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William B. Garrett

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LAND TRUSTS

_I do not own an inch of land, _
_But all I see is mine._
—LUCY LARCOM, _A Strip of Blue._

RECENT DEVELOPMENTS IN ILLINOIS LAND TRUST LAW

WILLIAM B. GARRETT

Probably the best known Illinois contribution to the trust field is the so-called "land trust." Actually the implications of the name "land trust" exceed the actual facts. Such trusts would better have been named "title holding trusts" for that is a far more accurate description of their function. Nevertheless, the term "land trust" will be used in this article.

There are land trusts in existence in other states—Indiana, Florida, Minnesota, and Colorado, for example. But there appears to be no case law in any of those states supporting them. Without supporting case law there are always misgivings concerning them. For example, some years ago there was a determined effort to develop the use of land trusts in Florida. Illinois forms were followed generally, with some expansion in the trustee's duties in order to lessen the danger that the Statute of Uses would be applied. However, it is understood that as of this date, there are doubts in Florida concerning land trusts in that state.

In an Illinois land trust the trustee holds legal and equitable title to real estate subject to full powers of direction and control in the trust beneficiaries. The duties of the trustee are to deal with the title on direction of the beneficiaries or such person as may be designated for the purpose by the beneficiaries and, at the end of a period specified in the trust agreement, if any property remains in the trust, to sell such property at public sale and divide the proceeds among those entitled thereto. The title is conveyed to the trustee by a so-called

Mr. Garrett, a member of the Illinois Bar, received his A.B. from Knox College and his LL.B. from Harvard University. He is an attorney of the Law Division of Chicago Title and Trust Company. Mr. Garrett is a member of the Chicago Bar Association Committee on Real Property, and is Editor of the Real Estate newsletter published by the Real Estate Section of the Illinois State Bar Association.
“full power deed in trust” whereby, so far as the public is concerned, all necessary power with respect to dealing with the title is in the trustee. The beneficiaries of such trusts retain the right of possession to the property together with all rights to the proceeds and avails therefrom.

The Illinois decisions concerning land trusts have been previously assembled and discussed. Therefore, it is enough here to mention rather hurriedly the leading Illinois cases decided prior to 1955 on various phases of land trust law. Cases decided subsequent to 1955 will be discussed in more detail.

The interest of the beneficiaries of a land trust is personal property. The Statute of Uses does not apply to land trusts. The trustee of a land trust is not liable for injuries suffered because of negligent maintenance of the trust property. The trust beneficiaries are not ipso facto agents of the trustee. Nor, ordinarily, is the trustee the agent of the beneficiaries. The land trust trustee may effectively exculpate himself from personal liability for contracts entered into on behalf of the trust. Judgments against land trust beneficiaries are not liens against the land trust property. Partition will not lie with respect to property held in a land trust.


"Recent cases" here means those which have been decided since 1955. They are not numerous, but they are of some significance.

The most important recent land trust decision is undoubtedly Horney v. Hayes. The land trust in this case had been established in 1948. Horney was the beneficiary. The real estate was subject to both a first and a second mortgage. On April 5, 1950, Horney assigned his certificate of beneficial interest as security for a loan from Hayes. The loan was once extended for thirty days, but was not paid at its maturity. By that time both the first and second mortgages were in default. There was an accumulation of mechanic's lien claims of record. Operating and maintenance bills were unpaid. After notice to Horney, the pledged certificate of beneficial interest was sold to Walsh at the office of the land trust trustee. Horney instituted the proceedings, alleging that the pledge of the beneficial interest was in fact a mortgage of real estate and that therefore he had a right of redemption.

In 1922, the Supreme Court of Illinois had decided DeVoigne v. Chicago Title & Trust Co. The DeVoignes, owners of a vacant lot, were building a home thereon. The contractors demanded security before they would proceed, and accordingly the property was conveyed into a land trust whereby it was provided that if the DeVoignes should pay the contractors within sixty days after completion of the construction, the trustee would reconvey the property to the DeVoignes subject only to the existing first mortgage. If, however, the contractors were not paid within sixty days after completion of the house, the trustee, after notice, would sell the property at public sale subject to the first mortgage. The contractors were to be paid from the proceeds of sale and the balance, if any, was to be distributed to the DeVoignes. The Supreme Court of Illinois held that the deed to the trustee and the trust agreement "were intended as a mortgage and created a mortgage." Being a mortgage, "it would continue to be a mortgage until the right of redemption should be barred in some of the modes recognized by law."

