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Testamentary  
Trust Will



One of the main reasons people establish a testamentary trust in their Will is in an attempt to **protect assets from erosion** due to possible family law property proceedings or potential insolvency of one or more of the beneficiaries.



## What is a Testamentary Trust (TT) Will?

A trust exists when a person or entity (the trustee) holds property for the benefit of another person or person/s (the beneficiary/beneficiaries). A testamentary trust is a trust created in a person's Will and does not come into effect until after the death of the person making the Will. There are a multitude of different types of testamentary trusts including life interests, rights of occupation and special needs trusts. The two most common forms of testamentary trusts are trusts for minors and discretionary testamentary trusts. Trusts for minors are probably the most common form of testamentary trust; however discretionary testamentary trusts have become increasingly popular in estate planning.

### ADVANTAGES OF A TESTAMENTARY TRUST WILL

#### 1. Asset protection

One of the main reasons people establish a testamentary trust in their will is in an attempt to protect assets from erosion due to possible family law property proceedings or potential insolvency of one or more of the beneficiaries.

Whilst the Family Court has very broad powers, which include the power to make orders binding on third parties such as trustees, to date the approach applied by the Family Court has by and large been to treat the assets of the trust as a financial resource of the parties, rather than part of the pool of assets available for division. This is particularly so where the trust is not controlled by that beneficiary. If nothing else, holding a beneficiary's inheritance in a trust prevents it

from being absorbed into a couple's combined finances, and makes it easier to identify.

In relation to protection against claims by creditors of an insolvent beneficiary, a testamentary trust established for that beneficiary is undoubtedly better than an absolute gift. Where a gift is paid absolutely to the beneficiary it will generally pass directly to a trustee in bankruptcy. It is important to think carefully about who controls the trust if there is a beneficiary at risk of insolvency.

#### 2. Flexibility

Testamentary trusts are flexible to meet changing circumstances and can continue for a maximum of 80 years. The beneficial enjoyment of the trust assets can change from year to year to suit the particular needs of beneficiaries as required.

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The terms of the testamentary trusts can also be tailored to suit your particular circumstances. For instance, you can restrict access to the assets of the trust in appropriate circumstances, such as where a beneficiary has an addiction or is unable to manage a sizable inheritance.

### **3. Taxation benefits**

Testamentary trusts are useful from a taxation perspective as they allow:

- the ability to split income to different beneficiaries to optimise taxation benefits;
- greater tax savings in providing income to a child or grandchild under 18, such as applying income towards their education, maintenance or advancement.

Although both testamentary and family trusts have similar features, there are considerable taxation advantages for minors under a testamentary trust.

Income received by beneficiaries from a family trust who are under 18 years of age will be subject to the highest marginal tax rates if that income exceeds approximately \$1,000. However, income received by beneficiaries from a testamentary trust is treated differently. Under a testamentary trust, all beneficiaries (including those who are under 18) receive the full income tax free threshold, and income above that amount is taxed at normal adult rates. This means that approximately \$18,200 per annum can be distributed free of tax to each beneficiary.

By dividing the income each year between family members, the beneficiary could significantly reduce the tax their family group will pay.



## Who is involved in a testamentary trust?

### THE TRUSTEES

Any person over 18 years of age can be appointed as a trustee and you can have more than one trustee. The trustee has effective control of the trust and distribution of income and capital of the trust and so they should be a person whom you know and trust to look after the best interests of the beneficiaries. Often the beneficiary of the trust will act as one of the trustees. Where a trust is being incorporated into a will for asset protection reasons (for example, to protect assets from erosion due to a family breakdown or potential insolvency) it is important to be realistic about the choice of trustees. In such instances it may not be appropriate to appoint the beneficiary as a sole trustee of their trust. You can appoint someone independent to act as trustee (either alone or jointly with the beneficiary) to protect the beneficiaries' interests.



### THE BENEFICIARIES

The beneficiaries are the individuals entitled to receive income and/or capital from the trust. As the trust is 'discretionary' it is up to the trustee which beneficiaries receive distributions from the trust. There is no restriction on who can be a beneficiary and it is common to find a primary beneficiary nominated (such as a spouse or child), with secondary beneficiaries including the primary beneficiary's children, grandchildren, other blood relatives and associated companies and trusts.

Generally the testamentary trust is structured so that the trustee has full discretion to make distributions of capital at any time; however this will depend on the reason for establishing the trust. For instance, where the trust is set up to provide for the surviving spouse but ultimately preserve the assets for the children, the trust may be structured so that the surviving spouse can receive income only but the capital is preserved for the children.

Increasingly, the traditional

husband and wife will ie. each to each other and then to the children is being replaced by a testamentary trust controlled by the surviving spouse under which the spouse and children are potential beneficiaries. Wills along these lines can, if the funds in the trust justify it, provide that on the death of the spouse, sub trusts come into existence for the benefit of each child and that child's family (and would be controlled by the child concerned).



## DISADVANTAGES OF A TESTAMENTARY TRUST WILL

### 1. Complexity

Wills incorporating discretionary trust are inevitably longer and can be more difficult for a Will-maker to understand. A Will-maker must be able to know and approve the contents of his or her will. If a Will-maker is not able or willing to go to the trouble of understanding how the Trust Will work then it should not be incorporated in the Will. For this reason, testamentary trusts will not be suitable for every client.

