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The Perpetual Business Purpose Trust: The Business Planning Vehicle for the Future, Starting Now

*Alexander A Bove, Jr. and Melissa Langa**

Most estate planning attorneys will agree that the trust is the most flexible and useful document we have in designing estate plans for clients, and the concept and use of trusts continues to expand and evolve over the years. We have even developed our own special acronyms for planning, with terms such as GRITs, GRATs, QPRTs, SLATs, CRUTs, and ILITs, each of which tells us the story and use of that trust. But every one of these trusts as well as the many others we use all have the same three common elements, a trustee, a corpus, and one or more beneficiaries, without which there can be no trust, we are told. And with a bit of thought one might argue that of the three elements, the most important could be the beneficiary, for without a beneficiary, a trust could have no purpose, and without a purpose, what would be the point of having a trust?

But what if we took this one step further? What if we design a trust that is created to accomplish a purpose, but has no ascertainable beneficiaries? Actually, this is not at all new. We have been living and working with such trusts for hundreds of years in the form of charitable trusts. But in fact, charitable trusts do have beneficiaries – the public – it's just that there are no identifiable beneficiaries in the terms of the trust. An essential role of a beneficiary in the non-charitable trust is to enforce the trust according to its terms. In the case of the charitable trust, it is the jurisdiction's attorney general (who represents the public) who would enforce the trust.¹ So does this leave us with the restriction that, with the exception of a charitable trust, we can only establish a trust that has identifiable beneficiaries? Until about a hundred years ago, that was the case (and it is still the case in the United Kingdom). Gradually, settlers began to have ideas about trusts that could be established to accomplish a purpose, rather than to provide for named individual beneficiaries. One of the earlier and most famous attempts in this regard was by the well-known author/playwright, George Bernard Shaw. Shaw left his estate in trust, directing the trustees to use the funds to develop a

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¹ *What Attorneys General Do*, NAT'L ASS'N ATT'YS GEN., <https://www.naag.org/attorneys-general/what-attorneys-general-do> [<https://perma.cc/BFV9-82LY>].

new alphabet, emphasizing the use of phonetics, and once accomplished, to translate one of his plays, into the new alphabet.² The trustees asked the court to rule on whether this trust could be carried out, as Shaw's instructions also called for determining how many people in the world would be speaking and writing English at any given time.³ The court quickly ruled that the trust purpose did not rise to the level of a charitable trust, and in addition, its terms would be virtually impossible and also wasteful to carry-out, and, equally important, there was no one to enforce the provisions of the trust.⁴

There were a number of somewhat similar cases after *Shaw* — similar, that is, in proposing a project for the trustees to complete as opposed to naming beneficiaries — but none of which was approved by the court. For example, in one case, a trust was established to promote the integrity and independence of newspapers,⁵ and still another to board up a house and keep it closed for 20 years.⁶ In all of these cases, the trusts failed because either they did not rise to the level of a charitable trust or they were wasteful and unattainable, and there was no one to enforce them.

In a few cases, the ego of the settlors seemed to get the better of them, but not the better of the court. In the *M'Caig* case, for instance, the settlor directed his fiduciaries to expend the remainder of his estate to erect artistic towers and statues of himself and family members to spread among his several properties.⁷ In rejecting the bequest as wasteful, the court said that such monuments would be "objects of no utility, private or public, objects which benefit nobody, and which have no other purpose or use than that of perpetuating at great cost, and in an absurd manner, the idiosyncrasies of an eccentric testator."⁸

Interestingly, if it weren't for cases like *Shaw* and *M'Caig*, and of course the many others whose settlors and testators had purposes in mind instead of persons who would enjoy the benefits of their estates, it might well be that the purpose trust (for anything other than pets and the upkeep of graves) would never have developed. And in fact, we are using the term "developed" somewhat optimistically. It is only with the adoption of the Uniform Trust Code ("UTC") that thirty-five states (as

² *In re Shaw* [1957] 1 All ER 745 at 745 (Eng.).

³ *See id.*

⁴ *See id.*

⁵ *In re Astor's Settlement Trusts* [1952] 1 All ER 1067 at 1067 (Eng.).

⁶ *Brown v. Burdett* [1882] 47 LT 94 at 94-95 (Eng.).

⁷ *M'Caig v. Univ. of Glasgow* (1906) SC 231, 231 (Scot.).