In the Horney case the Supreme Court carefully considered the DeVoigne decision and decided that it was not controlling. In Horney there was no provision for sale of the real estate and the trust was

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10 11 Ill.2d 178, 142 N.E.2d 94 (1957).
11 304 Ill. 177, 136 N.E. 498 (1922).
12 Id. at 183, 136 N.E. at 501.
13 Ibid.
not created as security for a debt. The transaction between Horney and Hayes was subsequent to the creation of the trust and was concerned only with the beneficial interest in the trust. Accordingly, the court held that Horney had no right of redemption. The beneficial interest was personal property and the law of pledges of personality was applicable.

The Horney and DeVoigne cases are discussed in some detail because of the possibility that some lenders might seize upon the Horney case as establishing a simple method of loaning money to individuals on real estate security and avoiding the twelve-month Illinois redemption period. The DeVoigne case was not overruled in Horney. It remains clearly the law that a land trust may not be used as a device to circumvent the right of redemption.

In the practical phase of the matter, the dividing line between a proper pledge of a beneficial interest in a land trust and a real estate mortgage may not always be easily determined. There are four tests set up in the Horney decision: (1) The trust must not provide for sale of the real estate on default in a debt; (2) the trust must not be set up as a security for a debt; (3) the pledge of the beneficial interest must be subsequent to the creation of the trust; and (4) the transaction must be concerned only with the beneficial interest in the trust. Those tests should be carefully applied.

In 1957, the General Assembly of Illinois adopted legislation permitting corporate trustees in certain cases to waive the right of redemption in mortgages executed by them after July 1, 1957. Certain exceptions are found in the statute, however. The waiver may not be made when the property in question is improved with or is to be used for construction of a dwelling for not more than four families. The law does not apply also where the land involved is used for agricultural purposes. Decree or judgment creditors of the trustee in its representative capacity and decree or judgment creditors of the trust estate are given three months after the sale in which to redeem. Although the statute does not specifically refer to land trusts, its primary effect is upon such trusts.

Schneider v. Pioneer Trust & Sav. Bank was decided in May 1960. A written offer to purchase real estate was directed to the trustee of a land trust. The sole beneficiary accepted the offer in his own name.

and without authority so to do from the trustee. The offeror failed to go through with the sale and the beneficiary brought suit against him. The court held that since there was no acceptance of the offer by the offeree, the trustee, a valid contract was never formed. The following words of Justice Bryant have applicability to several land trust situations:

The land trust form of land ownership yields certain benefits to the beneficiaries, whether it be effective management, secret ownership, insulation from personal liability or some other advantage. These benefits result from the willingness on the part of the courts of Illinois, to observe the form of the trust transaction. Reducing one's ownership to a beneficial interest brings about this result. Consistency requires, then, the observance by the beneficiary of the form of the trustee's ownership. Retaining the nature of his interest in order to be entitled to the advantages of a land trust, he may not then deal with the property as if no such trust existed. The trustee's interest is in the title to the real estate and if the beneficiary wishes to deal with that title, he must do so through the trustee.16

In 1957, the Supreme Court, in Chicago Land Clearance Comm'n v. Darrow,17 reaffirmed its previous holding18 that the beneficiary of a land trust is not a necessary party in a suit to condemn real estate. Such a decision confirms other decisions with respect to real estate held in land trusts, and again establishes the conclusion that the beneficiaries have no interest in the legal title. However, it should not be concluded from this case that the beneficiaries are not necessary parties to a mortgage foreclosure. Beneficiaries of land trusts should be made parties in mortgage foreclosures because of the holding in DeVoigne v. Chicago Title & Trust Co.19 wherein the court held that a land trust expressly established as a security device would not effectively bar the right of redemption of the beneficiaries.

