

# **Taxpayer Beware: Schemes, Scams & Cons**

Testimony Before the Senate Committee on Finance

April 5, 2001

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Good morning, Mr. Chairman and Members of the Committee. My name is JJ MacNab and I am an insurance analyst, financial planner, and writer located in Bethesda, Maryland.

This morning I will provide an overview of the tax evasion industry, their marketing practices, their surprising growth in recent years, and the role of the Internet in that growth. I will also address the current efforts by the Internal Revenue Service to curb these abuses and will comment on problems inherent in those efforts.

### I. Background

In the past ten years, tax evasion has grown from being a secret of the very wealthy to a mass marketed industry. An estimated \$300 billion in tax revenue is lost each year as a result of a variety of techniques ranging from sham trusts, offshore accounts, and abusive charitable schemes to the more sophisticated planning involving international business corporations and private offshore tax-exempt insurance companies.

As the promoters of these plans become more aggressive and their target market widens, this lost tax revenue will only increase. The IRS no longer acts as an effective deterrent to those who cheat, and where most taxpayers in the past begrudged their taxes, they paid them nonetheless, because it was the right and honorable thing to do. Today, many of those same people have decided that the system is corrupt and that only fools pay their taxes.

### II. The Causes Behind the Cheating

- **Tax Protestors:** While many people assume that this is a small, fringe group of people, such a characterization would be incorrect. In the past few years, the tax protestor movement has grown substantially and includes ex-IRS employees, attorneys, CPAs, and a wide variety of other professions. This growth is primarily due to the Internet, and the ease with which it allows people with common interests to share ideas, and to create inexpensive soapboxes upon which they can reach potentially thousands of readers at the same time.
- **Trickle Down Effect:** In 1989, Leona Helmsley made her infamous statement, “Only the little people pay taxes.” The little people listened and in the decade that followed her comment, have been taking increasingly aggressive steps to either reduce taxes or stop paying income taxes entirely. Abusive techniques which ten years ago would have only been promoted to a few hundred of the wealthiest Americans, are now mass marketed on the Internet, in in-flight magazines, on the radio, and in the back of respected newspapers and magazines.
- **Anger at Government Favoritism:** Our Tax Code is riddled with special interest tax credits and exceptions carved out for increasingly narrow groups. The size, complexity, and perceived government favoritism in the Code has eroded all respect for the tax system.

- **Greed:** Once paying taxes is no longer considered the honorable thing to do, it becomes easy for people to rationalize cheating.
- **No Fear of Reprisal:** The IRS is no longer effective at stopping or preventing tax cheaters. The odds of an audit have become so small that an increasing number of people have become “willing to risk the audit lottery.” And even if audited, most people believe that the Service has no teeth after the 1997 and 1998 hearings.
- **Scams:** Of those currently not paying taxes, perhaps the largest group has bought into a product or system that appears to be legitimate, but is actually a sophisticated confidence game. These consumers truly believe that what they have purchased is legal and ethical, and many of them are so enthused by their newfound knowledge and investment, that they, in turn, become marketers themselves.

### III. Is There Really a Problem?

Hundreds of thousands of middle to high income Americans are currently paying little or no income taxes at this time. The marketing has become increasingly pervasive and includes thousands of Internet websites, full page ads in USA Today and the Washington Times, mass emails, radio advertising, online bulletin boards, and word of mouth.

There are numerous tax evasion techniques being promoted, including the following:

