Preparing for an Inheritance: How to Manage Assets, Taxes, and Heirs

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Inheriting assets can be a complex — not to mention emotional — process. Whether you are inheriting money, property, or other valuable items, it is important to understand your rights and responsibilities. In this article, we will discuss what you need to know when inheriting assets, including estate taxes, probate, managing the assets, and seeking professional advice. The more prepared and knowledgeable you are ahead of time, the more manageable the situation will be when the time comes.

Understanding the Assets

Before you can make any decisions about how to manage your inherited assets, you need to understand what you have inherited. This means gathering information about the nature and value of the assets. Depending on the size and complexity of the estate, this process can be relatively straightforward or quite involved.

If you have inherited financial assets, such as cash, stocks, or bonds, you will need to obtain statements or other documentation that shows the value of these assets. If you inherited real estate, you will need a property appraisal to determine its value.

It is also imperative to consider any debts or liabilities that may be associated with the assets. For example, if you have inherited a property, you may also inherit any outstanding mortgage or property tax payments.

Again, if you have this information ahead of time, you won't have to do as much legwork down the road. While not everyone is comfortable discussing death, planning for the next stage makes the transition easier for everyone.

Estate Taxes

One of the most critical things to consider when inheriting assets is the possibility of estate taxes. In some cases, you may be required to pay federal or state estate taxes on the assets you inherit. The rules and thresholds for estate taxes vary depending on the jurisdiction and the size of the estate.

If you are inheriting assets that are subject to estate taxes, it is important to consult with a tax professional to determine your obligations. In some cases, it may be possible to minimize or defer estate tax payments through careful planning.

Estate Taxes in Minnesota

When inheriting assets from Minnesota, you should be aware of the size of the estate since Minnesota has its own estate level and tax rate separate from federal rules. Minnesota currently has two tax rates of 13% and 16% as a two-step method on gross estates

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worth in excess of $3 million. This is much lower than the federal level and an estate's assets are sometimes free of federal tax but still subject to state estate tax.

Another difference regards portability. While the federal exclusion amount can be passed on to a spouse to be used on the estate later, the Minnesota exclusion stays with the individual whether it is used or not.

Why does this matter? Let's look at an example.

Bill and Sally have worked hard to build their net worth over time and are cautious spenders, allowing them to continue to grow their accounts in retirement. When Bill passes away, Sally is set to inherit his accounts, which is what Bill wanted. What he didn't know is that the $2 million she will inherit, combined with her existing $2 million, will create a tax burden later.

Using the unlimited transfer between spouses, Bill was able to move everything of his to Sally but his estate never used the $3 million exclusion and it was lost. Now Sally has a net worth of $4 million, leaving $1 million subject to Minnesota state taxes upon her death.

Through estate planning, Bill and Sally could have avoided this tax and the cost to the family.

Probate

Probate is the legal process used to transfer assets from a deceased person's estate to their beneficiaries. Depending on the size and complexity of the estate, probate can both simple and complex.

If the deceased person left a will, the probate process will generally involve submitting the will to the court and obtaining court approval for the transfer of assets to the beneficiaries. If there is no will, the probate process may be more complicated and involve additional steps to determine the legal heirs.

Probate can be time-consuming and costly, and it may delay the transfer of assets to beneficiaries. In some cases, it may be possible to avoid probate through careful estate planning, such as setting up a living trust.

In Minnesota, if you assign beneficiaries on accounts or use a living trust, reducing the size of the estate left to go through probate, probate can be avoided. Minnesota has a limit of $75,000 of net worth going to probate that results in a shorter process and document known as "Small Estate Affidavit." This allows the family to better distribute assets and reduce time needed to deal with the estate.

Dealing with Multiple Heirs

If you are inheriting assets along with other family members, it is important to work together to divide the assets fairly. This can be a challenging process, and it may be wise to enlist the help of a mediator or attorney to facilitate the discussions.

When dividing assets, it is important to consider the wishes of the deceased person as well as the needs and preferences of the heirs. It may be helpful to prioritize certain assets based on their sentimental value or practical usefulness, rather than just their monetary value.

Managing the Assets

Once you have inherited assets, you will need to decide how to manage them. This may involve selling them, investing them, or holding onto them for the long term.

If you have inherited financial assets, such as stocks or bonds, you may want to consult with a financial advisor to help you make investment decisions. Depending on your goals and risk tolerance, you can invest in a diversified portfolio that includes stocks, bonds, and other assets.

If you have inherited real estate or other physical assets, you may need to make decisions about whether to keep, sell, or rent the property. These decisions depend on a variety of factors, including the current market conditions, your financial goals, and your ability to manage the property.

Here are two examples of choices you might have to make when inheriting assets.

1. When inheriting funds that are not part of a retirement account from an estate, your loved ones may ask to give you gifts of assets in their lifetime to avoid probate later. This can sound appealing but is often the wrong move. By doing this, you are now no longer eligible to receive the step-up in basis (where assets inherited adjust cost basis to value on the date of death) and will also inherit any tax bill associated with the funds. If you would have received them by way of the estate or as a beneficiary, you won't have a tax payment.

2. When inheriting a retirement account, rules apply regarding income tax and how long you have to complete liquidation. For example, if you inherit an IRA, you have 10 years from the date of passing to completely draw out all of assets and pay your respective tax. This can feel like a burden if you are at your highest income level — creating a tax of frustration out of a gift.

By understanding different ways to save and reduce your taxes, you can mitigate tax bills, enjoy earlier retirement, or re-tool your retirement financial picture.

Bringing in the Professionals

Seeking professional advice is an important step when inheriting assets. In many cases, the complexity of the estate and the assets involved can make it difficult for heirs to make informed decisions without expert guidance.

A variety of professionals can provide advice and assistance to heirs, depending on the nature of the assets and the needs of the heirs. Here are some examples:

Financial Advisors: A financial advisor can help you manage financial assets such as stocks, bonds, and mutual funds. They can help you create an investment plan, diversify your portfolio, and manage risk. Most importantly, a financial advisor can act as an advocate on your behalf by helping you get organized and understand what steps need to be taken. It is not uncommon for the financial advisor to work directly with other professionals on behalf of the client.

Attorneys: An attorney can provide legal advice and assistance in matters such as probate, estate planning, and tax planning. They can also help you understand your rights as an inheritor and navigate any legal issues that arise.

Accountants: An accountant can help you understand and manage tax obligations associated with inheriting assets, including estate taxes and income taxes.

Appraisers: If you have inherited physical assets such as real estate, art, or collectibles, an appraiser can help you determine the value of these assets. This information can be useful for making decisions about selling, holding, or insuring assets.

Mediators: If there are disputes among heirs about how to divide assets, a mediator can help facilitate discussions and reach a fair and equitable resolution.

When seeking professional advice, look for professionals who are experienced in the specific area of expertise you require. You may also want to consider their qualifications, reputation, and fees.

It is also important to remember that professional advice is just that - advice. Ultimately, you are responsible for making decisions about how to manage your inherited assets. With the support of expert guidance, however, you can make more informed decisions that align with your goals and values.

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