



THE
NORTHERN TRUST
INSTITUTE

THE PURPOSE TRUST

MONETIZE YOUR BUSINESS WHILE PRESERVING ITS LEGACY
FOR FUTURE GENERATIONS

A COMMON DILEMMA

Many business owners at some point may face a common dilemma. On one hand, they would like to transition out of owning and working in their business. Perhaps family succession is not an option — there are no family members who are ready or capable of taking over the business. On the other hand, their company is like a “third child” to them — the business owner cares deeply about the legacy of their business, their employees and the community that they serve. They may ask themselves:

“
*How will I know that my
business will be taken care of
by the new owner?*”

“
*How can I ensure my business
will be in good hands 50
years from now, when I am
no longer around?*”



A NEW APPROACH

The traditional approach to business ownership transition has been to sell the business to a third party (for example, a private equity firm) or set up an employee stock ownership plan (ESOP). These strategies have been proven and are, in many cases, the best option. However, a relatively new structure has emerged that some business owners are using to address the dilemma described above.

The concept of transferring ownership of a private business to a purpose trust was first popularized several years ago when the Patagonia transaction was announced.¹ However, purpose trusts are not just for billionaires, nor do they require the owner to donate their business to charity. In fact, a purpose trust transaction can be appropriate for businesses of any size and, when structured properly, can allow the owner to monetize their stake in the business while at the same time ensuring that the values of their business are preserved for future generations. This guidebook offers insights for business owners who may be interested in exploring a purpose trust transaction structure for their own business.²

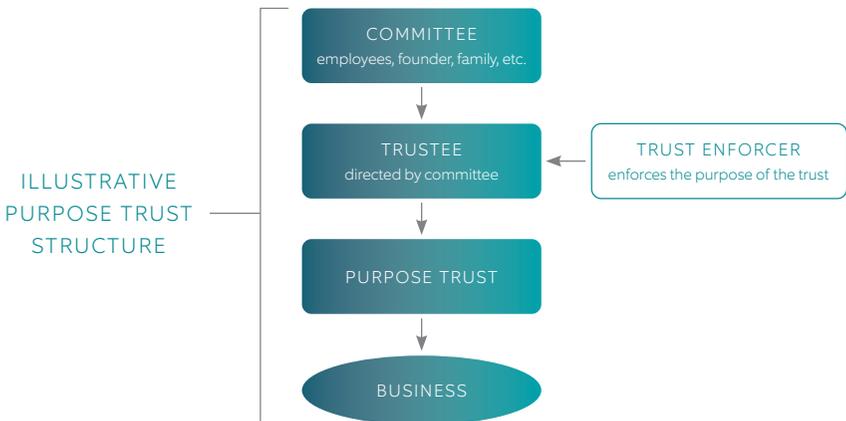
1 Yvon Chouinard, "Earth Is Now Our Only Shareholder," Patagonia, <https://www.patagonia.com/ownership/>; David Gelles, "Billionaire No More: Patagonia Founder Gives Away the Company," *The New York Times* (Sept. 14, 2022), www.nytimes.com/2022/09/14/climate/patagonia-climate-philanthropy-chouinard.html.

2 For a more detailed overview, see Susan N. Gary, "The Changing Landscape of Business Succession: How and Why Purpose Trusts Matter," *Ohio State Business Law Journal* (September 2023).

WHAT IS A PURPOSE TRUST?

A purpose trust is a type of trust created for non-charitable purposes that has no beneficiaries. When a purpose trust owns a private business, the stated purpose of the trust is to operate the business based on the guidelines set forth in the trust instrument.

Purpose trusts are often structured as directed trusts, where the trustee's role is solely to handle administrative duties related to the trust, and a committee is formed to direct the trustee on major decisions for the company, such as electing the board of directors. The committee can be comprised of various stakeholders such as employees, family members of the former owner, holders of non-voting stock, suppliers and customers. Because the trust has no beneficiaries, a "trust enforcer" is also appointed. It is the trust enforcer's job to ensure that the trustee is upholding the trust's purpose.



WHY CONSIDER A PURPOSE TRUST FOR YOUR BUSINESS?

