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"The difference between an American truck driver and a Chinese Cooley is the truck."
--Ludwig von Mises, Austrian School of Economics
And who more likely saves for and invests in the truck? The guy earning $40,000 per year or the one earning $400,000?

Tax and Financial Strategies

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Wealth Creation Strategies

How do Alcoholics Get Away with Financially Abusing Others?

A dozen years ago I stumbled upon the idea that alcohol and other-drug addicts ("alcoholics" or "addicts") not only commit the vast majority of physical and psychological abuse, but also most financial atrocities. My first article on the subject (February-March 1996 edition of the precursor to this newsletter, *Tax & Financial Trendletter*), titled "The Sobering of America: Alcoholism, Other Addiction and Financial Disaster," was seminal in helping clients forge the link between addicts in their lives and financial abuse. It also set me on a path that led to the publication of four books, numerous articles and, since August 2004, a web-based monthly newsletter, the *Thorburn Addiction Report* (www.AddictionReport.com).

The "Why"

I have answered the question "why" addicts abuse others throughout these works. They abuse because alcoholism causes egomania, which compels the addict to wield power. While this almost always takes form in psychological, verbal or emotional abuse, physical violence and financial abuse are also common threads to addiction-fueled egomania. Perversely, power can also be exerted through overachievement—after all, what better way to control family, friends, fans, constituents, customers and patients than through extraordinary competence and success. Those who doubt this might consider, as just one example of many, baseball, in which arguably the three greatest players ever—Ty Cobb, Babe Ruth and Mickey Mantle—were all full-blown alcoholics during their entire careers.

The "why?" gives clues that can help us identify alcoholics, most of whom are otherwise well hidden. Because they can be potentially lethal to your physical, emotional and financial well-being, outing hidden addicts before becoming personally, professionally or financially entangled can be a supremely useful survival tool. While keeping in mind that 10% of us are practicing alcoholics, consider how many people you know that can be positively identified as such. Unless you were raised in a family filled with addicts, you may think you know at most several—and yet, if you are familiar with five hundred people, the odds are you know fifty. Who the heck are they?

One of my main contributions came about from asking a simple question: if addiction causes misbehaviors, how often were the behaviors clues to underlying alcoholism? When able to dig deep enough I found it about 80% of the time, vastly greater than the statistical odds of 10%. Even relatively innocuous instances of verbal abuse often turned out to be subtle indicators of alcoholism. I concluded that if abusive behaviors are evident, rather than figuring someone is just "having a bad day" or suffers from a Personality Disorder, we should first look for alcoholism.

The "How"

But none of this explains "how." Just *how* does the alcoholic get away with abusing others—often repeatedly, frequently for years? Part of the answer can be found in the fact that if a parent was an alcoholic, we experienced abuse (even if only psychological or intellectual abandonment), which either we feel comfortable with or "learned" that's just how people are. And since the addict can be nothing if not charming and exciting in their reckless ways (who wouldn't fall in love with an Elvis or a Marilyn?), we put up with the behaviors, taking the good with the bad.

This doesn't account for the fact that we find ourselves abused by people we hardly know. Many find themselves abused by leaders, professionals (20% or so of doctors and lawyers are addicts) and con artists. How are addicts so convincing—to the point at which their lies are more believable than your truths? How could something recovering addicts admit to be all-too-true: when using, they can sell ice to Eskimos?

An additional piece of the puzzle lies in the addict's need to win regardless

of cost. After all, wielding power requires control over others. There is no more efficient way by which to control than to win and be better than everyone else. This may be the best theory accounting for the fact that 30% of Academy Award winning actors have been alcohol or other-drug addicts and a stunning five out of eight Nobel Prize winning authors from the United States during the 20th century were alcoholics. But it's not the only reason; as so often proves true in alcoholism, the paths of explanations and observations intertwine in convoluted ways. In this case, it provides a more direct clue as to "how" they get away with abuse.

