



WILLS and ESTATES

Information on Discretionary Will Trusts (Testamentary Trust Wills)

www.flemingmuntz.com.au



Fleming Muntz
Solicitors



**Solicitors for New South Wales
and Victoria**

568 Kiewa Street
Albury New South Wales
Australia

PO Box 910
Albury NSW 2640

fmlaw@flemingmuntz.com.au
www.flemingmuntz.com.au

Facsimile (02) 6041 1804
Telephone (02) 6021 2222

DISCRETIONARY TRUSTS AND THEIR USE AS WILL TRUSTS

Wills that incorporate discretionary trusts can provide various advantages. These notes discuss how the wills work, and what advantages there might be.

WHAT IS A DISCRETIONARY TRUST?

A trust arrangement is a relationship where one person (the trustee), is given an asset to hold for the benefit of another person or group of persons (the beneficiaries).

In a discretionary trust, there are two or more beneficiaries. In fact there is usually a large group of beneficiaries. It might be the members of a family, their partners and any descendants of those people. The trustee has discretion to select, from the group of beneficiaries, those who receive any payment of income or capital from the trust.

Significantly, no beneficiary of a discretionary trust has a right to demand any assets in the trust. The trustee is under no obligation to pay any money to any particular beneficiary. If the trustee chooses to distribute income or capital, the trustee may include or exclude any beneficiary he or she wishes.

The appointor of a trust is the person who has the power to “hire and fire” the trustee. In this way, the appointor is the ultimate controller.

The ability of the trustee to determine which beneficiaries receive any distributions, and how much they receive, is a key benefit of the discretionary trust.

ROLE OF EXECUTOR AND TRUSTEE

When making a will, whether or not it incorporates a discretionary trust, you appoint someone to be your executor and trustee. The task of being an executor is one of gathering in the assets and paying any debts. The task of a trustee is to hold money and property on behalf of beneficiaries and make distributions to them at the appropriate time.

The tasks of executor and trustee are usually handled by the same person or persons. The role of trustee may only last for one or two days pending distribution, or it may last for many years.

The trust created in a standard will is what is known as a fixed trust, in that the executor and trustee must distribute exactly in accordance with the will. The executor and trustee have no discretion to distribute the estate assets amongst beneficiaries as he or she chooses. The words “my trustee” in a will usually mean the

person who acts as executor and trustee of the estate.

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, as stated above, will have power to distribute assets passing to that trust amongst the trust's beneficiaries as he or she wishes.

A DISCRETIONARY TRUST IN A WILL

When you make a will, as an alternative to giving a beneficiary your estate or a share thereof directly, you can stipulate that the estate, or the share, is to pass to a discretionary trust for the potential benefit of that beneficiary and his or her family. This beneficiary is called the "primary beneficiary" of the trust. The beneficiaries of the trust can be the primary beneficiary and his or her children and grandchildren. 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 what the terms of a discretionary trust must be, and trust terms vary from one to another.

The discretionary trust terms which Fleming Muntz include in its wills are in a form which we believe to be generally desirable.

The main issues to address in preparing a discretionary trust are the identities of the appointor, the trustee and the beneficiaries, when the trust must end, what happens to assets in the trust at that time, and

what powers are given to the trustee and to the appointor.

Discretionary trusts can be established for the benefit of any beneficiary under a will. Many will makers make provision in their will for the establishment of a testamentary trust to benefit their children equally. Sometimes a will maker leaves everything to his or her spouse, if the spouse survives, but if the spouse does not survive the will maker then creates a testamentary trust(s) for the benefit of their children.

The identity of the appointor and trustee for any discretionary trust is obviously critical. You might expect that if you wished to establish a discretionary trust for a particular son, that son would be the appointor and trustee. However this arrangement will not provide the asset protection which would otherwise be available if the son shared the role of trustee and appointor with another person. This is discussed below. In some circumstances parents will elect to include a sibling as a co-trustee with the primary beneficiary, or even deliberately to exclude the primary beneficiary from being a trustee at all. For instance, if a child had a chronic gambling problem, it would be advisable for that child's share in the estate to be controlled by someone else, perhaps a sibling, utilising a trust.

It is a basic principle of law that a trustee must hold and manage assets in a trust for the benefit of the beneficiaries. The trustee can be, and in the case of most discretionary will trusts will be, one of the beneficiaries.

WHAT ARE THE ADVANTAGES

There can be several advantages in using discretionary trusts in wills including protection of family assets from various risks as well as some tax advantages.

The following are some examples of situations where a discretionary will trust can assist:

► Beneficiaries at Commercial Risk

Accountants, doctors, company directors, financial advisors and solicitors, amongst others, 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 therefore avoid having assets in their own name.

Many couples make 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 risky occupations, there is a risk that the inheritance may finish up in the hands of creditors of that person. This could happen if a successful negligence claim was brought against the spouse or child who had inherited from the estate.

If, on the other hand, the assets passing to the spouse or child had been given to a discretionary trust, controlled by the spouse or child and someone else, then the assets should not be available to a creditor of the spouse or child.

