Sentinel

Personal Financial Management Ideas

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Risk And Reward For Ballplayers

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Griping about free agency is a time-honored tradition among Major League Baseball fans. But for the past few years, it is players who seem to be finding free agency distasteful – or, at least, less appealing than the alternative.

Free agency is not entirely dead, as evidenced by Manny Machado's $300 million, 10-year contract with the San Diego Padres. Machado briefly secured the largest free-agent deal in history, though he did not hold the distinction for long; shortly after, Bryce Harper chose to commit to the Philadelphia Phillies when the team offered a $330 million deal over 13 years. This deal made Harper the highest-paid team-sports athlete in history, outstripping not only Machado but also Giancarlo Stanton's $325 million extension with the Miami Marlins in 2014, which Stanton signed prior to reaching free agency.

Ultimately, however, Machado and Harper are exceptions to the broader trend. Few teams these days regularly offer long-term, high-dollar-value contracts to players in their prime. Instead, an increasing number of young, up-and-coming players are forgoing the opportunity to become free agents in favor of signing multi-year contract extensions with their current teams. These extensions take players out of free agency market until they are past, and sometimes well past, age 30. And while contract extensions can sometimes be lucrative in their own right – Los Angeles Angels center fielder Mike Trout recently displaced Harper's record with an extension worth approximately $430 million over 12 years – usually an extension means forgoing the potential of a larger deal in favor of security.

Why are players increasingly making this trade-off?

Part of players' caution comes from the overall state of the league. As The Wall Street Journal noted in February, labor relations between teams and players are tense right now, with fears of a work stoppage after the 2021 season looming large. In this atmosphere, free agency is beginning to look deeply risky. After all, it took months for Machado and Harper to secure their respective deals, while NBA teams are still snapping up high-profile free agents within days of their entry into the market. As of March 1 – less than a full month before the season began – more than 70 major league players still had no contract. Essentially, younger players who take contract extensions are giving team owners potential discounts on their future performance in exchange for an upfront commitment.

Commitment can weigh even with free agents these days. ESPN reported that Harper may have had larger offers from other teams but was convinced by the Phillies' long-term commitment. His 13-year contract tied the record for length, and came with no opt-outs and a no-trade clause, which will means Harper may well play in Philadelphia for the rest of his career. If Harper had preferred a short-term contract and a second chance at free agency, he surely could have chosen that alternative. Instead, he told his agent that he wanted a lifetime deal, even at the cost of a lower annual salary.

In this environment, it may not be clear to a given player how best to proceed. Say a player is in his mid-20s and is an established star, a few seasons away from eligibility

Please Turn To *Ballplayers*, **Page 6**

Inside This Issue Of *Sentinel*

Dividing The World's Greatest Fortune *Page 2*
Making The Most Of Opportunity Zones *Page 3*
Duly Noted *Page 8*

Dividing The World's Greatest Fortune

Paul Jacobs, CFP®, EA

Divorce is never easy. But when one of the spouses in question is the richest person in the world, the complications increase exponentially.

Jeff Bezos became the first person to exceed a net worth of $100 billion on the Forbes list of billionaires in early 2018. About a year later, he and his wife of 25 years, MacKenzie Bezos, announced that they would separate, emphasizing the amicable nature of their breakup. The news kicked off wide speculation about how the couple would divide Jeff Bezos' 16 percent stake in Amazon, worth roughly $140 billion, as well as his other assets.

A 50-50 split would leave both Jeff and MacKenzie Bezos among the world's wealthiest people, and would likely make her the world's richest woman (though he would move a spot or two down the list of the world's richest men). This is not an unimaginable scenario. The pair live primarily in Washington state, which is a community property state. That means that any wealth created during their marriage should theoretically be split equally between the two, unless some other factors come into play.

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Jeff and MacKenzie Bezos married the year before he founded Amazon. No one could have written a prenuptial agreement in 1993 that anticipated a then-nonexistent company would become the commercial juggernaut that Amazon is in 2019.

