



# Your Trusted Counselor

## PLANNING TO RECEIVE AN INHERITANCE

When we think of estate planning, we often think about preparing our accounts and property to go to our loved ones in a tax-efficient way, protected from probate, disgruntled heirs, beneficiaries' creditors, divorcing spouses, bankruptcy, and the poor spending habits of children or other beneficiaries. We rarely consider planning for *receiving* an inheritance of our own.

Believe it or not, there are some essential things you must consider when you anticipate receiving an inheritance. Understanding these issues can be crucial to protect that inheritance from unnecessary taxes and outside threats like creditors, divorcing spouses, and bankruptcy.

### **Understanding the Nature of the Property to Be Inherited**

The first way to properly prepare to receive an inheritance is to discover what you will be inheriting. Is it real estate, a 401(k), or an individual retirement account (IRA)? Perhaps it is publicly traded stock, an interest in a family business, or just simply cash from a savings account or life insurance policy.

Whatever it is, there are steps you can take today to plan to receive and manage it properly. For example, if you will receive a large IRA account from a parent, do you understand the new rules associated with inherited IRAs as implemented by the SECURE Act, which became effective on January 1, 2020? If not, you should educate yourself now on how to maximize the tax benefits available under the law regarding required distributions. Without an understanding of these often complicated rules, you could make an irreversible mistake and withdraw all of the IRA funds at one time, thereby substantially increasing your tax liability in the year of withdrawal. There are a variety of nuances to these rules that a tax adviser or attorney can help you understand and navigate properly.

Likewise, if you are receiving rental property as a part of your inheritance, you should consider the business of being a landlord and if you even have an interest in continuing to operate such a venture. If not, you may want to prepare to find a buyer for the property who can offer you a fair price as soon as possible. Or, at the very least, look into hiring a property management company to take over as soon as you inherit the property.

### **Powers of Appointment**

If your loved one has completed trust planning that includes establishing an irrevocable trust for you, such trusts frequently include important features that are generally referred to as powers of appointment. A power of appointment in a trust is a right, often given to the beneficiary of the trust, to gift trust property to someone else or, in some cases, to yourself. These powers are often limited to making gifts to only certain classes of people (such as the descendants of the trustmakers), or they may be limited to making gifts only at death (a testamentary power of appointment) or during life (a lifetime power of appointment). Some trusts include both types of powers. These can be powerful planning tools that have been given to you through trust documents. Failure to recognize the existence of these powers can lead to unintended consequences, or at the very least, crucial missed asset protection and tax-planning opportunities.

If you know that you have been granted a power of appointment, you should attempt to obtain a copy of the relevant trust documents to carefully review and determine the nature of these powers. An experienced estate planning attorney can help you with this task. With this information, your professional advisers can properly advise you on the planning opportunities and tax consequences of the powers of appointment that may be available to you.

### **Keeping Inheritance Separate from Marital Property**

A common mistake made by married individuals who receive an inheritance is to commingle that inheritance with the property of both spouses. How can this be a mistake? An example may best illustrate the point:

Imagine Robin receives a cash inheritance from her deceased father of \$300,000 and she and her spouse Morgan decide to use the inheritance to buy a vacation cabin in the mountains. When purchasing the property, the title company assumes that because they are a married couple, they want to take title to the property as joint tenants with rights of survivorship and the deed gets prepared and recorded accordingly. Further imagine that over the years, they furnish the property together, maintain it, and enjoy many family vacations there. One night, however, Morgan has a little too much to drink at a bar, gets behind the wheel, and causes a deadly accident that results not just in a DUI, but also in a wrongful death lawsuit. Because Morgan's name is on the title to the property as a joint owner, Robin and Morgan discover that the family cabin is an asset that can be used to satisfy the lawsuit judgement against Morgan. As a result, they are forced to sell the cabin and use half of the proceeds to satisfy the judgement.

This unfortunate circumstance can be the result of Robin's failure to keep her inheritance as separate property. By commingling her property with Morgan, she made it much easier for the judgment creditor in the lawsuit to reach what otherwise would have been considered Robin's separate inheritance property.

Commingling inherited property can also lead to a similar result if Robin and Morgan ultimately divorce and the family court judge has to determine how to divide the marital property. Failing to keep the inherited property separate during marriage can often lead to that property being divided between spouses at divorce.

### **Inheritor's Trust**

A fourth way for you to prepare to inherit property is by using an inheritor's trust. This is a special type of trust that can be established by the individual who will be leaving an inheritance to you. An inheritor's trust is designed to receive the inheritance that you would otherwise receive directly. It must be carefully designed and implemented to work properly, and an experienced estate planning attorney should most certainly be used in the effort. A properly drafted inheritor's trust includes the following key elements:

- It is created and signed by the individual who will be leaving you an inheritance, not by you;
- The trust creator names the trust instead of you as the beneficiary of their will or revocable living trust;
- It typically has a spendthrift clause or is otherwise designed to protect the inherited property from creditors, divorcing spouses, lawsuits, bankruptcies, etc.;
- You are the beneficiary of the inheritor's trust; and
- You may also be named as the trustee or co-trustee of the inheritor's trust, depending upon how protective the trust needs to be of the trust property.

An inheritor's trust includes the following benefits:

- The inheritance can be excluded from your taxable estate, potentially saving your family estate taxes;
- The trust can be a more cost-effective way to protect the assets instead of your loved one revising their existing plans;
- Upon your own death, the inheritance will be distributed outside of your probate estate, which can help ensure privacy and lower attorneys fees and administration costs;
- The inheritance will likely be protected from creditors, lawsuits, and divorcing spouses;
- In some circumstances, the inheritance can even be controlled and managed by you as a trustee; and
- You can decide how remaining trust assets will be distributed after you pass away if the trust gives you that power (through powers of appointment).

An inheritor's trust can be a powerful tool to use when you anticipate receiving a large inheritance and would like to make sure that the inheritance is protected from certain tax consequences or threats from creditors.

If you would like to learn more about any of these concepts, give us a call. We would love to

discuss these ideas in greater depth with you so we can help you build and protect your wealth more effectively.

## WHAT KIND OF LEGACY ARE YOU LEAVING YOUR LOVED ONES?

Your family will be dealing with a lot of concerns if you become incapacitated or when you pass away. Don't add extra stress by failing to prepare for them! O'Connor Law Offices can provide you with peace of mind by drafting your Will, developing a full estate plan or assisting you with all of your wealth transfer needs. Call us today to schedule an appointment with Mona O'Connor to learn more.

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