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"No one can read our Constitution without concluding that the people who wrote it wanted their government severely limited; the words 'no' and 'not' employed in restraint of government power occur 24 times in the first seven articles of the Constitution and 22 more times in the Bill of Rights."

— Edmund Opitz, The American Way in Economics, The Freeman, October 1964

Tax and Financial Strategies

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Wealth Creation Strategies

Death, Taxes and Estate Planning for the Whole Family

Death: it's not the ultimate tax shelter. But it's a good one.
Death is not quite the ultimate tax shelter, because governments can tax your hard-earned income and wealth after death. The estate tax subjects those rare estates exceeding $5.43 million in net value* to a 40% federal tax; more commonly, income taxes hit previously untaxed income. There are several categories of such income, the most prevalent of which are withdrawals in excess of basis from pre-tax retirement accounts (think: IRAs, 401ks, 403bs and 457bs) and tax-deferred single-pay "non-qualified" annuities. If the decedent didn't withdraw the funds and pay the tax, heir(s) will.

If heirs pay tax on all withdrawals (in excess of basis, which consists of after-tax contributions) from pre-tax accounts, then how is death a good tax shelter? Inherited non-retirement account assets, including real estate, collectibles and stocks, get a "stepped-up" basis on appreciated assets. This means the heirs' cost is deemed to be the market value as of date of death, which allows heirs to sell and pay no tax. Moreover, not only is the appreciation not taxed, but any depreciation taken on rental property is not "recaptured," meaning it, too, is never taxed. Property sold before death is subject to tax on both appreciation and depreciation recapture.

How big a benefit is this? Compare a before-death with an after-death sale of a rental property worth $500,000 that cost $150,000 and on which $100,000 of depreciation was deducted before dying. If the taxpayer sold it even an instant before death, $450,000 of gain is subject to tax ($350,000 of appreciation plus $100,000 of depreciation, the "recapture" part). A typical federal tax on that large of a gain is 19-26%. For California residents or non-residents selling California property, it's 29-36%, or $130,500 to $162,000, depending on how much other income this gain is stacked on top of. If you object, "But the sale of such property is taxed at federal capital gain rates of only 15%—how can this be?" yes, $350,000 is taxed at an "advertised" rate of 15%, but there are a number of add-ons—mostly hidden from the ordinary taxpayer's view—that substantially increase this grossly misleading rate:

1. Once total income for the year exceeds $400,000 ($450,000 for joint filers), a 20% rate applies (note the potential $17,500 marriage penalty!).
2. The $100,000 representing prior depreciation is "recaptured" at a special tax rate of 25%.
3. The gain likely generates Alternative Minimum Tax, increasing the advertised rate by as much as 7.5%.
4. The new 3.8% "Net Investment Income Tax" (NIIT) hits once Adjusted Gross Income (AGI) for the year exceeds $200,000 ($250,000 for joint filers—creating yet another marriage penalty!).
5. Personal exemptions and itemized deductions are phased out beginning at $200,000 AGI ($250,000 for joint filers), which can add several percent to the advertised rate.

If instead the property passes to the heir(s) *after* death, the decedent's original cost and any depreciation taken is irrelevant. The heir(s) is (are) deemed to have purchased the property at full market value on date of death, even though no actual sale occurred. If the heir(s) then sell the property for the price they "paid," there's no taxable gain and, hence, no tax. Moreover, if the heir(s) keep the property, depreciation starts all over again using the inherited value (discussed later). This is

why we often say, "Die with the property," especially if it has appreciated substantially since the original purchase.

Should you sell or exchange before or after death?
If the value of a non-retirement asset is wildly overvalued, you might want to sell despite the tax cost. For real estate, consider a "like-for-like" tax-deferred exchange: real estate held for investment can be exchanged into other real estate held for investment. So long as certain rules are followed (the properties must all be in the U.S., for example), income tax is avoided.** Exchanges are also allowed for other types of property such as collectibles, but the rules are much more restrictive ("like-for-like" includes vacant land for commercial real estate, or commercial for residential income property, but does not include gold for platinum). While certain intellectual property rights can be exchanged on a tax-deferred basis (trademark for trademark, for example), such exchanges aren't allowed for securities like stocks or bonds.

