



# **FAMILY OFFICE 101**

Introduction to Family Offices

**Washington, D.C. Estate Planning Council**

April 20, 2023  
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# Today's Presenter



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# Learning Objectives

At the end of this presentation, you will be able to:



1. Define family office.
2. Identify the triggers that cause a family office to be established.
3. Explain the purpose of a family office.
4. List the four types of family offices.
5. Describe the core services a family office utilizes.
6. Describe the ways advisors supports the family office community.
7. Review the foundations of governance in a family office
8. Introduce structuring family office for operating and tax efficiency



# Defining Family Office

A private business that manages the financial and personal affairs of ultra-high net worth individuals and families, who own and control it.

# Growth Leads to Complexity

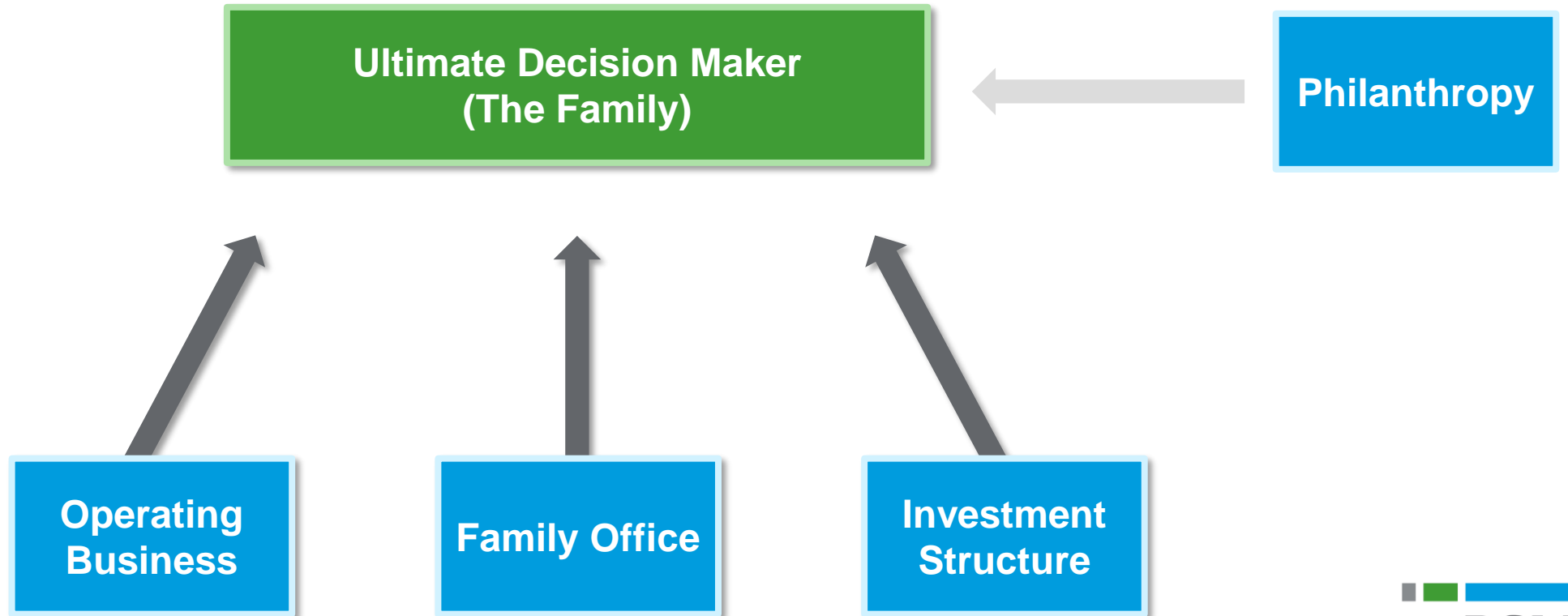
At the heart of a family office is a family or families.



As a family's situation becomes more complex, the need for a family office may arise.

# Ultimate Decision Maker in the Family Enterprise

The family is the primary decision-maker across all pillars.







# Triggering Events



# Triggers That Cause a Family Office to Be Created

A family has reached a complexity with their wealth that they are no longer able to administrate it themselves.



Diversification of assets and holdings



Liquidity from sale of operating business



Generational family value transition



Evolution and preservation of family legacy



Complexity of family matters affecting operating business



Succession planning at family level and C-suite level and wealth transfer



# Reasons to Start a Family Office

A family has reached a complexity with their wealth that they are no longer able to administrate it themselves.





