

# Florida Enacts Family Trust Company Legislation

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On June 13, 2014, Florida Senate Bills 1238 and 1320 were signed into law creating new chapter 662 of the Florida Statutes. Chapter 662, which becomes effective October 1, 2015, provides a framework for the formation and operation of Family Trust Companies (“FTCs”) in Florida. Florida has now joined at least 14 other states<sup>1</sup> that currently have similar legislation. Not all states with FTC legislation, however, are equally as popular. Some states, such as South Dakota, Nevada and New Hampshire, have been proactive in legislating and regulating FTCs in order to remain at the forefront of the race for business. Not surprisingly, these jurisdictions continue to be rewarded when wealthy families create new, or relocate existing, FTCs. Given Florida’s favorable trust laws and the absence of a state income tax, Senate Bills 1238 and 1320 should put Florida in contention for FTC business.

## What is an FTC?

An FTC (also commonly referred to as a “Private Trust Company” or “PTC”) is an entity owned by members of a family for the purpose of providing trustee and other fiduciary services to a limited class of family members or trusts created by or for the benefit of family members. In general, an FTC is similar to a public trust company, except that the FTC is formed in a jurisdiction that exempts the company from certain regulatory and capitalization requirements imposed on public trust companies because the FTC is not providing fiduciary services to the public. The services typically provided by an FTC include serving as trustee, investment advisor, agent or personal representative, as well as tax planning, tax preparation, and family education.

Fla. Stat. § 662.111 defines a “Family Trust Company” as, (i) a corporation or LLC, (ii) that is exclusively owned by family members, (iii) organized or qualified to do business in Florida, and (iv) acts or proposes to act as a fiduciary to serve one or more family members.<sup>2</sup> An FTC serves the particular family; as to non-family members, it may only serve as a fiduciary for up to 35 non-family members who are current or former employees of the FTC or a trust or entity that is a family member. This exception for services to non-family members is not found in all FTC jurisdictions, but it is important. Wealthy families tend to have long-term employees they treat as part of the “family” and want to provide for as such. Florida’s limited exception for certain non-family members provides FTC families the opportunity to set up a trust for a valued employee and have the FTC serve as trustee.

## Why choose an FTC?

Family trust companies are often created when a family needs an independent trustee, but does not believe that an individual or public trust company is the best fit for their specific circumstances. When this situation arises, it typically involves a family with one or more closely-held entities

owned by trusts created for the benefit of family members. The FTC is an attractive option in these scenarios because it permits the ownership interests of the family entity to be managed by multiple family members and key advisors under the protection of an entity without the involvement of a public institution or individual. The advantages of an FTC over each of these other trustee options include:

- Family privacy is protected for both financial and non-financial matters;
- The entity structure of an FTC provides liability protection for decision-makers who would otherwise be personally liable if serving as a trustee in their individual capacity;
- Trustee continuity is maintained upon the death, resignation or removal of a decision-maker;
- The FTC is free to establish its own fiduciary fees; and
- The FTC can be used to establish a resident trustee in a particular jurisdiction (such as Florida) to avoid state income tax on trust assets.

FTCs also have some disadvantages. Perhaps the largest deterrent to using an FTC is that creating and operating an FTC is expensive. The team of professionals for an FTC often will include attorneys with expertise in fiduciary and trust law, business law, banking law and securities law, as well as CPAs. Financial professionals are also necessary if the FTC will provide investment services. Another disadvantage is that the depth of experience in an FTC may not be as extensive as a public trust company. While public trust companies have decades of experience from across the country and even the world to draw upon when handling fiduciary matters, the experience in an FTC may only go as far as that of their team of professional advisors. Finally, the tax issues involved in structuring and operating an FTC are unsettled. As discussed below,<sup>3</sup> the Internal Revenue Service (“IRS”) has yet to issue final guidance clarifying the tax treatment of using an FTC to serve as a trustee for a family trust.