The state of any such agreement, or even its existence, is unclear. TMZ reported that there is no prenuptial agreement; if true, this could mean that the divorce will proceed under Washington's state law. (As of this writing, the pair has not formally filed divorce papers, in Washington or elsewhere.) It is possible that the couple could have signed a postnuptial agreement, however, which would shape the divorce proceedings. We may have no way to be sure, since prenuptial and postnuptial agreements are opaque by design. Even if we discover that Jeff and MacKenzie Bezos did sign such a document, we might never know exactly what it entailed.

The divorce is also likely to involve some nuanced questions of valuation. While publicly traded stock is easy to value, some of the assets in play are more complex. For instance, how to measure and divide the value of Jeff Bezos' stake in The Washington Post? This means that, for now, all estimates of the size of the divorce settlement are necessarily educated guesses.

Even so, it seems obvious that this divorce is on track to create one of the largest settlements on record. The most expensive divorce known prior to the Bezos breakup was the 1999 split of Alec and Jocelyn Wildenstein. Jocelyn Wildenstein was awarded $2.5 billion initially, and $100 million for each of the following 13 years, for a total payout of $3.8 billion. MacKenzie Bezos potentially stands to collect much more; even if she receives far less than 50 percent of the pair's current net worth, the award will easily surpass the value of this prior settlement.

Jacqueline Newman, a matrimonial law attorney who is a managing partner of Berkman Bottger Newman & Rodd LLP, told Business Insider that divorces involving high-net-worth individuals are often complicated by the fact that many of the couple's assets are not easy to divide. "The major thing for billionaires is that most of the time, their assets are very complex and mostly illiquid — with Bezos, a lot of his assets are linked to Amazon stock," Newman observed.

Beyond the wealth involved, the Bezos divorce raises questions for Amazon's immediate future. Not that the company is conceivably in any real trouble, but observers have speculated that Bezos may have to sell or transfer a significant portion of his Amazon stock – and thus decrease his level of control. And if MacKenzie Bezos suddenly comes into independent possession of half of the largest stake in the company and chooses not to liquidate it, she might seek a seat on the company's board or push for major strategic changes. Robert Frank of CNBC reported that, at the company's current valuation, MacKenzie Bezos could receive

Please Turn To ***Fortune*****, Page 5**

Sentinel

INVESTMENT FOCUS

Making The Most Of Opportunity Zones

Melinda Kibler, CFP®, EA

Taxpayers have a unique opportunity in 2019, thanks to a new program created more than a year earlier.

The "Opportunity Zones" program offers tax incentives to investors who, under certain circumstances, invest capital gains into projects designed to bolster economically struggling communities. While the program's newness means potential investors may have unanswered questions, if the program works as designed it should be a win-win scenario. Investors secure generous tax benefits, and struggling communities experience an infusion of investor interest and potential job creation.

The Tax Cuts and Jobs Act, which passed in late 2017, created the Opportunity Zones program. Investors can shelter capital gains from tax if they make long-term investments in these zones, which are census tracts that the Treasury Department has designated as experiencing economic distress. The law dictates that qualified Opportunity Zones retain their status for 10 years once they receive the designation.

The Opportunity Zones program was designed to spur investment and job creation in these distressed communities. The tax regulation also was meant as an incentive to encourage wealthy investors, such as Silicon Valley entrepreneurs, to liquidate highly appreciated securities and re-invest these assets outside of their companies, by relieving potential worries about a large capital gains tax bill.

The federal government provided a list of potential Opportunity Zones once the law took effect and allowed states to narrow their selection of census tracts for the ultimate list. The first zones were announced in April 2018; as of this writing, the government has designated 8,761 qualified Opportunity Zones spread across all 50 states, as well as the District of Columbia and several U.S. territories. Investors can participate in the program nationwide, as there is no requirement that they invest in zones within their own state of residence.

The government designated these zones based on census data from nearly a decade ago, which creates another enticing program feature. Some of the disadvantaged areas have become very desirable in the intervening years. For example, here in South Florida, Broward County has 30 Opportunity Zones and Miami Dade County has 68. These areas may be especially attractive to investors.

