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Trust UPDATE

Stillman BANK

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What lawyers tell the suddenly wealthy

The phrase "sudden wealth" may be associated with lottery winners, but life provides many other opportunities for a sudden increase in net worth—sale of a business, winning a lawsuit, accepting a lump sum retirement distribution or receiving an inheritance come to mind, for example. Pleasant though receiving sudden wealth undoubtedly is, for the inexperienced there can be a whole new set of unfamiliar issues. Some lawyers specialize in providing advice to those who are newly wealthy. They shared insights and best practices with lawyer and freelance writer G. M. Filisko, for an article published in December in the *ABA Journal*, "In the Money."

Sudden money is usually life changing. Those changes can be good, or they can be bad. In most cases, life never will be the same again.

Obstacles to wealth preservation

Taxes are the first concern when sudden money is coming into one's life. But according to the lawyers, taxes "are what they are." For lottery winners, for example, there isn't much tax planning to do. The tax rules for retirement distributions are pretty straightforward as well. Planning a liquidity event, such as the sale of a business, can get more complicated, but the lawyers report that it's not a difficult conversation to have.

The harder talk is about the friends who may show up, looking for a loan or offering an "investment opportunity." Most difficult of all is broaching the idea that one's family might not act honorably. Too often, the lawyers reported seeing windfalls dissipated to family members in just a few years.

How can one avoid these situations? Many lawyers recommend anonymity when possible. That's not an option for state lottery winners, who typically are required to be identified publicly. Even so, claiming the winnings may be deferred until some planning has taken place.

Another approach is to use a qualified financial counselor as a gatekeeper. That way, a person can say: "I don't handle the direct management of this money. You'll have to run your (request/loan/investment opportunity) by my (lawyer/manager/financial advisor)."

Sometimes the newly wealthy person is his or her own worst enemy. Some suffer from what one lawyer called "pent-up deprivation." Having struggled financially all their lives, they may go on a spending binge, or fail to take into account the long-term costs of some purchases; or they may want to show off their new wealth or thank people who have helped them in their lives. In such cases, the wealth may prove all too temporary.

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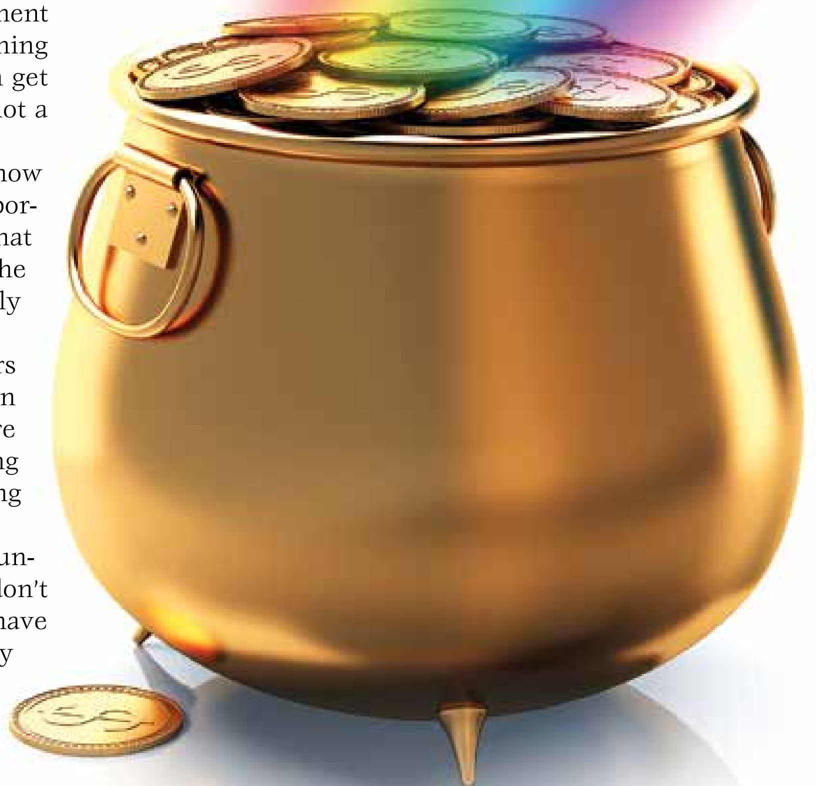

Costs

How much do lawyers charge for their wealth management plans? That will depend upon the complexity of the planning, and one gets what one pays for. For firms that specialize in this area, fees of $10,000 to $20,000 and up are not uncommon, according to the article.

