

# Family Office Planning: Turning Nightmare into Nirvana

**Probate and Pumpnickel**

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**KEEP  
CALM  
AND  
CARRY  
ON**

**“Keep Calm, Seriously?  
In This Family?!”**

# NIGHTMARE?!

- Lots of family members means lots and lots of differing opinions, goals, and communication styles
- Technology makes communication more difficult (email tone is very different from audible tone) and can make communicators less practiced and effective
- Multiple generations means differing expectations, values, and skill levels

# **NIGHTMARE?! Continued**

- Leadership is necessary but often viewed as oppressive or manipulative (depending on the leadership style) unless individuals have a meaningful voice
- Families are less secure than in the past making succession planning challenging (61% of first marriages end in divorce in the U.S.)
- With generational wealth comes generational documentation, information, and tax returns – much of which has no real ascertainable home or organization (which is fancy talk for no one can find anything)

# **NIGHTMARE?! Continued**

- Generational tax planning and issues span Code changes which makes the complicated almost unintelligible
- Tax and regulatory challenges make families often want to simply throw in the towel
- Greed and conflicts of interest undermine even the most well-laid family structure
- Inherited wealth is increasing exponentially making planning for continuation and management of this wealth more important than ever before

# How Did We Get Here?

- U.S. primarily an agrarian economy until the twentieth century
- Wealth has accumulated only by a small percentage of the population prior to WWII
- Between WWII and 1980 the middle class grew
- Prior to 1980, incomes were more or less in tandem with the growth of the economy as a whole

# How Did We Get Here? continued

- After 1980, the large majority of family economic growth occurred at the top end of the income distribution scale and families in the bottom half of the income distribution arch began to lag behind
- Most of the disparity has been driven by income from capital, not earnings (usually salaries) as typically supposed\*

\*Piketty, "Capital in the Twenty-First Century"



# Inequality of Income as a Wealth Driver

## Income Shares\*

	Low Inequality (Scandinavia 1970s/1980s)	Medium Inequality (Europe 2010)	High Inequality (Europe 1910; U.S. 2010)
Top 1%	7%	10%	20%
Next 9%	18%	25%	30%
Next 40%	45%	40%	30%
Bottom 50%	30%	25%	20%

\*Piketty, "Capital in the Twenty-First Century"

# What Does This Mean to Planning Professionals?

- Wealth is much more unequal than income in the United States
- According to *Forbes* magazine, not only is wealth held unequally, but the inequality appears to be growing fractally with the assets of the richest growing at the fastest pace
- Wealth concentration means that planners must address the unique needs presented by this concentration

# Perspective Shift Required

- Prior to the 1980s, some wealth was accumulated in trusts but because income from wages was growing at a healthy rate, divorce rates were relatively low, and the litigation environment was relatively sane, most families used trusts as wealth succession or tax planning tools only.
  - Trusts tended to terminate in stages during the beneficiary's lifetime
  - Investment authority was limited and not delegable
  - Trust terms were typically inflexible
  - Trustees didn't possess much statutory discretion

# Perspective Shift Required continued

- Very little concept of collective family activity beyond administrative functionality
- Estate planning tended to address families in silos rather than in community
- Estate planning professionals focused on tax and administrative efficiency rather than the possibility of financial leverage through collective wealth accumulation and management

# Perspective Shift Required continued

- Since the 1980s, the growth of family capital assets coupled with regulatory and statutory shifts has produced a sea change
  - Prudent Man Rule (Howard College v Armory) replaced by the Prudent Investor Rule (Uniform Investor Act – 1994)
  - Prudent Investor Rule is rooted in modern portfolio theory which requires a trustee to invest on the basis of risk and return objectives reasonably suited to the trust taking into account the trust portfolio as a whole

# Perspective Shift Required continued

- This allowed investment beyond the list of presumptively conservative investments such as government bonds and mortgages and enable the development of innovative trust solutions, making trusts more attractive
  - Asset Protection Trusts (both foreign and domestic)
  - Dynasty Trusts (and the statutory movement away from the common law perpetuity period)
  - Decanting Statutes
  - Statutory Expansion of Delegation Powers
  - Codification of Private Trust Company Concept

# What Does the Landscape Look Like Now?

- Approximately 80% of all trusts are settled by families comprising the top 10% of U.S. households (citation from economist Edward Wolff, New York University)
- These trusts hold assets that are generally not subject to the transfer tax system
  - Dynastic (especially in states that have repealed the common law perpetuity statutes)
  - Generation Skipping Transfer Tax Exempt

# What Does the Landscape Look Like Now? continued

- Fewer families who require planning services but those families who require these services have deeper and more complex needs
  - Trust and entity formation and maintenance
  - Fiduciary accounting
  - Asset protection
  - Fund and private equity management
  - Tax reporting and advice
  - Governmental regulatory advice
  - Interpersonal coaching and mentoring



# What Does the Landscape Look Like Now? continued

- Security evaluation and protection (both personal and assets)
- Charitable activity support and administration of charitable foundations and trusts
- Bill pay
- Real estate management
- Employee administration
- Service provider coordination

**Where Do We Go From Here?**

**Or**

**How Do We Create Nirvana From  
This Nightmare?**

Start with the simple steps and move to the more complex once the simple steps are complete.

