

Holding Back the Inheritance

By TATIANA SERAFIN

Fearing that their children might blow their legacies, more parents are shunning lump-sum payments to kids turning 21. How to set up a smart trust.

For children of the rich, the gravy train is starting to take a little longer to reach the station. A growing number of parents are shunning the time-honored practice of handing big inheritances to their children when they turn 21. Instead, they're waiting until the kiddies are in their 30s and 40s, and sometimes crafting trusts that place permanent restrictions on distributions.

It's part of a rising realization among the wealthy that many 20-somethings simply can't handle large sums; they can blow through them at alarming speeds. (See "[Goodbye, Family Fortune](#)," the Penta cover story of Sept. 19.)

In a recent survey by U.S. Trust, Bank of America Private Wealth Management, two-thirds of the respondents were unsure if their children could act responsibly with an inheritance. In addition, 45% said that their children had to be at least 35 to attain the appropriate level of financial maturity.

Although there are no clear rules of thumb on when a child should be handed the money, advisors increasingly are recommending waiting beyond age 21.

"Premature distributions to heirs can have the same effect as the jackpot has on lottery winners," says Paul Tramontano, co-CEO of New York-based Constellation Wealth Advisors. "The money becomes a burden, and your child may not fully develop into the adult you hope to raise. "As a result, more and more parents are using legal structures to keep kids on the straight and narrow.



Thomas Reis for Barron's

Here are some of the most effective moves:

Irrevocable Trusts

It is still common today for parents to transfer assets during their lifetime to their children to reduce the potential estate tax. But more parents are gifting the transferred money into trusts and thus keeping a hand in how distributions of income and principal may be made to their children.

Take the retired Florida couple in their 70s who recently came to Taylor Custis, senior financial planner at Wells Fargo Private Bank, to discuss options for their \$25 million estate. Their only daughter, who's in her 40s, is married to a man a decade younger. They are wary of their son-in-law's getting his hands on her money.

The couple wanted to take advantage of the federal lifetime gift-tax exemption, which allows each spouse to give a total of \$5 million to their children through the end of 2012. But they didn't want their daughter -- or son-in-law -- to have a \$5 million slush fund. So Custis recommended that the money be put in "an irrevocable inter vivos trust." The trust will last their daughter's lifetime. The two trustees -- in this case the mother and an independent trustee -- have the discretion to pay interest and principal, and the assets are protected in case of a divorce.

Revocable Trusts

A testamentary lifetime trust can also be set up via a will. A parent may specify in his or her will when and how the money will be given to a kid, but until the parent dies, he or she reserves the right to change the terms.

Custis met with a Boston-based widow with \$25 million in assets whose 40-year-old daughter previously had a substance-abuse problem, spends freely and has no job or independent financial security. For years, the mother had been giving her daughter an allowance. She finally concluded that the woman shouldn't inherit assets outright. The widow set up a lifetime trust in her will, directing that a professional trustee supervise income payments and distributions of principal.

Adding an "in terrorem clause" can help make a trust airtight, says lawyer Jonathan Mate, a sole practitioner specializing in trusts and estates. Indeed, if unsuccessful in court, an heir suing a trust with such a clause can be designated persona non grata and be blocked from the funds.

Here is what can happen if the trust is not airtight: An entrepreneur died with \$60 million in the bank. He left half the estate to his second wife and the remainder to a foundation -- before this split the estate is to pay out \$1.5 million to each of his four children from his first marriage. Two of the children, unhappy with the second wife's share of the pot, are contesting the will, putting all payouts on hold.

GRATs

A grantor-retained-annuity trust can be used in conjunction with the current \$5 million estate and gift tax exemption for individuals (\$10 million per couple) to save on taxes. See the story on page 34 for latest tax changes. The parent, as grantor, funds the trust with assets for a specific term from two to 10 years. For the designated period, the parent gets an annuity-like stream; the assets pass to the child or children without incurring gift-tax consequences. GRATs are most often used with a single, undiversified holding like a publicly traded single stock concentration. The parent can stipulate that the remaining assets be held in a trust for the benefit of the child.

