

**Financial planning**

Sudden wealth

The ABCs of trust services

**Wealth management**

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The trustee's duty to act



# The Prudent Investor

July 2024

## The problem everyone wants: Sudden wealth

*Changing circumstances can bring unexpected complexities.*

The most routine sources of sudden wealth are lump sum distributions from employer retirement plans and inheritances. Other events that can affect one's financial landscape include:

- divorce settlement;
- insurance settlement;
- sale of a business;
- inheritance;
- contract signing bonus;
- initial public offering;
- exercise of employer stock options.

As much as we all might wish for a windfall, there is a well-documented record of evaporation of sudden wealth. Many lottery winners are bankrupt within a few years, for example.

Inexperience with tax and investment issues is one part of the problem, of course. But there's also an emotional component, experts have found, that needs to be addressed. That's one reason for the common counsel to avoid rushing into any major decisions. Especially if the wealth is an inheritance, there may be issues of grief and loss intermingled with the possibility of financial security.

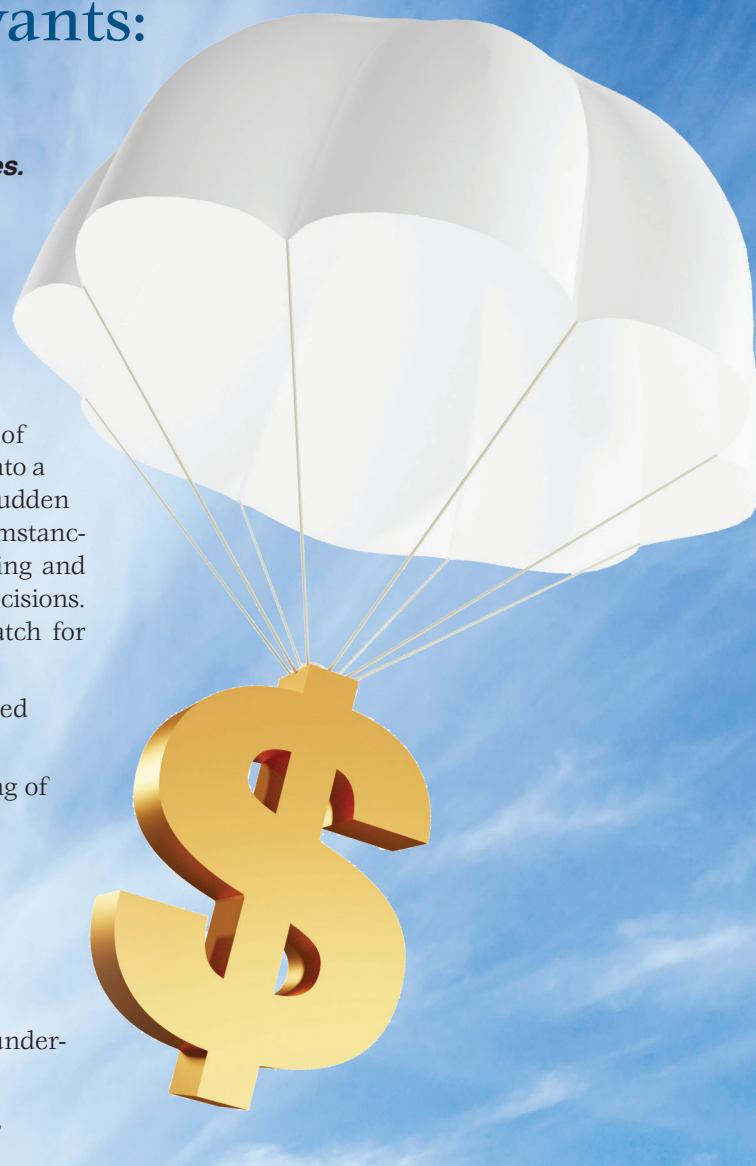
### Signs of trouble

When the wealth transfer trigger is one of life's major turning points, such as retirement or the death of a family member, the recipient of the windfall may be put into a vulnerable posture. The sudden change of financial circumstances can itself be bewildering and can lead to unfortunate decisions. Behavioral worries to watch for include:

- recurrent money-related ruminations;
- "ticker shock," a cycling of hope and anxiety that parallels the stock market's volatility;
- sleep disorders;
- guilt over the good fortune, inhibiting decision-making and undermining pleasure;
- fears of loss of control, paranoid thinking, concern about being exploited or hurt by others.

These are signs that professional financial management guidance is likely to prove helpful.

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*Changing circumstances can bring unexpected complexities.*



### Deferrable decisions

The first steps one needs to take upon receiving a windfall involve setting goals and developing strategies. A realistic assessment of long-term needs may not be easy, but it provides an important foundation. Matching resources to those needs comes next, followed by a strategy for investing and managing one's new assets. Until these steps have been taken, major temptations such as the following should be avoided:

**Early retirement.** As alluring as jumping off the treadmill of daily work life may be, one needs to plan for longevity as well. You need enough financial resources to cover the unexpected, as well as what you can foresee.

