When people talk about inheritance, they usually picture a paid-off house, a tidy investment account, or maybe a life insurance check that arrives just when the family needs it. In real California practice, I see something very different: estates clogged with “toxic” assets that cost more to unwind than they are worth, beneficiaries blindsided by taxes, and families caught in probate for years over things that could have been fixed with a few smart decisions.

Not all dollars are created equal. The way an asset is owned, titled, and taxed can turn a gift into a burden. California’s probate rules, community property system, and high real estate values magnify that effect.

This article walks through the six worst assets to inherit, why they cause so much trouble in California, and what good planning can do about it.

Why some inheritances cause more harm than good

The ugly surprises tend to fall into three broad categories.

First, tax traps. Certain assets come wrapped in deferred tax obligations. The decedent may have enjoyed tax deferral for decades, but the bill often lands in the heir’s lap at the worst possible time.

Second, legal friction. Some assets almost guarantee probate, multiple court proceedings in different states, or disputes among co-owners. California’s court backlog and statutory timelines can stretch all of this well past a year, sometimes well past two.

Third, liquidity problems. The inheritance looks large on paper but cannot easily be sold or used to pay expenses, leaving beneficiaries with ongoing costs and no clear way out.

The “worst” inherited assets usually check at least two of those boxes.

The six worst assets to inherit

Here are the categories that cause the most trouble in real California estates.

1. Large tax-deferred retirement accounts left without planning
2. Highly appreciated rental or investment property with messy ownership
3. Out-of-state real estate and timeshares
4. Annuities and life insurance structured the wrong way
5. Closely held business interests with no exit plan
6. Joint and beneficiary-designated accounts used as a shortcut to “avoid probate”

Let’s unpack each one and look at better ways to handle them.

1. Large retirement accounts: IRAs and 401(k)s that turn into tax headaches

From the original owner’s perspective, a 401(k) or traditional IRA is a wonderful asset. Contributions were often deductible, growth was tax deferred, and required minimum distributions were manageable in retirement.

For beneficiaries, especially in light of recent federal law changes, those same accounts can be among the worst assets to inherit.

The 10-year payout problem

Under the SECURE Act and later updates, most non-spouse beneficiaries must drain an inherited traditional IRA or 401(k) within 10 years. There are exceptions for certain "eligible designated beneficiaries," but many adult children do not qualify.

Imagine your son is at his peak earning years, in a high tax bracket, and he inherits a $500,000 traditional IRA. He may be forced to take large taxable withdrawals over a 10-year window, stacking that income on top of his salary and potentially pushing him into higher federal and California tax brackets.

If the same 500,000 were in a taxable investment account, he would receive a step-up in basis at your death. If he sold the holdings right away, there might be little to no capital gain tax. That contrast is stark.

The "5 by 5 rule" and trust distributions

People often hear about the "5 by 5 rule in estate planning" or the "5 of 5000 rule in trust" and assume it applies to all trusts. In many common U.S. Estate plans, this rule refers to a power held by a beneficiary to withdraw the greater of 5,000 dollars or 5 percent of trust principal each year without causing adverse estate tax inclusion beyond that amount.

In practice, this kind of power can help give adult children access to funds while still keeping most assets protected inside a trust. It does not fix the tax deferral problem in an inherited IRA, but it illustrates a broader point: if you are going to leave a large retirement account, you need a coordinated plan thomasmckenzielaw.com California Estate Planning that considers both tax rules and trust rules.

Smarter planning for retirement accounts

For California residents, better planning often means:

- Naming the right beneficiaries, and reconsidering them after life changes like divorce or a child's disability.
- Considering whether a trust should be the beneficiary, especially if you have minor children, blended families, or beneficiaries with creditor or addiction issues.
- Balancing Roth conversions during your lifetime with the benefit of leaving a less heavily taxed asset to your heirs.

The "best" choice is very fact-specific. A blanket rule such as "always leave IRAs outright" or "always to a trust" usually backfires.

2. Highly appreciated California real estate in the wrong wrapper

California real estate often makes families wealthy on paper, but that wealth can come with complicated strings attached.

