

OCTOBER 2006



**Summit**

160 Bovet Road  
Suite 405  
San Mateo CA, 94402  
info@summit-advisors.com  
650-357-9410

**Mark Pietrofesa**

mark@summit-advisors.com  
650-357-9410

**Rafael Velez**

rafael@summit-advisors.com  
650-357-9410

**William Fisher**

william@summit-advisors.com  
650-357-8812

**Michael Radakovich**

michael@summit-advisors.com  
503-445-6661

**Cristina Petersen**

cristina@summit-advisors.com  
650-357-8812

## Welcome to the Family Bank

IF YOU WANT TO CONTROL HOW YOUR ASSETS ARE DISTRIBUTED LONG AFTER YOU ARE GONE—AND AVOID ESTATE TAXES—A FAMILY BANK IS A GREAT OPTION.

For many wealthy families, estate planning can be overwhelming. Between setting up a complex array of trusts to avoid paying hefty estate taxes and drafting a will that will cover investing and philanthropic goals, many must also worry that their wealth may make their children and grandchildren complacent and unambitious—or worse, that it will fall into the hands of an heir's ex-spouse.

To overcome these fears, some choose to create a family bank. A family bank combines a dynasty trust with a limited liability corporation (LLC). This setup can create long-term tax advantages for your estate upon your death. It also allows you to limit how much of your assets are passed on to heirs outright, while still providing a financial resource from which they can borrow money throughout their lives.

### HOW IT WORKS

When you set up a family bank, your assets are given to the dynasty trust. When you pass away—or when your children reach a certain age—the family bank lends money to your heirs based on their needs, which may include paying for an education, buying a house or starting a business. Decisions on how much is lent to each heir, and for what purpose, are made by a board of trustees you appoint to oversee your family bank.

Loaning money to your children and grandchildren with strings attached is “a good way of maintaining control over your estate from the grave,” says Herbert K. Daroff, JD, a Boston-based family bank expert. While it can control how your money is allocated to your heirs, it also

spells out who is not entitled to any ownership of your assets. Daroff says the primary reason his clients establish a family bank is to ensure that their “kid's ex-spouse doesn't get a dime of the wealth they've created if they get divorced.”

Another motivation for setting up a family bank is to ensure you leave enough money to your children so they can pursue their own goals, but not so much that they can afford not to work at all.

Here are a few scenarios of how a family bank might be used:

- Your heir wants to go to college. Instead of paying for the tuition directly, you can loan him the money from the family bank. If he graduates with a predetermined minimum grade point average, the bank waives the loan. If he does not reach the specific grade point average, he has to pay back the family bank.
- Your heir wants to start a business. The heir creates a business proposal and presents it to the family bank's board of trustees. The trustees make suggestions and give input. Then the heir proposes the business to a few outside banks. If an outside bank approves a loan, the family bank gives the heir the loan at a lower interest rate. If the business fails, he can be assured that he won't go bankrupt.
- You want your heir to have a career that gives back to the community. Some careers that fall into this category, such as teaching,

# Welcome to the Family Bank

Continued from page 1

*Loaning money to your children and grandchildren with strings attached is a “good way of maintaining control over your estate from the grave,” says Herbert K. Daroff, JD, a Boston-based family bank expert.*

tend to be fairly low-paying jobs. You can encourage him to accept the job by matching the salary from the family bank’s funds. That way he can still pursue a fulfilling career without sacrificing the standard of living to which he is accustomed.

- Your heir wants to buy a house with a new spouse. The family bank lends them the money to buy the house, and the couple pays the interest on the loan. If the couple gets a divorce, the family bank has a lien on the house, effectively protecting it from the ex-spouse during the divorce settlement.

## CREATING YOUR FAMILY BANK

Daroff says that your goals for the family bank should be clearly stated in the dynasty trust

documents. Dynasty trusts are irrevocable, so once they are created, there is little you can change. However, he says, “You can build tremendous flexibility into a family bank” by being clear on how much power both your heirs and the trustees have in the decision-making process. You should also be clear on how you want trustees appointed to your family bank after you and your children are gone.

You may also want to write a letter to your children and other family members expressing how you wish the funds to be used. This helps minimize confusion—and family squabbles.

It is also a good idea to appoint an odd number of trustees to your family bank to avoid voting ties. Make sure there are at least a few trustees on the board who have a working knowledge of business in case a family member applying for a loan comes up with an unusual proposal. Your trustees should have the ability to enforce the trust’s rules while having the flexibility to adapt to future circumstances if you are gone or unable to guide the decision-making process.

## COSTS AND TAXES

Setting up a family bank can be costly. First, you’ll likely owe steep fees to lawyers, accountants and other financial planners who specialize in these vehicles. How much it actually costs to set up your family bank will depend on its complexity. While almost

anyone can set up a family bank, you should typically have at least a few hundred thousand dollars in it after the initial setup.

There are some tax implications, both good and bad, with a family bank. If you establish your family bank in a state that allows them to exist in perpetuity (like New Jersey, Florida or Delaware), you can effectively avoid all estate taxes as the assets are transferred to future generations. This not only allows you to shield your wealth from the government, but also allows the assets to grow, since they are invested when not being lent to heirs.

However, Daroff points out that when you donate your assets to the family bank, the assets are subjected to certain gift taxes. He recommends working with your financial planner to minimize these taxes.

In the end, Daroff says the need to control your assets should be just as important as any tax benefits you receive from establishing a family bank. Knowing that your heirs are well cared for can be very important, but knowing you provided a strong education in money management and instilled an appreciation of your family’s wealth can be just as valuable. ■

This newsletter is provided by the firm listed on the header. This firm is either a registered investment adviser (“RIA”), qualifies for an exemption or exclusion from registration as an investment adviser or does not fall within the definition of an RIA under the Investment Advisers Act of 1940 (the “Act”) or applicable state laws. Any subsequent, direct communication by the firm with a prospective client shall be conducted by a representative that is registered, qualifies for an exemption or exclusion from registration in the state where the prospective client resides or is not defined as an investment adviser representative under the Act or any applicable state laws.

This newsletter contains general information that is not suitable for everyone. The information contained herein should not be construed as personalized investment advice. There is no guarantee that the views and opinions expressed in this newsletter will come to pass. Investing in financial markets involves gains and losses and may not be suitable for all investors. Information presented herein is subject to change without notice and should not be considered as a solicitation to buy or sell any security.