

## TESTAMENTARY TRUSTS: THEY ARE NOT ALL THE SAME

Most of us know that a **testamentary trust** is a trust that is established by a person's **will**. Most of us are aware of the **benefits** of testamentary trusts. These include:

- **Control.** i.e. allowing the testator to exercise control over the future use or disposition of estate assets for various reasons (e.g. to protect/administer assets for the benefit of minors or others under a legal disability);
- **Tax Benefits.** i.e. each minor beneficiary of a testamentary trust can receive a tax-free distribution of \$6,000 and thereafter is taxed at normal adult marginal tax rates (as opposed to the usual position for minors in receipt of trust income - taxation at the top marginal rate). Thereafter, the testamentary trust can acquire other assets that create income streams for the testamentary trust which can then be distributed to minor beneficiaries to take advantage of this favourable tax treatment; and
- **Asset Protection.** i.e. ensuring assets are outside of the reach of a beneficiary's creditors and matrimonial claims and can be directed as desired and without transaction taxes.

**Typical Scenario:** For tax and asset protection reasons, you have advised your client to build his/her assets within a discretionary trust structure. Your client also has significant personal assets. Yet your client (and spouse) has a 'simple' will without a testamentary trust. When your client (or spouse) dies and probate is granted, his/her personal assets pass directly to the estate beneficiary personally. If the estate beneficiary is vulnerable to bankruptcy (e.g. company director or health/ other professional) or divorce, these assets are at risk. If that beneficiary is irresponsible or incapable of effectively managing the assets, these assets are at risk. If that beneficiary intends to apply income from the estate toward children under 18 years old, the top rate of tax will apply. A further transfer by the estate beneficiary to a discretionary trust (or other structure) to remedy such shortcomings will result in tax and stamp duty liabilities.

Your advice to this client was incomplete. In addition to the discretionary trust strategy, this client should have been advised to implement a testamentary trust. The effect of having a 'simple' will and not having a testamentary trust is that your client will suffer the very disadvantages you wished to avoid by implementing the discretionary trust structure.

**Not all testamentary trusts are the same.** If you are implementing testamentary trusts, it is most likely that your solicitors are simply providing you with stripped down discretionary trust deeds as a schedule to a will. This is not an optimal document. You should consider whether the standard will and testamentary trust you obtain from your usual solicitor addresses the following issues:

- Life Insurance, Compensation and Other Proceeds.** These proceeds are generally excepted under bankruptcy rules from having to be applied to settle debts of a bankrupt estate. One of the responsibilities of an executor, however, is to settle debts of the estate. A separate trust should be established in respect of these proceeds to 'ring fence' such proceeds and to avoid tainting this bankruptcy concession.
- Control of Existing Discretionary Trusts.** Unless the issue is addressed beforehand, the death of the appointor under an existing family trust can cripple the administration of the trust. This can be anticipated and dealt with by reviewing (and amending if necessary) the terms of the trust and by granting the power of appointment to an appropriate person by will. If family provision rules are a concern, granting the power of appointment by will should be avoided and other techniques used.
- Take Assets of Existing Discretionary Trusts Into Account.** In distributing the personal assets of the executor (and administering trusts over those assets in favour of beneficiaries), the executor should be directed, in giving effect to the wishes of the testator, to take account of the extent to which certain beneficiaries have otherwise benefited (or will benefit) by the testator passing control of existing discretionary trusts to those beneficiaries.
- Right of Occupation and CGT Main Residence Exemption.** With careful planning, the main residence exemption can extend beyond the testator's death. For estate beneficiaries other than spouses the exemption will only be available if they are granted a specific right of occupation in the property. Therefore the will/ testamentary trust should contain this express grant.

- Direction to Executors.** The objectives of most testators is to divide their *entire* wealth (e.g. personal assets, superannuation, assets in trust) in accordance with their estate planning objectives, rather than just dividing their personal estate. The will/testamentary trust should give the executor the power to apportion the testator's estate, and adjust entitlements from such estate, in such a way that the executor thinks appropriate to achieve these objectives.
- Flexibility to Amend Terms of Testamentary Trust.** Tax laws change constantly. Rather than second guessing future circumstances, the testamentary trust should give the executor the discretion to vary the terms of the trust within the bounds of the rule against delegation of testamentary power.
- Power to Avoid an Unwanted Testamentary Trust.** The terms of the will should allow the executor to distribute the estate directly to an adult beneficiary (and not to the testamentary trust) if the beneficiary so wishes. Alternatively, the estate should be capable of distribution to an existing discretionary or testamentary trust if so desired.
- Existing Loans and Beneficiary Entitlements.** Loans and entitlements to and from discretionary trusts do not cease to exist when the testator dies. The will/testamentary trust should set out the testator's wishes for these.
- Superannuation and Death Benefits.** Lump sum payments on death by a superfund are a 'death benefit', outside the general ETP taxing provisions and, depending on whether they are paid to dependants or not, entitled to concessional tax treatment (i.e. receipt tax free by dependants up to the deceased's pension RBL amount). In order to maximise the value of the 'death benefits' concession, the will/testamentary trust should contain a direction to the executor either to distribute the proceeds to 'dependants' or to hold such proceeds on specific trust (known as a 'default superannuation death benefits trust') for 'dependants' only.
- Important Trust Provisions.** As much thought should go into the terms of a testamentary trust as the terms of a discretionary trust made *inter vivos*. If your standard testamentary trust is a 'stripped down' discretionary trust and does not contain protective and concessional provisions ordinarily required in a standard discretionary trust, that testamentary trust is sub-optimal.
- Business Succession Agreements.** If applicable, the executor should be alerted to, and directed to uphold, any mandatory or optional 'buy/sell' or other agreements relating to the business of the testator. Also, it is often necessary to take action to ensure that the future control of non-estate assets dovetails with the terms of the testator's will.
- Estate Testamentary Trust.** Where, following the death of the testator, a sole primary beneficiary (e.g. sole surviving spouse) stands to inherit assets via a new testamentary trust, the executor of the estate should be empowered to administer the estate indefinitely *as if it were* a testamentary trust and should not be obliged to divest the estate assets to an actual new testamentary trust.

## A Parting Thought

It is commonly thought that wills and estate planning is an elementary field and that 'any solicitor' can advise adequately in these areas and prepare an effective will. This is a misconception. To advise properly in these areas requires command of a number of complex branches of law including family provision law, wills and succession law, superannuation, tax and stamp duty, trust law, guardianship and powers of attorney law and practice, family law, social security rules, partnership law, company law and bankruptcy law.

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