LAND TRUSTS IN TEXAS

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INTRODUCTION

A land trust has been defined as a "device by which real estate is conveyed to a trustee under an arrangement reserving to the beneficiaries the full management and control of the property."[1]

A typical Illinois land trust is usually created by two separate written instruments: (1) a recorded deed, which transfers title to the real property from the settlor (also called the grantor or trustor) to the trustee; and (2) an unrecorded trust agreement between the trustee and the settlor (and sometimes the beneficiary) of the trust.

The recorded deed to the trustee usually contains a provision which gives the trustee the express power to sell, contract to sell, mortgage, lease, or otherwise dispose of the trust corpus. The deed may further provide that persons dealing with the trustee, as purchaser, lender, lessee, or otherwise, are fully protected in relying upon the authority of the trustee to act with respect to the trust corpus, and are not required to investigate the authority of the trustee. The beneficiaries are usually not named, though a name for the trust is sometimes specified. The deed also may provide that the interest of the beneficiaries or any person claiming under them is limited to the proceeds from the disposition of the trust corpus. Finally, there may be an express statement that the interest of the beneficiaries is personalty, not realty.

In the second document, the trust agreement, which is not recorded, the settlor is usually, though not always, also the beneficiary. The settlor/beneficiary contracts with the trustee, and the contract provides for limits of the trustee's authority, notwithstanding the apparent unlimited authority of the trustee in dealing with third parties that is recited in the deed. However, the trust agreement usually provides that the agreement may not be recorded, and that the trustee is prohibited from disclosing the terms of the trust agreement or the names of the beneficiaries to third parties other than by court order or the written permission of all of the beneficiaries. Notwithstanding the apparent independent authority of the trustee contained in the deed upon which third parties are entitled to rely, as between the trustee and the beneficiary per the terms of the trust agreement, the trustee is given the power to dispose of the trust property to a third party only by written authorization from a majority (or sometimes all) of the beneficiaries, or, at the end of twenty years, he is directed to sell any remaining property and to distribute the proceeds to the beneficiaries. The beneficiaries retain the right to possess, manage, and control the property, and the right to receive all income and proceeds from the property. The parties usually agree that the interest of the beneficiaries is personalty only, and not realty. The trust is usually a living, revocable trust, with the settlor/beneficiary retaining the right to remove the trustee and to name another, or providing for successor trustees in the event that the original named trustee is removed or cannot serve for any reason. It typically provides for the beneficiaries to reimburse the trustee for his expenses, and to defend and indemnify him for any claims brought against him arising from his role as trustee.

There is a dearth of Texas legal authority dealing with land trusts, which is probably why there is a lack of understanding of the subject in Texas. In my research, I have found only one law review article, dating back to 1973. I have found no cases expressly discussing land trusts or Illinois land trusts.

Charles J. Jacobus, in his well known text, *Texas Real Estate Law*, describes another form of land trust which he indicates is becoming a common means of ownership in Texas. In this form of a land trust, a promoter buys land as a "trustee" on behalf of investors who are acquiring the property for management or speculative holding purposes. The theory is that the management and ownership will vest in only one person, who will be the trustee, for the benefit of the investors, who are the beneficiaries.[2] Jacobus points out that just calling a person a "trustee" does not create a trust. *Nalona Development Association v. Corsi*, 682 S.W.2d 246 (Tex. 1984). Jacobus asserts that this type of ownership maintains the secrecy of the beneficiaries, requires no initial cost to form, and has been used countless times without any adverse consequences, despite the fact that laws affecting the liabilities of the various parties are not well settled and may be subject to differing interpretations by Texas courts.[3] Despite passage of a Texas Trust Code, the legal requirements for a land trust are still a little hazy in Texas.[4]

Sometimes what is at the heart of a problem presents an opportunity. The fact that land trusts are not widely utilized in Texas, that the law is not well developed, and that land trusts are not fully understood by lawyers, accountants, title companies, lenders and brokers, creates both a problem and an opportunity. This paper will review the advantages and potential problems of using a land trust in real property transactions in Texas.

HISTORY OF LAND TRUSTS

Trusts have been around for a long time. They were utilized in feudal times to convey property to a trustee to hold for the benefit of third parties, such as the church, which could not legally own property in its own right.

Since ownership of land obligated the owner to pay taxes to the King, and to serve in the King's army, legal title was sometimes transferred to a relative or friends to remove the name of the real owner from the public ownership records. The former owner arranged to retain all of the benefits of ownership without having title in his name. The trustee to whom legal title was transferred dealt with the public as if he were the true owner. Sometimes only the trustee in whose name the property was legally titled and the true beneficial owner knew of the arrangement.[5]

The original "Statute of Uses"[6] outlawed the use of trusts by declaring that such arrangements vested all title in the real estate in the true beneficial owner, called the *cestui que trust* ("he for whose use land is held by another"). The English courts modified this rule by stating that a trust was valid so long as the trustee had some duties to perform and was not a mere "nominee" title-holder.[7]

MODERN USE OF LAND TRUSTS

Because this form of trust originated under the common law of Illinois, and because of its use in that state[8], the land trust is frequently called an "Illinois land trust." Legislation in several states, notably Alabama, Florida, Georgia, Hawaii, Indiana, North Dakota, Ohio and Virginia[9], has been enacted that recognizes and validates the use of these trusts.

In his survey of the issue in 1973, Richard Sayles found no known case law supporting the validity of the concept of a land trust in Texas.[10] My own research also finds no case law on the subject of land trusts or Illinois land trusts. But with increasing frequency, entrepreneurs and investors have heard of the benefits of using a land trust in other jurisdictions, and Texas lawyers are being asked to opine as to the viability of such transactions.

LAND TRUST THEORY

Part of the theory of a land trust is that the trustee has both legal title and equitable title to the real property. Equitable title is normally thought of as the right of the true owner to receive legal title at some time in the future, or to describe one's interest in real estate that legal title does not define. It has been defined in case law in Texas as "an enforceable right to have legal title transferred to the holder of the equity."[11] But in the case of a land trust, it is understood that the beneficiary will receive only the proceeds from the operation or sale of the property, not the title to the property itself. Therefore, by agreement of the parties, the beneficial interest in a land trust is merely the right to possession, rents, profits, management, and the right to direct the trustee as to the disposition of the property, and such beneficial interest is personalty, and not realty.

The states which have enacted land trust legislation specify that beneficial interests under a land trust are personal property. In other states, the doctrine of "equitable conversion" converts the seller's interest in the proceeds from a sale of real estate from a real property interest into personalty, that being the right to receive the proceeds of the sale. Part of the theory of the land trust is that since the trust agreement states that the trustee is to sell the property at the end of the twenty year term, the settlor's interest under the trust is converted from realty into personalty from the inception of the trust. In those states which have validated the use of land trusts, the courts will generally enforce the expressed intention of the parties to treat the interest of the settlor/beneficiary as personal property.[12]

The fact that the beneficiary has the power to direct the trustee as to the disposition of the property distinguishes it from the typical trust in which the trustee either has discretion to do what he thinks is appropriate, or is directed by the express provisions of the trust instrument as to what he is to do.

Because the beneficiary has the right to control and manage the trust property, Texas courts may consider the trust to be "dry" or "passive" and void the trust if it is challenged for some reason.[13] But it seems clear that the trustee has some significant duties, if only in his obligation to sell the property at the end of the twenty year term.

BENEFITS OF A LAND TRUST

The potential benefits of the land trust are numerous, including the following identified by Bill Bronchick: privacy for the beneficiaries; asset protection by discouraging lawsuits; ease of transfer of the beneficial interests without affecting the title to the real estate; convenience of multiple ownership; avoidance of probate; ease of establishment and dissolution of the trust; and minimal tax reporting requirements.[14]

Under normal circumstances the nature and extent of the beneficial interest will be hidden from public view. The transfer of the property to the trustee is all that is visible to outside third parties from public records. It will often be assumed that the transfer is merely an estate planning vehicle in the form of a typical living trust to avoid probate. A search of current deed records by the name of the owner will only reveal that title is held by a trustee. Because the trust is given a name (usually relating to the address of the property), title to the property may be reflected on the computerized records in the name of the trust, or the name of the trustee, or both. Computerization of deed records frequently results in the truncation of the grantee's name listed on the deed. If the name given for the grantee is the name of the trust, followed by the trustee's name ("1234 East Main Street Trust, I. M. Trustworthy, Trustee"), the abbreviated computer field which can be seen by the public may not even reflect the trustee's full name. The address for the grantee could show "c/o I.M. Trustworthy, Trustee."[15]

The trust itself is not a legal entity, but merely a relationship between two or more parties having different capacities.[16] Imagine for a moment that you and I do not trust one another, but we decide to make a bet on the outcome of a Dallas Mavericks and San Antonio Spurs NBA playoff game. Suppose we each bet $10 and give our combined $20 to a bartender to hold until the game is finished. We might instruct the bartender to pay the $20 to me if the Mavericks win, and to you if the Spurs win. If an IRS agent walks into the bar before the game is over, and announces that he is seizing the property of the bartender for failing to pay his taxes, the $20 the bartender is holding for our benefit should not be seized by the IRS to satisfy the tax obligation, because the bartender is merely holding our money in trust for our benefit, and it does not represent an asset that belongs to him for the satisfaction of his debts. The bartender is serving as our trustee, with clear instructions as to how the money is to be distributed depending upon the outcome of the game.

