



Decoding & Mastering

Testamentary Trusts

- **Demystifying Testamentary Trusts**

- Securing Your Generational Wealth and Property Portfolio *(Part 01)*

- **Managing Testamentary Trusts**

- Tax Implications and Challenges *(Part 02)*

Letter from
Investax Group
Adviser Library

Dear Reader

Welcome to the Investax Group Resource Library.

Our resource library has been created to assist you to navigate your way through the a range of accounting, taxation, wealth and financial planning, retirement planning situations that you may encounter when considering property investment, tax planning or planning for your financial future.

We are specialist property tax accountants renowned for reliable tax advice and property tax accounting services for property investors.

The property, development and construction sectors are complex and continually changing. New legislation from the State and Federal governments with funding challenges change how we invest and do business every year.

Knowledge Gives you a Huge Advantage

We believe that knowledge gives you a huge advantage in creating and effectively managing wealth; in planning to reach your goals: and in being prepared for whatever unexpected twists and turns life may present.

That's why our team of experts has created this eBook that seeks to inform you of not only the benefits, but also the potential risks and pitfalls of various strategies and investments.

We trust you enjoy this publication and find it informative. Of course, your feedback is always welcome as we strive to continually offer content in a format that is relevant to you.

Take the Next Step

We invite you to meet with one of our advisers to discuss what it was you were hoping to achieve when you obtained this document, and to establish if they can help you achieve your goals and objectives. Visit our website to discover our range of e books or to arrange an appointment with a member of our team.
www.investax.com.au

We look forward to meeting you soon



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Authors Bio



Ershad Ullah
Business Growth and Property
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Ershad is an accomplished accountant with over 15 years of experience. Renowned for his exceptional professionalism, he has garnered a reputation for delivering outstanding service to his clients, particularly in the realms of property investment and business consultation.

Passionate about empowering his clients to achieve greater financial success, Ershad offers expert advice on diverse areas, including tax minimization, investment properties, start-up business structures, business restructurings for asset protection coupled with future growth, and exit strategies. With a

dedicated and enthusiastic team of accountants, Ershad has propelled the Investax office to new heights.

When meeting with Ershad, clients not only benefit from the insights of a qualified and registered accountant but also from the wisdom of an experienced property investor with multiple successful ventures under his belt. As a business owner committed to excellence, Ershad's guidance goes beyond conventional accounting, making him a valuable asset for anyone seeking financial growth and prosperity.

Authors Note

Navigating the preservation of your assets for the benefit of your children and immediate family is a common concern among property investors, general investors, and business owners. Despite its importance, many of us fail to act, often due to the pressing demands of time or a lack of accessible knowledge. Discussions about trusts and asset protection strategies are abundant, yet clear, comprehensive information on how these strategies function can be elusive.

Imagine a trust so powerful that it could not only protect your family's wealth but also offer significant tax advantages long after you're gone. Welcome to the world of Testamentary

Trusts, a cornerstone in sophisticated estate planning. In Part 1 of this series, we explored the basics of Testamentary Trusts and their role in asset protection. A Testamentary Trust is a discretionary trust set up through a will, coming into effect upon the will-maker's death to manage and distribute their assets, including property.

This e-book will answer questions like:

- 1.** How can I ensure that only my children, and not my spouse's new partner or their children, will inherit my estate?

2. How can I protect my estate's assets in case the beneficiaries face personal lawsuits or bankruptcy?

3. I want to safeguard the assets I leave for my children against any impact from their potential divorces. How can this be achieved?

