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CREATING A LEGACY:

HOW MUCH WEALTH IS ENOUGH TO LEAVE CHILDREN

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"A very rich person should leave his kids enough to do anything but not enough to do nothing." – Warren Buffett

A client called me one afternoon to ask my advice about an automobile purchase. She had arranged to buy a Special Edition Volvo S60 as her son's first car, and wanted to know if the showroom had given her a good deal. I told her it was a good deal but a bad idea – most young people drive a three year-old Subaru, and that would be a much better choice. But our discussion went much farther. After extensive consultation, we also arranged to create a legacy trust – one that would leave funds to her children, and their children, and their children's children which would be protected by a trustee to ensure the family had assets after she was gone.

An 85 year-old former university professor told us that he wanted to provide in his will for a gift to the university. We reviewed his financial and tax picture, then asked him, "Why wait?" We designed a structure that allowed him to make the donation during his lifetime, and have the pleasure of seeing a chair named after him and created a system to ensure compliance with his legacy strategy.

Another client had established a trust for her son, where her husband could use the assets in his lifetime for his own benefit with the remainder going to her son. There was a clause in her will, known as a power of appointment, which allowed him to redirect a portion of their assets. Her intent was to make sure he would have financial options available – especially to donate to charity as part of his legacy. After her death and his remarriage he exercised the clause – not for charitable reasons but rather to make null and void the intent of her entire will. He transferred the trust – which carried his son's name – and all his other remaining assets to his second wife's children. His own children were left without the trust or any of his assets in their name.

Creating a legacy is a challenging subject for any individual. This is even more the case for high-net-worth individuals, simply because of the size of the assets and the complexity of the vehicles used to pass wealth to the next generation. The combination of money, emotion, family history and unresolved issues can be a volatile mix that brings out the worst in everyone. On the other hand it can be a tool for sound lessons and wise decisions that strengthen family bonds.

Properly planning your legacy is a complex process. It requires attention, forethought and good advice – about financial and tax strategies, certainly, but also about the psychological and emotional impact of your decisions. Should you transfer the bulk of your wealth while you are still alive? What structures and vehicles will you use? What lessons will your children learn – are they the ones you want? What is the balance you should strike between leaving money to your family and meeting your other goals – perhaps through charitable donations or gifts to others?

For many of my friends and clients alike, questions like these are regular pillow talk. They are increasingly prevalent and increasingly urgent – not surprisingly, because we are in the midst of one of

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the greatest wealth transfers in history. According to a study by Boston College Social Welfare Research Institute researchers John J. Havens and Paul G. Schervish, the transfer of wealth in the U.S. over the 55-year period from 1998 to 2052 will amount to at least $41 trillion and could be as high as $136 trillion. This will have a huge effect, not just on high net-worth families but on society as a whole.

How to cope with these questions? Many people would rather just put them aside and defer any decision making. But delay has consequences, and the cost of inaction can be high. There are consequences, as well, for taking too narrow a focus. Many people plan their estates – and in fact their lives – by focusing only on how to minimize taxes. Taxes are certainly important, but it is far more important to have an overall plan. Know your financial picture, know your children and know what you intend to accomplish. Once you've taken this broad view, you can determine what your goals are. Only then can you design a plan to meet them.

Transferring wealth is a complex process – for financial, psychological and emotional reasons. There are very real risks

Once you get past dealing with your own mortality, what makes the topic of legacies so difficult to discuss? Obviously, generational wealth transfers are not just financial transactions. Transferring wealth raises complex psychological and interpersonal issues – life goals and how children relate to them, the value of work versus the benefits of financial security and long family histories that mix love, fierce conflict, expectations, ambitions, resentment, rebellion and respect. All of this and more comes into play when legacy is on the table.

Even on a more mundane and practical level, transferring wealth to the next generation can create very real risk. Inheriting a great deal of money – like any other form of instant gratification – can lead the uninitiated or inexperienced into dangerous behaviors. There is no shortage of cautionary tales. Children who go on spending sprees, children who make bad life decisions such as dropping out of school, quitting jobs and falling into a variety of addictions – all of this can follow on sudden wealth. More subtly, they might lose their drive for success, give up on their ambitions and accomplish less than they would have if their wealth had not been guaranteed.

Every advisor can tell stories of children who blew huge fortunes quickly because their parents did not properly prepare them, or did not take the time to plan properly. Wealth spent on posh pads and fast cars? It's not at all that unusual.

Many people are looking for alternatives to sudden wealth transfer

The result is that many high-net-worth individuals are looking for alternatives. Warren Buffett, quoted at the top of this article, seems to have had just that that in mind. So do others. Facebook founder Mark Zuckerberg and his wife, Dr. Priscilla Chan, recently announced in an open letter to their newborn daughter Max that they will donate 99 percent of their Facebook holdings, valued at $45 billion, during

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their lifetime to create the Chan Zuckerberg Initiative, which will seek to "leave the world a better place for you and all children" by "advanc[ing] human potential and promot[ing] equality for all children in the next generation"; it will focus initially on "personalized learning, curing disease, connecting people and building strong communities."