Consider the fact that almost every musician, ever, who has created revolutionary change in music, has been an alcoholic. We owe the music of Beethoven, Mozart, Elvis, Jim Morrison, Janis Joplin, Jimi Hendrix, three of four Beatles, Curt Cobain and James Brown to alcoholism. Part of this can be explained by the willingness on the part of those with an inflated sense of self, usually alcoholics, to take the inordinate risks required to create revolutionary change. However, all-too-many actors and writers have been addicts, working in fields that are perhaps not as amenable to radical change as music. This is not to say that greatness is impossible without addiction, the evidence for which can be found from Bach to Meryl Streep and Judi Dench. But addiction increases the odds of success in fields that reward excessive risk-taking and require one to connect on an emotional level with the audience.

Visceral Connections

And this provides the vital clue. Addicts suffer damage to the frontal lobes of the brain, the seat of reason and logic. The lower brain centers, responsible for survival, instinctual actions and reactions, emotions and herding, are undamaged. We might hypothesize that this allows the primitive brain to override the restraints of the logical brain, allowing alcoholics to better connect with others at an emotional level. This should be helpful to a con-man when attempting to tap the primal instincts, including greed, and bilk the mark.

Reflect on the emotions that great writers cause their readers to feel. Edgar Alan Poe, Stephen King, Ernest Hemmingway, William Faulkner, John Steinbeck, James Thurber, Jack London, Tennessee Williams, Truman Capote and O. Henry—all alcoholics—can bring out extremes of fear, hatred, sorrow, passion and love you barely knew existed. Reflect on some of the greatest actors ever—Joan Crawford, Dorothy Dandridge, Robert Downey, Jr., Frances Farmer, Jamie Foxx, Judy Garland, Samuel L. Jackson, Vivien Leigh, David Niven, Jason Robards, George C. Scott, Peter O'Toole and Elizabeth Taylor, again, all alcoholics—with whom we can experience a deep emotional bond.

And so it is with the con artist tenant, contractor, debtor or financial salesman. I've deducted thousands of dollars of repairs to property vandalized by tenants who rented even from recovering addicts with the promise they'd be the best tenant ever. I've witnessed clients suffer tens of thousands of dollars of unexpected costs resulting from contractors who promised the world and left a concrete slab—with cracks. Debtors to bad debt deductions have mostly been addicts. And the financial con-man, while difficult to prove is an addict (and none of these are addicts every time), with enough information has proven more often than not to be one.

One of the premiere financial cons of all time was perpetrated by Charles Ponzi in 1920. He promised returns of 20% within months—and paid such returns by paying off early investors with funds provided by later investors. When his scheme collapsed, he was jailed for a time and then sent back to Italy, where he reportedly turned into an obvious drunk. But early in his drinking career, he connected. He made promises, and people believed him. It's not because they were stupid; rather, it was because Ponzi connected his lower brain center, the limbic system, to theirs. He knew what others wanted to hear on an emotional level and satiated their psychological needs—survival and belonging, creating a herding effect that proved difficult to resist. (Notably, politicians do this every day.)

Financial thuggery is perpetrated by people who are good at making sure your thinking is disconnected from economic or other reality. They get you to buy and do things you would never ordinarily consider. Since alcoholics have a far better ability to connect at the emotional level than others, addicts and con-artists are often one and the same.

Related articles

For more ideas on how to protect yourself from financial ruin, visit www.PrevenTragedy.com and www.GaltPublishing.com, or simply call us. For an article that tackled the idea that financial manias might also be driven by alcoholism on a number of levels, see the top story in the August 2007 issue of the www.AddictionReport.com entitled, "The Mortgage Mess, the Real Estate Bubble and Alcoholism." For an explanation of why politicians, professionals and con men are rarely mentioned by journalists as alcoholics while celebrities and sports figures are frequently outed, see the top story in the July 2007 issue of the www.AddictionReport.com entitled, "Rocky and Michelle Delgadillo: If they were celebrities, the press would fill us in on any drinking. But he's a city attorney and she's his wife."

Why a Health Savings Account is a Traditional IRA and Roth IRA Wrapped into One

For some, Health Savings Accounts (HSAs) are the best little tax shelter available. Distributions from traditional IRAs and other qualified retirement plans are taxed. Contributions to Roth IRAs and Roth 401k's are not deductible. Contributions to HSAs are deductible AND withdrawals from HSAs are tax-free IF used for qualified medical expenses. Hence, HSAs qualify for the best of both worlds: deductibility at the front end like a traditional IRA and tax-free withdrawals at the back end like a Roth IRA.

