

DISCRETIONARY TESTAMENTARY TRUST WILLS

WHAT IS A DISCRETIONARY TESTAMENTARY TRUST WILL?

A trust is a relationship where a person or group of persons, called the trustee(s), is given assets to hold for the benefit of another person or group of persons, called the beneficiaries.

In a discretionary trust there are two or more beneficiaries. Usually there are many beneficiaries. They may include the members of a family, their partners and any descendants of those people, as well as the partners and more distant relations of those descendants. The trustee has discretion to select from the group of beneficiaries those who receive any payment of income or capital from the trust assets.

No beneficiary of a discretionary trust has a right to demand any capital or income from the trust. The trustee is under no obligation to pay any money to any particular beneficiary.

Most discretionary trusts also have an appointor. The appointor of a trust has the power to remove the trustee and appoint new or additional trustees. Therefore, the appointor can be described as the ultimate controller of the trust. The appointor and the trustee can be the same person which means that the appointor can appoint an additional or alternative trustee. There can be multiple appointors and trustees.

A discretionary testamentary trust will is a will which establishes one or more discretionary trusts in the terms of the will and gives assets to that trust or those trusts.

THE ROLE OF THE EXECUTOR AND TRUSTEE OF YOUR ESTATE

When making a will, whether or not it incorporates a discretionary trust, you appoint someone to be your executor and trustee. The task of the executor is to gather in the estate's assets and pay any debts. The task of a trustee is to hold those assets on behalf of beneficiaries and make distributions to them at the appropriate time as directed by the will.

The tasks of an executor and a trustee are usually handled by the same person or persons. The words "my trustee" in a will usually mean the person who acts as executor and trustee. The role of the trustee may only last for one or two days pending distribution or it may last for many years, for example, where there are infant beneficiaries.

The trust created in a standard will, that is a will which does not establish a discretionary testamentary trust, is what is known as a fixed trust in that the trustee must hold specified assets, or a specified share of the estate for a beneficiary as directed by the will. The trustee has no discretion to distribute the estate assets amongst beneficiaries as he or she chooses.

If a will creates a discretionary trust then it is necessary to appoint a trustee of that trust in addition to the trustee of the estate. The trustee of the discretionary trust will have different powers to the trustee of the estate, although the same person could be appointed to both roles.

The trustee of the discretionary trust will have power to distribute assets of the trust and income earned from those assets amongst the trust's beneficiaries as the trustee sees fit.

A DISCRETIONARY TRUST IN A WILL

When you make a will, instead of giving a beneficiary your estate or a share thereof, you can give the estate or the share to a discretionary trust for the benefit of that beneficiary and his or her family and associates. This beneficiary is sometimes called the primary beneficiary of the trust.

When you include a discretionary trust in your will, the terms of the discretionary trust must be set out in the will. There is no law that stipulates the terms of a discretionary trust and trust terms vary from one trust to another. The discretionary trust terms which Harwood Andrews includes in its wills are similar to those which we include in our highly regarded discretionary trust deeds.

The main issues to address in preparing a discretionary trust will are:

- the identity of the appointors, the trustees and the beneficiaries;
- determining when the trust must end and what happens to assets in the trust at that time; and
- stating what powers are given to the trustees and to the appointors and whether any limitations are placed on those powers.

Discretionary testamentary trust wills can take various forms.

You might leave your estate to a single discretionary testamentary trust of which your spouse and children and others are all beneficiaries.

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Alternatively a separate trust could be established for the family of each child with your spouse as an appointor, trustee and beneficiary of each trust.

Another option is to leave your estate to your spouse directly, with no discretionary testamentary trust created at the time, but if your spouse has died before you then to a single discretionary testamentary trust for the benefit of all children and their families, or you may prefer to establish a separate discretionary testamentary trust for each child's family.

These options and their consequences need to be carefully considered when preparing a will.

You might expect that if you wished to establish a discretionary testamentary trust for the benefit of one of your children and their family, that child (the primary beneficiary) would be the sole appointor and trustee of the trust. However this arrangement would not provide the asset protection which would otherwise be available if the child shared the role of trustee and appointor with another person.

In some circumstances parents will elect to include a sibling of a primary beneficiary as a co-trustee and/or co-appointor with the primary beneficiary, or even to deliberately exclude the primary beneficiary from being a trustee or appointor at all. Alternatively, a trusted advisor or relation might be named as the co-trustee and/or co-appointor.

WHAT ARE THE ADVANTAGES?

The main advantages of discretionary testamentary trust wills are the protection of family assets from various risks, and possible taxation savings.

BENEFICIARIES AT COMMERCIAL RISK

Many professionals face the risk of being sued for a mistake made by them or one of their business partners in the conduct of their work. There is no guarantee that insurance will always cover such a claim. These people often therefore avoid having key assets in their own name. Many couples make "standard" wills leaving all of their assets to their spouse, but if the spouse predeceases then to their children.

If the spouse or any of the children are in occupations which expose them to the risk of claims, there is a possibility that the inheritance may finish up in the hands of claimants against the spouse or a child following a successful negligence claim.

If the assets intended to benefit the spouse or child had been given to a discretionary testamentary trust, the assets should not be available to a creditor of the spouse or child.

SPENDTHRIFTS AND GAMBLERS

Occasionally a will maker will have a child who is a spendthrift or has an addiction to drugs, alcohol or gambling.

A discretionary testamentary trust will can be used in these situations to benefit the child but without exposing the inheritance to the risk of being spent or gambled. The beneficiary is not deprived of a benefit from the estate but does not have control of what would otherwise have been their share.

