

## Dreaming Big: Financial Planning for Unexpected Wealth

Money fantasies are nice. Some of them even come true – unexpected inheritances, yearend bonuses and yes, in even one in several hundred million chances, a winning Powerball ticket.

Most of us have fantasized about the fun we'd have with found money if it ever found us. But how many of us have fantasized about what we'd do to make it do the most good for our families, the causes we care about and ourselves? Keep these ideas in your hip pocket if your ship ever comes in:

**Make sure you have good tax, legal and financial planning advice:** This is a good idea even if you *never* receive a windfall. A qualified tax adviser, attorney expert in estate matters and a financial planner will ground you in reality before your fantasy comes through. Should unexpected money appear, each expert would be able to look at your personal situation and assess the risks and strategies necessary to accepting the funds without costly tax or investing mistakes. While inheritances are not in themselves subject to income tax, bonuses and gambling winnings may be taxable at your highest marginal rate or even place some of your winnings in a higher tax bracket. State and local taxes may also apply.

**Force yourself to think about true necessities before luxuries:** The adage “Pay yourself first” also works in the fantasy world. What are the biggest financial problems you'd like to solve today? That might be the best approach to thinking about your reaction to a windfall. Have you always dreamed about buying a home and owning it outright? Shoring up a retirement and healthcare strategy that would stand you in good stead no matter what the market did for the rest of your life? How about paying for your kids' college in cash so they wouldn't have to shoulder debt after graduation? Taxes can eat away a significant portion of unexpected wealth, so it is best to set priorities first to create a lifetime of financial health. It makes little sense to have a brand-new luxury car in the driveway if retirement goals and other family objectives are left unfulfilled.

**Pre-think a plan for helping others:** The news media are littered with stories about poor souls who waste sudden fortunes after being preyed upon by friends, family members and strangers with a “cause.” Giving to others – whether part of a wealth management strategy or simple yearend tax strategy – should be planned with the best advice based on the circumstances and assets available. As long as you're fantasizing about wealth, consider fantasizing about the people and organizations you would really want to help with any extra money you had, and commit to getting the right financial advice before writing a single check. There are a few smart ways to give away money – and many more dumb ones.

**Know your fellow winners:** It's one thing to go in with co-workers or family on a weekly lottery pool on a casual, fun basis. Unfortunately, that friendly group dynamic could change significantly with a big windfall. This is clearly a question for your tax and legal advisers, but some experts suggest that people who regularly gamble together draft a partnership agreement that can be reviewed by a qualified attorney. The partnership might also obtain a Federal Employer Identification Number that enables the winnings and the tax burden to be distributed along agreed-upon lines if it acquires a winning ticket.

**Know the tax impact of any court award:** If you win money in a court case, you may be sharing it with Uncle Sam. Generally, compensatory damages for personal physical injury or physical sickness are not taxable. However, other types of court-related compensation could be taxable as ordinary income – that’s why it’s critical to check with a tax adviser as part of your legal strategy.

**Think about your work:** There are many people who say they’ll never quit their job if they come into money. But it’s an important issue. Money changes relationships, and that includes your friendships at the office. Consider talking with a planner about how much money you’ll need for the rest of your life -- then you can move to a new career or cause that reflects the “new” you.

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## Losing Your Inheritance to Uncle Sam – or Others

Successful estate planning takes not one generation, but two. The first generation needs to make a clear, sensible plan and the second needs to be involved in that plan.

The best estate strategies tend to be made with the advice of a financial adviser or an estate planning attorney. Without proper planning, estates can be eaten away by bad planning in ways ranging from the simple to the complex. They include:

**Failure to leave a will:** Most Americans know what a will is. So why won't they take the time to make one? The estimated numbers of Americans without any kind of will is staggering – between 60-70 percent. Yet without a will in place, some or all of a person's estate may be transferred to Probate Court with a complete stranger assigned to decide the future of the deceased's assets. If you are a parent, make a will. These days, consumer software programs offer will kits that conform to legal language in each state and are legally binding and inexpensive to complete. They also prompt you to do health care and other directives (see below) necessary for a complete estate plan.

**No plan for incapacity:** An 80-year-old grandmother sinks into dementia. A 30-year-old father of twins is left in a coma after a car accident. Anyone can be left incapacitated at any age with no clear game plan for spouses or heirs. This wastes money, time and creates great emotional hardship. The Terry Schiavo situation was a wakeup call to families who realized they left incomplete instructions for their health care wishes in case of temporary or long-term disability. Advance health care directives designate health-care decision makers and delineate their powers, and leave very precise instructions about life support and other treatment options. Some individuals underscore written directives by videotaping themselves giving these instructions. Powers of attorney can also be created to assign financial decision makers to the situation.

