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Private (Non-Charitable) Foundations in the United States

Wyoming versus New Hampshire—useful additions or confusing propositions?

Alexander A. Bove Jr. | Nov 15, 2019

One thing you can say about individuals living in the United States: We seem to be endowed with a certain entrepreneurship, always looking for new ways to do things,

especially if it involves making money. Take the move towards self-settled asset protection trusts (APTs), for example.[1] For 200 years, it was considered against public policy for an individual to create a trust for her own benefit, the assets of which couldn't be reached by her creditors. Then, somewhere around the 1960s and 1970s, billions of U.S. dollars began to flow to jurisdictions like the Cook Islands, Liechtenstein, Gibraltar and the like, where an individual could establish her own APT for herself and her family. It didn't take long for U.S. banks and trust companies and the thousands of lawyers who were losing all of that business to lobby for new laws that allowed an individual to establish a domestic APT for her own benefit, despite age-old public policy laws. As of this writing, 19 states have adopted such a law, apparently taking a modified view of public policy.

While private (non-charitable) foundations (NCPFs) are definitely not in the same category as APTs, causing us to lose billions of dollars in business, they're nevertheless a vehicle that's generated considerable offshore business and that could similarly attract considerable business in the United States. The problem up to now has been that, just as with the self-settled APT, the United States didn't recognize the NCPF. But now, two states, Wyoming and New Hampshire, have passed laws purporting to allow an individual to establish an NCPF. So, what's an NCPF, why would anyone want one and why do I use the word "purporting"?

NCPF Basics

The NCPF was developed in civil law jurisdictions (which make up most of the world), where the concept of a trust isn't recognized. In many ways, the NCPF can serve as a substitute for a trust, in that it can provide for the family of the founder (similar to the settlor of a trust) during the founder's life and after her death. But, most of the similarities end there. Because the principles of civil law don't recognize the divided ownership of property as we do in common law jurisdictions (that is, legal ownership in a trustee and beneficial ownership in the beneficiaries), they simply don't recognize trusts. Thus, although a private foundation may certainly have (and typically does have) beneficiaries, the ownership of the assets of the NCPF rests with the NCPF. The beneficiaries have no ownership or rights to ownership of

NCPF assets. The NCPF is a separate legal entity, standing by itself in every legal way. In a sense, it's like a corporation without shareholders. The NCPF is managed by a board or council, and the council's duty generally runs to the NCPF and not to the beneficiaries. This isn't to say that the board or council members may ignore the interests of the beneficiaries altogether. Depending on local law or the provisions of the regulations or bylaws of the NCPF, the founder could impose specific duties on the board, but in general, the relationship between the board and the foundation's beneficiaries is quite different from that of the trustee and the trust beneficiaries. (In virtually every NCPF jurisdiction, however, the board is required to exercise "good faith" in administering the NCPF and in dealing with the beneficiaries.)

NCPF Versus Trust

One of the main distinctions between a trust and an NCPF is that the beneficiary has a far less prominent role in an NCPF than she has in a trust. Of course, this can be enlarged in the regulations, and as noted below, it's immensely enlarged under the default rules of the New Hampshire foundation statute, but generally speaking, the board of the NCPF has far more freedom and control in running the NCPF, disclosing information to the beneficiaries and even from being removed. Remember, this is not a trust, and the underlying law regarding all of such issues is based on a very different concept. The huge amounts of family wealth that have been held and managed by foreign NCPFs over the last 100 or more years have reflected their founders' desire to keep the wealth properly managed and intact for generations while providing for descendants, without interference from the beneficiaries and without distributing the wealth outright.

In fact, this addresses the second question I raised earlier—why would anyone want an NCPF? For one thing, an NCPF (in its "pure" form) would allow the founder to retain more control than with a trust. As noted, the rights of beneficiaries are substantially more limited than under a trust, which for example, could be modified or even terminated by beneficiaries, against the intentions of the settlor, under provisions of the Uniform Trust Code, which a majority of states have adopted. Secondly, many advisors believe that because of the conceptual difference in the

legal structure of an NCPF, creditors of the founder or the beneficiaries would find it more difficult to reach the assets of the NCPF, especially, for example, in divorce cases. So, let's see how close New Hampshire and Wyoming have come to developing an NCPF law that could compare to the international NCPF laws briefly described above.

Hybrid Laws

Addressing my last introductory question, why did I use the word "purporting" in referring to whether the two states' NCPF laws really do allow an individual to establish an NCPF? Quick answer, detailed a bit further below: because, in my opinion, the drafters in both states weren't really sure what they wanted, or at least they didn't want a true NCPF law modeled after any of the commonly used jurisdictions and were happy with a hastily drafted hybrid law, which, in the case of New Hampshire, is far more like a trust than a foundation, and in the case of Wyoming, is far less like a foundation than a limited liability company (LLC).

New Hampshire

New Hampshire, which was the first of the two, adopted its NCPF law (the N.H. Act) in 2017.[2] The interesting, if not downright misleading, part for those advisors unfamiliar with the NCPF is the approach the drafters used to not so subtly suggest the provisions that may be included in the bylaws. That is, there are no less than a dozen or so important provisions in the N.H. Act that begin with the phrase, "unless the governing documents provide otherwise," meaning that the provision following this introduction may be omitted in the bylaws by simply stating otherwise. This might not be so disconcerting if it didn't lead to absurd results. For example, the duty to maintain records and the duty to manage the NCPF as a prudent person are among those basic and indispensable duties that may be omitted in the New Hampshire NCPF if the bylaws provide otherwise.[3] On the other hand, some of the provisions are consistent with those of the typical offshore foundation, such as the requirement that the NCPF have a stated purpose and the provision allowing the bylaws to state that the beneficiaries need not be kept informed.[4] Further to this

point, the NCPF is declared to be a separate legal entity (like a corporation) apart from its founders, officers and beneficiaries.[5] As for the stated purpose, the problem is that a New Hampshire NCPF may have a purpose but no one to enforce it, which could result in obvious problems and unnecessary expenses. There are provisions for an enforcer, but they aren't mandatory.

