Is an Irrevocable Trust a Good Idea?

An **irrevocable trust** is mainly used for tax planning, says a recent article from *Think Advisor* titled *"10 Facts to Know About Irrevocable Trusts."* Its key purpose is to take assets out of an estate, reducing the chances of having to pay estate taxes. For estate planning purposes, placing assets inside the irrevocable trust is the same as giving it to an heir. If the estate exceeds the current limit of $11.7 million, then an irrevocable trust would be a smart move. Remember the $11.7 million includes life insurance policy proceeds. Many states with estate taxes also have far lower exemptions than the federal estate tax, so high income families still have to be concerned with paying estate taxes.

However, let's not forget that beneficiaries must pay taxes on the income they receive from an irrevocable trust, usually at ordinary income tax rates. On the plus side, trusts are not subject to gift tax, so the trust can pay out more than the current gift tax limit of $15,000 every year.

If the trust itself generates income that remains inside the trust, then the trust will have to pay income taxes on the income.

Asset protection is another benefit from an irrevocable trust. If you are sued, any assets in the irrevocable trust are beyond the reach of a legal judgment, a worthwhile strategy for people who have a greater likelihood of being sued because of their profession. However, the irrevocable trust must be created long before lawsuits are filed.

A physician who transfers a million-dollar home into the trust on the eve of a malpractice lawsuit, for instance, may be challenged with having made a fraudulent transfer to the trust.

There is a cost to an irrevocable trust's protection. You have to give up control of the assets and have no control over the trust. Legally you could be a trustee, but that means you have control over the trust, which means you will lose all tax benefits and asset protections.

Most people name a trusted family member or business associate to serve as the trustee. Consider naming a successor trustee, in case the original trustee is unable to fulfill their duties.

If you don't want to give someone else control of your assets, you may wish to use a revocable trust and give up some of the protections of an irrevocable trust.

Despite the name, changes can be made to an irrevocable trust by the trustee. Trust documents can designate a "trust protector," who is empowered to make certain changes to the trust. Many states have regulations concerning changes to the administrative aspects of a trust, and a court has the power to make changes to a trust.

An irrevocable trust can buy and sell property. If a house is placed into the irrevocable trust, the house can be sold, as long as the proceeds go into the trust. The trust is responsible for paying taxes on any profits from the sale. However, you can request that the trustee use the proceeds from selling a house to buy a different house. Be sure the new house is titled correctly: owned by the trust, and not you.

Asset swaps may be used to change irrevocable trusts. Let's say you want to buy back an asset from the trust, but don't want that asset to go back into your estate when you die. There are tax advantages for doing this. If the trust holds an asset that has become highly appreciated, swap cash for the asset and the basis on which the asset's capital gains is calculated gets reset to its fair value, eliminating any capital gains on a later sale of the asset.

Loss of control is part of the irrevocable trust downside. Make sure that you have enough assets to live on before putting everything into the trust. You can't sell assets in the trust to produce personal income.

Transferring assets to an irrevocable trust helps maintain eligibility for means-tested government programs, like Medicaid and Supplemental Security Income. Assets and income sheltered within an irrevocable trust are not counted as personal assets for these kinds of program limits. However, Medicaid has a look-back period of five years, so the transfer of a substantial asset to an irrevocable trust must have taken place five years before applying for Medicaid.

Talk with your estate planning attorney first. Not every irrevocable trust satisfies each of these goals. It is also possible that an irrevocable trust may not fit your needs. An experienced estate planning attorney will be able to create a plan that suits your needs best for tax planning, asset protection and legacy building.