PRIVATE TRUST COMPANIES: A POWERFUL TOOL FOR FAMILY WEALTH STEWARDSHIP

BRYAN A. PHILLIPS
ALAN V. YTTERBERG
Houston
Ytterberg Deery Knull LLP

State Bar of Texas
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CHAPTER 5.1

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This article provides a general overview of the increasingly popular private trust company. By examining their characteristics, formation, licensing, and management structure, the authors explore why more and more wealthy families are turning to PTCs as a valuable tool in the preservation and management of wealth for future generations. The article is also based on lessons learned over years of establishing and helping administer private trust companies, and it highlights some pitfalls to avoid and issues that families should consider before committing to a family-owned corporate trustee. The Appendix contains a chart summarizing relevant attributes of multiple states that are considered prime jurisdictions in which to form a private trust company.

I. INTRODUCTION

One of the toughest challenges that wealthy families face is the growth and preservation of their wealth from generation to generation. This challenge is compounded by the presence of potential threats like litigation, divorce, and the federal transfer tax system.

Most of these families hold the common vision that their family legacy be maintained in both value and mission, while providing a better life for their members. Often this takes the matriarch or patriarch to legal counsel, where a well-developed estate planning strategy is put in motion, typically involving the use of irrevocable trusts. A high premium is placed on tax mitigation, distribution limits, and creditor protection, but families often struggle with how and when to involve beneficiaries versus other trusted individuals in the administration and investment of their trusts. This problem is compounded by the fact that, as wealth in the United States has skyrocketed, the assets in these trusts will likely pass through multiple generations of family members, the qualifications and interests of which are unknown.

Historically, the "trustee" function was rolled up into one individual or entity, who performs all the functions of administration, investment, and distribution of trust assets. Often a family member or trusted friend would be chosen to be trustee, but they may not be up to the task of managing significant wealth. Highly-qualified individuals could be appointed, but may not want to subject themselves to fiduciary liability. Individuals can also suffer from unpredictable personality changes and death, making transitions inevitable and difficult. Other families have chosen to engage a commercial corporate fiduciary, with their expertise, consistency, and capitalization. The existence of unique trust assets and need or desire for control, however, may lead the family to look beyond the traditional corporate fiduciary.

As a result, many wealthy families tend to seek and embrace trust and entity structures that encourage and create opportunities for each generation to discuss and influence the management of family wealth. This article will examine one such structure, the private trust company.

II. THE PRIVATE TRUST COMPANY

A private trust company (sometimes referred to herein as a "PTC"), also known as a family trust company or an exempt trust company, is an entity authorized to act as a fiduciary under state law for one or more families and does not solicit business from the general public. Private trust companies have existed in some form for decades. Even some well-known commercial trust companies started out as licensed trust companies formed to serve a single family. *See,* e.g., www.bessemertrust.com/what-makes-us-different/key-facts. Since then, modern private trust company statutes have evolved to lessen the regulatory burden on a trust company that only provides trust and fiduciary services to a limited class of family members, entities, charities, and family employees. Many states define this class by reference to a specified degree of kinship to a certain designated relative. *See***,** e.g.**,** Nev. Rev. Stat. § 669A.070; N.H. Rev. Stat. § 383D:4-402; Tenn. Code Ann. § 45-2-2001; *and* WY Stat § 13-5-301(vii).

A. Advantages of a Private Trust Company

Although by no means an exhaustive list, below is a summary of a few of the reasons why a wealthy family might find that a private trust company is a good trustee and governance solution:

1. <u>Family Participation</u>

One of the keys to preserving a family legacy is the development and growth of the human and intellectual capital of the family across multiple generations. Too many times, older generations will resist participation by younger generations in family business or trust matters. A private trust company provides a forum for current and future family members to have a voice in the management of family wealth held in irrevocable trusts long before they might otherwise become trustee. Further, this can be done without jeopardizing the spendthrift, tax and other benefits of such trusts. *See* I.R.S. Notice 2008-63, 2008-31 I.R.B. 261, *available at* http://www.irs.gov/pub/irs-drop/n-08-63.pdf. Although every family is different, finding ways for younger generations to participate in the PTC is key to preparing them for taking over and getting them to witness and "buy-in" to the importance of family governance. As will be discussed later in this Article, the administration of trusts by a PTC can be bifurcated into separate decision-making committees, populated with members based on expertise, governance needs, and tax considerations tailored to that committee. For example, an Investment Committee can be responsible for the investment management of trust assets, offering a mechanism for family members to get involved with trust investments and share their personal interests, without being involved with distribution or other trust decisions. Members of family lines can also serve as full or advisory members of the Board of Directors to participate in the overall governance and oversight of the family assets.

