

Planning for the **Suddenly Wealthy:** Call in the **SWATT Team**

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Coming into money can be both a blessing and a curse. Whether the client is a rookie professional athlete who just signed a multiyear, multi-million dollar contract; a young entertainer with a hit show and endorsements; the beneficiary of a trust that has terminated; a lottery winner; or the winner of a large verdict or settlement in a personal injury or divorce case, special attention from a team of professional advisors can avoid negative consequences from the windfall.

What's more, implementing a Sudden (or Substantial) Wealth Accumulation and Transmission Trust (SWATT) can mean the difference between the client enjoying lifelong comfort or ending up worse off financially than before the sudden wealth.

Concerns

Taxes: The influx of wealth may be taxable itself and when the proceeds



are invested there will likely be taxable income and gains. Mostly newly wealthy clients will be unfamiliar with their new tax requirements and may be faced with substantial federal and (perhaps multiple) state income taxes. The client may also now confront human resources issues under labor laws, and state and local payroll tax and insurance filings.

Requests from friends and family:

Newly wealthy individuals often discover that they can't say no to requests for financial assistance from family and friends, which can create cash flow problems and even generate gift tax obligations. A client who decides to

make generous loans instead of gifts face issues regarding documentation and taxation of interest.

Philanthropy: Charities will solicit the newly wealthy and the client will need guidance about evaluating institutions, rationalizing a coherent charitable program, impact on cash flow and tax-efficient mechanisms for contributions or pledges.

Investments and Insurance: New-found wealth can be poorly invested due to lack of experience and oversight. Building an effective wealth management team is of the utmost importance. There will be critical issues of appropriate wealth

allocation—for example, how much money to allocate toward non-financial assets such as residences, vehicles, jewelry and art. The purchase of such assets in turn creates a need for liability, and real and personal property, insurance. Life, health and disability insurance will be critical as well, the latter especially for the athlete or entertainer.

Without appropriate counsel on all of these issues, many newly wealthy individuals end up losing everything, despite their influx of money. We often hear of actors or other entertainers, sports figures and lottery winners who wind up with nothing because they don't know how to deal with these concerns and don't seek proper guidance.

A variety of professionals will be eager to provide advice: business managers (at least for athletes and entertainers), investment managers, tax accountants, and insurance brokers. Lawyers can take the lead on coordinating the different professionals, designing and implementing the optimal legal structure and promulgating clear lines of responsibility.

Goals

- Consider whether large, ongoing infusions of cash are likely—and for how long. Entertainers and athletes may have a relatively short period of years when very substantial remuneration may be expected. Lottery winners, beneficiaries of trusts, and winners of lawsuit settlements or verdicts may receive only a one-time windfall which should be shepherded very carefully.

- In many cases, the client will have significant intellectual property needs, such as handling endorsements, contracts, and the right of publicity. Intellectual property rules vary greatly from

state to state. For example, the right of publicity passes through the estate to beneficiaries in California but not in New York.

- Asset protection is key for the newly wealthy. A client may be inexperienced with normal business practices, and special attention should be paid to bookkeeping formalities and use of separate LLCs for different types of property, residences and vehicles.

Lawyers can effectively guide a client to these goals. Lawyers can negotiate service and employment agreements, commercial agreements, endorsement

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contracts, acquisition of real estate and other tangibles, charitable pledge agreements, wills, trust agreements, and other estate planning documents. Additionally, a lawyer can design, explain and implement an overall structure strategy geared toward protecting the client's assets while also enabling the client to retain ultimate control.

The SWATT

Basic Structure: The simplest way to structure a client's assets might be a "management trust." Such a trust will be tax neutral. There should be a bank as an administrative trustee, a trusted individual trustee, and a trust protector (to protect the client from being taken advantage of by a once-trusted individual).

The trust should permit distributions to the settlor/client, but it may also include discretion for distributions to

specific relatives or classes of relatives. Initially, the client may not be ready to make estate planning decisions, and so at inception the remainder of the trust upon the settlor's death may simply be left to the settlor's estate. Establishing the management trust structure immediately is critical, even if the client is not yet prepared to decide on estate dispositions.

