Multi-Generational Planning

By Amelia Renkert-Thomas, JD, LLM

Now that many states permit trusts to exist in perpetuity, more families are implementing multi-generational dynasty trusts. Families have ready access to extensive information about sophisticated planning techniques, but less guidance exists on fundamental questions about planning for the very long term, such as:

- The denominator problem: What will the family look like in 50, 100, 150 years and beyond?
- Choosing the right fiduciaries: Who will serve as trustee, and how will successors be chosen?
- Avoiding unnecessary complexity: How can the family ensure the trust will be flexible and robust enough to meet the needs of descendants hundreds of years in the future?
- Will the descendants become “trust fund babies”?

The Denominator Problem

For a family just embarking on multi-generational wealth planning, questions usually center on how best to pass wealth to children. When families amass significant wealth—enough to provide at least a financial cushion for two or more generations—they begin to think about how to benefit descendants further down the line. The following are two obvious points, each with less obvious implications.

The first obvious point. Each successive generation will almost certainly have more individuals than the previous one, so the family wealth will become divided into successively smaller portions. It is the rare family that has only one descendant; each child typically has multiple children, creating new branches to the family tree. Assuming a classic intergenerational distribution—parent’s assets are divided equally among children—each member of the next generation is going to inherit a fraction of the assets the parent inherited. This, of course, is not new. The problem is that the next generation’s sense of appropriate lifestyle and spending is learned, in many ways subconsciously, at the knee of someone with significantly greater wealth than the next-generation member likely will possess, and few next-generation family members really are prepared, psychologically and practically, to downsize. The key, then, is that the next generation’s sense of appropriate spending will be more widely dispersed than the prior generation—in age, capabilities, geographic location, marital status, number of children. I once helped a client who had created a substantial fortune envision the beneficiaries of that wealth 50 years hence. The client had four children between the ages of 20 and 30. We made some assumptions and then extrapolated the family tree: 50 years in the future, four generations would be alive, representing four branches of the family. G3 members would range in age from 28 to 48; G4 members would range in age from 1 to 26 (with more to come). The smallest of the four branches—the unmarried child—consisted of one person. The largest branch consisted of four generations and 16 people, ages 1 to 76.

The second obvious point. As numbers rise within each generation, so does heterogeneity. When the senior generation begins to plan, the children—their personalities, skills, talents, baggage, fears—generally are known. The grandchildren are all about possibility, and the great-grandchildren are often just a gleam in the family’s collective eye. For a family undertaking multi-generational planning, it’s worth keeping in mind that successive generations won’t look much like their first-generation predecessor.

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This analysis led us to draw the following conclusions about the consequences of the denominator problem:

- Sooner or later, the beneficiary group will grow faster than the family wealth.
- Separate branches will grow at very different rates.
- Individual family members will inherit wealth (or become primary beneficiaries of family trusts) at very different ages.
- Diversity of ages and viewpoints will increase with each successive generation.
- With each generation, those who manage or oversee the family wealth will become a smaller minority and likely will have to deal with a less-familiar, potentially more-demanding group.

We also posited the following actions that could minimize the effects of the denominator problem:

- Wealth holding structures must be robust but flexible.
- Transparency and flow of information will be essential to fostering effective collective decision-making.
- Education and training for family members is a must.
- The family must develop clear and accepted processes for decision-making and conflict resolution.
Choosing the Right Fiduciaries

Who owns the assets in a trust? Most families that create a trust assume that “the family” or perhaps “the beneficiaries” own the assets, but in fact the trustee is the legal owner under common law. A trust can be an extremely effective planning tool that offers tax savings, asset protection benefits, and professional management of complex assets. But choosing the wrong trustee—i.e., putting the wrong person or group in charge of the assets—can put all those benefits at risk.

What does a trustee do? A trustee is responsible for investing trust property, administering the trust, and making distributions, all in accordance with the terms of the trust. A good trustee understands the scope and responsibilities of the role and takes those responsibilities seriously. A good trustee:

- understands the grantor’s intent in creating the trust;
- knows the beneficiaries and monitors their needs, other assets, and sources of income;
- if not an investment expert, has the knowledge and experience to direct and monitor investment professionals (and/or, in the case of business-owning trusts, to appoint knowledgeable business advisors); and
- has the administrative capability (in-house or outsourced) to manage trust accounting, reporting, and compliance.

Trustee candidates come in the following forms:

- **Individuals** often provide more personalized service than corporate trustees. A knowledgeable family friend or advisor may bring a better understanding of the grantor’s intent and the beneficiaries’ needs, but may lack comprehensive investment knowledge or have limited access to investment and administrative resources.

- **Corporate trustees** typically offer a full package of services; many have served wealthy families for multiple generations and have developed strong teams. However, corporate reshuffling, promotions, and career transitions often mean that team members may change frequently. Families should be aware that some corporate trustees will not serve as fiduciary of a trust that holds interests in an operating business or other nonliquid assets.

  **Private trust companies** offer a family the opportunity to create its own custom-designed corporate trustee, which may be of significant value when trust assets include a substantial operating business or other unusual and nonliquid assets. Families should be aware, however, that a private trust company requires a substantial and ongoing investment in legal, accounting, and administrative structure and should be undertaken only with substantial due diligence and planning.

