Advising Military Clients on Lump Sum Income

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I bought myself a yacht, a mansion, a couple of cars. That ain't a million dollars. That's seven million dollars. I pretty much gave it away.[1]

I. Introduction

A large man sits on a stool in front of a background that mimics the appearance of a hundred dollar bill.[2] His movements are jerky and nervous.[3] His shoulders are hunched, as if defeated, tired, or both.[4] His body has grown soft, but like the ruins of Pompeii,[5] what the viewer perceives is the remnant of something once great and powerful—something once beheld—and something that once instilled fear in the opposition. The man is Keith McCants, a former player in the National Football League (NFL).[6] He is explaining how he lost the millions he earned as a football player, and is now broke.[7] He is not alone. An article in Sports Illustrated claims that as soon as two years after retirement, a staggering 78% of NFL retirees are broke or having "financial difficulties."[8]

In another story, a sixteen-year-old girl in the United Kingdom wins nearly three million dollars in a lottery jackpot.[9] She collects the money while making public statements that she would "not spend loads," "take some advice and see an accountant," and merely wanted a "normal home" and "normal car."[10] Eight years, two breast augmentations, $380,000 in cocaine, and four suicide attempts later, she is broke.[11] She, too, is not alone; the National Endowment for Financial Education estimates that 70% of large lump sum recipients will lose it all within a few short years.[12]

What could professional athletes and teenage lottery winners have in common with servicemembers? All three groups face the challenge of managing lump sum income. While NFL athletes and lottery winners are extreme examples, they illustrate the potentially perilous nature of receiving large amounts of money in a short period of time. Servicemembers receive far smaller (and therefore more manageable) sums, but they are at risk of sharing the same outcomes as the other groups: Years after receiving the money, they are no better off than they were before.[13]

This article guides judge advocates advising their military clients on managing their lump sum income. Although financial investment advice is not within the scope of the Army's legal assistance program,[14] financial planning matters frequently arise ancillary to the areas where Army lawyers do advise Soldiers, such as with wills and basic estate planning, separations and divorces, dependent support obligations,[15] separations, non-judicial punishment, and

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[1] *30 for 30: Broke* (ESPN television broadcast Oct. 2, 2012). In *30 for 30: Broke*, Keith McCants describes how he lost the money he earned as a player in the National Football League. *Id.*

[2] *Id.*

[3] *Id.*

[4] *Id.*

[5] *Archival Photographs*, POMPEII FORUM PROJECT, http://pompeii.virginia.edu (last visited Feb. 10, 2016) (showing archaeological photographs of Pompeii).

[6] *Keith McCants*, NFL.COM, http://www.nfl.com/player/keithmccants/2501941/profile (last visited Feb. 10, 2016). Keith McCants played in the National Football League for six seasons as a member of three different teams from 1990 to 1995. *Id.*

[7] *See supra* note 1 and accompanying text.

[8] Pablo S. Torre, *How (and Why) Athletes Go Broke*, SPORTS ILLUSTRATED, Mar. 23, 2009, at 90. *But see* Kyle Carlson, Joshua Kim, Annamaria Lusardi & Colin F. Camerer, *Bankruptcy Rates Among NFL Players with Short-Lived Income Spikes* (National Bureau of Economic Research, Working Paper No. 21085, 2015), http://www.nber.org/papers/w21085 (claiming much lower, but still significant rates of bankruptcy among NFL players after retirement).

[9] Callie Rogers, *Lottery Winner Who Spent Fortune On Drugs And Parties, Now Poorer But Happy*, HUFFINGTONPOST.COM (July 17, 2013), http://www.huffingtonpost.com/2013/07/17/callie-rogers-lottery-drugs-happy_n_3612836.html.

[10] *Id.*

[11] *Id.*

[12] NAT'L ENDOWMENT FOR FIN. EDUC., FINANCIAL WINDFALL (2004).

[13] *30 for 30: Broke*, *supra* note 1; Torre, *supra* note 8. *See also* FINANCIAL INDUSTRY REGULATORY AUTHORITY INVESTOR EDUCATION FOUND., FINANCIAL CAPABILITY IN THE U. S. 2012 REPORT OF MILITARY FINDINGS (2013) (showing 41% of military survey respondents report "somewhat or very difficult" time covering expenses and paying bills).

[14] *See* U.S. DEP'T OF ARMY, REG. 27-3, THE ARMY LEGAL ASSISTANCE PROGRAM (RAR 13 Sept. 2011).

[15] *Id.*

courts-martial.[16] The financial tools and instruction the military provides to servicemembers focus largely on basic budgeting of monthly pay and expense management.[17] But these tools tend to be silent on how to manage relatively large sums of money such as lump sum payments servicemembers receive or accumulate fairly regularly but are unaccustomed to handling.[18] These payments include re-enlistment and continuation pay and bonuses, separation pay (including Thrift Savings Plan distributions at separation or retirement), deployment savings, and lump sums from the sale of the primary home during a Permanent Change of Station (PCS) move.[19]

Servicemembers who lack a plan to manage lump sum payments over the course of their careers will limit the potential of those payments to contribute to long term financial health. The intent of this article is to assist Army attorneys in providing realistic goals and azimuth checks to their clients as opposed to financial advice. Part II discusses the behavioral and psychological aspects that may affect an individual's perspective on lump sum income as opposed to a salary paid over time. Part III discusses sources and amounts of lump sums payments in the military. Part IV proposes a systematic approach to managing lump sum income within an overall financial plan and introduce two laws that serve to protect servicemembers and their assets.

II. The Behavioral Aspects that Affect the Perception of Lump Sum Income

Do individuals see lump sum income differently than other income? After all, the well-known saying "easy come, easy go" generally refers to monetary gains.[20] Do individuals behave differently when they receive these large income gains than they do with their regular salaries? Studies conducted by academic psychologists and economists support the theory that individuals do indeed view lump sums differently and therefore treat them differently than smaller periodic payments.