Then what should you do with overvalued securities if you can't avoid tax by engaging in a tax-deferred exchange? Because of dramatic fluctuations in stock values, it's not always a great idea to hold them until you die. The tax cost of selling may be a lot less than a decline in market value. A real-life horror story demonstrates this idea.

Back in the late '90s a client, "Bill," was managing money for his aging mother, "Mary." Mary's assets consisted of her home and 10,000 shares of one stock worth about $80 per share when we spoke (she was woefully undiversified, which happened to work really well up to that point). Because Mary's cost was only about $5 per share, Bill was reluctant to have her sell and pay tax on the $75 per share gain, which would have cost about $225,000 in tax if the entire $800,000 holding was sold.

Bill understood that if he inherited the stock his "basis" (cost for tax purposes) would be whatever it was worth when his mother died. So, if he could sell it the day after Mary's death, he would pay no income tax. There was one big problem: although the company had been around for decades, it was a technology company, we were in the late stages of the Internet bubble and the market was looking for a pin. I pointed out that Mr. Market could take a whole lot more than Mr. Taxman (the tax would have been 28% of the gross value, so all the market had to do was drop by 28% and the profit from holding would be wiped out). Bill balked. I suggested Mary consider hedging her bets and sell half (I often say, "When in doubt, hedge"). Instead, Bill decided to hold. By the time Mary died two years later, the stock had sunk to $18 per share; Mr. Market took $620,000. The moral is obvious: those who own high-flying stocks in taxable accounts (think: Apple, Netflix, and Priceline) may wish to at least hedge.

When your spouse is your heir
Community property rules further complicate the decision-making process in whether to hold or sell/exchange before death. Spouses in non community property states get to step up the basis of the "inherited" half of a property owned by both spouses; the original basis is retained for the other half (the part the survivor already owned). Those in community property states,*** however, can step up the value of the entire property to the market value on the spouse's date of death *if* the property is owned as "community property." In California, property titled as "community property with rights of survivorship" gets a full step-up in basis and avoids probate. If the property ownership is titled as "community property," the survivor gets the full step-up in basis, but must file a "spousal property petition" (a short-form flat-fee inexpensive procedure in lieu of probate) to transfer ownership, unless the decedent had a revocable living trust. If the property is titled "joint tenants," probate and its attendant costs are avoided but the survivor generally can count on a step up in basis only on the decedent's half.

Depreciation and inherited property
One unheralded (and often overlooked) advantage of inherited property is that depreciation starts over, even if the property is inherited by a spouse (subject to the above ownership rules with half or full step-up in basis). One surviving spouse with a full step-up in basis recently opted to keep a rental property that had long ago been fully depreciated. Depreciation re-started using the current value of $400,000, yielding a (non-cash flow) depreciation deduction of nearly $15,000 per year. This saved her more than $5,000 annually, neatly offsetting the increased tax from the loss of joint filing status.

Death-bed tax planning
Unfortunately, the time of death isn't usually an event over which we have much choice. Yet knowing that we're going to die and *when* we die can make a huge difference in tax planning opportunities for us and our heirs. Some are unable to take advantage of such openings due to unforeseen accidents, heart attacks and other tragedies. However, if death is imminent, "end of life" tax planning can be invaluable.

Tax is always paid on non-Roth pre-tax retirement account withdrawals; it's only a question of who will pay, when and at what rates. We knew that "Tom" didn't have long to go and it was early in the year. He had a couple hundred thousand dollars left in his IRA that non-spouse heirs would inherit. He could (1) withdraw and pay taxes, (2) convert to a Roth IRA and pay taxes on the net conversion, (3) leave the IRA to his heirs (and they would pay taxes on withdrawals), or (4) some combination of the first three. Tax would be paid regardless, but with the Roth conversion option the *future growth* would be tax-free and his heirs could take required minimum distributions (RMDs) over their life expectancies (required of non-spouse heirs).

