Knox McLaughlin Gornall & Sennett, P.C.
Erie • Pittsburgh • Jamestown, NY
814-459-2800 • www.kmgslaw.com

What Are the Advantages of Owning Inherited Assets in an Irrevocable Trust?

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For individuals navigating estate planning and wealth preservation, irrevocable trusts offer a powerful and strategic vehicle for protecting inherited assets, minimizing death taxes and, to some extent, income taxes, and ensuring generational continuity. A particularly beneficial structure involves placing inherited assets into an irrevocable trust that includes two critical provisions: a step-up in basis and a contingency plan for asset distribution upon the death of the primary beneficiary. These components work in tandem to maximize the value of the assets while safeguarding long-term family interests.

What Is an Irrevocable Trust?

An irrevocable trust is a legal arrangement in which a grantor (sometimes referred to as a settlor) transfers assets to a trustee (whether during lifetime or upon death, or a combination of both), relinquishing all control and ownership to the assets. Unlike revocable trusts, these trusts generally cannot be altered or terminated without the consent of the trust beneficiaries. This lack of control by the grantor and the beneficiaries over the trust assets is what allows the trust to provide asset protection, tax advantages, and estate planning benefits.

Advantages of Owning Inherited Assets in an Irrevocable Trust

Owning inherited assets in an irrevocable trust offers asset protection advantages. Assets in an irrevocable trust are outside of the beneficiary's personal taxable estate (subject to step-up provisions) and protected from most potential creditors, private lawsuits, divorce, and more. Properly drafted irrevocable trusts may (if appropriate) also preserve step-up in basis upon the primary beneficiary's death. Finally, owning inherited assets in an irrevocable trust helps ensure controlled and strategic distribution of the trust income and principal to beneficiaries.

The Step-Up in Basis

One of the most significant tax benefits associated with inherited assets is the step-up in basis. When someone inherits an asset, such as real estate, stocks, or a business, the asset's cost basis is "stepped up" to its fair market value at the time of the decedent's death.

Why this matters:

- If the beneficiary sells the asset immediately after inheriting it, there is little or no capital gains tax due.
- This dramatically reduces the potential income tax liability of the person who inherited the asset compared to a person who received the asset as a gift during the grantor's lifetime. When an asset is gifted during the lifetime of a grantor, the asset retains the original cost basis.

Applying the Step-Up in an Irrevocable Trust

Typically, assets held in a revocable trust or owned outright by a decedent receive a step-up in basis at the time of the decedent's death. However, with careful trust design, certain irrevocable trusts can also achieve an additional step-up in basis at the time of the primary beneficiary's death. This is most commonly accomplished by including a carefully drafted general power of appointment in the trust for the primary beneficiary (when appropriate under the circumstances).

Properly structured, this allows the trust assets to qualify for a step-up in basis upon the death of the primary beneficiary, preserving the asset's full value for future generations.

Long-Term Planning for Successive Beneficiaries

An often-overlooked benefit of irrevocable trusts is the ability to specify how assets are distributed upon the death of the primary beneficiary. Owning assets in the name of an irrevocable trust gives an opportunity for the family wealth to be retained and managed responsibly across generations.

This provision is critical because:

- It prevents forced asset liquidation or disputes among heirs (in most circumstances).
- The grantor can designate alternate trust beneficiaries, such as grandchildren, charities, or a secondary trust.
- The assets can continue to be held in trust for asset protection and to minimize estate taxes for future beneficiaries.

Additionally, trust creators can include spendthrift clauses to protect future beneficiaries from most creditors, divorce settlements, or poor financial decisions.

The Importance of a Unified Estate Planning Strategy

Combining the step-up in basis with clear provisions for asset succession creates a comprehensive estate planning strategy. This approach:

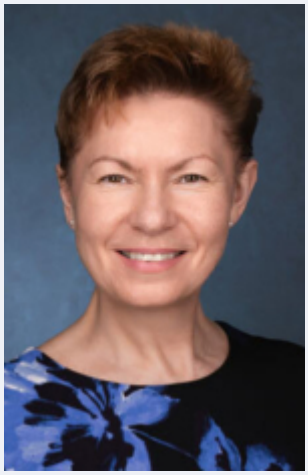
- **Minimizes Capital Gains Taxes:** Through the step-up in basis at the time of death.
- **Preserves Wealth**: Assets remain in trust and are managed according to the grantor's wishes.
- **Avoids Probate**: Assets held in trust bypass the probate process.
- **Offers Creditor Protection:** Particularly valuable if future beneficiaries face divorce, litigation, or bankruptcy.
- **Ensures Multigenerational Planning:** Establishes a clear pathway for asset distribution across generations.

Work With an Experienced Trust Attorney

Using an irrevocable trust to hold inherited assets, when properly structured to include a step-up in basis and succession provisions, can be one of the most powerful tools for legacy building and tax efficiency. However, these benefits require careful legal drafting and coordination with financial professionals. Trusts are not one-size-fits-all instruments, and the tax implications can vary based on individual circumstances and local or state laws.

Before creating or modifying any trust, consult an experienced estate planning attorney and tax advisor to ensure that your intentions are carried out with maximum benefit and minimal unintended consequences.

Knox Law's estate planning team has significant experience using trusts, including irrevocable trusts, to achieve our clients' asset protection and legacy goals. We are geographically located in Pennsylvania; however, we can help clients throughout the United States. Contact us to schedule a complimentary consultation and learn more.



Nadia A. Havard

Nadia A. Havard concentrates her practice in all areas of qualified and nonqualified retirement plans and employee benefits; transfer taxes; fiduciary income tax and trust administration; business; as well as estate planning and administration. She also helps nonprofits obtain and maintain their tax-exempt status.

nhavard@kmgslaw.com

814-459-2800



Thomas C. Hoffman, II

Thomas C. Hoffman II concentrates his practice on closely held business planning, business succession planning, implementation of sophisticated estate and trust planning, administration of complex estates and trusts, and the tax consequences of these matters.

thoffman@kmgslaw.com

814-459-2800

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