WHAT IS A TESTAMENTARY TRUST?

This information sheet is intended as general information only and should not be relied upon as legal advice.

A Testamentary Trust (**TT**) is a trust written into the terms of a Will. A beneficiary's inheritance is, then, deposited into the TT rather than passing to that beneficiary outright on the death of the Willmaker.

A TT operates similarly to a family trust, but only comes into existence following the death of the Willmaker. The TT is administered or managed by the trustee for the benefit of a range of potential beneficiaries who may receive income and/or capital from the trust at the trustee's discretion.

A TT is also known as a discretionary trust, because the trustee has complete discretion about who will receive income and/or capital from the trust and in what proportions.

In addition to the trustee, a TT may also have a protector (known as appointor or guardian). The protector oversees the work of the trustee. The protector has the right to remove the trustee and consent or veto core decisions, such as distribution of capital or exclusion of a beneficiary.

OVERVIEW OF POTENTIAL BENEFITS OF A TT

Asset Protection	- against creditors - in matrimonial disputes
Preservation of Assets	- for the children, if the spouse re-marries - for grandchildren, if the child dies - for the child, if the child is vulnerable or not trustworthy

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Tax Advantages	- minors taxed at adult rates - income splitting - income streaming

POTENTIAL ASSET PROTECTION
A TT may protect a beneficiary's inheritance if the beneficiary: - finds themself in financial difficulties (unable to meet creditor demands); or - becomes involved in property dispute because of a relationship breakdown; - is vulnerable because of a disability or addiction; - is susceptible to undue influence of a spouse or friends; or - is simply no good at managing money. This protection is possible as a result of the separation of the legal ownership (held by the trustee) and the beneficial interest (enjoyed by the beneficiary).

INCOME SPLITTING
TTs provide a favourable tax position when paying income distributions to children under 18. In other words, distributions of income from a TT to a child are treated as employment income and the child receives $18,200 tax free threshold (2013/2014 rate) and then pays marginal tax rates on the balance. This advantage is only available to TTs written into the Wills by Willmakers, not any other trusts.

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INCOME STREAMING

Income streaming is the ability to pay different classes of income to different beneficiaries.

For example, paying the fully franked dividend received on BHP shares to Beneficiary A and paying the franking credits to Beneficiary B. This gives the trustee the greatest flexibility when it comes to distributing income to the beneficiaries, and it also allows for a more tax effective trust.

EXAMPLE….

Glenn and Annie

Glenn is 57 and Annie is 55, they have 2 adult children, Jenny and Jarrod.

Jenny has 2 toddlers and is a stay home mum. Glenn and Annie do not like Jenny's husband.

Jarrod is getting married, this year, to Barbara. Barbara suffers from depression and has in the past battled an addiction to an anti-anxiety medication.

Jarrod runs his own business.

Although, generally pretty happy, Glenn and Annie are concerned that:

- Jenny and her husband may split up
- If Jenny dies, Jenny's husband should not get Jenny's inheritance
- Jarrod's business could go wrong
- Barbara could spend Jarrod's inheritance unwisely

The best solution to Glenn and Annie's concerns is incorporating TTs in their Wills –

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one for Jenny and one for Jarrod (or a joint trust for both of them).

The individual or the joint TT would not give Jenny's spouse any access to the money. Jenny would have to decide to give him funds in order for him to benefit.

If Jenny dies, the TT would continue for the benefit of her children and her husband does not need to control it.

In the meantime, Jenny and her children can share the income from the TT and pay hardly any tax – ie they can each receive $18,200 tax free per year – that's $54,600! Glenn and Annie just hope they can leave enough assets to generate so much income!

The individual or a joint TT would not give Barbara any control, either. Barbara will be one of the beneficiaries and if Jarrod decides to, she can receive funds.

Jarrod's inheritance is likely to be quarantined from creditors of his business and in the event of a dispute with Barbara!

Glenn and Annie asked the following questions:

Q: how much will it cost?

A: Between $1,700 - $2,200 to prepare the TT Wills for each of them, and then the ongoing annual cost of a tax return for the TT after its establishment.

Q: How much money should be left to a TT to make it worthwhile?

A: generally about $300,000 makes it worthwhile. But if there is an unstable marriage or business or the beneficiary cannot look after the money, even $50,000 makes it worthwhile because a TT gives you a shot at protecting it and preserving it for the person of your choice.

Q: Jenny has a large mortgage, she probably won't want a TT.

A: the TT can pay off Jenny's mortgage and Jenny will owe the TT these funds! She will have no debt to the bank, but the money will still be protected if she splits up from her husband or if she dies, her husband will not be able to take her inheritance to his next marriage as his own money. It will be preserved for the grandchildren.

General comment – as with everything in life – there are no guarantees! TTs will only achieve the above advantages, if the trustees and beneficiaries carefully follow the rules of the trust!

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