A. Same Sums, Different Mindset

1. Kahneman and Tversky

In 1979, two psychologists, Daniel Kahneman and Amos Tverksy, co-authored a paper titled *Choices, Values, and Frames*.[21] The paper introduced—or rather built upon—the concept of risk aversion that Daniel Bernoulli discussed in an essay he wrote in 1738.[22] While the idea that individuals are averse to loss and risk is intuitive and universally understood, Kahneman and Tversky sought to discuss why individuals make decisions that seem to contradict purely rational outcomes.[23] For example, they discussed the observation that individuals tend to see losses of a certain amount as far worse than a gain of the same exact amount.[24] In other words, an individual would find a loss of $100 as less attractive than a $100 gain would be attractive.[25] One particularly illustrative example Kahneman and Tversky highlight is the situation where study participants make one of two choices: A gamble, where he or she would have an 85% chance of losing $1000 and a 15% chance of losing nothing, or an automatic loss of $800.[26] A pure mathematical analysis states that the latter choice should clearly be more attractive, as the value of the first choice is an expected loss of $850 versus the sure loss of $800.[27] Kahneman and Tversky, however, cite to several studies that indicate individuals far preferred the gamble to the sure loss, indicating a preference for inferior sums based on emotion or circumstance.[28]

2. Richard Thaler

Richard Thaler, in his article *Anomalies: Saving, Fungibility, and Mental Accounts* advances the principle that

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16 MANUAL FOR COURTS-MARTIAL, UNITED STATES, R.C.M. 1101 (2012) (discussing process for deferral of court-martial related forfeitures); U.S. DEP'T OF ARMY, REG. 27-10, MILITARY JUSTICE para. 3-19b(7) (3 Oct. 2011) (discussing forfeitures as an option for punishment under non-judicial punishment procedures).

17 *See generally Money Management*, MILITARYONESOURCE.COM, http://militaryonesource.com/pfm (last visited Feb. 10, 2016); *Military Financial Readiness*, SAVEANDINVEST.ORG, http://www.saveandinvest.org/MilitaryCenter/ (last visited May 18, 2015). These are two websites directed at members of the military. Both sites provide instruction on budgeting, spending plans, general investing, and debt management; however, neither site discusses lump sum management.

18 *Id.*

19 *See generally* U.S. DEP'T OF DEF., MILITARY COMPENSATION BACKGROUND PAPERS (Nov. 2011) [hereinafter COMPENSATION PAPERS] (explaining background and rationale for separation pays, enlistment and continuation bonuses, and combat zone tax exclusions).

20 *See generally* Easy Come, Easy Go, MERRIAM-WEBSTER LEARNER'S DICTIONARY, http://www.learnersdictionary.com/definition/easy (last visited Feb. 10, 2016) (The contextual explanation for the entry is, "His attitude toward money has always been, easy come, easy go.").

21 Daniel Kahneman & Amos Tversky, *Choices, Values, and Frames*, 39 AM. PSYCHOLOGIST 341 (1984).

22 *Id.* Bernoulli "attempted to explain why people are generally averse to risk and why risk aversion decreases with increasing wealth." *Id.*

23 *Id.*

24 *Id.*

25 *Id.* at 342.

26 *Id.*

27 *Id.*

28 *Id.* ("Risk seeking in the domain of losses has been confirmed by several investigators (Fishburn & Kochenberger, 1979; Hershey & Schoemaker, 1980; Payne, Laughhunn, & Crum, 1980; Slovic, Fischhoff, & Lichtenstein, 1982). It has also been observed with nonmonetary outcomes, such as hours of pain (Eraker & Sox, 1981) and loss of human lives (Fischhoff, 1983; Tversky, 1977; Tversky & Kahneman, 1981).").

individuals classify income into certain "mental accounts"—or classifications of what money is for or how it is spent—purely in one's own mind.[29] Thaler's study established that individuals spend funds in these "mental accounts" in different ways, depending on how they classified the income.[30] In another article, Thaler introduces the "house money" effect, where "under some circumstances, a prior gain can increase subjects' willingness to accept gambles."[31] This is the very principle that highlights the danger of lump sums, particularly for members of the military: Recipients may view the money received in such sums differently than they do their periodic pay and act in ways they would otherwise find imprudent.[32]

B. House Money

Other studies support Thaler's "house money" mentality. Nicholas Souleles, a professor at the Wharton School at the University of Pennsylvania, conducted a study to determine the effect on spending upon a household's receipt of their yearly income tax refund.[33] Souleles sought to answer the question of whether the additional income would cause additional spending.[34] He found that within a quarter of a year, households had spent from 35% to over 60% of the income tax refund.[35] A second study Souleles contributed to in 2007 attempted to draw conclusions from a similar set of data: the 2001 federal income tax rebates.[36] The second study had similar results: While recipients saved some of the money initially (by paying down debt and increasing amounts in savings), participants had increased their spending equivalent to 40% of the rebate within nine months of receipt.[37] Instead of engaging in risk-reducing behavior (saving), participants opted to spend.[38]

A Vanderbilt University Law School paper indicates similar and possibly counter-intuitive results.[39] The authors analyzed data pertaining to different sets of lottery winners: those that won less than $10,000, those that won $10,000 to $50,000, and those that won $50,000 to $150,000.[40] They found that, with minimal variations, the amount the individuals won did not significantly affect their financial well-being three to five years from winning the prize; the groups filed bankruptcy at the same rates and with largely the same level of assets.[41] The researchers noted that even though some winners received enough money to pay off all of their debts, the funds merely postponed their bankruptcy instead of preventing it.[42]

Academics and economists continue to study this area because the findings can have wide-ranging economics policy implications and be the "key for the formulation of effective stabilization policies."[43] But this area is not just important to academics and economists; individual savers should be acutely aware that when they receive their lump sum payments, they are fighting a battle with their own perspectives, biases, and emotions when it comes to their desire to spend. Following a discussion of ways military members may face these challenges, Part IV of this article proposes a plan that can help mitigate their effects.

III. Sources of Lump Sum Payments in the Military

Soldiers receive lump sums from a variety of sources and at different points in their career—from the start of their career in the form of enlistment bonuses up to the very end of their career in the form of separation pay.[44] These lump sums can vary from the low thousands to the hundreds of thousands depending on the Army's operational requirements and the need to "provide monetary incentive[s] to induce persons to enlist for and serve in military skill specialties experiencing critical personnel shortages."[45] For example, the Army has, at times, offered $20,000 "quick ship" bonuses for new enlistees who agree to depart for basic training within thirty days.[46] In 2009, the Army offered $150,000 bonuses to

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[29] Richard H. Thaler, *Saving, Fungibility, and Mental Accounts*, 4 J. OF ECON. PERSPECTIVES 193, 194 (1990).