4. How can I ensure that only my children and family benefit from my hard-earned assets and property portfolio?

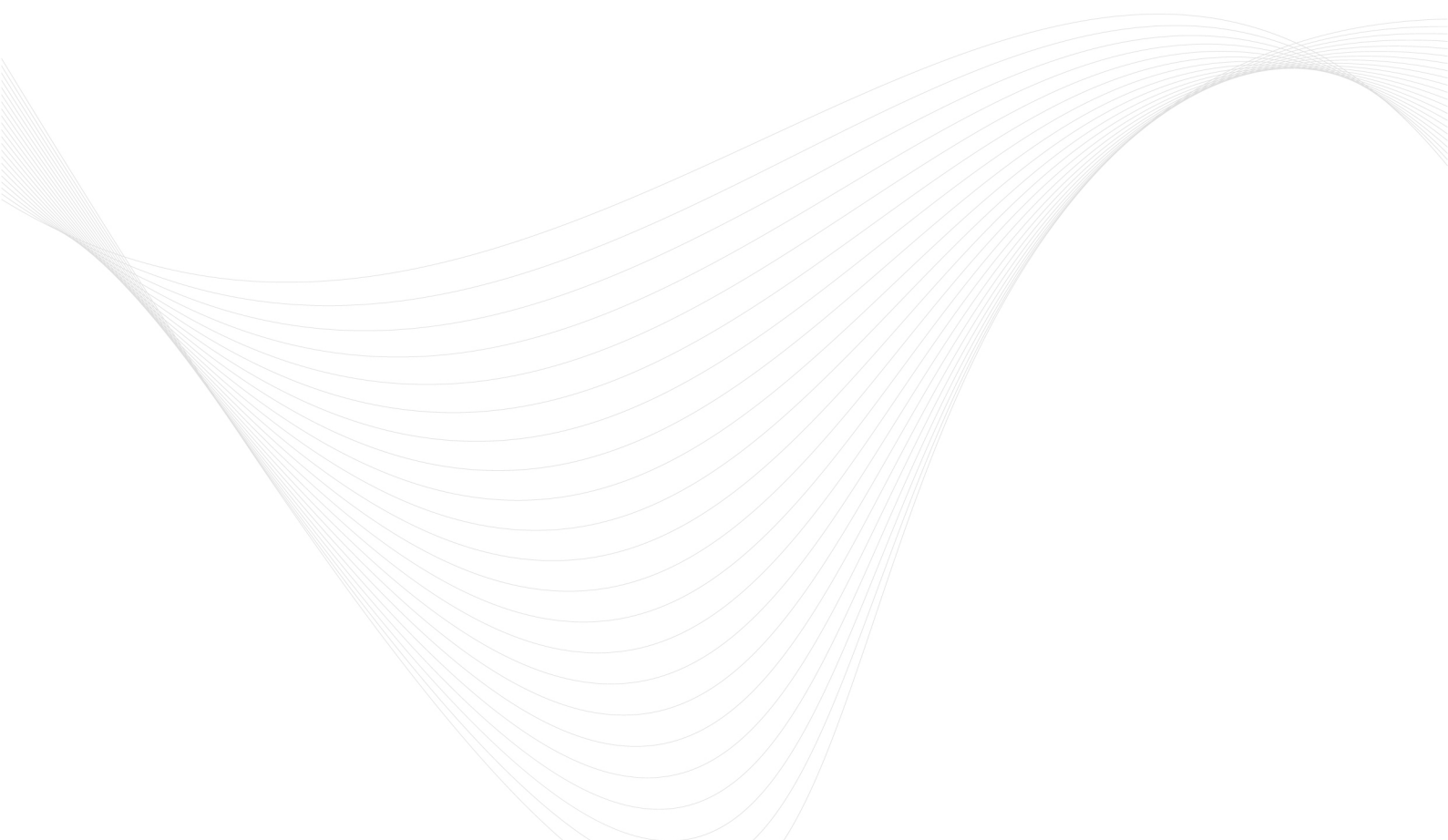
Testamentary Trusts are strategic tools for asset protection, ensuring that a deceased person's estate is reserved for chosen beneficiaries—typically children or immediate family—and shielded from claims by new spouses, their children, or creditors. This legal mechanism is demonstrated by the case of *Bernard & Bernard [2019]*, which showcased its effectiveness in excluding trust assets from matrimonial disputes in Australia.





Demystifying Testamentary Trusts

Securing Your Generational Wealth and Property Portfolio (Part 01)



What is a Testamentary Trust?

Testamentary trusts are discretionary trusts established through Wills, activated upon the death of the Will-maker. Upon the Will-maker's death, all the assets, including properties of the deceased, are distributed to the trustee of the Testamentary Trust.

