

If You Really Want Control Your Wealth, Then Think SMALL!

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“It isn't enough to have a trust fund any more. The next step is to have your own trust company.”²

Wealth families are taking more control over the inheritance process. One element that is gaining in popularity is the ‘private trust company.’ Rather than have the family’s money under the control of institutions, who often are more interested in selling a ‘product’ and providing good counsel, the families are turning inward.

A private trust company is a corporation that acts as a trustee of trusts. Usually for a single trust, or a series of trusts centering around one family, or a branch of a family. Frequently the settlor and/or the families are on the board of the trust company. That way they can have influence over the trust company - but do not directly ‘control’ the trust. In the past few years there has been a marked increase in the use of ‘private trust companies’ by wealthy families.

Private trust companies offer a multitude of advantages, including economies of scale, multi-generational management, more direct control over the family’s wealth, asset protection, to name only a few of the benefits.

Private trust companies are often part of a larger structure with a family office, where all of the extended family member’s investments are gathered and administered through a central office that employs a combination of family members and professionals. So rather than go directly to a large bank or trust company, these family are bringing many of the services being offered by the banks and trust companies ‘in house.’ Their private trust company traditionally has one family as its client.

We understand that private trust companies have been established by the Bell family of General Mills, the Cargills of the grain-trading company, the Pratt family of Standard Oil (Pratt

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² Rachel Emma Silverman, “Matters of Trust: Super-Rich Set Up Companies,” Wall Street Journal, August 4, 2007.
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was Rockefeller's partner), and by member of the Ziff family whose core wealth is publishing.

The concept of a company acting as a 'trustee' of a trust, goes back more than a century. Most national banks has as part of their name "... & NTA" (national trust association) - meaning they could act as trustees. The position of corporate trustees for near a century has been heavily regulated in a manner similar to banks and insurance companies. Most jurisdictions, both in the US and abroad do not allow corporations to act as trustees without being licensed, and subject to substantial capital requirements, supervision and reporting obligations (*e.g.*, audited financials), and in some instances, the information relating to the trust company and its activities are public information. As a result of the regulation, there is less competition, and higher fees.

We have now seen a number of domestic and offshore jurisdictions that are streamlined their corporate trust rules to permit minimal governmental involvement in forming a 'private trust' company whose services are limited to a select few related clients. In the US, many of the private trust companies are formed in states that do not impose an income tax on their operations and that have minimal capital requirements for such companies, such as Delaware, Texas, South Dakota, or Wyoming. In December 2006 the Bahamas passed a private trust companies act, and earlier this year the British Virgin Islands promulgated rules allowing the establishment of private trust companies. If the guidelines are followed, neither jurisdiction imposes any oversight on the companies, and taxation can be minimized at the trust company level, so that all of the tax consequences flow to the trust.

Discussions on the use of private trusts companies is becoming a prominent topic in sophisticated estate planning. At a recent ABA meeting in March in Washington D.C., the use of private trust companies was a major topic.

Some of the benefits of a private trust company include:

- Allowing the settlor to have a degree of control over the trust. In some jurisdictions, an element of control may cause the trust to fail, as not being separate from the settlor. Through the use of a properly structures private trust company, this issue can also be minimized.
- The aggregation of disparate family wealth under core management - achieve the economies of scale. The decedents of the Pratt family had 700 heirs, and many of their trusts had near or less than \$1 million in assets, so they were not able to access top money managers or many sophisticated investments. So they formed a family trust company to amalgamate the family's holdings under one private trust company. Some of the Pratts have had a family office for 107 years.
- Ability to obtain 'directors and officer' and 'errors and omission' insurance, they providing a degree of protection for the family members who often manage the extended family's wealth.
- With the litigation that often accompanies unsatisfactory investment returns, or

liability that may flow from certain types of investment (*e.g.*, liability for toxic clean-up from owning real estate), many trust companies have limited the type of investments that they will allow a trust to hold. By having a private trust company, the members of the family can determine what assets are acceptable.

- Establish long term, multi-generational management of the family's trust and wealth. Continuity of management has become a major issue as some of these trusts have grown exponentially in asset value, they are not likely to terminate or dissipate. Until recently, few states, or even offshore jurisdictions offered trust that were not subject to some time limitation - we now have six states, and multiple foreign jurisdictions that allow trusts to be formed in perpetuity.
- Obtain a degree of confidentiality that is not often available from traditional management structures.

