

## update

7 March 2008

## Testamentary Trusts

### *What are they and should I have one too?*

Testamentary trusts mean different things to different people. To a lawyer, a "testamentary trust" is any trust established by a person's Will. The testamentary trust can be a fixed trust, or a discretionary trust, or a hybrid. If, however, your accountant or financial adviser suggests you should think about having a testamentary trust, then they will be referring to a particular type of testamentary trust, which is a discretionary trust created by a person's Will.

As with a family discretionary trust set up in a person's lifetime, a testamentary discretionary trust has a trustee (or trustees), a range of discretionary beneficiaries (for example, spouse, children, grandchildren) and in some cases an appointor (for instance, the spouse) who controls the trustee/s.

Usually it is the trustee who determines which of the beneficiaries, if any, receive any income or capital from the testamentary trust and also the amount of any income or capital they are to receive.

Many of the benefits of a testamentary discretionary trust arise from the fact that while the assets of the testamentary trust may be controlled by the intended beneficiary, the assets held in the testamentary trust do not form part of the beneficiary's estate.

If an intended beneficiary faces bankruptcy, an inheritance "provided" for that beneficiary through a testamentary discretionary trust will not form part of the beneficiary's estate for bankruptcy purposes provided the testamentary trust is structured properly.

Similarly, assets held within a testamentary discretionary trust are unlikely to be the subject of a court order in the case of beneficiaries experiencing a break-up of their marriage. The assets in the trust may be regarded as a financial resource and have some effect on the terms of the

property settlement, but this is better than the property being at the disposal of a court order.

Testamentary trusts can also be used to control the flow of funds to beneficiaries such as vulnerable adult children, gamblers or spendthrifts.

Some of the other benefits that currently arise from testamentary discretionary trusts are as follows:

- testamentary discretionary trusts are established by a Will and therefore the willmaker has absolute control over the terms of the testamentary trust
- during the willmaker's lifetime, he or she can vary the terms of the testamentary trust at any time and from time to time
- the testamentary trust comes into existence on the willmaker's death so the willmaker can retain control and ownership of the assets up until the date of death
- the testamentary trust can continue for a period of 80 years if so required; it is also possible for the testamentary trust to vest at any earlier date if the trustee so decides
- it is possible to establish more than one testamentary discretionary trust in a Will
- infant beneficiaries (that is, those under 18 years of age) are taxed as adults with the benefit of the higher tax free threshold (currently \$6,000 rather than \$600), and normal adult tax rates apply rather than the higher tax rates generally applicable to the investment income of minors

### *Case study*

Mr and Mrs Norman have two children, Jack Norman aged 9 years and Olivia Norman aged 12 years. Mr Norman is a hardworking financial planner. He dies suddenly, leaving assets of \$400,000 apart from the family home.

Fortunately Mr Norman had established a testamentary discretionary trust in his Will with Mrs Norman as the trustee, and she and the two children as potential beneficiaries of the testamentary trust.

As trustee Mrs Norman invests the \$400,000 and decides to distribute the testamentary trust's annual income of \$24,000 as follows:

- Jack's income: \$12,000
- Olivia's income: \$12,000

As the children's income is derived from a testamentary trust, it is taxed in their hands at adult tax rates as follows:

- Jack's tax: \$900
- Olivia's tax: \$900

Of course, the income distributed to the children is not usually paid to them but rather used to pay expenses such as school fees for their benefit. That means, for example, that school fees can be paid out of income in respect of which little or no tax has been paid.

If instead Mr Norman's Will had left everything directly to Mrs Norman, then the \$400,000 would have been invested in her name and, as she has other income from her job as a teacher, the investment income of \$24,000 would have been taxed in her hands at a tax rate of say 30% (excluding Medicare levy):

- Mrs Norman's tax: \$7,200

As you can see the amount of tax saved by having the testamentary trust and distributing its income to the two children is \$5,400 in just one year. The actual tax saving could be closer to \$10,000 per annum if Mrs Norman were being taxed at the top marginal tax rate.

Nor are the tax benefits limited to parents with children under the age of 18 years. Grandparents who want to help financially with their grandchildren's education might also consider establishing testamentary trusts in their Wills.

Finally, if you are uncertain about the future need for a testamentary trust, an option is to prepare your Will in such a way as to give your beneficiaries the choice as to whether or not to utilise the testamentary discretionary trust when the time comes.

## For more information

For more information, please contact our Wills and Estates team:

- Robin Parsons, Accredited Wills & Estate Specialist and Special Counsel on 03 9321 7826  
rparsons@rigbycooke.com.au
- Dennis Millikan, Consultant on 03 9321 7845  
dmillikan@rigbycooke.com.au
- Peter Byrne, Senior Consultant on 03 9321 7825  
pbyrne@rigbycooke.com.au

### To unsubscribe from this publication

If you do not wish to receive publications of this type from us in the future, please notify us by one of the following methods:

- Send an email to [marketing@rigbycooke.com.au](mailto:marketing@rigbycooke.com.au)
- Send a fax message to "Attention: Rigby Cooke Marketing" on fax number +61 3 9321 7900
- Send a letter to "Attention: Rigby Cooke Marketing", GPO Box 4767UU, Melbourne Vic 3001

Your request to remove you as a subscriber should include the word "unsubscribe" and your full email address to allow us to correctly identify your removal from our lists.

### Reprint Permission

Articles in this publication may be reproduced in whole or in part, provided that appropriate recognition is given to the author and the firm, and prior approval is obtained. To obtain approval, please contact Rigby Cooke on +61 3 9321 7852 or email [marketing@rigbycooke.com.au](mailto:marketing@rigbycooke.com.au).

### Disclaimer

This publication contains comments of a general nature only and is provided as an information service. It is not intended to be relied upon, nor is it a substitute for specific professional advice. No responsibility can be accepted by Rigby Cooke Lawyers or the authors for loss occasioned to any person doing anything as a result of any material in this publication.

**rigbycooke | lawyers**

Level 13, 469 La Trobe Street  
Melbourne Vic 3000  
T 61 3 9321 7888  
F 61 3 9321 7900

[www.rigbycooke.com.au](http://www.rigbycooke.com.au)