

Washington University Law Review

Volume 9 | Issue 2

January 1924

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Recommended Citation

Benjamin Marks, *The Legal Status in Missouri of Business Trusts*, 9 ST. LOUIS L. REV. 136 (1924).

Available at: https://openscholarship.wustl.edu/law_lawreview/vol9/iss2/5

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THE LEGAL STATUS IN MISSOURI OF BUSINESS TRUSTS.*

In determining the legality of an organization in any given jurisdiction, the problem is to ascertain what the courts of last resort of that jurisdiction have held. If there has been no adjudication, then the task is to arrive at the most probable decision of such courts in the light of long established legal principles and the peculiar local statutes. Unfortunately, in Missouri, because of the comparative novelty of the business trust, there has been almost a total lack of decisions upon the subject. Hence, until there is such an adjudication by the Supreme Court of Missouri, anything that might be said as to the legal status of the business trust must necessarily be largely conjectural.

To be sure, there is nothing new in the trust relation, which is supposed to have had its origin as far back as the ancient Roman *fidei commissum*.¹ It is rather in its quite recent application to a form of business organization and its growing commercial importance that its novelty exists. There is, indeed, a remarkable similarity of purpose between the trust of old, and the business trust, or Massachusetts trust, as it is commonly called. Trusts were first introduced into England, as creatures of equity, to circumvent the public policy of the kingdom; to avoid the ancient restrictions on alienation, the numerous fines and reliefs imposed by the feudal law of tenure, the burdensome Statute of Mortmain, and finally, the dangers of confiscation and attainder resulting from participation in the civil wars between the two great houses of Lancaster and York.²

*Awarded Thesis Prize, June, 1923, Washington University School of Law.

1. Perry on Trusts, p. 3.

2. Tiedeman on Real Property, section 438.

In a like manner, business trusts have developed as substitutes for business corporations because of the many disadvantages and burdensome incidents imposed by the State upon corporate existence. There is, first of all, the great popular prejudice against corporations, as evidenced by partisan jury verdicts and the harassing, supervisory statutes enacted by the various State legislatures. Moreover, the corporation, being an artificial person has no legal existence beyond the boundaries of the State which created it.³ Nor is it a citizen within the meaning of Article 4, Section 2, of the Constitution of United States, which guarantees that "the citizens of each State shall be entitled to all the privileges and immunities of citizens in the several States," so that any State may impose numerous prerequisites as conditions to doing business in it.⁴ The business trust, lastly, seeks to evade the varied and heavy taxation which the business corporation has to bear—the organization tax, the franchise tax, and numerous others.

But whatever its legal purpose and commercial importance, the fact remains that there is nothing illegal in the organization itself at common law.⁵ That therefore in Missouri, in the absence of statutory regulation, the status of business trusts is an absolutely legal one. All persons, *sui juris*, have the same power to create trusts, and it is reasonably inferred that there is nothing illegal in the fact that the purpose of the trust is the management of a business for profit. This result has been established by a long line of cases too numerous to mention and is undoubtedly the law today.⁶

One of the foremost and earliest cases establishing this contention is the leading English decision upon the subject,

3. *Bank of Augusta v. Earle*, 38 U. S. 519.

4. *Paul v. Virginia*, 75 U. S. 168.

5. *Perry on Trusts*, p. 28.

6. *Crocker v. Malley*, 249 U. S. 223; *Spotswood v. Morris*, 12 Idaho 360; *Hoadley v. County Commissioners*, 105 Mass. 519.

*Smith v. Anderson.*⁷ In that case, shares to the amount of £400,000 were purchased by subscription in the Submarine Telegraph Company, and the title to the property of the company and the management thereof was vested in a board of trustees. The point to be decided was whether or not this organization was an association of more than twenty persons formed for the purpose of carrying on a business within the meaning of the Companies Act, 1862, s. 4, for if it was, then not being registered, it was illegal. In overruling the decision of the Master of the Rolls, the Court of Appeal held that the object of the deed of settlement was not to authorize the carrying on of a business within the meaning of the Act, but that it was to provide for the management of a trust fund by the trustees for the benefit of the *cestuis que trustent* (the shareholders).