In Texas, legal title is not taken in the trust, but only in the trustee. A trust is not a legal entity that can be sued, nor can it sue. If the trustee is careful to make it clear with third parties with whom he contracts that he is acting only in his capacity as trustee, then only the trust property will be liable for contractual obligations. On the other hand, because the beneficiary of the land trust retains the ability to manage and control the property, the land trust will not necessarily insulate the beneficiary from personal liability for negligence, violation of housing code or other statutes, or other actionable claims which take place on the property.

In any event, since the trustee may not reveal the identity of the beneficiaries absent a court order or the written consent of all of the beneficiaries, the privacy of the beneficial owners is preserved. This is probably the primary benefit of using a land trust in Texas. Before a potential lawsuit is filed, many a contingency fee lawyer will perform a cursory asset search from public records. Use of the land trust probably would not reveal the beneficiary's interest. Hence, lawsuits may be discouraged, and pre-judgment settlements may be easier to negotiate based upon the assumption by the creditor that the beneficiary has little or no assets. Even a post-judgment inquiry as to the judgment debtor's interest in real property can be honestly answered in the negative if the judgment debtor has previously transferred such interest to a trustee under a land trust agreement in which the agreement is made that the interest of the settlor/beneficiary is only personalty. A truly savvy judgment creditor's attorney would need to inquire as to the judgment debtor's beneficial interest in a trust in order to discover the nature of the beneficiary's asset. Even then, the judgment creditor might have to file a separate action against the trustee to bust the trust. Even if a judgment lien is abstracted or an IRS lien is filed against the beneficiary, the theory of a land trust is that such a lien will not attach to the real estate which is only in the trustee's name.

The beneficiaries could also issue a letter of direction to the trustee to execute an agreement with a management company to manage the property. This would limit the ability of tenants to discover the interests of the beneficiaries. Although Texas does have a statute which requires the disclosure of the owner upon request by a tenant or a government official, all that is required is the disclosure of the name and address of the holder of record title according to the deed records in the county clerk's office.[17]

The beneficiaries could also form a separately capitalized legal entity with limited liability to act as the management company for the trust property, such as a corporation, limited liability company, or limited partnership. That might also help to explain the beneficiary's personal involvement in managing the property, i.e., as an employee of such management company. In Texas, management companies can legally execute leases and file eviction proceedings on behalf of the owner. Although a separate management company would have to be licensed as a real estate broker under Texas law to manage the trust property for consideration, the management company owned and staffed by the beneficiaries would not have to be licensed if there was no intention or promise of receiving any valuable consideration for the performance of the management services.[18] But the use of a separate limited liability entity to manage all of the properties in which the beneficiaries have an interest would facilitate collection of rents, and obviate the necessity for several different trusts to have separate bank accounts. Banks would normally require that the trust instrument be provided prior to the establishment of a bank account for the trust, along with a tax identification number. A separate management company would enable the beneficiaries to be involved as officers, directors and shareholders of the management company with limited liability for their participation in the management of the trust properties, and to make distributions directly to themselves from the management company's bank accounts. It would also provide the beneficiaries with the ability to resort to the "higher authority" negotiating tactic when dealing with tenants and other third parties.[19]

Or the beneficiary could be named as a co-trustee after formation of the trust. The beneficiary could be designated as the managing trustee for purposes of property management, but still not be shown on the public deed records as an owner. Using one of the beneficiaries as a co-trustee exempts the originally named trustee from IRS reporting requirements.[20]

Since under present Texas law the creation of a trust does not require a filing fee, registration with state agencies, or recording costs, it would be fairly inexpensive for each property owned by or acquired for the settlor/beneficiary to be placed into a separate trust. Since no burdensome daily responsibilities are imposed on the typical trustee in a land trust, the named trustee could be a trusted friend from another state, which would make it even more difficult for third parties to serve the trustee with legal process or to depose the trustee.[21] Or the trustee could be a corporate trustee, to provide the beneficiaries with greater confidence. In Texas, a corporate trustee must meet strict requirements for capitalization that are typically far beyond the financial ability of the typical investor. Most corporate trustees in Texas are set up as trust departments of banks.

Because the beneficiaries are not tenants-in-common, no right of partition exists. The death of one beneficiary will not force the sale of the property, or a change in the management of the trust's real property. The personal property interest of the deceased beneficiary could pass to his heirs through devise or descent, or the trust instrument could provide for the disposition of the personal property interest of such beneficiary upon his death.

Because the beneficiaries are not partners, one beneficiary cannot bind another for trust obligations. And the trust agreement can prevent a creditor who does discover and succeed to one of the beneficiary's personal property interest from taking control of the property.

If the grantor/settlor of the land trust is also the beneficiary of the trust, the primary benefit of having used the land trust would be derived from camouflaging the nature and extent of the beneficiary's interest in public deed records. From a cursory look at the deed records or property tax rolls, the beneficiary's interest does not appear. The title to the property appears to be in the name of the trustee only. If, however, deed searches or property tax rolls will reflect the names of former owners, the use of a land trust may provide less camouflage than is desired. And, as the legal profession becomes educated to the use of the land trust as a means of hiding assets from creditors, one would expect that counter-tactics might evolve.

One of the benefits of using a land trust is the ease by which the beneficial interests which are personalty can be transferred. Acknowledgment before a notary and recording of the interest is not necessary. Normal title problems which arise on the death, insanity or bankruptcy of a joint owner can be avoided. Usually all that is required is that the transferring beneficiary execute an assignment of his interest and forward it to the trustee. The record title to the real property is undisturbed despite the transfer of the beneficial interests.[22]

Using a land trust will keep the legal title to the trust property unencumbered in spite of personal judgments or IRS liens against the beneficiaries. However, since the beneficiaries' interests are personalty consisting of the right to receive the income or proceeds of the property, a judgment creditor may be able to get a turnover order or charging order as to the judgment debtor's interest - but not a lien on the real property itself.[23] Most proponents of using a land trust assume that the apparent absence of real property interests in the name of the debtor will discourage creditors or possible litigants from filing suit in the first place, or that a settlement can be more easily negotiated if the creditor is unaware of significant assets owned by the debtor.

With a traditional land trust, the beneficiaries keep control of the property held in trust. Though the majority can direct the trustee as to the maintenance and disposition of the property, a minority cannot force the sale of the property.

POTENTIAL PROBLEMS OF A LAND TRUST

If in the deed from the original owner to the trustee of a land trust there is only a single grantor/settlor who is both the grantor and also the sole beneficiary, and the trust is discovered and busted, one problem scenario is that the property is treated as though both the legal and equitable title is vested in the settlor/beneficiary.[24] Under such scenario, it can be argued that the settlor/beneficiary is no worse off than if he had retained title in his name in the first place. However, some title insurance companies on the same logic may require that the original grantor/settlor of the trust be required to consent to any subsequent transfer of the title to the property. The title insurer may take the position that just because record title is in the name of the trustee and the trustee of the land trust executes and delivers a deed to a third party purchaser or a deed of trust for the benefit of a lender does not mean that the title insurer will be willing to insure the title of such purchaser or lender. The title insurer may require that the original grantor/settlor and any subsequent assignee of the beneficial interest consent to the transaction. The logic of a title insurer in this case would be that the execution and delivery of a deed to the property by the original owner in a transaction in which the grantor of such deed is also the beneficiary of the trust, is in fact not a transfer of the equitable title to the property. This problem could be addressed by having the original owner of the property execute and deliver a deed to the trustee not for the benefit of the original owner who would then be both grantor/settlor and beneficiary, but for the benefit of the third party. The transaction would then be less like a land trust, and more like a conventional trust.

With the settlor contributing his own property to the trust for his own benefit, the land trust is a self-settled trust, and therefore cannot be a spendthrift trust, which would ultimately prevent the trust's assets from being reached by creditors.

But what if the seller of property could be persuaded to transfer it into trust for the benefit of the buyer? Would the fact that the settlor of the trust is not also the beneficiary enable spendthrift provisions to be effective? Or what if the original settlor/beneficiary transfers his beneficial interest in the trust to a third party? This transfer of the beneficial interest could also be out of view of possible creditors.

