

Financial services research firm Cerulli Associates reports \$68 trillion in wealth will transfer between U.S. households over the next 25 years.<sup>1</sup> However, a number of variables could impact that total, including expenses associated with a longer life span, fluctuation in investment markets and ability to preserve capital and create tax-advantaged wealth transfer plans.

## ANTICIPATING A BOOM IN WEALTH TRANSFERS

### Overview

Baby boomers, the demographic born between 1946 and 1964, are the wealthiest generation in history. As they continue to age, a major wealth transfer is expected as they pass accumulated assets on to heirs.

According to Vanguard, 96 percent of the equities owned by baby boomers are concentrated among the wealthiest 20 percent.<sup>2</sup> This is because high net households tend to earn more than they spend, so equity portfolios can be left to grow unfettered by distributions for things like buying a home, funding college or paying for a wedding.

The latest long-running bull market — which celebrated its 10-year anniversary on March 9, 2019 — has added to the wealth of boomers in or approaching retirement. While recovery from the 2008 economic recession was slow, the sluggish pace precipitated considerable aid from the Federal Reserve and contributed to steady growth in the stock markets.

Since the decline, the Dow Jones Industrial Average (DJIA) has quadrupled from 6,500 to nearly 26,000. The S&P 500 has also flourished, rising from its 2009 low of 666 to above 2,800. These performance numbers constitute the lengthiest era of continuous gains in U.S. history.<sup>3</sup>

### Potential Headwinds

With such a large concentration of wealth, it's likely much of it will pass on to future generations. However, there are headwinds that must be considered for a successful transfer plan.<sup>4</sup>

- Baby boomers as a whole have a high tolerance for market risk. Their current portfolio allocation for stocks averages about 70 percent. With aggressive investing, a sudden market correction or sustained bear market could cause losses this generation may not have enough time to recover from.
- There is a strong possibility of a global recession, during which foreign investors may become risk averse and sell their U.S. holdings. This would reduce both the value of U.S. retiree stock holdings and the pool of would-be buyers.
- Should unemployment and inflation begin to rise, an increase in U.S. interest rates may trigger retirees to move more money into CDs and other fixed income investments.
- Baby boomers are the first generation to self-direct their own retirement income in 401(k)s and other defined-contribution plans. The loss of the traditional pension means more boomers have to rely on their own assets to maintain their lifestyle in retirement. This could cause many to shift assets into income-producing vehicles and reduce the amount of capital in the equity markets.

### Why Some of It Won't Transfer

#### Longevity Expenses

Health care expenses can add up fast. The cost of long-term care can put a major



dent in an estate plan over the long haul. According to LongTermCare.gov, baby boomers who have reached age 65 today can expect to live another 20 years, and 70 percent are likely to need some form of long-term services and support during their lifetime.<sup>5</sup> These range from bathing and feeding needs to managing household chores.

While fees vary based on location and other criteria, the following are annual median costs for long-term caregiving services according to Genworth's 2018 Cost of Care Survey.<sup>6</sup>

- Adult Day Health Care: \$18,720
- Assisted Living Facility: \$48,000
- Homemaker Services: \$48,048
- Home Health Aide: \$50,336
- Semi-Private Room in a Nursing Home: \$89,297
- Private Room in a Nursing Home: \$100,375

### Estate Taxes

There are two types of wealth transfer taxes: the estate tax and an inheritance tax. The recent Tax Cuts and Jobs Act increased the exemption amount for estate taxes. In 2019, only amounts that exceed \$11.4 million (\$22.8 million for a married couple) are subject to federal estate taxes, for which the top marginal rate is 40 percent.

The inheritance tax comes into play at the state level. Instead of being paid by the estate, which is how the estate tax is handled, inheritance taxes are paid by the recipients of inherited assets. As a general rule, heirs who are not related to the deceased pay a higher inheritance tax than family members, and most states exempt surviving spouses from the tax altogether.

Only 12 states and the District of Columbia currently impose an inheritance tax, which are also subject to exemption amounts. Those tax rates vary, with a top rate of 16 percent.<sup>7</sup>

### 2019 Exemption Amounts for States with an Estate Tax

- Connecticut - \$3,600,000
- District of Columbia - \$11,400,000
- Hawaii - \$11,400,000
- Illinois - \$4,000,000
- Maine - \$11,400,000
- Maryland - \$11,400,000
- Massachusetts - \$1,000,000
- Minnesota - \$2,700,000
- New York - \$11,400,000
- Oregon - \$1,000,000
- Rhode Island - \$1,561,719
- Vermont - \$2,750,000
- Washington - \$2,193,000

You can leave instructions for your estate to pay the inheritance tax for one or all of your beneficiaries as part of your estate plan.

## Strategies for Wealth Preservation

One way to preserve wealth is to transfer assets to more conservative investments as you age. While this may be a prudent move as baby boomers transition into retirement, it also reduces the opportunities for higher wealth accumulation over what could be a long retirement. Those with ample retirement income sources may want to retain a substantial allocation to equities for the sake of long-term growth.



When you consider retirement these days often runs 20 to 30 years, that is ample time to experience a variety of market ups and downs, recover from losses and achieve significant gains.

