What Is the Difference Between a Revocable and Irrevocable Trust?

They each have their pros and cons.

TIMOTHY E. PATERICK, MD, JD

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A trust is a separate legal entity people set up to manage their assets. Trusts are set up during a person's lifetime to ensure that assets are used in a way the people setting up the trust deem appropriate. Once assets are placed in a trust, a third party, known as a trustee, manages them. The trustee determines how the assets are invested and to whom they are distributed when the trust owner dies, although a trustee must manage the trust following the guidelines set out when the trust was formed.

A revocable trust and living trust are different terms that describe the same thing: a trust in which the terms can be changed at any time. An irrevocable trust is a trust that cannot be modified after it is created without the beneficiaries' consent.

Revocable Trust (Living Trust)

The owner of a revocable trust may change its terms at any time. The owner can remove beneficiaries, designate new ones, and modify stipulations on how assets within the trust are managed. Given the flexibility of revocable or living trusts, in contrast with the rigidity of an irrevocable trust, one might wonder why all trusts are not revocable.

However, there are a few key disadvantages to revocable trusts. Because the owner retains such a level of control over a revocable trust, the assets they put into it are not shielded from creditors as they are in an irrevocable trust. If the owner is sued, the trust assets can be ordered liquidated to satisfy any judgment put forth. When the owner of a revocable trust dies, the assets held in trust also are subject to state and federal estate taxes.

If the beneficiaries of a revocable trust are young (i.e., not of legal age) and the minor's real estate assets are held within a trust, it can replace the need to appoint a guardian, should the grantor die. In addition, if a grantor names beneficiaries whom they consider unreliable with money, the trust can set aside a specific amount to be distributed at recurring intervals or when they come of age (if they are minors).

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Irrevocable Trust

Despite what you may have heard, you probably do not need (or want) an irrevocable trust. When you create an irrevocable trust you are creating a document you cannot change easily, and the property you transfer to the trust is no longer in your control.

So why would anyone part with power over their own assets to rely on someone else to manage their money? There are three situations in which you might want to consider creating an irrevocable trust:

.When you want to minimize estate taxes: People who are willing to gift money every year can use these funds to purchase life insurance in an "irrevocable life insurance trust" that may enable their heirs to avoid paying estate taxes when they die. Another option is a "grantor retained annuity trust" that gives the creator of the trust a set income stream for several years and may allow some of the principal to go to family members' estate tax-free. The person establishing the trust also may create

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a "charitable remainder unitrust" that pays income to family now and leaves the remaining trust funds to a charity at their death. Only in rare instances may the trustee and the beneficiary be the same person in estate tax savings trusts, and there must, at a minimum, be a disinterested party serving as a co-trustee who has the power to overrule your directions.

If you wish the recipient to remain eligible for government programs: Disabled beneficiaries on Medicaid and Supplemental Security Income have stringent income and asset limitations, If they own or receive too much money, they can lose these government benefits. Irrevocable trusts can shelter income and assets so these limits are not exceeded. The Trustee of these "Medicaid trusts" can never be the Creator. Just like estate tax savings trusts, the Beneficiary has been divested of substantial control over the trust, so the government benefits continue to be provided, because the trust funds are not included as the Beneficiary's own assets and income.

If you wish to protect your assets from creditors: Protecting your assets from your creditors usually requires a trust to be irrevocable, and the Trustee and Beneficiary must be unrelated parties. These are commonly referred to as "asset protection trusts" and usually are created only in states that have favorable trust laws, such as Delaware, Nevada, and North Dakota. For people who frequently face lawsuits (such as surgeons, architects and real estate developers) these protections are very meaningful.

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If you are thinking about establishing an irrevocable trust to avoid probate and protect your privacy, you probably could be just as well-served with a revocable trust instead. Because trusts act as a substitute to wills, all trusts avoid probate unless the will "pours over" to the trust, because the court needs to know who the ultimate recipient is under the will. So almost all revocable trusts avoid probate. Ditto regarding privacy: revocable trusts are just as private as irrevocable trusts.

Irrevocable trusts often receive inferior income tax treatment than revocable trusts if income is not distributed to the beneficiaries. Irrevocable trusts usually have to pay an accountant to file a separate income tax return for the trust. In addition, you often need a third party to act as Trustee of an irrevocable trust. Whereas you would serve as your own Trustee of a revocable trust for free (since the trust's money is your money anyway), a third-party trustee of an irrevocable trust is going to want to be paid.

Revocable Trusts: What You Must Know

Is there a difference between a "revocable trust" and a "revocable living trust"? When a person (or persons) creates a trust during his or her lifetime and retains the power to revoke or amend the trust at any time, the trust is a revocable trust.

A revocable trust may be known by many different names, including revocable trust, living trust, revocable living trust, or inter-vivos trust. Furthermore, a trust might not include any of these words in the title, but it will still be a revocable trust.

More important than the name are the terms of the trust—and the critical terms that set revocable trusts apart from other types of trusts are the powers to revoke or amend. Contrast this with an irrevocable trust (a trust not intended to be easily revoked or amended) or a testamentary trust, which is created under a last will and testament at death and is not established until death.

