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/Report
CANADIAN EDITION

Passing it on: What will future inheritances look like?

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The biggest wealth transfer in history is set to take place. The enormous transfer of wealth to the Boomer generation has been the subject of much publicity over the past decade. But how well have Boomers and seniors planned for this event? What impact might tougher economic conditions have on future legacies? And how can we close the gap between expectations 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 Boomers stand to inherit approximately $1 trillion over the next twenty years.[1] In the U.S., the numbers were even higher, with some estimates around the US$41 trillion range.[2]

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 as seniors pass on. According to a recent BMO Retirement Institute survey, 30% of Canadian Boomers polled are expecting to receive an inheritance from someone in their immediate or extended family. Furthermore, many Canadians are not changing their view on leaving an inheritance – only 19% feel that they will not be able to leave an inheritance due to current economic turmoil.[3] Despite the positive outlook on inheritances, studies showed that a significant proportion of Boomers may not be properly prepared to manage this inflow of cash, nor have they explored strategies to ensure that a legacy will also be passed down to their children.

Counting chickens

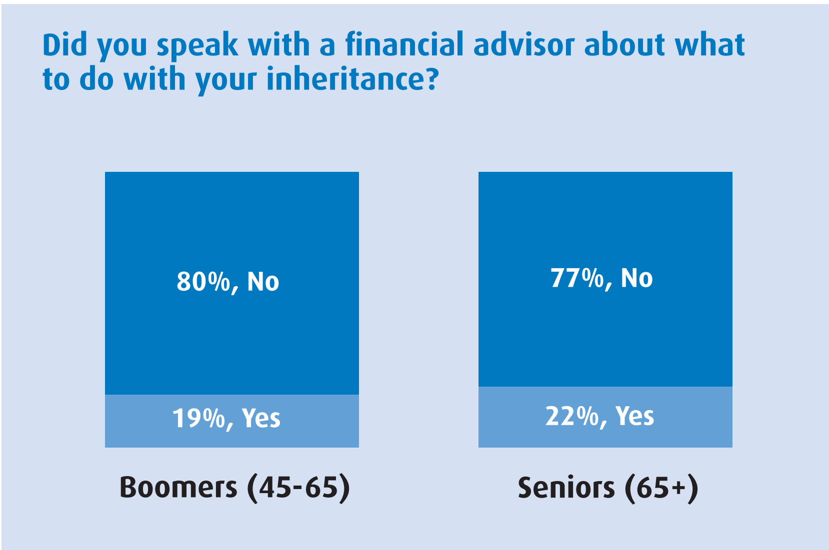
There are risks to incorporating an expected inheritance into a retirement plan without considering all possible scenarios (e.g., a smaller inheritance than expected). In 2006, a study showed that about 1.5 million Canadians were relying on their inheritance as the primary source of capital to fund their retirement.[4] The report stated that, on average, Canadians expected to receive a total of $150,600 in cash or cash equivalents, and $151,200 in non-cash inheritance.[5] But in reality, inheritance sums received were significantly less – the average inheritance received that year was $56,000.[6]

In the U.S., Boomers have also been receiving less than they expected. One report states that among Boomers who had already received at least one inheritance by 2004, the average value was US$64,000.[7] Furthermore, a 2002 study conducted on behalf of the American Association of Retired Persons (AARP) showed that an overwhelming 82.2% of Americans had received no inheritance whatsoever, and among those lucky enough to receive one, only 6.9% received more than US$100,000.[8]

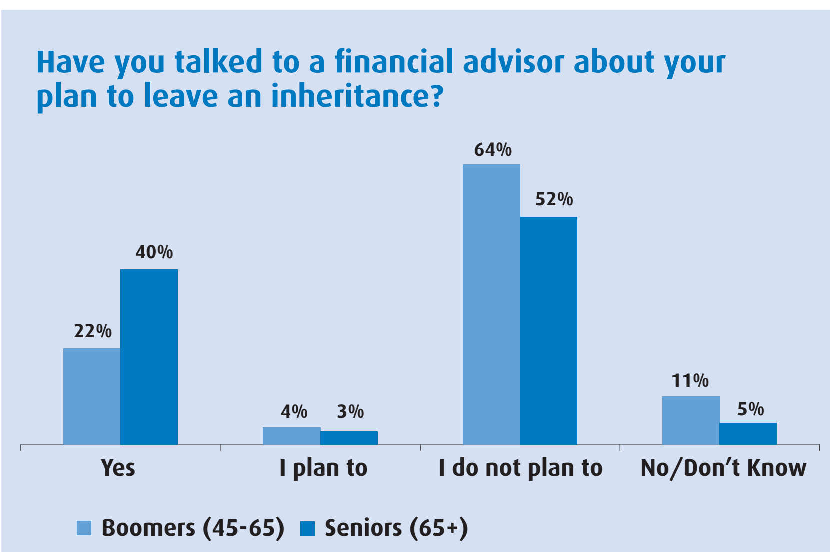
Closing the gap between expectations and reality

