

THE GUIDE TO **TESTAMENTARY** **TRUSTS**

Inclusive of a data capture to help establish your own for one or all of your family

GRANT ABBOTT

THE GUIDE TO TESTAMENTARY TRUSTS

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INTRODUCTION

A testamentary trust ("TT") is commonly used by estate planning lawyers to protect the assets and inheritance of the testator's beneficiaries from creditors, family law actions and, at the same time, provide flexibility in relation to the distribution of the estate. In essence, a testamentary trust, or multiple testamentary trusts, is a trust that arises from the estate of the deceased and its terms are contained in the Will.

There are other testamentary trusts that may arise on the death of a member of a superannuation fund and in relation to the death of a person with a life insurance policy. If you have super or a life insurance policy, please let us know so we can determine the best solution having regard for your needs and wishes.

A TT IN PRACTICE

Let's look at John Smith who is a widower with a daughter Sarah, who is an accountant and a son Jacob, who has been in and out of rehab on a number of occasions. John wants to split his estate worth \$1M into two. He has chosen Sarah as the Executor of his estate (the person managing the distribution of the estate in accordance with John's Will). John's Will enables Sarah to take her share of his estate and apply it as she desires. However for Jacob, John wants to place Jacob's share into a TT with the following terms and conditions:

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- Sarah is to act as Trustee of the Jacob TT;
- Sarah is to be the appointor of the Jacob TT – the person who can hire and fire the Trustee;
- Sarah as Trustee is to invest the monies of the Jacob TT for the benefit of Jacob and Jacob's bloodline;
- Beneficiaries of the Jacob TT are Jacob and his bloodline, but do not extend to his latest de-facto;
- Sarah is to only distribute income to Jacob with no capital drawdowns or distributions, unless to pay for medical or rehab expenses;
- Jacob is to receive income only after a drug test, which if he fails, the income is to be set aside;
- If Jacob passes away the TT is to continue for the benefit of his bloodline and if none are living, for the benefit of Sarah.

The terms and conditions of the trust, (including the appointer, income and capital beneficiaries, trustee, and so on) are to be designated in the Will of the deceased. Later on, we will look at some of the key terms and questions and provide a data capture that enables the creation of a testamentary trust.

Important: A testator (the person creating the Will) may want a TT for each of their children or one for the whole surviving family. In the John Smith case, he could have made one TT for both Sarah and Jacob with Sarah to hold the Trustee and Appointor positions, or one for each of them, or make Jacob's mandatory and Sarah to have the option of a TT so she can protect the monies her father has left her. There is no right or wrong answer: the testator, knows their family. Just bear in mind that the more TTs established, the more costs in administration each year but then again, the benefits as you will see below can be worth it.

THE PROS AND CONS OF A TT IN YOUR WILL

The benefits and limitations are discussed below.

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BENEFITS

- Control is held by the trustee of the testamentary trust and obviously the person who has the power to appoint and remove the trustee is called the appointer of the trust. It is vital to have a line of succession when it comes to appointors, to protect the wealth in the testamentary trust and to fulfill the aspirations of the testator.
- It is built for the purpose of looking after the family and others on the death of a family member, with income and capital distributed by the trustee to a group of family or non-family beneficiaries. Generally, the testamentary trust will require the trustee to look after family members in a specified way, rather than provide the trustee with complete discretion.
- It can be built to be bloodline specific preventing dissipation of family wealth outside of bloodline.
- The trustee is able to look after capital and income beneficiaries differently. The trustee may distribute a capital gain to one beneficiary and a dividend to another, while a third may receive property income (depending on the terms of the trust deed).
- A capital gains tax discount of 50% applies to any assets disposed of by the trustee provided the trustee has held them for more than 12 months. Although the trustee claims the discount, they distribute the pre-tax capital gain to the beneficiary. This enables the beneficiary to claim the discount in their own hands and more importantly, offset the capital gain with any capital loss that they may have from the disposal of assets in their own name, in the current or prior years.
- Assets are protected from creditors. Any assets in the testamentary trust may be protected from creditors of the potential family beneficiaries.
- If structured correctly, assets in the Trust may not form “matrimonial property” for family law purposes providing potential protection in the event of a family law dispute.
- The trustee of a testamentary trust may be in receipt of superannuation benefits on the death of a member of a superannuation fund with those benefits to be held for the use of the deceased’s dependant beneficiaries. Any such receipt by the trustee of the testamentary trust is tax free.
- *Minor beneficiaries are not subject to penalty rates of tax on distributions of TT income and are taxed as adults.*

