# Trust Q&A

As part of MAI's quest to educate our clients on various financial planning tools, we're providing a Q&A regarding trusts. We've all heard of trusts, but do you know why they are used, what is put in them, and what types there are? These questions and more are answered below.

**Why put your assets in a trust?**

Common types of assets used are cash, investment/brokerage accounts, alternative investments, business interests, real estate, and life insurance.

**What types of trusts are there?**

There are many types of trusts that are used for various purposes, however they fall under the umbrella of two main types – Revocable and Irrevocable.

**Do I need a Revocable Trust or an Irrevocable Trust? What's the difference?**

***Revocable Trusts***

Revocable trusts are used to avoid probate and specify how you would like your assets to pass upon death. The assets in a revocable trust are still owned by you, they remain in your estate, and you have full access to them. However, because of this, the assets are not protected from your creditors. Revocable trusts are also flexible in that the grantor (person who creates the trust and contributes assets to it, in this case, you) may change the terms and/or beneficiaries at any time.

One thing to note about a revocable trust is that it remains revocable as long as the grantor is alive. Upon the death of the grantor, it automatically becomes irrevocable and can no longer be changed.

***Irrevocable Trusts***

Irrevocable trusts are used for asset protection and estate planning. This type of trust can only be modified under very limited circumstances and the grantor no longer has access to or control of the assets.

Once assets are transferred to an irrevocable trust, they are generally protected from creditors. Asset protection is not only important for the grantor, but also for the beneficiaries of the trust. As long as the assets remain in the trust, creditor protection will remain. When the assets are distributed to the beneficiary, they are no longer protected from the beneficiary's creditors.

For estate planning purposes, once a completed gift has been made to an irrevocable trust, the assets and any future appreciation are no longer included in the grantors estate. For those who wish to reduce their potential estate tax due upon death which is currently at 40% (2019), an irrevocable trust is one option to consider.

When making a gift to an irrevocable trust, the grantor uses up a portion of their lifetime exemption. Under current law, each person is allowed to give up to $11,400,000 (2019) of assets, gift and estate tax free, throughout their lifetime. After this exemption is depleted, whether during life or at death, any additional lifetime gifts and/or the estate value at death will be taxed at the previously mentioned rate of 40% (2019).

In addition to estate tax, there is also generation skipping tax ("GST") which is currently at 40% (2019). When a person gifts assets to someone in the next generation, only the estate tax comes into play. When a person gifts assets to someone two or more generations below them, not only does estate tax come into play, but so does generation skipping tax resulting in the gift being taxed twice. Each person has a lifetime GST exemption equal to the lifetime estate tax exemption. The exemption amounts are equal however they cannot be added together, the maximum exemption per person is $11,400,000 regardless of what generation receives the gift. By applying the estate and GST exemptions to a gift to an irrevocable trust, the assets and their future appreciation are able pass to multiple generations both estate and GST free.

The current lifetime estate and GST exemption value of $11,400,000 is at a historic high and is currently set to sunset at the end of 2025. In addition, the value of the exemption changes each year and there is no absolute guarantee that it will remain this high in any future year. Since it is impossible to predict what the exemption will be in future years performing an estate review is recommended.

There are multiple types of trusts under the irrevocable trust umbrella that can be used for asset protection and estate planning. A few examples are as follows:

1. Irrevocable Life Insurance Trust - used to hold a life insurance policy and pass the death benefit to the beneficiary estate tax free.
2. Spousal Lifetime (Limited) Access Trust - used to remove assets from your estate while allowing your spouse access to the assets for their lifetime.
3. Charitable Remainder Trust - used to make a future contribution to a charitable organization while at the same time receiving a current income stream from the assets for a specified period of time.
4. Charitable Lead Trust – used to make an annual contribution to a charitable organization for a specified period of time. At the end of the time period the remaining assets pass to a specified beneficiary.
5. Grantor Retained Annuity Trust - used to transfer assets to a named beneficiary while retaining an annuity payment for a set number of years.
6. Dynasty Trust – used to transfer assets to multiple generations.

**In summary, what are the basic overall advantages and disadvantages of Revocable and Irrevocable Trusts?**

*Revocable Trust*

- Advantages
  - Probate avoidance
  - Grantor controls the trust and has full access to use the assets for any purpose
  - Grantor may change the terms and beneficiaries of the trust at any time
- Disadvantages
  - Does not provide creditor protection
  - Cannot be used for estate tax minimization as the assets remain in the estate of the grantor

*Irrevocable Trust*

- Advantages
    - Probate avoidance
    - Creditor protection
    - Removes assets and their appreciation from the grantors estate
- Disadvantages
    - Can only be modified or terminated under very limited circumstances
    - The grantor no longer has access to or control of the assets

Setting up any type of trust requires an estate planning attorney licensed to practice in the state the trust is being created in. Before enlisting an attorney, the main points a grantor should consider are what their purpose is for creating the trust, the terms they would like included, who the beneficiaries will be, and who the current and successor trustees (person who is responsible for carrying out the terms of the trust) will be. After the trust is created, the next crucial step is to fund the trust through transferring the assets into it. Your Financial Advisor is able to guide you through the process and help ensure proper funding of the trust ensues.