Both private trust companies (PTCs) and family offices (FOs) are often integral parts of family-owned and family-controlled enterprises. As services organizations that are used to manage and control assets, orchestrate transition, and represent family interests within a multi-generational structure, the overall goal of both types of entity is to guide the use and enjoyment of family assets across generations. The reasons for establishing an FO or a PTC—or both—are numerous and varied. For some families, the most streamlined and efficient approach involves integrating the two.

As a family enterprise grows, the integration of a PTC and an FO can be particularly attractive; if done properly, it can create economies of scale and result in efficiencies like those found in a multi-national corporation structured as a parent-subsidiary or branch operations. For example, one model moves the FO into a headquarters-type position as it takes on the supervision and control of the component parts of the operations of a family enterprise, resulting in consolidation, consistency, and substantial overall supervision of the group. The FO may supervise several subsidiary operations including fiduciary services, insurance companies, and philanthropy management—much like a corporate holding company popular with many parent-subsidiary companies of the world. From an ownership standpoint, the FO would hold the equity interests in the subsidiary operations. This model is efficient, offers creditor protection, and promotes consistency among

William J. Kambas is a partner at Withers Bergman LLP in Greenwich, Connecticut, and New York City. Amy M. Staehr is a partner at Long Reimer Winegar LLP in Jackson, Wyoming. Constance Shields is a partner at Withers Bergman LLP in New Haven, Connecticut, and New York City.
Tiered Structures for Family Office Operations
Integrating a Private Trust Company with a Family Office

By William J. Kambas, Amy M. Staehr, and Constance Shields

Both private trust companies (PTCs) and family offices (FOs) are often integral parts of family-owned and family-controlled enterprises. As services organizations that are used to manage and control assets, orchestrate transition, and represent family interests within a multi-generational structure, the overall goal of both types of entity is to guide the use and enjoyment of family assets across generations. The reasons for establishing an FO or a PTC—or both—are numerous and varied. For some families, the most streamlined and efficient approach involves integrating the two.

As a family enterprise grows, the integration of a PTC and an FO can be particularly attractive; if done properly, it can create economies of scale and result in efficiencies like those found in a multi-national corporation structured as a parent-subsidiary or branch operations. For example, one model moves the FO into a headquarters-type position as it takes on the supervision and control of the component parts of the operations of a family enterprise, resulting in consolidation, consistency, and substantial overall supervision of the group. The FO may supervise several subsidiary operations including fiduciary services, insurance companies, and philanthropy management—much like a corporate holding company popular with many parent-subsidiary companies of the world. From an ownership standpoint, the FO would hold the equity interests in the subsidiary operations. This model is efficient, offers creditor protection, and promotes consistency among operations, much like a logistics center. An alternative model results in the PTC as the headquarters or parent component.

Such integration, however, is not without risk and can have unintended consequences. In this article, we focus on some of the leading issues faced when integrating a family’s PTC with its FO. In certain cases, the combination of responsibilities into a unified structure will result in exponential benefits.

The Family Office
An FO is often formed when a wealth generator recognizes value in employing dedicated services to a family enterprise. An FO can be complementary to a PTC, though it involves different roles and a distinct approach to asset management. An FO may evolve out of a family business, but FOs are also commonly established following a liquidity event when a wealth generator decides that private, captive assistance is necessary. Although an FO may be tasked with managing certain assets otherwise held in trust, it is also common for an FO to offer services to family members directly and to manage assets and shareholdings outside of a trust structure. Additionally, legal developments around the private equity and FO industries like the December 2017 Lender Management v. Commissioner decision have validated the bona fide business purpose of a family-member-run FO.

No list of pros and cons of FOs is exhaustive, but certain themes emerge. Benefits of a comprehensive FO structure include protecting assets from creditor claims, ensuring the tax efficient transfers of assets to subsequent generations, managing transfers to descendants or their trusts consistent with family values (whether or not there is an established family mission or constitution), administering structural particularities such as QPTs, GRAT payments, the grant-making
fiduciary, there are income, estate, gift, and generation-skipping transfer tax considerations to keep in mind when family members create a PTC. The PTC may bear primary responsibility for the management of trust assets; as such, a PTC may emerge as a suitable mechanism to allow a family or its chosen advisors to retain some involvement in the trust management process. Additionally, through a PTC, the family and its advisors can tailor trustee services to the family’s goals while taking into account the family’s specific assets, whether those assets are human, social, intellectual, or financial. There have been productive developments in the PTC space, largely driven by variations in state regulation, resulting in the ability to choose regulated versus unregulated PTCs, all of which serve to make such entities even more attractive to the right clients.