Families sometimes invest considerable time in choosing a trustee without giving much thought to successor trustees. Typically, the issue of successors arises many years after the trust’s creation. How can a family ensure that the successor will be qualified and capable? And what provisions can be included to protect against an incompetent, ineffective, or downright dishonest trustee? The least-effective option is to name successor trustees in the document, because the successor may not be alive or capable of serving effectively when the time comes. Almost as ineffective is to give the trustee the right to name a successor, a practice that can perpetuate self-interested trustees. Giving the beneficiaries of the trust the power to name the trustee can work in the case of capable, adult beneficiaries, but it will not be so effective if beneficiaries are young, legally incompetent, disinterested, or otherwise incapable of exercising the power effectively.

A better option for trustee succession may be to name a protector for the trust. A protector may be granted a number of powers under the trust but the most common is the power to remove and replace the trustee. With this power, the protector serves as monitor and overseer of the trustee, providing an important check-and-balance to the trustee’s power. The protector is typically a knowledgeable individual who knows the family well and brings applicable professional expertise to the role. For larger trusts, or trusts holding complex assets such as interests in one or more closely held businesses, appointing a committee to the role of protector can be especially powerful; while an individual protector might become incapacitated or inattentive, a properly constituted committee should be able to exercise its responsibilities seamlessly for the duration of the trust. The committee serving as protector would have its own set of rules and procedures specifying its composition, responsibilities, decision-making procedures, and succession provisions.

Avoiding Unnecessary Complexity

I have seen clients become mesmerized by the intricacies of complex planning structures—multiple trusts, holding companies, interlocking entities, tiered partnerships, freeze or preferred return structures. They focus on the detail but lose sight of the big picture, which is transferring family wealth in ways that will maximize the family’s long-term benefit. In families’ defense, it is easy to get swept up in the benefits of complex techniques and hard to envision exactly how the structure will operate—and what resources will be required to maintain it—in the future. Complexity brings with it potential cost in the following forms:

1. The more-complex structure has more moving parts and more opportunities for glitches, conflicts, and issues that will require attention (at a price) in the future. For example, just moving cash through a holding structure to fund a new investment or make a distribution for taxes can create tax and legal issues, particularly if the cash is needed quickly and is in the “wrong” entity.
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2. A complex structure is more expensive to administer and requires greater and more-sophisticated ongoing resources. Administrative staff, accountants, investment advisors, bookkeepers, legal counsel, insurance advisors, etc. all need to understand the structure and its purpose, then work cooperatively to keep it operating smoothly. Families often are distressed when they see bills arising from conversations among advisors (sometimes without any family participation), yet such conversations are essential to running a complex structure.

3. Even if all parties understand the structure and its purposes at inception, memories fade, advisors come and go, circumstances and laws change, and the structure that once was a perfect example of form following function can seem more like a Rube Goldberg creation. Family members who don’t understand the purpose and operation of a planning structure are more likely to challenge its validity in the future.

So is the answer to throw out complex, sophisticated planning? No. The answer is to recognize that the extra return derived from the complexity—in terms of increased financial return, administrative cost and time, and the risk of future obsolescence. Families need to talk carefully about their wealth transfer goals—and the resources they are willing to commit to achieve those goals—long before they instruct lawyers to draw up documents. They should talk with other families who have implemented similar planning about their experiences, and they should talk with their team of trusted advisors about the long-term ramifications of the planning. The point is to utilize complexity when it adds value, but with eyes wide-open.

Will Descendants become ‘Trust Fund Babies’?

Warren Buffett’s widely publicized decision to transfer most of his wealth to charitable foundations rather than to his children and grandchildren has sparked discussion about whether inherited wealth might be a curse rather than a blessing. Inherited wealth cripples motivation, saps the will to work, and leads heirs to a life of unhappy indolence, or so this story goes. Rather than becoming independent contributors, heirs regress until, like infants, they become completely dependent upon their inheritances.

But is it true that wealth invariably cripples motivation? Clearly not. Some wealthy heirs do lose their way, but other heirs use their wealth as a critical tool to build rewarding lives and create value for themselves and others.

So, are there steps that families can take to reduce the risk that their children and grandchildren will become trust fund babies?

Perhaps the best way to inoculate the next generation is to set a good example. If parents do meaningful work and manage money wisely, if the family expectation is that all children will study hard, obtain the best possible educations, get good jobs, and live well within their means, then children are more likely to gain confidence and a sense of self-worth from work rather than spending. Children also need to understand the potential consequences of the denominator problem: Unless they, too, commit to sustaining and building the family’s wealth, the inexorable increase in beneficiaries at each generation will dissipate even the biggest fortune.

How wealth is transferred also makes a difference. Trying to protect wealth at all costs—by keeping the next generation in the dark about family wealth, failing to educate them in the basics of stewardship and wealth management, creating trusts with elaborate control provisions—generally backfires. Beneficiaries who sense that they aren’t trusted are much more likely to display the very behavior the grantor feared most. Beneficiaries who understand the uses and purposes of family wealth, who see themselves as responsible stewards with an important role to play in preserving and growing wealth, are more likely to carry on the family’s legacy.

Conclusion

Families considering multi-generational planning need to look beyond the documents and think about the long-term implications of wealth transfer for future generations of family members. Thinking about what the family may look like in the future, choosing capable fiduciaries and a durable method for selecting their successors, avoiding unnecessary complexity, and empowering beneficiaries to play a leading part in the management of the family’s legacy can make the difference between success and failure of the planning over generations.

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