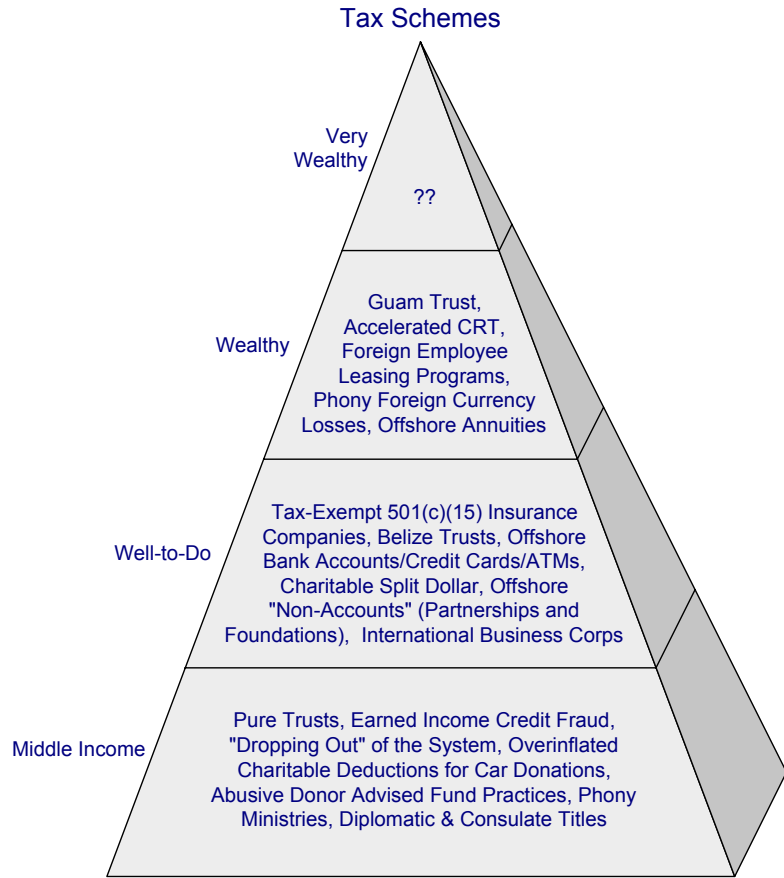
- "Tax-exempt" trusts and business structures;
- Offshore accounts, banks, businesses, trusts and foundations;
- “Dropping out” of the system by stopping all withholding and Social Security taxes, in some cases even filing for refunds of past years’ withholdings;
- Tax-exempt private insurance companies;
- Charity-like or religious entities established for personal use.

The target market for each technique varies; lower and middle-income consumers tend to buy into the simpler and less expensive techniques, higher income consumers lean more towards the complex and better researched.

The chart to the right is an example of the techniques being promoted to each income level. This is only a generalized example – there are many additional schemes not mentioned, and techniques listed often cross over into other income categories.

Some of the schemes are outright fraud; others thrive on ambiguity in the Tax Code. While the IRS has been unable to estimate the amount of taxes lost, the unofficial tally is approximately \$300 billion per year.

The top section of pyramid is largely unknown. Such high level techniques are usually kept secret through the use of non-disclosure agreements, where all the parties involved agree not to discuss the terms or details of the plan to any outsiders.



#### IV. Example #1: Pure Trusts

Pure Trusts go by many names (Constitutional Trust, Complex Trust, Liberty Trust, Pure Business Trust, Equity Trust, USA Trust, or Common Law Trust, for example) and have been marketed aggressively on the Internet in recent years. When I spoke with the Criminal Investigations Division of the IRS in 1999, they estimated that approximately 250,000 of these trusts were in existence at that time. By now, the numbers of trusts in place is most likely significantly higher.

- **How It Works:** There are many varieties of pure trusts currently being marketed, both domestic and offshore, but in general, it works like this: you place all of your business or personal assets into a trust or series of trusts, and pay little or no income, estate, or capital taxes ever again. In the meantime, you maintain full control over your assets and all of your personal expenses become deductible.
- **Why it Sells:** The marketers who sell such products appeal to specific types of consumers. The following is a brief list of some of the sales pitches used by various marketers today:

1. It's your "God given right" not to pay taxes;

2. There is a government conspiracy to obscure the truth that you don't have to pay taxes;
  3. Taxes are "voluntary" therefore smart people will not volunteer to pay;
  4. Taxes are unconstitutional - the 16th Amendment was never ratified
  5. Taxes only have to be paid by US citizens (defined as someone born in or living in Washington DC or the US territories) and foreign companies doing business in the US;
  6. Rich people save money on their taxes with these plans, so should you;
  7. The IRS is weak. Even if you're caught, Senator Lott will protect you;
  8. Audit Lottery – odds are phenomenal that you won't be audited;
  9. These are elite tax planning services offered by sophisticated advisors;
  10. Planning for "attributional black holes" – you can't be caught by IRS computers;
  11. Everyone cheats; you're a "chump" if you don't too.
- **Who are the Promoters:** The Internet has made selling tax scams to the public remarkably easy. It costs almost nothing to set up and maintain a website, and sending mass emails to thousands of targeted readers is very inexpensive. The promoters include anyone with a modem and a web account and consist of individuals, small companies, franchises, multi-level marketers, affinity programs, and church groups.
  - **The Size of the Industry:** As an exercise, I set aside two hours of uninterrupted time when I could browse the Internet to see how many tax scams I could find. I had done similar research in March of 2000 for a magazine reporter. Chart A shows a comparison of the number of websites that contained the phrase "pure trust" one year ago and today. The occurrence of "pure trust," for example, has grown from 867 web pages to 2,340, an increase of 170%. "Complex trust" occurrences have grown by almost 270% and "constitutional trust" has jumped by 536%. Despite the IRS' attempts to shut these particular programs down, they have increased dramatically in the past year.

	<b>March 2000</b>	<b>March 2001</b>
Common Law Trust	N/a	2,010
Complex Trust	490	1,810
Constitutional Trust	44	280
Contract Trust	N/a	972
Liberty Trust	N/a	354
Pure Business Trust	N/a	30
Pure Equity Trust	17	45
Pure Trust	867	2,340

***Chart A: Pure Trust References on the Internet***

In Appendix A of this report, I have prepared a summary of the actual websites I found during my two-hour search. Whereas early marketing materials and websites were generally characterized by patriotic themes and strong rhetoric, today's sites are quite often professional and many could pass for high-level law firms and financial services companies.

- **What’s Being Done to Stop These Promoters:** While the IRS’ Criminal Investigation Unit has been quite aggressive and successful at obtaining long prison sentences, their efforts are doing little to stop the marketing. Consumers have no idea that the IRS is winning or even fighting these cases, and considering that the bulk of the marketing materials state that the IRS is acting outside the scope of their authority, most of the consumers who have bought into these programs pay no attention to the IRS’ warnings.
- **Undercover Investigations:** The IRS has recently done a remarkable job with substantial undercover investigations, obtaining large fines and long prison sentences, and they are generally getting the word out to the press through press releases and with their recent Abusive Trust brochure. From an outsider’s viewpoint, however, their goal seems single-minded; they want to thoroughly punish those people who are breaking the law.

These undercover investigations, however, take too long to protect most consumers. The Anderson’s Ark investigation, for example, took more than two years to complete, and during that time, possibly thousands of additional consumers were duped into participating in that scheme. To make matters worse, the Anderson’s Ark website ([www.andersonark.com](http://www.andersonark.com)) is still up and running even though the leaders have either been arrested or are currently fugitives from the law.

- **The CID Brochure:** The Criminal Investigation Division has produced a very good brochure and website outlining arrests, sentences, what to watch out for. Unfortunately, very few consumers have seen either. Until the IRS can get the word out to the same masses that are frequenting the tax fraud websites, their efforts won’t go far.
- **The Marketing is Expanding Faster Than the IRS Can Act:** As one technique gets shut down, the marketers often adjust their sales pitch to incorporate the IRS’ efforts:
  1. **The Criminal Investigation Division is Illegal:** When the Criminal Investigation Division of the IRS releases arrest and conviction information, the promoters simply shrug. They instead point to their research, which “proves” that the Criminal Investigation Division is acting illegally, and cite examples of how the CID is losing their war. It is not uncommon to quote Senators Lott and Hatch on how the IRS oversteps its bounds and persecutes innocent citizens.
  2. **Ours is Different:** When the IRS released their notice and brochure regarding Abusive Trusts, several promoters carefully “analyzed” this information and showed why their Pure Trusts products differed the “Bad Pure Trusts” described in the notice, or they simply renamed their program to something other than a trust.
  3. **Following the Letter of the Law in Disclosing Foreign Trusts:** The IRS requires a taxpayer to disclose all ownership or beneficiary interests in offshore trusts. The marketers now recommend that their clients set up offshore partnerships or private interest foundations so that there is no “trust” in existence to be reported.
  4. **Changing Gears:** The IRS has been clear about its position on Abusive Trusts. Many marketers have now pivoted to non-trust planning, such as techniques to avoid employer withholding of income and Social Security taxes. Since these marketers are

only selling ideas and techniques rather than product, they usually state that their website materials are protected by the First Amendment.

