Morgan Stanley

PRIVATE WEALTH MANAGEMENT

MANAGING A FINANCIAL WINDFALL

Whether you have signed a big contract, received a sizable inheritance, sold a business or experienced some other major liquidity event, gaining liquid wealth at a young age presents a unique set of challenges and opportunities. The more prepared you are from both an emotional and wealth management perspective, the better able you will be to confront the challenges and maximize the opportunities implicit in your new financial position.

1 TAKE STOCK

2 ASSEMBLE YOUR ADVISORS

3 ESTABLISH YOUR PRIORITIES

4 BUDGET FIRST SPEND SECOND

5 LEARN HOW TO SAY "NO"

FAMILY DYNAMICS AND INHERITANCE

If there is a history of conflict in your family, or if you believe that the event has the potential for creating conflict in the future, it is often best to address the issue sooner rather than later. While not right for every family, establishing frameworks for communication, such as regular family meetings — sometimes facilitated by professionals — often helps to reduce the potential for devastating family conflict. More specifically, a thoughtful, fair-minded estate plan that has been clearly communicated to each beneficiary may not resolve all issues, but it is something that should be considered. If you are past that point, here are some thoughts to keep in mind:

- Sometimes family disputes are more about misunderstandings, divergent expectations and resistance to change than they are about greed. Sometimes they're about what happened at the dinner table many years ago or long pent-up jealousies and resentments. It may be easier to resolve financial disputes if you understand that they may not be principally about the money.
- Blame and anger create more blame and anger. When working through a dispute, try to avoid accusations and stick to the matters at hand.
- Don't forget that fights among wealthy heirs make very good tabloid copy. Public disputes over your inheritance can even have a material impact on the value of what you are inheriting. For example, the value of a privately held company can be greatly diminished by the distractions and reputational degradation caused by ownership disputes.
- If you cannot agree on a division of assets, try to agree on a fair process to resolve your dispute. If both sides can at least commit to the process, they have a better chance of reaching a resolution.
- If you have endured severe conflicts over an estate, do not allow history to repeat itself. Make sure that your children understand what to expect and why, and give them a chance to raise concerns while you are there to help resolve them.

ENJOYING GOOD FORTUNE

Sudden wealth can provide an amazing opportunity to create a better life for yourself and others. It can also create stress, complications and conflict. Set yourself up for success by surrounding yourself with competent advisors you can trust, and taking the time to understand the issues and make informed decisions. Most importantly, continue to enjoy the people and the activities that are important to you. A new level of wealth does not require you leave your current life behind. If managed well, it simply gives you the opportunity to enhance whichever areas of your life you choose.

[1] Source: IRS. Available at https://www.irs.gov/retirement-plans/plan-participant-employee/retirement-topics-ira-contribution-limits. July 13, 2023.
[2] Source: Family Business Institute. Available at: https://www.familybusinessinstitute.com/what-represents-failure-in-family-business/. May, 2, 2018. Accessed 05/2023.
[3] Source: Score.org. Available at https://www.score.org/blog/what-do-when-youve-unexpectedly-inherited-family-business. January 20, 2023.
[4] Morgan Stanley does not provide legal or tax advice.

CRC 4316899 03/2025 PWM7941501 CS 1614992-5555242 03/25

THE FIRST FIVE STEPS

While the best time to start preparing for a major liquidity event is at least two years before it occurs, circumstances do not always allow for planning in advance. If that's the case, you will need a somewhat accelerated process to define your goals, assemble your advisory team, formulate a strategy to manage tax consequences and create a wealth management plan that supports your deserved way of living and helps you achieve your fundamental goals.[4] The following five steps are a great place to start:

1. TAKE STOCK.
The first step in handling sudden wealth is to understand exactly what you have. That can be a surprisingly complex task. Start by reading all of the paperwork associated with the event and highlight everything you don't fully understand. Your focus should be on developing a list of questions to ask qualified professionals.

