TRANSCRIPT:

Mary: On today's episode, I am joined by Rachel Truhlsen. Rachel is one of my co-members at Vandenack, Weaver Truhlsen and I'm truly delighted to have her as a comember. We've met many years ago and we're considering this a reunion to practice together, and it's just been fabulous to date and I'm looking forward to fabulous things in the future. Today we are going to reverse roles and Rachel has agreed to interview me about family, private family trust companies. Rachel, thank you for joining me today and taking on the role of interviewer again in one of our episodes. Yeah, absolutely.

Rachel: Absolutely. Thanks for asking me to join you and I'm looking forward to this role reversal can you start off by explaining to me generally what a private family trust company is?

Mary: I can, and the interesting thing is, I was having a conversation with a wealth strategist last week and we were talking about a particular family and we were talking about private family trust companies and family offices and which would be the best for a particular client situation and he said, which is really true and I think this is important. He goes, you know, the term family office and the term, and these are, they're two very different things. Legally, private family trust company can mean a whole lot of things. So, the conversation we really need to have is what exactly are we trying to achieve for the client? What do they need to have done and what is the best format in which to accomplish that? So, it's really common with families to want to involve some of their family members Sure. Or some of their friends or advisors in assisting with the trust. They might involve a great trust company. We have some great trust companies for clients that would be good fits for the private family trust companies and there may be such a trust company involved even when we set up a private family trust company. But what we often have is clients who are just adamant about wanting to keep family friend in or they had a bad experience with mom or dad's estate in relation to a corporate trustee and they're just anti corporate trustee no matter how many times we explain to them all the reasons that they should consider a corporate trustee and so we see clients with significant accumulations of wealth wanting to name 82 year old family friend as their trustee. We're like, Okay, so what happens when you know something, you know when he gets demented mm-hmm. <affirmative> or gets covid or how does that work? Mm-hmm. <affirmative>, and by the way, do you have enough insurance for the guy? This guy's going to step in his trustee to your 15 different trusts and act as the trustee and oh, you have kids from four different situations and they are each in different situations. So we have some situations where despite our discussions, and there's some good reasons, we've talked in previous episodes about checks and balances and cross checks and early in our careers a trustee did everything and so there's trends recently that recognize the desire of family members to maintain some control and involvement on the part of family members and we've talked about directed trust. That's one of the recent trends in this area. There's special purpose entities. Trust protectors have become common in a lot of states. And the other strategy that we're talking about today is the private family trust company. What the private family trust company does is allows the families to integrate their objectives into planning that they can maintain tax benefits and asset protection of their trust strategies. Usually a private family trust company is going to be formed as an LLC corporation. Okay. Uh, can you form it in any state that you want to? And the answer to that is no. There are certain jurisdictions that allow the creation of private family trust companies. Okay. And as so often is the case when it comes to state law, the rules are different in each of those states. So, it's really important to consider which jurisdiction is the right one for a particular family and why. So, you've got to look at the rules, what they're trying to accomplish and have a good match between those.

Rachel: So, what would be some of the advantages then to a client if they were to decide that a private family trust company would be best for them?