Perhaps the true worst case scenario is that the deed's recitation that legal and equitable title is vested in the trustee results in the trustee being entitled to keep the property as his own, or pledge the property to his creditors, or the trustee's creditors being permitted to execute on property conveyed to the trustee.

§ 12.034 of the Texas Property Code provides as follows:

> "Merger
>
> (a) **If a settlor transfers both the legal title and all equitable interests in property to the same person** or retains both the legal title and all equitable interests in property in himself as both the sole trustee and the sole beneficiary, **a trust is not created and the transferee holds the property as his own.** . .
>
> (b) Except as provided by Subsection (c) of this section, a trust terminates if the legal title to the trust property and all equitable interests in the trust become united in one person."

Under such circumstances the beneficiaries might argue that not **all** of the equitable interests were conveyed, in that the right to receive the rents and proceeds, to manage the trust property, and to direct the trustee as to the disposition of the property is an equitable interest. But if the parties have agreed that the only beneficial interest retained by the beneficiary is personalty, then it follows that all of the real interests have been conveyed to the trustee, and the merger provision might be interpreted to vest the property in the trustee. Though this is a possible interpretation of § 12.034, this interpretation does not seem likely, in light of § 101.002 of the Property Code, which provides as follows:

> "**101.002 Liability of Trust Property**
>
> Although trust property is held by the trustee without identifying the trust or its beneficiaries, the trust property is not liable to satisfy the personal obligations of the trustee."

The issues have yet to be addressed by the courts in Texas.

In the case of *Spiritas v. Robinowitz*, 544 S.W.2d 710, 713-715, (Tex.Civ.App. 1976, *writ ref'd, n.r.e.*), two parties had entered into a joint venture agreement between "Spiritas, Trustee" and "Robinowitz, Trustee" for the purpose of purchasing land known as the Tucker Tract. In the agreement the joint venturers were designated as trustees so that they could transfer part of their interest to third parties from time to time, yet could limit actual participation in the venture to themselves. The agreement provided that it would be governed by the Texas Uniform Partnership Act and that title to the property would be taken in the name of "Robinowitz, Trustee." Subsequently, title to the Tucker Tract was taken in the name of "Robinowitz, Trustee," and four months later title to a different tract was similarly taken. Robinowitz borrowed the purchase money for the second tract from the bank, securing his promissory note with a first lien on that tract and with a second lien on the Tucker Tract. The court held that no trust concerning the property had been created (1) because article 7425b-7 does not include a partnership agreement where one of the partners takes title to partnership property in his name as "trustee," and (2) because the joint venture agreement, in which "Robinowitz, Trustee" was one of the partners, did not show with certainty an intent to hold the title in trust for the venture, as distinguished from the partnership. The Dallas court then reasoned:

> "[The] designation ["Robinowitz, Trustee"] was made because the parties contemplated that Robinowitz would act for the benefit of certain employees to be named later. Since the venture agreement does not state that "Robinowitz, Trustee" was to take title in a capacity of trustee for the joint venture rather than as "Robinowitz, Trustee," one of the partners, we conclude that the agreement does not create an additional trust for the benefit of the venture. On the contrary, the agreement provides that the relationship of the parties is to be governed by the Texas Uniform Partnership Act. We cannot impose a trust where parties have contemplated another relationship. G. Bogert, *Trusts & Trustees*, Section 45 at 316 (2d ed. 1965). Thus, the use of "trustee" in the deed is merely a description and without legal effect. It is as if title were in Robinowitz individually. . . .We conclude that the Texas Blind Trust Act has no application here, and that article 6132b, Section 10(3) of the Texas Uniform Partnership Act, Tex.Rev.Civ.Stat.Ann. art. 6132b (Vernon 1970) governs. . ."

TAX CONSIDERATIONS

The transfer of the property into a land trust would not constitute a taxable event. No consideration is necessary for the enforceability of the transfer of the real property into the trust. The transfer of the personal property beneficial interest would be subject to federal income taxation, but many of the costs of transferring real estate would be avoided.

For income tax purposes, since all of the proceeds from the operation of the trust property are disbursed to the beneficiaries in the proportion that their interests bear to the whole, no tax should be imposed upon the trust unless it is determined to be an association taxable as a corporation. There are six corporate characteristics considered by the IRS[25]: (1) presence of associates; (2) an object to carry on business and divide the gains; (3) continuity of life; (4) centralization of management; (5) liability of corporate debts limited to corporate property; and (6) free transferability of interests. It appears that there is no continuity of life given the typical twenty year disposition and disbursement of the sale proceeds requirement in the trust instrument. Limitations on the free transferability of interests could be included in the trust instrument. Since the trustee does not have responsibility for management decisions, and cannot act to dispose of the property absent direction from the beneficiaries, it is not likely that the IRS would find the presence of centralized management. A land trust will not be classified as an association taxable as a corporation unless it has four or more corporate characteristics. So it is important to be mindful of these characteristics when drafting the trust documents. If the trust has many members, centralized management, and starts doing business as an entity, it may be treated as a corporation. *Outlaw v. U.S.*, 494 F2d 1376 (1974). (Forty-one member land trust formed for the purchase, development and sale of crops from farm lands considered taxable association under I.R.C. 7701(a)(C)).

For federal income tax purposes, the land trust is treated as though the property is owned by the beneficiary. The trustee of a traditional land trust will not even have to file an information tax return. Instead the income and expenses of the beneficiaries will be reported on their personal IRS Form 1040, Schedule C. But vesting the trustee with additional duties may trigger IRS reporting requirements for the trustee.

For estate and gift tax purposes, the IRS treats a revocable, living trust as if title was still in the name of the settlor, if the settlor is the beneficiary and is still alive.[26] There is no gift tax due upon the transfer into a land trust.[27]

There is no requirement that the trust file for a tax identification number while the settlor is still alive. The IRS does not consider a land trust to be a trust at all, since the trustee has no significant duties with regard to the trust property.[28]

The trustee may be required to file an information return under 26 C.F.R. Section 1.671-4(b). If the trustee has significant responsibilities of managing the trust, a blank IRS form 1041 return is filed with an attached summary of the income and expenses of all of the trust properties, and the same items are reported on the grantor/beneficiary's federal income tax return. However, the appointment of one of the beneficiaries as a co-trustee with management responsibilities should exempt the trustee from such reporting requirements.[29]

Individuals who are active in the management of their own rental real estate are permitted to deduct passive losses of up to $25,000 against ordinary income, though the maximum amount is reduced by $1 for every $2 above $100,000 of the taxpayer's adjusted gross income. The beneficiary of a land trust who is actively involved in management of the trust property may be able to claim passive losses, including depreciation.[30]

The IRS has ruled that a land trust is not a true trust for tax purposes. Therefore, a beneficial interest in a land trust can be exchanged for other real estate under IRC Section 1031.[31] However, this ruling applies only to traditional land trusts, which have not yet been formally recognized in Texas. If the trustee is given additional duties to take the trust out of the Statute of Uses, the IRS may not apply the same rules. Bill Bronchik has suggested that it might be appropriate to step out of the trust by having the trustee deed the trust property to the beneficiary, then affect the tax free exchange, and then transfer the new property back into a land trust.[32] A transfer of property into a land trust for one's own benefit does not affect the capital gains exemption rules for a principal residence, nor does it affect the deduction for mortgage interest.[33]

STATUTE OF USES

The question of whether the land trust will be executed because the trustee has no material duties is governed by the Statute of Uses. The Texas version of the Statute of Uses is found at § 112.035 of the Texas Trust Code:

> "112.032 Active and Passive Trusts; **Statute of Uses**
>
> (a) Except as provided in Subsection (b), **title to real property held in trust vests directly in the beneficiary if the trustee has neither a power nor a duty related to the administration of the trust.**
>
> **(b) The title of a trustee in real property is not divested if the trustee's title is not merely nominal but is subject to a power or duty in relation to the property.**"

HOMESTEAD ISSUES

With respect to the ability of a beneficiary of a land trust in dealing with his creditors to claim the Texas homestead exemption, the law is not settled. In *In re Robinson*, a Chapter 7 bankruptcy debtor's real property lost its homestead character when he transferred title to trust for the benefit of **another**, even though he continued to reside on the property and maintained it as his principal residence. The debtor was not allowed to claim the homestead exemption in the property he did not own. *In re Robinson,* 180 B.R. 174 (Bkrtcy. E.D. Texas 1995).

So when bankruptcy is imminent or if problems with judgment creditors arise, if property that is exempt as homestead under Texas law has been transferred into a land trust, even where the settlor and the beneficiary are one and the same, it would appear to be a good idea to step out of the trust by having the trustee deed the trust property to the beneficiary before filing bankruptcy or facing a final judgment which can be abstracted.

