

Preparing Adult Children for Inheritance:

Maintaining Harmonious Relations Across the Generations
in Families of Affluence

Wealth created by one generation can provide for and deeply enrich the lives of generations to follow. However, multi-generational wealth may also pose challenges — to those who have earned it, as well as to those who will inherit it.

Men and women who have built considerable fortunes often fear that the comforts and trappings of wealth will distort the values of their children and grandchildren. Yet, too often, the many distractions of business, society and family prevent wealthy parents and grandparents from passing down the knowledge and tools needed to responsibly and capably wear the mantles of their inheritances. Unhappily, the consequences can be weakened family ties as well as weakened family fortunes.

This paper addresses critical issues of inheritance and suggests approaches for maintaining family harmony as wealth is passed to successive generations. For purposes of the following discussion, the term parents will include both parents and grandparents.

INHERITANCE: Four Basic Challenges

1. THE SENSE OF ENTITLEMENT.

Should a child be entitled to an inheritance?

Not surprisingly, parents and children may have very different opinions. Although parents are usually delighted to pass their wealth on to their children, some demand that their children adopt their values. Children, in turn, may chafe at such parental control and regard their inheritances as their entitlement, to which no strings should be attached.

Some parents require that inheritances be earned by establishing trusts that reward children at certain milestones — such as receiving a college degree, starting a business or attaining a designated level of income. This is not in itself a negative practice, but if parents establish such milestones, they should be reasonable and consistent with the child's best interest.

Open and ongoing discussions between parents and their children are critical to transferring values and expectations about family wealth. When parents begin sharing early on their values and expectations about family wealth, their children are more likely to be prepared — and less likely to be surprised, overwhelmed, disappointed or even bitter — when the time comes for the disposition of that wealth. Parents who conscientiously groom their children for the privileges and responsibilities of wealth are the most likely to have fulfilled their dreams for the thoughtful continuation of their legacies in the generations ahead.

2. HEIRS' DIFFERING NEEDS.

What parents haven't been amused (or baffled) that their children can be so very different from each other and grow up to lead such different lives?

This awareness is important as parents do their best to address their children's differing needs and circumstances while, at the same time, they endeavor to treat their children fairly. Consequently, it is critical for parents to discuss with their estate planning advisors how their estate plans should provide for their children. Should assets be divided absolutely equally? At first blush, that seems most equitable. But aren't there circumstances that might prompt parents to treat their children differently?

For example, what if a child or grandchild is disabled or has a chronic illness requiring considerable and ongoing medical care and services? A so-called "special needs trust" for the exclusive benefit of that descendant may be in order. And what about a family in which one adult child is a professional or entrepreneur earning a very high salary and bonus, while another adult child is a dedicated artist, social worker or teacher whose salary is quite modest? Is it appropriate for the parents to provide more for the lower salaried child — or will the child who inherits less feel "less loved" or resentful, while the child who inherits more feel embarrassed or guilty? These are not easy issues to resolve, but the best recipe for the most pleasant result is thoughtful discussion by the parents with their advisors — and, again, open communication with their children.

Although every family is unique, there are four general categories of inheritance challenges.

Four Basic Challenges *(continued)*

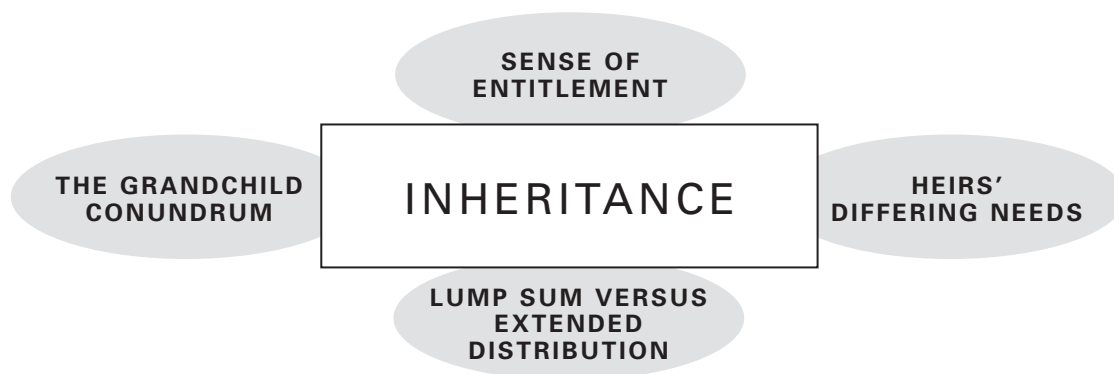
3. THE GRANDCHILD CONUNDRUM: “PER STIRPES” OR “PER CAPITA”?