The Darrow case has other implications. In that case the Supreme Court clearly reaffirmed basic premises of the Appellate Court decisions20 that a judgment against a land trust beneficiary is not a lien against the real estate in the land trust.21 In Illinois "all persons in-

16 Id. at 466, 168 N.E.2d at 809.
17 12 Ill.2d 365, 146 N.E.2d 32 (1957).
19 304 Ill. 177, 136 N.E. 498 (1922).
21 Ibid.
interested... [in the property to be condemned] as owners or otherwise as appearing of record must be made parties to the condemnation proceedings. Compare that language with the statutory provisions concerning the lien of judgments: "... [A] judgment of a court of record shall be a lien on the real estate of the person against whom it is obtained. ..." The Condemnation Statute speaks of persons "interested therein as owners." The Judgment Statute refers to "real estate of the persons." The Judgment Act goes on to define "real estate" thus: "... 'real estate' when used in this act shall include lands, tenements, hereditaments, and all legal and equitable rights and interests therein and thereto." There appears to be considerably more flexibility in the eminent domain statute with its reference to "all persons interested as owners or otherwise" than in the words of the Judgment Statute. Therefore, a fortiori, if a beneficiary in a land trust is not a necessary party in condemnation proceedings, judgments against such beneficiary cannot constitute a lien against the real estate held in such a trust.

Another recent case which points to the same conclusion as Darrow is Seno v. Franke, which reaffirms the previous holdings of the Illinois courts that the interest of beneficiaries in a land trust is personal property. The case was concerned with the beneficial interest in a land trust. The Supreme Court held that no freehold was involved, and the case was transferred to the Appellate Court.

THE FORCIBLE DETAINER CASES

During the days of housing shortages and rent control, there were a series of decisions in the Illinois Appellate Courts which held that the trustee must bring forcible detainer proceedings where land trust real estate is involved. These cases present the most striking of the

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27 20 Ill.2d 70, 169 N.E.2d 335 (1960).
very few inconsistencies in the Illinois decisions concerning land trusts. The Illinois statute relating to forcible detainer provides:

The person entitled to the possession of lands or tenements may be restored thereto in the manner hereafter provided. . . .

Moreover, since forcible detainer is a statutory procedure, the statute must be strictly followed. The Supreme Court has clearly spoken on the matter, saying:

... [I]n an action of forcible entry and detainer the immediate right of possession is all that is involved and the title can not be inquired into for any purpose.

In the ordinary Illinois land trust, the trust agreement provides that all rights of possession are in the beneficiaries. The courts have recognized this fact. It would appear, therefore, that the proper parties to bring forcible detainer proceedings would be the beneficiaries. But the so-called forcible detainer cases have not been overruled. They were decided in times of great stress when housing was inadequate, scarce, and difficult to find. Perhaps an Illinois court, some time in the future, will see fit to reverse them or to restate the law. But in the meantime, counsel with a forcible detainer problem concerning a land trust will do well to bear them in mind.

Relations of Beneficiaries Among Themselves

In most land trusts there are two or more beneficiaries. Where improved property is concerned, those beneficiaries are carrying on a business among themselves—the operation of an apartment building or commercial property or an office building or a farm. Such business is completely independent of the trustee, who knows nothing about it, does not participate in it, and has no interest in it.

Even though there may be no written contract among the beneficiaries concerning the operation of the trust property, nevertheless, if there is an agreement among them to carry on the enterprise jointly and according to their respective investments, there is a partnership

32 Brazowski v. Chicago Title & Trust Co., 280 Ill. App. 293 (1935).
33 Cases cited supra note 28.
present either by their oral agreement or by implication from the circumstances under which the business is carried on. It is not even necessary that the property be improved, so as to entail a day-by-day business operation. Where parties agree to engage in one or more particular transactions for the purchase and sale of real estate for profit, this constitutes a partnership as to the particular transaction or transactions.

The properly prepared land trust documents will include a carefully drawn contract setting out the relationships of the beneficiaries among themselves. This contract is separate and apart from the trust agreement. The land trust trustee has no part in it and no notice of its terms. It will provide for the manner of collecting income and for its distribution among the beneficiaries. In some cases a partnership will be established before the trust is set up, and the partnership itself will be the beneficiary. Where a partnership agreement has been prepared, there will accrue to it the benefits and certainty of the Uniform Partnership Act which is effective in Illinois.

