Authorized Reprint
Journal of Taxation of Investments
© CRI Civic Research Institute

Putting Family First: Intergenerational Wealth Transfer and Investment Planning

John R. Wiktor*

Introduction

Researchers have estimated that over the next 50 years, a wealth transfer of over $41 trillion will pass from one generation to the next. Despite the market recession that has occurred in the past years, this wealth transfer estimate continues to be validated. With this large wealth transfer expected to occur, the strategies that will be used to implement the wealth transfer may vary greatly from family to family. For example, one ongoing trend is for parents to include successive generations in their charitable plans. The following statistics published by the website *futureofphilanthopy.org* paint a picture of the correlation between philanthropy and the transfer of wealth to successive generations:

- From 1999 to 2003 the number of family foundations increased from 20,498 to 30,517. Assuming this rate of increase continues, the number of family foundations in the United States by the year 2020 is estimated to exceed 100,000;
- The total assets in family foundations in the period from 1999 to 2003 grew from $177 billion to $195 billion;
- Approximately 1.5 million estates worth $1 million to $10 million dollars are estimated to pass to the next generation through charity through 2017; and
- The low estimate of the total amount expected to be given to charity by 2017 as the next generation inherits wealth from their parents is 1.7 trillion dollars.[1]

---

* John R. Wiktor, J.D., is with the Chicago law firm of Horwood Marcus & Berk Chartered. He may be reached at jwiktor@hmblaw.com.

[1] Monitor Company Group, LLP, "U.S. Philanthropy by the Numbers," excerpted from Katherine Fulton & Andrew Blau, "Looking Out for the Future: An Orientation of Twenty-first Century Philanthropists" (2005), available at www.futureofphilanthropy.org.

In this instance, it is clear that the impact that a family's intergenerational wealth transfer has on charitable giving is significant.

When parents discuss their expected wealth transfer with their children, there can be many benefits for the younger generation, including an awareness of the family's wealth and values, a sense of money management, the ability to interact with outside advisors, and a deeper understanding of charity and those initiatives that interest the younger generations. Despite the obvious benefits of family planning, for parents, the combination of transferring wealth to the younger generations and teaching issues of money management and philanthropy can raise numerous questions, for example:

- How much is too much to leave to the next generation?
- How do I balance between leaving enough for my children and supporting charity?
- What charitable vehicles are best to emphasize philanthropy with the next generation?
- What are the benefits of intergenerational charitable planning?
- Is it better to be proactive now or wait until death?
- Can I foster an interest in my children's philanthropy?
- Will my original donor intent be continued by the younger generation?

This article discusses a six-step process to help answer many of these questions and provide guidance to families and advisors who are involved in intergenerational wealth transfer planning. The goal of this process is to promote family values and provide a good base from a tax and investment perspective.

Step 1: Defining Family's History and Values

Barbara Culver, editor of the *Journal of Practical Estate Planning*, once stated, "Philanthropy is one of the major ties that bind families together both emotionally and financially over generations by the preservation of family values. Philanthropy helps prepare the next generation to be successful heirs by instilling family values and at the same time teaching financial stewardship."[2] In that regard, the first step to successful intergenerational wealth transfer planning is for a family, in conjunction with its advisors, to define the family by looking at its history and values.

Today, the definition of family is constantly changing. The definition no longer includes only those descendants and ancestors whom an individual considers part of his or her "family," but also involves many different

[2] Quoted in Jim Grote, "Advisors and Clients in the Brave New World of Philanthropy," J. Fin. Plan. (June, 2007), Article One, electronic issue archive available at http://www.fpajournal.org/.

This article was originally published in JTI Vol 27 No 3, Spring 2010 and is reprinted with permission.

characteristics. For example, size, experience, and social trends are all characteristics that can help define a family.

In that regard, no matter what planning initiatives a family chooses to pursue, for intergenerational wealth transfer planning to be effective it is of primary importance for the family to define its path. Advisors can be helpful by asking questions of the family such as: What members of your family do you wish to involve in your planning? Do you intend for your planning initiatives to be public? Are there concerns about wealth transfer to younger generations? And, what experience does your family have with tax and charitable planning? When the family is defined at the outset of the relationship, it will be much easier for the advisor to suggest goals and initiatives that will be in line with the family's history and values.

Step 2: Timing/Fostering an Interest

An old saying is "start early and often." This is also true in the world of money management for family members. Many parents ask advisors at what age it is appropriate to involve children in their planning initiatives. In that regard, involving children in a family's wealth planning and money management initiatives even at a young age will often have benefits.