Tom's two heirs, his sons "Bob" and "Ned," had disparate tax and financial needs—Bob was in a low tax bracket and could use additional income, while Ned was a high-income earner. After taking his RMD for the

year, Tom split the IRA in two and converted one into a Roth. The traditional IRA named lower-income Bob as beneficiary, while the Roth named higher-income Ned. Tom died soon after. Cash from taxable accounts used to pay the tax on the conversion was deemed part of Ned's inheritance, serving to equalize the overall inheritance. Adding to the flexibility of Roth conversions, the executor of Tom's estate had until October 15 of the following year to recharacterize (undo) part or all of the conversion, giving Ned plenty of time to decide whether the full conversion was his optimal choice. Since Ned was the executor, he had full control over this.

Tax is also paid on gains embedded inside tax-deferred single-pay "non-qualified" annuities (those held outside of retirement plans). "Judy" had $100,000 of tax-deferred growth left inside such annuities, an amount that would, eventually, have to be withdrawn and taxed. She didn't have long to live—and it was January. People who die in January often get cheated, as they *could* have earned about $12,000—the standard deduction and personal exemption for those 65 and over—with zero tax owed. Judy could withdraw an additional $9,000 at a 10% tax rate (we had been taking enough yearly withdrawals to "use up" those lower brackets every year). If she lived long enough to receive only one month of Social Security she could take up to another roughly $25,000 at tax rates ranging from 15 to 23% (due to state income tax rates of zero to 8% on top of the nominal and, in this case, real 15% federal rate). Any *additional* withdrawals would be taxed at 33% and higher.

We knew that any withdrawals taken by "Ruth," Judy's daughter and sole heir, would be taxed at 34% or higher, with no change expected. Just before she died Judy took a $46,000 distribution, which Ruth inherited, paying $6,200 federal and state income tax, for a combined *average* rate of less than 14% (comprised of various marginal tax rates ranging from zero to 23%). Ruth would have paid $18,700 in tax on the same income. By having Judy take the withdrawal before she died, nearly $12,500 of tax was saved. Even if she spaced out the withdrawals over 25 years (and annuities frequently must be withdrawn within five years of death), Ruth would never have seen that much value in tax deferral.

Planning for the surviving spouse

Tax often skyrockets in the year after a spouse dies. Due to the halving of personal exemptions and the standard deduction, along with a lower threshold where Social Security benefits become taxable, a surviving spouse's total tax generally increases by 25-200% on the same income minus one Social Security check, depending on total and types of income. The year in which a spouse dies is the last year to file jointly; it matters not whether death occurs on January 1, leaving plenty of time to plan, or December 31, leaving no time for such planning. And unless the survivor remarries, it's the last year to take advantage of a couple of tax benefits: (1) the nominal 15% tax rate on $74,900 (for 2015) of taxable income, which gets cut in half the year following the death of one's life partner; (2) the higher $170,000 "Modified" Adjusted Gross Income (AGI) threshold for Medicare Premium Surcharges, which gets cut in half to a mere $85,000 for single filers.****

What can be done? The year of death of a spouse is often the last chance to take traditional IRA withdrawals or, better, convert to a Roth IRA at a lower tax rate than the survivor will be subject to for the rest of his or her life. A number of such clients have recently saved $10,000-$20,000 in tax on $50,000 to $100,000 of net conversions. In addition, once the funds are converted to a Roth IRA, tax is eliminated on future growth (and distributions). Since these Roth IRAs are likely to be inherited by children who take RMDs over their life expectancies, the long-term savings on tax-free growth may dwarf the tax savings from having converted while in low brackets. Obviously, while "end of life" tax planning can be emotionally challenging, when possible it's usually a great idea to get us involved to discuss options before death.

Things to do immediately after a loved one dies

We've heard horror stories of clients dealing with decedents' estates. It's a lot of work and confusion, even when a spouse dies. Several actions should be taken immediately after the obvious ones (such as notifying family and friends, arranging the funeral and ensuring any children and pets are properly cared for). While there are plenty of lists on the Internet of things to do when a loved one dies (simply Google "list of things to do when a loved one dies"), there are four we believe need special emphasis:

1. Order certified copies of death certificates from the funeral home or mortuary. You will need one for each claim of property or benefits of the decedent, including Social Security, Veteran's benefits, retirement accounts, life insurance proceeds and banks or brokerages where accounts are held. Because the more you order the cheaper they may be (but apparently not in California) and, if you need more later you will have to track them down at your county's vital records office, a good rule of thumb is to request a half a dozen for a simple estate, a dozen for someone with several bank, brokerage and retirement accounts, and a couple of dozen for more complex estates.