Assuming then the legality of the business trust in the absence of relevant statutory regulation, a doubt must arise as to whether the business trust is a partnership, or a pure trust. If the former, then the shareholders are personally liable for the debts of the association, and the business loses an attribute that is indispensable to an adequate substitute for a corporation. In fact, if the business is a partnership it must necessarily assume all the incidents of the partnership relation. Thus, if one of the shareholders died, his legal representatives would be entitled to an accounting, in equity, for his interest. Such proceedings, it can readily be seen, are wholly inconsistent with any practical association of a great number of shareholders.

Happily, through a long line of decisions an accepted test has been laid down for determining the distinction between the two forms of business organizations. The courts have repeatedly held that any business trust in which the shareholders, or *cestuis que trustent* have no substantial control of the management of the trust property by directing the

7. L. R. 15 Ch. Div. 247.

trustees, is a pure trust.⁸ Perhaps the leading case of *Williams v. Milton*⁹ will suffice to illustrate this type of business trust. The case came up in Massachusetts upon a question of whether the Boston Personal Property Trust was to be taxed under Massachusetts statutes as a partnership, or as a trust estate. The court held that whenever persons associate themselves to carry on a business for their mutual profit they are none the less partners because their shares are represented by transferrable certificates and as a matter of convenience the legal title to the partnership property is taken in the name of a third party. If such third party or trustee, as he is called, is under the direction and control of the shareholders, he is merely their agent and they as associated principals constitute a partnership.

But in this case the shareholders exercised no such control. There was no provision in the indenture of trust for any meeting to be held by them and the extent of their power in the management of the business was merely to give or withhold their consent to any alteration or termination of the trust agreement. Accordingly, the court held that the property of the Boston Personal Property Trust was not taxable as partnership property, but that it was taxable only as property held in trust.

The case of *Frost v. Thompson*,¹⁰ on the other hand, illustrates an association which was held to be a partnership. There, the certificate holders had the power to remove the trustees and appoint others in their place; they could meet and vote to amend the declaration of trust or terminate it entirely. Therefore, the holder of a promissory note of the voluntary association, the Buena Vista Fruit Company, was not precluded from bringing a suit in equity against all the shareholders as partners to establish the debt and to have

8. *Mayo v. Moritz*, 151 Mass. 481; *Connolly v. Lyons & Co.*, 82 Tex. 664; *Crocker v. Malley*, 224 U. S. 223.

9. 215 Mass. 1.

10. 219 Mass. 360.

applied in satisfaction of it partnership property which could not be attached at law. The court again clearly laid down the established rule. The learned Chief Justice said: "A declaration of trust or other instrument providing for the holding of property by trustees for the benefit of the owners of assignable certificates representing the beneficial interest in the property may create a trust or it may create a partnership. Whether it is the one or the other depends upon the way in which the trustees are to conduct the affairs committed to their charge. If they act as principals and are free from the control of the certificate holders, a trust is created; but if they are subject to the control of the certificate holders, it is a partnership."

This rule must necessarily raise the question of how much control the certificate holders must exercise to make the association a partnership. They can exercise no substantial control of the trustees, nor can they direct the business policy of the organization. They cannot meet and alter the declaration of trust nor can they terminate it. They cannot remove their trustees without cause and appoint new members in their stead. In short, the sole right of the *cestui que trust* is to have the property administered in his interests by the trustees, to receive income while the trust lasts, and to share in the *corpus* when the trust terminates.