2. ASSEMBLE YOUR ADVISORS.
The core of your team should comprise of your Private Wealth Advisor, a corporate attorney, a trust and estate attorney, an accountant and perhaps a personal manager or family office professional. Assuming you already have a relationship with a Morgan Stanley Private Wealth Advisor. You should vet all of these individuals by understanding their professional and disciplinary backgrounds. Ask for references, and check every one. Then check out professional organizations for disciplinary records. Be sure to review all agreements very clearly so that you understand exactly how, and how much, each of your advisors is being paid and what you can expect in return.

3. ESTABLISH YOUR PRIORITIES.
Give some serious thought to the kind of lifestyle you want to live and the people and causes you want to support, and discuss your ideas with your advisors. By defining and prioritizing your life goals, it may be easier for you and your advisors to create a customized plan that helps produce the income you need to support the life you want to live and the legacy you want to create.

4. BUDGET FIRST. SPEND SECOND.
Some newly wealthy individuals think first of celebrating their changed position by making one or more significant purchases. Before you go too far, it pays to sit down with your Private Wealth Advisor to determine a sustained level of spending given your potentially changing life goals. Remember that many big-ticket purchases come with major, long-term maintenance costs. Make sure you will be able to keep what you buy.

5. LEARN HOW TO SAY "NO."
Sudden wealth tends to attract new "friends" and long-lost family members. If you wish to help, consider adding a line to your household budget and stick to it. That will help you limit your gifts to a sustainable level and encourage you to consider carefully who is really worthy of your support. If you find it helpful, use your Private Wealth Advisor or other professionals as a buffer, allowing them to be an objective third party who can turn down requests.

SUSTAINABLE BUDGETING

You may have a long list of things you want to buy and do, and people and causes you want to support. Now you have the funds to make it all happen. Or do you? The case files are full of very successful people who depleted vast fortunes by overspending and over-gifting. Developing a sustainable budget should be a top priority, particularly if your accumulated wealth will now serve as your primary source of income.

ESTIMATE YOUR EARNINGS
Before you determine how much income you will need to derive from your invested assets, add up the income you will receive on a regular basis. This should include your salary and bonus, but only factor in distributions from trusts or other family support if it occurs on a predictable, regular basis. If you do not expect your salary to continue after your liquidity event (perhaps because you sold your business or quit your job), use a conservative estimate for any freelance or consulting income you expect.

TRACK YOUR EXPENSES
Prior to your liquidity event, write down everything you spend for at least three months and what you spend it on (broad categories are fine). Also be sure to capture regular annual expenses like property taxes, insurance payments and club dues. If you are already past that point, use bank records, debit and credit card statements to recreate your pre-liquidity-event expenses. Make sure to include any ongoing philanthropic commitments.

At this point, you should have a clear sense of whether your projected earnings can sustain your current lifestyle. If not, you will either need to reduce expenses or earn income from your investments to bridge the gap. Of course, most people look to enhance their lifestyle after a major liquidity event.

ESTABLISH YOUR GOALS
How do you want the money you have just received to change your life? Do you want to continue your current lifestyle and simply have more control over your time? Do you want to start a new business, travel or pursue some other lifelong dream? Are there organizations or family members you intend to support? Do you want to start a new business? This is a good time to sit down with your family, legal advisors, accountant and your Private Wealth Advisor to sort through your priorities and start putting some numbers to your ambitions.

CALCULATE SUSTAINABLE WITHDRAWALS
While the classic rule of thumb is that you can withdraw 4% of your savings per year on a sustainable basis, the reality is far more nuanced. The amount of income you can generate depends on your age, the performance of the markets, future changes in the tax code and, of course, how your money is invested. You should work with your Private Wealth Advisor to determine a sustainable level of withdrawals and a appropriate strategy to produce them.

SET YOUR BUDGET AND STICK WITH IT
Now that you have your spending priorities in order and a solid estimate of sustainable income, determine an ongoing budget based on your priorities and track your expenses against it. This is particularly important if you have substantially increased your spending levels as a result of your liquidity event. As your priorities and your portfolios evolve, this is a process that you will want to revisit on a regular basis. Remember that the ultimate goal is to make sure that you are directing your resources towards those areas that you have identified as most important to you. You want to make sure that overspending on the unimportant things does not erode your ability to afford the big things.