This illustrates the central problem I see with the New Hampshire law. It is simply not well thought out. How would an advisor, not familiar with NCPFs, understand which provisions to keep and which to override? The retention of all of the N.H. Act's default provisions would clearly result in having a trust rather than an NCPF, but we can't be sure how the Internal Revenue Service would view it. If it concluded the NCPF was a corporation, we could have some serious tax implications. Further, the N.H. Act's default requirements, such as the duty of impartiality, providing information and fiduciary liability to beneficiaries belong in trusts, not in foundations. In this context, the N.H. Act's provision for the founder's rights include such extremely broad rights that if allowed to apply, every New Hampshire NCPF would be reachable by creditors of the founder[6] and, unless treated as a corporation, all income would be taxed to the founder as a grantor trust. Confused yet?

All that being said, I suppose it's possible for an experienced advisor to navigate through the N.H. Act, overriding some of the default provisions, accepting others and drafting a reasonable set of bylaws, to end up with an NCPF that's reasonably close to its offshore counterpart. The trick is in the navigation of unfamiliar, potentially dangerous waters with no map.

Wyoming

The Wyoming statute, on the other hand, provides us with a path somewhat easier to follow, but in following it, we find that it appears to lead us closer to an LLC than a foundation. This isn't to say that it's clearly an LLC. It can't be, because the law clearly announces itself as the "Wyoming Statutory Foundation Act" (the W. Act).[7] The troublesome issue here, however, is that instead of regulations or bylaws, as are customary in an NCPF, the W. Act calls for an "operating agreement." Sound

familiar? While the term itself, of course, doesn't mean it can only be used in an LLC, as noted later, some of the central provisions of the W. Act are virtually identical to typical provisions of an LLC. Furthermore, under the W. Act, unlike the N.H. Act, the NCPF must have a beneficiary[8] (although there's no requirement that the beneficiary be a natural person). Basically, the operating agreement is much like the foundation regulations, but also disturbingly like the LLC operating agreement. Is the point of this to make some advisors comfortable with the law? If so, in my opinion, it leads to a loss of focus on what's being created.

In terms of keeping with the typical NCPF laws, Wyoming scores a just a bit higher than New Hampshire, in that, for one, the W. Act specifically provides that the directors must act "[i]n a manner not opposed to the best interests of the statutory foundation,"[9] instead of the interests of the beneficiaries, as would be the case with a trust (and with the N.H. Act). In addition, the W. Act allows for the appointment of a protector and specifically provides that the protector shall serve as a fiduciary.[10] Here, although a protector isn't mandatory, it's very important to consider appointing one, because without a protector, the beneficiaries have the right to request any information from the directors.[11]

With reference to my earlier mention of the "operating agreement" and its curious similarity to the LLC use, the W. Act's provisions for "beneficiary" and "beneficiary owner" generate further confusion along this line. First, there's no clarification of the difference between the two terms, but one can infer from the W. Act language that a beneficiary owner has a status similar to that of a member of an LLC, "sharing in the profits and losses of the foundation,"[12] and the transfer of a beneficial interest shall only have the rights of an "assignee"[13] (sound familiar?). It's important to note that it isn't clear whether this means that a creditor (who, it's clear may now reach a beneficiary's interest) would have only rights to a charging order or whether a strict foreclosure could result, as can happen in a typical LLC, but not in the typical NCPF! This is a definite oversight in the W. Act, though it should be noted that the W. Act allows the operating agreement to override this, hoping the advisor can keep track of all these twists!

From a U.S. income standpoint, the W. Act appears a little "safer" than the N.H. Act, because: (1) it doesn't default to a trust; (2) the powers of the founder must be specifically reserved rather than be automatic as in New Hampshire; and (3) based on the look-alike LLC provisions, that would likely be the result in a default situation, but no comment on whether that can be good or bad.

Tweaking Needed

Both acts need some serious tweaking and exercise before advisors can feel comfortable using them. At this point, it should be clear that both statutes are, unfortunately, guessing games. Perhaps the best idea would be for each of the two states to prepare "instruction manuals" for advisors, so they would know how to employ the law to meet clients' objectives. Until that happens, the open questions and hoped-for interpretations make the usual objectives of privacy, asset protection, beneficiaries' rights and certainty of tax consequences, with respect to both statutes, little more than confusing propositions rather than useful additions to the law.

Endnotes

1. Leimberg Services, *Asset Protection Newsletter #393* (Sept. 26, 2019).

2. NH Act R.S.A. Section 564 F New Hampshire.

3. *Ibid.*, Section 564 F 11-1104.

4. *Ibid.*, Section 564 F 11-1107.

5. *Ibid.*, Section 564 F 3-303.

6. *Ibid.*, Section 564 F 7-702.

7. W.S. Section 17-30-101, The Wyoming Statutory Foundation Act.

8. *Ibid.*, Section 17-30-201.

9. *Ibid.*, Section 17-30-501(d)(ii).

10. *Ibid.*, Section 17-30-504.

11. *Ibid.*, Section 17-30-701(b).

12. *Ibid.*, Section 17-30-602(e).

13. *Ibid.*

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