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Home Away from Home: Factors to Consider When Choosing Where to Locate a Private Family Trust Company

By Richard A. Johnson, Esq.
Richard T. Hills, Esq.
and
G. Michael Yopp, Esq.*

INTRODUCTION

Although only a limited number of states permit Private Family Trust Companies (PFTCs), significant

* Richard A. Johnson, G. Michael Yopp, and Richard T. Hills are partners in the Nashville, Tenn. office of Waller Lansden Dortch & Davis, LLP. Mr. Johnson's legal practice focuses on the representation of large family-owned and closely held businesses, high net worth individuals, family offices including their private family trust companies, and tax-exempt organizations. He formed the first private family trust company under Tennessee law and assisted in drafting new legislation updating Tennessee's private trust company law. Mr. Johnson is recognized for his tax law and trusts and estates experience by *Best Lawyers*. Mr. Yopp's legal practice centers on state and federal taxation, partnerships, limited liability companies, and general business law. His extensive experience includes estate planning, trust and estate matters, and conservatorships and guardianships. Mr. Yopp has been recognized for his tax law experience by *Best Lawyers* for more than 20 years. Mr. Hills' legal practice focuses on the representation of financial institutions ranging from de novo community banks, well-established bank holding companies with regional and national operations. He advises public and private trust companies in the organizational process and in connection with ongoing operational matters. Additionally, Mr. Hills assists financial services clients in mergers and acquisitions, stock and debt offerings, corporate formations and restructurings, recapitalizations, corporate governance, and regulatory compliance. The authors thank Nina Wall, Vanderbilt University Law School student, for her assistance with this article.

variations exist within the statutory framework and the underlying policies of those states. These variations have a significant impact on a PFTC's organizational structure, operating procedures, and costs. Thus, it is essential that the creator of a PFTC have complete knowledge of these differences when choosing the state in which to locate a PFTC. In addition, the operations of PFTCs can be significantly impacted by applicable trust laws and the corporate or limited liability company laws. This article will review the PFTC statutes in five of the more popular states — Florida, Nevada, Wyoming, South Dakota, and Tennessee — detailing the differences between each state's statutes impacting PFTCs and highlighting the potential effects of these differences.¹

IMPACT OF VARIATIONS IN PFTC STATUTORY LANGUAGE ON UTILITY OF STATE'S PFTC REGIME

Variations between states' PFTC statutory language lead to varying substantive requirements for the establishment of a PFTC. Substantive differences include the definitions of who can own a PFTC (e.g., "family members"), who can be served by a PFTC (i.e., "family members" and "family clients"), how a family is defined through familial relationship with "designated relatives" or "designated ancestors," and procedural differences and variations as to disclosure requirements.

Statutory Definition of "Designated Relative" or "Designated Ancestor" Varies Among States

Defining a PFTC's "designated relative" (sometimes called a "designated ancestor") establishes the

¹ Although South Dakota is included in this collection, many of South Dakota's requirements remain uncodified in statute. Instead, the information herein comes from telephone conversations with regulators at the South Dakota Department of Labor and Regulation — Division of Banking.

guidepost for determining the definition of a “family” and how extensive it is. The number of designated relatives a PFTC may use varies among the states under consideration.² Nevada and Wyoming both limit the definition of “designated relative” to one person, referencing only the common ancestor from whom the entire “family” descends.³ Florida is more permissive, allowing a PFTC to choose two designated relatives, as long as those designated relatives have no common ancestors within three generations, which means two unrelated families may form a PFTC together.⁴ Tennessee allows multiple designated relatives; the statute permits two married designated relatives and also includes within the definition of “designated relative” former or subsequent spouses of those original two married designated relatives.⁵ South Dakota statutes include no guidance regarding designated relatives, and the South Dakota Division of Banking implies that it will review each application to determine if the included family members are sufficiently related.⁶

Beyond Variations in “Designated Relative” Definitions, Significant Differences Exist in the Manner in Which These States Define “Family Members”

One of the most basic differences between states’ PFTC regimes is the manner in which each state de-

² See Fla. State. Ann. §662.111 (2017); Nev. Admin. Code §669A.050 (2017); Tenn. Code Ann. §45-2-2001(b)(2)(B) (2017); Wyo. Stat. Ann. §13-5-204 (2017).

