

How the Rich Stay Rich: Using a Family Trust Company to Secure a Family Fortune

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[H]e had started a story once that began, “The very rich are different from you and me.” . . . [S]ome one . . . said . . . , Yes, they have more money.

Ernest Hemingway, *The Snows of Kilimanjaro*¹

We’re not a family; we’re a firm.

King George VI, about the British Royal Family²

I. INTRODUCTION

This Article is about family trust companies and the way they are used by very wealthy families to preserve great fortunes. The province of the megarich (who remain very much upon the American landscape, the recent economic crisis notwithstanding³), the family

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¹ ERNEST HEMINGWAY, *The Snows of Kilimanjaro*, in *THE SNOWS OF KILIMANJARO AND OTHER STORIES* 3, 23 (1995).

² *THE HUTCHINSON ILLUSTRATED ENCYCLOPEDIA OF BRITISH HISTORY* 147 (Simon Hall et al. eds., 1998).

³ While the recent economic crisis has been consequential for the very rich (as for everyone else) and many great fortunes currently reflect the decline in the market, many of the America’s wealthiest families remain among the nation’s—and the

trust company is generally thought to be a vehicle for families with a net worth of at least \$200 million.⁴ While the family trust company has long been important in securing the fortunes of some of the nation's wealthiest families, the academic bar has paid it scant attention. This Article aims to redress this longstanding oversight, especially in light of recent changes in the law that make these entities far more accessible to the very wealthy.⁵

The purpose of this Article is not, however, merely to attend to the particulars of these new laws that so effectively facilitate establishment of these entities. The tendency of all lawyers (including legal scholars) is to examine laws *seriatim*, one by one, rather than pursuing the combined effects of rules drawn from diverse areas of the law—thus discerning neither the extraordinary burdens of such combined effects nor the opportunities created by layering the benefits of laws not intended to be used in concert. Accordingly, the real significance of new laws affording the very wealthy ready access to the family trust company cannot be apprehended if these rules are treated in isolation. The intent of this Article is to examine—indeed to expose—the role of the family trust company as the masterstroke in a series of aggressive planning techniques (tax-driven and otherwise) that are used by the very wealthy to secure and grow a fortune for untold generations to come. The family trust company positions a wealthy family to exploit the elimination of the Rule Against Perpetuities in certain states to create perpetual trusts, to “leverage” exemptions from or credits against federal transfer tax applicable to the transfers into such trusts, and, most importantly, to make the most of new laws under which the determination of investment risk for such trusts has become as much art as science.

But further, what must also be appreciated is that these new laws facilitating the establishment of family trust companies (with the attendant opportunities to exploit other laws) are by some lights enormously consequential for the health of a democratic polity. It

world's—most financially fortunate people. See generally Mathew Miller & Duncan Greenberg, *The Forbes 400*, FORBES, Oct. 6, 2009, at 44 (discussing both the increase and decrease in the net worth of the United States' richest individuals). “The rich haven't gotten richer—or poorer—this year.” *Id.* at 44.

⁴ Pierce H. McDowell III, *Family Owned Private Trust Companies*, ABA TR. & INVESTMENTS, May–June 2008, at 42, 44.

⁵ See Carol A. Harrington & Ryan M. Harding, *Private Trust Companies and Family Offices: What Every Estate Planner Needs to Know*, in SOPHISTICATED ESTATE PLANNING TECHNIQUES 675, 689–92 (ALI-ABA Course of Study, Sept. 4–5, 2008) (discussing recent changes, uses, advantages, and disadvantages of family trust companies), available at WL SP020 ALI-ABA 675.

has long been a commonplace of democratic theory that, while democracy is largely immune to some degree of material difference within a polity, intransigent and radical differences in means are problematic.⁶ For this reason, the dissipation of great fortunes—whether from the pressure of taxation or due to other causes—has been viewed as salubrious in a democratic polity.⁷ “Shirtsleeves to shirtsleeves in three (or so) generations” is more than a proverb; it is arguably an operating condition of a healthy democracy, ensuring relative equality over time, a similar vulnerability to the vicissitudes of fortune.⁸ If the family trust company succeeds where advisers claim it can, however, great fortunes will cease to dissipate, and what many believe to be a background condition of a thriving democracy will be (at least for the United States) a thing of the past.⁹

Furthermore, as part and parcel of its implications for democracy, the family trust company understood as a crucial element in an architecture of complex planning techniques provides rich social commentary. In some of the literature surrounding the family trust company, this entity is offered up not only as the keystone in an edifice of diverse legal rules, an apparatus to hold and manage various types of wealth, but also as a central *locus* of family activity. In particular, some advisors to the very wealthy recognize the family trust com-

⁶ The locus classicus of this argument is probably Jean-Jacques Rousseau’s *Contrat Social*. Speaking of the necessary conditions of a democracy, Rousseau counsels “a large measure of equality in rank and fortune, without which equality of rights and authority cannot long subsist [and] little or no luxury—for luxury either comes of riches or makes them necessary; it corrupts at once rich and poor, the rich by possession and the poor by covetousness” See JEAN-JACQUES ROUSSEAU, *THE SOCIAL CONTRACT AND DISCOURSES* 58–59 (G. D. H. Cole ed. & trans., J.M. Dent & Sons 1913) (1762); cf. *THE FEDERALIST* No. 10, at 43–44 (James Madison) (George W. Carey & James McClellan eds., 2001) (discussing the “latent causes of faction” that are “sown in the nature of man”).

⁷ See JOHN RAWLS, *A THEORY OF JUSTICE* 277 (1971). Rawls defends inheritance taxes not as a means to “raise revenue . . . but [instead, to] gradually and continually . . . correct the distribution of wealth and to prevent concentrations of power detrimental to the fair value of political liberty and fair equality of opportunity.” *Id.*

⁸ See, e.g., ALEXIS DE TOCQUEVILLE, *DEMOCRACY IN AMERICA* 50 (J.P. Mayer ed., George Lawrence trans., Anchor Books 1969) (1835) (describing how the seeds of aristocracy have never been sown into American culture); see also B. Douglas Bernheim, *Does the Estate Tax Raise Revenue?*, in 1 *TAX POLICY AND THE ECONOMY* 113, 121–32 (Lawrence J. Summers ed., 1987); Michael J. Boskin, *An Economists’ Perspective on Estate Taxation*, in *DEATH, TAXES AND FAMILY PROPERTY: ESSAYS AND AMERICAN ASSEMBLY REPORT* 56, 65 (Edward C. Halbach, Jr. ed., 1977) (suggesting a proper role of transfer taxes is to prevent “extreme concentrations of wealth from being passed from generation to generation”); Gary Solon, *Intergenerational Income Mobility in the United States*, 82 *AM. ECON. REV.* 393, 393–94, 403–05 (1992).

⁹ Boskin, *supra* note 8, at 65–66.

pany as a venue for what is termed “financial reproduction.”¹⁰ The family trust company can create a place (the suggestion is made) where the older generation can tutor the younger in wealth preservation consistent with the family’s particular ethos about money and investing. As each generation (operating within the trust company) embraces this ethos to preserve the family fortune, each generation becomes quite self-consciously identified with its wealth, cognizant of its privilege, and able—even eager—to manage its unique circumstances into the future. Thus the family trust company serves not merely to frame the family’s financial life but to frame the lives of the wealthy broadly understood. As the family trust company is explored along with those complex planning techniques for which it can be crucial, the impression is inescapable: the lives of the rich are as much informed by their extraordinary wealth as the lives of the poor are by their poverty.

Part II of this Article examines recent changes in the laws in some states that allow for ease of set up and operation of a trust company serving a related group of people. This Part examines both the “lightly regulated” and the unregulated versions of the family trust company, highlighting their advantages and disadvantages.

Part III presents tax-minimization strategies that are commonly utilized in conjunction with the establishment of the family trust company to virtually eliminate the transfer tax liability when families move assets from the initial wealth-creating generation to later generations. In particular, we consider the “Note-Sale,” a strategy used to “leverage” exemptions from or credits against federal transfer tax, allowing a family to move tens of millions of dollars into trust with little to no transfer tax liability. Further, if this trust is established in a “non-perpetuities” jurisdiction (something readily accomplished given that those states that allow the creation of a family trust company have also eliminated the Rule Against Perpetuities¹¹), the wealth denied to the federal fisc (along with the rest of the family fortune) can remain safely stowed in trust to serve successive generations of the family forever.

But these families are not merely interested in transferring great wealth into perpetual trust in ways that ensure that their wealth will escape transfer tax both at the time of transfer and later. These families are also concerned about what becomes of their fortunes after

¹⁰ See Linda C. McClain, *Family Constitutions and the (New) Constitution of the Family*, 75 *FORDHAM L. REV.* 833, 861 (2006) (terming this “social reproduction”).

¹¹ See *infra* Part III.A.

they are placed in trust. Part IV presents what is probably the most significant advantage afforded to the very wealthy by the family trust company: the opportunity to serve as trustee, and in that capacity, to continue to determine its own investment risk. Until the advent of the family trust company, provisions of the tax regime made it problematic for the family to employ strategies such as the “Note-Sale” and then name a family member to serve as trustee of the trusts necessitated by these strategies.¹² These families have typically had to resort to banks and other institutional trustees—most of which are inclined to invest conservatively, missing opportunities for returns rather than put the portfolio in jeopardy. This has not made these families happy. But further, about fifteen years ago, the law governing the investment of trust assets became more liberal as a result of the Prudent Investor statute, which made the determination of the risk profile appropriate to any portfolio in trust as much an art as a science. While institutional trustees may still be inclined to invest more conservatively, a case can now be made that, if the account is large enough and the horizon long enough, even highly speculative investments (with potential for enormous returns) can be appropriate for property in trust. Once the family establishes a family trust company, the family, serving as its own trustee, is poised to accept Prudent Investor’s invitation to invest aggressively. These trusts, which are filled with wealth that has never been and will never be subjected to transfer tax, potentially become investment juggernauts.

Whatever control of investing a family may acquire by establishing a family trust company, this control will be useless if the family cannot muster from generation to generation the financial acumen and the discipline to make state-of-the-art investment decisions. Part V examines the family trust company as a venue for what has been termed “financial parenting.” In this process, members of a wealthy family discern and embrace the magnitude of their privilege as well as its financial underpinnings—and acquire an “identity apart” from the rest of society.¹³ If the operation of a family trust company requires certain skills and attitudes, the trust company itself can serve as a forum in which education in these skills and attitudes can take place.¹⁴

¹² See McDowell, *supra* note 4, at 43–45.

¹³ See RAWLS, *supra* note 7, at 277 (stating that distribution of wealth can be an essential factor in “prevent[ing] concentrations of power detrimental to the fair value of political liberty and fair equality of opportunity”).

¹⁴ See JAMES E. HUGHES, JR., FAMILY WEALTH—KEEPING IT IN THE FAMILY: HOW FAMILY MEMBERS AND THEIR ADVISERS PRESERVE HUMAN, INTELLECTUAL, AND FINANCIAL ASSETS FOR GENERATIONS 117–19 (rev. and expanded ed. 2004) (discussing the competing demands on and skill required of a trustee).

But more importantly, the sustained process of gathering together for the purpose of preserving and growing wealth encourages families to discern and embrace the privileges of great wealth in such a way that the family trust company can only be privilege-sustaining, indeed privilege-enhancing.

Finally, in the wake of the recent economic turmoil, we might think that anyone with an entrepreneurial mindset would feel chastened, particularly given that many speculators have suffered enormous losses, and speculative excess is what—so many say—brought the U.S. economy to its knees. Many of the wealthy have seen a decline in the value of their holdings like everyone else. Be that as it may, with pundits disagreeing about the effectiveness of various antidotes to the crisis and no one confidently foreseeing the light at the end of the tunnel, the time could not be riper for the wealthy to want to manage their own risk, to protect against further downside, and to position portfolios to take advantage of early opportunities that will appear when the U.S. economy starts to recover.¹⁵ And this is no less the case where the property is held in trust.

II. THE MODERN FAMILY TRUST COMPANY

Continuing to invest the family fortune after it has been transferred into trust has long held significant appeal for wealthy families and, for well over a century, family trust companies have been used as a means to this end. Family trust companies first appeared in the late nineteenth and early twentieth centuries.¹⁶ At the time, they were organized as state-chartered and state-regulated banks under the same laws and regulatory requirements that would govern any state-chartered trust company serving the public.¹⁷ In our era, a family

¹⁵ Indeed, for many very wealthy people this economic crisis represents an opportunity of sorts. With asset values reduced, assets may be transferred within the family at substantially reduced value transfer tax costs. See Deborah L. Jacobs, *As Economy Declines, Donors Rethink Estate Planning*, N.Y. TIMES, Nov. 11, 2008, at F27.

¹⁶ See, e.g., Bessemer Trust, *Our Heritage*, <http://www.bessemertrust.com/portal/site/bessemernew/> (follow “Heritage” hyperlink) (last visited Mar. 9, 2010).

¹⁷ In fact, a number of these earlier family trust companies have grown into banking institutions that serve a larger public. Created to serve the family of Henry Phipps, Bessemer Trust opened its doors to the public in 1974. *Id.* Pitcairn Family Office was established to manage the fortune of the descendants of John Pitcairn, co-founder of what is now PPG Industries. Pitcairn Family Office, *Sustaining Generational Wealth*, <http://www.pitcairn.com/pitcairn.htm> (last visited Jan. 26, 2010). The firm opened its doors to other wealthy families in 1987, providing (among other financial services) fiduciary services. *Id.* Rockefeller Trust was established over 125 years ago by John D. Rockefeller to manage money for his descendants. See *Rockefel-*

trust company can still be organized this way,¹⁸ but recent changes in the law (at least in some states) make this unnecessary.

A. *The New Regulatory Regimes*

While a wealthy family can still create a national bank regulated by the Office of the Comptroller of the Currency, or a state bank regulated by state banking authorities,¹⁹ it is now also possible to create an unregulated or a “lightly regulated” trust company if the entity is limited in its purpose to serving as trustee of trusts benefiting a group of related people.²⁰ In one group of states, legislatures have responded with new and separate private trust company charters so that trust companies serving only a related group of people can be subject to “lighter” requirements than those imposed on trust companies serving the general public.²¹ In certain other states, liberalization of the law has occurred by simply allowing a limited-purpose corporation to act as a trust company under the general statutes of the state.²² Some states make available both options—light regulation or no regulation.²³ Whichever scheme a family elects, these innovations at the

ler & Co., Inc., About Rockefeller & Co., <http://www.rockco.com/who-we-are/our-history.aspx> (last visited Mar. 9, 2010).

¹⁸ The entity is unlikely to be organized as a national bank or a state bank, unless the family plans to effectively open a business and to take deposits and offer other conventional banking services. See Harrington & Harding, *supra* note 5, at 692–93.

¹⁹ *Id.*

²⁰ *Id.* at 689. Interestingly, states do not always specify what is meant by the requirement of a “related group of people.” See, e.g., S.D. CODIFIED LAWS § 51A-6A-1 (Westlaw through 2009 Reg. Sess. & Sup. Ct. R. 09-09). But see N.H. REV. STAT. ANN. § 392:40-a(1)(a) (Westlaw through ch. 1 of 2010 Sess.).

²¹ States permitting a “lightly regulated” family trust company include Alaska, ALASKA STAT. § 06.26.200 (LEXIS through 2009 1st Reg. Sess. & 2009 Spec. Sess.), Delaware, DEL. CODE ANN. tit. 5, §§ 773, 774, 779 (2007), New Hampshire, N.H. REV. STAT. ANN. §§ 392.40-a, 392.40-b, and South Dakota, S.D. CODIFIED LAWS § 51A-6A-4. See also DELOITTE DEV. LLC, PRIVATE TRUST COMPANIES: AN ALTERNATIVE APPROACH FOR WEALTHY FAMILIES 2 (2009), available at http://www.deloitte.com/assets/DcomUnitedStates/Local%20Assets/Documents/us_tax_PrivateTrustCompanies_070809.pdf (discussing jurisdictions allowing regulated private trust companies).

