FARM BUSINESS
FACT SHEET

GRDC
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THE ROLE OF TESTAMENTARY TRUSTS

WESTERN

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Tax-effective distributions through your Will

Key points

- An estate plan ensures wealth is dealt with after death as intended while minimising the impact of tax consequences, family disharmony and challenges against the estate.
- Testamentary trusts are created by a Will to provide a greater level of control over distribution of assets.
- There is no "one size fits all" structure. Planning is essential.
- It is important to seek qualified advice before implementing a testamentary trust in your estate plan.

PHOTO: EYETOEYE

Testamentary trusts allow for tax-effective distribution of capital and income to any nominated beneficiary.

WHAT IS ESTATE PLANNING AND IS IT DIFFERENT TO SUCCESSION PLANNING?

Estate planning is the process for identifying ways in which control can be passed to the next generation on death. Succession planning identifies ways in which control can be passed to the next generation on retirement, illness or incapacity of an individual. Both succession and estate planning involve passing control of personal assets to the next generation on the occurrence of a trigger event such as death, retirement, incapacity or permanent disablement.

For most farming families, the topic of estate or succession planning is a dreaded conversation often put in the too-hard basket and left until it is too late. An equal allocation of net worth is often not the objective; however, the needs of individuals and the viability of the family farming business are important considerations.

For most farming families, the traditional methods of inheritance are no longer a viable way to manage the transfer of the family farm and wealth. Gone are the days where the eldest son inherited and worked the family farm. The majority of farming children today have either moved off the land and sought other careers or, for those who have stayed on the land, they have significantly changed their approach on how to run and operate a farm. For those with children who are at different stages in life, trust structures can offer the perfect solution to transfer assets while ensuring control is maintained within the family.

WHAT IS A TESTAMENTARY TRUST?

A testamentary trust is an important structure that should be carefully considered when estate planning. A testamentary trust is a trust established by a Will that comes into existence on the death of the Will maker. It is a separate structure that holds estate assets for the benefit of a set class of beneficiaries, usually being a spouse, children and grandchildren.

A testamentary trust is a tax-effective mechanism for passing assets through different generations where beneficiaries are at risk from creditors, have a disability, or require further asset protection of their inheritance.

As with other forms of trusts, the benefits to farming families are that they allow for tax-effective separation of

farming land, the ability to split assets, stock, machinery and personal cash assets between different beneficiaries, and the ability to provide for non-farming beneficiaries.

HOW DOES A TESTAMENTARY TRUST WORK?

A testamentary trust has three key roles: the trustee, appointor and beneficiary.

The **trustee** of the trust is the legal owner of the property and controls the day-to-day operations of the trust and therefore has significant control. The trustee in its discretion determines how income is distributed and invested. The trustee can be one or more individuals or a company. In most instances, the trustee is usually the intended beneficiary; however, for a vulnerable beneficiary the trustee is independent and makes decisions for the benefit of the named beneficiary.

The **appointor** (principal) has the ultimate control over the trust and has the ability to appoint and remove the trustee from the trust at any time. It is important to consider who undertakes this role to ensure that the trust does not pass into the wrong hands.

The **beneficiaries** of a testamentary trust are usually known as a class of beneficiaries, which encompasses the intended beneficiary such as a spouse, partner or child but also includes other members of the family and direct descendants of the intended beneficiary to ensure that the trustee has discretion to make tax-effective distributions to members within the class of beneficiaries.

TIP:

A testamentary trust is not a viable or cost-effective option if the **assets in the estate are minimal**. It is recommended that a testamentary trust hold at a minimum $300,000 in assets to make it a cost-effective structure for a beneficiary.

HOW IS A TESTAMENTARY TRUST CREATED?

When a testamentary trust is incorporated into your Will, upon your death your Will specifies that the balance of your estate will be paid into one or more testamentary trusts. Your Will may specify particular assets or the amount that is to be paid into each trust (noting that not all trusts have to be equal in size). Your Will also specifies who the trustees and the beneficiaries are of each trust and any conditions that may be placed on the trust. Once your estate is administered and assets are placed in the trust, the trustee takes control and manages it in accordance with the trust deed.

Once the trust is established and the estate is finalised, generally no further legal assistance is required and the trustee will be required to consult with an accountant to meet the trust's ongoing tax obligations.

