

What Is A Business Trust?

**Before answering that question, maybe you should also ask yourself:
“Just how do I preserve my privacy, protect my assets against judgments and lawsuits, and significantly reduce income taxes, but not be exposed to the inherent risks of a sole proprietorship, partnership, corporation or other legislatively created types of business entity?”**

A Business Trust can and does accomplish all of these factors and more.

But...again, what is a Business Trust?

A Business Trust is recognized by the [Internal Revenue Service and by the courts](#) as a U. B. O. (Unincorporated Business Organization).

A Business Trust (U. B. O.) is a powerful entity by which individuals may combine their resources to operate a business for profit without the inherent liabilities of a partnership or the double taxation of corporations.

The U. B. O. is an organization created and managed by "Trustees" for the benefit and profit of persons who hold or may acquire transferable Trust Certificates. Similar to stock certificates of a corporation, Trust Certificates provide individual holders evidence of interest in the Trust estate (assets/income).

A U. B. O. is often called a "Common-law Trust," but this phrase is not descriptive of any of the peculiar characteristics of such organizations. The basis for the terminology "Common-law Trust" is that they are created under the common law of contracts and do not depend upon any statute for its existence. See the [United States Constitution, Article 1 Sec. 10, Clause 1](#).

As indicated by its name, a Business Trust is an estate adapted to business or commercial activities. Reduced to its bare essentials, the U. B. O. consists of some form of capital vested in trustees who manage the entity profitably for Trust certificate holders.

A U.B.O. is created when one or more persons transfer the legal title in property to trustees, with power vested in the latter to manage and control the property and business and to pay the profits of the enterprise to the Certificate Holders of the Trust or their successors.

In its typical and characteristic form, the U. B. O. is brought into being by a Declaration of Trust or Trust Indenture. This document makes all the provisions of who is whom and who is responsible for what, relative to the Trust activities.

The U. B. O. which had its beginnings in England in the 18th Century adapts the ordinary trust to the new purpose of carrying on a business.

Two of the most famous early business Trusts in England were Lloyds of London (1811), and the London Stock Exchange (1802). An explanation of their function, under the Common-law of England, can be found in [Smith v. Anderson, 15 Chancery Division 247 \(1880\)](#).

The Business Trust made its debut in Massachusetts in 1827. As a result, a U.S. Business Trust today is often called a "Massachusetts Trust" in legal circles. The U.S. Supreme Court defined the Massachusetts Trust as a form of business organization, common in Massachusetts, consisting essentially of an arrangement whereby property is conveyed to trustees: in accordance with terms of the Trust. The business is to be held and managed for the benefit of persons who hold transferable

certificates issued by the trustees showing the shares into which the beneficial interest in the property is divided. (Hecht v. Malley, 265 U.S. 144 (1924)) (446 U.S. 458, 469).

This U. B. O. method of transacting business in commercial enterprises originated in Massachusetts as a result of negative laws prohibiting the development of real estate without a special act of the legislature; or in other words, without "permission" of the State. So, the Business Trust was created under the Common-law right to contract to obtain legislatively constructed business organizations advantages but without having to gain "permission" to enter into a business activity and suffer under the burdens and restrictions that are placed on "statutorily constructed organizations".

During the last century and through the mid years of this century, the tax laws and State regulations strongly favored corporate structures. Detrimental and restrictive changes in these laws in the past 10-15 years have resulted in the resurgence of the use of the U.B.O. For example, in 1985, the Scudder Capital Growth Fund, Inc. and Kemper Money Market Fund, Inc. changed their forms of organization from corporate to a Business Trust Organization.

There are nine basic advantages of operating a business as a U. B. O. which cause it to operate lawfully:

