Life Guide

Managing an Inheritance

With an inheritance come a variety of potential outcomes, both good and bad. When managed prudently, a sizeable inheritance can represent a life-changing opportunity. Without an understanding, however, of the possible financial pitfalls surrounding an inheritance, you may find yourself in the center of a financial minefield. This guide is intended to assist you in making the most of an inheritance by successfully navigating through that minefield.

Table of Contents

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Tips for Managing an Inheritance

- [ ] **Take your time.** An inheritance is frequently related to the loss of a loved one, making this is an emotional time for you, and not the best time to be making important financial decisions. Short of meeting any required tax or legal deadlines, don't make hasty decisions concerning your inheritance. Try and maintain your current budget and lifestyle until you're in a better position to make financial decisions.

- [ ] **Identify a team of reputable, trusted advisors** (attorney, accountant, financial/insurance advisors). There are complicated tax laws and requirements related to certain inherited assets. Without accurate, reliable advice, you may find an unnecessarily large chunk of your inheritance going to pay taxes. In addition, you may benefit from a review of your overall financial situation in light of your inheritance.

- [ ] **Park the money.** Deposit any inherited money or investments in a bank or brokerage account until you're in a position to make definitive decisions on what you want to do with your inheritance. If married, you will need to decide if the account is in your name alone or held jointly with your spouse. Inherited assets have special protection in the event of a divorce. If you commingle inherited assets in a joint account, however, you run the risk of losing that special protection.

- [ ] **Understand the tax consequences of inherited assets.** If your inheritance is from a spouse, there may be no estate or inheritance taxes due. Otherwise, your inheritance may be subject to federal estate tax or state inheritance tax. Income taxes are also a consideration. Life insurance proceeds are generally received free of income tax. Non-retirement assets receive what is known as a "step-up" in cost basis, meaning that if you later sell these assets, any capital gains tax you owe on asset appreciation will be based on the asset's fair market value at the date of death (or at the alternative valuation date), instead of being based on what the deceased originally paid for the asset. Inherited retirement plan assets are subject to income tax when received by you from the plan.

- [ ] **Treat inherited retirement assets with care.** The tax treatment of inherited retirement assets is a complex subject. You'll have a variety of options available to you, but they come with time deadlines and vary according to the type of retirement plan and your relationship to the deceased. Make sure the retirement plan administrator does **not** send you a check for the retirement plan proceeds until you have made a distribution decision. Get sound professional financial and tax advice before taking any money from an inherited retirement plan…otherwise you may find yourself liable for paying income taxes on the entire value of the retirement account.

- [ ] **If you received an interest in a trust,** familiarize yourself with the trust document and the terms under which you receive distributions from the trust, as well as with the trustee and trust administration fees.

- **Take stock.** Create a financial inventory of your assets and your debts. Start with a clean slate and reassess your financial needs, objectives and goals. Should a portion of your inheritance be used to pay off debts? Fund a child's college education? A grandchild's college education? Saved for your retirement? Fund a career change? Take early retirement? Help a favorite charity? Do something special for yourself and your family? If you inherited real estate, will you keep it or sell it? If you decide to keep an inherited residence, will you live there or rent it?

- **Develop a financial plan.** Consider working with a financial advisor to "test drive" various scenarios and determine how your funds should be invested to accomplish your financial goals. The "step-up" in cost basis received by non-retirement plan inherited assets may make it attractive from a tax standpoint to sell those assets before selling other appreciated assets in order to rebalance your portfolio. Try not to let emotions guide your investment decisions…just because a particular investment was owned by the deceased doesn't mean that investment is the best choice for you in your situation today.

- **Evaluate your insurance needs.** If you inherited valuable personal property, such as jewelry or antiques, or real estate, you will probably need to increase your property and casualty coverage or purchase new coverage. If your inheritance is substantial, consider increasing your liability insurance to protect against lawsuits. Finally, evaluate whether your life insurance needs have changed as a result of your inheritance.

- **Review your estate plan.** Your inheritance, together with your experience in managing it, may lead you to make changes in your estate plan. For example, the inheritance may increase the size of your estate to an extent that it will be subject to estate taxes. You may decide that you're now in a better position to plan for either lifetime or testamentary charitable giving (or both). You may want to implement a program of planned lifetime giving to children and/or grandchildren. Your experience in receiving an inheritance may prompt you to want to do a better job of how your estate is structured and administered for the benefit of your heirs.

- **Decline the inheritance.** No discussion of an inheritance would be complete without mentioning the possibility that it might be in your best interests to decline (or "disclaim") all or a portion of the inheritance, in which case the money would go to the contingent beneficiaries named in the deceased's will (possibly your children). If, for example, the size of the inheritance would make your estate subject to federal and state estate taxation and you don't need the extra money, you may want to decline all or a portion of the inheritance. It might also make sense to disclaim an inherited IRA in favor of a younger family member who has a longer life expectancy over which to stretch the tax deferral benefits of an inherited IRA. Generally speaking, you can disclaim a percentage of your inheritance, a dollar amount or specified assets. If you're considering this option, it's important to get expert tax and legal advice quickly, before you receive any assets from the deceased's estate.

Common Inheritance Challenges

- **Co-Beneficiaries.** You may inherit assets together with other estate beneficiaries, such as siblings. If a parent simply leaves his or her estate to be divided among the children, without specifying who is to receive specific assets or possessions, conflicts with siblings can arise. In an attempt to avoid conflict, sit down and discuss all parts of the inheritance with your siblings, with each of you stating your views and opinions on the disposition of estate assets. Keeping lines of communication open is vital. If siblings cannot agree on the distribution of parents' personal property, consider a drawing that establishes an order of priority with a rotating first choice. Each sibling then selects a piece of personal property in the established order of priority. Another idea is to hold an estate sale, instead of trying to decide who gets what item. If siblings want specific items, they can be bought at the sale. The money from the sale can then be evenly distributed between all siblings.
- **Family home or vacation home.** Your inheritance may include the family homestead or a vacation home for which you (and possibly your siblings) have many fond memories. If you or any of your siblings want to live in the family home, you'll need to work out an equitable arrangement with the other estate beneficiaries for buying out their ownership interests in the property. If you're tempted to keep the family home or a vacation property for "sentimental" reasons, first do your homework. Investigate the costs involved, such as property taxes, insurance, maintenance and repairs and the cost of any mortgages on the property. The cold, hard cash required to hang onto the property may trump sentiment and a decision will be made to sell the property. In this case, siblings will need to agree on an asking price and may also need agree on who will be responsible for which elements of the sale.
- **Family business.** If your inheritance includes a family business and no succession plans are in place, timely decisions will need to be made about who will step in and run the business while longer-term plans are developed. You and your siblings may decide that none of you want to be active in the business, in which case you should sell the business or hire someone to run it on your behalf. If one or more siblings are active in the business, those who are not active should sell their share of the business. A common arrangement is to pay for a share of a small business interest out of cash flow over several years. A business appraiser can help establish the value of a small business.
- **Securities.** If you inherit securities, your best bet is to research those securities or work with a financial advisor to determine how the inherited securities fit into your investment objectives and portfolio. You can then sell or retain investments based on their expected future performance and your investment needs and objectives.
- **Retirement plan assets.** Inheriting retirement plan assets presents you with both opportunities and potential pitfalls. Depending on decisions you make, you could end up with a lifetime income or a large tax bill. Consider retaining a trusted financial advisor who can help you correctly navigate the complicated options you face with inherited retirement plan assets.

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