

Perspective from
Franklin Templeton
Wealth Planning

Your ship finally came in. Now what?

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Many people dream of winning the lottery or receiving an unexpected gift or inheritance from a long-lost relative. Or maybe it's a large bonus or company stock-related payout that results in an immediate cash infusion. Would this event be big enough to quit a job, retire or travel?

What would you do if that really happened?

Receiving a financial windfall can be exciting and overwhelming at the same time. It can also be confusing as you try to figure out what to do with it.

While people may spend time planning their first phone call after the big win, they may not be planning next steps.

First step, do nothing. Take a moment to understand what just happened.

Next step, meet with a financial professional and get some advice. A financial expert can help determine the best plan to manage the money that is most appropriate for your financial situation and goals.

Once you have experienced a financial windfall, you may want to put the money into a bank account or certificate of deposit until you establish a plan to manage the funds. An advisor may discuss whether setting up a trust is appropriate for your financial situation. Setting the money aside in an account will give you time to decide how to spend or invest.

Other initial steps may include paying off debt, especially prioritizing depending on the level of the interest rate. Or, building an emergency fund of at least three to six months' worth of expenses. Lastly, a comprehensive retirement review might be helpful to determine if new funds should be directed towards increasing contributions for long-term goals.

Taxes will impact your windfall

Before you can spend, there may be tax implications to consider.

How you claim the money and where you deposit it can make a big difference in how you are taxed.

In the case of a lottery win, for example, you may want to consult with a financial professional even before you claim your winnings.

Often with lottery rules, winners have an option to take a single lump sum, that is taxed or elect payments over time. This decision will make a difference in your net winnings.

Large compensation-related events can be complicated to understand and manage. The rules around exercising stock options or receiving restricted company stock are complex. For example, in some cases, a recipient can elect to pay taxes when a restricted stock award is granted and before having full ownership of shares (i.e., prior to vesting). This option allows the individual to potentially benefit from subsequent appreciation being taxed at long-term capital gains tax rates instead of ordinary income tax rates. This is referred to as an 83(b) election. (See Section 83(b) form.) Making decisions around managing non-cash compensation should be made thoughtfully with respect to tax implications and long-term wealth goals.

Inheriting property

When inheriting a house, first secure the property to protect it from theft or vandalism. Make sure the utilities are paid so you can keep the electricity and heat on while decisions are being made about the property. Funds to keep the house running may ultimately come out of the estate. If you have upfront costs, generally you will be able to seek reimbursement from the estate later.

Check in with your lawyer and an estate planner. Get legal advice early on to understand the steps involved if the property needs to go through probate. A lawyer can provide a calendar of required actions and a checklist of activities. If you are not the sole heir, you may have to decide with other heirs what to do with the property, whether that is selling the house or making some arrangement to buy their shares.

Timely financial activities include paying any taxes or past due bills. Check on the home-owner's insurance. You may be able to purchase vacant home insurance at a reduced rate for a limited period while you are preparing to sell the property.

Retirement accounts

If you inherit an IRA or 401(k), your financial advisor can help you navigate the rules for inherited retirement accounts. Rules differ for spouses compared with non-spousal heirs.

Looking ahead, the IRS recently provided clarity on the rules for distributing funds from inherited retirement accounts. The regulations require that annual, minimum distributions be made on inherited accounts where the original owner passed away after reaching their required beginning date (RBD). In addition, the heir must fully distribute the inherited account within 10 years after the death of the account owner. The rules differ depending on whether the account owner reached their RBD. In the case where the account owner dies prior to reaching the RBD, there is no annual distribution requirement. The inherited account only needs to be fully distributed by the end of the 10-year period. Spouses and

certain heirs are exempted from the 10-year rule and can stretch distributions based on their remaining life expectancy.¹ Additionally, spouses can elect to treat an inherited retirement account as their own. See our recent article on distributions, “Heirs must act on inherited retirement accounts this year.” (View <https://www.franklintempleton.com/articles-us/retirement/heirs-must-act-on-inherited-retirement-accounts-this-year>.)

Make a plan to stay on track

There are myriad factors that can influence your actions if you don’t have a plan. Emotional responses can drive financial choices and not always in ways that are the most beneficial. If you start spending immediately, or give money away to family and friends, your windfall could quickly shrink. Receiving a financial windfall can help you improve your financial situation, by paying down nagging debt, securing a 529 plan for children or grandchildren, or boosting retirement savings. For more helpful information see FINRA’s “Tips for Managing a Financial Windfall.” (View the article, <https://www.finra.org/investors/insights/managing-financial-windfall>.)

1. An exception to the 10-year distribution rule applies to eligible designated beneficiaries (EDBs). These types of beneficiaries include spouses, individuals with disabilities or those who are chronically ill, beneficiaries not more than 10 years younger than the account owner, or minor children of the account owner (up to age 21 upon which the 10-year rule applies). These EDBs have the option to take distributions gradually each year based on their remaining life expectancy.

WHAT ARE THE RISKS?

All investments involve risks, including possible loss of principal.

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