- 1) The U. B. O. is formed by contract between the parties setting forth the purposes, terms and conditions.
- 2) The U. B. O. is a legal entity and an artificial individual, with rights almost equal to a natural person (a human being), able to own property and conduct business like a natural person. It is irrevocable and no one has any reversionary right to its assets.
- 3) The U. B. O.'s assets are owned and its business activities managed by the trustees who accept such responsibility as fiduciaries on behalf of the beneficiaries.
- 4) The beneficial interests are divided into 100 Capital Units, evidenced by the issuance of Trust certificates, conveying to the holder limited rights to receive their pro-rate share of any distributions of income or assets that may be made by the Trustees.
- 5) The Certificate Units are personal property of the holder, and convey neither legal or equitable title to the Trust property, nor any voice in the management of its business or the selection of its Trustees.
- 6) The U. B. O. is subject to taxation on any undistributed net income and files a 1041 Fiduciary Return. The Certificate Holders are only taxed on what they receive as a 1099 or a K-1 distribution.
- 7) The assets of the U. B. O. are never subject to probate or estate tax because, as an artificial person, it never dies. Unlike a will, the U. B. O. is set up in contemplation of life, not death.
- 8) The Certificate Units become void upon the death of the holder and thus have no value to be subjected to estate tax or probate.
- 9) The life of the U. B. O. can be extended as deemed advisable by the Trustees. Or it may be terminated at any time by the Trustees in accordance with the Trust Indenture.

Since the Trust Indenture is a contract between the creator and the trustee, it controls the activities, powers and responsibilities of those who administer the Trust. No one has legal authority to change its provisions except those so authorized by the Indenture. Foremost among the advantages of trusteeship over the standard legal devices is its flexibility.

The document creating the Trust is the contract of the Trust, not statutes created by the State.

[Courts have long since supported the principal of the trustees carrying out the terms of their Trust contract.](#) Also, Trust property cannot be held under attachment nor sold upon execution for the Trustee's personal debts. Personal liability of a trustee cannot be enforced against the Trust property. If the trustee personally own any amount of Trust Certificates, these are personal property and can be attached.

This doctrine is supported in the case of United States National Bank of Omaha v. Andres Kaminski (Civil Action NO 77 Cv. 1830, District Court of Jefferson County, Colorado, June 16, 1980). The Bank alleged that Kaminski owed them \$20,000. When he had no personal assets to seize after they obtained a judgment, they tried to seize the assets of his Trust which he'd set up several years earlier. The Bank's action failed and they were unable to penetrate the Trust.

Beneficiaries cannot be held liable for debts incurred by the Trust. "If in fact, a true Trust has been created (and this is very important, i.e. the Trust must correctly be written and executed), the Certificate Holders are not personally liable on the obligations incurred by the Trustees or managing agents appointed by the Trustees.

Exposure to liability and potential law suits is one of those worries most of us lay awake at night thinking about, especially if we have a business where potential liability is omnipresent.

The past several years has seen the rise of countless bankruptcies being filed. Even many of the long thought of stalwarts of American industry have gone bankrupt. Big companies - including a big 8 accounting firm - and little ones like those of us who make up the vast majority of America's gross national product have been forced to take this route.

10 BIG ADVANTAGES OF A BUSINESS TRUST

Although businesses are organized as corporations, partnerships or sole proprietorships, one even better way to organize a business is as an Unincorporated Business Organization Trust.

"A business or common-law trust, commonly known as a Massachusetts trust, is a form of business organization consisting essentially of an arrangement whereby property is conveyed to trustees, in accordance with the terms of an instrument of trust, to be held and managed for the benefit of such persons as may from time to time be holders of transferable certificates issued by the trustees showing the shares into which the beneficial interest is divided, which certificates entitle the holders to share ratably in the income of the property, and on termination of the trust, in the proceeds thereof."[Corpus Juris Secundum 12A 495.]

"The essential attribute of a business trust is that the property is placed in the hands of trustees who manage and deal with it for the use and benefit of the beneficiaries." Enochs & Plowers v. Roell, 154 So. 299, 170 Miss 44.

The U.S. Supreme Court recognized the existence of business trusts and explained their advantages in the case Morrissey v. Commissioner of Internal Revenue, 56 S. Ct. 289, 296 U.S. 344, 80 L.Ed.263.

Common law trusts are not new. Some major US businesses that were originally organized as common law trusts include: American Express, Pepperell Manufacturing, Massachusetts Electric, Chicago Elevated Railroad and Associated Simmons Hardware.

The common law trust is created by a private written contract. A trust contract is basically created by two or more individuals: trustor or grantor and trustee. The trustor or grantor (the owner of the assets being transferred into the trust), makes an offer to the trustee to manage the trust. The trustor exchanges his or her assets (such as business interests, real estate, stocks and bonds) to the trustee for 100 Certificates (personal property similar to shares of stock in a corporation).