⁸ *Id.* at 242.

of this writing)⁹ have formally accepted the purpose trust. But what exactly is a purpose trust and how will it change the future of business succession planning?

A purpose trust is a trust that is established for a purpose,¹⁰ as opposed to the typical trust which is established to provide for beneficiaries – thus, a purpose trust has no beneficiaries.¹¹ It is this fact which distinguishes the purpose trust from all other trusts (except for pet trusts and trusts for the upkeep of graves). And it was this distinction that prevented purpose trusts from being recognized in most jurisdictions, because without a beneficiary, there would be no one to enforce the trust.¹² Although the answer to this problem seemed too obvious for discussion, the unique nature of the purpose trust and the somewhat rigid adherence to the centuries-old basic concept of the trust, amounted to a mold no one wished to break. Nevertheless, once the solution became apparent, the purpose trust began to take hold, opening the door for planning far beyond pets and graves. The missing piece to the puzzle, then, was the presence of an enforcer to enforce the trust. Thus, the enforcer, in effect, took the place of a beneficiary, and we then have a valid, enforceable trust, provided this new form of trust met the other requirements. Such other requirements actually apply to all trusts, but seem more applicable to purpose trusts, because at first glance, there seems to be no limit to the purposes a settlor can dream up (e.g. George Bernard Shaw). So, besides an enforcer, a purpose trust must have a purpose that is reasonably possible of attainment, not wasteful, and not against public policy.¹³ Thus, a purpose trust to establish a school for pickpockets would not make the grade, while a school for magicians would be fine.

Slowly, very slowly, the purpose trust began to take hold across the world, largely in the Caribbean, with jurisdictions such as Bermuda,¹⁴ the Cayman Islands,¹⁵ and the Bahamas¹⁶ adopting purpose trust law,

⁹ *Trust Code*, UNIF. L. COMM'N, <https://www.uniformlaws.org/committees/community-home?communitykey=193ff839-7955-4846-8f3c-ce74ac23938d&tab=groupdetails> [<https://perma.cc/UR9B-T34B>].

¹⁰ PAUL BAXENDALE-WALKER, *PURPOSE TRUSTS* 11 (Butterworths 1999).

¹¹ Alexander A. Bove Jr., *Are We Missing the Purpose of the Purpose Trust?*, *TR. & EST.*, Oct. 2020, at 2, 3.

¹² *See id.*

¹³ *Id.*

¹⁴ *See* Trusts (Special Provisions) Amendment Act 1998, § 12A (Berm.).

¹⁵ *See* Trusts Law (2011 Revision), § 99 (Cayman Is.).

¹⁶ *See* Purpose Trusts Act, 2004 (Bah.).

and in Europe, with Gibraltar¹⁷ and Guernsey,¹⁸ but not the United Kingdom, which still does not recognize non-charitable purpose trusts.¹⁹

While the purpose trust legislation and practice in the foreign jurisdictions for the most part reflected serious efforts to address the uses of a purpose trust and perhaps to attract business through their use, for the United States, the purpose trust was, and in most cases remains, an afterthought, an “extra” that came with the UTC. Section 409 of the UTC is a brief section which provides that a non-charitable trust may be established for a purpose, as long as it provides for an enforcer (while section 408 provides for the pet trusts and is typically two or three times the length and detail of the non-charitable purpose trust section.). In addition to the requirement of an enforcer, purpose trust law typically provides that trust assets in excess of those reasonably needed to accomplish the trust purpose will be returned to the settlor. Clearly, the Uniform Law Commission (who drafted the UTC for the states to use) felt that the purpose trust would be of little use.

Nevertheless, a number of planners, here and in other jurisdictions, began to see unique value of the purpose trust in ways not previously possible. For example, a purpose trust could be used to hold family vacation property in perpetuity allowing for family use for generations without estate taxes and unaffected by family disputes or creditor claims (of course, the trust would have to be adequately funded to carry the property). Perhaps the most significant use of the purpose trust and one which is gradually re-writing business succession planning is the idea of holding a family business (or control of the family business) in a perpetual business purpose trust. A famous illustration of this is the Bosch Corporation, which has been held in a purpose trust for over 60 years.²⁰ In that case, the business is owned part by the Bosch Purpose Trust and part by the Bosch Charitable Foundation, one part generating income for the Bosch family, the other for several charities.²¹

One problem for the business purpose trust here in the United States is that most of the states that have rubber-stamped UTC section 409, providing that their purpose trust must have a very limited duration, which weighs against using a business purpose trust in the states. A

¹⁷ See Purpose Trusts Act 2015, Act No. 2015-17 (Gib.).

