

### **Testamentary Trusts in Australia**

A testamentary trust is a trust established by a Will. Testamentary trusts can be mandatory or optional, fixed or non-fixed, flexible or protective, short or long term, charitable or non-charitable and can:

- Operate for as long as the beneficiary is less than 18 years of age or relatively young or immature;
- Provide asset protection and taxation advantages for a primary beneficiary – these testamentary trusts (often beneficiary controlled) are usually **optional** and non-fixed. The executor, in consultation with a primary beneficiary, usually has the power to utilise the trust for all, part or none of the beneficiary's share of an inheritance;
- Switch to a different phase of operation for the duration of a crisis, eg if the primary beneficiary loses the capacity to make decisions or is bankrupt;
- Block or restrict access to capital for a lifetime or other time period – these **fixed or flexible life interests** are usually mandatory and executor (or neutral party) controlled; or
- Endure as an executor or neutral controlled restrictive arrangement to provide needy or vulnerable beneficiaries with ongoing financial support from both income and capital, eg **special disability** or **all needs protective** trusts.

### **Taxation of Testamentary Trusts**

Income tax concessions apply to fixed and non-fixed testamentary trusts, allowing individual beneficiaries under 18 years receiving trust income to be taxed at the much lower marginal tax rates normally reserved for adults. Unlike companies, fixed and non-fixed testamentary trusts qualify for the same 50% capital gains tax discount rules applicable to individuals.

# Control of Testamentary Trusts

## Executor (or Neutral Controlled)

Will provides for the terms for administration and investment and sets out how income and capital are distributed and to whom

The principal beneficiary (or a carer) is consulted to assess ongoing needs

## (Primary) Beneficiary Controlled

Will provides the trust framework, eg the definition of the class of beneficiaries, control provisions and general powers

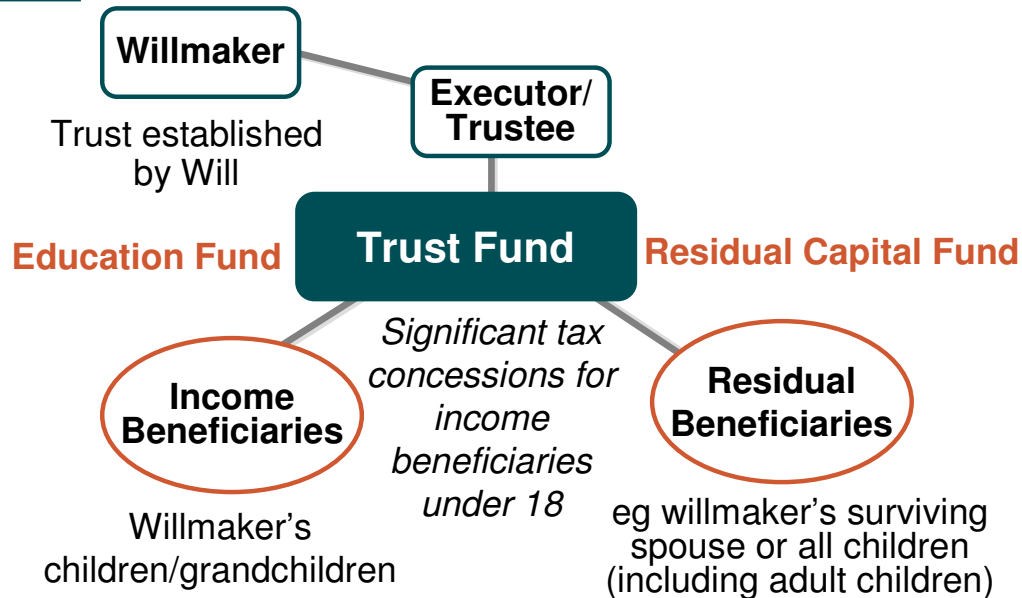
The primary beneficiary is to control the distribution of income and capital