Step-up in basis: your friend, if you do not give it away too soon

At death, most assets included in your taxable estate receive a new tax basis equal to fair market value. If you bought your San Jose rental for 200,000 and it is worth 1,200,000 when you die, your heirs get a basis of about 1.2 million. If they immediately sell for that amount, there is essentially no capital gain tax at that moment.

That step-up in basis is one reason many people ask, "Can I sell my house to my son for 1 dollar?" Generally, selling property for far less than fair market value is treated as part-sale, part-gift, with gift tax reporting issues and a carry-over basis that can actually hurt your child. A dollar deed can also trigger property tax reassessment in California, losing low Prop 13 values without gaining any income tax advantage.

In short, gifting a highly appreciated house outright while you are alive often destroys the step-up your children would have received at your death.

Worst ways to leave California real estate

From years in practice, here are patterns that reliably cause problems:

- Putting a child directly on the deed as a joint tenant "to avoid probate," which exposes the property to the child's creditors and divorces, and can mess up later planning.
- Letting rental property pass through a will alone, so your heirs are forced through a full California probate and cannot easily refinance or sell for months.
- Failing to update title when one spouse dies, leaving surviving family members scrambling when the second spouse passes.

The best way to leave your house to your children in California is usually by holding it in a properly drafted living trust, keeping control and tax benefits while you are alive, and allowing a smooth transfer at death without probate. For some families, a limited liability company (LLC) or partnership interests wrapped by a trust can add liability protection and management continuity.

3. Out-of-state real estate and timeshares

If you own a Nevada rental, an Arizona vacation home, or a scattering of timeshares across several states, your heirs may face "ancillary probate" proceedings in each of those states. Your California will has to be recognized there, local counsel must be hired, and the process can drag on.

These small interests are among the worst assets to inherit because the legal and travel costs often exceed the value of the asset itself. I have seen children spend thousands of dollars and a year of frustration to get clear title to a 4,000 dollar timeshare they did not even want.

In most cases, you can avoid that fate by:

- Titling out-of-state property in your living trust, or
- Using a simple entity, such as an LLC, held by your trust, so your heirs administer one California trust instead of several probates.

Timeshares deserve their own caution. The ongoing maintenance fees and difficulty in reselling often make them a negative asset. If you already own them, talk with an attorney about options to surrender, donate, or otherwise neutralize them rather than simply passing the problem to your children.

4. Annuities and life insurance that are structured poorly

Life insurance, when used correctly, is one of the cleanest assets to inherit. The death benefit usually passes outside probate directly to named beneficiaries. Individual income tax is typically not imposed on the death proceeds, although large policies can create estate tax issues for very high net worth families.

The trouble begins when:

- Policies name "my estate" as beneficiary, dumping the death benefit into probate and exposing it to creditors.
- Old policies have no living beneficiaries on record, or name a deceased person, forcing court involvement.

- Annuities are packed with riders and long surrender periods that make them costly to unwind.

Clients also ask about the “10,000 dollar death benefit.” Different contexts use that phrase, from small employer-provided life insurance to certain union or fraternal benefits. The important point is not the dollar amount, but how it is structured. A modest, properly designated death benefit that lands outside probate is usually more helpful than a large policy trapped in a lengthy court process.

One more nuance: non-spouse beneficiaries who inherit annuities or certain cash value life policies may face complicated income tax rules on withdrawals. That can make these contracts less attractive as inherited assets compared to a straightforward brokerage account.

If you are naming a trust as beneficiary of life insurance or annuities, you also want to coordinate that with your overall estate tax and asset protection goals. Poorly drafted beneficiary designations can undo otherwise careful planning.

5. Family businesses without exit plans

An ownership interest in a small business can be a wonderful legacy if the next generation wants to run it. It can also be one of the worst assets to inherit if:

- No buy-sell agreement exists among co-owners.
- Key information resides in the founder’s head and nowhere else.
- The business is valuable but illiquid, and the estate needs cash for taxes, debts, or equalizing distributions among siblings.

In California, I often see disputes when one child has been working in the business for years while others have not. If the parent’s estate plan simply divides everything equally, that can force a fire sale, or create a situation where the working child cannot afford to buy out the others.

A better plan might involve:

- A funded buy-sell agreement using life insurance.
- Voting and non-voting interests, with control passing to the child who runs the business and economic interests structured differently.
- A trustee or corporate fiduciary familiar with business operations if you are leaving interests in trust.

