

# Congratulations: You've Won the Lottery and You're Suddenly Wealthy!

*At RDM, we understand that wealth is more than money - it's about freedom, security, philanthropy, legacy and balance...we help you coordinate multiple financial goals through a maze of tax, legal and investment options. It is critical to understand, develop and implement effective, long-term strategies that align with your objectives and prepare you for the future.*

# Congratulations: You've Won the Lottery and You're Suddenly Wealthy!

## What is it?

Winning a lottery is usually an unexpected and happy event. But when you win a big jackpot, you may feel unprepared to deal with the financial issues that arise almost immediately. You may have to choose advisors; decide when, where, and how to collect your winnings; decide what to do with your winnings; and consider the tax and estate planning implications of your win.

## What should you do immediately after you win?

If you don't have a team of financial professionals in place, consider assembling a team of professionals before you claim your prize.

Financial professionals can help you set up trusts to shelter your money from taxes and to insure that the money goes to your heirs when you die. They can also help you minimize the taxes you pay this year and in the upcoming years, and they can help develop an investment strategy based on your short- and long-term needs.

## Claiming the prize

In some states, you must list a beneficiary in the event you die, and you must decide whether you want the money to be paid out as a lump-sum payment or in yearly installments. (You don't get to decide this in all states.)

**Tip:** *In some states, you're generally allowed to claim the prize as either an individual or a club. If you want to share your wealth with family members, list them as members of your club. (Again, this is only an option in some states.)*

### *Is it better to claim the prize anonymously?*

In some states (but not all), you're allowed to claim your lottery prize anonymously. If this is an option in your state, you should seriously consider it.

True, you won't be a local celebrity, you won't get your picture on television, and you won't get your name in the newspaper. On the other hand, your phone won't ring day and night with salesmen pitching the latest scheme, and you won't get letters from people around the country (and the world) asking for donations. You won't receive requests from every charity organization you've ever heard of (and many you haven't), and you won't get endless solicitations. Finally, you won't have people knocking on your door every day to introduce you to fail-safe investments in fast-food franchises, restaurants, vacation property, can't-lose commodities, and businesses that you didn't even know existed.

## Collecting your winnings

### *How is the money paid out?*

You may or may not get to choose how you collect your lottery winnings. It depends on the rules in your state.

In most states, you don't have a choice about how you receive your winnings. In these states, payments of large jackpots are usually spread out over 25 years or more. In some states, you can choose after you win how to receive your winnings, but you need to be careful because you could end up owing taxes on money you haven't yet received. In many states, if you win a "small" amount (e.g., \$250,000 or less), you'll receive the winnings as one lump-sum payment. If your winnings are larger, you may receive the money in equal installments (e.g., once a year for 25 years).

### *Income tax consequences of payout*

The government gets its share of your winnings before you receive a dime. Your state and federal governments will immediately withhold a portion of your lottery winnings.

If you don't have a choice as to how you receive your lottery winnings, you will be subject to income tax only on the amount of money you receive each year.

If you do have a choice and you elect to receive your winnings in installments rather than as a lump sum, you may still be subject to income tax on the entire lump-sum amount you could have received. This is known as constructive receipt. However, if you're a cash basis individual, a special rule may apply to you. If the qualified prize (e.g., your lottery winnings) is payable over a period of at least 10 years, and your option to elect a single cash payment or installment payments is exercisable not later than 60 days after you become eligible for the prize, you may not have to include the total value of the prize in your gross income right away. Make sure that before you decide how you will receive your winnings, you see a tax expert to discuss your options.

