BMO Wealth Insights

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Wealth Connects **the Generations**

Engaging the next generation

Preparing heirs for a lifetime of charitable giving

Ensuring a seamless transfer of wealth with an estate plan

BMO Wealth Management

Over the next 30 years, it's estimated that over $30 trillion in financial and non-financial assets in North America will change hands.[1] Wealth will change hands – and it's not just a change in ownership but also a change in the way transferred wealth is received and used by future generations. Successful transfers of wealth will require families to communicate and plan together to prepare heirs for their future inheritance.

This is a tremendous opportunity for individuals or families of wealth to think about legacy and estate planning for future generations. This magazine focuses on issues that impact the successful transfer of wealth from generation to generation.

How can children and grandchildren be prepared for their roles as inheritors and be engaged to receive it well? We will explore the expectation versus the reality of leaving and receiving an inheritance, and the many factors that affect that equation. The givers of wealth often want to influence how their gifts will be used and to prepare their heirs to be exceptional wealth stewards. They may also intend to make bequests to charities and institutions that are important to them. The transfer of wealth is subject to tax and estate law and the impact can be alleviated by effective wealth planning strategies. Finally, business owners will need to consider how the sale or transfer of their business can be balanced with the expectations of that business providing a source of retirement income.

Through our services, we can help reduce the complexity, allowing you to focus on what's important to you.

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Are they prepared? Children and grandchildren need to get ready for their roles as inheritors.

For many high net worth families, amassing wealth may be the easier part. Passing down the knowledge and tools necessary for a successful wealth transition, that is where things get difficult. Wealth creators can be busy with their businesses and community obligations and neglect this important step or, more commonly, simply don't know how to start.

As an inheritor, this can leave you in an awkward position. You may not know what is expected of you, what role you should play and how you should prepare for your inheritance. It's an all-too-common situation. According to *Preparing Heirs: Five Steps to a Successful Transition of Family Wealth and Values*, by Williams & Preisser, a quarter of heirs feel unprepared for their roles.

Empower yourself with knowledge and skills to help yourself and the wealth creator make the best decisions for themselves and your family's legacy.

An inheritance is a challenge

Do your parents like your taste in music? Do they have the same views on community involvement? Parents and children have different opinions on

many things and how you use your inheritance may be one of them. When we work with families, we see four main challenges:

1 **Sense of entitlement**
Your parents may worry that wealth will undermine your ambition or financial responsibility. Wishing to ensure that you will be a good steward of their wealth, they may want to stagger your inheritance according to milestones such as a college graduation or achieving a certain income threshold. You, on the other hand, may feel that an inheritance should come with no strings attached.

2 **Heirs' differing needs**
Parents generally hope to treat their children equally or fairly, according to their differing needs and abilities. For example, you might have a sibling with a chronic illness, or earning a smaller salary because they chose to be an artist or teacher or work for a not-for-profit organization. Your parents may consider providing a larger inheritance to your sibling, but you may not agree with the fairness of this decision.

3 **Grandchildren**
Your parents might struggle with how to divide their estate equitably if you and your siblings have a different number of children. Often grandparents seek to treat all grandchildren equally, but this could mean one sibling's family receives a larger share if they have more children. Again, it is important to understand the philosophy here to avoid strife.

4 **Lump sums or extended distribution**
Parents may worry about leaving lump sum payments if their children haven't achieved a certain level of maturity. They can also be concerned about protecting an inheritance from creditors or ex-spouses. For this reason, parents often consider using trusts to protect your inheritance for your benefit.

The key to tackling these challenges is open communication, giving parents an opportunity to explain their intentions and allowing you to understand them, and giving you the time to learn the skills you need to become a prepared and responsible inheritor.

Tell me a story — the tale of family values, vision and mission

Everyone loves to talk about themselves, especially people who've lived exciting lives and built successful businesses and careers. While your parents may be reluctant to open up about their estate plans, their net worth and what they intend for you to inherit, chances are they will relish the chance to tell their story.

Storytelling sessions aren't about dollars and cents – that part comes later. Instead, it's a chance to learn about your family's unique journey so that you can appreciate the values, vision and mission that led to the creation of the family wealth, as well as where you fit in.

Remember that each generation and each person has their own communication style. To glean as much as possible from your parents' storytelling, make sure you're communicating in the way they feel most comfortable. Skip the texts if your parents place a premium on face-to-face communication. They might even prefer to write you a letter or a short memoir detailing their life.

Also, recall that different personality types approach storytelling in different ways. For example, some family members may be very detail-oriented whereas others may be more about the big picture and the punchline. Taking personality preferences into consideration can also help to facilitate open communication.

As you talk, keep these things in mind:

- Be empathetic and respectful;
- Ask how your parents created their wealth;
- Ask about the challenges they encountered and how they overcame them;
- Find out what they consider to be their greatest accomplishment (the answer may surprise you);
- Ask if they have any regrets;
- Listen more than you talk; and
- Consider the similarities and differences to your own values, vision and mission and how to bridge the difference.

The key to engaging in family storytelling is the understanding that the family story contains the values and strategies that were deployed to garner your family's wealth.

