



## **AN INTRODUCTION...**

A Trust is a legally binding relationship between one person ('the Testator', if the trust is created by Will or 'the Settlor', if the trust is created during lifetime) who transfers assets ('the Trust Fund') to a person or groups of persons ('the Trustees') who then hold the assets for the benefit of an individual or group of individuals ('the Beneficiaries')

The Trustees must administer the Trust Fund in accordance with the powers, provisions and obligations set out in the document creating the trust, e.g. the Testator's Will or the Settlor's Trust Deed.

Generally there will also be a person nominated ('the Appointor') to oversee particular actions of the Trustees and in some cases, have the power to remove Trustees should they not be carrying out their duties in the correct manner.

The Trust Fund can consist of a wide variety of assets including land, cash, shares or even antiques that formed part of the Testator's estate.

Generally speaking, the maximum period that a Trust can run for is 80 years but within those parameters a Trust can last for any length of time as the Testator and Trustees see fit, be it during widowhood, until a child marries or a grandchild attains a certain age.

## **WHAT IS THE DIFFERENCE BETWEEN A FAMILY TRUST AND A TESTAMENTARY TRUST?**

The phrase 'Testamentary Trust' tends to be linked to the specific tax advantages that can be obtained from creating such a trust but the name itself contains no magic definition. A 'Testamentary Trust' is simply a trust that is created under the terms of a Will hence such structures are also commonly referred to as 'Will trusts'.

Unlike 'inter vivos' or lifetime trusts, a Testamentary Trust or Will Trust does not take effect until the Testator has died.

## **WHY CREATE A TESTAMENTARY TRUST?**

A Testamentary Trust creates a structure by which the Trustees can administer the Trust Fund in a flexible manner to deal with a Testator's particular circumstances.

Common reasons for establishing a Testamentary Trust include:

- controlling and protecting family wealth across the generations;
- income tax and capital gains tax efficiency;
- providing a workable, flexible framework for a Beneficiary who is either incapable of managing their own affairs or vulnerable to exploitation;
- creating a structure that allows a spouse or partner to benefit during their lifetime whilst ensuring that children (including those from a previous marriage) are financially provided for in the long term;
- creating separate Testamentary Trusts for each child or limb of the family which can then be independently managed and administered;
- postponing the entitlement of a young child or adult until they are older or have settled down in life whilst allowing money to be spent for their benefit in the meantime; and
- providing an additional layer of protection for family assets from potential risks of bankruptcy and family breakdown.

## WHAT ARE THE TAX ADVANTAGES OF A TESTAMENTARY TRUST?

It is never advisable to let pure tax considerations dominate broader estate planning considerations. However, if a Testamentary Trust is a suitable structure given your particular circumstances then there are numerous tax benefits which arise as a consequence of including a Testamentary Trust in your Will.

Such benefits include:

- income can be distributed to Beneficiaries in a way that ensures Beneficiaries (including children) with the lowest tax rates receive the highest amount of income. This is particularly useful if you a Testator is concerned with maximising the net amount of income available to the wider family, say, a surviving spouse and children of that relationship.
- for a Testamentary Trust the tax free threshold for each minor Beneficiary is \$6,000 above which the usual progressive tax rates are applied. This compares with a \$416 tax free threshold available to minor Beneficiaries of lifetime discretionary trusts above which penalty tax rates are applied.
- the different tax rates and potential tax savings are illustrated in the following tables:

Income tax rates for resident minors.		
DISTRIBUTION (\$)	UNEARNED INCOME TAX RATES (distribution from a lifetime trust)	EXEMPT TRUST INCOME (distribution from a testamentary trust)
0 - 416	Nil	Nil
417 - 1,307	66%	Nil
1,308 - 6000	45%	Nil
6001 - 35,000	45%	15%
35,001 - 80,000	45%	30%

Rates based on the tax year 2009/2010

Potential taxation benefits for a surviving spouse with three minor children			
ANNUAL TRUST INCOME	TAX Based on - distribution to surviving Spouse who has personal annual income of \$120k	TAX Based on - distribution to 3 children equally (inc. say payments for school fees)	ANNUAL TAX SAVING
\$72,000	\$28,200	\$8,100	<b>\$20,100</b>

Figures are approximate and are based on income tax rates for the tax year 2009/2010 excluding Medicare levy.

- specific income and asset types can be matched or 'streamed' to specific Beneficiaries, e.g. franked dividends go to those that would be able to get the benefit of the franking credits.
- there is no stamp duty on the creation of a Testamentary Trust.
- a Testamentary Trust structure may defer the payment of capital gains tax until assets are disposed by the Trustee or Beneficiaries.
- if charities, or other tax-exempt entities, are named as Beneficiaries then it is possible to distribute pre-tax income to such Beneficiaries.

