

The Evolution of Purpose Trusts

Tenn. Code Ann. §35-15-409



In a recent informal survey of more than 30 Tennessee trust lawyers,[1] only four had ever seen a "purpose trust," only three had actually drafted one, and many admitted they had never heard of them. So what are they, and why should we ever use them?

Historically, a trust existed only if a Trustee had fiduciary duties for the benefit of a human beneficiary. The only exception was a charitable trust, which by definition has no specific beneficiaries but instead an enforceable charitable purpose. Tennessee added two more exceptions to the beneficiary rule in 2004 when it adopted a modified version of the Uniform Trust Code (UTC). First, *Tenn. Code Ann.* §35-15-408 authorizes "Pet Trusts," allowing animals as beneficiaries instead of humans. Second, the subject of this column, *Tenn. Code Ann.* §35-15-409 authorizes "Purpose Trusts," which have no specific beneficiaries but instead an enforceable non-charitable purpose.

A successful non-charitable purpose trust needs a sufficient purpose, enforceability and careful drafting.

PURPOSES

Purpose trust purposes can be almost anything imaginable. Consider that the Tennessee Uniform Trust Code (TUTC) requires only that the purpose be lawful and possible to achieve[2] and (unlike the UTC) does not require that the purpose not be contrary to public policy.[3] Flexibility, thy name is Purpose Trusts. Here is a sampling of possible purposes:

"Do-Gooder Trusts." The Restated Comments to §35-15-409 cite as a classic purpose for a purpose trust "a bequest of money to be distributed to such objects of benevolence as the trustee may select." Such a trust gives the Trustee authority to meet human needs without regard to restrictions under charity law or tax law. It may also seem more valuable and flexible to some Trustors than a private foundation or donor advised fund, despite the lack of

charitable deduction upon creation. One Tennessee lawyer has prepared two of these, which he calls "do-gooder trusts," and says the Trustors and their families have found them quite beneficial.[4]

Unique assets. Some assets may be difficult to value or to transfer, require significant security, or otherwise have special characteristics suggesting the need for a trust focused on the best interests of the property, not of beneficiaries. Such assets might include unique real property, such as an historic or treasured home; tangible personal property such as intrinsically valuable or heirloom items, such as a Picasso or other work of art, art collections, auto collections, antiques, jewelry or memorabilia; and intangibles such as royalties, cryptocurrency or other digital assets.

"Steward Ownership." Beginning in Europe but spreading to America, purpose trusts (or their equivalent) are being used to hold stock in a company in order to create "steward ownership," shifting the focus to long-term value and/or social consciousness rather than short-term returns to individual shareholders.[5] For example, a Delaware purpose trust acts as an oversight board for all of Facebook's media content to ensure independence.[6] Such trusts may serve any number of other purposes as well, essentially limited only by the Trustor's imagination and creativity.[7]

Business interests and commercial properties. A purpose trust may be a helpful adjunct to a business enterprise, for example by conducting certain business transactions separately from the enterprise's balance sheet, such as purchase of equipment to be leased to the enterprise; by holding liquid assets for a related but separate purpose from the other owners' interests; or by holding voting or management shares where ownership needs to be segregated from other shares or from shares owned by an officer or other restricted owner.

Private Trust Companies. Wealthy families owning closely held business interests may create a private trust company to be trustee for all family trusts in order best to manage those interests and keep them within the family after deaths, disabilities, or divorces. At least one private trust company in Tennessee is owned by a purpose trust.

Festivals. A purpose trust can create or maintain support of community festivals, religious ceremonies or other unique activities.

Gravesites. A purpose trust can maintain cemeteries, individual gravesites or any other property wherever situated, and fund any activities or ceremonies associated with such properties. Unlike a statutory cemetery trust, which is declared to be a charitable trust and thus has inherent limitations and restrictions,[8] a purpose trust may be far more flexible and expansive.

Cryogenics. A purpose trust can retain funds to preserve frozen embryos or even to preserve a Trustor who is cryogenically frozen at death in the hope of being revived someday when technology allows.