[30] *Id.*

[31] Richard H. Thaler & Richard J. Johnson, *Gambling with the House Money and Trying to Break Even: The Effects of Prior Outcomes on Risky Choice*, 36 MGMT. SCI. 643, 644 (1990).

[32] *Id.*

[33] Nicholas S. Souleles, *The Response of Household Consumption to Income Tax Refunds*, 89 AM. ECON. REV. 947 (1999).

[34] *Id.*

[35] *Id.* at 955-56.

[36] Sumit Agrawal, Chunlin Liu, & Nicholas S. Souleles, *The Reaction of Consumer Spending and Debt to Tax Rebates—Evidence from Consumer Credit Data*, 115 J. OF POLITICAL ECON. 986 (2007).

[37] *Id.* at 989.

[38] *Id.*

[39] Scott Hankins, Mark Hoekstra, & Paige Marta Skiba, *The Ticket to Easy Street? The Financial Consequences of Winning the Lottery* (Vanderbilt University Law School Law and Economics, Working Paper No. 10-12, 2010), http://ssrn.com/ abstract=1324845.

[40] *Id.* at 3-4.

[41] *Id.* at 17-18.

[42] *Id.*

[43] *See* Tullio Japelli & Luigi Pistaferri, *The Consumption Response to Income Changes*, 2 ANNUAL REV. ECON. 479 (2010) ("Understanding how household consumption responds to changes in income is an important topic of research, in particular for understanding how consumers would respond to tax or welfare reforms, which is key for the formulation of effective stabilization policies.").

[44] *See* COMPENSATION PAPERS, *supra* note 19.

[45] *Id.* at 493.

[46] Josh White, *Many Take Army's 'Quick Ship' Bonus*, WASHINGTON POST (Aug. 27, 2007), http://www.washingtonpost.com/wp-dyn/content/article/2007/08/26/AR2007082601266.html. This article discusses the popularity of the bonus during 2007, the same year as the Iraq

Special Forces Soldiers who reenlisted for six years and bonuses of $75,000 for five-year enlistments.[47] The bonuses remained fairly constant in 2014 with the Army offering $72,000 for five-year enlistments for the same skill sets and military occupational specialties.[48] Army wide, the average enlistment bonus fluctuated from $18,300 in fiscal year 2008 to $3,500 in fiscal year 2011.[49]

In stark contrast to the bonuses during the height of the wars in Iraq and Afghanistan, in 2013 the Army initiated selection boards to separate a number of officers in the grades of O-3 and O-4 in response to decreasing personnel requirements.[50] These officer separation boards had authority to separate up to 2,000 officers from the active duty force, many of whom would have been entitled to involuntary separation pay if selected.[51] In 2014, for example, a captain with eight years of service would have been entitled to $54,595, while a major with ten years of service would have been entitled to $56,367.[52]

Deployment savings can also qualify as a lump sum payment of sorts, particularly for single Soldiers.[53] A deployed Soldier receives not only his normal salary but also other pay and allowances such as hostile fire and imminent danger pay,[54] hardship duty pay,[55] and family separation pay if the Soldier is married.[56] Moreover, the Soldier is not subject to federal or state income tax during the year he is serving in the hostile fire area, and the Army provides meals and housing, greatly minimizing the Soldier's expenses.[57] When the Soldier returns from deployment, he may have a sizable amount of money saved from accumulated deployment earnings.[58]

A final, commonly encountered type of lump sum is the income tax refund. Most income tax filings result in refunds to the taxpayer. For the 2014 tax year, over 83% of returns processed by the Internal Revenue Service through March 6, 2015 were refund returns.[59] The average amount of these refunds was $2,988.[60] Although tax refunds are merely the individual's money being returned to them, they are particularly susceptible to the "house money" effect described above. One study showed that after filing a tax return (and presumably discovering how large their refund would be), recipients increased their retail spending by as much as 11%.[61]

IV. Proposed Plan for Lump Sum Payment Management

A holistic plan for the management of lump sums incorporates not only the behavioral research in Part II, but also the specifics of the individual's financial situation, his age or stage in life, and his long term goals. A sound plan also considers the legal aspects of the lump sum, from income tax obligations to laws in place to protect consumers. While these circumstances vary by individual, the framework discussed below should provide flexibility regardless of the situation.

A. First, Do Nothing

"surge." The article indicates that 90% of new enlistees over the previous month accepted the bonus. *Id.*

[47] Military Personnel Message, 09-039, U.S. Army Human Res. Command, subject: Critical Skills Retention Bonus (CSRB) Program (2 Mar. 2009).

[48] Military Personnel Message, 14-303, U.S. Army Human Res. Command, subject: Selective Reenlistment Bonus (15 Oct. 2014).

[49] *Frequently Asked Questions About Recruiting*, U.S. ARMY RECRUITING COMMAND, http://www.usarec.army.mil/support/faqs.htm (last visited Feb. 10, 2016); *see also* U.S. GOV'T ACCOUNTABILITY OFF., REP. NO. GAO-11-631, MILITARY CASH INCENTIVES (2011).

[50] Military Personnel Message, 13-356, U.S. Army Human Res. Command, subject: FY14 Officer Separation Boards (OSB) and (Enhanced) Selective Early Retirement Boards (E-SERB), Captain (CPT), Army Competitive Category (ACC) (6 Dec. 2013); Military Personnel Message, 13-357, U.S. Army Human Res. Command, subject: FY14 Officer Separation Boards (OSB) and (Enhanced) Selective Early Retirement Boards (E-SERB), Major (MAJ), Army Competitive Category (ACC) (6 Dec. 2013).

[51] C. Todd Lopez, *Thousands of Officers to Face Boards for Early Separation*, UNITED STATES ARMY (Dec. 12, 2013), http://www.army.mil/article/116900.