Mary: So again, I mentioned that desire sometimes to have, you know, Jim Jackson is our close family friend, and we want to name him trustee of all our trusts. Right? And I'm never really sure you're doing Jim a favor. You think it's this great compliment, Hey Jim, I want you to be the trustee of this trust. And oh, by the way, I did an IDGE over here and I want you to be the trustee of the trust. Oh, the kids by the first marriage are the beneficiaries of this one. And the kids from the second marriage are the beneficiaries of this one. And by the way, we did this. So, do you mind being the trustee? And if I were Jim, my question would be, how much insurance do you have in place for me? And the other thing is what happens? Who's my successor? Because there's a lot of duties and responsibilities that go with being a trustee. It's a fiduciary obligation. Mm-hmm <affirmative>. And you really do need to know what to do. So, the Private Family Trust company lets us have Jim be involved. So, you can name private Family trust company, the private family trust company can engage Jim to act as an advisor to the company. The company itself is the trustee. So, if Jim gets demented or decides I've had enough, then there's a successor. The company can hire a successor to act in a capacity and actually a lot of times when we create a private family trust company, maybe there's a family CFO, sometimes a client sold a business that CFO might have worked for the business and then decides to act as the family CFO. So, you can have multiple parties or you can simply hire an accounting service through the private family trust company. All of those things, it's easier for the entity to obtain proper insurance coverage. So you want to get DNO insurance, you want to get ENO insurance, it provides protection. So you ask Jim and other members of the family or friends to be involved in help managing your affairs, you can provide them proper insurance through that entity. Another advantage of the private Family trust company is enhanced privacy. So a lot of our high net worth clients are very concerned with privacy. Right? Right Now we do have the Corporate Transparency Act coming into play and so we'll do an episode on that and how that's going to affect that enhanced privacy because it's certainly concerning about that ability. But at least for the moment, that's one of the reasons that we'll use the private family trust company. You can keep things just a little more private. The family can also stay in control. So if I use Delaware Trust Company, which is a fabulous trust company, but what I want to, I don't have any control over Delaware Trust, right? They're gonna have their policies, their procedures elect, their directors and officers in the private family trust company. I remain in control of who to a degree who's on my board of directors and how things work. So that is another advantage. Another thing with the private family trust company, it can be exempt from s c registration. So when you get involved with the s c, there's a whole lot of rules, right? And I'm definitely not an S E C expert, so I just know enough to say, Wow, you don't want to do that And we can get an s c expert on here to talk about those issues. But the other thing is improving family governance. So I know Rachel, when I've interviewed you in the past, you talk a lot about the importance of letting other family members know how the estate plan works and I think that's important regardless of the level of wealth. But I think it's really important if you have certain goals that are philanthropic in nature or you want to involve your kids in good financial decision making and to understand the family business. Mm-hmm. <affirmative>. And so by setting up a private family trust company, you can bring the children in. You might not want to put them on the board of directors at this point and it might not be kids, it might be other beneficiaries. If you don't have kids, you have siblings that you're benefiting or nieces and nephews or whatever the case might be. But you can involve them in the governance and begin to educate them. So sometimes we set up the private family trust company, we might create a committee for the kids to review a certain type of investment or we might ask them to just report on family activities and things like that that get them involved in the process. Okay. You can also have some efficiencies that come from the private family trust company. So as opposed to having, we have clients that have 15 or more trusts out there and each of those trusts has its own rules, has its own returns compliance. They may still have all those requirements, but we can centralize the addressing those issues through the private family trust company. Okay. We can also create some planning opportunities for tax deductions. So, another one of the things I like about the private family trust company is if you're just an individual and you no longer own your business and you sold it, there's a whole lot of limitations on what you can deduct. If you have the private family trust company and it qualifies as an active trader business, you're going to be able to deduct expenses under section 1 62. And so, one of the things that we will look at is are there entities in this mix that can pay management fees and the management can occur through the private family trust company. So it can do other things besides, I mean think about your average trust company, it may be a trustee, but it's often providing other services for which it is charging and while it's income to the private family trust company is going to be a deduction to an entity that it otherwise might not be deductible to or it might be limited. Right now there's a lot of factors in there that's beyond the scope of today's conversation, but it does create tax planning opportunities. Okay.

Rachel: Well and you've talked in prior episodes too about how jurisdiction is really important when you're creating a trust. Is that true with respect to this specific type of entity?

Mary: It is. It's true from a couple of perspectives. Okay. And so first as you want to make sure, as I mentioned earlier, that the goals and objectives of the family match up with what the state permits. The state of residents can also be a factor. So it might seem like, oh this magical thing, we're going to go create a private family trust company, but oh we live in Texas. So there's both regulated and unregulated entities. And sometimes a state might have rules that say, Hey, if you create an unregulated Nevada private family trust company, we're not going to let that company act as a trustee in our state. So you've got to look at that. Another thing to look at is, you know, do you care about dynasty trust and the rule against perpetuity statutes? So those are something that should be considered. Another thing about the jurisdiction is what's the economic condition of the jurisdiction? And another thing I think is really important is what is the commitment of that jurisdiction to supporting private family trust companies? Did they decide to add NA the statute on a whim, or does it have a long time history of supporting this type of operation? So that's the same thing I've talked about with trust. Right. So you have trust, you have states that have various trust laws that are protective of trace of trust. Well you look at Alaska, Alaska's demonstrated a pretty significant commitment. Another one of my favorite states is South Dakota. I think South Dakota has done a phenomenal job of demonstrating a total commitment to having asset protection trust available and various protective rules in that state. So the same thing applies here in the family trust company realm.