Without that kind of plan, your children may inherit a legal and emotional mess instead of a thriving enterprise.

6. “Shortcut” probate-avoidance tricks that backfire

Many of the worst assets to inherit are not inherently bad. They become problematic because of how they are owned or titled.

Common examples include:

- Joint bank accounts set up with an adult child “just to help pay my bills,” with no clear intention whether the account is a gift, a convenience, or part of the estate.
- Pay-on-death (POD) and transfer-on-death (TOD) designations misaligned with the will or trust, causing some children to be accidentally disinherited.
- Retirement and brokerage accounts that list ex-spouses, deceased relatives, or generic “estate” designations that force probate.

Which bank accounts avoid probate in California? Generally, accounts that have a valid POD or TOD beneficiary, or are titled in the name of your trust, can pass outside probate. But using those tools casually often creates lopsided inheritances or exposes funds to the wrong person's creditors.

The most common inheritance mistake I see is assuming that a simple will, or a handful of beneficiary designations, will override all other rules. Asset titling, contract law, and beneficiary forms often control ahead of what your will says.

California basics: wills, trusts, probate, and cost

Before looking at fixes, it helps to understand a few California-specific basics.

Do all wills in California have to go through probate?

If an asset is titled solely in the name of the decedent, with no trust or beneficiary designation, and the gross value of those probate assets exceeds a certain threshold, a formal probate is usually required.

A will does not avoid probate. It instructs the probate court. Assets held in a properly funded revocable living trust, or passing by valid beneficiary designation, generally bypass the formal probate process.

If you do not file probate in California when it is required, you can run into several problems: inability to sell or transfer property, penalties for failing to handle creditor claims, and disputes among heirs who cannot access assets. There is no statewide "probate police," but the practical roadblocks become severe.

Why people end up waiting 10 months after probate

Many families are surprised at how long California probate takes. Even in straightforward cases, it is common not to fully distribute assets until roughly 9 to 12 months after the court opens the estate. That timeline reflects statutory notice periods for creditors, required accountings, court calendars, and the time it takes to sell or retitle property.

Complex estates, contested matters, or multiple real properties can extend the process significantly.

Is it better to have a will or a trust in California?

For anyone who owns a home or significant assets in California, a revocable living trust is usually preferable to relying on a will alone.

A will still plays a role, often as a "pour-over" document that picks up stray assets and pours them into the trust. The trust, not the will, is typically the primary roadmap.

Is a trust perfect? No. There are downsides to a living trust in California:

- You have to properly fund it by retitling assets, which many people never complete.
- There is modest ongoing administrative work.
- Poorly drafted trusts, or trustees who do not understand their duties, can create a new layer of conflict.

What is better than a trust? In most California cases, nothing fully replaces the function of a revocable trust for avoiding probate and managing incapacity. However, for very small estates or very simple situations, beneficiary designations and pay-on-death arrangements can sometimes be sufficient.

What is the average cost for estate planning in California?

Costs vary widely based on complexity and region. For a typical married couple in California with a home and moderate assets, a comprehensive estate plan that includes a revocable trust, wills, powers of attorney, and healthcare directives often ranges from roughly 2,000 to 5,000 dollars with an experienced attorney. More complex plans involving tax planning or business interests run higher.

By comparison, the statutory fees for a California probate on even a modest estate can easily exceed that amount, and they are paid from the estate whether or not your heirs feel they received value.

Common mistakes with wills and trusts

When people ask, “What are the biggest mistakes people make with their will?” or “What are common mistakes people make with trusts?” they are usually thinking of technical errors. Those matter, but the worst mistakes are often more basic.

Here are a few patterns that cause recurring trouble:

- Naming the wrong people. “Who should I not name as a beneficiary?” Often, someone with serious creditor issues, active substance abuse, or a spouse who is already in a nursing home. In those cases, you might still provide for them, but through a trust with protections rather than an outright bequest.
- Overusing specific gifts. Leaving “the house to Child A and the rest to Child B” can become unworkable when property values change.
- Putting the wrong things in writing. There are at least three things to avoid putting directly in a will: detailed funeral instructions that need to be known immediately, complicated personal property spreadsheets that change frequently, and anything you would not want publicly filed, because wills can become part of the court record.

