

# Private Lending ED

## What are land trusts and how can I benefit by using them when lending private funds?

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There are two types of land trusts. The first one deals with land conservancy and is set up to either purchase or manage land for that purpose. The second one is the one we are interested in. The Merriam-Webster's dictionary of law defines a land trust as: a trust created to effectuate a real estate ownership arrangement in which the trustee holds legal and equitable title to the property subject to the provisions of a trust agreement setting out the rights of the beneficiaries whose interests in the trust are declared to be personal property, called also Illinois land trust or naked land trust.

Can you hear the silence? Hello? Anybody still here? I know, I know, it sounds really hard! Don't worry it's not! Once you understand how it works it will be easy to see the benefits of using one in private lending situations or for one's own real estate holdings.

Ok, so a land trust is like any other trust. There is a trustee and a beneficiary (or beneficiaries). In this type of trust the beneficiaries have total control over anything the trustee does, while the trustee holds legal title. This is completely opposite to a family trust, the one which most people are familiar. In a family trust the beneficiaries have no control over the trustee; it's the other way around. So don't confuse the two. Your house may be in your family trust, but the beneficiaries cannot sell your house, only you can. In a land trust the beneficiaries can decide to sell the house and will direct the trustee to act accordingly. Still with me? Great!

The number one benefit of using a land trust is because of the privacy it affords the holder of real estate. When one buys a property and registers the deed in their name anyone who knows how to read can find out who they are and how much they paid for their house. If placed in a land trust only the trustee is visible to the public. The beneficiaries cannot be revealed unless by court order.

A beneficiary of a land trust need only sign over beneficial interest to someone and they have suddenly conveyed their property without recording a deed! A beneficiary can also assign a successor in case of death and avoid probate proceedings. Another benefit is being able to gift partial interest in a land trust and keep the value of those interests under the \$13,000 (\$26,000 per couple) annual gift exclusion. Actually, this has dual benefits: to dispose of a property without paying the taxes on the gift and also exclude the property from a beneficiaries' estate. A land trust is vital for estate planning. It is both flexible and secure.

Many times partners in real estate worry that the other partner or partners are going to be sued. When a judgment is made against one of the parties it becomes an automatic lien against the real estate owned by that party. Beneficiaries of land trusts do not own real estate; they own personal property- the trust. The trust owns the real estate and therefore protects it from partition to satisfy the judgment. This will protect the private lender by becoming a beneficiary of all of the real estate which will be owned by the investor you are funding. I strongly recommend creating land trusts prior to closing with the bank and being added as a beneficiary of the trust along with the real estate investor who is purchasing the property. Remember, you

are not recording the trust agreement or assignment of beneficial interest anywhere. It remains a private, separate transaction. The title or the deed will be put into the name of the trustee. That is recorded with the county where the real estate is located.

Probate problems can be very difficult logistically to handle, especially after losing someone with multiple properties in many different states. If every property was in its own land trust then it would be considered personal property and only one probate court would have to administer the assets thereby simplifying matters.

Flexibility is a land trusts middle name. Any legally competent person or legal entity (i.e.: corporation; LLC; LLP; etc) can become a beneficiary of a land trust. Any number entities or individuals can hold simultaneous interest in a land trust. Married couples, who qualify, could hold their beneficial interests as tenants of the trust. Any number of properties can be owned by the same trust (not usually recommended). Since the trust owns the property, any legal encumbrances, such as divorce or bankruptcy, may not affect the conveyance of the property. Placing an apartment building and its land into a trust and issuing beneficial interests to each tenant could be used to convey the units without converting the building into condominiums. I usually hear right about now: "You're kidding, right?!" No I'm not!

Another huge benefit is the tax benefits of holding a beneficial interest in a land trust. Why? Because a land trust is considered a pass through entity by the Internal Revenue Service [See IRC §§163(h) (3) (4) and §163(h) (4) (D) and IRC §§25.2702-5(c) (1)-(7) concerning residential trust property]. This means that any interest, taxes and insurance paid for the property by the trustee is passed through to the beneficiaries enabling them to claim those items on their tax forms, if they are able to (please ask your accountants to verify that you qualify).

Land trusts are a very convenient way to handle real estate transactions. They are secure and private, obscuring any miscreant from taking legal action and they shelter the private money lender from any partnership adventures.

If you have any questions about this or other private lending question feel free to contact us at [mark@PrivateLendingED.com](mailto:mark@PrivateLendingED.com)

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