TESTAMENTARY TRUSTS

A testamentary trust is created within a last will and testament with the aim of distributing an inheritance to a designated group of individuals instead of directly to a single person.

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A testamentary trust is created within a last will and testament with the aim of distributing an inheritance to a designated group of individuals instead of directly to a single person. An individual is appointed as the trustee responsible for overseeing the trust, and a specified group of potential beneficiaries is also designated.

This division of authority and entitlements can offer potential tax benefits and safeguard assets from legal disputes involving a beneficiary or misuse by a beneficiary.

Benefits

1. A testamentary trust can shield assets for beneficiaries who may lack the financial acumen to manage their finances independently, such as a disabled child or a beneficiary with a penchant for excessive spending.
2. It offers protection for beneficiaries vulnerable to bankruptcy or divorce.
3. Income and capital can be distributed to beneficiaries in a tax-efficient manner, particularly beneficial when there are young children in the family.

How it works

A testamentary trust is established through your last will and testament, only coming into effect after your passing. Your will can specify that all or part of your estate assets should be transferred into the trust.
Typically structured as a discretionary trust, it grants the trustee full discretion in distributing assets to beneficiaries.

The choice of trustee is yours, whether it's the executors of your will, your spouse, partner, or your children. The trustee holds effective control over the trust, so it's crucial to nominate someone you trust to act in the beneficiaries' best interests. You can nominate more than one trustee and specify whether they can act individually or require joint decision-making.

When setting up a testamentary trust, you should consider:

- Whether to establish one or multiple testamentary trusts, with each trust possibly having a different trustee.
- Who should be the trustee.
- The process for appointing replacement trustees.
- Whether to limit beneficiaries to your descendants or include their spouses.
- Whether some beneficiaries should receive income while others receive capital.

For maximum flexibility, you may grant the executor of your will the discretion to not establish the trust based on circumstances at the time.
Because trust assets are not personally owned by beneficiaries, they may enjoy some protection from creditors, former spouses, or legal disputes.

Tax Advantages

While the primary purpose of a testamentary trust is to manage estate assets for income generation, it can also yield tax benefits.
The trustee typically has the discretion to manage the distribution of both capital and income to beneficiaries, considering their respective tax rates at the time to optimise tax-effective distributions.
Income distributed from a testamentary trust to children under 18 is taxed at adult rates, avoiding the higher penalty tax rates often applied to a child's income.

Centrelink Implications

It's crucial to assess the impact of a testamentary trust on individuals involved with the trust who receive or expect to receive income support payments from Centrelink or Veterans' Affairs (DVA).
If you designate a Centrelink recipient as the appointer, trustee, or beneficiary of your testamentary trust, all trust assets and income will generally be considered as part of their assessment, potentially affecting their entitlements. Therefore, you may want to consider excluding such individuals from any involvement with the trust.

Key Considerations

- Be mindful of the administrative costs associated with managing a testamentary trust, particularly if you appoint a professional trustee, as their services come at a cost.
- Note that the capital gains tax exemption for a family home does not apply if the home is owned by a trust.
- Regularly review your will to ensure it aligns with your current wishes and incorporates changes in your circumstances.

References

You may wish to refer to the following websites for further information about testamentary trusts:

- www.moneysmart.gov.au
- www.ato.gov.au
- www.serviceaustralia.gov.au

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