If I transfer my assets to a revocable trust, do I lose control of those assets? If you transfer your assets to a revocable trust, you retain control over those assets so long as you are the trustee of your trust or have the power to revoke the trust and retrieve the assets. In contrast, if you transfer your assets to an irrevocable trust, you usually do lose control over those assets.

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If I transfer my assets to a revocable trust, will they be protected from creditors? If you transfer your assets to a revocable trust, you retain control over those assets and, as a result, assets held in a revocable trust receive no protection from your creditors. Certain types of irrevocable trusts that may be created under the laws of certain states do provide protection from creditors—but even those types of irrevocable "asset-protection" trusts may not protect the assets from creditors whose claims arise before the creation of the asset-protection trust.

This is a very specialized area of the law, and you should consult with your estate-planning attorney to discuss further. Note, however, that it is common for revocable trusts to direct assets into subtrusts or separate trusts, which are created under the revocable trust upon the trust creator's death. When this type of subtrust is created under a person's revocable trust, the subtrust actually is an irrevocable trust that comes into existence at the trust creator's death

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and, depending on how such a trust is drafted, assets held in it may be protected from the creditors of the beneficiary for whom it was created.

Once my revocable trust is created, will there be no need for probate after my death? Creation of your revocable trust is only the first step to avoiding probate. To be sure that property is held in your trust at your death without a probate proceeding, your assets must be transferred to the trust during your lifetime, or directed to the trust by beneficiary designation or other transfer mechanism at death. There are a few different ways to accomplish the funding of assets into your trust. In Wisconsin, married couples who sign a marital property agreement that includes a "non-probate transfer" provision (sometimes known as a "Washington Will provision") are taking advantage of a provision of Wisconsin law that allows for the transfer of property at death without the need for probate.

This does not apply to real estate owned in a state other than Wisconsin and will not govern life insurance or retirement accounts with a proper beneficiary designation. If you do not have a marital property agreement with such a non-probate transfer provision, or if you are a single person in Wisconsin (or any other state), to be certain that your trust will own the property at your death you must either re-title your assets into your trust, or execute beneficiary designations, "transfer-on-death" designations, or "payable-on-death" designations for your accounts, real estate, and other assets, naming the trust as beneficiary. Of course, there are other ways to transfer property directly to individuals in a way that avoids probate, including establishing joint accounts and designating individuals as beneficiaries, but these bypass your trust provisions.

If I have a revocable trust, does that mean I don't need a will? Even with a revocable trust, a complete estate plan should include a will. When used in conjunction with a revocable trust, the will is often a "pour-over" will. This type of will directs that any assets governed by the probate court process at death (because you did not move the asset to the trust during your lifetime and there was no effective beneficiary designation transferring the asset at your death) be transferred (or "poured over") into your revocable trust so that the assets can be administered through the trust document as intended. The person responsible for that process is called a personal representative, and the will is the document in which you nominate that person.

In addition, in Wisconsin, a will is the document in which you nominate a guardian for any minor children. This is a completely separate process from the administration of your trust or estate and cannot be handled outside of court. Finally, in the event that there is any type of court proceeding or court action at death, the only individuals who can represent a decedent are personal representatives, so it is extremely important that they be nominated in a will.

Trusts are only for the wealthy or are only useful to avoid estate tax—why would I need a trust? First, the creation of an estate plan that has a revocable trust as its cornerstone is not necessarily more expensive than the creation of an estate plan with a "simple will." In either case, the relevant provisions regarding distribution of your assets after your death must be drafted and included in the document. Several good reasons exist to create a revocable trust beyond estate tax planning. These include avoidance of probate; providing a seamless mechanism for managing your affairs during your lifetime if you should become unable to manage them yourself; and providing for the management of property, including creditor protection and divorce protection, for future generations. In addition, the terms of a revocable trust are confidential. These reasons apply whether or not you have assets in excess of the high federal estate tax exemption.

FDIC Insurance for Trust Accounts

On January 21, 2022, the FDIC approved changes to the deposit insurance rules for trust accounts, POD (payable on death) accounts, irrevocable trust accounts, and mortgage servicing accounts. These changes took effect on April 1, 2024. The new rule is intended to establish a simple, consistent formula for calculating deposit insurance coverage for all revocable and irrevocable trust accounts. A deposit owner's trust deposits will be insured in an amount up to $250,000 per beneficiary, not to exceed five beneficiaries, regardless of whether a trust is revocable or irrevocable, and regardless of contingencies or the allocation of funds among the beneficiaries. In other words, if you have a revocable trust and, at your death, the trust is to divide for your three children, then the trust account would be insured for up to $750,000. The final rule provides a maximum amount of deposit insurance coverage of $1,250,000 per owner, per insured. Remember, the FDIC protection covers only checking accounts, savings accounts, money market deposit accounts, certificates of deposit, and certain retirement accounts. It does not cover mutual funds or other investment vehicles.

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Conclusion

Physicians must take a proactive role in their estate planning. The many important distinctions between an irrevocable and revocable trust are essential to estate planning and allow an in-depth understanding of which trust allows control over personal assets, protections from creditors, protection from probate, the need for a will, and their usefulness for avoiding estate tax. **PM**

Dr. Paterick is Professor of Medicine, Loyola University Chicago Health Sciences Campus, Maywood, Illinois; email: tpaterick@gmail.com