

# Secrets of the Irrevocable Pure Business Trust

by Arthur Thomas

**S** hopping for the best business trust can be a frustrating and confusing experience. What is "best" when it comes to trusts?

Even many experienced attorneys are often confused or, worse still, misinformed concerning the essential nature of the Irrevocable Pure Business Trust. Scores of trust writers have become convinced that theirs is the only good business trust on the market. Case law and rules of law have been cited to support their various positions.

Can they all be wrong? Are they all right? Whom can we trust when we seek liability protection for our businesses by means of a trust arrangement? The intent of this article is finally to put to rest any misunderstandings regarding the Pure Irrevocable Business Trust in words that are direct, simple, and incapable of being misunderstood.

There are literally hundreds of different kinds of trusts. A glance at Black's Law dictionary confirms the formidable array of equitable trust instruments which have been the subject of litigation in the past. This categorization also suggests to the uninitiated that any trust must follow precise guidelines and must conform to prescribed patterns, or it can be broken in court.

The truth is that although many trusts must conform, the Irrevocable Pure Business Trust need not and should not conform to any specific rule of law for trusts, for it is not truly a trust. It is a contract in the form of a trust. This is the great "secret" that has confused and misled so many trust writers.

## Two categories of trusts

It is helpful to divide trusts into two broad categories—the first being those trusts created by privilege, and the second, those which arise as a matter of right. Those trusts which are created by privilege are by far the most common. A brief discussion of both types will serve to illustrate the essential differences between the two.

## Statutory trusts

Trusts which are defined in precise terms and which are bound by procedural structure fall into the category of trusts which arise by privilege. In those cases, some deciding authority or agency, whether the I.R.S., the American Law Institute's Committee on Trusts, or some other body or agency, has seen fit to describe and limit a particular kind of trust.

"Charitable" trusts, "family" trusts, "grantor" trusts, and so on, are described and limited by the form given them by some committee or agency, which in turn has based its findings upon judiciary conclusions as provided in case law. In *Restatement of the Law of Trusts* we read:

"... The sections of the Restatement express the result of a careful analysis of the subject and a thorough examination and discussion of pertinent cases. The accuracy of the statements of law made rests on the authority of the Institute. They may be regarded as the product of expert opinion and as the expression of the law by the legal profession."

In other words, the form of a trust is normally dependent upon prior case law, and the authority for that "law" is based upon opinion. When we think of law, we normally think of statutes passed by the legislature, not rules passed by administrative agencies, or opinions of judiciary committees based upon prior case history. The legislature does not directly describe the form a particular trust is to take; but the legislature does have the power to delegate certain powers to other governmental agencies, including the authority to make their own rules. These rules are termed "administrative law" and become law (or the "rule of law") simply by being published in the *Federal Register*.

The trust maker is then forced to choose the form of his trust from among what is offered. When he does so, he is accepting a privilege from (ultimately) the legislature.

A privilege, of course, is that which is granted by the good pleasure of the author of that privilege. Privileges can be withdrawn,

revised or modified by the grantor of the privilege. The judiciary, on the other hand, is faced with what is known as the "Rule of Law," a formidable combination of rules and case law.

Case law can be quite flexible. For every case which points in one direction, there always seems to be another which points in the opposite one. We may conform as precisely as possible with the "rule of law"

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in forming a trust, and yet it can still be attacked in court by an opposing attorney.

Certainly a traditional trust of this nature can successfully avoid probate court, but what about total liability protection? What about privacy and tax reduction? Unfortunately, most trusts fail in this regard. They fail because they compromise the basic principle which lies at the foundation of all trusts, the *transfer of direct ownership*, which carries with it the consequent transfer of liability.

Liability always follows direct ownership. A trust transfers direct ownership to an artificial body, the "corpus" of the trust. But if that transfer is challenged in court, on the basis of the proper "form" of the trust, then the liability may be removed from the trust, usually to the detriment of some individual.

## Contractual right

The other broad category of trust is that created by *contractual right*. Privileges can be withdrawn, revised or modified by their giver. But a right is that which is incapable of revision or modification, and cannot be statutorily abridged. In *Restatement of the Law of Trusts*, which we quoted earlier, we read:

"A statement of the rules of law relating to the employment of a trust as a device for carrying on business is not within the scope of the Restatement of this Subject. Although many of the rules applicable to trusts are applied to business

trusts, yet many of the rules are not applied, and there are other rules which are applicable only to business trusts. The business trust is a special kind of business association and can best be dealt with in connection with other business associations.”

