Tips for Leaving an Inheritance to Family

Make sure you think about potential disruptions and plan ahead of time

Families inherit money and sometimes make the right moves investing and spending. Inheritances can also ignite disruption, divorce and a host of bad behavior – far from the hopes and plans of the benefactor.

What happens when you leave what's probably one of your biggest investments: your individual retirement plan?

Your Retirement Assets

Perhaps most important, your estate plan must address potential disruptions: the U.S. tax code will almost certainly change, your heirs will experience life's normal challenges and opportunities and something you never considered may befall those you leave behind. Early death, disability and divorce all happen every day.

You should probably leave your retirement assets to an individual. Such accounts include your:

IRA or 401(k)403(b) if you worked for a school or tax-exempt organization, a simplified employee pension (SEP-IRA), or any of a number of other plans. The retirement plans must go to your spouse unless he or she signed away control of them after you married (prenuptial agreements do not apply here), permitting you to designate a different beneficiary. You can leave your IRA to any person you choose.

Planning Ahead of Time is Key

What if you leave your retirement money to your estate instead of to a person? What if your beneficiary dies before you?

In either case, your savings must be liquidated and distributed over the next five years. You also lose the ability to arrange stretched payouts over individuals' life expectancies – usually lowering future income taxes significantly. Plus it creates a potential marital asset for many recipients, newfound wealth that can evaporate in the wake of some future family tragedy or feud.

You can use specialized trusts to help mitigate most risks, such as the danger of a family beneficiary blowing the inheritance. A number of vehicles exist for restricting a beneficiary's (irresponsible) access to the money. For example:

- An incentive trust that pays out only if the beneficiary meets certain conditions and goals
- A spendthrift trust also allows for monthly allowances or periodic payments for either the life of the beneficiary or until the funds are gone

You worked hard to save for your golden years. When the inevitable day comes and you no longer need what money remains, make sure you leave it behind the best way.