

Testamentary Trusts

A testamentary trust is a trust that becomes effective upon death. A testamentary trust must be established in a Will. The establishment of a testamentary trust allows the assets of the deceased person to be distributed to a range of beneficiaries. The advantages of creating a testamentary trust will be discussed in this article.

A trust can generally be described as a structure, whereby assets are held by a person(s) or company for the benefit of other individuals or companies.

A testamentary trust shares some similarities with a discretionary trust, as the trustee has absolute discretion over who is to benefit (and to what extent) from the distribution of the trust's income.

In order to get a better understanding of the terms commonly used in relation to trusts, some useful definitions are set out below:

Trustee: Person who holds property or assets on behalf of another. This person is appointed to have effective control of the trust, and owes a fiduciary duty (duty to act for the benefit of another and in good faith) to the beneficiary. The powers of a trust are normally limited by the trust deed, or if there is no deed, would be governed by the state Trustee Acts.

Beneficiary: A person for whom a trustee holds an asset.

Beneficial interest: The interest held by a beneficial owner (usually distinct from the legal owner).

Executor: The person or people nominated by a will maker to carry out the terms of a will.

A. Testamentary Trust – Background

A testamentary trust is established in a will, and it only comes into effect upon the death of the will maker. It is the estate (assets) of the deceased will-maker that funds the Testamentary Trust.

The most common testamentary trust is that of the “beneficiary-controlled” testamentary trust. Under a “beneficiary-controlled” testamentary trust, upon death and the granting of a probate or letters of administration (see Comasters article titled “Probate and Letters of Administration”), the assets of the deceased will-maker will pass from the executor of the will to the trustee of the beneficiary-controlled testamentary trust. This differs from simple or traditional wills, where assets pass from the executor to the beneficiary directly.

The trustee would therefore hold the assets in trust for the benefit of the specified beneficiary and other discretionary beneficiaries.

B. Specific Clauses Necessary in a Will to set up a Testamentary Trust

A testamentary trust (as with other discretionary trusts) is normally created through a trust deed.

For a beneficiary-controlled testamentary trust to operate, it is the will that forms the deed for the beneficiary-controlled testamentary trust.

Clauses to be inserted into the trust should therefore include:

- A definition of the beneficiaries of the trust
- The appointment of the initial trustee to the trust
- The powers and discretions exercisable by the trustee
- A provision allowing for the amendment of the deed
- Provisions relating to the life span of the trust (not exceeding 80 years)

C. Who should use a Testamentary Trust?

Questions for consideration when deciding whether to implement testamentary trusts in your will should cover the following:

- What assets will fund the trust after death? Would there be sufficient assets to fund the trust (eg are most of the assets owned jointly with another?)
- Who do you intend to benefit, and in what form is the benefit to be presented?
- Are there any special needs for any of the beneficiaries (eg special disability)?
- Is the trust to be mandatory or optional?
- Is an independent trustee required for the trust? (If so, who?)
- What would be the costs for establishing and maintaining the trust?

As mentioned above, a will maker has the option of allowing the executor of the will to exercise their discretion as to whether a testamentary trust is to be established. The discretion of the executor to not implement a trust should be exercised with the consent of the primary beneficiaries and is to be made at the time of administering the estate but prior to its distribution.

Laws regarding taxation, bankruptcy and trusts are constantly changing. The benefits of using a testamentary trust at a certain point in time may not necessarily be the same at a future point in time. Thus, it is a prudent measure to ensure that there is the option of not setting up a testamentary trust if not required.

To avoid ambiguity, it would be best that this discretionary power to not set up the trust be clearly stated in the will.

Every year the trust will need to pay administrative costs (for the maintenance of the trust), as well as incur accountant's fees owing to the requirement of trust taxation returns.

D. Advantages of Using a Testamentary Trust

The major advantage of using a testamentary trust is increased asset protection – in essence, this means that since your beneficiaries would not be inheriting the assets of the will-maker personally, greater protection would be afforded to beneficiaries who are facing bankruptcy, a relationship breakdown or if beneficiaries are intellectually impaired.

- **Creditor Protection** – a testamentary trust (beneficially controlled) can potentially provide protection from insolvency and other potential creditor liabilities. The discretionary nature of the trust is such that the assets of the trust are not owned by the primary beneficiary but are held on trust by the trustee of the Will. Action taken by creditors of the bene-

ficiary will therefore not expose the assets of the beneficiary

- **Income Tax Savings** – taxation payable on income generated by the trust is taxed at the marginal rate of the beneficiary who receives the income by way of trust distribution. Therefore, the trustee would be able to minimise taxation liability on the income by distributing trust income to a beneficiary on a low marginal tax rate.
- **Family Law Issues** – it has been stated that the use of testamentary trusts can protect assets in cases of relationship breakdowns resulting in the need for property settlements. However, one should be wary of this view, as the Courts could consider that a testamentary trust structure forms part of the financial resources of either party.
- **Infant and Intellectually Impaired Beneficiaries** – leaving assets to responsible trustees in a testamentary trust would aid beneficiaries who are unable or incapable of making decisions in relation to finance.

E. Setting up a Trust After Death

If a testamentary trust was not set up in a will prior to death, a post-death trust, similar to that of a testamentary trust could be established. The difference in setting up a 'post-death' trust is that assets of the post-death trust can only be limited to certain beneficiaries as defined under intestacy law (law that governs the distribution of a deceased estate in situations where there is no will). Setting up a 'post-death' trust would therefore not be as effective in terms of flexibility and financial planning.

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Bibliography: (1) Simpson, Andrew; *You Can't Take It With You*; Book.
(2) Comasters articles.

Comasters can draft Wills for clients, including Wills incorporating Testamentary Trusts.

Important: This is not advice. Clients should not act solely on the basis of the material contained in this paper. Our formal advice should be sought before acting on any aspect of the above information.

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