### *Can you split your lottery winnings among family members?*

It depends. In some states, you can purchase lottery tickets in several names. If a ticket purchased in the name of several people wins, all the people split the money. In other states, a ticket isn't purchased in anyone's name. It's a bearer instrument, meaning



that whoever holds the ticket can claim the prize money. If you want to split the prize money, you have to create a lottery pool before you purchase tickets. Here's an example of how a lottery pool may work:

- Several people pool their money to buy lottery tickets
- You record the name of each person and the amount he or she contributes
- You buy the lottery tickets
- You make photocopies of the tickets, which you give to each person in the pool
- If one of the tickets wins, the prize money is split among all contributors

**Example(s):** *Samantha creates a lottery pool among 15 coworkers. Samantha collects \$100 from the coworkers, keeps careful records, and buys 100 lottery tickets. One of the tickets is worth \$1 million. This means that Agnes, who bought 1 ticket, receives 1/100 of the total prize, or \$10,000. But Paula, who bought 10 tickets, receives 10/100 (1/10) of the total prize, or \$100,000.*

#### ***When should you collect your winnings?***

You are subject to income tax on lottery winnings in the year you receive the prize money, not the year you win the lottery. So, if you buy a lottery ticket for a game played on November 15 of Year 1, and you receive the prize money on November 30 of Year 1, you will be subject to income tax on your lottery winnings in Year 1.

In contrast, if you don't receive the prize money until January 7 of the next year (Year 2), you will then be subject to income tax on the winnings in Year 2. You can then invest the money in a short-term vehicle and collect enough interest on the money to pay some of the income taxes you will owe when you file your tax return for Year 2.

## **Short- and long-term financial planning**

You'll need to develop a financial strategy based on the amount you've won, your needs, and your short- and long-term goals. Your overall strategy will depend on your needs.

#### ***What are your needs?***

To figure out your needs, you need to examine your financial situation. Use the following questions to begin evaluating your financial needs.

- Do you have credit card debt or other debt on which you're being charged a high rate of interest?
- Do you have children you need to put through college? Do you need to bolster your retirement savings?
- Do you own a home?
- Are there charities that are important to you?
- What other financial concerns or obligations do you have?

#### ***Just how wealthy are you?***

Many lottery winners decide to quit their jobs, give money to their friends and family, and buy cars, only to realize later that they aren't really as wealthy as they thought they were. For example, even winning a \$1 million jackpot doesn't necessarily mean that you're suddenly wealthy; if that jackpot is paid out over 20 years, your annual payment may be less than what you earn by working.

#### ***Insurance planning***

Although you may not have previously owned one, you should consider purchasing an umbrella liability policy now that you're a lottery winner. It's sad to report, but your chances of being sued may increase when you win a lottery. Although your homeowners policy contains some liability coverage, it may not be enough to adequately protect you. You should also consider purchasing additional life insurance to protect your heirs in the event that you die leaving a large estate. You can set up an irrevocable life insurance trust to hold the life insurance policy so that proceeds from the policy won't be includable in your estate for estate tax purposes when you die, but may be used to pay any estate taxes that may be owed on your estate. Finally, consider increasing your deductibles on your automobile insurance to decrease the cost of your premium if you now have enough cash on hand to pay the deductible in the event of a collision. Call your insurance agent or insurance company for more information.

#### ***Income tax planning***

Once you win a lottery, you'll need to reconsider your income tax planning strategies. First, you'll need to know what your overall tax liability will be and how winning the lottery will affect you tax-wise not only this year but in the future. Depending on your tax bracket, you may need to pay estimated taxes if the tax on your lottery winnings has been under withheld. Don't forget about paying estimated state income taxes if necessary. You may also want to increase the amount you contribute to an IRA, Keogh plan, 401(k) plan, or other tax-advantaged account, or you may want to invest in tax-free or tax-deferred vehicles. Consult a tax professional for help with your individual situation.

#### ***Estate planning***

Due to your lottery winnings, your estate planning needs will become more complex. To protect your family's interests, consider setting up a living trust and specify that all lottery installments be trust accounting income. This will preserve your unlimited marital deduction and ensure that your spouse has income interest for the rest of his or her life in the event that you die. The trust should also specify how much of each lottery payment is considered principal and how much is income. This will avoid disputes between beneficiaries (often children), who receive the interest, and remainder persons (often grandchildren), who receive the principal. You may also want to set up trusts for your children to pay for college and find ways to lessen the impact of potential estate taxation. Consult an estate planning professional for help with your individual situation.



## DISCLOSURES

RDM Financial Group does not give tax or legal advice. Consult your tax advisor and attorney on all tax and legal matters.

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