Is the UBO Trust Legal?

One of the common questions arising in the formation of Common Law trusts surrounds its legality. The enclosed legal citations are some important cases validating the common law, contractual company, pure Unincorporated Business Organization Trust entity.

ARTICLE 1, SECTION 10 of the United States Constitution.... ***"No state shall pass any law impairing the obligation of contracts."***

CONFIRMING THE TRUST CONTRACT

A) Certificate Holders are devoid of legal rights, have no officers, are and must remain forever mute as to the selection, approval or disapproval of the trustees and their methods of conduct of business affairs would make the trustee absolute owner. Bourchard v. First People's trust, 253 Mas 351, 148 NE 895.

B) Right to Contract Schumman-Heink v. Folsom, 159 NE 250 (1927)

C) United States Supreme Court has long held and recognized that freedom to make contracts and have them enforced by the courts is a part of the bundle of rights protected by the "due process" clauses of both the Fifth and Fourteenth Amendments. Paterson v. Bank Eudora (1903) 190 US 169, 47 L Ed 1002, 23 SCt 821 and Muller v. Oregon, 208 US 412, 52 L Ed 551, 38 S Ct 324 1908v. U.S. 157 US 160, 39 L Ed 657, 15 S Ct 586 (1895).

D) The trust contract is established by private parties, for personal purposes, is not registered with the state corporation commissioner to comply with statutes relating to incorporating and does not invalidate the trust organization. Hodgkiss v. Northland Petroleum Consolidated, 104 Mont 328.67, P 2d 811.

E) Certificate holders of a Trust Contract enjoy an even greater immunity from personal liability than is accorded to stockholders of corporations. Goldwater v. Oltman, 210 Cal 408, 292 P624, 71 ALR 871.

F) One of the main objectives of a trust contract is to obtain most of the advantages of corporations, but with freedom from the burdens, restrictions, and regulations generally imposed upon them. Ashworth v. Hagen Estates 165 Va 151, 181 SE 381.

G) The United States Supreme Court has acknowledged the Trust contract as a "pure or true" trust, citing the Hecht case in Navarro v. Lee and Hecht v. Malley 265 US 144 (1924) and Navarro v. Lee 446 US 458(1980).

H) Business trusts are found in Corpus Juris Secundum and American Jurisprudence, 2d.

I) Business trusts are recognized under the term "common law trust" 88 American Law Reports 3d 704, citing Schumann-Heink v. Folsom 328 III 321, 159 NE 250, 50 ALR 485 (1927).

J) A Trust is one of several juridical devices whereby one person is enabled to deal with property for the benefit of another person. Restatement of the Law of Trusts, 2d Introduction Note, Pa. 1.

K) Any law or procedure materially affecting contract rights necessarily impairs the obligation of the contract upon which right is founded and is, therefore, violative of the United States Constitution. Smith v. Morse 2 CA 524.

L) The creation of a Pure Trust is not subject to legislative control. The United States Supreme Court holds that the trust relationship comes under the realm of equity based upon common law and is not subject to legislative restrictions as are corporations and other organizations created by legislative authority. Eliot v. Freeman 220 US 178.

M) The creator of a Pure Trust may mold and give it any shape he chooses, and he or the trustees may provide for the appointment of a successor or successors to the trustee or trustees upon such terms as he may choose to impose. Shaw v. Pine 12 Allen (Mass) 293; also in Harwood vs. Tracy, 118 Mo. 631, 24 SW 214.

N) The court will support the trustees in carrying out the terms of their Trust contract and agreement. Clews v. Jamison, 182 US 461, 21 S. Ct. 845.

O) Trust property cannot be held under attachment nor sold upon execution, for the trustees' personal debts. Personal liability of a trustee cannot be enforced against the trust property. Mayo v. Moritz, 24 N. E. 1083 (1890).

P) If the Trustee owned personally any amounts of beneficial interest, these Certificate Units can be attached. Hussey v. Arnold 70 N.E. 87 (1904).

CONTRACT TRUST RECOGNIZED BY IRS

A) Internal Revenue Regulations acknowledgement of contract Trust Organization. IRS Regulations 301, 7701 4 (b) Berry v. McCourt 204 NE 2d235, 240.

