INDEPENDENT WEALTH MANAGEMENT

Planning News

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INDEPENDENT WEALTH MANAGEMENT

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Tips for Managing an Inheritance

As the beneficiary of an inheritance, you are most likely to be faced with making many important decisions during an emotional time. Short of meeting any required tax or legal deadlines, don't make any hasty decisions concerning your inheritance.

Identify a Team of Trusted Professionals

Tax laws and requirements can be complicated. Consult with professionals who are familiar with assets that transfer at death. These professionals may include an attorney, an accountant, and a financial and/or insurance professional.

Be Aware of the Tax Consequences

Generally, you probably will not owe income tax on assets you inherit. However, your income tax liability may eventually increase. Any income that is generated by inherited assets may be subject to income tax, and if those assets produce a substantial amount of income, your tax bracket may increase. This is particularly true if you receive distributions from a tax-qualified retirement plan such as a 401(k) or an IRA. You may need to re-evaluate your income tax withholding or begin paying estimated tax.

You also may need to consider the amount of potential transfer (estate) taxes that your estate may owe, due to the increase in the size of your estate after factoring in your inheritance. You may need to consider ways to help reduce these potential taxes.

How You Inherit Assets Makes a Difference

Your inheritance may be received through a trust or you may inherit assets outright. When you inherit through a trust, you'll receive distributions according to the terms of the trust. You may not have total control over your inheritance as you would if you inherited the assets outright.

Familiarize yourself with the trust document and the terms under which you are to receive trust distributions. You will have to communicate with the trustee of the trust, who is responsible for the administration of the trust and the distribution of assets according to the terms of the trust.

Even if you're used to handling your own finances, receiving a significant inheritance may promote spending without planning. Although you may want to quit your job, or buy a car, a house, or luxury items, this may not be in your best interest. Consider your future needs, as well, if you want your wealth to last. It's a good idea to wait at least a few months after inheriting money to formulate a financial plan. You'll want to consider your current lifestyle and your future goals, formulate a financial strategy to meet those goals, and determine how taxes may reduce your estate.

Develop a Financial Plan

Once you have determined the value and type of assets you will inherit, consider how those assets will fit into your financial plan. For example, in the short term, you may want to pay off consumer debt such as high-interest loans or credit cards. Your long-term planning needs and goals may be more complex. You may want to fund your child's college education, put more money into a retirement account, invest, plan to help reduce taxes, or travel.

Receiving a significant inheritance may promote spending without planning, but don't make any hasty decisions.

Evaluate Your Insurance Needs
Depending on the type of assets you inherit, your insurance needs may need to be adjusted. For instance, if you inherit valuable personal property, you may need to adjust your property and casualty insurance coverage. Your additional wealth from your inheritance means you probably have more to lose in the event of a lawsuit. You may want to purchase an umbrella liability policy that can help protect you against actual loss, large judgments, and the cost of legal representation. You may also need to recalculate the amount of life insurance you need because of your inheritance. The cost and availability of life insurance depend on factors such as age, health, and the type and amount of insurance purchased.

Evaluate Your Estate Plan
Depending on the value of your inheritance, it may be appropriate to re-evaluate your estate plan. Estate planning involves conserving your money and putting it to work so that it best fulfills your goals. It also means helping reduce your exposure to potential taxes and creating a comfortable financial future for your family and other intended beneficiaries.

Some things you should consider are to whom your estate will be distributed, whether the beneficiary(ies) of your estate are capable of managing the inheritance on their own, and how you can best shield your estate from estate taxes. If you have minor children, you may want to protect them from asset mismanagement by nominating an appropriate guardian or setting up a trust for them. If you have a will, your inheritance may make it necessary to make significant changes to that document, or you may want to make an entirely new will or trust. There are costs and ongoing expenses associated with the creation and maintenance of trusts and wills. Consult with an estate-planning attorney for proper guidance.

Considerations When Making Gifts to Children

If you make significant gifts to your children or someone else's children (perhaps a grandchild, a nephew, or a niece), or if someone else makes gifts to your children, there are a number of things to consider.

Nontaxable Gift Transfers
There are a variety of ways to make transfers to children that are not treated as taxable gifts. Filing a gift tax return is generally required only if you make gifts (other than qualified transfers) totaling more than $15,000 per individual during the year.

- Providing support. When you provide support to a child, it should not be treated as a taxable gift if you have an obligation to provide support under state law. Parents of minor children, college-age children, boomerang children, and special-needs children may find this provision very useful.
- Annual exclusion gifts. You can generally make tax-free gifts of up to $15,000 per child each year. If you combine gifts with your spouse, the amount is effectively increased to $30,000.
- Qualified transfers for medical expenses. You can make unlimited tax-free gifts for medical care, provided the gift is made directly to the medical care provider.
- Qualified transfers for educational expenses. You can make unlimited gifts for tuition free of gift tax, provided the gift is made directly to the educational provider.

For purposes of the generation-skipping transfer (GST) tax, the same exceptions for nontaxable gift transfers generally apply. The GST tax is a separate tax that generally applies when you transfer property to someone who is two or more generations younger than you, such as a grandchild.

Income Tax Issues
A gift is not taxable income to the person receiving the gift. However, when you make a gift to a child, there may be several income tax issues regarding income produced by the property or from sale of the property.

Transfer by Gift Versus Transfer at Death

Difference in taxable gain when appreciated property is sold at fair market value (FMV) after the transfer.