In addition, there is never a mandatory distribution from an HSA during the owner's life. Any funds remaining at death can be rolled over to a spouse's HSA. If there is no surviving spouse, any leftover balance is taxed to the heirs. The disadvantage is that unlike IRAs such heirs must take a full withdrawal by the year following the owner's death.

	Traditional IRA	Roth IRA	HSA
Deductible going in?	Yes	No	Yes
Taxable coming out?	Yes	No	No*
Must have income from work?	Yes	Yes	No
Stretch-out withdrawal available at death?	Yes	Yes	No
Age limit for contributions	70 1/2	None	Usually age 65 (once enrolled in Medicare)
Must begin withdrawals at	70 1/2	After death, stretched out over beneficiary's life	After death of surviving spouse, withdraw by following year

* If used for qualified medical expenses. Withdrawals for non-medical expenses by those 65 and over are taxed at ordinary rates without penalty, so fare no worse than withdrawals from retirement plans.

Elder Abuse and Lunch Seminars for Senior Citizens

If *you* haven't yet received an invitation to a FREE! lunch or dinner seminar and you are over age 50, you've been lucky. If you've gotten such an invite and have been tempted to attend, please restrain yourself. I recently stumbled upon the likelihood that many if not most of these are schemes to separate you from your hard-earned wealth.

Every family is at risk for such scams. If you think this doesn't apply to you because you're under age 50, think again. Here's a version of the admonition above that may hit closer to home:

If a *parent* or *grandparent* hasn't yet received an invitation to a FREE! lunch or dinner seminar and they are over age 50, you, as someone who cares about them, have been lucky. If they've gotten such an invite and have been tempted to attend, please restrain them. I recently stumbled upon the likelihood that many if not most of these are schemes to separate them *and their progeny* (you!) from their hard-earned wealth.

A good 80-year-young friend-client almost fell for such a scam. An annuity salesman who billed himself as a "certified senior advisor" or some such worthless designation suggested he refinance his fully paid for $800,000 home with a $600,000 interest-only mortgage and purchase several variable annuities with the proceeds. (Yes, you read that right.) Fortunately, he consulted with me before entering the maelstrom of financial abuse and decided he was happy to remain debt-free.

What is an "annuity"?
A contract with an insurance company in which the individual makes either lump-sum or periodic payments to the insurer and in return receives a guaranteed lifetime income beginning either now or at some pre-determined future date

What is a "variable annuity"?
An annuity contract under which the dollar payments received are linked to bond or stock values (usually the latter)

Coincidentally at about the same time, another friend-client who is relatively financially aware asked me to read a book, *Missed Fortune 101* by Douglas R. Andrew. My friend told me he was thinking about implementing its recommended plan, which requires that one invest in variable universal life insurance policies. Oh, and it also suggests mortgaging one's home to the hilt and drawing the funds out of one's pension (even at the cost of early withdrawal penalties) and investing the proceeds in such policies.

What is "variable universal life insurance"?
A combination term and whole life policy, but with greater flexibility as to premium payments and returns on investment, which are linked to bond or stock values (usually the latter)

It later dawned on me that, well, some people are just too darned old to qualify for life insurance and the recom-

mendation that my elderly client invest in variable annuities might be a substitute. I proved to my satisfaction that the attempt at elder abuse was connected to Andrew's book when I saw the annuity salesman's sales package, which included an article written by two mortgage brokers that extensively cites the book.

I realized my clients were not alone in almost falling for this nonsense when I found over 60 reviews of the book at Amazon.com, with an average four-out-of-five star rating. A handful of one-star reviews attacked singular flaws, but none dissected and ripped it apart piece by piece in holistic fashion. After realizing that few if any other combination EA-CFPs with my unique set of experiences and personality type (INTJs comprise only 1% of the population) were in a position to do so, I figured if not me, who?

