Managing newly acquired wealth

The classic situation is that of the lottery winner. Suddenly besieged by an army of new friends, well-wishers and advisors, tempted by a world of seductive possibilities, all too often their stories end unhappily. Although lottery winners are exceedingly rare, the challenge of handling a large influx of money is actually quite common. Whether expected or not, an inheritance, divorce settlement, severance package or pension payout, proceeds from the sale of a business, life insurance, royalties, mineral rights or legal judgments—all can put in one's hands the equivalent of several years of ordinary earnings.

When you find yourself in this position, you're at a crossroads—suddenly called upon to switch from wealth-building mode to wealth management. You will, of course, face circumstances special to your situation. However, there are some general guidelines that apply to almost all such transitions.

Taking your time

Financial windfalls often come with an emotional price tag: the loss of a loved one, a serious injury, leaving a long-time job or selling a business. Even for the lottery winner, euphoria may make long-term planning a challenge. Fortunately, major decisions are not required immediately in most situations. Cash can be parked in the money market, in short-term CDs or in an interest-bearing bank account. Although interest rates are not very impressive these days, at least you won't lose money while you regroup.

In most cases, you may want to give yourself some time to regain your emotional bearings and to think about what uses of your new wealth will give you the most satisfaction.

Setting goals

Is your sudden wealth large enough that you can consider retiring? If that course is attractive to you, you should think of your assets—new and old—not as a lump sum but in terms of the after-tax annual income that they can produce over the course of your life. Is that figure enough to support the life that you envision for yourself and your family?

Or, if you will continue in your present position, do you simply want to clear debts, ensure your children's college education, invest for your eventual retirement and provide for those whom you leave behind?

In either case, you'll need to update your estate plan, so as to include your increased assets and provide for their management in the event of your incapacity, with a *revocable living trust* and/or a *durable power of attorney*.

Taxing matters

Is your new wealth taxable? It's taxable as ordinary income if it comes from lottery winnings, royalties, severance payments, mineral rights and the like. Legal judgments are taxable, except to the extent that they are compensation for physical injury.

If the money comes from the sale of a business, it may be subject to a tax on any capital gains realized. Proceeds from the sale of a personal residence also are subject to capital gains tax, but the first $500,000 in gains may be exempt for a married couple—$250,000 for singles. Pension payouts are taxable and may be subject to an early penalty tax, depending upon your age. However, tax can be deferred if rolled over into an IRA. IRAs and other retirement plans (but not Roth IRAs) are taxable as funds are withdrawn, and so allow deferral of taxes over several years. Most other inherited assets are received with a stepped-up basis and, thus, are subject to little or no tax if sold soon after acquisition.

As you can see, taxes can be a major complicating factor to new wealth. The services of an experienced tax advisor may help you uncover ways to minimize their impact and are well worth investigating.

Investing

You'll need to consider your assets as a whole, essentially starting from scratch. How do the new assets blend with your existing portfolio? There may be positions in the inherited assets that you will want to keep, perhaps for sentimental reasons, but they must be viewed objectively as to how they fit into the big picture. Nor need there be any rush. Selling and investing slowly over time as opportunities present themselves can lessen the probability of major mistakes.

Getting help

The planning and decision-making called upon by the receipt of a large lump sum can be overwhelming. And very few people have the investment management expertise that they will need.

You will be offered the services of a number of professionals—brokers, accountants, financial planners. Some of the latter may charge a fee based on the amount of assets under management; others may rely on commissions from the products that they sell you. Ask for and check references before entering into any agreement.

You may wish to consider our services in this regard. Our financial advisors and money management team represent decades of experience dealing with the challenges and opportunities that wealth presents, and our only focus is the needs of our clients. What's more, we can offer you the exact level of fee-based service that you may require—on an advisory basis or full asset management services.. A revocable living trust complements either of the services above, enabling the trustee to step in and handle your financial affairs when you are incapacitated. It also offers considerable estate planning advantages.

Working with clients and their tax and legal professionals to craft plans suited to the individual needs of our clients is our stock in trade. Call on us for assistance at any time.

Any developments occurring after January 1, 2009, are not reflected in this article.