future trust beneficiaries whose interests are not the same as or represented by the beneficiary-director.

Trustee's Compliance With Directions. While a trust is revocable, the trustee may follow a written direction of the settlor that is contrary to the trust terms. Otherwise, D.C.'s directed trust statute requires the trustee to follow the direction of a director unless the exercise of the power is manifestly contrary to the trust terms or the trustee knows the attempted exercise would constitute a serious breach of a fiduciary duty that the director owes to the trust beneficiaries. The statute is silent as to the minimum liability applicable to a directed trustee in following direction. While the trust agreement can specify the applicable liability standard, it cannot exculpate any trustee, directed or otherwise, for a breach of trust committed in bad faith or with reckless indifference to the trust's purposes or interests of the beneficiaries. In other words, liability cannot be set at the lower threshold of willful misconduct.

Duties To Monitor and/or Inform Others. The D.C. directed trust statute does not specifically address the duty of a trustee or a director to monitor the other or to provide advice regarding the actions of the other to the settlor, trust beneficiaries or other third parties. The terms of the trust agreement can seek to limit these duties, but the minimum liability standard for any breaches of trust committed in bad faith or with reckless indifference will apply.

Illinois

The Illinois Directed Trust Statute provides protection for a trustee acting (or declining to act) pursuant to the directions of a non-trustee directing party such as an investment trust advisor, trust protector or distribution trust advisor. It applies to all existing and future trusts that provide for a directing party or are amended to provide for a directing party (whether by court order or nonjudicial settlement agreement).

Director as Fiduciary. The Illinois Directed Trust Statute provides fiduciary authority for each of three types of directing parties—namely, investment trust advisors, distribution trust advisors and trust protectors—each of whom is subject to the same duties and standards applicable to a trustee of a trust. The default authority applies in each case only to the extent the trust agreement is silent. If an investment trust advisor is appointed, the default authority granted under the statute includes the ability to direct the purchase, transfer, assignment or sale of trust assets; investment of principal and income of the trust assets; and to control voting power and determine compensation of advisors, managers, consultants and other counselors to the trust. If a distribution trust advisor is appointed, the default authority granted under the statute includes the ability to direct all decisions relating directly or indirectly to discretionary distributions to or for one or more beneficiaries. If a trust protector is appointed, the default authority granted under the statute includes the ability to modify or amend the trust; modify the interest of a beneficiary or a power of appointment; remove or appoint a trustee or directing advisor; terminate the trust; and change the situs of the trust.

Trustee's Compliance with Directions. To the extent that a settlor names a directing party to act in the trust agreement, the trustee is not able to exercise any of the powers granted to the directing party and is referred to as an "excluded fiduciary" for purposes of those powers. The excluded fiduciary will not be held liable for any action that the excluded fiduciary takes based on instructions from a directing party except in instances of willful misconduct on the part of the excluded fiduciary (a higher liability threshold than gross negligence, bad faith and/or reckless indifference).

Duties to Monitor and/or Inform Others. Unless otherwise provided in the trust agreement, the trustee has no duty to monitor, review, inquire, investigate, recommend, evaluate or warn with respect to the directing party's exercise or failure to exercise the powers granted to the directing party by the trust agreement.

Maryland

Maryland's directed trust statute (Md. Estates and Trusts Code Section 14.5-808) includes a more limited liability standard for directed trustees and specifically regulates their obligations to oversee the actions of directors.

Director as Fiduciary. Maryland's directed trust statutes provide that any person, other than the settlor of a revocable trust, who holds a power to direct, consent to or disapprove any proposed or actual decisions of a trustee is a fiduciary who must act reasonably under the circumstances with regard to the trust's purposes and beneficiaries' interests. As a fiduciary, the power holder will be liable for any loss resulting from a breach of fiduciary duty. A beneficiary who holds a power to direct is not treated as a fiduciary to the extent of the interests of that beneficiary and the interests of any other persons who are subject to the beneficiary's control through the exercise of a power of appointment.

