FINANCIAL POST

Why you should take inheritance into account when planning your retirement finances

TED RECHTSHAFFEN | July 15, 2016 | Last Updated: Jul 18 3:07 PM ET

More from Ted Rechtshaffen

Brent Lewin/BloombergAccording to a recent CIBC study, $750 billion is going to be inherited in the next decade. Shouldn't we account for some of that?

A typical planning scenario at our firm might see a 59-year-old working couple planning out their retirement.

When we ask them if any parents are still alive, the answer is often yes.

When we ask if the parents might become a financial burden, be financially neutral or a source of future funds, most of the time, people suggest that there will be an inheritance. They then suggest that it is best not to include the inheritance in their planning.

But, according to a recent CIBC study, $750 billion is going to be inherited in the next decade. Shouldn't we account for some of that? More importantly, why are clients suggesting that we shouldn't account for the "likely" inheritance?

The answer usually includes some or all of the following four reasons:

1. I don't want to think about my parents' death.

2. Since my parents never talked about money, I don't really know how much it might be.

3. You never know. They may need all of their money, and it could be gone by the time of any inheritance.

4. I would rather control my destiny and not be reliant on anyone else.

While I understand where these responses come from, all of these involve some degree of sticking your head in the sand. In fact, we find that most clients end up meaningfully underestimating the amount that they end up inheriting.

The inheritance question should matter to the 59-year-old couple as they plan out the rest of their lives, as it could change some of their significant decisions. Below are some questions they may be facing:

*Would I retire from the job I hate a few years earlier if I knew I would inherit $500,000 when I am 65?

*Would we help our children with education costs or real estate costs — that they are really struggling with today — if we knew we would end up with $2 million in our own estate?

*Based on health issues, it looks like one member of the couple could face serious challenges in the next five to 10 years. Can we afford to go on those three big trips over the next three years that we always wanted to take?

*With this being a second marriage for both, we would really like to do some planning with life insurance to help ensure that our children are treated fairly. Can we afford to take out the insurance now while we are both healthy?

If they are pretty sure of a $500,000 inheritance versus no inheritance, would the answers to these questions change? All of them are somewhat time sensitive and demonstrate why it can be really valuable to have some handle on inheritance, and to include it in your retirement plan.

So, how can you deal with those original four reasons for choosing not to include an inheritance as part of your plan? Let's take them one at a time.

1. Given that the only certainties in life are death and taxes, it is probably good to accept that your parents will die. You may not like to think about it, but retirement planning is a serious topic for a 59-year-old couple, and understanding the inheritance scenario could have a big impact.

2. Despite society's stance that it's good to air out difficult topics, talking about money can be awkward. Your parents' money is your parents' money and, ultimately, they have to be comfortable sharing information with you about their finances. However, if you explain the retirement planning that you are doing, the types of questions you are trying to sort through and why a reasonably accurate picture will be helpful, it is possible they may open up. This may also be a good time to get them to review their own estate planning — at least in terms of wills, powers of attorney and how in the world someone else might find everything in an emergency.

3. On the issue of the disappearing inheritance — this can certainly be true the tighter money is for your parents. People do run out of money and there might be no inheritance. However, if your parents have lived a pretty good life financially, and especially if they still own real estate in a big city, then there will be some meaningful inheritance. While this may not be the norm, we often see clients in their 80s and 90s who are getting wealthier every year, as their net worth is rising much faster than they are currently spending money. Even the big worry of health care costs is a largely American fear, much more than a Canadian reality. While it is certainly possible to have sizable health care costs in Canada, it is the exception to the rule, and even when it happens, the high costs usually only last for a short period of time.

4. The final reason people mention is that they want to be in control of their financial future and not be reliant on an inheritance. I understand and appreciate the independence, but simply ignoring a big part of your future wealth can often lead to some poor decision making today. It is usually a mistake.

Our recommendation to a couple nearing their retirement is to try to have a chat with their parent or parents about finances. Even if it doesn't provide a clear answer, hopefully it can help you make an educated guess as to the likely number. We recommend that people include about 75 per cent of that estimate in their planning. As for timing, include it five years after your parents' life expectancy. In this conservative way, we can still help this couple make intelligent decisions and plans today, while leaving lots of cushion around the numbers and timing.

With $750 billion being inherited in the next decade, now is the time for many baby boomers to start planning for the better financial reality ahead.

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Ted Rechtshaffen is President and Wealth Advisor at TriDelta Financial, a boutique wealth management firm focusing on investment counselling and estate planning.tedr@tridelta.ca