Editor's Column
National Association of Estate Planners& Councils

Journal of Estate and Tax Planning

Unexpected Consequences for the Baby Boomers

In October 2007, a retired school teacher, Kathleen Casey-Kirschling (who was born one second after midnight on January 1, 1946) became the first Baby Boomer to apply for Social Security Benefits. Her benefits started on January 1, 2008. Her 79 million compatriots will soon follow – at an expected rate of more than 10,000 per day. According to a report in USA Today, roughly half of the people reaching age 62 in 2008 will choose to take early retirement and take about 75% of the benefits they would be entitled to if they waited until age 66. By 2012 the remaining participants will start retiring and take their full share. Or will they? There are more than a few surprises waiting for this bubble generation.

Entitlement Programs. There has been wide discussion of the impact of the baby boomer bubble on federal entitlement programs. In a USA Today article, Brian Riedl of the Heritage Foundation noted that *"This is the single greatest economic challenge of our era."* Mr. Riedl noted that without change to the entitlement system by 2030, *"Every couple will have their own retiree to support."*

The 2008 Annual Report Of The Board Of Trustees Of The Federal Old-Age And Survivors Insurance And Federal Disability Insurance Trust Funds (issued March 25, 2008) continued the alarm about the impact of baby boomers on the federal entitlement programs. A copy is available at www.ssa.gov. Among the comments in the report are:

- *"Annual cost will begin to exceed tax income in 2017 for the combined OASDI Trust Funds, which are projected to become exhausted and thus unable to pay scheduled benefits in full on a timely basis in 2041."*
- The Disability Insurance program could be exhausted by 2026.
- *"With informed discussion, creative thinking, and timely legislative action, present and future Congresses and Presidents can ensure that Social Security continues to protect future generations."*

Hopefully, the next Congress will have the political will to address this looming bankruptcy. What the report does not really address is the impact on the federal deficit of paying back those "*special obligations of the Treasury*" – commonly known as loans. The forced repayment and the impact on the federal budget may finally force Congress to address this festering problem.

Virtually every study that has analyzed the problem has called for an early as possible resolution of the problem. While not politically expedient, the studies have called for one or more of the following:

- Higher taxes
- Partial privatization
- Lower benefits
- Deferral of benefits to a later age
- Taxation of Benefits
- More of a “Needs Based System” where wealthier Americans receive reduced or no benefits

Many Americans have the illusion that they have been paying into a “social security account” which creates a contractual right to benefits from the federal government. Unfortunately, the US Supreme Court, in Flemming vs. Nestor, ruled that Congress retained the right to “*alter, amend, or repeal any provision*” of the Social Security Act. The FICA tax is just a tax, not an entitlement.

While Congress has not been willing to address the looming entitlement disaster, for over a decade Congress has made changes to the Internal Revenue Code designed to encourage Americans to plan for their own retirement and health costs. For example:

- Health Savings Accounts
- Retirement make-up provisions for those 50 and older
- ROTH IRAs
- ROTH 401(k)s
- Favorable tax provisions for long term care insurance policies
- Rules permitting increased employer and employee contributions to qualified retirement plans.

Until it becomes clear whether and how Congress will deal with the issue, estate planners and financial advisors need to encourage their clients to plan for a future with little or no federal entitlement rights – taking advantage of these favorable tax rules while they last.

In addition, the author often encourages his clients who are providing or expect in the future to provide help to other family members (e.g., parents, in-laws or siblings) to consider buying long term care for those family members, including them as beneficiaries in family trusts and otherwise making sure that their needs are addressed in the estate plan.

While there has been much media coverage about the problems in the entitlement programs, there are other areas which may be every bit as significant to estate and financial advisors, but which has not received nearly the same media attention. The remainder of this article will address some of those areas.

Family Business Transition. American businesses are overwhelmingly family owned. Ninety percent of all American businesses are family owned. Sixty percent of US publicly traded businesses are family controlled and thirty-five percent of Fortune 500 companies are family controlled. Over three million US family businesses have been created in the last five years.