Since the Opportunity Zones program is so new, some of its rules are not yet entirely clear. The Internal Revenue Service issued a set of proposed regulations in October, which answered at least a few outstanding questions. For example, the regulations add detail to the rules for the organizations that operate in Opportunity Zones, which must meet certain requirements in order for their investors to secure the tax benefits of the program. The regulations also clarify that nearly all capital gains qualify for deferral in this program, including gains experienced by partnerships and pass-through entities such as limited liability companies. The IRS originally planned to have a hearing regarding these proposed regulations on Jan. 10, 2019, but the hearing was delayed because of the partial government shutdown. As of this writing, a new date has not been announced.

Yet while some questions remain unanswered, the clock is ticking for investors hoping to make the most of the Opportunity Zones program. Taxpayers who want the greatest tax benefit must invest before the end of 2019, so investors do not have the luxury of waiting indefinitely for regulators to hammer out the rules. Given this deadline, the Treasury Department stated that taxpayers may rely on the proposed rules before they are final, as long as they meet certain requirements. This assurance will allow investors to proceed with some level of confidence, even as the pro-

Please Turn To *Zones*, **Page 4**

...Zones

gram evolves.

In order to take advantage of the tax benefits this program offers, a taxpayer must start with some form of capital gain. For example, the investor may have recognized a gain from selling a business, or simply from selling stock. The proposed IRS regulations define an eligible gain as any treated as a capital gain for federal income tax purposes, which casts a fairly broad net. The program also applies to either short- or long-term capital gains; either type of gain retains its status when the taxpayer participates in this program. Since short-term gains are taxed at a higher rate than long-term gains, this means the program may be especially attractive to investors who have assets that appreciated rapidly and may want to diversify a now-overweighted position.

The Wall Street Journal reported in November 2018 that more than 40 funds were seeking to raise a total of at least $8.9 billion, suggesting there is a strong expected appetite for this program in its initial stages.

To receive the program's tax benefits, a taxpayer then invests this gain in a "Qualified Opportunity Fund." It is important to note that a taxpayer cannot receive these tax benefits by investing in such a fund with cash from other sources. If an individual chooses to invest in the fund with something other than a capital gain, the investment confers no tax benefit. An investor who invests with both a capital gain and other cash will have to track each portion of the investment separately.

In order to secure its status, a Qualified Opportunity Fund must be a partnership or a corporation for federal tax purposes. It must also be organized in the United States (or a U.S. territory) for the purpose of investing in property in a qualified Opportunity Zone. And the fund must hold at least 90 percent of its assets in Opportunity Zone property. The Wall Street Journal reported in November 2018 that more than 40 funds were seeking to raise a total of at least $8.9 billion, suggesting there is a strong expected appetite for this program in its initial stages.

Taxpayers who want to take advantage of the program must invest the amount of the recognized capital gain in a Qualified Opportunity Fund within 180 days of triggering the gain. The clock does not stop at the beginning of the calendar year, so gains from 2018 may be invested in early 2019 as long as they fall within the 180-day window. The fund will then use the invested assets to acquire property in an Opportunity Zone directly or invest through another entity that purchases such property. If a pass-through entity plans to defer the capital gain, it must be invested within 180 days of the date the capital gain was triggered. If investors in the pass-through entity are going to invest the capital gain instead, they have the option to start the 180 day window either on the date the capital gain was triggered or on Dec. 31 of the year it was triggered.

Taxpayers recognize the immediate benefit of not having to report the capital gain on their tax return in the year they triggered it, but this is not the only potential upside. At the start, the taxpayer's basis in the Qualified Opportunity Fund is $0, in exchange for the capital gain tax deferral. After five years, the taxpayer's basis increases to 10 percent of the gain that he or she initially elected to defer. After seven years, the basis gets another 5 percent bump, for a total basis of 15 percent of the initial capital gain.

