

What if the River Moved? The Real Challenge of Estate Planning

Not very long ago, a colleague sent me some photos of the devastation Hurricane Mitch visited upon Honduras in 2008. You might call them “before and after” pictures. While there were certainly some terrible scenes, the one that struck me was absolutely stunning. It showed a beautiful river valley on a gorgeous sunny day. The sky was blue, the water even bluer and the landscape a verdant green. Only one thing was out of place. The Choluteca River Bridge that had once crossed the river was now stranded on the shore. When the bridge opened, it was considered an engineering marvel. Now it was, quite literally, irrelevant; the river had moved.

I thought this was a good metaphor for the challenges wealthy families face when trying to protect their wealth and create sustainability that will last for many generations to come. Estate planning is expensive, time-consuming and complex. The best experts on the team work very hard to craft thoughtful and structurally sound solutions (just like the Japanese engineers that built that bridge), but all the expertise in the world is not enough to prevent unforeseen consequences from derailing a plan and the result can be devastating for a family.

A Blueprint isn't Enough

We all *know* that having an estate plan is a good idea, but few of us have a grasp of exactly what that means. Time and again, I have met highly successful, sophisticated and wealthy individuals who believe that a will and perhaps some type of trust are sufficient to protect their assets and accomplish the transition of their life's work to their cherished family members. Certainly these are the essential starting points, but a surprising number of people have given little or no thought to how to prepare their families to handle the challenges created by their wealth that will inevitably arise after they are gone. At no time has this dilemma been more obvious to us all than the time we are currently living in. Our economy has suffered from a financial crisis that was largely unforeseen by the so-called “experts” and has had worldwide impact. The deep, unexpected and unprecedented worldwide recession that followed has created major financial stresses that have caused everyone to rethink the underlying fundamentals regarding their wealth. Business owners are operating in a new environment where credit is extremely tight and difficult decisions need to be made. If children have taken over businesses that prospered during the good times, they may not be prepared to handle these kinds of challenges.

Recently I visited with a very wealthy man in his early 80's who had been a successful and respected businessman for many years. We had a far-ranging conversation about his business and financial affairs and he seemed quite satisfied with the way he, his attorney and his accountant had arranged things. At one point, he had an assistant bring in the file with all of his estate planning documents. It included a will, some trusts and a few other things. The strange thing was that not one of those documents was in final form; each and every one of them was marked “draft.” Additionally, some of the elements he expected to find in that folder had never even been created, let alone communicated to the family members that would have to manage his business interests after he was gone.

This man's bridge – his estate plan – was still on the drawing board (and the blueprints weren't even final). In the meantime, the river might have moved, his goals in crossing it might have changed and the engineers who were helping him build the bridge – his attorney and his accountant – might have gone on to other things. Or, more likely, they simply grew frustrated at his delays in responding to them. This is not an unusual situation; most estate planning attorneys will acknowledge that only about fifty per cent of the strategies they recommend to their wealthy clients ever get implemented! The clients are not getting bad advice. They simply lack a clear vision for what they care about, what they want to see happen and how to make that a reality, so they become confused and uncomfortable with the process. It's almost as if the advisors speak one language and the clients another. This leads to incomplete plans that often become irrelevant soon after they are put in place. Worse, the wealth creators have no clear idea of how to begin to share their planning with their adult children. Wouldn't it be so much better for everyone concerned if estate planning led to increased personal well being, family harmony and business prosperity?

Let's review the four most common approaches to estate planning to understand how we arrived at the state we're in and what we can do about it.

Event-Driven Estate Planning

Many estate planning attorneys that I know have talked about a common pattern: they frequently receive calls from individuals or couples wanting to put together a will or trust in a hurry. Their sense of urgency and motivation to act is generally driven by some life event – such as a chronic illness, sudden life-threatening episode they or people they know have experienced

or perhaps an upcoming trip. Clients who are facing these circumstances typically have little patience for exploring their goals, involving their heirs in the discussion, or doing anything that does not absolutely need to be done. Something has jolted them into deciding they need a bridge built.

This approach, which I term *Event-Driven Planning*, can yield an acceptable result -- minimizing the estate's tax liabilities and avoiding a costly and time-consuming trip through probate – but it can have some unintended negative consequences, both in family relationships that suffer and missed opportunities that are lost. A highly successful client surprised me during a meeting in her beautiful Upper East Side apartment by breaking down in tears when her mother's estate was mentioned. It seems that her mother, after an illness, had put a basic estate plan in place that left all of her major assets to my client's brother and nothing to my client. Even though my client realized that her mother did this because her brother needed the money and she didn't, she was hurt, felt that her mother had “disinherited” her, and resented her brother. If there had been time for a discussion between mother and daughter, my client would have understood her mother's motivations and felt like she was part of the solution.