Usually, grandchildren are sources of undiluted and unadulterated joy for their grandparents. Yet, when grandparents make hasty decisions about dividing their estates among their descendants, tension and even heartache can follow.

Case in point: *Child A* has four children, and *Child B* has two children. Should the parents provide two equal pots — one for the four children of *Child A*, the other for the two children of *Child B*? In that scheme, *Child A*'s children will each receive half of what *Child B*'s children receive. The risk of this per stirpes (“by the roots”) method of disposition is resentment on the part of *Child A* or *Child A*'s children. The alternative is a *per capita* (“by the head”) distribution — that is, the grandparents would provide for six equal pots — one for each grandchild. The disadvantage is that the descendants may wonder why the estate was not divided equally between the families of the two children. Parents should determine the direction they wish to take after discussing the pros and cons of these dispositive schemes with their estate planning attorney and other trusted professional advisors. What may be right for one family may not be right for another.

4. LUMP SUM VERSUS EXTENDED DISTRIBUTION.

Parents may be uncomfortable with the idea that, upon their death, their children will receive large lump sum payments, large holdings of securities or other assets. They may sense that their children lack the maturity or sophistication to manage large sums or portfolios. Fortunately, there are time-honored alternatives to lump sum distributions. Perhaps the most popular of alternatives are trusts. Parents can establish trusts from which funds can be distributed to their children and grandchildren over time. Until the trust is terminated, the trustee holds legal title to the trust property and is obligated to safeguard and invest it in accordance with fiduciary laws and principles.



FOUR SOLUTIONS: 1. Opening Lines of Communication

Sometimes, what children don't know *can* hurt them. By the time children have reached their early twenties, they usually are mature enough to begin learning about their family's estate and the general plan for its disposition. Hiding the facts can be self-defeating. If the lines of communication are established early, the next generation can have the time and luxury to learn and reflect as they mature: What does the money mean to them? How will they use it?

It is hard to overstate the following: Communication among all family members is the key to preparing the next generations for the inheritances they one day will receive. Periodic family "board meetings" can enable family members to share with each other their expectations and concerns; to discuss and ultimately reach agreement on shared financial objectives and strategies; and to work together to resolve potential problems. For maximum communication and productivity, an objective third party — not the patriarch or matriarch, should lead family meetings. The third party — whether a wealth management professional, trust professional, investment manager, attorney or certified public accountant — can facilitate meetings with an impartiality that parents, no matter how well intentioned, simply cannot bring to the table.

Family meetings also work better if they are held in a neutral setting that allows everyone to feel equally situated. That rules out the parents' home or office.

Through hands-on experience, parents can teach their children about financial decision-making. For example, placing some assets in a limited partnership or limited liability company — and compensating family members for active participation — can instill in children a sense of ownership, promote responsibility and help prepare the younger generations for the day when the bulk of the family's wealth will be transferred to them.

When children reach their late teens, parents can consider inviting them to lead certain portions of the family meetings. A third party facilitator can help guide the children as they lead conversations on selected topics — *e.g.*, the best use of the family's vacation home and charitable giving decisions. Younger children can recommend and make decisions such as small philanthropic gifts and choosing among the family's favorite charities with an adult's guidance.

Including the "New" Son or Daughter

Some sons- and daughters-in-law are welcomed into the family as equals. Others are not treated as warmly or generously. When an in-law comes from a family of modest means, wealthy parents may hesitate to include him or her in family discussions regarding assets and inheritance.