The family blueprint

Once you understand the family story, you can move to the next phase. This means starting to document the vision, mission and values for the family as part of an overall blueprint. Your parents may already have started on this themselves; if not, work with your parents to help them more clearly articulate and document their views.

A family blueprint can include a family tree, a mission statement (family goals and objectives), a family entity diagram, the family balance sheet, income tax projections, cash flow projections and an outline of the estate disposition. It can be a guiding document, not only for the values your family holds dear, but also how assets, cash flow and estate disposition serve that purpose. It can also help you to see your roles and responsibilities within this family construct.

For example, if running a successful business is central to your family's values, the family blueprint helps to lay out the roles that family members can play.

> "The family blueprint helps to lay out the roles that family members can play."

The family blueprint can articulate your parents' philanthropic intent, if that is the direction they wish to follow. This can help to instill a sense of generosity and gratitude in younger family members and counter the sense of entitlement your parents may worry about. It allows the younger generation to learn about money management and due diligence in a supportive environment, under the watchful eye of a matriarch or patriarch.

A family blueprint is an evolving document reflecting market conditions, changing family dynamics, life events and philanthropic focus. It will be revised time and again as things change but can serve as a benchmark for the family's goals and objectives, an outline of the strategy for achieving them, and a way to educate family members about the family wealth.

The business at hand – the family meeting

With an understanding of your family's story, you are ready to delve deeper into conversations about wealth transfer. Use the structure of a family meeting to provide the space for that to happen. Family meetings can be an opportunity for information gathering and working together to resolve potential problems.

Some families have well-established, open lines of communication. Their family meetings can be as simple as a hike in the woods or a Sunday brunch – pretty much any time they gather together. Other families prefer a more formal approach. They might prefer to set aside several times throughout the year to discuss family business.

Regardless of how your family conducts its meetings, make sure there's an agenda so nothing falls through the cracks, and assign action items for each member to tackle before the next meeting. If your family is finding it difficult to get started, consider using a neutral third party to facilitate a family meeting.

As your family moves forward with the wealth transfer process, your parents can start assigning roles to different members based on their interests and skillsets. In general, there are four roles within a family's wealth transfer that can be filled by members of the next generation: beneficiary, trustee, steward and shareholder. Oftentimes, family members play one or more of these roles and should understand the different hats they might wear in playing each of these roles.

Final thoughts

In a perfect world, parents would have a well-thought-out plan for wealth transfer, explain their intentions and help their heirs learn their roles and responsibilities. But life doesn't always unfold in an orderly way or provide such a roadmap. Sometimes, inheritors may need to step in to play a more active role so they can empower themselves to be educated, responsible and prepared.

Passing it on:

Great expectations or reality?

The biggest wealth transfer in history is set to take place and this enormous transfer of wealth from one generation to another has been a hot topic. Some of the key issues surrounding the transfer lie with how well different generations have planned for this and what changing economic conditions might mean for future legacies. Perhaps the biggest question of all centers on how wide the gap truly is between expectation and reality?

Over the last decade, many studies have attempted to assign a number to the amount of

wealth that's set to transfer from one generation to the next. In the United States alone, it's been estimated that $68 trillion in financial and non-financial assets will change hands, leaving millennials five times wealthier by 2030.[2]

While the true figure is up for debate, there's no doubt that an unprecedented shift in wealth between generations is on the horizon. With possibly trillions in assets at stake, it's crucial for those leaving an inheritance – and those receiving one – to be prepared for all that it involves.

> "The lack of candid conversation between generations appears to be a major contributing factor to poor retirement and estate planning."

Closing the gap between expectation and reality

Transferring wealth isn't a precise science and no two situations are exactly alike. Timing and the amount of assets involved can influence what a wealth transfer looks like between generations.

Family discussions can help to weed out some of the uncertainties, but these aren't always easy to initiate. Older family members, for example, may be reluctant to discuss the financial details of their estate with their adult children. Lack of communication can be problematic, both for those transferring wealth and those inheriting it, when it leads to misunderstandings or poor planning.

Talking things over with a professional advisor can be helpful but this communication can also be lacking or nonexistent. For example, if you're receiving a large inheritance then using some of the proceeds to pay down debt or fund a retirement account could help pave the way for a smoother financial future. But without the advice of a trusted advisor, you may not be sure how to best put an inheritance to work. Equally, those passing on wealth may not understand the best options for passing it on while minimizing estate and income taxes for their heirs.

Factors impacting an inheritance

An inheritance can be large, small or somewhere in between. The size of an inheritance often depends on a number of factors, including:

- Life expectancy and retirement age of the person or persons passing on wealth
- Unanticipated events and health care expenses they may incur as they age
- Challenging markets, interest rates and inflation
- Taxes and fees on death
- Family size and the number of people and/or charitable organizations who stand to inherit

Life expectancy and retirement age

Thanks to healthier lifestyles and medical advances, people are living longer. National Center for Health Statistics reports that women live to a median age of 81.2 years, and men to 76.2 years.[3] This is good news from a longevity perspective since it means aging Americans have more time to enjoy their later years. But in terms of retirement assets needed, those additional years demand a significant amount of retirement savings – especially when aging means a significant uptick in health care needs.