# Purpose of a Family Office



# Purpose of the Family Office

The primary purpose of a family office is to protect, improve, grow, and govern the family wealth and overall well-being.





# Goals of Family Offices



Strategic Wealth Planning

Investment Management

Tax and Financial Planning

Family Unity

Charitable Giving

Trust and Estate Services



# Goals of Family Offices



## Strategic Wealth Planning

## Investment Management

## Tax and Financial Planning

## Family Unity

## Charitable Giving

## Trust and Estate Services

- Identify financial resources and objectives.
- Develop intergenerational wealth transfer planning.
- Identify appropriate asset allocation and investment strategy.
- Coordinate with professional advisors.
- Budget services, including wealth reviews, analysis of short- and medium-term liquidity requirements, and long-term objectives.

# Goals of Family Offices



Strategic Wealth Planning

Investment Management

Tax and Financial Planning

Family Unity

Charitable Giving

Trust and Estate Services

- Provide personalized attention.
- Monitor investment performance.
- Provide comprehensive performance reporting.
- Participate in manager selection.
- Provide due diligence on investments and external managers.
- Determine risk profiles and investment horizons.
- Determine the investment objectives and following philosophy of the family.
- Benchmark analysis and development of strategies to ensure hedging of concentrated investment positions.

# Goals of Family Offices



Strategic Wealth Planning

Investment Management

**Tax and Financial Planning**

Family Unity

Charitable Giving

Trust and Estate Services

- Oversee personal and entity tax compliance.
- Review personalized financial plans with each client.
- Tax planning individualized to the family and members.
- Design investment and estate planning strategies considering all income sources and their tax implications.
- Consolidate and report all family assets.
- Bill and expense payment and maintenance of financial records and reporting.

# Goals of Family Offices



Strategic Wealth Planning

Investment Management

Tax and Financial Planning

**Family Unity**

Charitable Giving

Trust and Estate Services

- Support a strategic long-term family vision.
- Support succession planning relating to disruptions in family leadership
- Evaluate the strengths, weaknesses, opportunities and threats (SWOT analysis) of senior executives both within and outside the family across the family enterprise.
- Analyze the family board regarding the roles of family and non-family directors.
- Develop formal knowledge-sharing, training and education programs
- Create and adopt family governance documents and family policies and procedures for resolving family conflict.
- Structure family social responsibility platforms and programs.



# Goals of Family Offices



Strategic Wealth Planning

Investment Management

Tax and Financial Planning

Family Unity

**Charitable Giving**

Trust and Estate Services

- Support the family's philanthropic mission.
- Develop personal donation programs.
- Administer family foundations.
- Form grant-making foundations and trusts.
- Organize charitable activities and related due diligence.

# Goals of Family Offices



Strategic Wealth Planning

Investment Management

Tax and Financial Planning

Family Unity

Charitable Giving

Trust and Estate Services

- Provide estate planning recommendations.
- Develop family wealth plans.
- Support trustees in their fiduciary duties.
- Provide services for estate settlement and administration.
- Provide wealth protection, transfer analysis, and planning.
- Protect assets.



# Types of Family Offices





# Types of Family Offices

Family offices can be grouped into four types.



Embedded Family Office



Single Family Office (SFO)



Multi-Family Office (MFO)



Virtual Family Office





# Embedded Family Office



Functions of the family office are embedded in the family business.

## Traits/Benefits:

- Lower cost
- Familiarity with the family and their business
- Deductibility of expenses and leverage of business infrastructure

## Limitations:

- Limited expertise on all areas of family's wealth
- Influence is limited beyond the business
- Longevity concerns

# Single Family Office



A standalone entity with staff performing services for a single family, separate from the family business or other investment vehicle.

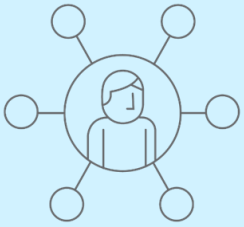
## Traits/Benefits:

- Engages in a broad array of services for the family
- High level of control and privacy
- Family-first orientation
- Lack of regulatory oversight

## Limitations:

- Level of expenses
- Necessity of returns and value creation
- Staffing and expertise

# Multi-Family Office



A single Registered Investment Advisor (RIA) or Trust Company manages the financial affairs of multiple families, who may be unconnected to each other.