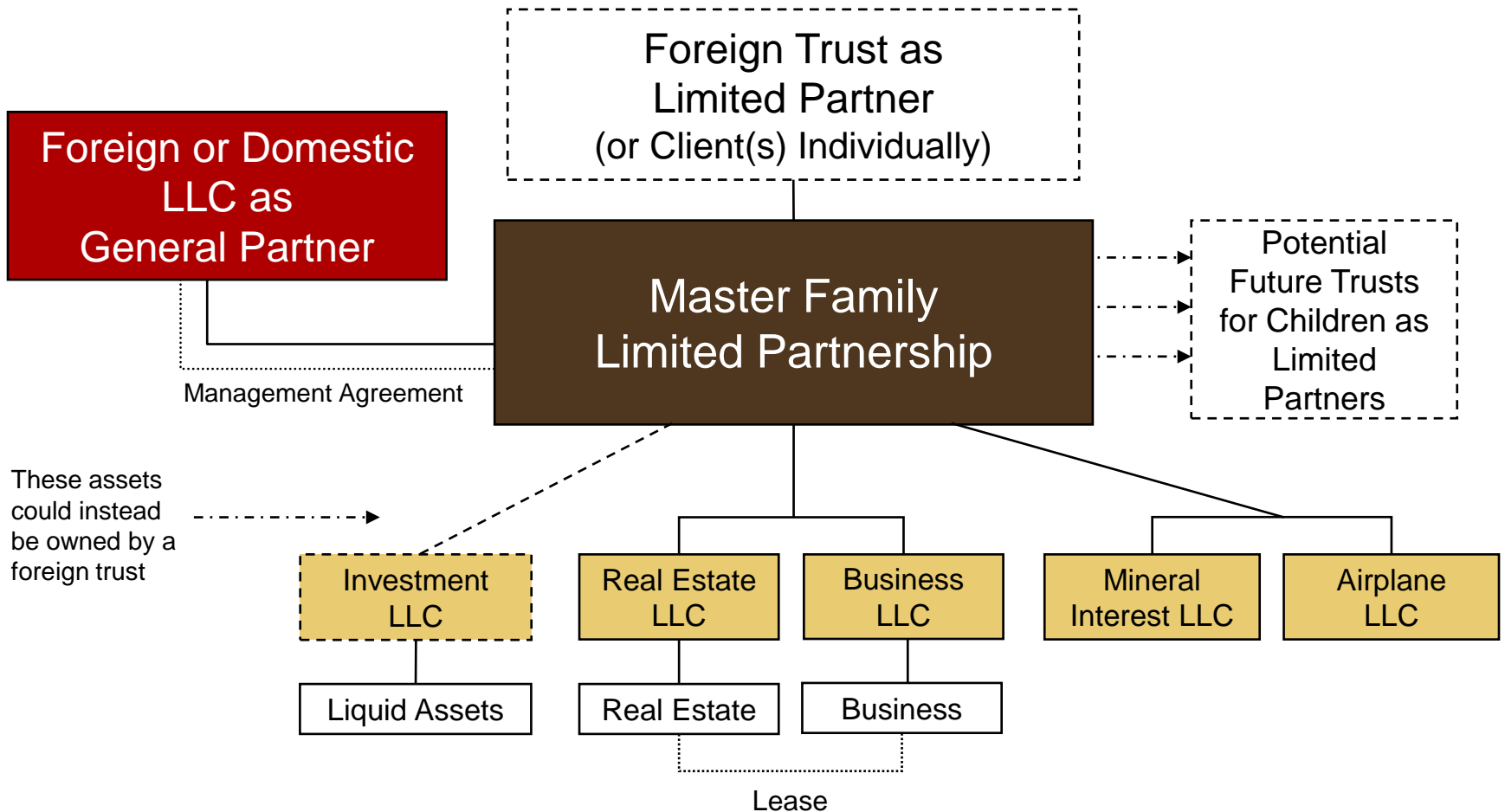
# Get to Know Your Clients as People

- Who is related to whom?
- What is their story?
- What assets do they own and why?
- What things (people, places, pets, causes, etc.) are important to them and why?
- How do they feel about wealth, tax, education, spirituality, charitable endeavors, family, children, etc.?
- What are their goals, hopes, fears?
- Where are they vulnerable and why?

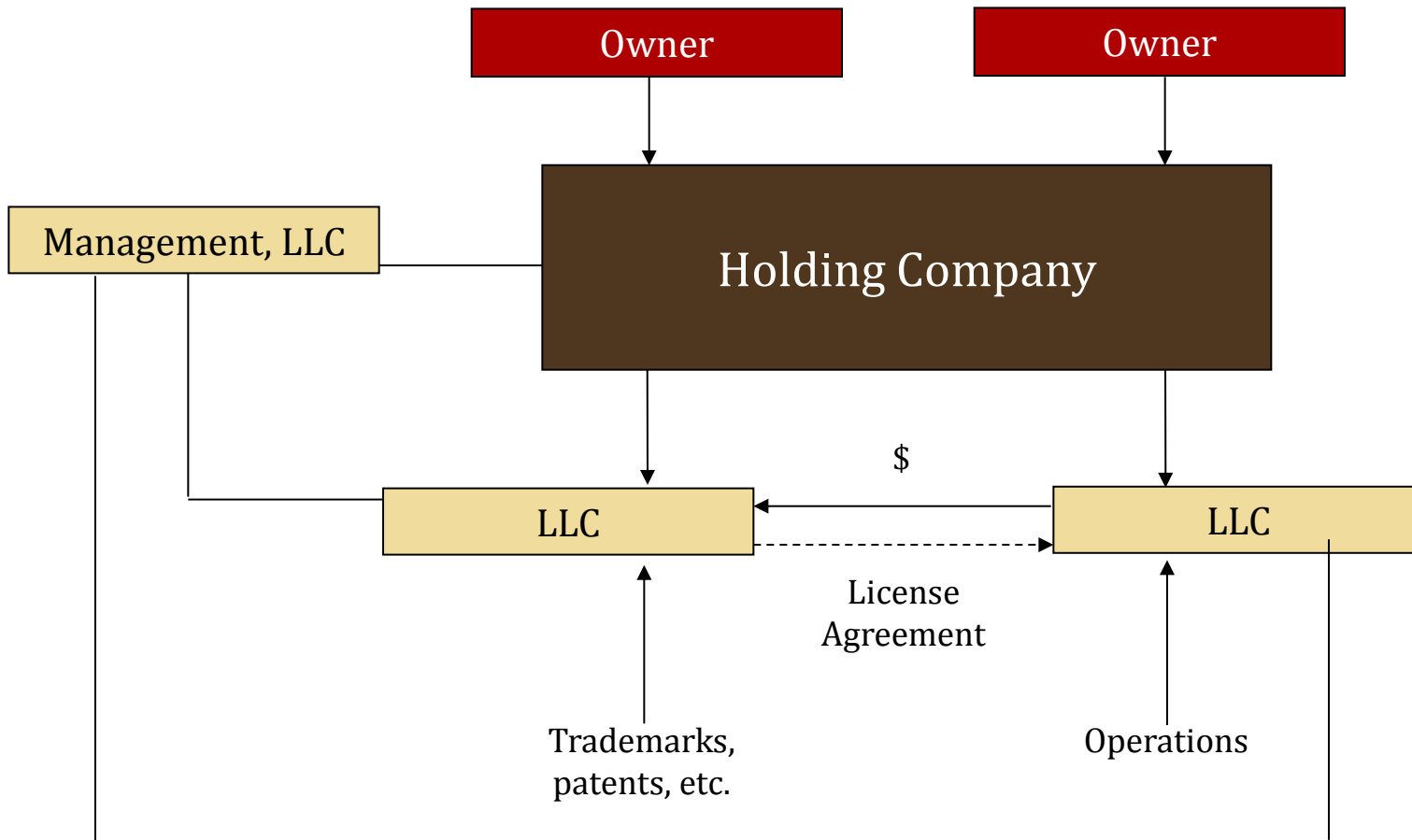
# Get to Know Your Clients' Assets and Asset/Business Structures

- What assets do they own?
- What income do these assets produce and what is the income tax effect?
- What structures are in place to protect those assets from operational risk? third-party creditors? income tax?
- How are the assets managed?