Obviously, there are uncertainties 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, particularly with the older generation, discussions of their death and the transfer of their estate, including writing a Will may be considered "taboo." The lack of candid conversation between generations appears to be a major contributing factor to poor retirement and estate planning. Moreover, the problem with this lack of dialogue is that it often leads to misgivings and financial insecurity in retirement for Boomers and seniors. For example, an increasing number of individuals are planning to bequest a portion of their wealth to charities as part of their legacy,[9] leaving their children empty-handed or with a smaller inheritance than expected.

Discussion is deficient not only between generations but also with advisors. A recent BMO Retirement Institute survey found that Boomers and seniors had not consulted with a financial advisor about their inheritance and/or their legacy plan.[10] For individuals who received an inheritance, decisions such as whether to pay down a mortgage or make a contribution to an RRSP or Tax-Free Savings Account (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.



Source: BMO Retirement Institute Inheritance Survey, 2009
Please note that due to rounding percentages may not add up to 100% (±1%)



Source: BMO Retirement Institute Inheritance Survey, 2009
Please note that due to rounding percentages may not add up to 100% (±1%)

Factors impacting size of inheritance

An inheritance can be impacted by:

- Life expectancy and retirement age
- Unanticipated events and health care expenses
- Challenging markets, interest rates and inflation
- Taxes 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 82.7 years, and men to 78.0 years.[11] This is almost ten years longer than the average life expectancy five decades ago.[12] This is good news – in terms of retirement dollars, those additional years demand a significant amount of 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 needing 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. In 2006, 45% of mature Canadians (50 years and older) reported spending more money on living and medical expenses than they had planned.[13] This is not unexpected, as the charges for basic accommodation in publicly supported long-term care institutions ranged from $540 to $3,960 a month per person.[14] Hence, 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. A previous BMO Wealth Institute report showed that the likelihood of becoming single in retirement is relatively high. In addition, the report also stated that married adults who become divorced or widowed could experience a decline in income of as much as 34%. For

Singles, health care costs could be higher because without a spouse to provide them with care-giving support, Singles may be forced to pay additional fees for meal preparation and daily living assistance. (For more information on the additional challenges Singles face, please refer to the BMO Wealth Institute report "Retirement for One – By Chance or By Design," January 2009.)

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. Meanwhile, Boomers on the brink of retirement may be faced with smaller nest eggs with which to fund their retirement lifestyles if their portfolio value declined with the stock market. The potential result is an inheritance that could shrink from one generation to another.

Taxes 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 upon death (see example below). Despite this fact, many 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 could force the sale of assets. For instance, a family cottage or investments may have to be sold as heirs try to come up with the funds to pay the taxes, probate, executor, trustee and legal fees. Being forced to sell assets to cover fees could negatively impact the net value of the estate.

Example: How taxes could reduce an inheritance

Margaret is 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). Upon 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 charged on her investments. The estate will need to pay approximately $115,000 in taxes on her RRSPs and $11,500 on her investments (assuming top marginal rate of 46%[15]). Assuming she has no other outstanding debts to be settled by her estate, the net value of her estate will be $223,500 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 a large percentage of the world's population. In Canada, Boomers account for approximately 30% of our population.[16] 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. Children are not the only ones to inherit this wealth. In the recent BMO Retirement Institute Inheritance survey, both seniors and Boomers indicated that they are planning on leaving an inheritance to someone other than their spouse/partner or child. Moreover, seniors are more likely than Boomers to plan on leaving an inheritance to a grandchild (37% vs. 18% respectively) or to a charitable organization (28% vs. 18% respectively).[17] Ultimately, this may reduce the size of the inheritance that will be distributed to each beneficiary.

Sometimes, instead of a 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. One quarter of Canadian Boomers surveyed had one or more parents who require regular assistance, and the majority (59%) of

Boomers who had children age 18 and over were still providing financial support to their children.[18] On the other hand, a U.S. survey found that 40% (or 2.5 million) of all grandparents whose grandchildren live with them reported being responsible for most of their basic needs.[19] 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.

Generational circumstances affect inheritances

Many of the risk factors mentioned earlier, such as longevity, the rising cost of living and intergenerational obligations, threaten to consume legacies that would have otherwise been transferred to future generations. But subtle differences in the way each generation views the world and the impact of outside forces beyond their control may also significantly shape the way money is channelled to the next generation.

