

TAX TALKS

Australia's Tax News Podcast - The Podcast for Australian Tax Professionals

The following information is only of a general nature and should not be taken as professional advice.

134 | Testamentary Trust Basics

A testamentary trust can be a really good idea. And it might be a complete waste of your time. It all depends on the size of your estate, your intentions and the individual circumstances of your intended beneficiaries.

Testamentary Trust

In this episode of Tax Talks Peter Bobbin of Argyle Lawyers will go through 15 questions you sent in over the past few months. Here is what we learned, but please don't rely on our notes alone. Peter explains all this much better than we ever could.

1 What is a testamentary trust?

A testamentary trust is a trust created testamentary. If a will directs the executor to set up a trust then the resulting trust is a testamentary trust. It could be a bare trust or a fixed trust. But in today's modern world it is usually a discretionary trust. They are all testamentary trusts if they all came by way of a direction from the will maker to the executor.

The opposite of a testamentary trust is an inter vivos trust. Inter vivos means among the living. And it just means that the trust wasn't set up through a testamentary will. So your family trust for example would be an inter vivos trust.

2 How do you establish a testamentary trust?

A testamentary trust comes from a direction of the will maker to the executor. The executor is tasked with the process of setting up a trust which is created on a testamentary basis.

3 When does a testamentary trust come to life?

The testamentary trust does not come into existence on death. For the trust to come into existence it requires the executor to administer that part of the estate and to actually establish the trust as directed by the deceased. The day the executor takes money out of residue and the day that those funds or assets are applied to the trust as directed, that is the day the trust is created.

4 Does the trust deed need to be part of the will?

No but sort of yes. When we create an ordinary family discretionary trust inter vivos, we do that by way of a deed. Its also available for executor to do this by deed depending upon the character of the assets that go into the testamentary trust. There are some potential stamp duty concerns.

5 Is the testamentary trust deed usually an annex to the will?

One approach is to extract all the terms in the will to provide some sort of a document that expresses the trust terms because in the years to come when the beneficiaries or other professional trustees are dealing with these trusts, somebody somewhere is going to ask, "Show me the terms'.

6 Is it possible for an intended trust to fail establishment?

In a sense yes. If a will seeks to set up a testamentary trust but there are not enough assets in the estate to carry through the direction to establish the trust, then you don't have a testamentary trust even though there is a direction to establish one.

If some clause of the will is excised by the court for some valid reason then there is also a failure of the testamentary to come into existence. Because without a valid will you can't have a testamentary trust coming out of that will.

7 Why establish a testamentary trust?

The key driver for the establishment of a testamentary trust is usually not tax at all. Will makers are often primarily concerned with control and family wealth preservation and hence desire a carefully devised estate plan. But it all depends on the perspective that you bring.

You might have a vulnerable beneficiary – for example due to disability or drug addiction – or a blended family with competing claims – for example from a second spouse and children from the first marriage.

Or you might wish to only transfer wealth to your direct descendants and not their partners.

You might be concerned that your surviving spouse may take on a new partner and spend all assets to the detriment of children and grandchildren.

Or one of your intended beneficiary might be at risk of being sued or facing bankruptcy.

Or there are tax issues to consider – for example as a non-resident to whom a bequest would trigger CGT event K3.

With the transfer balance rules forcing more benefits out of superannuation on the death of one spouse, you might view the testamentary trust as the 'natural home' for excess benefits.

And last but not least you might like the tax efficiencies as well as ordinary rates of tax for distributions to minors that a testamentary discretionary trust will bring.

8 Why not to establish a testamentary trust?

Testamentary trusts are not for everyone. Your estate needs to have enough assets to bear the annual compliance costs of running a trust. The trust needs to prepare accounts, lodge tax returns and obtain legal advice on the operation of the trust. And that all costs time and hence money.

And the benefits of income splitting and the exclusion from Division 6AA's penalty tax rates might be of no benefit to you in the first place. For example when you don't have children or grandchildren.

9 What to look out for when establishing a testamentary trust?

Testamentary trust wills are typically long and complex documents. So make sure you involve a good lawyer who knows what they are doing.

And then there is the issue of capacity. If your mental capacity to enter into such complicated document is challenged on the basis that you as the will maker did not understand what you signed, all the careful tax planning and will drafting may fly out the window, if the will is challenged. So make sure you do all this early enough.

10 What tax advantages does a testamentary trust bring?

There are a number of issues and traps to navigate to ensure that family wealth is not unnecessarily eroded by tax.

Apart from the availability of the CGT discount and income splitting, the two main tax advantages provided by a testamentary trust are the testamentary trust exceptions from the penalty tax rates of Division 6AA of Part III of the Income Tax Assessment Act 1936 (ITAA 36) and the way the capital gains tax (CGT) death rollover operates in the testamentary trust context.

11 What type of trustee to use?

The trustee can be an individual or more than one individual. But Argyle Lawyers tends to suggest a corporate trustee.

12 What goes into a testamentary trust?

Many assets don't go into the estate and hence wouldn't go into a testamentary trust either.

For example, super might go to SIS dependants and not into the estate. Life insurance payouts go to the nominated beneficiaries and not the estate. Property held as joint tenants goes to the other tenant in survivorship and not the estate. The same applies to shares and bank accounts in joint names. And family trusts don't go into your estate either. So the estate might be empty or minuscule and then there is nothing to put into a testamentary trust.

13 Difference between inter vivos and testamentary?

There are inter vivos trusts and testamentary trusts. Any trust established while living is an inter vivos trust.

14 Can a husband and wife create a joint testamentary trust?

Since there are no joint wills in Australia, there is no joint TT. So one spouse would create the testamentary trust for their estate. The other surviving spouse can then contribute their estate to that testamentary trust upon their death.

15 Does Div 6AA apply to income from assets contributed later?

At the moment nothing has changed yet re distributions to minors from testamentary trusts. Currently minors are still excepted persons for the purposes of Div 6AA. And this applies even when the income comes from assets that were contributed later.

MORE

[SIS Act NANI](#)

[ITAA97 NANI](#)

[Property vs Shares](#)

Disclaimer: Tax Talks does not provide financial or tax advice. This applies to these show notes as well as the actual podcast interview. All information on Tax Talks is provided for entertainment purposes only and might no longer be up to date or correct. You should seek professional accredited tax and financial advice when considering whether the information is suitable to your or your client's circumstances.

The information above is for general information only and should not be taken as constituting professional advice from Tax Talks. We are not a financial, legal or tax adviser. You should consider seeking independent legal, financial, taxation or other advice to check how the above information relates to your unique circumstances.