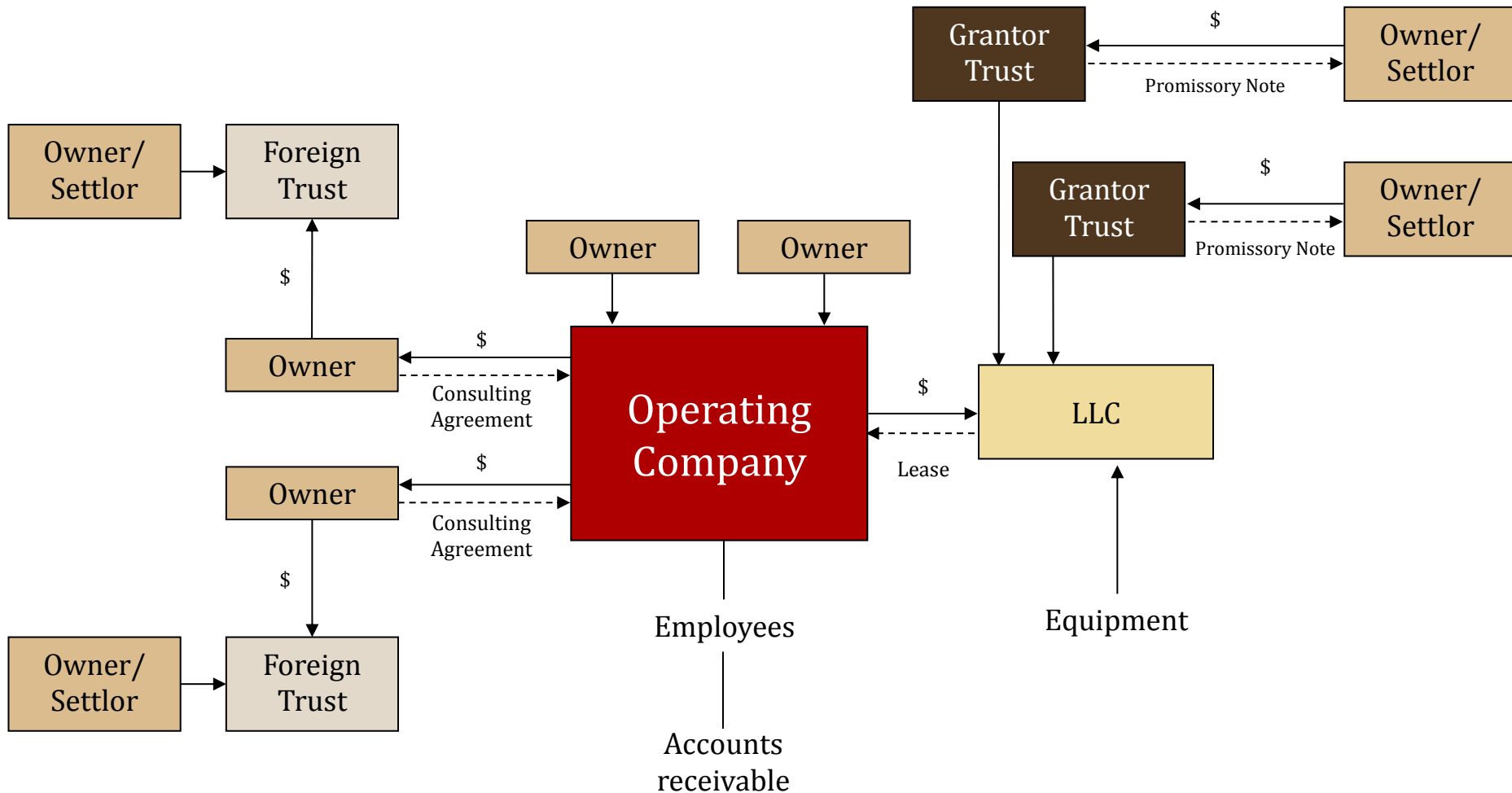
# Family Limited Partnership Structure



# Centralized Holding Company Structure



# Decentralized Business Structure



# Get to Know Your Clients' Estate Plan

- What are their dispositive goals and how do they plan to carry them out?
- What documents are currently in place and what documents are not yet in place?
- What is working for them and what isn't working? (Crummey Trusts vs IRC §2503(c) Trusts; Grantor Trusts vs NonGrantor Trusts; Domestic vs Foreign Trusts; term vs variable life insurance, etc.)



# **Organize Your Clients' Information So They Can Understand, Assimilate, and Utilize the Information Effectively**

- Use easy-to-understand organizational charts to explain and memorialize business structures and estate plans
- Provide electronic or hard copy structure, transaction, and/or planning binders to clients and their professional advisors
- Keep pending matters lists and provide agendas based on these lists as well as related documents, correspondence, charts, etc. in advance of client meetings

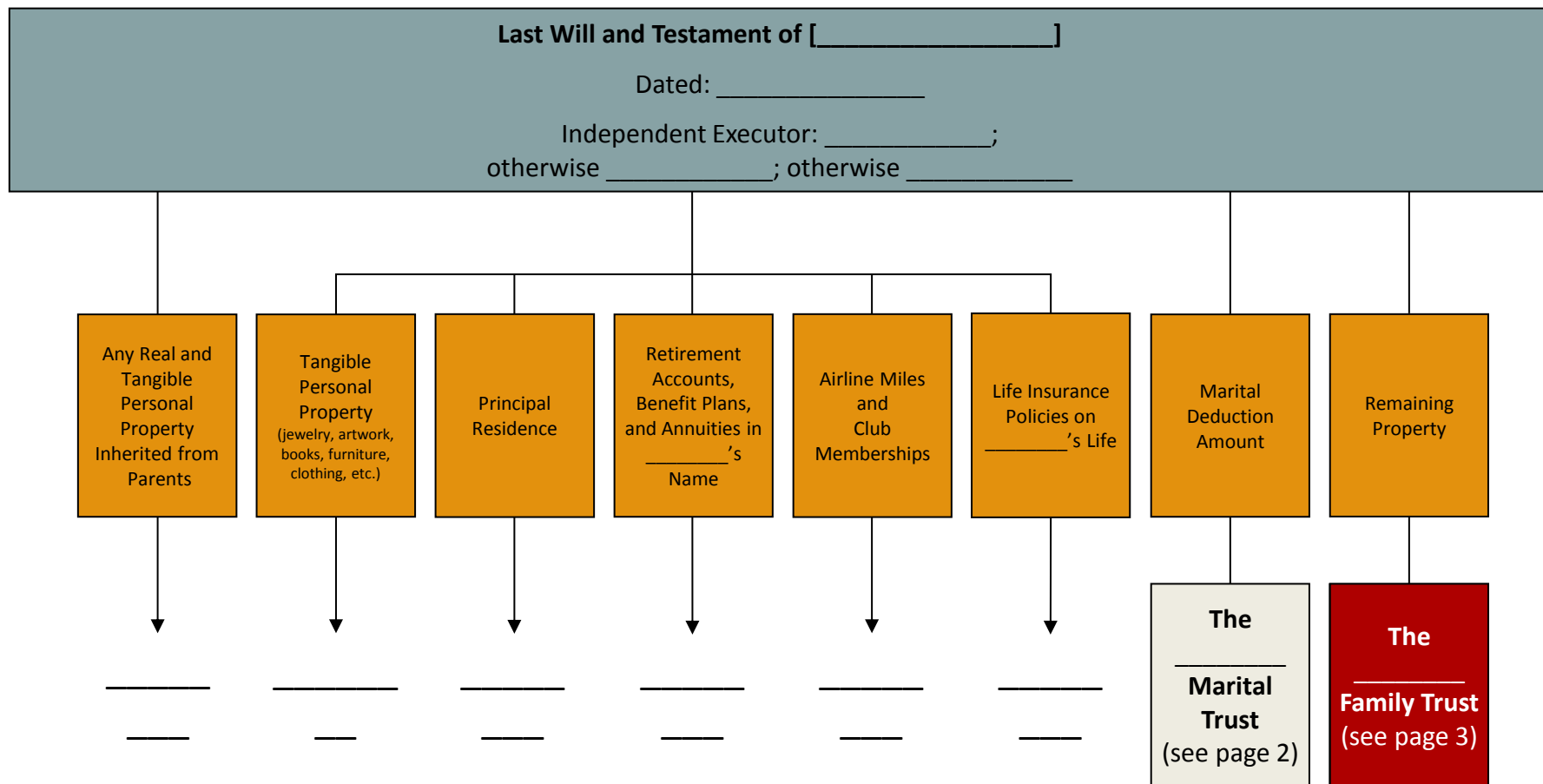
# **Organize Your Clients' Information So They Can Understand, Assimilate, and Utilize the Information Effectively**

**continued**

- Calendar client events on a shared calendar so that all advisors are “on the same page.”
- Proactively update this information in a timely manner

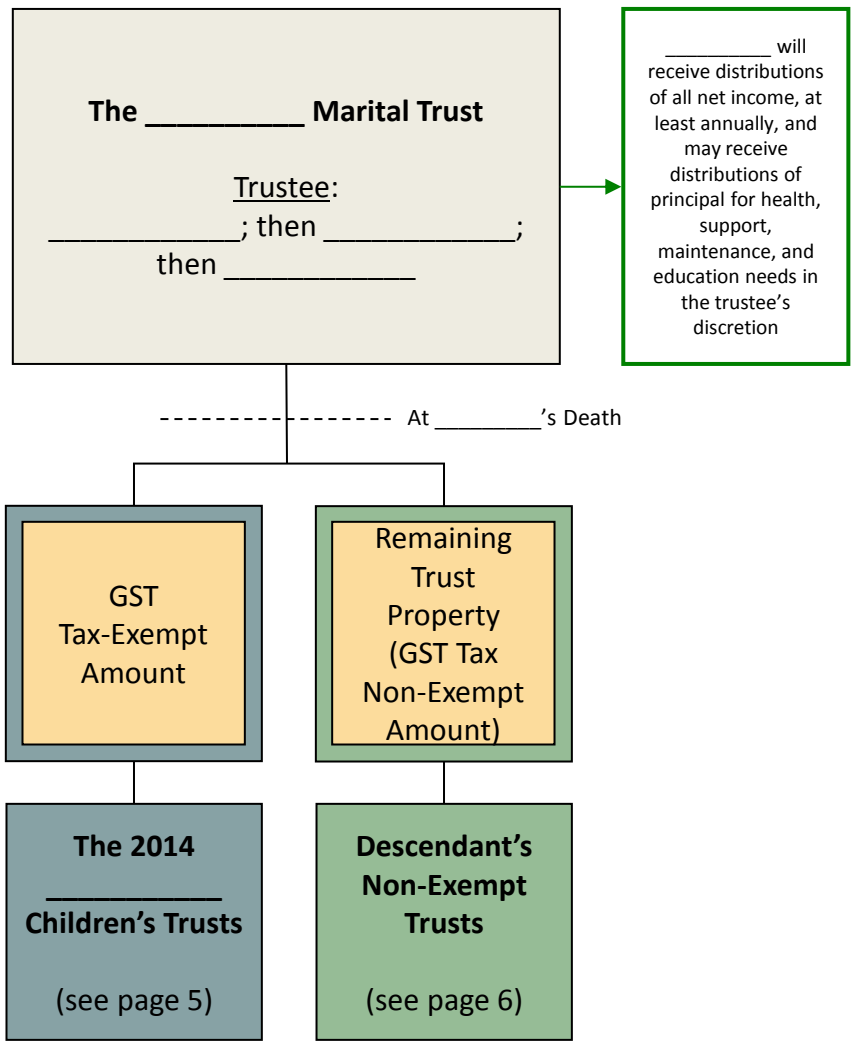
# ESTATE PLAN OF [NAME]