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DRAWBACKS

- Trusts are complex structures, particularly when different types of income and capital are distributed among beneficiaries under a wide-ranging trust deed. This means added costs of running a testamentary trust but in the long run, the protection afforded and the inter-generational flexibility for income distribution by the testamentary trust, can certainly justify these added costs.
- Where specific requirements are built within the trust deed (e.g. each child to receive a set amount of income each year), the drafting of the legal document is crucial and a poorly drafted deed will create more problems than benefits.
- As with an inter vivos trust, all income and capital gains must be distributed annually or the testamentary trustee pays tax on the income at the top marginal tax rate of 45%. In the case of a trust with different income and capital beneficiaries, this means that in terms of capital gains made by the trust, it must choose one of the following options and still balance between both types of beneficiaries:
 - Distribute capital gains to capital beneficiaries whenever made which reduces the asset base for the income beneficiary;
 - Distribute capital gains as part of the income of the trust to the income beneficiary if the income of the trust includes assessable capital gains;
 - Keep it in the trust with the trustee paying tax at 45%;
 - Keep it in the trust with the capital beneficiary paying tax with distributions recapitalised.
- Income distributed from the trust is subject to tax at the beneficiaries' marginal tax rate, (although imputation credits on dividends received and passed through to a beneficiary will shelter some of the tax payable). There are no tax concessions provided to beneficiaries of a testamentary trust except that minors are taxed as ordinary taxpayers with the usual issues arising for non-resident beneficiaries.

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QUESTIONS AND ANSWERS

1. Does the TT start as I complete my Will?

No. A trust can never come into existence until it is settled with some money or property. Up until that time, any TT terms set out in the Will only document the intent of there being a TT when the testator dies and there are funds or assets to settle the TT.

2. Who should be the Appointor and Trustee?

Generally, the first Trustee and Appointor to get things started may be the Executor. This is particularly the case where the estate is being held for minor children. A term of the TT may allow them to become a Trustee or Appointor at a designated time or age.

3. Can I change my Will and add a TT?

At any time, a testator can revoke their old Will and replace it with a new Will which may include one or more TTs.

4. Why is a Will with a TT more expensive to prepare than a normal Will?

A TT can be a very important feature to preserve family wealth and for some bloodline beneficiaries only, so it needs more legal work to meet your exact needs, hence the extra costs.

5. What if I have a young family?

Always prepare for the worst case and then anything lesser will work better. For a testator with a young family, what happens if both parents die? The questions to be asked include:

1. Who is to be the guardian of the children?
2. Will the guardian be paid for undertaking their designated responsibilities and if so, how much?
It will be for the Executor to manage the ongoing allocation of funding.
3. What assets or resources are to be provided for orphaned children and what are the applicable terms and conditions?

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As you can see, with a young family, implementing a TT in a Will can be a powerful and comforting strategy. Terms and conditions to be considered including, when will the children have access to capital – potentially age 25 unless it is to be used to acquire a first home or for education purposes. Plus a TT is an important mechanism for protecting from future family law or defacto spouse actions against the beneficiaries of the TT. When will the children become trustee of the TT or appointor? Plus, it is a good idea for the parents to put in place life insurance to benefit the children.

6. How many Trustees can I have?

It is important to have more than one person designated as Trustee so that the management and decision-making load is shared. Generally, it is preferable to have a special purpose corporate trustee with one or more directors, but remember at the end of the day it is the Appointor who has the power to appoint and remove the Trustee.

7. What about Super?

Superannuation sits outside of a member's Will but can be directed to the executor for distribution and inclusion in a special purpose TT from the Will, known as a super proceeds TT. However, a TT can be created by the Trustee of a self-managed super fund ("SMSF") rather than go through an estate – particularly if the estate may be challenged. It is much the same as a TT in a Will, but terms and conditions of the TT are to be inserted into a SMSF Will – a special purpose Will for SMSF monies only.