Unanticipated events and health care expenses

Long-term care is something many older Americans may need at some point, but the costs can deplete accumulated wealth. While Medicare can pay for some health care expenses, it has its limits. For example, Medicare can be applied to hospice care expenses, but it doesn't extend to long-term nursing home care. Becoming single in retirement can also affect the amount of wealth someone has to pass on. Someone who's

widowed, for instance, may be faced with paying for health care costs without a spouse or partner to provide them with support. On the other hand, if they have properly planned, they may have been left with more wealth through life insurance in the case of a spouse's death.

> "Additional years demand a significant amount of retirement savings – especially if one considers extra health care needs."

Challenging markets, interest rates and inflation

Stock market movements can make planning for a comfortable retirement challenging. Seniors, who typically invest more in fixed-income products such as CDs and bonds, may miss out on opportunities for growth by avoiding riskier investments, such as stocks. When inflation rises, holding more of their money in conservative investments could result in reduced purchasing power. As a result, there's little left behind for their heirs which could mean a smaller family legacy for future generations.

Taxes and fees on death

Estate taxes can be a hurdle for transferring wealth to the next generation. As of 2020, the estate tax exemption limit is $11,580,000, doubling to $23,160,000 for married couples. If filing an estate tax return is necessary, that can mean there is less to pass onto heirs of high net worth and ultra-high net worth individuals.

So how much of a bite can estate taxes take? Consider this scenario. Assume you plan to leave your entire estate to your sole heir. Your total assets are valued at $15 million. Of that amount, $11.58 million is exempt from estate tax, assuming you haven't used any of your lifetime exclusion. The remaining $3.42 million is taxed at the 40% tax rate, leaving your heir with a net of $13.362 million. That figure doesn't include any additional death taxes that may be owed at the state level.

Many people fail to take this into account when planning for the transfer of their estate. Not only can taxes and probate costs erode the value of an estate, they could force the sale of assets. For instance, a family home or investments may have to be sold to pay taxes and probate costs, executor, trustee, legal, accounting and appraisal fees. Thinking ahead to cover these contingencies can help you to keep more of the wealth being transferred in the family.

Family size – many ways to split the pie

Boomers who earned their moniker due to the boom in birth rates after World War II, represent a large percentage of the world's population. In the United States, boomers account for approximately 22% of our population.[4] It stands to reason that any legacy that the boomers' parents leave behind is likely to be split between multiple siblings.

But those aren't the only people who may stand to gain from a wealth transfer. Inheritances may also be split with grandchildren, allocated to trust funds or passed on to charitable organizations. Ultimately, this may reduce the size of the inheritance that's left to be divvied up between next-generation beneficiaries.

Instead of the slice of the pie you were expecting, you may only get the crust. This may be particularly true if you're caring for aging parents while simultaneously raising children. Even if you aren't paying for care for an aging parent out of pocket, taking time away from work to perform caregiving duties could mean fewer opportunities to save for retirement. And that could leave you with less wealth to transfer later.

Will boomers be the last generation to inherit?

Despite the many challenges that exist, including increased longevity, rising health care costs and inflation, boomers are unlikely to be the last generation to inherit. Nevertheless, the situation is complicated. Older Americans who still expect to fund their retirement with an inheritance may find that reality falls short of expectations, and future generations who are counting on receiving an inheritance should be aware of factors that reduce the amount of money they'll eventually receive.

Fortunately, there are strategies that American families can take to help achieve their vision for creating a lasting financial legacy. Communication and planning are fundamental keys to success. Though getting the conversation started can be difficult, it can be well worth the effort when creating a financial legacy is the goal.

Final thoughts

More than ever before, seeking out professional advice when it comes to things like estate planning, retirement and business succession is imperative due to complexity in taxes and potential strategies. By having open conversations about inheritance and wealth, and with the help of a BMO professional, families can be more confident about their financial future.

Preparing heirs for a lifetime of charitable giving

Six ways to teach your children the role of giving in wealth stewardship

Beyond the tax deductions, there are many rewards to engaging in charitable giving as a family.

Children of all ages can learn how to use wealth to help improve the lives of others or to support worthy causes. Even the very young can be taught to make charitable donations and volunteer their time. Whether your family has a well-established charitable giving program or you're just starting out, there are meaningful ways to establish a culture of stewardship and philanthropy that involves the entire family. Here is a timeline of suggested strategies to help prepare your children or grandchildren as they grow and mature for a lifetime of charitable giving.

Preschoolers

1 Take the kids with you when you volunteer your time

One of the most precious commodities you and your family can give is your time. From helping an elderly neighbor with yard chores to signing up at a soup kitchen, your children can see firsthand how they can help make a difference in the lives of others. Volunteering also builds self-esteem and confidence in children, while making them more aware of their community and its diversity.

2 Create a legacy account.

Earmark a portion of the household budget for specific charitable causes. This can be as simple as opening a designated bank account or as elaborate as establishing a trust. Consider diverting spending from even one small ongoing expense in your budget for charitable causes. As your children age, this act can demonstrate to them how one relatively small personal sacrifice can add up to a big contribution in the future.

Early elementary years

3 Encourage children to donate to charity.

As your children get older, they can begin to make donations themselves. Clothing is a perfect example, given how quickly children grow out of one size into another. As they outgrow their gently used or new clothes, encourage them to decide which items are suitable to donate. Let them put the bag together and bring it to the donation center with you. You can take the same approach with toys that your children are no longer interested in. In addition, don't shy away from donating gifts your children have received that you know they won't ever use or wear. Why not let someone who will enjoy those items use them?

