TESTAMENTARY TRUSTS

Save $23,100.00 per year!!

A Testamentary (or Estate) Trust is established through your Will. The mechanisms and powers for the trust are contained within your Will.

Testamentary Trusts can provide significant taxation benefits to your family if utilised in the most advantageous manner. These savings could easily be $23,100.00 per year or more (as illustrated in example 1), dependent upon the income generated and the family position.

Like a standard discretionary (or family) trust created inter-vivos (during your lifetime), the Testamentary Trust can provide for multiple beneficiaries to be potentially entitled to income and/or capital of your estate trust.

The potential tax savings are achieved through the discretionary nature provided within the trust to distribute the income generated to one or more of the potential beneficiaries.

A discretionary trust provides tax advantages via the discretionary nature income may be distributed. The Testamentary Trust similarly provides this discretion, however is 'turbo-charged' by s102AG of the Income Tax Act 1934.

How is it 'turbo-charged'? Under an ordinary discretionary family trust, income after the first $416 paid to a child under 18 years of age is taxed at the top marginal rate. Through a Testamentary Trust children receive full adult tax thresholds. Meaning approximately $20,000 per year can be paid to each child tax free (as of the 2013/14 financial year), the child then being taxed at normal adult rates thereafter.

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The scenarios following illustrate potential benefits of Testamentary Trusts over a range of circumstances.

Scenario 1 (1 Spouse passes away – children under 18):

CIRCUMSTANCES:
- Husband and wife in early 40's
- Have 3 children under 12
- Both earn $80,000 p/a or more
- Mortgage of $500,000 on house
- Both hold life insurance of $1mil.

HUSBAND DIES WITH STANDARD WILL:
- All assets pass to wife
- Wife pays off home loan
- Invests remainder, including other assets such as superannuation. Total remaining is $1mil
- Invested funds return $60,000 p/a
- Wife pays tax at 38.5% (including Medicare levy) resulting in tax payable of $23,100 p/a on income generated
- Leaving wife $36,900 p/a to spend on the family.

HUSBAND DIES WITH TESTAMENTARY TRUST WILL:
- All assets pass to the Testamentary Trust
- Wife is primary beneficiary and 3 children are potential beneficiaries
- Trust pays off home loan
- Trust invests remaining estate funds, earning $60,000 p/a
- Trust distributes $20,000 p/a to each child
- Children receive full adult tax thresholds and pay $0 in tax
- Family receives the full benefit each year of the $60,000 in income generated
- After 5 years this could result in a potential saving to the family $115,500!

Scenario 2 (1 Spouse passes away – children over 18):

CIRCUMSTANCES:
- Husband and wife in early 60's
- Have 3 children over 18
- Each child has 2 children under 12
- Both earn $80,000 p/a or more
- Both have life insurance of $1mil
- Both have superannuation of $500,000.

HUSBAND DIES WITH STANDARD WILL:
- All assets pass to wife
- Wife invests assets totalling $1.5mil
- Invested funds return $90,000 p/a
- Wife pays tax at 38.5% (including Medicare levy) resulting in tax payable of $34,650 p/a on income generated
- Leaving wife $55,350 p/a to spend.

HUSBAND DIES WITH TESTAMENTARY TRUST WILL:
- All assets pass to the Testamentary Trust
- The wife is the primary beneficiary. The 3 children and 6 grandchildren are potential beneficiaries
- Trust invests the estate funds, earning $90,000 p/a.
- Trust distributes $15,000 p/a to each grandchild
- Grandchildren receive full adult tax thresholds and pay $0 in tax
- Family as a unit receives the full benefit each year of the $90,000 in income
- After 5 years this could result in a potential saving to the family unit of $173,250!

Scenario 3 (Both Spouses passes away – children under 18):

CIRCUMSTANCES:

- Husband and wife in early 40's
- Have 3 children under 12
- Both pass away tragically in an accident
- With insurances, superannuation and other assets they have a net estate of $1.8mil.

BOTH PASS AWAY WITH STANDARD WILL:

- All assets pass to the 3 children equally
- Each child receives $600,000
- Will has been drawn to hold for the children subject to attaining 25 years of age, with power to advance funds for maintenance, education and welfare generally
- Trustees of each child's trust invest monies generating $36,000 p/a in income
- $20,000 is paid to each child for their education, maintenance and welfare – no tax being payable.
- Tax office considers no person is presently entitled to the remaining $16,000 in income (as the children are only entitled upon attaining the age of 25)
- $16,000 taxed at 46.5%
- Tax of $7,440 is payable each year
- Over 10 year period tax would be $74,400!