Probably in response to the large number of persons who have begun transferring property into living trusts to avoid probate costs and public filings, the Texas State Legislature in 1997 passed amendments to § 11.13 of the Texas Property Tax Code, dealing with the application of homestead exemptions to property which had been placed into trust:

> "For purposes of this section:
>
> (1) "Residence homestead" means a structure (including a mobile home) or a separately secured and occupied portion of a structure (together with the land, not to exceed 20 acres, and improvements used in the residential occupancy of the structure, if the structure and the land and improvements have identical ownership) that:
>
> (A) is owned by one or more individuals, **either directly or through a beneficial interest in a qualifying trust**;

(B) is designed or adapted for human residence;

(C) is used as a residence; and

(D) is occupied as his principal residence by an owner or, **for property owned through a beneficial interest in a qualifying trust, by a trustor of the trust who qualifies for the exemption.**

(2) **"Trustor" means a person who transfers an interest in residential property to a qualifying trust, whether by deed or by will, or the person's spouse.**

(3) **"Qualifying trust" means a trust:**

(A) in which the agreement or will creating the trust provides that the trustor of the trust has the right to use and occupy as the trustor's principal residence residential property rent free and without charge except for taxes and other costs and expenses specified in the instrument:

(i) for life;

(ii) for the lesser of life or a term of years; or

(iii) until the date the trust is revoked or terminated by an instrument that describes the property with sufficient certainty to identify it and is recorded in the real property records of the county in which the property is located; and

(B) that acquires the property in an instrument of title that:

(i) describes the property with sufficient certainty to identify it and the interest acquired;

(ii) is recorded in the real property records of the county in which the property is located; and

(iii) is executed by the trustor or the personal representative of the trustor."

PROBATE ISSUES

Because a land trust is a form of a living trust, probate could be avoided by providing for the transfer of the interest to another beneficiary upon the death of the original beneficiary.

Though estate taxes cannot be avoided, the probate process could be bypassed. Ancillary probate proceedings required in states where real estate is held by a decedent even though the decedent is a resident of another state can also be avoided since the decedent's beneficial interest in a land trust is considered personalty, and passes to the decedent's personal representative in the state of the decedent's domicile. Separate administration in the state where the land is situated is not necessary.[34]

SEPARATION OF ASSETS - LIMITATION OF LIABILITY

Each property owned by the settlor can be placed in a separate trust. Since each trust is a separate entity, the argument can be made that only the assets of that particular trust can be used to satisfy the claims of creditors of the trust. The trustee should always make it clear that he is only acting in his capacity as a trustee, and should sign all documents as follows:

1234 Main Street, Dallas, Dallas County, Texas Trust

By:____

John Trustee, as Trustee, and not personally, of the Trust named above.
All parties dealing with said Trustee shall look solely to the assets of the trust.

The Texas Supreme Court held in *Nolana Development Association v. Corsi* that a purported trustee who signed a letter without the restriction "as trustee" in which she agreed to be solely responsible to pay an additional $49,000 on a promissory note was individually liable to the joint venture for which she had allegedly held property.[35]

DEALING WITH THIRD PARTIES

Purchasers, lenders and title insurance companies have an interest in being able to rely upon the authority of the trustee in their dealings with him and the trust property. Since the recorded deed of the property into the trustee recites that the trustee can dispose of the property, and that all persons relying upon his authority need not inquire further, title companies, purchasers, and lenders, should be able to proceed with confidence in dealing directly with the trustee. Moreover, §§ 101.001 and 101.002 of the Texas Property Code should provide additional comfort to those parties:

> "101.001 Conveyance by Person Designated as Trustee
>
> **If property is conveyed or transferred to a person designated as a trustee but the conveyance or transfer does not identify a trust or disclose the name of any beneficiary, the person designated as trustee may convey, transfer, or encumber the title to the property without subsequent question by a person who claims to be a beneficiary under a trust or who claims by, through, or under any undisclosed beneficiary or by, through, or under the person designated as trustee in that person's individual capacity.**

101.002 Liability of Trust Property

> Although trust property is held by the trustee without identifying the trust or its beneficiaries, the trust property is not liable to satisfy the personal obligations of the trustee."

On the other hand, by virtue of his obligations in the trust instrument, the trustee is still accountable to the beneficiaries to the extent that the trustee acts without their express written authority.

SPENDTHRIFT TRUST PROVISIONS

Since in the typical land trust the settlor is also a beneficiary, under Texas law the contributions of the settlor to the trust can be reached by the trustor's creditors, even if there is a spendthrift provision in the trust agreement.

Section 112.035(d) of the Texas Trust Code provides as follows:

> "If the settlor is also a beneficiary of the trust, a provision restraining the voluntary or involuntary transfer of his beneficial interest does not prevent his creditors from satisfying claims from his interest in the trust estate."

In the seminal bankruptcy case of *In re Shurley*[36], the court held that spendthrift provisions in a land trust where the settlor and the beneficiary were one and the same, were not likely to be given effect, because of the self-settled nature of the trust, at least to the extent of the assets transferred to the trustee by the settlor/beneficiary. Under Texas law, the beneficiary's contribution of her property interest in a ranch and mineral interests to the trust defeated the trust's spendthrift and discretionary protection as to her interests, and, therefore, the beneficiary's interest in trust was not excluded from her Chapter 7 bankruptcy estate. The spendthrift provision in favor of the beneficiary of a discretionary spendthrift trust was not effective, where the beneficiary was also a settlor of the trust. Control was not required in addition to self-settling to defeat protective trust. The beneficiary, by transferring her property to the discretionary spendthrift trust, created, at least in part, the trust. To have the status as a creator of the discretionary spendthrift trust, the beneficiary needed only to deliver property in trust to some trustee for the benefit of some of the beneficiaries.[37]

A settlor cannot create a spendthrift trust for his own benefit and have the trust insulated from the rights of his creditors. *Daniels v. Pecan Valley Ranch, Inc.*, 831 S.W.2d 372 (Tex.App. - San Antonio 1992).

A settlor may create a trust in favor of some third party and prohibit assignment by such party of the beneficial interest in the trust, but the rule is otherwise in cases where a settlor creates a trust and makes himself the beneficiary thereof. *Glass v. Carpenter*, 330 S.W.2d 530 (App. San Antonio, 1959), *rehearing denied*.

The statute protecting the right of the trust settlor to include a spendthrift provision to prohibit the income and/or principal interest of a beneficiary from being transferred makes spendthrift trust assets "exempt", as that term is used in the turnover statute, though the statute does not expressly describe spendthrift trust assets as being "exempt" from attachment, execution, or garnishment."

EXECUTORY CONTRACT (CONTRACT FOR DEED) ISSUES

Sometime before the Texas State Legislature convened in 2001, a massive tornado hit the North Texas area, affecting dozens of homes in Tarrant County. Many of the homes which were destroyed were being purchased from a single seller, who was selling the properties using a contract for deed (otherwise known as an "executory contract," or "installment land contract," where the seller and buyer agree that the seller may deliver the buyer a deed at some time in the future after the full purchase price has been paid to the seller by the buyer). The buyers paid the seller an insurance premium in addition to a monthly principal and interest payment. However, the seller never bought casualty insurance with the monies collected from the buyers. When the tornado struck and the homes were damaged or destroyed, the buyers found themselves with no insurance. Then State Senator Mike Moncrief (now the mayor of Fort Worth), introduced legislation which was supposed to address the perceived problem. Along with this particular seller's fraudulent bath water, the Texas State Legislature threw out the contract for deed baby. The newly enacted statute became effective on September 1, 2001. The statute passed in 2001 begins at Section 5.061 of the Texas Property Code. Relevant portions follow:

"Sec. 5.062. APPLICABILITY.

a) This subchapter applies only to a transaction involving an executory contract for conveyance of real property used or to be used as the purchaser's residence or as the residence of a person related to the purchaser within the second degree by consanguinity or affinity, as determined under Chapter 573, Government Code. For purposes of this subchapter, a lot measuring one acre or less is presumed to be residential property.

(b) This subchapter does not apply to a transaction involving the sale of state land or a sale of land by the Veterans' Land Board under an executory contract.

(c) This subchapter does not apply to an executory contract that provides for the delivery of a deed from the seller to the purchaser within 180 days of the date of the final execution of the executory contract.

(d) Section 5.066 and Sections 5.068-5.080 do not apply to a transaction involving an executory contract for conveyance if the purchaser of the property:

(1) is related to the seller of the property within the second degree by consanguinity or affinity, as determined under Chapter 573, Government Code; and

(2) has waived the applicability of those sections in a written agreement.

Sec. 5.063. NOTICE.

