

# **INFORMATION BROCHURE-** **TESTAMENTARY DISCRETIONARY TRUSTS**

## **What is a Testamentary Discretionary Trust?**

A testamentary discretionary trust is a trust that is set up by the willmaker in their will which:

- Appoints a trusted family member(s), friend(s) or professional as trustee, to hold the estate upon trust in favour of a number of beneficiaries specified in the will.
- Those beneficiaries typically include the spouse and children as primary beneficiaries in the first place, but will also include other relatives such as parents, siblings and grandchildren of the primary beneficiaries within a discretionary class of beneficiaries.
- The person (or people) whom the willmaker most wants to maintain control of the trust (for example, the surviving spouse or children) are named as appointor of the trust and will have the right to appoint a replacement trustee. It is the appointor(s) who effectively maintains the ultimate control of the trustee's decision-making.

## **How Does a Testamentary Discretionary Trust Operate?**

The trust comes into operation upon the death of the willmaker. The trustee will take control of the willmaker's estate, in the name of the estate.

The terms of the trust will allow the trustee to exercise a discretion to distribute either income or capital or both to any of the beneficiaries named in the will during the life of the trust. The trustee may distribute capital and income to any nominated beneficiary at any time and in any proportion.

The beneficiaries pay income tax on their allocated share of income according to their normal marginal tax rates. However, unlike tax on income from a family trust, beneficiaries under 18 years of age are taxed at normal adult rates rather than at penalty tax rates. So the potential for tax savings when trust income is allocated to children may be substantial.

The strength of such trust arrangements lies in their flexibility. The power of a beneficiary to exclude him or herself from the trust, the power to advance capital and the power to bring the trust to an end, all create flexibility so beneficiaries can control when they take their inheritance whilst the trust may be wound up where family circumstances or legislative change make it appropriate.

### **Advantages of a Testamentary Discretionary Trust**

A testamentary discretionary trust has some of the following benefits:

- It may be used to keep the assets in the hands of the trustees rather than the beneficiary personally, so that the assets cannot be attacked by creditors, Family Law property settlements, trustees in bankruptcy, or those who prey on the weak;
- It may be used to keep assets in the name of the trustee rather than the beneficiary personally so they are not subject to means testing or assets testing by the Department of Social Security;
- It may be used by trustees to manage the affairs of minor beneficiaries, by distributing trust income (and possibly capital) to pay for maintenance and education until their adulthood, when they may decide for themselves how the funds are used;
- It may be used to distribute income to minor children of a beneficiary to generate tax savings on that income distribution;
- It can be used as a source of funds for borrowing by the beneficiary, until such time as the tax position of that person is such that other tax advantages can be used (for example, if she or he has children). At that time the beneficiary may repay any borrowed trust funds and use the trust to distribute income or hold assets in the ways set out above.

The tax benefits of a testamentary discretionary trust are that lower tax rates may apply to infant beneficiaries of the trust.

The effect of the current Tax provisions are that children under the age of 18 receiving excepted income from a Testamentary Trust may be entitled to be taxed at adult rates, including the adult tax-free threshold, rather than the higher tax provisions as set out in the Act.

A further advantage of a testamentary discretionary trust structure is that it avoids the double handling involved in setting up an estate proceeds trust, which may attract stamp duty and CGT.

### **Disadvantages of a Testamentary Trust**

A testamentary discretionary trust is useful if there are minor children in the family (to take advantage of the tax benefits), or where there are beneficiaries with a real likelihood of having marital or bankruptcy problems or any of the other categories of "problem beneficiaries". The structure is potentially complex and the cost of maintaining the structure (such as obtaining accounting and legal advice) may not be worth incurring where there is no real benefit to be gained.

The family may also be at the mercy of an inappropriately chosen trustee. The trusted family friend who has a restrictive view of how the family should be spending money may exercise the power to distribute very frugally. Family members who are trustees or who obtain control over the trust may act in concert to freeze out another family member.

If you are considering making a testamentary discretionary trust, we advise that you should also contact your accountant to discuss. We are unable to give accounting or financial advice.

### **Where to now?**

If you are interested in having a testamentary discretionary trust drawn for you, or you have any questions about how this structure may be applied in your circumstances, please call our office on 9692 6500 to make an appointment to discuss your estate planning requirements with one of our expert estate planning lawyers.