²² States permitting an unregulated family trust company include Virginia, see VA. CODE ANN. §§ 6.1-32.1 to 6.1-32.10 (LEXIS through 2009 Reg. Sess. & 2009 Spec. Sess. I), Colorado, and Wyoming. See DELOITTE DEV. LLC, *supra* note 21, at 2. States permitting an unregulated family trust company include Virginia.

²³ States allowing both include Massachusetts, MASS. GEN. LAWS ANN. ch. 172 §§ 5, 9A (West, Westlaw through ch. 39 of the 2010 Ann. Sess.), Nevada, NEV. REV. STAT. ANN. § 669.080(1)(n)(2) (LexisNexis, LEXIS through Apr. 2009), and Wyoming, WYO. STAT. ANN. §§ 13-5-101 to 104 (LEXIS through 2009 Gen. Sess.). See also DELOITTE DEV. LLC, *supra* note 21, at 2 (discussing state regulation of private trust companies).

state level have reduced formation and operation costs for these new entities.²⁴

1. The “Lightly Regulated” Family Trust Company

The “lightly regulated” family trust company is still chartered by the state and subject to state supervision, though not on a level comparable to a bank or trust company serving the general public. The organizing documents must, however, limit the purpose of the entity to the provision of fiduciary services to members of a family or a group of related people and, further, prohibit the trust company from soliciting business from the public at large.²⁵ Even a so-called “lightly regulated” family trust company will usually have to have a minimum number of directors²⁶ (and perhaps one or more directors domiciled in the state), a minimum number of board meetings per year,²⁷ a physical office in the state,²⁸ and a minimum number of employees.²⁹ Further, there must be in place a formalized risk-management discipline, which state regulators will periodically review; this discipline can include bylaws, a policy manual (setting

²⁴ Harrington & Harding, *supra* note 5, at 689.

²⁵ With respect to family trust companies, especially where unregulated but even where lightly regulated at the state level, some advisors have been concerned that these entities could be subject to registration with the Securities and Exchange Commission under the Investment Advisers Act of 1940 (1940 Act or the Act). *See, e.g., id.* at 694. Because these entities offer trustee services and investment advice, some advisors have worried that they are potentially subject to the 1940 Act. *See id.* at 681–82. Furthermore, because they are not regulated by state banking regulators to any meaningful degree, they would not qualify under the “bank” exemption under the Act. *Cf. id.* at 691 (“A [private trust company] may be exempt from registration as investment advisers with the SEC . . . if it is a regulated trust company.”). This would mean that, while changes in state law would exempt these entities from one form of regulation (i.e., state banking regulation), this exemption would subject them to another form of regulation (i.e., regulation under the 1940 Act). *Id.* at 693–94. In 2007, upon the representation that the family trust company organized as a limited liability company under Wyoming law did not hold itself out to the public as an investment adviser, the SEC issued an order of exemption under Section 202(a)(11)(F) of the Act. *See In re Gates Capital Partners, LLC, Investment Advisers Act of 1940 Release No. 2599* (Mar. 20, 2007), <http://www.sec.gov/rules/ia/2007/ia-2599.pdf>.

²⁶ *See* NEV. REV. STAT. ANN. § 661.135 (LexisNexis, LEXIS through Apr. 2009); N.H. REV. STAT. ANN. § 384:3(IV) (LexisNexis, LEXIS through ch. 327 of 2009 Sess.); S.D. CODIFIED LAWS § 51A-6A-13 (Westlaw through 2009 Reg. Sess. & Sup. Ct. R. 09-09).

²⁷ *See* NEV. REV. STAT. ANN. § 661.165; N.H. REV. STAT. ANN. § 384:7; S.D. CODIFIED LAWS § 51A-6A-15.

²⁸ *See* NEV. REV. STAT. ANN. § 660.015(1); S.D. CODIFIED LAWS § 51A-6A-58.

²⁹ *See, e.g.,* S.D. CODIFIED LAWS §§ 51A-6A-31 to -32 (minimum number of employees is one and state examinations occur every eighteen months).

forth, among other things, a committee structure and decision rules for those committees), annual reports,³⁰ and appropriate record keeping.³¹ Capital requirements vary by state but are universally modest, with some states as low as \$250,000³² and others up to \$2 million.³³ Some states imposing lighter capital requirements, such as South Dakota and New Hampshire, also require a surety bond of \$1 million.³⁴

2. The Unregulated Trust Company

Some states offer an even more permissive regime. In these states, a state-issued charter is not required to establish a family trust company, nor is the state required to exercise subsequent regulatory oversight.³⁵ States that allow family trust companies to form without any regulation typically permit the family to create a limited-purpose corporation that then acts as a trust company under the general statutes of the state.³⁶ The organizing documents—as was the case with the lightly regulated regime—must limit the purpose of the entity to the provision of fiduciary services to members of a family and, further, prohibit the trust company from soliciting business from the public at large.³⁷ For entities organized under these regimes, there are usually no capital requirements.³⁸ The simpler procedures required for organization, the absence of periodic examinations, and the absence of capital requirements allow a family trust company to be quickly and easily established and also make it less expensive to operate.³⁹

³⁰ See, e.g., NEV. REV. STAT. ANN. § 665.105; N.H. REV. STAT. ANN. § 392:40-b(III); S.D. CODIFIED LAWS § 51A-6A-34.

³¹ See S.D. CODIFIED LAWS § 51A-6A-30.

³² See DEL. CODE ANN. tit. 5, § 745 (2007).

³³ N.H. REV. STAT. ANN. §§ 392.40-a(II), 392.25(I); S.D. CODIFIED LAWS § 51A-6A-19.

³⁴ See N.H. REV. STAT. ANN. §§ 392.40-a(II), 392.25(I); S.D. CODIFIED LAWS § 51A-6A-19; Harrington & Harding, *supra* note 5, at 709.

³⁵ See generally DELOITTE DEV. LLC, *supra* note 21, at 2 (indicating that Colorado, New Hampshire, and Virginia recognize unregulated family trust companies).

³⁶ See, e.g., VA. CODE ANN. §§ 6.1-32.30:2(A), 6.1-32.30:3 (LEXIS through 2009 Reg. Sess. & 2009 Spec. Sess. I).

³⁷ *Id.* at § 6.1-32.30:2(D).

³⁸ See Harrington & Harding, *supra* note 5, at 709 (indicating that unregulated family trusts in Massachusetts, Nevada, Pennsylvania, and Wyoming do not require a minimum capital amount).

³⁹ *Id.*

B. Organizing the Family Trust Company: Type of Association and Location

Creation of a family trust company begins with a determination as to the type of business association and its governing structure. The family must also decide the state in which the family trust company will be organized and operated. These decisions are crucial if the family is to realize the potential of the family trust company, first as a significant component within an advanced tax planning strategy and later as a vehicle by which to secure the family fortune into the future.

1. Organization and Governance

A variety of considerations can drive the decision as to the type of business entity to be used. Since states that have liberalized their laws with respect to the formation of family trust companies usually permit these entities to be organized as limited liability companies, most families will organize as such, although some still may form a corporation.⁴⁰ To take advantage of those state statutes that have recently liberalized the regulatory framework applicable to family trust companies, the entity is typically organized for the limited purpose of providing trust services to a particular family or group of related individuals.⁴¹

Once a decision is made with respect to the type of business association to be used, the family must put in place a governance structure so that the family can, through the various administrative arms of the trust company, effectively control the investment of trust funds, among other things.⁴² The ownership interest is usually vested in in-

⁴⁰ A partnership would not be used because the entity would terminate when one of the partners died. *See, e.g.*, UNIF. P'SHIP ACT § 801(2)(i), 6 U.L.A. 189 (1997). This would defeat one of the purposes of creating an entity to serve as trustee rather than relying upon an individual.

⁴¹ Ronald D. Aucutt, McGuire Woods LLP, *The Nuts and Bolts of Private Trust Companies and Family Offices* (Mar. 8–9, 2008) 2–3 (outline of remarks on file with author).

⁴² *See id.* at 5–9 (discussing how private trust companies must be individually designed). While control of investing the trust corpus rarely has adverse tax consequences for the family, control of distributions of income or principal by family members to family members can have disastrous transfer tax consequences. *See id.* at 9–10 (discussing the tax considerations of the family trust company). Because the desire to control distributions is usually not the primary reason that a family establishes a family trust company, decision making within the family trust company can usually be structured so that adverse tax consequences are avoided. *See, e.g.*, I.R.S. Notice 2008-63, 2008-31 I.R.B. 261.

dividual family members.⁴³ Family members also serve on the board of directors.⁴⁴ The board can also include outside advisors of long standing.⁴⁵ To the extent that the applicable state statute requires one or more directors to be a resident of the state where the trust company has been created and where it will operate, local attorneys and other advisers can be named. In any event, states that permit a family to create a “lightly regulated” or unregulated family trust company also permit the family to control the board, the necessary presence of others notwithstanding.⁴⁶

2. Caveat: Liability

For the family that objects to bureaucratic red tape, the unregulated family trust company has appeal, at least at first glance. Ease of formation and operation aside, however, another reason for creating a family trust company is to overcome one of the drawbacks in naming an individual as trustee, that is, the personal liability of the trustee.⁴⁷ If the trustee is organized as a corporation or a limited liability company, then the trustee’s liability should be limited to the amount of any required formation capital and the value of any surety bond. So, for example, in South Dakota, where capital in the amount of \$200,000 is required for formation along with a \$1 million surety bond, liability would be limited to \$1.2 million.⁴⁸ This is the case, however, only if the corporate veil is not pierced. If the veil is pierced, then those members of the family deemed the principals are

⁴³ See Aucutt, *supra* note 41, at 9. Trusts established for the benefit of family members can also hold some or all of the ownership interest in a family trust company. *Id.* This is a further step that, among other things, removes the ownership interest from family members’ estates. Indeed, it is not uncommon for the trusts for which the family trust company is the trustee to own the family trust company. See, e.g., RICHARD R. DAVIS, *THE PHIPPS FAMILY AND THE BESSEMER COMPANIES* 16–17 (2007). This circularity may appear to present questions with respect to fiduciary duty and enforceability, as this structure renders the beneficiaries themselves, through their beneficial interests in the trust, economically identical to the trustee. While there are elements of irony here, in truth the situation is not fundamentally different from the situation where individual family members are the trustees of trusts benefiting the family.

⁴⁴ Aucutt, *supra* note 41, at 3.

⁴⁵ See *id.*

⁴⁶ See Harrington & Harding, *supra* note 5, at 689.

⁴⁷ *Id.* at 691.

⁴⁸ See S.D. CODIFIED LAWS § 51A-6A-19 (Westlaw through 2009 Reg. Sess. & Sup. Ct. R. 09-09).

potentially liable.⁴⁹ Thus, even a family that dislikes red tape may decide that some degree of regulation and organizational niceties such as bylaws, a policy manual, a committee structure with formalized decision-making processes, and good record keeping lend a crucial element to the entity in the form of organizational integrity.⁵⁰

3. Trust Company State *Situs*

Because not every state allows a family to establish a modern family trust company,⁵¹ obviously the entity must be organized and operated in a state where the law has been liberalized, unless the entity is to be organized under one of the legal regimes governing those trust companies serving the public.⁵² The state in which the trust company is organized and operated is important for other reasons as well, however. The *situs* of the trust company will also supply the *situs* and governing law for any trusts established by the family where the trust company is named as trustee.⁵³ If the family trust company is to be the masterstroke in a sophisticated estate plan, it is crucial that it be located in a state where the law is optimal for the realization of all aspects of the plan. The importance of state *situs* for purposes of diverse elements of the plan will become evident in Part III. At this juncture, suffice it to note only that fortunately for the families undertaking these complex estate plans, many of the states that have liberalized their laws with respect to forming privately owned, family trust companies have also changed their laws governing the creation and administration of trusts.⁵⁴

⁴⁹ Of course, by virtue of the family component of these trusts, the beneficiaries suing for breach of trust will be the children, siblings, cousins, nieces, and nephews of those serving in a decision-making capacity in the trust.

⁵⁰ See Harrington & Harding, *supra* note 5, at 693 (identifying favorable characteristics of a national or state-chartered, regulated limited purpose trust company that may enhance organizational integrity).

⁵¹ See, e.g., *id.* at 693–94.

⁵² Cf. *supra* note 17 (providing examples of trust companies serving the public).

⁵³ See, e.g., Harrington & Harding, *supra* note 5, at 695 (noting that considerations such as favorable trust and property law are important for families deciding where to form their regulated private trust companies).

⁵⁴ *Id.* at 689, 694–95 (listing the most common states used for private trust company formation and detailing jurisdiction considerations that make the particular states attractive to families forming such companies). Trusts for which the family trust company is the successor trustee are another question. The family trust company cannot create a nexus with respect to all important legal issues for a trust that names as initial trustee a person domiciled in another jurisdiction or another trust company located in another jurisdiction. See *id.* at 690 (noting that “a trust may not contain flexible trustee succession provisions”).

C. *Alternative Fiduciaries: “Big Banks” and Private Individuals*

Families of extraordinary wealth would almost always⁵⁵ be welcome clients of existing banks and trust companies that, for a fee, readily serve as fiduciaries for members of the public. Or, in the alternative, these families could avoid using a big bank by naming an individual as trustee, either a person expert in fiduciary matters such as a lawyer specializing in trusts and estates, or even someone without professional expertise, perhaps a family member. Either of these choices would allow a family to avoid the burdens of establishing and then operating a trust company of its own. Both a big bank trustee and an individual fiduciary have significant limitations, however, for people with considerable wealth who want to provide for multiple generations of their families by transferring their property into long-term trusts.

1. Alternatives: “Big Banks”

Big banks now typically offer their wealthier clients state-of-the-art estate planning assistance, along with structures and services consonant with changes in the law particularly attractive to the very wealthy eager to transfer their property into trust. For example, these institutions commonly have subsidiaries in states that allow for the creation of perpetual trusts.⁵⁶ Further, consistent with the Prudent Investor Act, these institutions often offer a platform of cutting-edge investments appropriate to the risk profile of large privately held fortunes, even those in trust.⁵⁷

For families establishing privately owned, family trust companies, however, these available structures and services are not enough. With respect to state *situs*, for example, not only is the possibility of establishing a perpetual trust at issue for these families, but there are other provisions of state law that can also be advantageous in establishing a trust. One state may allow perpetual trusts, but another may allow these plus have a more attractive law with respect to asset protection.

⁵⁵ Certain banks and conventional trust companies are reluctant to accept in trust volatile or hard-to-manage assets such as real estate, operating companies, or a non-diversified portfolio consisting in an ownership interest in either a closely held company or a publicly traded one where the family does not want the portfolio diversified. *See id.* at 689.

⁵⁶ *See, e.g.,* Ralph Engel & Al W. King III, *The Dynasty Trust*, CPA J., Sept. 1996, at 16, 18, available at <http://www.nysscpa.org/cpajournal/1996/0996/features/DynastyTrust.htm>.

⁵⁷ *See, e.g.,* Wilmington Trust, Investment Choices, <https://www.wilmingtontrust.com/wtcom/index.jsp?section=WAS&fileid=1146062540611>.

Prudent Investor statutes also vary state by state. In establishing a trust, these families want to elect the state *situs* that is optimal for them, not one determined by a large institution to be optimal for its client base.