**Relocation.** Changing domicile is a major life decision. Before permanently moving to a new city or state, it may be wise to live there temporarily, to become confident that it will be all that is hoped for.

**Major gifts.** Family members, friends, and even charities may approach the recipient of sudden wealth with requests for help. Keep in mind that a gift is forever, and the income that gift might earn goes along with it. Be certain that you can really afford to part with the capital. Don't overlook the fact that major gifts to friends and family may trigger gift tax obligations as well.

### If you have come into a fortune . . .

We have quite a bit of experience with wealth management. We know all about financial transitions and the emotional adjustments that go along with them. When you come into significant sums, call upon us for:

- **personal investment accounts**, with asset allocation planning, unbiased investment advice and fees linked to account value (not transactions);
- **revocable living trusts**, for an added measure of financial flexibility, including protection in the case of disability and probate avoidance;
- **rollover IRAs** to extend the tax-deferral benefits for your retirement money.

### If you will be giving a fortune . . .

If your estate plan includes a substantial legacy for a younger family member who lacks full financial maturity, 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.

For more information about how trusts may help you to make the most of what you own, please schedule a free consultation with one of our officers. □

## The "ABCs" of trust services

Trusts are not as mysterious as most people seem to think, and technological advances have made trust-based financial planning accessible to more and more families. That's one reason why discussions of trusts seem to be popping up in the popular press more and more.

The ABCs of a trust arrangement are not hard to follow:

- A.** You, the grantor, or donor, transfer money and/or property to the care of a trustee.
- B.** The trustee takes legal title to the money or property but receives none of the privileges or benefits of ownership.
- C.** The trustee is required to invest, manage and distribute the trust assets for the beneficiaries whom you name, according to your instructions. You and your attorney spell out those instructions in a formal trust agreement—or, if you're leaving your assets in what's known as a testamentary trust, in your Last Will and Testament.

A trust can do almost anything that you want it to. Perhaps that's what makes trusts so mystifying to most people. There's no such thing as a "typical trust."







QUESTIONS & ANSWERS

## On federal gift taxes

**Q.** *With the federal estate tax exemption this year of \$13.61 million per person (over \$27 million for married couples), I no longer am concerned about that tax. Do I still need to worry about the gift tax?*

**A.** Yes, you do. You are not likely to ever owe federal gift tax, but you are required to file a gift tax return for any year in which you give someone more than the gift tax “annual exclusion” amount. For gifts in 2024, that number is \$18,000. Last year, it was \$17,000. The exclusion is adjusted upward when inflation is enough to lift it by \$1,000. If you gave your child \$10,000 per year for ten years, no gift tax return would be needed. But if you gave \$20,000 in a single year, then a gift tax return is required.

**Q.** *How much gift tax would I owe on that \$20,000 gift?*

**A.** None, most likely. The excess amount, \$2,000, would reduce the amount of your eventual federal estate tax exemption. Nevertheless, the gift tax return must be filed.

**Q.** *I have three children, so am I limited to \$6,000 for each of them?*

**A.** No, the gift tax annual exclusion amount is \$18,000 per person.

Say an individual has three children, four grandchildren, and three great-grandchildren. Gifts of \$18,000 may be given to all ten descendants in 2024, removing \$180,000 from the taxable estate.

**Q.** *I paid my child's college tuition this year, over \$40,000. Do I have to file a gift tax return on that?*

**A.** No, you don't. Paying someone's tuition directly does not count as a taxable gift, no matter the amount of the payment. However, giving the child the cash to make the tuition payment would be a taxable gift.

**Q.** *Any other exceptions like that?*

**A.** Direct payment of medical expenses is also not a taxable gift.

Imagine that Mary paid \$10,000 directly to health care providers on behalf of her son, John, this year. She also gave him \$12,000 in cash to help him with his household expenses. Mary made direct tuition payments for each of her three grandchildren, totaling \$90,000. Finally, she gave each grandchild \$10,000 cash for “spending money.”

Mary has given away \$142,000 worth of her wealth to family members, but with the combination of exceptions she *won't* have to file a gift tax return.

**Q.** *I'm married. I want to give my son \$25,000. Should I just give him \$18,000, and have my husband write a check for the other \$7,000?*

**A.** That would be the simplest, when the gift is of cash. But what if the gift is a block of stock worth \$25,000? In that case, you and your husband may “split” the gift to apply both of your annual exclusions to the transfer. You have to file a gift tax return reporting the transfer to obtain split gift treatment, but it won't affect your eventual federal estate tax exemption.

**Q.** *I have some stocks that I bought for \$5,000 years ago. I can make a gift of that without filing a gift tax return, right?*

**A.** No, your tax basis does not come into play on this question. What matters is the fair market value of the shares today. Are they worth less than \$18,000? Then no tax return is needed. But if the market value is more than \$18,000 on the day of the gift, a gift tax return will be required.

**Q.** *Why do all this paperwork when I am almost certainly never going to have to pay a gift tax?*

**A.** That phrase “almost certainly” holds the key to answering your question.

What happens if you win the Powerball® and are suddenly worth \$200 million? Then you will almost certainly be paying estate and gift taxes, and your prior gift tax filings will come into play.