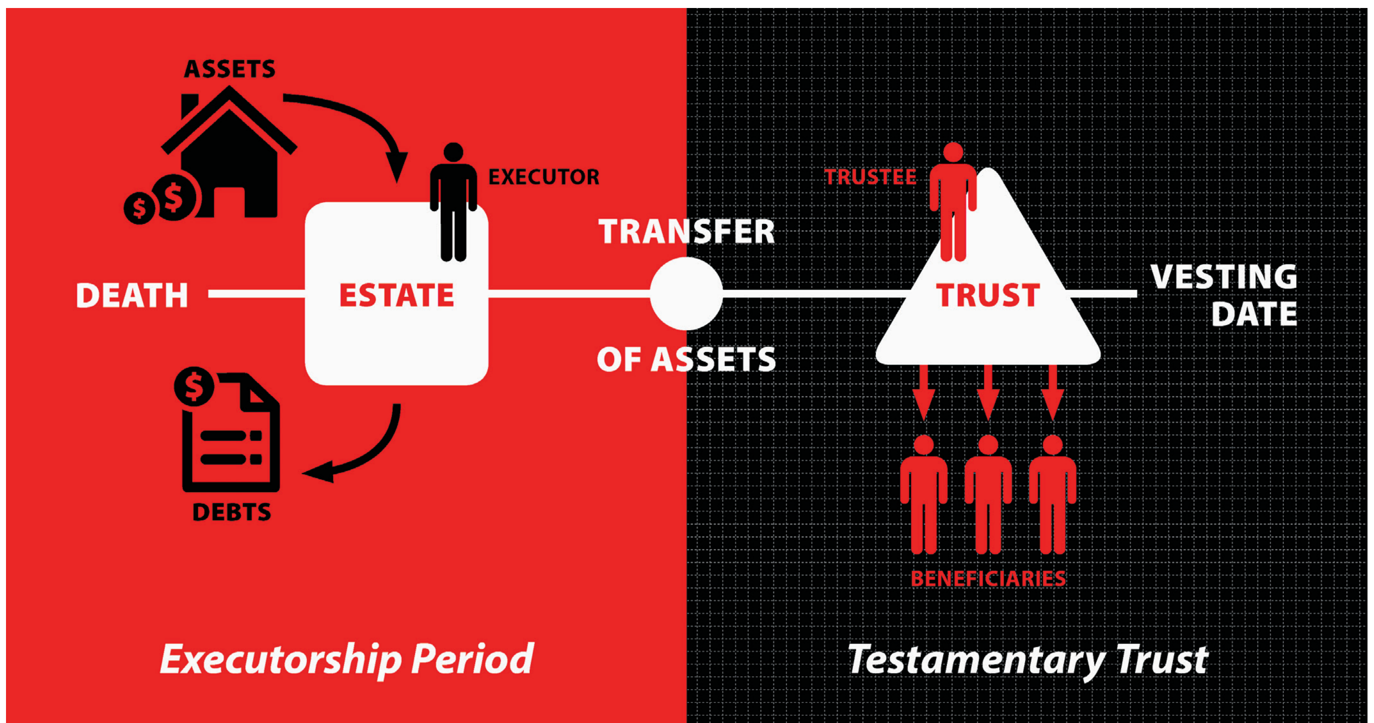
BENEFITS OF A TESTAMENTARY TRUST

A testamentary trust gives the **flexibility** to distribute capital and income to any nominated beneficiary at any time and in any amount.

Distributions from the trust can be made in a **tax-effective** way to those beneficiaries who would benefit the most from the distribution such as a spouse, children and dependent beneficiaries who are not working or receiving an income. Distributions to minors are particularly tax effective as they have a tax-free income threshold that is not usually allocated to minors outside of a testamentary trust.

Holding assets in a trust gives greater **protection** to those beneficiaries who are going through a divorce or family relationship breakdown, have creditors chasing debts or may be vulnerable. Holding assets in a testamentary trust provides a Will maker with greater assurance that their assets are not going to be wasted by the next generation.