Perhaps even more important, with respect to investments, these families want to continue to invest their property even after it has been placed in trust, notwithstanding any platform of sophisticated vehicles offered by existing banks and trust companies. A trustee has a duty not only to invest but to conserve the assets of the trust in accordance with statutorily mandated fiduciary standards. Any investment program subject to fiduciary standards must look to the interests of income beneficiaries and remaindermen, both born and unborn.⁵⁸ This is a tall order, and a big-bank trustee is mindful that, for any risk profile established by it, the standard of review looks to common fiduciary investment practice.⁵⁹ This means that banks and trust companies serving the larger public are generally loathe to invest an account more aggressively than they anticipate their competitors would invest, given the risk profile.⁶⁰ Also, while trustees are not required to guarantee results as they invest a trust portfolio, the duty of care encourages these institutions to attend to deliberative processes carefully recorded, as a prudent process is usually a good defense to a bad result.⁶¹

There are opportunity costs, however, attendant upon convening committees and reaching decisions in accordance with procedural dictates, and there are those who believe such tentativeness is ultimately unproductive, especially where the account is of significant size and the time horizon is that of the perpetual trust. Many families

⁵⁸ David S. Prince, *Sutton's Law and Economics Applied to the Professional Fiduciary: Helping the Trustee Avoid Predatory Litigants*, 119 BANKING L.J. 17, 34–35 (2002); Suzanne M. Trimble, *Life's Hard Choices: Why Choose a Corporate Trustee?*, CBA REC., Sept. 2000, at 44, 44 (2000).

⁵⁹ John H. Langbein, *The Contractarian Basis of the Law of Trusts*, 105 YALE L.J. 625, 656 (1995) [hereinafter Langbein, *The Contractarian Basis*] (explaining that the standard of prudent administration is “a reasonableness norm, comparable to the reasonable person rule of tort”); John H. Langbein, *The Uniform Prudent Investor Act and the Future of Trust Investing*, 81 IOWA L. REV. 641, 644 (1996) [hereinafter Langbein, *The Uniform Prudent Investor Act*] (stating that the “standard of prudent investing was the standard of industry practice—what other trustees similarly situated were doing”).

⁶⁰ See, e.g., Langbein, *The Uniform Prudent Investor Act*, *supra* note 59, at 649–50 (discussing how the Prudent Investor Act instructs investors to closely analyze risk and return objectives closely in every investment decision for the given beneficiary).

⁶¹ See Prince, *supra* note 58, at 30–35 (detailing the importance of careful documentation and thorough record-keeping for fiduciaries so that they may avoid litigation).

establishing privately owned, family trust companies want to be free of such constraints. These families are seeking to ensure full exploitation of any Prudent Investor statute by developing their own more nuanced risk profile to govern investment decisions for their property placed in trust and want, where possible, to be free of bureaucratic red tape so that they can turn on a dime in making investment decisions.⁶² In short, these families want a trustee that is willing and able to facilitate the realization of goals consistent with their own risk assessment.

2. Alternatives: Individual Trustees

Of course, these families could simply name an individual as trustee.⁶³ A lawyer with expertise in fiduciary matters could be named, but an individual without expertise could also be chosen. But to the extent that these families are seeking to establish their trusts in a state with statutes optimally advantageous for their particular purposes, an individual—expert or otherwise—cannot provide the nexus necessary to create *situs* unless he or she is domiciled in the desired state.⁶⁴ Further, even if an appropriate individual can be located in the desired state, individuals go on vacation, become incapacitated, die, and resign. This fact is usually of modest moment in a

⁶² And to the extent a big bank might be willing to look beyond its own investment platform to accommodate a particular family's investment interest, any investment direction would still be subject to the bank's deliberative process—red-tape that these families want to avoid.

⁶³ Naming a family member can have deleterious tax consequences, especially if he or she is either the grantor of the trust or a beneficiary of it. See *infra* note 79.

⁶⁴ For aggressive estate planning, establishing trust *situs* in a state with advantageous laws is key. To access a particular law (which will then govern the validity of the instrument and the subsequent administration of the trust), a trust must have a sufficient *nexus* with the desired jurisdiction. EUGENE F. SCOLES ET AL., CONFLICT OF LAWS § 21.3 (4th ed. 2004). A sufficient *nexus* will give rise to *situs* so that, under choice-of-law rules, judicial venue notwithstanding, the trust will be deemed governed by the laws of the desired jurisdiction. Arguably, *nexus* is a creature of grantor intent, meaning that a direction in the trust instrument with respect to governing law should suffice to establish *nexus* and thus *situs*. *Id.* §§ 21.1, 21.3. This rule is subject to the significant caveat, however, that the rule at issue not be at odds with a strong contrary local policy. *Id.* § 21.1. The continued presence of the Rule Against Perpetuities in a particular venue could present such an important contrary policy. Therefore, advisors (cognizant of how important governing law is in an aggressive estate plan) tend to err on the side of conservatism in securing *situs* for a trust. They thus look to case law determining *situs* where the grantor provides no direction in the trust instrument. Accordingly, to secure the validity of the trust, they secure sufficient *nexus* by naming as initial trustee an individual domiciled in or a bank authorized to conduct trust business in the desired jurisdiction. *Id.* § 21.3. To secure the desired administrative regime, the instrument also directs that the trust be administered in this jurisdiction on an ongoing basis. *Id.* §§ 21.3, 21.6.

garden-variety trust of moderate size, established to last one or two lifetimes. In the case of a perpetual trust holding a fortune in cutting-edge investments, however, such limitations can be consequential indeed. If an individual trustee is contemplated, what will be needed (vacations notwithstanding) is an unbroken line of succession from one honest, experienced, informed, and (ideally) astute individual to the next, with each residing in the appropriate jurisdiction. And ultimately, this succession of individual fiduciaries must potentially serve with respect to multiple trusts, all with slightly different rationales.

Further, given the complexity of the provisions in a typical perpetual trust and the challenges that inhere in investing a portfolio of great size, an individual trustee, even one with professional expertise, must commonly resort to a bank or other financial services provider or a collection of providers to serve as agent for the trustee in any number of capacities.⁶⁵ This does not mean that the individual trustee will delegate fiduciary responsibility, as he or she always retains a duty to monitor an agent's performance.⁶⁶ Nevertheless, when an individual trustee is named to serve alone, investment advice, custody, and sometimes even record keeping and tax return preparation are commonly contracted out to large corporate institutions.⁶⁷

Finally, trustees are personally liable for breach of fiduciary duty,⁶⁸ something that is always of concern but is particularly critical here where the plan contemplates a relatively aggressive posture on the part of the fiduciary with respect to investments. In naming an individual as trustee many families will attempt to redress this vulnerability by including an indemnification provision in the trust instrument, especially since individual trustees often find insurance coverage limited or unavailable.⁶⁹ Under current law, however, the legal force of such indemnifications is uncertain, with many commentators arguing that, to be binding, these must be limited in the trust agreement to particular assets or specified situations.⁷⁰ In addition, the intractable problem of personal liability here makes for yet another ob-

⁶⁵ *Id.* at 17.

⁶⁶ Iris J. Goodwin & Pierce McDowell, *Delegation of Fiduciary Investment Responsibility: Trustees Explore the Once Taboo*, TR. & EST., Mar. 1999, at 8, 10; Al W. King III & Pierce H. McDowell III, *Delegated vs. Directed Trusts*, TR. & EST., July 2006, at 26, 27.

⁶⁷ See, e.g., Harrington & Harding, *supra* note 5, at 689–91.

⁶⁸ Langbein, *The Contractarian Basis*, *supra* note 59, at 656.

⁶⁹ Kozusko, *supra* note 64, at 19.

⁷⁰ See, e.g., Melanie B. Leslie, *Common Law, Common Sense: Fiduciary Standards and Trustee Identity*, 27 CARDOZO L. REV. 2713, 2728 (2006).

stacle to finding individuals who are willing to serve as trustees, not only initially but successively. In contrast, the liabilities of a family trust company—and of any employee serving there—are more easily managed.⁷¹

Thus, a family trust company avoids the perceived opportunity costs inherent in the use of a big bank as trustee, as well as other limitations, such as potential liability, attendant upon naming an individual. The family trust company—itsself a corporate entity—then becomes an attractive alternative, blending the structural advantages of a corporate trustee with the discretionary latitude of an individual one.⁷²

III. VALUATION ALCHEMY: CREATING THE TRUST CORPUS

To justify an aggressive posture, the constraints of fiduciary duty notwithstanding, the trustee must look to the totality of facts and circumstances surrounding the trust. And the case for investing aggressively is better made where the corpus is considerable and the term of the trust extended.⁷³ Strategies for transferring the family fortune into trust with little or no transfer tax liability constitute an important prelude to the exercise of fiduciary investment discretion in ways that the family wants, because any tax paid is likely to reduce the funds that ultimately find their way into trust.⁷⁴ Also important for minimizing the overall tax burden on a family fortune is placing funds in a trust of extended duration. In this Part, we consider the advantages of establishing a long-term trust and examine one particularly powerful strategy for transferring funds to it with little to no transfer tax liability—the Note-Sale. If the Note-Sale is not adequate to shelter the family fortune, other strategies can be brought to bear on what remains—among the more popular being the “zeroed out GRAT.” These various techniques make possible the transfer of what is effectively tens of millions of dollars into perpetual trust without the family ever having to pay transfer tax.⁷⁵

⁷¹ Aucutt, *supra* note 41, at 3–4.

⁷² See Kozusko, *supra* note 64, at 17–19.

⁷³ See Langbein, *The Uniform Prudent Investor Act*, *supra* note 59, at 650.

⁷⁴ See, e.g., Harrington & Harding, *supra* note 5, at 697–99 (discussing potential tax issues for private trust companies).

⁷⁵ As this Article goes to press, the Estate Tax has been repealed effective January 1, 2010, pursuant to the Economic Growth and Tax Relief Reconciliation Act of 2001. Pub. L. No. 107-16, § 501, 115 Stat. 69. To minimize the projected drain on the federal fisc from the repeal of the tax as projected at the time of the 2001 legislation, the law included a provision whereby the Estate Tax is to resurrect on January 1, 2011, *id.* § 901, with a Unified Credit substantially reduced from the amount in effect

A. The Long-Term Trust

To take a step back, the need to invest subject to a fiduciary standard would not arise but for the family fortune being in trust. If the members of the family held family assets outright, then each generation of the family as it came into its inheritance would be free to invest—and indeed to risk—the funds as it saw fit. Thus, the question is why a very wealthy family eager to minimize its transfer tax burden would transfer its property into trust?

The simple transfer-tax reason⁷⁶ that wealthy families put their fortunes into trust is that only the initial transfer into trust—the transfer in fee simple from the donor to the trustee—is subject to transfer tax.⁷⁷ And this is the case even though multiple, successive generations of the family subsequently benefit from the property as equitable owners. In contrast, if the family fortune were transferred outright from parent to child and then from child to grandchild and so on, each of the transfers (all in fee simple) would trigger a tax.⁷⁸ Taken together, the multiple instances of taxation as property descended from one family member to another, generation to generation, would make for a great drain on the family fortune. But if the property is transferred into trust, it is not subject to transfer tax again

in 2009 immediately before the repeal of the tax (sufficient to shelter \$3,500,000) to the amount in play in 2001, when the legislation was first enacted (sufficient to shelter \$1,000,000). Compare I.R.C. § 2010(c) (2006), with I.R.C. § 2010(c) (2000). Many expect that Congress will act in late 2010 and reinstitute the Estate Tax retroactive to January 1, 2010. Martin Vaughan, *Estate-Tax Repeal Means Some Spouses Are Left Out*, WALL ST. J., Jan. 2, 2010, at B1. Others believe that Congress will simply wait and allow the tax to resurrect in 2011, as per the 2001 legislation. *Id.* With two wars underway and the federal deficit at historic levels, however, no one expects that the repeal of the tax will be made permanent. Accordingly, this Article proceeds under the assumption that, going forward, the Estate Tax will endure in much the same form it has had in the past. Finally, note that the Gift Tax was not repealed by the 2001 legislation as the Gift Tax plays (among other things) a critical role in backstopping the income tax. The Unified Credit currently applicable to the Gift Tax is sufficient to shelter \$1,000,000 in lifetime gifts. I.R.C. § 2505(a) (2006).

⁷⁶ Placing assets in trust can also protect them from beneficiaries' creditors as, generally, creditors of a trust beneficiary can only "stand in the beneficiary's shoes" and claim the income or principal that the beneficiary is legally entitled to receive at the time he or she is entitled to receive it. See UNIF. TRUST CODE § 501, 7C U.L.A. 520 (2006); RESTATEMENT (THIRD) OF TRUSTS: GENERAL PRINCIPLES § 60 (2003); Charles D. Fox & Michael J. Huft, *Asset Protection and Dynasty Trusts*, 37 REAL PROP. PROB. & TR. J. 287, 294 (2002) (noting that "[i]n most states, a beneficiary's creditors cannot reach trust assets if the trustee's power to distribute trust assets is subject to the trustee's discretion").

⁷⁷ See REGIS W. CAMPFIELD ET AL., TAXATION OF ESTATES, GIFTS AND TRUSTS 60–61 (23d ed. 2006).

⁷⁸ I.R.C. §§ 2501(a), 2511 (2006) (gift tax); *id.* § 2001(a) (estate tax).

until the trust terminates and the property goes outright to the beneficiaries (termed “remaindermen”). Only after the trust terminates, when those remaindermen—now holding the property outright and free of trust—transfer the property, will the property again be subject to transfer tax.⁷⁹ And most significantly, if the property can stay in trust in perpetuity, the property is beyond the transfer tax regime forever.

So not only is the overall transfer tax burden on multiple generations lessened substantially if the property is placed in trust, but the longer the trust lasts and the more generations of a family that can benefit from the property while it is in trust, the greater the overall tax savings. In short, the longer the term of the trust, the more “tax-efficient” the trust is.

Until the late 1980s, efforts to extend the time horizon for a trust into the distant future were thwarted by the common law Rule Against Perpetuities.⁸⁰ A movement to repeal the Rule⁸¹ has been fair-

⁷⁹ Many provisions under the federal transfer tax regime make it advantageous for the trustee to be an independent party, placing the exercise of certain aspects of fiduciary discretion outside the family and not in the hands of the donor of any trust or any beneficiary. For example, neither the donor of a given trust nor the trust beneficiaries should control discretionary distributions of income or principal. If the donor retains control of distributions from the trust, this power can potentially cause inclusion of the property subject to the discretion in the donor’s estate. See I.R.C. §§ 2036, 2038. If a beneficiary can make distributions to herself or to someone for whom she has a support obligation, this control will under certain circumstances be deemed a general power of appointment and cause inclusion of the property subject to the power in her estate. See *id.* § 2041. Further, if a family member controls distributions from a trust where she is not a beneficiary, but where other family members are beneficiaries, her control can also trigger application of the “reciprocal trust doctrine,” especially if she is a beneficiary of a second trust, one where those other family members are trustees. See *United States v. Estate of Grace*, 395 U.S. 316, 321–24 (1969). The consequence of running afoul of these rules is to make property once transferred into trust and (supposedly) beyond the reach of the transfer tax regime again subject to tax. Where the exercise of fiduciary powers through a family trust company is concerned, however, the Internal Revenue Service has recently begun to lay this matter to rest, providing guidance with respect to decision-making structures within a family trust company that will conform to the requirements of the transfer tax regime with respect to discretionary distributions of trust income and principal. IRS Notice 2008-63, 2008-2 C.B. 261.

⁸⁰ Stewart E. Sterk, *Jurisdictional Competition to Abolish the Rule Against Perpetuities: R.I.P. for the R.A.P.*, 24 CARDOZO L. REV. 2097, 2100 (2003).

