Complexity

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I suspect that were it not for the personal computer, our tax code would be far less complex today. When I started working at the Vermont National Bank Trust Department, our "sophisticated" calculator cost $1,500, which represented about 12.5% of my salary. Aided by up-to-date technology, I started doing fiduciary tax returns in early January. I worked nights and weekends, and relaxed on April 17th. Preparing a tax return using a pen and a calculator was fraught with tension. One error and I discarded the return.

Perhaps I suffer from a Tax Disorder. Perhaps it was my imagination, but the complexity of the tax code increased when our personal computers arrived. Otherwise, the populace would have rebelled. Was it just a coincidence in 1982, when I bought my PC, that the present Alternate Minimum Tax was enacted?

At some point I started to distrust the tax code or, more precisely, I may not have been up to understanding the complexities. So I embraced reverse engineering. I would input numbers into the software and the software would tell me the tax. Then I would reconcile the numbers with my understanding of the code.

My latest target is the Vermont Estate Tax. Reverse engineering of the Vermont Estate Tax revealed much. The tax return at first glance shows an increasing rate when assets pass the $2,750,000 exemption threshold, starting at 8% and capping at the highest rate of 16%. Reverse engineering revealed a different trajectory, starting at 35% and ending at approximately 10%

Complexity makes it harder for us to make good decisions. For example, legislators in Vermont recently proposed changes to the Vermont Estate tax law, claiming that the modifications did not create a Vermont Gift Tax. Fortunately, they decided not to make changes and voted to study the existing legislation instead[1]. Perhaps the legislators were influenced by some of us when we pointed out that the modifications expanded the gift tax already in existence for estates between $2,750,000 and $3,270,000[2]. Sometimes complexity has unintended consequences.

Complexity is also used as a tool to mask the less attractive aspects of a product or a service and sometimes as a tool to deceive. Most annuities and life insurance products fall within the safe category. On the other hand, funds comprised of investments that are not easily understood fall in the high risk category.

If the annuity salesman says that his product yields 4.68% and I calculate 2% using my simple spreadsheet, the annuity may not have been the best choice but the product is low risk if the provider is highly rated.

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[1] *H. 528*

[2] *The gift is brought back into the estate upon death.*

Sometimes the damage may be very harmful and the proposal may not appear to be complex. In the early seventies when the federal exemption was $60,000, I received a call from someone about to buy a 1 million dollar annuity paying 7% a year. The broker told him that the annuity would save all estate taxes, a sizable amount. The annuity payments ceased upon his death. I pointed out that if he died prematurely his wife and children may not have either a tax to pay or an inheritance.

I use the spreadsheet in a number of ways. I am also mindful of the banality of marketing: will I drift into using the spreadsheet and pie charts to deceive? I recently came close or perhaps I did deceive.

Last year I was attracted to a down jacket. A colleague suggested that I could wait a month and save 20%. I wanted the jacket! So I pulled up a spreadsheet, showed the life expectancy of the jacket, factored in the loss of one winter season if I waited, and made my case. My case was not persuasive so I shortened my life expectancy, recalculated, and made my case. Alas I had not factored in quality. This year the zipper broke in January and the jacket was not returned until the end of March.

Estate Planning is complex. For the most part, the goal is not marketing. If handled well, clients should be able to make the best choice. This is my role and this is my challenge.

When I am asked to evaluate an estate plan before the lawyer prepares the documents, I become suspicious when I see glossy presentations. Usually I am jealous. My spreadsheet lacks grandeur.

I recently evaluated a most impressive estate plan: page after page of colored charts. I thought I was looking at a Ferrari and my job was to look under the hood. I was not going to reverse engineer a Ferrari. I simply wanted to know what went into the formulas.

A key component was entered incorrectly. Things like this can happen. Consequently, the current tax projection over-estimated the tax. But then I noticed the marketing spin. The client was about to retire and live on his income. The program projected his future tax based on his life expectancy using either a Monte Carlo method or a Monte Carlo algorithm (or maybe they did the calculations in Monte Carlo?) I apologize. I really should understand this methodology. But it seemed strange that his assets would almost double in size in spite of the loss of his generous salary.

This program projected a sizable tax and created an urgency to embrace unnecessary complex tax saving strategies with unintended consequences.

I thought I was immune to gloss. That said I am having second thoughts. That winter coat that caught my eye, well it is glossy and it isn't very warm. Like many of our financial decisions, such as whether we take social security early or late, we are just trying to make educated guesses. Most decisions may not be perfect but we should be able to live with them. The winter coat, well, it has been re-branded. The jacket is a reminder of a less than perfect decision but one that still holds value. It functions very well in the first week of spring.