

So What's The Difference Between a Living Trust & an Irrevocable Trust?

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“Why wouldn’t they just form a living trust and put their house in it? After all, once that is done, their house is safe because the trust provides asset protection.” Unfortunately, this is a common misconception regarding how trusts work and the protections a trust can provide. Before covering some details about the differences between a living trust and an irrevocable trust, let’s go over some of the basics.

1. What is a living trust?

In a living trust, your assets are placed into a written trust for your benefit during your lifetime and then transferred to designated beneficiaries at your death by your chosen representative, called a "successor trustee". Living trust, revocable trust, and family trust are generally interchangeable terms and all refer to a trust whose terms may be changed at any time while the trustor (the creator of the trust) is living.

The key difference is that a living trust, or revocable trust, can be revoked, or changed at any time during the trustor’s lifetime vs an irrevocable trust is just that, irrevocable, unchanging.

Living trusts are generally created as the foundation of a well-structured estate plan and include brokerage accounts and bank accounts in excess of \$150,000. Creating a living trust can also be a way to limit tax liabilities and avoid probate.

2. What is an irrevocable trust?

An irrevocable trust (generally speaking) may not be modified or revoked by the trustor without the consent of the beneficiaries of the trust.

There are two common reasons to set up an irrevocable trust:

#1 Tax savings. Once a trustor creates an irrevocable trust and transfers assets to the trust, those assets are out of his or her name and are no longer part of the trustor’s taxable estate. Depending on the value of the assets transferred to the irrevocable trust, typically a gift tax return needs to be filed since this transfer is viewed as a gift to the beneficiaries of the trust.

ARE YOU MAXIMIZING YOUR TAX SAVINGS?



#2 Asset protection. When assets are transferred to an irrevocable trust, the individual transferring the assets into the trust are severing his or her ties to the assets, and they are no longer in the trustor's name. Because of this, and because the trustee of an irrevocable trust is an individual or entity (i.e. a bank) other than the trustor, the trustor no longer has control of the assets. The trustee has legal title of the assets, so if the trustor gets sued, the creditor cannot force the trustor to pull assets out of the trust to satisfy debts because the trustor does not have title to the assets in the irrevocable trust.

3. What are the ADVANTAGES and DISADVANTAGES of setting up a living trust?

ADVANTAGES of a Living Trust:

Avoid Probate: If a living trust is funded correctly (assets are titled in the trust) the decedent's estate will avoid probate.

Custom Game Plan: The trust allows for the trustor to set up the "game plan" for distributing his or her assets as he/she sees fit.

Minimize Tax Burden: Although this is not as important due to the increased estate tax exemption (for now), the trust can help lower the tax burden.

Privacy: Trusts typically provide privacy, whereas a probate is all public record.

Can Be Changed: Living trusts can be changed or revoked at any time while the trustor is living and, therefore, the trustor has a lot of control over his/her assets.

DISADVANTAGES of a Living Trust (compared to an Irrevocable Trust):

Limited Asset Protection: Living trusts do not provide asset protection because the trustor/trustee still has complete control of the assets funded into the trust and may be forced to pull assets out to satisfy creditor obligations.

Limited Tax Benefits: Living trusts do not provide the same tax-shelter benefits that an irrevocable trust does.



4. What are the **ADVANTAGES** and **DISADVANTAGES** of Irrevocable Trusts?

ADVANTAGES of an Irrevocable Trust:

Avoid Probate: If an irrevocable trust is funded correctly (assets are titled in the trust) the assets in the irrevocable trust avoid probate.

Custom Game Plan: The trust allows for the trustor to set up the “game plan” for distributing his or her assets as he/she sees fit.

Minimize Tax Burden: An irrevocable trust can be a very powerful tool for reducing the trustor’s tax burden.

Privacy: Trusts typically provide privacy, whereas a probate is all public record.

DISADVANTAGES of an Irrevocable Trust (compared to a Living Trust):

Cannot Change: Irrevocable trusts cannot be revoked or modified without the consent of the beneficiaries (at best) and may even require modification by filing an action in court.

Limited Loan and Financing Options: Once the trustor transfers assets into the trust, those assets are no longer part of the trustor’s net worth statement and could create issues for obtaining loans or refinancing assets in the future.

Limited Control of Assets: Because the trustor is not the trustee of an irrevocable trust, the trustor has very limited or no control once the assets are titled in the trust.

Costly: Typically, irrevocable trusts are expensive to set up and require annual costs to maintain (i.e. bookkeeping and tax returns).

5. Which trust is best for you?

For a very high net worth client, or a client that may have other potential creditor issues (not pre-existing creditor issues), an estate plan that includes an irrevocable trust would be beneficial for all the reasons stated above.

For a majority of individuals, the need for major tax planning is not a concern. As a result, a standard living trust is typically sufficient to take care of most needs and address the goals you may have regarding your estate.

At Law & Stein, we are well versed in living trusts, irrevocable trusts, and tax planning and are happy to help you or your clients with any estate planning services.



CALIFORNIA NEWS: AVOID STATE TAXES; DISSOLVE ENTITY BEFORE STATE DEADLINE

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