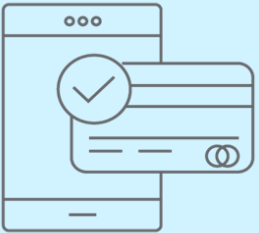
## Traits:

- Manages investments, fiduciary, trusts and estates, and offer concierge services
- May be either commercial **or** private

## Benefits:

- Broad expertise
- Expanded access to qualified investment managers
- Vast array of services
- Strong risk management

# Virtual Family Office



Offers the benefits of a traditional family office, without setting up a separate entity.

## Traits:

- Outsources services to external providers and consultants.
- Low complexity with less control by the family.

## Benefits:

- Minimizes overhead
- Mobilizes resources on an as-needed basis
- Allows for the cooperation of external advisors





# How Advisors Support the Family Office Community



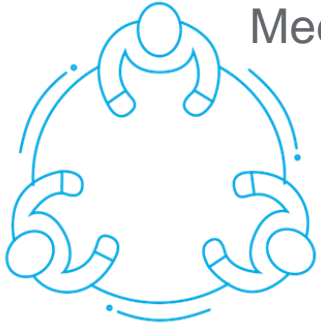
# Core Operational Services

Strategic Services	Technology	Tax and Wealth Planning	Investments	Risk Management	Philanthropy	Legal	Family	Finance	Operations
Family education	Social media	Tax compliance	Investment policy	Insurance	Philanthropic mission	Monitoring & oversight of outside counsel	Concierge services	Bookkeeping & reporting	Talent
Governance	Technology platform & controls	Tax planning	Asset allocation	Reputational risk	Family foundation operations	Document preparation	Household help	Cash Management	Office policies & procedures
Succession planning	Cloud computing	Wealth transfer planning	Manager selection	Fraud prevention & detection	Family foundation oversight	Contractual review	Property management	Budgeting & forecasting analysis	
	Family and business information continuity	Investment structure design	Benchmarking	Physical security	Charitable benchmarking	Contract oversight	Collections management		
			Performance Reporting	Cyber risk	Due diligence	Litigation oversight	Travel		
				Financial controls	Miscellaneous philanthropic activity	Regulatory compliance			

- Most often in-house
- Sometimes in-house
- Most often outsourced



# What are the needs of the family as a unit & individually?



Meet with family to determine specific needs.

## Recordkeeping & Reporting

- Consolidated Financial Statements
- Partnership Accounting
- Trust Accounting

## Lifestyle Management

- Tax Compliance
- Bill Paying & Cash Flow Management
- Property Management
- Special Projects

## Strategic Wealth Planning

- Income Tax & Estate Planning
- Integrated Financial Planning
- Insurance Planning
- Philanthropic Planning

## Investment Planning

- Investment Strategy & Policy
- Asset Allocation
- Manager Due Diligence & Selection
- Investment Performance Monitoring, Analysis and Rebalancing

## Risk Assessment & Management

- Strategic Risk Planning
- Cost / Benefit Analysis
- Checks & Balances Processes

## Family Legacy & Leadership Planning

- Governance Structure
- Owner Education
- Family Meetings
- Family Communication
- Strategic Philanthropy