A pack of lies and prevarications

The failures, shortcomings, twisted logic, deceit and lies in the book are so numerous, insidious and dangerous that I posted an over 5,000 word rebuttal under "book reviews" on both www.DougThorburn.com and www.AddictionReport.com. Since Amazon.com limits reviews to 1,000 words, I whittled it down and posted a 997-word review entitled "Utter Garbage." (Your cooperation in answering "yes" to the question, "Was this review helpful to you?" would be most appreciated.) I begin both reviews:

"Every flimflam man knows that the con must be carefully layered around a kernel of truth for credibility. *Missed Fortune 101* by Doug Andrew succeed in this by wrapping a number of preposterous ideas and prevarications around three basic and true axioms... Everything else in this book is not only utter nonsense, but potentially lethal to one's financial health."

I then give almost 50 examples of nonsense ranging from idiotic generalizations and deceit to outright lies, including:

- You can double your money 20 times in your lifetime. (The likelihood of which is little better than one in one million.)
- "When you pay down your mortgage, you decrease your assets." (This is idiotic. Assets always equal liabilities.)
- It's *always* best to sell your fully-paid for home and purchase a home with as little down payment as possible. (Almost *never* with less than 20% down—both to avoid Property Mortgage Insurance and to get a lower rate—and frequently more to the extent funds are available.)
- Non-spouse heirs far "too often" end up with only about 28% of the money that was left in their parents' IRAs. (This occurs in at most one half of one percent of all inheritances. The charlatan's ploy: scare you into agreeing to do whatever he says because life will be filled with disasters if you don't.)
- Taxable income can always be offset by an equivalent deduction. (Not true for any Social Security recipient in the phase-in range with a mortgage, among numerous other situations in which additional income affects other components of Adjusted Gross Income.)
- We can all do "what banks and credit unions do…you can safely use the principal (sic) of arbitrage to generate even greater income." (If it was that simple we'd all be very wealthy.)
- We will all be in higher tax brackets when retired than when employed. (Most will not; again, this is a classic bunko artist ploy.)
- One should purchase a retirement home at age 30, since it will be worth eight times more at age 60. (Sorry, but 1975-2005 was probably unique in our lifetimes, those of our children and those of our great grandchildren. And an 800% increase in values occurred in very few areas even over that three-decade period.)
- "Home equity has no rate of return when it is trapped in the house..." (This is one twisted assertion. The rate of return is equal to rent or mortgage interest you would otherwise pay.)
- "It doesn't make sense to postpone tax for some perceived advantage in the future." (It does if it's paid back at an equal or lower rate—and even at higher rates if the time frame is long enough.)
- Interest on an equity line used to purchase universal life insurance from which you contemplate borrowing is deductible. (No it's not. Never.)
- "One requirement [for withdrawing tax-free income from a Roth IRA] is that a distribution may not be made until at least five years after the first contribution is made." (A withdrawal from principal may be made at any time.)

A slice of truth sells

Incredibly, despite the fact that the book is also repetitive, filled with clichés and slogans and is very poorly written, this and Andrew's other similar books rank high in sales at Amazon.com and, apparently, at the likes of Borders, which carry his books. While I tip my hat to Mr. Andrew in regards to marketing acumen, it's frightening that good marketing can so overwhelmingly compensate for pathetic and outright financially dangerous content.

This is not to say there are zero advantages to variable life insurance. In ideal circumstances, it can act like a Roth IRA—the funds going in are not deductible, but the money coming out is tax-free, taken in the form of loans against the policy's death benefit. On the other hand, they can implode, resulting in everything that was previously borrowed or withdrawn becoming taxable. Obviously, this could be your worst tax and financial nightmare.

In almost every case, retirement plans should be funded *before* investing in either variable annuities or variable life insurance. Most people struggle to fund 401ks, IRAs and Roth IRAs. And because sales commissions, fees and surrender charges for the variable products are so high, those who can invest after funding IRAs, etc., generally shouldn't. It's far cheaper to invest directly in mutual funds, particularly of the no-load variety—and it's simpler, too. It's also far safer to invest in CDs and, if your home isn't yet paid for, extra payments on the mortgage.

Other Recent Scams

I recently received a very official looking postcard from the “Annuity Service Insurance Center,” informing me that I “may have an annuity that has reached the end of its surrender period.” I was asked to call their Center to “discuss” my options.