Intrafamily Loans

With interest rates at record lows, intrafamily loans can be a smart way for parents to assist children with funds while maintaining ultimate control. Lee Garsson, a wealth planner for Citi Private Bank, has seen an increase in these loans. One family client has a child in the construction sector, in which loan rates are high; the Bank of Mom and Pop provided a more favorable rate. The endgame: The child was able to pay off his bank loans with the intrafamily loan, paid less interest on borrowed funds and eventually repaid the loan to his parents.

Education

The most successful estate-planning tool is education, which many parents acknowledge they have failed to provide. Often, children of the rich have no idea how much money is coming their way.

"Families that do well, get the younger generation up to speed before they get money," says Constellation Wealth Advisors' Tramontano. Education should be ongoing. "We advise families to bring their children into meetings at the appropriate age, so they can see how the process works," he adds. "In this way, parents can more clearly communicate their wishes around investment or charitable donations while their children directly listen and learn."

In other words, the kids might start acting like adults. Wouldn't that be something?

Goodbye, Family Fortune

By MICHELLE SLATALLA

Will your kids be prepared for great wealth? What you can do now.

After his mother died, John Mecom Jr. was supposed to make sure her money was preserved for his four children.

Instead, the son of a Texas oil tycoon looted a multi-million dollar trust he was supposed to oversee, a lawsuit alleges. It claims he failed to account for \$536,691 he owed the fund, racked up "general

office and administrative expenses" of more than \$80,000 in one year and sold off nearly a million dollars' worth of his mother's art, antiques and jewelry.

Mecom Jr., who declined through his attorneys to comment for this story, said he was entitled under terms of his mother's will to do anything he wanted with her personal possessions, according to court documents.

But a lawyer who is suing him on behalf of his daughter sees the situation differently. "We think it was theft and that he was just a spoiled brat that was raised by a rich family that probably spent more time making money than they spent taking care of the kids," said James R. Lovell of Lovell & Lyle in Dumas, Texas.



Thomas Reis

More parents are wresting trust funds away from wastrel heirs.

These are the times that try rich men's souls. Even under normal circumstances, the average patriarch lives in fear that "a spoiled brat" who gets his hands on a family fortune will squander the inheritance. But these aren't normal circumstances. First there was the financial crisis of 2008 and the subsequent recession. Now there's the European debt debacle, which threatens to cascade through global banks and the world economy. The U.S. already is facing the real possibility of a new recession; economists put the odds at about 1 in 3. In other words, preserving a fortune is getting harder than ever.

The hysteria among the super-rich is palpable. They're worried their kids and grandchildren will fritter away the money it took forebears lifetimes to earn. They're asking: How do you prevent a child from growing up to be ne'er-do-well? Should you leave a spendthrift heir nothing? Or money with lots of strings attached? And what if a family squabble escalates into an expensive lawsuit?

"Families are saying, 'Oh my God, that last collapse was awful, and now we know there will be another big one, and when it comes it will be as scary as hell,' " says Maria Elena Lagomasino, chief

executive of GenSpring Family Offices, which manages the money of some of America's wealthiest families. "And, 'What if I'm not around to manage the next one? How do I make sure the next generation really has the preparation to get through the crisis?' "

With at least \$41 trillion in private wealth expected to be transferred from one generation to the next in the first half of this century, the stakes are high. As a result, rich families are sending kids to financial boot camps or giving them crash courses in money management at home. They're also crafting sophisticated "beneficiary rescues" to wrest trust funds away from wastrel heirs and hiring psychologists to help them broach the topic of money with kids. ("It's harder than talking to them about sex," one father confides.)

