

# THE PRIVATE TRUST COMPANY: A DIY FOR THE ÜBER WEALTHY

Christopher C. Weeg\*

*Editor's Synopsis: This Article focuses on the rise of private trust companies and how estate planners and settlors can use them while avoiding adverse tax consequences. In this analysis, this Article will explore the history, structures, tax consequences, and other considerations in using private trust companies. Furthermore, this Article will survey the laws of different states that have adopted legislation enabling private trust companies, and it will analyze the differences among them.*

<b>I.</b>	<b>INTRODUCTION</b> .....	122
<b>II.</b>	<b>THE PRIVATE TRUST COMPANY EXAMINED</b> .....	123
	A. History .....	124
	B. Should Your Family Go Private? .....	125
	1. Advantages .....	125
	2. Disadvantages.....	130
	C. Forming a Private Trust Company .....	132
	1. Which State? .....	133
	2. Regulated or Unregulated?.....	135
	3. Structure of a Private Trust Company .....	139
	4. Board of Directors .....	140
	5. Distribution Committee.....	140
	6. Investment Committee .....	141
	7. Amendment Committee .....	142
	8. Ownership .....	142
	9. Fees.....	143
<b>III.</b>	<b>TAX CONSIDERATIONS</b> .....	143
	A. History .....	143
	B. Notice 2008-63 .....	144
	1. The Facts and Issues .....	144
	2. The Firewalls .....	145
	3. Inclusion in Grantor's Estate Under Sections 2036 and 2038.....	146

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\* Associate with Meadows Collier, L.L.P., LL.M. in Taxation, University of Florida Levin College of Law Graduate Tax Program, 2016; J.D., Estate Planning Certificate, University of Florida Levin College of Law, 2015.

4. Powers of Appointment Under Section 2041 .....	146
5. Gift Completion.....	147
6. GST Tax .....	147
7. Grantor Trust Treatment.....	148
<b>IV. LEGISLATIVE LANDSCAPE.....</b>	<b>150</b>
<b>V. CONCLUSION.....</b>	<b>151</b>

As long as I'm alive, he's a millionaire  
 And even if I die, he's in my will somewhere  
 So he can just kick back and chill somewhere  
 He don't even have to write rhymes  
 The Dynasty like my money last three lifetimes.<sup>1</sup>

*Jay-Z, Diamonds from Sierra Leone.*

## I. INTRODUCTION

Jay-Z, rapper and entrepreneur with a net worth of over \$500 million,<sup>2</sup> likely shares the same goal of fellow dynastically-minded trust settlors—who are undoubtedly less lyrically inclined—of preserving wealth for future generations. An estate planner tasked with keeping a client's wealth flourishing—and out of the reach of the Internal Revenue Service (Service)—has many tools to accomplish this goal, and the most common arrangements use a dizzying array of trusts with peculiar names like NIMCRUT, QTIP, SLAT, ILIT, and, of course, the shark-fin CLAT. Until recently only two options existed to manage these trusts: hire either a corporate trustee, like a bank or trust company, or an individual trustee, such as a family member or trusted professional advisor.<sup>3</sup> But what about the ultra-wealthy family seeking ultimate flexibility, privacy, and control? Enter the private trust company.

<sup>1</sup> KANYE WEST FEATURING JAY-Z, *Diamonds from Sierra Leone* Remix, on LATE REGISTRATION (Roc-A-Fella Records 2005).

<sup>2</sup> See Zack O'Malley Greenburg, *Jay Z's Net Worth: \$520 Million in 2014*, FORBES (April 18, 2014, 10:43AM), [www.forbes.com/sites/zackomalleygreenburg/2014/04/18/jay-25-net-worth-520-million-in-2014/#7ef185a65569](http://www.forbes.com/sites/zackomalleygreenburg/2014/04/18/jay-25-net-worth-520-million-in-2014/#7ef185a65569).

<sup>3</sup> See Alan V. Ytterberg & James P. Weller, *Managing Family Wealth Through a Private Trust Company*, 36 ACTEC L.J. 623, 624 (2010).

Private trust companies have become an increasingly popular estate planning tool for managing dynastic wealth. A private trust company, or family trust company, serves as an umbrella trustee for family trusts.<sup>4</sup> True to its name, the private trust company does not provide fiduciary services for the general public, but rather only to a group of family members or affiliated parties.<sup>5</sup> Whereas the tax implications of this vehicle are still not set in stone, practitioners can likely avoid adverse tax consequences through careful governance structuring.

In the interstate competition for trust business, several states have passed legislation authorizing the formation of private trust companies. Florida is the latest state to join the private trust company party. Made effective in October 2015, the Florida Family Trust Company Act serves as one of the most robust statutes by authorizing the formation of three types of private trust companies in the state, as well as authorizing a multi-family option.<sup>6</sup>

This Article will provide an in-depth examination of the private trust company. To this end, it will span a broad range of topics, including the private trust company's governance structure, state supervision and regulation, tax consequences, and the current legislative landscape. Part II will provide an introduction to the private trust company by explaining its history, exploring the advantages and disadvantages of this estate planning vehicle, and walking through the formation of one. Part III will examine the potential income and transfer tax issues posed by the private trust company. Finally, Part IV will survey the law of the states that authorize the operation of a private trust company.

## II. THE PRIVATE TRUST COMPANY EXAMINED

This Part will explore the nuts and bolts of the private trust company. It will begin with a history lesson, and then, through an examination of the advantages and disadvantages, it will help to answer the question: "Should I (or, rather, my client) start my own private trust company?" This Part then explains how to form a private trust company, from choosing a situs to structuring the business.

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<sup>4</sup> *See id.*

<sup>5</sup> *See* Iris J. Goodwin, *How the Rich Stay Rich: Using a Family Trust Company to Secure a Family Fortune*, 40 SETON HALL L. REV. 467, 479 (2010).

<sup>6</sup> *See* FLA. STAT. § 662.01 -.151. All statutory citations in this Article are current unless otherwise indicated.

### A. History

In the late nineteenth and early twentieth centuries, wealthy families began using the private trust company to fulfill their wealth preservation goals.<sup>7</sup> These private trust companies were organized as state-chartered and state-regulated banks and were thereby governed under the same rules as public trust companies.<sup>8</sup> Although private trust companies may still operate this way, today they may organize—at least in some states—under their own, less strict set of rules.<sup>9</sup>

Some of the largest and most venerable trust companies started as private trust companies. In 1853, four families founded what is now U.S. Trust as a private trust company, which eventually began serving the public and evolved into the mega-corporate trustee it is today.<sup>10</sup> Bessemer Trust Company and Northern Trust Company—collectively with over \$1.5 trillion in trust assets under management—similarly started as private trust companies founded by the Phipps and Smith families.<sup>11</sup>

Although the number of private trust companies currently in operation is unknown, the increased passage of private trust company legislation suggests the trend is growing. Regulated private trust companies can be tracked based on the number of state charters granted, but no data is available for unregulated or unlicensed versions.<sup>12</sup> A 2007 *Wall Street Journal* article estimated there were “only a couple hundred private trust companies in the U.S.”<sup>13</sup> In a 2009 survey, there were fifty-eight regulated private trust companies.<sup>14</sup> Currently, South Dakota is

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<sup>7</sup> See Goodwin, *supra* note 5, at 472.

<sup>8</sup> See *id.* at 472.

<sup>9</sup> See *id.* at 472–73.

<sup>10</sup> See JAMES E. HUGHES, JR., FAMILY WEALTH—KEEPING IT IN THE FAMILY: HOW FAMILY MEMBERS AND THEIR ADVISERS PRESERVE HUMAN, INTELLECTUAL, AND FINANCIAL ASSETS FOR GENERATIONS 148 (Bloomberg Press, 2d ed. 2004).

<sup>11</sup> See *id.*

<sup>12</sup> See, e.g., NEV. REV. STAT. § 669A.100 (stating that a family trust company need not be licensed in the state to operate but *may* apply for a license if desired).

<sup>13</sup> Rachel Silverman, *Matters of Trust: Super-Rich Set Up Companies*, WALL ST. J. (Aug. 4, 2007), <http://www.wsj.com/articles/SB118618514414987894>.

<sup>14</sup> See John P.C. Duncan, *Risks and Opportunities for Private Trust Companies and Family Offices from State & Federal (Non-Tax) Legislative Developments and Proposals* (2010 A.B.A. Mid-Year Meeting, A.B.A. Sec. of Tax'n, Jan. 21-23, 2010), 2010 WL 476058, at 3 (2010) [hereinafter *Risks and Opportunities for Private Trust Companies*].

home to the highest number of regulated private trust companies with twenty-eight.<sup>15</sup>

## B. Should Your Family Go Private?

As a threshold consideration, only families with substantial wealth should consider a private trust company due to the complication and expense of forming and operating one. But what is considered substantial wealth? To even consider the private trust company route, estate planning experts generally recommend assets of at least \$100 million.<sup>16</sup> Though this amount of wealth may seem significant, the minimum net worth to make the 2014 *Forbes* 400 list is \$1.55 billion, up \$250 million from 2013 and more than \$1 billion from 1982 in today's money.<sup>17</sup> So, what does this mean? The number of families with wealth in the private trust company range is not only larger than one might expect, but also growing at a fast pace.