The purpose trust structure may be appropriate for those who are seeking to transition ownership of their business in a way that will protect their values and way of doing business, beyond simply generating profit. The trust instrument of a purpose trust specifies the trust's purpose — which, broadly speaking, is for the trustee to operate the business in line with the values the owner wants to perpetuate. For instance, the owner may want the business to continue to serve the local community, support the company's employees and uphold certain business practices.

In a purpose trust, the business can continue to grow and adapt to changing circumstances, but it must do so within the framework of values established in the trust instrument. One benefit of this structure is that, by stating in the trust instrument that one of the purposes of the trust is to maintain ownership of the business, the business owner can ensure the business will continue indefinitely without the risk of being sold by the trustee to a third-party buyer after the business owner exits the business. This protection appeals to owners who are concerned that a buyer may, for example, decide to change how the business is operated, reduce staff or move the business out of the community.

NOTABLE EXAMPLES OF BUSINESSES THAT HAVE UTILIZED PURPOSE TRUSTS:



ORGANICALLY GROWN
Eugene, Oregon



**ZINGERMAN'S COMMUNITY
OF BUSINESSES**
Ann Arbor, Michigan



text-em-all

TEXT-EM-ALL
Frisco, Texas

TRANSACTION STRUCTURES

OWNERSHIP TRANSFER

There are various ways to structure the transaction for transferring ownership of a private business into a purpose trust. For instance, the owner may transfer a majority of the shares of the business into the trust, or alternatively, transfer the intellectual property or other key assets of the business into the trust.

A purpose trust transaction can also be structured such that the voting shares of the business are transferred to the purpose trust while most of the economic benefits of the business, in the form of non-voting shares, remain with the owner or other family members if the owner prefers that they receive a stream of income from the business rather than the lump sum proceeds from a sale.

The transfer of the company by the owner to the purpose trust can be structured in various ways as well, including by gift, sale or a combination of the two. If the transaction is done by gift, the transaction can be structured so that the business owner makes a partial or complete gift of the company to the purpose trust. If the transaction is done by a sale, again this can be the owner's entire ownership or a portion thereof.

Each of these alternatives will have different tax implications depending on the type of company and structure of the transaction, which the owner should fully explore with tax advisors before pursuing a particular transaction structure.



FINANCING OPTIONS

If the owner does not choose to monetize their ownership in the business, they may make a gift of their shares to the purpose trust. However, if they would prefer to sell their stake in the business to the purpose trust, there are several options for financing the transaction.

A portion of the sale price may be financed from the cash flows of the business. Other potential financing sources include the business taking out a conventional bank loan, or issuing non-voting preferred stock to family members or other investors. Payment of the sale proceeds to the owner may be structured as a lump sum payment at closing or as a “sellers note,” where the business pays out the owner over a certain time period.

AFTER THE TRANSFER OF THE BUSINESS TO THE PURPOSE TRUST

CASH FLOWS

After the transaction is effectuated and the business is owned by the purpose trust, the trust instrument may specify how profits from the business are to be distributed. For instance, profits may be distributed to non-voting shareholders as dividends, to employees as profit sharing, as contributions to charities, or as rebates to customers. From a tax planning perspective, given the tax rate at the trust level, the goal is often to generate no taxable income for the trust (for instance, by indicating in the trust instrument that profits may be distributed to the trust only in the amount necessary to cover administrative costs).

FAMILY INVOLVEMENT IN THE BUSINESS

Post-transaction, the owner and their family may continue to be employed by the business, hold non-voting shares, receive dividends and serve on the committee that advises the trustee without the fear of negative tax implications or unintentionally unwinding the transaction. It is important to note, however, that if the transaction is made by gift, there is some tax law uncertainty as to whether a former owner who serves as a member of the committee has a “retained interest” under Internal Revenue Code Section 2036.³ At this time, no clear guidance exists as to what level of involvement, if any, would constitute a retained interest. If the transaction is made by sale, this retained interest should not pose the same transfer tax concerns.

³ Sec. 2036 requires that a decedent include in his or her taxable estate the value of any property in which the decedent retained a lifetime income interest or the right to the possession or enjoyment of the property.



