A ROUNDTABLE DISCUSSION

WEALTH MANAGEMENT

A LOOK INSIDE ESTATE PLANNING STRATEGIES AND OUTLOOK

One of the greatest wealth transfers in history is underway in the United States. And estate planning has become more critical and complex than ever with a need to balance tax strategies with family dynamics. Three local wealth management experts shared their thoughts on wealth transfer strategies with Crain's Content Studio.

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What are some trends you're seeing in intergenerational wealth management?

Carolynn Pfaff: One longer-term trend is to consider how much wealth is appropriate to leave to the next generation versus giving excess assets to charity. It used to be more common to leave as much as possible to children. Another trend is considering how much control children — including adult children — should have to inherited assets and at what age. Yet another is to think about including a corporate trustee to ensure trust assets are accounted for, invested appropriately, and distribution provisions are properly implemented. And for charitable purposes, donor advised funds (DAFs) are being used more frequently than private foundations.

Frank Paolini: In recent years, we've seen our clients make a significant shift toward impact investing and legacy planning over traditional "estate planning" that is simply aimed at achieving tax objectives. Instead of leaving descendants a pile of money, many clients have opted to create trusts that incentivize beneficiaries to advance certain charitable causes, or achieve certain life goals, in order to be eligible to receive distributions. These approaches are less about leaving an inheritance and more about making an impact of lasting importance, which can maintain positive family dynamics while also benefitting society.

> "A LEGACY IS A STORY — BOTH THE STORY OF HOW THE INHERITANCE CAME TO BE AND HOW THE INHERITANCE SHOULD BE MANAGED, USED AND PRESERVED."
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> —ALEX BIGELOW, BAIRD

Alex Bigelow: Primarily, the increase in involvement of multiple generations, or the proliferation of family meetings. Given the historically high estate-tax exemption and the fact that fewer families are staring at an estate tax, the trend in estate planning is a shift from quantitative issues to qualitative issues. While protective trusts for future generations continue to be a focal point, the involvement of the future generations in the planning has become more commonplace.

What should parents consider when determining how to involve their children in intergenerational wealth planning discussions? What kind of information is good to share and at what age?

Paolini: Parents shouldn't assume that all their children are equally capable of managing their inheritances, and they shouldn't feel compelled to treat their children in exactly the same manner in their estate plans. It's very common for each child in a family to have different needs. Moreover, each child will bring different financial skills and acumen to the table. This means that parents should consider creating separate wealth transfer strategies that are tailored to their children individually. Additionally, parents shouldn't be afraid to have their estate planner discuss their plans directly with their children, especially if the plan includes disparate treatment of their children. It's almost always better to head issues off while the parents are alive so that conflict among the children can be avoided. Good estate planners have tools that allow them to diplomatically and effectively help beneficiaries avoid potentially uncomfortable situations.

Bigelow: Parents don't have to share all aspects of their estate plan at once. Instead, they can do so in stages. Most notably, they might consider conversations about their experiences, their personal values, and their objectives without having to bring up specific holdings and dollar values. Of course, where there are illiquid assets like the residence, the vacation home, the family business, etc., it may be helpful to pay specific attention to those assets and invite discussion about how those pieces fit. When to cover all of this depends less on children's ages and more on their maturity, involvement and interest levels.

Pfaff: Very early on, when children are little, conversations about how to budget, spend, save, hold back funds for gifts, and even for charity, can be helpful to provide a base that will later be built upon. As children become adults, if a family's estate plan is complex, it's helpful to begin to include the children in discussions so they have a chance to gain a comfort level with the professionals they will one day likely work with. Generally, it's best to save specific information regarding the amount of money until a bit later. Once adult children begin to have children of their own, it's very helpful for the now grandparent generation to begin to share more information with their adult children. I have seen situations where adult children are forgoing a family vacation with young children in order to accomplish goals such as saving for their children's college education, when I know that the grandparents already have a plan in place to cover those costs.

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What are some pitfalls you've seen in families' planning — including with extended family — that should be avoided?

Bigelow: Planning to minimize estate tax at the expense of capital gains tax. Leaving inheritances exposed to mismanagement and creditors, including ex-spouses. Leaving inheritances outright to spouses and descendants whose own estate plans might differ from the client's plan if they were to predecease the client. Failing to coordinate retirement accounts and other beneficiary designations with wills and trusts. Failing to carefully consider the order of succession for trustees and other fiduciaries. Failing to build in flexibility such as the ability to replace a trustee or change the terms of a trust where that might be desirable. Failure to periodically review your estate plan as well as inform your trustees and executors that you have appointed them.

