Fact Sheet.

Australian Unity

What is a testamentary trust?

A testamentary trust is incorporated in a will, and does not come into force until the passing of the will maker. The will maker can decide which assets are held in the trust or can leave that discretion to the executor to consider what is most appropriate at the relevant time, and who will receive them. A testamentary trust may provide tax advantages for the beneficiaries, as well as asset protection benefits.

How does a testamentary trust work?

Once a testamentary trust comes into effect, the assets can be transferred directly to the trustee of the testamentary trust. The trustee (or trustees) then has effective control of the trust and its assets, though the trustee must act within the rules of the trust deed (which were designed by the will maker).

The trust's nominated beneficiaries are generally the will maker's partner, children and/or grandchildren.

The trustee generally has discretion to decide which of the nominated beneficiaries receive income and capital distributions each financial year.

It is therefore important you appoint someone you trust to act as trustee (for example your partner or adult children), or use the services of a trustee company.

Who should create a testamentary trust?

It may be prudent for you to consider using a testamentary trust, rather than directly distributing assets to your beneficiaries via your will, if you are concerned:

- your beneficiaries do not have the ability to manage or protect your assets after you pass away – for example, they might have lost capacity to manage their own affairs;
- your beneficiaries could face bankruptcy, family breakdown or legal action;
- your beneficiaries will not receive the full benefit of the income generated by your assets because of potential tax consequences.

Note: An executor can have flexibility to distribute some assets directly, as opposed to via a trust. It is possible to draft a testamentary trust so that if a beneficiary did not want to receive their portion of your estate by a testamentary trust, then.

How does a testamentary trust protect assets?

The testamentary trust legally owns the assets it holds. Your beneficiaries do not.

Therefore, assets are protected from your beneficiaries' creditors in the event of bankruptcy or successful legal action against them.

Similarly, holding assets in a testamentary trust may provide significant protection in a potential property settlement.

Your beneficiaries will not have access to your assets in the trust to liquidate and spend as they see fit. This can help ensure your assets are protected.

You may be able to improve the preservation of your assets for the next generation, however it is imperative for the testamentary trust to be drafted appropriately to ensure it is successful in protecting your assets.

How can a testamentary trust be tax effective?

Depending on your beneficiaries' circumstances, a testamentary trust could assist them with minimising tax liability as they have the ability to distribute income to a range of potential beneficiaries.

Importantly, any income allocated to a child under 18 from a testamentary trust is subject to adult tax rates (including the $18,200 tax free threshold). Note: other types of unearned income which is distributed to minors is generally taxed at penalty rates.

Here is an example to explain the potential tax effectiveness of distributions from testamentary trusts.

In our indicative example, Eve passes away leaving behind two sons and three grandchildren. Eve has set aside $1 million dollars for each son. Both sons are on the highest marginal tax rate of 45% (plus levies).

If Eve distributes this money via her will, and the sons invest this to generate an income of say 4% p.a., almost half of that income will be lost to tax (see Chart 1).

If, however, Eve utilises a testamentary trust, the amount of tax paid could be significantly reduced. For example, the trustee could choose to distribute no income to the two sons, but instead distribute the income to their spouses and children who earn no other income (see Chart 2).

As a result, the families would pay no tax on the income distributed by the testamentary trust.

And, should one of the sons face bankruptcy, divorce or legal proceedings, Eve's assets will be protected.

*This is an indicative example. Each individual's circumstances may differ and impact any tax liability. You should obtain your own tax advice.

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Chart 1: Indicative example –
Distributing an inheritance via a will

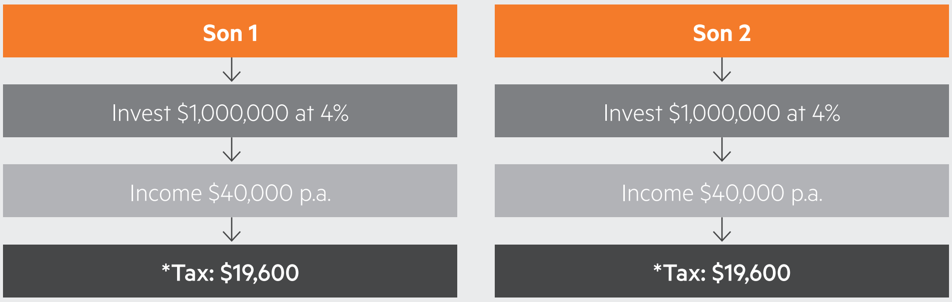
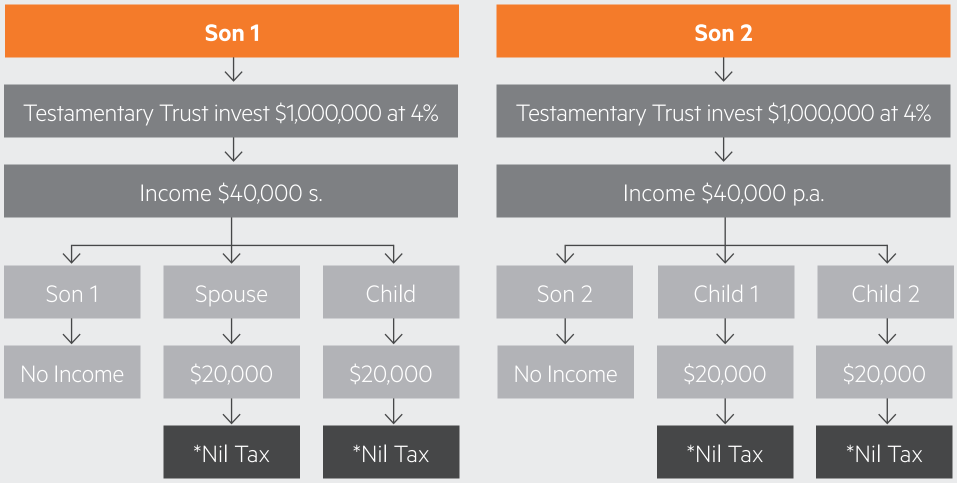


Chart 2: Indicative example –
Using a testamentary trust



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