TESTAMENTARY TRUSTS

ADELTA LEGAL

Level 3, 104 Frome Street
ADELAIDE SA 5000
Tel: (08) 8415 5000
www.adelta.com.au

TESTAMENTARY TRUSTS

A testamentary trust is a trust created by a Will. The will itself becomes the trust deed.

There are a variety of trusts that can be contained in a will:

1. **Trust for occupation and use of a property** (or a share of a property)

   These are commonly called life interests and can be restrictive or 'portable' which will allow the particular property to be sold and another purchased still held within the trust for the use of the beneficiary. These are a common estate planning tool for second or subsequent relationship where there is a desire to provide for the second partner but create certainty that the children from the first relationship will eventually inherit the share of the property (or its monetary value) on the death of the second spouse. Technically a true life interest is a different type of trust with particular tax implications but this term is commonly used by people to cover these rights of occupancy. There can be a great deal of flexibility in the operation of these trusts if desired but it does restrict the other party's uses of funds on a sale of the property.

   These trusts will not work if a property is owned as 'joint tenants' as the share of a party passes automatically to the other by survivorship and the will of the deceased person cannot control what happens to their share. Some people change the way they own the property to 'tenants in common' as part of the estate planning process in order to be able to incorporate these trusts in a will and therefore have more control over that person's share of the property.

2. **Protective trusts**

   These are to protect assets on behalf of a vulnerable beneficiary either due to a disability, bankruptcy, or addictions. There is always a balance between wanting to protect someone from themselves and controlling someone's life (and money) from the grave. There are many real circumstances where these trusts are useful devices to protect funds on behalf of a person who may be incapable of managing money, subject to undue influence or with health, gambling, or addiction problems. These trusts can include many flexible provisions but the essence of them is that someone else is managing the money for the beneficiary and there are many aspects of this to consider. Usually the assets held in these trusts are treated by Centrelink as the person's own assets for the assessment of any disability or aged pension entitlement.

3. **Special disability trusts**

   These are a specific type of trust which can be used for a beneficiary with a significant disability. These are 'Centrelink friendly' in that Centrelink does not include the assets of the trust in assessing the beneficiary's entitlement to any disability pension. However there are many rules to abide by to ensure that the Centrelink rules regarding valid special disability trusts are adhered to. Not any trust for a disabled person in a will will comply with these rules and care must be taken by the will drafter if one of these trusts is desired. There are limitations on what the trust assets can be used for which may not meet your circumstances. A separate fact sheet is available to discuss these trusts in more detail.

4. **Trusts for a period of time** (e.g. until a person reaches a certain age)

   These are commonly used where children are included in a will. Again there is always the balance between protecting a young person from making unwise or rash decisions with any money inherited and controlling from the grave. Common ages for funds to be kept in trust are 21 and 25. A child is not entitled to any inheritance until they reach the age of 18 in any event so any gift to a minor child will automatically be held in trust until 18. These trusts are used when an age older than 18 is desired.

A different example of a trust for a period of time is where a person is given the right to occupy a house for a short period (e.g. 12 months) and is commonly used where a child of the person resides with them in their home and they wish to protect them from being evicted from the property too quickly by the executors if the person died suddenly. Again these can be very flexible as with the 'life interest' trust above.

5. **Super proceeds trust**

This is a trust set up in the will to deal with the distribution of superannuation benefits and to ensure that superannuation benefits are only paid to a tax dependent and manage the funds on their behalf so as to retain the 'tax free' status of the funds. A tax dependent is a spouse, minor child or a person who was financially dependent on the deceased or had an 'interdependency' relationship.

6. **Discretionary testamentary trusts**

Instead of all of the assets of a deceased estate being distributed to the beneficiaries, some or all are retained in a trust for the benefit of the beneficiaries on an ongoing basis. Discretionary Testamentary trusts can have the benefits of asset protection and tax minimisation. However, creating a testamentary trust will mean a more complex will and will make administering your estate more complex and restricts the ability of beneficiaries to control activities and investments of the trust. They are useful when there are beneficiaries aged less than 18 years and where there are substantial assets or liability risks for a beneficiary.

A minor beneficiary is treated as an adult for tax purposes so income of the adult's tax free threshold can be distributed to a child tax free which can be a large tax saving for the family unit. Whilst there is asset protection in the case of bankruptcy or personal liability of a beneficiary so the trust assets are not at risk, the same level of protection does not apply in the case of separation or divorce. Assets in a testamentary trust can be relayed as a resource by the Family Court and taken into account in the division of assets between the parties. However they can be set up to provide complete protection against this if there is a rocky marriage at the time of the will being drafted.

The other benefit of a discretionary testamentary trust is that the beneficiaries of the family unit can be flexible with spouse, children and grandchildren being included so as to give many tax planning opportunities for that family. A will may contain a discretionary testamentary trust for each child and therefore have several set up in the will.

Adelta Legal can advise on all estate planning options with trusts at the time of making the will as to what will best suit you and your beneficiaries' interests in the most tax effective manner.

We offer a home visit service for those unable to get to one of our offices.

Check our website for more information at www.adelta.com.au