Ivy Law Group

TESTAMENTARY DISCRETIONARY TRUSTS

A testamentary trust is a discretionary trust created by a Will. You might be familiar with different types of trusts that are recognised by the law, each created for its individual purpose, and commonly include, family (discretionary) trusts, unit trusts, charitable trusts and superannuation trusts.

There are also several types of testamentary trusts, each drafted and tailored to the needs of the willmaker and the beneficiaries. The most commonly used testamentary trust is the 'Testamentary Discretionary Trust', which is similar to a family discretionary trust.

This document provides basic information relating to a Testamentary Discretionary Trust and its various features.

PRIMARY CHARACTERISTICS

While family discretionary trusts are often used by individuals during their lifetime, testamentary discretionary trusts are often incorporated by individuals in their Wills for various reasons.

Testamentary trusts are created with the objective of coming into effect after the willmaker's death. More often than not, the main beneficiary has effective control of the trust either by way of:

- the main beneficiary being the trustee, personally; or
- the main beneficiary having the ultimate power to appoint or remove the trustee(s).

Drafting testamentary trusts is influenced largely by the intended beneficiaries' identities and their stage of life.

TRUSTEE POWERS

When deciding on your testamentary trust, it is important to remember that the trustee can be granted the power and discretion to determine who among the possibly wide class of potential beneficiaries will receive distributions of income and/or capital. It is up to the willmaker to decide in their Will the extent of these powers.

ESTATE PLANNING

A Will is not always a sufficient tool in estate planning. A Will incorporated testamentary trust can fulfil what a Will alone may otherwise be lacking. An integral part of estate planning is also anticipating the impact of tax on the estate as well as the entitlements of the beneficiaries of the estate. A properly drafted testamentary trust can optimise the ultimate benefit, after payment all taxes and charges, available to the beneficiaries.

ASSET PROTECTION

Testamentary trusts have an added benefit of allowing beneficiaries to have a legal structure to 'quarantine' or protect their inheritance (benefit under the trust), differentiating their inheritance from their personal assets. This is particularly advantageous in the following circumstances, where a beneficiary:

- dies and the surviving spouse re-marries or enters into a de facto relationship, where the assets held in the testamentary trust may be insulated for the benefit of the deceased beneficiary;
- is in a family law litigation, where an inheritance is unlikely to be the subject of the orders made by the Family Court (Note: Though this is not impossible, as the inheritance may still be regarded as a 'financial resource' and therefore may impact upon the ultimate terms of a family law property settlement);
- is exposed to financial difficulty or claims by third parties, where the inheritance may be protected, as the assets are not held by the individual beneficiary, but rather by the trustee, of the testamentary trust on behalf of the beneficiary, who have the discretion to distribute to any of the nominated beneficiaries;
- is intellectually disabled or has some form of illness or other weaknesses, where the assets are managed for the benefit of that beneficiary;
- is a child, where his or her inheritance can be applied towards their education, travel and general advancement in life, until such a time that they are of a certain age and at which time the interest is fully vested under the trust.

INCOME AND CAPITAL GAINS TAX

Income streaming, or splitting income among a number of taxpayers, within a family (beneficiaries) is a powerful way to effectively reduce the overall impact of tax on a family as a whole.

Unlike an ordinary trust, when a beneficiary takes on the benefit (inheritance) under a testamentary trust they are not required to pay tax on the income generated from the inheritance at the top marginal tax rate, even where the beneficiary is a child under the age of 18 years receiving over $1,000.

The current resident tax rates 2021-22 (excluding 2% Medicare levy of 2%), are:

Taxable income	Tax on this income
0 – $18,200	Nil
$18,201 – $45,000	19 cents for each $1 over $18,200
$45,001 – $120,000	$5,092 plus 32.5 cents for each $1 over $45,000
$120,001 – $180,000	$29,467 plus 37 cents for each $1 over $120,000
$180,001 and over	$51,667 plus 45 cents for each $1 over $180,000

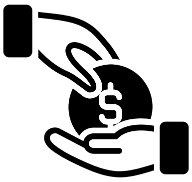
However, if income is split among a number of family members (taxpayers), then the overall tax implication on the family is significantly reduced.

In addition, capital gains realised on assets of a testamentary trust can also be streamed to one or more beneficiaries in a tax effective manner. Distributing to beneficiaries with low income in a particular year, allows them to take better advantage of the averaging rate of capital gains tax (CGT) losses over the years. This means that the tax payable on capital gains on realised assets can be considerably reduced if implemented appropriately.

INCOME AND CAPITAL GAINS TAX

It is important to note the following:

- Except certain assets such as your principal place of residence (your home) and car or motorcycle, most assets purchased by the deceased person before 20 September 1985 are subject to CGT when they are acquired by the beneficiaries from the date of death.
- Most assets purchased after 20 September 1985 by the deceased person are subject to CGT when they are sold or otherwise disposed of by the executor(s) or beneficiary/ies, as the case may be.
- Principal residence does not attract CGT provisions until two years after the date of death and the exemption continues if it continues to be the principal place of residence of the beneficiary.



Further, it is important to consider that the passing of assets from the deceased, if the deceased was survived by a spouse, to the surviving spouse could result in disentitlement. This can be remedied by incorporating a testamentary trust in your Will. Whether you are a recipient of a full or a part pension or otherwise, the current assets test as of 1 July 2021 is made available by Services Australia. (***Note: Such a Will has no effect on assets that are owned as joint tenants that pass as a result of the rule of survivorship).***

Any real property in NSW attracts land tax, unless the property is the principal place of residence. Land tax is calculated above the land tax threshold, either at the general threshold or the premium threshold, and applies for the full year following the taxing year of 31 December. Revenue NSW updates this information in October every year. A deceased person's principal residence is exempt from land tax until the property is transferred to a person other than the estate's personal representative or beneficiary, or for two years from the date of death. However, land tax is exempt if the occupant can live in the property under the deceased's Will (for example, by way of a life estate) or if the occupant lived in the property when the owner died and has been given permission to continue living there by the personal representative of the deceased.

SUPERANNUATION AND INSURANCE PROCEEDS

Superannuation and life insurance policies is another important consideration, where testamentary trusts have the ability to deal with the monies or proceeds of any annuity pursuant to any superannuation and life insurances policies in a tax effective manner.

The willmaker can direct the trustee of the superannuation fund as well as the insurance policy to pay the proceeds to the deceased's estate (legal personal representative) in which case the executor and, in the case of a testamentary trust, the trustee will deal with the proceeds in accordance with the terms of the Will and the testamentary trust.

Need help with your testamentary trust?

Our trusted Wills & Estate Lawyers are here to help. Call us on **02 9262 4003** for a confidential discussion or submit an online enquiry.