What is a trust and how can it benefit my estate plan?

Make Your Plan
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Key Insights

- Trusts are legal arrangements that control how your assets are handled before and after your death.
- They offer the potential for privacy, protection from creditors, and a way to manage estate tax costs.
- Trusts can be complex, and they should be reviewed carefully to ensure they align with the goals of your estate plan and current estate and income tax laws and exemption amounts.

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Trusts can be effective for achieving a variety of financial planning goals, including maintaining control over your assets, preserving privacy, lowering taxes, and even managing family dynamics. While trusts can be quite useful, they can also be complex. For this reason, it is important to evaluate your goals carefully and make sure that a potential (or existing) trust truly aligns with the objectives of your estate plan.

What is a trust?

A trust is a legal arrangement that separates ownership of an asset from control and/or use of that asset. Trusts usually involve a grantor (you), a trustee (you or someone you appoint to control the assets), and a beneficiary or beneficiaries (your heir(s) or an entity such as a charity).

When a grantor establishes a trust, they stipulate how the assets it contains will be handled going forward. Trusts allow you to pass assets to your beneficiaries without going through probate, the often lengthy and public legal process by which an estate is settled. Probate also involves administrative costs.

Trusts can hold cash, securities, real estate, personal property, and life insurance policies. Certain assets, such as those held in retirement accounts, are generally not held in trusts, as they must be owned by an individual taxpayer and are typically transferred based on their own beneficiary designations (see "How the assets in your estate are distributed").

How the assets in your estate are distributed

Your will and trust documents cover how most assets are distributed, with a few key exceptions.

Your will is one of the most important tools in your estate plan for laying out how your assets should be distributed, but it does not cover everything. Some assets are distributed based on rules that supersede any directives in a will. For instance:

- *Joint ownership*: Assets that are jointly owned with right of survivorship pass to the surviving owner. If you've added a transfer on death (TOD) designation to your joint account, assets would transfer to the named TOD recipients in the event that both owners pass away.
- *Retirement accounts*: These accounts include beneficiary designations that specify who will inherit the assets.
- *Death benefits from an insurance policy*: The beneficiary designation in the insurance policy dictates who will receive the policy benefit.

In the absence of a will, any solely owned assets not already held in a trust and without beneficiary or TOD designations will be distributed based on the probate rules of your state. For instance, if you are married with children, half of your assets may go to your spouse, with the other half distributed among your children. If you're single and don't have children, your parents or others deemed next of kin may receive your estate instead.

Wills do not have to be complicated, even when a trust is involved. Say your solely owned assets total $300,000 on the date of your death, which includes $75,000 in jewelry, furniture, and other personal property; $125,000 home equity; and $100,000 in cash and securities.

Your will might direct the following:

- $12,000 in jewelry goes to your daughter, two paintings worth $18,000 go to your son, and $45,000 in antique furniture is divided between your two children.
- A bequest of $25,000 of cash and securities goes to your favorite charity.
- A trust is created and funded with $50,000 in cash and securities, naming your granddaughter as beneficiary and your son (her father) as trustee. The trust's principal and interest can be used at any time for her educational expenses, and when she reaches age 25, any remaining trust assets go to her outright.
- Any remaining assets of your estate (in this case, $150,000) are to be distributed in equal shares to your children, per stirpes—meaning if one of your children predeceases you, the assets that would have gone to the now deceased child go instead to that child's heirs. If your will indicates per capita, rather than per stirpes, the assets would instead be divided evenly among the surviving beneficiaries.

Why establish a trust?

The first step in deciding whether you would benefit from establishing a trust is to clarify and prioritize your goals. Your goals can help you determine which trust(s) might make the most sense for your situation or whether your objectives can be more easily achieved by maintaining an up-to-date will combined with other financial planning actions such as directly naming beneficiaries or transfer on death (TOD) designations on your assets. (See Fig. 1, "The difference between wills and trusts.") For instance, do you want to:

Goal: Maintain control of your assets after your passing

A **revocable living trust** is one of the most widely used trusts. It allows you to maintain control over your assets while you are alive and make updates to how your assets should be managed upon your passing as your situation and wishes change. For instance, as your children transition to adulthood, get married, have children, or face divorce, you can make changes to the stipulations in your trust to reflect those changing circumstances. Upon your death, it becomes **irrevocable**, meaning no further changes can be made and it must be managed based on the directives in place when you passed away.

An **irrevocable living trust** allows you to set terms for the distribution of assets upon your passing, but once the trust is established and funded, the assets are mostly removed from your beneficial ownership and control. So, in terms of flexibility to make changes and access funds during your lifetime, revocable trusts provide greater control. But, for individuals who are interested in sheltering assets from creditors, lawsuits, and estate taxes, irrevocable trusts may provide greater protection.

