

BUSINESS TRUST SUMMARY

by

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Many people may have heard of Business Trusts, including some attorneys. But in my experience, few have a clear understanding of their possible benefits when properly drafted and utilized. This brief Summary is intended to familiarize the experienced as well as the novice person as to why and how a Business Trust may prove to be very beneficial.

In a nutshell, a carefully drawn and legally operated Business Trust can enjoy many of the advantages of a corporation or other artificially created entities without the burdens and restrictions. They might be as follows:

1. Limited liability
2. Estate preservation
3. Privacy and anonymity
4. Single taxation, not double
5. Legally maintaining control as Trustee

A married couple could be facing some rather onerous tax consequences, both Federal and State, on estates exceeding just a few million dollars. A single person could be hit with a “hair cut” of 55% or more on estates exceeding a mere \$5 million! This could be even more devastating where estates lack liquidity and could therefore be forced to partially or totally liquidate, or be required to significantly borrow money in order to settle the tax burden before estates can be passed on to the intended heirs or family members.

In my past experience of conducting Business Trust Seminars all over the country the past 25+ plus years, one of the first things I’d like to point out is this: If one searches in the “T” section of the law books in most any law library, you’ll discover all kinds of laws pertaining to Trusts, such as Family Trusts, Revocable Trusts, Irrevocable Trusts, Living Trusts, Testamentary Trusts, Survivor Trusts, etc., just to mention a few.

For the most part, all of these types of Trusts rely upon and derive their power, privilege and benefit from Statutory Law for their creation and existence, meaning that statutes had to be first passed into law in order for these kinds of Trusts to be created. Even more importantly, such statutes or laws determine how they are to be treated for legal and tax purposes, both Federal and State, such as Estate Taxes and / or Income Tax.

But if one searches in the “B” Section of these same law books any similar kind of law library (such as American Jurisprudence, Second Edition, Volume 13), you’ll easily discover nearly 200 pages of all kinds of legal precedence dealing with an entirely different kind of Trusts referred to as “Business Trusts.” An obviously question comes to mind, “Why are these Trusts not in the same section of the same set of law books?” The answer has to be more than obvious: “They simply cannot be the same kind of a legal entity.”

Statutory Trusts are an anomaly in the law. I say this because they are specifically created to divide and separate Legal and Equitable Ownership of property, whether real or personal, into two persons or two classes of persons. To illustrate this, draw a big circle; then draw a line down top to bottom through the center. One-half of this circle is owned by the Beneficiary, but they lack possession and control until some future date. Control is retained by the other half of this circle, the Trustee(s) until certain conditions are satisfied, such as the Beneficiary reaching a particular age, gets married or maintains good grades in school, etc. Then the transfer of the Trust Assets can be completed and the Beneficiary is able to receive both Legal and Equitable possession of the Trust properties and / or assets. By statutory law, these two halves cannot merge or such trusts will terminate.

Attorneys, and especially bank trust departments, derive a great deal of income from all kinds of these statutory trusts because such entities require a 3rd person or entity to act as Trustees in order to carry out the conditions of the separation of this Legal and Equitable ownership. But in many instances, people do not wish to have another party involved in their confidential undertakings. They want some kind of control but are continually told this is not possible in a Trust, even to the point of claiming it to be “illegal.”

However, in a Business Trust, there is NO division or separation of Legal and Equitable title or ownership of any of the Trust asset. Trust assets are held by the Business Trust in FEE SIMPLE. For this reason, some might – and in fact quite often do - argue that Business Trusts fail to meet the statutory definition of a Trust, and perhaps they would be correct, except for those law books in the “B” section that clearly evidence otherwise. They also list many of the unique features and particular benefits of a Business Trust.

There are several kinds of Business Trusts, but for the most part, they derive their power, privilege and benefit NOT from any particular statute, but from Contract Law and the Common Law. For this reason, they are often referred to as Common Law Trusts.

A little legal history may help. Common Law is much older in this country than is Statutory Law, but is every much as legal and binding, if not more so. Common Law is based upon how mankind has been dealing with one other in commerce over many decades and even centuries, going back well into the old English Common Law, before this country was ever founded.