Parents teach their children about the value of money in many different ways. For some parents, money lessons start with giving the children an allowance at an early age. For others, the money lessons start when the child opens a bank account and is taught the value of saving. For yet others, philanthropy can also have an important influence on teaching money lessons.

Children, however, should not be forced to participate. The desire to participate will lead to greater success than the obligation. Consider different methods to involve the successive generations in money management, rather than just imposing an obligation once the child reaches a certain age. Most important, however, parents who enjoy teaching their children about money management and derive a sense of accomplishment from managing their money appropriately will form the best model.

Step 3: Sharing the Money Message

The third step to successful intergenerational wealth transfer planning is to determine the amount that parents would like to pass on to successive generations. This often involves two factors:

1. The amount that the parents feel necessary for the children to maintain their accustomed standard of living, often balanced against a desire to see children establish their own work ethic; and
2. In many cases, philanthropic adults want to balance their philanthropic initiatives with a wealth transfer to their descendants.

This article was originally published in JTI Vol 27 No 3, Spring 2010 and is reprinted with permission.

The primary problem many advisors face is clients who are concerned about their children and younger generations receiving too much too soon. While parents have a tendency to want to leave some inheritance to their children, they do not want this inheritance to become a cause for the destruction of their family. In these instances, dynasty trusts, discussed below, may be an invaluable planning tool.

The amounts that parents want to pass on to future generations, whether to maintain an accustomed standard of living or to support philanthropic goals, can vary immensely. The family's advisors are, therefore, an intricate part of this planning step. For the philanthropic family, for example, a family's investment advisor can be helpful by creating projections that will estimate the value necessary to maintain a family's customary standard of living yet still allow it to achieve philanthropic goals. The advisors can also suggest vehicles by which the parents can achieve these multifaceted goals. For example, a charitable lead trust can be an excellent vehicle for giving to charity while postponing a child's inheritance until the child has reached a certain age.

Step 4: Choosing the Right Wealth Transfer Vehicle

Not every planning vehicle will fit with every family's history, values, charitable goals, and mission statement. Instead, the advisor must be in tune with the family to help suggest the best and most appropriate transfer vehicle. Therefore, the fourth step to a successful intergenerational wealth transfer plan is to choose the correct transfer vehicle. Any of the following options may be appropriate for a given client.

Basis Step Up. Many estate planning transfer vehicles for dealing with family wealth transfer are detailed and complex. The basis step up, however, is one of the most useful intergenerational wealth transfer solutions and does not involve complicated drafting or extraordinary amounts of paperwork.

The basis step up concept is very simple. When a client purchases or is gifted an asset, the client receives a basis in the property. The client who sells the asset prior to death will recognize gain on the difference between the fair market value (FMV) at the time of sale and the client's basis. If, on the other hand, the client retains the asset until death, the successors in interest will generally receive a basis in the asset equal to the FMV, most likely as of the date of the client's death.[3] Therefore the asset can be sold immediately after the client's death and no gain will be recognized.

The basis step provides a very important planning technique for intergenerational wealth transfers. For example, those clients who currently have in their portfolios marketable securities with large amounts of built-in gain

---

[3] IRC § 1014. Under current law applicable only with respect to the assets of decedents who die in 2010, the FMV-at-death basis system has been modified as part of the repeal of

This article was originally published in JTI Vol 27 No 3, Spring 2010 and is reprinted with permission.

may be better served to hold onto the asset until death. By doing this the tax on the built-up capital gain will be avoided and a larger amount of wealth can be transferred to future generations.

Family Business Succession. A family business is often a major issue in a family's intergenerational wealth transfer planning. The transfer of a family business not only raises many complex financial, tax, and legal considerations, but often raises critical interfamily issues. For example, to which family members will the client transfer the business? Are there certain family members who are more involved in the business than others? How can the client "even out" the assets among those family members who do not receive part of the business? And how can a client who is transferring the family business upon death to children ensure that the surviving spouse gets income?

Because of these issues, the transfer of a family business among generations often is not successful. According to the Small Business Administration, only 30 percent of the country's estimated 21 million family owned businesses make it to the second generation. The SBA further proffers that only 15 percent of family owned businesses make it to the third generation.[4]

Because of the complex issues associated with the transfer of a family business, advisors should consider the many options available to successfully transfer the business to future generations. In regard to planning techniques, family limited partnerships and installment sales are often primary vehicles used to transfer the business to future generations. In addition, advisors often combine these transfer techniques with gifting strategies to make the transfer more efficient from a tax perspective. Finally, in addition to the actual transfer technique used, it is of primary importance for the advisor to review with the family all of the non-tax and family issues associated with the transfer of a family business in order to make that transfer most successful.

