Why would you include a Testamentary Trust in your Will?

I often advise clients to consider including Wills containing Testamentary Trusts in their estate plans. Testamentary Trusts are also known as Inheritance Trusts or Testamentary Discretionary Trusts. A Trust is a relationship where a person (Trustee) holds property for the benefit of other people (beneficiaries). A Testamentary Trust is a type of Trust established by a Will. The Will writer leaves part or all of their estate (Trust Fund) to a Trustee who makes decisions on how to invest the Trust Fund and who receives money from the Trust.

The three major reasons for establishing a Testamentary Trust are:

1. to protect assets from divorcing spouses and separating partners of your

children (or other beneficiaries);

2. to protect assets from creditors of your children; and
3. for tax reasons.

How do you achieve asset protection?

Asset protection is achieved by not leaving assets to children which become part of their own estates and are then subject to claims by third parties. Rather, the Trustee (the person in charge of the Trust) of a Testamentary Trust has discretion as to how to apply the income and capital of the Trusts to a class of beneficiaries which you specify in your Will.

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It is usual to list a number of beneficiaries. "Beneficiaries" means the group of family members or others (such as charities) who may potentially get to receive some of the money from the Trust Fund. This could include:

1. a share of income in a particular year;
2. some of the capital of the Trust Fund (such as the proceeds from selling an asset owned by the Trust); or
3. a loan from the Trust.

Not all of the beneficiaries will necessarily benefit in any particular tax year or at all. Some of the beneficiaries may never be chosen by the Trustee to receive anything from the Trust. Others may find that the Trustee is always keen to help them. Just because a beneficiary receives a benefit in one year does not mean that such beneficiary is entitled to any further benefits from the Trust in the future. The beneficiaries are therefore usually able to defend claims by third parties by legitimately saying that they simply do not have any right or access to the assets of the Trust.

If a beneficiary of a Testamentary Trust separates from their spouse, the assets held in that Trust may be wholly or partly removed from the asset pool against which the former spouse can make a claim.

Here's an example:

> John and Mary were married for 10 years and are now divorced.
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> John is a beneficiary of his mother's (now deceased) Testamentary Trust which includes an investment property. On a Family Law property settlement,
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> Mary may not have access to any future income or capital derived by the investment property owned by the Testamentary Trust.
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> Noteworthy, if John has already received some income from the Trust, Mary may be able to claim some of that income as part of the Family Law property settlement.

Wills containing Testamentary Trusts form a hurdle making it harder for creditors and divorcing or separating spouses to claim a share of the Trust assets, but do not guarantee against such claims succeeding.

How can a Testamentary Trust minimise tax?

In terms of tax reasons, unlike Family Trusts, minors are now entitled to a tax free threshold of more than $18,000.00 per year. This means that income from a Testamentary Trust may be applied for the benefit of grandchildren who are under 18 in a way which minimises the tax payable by the family concerned.

The terms of the Testamentary Trust are contained in the Will and do not come into operation until the Will maker has died.

Running costs after death include accountancy and legal costs. You also need to open a bank account for each Trust.

Your estate needs to be a reasonable size to justify the set-up cost and ongoing expense after death of having Wills containing Testamentary Trusts.

Wills for a couple may be designed so that Testamentary Trusts are applicable only in the event of both deaths, when a Trust could be set up for each of your children and their respective families. I usually advise appointing more than one Trustee of each such Trust.

Alternatively, you can set up one Testamentary Trust for the benefit of all of your children. Again, it would be preferable to have more than one Trustee.

Wills containing Testamentary Trusts are useful tools in estate planning. Any assets held outside your estate, such as those in superannuation and family/trading trusts, can also be directed into them. Family/trading trusts are also discretionary trusts but are set up in a person's lifetime to hold investments or as a trading entity.

If you're reviewing your estate planning requirements, it is also important to remember lifetime considerations like Enduring Powers of Attorney and Advance Care Directives.

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