The American Law Institute's classic multi-volume study of trusts fails even to discuss the irrevocable business trust! Why? They won't discuss it because it really isn't a trust, and the rules for trusts just don't apply

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to it. In reality, it is a *contract in the form of a trust*.

As businesspeople, we all want security. We want security for our businesses and we don't want someone else telling us how to organize or run our businesses. We conduct business by entering into contracts. An Irrevocable Pure Business Trust permits us to organize our trust upon the principle of contract rather than the insidious and fickle notions of quasi-legislative privilege.

Article I Section 10 of the Constitution provides that:

“No state shall... pass... any Law impairing the Obligation of Contracts.”

That section of the Constitution provides, in a nutshell, the sum strength and structure of the Irrevocable Pure Business Trust. Any other position serves only to weaken the essential nature of the business trust. Indeed, the Courts have ruled that:

“A pure trust is not so much a trust as a contractual relationship in trust form.” (*Berry v. McCourt*, 204 NE2d 235)

The right to contract is protected, as we have pointed out, by the Constitution:

“A pure Trust is established by contract, and any law or procedure in its operation, denying or obstructing contract rights impairs contract obligation and is, therefore, violative of the United States Constitution.” (*Smith v. Morse*, 2 CA 524)

And again:

“The right to create the Business Trust is based on the common-law right to contract by individuals establishing it.” (*Gleason v. MacKay*, 134 Mass, 419)

It is very important to construct the business trust such that every officer or party of interest has a contractual relationship to the trust; otherwise, the

protection of the contract is lost. The trustees must be appointed and must accept their position by contract. The business manager must be contracted in the same manner. Every party in interest must have some kind of contractual relationship with the business trust. If the trust should ever once partake of the privileges afforded by legislatively granted agencies, then it will compromise the strength of its own position.

Granted, statutes rarely directly address trusts; but, for convenience to the reader, let us, for a moment, refer to “the rule of law” comprising case law and agency regulations published in the Federal Register as simply “Statutes.”

Now we know that business trusts (common-law contractual trusts) are created by contract. But if those trusts which are created by contract ever partake of the privileges granted trusts by the “Legislature,” then said trusts immediately become subject to whims of the “Legislature,” and they lose the right to the unassailable protection of a contract. It is like a “Tar Baby.” When we first touch the tar, we are stuck.

The “Ashwander Doctrine” explains this principle:

“... anyone who partakes of the benefits or privileges of a given statute, or anyone who even places himself into a position where he may avail himself of those benefits at will, cannot reach constitutional grounds to redress grievances in the courts against the given statute.” (*Ashwander v. T.V.A.*, 287 U.S. 288, 56 S.Ct. 466)

The bottom line is quite simple. It is a matter of rights vs. privilege. Why should we restrict the operation of our businesses to the territory granted by legislative privilege when it is not really necessary? Not only is it unnecessary, it can be downright foolhardy.

Any smart lawyer can tell you that for every case law on one side of an issue, there usually exist two on the other side. Case law is always a two-edged sword. It cuts both coming and going. The Irrevocable Pure Business Trust, on the other hand, is:

“A trust organization, consisting of a U.S. Constitutional right of contract which cannot be abridged. The agreement when executed becomes a Federal organization and not under the laws passed by any of the several legislatures.” (*Crocker v. MacCloy*, 649 U.S. Supp. 39 at 270)

In sum, there is at least one very important difference between a true Irrevocable Pure Business Trust and other trusts. Those “other trusts” may even have the outward form and name of the irrevocable business trust, but they lack the substance thereof.

That difference lies in contract. If the trust is formed and organized by contractual relationships, and protects the parties in interest by providing them an “arm's length distance” relationship to the trust, then it is a true Irrevocable Pure Business Trust. If the trust partakes of statutory privileges then it is a “statutory” trust, and the loopholes provided by privilege can be plugged at will by the legislature, which has the power to suspend its privileges as easily as it can grant them. We would be wise not to rely upon statutory privilege and the case law that supports those privileges. Rather, we should rely upon the constitutional safeguard against the impairment of contracts.

That way we may totally avoid the contentious litigation that comes from challenges to statutory trusts. We are then out of the legislative statutory system and under the protection of the constitutional common law. We are in the realm of positive law as opposed to colorable statutory law.

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We are, in short, in a position of strength through having separated ourselves from any connection with any trust or trust property outside the bounds of a contractual relationship. It is axiomatic that liability follows direct ownership, and de facto ownership has been the object of innumerable IRS challenges to traditional trusts.

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(Article reprinted from the August 1993  
LIFE & HEALTH INSURANCE SALES.)