**Framework for Organizing the Division of Labor**

Traditional FO services include responsibilities that fit into one or more of the following categories: managing investments, administrative services, legal services, tax services, wealth transition and legacy planning (i.e., estate and inheritance planning), and philanthropy. Some might suggest that the heart of an FO is investment management, but a fully developed FO can provide a number of other services, ranging from training and education to ensuring that best practices are followed in family governance.

Although not required, many PTCs comply with IRS Notice 2008-63, which is the IRS’s only attempt to delineate roles and responsibilities within a PTC structure as they relate to US gift, estate, and generation-skipping transfer tax. Traditional PTC services can be broken down into three key areas—distribution decisions, investment decisions, and amendment powers (as they relate to the PTC structure). Under the basic framework employed by many PTCs, the following roles and responsibilities are generally integrated first for PTC management, but also with respect to areas of overlap with the FO:

1. **Board**: The board members may run all facets of the PTC or FO themselves. The board may create one or more committees and board members either serve on those committees themselves or appoint individuals to serve. In simpler PTC or FO structures, the committee members are also board members. In larger
The Private Trust

A PTC is a fiduciary vehicle used to oversee assets within a trust structure by acting as trustee of one or more trusts for the benefit of a single family. Because trusts are a primary tool for managing and serving wealth through generations, the ultimate day-to-day control of those trusts as exercised through a trustee is a key factor for insuring the family's trust and its assets operate in a manner consistent with the family's vision and values. Because the PTC is a family-established and, in some cases, a family-controlled fiduciary, there are income, estate, gift, and generation-skipping transfer tax considerations to keep in mind when family members create a PTC. The PTC may bear primary responsibility for the management of trust assets; as such, a PTC may emerge as a suitable mechanism to allow a family or its chosen advisors to retain some involvement in the trust management process. Additionally, through a PTC, the family and its advisors can tailor trustee services to the family's goals while taking into account the family's specific assets, whether those assets are human, social, intellectual, or financial. There have been productive developments in the PTC space, largely driven by variations in state regulation, resulting in the ability to choose regulated versus unregulated PTCs, all of which serve to make such entities even more attractive to the right clients.

Division of Labor

When considering a combined structure, whether in a parent-subsidiary arrangement or branch operations, careful thought should go into the division of roles and responsibilities. The services contained in and offered by each of the two asset oversight regimes—the PTC and the FO—are often quite different and yet overlap in ways that result in redundancies that can be eliminated. Where employees or other personnel are shared, the form of the arrangement should be carefully considered; in many cases employees may be engaged by each separate entity for specific services. There is no single approach to organizing an FO or a PTC, and both organizations often grow organically in response to a particular family's needs over time. FOs, for example, often begin small by providing administration and accounting services and eventually grow to include investment management, tax and wealth planning support, philanthropy oversight, legal services, and personal services (often including planning family meetings and overseeing general family communications).

In contrast, a PTC is often created when a family's fiduciary needs are complex, when privacy is a primary family concern, or when the needs and demands of the family trusts are so rare or unusual that standard trustee arrangements fall short. In such instances, a PTC is organized in one fell swoop, taking into account all of the needed roles and responsibilities from the start. A PTC, either through its officers or through committees, may also be tasked with investment management, organizing family meetings, and communications management.

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1. Board: The board members may run the affairs of the PTC or FO themselves. The board may create one or more committees and board members either serve on those committees themselves or appoint individuals to serve. In simpler PTC or FO structures, the committee members are also board members. In larger structures, the board may set the big picture and appoint other individuals to the various committees to implement and oversee their plan.

2. Discretionary Distribution Committee: In a PTC, the discretionary distribution committee is responsible for authorizing discretionary distributions from any trust for which the PTC is the trustee. Generally, anyone "related or subordinate" to a trust grantor or beneficiary may not serve on this committee. It is possible to create multiple distribution committees so that a family member could serve on a committee for a trust in which the member had no interest. It is also possible to create a HEMS (health, education, maintenance, and support) discretionary distribution committee, on which related or subordinate persons can serve. FO members may be involved in this committee, particularly with respect to cash flow considerations, but the FO itself will not typically have a distribution committee.

