
# Testamentary Trusts In Wills

## What is a testamentary trust?

A testamentary trust is simply, a trust established in a Will. Most trusts are discretionary trusts due to their tax and asset protection advantages and this is the type we use in our Wills.

Discretionary trusts are quite common in Australia. They can also be established outside of a Will and you may know them by their familiar name of 'Family Trusts'. There are over 400,000 active discretionary trusts in Australia.

When the discretionary trust is placed in a Will, it is called a Testamentary Discretionary Trust (TDT). TDTs have even more advantages than Family trusts.

You can write a Will to include a TDT so that your beneficiary has the option to hold some or all of their inheritance in the TDT, rather than outright. The TDT cannot be used before the Willmaker dies, it only is available for use by the beneficiary once the beneficiary is entitled to their inheritance. The important thing to note is that if you do not include one in your Will, the beneficiary will not have the benefit of one.

## The main features of the TDT include:

- the TDT can buy, sell and deal with assets similar to a natural person;
- a trustee controls the TDT. The trustee determines what the TDT will sell or invest in. They also decide who will receive the income earned by the TDT, or the capital of the TDT from the pool of beneficiaries named in the TDT. You can have more than one trustee, and a trustee can be a beneficiary;
- the TDT has a pool of beneficiaries (normally family members and their entities) who the trustee can choose from (in the trustee's discretion) to give income or capital to. The trustee can give whatever amount it decides, to one or more of the beneficiaries (equally or unequally, or nothing at all);

- the TDT starts on the death of the Willmaker. The maximum life of the TDT allowable is 80 years (with the exception of South Australia), from its commencement. The trustee is normally given the power under the TDT to wind it up earlier if they wish.

The TDT is a very flexible entity, allowing the trustee plenty of freedom to deal with the trust fund for the benefit of the beneficiaries. Take a look at the diagrams at the end of this Fact Sheet to get an idea of how the trust is structured.

As a rule of thumb, if you are gifting more than $300,000 to a beneficiary, then you should seriously consider giving the beneficiary the option of taking their gift in a TDT. You may still wish to consider a TDT for a lesser amount, if the beneficiary is 'vulnerable' (see our discussion below).

## Tax Advantages of the TDT

The TDT allows the trustee to assign the income earned in the trust to different beneficiaries in the trust to take advantage of their different tax rates.  This effectively allows you to income split with various beneficiaries of the trust.

Minors (e.g. children under 18) have even greater tax benefits.  They are taxed at adult rates and when combined with the low and middle income tax offsets, their effective tax free threshold is $21,884 for the 2023/24 financial year. The concession extends to all minors who are in the pool of beneficiaries in the TDT such as children, grandchildren and nieces and nephews, as you specify).

This is significantly more than the tax free threshold for children in the Family trust, which is currently $416 per minor.

Our examples of Michael and Mandy at the end of this Fact Sheet clearly show the tax savings they would enjoy if they were left their inheritance in a TDT by the Willmaker, rather than receive their inheritance outright.

The table below summarises the tax savings in each scenario:

| Example | Tax Saving |
|---|---|
| Example 1: Mandy doesn't work, has 2 children | $4,387 per year |
| Example 2: Mandy has a part time job, and 2 children | $13,325 per year |
| Example 3: Michael has a full time job, and 2 children | $15,910 per year |
| Example 4: Michael has a full time job and no children | $3,010 per year |

## Other Advantages of using TDTs in your Will

TDTs have the following additional benefits:

- TDTs significantly reduce the risk of the inheritance you give to a beneficiary being 'lost' to third parties or your in-laws, particularly on the death of the beneficiary. For example if you leave an inheritance to your adult child in a TDT, then on that child's death the inheritance remains in the TDT for that child's children (your grandchildren) and will not pass under your child's Will to their spouse;
- Protection of the inheritance from the beneficiary's creditors and some protection against the beneficiary's spouse in a marital breakdown;
- Protection of the inheritance where the beneficiary is 'vulnerable' (for instance, has a disability, addiction or is a spendthrift, bankrupt or a 'financially at risk' person). See our Fact Sheet on **Protective Trusts in Wills** for more information.

## What are the disadvantages of a TDT?

- Once the TDT comes into existence (that is, on the Willmaker's death), the TDT needs a tax file number and will need to lodge a tax return each year on any income earned. This is an ongoing maintenance cost. Because the tax return will be similar to that of a family trust, most accountants are well acquainted with this process and do not see it as complex. There are no government fees or audit requirements;
- The cost of establishing the TDT in the Will is paid for now by the Willmaker, even though the benefits of the TDT will be enjoyed by the beneficiaries.