What to tell the kids

Some people have a good handle on managing their wealth, yet they are uncertain how much to tell their children. There is a well-founded concern about not "spoiling" children with too much money, or expectations of money, too early in the children's lives. They may disguise the magnitude of their wealth by saying: "We're not rich, but we are comfortable. Some people have more money than we do; some have less. We're somewhere in the mix, living within our means."

One couple reported planning for two trusts for their son, under the guidance of their attorney. One trust was for his education expenses. The second trust will release his fortune to him in stages, with distributions at ages 25, 30 and 35. In that way he may develop financial maturity as his parents have.

Family philanthropy is another way in which wealthy parents share their values with their children. This may take the form of a charitable trust, a private foundation, or simply a plan for giving some family assets to charity each year. The children may participate in identifying the charitable beneficiaries.

Asset protection

A recurring theme in lawyer's discussions with their suddenly wealthy clients is the importance of asset protection. Such protection may be had with sound trust planning.

If your estate plan includes a substantial legacy for a family member, consider using a trust for the bequest. Your trust will be a gift of more than financial resources. You will be including our investment and financial management expertise as well. A gift or bequest in trust can provide for a lifetime of financial security. Approaches to discuss with your trust officer include:

- Gifts-to-minors trusts;
- Incentive trusts;
- Sprinkling trusts; and
- Spendthrift trusts.

Talk to us

Wealth management is about taking control of your assets, as well as letting go of control, so you can enjoy your life. We can help you with all phases of your asset management. If you would like to learn more about how our personal trust services might help you to conserve and manage your wealth, we invite you to meet with us in person. We look forward to meeting with you to discuss your goals and requirements. ☐

If you are seeking help in managing a substantial sum, you likely will interview a number of potential advisors. How do you avoid the Bernie Madoffs who may yet be out there? Here are some pointers for the process.

Ask questions. You need to know about past returns, whether any returns are guaranteed, and when you can get your money out.

RED FLAG If someone downplays such worries, he or she may not be right for you.

Ask for written materials. You want to review longevity of the firm and the credentials of the advisors with whom you'll be working.

RED FLAG Watch out for firms whose history you can't easily trace, for gaps in history, and for unfamiliar credentials. You can check on professional certifications with the organizations that issue them.

Bring a trusted advisor along for the interview. Your attorney or accountant will provide additional perspective, and he or she may spot issues that you miss.

RED FLAG If there is resistance to your bringing an advisor along, or if you are told not to take notes, be wary. You need privacy; the firm that you are interviewing should not.

If it sounds too good to be true, it is too good to be true. Ask yourself, "Why is this opportunity being presented to me?"

RED FLAG Grandiose claims, answers that don't make sense and material omissions are all signs of trouble.

Take your time. Anything worth investing in today still will be worth investing in tomorrow.

RED FLAG A salesman who is pushing for a rapid signature is being unprofessional and, perhaps, unethical. Don't invest in anything if you can't take time to discuss it with family members.

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This estate tax break is not automatic

When the general press reports on the federal estate tax, the amount exempt from that tax is sometimes oversimplified. The exempt amount for persons who die in 2017 is $5.49 million. "For married couples, nearly $11 million may pass tax free" is accurate, but there's a bit more to it. That doubling of the exemption for couples comes with a price.

Since 2010 the amount exempt from federal estate tax has been "portable." That means that when a spouse dies, the survivor inherits any unused federal estate tax exemption. Say a husband's will leaves $1 million divided among his children, and the balance of his estate to his wife outright. The marital deduction protects any amount going to a surviving spouse from estate tax (assuming the spouse is a U.S. citizen), while the exemption amount reduces the tax on the $1 million for the children to zero. The wife's estate would have Deceased Spouse's Unused Exemption Amount (DSUEA) of $4.49 million. Should the wife die later the same year, her estate would be entitled to a total estate tax exemption of $9.98 million.

However, to secure that DSUEA for the wife, the executor of the husband's estate will have to file an estate tax return, electing to preserve that tax benefit.

