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Trust UPDATE

Citizens Bank
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Financial self-defense

Bernie Madoff is still in jail. That doesn't mean investors can let down their guard.

Meet Timothy Krieger. In high school and college, he was a star wrestler, four times an All-American. In 1995 Krieger met Larry Zilverberg, himself a former state wrestling champ. Zilverberg owned a trading business, and he was seeking to employ former athletes because such people tend to be fiercely competitive—a key attribute for a successful trader, he believed. Krieger joined the firm, and he soon was making a six-figure salary trading cheese.

However, Krieger felt that he could do better, and so he formed his own trading company in 1999. The company did well, yet Krieger wanted more. In 2006 he started another firm, Twin Cities Power, and began trading electricity futures, then a new market. Once again, the firm prospered for several years. However, some of his investors began losing faith, and a major loan was called in 2010.

In 2012 Twin Cities Power began offering the public unsecured subordinated notes, a type of junk bond, with average yields of 14% annual interest. At that time the 10-year Treasury note was paying less than 2%, and interest on bank accounts was well below that. Many investors were seeking better-income investments. Some 700 investors took the bait from Twin Cities Power, buying some $30 million worth of notes.

When something sounds too good to be true, it probably is not true. In 2015 the firm was renamed Aspirity, and its assets were transferred to another company owned by Krieger in exchange for a loan. After he stopped paying on the loan in 2017, the firm declared bankruptcy, leaving the noteholders in the lurch.

The Minneapolis Star-Tribune interviewed several investors. They tended to be retirees from around the country who had invested a few hundred thousand dollars of their retirement savings in these notes. Said one: "I am

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a university professor, and I knew it was risky. But I didn't keep up with their business or what they were doing."

Over the years, Kreiger is alleged to have taken some $18 million out of his various companies, but he now claims to be broke. Many lawsuits have been filed—former traders for his firms claim that they haven't been paid their commissions; investors claim that fraud was used to sell the notes. The bankruptcy court has its work cut out for it.

The only reliable defense is a good offense

How can you avoid the fate of Kreiger's unfortunate clientele? Keep your guard up and take nothing for granted. Here are three steps for starters.

1. Develop a coherent investment strategy, tailored to your own circumstances. In the abstract, setting personal investment goals in terms of income, growth, and safety sounds easy. In reality, it isn't. If you're a growth-minded investor, for example, certainly you would rather double your money in one year instead of six. But are you willing to risk everything for the sake of a possible (but improbable) quick payoff? Income-oriented investors must make similar judgments.

The development of realistic investment goals is worth the effort, not only for its own sake but also because the results promote a healthy skepticism that con artists dread.

2. Select investments to fit your goals. Don't settle for what someone wants to sell you. Even in these times of economic uncertainty, good, solid investment opportunities exist. But they won't come knocking at your door. You must seek them out yourself or engage a professional advisor to research them for you.

3. Choose a professional advisor as carefully as you would select a million-dollar investment. If you can devote only limited time to the business of investing, good advice is the best buffer against bad or downright larcenous advice. We don't claim to be the only source of sound investment guidance. There are others, and you may want to talk with them as well as with us.

Like to explore the question of financial self-defense further? We're at your service. ☐

Trite, but true

When people read these commonsense rules, they tend to say, "Of course, that's obvious." If only they would follow them!

- Never send money to a stranger on the basis of a telephone call.
- Don't take promises of extraordinary investment returns at face value. If the promoters knew an easy way to make a fortune, why would they share the secret?
- Don't be hustled by high-pressure tactics. The investment world is not going to run out of good opportunities in the next 20 minutes.
- Beware of those who claim that they're doing you a favor because you're a member of a certain organization, church, or professional group.
- Don't assume that state and federal regulators can protect you fully from investment scams and frauds. As the story in this article vividly illustrates, by the time that the law catches up with the company that took your money, the money may be gone for good.

