MUST YOU PAY INCOME TAX ON INHERITED MONEY?

By Greg Koch, Koch Insurance Brokers LLC, Koch Financial Group LLC

The good news is, generally inheritances are not taxed as income.

An inheritance can be a windfall in many ways—the inheritor not only gets cash or a piece of property, but doesn't have to pay income tax on it. Someone who inherits a $500,000 bank account doesn't have to pay any income tax on that amount.

It doesn't matter how the property passes to the inheritor. Whether the property passes under the terms of a **will or trust**, or the inheritor was a designated beneficiary (for example, a payable-on-death bank account), it's not taxable income.

However, in most cases the inheritance tax will be paid by the Estate of the deceased before monies are dispersed.

Exception for Money in Retirement Accounts - IRAs and 401(k) Plans

There's always an exception to the rule. In this case, it concerns funds in retirement accounts, which may be taxed when they're withdrawn by inheritors. It depends on the kind of account.

Tax-Deferred Retirement Plans

The money contributed to conventional IRAs and 401(k) plans is generally not taxed before it is put in. Either contributions are made with pre-tax dollars, or the contributor gets a tax deduction for the contribution. Income tax on the funds is deferred until money is withdrawn from the account, either by the original contributor or by the person who inherits the account.

A beneficiary who withdraws money from an inherited account must report that money as ordinary income. The tax will be due with the person's regular annual income tax returns (state and federal).

If some contributions were nondeductible, then the beneficiary doesn't have to pay tax on them. Figuring out just what portion of the funds isn't taxable, however, can be complicated. The beneficiary will probably need some expert help.

Surviving spouses who inherit a retirement account can defer the tax by rolling over the account into a retirement account of their own (talk to an expert for all the details). Other beneficiaries can change the account into an "inherited IRA" and withdraw the money over several years, spreading out the income tax as well.

Roth Retirement Plans

Money that a beneficiary withdraws from a Roth IRA, however, is generally not taxable income. Roth accounts are funded with money that has already been taxed, so the accounts are treated like other inherited property.

People don't have to pay income tax on amounts they take from a Roth account they inherited if:

- the money was contributed by the person who created the Roth account (that is, it isn't a return on the investment of contributed funds), or
- the account was opened and contributed to at least five years earlier.

For additional information, please call Greg Koch at 610.370.7268; or email Greg@KochInsBrokers.com.

KOCH FINANCIAL GROUP
Navigating Your Financial Future