Rachel: Right. Right. So because if you're going to select your state based upon your goals, so you want to make sure the state's going to support that what is the typical ownership structure then of this type of a company?

Mary: So again, the exact and best structure is going to vary based on the family and the particular objectives. So in working with these, I've created a number of different structures depending on that. So sometimes we might have multiple level entities for different reasons. A private family trust company might operate in conjunction with a family office. That family office may be created in a different jurisdiction, the same jurisdiction, that type of thing. So what exactly are we trying to do? So we talk about objectives of involving the family. I talked about that. Do we want to involve the family or do we not care about that? Some of the private family trust companies maybe involve whether there's a family foundation and we're gonna have the private family trust company act in relation to that. So depending on exactly what the activities are going to be is going to drive that structure. Okay.

Rachel: Okay. That makes sense. How then does the governance of the company work? How is it governed?

Mary: So typically you're going to have a board of managers or directors, but there are also going to be committees and one of the thing for most private family trust companies, you can have the creator or the senior family member continue to own it. But to the extent that's the case and you have to start thinking about various tax issues, both the state tax, income, tax, powers of appointment, too much control, all of those type of issues, if this company's actually acting as trustee of the trust. So what typically is required is that you're going to have various committees. So operational documents might be one of them and you might need non-family members, professionals or somebody who is not controlled by the family who's going to be responsible for operational documents. So that changes can't be made or powers don't exist that are going to result in some of the issues that you might be concerned about. You also may have committees, and it's similar to the directed trust concept. So you might have a distributions committee that's going to review distributions to be made from the trust. It's similar to if you hired a corporate trustee, they're going to have a distribution committee that reviews any requests for distributions. Same thing with investments. So the private family trust company might have a CIO and that CIO's job might be to oversee or ensure compliance of the various investment advisors that the family has managing the assets of trust or other assets. So you might have a special needs trust and the rules for what you can invest in and that might be different from the assets of theit. So your CEO just ensures that we have investment policy statements for each of those trusts and they're being complied with. Mm-hmm. <affirmative>, most PFT states do require that there is one board member who is going to be a resident of the state. Okay. So it's important to take a look at that statute and address that, if that's the case. Mm-hmm. <affirmative>.

Rachel: Okay. Well if you had a client that is from Iowa for example, how would they go about creating this type of a, of an entity in South Dakota or Nevada?

Mary: So the private family trust company jurisdictions almost always have side requirements. Okay. So in some cases it can be met by simply having a registered agent in registered office and there are professionals companies that provide that type of service. Others might have a more significant requirement for the jurisdiction. So you have to look at that and say, can I establish that? Do we actually have to have an office in that jurisdiction? I see. If an office is required, you're gonna have to come up with an approach. And that's why let's say we have a California resident establishing a Nevada, well maybe they have a Nevada condo and that condo could be established as the office to maintain the records. But that has to be considered in deciding the jurisdiction.

Rachel: Okay. what are the formalities then with respect to setting up the private family trust company?

Mary: So, there's a difference between the regulated and the unregulated, which we're going to talk about a little bit, but it's really common for there to be a requirement of a certain number of meetings per year. For example, maybe there's a requirement for a quarterly meeting that might be of the board of directors and the committees. So it's important to actually hold those meetings and then to document those. The same thing with your committees. There's very specific rules about policies that are required creating those and complying them. So those should be done at the appropriate committee level and they should be documented. There's also various filing trust account reviews. You need to have, you know, I mentioned the investment policy statements. You want to have those and they should be reviewed from time to time, especially as trust laws change. Mm-hmm <affirmative> and as you add or subtract trusts or other entities from the process. But each jurisdiction that allows private family trust companies has some specific rules and they might vary between the regulated and the unregulated. But my policy is generally complying with the formalities required for a regulated private family trust company even if you are unregulated because that's a best practice.

Rachel: Sure. Okay. Well now you mentioned again and you did before as far as regulated and unregulated. Can you explain the differences between the two?

