

Smooth Decisions for Lump Sums

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The Do's and Don'ts of Large Payouts

Foremost: let's define 'large'? Clearly, a large sum of money varies from person to person. Someone with extreme wealth (Bill Gates) may consider \$100,000 petty cash whereas others view this as a nice nest egg. Accordingly, the lump sum's beneficiary's financial attitude will vary. Some may hoard it; others may spend lavishly. Initially, most don't know what to do. While there are no absolutely correct answers, we feel there are certainly more prudent ones than others.

It may seem paradoxical to say that a large cash payout can be as intimidating as it can be exciting. Before you dismiss the idea of that significant wealth is coming your way, consider these potential roads to riches:

- **Retirement.** If you are one of 76 million baby boomers born between 1946 and 1964 and participates in a 401(k) or other retirement program, you may find yourself with a considerable cash balance upon retirement¹ (current market conditions notwithstanding). It's essential that you know your options here to minimize the tax burden associated with retirement plan distributions.
- **Inheritance.** Perhaps you are fortunate enough to be remembered by a wealthy aunt or other well-off family member? The government estimates by 2015, inheritances will reach \$340 *billion*.² A caveat: being in a large family can significantly reduce your size of payout.
- **Divorce.** Perhaps marital bliss turned into a marital miss? We all know how common divorce has become. Large, cash settlements are quite common.
- **Insurance payouts.** This type of lump sum is quite frequent in the form of life insurance. The proceeds are generally tax-free to the beneficiary.
- **Employment related bonuses/stock options.** Usually, this is the time of year when bonuses are received. Sometimes it is budgeted as part of regular pay, other times it can be a very pleasant surprise. Pay attention to taxes, as bonuses can be the number one culprit leading to underpaid taxes at year-end.
- **Sale of business.** For many small business owners, this can be a large significant component of their net worth. There are a variety of options that can eliminate or minimize the taxes thereon. We're not being self-serving by suggesting you enlist a CPA early in the process.
- **Lottery.** Even though we've served clients who have had large winnings, we suggest you save your money for more productive purposes (with much better odds of return).

Now that you realize it is not far fetched to receive notable amounts of money, let's consider some financial do's and don'ts.

1. **Do pause and relax.** Deposit monies in an interest-bearing money market before making any future moves. Determine what, if any, tax consequences may be attached to the money. See #4.
2. **Don't go on a spending spree.** Amazingly, many windfall recipients end up with more financial pressure than before. Living beyond one's means is a common occurrence.
3. **Do know your financial limitations.** Your financial situation just got a bit more complicated and mistakes can become much more expensive. Leading us to #4....
4. **Do get professional advice.** Seek help from trustworthy and competent CPA's, financial planners and lawyers. Financial horror stories usually come from the do-it-your-selves. Shift this burden to those that have the training and expertise.
5. **Don't get greedy.** Again, it is amazing how frequently financial novices with sudden wealth are lured into sexy, get rich proposals. They want to be a 'player'. The sudden attention is flattering but the financial effect can be flattening.

Certainly, this list is not exhaustive. But the suggestions are connected by a common link: with increased wealth, comes increased responsibility. While feelings of anxiety are certainly understandable, reckless fiscal decisions are not. The financial opportunity can "enrich" one's life in many ways - if approached prudently. Remember, it's only money – make sure you control it; not vice versa.

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¹ Forum for Investor Advice 2001

² Bender: Financial Planning for the Elderly, 1999