B) An "exchange" is a reciprocal transfer of property as distinguished from the transfer of property for a money or consideration only. TR 118, S. 39.112 (a) 1(e).

C) The owner of Beneficial Certificates is not an owner as a stockholder is an owner; the Certificate Holders have no ownership whatever in property held by the Contract Trust, nor do they have any voice or control over the Trustees. Becker v. St. Louis Union Trust Co. 296 US 48, 50; 80L ED35:56 S CT 78.

D) "The Internal Revenue Code classifies a Trust as an 'individual' for tax purposes." Trusts are included with persons and "individuals" in Section 1 which lists entities which are subject to tax. Also Section 3(b)(2) refers to Trusts as individuals. Also the tax forms for trusts clearly illustrate they are not to be Corporations, partnerships, etc. "A trust certificate, while valuable, has 'no determinable value' when exchanged for assets, and thus there is no taxable event because of this

exchange, as determined by the U.S. Supreme Court Burnett v. Logan 283 U.S. 404), also (Stern v. C.I.R., 747 F. 2d 555(1984).

NO GIFT OR ESTATE TAXES

A) Certificates have no ascertainable "Fair Market Value", and have minimal value to someone else. Bad bargains do not result in taxable gifts. Contract Trust in a genuine business transaction. Estate of Anderson V. Commissioner of Internal Revenue. 8 Tax Court 706.721.

B) Rationale of federal estate tax is not a levy on property of the estate but on its transfer at death. Second National Bank of Newhaven v. U.S. 422 F 2d 49 (1970).

C) If a bona fide transfer, sale or exchange is made at arm's length in the ordinary course of business, the transaction will be assumed to be for consideration and not gratuitous. A consideration that is not reducible to a value in money or money's worth, i.e., love and affection or promise or marriage, is to be wholly disregarded and considered totally gratuitous. Internal Revenue Service "Federal Estate and Gift Taxation Publication" #488.

D) The United States Circuit Court of Appeals for the First Circuit has long held that full and adequate consideration is met by issuance of trust certificate units in exchange for real and personal property invested in a "pure" trust organization. Carpenter v. White, CIR, 80 F 2d 145.

E) The measure of the gain of an exchange is the difference between the (adjusted) cost basis of the property transferred and the fair market value of the property received. Internal Revenue Code 1001 (a), (b) Parrington v. Attorney General, LR. H. L. 100. 122.

F) No "Equitable Construction" of a tax statute. Code must be strictly construed. Gain [is] measured from fair market value of property received. U.S. v. Merriam, 263 US 179 (1923), Commissioner v. Harrelson 282 US 55 (1930), Gould v. Gould US151.

G) The "fair market value" is the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell, and both having knowledge of all the relevant facts. It may not be determined by a forced sales price, nor is it to be determined by the sale price of the item in a market other than that in which such item is most commonly sold to the public. Federal Estate and Gift taxation, Publication No. 448, Davis v. U.S. (1961) 287 F 2d 168, 82 S Ct. 805 affirmed in part and reversed in part on other grounds, 370 US 65, 82 S Ct 1190, 8L Ed 335, Rehearing denied 371 VS 854 , 83 S. Ct 14, 15.F).

H) IRC Section 1001 (b) requires that the capital gain be measured by "the fair market value" of the property received (emphasis added) by the taxpayer, not by the fair market value transferred by the taxpayer in exchange for the property received. To say that the fair market value of the property received is the same as the fair market value of the property given up not only ignores realities, but is the use of a formula which is radically different from the recognized formula approved by the courts for determining fair market value. Commissioner v. Marshman 279 F 2d 27, Cert. den. 364 US 918,8 S Ct 282, 286; 5 L Ed 2d 259, Maxfield v. U.S. 152 F 2d 593, Cert. den. 2 Cases 327 US 791,66 S Ct 821.9.