As I mentioned earlier, investors who want the greatest possible benefit need to invest in a Qualified Opportunity Fund by Dec. 31, 2019. This is because investors are allowed to defer tax on the original gain until the earlier of Dec. 31, 2026 or the date the investor sells or exchanges the position in the Opportunity Fund. Since all investors must report deferred capital gains by the end of 2026, regardless of how long they have held the property, securing the full 15 percent basis adjustment will only be possible for those who act quickly. At the end of 2026, taxpayers must recognize either the difference between the fair market value of the investment and their basis in the Qualified Opportunity Fund or the difference between the original deferred gain and their basis in the Qualified Opportunity Fund, whichever is less.

Once the capital gain is reported and the tax is paid for 2026, the investment's basis will increase by the amount of

Please Turn To *Zones*, **Page 5**

...Fortune

as much as $66 billion in Amazon stock, instantly making her the company's second-largest shareholder. While she worked for Amazon in its earliest years, MacKenzie Bezos has not been significantly involved in the company since then; she has, instead, focused on her career as a novelist.

CNBC's Frank also suggested that MacKenzie Bezos may choose not to push for any settlement that requires her ex-husband to liquidate or transfer his shares, because the family fortune's potential growth is largely tied to Jeff Bezos' ongoing control of Amazon. The nuance of the final settlement may also reflect the pair's intentions for the futures of their four children.

The lesson to draw from the divorce of Jeff and MacKenzie Bezos is, first and foremost, the importance of prenuptial agreements for people of high ambition, even if the assets involved at the time of the marriage are not significant. Prenuptial agreements can be difficult to discuss, but the best time to decide on how to divide assets is before a potential breakup, not during one. While postnuptial agreements often have a more difficult time withstanding a court's scrutiny, a properly structured agreement can still provide clarity and protection for both partners. Postnups can also be narrow, which means entrepreneurs can consider documents specifically focused on a divorce's impact on a business or intellectual property, if they wish. In addition, both prenups and postnups can help protect the couple's privacy during divorce proceedings.

Not everyone needs a prenuptial or postnuptial agreement. But if you aim to be the next Jeff Bezos, you definitely are among those who do.

Editor's Note: This blog post was originally published online on Jan. 31, 2019.

...Zones

capital gain reported. If the taxpayer continues to hold the investment to the 10-year mark and then sells it, the basis becomes equal to the fair market value of the investment on the day of the sale. Therefore the entire capital gain above the 2026 basis is wiped out. Theoretically, investors can continue to reap the benefits of tax free gains until Dec. 31, 2047, when the program ends.

Essentially, the program can give participating taxpayers three distinct benefits. They can defer tax on their initial capital gain until 2026. They can permanently exclude some portion, either 10 or 15 percent depending on the length of their investment, of the deferred gain. And they can permanently exclude all post-2026 appreciation in the investment if they hold their position for at least 10 years.

Like many tax programs, certain standards apply and testing will take place to ensure that investors are meeting all the requirements in order to receive their tax incentives. The program includes a test at six months and on Dec. 31 to make sure that all assets in a Qualified Opportunity Fund meet the "90/10" rule. This rule states that at least 90 percent of a fund's assets must be qualified Opportunity Zone property: stock, partnership interests or business property. The precise rules about how the assets are measured, as well as what qualifies as Opportunity Zone business property, are beyond the scope of this article, but investors should be aware that if a fund fails this test, the government will impose financial penalties, which the fund will pass through to investors.

The basic idea of the program as I have explained it in this article is relatively straightforward. However, the details are complex, and they continue to evolve. Under the circumstances, taxpayers will be wise to involve a tax professional if they wish to participate. At a minimum, taxpayers should take care to document the logic behind their positions, and all other aspects of the transaction, thoroughly.

The Opportunity Zones program offers a new and exciting prospect for investors, with a generous tax incentive to encourage them to participate sooner rather than later. While many questions remain, it is clear regulators are doing all they can to give potential participants the green light even before regulations are fully final. With a bit of caution and common sense, taxpayers should make the most of the opportunity that Congress has created.

Editor's Note: This article was originally published online on Feb. 4, 2019.