However, it is crucial to remember the role the in-law will play in preparing the next generation for inheritance and their impact on how major financial decisions and financial strategies are made. Successful planning includes integrating all family members.

FOUR SOLUTIONS: 2. Updating Estate Plans

Parents with large estates develop estate plans with several goals in mind: devising the distribution to their descendants, minimizing transfer taxes (gift taxes, estate taxes and generation-skipping transfer taxes), and preserving their assets. Yet, frequently, once an estate plan has been developed, it is never revised. Failure to review and update an estate plan is almost a guaranteed recipe for disaster.

It is very important for clients and their estate planning advisors to keep the channels of communication open and ongoing. In this way, advisors can be aware that clients' changed circumstances necessitate changes to estate plans. It is extremely gratifying when clients take the necessary steps to revise those plans. The list of changed circumstances is unending: retirement, marriage, divorce, births, deaths, illness, a changed economy, etc. Then, too, there are changes in tax and other laws that may necessitate reviewing and revising of estate plans.

Flexibility in the design of an estate plan is key. While the estate plans of some wealthy families can include several trusts, some of which may be irrevocable, a family's estate plan needs to be flexible enough to accommodate changing family dynamics.

Such flexibility enables parents to respond to a variety of changing circumstances, some of which are listed above. Consider another situation: Parents may feel their children have achieved considerable financial success and do not need a large inheritance. On the other hand, parents may find that their estates have been eroded by market or other conditions and decide to bequeath to their children their entire estates. In either case, parents should update their plans with the assistance of their estate planning advisory team and should inform their children about the changes they have made — and why (for tax reasons? charitable reasons? other reasons?). When children understand their parents' motivations and decisions, they tend to respond much more positively to change.

Flexibility also extends to trusts. Parents can establish trusts with very specific terms and then alter those terms as conditions warrant. Changes may reflect a child's personal growth and maturity, a child's financial success, or a child's need for special assistance. Any modifications to the terms of a trust must be made formally, with the counsel of the trust professional. These changes should be completed as soon as possible and the trustee is required by law to follow the terms of the most current trust document or amendment. Verbal requests carry no legal weight and cannot negate the terms of the most current instrument.

FOUR SOLUTIONS: 3. Charitable Giving as a Teaching Tool

While parents generally delight in passing on their estates to children and grandchildren, many also feel strongly committed to passing some of their wealth to charitable causes they have been devoted to during their lifetimes. Deciding how much to give to descendants — versus how much to give to charity — requires thoughtful deliberation.

Parents may decide to provide each child with a set amount and leave the rest to charity. If this is the case, adult children should be informed about their parents' choice and the reason for the decision. Discovering too late that they will receive only a portion of their parents' estate may cause children to squabble or even to initiate costly and bitter legal battles.

Approached sensitively, charitable giving can be a wonderfully unifying force. Children can be quite positive about funds designated for charities when they are allowed to have a role in the charitable decision-making. A family foundation or donor-advised fund offers children a heightened understanding about the ways in which others will benefit. It turns their focus outward toward the community. For example, in a family of five, each member could make decisions about one-fifth of the money set aside for charitable grant making during the year. This fosters collaborative thinking and consensus building and family members can move to broader discussions about their wealth and the family's estate plan.

FOUR SOLUTIONS: 4. The Helpful Role of Trusts and Trustees

Many parents establish trusts as vehicles for conserving their estates, reducing taxes and providing for charitable giving. Trusts, in particular, make enormous sense for children under age 21. Similarly, trusts can be highly appropriate for young adults in their twenties or thirties, while they may be less appropriate for older, more responsible adults. Because assets are held in the trust and distributed from it according to the wishes of the trust's creator ("grantor" or "settlor" or "trustor"), parents who create trusts find comfort in knowing that their children and grandchildren will benefit from a properly managed inheritance.

