



## Tips to Help Make the Most of Your Inheritance

Baby boomers in the U.S. are set to bequeath \$68 trillion in wealth by 2043, as part of the Great Wealth Transfer. Much of that will be left to Generation X and millennial heirs. If you expect to receive an inheritance, planning ahead for how you will use the wealth and account for any taxes will help you make the most of your windfall.

### If you will inherit money...

If you stand to inherit a significant amount of money, earmark it toward financial goals ahead of time so you'll be confident you're putting it where it will do the most good. Here are a few options to consider:

- **Pay off high-interest debt.** High-interest debts such as credit card debt and personal loans eat away at your efforts to build savings. If you carry a balance, interest payments cause your debt to grow quickly. Pay off debts to save on interest and free up cash for other financial goals.
- **Make a down payment on a home.** Many mortgages require you to put down as much as 20 percent of the purchase price of a house. The larger your down payment, the smaller your monthly mortgage payments and interest rate will likely be. If you already have a mortgage, you can use the cash to pay it down early.
- **Save for retirement.** Use your windfall to help you boost savings in a tax-advantaged retirement account, such as a 401(k). In 2021, you can save up to \$19,500 in your 401(k), or \$26,000 with catch-up contributions for those age 50 and older. Money invested in the account grows tax-deferred until you retire.

### If you will inherit a house...

Real estate can make a more complicated inheritance. Here are two important questions to help you prepare to inherit a house:

- **What are the costs?** Unlike a cash inheritance, a real estate inheritance can come with financial obligations. If you've been told that one day the family house will be yours, find out ahead of time what costs you may need to cover should you decide to keep the home. First, is there a mortgage? If so, do the terms of the mortgage allow you to take over payments, or do they require the mortgage balance to be paid in full when the property transfers ownership? Also, be aware of property taxes and maintenance costs. If you're not readily able to cover these costs, you may consider selling the home.
- **Is the inheritance shared?** It's not uncommon for siblings to inherit a piece of property together. If that's your situation, then the most important thing is understanding each heir's wants and needs. Then you can decide whether it makes sense to sell the home and split the profit, rent it out jointly, or keep it in the family by having one heir buy out the others' shares.

### **Managing taxes**

Before you can be sure exactly how much you'll be getting from an inheritance, you have to consider the tax bill. How much you might owe depends on several factors:

- In general, you do not owe income taxes on an inheritance. An exception occurs when you've inherited the right to receive payments, say from a traditional IRA or 401(k).
- Federal estate taxes — charged to the estate — are not levied on estates worth less than \$11.7 million. Connecticut, Hawaii, Illinois, Maine, Maryland, Massachusetts, Minnesota, New York, Oregon, Rhode Island, Vermont, Washington, and the District of Columbia levy estate taxes on people who lived or owned property within their borders.
- Inheritance taxes — charged to the heir — do not exist at the federal level, though Iowa, Kentucky, Maryland, Nebraska, New Jersey, and Pennsylvania levy their own on inheritances from decedents who lived or owned property in those states. Often, closely related heirs are exempt from these state inheritance taxes.
- If you sell a home you inherited for more than its fair market value at the time you inherited it, you will realize a capital gain and potentially owe capital gains tax. You may avoid all or part of this tax if you use the house as your primary residence for two years out of a five-year period before selling.

Planning for inheritance is an important part of keeping on top of your personal finances, helping you decide how much you need to save for your financial goals and what you need to do now so a bequest can do the most good in the future.

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## SOURCES

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