2. <u>Improved Continuity</u>

Traditionally, wealthy families have named family members, trusted advisors, or financial institutions as trustees of family trusts. Unfortunately, there is a degree of uncertainty with these choices because individuals can die, become incapacitated, move, retire, or otherwise become unavailable, and financial institutions can merge, fail, or change personnel. As an alternative, having a private trust company as trustee provides much more stability, because a private trust company can be in existence for as long as the family needs. Personnel can be tailored to fit the family's specific needs, in the timeframe and manner as dictated by the family.

3. <u>Flexibility and Adaptability</u>

Historically, it was common for trust planning to involve co-trustee arrangements to allocate duties among multiple parties. Still others would include distribution or investment standards to provide guidance to trustees that fit the then-philosophy of the family. Although effective so long as the status quo is maintained, irrevocable trusts can fall short when family circumstances change through multiple generations, but the trust terms cannot. This issue has been mitigated somewhat in recent years, as irrevocable trusts have become less immutable due to significant developments in state trust decanting laws. In many states, a trustee can now distribute the assets of a trust to another trust and, in the process, make certain changes to the trust terms. *See* Chapter 112, Subchapter D, of the Texas Property Code.

Although decanting represents a huge step forward in the flexibility of multigenerational trusts, going through a decanting process to make "tweaks" to trustee governance can be a bit like shooting a fly with a howitzer. In contrast, private trust companies are typically organized as limited liability companies with easily amendable operating agreements. If enough PTC-owning family members agree (a hurdle that can be intentionally high or low depending on how the PTC is originally set up), governance and operational changes can be made to the private trust company without upsetting the trust structure, creating new trusts, or generating significant legal fees.

4. <u>Director and Officer Structure –Limited Liability and Governance</u>

Trustees of trusts are generally subject to a fiduciary duty that is considered a higher standard of conduct than the "business judgment" rule imposed on most corporate directors. See *Rawhide Mesa-Partners, Ltd. v. Brown McCarroll, L.L.P.*, 344 S.W.3d 56, 60 (Tex. App.— Eastland 2011, no pet.); *and* Nev. Rev. Stat. Ann. § 164.745(1)-(2). Some state laws allow fiduciary duties and responsibilities to be waived or limited by the trust grantor (*See* Tex. Prop. Code Ann. § 111.0035) but highly qualified individuals are (understandably) hesitant to accept a fiduciary role and expose themselves and their assets to liability under a fiduciary duty standard.

In contrast, a private trust company arguably puts its directors, officers, and committee members in a position more akin to directors of a corporation than that of trustees. *See* Texas Finance Code § 181.005, *but see* Texas Finance Code § 183.110. The "business judgment rule" generally provides that decision-makers of a corporate entity will be protected for decisions made on an informed basis, in good faith, and in the honest belief that the decisions were made in the best interest of the entity. *See*, e.g., Nev. Rev. Stat. Ann. § 78.138(3); *and Sneed v. Webre*, 465 S.W.3d 169 (Tex. 2015) (citing *Cates v. Sparkman,* 11 S.W. 846, 848-49 (Tex. 1889)). In addition to the general rule of limited personal liability and the business judgment rule, it is quite common to have language in the bylaws or operating agreement of the private trust company that indemnifies and holds harmless, to the fullest extent permitted by applicable law, the directors and other designated parties from claims and expenses arising from their role at a private trust company.

A good governance structure is necessary, however, for a private trust company to provide these liability protections. Formalized processes such as regular meetings, minutes, prepared reports containing information material to the issue at hand, and disclosure of potential conflicts should be developed and followed to put those involved in the best position to invoke the business judgment rule. These processes will allow the private trust company to be better equipped to (i) recruit highly qualified individuals to serve the family, and (ii) provide participatory and non-participatory family members comfort that decisions are being made properly and documented in a way that makes oversight and review more efficient.