³ Nev. Admin. Code §669A.050; Wyo. Stat. Ann. §13-5-204.

⁴ Fla. Stat. Ann. §662.111, §662.120.

⁵ Tenn. Code Ann. §45-2-2001(b)(2)(B)

⁶ S.D. Codified Laws §51A-6A-1 (2017); Telephone conversation with regulator, 7/17/2017.

fines families, and the statutory definition of “family member” varies widely among these states.⁷ Florida’s statute is the most restrictive, requiring six degrees of lineal kinship, while Tennessee permits the most liberal lineal kinship, allowing 12 degrees to suffice for family membership.⁸ Tennessee is similarly permissive in the category of collateral kinship, where up to 11 degrees of collateral kinship is sufficient, whereas Florida, Nevada, and Wyoming restrict family membership to only nine degrees of collateral kinship.⁹ Like the definition of “designated relative,” South Dakota statutes do not include a definition of “family member,” but instead seem to determine family membership on a case-by-case basis.¹⁰

Who Can a PFTC Serve?

Florida, Nevada, and Wyoming simply define a PFTC’s clients as the family members. In contrast, Tennessee provides a separate definition of “family clients” that may be served by the PFTC. This definition of family clients includes both family members as well as other persons who can be clients of the trust company. In all statutes, however, the definitions of allowable PFTC clients are detailed and complex. A chart of permissible clients can be found below:¹¹

⁷ See Fla. Stat. Ann. §662.111(11); Nev. Admin. Code §669A.070; Tenn. Code Ann. §45-2-2001(b)(2)(E); Wyo. Stat. Ann. §13-5-204(a)(vi).

⁸ See Fla. Stat. Ann. §662.111(11); Tenn. Code Ann. §45-2-2001(b)(2)(E).

⁹ Tenn. Code Ann. §45-2-2001(b)(2)(E); Fla. Stat. Ann. §662.111(11); Nev. Admin. Code §669A.070; Wyo. Stat. Ann. §13-5-204(a)(vi).

¹⁰ S.D. Codified Laws §51A-6A-1 (2017); Telephone conversation with regulator, July 17, 2017.

¹¹ South Dakota is not included in this chart because of the lack of statutory authority governing the definition of family members and permitted clients.

State	Florida ¹²	Nevada ¹³	Tennessee ¹⁴	Wyoming ¹⁵
Lineal kinship to designated relative?	6 th degree	10 th degree	12 th degree	10 th degree
Collateral kinship to designated relative?	9 th degree	9 th degree	11 th degree	9 th degree
Adopted children?	Statute silent	Included	Included	Included
Stepchildren?	Statute silent	Included	Included	Included
Foster Children	Statute silent	Statute silent	Included	Included

¹² See Fla. Stat. Ann. §662.111(11), (12).

¹³ See Nev. Admin. Code §669A.070.

¹⁴ See Tenn. Code Ann. §45-2-2001(b)(2)(D), (E).

¹⁵ See Wyo. Stat. Ann. §13-5-204(a)(vi).

Spouse/former spouse?	Included, as well as fifth degree lineal kinship of spouse/former spouse	Included, as well as fifth degree lineal kinship of spouse/former spouse	Included, as well as fifth degree lineal kinship of spouse/former spouse	Included, as well as fifth degree lineal kinship of spouse/former spouse
Family affiliate?	Included	Included, as well as affiliate's officers/directors and their immediate family members	Included, as well as affiliate's officers/directors and their immediate family members	Included
Family member trust?	Included	Included	Included	Included if funded or administered by family member
Nonfamily member trust?	Included if all noncharitable beneficiaries are family members	Included, if at least one family member is a beneficiary	Included, if at least one family member is a beneficiary	Statute silent, likely excluded
Family member estate?	No ¹⁶	Included	Included	Statute silent, likely excluded
Nonfamily member estate?	No ¹⁷	Included, if at least one family member is a beneficiary	Included within the definition of "family client"	Statute silent, likely excluded
Charitable foundation?	Included if the majority of the foundation's governing body members are family members	Included if a family member is an organizer, incorporator, member of board, trustee, major donor or noncharitable beneficiary, along with the officers, directors, individual trustees and managers of that foundation, as well as the immediate families of such individual	Included if an organization, foundation or trust whose primary purpose is not-for-profit whether or not tax qualified if a family client is an organizer, incorporator, member of board, trustee, major donor or noncharitable beneficiary, along with the officers, directors, individual trustees and managers of that foundation, as well as the immediate families of such individual	Statute silent, likely excluded
Nonfamily employees	Up to 35 nonfamily members if the individuals are current or former employees of the PFTC, or of trusts, companies or other entities that are defined as family members	Statute silent	Included if individual is a full-time employee of the PFTC or a full-time employee providing personal services to a family member	Statute silent

