ZENO'S PARADOX

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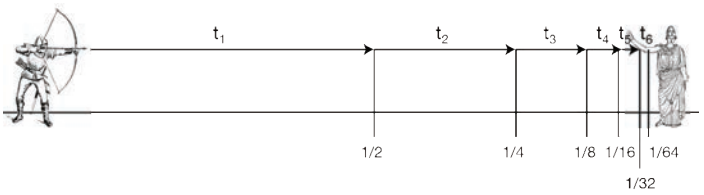
When I was a youth, my parents monitored me for both my safety and hints of my future potential. Their surveillance for safety was a great idea, history shows. Potential, on the other hand, was problematic. One day, Dad brought home a neighbor to show my "promise" as an artist. "Look at Jackie's selection of color," he beamed, but I remained focused on my painting of a German Shepherd. I did not want to tell my proud father that it was paint-by-number.

Then one day, potential may have arrived. My grade in the New York State Regents Exam in arithmetic showed up, and I had a perfect score. The verdict at home: I would become a mathematician. Unfortunately, I enrolled in Algebra the next year, and my math-whiz career ended quickly. It became evident that my brain needed to adjust, and whether that was true or not, I blamed the ancient philosopher Zeno's best-known paradox.

Zeno's Paradox

You will never reach point B from point A as you must always get half-way there, and half of the half, and half of that half, and so on. . . .

My algebra teacher explained with the image of an archer. He drew a line on his blackboard representing the flight of an arrow toward a target. In describing Zeno's paradox, he then stated that a line can be divided in half infinitely. So I pictured an infinite number of dots and concluded that I had to touch each one before I got to the target. I knew the arrow got to the target, but my mathematics did not arrive there.



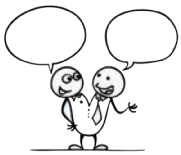
I think I have been cursed by the specter of Zeno's paradox. Zeno simply shows up unannounced in so many different places. In college, I went to the men's room of a local tavern and encountered this on the wall:

The statement below this line is true

The statement above this line is false

My brain went into a loop – up, down, up, down. Everyone waiting for me probably thought I was sick.

I suspect Zeno had offspring:



Oxymoron
Glib & Flippant Contradictory Language

Conundrum
Somber, confusing & unsolvable

Enigma
Studious & Complex

Catch-22
Inclined to work in a regulatory environment

And so, the curse continues.

Sometimes in estate planning I will hear accurate statements that take me back to Zeno and his offspring reminiscent of a scene in the movie "Absence of Malice," when Sally Field says at the end of the movie in response to a reporter's question: "That's true, isn't it?" The reply: " No. But it's accurate."

Is the top Vermont Estate tax rate 16 percent? No. But it's accurate. The Vermont website says Vermont has no gift taxes. Is that correct? No. But it is accurate.

Truth and accuracy are all about perception. In defense of our legislators, an estate planner's perception is focused on the client. In Vermont, a taxable estate of 3 million would be assessed $100,000. That translates to 3.33%. That said, an estate planner would see a savings of $100,000 by addressing the amount above the exemption of $2,750,000 and that translates to 40%.

The top Vermont rate is 16% after the taxable estate passes the threshold of $10,040,000. If a Vermonter changes residence to "tax-free" states such as Florida, with a taxable estate of $10,040,000, how much would they actually save? 6.42%. If 100 million? 9.28%. Fortunately for the taxpayer, the arrow never reaches the target of 16%. Fortunately for Vermont, the arrow often does (15.47% on 100 million) as a result of the shift of a portion of the federal tax. Alas, a Florida resident can't deduct a state estate tax and we can.

The complexities of our law also mask a gift tax for some estates. That said, the gift tax will be paid on death and not at the time of the gift.

The most important player in an estate plan is the attorney. Lawyers have been trained to be accurate, and they have been trained to give you the right answers. Sometimes I think my answers to estate planning questions are close to, if not 100 percent accurate; I think I am in the A to A+ territory. I also know that I am probably struggling to move from C+ to a B- because sometimes I answered the question correctly but it is the wrong question.

I know lawyers contribute to legislation. I know lawyers will studiously avoid a paradox. When I came upon the following paradox, I knew that it was devised by a disgruntled law student who did not graduate because he or she could not endure three years under the scrutiny of lawyer teachers:

Paradox of the Court

A law student agrees he will pay his teacher after he wins his first case. The teacher then sues the student (who has not yet won a case) for payment.[1]

I reject the Paradox of the Court, and I am sympathetic with our readers' own attorneys. They, like me, have to deal with Zeno's offspring. Unlike me, however, they may have avoided the curse.

Estate planning is very important. It affects the lives of others. The focus is not just on saving taxes; it is the importance of each of our legacies. And for many of us, procrastination is just so easy. We face mortality, decisions, and complexity. We need to ask the right questions and understand the right answers.