¹⁸ See Trusts Law, 2007 (Guernsey).

¹⁹ Alexander A. Bove Jr. & Melissa Langa, *The Purpose of Purpose Trusts*, BOVE & LANGA (Mass. Laws. Wkly.), Mar. 1, 2004, at 1, 3.

²⁰ See *Robert Bosch: Legacy*, BOSCH, www.bosch.com/stories/robert-bosch-legacy [<https://perma.cc/9G76-RJTH>].

²¹ See *Who We Are*, ROBERT BOSCH STIFTUNG, www.bosch-stiftung.de/en/who-we-are [<https://perma.cc/8Y3K-AUQS>] (stating that the foundation “directly serves charitable purposes,” while the shareholder also “receives a proportion of the distributed dividends in the company.”).

few states, such as Delaware, New Hampshire, South Dakota, and Oregon, had the foresight to allow such trusts to continue in perpetuity.²²

The use of a purpose trust in the business context can take a number of different forms, depending of course on the family circumstances and objectives. For the sake of simplicity, let's picture a perpetual purpose trust to which all of the controlling interest in a closely-held family business is transferred. The trust would provide that the company would be managed by carefully chosen individuals, including family members and possibly certain long-term employees or outside consultants. The trust would include provisions for an advisory committee, which could also include family members, to allow them to participate in company management and decisions. Note that the business could continue to be run by its existing managers, but they would answer to the trustees of the trust which owns the shares, and the trustees would answer to the enforcer (which could also be in the form of a committee) but typically, less active than the advisory committee. Finally, most business purpose trusts contain provisions for a trust protector (or protector committee) who could amend the trust, change the trust situs or governing law, or the rules for removing and appointing members of the other committees. Unless otherwise desired, the trust could prohibit a sale of the company or control by outside investors.

Though the above arrangement may appear to take away benefits from the family, the trust/business structure can be quite flexible. For example, family members who are not employed by the company could hold (individually or through a trust) dividend-paying, non-voting shares of the company, generating a share of the company profits. Family members who are employed by the company can receive salaries and bonuses as appropriate.

Once the decision is made to carry on the business for the family (and in some cases for the public) in perpetuity, the first step, of course, is to transfer the ownership and control of the business to the trust. Unlike the "normal" trust, unless there is a charitable objective, the purpose trust has no dispositive provisions. Replacing the dispositive provision is the statement of the trust purpose, which in this case would be the maintenance and enhancement of the Family Company. In transferring the ownership to the trust, the owners(s) would encounter the same valuation concerns (minus the minority discount) as with any other transfer of this sort, so a proper valuation is important. The larger

²² See Susan N. Gary, *The Oregon Stewardship Trust: A New Type of Purpose Trust that Enables Steward-Ownership of a Business*, 88 U. CIN. L. REV. 707, 720 (2020); see also Howard Zaritsky, *The Rule Against Perpetuities: A Survey of State (and D.C.) Law*, ACTEC ST. SURVEY 2, 7, 8, https://www.actec.org/assets/1/6/Zaritsky_RAP_Survey.pdf?hssc=1.

practical hurdle typically encountered is *where does the purchase money come from?* In at least one case, the trust solicited investors to purchase bonds with an attractive interest rate, which the company would redeem as early as possible from its operation (a "bootstrap" sale).²³ In cases where use of the gift tax exemption would be meaningful, that would also be an option. Another alternative would be for the company to issue special, callable, non-voting preferred shares with a high dividend. The company could gradually redeem the outstanding preferred shares.

Since the trust's shares are not owned by any of the family members, the typical problems that go with ownership are eliminated. That is, family ownership or control disputes, divorces, early death or incompetence, creditor attacks, and tax issues (discussed below), including valuation and liquidity problems, are no longer an issue.

Once the owner(s) has made a completed transfer, either by sale or gift for valid consideration, barring retention of excess control, the value of the company should not be included in the transferor's estate. What will be included, depending on the method of sale, will be the balance of any sales proceeds remaining on death. Efficient tax planning could result in saving on this part as well. Similarly, since the other family members own no shares, the business value will not be included in their estates. As noted above, however, the original owner(s) must be careful not to retain control over the shares held in the purpose trust, as this would risk estate tax exposure.