Assumes \_\_\_\_\_ survives \_\_\_\_\_



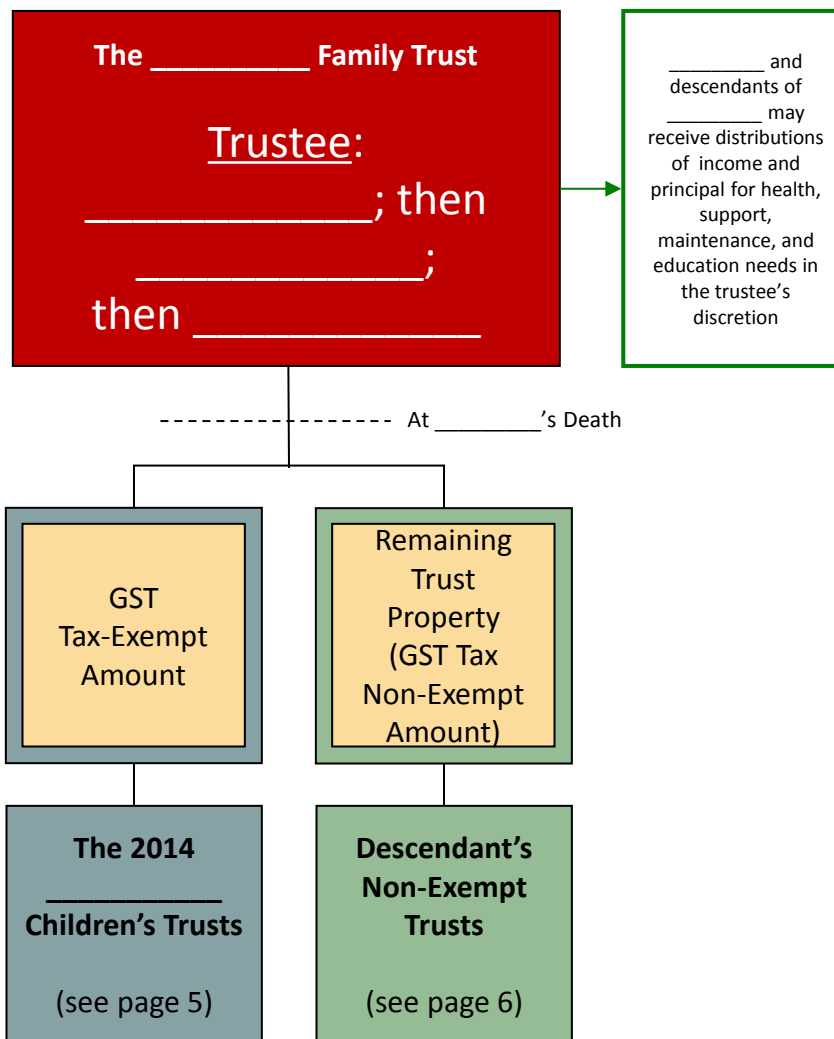
**ESTATE PLAN OF [NAME]**

Assumes \_\_\_\_\_ survives \_\_\_\_\_



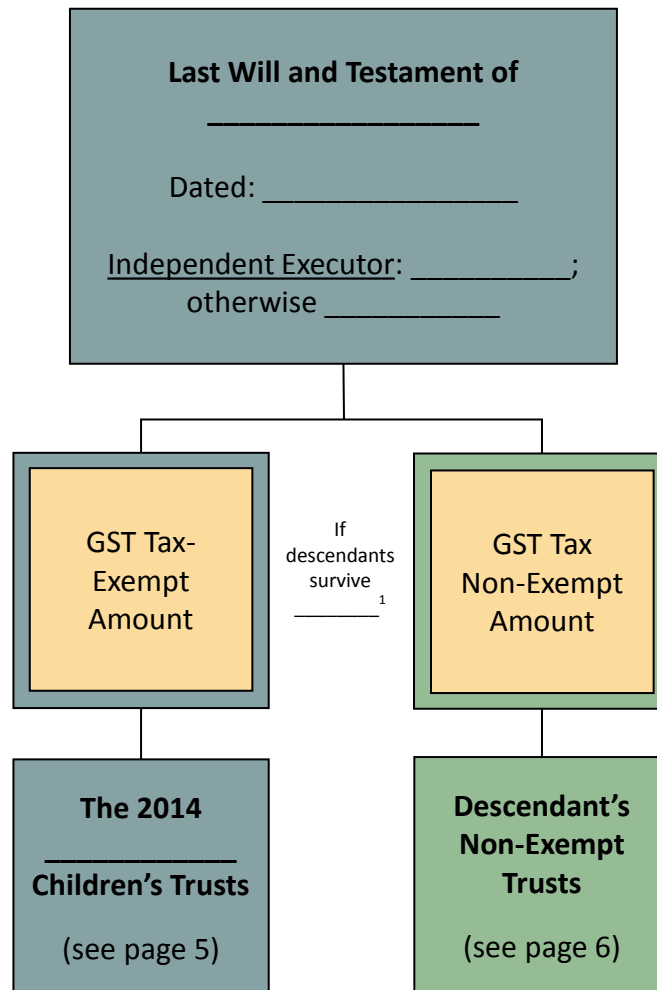
# ESTATE PLAN OF [NAME]