The estate tax return will be required even if the husband's estate is so small that no return is otherwise needed. Completing a federal estate tax return is not a job for an amateur, so the estate will have to go to some expense to save the wife's full exemption entitlement.

The real world

The expense of hiring a professional to file an estate tax return is small compared to the potential benefit. Yet it seems that a great many executors have overlooked this important opportunity, perhaps to save on administration expenses. One result has been a deluge of private rulings requesting extensions of time to make the portability election for the federal estate tax. A recent advisory from the IRS made very clear the circumstances in which the IRS will look favorably on an application for relief:

"If the taxpayer had a GROSS ESTATE of more than $5 million—no relief is available to him at all, even if the estate is nontaxable due to the marital deduction. The taxpayer had an absolute obligation to file a Form 706 within 9 months of date of death and having failed to do so, the election for portability is missed.

"If the taxpayer had a GROSS ESTATE of less than $5 million, having missed the ability of timely filing a Form 706, the taxpayer's only recourse for obtaining the portability election is to seek relief through the private letter ruling process. The relief will likely be granted. Merely filing a late Form 706 would be ineffective in making this election and the election will not be respected."

Impact

The graph at left is an IRS report of the number of estate tax returns filed, and total estate tax collections. Estate tax revenue has returned to 2009 levels, but estate tax return filings remain at historically low levels. An expected jump in returns to claim the portable estate tax exemption has not materialized. ☐

Estate Tax Returns Filed and Total Net Estate Tax, 2006–2015

Source: IRS

"Nanny taxes" back in the news

Two of President Trump's nominees failed to pay "nanny taxes," it has been learned. When President Clinton nominated Zoë Baird to be attorney general in 1993, the discovery that she had employed illegal immigrants and failed to pay their Social Security taxes derailed her nomination. The public relations firestorm was so severe that the next nominee, Kimba Wood, also had to withdraw from consideration when it was learned that she also had employed an illegal immigrant as a nanny, even though Wood had properly and timely paid all taxes.

Mick Mulvaney, who will head the Office of Management and Budget, paid for help in raising the family's triplets from 2000 to 2004. He stated that he didn't realize the worker qualified as his employee, but now he has paid back taxes of more than $15,000. Labor Secretary nominee Andy Puzder also paid back taxes on an undocumented worker who worked as a housekeeper for a few years, but Puzder later withdrew.

"Nanny taxes" is shorthand for the federal taxes that must be paid for household employees, Social Security and Medicare taxes, and federal unemployment tax. State taxes may apply as well. The taxes are reported on Schedule H. Filings of Schedule H have dropped steadily in recent years, from nearly 300,000 in 1999 to under 200,000 in 2014. However, total taxes paid have increased, reaching more than $1 billion in 2014.

The taxes must be paid for household employees, but not for the work of independent contractors, who are instead considered self-employed. According to IRS Publication 926, "A self-employed worker usually provides his or her own tools and offers services to the general public in an independent business." The independent contractor has control over the job and is not working under the direction of the homeowner.

The threshold for paying Social Security and Medicare taxes is the payment of cash wages of $2,000 or more in a single year. Wages don't include the value of food, lodging, clothing, transit passes or similar items—but if a cash allowance is provided for these things, then it does count. The threshold for paying federal unemployment tax is $1,000 in a single calendar quarter.

The unemployment tax is 6% of the first $7,000 in cash wages. Social Security and Medicare taxes are 15.3% of cash wages, divided equally between the employer and the employee. The employer may withhold the employee's portion from the wages, but has the option of paying the entire tax. In that case, the payment of the employee's share results in additional W-2 income for the employee.

Nanny taxes need not be paid for wages going to a spouse, a child under 21, or to parents in most cases. Additional information on the subject of taxes for household help may be found in IRS Publication 926. ☐

Keep financially fit

Ask our trust and investment pros about an asset management program that is tailored to your unique needs.

David Bogner
Vice President & Trust Officer
(815) 332-8864
davidb@stillmanbank.com

Jeffrey Hartle
Vice President
(815) 332-8843
jeffh@stillmanbank.com

Stillman BANK
Trust & Asset Management
8492 E. State Street • Rockford, IL 61108
815-332-8100
www.stillmanbank.com