Passing it on?

Expectation versus reality for leaving and receiving an inheritance.

The biggest wealth transfer in history is set to take place. This enormous transfer of wealth from one generation to another has been the subject of much debate over the past decade. But how well have the different generations planned for this event? What impact might tougher economic conditions have on future legacies? And how can we close the gap between expectation and reality?

Over the last decade, many studies have attempted to quantify the magnitude of the wealth that will transfer between generations. In Canada, it has been estimated that $1.1 trillion in household balance sheet assets will be transferred. Spanning 1.4 million wealth transfer events, this movement of personal assets marks the largest wealth transfer in Canadian history. Approximately $699 billion will be in the form of deposit products, investment funds and direct securities and $360 billion in real estate assets – primarily residential real estate.[1]

While the size of the pie is up for debate and continues to be influenced by market conditions and other factors, there is certainly an expectation that an unprecedented shift in wealth from one generation to the next will take place over the next few decades. With so much wealth changing hands, there is the possibility that many individuals who will receive or leave an inheritance may not be properly prepared to manage this inflow or outflow to ensure that a legacy will also be passed down to their children.

> “The lack of candid conversation between generations appears to be a major contributing factor to poor retirement and estate planning.”

Closing the gap between expectation and reality

For people expecting an inheritance there can be many unknowns involved in the transfer of wealth such as timing and the actual monetary value of the inheritance. Some of these uncertainties can be solved through discussion between family members. However, for some individuals, discussions about their death and the transfer of their estate, including writing a Will may be difficult. The lack of candid conversation between generations is often a contributing factor to poor retirement and estate planning. Moreover, when families aren't having transparent dialogue, it can lead to misgivings and financial insecurity.

While discussion may be challenging between generations in the same family, it can be equally difficult to have a conversation with a financial advisor. But not seeking advice can have significant consequences. For individuals who received an inheritance, decisions such as whether to pay down a mortgage or contribute to an RRSP or TFSA can have long-term financial implications. On the other hand, when leaving an inheritance, individuals may not have properly assessed their total wealth – including stocks, bonds, mutual funds, property, businesses and other important assets that would be available for distribution or given adequate consideration to minimizing taxes due upon death.

Factors impacting an inheritance

The size of an inheritance depends on a number of factors:

- life expectancy and retirement age
- unanticipated events and health care expenses
- challenging markets, interest rates and inflation
- taxes and fees on death
- family size

Life expectancy and retirement age
Thanks to healthier lifestyles and medical advances, we are living longer. Statistics Canada reported that Canadian women live to a median age of 84.1 years, and men to 80.0 years.[2] This is almost 10 years longer than the average life expectancy five decades ago.[3] This is good news from a longevity perspective, yet in terms of retirement assets needed, those additional years demand more retirement savings – especially if one considers the extra health care needs that typically go hand-in-hand with aging.

Unanticipated events and health care expenses
Longer lives mean an increased risk of costly medical care or daily living assistance within one's lifetime. While some government funding kicks in for all Canadians, there are limits, and coverage varies across provinces. Canadians can anticipate paying more out of their own pockets to cover medical essentials and long-term care services in the future. Becoming single in retirement may also severely impact your income and expenses. Those who are divorced or widowed could face higher costs for dealing with ill-health or infirmity without a spouse or partner to provide them with caregiving support.

> "Additional years demand a significant amount of more retirement savings – especially if one considers extra health care needs."

Challenging markets, interest rates and inflation
Today, the markets are affecting all generations. Seniors, who typically invest more in fixed-income products such as GICs and bonds, are forced to balance a low rate of return with a higher rate of taxation, as compared to capital gains and Canadian dividend income. As a result, many of these individuals may be forced to use up more of their assets than originally anticipated simply trying to

keep up with rising inflation costs, leaving little behind for their successors. The potential result is an inheritance that could shrink from one generation to another.

Taxes and fees on death

Although there are no estate taxes in Canada, a significant proportion of an inheritance could be consumed by probate fees and capital gains taxes due on death. Yet, many people fail to take this into account when planning for the transfer of their estate. Not only can taxes and probate fees erode the value of an estate, they can force the sale of assets. For instance, a family cottage or other investments may have to be sold to pay taxes and probate, executor, trustee and legal fees.

A case study on death and taxes

How could taxes and fees reduce an inheritance? Let's consider Margaret, a widowed mother of three adult children who lives in Ontario and has significant assets registered in her name only. Her assets include RRSPs worth $250,000 and investments valued at $100,000 (for which she paid $50,000). On her death, the total estate value will be $350,000. However, this is not the amount that will be distributed to her children, because there will be taxes due on her investments. The estate will need to pay approximately $120,000 in taxes on her RRSPs and $12,000 on her other investments (only half of the capital gains are taxable and assuming a top marginal rate of 48%). Assuming she has no other outstanding debts to be settled by her estate, the net value of her estate will be $218,000 – which may be further reduced by probate, executor, trustee and legal fees.

Family size – many ways to split the pie

Boomers, who earned their moniker due to the boom in birth rates after World War II, represent approximately 30% of our population.[4] It stands to reason that any legacy that the boomers' parents leave behind is likely to be split between multiple siblings.

But the demand for a slice of the pie does not end there. Boomers are not the only ones to inherit this wealth. Inheritances may also be split with grandchildren, allocated to trust funds or bequeathed to charitable organizations. Ultimately, this may reduce the size of the inheritance that will be distributed to each beneficiary.

Sometimes, instead of a slice of pie, you get a sandwich. There are costs associated with being part of an interdependent, intergenerational family unit. It is not uncommon today for boomers, also referred to as the sandwich generation, to be simultaneously providing financial assistance to their grown children, aging parents and, in some cases, even their grandchildren. These added responsibilities not only diminish the boomers' inheritances and their existing retirement nest eggs; they may also reduce or eliminate any hopes of an inheritance for subsequent generations.

Will boomers be the last generation to inherit?

Like any inheritor, Boomers will be faced with two potentially competing impulses: the desire to support and provide for their families in the future, and a need to remain self-sufficient through their retirement years.

Despite the challenges, boomers are unlikely to be the last generation to inherit. Nevertheless, the situation is complicated. Boomers who still expect to fund their retirement with an inheritance may find that reality falls short of expectations, and future generations who are counting on receiving an inheritance should be aware of the many risk factors that could reduce the amount of money they will receive.

There are strategies that Canadian families can take to help achieve their inheritance vision and maximize the intergenerational transfer of wealth. Communication with advance planning is key. While proactively initiating a family conversation on the transfer of wealth may seem emotionally daunting to some, the risk of holding onto unrealistic expectations is likely to have far worse consequences.

Final thoughts

More than ever before, Canadians and their children are encouraged to seek professional advice on topics that impact them financially – such as business succession, retirement resources, long-term care options and estate planning strategies. By having open intergenerational conversations about inheritance and with the help of a BMO financial professional, boomers and their families can be empowered to make prudent planning decisions about their legacy plans.

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[1] Investor Economics Household Balance Sheet Report 2019, Retirement and Inheritances, Section 3, page 122.
[2] Table 13-10-0389-01: Life expectancy, at birth and at age 65, by sex, three-year average, Canada, provinces, territories, health regions and peer groups. Statistics Canada website, accessed March 2020.
[3] Statistics Canada. Life expectancy, 1920–1922 to 2009–2011.
[4] Generations in Canada, Table 1. Statistics Canada website, 2011.

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