Assumes \_\_\_\_\_ survives \_\_\_\_\_



**ESTATE PLAN OF [NAME]**

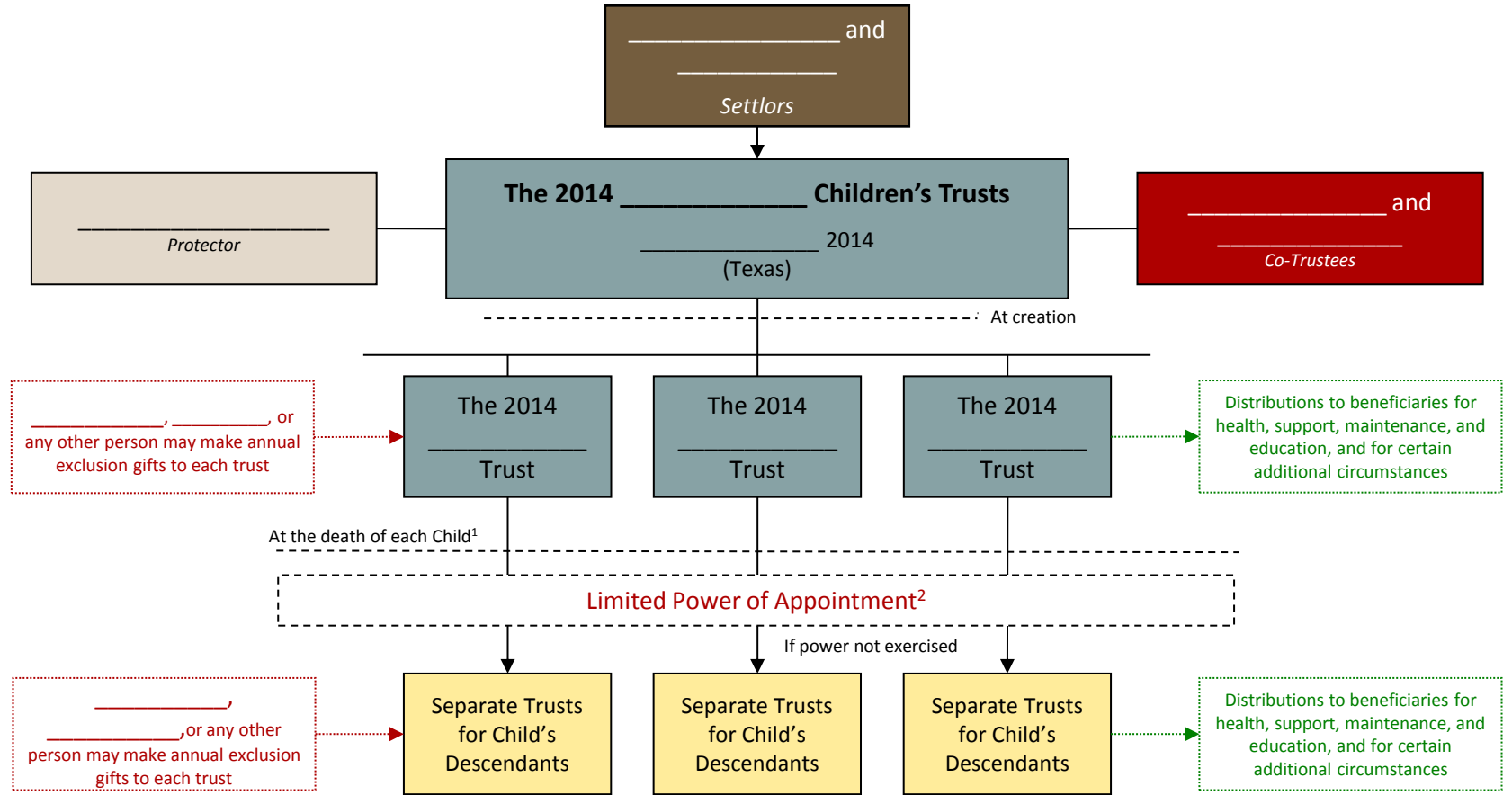
Assumes \_\_\_\_\_ survives \_\_\_\_\_



<sup>1</sup> If no descendants survive \_\_\_\_\_, all of \_\_\_\_\_'s estate will be distributed 50% to \_\_\_\_\_, 25% to \_\_\_\_\_, and 25% to \_\_\_\_\_.

# THE 2014 [NAME] FAMILY TRUST AGREEMENT

## Dispositive Provisions



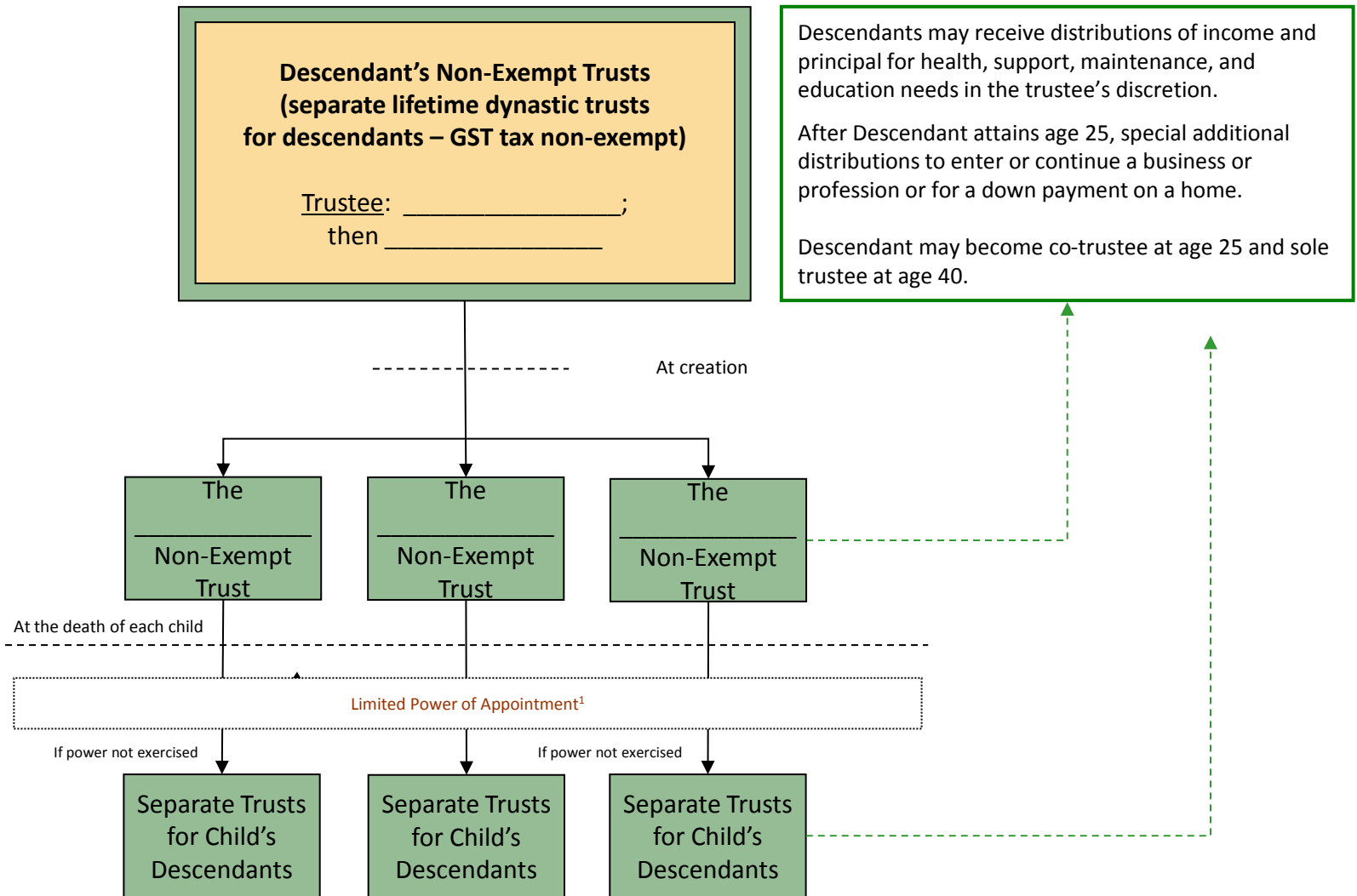
<sup>1</sup> Trusts for other children, grandchildren, and more remote descendants can be created prior to death of children.

<sup>2</sup> Exercisable in favor of [Name]'s and [Name]'s descendants and one or more charitable organizations.

Income Tax	Gift Tax	Estate Tax	GST Tax
Grantor trust for income tax purposes as to [Name] and [Name] because of right to reacquire trust property under Article 3-3.10. IRC § 675(4).	Gifts reportable on Form 709; gifts qualify for annual exclusion because beneficiaries have withdrawal right under Article 1-3.2. IRC § 2503(b).	Not includable in [Name] or [Name]'s estate because no retained interests or powers under §§ 2036, 2038, or 2041.  Not includable in descendants' estates because descendants hold only a limited power of appointment under Article 1-3.4. IRC § 2041.	GST tax exemption should be affirmatively allocated on Form 709 for each year in which a gift is made.

# ESTATE PLAN OF [NAME]

## Testamentary GST Tax Non-Exempt Trusts



<sup>1</sup> Each child holds a limited power of appointment exercisable in favor of \_\_\_\_\_ and \_\_\_\_\_'s descendants and one or more charitable organizations.