## WHAT ARE THE DISADVANTAGES?

As with all estate planning matters, not every structure will be suitable for every person. Consideration should be given to the Testator's particular needs and circumstances.

In reviewing the options available, some of the commonly discussed disadvantages of Testamentary Trusts (and indeed trusts in general) are as follows:

- generally speaking, an estate must have income-generating assets valued in excess of \$500,000 for the taxation benefits to be significant. In determining the size of an estate the following issues should be considered:
  - jointly owned assets do **not** form part of the Testator's estate as they will pass by survivorship and not through the Testator's Will;
  - where the Testator has nominated a beneficiary under a life insurance policy, the proceeds will be paid to that person directly and will **not** form part of the Testator's estate;
  - death benefits from a superannuation fund do **not** automatically form part of the member's estate. The Trustee of the superannuation fund generally has a discretion whether to pay the benefits to the member's estate or directly to the member's dependents subject to any binding death nomination made by the member;
  - assets that are already held in a lifetime discretionary trust do **not** form part of the Testator's estate.
- the cost of establishing a Testamentary Trust is comparable with the combined cost of establishing a lifetime discretionary trust and a Will but the more complex the trust structure, the higher the initial set-up fees (which are not tax deductible).
- in addition to the initial set-up fees there will be ongoing, annual accounting together with other professional (e.g. financial advice) and compliance fees.
- if the Trustee distributes income to Beneficiaries in order to arrange the most tax effective scenario, some Beneficiaries may inherit more than the Testator would have wished simply because they are in a low tax bracket.
- complexity and formality of the structure can be a headache. For example, minutes are required for each Trustee resolution. If the Trustee is not the primary Beneficiary, a Beneficiary must ask a Trustee, if e.g. they would like a large distribution for a major purchase or almost any kind of unusual event, because they are not controlling the underlying assets.
- since changes to the Social Security rules in 2002 the whole of the assets of a trust can be counted as belonging to a Beneficiary on a pension or other social security means tested benefits.
- subject to the terms of the trust, retaining the main residence in a Testamentary Trust may result in a loss of the CGT exemption. Land Tax consequences would also need to be considered.
- as with all discretionary structures, much will depend on the decisions taken by the person in ultimate control, in this case the Trustee of the Testamentary Trust. This can be off-putting for certain Testators who prefer certainty over flexibility.

## WHAT DUTIES DO TRUSTEES HAVE?

The Trustee's responsibilities will depend on specific terms of the Will. In general the duties and obligations of a Trustee include:

- ensuring that they understand the terms of the Trust Deed or Will and act accordingly;

- acting impartially and unanimously and taking reasonable care when exercising powers;
- keeping full records of all trust assets and income/capital movements and keeping Beneficiaries suitably informed;
- notifying the ATO of relevant tax events;
- not benefiting from their position as a Trustee unless expressly allowed by the Will.

The role of Trustee is fundamental to how the Testamentary Trust is managed and administered.

The Testator should be completely satisfied that the Trustee is reliable, trustworthy and capable of carrying out their duties impartially and in the best interests of the class of Beneficiaries.

### **SHOULD I INCLUDE TESTAMENTARY TRUSTS IN MY WILL?**

As with all good advice the answer will depend on your particular needs and circumstances. Ultimately it will be a question of balancing competing interests and concerns in order to determine which structure best suits your current situation.

Whilst consideration should always be given to potential future issues and outcomes it is always advisable to structure your estate planning for the here and now with an eye on regularly reviewing those decisions and updating your estate planning as and when your circumstances change.

Invariably the key question will not be one of tax but one of control, namely, who will control your estate (including any related entities such as companies, lifetime trusts and superannuation) and how they will do it.

Once that is established you can decide how best to use those pre-existing structures to benefit your intended beneficiaries and what degree of certainty, control and flexibility you want from any structures created under your Will.

### **HOW CAN TEECE HODGSON & WARD ASSIST?**

If you require further information or advice concerning the above please contact Richard Neal, Deborah Linwood or John Maitland using the contact details provided below.

If you wish to instruct this firm you may also wish to read and complete our estate planning questionnaire which can be found at [http://teece.com.au/files/estate\\_planning\\_questionnaire.pdf](http://teece.com.au/files/estate_planning_questionnaire.pdf)

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This Information sheet is intended to provide general information about current law relating to Testamentary Trusts. It is not intended to be comprehensive or to provide any specific legal and / or tax advice and should not be acted or relied upon as doing so.

Professional advice appropriate to a specific situation should always be obtained.

DATED 1 October 2009