During Old England, King’s Rule prevailed, meaning that the final and absolute power resided with the Crown, as it had for many centuries. The King or Queen determined who was to be granted favor, such as lands or property, when and for what reason, if any, or who would be taxed and the amounts, as well as those who might be possibly enslaved, imprisoned, pardoned or even tortured and sadly executed. The people had little say in governing. The Crown even determined what religion was to be favored or allowed, but that’s a subject for another time and place.

When an English citizen of that day passed over, even if they had previously been granted the land upon which they had grazed their animals or farmed, rather than have it again seized by and turned over to the King and handed out as spoils to the Crown’s

favorite supporters, common citizens began to secretly and quietly enter into sacred private “contracts,” recording and preserving deeds and title to their lands for their own deserving families and heirs. This process was carried on throughout many of the lands that good Old England claimed as their own, like Scotland, Ireland, etc.

As we know, one of the primary reasons for the early colonist coming to America was to flee from this type of what was considered tyrannical rule by the King, and eventually, freedom and Democracy was eventually established. But before all kinds of laws and statutes could be enacted and become law, the early settlers agreed to be governed and abide by the Old English Common Laws, including Admiralty Law, an even higher set of Governing Rules between countries, something that prevails even to this day around the world. You might also recognize common law since its adoption into the Uniform Commercial Code, or UCC.

Hidden within those values of Common Law were sacred contracts that had been honored down through time as to how one generation dealt with one another, despite the possible corrupt King’s Rule. One of these was the Contract Trust or Common Law Trust, as it has also later become known. And it has continued even to this very day.

A little research will evidence that one of the most well known of these was the Massabi Iron Ore Trusts; a massive and very successful commercial mining undertaking. There are numerous others also. Many of Europe’s great banking families set up these same kinds of Common Law Trusts for a host of reasons, not the least of which was to avoid unnecessary taxation, or liability from creditors and quite often, obtain the greatest measure of anonymity from the prying eyes of the public and even their creditors.

If you do any sort of research on Business Trusts, you’ll soon learn of their prolific early use in the state of Massasschuttes. For this reason, they are sometimes referred to as Massasschuttes Business Trusts. For the most part, however, they are one and the same.

You should be mindful that there are two types of Business Trust Organizations, or as I like to refer to them as BTO’s. Later on, I’ll explain how to easily determine which type of BTO is which, for tax purposes. This is a crucial key element.

A BTO is established by Contract involving two or more people. This right to contract is guaranteed by the “liberty” clause of due process as contained in our own Constitution, specifically Article One, Section Ten. In other words, our right to contract is literally guaranteed.

As stated previously, a BTO is created by Contract and must therefore meet all three of the essential elements of a contract: (1.) Offer, (2.) Acceptance and, (3.) Consideration.

Assume that an individual (such as yourself), whom we’ll call an Exchanger, desires to transfer title to property, real and / or personal, to his or her intended heirs using a BTO. After the Contract or Indenture is properly drafted and able to become a legal entity, the Exchanger makes the Offer, fulfilling # 1 above.

Since this BTO entity is at first merely pieces of paper and just like a Corporation, cannot act or speak for itself, a real person needs to be selected or appointed to facilitate this Exchange and sign the appropriate documents for and on behalf of the BTO. This person is called the Creator, and makes the Acceptance, fulfilling # 2 above.

After the Transfer and Acceptance are completed, Shares of Beneficial Interest are issued to and received by the person making the transfer. This satisfies the third element, that of Consideration, or # 3 above. It is important to make note that all of this process is done irrevocably. In other words, the contract is completed and it is set now in stone!

Included in the BTO Contract Indenture is the naming of the desired Trustee or Trustees, including their all-important powers, such as whether the BTO is to be ruled by a mere majority vote, if more than one Trustee is appointed, or by a unanimous vote.