A recent study from U.S. Trust shows that only half of millionaire baby boomers think it's important to leave money to their children. A third of them said they would rather leave money to charity. And a CNBC article on boomers' skepticism about too-large donations shows that there are two explanations for their apparent stinginess. One is that boomers want their children to grow up with the same values they had. They think it will be better if their children learn about struggle, hard work, failure and the joys of earned success – lessons that, they believe, helped them become more successful. A skeptic might say that 30 years of bull markets and strong economic growth helped the boomers toward prosperity, but that doesn't mean that their stated concerns aren't valid. A second, and perhaps more realistic, explanation is boomers think their children cannot handle money. In fact, U.S. Trust found that only 32 percent of baby boomers are confident their children will be prepared emotionally and financially to receive a financial legacy.

Asking the right questions about the next generation may point you toward alternative ways of giving

If you share those concerns, what are your options? Are there alternatives to a large lump-sum inheritance that are worth considering?

The first step is to think through your concerns about creating an inheritance – not in the abstract, as we've done just above, but in terms of you, your children and the issues that you both face. That means thinking about how they as individuals would react to sudden wealth – would it be an opportunity to prosper? Or would it open the door to dangers, creating a potential abyss?

The second step is to realize that there are many alternatives to a traditional legacy. As you review the challenges, some of these alternatives will naturally suggest themselves. For example:

- Are there relationship issues – for example, divorces and other social conflicts with friends, ex-wives, current spouse, in-laws that might result in a future problem? *The structure of the legacy should take these into account.*

- Are the children burdened by huge educational loans? *Before you even begin to think about a legacy, you might consider clearing up this debt. College loans are usually expensive, and repayment comes due just as the children are first getting their start in life. A gift of debt relief can be truly meaningful. A parent can use the need for reduction of educational debt as an excuse to delay other gifts until the children mature.*

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- Do children or grandchildren have an education 529 plan? *Think about contributing to this. Contributions within the gift tax annual exclusion amount are generally free of both gift tax and generation-skipping transfer tax. Qualifying distributions for educational expenses are income-tax free to the designated beneficiary.*

- *Consider paying for children or grandchildren's tuitions directly to the university, as these are not considered taxable gifts.*

- Can medical issues for a child or grandchild cause a financial hardship? *Consider setting up a special needs trust to ensure proper attention is paid to the child when you can't.*

- Does a child have a drug or gambling problem or other destructive addictions? *Consider a trust. In every large lump-sum inheritance, there is the possibility that children may never do another day's work and spend it all on vices or fast living. If there is already a known risk, why increase the odds of their falling prey to it? A well-managed trust and a good trustee can keep that from happening.*

There are many alternatives to a one-time lump-sum transfer

These are just a few examples. But they illustrate the kind of thinking you'll want to do in planning how to pass on your wealth. The point is to take into account the full reality of your family situation, and think through every option. The main takeaway is this: *You do not need to feel compelled to commit to a one-time lump-sum wealth transfer. There may be powerful arguments against giving too much, too soon. You will want to give due consideration to speeding up, curtailing or redirecting such transfers.*

A client owned a piece of historic designated real estate that she wanted to pass on to the family. She did not have the liquidity to just give it to her children, as she needed the tax benefits and a place to sleep, but was willing to live with reduced benefits as time went by. She transferred the house to a LLC and every year she gifted a share of the LLC to a trust equal to the gift exclusion to her children. However, she got to live in the house and ensure her historic residence stays in the family.

The planning process must address more than just family issues, of course. There are financial and tax strategies to consider as well. A thorough review will encompass financial planning, tax and legal issues as well as your goals, hopes, dreams and family realities.

In the second part of this article, we will review in detail some of the most-used alternatives to a lump-sum transfer.

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About Robert G. Kuchner

Robert G. Kuchner, CPA/PFS, is a Partner at Marks Paneth LLP. Mr. Kuchner serves a diverse spectrum of privately owned companies and their owners as well as clients in the theater, media and entertainment industry. He also provides family office and business management services to a varied client base. Mr. Kuchner holds a Bachelor of Business Administration degree in Public Accounting from Hofstra University's Frank G. Zarb School of Business, where he currently serves on its Dean's Advisory Board. He is based in Marks Paneth's midtown Manhattan headquarters.

About Marks Paneth

Marks Paneth LLP is an accounting firm with more than 550 people, including over 70 partners and principals. The firm provides public and private businesses with a full range of auditing, accounting, tax, consulting, trade remediation and valuation services as well as litigation and financial advisory services to domestic and international clients. The firm also specializes in providing tax advisory and consulting for high-net-worth individuals and their families, as well as a wide range of services for international, real estate, hospitality, media, entertainment, nonprofit and government services clients. The firm has a strong track record supporting emerging growth companies, entrepreneurs, business owners and investors as they navigate the business life cycle. Its headquarters are in New York City. Additional offices are in Washington, DC, New Jersey, Long Island and Westchester. For more information, please visit markspaneth.com.

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