Calculation Steps	Transfer by Gift	Transfer at Death
Sales price (FMV)	$100,000	$100,000
– Income tax basis	– $20,000 (carryover of donor's basis)	– $100,000 (stepped-up to FMV)
Taxable gain	= $80,000	= $0

- Income for support. Income from property owned by your children will be taxed to you if used to fulfill your obligation to provide support.
- Kiddie tax. Children subject to the kiddie tax are generally taxed at their parents' tax rates on any unearned income over $2,200 (in 2021). The kiddie tax rules apply to: (1) those under age 18, (2) those age 18 whose earned income doesn't exceed one-half of their support, and (3) those ages 19 to 23 who are full-time students and whose earned income doesn't exceed one-half of their support.
- Basis. When a donor makes a gift, the person receiving the gift generally takes an income tax basis equal to the donor's basis in the gift. The income tax basis is generally used to determine the amount of taxable gain if the child then sells the property. If

instead the property were transferred to the child at your death, the child would receive a basis stepped up (or down) to the fair market value of the property.

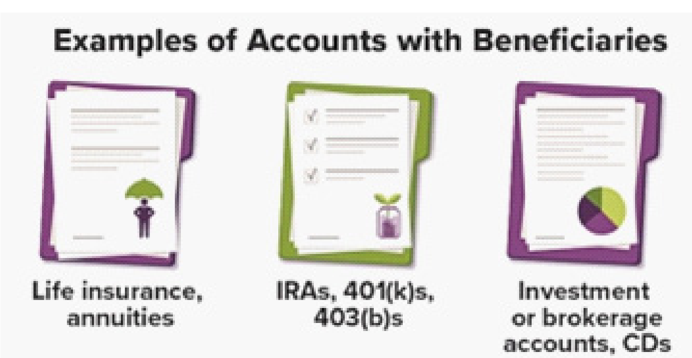
Gifts to Minors
Outright gifts should generally be avoided for any significant gifts to minors. For this purpose, you might consider a custodial gift or a trust for a minor.

- Custodial gifts. Gifts can be made to a custodial account for the minor under your state's version of the Uniform Gifts/Transfers to Minors Acts. The custodian (an adult or a trust company) holds the property for the benefit of the minor until an age (often 21) specified by state statute.
- Trust for minor. A Section 2503(c) trust is specifically designed to obtain the annual gift tax exclusion for gifts to a minor. Principal and income can (but need not) be distributed to the minor before age 21. The minor does generally gain access to undistributed income and principal at age 21. (The use of trusts involves a complex web of tax rules and regulations, and usually involves up-front costs and ongoing administrative fees. You should consider the counsel of an experienced estate professional before implementing a trust strategy.)

Life Insurance Beneficiary Mistakes to Avoid

Life insurance has long been recognized as a useful way to provide for your heirs and loved ones when you die. Naming your policy's beneficiaries should be a relatively simple task. However, there are several situations that can easily lead to unintended and adverse consequences you may want to avoid.

Not Naming a Beneficiary
The most obvious mistake you can make is failing to name a beneficiary of your life insurance policy. But simply naming your spouse or child as beneficiary may not suffice. It is conceivable that you and your spouse could die together, or that your named beneficiary may die before you do. If the beneficiaries you designated are not living at your death, the insurance company may pay the death proceeds to your estate, which can lead to other potential problems.



Death Benefit Paid to Your Estate
If your life insurance benefit is paid to your estate, several undesired issues may arise. First, the insurance proceeds likely become subject to probate, which may delay the payment to your heirs. Second, life insurance that is part of your probate estate is subject to claims of your probate creditors. Not only might your heirs have to wait to receive their share of the insurance, but your creditors may satisfy their claims out of those proceeds first.

Naming primary, secondary, and final beneficiaries may avoid having the proceeds ultimately paid to your estate. If the primary beneficiary dies before you do, then the secondary or alternate beneficiaries receive the proceeds. And if the secondary beneficiaries are unavailable to receive the death benefit, you can name a final beneficiary, such as a charity, to receive the insurance proceeds.

Naming a Minor Child as Beneficiary
Unintended consequences may arise if your named beneficiary is a minor. Insurance companies will rarely pay life insurance proceeds directly to a minor. Typically, the court appoints a guardian — a potentially costly and time-consuming process — to handle the proceeds until the minor beneficiary reaches the age of majority according to state law.

If you want the life insurance proceeds to be paid for the benefit of a minor, consider creating a trust that names the minor as beneficiary. Then the trust manages and pays the proceeds from the insurance according to the terms and conditions you set out in the trust document. Consult with an estate attorney to decide on the course that works best for your situation.

Per Capita or Per Stirpes Designations
It's not uncommon to name multiple beneficiaries to share in the life insurance proceeds. But what happens if one of the beneficiaries dies before you do? Do you want the share of the deceased beneficiary to be added to the shares of the surviving beneficiaries, or do you want the share to pass to the deceased beneficiary's children? That's the difference between per stirpes and per capita.

You don't have to use the legal terms in directing what is to happen if a beneficiary dies before you do, but it's important to indicate on the insurance beneficiary designation form how you want the share to pass if a beneficiary predeceases you. Per stirpes (by branch) means the share of a deceased beneficiary passes to the next generation in line. Per capita (by head) provides that the share of the deceased beneficiary is added to the shares of the surviving beneficiaries so that each receives an equal share.

Disqualifying a Beneficiary from Government Assistance
A beneficiary you name to receive your life insurance may be receiving or is eligible to receive government assistance due to a disability or other special circumstance. Eligibility for government benefits is often tied to the financial circumstances of the recipient. The payment of insurance proceeds may be a financial windfall that disqualifies your beneficiary from eligibility for government benefits, or the proceeds may have to be paid to the government entity as reimbursement for benefits paid. Again, an estate attorney can help you address this issue.