Here is another key element of a BTO: The Transferor or Exchanger can be named as and appointed to be one of, if not the only initial Trustee of the BTO, “as if,” they were a completely different person in the law. In other words, they are occupying more than one role in this contractual undertaking. Obviously, upon his or her death, the BTO contract could, and should provide for subsequent Successor Trustee(s) to take over so that the BTO might continue forward as originally intended.

Although not mandatory, it is recommended that all the above steps in #1, #2, and #3 above, be undertaken before and witnessed by a Notary Public. Thereafter, the initial Creator’s function is then completed as defined within the BTO Contract or Indenture and their role is ended and they resign, having fulfilled their limited and only duties.

The BTO is then able to immediately begin doing business just as is any other artificial entity, such as a Corporation, LLC or Partnership. It can open up a checking account, enter into agreements to purchase or sell property, whether real or personal, open and operate a business, hire or fire employees, etc. It obviously needs to establish and keep its own set of books and records. Most importantly, if dealing with the public, it should obtain its own requisite Business License, Tax I.D. #, then file and report any earned, retained or distributed income, both Federal and / or State, as the case may be, etc.

If the BTO distributes any income to the Certificate Holders from time to time, such distributions would be treated as a deduction or expense to the BTO and the receiving person or entity could be subject to the appropriate ordinary income distribution as the case may be. A BTO issues either W-2’s or 1099’s and would file a 1041 Federal Tax Return.

Caution: In this day and age, it’s rather common to find controversial and conflicting information about virtually any topic, especially on the internet. Some of it might be quite accurate and some not. This is particularly applicable to BTO’s for two primary reasons:

1. They are not as commonly used today as are many other forms of artificial business entities, such as a corporation, LLC, etc.
2. Some people have established BTO’s and then unfortunately, conducted themselves in an illegal manner for tax purposes. I’ll give you an example:

If you were to establish a BTO, then operate it “as if,” it was just you, including failing to open up a separate bank account, but instead wrote checks for it to pay your own personal expenses, and more importantly, you failed to keep separate books and records and then also failed to properly file applicable tax returns for a number of years, you would naturally expect the IRS to take a very dim view of this activity and likely deal with it as illegal or a “sham.” Why? Because it highly likely is. Form alone is not necessarily controlling in such a case. One must also look at the substance of what is taking place.

This kind of an example cannot, and should not be viewed as applicable for each and every other BTO use or experience, any more than if one set up a Partnership, LLC or a Corporation, and conducted them in a similar “sham” fashion. Such would not make every Partnership, LLC or Corporation illegal. Each and every case must be investigated based upon its own individual set of circumstances, both as to the applicable documentation and laws, as well as to the conduct of the business itself. You can’t merely brand everything with the same hot iron, even though others, especially the IRS, might wish otherwise.

The IRS prefers to get their hands on such sham situations where they can literally “scare,” the unsuspecting public into compliance with their preferred way of doing business simply because they might not understand even what a BTO is all about, or merely suspect it might be engaged in some kind of tax evasion, just because it’s unfamiliar to them, whereas a Partnership, Corporation or LLC may not be.

In other words, be cautious and do not engage in merely “throwing the baby out with the bath water,” before first doing your own legal research, rather than relying upon even well intended second hand advice or opinions. The BTO topic is certainly not new and isn’t that difficult to understand and properly follow if you know the basics.

We must remind ourselves that by properly following the applicable law regarding BTO’s, you have nothing to fear, any more than you might if establishing a Partnership, LLC or Corporation, or a properly drawn and utilized Statutory Trust. I have had extensive legal back-up regarding BTO’s, and have also been involved in many IRS audits of BTO’s, where nothing whatsoever was found to be out of compliance in the slightest manner. I’ve also seen some major problems and big-time screw-ups that have occurred.

CHANGING OWNERSHIP OF PROPERTY

There are only three (3) ways to change ownership in a piece of property, whether it’s a piece of real estate or personal property, such as a bank account, mutual funds, stocks, bonds or a brokerage account.

SELL, GIFT or EXCHANGE

With few exceptions, all three ways create a taxable event.

If something is SOLD, in order to determine what taxes might be due, one must look at the value of what is received, then deduct the cost or basis of what was sold, and unless

there is some exclusion, Federal Income or Capital Gains Tax (and possibly State Income Taxes) could be due.