2. Notify the Social Security Administration (SSA) and all pension payers of the death. Be careful to specify who is actually deceased ("60 Minutes" aired a report in late 2014 on the frozen assets of survivors because someone got the idea the survivors were the decedents).

3. Watch the mail for bills that need paying. This wouldn't be

on the "immediate" list were it not for the pain of later having to ask that late fees be abated; this will also help you figure out which services (cable, telephone and the like) can be shut off and subscriptions (magazines, wine club, etc.) terminated.

4. Find all payees to whom automatic payments must still be made and make new arrangements.

Things to do to avoid tax and financial headaches

There are five additional crucial items we don't see mentioned elsewhere (probably because tax professionals don't usually write such lists):

1. Most commentators suggest applying for a Federal Employer Identification Number (FEIN) for the estate. We suggest first determining whether one will be required. It often isn't required for the death of a spouse and, for a single person, it's required only if income will be earned by the estate. In many cases, it won't be. There may be little left in taxable accounts, or such accounts were titled "payable on death" or "transfer on death." These pass directly to beneficiaries, as do retirement accounts that name beneficiaries other than the estate. If there's no income, there's no need for an income tax return of the estate (and, as an extra benefit, probate may conceivably be avoided if there is no living trust or even, in isolated cases, a will). The most common otherwise "simple" situation where an income tax return of an estate is required is to report the sale of a home. This usually creates a deductible capital loss to the estate and, ultimately, heirs, so having to request an FEIN can be a good thing.

2. Save statements from bankers and brokers for the month prior to and month of death of a single person. Consider a person dying March 20. Interest (what little there may be in an era of zero interest rates) is paid monthly; dividends are typically paid at the end of each quarter. If you think the financial institution will report the dividends paid March 31 to the correct entity—the decedent's estate and not the decedent's Social Security number (SSN)—think again. Income pre-death and post-death must be divvied up; the only way to do this correctly is by reviewing bank and brokerage statements for the month of death.

3. Provide death certificates to all bankers and brokers as soon as you have them. For single filers for the year of death, 1099s rarely match income. We've seen after-death sales of hundreds of thousands of dollars of stock, with thousands in dividends, reported to the decedent's SSN. You can reduce the income mis-match problem and odds of IRS inquiries (who needs those?) by changing the reporting of accounts from the decedent's SSN to an estate FEIN as quickly as possible. Also, see if the broker can fix any incorrect reporting for the year—it may be too late when 1099s are issued early in the year after death.

4. Ask brokers to provide date of death values for each security owned in non-retirement accounts. These amounts become the "cost/basis" for all sales going forward, whether for an income tax return of the estate or heir(s). Don't count on Form 1099-B to report the date of death value accurately. Even for surviving spouses, if the entire value on date of death doesn't become the cost/basis, half of the value does—so these values are needed regardless of heir.

5. Within the boundaries of what the law allows, try to ensure that none of the heirs has immediate access to large amounts of a decedent's financial accounts. This applies especially to retirement funds. We've seen too many heirs gain access to IRAs and almost immediately disburse the funds—what a disaster. Because you can't undo such withdrawals—there is no 60-day rollover period on inherited retirement accounts—whatever is withdrawn is taxable, regardless of the heirs' needs. While seemingly a blessing for those who need the cash, there are almost always better ways of handling such funds than taking and subjecting them to tax immediately (or losing the long-term tax-free growth of Roth IRAs). In most cases, you can split inherited retirement accounts into individual heirs' sub-accounts, allowing each heir to determine what to do with their inheritance. In one case of jumping the gun on an inheritance, the tax was $9,000 rather than a total of $4,000 the withdrawal would have created had it been spread over three years (and because the decedent died in December, it could have been spread over 14 months). In another, the executor disbursed each heir's $30,000 share of an IRA almost immediately, instead of letting each heir decide what to do with the funds. Using the same tax and growth assumptions, the $30,000 would grow to $50,000 in 30 years in a taxable account, rather than $80,000 had it been left in an IRA with annual RMDs. Ouch.

