

Comparing Inter Vivos And Testamentary Trusts

Creating and adhering to an estate plan is no simple task. Generally, the end goal of estate planning is to divide up and transfer assets to loved ones at a minimum or zero tax cost. Of course, a will is a good starting point, but it may be supplemented by various other estate planning techniques, including trusts.

Trusts are essentially used to accommodate asset transfers beyond dispositions in a will. There are two main types of trusts: the inter vivos trust and the testamentary trust. Let's take a closer look at each option.

Inter Vivos Trust

An inter vivos trust, sometimes called a "living trust," is created during your lifetime. The trust may be irrevocable or revocable, depending on your needs.

As the name implies, an irrevocable trust requires that you give up rights to revoke or revise the trust. For example, you can't change the beneficiaries or otherwise amend the terms. With a revocable trust, you retain the right to make changes up until the time of death.

The assets in an irrevocable trust are removed from your taxable estate, while revocable trust assets aren't. But the estate tax shelter is no longer as powerful an incentive as it used to be due to the generous federal gift and estate tax exemption. For 2023, the exemption is \$12.92 million, up from \$12.06 million in 2022.

A revocable trust gives you more flexibility in handling trust assets. For this reason, it's generally the preferred type of inter vivos trust.

Regardless of whether the trust is irrevocable or revocable, assets are titled in the name of the trust, giving the trust legal ownership. When the grantor passes away, the designated beneficiaries are granted access to the assets, which are then managed by a successor trustee, based on the trust terms.

Most notably, the trust's assets avoid probate, which can be a lengthy and costly process in some states. Also, probate is open to the public, so the inter vivos trust ensures privacy. Assets held in trust are seamlessly transferred to the intended recipients. This is usually the main benefit sought by parties creating an inter vivos trust.

Testamentary Trust

As opposed to an inter vivos trust, a testamentary trust is created when the grantor passes away. It doesn't officially become effective until the grantor's death, and at that time it becomes irrevocable.

Unlike an inter vivos trust, your estate will likely have to pass through probate before a testamentary trust begins to operate. Once the trust is created by will, the executor adheres to the terms regarding transfers to the trust.

Because the trust must go through probate, it may be problematic if you use certain assets, such as real estate or securities. This may also cause concerns if the beneficiaries need fast access to funds.

Note that the testamentary trust may be coordinated with the gift and estate tax exemption, to ensure that your estate doesn't encounter any federal estate tax problems upon the transfer of assets. This type of trust allows you to maintain control over assets until death and provide future security for your heirs.

What's The Right Trust For You?

There's no right or wrong answer to that question. The choice between an inter vivos or testamentary trust often depends on your estate planning objectives, including whether you prefer to avoid probate or to maintain control over assets. Turn to your estate planning advisor for help in creating the right trust for you.

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