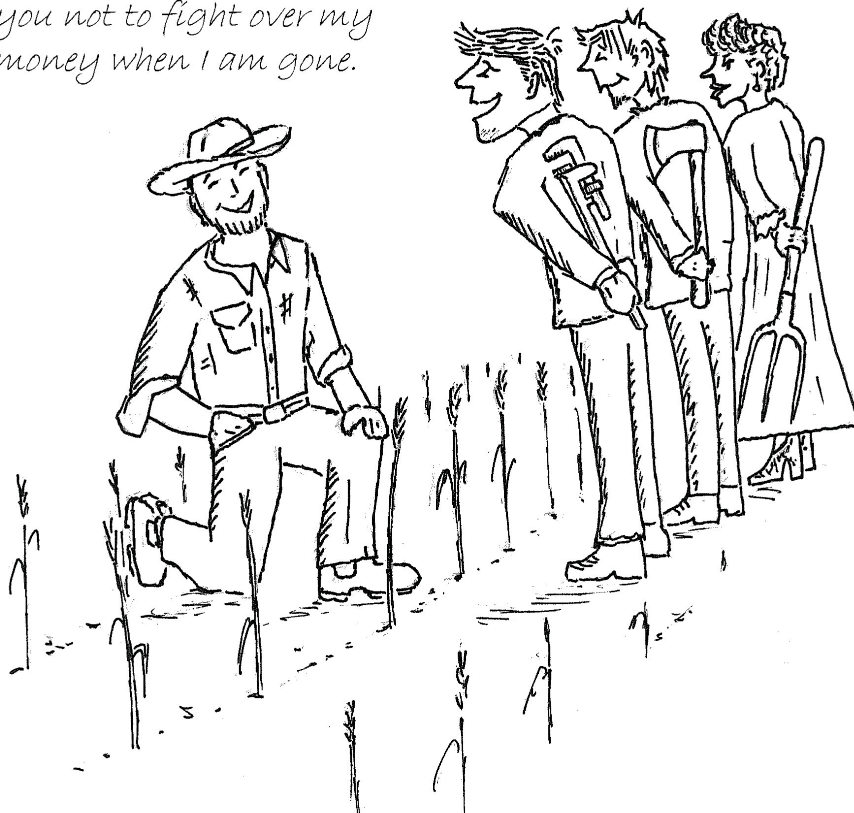
LIFE OF A TRUST FROM DEATH UNTIL VESTING



Testamentary trusts can be **tailored** to achieve particular objectives for each beneficiary as there is no one size fits all.

MATTERS TO CONSIDER

While the benefits of having a testamentary trust are substantial, there are a few things you should first consider before entering into a testamentary trust. There are **ongoing fees** and costs associated with a testamentary trust such as regular accounting and financial planning fees to ensure that the trust complies with its tax obligations.



FREQUENTLY ASKED QUESTIONS

1 Who can be the trustee of a testamentary trust?

You can appoint anyone you wish to be trustee including a spouse, child or the executors of your estate. It is important to remember that the trustee of the trust has significant control of the trust. As such appointing a trustee is an important decision that can have a great impact on your succession plan.

2 Do all assets have to go into a trust?

No, you can allocate certain assets to a trust, and pass certain assets absolutely to a beneficiary. It is important that you seek advice regarding what assets pass to a trust and those that do not as each asset will be treated differently by the estate and have separate tax consequences.

3 When does a testamentary trust end?

A testamentary trust can end in one of two ways.

The first is at the specified vesting date. In all Australian states and territories (excluding SA, which has no vesting requirements), a trust will vest 80 years after it is established. For a testamentary trust, this is 80 years from the date of death of the Will maker once the testamentary trust comes into existence.

The second is at an earlier date at the discretion and consent of the trustee and appointor of the trust. A beneficiary can request the trustee and appointor to vest the trust early and to have the assets of the trust distributed. Before any trust is vested it is vital that the trustee seeks financial advice as to the tax consequences that may be triggered by the vesting of the trust.

4 Is a testamentary trust different from a family trust?

A testamentary trust is essentially the same as a family trust except that it does not come into existence until the death of the Will maker.

Both trusts are discretionary in nature and allow the trustee to make tax-effective distributions to those beneficiaries who will receive the best tax treatment.

It is important to note that if you have a family trust, these assets will not pass to your estate on your death and separate succession planning needs to be undertaken in respect of your family trust.

