

Statutory Versus Contract-Law Trusts

Understanding The Differences



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There are many ways in which entrepreneurs can protect themselves and conduct business, such as through a limited liability company, S corporation, C corporation, trusts, etc. When conducting business, people most commonly use one of those first three structures. For business owners looking for advanced protection, privacy and planning, this is where trusts come into play.

Before looking at a couple of different kinds of business trusts, let's start by explaining what a trust is. A trust is a contract between the parties involved to grow assets for the beneficiaries of the trust. If created well, a trust can last for multiple generations and create substantial wealth for a family. It is the trustee's role to grow the trust's assets by making smart investments of the trust's funds. You are in control of the type of trust you create and the jurisdiction it follows. Below are two types of trusts business owners can use, each of which offers its own advantages and drawbacks.

Statutory Trusts

Statutory trusts are regulated by the Uniform Statutory Trust Entity Act. They are based on the law of the state in which they are set up, so these trusts vary by state. This type of trust can enhance privacy when conducting business. This is because the beneficiary of the trust is kept private. This differs from other company structures, such as LLCs, S corps and C corps, where ownership is in the public domain. Statutory trusts are often used for real estate and passing down one's assets to family members. Profits are distributed to the beneficiaries, which can lead to higher levels of taxation.

Statutory trusts are often a good option for individuals with a net worth of \$1 million to \$5 million. This is due to the simple nature of setting up such a trust and its standard terminology, which is already templated out. This makes a statutory trust a much cheaper and quicker option compared to the more expensive contract-law trust.



Contract- Law Trusts

These are often referred to as a pass-through trust agreement, which means the income may or may not be passed through to the beneficiaries similar to some statutory trusts. Contract-law trusts offer increased privacy and security similar to statutory trusts. They are based on advanced tax and estate planning rules, which can help individuals keep more of their hard-earned money.

Contract-law trusts are filed as complex trusts using Form 1041 with no requirement to distribute income to the beneficiaries during the taxable year. The accounting and legal rules are different from those of statutory trusts.

Contract-law trusts are based on private contracts, which are linked to Article 1 Section 10 of the Constitution. This shows that nothing can come in the way of you and a private contract you create, which is what is created when you have a contract-law trust. This supersedes statutory law and is directly filed with the Internal Revenue Service by obtaining a federal tax exempt EIN, allowing you advanced rulings based on Supreme Court cases.

Issues with this type of trust include the expense of setting one up compared to statutory trusts. It can also be difficult to find experts who are well versed and able to speak on contract-law trusts. Contract-law trusts are best suited to high-net-worth individuals and family offices, who have a team of experts who are well versed in operating this type of business structure and can keep up with the correct administration of it. The legal rules and regulations are more complex in nature than those of statutory trusts as contract-law trusts are a more advanced tool.

Bottom Line

There are many types of trusts that can be subdivided into revocable or irrevocable, grantor or non-grantor, and so on. Each of them does things differently. This means that deciding which is best for your situation can get confusing quickly. To achieve the outcome you are looking for, it's important for you to do your own detailed research before you decide which is best for your needs. Statutory trusts are the more popular option for business owners, but for those who are looking for a more advanced solution, contract-law trusts are well worth looking into.

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