# Price & Farrington's Estate and Tax Planning *Fast* Faxts

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***Estate, Tax, Retirement and Wealth Preservation Planning***



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## Trust Frauds, Fantasies and Abuses: Trying to Trick Uncle Sam


Trusts are often referred to as the most powerful clubs in the planner's golf bag. The tax and non-tax benefits of trusts are supported by the Code, Courts and IRS. But their benefits can seem so magical that it's only a small step from a valid application of trust and tax law to a fantasy with no basis in law whatsoever. Profit-hungry charlatans use the complexity of trust and tax law to sell their schemes at outrageous prices to an unsophisticated (or sometimes just plain greedy) public. Dishonest people can use trusts to obscure their financial dealings through sham arrangements. Tax avoidance is legal (and good planning). Tax evasion isn't. The IRS has recently served notice that it is going after the promoters and participants of "abusive trusts" that hide income – with revenue loss in the billions - seeking taxes, penalties and possible criminal charges.

***What is a Constitutional Trust?*** Also known as "pure" (or some other patriotic name), this is a slickly promoted scheme with no basis in law or fact. Because a trust is a form of contract and the Constitution forbids the "impairment" of contracts, a trust (so it is argued) cannot be taxed or otherwise "impaired". Judges have routinely described this argument as "frivolous" and "ridiculous" and have heavily (and repeatedly) fined anti-tax zealots making this argument. Fact: *Someone*, *the trust, the grantor or its beneficiaries is always taxable on trust income.*

***Can my future wages, salary or other earnings be transferred to a trust?*** Any property interest can be transferred to a trust. But the transfer might not have any tax consequences. The courts have made it clear that any form of earned income is *always* taxed to the person who earns it. An attempt to shift taxation through an "assignment of future income" to a trust is a waste of time and ignored for federal income tax purposes. Anyone who tells (or tries to "sell") you otherwise is incredibly ignorant or dishonest or both. Many abusive trust arrangements are attempts to disguise the true ownership of property by tranferring title without actually transferring control or use. Trying to assign income without making a true, irrevocable assignment of property won't work. But it could subject you to interest, penalties and possibly criminal charges!

***Can I use a trust to deduct the expenses of maintaining my house?*** Scam artists claim they can spin straw into gold, creating income tax benefits by transferring a client's personal residence to a trust (other than to a Qualified Personal Residence Trust), and then treating it as though it were a rental property, claiming otherwise non-deductible maintenance expenses. Another scam claim is that the tax basis of the residence can be increased when it is transferred to the trust, even though no taxable gain or loss was reported by the transferor. *Here is a basic principle of tax law: food, shelter, clothing and other personal living expenses are not deductible.* Straw into gold is a fairy tale told by abusive trust promoters.

***Can a charitable trust be abusive?*** Yes; there are specific, stringent requirements for charitable trusts and deductions. For a trust to be tax-exempt and for contributions to a trust to be deductible for federal income tax purposes, it must be operated solely for charitable purposes and must serve public (not private) interests. Abusive charitable trusts serve no public purpose. *Example*: grantor pays child's college tuition from a "charitable trust" he's created and claims the check to the college as a deductible charitable donation, not a non-deductible personal expense.

***Can "offshore" trusts be used to avoid income taxes?*** Offshore trusts have legitimate uses. But a foreign trust created by a U.S. citizen or resident is considered to be a "grantor" trust, with the grantor taxed on all income earned by the trust anywhere in the world if any of the income is or *might be* distributed to a citizen or resident of the U.S. *You realize no income tax savings from a foreign trust.* Claims to the contrary are usually based on a fraudulent shell game involving manipulating multiple trusts, corporations, accounts and jurisdictions.

*"Sweetie, show the Hazlitts the watercolors you made in jail."*

***Are revocable living trusts abusive?*** Nope. They are legitimate estate and financial planning devices.

***Who is promoting these trust abuses and why?*** Dishonest promoters preying on greedy, gullible, angry, paranoid and sometimes dishonest taxpayers.

***How can I recognize when a trust might be a sham or a fraud?*** In an abusive arrangement: (1) deductions are claimed for personal living expenses; (2) true ownership of assets is disguised; (3) income isn't taxed to the person who earns it; (4) a new tax basis is claimed for property transfered to trust even though no taxable gain or loss is realized; (5) income is received that isn't taxed to anyone, even though a trust's income must be taxed to someone; and (6) charitable deductions are claimed for payments personally benefitting family members.

***Are there any other warning signs?*** Here are red flags: promoters using trust descriptions like "Fair", "Pure", "Equity", or "Patriot"; and claims to "secret" or "insider" information known only to the famous or wealthy. *Bear in mind*: abusive trust promoters fear a second opinion and will usually discourage you from consulting with a lawyer or other advisor. If you see promotional materials that claim tax benefits that seem too good to be true, check with a knowlegeable attorney or advisor before spending money and risking a lot more than you bargained for. ⌘