Helping Your Children

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These days, given the current economic climate amidst the COVID-19 pandemic, many parents of adult children may feel their own finances are in relatively good order, yet they may have concerns about their adult children and their ability to support themselves during this unprecedented period of uncertainty. Helping your children is a parental instinct, and if you have the means you certainly want to help them out. However, remember to do so prudently so you don't impact your own retirement, estate planning or tax situation. This article explores ways to effectively help your adult children while keeping your own wealth plan in order.

While many parents of young adults feel they have either achieved or are on track to achieving financial success, they may be worrying that their children are not going to attain the same level of success on their own. Much of this concern is driven by the current economic environment young adults face today, which includes relatively high unemployment, expensive housing, large student debts, and underemployment of young adults to find meaningful employment in fields related to their education. Appreciating the sacrifices made by their parents to help them, many parents of young adults believe it is their obligation to "pay it forward" by helping their children to become financially secure.

However, these parents are concerned that there is a limit to the support they can provide. What effect will the financial decisions they make today mean for their own financial future, and their own desire to achieve and maintain financial security? Just how much money is available in the "Bank of Mom and Dad" ("Family Bank") to support the financial needs of every family member, and allow them to pursue their own financial and retirement goals?

Helping our children

While regular, small amounts of financial support may not seem that much to parents still in their prime working years, consider the financial impact of providing a child $500 per month to help pay for their cell phone, internet and/or credit card bills. This adds up to $6,000 per year, an amount that could have a significant impact on the accumulation of retirement savings. For a parent aged 50, contributing the $6,000 to a Registered Retirement Savings Plan ("RRSP") each year could result in almost $140,000 of additional RRSP savings by age 65, assuming an annual growth rate of 6%. Put another way, this could result in about $260,000 in additional pre-tax income in retirement from a Registered Retirement Income Fund ("RRIF").

Making sure you have a financial plan

For adult children that have become accustomed to a level of financial support, it is important not to cut them off all at once. Open communication is required and may involve many conversations to set expectations for the future. It is important for all family members to understand that the Family Bank is a limited resource, and ultimately it is intended to be used to support the parents and their financial goals.

Determining how much of the assets in the Family Bank are necessary for financial goals such as retirement, requires a comprehensive wealth plan. The preparation of a financial plan that incorporates all available financial resources and includes all financial goals is an important first step. Your BMO financial professional can help with this process.

Once retirement needs have been accounted for and are on track to be achieved, competing interests of other family members, including adult children and aging parents, can be considered. Family members that have expectations of support need to understand the impact of these handouts on your retirement plans if financial resources are tight, and an open discussion will provide a new perspective. This discussion is especially important if prolonged financial support will deplete retirement savings to the extent that parents will need financial support themselves from their adult children in the future.

Teaching financial stewardship

A reliance on the Family Bank may arise simply because kids have not learned enough about money from their parents. An understanding of personal finances involves learning how to budget, and establishing a "saving and investing before spending" habit. This will help children learn how to live within their means, rather than always looking for a financial top-up to support an extravagant lifestyle. Parents who model good financial behaviours may have more success teaching their kids about finances because they practise what they preach. This could include the following:

- Putting money aside for specific purposes, such as a post-secondary education using a Registered Education Savings Plan ("RESP"), is a good way for parents to reinforce the message of budgeting for the future, especially given that children who pursue a post-secondary education are the direct beneficiaries of these plans. And, because RESP contributions are supplemented by contributions from the Federal, and potentially provincial government, helps funds in these plans grow more quickly.

- A Registered Disability Savings Plan ("RDSP") is a tax-incented plan to encourage parents, family members and others to save for the long-term financial security of a beneficiary who qualifies for the Federal Disability Tax Credit ("DTC"). Another savings option to ensure that a disabled beneficiary's benefits are maintained, is a trust that is entirely discretionary with respect to the payment of income and capital (also known as a "Henson trust") – set-up as inter vivos or testamentary trust.

- As paper money becomes less and less prevalent, the idea of having only so many dollars in your pocket to spend is quickly disappearing. To help reinforce this concept with younger children, give them gift cards with pre-loaded balances for special occasions that they can use at their favourite retailers. As long as the value is small and parents can ensure that the card is not lost or forgotten, this can help to reinforce the message of budgeting and spending only up to an available limit (including sales taxes) from an early age.

