The Legal Forms of Business: Common Law Trust

When doing business, credit professionals must consider the type of organization used by the debtor. It is of utmost importance to the creditor to know who is legally liable for the business's debts in the event of failure or death of a principle. There are many different types of businesses, one of which is a common law trust.

Unlike a corporation, the powers of the common law trust are not generally derived from statutory law, but rather come from a trust agreement. A common law trust is formed by agreement between owners of a property or business and a trustee or group of trustees. The trustees hold legal title to all property of the business and manage its affairs. The certificate holders participate proportionately in the income from the trust and also share proportionately in the proceeds when the trust is dissolved.

Continuity

Depending upon the agreement, a trust may continue for a specified duration or may intend a perpetual existence. The death of a certificate holder does not dissolve a common law trust and instead, passes through the estate of the deceased.

Capital

The capital of the common law trust is equal to the value of the property transferred to the trustees. Profits are generally distributed at the end of the fiscal period. For a credit appraisal, credit professionals should obtain a balance sheet, income statement and statement of cash flows. Initially, a common law trust was not required to pay taxes, but more recently it has increasingly been taxed as a corporation.

Liability

In most cases, the certificate holders are protected from claims over and above the extent of their investments. The exception occurs when the beneficiary has a voice in the affairs of management. In states where the common law trust is treated like a partnership, the certificate holders are not exempt from personal liability for debts.

Trustees are accountable for the fiduciary affairs of the common law trust. They are accountable to the certificate holders for the property entrusted to them and for any loss due to misconduct or mismanagement. With third parties, the trustees are personally liable for the commitments unless they have been absolved from this responsibility by the party with which they have made a contract.

In dealing with common law trusts, it is important for the credit professional to know how the entity is viewed by the courts in the states where merchandise is to be shipped, as well as the state where the headquarters of the trust are located.

Source: NACM's *Principles of Business Credit*