- **Most Promoters are Simply Ignoring the IRS:** The number of websites selling pure trusts has blossomed in the past few months, despite the big investigations and arrests. In one week, I received three “spam” email messages, one to set up an offshore private bank, another to make \$5,000 per week from home helping others opt out of the income tax system, and a third which offers foreign accounts with numbered credit cards so that I can access my offshore money.

## V. Example 2: “Dropping Out” of the Tax System

In February and March of this year, USA Today and the Washington Times each ran full page ads for a group who “proves” that taxes are unconstitutional, citing an ex Criminal Investigation Division Special Agent as their researcher. In January of this year, I received an email solicitation from an “Associate” of the Joy Foundation, offering me an opportunity to resell their information package showing employees how to “legally” stop taxes from being withheld from their paychecks.

Unlike the Pure Trust schemes, this is a relatively new scam on the Internet, but similar to the pure trust market, it is rapidly gaining momentum. A brief online search uncovered that the following companies have stopped withhold taxes, and have advised their employees that their income is not subject to any tax filing. Furthermore, several of these companies have applied for a refund for past years’ taxes:

No Time Delay Electronics Inc. (California)	Cencal Aviation Products (California)
Moran Mortgage Company (Illinois)	Batavia Enclosures Inc. (New York)
Sunshine Foot Clinic Inc. (Arkansas)	Kristi Tool Company (Massachusetts)
DMI Mechanical (California)	Certon Inc. (Texas)
Home Investors Inc. (Missouri)	Ikon Roofing (California)
Bosset Marketing Partners Inc. (Florida)	N.T.D. Electronics (California)
Arrow Custom Plastics Inc. (Texas)	

This is a new industry, and if the IRS acts quickly, it can stop the schemes before they grow out of control. It does not appear, however, that the IRS considers such preventative measure a priority. On March 31, 2001, in an article entitled “Company Faces I.R.S. Suit for Not Withholding Taxes,” the New York Times reported the following:

Several senior I.R.S. officials have said in recent weeks that they expect that business owners who boasted about not withholding taxes would be indicted, but not for several years.

In contrast, the promoters of this program are making a concerted effort to increase their numbers. They have frequently referred to the IRS’ inactivity as “proof” that their strategies work and on the We The People website ([www.givemeliberty.org](http://www.givemeliberty.org)) make the following prophesy:

We think the genie is out of the bottle now, and even if the IRS tries to stuff it back in, we've run off with the cork, and the genie will just escape again.

If the IRS does indeed wait years to indict, hundreds if not thousands more businesses will follow in the footsteps of the companies listed above. And these employers will advise their employees that their employment income is no longer subject to taxes. Waiting years to enforce the laws will only result in a large number of taxpayers falling into the trap of tax evasion, facing substantial future taxes, interest, and penalties which many will be unable to pay.

## **VI. Example 3: Proliferation of Foreign Accounts**

This is an extremely complex market, with literally thousands of variations that range from legitimate tool to scam and a thorough review is beyond the scope of this testimony. I have provided the following examples to give an idea of just how pervasive the marketing is, and how simple and inexpensive it is for consumers to move money offshore:

- **Swiss Bank Accounts:** You can now open a numbered Swiss Bank account online at [www.swissnetbank.com](http://www.swissnetbank.com) with as little as \$200.
- **Fill Your Online Shopping Cart with Tax Saving Devices:** A website called Global Money Consultants ([www.global-money.com](http://www.global-money.com)) allows you pick and choose your offshore entities with the click of a mouse. You simply add your items (Panamanian Foundations, Anonymous North European Debit Card, Niue Corporations, or a St. Vincent Offshore Bank, for example) into your virtual shopping cart and check out using your e-money account. Appendix B contains a printout of the front page of this website.
- **International Business Corporations (IBCs):** To give an example of the growth experienced in the offshore market, in the late 1980s, the British Virgin Islands had roughly 10,000 of these phony corporations in place. In the year 2000, this number had swelled to approximately 350,000.
- **Tax-Exempt Insurance Companies:** In the March 5, 2001 issue of Forbes Magazine, the article entitled "Are you a Chump?" outlined a tax evasion technique involving a 501(c)(15) insurance company used "to shield hundreds of millions of dollars or investment earnings from taxes" for a single wealthy taxpayer. This technique is now gaining popularity among the moderately wealthy and the IRS is currently granting tax-exempt status at a rate of ten per week.