### 1. Advantages

The private trust company vehicle offers many advantages for a family with long-term estate planning goals. In addition to increased privacy, flexibility, and control when compared to traditional trustees, a private trust company also provides intangible benefits like promoting family leadership succession, family cohesion, and intergenerational cultural succession.<sup>18</sup> A private trust company also facilitates both simplified trustee succession and enriched financial wealth succession from the older generation to the younger ones.<sup>19</sup>

First, a private trust company can serve as the administrative center of family business, or the "family seat."<sup>20</sup> A centralized and interactive

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<sup>15</sup> See *Where to Establish a Private Family Trust Company*, SOUTH DAKOTA TR. CO., <http://www.sdtrustco.com/About-South-Dakota-Trust-Company/Private-Family-Trust-Companies/Where-to-Establish-a-PFTC-.aspx> (last visited June 27, 2017).

<sup>16</sup> See Ytterberg & Weller, *supra* note 3, at 625.

<sup>17</sup> See Carol L. Schreder, *The IRS Issues Guidance on Private Trust Companies*, EST. PLAN., Jan. 2009, at 8, 8; see also Carol O'Donnell & Will Sanderson, *What Does it Take to Make the Forbes 400? Increasingly More and More*, FORBES (Oct. 3, 2014, 6:58AM), <https://www.forbes.com/sites/carlodonnell/2014/10/03/what-does-it-take-to-make-the-forbes-400-increasingly-more-and-more/#467cd1b64ed3>.

<sup>18</sup> See John P.C. Duncan, *Strategic Family Wealth Planning and the Private Family Trust Company*, CLE Materials from Financial Research Associate LLC's (FRA) 2014 Sustainable Family Office Operations & Management Conference, at 14.

<sup>19</sup> See *id.*

<sup>20</sup> HUGHES, JR., *supra* note 10, at 150.

base of financial operation can encourage participation by younger generations in their own investment and entrepreneurial activities, thereby providing a venue for “financial reproduction.”<sup>21</sup> Further, the older generation can educate the younger generation on wealth preservation consistent with the family’s particular philosophy on spending and investing.<sup>22</sup>

Through this participation and integration, the private trust company can provide experience to the younger generation to further a family legacy.<sup>23</sup> For those interested in participating in investment decisions, family members may also serve on the Investment Committee, which is responsible for the financial management of trust assets.<sup>24</sup> This option provides an opportunity for less experienced family members to learn the ropes of asset management, while they are still subject to the oversight of the other committee members. Furthermore, the family member’s participation in investment decisions through membership on the Investment Committee—if properly structured—will not jeopardize spendthrift protection, tax, and other benefits and provisions of irrevocable trusts under the private trust company’s umbrella.<sup>25</sup> Finally, a private trust company can be managed in accordance with a family’s mission statement, whereby its principles and goals, as well as its standards related to charitable giving and investment strategy, can drive wealth management.<sup>26</sup>

The consolidation of all family trusts under the private trust company umbrella can result in cost savings through economies of scale and better coordination of asset management and protection. A private trust company, in some scenarios, may offer savings over a corporate trustee, which typically charges a fee based on a percentage of assets under management.<sup>27</sup> The expenses of a private trust company, on the other hand, are the actual costs necessary to operate the company. Moreover, a private trust company can expand or contract, along with a family, to meet the representation needs of all members.<sup>28</sup>

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<sup>21</sup> Goodwin, *supra* note 5, at 470.

<sup>22</sup> *See id.*

<sup>23</sup> *See* Ytterberg & Weller, *supra* note 3, at 631.

<sup>24</sup> *See id.* at 625.

<sup>25</sup> *See id.*

<sup>26</sup> *See* HUGHES, JR., *supra* note 10, at 150.

<sup>27</sup> *See* Schreder, *supra* note 17, at 10.

<sup>28</sup> *See* HUGHES, JR., *supra* note 10, at 150–51.

A private trust company can merge with an existing family office and thereby consolidate nearly all family operations under one roof, resulting in further economies of scale.<sup>29</sup> Families looking to expand an existing family office are likely candidates for a private trust company. Compared to a private trust company, a family office provides a broader spectrum of services—both professional and personal—through the management of the operational aspects of family life; these services range from estate planning, filing tax returns, and managing investments, to hiring household staff, paying bills, booking travel, and managing properties.<sup>30</sup> Whereas a family office's business is running the family itself, a private trust company's business is running the family's trusts. The combination of these two entities offers the ultimate in private wealth services.

Private trust companies offer stronger confidentiality and communication because only a family's personal team of trusted professionals handles and reviews its information.<sup>31</sup> With a typical corporate trustee, any number of people may be involved with the management of the family trusts. Further, beneficiaries likely have better access and closer relationships with the employees of a private trust company, facilitating the most attentive service to the family's affairs.<sup>32</sup> A corporate trustee may merge, close, or change personnel abruptly and cause disruption to fiduciary services, which may raise quality concerns.<sup>33</sup> Private trust company employees, on the other hand, work directly for the family, ameliorating the hierarchical and bureaucratic issues associated with large, and at times impersonal, corporate trustees. Finally, a private trust company can obtain truly independent advice because it does not sell its own financial products.<sup>34</sup>

A private trust company offers a family a higher level of control through its flexible governance structure.<sup>35</sup> A family can hand-pick and

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<sup>29</sup> See *id.* at 150.

<sup>30</sup> See Stephen Campbell, *A Practitioner's Guide to Family Office Planning*, EST. PLAN. Aug. 2012, 13, 13.

<sup>31</sup> See *id.* at 14.

<sup>32</sup> See Ytterberg & Weller, *supra* note 3, at 626.

<sup>33</sup> See *id.* at 625.

<sup>34</sup> See Johnathan Forster et al., *The Private Trust Company – A Fiduciary Services and Asset Management Alternative for High Net-Worth Families*, ALERT (Greenberg Traurig, LLP) Mar. 2006, at 1, <http://www.gtlaw.com/portalresource/lookup/wosid/contentpilot-core-401-7484/pdfCopy.name=/0308.pdf?view=attachment>.

<sup>35</sup> See *id.*

personally manage its own professionals and staff of the company.<sup>36</sup> Unlike a corporate trustee, a private trust company elects its own board of directors, which can include family leaders and trusted outside advisors.<sup>37</sup> And unlike an individual trustee, a board can continue to operate even if a director dies or retires, thus preventing a gap in leadership.<sup>38</sup> As time passes and entire generations come and go, the private trust company will remain a financial pillar and a knowledge base to the family.

As a corporate entity, a private trust company has a perpetual life and can thus alleviate trustee succession concerns.<sup>39</sup> Whereas an individual trustee may die, become incapacitated, or retire, a private trust company provides stability because it can last for as long as needed.<sup>40</sup> Moreover, removing a board member is far easier and cheaper than removing a trustee: simply do not re-elect the member.<sup>41</sup>

The private trust company also offers greater investment discretion over traditional trustees, which encourages flexibility and diversification when managing trust assets.<sup>42</sup> For example, the private trust company may be an attractive option for family members or professional advisors who would otherwise not want to subject themselves to potentially unlimited liability while serving as an individual trustee.<sup>43</sup> Whereas the fundamental standards of fiduciary conduct apply to a private trust company while serving as trustee during trust administration,<sup>44</sup> the more lax “business judgment rule” governs the investment decisions of its board of directors.<sup>45</sup> For the business judgment rule to apply to a decision made by the board,

- (1) a judgment must have been made;
- (2) the directors must have informed themselves with respect to the decision to the extent reasonably believed appropriate under the circumstances;
- (3) the decision must have been

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<sup>36</sup> See Ytterberg & Weller, *supra* note 3, at 625–26.

<sup>37</sup> See HUGHES, JR., *supra* note 10, at 150.

<sup>38</sup> See Schreder, *supra* note 17, at 10.

<sup>39</sup> See HUGHES, JR., *supra* note 10, at 150.

<sup>40</sup> See Ytterberg & Weller, *supra* note 3, at 625.

<sup>41</sup> See Schreder, *supra* note 17, at 10.

<sup>42</sup> See *id.*

<sup>43</sup> Traditional trustees, however, typically have unlimited liability unless the trust document says otherwise. See HUGHES, JR., *supra* note 10, at 151.

