Exploring Six Common Myths about Trusts

Most of us know that a trust is a useful way to safeguard financial assets for your benefit or for someone else. But the common misconceptions about trusts could cause you to bypass them entirely, or plan to use them improperly.

Myth #1: Now that Federal Law Allows a $5-Million-Plus Exemption and Includes "Portability," Estate Taxes Are No Longer a Problem

A properly written irrevocable trust can be an excellent vehicle to protect your financial assets against heavy federal and state estate taxes. Another type of trust is a revocable living trust, which is one of the most popular trusts used today.

A revocable living trust is designed to avoid the expense and public nature of the probate process. It performs the basic functions of a trust, allowing the management of assets for someone who is not capable of managing those assets themselves. A simple revocable living trust, however, does not save estate taxes, although it may defer estate taxes upon the death of the first spouse.

Note: Even though the federal estate tax exemption is expected to rise to $11.2 million for 2018 (up from $5.49 million in 2017) many states still have estate taxes with much lower thresholds. Please talk with your estate planning advisor about your situation.

Myth #2: The Only Purpose of a Trust is to Save Estate Taxes

A trust can be used to safeguard assets from estate taxes, but that is not its only purpose. The primary purpose of a trust is to manage assets and control their distribution. Some trusts can also save income taxes, in addition to estate taxes.

For example, you might want an irrevocable trust to help protect you from the cost of care if you need a nursing home or home health care in a state with community Medicaid.

Another example: With an irrevocable charitable remainder trust, you can fulfill philanthropic desires. In this case, the donor places assets into the trust that may qualify for an income tax deduction.

By placing the assets into an irrevocable trust, they are removed from the estate and save estate taxes. The charitable remainder trust pays income to the donor and upon the donor's death, the assets pass to charity.

Yet another type of trust is used when someone remarries and they want to ensure that, at their death, their assets pass directly to their children rather than to the children of their new spouse's prior marriage.

Myth #3: You Have a Small Estate So You Don't Need a Trust

Your estate may be larger than you realize. Factor in the value of your retirement plans, life insurance, and your home. Your estate could be large enough to be subject to substantial estate taxes, causing you to benefit greatly from the estate tax shelter provided by a trust.

Another situation where you may benefit from a trust is with a special needs trust. An example would be a family with a disabled adult child who receives government assistance for basic living and medical expenses. A special needs trust would allow friends and family to donate money directly to the trust, which then uses the money to provide extras for the child, such as trips to visit relatives, clothes, or entertainment. In this way, the trust can provide for the child without jeopardizing government assistance.

Myth #4: If You Create a Trust, You Lose Control

If an irrevocable trust is created, you generally lose control. However, revocable living trusts remain under the control of the trust creator. There are also some irrevocable Medicaid trusts that may allow you some control.

There are types of trusts that offer flexibility. Depending on state law, an incentive based trust may stipulate that the beneficiary graduate from college or attain a certain age before becoming eligible to receive trust income or assets.

Myth #5: Family Knows Best

A trust will manage and distribute your assets, so it may be better not to have a family member or a friend in charge. Assets must be managed according to the specific requirements of the trust. Failure to administer the trust properly can cause loss of assets or the tax advantages of a trust.

Consider professional management, either as a sole or co-trustee, to ensure the trust is being followed and utilized to its fullest advantage. Your attorney or estate planning advisor can help you decide the best option for a trustee (or trustees).

Myth #6: A Trust Will Keep Creditors at Bay

Some trusts are designed to protect your assets from creditors. This is a very complicated area of the law and should be left to your attorney. Trusts established to protect assets generally do not protect those assets from an event that occurred prior to the trust being established.

Trusts can be an integral part of planning for your financial future. It is important to discuss your specific financial situation and the relevant trust options with an attorney specializing in estate planning or another financial professional. With their assistance, you can build a complete financial portfolio while protecting and managing your assets.

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