8. What about Insurances?

Insurance sits outside of a member's Will but can be directed to the executor for distribution and inclusion in a TT from the Will. However, a TT can be created by an adviser to the insurance beneficiary rather than go through an estate – particularly if the estate may be challenged. It is much the same as a TT in a Will, but terms and conditions of the TT are to be created by the adviser in concert with the TT beneficiaries or at the prior directions of the testator.

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DATA CAPTURE – WILL WITH TESTAMENTARY TRUST (“TT”)

The following interview for your Will and TT (plus SMSF Will if you have a self-managed super fund) captures details around who will be looking after your affairs in the event of your passing (your executor).

It also looks at whether you want to leave any specific gifts to anyone and finally who and what percentage of the estate you would like to leave to one or more of your primary beneficiaries once gifts, taxes and loans are paid out. Also, for completeness, if your chosen beneficiary is not alive, what is to happen to their intended share - such as being redistributed to the remaining primary beneficiaries, or to be passed onto a secondary beneficiary if there is no surviving primary beneficiary, such as a spouse, alive at the time of your death. And of course, you can provide that one or more of the gifts or residue of the estate be placed into a family TT or special purpose TTs for one or more child beneficiaries.

The interview also includes whether you have any funeral wishes, what may happen to digital assets such as Bitcoin or Facebook, if you have children under 18 or pets, who is to be their guardian and if you own a property and want your spouse or some other person to live in the property for their life (known as a life interest in property).

If you have a self-managed superannuation fund you will also be able to leave instructions on how you would like your superannuation benefits paid in the event of your death. Your Will cannot designate at law, what happens to your superannuation benefits. This is the purpose of the SMSF Will.

If you have any questions, please do not hesitate to contact us and we look forward to receiving the following information as soon as possible so that we can complete the relevant documents based on your Interview Data Capture.

Alternatively, we can complete the Interview Data Capture by way of a Zoom meeting – please contact us to arrange this meeting.

Bloodline Focus: Importantly, we can build a set of documents that ensures that your wealth is protected for the benefit of your bloodline. If this is of interest tick the box below:

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- Please ensure that any estate planning or other documents are established for the benefit and also the protection of my bloodline.

A. YOUR NAME AND ADDRESS

NAME	AGE	ADDRESS

B. COMMON PARTIES AND ADDRESSES

To make life easier, please enter in this table all those persons who may be nominated by you in various capacities as your enduring power of attorney, estate including Executors, family members, beneficiaries and any other person for example, this may be: John Smith – Son – 11 Olde Road Jonestown WA 7043

NAME	RELATIONSHIP TO YOU	ADDRESS

C. WHO IS TO BE YOUR EXECUTOR?

1. After your passing, a specialist probate lawyer will seek probate for your Will through the State Supreme Court. Once probate is granted, your Executor is formally appointed to act as the Executor of the estate. Please detail below from the list of people above, who is to be your Executor. This may be held jointly or by one or more persons. If you want different persons for the roles, please write in the box the name of those persons but for simplicity and safety it is best to have one person or persons doing the same role.

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NAME OF EXECUTOR – ensure their details are in the common parties above

2. In the event that none of your Executors are able to fulfill their duties because of sickness, incapacity or death; who is to be your successor Executor? This may be held jointly by one or more persons. If you don't want a second line of Executors just put "NA"

NAME OF SUCCESSOR EXECUTORS – ensure their details are in the common parties above

3. In the event that none of your first or second line Executors are able to fulfill their duties because of sickness, incapacity or death; who is to be your third line of Executor? This may be held jointly by one or more persons. If you don't want a third line of Executors just put "NA"

NAME OF SECOND SUCCESSOR EXECUTORS – ensure their details are in the common parties above

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We will be looking at making specific gifts such as jewellery, a car, cash or property to a specific beneficiary soon. After that we will look at sharing up the residue of your estate amongst designated beneficiaries. This may go to them directly, at their option into a TT or a TT which they must take for their protection. Before we get to that, consider the TT options that you may want for either the family or specific people. Just insert details that you want in the boxes below and when it comes to specific gifts or residue, just name the TT as being the recipient and we can do the rest.