Paolini: The biggest pitfall I've seen is in not accounting for the likelihood of strife among the extended family after the individual making the bequests has passed. Family interactions that seem reasonable now very regularly become complicated once money is added to the mix. Even if you think the likelihood of conflict between your heirs after you die is extremely low, you should nonetheless have a candid discussion with your planner about the possibility of conflict in order to be certain that you've build the best structure to maintain familial harmony.

Pfaff: One of the most common pitfalls is giving a significant gift or inheritance to a beneficiary outright and free of trust, or even giving a beneficiary withdrawal rights from a trust at certain predetermined ages. First, gifts and inheritances received outright and free of trust generally do not take maximum advantage of creditor protection that may be available, which can become meaningful if the recipient gets into any creditor issue, including experiencing a divorce. Second, gifts and inheritances received outright and free of trust do not maximize available generation-skipping transfer tax benefits (GST). Third, beneficiaries who receive assets may not yet have the experience to manage investing and spending decisions in a way to ensure assets are there to help impact their life in a positive way for a long period of time. Another pitfall is failing to consider extended family members or friends who have come to rely on financial help, but who are not recipients under your will or trust upon your passing. One last pitfall is not carefully considering whom to name as executor or trustee. The person serving in these roles must have the time, expertise and commitment to attend to all matters properly, including the annual accountings, tax filings and interpersonal communication issues that often arise.

What's the difference between leaving an inheritance versus a legacy for future generations?

"POOR DRAFTING CAN OFTEN BE FIXED, BUT A BAD TRUSTEE COULD BE CATASTROPHIC TO ANY WELL THOUGHT-OUT ESTATE PLAN."

— FRANK PAOLINI, NEAL GERBER EISENBERG

Bigelow: An inheritance is a thing. It's a birthday gift or a Christmas present, a check for graduation or a wedding, or a winning lottery ticket. A legacy is a story — both the story of how the inheritance came to be and how the inheritance should be managed, used and preserved. It has meaning. A lot of us would probably rather receive the inheritance. No strings attached. However, put us on the other side of the fence and we would probably rather leave the legacy. We would want our children to come together to enjoy the family beach house or cabin, to carry on the business a certain way, or simply to leave things for their children better than how they found/received it, just like we did for them.

Pfaff: To me, leaving an inheritance means simply leaving assets. But leaving a legacy means also providing some direction about the intended purpose of the assets. This can be accomplished using various methods, ranging from very legally enforceable (such as carefully designed trust provisions) to more flexible and open to a trustee or beneficiary's interpretation (such as statements of intent or letters of wishes). Leaving a legacy could also imply a charitable component, in which family members may or may not be involved.

Paolini: With an inheritance, it's usually a single lump sum influx of cash to the beneficiary. Although that influx can be life changing, a legacy can be set up to be goal-oriented or incentivized in ways that make the person or the world better.

Given the market volatility and potential for a recession, should clients consider wealth transfer planning strategies, to individuals or charities, during lifetime vs. waiting until death? If so, what types of techniques could be used for the clients to maintain flexibility?

Pfaff: As a starting point, low asset values provide an excellent wealth transfer opportunity, because transferring assets while their value is lower (versus higher) makes more effective use of available gift and estate tax exemptions and exclusions. Some wealth transfer strategies also work more effectively during low interest-rate environments, while others are more effective during high interest rate environments. So if opportunities like low values or appropriate interest rates for the strategy you want to use presents themselves during your lifetime, and you know you have more than enough assets to support your lifestyle for the rest of your lifetime, then it makes sense to consider transferring assets now rather than waiting until your death. The concern with transferring assets during lifetime is that sometimes there are unforeseen changes in tax law, family circumstances or your balance sheet. So building maximum flexibility into irrevocable trusts is critical.

Paolini: There are always good reasons for lifetime gift planning. Sometimes there are beneficial tax incentives. Some people like to see their money being put into action. But it doesn't have to be one or the other. Estate planners have financial planning tools that allow their clients to make hybrid gift trusts that allow for charitable contributions today that also leave residual trust funds for the benefit of the clients' beneficiaries.

Bigelow: Assets or percentages/dollar amounts that can be earmarked "for the kids (or others)" today are best transferred when values are relatively low so as to minimize the use of gift/estate tax exemptions. That is, if values are expected to increase, it generally makes sense to move them now. If there is a desire for continued control or access or income, a direct gift may not be as advantageous as an installment sale or a gift to a trust such as a Spousal Limited Access Trust. When it comes to charitable gifts, it may not be as valuable to give depreciated assets because the capital gains tax savings and/or income tax deduction may not be quite as high.

How can clients protect their assets from threats such as creditors and bankruptcy and/or future estate taxes after their death?

Paolini: The most important facet in protecting one's assets after death is to choose your trustee wisely. Many clients mistakenly feel that they can draft against all possible scenarios, but that's simply not possible. Instead, it's much more important to have the right person, or people, in charge to handle the unforeseen issues. Poor drafting can often be fixed, but a bad trustee could be catastrophic to any well thought-out estate plan.

