

What is a testamentary trust?

A testamentary trust is typically prepared as a discretionary family trust established under the terms of a Will. The assets that form part of the estate will be held in trust for a potential beneficiary until the termination of the trust (for example, in the event the beneficiary reaches a nominated age).

What are the benefits of a testamentary trust?

Benefits of establishing a testamentary trust under the terms of a Will include:

1. considerable tax savings. For example, children under the age of 18 years who receive income from a testamentary trust are taxed on that income as adults, and therefore enjoy the normal tax free threshold and marginal tax rates which apply to adults;
2. an inheritance may be protected against creditors in the event of a beneficiary's bankruptcy;
3. in the event the beneficiary becomes part of divorce proceedings, an inheritance is less likely to be distributed pursuant to a Family Court order in property settlement proceedings; and
4. families can ensure adequate funds are provided for a beneficiary and at the same time protect the funds by keeping them out of the beneficiary's control.

A testamentary trust offers no protection against a Family Provision application and, like all provisions of a Will, may be attacked in such an application.

Other issues to consider

1. The Trustees of the testamentary trust do not have to be the executors of your estate.
2. The guardian of your infant children will need to work with the Trustees, so choose people for these roles who don't have obvious conflicts of interest.
3. You can make specific gifts of property to beneficiaries that take effect before the balance of your estate goes into the testamentary trust.
4. Your creditors will be paid out of the estate before any assets go into the testamentary trust.

Key Roles in a Testamentary Trust

Trustee

The Trustee (or the Directors of the nominated corporation) sees to the administration of the testamentary trust assets in accordance with the terms stipulated by you and within the powers afforded to them.

The Trustee has the day to day management of the testamentary trust assets and should be someone who is financially savvy but who will also administer the Trust Fund in accordance with your wishes.

You should consider appointing more than one Trustee to jointly perform this role.

Principal

The main function of a Principal is to remove/replace the Trustee if and when required. This could arise if the Principal believes that the Trustee is not administering the Trust in accordance with their powers or in accordance with your wishes.

We suggest that you nominate a person that is distanced from the Trustee but who still has the ability to monitor the administration of the Trust Fund and who is not afraid to exercise their power.

Alternative Principal

The Alternative Principal is a person that the Will Maker nominates to act in the role of the Principal if the Principal were to be removed from that role. The most common occurrences of this are where the Principal resigns from their role or passes away.

Beneficiaries

These individuals, class of individuals or entities are entitled to receive a distribution of the income and/or capital of the testamentary trust assets, which is made at the discretion of the Trustee. It is usually preferable to have a testamentary trust for each beneficiary, so if a couple has 2 children, their Wills would provide for the establishment of a testamentary trust for each child, with (usually) 50% of their parents estate going into each trust. Each child would be nominated as the primary beneficiary, however their extended families (future spouses, children, parents in law etc.) would be listed as secondary beneficiaries.