State Death Taxes in 2018				
State	Estate tax	Inheritance tax	Estate tax exemption (millions)	Top tax rate
Washington	✔		$2.193	20%
Oregon	✔		$1.0	16%
Minnesota	✔		$2.4	16%
Illinois	✔		$4.0	16%
New York	✔		$5.2	16%
Connecticut	✔		$2.6	12%
Rhode Island	✔		$1.58	16%
Massachusetts	✔		$1.0	16%
Vermont	✔		$2.75	16%
Maine	✔		$5.6	12%
Hawaii	✔		$11.18	15.7%
District of Columbia	✔		$11.18	16%
Maryland	✔	✔	$4.0	16%
Nebraska		✔		18%
Iowa		✔		15%
Kentucky		✔		16%
Pennsylvania		✔		15%
New Jersey		✔		16%

Source: Tax Foundation, April 5, 2018

State death taxes are in retreat

The phrase "state death taxes" has been in the tax code for many decades—it was not invented by Republicans, as some have argued, though they certainly did popularize its use. The phrase encompasses the two distinct kinds of taxes imposed at death by the various states:

- ***Inheritance taxes*** are imposed upon the right to receive property. The amount of any exemption as well as the rate of taxation typically depends upon the relationship of the recipient to the decedent.
- ***Estate taxes*** are imposed upon the right to give property away at death. An exemption applies to the estate as a whole, as does the tax rate. Typically, amounts passing to charity and surviving spouses are exempt.

The federal government imposes only an estate tax, with an exemption this year of $11.18 million and a tax rate of 40%.

The sea change

In the last century, all states imposed one or the other kind of death tax, and a few states levied both. The IRS allowed a credit against the federal estate tax for any state death taxes paid, dollar for dollar, up to stated limits. Many states keyed their estate taxes to the maximum allowable credit, no more or less. Repealing such a state death tax would have been pointless, because it would not have changed the total tax liability of an estate; it would have only meant more money for the IRS.

However, the format changed in 2001, when the credit was converted to a deduction for state death taxes. The change was accompanied by an increase in the amount exempt from federal estate tax, so on net this was still a better deal for taxpayers. Making state death taxes deductible, rather than creditable against federal taxes, meant that if any state repealed its death taxes, the benefit would accrue to the estates, not to the IRS.

States rapidly began to repeal their estate and inheritance taxes, as well as increase amounts exempt from tax. Today 12 states and the District of Columbia continue to have an estate tax; five have an inheritance tax, and one—Maryland—has both. (See table above.)

The future

The doubling of the amount exempt from federal estate tax last December is temporary, and the smaller exemption is scheduled to return in 2026. Nevertheless, the increase in the federally exempt amount increases the pressure on the remaining states with death taxes to increase their exemptions or drop these taxes altogether. ☐

Hazards of e-filing

When Timothy Geithner was nominated to become Treasury Secretary in 2009, an issue was made of his failure to fully pay his taxes. The shortfall was discovered during an IRS audit in 2006. Geithner took full responsibility for the mistakes, which he attributed in part to his use of TurboTax in preparing his returns. Geithner nevertheless was confirmed.

TurboTax came up again in a recent Tax Court case. John used that software to prepare his 2012 tax return. He timely e-filed the return on April 12, 2013. Unfortunately, John made an error when he input his wife Nancy's Social Security number. Because the number did not match the name, the IRS rejected the return, sending a notification to TurboTax. An email was sent to John informing him of the problem, but he did not see the message. He did not log into his 2012 TurboTax account for another 18 months.

The oddest part of the story is that John also failed to notice that his taxes due to the IRS never were withdrawn from his bank account—the amount owed was $395,619! John later said that the fact that the account had an unusually large balance led to the oversight.

After he discovered the rejection of his e-filing, John filed a corrected return and paid the taxes due in January 2015. The IRS then assessed an additional $26,216 in interest payments for the late payment, and John paid that as well. However, he challenged the two penalties that the IRS assessed, $41,539 for the late payment of the tax and $89,014 for the late filing of the return. We don't know if John invoked the "Geithner defense," but, given that he had made a good faith effort, the penalties seemed overly harsh. When the IRS refused to relent, he took the matter to the Tax Court.

At trial John's attorney conceded that there was really no defense against the late payment penalty—the payment was late, after all. But John had made a reasonable effort to file his return in a timely manner. What's more, the attorney argued that if John had filed on paper, rather than e-filing, the IRS would not have rejected the return. Presumably, it would have accepted the return and the tax payment but asked for a correction.

The Court did not find these arguments persuasive. First, the argument that the IRS had a practice of accepting paper returns when comparable e-filings were rejected was not properly supported by the evidence. More importantly, TurboTax had alerted John to the error on his return in a timely manner. The software also has a feature to "check e-file status." Had John properly used the software as designed, he would have discovered the error much earlier and avoided the penalties. □