Imagine a special safe where your money and properties can be kept after you're gone. This safe, known as a Testamentary Trust, is a smart way to ensure your assets are distributed carefully and wisely. It's like a treasure chest that you leave behind, with a trusted family member (the trustee) holding the key. The trustee decides when to open the chest and share the treasure with the people you've chosen (the beneficiaries).

Using a testamentary trust means you're thinking ahead. It's like planting a tree that provides shade long after you're gone.

Asset Protection:

Remarriage or New Relationship of the Surviving Partner

If a Will doesn't use Testamentary Trusts and leaves everything directly to the surviving spouse, those assets could be at risk if the spouse remarries or enters a new de facto relationship. Assets intended for the children of the original marriage may inadvertently benefit the new partner and their family. However, a Testamentary Trust can secure these assets, ensuring they are preserved for the designated



A Testamentary Trust serves as a strategic tool to preserve a deceased person's assets specifically for their children

heirs, such as the deceased's children and grandchildren, regardless of any new relationships the surviving spouse may enter.

A Testamentary Trust serves as a strategic tool to preserve a deceased person's assets specifically for their children, safeguarding the inheritance against the complexities of blended family dynamics. In the event the surviving spouse remarries and has more children, the trust prevents the dilution of the original children's inheritance. It legally restricts access to the assets, ensuring that only the deceased's children are the recipients of their legacy, irrespective of any new familial bonds formed by the surviving spouse.

Asset Protection:

Marriage Break Down

The assets that are placed within a testamentary trust are, in a legal sense, the property of the trustee, not the beneficiaries. This arrangement can safeguard those assets in scenarios where the beneficiaries might face bankruptcy or legal judgments, providing

a layer of financial protection. Assets held in such a testamentary trust follow the same principle as Discretionary Trusts.

Used right, the Testamentary Trust can be a powerful ally in your asset protection strategy.

The Case of Bernard & Bernard (2019)

The case of Bernard & Bernard [2019] serves as a pivotal example of the robustness of testamentary trusts in safeguarding assets during matrimonial disputes in Australia. When a financial feud erupted between a husband and wife, the husband was able to exclude a significant \$3.5 million in assets from the matrimonial property pool, assets that were part of a testamentary trust established by his late father.

In this landmark case, the husband's father meticulously crafted his Will to create two parallel testamentary trusts—one for his son and another for his daughter. Crucially, the son was designated as the primary beneficiary of his trust, but it was his sister who wielded exclusive control as trustee, and vice versa for her trust. The wife's contention was straightforward: she proposed that the mirrored nature of the trusts essentially rendered the assets personal to each sibling. Had the Court concurred, the property pool

subject to division in their divorce would have been substantially larger.

However, the Court disagreed with the wife and ultimately found that the trust assets were not matrimonial property because:

- The husband had no legal title to the assets of the trust as he had no control over the trust assets, nor any guaranteed entitlement to the trust capital or income; and
- The husband's sister had complete discretion in determining trust distributions to the beneficiaries (the wife and the parties' children were also beneficiaries).

While the trust assets were not matrimonial property, the Court found the testamentary trust was a financial resource of the husband.

This case perfectly illustrates how a testamentary trust can provide additional asset protection in the circumstances of a relationship breakdown.

Reference - Bernard & Bernard

<https://www.familylawresources.com.au/bernard-2019-famca-421-5-july-2019-henderson-j/>



protection arises because the trustee holds the assets for the beneficiaries' benefit

Asset Protection:

Shielding from Creditor Claims

Assets within a Testamentary Trust, managed by a trustee, can provide a layer of protection against claims by third parties toward the beneficiaries. Should a beneficiary face financial instability, assets inherited and under the trust's care are less vulnerable to creditor assertions.

By allocating the estate's assets under the care of a Testamentary Trust's trustee, these assets are safeguarded from potential claims by third parties against a beneficiary. This protection arises because the trustee holds the assets for the beneficiaries' benefit, not in the beneficiary's personal capacity, which would normally expose the assets to claims.