(a) Notice under Section 5.064 must be in writing and must be delivered by registered or certified mail, return receipt requested. The notice must be conspicuous and printed in 14-point boldface type or 14-point uppercase typewritten letters, and must include on a separate page the statement:

NOTICE

YOU ARE NOT COMPLYING WITH THE TERMS OF THE CONTRACT TO BUY YOUR PROPERTY. UNLESS YOU TAKE THE ACTION SPECIFIED IN THIS NOTICE BY (date) THE SELLER HAS THE RIGHT TO TAKE POSSESSION OF YOUR PROPERTY.

(b) The notice must also:

(1) identify and explain the remedy the seller intends to enforce;

(2) if the purchaser has failed to make a timely payment, specify:

(A) the delinquent amount, itemized into principal and interest;

(B) any additional charges claimed, such as late charges or attorney's fees; and

(C) the period to which the delinquency and additional charges relate; and

(3) if the purchaser has failed to comply with a term of the contract, identify the term violated and the action required to cure the violation.

(c) Notice by mail is given when it is mailed to the purchaser's residence or place of business. The affidavit of a person knowledgeable of the facts to the effect that notice was given is prima facie evidence of notice in an action involving a subsequent bona fide purchaser for value if the purchaser is not in possession of the real property and if the stated time to avoid the forfeiture has expired. A bona fide subsequent purchaser for value who relies upon the affidavit under this subsection shall take title free and clear of the contract.

Sec. 5.064. SELLER'S REMEDIES ON DEFAULT. A seller may enforce the remedy of rescission or of forfeiture and acceleration against a purchaser in default under an executory contract for conveyance of real property only if:

(1) the seller notifies the purchaser of:

(A) the seller's intent to enforce a remedy under this section; and

(B) the purchaser's right to cure the default within the 60-day period described by Section 5.065;

(2) the purchaser fails to cure the default within the 60-day period described by Section 5.065; and

(3) Section 5.066 does not apply

Sec. 5.065. RIGHT TO CURE DEFAULT. Notwithstanding an agreement to the contrary, a purchaser in default under an executory contract for the conveyance of real property may avoid the enforcement of a remedy described by Section 5.064 by complying with the terms of the contract on or before the 60th day after the date notice is given under that section.

Sec. 5.066. EQUITY PROTECTION; SALE OF PROPERTY.

(a) If a purchaser defaults after the purchaser has paid 40 percent or more of the amount due or the equivalent of 48 monthly payments under the executory contract, the seller is granted the power to sell, through a trustee designated by the seller, the purchaser's interest in the property as provided by this section. The seller may not enforce the remedy of rescission or of forfeiture and acceleration.

(b) The seller shall notify a purchaser of a default under the contract and allow the purchaser at least 60 days after the date notice is given to cure the default. The notice must be provided as prescribed by Section 5.063 except that the notice must substitute the following statement:

NOTICE

YOU ARE NOT COMPLYING WITH THE TERMS OF THE CONTRACT TO BUY YOUR PROPERTY. UNLESS YOU TAKE THE ACTION SPECIFIED IN THIS NOTICE BY (date) A TRUSTEE DESIGNATED BY THE SELLER HAS THE RIGHT TO SELL YOUR PROPERTY AT A PUBLIC AUCTION.

(c) The trustee or a substitute trustee designated by the seller must post, file, and serve a notice of sale and the county clerk shall record and maintain the notice of sale as prescribed by Section 51.002. A notice of sale is not valid unless it is given after the period to cure has expired.

(d) The trustee or a substitute trustee designated by the seller must conduct the sale as prescribed by Section 51.002. The seller must:

(1) convey to a purchaser at a sale conducted under this section fee simple title to the real property; and

(2) warrant that the property is free from any encumbrance.

(e) The remaining balance of the amount due under the executory contract is the debt for purposes of a sale under this section. If the proceeds of the sale exceed the debt amount, the seller shall disburse the excess funds to the purchaser under the executory contract. If the proceeds of the sale are insufficient to extinguish the debt amount, the seller's right to recover the resulting deficiency is subject to Sections 51.003, 51.004, and 51.005 unless a provision of the executory contract releases the purchaser under the contract from liability.

(f) The affidavit of a person knowledgeable of the facts that states that the notice was given and the sale was conducted as provided by this section is prima facie evidence of those facts. A purchaser for value who relies on an affidavit under this subsection acquires title to the property free and clear of the executory contract.

(g) If a purchaser defaults before the purchaser has paid 40 percent of the amount due or the equivalent of 48 monthly payments under the executory contract, the seller may enforce the remedy of rescission or of forfeiture and acceleration of the indebtedness if the seller complies with the notice requirements of Sections 5.063 and 5.064.

Sec. 5.067. PLACEMENT OF LIEN FOR UTILITY SERVICE.

Notwithstanding any terms of a contract to the contrary, the placement of a lien for the reasonable value of improvements to residential real estate for purposes of providing utility service to the property shall not constitute a default under the terms of an executory contract for the purchase of the real property.

Sec. 5.068. FOREIGN LANGUAGE REQUIREMENT.

If the negotiations that precede the execution of an executory contract are conducted primarily in a language other than English, the seller shall provide a copy in that language of all written documents relating to the transaction, including the contract, disclosure notices, annual accounting statements, and a notice of default required by this subchapter.

Sec. 5.069. SELLER'S DISCLOSURE OF PROPERTY CONDITION.

(a) Before an executory contract is signed by the purchaser, the seller shall provide the purchaser with:

(1) a survey, which was completed within the past year, or plat of a current survey of the real property;

(2) a legible copy of any document that describes an encumbrance or other claim, including a restrictive covenant or easement, that affects title to the real property; and

(3) a written notice, which must be attached to the contract, informing the purchaser of the condition of the property that must, at a minimum, be executed by the seller and purchaser and read substantially similar to the following:

WARNING

IF ANY OF THE ITEMS BELOW HAVE NOT BEEN CHECKED, YOU MAY NOT BE ABLE TO LIVE ON THE PROPERTY. SELLER'S DISCLOSURE NOTICE CONCERNING THE PROPERTY AT (street address or legal description and city) THIS DOCUMENT STATES CERTAIN APPLICABLE FACTS ABOUT THE PROPERTY YOU ARE CONSIDERING PURCHASING.

CHECK ALL THE ITEMS THAT ARE APPLICABLE OR TRUE:

____ The property is in a recorded subdivision.
____ The property has water service that provides potable water.
____ The property has sewer service.
____ The property has been approved by the appropriate municipal, county, or state agency for installation of a septic system.
____ The property has electric service.
____ The property is not in a floodplain.
____ The roads to the boundaries of the property are paved and maintained by:
  ____ the seller;
  ____ the owner of the property on which the road exists;
  ____ the municipality;
  ____ the county; or
  ____ the state.
____ No individual or entity other than the seller:
  (1) owns the property;
  (2) has a claim of ownership to the property; or
  (3) has an interest in the property.
____ No individual or entity has a lien filed against the property.

____ There are no restrictive covenants, easements, or other title exceptions or encumbrances that prohibit construction of a house on the property.

NOTICE: SELLER ADVISES PURCHASER TO:

(1) OBTAIN A TITLE ABSTRACT OR TITLE COMMITMENTCOVERING THE PROPERTY AND HAVE THE ABSTRACT OR COMMITMENT REVIEWED BY AN ATTORNEY BEFORE SIGNING A CONTRACT OF THIS TYPE; AND

(2) PURCHASE AN OWNER'S POLICY OF TITLE INSURANCE COVERING THE PROPERTY.

_____________________________ _____________________________
(Date) (Signature of Seller)

_____________________________ _____________________________
(Date) (Signature of Purchaser)

(b) If the property is not located in a recorded subdivision, the seller shall provide the purchaser with a separate disclosure form stating that utilities may not be available to the property until the subdivision is recorded as required by law.

(c) If the seller advertises property for sale under an executory contract, the advertisement must disclose information regarding the availability of water, sewer, and electric service.

(d) The seller's failure to provide information required by this section:

(1) is a false, misleading, or deceptive act or practice within the meaning of Section 17.46, Business & Commerce Code, and is actionable in a public or private suit brought under Subchapter E, Chapter 17, Business & Commerce Code; and

(2) entitles the purchaser to cancel and rescind the executory contract and receive a full refund of all payments made to the seller.

(e) Subsection (d) does not limit the purchaser's remedy against the seller for other false, misleading, or deceptive acts or practices actionable in a suit brought under Subchapter E, Chapter 17, Business & Commerce Code.

Sec. 5.070. SELLER'S DISCLOSURE OF TAX PAYMENTS AND INSURANCE COVERAGE.

(a) Before an executory contract is signed by the purchaser, the seller shall provide the purchaser with:

(1) a tax certificate from the collector for each taxing unit that collects taxes due on the property as provided by Section 31.08, Tax Code; and

(2) a legible copy of any insurance policy, binder, or other evidence relating to the property that indicates:

(A) the name of the insurer and the insured;

(B) a description of the property insured; and

(C) the amount for which the property is insured.

