

Intergenerational Planning: Rethinking Lump-Sum Inheritances to the Wayward Child

Handicapped balance sheets seemingly plague everyone from our largest financial institutions to the lowest-income individuals and families. It's no secret that this economic crisis was largely built on people's poor spending patterns, facilitated by the easy availability of borrowed cash (primarily through home loans) to provide for goods and services otherwise not available except through personal savings. Lessons to be learned from our current crisis can be directly applied to improving the distribution of assets to our financially challenged children or heirs.

There is no question that the prudent management of cash flows is the cornerstone necessary for any individual to build or sustain wealth. And it is no coincidence that the poor management of cash flows is the very means that will destroy it. Recently Americans have had a history of poor cash flow management as measured by inadequate savings and high levels of household debt. Anyone with good income can accumulate assets by borrowing to buy cars, boats, homes, etc., and so possess the appearance of wealth without having the true substance, "equity."

The wealth development process has never really changed: prudent cash flow management that enables savings, savings that enable equity growth, and equity growth that culminates in financial independence. Many of our children understand, yet struggle with implementing, this relatively simple concept. For them, the short-sighted but powerful "buy now pay later" force is much stronger than its longer-term, albeit less appealing, "pay (save) now buy later" cousin. The fear is that until the financially challenged understand the interplay of cash flow management to wealth and can demonstrate the discipline to execute it; the temptations of lump-sum inheritances are overwhelming and should be avoided. Would you leave a large plate of cookies alongside a toddler's dinner plate and ask him to make the right choice? Of course not, until the child understands the long-term health risks of a diet high in sugar or the benefits of a well-balanced nutritional regimen, it would be irresponsible to place that plate of cookies in front of him for dinner.

Similarly, how you structure the distribution of your assets can unintentionally hurt the heirs of your estate. When adult children are involved, leaving assets in equal lump-sum shares is still a common practice in most estate plans today. But, this "one size fits all" approach has serious flaws. If your beneficiaries do not manage their personal finances very well, they may be that much less capable of managing larger sums received as an inheritance. Therefore, if the goal is the long-term success of your children's finances, it is imperative to first consider the financial abilities of each child independently and cater a distribution method that is best suited for each of them.

One way to address this is to recognize that spending behavior is not easily changed. Rather than leaving a lump-sum amount, consider an income stream to such individuals as a more

responsible distribution of your wealth. The good news is, if your beneficiary develops a better sense of personal finance at some point, he (or she) still has the opportunity to invest that income stream to help accelerate and build his own wealth base.

The benefits of income streams over lump-sum dollars to the financially challenged are not hard to see. Income streams, like a paycheck, generally provide for lifestyle expenses to cover mortgage payments, food, dining and similar everyday expenses. Since the availability of assets comes in reliable monthly doses, the stream will serve to provide a structured access to money without the temptations that come with a lump-sum distribution.

By contrast, large dollar assets cater themselves to large ticket purchases (cars, boats, etc.), risky business ventures and increased susceptibility to con artists. Remember, the very knowledge and behaviors that kept you and your assets out of trouble may not be possessed by your beneficiaries, especially if they have a history of poor financial choices.

Depending on the size of the estate, this income-oriented distribution strategy can be facilitated in different ways. Larger estates may benefit from the use of a properly structured trust and professional trustees to manage it. Alternatively, especially for smaller levels of assets, something as simple as an immediate annuity from one or more highly rated insurers could do the job adequately (a “period certain” annuity is suggested if the beneficiary has a spouse or children but consult an insurance agent first for all options). Another key benefit is that the structure of a trust or the state of residence of an annuity could provide your beneficiaries with an important level of asset protection from creditors as well (review your state’s applicable laws or consult a qualified attorney for more detail).

Those who build wealth generally have the best skill set to maintain it. Imagine what this nation would be like if Social Security was given as a lump-sum dollar amount rather than a lifetime income stream. Any such proposal would be shot down before it even left the ground. On the same note, think twice about leaving large lump-sum inheritances to your financially struggling children (heirs). Better yet, teach them your own financial discipline to give them the skill set that they and society in general so desperately need.

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