TESTAMENTARY DISCRETIONARY TRUST INFORMATION SHEET

- WHAT IS A TESTAMENTARY DISCRETIONARY TRUST AND WHY DO I NEED ONE?

Robinson Locke Lawyers

WHAT IS A TESTAMENTARY DISCRETIONARY TRUST?

A testamentary trust is a trust established by the terms of a will. It is common for wills to establish some form of testamentary trust although these trusts are usually only for a short period of time or for a specific purpose. No magic so far.

Chances are, you have heard of discretionary trusts before and may already have a discretionary family trust. Put simply, in a discretionary trust, the beneficiaries of the trust do not have a fixed interest in the capital or income of the trust. Distributions of capital and income are at the discretion of the appointed trustee.

No prizes for guessing that a Testamentary Discretionary Trust is simply a discretionary trust that is established by the terms of a will.

The magic arises from a combination of the long established benefits of a discretionary trust and the special tax treatment of testamentary trusts. It is a compelling combination.

WHY DO I NEED A TESTAMENTARY DISCRETIONARY TRUST?

1. TAX EFFECTIVENESS

A Testamentary Discretionary Trust can save your beneficiaries a significant amount of tax.

The testamentary trusts established by our form of will enable each primary beneficiary (generally your spouse or partner if they survive you or, if they don't, then each of your children) to allocate the inherited assets and/or the income earned from those assets between themselves, their children and a wide range of other potential beneficiaries (generally, a wider range of their relatives).

This can produce a tax advantage which would not be present if the trust had been created during your lifetime. If, for instance, the primary beneficiary distributes to her or his children, *even though those children are under 18 years of age, distributions to them will be taxed at adult rates because the trust is testamentary in nature. They will be entitled to a full adult tax free threshold and stepped marginal rates.* This contrasts with distributions from a trust created during your lifetime which are penalised because such distributions are considered unearned income of a minor, and above a very low tax-free threshold of only a few hundred dollars are taxed at the very top marginal tax rate. *The tax savings can be very significant!*

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Let us illustrate this with an example:-

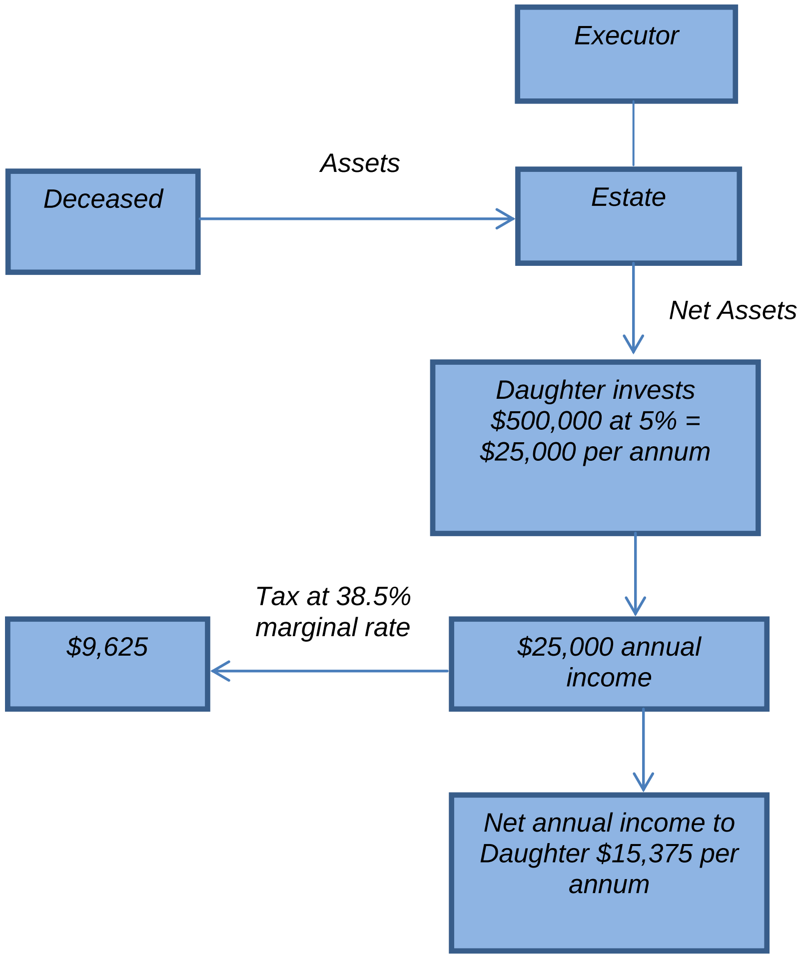
After a long and active retirement travelling the globe, you pass away. Over the years, you spent most of your savings and superannuation, but still owned your modest family home worth $400,000.00 and had $100,000.00 in savings. Your simple will gives everything to your only daughter.