In a great many instances, however, the relationships of the beneficiaries among themselves are highly informal, even though in law a partnership may exist. The trust agreement may provide, directly or indirectly, that any beneficiary may veto a direction to the trustee to convey the property, even though the interest of that beneficiary is but a small fractional interest in the whole beneficial interest. The spirit of friendship and cooperation usually present when the trust was established does not always carry on through the years. Situations arise where one beneficiary or one group of beneficiaries want to sell the property. But there is a dissenter or dissenters. An impasse results. There is no clear method to unfreeze the situation where some beneficiaries want to sell and others do not. Partition is out of the question. A method which has been followed in such situations is the institution of proceedings in chancery for an accounting and dissolution of the partnership of the beneficiaries. It is understood that this method has been followed in several cases in the Circuit or Su-

86 Harmon v. Martin, 395 Ill. 595, 71 N.E.2d 74 (1947).
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Prior Courts of Cook County. However, none has yet reached the Appellate or Supreme Court.

One means which has been suggested to avoid the above dilemma is to provide in the trust agreement that on direction from any beneficiary, the trustee will convey the interest of such beneficiary to him. Thereupon, partition proceedings may be brought. However, there are dangers in such a radical departure from the usual land trust forms. For example, a court might well conclude that because of a provision putting such power in each beneficiary, the Statute of Uses would operate at the organization of the trust. Or because of the ease by which a single beneficiary can convert his land trust personal property into real estate, his interest in the trust from the outset could be held to be real estate.

TAXABILITY AS AN ASSOCIATION

The land trust trustee is not concerned with income taxes because the trustee, since he holds only the legal and equitable title with no control over the use, proceeds, or avails of the property for which the title is held in trust, has no income, actual or constructive. The beneficiaries, however, do have income and as surely as the day follows the night, federal income tax problems arise. It is not the intention here to deal with all of those problems. Some, however, should be discussed.

In many land trust situations the subject of the trust is the title to valuable, improved real estate. In such cases there frequently are a number of beneficiaries. Efficient management would forbid the concurrence of all the beneficiaries in the many day-by-day decisions which must be made. Further, some permanence in the ownership and control is desirable. The net result of such features is the possibility that the entity will be treated by the Treasury Department as an association, and therefore taxable as a corporation. Up until quite recently there were no definitive regulations from the Treasury concerning this problem. There had been some articles in legal publications dealing indirectly with the subject. Those articles, although they cited pertinent cases, made no pretense of being final treatments of the subject. In addition, there was some text book treatment of the problem in The Joint Venture and Tax Classification.


40 Taubman, The Joint Venture and Tax Classification (1957).
In 1960, however, regulations dealing generally with the problems of classification of organizations for tax purposes were issued by the Treasury Department. The inspiration of these regulations, at least in part, was the *Kintner* case. In that case a group of physicians were seeking to obtain the opposite result to that usually sought by land trust beneficiaries. The doctors wanted to be taxed as an association in order that they could establish a pension plan.

The regulations set forth six tests to determine whether a group should be treated as an association for tax purposes. They are: (a) a group of associates, (b) an objective to carry on a business and divide the gains therefrom, (c) continuity of life, (d) centralization of management, (e) liability for corporate debts limited to corporate property, and (f) free transferability of interests. However, it is not necessary that all of the so-called corporate characteristics be present for the corporate or association basis of taxation to be imposed. The regulations state that an unincorporated organization shall not be classified as an association unless such organization has more corporate characteristics than noncorporate characteristics.

In considering corporate characteristics there is no need to dwell upon the first one, "a group of associates." Obviously, there can be no association where the land trust has but one beneficiary.

The second-named characteristic is "continuity of life." An organization has such continuity if the death, insanity, bankruptcy, retirement, resignation, or expulsion of any member will not cause a dissolution of the organization. This so-called corporate characteristic will be eliminated if the beneficiaries are united together by a partnership agreement which states that the relationship will terminate upon the death or withdrawal of a member. Further, it is the law of Illinois that as a general rule, the death of a partner dissolves the partnership. However, the surviving partners may, pursuant to the partnership agreement, have the right to purchase the interest of the deceased partner on terms set forth in the agreement.

