

# CGC Law

A Guide To

## TESTAMENTARY DISCRETIONARY TRUSTS



Estate Planning

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# THE POWER OF INCOME STREAMING

Example: Rental income from your property streamed to the minor children of your beneficiaries, via a testamentary trust.

The key is that, with a testamentary discretionary trust, minors (i.e, children under 18 years old) are taxed like adults with the same tax rates, including the tax-free threshold. This is contrasted with a normal family trust, where distributions to minors are taxed at penalty rates. See the table below:

Income tax rates for resident minors		Based on FY20 rates
Distribution	Family Trusts	Testamentary Trusts
0 - 416	0%	0%
417 - 1,307	66%	0%
1,308 - 18,200	45%	0%
18,201 - 45,000	45%	19%
45,001 - 120,000	45%	32.5%
120,001 - 180,000	45%	37%
180,001+	45%	45%

When a recipient in your will earns income from a gift – e.g, rent on an investment property, or capital gains when they sell it – that income will be taxable.

While they have children under 18 years old, that income can be ‘streamed’ to the kids to take advantage of their preferential tax rates. This requires a special structure called a ‘testamentary discretionary trust’ that can only be created under a will.

Income can also be streamed to low-income-earning adults, such as full-time or part-time students, which similarly provides a valuable mechanism for reducing tax.

# ASSET PROTECTION

## Bankruptcy

Assets held in your beneficiary's own name are vulnerable to claims from the beneficiary's creditors. For example, if the beneficiary makes an investment that goes bad, or someone has an accident for which the beneficiary is held liable, then your hard-earned assets may be used to pay the debts.

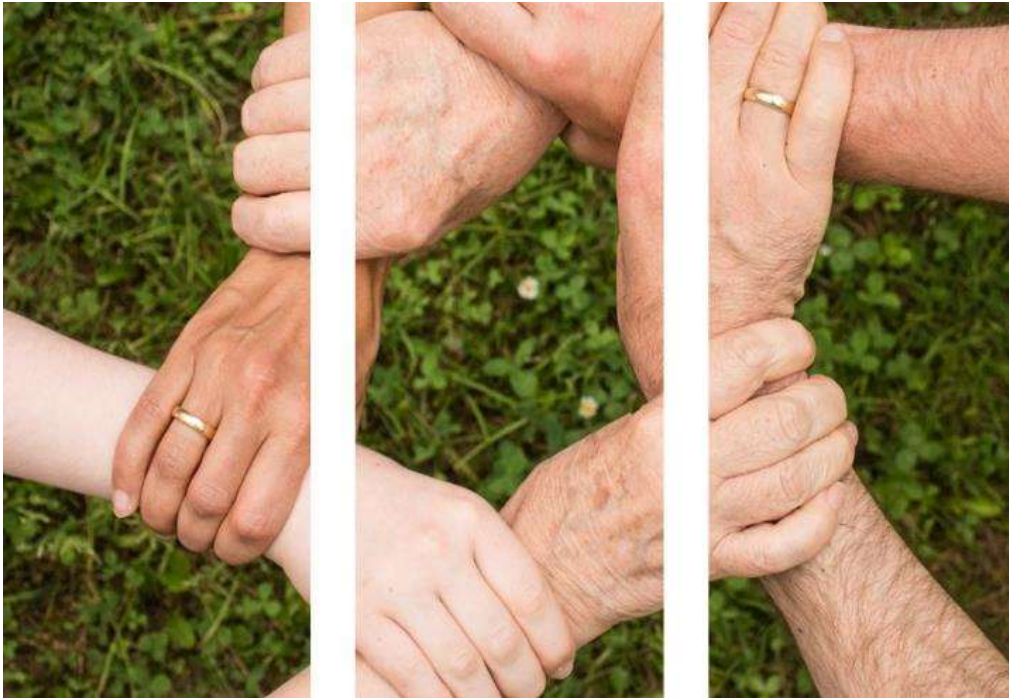


## Family Law claims

If your beneficiary is involved in a marriage or de facto relationship that breaks down, the beneficiary's former spouse may make claims against the beneficiary's assets. The Family Court of Australia has broad powers to divide the beneficiary's property between the spouses and require the payment of maintenance (i.e., alimony).

**Placing your assets in a testamentary discretionary trust of which your beneficiary is not the trustee may help to insulate your hard-earned assets from such claims. This is because technically the trustee owns the assets and, as it is a discretionary trust, the beneficiary does not have a fixed entitlement to the assets.**

# PRESERVING YOUR BENEFICIARIES' CENTRELINK ENTITLEMENTS



## Many Centrelink entitlements are means-tested.

Eligibility to receive the welfare benefit depends upon the value of the intended recipient's assets (the "assets test") and the level of the intended recipient's income (the "income test").