This is also the age when children can join in charitable activities within school, scouting or religious groups. It can be tempting to simply make a monetary donation when these groups reach out, but your children will learn more about

giving if you take time with them to participate. For example, if you get a call to donate non-perishables to a food pantry, make a short visit to a local food store with your kids to choose items. Alternatively, allow them to rummage through your pantry for potential donations.

4 Use a save/share/spend jar system

Once your children start earning their own money, either from gifts, an allowance or earnings, show them how to divide their money up for specific needs. This teaches them financial responsibility and sets the foundation for later in life when they will need to manage their money. Here's how it works:

Save jar: This is money set aside for the long term. For children, it can be used to buy an expensive toy, their first cellphone or a new bicycle. As adults, this translates into traditional savings or retirement investing, such as IRA contributions.

Share jar: This jar is designated for charitable causes. Children can take money from it when the family is making any kind of cash donation or purchasing items to be contributed. It becomes the source for a variety of philanthropic endeavours over the years.

Spend jar: These funds cover day-to-day expenses. For children, this might include a portion of their lunch money or perhaps a small

contribution to a special family dinner. For adults, this money supports lifestyle needs.

Eventually, children can learn how to use a budget to designate how much money goes into each jar, and then how the jars relate to actual saving and investing accounts at financial institutions.

Older elementary and middle school kids

5 Allow children to direct a portion of the family's charitable gifts

At this point, your children may be very aware of the charities you support as a family. Consider sharing more details with them about the amounts you typically donate and how you distribute them. This is a great opportunity for you to learn what's important to your children and how they would like to help. In turn, they learn the responsibility of helping others more directly and see the effect of charitable donations. Finally, it encourages them to understand how the funds are used by the recipients, whether you give to an organization or an individual.

Middle school and older

6 Allow kids to propose charities for the family to support

This is the time for your children to learn how to research and choose a worthwhile cause. You can even ask them to submit a formal proposal to you or give a presentation about the charities they like. A good age to start this is between 10 and 12. Encourage them to research organizations online, even if they are already familiar with the charity. If the organization is local, make some time to visit as a family and see firsthand what the group does. Then, discuss the pros and cons of each to help determine which charities to support.

Next, get the children involved with making the actual donation. Although it's convenient to simply transfer funds online, if you do, you'll miss out on the most gratifying step in the process – seeing the impact of the donation for the recipient. When appropriate, deliver your donation in person. This moment is often the most inspirational part of the giving process and helps encourage future giving.

Teaching children tax advantages of charitable giving

If you itemize deductions on your tax return, you may be eligible to take a tax deduction for certain donations. As your children get older, be sure to teach them about this added benefit of giving and about consulting with a tax advisor to determine the most tax-efficient options for your family.

Qualified 501(c)(3) organizations:

- Cash donations are deductible (changed under TCJA) up to 60% of adjusted gross income (AGI) and includes cash gift to donor advised funds.
- Temporary adjustments under CARES Act:
  - For 2020 only, cash contributions to qualified public charities, are deductible up to 100% of AGI and
  - For 2020 only, taxpayers who do not itemize their deductions, are allowed a one time "above the line" deduction for gifts made to a qualified charity ($300 single; $600 married filing joint)
- Noncash donations deductible up to 30% of AGI.

Final thoughts

Importantly, these six steps create habits that can help define how your children will steward their time and wealth as they mature. For example, they're likely to continue volunteering throughout their lives if they start young. Likewise, they'll see lifelong benefits to learning how to manage money in a way that lets them achieve their goals while also helping others. Finally, researching charities and presenting options to the family will help your kids gain skills that will be useful later.

Ask your BMO financial professional for information on strategies for charitable giving that may be appropriate for your family.

Ensuring a seamless transfer of wealth with an estate plan

Estate planning can help with preserving wealth for future generations.

Having a well-organized estate plan matters when creating a financial legacy is the goal. But the actual work of creating an estate plan – from determining how assets are to be divided to managing the tax implications of transferring wealth – is too often neglected. The result? The people you want to pass your wealth on to may be unprepared to receive it.

The good news is that creating an estate plan is easier than you might think. It begins with understanding which tools you need. A will is the cornerstone of a solid estate plan, but you may also need a trust, life insurance and power of attorney documents to round things out. Once

you've got your toolbox together, you can work on shaping a financial plan that fits your needs and goals.

Estate planning begins with a Will

A Will is the most basic estate planning document you can have. Writing a Will puts you in control of how your assets are distributed after you die. Without a Will in place—which is called intestacy—your heirs must follow the inheritance rules set down by state law. That means your assets may not go where you want them to.

While it won't allow your loved ones to avoid the probate process, having a Will can help them avoid family conflicts over who's entitled to what after you die. You can also use a Will to name a legal guardian for minor children.

Every state has its own rules for drafting a legal Will. If you're unsure where to start with writing a Will, an estate planning attorney can help. And once you have a Will in place, it's important to keep it up to date. Major life changes, such as getting married or divorced, or having a child can make it necessary to change the terms of your Will.