Two other clients – brother and sister – spent a great deal of time worrying about their parents, who worked hard all their lives and appeared to have modest means. My clients were stressed about how they would pay for long-term care or nursing homes for their parents. While we were working together, both parents died, leaving unexpected multi-million dollar estates. Their wills had been created quickly during an illness. As a result, not only did my clients worry for nothing, but more of the estate was lost to taxes than would have been the case with a more careful planning process.

An event-driven estate plan is like coming up to the river's edge and deciding to cross. Grabbing on to any boat moored at the shore will do the job, but there is often a better way.

Expert-Driven Estate Planning

Most financially successful individuals have heard their CPA or family attorney say, “You really ought to do some estate planning.” The major idea behind this suggestion is usually the same: to minimize tax liabilities. Each expert – attorney, CPA, insurance agent, investment advisor, etc. – executes a piece of the plan, with very little collaboration between them – they seem to operate in *silos*. There is generally no time or effort given to the development of a vision for the family, goals are rarely stated, let alone written down and communicated to other family members, and complex structures are used which may be effective for tax-purposes but are not fully understood or truly maximized. You might say the tax tail wags the wealth dog in this instance, since taxation is the primary focus.

Expert-driven estate plans deliver tax benefits but so often important opportunities are lost or overlooked along the way. For example, many wealthy families are utilizing Grantor Retained Annuity Trusts (GRATS) as a means to push high growth assets out of their estates at a minimal cost in gift taxes. GRATs are particularly attractive now due to low interest rates, and so, many Trust and Estate attorneys are advising clients to take advantage of the current interest rate structure by establishing GRATs. This strategy enables a Grantor to transfer an asset such as stock, a business interest or an interest in real estate into a trust that runs for a specified term of years. During the term of the trust, the grantor receives income payments from the trust. At the end of the term, the assets in the trust are transferred to the beneficiaries. The amount of the taxable gift is determined at the beginning of the trust term and is based upon the current value, annual payout, length of the term of the trust and the Applicable Federal Rate. Presumably the assets contributed to the GRAT will have appreciated in value during the period of time they were held in trust and so the ending value that ends up *outside* the taxable estate of the Grantor (or in the “hands” of someone else) is substantially greater than the amount of the taxable gift. Sounds like a great tax saving strategy – and it often is, but it can have unintended consequences. I had a conversation a few years ago with new clients (the husband was a successful real estate developer) that points up the pitfalls of using this type of expert-driven strategy in isolation. When the couple came to me they had some strategy-planning in place, including a number of GRATs that held partial interests in some of the real estate deals the husband had structured. The husband was a graduate of HBS and his wife was a HLS grad, and they joked that they were smart enough to understand what a GRAT did if they re-read the document, but they really weren't sure why they had used this technique, other than to save taxes. In the period of time since the GRATs had begun, the real estate interests had substantially increased in value, so the technique was working beautifully *from a tax-saving point of view*, but an unforeseen consequence of the planning was the fact that their two children (unmarried, in their early 20's, and still struggling to find their own identities) would become multi-millionaires as a result of being the remainder beneficiaries of the trusts. No thought had been given at the time the GRATs were established to the fact that this *GIFT* of substantial wealth would also carry a burden – and no work had been done to prepare the children for the challenges of living with the burden.

An expert-driven estate plan is like being told by an engineer that you need a bridge. There is no real understanding of what the bridge can do for you, little detailed discussion of placement and very little context of how the bridge will really be used.

Process-Driven Estate Planning

Because of the shortcomings in the more traditional event- and expert-driven estate planning approaches, some very creative organizations have created processes that are intended to add

depth. These systems help the person initiating the estate plan to focus on goals to some degree, usually by means of a detailed questionnaire. The process also tends to recognize some role for family members who are likely to be impacted – including the spouse and the ultimate heirs.

The issue with process-driven estate planning is that it can be used out-of-the box by a professional who may not fully be versed in it. This can result in a “one-size-fits-all” approach that is only marginally better than event- or expert-driven estate planning. The opportunity to be a “50-year family” or a “100-year family” is usually lost. Families that go through process-driven planning could be just as vulnerable to the old saying “dust to dust in three generations” (statistics show that 70% of estate plans fail by the third generation, separating heirs from their wealth). Because the emphasis is on the process, there is little deep connection to the plan – or understanding of what it can do.

I am reminded of a family that spent a great deal of time putting a very complex plan in place. Dad was a very busy executive active well into his eighties. When the plan was first designed, a family meeting was held and the children were told about the plan’s elements. Even the spouses were invited to attend. Everyone was thrilled that such good planning and progress had been made while Mom and Dad were both alive. But as the years progressed, Dad found that he would rather spend his time pursuing his business passions. Slowly the lines of communications with family members and the sense of shared purpose were replaced by compliance issues, tax planning and the stuff of day-to-day financial administration. Little time, effort or expense was allocated to growth of the family and further definition of their purpose. The result was that many great possibilities were lost and opportunities were missed to deepen family ties and mentor the younger generation and help to clearly define their roles within the family system. That plan will most likely fail as a result.