Follow the below example for the son of John Smith who is the testator making the Will. Call us if you need help:

Sample: Max Smith Family Legacy Trust

Name of the Testamentary Trust	Max Smith Family Legacy Trust
Name of the First Appointor and any terms and conditions on their appointment	Max Smith
Name of the second Appointor and any terms of conditions on their appointment	Bill Smith when he turns 18 and until then if his dad Max is not around his Uncle Tim Smith
Name of the Trustee or Trustees	Set up a company with Max and Tim as directors
Beneficiaries	Max and his bloodline children and if there are none, then his brothers and sisters.
Terms and Conditions for Beneficiaries	Any beneficiary under the age of 25 is not to receive a capital distribution unless it is to acquire a property, pay for medical or educational expenses
Terms and Conditions for Beneficiaries	Any beneficiary under the age of 25 is not to receive a capital distribution unless it is to acquire a property, pay for medical or educational expenses
Additional Terms and Conditions	Any beneficiary known to have a drug or alcohol addiction is to have treatment paid from the capital of the Trust

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YOUR TESTAMENTARY TRUSTS

1. FAMILY OR SPECIFIC PERSON TT

Name of the Testamentary Trust

Name of the First Appointor and any terms and conditions on their appointment

Name of the second Appointor and any terms of conditions on their appointment

Name of the Trustee or Trustees

Beneficiaries

Terms and Conditions for Beneficiaries

Additional Terms and Conditions

2. FAMILY OR SPECIFIC PERSON TT

Name of the Testamentary Trust

Name of the First Appointor and any terms and conditions on their appointment

Name of the second Appointor and any terms of conditions on their appointment

Name of the Trustee or Trustees

Beneficiaries

Terms and Conditions for Beneficiaries

Additional Terms and Conditions

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3. FAMILY OR SPECIFIC PERSON TT

Name of the Testamentary Trust

Name of the First Appointor and any terms and conditions on their appointment

Name of the second Appointor and any terms of conditions on their appointment

Name of the Trustee or Trustees

Beneficiaries

Terms and Conditions for Beneficiaries

Additional Terms and Conditions

E. WILLS - SPECIFIC GIFTS BEFORE ALLOCATING THE BALANCE OF THE ESTATE

After appointing a chain of Executors to manage your estate the next step is to guide your Executor with your desire to make a specific gift to a spouse, child, grandchild or other person. Once this is done and the gifts are made, anything left over forms the residual estate which may be passed in its entirety to a spouse or children individually or to be shared. Importantly, specific gifts rank higher in importance than the remaining estate so spend time on specifics.

The first step then is to look at specific gifts. Now do you want to make any specific gifts to any person – such as “My investment property at 5 Smith Street Collingwood Vic is to go equally to my eldest daughter Jane” or “My sister Jonie Smith is to receive \$100,000” or “All my estate is to go to my wife Janelle” or “My Executor is to distribute my personal effects and jewellery in a fair and reasonable manner.” If using a TT, then it could be “transfer the property at 100 Bump Road Dubbo NSW into the Max Smith Family Legacy Trust”.

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Feel free to make as many bequests as you want – the more specific gifts you complete, can make the role of the Executor that much easier and faster.

With any specific gift, a testamentary trust can be installed to protect the Gift within a TT structure. If you want the gift to go to a TT, just insert unequivocal details of the gift and the name of the TT you have assembled above in the gifts below. If you have any digital assets (such as Bitcoin) you can transfer them as specific gifts if you desire and leave details with the Executor of how to access the digital asset.

SPECIFIC GIFTS

GIFT	NAME OF PERSON OR TT

F. THE REMAINING ESTATE

If there are any assets or monies left over after paying all expenses of the estate (and also paying out all specific gifts) the remainder of the estate called the residual estate is to pass to the main beneficiaries if they are alive.

a) **MAIN BENEFICIARY:** Who are the main beneficiaries and if more than one, are they to take equally, or note down any specific percentages for any beneficiary or beneficiaries?

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NAME OF PERSON

PERCENTAGE OF ESTATE

b) If the main beneficiary or beneficiaries are not alive then who is to get their benefits – choose from one of the following:

- Their bloodline children which may be held in trust subject to the Executor's discretion and on the advice of the adviser of the Estate
- Any surviving Main Beneficiary in equal proportions
- To be paid to the Secondary Beneficiary
- To be paid to any Bloodline Beneficiary at the Executor's discretion

c) **SECONDARY BENEFICIARY:** If the main beneficiary has passed the estate (in the event of their death) to a secondary beneficiary or beneficiaries, are they to take equally or if not, note down any specific percentages for any beneficiary or beneficiaries?

