LAND TRUSTS
and the Illinois Farmer

N. G. P. Krausz and R. J. Trompeter

College of Agriculture
Cooperative Extension Service
University of Illinois at Urbana-Champaign
Circular 1098
A land trust is a special kind of trust recognized in Illinois and a few other states. Although a trustee in this type of trust holds record title to real estate, the beneficiary or beneficiaries have most of the powers of an owner, including possession, management, and the income from the property.

How is a land trust established?

In the usual procedure a landowner transfers property he already owns to a trustee; or, if purchasing property, he has the seller convey the property directly to the trustee. The landowner may name himself as trustee, but there are advantages in appointing a corporate trustee such as a bank. The public records show the trustee to have all the powers of ownership, but the trustee's powers actually are restricted by a trust agreement (not recorded), which places possession and management powers in the beneficiary. The trustee is concerned with the property only when the title to the land is involved.

Generally, the trust period is initially limited to 20 years to avoid conflicts with legal rules. After this period, or after an extension by the parties, the trustee is usually required to transfer title to the beneficiaries, or to sell the property and distribute the proceeds to the beneficiaries.

How do inheritance laws apply to beneficial interests?

The interest of a deceased beneficiary is included in his probate estate as personal property (rather than real estate). It will pass under his will, if he has one, or under the law of descent if he has failed to make a will.

What are some reasons for using a land trust?

Avoidance of problems of multiple ownership. Transactions involving real estate often become more complicated when property is owned by several persons. For example, to sell or mortgage the land, all owners and their spouses must sign the documents. If one owner dies, becomes incompetent, or goes bankrupt, partition and

N. G. P. Krausz is Professor of Agricultural Law, and R. J. Trompeter is Research Assistant, Department of Agricultural Economics.
sale of the land may be required. A joint tenant or tenant in common of real estate can force a partition and sale for any reason.

If the land is held in a land trust, these problems are much less serious. The trustee alone signs documents relating to the title to the land. Complications in the affairs of one beneficiary (or the death of a beneficiary) do not affect the rights of others. Because the beneficiary's interest is personal property rather than real property, one beneficiary usually cannot force partition or sale.

In addition to these benefits during one's lifetime, a farmer who wants his farm to remain in one parcel after his death but wants his children to share the income may find a land trust is an appropriate device.

**Gradual distribution of land.** Sometimes a landowner wants to make transfers of land to members of his family. For example, a farmer may want to give his farm to his children gradually to minimize estate and inheritance taxes. He could do this without a land trust by conveying a few acres each year. Each conveyance, splintering off a small parcel, would require all the formalities of any transfer of real estate. On the other hand, if the land were held in a land trust, the conveyances could be made by a simple assignment of a beneficial interest. Such an assignment can be compared to transferring shares of stock in a corporation.

**Avoidance of probate.** A land trust, like any trust, can grant possession and use of the trust property to one beneficiary for life with full ownership rights passing to another upon the prior beneficiary's death. This avoids probate of the property when the life beneficiary dies. However, it is more common for each beneficiary to have full ownership of his interest in the trust. As the beneficiary transfers part of his interest to others by gift or sale, he may have less estate to probate.

If a person dies owning land in another state, a second probate proceeding is required in that state because the land is located there. If the land is held in a land trust, that second proceeding is avoided because the personal property interest under the trust is deemed to be located in the state of the decedent's domicile. The beneficiary's rights under the trust (which are in the form of personal property) may be bequeathed to his spouse, children, or others by his will and with probate proceedings only in the state where the beneficiary resided.
Insulation of land against judgments. When a creditor obtains a judgment against a landowner, he can perfect it into a lien against the property by a proper filing. However, if the property is held in a land trust, a creditor cannot obtain a lien on the property because the title to the property is in the trustee, not the beneficiary. Thus, land in a land trust is somewhat insulated from creditors.

Creditors can reach the beneficial interest of a beneficiary. When there are several beneficiaries, creditors may attach and sell the interest of one of the parties, but the title to the land and the interest of other beneficiaries are not directly affected.

Privacy of ownership. Normally, ownership of land is a matter of public record. If, for whatever reason, an individual wants to keep his ownership of land private, he can do so through a land trust. The trustee is the owner of record and is usually prohibited by a clause in the trust agreement from disclosing the beneficiary (unless required to do so for various legal reasons). Thus, if Smith purchases land and has it transferred directly from the seller to the trustee, the fact that Smith is the beneficiary and has most of the incidents of ownership need not be known to anyone but Smith and the trustee.

Are there disadvantages in the use of land trusts?

Limited duration. Land trust agreements typically have a provision which states that if any property remains in the trust after 20 years the trustee shall sell it and distribute the proceeds. Successive or extended land trusts can be used, however, to avoid sale of the property. Alternatively, the trustee can be required to distribute the property to the beneficiaries at a time stated in the agreement.

