Ten Questions to Help Families Navigate the Great Wealth Transfer

Family philanthropy can offer a valuable compass.

Philip T. Tobin | Sep 11, 2018

Americans are currently experiencing the greatest transfer of wealth in history, and many may be unprepared to successfully navigate it.

The statistics paint a picture: An estimated $59 trillion will pass from an aging generation to younger generations by 2061, including $21 trillion destined for charities. At its peak between 2030 and 2045, 10 percent of the total wealth in this country is expected to change hands every 5 years . This massive transfer of wealth between generations presents significant challenges for the parents or grandparents who now own this wealth, the heirs and charities who will be beneficiaries of transferred wealth, and the professional advisors who will guide their clients through this transfer and ideally remain as trusted advisors to the heirs after the wealth eventually transfers.

But maintaining that relationship from client through future generations is something that many financial advisors struggle with, and the stakes couldn't be higher. In a majority of wealth transfer cases, assets leave the client's financial advisor and go to the advisor of the heirs, causing a major transfer of business among professional advisors around the country.

The stakes are just as high for the heirs. Younger generations unprepared for significant inheritances often result in the failure of those estates. Studies show that the reason for this isn't related to legal or accounting reasons, but the failure of older generations to adequately prepare the heirs for the consequences of inherited wealth. Professional advisors generally do a credible job in the traditional areas of wealth preservation, governance and tax avoidance—the money often transitions well, but the families themselves don't.

The situation raises the question of how financial advisors and future heirs can successfully navigate this massive transfer of wealth. One of the most effective answers is family philanthropy, a solution that many financial advisors and their clients may not be as familiar with as they should. But proactive financial advisors have the opportunity to become involved, earn trust and help families successfully transition wealth across multiple generations while maintaining crucial client relationships across this country's greatest wealth transfer.

Role of Philanthropy

Philanthropy helps in the successful transfer of wealth in two primary ways:

First, philanthropy can play a role in facilitating the tax-smart transfer of illiquid wealth. Much of family wealth in the United States is in the form of illiquid assets, such as closely held stock, limited liability companies, limited partnership and real estate. For many families, illiquid assets can amount to as much 80 percent or more of the family wealth. Advisors who understand and can effectively communicate financial/philanthropic strategies that reduce the tax bite on transfer of illiquid assets increase their chance of retaining management of the illiquid assets (and may be eventually liquidated).

Second, philanthropy is a useful tool in helping educate heirs on the responsibility of inheritance. In their book, *Philanthropy, Heirs & Values*, authors Roy Williams and Vic Preisser make a strong argument for family philanthropy and its role in preparing heirs for their inheritance. The authors surveyed more than 3,250 affluent families and nearly 100 family foundations to investigate how those families used their philanthropy as a tool to educate the next generation about successful wealth-handling and to ensure their values are preserved for generations to come.

Studies show that using philanthropic tools to educate heirs and prepare them for the consequences of inherited wealth substantially increases the odds for successful transfer of family wealth. Earning the loyalty of the heirs during the remaining lifetime of the parents or grandparents increases the chances of retaining management of the financial and philanthropic assets that will eventually be transferred to the heirs.

Example. Consider the following example, from a family that I've worked with, which illustrates how philanthropy can be used toward those purposes.

A few years ago, Aggie Barker expressed concern to her financial advisors that her seven grandchildren may not be prepared for the inheritance that would come to them on her passing. She wanted to provide a level of financial support through an inheritance, but was worried that giving them so much wealth might spoil them. The family's financial advisor and lawyer described how family philanthropy had played a key role in preparing the younger heirs for successful wealth transfer in a previous client experience. This prompted Aggie to establish a donor-advised fund.

By engaging the grandchildren in the donor advisor process, Aggie believes her children will acquire skills that are critical to their success as responsible, caring adults with communication, openness, trust, responsibility and sharing common values and family missions.

Aggie assembles the entire family twice each year. At the first meeting in February, she allocates a target amount that each grandchild (8 years and older) can distribute from the family's DAF to a charity of the child's choice. At the second meeting, around Thanksgiving, each of the children explains what charity they chose and why that choice was important to them.

Result. Aggie's heirs are well on their way of being prepared to successfully inherit significant wealth by having been exposed to the philanthropic process, and the responsibility that comes with it, at an early age. And more importantly, her financial advisor stands a good chance of remaining involved with the Barker family long past Aggie's passing. It's illustrative of how the country's wealth transfer can be successfully prepared for and navigated by families and their trusted financial advisors.

Becoming Involved with Family Philanthropy

Relationships like that between the Barkers and their financial advisor don't blossom overnight. So where to start?

Become familiar with tax-smart financial/philanthropic strategies. These are the strategies that reduce taxes on the transfer of illiquid wealth and assets held in tax-deferred retirement plans.

Position yourself to play a meaningful role in the transfer process. Because of the trusted relationship with your client, you're uniquely positioned to play a lead role in working with the family before, during and after the wealth transfer. The process often calls for a team approach with an assembly of trusted advisors: the financial/investment advisor, CPA/tax consultant, estate-planning attorney, insurance professional and family's philanthropic advisor. The latter professional is especially effective in navigating the complexities of family dynamics in reinforcing values and a sense of mission in the heirs.

Become familiar with options for family philanthropy. Familiarize yourself with the various philanthropic vehicles:

1. **Private foundations.** Long considered the philanthropic vehicle of choice for families of wealth, PFs come with a perception of prestige, a sense of absolute control over grantmaking, as well as the ability to continue family involvement

over successive generations. Experts suggest a minimum economical size of $3 million to $5 million.
2. **DAFs.** Because of their simplicity, flexibility, privacy and low cost, DAFs are the most popular form of planned charitable giving in America now, outnumbering PFs nearly three to one , with a minimum fund size as low as $5,000 to $10,000.
3. **Use both options.** There's merit in considering the creation of a DAF alongside an existing PF, each having the same name. Because each option has its own merits and limitations, the family has choice in employing which option best accomplishes the wealth transfer strategy desired.

Wealth Transfer Checklist

Here's is a 10-point questionnaire that a financial advisor can use to help the client evaluate the family's wealth transfer plan:

1. Does the client's family have a mission statement that spells out the overall purpose (the why) of the family's wealth?

2. Has the entire family participated in most important decisions, such as defining the mission of the family's wealth?

3. Do all the heirs have the option of participating in the management of the family's assets?

4. Do heirs understand their future roles and have they "bought into" those roles?

5. Have the heirs reviewed the family's estate plans and documents?

6. Do current wills, trusts and other documents provide for a rational distribution of financial and philanthropic assets to the heirs and to charity?

7. Does the family's mission provide incentives and opportunities for heirs to demonstrate their readiness to succeed?

8. Are heirs encouraged to participate in the grantmaking decisions of the family?

9. Does the family consider family unity to be just as important as family financial strength?

10. Does the family communicate well throughout the family and regularly meet as a family to discuss issues and change?

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