Protect Your Children From *Your* Wealth

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More money won't solve all of your problems; in fact, it can create new ones. While many families focus on acquiring enough money to give their children a comfortable lifestyle, fewer families take time to consider the potential negative impact wealth can have upon their children. While money can provide a comfortable lifestyle and security, it can destroy the incentive to work hard at school and pursue a meaningful career. Parents' wealth can foster laziness and sloth in children by creating a sense of entitlement without the requirement of "paying dues," that is, working hard and suffering setbacks.

There are some important financial planning strategies to be employed, both during lifetime and post-mortem, in order to increase the likelihood of your children acquiring a proper understanding of your values and priorities. These strategies will also enable you to accomplish worthwhile financial goals through the next generation.

The first principle is to lead by example. It simply is not good enough to be a hard working person yourself, and a caring, nurturing parent even though those traits are very important. Children will model their parents' behavior, in all things, good and bad. It's important for parents to be intentional in their handling of spending, debt, asset purchases, investments, taxes, and vacations, not to mention alcohol, hours at work, and other relevant behaviors. Children pick up far more by observing what you do than by listening to what you say to them.

Next, deal with the unthinkable—what if both parents die prematurely? It is not enough to have a simple will, although that is better than nothing. Estate documents should be coordinated to achieve your wishes. At a minimum, they should include a pourover will, a revocable living trust, a durable power of attorney, and an advance medical directive. In addition to minimizing the bite of estate taxes, the revocable living trust should have "sprinkling provisions." This avoids dumping a fortune into the lap of a 21-year-old. Rather, it intentionally sprinkles the family wealth to the child intermittently over a number of years; for example, 1/3 at age 25, ½ at age 30, and the balance at age 35.

Another planning technique is life expectancy distributions for inherited IRA's, 401(k)'s or other qualified retirement plans. Unlike a spouse, who can rollover the deceased spouse's IRA tax-free, a child must pay income taxes when he or she receives a deceased parent's IRA. This can be done all at once if the IRA comes out in a lump sum – this is usually a costly decision because of the taxes paid up front -- or gradually over the remaining child's life expectancy, which tends to be a better choice. The child makes this decision after the parent is gone, often with no help or advice. Parents should write a letter to their children explaining this choice, and recommend they visit their financial advisor prior to making such a huge (and costly) decision.

One very effective instrument is a family partnership. This has creditor protection benefits, limited access by the children for many years, and significant estate tax savings if used in conjunction with gifting units of the partnership to an irrevocable

trust.

Finally, deal with lifetime issues. Parents may want to establish irrevocable trusts for their children as beneficiaries. Different types include “spendthrift” trusts, discretionary trusts, support trusts, and self-settled trusts. These trusts can not only protect the children from wasting the family wealth, but if drafted properly can also protect the money from creditors, divorced ex-spouses of the children, and other problems. In some cases, unused UGMA/UTMA dollars can be deposited into the irrevocable trust (with the adult child’s consent) so that gifting by the parent is not an issue.

If philanthropy is an important value to the family, parents can establish charitable foundations and appoint their children to serve on the board and participate in decision-making. Used properly, this can have an enormous impact on the thinking and values of a young person. It also has beneficial income tax and estate tax savings.

Protecting children from the family wealth does not happen by accident. Design a long-term plan that is purposefully created, aided by competent counsel, based upon the family’s values and coordinated with tax and estate planning.

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