¹⁶ Fla. Stat. Ann. §662.131. Florida PFTC is prohibited from serving as a personal representative of a Florida probate estate.

¹⁷ *Id.*

Much like the other provisions highlighted in this article, the definition of a family affiliate varies from state to state. Florida defines a family affiliate as "a company or other entity in which one or more family members own, control, or have the power to directly or indirectly vote more than 50 percent of a class of voting securities of that company or other entity."¹⁸ Tennessee defines a family affiliate as a "company or other entity in which one (1) or more family members, directly or indirectly, through ownership of voting securities or equity, by contract, through power of direction, through beneficial or other ownership in one or more entities or otherwise, owns a majority interest or may direct or cause the direction of the management and policies of the company or other entity,

whether alone or in combination with others."¹⁹ Nevada defines a family affiliate as "a company or other entity with respect to which one or more family members or affiliates own, directly or indirectly, a material interest in the company or entity, or possess, directly or indirectly, the power to direct or cause the direction of the management and policies of that company or entity, whether through the ownership of voting securities, by contract, power of direction or otherwise."²⁰ Lastly, Wyoming defines a family affiliate as "a company or other entity, including charitable non-profit organizations, charitable foundations, charitable trusts, or other charitable organizations, with respect to which one or more family members or affiliates

¹⁸ Fla. Stat. Ann. §662.111(10).

¹⁹ Tenn. Code Ann. §45-2-2001(b)(2)(C).

²⁰ Nev. Admin. Code §669A.060.

own, directly or indirectly, one hundred percent of the company or entity or possess, directly or indirectly, the power to direct or cause the direction of the management and policies of that company or entity, whether through the ownership of voting securities, by contract, power of direction or otherwise.”²¹ Given these various definitions, a family may want to consider a state’s specific definition of “family affiliate” when choosing where to establish its PFTC.

Families Interested in Anonymity Should Choose a State That Guarantees Complete Anonymity in Establishing a PFTC

One of the benefits of establishing and maintaining a PFTC is the anonymity it provides, but the degree of anonymity permitted varies among the states under consideration. Tennessee, for example, allows total anonymity except for the name of the trust company. Additionally, the name of the entity is not required to include the word “trust.” Without knowing the entity name it would be very difficult to search for the PFTC on the Secretary of State website given the name does not have to include the word “trust.”²² Similarly, Nevada maintains complete anonymity, requiring a subpoena for any disclosures.²³ Wyoming provides significant anonymity, but the name of a newly established PFTC might be subject to disclosure.²⁴ Similarly, Florida shields some personal information, but some PFTC details are subject to disclosure under the state’s financial code.²⁵ South Dakota statutory language emphasizes confidentiality.²⁶

Procedural Variations Between Statutory Language Can Have Significant Effects On the Feasibility of Creating and Maintaining a PFTC

In addition to significant substantive variations within these states’ PFTC statutes, application proce-

dures and requirements vary among the states under consideration. Although admittedly less crucial than the substantive differences between PFTC statutes, a state’s application procedure and requirements may influence a family’s decision to establish a PFTC in that particular state. Additionally, a family should also consider a state’s capital, bond, and/or insurance requirements to determine which state’s requirements best suit the family’s needs.

