

# When Should You Consider a Revocable Trust?

Written by Nicole Drury and Stephanie Vitti

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Brain Teaser of the Month: What is the northernmost capital city in the world?

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Trusts are a hot topic. We've noticed that above a certain asset level, there is a sense that one "needs a trust" or "should have things in trust." There are certainly cases when establishing a living trust can be beneficial. We explore some ideas around revocable trusts below.

## What is a Revocable Trust?

In this article, we intend to discuss revocable trusts, sometimes called "living trusts." These are not the same as irrevocable trusts, which are used when gifting assets. Those are called "irrevocable" because they are irreversible (the gift cannot be taken back).

In contrast, a revocable trust is not gifted at all. In a revocable trust, the assets are yours to use as you please throughout your life. As such, you can be both the grantor and trustee of your own revocable trust.

To understand one reason why revocable trusts are used, we must first discuss the concept of probate.

## Probate

Probate is the legal process that occurs after death. When someone dies in the United States, as a general matter, their last will and testament will be submitted to the probate court. The probate court will determine if the will is valid and then admit the will to probate and name an executor or personal representative to supervise the distribution of assets<sup>1</sup>.

The purpose of probate is to ensure that the decedent's wishes are respected and to appoint an executor or personal representative. There are several drawbacks to probate:

1. Probate takes time – in some counties, the process could take months or even years if the estate is complex.
2. Probate is not private – court proceedings are open to the public.
3. Probate can be expensive – there can be court costs, as well as attorney costs if an attorney is helping you through this process.

What do you accomplish by having a revocable trust? The assets within a revocable trust avoid probate altogether.

A revocable trust is often referred to as a “will substitute.” If you have a revocable trust and if you have titled all asset that you own in the name of the revocable trust, then your will does not have to be probated. Your assets will be distributed in accordance with the terms of the revocable trust by your successor trustee. A revocable trust can be faster, it's private, and it avoids the cost of probate.

There are other types of assets that avoid probate<sup>2</sup>. For example, retirement accounts such as IRAs, SEP IRAs and 401(k)s will avoid probate because they will pass directly to the named beneficiaries on those accounts. Joint accounts titled as “Joint with Rights of Survivorship” will also avoid probate and pass directly to the surviving joint owner. Many married couples have accounts with joint titling for this reason. Life insurance and annuities also pass to directly to the named beneficiaries on the policy.

## Advantages of a Revocable Trust

As mentioned above, one advantage of the revocable trust is avoiding probate.

Does everyone need to avoid probate? Probably not. There are plenty of estates that are small, with assets that can easily be distributed to heirs.

There are a few times when you might look to avoid the probate process:

- If you think someone will contest your will – A will can be contested in court. A living trust is harder to challenge and would require much more effort from those looking to initiate a dispute. If you are in a situation where you think someone will contest your will, you might consider establishing a trust. One example would be if you plan to leave a lot of money to friends, instead of family. The family may decide to fight this in probate and claim the friend had undue influence on you.
- You are planning to leave money in a non-traditional way – For example, you leave nothing to your children and everything to charity.
- You live in a state where probate is expensive or time-consuming – In certain states, the cost of probate is calculated as a percentage of the estate. You should be aware of the cost of probate in

your area. An estate attorney can give you a sense of how long the courts typically take in your county.

- You have assets in more than one state – If you own a home in another state, your heirs may need to go through probate in another state<sup>3</sup>. For example, New York courts do not have authority to administer assets in another state. If you live in New York but own a home in Florida, your heirs will have to conduct an ancillary probate in Florida.
- You want your estate details to remain private – Probate proceedings are part of the public record. Assets in a living trust are private.

Another advantage of a revocable trust is that it can protect you in the case of incapacity. You can name a successor trustee in your trust document to take control of your trust if you become incapable of handling your financial affairs in the future. Having a trust means that someone can take over long before you are deceased, since a will only goes into effect at death.

Note that you do not need separate trusts for your assets. Multiple assets and multiple properties can all be placed in the same revocable trust. However, you must transfer title of all of your assets to the revocable trust and the failure to transfer title of any asset will mean that the asset not transferred to the trust must go through the probate process. It should also be noted that there will generally be a cost associated with transferring title of assets to your revocable trust.