NAME OF PERSON

PERCENTAGE OF ESTATE

d) If the secondary beneficiary or beneficiaries are not alive, then who is to get their benefits – choose from one of the following:

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- Their bloodline children which may be held in trust subject to the Executor's discretion and on the advice of the adviser of the Estate
- Any surviving Main Beneficiary in equal proportions
- To be paid to the Secondary Beneficiary
- To be paid to any Bloodline Beneficiary at the Executor's discretion

G. EXCLUDING A PERSON OR LIMITING THEIR BENEFITS AND WHY

Is there any person you want to leave out of your Will or provide only a small legacy for them? You can note the person and the reasons for making your decision here:

NAME OF EXCLUDED OR LIMITED BENEFICIARY	REASONS WHY

H. FUNERAL WISHES

What are your funeral wishes?

I. CHILD AND PET GUARDIANSHIP

If you have children or pets, who is to be their guardian? Please identify specifically with name of the guardian and any financial provision to be made to them to act as guardian.

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NAME OF CHILD	NAME OF GUARDIAN	SECOND GUARDIAN IF FIRST NOT ABLE OR ALIVE
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J. PET GUARDIANSHIP

NAME OF PET	NAME OF GUARDIAN	SECOND GUARDIAN IF FIRST NOT ABLE OR ALIVE
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K. LIFE TENANCY

If you own a property outright, (not jointly), you can gift this to one or more of your beneficiaries or let it pass to the remainder of your estate to go to your principal beneficiaries. Alternatively, you may request that one or more persons such as a spouse or de facto live in the property for the remainder of their life – commonly known as a life interest trust. If you desire this strategy, please write down the property address and who is to live in it below:

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Name of the Life Interest Trust

Name of the First Appointor and any terms and conditions on their appointment

Name of the second Appointor and any terms of conditions on their appointment

Name of the Trustee or Trustees

Life Interest Beneficiaries - Names

Terms and Conditions for Life Interest Beneficiaries

Additional Terms and Conditions - such as what happens if property sold

L. SMSF WILL

Your superannuation benefits may pass to your estate or directly to one or more of your dependants. A dependant includes your spouse, de facto, any child, any person living with you at home or any person who is financially dependent upon you (their quality of life is enhanced by ongoing and continuous contributions to their wellbeing).

A SMSF Will is a set of instructions for the Trustee of your SMSF to follow in the event of your death. In short, you can pay a lump sum to your estate to be included as part of your Will or pay it directly to a dependant who can then use that money as they wish, or you can direct it to be paid into a trust for them (SMSF Death Benefits Trust) or let them transfer it to any company or trust that they own. In some cases such as with a spouse, child under the age of 18 or financial dependant (including disabled children) an income stream or pension may be paid. This can be very tax effective.

Like the Will, the SMSF Will provides the ability to pay an amount to a dependant or your estate. Please complete the box below. For example: Jane Smith – 100% of MY Super – BC

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**NAME OR
ESTATE**

**PERCENTAGE OF
SUPER**

**INCOME, LUMP SUM, TT OR BENEFICIARY'S CHOICE
(BC)**

In the event the principal beneficiary of your superannuation estate is not alive, choose to whom your superannuation benefits are to go:

**NAME OR
ESTATE**

**PERCENTAGE OF
SUPER**

**INCOME, LUMP SUM, TT OR BENEFICIARY'S CHOICE
(BC)**

If the secondary superannuation beneficiary is not alive then choose where it is to go:

- The deceased's estate for the sole benefit of the deceased's bloodline or lineage unless a SMSF Death Benefits Trust can be established under the Superannuation Laws for the bloodline or lineage of the deceased member only
- The deceased's estate for the benefit of their family and estate beneficiaries and charities
- The deceased's estate for the benefit of the bloodline children of the succeeding beneficiary to be held in trust with income to be paid quarterly but no capital distribution until they reach age 25. If there are no bloodline children of the succeeding beneficiary, then the share of my superannuation interest is to be paid to the remainder of my children that remain alive in equal proportions

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Any other - please note below