

The Purpose of Purpose Trusts

By Alexander A. Bove Jr.

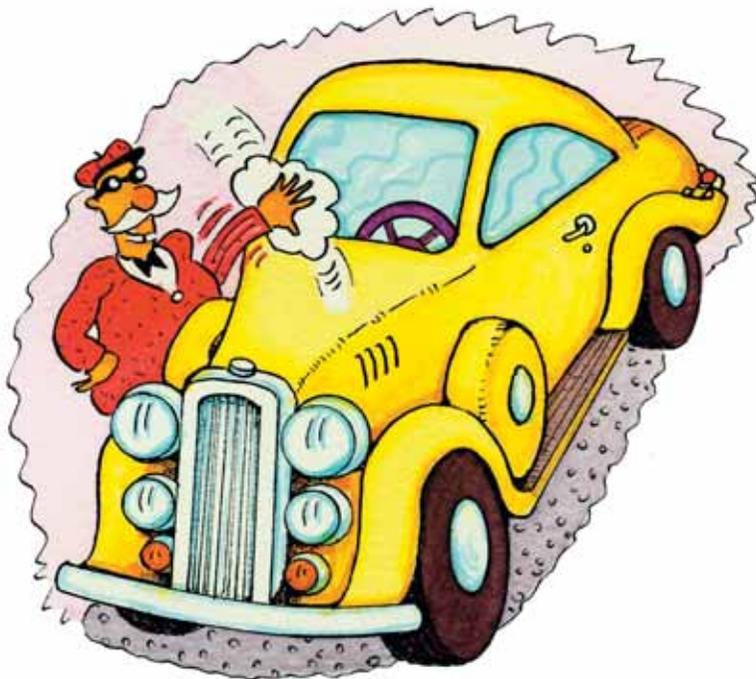
It is truly interesting (at least for those of us who practice trust law) to note how the use, drafting, and concepts of trusts have developed and expanded over the years. For instance, the irrevocable life insurance trust was practically unheard of until the 1940s or so, and virtually no one used trusts to avoid probate until forced to do so in the late 1960s by the popularity of Norman F. Dacey's questionable book, *How to Avoid Probate* (1966). Then every decade or so developments in the federal tax laws generated new breeds of trusts—the Clifford trust, the charitable remainder trust, the minor's trust, the grantor retained income and annuity trusts, the qualified personal residence trust, and so on. More recently we have seen the advent of the "offshore" trust, typically associated with asset protection, which, like all the other trusts, carries with it its own special provisions. And now, we are seeing still another special form of trust, the "purpose trust," which requires some rethinking of the basic elements of a trust and, of course, of the provisions needed to make it work.

Briefly, a purpose trust is a trust established for a purpose rather than for specified beneficiaries. In at least

one respect, this concept is not new. After all, a charitable trust is typically established for a purpose and typically has no identifiable beneficiaries, but a charitable trust has never raised the eyebrows of a trust lawyer or a judge. A trust established to maintain a public park or to fund medical research is not unusual and, if properly drafted, is seldom questioned because such trusts are regarded as charitable and may be enforced by the attorney general for the benefit of the public. The "new" concept referred to here is the noncharitable purpose trust. An example of a noncharitable purpose trust would include one in which a settlor established a trust to maintain his collection of antique automobiles or perhaps one for the purpose of constructing a home for the maintenance and care of his pets and all their offspring.

Those who recall the basic elements of a trust will note that such noncharitable purpose trusts will fail for a number of reasons. First, these trusts violate the rule against perpetuities because there is no measuring of human life. Second, and perhaps more convincing, no ascertainable beneficiary exists to enforce the trust. An inviolable rule of trust law states that if no one can enforce the trust, then there can be no trust. As noted earlier, although a charitable trust may have no named beneficiaries, the state attorney general can enforce the trust. In our examples above, however, certainly neither the antique automobiles nor the cats and dogs could sue the trustee to enforce the trust, and none of them is capable of having a personal representative. A trust (as we know it) must have beneficiaries whose identity can be established with certainty. If the identity or method of determination of the ultimate beneficiaries of a trust is so vague that neither the trustee nor a court can readily determine whether any given individual at any given time was or was not a beneficiary, the trust would be unenforceable under common law and, therefore, invalid, unless, of course, its purpose was charitable.

