Clients rarely come into my office asking about “estate tax exemptions” or “basis step-up.” They sit down and ask a version of the same question:

“How much can you inherit from your parents without paying taxes?”

That simple question hides several different tax systems, plus a tangle of state rules, trust strategies, and long term care traps. If you only look at one piece, you can make decisions that save a few dollars in probate costs while costing your family tens of thousands in taxes or nursing home recovery later.

This guide walks through how much you can inherit tax-free, what actually gets taxed, and how tools like wills, trusts, and beneficiary designations fit into the picture. I will also flag some of the most common inheritance mistakes I see in practice, and when it is worth paying for comprehensive estate planning help.

Federal tax basics: what is and is not taxed when you inherit

The first surprise for many people is that, in most cases, you do not pay federal “inheritance tax” when you receive money or property from a deceased person. At the federal level, the tax is on the estate of the person who died, not on the recipient.

The federal estate tax exemption

For someone dying in 2024, the federal estate tax exemption is very high, a bit over 13 million dollars per person. Married couples can often, with proper planning, protect roughly double that amount using “portability” and trust strategies.

This means that the overwhelming majority of families will never pay federal estate tax at current levels. The estate will file an estate tax return only if the taxable estate exceeds the exemption, or in some cases to preserve portability for a surviving spouse.

However, this large exemption is scheduled to drop roughly in half at the end of 2025, when current law sunsets. For families with a combined net worth in the 5 to 20 million range including real estate and retirement accounts, this looming reduction is not theoretical. It should inform decisions about gifting, irrevocable trusts, and life insurance planning in the next few years.

Do beneficiaries pay income tax on what they inherit?

Here is where confusion starts. You typically do not pay income tax just because you inherit an asset. But you might pay income tax later, depending on what you inherited.

Common patterns:

- Cash from a deceased person’s bank account is generally not taxable income to you.
- Life insurance paid to a named beneficiary is generally income tax free.
- Traditional IRAs and 401(k)s are pretax accounts, so the distributions you take as a beneficiary are usually taxable as ordinary income.
- Roth IRAs are usually income tax free when distributed to beneficiaries, though timing rules now apply.
- Non-retirement assets like a house, brokerage account, or a small business interest generally get a “step-up” in cost basis to the date of death value, which can dramatically reduce capital gains tax if you sell.

The step-up in basis rule is easy to underestimate. I once worked with siblings whose parents had bought a house for around 60,000 dollars decades ago in a neighborhood that had become trendy. At the parents' death, it was worth about 650,000 dollars. Had the parents gifted that house to the kids during life, the children would have inherited the 60,000 dollar basis, and later faced huge capital gains tax on sale. Because they inherited at death, their basis "stepped up" to 650,000 dollars. When they sold soon after, there was essentially no capital gain and no tax.

That single decision, to leave the house at death instead of gifting it early, saved well into six figures in tax.

How much can you inherit tax-free from your parents?

When people ask this, they usually mean one of three things: federal estate tax, income tax on inherited retirement accounts, or state inheritance or estate taxes. It helps to separate those.

Federal estate tax "hit" point

From a federal estate tax perspective, in 2024, you can inherit any amount from parents whose combined taxable estate is below the federal exemption and pay no federal estate tax. That protection covers millions of dollars.

For very large estates, planning is more intricate. Strategies include lifetime gifting up to the combined gift and estate tax exemption, use of various irrevocable trusts, and sometimes advanced techniques like family limited partnerships or grantor retained annuity trusts (GRATs). For most middle class and upper middle class families, these tools are optional. For estates above roughly the future reduced exemption, they become quite important.

Income tax on inherited retirement accounts

A more common issue today is the tax impact of inheriting IRAs and 401(k)s. The SECURE Act rules require most non-spouse beneficiaries to empty inherited traditional IRAs and 401(k)s within 10 years of the owner's death. You are not paying "inheritance tax," but you might be forced into higher tax brackets by those distributions.

If your parents have large retirement accounts and modest other assets, the key question is not "How much can I inherit tax-free" in the estate tax sense, but "How can we spread this income out to avoid stacked-up income tax." Roth conversions during the parents' lifetime, thoughtful beneficiary choices, and the use of certain types of trusts can all help manage this.