5. <u>Choice of Trust Jurisdiction</u>

Several states have been progressive in modernizing their trust laws. Although a comparison of state trust law is beyond the scope of this Article, the ability to establish and operate a private trust company in a jurisdiction other than the family's home jurisdiction provides significant flexibility when doing trust planning. Beyond trust law, families in jurisdictions that impose state income tax on trust income may seek to use a private trust company to move their existing trusts and form new trusts in a state with little or no income tax.

6. Investment Flexibility

It is commonplace for wealthy families to have heavy concentrations of their wealth in assets such as family businesses, real estate, or in stock of a particular publicly traded company. Private trust companies have the flexibility to be less risk averse than other types of fiduciaries and better attuned to the special interests the family may have in certain assets. The Uniform Prudent Investor Act, which has been adopted in 46 states, lends support to families who want to retain heavily concentrated assets. For example, the UPIA provides that diversification does not have to occur if the trustee reasonably determines that, because of special circumstances, the purposes of the trust are better served without diversification. *See*, e.g., Tex. Prop. Code Ann. § 117.005. In addition, the Act provides a list of circumstances that a trustee shall consider in investing and managing trust assets as relevant to the trust or its beneficiaries. One such circumstance is an asset's special relationship or special value, if any, to the purposes of the trust or to one or more of the beneficiaries. *Id.* at § 117.004. Commercial corporate trustees may find it difficult to evaluate and act on such special circumstances. On the other hand, family members and trusted advisors serving on the Investment Committee of a private trust company will likely be more in tune with the special relationship or special value that a particular asset has to the overall purpose of the trust or to certain family members.

Not only can a private trust company provide an opportunity for the participation in the management of family wealth across multiple generations, but it can also expand the available investment opportunities for certain family members. For instance, some family trusts standing alone may not meet the minimum investment requirements for alternative investments such as private equity funds and hedge funds. A private trust company can provide an avenue for these trusts to gain access to alternative investments that they would not normally have. Trust companies and banks that qualify to act as fiduciary are permitted by states to establish common trust funds. *See,* e.g., Nev. Rev. Stat. § 164.080(1); N.H. Rev. Stat. § 391:1(2010); Tex. Prop. Code Ann. § 113.171; *and* Wyo. Stat. Ann. 2-3-402. As a result, family trusts regardless of their size would be able to gain access to alternative investments by investing in a common trust fund.

B. Jurisdictional Considerations Before Deciding on a Private Trust Company

Despite being an excellent tool for many wealthy families, the decision to form a private trust company should not be (and often isn't) taken lightly. Foremost in the mind of most PTC clients is the potential cost and time commitment associated with forming and operating a PTC. Although both of these vary greatly depending on the circumstances of the family and the trusts and assets to be administered, the factor next most impactful on cost and time commitment is the choice of PTC jurisdiction. Factors to consider when choosing a PTC jurisdiction include:

- Modern private trust company laws – Consider the scope of potential family clients that may be served by the PTC, capital requirements, reporting and examination requirements, residency of directors and officers, and meeting requirements.
- Favorable attitude toward PTCs by regulatory authority – Despite legislative action, it is important that a banking department has "bought in" to the idea of PTCs and their lack of threat to the public interest. This allows for a seamless and efficient relationship between PTC management and regulators.
- No state income tax for trusts – This can be one of the most impactful benefits of establishing a private trust company in a jurisdiction other than that of the home state. As discussed below, however, strict adherence to the nexus and governance structure will be necessary.
- Up-to-date trust laws – Consider the potential for changing the governing law of existing trusts to and creating new trusts under the often more favorable and flexible trust laws of the PTC jurisdiction (e.g., decanting powers and RAP periods).
- Accessibility – Again, as discussed below, many actions of the PTC and its Directors and Officers need to take place in the chosen jurisdiction. Therefore, ease of access to the jurisdiction and likelihood of particular family members and PTC participants to make the trip should be considered.

Additionally, the following outlines some crucial factors to consider prior to choosing a jurisdiction and embarking on the development and chartering process. The chart in the Appendix also provides a brief side-by-side comparison of the primary PTC states.

1. Establishing and Maintaining Nexus – "Planting the Flag"

Each state's regulatory banking department is responsible for ensuring that any entity providing fiduciary services within its borders qualifies to do so under applicable state statutes and rules. This becomes particularly crucial when a PTC is formed in a jurisdiction other than the family's or family office's home state. In this case, not only does the PTC need to be formed and operated in a way to satisfy the laws and rules of the chosen jurisdiction, but care must also be given to not engage in "trust business" back in the home state such that the home state regulatory authority, or worse the home state taxing authority, determines that the PTC is really located in the home state.

