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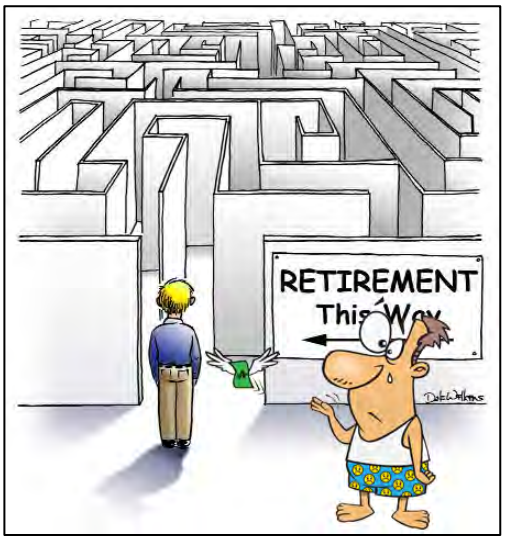
Disclaim your inheritance? It might make sense

Navigating the Retirement Maze



"If there's a will… I want to be in it."

- *Winston Churchill, British statesman, historian (1874 – 1965)*

The thought of giving away an inheritance might seem absurd at first. Give away money or goods that have been legally bequeathed to you, and tax-free at that? Agatha Christie wrote classic murder mysteries around the theme of inheritances gone wrong. Wills and estates are litigated for years by heirs who didn't think that they were getting their fair share. Yet here I am, writing a column about giving away your inheritance. Yes, I am of sound mind as I write this.

The reality is that there are valid reasons for disclaiming an inheritance, mostly relating to tax and family situations that may not have been anticipated when a will was first drawn up and signed. So put down your yacht and sports car catalogs and read the following.

Why turn down an inheritance?

Disclaiming an inheritance means that you give up the right to an asset that was bequeathed to you. The inheritance could have come from a will, a trust, or a court decision if the decedent died intestate. Partial disclaiming of your inheritance, either a specific percentage or dollar amount, is also possible. Once done, though, the disclaimed inheritance is irrevocable, so you need to be certain when you do this.

As nonsensical as this may seem, there are reasons that an inheritance should be declined, either in part or in whole. You might do it to benefit another beneficiary, say a sibling, who has a greater need for the assets than you. Back when your parents drew up their wills, they might have envisioned an equal division of estate assets among their children as seeming fair. But if one sibling ended up becoming extremely wealthy, while another did only so-so, the better off of the two might see that their other sibling has a greater need for the inheritance.

Another scenario could be that a long-term illness of one spouse has severely depleted a couple's assets to the extent that the remaining assets might be inadequate to support the surviving spouse. If the decedent's will bequeathed part of their estate to the couple's children, they might choose to disclaim their portion to help their surviving parent.

Another reason could be that a beneficiary is facing bankruptcy or claims from creditors. Rather than have the inherited assets eventually be taken by creditors, they might be better off going to a contingent beneficiary. Also, if a will that was signed long ago no longer results in the distribution of an estate's assets that would respect the wishes of the decedent, disclaiming part or all of an inheritance can help rectify any discrepancies between the will and the wishes of the deceased.

Taxes are another reason for disclaiming. Suppose inheriting assets would put your estate over the estate tax limits, and you don't see a need for all of those assets. In that case, you might be better off disclaiming part or all of your bequest that would then go to those who wouldn't have a similar estate tax liability.

IRAs are different

While receiving or disclaiming an inheritance of most assets is straightforward, IRAs are not. An Inherited IRA has different rules for required minimum distributions (RMDs), particularly since The SECURE Act of 2020. Most beneficiaries must empty their IRA no later than the end of the tenth year following the decedent's death or face significant penalties. There is a beneficiary classification, called Eligible Designated Beneficiaries (EDBs), who don't have to abide by this ten-year rule and can use the old "stretch IRA," where the IRA must annually distribute required minimum distributions (RMDs) over the lifetime of the beneficiary. EDBs include:

- Surviving spouses (who also have the option to roll the IRA into their own)
- Disabled individuals (under strict IRS rules)
- Chronically ill individuals
- Minor children of the account owner up to the age of majority or 26 if still in school
- Individuals not more than ten years younger than the IRA owner

If a contingent beneficiary is an EDB, they could take better tax advantage of an Inherited IRA, which could be another reason for disclaiming.

Disclaiming the right way

It isn't difficult to disclaim an inheritance, but it needs to be done correctly. Here are the rules for disclaiming an inheritance:

- It must be in writing, signed by the disclaimer, which identifies the decedent, the asset(s) to be disclaimed, and the amount to be disclaimed.
- It must occur within nine months of the death of the decedent. (Minors have nine months after they cease to be minors.)
- You cannot receive any benefits from the inheritance before disclaiming it.
- It must be delivered to the executor (will) or the trustee (trust).

State laws on disclaimers may vary, so be sure to check with an attorney on the prevailing laws and for guidance with the drafting of the letter. Having the letter notarized and delivered by registered mail is prudent. Also, discuss this option with your financial advisor to get a second opinion on whether this is a sensible move. Finally, realize that your disclaimed portion goes to the contingent beneficiary or beneficiaries in the will or trust, not someone of your choice. So, if you are a beneficiary for an estate, do some homework to make the best decision for yourself and others.

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