...Ballplayers

for free agency – that is, six years of major league play. If he locks himself into a relatively small deal, the money is guaranteed, no matter what happens in his career. If he turns the extension down and waits for free agency, he could secure a significantly more lucrative contract – assuming a team is willing to offer one. But waiting also represents risk in the form of potential injury or other changes for the worse in a player's performance.

As is the case for many financial planning questions, there is no one right answer to whether a player should secure an extension at a relatively lower dollar amount or sacrifice some security in search of a larger payday. In essence, a player asking this question is asking whether the offer from their current team is "enough." Is a shot at a bigger payout worth the risk of forgoing a sure thing? One way to find an answer is to perform – or have a professional perform – a risk-reward analysis.

Free agency is not entirely dead, as evidenced by Manny Machado's $300 million, 10-year contract with the San Diego Padres.

We used Yankees pitcher Luis Severino as a test case. Severino, who is 24 years old, recently signed a four-year deal, with a fifth-year option, worth up to $52.25 million assuming the Yankees keep him on for the fifth year. We ran two projections of his potential cash flow: one with his contract extension, and another where he held out and signed a major free agency deal a few years down the line. We roughly tripled his payday to $150 million, paid over six years, in this hypothetical version of events.

In both projections, we assumed Severino would buy a house worth about 10 percent of his overall contract: $5 million in version A and $15 million in version B. In the first scenario, we assume Severino will retire at age 30, while in the second we assume he will retire at age 34 to account for the later start of the free agency contract. In neither case did we assume he would have a second-act career, though many former players do go on to work as broadcasters, entrepreneurs and authors, among other professions. We assumed 3.1 percent inflation, a long-term average based on historical data, and a 6 percent return on an investment portfolio, which represents a relatively conservative investment approach. We set annual tax at 45.82 percent, though the specific rate would actually vary based on the state and local taxes due, as well as any changes to the federal tax regime.

As all of these assumptions suggest, a risk-reward analysis is inherently based on estimates. But the results are still useful when approaching the problem.

Age	Annual Expenses		Total Portfolio Value at Year-End	
	Contract Extension	*Free Agency*	*Contract Extension*	*Free Agency*
25	$350,000	$1,000,000	$2,952,827	$1,408,741
35	$474,957	$1,357,021	$25,496,602	$72,754,111
45	$644,527	$1,841,506	$28,504,617	$81,313,269
55	$874,637	$2,576,431	$30,288,809	$86,547,366
65	$1,186,901	$3,391,146	$29,545,996	$84,173,522

In this projection, we started from the total potential contract value Severino could expect in each scenario, and then worked back to determine his baseline annual spending, assuming he lives to be 90 years old. The question we were attempting to answer was, essentially, would both contracts give Severino "enough" to live on comfortably without other sources of income, assuming he invests prudently to keep ahead of inflation.

In scenario A, based on Severino's actual contract extension, $52.25 million becomes about $23 million after taxes. If he prudently invests this amount, Severino can expect to see an additional $64 million over the course of his life. This equates to annual spending of about $350,000 in the first year, rising by inflation to $1.2 million a year in spending by age 65. Assuming he is able to make and stick to a reasonable financial plan, Severino should never need to work again unless he wishes to. Yes, he would certainly have even more money if he secured the free agency contract – but he would risk an outcome where he gets much less if, for instance, he suffers a career-ending injury before he can enter the free-agent market. And, while we didn't allow for this possibility in our examples, it is worth

Please Turn To *Ballplayers*, **Page 7**

...Ballplayers

noting that Severino may still enter the free-agent market at age 29, potentially increasing his total career earnings yet again. If Severino does take the risk and hold out for the big free-agent contract, his annual spending could be $1 million in the first year, rising to $3.4 million per year at age 65, as shown in scenario B.

Of course, no plan remains pristine and unchanged over the entire course of a person's life. In reality, you would never make a financial plan at age 25 and leave it untouched for decades. Most players' spending will be front-loaded, as they acquire houses and raise their families during and immediately following their MLB careers, which can affect how these estimates play out. When running projections, it is also important bear in mind that each year's spending won't be the same, even aside from inflation, as children grow up and eventually move out. Instead of serving as a crystal ball, this sort of analysis allows you to see a reasonable approximation as to how your money relates to your desired lifestyle once you are long past the end of your career.

