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The Many Uses for Trusts in Estate Planning

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Trusts, used properly, can provide significant estate planning advantages for you and your beneficiaries. Trusts serve many purposes: for disability; probate avoidance; minors; asset protection; special needs; business ownership; wealth replacement; and retirement planning, to name just a few. This article briefly explores the general advantages of trusts and some of the most common types.

Revocable vs. Irrevocable Trusts

There are two basic types of trusts: revocable and irrevocable. Probably the most common type of trust is the *revocable* living trust. Assets transferred to a revocable trust remain within your control as the trustmaker, and the trust can be amended or revoked by you at any time. In contrast, *irrevocable* trusts are not amendable or revocable by the trustmaker(s).

Revocable Living Trusts

With a revocable living trust, you transfer your property to the trust during your lifetime. Revocable trusts can be excellent vehicles for disability planning, privacy, and probate avoidance. A revocable trust controls only the property that you have transferred into it and may not control disposition of your other property.

Planning Tip: Unlike with a trust, you can't use your will to hold title to your property during life. And whether estate planning is done by will or trust, it is important to ensure that any of your property that passes by *contract*, i.e., by beneficiary designation on a retirement plan or a life insurance policy – does not thwart the estate planning objectives set forth in your living trust or will.

Asset Protection for You as Trustmaker

The goal of asset protection planning is to insulate assets that would otherwise be subject to the claims of your creditors. Typically, a creditor can *only* reach assets titled to the debtor. This is where trusts come into play.

Planning Tip: The right types of trusts can insulate assets from creditors because you, as the debtor, do not hold title to the assets. As a general rule, if you, as trustmaker, create an irrevocable trust and you are a *beneficiary* of the trust (i.e., a so-called "self-settled" trust), assets transferred to the trust are not protected from your creditors.

Until fairly recently, the only way to remain a beneficiary of a trust and also protect the trust assets from your creditors was to establish the trust outside the United States in a favorable jurisdiction. This can be an expensive proposition.

The laws of a handful of states (including Alaska, Delaware, Nevada, Rhode Island, South Dakota, and Utah) now permit *self-settled spendthrift trusts* or what are commonly known as *domestic asset protection trusts*. Under the laws of these few states, if you, as trustmaker, transfer assets to a specially drafted irrevocable trust and are also a trust beneficiary, you can protect those assets from your creditors as long as distributions can only be made to you only in the discretion of an *independent trustee*. This technique will not work when the transfer is done to defraud or hinder creditors.

Planning Tip: If you are unwilling to give up a beneficial interest in your assets in order to protect them from future creditors, a trust established under the laws of a jurisdiction that permits self-settled spendthrift trusts might be appealing.

Asset Protection for Your Trust Beneficiaries

A revocable living trust provides no asset protection for you during your life. Upon your death, however, or upon the death of the first spouse to die if it is a *joint* trust, the trust becomes irrevocable as to the deceased trust maker's property and can provide asset protection for the beneficiary(ies). Once the trustee distributes the assets to a beneficiary, those assets are no longer protected and can be attached by that beneficiary's creditors. If the beneficiary is married, the distributed assets might also be subject to the spouse's creditor(s) or available to the former spouse upon divorce.

Planning Tip: Consider trusts for the *lifetime* of your beneficiaries to provide prolonged asset protection for the trust assets. Lifetime trusts permit your financial advisor to continue to invest the assets as you desired, which helps ensure that trust returns are sufficient to meet your objectives for your beneficiaries.

The more rights the beneficiary has to trust distributions, the less asset protection the trust provides. If your beneficiary has the right to compel a distribution from a trust, so too can a creditor compel a distribution from that trust. A creditor will simply salivate in anticipation of any automatic distribution to your beneficiaries. A trustmaker should allow only *discretionary distributions* to beneficiaries by an independent trustee.

Irrevocable Life Insurance Trusts

One of the most common trusts is the irrevocable life insurance trust (ILIT).

The death proceeds of life insurance owned by you are includible in your gross estate for Washington and federal estate tax purposes. You can avoid this adverse result by having an ILIT own the insurance policy and also be its beneficiary. Although this trust is irrevocable, the trust terms can grant an *independent trust protector* significant flexibility to modify the terms of the trust to account for unanticipated future developments, including the possibility of your accessing the policy's cash value during your life.

Conclusion

You can protect your assets from creditors or the taxman by placing them in a well-drafted trust, and you can protect your beneficiaries from claims of creditors and predators by keeping those assets in trust over your beneficiary's lifetime. Working closely with you, your estate planning attorney can help ensure that the plan meets your unique planning objectives.

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