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Too Rich, Too Soon

BY JESSICA SILVER-GREENBERG

Chris Kemper thought she was dreaming when she found out that her grandmother had left her \$6 million when she died in October 2010.

But her elation quickly turned to terror when she realized she had no idea what to do with that life-changing fortune. "I was thrilled and so scared that I would bungle it," says Ms. Kemper, a 44-year-old finance executive who lives in Westchester, Ohio.

Despite the bitter economic downturn, one part of the American dream is alive and well: the possibility of sudden wealth.

Examples abound. Consider David Choe, an artist who five years ago decided to accept payment in stock options from Facebook for painting murals in the then-fledgling firm's offices. He stands to realize as much as \$200 million when the company goes public later this year.

Then there's basketball point guard Jeremy Lin of the New York Knicks, whose meteoric rise could well lead to vast riches from world-wide endorsements, and the still-anonymous winner of this month's record \$336 million multi-state Powerball lottery jackpot.

Most, however, who receive sudden wealth will do so through more-conventional means. More than nine million households in the U.S. reported getting an inheritance of at least \$100,000, according to the latest available data from the Federal Reserve's Survey of Consumer Finances. Baby boomers—those 78 million people born from 1946 through 1964—are expected to inherit some \$8.4 trillion during their lifetimes, according to the Center for Retirement Research at Boston College.

Yet such life-changing windfalls can just as quickly vanish, say advisers who work with those who suddenly become wealthy.

Tales abound about lottery winners who squander their millions so quickly that they have to sell any future income

for pennies on the dollar and professional athletes plunged into bankruptcy after mismanaging their multimillion-dollar fortunes. Consider former baseball star Lenny Dykstra, who filed for bankruptcy in 2009 after once having a net worth estimated at \$58 million.

There are a number of strategies that can help maximize that windfall, ensuring that it lasts, says Lisa Featherngill, head of financial planning at Abbot Downing, a boutique unit of Wells Fargo servicing wealthy clients.

The key, Ms. Featherngill says, is solid planning. Assemble a team of advisers ahead of time, especially if you have some forewarning, as with an initial public offering. Your team should include a lawyer, an accountant and a financial adviser.

Here are the strategies advisers recommend.

First, buy some time. One pitfall for new millionaires is acting too quickly, financial advisers say. Many mistakes—extravagant purchases, foolhardy investments—are made in the first months after a windfall.

Their advice: Wait. "It's an extremely emotional time, so it's really important that you take a break to let it all sink in," says Judy Haselton, a certified financial planner at Harmony Financial Advisors in New York. "Take the time to make a list of goals that outline what you'd like to achieve with your wealth."

Susan Bradley, founder of the Sudden Money Institute, a firm in Palm Beach Gardens, Fla., has branded this time the "decision-free zone."

Count your money—and lock it up. Come up with your "end-of-day number," says Robert Pagliarini, president of Pacifica Wealth Advisors in Mission Viejo, Calif. To get that, take your gross expected windfall, then subtract taxes and any debts. Now you have a workable estimate and can realistically assess how long it will last.

Before making any important investment decisions or purchases, sock away your wealth in a safe place, such as a money-market account or short-term certificates of deposit, advisers say. Set aside a reserve fund that you won't touch. The fund should cover at least 18 months of expenses.

Don't be a sucker. You may find yourself besieged with "can't miss" investment pitches. Let your adviser play the bad-cop role. Tell your uncle who approaches you with a far-fetched investment idea that you have to run the idea by your financial adviser.

Richard Hearn, president of Starcare Associates, a financial-advisory firm in Newport Beach, Calif., tells clients to refer all investment ideas directly to him. He then asks them for a formal business plan. "Ninety-nine percent of the time, I never get that proposal," he says. "But it's a way of warding off potentially bad investment ideas."

There also is the temptation to help out family members or friends. If you decide to do that, make sure that you set up a formal contract. Lending money can very quickly destroy relationships if not done carefully.

Contracts should be drawn up and signed by both parties. Advisers recommend that the terms of the loan don't exceed 36 months.

