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## **TESTAMENTARY TRUSTS**

I have talked often about the benefits of TESTAMENTARY TRUSTS. The attached article which first appeared in the Investing Times provides as good an explanation as I have ever seen. The example given is very reminiscent of my story a couple of years ago about the profligate brothers, Tom, Dick and Harry.

Testamentary Trusts are not just for you but also for your children, your parents and other members of the family.

The article is easy to read and well worth the five minutes that you would spend on it.

Regards  
**VPro Lawyers**

**Mike Lyons**

## **Setting up a testamentary trust as part of your will keeps your legacy safe from divorce, creditors and the tax office.**

Bart had built a \$3 million estate over his 62-year life, which he left in equal shares through his will to his three kids to set them and the grandchildren up for life. He never dreamt that his eldest son's marriage would end in a bitter divorce that would take \$500,000 of his inheritance. He also didn't know that his other son was involved in a high-risk business venture that would fail, resulting in his creditors taking his full \$1 million inheritance. He also didn't consider the additional tax burden he placed on his daughter, a successful executive – she pays roughly \$30,000 in additional income tax to the tax office on the income her inheritance generates every year.

The harsh reality in this instance is that half of Bart's estate is now lost from his beneficiaries forever, while the tax office takes a bite on income from assets that Bart already paid tax in his lifetime! Bart could have avoided this dire state by using testamentary trusts in his will. The simple truth is that testamentary trusts are easy to understand, they don't cost the earth to incorporate in your will and they actually work.

A testamentary trust is usually a trust established after death under provisions in your will. Once your estate is sorted, your will becomes the trust deed (the rules) for the trust/s. As usual, you need to balance the reasons why you want to use testamentary trusts for your estate planning.

Here are the key reasons people use them:

### **1. Divorce**

Assets held in the trust do not belong to an individual. This puts them out of reach in the event of a divorce. The Family Court cannot make an order to distribute those assets to the divorced son/daughter-in-law. This is extremely beneficial if the beneficiary maintains custody of children after divorce; it means that the entire inheritance is preserved for the beneficiary and then later for the grandchildren.

### **2. Creditor Protection**

Assets in the testamentary trust are protected from a beneficiary's creditors. The bequest is also protected from the debts a beneficiary may incur by giving guarantees for their spouse's business debts. Spouses often guarantee the business debts of each other without a second thought, so using testamentary trusts could eliminate some of the pressure that a spouse might feel to put their inheritance up as security for their partner's ventures.

### **3. Tax Benefits**

Trusts can stream income to various beneficiaries, allowing use to be made of income splitting to a spouse/child to save tax. Importantly too, children are taxed as adults, which makes income distributions to children under 18 tax-effective as they attract adult marginal rates, including the \$6,000 tax-free threshold (higher if the low income rebate applies), versus the "penalty" child tax rate of 48.5%. Any realised capital gains can also be streamed to low income earners to reduce tax. Savings can be significant over time.

If you can't see the benefits in these three key areas, there are several more reasons to use testamentary trusts as follows:

**Education** – Grandparents in particular are interested in leaving bequests via testamentary trusts for payment of boarding school and tuition fees for grandchildren. This may be a more tax-effective method of providing for their education rather than leaving additional bequests to their own children for the purpose of educating the grandchildren.

**High Risk Beneficiaries** – Testamentary trusts protect bequests to beneficiaries in high-risk professions or businesses from negligence law suits.

**Remarriage of Spouse** – Testamentary trusts can be used where you wish to provide for your spouse but are concerned that he/she may remarry and divert the family assets to the new family or, as sometimes happens, he/she may use the family assets in risky ventures at the suggestion of the new spouse.

**Spendthrift/Gambler/Drug Addict or Disabled Beneficiary** - You can provide for a troubled beneficiary or a disabled beneficiary through a testamentary trust to ensure his or her share is kept intact. The capital can be protected and the income they need to survive controlled by trustees that you can choose.

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