5 Is it possible to set up a testamentary trust after my death if I don't put it into my Will?

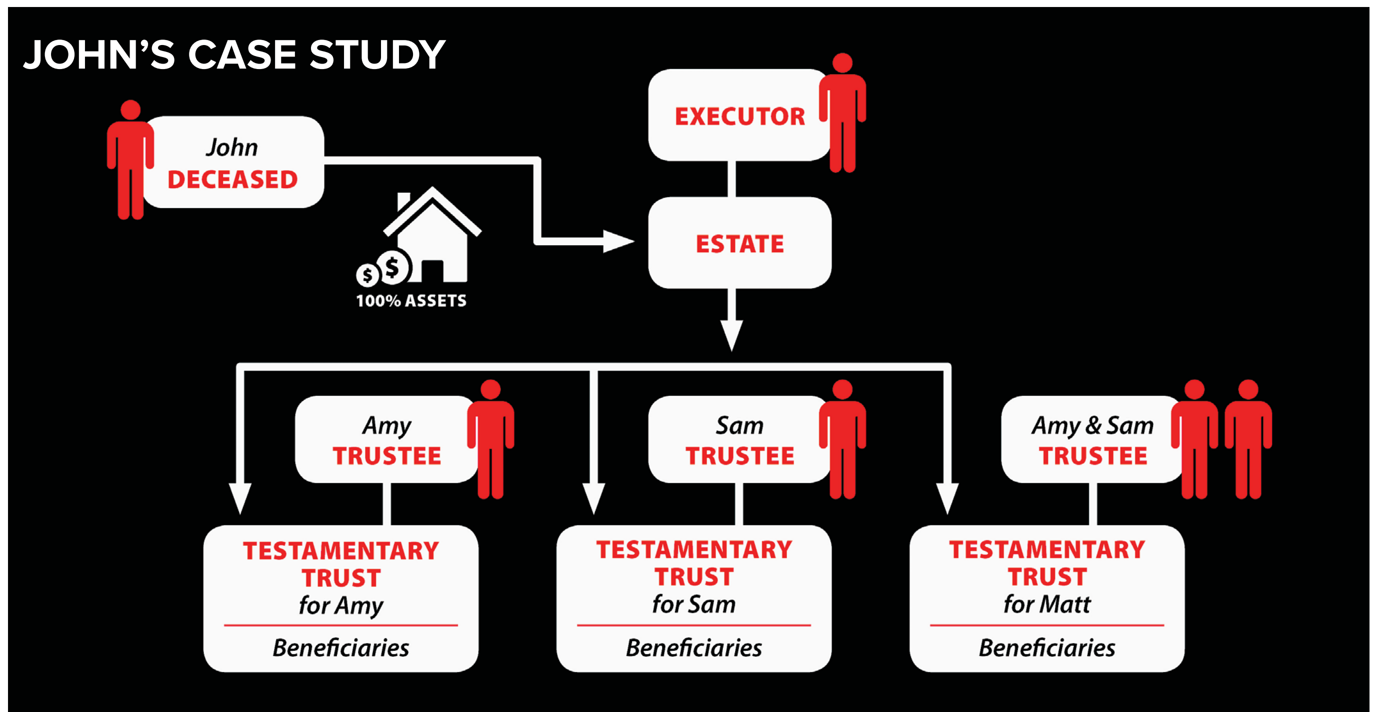
Yes, but there are limitations and it is not recommended. While establishing a testamentary trust in a Will is by far the best and simplest approach, it is possible to establish a post death testamentary trust (known as an estate proceeds trust). An estate proceeds trust is more restrictive and does not offer capital gains tax and stamp duty exemptions and is restricted to a set class of beneficiaries who would otherwise be entitled to receive your estate under intestacy laws.

Case study

John (64) runs and operates a grain farm. He owns approximately $400,000 of plant and equipment, farm land valued at $2.2 million, an investment property valued at $500,000 and cash of $90,000. He has three children: Amy (31), who is in an unstable relationship with two minor children and owns her own design business; Sam (29), who is single and assists with working the family farm; and Matt (27), who is also single, unemployed, lives at home and has a drinking problem and mental health issues.

John wishes to support all of his children on his death, but wants to provide Sam with an opportunity to run the family farm and provide extra support to Matt during his lifetime.

Without discussing the equalisation of the distributions of the estate, the main



focus of this case study is to highlight the reasons why a testamentary trust is an appropriate option for each of John's children.

Amy is in an unstable relationship and if she was to receive her inheritance outright there is a much greater likelihood that it will be included in a property settlement in the future and her inheritance may be split with her former spouse. Amy also owns her own business and is at risk of creditors chasing her if her business is unsuccessful. Holding assets in a testamentary trust offers the best protection of Amy's inheritance from any bad business debts or future family law property settlements.

Sam is quite stable and a testamentary trust will give him protection in the future and allow for tax-effective distributions to himself and his future family.

Matt is a vulnerable beneficiary who is unable to manage his finances. A testamentary trust provides a mechanism for an independent person (such as Amy and Sam) to act as Matt's trustee to ensure that he is adequately looked after and supported without the risk that his inheritance is lost through frivolous spending.

This case study highlights several ways that a testamentary trust is beneficial for different beneficiaries.

An experienced succession planning lawyer will work closely with you to determine the best options available to you regarding your personal succession plan.

Useful resources

FindLaw Australia:
http://www.findlaw.com.au

Australian Investors Association:
http://www.investors.asn.au/education

GRDC Fact Sheets: ***Farm Business Management – The benefits of separating land assets from the operating business***
https://grdc.com.au/resources-and-publications/all-publications/factsheets/2014/03/fbm-landassetsvsoperatingbusiness

More information: ORM Pty Ltd, 03 5441 6176, admin@orm.com.au

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