Despite their growth and large impact on the American economy, 65% of family owned businesses fail to survive to the second generation and 86% fail to survive to the third generation. A large reason for this failure rate is the failure of family leaders to plan for the passage from one generation to the next. This issue is particularly acute for companies run by baby boomers. In January 2003, Mass Mutual Financial Group and the Raymond Institute issued an interesting study on American Family Businesses. The report showed that 39% of family business leaders expected a change in leadership in the following five years, but 42% had not identified a successor leader and 20% had done no estate planning. This lack of planning is a disaster waiting to happen for many businesses – especially if the existing leadership should die or become incapacitated prematurely.

The passage of any business can be a highly chaotic event. It can be even more so in a family business. Emotion issues which are largely absent from non-family transfers can often destroy the transfer – and the business and family in the process. An increasing part of estate and financial planning is helping family businesses manage the emotional, management, business, legal and tax complexities of transferring the family business from one generation to the next.

Selling the Closely Held Business. In 2001 roughly 50,000 small business owners intended to retire. In 2009, the number is expected to be 750,000 – a 15 fold increase. Unfortunately for the owners who intend to sell the business, there are no more buyers than then there were in 2001.

Baby boomer business owners have often spent a lifetime plowing all of their energy into a closely held business, expecting the business to provide for their long term retirement needs. The author has found that many entrepreneurs have 70-90% of their accumulated wealth tied up in their closely held business.

According to a 2003 article by Roger Winsby, entitled: "Sell Side Trends. The Business Transition Tidal Wave," roughly a 33% expect to pass the business on to family members, 33% expect to sell to outsiders and 18% intend to sell to employees. The remaining portion will just shut their doors.

Unfortunately for the owners who intend to sell the business, there are no more buyers than then there were in 2001. As a result the price for small businesses are being driven down, even while the seller is being required to assume more risk in the sale through long term buy-outs, employment agreements, earn-outs and other deferred payment arrangements.

Selling to employees and family members is often an even riskier venture when the buyers lack sufficient capital to provide any significant down payments, forcing the owner to receive long term payments from buyers who may not have the requisite entrepreneur skills and funds to keep the business alive in a competitive market.

For a closely held business owner who wanted a stress-free retirement, the sale may keep him at risk and in stress for long into his retirement.

Housing Impact. In January 2008, the Journal of the American Planning Association published an article by Dowell Myers and SungHo Ryu entitled "Aging Baby Boomers and the Generational Housing Bubble." The article addressed another unexpected aspect of the baby boomer bubble – its impact on housing.

The authors noted that baby boomers have significantly increased the size and value of their homes over the last three decades and as a result have driven up the value of homes. Not only have they driven up the value of their primary residences, but many own second homes. According to the US Census, in 1980 roughly 1.7 million Americans have a second home. By 2000, the number was 3.6 million.

The looming retirement of 79 million people will reverse this trend. The article notes: *"We also expect that this change will make many more homes available for sale than there are buyers for them."* As baby boomers retire, down size, move to their second homes or into long term care facilities, they will drop more homes on the market then there are buyers. The resulting supply over demand will drive down the price of housing and potentially create blighted areas of unsold housing. The article notes that this trend has already started in Connecticut, Hawaii, New York, North Dakota, Pennsylvania, and West Virginia. It is expected to begin in Massachusetts in 2011, with other states following in the years to come. According to the report Arizona, Florida and Nevada will be the last to be impacted by this demographic bubble.

According to a number of studies, home equity constitutes at least 50% of the net wealth of half of the US households. Given the current mortgage crisis, the falling real estate values and this new demographic imperative, estate and financial advisors need to encourage their clients to consider the impact on both their retirement and their estate if the value of their homes not only fail to retain their current value, but actually drop over the next several decades.

Divorced Men. Baby boomers tend to divorce at rates which are three times their parent's generation. One unintended consequence of this high divorce rate is the number of single men who are entering retirement age without a family support structure. The dysfunctional families created from these high divorce rates often mean that the children and step-children are not willing to take on the burden of aiding fathers in their elderly years. Interestingly, the studies report that step-children are more likely to take care of a step-mother than a step-father.

These "orphaned fathers" will have to prepare for their long term financial and health needs without the aid of the normal family support system. Planners will need to be cognizant of this lack of support in planning for such clients.