⁸¹ Elements of the estate planning bar and certain banking interests spearheaded this movement. See Robert H. Sitkoff & Max M. Schanzenbach, *Jurisdictional Competition for Trust Funds: An Empirical Analysis of Perpetuities and Taxes*, 115 YALE L.J. 356, 373–74 (2005) (describing the race between states to abolish the Rule Against Perpetuities); see also Joshua C. Tate, *Perpetual Trusts and the Settlor’s Intent*, 53 U. KAN. L. REV. 595, 596 (2005) (discussing the abolition of the Rule Against Perpetuities in the context of perpetual dynasty trusts).

ly successful, however, and to date, nearly one-half of the states and the District of Columbia have eliminated the Rule altogether (or effectively done so).⁸² A trust can now be of virtually infinite duration provided that it is established in a “non-perpetuities” jurisdiction. Leaving aside strategies for funding a perpetual trust, the mere fact that trusts can last in perpetuity constitutes an enormous advantage for wealthy families because once wealth is in a perpetual trust, it sits beyond the reach of the transfer tax regime forever.⁸³

The fact that to date the Rule Against Perpetuities remains intact in many states is no impediment to a wealthy family still living in a perpetuities jurisdiction. Wherever family members live, the family simply needs to name a trustee in a non-perpetuities jurisdiction who can administer the trust in that state.⁸⁴ The need for a “nexus” with a non-perpetuities jurisdiction does, however, mean that, for a family planning to place a family trust company at the helm as trustee of a perpetual trust, the family needs to establish its trust company in a state that not only permits a modern family trust company but also has eliminated the Rule Against Perpetuities. Fortunately, for the

⁸² See, e.g., ALASKA STAT. § 34.27.100 (LEXIS through 2009 1st Reg. Sess. & 2009 Spec. Sess.); ARIZ. REV. STAT. § 13-2901(A)(2) (LexisNexis, LEXIS through 49th Legis. 4th Spec. Sess. & ch. 1 of 5th Spec. Sess.); COLO. REV. STAT. § 15-11-1102.5(1) (LEXIS through 2009 Legis. Sess.); DEL. CODE ANN. tit. 25, § 503 (2007); IDAHO CODE ANN. § 55-111 (LEXIS through 2009 Reg. Sess.); 765 ILL. COMP. STAT. ANN. §§ 305/1-6 (LexisNexis, LEXIS through Public Act 96-884 of 2009 Legis. Sess.); ME. REV. STAT. ANN. tit. 33, § 101-A (Westlaw through 2009 1st Reg. Sess.); MD. CODE ANN., EST. & TRUSTS § 11-102 (West, Westlaw through 2009 Reg. Sess.); MO. ANN. STAT. § 456.025 (West, Westlaw through 2009 1st Reg. Sess.); NEB. REV. STAT. ANN. § 76-2005(9) (LexisNexis, LEXIS through 2009 1st Sess.); N.H. REV. STAT. ANN. § 564:24 (Westlaw through ch. 1 of 2010 Sess.); N.J. STAT. ANN. § 46:2F-9 (West 2003); OHIO REV. CODE ANN. § 2131.09 (LexisNexis, LEXIS through 128th Gen. Assem.); 20 PA. CONS. STAT. ANN. § 6107.1 (West 2005); R.I. GEN. LAWS § 34-11-38 (LEXIS through ch. 365 of Jan. 2009 Sess.); S.D. CODIFIED LAWS § 43-5-8 (Westlaw through 2009 Reg. Sess. & Sup. Ct. R. 09-09); VA. CODE ANN. § 55-13.3 (LEXIS through 2009 Reg. Sess. & 2009 Spec. Sess. I); WASH. REV. CODE ANN. § 11.98.130 (West, Westlaw through 2010 Legis. effective through Mar. 16, 2010); WIS. STAT. ANN. § 700.16 (West, Westlaw through 2009 Act 78, Acts 80-93, and Acts 95-100); WYO. STAT. ANN. § 34-1-139(b)(i) (LEXIS through 2009 Gen. Assem.). The District of Columbia has also eliminated the Rule against Perpetuities. D.C. CODE ANN. § 19-904 (LexisNexis, LEXIS through D.C. Act 18-254). In addition, several states significantly extend the rule as it applies to trusts. FLA. STAT. ANN. § 689.225 (West 2008) (360 years); NEV. REV. STAT. ANN. § 111.1031 (LexisNexis, LEXIS through Apr. 2009) (365 years); UTAH CODE ANN. § 75-2-1203 (LEXIS through 2009 1st Spec. Sess.) (1,000 years).

⁸³ BORIS I. BITTKER & LAWRENCE LOKKEN, FEDERAL TAXATION OF INCOME, ESTATES & GIFTS 120.1, at 120.1-120.2 (2d ed. 1993); JOEL C. DOBRIS, STEWART E. STERK & MELANIE B. LESLIE, ESTATES AND TRUSTS 822-23 (2d ed. 2003) (1998).

⁸⁴ Of course, the family could also employ an individual trustee resident in the jurisdiction or big bank trustee authorized to conduct trust business in the jurisdiction with the caveats stated *supra* Part II.C.1.

family wanting to establish its own trust company and name that entity trustee of a perpetual trust, many of the states that have liberalized their laws with respect to forming privately owned, family trust companies have also changed their laws to eliminate the Rule Against Perpetuities.⁸⁵

B. Funding the Trust

The potential tax when the property is initially transferred into trust remains at issue, however, and for a family of great wealth, this amount can be considerable. Once a perpetual trust has been established, the scene then shifts to strategies to transfer property into it with little to no transfer tax liability. This is accomplished by exploiting the various credits and exemptions from transfer tax under the Internal Revenue Code (included there so that taxpayers of modest means can transfer assets without incurring liability). For the very wealthy, however, the trick is not to use these credits and exemptions “dollar-for-dollar” (i.e., a dollar of credit or exemption applied to shelter a dollar of family wealth). Instead, sophisticated planning techniques (like the Note-Sale) subject assets to discounting techniques and then in various ways “leverage” the credits and exemptions, so that the dollar limitations as per the Internal Revenue Code become more apparent than real.

1. The Unified Credit and the GST Exemption

Like all non-charitable gratuitous transfers, transfers into trust are subject to Estate Tax (if made at death) or to Gift Tax (if made during life).⁸⁶ Shelter from the Estate and Gift Tax is available, however, in the form of the Unified Credit.⁸⁷ If the trust benefits grandchildren and more remote descendants, then in addition to Estate or Gift Tax, transfers to the trust will be subject to the Generation-Skipping Transfer (GST) Tax.⁸⁸ Generation-skipping transfers, however, can also be sheltered – with the GST Exemption.⁸⁹

With respect to the Unified Credit, every transferor currently has a lifetime credit sufficient to shelter up to \$3.5 million in transfers

⁸⁵ See *supra* Part II.A; sources cited *supra* note 82. Trusts for which the family trust company is successor trustee are another question. The desired jurisdiction can be challenged if the initial trustee is domiciled in an undesirable jurisdiction.

⁸⁶ I.R.C. § 2001 (2006) (estate tax); *id.* §§ 2501(a), 2511 (gift tax).

⁸⁷ *Id.* § 2010 (estate tax); *id.* § 2505 (gift tax).

⁸⁸ See *id.* § 2601.

⁸⁹ *Id.* § 2631.

made during life or at death.⁹⁰ At present, however, only \$1 million of the credit is available for use during life, and, accordingly, this amount becomes the operative figure for many planning strategies.⁹¹ This is because, even though the Unified Credit can be applied to transfers made at death, most of the more sophisticated tax planning strategies make use of transfers not at death but during life—gifts essentially.⁹² There are reasons for this, the most important of which is that gifts can be timed, effectively giving the taxpayer significant control over the gift's value. This control over the timing of the transfer—and thereby the value of the gift for transfer tax purposes—is a large element of not only the Note-Sale, but of other strategies as well.⁹³

But there is an additional transfer tax applicable to transfers made to a long-term or perpetual trust—the GST Tax.⁹⁴ The Estate and Gift Tax is designed to tax wealth every generation. Nevertheless, as noted above, trusts benefiting successive generations can neatly avoid successive impositions of estate and gift tax as the property in trust becomes available to grandchildren and more remote descendants.⁹⁵ This means that, if the Estate and Gift Tax was the sole transfer tax, the initial transfer into trust would be subject to tax but, after that, multiple generations would enjoy the property without further imposition of tax. In 1986⁹⁶ in an effort to close this loophole, Congress layered on to those transfers the GST Tax and subjected generation-skipping transfers (whether made outright or in trust) to this additional tax.⁹⁷ Thus, like all non-charitable gratuitous transfers, generation-skipping transfers are subject either to the Gift Tax (if

⁹⁰ *Id.* § 2010(c).

⁹¹ *Id.* § 2505(a).

⁹² Even though the Estate Tax and Gift Tax generally work together to make for a unified regime, gifts are still more “tax efficient” than transfers at death. *See* CAMPFIELD ET AL., *supra* note 77, at 12, 70–71.

⁹³ A second reason that gifts are more “tax efficient” than transfers at death is that gifts are tax exclusive while transfers at death are tax inclusive; the funds used to pay the gift tax are not themselves subject to tax, while funds used to pay estate tax form part of the base against which the rate of taxation is applied. *See id.* at 12. This second reason is less relevant here in that no transfer tax will be paid.

⁹⁴ *See generally* I.R.C. §§ 2601–2663.

⁹⁵ *See* CAMPFIELD ET AL., *supra* note 77, at 726–28.

⁹⁶ A federal tax on generation-skipping transfers was first enacted in 1976. This tax was considered conceptually flawed; Congress therefore substantially repealed it and enacted a new tax in 1986. *See* CAMPFIELD ET AL., *supra* note 77, at 727 (citing H.R. REP. NO. 99-426, at 824 (1985)).

⁹⁷ *Id.*

they occur during life) or to the Estate Tax (if they occur at death).⁹⁸ But where the transfer potentially benefits grandchildren or more remote descendants, the transfer is subject to the GST Tax in addition to the Estate or Gift Tax.⁹⁹ Taken together, the Estate or Gift Tax and the GST Tax make for a virtually confiscatory imposition of tax.¹⁰⁰

For those seeking to circumvent the transfer tax regime with long-term trusts, such is the bad news. There is also good news, however, in the form of a lifetime exemption from the GST Tax, currently in the amount of \$3.5 million, the entire amount of which can be used to shelter transfers made during life or at death.¹⁰¹ While (unlike the Unified Credit) the entire GST Exemption of \$3.5 million can be used for transfers during life if the taxpayer so chooses, the transfer will also be subject to the Gift Tax; there the Unified Credit will shelter only \$1 million of the transfer.¹⁰² Consequently, even though a transfer in excess of \$1 million could be sheltered from the GST Tax, the excess would be subject to the Gift Tax.¹⁰³ Therefore, the \$1 million amount sheltered by the Unified Credit operates for most wealthy donors as a cap here as well, as families tend to be disinclined to incur tax for lifetime transfers.¹⁰⁴

2. The Note-Sale

Transfers to a perpetual trust will then be subject both to the Gift Tax and to the GST Tax and must be sheltered from both unless a tax is to be paid. The Note-Sale is a strategy for sheltering the funding of a perpetual trust and constitutes a two-stroke finesse of the

⁹⁸ *Id.* at 729.

⁹⁹ *See id.* at 729–730. The GST Tax is applicable to a transfer made to or for the benefit of a “skip person,” meaning any person of a generation that is two or more generations below the transferor (such as a grandchild). *See* I.R.C. § 2613(a)(1) (2006). “Direct skips” to such persons are taxable and would include gifts outright and gifts in trusts that benefit solely skip persons. *See id.* § 2612(c)(1). Where trusts benefit both skip and non-skip (i.e., children) persons, then “taxable distributions” of income and principal from such trusts, as well as “taxable terminations” from such trusts (where property goes outright to one or more skip persons), are subject to tax. *Id.* § 2612(b).

¹⁰⁰ *See* CAMPFIELD ET AL., *supra* note 77, at 735–36.

¹⁰¹ *See* I.R.C. § 2010(c).

¹⁰² *See id.* § 2631(a).

¹⁰³ *See supra* notes 94–100 and accompanying text.

¹⁰⁴ Because the Gift Tax will have to be paid if the taxpayer makes lifetime transfers in excess of \$1 million, transfers to a perpetual trust are unlikely to be made in excess of \$1 million.

meager \$1 million of Unified Credit applicable to gifts and the GST Exemption that it effectively caps.

a. Step One: The Valuation Envelope

If the GST Exemption and Gift Tax Credit are applied dollar-for-dollar, \$1 million of the GST Exemption and the current Gift Tax Credit will shelter only \$1 million of assets. There are, however, more tax-efficient ways to make gifts and to use the GST Exemption and the Gift Tax Credit. Family assets are made eligible for valuation discounting by first swallowing them in a family limited partnership, a close corporation, or a limited liability company before they are transferred into trust.¹⁰⁵ This entity is then capitalized into voting and non-voting shares and, for the time being, the head of the family retains both.¹⁰⁶

At this point the stage is set to make more effective use of the GST Exemption and Gift Tax Credit. The non-voting shares are now eligible for a valuation discount for both lack of marketability because they represent an interest in a closely held entity¹⁰⁷ and lack of control because they have no voting rights.¹⁰⁸ Conservative planners

¹⁰⁵ See Richard A. Oshins & Steven J. Oshins, *Protecting & Preserving Wealth into the Next Millennium*, TR. & EST., Oct. 1998, at 68, 82–88 (discussing benefits of an installment sale to a grantor trust). Assets that might be transferred into this closely held envelope include a family business (an operating company that may itself be closely held), publicly traded securities, real estate, private equity, etc. See *id.* at 70–72. Once the closely held envelope is created and assets have been transferred to it, the head of the family takes back the voting and non-voting shares. See *id.* at 76.

¹⁰⁶ See *id.* at 76–77.

¹⁰⁷ See Rev. Rul. 59-60, 1959-1 C.B. 237, 240. Discounts as high as thirty-five percent are commonly applied in valuing interests in closely held businesses—that is to say, in valuing interests for which there is little to no market because they are not publicly traded. Valuing closely held interests begins by reference to comparable assets that are publicly traded. See *id.* at 239. Then, assuming there is no ready market for the particular interests in question, a discount is applied under the assumption that a buyer would not pay as much for such interests. If any stock is also subject to restrictions on sale, the marketability discount can be substantially greater. See *Estate of McClatchy v. Comm’r*, 147 F.3d 1089, 1094, (9th Cir. 1998). Note, however, that the Internal Revenue Service can resist or seek to reduce a marketability discount where a closely held entity is holding assets that are readily marketable. See *McCord v. Comm’r*, 120 T.C. 358, 395 (2003). *McCord* concerned two limited partnerships where one-third of one partnership and two-thirds of a second partnership consisted in marketable securities or interests in real estate holding partnerships. *Id.* at 367–68. The taxpayer claimed a thirty-five percent discount for lack of marketability, but the Tax Court reduced the discount to twenty percent. *Id.* at 389, 395. Even in this instance, however, some discount was deemed justified given the partnership envelope. See *id.* at 395.

¹⁰⁸ See, e.g., *Estate of Bright v. United States*, 658 F.2d 999 (5th Cir. 1981). The ability to obtain a discount for lack of control even where all the interests in the

would generally apply a forty percent discount under these circumstances.¹⁰⁹ As such, assets that would be worth \$1 million, if held free of the closely held entity, can now be valued at \$600,000. Accordingly, \$1 million of the GST Tax Exemption and the Gift Tax Credit can now be used to shelter assets that would have a value of approximately \$1.667 million were they held free of the closely held entity. Note also that these amounts will double in the case of a married couple planning together.

The head of the family then transfers \$1 million in cash or equivalents to the perpetual trust.¹¹⁰ Under the Note-Sale strategy, this transfer (the “seeding” of the trust) is the only transfer that is actually a “gift” for Gift Tax purposes, and it is here that the Gift Tax Credit and \$1 million of the GST Exemption are applied.

b. Step Two: Purchase of Discounted Assets

The placement of a family’s wealth into a closely held entity and the establishment of a perpetual trust are preliminary steps. While some advantage would be gained if the non-voting (now discounted) shares were simply contributed to the perpetual trust (instead of “seeding” the trust with \$1 million in cash), this would not realize the full potential of the Exemption or the Credit. So, instead, at this juncture the trustee of the trust (here the Family Trust Company) steps forward and purchases \$10 million of the non-voting shares from the head of the family and gives back an installment note¹¹¹ in

closely held entity are owned within a family (or by trusts for their benefit) is the legacy of *Bright*. The case vindicated a long established precedent that attribution should not apply to lump together family members’ stock for valuation purposes under the transfer tax regime. *See id.* at 1002; Rev. Rul. 93-12, 1993-1 C.B. 202 (where the Service acquiesced in *Bright*).