"Kids need education," said Sara Hamilton, chief executive of the Family Office Exchange, which advises ultra-wealthy families. Hamilton also teaches financial skills to 35 or 40 heirs at a time who enroll in a four-day private wealth management course that the University of Chicago offers twice a year (tuition: \$8,950). The course covers the basics -- of investing, tax law, estate planning and philanthropy -- at the behest of parents who, Hamilton says, are "concerned about whether the wealth will disincentivize their kids from leading productive lives. That's the No. 1 concern that drives the education piece."

The good news is that despite all the hand-wringing, there's little evidence yet that family fortunes are taking big hits. Last year, the richest people in the world -- the segment of the population with \$30 million or more -- saw their wealth increase by 11.5%, according to the latest annual World Wealth Report from Capgemini and Merrill Lynch.

Nevertheless, recent history is rife with, well, heir-raising horror stories. In Canada, there's the seemingly endless saga of the drug-abusing daughter of deceased media mogul Pierre Peladeau. Anne-Marie Peladeau sued her brothers -- after they cut off her \$10,800 monthly allowance -- before heading off to a stint in a rehab center named for her family. In California, Korbel Champagne baron Gary Heck and his daughter, Richie Ann Samii -- whom he sued for defaming him on the Internet -- fought in court for three years over more than \$9 million in trust-fund income following her arrest for sexually assaulting two employees. (The father and daughter eventually settled, for an undisclosed sum estimated to be in the millions of dollars.)

The Stages of Wealth

Start educating your child early, and keep at it well into adulthood.

AGE 8: Each week put a small allowance -- \$1 to \$5 in dollar bills -- into an envelope and hand it to your child. Explain that it's up to him to decide whether to buy candy or save up for, say, a skateboard. (Don't undercut the lesson by buying the skateboard yourself.)

AGE 10-12: Invite your child to start attending regular family meetings. Discussion items: How lucky we are to be financially comfortable and what we as a family think is

the purpose of our money. Should we take fancy vacations or give to charities? Make it clear your kid's opinion matters.

AGE 12-14: Make sure your kid knows how to manage a checkbook. And at the family meetings, start making it clear where the family money came from—somebody's hard work! Start setting future expectations: Tell your child, "You're going to have to make your own fortune," or "Someday this will all be yours to preserve."

AGE 14-16: Don't be afraid to invite your banker or financial advisor to attend family meetings. It can be easier to have a neutral third party broach delicate topics such as a prenup and how much money you plan to leave your kids.

AGE 15-20: If the message isn't getting through, initiate steps for a "beneficiary rescue." Shift assets from normal investment accounts and minors' trusts into entities that you firmly control, such as family limited partnerships.

AGE 20-25: Make it clear you'd welcome your kid into the family business -- as soon as he's ready. College is a first step, and training at someone else's company can offer perspective. Remind your child that you love him and have total confidence in his ability to make his own way into the world. He'll thank you for it when he's 40.

AND BACK IN TEXAS, John Mecom Jr.'s daughter Katsy Cluck filed suit against him in 2008, in a messy and expensive case that names her three siblings as involuntary plaintiffs and involves five separate teams of lawyers, each trying to determine how much money matriarch Mary Elizabeth Mecom had at the time of her death in 1996.

In 1983, when Mrs. Mecom set up the trust, the multi-million dollar fund's assets included cash and bonds, more than 140,000 shares of stock in 16 different companies and the household possessions of her French château-style home.

As trustee, her son John Jr. was instructed under terms of the trust to distribute what was left of the assets to his four grown children upon her death.

But John Mecom Jr., a former owner of the New Orleans Saints football team, never gave the children a penny from the trust, according to the lawsuit. It pits against each other two generations of a family whose wealth was once estimated at more than \$200 million.

"Dear Daddy," reads a plaintive letter Mecom Jr.'s four children sent him, asking what happened to the money. "We are all adults now with our own financial responsibilities and it is very difficult to plan for the future when we have these unresolved issues hanging over our heads."

The Mecom case, which has wended a slow, Dickensian route through the court system, is headed to trial after a state Court of Appeals ruling earlier this year determined that John Mecom Jr. demonstrated an "inability thus far to fully explain his activities as trustee, including his personal transactions."