## Who is a Family Member?

The term “family member” is broadly defined under chapter 662, though not as broadly as other jurisdictions.<sup>4</sup> Relatives within the sixth degree of lineal kinship or ninth degree of collateral kinship to a designated relative<sup>5</sup> are included, as well as spouses and former spouses of a family member and relatives of such spouses within the fifth degree of lineal kinship.<sup>6</sup> Trusts are included as “family members” provided that they are either created and funded exclusively by family members or all non-charitable qualified beneficiaries of the trust are family members.<sup>7</sup> A trust composed exclusively of charitable beneficiaries qualifies as a family member if all of the charitable beneficiaries are charitable entities in which a majority of the governing body is composed of family members.<sup>8</sup> Family entities 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 entity are included as family members<sup>9</sup>, as well as charitable entities in which a majority of the governing body is composed of family members.<sup>10</sup>

### Types of FTCs in Florida

A family trust company operating in Florida is not required to be licensed, although the decision whether to be licensed will impact the type of services that the FTC will provide.<sup>11</sup> As discussed in detail below,<sup>12</sup> the Securities and Exchange Commission (“SEC”) regulates investment advisors. Therefore, an FTC that will not provide investment services may choose to be unlicensed because it should not fall within the SEC’s regulatory grasp. If the FTC will provide investment services, however, then the FTC must either register with the SEC or qualify for an exemption from SEC registration. An FTC that satisfies the SEC definition of a “family office” is exempt from registration and, therefore, may choose to be unlicensed. Otherwise, the FTC likely will choose to be licensed in order to seek the SEC exemption for FTCs operating under a state charter or license.

The organizational and operational requirements for licensed and unlicensed FTCs have some differences. Both licensed and unlicensed FTCs are required to maintain a minimum capital account of at least \$250,000, have a principal office physically located in Florida, maintain a minimum of 3 directors (if a corporation) or managers (if an LLC) and have a deposit account with a state-chartered or national financial institution that has a principal branch in Florida.<sup>13</sup> However, only a licensed FTC is required to maintain fidelity bonds and an errors and omissions policy of at least \$1 million on all active management.<sup>14</sup> In lieu of maintaining fidelity bonds, a licensed FTC may increase its minimum capital account by \$1 million.<sup>15</sup> Further, a licensed FTC must file an application with the Office of Financial Regulation (“OFR”) and pay an initial fee of \$10,000 while an unlicensed FTC must only register with the OFR and pay an initial fee of \$5,000.<sup>16</sup>

The class of family members which may be served by a licensed FTC and unlicensed FTC also differs. Specifically, an unlicensed FTC may only serve relatives within the fourth degree of lineal kinship or seventh degree of collateral kinship to a designated relative.<sup>17</sup> A licensed FTC may serve relatives within the sixth degree of lineal kinship and ninth degree of collateral kinship to a designated relative.<sup>18</sup> Moreover, a licensed FTC may have up to two designated relatives while an unlicensed FTC is limited to one designated relative.<sup>19</sup> Permitting a single FTC to serve two families may prove to be a selling point for Florida, as most, if not all, other jurisdictions limit an FTC to a single family.

### Authorized and Prohibited Activities

An FTC is authorized to perform a variety of services for family members under chapter 662, including, but not

limited to, serving as trustee, advisory agent, conservator, custodian, escrow agent, financial advisor, guardian, investment advisor and investment manager.<sup>20</sup> These services may be performed inside Florida and, in addition, may be performed outside Florida to the extent that other jurisdictions will give full faith and credit to the authority of the Florida FTC. If an FTC is not well equipped to exercise certain authorized powers (such as if the FTC does not employ an investment advisor or investment manager), then it may delegate duties and authority to other professionals or even retain a financial institution’s trust department or a public trust company to assist.<sup>21</sup>

There are certain activities that an FTC is expressly prohibited from performing. First and foremost, an FTC may not engage in fiduciary services with the public because such action would directly conflict with a principal purpose of chapter 662 and provide an avenue to avoid the enhanced regulatory requirements that apply to public trust companies under chapter 658.<sup>22</sup> Second, an FTC is prohibited from engaging in commercial banking, such as accepting deposits and cashing checks.<sup>23</sup> This limitation does not prevent an FTC, however, from establishing accounts at financial institutions for its own purposes or on behalf of family members to whom it provides fiduciary services. Finally, an FTC is prohibited from serving as a personal representative of a Florida probate estate or as an agent under a Florida durable power of attorney.<sup>24</sup>