## Disadvantages of a Revocable Trust

First, there is an upfront cost to establishing a trust. If you visit an estate attorney, you will notice that a will is less expensive to draft than a trust. Of course, the cost may be worth it to avoid the legal fees on the back end (during the probate process). You will have to decide what works best for you and your family.

The other downside is that you will need to take time upfront to actually retitle all of your eligible assets into the trust. This includes retitling bank accounts, investment accounts, deeds to your properties, etc. This can be a time-consuming process. If you are retitling real estate, you will need to also check with your mortgage provider since you are technically changing the ownership of the asset that serves as collateral. Many mortgage providers will allow this, but it must be checked before you move forward.

There are two misconceptions regarding revocable trusts. First, a revocable trust does not avoid estate tax. All assets in a revocable trust are considered to be part of your taxable estate.

Another misconception is that a revocable trust protects against creditors. This is not the case, so if you have an investment property that you rent out, you might want to consider owning that property in an LLC instead of a revocable trust.

## An Alternative to a Revocable Trust – “Transfer on Death”

We feel it’s important to mention another way to avoid probate that does not involve a living trust. By retitling accounts as “transfer on death (TOD)” or “payable upon death (POD),” you can name beneficiaries (similar to how beneficiaries are named on an IRA). These accounts will avoid probate and pass directly to the named beneficiaries<sup>4</sup>. You can do this with investments accounts and bank accounts, and it’s typically as easy as signing one form.

Please reach out to us if you’d like to explore TOD titling on your Morgan Stanley accounts. This can be a great option for estate planning if (i) your estate will not be subject to any state or federal estate tax and (ii) you don’t own real estate and your estate consists of only securities and cash.

Note that any asset with a named beneficiary – such as an IRA or TOD account – will supersede your will. Your will only governs assets that go through the probate process, and IRA and TOD accounts do not go through probate. For this reason, you should make sure your named beneficiaries are up-to-date and reflect your current wishes.

If you have any questions or would like to discuss, please feel free reach to out to us.



Names from Left to Right are: Stephanie, Ryan, David, Linda, Evan, Nicole, Marybelle, Michael, Dave, Melanie

HLS Wealth Management at Morgan Stanley  
1290 Avenue of the Americas  
12<sup>th</sup> Floor  
New York, NY 10104

Evan Semegran  
Managing Director, Wealth Management  
Financial Advisor  
212-492-6324, [evan.m.semegran@ms.com](mailto:evan.m.semegran@ms.com)

David Glickstein  
Executive Director, Wealth Management  
Financial Advisor  
212-492-6792, [david.b.glickstein@ms.com](mailto:david.b.glickstein@ms.com)

Michael H Bertelle  
Assistant Vice President  
Investment Consultant      Group Director 212-492-6305, [michael.bertelle@ms.com](mailto:michael.bertelle@ms.com)      212-492-6754,  
[melanie.burnett@ms.com](mailto:melanie.burnett@ms.com)

David Bent  
Registered Associate  
212-492-6734, [dave.bent@ms.com](mailto:dave.bent@ms.com)

Ryan Dorian  
Registered Client Service Associate  
212-492-6972, [ryan.dorian@ms.com](mailto:ryan.dorian@ms.com)

Nicole Drury  
Executive Director, Wealth Management  
Financial Advisor  
212-492-6323, [nicole.drury@ms.com](mailto:nicole.drury@ms.com)

Stephanie Vitti  
First Vice President  
Financial Advisor  
212-468-4526, [stephanie.vitti@ms.com](mailto:stephanie.vitti@ms.com)

Melanie Burnett  
First Vice President

Linda Zheng  
Wealth Management Associate  
212-551-7225, [linda.zheng@ms.com](mailto:linda.zheng@ms.com)

Marybelle Santiago  
Senior Client Service Associate  
212-492-6911, [marybelle.santiago@ms.com](mailto:marybelle.santiago@ms.com)

## Brain Teaser of the Month Answer – Reykjavik, Iceland

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### Sources:

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2. [Understanding Which Assets Must Go Through Probate](#) – agingcare.com
3. [Where to File Probate - What You Need to Know](#) – trustandwill.com
4. [Understanding Which Assets Must Go Through Probate](#) – agingcare.com

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