<sup>44</sup> See RESTATEMENT (THIRD) OF TRUSTS §§ 76-79 (AM. LAW INST. 2007).

<sup>45</sup> See Ytterberg & Weller, *supra* note 3, at 631.



made in subjective good faith; and (4) the directors must not have a financial interest in the subject matter.<sup>46</sup>

This deferential standard of review enables the board members to make bolder and more dynamic investment decisions when managing the assets of the family trusts.<sup>47</sup>

In addition to receiving the benefit of the business judgment rule, board members also receive the benefit of having their liability limited to the company's capital, in the absence of criminal or reckless conduct.<sup>48</sup> The by-laws or operating agreement of the private trust company can further limit liability of its members through an indemnification and hold harmless clause against losses arising from their roles in the company.<sup>49</sup> This limited liability coupled with a more relaxed standard of review may enable a private trust company to recruit advisers more easily to the board.<sup>50</sup>

As compared with a corporate trustee, a private trust company may be better suited to manage a portfolio with heavily concentrated or illiquid assets, such as real estate, stock in a particular company, or a family-owned business.<sup>51</sup> Although in theory the prudent investor rule would permit an investment strategy of holding such assets,<sup>52</sup> a corporate trustee may nonetheless choose to diversify the trust assets to avoid any potential liability for investment losses.<sup>53</sup> Indeed, a corporate trustee may deem an investment directive of retaining a family business to be a "course of conduct . . . potentially so risky" that the trustee may be unwilling to follow the directive.<sup>54</sup>

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<sup>46</sup> *Id.*

<sup>47</sup> See HUGHES, JR., *supra* note 10, at 151.

<sup>48</sup> *See id.*

<sup>49</sup> See Ytterberg & Weller, *supra* note 3, at 631.

<sup>50</sup> See Schreder, *supra* note 17, at 8.

<sup>51</sup> See Ytterberg & Weller, *supra* note 3, at 626.

<sup>52</sup> See UNIF. PRUDENT INV'R ACT § 3 (UNIF. LAW COMM'N 1994) (providing an exception to the duty to diversify where, "because of special circumstances, the purposes of the trust are better served without diversifying"). Furthermore, "[t]he wish to retain a family business is another situation in which the purposes of the trust sometimes override the conventional duty to diversify." *Id.* cmt.

<sup>53</sup> See Goodwin, *supra* note 5, at 507; *see also* Ytterberg & Weller, *supra* note 3, at 626.

<sup>54</sup> John H. Langbein, *Mandatory Rules in the Law of Trusts*, 98 NW. U.L. REV. 1105, 1116–17 (2004). Retaining such an asset is unattractive to the traditional trustee because "[o]perating a business (or hiring and monitoring agents to operate the business) is far

On the other hand, a private trust company may be less risk averse than a traditional trustee and have a better understanding of an asset's special relationship or value to the purposes of the trust or to its beneficiaries.<sup>55</sup> Family members and trusted advisers may serve on the Investment Committee of a private trust company and protect special assets from needless diversification.<sup>56</sup> Moreover, an Investment Committee can offer more flexible investment strategies, as opposed to a stiff one-size-fits-all plan offered by corporate trustees with thousands of trust accounts.

## 2. *Disadvantages*

Bespoke fiduciary services that provide greater flexibility, control, and privacy entail significant up-front and ongoing costs. First, forming a private trust company requires a large initial investment. As with forming any new company, there will be legal fees for drafting governing documents and navigating state requirements for setting up a private trust company. In states that authorize private trust companies, there will be an application or registration fee, typically between \$5,000 and \$10,000.<sup>57</sup> These states also require a minimum capital contribution, which generally ranges from \$200,000 to \$500,000.<sup>58</sup> Such costs are higher for regulated (or licensed) private trust companies than their unregulated (or unlicensed) counterparts.<sup>59</sup>

Operating a private trust company is similarly expensive. The hard costs to run a private trust company include paying a skilled team of outside advisers, which may consist of CPAs, attorneys, estate planning professionals, and investment advisers.<sup>60</sup> The departure of these key

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more challenging than conventional fiduciary investing in a portfolio of marketable securities, whose performance is easily monitored through market prices and benchmark portfolios such as the various market indexes." *Id.* at 1115. Moreover, corporate trustees (and their errors and omissions carriers) are generally more sensitive to trust law, which "discourages investments that require trustees to engage in active entrepreneurship." *Id.*

<sup>55</sup> See Ytterberg & Weller, *supra* note 3, at 626.

<sup>56</sup> See *id.*

<sup>57</sup> See, e.g., *South Dakota Trust Company PFTC Services*, PRIVATE FAMILY TRUST COMPANY.COM, [www.privatefamilytrustcompany.com/Trust-Information/PFTC-Services.aspx](http://www.privatefamilytrustcompany.com/Trust-Information/PFTC-Services.aspx).

<sup>58</sup> See, e.g., *id.*

<sup>59</sup> See, e.g., *id.*

<sup>60</sup> See HUGHES, JR., *supra* note 10, at 151–52. There may be some overlap with the costs to run a family office and the costs to run a private trust company, such as in-house professional and staff fees. Accordingly, families interested in forming a private trust

personnel could cause a disruption in operation and leadership. The operation of a private trust company will generate significant soft costs as well.<sup>61</sup> Family leaders will need to oversee the day-to-day management of the enterprise, including supervising employees and attending meetings and elections.<sup>62</sup>

Private trust companies are generally under the oversight of a state agency and thus must comply with regulatory and reporting requirements. Private trust companies must maintain business records and accounts for examination by state agencies, as well as pay examination and license renewal fees. Further compliance costs may be incurred when adhering to the changing policies and procedures of the appropriate state banking authority.<sup>63</sup>

Although a private trust company keeps more business in-house as compared to a corporate trustee, there may be a loss of confidentiality through the regulatory filings that potentially may divulge personal family information.<sup>64</sup> Employee turnover also may leak this information to the public, but this can be mitigated by confidentiality agreements with employees.<sup>65</sup>

Families looking for definite answers to tax questions posed by the private trust company route should be wary. In 2005, the Service declared that it would no longer issue private letter rulings addressing private trust companies.<sup>66</sup> Then, in 2008, the Service issued and sought public comments on a proposed revenue ruling addressing the income and transfer tax concerns posed by a private trust company.<sup>67</sup> Despite receiving comments from several organizations and law firms,<sup>68</sup> the Service has not yet issued any final guidance. In the absence of any

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company may find the costs of operating a family office as a helpful guide. Depending on the size and location, annual operating costs of a family office can range from \$1.3 million to \$16 million. *See* Campbell, *supra* note 30, at 16. As a general rule, these expenses approximate about 1% of the total active assets of the family (not net worth). *See id.* at 18.

<sup>61</sup> *See* Goodwin, *supra* note 5, at 510; *see also* HUGHES, JR., *supra* note 10, at 152.

<sup>62</sup> *See* HUGHES, JR., *supra* note 10, at 152.

<sup>63</sup> *See id.*

<sup>64</sup> *See id.*

<sup>65</sup> *See id.*

<sup>66</sup> *See* Rev. Proc. 2005-3, 2005-1 C.B. 118.

<sup>67</sup> *See* Notice 2008-63, 2008-2 C.B. 261.

<sup>68</sup> *See, e.g.*, Letter from Ronald D. Aucutt, of McGuireWoods, to Service (Nov. 3, 2008) [http://www.actec.org/assets/1/6/Aucutt\\_Comments\\_Notice\\_08-63\\_11\\_3\\_08.pdf](http://www.actec.org/assets/1/6/Aucutt_Comments_Notice_08-63_11_3_08.pdf) (commenting on Notice 2008-63, 2008-2 C.B. 261).

administrative guidance and a dearth of case law, the private trust company is a relatively untested vehicle. Practitioners are blazing their own trails, and careless planners can get burned.

Finally, certain benefits of the private trust company may also be seen, in another light, as disadvantages. First, a family's participation in a private trust company may be a source of conflict and tension, particularly when money and control of family assets are at stake. In these scenarios, a trustee wholly independent of family control may be desirable.<sup>69</sup> Additionally, the limited liability afforded to the board of directors could be an issue in cases of mismanagement, poor investment performance, or breach of fiduciary duties.<sup>70</sup> If this occurs, the family's recourse will be limited to the capital of the company as compared with the deeper pockets of a corporate trustee.<sup>71</sup>

### C. Forming a Private Trust Company

After weighing the advantages against the disadvantages and deciding to go the private route, a family has some important decisions to make. First, the family must choose in which jurisdiction to establish the private trust company. The state's tax, trust, and property laws, as well as the applicable private trust company statutes, will likely drive this decision. Once the jurisdiction is chosen, the family must decide whether to be regulated or unregulated by the state banking authority; most private trust company statutes allow only the regulated option.<sup>72</sup> Based on these considerations, some of the most common jurisdictions for private trust companies are Alaska, Delaware, Nevada, New Hampshire, South Dakota, Tennessee, and Wyoming.<sup>73</sup> Finally, the family must decide how to structure its private trust company, not only for smooth operation and effective leadership, but also with a keen eye for tax consequences.

