

MONEY MYTHS SERIES

The Pure Trust Scam: Constitutional, Contract and "Never Pay Tax" Trusts

How pure, constitutional and contract trusts are sold, why the IRS and the courts reject them, and what buyers and promoters have paid for it.

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Part of our [money myths series](#).

The claim: move your business, your house and your income into a "pure trust" (also sold as a constitutional trust, contract trust, or common-law business trust) and you'll never pay income tax again, because the trust is a private contract the IRS can't touch.

The verdict: the IRS warned against these exact trusts in Notice 97-24 in 1997, courts have thrown them out for more than 45 years, and the Justice Department is still sending promoters to prison in 2025 and 2026. The buyer owes the tax anyway, plus penalties that reach 75% for fraud.

\$5,000 to \$70,000

What promoters have charged per trust package, per the IRS

1997

Year IRS Notice 97-24 called these arrangements shams

\$60 million

Tax loss from one trust promoter, Aegis (DOJ, 2009)

223 months

Longest Aegis promoter sentence (DOJ, 2008)

75%

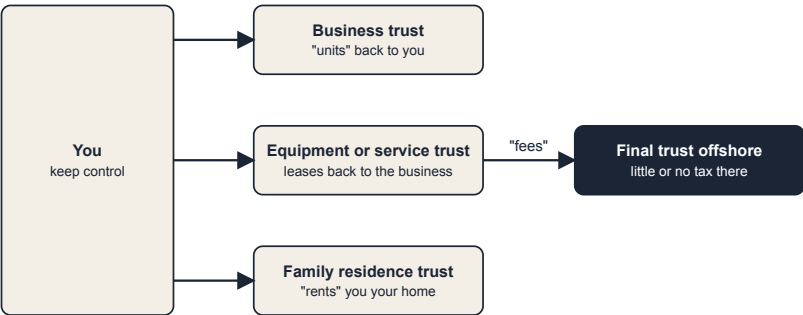
Civil fraud penalty on the underpaid tax, IRC § 6663

Who gets paid when you follow this advice: the promoter, more than once. The IRS says promoters "have charged \$5,000 to \$70,000 for their packages." Court records show the prices: an \$8,000 seminar in Zmuda, \$9,500 in tuition for a National Trust Services workshop in Aldridge, and a \$12,000 "comprehensive trust packet" that the Muhichs' company paid for in Muhich. The four promoters a Colorado jury convicted in June 2026 charged \$25,000 to \$50,000 to set up their layered trusts, and one of them, a CPA, prepared hundreds of false returns for the buyers. Notice 97-24 adds that the trustee "may be the promoter," so the fees can keep coming for years.

What is a "pure trust" or "constitutional trust"?

It's a sales label for a trust the promoter says sits outside the tax law because it's a private contract, and the IRS lists the "trust is a form of contract" argument as frivolous, with a \$5,000 penalty for using it (Notice 2010-33).

The names change every few years: pure trust, constitutional trust, contract trust, common-law business trust, complex trust, and lately "non-grantor irrevocable trust." IRS Notice 97-24 described the structure in 1997, and it hasn't changed: the business goes into a business trust that issues "units" back to the owner, equipment goes into a trust that leases it back, the home goes into a family residence trust that "purports to rent the residence back to the owner," and the money ends up in a final trust that "often is formed in a foreign country that will impose little or no tax on the trust." Through all of it, the owner keeps running the show. The Notice puts the pitch in one line: "the promise of tax benefits with no meaningful change in the taxpayer's control over or benefit from the taxpayer's income or assets."



Layer (Notice 97-24)	What it claims	Why it fails
Business trust	The business now belongs to a trust	Sham: IRS may ignore the trust (Notice 97-24)
Equipment or service trust	Lease payments shift income out	Assignment of income; grantor trust rules
Family residence trust	Your home becomes a deductible rental	Little or no rent is paid; personal expenses aren't deductible (IRC § 262)
Final trust offshore	Income lands where there's no tax	Grantor trust rules reach foreign trusts; 35% penalty for unreported transfers

Calling something a trust doesn't make it one for tax purposes: "Mere association of the term 'trust' with a financial arrangement does not make it a legitimate trust for federal income tax purposes."

