

Is a Trust a Legal Entity?

Take-Away: There is a departure from common law that now deems a trust to be a separate legal entity that is distinct from the trustee and the trust beneficiaries.

Background: The traditional view of trusts, which is still followed in England and most other common law countries is that a trust is not a separate legal entity but instead a fiduciary *relationship* with respect to specified property. That is what I learned when in law school over 50 years ago. The focus on the *relationship* of the trustee to property held in the trust means that a lawsuit by a third party could not be brought against the ‘trust’ as a separate entity but instead had to be brought against the trustee personally who may have had a right of indemnification from the trust estate if the trustee acted properly. [The *Restatement (Second) of Trusts*, Section 261, notes that “The trustee is subject to personal liability to third persons on obligations incurred in the administration of the trust to the same extent that he would be liable if he held the property free of trust.”] One example of the common law’s treatment of a trust was in a concurring decision by a federal court of appeals judge in *Church Joint Venture, LP v Blasingame*, 947 F.3d 925, 935 (Sixth Circuit, 2020) who observed:

“[a] corporation and a trust are not one of a kind. A corporation is a distinct legal entity with legal rights, obligations, powers, and privileges independent of the natural individuals who created it. A trust isn’t an entity at all; it is a fiduciary relationship between multiple people... How could one pierce the veil of a trust? It doesn’t have a veil, much less any form to pierce into. And what could it mean for a trust to be a beneficiary’s alter ego? An alter ego is simply an entity’s second self. As a non-entity, a trust can be a self of any sort-secondary or otherwise.”

However, this common law principle that a trust is strictly a *relationship*, and not a separate legal entity, is rapidly changing.

Separate Legal Entity: To be a legal entity (or person) means to be treated as an independent unit for legal purposes. The three key features of a legal entity are: (i) the ability to hold property; (ii) the power to enter into contracts; and (iii) the ability to sue and be sued, all in its own name or capacity. The *Restatement (Third) of Trusts*, Section 2, contains a revealing Comment on the nature of trusts and how they are treated by courts:

“Technically, the trust is still not generally recognized as a legal ‘entity.’ But in this Chapter and elsewhere in this country, the trust is treated as an entity to such an extent that it is no longer inappropriate to refer to claims against or liability of a ‘trust’ (as in the title and content of this Chapter) and to the liability or debt of a beneficiary to a ‘trust.’ Increasingly,

modern common-law and statutory concepts and terminology tacitly recognize the trust as a legal 'entity, consisting of the trust estate and the associated fiduciary relation between the trustee and the beneficiaries.'

This evolution in how a trust is viewed by courts is documented by the fact that a federal Bankruptcy Court in Michigan jumped on the *Restatement's* distinct legal entity 'bandwagon' when the *Restatement* was cited by that court as authority for the proposition that a trust is considered a 'distinct legal entity' consisting of the trust estate and the associated fiduciary relationship between the trustee and the beneficiaries. *In re Lewiston*, 539 B.R. 154, 159 (Eastern District of Michigan, 2015.)

Implications? Classifying a trust as a legal person has many implications, e.g., that a trust can hold property in its 'own' name, that it can enter into a contract in its 'own' name, and that it can be a party to a lawsuit, independent of its trustee, or its trust beneficiaries. These activities are all becoming regular occurrences. However, if a trust is starting to be treated as a legal entity, much like a corporation, that may lead to the conclusion that creditors of trust beneficiaries are more likely to pursue trust assets if the beneficiaries lack personal assets sufficient to cover their debts. Consequently, this may be an unintended consequence of treating a trust as a separate legal entity, since courts may be more inclined to 'pierce' any separation, i.e., veil, between the trust assets as separate, albeit owned by an artificial legal entity much like a corporation, and the entity's equitable ownership when respecting that separation would enable an unfair or fraudulent result.

Trust Codes: The Uniform Trust Code (UTC), on which the Michigan Trust Code (MTC) is principally based, rejects the requirement of the trustee's personal liability while not quite going to the point of treating the trust as a separate legal *entity*, but it is close to that in the result. These Trust Codes take an intermediate step of enabling a third-party claim to be brought against the trustee in the trustee's fiduciary, not personal, capacity. [UTC 705.]

Example 1: Alex is trustee of an irrevocable trust. Alex enters into a contract with XYZ, Inc. to repair a roof on a building owned by the trust. Later on, Alex formally resigns as trustee. Alex is replaced by Ben as trustee of the trust. XYZ subsequently sues the former trustee Alex for breach of contract for nonpayment after the roof repairs have been completed. During the course of that litigation the facts reveal that the roof repair contract was, in fact, breached, but that the facts also disclose that Alex signed the roofing contract in his fiduciary capacity on behalf of the trust. At common law, Alex could not transfer that contractual liability to Ben without XYZ's consent. [*Restatement (Second) of Trusts*, Section 280.] However, under the Trust Codes, that contractual liability is transferred automatically.

Alex is not personally liable to XYZ, and he no longer has fiduciary capacity. Ben is liable to XYZ to pay the contract amount but only in Ben's fiduciary capacity. [UTC 1010(a)(c); MCL 700.7910(1)(3).]

Example 2: Alex is trustee of an irrevocable trust. Alex hires XYZ to repair the roof of a building owned in the name of the trust. During those repairs building materials fall from the roof and injured Clare who was walking by the building when the materials fell. Alex formally later resigns as trustee. Ben replaces Alex as trustee. Clare then sues Alex and Ben in tort for the failure to effectively supervise an agent, the employees of the roofer. Pretrial discovery shows that Alex was not personally at fault for the accident. Alex is not personally liable in a personal capacity, and he no longer has fiduciary capacity. Ben is liable to Clare but only in his fiduciary capacity. Ben is personally liable for the tort judgment that arise from ownership or control of the trust estate property or for a tort committed in the course of the trust's administration, but only if he was personally at fault. [MCL 700.7910(2).]

Purpose Trusts: While the Trust Codes do not declare (yet, anyway) a trust as a separate legal entity, these Codes clearly treat it as such for liability purposes. Consider, as well, that at common law a trust required a beneficiary who could enforce the terms of the trust against the trustee. The UTC and the MTC both provide, as does the *Restatement (Third) of Trusts*, Section 21, that a trust is created *only if* it has a definite beneficiary. [UTC 402(s)(3); MCL 700.402(c).] Yet, now, a trust can be created without a beneficiary, e.g., a pet trust, or a trust that is created to protect and preserve cemetery lots. [MCL 700.7408.] Or, consider MCL 700.7409(a), which allows a trust to be created for a noncharitable purpose without a definite or definitely ascertainable beneficiary or for a noncharitable but otherwise valid purpose to be selected by the trustee, for a period up to 25 years. Anecdotally, other states are adopting trust statutes that are intended to hold business assets without any identifiable trust beneficiary, e.g., the apparel company Patagonia.

Conclusion: The law regarding trusts is fast evolving, as reflected by the trend to treat a trust as a separate legal entity. Purpose trusts without beneficiaries, trusts that can exist in perpetuity where the Rule Against Perpetuities has been repealed so that a dynasty-type trust resembles a corporation with perpetual existence, a trust that can contract in its own name (without implicating the trustee) are all signs of this evolution. When looking for an explanation for this evolution, it is probably the tendency of modern America to look at a trust more like a binding contract between the trustee and the settlor, or the trust beneficiaries. Applying contract principles to how a trust is administered tend to explain, in part, how a trust is viewed more like a corporation (with separate legal existence) than a *relationship*.

