COOPER GRACE WARD
LAWYERS

Estate planning

Should your Will include a testamentary trust?

Key points

- A testamentary trust is a trust established under a Will, which only comes into existence after your death
- Testamentary trusts can be useful for a variety of reasons including asset protection, income splitting, financial management and matrimonial property disputes
- Unlike a normal family trust, all beneficiaries, including those under 18, receive the benefit of the full income tax free threshold

1. A testamentary trust is a trust established under a Will, and does not come into effect until after your death. The terms of a discretionary testamentary trust are similar to those contained in most family discretionary trusts.

2. A testamentary trust allows you to pass assets on your death to be used for the benefit of the people you wish to benefit, without passing absolute ownership of the assets. This may have some advantages and provide asset protection depending on your, and the intended beneficiaries', circumstances.

3. Testamentary trusts provide a mechanism by which assets can be held within the estate for a reasonable period of time after your death rather than being distributed immediately.

Is a testamentary trust for you?

4. A testamentary trust might be useful where:

   (a) you have young children or grandchildren

   (b) your beneficiaries (your spouse or adult children) have potential risk issues (for example they have a business or are professionals)

   (c) your intention is to protect assets for your children but still provide for your surviving spouse

   (d) you have a child with special needs or one who would not be responsible controlling their inheritance

   (e) you want to ensure that your assets pass down your family line

   (f) you would like to protect your assets from claims by spouses or partners if any of your children are involved in a matrimonial property dispute

   (g) you have more than $1.6 million in superannuation (because the recent changes to superannuation law mean that the excess will leave the super fund after your death).

What are the main benefits of testamentary trusts?

5. The main benefits of properly structured testamentary trusts are:

   (a) protection of the assets in the trust from the risk of the beneficiaries

   (b) being able to distribute income to children who are under 18 (or for their benefit) at normal adult tax rates.

6. It is possible to include provisions in the testamentary trust to ensure that only your blood descendants can ever receive capital entitlements in the trust.

Asset protection

7. A testamentary trust can provide significant asset protection for your beneficiaries, which will be important if they are engaged in an occupation that carries significant risk of litigation or owns a business.

8. Couples generally acquire assets in the name of the spouse who has the lower risk profile. However, if that person dies and leaves all their assets to the spouse with the higher risk profile, the family's assets may be exposed.

9. If, instead, the assets are held in a testamentary trust, your surviving spouse can control the assets and ensure that any income and capital from the estate is used for the benefit of your children and family members. Your spouse will not have direct ownership, which means that the assets themselves should be protected to some extent.

10. The same issues arise if adult children have high risk profiles.

11. Testamentary trusts can also provide some protection for adult children in a matrimonial property settlement – provided they do not have sole control of the trust.

Income splitting

12. Income received by beneficiaries who are under 18 from a family trust will be subject to maximum tax rates if that income exceeds $416.

13. Under a testamentary trust, all beneficiaries, including those under 18, receive the benefit of the full income tax free threshold, and income above that amount is taxed at normal adult rates. This means that approximately $20,000 can be distributed to each beneficiary free of tax each year.

14. This can be of significant benefit to beneficiaries who have children under 18 as they can effectively pay things like living and educational expenses for their children out of pre-tax income.

15. It is also becoming more and more common for grandparents to help out with grandchildren's school fees, which can be very tax effective if paid from a testamentary trust.

What if my beneficiaries do not want a testamentary trust?

16. Testamentary trusts can generally be wound up without tax or duty consequences if the trustee decides it will be of no use.