



## BUILDING A LEGACY

### *An Introduction to Multigenerational Wealth Planning*

— Stephanie Zaffos, J.D.

How do you preserve family wealth across multiple generations? It's not easy—it takes work. Sustaining a financial legacy can be a surprisingly complicated task, fraught with emotion and difficult decisions. More resources don't necessarily ease the burden either. Often, greater wealth means even greater complexity in the form of additional beneficiaries, investment opportunities, and estate planning strategies. It may then come as no surprise to learn that in approximately two-thirds of cases, family wealth is exhausted before the end of the second generation. In 90 percent of cases, wealth is exhausted before the end of the third generation.<sup>1</sup>



The key to avoiding this situation is proactive, professional planning. With guidance and knowledge, many people find that the process can be an exciting opportunity for growth and empowerment. In this guide, we offer our suggestions for turning estate planning into a chance to pass on values—not just assets—to the next generation and beyond.

<sup>1</sup> "Can You Make the Money Last? The Road to Sustainable Wealth." *Merrill Lynch Private Banking & Investment Group*: 4. Web. 16 November 2014.

## It Pays to Plan Ahead

In an ideal world the estate-planning process would begin proactively, before life's uncertainties intervene. But in many cases advice is typically sought only *after* a major life event occurs.

### Trigger Events



Sale of Family  
Business



Marriage



Birth of a  
Child/Grandchild



Divorce



Health Scare

If you fall into any of the above categories, don't feel abashed. The circumstances that trigger wealth transfer planning matter less than actually executing an effective strategy as soon as possible.

Even with relatively simple estate planning it's possible to not only preserve family wealth, but also work to increase it. The wealth gained through accrued interest is an attractive upside to many wealth transfer plans. However, the financial benefits of avoiding unnecessary estate taxes are often even more dramatic.

The federal estate and gift tax is currently 40 percent for individuals who leave or give more than about \$5.43 million (the exact number is adjusted every year for inflation). That means that with no planning in place, an individual whose estate totals \$105 million can expect approximately \$40 million to go to the federal government before his or her beneficiaries receive anything. The estate that was once worth over \$100 million is now valued at \$65 million—the loss of a significant sum that won't be passed onto the next generation.

Estate planning is designed to help prevent this situation. For example, having life insurance that is owned by and payable to an irrevocable life trust is one straightforward way to protect future inheritances from being taxed. This structuring prevents the proceeds from being included in the insured's taxable estate upon death. Accordingly, all policy proceeds (which can pay for the estate taxes owed to Uncle Sam) pass to benefit the insured heirs. A simple difference in who owns the insurance can potentially have a big impact on the family's bottom line.

#### ESTATE PLANNING LESSONS

#### Philip Seymour Hoffman (1967-2014)



Hoffman's will was almost ten years old at the time of his death and had not been updated to account for the birth of two children and a much larger financial estate. All assets (approximately \$35 million) passed outright to his surviving significant

other, Mimi O'Donnell, from whom he was estranged at the time of his death. There was no planning for preservation of his estate tax exemption amount, and nothing to ensure that Mimi would pass the assets to Hoffman's children at her death. Leaving the assets to Mimi in trust, rather than outright, would have protected them from Mimi's creditors or future spouses. Additionally, if Mimi were to disclaim some or all of the assets, it remains unclear whether these assets would pass to a trust only for the benefit of one child (who was already born at the time Hoffman executed his will) or to all his children. Consequently, a judge and the interpretation of New York intestacy laws, not Hoffman, would determine who would benefit from Hoffman's estate.<sup>2</sup>

Similarly, by leaving assets to your children in trust, rather than outright, you can prevent the assets from being included in the children's estates at their deaths. You can additionally shelter a portion of transferred assets, including all the income and growth thereon, for future generations by utilizing the Generation-Skipping Transfer (GST) tax exemption.

Creating a wealth transfer plan could also introduce the added benefit of allowing the first generation to impart certain values to their beneficiaries through their assets. Individuals for whom education is important may decide to designate funds for the college or postgraduate education of their grandchildren. Others create a charitable trust for philanthropic purposes. Estate planning demonstrates to your beneficiaries that you care about your financial resources and to what ends your wealth should be used. Most significantly, it shows that your legacy is important and that you don't want to leave these decisions to the whims of a probate court after you have passed.

## The Benefit of a Fire Drill Memo

"Fire drill memos" can show a client what would likely happen to their assets if the Grim Reaper appeared at that very moment.