The threshold issue to address in each jurisdiction is the local presence or nexus requirement for a PTC. Most PTC jurisdictions require that a physical office be located in the state, with at least one local trust officer to provide administrative services and communicate with representatives of the banking department, if necessary. *See* Nev. Rev. Stat. § 669A.140; WY Stat § 13-5-604; Tenn. Code Ann. § 45-2-2002; *and* Tex. Fin. Code § 182.014. One or more local banking accounts is also typically required to hold the minimum capital and operational funds. *See*, e.g., Nev. Rev. Stat. § 669A.140. Beyond this physical presence, how the PTC conducts its business is imperative to maintain nexus with the desired jurisdiction. Although perhaps not formally required by state law, the following should occur in the PTC jurisdiction:

- The acceptance of all new trust business;
- At least one, but preferably two or more, meetings of the Board of Directors per year;
- Adoption of budget and trustee fee schedule;
- Distributions and other tax sensitive decisions; and
- Depending on the reach and impact of the home state laws, decisions involving significant investment changes (i.e., more than just ongoing investment monitoring).

Taking these steps not only bolster nexus with the PTC jurisdiction, but also have the added benefit of encouraging good governance and providing substance to the separate existence of the PTC from its decision-makers for liability and tax purposes.

2. <u>Licensing, Regulatory Oversight and Disclosure Requirements – "Regulated" vs. "Unregulated"</u>

States with modern private trust company laws recognize the distinction between trust companies that solicit business from the general public and private trust companies that provide trust and fiduciary services to a single family. From a regulatory oversight standpoint, there is a public interest to protect in the former, but not the latter. Nev. Rev. Stat. § 669A.010(2). Therefore, the level and frequency of regulatory oversight for private trust companies is appropriately reduced in these states and comes primarily in the form of initial licensing, periodic reporting and examinations.

a. Licensing Process

The application process for a proposed private trust company to obtain a charter or license varies from state to state, but generally consists of some variance of the following items: (1) application form; (2) proposed organizational documents (certificates of formation; operating agreement; etc.); (3) strategic business plan; (4) pro-forma financial projections; (5) biographical and financial information on the proposed directors, officers, and principal shareholders; (6) application fee; and (7) request for exemption from designated regulatory requirements, if permitted by statute or regulatory authorities. It is important to note that states are keenly aware of the importance that wealthy families place on confidentiality, and typically provide that most, if not all, of the information submitted during the licensing process is given confidential treatment. Hearings on a license application are rarely required, but some states (*e.g.*, Texas) complete a formal examination of the private trust company and its proposed business plan and pro formas before granting a license. Tex. Fin. Code § 182.004. The laws or regulations in each state typically provide a limited timeframe within which the banking commission must evaluate the application and either grant or reject the application.

b. Ongoing Regulatory Oversight

Most states require some form of annual report to be filed with the state regulatory agency, which can include items such as:

- Financial Statements (Balance Sheet and Income Statement) of the PTC, as an entity;
- PTC bank statements with reconciliations;
- High-level breakdown of trust assets;
- Changes in ownership and control;
- Updated bonding/insurance certificates;
- Renewal fees; and
- Comparisons to initial business plan and pro-forma financials.

Beyond this annual reporting, licensed PTCs are subject to periodic examination by the applicable banking commissioner's office. PTCs in states such as Nevada and Wyoming are examined every three years, while a state like Texas examines its exempt trust companies every year. Nev. Admin. Code § 669A.200; WY Stat § 13-5-607; Tex. Fin. Code § 181.104. The scope and depth of the examination varies by state, but the primary focus of the examination is to ensure that the PTC is following its procedures and carrying out its fiduciary responsibility in a sound manner. An examination typically begins with the agency requesting certain financial and operational documentation from the PTC, with follow-up spot testing of select PTC transactions (*e.g.*, recent distribution and investment decisions). Pursuant to conversations with representatives of the Tennessee Department of Financial Institutions, for example, the TDFI gathers this information and then evaluates the PTC based on the Federal Financial Institutions Examination Counsel MOECA Rating Components of: Management, Operations/Internal Controls/Auditing, Earnings, Compliance, and Asset Management. Although seemingly daunting, the important take-away is that none of the regulatory agencies are out to "fail" a PTC. In our experience, each examination team is eager to work with the PTC client to help them address any areas of concern or where improvements in governance and operations can be made.

