# The Family Bank –Multi-Generational Mentoring, a Helping Hand, and Accountability

With the passage of the new tax act in December, 2017,[1] and the resulting increase in federal estate, gift and GST[2] tax exemptions to $11.18 million per person ($22.36 million per married couple) for 2018, clients have more flexibility than ever before to accomplish their estate planning goals, without incurring an onerous wealth transfer tax burden. Serendipitously, this increase in flexibility is arising after the wave of gifts to children and grandchildren in 2010 and 2012 and the tremendous success of estate freezing gift strategies (primarily grantor retained annuity trusts and sales to intentionally defective grantor trusts) since 2009. Many clients have concluded, accordingly, that their children are provided for sufficiently to allow these clients to utilize these new exemptions to focus more on a broader group of individuals, such grandchildren, siblings, nieces and nephews, and family friends. These clients are now creating Family Banks to provide capital to that broader group of individuals for business ventures, public-spirited projects, and human capital development, but in a way that fosters personal commitment, accountability and multi-generational mentoring.

## What is the Family Bank?

The Family Bank is a trust (or non-profit, not-tax-qualified organization) that is funded for a customized set of purposes, to be used by or for one's family (broadly defined), with the expectation that its flexible design will financially support one or more of the following types of activities:

- Business, active investments, and career opportunities of particular interest to individual family members, relatives and family of affinity; and
- Public policy advocacy and personal philanthropy that is more flexible than would be permitted for a tax-qualified charity.

The Family Bank makes capital available for purposes that blend personal and family values and that promote active family participation in both wealth building and helping others, without being confined to traditional models for organizing family wealth or philanthropy. The Family Bank recognizes that controlling or using capital to build businesses, improve the lives of family members and others, and expand human knowledge is usually more satisfying than merely

1 The Tax Cuts and Jobs Act, Pub. Law 115-97
2 The Generation Skipping Transfer Tax



 

funding a person's lifestyle. The Family Bank emphasizes both the tangible and intangible returns on the family's investment and active participation, and provides younger generations the opportunity to learn decision-making and financial matters from actual, hands-on practical experience and role modeling from others.

The Family Bank is not a typical family wealth management strategy. It is not intended to fund personal consumption or even living expenses, per se, and there is no sense of economic entitlement. Similarly, it is not intended to fund traditional charity, because, unlike a tax-qualified charity, there are few constraints on the family's ability to define the use of funds, whether to finance profit-making endeavors or public spirited projects. Equally importantly, the Family Bank is not a so-called "incentive trust;" there is no "if you do x, then you get y" formula.

Rather, the Family Bank is a pool of capital available to family members and others who demonstrate that they can put that capital to productive use. That demonstration is required prior to receiving any assistance, similar to a grant process or the loan application process for a small business, and on an on-going basis, thus creating a process for accountability from inception to completion.

**Why would a Client create a Family Bank?**

Our clients who have created Family Banks do so because they believe that using capital to build businesses or careers, to improve the lives of family members and others, and to expand human knowledge is usually more satisfying than other - more personal consumption oriented - uses for a family's excess wealth. These clients believe that, through financial support and mentoring in decision-making, they can foster commitment and active participation by family members (whether of blood or affinity) and others in building wealth and helping others and can provide a user-friendly process for those individuals to receive multi-generational role modeling and teaching by example, whether from the client's peers or qualified family members themselves.

**What does a Family Bank look like?**

Each family's application of this idea is customized for its own agenda. The design of the structure of course must accommodate tax costs but should not allow tax issues to limit uses of the funds, as is the case in most family wealth structures today. Certain elements commonly inherent in most Family Banks are:

- **Structure** – as noted, our clients have created Family Banks using trusts as the basic platform. There is an administrative trustee that is responsible for meeting certain basic requirements (filing tax returns, arranging for custody of assets, etc.), as well as an independent protector responsible for replacing fiduciaries that are not performing properly. Decisions regarding whether and to what extent to grant applications for funds, as well as ongoing monitoring of prior grants (including investments), is handled by a committee consisting of specially appointed peers, colleagues and qualified family members, who possess in the aggregate the necessary investment and mentoring skills and relationships with the family.

- **Funding** – Our clients have funded Family Banks by "keeping it simple" with direct gifts of liquid assets and venture capital investments that no longer have capital commitments or vesting issues. Thus, they have funded their respective Family Banks, at little or no gift tax cost and without future GST consequences. In each case, there is no charitable deduction to reduce or avoid taxes.

- **Taxation** – The Family Bank is subject to U.S. federal income taxes, and distributions to applicants are taxed to the beneficiaries as income in a particular year to the extent the Family Bank has distributable income for that year. Loans to individuals are subject to the usual tax rules for intra-family loans, while direct investments in new businesses are treated most favorably (as one would expect). Taxes are the cost of flexibility, but are manageable as a practical matter.

- **Reporting** – Family Banks can be created as so-called "quiet trusts" if the client decides that is appropriate. Thus, the broad groups of individuals that are beneficiaries are not entitled under applicable law to receive reports or accounts. Instead, those reports are sent to the protector who is responsible for receiving those reports and acting accordingly on behalf of those beneficiaries, and ultimately in determining when and to what extent beneficiaries should become informed about the Family Bank.

**Client's required input on Family Bank design**

As one might imagine, clients must answer certain fundamental questions concerning the "how" of the Family Bank, such as:

- Should the individuals who benefit be limited to family members or include non-family such as close friends, community leaders, business associates, and deserving individuals who nevertheless would not qualify as a "charity case" (for a tax-qualified grant from a private foundation)?

- Should funding money-making enterprises or careers that are expected to be relatively lucrative be the only permissible use of funds, a priority use of funds, or simply one factor taken into consideration in a beneficiary-applicant's request for funds?

- If not limited to funding money-making enterprises or careers, should the purposes nonetheless be limited to careers or activities that would allow the recipient to be reasonably self-supporting at least at a level that supports a modest life style, albeit, if the original funds were provided on a soft-loan basis, without the ability to repay those funds out of the recipient's earnings?
- Should funds be disbursed with a strong view to preserving and enhancing the Family Bank's assets with returns from successful projects or should it be expected that over the course of time the risk and other characteristics of funded projects will tend to reduce the size of the Family Bank's assets (absent extraordinary success on a given project)?

While difficult, clients answering these types of questions is necessary for the proper design of the Family Bank, and more importantly, for their families to have a long-term, healthy relationship with, and understanding of, available resources.

**Risks inherent in a Family Bank are manageable**

There are, of course, risks in the Family Bank structure. If operated improperly, the Family Bank could become a mere "incentive trust" used to control conduct rather than promote commitment, personal growth, and family and community values. Also, potential conflicts can arise between use of funds for enhancing careers of family members vs. funding the dreams of others in less fortunate circumstances, because of the powerful temptation to use "family" money for experimenting with business ventures and careers in order to conserve one's "personal" money for future personal use. Furthermore, there is a generalized risk of divergence of purpose and misuse of funds because there are few inherent checks and balances supplied by the law, as there are with personal trusts and tax-regulated charitable trusts and foundations. These risks, while indeed real, are readily manageable with thoughtful design and operation of the Family Bank and sufficient built-in flexibility and adaptability.

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Now is the opportune time for clients who want to provide well-managed and effective assistance to their family, certain family friends, and others that would generally not be available to them absent a Family Bank and that can help those individuals pursue opportunities for entrepreneurship, venture philanthropy and human capital development in a structured and more-likely-to-succeed manner.