What is a Trust?

A trust is part of the process of estate planning, which involves deciding how a person wants his or her assets distributed after they die.

Basically, a trust is a legal arrangement in which you transfer the legal title to certain property (cash, investment accounts, real estate, etc.) to a person (the "trustee") who agrees to hold that property for the benefit of a third person (the "beneficiary") according to the terms of the trust document. Trusts also can help minimize gift and estate taxes.

A trust does not replace a will. Usually, Trusts deal only with specific assets, such as life insurance or a piece of property. A Will deals with distribution of nearly everything else in an estate.

3 Basic types of Trusts

Testamentary Trust: A testamentary trust doesn't take effect until after the person is deceased. It must go through probate before the trust is established. The funds entering into this type of trust are taxed according to the current estate tax law.

Revocable Trust: With a revocable trust, the person retains control of all the assets in the trust, and can revoke or change the terms of the trust at any time. (Also known as a "Living Trust")

Irrevocable Trusts: Irrevocable trusts typically can't be changed without the beneficiary's consent. But the appreciated assets in the trust aren't subject to estate taxes. (Usually used for Medicaid planning or tax planning purposes)

Each type of trust has advantages and disadvantages. A trust is a legal entity, so you must follow state rules to ensure that the trust is set up correctly.