TRUSTEE ROLES AND CONSIDERATIONS

When planning the transaction, from a fiduciary perspective it is important to 1) choose the appropriate jurisdiction for the purpose trust,⁴ 2) select the right trustee, trust enforcer and committee members, and 3) clearly define the roles of each party and the stated purpose of the trust in the trust instrument. Doing so will help address potential fiduciary issues down the road, such as:

AN OFFER THAT IS HARD TO REFUSE

What if the purpose trust includes maintaining ownership of the business indefinitely, but 10 or 100 years later someone offers to buy the business for 100 times its current value? What if 100 years from now the business landscape has changed such that it no longer makes sense to keep the business in operation in its current form? Ultimately in these scenarios, the trust enforcer, committee and trustee will need to determine whether or not the overall purpose of the trust would be better served by selling. In order to avoid this predicament, it is recommended that the business owner chooses to draft the trust instrument in a way that does not prevent a sale but rather provides guidelines specifying under what circumstances the trustee is allowed to consider selling the business.

⁴ For instance, Oregon and Delaware are often described as states that have statutes designed for using purpose trusts to transfer the ownership of a closely held business.



THE TRUST ENFORCER GOES ROGUE

What if 50 years from now the trust enforcer is simply incompetent or refuses to enforce the purpose of the trust? One option for addressing this potential issue is by stating in the trust instrument that the current trust enforcer selects their successor, and creating a list of qualifications for the role. Some purpose trust structures also include a “stakeholder grievance process” that allows stakeholders (employees, vendors, investors, customers, etc.) to file a complaint if they feel that the enforcer, trustee or committee are not fulfilling their duties to the purpose of the trust.

ANSWERING TO MULTIPLE VOICES

Although a purpose trust does not have beneficiaries, there are instances where conflicts of interest may arise among parties — for instance, between the trustee’s interests in upholding the purpose of the trust and the financial interests of family members who hold non-voting shares of the business. The purpose trust structure can again help mitigate these conflicts by ensuring that the committee that directs the purpose trustee includes family members, employees and other stakeholders to provide them with a voice in the operation of the company.

PURPOSE TRUST TRANSACTION CHECKLIST

To make an informed decision about whether to pursue a purpose trust transaction, business owners should recognize that purpose trusts are one of several options for transferring ownership of a business and ensure they fully understand the benefits and considerations of each alternative.

YOU MAY CONSIDER TRANSFERRING OWNERSHIP OF YOUR BUSINESS TO A PURPOSE TRUST IF:

- Achieving the highest possible sale price for your business is less important to you than other factors such as continuing the legacy of your business
- There are no family members who you believe would be willing or capable of succeeding you as the owners of the business
- You would like to ensure that your business is not sold to a third-party buyer years later after you are no longer around
- It is important to you that your business continues to serve the community in which it operates over the long term
- It is important to you that your business continues to thrive for the sake of your employees
- The potential tax benefits (for example, deferring capital gains) of an ESOP transaction are less important to you than other factors
- You are willing to raise debt at your company to finance the transaction or, alternatively, you are willing to be paid out over a longer period of time for your ownership stake in your business
- You are concerned with the level of ongoing oversight required for managing an ESOP
- You have a sense of who the members of the committee that directs the trustee of the purpose trust might be
- You prefer a transaction that may take less time and require fewer transaction expenses than a third-party sale process or ESOP

HOW WE CAN HELP

Our experts at Northern Trust have deep experience working with business owners to combine complex estate planning strategies with the ownership transition of a private business. For instance, our sophisticated trusts and estates practice has served as trustee of purpose trusts holding private businesses, and our business advisory practice helps business owners evaluate strategic alternatives for transitioning ownership of their business. Your team at Northern Trust can help further explore whether a purpose trust transaction may be appropriate for your business and connect you with the right advisors.

EXPLORE OUR INSIGHTS

BUSINESS OWNER SERVICES

Our comprehensive guide to the services we provide business owners at Northern Trust

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PLANNING WITH PURPOSE

A new approach to planning for an effective transfer of wealth across generations

[LEARN MORE](#)

THE ROAD TO WHY PODCAST

Our Director of Business Services interviews business owners and entrepreneurs on the topics of business, family, wealth and legacy

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