Avoid Trust Shams

Also know which trusts to avoid. Promoters of pure trusts, common law trusts or constitutional trusts ensnare a gullible public. These promoters claim that these trusts predate our tax laws and are immune from taxation. Or they claim their trusts can lawsuit-proof your assets. The tax claims are nearly always bogus.

Pure trusts are shams. They won't give you a legitimate tax benefit, or other benefits beyond what you could get from other trusts. The IRS has challenged these abusive trusts and penalized their promoters and taxpayers who unlawfully used these trusts to avoid taxes. A grantor trust requires the grantor to pay taxes on the trust income. An irrevocable trust pays the taxes on its income. In either case, taxes are payable on trust earnings. A trust is generally not the way to avoid income taxes.

Can a pure trust creditor-proof your assets? Possibly. The answer depends on whether the trust is irrevocable and whether you surrendered control over the trust. The asset protection and tax benefits that one can derive from any trust will be based solely on its terms and characteristics of the trust, not the name of the trust.

Most pure trusts are simple, revocable grantor or nominee trusts. They compare to living trusts. They will give you neither asset protection nor tax benefits. Avoid organizations or promoters who claim their trust enjoys special powers or immunities. Have your attorney prepare or review your trusts. You want your trust to give you every benefit that you expect - not huge tax troubles.

Gifting for Asset Protection

Gifting can be a sensible strategy to reduce estate taxes and protect your assets. For example, you may save income taxes by transferring income-producing assets to a recipient in a lower tax bracket. Gifts can also reduce your taxable estate (and estate taxes) while you simultaneously reduce the assets exposed to your creditors.

The annual gift tax exclusion currently lets you transfer $12,000 annually per recipient, tax-free – provided your gift is immediately available to the recipient. If you and your spouse jointly own and gift property, your combined annual exclusion doubles to $24,000 per recipient. A couple with three children can gift $72,000 annually, tax-free. You can accelerate your gifting to more rapidly shift vulnerable assets out of your name. Below are different ways to transferring what you have:

- *One option is to transfer your property in exchange for an installment sale note payable over a number of years.* You can forgive $12,000 installments per recipient annually, without tax consequences. Your promissory note would be self-liquidating and your transfer would be a fair consideration exchange and therefore not fraudulent. To protect your note from your creditors, title it to a limited partnership or LLC.
- *A bypass-generation gift can accelerate your gifting.* These gifts, however, may impose a generation-skipping transfer tax of 50% (plus the gift tax that applies to larger gifts). To avoid this tax, use a generation-skipping trust.
- *Gift whatever assets are most vulnerable to creditors.* Retain those assets that are exempt from creditor claims or are otherwise protected.

- *Another option is to transfer property to a minor child through a children's or minor's trust.* Or make gifts under the Uniform Transfers to Minors Act. But you won't get absolute protection if your transfer is fraudulent. Your beneficiaries' creditors, however, cannot seize the funds until distributed to the beneficiaries.