If one of your beneficiaries receives a mean-tested welfare benefit, assets given to the beneficiary directly under a 'simple' will – and income earned from those assets – may affect the beneficiary's entitlement to the benefit.

## BENEFICIARY SUPPORT TRUST

Also called a “Protective Trust” or “Capital Protected Trust”, a Beneficiary Support Trust is a special type of trust created under a will for one particular beneficiary where the beneficiary does not have any control over the allocation of the assets.

This is especially useful where there is a concern that the beneficiary may be unable to manage his/her own finances – e.g, by virtue of having an intellectual disability or a problem with drugs, alcohol, or gambling.

Where assets are in a trust, in determining the assets test and the income test, Centrelink focusses on whether the recipient has control over the assets, so a Beneficiary Support Trust may reduce the risk of the beneficiary losing his/her Centrelink entitlements.

“ *... especially useful where there is a concern that the beneficiary may be unable to manage his/her own finances – e.g, by virtue of having an intellectual disability or a problem with drugs, alcohol, or gambling.* ”

## SPECIAL DISABILITY TRUST

A Special Disability Trust is a trust created for one particular beneficiary who has a “severe disability” (as defined by legislation).

If the terms of the trust comply with the requirements of the Department of Social Services, assets in the trust are exempt from means testing by Centrelink and the Department of Veterans’ Affairs (up to a maximum of \$657,250 for the assets test from 1 July 2017 – this amount is increased annually).

Wills with testamentary trusts can use the above trust structures aimed at preserving Centrelink entitlements.



## THE IMPORTANCE OF FLEXIBILITY

### **Keep your beneficiaries' options open.**

Simple wills force your beneficiaries to take all of their gifts directly. That limitation may prove to be costly as it:

- places the assets at risk by exposing them to claims from your beneficiaries' creditors; and
- prevents your beneficiaries from enjoying the tax savings from income streaming, which can be significant.

The key is to keep your beneficiaries' options open. **Wills with testamentary trusts give your beneficiaries the choice** as to whether to take the assets directly or via a testamentary discretionary trust, depending upon what suits their particular circumstances in the future when you pass away.

Testamentary trusts allow the beneficiaries to receive the assets in the way that best suits their personal situation at the relevant time.

### What if they want to sell the Property to pay their mortgage?

The tax advantages of a testamentary discretionary trust are relevant where the beneficiary chooses to retain the assets to earn income from them. If the beneficiary chooses to immediately sell the property (e.g. to help pay off their own mortgage) then the beneficiary may prefer to receive the property directly. Wills with testamentary trusts give the beneficiary that choice.

### Power of Adjustment

Simple wills may be too rigid: they don't give the executor room to make adjustments to deal with unintended scenarios.

For example, if two beneficiaries are intended to receive equal shares but the gift to one of them turns out to be subject to an unexpected tax, the executor needs the flexibility to increase the gift to that beneficiary to achieve a more equitable distribution on an after-tax basis. Wills with testamentary trusts give the executor a general power to make such adjustments.

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*Testamentary trust wills give your beneficiaries the choice as to whether to take the assets directly or via a testamentary discretionary trust, depending upon what suits their particular circumstances in the future when you pass away.*

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# EXCLUDING PEOPLE FROM YOUR WILL



When you pass away, any "eligible person" may make an application to the court for a family provision order if they believe that there has been inadequate provision for them under your will. If an order is made, interests under your will may be adjusted and the applicant may be able to obtain part of your estate, contrary to your will.

## Who is an "eligible person"?

Broadly speaking, this may include anyone to whom you had a responsibility, potentially including a current or former spouse or de facto partner, children, and grandchildren and other dependents and even persons living in your home.

## How can the likelihood of a successful family provision order be reduced?

The likelihood of a family provision order being successful might be reduced by expressly excluding people who may be eligible persons in the will, outlining the reasons why they have been excluded. This is not usually a feature of a 'simple' will but can be included in a will with testamentary trust.



## What might be a valid reason to exclude someone?

There is no guarantee that any particular reasons will be acceptable. The following are some examples of potentially valid reasons:

- sufficient provision was made for the excluded person during your lifetime;
- you and the excluded person have had no contact for a long time and no relationship of love/affection exists between you;
- you have not had any responsibility for the welfare of the excluded person for many years;
- the financial circumstances of the excluded person are much better than those of the included beneficiaries; and/or
- the excluded person has received, or is likely to receive, significant assets from the estate of another person.

**Please note that, as the will becomes a public document at probate, any such reasons will ultimately be visible to the public.**



# CGC Law

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Should you require professional advice, please contact us.

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