### OFR Oversight

The OFR, which generally oversees the operations of financial institutions in Florida, is also tasked with regulating FTCs operating under chapter 662. Generally, the OFR is required to examine an FTC at least once every 18 months.<sup>25</sup> The OFR may, however, accept an audit of an FTC prepared by an independent certified public accountant licensed in Florida in lieu of performing the examination itself, provided that the OFR performs at least every other scheduled examination.<sup>26</sup> Permitting audits in lieu of full examinations are intended to reduce the burden of an examination on both the FTC and OFR. In addition to scheduled examinations, the OFR also has authority to examine or investigate an FTC at any time it deems necessary to confirm that the FTC has not violated any provision of chapter 662 or any rule adopted by the Financial Services Commission to carry out chapter 662.<sup>27</sup> The fees and costs, including travel and salary expenses, incurred by the OFR in conducting any examination must be paid by the FTC.<sup>28</sup>

Although it is too early to determine exactly what an OFR examination will look like, at least with respect to licensed FTCs, it is anticipated that the process will be similar to the examination of a public trust company. Families choosing to form licensed FTCs in Florida likely will do so, at least in part, to claim an exemption from the SEC registration requirements discussed below. A cursory examination process could jeopardize a licensed FTC’s exemption with

the SEC, which would certainly deter families from locating their FTCs in Florida.

The OFR has a variety of enforcement powers to penalize an FTC should it discover a violation. Specifically, the OFR may revoke a company's license, issue a cease and desist order, levy monetary fines and remove a family trust company-affiliated party.<sup>29</sup> A company charged with a violation has the opportunity for a hearing pursuant to Sections 120.569 and 120.57 of the Florida Statutes to dispute or mitigate the claim. In addition to imposing penalties for violations of chapter 662, the OFR has authority to penalize an FTC if it discovers that the company has committed a breach of fiduciary duty in providing services to the family members.<sup>30</sup> Therefore, an FTC will not only have to answer in a court proceeding to a beneficiary who is damaged by a breach, but it may also have to answer in an administrative proceeding to the OFR and potentially risk losing its ability to operate in Florida.

**Existing FTCs Must Convert**

Prior to the enactment of chapter 662, an entity seeking to operate as a family trust company in Florida had to either, (i) comply with the regulatory requirements to be a public trust company under chapter 658, or (ii) obtain an exemption letter from the OFR to be exempt from certain regulatory requirements applicable to a public trust company. This exemption letter process is not well-known to many Floridians and the requirements to receive an exemption are not clearly defined.

At the eleventh hour of bill drafting, the OFR requested the addition of Section 662.151(3), which provides that all companies in operation as of the effective date of chapter 662 (i.e., October 1, 2015) that meet the definition of a family trust company shall have ninety (90) days to apply for licensure as a licensed family trust company, register as a family trust company or foreign licensed family trust company, or cease doing business in Florida. It seems that the OFR's goal in adding this subsection is to create a uniform set of rules for all family trust companies operating in Florida and to streamline regulation. Accordingly, it appears that any family trust companies currently operating under an exemption letter from the OFR must convert to a chapter 662 FTC within 90 days after October 1, 2015, if they wish to continue operations in Florida.

**Securities Issues for FTCs**

An FTC that provides investment services must be sensitive to its classification as an investment adviser for SEC regulatory purposes. The SEC regulates "investment advisers" primarily under the Investment Advisers Act of 1940. SEC registration requirements for investment advisers include, (i) filing a Form ADV with the SEC, which must be

kept current, (ii) annual filings with the SEC of an audited balance sheet, (iii) undergoing an annual examination by an independent public accountant to verify client assets, and (iv) inspections and examinations by SEC staff.<sup>31</sup> An "investment adviser" is defined as any person or firm who, for compensation, engages in the business of advising others, either directly or through publications or writings, as to the value of securities or as to the advisability of investing in, purchasing or selling securities.<sup>32</sup>

An FTC that provides investment services generally falls within the definition of an "investment adviser" and, therefore, would be required to register with the SEC. However, there are two notable exemptions.

