EUROZ HARTLEYS

Testamentary Trusts

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We all recognise that it's well worth spending time on estate planning to take care of those that may be left behind. Estate planning is a serious topic – it can cover a myriad of issues and considerations. The family situation, structure of assets, taxation, superannuation and government benefits are some of the pieces that come together when documenting an estate plan.

Estate planning is not simply the creation of a Will, but usually encompasses other types of documents such as Enduring Powers of Attorney and superannuation death benefit nominations. A Will, in its simplest form, is where you put in place instructions to transfer assets in the event of your death. Did you know that your Will can allow for the creation of testamentary trusts?

What are Testamentary Trusts?

They are trusts that are created by a Will and come into effect after the death of the testator (i.e. the person writing and executing their Will). There are different types of testamentary trusts, but it is usually a trust where the "trustee" has discretion regarding the distributions to the beneficiaries. You can even have multiple testamentary trusts within your Will.

A Will also sets out the terms and rules of the testamentary trust, in the same way a trust deed would for a family trust. In practical terms, this means instead of your Will stating that assets are to be left to certain individual beneficiaries; it instead states that the assets are to be held on trust for those same beneficiaries.

The main advantages of testamentary trusts relate to their ability to protect assets and to reduce tax paid by beneficiaries from income earned by the inheritance.

In addition, a testamentary trust can restrict or deny distributions to those who do not use the funds for the purposes set out in the trust deed.

When no longer required, a testamentary trust can be wound up subject to the rules within the Will.

How does a Testamentary Trust provide Asset Protection?

Like all discretionary or family trusts, testamentary trusts can separate who owns the asset and who ultimately benefits from the asset. It is this separation that may allow testamentary trusts to protect assets from legal action involving the beneficiaries. This is particularly appealing to people who are concerned about:

- Beneficiaries becoming separated or divorced
- Beneficiaries who may become bankrupt
- Spendthrift beneficiaries

In practical terms this may involve the inheritance passing to the testamentary trust for the benefit of the beneficiary but it will be controlled by someone else (the trustee). This way the trustee can ensure that the funds are released in a manner that would be fitting of the testators wishes.

How does a Testamentary Trust help to Reduce Tax?

Testamentary trusts allow for income splitting. This means to minimise tax payable, the income generated by the inheritance pool can be split amongst the beneficiaries of the trust. However, there is one key difference that sets testamentary trusts apart from ordinary discretionary trusts.

Income splitting to children under the age of 18 will not be subject to penalty tax rates. This means income chosen to distribute to minors can be taxed at normal adult rates. This can provide significant tax benefits where surviving partners are already on high marginal tax rates, as the children have access to the tax-free threshold and lower tax tiers.

Conclusion

The inclusion of a testamentary trust is optional. A testamentary trust is a trust created pursuant to a Will and takes effect upon death. Despite the requirement to complete annual accounting and compliance work, it can serve as an effective financial structure. Feel free to contact your adviser if have any queries or wish to obtain a referral to an estate planning lawyer.

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