Asset Protection:

Asset Protection for Beneficiaries with Disabilities and Special Needs

A Testamentary Trust is really helpful for beneficiaries who may not be able to manage an inheritance on their own, like those with intellectual disabilities, illnesses, addiction issues, or other challenges. If a child or another beneficiary can't handle their inheritance for a while, a Testamentary Trust allows the family to take care of the assets for them. This way, the family, not a government organization, gets to manage and protect the inheritance until the beneficiary is ready.

Pro Tips for Establishing a Testamentary Trust

Understand the Purpose:

- Research and comprehend the benefits of a testamentary trust, particularly how it can protect your assets and provide tax advantages.
- Assess your family's future requirements and the potential impact of relationship changes on your estate.

Generational Impact:

- Find out how the Testamentary Trust helps generations of your beneficiaries.

- If you or your siblings anticipate inheriting property from your parents or grandparents in the future, it is a worthwhile conversation to have with your family members to strategically structure the inheritance in the most effective way possible.

Asset Protection:

- Choose a reliable and financially savvy trustee to manage the trust's assets.
- Like the 'Bernard case' mentioned in this article, consult with the legal team to have a different trustee for multiple Testamentary Trusts if you have multiple beneficiaries and properties to be included in the Testamentary Trust.

Consult a Professional:

- Seek legal advice to navigate the complexities of setting up a Testamentary Trust tailored to your specific circumstances.
- Consult with an experienced accountant regarding the Will and Testamentary Trust to understand the tax consequences.

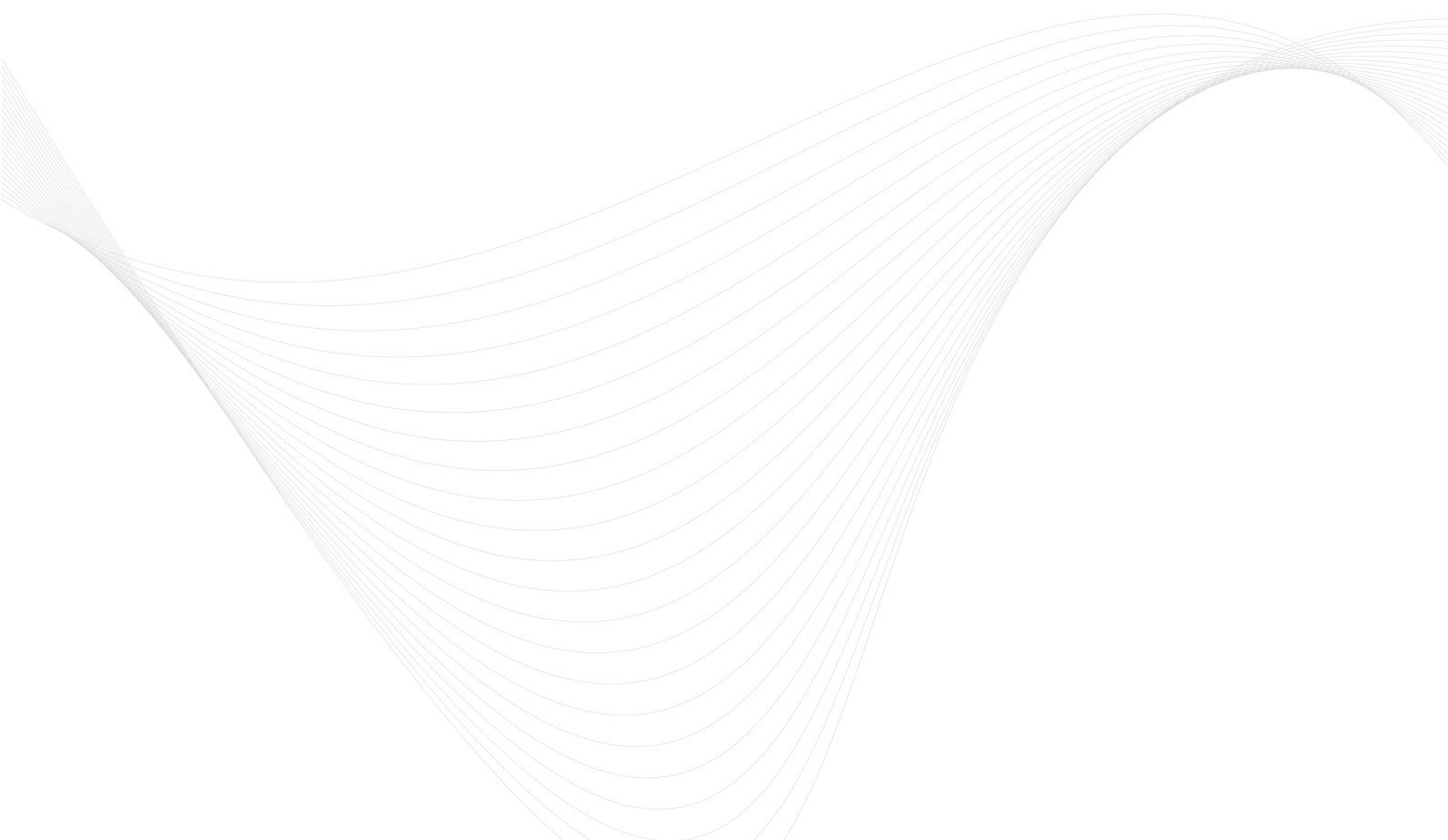
Update Regularly:

- Keep the trust deed and your will current to accommodate life changes and legislative updates.
- Review your Will annually to determine if it requires amendment due to the purchase of new assets or the sale of existing assets.



Managing Testamentary Trusts

Tax Implications and Challenges (Part 02)



The most prominent tax advantages include:



Testamentary Trust allows for income splitting among family members

Tax Benefit:

Tax Treatment of Income Distributed to Minors

When considering the creation of a Testamentary Trust within the framework of Division 6AA of the ITAA 1936, there are notable tax advantages to be aware of.

- Division 6AA of the ITAA 1936 typically imposes higher tax rates on distributions made to minors (individuals under 18 years of age). However, when such distributions are made from a testamentary trust, they are considered ‘excepted trust income’.
- Unlike ordinary trusts, where income distributed to minors is taxed at penalty rates, income from a testamentary trust is taxed at standard adult marginal tax rates. This can result in significant tax savings, especially where the income would otherwise be taxed at the highest marginal tax rate.

Tax Benefit:

Income Splitting

- A Testamentary Trust allows for income splitting among family members. Beneficiaries of the trust may include children and grandchildren who are taxed at adult marginal rates on the income received from the trust.
- By distributing income among several beneficiaries who may have lower income, or no other income, the overall tax burden on the income generated by the trust’s assets can be reduced.

Tax Benefit:

Capital Gains Tax (CGT)

- Capital gains can be distributed to various family members in accordance with the trust deed and at the trustee’s discretion. Depending on the beneficiary of the trust, a 50% discount on capital gains may be available for the sale of assets.
- Testamentary trusts may also provide benefits regarding capital gains. Beneficiaries receiving capital gains through a testamentary trust may be able to access the 50% CGT discount, even if the assets were held by the trust for less than 12 months, provided the original owner held them for at least 12 months.



Income distributed to minors from a standard trust is taxed at a high penalty rate

Example:

Tax Benefit in Action

Scenario:

Let's consider the case of Richard, whose father left him an investment property and shares through a Testamentary Trust. Richard's two children, Ron and Tracey, are also beneficiaries of this trust. Both Ron and Tracey attend private school and have no income of their own, making them 'excepted persons' under Division 6AA of the ITAA 1936.

During the financial year, the Trust generates a profit of \$40,000 from the investment property. As the trustee, Richard has the discretion to distribute this income.

Richard decides to distribute the \$40,000 profit equally between Ron and Tracey. Since

they are minors with no other income, this distribution falls under the special tax provisions of a Testamentary Trust.

Tax Implications:

Normally, income distributed to minors from a standard trust is taxed at a high penalty rate. However, in the case of a Testamentary Trust like Richard's, Ron and Tracey's income is taxed at standard adult marginal tax rates. This can result in substantial tax savings. For instance, if each child receives \$20,000, they would be taxed far less (up to NIL) than if the income were distributed to Richard, who might be in a higher tax bracket.