But now, primarily from offshore jurisdictions, which are sometimes credited with giving us a number of other unique ideas for creative trust provisions (the "flee" clause, the "anti-duress" clause, and the change-in-governing-law clause), comes the purpose trust, which, although definitely not faster than a speeding bullet, can in fact leap over age-old trust laws in a single bound. Generally speaking, a purpose trust has no direct individual beneficiaries, even though there may be individuals who happen to benefit from the trust carrying out its



Slug Signorino

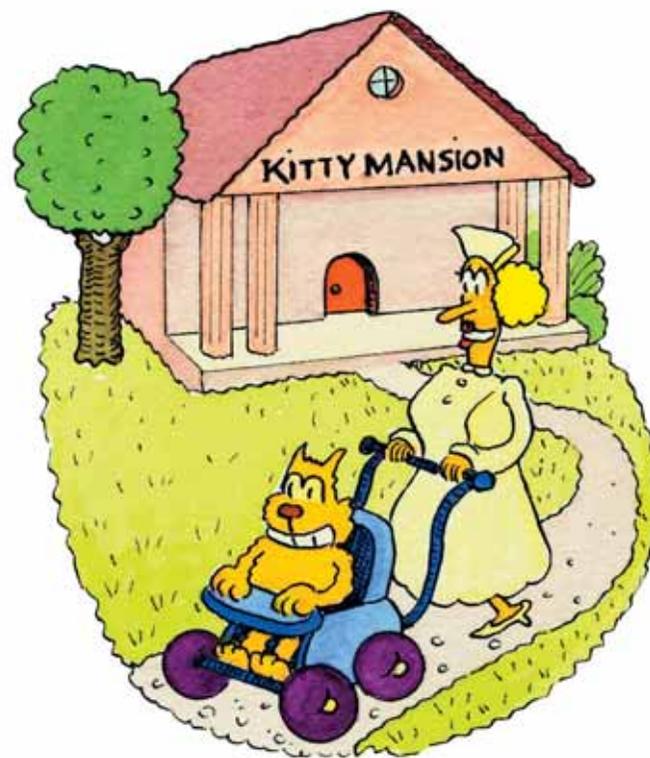
purpose or beneficiaries who may take when the purpose is satisfied or the trust terminates for some other reason. For instance, in the illustration above, a valid purpose trust could be established for the maintenance of the settlor's collection of automobiles, and, if the settlor's child or children were using the automobiles, they would indirectly benefit from the trust, although under trust law they would not be considered beneficiaries and would have no standing to enforce the trust. Similarly, the trust could provide that if and when the automobiles were unusable or disposed of, or simply after a set period of time, the trust would terminate, and the settlor's children would receive any assets (the automobiles) remaining in the trust. The fact that the trust designates the children as remaindermen after completion of the purpose does not change the character of the trust or by itself make the trust valid. In those jurisdictions that do not recognize purpose trusts, a trust with these provisions would be considered void, and one of two things would happen: either the bequest would pass directly to the children without regard to the instructions to maintain the automobiles or the entire bequest would fail and pass by intestacy in the settlor's estate. Cases have reached both results.

The offshore jurisdictions that have recognized purpose trusts have done so through formal legislation. These jurisdictions include, among others, the Isle of Man, Jersey, the British Virgin Islands, Bermuda, the Cayman Islands, the Cook Islands, and Nevis. Some states also have adopted purpose trust law, but in a far more limited way than the off-

Alexander A. Bove Jr. is a partner with Bove & Langa PC in Boston, Massachusetts, and chairs the I-3 Asset Protection Planning Committee. This article is excerpted from Mr. Bove's chapter on purpose trusts in volume II of *Asset Protection Strategies*, to be published by the American Bar Association in fall 2004.

shore jurisdictions. The thrust in the United States to adopt purpose trust legislation appears to be largely related to and motivated by the public's desire to be able to establish valid trusts for their pets, although other "honorary" trusts (such as trusts to maintain gravesites or say masses) are usually allowed on the same basis. The popularity of pet trusts is clearly reflected in the 1993 amendment to Uniform Probate Code § 2-907(b). That section, which is optional for states adopting the code, specifically acknowledges and validates honorary trusts and trusts for pets, but it distinguishes in greater detail trusts for pets. See also Colo. Rev. Stat. Ann. § 15-11-901 and Cal. Prob. Code § 15212, which both have certain specific provisions under which trusts for pets can be valid. The Uniform Trust Code also contains a section authorizing trusts for animals. UTC § 408. Contrast this unique and focused legislation with the broad and flexible purpose trust legislation found in the offshore jurisdictions mentioned above, which includes no mention of pets at all.

The few states that have adopted the Uniform Trust Code (2001) (UTC) also allow purpose trusts beyond trusts for animals. UTC § 409 provides that "[a] trust may be created for a noncharitable purpose without a definite or definitely ascertainable beneficiary or for a noncharitable but otherwise valid purpose to be selected by the trustee." UTC § 409 limits the term of such a purpose trust to 21 years. Interestingly, the UTC does not invalidate the trust after the 21-year period, but it merely declares the trust unenforceable. Presumably, then, a court, upon petition, could declare the trust invalid, inasmuch as its terms have become unenforceable. When that happens, unless the trust



Neither the antique automobiles nor the cats and dogs could sue the trustee to enforce the trust.

provides otherwise, the corpus would revert to the settlor or the settlor's estate. It would be unusual, and certainly a lack of foresight, if a drafter did not provide for disposition of the trust property after the purpose was carried out or in the event it could not be carried out.

