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Should a Trust Be Part of Your Estate Plan?

Trusts used to be seen as an estate planning tool for only the very wealthy, who have complicated family situations to sort out, and high-value assets to protect.

Times have changed. Modern lives are complicated, asset values are high, and good estate planning is for everyone.

Let's look at one family to see where trusts could help: Jean and Tim and are in their late 60s and have been married for 15 years. Tim is retired with a pension. Jean owns a small business. Together, they own an investment property, and their primary home is a lake house that is a family gathering place. They have a blended family of five adult children, but don't have children together. Tim was left money by his parents for the care of a younger sister with special needs.

They want their children to share equally in the real estate, and they also want to ensure that Tim's sister will always have care.

How should they sort out their estate plan? We take a look at some of the advantages of trusts over wills, and how trusts can be flexible instruments to create the estate plan you want.

Probate is Lengthy, Expensive and Exposed to Public View

Probate is the process by which a will transfers an estate to a beneficiary. Under the probate process, an inventory of assets is performed, and an appraisal is made. All debts are discovered and paid. Only then are remaining funds or property distributed to beneficiaries. As all of this is done under the direction of judge, probate is part of the public record.

While wills are necessary in some situations, such as establishing a guardian for a minor child, using a trust to leave property to heirs can be an effective, quick and private way to transfer your estate.
With a revocable trust, the assets transfer into the trust during one's lifetime and are controlled until death by the grantor (and then are passed to the designated beneficiaries by the successor trustee after death). While living, the grantor still has control over the assets and can remove them from the trust, change the beneficiary, or even add more assets. Assets in a revocable trust are subject to estate taxes because the grantor retains control, and they are considered part of the estate.

A Trust Can Wall Off Your Assets from Creditors – and Reduce Taxes

An irrevocable trust, which cannot be changed once it is created, removes assets from your estate. The assets in this type of trust cannot be pursued by creditors and are not subject to estate taxes.

Protection for Your Heirs

Trusts can be structured so that various conditions are met before money passes to heirs. In most cases, this is to ensure that younger generations have time to mature and build their own lives before taking on the responsibility of the inheritance. The trust may be structured to provide income at younger ages, but not to allow the full inheritance to pass until they beneficiary as reached a given age or has achieved other milestones.

For this type of trust, it's important to select the trustee carefully, as they will be charged with ensuring the conditions are met. It's also a good idea to obtain legal advice on the enforceability of the conditions being imposed.

Providing for Care that Combines Inheritance with Benefits

A special needs or supplemental needs trust is set up specifically to provide for the child without impacting government benefits such as Supplemental Security Income or Medicaid. Even a small legacy (as little as $2,000) can result in temporary ineligibility for federal programs, until the money is gone. For someone with complex medical needs who requires constant and lifelong care, losing Medicaid benefits can be devastating.

This type of trust has complex rules that are required by the Social Security Administration and state agencies. The things that it can cover are specific, and usually, these trusts are managed by specialized companies.

Charitable Trusts Can Provide Income and Create a Legacy

Charitable trusts allow you to leave a legacy by continuing to support charities that are meaningful to you. They can be structured to provide income to you or a beneficiary for a period of time and then the remainder of the trust passes to the designated charity.

Assets are removed from your estate when the trust is formed, so estate taxes are reduced. This type of trust can also be an excellent way to deal with highly appreciated assets such as stocks or real estate, when a large tax bill would otherwise be due if the asset were sold.

Trusts in Action

Let's go back to Tim and Jean, our couple that was contemplating their estate plan.

The answer was simple – the primary home went into a living trust so that the house would pass to their children without going through probate. Tim and Jean still live in the house and can sell it if their plans or their needs change. A separate trust was created for the money earmarked for the care of Tim's sister. The inheritance will not pass directly to her, and her benefits will not be disrupted.

The Bottom Line

Trusts are flexible instruments that can help ensure that your privacy is maintained, your estate is protected, and your wishes are carried out to your specifications. They can also be an effective tool to minimize taxes when deployed for charitable giving. And most importantly, if there are children or adults that require special care, a trust can ensure that the inheritance does not disrupt existing benefits.