Disadvantages

Scenario: The initial fee to set up a Testamentary Trust is typically higher than that of a simple will. While a simple will may cost less than a thousand dollar, a will that includes a Testamentary Trust could range from \$2,500 to \$5,000.

Ongoing Costs: There are no ongoing costs associated with a Testamentary Trust until it is activated upon the Testator's death. Once activated, the Trust must obtain a TFN and lodge annual tax returns. The cost of preparing the annual return typically exceeds a thousand dollars and can amount to several thousand, depending on the number of properties and assets held in the Trust.

Centrelink Benefit: If your spouse is a beneficiary and has control over the trust, Centrelink will consider both the trust's assets and income as belonging to your spouse, which could affect their eligibility for Centrelink benefits. Control can mean directly managing the trust or merely having the potential to benefit from it.

For other beneficiaries who might not have control, Centrelink applies a 'control test' to determine how much of the trust's income and assets should be attributed to them for means-testing purposes. If a beneficiary has a significant controlling role, such as being a trustee or appointor, they may be considered the 'controller'. Consequently, a portion or the entirety of the trust's assets and income could be counted in their means test. This attribution could also extend to situations where an associate of the beneficiary is the trustee. In

such cases, any distributions to non-controlling beneficiaries could potentially be seen as gifts.

Beneficiaries without control over the trust will have any income distributions assessed under Centrelink's standard income tests. It's important for beneficiaries currently receiving Centrelink benefits to get professional advice to understand the impact that an inheritance through a testamentary trust might have on their Centrelink assessments.



Pro Tips for Maximising Testamentary Trusts Benefits

Plan for Tax Implications:

- Structure it in a way that helps to legally reduce your family's taxes.
- Structure the beneficiaries in a way that they can leverage the Testamentary Trust's potential to distribute capital gains tax in an efficient manner.
- Work with an accountant who understands the tax outcomes, especially considering the distribution of income.



Consult with accountants when the testator passes away

Consult a Professional:

- Seek legal advice to navigate the complexities of setting up a Testamentary Trust tailored to your specific circumstances.
- Consult with accountants when the testator passes away to activate the Tax File Number (TFN) and the Testamentary Trust.

Review Centrelink Impact:

- Investigate how the trust may affect beneficiaries' Centrelink benefits, especially if they have control over the trust.
- Consult with your legal team regarding this so the beneficiaries do not suffer an adverse effect on their Centrelink benefits.

Educate:

- Educate the Testamentary trustees and beneficiaries about their roles and the trust's workings to avoid misunderstandings and mismanagement.
- Educate them about the tax implications, asset protection, and tax strategies behind the Testamentary Trust.

Understand Costs:

- Prepare for the initial establishment costs
- Ongoing management expenses of the trust.

Conclusion

Testamentary Trusts serve as powerful tools for securing and managing your generational wealth and property portfolio. Testamentary Trusts offer strategic advantages in estate planning, ensuring that your assets are preserved and distributed according to your wishes.

In 'Demystifying Testamentary Trusts: Securing Your Generational Wealth and Property Portfolio', we highlighted how these trusts protect your estate from unforeseen circumstances such as relationship changes and creditor claims. The case of Bernard & Bernard underscored the robustness of Testamentary Trusts in safeguarding assets over generations.

In 'Managing Testamentary Trusts: Tax Implications and Challenges', we delved into the complex tax implications associated with Testamentary Trusts. While they offer

significant tax benefits, careful management is required to navigate potential challenges and ensure compliance with evolving tax laws.

Looking ahead, understanding these nuances is crucial for making informed decisions about your financial legacy. Whether you're interested in protecting your assets or maximizing tax efficiency, Investax Accountant is here to provide personalized guidance. Our experienced team specializes in property tax accounting and SMSF management, ensuring that your Testamentary Trusts are structured to meet your specific goals.

Stay informed with Investax Accountant as we continue to unravel the intricacies of Testamentary Trusts and offer insights that empower you to secure and grow your wealth effectively.



