Everything you need to know about a family office

18 JULY 2019

CATEGORY:
ARTICLE

The modern notion of a family office charged with the stewardship of a single family's wealth for current and future generations emerged in the 19th century. The idea of the single-family office gained attention in Europe through families like the Medicis and Rothschilds and then spread to the US in the 19th century, through families like JP Morgan's House of Morgan and shortly thereafter the Rockefellers. The dynasties in Asia also have examples of similar embedded stewards or services providers. Today, families with family offices have proliferated, which may be related to the growth and concentration of privately held wealth.

Family offices take many forms, but in a very general context they typically fall into one of three general categories:

- Single-family office (SFO) – A SFO is dedicated to one family, perhaps with multiple households and often serving not only the matriarch and patriarch (G-1), but very often the second and subsequent generations.
- Multi-family office (MFO) – A MFO is an independent entity that manages the wealth of several families; it may be a small enterprise (at times growing out of a single family office), or it could be a division within a large bank or financial services firm.
- Hybrid or virtual family office (VFO) – A VFO outsources many services it provides to the family.The VFO may have few administrative or accounting staff, while outsourcing investing, legal,accounting, technology, and other services.

Whether an SFO, MFO, or VFO, a family office can take many forms. Family offices have highly individualised and developed structures tailored to the family and the services provided.

As family wealth increases and business needs become more complex, the family office may evolve. This evolution can very generally be seen as a transition from a founder's simple, informal office into a complex, full-service operating business. Conversely, the family office could be scaled down if the family's needs become less complex.

How do you maximize economic efficiency?

Often the first question when creating a family office is "what is the best structure?" The answer is "it depends." In reality, there is no single "best structure." The first step in determining the right structure is to consider flexibility in legal forum and applicable jurisdictions. Planners who advise on creating a family office must fully understand, quantify and evaluate the relative pros, cons and trade-offs of the available options. The relevant considerations include but are not limited to: scope of services provided; capital funding requirements; investment classes, pools and style; required oversight of operating businesses; and after-tax costs.

Because of potentially problematic liability provisions of partnerships, generally, and potential restrictions in flexibility of income and expenses in S corporations, many decision-makers in family office structures chose between an LLC and a C corporation.

Operationally, the family office is an embedded services provider. It has the potential to be a bona fide trade or business and with that comes the benefits and burdens of running a business. Some of the tax benefits include enhanced abilities to take tax deductions when properly structured.

As an embedded services provider in a structure that involves underlying investment vehicles structured as partnerships (such as family limited partnerships or family limited liability companies), the family office can be the recipient of an incentive allocation (also called a profits interest or carry). This planning can bring benefits, but also considerations.

How do you institutionalize multigenerational engagement?

We look for ways to make the family office a win-win arrangement. While legal structures and documents such as employment agreements will be essential for the protection of all concerned, it is important to craft a mutually beneficial compensation structure. There are three key stages to consider:

- **Attracting talent.** Recognizing the unique needs and demands of key personnel, potential for outside (or inside) investors, and whether co-ownership arrangements should be considered.
- **Compensating talent.** Recognizing that fringe benefits and/or equity incentives can and in many cases should play an important role in the planning.
- **Retaining talent.** Long term employment and mutual commitment to certain key employees and/or family members is enhanced with retention incentives and, in some cases, a retirement plan.

Regardless of the compensation arrangement, it is important that the family office be developed in a manner that it will – either initially or evolved over time – introduce rising generations to the legal structure, roles and responsibilities within the overall family enterprise. This will include the integration of family members into the structure, by, at times, giving the rising leaders a role in the structure, even if they do not join the enterprise as a career.

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