

Revocable Trusts:

Clarifying Uses and Correcting Misconceptions

One of the most widely used and most misunderstood estate planning tools is the revocable trust. Often referred to as living trusts, will substitutes, or lifetime trusts, revocable trusts have an important place in a family's wealth management plan, as long as they are properly understood, implemented and administered.

What Are They?

Revocable trusts accomplish many goals for families, but most simply put, they are a will replacement. Their primary purpose is to dispose of an individual's assets upon his or her death according to terms outlined. Like a will, a revocable trust may be amended or "revoked" by the creator (the "grantor") during his lifetime as long as he is not incapacitated. Upon the grantor's death, the revocable trust becomes "irrevocable" and cannot be modified without judicial participation, similar to a will.

How Do They Work?

During one's lifetime, a grantor executes a revocable trust, becomes the trustee and typically retitles some or all of his or her individually titled assets into the name of the revocable trust. While alive, the grantor controls the revocable trust and the assets titled therein as if they were the grantor's. Upon the grantor's incapacitation or death, a successor trustee steps in and fulfills the terms outlined in the trust. The terms often include funding and administering sub-trusts for the benefit of surviving spouses and children.

What Are the Benefits?

A revocable trust offers a multitude of benefits which vary depending upon the circumstances of each family. However, the following is a list of some of the more important and common benefits:

- 1. Asset administration continuity.** When a grantor/trustee becomes incapacitated or dies, a revocable trust provides a seamless transfer of administrative duties to the successor trustee potentially saving time, headaches and money during what is usually a difficult period for families.
- 2. Avoidance of probate.** Assets held in a revocable trust generally are not subject to the probate process. Typically, only assets held in the individual name of the deceased are subject to probate.

- 3. Preservation of exclusion amounts.** Revocable trusts are often drafted to preserve the exclusion amount of the first spouse to pass. The exclusion amount is the asset value each individual can protect from estate taxes and is currently \$5,000,000.

Under existing tax law, there is “portability” of unused exclusion amounts from the first deceased spouse to the surviving spouse. At first blush, this may be incentive for families to delay planning and not use revocable trusts. However, for families with more than \$5,000,000 in total assets, effective exclusion amount planning using revocable trusts can provide significant long-term benefits—benefits which can be lost if a family relies solely on portability.

- 4. Thoughtful distribution rules for survivors.** Revocable trusts are often drafted to provide thoughtful disposition rules for surviving spouses and/or children once the grantor has passed.
- 5. Creditor protection for surviving spouse and children.** Assets that remain in the trust after a grantor’s passing often times will have significant asset protection benefits for the surviving spouse and children.

What Are the Misconceptions?

Significant misconceptions exist over the use of revocable trusts, including:

- 1. Assets are not subject to estate taxes.** Generally, any asset an individual controls, or has the benefit of at death, is subject to

estate taxes in his or her estate, irrespective of title. Assets titled in a revocable trust are not exempt from estate taxes.

- 2. Creditors cannot reach a grantor’s assets held in a revocable trust.** Generally, any asset an individual controls is reachable by his or her creditors. While a grantor is alive, the revocable trust assets are administered as if they were the grantor’s; the grantor having control and access to the assets. A creditor of the grantor can reach these assets. Revocable trusts do not provide any legal protection against the grantor’s creditors.
- 3. Using a revocable trust to avoid probate is an absolute necessity.** While probate in some states is costly and burdensome, in a vast number of states there are streamlined procedures for probate administration that significantly reduce, if not eliminate, most of the headaches. However, probate avoidance should not be the leading motivator for creating a revocable trust.

Conclusion

Revocable trusts routinely serve as the backbone of most families’ estate plans. Carefully planning the terms of these documents, and fully understanding their benefits and limitations is an important part of developing an effective wealth management plan.

For more information, please contact Calamos Wealth Management at 888.857.7604.

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