The Only 3 Reasons Why You Should Have an Irrevocable Trust I Investopedia

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You probably don't need an irrevocable trust. When you create an irrevocable trust you are creating a trust that cannot easily be changed. When you sign it and transfer property to the trustee of the trust, those funds are locked in, outside of your control, and are now administered by the trustee.

Why would anyone part with control of his assets and rely on someone else to control his money? The only time you might want to consider creating an irrevocable trust is when you want to (1) minimize estate taxes, (2) become eligible for government programs, and (3) protect your assets from your creditors. If none of these apply, you should not have one.

General Information About Trusts

All trusts have three parties:

- The settlor, who creates the trust document and transfers property to the trust,
- The trustee, who follows the trust's instructions, invests trust funds, uses trust property for the beneficiary and pays the trust's administrative expenses, and
- The beneficiary, who just sits back and enjoys the benefits from the trust's assets and/or income.

If you act as all three parties you have a true revocable trust, which you can change and revoke any time, but you only receive limited protection, minimal estate tax savings, and no special government program benefits. If, however, you take away your ability to change the trust or name a trustee who is unrelated to the beneficiary, you have given up a substantial amount of control over the trust. Under these circumstances the government concedes that you divested yourself of enough power to grant the beneficiaries of the trust certain benefits.

The Only Occasional Benefits of Irrevocable Trusts

1. **Minimizing Estate Taxes:** People who are willing to gift smaller amounts of money every year, such as the current $14,000 annual exclusion, can use these funds to purchase life insurance in an "irrevocable life insurance trust" that avoids paying estate taxes when they die. They may also create a trust that pays income to their family now, and leaves a charity the remaining principal at their death. If the trust is irrevocable, these funds avoid estate tax consequences when you pass away. (For related reading, see: *7 Reasons to Own Life Insurance in an Irrevocable Trust*.)
2. **Becoming Eligible for Government Programs***:* Disabled beneficiaries on Medicaid and Supplemental Security Income have stringent income and asset limitations (if they own too much property they can lose these government benefits) that irrevocable trusts shelter from being exceeded. Here the trustee and the beneficiary cannot be the same person. Again, the beneficiary has been divested of substantial control over the trust, so the government allows the funds to not be included as the beneficiary's own assets and income, thereby maintaining the government benefits.
3. **Protecting Your Assets:** Protecting your assets from your creditors usually requires that the trust is irrevocable and the trustee and beneficiary are unrelated parties (or, at most, the same party with limited power over trust funds). For people who frequently face lawsuits (including surgeons, architects and real estate developers) these protections are incredibly meaningful, though the laws on creditor protection over your assets vary state-to-state. (For related reading, see: *Protect Your Personal Assets*.)

The Many Negatives of Irrevocable Trusts

If you are not wealthy there is no good reason to fund an irrevocable trust with life insurance, create charitable remainder trusts, or gift substantial property prior to your death. These actions only make sense if your estate will be sizable—there is no federal estate tax below $5,490,000 per spouse—so few people need an irrevocable trust for estate tax savings.

If you do not plan on receiving Medicaid (let's be honest, Medicaid benefits are not particularly lavish) there is no reason to have the majority of your assets transferred to an irrevocable trust. (For related reading, see: *4 Tips for Qualifying for Medicaid*.)

An irrevocable trust "may" protect your assets, but a court can reclaim these assets when it feels you unjustly transferred funds to the trust in contemplation of a lawsuit. And you don't need an irrevocable trust to protect your beneficiaries, since a carefully drafted revocable trust protects every beneficiary except you and your spouse (and even she may be protected). If you sense there is little chance of you being sued, or that the person you would name as trustee is less responsible than you, this may not be a good option.

Since trusts act as a substitute for wills, all trusts avoid probate unless the will "pours-over" to the trust (since the court needs to know who the ultimate recipient is under the will), so even a revocable trust avoids probate. Ditto regarding privacy: Revocable trusts are just as private as irrevocable trusts.

Irrevocable trusts often have worse income tax treatment than revocable trusts if income is not distributed to the beneficiaries. Irrevocable trusts also often incur expenses since, unlike revocable trusts, many have different tax identification numbers than that of the settlor and thus require their very own income tax return. (For related reading, see: *Life Estate vs.Irrevocable Trust: Which Is Better for You?*)

Most importantly, you lose control of property transferred to an irrevocable trust. Has your youngest child ticked you off? Too bad, he is permanently a beneficiary. Estate tax exemptions have increased and your estate is no longer estate taxable? Sorry, you can't reclaim the asset. Want more income, or want your trustee to sell your current house and upgrade to a larger one? Hope you're on good terms since you are not the trustee, and he or she is the person who gets to decide.

Yes, you can retain some powers that give you limited control, and you can take some actions to modify irrevocable trusts. A court can be petitioned to change the trust, or every beneficiary can agree to change it (this is usually not even possible when there are minor beneficiaries), and some states allow these trusts to be decanted. But this requires other people (or worse, courts) to agree with your point of view. (For related reading, see: *Irrevocable Trusts: New Trends You Need to Know*.)

The lesson should be clear: Do not create an irrevocable trust unless you fit into the three categories discussed.