Management considerations

Risk management and controls

For family offices and the families they serve, the global risk environment is constantly changing. However, several risk areas continue to be top of mind: cyber risk, fraud risk and organizational and operational risk.

- **Cyber risk.** Areas of exposure include personal identities, reputations, public and private schedules, business and personal travel, investment accounts, business dealings, and many more.
- **Fraud risk.** This is an important area of exposure due to family office proximity to cash and assets and the significant control a single employee may have over financial activities and family communications.
- **Organizational and operational risk.** This includes family office employees, processes, systems, and external parties, as well as the physical security of family members themselves.

The approach to risk management depends on many factors, including the family office's specific priorities, size, experience, and degree of sophistication. A sound risk management framework with effective internal controls should consider such factors and is an essential part of protecting the family's wealth, safety, privacy and reputation. Common elements of an effective risk management framework—one that is continually updated and improved—may include one or more of the following:

- **Periodic Process Assessments** to evaluate the current state and provide recommendations on internal controls and other procedures, with focus on the design and operation of the process. Process assessments can be tailored as necessary based on the structure, including:
  - Internal Controls Assessments to help a family office evaluate the internal controls framework for one or more business cycles, including assessing the level of oversight and transparency.
  - Investment Oversight Assessments to understand the family office's governance structure and oversight framework for its investments held.
- **Audits of Financial Statements** prepared by the family office for one or more entities such as a private foundation, trust, or the family office itself. Auditors assist those charged with governance in fulfilling their obligations to oversee the financial reporting and disclosure process.
- **On Call Accounting Services** to help address the multitude of questions and issues that arise as a family office prepares financial statements or as their business evolves and they enter into complex and unusual transactions.
- **Family Business Strategy and Governance** to help navigate the complexities of balancing family members' goals and business needs. Development of a strategy and governance framework typically supports a long view of family wealth preservation and growth.

Figure 11: Common risks facing family offices

Financial

- Improper trade authorization
- Deviation from investment policy

Technology

- Cybersecurity
- Data confidentiality/privacy
- Business continuity

Employment

- Payroll fraud
- Internal data theft

Management considerations

Tax, legal and regulatory

The tax, legal and regulatory framework for family offices can be complicated, requiring the expertise of competent advisers.

Tax

Deloitte has amassed a significant amount of experience working with hundreds of family offices on a variety of tax matters. Common discussion topics on structuring family offices often include the following:

- For tax purposes, should the family office be structured as a flow-though entity (i.e., partnership or S corporation) or as a stand-alone entity (i.e., C corporation)?
- Will the family office activities rise to the level of a trade or business?
- How can a family office be funded tax-efficiently?
- Should the family office consider a transfer pricing study to determine how it charges for the provision of services?
- Are there sales or use tax issues related to the provision of services?
- How will the family office be taxed from a multistate perspective?
- What are the tax considerations if a family office desires to engage in philanthropy?
- Are there gift, estate, and generation-skipping transfer tax issues concerning family office ownership and succession?

Internal Revenue Service (IRS) oversight

Although the IRS does not formally "oversee" family offices, many wealthy families with extensive operations and complex organizational structures face a higher probability of involvement in tax controversy. In 2020, the IRS announced a renewed effort to examine tax returns filed by high-wealth taxpayers and their related entities through their Global High Wealth (GHW) program and related IRS programs.

A family office can work with their tax advisers to proactively assess and address risks for the family, including preparing for tax audits by revenue authorities in the United States and other countries, if applicable, along with preparation for any tax controversies that may arise from such audits.

Legal

The Deloitte US Firms do not provide legal advice. Engaging competent legal counsel to advise the family office on legal matters and other structuring aspects is extremely important. Legal counsel can advise on such issues as the appropriate legal entity type and legal jurisdiction for the family office. Legal counsel may also assist with determining the appropriate ownership and governance structure for the family office. And there may be additional contractual agreements that are necessary for the family office to conduct its business.

Securities & Exchange Commission – the "family office" rule

In 2011, the Securities and Exchange Commission (SEC) adopted a new rule defining a "family office" that would exclude it from the definition of an investment adviser under the Investment Advisors Act of 1940. Since the release of this rule, many family offices providing investment services to their clients have structured themselves in a manner to qualify under this definition. Accordingly, SEC legal counsel should be engaged to address this matter for the family office, particularly if investment-related services are being considered.

The comments in this section only provide a cursory overview of the tax, legal, and regulatory environment applicable to family offices operating in the United States. Matters concerning the structure of family offices in foreign jurisdictions are beyond the scope of this section.

Tip:

Family offices can effectively prepare for a tax examination by conducting a periodic audit readiness assessment. This can range from a simple discussion with internal advisers to a detailed audit readiness assessment that includes document analysis, interviews, and other data gathering. **Click the icon to learn more.**

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