Greenhalgh Pickard
SOLICITORS AND ACCOUNTANTS

Testamentary Trust Wills
- *Is it right for you?*

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[01] What is a Testamentary Trust?

All Wills whether they are simple or complex incorporate a trust. The difference between what is considered a Standard Will and a Testamentary Trust Will (TT Will) is the scope and detail of the trust provisions and clauses. The reason for the expansion of the trust provisions is to provide greater flexibility in the distribution of the Estate's assets to the various identified beneficiaries.

[02] Is a Testamentary Trust right for me?

Unlike a Standard Will, a TT Will does not make direct gifts to your chosen beneficiaries rather it establishes individual Trusts. By doing this, you are enabling your assets to be protected by the Trusts, and not owned by your beneficiaries. This is an important factor to consider if you are concerned with;

- Your beneficiaries not having the ability to act, whether this be due to mental capacity, substance abuse, gambling issues or other potential issues.
- Your beneficiaries are bankrupt, could face bankruptcy, legal action or divorce.
- Your beneficiaries not receiving full benefit of the income generated by your assets due to being high income earners as this will result in being heavily taxed.

After Dan passed away Sally was concerned that their son Ben was going through some financial hardships, and wondered what would happen after she passed away. After taking advice, Sally spent $2000 more to get a Testamentary Trust Will completed. As it worked out, when Sally passed away Ben was in fact bankrupt with his estate having debts of more than $1 million. Because Sally had organised a testamentary trust, her estate of $850,000 was held in Trusts for Ben until he came out of bankruptcy.

[3] How can a Testamentary Trust benefit me?

Taxation

Income can be split to take into account the different marginal tax rates of beneficiaries.

If beneficiaries are under 18 they gain the benefit of the tax free threshold for adults rather than the lower threshold for unearned income distributed to children. That is approximately $20,800 as opposed to $416. Take into consideration the following scenario:

Brigid as Trustee of a Testamentary trust has earned income of $6000 in interest and $6000 in fully franked dividends. She wishes to distribute the $6000 to each of the two beneficiaries. One beneficiary, Peter, is a minor with no income. The other beneficiary, Bob, is an adult with $20,000 in other income. Brigid can choose to help obtain a better tax position by distributing the interest income to Peter and the dividend income – with franked credits attached – to Bob.

Dean dies leaving the estate which comprises an investment portfolio valued at $1.2 million. Dean leaves his whole estate to his widow Lisa, who already earns $120,000 per annum. Lisa can use the investment portfolio to look after their three children, aged between eight and 14. In the first year after Dean's death, Lisa received income of $72,000 from the investment portfolio. As she already has income of $120,000, The tax that Lisa will pay on the $72,000 will be approximately $29,280. If Dean had established a Testamentary trust instead, Lisa could have distributed the $72,000 trust income in their first year equally between her three children – that is, each child would have received $24,000 income. As each would have been taxed as an adult, tax payable per child could be said to be:

Tax on $24,000= approximately $967
Total tax payable 3x $967 = $2,901
The total tax "saving" would be $29,280 $-2,901 = ***$26,379 in one year alone.***
The savings over a number of years would be highly significant.

A Testamentary trust may provide capital gains tax and stamp duty flexibility and provide opportunities to reduce tax on your superannuation.

Education

Income from a Testamentary trust can be used for the education, maintenance and advancement of minors with no tax payable.

Protecting your assets

Leaving a bequest directly to a beneficiary means those funds may be subject to a claim by a creditor of the beneficiary. If the beneficiary is bankrupt the bequest could be claimed by the trustee to satisfy creditor claims. For example when you make your will, beneficiaries involved in business may be successful at the time, however circumstances can change. Having the beneficiaries' assets in a Testamentary trust also protects assets from a claim under a guarantee given by the beneficiary or their spouse.

Where a beneficiary dies, a bequest from your estate may be subject to claims from the deceased beneficiary's family and dependants. Also, in some states the courts consider the size of the deceased's estate when deciding family provision claims. This is not the case with Testamentary Trusts.

Marital problems

If a beneficiary separates from their spouse the assets in a Testamentary trust are not subject to a claim by the spouse.

There are concerns that after you die your spouse may remarry and give some of your assets to a new family or children from a former relationship.

There are concerns that your spouse may put the assets you leave at risk in business ventures or with reckless spending.

In either of these circumstances a trustee could ensure this didn't happen.

High Risk beneficiaries

If a beneficiary is in a high risk profession or business, the assets can be protected from potential claims.