Elderly Women. It has long been known that statistically women outlive men. One consequence of the baby boomer bubble will be the large number of single elderly women. See the attached chart. At age 85, there are more than twice as many women as men still living.

Targeted marketing of estate planning and financial services to this population will increase over the next several decades. Planners will have to have the personal skills to deal with the unique concerns of elderly women. For example, in many households, women have not actively participated in the financial decision making for the family. Once the husband dies, the wife may be ill prepared to make these decisions, particularly when her mental capacity will be diminishing with age. Trust and simplicity will become a pivotal part of planning for such clients.

<u>Incapacity Planning</u>. According to the Alzheimer's Association one out of every eight people over age 65 have Alzheimer's, while one out of every two over age 85 have the disease. As baby boomers age, their mental capacity and decision making abilities will naturally decrease. Every baby boomer should have a medical directive and durable general power of attorney so that decisions can still be made upon their incapacity. Even those clients who refuse to address their own mortality by drafting a will should want to execute these documents to avoid the cost, conflict and delay of having a guardian appointed upon incapacity. This need is particularly for acute for single baby boomers that may have no family support system in place.

<u>Retirement</u>. It has long been known that baby boomers were not putting away sufficient funds for their retirement. One explanation has been that they thought the inheritance they were going to receive from their parents would help cushion their retirement. About the time the baby boomers started retiring at age 60-65 mom and dad were expected to pass on a nice inheritance.

Unfortunately for the baby boomers who expected this inheritance, it does not appear to be happening. According to a study by AARP, only about 19% of baby boomers will receive an inheritance – at a median value (in 2005) of $49,000. Mom and dad are not only not dying at age 65-70, they are living an expensive retirement lifestyle whose travel, upkeep and health care costs are eating up junior's inheritance. An article by Charlie Douglas entitled 'Where's my Inheritance?" in the October 2006 edition of NAEPC Journal of Estate and Tax Planning points out that *"But timely inheritances that could help quench Boomer's retirement thirst may prove to be more like a mirage."*

Perhaps because of a growing recognition of all of the above trends, a June 12, 2007 report on CBS NEWS noted that 80% of baby boomers expected to work at least part time after retirement. Some will do it because they like to work. Many will do it because they have no choice.

John J. Scroggin, Editor NAEPC
Journal of Estate and Tax Planning

Table 1.1 Population by Age, Sex, Race and Hispanic Origin[1]: 2006
(Numbers in thousands. Civilian noninstitutionalized population.[2])

Age	Both sexes		Male		Female	
	Number	Percent	Number	Percent	Number	Percent
All ages	293,834	100.0	144,188	100.0	149,647	100.0
Under 55 years	227,349	77.4	114,127	79.2	113,222	75.7
55 to 59 years	17,827	6.1	8,633	6.0	9,194	6.1
60 to 64 years	13,153	4.5	6,243	4.3	6,910	4.6
65 to 69 years	10,231	3.5	4,782	3.3	5,449	3.6
70 to 74 years	8,323	2.8	3,743	2.6	4,580	3.1
75 to 79 years	7,644	2.6	3,252	2.3	4,392	2.9
80 to 84 years	5,318	1.8	2,078	1.4	3,240	2.2
85 years and over	3,989	1.4	1,329	0.9	2,660	1.8
Under 55 years	227,349	77.4	114,127	79.2	113,222	75.7
55 years and over	66,485	22.6	30,061	20.8	36,424	24.3
Under 60 years	245,176	83.4	122,760	85.1	122,417	81.8
60 years and over	48,658	16.6	21,428	14.9	27,230	18.2
Under 62 years	250,646	85.3	125,358	86.9	125,289	83.7
62 years and over	43,188	14.7	18,830	13.1	24,358	16.3
Under 65 years	258,330	87.9	129,003	89.5	129,327	86.4
65 years and over	35,505	12.1	15,185	10.5	20,320	13.6
Under 75 years	276,883	94.2	137,529	95.4	139,355	93.1
75 years and over	16,951	5.8	6,659	4.6	10,292	6.9

[1]Hispanics may be of any race.

[2]Plus armed forces living off post or with their families on post.

SOURCE: U.S. Census Bureau, Current Population Survey, Annual Social and Economic Supplement, 2006.

Internet release date: July 27, 2007