### *Categories of Australian Testamentary Trusts*

1. **Absolute entitlement**, eg an inheritance to pass to an outright adult beneficiary as the administration of the deceased estate is completed.
2. **Defeasible**, eg prospective primary beneficiary trusts and prospective outright beneficiary trusts where control or ownership passes if and when an age is attained.
3. **Contingent**, eg education testamentary trusts.
4. **Fixed life interests**, eg for a surviving domestic partner.
5. **Rights of occupation**, ie of a family home or other real estate.
6. **Capital reserved (all capital)**, eg capital protected testamentary trusts or flexible life interests with a lifetime principal beneficiary and a class of alternate potential income beneficiaries.
7. **Capital reserved (residual capital only)**, eg special disability trusts (with a sole lifetime principal beneficiary) or all needs protective trusts (with a lifetime principal beneficiary and a class of alternate potential income beneficiaries).
8. **Charitable** (with a fixed charitable beneficiary or beneficiaries or a class of potential beneficiaries).
9. **Fully discretionary** (with a relatively **narrow class** of beneficiaries), eg superannuation death benefits testamentary trusts (limited to beneficiaries who are death benefit dependants for income tax purposes).
10. **Fully discretionary** (with a relatively **wide class** of beneficiaries), eg single or staggered release beneficiary controlled testamentary trusts.

The various trusts referred to in 1 to 8 above are usually executor (or neutral trustee) controlled and those referred to in 9 and 10 above are usually primary beneficiary controlled.

# Education Testamentary Trust



## **Major Reason for an Education Testamentary Trust in Australia**

To fund all or part of the cost of primary, secondary and/or tertiary education for children or grandchildren (or other dependants or relatives) of the willmaker. **Trustee**

The trustee is usually the executor of the deceased estate and is not usually subject to a power of appointment by a third party.

### **Income, Losses, Loans and Pension Benefits**

The trustee pays tax on behalf of the income beneficiaries (for as long as they remain under 18 years) on all trust income spent on or allocated or paid to or for them, with credit for any tax already paid, eg via dividend franking credits. A family trust election may be needed, eg so that both the trust and its beneficiaries can claim dividend franking credits.

### **Trust Capital**

The trust capital is usually reserved for the residual beneficiaries of the deceased estate, although it may be available to cover any shortfall in the level of trust income needed to fund the education expenses. If a taxable capital gain is triggered in respect of assets funding the testamentary trust, the executor usually has the power to reimburse or pay any tax payable in respect of the gain.

*Note 1:* In the case of beneficiaries other than children, class closing provisions are included in the terms of the Will to prevent the trust having to continue for an unduly extended time.)

*Note 2:* Primary and secondary education trusts established during a person's lifetime do not usually qualify for excepted income tax concessions – key exceptions are child support trusts and trusts for a minor in respect of whom a Government carer's allowance is payable.

# Types of Testamentary Trusts – Further Reading

**Australian Master Estate  
Planning Guide –  
Chapters 20-26**

**You Can't Take It  
With You –  
Chapter 11**

**The latest version of this Pocket Summary is at  
[www.mooreslegal.com.au/services/estateplanning/pocketsummaries](http://www.mooreslegal.com.au/services/estateplanning/pocketsummaries)**

### **Further Reading**

- *Australian Master Estate Planning Guide* – Allan Swan, to be published (in both a Standard and Premium Edition) by CCH in 2012.
- *Estate Planning Documents* – Allan Swan, Moores Legal (includes many of the Pocket Summary series).
- *You Can't Take It With You* – Andrew Simpson, Wrightbooks.
- *Tax Issues in Family Law Property Settlements* – Peter Szabo, Moores Legal.

### **Australia-wide Seminar, Workshop & other Presentations – Allan Swan**

**EPSTTAP Introductory:** • Estate Planning – The A-Z (includes page 1 of this Pocket Summary) • Superannuation – The A-Z • Trusts – The A-Z (1).

**EPSTTAP Advanced:** • Estate Planning – Case Studies • Estate Planning Masterclass (1 & 3) • Superannuation – Death Benefits & Binding Nominations • Testamentary Trusts – Drafting the 6 Major Types (all) • Trusts & Deceased Estates – Income & Capital Distributions (1) • AMEPG Chapter Workshops.

Allan's local Moores Legal client, community & discussion group topics are:

- Estate Planning – Protecting & Enhancing Wealth • Estate Planning – Vulnerable Family Members • Family Trusts – Income & Capital Overview • Farm Succession – Avoiding Tax Pitfalls & Anticipating Disputes • Providing an Estate Planning Service for Clients • SMSFs – Instalment Warrants, Pensions & Binding Death Benefit Nominations • Tax & Business Structures Overview • Update – Estate Planning, Superannuation, Trusts, Tax & Asset Protection.

To book Allan for any of these topics, contact Lilian Bruère on 03 9843 2153. All Pocket Summaries are copyright and are for general information purposes only and should not be relied on as (or in substitution for) legal or other professional advice.