

# What to Do With an Inheritance

When a loved one dies, it's already an emotional time, and receiving an unexpected windfall only complicates things. An inheritance can completely change your lifestyle or at least bolster your financial outlook, but only if you make sound decisions. The most important thing to keep in mind when dealing with an inheritance is to create a plan for its use. Because of the emotional circumstances surrounding your inheritance, it may be best to wait before making any decisions so you have time to process your thoughts and develop a coherent plan.

## Make a Plan

Take all the time you need in order to formulate a plan for your inheritance. In the meantime, you can keep the money in a high-yield savings account, CD or money market account, as long as it is safe and liquid. This waiting period will help you clear your head and avoid making rash spending decisions.

To make your plan, you should first get a clear picture of your current financial situation. How much debt do you have and what are the interest rates? Do you have an adequate emergency fund and insurance? Are you saving enough for retirement? Do you have enough money to pay your monthly expenses? Once you answer these questions, you can identify weak areas and allocate inheritance money there. While making your plan, keep in mind that your goals shouldn't change after an inheritance; rather, you should use the money to reach the goals you already had.

**Pay down debts.** High-interest debts should be your first priority, because the money you pay in interest can never be

recovered. Credit cards, consumer loans and car loans are all examples of "bad debt" that you should prioritize over lower-interest debts, such as your mortgage or student loans. If you decide to put extra money toward mortgage payments, make sure you're not losing the mortgage interest tax advantage.

**Add to an emergency fund.** You should have a savings account with money readily available for emergencies such as unexpected car repairs, health expenses or job loss. Most experts agree that you should save between three and six months of expenses. You should keep

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your emergency fund in a safe and liquid account so you can easily access it in an emergency.

**Invest it.** If you determine that your odds of living comfortably in retirement are low, use the inheritance to fund your retirement account, choosing the appropriate risk level for your age and tolerance.

**Other.** If your finances are already in good shape, there are many other ways you can use your inheritance. First, you can use a portion of it as fun money



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without feeling guilty. You may also consider donating it to a cause your benefactor would have supported, or spending it in another way that keeps his or her legacy alive. Another worthy use of an inheritance is saving for your child's or grandchild's college fund, or even going back to school yourself.

### Things to Consider

- Your inheritance might come with tax implications, so make sure that is factored into your overall plan to avoid unpleasant tax surprises.
- If your inheritance significantly increases your estate, you may need to create or tweak your estate plan.
- Certain inheritances, such as expensive jewelry, come with added insurance needs.
- Beware of lifestyle inflation, because you may get used to an inflated lifestyle, run out of money and be forced to give up comforts you've come to expect.
- If you've inherited an IRA from your spouse, you can roll it into your own. But if it's not from your spouse, you'll be required to make a minimum distribution each year, for which you should create a plan. If it's a Roth IRA, you won't have to pay taxes on distributions.
- Oftentimes, heirs make irrational decisions because they consider the money to be "found money," and thus less important than earned money. Having a smart plan for your inheritance will help you treat it rationally.