A process-driven estate plan is like focusing on building the bridge. The immediate purpose of each element that supports the bridge is clear and there is some consideration of how the bridge will be used, but there is not a lot of reference to the wider landscape.

Purpose-Driven Estate Planning

In my experience, the best way to approach estate planning is to drive it with a clear purpose and to get every family member to buy into the process and have a designated role. Purpose-driven estate planning starts with a client retreat. Like a business retreat, this has very clear goals:

- To determine what the family stands for and articulate its special mission and vision (the family “brand”).
- To develop a detailed plan for how the family will utilize, preserve and grow its resources – and what activities it will undertake with them (the “business plan”).

- To get everyone’s buy-in and assign appropriate roles to family members – now and into the future (the “game plan”).
- To consider the design and implementation of a Family Council.

Done properly, this type of planning will help client families use their resources to help their family members flourish for many generations to come. But like a business, it has to approach estate planning with a purpose. This can be extremely powerful on a number of levels.

One client I worked with had married into a family with four adolescent and young adult children. When her husband died some years later, leaving her most of his wealth for her lifetime, with the hope that she would mentor his children and teach them to be good stewards of the wealth, she was understandably nervous. She was afraid that the now-grown children and their families would be angry about the financial arrangements, reject her and perhaps even instigate lawsuits to overturn their father’s instructions. In order to carry out his wishes and maintain and build harmony in the father’s absence, we had to do some serious work at the human level that was not about money. My client and I decided on a Family Meeting to build the foundation for ongoing communication about the family’s purpose. I introduced her to the “Treasure Box” approach. She selected beautiful boxes for each member of the family. The real surprise came when they opened them. Every one contained a handwritten note that she wrote to the recipient recounting an event in their shared history. She won them over that day through something that was emotional, impactful and experiential. Family members still enjoy close interpersonal relations, and the family’s overall financial position is still extremely strong. They have continued the practice of an annual meeting to strengthen their ties, further develop their shared charitable vision and keep lines of communication open. Part of the goal of the family is to aid each member in fully realizing their particular passion and so we have used assessment tools designed to help them identify and work towards their personal goals. The “Family Bank” has made loans to family members who wanted to begin or improve their businesses, after submission of their business plans. Governance issues have been discussed and some changes have been made where necessary. The family’s Private Foundation has been a wonderful teaching tool for the younger generations, in addition to providing important income, estate tax and philanthropic benefits. Understanding how to act as a Board Member, review of annual financial statements, development of the family’s charitable mission statement, portfolio decision-making, review of charitable purposes of applicant donors, presentations to adult family members by the younger generation – all are possible mentoring opportunities present with the use of a Private Foundation.

A Purpose Driven Plan is a flexible structure, designed to “bear up” under the stresses created by changes in the family and its finances as the years go by, but also one that takes full advantage of the opportunities that wealth brings to families.

The purpose-driven estate plan is like a journey. It starts with understanding the entire landscape on both sides of the river, knowing where you want to cross, why you want to cross and who will be crossing with you. In addition, the purpose-driven plan sets in place tools and systems for the family to use to create better communication and shared vision. Finally, the purpose-driven plan incorporates systematic mentoring of younger family members to prepare them for the unexpected events that are sure to come in the future – such as the river changing its course.

It Matters How You Build It

A family’s true wealth is comprised of its financial, human and intellectual capital, as well as their social capital. The goal of estate planning should be the development of a plan that

preserves and transfers this *true wealth* in ways that sustains it for multiple generations into the future, contributing to the growth and fulfillment of family members yet unborn.

Remember that bridge? The work is in the river. Make no mistake about it - building an estate plan that accomplishes these goals takes a fair amount of work, dedication and commitment on the part of the family members and their team of advisors. Building it to do what you really want it to do – and so that it is more likely to hold up to the unexpected – takes even more focus and persistence. In the long-run, though, the rate of return is well worth it. And nothing – not even something as significant as a river that changes its course – will prevent you from achieving your purpose.



Kathleen C. Peer, JD, CFP® helps families in business thrive. She combines legal and financial expertise with a profound appreciation for individual family members and the contributions each can make to family enterprises. Kathy brings family members together to create shared visions – and to acknowledge and support each other in individual ones. Her work helps families be purposeful about their enterprises and their affluence. Kathy coordinates the work of various trusted advisors to create a seamless, integrated plan that goes far beyond “death and taxes” to embrace family history, destiny and potential. A second-generation attorney, Kathy divides her time between Stuyvesant, New York and New York City.

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