State estate taxes and inheritance taxes

Federal rules are only half the picture. A number of states have their own estate taxes, often with much lower exemptions than the federal level. A few states also impose inheritance taxes, which are paid by the recipient and can vary based on the relationship to the deceased.

For example, some states tax estates above 1 to 2 million dollars, significantly below the federal threshold. That can catch families with a paid-off home in a high cost area, a few retirement accounts, and perhaps a second property or small business.

If your parents live in a state with its own estate tax, the amount you can inherit tax-free from them for state purposes might be far lower than the federal exemption. In multi-state families, planning often needs to consider where the parents live, where the adult children live, and where real estate is located.

Because those rules vary widely and change frequently, you need current local advice, not assumptions based on a friend's situation in another state.

When a will is enough, and when you should think about a trust

Many people ask: is it better to leave a house in a will or trust? The legal answer is "it depends," but there are some consistent patterns.

A will takes effect at death and typically sends assets through probate. A revocable living trust holds assets during life and continues at death, generally avoiding probate for those assets if properly funded.

Leaving a house in a will can be perfectly reasonable if:

- Probate in your state is relatively simple.
- You have a single property in one state.
- Your family dynamics are straightforward.

Using a trust to own the house during life makes more sense if you own property in multiple states, want to avoid the delay and cost of probate, need privacy, or want detailed control over how and when children receive the property.

What is the best way to leave your house to your children? For many clients, it is to keep the house in their own name or a revocable trust until death, so the children receive the stepped-up basis. Then, either the trust or the will can order an immediate sale with cash distribution, or give the children clear options with buy out provisions. Titling the house jointly with a child during life or deeding it to them outright often causes more tax and family problems than it solves.

One of the most common inheritance mistakes I see is parents adding one child to the house deed "for convenience" or "to avoid probate" while ignoring the other children. This can unintentionally disinherit siblings, trigger gift tax issues, reduce the stepped-up basis, and expose the house to that child's creditors or divorce.

Revocable vs irrevocable trusts, and the "5 and 5" and "5 year" rules

People often hear about irrevocable trusts at seminars or from friends and want to know if they "should put the house in an irrevocable trust." That is a significant step with real consequences.

A revocable trust is primarily about probate avoidance, privacy, and management during incapacity. You keep control and can change it at any time. Assets in a revocable trust are counted as yours for estate tax and Medicaid purposes, but they also receive a step-up in basis at death.

An irrevocable trust is different. You give up certain rights and control, which can help remove assets from your taxable estate or protect them from nursing home spend-down, but you also lose flexibility. That trade-off is serious.

The so called 5 by 5 rule in estate planning refers to a common power granted to trust beneficiaries: the right to withdraw the greater of 5,000 dollars or 5 percent of trust principal each year. This can preserve certain tax advantages while keeping assets largely in trust, but it must be drafted and administered carefully.

There is also the Medicaid related 5 year rule for irrevocable trusts, often discussed in the context of nursing home planning. If you transfer assets into most types of Medicaid asset protection trusts, Medicaid looks back 5 years to see if you made gifts that would disqualify you. Anything transferred within that 5 year lookback can trigger a period of ineligibility for long term care benefits.

How to avoid the Medicaid 5 year lookback problem? The only honest answer is to plan early, well before a crisis. Once someone clearly needs nursing home care in the near term, most aggressive transfers will either be ineffective or cause penalties. The idea of a simple "Medicaid loophole" that lets you move assets at the last minute and fully protect them is, in most situations, a myth. There are planning techniques that can soften the blow late in the game, but they are technical, state specific, and almost never as clean as early, gradual planning.

Can a nursing home take your house if it is in a trust?

Families often ask this after hearing half-truths from neighbors. A nursing home itself does not typically "take" your house. The issue is Medicaid eligibility and estate recovery.

If the house is in a revocable trust and you apply for Medicaid, the house usually still counts as your asset for eligibility. After death, the state might attempt estate recovery, which can reach assets that passed through probate and, in some states, certain non-probate transfers.

