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Managing Family Wealth Through a Private Trust Company

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Managing Family Wealth Through A Private Trust Company

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This article examines private trust companies, which have become an increasingly attractive tool for certain wealthy families seeking a forum for current and future generations to discuss and influence the preservation and management of wealth held inside of irrevocable trusts without jeopardizing the spendthrift, tax, and other benefits of such trusts. The article discusses various other reasons for creating private trust companies along with the steps required to apply for and be granted a state trust charter. The article also looks at favorable state law developments, recent helpful proposed guidance from the Internal Revenue Service, and the governance structure of private trust companies. The Appendix to the article contains a chart summarizing relevant attributes of five states with attractive laws and regulations.

Introduction

One of the toughest challenges that wealthy families face is the preservation and growth 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.

To combat these threats, wealthy families typically take advantage of planning strategies that involve the transfer of wealth to irrevocable trusts. Most wealthy families place a high premium on the ability to participate in the investment management of family wealth inside of irrevocable trusts. Unfortunately, it can be difficult to accomplish this goal when an independent individual or a financial institution is serving as trustee. As a result, wealthy families tend to seek and embrace structures that encourage and create opportunities for each generation to discuss and influence the management of family wealth held inside of irrevocable trusts. This article will examine one such structure, the private trust company.

A private trust company, also known as a family trust company or an exempt trust company, is an entity authorized to act as a fiduciary under state law, but prohibited from soliciting business from the general public. A private trust company can only provide trust and fiduciary services to a limited class of family members and, in some cases, charities and family employees. Many states define this class by reference to a specified degree of kinship to a certain relative designated in the charter application.[1]

Some further introductory comments regarding private trust companies are merited. First, private trust companies are best suited for

[1] *See*, e.g., Nev. Rev. Stat. §§ 669A.070(1)(a) and (b) (2010); *and* N.H. Rev. Stat. Ann. § 392-B1(IV)(a)(1) and (2) (2010).

families with sufficient assets held in trust to justify the cost and effort involved in establishing and operating a private trust company. As a general rule, trusts with $100 million or more in assets might be a reasonable threshold. Second, families must be prepared for both the application process and the governance process that come with a private trust company. Finally, except as noted below, a private trust company must apply for and be granted a state charter.

I. Reasons for Creating a Private Trust Company

Wealthy families create private trust companies for some combination of the following reasons:

A. Participate in Investment Management of Family Wealth

As mentioned above, one of the attractive features of a private trust company is that it provides a forum for current and future family members to have a voice in the management of family wealth in irrevocable trusts without jeopardizing the spendthrift, tax and other benefits of such trusts. The Investment Committee of a private trust company, which is responsible for the investment management of trust assets for which the private trust company has investment discretion, offers such a forum by allowing family members to serve as members of that committee.

B. Leverage Favorable State Laws

Several states have been progressive in modernizing their trust laws.[2] This article will focus on five states in particular that not only have modern trust laws and favorable tax laws, but also have infrastructures that encourage and support the growth of private trust company business. These states are Nevada, New Hampshire, South Dakota, Texas, and Wyoming.

C. Provide Stability to Trustee Designation

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 stability because a private trust company can be in existence

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2 *See* Daniel G. Worthington & Mark Merric, *Which Situs is Best?* Tr. & Est., Jan., 2010, at 54.

for as long as the family needs it, and personnel can be tailored to fit the family's specific needs.

D. Recognition of Family's Special Relationship with Heavily Concentrated Assets

It is commonplace for wealthy families to have a heavy concentration of their wealth in assets such as family businesses, real estate, or in stock of a particular publicly traded company. In comparison to corporate trustees, who may be predisposed to diversify those holdings, private trust companies may be less risk averse and better attuned to family assets and the special place they hold within the context of the family. The Uniform Prudent Investor Act, which has been adopted in most states,[3] lends support to families who want to retain heavily concentrated assets. For example, the Act 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.[4] In addition, the Act provides a list of circumstances that a trustee shall consider in investing and managing trust assets as are 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.[5] 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.

