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Land Trusts Get No Respect

About once a week we get a comment about land trusts from someone who has no clue what a land trust is and occasionally their comments are so strange we literally break out in laughter. One of the most recent comments was, "I looked in Sunbiz.org and couldn't find your land trust so it must be illegal." The more common comment is, "I need to see the incorporation papers for the land trust."

I suggest you save this article in a safe place and next time someone or some professional asks you "What is a land trust?", or asks one of the above questions; send this to him/her.

One of the other comments that is actually disturbing is "I have to have the Social Security or TIN (Tax Identification number) number for the land trust." This is bothersome, not because it is a senseless question as you will soon see, but rather a disturbing trend where realtors are asking for copies of buyers' drivers' licenses, social security numbers of buyers – even when an LLC or corporation is involved.

There is no reason that they need these very personal and confidential identification numbers. The closing agent will need them at the appropriate time when the property is closing because of IRS requirements, but not when an offer is made on a property. Why would they ask for them when they have no use for them? Are they selling them online with the rest of the personal info of the buyers, or are they trying to intimidate buyers to not make offers so they keep the property as a "Pocket Listing" for their buddies?

I am submitting the following explanation to clear the air about land trusts. First there are two types of land trusts. The less common one is where a conservancy group purchases or administers land in a trust, hence "land trust". We won't go into these because they are of no relevance to what we do as investors.

Land trusts are simply an agreement (trust document) whereby the Trustee agrees to hold ownership of a piece of real property (real estate), as dictated by the terms of the agreement (trust) for the benefit of another party (Beneficiary). The Beneficiary can be one or many people or entities such as LLCs, Corporations, partnerships or even other trusts. The Beneficiaries are the owners of the trust and the Trustee administers the day-to-day administration of the Trust's business.

Accountants and the IRS call trusts "pass-through entities", meaning the results of all financial transactions pass through the trust without taxation to this entity (the trust in this case). The Beneficiaries are then taxed according to their personal or entities' tax status. So the question, "Do I need a tax ID number for

the trust?” is not relevant and more importantly, the trust cannot open a bank account – because it can’t get a tax ID from the IRS.

The most common mistake of closing agents who haven’t been experienced in closing sales of properties in land trust is to issue the proceeds to the trustee in the name of the trust. With no bank account, the trustee can’t cash the check and can’t wire the funds in because he can’t open an account.

The Beneficiaries have to give the closing agent an “Authorization to Distribute Proceeds” letter that gives the agent the authority to distribute the proceeds of a sale to whomever, or whatever, the Beneficiaries actually are. In this document, the beneficiaries will direct the closing agent to use their appropriate Tax ID numbers and what specific amounts to distribute to each Beneficiary. The Trustee of the land trust should never be disbursed money unless he is the sole Beneficiary and he gives the Authorization to Distribute Funds Letter to the closing agent.

So what’s the fuss about land trusts anyway? First, they have been around since Roman Times. When wealthy land owners went off to war, they put their land holdings into trusts in case they didn’t come back from the war. They could feel assured that the Trustee would administer the trust according to its terms and conditions for the best interests of the remaining Beneficiaries. It has worked all that time, yet still today we have “professionals” who don’t care about understanding this important financial planning instrument.

I think that some investors have taken the land trust to a new level by believing that when the Beneficial Interest of a land trust is transferred, there are not documentary stamps due on the transfer or sale by the Beneficiary to a new Beneficiary. This is TOTALLY wrong, and it is Florida law that stipulates that a change of Beneficiary by sale or transfer triggers transfer fees/documentary stamps. If the Trustee is changed, but the Beneficiaries remain the same, there are no doc stamps due, just the filing and recording of a new Deed to Trustee.

We have used land trusts for at least 20 years and others have used them for the last 100 years so we know they work. Land Trusts have had much less scrutiny by the courts than LLCs who are still winding through the state courts. The Supreme Court made their ruling last year which will change the way LLCs are handled.

In short, lenders hate land trusts but allow them in REO transactions, but not short sales. The reason being the lenders never know for sure who the actual owner (Beneficiary) is even at the closing because the Beneficial Ownership can be transferred in minutes without the recording of any documents.

The majority of attorneys hate them because, at least in their mind, they believe it takes business away from them. If they embraced the concept and purpose of

the land trust, they might do much better. I recently spoke to a paralegal that had done hundreds and hundreds of land trust closings for her former attorney – yes, some attorneys specialize in land trusts. These closings were for some of the wealthiest and most famous people in the country but their names never showed in the public record.

The real purpose of a land trust is to make the beneficial owners of the trust anonymous in the public record. This is what some attorneys call the most “perfect” form of asset protection as the first line of defense – if the plaintiff’s attorney can’t find the asset, he is less likely to take on litigation where the defendant has little or nothing. If you decide to do a land trust to help “hide” assets, don’t put yourself as Trustee or you have defeated the entire point of stealthing your assets.

Here is the best way to use a land trust when doing real estate deals if you have no money or don’t want to put money up to close. The usual method is a double closing called an “A – B” and “B – C” transaction. The “players” in this transaction are the “A” being the original seller, “B” being the investor, and “C” being the end-buyer. This method requires money being brought to the closing table by the investor “B” unless he can use the end-buyer’s money “C”. This can be an issue for a closing agent if it is not done properly which may mean hard money or transactional funding for one day.

A much easier solution is to have the end-buyer (“C”) allow the investor (“B”) to use his money to close. Get this in writing so your closing agent is agreeable to doing the closing. If you try this with an end-buyer who is getting conventional financing to buy the property, you will likely kill the deal or get indicted for bank fraud sometime in the distant future when you least expect it. Just because someone told you they did it doesn’t mean it is at all legal.

Using a land trust to do this transaction requires the investor “B” to put a Contract on the property (with “A”) but the buyer (“B”) is the Trustee of a land trust. Just prior to, or even minutes before the actual closing talks place, “B” who is usually the Trustee, transfers the beneficial ownership to the end-buyer “C” and “C” uses his money to close as he is buying the property directly from “A” and the Beneficiary of the land trust. After the closing, “C” will replace “B” as the Trustee so “C” has complete control of the trust’s business.

It is the end-buyer’s (“C”) legal responsibility to issue a IRS Form 1099 to the former Trustee or Beneficiary if he/it is an individual or LLC. No such 1099 is required if it is a corporation – check with you CPA on this most important issue, otherwise you may be responsible for paying the income taxes on the profit (“B”) made if he/it doesn’t repost the income!

I haven’t mentioned Living Trusts because they have a different function that is far more important than land trusts. Their function is to avoid probate among

other things which can save estates of thousands to millions of dollars by avoiding probate. If you think you got a great deal on a Simple Will, wait until it has to be probated! Between taxation and attorneys' fees for contested estates, sometime 70% can be lost.

None of the above is legal advice, so always check with an attorney who knows about, and regularly uses land trusts in his/her practice. Always consult with your CPA about income tax consequences, especially if you are doing real estate full-time and own an LLC as your transaction vehicle. You may be better off using a Sub S Corp in many cases.

To your limitless success,

Dave Dinkel

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