c. Unlicensed/Unregulated Private Trust Companies

Certain states (*e.g.*, Florida, Nevada, Wyoming) allow a private trust company to provide trust and fiduciary services to a single family without first obtaining a license. Fla. Stat. § 662.114; Nev. Rev. Stat. § 669A.100; WY Stat § 13-5-701(d). These unregulated or unlicensed private trust companies enjoy reduced or no capital requirements or state regulatory oversight, and formation typically only necessitates filing the organizational documents and other registrations or notifications required by the local jurisdiction. As a result, an unlicensed PTC can become operational sooner and with less financial commitment and expense than a regulated or licensed private trust company.

At first glance, there is a definite allure to an unregulated or unlicensed trust company, but drawbacks exist. First, operating in the fiduciary world without the safety net of regulatory oversight can be risky. Those non-family individuals running a PTC often prefer to have a regulatory agency confirm that the PTC has an infrastructure and is operated based on sound fiduciary processes, policies, and procedures. Second, the unsupervised nature of an unlicensed PTC likely causes it to be subject to the Investment Advisers Act of 1940, thereby necessitating reliance upon the "family office exception" to avoid registration with the SEC as an investment advisor. 15 U.S.C. §§ 80b-2(a)(11)(A). Third, a private trust company often faces situations in which it will be called upon to extend its reach beyond the state where it is formed, whether because the PTC has been formed in a jurisdiction other than the family's home state or due to the transient nature of wealthy families. Unlicensed PTCs have limitations on their ability to engage in certain interstate activities. Many states require reciprocity of laws as a prerequisite for an out-of-state trust company to act as a fiduciary in that state. See Tex. Estates Code § 505.003. Unlicensed PTCs may find it difficult to obtain certain positions, such as serving as an executor of an estate or engage in certain business in states that do not recognize unlicensed trust companies. Keep in mind, however, that the investment and business limitations often can be addressed with the use of investment entities or other similar means of holding assets. Finally, a private trust company must qualify to serve as successor trustee of existing family trusts. If there are irrevocable family trust documents that require a trustee to have minimum capital and a state or national charter, an under-capitalized or unregulated or unlicensed trust company may be prohibited from serving as successor trustee of those trusts unless the trusts are decanted or judicially modified.

III. PRIVATE TRUST COMPANY GOVERNANCE AND MANAGEMENT

A. Independence/Tax Considerations

Although the structure of a private trust company should be designed to fit the governance and fiduciary needs of the family, it is imperative that the ultimate structure be respected by the IRS and not put the family in a worse position than if they had not utilized a private trust company. The IRS issued Notice 2008-63 on July 11, 2008, which contained a proposed revenue ruling addressing the transfer tax and income tax consequences of a private trust company serving as trustee of family trusts. I.R.S. Notice 2008-63, 2008-31 I.R.B. 261, *available at* http://www.irs.gov/pub/irs-drop/n-08-63.pdf. The proposed revenue ruling incorporates and expands on views approved by the IRS in prior private letter rulings. *See* PLR 9841014; PLR 9842007; *and* PLR 200125038. The stated goal of the IRS in the proposed revenue ruling was to establish that the tax consequences of using a private trust company as trustee were no more restrictive than if the individual taxpayer acted directly as trustee.

The proposed revenue ruling examines two situations involving the replacement of an institutional trustee of family trusts with a newly created private trust company. Situation 1 deals with a private trust company formed and governed under a state statute. Situation 2 looks at a private trust company established in a state without a governing statute.

Within the context of these two situations, state law and the governing documents, respectively, restricted certain family involvement in the activities of the trust company to prevent adverse transfer tax consequences from occurring. These restrictions provide that: (1) no family member serving on the Discretionary Distribution Committee (DDC) can participate in DDC activities involving any trust of which that family member or his or her spouse is either grantor or beneficiary, or any trust having a beneficiary to whom that family member or his or her spouse owes a legal obligation of support; (2) family members cannot enter into reciprocal agreements, express or implied, regarding discretionary distributions from any trust for which the private trust company is serving as trustee; and (3) only officers and managers of the trust company can participate in certain personnel decisions.