New Hampshire grants a trustee additional leeway regarding the duty to diversify by providing that a trustee will not be liable to the beneficiaries to the extent that the trustee acted in reasonable reliance on the provisions of the trust or court order, or determined not to diversify the investments of a trust in good faith in reliance on the express terms of the trust or court order.[6] On March 29, 2010, South Dakota Codified Law was revised regarding the diversification of trust assets. Now, a trustee in South Dakota, regardless of the concentration or lack of diversification, need not diversify if the trust instrument or court order allows or directs retention of assets forming part of the trust corpus,

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[3] BOGERT, TRUSTS & TRUSTEES § 671 (2010).
[4] UNIF. PRUDENT INVESTOR ACT § 3 (1995).
[5] *Id.* at § 2(c)(8).
[6] N.H. REV. STAT. ANN. § 564-B:9-901(b) (2010).

and no trustee is liable to a beneficiary to the extent the trustee acted in reliance on the provisions of the trust instrument or court order.[7]

E. Expansion of Investment Opportunities for 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.[8] As a collective investment fund, a common trust fund can invest in an array of assets including private equity funds and hedge funds, and units in a common trust fund can be purchased for trusts managed by the private trust company. 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. Common trust funds are an exception to the definition of an "investment company" under the Investment Company Act of 1940, and consequently, they operate outside of the regulatory purview of the SEC.[9]

F. Reduced Regulation

There is a definite 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 with the former, but not the latter.[10]

1. *Regulatory Oversight*

Several states have recognized this distinction and have reduced the level and frequency of regulatory oversight for private trust companies accordingly. In Nevada, the Division of Financial Institutions has discretion to examine the books and records of a licensed family trust com-

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7 S.D. Codified Laws § 55-5-8 (2010).

8 *See, e.g.*, Nev. Rev. Stat. § 164.080(1)(2010); N.H. Rev. Stat. Ann. § 391:1(2010); S.D. Codified Laws § 51A-6A-64(2010); Tex. Prop. Code Ann. § 113.171(a)(2009); *and* Wyo. Stat. Ann. 2-3-402(a)(2010).

9 15 U.S.C. §§ 80a-2(a)(5)(C) and 80a-3(c)(3) (2010).

10 Nev. Rev. Stat. § 669A.010(2) (2010).

pany.[11] Indications are that the regulatory scrutiny of a private trust company by the Division will be less than that of a public trust company, provided that the statutory requirements are adhered to and no family litigation or complaints are present. Likewise, the South Dakota Division of Banking examines a private trust company every thirty-six months rather than on an annual or more frequent basis.[12]

2. *Allowed Exemptions*

Some states distinguish private trust companies from public trust companies through the ability to apply for exemptions from certain regulatory requirements. For example, Texas permits a trust company that limits its clients to individuals who are related within the fourth degree of affinity or consanguinity to the designated relative to apply for exemptions from a specified list of regulatory requirements.[13] One of the exemptions is from the requirement that the number of directors cannot be less than five with the majority of the directors being Texas residents.[14] The Texas Banking Commission has allowed private trust companies to have a minimum of three directors with just one director being a Texas resident.[15] Recognizing the importance that wealthy families place on confidentiality, a private trust company in Texas can also apply to exclude the report of assets portion of its statement of condition and income from being a matter of public record.[16] New Hampshire permits a family trust company or a proposed family trust company to request in writing that it be exempted from any provision of Title XXXV, which provides the regulatory requirements for banks in that state.[17] In contrast to Texas and New Hampshire, Wyoming does not provide for statutory exemptions. However, its banking commission has authority to grant exemptions and has displayed a willingness to do so in situations where a trust company serves only one family. As a general rule, a private trust company that has been granted any exemption will be required to file an annual certification that it is maintaining the conditions and limitations of that exemption.[18]

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[11] *Id.* at § 669A.260(1).

[12] S.D. Codified Laws § 51A-6A-31 (2010).

[13] Tex. Fin. Code § 182.011(a)(1) (2009).

[14] *Id.* at §183.103.

[15] 7 Tex. Admin. Code §21.24(c)(3).