Situs: The trust should have a situs in a flexible trust and LLC jurisdiction because there will be multiple fiduciaries with different roles and a variety of special purpose entities or assets held by the trust (usually LLCs). At the moment, New York trust law is still evolving in these respects, so many practitioners will use Delaware trusts and Delaware LLCs.

Fiduciaries: The bank administrative trustee can keep track of investments and custody assets and, as necessary, implement trades and track results. Obviously the location of the financial institution can provide a jurisdictional nexus for the choice of law. Having the bank handle routine administration matters will free up the other professionals (trustee, trust protector, distribution and investment directors, lawyers and accountants) for more discretionary and globally important decisions. Some banks can also provide ancillary services such as LLC maintenance, family office services or even investment management.

Often, the individual (non-administrative) trustee will also be the business manager. Perhaps yet another individual would be responsible for directing distributions to beneficiaries (whether from inception or after

death of the client). Investments may be supervised by either the business manager/trustee or a separate investment director.

A trust protector provides the safety feature of preventing one of the other fiduciaries (bank or individual trustee, distribution director, investment director) from taking advantage of the client or just doing a poor job. An alternative would be for the settlor/client to retain the unfettered right to remove and replace fiduciaries and the right to revoke or amend the trust, but that would leave the risk that a third party might improperly prevail on the client to bring down the entire structure without the participation or at least consent of any of the professionals who set up the trust in the first place.

Amendments: To retain maximum flexibility and to deal with changes in tax or substantive law or family and financial circumstances, the settlor/client should have broad power to amend or revoke the trust or remove fiduciaries but (here's the critical part) only with consent of the trust protector (or in the case of removal of the trust protector, consent of the trustee). By the same token, the trust might give the trustee and the trust protector the right to make technical and administrative amendments even without the settlor's consent, for example, if the settlor becomes incapacitated.

LLC Structures

The SWATT will usually own a master holding LLC (managed by the individual trustee) with different classes of assets held in different LLCs. There may be separate subsidiary LLCs for each residence, boat or plane, valuable

automobiles and portfolio investments. There may also be separate subsidiary LLCs to deal with all human resources issues and perhaps also to deal with insurance functions. Finally, there may be a separate LLC to deal with intellectual property, endorsements, branding and related issues.

Each of these LLCs will have a manager, who may also provide professional advice in that area. The individual trustee, as manager of the master LLC

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that holds the subsidiary LLCs, should be able to change the managers if there are any problems. However, the trustee would not need to be involved in the day-to-day management of each of these LLCs unless and until there is a problem.

Add in Estate Planning

Once the client is prepared to deal with estate planning, the management trust can also become a testamentary substitute because it already holds all or most of the client's assets. That will truly make it a SWATT. For privacy purposes, the management trust might pour over into a separate revocable trust at the settlor's death, so that any counterparties who need to see the management trust are not privy to the estate plan. In designing and drafting the testamentary revocable trust, all of the usual estate planning questions will arise, but there may be particular

and sensitive issues regarding liquidity and tax allocations.

The client will still need a pour-over will to dispose of assets not in the trust, as well to name guardians for minor children and to exercise any testamentary powers of appointment. A will is also needed to appoint an executor to deal with postmortem financial claims, paternity claims, and any personal rights that were not or could not be assigned to the trust.

Finally, to facilitate estate planning transactions, including GRATs, installment sales, and creation of completed-transfer trusts, the management trust itself should authorize all of these techniques as well as decanting as needed. The trust instrument could also allow the trustee and the trust protector to engage in estate tax savings transactions even if the settlor becomes incapacitated, as long as the trust's general pattern of dispositions is followed.

Conclusion

Lawyers are well-equipped to meet the challenge of representing a suddenly wealthy client. An effective lawyer can ascertain each client's needs and goals, circumstances and resources, strengths and weaknesses, and then coordinate a team of advisors to administer a SWATT trust and LLC structure. When a client's assets are appropriately structured, the upsides are clear: strong monitoring and supervision and authorization of the right people (the SWATT team!) to handle their respective areas of responsibility. Then the client is free from administrative headaches and also free to make necessary changes in goals or personnel.