BOTH PASS AWAY WITH TESTAMENTARY TRUST WILL:

- Separate Testamentary Trusts are established for each child
- All assets pass to the Testamentary Trust
- Each child is primary beneficiary of own trust and is presently entitled to the funds (although the trust only provides them power to appoint a trustee of the trust once they attain the age of 25 years)
- Trustees invest funds and receive $36,000 p/a in income
- $20,000 is paid to child for education, maintenance and welfare – no tax payable
- As children presently entitled the remaining $16,000 is taxed at ordinary adult rates
- Total tax payable per annum would be $3,477.
- Over 10 year period tax would be $34,770
- Compared to standard Will example tax of $74,400, each child saves $39,630!

Scenario 4 (Both Spouses passes away – children over 18):

CIRCUMSTANCES:

- Husband and wife with 3 children
- Each child has 2 children under 18
- Their combined estate, with insurances and superannuation is $3mil
- All children earn income of $80,000 p/a
- Children's spouses do not work
- Husband and wife pass away via accident or illness.

BOTH PASS AWAY WITH STANDARD WILL:

- All assets pass to the 3 children equally
- Each child receives $1mil
- They invest monies and receive $60,000 p/a in income.
- Each pays tax at 38.5% on invested funds, being $23,100 p/a tax
- $36,900 p/a to spend on the family.

BOTH PASS AWAY WITH TESTAMENTARY TRUST WILL:

- Separate Testamentary Trusts established for each child
- $1mil passes to each Testamentary Trust
- Each child is the primary beneficiary
- Their spouse and children are potential beneficiaries
- Trust invests assets, earning $60,000 p/a
- Trust distributes $20,000 to each grandchild and $20,000 to the spouse
- Children receive full adult tax thresholds
- Both children and spouse will pay $0 tax
- Family receives the full benefit each year of the $60,000 in income generated
- After only 5 years that could result in a potential saving to the family $115,500!

SPECIAL STAMP DUTY WARNING!!

If you have 2 or more children (or potential beneficiaries), you own 1 or more properties and 1 of your beneficiaries might chose to keep a property as part of their entitlement then you could be costing them tens of thousands of dollars in stamp duty.

Take an example of a Will leaving everything to 3 children equally with no special clause dealing with appropriation of assets (over 95% of Wills reviewed by our firm have not had this clause). Both parents have passed away leaving $500,000 in superannuation, $500,000 in cash and shares and a house worth $500,000 as well. 1 child chooses to take the house as their share, the others split the cash and shares.

Note the Office of State Revenue ("OSR") provides a special exemption on duty when assets are transferred to a beneficiary – being $50 (in NSW) instead of full ad valorum rates.

MOST WILLS RESULT
The OSR would consider with most Wills that each child is entitled to one third of the assets in the estate each. This means one third the house each in this example.

In this case the OSR would say the child taking transfer of the house is entitled to a duty exemption on the 33.3% of the house they are entitled to, but pay full ad valorum rates on the remaining 66.6% the other children are entitled to. This would equate to stamp duty of $10,543.

APPROPRIATION CLAUSE INCLUDED
If your Will includes an appropriation clause the OSR would allow 1 child to 'appropriate' the house in full to cover their entitlement. This results in the OSR saying that child is entitled to the full exemption on duty for the transfer of the property, meaning only $50 in stamp duty would be payable in the example provided! A saving of $10,493 for a simple clause. (Well perhaps not so simple given most legally drafted Wills and even legal precedents do not include it!).

Our Testamentary Trust Wills include the required appropriation clauses to save the potential duty. If you hold more than 1 property, or property of greater value than the example, then what potential stamp duty (tax!) liability are you leaving your children?

YOUR PARENTS' WILLS

Now you have an understanding of the potential tax and duty savings you can provide for your family if you pass away, you need to appreciate how you could likewise be the benefactor of many of these savings from your parents' Wills when they pass away.

In most circumstances the potential benefits your family can achieve from Testamentary Trust Wills will more immediately be from your parents. Often this can be a difficult subject for children to raise with their parents, however most of our clients find that pointing out the potential savings noted in this document, as well as the asset protection noted in our 'Testamentary Trusts – Keep it in the Family' brochure, are sufficient to show parents the savings achieved by Testamentary Trust Wills far exceeds the costs.

Contact Us:

Every persons circumstances will differ and do not necessarily fit the examples provided. The examples are provided by way of demonstration only. Telephone our office to book an appointment to discuss the savings that could be made with your current circumstances.

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