

FREQUENTLY ASKED QUESTIONS
Testamentary Trusts





What is a Testamentary Trust?

A testamentary trust is a discretionary trust set up by a Will. Creating a testamentary trust in your Will can have significant advantages for your beneficiaries instead of giving them an outright gift in a standard Will.

Under a standard Will without testamentary trusts, a beneficiary receives their inheritance directly in their own hands. It is then up to the beneficiary to decide how that money is invested or spent. The beneficiary will pay income tax on any investment income earned by the inheritance at his or her marginal tax rate. The inheritance forms part of the beneficiary's pool of personal assets which are available for distribution in the event of relationship breakdown or insolvency.

By contrast, a testamentary trust involves a trustee holding the inheritance on trust for a number of potential beneficiaries, usually family members or related entities, who are identified in the Will. Depending on your objectives, the trustee may be the principal beneficiary (e.g. your child) or a trusted independent person (e.g. your accountant or a friend). The trustee has the discretion to regularly distribute the income and capital of the trust between the potential beneficiaries.

What are the advantages of testamentary trusts?

Protection from Divorce

If a beneficiary (say, your child) separates and is involved in family law property proceedings, a testamentary trust will keep your child's inheritance separate from his or her own assets, and likely quarantine it from a claim by the separated spouse. In this way, your estate is left to your direct descendants, rather than potentially being divided in a family law dispute. If you are particularly concerned about relationship breakdown in the next generation, we can customise a testamentary trust to provide the maximum protection for your beneficiaries.

Protection from Bankruptcy

Asset protection is a growing concern as more people become involved in financial activities (such as giving guarantees for business or borrowing to invest) or are involved in a profession that may expose them to liability. A properly designed testamentary trust can provide important protection for your intended beneficiaries. The assets within the testamentary trust are segregated from a beneficiary's personal assets and will be protected if a beneficiary gets into financial difficulties or becomes bankrupt.

Tax Planning Opportunities

A testamentary trust provides considerable opportunities to minimise the tax that would otherwise be payable by your principal beneficiaries. A testamentary trust enables the trustee to distribute income between beneficiaries in such a way as to manage the total income tax payable by the group.

The particular benefit of testamentary trusts, as opposed to trusts set up during a person's lifetime, is the tax treatment of income paid to minors. Where minor children receive income from a testamentary trust, they are taxed on that income as adults, and enjoy an adult's tax-free threshold. From 1 July 2012, the tax-free threshold increased from \$6,000.00 to \$18,200.00, so the potential tax savings where income is distributed to minors from a testamentary trust are now even more significant.





An Illustration

You intend to leave a Will in which your son, Bill, is to receive an inheritance of \$600,000.

Bill earns a salary of \$90,000 and has three young children. Bill plans to invest his inheritance in a mixture of shares and term deposits. Bill's financial advisor tells him he can expect an investment return of 8% being an annual investment income of \$48,000.

If Bill receives his inheritance directly under a standard will, the investment income is added to Bill's salary and Bill will be liable to pay 37% tax on any income earned on the inheritance.

Alternatively, if your Will creates a testamentary trust controlled by Bill, he will be able to distribute the investment income between his three children as follows:

Beneficiary	Income	Tax
Child 1	\$16,000	\$ Nil
Child 2	\$16,000	\$ Nil
Child 3	\$16,000	\$ Nil
Total		\$ Nil

This amounts to a tax saving of \$18,000 for Bill and his family for each financial year.

(Note: these tax calculations are based on rates effective as at 1 July 2019. Medicare and other levies have not been considered for these purposes.)

What are my options?

The terms of the testamentary trust can be tailored to suit your goals and the needs of your intended beneficiaries. For example, you may wish to make the testamentary trust optional and give your principal beneficiaries the choice to take the whole or part of their inheritance directly rather than in a trust. Alternatively, you could make the testamentary trust mandatory and place restrictions or conditions on how the capital or income of the trust is distributed.

The testamentary trust may have a wide pool of potential beneficiaries to provide maximum flexibility to the trustee, or you may wish to restrict the potential beneficiaries of the trust to your children and grandchildren.

We can discuss your wishes and guide you through your options to create a Will with testamentary trusts that suit your circumstances. The important thing is that your beneficiaries can only enjoy the advantages of a testamentary trust if you provide for this in your Will. A testamentary trust cannot be inserted into a Will after the will-maker's death.

Click on the article titles below to learn more about Testamentary Trusts

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[Protecting clients estates with testamentary trusts](#)





A message from **Phil Davey**

DDCS Lawyers has dedicated estate planning lawyers who are highly experienced with testamentary trusts. We can advise and assist you with preparing a Will with testamentary trusts.

For further information or to make an appointment with our Wills & Estates Team, please contact Phil Davey or Theresa Dowling on 6212 7600 or by email at estates@ddcslawyers.com.au.

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