Capital and Bond Requirements May Influence Families’ Decision to Establish Trusts in a Particular State

All of the states under consideration require that families establishing a PFTC demonstrate a minimum level of capital and some require the families to maintain some form of bond or insurance. In Florida, for example, a PFTC with one designated relative requires \$250,000 in capital, while a PFTC with two designated relatives requires \$350,000 in capital.²⁷ Florida also requires a \$1 million fidelity bond, although the requirement can be satisfied by pledging an additional \$ 1 million of capital.²⁸ Florida also requires a \$1 million errors and omissions insurance policy.²⁹ Wyoming requires \$500,000 in capital and requires a \$1 million bond, but families can pledge their entire capital in lieu of the bond.³⁰ Nevada requires \$300,000 in capital, and only requires bond as the family deems necessary.³¹ South Dakota requires \$200,000 in capital, although the head of the Division of Banking has discretion to require more, and requires both a \$1 million Directors’ and Officers’ insurance policy and a \$1 million bond.³² Most permissively, Tennessee neither requires any particular minimum amount of capital nor requires any bond or liability insurance.³³ The Tennessee Department of Financial Institutions generally allows the family to set the capital requirement with input from the Department.

²¹ Wyo. Stat. Ann. §13-5-204(a)(v).

²² Tenn. Code Ann. §45-1-120, §45-1-109, §45-1-124, §45-2-173, §45-2-1603. In summary, unless the Commissioner of the Tennessee Department of Financial Institutions determines otherwise, information from the Department’s records, examination information, and any other document regarding the condition and affairs of the PFTC are privileged, confidential, and not subject to subpoena except for certain state and federal agencies and proceedings in which the Commissioner filed an action. The Commissioner and Department employees take an oath to safeguard the Department’s records, and it is a criminal offense if the oath is willfully violated.

²³ Telephone conversation with regulator, July 12, 2017.

²⁴ Telephone conversation with regulator, July 13, 2017.

²⁵ See Fla. Stat. Ann. §662.141; §119.07.

²⁶ S.D. Codified Laws §51A-6A-2.

²⁷ Fla. Stat. Ann. §662.125.

²⁸ Fla. Stat. Ann. §662.126.

²⁹ Fla. Stat. Ann. §662.126.

³⁰ Wyo. Stat. Ann. §13-5-208.

³¹ Nev. Admin. Code §669A.160.

³² Telephone conversation with regulator, July 17, 2017.

³³ See Tenn. Code Ann. §45-2-2001, §45-2-2002.

Variety in Residency Requirements Allows Families to Choose a State Trust Regime That Best Suits Their Needs

Each state discussed in this article requires a PFTC to establish a physical office in the state of incorporation.³⁴ The states vary, however, in officer or board member residency requirements.³⁵ Florida and Nevada each require that at least one officer or director be a resident of the state of incorporation, while neither Tennessee nor Wyoming require any director or officer be a resident of the state.³⁶ South Dakota requires that a PFTC have between three and 12 board members and further requires that one board member be a South Dakota resident.³⁷

Significant Variations in Application Approval Times Can Mean Delays in Establishing a PFTC

A family considering establishing a PFTC likely desires an expedient and relatively inexpensive application process. While each of these states has stated application fees and have published anticipated application turnaround times, the details of the procedure vary from state to state. Florida requires a \$10,000 application fee and can establish a PFTC within 90 days of a completed application.³⁸ To apply in Nevada, a family must submit a \$3,000 application fee, and an application takes between four and six months to process.³⁹ Like Florida, Wyoming requires a \$10,000 application fee, but can process an application in 45 days.⁴⁰ South Dakota requires that a family submit an application with a \$5,000 application fee, and the initial review takes 30 days.⁴¹ After the initial review, the South Dakota Division of Banking will communicate with the applicant to gather more information, ultimately approving or denying the application anywhere between 90 days and six months after the ap-

³⁴ Fla. Stat. Ann. §662.1225; Nev. Admin. Code §669A.140; Tenn. Code Ann. §45-2-2002; Wyo. Stat. Ann. §13-5-206.

³⁵ See Fla. Stat. Ann. §662.125; Nev. Admin. Code §669A.140; Tenn. Code Ann. §45-2-2001, §45-2-2002; Wyo. Stat. Ann. §13-5-201 et seq.

³⁶ Fla. Stat. Ann. §662.125; Nev. Admin. Code §669A.140; Tenn. Code Ann. §45-2-2001, §45-2-2002; Wyo. Stat. Ann. §13-5-201 et seq.

³⁷ S.D. Codified Laws §51A-6A-13.

³⁸ Fla. Stat. Ann. §662.121; Telephone conversation with regulator, July 12, 2017.

³⁹ Nev. Admin. Code §669A.190; Telephone conversation with regulator, July 12, 2017.