* For 2015, adjusted for inflation; double, or $10.86 million, for a married couple with proper structuring of their estate and filing of an estate tax return on the first death. Careful, though: 14 states have an estate

tax (the tax based on asset values on date of death), ranging from 12% to 19%, starting at total estate valuations as low $675,000 for New Jersey, $921,655 for Rhode Island, $1 million for Massachusetts, Maryland, New York and Oregon and $2 million in Washington state, Maine and Connecticut. In addition, seven states (including two with estate taxes—New Jersey and Maryland) have inheritance taxes, which impose a tax on an inheritance by "non-close" relatives. Careful, there, too—"non-close" can include siblings.

** Since regional levels of over- and under-valuation are usually similar, this may not work if you insist on being among the 90% of owners whose rental property lies within 100 miles of your home. However, if you are willing to look elsewhere you have a better shot at preserving values. For example, if in 2006 you exchanged California property into property in large swaths of such states as Tennessee or Pennsylvania, the profits earned up to that point may have been preserved, because prices in large parts of those and many other states in the interior of the country declined only minimally.

*** Community property states are Wisconsin, Idaho, Washington, California, Nevada, Arizona, New Mexico, Texas, Louisiana and, by mutual agreement of the spouses, Alaska. "Community property" means, generally, each spouse owns half of the other's assets and vice versa, except for inheritances and property acquired before marriage that hasn't been "co-mingled."

**** Taxable income is income after all allowable deductions, which includes personal exemptions and either the standard or itemized deductions. Adjusted Gross Income (AGI) is total income before those allowable deductions. "Modified" AGI is AGI plus otherwise "tax-free" municipal bond interest.

Wealth Creation and Limiting Financial Losses During Young Adulthood and Beyond

In the last few years, we've had a number of "children" of long-time clients reach adulthood and become full clients themselves. Above, we wrote about some pre- and post-death financial ideas you won't read about elsewhere. To balance this, we'll discuss a few ideas on how to decrease financial challenges for those just starting out. These uniquely connect dots between seemingly disparate topics.

There are many great tomes on systematic savings and investing plans, from *The Richest Man in Babylon* to *The Millionaire Next Door* and seemingly anything by Dave Ramsey or Suze Orman. Simply google "great *books* on savings for young people" and "great *ideas* on savings for young people" and you'll find a wealth of information, ideas and reading materials. In issue # 32 of *Wealth Creation Strategies*, I emphasized the value of saving and investing early and regularly in life to maximize wealth creation. To use an example, if you want to have $1,000,000 saved at age 65 and you earn 6% per annum,* either a tad more than $6,000 yearly starting at age 25 or $11,800 yearly starting at age 35 will do the trick. The ten-year delay from 25 to 35 requires nearly twice the yearly investment to achieve the same goal. In issue # 34, I discussed the theory behind the creation of wealth (and it isn't income transfers, minimum wage laws or lotto wins). Both of these are well worth reading (or re-reading) and are excellent supplements to the above-mentioned books and articles.

They will help you starting out while repaying student loan debt created by paying inflated bubble-like tuition costs (caused by the same easy money responsible for the housing bubble) and paying for your grandparents' support via Social Security and Medicare, not to mention subsidizing your parents' support via the "affordable care" act, all manifesting as unfunded federal liabilities of some $100 trillion (see http://www.wsj.com/articles/dear-class-of-2015-youre-in-big-trouble-1431471621). All this, while the average net worth of those over age 65 is 20 times the average net worth of those ages 25-35.

Which retirement plan should you invest in?

Something not emphasized by others but addressed in numerous articles in *Wealth Creation Strategies* is to carefully decide whether to contribute to a traditional IRA, 401k or similar pre-tax retirement plan, or Roth IRA (or, carefully and with an understanding of their challenges, Roth 401k). The decision is largely a function of your current tax rate, including the effect of the low-income "retirement savings contribution credit," and your expected future tax rate based on long-term earnings prospects. Few people think through these options carefully, perhaps because the future is unknowable. However, with innumerable variables, rules of thumb can be helpful: contribute to Roth IRAs when the tax savings for traditional IRA contributions is low (usually 15% or lower federal) and to pre-tax plans to the extent one saves at high (usually 25% or higher federal) marginal rates.