The first is known as the "family office" exemption. Based on a SEC ruling from June 2011,<sup>33</sup> "family offices"

are excluded from the definition of an investment adviser and thus are not subject to regulation under the Investment Advisers Act of 1940. To constitute a family office, an FTC generally must, (i) have no clients other than family clients (with a one year transition period for certain successors in interest), (ii) be wholly owned by family clients and exclusively controlled (directly or indirectly) by one or more family members and/or family entities, and (iii) not hold itself out to the public as an investment adviser. Importantly, as to chapter 662 FTCs, a family office serving more than one family cannot qualify under this definition.

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The second is a state regulation exemption. Under this exemption, an FTC may avoid SEC registration if it operates under a state charter or license, regardless of whether it qualifies as a “family office” under the SEC definition.<sup>34</sup> Effectively, the FTC is trading SEC regulation for state regulation. In drafting chapter 662, it was intended that a licensed FTC formed and operating under chapter 662 be exempt from SEC registration by virtue of this state regulation exemption. Even though an FTC serving two families could not qualify under the SEC “family office” definition, it could, however, be exempt under the state regulation exemption as a result of being licensed.

### Tax Issues Related to FTCs

The use of an FTC as a fiduciary of family trusts presents some unresolved issues from a federal transfer tax perspective. Although the IRS initially issued private letter rulings<sup>35</sup> in this area, it has stopped doing so in anticipation of issuing public guidance.

Importantly, IRS Notice 2008-63 contains a proposed revenue ruling that provides safe harbor guidance on income, gift, estate and GST tax consequences of using a family trust company to serve as the trustee of trusts in which family members are grantors and beneficiaries. As provided in the notice, the intent of the proposed revenue ruling is “to confirm certain tax consequences of the use of a private trust company that are not more restrictive than the consequences that could have been achieved by the taxpayer directly, but without permitting a taxpayer to achieve tax consequences through the use of a private trust company that could not have been achieved had the taxpayer acted directly.”

The proposed revenue ruling addresses two situations. Under Situation 1, a private trust company is created in a state that requires a Discretionary Distribution Committee (DDC) to make all decisions regarding discretionary distributions from each trust for which it serves as trustee. In addition, state law has the following “firewalls”:

- 1) No family member serving on the DDC may participate in making discretionary distribution decisions with respect to any trust of which that person or his or her spouse is either a grantor or a beneficiary, or with respect to any trust of which the beneficiary is a person to whom the family member or his or her spouse owes an obligation of support;
- 2) Only officers and managers may participate in decisions regarding personnel of private trust company;
- 3) Nothing in state statutes or in the company’s governing documents may override a more restrictive provision in the trust instrument of a trust for which the private trust company is acting as trustee; and
- 4) No family member may enter into any reciprocal agreement regarding discretionary distributions from any trust for which the private trust company is serving as trustee.

Under Situation 2, a private trust company is created in a


state that does not have legislation governing the formation and operation of a private trust company. However, the governing documents of the private trust company have the same “firewalls” that are imposed under state law in Situation 1. In addition, the governing documents create an “Amendment Committee,” a majority of which must be neither family members nor related or subordinate to family members, and, by majority vote, can make changes to the governing documents regarding the creation, function or membership of the DDC or the Amendment Committee, and any of the firewalls.

Based on the firewalls and the facts in the proposed revenue ruling, which address various family trusts along with family members serving on the DDC and as officers of the company, the IRS proposed to rule that:

- 1) The appointment of the private trust company as trustee of the family trusts will not alone cause the value of trust assets to be included in a grantor’s gross estate under I.R.C. § 2036(a) or 2038(a);<sup>36</sup>
- 2) The appointment of the private trust company as trustee of the family trusts will not alone cause the value of trust assets to be included in a beneficiary’s gross estate under I.R.C. § 2041;
- 3) The appointment of the private trust company as trustee of the family trusts in which the trustee has discretionary power to distribute income and principal to the grantor’s descendants will not alone cause the grantor’s transfers to the trust to be treated as incomplete gifts under I.R.C. § 2511, or any distribution from the trust to be a gift by any DDC member;
- 4) The appointment of the private trust company as trustee of the family trusts will not alone affect the GST exempt status of the trust under Treas. Reg. § 26.2601-1(b)(1)(i), or change the inclusion ratio; and
- 5) The appointment of the private trust company as trustee of the family trusts will not alone cause the grantor or beneficiary to be treated as the owner of the trust under I.R.C. §§ 673, 676, 677, or 678. The IRS stated the application of I.R.C. § 674 will depend upon the particular powers of the trustee and may depend on the proportion of the members of the DDC with authority to act with regard to that trust who are related or subordinate to the grantor. The IRS also stated that the operation of the private trust company could cause a grantor to be treated as an owner under I.R.C. § 675; however, it would depend upon the specific facts and circumstances.

Final guidance relating to the tax consequences of using an FTC to serve as trustee of a trust for a family member has yet to be issued by the IRS, although it could be at any time. This project has been listed on the IRS Priority Guidance Plan for several years. Until final guidance is released or the IRS begins issuing private letter rulings again on this issue, families cannot be certain how the IRS will treat the use of a family trust company for income and transfer tax purposes.

**Conclusion**

Florida's family trust company legislation is a significant development in Florida trust law and in the promotion of trust business within the state. The breadth and flexibility of the statutes should allow Florida to be competitive with others states that have enacted family trust company legislation. Although, family trust companies may present some challenging securities law and tax law considerations, many families will find them attractive solutions for the management and preservation of multigenerational wealth. 



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**Endnotes**

- 1 States other than Florida that currently have FTC legislation include: Alaska, Arkansas, Colorado, Delaware, Louisiana, Mississippi, Nevada, New Hampshire, Oklahoma, Pennsylvania, South Dakota, Tennessee, Virginia and Wyoming.
- 2 F.S. § 662.111(12).
- 3 See section entitled "Tax Issues Related to FTCs."
- 4 Compare F.S. § 662.111(11) with NRS § 669A.070.
- 5 The term "designated relative" means a common ancestor of a family, who may be a living or deceased person, and who is so designated in the application for a license or annual license. F.S. § 662.111(9). A licensed family trust company may have up to two designated relatives, while an unlicensed family trust company is limited to one designated relative. F.S. § 662.120.
- 6 F.S. § 662.111(11).
- 7 *Id.*
- 8 *Id.*
- 9 F.S. § 662.111(e).
- 10 F.S. § 662.111(j).
- 11 An FTC licensed in another jurisdiction may operate in Florida if it becomes licensed in Florida or registers with the Office of Financial Regulation. See F.S. §§ 662.150 and 662.151.
- 12 See section entitled "Securities Issues for FTCs."
- 13 F.S. §§ 662.121 – 662.1225.
- 14 F.S. § 662.126.
- 15 *Id.*
- 16 Compare F.S. §§ 662.121 and 662.122(3).
- 17 F.S. § 662.111(11).
- 18 *Id.*
- 19 F.S. § 662.120.
- 20 F.S. § 662.130(1).
- 21 *Id.*
- 22 F.S. § 662.131(2).
- 23 F.S. § 662.131(1).
- 24 F.S. §§ 662.131(3) and (4).
- 25 F.S. § 662.141(1).
- 26 F.S. § 662.141(2).
- 27 F.S. § 662.141.
- 28 F.S. § 662.141(5).
- 29 F.S. §§ 662.143-145.
- 30 F.S. §§ 662.142(1)(i), 143(1)(h) and 145(1)(i).
- 31 15 U.S.C. § 80b-3.
- 32 15 U.S.C. § 80b-2(a)(11).
- 33 SEC Release No. IA-3220; File No. S7-25-10 (June 22, 2011); 17 C.F.R. 275.202(a)(11)(G)-1.
- 34 15 U.S.C. §80b-2(a)(11)(A) and §80B-2(a)(2)(C).
- 35 See e.g., PLR 200523003, 200546055 and 200548035.
- 36 References to "I.R.C." are to the Internal Revenue Code of 1986, as amended.

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