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Trusts and Estates Forum

The Purpose of Purpose Trusts

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Raise your hand if you remember the three elements of a trust from your law school class on trust law. If you're thinking: "a trustee, a corpus, and one or more beneficiaries", you would be right. You might also remember, however, that to have a valid trust the requirements go a bit further than that. For instance, there is the three hundred year old rule it seemed only the professor understood, called the "rule against perpetuities", which, simply stated, says that a trust cannot last forever, unless it is established for charitable purposes. The term of a non-charitable trust was measured by "lives in being" when the trust was created, referring to human lives, of course, and was generally limited to 21 years after the death of a life in being at the beginning of the trust period. For this reason, most non-charitable trusts contain a provision something like, "unless terminated sooner, this trust shall terminate twenty one years after the death of the last surviving beneficiary who was alive at the creation of this trust".

As of this writing, at least 14 states and the District of Columbia have abolished or substantially extended the rule against perpetuities and a member of others have proposed legislation to do so, meaning that in such jurisdictions there is either no term limit or an expanded limit and non-charitable trusts can go on virtually forever. But even in those jurisdictions, the essential elements of a trust must still be present: a trustee, a corpus, and at least one beneficiary. The absence of any of these would prevent the establishment of the trust. The fact that a court can always appoint a trustee where there is none does not change the requirement, as the appointment itself would fulfill the requirement, assuming the court recognized the settlor's intention to create a trust. The court, however, would not attempt to supply either of the other requirements. For instance, the present or future existence of a beneficiary is essential, since without a beneficiary, there would be no one to enforce the trust, and in accordance with trust law the trustee would simply have full ownership of the trust corpus. For charitable trusts, where there is no identifiable beneficiary but rather the public as a whole who are deemed to benefit from the charitable purposes of the trust, it is accepted virtually world-wide that the attorney general of the applicable jurisdiction has the power to enforce the trust on behalf of the public. Thus, all the elements would be present.

It follows under this reasoning, then, that with very limited exception one cannot establish a non-charitable trust for a non-person or for beneficiaries whose identity cannot be determined with certainty. For instance, a trust to maintain the settlor's collection of antique automobiles would fail as not having a beneficiary who could enforce the trust, and it would certainly not qualify as a charitable trust. Similarly, a trust, whose ultimate beneficiaries are so vague that neither the trustee nor a court could readily determine whether any given individual at any time was or was not a beneficiary, would be unenforceable and therefore invalid, unless, of course, its purpose were charitable. Now, however, all this is changing.

From the offshore jurisdictions which are sometimes credited with giving us a number other unique ideas for creative trust provisions (viz., 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. Simply stated, a

purpose trust is a non-charitable trust established for a specific purpose rather than for specified beneficiaries. That is to say that 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 purpose, or beneficiaries who may receive trust property 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 offshore 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. 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 remaining in the trust.

As suggested above, the concept of the purpose trust seems to have originated offshore. While the United Kingdom still refuses to recognize such trusts, a number of other common law jurisdictions (viz., Bermuda, The Cayman Islands, Nevis, The Cook Islands, and the British Virgin Islands, among others) have enacted legislation specifically allowing such trusts. And now, even some states here in the US have acknowledged the validity of such trusts, though on a limited basis.

Section 409 of the Uniform Trust Code (2001) ("UTC") provides that,

“a trust may be created for a non-charitable purpose without a definite or definitely ascertainable beneficiary or for a non-charitable but otherwise valid purpose to be selected by the trustee”.

The UTC goes on, however, to limit the term of such a (purpose) trust to 21 years and generally limits the amount of trust property to the amount required to achieve the purpose of the trust. Interestingly, the wording of the act does not invalidate the trust after the 21 year period, it merely declares it to be unenforceable. Presumably, then, a court could, upon petition, declare

the trust invalid, inasmuch as its terms are unenforceable. When that happens, unless otherwise provided in the trust, the corpus would revert to the settlor or her estate. [Note that the Uniform Trust Code has been enacted in at least five states, and was introduced in the Massachusetts 2002-2003 legislative session as H.B. 3552.]

If a US person wished to establish a purpose trust for a longer term than permitted in the US in those states that have adopted the Uniform Trust Code, it would be a simple matter to settle one in any of the several offshore jurisdictions recognizing such purpose trusts. Some commentators feel that one of the most flexible of such jurisdictions is The Cayman Islands, under their recent 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 there is any question of certainty of the purpose or the possibility of achievement of that purpose (discussed below), the trustee may be authorized under the trust to resolve any uncertainty without the need for court intervention.

Whether the purpose trust is created offshore or onshore it must meet, as with other trusts, certain requirements or it will fail, despite the potentially broad scope of such a trust. The first requirement is that it be subject to enforcement. Most of the offshore statutes as well as the Uniform Trust Code require the trust to name an enforcer (sort of a private attorney general) and provide for court appointment of one if the trust fails to do so.

Next, the purpose or object of the trust must be certain, reasonable, and possible. The case of the late famous author, 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 on a number of 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, complicated will, written in part by Shaw himself at age 94, who is described by the court as having been “a kind of itching powder to the British public”, generated the obvious question of

whether the trust were valid and enforceable. In its holding that they were not, on the basis that they were not for a charitable purpose (since the UK did not and does not recognize purpose trusts), the opinion also indicated that at least some of the purposes were virtually impossible to carry out. 1 WLR729(1957).

Even if the purpose is possible to carry out, the court will not enforce it if it is wasteful, useless, or otherwise against public policy. An interesting illustration of this is the case of Anne Maria Burdett, whose will devised her home and contents to trustees, directing that on the day of 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 it would pass to named beneficiaries. Her will was contested by the remaindermen, but in the meanwhile the house was, in fact, bricked and boarded up as directed. Not surprisingly, extensive litigation ensued, and ten years later the remaindermen’s appeal was successful, and the trust ordered the trust to be terminated on the basis that it was wasteful, useless, and did not constitute a disposition of the property.

While these may be interesting, if not entertaining, illustrations of would be purposes trusts, what are the practical uses of such trusts that gave rise to the extensive recognition and legislation? The answer is that modern day purpose trusts can be used for personal or philanthropic purposes that do not otherwise qualify as charitable; for holding and providing for control of a family business (indefinitely, in jurisdictions not bound by the rule against perpetuities); to provide complete privacy and creditor protection where, for instance, the purpose of the purpose trust is to maintain a non-charitable foundation for the benefit of the settlor and members of the settlor’s family; and quite commonly, to hold ownership of companies which 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 US client and then make the transfer of desired assets to the trust. In the typical case, the trust and the transfer are

tax neutral, so there are no taxes to worry about (though there are IRS information forms that must be filed). So long as the governing local requirements of the purpose trust are met, it may generally be administered anywhere in the world, including the U.S., of course. Therefore, it should be possible to establish a purpose trust in an offshore jurisdiction, then after a short while, move the administration of the trust to another jurisdiction, such as the U.S., but retaining the governing law of the original jurisdiction. If certain other requirements are met, this could eliminate the need to file the aforementioned foreign trust reports with the IRS. And as planners become more and more familiar with purpose trusts, no doubt more and more purposes will be found.

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