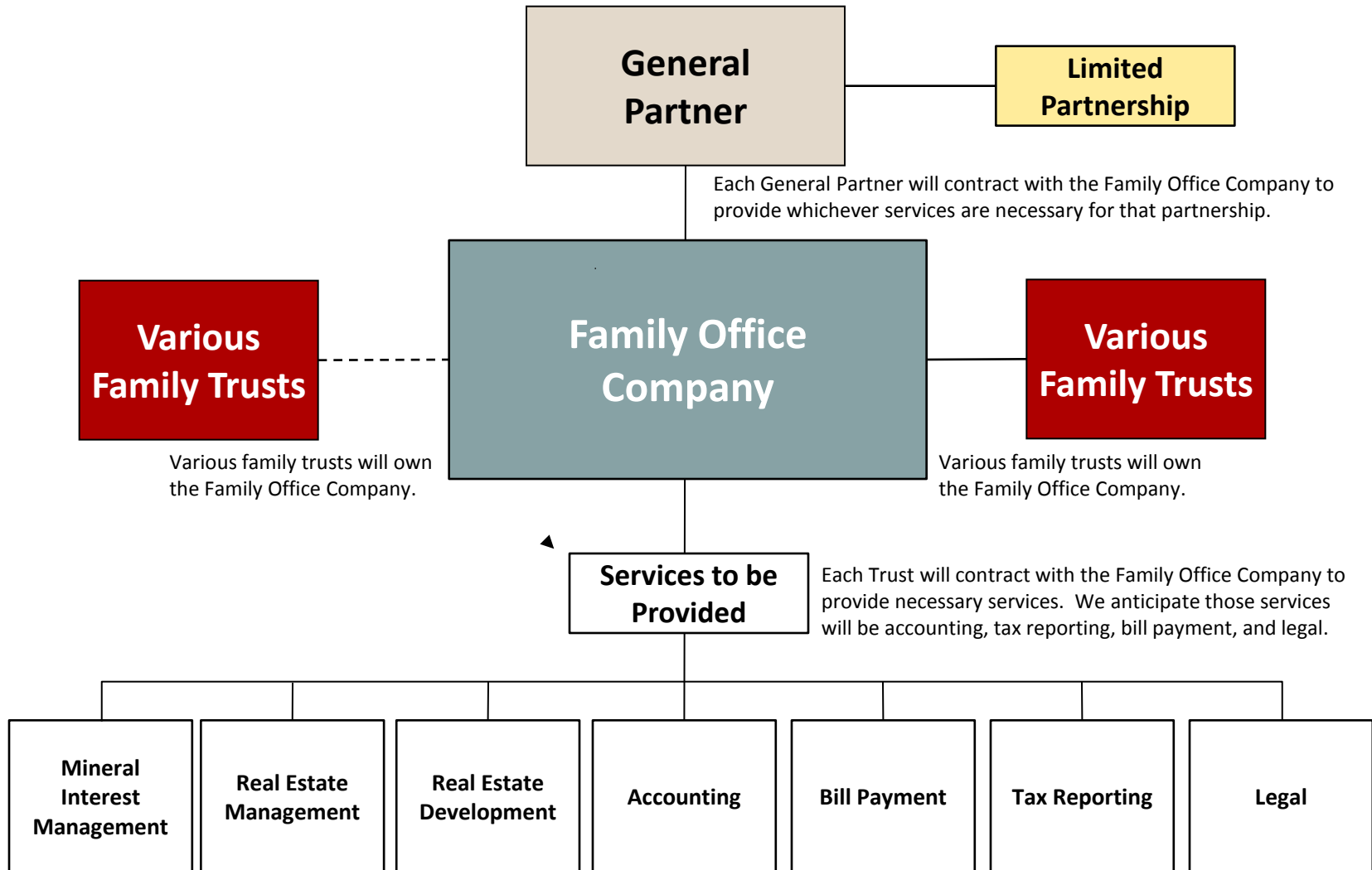
# Organize Your Clients' Family Governance and Administrative Process

- Option 1 – Family Office
  - Single Family Office can provide
    - bookkeeping services
    - travel arrangement
    - bill pay
    - administrative support
    - document retention
    - employee management and compensation services
    - co-ordination of professionals
    - investment services
    - tax reporting/tax return preparation
    - asset maintenance
    - security services

# Organize Your Clients' Family Governance and Administrative Process continued

- Multiple Family Office can provide what a single family office can provide but can spread the cost among a larger group and can often afford to employ a "deeper bench" to provide its services to its clients (family members)
- Family Offices are a wonderful first (and efficient) organizational step but they are necessarily administrative in nature and don't in, and of, themselves provide a governance or operational structure
- One option for a governance and an operational structure would be to organize the family office as a management company owned by trusts for the benefit of the family members

# Family Office Company Management Structure



# Organize Your Clients' Family Governance and Administrative Process continued

- Option 2 – Family Office with a Family Trust Company
  - Addition of a Family Trust Company to a Family Office Structure assures the family's ability to
    - implement governance decisions
    - provide for fiduciary continuity
    - insulate family members and family office personnel from fiduciary liability
    - provide for more flexibility in managing and investing trust assets
    - protect against wealth dissipation

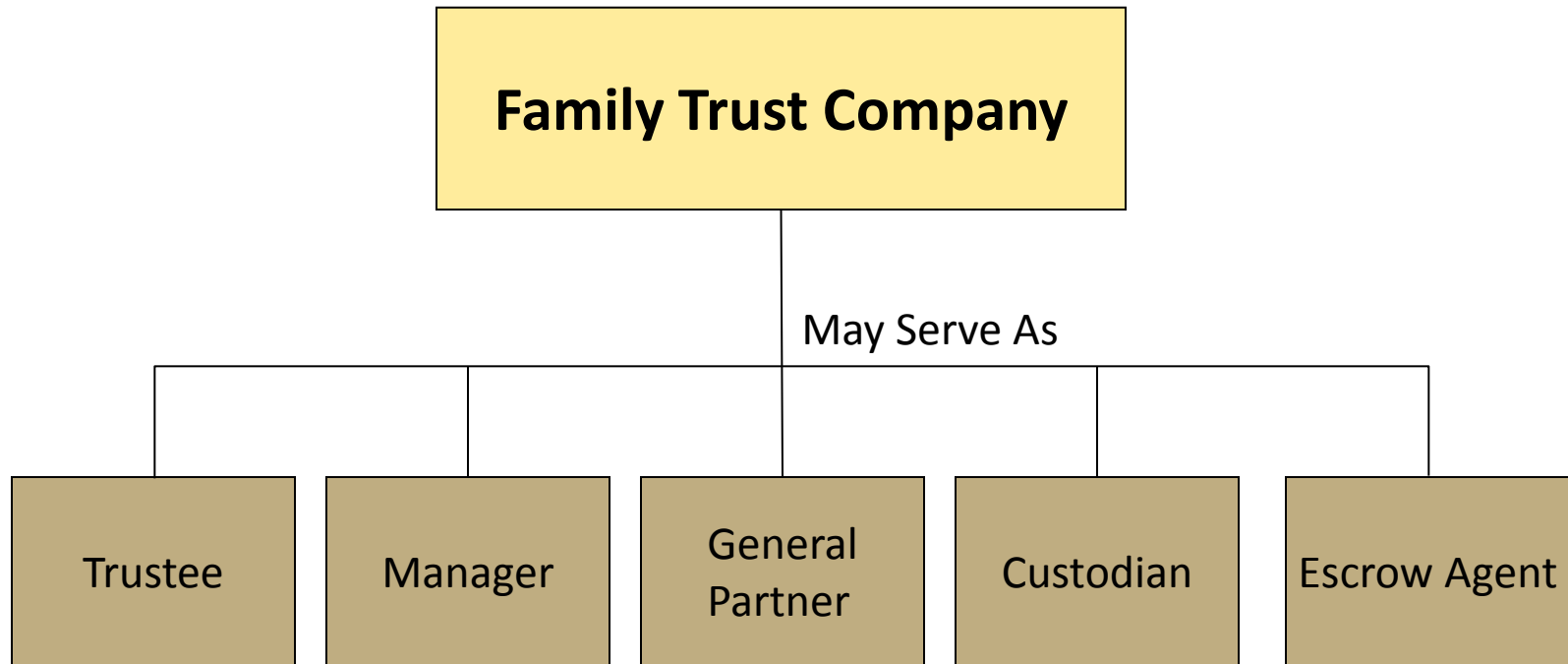
# **Family Trust Companies Can Protect Against Wealth Dissipation**

The U.S. Trust 2014 “Insights on Wealth and Worth” found that the top five risks that affect overall family financial well-being are divorce, addictions, untimely death or disability of a primary income earner, medical crises, and disagreements over inheritance or distribution of family assets