There is very little choice here, as the ability for the beneficiaries to obtain a TDT like this is not possible in any other way. There is a limited ability to obtain a post death trust, but it is very restrictive, and expensive to establish post death.

## In Summary

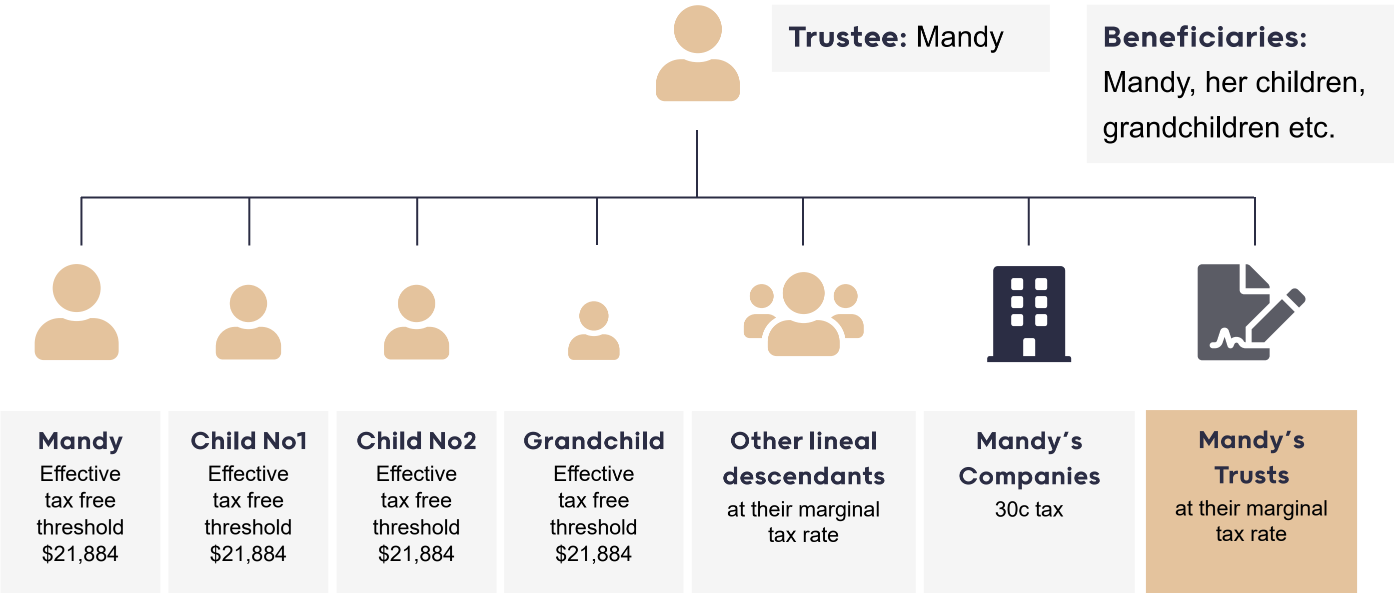
The inheritance you leave can be significantly enhanced by placing it in a TDT which offers a tax effective environment for it to grow. In addition, the inheritance receives added protection from the ravages of imprudent beneficiaries, or unscrupulous third parties.

The ways to obtain this valuable vehicle are very limited. The TDT must be created in your Will. It is a small window of opportunity, but the benefits can last for years.

Estate First offer competitive fixed fee pricing on TDT Wills. Please contact us on 1300 132 567 or email us at **info@estatefirst.com.au** to discuss how we can help you implement TDTs into your Wills.

## Testamentary Discretionary Trust

**Example 1:** Mandy + 2 kids
Mandy – no other income




Trust receives $600,000 inheritance, which is invested (property, shares, term deposit, etc)

Income earned each year by inheritance: $43,000

Mandy assigns the income: Mandy $21,884, Child No. 1 $10,558, Child No. 2 $10,558 →
Tax on income: $NIL