[52] 10 U.S.C. § 1174 (2012); *DOPMA/ROPMA Reference Tool: Separation Pay*, RAND CORPORATION, http://dopma-ropma.rand.org/separation-pay.html (last visited Feb. 20, 2016).

[53] Ryan Guina, *How to Save Money While Deployed*, THE MILITARY WALLET (Aug. 11, 2010), http://themilitarywallet.com/how-to-save-money-while-deployed/; Rob Berger, *Saving and Investing on Your Military Deployment*, DOUGHROLLER (Sept. 9, 2013), http://www.doughroller.net/personal-finance/saving-investing-military-deployment/.

[54] U.S. DEP'T OF DEF., 7000.14-R, DOD FINANCIAL MANAGEMENT REGULATION, vol.7A, ch. 10 (Jun. 2014) [hereinafter DoD FMR]. Servicemembers are entitled to $7.50 per day, up to $225 monthly, for service in areas the DoD FMR designates as imminent danger areas. *Id.*

[55] *Id.* ch. 17. Servicemembers are entitled to additional payments of up to $150 per month depending on duty location or mission. *Id.* The total amount of hardship duty and hostile fire/imminent danger pay a servicemember may receive in one month may not exceed $325. *Id.*

[56] *Id.* ch. 27. Servicemembers that are separated from their dependents are entitled to family separation allowance in the amount of $250 per month. *Id.*

[57] 26 U.S.C. § 112 (2012).

[58] *See* Guina, *supra* note 53; Berger, *supra* note 53.

[59] Internal Revenue Serv., *Visits to IRS Website Increase as Taxpayers Turn to IRS.gov for Answers During Filing Season*, INTERNAL REVENUE SERV. (Mar. 12, 2015), http://www.irs.gov/uac/Newsroom/Visits-to-IRS-Website-Increase-as-Taxpayers-Turn-to-IRS.gov-for-Answers-During-Filing-Season.

[60] *Id.*

[61] Brian Baugh, Itzhak Ben-David, & Hoonsuk Park, *Disentangling Financial Constraints, Precautionary Savings, and Myopia: Household Behavior Surrounding Federal Tax Returns* (Charles A Dice Ctr. for Res. in Fin. Econ., Working Paper No. 2013-20), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2370507.

In her book, *Sudden Money*, Susan Bradley, a financial advisor, refers to the first stage after receipt of a lump sum as the "decision free zone."[62] She argues that when receiving a lump sum, the recipient should strive to "create an environment that is free from emotion-based decisions and free from the influence of others."[63] She advocates this approach regardless of the amount received or how experienced or savvy an individual is with managing his finances.[64] Don McNay, a financial consultant and author of instructional guides for lottery winners espouses a similar view: His first rule is, "Never tell anyone you've won."[65] His second rule is, "Don't make any quick decisions."[66] These steps make sense in the context of the research in Part II; a certain perspective may sway an individual when deciding how to use a lump sum, and fighting the tide of emotions from oneself and others is a challenging ordeal. To successfully battle these emotions and biases, a lump sum recipient must make a conscious and deliberate effort to refrain from making immediate decisions, at least for a period of time when emotions and impulses have subsided.[67] That time is unique to every individual; it could be days, all the way to months. McNay even advises prize recipients that they choose a stream of payments rather than a lump sum to avoid dealing with the problem of lump sums entirely.[68]

While a Soldier may not be able to elect the method of payment for his bonus, he can simulate a stream of payments by depositing the bonus in a separate account or a sub-account. If "doing nothing" is not an option, he can instead limit himself to withdrawing the money in equal amounts over a period of time such as a year or six months, which should dissipate the initial rush of emotion that tends to accompany lump sums.[69] To simplify this process, some online banks permit creation of secondary accounts or sub-accounts with a few clicks that have all the features of a standard account including periodic withdrawals to the account holder's primary account.[70]

B. Second, Assess Duties and Obligations

The next phase of a sound plan—after emotions have subsided at least somewhat—is a thorough assessment of any obligations a lump sum recipient may assume as a result of the income he receives. These obligations may include tax consequences, current or outstanding debts, and expenses.

1. Tax Consequences

The first concern when it comes to lump sums is the effect on the recipient's taxable income. That is, not only will taxes have to be paid on the lump sum, but because the U.S. tax system is progressive, the amount may push the recipient's household into a higher tax bracket which will result in a greater tax burden than he may have expected.[71] A single filer with over $37,450 in taxable income for 2015 will move from the 15% to the 25% tax bracket on income over that amount; that is, any income over $37,450 will be taxed at 25%.[72] This change is sufficient to turn a tax refund into a tax payment.

One additional benefit of acting methodically, as discussed in Part IV, is that individuals will not underestimate their tax burden and spend more than they actually had available after taxes are due.[73] While the Defense Finance and Accounting Service (DFAS) typically withholds federal and state income taxes from bonuses, the change in income may still cause lump sum recipients to understate or even overstate their final tax bill.[74] An understatement will be more likely if the recipient also receives income from other sources that he is not accustomed to withholding or paying estimated taxes on, such as interest income, capital gains, or rental income from a second home.[75] To accurately forecast any changes in his tax bracket, a lump sum recipient should tally all taxable sources of income, including the bonus or other lump sum, for the calendar year and compare it with the

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62 SUSAN BRADLEY, SUDDEN MONEY: MANAGING A FINANCIAL WINDFALL 19 (2000).

63 *Id.*

64 *Id.*

65 Don McNay, *Why do People Run Through Large Sums of Money Quickly?*, HUFFINGTON POST (Dec. 6, 2012), http://www.huffingtonpost.com/don-mcnay/why-do-people-run-through_b_1945118.html.

66 *Id.*

67 BRADLEY, *supra* note 62.

68 McNay, *supra* note 65.

69 BRADLEY, *supra* note 62.

70 *See, e.g.*, *360 Savings Guide*, CAPITAL ONE BANK, https://home.capitalone360.com/savings-guide-multiple-accounts (last visited Feb. 10, 2016) (explaining the ability to create unlimited subaccounts, either checking or savings, with customizable names that can be tied to specific goals, e.g. "Car Fund" or "College Fund").