There is another possibility. The current large estate tax exemption is set to expire after 2025. That would bring the exemption down to \$5 million (plus inflation adjustments). There has been some political support for reducing that exemption to \$3.5 million, and perhaps dropping the inflation adjustments, which are a fairly recent phenomenon.

Keep in mind also that just 21 years ago, the federal estate and gift tax exemption was only \$1 million. You might not be off the hook, after all. □

## The trustee's duty to act

In 2005, Richard Ripps executed his will and a restated revocable trust. His three children from an earlier marriage were the trust beneficiaries. The will poured all of Ripps' estate assets into the trust. When he died a year later, Ripps' estate was worth about \$12.9 million, consisting of various real estate development projects.

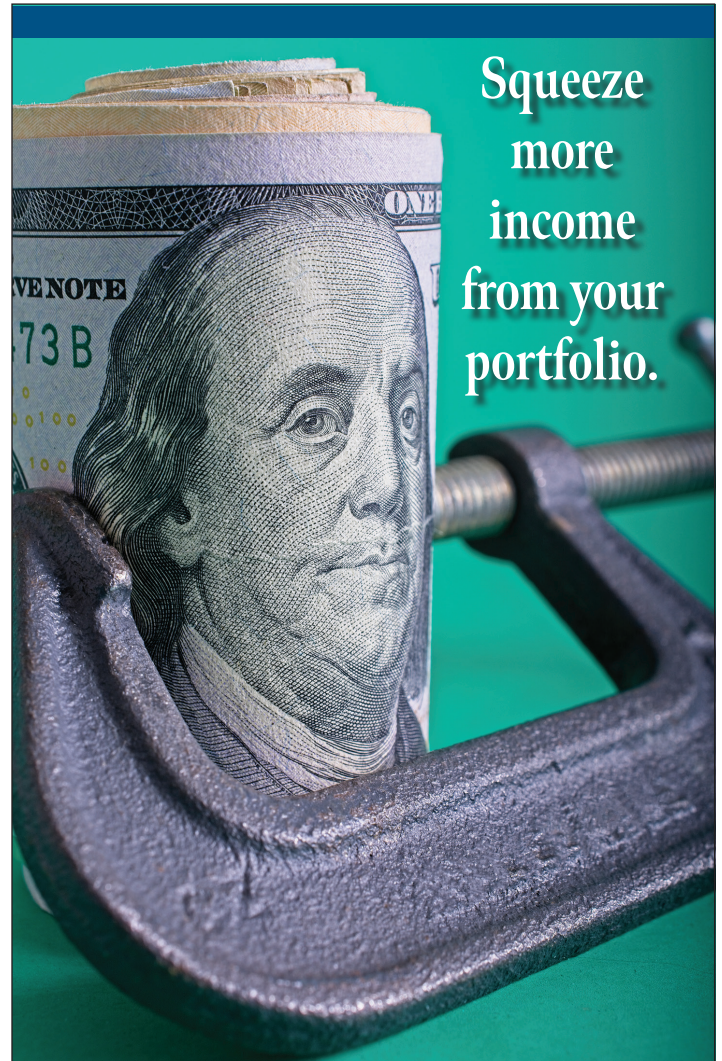
Attorney Laurence Rubinow and another attorney were nominated to be executors of the Ripps estate and trustees of the trust. The other attorney resigned the positions, and Ripps' surviving spouse was made co-trustee of the trust. Together with Ripps' business partner, Finguerra, Rubinow continued to manage the real estate interests. In 2011, one of the operating agreements for a development project was amended to provide Finguerra with a salary of \$175,000 annually, retroactive to 2007.

In 2016, Ripps' ex-wife, the mother of the three trust beneficiaries, was named a third trustee of the trust. She began asking questions about the management of the estate, why nothing had been distributed from the estate to the trust in ten years, whether certain management decisions for the real estate had been in the best interests of the beneficiaries, and why Rubinow and law firms he was associated with had collected some \$1.8 million in fees from the estate. Eventually her questioning led to a request to the Probate Court that Rubinow be removed as executor for conflicts of interest and malfeasance, which the Court denied.

Next, the beneficiaries and the ex-wife sued the surviving spouse in her capacity as trustee, alleging a breach of her fiduciary duties. She had failed to attend any of the Probate Court hearings, and she had rubber-stamped the payments to Finguerra without investigation. Most important, she had not taken any steps to acquire the property that was to pass to the trust, and had not even questioned the executor about the timeline for distributions or the management of the real estate.

The Probate Court ruled against the beneficiaries, saying essentially that the trustee's fiduciary obligations did not begin until the property was transferred to the trust. On appeal, the Connecticut Supreme Court reversed that judgment. "A trustee owes a fiduciary duty to administer the trust in the interest of the beneficiaries, and that duty commences when the trustee accepts the trusteeship." The trustee must collect and protect the property that will belong to the trust, and must take timely steps to enforce the claims of the trust.

The case was returned to the trial court for additional fact-finding, which could include a claim for damages by the trust beneficiaries. □



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Telephone: (207) 622-5801 Fax: (207) 621-6790

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