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Insights on key topics—
through a multi-generational lens.

TOPIC:

GENERATIONAL WEALTH TRANSFER: "EQUAL VS. FAIR"

Determining how to pass on your estate can be a complicated matter, especially if assets are to be distributed unequally among adult children. Equal distribution—if that's even possible—may seem like an attractive default approach, but “equal” doesn't necessarily mean “fair.”

This edition of Family Matters addresses ways to think about dividing estates among children or other heirs. With input from Calamos Wealth Management's Senior Vice President, Head of Wealth Strategy and Trust Services, Nancy Anderson and Senior Wealth Advisor, Richard Gotterer, this article can help orient you whether you're seeking to maximize equality or, at the other end of the spectrum, to leave a particular child out of a will entirely.

We created the *Family Matters* insight series to spark ideas and spur conversation among family members on a wide range of important financial topics. They're purposely written as a primer for more in-depth discussions with your Calamos Wealth Management advisor on how the matters presented will apply to you and your family's unique situation. We hope you find that the multi-generational lens by which topics are presented promotes pass-along readership to multiple family members. Your Calamos Wealth Management advisor is available to all members of your family to provide guidance on matters you care about most.

When one child works in the family business

Matteo is the fourth generation Cantoni to work with shoes. What started as a humble shoe-shop in Italy has grown into a globally recognized brand headquartered in the States, with Matteo at the helm. His daughter Giulia has followed in his footsteps (literally) ever since she was a child, spending many years by his side in the booming business.

Nearly all of Matteo's net worth is in the business, and he believes Giulia deserves a far greater share than her sister, Chiara, whose interests have always been outside the business. But the last thing Matteo wants is to cause acrimony between his daughters after he is gone.

"Equal" doesn't always mean "fair" when it comes to asset division. "Even if a parent wanted to split assets equally, it's difficult to equalize the gift down to the penny, especially when a business is involved," says Nancy Anderson, Head of Wealth Strategy and Trust Services at Calamos Wealth Management.

Therefore, Anderson always seeks a clear understanding of a client's objectives and family dynamics. She says:

"Understanding family values and grantor's intent is crucial before making decisions about bequeathing assets. Do you want to preserve family harmony? To financially recognize certain children over others? To ensure your assets are protected down the line? Based on these answers, we can work together to formulate an asset division plan that embodies their goals and recognizes the emotional value, the future growth—and sometimes business risks—of certain assets, beyond just their current dollar values."

In building such a plan, Anderson notes it often works well to give each child different types of assets. That's especially true when it comes to family businesses.

For example, Anderson cites a client whose son was active in the family business and the daughter was uninvolved. The approach there was to set up a trust funded with some of the family assets and supplemented with life insurance, with the daughter as the larger beneficiary, and to pass the business to the son who has been running the business for many years and was part of the business succession plan.

"The person inheriting the business needs to understand the business and have a capacity to grow it," says Anderson. "It's usually best to keep the business as one whole asset rather than dividing it into shares. Find other assets that may be attractive to other children."

Parents, says Anderson, should start the conversation about business transfer as part of their business succession plan and set the expectations during their lifetime. Leaving asset divisions to the children will create family conflicts. Don't assume that because your kids get along well that a good outcome will arise by leaving equal shares of the business to everyone and expecting them to sort out among themselves who will keep shares and who won't. There are too many uncertainties—and too much potential for frayed relations. Maybe the child not in the business doesn't understand what it takes to succeed. Or either child gets divorced or goes into debt.

"What's needed is good family governance—for the sake of relations and for the business itself," says Anderson.

Good governance may imply an unequal—though not necessarily unfair—distribution, whether upon the point of asset transfer or down the road. As Anderson explains, assets in a business might be worth \$5 million at the time of transfer, but given future uncertainties, that value could fall greatly in the years ahead. The person receiving the business needs to understand that risk and be able to address it. Otherwise, acrimony could arise later on despite careful planning and transparent communication.

When one child is more attentive and deserving—or has a far greater need

Josef and Sandy Krause have enjoyed their empty-nesting years, but at times wish they saw more of two of their three children. Their daughter Melanie lives close to home and loves stopping in for Salmon Sundays. They see much less of their two sons, both of which have far greater financial assets than does Melanie—one through his own earnings and one through marrying into a high-society family.

Josef and Sandy always imagined dividing their estate equally but have recently decided to give Melanie a greater share. They worry, however, this decision will cause their sons to resent them after they are gone—or, worse, to resent their sister. Is there a way to discretely leave Melanie more of the estate than her brothers realize, thereby heading off any conflict?