71 *See* Progressive, MERRIAM-WEBSTER'S DICTIONARY, http://www.merriam-webster.com/dictionary/progressive (last visited Feb. 10, 2016) (defining progressive in the context of a tax that is "increasing in rate as the base increases"); *see also* INTERNAL REVENUE SERV., PUBLICATION 15: EMPLOYER'S TAX GUIDE 2015 (2014) [hereinafter EMPLOYER'S TAX GUIDE] (outlining tax brackets for the 2015 tax year).

72 EMPLOYER'S TAX GUIDE, *supra* note 71.

73 BRADLEY, *supra* note 62, at 27 (advocating careful assessment and projection of one's tax burden to avoid the risk of being surprised by its size when the filing season begins the following year).

74 EMPLOYER'S TAX GUIDE, *supra* note 71. Typically, Defense Finance and Accounting Service (DFAS) exercises the standard federal supplemental withholding rate imposed by the Internal Revenue Service, currently a flat 25%. *Id.* If the servicemember is subject to state income taxes, DFAS will also withhold bonus and special pays based on the state's supplemental rate. *See Roth TSP: One Time Tax Rates for Reserve & Guard*, DEF. FIN. & ACCT. SERV., http://www.dfas.mil/militarymembers/tspformilitary/rothtsprctaxinfo.html (last visited Feb. 10, 2016).

75 INTERNAL REVENUE SERV., PUBLICATION 505: TAX WITHHOLDING AND ESTIMATED TAX 23 (2014).

IRS's tax bracket chart.[76] The recipient should then calculate the amount withheld and then compare that with his overall estimated tax liability.[77] Appendix A illustrates an example of this calculation.

2. Debt Analysis and the Fair Debt Collection Practices Act

A servicemember may have had outstanding debts before receiving the lump sum, and repayment of existing debts is one method of using the lump sum in a potentially constructive manner. Legal assistance attorneys should ensure their clients are aware of the Fair Debt Collection Practices Act (FDCPA) and its protections. The FDCPA is an act Congress established in 1977 to protect consumers from debt collectors—particularly in the means they use to contact and convince the consumers to repay the debt.[78] The FDCPA prohibits a host of abusive practices employed by debt collectors.[79] For example, the FDCPA limits debt collectors to calling during reasonable hours,[80] prohibits "obscene or profane" language used in the course of communication regarding the debt,[81] and prevents debt collectors from making false or exaggerated legal claims if the debt is not paid.[82]

How does this apply to servicemembers receiving lump sum payments? At a minimum, awareness of the FDCPA will ensure servicemembers do not simply agree to pay a debt collector out of fear. Under the FDCPA, a debt collector must "validate" the debt they are seeking repayment on by providing specific information about a loan they are seeking to collect.[83] Under that same section, a debt collector that has not provided this notice within five days of the initial communication with the consumer has violated the FDCPA and would be liable for actual damages or statutory damages of $1,000.[84]

If the servicemember recognizes the debt after validation, he may still not be legally compelled to pay the debt. A debt collector cannot sue to compel payment of a debt on which the statute of limitations has run.[85] In fact, the FDCPA requires that a debt collector answer truthfully if an individual asks if the debt is "time-barred."[86] The statute of limitations on debts varies by state and type of debt.[87] And, in some circumstances, paying on an old debt on which the statute of limitations has already run can restart the statute of limitations period in a process referred to as "debt re-aging."[88]

3. The Fair Credit Reporting Act

Congress enacted the Fair Credit Reporting Act (FCRA) in 1970 in the face of a credit reporting system of growing complexity and with the knowledge that "lenders can use the information advantage over their existing clients to extract monopoly rents."[89] In other words, companies can profit from the information that consumers do not know or understand.[90] Congress sought to create a framework that distributes credit information "in a manner that is fair and equitable to the consumer with regard to confidentiality, accuracy, and the proper use of such information."[91]

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[76] *Id.* at 25-26.

[77] *Id.*

[78] *See* Pub. L. No. 95-109, 91 Stat. 874 (codified as amended at 15 U.S.C. §1692 (2012)). From Congress' perspective, "[t]here is abundant evidence of the use of abusive, deceptive, and unfair debt collection practices by many debt collectors. Abusive debt collection practices contribute to the number of personal bankruptcies, to marital instability, to the loss of jobs, and to invasions of individual privacy." *Id.* On the other hand, they also sought to "insure that those debt collectors who refrain from using abusive debt collection practices are not competitively disadvantaged." *Id.*

[79] *Id.*

[80] 15 U.S.C. § 1692c (2012).

[81] 15 U.S.C. § 1692d (2012).

[82] 15 U.S.C. § 1692e(5) (2012).

[83] 15 U.S.C. § 1692g (2012). Within five days, the debt collector must provide notice of the following: (1) the amount of the debt; (2) the name of the creditor to whom the debt is owed; (3) a statement that unless the consumer, within thirty days after receipt of the notice, disputes the validity of the debt, or any portion thereof, the debt will be assumed to be valid by the debt collector; (4) a statement that if the consumer notifies the debt collector in writing within the thirty-day period that the debt, or any portion thereof, is disputed, the debt collector will obtain verification of the debt or a copy of a judgment against the consumer and a copy of such verification or judgment will be mailed to the consumer by the debt collector; and (5) a statement that, upon the consumer's written request within the thirty-day period, the debt collector will provide the consumer with the name and address of the original creditor, if different from the current creditor. *Id.*

[84] *Id.*; 15 U.S.C. § 1692k (2012).

[85] *See Time-Barred Debts*, FED. TRADE COMM'N, https://www.consumer.ftc.gov/articles/0117-time-barred-debts (last visited Feb. 10, 2016).

[86] 15 U.S.C. § 1692e(2)(A) (2012) (prohibiting the "false representation of the character, amount, or legal status of any debt"); 15 U.S.C. § 1692f(1) (2012) (prohibiting the "collection of any amount (including any interest, fee, charge, or expense incidental to the principal obligation) unless such amount is expressly authorized by the agreement creating the debt or permitted by law").

[87] *See* FED. TRADE COMM'N, *supra* note 85.