Trustee's Compliance With Directions. If the trust agreement requires the trustee to follow directions, then the trustee must act in accordance with those directions and is not liable for a loss resulting from this compliance except in the case of the trustee's willful misconduct. Maryland's statute also provides that the trustee may not follow the directions if the attempted exercise is manifestly contrary to the trust's terms (unless expressly waived in writing by the settlor) or the trustee knows the attempted exercise would constitute a breach of a fiduciary duty that the director owes to the trust beneficiaries. The directed trustee is not completely exonerated from liability for compliance, although it can apply at the higher threshold of willful misconduct, rather than gross negligence, bad faith and/or reckless indifference.

Duties To Monitor and/or Inform Others. When the trust agreement requires a trustee to follow the directions of a director, Maryland's statute clearly eliminates any duty of the directed trustee to monitor the conduct of the director; to provide advice to the director; or to communicate with, warn or apprise a beneficiary or other third party in instances when the trustee would or might have acted differently than directed by the director. The statute specifically presumes that any actions taken by the trustee in carrying out directions are administrative in nature and do not evidence the trustee's monitoring of or participation in the director's decisions.

New York

New York is one of the few states without a directed trust statute. Its general trust laws do not authorize the appointment of non-trustee fiduciaries nor the division of specific responsibilities and corresponding liabilities among co-trustees. Under N.Y. EPTL Section 10-10.7, some liability protection is offered to a dissenting trustee who joins in carrying out a decision by the majority. If the trustee's dissent is expressed promptly in writing to the other trustees, then the dissenting trustee is not liable for the consequences of any majority decision. The dissenting trustee cannot avoid liability for failing to join in administering the trust or to prevent a breach of the trust.

There is authority under New York case law for wills and trusts to divide responsibility among fiduciaries and to give advisers the power to direct fiduciaries, but the New York courts have invalidated the bifurcation of fiduciary liability under such arrangements. A New York Directed Trust Act has been proposed and approved by the New York City and New York State bar associations to specifically authorize directed trusteeships and provide comprehensive rules for how they should function. Until such legislation is enacted, New Yorkers wishing to create directed trusts may want to form their trusts in another state with a directed trust statute, such as Delaware.

Virginia

The Virginia Uniform Directed Trust Act, found under Article 8.2 of the Virginia Code (VUDTA), generally follows the Uniform Law Commission's Uniform Directed Trust Act and provides a comprehensive statutory framework for directed trusts.

Director as Fiduciary. VUDTA expressly permits a trust agreement to grant a power of direction to a director. In exercising that power, the director generally has the same fiduciary duty and liability to the trust and its beneficiaries as a trustee would in similar circumstances. The trust agreement can vary these duties or the liability to the same extent permitted for trustees. VUDTA excludes certain powers from application of this fiduciary standard, including (1) powers of appointment to enable a person to designate a recipient of trust property, (2) powers to appoint or remove a trustee or trust director, (3) powers of a settlor over his or her revocable trust, and (4) powers of a beneficiary to the extent that they affect the beneficial interest of that beneficiary (or another beneficiary represented by the beneficiary).

Trustee's Compliance With Directions. Under VUDTA, a directed trustee must take reasonable action to comply with the direction of a director unless, by this compliance, the trustee would engage in willful misconduct.

Accordingly, while VUDTA does not completely exonerate directed trustees when following directions, it does provide a higher liability threshold compared to standards based on gross negligence, bad faith and/or reckless indifference.

Duties To Monitor and/or Inform Others. Under VUDTA, unless the trust agreement provides otherwise, neither a directed trustee nor a director has a duty to monitor the actions of the other or to inform or give advice to a settlor, beneficiary, trustee or director concerning instances when the trustee might have acted differently than a director or a director might have acted differently than a trustee or another director. A directed trustee and a director are responsible only for their specified powers and duties and are not required to monitor or oversee the actions of the other. VUDTA does require directed trustees and directors to share information with one another that is related to the exercise of both of their powers and duties, although neither will be liable for acts in reliance on information received from the other unless such action amounts to willful misconduct.

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