BUSINESS GUIDE SERIES:

TESTAMENTARY TRUSTS

ADVANTAGES OF TESTAMENTARY TRUSTS

Taxation Benefits

Under current tax laws, income distributed from testamentary trusts to children or grandchildren under the age of eighteen will be taxed at normal individual tax rates. The current tax free threshold is significantly higher than the tax free threshold where distributions are made to children or grandchildren under family trusts. Where there are several children or grandchildren, the tax relief can be significant, particularly where there are a number of years until they attain the age of eighteen. Any capital gains realised on assets held by a testamentary trust can also be streamed to beneficiaries in a tax effective manner. Tax laws may, of course, change over time.

Creditor Protection

If a child or other beneficiary is experiencing solvency difficulties or is already bankrupt at the time of a distribution under a normal Will, it is possible that the distribution may end up in the hands of creditors rather than being used for the intended benefit of the beneficiary. This need not be the case where a testamentary trust is used, as the beneficiary has no actual entitlement to a distribution until the trustee so determines. Accordingly, assets can be retained within the trust free of adverse creditor claims.

Family Law Considerations

A parent may not want a child's spouse or de facto partner to be able to claim against the family assets in the event of marriage breakdown. If testamentary trusts are used and an appropriate trustee and appointor are appointed, there can be a reduced likelihood of a child's spouse making a successful claim to assets bequeathed by the parent.

What is a Testamentary Trust?

Testamentary Trusts are discretionary trusts in Wills. The trustees of each trust can decide from time to time who will receive the benefit of the distributions from that trust for any given period.

Why incorporate a testamentary trust in a Will?

Testamentary trusts are designed to provide maximum flexibility and allow for tax-effective distribution of capital and income.
They provide a greater degree of protection for the assets than if the assets were held by the beneficiaries in their personal names. They can be validly created for up to 80 years, meaning they can benefit two to three generations with the distribution of income and assets being completely flexible.

PROTECT YOUR ASSETS NOW

Incorporating a Testamentary Trust within your Will can provide significant flexibility as well as significant asset protection and tax minimisation for those who benefit from your estate.

DISADVANTAGES OF TESTAMENTARY TRUSTS

Succession Issues

The trustee essentially controls the trust and has discretion to determine the future of the trust and its assets. The trustee can distribute all or any part of the income to one or more of the beneficiaries, at such times and in such amounts as it sees fit. As such, the succession of the role of trustee must be specifically spelt out in the Will if the individual wishes to determine who will control the trust upon the death of that trustee.

If the trust restricts access to capital or income, then a beneficiary may be upset and challenge the terms of the Will. The possibility of a challenge may be reduced by the Will-maker communicating their intentions to their beneficiaries at the time they prepare their Will. Administration of the trust may require a level of co-operation between family members who may share the role of trustee of the trust. This could lead to potential disharmony.

Administration Costs

Assets of a testamentary trust must be sufficient to justify the expense of administering the trust, for example, tax returns will need to be filed every year. The trustee may also need to meet with probate court regularly to prove that the trust is being handled in a responsible manner.

Capital Gains Tax

If the trust has capital assets that are sold at a loss, then those capital losses cannot be distributed to beneficiaries but must be carried forward in the trust and set off against future capital gains (if any).

Superannuation and Insurance Proceeds

Where testamentary trusts are used, the individual's estate can be nominated as the beneficiary of superannuation or insurance proceeds.

In this way, flexibility can be retained as to the level of distribution to respective dependants, as well as having the proceeds protected within the trusts.

Preservation of Government Benefits

Assets in a testamentary trust are not currently taken into account by Centrelink with regards to pension eligibility of a beneficiary.

However, the income distributed by the testamentary trust is taxable in the hands of the beneficiary. Care must be taken to ensure that the beneficiary's pension eligibility is not jeopardised by their inheritance which may affect their income test.

Incapacity

If a child or any other beneficiary is temporarily incapacitated, testamentary trusts will enable the assets to be managed by the nominated trustee for the benefit of that beneficiary rather than having a portion of the estate controlled by a government agency.

ASSET AND ESTATE PLANNING

A Will incorporating testamentary trusts generally will only form part of a total asset and estate plan.

The following should also be considered:

- The control of family companies and trusts following death
- Superannuation arrangements
- Business succession arrangements
- Prospective inheritances
- Enduring Powers of Attorney
- Appointment of Enduring Guardians
- Family law considerations.

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