Plan your estate. One thing to watch for right off the bat: underestimating your tax bill. "Over and over again, people are surprised because they didn't understand how much taxes should be paid on their new wealth," says Melissa Labant, tax director at the American Institute of Certified Public Accountants.

Double-check your existing will. Update any beneficiary designations to ensure that you won't unwittingly give assets to someone you didn't intend.

If you don't have one already, set up a power of attorney—a legal arrangement that enables you to hand over management of your finances to family

members or friends if you become too sick or otherwise unable to handle your money on your own.

A good option is a "springing" power of attorney, which doesn't take effect immediately, but rather springs into action only after you have been deemed incapacitated.

Next, hire an estate-planning attorney to help you map out a plan to distribute money to your children, grandchildren or other family members. One popular tool is a bypass trust—also called a "credit shelter" trust—which helps couples protect more of their assets from estate taxes, says David J. Kautter, managing director of the Kogod Tax Center at American University's business school.

Here is how the strategy works: When one spouse dies, the trust allows the maximum amount of money that is shielded from estate taxes to go in, with both the remaining spouse and any children the couple may have to be named as beneficiaries.

During the remainder of the surviving spouse's lifetime, the husband or wife can benefit from the interest generated by the trust. Any assets that remain after the second's spouse's death are passed, tax-free, directly to the couple's heirs.

Congress increased the amount that individuals can leave to their heirs or gift during their lifetime without getting hit by estate or gift taxes from \$1 million to \$5 million—at least until the end of this year, when it is scheduled to revert to \$1 million.

Still, some parents don't like the idea of setting up a trust for their children that could spoil them. "The idea of a trust-fund kid sends shivers down many parents' spines," Ms. Labant says.

One way to avoid that is to set up a trust that limits any large payouts until a child reaches a certain age. For example, some are structured to give children a 10% payout when they reach 25 years old, 20% at 35 years old and so on.

Invest for the long term. After your estate is in order, it is time to focus on your investment strategy to minimize risks and ensure a reasonable growth rate.

Many recipients of money from an IPO fall victim to what investors dub "Stockholm syndrome." Instead of diversifying their investments, they keep a large chunk of their money in company stock. "There is a problematic reluctance to sell because of loyalty to the company," Mr. Pagliarini says. That can leave you vulnerable to a sudden shift in

the market.

Instead, you should spread that money out into a mix of stocks, bonds and real-estate investment trusts, says Jim Steiner, head of Abbot Downing. With financial markets still extremely volatile, also keep some portion of your wealth in cash so that you have some "dry powder" at the ready, he says.

Become a benefactor. Giving to charity can help to minimize taxes as well as fund a pet cause.

One popular option: a donor-advised fund. These are offered through community foundations and are set up by firms such as Vanguard Group and Charles Schwab. These funds allow you to direct investments, get a tax deduction and make bequests on your own timetable.

Another way to give and reduce the amount you hand over to Uncle Sam is to give stock or real estate that has grown in value to a charity instead of cash.

Say you have set aside \$100,000 worth of stock to give and those holdings have increased by 50%. If you sell that stock and convert it to cash, you have to pay taxes on any gains, says Melanie Lauridsen, a tax specialist at the American Institute of Certified Public Accountants.

Instead, transfer those holdings directly to the charity. "That way, you get more bang for your buck," Ms. Lauridsen says. "If you transfer the property, you don't have to pay those capital-gains taxes."

Have some fun. Once you have mapped out a financial plan, you can begin to make those purchases you always have dreamed about.

Ms. Kemper, the finance executive from Ohio, wasn't sure what to do with her sudden windfall, and she was reluctant to spend any money.

Tom Bentley, her financial adviser, helped her set up trusts to protect her wealth, while encouraging her to finally build the dream house she and her husband had always fantasized about.

The couple decided to build a four-bedroom home for \$502,000. Just for fun, they added a theater room and Jacuzzi.

With interest rates so low, they took out a mortgage rather than paying in cash. "It's really exciting," says Ms. Kemper, who moved in this July.

Now that she has some more money, Ms. Kemper is taking her family on all those dream-destination trips that weren't possible before.

Next up: Alaska.