In this case, the decision about dividing assets doesn't necessarily imply more love for one child than others. Rather, these parents simply wish to recognize one child's attentiveness and contribution to the family. Other parents may wish to leave a greater share to a child with special needs—or with children of their own with special needs.

With respect to family harmony, however, it is risky business to attempt disproportionate distributions in a non-transparent way.

One possible way to attempt to do so involves named-beneficiary accounts, as such transfers occur outside the probate process. Therefore, it may be possible to more subtly transfer a disproportionate amount of assets upon death through vehicles such as transfer on death (TOD) or payable on death (POD) designations.

"TOD" is the term applied to investment and other non-bank accounts that have a named beneficiary, such as individual retirement accounts, 401(k)s, and other

retirement accounts. The account holder can specify the percentage of assets each beneficiary receives. "POD" is the term applied to bank accounts with named beneficiaries.

However, these mechanisms are by no means certain to avoid attention from other heirs or potential heirs. "In death, everything may ultimately come out," explains Gotterer. "Even if other children aren't directly aware of disproportionate asset transfers, they may observe a change in spending and become suspicious."

For example, the child who received more wealth may undergo a lifestyle change following the inheritance that could tip off unwitting siblings—something as simple as a new car or a vacation out of character with past spending.

That's why, in most situations, Gotterer advises transparency in actual estate transfers, complemented by gifts given during parents' own lifetimes.

He said, "A lack of transparency is an invitation for divisions. So, if the parents value family harmony while also wanting to financially favor one or more children over others, the best way to do that is gifting financially while still alive."

(For more on making gifts during one's own lifetimes, read a previous entry in this series, which offers insights on tax and asset-protection factors: "Family Matters: Gifts to Family and Charities During Your Lifetime.")

Anderson, too, advises clear communication: "You don't have to treat each child equally," she says. "But explain your plans—and your reasons for them—during your lifetime. If family harmony is your goal, take proactive steps to preserve it."

Writing one child out of an estate plan entirely

After years of emotional pain, Gabriel Kowalski has now decided to "go nuclear" and officially cut his son Simon out as a beneficiary of his \$5 million IRA. The tipping point came when Gabriel's wife,

and Simon's mother, died after a six-month illness. Simon visited her a total of one hour during all that time, and when it came time for the funeral, he flew in and out the same day.

Gabriel plans that his other two children will each receive one-third of the IRA assets, with most of "Simon's third" going to charity; a small fraction of it will pass via trust to Simon's children to fund their college educations. Should Gabriel announce his decision?

"While I nearly always suggest transparency when it comes to estate planning, that suggestion assumes that family harmony and fair distributions—however "fair" is defined—are among the parents' goals," says Gotterer. "Unfortunately, situations do arise in which striving for family harmony is simply not a realistic or appropriate objective," he says. "If a parent has decided to completely write a child out of an estate plan, announcing that plan is unlikely to be a good idea. In such cases, the focus should shift to protecting the assets."

That means engaging an attorney to review documents and ensure the language is clear with respect to disinheriting a would-be heir. When a will explicitly notes an intention that a child not receive any assets, the will is much less likely to be successfully challenged in court. In some cases, it may also be wise to include language to the effect that anyone seeking to challenge the will's provisions automatically the will forfeit any assets designated for them. And, of course, trusts should be considered as mechanisms to further protect assets and carry out specific wishes.

Trusts may also be helpful if one wishes to pass assets to one or more grandchildren, "skipping over" their parents, as with Gabriel leaving limited funds to Simon's children. "Situations such as these usually arise only after years of emotional agony," says Gotterer.

Conclusion

In most cases, parents want their asset divisions to both be fair and to be perceived as fair.

To achieve the former, develop a plan with your advisory team—wealth manager, attorney, CPA and perhaps others—that considers your objectives and, for various assets, both their dollar value and emotional value.

To achieve the latter, coordinate with your advisor to establish a thoughtful communication plan to convey your decisions to heirs. Even a ten-minute conversation about, say, why you are leaving the house to one child and not the others, may serve to forestall what might otherwise be decades of rancor after you are gone. Your financial advisor can facilitate such conversations—whether a brief check-in or an in-depth family meeting. While you can't and shouldn't try to take responsibility for others' thoughts and feelings, you can and should take care to express your own.

"When parents are alive, the extended family tends to rally around them, such as for holidays," says Gotterer. "When they are gone, that rallying point is no longer there, and families tend to drift apart. If your goal is to foster continued family closeness, you need to fully consider the implications of your estate-planning decisions."

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