A GENERAL ADVICE (NSW)
TESTAMENTARY TRUSTS

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What is a Testamentary trust?

As the size of estates are growing, Testamentary Trust Wills are becoming more popular. Here is a summary of the concept.

Testamentary trusts are trusts established under a Will. Rather than giving a beneficiary their inheritance “outright”, this type of Will gives them the option to take their inheritance in the form of a trust. It is an optional vehicle for inheritance which has the potential to provide important asset protection and taxation minimisation benefits.

Under the Will, separate trusts are created for each primary beneficiary. They can appoint themselves as the trustee of their trust and make distributions from the trust in their sole discretion, as they see fit.

If the primary beneficiary has not reached your nominated age (usually 18 or 21) or have been disqualified from acting as a trustee (see **Asset Protection** below), your executors appoint an alternative trustee, during that time.

The beneficiaries of each trust can include the primary beneficiary themselves, their children, their spouse, siblings, parents and other relatives, but all distributions require the consent of the primary beneficiary. If the primary beneficiary is under a legal disability or lacks capacity, their guardian or legal personal representative will have the power to consent in their behalf.

The trusts that are established, can continue after the primary beneficiary’s death. The primary beneficiary can transfer the power to nominate a replacement trustee, and the power to consent to distributions, by deed or in their Will. If no such nomination is made, the primary beneficiary’s executor Will have these powers.

After your death, when the testamentary trusts are established, an annual tax return will need to be lodged until the trust is fully distributed.

The primary beneficiary can end the trusts at any time or can choose not to use the trust structure at all. We strongly recommend that the primary beneficiary receives accounting and legal advice before making these types of decisions.

Tax Management

A primary motivation behind Testamentary trusts is often for tax minimisation purposes.

Under a simple Will, if a beneficiary earns an income from their inheritance, such as profit received from an investment, the income would be taxed at the beneficiary’s marginal tax rate, which in addition to their usual income, could be relatively high.

However, if the investment is retained in a Testamentary trust, the income that is earned can be split amongst the beneficiary’s family. This means that a spouse or children who are not working or not receiving an income, can receive an income from the Testamentary trust which would be taxed at a much lower marginal rate, keeping the overall tax liability down.

For tax reasons, a Testamentary trust Will also specifically excludes “Foreign Persons” as potential beneficiaries.

Asset Protection

Inheritances are generally assets that can be claimed upon in property settlement proceedings under the Family Law Act and can be claimed by a trustee in bankruptcy.

However, Testamentary trust Wills contain provisions that disqualify a beneficiary from acting as trustee if their relationship with their spouse breaks-down or they become insolvent. In these circumstances, a substitute trustee is appointed by your executors.

If a claim is made against the beneficiary, they can argue that they have no particular interest in the inheritance, other than to be considered as a potential beneficiary by the trustee.

The theory is that a trustee in bankruptcy Will have difficulties claiming the inheritance, because the beneficiary does not have an identifiable share.

Similarly, if a beneficiary’s relationship with their spouse or partner breaks-down, they can argue that they have no identifiable entitlement to the inheritance. This means that the funds may not form part of the beneficiary’s assets for identification within the matrimonial pool during a property settlement but are considered more generally as a “financial resource”.

Is a Testamentary trust right for you?

If you have significant assets, we recommend Testamentary trusts Wills.

If any of your children are relatively well-off and could benefit from potentially substantial tax savings, we recommend Testamentary trusts Wills.

If there are other issues of concern that a beneficiary may face in the future, such as a breakdown of their relationship or financial problems, we recommend Testamentary trusts Wills.

The costs involved in drafting a Testamentary Trust Will are often well worthwhile as a long-term investment in children’s financial security.

We recommend discussing this form of estate planning with your accountant, who can further explain the potential benefits and provide advice from their perspective.

Please do not hesitate to contact us if you have any further questions about Testamentary Trust Wills or your specific estate planning.