[16] *Id.* at § 21.24(c)(1).

[17] N.H. Rev. Stat. Ann. § 392-B:5(II)(b) (2010).

[18] N.H. Rev. Stat. Ann. § 392-B:22 (2010), Tex. Fin. Code § 182.013(a) (2009).

3. *Unregulated or Unlicensed Private Trust Companies*

Certain states allow an unregulated or unlicensed private trust company to be formed for the purpose of providing trust and fiduciary services to a single family. An unregulated or unlicensed private trust company differs from a regulated or licensed private trust company in that it does not have a state charter, capital requirements, or state regulatory oversight. As a result, an unregulated or unlicensed private trust company 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. However, there are several potential drawbacks. First, operating in the fiduciary world without the safety net of some degree of regulatory oversight can be risky. Consequently, it would behoove the management of an unregulated or unlicensed private trust company to create an infrastructure based on sound fiduciary processes, policies, and procedures. Second, even though an unregulated or unlicensed trust company is not regulated as such at the state level, it is not necessarily free of all regulation. Its unsupervised nature potentially brings it within the definition of an investment adviser and makes it subject to SEC registration under the Investment Advisers Act of 1940.[19] Third, as will be discussed in detail below, a private trust company may face situations in which it will be called upon to extend its reach beyond the state where it is located. In that regard, an unregulated or unlicensed trust company may have limitations on its ability to engage in interstate activities. Finally, it will be important for a private trust company 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 judicial modification can be obtained.

Finally, it is reported that Massachusetts, Pennsylvania, Virginia, and Wyoming permit unregulated or unlicensed private trust companies.[20] Arguably, Tennessee and New Hampshire could be included in this group because they allow a private trust company to apply for exemption from any provision of their Banking Act or the rules thereof.[21] Effective October 1, 2009, Nevada enacted a separate statute governing

[19] 15 U.S.C. §§ 80b-2(a)(11)(A), 80b-2(a)(2)(C) (2010).

[20] Iris J. Goodwin, *How the Rich Stay Rich: Using a Family Trust Company to Secure a Family Fortune* (2009), Expresso, available at http://works.bepress.com/iris_goodwin/1 at 10.

[21] Tenn. Code Ann. § 45-2-2001(b) (2010) and N.H. Rev. Stat. Ann. § 392-B:5(II)(b) (2010).

family trust companies.[22] Under the statute, a family trust company is not required to be licensed.[23]

G. Potential U.S. Trustee for Domesticating Foreign Trusts

Given the number of wealthy, multi-jurisdictional, international families, there is a strong likelihood that many of these families have trusts in jurisdictions outside of the U.S. As part of the planning process, it is quite common for these families to have provisions in their trust documents permitting beneficiaries to personally use trust assets. In that regard, there is case law authority in the U.S. for beneficiaries of U.S. trusts to personally use trust assets, like vacation homes, rent-free without incurring income tax consequences.[24] However, as a result of increased IRS and Congressional scrutiny of foreign accounts and assets, the Foreign Account Tax Compliance Act (FATCA), which was part of the Hiring Incentives to Restore Employment (HIRE) Act, was enacted on March 18, 2010.

Section 533 of the HIRE Act amended I.R.C. § 643(i)(1) to treat the use of property in a foreign trust by a U.S. grantor, U.S. beneficiary or any related U.S. person after March 18, 2010 as a distribution of the fair market value of the use of the trust property. The only exception is if the trust is paid the fair market value of the use of the trust property within a reasonable period of time of the use. Similar rules do not apply to domestic trusts, and a private trust company in the U.S. may provide a means to address these concerns.

In addition to enhanced scrutiny, foreign trusts can have onerous reporting requirements for U.S. persons. One primary example of this is I.R.C. § 6048(a), which requires the reporting of any reportable event involving a foreign trust. A reportable event means: (1) the creation of any foreign trust by a U.S. person, (2) the transfer of any money or property to a foreign trust by a U.S. person, and (3) the death of a citizen or resident of the U.S. if the decedent was treated as the owner of any portion of a foreign trust under the grantor trust income tax rules or a portion of the foreign trust was included in the decedent's gross estate for estate tax purposes.[25] The reporting requirement is met by timely filing the Annual Return to Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts (IRS Form 3520). Clearly there are a number of factors to consider, but naming a private trust company

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22 NEV. REV. STAT. § 669A (2010)

23 *Id.* at § 669A.110.