3. Compensation and Nominating Committee: The compensation and nominating committee reviews and recommends to the board the salaries of executive personnel, managers, and employees and the policies, terms, and conditions of employment. The compensation and nominating committee also reviews the qualifications of potential candidates for positions on the board and committees. This is equally true for an FO or PTC.

4. Investment Committee: The investment committee develops an investment policy and oversees the implementation of an investment plan for each underlying trust. Family members can sit on this committee. By allowing younger family members to participate in a non-voting capacity the family has an opportunity to educate younger generations in the family's investment policies, mission, and vision. This strategy also helps develop future committee and board members.

5. Audit Committee: The audit committee is responsible for choosing an independent auditor and reviewing the scope, timing, and results of the audit of the PTC's financial statements with the auditors. Some states do not require an audit for PTCs.

6. Amendment Committee: The amendment committee is particularly important in a PTC. It has the exclusive authority to make decisions regarding amending the tax-sensitive portions of the PTC's governing documents. This committee is also made up of individuals who are not "related or subordinate" to a trust grantor or beneficiary.

Employment Matters

In an integrated structure, economies of scale often lead to shared employees. Although the cost savings may be attractive, the FO must respect the integrity of its operations, especially with regard to its classification as a trade or business, which can have income tax ramifications. The integrity of its FO-trade or business classification will determine whether and to what extent certain income tax deductions, expenses, and credits are available. Determining the presence of a bona fide trade or business is more than mere form; there is some guidance available. The analysis is informed by the wide variety of US tax law that evaluates the existence of a trade or business generally, as well as in the international tax context where non-US operations expand into the United States and there have been requirements that the IRS, Treasury, and Tax Courts evaluate the level of substance that constitutes a US taxable presence (i.e., the presence of a bona fide trade or business).

A US Trade or Business?

The term "trade or business" is famously not defined in the IRC or Treasury Regulations. However, a sampling of case law decisions and IRS rulings illustrates that activities for the production of income that are "considerable, continuous and regular" can constitute a bona fide trade or business. This was most recently illustrated in the FO case of Lender Management LLC v. Commissioner, as well as in a line of cases that includes Higgins v. Commissioner, Gentile v. Commissioner (as well as Dittman and Cull, each with facts somewhat similar to Gentile), Purvi v. Commissioner, Whipple v. Commissioner, and Inex de Amorin v. Commissioner, each of which...
The question of material participation could remove the family enterprise from the passive activity loss tax rules that limit a taxpayer’s use of losses.

helps inform the analysis relevant to the scope of activities that should be considered when analyzing the substance and materiality of a trade or business and its presence in a given location.

By contrast, the case of Continental Trading, Inc. v. Commissioner illustrated that isolated, noncontinuous, and casual investment transactions are not sufficient to rise to the level of a US trade or business. Neither the mere holding of portfolio stock investments nor routine clerical and administrative duties carried on by a US office to manage US investments is sufficient, by itself, to give rise to a US trade or business (looking at cases like Aktiebolaget Separator v. Hoey and Scottish American Investment Co. v. Commissioner, which provide clarity that ministerial and administrative investment-related activities may not rise to the level of a US trade or business). This is consistent with cases pertaining to passive activity losses and the hiring of outside managers in real estate activities, such as was illustrated in the 2018 Tax Court case of Robinson v. Commissioner.

As a rule of thumb, investors acting on behalf of their own funds typically do not have a trade or business, but professionals who manage the capital of others may. Given the nuanced nature of the analysis, it is advisable to clearly delineate services and memorialize the roles and responsibilities of each respective actor in the corporate government documentation as well as through agreements such as administrative services agreements between and among family enterprise entities.

As with sharing personnel, sharing office space and materials is possible, though this must be closely analyzed, especially if there is overlap in the structure with a tax-exempt private family foundation, where self-dealing, excess business holdings, and the possible imposition of excise tax need to be navigated.

Would There Be “Material Participation”?

In real estate and some other ventures, the question of material participation could remove the family enterprise from the passive activity loss (PAL) tax rules that limit a taxpayer’s use of losses. Similarly, material participation can now have meaningful effect on business operations with respect to the 3.8 percent Net Investment Income Tax (NIIT).

PAL is the amount by which the losses from all passive activities exceed the income from all passive activities. Such losses cannot be used to offset income from non-passive activities; they can only be used to offset income from passive activities. Any passive loss in excess of passive income is suspended and carried forward to be offset against future passive income or until the disposition of the passive activity.