(b) The seller's failure to provide information required by this section:

(1) is a false, misleading, or deceptive act or practice within the meaning of Section 17.46, Business & Commerce Code, and is actionable in a public or private suit brought under Subchapter E, Chapter 17, Business & Commerce Code; and

(2) entitles the purchaser to cancel and rescind the executory contract and receive a full refund of all payments made to the seller.

(c) Subsection (b) does not limit the purchaser's remedy against the seller for other false, misleading, or deceptive acts or practices actionable in a suit brought under Subchapter E, Chapter 17, Business & Commerce Code.

Sec. 5.071. SELLER'S DISCLOSURE OF FINANCING TERMS.

Before an executory contract is signed by the purchaser, the seller shall provide to the purchaser a written statement that specifies:

(1) the purchase price of the property;

(2) the interest rate charged under the contract;

(3) the dollar amount, or an estimate of the dollar amount if the interest rate is variable, of the interest charged for the term of the contract;

(4) the total amount of principal and interest to be paid under the contract;

(5) the late charge, if any, that may be assessed under the contract; and

(6) the fact that the seller may not charge a prepayment penalty or any similar fee if the purchaser elects to pay the entire amount due under the contract before the scheduled payment date under the contract.

Sec. 5.072. ORAL AGREEMENTS PROHIBITED.

(a) An executory contract is not enforceable unless the contract is in writing and signed by the party to be bound or by that party's authorized representative.

(b) The rights and obligations of the parties to a contract are determined solely from the written contract, and any prior oral agreements between the parties are superseded by and merged into the contract.

(c) An executory contract may not be varied by any oral agreements or discussions that occur before or contemporaneously with the execution of the contract.

(d) The seller shall include in a separate document or in a provision of the contract a statement printed in 14-point boldfaced type or 14-point uppercase typewritten letters that reads substantially similar to the following:

THIS EXECUTORY CONTRACT REPRESENTS THE FINAL AGREEMENT BETWEEN THE SELLER AND PURCHASER AND MAY NOT BE CONTRADICTED BY EVIDENCE OF PRIOR, CONTEMPORANEOUS, OR SUBSEQUENT ORAL AGREEMENTS OF THE PARTIES. THERE ARE NO UNWRITTEN ORAL AGREEMENTS BETWEEN THE PARTIES.

_____________________ ____________________________
(Date) (Signature of Seller)

_____________________ ____________________________
(Date) (Signature of Purchaser)

(e) The seller's failure to provide the notice required by this section:

(1) is a false, misleading, or deceptive act or practice within the meaning of Section 17.46, Business & Commerce Code, and is actionable in a public or private suit brought under Subchapter E, Chapter 17, Business & Commerce Code; and

(2) entitles the purchaser to cancel and rescind the executory contract and receive a full refund of all payments made to the seller.

(f) Subsection (e) does not limit the purchaser's remedy against the seller for other false, misleading, or deceptive acts or practices actionable in a suit brought under Subchapter E, Chapter 17, Business & Commerce Code.

Sec. 5.073. CONTRACT TERMS PROHIBITED. A seller may not include as a term of the executory contract a provision that:

(1) imposes an additional late-payment fee that exceeds the lesser of:

(A) eight percent of the monthly payment under the contract; or

(B) the actual administrative cost of processing the late payment;

(2) prohibits the purchaser from pledging the purchaser's interest in the property as security to obtain a loan to place improvements, including utility improvements or fire protection improvements, on the property; or

(3) imposes a prepayment penalty or any similar fee if the purchaser elects to pay the entire amount due under the contract before the scheduled payment date under the contract.

Sec. 5.074. PURCHASER'S RIGHT TO CANCEL CONTRACT WITHOUT CAUSE.

(a) In addition to other rights or remedies provided by law, the purchaser may cancel and rescind an executory contract for any reason by sending by telegram or certified or registered mail, return receipt requested, or by delivering in person a signed, written notice of cancellation to the seller not later than the 14th day after the date of the contract.

(b) If the purchaser cancels the contract as provided by Subsection (a), the seller shall, not later than the 10th day after the date the seller receives the purchaser's notice of cancellation:

(1) return to the purchaser the executed contract and any property exchanged or payments made by the purchaser under the contract; and

(2) cancel any security interest arising out of the contract.

(c) The seller shall include in immediate proximity to the space reserved in the executory contract for the purchaser's signature a statement printed in 14-point boldface type or 14-point uppercase typewritten letters that reads substantially similar to the following:

YOU, THE PURCHASER, MAY CANCEL THIS CONTRACT AT ANY TIME DURING THE NEXT TWO WEEKS. THE DEADLINE FOR CANCELING THE CONTRACT IS (date). THE ATTACHED NOTICE OF CANCELLATION EXPLAINS THIS RIGHT.

(d) The seller shall provide a notice of cancellation form to the purchaser at the time the purchaser signs the executory contract that is printed in 14-point boldface type or 14-point uppercase typewritten letters and that reads substantially similar to the following:

NOTICE OF CANCELLATION
(date of contract)

YOU MAY CANCEL THE EXECUTORY CONTRACT FOR ANY REASON WITHOUT ANY PENALTY OR OBLIGATION BY (date).

(1) YOU MUST SEND BY TELEGRAM OR CERTIFIED OR REGISTERED MAIL, RETURN RECEIPT REQUESTED, OR DELIVER IN PERSON A SIGNED AND DATED COPY OF THIS CANCELLATION NOTICE OR ANY OTHER WRITTEN NOTICE TO (Name of Seller) AT (Seller's Address) BY (date).

(2) THE SELLER SHALL, NOT LATER THAN THE 10TH DAY AFTER THE DATE THE SELLER RECEIVES YOUR CANCELLATION NOTICE:

(A) RETURN THE EXECUTED CONTRACT AND ANY PROPERTY EXCHANGED OR PAYMENTS MADE BY YOU UNDER THE CONTRACT; AND

(B) CANCEL ANY SECURITY INTEREST ARISING OUT OF THE CONTRACT. I ACKNOWLEDGE RECEIPT OF THIS NOTICE OF CANCELLATION FORM.

________________________ ______________________
(Date) (Purchaser's Signature)

I HEREBY CANCEL THIS CONTRACT.
________________________ ______________________

(Date) (Purchaser's Signature)

(e) The seller may not request the purchaser to sign a waiver of receipt of the notice of cancellation form required by this section.

Sec. 5.075. PURCHASER'S RIGHT TO PLEDGE INTEREST IN PROPERTY ON CONTRACTS ENTERED INTO BEFORE SEPTEMBER 1, 2001.

(a) On an executory contract entered into before September 1, 2001, a purchaser may pledge the interest in the property, which accrues pursuant to Section 5.066, only to obtain a loan for improving the safety of the property or any improvements on the property.

(b) Loans that improve the safety of the property and improvements on the property include loans for:

(1) improving or connecting a residence to water service;

(2) improving or connecting a residence to a wastewater system;

(3) building or improving a septic system;

(4) structural improvements in the residence; and

(5) improved fire protection.

Sec. 5.076. RECORDING REQUIREMENTS.

(a) Except as provided by Subsection (b), the seller shall record the executory contract, including the attached disclosure statement required by Section 5.069, as prescribed by Title 3 on or before the 30th day after the date the contract is executed.

(b) Section 12.002(c) does not apply to an executory contract filed for record under this section.

(c) If the executory contract is terminated for any reason, the seller shall record the instrument that terminates the contract.

(d) The county clerk shall collect the filing fee prescribed by Section 118.011, Local Government Code.

Sec. 5.077. ANNUAL ACCOUNTING STATEMENT.

(a) The seller shall provide the purchaser with an annual statement in January of each year for the term of the executory contract. If the seller mails the statement to the purchaser, the statement must be postmarked not later than January 31.

(b) The statement must include the following information:

(1) the amount paid under the contract;

(2) the remaining amount owed under the contract;

(3) the number of payments remaining under the contract;

(4) the amounts paid to taxing authorities on the purchaser's behalf if collected by the seller;

(5) the amounts paid to insure the property on the purchaser's behalf if collected by the seller;

(6) if the property has been damaged and the seller has received insurance proceeds, an accounting of the proceeds applied to the property; and

(7) if the seller has changed insurance coverage, a legible copy of the current policy, binder, or other evidence that satisfies the requirements of Section 5.070(a)(2).

(c) A seller who fails to comply with Subsection (a) is liable to the purchaser for:

(1) liquidated damages in the amount of $250 a day for each day after January 31 that the seller fails to provide the purchaser with the statement; and

(2) reasonable attorney's fees

Sec. 5.078. DISPOSITION OF INSURANCE PROCEEDS.