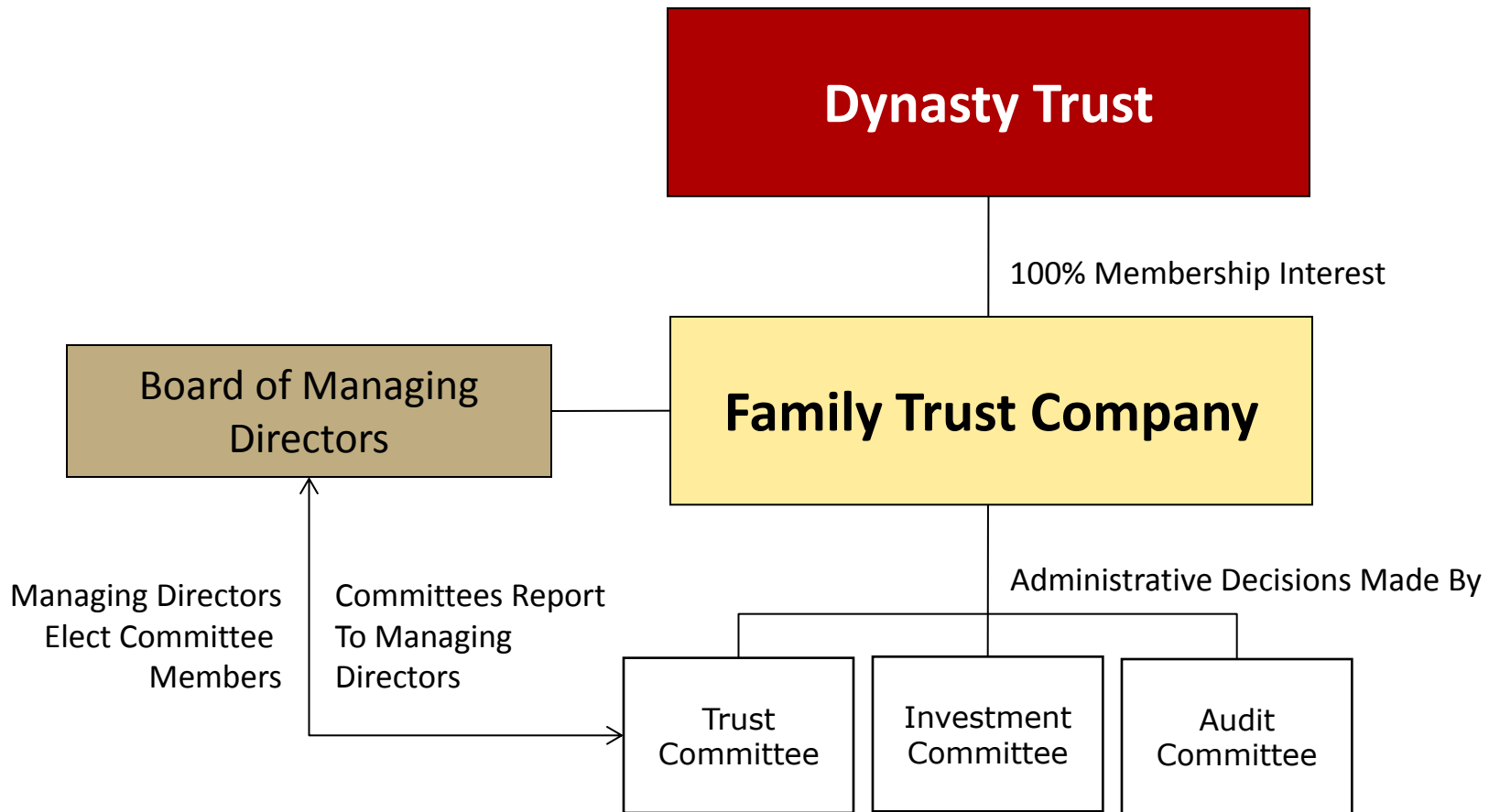
# Two Types of Family Trust Companies

1. Unregulated Private Trust Company – a corporation or limited liability company that is permitted to act as a fiduciary but is not state or federally chartered
2. “Lightly” regulated Private Trust Company – a corporation or limited liability company that is state chartered and subject to regulatory supervision but not on the same level as a trust company that serves the general public

