

## ESTATE PLANNING

# What to Consider When Deciding Between a Revocable and Irrevocable Trust

There are important differences between the two types of trusts, including the amount of control you'll have over your assets.



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Trust funds are not just for the ultra rich. These sophisticated estate-planning tools can make just as much sense for middle-class Americans who own a home and have a net worth of at least \$100,000. Although they can be set up differently, all trusts are either revocable or irrevocable. "A revocable trust is like the minivan of estate planning," says Steve Parrish, co-director of the Center for Retirement Income at the American College of Financial Services. "They are multipurpose and used more by the upper-middle class. An irrevocable trust is like a high-performance sports car. They can be more expensive but also more customizable to a specific need."

As a legal entity, a trust can own assets such as real estate, brokerage accounts, life insurance, vehicles, bank accounts and personal belongings like jewelry. You transfer over the title and ownership of these assets to the trust, which stipulates what should happen to that property after you die, including who should receive it and when.

A trust has three main parties. The **grantor** is the person depositing assets into the trust. The **beneficiary** is the person who receives the assets and income. A trust can have one or more beneficiaries. The person or organization overseeing the trust assets is called the **trustee**. The trustee distributes the assets according to the trust document and files the trust's tax returns when needed.

One person can fill multiple roles. For example, you could set up a trust as the grantor and also manage it yourself as the trustee while you're alive, thereby eliminating the need for a paid professional. The same person you appoint as executor of your will can also be named as your trustee or successor trustee. Once you've put assets into a trust, your ability to alter it or get the assets back will depend on whether the trust is revocable or irrevocable.

### **Control Over the Assets**

A **revocable trust** keeps your options open. As the grantor, you can **amend or revoke the trust at any point**, and that includes naming a different trustee or beneficiary. "This gives you leverage over the inheritance," says Nick Maggard, attorney at Maggard Elder Law in Florence, Ky. "If your beneficiary doesn't listen to you, you can still change the terms of the trust."

**You can even take your assets back from a revocable trust.** There are typically no tax consequences for doing so because only after-tax assets can be placed in a trust while you're alive. Pretax retirement funds, such as a 401(k), can't go inside, as that would require changing the owner of these accounts to a trust, and when that happens, the IRS considers the transfer of ownership a taxable withdrawal.

If a revocable trust seems much like owning the assets yourself, that's because there's really little difference in the eyes of the law. Any assets in your revocable trust still count as part of your estate and aren't sheltered from either estate taxes or creditors.

So, you might ask, why bother having a revocable trust at all? For one thing, it's a **smoother transition for your finances if something happens to you**. If you die or can no longer manage your financial affairs, your successor trustee takes over and manages the trust assets according to your instructions in the trust documents. Otherwise, your family members would need to go to court for the right to manage your assets and pay your bills if you become mentally incapacitated. Some families address this problem by creating a financial power of attorney, but Maggard says that a revocable trust offers stronger legal authority, ensuring that your wishes are followed.

The second reason to have a revocable trust is that **the trust assets bypass probate after you die**. During probate, a state court validates your will and distributes your assets according to your written instructions. If you don't have a will, your property is distributed according to state law, and if you own homes in multiple states, your heirs must go through probate in each one. But if that real estate is in a revocable trust, your heirs could handle everything in your state of residence and receive their inheritance more quickly, as probate can take months and sometimes years.

Even for a straightforward estate, probate expenses can be sizable. After fees for attorneys, courts, appraisals and executors, **probate can end up costing 5% or more of the total estate**, about \$20,000 on a \$400,000 estate, according to Nolo Press, a publisher specializing in legal topics. By comparison, an attorney charges about \$1,000 to \$1,500 to set up a revocable trust.

The contents of your revocable trust also remain **private**, off limits to nosy neighbors and predatory scam artists, whereas estates that go through probate are a matter of public record that anyone can access. "No one knows what Hugh Hefner was really worth at the end because most of his assets were in trusts. He didn't have all his financial secrets laid out at death, like Prince or Aretha Franklin," says Parrish.

He notes that upper-middle-class families often prefer revocable trusts because they're typically simpler and less expensive than irrevocable trusts. One-stop shopping also plays a role. "Attorneys offer revocable trusts as part of a standard estate plan package, including a will and power of attorney."

### **Tax Benefits at a Price**

As you might guess by the name, an **irrevocable trust** is harder to change. Even revocable trusts eventually become irrevocable when the grantor can no longer manage his or her own financial affairs or dies. At that point, a revocable trust is set in stone.

To change an irrevocable trust while you're alive, the bar is high but not impossible to overcome. You'll **need the consent of all parties, including the beneficiary and trustee, to make any changes** because you lose sole control of the assets in an irrevocable trust. Maggard says you could get the assets back if your trustee and beneficiary can be counted on to agree.

In exchange for you giving up control, the assets in an irrevocable trust are **no longer part of your taxable estate at death**. The federal estate tax exemption currently lets you leave a generous \$11.7 million tax-free to heirs. That number used to be significantly lower: \$3.5 million in 2009 and \$675,000 in 2001. "You're seeing a rise in interest for irrevocable trusts these days as people are concerned the estate tax threshold could go down," says Maggard.

**But assets in an irrevocable trust generally don't get a step up in basis.** Instead, the grantor's taxable gains are passed on to heirs when the assets are sold. Revocable trusts, like assets held outside a trust, do get a step up in basis so that any gains are based on the asset's value when the grantor dies. The Biden administration would like to eliminate the step up in basis for revocable trusts and tax any appreciation at death. For irrevocable trusts, gains would be taxed when the appreciated assets are transferred to the trust.

**An irrevocable trust also protects the assets from lawsuits and creditors.** With the assets no longer in your name, people can't file a claim against them. "Someone who doesn't have any long-term care insurance might use an irrevocable trust to protect the inheritance for their heirs, so the assets aren't taken by a nursing home or Medicaid," Maggard says.

The **protections don't come immediately.** Assets in an irrevocable trust for five years or less are still fair game for Medicaid. For creditors, it's two years under federal bankruptcy law and longer in some states. Even your heirs are protected. If the assets are titled under the trust rather than the heir's own name, the inheritance is shielded from claims in a lawsuit or divorce.

Irrevocable trusts often **cost more to put together because they're customized to your specific tax-planning needs and the kind of property you own**, Parrish says. The cost to set one up typically ranges from \$3,000 to \$6,000, and an especially complex irrevocable trust can be even more expensive. Some irrevocable trusts are designed for a specific purpose, such as a special-needs trust for a disabled family member or a charitable trust for donating assets.

Irrevocable or not, a trust is no use to you if you never finish setting it up, and that's a common mistake, says Parrish. "If someone pays to set up a trust, leaves the documents on a shelf and forgets to fund it, the trust does nothing."

**NYSUT Note:** NYSUT members have access to discounted rates for Trusts and other legal services thru the NYSUT Member Benefits Trust-endorsed Legal Services Plan. Click [here](#) to learn more about how the Legal Services Plan can assist you with everything from preparing crucial estate planning documents to dealing with traffic violations, with access to a national network of attorneys.

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