> "A Will is the only legal document that can ensure that your assets will be distributed to the beneficiaries or heirs of your choice."

What's in a Will?

A Will can be very simple or very complex, depending on the details of your estate. The basic elements of a Will can include:

- The name of the testator (i.e. the person making the will – that's you)
- A revocation of all former Wills and codicils (a supplementary document to a Will which may change, add or delete wording from the original Will)
- Appointment of an executor (aka personal representative in some states) and possibly a trustee
- Authorizations to pay outstanding debts, including taxes, fees, funeral expenses and other administrative expenses before any gift of property can be made
- Appointment of a guardian for dependent children, in terms of their care and upbringing in the event of parents' death
- Funeral instructions regarding funeral arrangements and the disposition of the body
- Instructions for the disposition of property, including digital assets, to the people or organizations that will receive part of your estate

Again, these are all details that a financial professional or estate planning attorney can help you hammer out.

It's also important to point out that for a Will to be valid, it must be properly signed and witnessed. Witness requirements vary from state to state but generally, a witness must be an adult of sound mind who doesn't stand to benefit from the Will's terms in any way.

What a Will can help you do

The primary function of a Will is to create a plan for distributing your assets to your heirs and beneficiaries once you die. Heirs are people who are related to you by blood, such as children, grandchildren or siblings. Beneficiaries are people who may not be related to you but are named in the Will.

There are two ways you can use a Will to distribute assets:

Specific property bequests

You can use a Will to leave specific items to specific heirs or beneficiaries. For example, you

may want to leave your grandmother's china set to your daughter or a set of golf clubs to your son. With a will you can expressly say who gets what when you pass away.

Gifts of cash

You can also use your Will to gift cash. For example, you may want to leave each of your grandchildren $10,000 to help buy a first car or pay for college. When leaving cash gifts, it's helpful to review them every so often to make sure the amounts still reflect your goals.

Preparing a Will is something you can do yourself, thanks to online software programs. But given the importance of making sure your will is accurate and legal, it's important to consider seeking the advice of an attorney or financial professional when drafting one.

What's a trust and does it belong in your estate plan?

A trust is a more advanced estate planning tool compared to a will. It's essentially a special way of holding property.

It involves creating a trust document, which specifies which assets you want to leave in the trust. You then name a trustee to manage those assets on behalf of the people or organizations you name as beneficiaries.

A trust, when structured properly, can provide protection from creditors, guide the management and use of your wealth during your lifetime and after death, provide privacy, and minimize estate taxes. Keeping assets in a trust can also keep them out of the probate process, while letting you leave specific instructions on how they should be managed for your beneficiaries.

Revocable and Irrevocable Trusts

There are two main types of trusts you can include in an estate plan: revocable and irrevocable.

A living trust (revocable) is a legal entity that you create while you're alive to own property such as your house, a boat, or investments. Again, property that passes through a living trust is not subject to probate — it doesn't get treated like the property in your will. This means that the transfer of property through a living trust is not held up while the probate process is pending (sometimes up to two years or more).

Instead, the trustee will transfer the assets to the beneficiaries according to your instructions. The transfer can be immediate, or if you want to delay the transfer, you can direct that the trustee holds the assets until some specific time. For example, when leaving assets to a child you may want them to reach a certain age or get married as a condition of the transfer.

Living trusts are attractive because they are revocable, meaning you can change the trust terms or even dissolve it during your lifetime. Living trusts are also private, since unlike a will, a living trust is not part of the public record. No one can review details of the trust documents unless you allow it. Living trusts can also be used to help you protect and manage your assets if you become incapacitated. If you can no longer handle your own affairs, your trustee (or a successor trustee) steps in and manages your property.

Unlike a living trust, an irrevocable trust can't be changed or dissolved once it has been created. You generally can't remove assets, change beneficiaries, or rewrite any of the terms of the trust. Still, an irrevocable trust is a valuable estate planning tool.

First, you transfer assets into the trust — assets you don't mind losing control over. You may have to pay gift taxes on the value of the property transferred at the time of transfer. Provided that you have given up control of the property, all of the property in the trust, plus all future appreciation on the property, is out of your taxable estate. That means your ultimate estate tax liability may be less, resulting in more passing to your beneficiaries.

Property transferred to your beneficiaries through an irrevocable trust will also avoid probate. As a bonus, property in an irrevocable trust may be protected from your creditors. There are many different kinds of irrevocable trusts. Many have special provisions and are used for special purposes. Some irrevocable trusts hold life insurance policies or personal residences. You can even set up an irrevocable trust to generate income for you.

How to create a trust as part of your estate plan

Similar to a Will, a trust document must be properly drafted and executed to be valid. This means you, as the settlor or grantor, make trust declaration stating your intentions for creating the trust, naming the trustee and beneficiaries and specifying how trust assets should be managed. This declaration can also specify when a trust should be terminated since they can't continue indefinitely.

Choosing a trustee is one of the most important parts of the trust creation process. The trustee should be someone you can rely on to follow the trust terms and manage assets according to your wishes. But beyond that, they should have a solid understanding of financial affairs and have no potential conflicts of interest that could overshadow the beneficiaries' interests. Technically, you could name anyone, including yourself, to act as trustee. But depending on the circumstances, it could make more sense to appoint a corporate entity to fill this role.