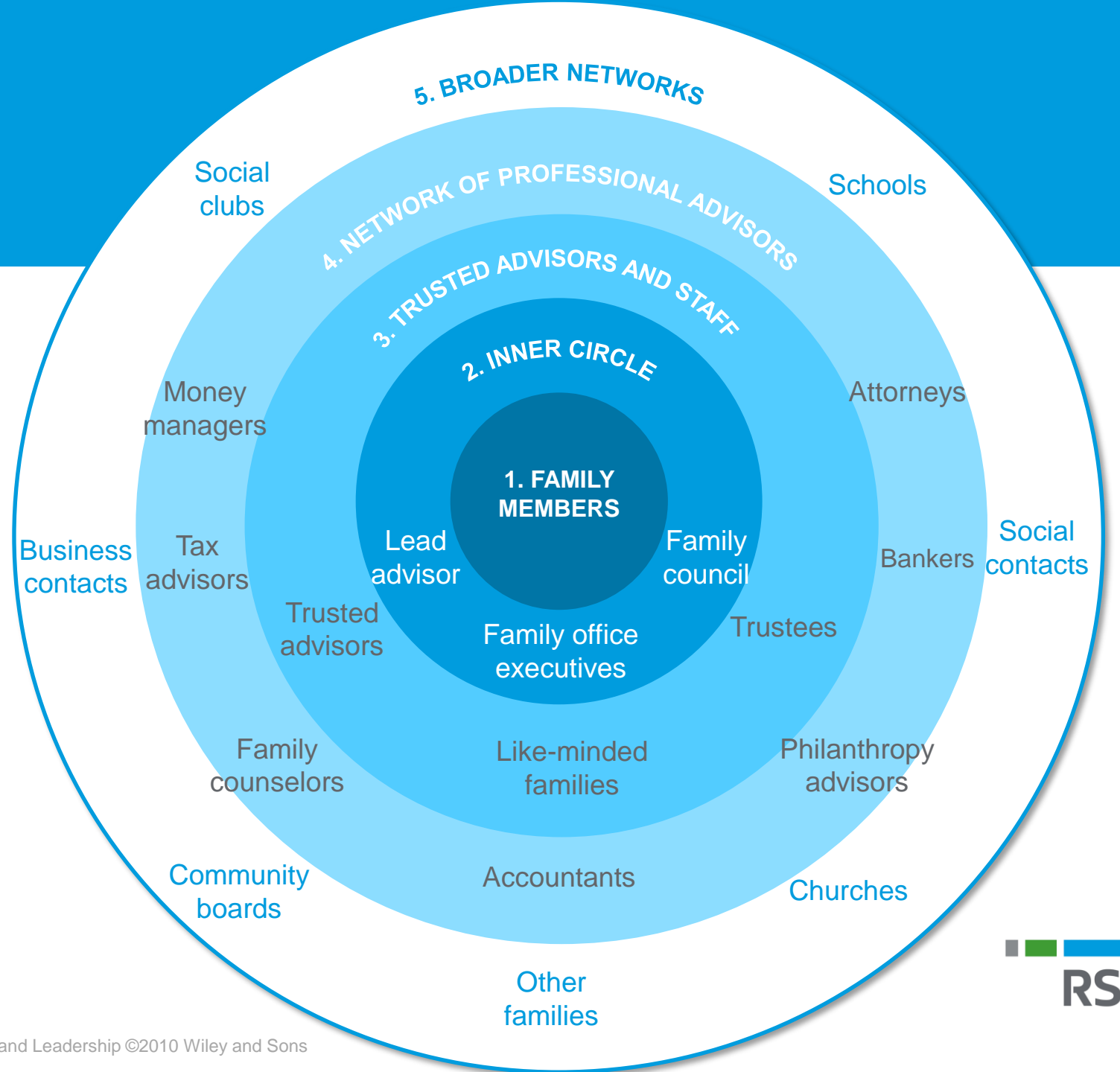
Offices evolve from foundational requirements to strategic functions

*Define the specific needs of the family through interviews and meetings with family members*



# Advisor Team

The goals of the family should determine the advisors who are active in their advisory network.





# Advise by asking Probing Questions

Tailor questions to address family's priorities or concerns.

New Office

- Ask open-ended questions which encourage deeper thought.
- Understand a family's journey and goals.
- Build trust and goodwill.
- Show interest in and tailoring experience and services to a family's long-term success.

Established Office



# Governance



# Foundations for Governance



## Family Assembly

- Annual meeting
- Dialogue about the business and family office
- Decisions about family activities
- Elects Family Council



## Family Council

- Goal setting and planning
- Organize meetings
- Relationship building & conflict management
- Education and development
- Conduit of family communication and sets policies



## Board of Directors

- Oversees, monitors, and sets direction for family office
- Hires and evaluates key leaders



## Family Constitution

- States family membership
- Family mission statement and core values
- Roles and responsibilities
- Outlines family education, employment, committees and other policies





# Structuring a Family Office for operations and tax efficiency



# Family Office Restructuring Post Lender Management, LLC vs. Commissioner

## Findings:

- 2017 US Tax Court found family office to be engaged in the trade or business of providing investment management services.
- Family office entitled to deduct ordinary and necessary expenses as business expenses under IRC Section 162.
- If family office was determined to be merely an investor or if family members were found to be managing their own money, expenses would be characterized as investment expenses under IRC Section 212 (currently non-deductible under the Tax Cuts and Job Act).
  - Supreme Court held in Higgins (1941) that management of one's investments is not trade or business.
  - No definition of trade or business in Tax Code



# Family Office Restructuring Post Lender Management, LLC vs. Commissioner (cont.)

## Key Case Points:

1. Activities of Family Office – Court concluded these activities went beyond those of an investor and were comparable to services provided by a hedge fund manager.
2. Compensation of the Family Office – Profits interest was the primary source of compensation vs. guaranteed fee for services provided.
3. Family Relationship – Most of the assets under management were owned by members of family that had no interest in the family office. The 3 investment LLCs each had a unique investment strategy.

