Trust Scams

They are all over the country: con artists pitching phony trust schemes to gullible people who are over-eager to cut their income taxes. In 2002 the Justice Department filed civil suits in San Diego, Boston and Cincinnati to stop the promoters who sell their “trust packages” for as much as $15,500. They operate through attorneys and accountants who participate in businesses such as the “National Association of Certified Estate Planning Attorneys” and the “Liberty Network.” So, you don’t have to live in one of the above cities to possibly run across one of these “too good to be true” opportunities.

The sales pitch for an abusive trust arrangement usually claims to (a) make personal living expenses deductible; (b) create artificial charitable deductions for payments that benefit the taxpayer, or his family, but not a charity; or (c) eliminate income taxes on income from assets which taxpayer still controls, albeit indirectly. This has been going on for quite some time. In 2001 there were 45 people convicted of tax evasion because of their use of phony trusts. Those sentenced to prison received terms averaging more than five years. In that year the IRS had 160 open criminal investigations involving abusive trusts.

The promoter being sued in San Diego has allegedly cost the Treasury more than $135 million in unpaid taxes so far. Nationally, the IRS estimates that abusive trust schemes cost the public about $3 billion every year. Honest taxpayers have to take up the slack for the lost revenue.

“Trust scam” is probably the best label for these adventures in tax evasion. The promoters, however, dress them up with fancy titles like: Common Law Business Trust, Constitutional Trust, Massachusetts Trust, Equipment Trust or Service Trust. They even use a legitimate sounding entity such as “Asset Management Company.” That is a trust designed to “own” the taxpayer’s assets just to disguise the fact that the control of and the benefit from the assets remained with the taxpayer.

Some red flags for a trust scam are the following claimed benefits from establishing a trust. Your personal living expenses will be deductible. The trust assets will not be taxed at your death, (nor any gift tax paid on the transfer) even though you still control them, receive the income from them, and can get them back at any time. Expenses paid by the trust are deductible on your personal income tax return. You can avoid a capital gains tax on the sale of an asset by first transferring it to the trust, which then sells it. You will get a charitable deduction even though no charity gets any benefit from the trust. Self-employment taxes can be avoided by owning your business through a trust.

Even more contemptible are the promoters who were caught by the Federal Trade Commission selling more than 3,000 “living trusts” to elderly consumers in 43 states. They represented that the trust: avoided all probate and administrative costs at death; allowed assets to be distributed immediately upon death; protected against catastrophic medical costs; was an estate planning tool appropriate for all consumers; and was prepared by a local attorney. None of the statements were true.

The FTC was also involved in a case that spells the doom of the off-shore “asset protection trust.” In a case decided by the U.S. Ninth Circuit Court of Appeals, Linda and Michael Anderson were held in contempt of court and jailed because they refused to repatriate millions of dollars of assets they had sent

to a Cook Islands trust, which they still controlled as “trust protectors.” The trust property was their ill-gotten gains from a Ponzi scheme, which the FTC wanted to seize on behalf of the victims.

A legitimate trust can hold assets transferred to it by an individual (who may also serve as trustee), collect the income, distribute the income to the same person who then reports that income on his income tax return. The trust files an income tax (Form 1041) and can deduct only those expenses related to the production of the income. Its ability to deduct expenses is no better than the original owner’s. This is no less true when the trust is located outside the U.S., but benefits the grantor of that trust who continues to reside in this country.

Aside from the tax issues, some of the scam artists are disrupting the estate plans of their “clients” with dispositive provisions in the trust after death that are purposely ambiguous. When the trust language aims to confuse the issue of who has a right to the income and owes taxes, it can also confuse who is entitled to the property upon the death of the founder of the trust. This leaves the door wide open for someone to take assets that would have otherwise gone to the founder's heirs under a last will and testament.

Just remember, if something seems too good to be true, it probably is.

For more detailed information on abusive trusts and trust scams you can visit two excellent Web sites: www.taxprophet.com and www.leimberg.com.

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