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5 Recent Developments Family Offices Are Watching In 2024

By **Sara Wells, John O'Brien and Christine Schleppegrell** (January 2, 2024, 4:52 PM EST)

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Although family offices have long been exempt from many of the more onerous regulations and reporting requirements governing U.S. investment advisers and asset managers, recent amendments to federal rules will have an impact on how family offices invest and operate in 2024.

These include Investment Advisers Act amendments affecting private fund advisers; the Corporate Transparency Act, which took effect on Jan. 1; gift and estate tax exemption increases; an IRS notice on compliance when using employee stock ownership plans; and new rules affecting ESG-related funds.

SEC Private Fund Adviser Rules

In August 2023, the U.S. Securities and Exchange Commission adopted new and amended rules under the Investment Advisers Act that will impose additional requirements on advisers to private funds.

Whereas some of the rule changes only concern SEC-registered advisers, others will apply to any investment adviser to a private fund regardless of whether the adviser is exempt from registration with the SEC, is registered with a state securities regulator, or is based in the U.S. and entirely unregistered.

Among the more tangible implications, these rule changes will result in more private funds being subject to annual audits, and many private fund investors receiving detailed quarterly statements that include performance information. But these new requirements will also have more far-reaching implications for the overall private fund market.

Namely, private fund advisers will be limited in their ability to allocate regulatory and compliance expenses to and among the private funds they manage, effectively will be prohibited from giving investors preferential liquidity arrangements or access to fund holdings or exposures unless all investors are afforded equal treatment, and will be required to provide notice to fund investors if any investor receives preferential treatment with respect to material economic terms, e.g., fee arrangements.

Affected advisers are expected to incur substantial costs as they build out their systems and operations to come into compliance with these changes.

These changes to the private fund market could affect single-family offices that either have engaged investment advisers to manage their assets or invest in private funds managed by third-party investment advisers, even if such single-family offices are not directly subject to the Advisers Act in reliance on the exclusion from the definition of "investment adviser" afforded to family offices pursuant to Section 202(a)(11)(G) of the Advisers Act and Rule 202(a)(11)(G)-1 promulgated thereunder.

As investors, family offices will receive more frequent information about their private fund investments, which will likely be more uniform across different private fund managers. These rule changes will also protect family offices from any indirect harm resulting from other investors being provided with relatively beneficial arrangements.

At the same time, in adopting these rule changes, the SEC effectively removed a family office's ability to negotiate better terms for itself when investing in private funds.

In response to these changes, asset managers could increase offerings in registered products or in unregistered products that are less implicated, such as collective investment trusts. Further, these changes generally will have less impact on non-U.S. funds, which could result in more private fund products being offered overseas and in which U.S. family offices could participate through overseas offerings.

Many multifamily offices, almost all of which were required to register with the SEC as investment advisers in 2010 in the wake of the Dodd-Frank Wall Street Reform and Consumer Protection Act, will be substantially affected by these rule changes to the extent that they manage private funds.

Although several industry groups brought legal action contesting the validity of these rule changes, it is unlikely that there will be a judicial determination on the issue within a timeline that aligns with the required compliance dates.

Corporate Transparency Act

With the Corporate Transparency Act having taken effect on Jan. 1, affected entities, including many family offices, should be aware of and begin preparing for new requirements, including for beneficial ownership information reporting.

The CTA establishes uniform BOI reporting requirements for certain business entities created or registered to do business in the U.S. The goal is to establish a central registry of beneficial owners of legal entities to provide transparency and combat money laundering and illicit financial activities by those that control smaller unregulated businesses.

Many family offices that are formed as corporations or LLCs are now subject to CTA reporting. While some family offices may qualify as a large operating company or a subsidiary of a large operating company, and as such be exempt from reporting, the structure of investments and limitation on the subsidiary exemption may not exempt all family offices. Further, information about a family office may require disclosure if it invests in a reporting company and exercises substantial control over the company or owns or controls a 25% ownership interest.

Gift and Estate Tax Exemption

The Internal Revenue Service has announced that the annual gift tax exclusion will increase in 2024 due to inflation. The exclusion will be $18,000 per recipient for 2024 — the highest exclusion amount ever. In addition, the estate and gift tax exemption will be $13.61 million per individual for 2024 gifts and deaths, up from $12.92 million in 2023.

As many high-net-worth individuals take into account the gift tax exclusion as part of their tax planning strategy for family offices and wealth preservation and transfer, this increase in the total amount of money that can be transferred tax-free will be of particular concern to family offices going into an election year in the U.S.

With the possibility of the estate and gift tax exemption being cut by approximately one-half on Jan. 1, 2026, it will be crucial for family offices to advise their clients on making use of the increased exemptions before that date. Not only will gifted assets be removed from the taxpayers' taxable estates, the assets' future appreciation will also avoid gift and estate taxes.

IRS Compliance Actions for ESOPs

In August 2023, the IRS issued IR-2023-144 warning stakeholders of compliance issues associated with employee stock ownership plans, or ESOPs, related to the tax liability of high-income taxpayers.

Although it is unclear what prompted the notice, the IRS' intent is clear: It has a new enforcement focus on ESOP-related tax avoidance, particularly with respect to S corporation ESOPs. The notice addresses what the IRS views as problematic transactions and tax avoidance involving high-income taxpayers and ESOPs.

Family offices that use ESOPs as part of their tax strategies must more closely examine the valuation of employee stock, the allocation of shares, and transactions with ESOP loans given the IRS' specific identification of such types of transactions as cause for compliance issues.

The notice provides a range of compliance tools to rein in violations, including increased education, outreach and audits, as well as encouraging the reporting of those who promote improper and abusive tax schemes and tax return preparers who purposely prepare improper returns.

Expanded ESG Investments

Recent surveys[1] show that more than a quarter of family offices invest in, or are interested in investing in, funds and companies that focus on environmental, social and governance — or ESG — principles.

Some family offices have incorporated ESG principles into their core values and overall investment strategies, but the ESG market and regulatory landscape around ESG investing are rapidly changing, which may make it harder for family offices to find optimal ESG-related investment opportunities.

In September 2023, the SEC adopted an amendment to the so-called names rule, which governs naming conventions for registered funds. Those changes will impose new disclosure, compliance, reporting and recordkeeping requirements on funds with names that imply that their portfolios include certain investment characteristics.

This will especially affect ESG-related funds, as now any registered fund with a name that touts a sustainable or green focus, for example, will be required to maintain an 80% investment policy in that area. Although private funds are not subject to this amended rule, the SEC has also focused on private funds and their advisers that misleadingly convey a focus on ESG-related investments.

More substantial regulatory changes in the investment space relating to ESG have been stuck in the proposing stage at the SEC for several months, and it is unclear when, if ever, they will be adopted.

Conclusion

Investors in many asset classes are positioning themselves to be more adaptable in 2024 to minimize volatility in uncertain market conditions. That is equally true for many family offices, as they are paying closer attention to how these regulatory changes in 2024 will affect their investment strategies amid a changing global economy and more sophisticated acquisitions.

As where family offices are investing has recently expanded, both in terms of geography and asset types, it is more important than ever for these multigenerational, high-net-worth individuals to have a firm grasp of both the legal and geopolitical landscape.

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[1] https://www.fintrx.com/hubfs/_Approved%20Marketing%20Collateral/PDFs%20and%20Reports/The%20Rise%20of%20ESG%20Investing%20Among%20Family%20Offices.pdf.