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<sup>69</sup> See Carol A. Harrington & Ryan M. Harding, *Private Trust Companies and Family Offices: What Every Estate Planner Needs to Know*, in *Sophisticated Estate Planning Techniques* (ALI ABA Course of Study, Sept. 4-5, 2008), WL SP020 A.L.I.-A.B.A. 675, 692 (2008).

<sup>70</sup> See *id.*

<sup>71</sup> See *id.*

<sup>72</sup> See Ytterberg & Weller, *supra* note 3, at 629.

<sup>73</sup> See John P.C. Duncan, *State of the Private Family Trust Company Today—Accomplishments and Challenges*, 2014 PRIV. FAM. TR. SYMP., at 26–27 [hereinafter *State of the Private Family Trust Company Today*].

### 1. Which State?

When choosing a jurisdiction, families should strongly consider a state with a generous Rule Against Perpetuities (RAP) regime and no state income taxes. For settlors concerned with the generation-skipping transfer (GST) tax, RAP-friendly states—those that have abolished or generously extended the RAP—should be at the top of the list. In these states, trusts with a GST allocation sufficient to cover the initial value of the property transferred may exist indefinitely<sup>74</sup>—or between 360 and 1,000 years<sup>75</sup> depending on the jurisdiction—outside the reach of the transfer tax regime.<sup>76</sup> Furthermore, these jurisdictions will facilitate a family’s long-term, multi-generational estate planning goals.<sup>77</sup>

The tax landscape of the jurisdiction should weigh heavily in the choice of where to start your private trust company. States with no state income taxes are an obvious choice.<sup>78</sup> Currently, seven states do not levy an income tax: Alaska, Florida, Nevada, South Dakota, Texas, Washington, and Wyoming.<sup>79</sup> And luckily for families interested in going private, all of these states have passed legislation authorizing private trust companies.<sup>80</sup> Five of these states—Alaska, Florida, Nevada, South Dakota, and Wyoming—have either abolished the RAP or offer vesting periods of at least 360 years.<sup>81</sup> Unsurprisingly, these five states also placed in the top five in the Tax Foundation’s 2017 State Business Tax Climate Index.<sup>82</sup> Thus, these five tax and RAP-friendly states with

<sup>74</sup> See Grayson M. P. McCouch, *Who Killed the Rule Against Perpetuities?*, 40 PEPP. L. REV. 1291, 1292–94 (2013) (discussing RAP and the GST tax exemption).

<sup>75</sup> See *id.* at 1304 (citing FLA. STAT. § 684.225 (2012)).

<sup>76</sup> See *id.* (citing UTAH CODE ANN. § 75-2-1203 (2012)).

<sup>77</sup> See *id.* at 1300–02 (discussing the marketing of perpetual trusts).

<sup>78</sup> See Harrington & Harding, *supra* note 69, at 695–97.

<sup>79</sup> See Lyman Stone, *State Personal Income Tax Rates and Brackets 2014 Update*, FISCAL FACTS, NO. 422 (Tax Found., Washington D.C.), Mar. 2014, <https://files.taxfoundation.org/legacy/docs/FF422%20-%20State%20Income%20Tax%20Rates%20and%20Brackets.pdf>.

<sup>80</sup> See *id.*

<sup>81</sup> Alaska has abolished the RAP, but powers of appointment must terminate or be exercised within 1,000 years. See ALASKA STAT. §§ 34.27.075, 34.27.051. Florida has a 360-year RAP. See FLA. STAT. § 689.225(2)(f). Nevada has a 365-year RAP. See NEV. REV. STAT. § 111.1031(1)(b). South Dakota has abolished the RAP. See S.D. CODIFIED LAWS § 43-5-8. Wyoming has a 1,000-year RAP. See WYO. STAT. ANN. § 34-1-139.

<sup>82</sup> The top spots went to Wyoming, South Dakota, Nevada, Alaska, and Florida, respectively. See Jared Walczak et al., *2017 State Business Tax Climate Index*, TAX FOUNDATION 5, <https://files.taxfoundation.org/20170302120920/TF-SBTCI-2017-Final>

private trust company legislation should be at the top of every family's list.

In addition to RAP and tax considerations, families should look for a state with advantageous fiduciary laws and investment standards. Key considerations include the adoption of the Uniform Prudent Investor Act with a modern Prudent Investor Rule, as well as a progressive version of the Uniform Trust Code.<sup>83</sup> This ideal combination offers relaxed diversification rules that would permit appropriate asset concentrations. Families should also examine each state's asset protection and creditor protection rules, as well as its principal and income act.<sup>84</sup> For families with multi-generational estate planning goals, a jurisdiction that provides flexibility for beneficiaries through relaxed trust reformation, modification, and termination rules, combined with strong decanting authority, should rank high on the list.<sup>85</sup> Finally, state law governing liability of the private trust company and its directors should also factor into the decision.<sup>86</sup>

Soft factors, like a state's business and legal climate, are important to consider. A competent and responsive state regulatory agency is key to the smooth operation of a private trust company.<sup>87</sup> Additionally, a reliable legal infrastructure, one with an accessible court system and a robust body of case law, is a strong selling point.<sup>88</sup> Finally, assuming the family will have a long-term business relationship with the jurisdiction, an ideal state should also be able to tout a competitive economic environment.<sup>89</sup>

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1.pdf. The methodology focused on corporate tax, individual income tax, property tax, and sales tax rates. *See id.* at 9–10.

<sup>83</sup> *See* Harrington & Harding, *supra* note 69, at 695; *State of the Private Family Trust Company Today*, *supra* note 73, at 23.

<sup>84</sup> *See* Harrington & Harding, *supra* note 69, at 695.

<sup>85</sup> *See State of the Private Family Trust Company Today*, *supra* note 73, at 23.

<sup>86</sup> *See* Harrington & Harding, *supra* note 69, at 695.

<sup>87</sup> *See id.*

<sup>88</sup> *See id.*

<sup>89</sup> *See generally* ARTHUR B. LAFFER ET AL., RICH STATES, POOR STATES: ALECC-LAFFER STATE ECONOMIC COMPETITIVENESS INDEX (9th ed. 2016), <https://www.alec.org/app/uploads/2017/04/2017-RSPS-INDEX-v5.pdf>. The study's methodology analyzed fifteen economic policy considerations influenced directly by state legislatures, which included, inter alia, tax and labor policies and quality of the state's legal system. *See id.* at 108–09 app. Popular private trust company jurisdictions South Dakota, Nevada, and Wyoming placed in the top fifteen. *See id.* at 56.

The actual private trust company laws of each state are of course a major factor as well. The most dynamic statutes authorize both regulated and unregulated trust companies in order to meet the varied needs of families looking to go private.<sup>90</sup> Families should seek strong confidentiality protections related to application materials, company financials, customer accounts, and identities of owners and managers.<sup>91</sup> Families should also examine the applicable state statutes for the differences on how to obtain and maintain a state charter, which typically consist of the following: minimum capital requirements, insurance and bonding requirements, annual reporting requirements, board meeting requirements, bonding, number and residency of directors, and type of entity.<sup>92</sup> The ongoing regulatory operational costs should be factored into the decision as well, such as annual certification fees and inspection requirements imposed by the state banking authority. Finally, families should understand the limits the statute places on the range of fiduciary, agency, and advisory services, and to whom those services may be provided.<sup>93</sup>

## 2. *Regulated or Unregulated?*

Private trust companies were originally organized as state-chartered banks and therefore regulated under the same rules as a trust company that serves the general public.<sup>94</sup> Today, a private trust company may either be “lightly regulated”—as compared with the level of regulation of banks and public trust companies—or unregulated.<sup>95</sup> A regulated private trust company is organized under its own state charter and subject to state supervision and regulatory requirements.<sup>96</sup> An unregulated private trust company, on the other hand, operates under relatively little or no state regulation.<sup>97</sup> A small subset of states explicitly authorize both

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<sup>90</sup> See *Risks and Opportunities for Private Trust Companies*, *supra* note 14, at 1, exhibit 3.

<sup>91</sup> See *id.* at 3, exhibit 1.

<sup>92</sup> See Ytterberg & Weller, *supra* note 3, at 632–33, 640 app.

<sup>93</sup> See *State of the Private Family Trust Company Today*, *supra* note 73, at 24. In general, a private trust company may only provide services to family members and affiliated entities.

