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Your Money, Your Dreams, and Your Heirs, Part One

The Issue

Some of these questions may sound familiar:

Do you plan to support any of your friends or family members financially?

Do you intend to pay for college for any relatives?

What values do you want to pass to your heirs?

How do I share my wealth with loved ones without ruining their potential?

These are all questions that help us as financial advisors build financial plans and provide recommendations, helping you achieve your goals, protect your assets, and grow your portfolio over your lifetime. Through our financial planning process, we help our clients prepare to be the best stewards of their wealth.

Wealth preservation can involve complex financial planning. Using financial planning models, we can give clients the confidence to use their wealth to support parents, pay for children's colleges, and take the whole family on vacations across the world. We constantly look for tax planning opportunities, with the goal of keeping as much money in our client's pockets as possible. We encourage our clients to complete estate plans and insurance reviews to protect the wealth they've accumulated.

All the above planning strategies help clients maintain their wealth during their lifetimes and share their wealth with their relatives, friends, children, or maybe even charity after they pass away. But, while we spend so

much time ensuring wealth can be preserved and passed to the next generation, do we actually prepare our families, specifically our children and other heirs, to receive the eventual wealth? The answer, in most cases, is likely no.

An Example – Life in the Gilded Age

Answering the question above requires more than just setting up a trust to distribute incrementally to children at ages 25, 30, 35, and 40. The answer is more complex than teaching your children the value of hard work and requiring them to have some skin in the game while they are growing up. This is about preparing your heirs to receive the entire value of your hard-earned wealth.

Consider the Vanderbilt family. Cornelius Vanderbilt amassed an estate of approximately $167 *billion* in today's dollars when he died in 1877. Within a few decades, his heirs had squandered his entire estate. Putting into context the extent to which the estate had been depleted, Arthur T. Vanderbilt II wrote in his book *Fortune's Children: The Fall of the House of Vanderbilt,* "when 120 of the Commodore's descendants gathered at Vanderbilt University in 1973 for the first family reunion, there was not a millionaire among them." The Vanderbilts, along with many other fortunate families have all succumbed to the same tragic fate.

Today -- The Long and Twisty Road

Here is the stark reality. In a study of over 3,000 affluent families, more than 70% failed to pass on a single dollar to the second generation (grandchildren) and 90% of wealth fails to make it through the second generation. Did all of these families not have efficient and well-articulated estate plans in place? Surely, most did. So how and why does wealth fail to pass two generations over 90% of the time. Complex family dynamics, lavish spending, and poor financial decision making all contribute to the dissolution of most estates. And it doesn't just happen within families that have obvious issues at the onset. Perhaps not surprisingly, money is an accelerator for family infighting and poor behavior.

Let's consider a practical, real world example (not a real client). In 2019, you sell your company for $50M. The shares of your company are eligible for Qualified Small Business Stock (QSBS) treatment. QSBS allows you to exclude up to $10M of gain, or 10x your basis from federal tax. However, you can gift a portion of those shares to say, your children by setting up an irrevocable trust, each of which would get its own $10M gain exemption. So, if set up correctly, you could hypothetically pay no federal tax on the $50M sales price.

Through robust financial planning and estate planning, we helped this client mitigate taxes, set up trusts to provide for the future, complete a meticulous estate plan for their own estate, and create a financial model to ensure their windfall could support them for the remainder of their own lives. But financial and estate plans alone will not guarantee all this client's money is going to support all of their intended goals. Richard Del Monte, author of *Endless Inheritance* argues there is a third pillar to successful inheritance, and that is preparing the next generation to receive the wealth you've created. Unfortunately, this third, yet critical pillar, is often the one that is overlooked.

It's easy to think that your family might not fall victim to the wealth transfer trap, but the unfortunate reality is that it happens to more than 90% of families. Further complications arise when other common factors are added to the mix. Blended families with children from previous marriages and ongoing family businesses. Parents may loan one child money during their lifetime and deduct the loan from the value of the estate. Despite the fact the estate is still evenly split, siblings may consider their eventual inheritance to be unfair. Complex or overly strict estate plans can foster resentment between siblings or cause the children to feel ill will toward the parents who created the trust in the first place.

Ultimately, the emotions of money, both good and bad, are perverse across all families. And when it comes to passing wealth to future generations, our desire to provide for our children and leave them better off may be at its most vulnerable. This isn't something that comes naturally to anyone, as far as we know. Effectively passing wealth to our children requires thorough financial planning, extensive preparation, and communication.

Gathering Your Thoughts

Consider this exercise before you gather with your family at Thanksgiving. Imagine Thanksgiving or Christmas with your family when you are 90 years old. Who is there? What is everyone doing? Are they happy? How do they interact with each other? What do you want to tell your children and grandchildren most? You may share your thoughts with us if you would like, but the exercise itself will be useful as we start to discuss some of the solutions.

Over the next few days, we will be putting out one more letter that breaks down how to talk to your children about money, when to have the conversations, and what to discuss. These conversations are important, and it will take time to decide how best to have the money conversation with your family.

Here are few hints about what is to come:

- Promoting your family history and values
- Psychological problems and money
- Solving the problems

We hope that you found this informative and interesting and, as always, we look forward to hearing any comments or questions you may have. Thank you for the trust you've placed in Vista.

Your Vista Wealth Management Team