The conclusion might safely be reached, then, that the Missouri Supreme Court will apply the rule established in Massachusetts and followed in the great majority of States, as to the partnership nature of the business trust. Undoubtedly, it will construe some of them to be pure trusts and others partnership associations. It will be necessary to examine each particular association and determine from the declaration of trust and the actual conduct of the certificate holders and trustees, the extent and limitations of their power. Then, and only then, can it safely fix the

legal status of the business trust as a pure trust or a partnership.

Up to this point, to avoid confusion, the absence of relevant statutes affecting the business trust has been assumed. There are in Missouri, as in a great many other States, numerous statutes regulating corporations, and particularly a constitutional provision¹¹ and a statute¹² defining such a corporation as is amenable to the other regulatory statutes. The Missouri Legislature has enacted:—"The term 'corporation', as used in this chapter, shall be construed to include all joint stock companies or associations having any powers or privileges not possessed by individuals or partnerships." To determine whether the business trust is within the meaning of this statute, two questions must be answered. First, does it possess powers and privileges not possessed by individuals or partnerships; secondly, is the business trust an association?

That it does possess powers or privileges not possessed by individuals or partnerships can scarcely be denied. In Kansas, under a statute entirely similar to that of Missouri, a business trust was held to exercise many of these powers and privileges, some of which the court points out.¹³ For example, there is in most declarations of trust a limited liability clause, under which, both shareholders and trustees are exempt from all personal liability. The business trust is not dissolved at the death of a trustee or certificate holder. The joint property of the organization is continued during the existence of the trust freed from the rules of joint tenancy or tenancy in common. Moreover, it may adopt a common seal, and the interest of the shareholder is represented and measured by negotiable shares of certificates which are given *voting* power the same as cor-

11. Constitution of Missouri, Art. 12, Sec. 11.

12. R. S. Mo. 1919, Sec. 9722.

13. Lumber Co. v. State Charter Board, 107 Kan. 153.

porate stock. Lastly, the trustees may elect officers who have the authority and duties incident to like officers in corporations; and in such elections a majority vote, and not a concurrence of the trustees, is sufficient.

While Kansas has held that the business trust does possess powers or privileges not possessed by individuals or partnerships, at least one State, Idaho, is at variance with it. In *Spotswood v. Morris*,¹⁴ that court held that the business trust could not legally possess or exercise powers or privileges of corporations, since to exercise such a prerogative requires a sovereign grant. But as a recent Kansas case,¹⁵ in upholding the earlier view of the same court, pointed out, the Idaho decision rests on the fact that their statute is different from that of Kansas. The Idaho statute reads: "The term 'corporation,' as used in this article shall be held and construed to include all associations, and joint stock companies having or exercising any of the powers or privileges of corporations not possessed by individuals or partnerships." Of course to exercise legally a privilege of a corporation requires a legislative grant. But in the Kansas statute and the Missouri statute the words "*of corporations*" are omitted and therefore a different legislative intent must be presumed. In the Missouri statute it is merely "powers or privileges not possessed by individuals or partnerships" and it has been pointed out that the business trust does in every sense exercise such powers.

Granting then that the business trust does usurp many corporate privileges, the next consideration is whether that organization is an association within the meaning of Section 9722, R. S. Mo. 1919. Singularly enough, none of the decisions construing the so-called Massachusetts trust under statutes similar to those of Missouri, have considered this question. Thus, in both of the Kansas cases,¹⁶ where the

14. 12 Idaho 360

15. *Harris v. U. S. Mexico Oil Co.*, 204 Pac. 754.

16. 107 Kan. 153, 204 Pac. 754.

trusts were declared within the statute, only the question of whether they exercised powers and privileges not possessed by individuals or partnerships was considered. They ignored the problem or else flatly assumed that the trust was an association. So, too, in the Idaho case,¹⁷ was this problem ignored.

Now the fact is indisputable that every partnership must be an association in the sense that the individual members thereof are associated together for a common purpose—the management of a business for profit. It has been shown at length that certain types of business trusts are really partnerships, where the certificate holders retain a substantial control over the trustees. In such cases, as explained before, the certificate holders are held to be the principals who are conducting the business for profit, and the trustees are merely their agents. They are the *socii*, united as partners in a common enterprise and hence must be denominated an association such as the Missouri statute refers to.

