Whistleblowers:

13 Step Tax Planning Check List to Maximize Success

1. Hire a Tax and Financial Professional

State and federal taxes are due on whistleblower awards, and they must be paid. That said, federal and state tax law actively encourage certain kinds of savings and investments, and someone who knows the rules, regulations and options can not only save you money by reducing your legal tax burden, they can also save you from making very costly mistakes.

2. Consider Keeping a Low Profile

In a False Claims Act case, unless you filed your case as a corporate relator, it may be impossible to remain entirely anonymous. If you are an IRS, SEC, or CFTC whistleblower, however, your anonymity is guaranteed should you wish to preserve it. The chief advantage of anonymity is that your name and the amount of your award will not become part of the public record. This may have very tangible benefits in terms of future employment. If you are a False Claims Act whistleblower, your name will almost certainly be part of the public record, but it may not be very easy to find. Unless your award is so large you may never have to work again, you may want to keep a low profile in order to keep it that way.

3. Obtain Tax Advice Before You Sign Settlement Documents

Settlements have tax consequences and it is appropriate, if not downright necessary, to obtain tax advice before you sign an agreement. In many legal settlements, wording can improve your tax posture. Tax language and reporting can impact how your recovery is taxed, how you can deduct your attorney fees, or both. It never hurts to have a tax consultant see if language can be tweaked to improve your outcome. Even the way a check is prepared, or a wire is sent, can impact your taxes. It is always better to be safe than sorry.

4. Annuities Can Be Your Friend

An annuity is simply a contractual arrangement in which a third-party company pays you out a sum of money over a set period of time, with taxes due only as those payments are made. If you are interested in this kind of structured settlement, you and your lawyer will need to take time before the settlement to explore available options, and to make the necessary arrangements before the final settlement documents are signed. Annuities are 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.

5. Consider Moving to a Low-Tax State

If you are about to recover a very large and long-awaited sum, you might want to consider the tax consequence of where you reside. If you live in California, for example, you will pay up to 13.3% in state income tax on your recovery. But would you be just as happy living in Nevada or Florida, which has no state income tax? Something to consider!

The laws governing residence and domicile vary, but most of the steps that are appropriate to establish or move one's residence are common-sense, including 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, be aware that high-tax states may claim you are still a resident after you receive your recovery. If you plan your move well in advance and follow the advice of a tax professional, you can reduce any chance of controversy and maximize your chance of success.

6. Run Some Tax Projections

In addition to getting practical advice about the larger tax picture you will face when your award is finally made, you will want to "run the numbers" so that you have a good idea of the tax consequences of your decisions. Consider how much you may owe, and how your attorney fees and other expenses will be computed. These numbers are very important when computing state taxes, a subject you will need to consider before your case is resolved.

7. 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 card debt) can be a particularly smart move and the best "investment" you can make.

8. Avoid Sudden Lifestyle Changes

If your recovery is large, it may be tempting to make up for lost time and to splurge 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. That said, 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 any drastic changes.

9. Get Financial Advice and Invest Prudently

Consider splitting your funds and investing them with different financial advisers so you are not putting all your eggs in one basket. Consider hiring a fee-only advisor whom you pay not to manage your assets, but rather to give you independent financial advice. To get started, consider safe, short-term investments such as Treasury bills. Ask your advisors to suggest an investment portfolio divided between equities (stocks) and fixed income (bonds). Consider different asset allocations between these broad classes based on risk and return. Ask for examples of how the returns will come in. Do not invest in deals that promise too-good-to-be-true returns or that involves complex strategies you do not understand. Remember that it takes a 100 percent gain to recover from a 50 percent loss!

10. Consider Asset Protection Strategies

As you gain wealth, you may need to “fence up” in order to protect yourself from those making claims against you. Claimants may include disgruntled spouses or ex-spouses, or those creating “make weight” lawsuits based on minor traffic accidents. The bottom line is that now that you have a secure nest egg of money, you will want to make it difficult for the unscrupulous to reach the nest. Common asset protection strategies include trusts, family limited partnerships, and limited liability companies.

11. Consider Family Gifts

Family gifts are normally an estate planning topic, but they are also worth noting separately. 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. Be sure to 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 IRS statute of limitations (3 years from filing) will run.

12. Consider Charitable Gifts

If you are facing a big tax bill, one way to reduce that bill is to consider gifts to charity which will help offset income with charitable contributions. Some people form their own private foundation or a donor advised fund (DAF), especially if they aren’t sure where they want their money to go before the end of the year. Donor advised charities can operate in a number of ways. For example, in a charitable lead annuity trust (CLAT), money can be deposited with a portion of the income from the investment sent to a charity, with the remaining assets returned to the donor after a certain period of time; the longer the time period, the larger the deduction. A charitable limited liability company operates a bit differently, but has the same objectives and benefits to both the donor and the charity recipient.

13. Revise or Implement an Estate Plan

Whether your recovery is big or small, you should 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. Of course, 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. Gifts of family partnerships, real estate and interests in businesses usually also require gift tax returns even if less than the $14,000 value.

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