<sup>94</sup> See Goodwin, *supra* note 5, at 472–73.

<sup>95</sup> *Id.* at 473.

<sup>96</sup> See *id.*

<sup>97</sup> See *id.*

regulated and unregulated private trust companies,<sup>98</sup> with Florida being the latest state to pass such legislation.<sup>99</sup>

A regulated private trust company's organizing documents must limit providing trustee services to family members and also prohibit soliciting business from the general public.<sup>100</sup> Whereas the requirements vary by state, a regulated private trust typically must have a minimum number of directors (one of whom is in-state), a minimum number of board meetings per year, a physical office in the state, and a minimum number of employees.<sup>101</sup> A regulated private trust company must also maintain a minimum capital account,<sup>102</sup> which typically ranges from \$200,000 to up to \$2 million.<sup>103</sup> State regulators may further require bonds and insurance of a \$1 million or more.<sup>104</sup>

A regulated private trust company must establish a formalized risk-management system subject to periodic review by state regulators.<sup>105</sup> This system includes policy and procedure manuals such as bylaws, annual reporting and record keeping rules, and governance charts.<sup>106</sup> Additionally, a regulated private trust company is subject to annual state audits and other examinations and inspections.<sup>107</sup> Although some confidentiality may be lost through the application process and more rigorous supervision, state agencies generally keep a private trust company's books and records confidential.<sup>108</sup>

Despite its significant up-front investment and ongoing expenses, a regulated private trust company offers advantages over its unregulated counterpart. Because it is subject to state regulation, a regulated private trust company is excluded from the Securities and Exchange

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<sup>98</sup> See Christopher M. Reimer, *The Undiscovered Country: Wyoming's Emergence as a Leading Trust Situs Jurisdiction*, 11 WYO. L. REV. 165, 187 (2011).

<sup>99</sup> See S. 1238, 2014 Leg., Reg. Sess. (Fla. 2014) (enacted).

<sup>100</sup> See Goodwin, *supra* note 5, at 474.

<sup>101</sup> See *id.*

<sup>102</sup> See *id.* at 475.

<sup>103</sup> See Harrington & Harding, *supra* note 69, app. A at 709. A South Dakota regulated private trust company must maintain a \$200,000 minimum capital account as compared with \$2 million for one operated in Pennsylvania. See *id.*

<sup>104</sup> See Goodwin, *supra* note 5, at 475.

<sup>105</sup> See *id.* at 474.

<sup>106</sup> See *id.* at 474–75.

<sup>107</sup> See Reimer, *supra* note 98, at 189.

<sup>108</sup> See *id.* at 178–79.



Commission's (SEC) definition of investment adviser.<sup>109</sup> As such, it does not have to register with the SEC and comply with burdensome federal regulation.<sup>110</sup>

Some argue that a regulated private trust company, with its extra bells and whistles and state supervision, may "provide greater legitimacy (particularly with tax sensitive distribution issues), liability protection, and may make piercing the corporate veil more difficult" when compared with an unregulated private trust company.<sup>111</sup> One commentator, however, finds the argument of a stronger corporate veil to be exaggerated due to the family dynamic of the private trust company: "[B]y virtue of the family component of these trusts [administered by the private trust company], the beneficiaries suing for breach of trust will be the children, siblings, cousins, nieces, and nephews of those serving in a decision-making capacity in the trust."<sup>112</sup> Finally, for trust settlors looking to establish residency in a tax-friendly state, operating a regulated private trust company provides a strong nexus to that jurisdiction.<sup>113</sup>

An unregulated private trust company is subject to reduced regulatory oversight as it does not need a state charter to operate.<sup>114</sup> Like their regulated counterparts, unregulated private trust companies must limit providing trustee services to family members.<sup>115</sup> Unlike their regulated counterparts, however, there are typically no minimum capital requirements.<sup>116</sup>

Families looking for a private trust company with less formality and expense may prefer the unregulated option. Unregulated private trust companies typically may be formed more quickly and cheaply because they do not need a state charter and have reduced capital requirements and state regulatory oversight.<sup>117</sup> Due to this reduced level of state

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<sup>109</sup> See Christopher M. Reimer, *Private Trustees Beware: A Review of the Sweeping New SEC Registration Requirements Under the Dodd-Frank Wall Street Reform and Consumer Protection Act*, 12 J. BUS. & SEC. L. 337, 345 (2012).

<sup>110</sup> See *id.*

<sup>111</sup> Harrington & Harding, *supra* note 69, at 693.

<sup>112</sup> Goodwin, *supra* note 5, at 478 n.49.

<sup>113</sup> See FLA. SENATE, BILL ANALYSIS AND FISCAL IMPACT STATEMENT, S. 1238, 2014 Leg., Reg. Sess. (2014).

<sup>114</sup> See Goodwin, *supra* note 5, at 475.

<sup>115</sup> See *id.*

<sup>116</sup> See *id.* at 475 (citing Harrington & Harding, *supra* note 69, at 709).

<sup>117</sup> See Ytterberg & Weller, *supra* note 3, at 629.

supervision, there also will be lower compliance costs through fewer filings and examinations while operating.<sup>118</sup>

Choosing to be unregulated also has its disadvantages. Operating a private trust company under little or no regulatory oversight may be risky.<sup>119</sup> Some amount of supervision could help detect fraudulent or unsound practices that otherwise may go unseen by family members. Further, a private trust company subject to periodic review by state regulators could also encourage an effective formalized risk-management system.<sup>120</sup>

Due to this lack of regulatory oversight, unregulated private trust companies should take special care with establishing infrastructure for sound fiduciary processes, policies, and procedures.<sup>121</sup> Important policies and procedures include:

- (1) formal acceptance and closure of fiduciary accounts;
- (2) performance and documentation of initial and annual investment review of fiduciary assets for which a private trust company has investment discretion;
- (3) performance and documentation of initial and annual administrative review of fiduciary accounts being administered by a private trust company;
- (4) internal controls to safeguard fiduciary assets, monitor the accuracy and reliability of fiduciary records, and ensure compliance with applicable laws and regulations;
- (5) proper recording and maintenance of internal committee minutes; and
- (6) written and board of director approved plan for audit of fiduciary activity.<sup>122</sup>

Additionally, the private trust company should put in place a due diligence system to effectively select and review the performance of third party service providers and advisers.<sup>123</sup>

Unlike its regulated counterpart, an unregulated private trust company may have to register with the SEC as an investment adviser.<sup>124</sup>

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<sup>118</sup> See Reimer, *supra* note 109, at 189.

<sup>119</sup> See Ytterberg & Weller, *supra* note 3, at 629.

<sup>120</sup> See Harrington & Harding, *supra* note 69, at 693.

<sup>121</sup> See Ytterberg & Weller, *supra* note 3, at 629.

<sup>122</sup> *Id.* at 638–39.

<sup>123</sup> See *id.* at 639.

In the past, private trust companies were exempt from SEC registration under the private adviser exemption.<sup>125</sup> The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank Act),<sup>126</sup> however, repealed the private adviser exemption and replaced it with the family office exception.<sup>127</sup> To qualify under this new exception,

a private trust company . . . must be wholly owned by family clients ('Ownership Test') and exclusively controlled, either directly or indirectly, by family members or family entities ('Control Test. . .'). Both . . . tests can be met by having the family members, or trusts for their benefit as shareholders of the private trust company.<sup>128</sup>

Alternatively, a private trust company could simply delegate investment responsibilities to a separate investment adviser to avoid SEC registration.<sup>129</sup>

### 3. *Structure of a Private Trust Company*

A family must first decide the type of entity to operate its private trust company.<sup>130</sup> States typically authorize operation as a corporation or limited liability company,<sup>131</sup> with most families choosing the latter.<sup>132</sup> The entity is formed with the "limited purpose of providing trust services to a particular family or group of related individuals. . . ownership interest is usually vested in individual family members."<sup>133</sup>

Next, the family must decide on a governance structure that facilitates the overall management of the trust company, the investment of

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<sup>124</sup> See Reimer, *supra* note 109, at 371. If a private trust company receives compensation for providing securities advice, it will be considered an investment adviser under the Dodd-Frank Act. See 15 U.S.C. 80b-2(a)(11).

<sup>125</sup> See *id.* at 339.

<sup>126</sup> Pub. L. No. 111-203, 124 Stat. 1376-2223 (2010) (codified as amended at 12 U.S.C. §§ 5301-5641).

<sup>127</sup> See Reimer, *supra* note 109, at 339.

<sup>128</sup> *Id.* at 371. A "family entity" includes any of the trusts, estates, companies, and other entities included in the definition of family client. See *id.*

<sup>129</sup> See FLA. SENATE, *supra* note 113, at 2.