Management problems. A land trust neither solves old management problems nor creates new ones. Usually, all beneficiaries share in the management of real estate held in a land trust unless other provisions are included in the trust agreement. To avoid "control" problems in multiple beneficiary situations, a management agreement should be used. The agreement could designate a specific party to operate the property and perform such functions as collecting rent, contracting for necessary materials, paying expenses, and performing other ministerial activities. Policy decisions could be made by majority rule.
Revoking the trust agreement may create a tenancy in common. The person who creates a land trust can normally revoke it. If, however, he has transferred some of his interest to others, those beneficiaries usually must consent before the trustee will convey the title. If everyone agrees to the revocation, or if the trust is revoked under some procedure that has been placed in the trust agreement, the original owner and the new beneficiaries become tenants in common, according to their interest in the trust. Thus, if the original owner had irrevocably given away half of his beneficial interest under a land trust, upon revocation he would own half the real estate as a tenant in common with the other beneficiaries.

**Loss of homestead exemption.** If the property in the land trust is used as a personal residence, the usual homestead exemption available to the owner ($10,000) is lost to the beneficiary because record title is in the trustee and the exemption is not applicable to personal property.

**Possible loss of redemption rights.** When a person purchases real estate under a mortgage and fails to make payments, he can lose the land through a foreclosure. There is a provision in the law, though, that permits him to “redeem” the property within 12 months—that is, he can get it back by paying the amount paid by the purchaser at the foreclosure sale plus costs. But if a purchaser of land had the property placed in a land trust, his interest would be personal property—not real estate—and he would have no redemption rights in the land. However, a trustee who gives a mortgage on the land in the trust still retains redemption rights in the property unless such rights are waived in the mortgage.

**Who actually controls the property held in a land trust?**

Control depends upon the trust agreement, but usually the possession, use, management, and income are reserved to the beneficiaries. The beneficiaries also retain the power to direct the trustee to make a deed or mortgage or other legal document that affects the title to the real estate.

**Who can sell real estate held in a trust agreement?**

The person(s) with the power of direction over the trustee can direct the trustee to sell the property. Generally, this would be the beneficiaries or some of the beneficiaries, as provided in the trust
agreement. The beneficiaries themselves may sign a land contract to sell the property in the trust, but the purchaser in such a case is not bound unless the names of the trustee and all the beneficiaries are disclosed to him at the time of the sale.

**Who can lease property held in a land trust?**

The beneficiaries acting together can execute valid leases. It is highly recommended, however, that the trustee join in the transaction or that the trustee sign the leases at the direction of the beneficiaries (or some of the beneficiaries) as provided in the trust agreement.

**Can a beneficiary's interest be used as collateral for a loan?**

Yes. The beneficial interest in a land trust is treated as personal property (as opposed to real estate). Thus, a creditor who is assigned such an interest as collateral has a security interest (under Article 9 of the Uniform Commercial Code), not a mortgage.

**Can inheritance or estate taxes be saved by use of a land trust?**

Estate and inheritance taxes can be lowered by reducing the size of the estate through gifts. A land trust simplifies the problem of making gifts of land. A farm or farms can be placed in a land trust and gifts of "shares" or "units" of the interest in the trust can be made annually. Note, however, that if the value of the land is appreciating, it may be necessary to have an appraisal each year to determine how many "shares" or "units" of the interest can be given away without exceeding gift-tax exclusions and exemptions.

**Are there any income tax implications?**

Income produced by property held in a land trust is taxed to the beneficiaries. Depreciation and other expenses are available to the holders of the beneficial interest in proportion to their shares of beneficial ownership.

Often the beneficiaries enter into a partnership agreement in order to manage and operate the land. A partnership income tax form is then filed to show the distribution of net income to the partners (beneficiaries).
There is a slight chance that the trust could be taxed like a corporation if it operates like a corporation. In that event, the trust income would be taxable and any proceeds received by the beneficiaries would also be taxed. By IRS regulations a land trust may be treated as a corporation for tax purposes if it has the following characteristics: centralized management, continuity of life, free transferability of interests, and limited liability. An agreement among the beneficiaries that management policies are to be decided by a majority vote of all beneficiaries should negate the “centralized management” test and avoid the trust’s being taxed as a corporation. A manager could be given authority to make “operating” decisions. An attorney should be consulted as to the most appropriate procedure for each particular situation.

**How does the use of a land trust differ from using a corporation?**

One difference was noted above: proceeds may be taxed twice if a corporation is used. In that sense, then, a land trust is more beneficial.

A land trust can be used only for holding and operating real estate; it is not designed for holding personal property. In this sense a land trust is less flexible than a corporation.

A fringe benefit program can be set up if a corporation is used but is not possible under a land trust.

There are other considerations that affect the decision of whether to use a land trust or a corporation. An attorney should be consulted.

**How much does a corporate trustee charge for holding title in a land trust?**

The fees vary. Some charge flat fees from $50 to $100 for “acceptance,” an annual fee of $25 to $50, and a charge of about $10 for executing documents (some trustees will execute a few documents free). Other institutions charge on a sliding scale based on the value of the property. These fees rarely exceed 0.2 percent of the value of the property up to $100,000 and 0.5 percent above $100,000, with special (but rather nominal) charges for execution of documents.
The Illinois Cooperative Extension Service provides equal opportunities in programs and employment.

Urbana, Illinois

September, 1974