⁴⁰ Wyo. Stat. Ann. §13-5-209; Telephone conversation with regulator, July 13, 2017.

⁴¹ Telephone conversation with regulator, July 17, 2017.

plication.⁴² Tennessee requires the smallest application fee of \$1,000 and can process an application in 45 to 60 days, potentially completing the process within 30 days, if necessary.

INVESTMENT ADVISOR EXEMPTION

The Investment Advisers Act of 1940 (IAA) identifies who must register as an investment adviser. Prior to the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act),⁴³ the IAA had an exemption from registration for “private advisers.” Prior to the Dodd-Frank Act, family offices and private family trust companies serving only one family used this exemption to avoid the requirement to register as an investment adviser. The Dodd-Frank Act eliminated the private adviser exemption but created a new exemption for family offices and delegated the definition of a family office to the Securities and Exchange Commission (SEC). The SEC defined a family office as a company wholly owned by family clients and exclusively controlled (directly or indirectly) by one or more family members.⁴⁴ The definitions of “family members” and “family clients” for purposes of the SEC rule, however, are generally more limited in scope than the equivalent definitions under state PFTC laws.⁴⁵

Trust companies subject to state regulation are also excluded from the definition of an investment adviser under the IAA. Section 202(a)(11)(A) of the IAA excludes from the definition of investment adviser any bank.⁴⁶ The IAA defines the term “bank” to include any banking institution or trust company which (i) is doing business under the laws of any State or the United States; (ii) a substantial portion of the business of which consists of receiving deposits or exercising fiduciary powers similar to those permitted to national banks; and (iii) *is supervised and examined by a State or Federal authority having supervision over banks or savings associations.*⁴⁷ This exception will not apply to trust companies that are not regulated by state law, such as unregistered trust companies operating in Florida, Nevada, or Wyoming.

Corporation and Limited Liability Company Statutes

Generally, a PFTC is organized as a corporation or a limited liability company. When using either entity,

⁴² Telephone conversation with regulator, July 17, 2017.

⁴³ Pub. L. No. 111-203.

⁴⁴ 17 C.F.R. §275.202(a)(11)(G)-1.

⁴⁵ See 17 C.F.R. §275.202(a)(11)(G)-1(d)(6); 17 C.F.R. §275.202(a)(11)(G)-1(d)(4)

⁴⁶ 15 U.S.C. §80b-2(a)(11)(A).

⁴⁷ 15 U.S.C. §80b-2(a)(2).

due to federal tax law considerations, the PFTC's shareholder or member, as the case may be, may be a trust or other entity with an independent individual making decisions for such owner entity. Generally, the independent person has exclusive control of any modification of tax-sensitive provisions in the organizational documents. In addition, the organizational documents will provide, for example, a trust distribution committee in which independent persons make distribution decisions. Although the independent person or entity can be removed and replaced, the ability of an independent person to have sole authority to vary the tax-sensitive provisions must be irrevocable. This type of structure is analogous to Situation 2 of IRS Notice 2008-63.⁴⁸

In contrast to this structure, Tennessee PFTCs may be organized under either Situation 1 or 2 of IRS Notice 2008-63 as limited liability companies with a family being direct owners of the entity. Situation 1 is possible because Tennessee's LLC Act contains a unique provision. This provision allows Tennessee's LLC law to be modified to vest, irrevocably, in a non-member, independent person or entity, the exclusive

right to modify the governing documents with respect to the tax-sensitive provisions. In effect, an independent person or entity exercises the governance rights (without any financial rights) with respect to the LLC on any matters that concern the tax-sensitive provisions in the organizational documents. As a result, the family may directly own the LLC but will not have governance rights related to changes in the organizational documents regarding tax-sensitive matters. This structure, in effect, is similar to Situation 1 of the IRS Notice.

CONCLUSION

When establishing a PFTC, selecting a home state can have significant impact on the PFTC's organization and operation. Statutory variation in substantive elements (like the definition of "designated relative" and "family member") and application procedures and requirements (such as minimum capital requirements and application fees) mean that the establishment and operation of a PFTC differs significantly from state to state. Accordingly, families considering establishing a PFTC should carefully consider each state's corresponding statutory regime.

⁴⁸ 2008-31 I.R.B. 261.