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Let's chat

Testamentary trusts: When would your client benefit from it? – February 2022

With:
Darius Hii – Tax and estate planning lawyer; Chartered Tax Advisor; and Director at Chat Legal

Information provided is general in nature; precise application depends on specific circumstances

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Why use a testamentary trust?

- Provides you with flexibility and certainty of who looks after a recipient's 'inheritance'
- Tax planning opportunities recipients with minor children
- Provides protection against bankruptcy (if structured properly)
- Provides protection against family Court proceedings (if structured properly)

Couple with young children

- Assume:
  - Father making $100,000/year
  - Mother making $100,000/year
  - Two minor children
  - Family house owned as joint tenants
  - Minor investments
  - Life insurance of $1,000,000
- Testamentary trust of potential use if life insurance paid to estate
  - Surviving spouse receives $1,000,000 and then invests
  - Assume a 3% return on investment
  - $30,000 additional income in spouse name
  - Taxed at marginal rate of ~30%, spouse pays $9,000 in tax
  - If received in a testamentary trust, additional income can be distributed $15,000 to each child, who receives first $18,000 tax free

Professional couple with young children

- Assume:
  - Prior example but couple (either or both) are in high salary positions
  - An additional investment property or two
- Testamentary trust of potential use even without requiring life insurance paid to estate

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Couple with young children

- Assume either of above scenarios
- In the event both Mum and Dad are deceased, steps can be taken to ensure the correct persons are managing the money for any minor children
- With a testamentary trust flexibility allows the persons in control to determine the most appropriate time to pass control of inheritance to the children (whether 18, 21 or 25) – Mum and Dad do not need to make such a determination whilst they have no idea as to how their children would turn out

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Couple with adult children

- Assume:
  - Mum and Dad at retirement age (67 years)
  - Three children (each having their own family)
  - Family home owned as joint tenants (debt free and valued $1,000,000)
  - $800,000 in superannuation combined
  - Share investment $300,000
  - No trusts or companies
- Testamentary trust of potential use in the event both Mum and Dad are deceased:
  - Each child receives their inheritance ($700,000) into a structure where they can make their own separate investments
  - Assuming a return on 3%, on investment $21,000 additional income can be split amongst each child's family
  - Assuming children are on 30% tax bracket, potential $6,300 in tax savings

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Protect assets from bankruptcy

- Assume:
  - Partner 1 is a director of a company which runs a business
  - Partner 2 owns the family home
  - Investments are held in trust/company structures
- Testamentary trust of potential use if Partner 1 does not wish to receive the family home in personal name and potentially expose the home to any litigation risk arising from Partner 1's role as a director of a company running a business
- Same scenario may apply if Partner 1 is in a highly litigious occupation and wish to mitigate the risk of potential exposure of the family home
- Partner 2 will would distribute estate to a testamentary trust and not in the name of Partner 1

Protect assets from family Court proceedings

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- Assume:
  - Mum and Dad wish a standard asset holding
  - Son and Daughter, each with a partner
  - Uncertain with Son's partner
- Testamentary trust can be of use by gifting the Son's inheritance to a testamentary trust controlled by the Daughter for the benefit of the Son's children
- Provided proper advice is sought by the Daughter as to how best to manage the testamentary trust, and it cannot be shown the Daughter is acting as an extension of the Son, then it can be difficult for the Son's partner to stake claim to the assets of the testamentary trust

When not to use a testamentary trust

- Insufficient assets to form part of an estate:
  - Example:
    - Husband and wife
    - House in joint names
    - Joint bank accounts
    - Life insurance sufficient to cover house debt
    - Superannuation
    - No benefit of testamentary trust for spouse from a tax planning perspective
    - Steps may be taken to separate assets if required for other purposes
  - Example 2:
    - Family home in personal name
    - All other assets held in trusts and companies
    - No life insurance
  - Example 3:
    - Single and haven't saved money

When not to use a testamentary trust

- Insufficient assets to form part of an estate:
  - Husband and wife
  - Young children
  - House in joint names
  - Joint bank accounts
  - Life insurance sufficient to cover house debt only
  - ~$200,000 in Superannuation
  - No benefit of testamentary trust for spouse from a tax planning perspective
  - Steps may be taken to separate assets if required for other purposes

When not to use a testamentary trust

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- Insufficient assets to form part of an estate:
  - Husband and wife
  - Young children
  - Family home in personal name
  - All other assets held in trusts and companies
  - No life insurance

When not to use a testamentary trust

- Insufficient assets to form part of an estate:
  - Single
  - No assets

When not to use a testamentary trust

- No one trusted available to manage testamentary trust
- Concept unable to be understood by Willmaker
- Compliance costs exceeds tax planning benefits

Contact details

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