Can a trust let you stop paying income tax?

No: "an individual cannot escape taxation by attributing income to a purported trust" (Rev. Rul. 2006-19), and that holds "regardless of the form of the entity, such as a trust or common law business trust."

The ruling says these schemes are ignored "because taxpayers cannot assign personal income to a trust in order to avoid tax, because such trusts are shams for federal tax purposes," and because the grantor trust rules tax the income to the person who controls it.

Assignment of income. "Income that is earned by one person cannot be assigned to another for federal income tax purposes," the IRS says. You're liable for tax on what you earn even if it's paid straight into a trust.

Sham. When the trust has no real economic effect, "the IRS may ignore the trust and its transactions for federal tax purposes" (Notice 97-24).

Grantor trust rules. If you control who benefits (IRC § 674) or the income can be paid to you or your spouse (IRC § 677), you're treated as the owner and the income goes on your return (IRC § 671). California adopts the same federal trust rules for state income tax (Rev. & Tax. Code § 17731).

And if a trust really were separate, it would pay its own tax, at rates that reach 37% on 2026 taxable income above \$16,000 (Rev. Proc. 2025-32). A single person doesn't hit 37% until \$640,600. The IRS's own talking points put it plainly: "Trust tax rates are high compared to individuals and corporations." Our page on [whether the rich use trusts to avoid taxes](#) runs the numbers.

What is the newer "non-grantor irrevocable trust" version?

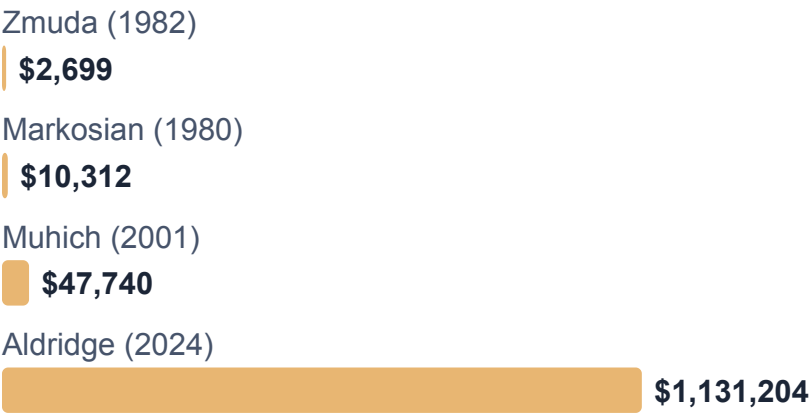
It's a trust sold as "non-grantor, irrevocable, complex, discretionary, spendthrift," built on a misreading of IRC § 643(b) that IRS Chief Counsel rejected in AM 2023-006 (2023).

The pitch says capital gains and big dividends are "principal," so the trust never reports them as income. Chief Counsel's memo explains that promoters "mistakenly assume that income in § 643(b) refers to the taxable income of the trust," and concludes that "all of the income attributable to capital gains and extraordinary dividends must be reported by the non-grantor trust as income on Form 1041." The IRS says it first found promotional material for this structure in March 2021. Its talking points answer the claimed loophole directly: "There is no such exclusion or deduction from taxable income of a trust."

A Colorado promoter, Timothy McPhee, was sentenced in December 2025 to 12.5 years in prison; IRS Criminal Investigation says his clients "paid taxes on only about 2% of their income" and the shelter cost the United States about \$45 million. In June 2026 a jury convicted four more promoters of a layered business trust, family trust, charitable trust and "private family foundation" that was advertised as letting clients "own nothing, control everything" and avoid tax on "upwards of 98%" of business profits.

What happened to people who bought these trusts?

They lost in court, paid the tax with interest and penalties, and in the worst cases went to prison themselves.