24 Sparrow v. Comm'r, 18 B.T.A. 1, 16-17 (1929); Plant v. Comm'r, 30 B.T.A. 133, 142-43 (1934) *aff'd* 76 F.2d 8 (2d Cir. 1935); DuPont Testamentary Trust v. Comm'r, 66 TC 761, 766-70 (1976).

25 I.R.C. § 6048(a)(3)(i)-(iii).

in the U.S. as successor trustee of a foreign trust can be a key step toward domesticating the trust to eliminate this reporting requirement.

H. Limited Personal Liability

Serving as individual trustee can subject family members and trusted advisors to unlimited personal liability. As a general rule, members of a board of directors of a private trust company have limited personal liability. There is also a school of thought that the decisions of the board of directors of a private trust company are governed by the business judgment rule rather than the higher fiduciary standard of review for trustees.[26] The higher "trustee level" liability is maintained at the private trust company, while the directors of the private trust company operate under the business judgment rule. According to the business judgment rule, a more limited standard of review will apply to any decision of a board of directors if the following conditions are present: (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 made in subjective good faith; and (4) the directors must not have a financial interest in the subject matter.[27] 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 and against any and all losses, claims, damages, judgments, liabilities, obligations, penalties, settlements, and reasonable expenses arising from their status with a private trust company.

I. Preserving the Family Legacy across Multiple Generations

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. Human capital is all the individuals who make up a family, and intellectual capital is everything that each individual family member knows.[28] The participatory nature of a private trust company, particularly in regard to the investment management of family wealth, is an excellent foundation from which human and intellectual capital of a

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[26] *See, e.g.* 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 151 (rev. ed. Bloomberg Press 2004).

[27] Melvin A. Eisenberg, *Background Study for the California Law Revision Commission on Whether the Business-Judgment Rule Should Be Codi?ed.* (May 1995)(on file with the California Law Revision Commission).

[28] HUGHES, *supra* note 27, at xv.

family and its trusted advisors can be developed and grown in the pursuit of preserving a family legacy.

J. SEC Registration by Family Offices

The Dodd-Frank Wall Street Reform and Consumer Protection Act was signed into law by President Obama on July 21, 2010. This Act may impact family offices in two ways. First, it repeals the private adviser exemption to the SEC registration requirement.[29] The private adviser exemption had allowed many family offices to avoid SEC registration as long as the family office had fewer than fifteen clients during the course of the preceding twelve months.[30] Second, the Act provides a family office exemption to the SEC registration requirement, and it grants the SEC the authority to define a family office for purposes of this exemption.[31] In light of SEC Proposed Rule 202(a)(11)(G)-1, which defines a family office, and the volume of comments it generated from the family office and professional communities, uncertainty remains as to what family offices will qualify for the exemption.

With the repeal of the private adviser exemption and the uncertainty surrounding the SEC's definition of a family office, many family offices may eventually fall under the umbrella of SEC registration. In that respect, it is important to note that regulated or licensed private trust companies continue to be exempt from SEC registration.[32] Consequently, a family office that will be subject to SEC registration, either due to the repeal of the private adviser exemption or because it falls outside of the SEC's definition of a family office, may be able to avoid registration by transferring its investment management to a regulated or licensed private trust company.[33]

II. Requirements for State Charter

As might be expected, the application process for a proposed private trust company to obtain a charter or license varies from state to state. Although there are differences among the states, the application process generally consists of some variance of the following items: (1) application form; (2) proposed organizational documents (articles of incorporation; bylaws; etc.); (3) strategic business plan; (4) pro-forma

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[29] Dodd-Frank Wall Street Reform and Consumer Protection Act, H.R. 4173, 111th Cong. § 403 (2010).