On the trust side, common missteps include:

- Failing to fund the trust, so assets still go through probate.
- Forgetting to update beneficiary designations on retirement accounts and life insurance to align with the trust.
- Using an irrevocable trust, or a trust with harsh distribution rules, without fully understanding the “5-year rule for a trust” or “7-year rule for trusts” you have in mind. Many of those rules come from other countries’ inheritance or tax systems and do not apply the way people think in California.

Regarding timing rules, U.S. Federal tax law sometimes uses 2-year or 5-year windows for certain trust and estate tax elections. There is also a “2-year rule after death” in some benefit plans or wrongful death contexts, but it is not a universal estate planning principle. This is exactly why copying rules from an article without context often causes more harm than good.

Trusts, taxes, and the Medicaid lookback

Clients frequently ask whether trusts avoid “inheritance tax” and whether they are protected from nursing homes.

Do trusts avoid inheritance tax?

California has no state inheritance tax, and no separate California estate tax, for deaths under current law. At the federal level, as of the current rules, only estates above a very high threshold face estate tax.

A revocable living trust does not, by itself, avoid federal estate tax. For families under the federal threshold, that is irrelevant. For larger estates, more advanced tools such as irrevocable life insurance trusts, grantor retained annuity trusts, or charitable strategies may be used.

What taxes do trusts avoid? Properly used, trusts can help minimize probate fees, reduce some capital gains in certain situations, shift income among tax brackets, and protect growth from being dragged into later generations' taxable estates. But they are not a magic shield against all taxes.

Medicaid, Medi-Cal, and the 5-year lookback

The question "How to avoid Medicaid 5 year lookback?" or "Can I lose my home if my husband goes into a nursing home?" comes up constantly.

Medicaid is a federal-state program. In many states there is a 5-year lookback period, during which transfers for less than fair market value can trigger penalties for nursing home coverage.

California's Medi-Cal rules have evolved, and the state has narrowed when it will seek estate recovery. However, planning to qualify for public benefits and protect a home if a spouse needs long-term care is highly technical and very fact-specific.

Can a nursing home take your house if it is in a trust? The nursing home itself does not take the house. The issues are whether Medi-Cal will consider the property an available resource, whether eligibility is affected by transfers to a trust, and whether the state can seek recovery from your estate later. Different kinds of trusts, revocable vs irrevocable, have very different treatment.

Which is better, a revocable or irrevocable trust, in this context? For basic estate planning and probate avoidance in California, a revocable living trust is usually the standard. For asset protection and long-term care planning, certain irrevocable trusts are sometimes used, but only after a careful analysis, because you typically give up control and flexibility.

What not to do right after someone dies

A brief practical note. When a parent or spouse dies, people often feel pressure to "do something" immediately.

Here are the things I urge families to avoid in the first wave:

- Do not rush to close accounts or retitle property without legal guidance; you can accidentally trigger taxes or lock out other heirs.
- Do not write large checks out of joint accounts to "reimburse yourself" without documentation.
- Do not start giving away or selling personal property before you understand who legally owns it under the will or trust.

The first steps after a death are usually simpler: secure property, locate estate planning documents, get multiple certified copies of the death certificate, and schedule an appointment with the drafting attorney or a qualified probate lawyer.

Pulling it together: building a better inheritance

The six worst assets to inherit are not inherently bad investments. The problem is their combination of tax complexity, legal friction, and emotional baggage when they are handed off without a plan.

For most California families, the best way to leave inheritance to your children is a coordinated structure that includes:

- A revocable living trust, properly funded, tailored to your family dynamics.
- Updated wills, powers of attorney, and health care directives.

- Carefully drafted beneficiary designations on retirement accounts and life insurance that track your trust's design.
- Thoughtful decisions about who serves as trustee and whether a trustee can also be a beneficiary, which is common but must be structured carefully to avoid conflicts and tax issues.

There is no one "2-year rule for trusts" or "7-year rule on inheritance" that magically solves all of this. What works is a realistic look at your actual assets, your children's real strengths and weaknesses, and the California rules that apply.

If you take the time to align all three, the assets your family inherits will be assets they can actually use, not burdens they struggle to escape.