While the business purpose trust, if properly structured, would seem to offer near "ideal" tax opportunities, there is one "catch" to the tax side of it, at least where income taxes are concerned. Because the non-charitable purpose trust is so rarely used in this country, there are practically no rules and almost no tax history on its use. All that we have at this time is a single revenue ruling²⁴ on a pet trust (also a non-charitable purpose trust), so the basic structure and tax treatment of this trust is admittedly the same as a business purpose trust. In that ruling, income from a trust was to be used for the maintenance of a cat. Since Internal Revenue Code ("IRC") section 661 allows a trustee to deduct distributions made to a trust beneficiary, the trustee proposed to deduct from the trust's taxable income distributions made for the benefit of the cat. The IRS pointed out that the other "side" of IRC section 661 is the requirement under IRC section 662 that the beneficiary report the trust distribution as income. Since the cat wouldn't be reporting the trust income, the trust could not deduct it. Thus, the ruling held and continues

²³ See generally Michael C. Farrar, "Bootstrap" Sales in the Supreme Court, 40 NOTRE DAME L. REV. 304 (1965) (explaining how businesses use bootstrap sales to avoid taxes and how this practice is viewed by the law).

²⁴ See Rev. Rul. 76-486, 1976-2 C.B. 193.

to stand for the fact that unless the trust distribution will be reported by an individual or non-charitable entity as income, the trustee will not be entitled to a section 661 deduction for the distribution.²⁵

Accordingly, even if the purpose trust distributes its profits, unless the distribution qualifies as a charitable deduction or is a deductible business or investment expense, the trust will be taxed on its income at the higher trust tax rates.

Estate taxes are another story, however. Whereas in the typical successful family business picture, some or all of the business value would be included in the owners' estates, then possibly again in subsequent generations, accompanied of course by valuation issues and possible family obstacles, the use of a business purpose trust could avoid estate taxes, costs, loss of value, and insure longevity of the business. In addition, it has been found that the purpose trust arrangement results in greater retention of employees, as they don't feel they are working to build a company for sale to others, with new management and more profit for the selling shareholders.²⁶

More specifically, the typical objectives of a purpose trust ownership would reflect the following:

1. Ensure retention and continuation of the business indefinitely;
2. Allow family members, descendants, and key employees to manage or participate in management of the business;
3. Provide benefits to family members in and out of the business, as well as other parties, such as employees and charities;
4. Consider and develop the favorable impact the company has on the community;
5. Protect against outside disruptions or exposure to loss of business ownership, such as divorce, lawsuits, estate disputes, and the like; and
6. Protect against sale of the business or hostile takeovers by outside investors.²⁷

Once the decision is made to form a perpetual business purpose trust, and the decisions regarding trustees, advisor, enforcer, and protector committees are thought out, the next important issue is the gov-

²⁵ See *id.* A "bootstrap" sale occurs when the buyer's payments to the seller are made primarily (sometimes totally) from the cash produced by the item purchased by the buyer (e.g., stock dividends, rent, etc.). See Geoffrey J. Lanning, *Tax Erosion and the "Bootstrap Sale" of a Business—I*, 108 U. PA. L. REV. 623, 623 (1960).

²⁶ See Alexander A. Bove Jr., *The Purpose Trust Has a New Purpose*, PROB. & PROP., July/Aug. 2019, at 40, 42.

²⁷ *Id.*

erning law of the trust. From the authors' research, the better states to consider are, in this order, Oregon, South Dakota, and Delaware. Oregon²⁸ and South Dakota²⁹ are the only two states that have specific purpose trusts statutes, and all three allow perpetual purpose trusts.³⁰ The Oregon statute was thoughtfully and specifically designed for the establishment of a business purpose trust, and in fact, unlike any other jurisdiction, domestic and international, it can't be used for any non-business type of purpose trust.³¹ Thus, if business owners wish to provide for continuation and growth of their business for generations, why not do-so in a jurisdiction with laws designed for that very purpose?

²⁸ See OR. REV. STAT. § 130.193 (2019).

²⁹ See S.D. CODIFIED LAWS § 51-1-20 (2021).

³⁰ See OR. REV. STAT. § 130.193(14); see also Bove Jr., *supra* note 26, at 42 (stating that Delaware, New Hampshire, and South Dakota allow perpetual purpose trusts).

³¹ See OR. REV. STAT. § 130.193(1).