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Generations Spring/Summer 2023 - A Perfect Pairing: High Net Worth Families and Private Trust Companies

A private trust company is a trust company established to provide trustee services for trusts created by one family, not the general public. A growing number of high net worth families are incorporating private trust companies to provide fiduciary services to the family trusts within their structure. Adding a private trust company is often a natural next step for families that desire internal management and control, particularly when a family office is already in the mix. A private trust company can offer many advantages over working with an institutional or individual trustee, and if an operational framework has already been established, integration into the family's existing structure can be seamless. As generational family trusts divide into separate trusts for children and grandchildren and there are multiple trusts benefiting members of the same extended family, economies of scale weigh in favor of consolidating governance in one entity owned and controlled by family members.

Many states now have private trust company legislation. It is no surprise those same jurisdictions are the well-known industry leaders in terms of trust legislation. Among the front-runners are South Dakota and Wyoming, each offering its own benefit. For example, families with large operating businesses or real estate empires, where some but not all family members or the family branches are involved in the management, may prefer private trust companies formed under South Dakota law, which offers some degree of regulation. In contrast, Wyoming's unregulated model may be optimal for families that value confidentiality, autonomy and ease of administration.

Typically, the owner of a private trust company is a purpose trust, the sole function of which is to hold shares of stock or membership interests in the private trust company. The purpose trust can also be used as a vehicle to own the entity that is the family office, placing the ownership, management and control under one umbrella. Governance at the level of the purpose trust typically consists of a different protector for each family branch, appointed by members of that family branch. From there, it is open architecture in terms of developing the right approach for each family.

The level of customization can be illustrated with a few examples. For families that desire direct involvement, the protector representative of a particular family branch can correlate to a seat on the board of the private trust company. Having a designated seat on the board allows the family representative to be involved in the decisions of the private trust company and report back to the family branch at family meetings. The family can establish various age and qualification standards for the protector representative of that branch. In that way, different family branches can set their own criteria, which can be tailored to each family's circumstances. At the same time, younger generations can become more involved as appropriate and can gain valuable experience, while older generations can be phased out or retain control, depending on the family dynamic.

Alternatively, with a more hands-off approach, a protector committee can be elected by various family branches at the level of the purpose trust. That protector committee can simply elect members of the board and, if a family office already exists, nominate the family office entity or high-ranking employees of the family office to serve on the board. In that case, the protector committee may only want broad oversight authority over the family office; but if further checks and balances are warranted, a nominated representative of the protector committee can be given an overseer role on the board, with or without voting rights.

The various U.S. tax considerations for settlors and beneficiaries of the family's trusts who serve as protectors or board members (or provide important removal and appointment functions) are addressed in the deed of the purpose trust or the bylaws or operating agreement of the private trust company. Generally speaking, separate distribution committees are formed for different trusts. Additionally, HEMS committees (for health, education, maintenance and support) are designated to make trust distributions subject to a legally ascertainable standard. Separate investment management committees can be established for different trusts or asset classes, with trust settlors and beneficiaries serving with minimal restriction. Many of the relevant U.S. tax issues were addressed by the IRS in guidance published in 2008. That said, several important issues remain open. Advice at all stages of the implementation and administration of a private trust company structure is warranted, especially when customizing the roles for a particular family's needs. With proper restrictions in place, settlors and beneficiaries of family trusts can be involved in everyday management, with the advantage of having continuity of the governing structures in the event of disability or death.

Family offices searching for innovative solutions should consider the significant benefits that a private trust company can offer. With the ability to leverage valuable systems already in place, integrating the private trust company into an existing family office structure can be a smooth and seamless process. As families become more international, the private trust company can readily be adapted to accommodate the ever-changing needs of the family members its serves, allowing the family to remain collectively invested, its decision making fully integrated and its worldwide wealth managed under one platform.

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