Disabled or beneficiaries with problems

Funds can be placed in a Testamentary trust to provide support for a beneficiary who is incapable of managing their own affairs or is prone to making poor decisions. For example, children with gambling or drug issues. If the beneficiary is currently (or is likely to be) in receipt of Centrelink benefits, consideration can be given to provide accommodation, care and some funds without impacting on their Centrelink entitlements.

Keeping your assets within your family line

You want your assets to go through your children to your grandchildren. A Testamentary trust can prevent assets being dissipated by parents through bad luck, bad management or adverse life events.

Giving assets over time

Where beneficiaries are young you may be concerned that, while they have immediate needs in their life such as a home and education, by receiving their bequest in a lump payment they may not use it wisely. By using a Testamentary trust you could provide assets and income over time.

[4] The Structure of Testamentary Trust Wills

The role of the executor is to carry out the wishes of the will maker after they die. They organise to collect the assets of the deceased, pay the debts and distribute the property as set out in the deceased's will.

In relation to the distribution of the property, if that property is being held by a trust then there needs to be a trustee.

Often the role of executor and trustee is held by the same person or persons. This is not necessarily the case in a Testamentary trust because the trust may operate for extended number of years, and also, a balance needs to be sought in relation to a beneficiary of the estate (via the Testamentary trust) having some say in relation to how the Trusts affairs are conducted.

One might think at first instance that the beneficiary should simply be the trustee of their own Testamentary trust/s (apart from wasteful children or children without the intellectual capacity to take care of their own affairs) as they presumably would be in the best position to take advice and make decisions in relation to the operation of those Trusts. The reason why we do not recommend this approach is because if the beneficiary is made bankrupt (either at their own hands or at the hands of creditors) or they are involved in a matrimonial separation then the courts will most likely determine that the assets in the Testamentary Trusts are truly assets owned by the beneficiary and not quarantined providing the trust arrangement.

The only way to attempt to safeguard against such circumstances is to have independent trustees appointed to the trust/s. It may well be that there could be a joint trustee arrangement, such that there is one independent trustee and the other being the beneficiary. If this is the case then there needs to be a provision in the Testamentary Trusts that if the beneficiary becomes bankrupt or is involved in a matrimonial matter they are automatically removed as a trustee of their trust/s.

The important component of this is that in an evidentiary way the independent trustee must remain independent. They cannot simply take instruction from the beneficiary trustee as to what decisions they were to make. For example you would not want to see an e-mail from the independent trustee to the beneficiary trustee saying "you tell me what you want me to do".

Our company provides a corporate trustee service which can either be appointed solely or jointly. The benefit of a corporate trustee is that the decisions of the corporate trustee are based on the experience and technical skills of the company. It also demonstrates a prima facie independence.

As a long-term proposition, since you have a number of children, each child beneficiary can be appointed as a trustee of their own Testamentary trust, and one of your other children appointed as the independent trustee to their trust, and vice versa. This is more likely to be susceptible to challenge concerning the true independence of the sibling.

An alternate proposition is that a friend of the family is appointed as the independent trustee, or as the sole trustee.

In short, the Testamentary trust is designed to be as flexible as possible to provide the best tax/protection position for each of the beneficiaries not only as at the date of your death but also in the years that follow.

[5] What are the disadvantages?

There is the ongoing cost of administering the trust, namely accounting and tax fees. For this reason it must be considered whether the income from the trust justifies incurring the management expense.

Potential disputes between trustees and beneficiaries that can alienate family members. Selecting the right people to be your trustees can be a problem.

As with all estates, a will establishing Testamentary Trusts can be challenged by eligible claimants including a surviving spouse or children who have "missed out" or are unhappy with their share or by not getting payment straight away.

Invariably Testamentary Trusts involve complexity which can require professional advice. It will also be more difficult for the person making the will to understand. It is important to note that a complex Will can be attacked on the basis that the Will-maker did not understand the financial arrangements he or she were making, thus professional advice and explanations are important. Also, depending on the circumstances there may be duty and CGT implications.

Deciding whether a Testamentary Trust Will is right for you is of course a matter of obtaining good advice and weighing up the pros and cons.

[6] Can a Testamentary Trust Will aid in business succession?

Testamentary trusts are often a useful tool in planning business succession. For example a person may want their business to be continued by the eldest child, but doing so leaves little else for the other children. In addition they may want income from the business to go to the support and maintenance of their spouse.

A testamentary trust will could be used to achieve a fair distribution, in this case supporting the spouse and allow the eldest son to run the business and buy out the other children over time.

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