
Revocable vs. Irrevocable Trusts



Trusts are a valuable estate planning tool, but they can be confusing to the layman. From an estate planning perspective, individuals have options for maintaining control over their hard-earned assets.

A popular asset protection tool often used in estate plans is a living trust. Living trusts come in 2 basic forms: revocable and irrevocable. Each type of trust has a specific purpose.

To better understand living trusts, it helps to define some key trust-planning terms:

- Inter Vivos Trust: another term for a living trust
- Trustor/Grantor: the Trustor or Grantor is the party that creates the Trust
- Beneficiary: the person (or heirs) who inherit specified assets from a Trust, Will, or life insurance policy
- Trustee: the person given control or powers of administration of the trust property, with a legal duty to follow the rules of the Trust (as set by the Trustor)
- Probate: the legal process through which a deceased person's estate is distributed to heirs and final debts are paid
- Estate: an individual's estate includes all the money and property owned by a person at death

What is a Trust?

A living trust is a legal document created by a Trustor during their lifetime. A trust is an estate planning tool that provides protections above and beyond a simple Will. The Trustor's assets are titled in the name of the living trust by the trust owner and are used by the trustor while they are alive.

Living trusts are beneficial in a number of ways. Both forms of trusts avoid probate, a legal process which can be lengthy, expensive, and delay distributions to your heirs (while also reducing what they inherit). With a trust, your successor Trustee will distribute your assets according to your instructions, without court intervention.

Trusts are also less susceptible to a legal contest. Since trusts bypass probate, they are not subject to public scrutiny. Wills, on the other hand, become public records so virtually anyone can find out how you've decided to distribute your estate. Beyond that, trusts are a great tool to have in the event of incapacitation. If anything happens to you that prevents you from managing your own affairs, your successor trustee can step in without the intervention of a court or an expensive guardianship proceeding.



What is a revocable trust?

A revocable trust is a trust document that can be changed over time or cancelled by the Trustor. During the life of the trust, earned income is distributed to the Trustor, and only after death do assets transfer to the beneficiaries.

Benefits:

Most Trustors create a revocable trust to avoid probate. Revocable trusts come with many of the benefits listed above, but do not provide the same degree of asset protection or tax savings of an irrevocable trust. It's worth noting that revocable trusts become irrevocable when the Trustor passes (or if a designated event happens, like the passing of the Trustor's spouse, or the mental incapacity of the trustor). This prevents trustees or beneficiaries from deviating from the Trustor's wishes after a Trustor passes.

Drawbacks:

Revocable trusts provide Trustors with the flexibility to make changes and retain control over their assets. A key drawback is that revocable trusts do not avoid estate or inheritance taxes. Because the Trustor still retains control over assets during their lifetime, these trusts also do not protect assets from creditors or legal claims.

When is a revocable trust best?

A revocable trust is best for those who do not expect to face estate or inheritance taxes (in general, those with total assets less than \$1 million, depending on your state of residence). Individuals who want to maintain control and ownership over their assets during their lifetime, with the flexibility to make changes to their trust will prefer revocable trusts.

They work particularly well for those who fear they may be mentally incapacitated in the future. Revocable trusts allow successor trustees to step in, without court permission, if a Trustor is unable to manage their own affairs. The successor trustee must follow specific instructions (established by the Trustor) to manage the affairs of an incapacitated Trustor.

What is an irrevocable trust?

An irrevocable trust is a trust that cannot be modified or terminated without the beneficiary's permission. This removes the rights of ownership from the Trustor and only a beneficiary can approve changes after this trust is created. While this may seem counterintuitive, there are many good reasons why one might want to move assets out of their estate.

Benefits:

Once assets are transferred to an irrevocable trust, the Trustor is no longer considered the "owner"- an independent trustee makes all the decisions regarding investments on behalf of the trustees, protecting assets from loss to creditors or lawsuits (including divorces).

Irrevocable trusts provide state and federal estate tax protection to the beneficiaries who inherit the assets held in trust. If a grantor is close to qualifying for the federal estate tax (an estate valued at more than the federal exemption of \$11.2 million can expect to pay up to 40% in estate taxes. About half the states impose some form of estate or inheritance tax. State exemption thresholds range from \$1 million to over \$5 million and tax rates range from 0.8% to 20%. However, these exemption levels and tax rates are almost constantly in flux, varying based on political changes.

Irrevocable trusts can also protect assets, even from nursing homes. Because the trust's assets aren't considered within the ownership or control of the trustor, they are not considered part of the Trustor's income for Medicare/Medicaid purposes.

Drawbacks:

Once an irrevocable trust is executed, it is set in stone. This means if you change your mind about your intended beneficiaries or trustees after the fact, you cannot modify the document to reflect your desires without permission from the designated beneficiary. Irrevocable trusts are also complex legal documents that can be more expensive (initially) than a revocable trust or simple will.

When is an irrevocable trust best?

In general, irrevocable trusts are best for those with assets beyond their state or federal exemption levels. Also, these trusts offered enhanced asset protection if you fear that you will need long-term care in the future, or you are in a profession prone to personal lawsuits.

Combining different trusts

It is possible to get the best of both worlds when trust planning. Some Trustors create both revocable and irrevocable trusts to benefit from the flexibility of revocable trusts, for assets they wish to retain control over, and irrevocable trusts for assets that may otherwise be subject to estate taxation. Knowledgeable professionals can help you determine a trust strategy that achieves your specific goals, so the tough decisions don't lie entirely on your shoulders.

Next Steps

If you'd like to learn more about trusts, contact our professional accountants. We can help you determine which type of trust will work best for you and create a trust that will suit your needs.



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