References

Bernard & Bernard

<https://www.ato.gov.au/api/public/content/0-93638c4a-a53a-4d5b-9dca-85b8530febc4>

DIV6AA of the ITAA 1936

[https://www.ato.gov.au/law/view/view.htm?docid=EV/1051924150871&PiT=99991231235958#:~:text=Subsection%20102AG\(1\)%20of%20the%20ITAA%201936%20provides%20that%20where,in%20the%20opinion%20of%20the](https://www.ato.gov.au/law/view/view.htm?docid=EV/1051924150871&PiT=99991231235958#:~:text=Subsection%20102AG(1)%20of%20the%20ITAA%201936%20provides%20that%20where,in%20the%20opinion%20of%20the)

Marginal Tax Rate

<https://www.ato.gov.au/Rates/Tax-rates—Australian-residents/>

Penalty Tax Rate

<https://www.ato.gov.au/rates/Tax-rates-if-you-re-under-18-years-old/>

Centrelink Income Test

<https://www.servicesaustralia.gov.au/income-test-for-age-pension?context=22526>

Centrelink Control Test

<https://www.servicesaustralia.gov.au/private-trusts-and-companies?context=22526>

Glossary

Testamentary Trust: A type of trust created as per the instructions in a person's will, which comes into effect upon their death.

Beneficiary: An individual or entity who is designated to receive benefits or assets from a trust or estate.

Trustee: A person or organization appointed to manage and administer a trust's assets on behalf of its beneficiaries.

ITAA 1936: Income Tax Assessment Act 1936, a key piece of legislation governing income tax in Australia.

Division 6AA: A specific provision within the ITAA 1936, which deals with the taxation of minors' income.

Marginal Tax Rate: The rate at which the last dollar of a taxpayer's income is taxed, which increases as income rises.

Capital Gains Tax (CGT): A tax on the profit realized from the sale of a non-inventory asset that was greater than the amount realized on the sale.

CGT Discount: A reduction in the taxable gains on an asset, typically 50% for assets held for more than 12 months.

Testator: The person who has made a will or given a legacy.

Income Splitting: The practice of dividing family income so as to fall into lower tax brackets, thereby reducing the overall tax burden.

Centrelink: A program by the Australian Government that delivers social security payments and services to Australians.

Means Test: An assessment of an individual's financial resources to determine eligibility for certain benefits or services.

Appointor: In the context of a trust, this is the person who holds the power to appoint or remove trustees.

Estate: The total property, assets, and liabilities left by an individual at death.

Asset Protection: Strategies implemented to protect assets from creditors or lawsuits.

Matrimonial Disputes: Legal disputes arising between married or de facto couples, often related to the division of property and assets.

Generational Wealth Preservation: Strategies and planning undertaken to ensure wealth is passed down and preserved through multiple generations.



Why Choose Investax Group

Property Tax Specialist

We are specialist property tax accountants renowned for reliable tax advice and property tax accounting services for property investors.

We assist property investors with the following:

- Ownership Structure planning and asset protection
- Tax Planning & Tax Returns
- CGT, GST and Margin Scheme

Small to Medium Business Tax Specialist

The last 15 years of industry experience taught us no two businesses are the same because different individuals operate them. Success could mean completely different things to different individuals.

At Investax, our business tax accountants and business specialists work closely with you to meet your personal business goal, strategic planning, succession planning, and use structure to create better tax planning and asset protection. Our team has experience

doing bookkeeping, BAS and Annual tax returns for clients ranging from but not limited to start-ups, online stores, family owned businesses, law firms, real estate businesses, franchise models, mortgage businesses, property developers, Electricians, builders, medical practices, coffee and retail shops.

Superannuation Tax Specialist

At Investax, our team understand that every decision you make regarding your super will impact your retirement. We know how critical it is to have a solid foundation for your superannuation investment journey. We collaborate with a reliable, trustworthy, and expert team of advisors in the industry to help you achieve your financial objectives. Our wealth management team can help you identify and achieve a realistic superannuation goal. If the plan is to purchase a property in the SMSF, our wealth management team and finance team can work together to achieve the best possible result for your retirement objective.



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