The status of such business trusts must then necessarily be fixed as corporations. The certificate holders are, in effect, an association of individuals who operate the business and that association certainly possesses many of the powers and privileges not possessed by individuals or partnerships, within the meaning of the Missouri statutory definition of a corporation. In view of this, it would seem logical to suppose that “*quo warranto* would lie against any association of persons who act as a corporation within this State without being legally incorporated”.¹⁸ Such an association is nothing more or less than a subterfuge to enjoy corporate privileges without incurring corporate obligations.

Indeed a Kansas City Court of Appeals case,¹⁹ following a

17. *Spotswood v. Morris*, 12 Idaho 360.

18. Opinion No. 575. Aug. 19, 1919, of Attorney General of State of Ohio.

19. *Schmidt v. Stortz*, 236 S. W. 694.

similar California decision,²⁰ holds that such a trust is an "unincorporated association" organized to sell shares within the Blue Sky Law (Section 11919 Art. 7. Ch. 108 R. S. Mo. 1919) and not having obtained permission to sell its certificates, is illegal.

On the other hand, the recent case of *State v. Lee*²¹ seems to intimate that such a common law trust need not be incorporated. The Missouri Supreme Court says: "It is obvious that the article of the Constitution and statute referred to do not by legislative fiat convert joint-stock companies or voluntary associations into corporations or require their incorporation before doing business." But the court was considering whether a building and loan association, which was organized under peculiar Missouri statutes relating to such associations, was a corporation and it is hardly probable that the decision embraces the ordinary type of trust under consideration. Moreover in *Williams v. United States Express Company*,²² the Court of Appeals held that a joint stock company was a corporation and could be sued as such. Since the business trust of the partnership type is an association, it may fairly be concluded that it, too, is a corporation and may be sued as such.

Moreover, business trusts of this nature organized in other States may be kept from doing business in Missouri until they conform to Missouri corporation laws. They may be considered as corporations, and the State may impose any conditions it deems expedient as conditions precedent to their establishment in Missouri.

All this may be said of any business trust in which there are associate powers among the certificate holders. But a more difficult task is encountered in determining the status

20. Ex parte Gerard 200 Pac. 593.

21. 233 S. W. 20.

22. 195 Mo. App. 362.

of a pure trust. Is it an association within the meaning of R. S. Mo. 1919, Sec. 9722, and therefore subject to regulation by the State as a corporation?

In view of a leading English decision²³ and a United States Supreme Court opinion²⁴ in which the matter is discussed, the contention that a pure trust is an association is barely tenable. In such a business trust the beneficiaries have no relation whatever *inter se*. It is admitted that they are not partners nor associates for any purpose. They have no title in the *corpus* of the trust, no shareholders meetings, no control of the management or trustees, nor can a provision in a declaration of trust that the beneficiaries shall be trust beneficiaries only, without partnership, associate or any other relations whatever *inter se*, show any possible intention on their part to form an association. Their sole relationship is that they have individual and separate beneficial interests in a trust fund.

In the leading English case of *Smith v. Anderson*,²⁵ previously referred to, the court had occasion to decide whether a pure trust was an association within the meaning of the Companies Act, 1862, s. 4. This extract from the Court's opinion may well be quoted: "I cannot find that this deed constitutes any association whatever between the persons who are supposed to be *socii*. * * * There has never been anything creating any mutual rights or obligations between those persons. They are from the first entire strangers who have entered into no contract whatever with each other, nor has either of them entered into any contract with the trustees or any trustee on behalf of the other, there being nothing in the deed pointing to any mandate or delegation of authority to anybody to act for the certificate holders as between themselves, and nothing, as it appears to me, by which any liability could ever be cast

23. L. R. 15 Ch. Div. 247.

24. 249 U. S. 223.