A few states, including, for example, Pennsylvania, allow some form of purpose trust through case law. Whether through case law or by statute, the application and use of purpose trusts in the United States is extremely narrow and the term unnecessarily limited. For instance, if an individual wishes to provide for the long-term maintenance of a private building without mingling that asset with other assets in a trust that provides for individual beneficiaries, perhaps from a concern that dispositive disputes could override a restraint on sale of the property, why should the grantor be limited to 21 years? If a U.S. person wishes to

establish a purpose trust for a longer term than permitted in the United States under adoptions of the Uniform Trust Code, the Uniform Probate Code, or local law, the grantor can settle the trust in any of the several offshore jurisdictions recognizing such purpose trusts and then can administer the trust in the United States, as pointed out below.

Whether the grantor creates the purpose trust offshore or onshore, the trust must meet certain requirements that apply to all trusts or it will fail, despite the potentially broad scope of such a trust. The first requirement is that the trust be subject to enforcement. Most of the offshore statutes as well as the Uniform Trust Code require the trust to name an enforcer to enforce the terms of the trust (sort of a private attorney general) and provide for court appointment of one if the trust fails to name the enforcer. The Uniform Probate Code permits an enforcer to be named and appointed but does

The 47-clause will generated the obvious question of whether the trusts were valid and enforceable.

not require one, further indicating the casual attitude in the United States toward such trusts.

Next, the purpose or object of the trust must be certain, reasonable, and possible. The case of George Bernard Shaw is a good illustration of a purpose trust that seems to fail on all three counts. In his will, Shaw directed that the residue of his estate be held in several trusts for, among other unusual purposes, the study of the advantages of developing a phonetic alphabet and the determination of the number of living persons who speak and write English based on the 26-letter alphabet, "at any and every moment in the world." The 47-clause, lengthy, and complicated will, written in part by Shaw himself at age 94, generated the obvious question of whether the trusts were valid and enforceable. The court described Shaw as having been "a kind of itching powder to the British public" and then held that the trusts did not state a charitable purpose. That conclusion meant that the court held the trusts invalid because the UK did not and still does not recognize noncharitable purpose trusts. The opinion also indicated that at least some of the purposes were virtually impossible to carry out. *Re Shaw* [1957] 1 WLR 729.

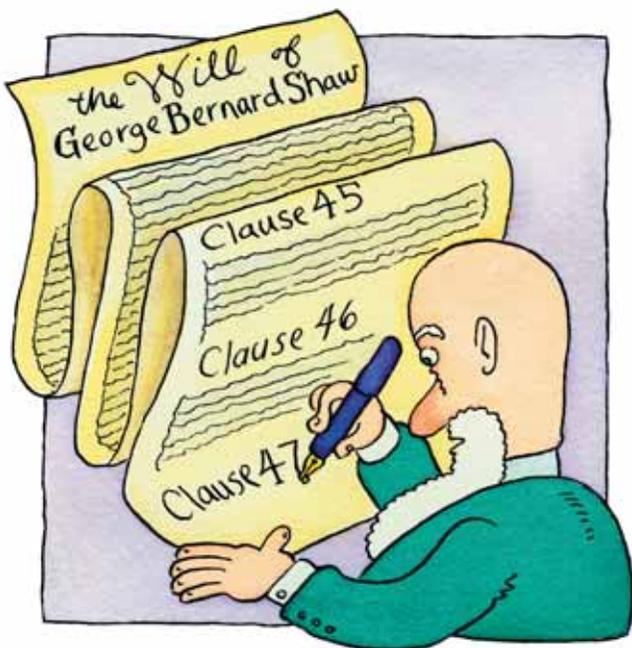
Even if the purpose is possible to carry out, the court will not enforce a purpose that is wasteful, useless, or otherwise against public policy. An interesting illustration of this principle is the case of Anne Maria Burdett, whose will devised her home and contents to trustees, directing that on the day of her funeral the trustees arrange to have the doors and windows of her home bricked and boarded up "and nailed with good long nails," and basically kept "in state" for 20 years after her death; thereafter the house would pass to named beneficiaries (remaindermen). The remaindermen contested the will, but in the meantime the house was, in

fact, bricked and boarded up as directed. Not surprisingly, extensive litigation ensued. Ten years later the remaindermen succeeded in their appeal, the court ordered the trust property unboarded, unbricked, and sold and the trust terminated on the basis that it was wasteful, useless, and did not constitute a disposition of the property. *Brown v. Burdett* [1882] 21 Ch. D. 667.