Both revocable and irrevocable trusts allow you to stipulate how your assets should be managed in the case of incapacity.

The difference between wills and trusts

(Fig. 1) Both tools allow you to express your wishes for what happens after you die, but they play different roles in an estate plan

Consideration	Wills	Trusts
Transfer of Assets to Beneficiaries	– Generally require transfer of ownership to beneficiaries *immediately upon settlement of the estate* – Can direct assets to go into trust (via testamentary trust or pour-over will)	Allow you to *specify exactly how and when* assets and property are transferred to your beneficiaries
Exposure to Probate	Are subject to probate	Can help avoid probate
Establishment	Fairly easy to establish and modify	Require some administrative work to establish and properly fund
Revisability	Yes	Yes, but limited for irrevocable trusts
Costs	Minimal cost to establish and make changes	Can be more costly to establish and make changes
Privacy	Are public record	Are generally confidential
Legal Protections	Can be subjected to court challenges	Provide some protection against lawsuits and creditors when the grantor dies
Management of Estate Taxes	Assets are generally included in taxable estate	In some cases, assets may be excluded from taxable estate and reduce estate taxes
Designation of Guardianship	Yes	No
Property Left to Minors	Name managers (custodians) for property until the minor reaches age of majority	Name managers (trustees) for property and *stipulate how and when it is to be passed to the minor*
Designation of Authority Upon Death	Name an executor of your estate	Name a successor trustee to execute stipulations outlined in the trust

A **testamentary trust** is generally created by a will and is therefore irrevocable once established (because the grantor would have passed away). It directs how and when assets are distributed to your beneficiaries and can last for a beneficiary's lifetime or be set to dissolve after a period of time.

One common type of testamentary trust is a **qualified terminable interest property trust (QTIP)**, which is typically used in the event of a second marriage, when there are children from a previous marriage. For instance, a QTIP could hold assets for the benefit of your current spouse during their lifetime. Upon their death, the remaining assets would pass to your children from your previous marriage (instead of someone else).

Goal: Manage your expenses and estate taxes

Placing your assets in a revocable living trust can reduce the probate costs of settling your estate. For example, if you own real estate in a state other than your legal residence, placing that property in a trust would avoid a second state's probate process. Since you maintain control of a revocable trust during your lifetime, any income or growth generated by the account is taxable to you (as with any other taxable account), and the assets will be considered part of your estate for estate tax purposes.

Irrevocable trust assets are neither subject to probate nor counted in your taxable estate for estate tax purposes.

Trust alternative

As your children become more financially responsible, you may be able to simplify your estate plan. For instance, if you set up a trust because your children were not mature enough to handle the money, you might now consider naming them in your beneficiary designations on IRAs or as a transfer on death designation on eligible investment accounts. This approach will still help them avoid probate but eliminate the administrative requirement of passing the assets through a trust first.

Federal estate tax rates range from 18% to 40% and are applied to assets above the individual lifetime gift and estate tax exemption of $13.61 million (in 2024). So if your estate's assets are likely to exceed that amount, establishing and funding an irrevocable trust during your lifetime can help to reduce the amount of your estate that could be subject to estate taxes. This higher estate tax exemption amount is subject to sunset at the end of 2025, meaning it could be cut by half starting in 2026.

While irrevocable trust assets can reduce estate taxes upon your passing, *income* taxes related to these trusts can be complex and may not be favorable. Still, placing assets in an irrevocable trust can help shelter those assets from estate taxes, creditors, and lawsuits—and provide control over the distribution of assets after your passing. Keep in mind that unlike with a revocable living trust, which can be updated or dissolved at any point during your lifetime, an irrevocable trust is difficult to modify once it is established and funded. So you'll generally want to be confident that the rationale for creating the trust and the stipulations you've laid out in it are highly unlikely to change.

There are several types of irrevocable trusts. One example is an **irrevocable life insurance trust**, which enables you to exclude the proceeds of a life insurance policy from your estate. The trust owns the policy and it is typically funded with annual premiums designed to not exceed the annual gift exclusion limit ($18,000 per person, per recipient in 2024), with your heirs as beneficiaries of the policy's death benefit received by the trust.

In some cases, a **bypass trust also known as an (A-B trust)** can help manage estate taxes. This type of strategy involves creating two trusts upon the passing of the first spouse, an **A-trust** and **B-trust**. Typically, the deceased spouse's portion of the couple's assets (at least up to the state or federal estate tax exemption amount) is placed in an irrevocable B-trust, commonly referred to as a **bypass trust** or **credit shelter trust**. This trust is intended to bypass the surviving spouse and ultimately pass to other beneficiaries, such as the children. B-trust assets *will not* be included in the surviving spouse's eventual taxable estate, but they *do not* receive a step-up in cost basis upon their passing either, which may lead to negative tax ramifications for the ultimate beneficiaries (such as the children).