<sup>130</sup> See Goodwin, *supra* note 5, at 476.

<sup>131</sup> See Ytterberg & Weller, *supra* note 3, app. at 640.

<sup>132</sup> See Goodwin, *supra* note 5, at 476.

<sup>133</sup> *Id.* at 476-77.

trust assets, and the making of distributions to trust beneficiaries.<sup>134</sup> To this end, a private trust company usually consists of a Board of Directors, Distribution Committee, and Amendment Committee.<sup>135</sup> Tax considerations have helped shape the governance structure of a private trust company, including the makeup of the Distribution Committee and Amendment Committee.<sup>136</sup> These considerations are predicated on creating firewalls between grantors and beneficiaries of family trusts in order to limit the family's participation in tax-sensitive decisions.<sup>137</sup> Tax-sensitive decisions refer to those that could cause adverse tax consequences to the grantor, beneficiaries, or the trust.<sup>138</sup>

#### 4. Board of Directors

The Board of Directors, as the governing body of the private trust company, administers the general, day-to-day responsibilities.<sup>139</sup> These responsibilities include regulatory compliance, creation and review of internal policies and procedures, delegation of investment and administrative duties, and formation of internal committees.<sup>140</sup> The founding member or other shareholders may appoint the directors,<sup>141</sup> who are typically family members and trusted outside advisers.<sup>142</sup> Most states require a minimum number of directors, one of whom must typically be in-state.<sup>143</sup> A family can name a local attorney or other adviser to satisfy the residency requirement.<sup>144</sup>

#### 5. Distribution Committee

The Distribution Committee controls distributions from the trusts administered by the private trust company.<sup>145</sup> Its duties include the review, approval, rejection, or deferral of decisions related to these

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<sup>134</sup> See *id.*

<sup>135</sup> See Ytterberg & Weller, *supra* note 3, at 636–38.

<sup>136</sup> See *id.* at 637–38.

<sup>137</sup> See *id.* at 635, 637.

<sup>138</sup> See John Duncan & Michael Conway, *Anticipated: Ruling on PTCs, TR. & EST.*, July 2006.

<sup>139</sup> See Ytterberg & Weller, *supra* note 3, at 637.

<sup>140</sup> See *id.*

<sup>141</sup> See *id.*

<sup>142</sup> See Goodwin, *supra* note 5, at 477.

<sup>143</sup> See *id.* at 474.

<sup>144</sup> See *id.* at 477.

<sup>145</sup> See Ytterberg & Weller, *supra* note 3, at 637.

distributions.<sup>146</sup> The Distribution Committee also handles certain non-distribution decisions, like the beneficiaries' personal use of trust or estate property.<sup>147</sup>

Tax issues may arise where family members exercise too much influence over certain distribution decisions of the private trust company. Based on the suggested firewalls in Notice 2008-63 (discussed *infra* in Part III), the bylaws of the private trust company should prohibit a family member serving on the Distribution Committee from participating in distribution decisions involving any trust of which that family member or his or her spouse is either a grantor or beneficiary and any trust having a beneficiary to whom that family member or spouse owes a legal obligation of support.<sup>148</sup> A more conservative approach is to allow only independent persons to serve on the Distribution Committee.<sup>149</sup>

An independent person is . . . an individual who is not a grantor or beneficiary of a trust or estate being administered by the private trust company, and who is not a related or subordinate party as defined in section 672(c) as to any grantor or beneficiary of any such trust.<sup>150</sup>

Additionally, family members should not attend distribution meetings in which sensitive, discretionary distribution decisions are made; the minutes of these meetings should document the individuals present and how the discretionary distribution decisions were decided.<sup>151</sup>

#### 6. Investment Committee

The Investment Committee is responsible for the prudent investing of trust assets.<sup>152</sup> Major duties include selecting and monitoring investment advisers, reviewing investments of trust assets, and establishing investment policies for each trust account.<sup>153</sup> Unlike the Distribution

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<sup>146</sup> See *id.*

<sup>147</sup> See *id.*

<sup>148</sup> See Notice 2008-63, 2008-2 C.B. 261.

<sup>149</sup> See Ytterberg & Weller, *supra* note 3, at 637.

<sup>150</sup> *Id.* All "section" references are to the Internal Revenue Code.

<sup>151</sup> See RIA EST. PLAN. ANALYSIS, Private Trust Company (PTC) as Trustee of Family Trusts - Estate Tax Consequences Under Retained Life Estate Rule, § 43,325.1 at 3.

<sup>152</sup> See Ytterberg & Weller, *supra* note 3, at 638.

<sup>153</sup> See *id.*

Committee, family members may serve on the Investment Committee without jeopardizing any tax planning.<sup>154</sup>

#### 7. *Amendment Committee*

As with the Distribution Committee, the Amendment Committee is specifically recommended by Notice 2008-63.<sup>155</sup> And also like the Distribution Committee, only independent persons should serve on the Amendment Committee to comply with the Notice's firewalls.<sup>156</sup> The Amendment Committee has the exclusive power to make changes to the private trust company's governing documents with regard to: "(1) the creation, function, or membership of the Distribution Committee or of the Amendment Committee; (2) the provisions delegating exclusive authority regarding certain personnel decisions to the officers and managers; and (3) the prohibition against reciprocal agreements between family members."<sup>157</sup>

#### 8. *Ownership*

An important question yet to be addressed is who (or what) should own the entity—that is, the senior generation, the younger generation, or perhaps an irrevocable trust? While this may come down to personal preferences and the types of services the private trust company will provide, there are considerations to discuss with the family. From a control standpoint, the senior generation may desire to own the private trust company. The younger generation, on the other hand, may want to take the leading role in the family's financial operations and thus could be a viable owner. Alternatively, the trust company could issue voting and nonvoting stock tailored to the family's situation.

A trust may be the owner for asset protection purposes, as well as for probate avoidance. In this case, the private trust company often serves as the trustee of the owner-trust. Importantly, an irrevocable trust may be the safest option in order to comply with Notice 2008-63 and avoid adverse tax consequences. Similar to the role of the Amendment Committee discussed above, the irrevocability of the trust would ensure tax sensitive portions of organizational documents may not be amended. Finally, if the entity is structured as a pass-through entity (for example, a

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<sup>154</sup> *See id.*

<sup>155</sup> *See* Notice 2008-63, 2008-2 C.B. 261.

<sup>156</sup> *See* Ytterberg & Weller, *supra* note 3, at 638.

<sup>157</sup> *Id.*

limited liability company taxed as a partnership for federal income tax purposes), then reporting the flow-through net income (or loss) on the owner's income tax returns should be considered.

#### 9. Fees

The family must decide how the private trust company will be paid for the services it renders. A significant motivation for starting a private trust company may be to avoid the traditional percentage of assets under management fee schedule many corporate trustees charge. Accordingly, family members may desire to structure the engagement as an hourly billing or a similar arrangement more closely tied to services actually rendered. With regard to deductibility, trustee fees are usually deductible under section 212 on the trust's income tax return,<sup>158</sup> but services rendered by a private trust company combined with a family office may pose deductibility concerns if the family office's activities do not rise to the level of a "trade or business," but are instead merely a cost center for the family.<sup>159</sup>

### III. TAX CONSIDERATIONS

A family's decision to form a private trust company is generally not driven by tax concerns. Nonetheless, adverse income and transfer tax consequences pose important planning considerations. Planners should focus on the control and discretion that grantors and beneficiaries exercise over family trusts administered by private trust companies. Through proper governance structure and procedures, a family can avoid potentially negative tax consequences.

#### A. History

Although dating back over 150 years, private trust companies are still a relatively rare estate planning vehicle, and it is unclear exactly how they fit into the existing transfer tax provisions. The Service has issued only a handful of private letter rulings between 1998 and 2005, and it appears no court has addressed them otherwise. From an estate tax perspective, private trust companies went unaddressed until 2001 with

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<sup>158</sup> See Treas. Reg. § 1.212-1(i).

<sup>159</sup> See *id.*

the Service's first letter ruling on sections 2036, 2038, and 2041 inclusion issues.<sup>160</sup>

In 2005, the Service announced that it would no longer issue letter rulings on private trust companies because it was considering a revenue ruling.<sup>161</sup> Three years later, it issued Notice 2008-63 (the Notice), which was released as a first draft of guidance in the form of a proposed revenue ruling concerning the income, gift, estate, and GST tax consequences posed when family members create a private trust company that serves as a trustee of trusts of which the family members are grantors and beneficiaries.<sup>162</sup>

#### B. Notice 2008-63

The Notice's objective was to confirm income and transfer tax consequences from the taxpayer's use of a private trust company that were neither more nor less restrictive than the results that the taxpayer could have achieved directly, thereby putting the private trust company vehicle and the traditional trustee options on equal tax footing.<sup>163</sup> To ensure the ruling would achieve this intended result, the Service solicited the public's input and received comments from several prominent law firms and organizations, including the American College of Trust and Estate Counsel (ACTEC), the American Institute of Certified Public Accountants (AICPA), the New York State Bar Association's Tax Section, and the Florida Bar Real Property, Probate and Trust Law Section and Tax Section.

