

Estate Planning Pitfall - You don't Understand the Differences Between a Revocable and Irrevocable Trust

Trusts are powerful estate planning tools, but not all trusts work the same way. Two of the most common options are revocable trusts and irrevocable trusts. Understanding their differences can help you make informed estate planning decisions.

A revocable trust — often called a living trust — provides flexible. You (the grantor) retain full control over the trust assets during your lifetime. For example, you can add or remove assets, change beneficiaries and amend or revoke the trust.

Because the grantor maintains control, the IRS generally treats the trust assets as still belonging to the grantor for tax purposes. Notably, revocable trusts don't provide asset protection from creditors or reduce estate taxes on their own. However, they're widely used because they help avoid probate, provide continuity if the grantor becomes incapacitated, and keep estate details private.

An irrevocable trust, as the name suggests, is far less flexible. Once you establish and fund the trust, you typically can't change or cancel the trust or reclaim the assets. This loss of control is intentional and can create significant planning advantages. Assets placed in an irrevocable trust are generally removed from your taxable estate, which can reduce estate taxes. In addition, those assets may be protected from creditors and lawsuits, depending on how the trust is structured.

The trade-off is complex. Irrevocable trusts require careful drafting, ongoing administration and a clear understanding of tax consequences. Income generated by the trust may be taxed differently, and mistakes can be difficult — or impossible — to undo.

In a nutshell, revocable trusts prioritize control and simplicity, while irrevocable trusts prioritize tax efficiency and asset protection. There's no one-size-fits-all solution. The right choice depends on factors such as your net worth, family goals, business ownership, and long-term financial plans.