The family that is depicted in the proposed revenue ruling owns 100% of the private trust company stock. As a result, one of the issues addressed in this proposed revenue ruling is the potential for family shareholders to change the applicable provisions of the governing documents regarding the DDC, and thus cause estate tax inclusion under I.R.C. § 2036(a) or § 2038(a).

In Situation 1, state law prohibits the family from changing the provisions of the DDC governing documents. In Situation 2, the IRS presents us with the concept of an Amendment Committee, with the sole authority to make changes to the governing documents regarding the creation, function, or membership of the DDC or of the Amendment Committee itself, the provisions delegating exclusive authority regarding personnel decisions to officers and managers, and the prohibition against reciprocal agreements between family members. Two of the three members of the Amendment Committee are non-family members, nonemployees of the private trust company, and not related or subordinate to any family member as defined by I.R.C. § 672(c).

With regard to income tax matters, however, it should be noted that the proposed revenue ruling does not provide an upfront safe harbor to avoid triggering certain provisions of the grantor trust rules. For instance, whether the grantor trust rules will be triggered under the administrative powers of I.R.C. § 675 is a question of fact, and it cannot be determined until the income tax returns of the parties involved are examined.

The IRS requested and received comments from numerous practitioners regarding the proposed revenue ruling, but final guidance has never arrived and seems unlikely in the near term. Anecdotally, the IRS had more important matters to deal with in 2008/2009 after issuing the proposed revenue ruling. For now, the proposed revenue ruling serves as the primary guidance from the IRS regarding firewalls that can and should be incorporated into the governing documents of a private trust company.

Well-drafted firewalls are not enough, however, if they are not respected. Families that form private trust companies must commit to populating and running the trust company within the restrictions and with the formalities necessary to give effect to the terms of the governing documents. Although a well-run PTC can provide a family with more flexibility in trust administration than they could have with individual trustees, short-cutting the governance structure or running afoul of the firewalls can result in worse tax results than if the PTC had never been used.

B. Ownership

Although often taken for granted by families when they first decide to form a private trust company, the ownership structure of the PTC can be the most important consideration for successful long-term stewardship of family wealth. The owner of the private trust company appoints the Directors and holds the power to adopt and amend the governing documents of the PTC (subject to appropriate tax-motivated limitations, *i.e.*, the Amendment Committee concept). Therefore, despite not being responsible for the day-to-day operation of the PTC, ultimate authority over the trust company and its direction lies with the owners.

Many options exist when determining how a PTC should be owned. Although a full analysis of each possibility is beyond the scope of this Article, it is important to address two primary directions the ownership structure can take.

1. Individual Ownership

With the proper tax firewalls in place, we now know that direct family ownership of private trust companies is possible under the Federal Tax laws. *See* I.R.S. Notice 2008-63. Making the matriarch or patriarch, for example, the direct owner of the shares or membership interests of the PTC is the most streamlined and efficient approach when initially forming the trust company. There are more sophisticated governance structures available, but those take time to develop, implement, and explain to the regulatory authority, if applicable. Starting with direct ownership is often ideal in situations where the PTC needs to be formed "quickly" to address a trustee vacancy (or upcoming vacancy).

Individual ownership is often not the best long-term approach, however, as it fails to adequately address the certainty that individuals die. When that ultimately happens, running an interest in a PTC through probate and subjecting it to Federal Estate Tax is not ideal. Individual ownership also suffers from more regulatory involvement with the internal family governance structure. Transfer and voting restrictions must be put in place to provide the rules of engagement for family members to work and vote together on issues. Individual ownership of a PTC necessitates that these rules be baked into the PTC governing documents themselves, where the regulatory authority will have clear visibility and be notified when changes or tweaks are made.

2. Trust Ownership

Alternatively, a number of these issues may be addressed by placing the ownership of a private trust company in a long-term, Federal Estate Tax-exempt trust. Trust ownership addresses the mortality issue by providing continuity of ownership over the generations. Further, the trust agreement can effectively set forth the powers of family members (as trustees, protectors, etc.) with respect to the shares or membership interest in the PTC held in trust.

However, not only is trust ownership more complicated than direct ownership, trusts are arguably less flexible than entity documents to adapt to changing circumstances within the family. This flexibility issue can be addressed by introducing a family-owned management entity to serve as protector or investment advisor over the trust, with governing documents that the controlling family members can amend as appropriate.