¹⁰⁹ In the past, courts have granted a single discount percentage, such as forty percent, without segregating the discount attributable to minority status from that attributable to lack of marketability. It is important to recognize the distinction between the discount for lack of control and that for lack of marketability, however, because in recent years the courts have tended (quite properly) to analyze these discounts separately in arriving at a discount appropriate in a given situation. *See, e.g., Estate of McClatchy*, 147 F.3d 1089.

¹¹⁰ Either cash or discounted assets can be used here, although the real advantage of the discounted assets materializes in Step Two. *See Oshins & Oshins, supra* note 105, at 68, 93.

¹¹¹ The terms of the loan are governed by many considerations under the transfer tax regime. First, the loan will be an intrafamily loan and so, to avoid gift-loan treatment under I.R.C. § 7872, it must bear an interest rate of at least the Applicable Federal Rate. *See* I.R.C. § 7872(a), (e) (2006). This is a market rate of interest determined by reference to the average yield on U.S. government obligations. *See id.* §§ 1274(d)(1)(C), 7872(f)(2). As it works out, however, the rate is generally more than fair to the borrower when compared to rates that are likely to be commercially

the amount of \$9 million, along with the \$1 million (just received when the trust was seeded) as a down payment. Per the note, the trustee is required to pay only interest during the term, with principal due in nine years—at the end of the term—in the form of a balloon payment, with a right of prepayment.¹¹²

Courtesy of the trustee's purchase of the assets in exchange for the note, the fair market value of the assets that ultimately fund the trust is \$10 million instead of the \$1 million contributed gratuitously. Further, because the assets were initially placed in a closely held entity, the \$10 million of assets that ultimately fund the trust would be worth approximately \$16.67 million if held free of this entity—or \$20 million and approximately \$33.3 million, respectively, in the case of a married couple.¹¹³

The \$10 million amount of the note is only ten times the \$1 million gift, a margin that is not so great that it vitiates the claim that the entire transaction has a business purpose.¹¹⁴ And so long as the transaction has a business purpose, the transaction occurs outside the scope of the transfer tax regime. Under the Gift Tax Regulations, the transfer is not a gift if it is “a sale, exchange, or other transfer of property made in the ordinary course of business (a transaction

available. The nine-year term will make it a long-term loan under § 7872, therefore making it eligible for the long-term interest rate (usually a lower rate than the shorter term rates). The Applicable Federal Rates are redetermined each month. *See id.* § 1274(d)(1)(B). For term loans of more than three years, the market interest rates for longer term obligations are used, depending on the term of the loan. *See id.* § 1274(d)(1)(C). In the case of a term loan, the Applicable Federal Rate for the entire period of the loan is determined by the rate for the month in which the loan is made. *See id.* § 7872(f)(2)(A). In the case of a demand loan, which has no application in the Note-Sale, the rate varies from month to month as the Federal rates are re-determined. *See id.* § 7872(f)(2)(B).

¹¹² The loan will be an intrafamily loan, so to avoid gift-loan treatment the interest rate will be determined by the Applicable Federal Rate. *See id.* § 7872(a),(e). The nine-year term will make it a long-term loan. Oshins & Oshins, *supra* note 105, at 84.

¹¹³ Oshins & Oshins, *supra* note 105, at 82.

¹¹⁴ The business purpose of the closely held entity also lends support to the business purpose of the entire transaction. The closely held entity needs a genuine business purpose beyond its role in a tax-minimization strategy. Such a purpose could be, for example, the need to bring managerial integration to a diverse and complex portfolio of assets. Absence of some bona fide business purpose will invite numerous objections from the Internal Revenue Service and the courts such that the closely held entity is likely to be viewed as a mere tax avoidance artifice. This is especially the case where this “wrapper” holds largely passive investment assets (such as marketable securities) that could just as well be held outright. *See* Oshins & Oshins, *supra* note 105, at 82. In addition, care must be taken that the closely held entity is used in a way consistent with a business purpose. *See infra* notes 115–16. For example, all assets should not be transferred into the closely held entity necessitating the payment of household obligations out of the closely held entity.

which is bona fide, arm's-length, and free of any donative intent)."¹¹⁵ Other elements of the transaction also lend support to the claim that the Note has a business purpose, including the timing of the purchase of the shares relative to the funding of the trust where at least a six-month lag is recommended.¹¹⁶

¹¹⁵ See Treas. Reg. § 25.2512-8 (as amended in 1992). To escape Gift Tax treatment, it is also important here to establish that the transfer was for "adequate and full consideration in money or money's worth." *Id.* The element of consideration not only removes the transfer from the realm of the gift tax, but also ensures that the value of the trust will not be included in the donor's estate if she were to die during the term of the Note. See I.R.C. §§ 2036, 2038(a) (2006). Attention to the valuation of assets transferred into trust is then important. The plan here is to have the note repaid before the donor dies—thus the prepayment provision of the Note. In the event, however, that the donor dies during the term of the Note, the Note itself will be in the donor's estate, but it may be eligible for discounting because of its long-term and low interest rate. Oshins & Oshins, *supra* note 105, at 84. Furthermore and most importantly, however, if the Note winds up in the donor's estate, the appreciated assets of the trust do not.

¹¹⁶ Recently, the Internal Revenue Service has attacked the use of closely held entities as discounting devices by relying on I.R.C. § 2036(a). Several decades of case law (in which the Internal Revenue Service has acquiesced) preclude the Service from attacking the discount by aggregating the interests of family members and trusts for their benefit in determining whether the value of closely held interests should be discounted for lack of control. See, e.g., *Estate of Bright v. United States*, 658 F.2d 999 (5th Cir. 1981) (Internal Revenue Service acquiesces in Rev. Rul. 93-12, 1993-1 C.B. 202). In two cases with similar facts, the Internal Revenue Service has more successfully applied § 2036(a), however, as it includes in the decedent's gross estate any asset as to which the decedent has retained a right to the income from the property. See *Strangi v. Comm'r*, 417 F.3d 468, 475 (5th Cir. 2005); *Estate of Thompson v. Comm'r*, 382 F.3d 367, 373 (3d Cir. 2004). In these two cases, the Internal Revenue Service also successively applied § 2036(a) to include the underlying assets held in any entity in a decedent transferor's estate where the partnership was formed only shortly before the decedent's death, lending an aura of the testamentary substitute to the transaction, and the decedent transferred nearly all his net worth to the closely held entity, necessitating that he rely on income from the entity for his support until his death—the last being critical to the application of § 2036(a). See *Strangi*, 417 F.3d at 472; *Thompson*, 382 F.3d at 369. Finally, the entity was funded almost entirely with marketable securities. See *Strangi*, 417 F.3d at 478; *Thompson*, 382 F.3d at 370. In *Estate of Kimbell v. United States*, 371 F.3d 257 (5th Cir. 2004), however, the U.S. Court of Appeals for the Fifth Circuit reached a contrary result. While, as in *Thompson* and *Strangi*, the decedent had transferred property to a family limited partnership not long before his death, in *Kimbell* there were good business reasons for placing the assets (which included oil and gas working interests) in a partnership. *Id.* at 267. Further, the transferor retained sufficient property to provide for his own support. *Id.* at 259. Care must be taken to see that the closely held entity is created well in advance of the death of the transferor, that there is a business purpose (other than tax avoidance) for creation of the entity, that all the formalities of maintaining and operating the closely held entity are observed, that assets transferred to the entity are operating assets requiring management (rather than passive investment assets, such as marketable securities), and that the decedent has retained sufficient wealth to support herself without receiving income from the entity. See generally Oshins & Oshins, *supra* note 105.

The Note-Sale also exploits certain aspects of the income tax regime. The trust will be drafted so that, during the life of the donor, it will be a “grantor trust” for income tax purposes. This “grantor trust status” is created by turning to the parts of the Internal Revenue Code that govern the income tax regime and including a provision in the trust that intentionally violates one or more of the grantor trust rules under the Internal Revenue Code—for example, by giving the donor the right to exchange property in the trust for property of equivalent value.¹¹⁷ Whatever power is included here, it is unlikely that the donor will exercise it. This does not matter. The mere presence of the power in the trust agreement will ensure that the donor is considered the “owner” of trust assets for income tax purposes and, most importantly, transactions between the trust and the donor (the Note-Sale, for example) will be ignored for income tax purposes.¹¹⁸ Thus, while the sale of the non-voting shares to the trustee would otherwise be a realization event for income tax purpose, no gain will have to be recognized. For income tax purposes, it is as if the trust does not exist and the transaction did not happen.¹¹⁹

3. Other Strategies

Effective as the Note-Sale might be for transferring tens of millions of dollars with the application of only the \$1 million Gift Tax Credit and \$1 million of the GST Exemption, many families still find themselves with considerable wealth remaining in the hands of the donor generation. Other strategies are available to transfer additional wealth with little to no transfer tax, however, and this is the case even if the donor generation has completely exhausted its \$1 million (\$2 million in the case of a couple) Gift Tax Unified Credit. Indeed, especially popular in such circumstances is the Grantor Retained Annuity Trust (GRAT) and in particular its most aggressive application, the “zeroed out” GRAT.¹²⁰

¹¹⁷ See I.R.C. §§ 673–679 (2006). This planning opportunity is possible because the grantor trust rules (which are primarily creatures of the income tax regime) “do not work *in pari materia*” with the gift tax regime. See Oshins & Oshins, *supra* note 105, at 73. Care must be taken, however, to make certain that this retained power offends only with respect to the income tax regime but does not vitiate the transfer for purpose of the transfer tax regime. For purposes of the Estate and Gift Tax or indeed the GST, it is essential that the transfer be complete.

¹¹⁸ See Rev. Rul. 85-13, 1985-1 C.B. 184.

¹¹⁹ See Oshins & Oshins, *supra* note 105, at 73; Randall D. Roth, *The Intentional Use of Tax-Defective Trusts*, in 26 INSTITUTE ON ESTATE PLANNING 400, 403.3–404.1 (John T. Gaubatz ed., 1992).

¹²⁰ See CAMPFIELD ET AL., *supra* note 77, at 245–46 (citing *Walton v. Comm’r*, 115 T.C. 589 (2000)).

The GRAT is a creature of reforms enacted in 1990 that resulted in the addition of Chapter 14 of the Estate and Gift Tax with its special valuation rules.¹²¹ These strict valuation rules are applicable to certain transfers in trust, especially those where the donor generation retains a present interest structured as an annuity¹²² while transferring a remainder interest to the donee generation, thereby making a gift to them.

Consistent with the Chapter 14 valuation rules, if the donor generation retains a large enough income interest, the actuarial value of the remainder—the gift to the donee generation—will be zero or very close to it, making for a “zeroed-out” GRAT.¹²³ Where the value of the remainder is zero or nearly so, there will be little to no gift tax due on the transfer—a welcome outcome where the donor generation has already exhausted its gift tax Unified Credit. The value of the remainder interest will be zero where the donor generation retains a very large income interest. To satisfy this income interest will require (pursuant to the required valuation methodology) not only the income produced by the trust assets, but also a return of principal. At the end of the annuity term, nothing will be left to be distributed to the donee generation, at least per the Chapter 14 valuation

¹²¹ These valuation rules were meant to eliminate certain capitalization strategies by which closely held companies were capitalized so that the donor generation could retain a preferred interest in a family business while the younger generation received common stock. *See id.* at 230–36. These interests were subjected to various favorable valuation techniques so that the interest passing to the donee generation was often valued at a fraction of its worth at the time of the transfer. *See id.* at 230–31.

¹²² Of course, the value of the gift also reflects the retained annuity. This income interest must consist in annual payments of either (1) a fixed dollar amount or (2) an amount equal to a fixed percentage of the trust value, determined annually. *See* I.R.C. § 2702(b)(1)–(2) (2006). Where an income interest does not conform to these requirements, the income interest will be valued at zero, potentially making for an expensive gift to the donee generation of 100 percent of the value of the property transferred into trust. *See id.* § 2702(a)(2)(A).

¹²³ The “zeroed out” GRAT was for some time deemed controversial as the Internal Revenue Service and the estate planning bar argued about the meaning and interpretation of Example 5 under Treas. Reg. 25.2702-3(e) (2007). The IRS had argued that the retained interest should be valued as an annuity payable for the shorter of the term of the retained annuity or the grantor’s death. *See, e.g., Walton*, 115 T.C. at 594. This analysis would reduce the value of the retained interest and therefore increase the value of the remainder (the gift). The Tax Court, examining the legislative history of § 2702, ultimately concluded that Example 5 in Treas. Reg. 25.2702-3(e), is an “unreasonable interpretation and invalid extension” of § 2702. *Walton*, 115 T.C. at 604. The Commissioner has since acquiesced in the Tax Court holding and has issued regulations affirming the result in the case. *See* Rev. Rul. 2003-72, 2003-2 C.B. 964; Treas. Reg. 25.2702-3(e), exs. 5, 6, & 8 (2009) (amended in 2005).

rules.¹²⁴ Of course, these calculations are predicated on the value of the property on the date it is transferred into trust together with the imputed rate of appreciation.¹²⁵ The donor is betting, however, that the reality will be very different—a point to which we will return momentarily.

But there are drawbacks to the GRAT. Probably its biggest disadvantage is that it does not readily lend itself to a perpetual trust. The donor's GST Exemption cannot be applied to shelter the property transferred to the GRAT until the expiration of the donor's present interest.¹²⁶ By that point, if all has gone according to plan, the assets will have appreciated far in excess of their initial worth. In short, this means that the GST Exemption cannot be leveraged here, but must be applied dollar-for-dollar. For this reason, GRAT remaindermen are always children rather than more remote generations, so as to avoid generation-skipping liability.¹²⁷ Absent application of the GST Exemption, transfers to subsequent generations will be subject to transfer tax.

Other "high-tech" strategies also remain—large designs that again allow a wealthy family to minimize its transfer tax liability, even where the Unified Credit and Generation-Skipping Tax Exemption have been exhausted. For example, the charitable lead trust is a split-interest trust that can allow a family to transfer significant wealth to children and more remote generations with little to no transfer tax liability.¹²⁸ As with the GRAT, the donor can effectively "zero out" the charitable lead trust by setting the payments to charity high enough that the present value of the lead interest to charity will be equal to or almost equal to the full value of the assets contributed to the trust. If

¹²⁴ Cf. CAMPFIELD ET AL., *supra* note 77, at 245–46 (providing an example).

¹²⁵ See *id.* at 241–43.

¹²⁶ § 2642(f) (1), (3).

¹²⁷ There are other drawbacks to the GRAT. First, in utilizing the Note-Sale strategy, it is advantageous if the grantor of the perpetual trust (and holder of the Note) survives the term of the Note so that the Note does not wind up an asset of his estate. See Oshins & Oshins, *supra* note 105, at 84. But it does not entirely scuttle the plan if in fact the grantor dies before this happens. See *id.* In the case of a GRAT, the grantor of the trust must survive the term of the retained annuity or all the property in the trust will be restored to his estate for estate tax purposes under I.R.C. § 2036(a). See *id.* Second, with respect to the Note-Sale, the rate of return that must be applied to the Note is almost always going to be lower than the rate used to value the GRAT remainder because of the difference in requirements of the valuation regimen applicable in each case. See *id.* The consequence is that the rate of appreciation that must be achieved for the Note-Sale to be successful is likely to be lower than the rate for the GRAT. See *id.*

¹²⁸ § 2522(c) (4) (B); T.D. 8923, 2001-1 C.B. 485.

the donor zeros out the trust, the value of the gift to the donee generation will be zero or close to it, and again, no transfer tax will be owed.