There are valid reasons for financial 'confidentiality.' One traditional vehicle for achieving this goal was the famed secret 'Swiss bank account.' Recent events in Switzerland and Liechtenstein teach us that there is no secrecy in an institution as big as an offshore bank or trust company. If a client is truly seeking privacy, they should think small, and consider establishing a private trust company.

There are valid reasons to keep ones your business affairs from becoming public (*e.g.*, you want to assemble multiple parcels into one large tract to be developed), or if the extent of your wealth were to become known, the reaction from friends, family and business associates - mostly with their hand out asking for money, or even to avoid the potential for kidnapping. However, nefarious goals, such as tax evasion must be avoided.

In the past few decade there have been several instances of massive disclosure of so-called offshore 'secret' information, and there is likely to be much more disclosure in the future. Just a few instances will serve as a stern example.

Castle Bank: The IRS working through an informant, hired a prostitute to entertain a Bahamian banker. While they were out to dinner, the banker's briefcase was taken, the contents copied, including his list of US customers who had accounts, many of which were undisclosed. The Supreme Court held the rights of taxpayers were not violated, and since the information belonged to the bank/banker, not the client, they had no standing to challenge the theft.

Guardian Bank: Mr. Mathewson was president of Guardian, a Cayman bank. He was arrested in the U.S., and provided copies of all of the bank records, and his personal records of the client's entities/trusts. This earned him a substantially reduced sentence.

Bank Julis Bär: Someone has been positing secret information from the Bank's Cayman branch on the Web - which has led to investigations of some of the Bank's clients.

LGT Group: LGT operates a bank and trust company in Liechtenstein. A former employee recently sold to German for \$7.5 million a DVD that contained account information on 1,400 customers of the trust company. The information has led to investigations in 6 countries, arrests, and recovery of substantial unpaid taxes, not to mention the embarrassment of many corporate executives and governmental officials.

USB: An ex-banker from UBS recently plead guilty to aiding US clients evade tax. He is naming names, and providing details (*e.g.*, for one US client he smuggles diamonds into the US in a tube of toothpaste). The US has obtained a “John Doe” subpoena against the bank. This may ultimately lead to some disclosure by Swiss banks.

Rewards: Germany having paid \$7.5 million for information, quickly received more than \$82 million in voluntary tax payment from taxpayers who wanted to show their good faith. England has a tax avoidance hot line - last year it received 20,00 tips. The US’ IRS has established the Office of Whistleblower. The IRS is now paying rewards of up to 30%! Think about how much money a secretary in an ‘offshore’ bank or trust company can make by violating home-country secrecy laws and disclosing a 1,000 names/account information. Or the ex-wife/girlfriend, who doesn’t like the prenuptial or cohabitation agreement. The incentives are in place to generate disclosure of ‘secret’ bank information - and people will be coming forward!

In the US, as long as the government was not a party to the theft of confidential information it can be used in a criminal prosecution. Even if the government was complicity, the information will support a civil claim (*e.g.*, tax, interest and civil fraud penalties).

What is someone to do who has a legitimate need for privacy and confidentiality in their financial affairs? For more than two decades there has been an emerging trend for wealthy families to establish “private trust companies.”

Although in most jurisdictions private trust companies are formed as corporations, in some jurisdictions, such as South Dakota, they are often formed as limited liability companies.

A private trust company does not enhance any tax benefits for trust or the beneficiaries. A private trust company should be used purely as a business and management tool. Careful attention needs to be paid to the structure of private trust companies, for the IRS will not rule if a private trust company is the owner of the underlying assets for estate or gift tax purposes. However, on July 11 the IRS issued taxpayer friendly Notice 2008-63, that gives taxpayers more control over their trusts, while protecting them from negative estate and gift tax consequences. This new Notice will make PTCs more attractive.

Some very sophisticated structures for private trust companies have the shares being owned by a ‘purpose trust’ rather than by the family members. A purpose trust is a special type of trust that has no beneficiaries - but exists to carry out a purpose, *e.g.*, the ownership of the

stock of a private trust company.

A private trust company offers many business advantages to a wealthy family, in addition to enhanced confidentiality and economics of scale. A private trust company should be considered when evaluating the use of a family office, and other aspects of multi-generational estate planning.