

# The nuts and bolts of testamentary trusts

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In [an earlier article](#), I briefly analysed family trusts and discussed some of their benefits. This article will consider the role that *testamentary* trusts can play in a well thought-out estate plan.

Because this subject matter is so broad, I have made this article a 'grab bag' of things that readers might think about when considering whether a testamentary trust might have a place in their estate plan. Any decision to use testamentary trusts should be accompanied with bespoke legal, accounting and financial advice.

## Family trusts v testamentary trusts?

Like family trusts, testamentary trusts provide an opportunity to separate legal control and beneficial ownership in assets owned within them. Unlike family trusts, which are created during lifetime, testamentary trusts are created by a will and only come into effect upon the death of the will-maker.

That difference aside, testamentary trusts generally operate within the same legal framework as trusts created during lifetime. But as we will see now, they require considerations and create opportunities that are unique and independent of family trusts.

## How do testamentary trusts work?

A will incorporating a testamentary trust can be thought of as a simple will *plus a trust*.

Testamentary trusts therefore offer a will-maker an alternative to gifting assets in their wills **directly** to beneficiaries. Instead, they provide a will-maker the option to pass estate assets to a trustee to 'hold upon trust' for an intended beneficiary, pursuant to a trust structure.

The trustee can also be a beneficiary of the trust depending on the will-maker's objectives in creating the trust.

By splitting ownership and control in assets *after a will-maker's death*, testamentary trusts effectively allow a will-maker to exert a degree of control over how their assets are used from beyond the grave – referred to in this article as 'post-death control'.

## Controlling from beyond the grave

'Post-death control' can be understood as the ability of a will-maker to impose 'checks and balances':

- at the time that they draft their will;
- on the administration of their wealth after their death;
- to direct how assets are to be distributed to their ultimate beneficiaries.

There are several reasons why a will-maker might want exert control from beyond the grave. An example follows.

## Protective testamentary trusts

Testamentary trusts can be designed to provide principally for a specified beneficiary, while also denying that beneficiary control over decisions made in relation to the inherited assets.

Such trusts are often termed 'protective trusts' or 'All needs protective trusts' and usually:

- nominate a beneficiary for whose benefit the trust is to be administered (principal beneficiary);
- include provisions (written into the will) elevating the interests of the principal beneficiary to paramount importance;
- impose an obligation on the trustee to consult with the principal beneficiary from time to time.

Vulnerable beneficiaries can be protected by providing for them as a principal beneficiary through the testamentary trust but vesting control of the trust (and decisions that affect its income and capital distributions) to an independent trustee.

The use of protective testamentary trusts may be an option where a will-maker is concerned that an intended beneficiary is physically or mentally (or for any other reason) unable to take responsibility for the management of their own financial affairs.

A more nuanced approach can be adopted when appropriate. For example, a testamentary trust could provide a Principal Beneficiary with a degree of autonomy but require them to seek third-party approval before inherited assets are sold.

## Beneficiary controlled testamentary trusts

Where a will-maker is not concerned about the vulnerability of a future beneficiary, testamentary trusts can also be utilised to promote asset protection and tax planning on the same basis that family trusts do.

In these circumstances, the will-maker may provide effective control of the testamentary trust to an intended beneficiary. This could take the form of appointing them as the initial trustee and appointor (the person who can hire and fire a trustee) of a testamentary trust.

Such a move could allow the person inheriting the assets to split control and ownership in their inherited assets in a manner that they choose. These testamentary trusts can be incorporated into a will on a basis that their use by the intended beneficiary is optional.

## Trustee selection

One of the differences between family trusts and testamentary trusts is the person who instigates the creation of a testamentary trust never controls it. This is because it doesn't come into being until after the will-maker's death.

What this means is that will-makers have to decide who will be in control of their testamentary trusts after their death. The choice of a future trustee can be a difficult one to make and is critical to the future administration of the trust:

Independent trustees can be difficult to locate and expensive to engage. And where family members – such as a will-maker's children – might be considered for the role, the family dynamic becomes an important factor.

It may be necessary, for example, to nominate one child over others due to intra-family relationships. The will-maker will also need to assess their children's respective skill sets.