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42 United States v. Kintner, 216 F.2d 418 (9th Cir. 1954).
43 In my discussion of the problems of classification for income tax purposes, I am indebted to unpublished material prepared by Jackson L. Boughner of the Chicago Bar.
44 Treas. Reg. § 301.7701.2 (1960).
In connection with so-called "continuity of life," it should be of
no consequence whatsoever that the land trust itself might have such
continuity. Neither the land trust nor the land trust trustee is a mem-
ber of the group of "associates" who are carrying on a business and
dividing the gain therefrom, which are the first and second require-
ments for treatment as an association. The beneficiaries are the group.
They are carrying on the business. They divide the gains. The land
trust and its trustee have no interest, no knowledge, and no rights
therein. Therefore, only the continuity of life of the organization set
up by the beneficiaries to carry on their enterprise is of consequence
in finding continuity of life for purposes of the regulations.

Obviously, termination by death or withdrawal of a partner is a
disadvantage in the continuous operation of the enterprise carried
on by the land trust beneficiaries. But the danger of its absence—
taxation as an association before distribution of earnings—may be
sufficient to overcome the disadvantages of its presence. And the
regulations clearly state that a provision that the business will be
continued by the remaining members after death or withdrawal of
a member does not give to the organization the corporate characteris-
tic of continuity of life.\footnote{47}

Centralized management, under the regulations, exists where any
person or any group of persons which does not include all members
has continuing exclusive authority to make the management decisions
necessary for the conduct of the business for which the organization
was formed. Where there are numerous beneficiaries in a land trust,
some form of centralized management cannot well be avoided. An
agreement for centralized management may be effective among par-
ticipating partners, but under partnership law each partner may never-
theless have implied power to bind the partnership.\footnote{48 But there are
statutory restrictions on that power of any partner to act on behalf
of the partnership. Such acts by a partner as the following may not
bind the other partners.\footnote{49}

\begin{itemize}
  \item (a) An act of a partner which is not apparently for the purpose of carrying
        on the partnership in the usual way.
  \item (b) Assignment of partnership property for the benefit of creditors.
  \item (c) Disposal of the good will of the partnership.
\end{itemize}

\footnote{47 Treas. Reg. § 301.7701.2 (1960).}
\footnote{48 Ill. Rev. Stat. ch. 106½, § 9 (1959).}
\footnote{49 Ill. Rev. Stat. ch. 106½, § 9(1) (2) (3) (1959)
(d) Any act which would make it impossible for the partnership to carry on its ordinary business.
(e) Confession of a judgment.
(f) Submission of a partnership claim or liability to arbitration or reference.

There is the further restriction that no partner may bind the partnership in contravention of his authority to any person who has knowledge of the restrictions on his authority. Those are rather imposing restrictions upon a partner's right to bind his fellows. Among the partners there is little doubt that the powers of individual partners may be limited. That however, as noted above, does not affect apparent authority.

The foregoing bears also on the so-called corporate characteristics of "limitation of liability." If the beneficiaries are partners and subject to the Uniform Partnership Act, the regulations specifically provide that there is no limitation of liability unless there is a limited partnership.

In many real estate enterprises, where the legal title is in a land trust trustee, restrictions on the transferability of beneficial interests are desirable. There are several different motives which might require control of membership of the beneficiary group. Provisions to that effect are included in the partnership agreement, although they are not ordinarily incorporated in the trust agreement. Such inclusion clearly would eliminate any question of free transferability of interests set forth in the regulations as one of the corporate characteristics.

It well may be that a wholly informal partnership agreement among partners would preclude the association treatment for federal tax purposes. However, it would seem that better practice would require a carefully drawn written partnership agreement for tax reasons, as well as for clear understanding among the beneficiaries.

STUDY OF LAND TRUSTS

There are many thousands of parcels of Illinois real estate to which title is held in land trusts. Millions of dollars of value are involved. Obviously the subject of land trusts is one of considerable importance in Illinois. The Chicago Bar Association Committee on Devel-

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52 Treas. Reg. § 301.7701.1-.7701.4 (1960).
opment of the Law sometime ago appointed a subcommittee on Illinois land trusts. The upshot was that the Bar Association in March of 1960 appointed a Special Committee for the Study of Land Trusts. Representatives from other Bar Association committees concerned with substantive law were appointed to that committee. Real property law, state and local taxation, federal taxes, trusts, and matrimonial law are all represented. The Special Committee has had regular meetings. It is expected that the final report of the Committee will include suggestions and comments which will be helpful in administering land trusts and in interpreting their legal consequences and implications. It is possible that some legislation will be recommended. All lawyers who are concerned with land trusts await that report with great interest.