[30] 15 U.S.C. § 80b-3(b)(3) (2010).

[31] Dodd-Frank Wall Street Reform and Consumer Protection Act. H.R. 4173 §§ 409, 411.

[32] 15 U.S.C §§ 80b-2(a)(11)(A), 80b-2(a)(2)(C) (2010).

[33] Rashad Wareh, *Financial Reform Knocks on the Family Office Door*, Tr. & Est., Aug. 2010 at 48.

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 typically provide that some or all of the above information is given confidential treatment.[34] The Appendix of this article contains a list of certain key requirements for a private trust company to acquire and maintain a trust charter or license, and how they apply in Nevada, New Hampshire, South Dakota, Texas, and Wyoming.

III. Tax Considerations

The IRS issued Notice 2008-63[35] on July 11, 2008. This Notice contained a proposed revenue ruling addressing the transfer tax and income tax consequences of a private trust company serving as trustee of family trusts. The proposed revenue ruling incorporates and expands on views approved by the IRS in prior private letter rulings.[36]

The stated goal of the IRS 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.[37]

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.[38] Situation 2 looks at a private trust company established in a state without a governing statute.[39]

Within the context of these two situations, the proposed revenue ruling restricts certain family involvement in the activities of the trust company under state law or the governing documents that will 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

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34 E.g., N.H. Rev. Stat. Ann. § 392-B:8(I) (2010), S.D. Codified Law § 51A-6A-2 (2010).

35 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.

36 *See* PLR 9841014 (Jul. 2, 1998); PLR 9842007 (Jul. 2, 1998); PL.200125038 (Mar. 2001).

37 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, at 1.

38 *Id.* at 3.

39 *Id.* at 5.

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.[40]

The family that is depicted in the proposed revenue ruling owns 100% of the private trust company stock.[41] 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.[42] In Situation 2, the IRS presents us with the concept of an Amendment Committee to prevent adverse tax consequences in the absence of state law.[43] The governing documents grant the Amendment Committee the sole authority by majority vote 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.[44] Two of the three members of the Amendment Committee are 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).[45]

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 income tax 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 proposed revenue ruling leaves several questions unanswered. For example, does the definition of a trust beneficiary include those parties with remainder and contingent interests? Also, does participation in DDC activities include other actions besides voting? The IRS requested and has received comments from numerous practitioners regarding the proposed revenue ruling. Final guidance from the IRS has

40 *Id.* at 4.
41 *Id.* at 5.
42 *Id.* at 10.
43 *Id.* at 6-7.
44 *Id.*
45 *Id.* at 7.

been anticipated for some time now. In the interim, the proposed revenue ruling does identify firewalls that can and should be incorporated into the governing documents of a private trust company.

IV. Obtaining a Physical Presence in Another State

As noted above, wealthy families tend to charter private trust companies in pro-business states that have favorable tax and trust laws. Often, the state chosen will not be where the family resides or conducts the bulk of its business. Due to this distance between the families and the location of their private trust companies, some families may desire that their private trust companies have some form of physical presence in the states where the family members reside. Short of obtaining a trust charter, what options are available to allow a physical presence in another state?

In March, 1997, the Conference of State Banking Supervisors published the Multistate Trust Institutions Act as an obvious response to the Riegle Neal Interstate Banking and Branching Efficiency Act of 1994.[46] The Multistate Trust Institutions Act provides states with statutory options that open the door for interstate trust activity. In that regard, two important developments evolving from this Multistate Trust Institutions Act should be mentioned. First, the majority of states have adopted the interstate trust activity provisions of this Act, or they have enacted similar legislation regarding interstate activity. Second, to further complement its efforts to encourage the safe and sound transaction of interstate trust activity, the Conference of State Banking Supervisors drafted the Nationwide Cooperative Agreement for Supervision and Examination of Multistate Trust Institutions in 1999. The legislation's primary purpose is to promote communication and coordination among state regulatory agencies and avoid unnecessary duplication.