Mary: Yeah, so the generality there is an unregulated private family trust company has less significant compliance requirements. For example, there might be a comp, a capital requirement for a regulated private family trust company. You have to keep so many hundreds of thousands in the regulated private family trust company, whereas the unregulated doesn't have that requirement and the other requirements might be things like state audit requirements. Mm-hmm <affirmative>, you're going to have that in the regulated company. You're going to not have that in the unregulated company. Some of the procedure requirements that I mentioned earlier and the compliance are different between the two types of entities. So it's not uncommon that you might look at in unregulated private family trust company saying, well let's go for the simplicity. And it's a little more private than they're regulated. But the best practices would be, you know what, even if you're an unregulated private family trust company, consider essentially complying with the rules that apply to the private fam or to the regulated private family trust company. Because then if a question's raised, you are doing best practices. Mm-hmm <affirmative> one of several factors that's considered, and I've heard some well strategists I talked with say, Hey, it's about a dollar amount to make a decision. If you're under a certain dollar amount, then unregulated is fine. If you're over a certain dollar amount of what's going to be involved in that private family trust company, then you should be regulated that again, you can always get a generality. You know, you can ask somebody how much money should you have before you need, long before you don't need long term care insurance and I've heard anywhere from 1 million to 15 million. Right. So the answer to that varies depending on who's giving the answer. I think it's more like instead of trying to make a bright line rule related to a dollar amount, it's what exactly are we doing? How complicated are we? What kind of risks do we have? Can we ensure those risks and let's make sure that our advice is protecting the family wealth accumulation.

Rachel: Right. So then are both options available under the state statute whether to be regulated or not regulated?

Mary: And that's true in most states. Okay. So again, each jurisdiction that has the rules has different rules, but that's the common structure.

Rachel: Okay. what are their alternatives then to the private family trust

Mary: I mentioned sometimes you can simply create an entity that's a management company and do a lot of the things that you can do in the private family trust company. The big difference there is that you can't act as trustee through that entity. Right. So instead, you might look at a directed trust. So the directed trust, as I mentioned, is where you bifurcate the role of the trustee. So instead of having a corporate trustee that's gonna do anything and everything, you simply have what's called an administrative trustee who takes on a dimis role. Okay. In managing trust. And then you create the different committees. Now that directed trust approach works really well if you have a couple trusts. We have clients who have created multiple trusts for good reasons. I always say, Hey, every trust that you create is another income tax bracket. Because those trust income tax rates hit the highest at the right most amount. Mm-hmm. <affirmative> I'll say to, you know, people say, Well Mary, thanks for all those trust we created <laugh>. But then when we show them the tax and that structure versus one trust, it's like, oh maybe that wasn't such a bad idea. But you know, there's, there's family members who might create various different tri trust for good reasons. Mm-hmm <affirmative>, you might create a grant because you're thinking about a business exit. You might decide to do anit, you might decide to do a dynasty trust. You have various trust for various reasons, you create a revocable trust. So at that point, if you have a directed trust, every time you make a change on one trust, you have to make them on all assuming that you want consistency between those trusts, which is sometimes the case and sometimes not. Right. And so then the last thing is what we call just that single purpose entity. But again, as I mentioned then you still have to bring in a qualified administrative trustee, but it does work in that situation where we can create a family management type of company or family office as an alternative. And it all comes down to exactly what are you trying to do. Yeah.

Rachel: What the goals are for the client. Yep, yep. Everyone's different too. So thank you for sharing all that wonderful information. Do you have any last thoughts that you want to share?

Mary: So just my favorite couple comments is I'm really careful about terms mm-hmm. <affirmative> because everybody thinks, hey, I have a living trust. And a living trust as you know, can refer to a whole lot of different types of trust. Mm-hmm. <affirmative>, private family trust company. Well there's definitely a legal definition of that by jurisdiction Sometimes gets used in a way that's like, oh, we have this same thing with family office. So the most important thing is always to be really clear about the objectives and say which tool is gonna be the very best tool to meet those objectives. Right.

Rachel: Absolutely.

Mary: Thank you. So Rachel, thanks for being the interview. You're welcome. I really appreciate you being here.