As a result of recent changes in the federal estate tax, fewer people now need complex tax savings trusts – or so we thought on first inspection. Then we noticed

[1] Paraphrasing Aulus Gellius, *Attic Nights,* Book 5, Chapter 10

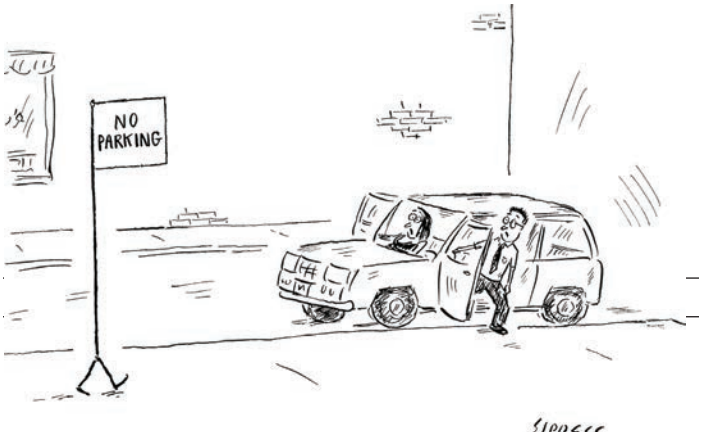
that the generation of those in need of planning often have large IRAs – not enough to cause estate taxation but substantial enough to need planning to avoid the possibility of an income tax at a rate as high as the highest estate tax rate.

What follows is an effort to assist those who would like to complete their estate plans.

Often, complexity and legalese are showstoppers. So, I have boxed in areas that you don't have to read if the questions are not relevant to you. If relevant, you may want to ask your lawyer or trust officer the question without having to suffer through my efforts to explain the reason for the question.

Some, and perhaps many, lawyers are dealing with recent changes in Vermont law regarding trusts. So, we are still struggling with clarity while also now rooting out the offspring of Zeno in fiduciary law, as well as tax law. Here are a few of the challenges that may be relevant in reviewing your estate plan —and the estate plans of others, such as those of your own parents. We live longer; and paradoxically, assets can grow in value and the need for longer-term planning also grows, all while we are preoccupied by the prospective challenges of living in a nursing home.

Sometimes newly enacted laws need time for clarification



Estates above or approaching $2,750,000

The Question: Have you called your attorney or trust officer to review your estate plan recently?

Sophisticated trust plans designed to save federal estate taxes may no longer be necessary for federal tax reasons, but ironically, they can generate state estate taxes that can easily be avoided by way of simple amendments.

Larger estates may not be subject to the Vermont gift tax. Gifts may help avoid the approximately 10 percent rate of Vermont estate tax at the high end, but gifts of appreciated assets could ultimately be subject to a greater tax to the recipients (on capital gains). Selection of assets to give is important. Under current law, most property we own will have the cost basis change upon death, so that capital gains on a subsequent sale may disappear. If we give assets before death, the basis does not change.

Second marriage and the objective to take care of both the new spouse and the children of a first marriage.

The Question: What is the impact of my IRA on my estate plan? What will be the impact on both my spouse and my children?

If an IRA is a significant asset in your estate, your lawyer knows that if you set up a trust for your spouse, the taxes on the required minimum distributions (RMD) to the trust may be subject to a very high rate

if taxed in the trust (income above $12,300 will face federal and state income taxes totaling approximately 46 percent in Vermont). If the trustee pays out all of the RMD to the spouse, the tax may – and often is – significantly less. So, lawyers concerned about the income tax consequences sometimes insert a clause that tells the trustee to pay out all of the RMD to the surviving spouse. What gets lost in the strategizing is that the RMD is designed to have an IRA pay out over the beneficiary's life expectancy. If the surviving spouse lives to his or her life expectancy, there will thus be nothing left in the IRA for the children.

The New 10 Percent Rule and your IRA

The Question: If you are naming your trust as the beneficiary of your IRA: Does the 10 percent rule apply to my IRA?

Vermont recently changed its laws to define trust income in greater detail. Regarding IRAs, some lawyers and trust officers now define 10 percent of the RMD as the income, with the rest going to principal. However, I have never met a conventional IRA that is subject to this rule. If you have an IRA in the form of an annuity account, then, yes, it may apply.

Here is an example of the impact of misunderstanding a rule. The income beneficiary of the trust is age 33. The IRA generates approximately $30,000 in income. The RMD is $30,953. The 10 percent rule is invoked in error. Instead of receiving the $30,000, the beneficiary is destined to receive only ten percent of it: $3,095. The balance of the RMD, $27,857, is trapped in the trust, in which the income tax is significantly greater. This same formula would continue during the life of the beneficiary.

If your lawyer or your trust officer disagrees, you can amend your trust to reflect your desired definition of income. If the trust is already irrevocable, call me, and I will give you a list of agreeable lawyers who will disagree with the first-look interpretation of the rule (unless, of course we are talking about an annuity).

The new rule of notification: sharing the privacy of your assets with those you do not want in the room.

The Question: After I die, who will have the right to see the transactions of my trustee?

When a trust is revocable, the client controls the trust and determines who is privy to the transactions. When the trust becomes irrevocable, the rules change. The new default rules, unless the trust provides otherwise, include those whom you might not want to be privy to the transactions. You might not want the spouse of a divorced child to have access to all transactions as a result of an interest of a grandchild. If there is a non-profit in the wings, do you want them in an oversight role? In short, oversight can be important if necessary, but having too many people in the room can ruin an otherwise nice relationship. Your lawyer can override the default rules.

Zeno is alive and well, and we need to be mindful. That said, I have personally resolved the paradox. I now picture my finger running over an infinite number of dots, and -- voila! – I bump into the target while en route to infinity.