## Limitations of testamentary trusts

There are limitations associated with the use of testamentary trusts and with post-death-control.

### The life of a trust

In South Australia, trusts can exist in perpetuity. In other states, trusts can exist for the perpetuity period – generally for up to 80 years (and 125 years in Queensland). Therefore in all states other than South Australia, there is a limit on how long post-death control can be exerted.

### Trustee succession

With the passage of time, arrangements for ongoing trustee succession will be needed.

### The tension between control and flexibility

Depending on a will-maker's motivation for creating a testamentary trust in their future estate, a future trustee's powers and discretions in administering that trust can be drafted to be anything from wide (even absolute) to non-existent.

If discretions remain active after a will-maker's death, the creation of a testamentary trust shifts the focus of control from the will-maker (and the enforceable terms of their will) to the trustee and their successors (and the terms of the trust).

Removing or reducing the scope of discretions, and hardwiring trust distributions, enhances control of inherited assets but at the cost of flexibility, and potentially more advantageous financial outcomes.

Therefore there is always tension between the degree of post-death control that a will-maker is able to achieve and the flexibility of a future testamentary trust.

### Reliance on future trustees

Unless trust discretions are completely hardwired, will-makers need to rely on future trustees to act appropriately in administering the testamentary trust.

There are also a couple of potential downsides:

- ongoing administrative costs, which need to be justified relative to the benefits that are likely to be achieved
- the necessity for a more complex (and therefore more expensive) will, and increased complexity in the future estate administration

Also, notwithstanding the potential tax benefits we outline briefly below, the taxation of trusts is complicated and, to a degree, uncertain.<sup>[\[1\]](#)</sup> In particular, the legislative framework dealing with the taxation of minors on income is complex, lacks clear judicial comment or consideration, and also lacks ATO guidance. A conservative approach accompanied by bespoke advice is warranted.

## Advantages of testamentary family trusts

In addition to the advantages that family trusts generally offer, testamentary trusts currently offer a tax benefit that family trusts don't.

The law of trust taxation is extremely complex and cannot be addressed fully here. But here is a glimpse:

- in a family trust, any income distributed to a minor beneficiary in a single financial year in excess of about \$500 is taxed at maximum marginal tax rates, and is therefore not commercially viable.
- in a testamentary trust it is possible to distribute income from testamentary trusts to minors taxed at ordinary adult marginal rates<sup>[\[2\]](#)</sup> that include the tax-free threshold.

Despite some possible downsides, testamentary trusts are therefore a potentially valuable estate tax planning tool.

Case study

Leonard is a single man with two adult children aged 18 and 19. His assets include his business conducted though a corporate entity and substantial assets in his personal name. He wants to provide equally for his two children after his death but does not want them to be in complete control of their inheritance until the youngest is 30 years old.

Leonard has a good relationship with each of the children and they all get on well with each other. He holds a family meeting with the children, his solicitor and accountant to discuss options.

Leonard ultimately decides to make the asset protection and tax planning benefits of testamentary trusts available to his children. As a result, he executes a will that will creates a trust on his death in respect of all of his assets.

- He appoints the two children and his accountant jointly as appointors of the trust.
- He imposes restrictions on the sale of assets while the accountant is acting as appointor, with all trust decisions to be made unanimously between the two children and the accountant.
- The accountant’s role will cease when the youngest child reaches the age of 30, at which time the children alone will control the trust and its assets.

Conclusion

Testamentary trusts can, in appropriate circumstances, offer benefits to a will-maker’s future estate and the ability to exert control over estate assets from beyond the grave.

An assessment of those benefits must be tempered with an appreciation of the complexity, and limitations associated with future trust administration and the challenges associated with identifying appropriate trustees.

As a result, the use of a testamentary trust should only be considered on a case-by-case basis and on the basis of professional advice.

[1] See for example the ATO’s preparedness to address the administration of testamentary trusts in accordance with the practices set out in PSLA 2003/12. Ultimately however that practice statement does not have the force of legislation but is an administrative statement to provide guidance to ATO staff.

[2] Advice should be sought on a case-by-case basis

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