As discussed in issue # 25 of *Wealth Creation Strategies*, Roth IRAs are a no-brainer and should be your default. They are a great way to save for homes, businesses and college education for your children as your contributions can be withdrawn at any time tax- and penalty-free; only the earnings must ride until you are 59 ½ (or permanently disabled or dead, which means they serve as a form of limited disability and life insurance). We're here to provide much-needed counsel, especially when there are countless hidden, very high tax rates (not the least of

which is created by that retirement savings contribution credit).

Using Personality Type to increase your income and wealth

Two other topics should be explored for long-term wealth creation and preservation of capital when you are just starting out: Personality Type and substance addiction.

The late David Keirsey, who wrote his masterwork *Please Understand Me* in 1978, described four human "Temperaments," each of which is subdivided into four specific "Personality Types" (creating 16 Types in all per the Myers-Briggs Type Indicator®). Understanding not only your Personality Type but also those of your employers, co-workers, employees, family and friends can help you in countless ways through life, especially romantically and financially. Of course, we'll explore the financial idea.

Had I understood my own Type when I was just starting out, I would have benefitted in several ways. First, I could have better focused on subjects which, at first glance, seem more consistent with my Personality Type. Of course, I might have settled on something else and you wouldn't be reading this. Had I understood Type and Temperament, once I started preparing tax returns I might have more quickly adapted my profession to my Personality Type. Working in professions and occupations consistent with one's Type ups the odds of maximizing one's happiness and income, which explains why "do what you love and the money will follow" can work as well as it does. On the other hand, so does adapting your profession to your style, which can give you a niche and, therefore, a unique competitive advantage.

As it turns out, I partly adapted the profession to my Temperament long before I learned about Keirsey's work. Each Temperament excels at its own intelligence—tactical (SP in the Myers-Briggs lingo, or Artisan, using Keirsey's nomenclature), logistical (SJ, or Guardian), diplomatic (NF, or Idealist) and strategic (NT, or Rational). Since my Temperament, the "Rational" (Myers-Briggs refers to it as the "iNtuitive Thinker") excels at long-term strategic thinking, it's no coincidence that I named my firm "Income and Capital Growth *Strategies*" more than a decade before knowing the word is perfectly consistent with my Personality Type. Nor is it a coincidence that, from the beginning, the client letter tackled subjects far larger in scope than taxes; the Rational is nothing if not a "big-picture" thinker. Consistent with that attitude, I earned a Certified Financial Planner® designation (which focuses on individuals' financial positions and goals from a "big picture" point of view) just a few years after becoming an Enrolled Agent. Long before I understood my own Type, the long-term strategic thinker in me counseled taxpayers to strive for lower lifetime taxes by doing all they can to average income over long periods; Roth IRA contributions and Roth conversions (moving IRAs to Roth IRAs, subjecting retirement funds to tax when *you* want to—often at low tax rates) made this much easier to accomplish.

Additionally, understanding Type and Temperament improved my interactions with clients and business associates. I learned that I naturally think in bottom lines and terse terms, while others may prefer a one-two-three approach and a softer tone. This helped me to more effectively communicate with clients, increasing the odds of satisfying and, therefore, retaining clients. Long ago, I made several changes to the client engagement agreement that increased the number of potential clients who became actual clients: I converted several "thinking" words to "feeling" words, turning a harsher tone into a softer one. It has also helped immensely in attracting and retaining great associates and in understanding their strengths and weaknesses. For example, in the years before Keri (our wonderful tax season temp for the last several years), we used verbiage in our annual ad seeking a temporary employee designed to attract Personality Types I work with best. My knowledge of Type and Temperament has helped me to more effectively operate the business on many levels, which has and continues to translate to helping clients in diverse ways I would otherwise be less able to do.

So, how can this help you increase *your* income in the long run? Many ways are inferred above: understanding your employer, co-workers, employees and customers will help you to more effectively communicate with them, increasing the odds of satisfying their needs and, thereby, upping the odds of increasing your income. Either switching to the right profession or adapting your profession to your Type (which is how many profitable and wonderful niches are created) will increase your happiness and, therefore, productivity, with obvious financial benefits. Many organizations use Keirseyan Temperament and the Myers-Briggs Type Indicator® to build more effective and productive teams. And last but not least, "Typing" your partners, family and friends can lead to a more satisfying and productive personal life, which may translate to greater income potential.

