STRATEGIES TO CONSIDER BEFORE

LEAVING YOUR CHILDREN AN INHERITANCE

If you are a parent who frets about what your wealth will do to your children, you're not alone. Many clients want to leave money and property to their children, but they are worried that their children are ill-equipped to manage sudden wealth. Some worry that by providing too much wealth it will deprive children of ambition, determination, drive and hard work.

Is inherited wealth an "initiative sucker" that saps children of motivation? Or can it be used to create an enhanced and more satisfied life?

The answer is probably "yes" to both questions. Yes, it can cause some to lose their ambition and initiative. However, with the appropriate effort and structure, those who inherit can use the inherited wealth as a tool to establish meaningful lives of their own.

If you are anxious about leaving your children an inheritance, consider using one or more of the following 5 strategies:

1. **<u>Give your Children a Financial Test</u>.** An individual can gift up to $14,000 (in 2014) per year to as many people as they wish without any federal gift tax consequence. This is known as the federal gift tax annual exclusion. If you are married, both you and your spouse can give up to $28,000 (in 2014) per person per year. Parents can make such annual exclusion gifts to their children without any restrictions and rules and then sit back and see what happens. It's like "kicking the tires" or taking a "test drive." Before leaving a considerable inheritance to the children, see what they will do with one or more annual exclusion gifts. Will they save the funds? Will they invest or spend the funds wisely? Will they use the funds to pay off a debt? Or will they blow the funds on a fancy sports car or in Las Vegas?

2. <u>Use Incentive Trusts</u>. Many parents dread that too much wealth can crush ambition and drive. The solution for some parents is to use incentives within a trust rather than leaving a large inheritance outright to the children. For example, trust distributions to a child can match the child's earnings. The built-in incentive with the clause is, of course, to work – the more money earned by the child, the more trust funds will be distributed.to the child. But what if the child works in a productive but low-paying field (e.g., teacher or employed by a charitable organization). You can add language that will ensure distributions in such situation (e.g., trust distributions geared to a child's educational accomplishments or gainful employment even if not high-paying).

3. <u>Tie Trust Distributions to Ages and Events</u>. Many parents create their trust so that their children get a small amount of money each year and larger amounts when they reach certain ages (e.g., 25, 30 and 35). A popular option is to distribute trust income when the children are young, and then to distribute trust principal when they are older and, ideally, finished with school, have a career, perhaps have married and started a family and have greater financial sophistication. For example, a typical trust can be structured as follows. The child may receive discretionary distributions of trust income until age 21, then receives mandatory distributions of trust income thereafter until the trust terminates. In addition, the child may receive discretionary distributions of trust principal until the trust terminates. Mandatory distributions of trust principal occur when the child attains certain ages (e.g., 1/3 at age 25, ½ of the remaining balance at age 30 and the balance at age 35).

4. Get your Children Involved in a Private Foundation. Creating a private foundation can be a great opportunity to support charitable causes that you believe in, receive a tax deduction, and teach children about money and philanthropy. In general, private foundations are required to distribute 5% of the fair market value of their assets annually to charities. Each child can be given responsibility to research a cause or charity and donate a small percentage to it. Hopefully, the children will get excited about their own causes and seeing how their money could have an impact. It's a terrific learning experience.

5. Give without Providing Cash. There is an alternative to outright gifts of cash. Many parents use their federal gift tax annual exclusion to directly pay down a child's debt (e.g., mortgage or school loans). This can make an important difference to the child's future financial position without placing cash directly into his or her hands today.

As a parent, you want what is best for your children. It's normal and realistic to worry how a large inheritance will influence their drive and choices for life. With some planning, money can be an instrument that enriches their lives rather than an anchor that pulls them down. Consider using one or more of the above approaches.