

## **Property Insurance**

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# **Land Trust Can Protect Your Real and Personal Property**

In these difficult economic times, people continue to search for ways to protect their assets from creditors and to obtain some security for their largest investment, their property. Land trusts protect the true owner of the property from liability and may also preserve and protect the asset from creditors.

### **What is a Land Trust?**

Like other trusts, a land trust holds property and is controlled or handled at the direction of an appointed trustee. Generally, that named trustee is liable for any loss caused by a violation of his duties as trustee, whether the violation is a result of negligence or mere oversight as well as when the trustee is wrongfully motivated. *Stuart v. Continental Ill. Nat'l. Bank & Trust Co. of Chicago*, 68 Ill. 2d 502, 525, 369 N.E.2d 1262, 1272 (1977). Thus, to escape liability for an action upon the property, the question of possession and control is a determining factor. If a trustee does not possess and control the premises upon which defective condition exists, the failure to remedy them cannot be said to be the result of his negligence or the breach of any existing duty. *Anderson v. Cosmopolitan National Bank of Chicago*, 132 Ill. App. 2d 307, 270 N.E.2d 254 (1st Dist. 1971). Put another way, premises liability may arise out of a negligent act committed by one who has possession and control of property, without regard to the character of his interest in that property. *Gulf Oil Corp. v. Curry & Marchman Well Servicing Co.*, 70 Ill. App. 3d 897, 388 N.E.2d 1008 (5th Dist. 1979). That is, an owner of a property may not be liable if all control has been tendered to another whether through a contract or lease agreement, or even tendered to a management company.

Although a “land trust” and “land in trust” sound remarkably similar, they have very different legal effects. “Land in trust” is like any other property in trust where the trustee has the duty to manage, report, pay income, or perform the other duties set forth in the trust agreement. Therefore, if the owner of property merely places the property in a trust in which the owner is also the named beneficiary, the owner may retain responsibility for a negligent act upon the land.

On the other hand, a “land trust,” is a form of ownership of real estate where the trust has title to real property and the beneficiaries have the beneficial interest (personal property) as well as right of control and direction. Put another way, whatever the beneficiary says, the trustee must do. Consequently, in a land trust arrangement, the beneficiaries, rather than the trustee, are liable for the defective condition on the property. The trustee in a land trust does not possess or control the property, but simply holds title to it. Based upon this reasoning, the courts in Illinois hold that a trustee who has legal title to realty is not liable for damages resulting from defects in the trust premises when by the terms of the trust agreement the beneficiaries have the power to make the needed repair. *Anderson*, 132 Ill. App. 2d at 310, 270 N.E.2d at 255.

### On What Basis Can Liability Attach?

The Illinois Supreme Court in *Chicago Federal Savings and Loan v. Cacciatore*, 25 Ill. 2d 535, 185 N.E.2d 670 (1962), opined that in some instances a land trust can be used to circumvent a federal tax lien upon a parcel of property. In *Chicago Federal Savings and Loan*, the defendants held their property in a land trust and executed a series of mortgages through that trust. Between the recording of the original mortgage and the recording of the second mortgage, a federal tax lien was assessed and properly recorded against the property in Cook County. The court ultimately held that the second mortgage was superior to the federal tax lien even though it was filed later. While the court recognized that the tax lien was recorded before the second mortgage, it implied that the government was standing in the wrong line to collect on that lien.

Specifically, the court held that the “[f]ederal lien against the trust beneficiary did not attach to the real estate to which the beneficiary had no title under the law of this State.” *Id.* at 540, 185 N.E.2d at 672-73. The federal tax lien statute states that a lien in favor of the United States shall be “upon all property and rights to property, whether real or personal.” 26 U.S.C. § 6321. Although the court addressed this statutory provision, it noted that the threshold question was “whether and to what extent the taxpayer had property or rights to property to which the tax lien could attach.” *Id.* at 541, 185 N.E.2d at 673. To answer that question, “both state and federal courts must look to state law, for it has long been the rule that in the application of a federal revenue act, state law controls in determining the nature of the legal interest which the taxpayer had in the property sought to be reached by the statute.” *Id.* (citing *Morgan v. Commissioner*, 309 U.S. 78, 82 (1940)). Accordingly, because the defendant had no state recognized interest in the real estate, but only beneficiary interest in the personal property, the federal tax lien could not have attached to that real property. The second mortgage, however, was specifically secured by the real estate.