Mandy's tax if inheritance in her own hands: $4,287 per year

### Saving: $4,287 per year*

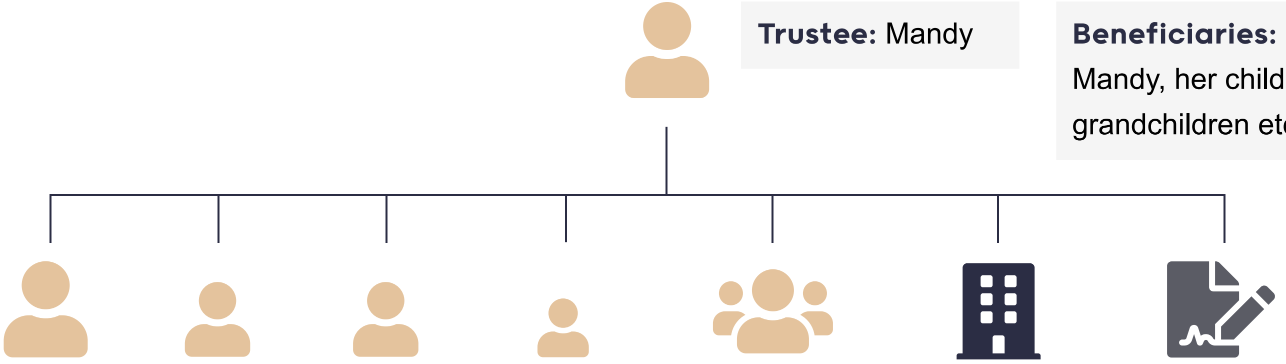
*(2023/24 tax rates. Excludes Medicare levy. Includes Low Income Tax Offset where applicable.)

## Testamentary Discretionary Trust

**Example 2:** Mandy + 2 kids
Mandy – has part time job: $35,000 p/a

**Trustee:** Mandy

**Beneficiaries:** Mandy, her children, grandchildren etc.



| Mandy | Child No1 | Child No2 | Grandchild | Other lineal descendants | Mandy's Companies | Mandy's Trusts |
|---|---|---|---|---|---|---|
| Taxed at her marginal rate | Effective tax free threshold $21,884 | Effective tax free threshold $21,884 | Effective tax free threshold $21,884 | at their marginal tax rate | 30c tax | at their marginal tax rate |

Trust receives $600,000 inheritance, which is invested (property, shares, term deposit, etc)

Income earned each year by inheritance: $43,000

Mandy assigns the income: $21,500 to Child No. 1 + $21,500 to Child No. 2 → Tax on income: $NIL
(By doing this, Mandy keeps her income under $37,500 and receives the full Low Income Tax Offset.)

Mandy's personal tax: $2,492

Mandy's tax if inheritance in her own hands: $15,817 (based on income of $35,000 + $43,000 = $78,000).

### Tax Saving $13,325 per yr*

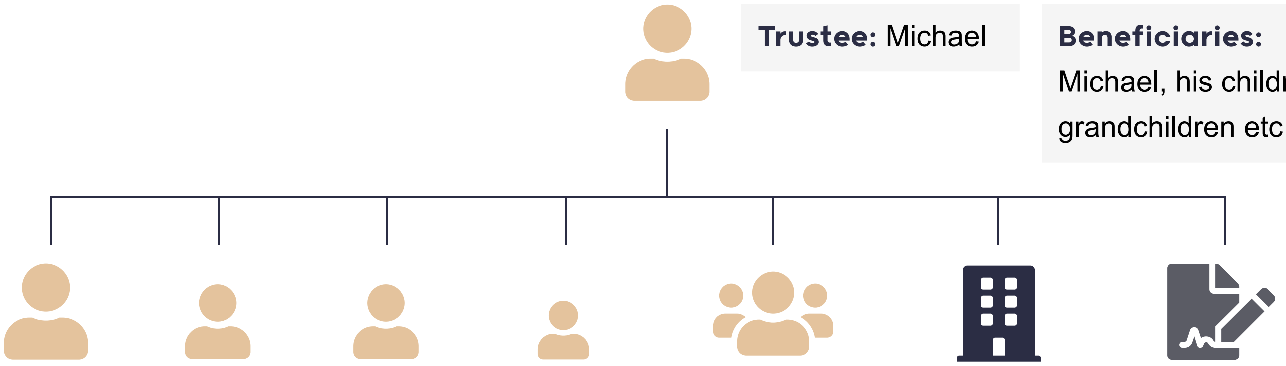
*(2023/24 tax rates. Excludes Medicare levy. Includes Low Income Tax Offset where applicable.)