There are several advantages to doing so. A corporate trustee is not related to any family members who are beneficiaries, so it's truly independent, with no conflict of interest. Unlike a person, a corporate trustee can't die or become incapacitated, leaving a void in the administration of the trust.

Special trust types

Some trusts are designed for specific purposes. For example, you can create a trust for the benefit of a disabled beneficiary, such as a child or an adult relative with special needs. The main reason for doing so is usually to allow them to remain eligible for government benefits, while still providing them with financial support.

It's also possible to create a trust for a spendthrift beneficiary and structure it to prevent them from spending down assets. If you don't want your adult children squandering your wealth, for instance, you can use this type of trust to manage those assets.

Bottom line, the asset protection and tax planning opportunities associated with a trust make it an attractive estate planning tool. Not to mention, trusts are extremely flexible and can be tailored to fit a variety of needs.

Professional advice is essential when creating a trust, given the level of planning that may be involved and the complexities of ever-changing tax codes. It's helpful to seek out expert advice from a legal and tax professional who deals in Wills and estate matters if you're considering including a trust in your estate plan. BMO is able to start the planning process and collaborate with outside advisors lowering the potential costs associated with estate planning and ensuring a holistic, independent perspective.

Life insurance and estate planning

Life insurance is also something that can be an effective tool for transferring wealth during your lifetime and beyond.

Generally, a life insurance policy can be used to pay off a mortgage or other debts, cover basic living expenses, pay for funeral costs or help a surviving spouse fund college costs for children. A life insurance policy can also be used to pay any estate taxes owed when the policy owner passes away. This is especially important if you

own assets that have already appreciated or will appreciate in value and you don't want your beneficiaries to have to liquidate them to pay estate taxes. The proceeds from a life insurance policy generally aren't taxable for beneficiaries.

Life insurance can also be used in other ways during your lifetime. For example, you could use a life insurance policy to fund a succession plan when passing on a business. The type of policy usually names the business as the beneficiary, but it can allow successors to keep the business running financially.

And with some life insurance policies, you can accumulate cash value that you can borrow against if necessary. While that may seem counter-intuitive to building wealth, it may be reassuring to know the option is there if you need it.

Final thoughts

Estate planning can be a lifelong effort but it's important for ensuring that your wealth is transferred as efficiently and effectively as possible. Having an estate plan in place can offer peace of mind to both you and your heirs and beneficiaries for ensuring a seamless transfer of assets. If you're not sure where to begin with estate planning, get in touch with your BMO financial professional to determine if a Will, trust or life insurance are appropriate for your financial needs and goals.

As a business owner, what's your succession and transition plan?

Retiring from your own business can be difficult after having invested the better part of your working years to achieve success. And, business owners who want to pass on that successful business may be faced with a bigger dilemma of if and how to transfer the wealth they have accumulated through their business. A number of critical factors need to be considered including how they will exit from their business, the valuation of the business, family considerations and expectations and their own retirement plans.

There are several options to exit the business – from selling it to a third party or current management team to transferring it within the family. The value of the business will also impact how much wealth can be transferred or leveraged for retirement. Finally, has the business owner saved enough to fund their retirement or will they have to depend on the sale of their business or continuing to draw income from the operating business to fund it? These considerations require business owners contemplating a future sale or transition to set their vision, goals and exit plan early which is critical for success.

Turning a business into a retirement asset and sharing the wealth

Two questions must be considered when trying to convert an operating business into liquid assets to fund retirement and pass on wealth to the next generation:

- How much is the business worth?
- What methods are available to convert a business into retirement capital?

Before answering these, business owners must first assess whether it's even possible to find a buyer for the business, or to convert the business into retirement funds? If the business operation is heavily reliant on the active involvement of the business owner to generate future cash flows, this may be a barrier to successful succession including the value of the business in the marketplace and the conversion of a business into retirement capital.

Exit options for business owners

Private business owners have a number of exit options, some of which will influence the transfer of wealth:

- selling their business to an unrelated person
- transferring or selling the business to a family member
- winding down and closing the business

Business owners considering a transfer or sale within the family must first determine if any family members are interested in assuming ownership responsibilities, and they must help set expectations with those family members on the future management and/or ownership roles. If the family lacks interest, capability and/or drive, the business owner may require additional flexibility when considering exit options. First and foremost, how they exit their business will impact how they transfer wealth.

Challenges to withdrawing from your business

There can be barriers to exiting a business and these make it crucial to formulate a succession and transition plan well in advance of the eventual transition to successfully retire from a business and transfer wealth. Here are some situations that can put your wealth plans at risk:

- **Business in decline** – Putting personal funds back into a business going through a downturn might help bridge the business to better times. Ongoing personal funding of current operations without a long-term revitalization plan could lead to a situation in which such investment might never be recovered.
- **Selling with vendor financing** – Often, a purchaser of a private business does not have the capital, or the ability to borrow sufficient funds, to pay for it outright. This is often the case for a sale to key employees or non-family management team members. To facilitate a sale, business owners often provide financing, expecting repayment over a number of years. If the business does not succeed under new leadership, or the new owners do not honor their financial commitments, you may be left receiving only a portion of the negotiated sale price.
- **Failure of a family business** – Many business owners planning to pass on their business to the next generation put ownership structures in

place to allow for continued cash flow, often in the form of dividends, to help provide for their own retirement funding needs. Unfortunately, some family businesses do not survive into a second generation, and so you may not receive the ongoing retirement income you expect.