Most players' spending will be front-loaded, as they acquire houses and raise their families during and immediately following their MLB careers, which can affect how these estimates play out.

That desired lifestyle directly contributes to answering the question of whether a given contract amount is enough, whether a player is evaluating a given offer or deciding how much to ask for in negotiations. A particular player will need to consider some fundamental questions when setting up this sort of projection, the first and most important of which is: Where do you want to live? Different parts of the country have different costs of living, and especially impose widely different levels of tax, which can mean a dollar goes further in less expensive parts of the country. As an example, a report from NBC suggested California's hefty state tax burden and higher cost of living may have handicapped multiple teams, especially the San Francisco Giants, in the bidding war for Harper.

Any amount beyond this baseline is "extra" as far as financial planning is concerned. You can use it to inflate your lifestyle, support charitable causes, increase the amount you plan to pass to your heirs or pursue other financial goals. Having more cash to throw at these goals is nice, but when you are choosing between securing a sure thing and taking a risk, it's important to understand what is or is not extraneous to your fundamental goals.

Different parts of the country have different costs of living, and especially impose widely different levels of tax, which can mean a dollar goes farther in less expensive parts of the country.

The risk-reward calculation may also look different from an agent's point of view. If an agent relies principally or entirely on one client, he or she may not want to take on the risk of holding out for free agency, even if the potential payout is much larger. On the other hand, agents who work with many players have diversified away some of their risk, so they may encourage a player to take the risk of waiting, especially if they worry that players deferring free agency may broadly depress the market.

If an agent relies principally or entirely on one client, he or she may not want to take on the risk of holding out for free agency, even if the potential payout is much larger.

Ultimately, the decision to settle for a smaller payday in order to secure peace of mind is one every individual player will have to make for himself. But a thoughtful, methodical approach shows that there is no need to make such a decision entirely in the dark when it comes to the potential financial consequences.

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IRS Offers Penalty Relief, Then Offers More. Many taxpayers owed money to the Treasury when they completed their first tax returns covered by rules that took effect in 2018. In response, the IRS in January offered some relief from penalties for failing to prepay enough of the tax bill. Penalties were to be waived for taxpayers who paid at least 85 percent of the total liability, rather than the usual 90 percent. Under pressure from lawmakers and IRS in-house Taxpayer Advocate Nina Olson, the IRS in March waived penalties for anyone who had paid at least 80 percent of the total liability during 2018. Early filers who were penalized before the additional relief was granted can request a refund. *IR-2019-55*.

A Novel Approach To Retirement Savings And Student Loans. In a private ruling, the IRS allowed an employer to make "matching" retirement plan contributions on behalf of employees who dedicate at least 2 percent of their compensation to repaying student loans. Under the proposed modification of the employer's 401(k), workers could direct some of their income to the plan but would not be required to do so in order to receive a 5 percent employer contribution at the end of the plan year. The IRS ruled that the proposed change would not violate restrictions on a qualified plan making benefits contingent on some other employee behavior. Although the ruling does not establish a binding precedent, it provides a road map for employers who want to encourage employees to save for retirement and to address their educational debt. *PLR 201833012*.

For Tax Expert, Ignorance Of The Law Is No Excuse. The Tax Court showed little sympathy for a California CPA who held a master's degree in taxation but failed to follow the rules governing the rental properties he owned and operated. The IRS rejected claims by Glenn Cunningham Ballard and his wife that they qualified as real estate professionals and could thus deduct losses from rental properties against their other income in the years 2008-10. In a summary opinion, Judge Tamara Ashford agreed, saying the couple's reconstruction of records was not reliable and that Ballard's testimony was "incredible, uncorroborated and self-serving." Ashford found no reason to excuse Ballard's "misunderstanding of the law" given his education and professional experience. *Glenn Cunningham Ballard and Yu-Yuan Pu v. Commissioner of Internal Revenue*, T.C. Summary Op. 2018-53.

Sentinel

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