# For Any Entity Created By and For the Benefit of the Family



# Family Trust Company Structure





# Board of Managing Directors Structure

## Board of Managing Directors

Family Member Managing Directors  
- Voting

Non-Family Member Managing Directors  
- Non-Voting

May Elect

Must Elect

**Vice President**

**Chairperson of Managing Directors**

**Advisory Directors**

**President**

**Tax Matters Partner**

**Secretary**

**Assistant Vice President**

**Treasurer**

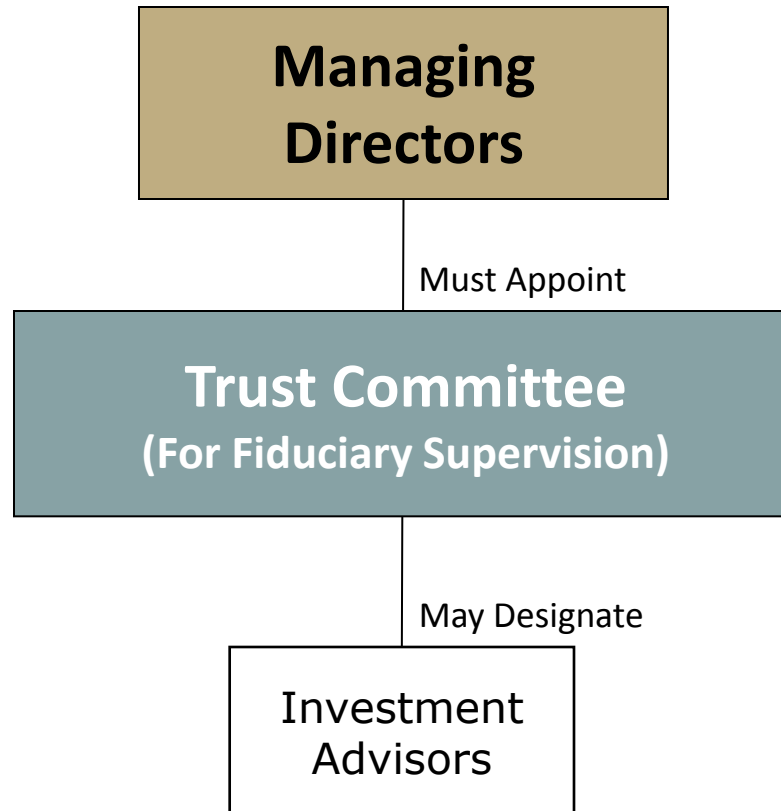
**Assistant Secretary**

**Senior Trust Officer**

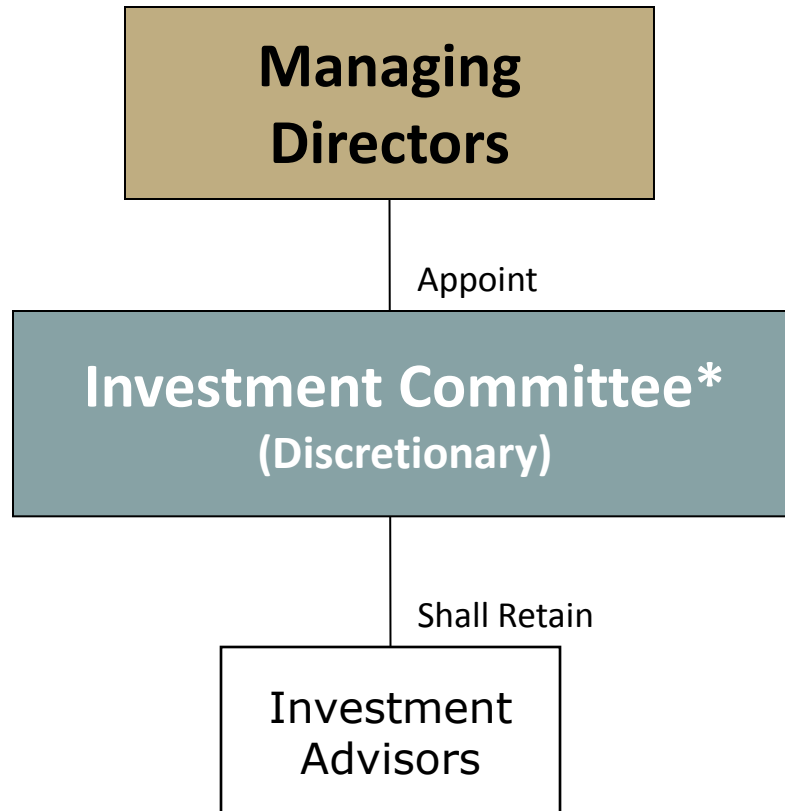
**Manager of Trust Office**

**Compliance Officer**

# Family Trust Company Trust Committee Structure

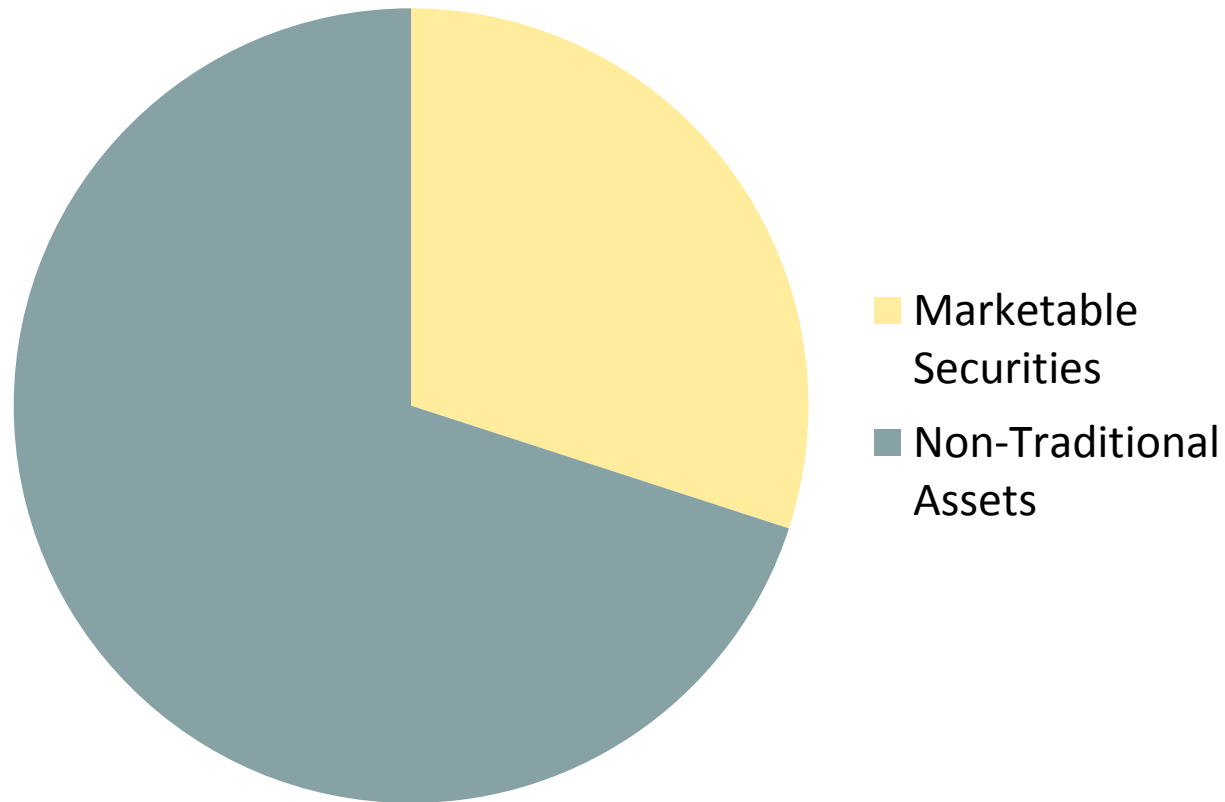


# Family Trust Company Investment Committee Structure

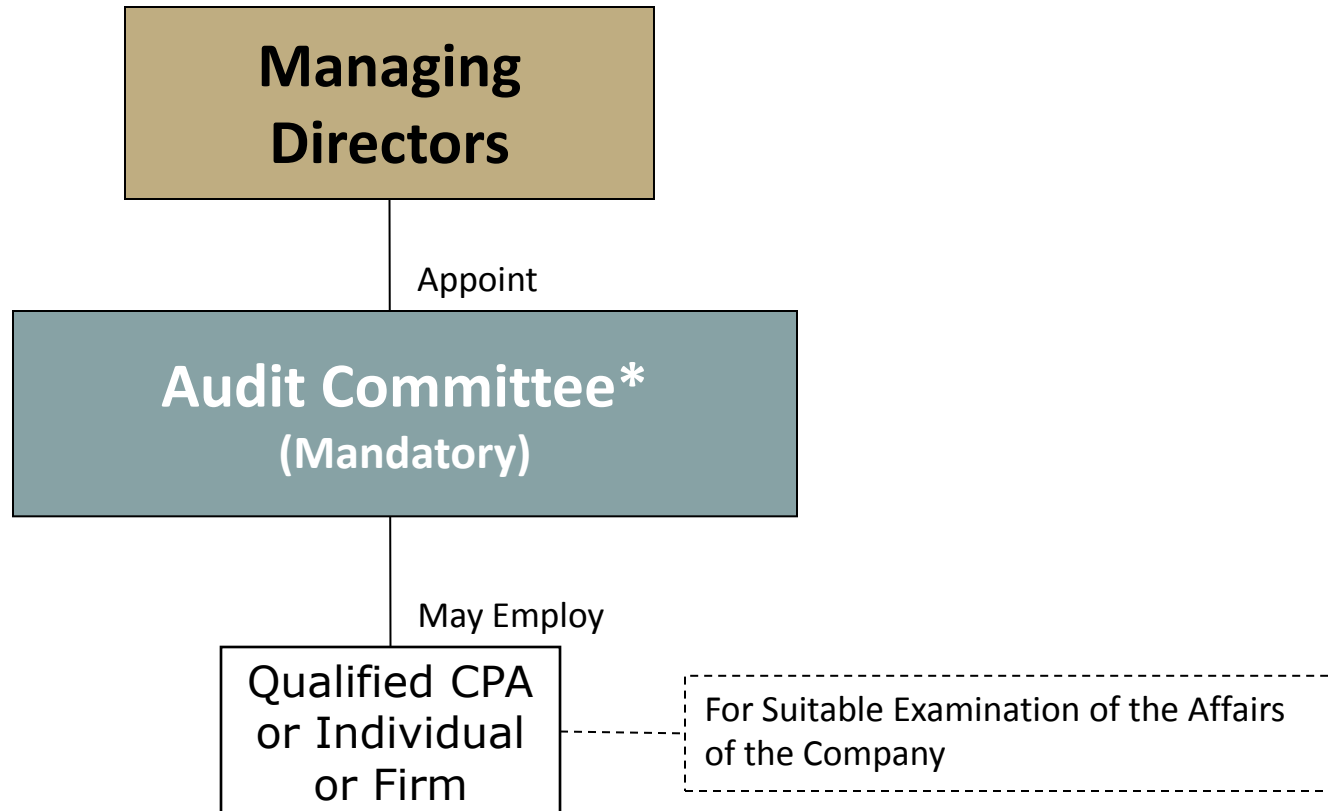


**\* FOR FIDUCIARY SUPERVISION:** All voting members must be Managing Directors, Officers, or persons deemed by the Managing Directors to be third-party investment professionals

# Family Trust Company Investment Structure



# Family Trust Company Audit Committee Structure



# Family Trust Company Committee Structures

- Give family members an opportunity to participate in areas where they are most comfortable
- Allow younger family members to be mentored by older members of the family or third party advisors
- Provide checks and balances

# Final Thoughts

- Estate planning has changed dramatically over the last thirty years and those changes will likely continue as the U.S. adapts to the changing global landscape
- It is our great honor as professional advisors to be able to assist our clients with the process of marshalling, protecting, and governing their wealth for their generation, as well as future generations, utilizing organizational and structural tools that will turn their family nightmare into nirvana

# Special Thank You to Our Friends at



PROVIDENCE  
FAMILY OFFICES

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**Shelley R. Perry**  
Managing Director

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