### Worst-Case Scenario



In the worst-case scenarios, when an individual has very little planning in place, the results are typically sobering: an expensive and lengthy probate court experience for the next of kin (and potentially a battle among the heirs), assets allocated based on widely varying state laws, and significant amounts of money lost to taxes that might have otherwise gone to the family or other designated heirs.

### Best-Case Scenario



But a little planning can go a long way. The best-case scenarios, in which various wealth transfer strategies are properly executed, create a very different picture: a simple legal process for survivors, increased wealth through tax savings and enhanced asset values, and improved peace of mind.

Sometimes the planning process has an additional benefit. When individuals see their assets inventoried in front of them, they often realize the extent of their wealth. They take great pride in the financial foundation created and the family legacy opportunity that now awaits.

### ESTATE PLANNING LESSONS

#### Lauren Bacall

(1924-2014)



(Public Domain)

Bacall left an estate of approximately \$27 million. After certain bequests, she left the remainder of her assets to her children, outright and free of trust. Bacall could have provided for her children in lifetime trusts rather than outright.

This simple change would have ensured that their inheritances would not be included in their taxable estates at their deaths, and would be protected from creditors and spouses. Further, to the extent that Bacall had remaining GST exemption at her death, this would have sheltered her children's inheritances, and the income and growth thereon, from transfer taxes for several generations.<sup>3</sup>

# Steps for Creating an Effective Wealth Transfer Strategy

Regardless of net worth, the creation of a wealth transfer strategy typically consists of the following steps:

1. **Identify your objectives.** Prepare to get philosophical about money. Ask yourself what your primary goals are for your estate, as well as your personal concerns. Here are some statements often heard as part of the process: “I don’t want my children to become trust-fund babies.” “I want to make sure the government doesn’t get a dime of my hard-earned money.” “I’d like to help out my great-grandchildren, even if I never get the chance to meet them.” The emotional aspects of money are extremely powerful, and there are no right or wrong answers here. Identifying your goals and sharing them with your advising team can help ensure that the estate-planning framework is crafted with your higher-order, heart-driven objectives in mind.
2. **Determine your financial needs.** Before you figure out what you can give away, you have to figure out what you’ll need over the course of your lifetime. To do this, begin by assembling a summary of your cash flow for the last year—your income less your spending. One important consideration: if your wealth has recently been created, your cash needs may increase significantly in the short term. Why? Historical trends show that spending rises in the first few years after a liquidity event as the financial barrier to owning things diminishes. With cash in hand, human nature often takes over as money burns a hole in your pocket.

## ESTATE PLANNING LESSONS

### Mickey Rooney (1920-2014)



(Public Domain)

At the time of his death, Rooney had few assets to pass to his beneficiaries, but there was still a battle over where to bury his remains. His wife, Jan, who he was separated from at the time of his death, wished for him to be buried at a family plot in Westlake, California—a plot purchased when they were still happily married. However, approximately a month prior to his death, Rooney executed a new will disinheriting Jan (along with most of his children). At that time, he told his conservator, Michael Augustine (who was also named executor of his will), that he wished to be buried in Hollywood. Since Rooney was still technically married to Jan at the time of his death, and he did not have a formal burial agreement in place, it took the filing of a court petition and a later settlement between the parties for his wishes to be followed. If the place and manner of your burial is important to you, it is a good idea to put formal instructions in your will as well as in your health care directive and make sure they match.<sup>4</sup>

Next, work with your advising team to establish a budget—even if that budget is for hundreds of millions of dollars. The only way an investment portfolio will last for multiple generations is if distributions are limited to no more than three or four percent annually; a budget will help control spending behaviors. This budget should be revisited annually (more frequently in the first year or two) to keep your goals and spending habits in check. Your advising team can also help you analyze the potential benefit of health, life, and disability insurance.

3. **Create an inventory of your assets.** Most assets fall into a few general categories: financial assets (stocks, bonds, etc.), business interests (companies owned, private equity investments), life insurance, and real estate. It’s not uncommon for wealthy investors to have numerous illiquid assets. Accordingly, there typically is more planning to be completed in these cases because the process of transferring these assets over to beneficiaries is not always straightforward. Closely held business interests and illiquid assets often provide some of the best planning opportunities, as their valuation for transfer tax purposes may be discounted due to certain limitations inherent in the asset class. For example, valuing an interest in a closely held LLC is not as simple or unambiguous as determining the share price of a publicly held stock on any given day.

<sup>4</sup> Public Domain, Will of Mickey Rooney, California Superior Court.

