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How To Avoid Inheritance Mistakes

Grief-stricken heirs sometimes squander inherited money.

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When a widow approached CPA Ryan Dumermuth to help guide her through some insurance policies her late husband had left her, he discovered the insurance company had taken the opportunity to sell her additional policies she didn't need.

"The money involved in this exchange was significant, and I have been working with her to correct a costly mistake," said Dumermuth, a partner with Rea & Associates, a CPA firm in New Philadelphia, Ohio. "It was an emotional time for my client. She trusted the insurance representative and acted too quickly."

During times of grief after losing a loved one, family members often become overwhelmed and make quick decisions about inheritance details they don't understand, according to Lori Luck, CPA/PFS, with CLS Financial Advisors in Portland, Ore.

"Often a survivor is in shock when he or she loses a loved one, and in those circumstances, it's hard to figure out how to make decisions and move forward," she said. "It is always best to take time to think about the available options and seek advice."

Luck, who has specialized in financial planning for 25 years, has seen heirs make plenty of mistakes that could have been avoided through careful planning and conversations with family members and experts.

"If you lose a parent or spouse, that is life-changing, and you will be distraught," she said. "Lay the groundwork for handling the estate, and break it down into small pieces as you work through recovery."

Robert Westley, CPA/PFS, a wealth adviser with Northern Trust in New York City, counsels his clients to invest their inheritance rather than spend it on new homes, vacations, luxury items, and consumer goods that depreciate over time.

"Oftentimes, found money leads people to spend it foolishly," he said. "People tend to be more careful with money earned through their hard work, and they should treat any windfall the same way by putting it to work for them."

Here are the most common mistakes people make when they inherit money, as well as strategies for navigating through the fog of grief to make wise decisions:

Acting too quickly. The death of a loved one leaves devastated family members in its wake. "They don't recognize that the situation, by nature, is often a period of high stress," Luck said. "They have lost a parent, a spouse, a sibling, and they may not be at their best for making decisions." Luck advises grieving family members to slow down, take their time, and step cautiously through their decision-making process.

Repeating bad decisions. Almost everyone has made a bad investment decision or acted on bad advice that caused them to lose money at some point in their lives. When you are trying to decide what to do with an inheritance, look to your past financial decisions. Remembering an error from the past or a lapse in judgment can turn a mistake into a lesson. "We've all made mistakes, but they are only truly mistakes if you don't learn something and prevent them from happening again," Dumermuth said. "If you made a mistake with $500, avoid making the same mistake with $10,000."

Overestimating the value of an inheritance. An unexpected inheritance may seem like a windfall, and you may be tempted to quit your job or change your lifestyle. "Often the amount of an inheritance seems like a large sum of money, but in reality, it is easy to consume in a short period of time," Luck said. Ask a professional adviser to help you by preparing cash flow projections to predict, on paper, how you might spend funds before you actually spend, to assess its impact and keep you on track for your goals, she added.

Failure to seek professional help. Navigating new wealth is complicated, and mistakes happen when you buy products, make investments, and cash out annuities without fully understanding the consequences of your actions. Westley advises heirs to hire a competent financial adviser who can help prioritize savings and debt payments and minimize tax liability. "I recommend my clients use their money to set up a six-month emergency fund, pay down high-interest debt such as credit cards, car loans, and personal loans, and then pay down mortgage and student loans," he said. "I also suggest they maximize their retirement accounts and look for ways to minimize tax liability."

Creating strife among fellow heirs. When parents, spouses, or siblings do not share wills or details about their financial position with their family members before they die, there may be discord among the heirs, especially if the inheritance is not evenly distributed. It is especially hard when shared property, such as a business or a home, is involved. "We emphasize the importance of planning to avoid those kinds of situations," Westley said. "We encourage clients to have a family discussion before there's a death so everyone is on the same page about wills and the wishes of their loved ones."

Many people welcome a financial windfall through inheritance, but when it occurs, they are often grieving over the loss of their loved one and are ill-prepared to handle money or property wisely. That may lead to costly mistakes. A CPA financial planner is uniquely qualified to help clients cut through the complicated financial entanglements an inheritance can bring. To avoid expensive errors, it's never too early to seek help from a professional, even before an inheritance is on its way.