In regard to interstate activity and obtaining a physical presence in another state, the Multistate Trust Institutions Act lays out two specific options. The first option is a "representative trust office." A representative trust office is defined as an office at which a trust institution has been authorized by the commissioner to engage in trust business other than acting as a fiduciary.[47] Although a representative trust office gives an out-of-state trust company (hereinafter referred to as a "foreign trust

[46] Riegle Neal Interstate Banking and Branching Efficiency Act of 1994, Pub L. No. 103-328, 108 Stat. 2338 (1994). This statute permits adequately capitalized and managed bank holding companies to establish branches nationwide, by *eliminating* state-level barriers to interstate banking. Before this law went into effect, banks were required to establish subsidiaries in each state in which they conducted business, and could not accept deposits from customers outside their home states.

[47] Multistate Trust Instit. Act § 1.002(a)(28) (1997).

company") a physical presence in another state, the activities that it can conduct from that office are limited. For example, Texas restricts the activities of a representative trust office to the following:

- Solicit, but not accept fiduciary appointments;
- Act as a fiduciary in Texas to the extent permitted for a foreign corporate fiduciary by Section 105A of the Texas Probate Code;
- Perform ministerial duties with respect to existing clients and accounts of the trust institution;
- Engage in any activity not requiring a trust charter; and
- Receive personal property for safekeeping or act as an assignee, bailee, conservator, custodian, escrow agent, registrar, receiver, or transfer agent to the extent not acting in a fiduciary capacity.[48]

The second option under the Multistate Trust Institutions Act for a foreign trust company to obtain an authorized physical presence in another state is a "trust office." A trust office is defined as "an office, other than the principal office, at which a trust institution is licensed by the commissioner to act as a fiduciary."[49] In essence, a trust office in another state gives a foreign trust company the authority to conduct fiduciary activities to the same extent as a trust company chartered in that state.

Finally, in seeking authority to establish a representative trust office or a trust office in another state, a foreign trust company must be aware that reciprocity may be a factor. That is, there are states that require reciprocity as a prerequisite to a foreign trust company obtaining authority for a representative trust office or trust office. Such states will look to the foreign trust company's home state to determine if it grants trust companies chartered or licensed in other states similar treatment in establishing a representative trust office or trust office.[50]

V. Governance Structure

The governance structure of a private trust company typically consists of the following components: Board of Directors, Distribution Committee, Investment Committee, and Amendment Committee. Each component has the following responsibilities and internal make-up:

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48 Tex. Fin. Code Ann. § 187.201(a) (Vernon 2010).

49 Multistate Trust Inst. Act § 1.002(a)(37) (1997).

50 *See, e.g.*, 3 Colo. Code Regs. §§ 701-6 at TC22(B)(1)(c), TC22(C)(1)(c) (2010) *available at* http://www.dora.state.co.us/banking/rules&regulations/trustcompany/tc22.pdf;Tex. Fin. Code Ann. § 187.102(a)(1)-(2) (Vernon 2010).

A. Board of Directors

The Board of Directors, as used throughout this article, refers to the governing body of a private trust company entity, whatever it may be called. The board of directors is responsible for the overall management of the private trust company, regulatory and audit matters, operational matters, the formation of internal committees, the selection of committee members, the delegation of investment and administrative duties and responsibilities to internal committees, the development and approval of the Statement of Principles of Trust Management, and the initial approval and annual review of internal policies and procedures. The founding family member, organizer, or initial member of a private trust company can appoint the directors.

B. Distribution Committee

A Distribution Committee 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, it should encompass certain non-distribution decisions such as the personal use of trust or estate assets by beneficiaries.

The firewalls that evolved from IRS Notice 2008-63 should be incorporated into the bylaws of a private trust company. That is, the bylaws should contain the following provisions: (1) no family member serving on a Distribution Committee may participate in any activities of the Distribution Committee 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 with anyone, express or implied, regarding distribution decisions with respect to any trust for which the private trust company is serving as trustee; and (3) only officers and managers of the private trust company can participate in certain personnel decisions. Members of a Distribution Committee may, but need not be directors. Although the statute and the governing documents in IRS Notice 2008-63 did not restrict who could serve on the Distribution Committee, the conservative approach at this time is to require that all members of the Distribution Committee be independent persons. An independent person is defined as 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 I.R.C. § 672(c) as to any grantor or beneficiary of any such trust.

