Understanding Testamentary Trust Wills

Wills & estate planning series

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When a person dies they usually leave behind a Will that specifies what is to happen to their assets upon their death and which specifies who are executors, being the person (or people) whose role it is to secure and distribute assets of the deceased and ensure the terms of the Will are carried out lawfully.

A Testamentary Trust Will includes a discretionary trust created within the Will.

A discretionary trust (including a family trust) can be created during your lifetime where a person or corporation (a trustee) holds assets, property and other investments for the benefit of a number of people, usually related by family. In these circumstances the trustee has total discretion as to how to distribute income and capital to the various beneficiaries.

Creating a Testamentary Trust within your Will can sometimes allow a more effective strategy to leave assets to a person instead of making the gift directly. The advantages are discussed below.

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What is the role of an Executor and Trustee?

When you are making a Will, whether or not it includes a Testamentary Trust, you appoint someone to act as an executor who carries out the important role as your legal representative after your death.

An executor has many important duties which include notifying banks and credit unions, ascertaining and taking control of the deceased's assets, identifying who the beneficiaries of the estate are, determining what their entitlements are and obtaining the grant of Probate from the Supreme Court of South Australia or another State.

You will also appoint a trustee (usually the same person as the executor) who will hold monies and other assets on behalf of the beneficiaries and make distributions at appropriate times. The role of a trustee may last for many years particularly if they are holding monies on behalf of a minor beneficiary pending them attaining a certain age.

The trustee appointed to a Testamentary Trust will have the power to distribute monies and assets that pass into that trust, to the beneficiaries in any way they choose.

What are the advantages?

1. Protection from divorce

   A common held fear amongst Will makers is that their estate may unwittingly pass to the benefit of a child's spouse or partner in the event of a breakdown of relationship.

   Assets or monies received by a beneficiary through your estate and used for the mutual benefit of your child and their spouse are often difficult to trace and/or isolate from the jurisdiction of the Family Court on separation.

   The powers of the Family Court are quite broad, but it may be possible to reduce the ability of your inheritance being split between a separating couple if, instead of giving your child a direct gift in your Will, you provided for them via a Testamentary Trust.

2. Protection from bankruptcy

   The risk of being sued, particularly for those persons whose trade makes them vulnerable such as doctors, lawyers, accountants, sole traders and so on, is ever present and usually results in them not owning any assets in their sole name.

   If a beneficiary experiences financial difficulties and receives a windfall from your estate it is possible that your gift can be attacked by creditors instead of being used to the advantage of your beneficiary.

   With a Testamentary Trust the trustee determines who receives the income and/or capital of your estate and can decide what (if anything) to pay to a bankrupt beneficiary, including nothing.

3. Protection for a person suffering an incapacity

   On occasions testators wish to benefit someone who suffers from an intellectual handicap or perhaps suffers from a significant drug or alcohol dependency. Rather than providing a direct gift to them which may be squandered or otherwise not able to be handled, you may provide for their benefit through a Testamentary Trust where your appointed trustees remain in control.

4. Taxation advantages

   One of the most significant advantages to establishing a Testamentary Trust within your Will is that your trustee has powers which assist to maximise the benefit your whole family receives from your assets, by taking into consideration greater tax burdens which some beneficiaries might face.

   Tax must be paid on any income or interest earned from investments using moneys received from a deceased estate at the beneficiary's own marginal tax rate. For example if interest of $40,000 is earned through investments made from estate monies valued at $500,000 a beneficiary may pay tax on that interest of $6,600.

   However, if the same amount of interest was earned via a Testamentary Trust and split amongst several beneficiaries including minor children then it is possible no tax is payable.

   That saving would occur in each and every year the investment is maintained.

   In addition to this, the tax free threshold of minor children is significantly higher than that of distributions from discretionary or family trusts.

What assets can comprise the Testamentary Trust?

Only those assets which are in a deceased's sole name can fall into and form part of the Testamentary Trust assets.

It is therefore important for an experienced solicitor at Andersons to reflect on your personal wealth and ensure all assets, including potential estate assets such as insurance policies and superannuation benefits will be directed to your estate on death.

Our recommendations

If you are contemplating the creation of a Testamentary Trust Will you should first speak with one of Andersons' experienced solicitors to ensure it is the right model for you, that your assets will comprise part of your estate for your family to benefit from and that the right provisions for control of the Testamentary Trust and protection for your beneficiaries are incorporated.