## Testamentary Discretionary Trust

**Example 3:** Michael + 2 kids
Michael has a full-time job at $120,000 p/a

**Trustee:** Michael

**Beneficiaries:** Michael, his children, grandchildren etc.



| | | | | | | |
|---|---|---|---|---|---|---|
| **Michael** Taxed at marginal rate | **Child No1** Effective tax free threshold $21,884 | **Child No2** Effective tax free threshold $21,884 | **Grandchild** Effective tax free threshold $21,884 | **Other lineal descendants** at their marginal tax rate | **Michael's Companies** 30c tax | **Michael's Trusts** at their marginal tax rate |

Trust receives $600,000 inheritance, which is invested (property, shares, term deposit, etc)

Income earned each year by inheritance: $43,000

Michael assigns the income: $21,500 to Child No.1, $21,500 to Child No.2 → Tax on income: $NIL

Michael's personal tax: $29,467

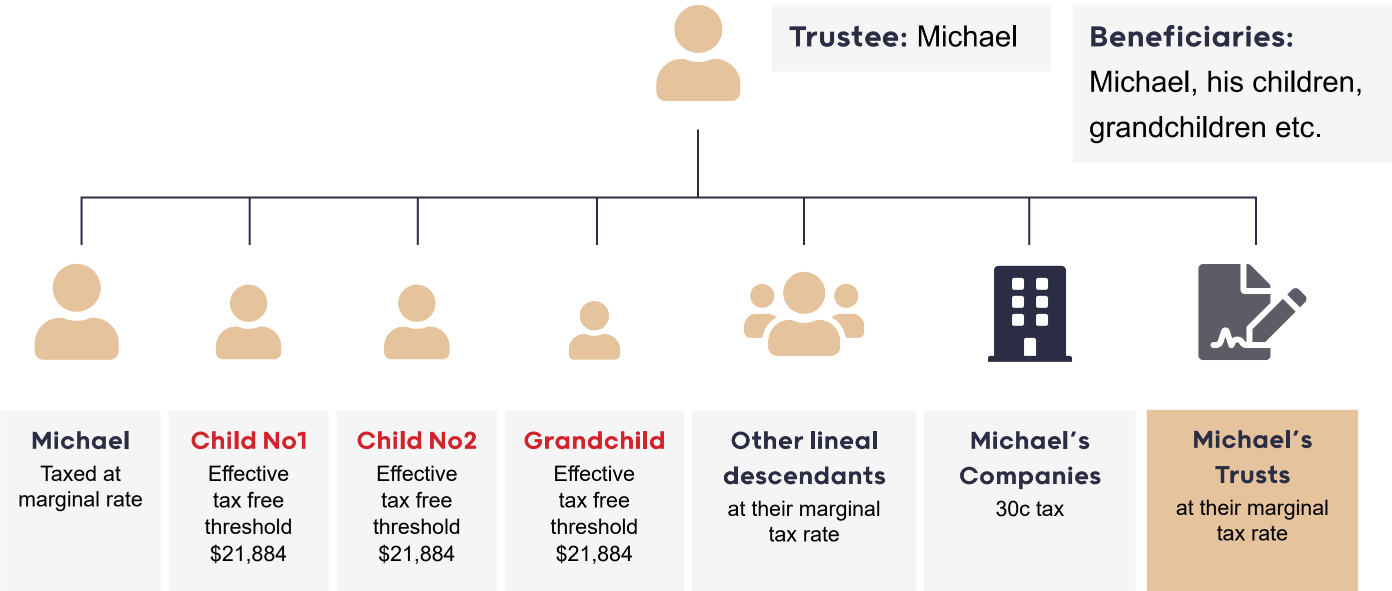
Tax to Michael if he received the inheritance outright = $45,377 (being tax on income of $120,000 + $43,000 = $163,000)

### Tax Saving $15,910 per yr*

*(2023/24 tax rates. Excludes Medicare levy. Includes Low Income Tax Offset where applicable.)

## Testamentary Discretionary Trust

**Example 4:** Michael, but no children yet
Michael earns $120,000 p/a




Trust receives $600,000 inheritance, which is invested (property, shares, term deposit, etc)

Income earned each year by inheritance: $43,000.

If Michael has no TDT the inheritance income of $43,000 will be taxed at his marginal rate. His tax on income of $120K + $43K would be $45,377.

If Michael has a TDT he could decide to distribute $43,000 of inheritance income to a shelf company he establishes as a beneficiary (which is taxed at a flat rate of 30%). His tax would be $29,467. His shelf company's tax would be $12,900. TOTAL TAX: $42,367.

### Tax Saving $3,010 per yr*

*(2023/24 tax rates. Excludes Medicare levy.)