The Internet, savvy promoters, and smart encryption programs have made it possible for average income taxpayers to move money offshore without being detected and without being traced by the IRS' computer systems. Unless the service goes to the source (the promoters), they have no way of knowing whose money is offshore.

## **VII. What can be done to fix the problem?**

- **Time is of the Essence:** As mentioned earlier, two to three-year undercover investigations may lead to substantial sentences and fines, but in the meantime, the promoters are selling their scams to thousands of innocent consumers. When senior IRS officials tell the New York Times that they do not intend to convict non-withholding employers until years from now, other employers (and their hapless employees) become involved in such programs in the meantime. If the IRS' mission is to serve the customer, many of those customers would be best served by being protected from charlatans. The IRS must move quickly to shut down Internet marketers promoting tax fraud.
- **Targeted Investigations:** There has been much talk in recent weeks about face-to-face audit counts and computer matching programs. While computers are useful in catching errors, they will do little to catch tax fraud promoters, who often are fully compliant in preparing their own tax returns. Furthermore, these promoters (as well as attorneys, CPAs, and financial planners) are quickly adapting to the IRS' matching system and are advising clients to take risk only in those areas where they can't be caught. The nickname for this technique is "attributional black hole planning." Furthermore, thanks to the Internet, to sophisticated encryption programs, and to a new digital form of money (e-money), transferring assets offshore without leaving a trace has become relatively simple. The IRS cannot rely on computer programs to catch all or even most of the Internet-related tax cheats; they should also be using basic investigative techniques to locate the promoters online.
- **Consumer Education:** When you perform an Internet search on basic tax fraud phrases such as "pure trust" or "international business corporation", the IRS' website does not appear in the results. The consumer fraud section of the IRS website should be expanded, with appropriate metatags inserted to ensure high placement in the various search engines. In addition, spokespersons for the IRS should be visiting the a wide range of talk shows and radio shows, and giving magazine interviews just as the fraud promoters do.
- **Working with Professionals:** All four professionals on this panel have dedicated significant time and energy over the past few years to learning about tax scams and informing consumers that these plans don't work. The IRS should consider working more closely with those in the private sector who have made an effort to track such scams.

## VIII. Summary

If left unchecked, this culture of tax evasion will blossom, and if it gains enough momentum, could render our current tax system useless. There has to be a concerted effort to better inform the public and in cases where promoters are selling tax fraud, such businesses and websites should be shut down as quickly as possible. While long-term investigations yield big sentences, in the meantime, thousands of additional consumers are falling into the promoters' traps.