I) This definition primarily benefits the Treasury in estate tax situations. However, IRS may not have one definition for "fair market value" at one time when it is beneficial, and a different one for another time when the benefit goes to the taxpayer. The IRS is obliged to keep their conclusion that the fair market value of valuable beneficial units cannot be determined in any forum other than a voluntary sale. The IRS may not force a sale to determine price where the item displays an inherent yet unsettled value. They may also not force the beneficial units to be sold in a market other than that in which such certificates may commonly be sold to the public. In addition, when the Treasury says "public", they mean at retail rather than wholesale. The value of the above definition is evident in the point that the client may plan affairs around hard and fast rules not subject to change. Federal Estate and Gift Taxation, Publication No. 448, p. 39 Burnett v. Logan, 283 US 404, 51 S Ct. 75 LED 1143 (1931).

J) Interests which terminate "on" or "before" death are not a proper subject of the Federal Estate Tax. Knowlton v. Moore, 178 US 41, 20 S Ct 747, 44 L Ed 969(1900); YMCA V. Davis. 264 US 47 (1924), 44 S Ct 291, 68 LED 564; Goodman v. Grander, 243 F 2d 264 (1957); Babb v. US 349 F Supp 792(1972).

K) Because Code Sec. 644 does not provide a method for determining the basis of property transferred (into a trust), Code Sec.2516 of the gift tax provisions controls. Under Code Sec. 2516, the distribution of (property) was deemed to be a transfer for full and adequate consideration --. Accordingly, the trust's basis in the (property) was its "fair market value on the date of transfer." (St. Joseph Bank and Trust Co., Ca-7, 83-2 USTC 9586 (907CCH - Standard Federal Tax Reports 46, 191.))

CONTRACT TRUST AS A LEGAL ENTITY

A) The Contract Trust owns the property and is a distinct legal entity. Beneficial Certificate Holders are not treated as co-owners of trust property. National City Finance v. Lewis (Cal App) 3P 2d 316 (Rehearing denied) 4P2d 163; Beilin v. Krenn & Dato 350 III 284, 183 NE330; Hemphil v. Orloff 238 Mich 508, 213 NW 867, 58 ALR 507, and 277 US 537, 72 L Ed 978. 48 S Ct 577, Annotation 156 ALR 32. Goldwater v. Oltman, 210 Cal 408: 292 P 624.

B) The Contract Trust does not escape the necessity of having substance and business motives. "Sham" transactions, having no economic effect other than the creation of income tax losses, cannot be recognized for tax purposes. Thompson v. Commissioner. 631 F 2d 642. 646 (1980) Cert. Denied 452 US 961 (1981), Edwards v. Commissioner. 415 F 2d 578, 582, Lewis and Talor, Inc. v. Commissioner, 447 F 2d 1074 (1971).

C) The fact that transactions of business are so arranged that tax consequences are highly favorable (or altogether avoid taxes) affords no license to the government to recast it into a mold or less advantage. Gyro Engineering, Inc. v US. F 2d 578, 582, Peter Pan Seafoods, Inc. V. US 417 F 2d 670.

D) "It (Pure Trust) is established by legal precedent that pure trusts are lawful, Valid Business Organizations." Baker v. Stern 58 A.L.R. 462.

E) "Trust or trust estate is a legal entity for most all purposes as are common law trust." Burnett vs. Smith 240 S.W. 1007 (1922).

LEGAL AND EQUITABLE TITLE HELD BY CONTRACT TRUST

A) Legal and equitable title held by contract trust. Hecht v. Malley US 144.68 L Ed 949, 44 Ct. 462, Williams v. Milton 215 MASS 2. 102 NE 355, Goldwater v. Oltman, 210 CA 148, 292 P624, 71 ALR 871.

B) When legal and equitable title, possession and control of property are legally and irrevocably passed from the Trustor (contracting investor) to himself as Trustee in legal contemplation, it is as though the trustee receiving the conveyance is another person. Com. of Internal Revenue v. St. Louis Union Trust Co., 296 US48, 50 (1935).

C) Property invested in the Contract Trust Organization must be fixed and irrevocable. Thus the Trustor (contracting investor) may legally be recognized as a different person even when de facto he/she may be the same human being. Trusteeship is a position created by parties at arm's length which when established is an office to be occupied by any qualified person. Becker, Collector Internal Revenue v. St. Louis Union Trust Co. 296 Us 48, 50. 50: 80 L ED 35 56 S Ct 78.

D) Genuine contractual obligations control the substance. Estate of Hilt N. Goodwyn, T.C. Memo 1976-238.