[88] *Id.*

[89] WORLD BANK, GLOBAL FINANCIAL DEVELOPMENT REPORT: RETHINKING THE ROLE OF THE STATE IN FINANCE 131 (2012); *see also* Pub. L. No. 91-508, 82 Stat. 146 (codified as amended at 15 U.S.C. §1681 (2012)) ("An elaborate mechanism has been developed for investigating and evaluating [consumers' credit].").

[90] *Id.*

[91] Commentary on the Fair Credit Reporting Act, 16 C.F.R. § 600 app. (2011). *See also* WORLD BANK, GLOBAL FINANCIAL DEVELOPMENT REPORT: RETHINKING THE ROLE OF THE STATE IN FINANCE 131 (2012) ("The state therefore plays an important role in promoting the exchange of

The FCRA overlaps with the FDCPA in its protections in a situation where a debt collector ties a servicemember to a debt that may have been charged off by the original lender.[92] While the FDCPA protects consumers from practices involved in the collection of the debt itself, the FCRA protects consumers from the effects of the debt on the consumer's financial reputation, i.e. his credit report.[93] Section 1681c(a)(4) of the FCRA imposes a credit reporting statute of limitations of seven years on accounts that lenders have already sent to collections or "charged off their profit and loss."[94] Thus, an old, unpaid debt may not necessarily appear on an individual's credit report or affect his corresponding credit score.[95] Consequently, repayment of a debt under collections may not have any effect on a borrower's credit score if it has already been removed from the credit report as the FCRA requires.[96] A debt's credit reporting status is independent from its legal enforceability; a servicemember seeking to repay old debts should ascertain both the FDCPA status and the FCRA status of that debt, as they may vary.[97] A typical consumer credit report would provide most information on a debt's FCRA status, but a debt's FDCPA status would have to take into account the laws of the state in which the debt is recorded and would require additional legal research.[98]

4. Current Expense Analysis

In addition to other financial advisors, Bradley also advocates an expense analysis step.[99] This is a prudent exercise regardless of whether one expects to receive a lump sum or not. This analysis involves a breakdown of all recurring household expenses from the most significant to the most mundane, then classifying them into two categories: necessities and "discretionary spending."[100] The purpose of this is to develop a sense of the cash flow within the household, and then use this information to control spending, mostly by limiting the discretionary outflows.[101] One way to preserve a lump sum, for example, is to attempt to maintain current spending patterns for as long as possible even after the lump sum.[102] The servicemember must recognize that the typical military lump sum payment (of $5,000 to $150,000, for example) is not sufficient to allow a permanent, immediate lifestyle change.

One way to increase awareness of increasing discretionary spending is to manage the phenomenon called "lifestyle creep."[103] This term refers to minor expenses that spenders treat as lifestyle enhancements that accumulate to large expenditures over time.[104] For example, in a post lump-sum spending spree, a family may decide to join a gym ($50 monthly), upgrade their cable package ($60 monthly), upgrade their phone plan ($20 monthly), eat out once more per week ($200 monthly), and upgrade to a new television and computer ($3000) after receiving a lump sum payment. In isolation, each expense seems minor, but over the course of one year, these minor lifestyle enhancements will cost nearly $7,000. Even a seemingly minor expense like a $4.00 cup of coffee before work can add up to nearly $1,000 over a year. The fact that a household incurs these additional expenses in different areas, varying amounts, and dispersed time periods makes the cumulative effect of the spending more difficult to perceive unless its members are consciously monitoring it.

While curtailing all discretionary spending is not a realistic, or even desirable, goal, servicemembers should carefully track and assess new household expenses after receipt of a lump sum. Careful tracking will assist the servicemember in determining whether he is living beyond his means or underestimating the opportunity cost of those additional expenses. Assuming a yearly return of 11.5%, that $7,000 invested in a broad market index fund that holds shares

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credit information and in protecting open and equal access to the market for credit information.").

92 15 U.S.C. § 1681c(a)(4) (2012); *see also* U.S. GOV'T ACCOUNTABILITY OFF., REP. NO. GAO-09-748, CREDIT CARDS (2009) (defining "charge off" as a declaration from a credit card company as a debt that is unlikely to be collected). *Id.* This assists the credit card company in obtaining a tax deduction for the bad debt, but does not forgive the debt to the consumer. *Id.* This creates the market for debt collection firms who purchase these debts for a fraction of their original value. *Id.*

93 15 U.S.C. § 1681c(a)(4) (2012); *see also* WORLD BANK, GLOBAL FINANCIAL DEVELOPMENT REPORT: RETHINKING THE ROLE OF THE STATE IN FINANCE 131 (2012) (discussing the concept of "reputational collateral").

94 *Id.*

95 *It is Possible to Owe Debts Not on Your Credit Report*, EXPERIAN (Aug. 1, 2012), http://www.experian.com/blogs/ask-experian/2012/08/01/it-is-possible-to-owe-debts-not-on-report/.

96 *Id.*

97 *Id.*; *see also* FED. TRADE COMM'N, *supra* note 85.

98 *Id.*

99 BRADLEY, *supra* note 62, at 30; *see also The Budget Breakdown*, DAVERAMSEY.COM (Jul. 30 ,2012), http://www.daveramsey.com/article/the-budget-breakdown/lifeandmoney_budgeting/; *Your 2015 Financial Road Map*, SUZEORMAN.COM (Jan. 3, 2015), http://www.suzeorman.com/blog/your-2015-financial-road-map/ (discussing approaches to creating household budgets).

100 *Id.*

101 *Id.* at 31.

102 *Id.*

103 *See generally* Hank Coleman, *Avoiding Lifestyle Creep*, FIVE CENT NICKEL (Oct. 8, 2012), http://www.fivecentnickel.com/2012/10/02/avoiding-lifestyle-creep/; April Dykman, *Detecting and Preventing Lifestyle Creep*, GET RICH SLOWLY (Dec. 21, 2011), http://www.getrichslowly.org/blog/2011/12/21/detecting-and-preventing-lifestyle-creep/; Matthew Amster-Burton, *Lifestyle Creep: Are You Living Beyond Your Means?*, MINT LIFE (Mar. 30, 2010), https://www.mint.com/blog/how-to/living-beyond-your-means/.