##### 1. *The Facts and Issues*

In the Notice, parents established an irrevocable trust for each of their children and grandchildren.<sup>164</sup> The children also established irrevocable trusts for their own descendants.<sup>165</sup> They were all discretionary trusts with power to distribute income and principal.<sup>166</sup> Each trust also provided the beneficiary with a non-general testamentary power of

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<sup>160</sup> See Priv. Ltr. Rul. 01-25-038 (June 22, 2001). From an income tax perspective, the Service addressed private trust companies in 1998 in a pair of letter rulings. See Priv. Ltr. Rul. 98-41-014 (Oct. 9, 1998); see also Priv. Ltr. Rul. 98-42-007 (Oct. 16, 1998).

<sup>161</sup> See Rev. Proc. 2005-3, 2005-1 C.B. 118.

<sup>162</sup> See Notice 2008-63, 2008-2 C.B. 261.

<sup>163</sup> See *id.*

<sup>164</sup> See Notice 2008-63, 2008-2 C.B. 261, 261.

<sup>165</sup> See *id.*

<sup>166</sup> See *id.*



appointment.<sup>167</sup> Finally, the grantor or primary beneficiary of each trust could appoint a successor trustee other than him or herself.<sup>168</sup> At the trusts' inception, the family named a corporate trustee that later resigned.<sup>169</sup> The family then formed the private trust company and named it successor trustee of each family trust.<sup>170</sup>

The Notice addressed five common issues posed by family trusts administered by a private trust company: (1) inclusion of the value of trust assets in a grantor's gross estate under section 2036 or under section 2038, (2) inclusion of the value of trust assets in a beneficiary's gross estate due to a general power of appointment under section 2041, (3) treatment of transfers to trusts as completed gifts, (4) effect on the status of a GST-exempt trust, and (5) treatment of a grantor or beneficiary as the owner of a trust for income tax purposes.<sup>171</sup>

## 2. *The Firewalls*

To avoid any adverse consequences, the Notice recommended a system of firewalls shielding grantors and beneficiaries from tax-sensitive situations. First, the Notice recommended the creation of a Discretionary Distribution Committee (DDC).<sup>172</sup> To prevent inclusion in a grantor's gross estate under sections 2036(a) or 2038(a), the DDC must have the "exclusive authority to make all decisions regarding discretionary distributions."<sup>173</sup> Furthermore, no member of the DDC may make discretionary distributions with respect to any trust of which that person or his or her spouse is either a grantor or a beneficiary, or, with respect to any trust of which the beneficiary is a person to whom the member or his or her spouse owes an obligation of support.<sup>174</sup> Finally, a shareholder of the private trust company may not change the governing provisions regarding the DDC.<sup>175</sup>

The Notice also recommended an Amendment Committee with the sole authority to make fundamental changes to the company's governing

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<sup>167</sup> *See id.*

<sup>168</sup> *See id.*

<sup>169</sup> *See id.* at 262.

<sup>170</sup> *See id.*

<sup>171</sup> *See id.* at 261.

<sup>172</sup> *See id.* at 263.

<sup>173</sup> *See id.* at 261–63.

<sup>174</sup> *See id.* at 263.

<sup>175</sup> *See id.*

documents, including changes to the creation, function, or membership of the DDC or the Amendment Committee itself.<sup>176</sup> The Amendment Committee must be composed of a majority of “individuals who are neither family members nor persons related or subordinate (as described in section 672(c)) to any shareholder . . . of the [company].”<sup>177</sup> The bylaws must vest exclusive authority in the officers and managers to make decisions regarding the personnel of the private trust company, such as hiring, firing, and compensating employees.<sup>178</sup> Finally, the bylaws must also prohibit family members from entering into reciprocal agreements with each other regarding discretionary distributions.<sup>179</sup>

### 3. *Inclusion in Grantor’s Estate Under Sections 2036 and 2038*

A private trust company may serve as the trustee of a family trust and not cause the value of the trust assets to be included in the grantor’s gross estate under sections 2036 or 2038.<sup>180</sup> The firewalls mentioned above will prevent family members from having a right or power under sections 2036(a) or 2038(a) or from inserting themselves in the position of having such a right.<sup>181</sup> By shielding grantors and their spouses from participation in certain discretionary distribution decisions, a family member may serve as an officer, director, or member on the DDC and not cause any portion of a trust to be includible in a grantor’s gross estate.<sup>182</sup> Finally, grantors who are also shareholders of the company similarly will not run afoul of sections 2036 or 2038.<sup>183</sup>

### 4. *Powers of Appointment Under Section 2041*

A private trust company may serve as the trustee of a family trust and not cause the value of the trust assets to be included in a beneficiary’s estate under section 2041.<sup>184</sup> By prohibiting both beneficiaries from involvement in sensitive discretionary distributions and family members from entering into reciprocal arrangements that affect

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<sup>176</sup> *See id.* at 262–64.

<sup>177</sup> *Id.* at 262.

<sup>178</sup> *See id.*

<sup>179</sup> *See id.*

<sup>180</sup> *See id.* at 262–63, 268.

<sup>181</sup> *See id.* at 263.

<sup>182</sup> *See id.*

<sup>183</sup> *See id.*

<sup>184</sup> *See* Notice 2008-63, 2008-2 C.B. 261, 264, 268.

distribution decisions, the firewalls ensure that a beneficiary will not be deemed to have a general power of appointment, that is, the power to distribute trust assets to himself, his estate, his creditors, or the creditors of his estate.<sup>185</sup> Thus, beneficiaries are free to serve as officers, directors, and members of the DDC without triggering section 2041, as long as they cannot participate in distributions for their own benefit.<sup>186</sup> Further, beneficiaries who are shareholders of the private trust company or participate in its daily activities—such as decisions regarding investments, or the retention of attorneys, accountants, or other professional advisors—also will not trigger section 2041.<sup>187</sup>

#### 5. Gift Completion

A private trust company may serve as the trustee of a family trust in which the trustee has discretionary powers and not cause the grantor's transfer to that trust to be deemed an incomplete gift under section 2511.<sup>188</sup> By precluding grantors and their spouses from participation in discretionary distributions from trusts of which they are the grantors or beneficiaries, as well as prohibiting family members from entering into reciprocal agreements that affect distribution decisions, grantors will not have the power to change the interests of the beneficiaries.<sup>189</sup> Thus, the transfers to the trusts will be deemed completed gifts.<sup>190</sup>

#### 6. GST Tax

A private trust company may be appointed and serve as the trustee of a family trust and not cause adverse GST tax consequences.<sup>191</sup> The appointment of the private trust company as successor trustee is considered an administrative change that does not shift the beneficial interests in a trust to a beneficiary that occupies a lower generation than the person who held the beneficial interest prior to the resignation of the corporate trustee.<sup>192</sup> Thus, the appointment of the private trust company

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<sup>185</sup> See I.R.C. § 2041(b)(1); see also Notice 2008-63, 2008-2 C.B. 261, 264.

<sup>186</sup> See Notice 2008-63, 2008-2 C.B. 261, 264.

<sup>187</sup> See *id.*

<sup>188</sup> See *id.* at 265.

<sup>189</sup> See *id.*

<sup>190</sup> See Treas. Reg. § 25.2511-2(b) (retained power affecting beneficial enjoyment); see also Treas. Reg. § 25.2511-2(c) (retained power to name and change interests of beneficiaries).

<sup>191</sup> See Notice 2008-63, 2008-2 C.B. 261, 266.