(a) The named insured under an insurance policy, binder, or other coverage relating to property subject to an executory contract for the conveyance of real property shall inform the insurer, not later than the 10th day after the date the coverage is obtained or the contract executed, whichever is later, of:

(1) the executory contract for conveyance and the term of the contract; and

(2) the name and address of the other party to the contract.

(b) An insurer who disburses proceeds under an insurance policy, binder, or other coverage relating to property that has been damaged shall issue the proceeds jointly to the purchaser and the seller designated in the contract.

(c) If proceeds under an insurance policy, binder, or other coverage are disbursed, the purchaser and seller shall ensure that the proceeds are used to repair, remedy, or improve the condition on the property.

(d) The failure of a seller or purchaser to comply with Subsection (c) is a false, misleading, or deceptive act or practice within the meaning of Section 17.46, Business & Commerce Code, and is actionable in a public or private suit brought under Subchapter E, Chapter 17, Business & Commerce Code.

(e) Subsection (d) does not limit either party's remedy for other false, misleading, or deceptive acts or practices actionable in a suit brought under Subchapter E, Chapter 17, Business & Commerce Code.

Sec. 5.079. TITLE TRANSFER.

(a) The seller shall transfer recorded, legal title of the property covered by the executory contract to the purchaser not later than the 30th day after the date the seller receives the purchaser's final payment due under the contract.

(b) A seller who violates Subsection (a) is liable to the purchaser for

(1) liquidated damages in the amount of:

(A) $250 a day for each day the seller fails to transfer the title to the purchaser during the period that begins the 31st day and ends the 90th day after the date the seller receives the purchaser's final payment due under the contract; and

(B) $500 a day for each day the seller fails to transfer title to the purchaser after the 90th day after the date the seller receives the purchaser's final payment due under the contract; and

(2) reasonable attorney's fees.

(c) If a person to whom a seller's property interest passes by will or intestate succession is required to obtain a court order to clarify the person's status as an heir or to clarify the status of the seller or the property before the person may convey good and indefeasible title to the property, the court in which the action is pending may waive payment of the liquidated damages and attorney's fees under Subsection (b) if the court finds that the person is pursuing the action to establish good and indefeasible title with reasonable diligence.

(d) In this section, "seller" includes a successor, assignee, personal representative, executor, or administrator of the seller.

Sec. 5.080. LIABILITY FOR DISCLOSURES. For purposes of this subchapter, a disclosure required by this subchapter that is made by a seller's agent is a disclosure made by the seller.

SECTION 2. The following are repealed:

(1) the heading to Subchapter E, Chapter 5, Property Code; and

(2) Section 5.092, Property Code.

SECTION 3.

(a) This Act takes effect September 1, 2001.

(b) The changes in law made by Sections 5.063, 5.064, 5.065, and 5.066, Property Code, as amended and redesignated by this Act, apply only to a purchaser who defaults under Subchapter D, Chapter 5, Property Code, as amended by this Act, on or after September 1, 2001, regardless of when the contract was entered into. A purchaser who is in default before September 1, 2001, is covered by the law in effect when the default occurred, and the former law is continued in effect for that purpose.

(c) The changes in law made by Sections 5.068 and 5.069, Property Code, as amended and redesignated by this Act, and Section 5.070, Property Code, as added by this Act, apply only to transactions involving executory contracts for conveyance for which negotiations begin on or after September 1, 2001. For purposes of this subsection, negotiations begin on the date an offer to enter into an executory contract for conveyance is made. Transactions involving executory contracts for conveyance for which negotiations begin before September 1, 2001, are covered by the law in effect when the negotiations began, and the former law is continued in effect for that purpose.

(d) The change in law made by the amendment of Section 5.091 and the repeal of Section 5.092, Property Code, by this Act and the application of Section 5.071, Property Code, as amended and redesignated by this Act, and Section 5.080, Property Code, as redesignated by this Act, applies only to transactions involving executory contracts for conveyance for which negotiations begin on or after September 1, 2001. For purposes of this subsection, negotiations begin on the date an offer to enter into an executory contract for conveyance is made.

(e) The change in law made by the amendment of Section 5.091 and the repeal of Section 5.092, Property Code, by this Act and the application of Section 5.072, Property Code, as added by this Act, Section 5.074, Property Code, as redesignated by this Act, and Sections 5.073 and 5.076, Property Code, as amended and redesignated by this Act, applies only to a contract entered into on or after September 1, 2001.

(f) The change in law made by the amendment of Section 5.091 and the repeal of Section 5.092, Property Code, by this Act and the application of Section 5.075, Property Code, as amended and redesignated by this Act, applies to a purchaser on or after September 1, 2001, who accrues interest as provided by that section regardless of when the interest accrued.

(g) The changes in law made by the amendment of Section 5.091 and the repeal of Section 5.092, Property Code, by this Act and the application of Subsections (a) and (b), Section 5.077, Property Code, as amended and redesignated by this Act, and Subsection (a), Section 5.079, Property Code, as redesignated by this Act, apply to an executory contract on or after September 1, 2001, regardless of when the contract was entered into.

(h) The change in law made by Subsection (c), Section 5.077, and Subsection (b), Section 5.079, Property Code, as amended and redesignated by this Act, applies only to a violation that occurs on or after September 1, 2001. A violation that occurs before September 1, 2001, is covered by the law in effect when the violation occurred, and the former law is continued in effect for that purpose.

(i) The change in law made by Section 5.078, Property Code, as added by this Act, applies to an executory contract regardless of when the contract was entered into. A named insured who currently holds an insurance policy binder or other coverage relating to property subject to an executory contract shall notify the insurer as provided by Subsection (a), Section 5.078, Property Code, not later than January 1, 2002."

In 2005, the Texas legislature expanded the definition of an "executory contract" to include an option to purchase real property that includes or is combined or executed concurrently with a residential lease agreement, together with the lease, is considered an executory contract for conveyance of real property. An analysis of this new statutory provision which became effective January 1, 2006, as it relates to an option to transfer the beneficial (arguably personal property) interest in a land trust combined with a residential lease agreement, is beyond the scope of this paper. But as is evident from the above statutory language, compliance with the statute appears to be required for a transaction involving an executory contract for conveyance of real property used or to be used as the purchaser's residence or as the residence of a person related to the purchaser within the second degree by consanguinity or affinity, if the executory contract does not provide for the delivery of a deed from the seller to the purchaser within 180 days of the date of the final execution of the executory contract.

Query: Does the executory contract statute apply to an agreement which transfers only the beneficial interest in a land trust, but does not provide for the delivery of a deed from the seller to the purchaser within 180 days?

There are two schools of thought. One argument is that all that the buyer gets is a personal property interest. Recall that the beneficial interest in a land trust is defined by agreement to include merely the right to possession, rents, profits, management, and the right to direct the trustee as to the disposition of the property, and that such beneficial interest (by agreement) is personalty, and not realty. Under this school of thought, perhaps the executory contract statute does not apply.

Another school of thought is that the buyer is in reality obtaining certain rights and interests that are generally thought of as real property interests (such as the right to possession), that the property is in fact being used as the purchaser's residence, and that since the agreement between the parties does not provide for the delivery of a deed from the seller to the purchaser within 180 days of the date of the final execution of the agreement, the executory contract statute should apply.

Be mindful that if a court were to determine that an agreement involving the transfer of the beneficial interest in a land trust (where the purchaser is using the property as his residence and no deed is to be delivered within six months) should be governed by the executory contract statute, the consequences could be disastrous. If the seller has not provided the required disclosures or otherwise complied with the statute, the seller may be guilty of a deceptive trade practice, may have to refund all payments made to the seller, and, worst of all, may face a lawsuit seeking $250 per day and attorney's fees. Given the draconian nature of the remedies provided by the executory contract statute, are the risks of selling residential property by financing the sale of the beneficial interest in a land trust worth the benefits? Until an appellate court in Texas rules on the subject, the answer is "no."

MISCELLANEOUS ISSUES

A debtor/creditor relationship is inconsistent with the fiduciary duty necessary to create a trust.

No particular form of words is required for the creation of a spendthrift trust; however, the trustee must have the duty to preserve trust funds and a trustee who has no duty except to make payments as they become due is a trustee of a "passive" or "dry" trust which cannot constitute a valid spendthrift trust.

A settlor may within a trust instrument relieve the trustee of certain duties, restrictions, responsibilities and liabilities imposed on him by statute. V.T.C.A. Property Code Sections 113.056(a), 113.059(a). *Neuhaus v. Richards*, 846 S.W.2d 70 (Tex.App.-Corpus Christi 1992).

Under a general exculpatory provision of a trust instrument stating that "No Trustee shall be liable for negligence or error of judgment but shall be liable only for his willful misconduct or personal dishonesty," trustees were not held to a prudent person standard, but could be liable only for willful misconduct or personal dishonesty.

