



## **TESTAMENTARY DISCRETIONARY TRUSTS – IS THIS FOR YOU?**

### **1. WHAT IS A TESTAMENTARY DISCRETIONARY TRUST (TDT)?**

A Testamentary trust is a trust created under a person's Will and commences to operate only on the death of the Will maker (the "testator"). This is distinct from a trust established during a person's lifetime (an "inter vivos trust").

A testamentary trust is funded with assets from the testator's estate and enables assets to be transferred at the trustee/executor's discretion for the overall benefit of one or more beneficiaries.

### **2. WHY ESTABLISH A TESTAMENTARY TRUST WILL?**

A TDT Will is often established for one or more of the following reasons:

- The testator has substantial assets, and plans to grow that wealth for the benefit of beneficiaries;
- The testator requires after-death continuance of trusts, business assets or property; or
- A specific beneficiary is vulnerable and needs protection.

One of the main reasons for establishing a testamentary trust is asset protection. A TDT Will can restrict access to the assets and income of the estate by beneficiaries. The discretionary beneficiaries do not have a legal interest in the income or capital of the testamentary trust until the trustee makes a distribution in their favour. The beneficiaries only have "a mere expectancy" and do not have a proprietary interest in the assets of the estate.

### **3. BENEFITS OF A TDT WILL**

#### **Asset Protection:**

TDT Wills can protect beneficiaries from statutory or personal disability including;

- Bankruptcy;
- At-risk professionals, e.g. doctors, engineers or builders;
- A spendthrift child who has a gambling problem or who does not understand finances;
- An intellectually challenged beneficiary who is unable to manage his or her own affairs;
- Family law disputes (note that the Family Court's power is increasing and careful management of the estate and testamentary trusts are required to minimise family law risks).

## **Flexibility:**

A TDT Will is flexible to meet changing circumstances and can continue for a maximum of 80 years. The beneficial enjoyment of the trust assets can change from year to year to suit the particular needs of beneficiaries as required.

## **Taxation Benefits:**

From a taxation perspective, the potential benefits of a TDT Will are:

- The ability to split income to different beneficiaries to optimise taxation benefits; and
- Greater tax savings in providing income to a child or grandchild under 18, such as applying income towards their education, maintenance or advancement.

Consider an example. You and your spouse die and leave everything to your two children - a daughter and son. Your children sit down with us and the accountant and financial planner to work through the opportunities provided by the TDT Will.

Angela sets up a TDT Will. Conversely, Ryan the restless son wants to take his money in the hand and run. Both earn an income of \$150,000 the following year on the inheritance. Angela has 5 children all under 18. They pay less than \$7,000.00 in tax in total.

Ryan a miner with his own wife and children is already paying tax on the highest marginal tax rate. He is taxed at 46.5% on his \$150,000. He therefore pays \$69,750 in tax.

Angela's children never actually see any of the money. It is an accounting entry. The income distributed from the TDT Will to the children is not paid or held in trust for them. Instead, (much like Family Trusts) it is applied towards the children's living expenses, school fees, holidays and birthday presents. Or, perhaps Angela needs a new 4WD to drive the children to school in.

Given that taxation rules are constantly changing, it is prudent to review one's estate and succession plans at least every three years.

## **Two Examples of What Not to Do:**

1. When Jasmine died she left everything to her only child Maree. Maree was married to Damien who was a perpetual student. Damien had completed numerous courses but had never settled on a career. They used Maree's inheritance to pay off the mortgage and travel. Prior to her death, Jasmine was constantly telling Maree that her husband was a "bludger". Eventually Maree came to the realisation that her mother was right and her relationship with Damien ended. In the property settlement Damien received roughly half of their assets, much of which had come from Jasmine.
2. Alistair was a solicitor in a partnership that carried out due diligence on a large company for a client looking to take over the company. The due diligence failed to detect some significant fraud committed by the company principals. The client took over but the company went into liquidation soon after and an action was commenced against Alistair's partnership for damages. Fortunately Alistair owned very little in his name, preferring to keep assets well out of his (and his creditor's) legal reach. When his wife and father both died in the same year, his strategy fell apart. Both left assets to him personally in their Wills. Those assets were totally exposed.