I don’t own an annuity and have never owned one. This was simply a way to get me to call them, which would establish a business relationship, possibly allowing an annuity salesman to circumvent the “do not call” registry to try to sell me an annuity.

Another recent innovation in scamdom is **selling software that shows how you can use a home equity line of credit to pay down your home loan**. If you just read that sentence twice and are asking yourself, “huh?” you’ve got the picture. Some companies are charging as much as $3,500 for the privilege of using their software to help you more quickly pay down your main loan this way.

Do yourself a favor: if you want to pay off your mortgage quicker, add the $3,500 you were going to get conned out of to your payment. Add other funds to your payment when you want to. Any other method of paying down your loan, including bi-monthly payments, is but a gimmick. Oh, and before you get a new loan, consider making it a 15-year mortgage rather than a 30-year loan. You’ll save up to a half percent on the entire loan amount, which can really add up over time.

Another is exemplified in a radio ad in which **a woman brags, "I own 16 rental properties, I have a C corp, an S corp and six LLCs…”** An announcer urges the listener to free himself from the daily grind of working for someone else 9 to 5. So fine, instead spend 80 hours per week managing the rental properties (and now, trying to keep them out of foreclosure), keep the books and prepare the returns for those zillion entities. One way to get wealthy is NOT to unnecessarily complicate your life or create entities just for the sake of creating entities. And just how does incorporating multiple times increase anyone’s wealth other than that of your lawyer and tax professional?

And while not quite full-blown scams, the slew of **mortgage foreclosure seminars and books** on profiting from them suggests the possibility that houses going through foreclosure today will again meet the same fate a couple of years from now. In other words, what was a $500,000 house selling today in foreclosure for $400,000 may well end in another foreclosure and sell for $300,000 or less. Yes, you can make money in foreclosures—but it’s not easy and it may be way early.

At least there are fewer Nigerian widows looking for your money nowadays. These include Mrs. Mabel Nora, widow to the late Sheik Madu, a new Christian convert, suffering from late-stage cancer with only six months to live, whose late husband was killed working on a Nigerian oil platform in a terrorist attack, but who had unknowingly just before his death inherited a vast wealth from a Nigerian oil minister, the funds from which are tied up in a corrupt proceeding in a Nigerian court and for which Mrs. Nora needs an advance of 50,000 U.S. dollars in order to pay the lawyer, after which she will gladly share 20% of the proceeds and donate the rest to the development church in Africa to help the less privileged, and who prayed over this and knows it’s the right thing to do, and who is yours in Christ, amen.

Reverse Mortgages: An Expensive Last Resort

Reverse mortgages can be a godsend for mature homeowners age 62 and over who have outlived their liquid savings. They allow homeowners to take a lump sum, monthly income, line of credit or combination of all three from home equity. No income, asset or credit hurdles must be met. No payments need to be made. The loan does not have to be repaid until the home is sold or the owner moves out or dies.

However, this equity-tapping device should be a last resort and only for the mature person who expects to stay put for at least a decade and preferably until death. It generally should not be used by those with access to other funds. In other words, a reverse mortgage is the lesser of the evils for the house-rich and cash-poor.

A reverse mortgage should not be taken by one who thinks he may move or die anytime soon. Upfront fees (which can be added to the loan amount, but on which interest accrues) generally come to $10,000-$20,000. The shorter the period of time the borrower stays in his home, the higher the yearly cost. A $150,000 reverse mortgage with $15,000 in upfront fees lasting only five years costs 2% per year on top of the stated interest. This is similar to upfront points on a standard loan: the quicker the loan is paid off, the higher the effective interest rate.

Someone desperate for cash may be far better off financially by borrowing on a line of credit, even at higher rates. Credit lines generally cost little or nothing in upfront fees.

Selling should be considered before taking a reverse mortgage. Selling frees up all the equity (not just the portion available from a reverse mortgage, which is limited) and, invested, earns income.