Trustees play a critical role. When parents are no longer capable or no longer living, trustees function as the family's CEO and CFO. They gather information about the family and its members, and they offer guidance to children and grandchildren. Critically, the trustee manages the investments held in trust for the benefit of the children (or beneficiaries) a task that can overwhelm even the most mature and knowledgeable of children. A responsible child with a \$100,000 annual income may not have the time, experience or desire to manage a \$20 million estate. The trustee assumes the burdens of this responsibility, leaving the children free to enjoy the benefits and fruits of their inheritances.

Who can parents choose as trustee? Parents can choose one or more individuals, a corporate trustee, or a combination of the two. Selecting a family member often can present risks, despite the fact that a family member often will not charge a fee for his or her services as a trustee. The risks include overburdening the family member/trustee with difficult decisions regarding investments, the timing of distributions to beneficiaries and the amounts of those distributions. Individual trustees who are family members often get caught between family members' competing desires, which can result in faltering family relationships.

On the other hand, corporate trustees are not related to the beneficiaries and their professional experience and expertise positions them well to treat all beneficiaries fairly and with impartiality. Corporate trustees also provide continuity: While an individual trustee may become ill and unable to act — or may die — a trust company can continue to act for generations.

Another benefit is that corporate trustees are guided by statutorily adopted “prudent investor” rules that prescribe the exercise of reasonable care, skill and caution as well as a general duty to diversify the trust’s investments. Corporate trustees must also be mindful of the provisions of the trusts they administer — not only provisions that relate to investments held in the trust, but also to provisions that inform the trustee that the interests of both current and future beneficiaries must be protected.

In addition to the management and diversification of trust assets, a corporate trustee assumes direct responsibility for a complete range of services including trust administration, preparing trust tax returns, acting as a family advisor, administering the trust according to its terms and managing closely held businesses and non-marketable trust assets.

By blending the skills of a team of financial experts with the requisite educational background and years of hands-on experience, a family can be assured that assets pass from one generation to the next in a smooth and orderly manner. This team of professionals may include experts in financial planning, private banking, trust administration and investment management, in collaboration with the family’s legal and tax advisors.

A carefully conceived and executed estate plan requires thorough knowledge of estate, gift, transfer and income taxes, business administration, accounting, real estate and investments. A corporate trustee can successfully guide you through the myriad of alternatives to create a customized strategy for protecting, growing, managing and distributing your assets.

IN SUMMARY, the task of transferring wealth from generation to generation can be eased, and the results envisioned by parents can be achieved through thoughtful, collaborative planning and open channels of communication.

By leveraging the advice of professionals, parents can help to ensure that their wealth will be passed to their children in a manner that maintains the harmonious family relationships they have always envisioned.

Joe Calabrese is Executive Vice President with Harris N. A. and President of Harris myCFO, Inc. Harris myCFO™ provides comprehensive family office solutions and wealth management services to individuals and families of substantial wealth. Mr. Calabrese is responsible for the strategic direction, growth and delivery of investment advisory, family office, fiduciary and private banking services to affluent clients.

Mr. Calabrese joined Harris in 2002 and has more than 20 years of financial services and wealth management industry experience with a broad background in investment management, finance and taxation.

Mr. Calabrese graduated from McGill University, Montreal, with a joint honors degree in Economics and Finance. He has been a Chartered Accountant since 1984. Mr. Calabrese makes his home in Lake Forest. He is a Director of Junior Achievement and serves on the Board of Trustees for the Goodman Theatre.

Harris myCFO™ is the brand used by Harris myCFO, Inc., providing family office services, Harris myCFO Investment Advisory Services LLC, an SEC-registered investment adviser, and certain divisions of Harris N.A. and its affiliates that are national banks with trust powers. Not all products and services are offered in every state and/or location.

Harris myCFO™ is part of BMO Financial Group, one of North America's most diversified financial services firms.

Please contact us for more information and/or for additional white paper titles or copies.

We look forward to the privilege of serving you.

For more information, visit us at:

harrismycfo.com

Or call us at:

1-877-692-3611

This document is intended for marketing and informational purposes only and should not be considered legal or tax advice.