If the house is in a properly drafted and seasoned irrevocable Medicaid asset protection trust, and the transfer was made more than 5 years before application (longer in some states), then in many jurisdictions that house is shielded from spend-down and recovery. However, that protection came at the cost of your full control. You cannot freely sell or mortgage the property and pocket the cash.

What is the downside of putting your house in an irrevocable trust? You give up control, flexibility, and sometimes tax benefits. Depending on how the trust is drafted, you might lose the full step-up in basis or the homeowners capital gain exclusion on sale. Financing or refinancing can be more difficult. Family conflicts can erupt if the children are named as trustees with real power over your home.

Used for the right reasons, irrevocable trusts are powerful, but they should not be a default. In my practice, the only three reasons you should have an irrevocable trust generally fall into three broad categories: large estate tax planning, serious asset protection or Medicaid planning, and certain special needs situations. Outside those, a revocable trust or even a well drafted will might serve you better.

The 7 year rule for trusts and gifts in the UK context

People occasionally ask about the 7 year rule for trusts because they have read UK based articles online. That rule is part of the United Kingdom's inheritance tax system, where gifts made more than 7 years before death can escape inheritance tax. It does not directly apply under U.S. Federal tax law, though U.S. Citizens who have property or connections in the UK may need dual-country planning.

Online articles mix UK and U.S. Concepts freely, so be careful not to import the wrong rule to the wrong jurisdiction.

Bank accounts, probate, and beneficiary designations

Clients are often surprised when I explain which bank accounts avoid probate. It has nothing to do with balance and everything to do with titling.

Accounts with "payable on death" (POD) or "transfer on death" (TOD) designations, or joint accounts with rights of survivorship, usually pass outside probate directly to the named individual. Retirement accounts with named beneficiaries also avoid probate, as do many life insurance policies and annuities.

Avoiding probate with beneficiary designations is simple and cheap, but there are two common problems. First, people forget to update beneficiaries after divorce, births, or deaths. Second, everything sails past the will and trust, which can undermine a carefully designed plan.

Imagine a person whose will says that assets should be split equally among three children, but whose largest account names only the eldest child as beneficiary because the others were born later and the form was never updated. That entire account will likely pass to the eldest child alone. Fighting that result requires expensive litigation, and there are no guarantees.

Who should you not name as a beneficiary?

Beneficiary designations feel easy, which is why they are so often done badly. Certain choices create predictable trouble. Here are categories that usually should not be named directly as beneficiaries, or at least not without careful thought:

1. Minors. A six year old cannot legally manage an inherited IRA or life insurance policy. The court will likely appoint a guardian, and the money may be handed over in full at 18, whether or not the child is ready.
2. People with serious creditor or divorce problems. Inheriting outright just hands their creditors ammunition.
3. Beneficiaries with significant disabilities who receive means tested benefits. An outright inheritance can accidentally disqualify them from important programs, whereas a special needs trust could preserve both the inheritance and the benefits.
4. Former spouses, unless you have a very specific reason. Old forms naming an ex-spouse are an ugly surprise for new families.
5. “My estate” as a beneficiary of retirement accounts, unless your lawyer has a clear plan. Doing so can accelerate required distributions and lose tax advantages.

A better approach in complex cases is to name a properly drafted trust as the beneficiary, so the trust can control timing, protections, and contingencies.

What should not be included in a will

A will is a powerful but limited tool. Certain items either do not belong in a will or simply will not work there.

Do not try to dispose of assets that already have beneficiary designations or are held as joint tenants with right of survivorship. The contract or title will win. People often write careful instructions in a will about a retirement account that already has an old form directing the money elsewhere.

Do not put overly detailed instructions about funeral or cremation in a will that will only be read after those decisions are made. Use a separate letter or state specific designation, and also talk to your family during life.

Do not include vague or unenforceable promises like "I want the children to work it out fairly among themselves" in place of clear distributions. That language invites conflict, not harmony.

And do not assume a will alone is "comprehensive estate planning." That phrase really refers to a coordinated plan that integrates wills, trusts, powers of attorney, health care directives, beneficiary designations, tax planning, and, for some clients, long term care and business succession planning. A will is one piece, not the whole puzzle.