The trustee could be someone else in the family, or an independent person, or a trustee company, who can control the inheritance and distribute to the beneficiary and their family members as considered appropriate by the trustee.

Some will makers making a "standard" will will exclude a child with gambling or spending problems from any share in the estate. This raises the possibility of a claim against the estate by the child.

Establishing a discretionary trust under the will to hold a share of the estate for the benefit of the relevant child may reduce the risk of such a claim as the child is not necessarily excluded from a benefit, but the benefit will be subject to the discretion of the trustee.

BENEFICIARIES IN AN UNSTABLE RELATIONSHIP

Parents making wills are sometimes concerned that when their estate passes to a child some of the estate will end up in the hands of the partner of that person if their relationship breaks down.

The Family Law Act applies to both married couples and couples who have been in a de facto relationship for more than two years or have a child born of their de facto relationship.

Under the Family Law Act, money which is inherited by a partner may be excluded from the pool of matrimonial assets for distribution between the parties on a breakdown of the relationship. However, the inheritance loses that status over time.

An inheritance might be received by the child of the will maker but then spent by that person and his or her spouse on mutual expenses. The Family Court will be reluctant to give back to the child the money he or she inherited before the other assets of the couple are divided.

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Instead of giving assets to a child in an unstable relationship, a will maker should consider giving those assets to a discretionary testamentary trust controlled by that child and another person as trustees. This means that the assets will not be mixed in with matrimonial assets.

The Family Court can make orders affecting property in a discretionary trust if a party to the relationship is the sole trustee and appointor of, or has effective control of, that trust. If there is an additional trustee and appointor who is outside the relationship and who administers the trust in a proper manner, the Court is then unlikely to have the power to make an order relating to the assets of the trust.

It is worth noting that the Family Court has over time gained more power in relation to discretionary trusts. There is no certainty that assets in testamentary trusts will always remain out of the Court's reach even when the trust is run by people who are outside the relationship.

TAXATION OF TESTAMENTARY TRUSTS

There can be tax advantages with a discretionary testamentary trust will. If you leave assets directly to a beneficiary in your will, be it a spouse or child, and that beneficiary invests the inheritance, tax must be paid on the income earned from the inheritance at the beneficiary's marginal tax rate.

The tax rates are as follows for the 2020-2021 year:

0 to \$18,200	0%
\$18,201 to \$45,000	19%
\$45,001 to \$120,000	32.5%
\$120,001 to \$180,000	37%
\$180,001 +	45%

Note:

- > The Medicare Levy applies in addition to the above.
- > The low income tax offset means that no tax is payable up to approximately \$20,500 (subject to application of the Medicare Levy).
- > The rate stated applies only to the income within the range stated.

If a beneficiary is working then he or she will presumably be paying tax at the 32.5% rate or higher. Any additional income from invested inheritance will be taxed at that rate or at a higher rate in the event of the additional income taking the beneficiary into the next tax bracket.

If the share of an estate which a beneficiary would have received under a standard will is instead given to a discretionary testamentary trust and invested, then the income can be distributed amongst the beneficiaries of the trust in the most tax effective manner.

A unique attribute of discretionary testamentary trusts is that income from such a trust distributed to children under 18 years will be taxed at adult rates - that is, the rates set out above. By contrast, if income is distributed to a child under 18 from a trust established outside of a will, the distribution is tax free up to \$416 only and thereafter the top marginal tax rate applies. It is therefore pointless for a beneficiary to establish a discretionary trust with inherited assets if the intention is to reduce tax by distributions to minors.

For example, Anne is a well-paid company executive. She pays tax at the top marginal rate. Her mother has recently died and her father died several years ago. She has one brother and her mother's estate is divided between her and her brother. She receives \$2 million from the estate and she invests this to earn \$40,000 per annum in interest.

Anne then must pay tax on the \$40,000 being \$18,000 (plus the Medicare and flood Levies) every year.

Anne has two children aged under eighteen who are at school.

If Anne's mother had gifted the \$2 million to a discretionary testamentary trust, instead of to Anne personally, the tax outcome for Anne would have been more favourable. The trust could invest the \$2 million. The same income of \$40,000 could be distributed amongst Anne's two children, with each receiving \$20,000 per annum, which can be applied to school fees and other expenses. No tax is payable by the children. Tax of \$18,000 per annum plus the Medicare levy has been saved.

The tax savings that can be made by utilising a discretionary trust can be very substantial and can accrue year after year.

Of course, because you do not know when you are going to die you cannot be certain about the extent of the taxation benefits which might be available. That will depend upon the primary beneficiary's personal and financial circumstances at the time.

As the asset protection benefits and tax savings can be substantial, a discretionary testamentary trust should be considered when making your will.

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EXCEPTED TRUST INCOME

On 22 June 2020, the Government passed legislation to amend Division 6AA of the Income Tax Assessment Act 1936 (Cth) to ensure that tax concessions available to minors in relation to income derived from distributions by the trustee of a discretionary testamentary trust, as described above, only apply in respect of income generated from assets of the deceased estate that are transferred to the testamentary trust (or the proceeds of the disposal or investment of those assets).

These changes to the Act mean that if assets are transferred to the discretionary testamentary trust which are not derived from the deceased estate, income earned on those assets will not be "excepted trust income" if paid to a minor person, meaning that tax will be paid at the top rate on that income.

DISCLAIMER

This information is of a general nature only. It is not legal advice and should not be relied upon as such. You should obtain specific legal advice about your circumstances before making any will.

CONTACT

Harwood Andrews Wills and Estates lawyers specialise in the development of discretionary testamentary trust wills. Visit our website for further information or email wills@ha.legal.