If the language of a trust instrument unambiguously expresses the intent of the settlor, the instrument itself confers the trustee's powers and neither the trustee nor the court may alter those powers. V.T.C.A. Property Code Sections. 113.056(a), 113.059(a).

Exculpatory clauses in a trust instrument are strictly construed, and the trustee is relieved of liability only to the extent that the trust instrument clearly provides that he shall be excused. V.T.C.A. Property Code Sections. 113.056(a), 113.059(a).

There appear to be ample safeguards for the trustee in the Texas Trust Code adopted as part of the Texas Property Code in 1985. To the extent that the typical land trust agreement provides for the beneficiaries to have the right to manage the property, the trustee should not be held liable for losses incurred in the process.

Property Code § 114.003 provides as follows:

> **"If a trust instrument reserves or vests authority in any person to the exclusion of the trustee, including the settlor, an advisory or investment committee, or one or more cotrustees, to direct the making or retention of an investment or to perform any other act in the management or administration of the trust, the excluded trustee or cotrustee is not liable for a loss resulting from the exercise of the authority in regard to the investments, management, or administration of the trust."**

USE OF A LAND TRUST TO ATTEMPT TO HIDE A TRANSFER WHICH TRIGGERS THE RIGHTS OF A LENDER UNDER A DUE-ON-SALE CLAUSE IN A MORTGAGE

Before the "due-on-sale" clause came into existence in mortgage instruments in the early 1970s, investors could buy real property utilizing a corporate entity or some other legal entity which provided limited liability to the investor, and take title to the property being acquired, subject to the debt, without assuming the debt.

But the advent of the "due-on-sale" clause, which later evolved into a "due-on-transfer" clause, created a dilemma for many an investor, because the holder of an existing note secured by a mortgage or deed of trust had the right to call the entire principal balance immediately due and payable upon the transfer of any interest in the property by the owner to a new owner. The due-on-sale clause is only a right to call the note due, which may be exercised at the option of the holder of the note if an interest in the property is transferred. But it is not an automatic or self-executing right. The lender will typically call the note due only if the rate of interest in the note is lower than the current market rate of interest. Occasionally there are note holders which wish to immediately recover their principal balance to be able to make other investments, regardless of the fact that the current market rate of interest is lower than the rate of interest being earned on the existing note. But as a general rule, most institutional note holders have large portfolios which are serviced by companies which specialize in the collection of mortgage notes.

Many note holders will require the borrower to escrow one-twelfth of the annual property taxes and casualty insurance premiums, and require the borrower to forward property tax statements and insurance renewals to the lender for payment from the escrowed funds. If title to the property changes hands, and a deed to the property is filed in the real property records evidencing the change in the ownership, the taxing authorities reflect the new owner's name in the tax statements, and this alerts the note holder to the fact. If the new owner changes the insurance policy to reflect his ownership interest (which change will be necessary to provide the new owner with insurance coverage), the change will be reflected on the insurance renewal which the note holder receives, and once again the note holder will be alerted to the fact that the property has changed hands.

Prior to 1982, the courts in certain states held that due-on-sale clauses were unenforceable under certain circumstances. So in 1982, Congress passed the Garn-St. Germain Depository Institutions Act, which, among other things, pre-empted state law regarding the enforceability of due-on-sale clauses.

12 USC Sec. 1701j-3

Sec. 1701j-3. Preemption of due-on-sale prohibitions

"(d) Exemption of specified transfers or dispositions

With respect to a real property loan secured by a lien on residential real property containing less than five dwelling units, including a lien on the stock allocated to a dwelling unit in a cooperative housing corporation, or on a residential manufactured home, a lender may not exercise its option pursuant to a due-on-sale clause upon -

(8) a transfer into an inter vivos trust in which the borrower is and remains a beneficiary and which does not relate to a transfer of rights of occupancy in the property . . ."

Moreover, section 1701j-3(e) authorizes the issuance of rules and regulations to be published by the Federal Home Loan Bank Board, in consultation with the Comptroller of the Currency and the National Credit Union Administration Board. Similar to the rules and regulations of the Federal Tax Code, the rules and regulations under Garn-St. Germain are persuasive authority. Section 591.5(b)(1)(VI) of the promulgated rules and regulations states a different standard than the statute itself for the exception to the right of a residential lender to exercise its option pursuant to a due-on-sale clause. The relevant exception in the rules is:

> "A transfer into an inter vivos trust in which the borrower is and remains the beneficiary and occupant of the property, unless, as a condition precedent to such transfer, the borrower refuses to provide the lender with reasonable means acceptable to the lender by which the lender will be assured of timely notice of any subsequent transfer of the beneficial interest or change in occupancy."

Section 1701j-3(d)(8) of the Garn-St. Germain Act gives the homeowner the power to transfer title into a land trust without triggering the due-on-sale clause (if such transfer does not relate to a transfer of rights of occupancy in the property). This change in record title to the trustee can be communicated to the lender, and the property tax records and insurance policy will reflect the new record owner, the trustee. If the homeowner subsequently transfers his beneficial interest to a third party, there is no change in the record title, insurance remains in the name of the trustee, and the lender is unlikely to discover that the beneficial interest in the land has changed hands. But if the borrower does not remain a beneficiary of the land trust, **or** the transfer does include a transfer of rights of occupancy in the property, the holder of a loan secured by a deed of trust with a due-on-sale clause that discovers such a transfer will have a strong argument that the due-on-sale clause should be enforced.

CONCLUSION

Like a magician's illusion, the land trust does not always appear to be what it really is. The land trust uses its own form of smoke, mirrors, and misdirection to hide the true beneficial owner. But like magic, if everyone understood the secret of the trick, it would lose its impact. The land trust may serve to camouflage the beneficiary's interest, but it's not complete protection from creditors.

END NOTES

1 *Robinson v. Chicago Nat. Bank*, 32 Ill. App. 2d 55, 176 N.E.2d 659 (1st Dist. 1961), quoted in *The Law of Real Estate Financing*, *Chapter 1, Selection of Ownership Entity, Illinois Land Trusts*, Michael T. Madison, Jeffry R. Dwyer, and Steven W. Bender, 2006

2 *Texas Real Estate Law*, Charles J. Jacobus, 9th Ed., Thomson South-Western, 2005, at page 94.

3 *Ibid*, at 94

4 *Ibid*, at 94

5 *Your Step-by-Step Guide to Land Trusts*, William Bronchick, 1999

6 27 Henry VIII, chap. 10,

7 Bronchick, *supra* at 8.

8 Sayles, Richard A., *A Device for Texas Land Development: The Illinois Land Trust*, 10 Houston L.Rev. 692, 1973

9 Report of the American College of Trust and Estate Counsel, *Validity of Illinois Land Trusts*, August 2, 1993.

10 Sayles, Richard A., *A Device for Texas Land Development: The Illinois Land Trust*, 10 Houston L.Rev. 692, 1973

11 *Neeley v. Intercity Management Corporation*, 623 S.W.2d 942 (Tex.Civ.App.-Houston, 1981), *rehearing denied.*

12 Bronchick, *supra* at 14 and 15.

13 *Neeley v. Intercity Management Corporation*, 623 S.W.2d 942, 950 (Tex.Civ.App.-Houston, 1981), *rehearing denied*.

14 Bronchick, *supra* at 17.

15 *Id.* at 19 - 27.

16 *Id.* at 43.

17 DeBole, Paul L., *The Attorney's Guide to Trust Conveyances*, The Practical Real Estate Lawyer, January 1998, at 84

18 Texas Property Code § 92.201 *et.seq*.

19 Texas Real Estate License Act, Article 6573a.

20 Bronchick, *supra* at 49, 50.

21 *Id.* at 50.

22 *Id.* at 32.

23 Sayles, supra, at 694.

24 Sayles, supra, at 695.

25 Bronchick, *supra* at 49, 50.

26 Treas. Reg. Sec. 301.7701-2(a)(1) (1972)

27 I.R.C. §§ 671-678

28 Bronchick, *supra* at 70.

29 *IRS Revenue Ruling No. 92-105.*

30 Bronchick, *supra* at 71.

31 Bronchick, *supra* at 71, 72.

32 *IRS Revenue Ruling No. 92-105.*

33 Bronchick, *supra* at 72.

34 Bronchick, *supra* at 73.

35 Garrett, *Land Trusts*, 1955 U. Ill. L.F. 655, 661.

36 *Nolana Development Association v. Corsi*, 682 S.W.2d 246 (Tex. 1984)

37 *In re Shurley*, Bkrtcy. W.D. Tex. 1994, 171 B.R. 769, *appeal decided* 115 F.3d 333, *rehearing and suggestion for rehearing en banc, denied* 124 F.3d 195, *certiorari denied* 118 S.Ct. 444, 139 L.Ed.2d 380.