

REVOCABLE VS. IRREVOCABLE TRUSTS



Q. What is the difference between a Revocable and Irrevocable Trust?

A. Revocable Trusts

A Revocable Trust is often utilized to ensure that one's assets pass at death without the need to probate a will. Probate is the process whereby a will is authenticated and its provisions are carried out under the supervision of the Surrogate's Court. The probate process is normally straightforward but can be complicated by a variety of factors.

A Revocable Trust is sometimes recommended for those who are in a second marriage, who have a developmentally disabled child, or who wish to disinherit a child. This is because a Revocable Trust usually ends automatically upon a person's death and the assets it contains pass to beneficiaries with no Court oversight and resultant delays. A Trust is a contract executed during life. This makes it different from a Will and makes it much less likely to be challenged at death.

A Revocable Trust alone, however, will not address all of one's potential estate planning concerns. Contrary to the claims of unscrupulous promoters, a Revocable Trust will not protect assets in the event of a long term illness. Nor will it protect assets from being subjected to estate tax upon death. Common sense dictates these limitations. To the extent that the Grantor of a Revocable Trust has complete access to all of its assets, how then can he turn around and claim that they are unavailable to pay the nursing home? Or that they should not be a part of his taxable estate at death. In estate planning, as in other areas of life, if it sounds too good to be true – it is!

Assets will not be immune from health care claims or estate taxes unless the owner actually parts with them.

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Often an individual transfers a house or liquid assets to children in an attempt to shield them. A simple transfer of this type is almost always inadvisable. For example, if I were to gift my house to my children, I would lose my property tax exemptions. It would be subject to my children's creditors – including spousal claims in the event of a divorce! Lastly, a simple transfer to children will likely result in capital gains taxes for them. This is because a gifted asset results in the donor's purchase price being used as the "floor" to measure gain when the children later sell.

Individuals who wish to protect assets for the future and commence the running of the so-called 5 year look-back period would be well advised to consider an Irrevocable Trust.

Irrevocable Trusts

Yes, the term "Irrevocable" is a turn-off. However, if the trust is properly drafted, one need not surrender all control.

For example, the term Irrevocable does not mean that the house can't be sold. It simply means that the Trustee of the trust is the one who signs the deed at the closing. And to play devil's advocate, one must ask what would happen if the Trustee refuses to sign off on the sale? The Grantor of a properly drafted Irrevocable Trust would simply exercise his or her ability to replace the Trustee with another individual. Conversely, the Trustee can't sell the house if the parents don't want it to be sold-provided that the Trust contains this protection.

An Irrevocable Trust can also preserve the parent's ability to alter their beneficiaries' percentages or to add beneficiaries later. This is critically important in the event of a tragedy. If a parent (God forbid) loses a child, you should be able to freely assign that child's share to your grandchildren or, as the case may be, to your remaining children.

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If the trust states (and it should) that the parent is allowed to live in the house for life, then he or she will retain all applicable property tax exclusions. Moreover, when it passes out of the trust to the children upon the death of the parent, all of the built-in capital gains are erased.

So then, what exactly does the term Irrevocable mean? Simply that the parent acting alone cannot take back what he or she has transferred into the trust. For many of us, this should not be such a big deal – as long as the trust contains the above-referenced “parent protections.”

The most important thing to keep in mind when assessing your planning options is that you should retain as much of your control as possible. Your documents can and should be customized to your individual needs and concerns.