However, this strategy may not work for everyone, so it's best to seek advice for your personal situation.

## Strategies for Wealth Transfer

With strategic foresight, some ultra high net worth households may want to start whittling down their estates to below the current federal exemption (\$11.4 million per person, \$22.8 million per couple) to avoid the 40 percent estate tax. Bear in mind the current tax cuts are scheduled to expire at year-end in 2025. If you're contemplating ways to minimize taxes on the assets you plan to leave heirs, consult with an experienced tax professional regarding appropriate strategies for your situation. Consider:<sup>8</sup>

- You may currently gift up to \$15,000 to as many different people as you'd like without any tax consequences.
- Any payments you make for qualifying college tuition or medical bills for other people are non-taxable gifts that do not count toward the \$15,000 annual limit.
- You may contribute money to pay for others' college education via a 529 College Savings Plan. The advantage of this type of account is that you may retain ownership with control over contributions, distributions and investments, which grow tax-free. If the named beneficiary doesn't need the money for college, you may take back the funds or change the beneficiary. Gains not used to pay college expenses will be subject to federal and possible state income taxes, as well as a 10% penalty.
- For tax purposes, it may be better to retain your current taxable portfolio than cash it out before you pass away. In this scenario, non-retirement investments (e.g., real estate, collectibles, stocks and mutual funds) benefit from a one-time step-up in basis, so capital gains taxes are imposed only on future growth. In the case of a spouse, the step-up is available both at the first death and then again when the surviving spouse passes the estate to heirs.
- If you're concerned with how well your heirs will be able to manage an inheritance windfall, you may wish to place assets in a trust with conditions on how or when the money is distributed. Also note that a trust can be utilized to minimize estate taxes and avoid probate.

***"Take care with that legacy planning now, and your heirs will be well in the black later on."***<sup>9</sup>

## Final Thoughts

Studies show up to 70 percent of high net worth families lose their wealth by the second generation; 90 percent lose it by the third generation.<sup>10</sup>

This is a key reason why it's important to involve your adult children when you begin work on an estate plan. The more in the loop they are, the better they'll understand why you and your advisor set up your accounts the way you have. It's also a good idea to let your heirs meet with your financial advisor to develop trust; they should feel confident they can rely on him or her during the painful period of both losing a parent and receiving a financial windfall.



- <sup>1</sup> MacKenzie Sigalos. CNBC. Nov. 20, 2018. "\$68 trillion is about to change hands in the US." <https://www.cnn.com/2018/11/20/great-wealth-transfer-is-passing-from-baby-boomers-to-gen-x-millennials.html>. Accessed March 18, 2019.
- <sup>2</sup> Fred Slade. BenefitsPro. May 21, 2018. "Is there a baby boomer retirement effect on the stock market?" <https://www.benefitspro.com/2018/05/21/is-there-a-baby-boomer-retirement-effect-on-the-st/>. Accessed March 18, 2019.
- <sup>3</sup> Matt Egan. CNN. Aug. 22, 2018. "Market milestone: This is the longest bull run in history." <https://money.cnn.com/2018/08/22/investing/bull-market-longest-stocks/index.html>. Accessed March 18, 2019.
- <sup>4</sup> Fred Slade. BenefitsPro. May 21, 2018. "Is there a baby boomer retirement effect on the stock market?" <https://www.benefitspro.com/2018/05/21/is-there-a-baby-boomer-retirement-effect-on-the-st/>. Accessed March 18, 2019.
- <sup>5</sup> Longtermcare.gov. Oct. 10, 2017. "How Much Care Will You Need?" <https://longtermcare.acf.gov/the-basics/how-much-care-will-you-need.html>. Accessed March 18, 2019.
- <sup>6</sup> Genworth. June 2018. "Genworth Cost of Care Survey 2018." <https://www.genworth.com/aging-and-you/finances/cost-of-care.html>. Accessed March 18, 2019.
- <sup>7</sup> JRC Insurance Group. Dec. 12, 2018. "The Complete List of States with Estate Taxes (Updated for 2019)." <https://www.jrcinsurancegroup.com/the-complete-list-of-states-with-estate-taxes/>. Accessed March 18, 2019.
- <sup>8</sup> Ashlea Eberling. Forbes. Nov. 15, 2018. "IRS Announces Higher 2019 Estate And Gift Tax Limits." <https://www.forbes.com/sites/ashleaeberling/2018/11/15/irs-announces-higher-2019-estate-and-gift-tax-limits/#4a2817834295>. Accessed March 18, 2019.
- <sup>9</sup> MacKenzie Sigalos. CNBC. Nov. 20, 2018. "\$68 trillion is about to change hands in the US." <https://www.cnn.com/2018/11/20/great-wealth-transfer-is-passing-from-baby-boomers-to-gen-x-millennials.html>. Accessed March 18, 2019.
- <sup>10</sup> Gabriel Garcia. CNBC. May 22, 2018. "That \$30 trillion 'great wealth transfer' is a myth." <https://www.cnn.com/2018/05/22/that-30-trillion-great-wealth-transfer-is-a-myth.html>. Accessed March 18, 2019.

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