As noted above, numerous offshore jurisdictions have adopted purpose trust legislation. In general, these jurisdictions all have the same basic requirements for the trust to be valid, and most of the rules use the 1989 Bermuda statute as a model. Perhaps the most illustrative and clearly set forth elements are those of Belize, in Sections 7 and 15 of the Belize Trusts Act 1992, indicating that a noncharitable purpose trust will be valid, provided that:

- the purpose is specific, reasonable, and capable of fulfillment;
- the purpose is not immoral, unlawful, or contrary to public policy;
- the terms of the trust are not so uncertain that its performance is rendered impossible; and
- the terms of the trust provide for the appointment of a successor to any protector (enforcer).

Of course there are numerous other terms to consider, such as selection of trustee, who may act as trustee and enforcer, registration requirements, and so on. Some commentators feel that one of the most flexible of the offshore purpose trust statutes is that of the Cayman Islands, under their 1997 STAR (Special Trust Alternative Regime) Trust legislation. A trust settled under this law may be both a "person" trust (having identifiable beneficiaries) and a purpose trust at the same time. Further, if any question of certainty arises, the trust agreement may authorize the trustee to resolve the uncertainty without the need for court intervention. As with most other offshore jurisdictions, however, the trustee must be a





The court ordered the trust property unboarded, unbricked, and sold and the trust terminated on the basis that it was wasteful.

licensed trustee in that jurisdiction. The enforcer need not be located in the jurisdiction but would be subject to the laws and court orders of the jurisdiction for all activities and administration of the trust.

As to which jurisdiction to select, whether domestic or offshore, there are, of course, numerous factors to consider, including the purpose and term of the trust, the most logical place for administration, the laws of the jurisdictions under consideration (which is to say, the flexibility of the applicable statute), and, perhaps, the client's travel preferences.

Although the illustrative cases discussed earlier may be entertaining narratives of would-be purpose trusts, what practical uses of purpose trusts have given rise to the increasing recognition of purpose trusts and legislation concerning these trusts?

of the trust is to maintain a noncharitable foundation for the benefit of the settlor and members of the settlor's family and, quite commonly, to hold ownership interests in companies that lease assets to other companies for off balance sheet transactions.

For those attorneys familiar with the establishment of trusts in other jurisdictions, it is a relatively simple matter to form a purpose trust in a selected jurisdiction for a U.S. client and then make the transfer of desired assets to the trust. In the typical case, the trust is drafted so that the transfer to the trust is tax neutral and the income is taxed to the grantor (a grantor trust under Code §§ 671-679). There should be no new taxes to worry about, although under Code § 6048 and Rev. Proc. 97-37, IRS information forms must be filed. Because a purpose trust has no beneficiaries, however, if the trust is drafted so that it is not a grantor trust, some tricky, if not odd, tax considerations apply. For instance, Code §§ 641 and 651 provide for a deduction for amounts that a trust distributes to a beneficiary, and corresponding Sections 642 and 652 provide that the beneficiary receiving such distributions shall include the same

The answer is that modern day purpose trusts can be used for personal or philanthropic purposes that do not otherwise qualify as charitable. For instance, a purpose trust can hold and provide for control of a family business (indefinitely, in jurisdictions not bound by the rule against perpetuities); can direct maintenance and preservation of family or business property without interference by beneficiaries; and can provide complete privacy and creditor protection when, for example, the purpose

in his or her gross income. But what happens to these rules in the case of a purpose trust that distributes income for the upkeep of an automobile or the care of a cat? Obviously neither the car nor the cat will be filing a tax return, and it would not seem fair, on the one hand, that the trust should simply be denied the deduction and taxed at the higher trust tax rates, because it is not accumulating the income. On the other hand, to allow a deduction for trust distributions that are not taxed to anyone will not fly under our tax laws.

The IRS has considered this odd situation, and in Rev. Rul. 76-486 ruled that, although no deduction is allowed for the trust distributions to a non-individual (because no one will be taxed on them), the trust should not be taxed at the higher trust rate, because it is not accumulating the income. Instead, the Revenue Ruling provides that the trust in such a case will be taxed at the rate of a married person filing separately.

Even though the trust may be established in an offshore jurisdiction, if the settlor is a U.S. person, U.S. tax laws must still be considered. Because this is the case, perhaps importing the offshore trust and the offshore law to the United States should be considered. If the purpose trust meets the local offshore jurisdictional requirements, the trust may be generally administered anywhere in the world, including the United States. Therefore, it should be possible to establish a purpose trust in an offshore jurisdiction and then after a short time move administration of the trust to the United States while retaining the governing law of the original jurisdiction. If certain other requirements are met, this could eliminate the need to file the aforementioned reports with the IRS. And as U.S. planners become more and more familiar with purpose trusts, no doubt more and more purposes will be found. ■