- **Inflexible business structures** – Sometimes, the availability of suitable cash flow from a withdrawal from a business is restricted by previous planning, such as estate freezes that pass on growth in the business to other owners.

Any of these situations could have a negative impact on the ability to exit from the business effectively, retire comfortably, and transfer wealth to the next generation. Planning to exit from a business includes two fundamental components that should be addressed well in advance of the eventual exit: the transfer of ownership and the transition of management. When planning to exit from the business, owners and their families often initially focus on the transfer of ownership which includes tax structuring and related business valuations, legal agreements, among other procedural items. A common area that is often initially overlooked is the transition of management of the business which is a process that requires considerable attention and time. When preparing for exit, it is key for business owners to work "on" the business versus "in" the business ideally building a management team and organization that can operate successfully in their absence in advance of their eventual exit. This serves to de-risk the business, provide flexibility in exit options, and makes the business more appealing to potential buyers.

Valuating a private business

Assessing a reasonable value for a private business is no easy task. Often, there is a limited amount of information available to benchmark a business. When private business owners require a formal valuation of their business, a professional business valuator can be consulted. Often, the result of a formal business valuation is lower than the business owner expected, as the only true value of a business is the amount that a willing and informed buyer will pay. Private businesses can be valued by a number of methods:

- Income approach – applying an appropriate multiple to the value of future cash flows or income;
- Market approach – based on the prices obtained from the sales of similar companies; and
- Asset-based approach – the value of assets in the business, less any liabilities.

> "A common area that is often initially overlooked is the transition of management."

Determining the value of a private business involves a number of factors and is often complex. Simply put, the fair market value of a business is a function of the risk of achieving future cash flows/income. In arriving at the fair market value of a business, a normalized level of sustainable future income is established which requires adjustments to remove expenses of the current business owner not related to operations, non fair market value items, and any anomaly or one-time items. In addition, comparable transactions are scarce given the limited availability of private company transaction disclosures, and it can be challenging to make objective valuations of the physical assets of a business.

How much is enough?

There is no simple answer to the question of how much to save for retirement. Every business owner and their family have their own set of unique circumstances and requirements. The amount of

savings required for a comfortable retirement can depend on a wide variety of factors:

- How much do you intend to spend annually in retirement?
- How much can you save each year leading up to retirement?
- How old are you now and when do you expect to retire?
- How will your longevity affect the sustainability of your savings?
- What other sources of income such as social security benefits, IRAs, 401(k), 403(b), and other government and private employer pensions will be available to you?
- What about future health care costs and taxes on sources of retirement income?

A personal financial plan can help to put all of these individual factors together to determine the right amount of savings to meet retirement goals.

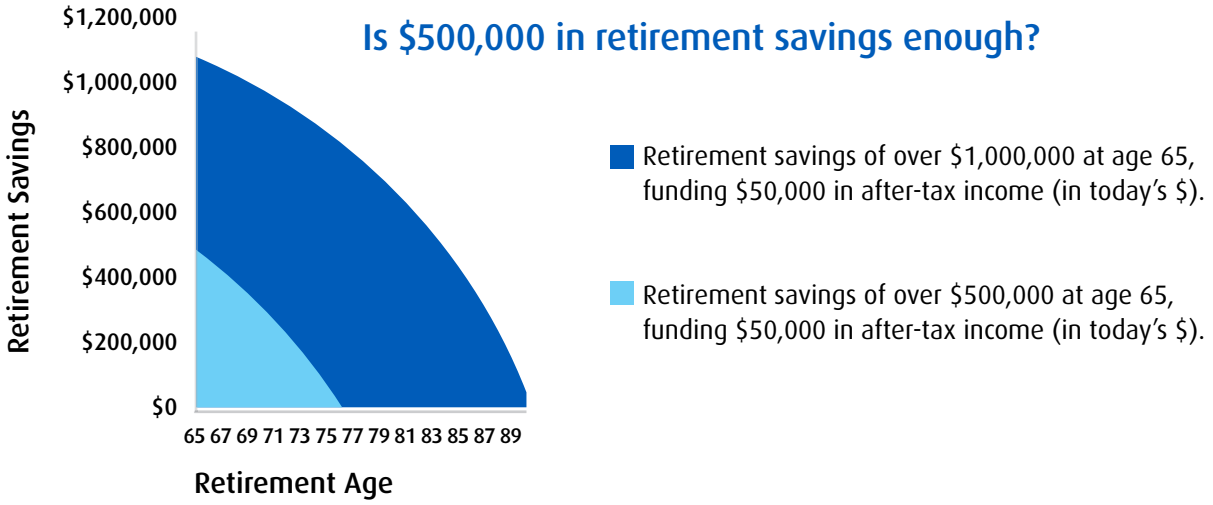
Many business owners may have to rely on the value of their business to supplement their retirement savings to help fund their future retirement income. For example, withdrawing income at a rate of $50,000 per year can cause a $500,000 pool of retirement savings to be depleted in about 12 years (see chart).