4. Beating the Imputed Rate of Appreciation

If any of these strategies are to “work,” however, the assets must, at a minimum, appreciate at a rate higher than the interest rate on the loan (in the case of the Note-Sale) or than the imputed rate of growth under Chapter 14 (in the case of the GRAT or the charitable lead trust). In the case of the Note-Sale, this is highly likely to happen. The discounting of the assets by virtue of the closely held “wrapper” ultimately ensures that the assets making their way into the trust are more valuable than the amount the trustee has paid for them.

Nevertheless, valuation discounts and leveraging notwithstanding, each of these strategies realizes its greatest potential when the underlying assets—those transferred to the closely held entity—hold significant appreciation potential. The prospects for transferring wealth between generations without having to pay transfer tax increase exponentially if the property placed into the closely held entity is a business being formed, a new product being developed, a new location for an existing business, an investment opportunity, or a closely held business soon to go public. Ideally, the assets transferred into the “envelope” are significant interests in a venture that can reasonably be predicted to explode in value. It is here that roughly \$33 million (itself transferred without paying transfer tax) can easily become \$100 million.¹²⁹

Of course, if these assets are going to be transferred into trust, even as non-voting shares of a closely held wrapper, the family requires a trustee that is willing to hold such an investment. At this point, the stage is set to consider the legal discretion a trustee might have to do just that.

IV. PUTTING THE PEDAL TO THE METAL: FIDUCIARY INVESTMENT DISCRETION

If addressing the dissipation of assets held in trust is indeed the last frontier in the preservation of great fortunes, it is no longer plausible to chalk this problem up simply to the drain of transfer tax.

¹²⁹ The timing of the transfer, however, has to be carefully calculated, such as in the instance of an initial public offering where the stock is to be valued before the public offering. If this value is to be sustained, the more time between the transfer into trust and the public offering, the better.

Indeed, wealthy families whose property has long been in trust, where it was safe from the dissipating pressure of the fisc, have for decades appreciated the pernicious effects of a conservative fiduciary investment philosophy (supported by a conservative law governing fiduciary investment discretion).¹³⁰ For the more recently wealthy, concern with fiduciary investing has come front and center. These families rely on tax-minimizing strategies (such as the Note-Sale) that not only transfer assets into trust with little to no transfer tax liability, but also make integral to the plan a certain rate of appreciation with respect to transferred assets.¹³¹ These modern strategies can only succeed if the property transferred consists of appreciating, potentially volatile assets – and, moreover, that those assets do indeed appreciate, volatility notwithstanding. These families understand the element of risk that was in play in making their fortunes and look to bring this entrepreneurial mindset to the management of these assets going forward. Fortunately for these families, the modern fiduciary duty of care can contemplate an aggressive investment posture on the part of a trustee, especially where the trust holds a large portfolio and where the time horizon as per the trust terms is long enough. Indeed, the new standard of care makes it possible to do with property in trust what has rarely been done before¹³²—and potentially great fortunes do not merely cease to wane but can actually appreciate. The only proviso is that the fiduciary must be willing to embrace the new standard of fiduciary investment responsibility in all its potential.

The common law trust has existed for centuries, but only in recent decades has the law governing fiduciary investing done other than encourage trustees to conserve trust property.¹³³ For many years, the trustee's primary duty was to avoid risk, including the risk inherent in investing assets for growth.¹³⁴ And a case can be made that this risk-averse attitude comported with donors' expectations, especially in earlier eras when the asset placed in trust was almost certainly land and the only reason to transfer property to future generations in trust rather than outright was to avoid transfer tax.¹³⁵ When the likely *res* ceased to be land and became a portfolio of marketable securities, however, donors and their beneficiaries began to rankle under a law that looked only to conserve assets at nominal value even

¹³⁰ See HUGHES, *supra* note 14, at 116–18.

¹³¹ Cf. Oshins & Oshins, *supra* note 105, *passim* (describing strategies to this end).

¹³² See, e.g., DAVIS, *supra* note 43, at 81–93.

¹³³ See HUGHES, *supra* note 14, at 196–99.

¹³⁴ *Id.* at 96–98.

¹³⁵ Langbein, *The Contractarian Basis*, *supra* note 59, at 633.

while the purchasing power of those assets declined. Donors and beneficiaries alike noted that between inflation and trustees' commissions, assets placed in trust dwindled however modest the distributions to beneficiaries under the trust agreement.¹³⁶

A. *Prudent Man*

This focus on conserving the face value of trust assets was mandated under the earlier law governing investment of trust assets, the Prudent Man Rule, originating in the 1830 case *Harvard College v. Amory*.¹³⁷ In *Amory*, the court directed that when investing, trustees should proceed as “men of prudence, discretion and intelligence manage their own affairs, not in regard to speculation, but in regard to the permanent disposition of their funds, considering the probable income, as well as the probable safety of the capital to be invested.”¹³⁸ Soon canonical, the Prudent Man Rule, with its emphasis on capital preservation and distaste for speculation, made its way into the Restatement of Trusts¹³⁹ in 1935 and later in 1959 into the Restatement (Second) of Trusts.¹⁴⁰ Underscoring the duty to preserve capital, the Restatement (Second) directed the trustee “to make such investments and only such investments as a prudent man would make of his own property having in view the preservation of the estate and the amount and regularity of the income to be derived”¹⁴¹

Under the Prudent Man Rule, the methodology of risk assessment required the trustee to weigh each asset in isolation rather than as an element of a larger portfolio.¹⁴² This approach had the conse-

¹³⁶ See *id.* at 638–40.

¹³⁷ 26 Mass. (9 Pick.) 446, 461. *Amory* augured a degree of progress, however, as in the nineteenth and early twentieth centuries, most states mandated that trustees confine their investment discretion to a statutory list of investments suitable for trustees—usually government bonds, first mortgages, and preferred stocks. *King v. Talbot*, 40 N.Y. 76, 88–90 (1869). Even common stock was severely discouraged. *Id.* at 89. “The Massachusetts rule represented a great advance by abandoning the attempt to specify approved types of investment.” Langbein, *The Uniform Prudent Investor Act*, *supra* note 59, at 644. Finally, between the 1930s through the 1960s, “a majority of states replaced legal list statutes with the Prudent Man Rule.” Jesse Dukeminier & James E. Krier, *The Rise of the Perpetual Trust*, 50 UCLA L. REV. 1303, 1336 (2003).

¹³⁸ *Amory*, 26 Mass. (9 Pick.) at 461.

¹³⁹ RESTATEMENT OF TRUSTS § 227 (1935).

¹⁴⁰ RESTATEMENT (SECOND) OF TRUSTS § 227 (1959).

¹⁴¹ *Id.*; see also Langbein, *The Uniform Prudent Investor Act*, *supra* note 59, at 644–45 (discussing this rule).

¹⁴² Jerold L. Horn, *Prudent Investor Rule, Modern Portfolio Theory, and Private Trusts: Drafting and Administration Including the “Give-Me-Five” Unitrust*, 33 REAL PROP. PROB. & TR. J. 1, 7 (1998).

quence of prohibiting certain investments entirely and rendering others (such as U.S. Treasuries where principal was for all intents and purposes guaranteed) inherently safe. Furthermore, trustees shied away from new types of investments.¹⁴³ And delegation of investment authority (something that the introduction of new types of investments might require)¹⁴⁴ was simply verboten.

B. Prudent Investor

About twenty years ago, however, the law governing the investment of trust assets began to change. Sophisticated studies examining financial markets in light of modern “portfolio theory” suggested that complaints of settlors and beneficiaries bespoke economic reality, especially once trusts were no longer invested in land but rather in marketable securities. The law responded with a new standard to govern the investment of trust funds. Thus, Prudent Investor supplanted Prudent Man.¹⁴⁵

As a theory of efficient markets, modern portfolio theory provided a new understanding of the risk inherent in investing (including investing in trust) and suggested a new methodology by which to manage it. At its core, efficient market theory teaches us that it is impossible to predict which securities will do better or worse.¹⁴⁶ Simply stated, each security has risks. Even an investment (such as a U.S. Treasury bill) seeming to conserve trust principal at its face value is itself not without risk—if nothing else, the risk of inflation.¹⁴⁷ All that can be done with respect to risk is to manage it.

Managing risk begins by appreciating that every security is subject to risk of two types.¹⁴⁸ Market risk plagues all securities indiscriminately and reflects general economic and political conditions—for example, the risk of an attack by a foreign power (such as the attacks on September 11, 2001), a general economic downturn (such as the current global recession), or a change in interest rates by the Federal

¹⁴³ See *id.*

¹⁴⁴ See *id.*; see also Goodwin & McDowell, *supra* note 66, at 8; Langbein, *The Uniform Prudent Investor Act*, *supra* note 59, at 650–51.

¹⁴⁵ See Langbein, *The Uniform Prudent Investor Act*, *supra* note 59, at 642.

¹⁴⁶ Christopher P. Cline, *The Uniform Prudent Investor and Principal and Income Acts: Changing the Trust Landscape*, 42 REAL PROP. PROB. & TR. J. 611, 613 (2008).

¹⁴⁷ See UNIF. PRUDENT INVESTOR ACT § 2 cmt., 7B U.L.A. 22 (1994); Langbein, *The Uniform Prudent Investor Act*, *supra* note 59, at 649.

¹⁴⁸ See JONATHAN R. MACEY, AN INTRODUCTION TO MODERN FINANCIAL THEORY 23–25 (2d ed. 1998).

Reserve.¹⁴⁹ With respect to market risk, little can be done to mitigate volatility.¹⁵⁰ The only comfort lies in recognizing that, when the investment is made, the market factors this risk into the return. A higher market risk garners a higher rate of return. Market risk is compensated risk.¹⁵¹

In contrast, nonmarket or industry risk is the risk that something will affect the fortunes of a particular industry or firm, such as if an ore necessary for production of a particular product becomes unavailable.¹⁵² And within a particular firm, there is the further risk that a key person might die unexpectedly or that a fire might make a plant inoperable.¹⁵³ Where industry risk is concerned, however, the return does not reflect the risk.¹⁵⁴ The only way to manage industry risk is through diversification of investments within a portfolio—diversification among financial sectors and within financial sectors.¹⁵⁵

Thus, given that no one can outsmart the market and that risk is inherent in all investing, an investor can only proceed by determining the level of volatility, including the risk of inflation, that she is willing to accept in exchange for the return she hopes to receive. This will determine the level of market risk she assumes. Then, with respect to nonmarket risk, an investor must diversify her portfolio bearing in mind the level of market risk she has chosen.¹⁵⁶

In 1987, there began a fundamental revision in the law governing the investment of trust property in light of this theory of efficient markets.¹⁵⁷ Especially important were its implications for the concept of “prudent investment.” The American Law Institute started revising the Restatement of Trusts in 1991 and released the final text in 1992.¹⁵⁸ The Uniform Law Commission followed suit and in 1994 codified the revised Restatement principles as the Uniform Prudent Investor Act.¹⁵⁹ To date, forty-six states have adopted some version of the Uniform Act.¹⁶⁰

¹⁴⁹ *Id.* at 22.

¹⁵⁰ *Id.* at 24.

¹⁵¹ *Id.* at 23–35.

¹⁵² *Id.* at 22.

¹⁵³ *Id.*

¹⁵⁴ MACEY, *supra* note 148, at 25.

¹⁵⁵ *Id.* at 23–25.

¹⁵⁶ Cline, *supra* note 146, at 613.

¹⁵⁷ Langbein, *The Uniform Prudent Investor Act*, *supra* note 59, at 641.

¹⁵⁸ *Id.*

¹⁵⁹ *Id.* at 641.

¹⁶⁰ UNIF. PRUDENT INVESTOR ACT tbl., 7B U.L.A. 1–2 (1994).

In this new era, trust investment law has set aside its preoccupation with speculation and speculative investments. “The universe of investment products changes incessantly,” the Uniform Act counsels.¹⁶¹

Investments that were at one time thought too risky, such as equities, or more recently, futures, are now used in fiduciary portfolios. By contrast, the investment that was at one time thought ideal for trusts, the long-term bond, has been discovered to import a level of risk and volatility—in this case, inflation risk—that had not been anticipated.¹⁶²

As part and parcel of this reframing of the concept of prudent investing, the law also jettisoned the idea that some categories of investments are per se prudent and others imprudent¹⁶³ in favor of directing trustees to develop a risk profile appropriate to the particular trust in question.¹⁶⁴ “[T]rust beneficiaries are better protected by . . . close attention to risk/return objectives . . . than in attempts to identify categories of investment that are per se prudent or imprudent.”¹⁶⁵ The trustee is now to invest for “risk and return objectives reasonably suited to the trust.”¹⁶⁶ And the degree of risk appropriate for a particular trust is highly situational. “[T]olerance for risk varies greatly with the financial and other circumstances of the investor, or in the case of a trust, with the purposes of the trust and the relevant circumstances of the beneficiaries.”¹⁶⁷ Indeed, if the “main purpose” of the particular trust “is to support an elderly widow of modest means,” that trust “will have a lower risk tolerance than a trust to accumulate for a young scion of great wealth.”¹⁶⁸

But addressing market risk through appropriate risk and return objectives is not all the law now requires of fiduciaries. Industry risk is not to be ignored either. Portfolio theory, when informing the law of fiduciary duty, mandates a diversified portfolio.¹⁶⁹ Although diversification had a place in the old law governing fiduciary investing,¹⁷⁰

¹⁶¹ *Id.* § 2 cmt., 7B U.L.A. 22.

¹⁶² *Id.*

¹⁶³ “A trustee may invest in any kind of property or type of investment consistent with the standards of this [Act].” *Id.* § 2(e), 7B U.L.A. 20.

¹⁶⁴ *Id.* § 2 cmt., 7B U.L.A. 21.

¹⁶⁵ *Id.*

¹⁶⁶ UNIF. PRUDENT INVESTOR ACT § 2(b), 7B U.L.A. 20.

¹⁶⁷ *Id.* § 2 cmt., 7B U.L.A. 21.

¹⁶⁸ *Id.*

¹⁶⁹ *Id.* § 3 cmt., 7B U.L.A. 22.

¹⁷⁰ *See, e.g.,* First Ala. Bank of Huntsville v. Spragins, 515 So. 2d 962 (Ala. 1987).

the new law enlarges its significance. Indeed, the requirement of diversification serves in the new law to propel the entire methodology of Prudent Investor toward a comprehensive perspective, so that attention focuses on the portfolio as a whole with any particular security justifiable only in relation to the rest of the account.¹⁷¹ As the Uniform Act counsels, “A trustee’s investment and management decisions respecting individual assets must be evaluated not in isolation but in the context of the trust portfolio as a whole.”¹⁷² The official Comment continues, “An investment that might be imprudent standing alone can become prudent if undertaken in sensible relation to other trust assets, or to other nontrust assets.”¹⁷³ Not only is no asset without risk, but also no asset is inherently appropriate or inappropriate except in relation to the whole portfolio.

If the requirement of diversification propels the new regime toward a comprehensive perspective in evaluating risk, this same comprehensive perspective can at times argue for a suspension of the requirement of diversification. That is to say, although diversification is central to the methodology of Prudent Investor, even diversification can be set aside if under the circumstances it is prudent to do so.¹⁷⁴

A final point about the influence of modern portfolio theory on the law of fiduciary investing: whereas the Prudent Man statute forbade the delegation of fiduciary investment responsibility,¹⁷⁵ the new law is much more tolerant of delegation and even encourages it in certain situations.¹⁷⁶ Such tolerance naturally accompanies the recognition that any asset is potentially an appropriate investment. If any asset is a possible investment in trust, then a trustee potentially needs to be competent with respect to a breadth of possible investments, including complex, state-of-the-art vehicles heretofore rarely found in fiduciary accounts, such as futures, derivatives, private equity, venture capital, closely held operating companies, and more. Further, in addition to being competent to determine whether any such investment was suitable for the account, the fiduciary must also be able to manage the asset once it is placed in trust. Few financial

¹⁷¹ See UNIF. PRUDENT INVESTOR ACT § 2(b), 7B U.L.A. 20; see also RESTATEMENT (THIRD) OF TRUSTS: PRUDENT INVESTOR RULE § 227 cmt. g (1992) (discussing investment planners’ strategies for diversification).

