Mellor Olsson

Wills & Estate Planning Fact Sheet

Testamentary Trusts

What is a Testamentary Trust?

A Testamentary Trust is created by a Will to hold assets on behalf of beneficiaries for however long specified, potentially indefinitely. Ordinarily the estate assets are fully distributed to the beneficiaries of the Will. However, with a Testementary Trust some or all of the estate assets are retained in a trust, not only for the intended beneficiary, but for their extended family and other related entities. The use of a Testemantary Trust has certain benefits that are not available under an ordinary Will.

What are the benefits of a Testamentary Trust?

- Asset Protection | The assets of Testamentary Trusts are not owned by the beneficiaries directly. Therefore a Testementary Trust can offer a level of protection from creditors of the beneficiaries and, in limited circumstances, spouses. This structure can also be used to protect the beneficiary in the event the beneficiary has a disability, has issues with managing finances or has other social issues.

- Tax Minimisation | Testamentary Trusts allow the income generated by the estate assets to be taxed more effectively by:

  - Flexibility of distribution | The controller or trustee of the Testamentary Trust (who is usually the intended beneficiary of the Will) can decide to allocate income to a wide range of beneficiaries to ensure a low overall rate of tax is achieved.

  - Adult tax rates apply to children under 18 years of age | As opposed to family trusts, distributions from Testamentary Trusts to minor beneficiaries are treated as if the minor beneficiaries are adults, therefore allowing them to use the tax free threshhold. This applies to minor beneficiaries of the Testamentary Trust and therefore can include children and grandchildren of the intended beneficiary.

- Stamp Duty and Capital Gains Tax | No stamp duty or capital gains tax is imposed on the transfer of assets on death to a Testamentary Trust. Often it is too cost prohibitive to transfer assets to a trust due to the stamp duty and capital gains tax payable, despite there being advantages of owning assets in trust. The death of a person is a tax effective time to allow the transfer to occur.

Who should use a Testamentary Trust?

A Testamentary Trust should be established only if some or all of the benefits mentioned above can be obtained, and the benefits outweigh the cost of administering the Testamentary Trust and the complexity of arrangements. Accordingly, one or more of the following should exist:

- One or more beneficiaries wish to invest their share of the estate over the long term. If the beneficiaries wish to use their entitlement to repay debts or spend, there is no point establishing a Testamentary Trust.

- A minimum level of assets in the Testamentary Trust to justify the cost. $500,000 is a guide to a minimum level. This figure may be lower if the major reason for the existence of the Testamentary Trust is for asset protection or because a protective structure is required.

Who has control over the assets of the Testamentary Trust?

The day to day control of the Testamentary Trust lies with the trustee of the Testamentary Trust, as set out in the Will, and can be any person, group of people, or company. Often the intented beneficiary of the Will is the trustee until death and then control is pased on to other family members.

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Consideration should be given to appointing an independent person as a trustee of the Testamentary Trust if asset protection is important.

Do all assets of the estate need to be transferred to the Testamentary Trust?

No – specific assets can be distributed to any beneficiary, rather than being passed to the Testamentary Trust. Usually the Will is structured such that the family home, personal belongings, and household effects of the deceased are passed to the surviving spouse or children, as there is usually no benefit to be obtained by transferring them to the Testamentary Trust.

Can the Testamentary Trust be vested when circumstances change?

This depends on the wording of the Will, however, generally the trustee has the power to end the Testamentary Trust at any time.

If the Will is structured to allow flexibility, the executor can have the option to transfer the estate assets directly to the beneficiaries of the deceased Will in the first instance, rather than to a Testementary Trust. This avoids the cost of administering the Testamentary Trust in circumstances where it is not of benefit or not wanted by the beneficiary.

Can more than one Testamentary Trust be established?

Yes – it is common for the Will to create a separate Testamentary Trust for each beneficiary. This allows each beneficiary to take control over their share of the estate. This avoids the need for two or more beneficiaries to jointly control one Testamentary Trust, which may result in conflict. However, there may be assets that are jointly owned by each Testamentary Trust, which will require agreement between the trustees.

What are the negatives?

A Testamentary Trust is a complex structure that requires ongoing administration. There are additional accountancy and other costs to maintain a Testamentary Trust.

Mellor Olsson has experienced practitioners who provide advice and prepare Wills to suit your individual circumstances.

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