Individual returns only. Zmuda's fee was \$8,000 for the seminar plus \$10 to join the association.

Case	Promoter's price	Tax deficiencies	Penalties	Total owed
Zmuda v. Commissioner, 79 T.C. 714 (1982)	\$8,010	\$2,699	Not totaled here	\$2,699 plus penalties
Markosian v. Commissioner, 73 T.C. 1235 (1980)	Not stated	\$10,312	None at issue	\$10,312
Muhich v. Commissioner, 238 F.3d 860 (7th Cir. 2001)	\$12,000	\$39,783	\$7,957	\$47,740
Aldridge v. Commissioner, T.C. Memo. 2024-24	\$9,500	\$646,402	\$484,801.50 (fraud)	\$1,131,203.50

Markosian v. Commissioner, 73 T.C. 1235 (1980). A dentist signed a preprinted "Declaration of Trust of This Pure Trust" and paid the trust 80% of his practice income as a "management fee" that the court said was "picked out of the air." The couple "conducted their business and lived their private lives exactly the same as before the trust was created." The Tax Court disregarded the "paper entity" and upheld a \$10,312 deficiency.

Zmuda v. Commissioner, 731 F.2d 1417 (9th Cir. 1984). The taxpayer paid \$8,000 for a seminar and \$10 to join the group selling the plan. The Ninth Circuit, whose rulings bind federal courts in California, affirmed: "The ALA plan was a sham from inception." The seminar fee wasn't deductible either.

Muhich v. Commissioner, 238 F.3d 860 (7th Cir. 2001). A \$12,000 trust packet ended in deficiencies of \$17,898 and \$21,885 plus accuracy penalties. The court noted that "courts have uniformly held that such transactions are a sham."

Richardson v. Commissioner, 509 F.3d 736 (6th Cir. 2007). An Aegis buyer turned salesman told seminar audiences they could cut taxes by up to 70%. In 1997 he and his wife held a trust "board meeting" where they "discussed IRS Notice 97-24, which warned taxpayers about the illegality of abusive trusts," and kept going. The fraud penalties were affirmed.

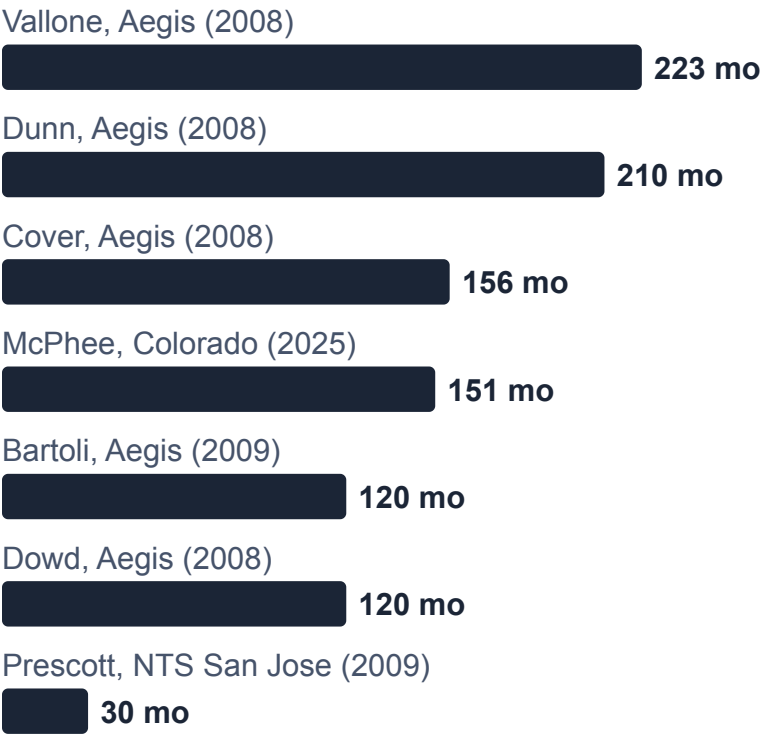
Aldridge v. Commissioner, T.C. Memo. 2024-24. A couple attended a National Trust Services workshop with \$9,500 in tuition, where they learned to "convert their living expenses to business expenses." The Tax Court held the trusts "were shams, lacking in economic substance, and were mere alter egos," and entered decision for the IRS

on \$646,402 in deficiencies and \$484,801.50 in fraud penalties for 1999 through 2004. By then, Mr. Aldridge had served nine years in prison and Ms. Aldridge five years and three months.