Your daughter is now in her late forties with two children aged 12 and 14. Your daughter and her husband work hard and each earn just over $80,000.00 per annum. They have paid off their mortgage but have little spare cash after the cost of day to day living and supporting and educating your grandchildren. School fees are worrying them.

Your daughter receives her $500,000.00 inheritance and invests it at 5% per annum earning $25,000.00 per annum. She is on a marginal tax rate of 38.5% including Medicare Levy so will pay <u>$9,625.00 in tax</u> on the additional income.

Your daughter's position looks like this:-

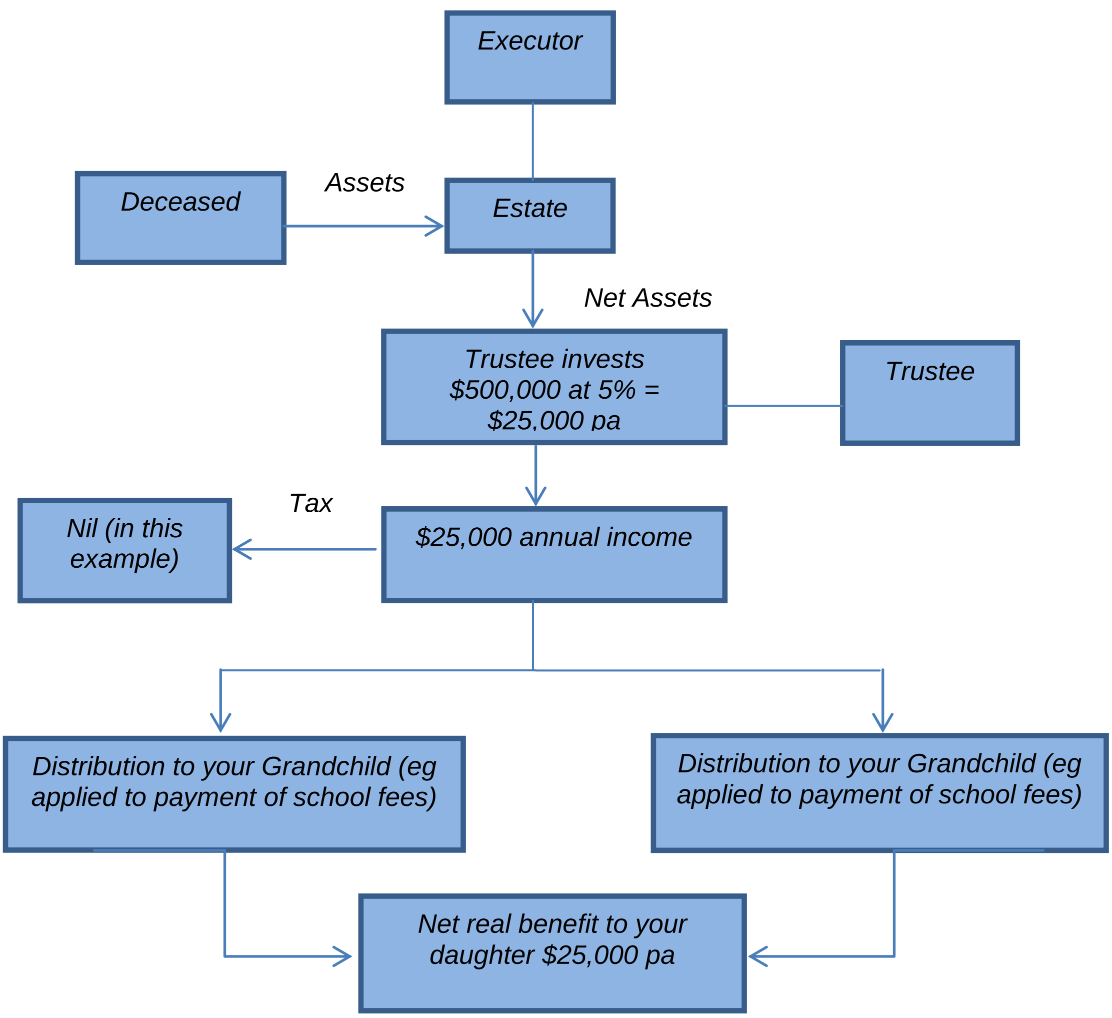
WITH NO TESTAMENTARY DISCRETIONARY TRUST IN PLACE:



Contrast the position if your will established a Testamentary Discretionary Trust with your daughter as the primary beneficiary into which the $500,000.00 was paid. Your daughter could choose to distribute $12,500.00 of trust income to each of your grandchildren on which <u>no tax</u> would be payable. That distribution could be applied to pay your grandchildren's school fees thereby effectively benefitting your daughter.