Any assets that were not used to fund the B-trust are typically placed in a **marital trust (A-trust)** to benefit the surviving spouse. Since the surviving spouse maintains full control over the A-trust, those assets *will* eventually be included in their taxable estate (and may be subject to estate tax) and do receive a step-up in cost basis, which can save money on taxes for the ultimate beneficiaries of both trusts.

In recent years, bypass trusts have become less common because (a) the federal estate tax exemption has more than doubled since the Tax Cuts and Jobs Act was passed in late 2017 as well as (b) the advent of portability provisions in federal tax law. **Portability provisions** allow the surviving spouse to combine their federal estate tax exemption with any leftover exemption from the deceased spouse, meaning that the lifetime federal estate tax exemption for a couple in 2024 is $27.22 million. Again, unless legislative action is taken, this amount is set to revert to the lower 2017 exemption amount at the end of 2025.

Bypass trusts can still benefit ultrahigh net worth families and prove useful for limiting estate taxes at the state level for others. Currently, 12 states and the District of Columbia have some form of estate tax. The estate tax exemption amounts vary: For instance, $1,000,000 in Oregon; $6,940,000 in New York; and equal to the federal exemption level in Connecticut (as of 2024). If you're considering using a bypass trust, be sure to understand your state's estate and inheritance tax laws and exemption amounts. Also, consider using flexible language such as "may" instead of "shall" to avoid potentially running into issues if exemption levels (or your plans) change in the future. If you established your estate plan many years ago and directed the execution of a bypass trust in your will, revisit the language to ensure that it still aligns with your needs and goals, as well as current estate tax laws and limits.

Trust alternative

Some states allow you to own certain assets, such as your home or a vacation property, in joint tenancy with rights of survivorship (JTWROS). Several states also allow for a TOD designation on real estate deeds. Assets titled in this way avoid the probate process as they transfer ownership automatically.

Goal: Maintain your privacy

Trusts (of all kinds) generally provide much greater privacy than the probate process. A revocable living trust paired with a **pour-over will** is an effective way to maximize the confidentiality of your estate in the case that you pass away without having retitled all of your assets to avoid probate. A pour-over will lets the executor of your estate transfer any remaining probate assets into a living trust that you had established during your lifetime. In this situation, the trust, rather than the will, controls the disposition of assets—thus taking the details of your estate settlement out of the public record. These "poured over" assets must still pass through probate, however, so there is a benefit to placing your assets in a trust or naming the trust as TOD during your lifetime.

Goal: Establish a charitable bequest

Creating a charitable trust offers both estate-planning benefits and the opportunity to leave a charitable legacy. For instance, a **charitable remainder**

trust (CRT) generates income to one or more beneficiaries for a specific period of time, with the remaining trust assets passing to one or more charities when the trust closes down. By comparison, a **charitable lead trust (CLT)** generates income for a charity, with the remaining trust assets passing to your beneficiaries when the trust is dissolved.

Goal: Manage family dynamics to promote harmony

Your estate planning should consider the effects of your decisions on family dynamics. Work to align your plans with those of your spouse or partner, and seek to divide assets among your heirs in a fair and equitable manner. Generally, trusts can offer more flexibility than a will alone, especially if you have a more complex family situation. For instance, if you have children from a previous marriage, a family member with special needs, or an adult child who has struggled with job stability or addiction, a trust can help to ensure that your wealth is passed along in the manner you specify as most appropriate.

If a trust makes sense for you, it's important to name a successor trustee, and make sure the named trustee can manage the financial and personal responsibilities. Naming multiple successor trustees isn't ideal, as it can sometimes lead to indecision when actions need to be taken. Naming one trustee can make execution of the trust simpler but can cause conflict if you haven't had that conversation with the other prospective trustees (typically other children). So however you opt to title your trust, make sure you've communicated that preference and reasoning to all parties.

In instances where trusts are financially complex or there are no suitable candidates to act as successor trustees, you might consider employing the services of a trust company. Either way, communicate your plans to your entire family about how your trust should be managed and why.

Consider how a trust could benefit your estate plan

A trust or a set of trusts can help you achieve your vision of how your assets will be distributed after you have passed. Your estate plan must be able to adapt with changing conditions, however, so be sure to build flexibility into the language of your estate-planning documents. Revisit your plan and trusts every few years to make sure they are still in line with your desires and your family situation.

Also, consider whether you can explain what your trust aims to accomplish to a family member in clear language. If you cannot, your plan may be more complicated than is necessary. Be sure to consult with an estate-planning attorney to ensure your estate plan truly fulfills your needs.

Trust alternative

Instead of a CRT or CLT, you can leave a bequest to a donor-advised fund (DAF) and have assets distributed to charities on a schedule based on your recommendation. You can also involve your family by naming a successor donor-advisor.

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