Bigelow: Giving or leaving assets to irrevocable trusts for loved ones — instead of outright to them — can insulate those assets from outsiders. Trusts can be designed with a fair amount of flexibility. If the goal is to protect assets from the beneficiary him/herself, another trustee can be named. If giving the keys to the beneficiary is not the issue, but there is still a need to protect assets from outsiders, the beneficiary can be his/her own trustee and distributions of principal can be limited by a co-trustee or to those needed for health, education, and support.

Pfaff: As a general rule, it's easier to protect assets from the claims of creditors if the assets exist in a trust that was created for you, as the beneficiary, by another person (the Grantor). Well-designed trusts often do not "force" distributions out of the trust to the beneficiary, because assets that remain in trust can maximize creditor protection and GST tax benefits to the extent possible. Properly designed trusts can be GST tax exempt, meaning that they will not be subject to the GST tax as they pass from one generation to the next, so long as the assets remain in trust.

How does a family best plan and evaluate long-term philanthropic decisions and other charitable activities?

Bigelow: Don't make decisions on what to give based on tax consequences. It is always better for the family to keep the money and pay tax than it is to give the money away. If charity has a place in the estate plan, be thoughtful and specific. For example, don't give money to your alma mater's general operating fund so they can repave parking lots or pay law school professors' salaries. Specify that you want the funds used to be used to endow a scholarship or for the football team. Along the way, involve family members who should have a say. Talking to children and grandchildren to find out what they would do with X amount of money can be a great way to help them develop their own sense of philanthropy and encourage future giving.

"BEYOND WORKING WITH A HIGHLY QUALIFIED PROFESSIONAL, WHAT MATTERS THE MOST IS THAT YOU HAVE A STRONG PERSONAL COMPATIBILITY WITH YOUR ESTATE PLANNING ATTORNEY."

— CAROLYNN PFAFF, BMO PRIVATE BANK

Pfaff: The amount of assets, family values and the interest of future generations in being involved in the process of managing the assets destined for charity must all be considered. Some families like to use charitable vehicles as a tool to teach children how to think about investing and spending decisions, and to generate an interest in working together as a family and an interest in charitable giving. The most commonly used tool is a donor advised fund (DAF), because it is the simplest and most cost effective. A DAF is set up by an account owner who names an advisor to recommend charitable distributions from the DAF to qualified charities. Not all DAFs are alike, so you have to make sure you understand what you want to accomplish and whether a given DAF is appropriate for you. Large gifts that include naming rights — the right to name a physical piece of property, such as a building after the donor or another person — must be carefully reviewed by an attorney who is familiar with the potential pitfalls.

Paolini: Consider the ultimate result that would make you happy five, 10 and 20 years after you've passed, then make your decisions and set up your activities accordingly.

When looking for providers to help develop an intergenerational plan, how can someone know who is a good fit for their family? What questions should they ask a potential advisor?

Paolini: A personal connection with your estate planner is paramount. Remember, you will be sharing very intimate details with this individual. Once you have an advisor like that in mind, ask about the person's level of experience in estate planning for people who share attributes similar to yours regarding wealth and family dynamics.

Pfaff: Ask your financial advisors, CPAs and attorneys you may work with on other matters who they recommend you should interview to work with you as the attorney on your estate plan. In some cases you'll see some similar names surface. Beyond working with a highly qualified professional, what matters the most is that you have a strong personal compatibility with your estate planning attorney. In order to do their best work for you, they have to understand your entire balance sheet, your confidence level in your children's ability to manage money, and your real concerns about your loved ones. These are highly personal conversations and require trust.

Bigelow: The ideal candidate should approach wealth management from all angles not with a focus on investments or insurance as a solution, as a process not a product, and with a customized approach and not with a one-size-fits-all mindset. The client might ask, "Who do you have on your team? What are the roles of other team members? How might they work with other members of my family? How many other families do you work in this capacity with? How many have you worked with?"

ABOUT THE PANELISTS

ALEX BIGELOW, Managing Director, is Baird's Private Wealth Management Market Director in Chicago. He joined Baird in 2016 and has more than 35 years of experience in the financial services industry. In his current role, Bigelow is responsible for a market with six branches and more than 100 associates. Bigelow is a board member of the Securities Industry & Financial Markets Association (SIFMA), and an active participant on SIFMA's Curriculum Committee.

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FRANK PAOLINI is a partner with Neal Gerber Eisenberg's Private Wealth Services practice group. He focuses on private wealth planning and preservation, as well as trust and estate litigation. Paolini advises clients regarding complex tax, trust and estate planning, administration, litigation and dispute resolution. He also advises nonprofit entities and family offices regarding business operations and strategies and issues related to administering private foundations and public charities.