MANAGING TAX CONSEQUENCES

There are legal strategies that may be employed to reduce the taxes owed due to a liquidity event. However, exceptional caution should be exercised. Dozens, if not hundreds, of ultra high net worth individuals have wound up in bankruptcy court because they ran afoul of the tax codes. In that spirit, here is the one piece of advice you should always follow: It is essential that you have highly qualified professional tax advisors who can help you identify your goals with respect to managing tax consequences.

ESTABLISH A PENSION AS A TAX-DEFERRED SAVINGS VEHICLE
For those under 50, federal tax-deductible or after tax Roth contributions to a qualified defined contribution plan or SEP IRA are capped at $66,000, in each case for 2023.[1] A defined-benefit pension may allow you to defer a substantial sum of money. How much you may be able to defer will depend on your age, marital status and whether you are able to spread payments from your liquidity event across multiple years. However, this strategy only works if the windfall is wages from employment or net earnings from self-employment, so it may not be applicable in all cases. (The tax-deferred savings strategy may still be attractive to business owners.) Also, if you are an owner of a business with employees, you may need to also provide retirement benefits to the employees for certain types of retirement plans.

INHERITING THE FAMILY BUSINESS

The demands of taking over a family business vary considerably based on a number of factors, including:

- The size, nature and financial condition of the enterprise
- Your educational and career background
- Your previous involvement with the day-to-day operations of the business
- The level of shared ownership of other people

In any case, you will very quickly be faced with two essential questions: Do you want to keep the business or sell it? If you want to retain ownership, do you want to manage the business on a day-to-day basis, or hire a capable executive to assume that role? The statistics suggest that your answers should be based at least as much on your preparation as your enthusiasm. According to the Family Business Institute, only about 30 percent of family businesses survive into the second generation and the likelihood of survival greatly diminishes for generations beyond.[2]

The cost basis of an inherited business can also be an important factor to consider, as a step-up in the basis can make a sale relatively attractive. Should you decide to press on and retain ownership, here's a good way to get started:

ASSEMBLE YOUR COMPANY'S ADVISORS
Gather your company's key outside advisors to discuss key issues in both the operations of the company and its transition to your ownership. This should include bankers, attorneys, accountants and your Private Wealth Advisor. You may also want to bring in some advisors of your own to provide a fresh perspective.

REVIEW KEY DOCUMENTS[3]
Make sure you read and understand the essential documents that will help you understand where your company stands:

- Tax returns and bank statements
- Business and personal insurance packages
- Letters of incorporation, registrations and trademarks
- Any applicable licenses
- Balance sheet
- Current budget
- Current business plan
- Documentation for loans, lines of credit, mortgages and any other forms of debt or other liabilities

MEET WITH EMPLOYEES AND CUSTOMERS
Meet with your managers, rank and file employees and key customers to get a deeper look at the strengths and weaknesses of the enterprise. Understand that employees, and perhaps even customers, are likely to be nervous about a change in ownership, so you will want to demonstrate that you are clearly and confidently in charge. However, be careful about making promises before you know you can keep them or making big changes quickly. Listen more and speak less, particularly if you have not played a previous role in the operations of the business.

FOCUS ON THE BUSINESS PLAN
Once you have come to understand the challenges and opportunities facing your company, create or revise the business plan to reflect your vision of its future. Consult your advisors and key employees not only to gain important perspective, but to help create enthusiasm for and confidence in your direction.

ADDRESSING CONCENTRATED EQUITY POSITIONS

Whether you have inherited or created a sizable estate or sold your company for stock in the acquirer, many liquidity events arrive in the form of a highly concentrated equity position. How, and when, you go about managing that position can have a substantial impact on your tax liability, your net worth and even your public reputation. Significant legal and tax implications are associated with many strategies, so be sure to discuss any course of action with your accountant, attorney and Private Wealth Advisor before proceeding. For a more in-depth look at the following strategies, speak to your Private Wealth Advisor, or request a copy of the Morgan Stanley white paper, "Managing Concentrated Positions."

Strategies to reduce exposure to a concentrated equity position:

- Rule 10(b)5-1 Selling Program
- Exchange Funds
- Sale
- Charitable Gifts
- Family Gifts

Note that there are complex tax issues associated with many of these strategies, so be sure to consult with a tax advisor.