

Thinking About Using an Illinois Style Land Trust-Why Would You Do That?

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Clients will often come to us to discuss the next great planning “Holy Grail.” In the tax area the Holy Grail was the Constitutional Trust that would assure them the elimination of all of their state and federal income tax liability. In the asset protection area it was the off-shore trust that couldn't be pierced by a creditor and in the real estate area, the Illinois style land trust that would provide anonymity and presumably asset protection from creditors.

What seems to be so logical often isn't. Just because the Illinois Land Trust has been successfully used in Illinois, trying to apply the same rules to Minnesota property can have very unpredictable consequences. While some may say the trust is legal, legality should not be the prime or only concern.

An Illinois land trust involves titling property you're purchasing in the name of a trustee, usually a bonded corporate trust organization that has been organized for the purpose of holding title to many residential and commercial properties. The trust agreement, containing the name of the beneficiary is not recorded at the state or county level. Thus its primary benefit is providing anonymity since there is no public record showing the identity of the beneficial owner. Lenders in Illinois have developed a mortgage lending system that allows working with land trusts. Lenders operating in other states, including Minnesota, likewise have to work within the statutory, title and legal framework of those states.

So what are some of the issues and problems that individuals potentially face using such a land trust for homestead property? They include the following:

Consider the Homestead Real Estate Tax Credit. By way of an attorney general's opinion, homestead property held in a trust will qualify for the real estate tax credit if the trustor (the person starting the trust), the trustee (the person managing the trust) and the beneficiary of the trust are the same. Such a trust is almost always deemed a grantor trust, meaning the trustor/beneficiary is taxed on the income of the trust. A land trust, however, is not likely to qualify, since by definition the trustee is not the beneficiary.

- Consider the Homestead Exemption. Like many states, Minnesota allows homeowners to protect a certain level of home equity from creditors and in bankruptcy, from the trustee. For 2010, the equity amount is \$300,000, although this amount may be less under some circumstances. Generally, to protect the homestead from creditors, it must be owned by the individual being pursued by the creditor. See Minn Stat §510.01, et seq. Ownership by the trust risks defeat of the homestead protection. Defenders of the land trust would say, that's exactly the point, the creditor never knows that the homeowner actually owns the home. However, creditors who obtain a judgment are entitled to a complete asset disclosure under oath as to the assets owned, even beneficially, by the judgment

debtor. Failure to disclose their assets, fully and honestly, can land a judgment debtor in jail, as former auto mogul Denny Hecker found out recently. In bankruptcy, it's even more important that the debtor can prove actual, and not just beneficial, ownership to the property. See 11 USC §522. In bankruptcy the petitioner who fails to prove actual ownership of their homestead at the time of filing, risks loss of their exemption and having to "buy" their home back from the trustee.

- Consider the financing or refinancing of the homestead. Most lenders today are willing to finance or refinance a homestead owned by a trust where the trustor/trustee and trust beneficiary are the same. However, the title process guidelines (see Section I-H of the "White Pages" of the Minnesota Title Standards) require the presentation of a certificate of trust, affidavit of a current trustee and a copy of the trust for examination and the recording of the certificate of trust and possibly the trust or a memorandum of trust, depending on the circumstances.
- For real estate investors proposing to use a land trust to own their investment properties, there exists a more sensible alternative; namely, the limited liability company ("LLC"). The LLC provides for limited liability to its owner, meaning that the LLC owner's personal assets are shielded from liability arising with respect to the property.

Ask some investors what their rationale is for using a land trust as opposed to a LLC and you will likely get this response: "the land trust provides for complete anonymity for the beneficiaries." An LLC, however, can provide similar anonymity. For example, there is no requirement that the individual members of the LLC be disclosed in the LLC's articles of organization or its annual reports (only the names of governors and managers must be disclosed). Regardless, absolute anonymity is not a necessity for real estate investment, especially given the strong limitations on personal liability provided by the Minnesota Limited Liability Company Act.

One final advantage of the LLC form of ownership over the land trust: legal precedent. That is, Minnesota courts have addressed numerous issues related to limited liability companies; a similar body of controlling law does not exist for Illinois Land Trusts. The existence of controlling legal precedent is of great importance to professional advisors who rely on such precedent to advise clients as to a particular course of action.

While still considered "new" by legal standards (the first LLC statute was enacted in Wyoming in 1977), the LLC has become the vehicle of choice for real estate ownership. This trend will likely continue in the years to come, and investors would be wise to use this known quantity instead of ownership structures with less certain legal effect.