**Failure to coordinate or update beneficiaries:** Any child who has struggled to settle a parent's estate is very likely to have had problems with beneficiary designations on retirement accounts, investments, insurance policies, savings accounts and bonds. Many people think that beneficiary designation occurs at the creation of the will -- not true. Beneficiary designations should be reviewed every few years for accuracy or when a major life event requires a change.

**Failure to inventory:** A parent may think they've got a great system for organizing their investments and estate instructions. But if they die or are incapacitated, heirs may find it difficult to navigate their bookkeeping system or find key documents and investments left inside the house or in safe deposit boxes elsewhere. Financial advisers can provide a centralized system of organization for clients by keeping a separate index of those materials to help guide family members and heirs through a serious illness or estate settlement. Failure to find key documents may lead to severe tax consequences later.

**No attention to special situations:** If both parents die, how will substantial assets or life insurance proceeds be managed for minor children? If there is an adult child with a disability, is a Special Needs Trust or other directive in place? If a parent, friend or sibling dies without instructions for his pet, who will get Fido? A person's last wishes are as unique as they are and should be considered part of the estate planning process. Heirs should insist on those provisions so they can distribute assets with maximum speed and minimum disagreement.

**No Power of Attorney or Inadequate joint name provisions:** An incapacitated relative not only needs someone properly designated in his or her directives, but they need that person to have proper access to funds. To provide for this, a durable power of attorney can be filed with the account custodian, or joint names can be listed on the accounts so bills can be paid. Naming a joint owner to an account may cause negative consequences, so consult your financial or tax professional before doing this.

**Failure to update:** Anytime there's a divorce, a change in permanent residence or a major life transition, it's a good reason to review an estate plan. Enlist your legal and financial planning professionals in this effort. Both perspectives are necessary.

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## The Pros and Cons of Reverse Mortgages

If you're at least 62 years old and the owner of a home that has significant equity, you have an opportunity to turn that equity into tax-free cash without having to move or make a monthly payment. It's called a reverse mortgage and can be a great financial tool – if you make sure it's truly right for you.

A reverse mortgage gets its name because it is the reverse of a traditional mortgage. Instead of the borrower making payments to the lender, the lender makes payments to the borrower, building the owner's debt level in the property as time goes on. The borrower gets to stay in the house and doesn't have to pay back the money as long as he or she continues to live in the home. When the owner dies or moves away, the house can be sold, the loan paid off and any leftover money goes to the living owner or the designated heirs. Yet it is not absolutely necessary that heirs have to sell the house – they can either pay off the reverse mortgage through their own funds or a refinance as long as they do it within a year of inheritance.

There are three basic types of reverse mortgages. The first are **single-purpose reverse mortgages**, which are offered by some state and local government agencies and nonprofit organizations; next are **federally-insured reverse mortgages**, which are known as Home Equity Conversion Mortgages (HECMs), and are backed by the U. S. Department of Housing and Urban Development (HUD); and finally **proprietary reverse mortgages**, which are private loans that are issued by the companies that develop them.

Borrowers may receive the money from a reverse mortgage in three ways:

- A lump sum cash payment;
- A monthly cash payment;
- A line of credit;
- Some combination of the above.

Reverse mortgages have traditionally been chosen by older Americans who can't cover a major medical bill or who otherwise have a need for cash for such things as long-term care premiums, home healthcare services or domestic help. More recently, though, they've become popular with individuals who see them as a better alternative to home equity lines for a variety of purposes from funding travel to financing second homes.

It's a good idea to consult with your financial adviser before you make this decision. These loans can be very complex. You may be required to meet with a counselor before you can apply, and this may delay closing on this type of financial arrangement for two to three months.

There are several potential drawbacks to reverse mortgages that need to be considered:

**They're expensive:** Reverse mortgages are generally more expensive than traditional mortgages in terms of origination fees, closing costs and other charges. For instance, a \$200,000 reverse mortgage may cost as much as \$10,000 in various fees. Private lenders are generally the most expensive, and some may charge ongoing fees for the life of the mortgage. You'll need to shop several lenders to compare, and focus on total annual loan cost.

**You'll still need to watch interest rates:** Reverse mortgages have rates that are typically higher than those charged on conventional mortgages. Interest is charged on the outstanding balance and added to the amount you owe each month. Again, check the total annual loan cost.

**You'll need to make sure you're not endangering your federal retirement benefits:** If your total liquid assets exceed allowable limits under federal guidelines, you might endanger your benefits. Make sure the monthly amount of your cash advance doesn't leave you with too much cash after your bills are paid.

**Your mortgage can be called:** If you fail to pay your property taxes, fail to adequately maintain your home or pay your insurance premiums, the lender can declare the mortgage due or reduce the amount of monthly cash advances to pay those overdue amounts.

**You may not leave much to the kids:** If your house is your major asset, getting involved in a reverse mortgage may not leave much to the next generation – if it appreciates, there may be some difference that the kids can have. That's why that in addition to discussing a reverse mortgage with a financial adviser, senior citizens really need to talk about it with their families.

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