25. L. R. 15 Ch. Div. 247.

upon the certificate holders either as between themselves, or as between anybody else.* * * Persons who have no mutual rights and obligations do not, according to my view, constitute an association because they happen to have a common interest or several interests in something which is to be divided between them."

The United States Supreme Court, in *Crocker v. Malley*,²⁶ also seems to adhere to the view that the pure trust is not an association. In that case the Massachusetts Realty Trust brought an action to recover income taxes paid to the collector of Internal Revenue. The question before the court was whether that company, which was a pure trust, was a joint-stock association within the meaning of the Income Tax Act, Oct. 3, 1913. In holding that it was not Mr. Justice Holmes said: "* * * it would be a wide departure from normal usage to call beneficiaries here a joint-stock association when they are admitted not to be partners in any sense, and when they have no joint action or interest and no control over the fund. On the other hand, the trustees by themselves cannot be a joint-stock association within the meaning of the Act unless all trustees with discretionary powers are such. * * * We perceive no ground for grouping the two—beneficiaries and trustees—together, in order to turn them into an association, by uniting their contrasted functions and powers, although they are in no proper sense associated." Thus the trust was held to be free from any liability to pay taxes as a joint-stock association.

Having concluded this phase of the subject, a brief summary of the legal status of business trusts in Missouri may now be reached. There seem to be, in the last analysis, two separate and distinct classes of these business trusts. Where the *cestuis que trustent* retain a substantial control over the trustees, the organization has been denominated

26. 249 U. S. 223.

a partnership. Such a trust is an association and possesses powers or privileges not possessed by individuals or partnerships within the provisions of Sec. 9722 R. S. Mo. 1919 and Article 12 Sec. 11 of the Constitution of Missouri. It then becomes a corporation by statutory definition. In view of *State v. Less*²⁷ it would seem that the only apparent effect of this statute is to permit such a trust to sue and be sued as a corporation and not to require it to become incorporated. However, this case is decided with reference to peculiar specific statutes affecting building and loan associations. Such specific statutes would normally take precedence over a general statute of the nature that has been considered. Therefore, until the contrary is held, this class of business trusts seems to be illegal, as usurping corporate powers and privileges without being legally incorporated.

The second class of business trusts in which there are no associate powers among the beneficiaries, has been termed a pure trust. It is a legal organization, it is not amenable to Missouri corporation laws, nor is it subject to the Federal Income Tax Act, as such.²⁸ It seems, though, that the Missouri courts would hold even the pure trust subject to the regulation of the Missouri "blue sky" law, as to the issuing of shares of certificates.²⁹

In conclusion, it would seem that the line of demarcation between the illegal organization and the legal one (the pure trust) is not an absolute, arbitrary one. Therefore, in fixing the status of any particular organization, the courts will have to arrive at the intention of the settlors as evidenced by the declaration of trust. If this instrument disclaims any associate powers among the beneficiaries, and the actual passive conduct of such beneficiaries

27. 233 S. W. 20.

28. However, under the more specific Income Tax Act of 1921, pure trusts were held amenable to the Act.

29. *Schmidt v. Stortz*, 236 S. W. 694.

proves only an intention to form a pure trust, then the courts, in the absence of any future specific statutes, must declare them a valid, legal organization.

As a matter of practical consideration, however, it seems improbable that business men will invest their capital in a pure trust, in which they have no voice in the management or control, in proportion to the respective voting powers of their certificates. Practically, then, most of these organizations will prove to be adroit, ingenious schemes for circumventing corporate liability, and these the courts must oust. But in some fields the pure trust has proved a very serviceable, practical organization, particularly in the business of dealing in real property.³⁰ Such trusts, it may well be presumed, will be held valid by the Supreme Court of Missouri when the matter arises for adjudication.

BENJAMIN MARKS, '23.

30. Business Trusts as substitutes for Business Corporations, Thompson, p. 43.