104 *Id.*

in the largest American companies could be worth over $60,000, non-inflation adjusted, in twenty years.[105]

5. The Emergency Fund

Lump sum recipients should prioritize creation of an emergency fund or "rainy day" fund.[106] This is an easily accessible fund from which a household can draw in the event of an unexpected expense or life situation.[107] Despite the utility of such a fund, the participation rate among the general population is likely low. The Federal Reserve's personal savings rate statistics show a savings rate of 4.4% as of November 2014 (compared to 10-15% during the 1960s to the mid-1980s) and consumer debt statistics show an average of debt of approximately $10,300 per household.[108] These figures indicate a low likely participation rate for emergency funds of any amount and a similarly low rate for emergency funds that contain at least six full months of household expenses.[109]

The fund should have certain characteristics.[110] First, the funds should be easily accessible.[111] A standard checking or savings deposit at a nearby bank would meet these requirements. While a certificate of deposit may yield a higher interest rate, the money within may not be accessible for a few days, defeating its purpose if a household needs to access the funds immediately.[112] Second, the money should be in a liquid and stable form, i.e. cash, and not in possibly volatile and unpredictable investments such as stocks or bonds.[113] And third, the fund should be large enough to cover at least three to six months of full household living expenses including rent or mortgage payments.[114]

C. Assess Priorities and Deploy Funds

Once the lump sum recipient addresses the immediate financial priorities of taxes, debts, credit, and emergency funds, he can begin looking towards his short and long-term goals. As stated in Part I, this article and the Army legal assistance program do not aim to provide specific financial and investment advice. But informing the client of his options may encourage the client to use the money for purposes other than consumption of material goods.

For example, if a military client wants to increase his retirement savings, he has access to the Thrift Savings Plan (TSP), a 401(k)-like tax-deferred investment account.[115] Financial writers and advisers (at least those who do not work on commission) consider the TSP to be one of the best, if not the best, investment vehicles in existence, primarily due to its incomparably low expense fees.[116] With a simple adjustment on the My Pay website, a servicemember can allocate up to $18,000 of his base pay or lump sum bonus into the TSP per year.[117] This allocation not only invests the Soldier's hard-earned savings in a low expense investment vehicle, but it reduces his taxable income and, accordingly, his tax liability.[118]

Finally, a Soldier and his Family should not hesitate to spend part of the lump sum on fun and leisure purchases.[119]

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105 Aswath Damodaran, *Annual Returns on Stock, T.Bonds and T.Bills: 1928–Current*, NEW YORK UNIV. SCH. OF BUS., http://pages.stern.nyu.edu/~adamodar/New_Home_Page/datafile/histretSP.html (last visited Feb. 10, 2016) (showing average nominal return of the S&P 500 index from 1928-2014 at 11.53%).

106 *See generally* Vibha Bhargava & Jean M. Lown, *Preparedness for Financial Emergencies: Evidence from the Survey of Consumer Finances*, J. OF FIN. COUNSELING & PLANNING 17 (2006).

107 *Id.* A household should not necessarily consider their emergency fund as "savings." The term implies a growth-oriented goal and perhaps the ability to be tapped for various non-emergent expenses. *Id.* This purpose runs contrary to the purpose of an emergency fund, and such a "mental account" may lead a household to spend the fund rather than preserve it.

108 *Personal Saving Rate*, FED. RES. BANK OF ST. LOUIS, http://research.stlouisfed.org/fred2/series/PSAVERT/ (last visited Feb. 10, 2016); *Federal Reserve Statistical Release*, BD. OF GOVERNORS OF THE FED. RES. SYS., http://www.federalreserve.gov/releases/g19/current/ (last visited May 18, 2015); *see also* Y. Regina Chang, Sherman Hanna, & Jessie X. Fan, *Emergency Fund Levels: Is Household Behavior Rational?*, J. OF FIN. COUNSELING & PLANNING 1, 2 (1997) ("[M]ajority of families had insufficient funds to cover normal total household income for the average time a household could expect to be out of work.").

109 *Id.*

110 *Id.*

111 *Id.*

112 *Id.*; *see also High-Yield CDs–Protect Your Money by Checking the Fine Print*, SEC. & EXCH. COMM'N, http://www.sec.gov/investor/pubs/certific.htm (last visited Feb. 10, 2016).

113 Bhargava and Lown, *supra* note 106, at 17.

114 *Id.* at 18.

115 5 U.S.C. § 8440(e) (2012). This statute implements the Thrift Savings Plan for uniformed service members.

116 *See* Elliot Raphaelson, *Think Twice Before Rollover from the Federal Thrift Savings Plan*, CHICAGO TRIBUNE (Sept. 2, 2014), http://www.chicagotribune.com/business/sns-201409021900--tms--savingsgctnzy-a20140902-20140902-story.html (discouraging rollovers from the Thrift Savings Plan (TSP) because its low fees are nearly unmatched in the industry); John Hechinger, *Brokers Lure Soldiers Out of Low-Fee Federal Retirement Plan*, BLOOMBERG BUSINESS (Aug. 12, 2014), http://www.bloomberg.com/news/articles/2014-08-12/brokers-lure-soldiers-out-of-low-fee-federal-retirement-plan (describing aggressive efforts by financial firms to entice TSP participants into transferring their accounts to more expensive options).

117 26 U.S.C. § 402(g) (2012); Internal Revenue Serv., *COLA Increases for Dollar Limitations on Benefits and Contributions*, RETIREMENT PLANS (Jan. 13, 2015), http://www.irs.gov/Retirement-Plans/COLA-Increases-for-Dollar-Limitations-on-Benefits-and-Contributions.

118 *Id.* (Elective deferrals are not included in income up to the statutory limit, $18,000 for 2015.).

