



Irrevocable Trusts Demystified

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What We'll Cover Today

- What irrevocable trusts are — and what they aren't
- Pros and cons of using irrevocable trusts in your planning
- Understanding the tradeoffs of giving up control
- Trustee role and responsibilities, including Crummey notices and annual gifting
- Common pitfalls and costly mistakes to avoid
- Q&A session at the end

SECTION 1

What Are Irrevocable Trusts?

What Is an Irrevocable Trust?

- A trust that is created by one or more people for the benefit of one or more people. The creators cannot be the beneficiaries. Once created and funded, the trust generally cannot be amended, modified, or revoked by the grantor without consent of the beneficiaries. Created during life or at death.
- The Grantor transfers ownership of assets to the trust via gift or sale — those assets are no longer part of the grantor's personal estate.
- Managed by a trustee which may be an individual or a corporate trustee.
- Unlike a revocable living trust, the grantor cannot serve as trustee or retain control over the assets because otherwise they have not truly given away the assets.
- Common types include Intentionally Defective Irrevocable Trusts (IDITS), Irrevocable Life Insurance Trusts (ILITs), Special Needs Trusts, Charitable Remainder Trusts, SLATs, and GRATs

Revocable vs. Irrevocable Trusts

Revocable Living Trust

- Can be changed, amended, or revoked at any time during your lifetime
- You typically serve as your own trustee and retain full control
- Assets remain in your taxable estate
- Does not protect assets from creditors during your lifetime
- Becomes irrevocable at your death or permanent incapacity

Irrevocable Trust

- Generally cannot be changed once established — the grantor gives up control
- Grantor/Creator of the Trust cannot serve as Trustee
- Assets are removed from the Grantor's taxable estate
- Provides strong asset protection from creditors (if properly structured)

Format Of Irrevocable Trusts and Transfers

Revocable Family
Trust or Individual

Transfer

Irrevocable Trust



SECTION 2

Pros, Cons & Tradeoffs

Pros & Cons of Irrevocable Trusts

Advantages

- Removes assets from Grantor's taxable estate — can significantly reduce estate tax exposure. Appreciation transferred to beneficiary.
- Strong creditor protection — assets are generally beyond reach of the beneficiary's personal creditors.
- Life insurance proceeds pass estate-tax free when held in an ILIT.
- Preserves eligibility for government benefit programs (Medi-Cal, SSI).
- Provides for a special needs beneficiary without disqualifying their benefits.
- Enables charitable giving strategies with potential income tax deductions.
- Allows Grantor to direct terms of asset use and distribution beyond life of initial beneficiary.

Disadvantages

- Loss of direct control — Grantor cannot freely change the terms, take back the assets, manage the assets.
- Inflexibility — life circumstances change, but the trust terms may not.
- Requires careful, ongoing administration; errors can create serious legal exposure – Notices, tax filing.
- No Basis Adjustment: Irrevocable Trust takes property at the basis the Grantor had.
- Potential gift tax consequences of funding trust.
- Cost and complexity of professional drafting and ongoing management – trustee fees, annual tax return
- Higher tax rates. Irrevocable Trusts reach their highest income tax rates at \$16,000 of annual income.

Understanding the Tradeoff: Giving Up Control

- The loss of control is not a bug — it’s the feature: the asset protection and tax benefits only work because the Grantor has genuinely given up ownership and control. The Grantor no longer owns the assets thus the assets are not taxed at his or her death and escape creditors.
- The IRS scrutinizes retained powers carefully — if you retain too much control, the trust assets may be pulled back into your taxable estate.
 - Power of Substitution: Grantor retains right to swap trust assets by substituting them for property of equivalent value.
 - Limited Power of Appointment: Grantor retains power to dictate how trust assets are distributed among a defined class of beneficiaries (children, grandchildren)
 - Power to Add Charitable Beneficiaries: Grantor may add a 501©(3) charity as beneficiary
- Before creating an irrevocable trust, ask: “Will I ever need access to these assets?” If yes, pause — there may be better planning tools available.
- Irrevocable trusts work best when your financial situation is stable, your planning goals are clear, and you are working with qualified legal counsel.

Intentionally Defective Grantor Trust (IDGT)

An Irrevocable Trust, created during life, that allows the creator of the trust to transfer assets from his or her estate while purposely treating those same assets as the Grantor's for income tax purposes.

- Estate/Gift Taxes: The gift or sale of the asset to the irrevocable trust leaves your taxable estate thus freezing the assets value for estate tax calculations. Future growth of asset is outside Grantor's estate for estate tax purposes.
- Income Taxes: While alive, the Grantor agrees to be personally responsible for the income tax on the assets in the irrevocable trust even though he or she does not get that income. Payment of the income tax is a tax free gift to the beneficiaries.
- Example: Jan owns 100% interest in XYZ Corp. worth \$1m. She gifts 49% of the stock to an IDGT fbo Max.
 - Gift/Estate Tax: 49% of stock is valued. It would not be valued at \$490,000 because it is a minority interest presumably with lack of marketability and lack of control. Appraisal discounted 15-30%. Value gifted = \$343,000-\$416,500 depending on discounted amount. Jan files gift tax return and the amount of her estate tax exemption is reduced by gifted amount.
 - Income Tax: If income is distributed or earned by the trust, Jan pays the income tax. The assets of trust are not reduced and can continue to grow outside of both Jan and Max's taxable estates. Trust takes assets at the Grantor's tax basis so when sold, there will be capital gain based on the reduced valuation.
 - Appreciation: If company is valued at \$2m when Jan dies, the 49% is \$980,000 which was gifted for \$343,000-\$416,000