4. **Evaluate the planning currently in place and address any holes.** In addition to basic estate planning documents, such as wills and revocable living trusts, many families find that they are able to address most of their wealth transfer needs using a combination of three common strategies:

- simple gifts
- transfers to irrevocable trusts (including IDGTs: Intentionally Defective Grantor Trusts)
- GRATs (Grantor Retained Annuity Trusts)

All of these strategies seek to achieve the tax-efficient transfer of wealth to family members (or other beneficiaries) while promoting and preserving the transferor's values and objectives.

Holes are often found when basic estate planning documents are reviewed. Many times, these holes are driven by substantial changes in tax laws since the initial crafting of the plan, and/or a significant change in net worth. Furthermore, supporting documents may not automatically reflect these new factors. Family members might also have changed (due to births, deaths, marriages, divorces, etc.) which could prompt a revision to the overall plan, but at a minimum existing documents should be updated.

5. **Craft flexibility for future generations.** It's important to find the right balance between preserving one's legacy and keeping things flexible enough to accommodate unforeseen circumstances. For example, designating a particular corporate trustee might make sense for the current generation, but what about two or three generations down the line? This issue can be directly addressed by simply allowing the beneficiaries to assign new corporate trustees, ideally within a specific time frame such as every three years.

Another way to create flexibility is to name a trust protector. This has become increasingly popular. A trust protector permits a grantor to appoint an individual (or series of people) with broad powers to modify an irrevocable trust, for the purpose of continuing to achieve the grantor's objectives without forfeiting the tax benefits of the irrevocable trust. It's important to be mindful when considering the concept of irrevocability. It is a crucial aspect of estate planning, but as we all know it's impossible to predict the future. Plan with this concept of caution and flexibility in mind and you will be doing your beneficiaries an enormous favor.

## Stumbling Blocks: Confronting Difficult Questions



### The Family Home

What happens to the family home while Mom and/or Dad are still alive? If Mom and Dad wish to preserve their liquidity by utilizing wealth transfer strategies, a financially sound trust strategy is to create a QPRT (Qualified Personal Residency Trust). This strategy will allow the first generation to remain in the house while paying rent to the generation that owns the property. Many clients feel uncomfortable with this idea yet struggle to choose a more attractive strategy.



### Defining Equality Between Heirs

To what extent should the spouses of children be included in the wealth transfer plans? Are spouses treated to the same assets as children? What happens to those assets in the case of divorce? A good advising team will guide you through the process of thinking through these difficult questions to find answers that feel appropriate for you and your family. There often is not a perfect answer here. We refer grantors back to their guiding purpose and the desired legacy they wish to achieve.



## The Road Ahead

If you are like most people, estate planning is not at the top of your to-do list. While the value of tax and estate planning is easily understood, actually doing something about it can be a time-consuming and emotionally daunting task. At Convergent Wealth Advisors we provide professional guidance that is essential to effective multigenerational wealth planning. Your legacy is important. We encourage action to help ensure you achieve your aspirations built from a lifetime of hard work.

If you would like to learn more, please contact your financial advisor or visit [ConvergentWealth.com](https://ConvergentWealth.com).

Convergent's Live Well Series is produced to advance dialogue on topics to help people "Invest Well. Manage Well. Live Well.<sup>TM</sup>,"

It is our hope that these articles will illuminate, intrigue, and inspire—and we invite you to join the conversation.

If you have questions, or wish to discuss any of our thought leadership articles, please contact your investment advisor or email us at: [LiveWell@ConvergentWealth.com](mailto:LiveWell@ConvergentWealth.com)

---

Disclosure: Past Performance Is No Guarantee Of Future Performance. Any opinions expressed by Convergent employees are current only as of the time made and are subject to change without notice. This article may include estimates, projections or other forward looking statements, however, due to numerous factors, actual events may differ substantially from those presented. While we believe this information to be reliable, Convergent Wealth Advisors bears no responsibility for the advice or information provided in this article whatsoever or for any errors or omissions. Moreover, the information provided is not intended to be, and should not be construed as, investment, legal or tax advice. Nothing contained herein should be construed as a recommendation or advice to purchase or sell any security, investment, or portfolio allocation. This article is not meant as a general guide to investing, or as a source of any specific investment recommendations, and makes no implied or express recommendations concerning the manner in which any client's accounts should or would be handled, as appropriate investment decisions depend upon the client's specific investment objectives. **Non-deposit investment products are not FDIC insured, are not deposits or other obligations of City National Bank, are not guaranteed by City National Bank and involve investment risks, including the possible loss of principal.**