Perspectives on an inheritance

Both seniors and Boomers agree on the importance of leaving an inheritance. However, seniors are likely to feel more obligated than Boomers to do so.[20] The reason for this distinction may be that seniors grew up with an intimate understanding of deprivation, first surviving the Great Depression, and then fighting in the Second World War. Because they had endured such hardships, some seniors may feel compelled to provide financial assistance to others. In contrast, Boomers were raised in a time of relative peace and affluence, and have generally grown up accustomed to a life of abundance. Socially, they are idealists who value financial self-sufficiency, making the world a better place for all and enjoying a high standard of living. Unlike the seniors, they may consider leaving a legacy as a bonus instead of a requirement. As a result, intergenerational differences in perspectives on an inheritance will affect the distribution of the wealth.

Behaviour and lifestyle differences

While seniors often take pride in living frugally to provide for their loved ones after they have passed on, Boomers have grown up understanding a direct correlation between hard work and rich rewards, and may therefore believe that hard-earned rewards should be enjoyed. According to the last BMO Wealth Institute report, Boomers are concerned about outliving their retirement savings, and some are considering replenishing their retirement resources by working longer or returning to work. (For more information, please refer to the BMO Wealth Institute report "Boomers Revise their 'Retire-by' Date as Financial Landscape Changes," April 2009.) Conversely, seniors may feel more secure about their financial situation, given their lifestyle and affinity for lower-risk investments. In the current environment, one would presume that an individual's priority would shift from leaving a legacy for future generations to self-preservation.

Higher level of debts equals smaller inheritance

Carrying debt into retirement may be a reality for some. In fact, as members of a credit-driven economy, some Boomers may carry more debt into retirement than their parents did. Of the Boomer retirees surveyed in 2006, 64% reported that they carried debt into retirement.[21] Both Boomers and seniors are responsible groups who are focused on repaying their personal debts. While the majority of Boomers and seniors surveyed claimed that paying off their mortgage and personal debt is important to them,[22] any unpaid debts will reduce the estate value for heirs.

Annuities may grow in popularity as retirees negotiate unprecedented hurdles

Maintaining financial independence throughout retirement is a major consideration for most people. However, Boomers may require more reserves than their predecessors to overcome recent economic upsets. The pressure to simply afford basic needs and wants throughout the retirement years is further intensified by increased longevity. For this reason, annuities or other products that provide a steady income stream for a guaranteed period, or the lifetime of the owner, may become the retirement income product of choice. However, from a legacy point of view, annuities can diminish or eliminate the size of the estate left for beneficiaries.

Will Boomers be the last generation to inherit?

On the one hand, Boomers are an extremely generous bunch, with strong ideals and a deep sense of commitment towards loved ones, and the world they will pass on. On the other hand, given the current economic climate and other challenges mentioned earlier, some Boomers are torn between a desire to give and a sense of responsibility to remain self-sufficient throughout their retirement years.

Despite the factors and generational circumstances discussed, Boomers are likely not to be the last generation to inherit. Many Boomers still stand to receive an inheritance, and the majority of them expressed a desire to pass on a legacy for future generations to enjoy.[23] Nevertheless, the reality is a lot more 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. More than ever before, Boomers and seniors 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 financial advisor, Boomers and their families can be empowered to make prudent planning decisions about their legacy plans.

1,4 The Canadian Inheritance Study, Decima Research, 2006
2 Boston College Social Welfare Research Institute, January 2003
3 BMO Retirement Institute Inheritance Survey, 2009
5,6 The Canadian Inheritance Study, Decima Research, 2006
7 In Their Dreams: What will Boomers Inherit?, AARP Public Policy Institute, May 2006
8 Pennies from Heaven: Will inheritances bail out the Boomers, AARP 2003
9,10 BMO Retirement Institute Inheritance Survey, May 2009
11 Statistics Canada, CANSIM table 102-0511 and Catalogue no.84-537-XPB.
12 The Conference Board of Canada, 2008
13 The Canadian Inheritance Study, Decima Research, 2006
14 National Union of Public and General Employees, Dignity Denied Long-Term Care and Canada's Elderly, 2007
15 Only half of the capital gains are taxable
16 Census Canada, 2006
17,20 BMO Retirement Institute Inheritance Survey, May 2009.
18 Globe and Mail/BMO 2006 State of the Boomer Study – The Strategic Counsel
19 2006 American Community Survey
21 Globe and Mail/BMO 2006 State of the Boomer Study - The Strategic Counsel
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