Understanding substance addiction can protect you financially and emotionally

The second subject that has never before been linked to long-term wealth creation and preservation of capital is an understanding of alcohol and other-drug addiction. My books and online www.addictionreport.com provide a plethora of evidence that nearly all financial scams are perpetrated by substance addicts and some 40% of divorces result from abuse owing to the inflated ego created by addiction in one spouse or the other. Many have lost as much as 90% of their wealth due to having succumbed to a Ponzi or other financial fraud, and most divorces involve the loss of at least half of one's wealth. These losses can be prevented by identifying likely addicts *before* becoming financially, professionally, emotionally or romantically entangled. Us-

ing the tools I developed from thousands of hours of research and experience, described in depth in my books (see http://www.amazon.com/Doug-Thorburn/e/B001K8XEPO/ref=ntt_athr_dp_pel_1), I would have spotted behavioral signs of early-stage substance addiction (which center on an inordinately large sense of self-importance—an inflated ego) in my long-ago ex-wife within a couple of months of meeting her (long before marriage) and in my long-ago ex-fiancée within a week. The wealth I created up to that point was more than halved by my divorce and further impaired by the failed engagement (not to mention, for a time, my sanity). While I was in a position to turn lemons into lemonade, most are not. Young people can learn how to use these tools to protect themselves without going through the financial and emotional turmoil I went through.

Many think they would know who the addicts are in their lives. Oh? How many people do you know? Say it's 400. How many of these have you identified as likely substance addicts? Two or three? Maybe four? Since 10%** of the U.S. population consists of addicts, you know 40. Who are the other 36?

Because 90% of addicts are functional for 90% of their drinking and using careers and the drinking and using is often well-hidden, without the tools I describe in my books there is no way to know who most of them are. Some are relatively innocuous. However, egomania impels the alcohol and other-drug addict in the early- to middle-stage of his or her disease to wield power over others. The most effective way to wield that power is through abuse—sometimes physically, sometimes financially, and always emotionally, verbally or psychologically. The form misbehaviors take are a function of circumstances, environment, drug of choice and the addict's underlying Type and Temperament. However, addicts will act badly some of the time, the misbehaviors may be directed at you, and addicts are *capable* of *anything*—including destroying relationships and ruining lives, emotionally, physically and financially.

I hope this article has given you some ideas on how to enrich your lives. Begin creating and preserving wealth now. We're here year-round and would be delighted to delve deeper into these and other topics with you.

* For purposes of the illustration, this assumes a stable 6% per annum; volatility changes the results.

** The rate of alcohol and other-drug addiction varies among ethnicities based in ancestry. It's a function of how long one's ancestors have had access to fermented fruits and grains in ample enough quantities to create enough alcoholism to build a resistance to it.

Financial History Repeats Itself

But Underlying Conditions are Much Worse

> "It was the greatest and boldest operation ever undertaken by the Federal Reserve System, and, in my judgment, resulted in one of the most costly errors committed by it or any banking system in the last 75 years. I am inclined to think that a different policy at that time would have left us with a different condition at this time… Business could not use and was not asking for increased money at that time."

In his "Weekly Market Comment," John P. Hussman explains this was the testimony of Adolph Miller, former Federal Reserve Board Member, before the U.S. Senate in 1931 about the Federal Reserve's 1927 interest rate cuts and acceleration of open market purchases which, according to Hussman, "fueled speculation and low-quality credit expansion that culminated in the 1929 peak, collapse, and ultimately the Great Depression." Then he quotes Ludwig von Mises, *The Causes of Economic Crisis* (1931):

> "Credit expansion cannot increase the supply of real goods. It merely brings about a rearrangement. It diverts capital investment away from the course prescribed by the state of economic wealth and market conditions. It causes production to pursue paths which it would not follow unless the economy were to acquire an increase in material goods. As a result, the upswing lacks a solid base. It is not a real prosperity. It is illusory prosperity. It did not develop from an increase in economic wealth [i.e. the accumulation of savings made available for productive investment]. Rather, it arose because the credit expansion created the illusion of such an increase. Sooner or later, it must become apparent that this economic situation is built on sand."