For this level of retirement income to be sustainable during a retirement that lasts from age 65 to 90, more than double the initial amount of savings, or almost $1,100,000, will be needed. This sizable difference highlights the importance of being able to depend on the value of your business for your retirement.

Planning for the future

Retirement planning for private business owners can be complex, as it is necessary to have a business succession plan and a personal financial plan focused on retirement that work together well in advance of the eventual transition event. Both of these plans require a personal commitment in order to create an overall retirement plan that can be successfully achieved.

A formal, written business succession plan has many components and its development considers many options. Its purpose is to set an overall process and a time schedule over several years for the business owner's planned withdrawal from the business to ensure a successful transition. Most importantly, it includes both technical concerns, such as legal, accounting, tax and valuation matters



Assumptions: The savings are accumulated in a non-registered investment account with a rate of return of 4% from interest income, taxed at an average tax rate of 20%. The withdrawals of $50,000 in after-tax income in retirement are indexed at 2%. The calculations do not take into consideration any additional sources of income such as government benefits, corporate pension, registered assets or corporate accounts.

and softer interpersonal issues that are of the utmost importance for family members, key employees and other business stakeholders, including ensuring business continuity in the owner's absence. The most successful business succession plans take a number of years to implement and cover both the technical and soft interpersonal issues inclusive of the transition and grooming of management of the business which takes several years depending on the nature of the business operations.

Putting effective business succession and transition, and retirement plans in place

If you are intending to sell your business as part of your retirement plan, there are a number of steps that can be taken in advance, including working with business advisors to de-risk the business to increase commercially transferrable goodwill and the related proceeds of sale, and under the guidance of your taxation professional, to minimize the amount of taxes owed. Eligible investors who invest in small businesses under IRC Section 1202 are able to exclude 100% of capital gains on the sale of qualified small business stock (gross assets not exceeding $50 million) . The exclusion is limited to $10 million or 10 times the adjusted basis of the stock, whichever is greater, per 2015 PATH Act.

> "The most successful business succession plans take a number of years to implement."

An effective retirement plan includes savings outside of the assets of the business that can be used to help fund your retirement. You can diversify your retirement assets by maximizing contributions to your employer's 401(k), taxable investment accounts, tax deferred IRAs, non-taxable Roth IRAs and life insurance.

One additional option may be available for business owners that have buildings, land or other valuable assets as part of their business. Even if the operating business cannot be sold and converted into necessary retirement funds, such assets are more liquid and often are quite valuable. However, the tax implications of the sale of any business assets must be carefully considered.

The importance of owning diversified retirement savings personally and outside of your business cannot be emphasized enough, given the risks and challenges in converting business assets into funds that can be used for retirement and wealth transfer to the next generation.

Final thoughts

A business owner's ability to transfer wealth to the next generation will be highly contingent on their plans for exiting the business. The exit from the business will be highly influenced by how they plan to transition the business, the value of the business, and the retirement plans in place to fund retirement. Finally, all of these considerations will impact the transfer of wealth to the next generation.

Working together with BMO financial professionals who understand the needs and challenges of private business owners and their families can help you make the plans necessary both for your business and your personal situation in parallel in order to achieve a financially stronger future.

Final thoughts

BMO Wealth Management provides services that can help you develop a customized wealth management plan tailored to your lifestyle, business and goals. Our strategies evolve as circumstances change to help deliver on your current and future wealth management needs. Our financial professionals work to understand your needs and to recommend a holistic wealth solution that encompasses your financial situation, your personal and family objectives and your stage in life.

Who do we help?

We serve a broad spectrum of clients, including ultra–high-net-worth and institutional clients, from individuals and families to business owners and entrepreneurs, professionals and executives, and corporations and institutions. We operate in the United States, Canada and in select global markets, including Asia and Europe.

For an individual or family, we can help remove the complexities that accompany wealth. We can also provide guidance on transitioning wealth to your heirs while providing a lasting legacy to future generations.

We aim to simplify the process of transferring wealth and help build a comprehensive wealth management strategy.

Our wealth management approach is based on helping our clients plan, grow, protect and transition their wealth. We work with you to help develop solutions that match your needs.

Plan

A sound wealth plan is a vital component in achieving your current wealth goals and securing the financial future for you and your family.

Grow

Although no one can fully predict the future, our financial professionals will work with you to help you grow your wealth; you can also use our self-directed services to develop your own solutions.

Protect

The careful balance of risk and reward is one of the primary benefits of professional wealth management, helping to protect your portfolio from market volatility.

Transition

We will work with you and your family to put strategies in place to prepare for life changes and help to make unexpected transitions as smooth as possible.

BMO Wealth Management publications

BMO Wealth Management publishes a variety of financial, retirement, tax and estate articles that provide insights and strategies around wealth planning. Speak with your BMO financial professional about other BMO Wealth Management publications that can help you make sound decisions for a better financial future.

[1] The "Greater" Wealth transfer, Accenture, June 2012.
[2] The Great Wealth Transfer, Cerulli, 2019.
[3] Mortality in the United States 2018, CDC, January 2020.
[4] Millennials overtake Baby Boomers as America's largest generation, Pew Research, 2020.

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