¹⁷² UNIF. PRUDENT INVESTOR ACT § 2(b), 7B U.L.A. 20.

¹⁷³ *Id.* § 2 cmt., 7B U.L.A. 21 (portfolio standard of care); see also RESTATEMENT (THIRD) OF TRUSTS: GENERAL PRINCIPLES § 90(c) (2007).

¹⁷⁴ See *infra* Part IV.C.

¹⁷⁵ Goodwin & McDowell, *supra* note 66, at 10.

¹⁷⁶ UNIF. PRUDENT INVESTOR ACT § 9, 7B U.L.A. 39–40.

managers are sufficiently knowledgeable across the financial spectrum to make these decisions across such a range of complex investments. Accordingly, if the concept of fiduciary prudence is to be informed by modern portfolio theory without equivocation, the law must contemplate delegation of fiduciary investment responsibility to specialized managers where at least certain assets are concerned.

C. Portfolio Theory and the Perpetual Trust

This new legal order is an invitation to trustees to invest assets in ways heretofore unimaginable for property placed in trust, especially in the case of a perpetual trust holding a great fortune. Prudent Investor recognized that the mix of investments and overall risk profile appropriate to a particular account must speak to the size of the account, the terms of the trust instrument, and the situations of beneficiaries. Because the size of account and the investment horizon now matter in determining the magnitude of risk appropriate to a trust portfolio, a family that transfers its considerable wealth into a perpetual trust can justify types of securities with magnitudes of risk (and potential returns) that could not be justified in a smaller trust or in one that would terminate sooner.¹⁷⁷

Academic commentators are well aware of the perpetual trust, but to date, they tend to view it primarily as a vehicle by which a family exploits the repeal of the Rule Against Perpetuities by placing its property beyond the reach of the transfer tax regime for untold generations to come. In addition, this literature contains occasional references to the utility of the perpetual trust for asset protection purposes.¹⁷⁸ These observations are correct, as far as they go. The real significance of the perpetual trust cannot be appreciated, however,

¹⁷⁷ As one commentator explains, it is not risk per se that investors seek to avoid, but the substance of risk. Robert H. Jeffrey, *A New Paradigm for Portfolio Risk*, J. PORTFOLIO MGMT., Fall 1984, at 33, 33. What must be avoided is a dependence on liquidity when asset values are in a slump. As the Restatement explains with regard to property in trust,

Risk tolerance largely depends on a combination of the regular distribution requirements of the trust and any irregular distributions that may in fact become necessary or appropriate. . . . Thus, these various distribution requirements facing the trustee effectively serve to define the consequences of the volatility risk with respect to a particular trust.

RESTATEMENT (THIRD) OF TRUSTS: PRUDENT INVESTOR RULE § 227 cmt. e (1992).

¹⁷⁸ See generally Joel C. Dobris, *The Death of the Rule Against Perpetuities, or the RAP Has No Friends—An Essay*, 35 REAL PROP. PROB. & TR. J. 601 (2000) (discussing the changes that have come to trusts as a result of the tendency of states toward repealing or limiting the scope of the Rule Against Perpetuities); Sterk, *supra* note 80 (same).

until we discern how it can serve the family as a multigenerational investment vehicle. Only then can we see how the attributes of tax minimization and asset protection contribute to the determination of the overall risk profile appropriate to the account when portfolio theory governs the investment of trust property. It is here that the true value of tax minimization and asset protection lies.

Arguably then, a trustee of a large perpetual trust can justify within the portfolio certain risks that would not be consistent with its fiduciary duty in other types of trusts. Obviously, the risk calculus now deemed appropriate to property in trust provides an investment advantage to the ultra-wealthy (as compared to the merely affluent) who not only have great wealth to place in trust but whose fortunes are sufficiently large to fund a trust lasting for multiple generations. To say only this, however, would be merely to offer the commonplace observation that the rich are afforded opportunities to get richer that others do not have. The claim extends further. What is noteworthy in the case of the perpetual trust is the magnitude of the opportunity. At this juncture, we can begin to discern how the tax saved when a large fortune is placed in a perpetual trust becomes truly valuable. As important as the elimination of a tax burden might have been in an era when trusts were invested to preserve the face value of assets, where a perpetual trust is invested subject to portfolio theory, the tax saved contributes to the size of the *res* going forward—and supports the continued justification under the law for investing at least some portion of the account in aggressive or even speculative securities. As tax is saved with each generation and returns consistent with the risk profile of the account are realized, the perpetual trust potentially becomes an investment juggernaut. Savings achieved when creditors' claims are avoided contribute here as well.

In short, when applied to the *res* of a large perpetual trust, portfolio theory legitimates, and indeed encourages, an entrepreneurial mindset in a fiduciary that would have been unthinkable in earlier eras. For the family establishing a perpetual trust to realize the investment potential that a more sophisticated understanding of risk might offer, however, the trustee becomes a crucial figure. Even in the face of changes in the law governing fiduciary investment responsibility, however, corporate fiduciaries—big banks—remain very conservative when it comes to investing assets in trust. The theory of efficient markets notwithstanding, a recent study of the investment practices of big-bank fiduciaries indicates that Prudent Investor has

had at best a modest impact on the way these institutions invest.¹⁷⁹ It might be expected that, in the wake of Prudent Investor, trust portfolios at these institutions would at a minimum exhibit a significant percentage shift away from assets where face value is more secure but returns are limited (debt) toward more volatile assets where return would be greater (common stock). Since the advent of Prudent Investor, however, this shift has occurred only to a modest degree.¹⁸⁰

But wealthy families seeking to grow their assets in trust are looking for more than a shift from debt to equity. Take, for example, the risk inherent in a decision to hold a concentrated position—that is, to maintain a trust wholly or partially undiversified. Whereas the very wealthy may welcome an investment methodology that sanctions reference to the trust portfolio as a whole, at times these families do not want to be encumbered by the finer points of diversification. Indeed, it is not uncommon for a significant portion of the portfolios of the very wealthy to be in holdings such as a large block of founder's stock (possibly with a low tax-cost basis) or a closely held operating company.¹⁸¹ While there is no doubt that Prudent Investor places a premium on diversification, an argument can be made that would allow a liberal reading of this requirement, especially where assets are held in a large perpetual trust. First of all, the Uniform Act is only a default regime.¹⁸² But further, even the default rule explicitly allows for an exception where “the trustee reasonably determines that, because of special circumstances, the purposes of the trust are better served without diversifying.”¹⁸³ Within a large perpetual trust, a case can be

¹⁷⁹ See generally Max M. Schanzenbach & Robert H. Sitkoff, *Did Reform of Prudent Trust Investment Laws Change Trust Portfolio Allocation?*, 50 J.L. & ECON. 681 (2007) (investigating the effect of changes in state prudent trust investment laws on asset allocation in noncommercial trusts). Using state- and institution-level data from 1986–1997, the writers found that after adoption of the new prudent-investor rule, institutional trustees held about 1.5–4.5 percent more stock at the expense of “safe” investments. *Id.* at 707.

¹⁸⁰ *Id.* at 707.

¹⁸¹ Cf. Langbein, *The Uniform Prudent Investor Act*, *supra* note 59, at 658 (discussing the difficulties that small investors face when attempting to diversify a portfolio).

¹⁸² Cline, *supra* note 146, at 635.

¹⁸³ UNIF. PRUDENT INVESTOR ACT § 3, 7B U.L.A. 29 (1994); see also RESTATEMENT (THIRD) OF TRUSTS: PRUDENT INVESTOR RULE § 227(b) (1992) (“[T]he trustee has a duty to diversify the investments of the trust unless, under the circumstances, it is prudent not to do so.”). The Comments further elaborate,

The objective of prudent risk management imposes on the trustee a duty to diversify trust investments unless, under the circumstances, the objectives of both prudent risk management and impartiality can be satisfied without doing so, or unless special considerations make it prudent not to diversify in the particular trust situation.

made that a trustee can justify certain risks that might otherwise be inconsistent with its fiduciary duty.

Nevertheless, big banks remain reluctant to hold concentrated positions, especially in assets that are illiquid for which there is little to no market, assets that are common among the significant holdings of the wealthy (like closely held companies).¹⁸⁴ Against a more liberal reading of Prudent Investor, these institutions argue that their conservative posture is consonant with current law.¹⁸⁵ First and most basically, Prudent Investor is of relatively recent vintage (so the argument goes), and thus there is relatively little case law to underscore the Uniform Act or to inform its application in myriad particular situations.¹⁸⁶ Indeed, where interpretive authority is not available, some commentators are inclined to fall back on case law arising under the Prudent Man statute to inform the category of “prudence.”¹⁸⁷ Second, what case law there is under the new regime still calls into question the extent to which a trustee can decide not to diversify, even where the concentrated position is authorized under the trust agreement.¹⁸⁸ Finally, the Restatement is more explicitly conservative, stating that “trust provisions are strictly construed against dispensing with [the requirement of diversification] altogether.”¹⁸⁹ Even where the trustee is authorized with respect to a concentrated position, such a provision does not “relieve the trustee of the fundamental duty to act with prudence,”¹⁹⁰ nor does authorization to hold a particular in-

Id. cmt. g.

¹⁸⁴ See Oshins & Oshins, *supra* note 105, at 68.

¹⁸⁵ See Stewart Sterk *Rethinking Trust Law Reform: How Prudent Is Modern Prudent Investment Doctrine?*, 95 CORNELL L. REV. (forthcoming July 2010).

¹⁸⁶ See Cline, *supra* note 146, at 620.

¹⁸⁷ See *id.* at 620–23; see also *First Ala. Bank of Huntsville v. Spragins* 515 So. 2d 962, 964 (Ala. 1987) (finding against the trustee that boilerplate language was not sufficient to justify undiversified concentrations of anything, although the Alabama Prudent Man Statute is generally taken to rely on general principles of fiduciary investing).

¹⁸⁸ See, e.g., *In re Trusteeship of Williams*, 591 N.W.2d 743, 748 (Minn. Ct. App. 1999), *aff'd on reh'g*, 631 N.W.2d 398 (Minn. Ct. App. 2001) (exculpation clause did not protect trustee where only partially diversified concentrated stock holding existed); *In re Strong*, 734 N.Y.S.2d 668, 669–70 (App. Div. 2001) (trustee prevailed against beneficiary alleging improper diversification despite authorization in the trust instrument to hold a concentrated position); *Fifth Third Bank v. Firstar Bank, N.A.*, No. C-050518, 2006 WL 2520329, at *4 (Ohio Ct. App. Sept. 1, 2006) (finding against trustee who retained assets not normally suitable in trust, notwithstanding exculpation clause in trust instrument). For a general discussion of these cases and others, see Cline, *supra* note 146.

¹⁸⁹ RESTATEMENT (THIRD) OF TRUSTS: GENERAL PRINCIPLES § 91 cmt. f (2007).

¹⁹⁰ *Id.*

vestment and not diversify a portfolio “constitute an exculpatory clause.”¹⁹¹

The debate about inferences legitimately drawn from the Uniform Act notwithstanding, the very wealthy have in important respects moved on. For them, where investing for a large perpetual trust is concerned, genuine diversification involves deeper, more sophisticated issues than merely the appropriate allocation between fixed income and equity or a decision to hold a concentrated position. The very wealthy now appreciate that, in a large portfolio, genuine diversification requires representation of different investment philosophies and the inclusion of investments as wide-ranging as hedge funds, private equity, venture capital funds, and real estate—interests not traded in the public securities markets. Indeed, to realize the full potential of portfolio theory for purposes of these families, the trustee needs access to state-of-the-art investment opportunities (vehicles not likely to be publicly traded), together with the specialized knowledge to assess risk with respect to such holdings. Large institutional trustees now typically offer a platform of such investments,¹⁹² but even this menu may not satisfy an entrepreneurial family willing to search the world for opportunities.

With the advent of Prudent Investor, these families began to press big-bank fiduciaries to accept outside managers, encouraging them to delegate investment responsibility, especially for purposes of state-of-the-art assets.¹⁹³ If Prudent Investor not only tolerates delegation of fiduciary investment responsibility but would even appear to encourage it in certain situations,¹⁹⁴ delegation remains a controversial matter for the big-bank trustee (like so many apparently liberalizing aspects of Prudent Investor). This is because the initial decision to delegate, as well as all subsequent decisions with respect to the delegation, are fiduciary acts carrying with them fiduciary liability.¹⁹⁵ The Prudent Investor Rule is clear that the trustee must have good

¹⁹¹ *Id.*

¹⁹² See, e.g., Citi Private Bank, Investing, https://www.privatebank.citibank.com/our_services/individuals_families/investing.htm (last visited Mar. 11, 2010).

¹⁹³ See Goodwin & McDowell, *supra* note 66, at 8. A number of years ago, *Forbes* magazine in its issue on “The 400” reported that, while approximately ninety percent of the clients of a major money center bank allowed that institution to manage all of their money about ten years ago, now seventy percent of these clients use multiple managers. Robert Lenzner & Scott McCormack, *Achieving Immortality via the Family Office*, *FORBES*, Oct. 12, 1998, at 47, 52.

¹⁹⁴ See UNIF. PRUDENT INVESTOR ACT § 9, 7B U.L.A. 39–40 (1994).

¹⁹⁵ RESTATEMENT (THIRD) OF TRUSTS: PRUDENT INVESTOR RULE § 171 (1992).

reasons to delegate.¹⁹⁶ Once a sufficient rationale for delegation has been developed, the fiduciary is responsible for the choice of the agent.¹⁹⁷ And after the agent is selected, the fiduciary must continue to exercise discretion, establishing the scope and terms of delegation and conducting periodic reviews.¹⁹⁸ The Restatement takes a similar position.¹⁹⁹ Regulations issued by the Office of the Comptroller of the Currency, the regulatory authority for federally chartered banks, sound a similar theme, expressly providing that a bank that delegates its authority over investments is nevertheless deemed to retain “investment discretion.”²⁰⁰

Finally, in those instances where the stars align sufficiently so as to justify delegation of fiduciary investment responsibility, the total fees to the trust are likely to be as much as twice the fee that the fiduciary would otherwise charge.²⁰¹ Fees charged by big-bank fiduciaries have long been a source of irritation to wealthy families, and the prospect of paying double makes for a special frustration.²⁰² While the family might anticipate that the presence of the outside adviser would result in a commensurate reduction in the trustee’s fee, the need for ongoing exercise of fiduciary discretion (along with the attendant liability) provides continuing justification for the bank to impose its standard fee (or something close to it). And this is the

¹⁹⁶ See *id.* § 227 cmt. j.

¹⁹⁷ UNIF. PRUDENT INVESTOR ACT § 9(a)(1), 7B U.L.A. 39.

¹⁹⁸ *Id.* § 9(a)(2)–(3), 7B U.L.A. 39–40.

¹⁹⁹ See RESTATEMENT (THIRD) OF TRUSTS: PRUDENT INVESTOR RULE § 171. Again, the Restatement sounds the more conservative note: in the act of delegating, the trustee must act responsibly. See *id.* “In deciding whether, to whom and in what manner to delegate fiduciary authority in the administration of a trust, and thereafter in supervising agents, the trustee is under a duty to the beneficiaries to exercise fiduciary discretion and to act as a prudent person would act in similar circumstances.” *Id.* The Comments would have a trustee (1) determine what investment responsibilities to delegate, (2) select an appropriate agent, (3) negotiate the terms of the delegation, and (4) monitor the agent’s performance to an appropriate degree under the circumstances. See *id.* § 227 cmt. j.