Gifting Strategies. In addition to the basis step up, another easy and commonly used technique to transfer assets to future generations is an annual

---

the estate tax. Basically, in 2010 IRC § 1022 provides that a beneficiary's basis in a decedent's appreciated property will remain equal to the decedent's basis in that property; if the property's fair market value is lower than the decedent's basis, then the basis will be lowered to the fair market value on the date of the decedent's death (just as would have been the case under IRC § 1014). The Code does provide for a "Special Basis Adjustment" that permits an executor to increase the basis of a decedent's appreciated property by up to $1.3 million plus the value of a decedent's unused capital loss carryovers and net operating loss carryovers (but not in excess of the fair market value of the property on the date of the decedent's death). The Code also provides for an additional $3 million "Spousal Basis Adjustment" that may be allocated to "qualifying terminable interest property" as defined in IRC § 1022(c)(5). At this time it is unclear whether this modified regime will remain in place for some or all of 2010 or be repealed retroactively.

[4] Beth Adamson, "Building a Solid Future for Family Owned Businesses," 63(6) S. Dakota Bus. Rev. 10 (March 2005).

gifting program. Currently, a client can make an unlimited number of $13,000 gifts of cash or other property on an annual basis tax free.[5] To ensure the tax savings, the client must only remember that no individual may receive more than $13,000 in a calendar year (note that spouses may combine their annual exclusion gifts to make an unlimited number of $26,000 gifts). The annual gifting exclusion not only applies to cash gifts, but to other assets as well, so the client may also gift marketable securities and/or interests in real estate.

Caution: When gifting noncash assets, keep in mind the basis step-up rules and consider whether it is appropriate to currently gift those assets or more tax-savvy to hold them until death to benefit from the basis step up.

As with any transfer strategy, but especially gifting, an advisor must be certain to first ascertain the "money personality" of the parents. Although easy to implement, gifting assets during lifetime is not for everyone. Some clients' money personalities will cause them to be fearful that, by gifting away their assets, they will be vulnerable and will someday be without the money they need to live their desired lifestyle. In such cases, a testamentary transfer strategy will be more prudent.

Dynasty Trusts. A dynasty trust is designed to hold the assets in trust without direct ownership being transferred to any beneficiary. Successor generations may benefit by receiving distributions of income or principal and assets that remain in the trust will provide future growth. In addition, with proper planning, dynasty trusts can provide income, transfer, and generation skipping tax benefits.

Dynasty trusts can be an important part of a family's intergenerational wealth transfer planning. If the parents are concerned that a child may receive too much money too early, the dynasty trust may be the perfect tool. For example, the parents may set limits as to when the children may actually withdraw assets from the trust—say, one-half at age 25 and the balance at age 30. Or the parents may decide that the assets will be distributed only at the discretion of the trustee, and the children will never be able to fully take the money from the trust.

In addition, dynasty trusts have become a popular tool for parents who want to transfer their assets but are concerned about their child's vices, such as drugs or alcohol. In this instance, an advisor who is drafting the dynasty trust can include language in the trust agreement directing that distributions will be made only if the child's vices are corrected.

Finally, dynasty trusts may be implemented either during a parent's lifetime or as part of testamentary transfers. When combined with the techniques discussed above, such as installment sales or gifting programs, dynasty trusts

---

[5] IRC § 2503.

This article was originally published in JTI Vol 27 No 3, Spring 2010 and is reprinted with permission.

are a great tool to allow parents to transfer assets to their children, obtain some tax benefits, and provide a mechanism so that their children will not get all their money at one time.

Charitable Planning. Charitable planning is one of the most popular and often discussed tools associated with intergenerational wealth transfer. Charitable planning may provide tremendous tax benefits to the transferor and, if done in a way that maintains involvement of future generations, will likely instill a sense of philanthropy in the clients' progeny. The following discusses some charitable planning wealth transfer tools. Three useful vehicles are:

- *Family Foundation:* The family foundation is generally a great vehicle for families that want to put into place some organization that will last from generation to generation. A private foundation can be organized as a not-for-profit corporation or a trust. A private foundation organized as a not-for-profit corporation provides more flexibility for future generations to alter the management structure and purpose of the foundation, whereas the trust structure is irrevocable and generally requires court action to deviate from the stated purpose. Whether organized as a trust or not-for-profit corporation, the most successful foundations are those that incorporate intergenerational planning, thus allowing the management of the foundation to easily transition from one generation to another.
- *Donor Advised Fund:* The donor advised fund is a simpler form of the family foundation, but still allows a family to attain many of the same intergenerational philanthropic goals. Families that do not want to spend the time managing a foundation and complying with the complex tax rules and regulations governing foundations should consider organizing a donor advised fund. A community foundation is often an excellent source through which donors can establish a donor advised fund though many larger charities also sponsor donor advised funds of their own. By organizing a donor advised fund through a community foundation, a family can further its philanthropic goals in their own "backyard."
- *Charitable Trust:* A charitable trust is also an effective means to accomplish intergenerational wealth transfer and tax planning. The most common forms are a charitable lead trust or a charitable remainder trust. As previously mentioned, a charitable lead trust can be an effective means to benefit charity now while holding the remainder for future generations. A charitable remainder trust if structured properly can also be an effective tool to accomplish intergenerational charitable planning while still allowing a donor to pass wealth on to future generations. For example, a donor who creates

a remainder trust can use the annuity payments to purchase an insurance policy on the donor's life. The insurance policy proceeds will be a source to replace the wealth that was gifted to the remainder trust—thus the donor's goal of passing wealth on to future generations will be recognized. Then, the charity named as the remainder beneficiary could be the grantor's family foundation—thus the grantor's intergenerational charitable goals will be recognized.

Step 5: The Family Meeting

Today we live in an increasingly global world. Family members live even further away from each other, and grow further apart. The family meeting is not only an important step for intergenerational wealth transfer planning, but also has the additional benefit of bringing together generations of family members that do not live near each other.

Not surprisingly, family meetings have become very popular. The meeting can be held at the home of a family member or at an easily accessible vacation spot. Generally it is important for the family to have a moderator for the meeting. Therefore, often the family's trusted advisors attend the meeting.

The family meeting is an extremely effective way to review the family's wealth transfer and philanthropic goals. The family's advisors should suggest that at the meeting the parents discuss with their adult children the parents' plans for wealth transfer. This will allow the children to understand their parents' estate plan and should lead to less anguish or, worse, litigation and family fighting after the parents' death. The advisors can also discuss the asset portfolio that will be used to implement the plan. By doing this, the parents will be able to review their transfer planning goals, and the children will gain a better understanding of the portfolio of assets that will transferred over time.

Also, the advisors should specifically review the vehicles that will be used to complete the wealth transfer. For example, if the family has established a foundation or donor advised fund, the family meeting is an opportunity for the family to discuss which charitable initiatives the family will support that year. An advisor may suggest that each year one or two family members research a charitable cause to support and give a report at the family meeting as to why that cause should be supported. The result will be that the family will learn about different charitable initiatives, and the reporting family member will have a personal stake in the family's philanthropic goals.

In addition to the other benefits, the family meeting can be a time to assess the accountability and the effectiveness of the wealth transfer plan that has been put into place. Accountability can be measured by the extent that all members of the family participate in the wealth transfer initiatives. Effectiveness can be measured through the growth of assets, the goals that have been achieved, and the purposes that have been furthered.

This article was originally published in JTI Vol 27 No 3, Spring 2010 and is reprinted with permission.

Step 6: Ongoing Support

Intergenerational wealth transfer planning is a process, not an event. The sixth step to successful intergenerational family planning is the ongoing support of both the family's advisors and, where applicable, the charities that the family wants to support.

Some individuals, even those who have put a transfer plan into place, can be resistant to continued discussions about and updates to their plan. Further, some financial advisors wonder if it is appropriate to continue to recommend additional planning ideas and opportunities to families that have structured an intergenerational transfer plan. However, clients generally want their advisors to continue to initiate discussions and offer suggestions regarding their transfer plan.

Conclusion

The huge intergenerational transfer of wealth that will occur over the next 50 years will have a significant impact on families. For the transition of wealth to be smooth, it is important that families, advisors, and charities, where applicable, work together to develop a clear plan that will successfully pass assets from one generation to another. Parents need to consider the most effective way to communicate their money values by determining the right age at which to involve their children, the amounts to be passed, and the vehicle to accomplish these multi-faceted goals. Children need to be open to the idea of money management and philanthropy and over time develop their own goals and initiatives. In addition, advisors must be proactive in discussing wealth transfer planning with their clients and then maintaining constant contact in order to review the plan that has been instituted. With all of these parties working together, parents, children, advisors, and charities will all benefit.