C. Management

The internal governance structure of a private trust company typically consists of the following components: Board of Directors, Officers, Distribution (or Discretionary Decisions) Committee, Investment Committee, and Amendment Committee. Each component has the following responsibilities and internal makeup:

1. Directors and Officers

The Board of Directors (or Directors, as used throughout this article), refers to the governing body of a private trust company entity, whether Directors of a corporation or managers of a limited liability company (some states also allow Directors of LLCs). The Board of Directors is responsible for the overall management of the private trust company, regulatory and audit matters, operational matters, the formation and membership selection of internal committees, the development and approval of the Statement of Principles of Trust Management, the initial approval and annual review of internal policies and procedures, and the acceptance of fiduciary accounts. Directors are elected and subject to removal by the owner of the PTC and serve for the term established by the owner and/or as set forth in the governing documents. Importantly, in a typical PTC structure, the Directors are not directly responsible for much of the fiduciary decision-making for accounts, which is effectively delegated to committees (discussed below). The Directors are, however, expected to retain and provide general supervision over the PTC's exercise of its fiduciary powers. This is typically handled by the Directors' periodic review of the actions of the various committees to determine if a change of membership is appropriate or other action should be taken.

Officers of private trust companies serve an entirely ministerial function and handle the day-to-day operations of the private trust company. Typically provided no decision-making authority, the Officers will carry out decisions made by the Directors and Committees and serve as the face of the PTC with third-parties. It is common for the head of a family office (whether or not a family member) to serve as the President of the private trust company.

2. Committee Structure

Absent direct provisions to the contrary in a trust agreement, a traditional trustee makes all the investment, distribution, and tax-sensitive decisions and elections with respect to trust assets. Perhaps one of the most significant advantages of a private trust company is the ability to slice and dice these decisions into various committees. Each committee can be populated with individuals with the skillset appropriate for that particular committee's responsibilities, without the need for them to participate in other committees where they would be less suited or disallowed under applicable tax law. At minimum, a PTC will have at least one Investment Committee, one Distribution Committee, and one Amendment Committee.

The Investment Committee is responsible for the prudent investment of trust assets for which the private trust company has investment discretion. The major duties include the selection of third party investment advisors, monitoring of the performance of investment advisors, initial and annual investment review of trust assets, the establishment of investment policy statements for each trust account, and direct investment of trust assets. We learned from the proposed revenue ruling that family members can be members of the Investment Committee without triggering adverse tax consequences, and, therefore, the Investment Committee can serve as the primary platform for achieving a family's goal of participating in the preservation and growth of family wealth held in irrevocable trusts.

A Distribution Committee (or sometimes referred to as a Discretionary Decisions Committee or Discretionary Distribution Committee, the "DDC") is responsible for the prudent management of a private trust company's fiduciary distribution authority. This includes the review, approval, rejection, or deferral of decisions regarding distributions from trusts and estates administered by a private trust company. In addition, the DDC would typically have authority over certain non-distribution decisions such as the personal use of trust or estate assets by beneficiaries, allocation between principal and income, authority over trust-owned life insurance policies, and other "tax-sensitive" decisions. The powers of the DDC necessitate inclusion of firewalls that evolved from IRS Notice 2008-63 into the governing documents of the private trust company, which should include restrictions on grantors, beneficiaries, and certain related and subordinate persons from participating in decisions of the DDC. Arguably, PTC documents may not need to track the Proposed Revenue Ruling exactly, but practitioners should be careful to not allow a family member or other individual to exercise authority through the PTC structure that he or she would not be able to exercise directly as trustee.

As discussed above, the concept of an Amendment Committee is a product of IRS Notice 2008-63. An Amendment Committee is typically given the exclusive authority to make changes to the governing documents of the private trust company with respect 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 certain officers and managers; and (3) the prohibition against reciprocal agreements between family members. In IRS Notice 2008-63, two of the three members of the Amendment Committee were non-family members, non-employees of the private trust company, and not related or subordinate to any family member as defined by I.R.C. § 672(c) ("Independent Persons"). Although this hypothetical Amendment Committee had a minority of family members on the committee, the conservative approach is to require that all members of an Amendment Committee be Independent Persons.