► Spendthrifts and Gamblers

Occasionally a will maker will have a spouse or child who is a spendthrift or has a gambling habit.

A discretionary will trust can be used in a situation to ensure that the beneficiary is not deprived of a benefit from the estate, but does not have control of what would otherwise have been his or her share. If the beneficiary's share is given to a discretionary trust, the trustee can be someone else in the family, or a trustee company, who can then control the inheritance on behalf of the beneficiary, and distribute to the beneficiary and his or her family as considered appropriate.

Some will makers exclude a child with gambling problems from a share in the estate altogether. This raises the possibility of a claim against the estate by the child. Using a discretionary trust will may reduce the risk of such a claim.

► Beneficiaries in an Unstable Marriage

Will makers are often concerned that, when their estate passes to a child, some of the estate will finish in the hands of the spouse or partner of the child if the child's marriage or relationship breaks down.

Under the *Family Law Act*, money which is inherited by a spouse should be excluded from the pool of matrimonial assets for distribution between the parties on a breakdown of the marriage. Often however, the inheritance is "lost in the wash" with other assets. It might be received by the child of the will maker, but then spent by the child and his or her spouse on mutual expenses. It then becomes difficult for the Family Court to give back to the child the money he or she inherited before the other assets of the couple are divided. The total asset pool of the couple might be such that if the inheritance

is given back, very little is available for distribution between the parties.

If, instead of giving assets directly to a child in an unstable marriage, a will maker gives those assets to a discretionary trust, then the assets do not get mixed in with matrimonial assets. The Family Court can make orders affecting property in such a trust if a party to the marriage is the sole trustee and appointor. If there is another trustee and appointor, who is outside the marriage, then the Court is unlikely to be able to order that person to do anything with assets in the trust under current laws.

TAXATION ISSUES

There are tax advantages which are a handy bonus with a discretionary trust will.

If you leave assets directly to a beneficiary, be it a spouse or child, and that beneficiary invests the inheritance, tax must be paid on the income earned at the beneficiary's marginal tax rate.

The tax rates are as follows for the 2010-2011 year.

0 to \$6,000.00	0%
\$6,001.00 to \$37,000.00	15%
\$37,001.00 to \$80,000.00	30%
\$80,001.00 to \$180,000.00	37%
\$180,001 .00 +	45%

Note:

- The Medicare Levy is in addition to the above.
- The low income tax offset means that no tax is payable up to \$14,000.00.

If a beneficiary is working then he or she will, presumably, be paying

tax at one of the higher rates above, and any additional income from invested inheritance will be taxed at that rate, or at a higher rate, in the event of the income taking the beneficiary into the next tax bracket.

On the other hand if the same beneficiary's share in an estate is given to a discretionary trust and invested, then the beneficiary may be able to distribute income amongst his or her family, on the most tax effective basis. Most importantly in this situation, if any income can be distributed to children under 18 years, those children will be taxed at adult rates, including an adult's tax free threshold. This is contrary to the situation when income is given from a trust to a child under 18 when the trust is established outside of the will. Where the trust is established outside the will, any distribution of income to a minor is tax free up to \$416.00 only, and thereafter the top marginal tax rate applies. (This is why it is pointless for a beneficiary to establish a trust with inherited assets after the death of the will maker if the aim is to reduce tax by distributions to infants.)

For example, Kate is a well paid computer consultant. 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 \$200,000.00, and she invests this to earn \$10,000.00 per annum in interest. She then must pay tax on the \$10,000.00, being \$4,500.00 (plus the Medicare Levy) every year.

Kate has three children aged under eighteen, who are at school. If, instead of Kate receiving \$200,000.00 directly, her share in the estate had been given to a discretionary will trust, the situation

would have been much better from the tax point of view. Kate could have arranged for the trust, which she controls, to invest the \$200,000.00. The same income of \$10,000.00 would have been earned, but Kate could now distribute this amongst her three children, with each receiving \$3,333.00 per annum. This will result in no tax being payable by the trust, or the children which therefore saves the family \$4,500.00 per annum. The same savings might be available to Kate's brother's family.

The tax savings that can be made by utilising a discretionary will trust can be very substantial, and you must bear in mind that they can accrue year after year.

Of course, because you do not know when you are going to die, you cannot tell for certain the extent of benefits that might be available from discretionary testamentary trusts. That will depend upon the primary beneficiary's personal and financial circumstances at the time.

Nonetheless, as the asset protection benefits, and tax savings, can be substantial, and as the discretionary trust is only an option to a beneficiary in a will, if there is any possibility of benefit, the testamentary trust should be considered in your will.

TAXATION OF TRUSTS

There is a possibility that the laws governing taxation of trusts will change in the future. However based on the changes indicated to date, the tax advantages discussed above will still be available.

QUESTIONS

If you have any questions as to the way in which a testamentary trust will can be used to add protection to your estate planning, Fleming Muntz Solicitors can provide specialist advice.

DISCLAIMER

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