

## TESTAMENTARY TRUSTS

What is a testamentary trust?

"Testamentary" is a legal term that means the issue relates to the making of a will. A "trust" is where one person holds the legal title of property for the benefit of another person (not themselves). A "trustee" is the person who take the ownership in "trust" for another person (known as the "beneficiary"). Under the trust the trustee owes a legal financial duty to the beneficiary.

A testamentary trust is established under a will to appoint a trustee to use property for the benefit of the beneficiary in the way that the will specifies. Many people, especially those of wealth, create trusts to protect assets or to minimise tax. In the same way a trust can be set up under a will. These trusts can last for many decades following the date of death.

The trustees

Anyone you wish, including the executors of your will, your spouse or partner, or your children. The trustee has effective control of the trust, so the trustee should be a person who you know, and whom you trust to act in the best interests of those who are to receive the main benefit of either the whole or that part of your estate that will be left subject to the testamentary trust. It is possible to establish a number of testamentary trusts under a will and name different trustees for each of them.

Under the trust the trustee can either be given specific instructions on how the money will be spent, or they can be given a discretion.

Often it is better to allow for a discretion because:

- it is the most flexible type of the trust;
- it may provide the best chance of the beneficiaries' actual future needs being met;
- it may best allow for the best interests of the beneficiary to be met.

Choosing a trustee

This is a significant decision and should not be made without serious thought. The person you choose will have a lot of responsibility, and should have some financial management skills (or access to those skills).

You can choose:

- a private trustee company; or
- an individual.

## Private trustee companies

Law regulates private trustee companies. The advantages of using these companies are:

- they are professional;
- they are independent;
- they are companies and therefore, unlike an individual trustee, can continue to act as trustee into the future.

The disadvantages are:

- the trustee will not have a personal relationship with the beneficiary;
- the company will charge.

It is possible to appoint an individual as a co-trustee with the company.

## Individual Trustee

The main advantages of an individual trustee are:

- you can appoint someone with a personal relationship with the beneficiary;
- it may be cheaper.

The main disadvantages are:

- the individual may not have sufficient expertise;
- there can be a conflict of interest with the best interests of the beneficiary, especially if the trustee is a residuary beneficiary under the will.

## Trustee's duties

The trustee must take into account:

- the purpose of the trust;
- the needs of the beneficiary;
- prudent (not speculative) investments;
- the duration of the trust;
- the need to generate an income;
- the need to keep proper accounts.

## Challenging a trust

It is possible for the beneficiary to challenge the decision making of the trustee, but this requires an action in court and should be first discussed with a solicitor.

## Advantages of a testamentary trust

Income Tax benefits:

- By splitting the income from the trust, benefits can be distributed between the children so that they amount to less than \$6000, the current tax-free threshold; or between \$6000 and \$20,000, which is taxed at lower rate of 17%.

- As testamentary trusts are discretionary, a financially savvy trustee can adapt the distribution to changing circumstances.
- There are particular tax benefits for children (under the age of 18). Under the Tax Act income distributed to child beneficiaries from a family trust may be subject to penalty rates, but children who receive income or capital gains from a testamentary trust are taxed at normal marginal rates.
- However, for the ordinary rate to apply, the testamentary trust must not be intended merely to evade higher tax rates, but must be primarily for the benefit of the child. This would cover such things as food, clothing and education.

#### Capital Gains Tax and Stamp Duty benefits:

- If the Trustee merely distributes land to beneficiaries under the deceased's will, the transfer is direct from the deceased to the beneficiaries. Therefore:
  - No stamp duty is payable because the Trustee does not OWN the land - they merely CONTROL the land via the testamentary trust.
  - There is no "disposal" of the land and therefore the Trustee does not have a Capital Gains Tax bill
- In short, the Trustee has CONTROL of the deceased's assets but for tax purposes does not OWN the assets.

#### Asset protection:

- If you have a beneficiary who has an intellectual impairment, you could leave part of your estate for that person's benefit by naming that person as the primary beneficiary (but not a trustee) of a testamentary trust. This will prevent unscrupulous persons from taking advantage of the beneficiary with an impairment and protect his or her share of your estate. Either a family member, professional adviser or a trustee company could be named as the trustee of this type of testamentary trust.

#### Protection of assets from creditors or against litigants in professional negligence claims

- Testamentary trusts are a wise precaution if the beneficiaries may face legal action or bankruptcy, such as those in professions frequently subject to litigation, or high-risk business.

#### Protection of assets from Family Law claims

- Subject to satisfactory drafting, provision can be made to protect your hard earned assets from claims which may be made by strangers in blood to your family, such as estranged spouses or defacto partners.

#### Preservation of pension entitlements

- The Trustee never owns the land - they only control it via the testamentary trust, therefore the passing of the land from the deceased to the beneficiaries need not effect the Trustee's Social Security entitlements.

#### Superannuation Death Payments and Deferred Annuities

- Depending on their status as a "family member" and their income, your nominated beneficiaries may have to pay tax on your Superannuation and Annuities when you die.

- Others in your family may have paid no tax on the same Superannuation.
- The laws are continually changing and your family members' income and status can change.
- Therefore, it is better to leave the Superannuation via your Will (and in the testamentary trust).
- Your Accountant and Adviser can then advise your family on who is best to receive the Superannuation for tax purposes after you die.
- Your Adviser can arrange for you to "request" that your Superannuation be paid into your Will.
- Some Superannuation Funds allow you to do more than a request, via a nomination.
- They may allow you to do a "binding nomination".
- If you renew this every 3 years and follow the other requirements then the Super Fund has no choice other than to pay the Super when you die to the persons you nominate.
- Then your family may be able to take the Superannuation - tax free.
- For non-binding nominations the institution controlling your Superannuation has the discretion to pay out your Superannuation as it sees fit.
- However, most institutions will comply with your request to have the Superannuation dealt with in your Will.

#### Drawbacks of a testamentary trust

##### Account keeping

- It is important to appoint a trustee who will be diligent in keeping the trust's financial records in order.
- This is important for two reasons.
  - (1) Various provisions of the ITAA require in-depth accounting records to be kept.
  - (2) As a testamentary trust may endure for the life of a beneficiary, records may have to be kept for many years.
- A potential solution is to appoint a qualified accountant as a trustee; however, this can prove costly.

##### Length of trusts

- A possible disadvantage of testamentary trusts is that the financial affairs of family members may be inextricably linked for many years.
- Sometimes serious family disputes may arise.
- Careful drafting of the trust can minimise disagreements and equip the trustee with the power to deal with disputes between beneficiaries.
- This may sometimes involve a trust being wound up.
- Testamentary trusts may also be challenged via the Administration and Probate Act 1958 (Vic). In certain circumstances the Court may order that provision be made out of the estate of a deceased person for the proper maintenance and support of a person for whom the deceased had responsibility to make provision.

##### Amount of assets

- If all your assets are owned jointly with another person or by a family trust, there may be insufficient assets in your estate to make the establishment of a testamentary trust worthwhile.

- However, if you are uncertain about whether you will have sufficient assets in your estate, a testamentary trust can simply be included as an option in your will, with the trustee(s) making the decision whether or not to implement the trust at the relevant time.

#### The difference between a Testamentary Trust and a Family Trust

The assets of your family trust will not form part of your estate. If all assets are presently owned by your family trust, there would be no point in establishing a testamentary trust unless you planned to wind down your family trust and transfer the assets in it to yourself.