The FO/PTC integration analysis should address whether a trust within a family enterprise, for example, is generating purely passive income (no material participation). Whether any given activity or project will constitute an active business or is merely passive as to its indirect owners depends on whether the trust “materially participates” in the real estate business itself. Passive activities are those in which an owner does not materially participate.

Where integration can include the personnel needed to support active and material participation in a venture, substantially more positive tax consequences may result. For a trust to be viewed as being a material participant in an activity or project, the IRS’s position is that the trustee must materially participate in the activities of the business and generally may not delegate that responsibility to others. It may be possible to staff a PTC with those who can offer the capability of materially participating in an activity or project. This has two benefits from a US tax perspective: (i) it could prevent application of the 3.8 percent NIIT; and (ii) there is generally greater flexibility in utilizing tax deductions. In such a case, a trustee (i.e., someone in a fiduciary position in the trust) would also serve as a top-level manager of an activity or project. This position would likely require (i) a minimum commitment to the management activity of more than 500 hours per year, and (ii) a minimum commitment to real property trades or business of more than 750 hours per year (which is the time commitment sufficient to characterize the person as a “real estate professional” for US tax purposes, subject to additional IRS formalities).

Choice of Jurisdiction

As a starting point in establishing an FO/PTC structure, determining where to form the structure is crucial. That decision will affect the governing law of the structure, as well as the powers and duties applicable to the structure’s fiduciaries and beneficiaries. This decision need not be limited to jurisdictions where family members reside. With the growth of interstate competition for trust and fiduciary services, FOs and PTCs now have a variety of choices from which to establish and administer family wealth.
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Choice of Jurisdiction

A simple internet search will generate scores of articles arguing in favor of establishing Is in a particular state. Many of these articles have the obvious agenda of promoting the business of the practitioner or company that prepared the article. In fact, there is no one-size-fits-all answer to the question of which jurisdiction is best for locating a PTC, FO, or family wealth. Rather, a client and her advisors should examine the laws of each jurisdiction and attempt to make the most beneficial choice based on the family's needs, goals, and values.

At a minimum, this choice should take the following features of a jurisdiction into account:

- Low tax burden: This includes not only state-level income tax, but also estate and gift tax, business tax, insurance premium tax, property tax, and sales and use tax.
- Flexible PTC laws: A small number of states permit highly regulated or completely unregulated PTCs. States have widely varying rules about mandatory charitable giving, minimum capital requirements, fees, banking division oversight, etc.
- Modern trust and fiduciary laws: The chosen state's laws should cover discretionary trust protection, privacy protection, directed trusts, special purpose trusts, asset protection trusts, trust protectors and advisors, special purpose entities, prudent investor rules, etc.
- Flexible and protective business entity laws: Both an FO and a PTC are business entities. States offer varying degrees of privacy protection, and flexibility in the operation of corporations, partnerships, and limited liability companies.
- Elimination or relaxation of the common law rule against perpetuities: An alteration or extension of the traditional 21-years-plus-a-life-in-being perpetuities rule permits families to use their generation skipping transfer tax exemption to create perpetual or nearly perpetual trusts to hold family assets free from the steady drain of transfer taxes.
- Favorable trust and business laws: A trust and business-friendly environment, including efficient and proactive legislative and judicial branches and availability of local firms and infrastructure to maintain an FO and PTC are critical. Although the selection of a jurisdiction is important, a family wants as much reassurance as possible that the selected situs will continue to remain a favorable one in the future.
- Tax nexus: Family members residing in high-tax jurisdictions, including US states that impose a state income tax, generally want to minimize or eliminate the ability of their home jurisdiction to impose tax on assets administrated by the FO and PTC. Such tax can pose a significant restraint on the growth of family wealth.

At this time, five jurisdictions stand out as being attractive for PTC and family wealth situs purposes: Alaska, Nevada, New Hampshire, South Dakota, and Wyoming. Each has its advantages and disadvantages, each of which a family must weigh based on its particular circumstances.

Choose Your Regulator (State Versus SEC)

Both FOs and PCIs can find themselves subject to the supervision of one or more regulatory overseers. For example, PCIs can be established in a lightly regulated or unregulated manner, in which case the state level of scrutiny may exercise some regulatory authority. An FO, especially if it is serving non-family interests, can be subject to regulations under the Securities and Exchange Commission (SEC), specifically the Investment Advisers Act. It is typically advisable that the services provided by the FO (directly or through committees) be tailored to investment advisory and monitoring subject to the SEC family office examination.
How to Navigate the Rabbit Hole
The Journey of a CMBS Loan After It Closes