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Perspectives

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Your Children and Their Financial Inheritance

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When was the last time someone handed you a $1,000,000 check? How do you think your children will manage if they are handed this amount of money? These are questions we ask our clients to ponder as they think about passing wealth to the next generation. Perhaps $1,000,000 is not your family's number, but the point is to think about how prepared your children and grandchildren are to receive a significant sum of money on your death. Will their inheritance be a blessing or a burden? Are there ways to prepare them to increase the odds of your financial success being a blessing to them?

I have the honor to serve many different families, and over the years, I have had the benefit of learning several ways in which parents teach their children to handle finances. I will share a few unique strategies others have used to prepare their children for financial independence and to eventually act as a steward of their own inheritance.

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- Competitive Investing: For many years, we have worked with a family who successfully taught their two sons to invest using Roth IRA's. When we began our relationship, the two boys were still in high school. Both had summer jobs and thus were eligible to contribute to this type of account. Every year, the parents contributed a portion of their annual gift tax exclusion to the Roth IRA. The boys were allowed to use a portion of the contributed amount to buy stocks of their choice. Annually, we prepared a portfolio review for each son and compared their investment returns. This was always a friendly competition between the two. They are now grown and they successfully manage their own finances. By having a real life opportunity to invest a small sum of money year-after-year, they learned both how different assets perform over various market cycles and how to compare their returns against similar benchmarks. There are complex IRS rules to investing in a Roth IRA, so this strategy may not work in all situations. Other types of accounts that can be utilized if necessary. The idea is to use annual exclusion gifts to fund an investment account for the child and have the child actively participate in the management of that account.
- Spending Matters Most: One retired couple focused on teaching their two daughters and three grandchildren the importance of living within a budget and below their means. The father made it his practice throughout life to invest half of any pay increases the family received into the stock market. For years he consistently purchased solid U.S. large company stocks and reinvested the dividends. It was his philosophy that if they were successfully surviving financially before the pay increase, they could incorporate half the pay raise into their spending budget, but the other half was to be invested into other companies. He taught his daughters this strategy and the importance of living within a budget and paying attention to their spending. This family is an example of it is not what you make that is important, but rather what you spend that will determine your financial success.
- Another family implemented a similar strategy with annual dividends payments. The father of this family started a small business and employed his three sons. Over many years the company grew to be very successful. Each year, rather than giving the sons 100% of their dividends, he held a portion back and invested the money into equities for each son. He encouraged his sons to focus on the family business and not pay attention to the investment accounts

he was managing for them. When the father died, the sons were surprised by how successful their father had been investing their dividends. In this situation, he not only taught them to live with less than they earned, but he also taught them the importance of diversification. The family owned business made up a large portion of their net worth. By using a portion of the annual dividends to buy stocks outside of the family business, they were able to diversity a large portion of their assets.

- Run Your Life as a Business: One father taught his children to manage their household finances like a business. He instructed them to be the President and CEO of their own life. The responsibilities of this position included fully understanding the income and expense reports (a budget) and the balance sheet (a personal financial statement) of the company. These financial reports taught them the importance of knowing their numbers and reviewing them regularly to ensure the company was staying on track. As with any successful business, the President and CEO reports to a Board of Directors. He encouraged his children to employ their own Board of Directors. He suggested they consider having an investment advisor, an accountant, an attorney, a banker and an insurance specialist on their Board. He taught them to regularly meet with the Board members to share the results of their efforts and to present their future goals for the company. It is a creative way to teach accountability and monetary responsibility with the expert advice from others helping to keep the company successful.

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- Contingency Plan: One family focused on mitigating risk. They encourage their children to obtain a higher education and pursue careers of their desires, but to also learn a trade or a service that would be needed no matter what the economic conditions. They also encouraged their children to learn basic skills to care for their home and automobile. Their belief was by knowing how to change a tire or the oil in their car or being able to fix basic home repair needs, they could save money over time. They believed having diversified skills and continuing to build on these skills would benefit their children no matter what life presented to them. For this family, planning for when the unthinkable happens is often overlooked, but is critically important. We all have risks in our lives – risk of an accident leaving us disabled, risk of losing a job or a loved one who supports the family. Having many skills will benefit these children in the event life doesn't unfold as planned.
- Making a Difference to Others: Philanthropy provides an opportunity to teach not only financial lessons, but also incorporate passing along family values. Greenleaf Trust often hosts annual family meetings. For one family, the topic of charitable giving is a part of each meeting. Annually, the children and grandchildren are required to research a charity of their choice and to present their suggestions to the family. Throughout the year, they are encouraged to visit the charity, and learn how their potential gifts may be utilized. Upon request, we provide and review the non-profit's 990 tax return with the presenters. The tax return offers an opportunity to teach and review how charity operates. These conversations also lend themselves to teaching family values. It offers time to reflect on how the family's nest egg was built and will be beneficial to the children and the grandchildren as they continue the family's legacy when the parents are no longer alive.

There is not one easy way to teach financial independence. Consistency and time are important variables that will help contribute to the success of preparing your children to manage their future responsibility of caring for their potential inheritance. As always, your Greenleaf Trust client centric team stands ready to assist your family in teaching the next generation so their inheritance will be a blessing and not a burden.