<sup>192</sup> See *id.* at 265.

does not change the GST-exempt status of a trust or the inclusion ratio of a GST trust.<sup>193</sup>

### 7. Grantor Trust Treatment

A private trust company may serve as the trustee of a family trust and not cause a grantor or beneficiary to be considered the owner of that trust for income tax purposes under sections 673, 676, 677, or 678.<sup>194</sup> The company's administrative controls are not considered exercisable primarily for the benefit of the grantors of the family trusts, and a grantor's ownership or management of, or employment by, the private trust company will not cause ownership treatment.<sup>195</sup> Whether a grantor or beneficiary is determined to be the owner of the trust under section 675 is a question of fact based on the operation of the private trust company, the DDC, and the family trusts.<sup>196</sup>

With regard to ownership under section 674, the issue turns on the particular powers of the trustee, as well as the number of members on the DDC who are deemed "related or subordinate" to the grantor as defined in section 672(c).<sup>197</sup> A "look-through" test is applied to the DDC to determine whether the powers to affect a trust's beneficial enjoyment will be attributed to the grantor.<sup>198</sup> Under the test, each DDC member who is authorized to act on behalf of the grantor's trust is treated as an individual trustee in determining whether that person is related or subordinate to the grantor; no more than half of the members of the DDC may be related or subordinate to the grantor.<sup>199</sup> A non-family member serving on the DDC who is an employee of the private trust company will be related or subordinate to any grantors who are officers or managers in the private trust company.<sup>200</sup> Further, a grantor's ownership of voting stock of the private trust company will not cause members of the DDC to be related or subordinate because of the wall erected by the Amendment Committee around the DDC.<sup>201</sup>

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<sup>193</sup> See Treas. Reg. § 26.2601-1(b)(4)(i)(E), Examples 4 and 10.

<sup>194</sup> See Notice 2008-63, 2008-2 C.B. 261, 267-68.

<sup>195</sup> See *id.* at 268.

<sup>196</sup> See *id.*

<sup>197</sup> *Id.*

<sup>198</sup> See *id.* at 267.

<sup>199</sup> See *id.*

<sup>200</sup> See *id.*

<sup>201</sup> See *id.* at 268.

Finally, certain changes in circumstances would not change the private trust company's tax consequences provided for under the Notice.<sup>202</sup> For example, discretionary distributions made pursuant to an external ascertainable standard or sole ownership of the private trust company vested in a single family member would not cause any different tax results.<sup>203</sup> A change, however, to the governing documents or the make-up of the DDC or the Amendment Committee could trigger adverse tax consequences.<sup>204</sup>

Although the Notice serves as a roadmap to avoid most adverse tax consequences posed by private trust companies, it falls just short of achieving its goal of confirming tax consequences that are not more restrictive than the consequences that could have been achieved by the taxpayer directly. The flat prohibition on participation by a family member in all discretionary distribution decisions with respect to any trust of which that person or his or her spouse is either a grantor or a beneficiary is overly broad and needlessly conservative. An individual trustee may participate in discretionary distributions to or for the benefit of other family members pursuant to an ascertainable standard and not cause inclusion under sections 2036 or 2038.<sup>205</sup> Thus, the Notice's ban on involvement in *all* discretionary distributions, including those subject to an ascertainable standard, is more restrictive than the results that could have been obtained by using an individual trustee.

Nearly a decade has passed since the Service put the private trust company's transfer tax issues in "areas under study" limbo, whereby the Service will not issue rulings or determination letters,<sup>206</sup> and eight years have come and gone since it issued Notice 2008-63. As of the date of this publication, the private trust company remains a largely untested vehicle, and estate planners are still without firm tax guidance. Once guidance is finally released, however, there could be a "flood of PTC formations" as wealthy families decide to take the plunge with the Service's blessing.<sup>207</sup> Hopefully the Service will dust off its first draft and release a final revenue ruling in the near future. Until then, however, ignorance of the Notice and its prescribed firewalls is at the family's peril.

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<sup>202</sup> *See id.*

<sup>203</sup> *See id.*

<sup>204</sup> *See id.*

<sup>205</sup> *See Estate of Cutter v. Comm'r*, 62 T.C. 351, 354 (1974).

<sup>206</sup> *See Rev. Proc. 14-3*, 2014-1 I.R.B. 111.

<sup>207</sup> John P.C. Duncan, *Breaking the PTC Logjam*, Tr. & Est., Sept. 2008.

#### IV. LEGISLATIVE LANDSCAPE

Due to their increased popularity in recent years, private trust companies have caught the eye of many state legislatures that now welcome them—and the business they bring to their states—with open arms. Indeed, interstate rivalry for a piece of the private trust company pie is a powerful motivator for passing attractive legislation, which has led to a sharp increase in the number of private trust company statutes introduced in the past several years. In fact, private trust company legislation in two more states, Florida and Washington, recently took effect in 2015.<sup>208</sup>

Not all private trust company legislation is created equal. The most dynamic state statutes offer both a regulated and unregulated option, whereas others offer one or the other. Some states authorize unregulated private trust companies not by explicit statute, but instead by allowing them to operate as limited purpose trust companies for the exclusive purpose of providing trustee services to a family.<sup>209</sup> A final flavor allows private trust companies to operate by administrative exception to the state's Banking Act.<sup>210</sup>

Private trust companies may operate in the following states: Alaska,<sup>211</sup> Arkansas,<sup>212</sup> Delaware,<sup>213</sup> Louisiana,<sup>214</sup> Massachusetts,<sup>215</sup> Mississippi,<sup>216</sup> Nevada,<sup>217</sup> New Hampshire,<sup>218</sup> North Carolina,<sup>219</sup> Oklahoma,<sup>220</sup> Pennsylvania,<sup>221</sup> South Dakota,<sup>222</sup> Tennessee,<sup>223</sup> Texas,<sup>224</sup>

<sup>208</sup> See WASH. REV. CODE § 30B.64.010(1); *see also* FLA. STAT. § 662.115.

<sup>209</sup> See Harrington & Harding, *supra* note 69, at 693–94.

<sup>210</sup> See DELOITTE, PRIVATE TRUST COMPANIES AN ALTERNATIVE APPROACH FOR WEALTHY FAMILIES, at 2 (2009).

<sup>211</sup> See ALASKA STAT. §§ 06.26.200 - .245.

<sup>212</sup> See ARK. CODE ANN. § 23-51-118.

<sup>213</sup> See DEL. CODE ANN. tit. 5, § 774 (allowing limited purpose trust companies).

<sup>214</sup> See LA. REV. STAT. §§ 6:591- :593.

<sup>215</sup> See MASS. GEN. LAWS ch. 172, § 9A (allowing limited purpose trust companies).

<sup>216</sup> See MISS. CODE. ANN. §§ 81-27-4.301 - .303.

<sup>217</sup> See NEV. REV. STAT. §§ 669A.010 - .135.

<sup>218</sup> See REV. STAT. ANN. §§ 383-D:1-101 - D:12-1203.

<sup>219</sup> See N.C. GEN. STAT. §§ 53-363 to -365.

<sup>220</sup> See OKLA. STAT. tit. 6, §§ 1740, 1741, 1755.

<sup>221</sup> See Ytterberg & Weller, *supra* note 3, at 629.

<sup>222</sup> See S.D. CODIFIED LAWS §§ 51A-6A to -66.

<sup>223</sup> See TENN. CODE ANN. §§ 45-2-2001 - 2004.

Virginia,<sup>225</sup> and Wyoming.<sup>226</sup> A minority of states authorize both regulated and unregulated private trust companies; these states include Florida, Massachusetts, Nevada, New Hampshire, Pennsylvania, Tennessee, and Wyoming.<sup>227</sup> Currently, the most popular private trust company states are Alaska, Delaware, Nevada, New Hampshire, South Dakota, Tennessee, and Wyoming.<sup>228</sup>

No doubt states have noticed the increase in private trust companies, and their legislatures have responded accordingly. The mere passage of legislation, however, does not guarantee an influx of business. Despite enacting a private trust company statute in 2008, Colorado received no applications and, as a result, recently repealed its law.<sup>229</sup> In view of the fact that a majority, if not all, of the top-rated trust jurisdictions now authorize private trust companies, we may likely see a leveling off of new legislation.

## V. CONCLUSION

The private trust company was born in the Gilded Age when America's wealthiest families used them to shepherd their new fortunes to future generations. Today, this estate planning tool serves the same goals of allowing a family to take an active role in the management of its portfolio and administration of its trusts, while still preserving careful tax planning. Before going the private route, a family must be willing to make substantial commitments of both money and time, which renders high net worth a necessary—but not a sufficient—condition to justify integrating this vehicle into a family's estate plan. The future of the private trust company is bright as the states continue to pass and improve legislation and we inevitably get closer to final IRS guidance.

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<sup>224</sup> See TEX. FIN. CODE ANN. § 182.011.

<sup>225</sup> See VA. CODE. ANN. §§ 6.2-1074 - 1080.

<sup>226</sup> See WYO. STAT. ANN. §§ 13-5-101 - 113.

<sup>227</sup> Goodwin, *supra* note 5, at 473 n 23; see also Ytterberg & Weller, *supra* note 3, at 629.

<sup>228</sup> See Harrington & Harding, *supra* note 69, at 694.

<sup>229</sup> See 2013 Colo. Sess. Laws 1464; see also OFFICE OF POLICY, RESEARCH AND REGULATORY REFORM, DEP'T OF REGULATORY AGENCIES 2012 SUNSET REVIEW: BANKING BOARD AND THE DIVISION OF BANKING 38 (2012).