119 Amit Kumar, Matthew Killingsworth, & Thomas Gilovich, *Waiting for Merlot: Anticipatory Consumption of Experiential and Material Purchases*, PSYCHOL. SCI., Oct. 2014, at 1929 (supporting the idea that money spent on experiences provides an individual with longer lasting happiness than does

If the Soldier seeks to spend, he may be better off spending on "doing" rather than "having" and avoiding the "lifestyle creep" purchases discussed in Part IV above.[120]

V. Conclusion

While judge advocates are not financial advisers and should not act as such, the broad scope of client practice, from legal assistance to trial defense, makes financial discussions a likely occurrence.[121] Whether it is the OSB-selected Captain with a $90,000 separation payment at Legal Assistance for a will or the recently-returned Sergeant First Class with $60,000 in deployment savings seeking tax assistance, judge advocates can add value by encouraging their clients to plan for the constructive use of their lump sums and by helping them to avoid emotionally driven, hasty decisions. The sizes of lump sums in the military are not sufficient to provide a permanent change to an individual's standard of living, but they can significantly increase savings or emergency funds and add to the servicemember's peace of mind and financial stability over the long term if employed wisely. The key is to offer a basic framework to the client that is both aspirational and attainable. While it would be laudable for a young Soldier to put his entire $15,000 re-enlistment bonus into an emergency fund, it is unrealistic—so much so that the client might disregard all of the practitioner's advice. The attorney should understand the client's perspective and life circumstances and adjust the proposed framework accordingly. Ultimately, if a lump sum recipient does not make any rash decisions and has outlined at least some broad goal for the money, that is a victory in itself.

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money spent on material objects, based on a social psychology and behavioral economics study); *see also* James Hamblin, *Buy Experiences, Not Things*, THE ATLANTIC (Oct. 7 2014), http://www.theatlantic.com/business/archive/2014/10/buy-experiences/381132/.

[120] *Id.*

[121] *See* U.S. DEP'T OF ARMY, LEGAL ASSISTANCE, *supra* note 14.

Appendix A: Comparison of Tax Liability After Lump Sum

The two scenarios below outline the differing tax liability between two Soldiers.

E-6 (over 8 years of service) with no dependents, assuming exemption from state tax:	E-6 (over 8) with no dependents, assuming exempt from state tax, with lump bonus income and other additional income
Basic Pay[122]: $3,261	Basic Pay: $3,261
BAH (Fort Drum)[123]: $1,305 (non-taxable)	BAH (Fort Drum): $1,305 (non-taxable)
BAS: $367.92[124] (non-taxable)	BAS: $367.92 (non-taxable)
	Re-enlistment bonus: $20,000
	Capital Gains & Interest Income: $6,200
2015 Gross Income: $39,132	2015 Gross Income: $65,332
Total taxable income less standard deduction ($6,300) and personal exemption ($4,000)[125]: $28,832	Total taxable income less standard deduction ($6,300) and personal exemption ($4,000): $55,032
Tax Bracket: 15% Amount withheld (1 allowance)[126]: $4463.55	Tax Bracket: 25% Amount withheld (1 allowance and standard 25% DFAS lump sum withholding): $9463.55
2015 tax due[127]: $3863.55 Result: $600 tax refund	2015 tax due: $9551.75 Result: $88.20 tax due

[122] *2015 Military Pay Chart*, DEF. FIN. & ACCT. SERV., http://www.dfas.mil/dam/jcr:b6ef41d4-f071-45f9-b863-70b202be05a6/2015MilitaryPayChart_2.pdf (last visited Feb. 10, 2016).

[123] *2015 Without Dependents BAH Rates*, DEF. TRAVEL & MGMT. OFF., http://www.defensetravel.dod.mil/Docs/perdiem/browse/Allowances/BAH /PDF/2015/2015-Without-Dependents-BAH-Rates.pdf (last visited Feb. 10, 2016).

[124] DEF. FIN. & ACCT. SERV., *supra* note 121.

[125] INTERNAL REVENUE SERV., *supra* note 72.

[126] *Id.*; *Calculation of "Take Home" Pay*, PAYCHECK CITY, http://www.paycheckcity.com/calculator/salary/ (enter yearly gross base pay in "Gross Pay" box, select Texas in "state for withholding" drop down box, "Annually" for "Gross Pay Type" drop down box and "Annual" for "Pay Frequency" drop down box to simplify, enter 1 for # of Federal Allowances; then follow "Calculate" hyperlink).

[127] *Id.* (calculation based on 2015 tax brackets).

Appendix B: Sample Information Paper

INFORMATION PAPER

SUBJECT: Preserving and Maximizing Your Lump Sum Payment

1. Purpose: To provide Soldiers with a framework for preserving and maximizing the benefit of their lump sum payment.

2. If you have received a large cash bonus as part of your military service, you should be careful how you spend it. The money may seem like plenty at first, but careless spending will consume it quickly.

3. Go through the following steps before you spend your lump sum:

a. Do Nothing. Choose an amount of time during which you will not spend any part of the bonus. Unless you are in the midst of a financial emergency, you should not need the money right away. Whether for a week or a month, take this time to let the emotions that come with receiving large sums of money subside.

b. Determine Tax Impact. DFAS will typically withhold 25% of any bonus you receive from the Army, but the bonus may still push you into a higher tax bracket. If you receive any other type of income, such as interest, capital gains, or rental income, you may owe more in taxes than you anticipated when you file the next year. Visit your local Tax Center for advice on your situation.

c. Assess Your Debts and Obligations. Do you have existing credit card debt? Do you have a mortgage that you want to pay off early? Create a list of all your current debts and decide whether you want to put your bonus towards any of them. For example, if you have an existing auto loan with a high interest rate, it may be advantageous to use your bonus to pay off the loan. The same applies to any high interest credit card balances you may have.

d. Figure Out Your Household Expenses. Receiving a bonus is a great way to get an azimuth check on your financial well-being. Start with a list of your monthly income from all sources. Then, list all your monthly expenses and compare the two. Are you spending more than you are earning? Find areas where you can apply your bonus to reduce some of your monthly expenses. Paying off an auto loan or credit card puts that monthly payment right back in your pocket.

e. Create a Rainy Day Fund. Finance experts recommend an emergency fund of 3-6 months of total household expenses to cover any unexpected expenses. If you don’t have an emergency fund, getting a bonus is a great way to start one. Set up a checking or savings account separate from the ones you normally use and forget about it until you need it.

4. Finally, make a short list of your long and short-term goals and spend accordingly. These goals can include long term financial goals like college funds, but they can also include fun purchases like vacations. Whatever you decide, ensure that you spend in a systematic and purposeful way, and stick to the priorities you laid out in your plan.