

Revocable Trusts – Separating Fact from Fiction

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You've finally decided to meet with a lawyer to create an estate plan, and you're thinking about whether you should create a trust. Or perhaps you already have your estate plan in place and its cornerstone is a revocable trust. Revocable trusts are a very common and effective estate planning tool – but can you separate trust fact from fiction? This snapshot will highlight some of the most common misconceptions about revocable trusts.

Myth #1: There's a difference between a “revocable trust” and a “revocable living trust”. (Answer: False)

Facts: When a person (or persons) creates a trust during his or her lifetime and retains the power to revoke or amend the trust at any time, the trust is a revocable trust. A revocable trust may be known by many different names, including: revocable trust, living trust, revocable living trust or inter vivos trust, or a trust may not include any of these words in the title, but still be a revocable trust. More important than the name are the terms of the trust – and the critical terms that set revocable trusts apart from other types of trusts are the powers to revoke or amend. Contrast this with an irrevocable trust (a trust not intended to be easily revoked or amended) or a testamentary trust which is created under a last will & testament at death and not established until death.

Myth #2: If I transfer my assets to a revocable trust, I lose control of those assets. (Answer: False)

Facts: If you transfer your assets to a revocable trust, you retain control over those assets so long as you are the trustee of your trust or have the power to revoke the trust and retrieve the assets. [In contrast, if you transfer your assets to an irrevocable trust, you generally do lose control over those assets.]

Myth #3: If I transfer my assets to a revocable trust, they will be protected from creditors. (Answer: False)

Facts: If you transfer your assets to a revocable trust, you retain control over those assets (see Myth #2, above) and, as a result, **assets held in a revocable trust receive no protection from your creditors**. There are certain types of irrevocable trusts that may be created under the laws of certain

states that do provide protection from creditors – but even those types of irrevocable “asset-protection” trusts may not protect the assets from creditors whose claims arise before the creation of the asset-protection trust. This is a very specialized area of the law, and you should consult with your estate-planning attorney to discuss further. Note, however, that it is common for revocable trusts to direct assets into subtrusts or separate trusts which are created under the revocable trust upon the trust creator’s death. When this type of subtrust is created under a person’s revocable trust, the subtrust is actually an irrevocable trust that comes into existence at the trust creator’s death and, depending on how such a trust is drafted, assets held in it may be protected from the creditors of the beneficiary for whom it was created.

Myth #4: Once my revocable trust is created, there will be no need for probate after my death. (Answer: It Depends)

Facts: Creation of your revocable trust is only the first step to avoiding probate. In order to be sure that property is held in your trust at your death without a probate proceeding, your assets must be transferred to the trust during your lifetime, or directed to the trust by beneficiary designation or other transfer mechanism at death. There are a few different ways to accomplish the funding of assets into your trust. In Wisconsin, married couples who sign a marital property agreement that includes a “non-probate transfer” provision (sometimes known as a “Washington Will provision”) are taking advantage of a provision of Wisconsin law that allows for the transfer of property at death without the need for probate. This does not apply to real estate owned in a state other than Wisconsin and will not govern life insurance or retirement accounts with a proper beneficiary designation. If you do not have a marital property agreement with such a non-probate transfer provision, or if you are a single person in Wisconsin (or any other state), then to be certain that your trust will own the property at your death you will need to either re-title your assets into your trust, or execute beneficiary designations, “transfer-on-death” designations or “payable-on-death” designations for your accounts, real estate, and other assets naming the trust as beneficiary. Of course, there are other ways to transfer property directly to individuals in a way that avoids probate, including establishing joint accounts, and designating individuals as beneficiaries, but these bypass your trust provisions.

Myth #5: If I have a revocable trust, I don’t need a will. (Answer: False)

Facts: Even with a revocable trust, a complete estate plan should include a Will. When used in conjunction with a revocable trust, the Will is often a “pour-over” Will. This type of Will directs that any assets governed by the probate court process at death (because you did not move the asset to the trust during your lifetime and there was no effective beneficiary designation transferring the asset at your death – see Myth #4, above) be transferred (or “poured over”) into your revocable trust so that the assets can be administered through the trust document as intended. The person responsible for that process is called a personal representative, and the Will is the document in which you nominate that person. In addition, in Wisconsin, a Will is the document in which you nominate a guardian for any minor children. This is a completely separate process from the administration of your trust or estate and cannot be handled outside of court. Finally, in the event that there is any type of court proceeding or court action at death, the only individuals who can represent a decedent are personal representatives so it is extremely important that they be nominated in a Will.

Myth #6: Trusts are only for the wealthy, or are only useful to avoid estate tax – and since the estate tax exemption is so high, I don’t need a trust. (Answer: False)

Facts: First, the creation of an estate plan that has a revocable trust as its cornerstone is not necessarily more expensive than the creation of an estate plan with a “simple will”. In either case, the relevant provisions regarding distribution of your assets after your death must be drafted and included in the document.

There are a number of good reasons to create a revocable trust beyond estate tax planning, including avoidance of probate (see Myth #4, above), providing a seamless mechanism for managing your affairs during your lifetime if you should become unable to manage them yourself and providing for the management of property, including creditor protection and divorce protection for future generations. In addition, the terms of a revocable trust are confidential. These reasons apply whether you have assets in excess of the high federal estate tax exemption (see sidebar: Estate and Gift Tax Exclusions and Exemptions) or not.

Estate and Gift Tax Exclusions and Exemptions.

2022 Gift tax exclusion. The amount that can be transferred to any individual without any gift tax consequence, including the use of any of your lifetime exemption, has been raised from \$15,000 to \$16,000 for the year 2022. Remember this is the gift tax annual exclusion for present interest gifts only. The exclusion will not apply to a gift of a future interest, so only some gifts to trusts qualify for the exclusion.

Estate/Gift Tax Exemption. For 2021, the lifetime exemption for both gift and estate taxes was \$11.7 million for an individual, or \$23.4 million for a married couple. For 2022, an inflation adjustment has raised it to \$12,060,000 million per individual, or \$24,120,000 million per couple. Remember, the increased exemption is to expire on December 31, 2025, when it reverts to pre-Tax Cuts and Jobs Act levels, with an inflation adjustment, may be expected to be \$6,600,000 per person, or \$13,200,000 for a married couple.

FDIC Insurance for Trust Accounts

On January 21, 2022, the FDIC approved changes to the deposit insurance rules for trust accounts, POD (pay on death) accounts, irrevocable trust accounts, and mortgage servicing accounts. These changes take effect on April 1, 2024. The new rule is intended to establish a simple, consistent formula for calculating deposit insurance coverage for all revocable and irrevocable trust accounts. A deposit owner’s trust deposits will be insured in an amount up to \$250,000 per beneficiary, not to exceed five beneficiaries, regardless of whether a trust is revocable or irrevocable, and regardless of contingencies or the allocation of funds among the beneficiaries. So, if you have a revocable trust and, at your death, the trust is to divide for your three children, then the trust account would be insured for up to \$750,000. The final rule provides a maximum amount of deposit insurance coverage of \$1,250,000 per owner, per insured. Remember, the FDIC protection only covers checking accounts, savings accounts, money market deposit accounts, certificates of deposit and certain retirement accounts. It does not cover mutual funds or other investment vehicles.

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