Testamentary Trust – What is it?

A testamentary trust is just like a typical discretionary (family) trust. However, the difference is that it a testamentary trust is created under a person's Will rather than by a trust deed. Instead of assets passing directly into the hands of a beneficiary, assets pass into a discretionary testamentary trust controlled by the people you nominate to control it in your Will. There are many things that need to be considered to ensure that if you choose to establish a testamentary trust in your Will, it is structured in a properly legally binding manner to best benefit your beneficiaries. .

When is the testamentary trust established?

A testamentary trust takes effect upon the death of the Will maker when the assets are ready to be distributed following any legal requirements, such as a grant of probate being obtained. Any asset owned solely by the Will maker at the time of their death passes via the estate.

Who are the primary beneficiaries and who controls the testamentary trust?

A Will maker nominates the primary beneficiary or beneficiaries of the testamentary trust in the Will, and also the person or persons who will act as trustee and appointor of the trust, who essentially control the trust and determine distributions of capital and income.

A Will can contain one or multiple testamentary trusts depending on the needs of your beneficiaries and the assets that will pass to such trust. A Will maker can also choose to only set up a testamentary trust for certain beneficiaries.

A Will maker can also provide the primary beneficiary with an option to "opt out" of taking their inheritance via the testamentary trust to give that beneficiary ultimate flexibility to decide, with appropriate financial advice, what is best for them at that time. It is important to note, however, that if such an option is provided in the Will, the testamentary trust does not provide any asset protection for the nominated primary beneficiary.

Who should be considering a testamentary trust?

There are many people who should consider incorporating a testamentary trust in their Wills for the benefit of their beneficiaries, such as:

- An individual who has built up considerable wealth or who has assets in his or her sole name or intends to do so in the future;
- An individual who would like their beneficiaries to have asset protection or receive their inheritance in a tax effective manner;
- A will maker who runs his or her own business;

Who should be considering a testamentary trust? cont.

A Will maker should also consider incorporating a testamentary trust into their estate plan if any of their beneficiaries are:

- a minor;
- has impaired mental or physical capacity;
- is a gambler, alcoholic, spendthrift, etc;
- is or has been bankrupt;
- is involved in a marital dispute or potential family law proceedings.

How does a testamentary trust provide asset protection to the primary beneficiary?

Because beneficiaries have only a discretionary (or contingent) interest in the assets held in the testamentary trust (legal title being held by the trustee), if structured correctly, the assets of the trust are generally protected from attack by creditors or family law proceedings involving the primary beneficiary.

It is important to note that if you wish to include a testamentary trust for the purpose of providing asset protection from creditors or family law proceedings, the appointment of the trustees and appointors needs careful consideration.

What are the tax advantages?

A testamentary trust can allow for income to be taxed less harshly then if it were to be distributed to a beneficiary directly.

Incorporating a testamentary trust in your Will for your beneficiary/ies can give them and their lineal descendants considerable tax planning. The trustee of the testamentary trust has discretion to make multiple distributions to any person in the class of beneficiaries (spouse, children, grandchildren, parents etc.), and these distributions can be tailored to best optimize the benefits of each person's marginal tax rate, particularly, as concerns minors or low income earners. Subsequently, the tax payable by the testamentary trust is lower.

What are the tax advantages? cont.

Income distributed from a testamentary trust to a minor (not engaged in full-time occupation) is taxed at normal adult marginal rates. Therefore, the adult tax-free threshold applying to such distributions creates the potential for significant tax savings.

Therefore, creating a testamentary trust enables distributions to minor children and low income earners at concessional tax rates while retaining ultimate control over the capital in the hands of the trustee of the testamentary trust.

What if a beneficiary receives Centrelink benefits?

A beneficiary of a testamentary trust who is receiving Centrelink benefit payments may be subject to a reassessment of the means testing considered for the income they receive from Centrelink.

If a person receiving a Centrelink benefit is also nominated to act as a trustee and/or appointor of a testamentary trust, they should also make enquiries as to whether this will result in a reassessment of the means-testing.

If a beneficiary receives a disability pension from Centrelink, we can discuss with you the option to incorporate a Special Disability Trust in place of, or to work in conjunction with, a testamentary trust for such a beneficiary.

If a beneficiary of your Will receives any type of Centrelink benefits, they should seek advice on the implications for them of receiving an inheritance outright or via a testamentary trust. Likewise, if a person you are nominating as a trustee and/or appointor of a testamentary trust, they should also seek advice as to any implication prior to accepting such a role.

Want to know more?

For expert advice on whether you should incorporate a testamentary trust in your Will, and how it should be structured to get the best result desired for your beneficiaries, contact Teresa Catalano, Wills and Estates Accredited Specialist, of iWills Legal.