ENFORCEMENT

Unlike a traditional trust, a purpose trust has no beneficiaries with standing to obtain accountings or to petition a court for redress. In the case of a charitable trust, the state Attorney General acts in place of all possible charitable beneficiaries to enforce the trust purposes. Similarly, a non-charitable purpose trust needs a third-party enforcer.

The statute allows the Trustor to appoint as the enforcer either a Trustee, a Trust Protector or Trust Advisor, or an "other person," which may suggest something like a "stewardship committee" or other designated entity or group. Although the statute does seem to allow the Trustee to be his own enforcer, it is not clear how that would really work. Thus, a draftsman should carefully consider who should monitor and control the Trustee's actions. Best practice might be to name a separate Trust Protector,[9] not only to enforce the purpose, but also to be granted powers that can best ensure the long-term viability of the purpose, such as the power to modify the terms of the trust if needed.[10]

DRAFTING

Purpose. A clear statement of purpose is the heart of the purpose trust. It should be as precise as possible while still allowing flexibility during the long tenure of the trust.

Duration. The TUTC specifies a 90-year maximum duration on purpose trusts, far superior to the 21-year limit under the UTC. Still, several states, including Delaware, South Dakota, Nevada and Wyoming, allow purpose trusts to be perpetual. Given Tennessee's drive to remain among the most innovative trust jurisdictions, we should expect this statute to be amended soon to adopt a 360-year limit to match its rule against perpetuities limit, potentially greatly expanding the use of purpose trusts in Tennessee. In the meantime, a 90-year trust can be drafted to stipulate a mechanism for creating a new purpose trust at the expiration of the first term, or to allow a Trust Protector to amend the trust to adopt any longer term later authorized by statutory amendment.

Excess funds. The statute provides that a court may, upon petition by a party with standing, determine that the value of the trust property exceeds the amount required for the intended use, in which case the excess funds must be distributed. The

CONTINUED ON PAGE 48 >

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document can state where any such excess assets go; or if the document is silent, such excess reverts to the Trustor, if living, otherwise to the Trustor's successors in interest, *i.e.*, the Trustor's testamentary beneficiaries or heirs at law. Thus, it is the default taker who would have both an interest and standing to ask for such a determination. If the purpose is broad enough (for example, a "do-gooder trust"), there should perhaps never be any excess funds. In any event, careful drafting to define the taker in default may reduce the probability of any such petition.

Taxation. A purpose trust is taxed like any other irrevocable trust, so the planner must consider the usual host of gift tax, estate tax, generation-skipping tax and income tax issues.[11] Consider the tax effect of the possibility of there being excess funds, especially any potential reversion to the Trustor.

Fiduciary duty. Since there are no beneficiaries of a purpose trust, the Trustee has no fiduciary duty to any individuals, only the duty to carry out the trust purpose, subject to an enforcer, presumably a Trust Protector. In turn, a Trust Protector is a fiduciary only with respect to each power granted to such Trust Protector, and in exercising any such power, the Trust Protector's only duty is to act in good faith in accordance with the terms and purposes of the trust.[12] In other words, although a chain of duty and liability exists, no clear body of law yet exists regarding fiduciary duties (and potential breaches thereof) on purpose-based trusts rather than beneficiary-based.

In summary, purpose trusts may be beautiful buds in the garden of trusts, soon to blossom. Or in the words of Marshall H. Peterson, Esq.:

The cestui que trust is passé,
As ephemeral as a delicate Vouvray.
The purpose may be fraught.
A beneficiary there is not.
Fiduciary duty? No Way!

NOTES

1. An email was sent to all practitioners in Tennessee who are Fellows of the American College of Trust and Estate Counsel (ACTEC).

2. *Tenn. Code Ann.* §35-15-404. Delaware's statute requires that the noncharitable purpose be "not impossible of achievement." 12 Del. C. §3556.