Subsequently, in *People v. Chicago Title and Trust Co.*, 75 Ill. 2d 479, 389 N.E.2d 540 (1979) the Illinois Supreme Court wrote an opinion that seemingly overruled *Chicago Federal Savings and Loan v. Cacciatore*. The Internal Revenue Service, in its discussion of Illinois land trust doctrine, also supports that position. IRS LB 319, 1987 WL 754207. In *Chicago Title*, the state brought action to recover unpaid real estate taxes on a property held in a land trust. The court opined that the beneficiaries, although holding no title to the land, could attribute for all aspects of ownership and therefore should be considered “owners” of the land and thus become liable for the unpaid tax. *Id.* at 494, 389 N.E.2d at 546. The *Chicago Title* court cited *Chicago Federal Savings and Loan* for several principles of law. Nowhere within the body of the opinion did the court distinguish the facts of the two cases or imply that the prior case was no longer good law. As taxpayers, perhaps we can safely presume that the case was decided on policy. If the court held otherwise, the state would bar itself from collecting taxes owed to it. This presumption is supported by the Illinois Appellate Court for the 1st District in *Wagemann Oil Co. v. Marathon Oil Co.*, 306 Ill. App. 3d 562, 714 N.E.2d 107 (1st Dist. 1999) in which the court declined to extend the prior ruling and in fact limited it to three scenarios; statute of frauds, real estate taxation, and eminent domain proceedings. *Id.* at 573, 714 N.E.2d at 115. The Illinois Supreme Court denied appeal, perhaps implying that it agreed with the appellate court’s interpretation.

In *Wagemann*, the plaintiff was assigned the beneficial ownership of property held in a land trust as collateral for a loan. Nearly 20 years later, the beneficial owners directed the trust to transfer the property to them as tenants by the entirety. The plaintiff filed suit seeking to impose a constructive trust and to set aside the transfer. The court ruled in the plaintiff’s favor and imposed a constructive trust in a form of a lien. The court further held that the transfer of the trust property into a tenants-by-the-entirety estate was void. During the proceedings, the defendant secured and properly recorded a judgment against the beneficial owners. In addition, the government filed two federal tax liens against the beneficial owners and properly recorded them with the county. The plaintiff argued that because it was the first to record the lien, it should have priority. The court, however, applied the logic of *Chicago Federal Savings and Loan* and held that plaintiff’s beneficial interest did not attach to the real estate itself. *Id.* at 573, 714 N.E.2d at 115.

The Supreme Court of United States has held that “the federal tax lien statute itself creates no property right but merely attaches consequences, federally defined, to rights created under state law.” *United States v.*

*Craft*, 535 U.S. 274, 278 (2002). The court reaffirmed the rule that it will first “look to state law to determine what rights the taxpayer has in the property the Government seeks to reach, then to federal law to determine whether the taxpayer’s state-delineated rights qualify as ‘property’ or ‘rights to property’ within the compass of the federal tax lien legislation.” *Id.* Accordingly, to determine liability, a court would first have to determine what interest the beneficiary to the trust holds under Illinois law. (The *Cacciatore* and *Wagemann* decisions, along with numerous others defining a land trust, hold that the beneficiary holds only interest to personal property and no interest in the real estate.) Next, the court must contemplate federal tax lien legislation to determine what happens to that property. The government can attach personal property, but not the real estate interests that are held by the trust. Thus, the property held in trust may be protected from tax ramifications or a sale to recover taxes. If a trust secures a mortgage only the mortgage holder, in this instance, would have the ability to attach the property.

### **Conclusion**

The economy, the tumultuous housing market, rising taxes and even fear of the future may create an interest in a land trust provision for the placement of real and personal property. While this vehicle may not be right for every person, it may benefit others by protecting the property from being encumbered by tax liens.

### **About the Author**

**Tracy E. Stevenson** is a partner in the Chicago firm of *Robbins, Salomon & Patt, Ltd.*, where she concentrates her practice in medical malpractice defense and insurance defense. She has defended cases on behalf of physicians and hospitals and represented various major insurance companies in claims involving fraud. Ms. Stevenson also represents corporations in litigation matters including TRO’s and shareholder actions. She is licensed in Michigan as well as Illinois and speaks at various seminars around the country.