Selling should also be contemplated by anyone for whom the monthly cash

flow from a reverse mortgage may not be adequate in future years. The possibility of future major repairs on one's home should be considered as well—after all, where will the money come from? While a reverse mortgage can be tapped for lump sums after monthly payments begin, such payments will be proportionately reduced. In addition, because monthly payments from reverse mortgages are not inflation adjusted, as time goes on purchasing power is reduced.

Generally, except to the extent required to pay off an old loan or fund needed repairs, lump sums should not be taken due to a risk of being taken to the cleaners by unscrupulous "investment advisors." As noted in this issue's articles on elder abuse and other scams, I've recently helped protect several mature clients (all in their 80s) from annuity salesmen who suggested that funds withdrawn from reverse mortgages or refinanced homes be used to purchase annuities. Even hedge fund operators, who are extremely savvy investors, have gotten themselves into trouble recently by using such leverage. Those cajoling elderly people to borrow against their homes and invest the proceeds are, in my opinion, financial thugs committing a vile form of elder abuse.

The borrower who is looking for a steady cash flow can select between a "tenure" or "term" payment. The tenure payment is similar to a lifetime annuity: payments continue for the life of the borrower even if the mortgage ends up exceeding the home's value. A term payment provides a fixed payment over a specific period such as 10 or 15 years. Although this pays a higher monthly income, it conflicts with the idea that it's intended to last for the rest of one's life and that other sources of funds have been exhausted.

There is far more to reverse mortgages beyond the scope of this article. However, if you've read this far and you're still considering one, make sure you:

1. Know how interest is calculated, which is almost always a variable rate. There is an enormous difference in both rates and caps on rates between loans on which rates are adjusted monthly vs. yearly. In addition to interest, resign yourself to paying for mortgage insurance. This protects the lender (not you) in case you live so long that the always increasing loan amount, largely accrued interest, climbs above the home's value or the home's value declines below the loan amount.
2. Understand that those with existing loans, who must use the "lump sum" feature of a reverse mortgage to pay off the old loan, are left with no mortgage deduction. While this should be moot, since as a "last resort" other income isn't likely high enough to generate much of a tax (and the borrower may not be itemizing deductions anyway), this could be relevant if there is an unexpected income windfall.
3. Accept the fact that repaying a reverse mortgage could generate a substantial interest deduction all in one year, which may save little or nothing in tax due to low or negative taxable income, unless paid in a year in which there is an unexpected taxable windfall. Even then, it may be limited due to caps on mortgage interest deductions.
4. Understand that the allowable reverse mortgage is a function of the owner's age (older owners can get larger loans), the current interest rate (higher rates translate to lower available loans) and the value of the home.
5. Learn the difference between reverse mortgages that are government-insured and those that are not. Government insured loans have low overall limits on allowable loan amounts, but lower interest rates than those that are not insured.
6. Investigate the possible adverse effect of a cash-out or income from a reverse mortgage on Medicaid eligibility.
7. Shed light on all these points and more in a booklet available from AARP, "Home Made Money: A Consumer's Guide to Reverse Mortgages," available at http://www.aarp.org

California Continues Non-Conformity

My contempt for the California legislature is greater than for most of their brethren. It has opted not to conform to federal tax rules on so many levels it boggles the mind. We have no capital gains exclusion, which is a disaster for accumulating capital, which is solely responsible for Americans' high standard of living (an assertion I will more fully explain in an upcoming newsletter). We have no deduction for Health Savings Accounts, discouraging their creation, increasing the odds that the electorate will finally give up on free market solutions for high medical costs and put our medical care into the hands of the Department of Motor Vehicles. They have maintained a plethora of differences in regards to depreciation and amortization for capital equipment and intangibles. There are huge differences in kiddie tax rules, passive loss rules for real estate professionals and net operating loss carryforwards. Most if not all of these differences favor government spending over the prerogative of the individual spending his or her own funds where he chooses.

Now, aside from over 100 others, there's a particularly new irksome area of non-conformity relating to deductibility of traditional IRAs and contributions to Roth IRAs. While the phase-out ranges were increased for federal purposes, they are stuck at 2006 levels for California purposes. So if I tell you an IRA is allowable this year, but then I backtrack and say, "Oops! It's not deductible or allowable for California," I hope you understand that I'm only the messenger. As usual, your wrath should be directed at the California legislature.