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Living Well In Retirement

How To Make The Most Of Your Inheritance

For some boomers, an inheritance could make the difference between a comfortable retirement and a stretched one.

As a whole, baby boomers are expected to receive an estimated $8.4 trillion in inheritances; they've gotten $2.4 trillion already with $6 trillion more on the way, according to the Center for Retirement Research at Boston College. That works out to a median amount of $64,000, but an average of nearly $300,000 per inheriting household. The wealthiest 10% of households will receive a median of $335,000 per household and an average of nearly $1.5 million.

Not everyone will inherit large sums--or anything at all. In fact, some boomers are now supporting or will end up supporting their own aging parents. But if you do get an inheritance, what should you do next?

"Don't just blow it, and then regret it; think about it carefully," Janet Briaud, a fee-only financial advisor in Bryan, Texas, tells inheritors. That holds true no matter the amount, and no matter your net worth before. (Inheritances can have a bigger impact on a low-wealth household, where the projected windfall equals an average 64% of their current net worth, compared with only 22% for a high-wealth household, according to the Boston College study). In any case, if you get an inheritance and plan right, it can definitely change your life and retirement for the better.

Briaud saw one single working parent who was living week to week change her life with a $1 million inheritance. She bought a house, put her kids through college, and still had a retirement nest egg. Another recent inheritor in her 60s is now considering retiring earlier than she had planned. Other heirs have bought second homes, taken trips, purchased cars and planned legacies for their own children.

But don't get ahead of yourself.

The first thing to do if you get an inheritance is to step back and look at how it affects your personal balance sheet. If you're in the situation where you're having (or going to have) a hard time making your income in retirement match your basic recurring expenses, then you should consider using a portion of the inheritance to buy an immediate fixed annuity that pays you a set amount for life, suggests Jean Setzfand, director of financial security for AARP.

On the other hand, if you're well-prepared for retirement, then you probably want to keep the inheritance in a lump sum to draw upon when you want. "Instead of it filling a basic needs gap, it's more of a lifestyle gap," says Setzfand.

Folks tend to treat inheritances differently than, say, lottery winnings, according to planners who have watched clients with both. Winners are more likely to run through their money quickly. Inheritors, by contrast, have an emotional attachment to the money and often preserve it in a separate bucket from the rest of their assets. That's true even if they don't squirrel it away in an investment account.

John O. McManus, an estate lawyer in New Providence, N.J., has clients who used an inheritance to buy a beach house, an asset the couple viewed as appreciating, and as a memorial of sorts to their parents.

His clients' thinking, he explains: "This is place for the extended family to congregate and reminisce, and it supports the family values that grandma and grandpa espoused."

It's fine to do what your folks would have wanted--as long as that's what you want too, and it makes economic sense. Those stuck on doing what they think their father or Aunt Sue wanted, and keeping their inheritance invested the way their benefactors invested it, need a reality check, says Myra Salzer, a fee-only financial planner in Boulder, Colo., and author of the book *Living Richly*, a guide for inheritors who are living off generous inheritances. "I encourage people to look at things in one great big bucket. These are assets to serve you. How are you going to invest them to serve you best and to accomplish what you want?" Salzer asks.

Where should you park the money until you figure out whether to buy that beach house or mesh it with your other investments? Cash, short-term CDs, even high-quality municipal bonds. For her Texas-based clients Briaud favors Texas muni bonds paying 4.5% tax-free. She personally has $70,000 she inherited from her mom, who lived in Canada, in a money market account in a Canadian bank (the Canadian dollar has gone up).

If you don't have an emergency fund equal to at least six months of expenses, use at least part of the inheritance to create one. (An emergency fund should be kept in safe and liquid investments.)

Spending inherited money is not, in itself, a bad thing. But before you spend, pay down debt, particularly high-rate credit card debt and car loans. If your mortgage will be a burden in retirement, consider paying that down too. (First, however, consider the tax angles, since mortgage interest is deductible for taxpayers who itemize.)

And always keep your eye on that retirement ball. Say you've been paying $500 a month on a car loan, and you want a new car as a treat. Pay off the loan, trade in the old car, and buy the new one with inherited cash. Then use that $500 a month you were paying on the old loan to boost your tax-deferred retirement savings. "If you go off and spend the $500 a month on something else, you're no farther ahead," Briaud warns. One Briaud client who is a college professor is using the interest on her $1 million inheritance to help pay daily expenses, including a $1,000 monthly mortgage, so she can put more of her paycheck into her 403(b) retirement savings plan at work.

Consider, too, using the inheritance to help pay for your kids' college education, so they won't be saddled with excessive student debt. But don't do this if you're not saving enough for your own retirement too, warns Setzfand. "If you're paying for college and not saving for retirement, you need to start saving and setting something aside for yourself before you think about giving your kids a free ride," she says.

Those who are past college bills and well fixed for retirement may want to use the occasion of receiving an inheritance to think about their own legacy. Well-off boomers even might consider asking their parents to skip them altogether, or reduce their potential inheritances, in favor of leaving something to the grandkids. That works best if it's planned in advance, and the grandkids are named in the grandparents' will or trust and on beneficiary forms. It can also be done after the fact if you "disclaim" the assets within nine months of your parent's death. But be careful if you want to go this route. Don't endorse a check from your parents' insurance carrier, sign a deed to their house or retitle a retirement account, or you might not be able to disclaim, warns McManus.

Another tricky area is if your dad or mom leaves you a big Individual Retirement Account. That's because special rules apply if you inherit an IRA. You have to take money out, starting the year after the IRA owner's death, and you might be tempted to take out the whole amount as a lump sum. But beware, warns Francis St. Onge, an enrolled agent and financial planner in Brighton, Mich. The money you take out of a traditional IRA counts as taxable income, added on to your regular income. By recasting the IRA as an inherited IRA, you can take smaller minimum payouts over your lifetime, lessening the tax hit, and giving you a lifetime source of a little extra cash.

If you've inherited a Roth IRA, lucky you. You still have to take minimum payouts, but the withdrawal doesn't count as taxable income, because your dad or mom already took the income tax hit.

You might also think about using an inheritance to stockpile some tax-free Roth savings for your own retirement and your heirs'. In one case St. Onge advised an heir in his 50s who was already contributing the maximum to his 401(k) to fund a Roth IRA in addition to the 401(k). (His employer doesn't offer a Roth 401(k) option.)

One final warning for prospective boomer inheritors: Any future inheritance is not a sure thing. Most boomers get their inheritance upon the death of the surviving parent. (According to the Boston College study, 74% of the inheritance dollars to date were passed from parents to boomers). With boomers' parents living into their 90s and beyond, and facing unknown medical and long-term care costs, they might consume more of their assets than expected.