The PTC can, and often will, have multiple Investment and Distribution Committees. These multiple committees can be thought of as horizontally or vertically sliced. That is, vertical sliced committees might serve a particular family line's trusts, rather than serving across all families. This is particularly common a couple generations down from the patriarch or matriarch, where siblings or cousins have differing views of investments or distributions. Separate committees can be formed to serve these family groups to avoid infighting and without moving the trusts from the PTC. Horizontal sliced committees are more common at the Investment Committee level, where a separate committee might be created with authority over certain specific assets. For example, for families with an ongoing family business or franchise, a separate committee can be created and populated with individuals most fit to advise the business or one or more family members that need decision-making authority over operations. These committee structures are nearly completely customizable, but the use of this flexibility should be weighed against the administrative hassle and difficulty of oversight of numerous committees by the Directors. PTCs are typically formed to empower collective family member decision-making, which might be diluted by creating too many committees.

D. Policies and Procedures

Although a private trust company may be subject to less regulation than a public trust company, that fact should not deter the management of a private trust company from having policies and procedures in place to assure the adherence to sound fiduciary principles. In fact, some sort of policy manual is required or expected by regulatory authorities, if applicable. Key among these policies and procedures are the following: (1) formal acceptance and closure of fiduciary accounts; (2) initial and annual investment review of fiduciary assets for which a private trust company has investment discretion; (3) 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; (6) a due diligence process for not only selecting third party service providers and advisors, but also for monitoring their performance; and (7) a written and Director approved plan for audit of fiduciary activity, as appropriate. Although, these policies and procedures are important, care should be taken to not create trip points for PTC administrators. Most regulatory examinations will involve making sure a PTC is following its own procedures. A balance should be found between good operational policies and unnecessary procedures that are later ignored.

IV. CONCLUSION

The private trust company can be an excellent option for wealthy families with substantial wealth in irrevocable trusts. Beyond simply providing an alternative trustee solution to individuals and traditional corporate trustees, a PTC allows a family to design a robust governance structure within which successive generations can work together to be good stewards of the family wealth. Further, the flexibility of the Director and multiple committee structure can be leveraged to put both family members and third-party advisors in roles where they can best serve the family. These benefits do not come without cost, however. To gain full advantage of what a private trust company can provide, the family must commit the time and resources to design, implement, and administer a corporate fiduciary with a high standard of governance. If so, the PTC will serve the family well for generations to come.*

 Portions of this article are based upon on a prior article by Alan V. Ytterberg and James P. Weller, Managing Family Wealth Through a Private Trust Company, published in the ACTEC Journal on April 8, 2011.

	Nevada	Tenness	New Hamp	Texas	Wyomir	Florida
Scope of family elig served by PTC	10th degree of lir kinship & 9th deg collateral kinship designated relati	12th degree of lir kinship & 11th de collateral kinship designated ances	5th degree of line kinship & 9th deg collateral kinship the designated r (NOTE: Alternati PTC may elect to 10 generations o descendants of designated relati	Persons related v the 7th degree of consanguinity or	10th degree of lir kinship & 9th deg collateral kinship designated relati	6th* degree of lir kinship and 9th* of collateral kinsl designated ances (NOTE: No execu positions) (NOTE: may serv of 2 designated ancestors)
Unlicensed PTC Allo	Yes	No	No	No	Yes	Yes (*Alters scop eligible family m to 4th degree of l and 7th degree o collateral kinship
D&O Residency Requirements	One officer NV re	One officer TN re	None	One director and officer TX reside	One officer WY r	One director FL r
Physical Office Requ	Physical office re	Physical office re	None (but recommended)	Physical office re	Physical office re	Physical office re
Minimum Capitaliza	$300,000	$100,000	$200,000	$500,000	$500,000	$250,000 ($350,(two designated ancestors)
Financial & Biograp Reports Required w Application	Yes	No (Non-financia by TDFI)	Yes	Yes	Yes	Yes
Insurance and Bonc Required	Fidelity Bond	None	Fidelity Bond anc Insurance	Fidelity and E&O Insurance	Fidelity Bond	Fidelity Bond anc Insurance
Periodic reporting (Licensed PTCs)	Annual (unaudite financial stateme	Annual (unaudite financial stateme TDFI questionnai	Annual and Quar reports of condit income. Annual Certification.	Annual report of condition and in company. Annua financials and ag upon procedures	Annual (unaudite report of trust as financial conditic company	Quarterly report capital account, bonds, and insur Annual renewal application. No t financial informa provided.
Regulatory Examina	Every 3 years	As agreed betwe and TDFI (typical least every 3 yea	Every 3 years	Annually	Every 3 years	Every 3 years