PERSPECTIVE

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You've Won The Case, Your Client Will Recover, So Now What?

By Robert W. Wood

Legal victories can be sweet, whether by settlement or judgment. Everyone wants to win, but lawyers may not consider all the ramifications to the client. Whatever kind of case your client is pursuing, much can change when the money comes in. For some, when success comes, it can be bewildering.

Well-meaning family, friends and advisers may rush to help, and a few vultures may show up, too. Having come so far, you want to maximize security and opportunity, while steering clear of risks. This checklist can help.

Get tax advice. Settlements and judgments have tax consequences. Try to get tax advice before your client signs an agreement. Often, wording can improve the tax posture. Tax language and reporting can affect how the recovery is taxed, deducting attorney fees, or both. Even the way a check is prepared or a wire is sent can affect your taxes. Ask your client to get someone to "run the numbers" to have a good idea of the tax consequences.

Consider a low profile. Publicity can be inevitable, but consider whether and how much there should be when you can. Especially in settled cases, avoiding amounts can be wise. Consider the type of case and the nature of the legal fees, and whether publicity may attract a tax audit (yes, it can happen) or vultures.

Structured settlements. A structured settlement is possible in many types of cases, not just injury cases. The defendant pays a third party, who then pays out the money over a set period. If your client is interested in the tax and financial benefits of a structured settlement, you will need to take time before the settlement to explore available options, and to make the necessary arrangements before the settlement documents are signed. It can be a good way to reduce taxes, plan for the future, ensure long-term economic security, and shelter income from a wide variety of social and economic pressures that may hit as the settlement becomes final.

Consider moving to a low-tax state. If you are about to recover a large and long-awaited sum and it is taxable, your client might want to consider the tax consequence of where he or she resides. In California, you pay up to 13.3 percent in state income tax. But would you be just as happy living in Nevada or Florida, which has no state income tax?

The laws governing residence and domicile vary. Still, many of the steps that are appropriate to establish or move one's residence are common-sense. They include such items as physical presence, intent, voting, driver's license and vehicle registration. Seek professional help from a qualified tax attorney to make sure everything is in order.

Depending on your timing and thoroughness, a high-tax state may claim you are still a resident after you receive your recovery. If you plan a move well before a recovery and follow the advice of a tax professional, you can reduce any chance of controversy and maximize your chance of success.

Pay off debts. Paying off debts is almost always a good idea, and can be tremendously liberating. With low interest rates and low yields on most investments, paying off high-interest debt (such as credit cards) can be a smart move.

Avoid sudden lifestyle changes. If your recovery is large, it may tempt to make up for lost time, splurging on items you and your family have put off. Some of this is fine, particularly for items most people view as essential like housing, transportation and education. Yet unless your recovery is so large as to put you in immediate retirement mode, most experts suggest taking time to let the effects of a large financial award sink in. For the first six months or so, it may be best for you not to make drastic changes.

Invest prudently. Consider dividing your funds and investing with different financial advisers rather than putting all your eggs in one basket. Ask your advisors to suggest an allocation between equities (stocks) and fixed income (bonds). Ask for examples of how the returns will come in. Do not invest in deals that promise too-good-to-be-true returns or in complex strategies you do not understand. Remember, it takes a 100 percent gain to recover from a 50 percent loss.

Consider asset protection strategies. As you gain wealth, you may need to protect yourself from claims. Claimants may include disgruntled spouses or ex-spouses, employers or employees, or frivolous lawsuits. Common asset protection strategies include trusts, family limited partnerships and limited liability companies.

Gift and estate planning. Whether your recovery is big or small, think about estate planning. Even if you aren't wealthy, you'll save yourself and your family money, time, expense and privacy by having a plan in place. A living trust and a pour-over will (that upon your death pours all your assets into your trust) will keep your estate out of probate.

Probate is public, time consuming, expensive and unnecessary. You want to avoid it. You should also consider taxes. The good news is that under current tax law there is no federal estate tax for any sum you leave your heirs under $5.34 million in value. In 2015, the amount goes up to $5.43 million.

Since the $5.34 million tax-free allowance is per person, a married couple can double this amount before paying estate tax if they are careful and structure it properly. Normally, a trust to the surviving spouse keeps the maximum amount going to the children without tax, if that is the couple's goal. Note that gifts made during your life are added to those made at death, and you will need to file gift tax returns every year in which you give more than $14,000 per person.

You can generally give up to $14,000 per year to any number of people without filing a gift tax return. This allowance is personal, so you and your spouse combined could give as much as $28,000 to each person. Get a qualified lawyer to help you formalize and record your gifts.

Gift tax returns are often a good idea, even when they are not required, as a gift tax return ensures that the Internal Revenue Service statute of limitations (three years from filing) will run. Gifts of family partnerships, real estate and interests in businesses usually also require gift tax returns even if less than the $14,000 value.

Conclusion? Enjoy your success. You can't do everything at once, and you are bound to make mistakes, but if you follow the steps outlined above, you should be well on your way.

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