Now, your daughter's position looks like this:-

WITH A TESTAMENTARY DISCRETIONARY TRUST IN PLACE:



Similar considerations apply to middle-aged mums and dads where mum or dad dies and the survivor receives a lump sum life insurance payout. If those funds are invested in the survivor's name, the investment income will be added to the survivor's other income and will be taxed at the survivor's highest marginal tax rate.

With a Testamentary Discretionary Trust in place and the life insurance payout directed into the estate, the survivor has the flexibility to choose to distribute some or all of that investment income directly to the children and pay little or no tax on that distribution.

Summing up, the trusts in our form of will give each of the primary beneficiaries discretionary power to distribute income and/or capital among a wide range of potential beneficiaries, and this discretionary power to allocate income can result in considerable, and continuing, annual tax savings following your death.

2. ASSET PROTECTION

Assets held in trust are afforded some protection from loss simply by virtue of being trust assets.

Our form of will enhances and enlarges this asset protection for beneficiaries against loss through divorce, bankruptcy or other disastrous changes in circumstances. That said, it is extremely difficult to protect the assets of a person from being accessed or taken into consideration by the court for the purposes of a matrimonial property settlement and the use of a testamentary discretionary trust cannot be relied on to be effective in this regard.

The trusts provide that if a beneficiary enters a marriage or relationship breakdown, or becomes bankrupt or mentally incapacitated, control of the trust is removed from the beneficiary concerned, and the executor of the estate will take control of the trust until the problem is resolved.

3. FLEXIBILITY — GIVING BENEFICIARIES THE CHOICE OF TAKING THEIR INHERITANCE DIRECTLY AND ABSOLUTELY OR IN TRUST FORM

BENEFICIARIES (YOUR SPOUSE, CHILDREN AND GRANDCHILDREN) HAVE A CHOICE

The form of will we use offers those of your beneficiaries who have reached maturity (25 years old is suggested, although you may choose a different age) the opportunity to choose whether to take their benefits directly and absolutely, or to have those benefits held in trust for them.

A beneficiary who decides to participate in the trust structure is not forever bound to continue participation: he or she can resile from the trust structure at any time.

If your primary purpose is to provide your children with tax advantages with a degree of asset protection thrown in, then it is important to allow each of your children the choice to decide not to participate in the trust structure if that structure does not provide any advantage to them. The benefits of a Testamentary Discretionary Trust may be of more value to some of your children than to others.

If your primary purpose is to give strong asset protection, you may need to restrict or remove the beneficiaries' ability to choose not to participate in the trust structure and to control the trust generally.

BENEFICIARIES RETAIN CONTROL OF TRUST

Where a beneficiary has attained maturity and chooses to use the trust, the beneficiary retains key powers to control the trust. The beneficiary has practically as much control as they would have with a simple or absolute gift.

IS MY ESTATE LARGE ENOUGH TO WARRANT A TESTAMENTARY DISCRETIONARY TRUST?

THE TAX SAVINGS TO YOUR CHILDREN CAN BE SUBSTANTIAL EVEN FOR MODEST ESTATES

If you have children, young or old, a Testamentary Discretionary Trust can be a fantastic investment made on their behalf, even if your estate is modest. The cost of preparing your will can be vastly outweighed by the potential tax savings you are giving to your children and there is the added peace of mind that comes with knowing that you have taken steps to protect your estate in the hands of your spouse and children.

If you are unsure whether your estate is large enough to justify including a Testamentary Discretionary Trust in your will, don't forget:-

1. that your estate could be larger than you think when you include the value of your home, superannuation and life insurance proceeds; and
2. that the taxation benefits to your beneficiaries flow from your beneficiaries' financial position at the time they inherit from you, not your financial position. Even if your children earn only an average income, the ability to divert income to your grandchildren year after year and pay little or no tax on that distribution can add up to big tax savings. *This valuable benefit cannot be accessed effectively in any other way.*

IT ALL SOUNDS COMPLICATED

We will cut through the complexity and help you to understand how a Testamentary Discretionary Trust can work for you. Our form of will has been drafted to be as simple as possible.

The effort is worthwhile! A Testamentary Discretionary Trust could be the best thing you could leave behind for your children and grandchildren. Something they will appreciate year after year!

Thank you for taking the time to read this information sheet.

Please feel free to contact Gary Hugill of our office on (07) 3210 5209 if you have any queries, whatsoever.

Robinson Locke

Please note that this information sheet is intended to provide general information only. It must not to be relied upon in lieu of proper, specific legal advice taking into account your particular circumstances.