Pension funds that guarantee an inflation-adjusted future income to retirees assume a rate of return they will achieve on their investments. This, along with actuarial estimates of pensioners' life expectancies and future rates of inflation, determines how much must be invested in current accounts to keep that promise. Many government pension funds, which are nearly the only pensions left for which a lifetime payout is "guaranteed," are not only woefully and purposely underfunded but are also using grotesquely inflated assumptions for the rate of return they will achieve on their investments. When the current stock market boom ends and the inevitable collapse occurs, the extraordinary underfunding of pensions will become obvious and seriously exacerbate the battle

between government pensioners and taxpayers. Promises to retirees should normally be kept, but what if the promises are proven to have been made with fraudulent intent by politicians seeking votes and power, who are long out of office when their lies become obvious?

Mike "Mish" Shedlock, at www.GlobalEconomicAnalysis.blogspot.com, regularly analyzes the pension shortfall with a focus on his home state, Illinois. In his March 2, 2015 piece entitled "Illinois Pension Plans 39% funded; Taxpayers On the Hook for $105 Billion in Liabilities; It Will Get Worse!" Mish describes a $105 billion deficit with less than five million households, or $22,000 per household. He writes:

> "Illinois promises range from 7.0% to 7.5%. How do you get [returns of] 7.5% in a 2% world? The correct answer is: *you don't*. But insurers and pension plans try, by taking risks. And the more risk they take, the higher and higher into bubble territory go stock market and junk bond valuations…. Simply put, numerous US pension plans are in deep, deep trouble. Illinois is at the top of the list. Plan assumptions cannot and will not be met. It's far too late for token improvements."

In a May 8, 2015 post ("Illinois Supreme Court Rules 2013 Pension Reform Law Unconstitutional; Chicago Teachers 'Insulted by 7% Pay Cut Offer'") he points out that if 2% returns are assumed rather than the 7% actuaries currently estimate, the deficit is closer to $500 billion, or some $100,000 per household. Mish expects negative returns for both stocks and bonds over the next seven to ten years (as do Jeremy Grantham at www.gmo.com and John P. Hussman at www.HussmanFunds.com).

Someone else who I would infer expects negative returns is Ruchir Sharma, head of emerging markets and global macro at Morgan Stanley Investment Management. He writes in a May 11, 2015 piece, "The Federal Reserve Asset Bubble Machine" in *The Wall Street Journal*:

> "The Fed's defenders quibble that houses are less pricey than in the bubble of 2007, or that stocks are less pricey than in 2000, which misses the difference this time around. In the past 50 years, valuations of U.S. stock prices have been higher than they are now for less than 10% of the time, and similar figures hold for bonds and houses. This kind of synchronized boom has never happened, not even before the last two major meltdowns. My research team's composite valuation for the three major financial assets in America—stocks, bonds and houses—is currently well above levels reached during the bubbles of 2000 and 2007."

This cannot end well.

Just How Much is One's "Fair Share"?

In an age of demagoguery, it's important to be mindful of facts. Here's a chart that speaks to this:

Group of taxpayers by income	Income* range	Share of total US income	Share of total income tax
Bottom fifth	**$0—$24,000**	**4.5%**	**-2.2%**
	$24,200—$47,300	**9.3%**	**-1%**
Middle	**$47,300-$79,500**	**14.8%**	**5.9%**
	$79,500-$134,300	**20%**	**13.4%**
Top fifth	**Above $134,300**	**51.3%**	**83.9%**

* Income includes untaxed income including employer-provided health coverage, muni-bond interest and retirement plans. Income and shares of tax are estimated for 2014. Source: Tax Policy Center, *The Wall Street Journal*

If you object, "they didn't earn their wealth," that's true of lottery winners and politicians. Everyone else worked for it, or their parents did. If you say, as Justice Oliver Wendell Holmes famously commented, "Taxes are the price we pay for civilized society," federal, state and local taxes comprised only 12.5% of total income (GDP) when he uttered those words (they total about 40% of GDP today).

If you think the Founders aren't turning in their graves, consider that Benjamin Franklin said, "It would be a hard government that should tax its people one-tenth part of their income." He also said, "Our new Constitution is now established, and has an appearance that promises permanency; but in this world nothing can be said to be certain, except death and taxes." Will Rogers retorted, "The difference between death and taxes is death doesn't get worse every time Congress meets."