Courts also fine people who keep arguing. In *Swanson v. Commissioner* (9th Cir. 2011), the Ninth Circuit upheld a \$12,500 penalty under IRC § 6673, which lets the Tax Court impose up to \$25,000 for frivolous positions.

Have trust promoters gone to prison?

Yes, many: the Aegis prosecution in Chicago alone produced "convictions of more than 30 defendants" and a \$60 million tax loss to the United States, according to the Justice Department.



Promoter	Sentence	Source
Michael A. Vallone, Aegis	223 months (18.5 years)	DOJ, Oct. 2008
Timothy Shawn Dunn, Aegis	210 months	DOJ, Dec. 2008
William S. Cover, Aegis	13 years (156 months)	DOJ, Oct. 2008
Timothy McPhee, Colorado	12.5 years (151 months)	IRS-CI, Dec. 2025
Edward B. Bartoli, Aegis	10 years (120 months)	DOJ, 2009
Michael T. Dowd, Aegis	10 years (120 months)	DOJ, Nov. 2008
Roderick Prescott, National Trust Services	30 months	DOJ, Oct. 2009

Aegis sold trusts to about 650 clients. Its founders and managers drew sentences from 10 years to 223 months, plus a \$4.125 million forfeiture order. California had its own: National Trust Services of San Jose was enjoined in San Diego federal court in 2003, in a case where the government estimated a \$135 million revenue loss; its principals deposited about \$3.5 million from selling trusts. One of them, Roderick Prescott, was sentenced to 30 months in 2009 for evading at least \$550,000 of his own taxes. In June 2026 a jury convicted Prescott again, this time for promoting the "private family foundation" layer of the Colorado scheme, even though he had been "permanently enjoined from promoting abusive tax shelters."

In Los Angeles, the Justice Department sued two promoters of common-law trusts who had customers sign an "Oath of Privacy" with penalties "of up to \$100,000" for disclosing trust business, and in 2011 a federal judge in the Central District of California preliminarily enjoined them. The court found more than \$1.1 million in tax deficiencies for just four of their customers.

What penalties can a buyer face?

The tax itself, plus a 20% accuracy penalty (IRC § 6662) or a 75% fraud penalty (IRC § 6663), plus up to \$25,000 if you litigate frivolous arguments in Tax Court (IRC § 6673), and in the worst cases a felony charge.

Tax evasion under IRC § 7201 carries up to 5 years in prison per count. Notice 97-24 also flags a penalty equal to 35% of the gross value of property transferred to a foreign trust that isn't reported. Promoters face their own penalty, 50% of the gross income from the activity (IRC § 6700), and injunctions (IRC § 7408). California mirrors both: the Franchise Tax Board's promoter penalty follows § 6700 (Rev. & Tax. Code § 19177), and it can ask a court to enjoin promoters (Rev. & Tax. Code § 19715). The IRS's 2023 Dirty Dozen warning applies to every version of this pitch: taxpayers "are legally responsible for what's on their return, not a promoter making promises and charging high fees."

Is the California "living trust mill" the same scam?

No, it's a cousin: trust mills sell real but cheap living trust packages through non-lawyers, mainly to set up annuity sales, and the California Attorney General warns that their "sales agents are not attorneys and are not experts in estate planning."