3. The Restated Comments to *Tenn. Code Ann.* §35-15-404 do acknowledge that some purposes may be so noxious as to truly offend public policy, but that in Tennessee they are expected to be rare. The Comments also rather oddly require that the "administrative and non-dispositive trust terms … not divert trust property to achieve a trust purpose that is invalid, such as one which is frivolous or capricious," which appears to be a convoluted way of saying that the primary purpose must also not be frivolous or capricious. The Restatement (Third) of Trusts, §47, opines that "it is capricious to provide that money shall be thrown into the sea, that a field shall be sowed with salt, that a house shall be boarded up and remain unoccupied, or that a wasteful undertaking or activity shall be continued."

4. Another Tennessee lawyer described his creation of an equivalent "do-gooder trust" without specifically using the purpose trust statute by granting the lifetime beneficiary of a typical trust a limited power of appointment to appoint trust assets to any individuals he deemed to be deserving and needy.

5. Alexander A. Bove Jr., "The Purpose Trust Has a New Purpose," *Probate & Property, A Publication of the American Bar Association Real Property, Trust and Estate Law Section*, July/August 2019, available at https://www.americanbar.org/groups/real_property_trust_estate/publications/probate-property-magazine/2019/july-august/the-purpose-trust-has-new-purpose. Mr. Bove also describes perhaps the first attempt at a purpose trust, created under the will of George Bernard Shaw, who died in England in 1950. The trust instructed the trustees to develop a new "improved" alphabet and then to promote such alphabet. The English court held the trust void. Perhaps Tennessee's statute would now condone and enforce such a purpose, depending on whether the purpose is "possible to achieve."

6. Thomas, Duda and Maurer, "Independence With A Purpose: Facebook's Creative Use of Delaware's Purpose Trust Statute to Establish Independent Oversight," *Business Law Today, A Publication of the American Bar Association Business Law Section,* December 2019, available at https://businesslawtoday.org/2019/12/independence-purpose-facebooks-creative-use-delawares-purpose-trust-statute-establish-independent-oversight.

7. A sample form for a purpose trust as sole owner of an LLC can be found at https://emlaw.com/wp-content/uploads/2020/10/abf-Special-Purpose-Trust-Form.docx, generously provided by Richard Johnson and Aaron Flinn of Waller Lansden Dortch & Davis, LLP, in Nashville.

8. *Tenn. Code Ann.* §46-7-101 et seq.

9. Effective May 10, 2019, *Tenn. Code Ann.* §35-15-1301, et seq., provides that a Trust Protector may be an LLC rather than an individual, to be known as a "Special Purpose Entity" (SPE), if it meets certain requirements. The trustee of the trust must be a Tennessee corporate trustee, but the LLC may consist of one or more individuals from any jurisdiction. Such an LLC may be only thinly capitalized, or perhaps have no capital at all, thus effectively reducing the risk of liability for breach of fiduciary duty. It may also provide continuity in the event of an individual Protector's death or disability. A Tennessee SPE would also give Tennessee resident status to non-resident Protectors if a Tennessee nexus were desirable for income tax or other reasons. The cost is an initial fee of $1,000 to the Department of Financial Institutions plus an annual renewal fee of $1,000.

10. A surprisingly long list of possible powers that may be granted to a Trust Protector is provided in *Tenn. Code Ann.* §35-15-1201. The draftsman of a purpose trust should choose wisely from among them to give the Trust Protector enough power to protect the purpose but not enough to stray.

11. Distributions to beneficiaries from an irrevocable trust normally carry out distributable net income (DNI), requiring the Trustee to issue Form K-1 to each such beneficiary to report his or her share of the income, to include on their own personal income tax return. However, a purpose trust technically has no beneficiaries, only potential distributees. Thus, it might make more sense, depending on the trust's purpose, for the Trust to pay all federal income tax under the income accumulation rules of Regulation §1.661(a)-1, rather than taking a deduction for distributions to distributees under Regulation §1.661(a)-2, even if that caused taxation at a slightly higher tax rate in the trust than the distributee's tax bracket, as taxing the distributee might unnecessarily complicate the distributee's life with tax reporting, and thus be inconsistent with the trust purpose. There appear to be no rulings on this issue yet, other than Revenue Ruling 76-486, which concerned a pet trust.

12. *Tenn. Code Ann.* §35-15-1202.