²⁰⁰ See 12 C.F.R. § 9.2(i) (2009). Under this regulation, a bank is required to conduct an initial postacceptance review and annual reviews of all assets of fiduciary accounts for which the bank has investment discretion. *Id.* § 9.6(b)–(c). Furthermore, state-chartered banks are directed to heed any state banking regulations bearing upon the issue of delegation. *Id.* § 9.7(d)–(e).

²⁰¹ Goodwin & McDowell, *supra* note 66, at 14 n.12.

²⁰² Cf. HUGHES, *supra* note 14, at 149–50 (discussing reasons why families even of substantial means might consider a PTC over a large bank).

case, even though an outside agent is providing day-to-day management of certain assets.²⁰³

If the theory of efficient markets has come to inform the legal standards governing the investment of property in trust, what it has put in place is as much an art as it is a science. Gone are the bright-line tests that separated the investment wheat and chaff into the secure and the speculative. Now, at least at the margins—and large perpetual trusts are at the margins—fiduciaries may disagree as to the level of risk appropriate to an account. And it is for this reason that many families establishing large perpetual trusts want to place a privately owned, family trust company at the helm. The complete realization of the potential of portfolio theory when applied to a trust *res* ultimately depends on the trustee's calculus of risk, both in light of an interpretation of the trust instrument and the beneficiaries' situations. For the family establishing a perpetual trust to realize the investment potential that a more sophisticated understanding of risk might offer, the trustee is all important.

V. FINANCIAL REPRODUCTION AND THE FAMILY TRUST COMPANY

While establishing a family trust company might appear to be the final frontier in securing a fortune long into the future, more is required. If wealthy families are going to take unto themselves the role of fiduciary, in order to bring a sophisticated understanding of risk to bear on trusts designed as multi-generational investment vehicles, family members must be prepared to oversee the day-to-day management of an ongoing enterprise, not the least of which includes making state-of-the-art investment decisions. In creating a family trust company and making it trustee of family trusts, financial entropy will not be averted, and indeed much of the family's financial security is sure to be jeopardized, unless at least some family members are ready, willing, and able to undertake the considerable responsibility of managing the trust company. Further, given that the investment horizon here is multigenerational, this need for financial acumen and indeed personal discipline is also multigenerational. Ensuring that every generation has at least some family members prepared to bring facilitating attitudes about money, investing and risk to bear on the family fortune requires attention within the family

²⁰³ Moreover, the fees not only discourage the family from pursuing delegation (and the accompanying introduction of state-of-the-art investment vehicles), but they also factor into the initial exercise of discretion in deciding to delegate, as Prudent Investor also imposes a duty to minimize costs. *See* UNIF. PRUDENT INVESTOR ACT § 9 cmt., 7B U.L.A. 42 (1994); Goodwin & McDowell, *supra* note 66, at 10, 12.

to the cultivation of such attitudes from generation to generation.²⁰⁴ Absent sustained talent and discipline, the slow, steady, downward trajectory of the trust portfolios of an earlier era will soon in retrospect bespeak a golden era in the financial life of the family.²⁰⁵

In the face of this need to attend to the intergenerational cultivation of attitudes about wealth and investing in addition to managerial expertise, there has grown up a considerable industry to guide the very rich in what might be termed “financial reproduction” or “financial parenting.”²⁰⁶ The literature of this industry puts forward various techniques for the transmission of attitudes and perspectives calculated to foster prudence and indeed industriousness within the family.²⁰⁷ But at the end of the day, what this literature counsels is that the family that would preserve its fortune must become quite self-consciously identified with its wealth.²⁰⁸ And further, the family that would manage and indeed grow its wealth must effectively commit itself to maintaining this identity as a wealthy family across generations.²⁰⁹ Interestingly, some of the literature even goes so far as to draw a parallel between the family that would preserve and grow its fortune and a business enterprise.²¹⁰

This literature of “financial parenting” often takes as its point of departure a phenomenon termed “affluenza”—that is, myriad species of self-indulgence and accompanying desuetude that supposedly characterize the lives of second- and third-generation members of wealthy families.²¹¹ Investment options notwithstanding, it is this self-

²⁰⁴ JAMES E. HUGHES, JR., FAMILY: THE COMPACT AMONG GENERATIONS 19 (2007).

²⁰⁵ See *id.* at 13–15.

²⁰⁶ See generally, e.g., HUGHES, *supra* note 14, at 181–88. In at least some of this literature, attention is also bestowed on nonfinancial attributes of family life, with efforts to make the question of money secondary. See, e.g., HUGHES, *supra* note 204, at 19–20. But at the end of the day, these other aspects of family life are present only as a factor in the maintenance of great wealth, because what is at stake here is holding on to the fortune. See *id.* at 15–16.

²⁰⁷ See HUGHES, *supra* note 204, at xxiv–xxvii.

²⁰⁸ See *id.* at 19–20.

²⁰⁹ See *id.* at 16.

²¹⁰ See, e.g., HUGHES, *supra* note 14, at 5–6; see also McClain, *supra* note 10, at 861–62 (providing additional discussion and examples of this metaphor).

²¹¹ See generally JESSIE H. O’NEILL, THE GOLDEN GHETTO: THE PSYCHOLOGY OF AFFLUENCE (1997). O’Neill was the granddaughter of the former president of General Motors. *Id.* at 2–3. Drawing upon her own experience, she developed the term “affluenza” as a summary reference to the flaws often developed by children of the very wealthy. *Id.* at 37–38; see also Linda C. McClain, *supra* note 10, at 861 (discussing the role of “affluenza” in wealth transfer between generations and attributing the term to O’Neill); McDowell, *supra* note 4, at 43 (attributing part of the popularity of family private trust companies to a desire to avoid “affluenza”).

indulgence and desuetude (so this literature claims) that ensures great fortunes are soon lost and lends truth to the proverb “shirtsleeves to shirtsleeves in three generations.”²¹²

But for a wealthy family intending to preserve a great fortune (as in the instance of a family establishing its own trust company), more is necessary than simply stemming the tide of second- and third-generation social alienation or indeed decadence.²¹³ It is not simply a matter of inculcating moral and cultural values in children so as to create persons capable of responsible personal self-governance.²¹⁴ What a wealthy family is ultimately about (so this literature counsels) is its fortune—not just preserving it, but ideally growing it. To do this, members must appreciate the essential attributes and insights of the generation that made the fortune—the enterprising generation. Taken together, these attitudes and insights make for a particular ethos about wealth and privilege. The goal is to have later generations embrace this ethos with a certain consciousness, knowing that this set of attitudes—values instrumental in the family’s financial success—along with extraordinary wealth, set the family apart in the world. Financial educators serving the very wealthy suggest that they engage their “children from an early age in discussions about . . . the purpose of family wealth” (a process called “wealth education”).²¹⁵ The idea is to apprehend the family’s “differentness”—that is, the origin of its privilege as well as the character traits, attitudes and possible expertise that have sustained this privilege (all of which some term “the family story”).²¹⁶ Indeed, to underscore the importance of this self-conscious identity, one advisor has even likened the multigenerational wealthy family to a “tribe.”²¹⁷ “Becoming a tribe requires a family to adopt a form of decision making that seeks consensus about what actions will likely perpetuate the tribe’s success and thus its survival.”²¹⁸

Given that these families are seeking to maintain their wealth far into the future,²¹⁹ this education ultimately requires an institutional framework, a governance structure that will bring discipline to the development of this ethos and then allow for constructive reconside-

²¹² See HUGHES, *supra* note 14, at 3.

²¹³ See HUGHES, *supra* note 204, at 15–20.

²¹⁴ See *id.* at xxvi.

²¹⁵ McClain, *supra* note 10, at 863.

²¹⁶ HUGHES, *supra* note 204, at xix; see also HUGHES, *supra* note 14, at 4, 45.

²¹⁷ See HUGHES, *supra* note 204, at 102–06.

²¹⁸ *Id.* at 104.

²¹⁹ See HUGHES, *supra* note 14, at 8–11.

ration of it by subsequent generations.²²⁰ What is needed is “a long series of linked transitions” and a system of family governance that will “guide[] the joint decisions family members must make to successfully complete those transitions.”²²¹

It is in this way that the Family Mission Statement found its way into the literature guiding the very wealthy in their efforts at financial reproduction.²²² Adopted from the corporate world where such statements serve to bring specificity and focus to the interactions and endeavors of diverse protagonists,²²³ Family Mission Statements were first put forward for families of average means; the idea was to catalyze within the family a discussion of its basic values and then “codify” them into a constitution of sorts.²²⁴ This document is to unify families around fundamental principles that “get built right into the very structure and culture of the family.”²²⁵ Like any constitution, the Family Mission Statement serves as a point of reference as the family moves forward.²²⁶ It can also be revisited and amended in light of fundamental changes in the family or the larger world.

Still embraced by many people of modest means as a tool of the broader endeavor of “social reproduction,”²²⁷ the Family Mission Statement has nevertheless acquired a certain edge as wealth educators now proffer it to the very wealthy in pursuit of the narrower goal of “financial reproduction.”²²⁸ Most basically, these families are advised that the process of developing such a statement provides a context in which a wealthy family can confront the origin and meaning of privilege in its own instance and, further, reinvent itself as a wealthy family from generation to generation.²²⁹ Interestingly, however, especially where the very rich are concerned, some of this literature draws parallels between the wealthy family seeking continued finan-

²²⁰ *Id.* at 4.

²²¹ See HUGHES, *supra* note 204, at 104.

²²² See, e.g., HUGHES, *supra* note 14, at 43–46.

²²³ See generally JEFFREY ABRAHAMS, THE MISSION STATEMENT BOOK: 301 CORPORATE MISSION STATEMENTS FROM AMERICA’S TOP COMPANIES (1999) (discussing mission statements of top corporations and how they helped focus the corporation’s vision and achieve success); PATRICIA JONES & LARRY KAHANER, SAY IT AND LIVE IT: THE 50 CORPORATE MISSION STATEMENTS THAT HIT THE MARK (1995) (same).

²²⁴ STEPHEN R. COVEY, THE 7 HABITS OF HIGHLY EFFECTIVE FAMILIES 72 (1997)

²²⁵ *Id.* at 142.

²²⁶ See *id.* at 140–42.

²²⁷ McClain, *supra* note 10, at 861.

²²⁸ See HUGHES, *supra* note 14, at 43.

²²⁹ See *id.* at 4.

cial prosperity and the well-managed business enterprise.²³⁰ The claim is that the business enterprise provides an apt analogy because, like a business, the object of the family is “to organize [its] financial, intellectual, and human assets for the purpose of preserving and enhancing each of these in succeeding generations.”²³¹ One wealth adviser elaborates, “[T]he most important role in the management of an enterprise is arranging for orderly succession.”²³² And further on: “Families attempting long-term wealth preservation often don’t understand that they *are* businesses and that the techniques of long-term succession planning practiced by all other businesses are available to them as well.”²³³

The wealthy family-as-business ceases to be a metaphor, however, and becomes a reality when this literature turns to consider the uses of the family trust company. While perhaps not appreciating the magnitude of the investment opportunity presented by these entities (especially under Prudent Investor), this literature still recognizes that the family trust company can serve the family in the mechanics of investing—for example, as a consolidation vehicle, allowing all family holdings to be managed in one place and subjected to a coordinated, long-term investment strategy.²³⁴ More interestingly, however, is the insight in this literature that the family trust company can serve as the primary institutional context for the essential tasks of “financial reproduction” in all its dimensions and across multiple generations.²³⁵ For a very wealthy family, myriad aspects of family life can be coordinated through the trust company. The trust company is a “family seat,” a “repository for the family history” with a “perpetual life,” a locus for governance of many types to take place, a meeting place where the wealthy family interacts and perpetuates its identity as a wealthy family.²³⁶ Most importantly for a family identified with its wealth, the family trust company provides a context in which successive generations can be tutored in long-term wealth preservation consistent with the family’s particular ethos about money and investing, perhaps articulated in a Family Mission Statement. The family trust company presents a golden opportunity to put into play the attitudes

²³⁰ See sources cited *supra* note 210.

²³¹ McClain, *supra* note 10, at 862 (quoting Brett Anderson & Thomas Kostigen, *The Family Mission Statement*, WORTH, Dec. 2003, at 70, 72).

²³² HUGHES, *supra* note 14, at 5.

²³³ *Id.* at 5–6.

²³⁴ *Id.* at 150–53.

²³⁵ See *id.* at 152–53.

²³⁶ *Id.* at 150–53.

and skills deemed instrumental to the family's historic financial success. As successive generations of a family manage their investment risk to secure their fortune long into the future, successive generations are also given opportunity to rediscover and indeed reaffirm their "differentness"—their privilege.²³⁷

The suggestion that the family trust company can serve as a context within which a wealthy family can develop an ethos about money and investing—and ultimately an identity as a wealthy family—acquires great resonance when considered alongside the opportunities under the Prudent Investor statute to invest property in trust, especially where the portfolio is large enough and the time horizon extended. To realize the full potential of Prudent Investor as applicable to a large perpetual trust, a trustee needs a sophisticated understanding of risk and skills sufficient to choose investments consistent with the risk profile. If a family seeks to take this role through a family trust company, these aptitudes must somehow be present in every generation going forward. What the literature of financial reproduction makes clear, however, is that the development of these aptitudes in one generation and the transmission of them to another is (of necessity) about much more than investing.²³⁸ As older and younger generations of a family come together to play various roles in the management of the family fortune—and to exploit the opportunities available under Prudent Investor where a fortune is in trust—what is also happening is the transmission of an identity as a very wealthy and privileged family.

VI. CONCLUSION

The family trust company must be appreciated as yet another step in a succession of developments in the law that uniquely serve the very wealthy. The family trust company positions a wealthy family to exploit the elimination of the Rule Against Perpetuities in certain states in order to create perpetual trusts, to leverage exemptions from or credits against federal transfer tax applicable to transfers into such trusts, and, most importantly, to make the most of new laws under which the determination of risk for such trusts has become as much an art as a science. In short, relying upon an architecture of complex planning techniques, the very wealthy utilize the family trust company as the keystone within these strategies to secure their fortunes for untold generations to come.

²³⁷ See *id.* at 150–53.

²³⁸ See HUGHES, *supra* note 204, at 14–20; HUGHES, *supra* note 14, at 4.

It is only in the literature of “financial reproduction,”²³⁹ however, that the true significance of the family trust company becomes apparent. With the family trust company as capstone, an assemblage of complex planning techniques ceases to be a mere paper stratagem, a maze of legal formalities that resonate in the Internal Revenue Code and in state laws, but that otherwise have little import for the lives of the wealthy who put these structures in place. Once these techniques are grounded within the family trust company, they readily acquire a social dimension. As family members gather together within the family trust company to realize the potential of the complex structures they have put in place, the family is encouraged to appreciate the significance of its wealth as well as embrace its privilege. The literature of financial reproduction suggests that the family ultimately secures its fortune by acting within the family trust company to make great wealth an integral part of its identity.

And what about shirtsleeves to shirtsleeves in three generations? No treatment of the family trust company should come to a conclusion without pausing to consider the significance for democracy of structures that permanently secure the very wealthy in their fortunes. If liberty allows for the accumulation of great wealth, then in a democracy the forces that operate to dissipate this wealth have long been thought salubrious so that, at least over time, citizens remain similarly subject to the vicissitudes of fortune. If this is the case, then the potential of the family trust company to forestall the dissipation of great wealth, rendering some families secure in ways unimaginable for others, is also the potential to locate these families in a world apart—precisely what many theorists of democracy would seek to avoid.²⁴⁰ This is food for thought.

²³⁹ See, e.g., HUGHES, *supra* note 14, at 43.

²⁴⁰ See, e.g., MICHAEL J. GRAETZ & IAN SHAPIRO, DEATH BY A THOUSAND CUTS: THE FIGHT OVER TAXING INHERITED WEALTH 266–78 (2005).