Additional Types of Irrevocable Trusts

- **Dynasty Trust:** Irrevocable Trust set up by a person when gifting assets at their death. Provides for beneficiary per terms of trust instead of giving asset outright to beneficiary.
- **Irrevocable Life Insurance Trust (ILIT):** Holds a life insurance policy outside the taxable estate. Owner of policy is trust. At death of insured, the benefit passes estate-tax free to beneficiaries. If life insurance is owned by the insured, the value is included in estate for estate tax purposes.
- **Special Needs Trust (SNT):** provides for a disabled beneficiary without disqualifying them from SSI, Medi-Cal, or other government benefit programs
- **SLAT:** an irrevocable trust created by one spouse for the benefit of the other spouse. This provides asset protection but risks no basis step up at death and problems upon death of one spouse or divorce.
- **Charitable Lead/Remainder Trusts:** provides for a continuous stream of income to one or more charities for a set period (lead or remainder). Outside that set period, heirs receive the benefit. Allows for charitable contribution which minimizes gift and estate taxes.

SECTION 3

Trustee Role & Responsibilities

The Trustee's Role

- Fiduciary duty — The trustee must act solely in the best interests of the beneficiaries, not their own
- Prudent investor standard — Invest and manage trust assets with reasonable care, skill, and caution. The Trust can be drafted to waive prudent investor rule and allow one asset in case of a closely held business interest.
- Duty to inform — Keep beneficiaries reasonably informed about the trust and its administration.
- Record-keeping — Maintain accurate records of all transactions, income, and distributions.
- Tax filings — Irrevocable trusts have their own tax ID (EIN) and typically must file annual returns (Form 1041/541).
- Impartiality — Balance the interests of current income beneficiaries and remainder beneficiaries.

Crummey Notices & Annual Gifting

What Is a Crummey Notice?

- Named after *Crummey v. Commissioner* (1968) — a required written notice sent to ILIT beneficiaries when a gift is made to the trust.
- To qualify for the annual gift tax exclusion (\$19,000/person in 2026), each beneficiary must have a temporary right to withdraw the gift.
- The withdrawal window typically lasts 30–60 days, after which the trustee uses the funds to pay the life insurance premium/invest assets.
- If Crummey notices are not sent — or not properly documented — the IRS can disallow the annual exclusion and assess gift tax.

Annual Gifting Procedure

- Grantor makes annual gift to the ILIT (up to \$19,000 per beneficiary for 2026).
- Trustee sends written Crummey notice to each beneficiary informing them of their withdrawal right.
- Beneficiary's withdrawal window opens (typically 30–60 days) and then closes without exercise.
- Trustee uses the gift to pay the life insurance premium on time or add assets to trust.
- Trustee retains copies of all notices and documentation in case of IRS audit.

SECTION 4

Common Pitfalls & Costly Mistakes

Common Pitfalls to Avoid

- Retaining too much control — If the grantor retains certain powers, the IRS may pull the assets back into the taxable estate.
- Transferring the wrong assets — Appreciated assets may trigger capital gains issues.
- Skipping or losing Crummey notices — Failure to document the notice process can cost you the annual gift tax exclusion.
- Poor trustee selection — Choosing an unqualified or conflicted trustee creates legal and administrative liability.
- Failing to coordinate with the rest of your estate plan — Beneficiary designations, titled assets, and your revocable trust must all align.

Is an Irrevocable Trust Right for You?

Consider It If...

- Your estate may be subject to federal or state estate tax (CA has no estate tax).
- You want to hold a life insurance policy outside your taxable estate to avoid inclusion in your estate at death.
- You have a disabled child or family member who needs long-term financial support.
- You are concerned about future creditors or professional liability exposure.
- You want to stop estate taxes at every generation.
- You want to make a meaningful charitable gift while receiving an income stream.

Probably Not If...

- You may need access to these assets in the future.
- Your estate is well below estate tax thresholds (\$15m federal) and you have no other specific planning goal. However, you may choose to leave your assets at death in irrevocable trusts.
- Your financial situation is uncertain or likely to change significantly.
- You haven't yet established a solid revocable living trust as the foundation of your plan.
- You don't have qualified legal counsel — DIY irrevocable trusts are a common source of serious errors.

Questions?

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Date: July 15, 2026 Pacific

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Presenter



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Paula manages MRC's Estate Planning practice with more than 27 years of experience. She is a Certified Specialist in Estate Planning, Probate, and Trust Law as designated by the State Bar of California Board of Legal Specialization and holds an LL.M. in Taxation.

Paula is married with a daughter, two stepsons, and a cocker spaniel named Lucy. When not planning estates, Paula spends her time between California and Colorado enjoying the outdoors with her family.

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