BLB&B Advisors, LLC
FINANCIAL GUIDANCE SINCE 1964

MONEY *notes*

The US is on the brink of a massive intergenerational wealth transfer. Over the coming 25 years, it is estimated that up to $72.6 trillion will be passed along to heirs as inheritance. Charitable organizations also stand to benefit during this timeframe to the tune of about $11.9 trillion.[1] While this is great news for the recipients of this wealth, it is imperative that both the givers and the receivers plan and prepare well in advance for this wealth transition. Ideally, proper advance planning by both the givers and receivers will help families avoid an all too common phenomenon. Did you know that about **70% of wealthy families lose a majority of their wealth before the end of the second generation and 90% tend to lose it all before the end of the third generation**? [2]

There are many reasons why this occurs. Usually, the first generation works hard and saves diligently in order to build their wealth. Their children (the second generation) experience firsthand the effort and sacrifice required to grow their family's wealth and, thus, tend to make smarter financial decisions in order to preserve and even grow their family's wealth.

The third generation, however, is often too far removed from the origins of their family's wealth and, in many instances, is not taught much about money or how to manage it. Unfortunately, splurging upon receipt of an inheritance is the norm – it takes the average recipient of an inheritance just 19 days until they buy a new car! At the same time, the third generation is accustomed to, and may even feel entitled to, enjoy a comfortable lifestyle.

The truth is, most inheritors of wealth receive very little financial insight or guidance from the previous generations. Frequently, they unsuccessfully struggle to manage their newfound wealth on their own.

All is not lost, however, and there are some simple steps your family can take to avoid the common pitfalls that jeopardize the longevity of your family's wealth. Families that are able to sustain wealth across multiple generations tend to exhibit key commonalities – from shared values and open, honest communication, to a passion for financial learning and a commitment to thoughtful planning. Perhaps most importantly, however, they rely on the trusted counsel of professional advisors to help guide them on their wealth journey.

In this 2-part series, we will focus on some simple steps your family can take to successfully navigate the transfer of your family's wealth from one generation to the next, and so forth. This article focuses on how the intended recipients can prepare themselves to receive an inheritance. Our second article will focus on ways the older generation can prepare themselves and their family for their impending transfer of wealth.

Drivers of Success – How to Navigate the Receipt of Wealth
While your particular circumstances, short-term needs, and long-term goals are unique, the following short list of best practices can dramatically improve your chances of not just sustaining, but enhancing the wealth you inherit:

1. ***Think before you act****:* don't fall into the all-too-common trap of looking on a windfall or inheritance as an opportunity to overindulge. Certainly, there's nothing wrong with setting aside a little money to splurge with; but if you binge spend now, odds are you'll come up short of reaching your long-range financial goals. Before making any decisions about what you will do with your new inheritance, talk with your financial advisor, your estate planning attorney, and your tax advisor. Each of these people will be able to provide you and your family critically important information and strategies designed to protect, preserve, and grow the wealth you inherit as well as pass it along to the next generation when the time comes.

2. ***Retirement first:*** as humans, we are hard-wired to focus more on short-term needs rather than long-term objectives. Whether it's buying a bigger house or sending our kids to private school, our immediate concerns often feel far more pressing than something many years down the road like retirement. When you receive a windfall, however, try to think in reverse – from the furthest away to the closest.
   Ideally, you should allocate the lion's share of your inheritance to your retirement savings; then move to mid-range goals such as putting money into a 529 Plan account for your children's education; and finally address your shorter-term needs. It may seem counterintuitive, but by addressing long-term needs first, you may be able to free up more of your regular income to handle day-to-day financial needs.

3. ***Pay off high-interest debt****:* the one area where short-term needs should override long-term goals is in regards to any high-interest debt you may have. Prior to putting money away for retirement or making lifestyle purchases, pay down any credit card and personal loan debt you may be carrying.

4. ***Don't overlook tax obligations****:* with the federal estate tax exemption in 2022 at $12.06 million per individual (and $24.12 million per couple), federal estate taxes are generally not a concern for the vast majority of estates. But, beyond this amount, federal estate taxes quickly approach 40%. Also, this amount is due to sunset in 2026 and will fall back to $5 million (adjusted for inflation). Additionally, a number of states including Iowa, Kentucky, Maryland, Nebraska, New Jersey and Pennsylvania impose state-mandated inheritance taxes of up to 18%.[3] Maryland even imposes both an estate tax paid by the estate and then an inheritance tax which must be paid by the heirs. [4]

5. ***Become part of the conversation:*** if you believe there is an inheritance potentially coming your way, initiate the inquiry. Approach the possibility of future inheritance the same way you might discuss other sensitive family topics – with an open and honest communication. Ask questions not only about the source of the family wealth, but the strategy, effort, and goals of the originating family members and the current status of those investments. Ask the prior generation for guidance on how they believe you can best prepare yourself to receive and preserve the family legacy. It can also be helpful to bring other named beneficiaries into the conversation.

Special circumstances

While most inherited assets, like cash, stocks, and bonds are relatively simple and straight-forward, you may receive assets that are held in trust or assets where you'll need to make certain distribution decisions.

Assets Held in Trust

Oftentimes, parents turn to trusts not as a way to micromanage their children's inheritances, but as a means of ensuring that those assets are protected from potential creditors or a future divorce. When assets are in trust, the inheritance will be managed by a trustee (usually an investment advisor, banker, lawyer, or other family member) who is responsible for overseeing the investment and distribution of assets according to the trust's language. As a beneficiary, you'll want to carefully read the trust documents so that you understand the trustee's duties and obligations. Also, you will want to make certain that you receive regular updates on the trust's investments, distributions, and performance.

Inherited IRAs

If you're the named beneficiary on an IRA, you will have some decisions to make about how and when you will begin to take distributions. While the IRA inheritance, itself, is tax-free, you will need to take distributions from your inherited IRA and these distributions may be taxable to you at your income tax rate. The timing of your required distributions and your potential tax burden on these beneficiary IRA distributions is determined by the type of IRA involved and your relationship to the decedent. Generally, non-spousal IRA beneficiaries will need to withdraw the entire IRA account amount by the 10th year following the original IRA owner's death (provided they died after 2019).

Regardless of the nature of inherited assets, whether they are held in trust or directly distributed, the advice and guidance of a trusted advisor can make all the difference between receiving a legacy that endures or a gift that quickly disappears. When is the best time to sit down and discuss an inheritance or windfall? Ideally, long before you ever receive it. Knowing that you will receive a sizable amount at some point in the future can open up a world of new planning opportunities and impact how best to direct your existing portfolio assets. If you anticipate receiving assets in the future, talk to your BLBB financial advisor in advance of this event (215-643-9100).

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[1] https://www.bloomberg.com/news/articles/2022-02-02/what-the-73-trillion-great-wealth-transfer-means-for-america-s-super-rich

[2] (https://www.thinkadvisor.com/2022/01/20/the-84t-wealth-transfer-underway-now-by-the-numbers-cerulli/#:~:text=Between%20now%20and%202045%2C%20multigenerational,new%20report%20from%20Cerulli%20Associates)

[3] (https://www.aarp.org/money/taxes/info-2020/states-with-estate-inheritance-taxes.html)

[4] (https://www.kiplinger.com/taxes/601639/estate-tax-exemption-2022)

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