# Hellmann vs. Commissioner (settled out of court)

While we don't know how the tax court might have ruled, prior to the settlement, the court issued an order calling for additional factual development. In its ruling, the tax court found that several factors are indicative of a family office trade or business including:

- 1.The manner in which the family office is compensated for its services.
- 2.The nature and extent of the services provided by the family office employees.
- 3.The relative amounts of expertise possessed, and time devoted by family office employees versus outside investment managers and consultants.
- 4.The individualization of investment strategies for different family members with differing investment preferences and needs.
- 5.The proportionality (or lack thereof) between the share of profits inuring to each family member in his or her capacity as an owner of the family office and the share of profits inuring to that same individual in his or her capacity as an investor in the managed funds.

# Hellmann vs. Commissioner

## Key Points:

- GFM LLC managed assets for only four family members, fewer than the *Lender* family office managed assets for, and each of those family members were close to each other geographically and personally.
- The Tax Court also contrasted the facts in Hellmann with those in Lender by highlighting that GFM managed investment assets for fewer family members than in Lender and that those family members were close to one another both geographically and personally, whereas the family members in Lender were geographically dispersed and, in some instances, not on speaking terms with one another.
- Further, all the owners in GFM LLC were also investors in the underlying investment partnerships. In fact, each of the four owners in GFM LLC owned a 25 percent profits interests, the same proportionate ownership they held in the underlying investment partnerships.

# Examples – Comparison of Structures

	Common Structure <u>No Planning</u>	Carried Interest Structure <u>LLC Management Company</u>	Carried Interest Structure <u>C corp Management Company</u>
Family office salaries and overhead expenses	Non-deductible	Deductible	Deductible
Investment advisor and manager fees	Non-deductible	Deductible	Deductible
Hedge fund management fees	Non-deductible	Non-deductible	Deductible
Personal Holding Company Tax	No	No	Yes
Tax on distributions	No	No	Yes
Income tax rates	Individual/Trust Rates	Individual/Trust Rates	Corporate Rates

*NOTE: The carried interest structure, or any structure, is dependent on underlying facts and outcomes will vary. The presentation is meant to illustrate possible consequences.*

# Single family office vehicles

## Structure Type

## Benefits

## Challenges

### C-Corporation structure

- ✓ Investment expenses are not separately stated and treated
  - ✓ Not viewed as a collection of shareholders
  - ✓ Lower income tax rate
- ✓ Multiple classes of stocks, each with different rights and/or economic interests

- Accumulated earnings tax and managing earnings and dividends
  - Double taxation
- Personal holding company tax
- Limitation on net operating loss usage

### Flow-through structure

- ✓ Avoids double taxation on original distributions and income retains character
- ✓ Excess profits can be flowed through to estate tax friendly ownership vehicles
- ✓ Potential to have special allocations of underlying management fees

- Disallowance of passive losses or of active trade/business losses in excess of permitted threshold
  - Expect IRS to challenge and/or not respect similar structures
  - Limitations at partner level for other tax attributes
- Carried interest (3 year holding period to achieve capital gain rate)



# Family Office Restructuring Issues to Consider

- Family office goals and objectives
- Nature and amount of family office overhead
- Entity selection
- Nature of investments and cash flow
- Expertise and qualifications of family office personnel
- Adequate governance and succession framework
- Overlap of investment assets and family office ownership
- Thorough tax, legal, and risk analysis
- Increased Administrative costs (tax compliance, reporting, additional employees)

# Target Market

- Any family office including single-family offices, virtual family offices, or multi-family offices managing assets in excess of \$250,000,000
- Non-deductible expenses in excess of \$1,500,000 This includes costs for employees, rent, overhead.
  - Need to also analyze underlying investments and the non-deductible Sec. 212 expenses (management fees).
- Multi-generational Family preferred (though 1<sup>st</sup> generation can be analyzed).
- Sophisticated investment and finance teams
- Family Office Plans to Offer Multiple services and receive compensation



# Conclusion



## Key Takeaways

A family office is a private business that manages the financial and personal affairs of ultra-high net worth individuals and families, who own and control it.

The Family Enterprise is how the family views their needs. It composed of three pillars: the operating business, the family office, and the investment structure. Philanthropy complements.

A family may create a family office when it has reached such a complexity with their wealth that they are no longer able to administrate it themselves.

There are four types of family offices: embedded family office, single family office, multi-family office, and virtual family office.

Governance is the foundational guidelines and process of decision making for jointly owned assets.

Unique fact patterns provide opportunities for operational and tax efficiencies





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