The advantages of a Tax-Free Savings Account

Tax-Free Savings Accounts ("TFSA") are a great way to make savings more tax efficient and extend parents' ability to use resources in the Family Bank to meet financial goals. Although the amount that can be contributed annually to a TFSA is limited, income earned in a TFSA is generally not subject to any Canadian taxation. Furthermore, funds can be provided to an adult child to allow them to contribute to their own TFSA, subject to their personal TFSA contribution limit. Since the income earned within a TFSA is tax exempt and is not subject to the attribution rules, a TFSA provides a simple and effective income-splitting tool, and a way to help adult children build a nest egg of their own.

Income-splitting opportunities

If the Family Bank does have the financial resources to provide for the goals of the whole family, additional income-splitting strategies (beyond a TFSA) can help increase the benefit available for children and dependent parents. Through the use of a family trust, or a carefully documented prescribed rate loan strategy, the tax cost on income can be legitimately allocated to family members in a lower income tax bracket. Strategies such as these can make more funds available on an after-tax basis to meet the needs of family members. Other effective strategies could involve the use of an "estate freeze" to transfer the future growth of your business to the next generation(s), or gifts to children – typically through a trust structure – to acquire investments which could generate future income or capital gains (subject to the possible application of the attribution rules and/or the "tax on split income" ("TOSI").

Leaving a legacy of financial comfort

Some parents don't realize how much their children depend on them financially, and consequently don't provide adequately for them in their estate plans until both spouses have passed away. This makes it difficult for a surviving spouse to manage their own needs and also provide support for their children (or children from a previous relationship). Estate plans should provide adequate support for dependents to ensure a smooth transition for the surviving spouse, particularly in the context of "blended" families. One way to make additional funds available to help the Family Bank provide for both a surviving spouse and adult children is an insurance policy. A joint insurance policy on both spouses that provides a lump sum, tax-free payment to the surviving spouse to supplement income or to support children who may be struggling financially, is a good option. Further, life insurance is an excellent tool for equalizing an inheritance among children where one or more of them may have received partial advance inheritances during the lifetime of the parents. Also consider "cascading" insurance, where a parent or grandparent can purchase an insurance policy on a child or grandchild, creating significant cash values over time, as the cash grows tax-deferred and the proceeds are paid out tax-free on death. The costs are lower the younger the child is, and their health is never likely to be better. If done generation after generation, it can "cascade" wealth from one generation to the next in a very cost and tax-efficient manner.

Now or later?

Even if the Family Bank is well funded and can afford to provide ongoing support for adult children, it is important to realize that this will reduce the amount available for undetermined, but likely expenses such as healthcare and long-term care as one ages.

How to provide gifts to children

If you have decided to provide a gift to one or more of your children, there are many issues that should be considered prior to making the gift. This is particularly important if your child is in a relationship and you want to ensure that the amount gifted "stays in the family."

As an example, in cities with high housing costs many parents choose to help their adult children by providing large lump sum amounts to help with the down payment on a home purchase. These transfers often represent a form of early inheritance that has helped many young adults enter the competitive urban real estate market. However, a word of caution; any financial transfers to children may become property that has to be shared with a child's spouse in the event of a breakdown of their relationship. To protect against this, you may want to consider loaning the funds to your child and his/her spouse or common-law partner, and to register the loan as a mortgage on title to the home. There are many tax and legal nuances involved with this strategy, and professional advice should be sought, particularly to ensure that the funds are protected on any breakdown of the relationship. If properly structured, this loan can also be protected from the child's creditors.

If this option is not possible, or if the funds are not being used for a home purchase, other strategies to protect the money include executing a Deed of Gift prior to gifting the funds, or having your child execute a marriage/co-habitation contract prior to receiving the funds.

Seek advice

It is important to discuss your unique situation with your BMO financial professional, who will be able to work with you and your other professionals to develop a personalized financial plan. By working together with your BMO financial professional, it's possible to achieve greater peace of mind as you work toward building the financial comfort that you desire for yourself and your family.

For more information, speak with your BMO financial professional.

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