Transferring Wealth: A Family Affair

“A good man leaveth an inheritance to his children’s children.” - Proverbs 13:22

The transfer of wealth has begun. As the baby boomers’ parents make their exit, their assets and accumulated wealth are beginning to pass on to their children and their children’s children. According to a recent extensive survey by Decima Research, this will involve a one-trillion-dollar transfer of wealth over the next two decades in the form of cash and securities, real estate, and other valuables.

Planning for the trillion-dollar wealth migration

As part of your overall wealth management strategy, investors need to consider various strategies and plan for the transfer of that wealth to their children and perhaps their children’s children. And the sooner the better. By starting the estate planning process early, benefactors can better utilize a wider range of tax-efficient wealth transfer strategies that accomplish their goals with a minimum amount of taxation.

The gift of giving

There is a lot to be said for doing as much as possible while still alive. The most tax-efficient way of transferring wealth to the children and grandchildren is cash gifting. Gifts of cash provide a financial benefit to family members who can use it to further their own lives by funding an education, buying a home, or building their own investment portfolio. There are no tax implications for the beneficiaries, it reduces your estate for probate purposes, and gratitude can be expressed while you’re still around to receive it. But be aware that some gifts, transfers, or loans to a spouse or a related minor child may result in income being attributed back to the person giving the gift or loan.

More importantly, a program of cash gifting to your offspring and grandchildren should depend on first making certain that you and your spouse will still be able to provide financially for your own retirement years.

The matter of trusts and insurance

If cash gifting is not an option, then there are other wealth transfer tactics to consider. Various trusts and insurance products have emerged over the past few years that help manage the transfer of assets to beneficiaries.

For example, what is called an “intervivos” trust (set up while a person is alive) can place assets (that might otherwise form part of the estate) in a trust for beneficiaries. How the assets are to be invested and distributed to beneficiaries can be specified in the terms of the trust. The assets settled to this type of trust would not form part of the estate and would not attract probate fees on death. The income derived from the trust’s investments can be retained and taxed within the trust or flowed out of the trust and taxed in the hands of the trust beneficiary. This may appeal to those baby boomers who themselves are in the prime of their life, successful in their own right, and most likely in a high marginal tax bracket.

Children and grandchildren who may have trouble handling a large sum of money may be better served if their inheritance was in the form of a trust set up with specific disbursement instructions, such as accomplishments (graduating from university) or specific age milestones (such as 25, 35, and so on.)

Life insurance, on the other hand, is a cost-effective way of creating an instant estate, leaving a tax-free cash benefit directly to your children or to pay taxes owing on all your assets deemed sold at the time of your death.

Alternatively, you may wish to invest in a tax-exempt life insurance policy, such as participating whole life or universal life with your child or grandchild named as beneficiary. Your annual policy deposits grow in an insurance investment portfolio on a tax-sheltered basis. After your death, the life insurance proceeds are paid directly to your named beneficiary(ies) tax-free.

Another option is to purchase a cash-value life insurance policy on the life of your child(ren) or grandchild(ren). Not only will you provide them with a financial head start, but your deposits will also take advantage of long-term, compounded growth in a tax-exempt policy that your child(ren) or grandchild(ren) can take advantage of during their lifetime.

Turning promises into action

Successful estate planning requires good communications among all parties concerned. Those who are to benefit from the transfer of your estate's assets need to know that you do have a plan in place and what they can realistically expect in terms of after-tax inheritance so they can factor it into their own long-term financial planning. Communication and consultation also goes a long way to dampen any unrealistic financial expectations and clarify, if necessary, why some children or grandchildren are being treated differently. This can reduce the possibility of disputes and hurt feelings after you're gone.

Communications with your financial and legal advisors is just as important. Raymond James Estate Planning Advisors and Financial Advisors are experienced in the special issues of transferring wealth from one generation to the next. Clients engaged in estate planning should talk to their advisor about the Raymond James Estate Planning and Preservation Strategies. It could affect your whole family's future.

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