In a joint suit by the State Bar and the Attorney General, the packages sold for "\$1,000 to more than \$2,000," agents "typically earned a 30 percent commission on each package," and the company sold more than 10,000 trust packages and more than \$200 million in annuities. Only active State Bar licensees may practice law in California (Bus. & Prof. Code § 6125). A trust-mill trust is usually a legal document with defects, while a pure trust is a tax scheme. Our page on [common defects in online and packaged trusts](#) covers the first problem, and [what a living trust costs in California](#) shows what a real one runs.

What should you do if you already bought one?

1 Stop filing returns that rely on it

Notice 97-24 urged people in these trusts to file amended returns. The buyers in Richardson and Aldridge kept going after warnings, and that's what turned tax bills into fraud penalties.

2 Get advice from someone who didn't sell it to you

The IRS says to "consult a tax professional not involved in promoting the investment." Talk to a tax attorney before you contact the IRS.

3 Get your property back into your own name or a real trust

A house deeded to a sham trust still has to be retitled correctly, and an estate planning attorney can do it with a revocable or properly drafted irrevocable trust.

When is an irrevocable trust legitimate?

Often: Notice 97-24 itself says trusts "are frequently used properly in estate planning, to facilitate the genuine charitable transfer of property, and to hold property for minors and incompetents."

A real irrevocable trust means giving up control and accepting that the trust or its beneficiaries pay the tax. A revocable living trust is a grantor trust by definition (the IRS says "All 'revocable trusts' are by definition grantor trusts"), so it saves no income tax, and it doesn't need to. It avoids probate. If someone sells you a trust that lets you keep control and stop paying tax, it isn't one of these. See the real dangers of irrevocable trusts in California and whether a living trust files its own tax return.

What the promoter says	What the law says	Authority
A pure trust is a private contract outside the tax code	Frivolous position; \$5,000 penalty	Notice 2010-33
Income paid to the trust isn't yours	Income is taxed to the person who earns it	IRS Q&A; Rev. Rul. 2006-19
You keep control, the trust pays no tax	Control makes you the owner for tax purposes	IRC §§ 671, 674, 677
Your house, car and school costs become deductible	Personal expenses aren't deductible through a trust	IRC § 262; Notice 97-24
Capital gains are "principal," never taxed	Gains must be reported on Form 1041	AM 2023-006
Courts have upheld it	Courts "have uniformly held that such transactions are a sham"	Muhich (7th Cir. 2001)

Frequently asked questions

Is a pure trust legal?

You can sign the documents, but the tax treatment promised doesn't exist. The IRS may ignore the trust as a sham and tax all of the income to you (Notice 97-24), and claiming the trust is a protected private contract is a frivolous position (Notice 2010-33).

Is a constitutional trust or contract trust different from a pure trust?

Only in name. Rev. Rul. 2006-19 says the sham analysis applies "regardless of the form of the entity, such as a trust or common law business trust."

Does a trust have to file a tax return?

A trust that isn't a grantor trust must file Form 1041 for any year it has \$600 of income or a nonresident alien beneficiary. A revocable living trust usually reports through your own return.

Can buyers go to prison, or just promoters?

Buyers can. In Aldridge, the couple who bought National Trust Services trusts served nine years and five years and three months in prison before the Tax Court case was decided. One of the Colorado promoters convicted in 2026 was also convicted of six counts of tax evasion for using the shelter herself.

Will a pure trust protect my assets from lawsuits?

Not if you keep control. Courts treat a trust you run for your own benefit as your alter ego. Our page on [what actually works for asset protection in California](#) covers the real options.

How is this different from the sovereign citizen trust pitch?

The sovereign citizen version adds theories about a secret account tied to your birth certificate. The tax result is the same. See [the sovereign citizen trust scam](#).

This page is general information about the law as of its update date. It isn't legal, tax, or investment advice for your situation, and reading it doesn't create an attorney-client relationship.

More myths from social media, checked against the actual rules: [the money myths series](#).

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Questions about your own plan?

Ridley Law helps California families with trusts, wills, trust administration and probate from Port Hueneme, serving Ventura, Santa Barbara and Los Angeles counties. The first call is free and runs 30 minutes.

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