### 2. Testamentary trusts can be attacked

Even though a testamentary trust may be considered by a Will-maker to be a prudent provision for family members, like all Wills, it may be attacked by certain "eligible applicants" under a Family Provision Application. The surviving spouse, children and certain dependants have a right to

challenge a Will in this way. While there are strategies that may be used to frustrate or restrict family provision claims, they are unlikely to result in the same benefits provided by a testamentary trust.

### 3. Opting out

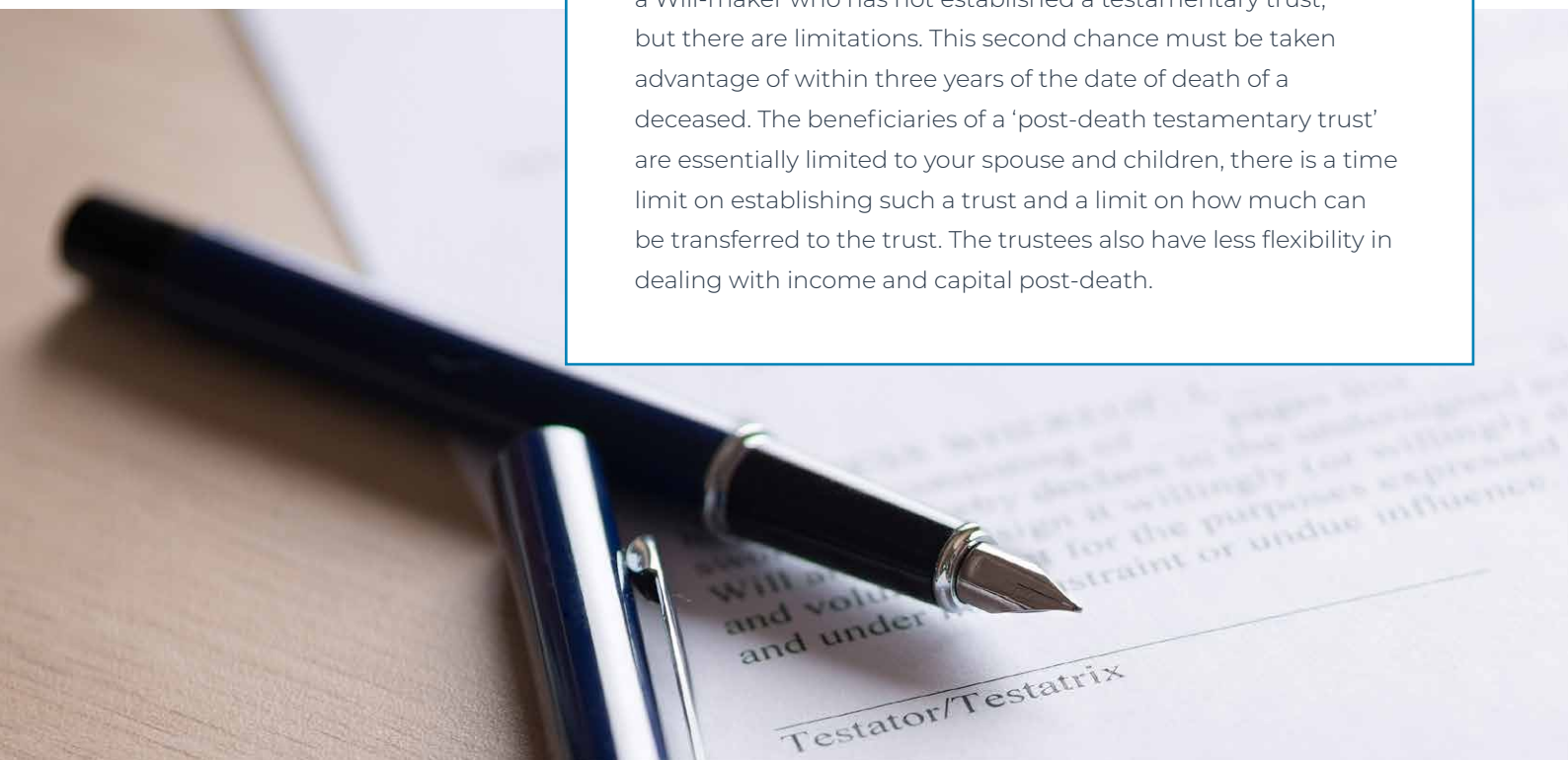
In some cases the circumstances of a beneficiary at the time of the Will-maker's death may make it desirable for the inheritance (or part of it) to pass directly to that beneficiary. For example, it may make better sense for the assets to pass to a beneficiary absolutely where the estate is only small or where the beneficiary has

no family and no insolvency risks.

To ensure flexibility and to get around this issue the testamentary trust wills we prepare provide that the executors may, if requested and provided the beneficiary is not at risk, distribute some or all of the assets which would otherwise have been held in the trust directly to the beneficiary. Whilst it may be that a particular beneficiary's circumstances do not warrant a trust, or for tax reasons an asset may be better passed outside the trust, it is better to include the protection of a trust in the Will with the ability of the executor to 'option out' if required.

## It is possible to set up a similar trust after my death if I don't change my Will now?

The Tax legislation provides a second chance to the family of a Will-maker who has not established a testamentary trust, but there are limitations. This second chance must be taken advantage of within three years of the date of death of a deceased. The beneficiaries of a 'post-death testamentary trust' are essentially limited to your spouse and children, there is a time limit on establishing such a trust and a limit on how much can be transferred to the trust. The trustees also have less flexibility in dealing with income and capital post-death.



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