Gifting to children: tax limits and practical wisdom

People often ask: what is the best way to gift ***Comprehensive Estate Planning Attorney Near Me*** money to an adult child? The technical answer looks at annual gift tax exclusions, lifetime exemptions, and possible use of 529 plans or direct tuition payments. The human answer considers the child's maturity, spending habits, and your own financial security.

Under current federal law, you can generally give a certain amount per person per year without using any of your lifetime gift and estate tax exemption. That annual exclusion amount adjusts over time, but many parents overestimate its importance. Even gifts above the annual exclusion usually just require a simple gift tax return and use part of your lifetime exemption. Most families never actually pay gift tax.

The bigger problem is giving too much, too early, in a way that weakens your own retirement security or enables unhealthy behavior in the child. I have seen modest but steady annual gifts fund a child's IRA, help with a home down payment, or support graduate school in very constructive ways. I have also seen sudden, large windfalls derail sobriety or cement a dependent lifestyle.

With real estate, parents sometimes want to deed a house or second property outright to a child during life. For tax purposes, that can sacrifice the step-up in basis. For Medicaid purposes, it can cause long term care penalties if done within the lookback. For practical purposes, it gives creditors and spouses of the child a potential claim on the property. A carefully structured trust is often safer than a bare transfer.

Inheritance, Medicaid, and the myth of simple loopholes

Every few months, someone sits in my office with a story about a "Medicaid loophole" that let a friend's relative keep every asset while the government paid for years of care. When we unpack the facts, it usually turns out that: the family started planning long before the nursing home admission, or the person received care that did not involve Medicaid, or there were unique state specific exemptions involved.

There is a real 5 year rule for irrevocable trusts and gifts in the Medicaid context, and it can be used to protect assets legitimately. But that rule is not a magic spell you can invoke at the last minute. Transfers within that period create gift penalties, and attempts to hide or shuffle assets can lead to far worse problems.

Thoughtful planning can, however, balance inheritance goals and long term care realities. For example, a couple might decide to protect a primary residence and a modest nest egg through early irrevocable trust planning, while accepting that investment accounts above that level will be used for their own care if needed. That approach leaves the children something meaningful without engaging in unrealistic or risky schemes.

Cost and value of working with an estate planning attorney

People are rightly concerned about cost. They ask: how much does it cost to have an estate planning attorney, and is it worth it?

Fees vary widely by region, complexity, and attorney experience. For a basic will based plan, you might see flat fees starting in the low four figures in many markets. A comprehensive estate planning package that includes a revocable living trust, pour over wills, durable powers of attorney, advance health care directives, and funding guidance may cost more, sometimes in the mid to upper four figures depending on complexity. Advanced tax or asset protection planning involving multiple irrevocable trusts can run higher.

The better question is what problem you are paying to solve. A cookie cutter will or a fill in the blank online form might cost far less, but it will not tailor itself to your blended family, disabled child, second marriage, or multi state property. I have seen many families spend ten or twenty times the cost of a good plan on probate litigation, tax problems, or Medicaid mistakes that came directly from poor or incomplete planning.

A comprehensive estate planning process should feel like a guided conversation about your goals, fears, and family dynamics, translated into precise legal documents and coordinated titling. When done Comprehensive Estate Planning Attorney Near Me right, it is not just paperwork. It is a map for how your money, house, and values move to the next generation with a minimum of unnecessary tax, delay, or conflict.

Pulling the threads together

So, how much can you inherit tax-free? From a pure federal estate tax perspective, probably a lot, especially under current exemptions. From an income tax perspective, it depends what you inherit: pretax retirement accounts bring tax with them, while most other assets do not. From a state perspective, you might face estate or inheritance taxes at much lower thresholds than you expect.

The more useful question is how to shape your parents' planning, and your own, so that wealth transfers in a tax efficient, orderly, and fair way. That usually means a clear will or revocable trust, carefully chosen beneficiary designations, attention to basis and timing for gifts, and realistic decisions about long term care.

Handled well, inheritance can be a quiet, stabilizing gift, not a legal or tax mess. The law gives you tools. The challenge is using them thoughtfully, in light of your real life family and the rules in your particular state, rather than chasing generic loopholes or one size fits all strategies.

Parker Law Offices
28202 Cabot Rd 3rd Floor, Laguna Niguel, CA 92677
9493853130