E) Trustees of the Contractual Trust have the exclusive power to interpret or construe the intent and direction of the Trust Indenture. Cohen v. US Trust Securities Corporation, 40 NE 2d 282.

F) Statutes may authorize limited liability of partnerships and corporations, but those statutes do not by implication prohibit the creation of Contract Trusts to enjoy similar immunity by virtue of the Common Law. Goldwater v. Oltman, 292 P 624. 71 ALR 871 Annotation.

G) In tax context, "Associated" relates to a joint action and interest of the stock holders and their directors. Contract Trust Trustees and Beneficiaries are not associated in a joint action. Elm Street Realty Trust, 76 TC No 68 (1981); Morrissey v.CIR, 296 US 34 (1935); Crocker v. Malley, 249 US 223 (1919); Internal Revenue Regulations 301.7701-1, 2 (a) (2); Schumann Heink v. Folsom.159 NE 250, annotation 58 ALR 485; Hecht v. Malley, 265 US 144.

H) IRS Regulations state the term "Person" includes an "Unincorporated Organization or Group". Internal Revenue Regulations 301.7701-1, (a) Internal Revenue Ruling 73-254.

I) It is whether the entities were taxable as associations with the corporation rates applied, or as trusts (with the conduit method applied). Commissioner v. Brouillard, 70 F 2d 154, 157, Cert. denied 293 US 574 No. 152.

J) The United States Supreme Court articulated what has become recognized as the standard for determining whether an entity will be taxed as a corporation or as a trust by saying that it's the nature of the entity's dominant functions and attributes which determines whether it is an association for tax purposes. The system and course of procedure approximates much more closely that of an ordinary partnership among personal friends reposing "full confidence" (Pure trust thus a Contract Trust) in each other. The resemblances predominate strongly in favor of trusts, not associations. Commissioner of Internal Revenue v. Brouillard. Same v. Shepherd Syndicate, and Same v. Pryor &

Lockhart Development Co., 70 F 2d 154 Cert. den. 293 US 574 No. 152. Hemphil v. Orloff, 277US 537, 48 S Ct 277, 72 L Ed 978 cited Ibid.

ADDITIONAL LEGAL BACK UP

"Dignity of contract cannot be set aside because a tax benefit results either by design or accident." Edwards v. Commissioner, 415 F 2d 578, 582, 10th Cir. (1969).

"A Pure Trust is not illegal if formed for the express purpose of avoiding taxation." Weeks vs. Sibley, (D.C.) 269 F. 155.

Each taxpayer in our country has the perfect right to do everything within his or her power to legally reduce his or her liability to the least legal limit that can be reached.

The government does not contend that the trusts were not valid legal entities, from the people who set them up or from those who held certificate units. U.S. v. Brownlee.

The validity and capacity of these contractual companies has been recognized in other "sister states" and would refer your attention, in this regard, to State v. Cosgrove, 210 P. 393 (Supreme Court of Idaho, 1922) and Pacific American Realty Trust v. Lanc Tot, 381 P. 2d 123 (Supreme Court of Washington, 1963).

In the celebrated case of United States v. Dahlstrom, 713 F.2d 1423 (C. A.9, 1983) before the United States Court of Appeals for the Ninth Circuit. The opinion, decided August 24, 1983, dealt a death blow to IRS hopes of utilizing mis-information schemes to terrorize average taxpayers with the spectre of criminal liability and deter them from engaging in creative tax planning.

A trust can be a separate, legal profit making, business entity. When trust income is accumulated or distributed at the sole discretion of the Fiduciary (the Board of Trustees), net income so held and accumulated is taxable to the trust. Only the income that is distributed to the beneficiaries is taxable to them. In one case, the IRS claimed that the trust was an association taxable as a corporation. Then the Board of Tax Appeals held that the trust was not an association, and thus not so taxable. It also held that income earned by the trust in any given year, not distributed, as is the case with incorporated businesses. Buitar Family Trust Estate v. Commissioner 72 F 2d 544 (1934).

And, most important of all, the contractual companies are not trusts under the Code, for trusts, by their very definition, at common law, require a division or split of title (legal and equitable) between the trustees, serving on the corpus of the trust, and the beneficiaries.