## APPENDIX A

### Two Hour Research Project

Website	Business Name	Comments
www.yourtaxfreedom.com www.incometaxfreedom.com	The 4 Your Success Group (Minnesota)	“Many Americans have a very definite idea about how the Internal Revenue Service behaves. And in many respects, they are correct. Testimony before the Senate Committee in October of 1997 revealed, for the first time for many Americans, just how the IRS tries to intimidate and bully you.”
http://landbusiness.safeshopper.com	Land Business Systems (Pennsylvania)	Also sells mineral supplements on eBay.com, battery recovery systems, “Liberty Pure Trusts,” and “Constitutional Products.”
<b>www.taxgate.com</b>	RBH and Associates (New Jersey)	“US Income Tax Law:” Very large Pure Trust and tax avoidance portal. Has more than 1,325 pages of data and articles. Not selling products, but charge \$165 for membership / consultation. Website states that it has 345,000 hits per month.
www.buildfreedom.com/economic/eco_6.html	Terra Libra Ventures (Arizona)	“Freedom” Portal. Offers books for sale, as well as free information such as “How to Stop Employers From Withholding Income Taxes.”
www.heritage-institute.com	Heritage Institute for Estate Planning (California)	Offers Contractual Pure Trusts and Living Trusts. Explains that Pure Trusts are “safe” from Medicaid look-back rules. Displays the Better Business Bureau Reliability Seal.
www.solgroup.com www.puretrust.com www.no1040s.com	!SOLUTIONS! Group (Ohio)	Offers the Liberty Pure Trust. Also sells web-hosting and offshore investments. Counter shows almost 39,000 “hits.”
www.cktrust.com	Without Prejudice (Tennessee)	Run by a “barrister at law” named Austin Gary Cooper. Offers the “Clark Kent Trust,” (a Pure Trust) for \$578 and an expatriation / repatriation kit for \$388.
www.yelmtel.com/~trusts	Family of Eagles Ltd. / American Beauty Rose (Washington)	Pure Trusts sold by private appointment only.
www.webtrust.com	Localink Information Services (California)	Sells Living Trusts and Irrevocable Pure Business Trusts. Offers sample documents for \$9.95.
www.iossbs.org	Int’l Organization of Self Sufficient Benefit Societies (Nevada)	A “fraternal society”. Also sells water purifiers, waste systems, pyramid greenhouses, offshore credit and ATM cards, offshore bank accounts and trusts.
www.i-f-c.com	Innovative Financial Consultants (Arizona)	Also offers Pure Trust Organizations, offshore banking, foreign bank formation, and Limited Liability Companies. Counter indicates almost 67,000 “hits.”

<b>Website</b>	<b>Business Name</b>	<b>Comments</b>
<b>www.f-f-a.com</b>	Financial Fortress Associates (Texas)	Sells Pure Trust Organizations, Limited Liability Companies, conducts regular sales seminars, and claims 7,000 clients.
www.puretrusts.com www.givemeliberty.net	R&H Publishers (Oklahoma)	Offers books, packages, and "do-it-yourself" manuals to set up Pure Trusts.
http://webf0126.ntx.net	BizNet Equity Management Trust (Florida)	Sells Pure Common Law Trusts through a "Do-It-Yourself Trust System." "Authorized dealer of EHMT". Currently hiring new dealers.
www.ehmt.com	Entrepreneur Holdings Management Trust (Florida)	No information. Just a one page site that says "International Strategies" with a phone number. Copyright information shows 1994-2001.
www.webyellowpages.com/pill	Prosper International League Ltd. (Florida)	Claim 20,000 customers and seven years' experience setting up Pure Trusts. Multi-level marketing program. Also offers offshore credit cards, offshore banking, and Belize Trusts. "Start an account for only \$200."
www.joyfoundation.com	The Joy Foundation (Florida)	The Joy Foundation. Earn an Associates Degree in avoiding income taxes. Multi level marketing program. Join for \$1,680. Also sells books through Amazon.com.
www.wealth4freedom.com	Capital Strategies (Florida)	Same website as The Joy Foundation. Presumably a dealer/associate.
www.pure-trust.com	Lamb & Associates (California)	Recently merged with pre-paid legal services website.
http://home.swbell.net/ministry/	International Fellowship of Churches and Ministers (Texas)	"Education - Ordination - Church Charters - Irrevocable Pure Trusts and Snorends". Purchase a church charter for \$300 and "Free your church, yourself, your business from undue tax burden."
www.freedomtrustgroup.com	Freedom Trust Group (South Carolina)	Sells software so that buyer can produce an "unlimited number of all five different types of common-law irrevocable contracts of Pure Trusts." Also sells International Business Corporations.
www.trustenterprises.com	Trust Enterprises (California)	The CPA who started the current movement by obtaining a letter from the IRS saying that a "Pure Trust Organization has no tax requirements."
<b>www.mysticbird.com</b>	The Phoenix Group (Oregon)	Sells "Contractual Business Entities." "The IRS is very aware of what a "pure common law trust" (CBE) is, and understands that they are exempt from statute."
www.successlinks.com	Institute of Global Prosperity (Florida)	Audio tape and seminar package to set up offshore accounts, trusts, Internal Business Corporations, and Limited Liability Companies.