If something is GIFTED, in order to determine what Federal Gift Taxes might be due, one must look at the value of whatever is gifted, then after taking into account any exclusions, calculate the Federal Gift Taxes due based upon the Gift Tax Table

(See Federal Gift Tax Schedule).

If something is EXCHANGED, in order to determine what Federal Income Taxes (and possibly State Income Taxes) might be due, one must look at the value of what is exchanged vs. what is received. In some cases, one can enter into a Section 1031 “Tax Free” Exchange, but that is usually limited to real estate only.

Where a BTO has a big advantage over other types of business entities, including even Statutory Trusts, is in how the property, real or personal, is transferred into it. It is done by EXCHANGE, and a taxable event is actually created. I’ll explain.

First, the BTO Contract or Indenture document must be drafted. Then someone must be designated to act as a Creator, on behalf of the initial Exchanger, who seeks to transfer his or her property, real or personal, into the named BTO. As previously stated, this is done by Contract. The Exchanger or Transferor receives 100 Certificates of Beneficial Interest in the named BTO.

These Certificates state: “These Certificates Contain the Rights of Royalty Income Only to the Holder Thereof at the Sole Discretion of the Trustee(s).”

But here’s an important KEY: These Certificates also state that: “Upon the death of the holder thereof, these Certificates become Null and Void.” In other words, for tax purposes, what has been created is:

AN OPEN TRANSACTION THAT NEVER CLOSES!

Upon the death of the original Exchanger, their Certificates revert back to the BTO and the person or persons appointed as Successor Trustee(s) have absolute authority to issue new Certificates to anyone of their choosing. Since just like in a corporation, the Trust itself doesn’t die or cease to exist unless the Trustees decide that all assets are to be sold and the BTO dissolved. In other words, since the BTO doesn’t die like a natural person, there can never be any “death tax,” Federal Estate Tax, or State Inheritance Tax upon the BTO assets after once being initially transferred into it.

But of course, upon the distribution of any BTO income, the Certificate Holders would each be subject to their share of 1099 reportable income, just as they would if the Trustee(s) elected to sell all of the BTO assets and liquidate the Trust, the latter being classified as Capital Gains.

Since the BTO Certificates are of “Undeterminable Value,” and “Become null and void upon the death of the holder thereof,” they obviously should not be subject to any Probate, Gift, Federal Estate Tax or State Inheritance Tax.

The key to the continued operation of the BTO resides solely with the Trustee(s), but not the Beneficiaries. The BTO contract allows the Trustee(s) to deal with and treat the BTO assets “as if,” it was their own personal property, whereas the Beneficiaries are to remain silent and solely dependant upon the Trustee(s) for a Contingent Right to Royalty Income only, if any.

Moreover, the Business Trust law allows the same persons or classes of persons to act both as Trustees and as Beneficiaries, “as if,” they were two separate parties in the law.

A good example of this might be as follows: You could be acting as a President of one corporation, a Partner in another company and as a CEO or Secretary in a third company, each with separate and distinct powers, duties, compensation and limitations under applicable law. Yet at the same time, you also carry your own individual entity as a real person.

For example, suppose a BTO has an asset worth \$1,000,000 and the Trustee(s) decided to sell everything. They are totally free to do so but the proceeds are to be contractually divided. Assuming three Certificate Holders, each one would receive their proportionate and rightful share or \$333,333.

Such a distribution may be subject to income or capital gains tax to the recipient Certificate Holder unless they have established themselves with their own BTO, in which case such income might also be received with favorable tax consequences, depending upon the jurisdiction of where such a BTO may have been created. More on that late

In Summary, when properly drafted and utilized, a Business Trust, or better yet, multiple BTO’s, can accomplish many beneficial aspects of passing one’s assets to their intended heirs without probate, gift, state inheritance taxes or Federal Estate tax, all with the greatest measure of privacy and protection from creditors, yet retain control of their estate assets “as if,” all assets were still in their own name(s) during their mortal existence.

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