C. Investment 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, the monitoring of the performance of investment advisors, initial and annual investment review of trust assets, and the establishment of investment policy statements for each trust account. Because family members can be members of the Investment Committee without triggering adverse tax consequences, 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.

D. Amendment Committee

As discussed above, the concept of an Amendment Committee is a product of IRS Notice 2008-63. An Amendment Committee is 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 the 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). Similar to the Distribution Committee, the conservative approach is to require that all members of an Amendment Committee be independent persons.

VI. Fiduciary Policies and Procedures

Although a private trust company is 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. Key among these policies and procedures are the following: (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.

A private trust company should also have a due diligence process for not only selecting third party service providers and advisors, but also for monitoring their performance. This due diligence process will predominantly come into play when investment management of trust or estate assets is assigned to outside advisors.

VII. Conclusion

The private trust company is a fast-evolving and increasingly attractive tool for addressing the multi-faceted trust and wealth management needs of wealthy families. The appeal of a private trust company lies in its ability to separate control from ownership. That is, a private trust company allows wealthy families to have a greater degree of control over the management of wealth, while not having ownership of that wealth for transfer tax and other purposes. In considering a private trust company, it is important for wealthy families to recognize that it is a highly specialized area of the law. The success of a private trust company depends on a high standard of governance, a strong commitment of time and energy from current and future generations of a family, and a team of experienced advisors.

APPENDIX

Subject	Nevada	New Hampshire	South Dakota	Texas	Wyoming
	Nevada Revised Statutes, Title 55, Chapter 669A	New Hampshire Revised Statutes Annotated, Title XXXV, Chapter 392-B	South Dakota Codified Laws, Title 51A, Chapter 06A	Texas Financial Code, Title 3, Chapters 181-183	Wyoming Statutes Annotated, Title 13, Chapter 5
1. Annual Reporting	Financial Statement of trust company to assure in compliance with minimum capital requirements	Annual Certification complying with conditions & limitations of exemptions granted	Annual Report of Trust Company	Statement of Condition & Income; annual certification complying with conditions & limitations of exemptions granted	Report of Trust Assets & Report of Financial Condition
2. Board Meetings	No Express Mention	Not less than 4 times per year	4/Year; 1/Quarter	1/Quarter	1/Quarter
3. Bonding	Directors & Managers have discretion as to the amount	Pledge of securities or surety bond in amount Commissioner deems appropriate not to exceed $1,250,000 initially	$1,000,000 Fidelity Bond; $1,000,000 D & O Insurance Policy	$1,000,000 Bond	None explicitly required
4. Location of Board Meetings	No Mention	No Mention	No Mention	No Mention	No Mention
5. Minimum Capital	$300,000	Not less than $250,000	$200,000; $100,000 of it deposited with bank division	$1,000,000; discretion to lower to $250,000	$500,000; Paid-in Surplus of $150,000
6. Number of Directors	No Mention	Not less than 3 directors, trustees or managers	Minimum of 3, but no more than 12	At least 5, but not more than 25; Banking Commissioner has allowed exempt trust company to have 3	At least 5; but may be reduced to 3 in certain circumstances
7. Number of Organizers	No Minimum Number	Minimum of 3	3 or more	No Minimum Number	Any Number
8. Physical Office in State	Office & one officer with original or true copies of material business records and accounts	No Mention	Implied in Charter Application	Office with one officer; books & records maintained there	Some presence implied
9. Residency of Directors	No Mention	Need not be resident of U.S. or NH unless ordered by Commissioner	One SD Resident; 2/3 U.S. Citizens	Majority TX Residents; Commissioner has allowed exempt trust company to have only one TX Resident	No Mention
10. Type of Entity	Corporation or LLC	Corporation or LLC	Corporation or LLC	Trust Association or Limited Trust Association	Corporation