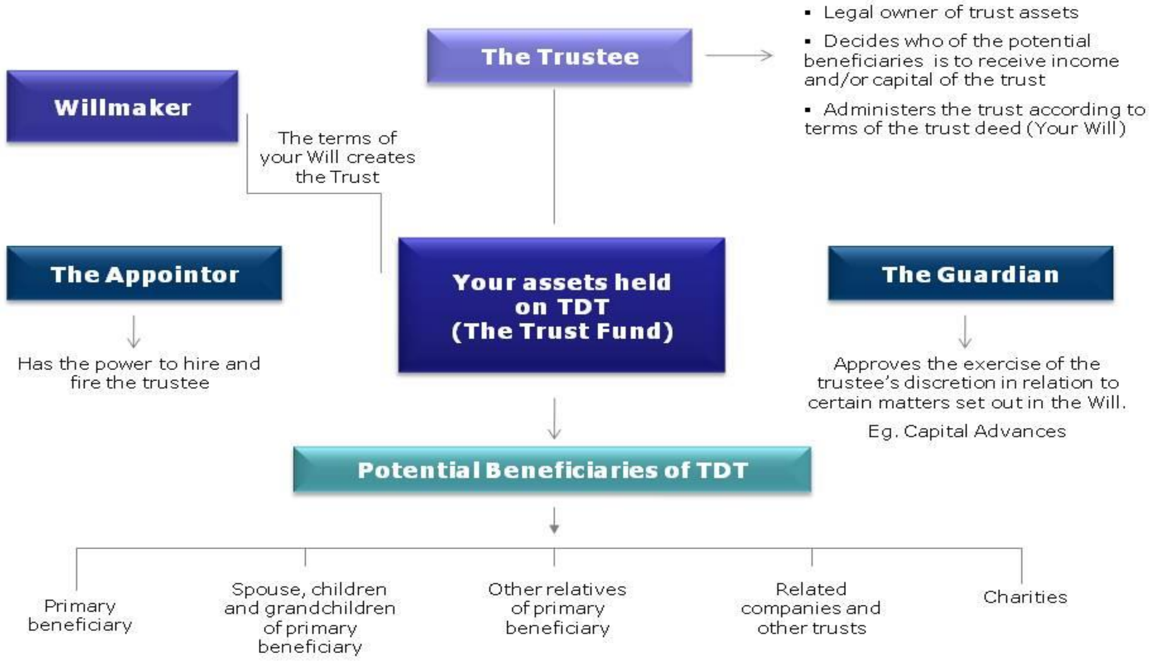
What is a Testamentary Discretionary Trust?

A Testamentary Discretionary Trust (**TDT**) operates very similarly to a Family Discretionary Trust. It has a trustee and two or more potential beneficiaries who are entitled to receive the income and/or capital of the trust at the trustees discretion (please see diagram below). It is called a discretionary trust because the trustee in each financial year exercises its discretion to determine who will receive the income and/or capital from the trust fund and in what proportion.

In addition to the position of trustee, a TDT may also include the positions of an appointor and/or guardian. An appointor may be included in the terms of the trust deed if an independent trustee is appointed, thereby giving the power to appoint or remove the trustee to one of the beneficiaries of the trust. In most cases this would be the primary beneficiary.

Similarly a trust may include a Guardian for the same reasons. A Guardian's function is to oversee some of the more significant decisions a trustee may make. For example if the trustee wishes to make a capital distribution it may be required to obtain the consent of the Guardian before doing so.

Testamentary Discretionary Trust (TDT)



Peter and Susan's Story

Peter is 60 years of age and Susan is 62; they are both semi-retired and are now concerned that they have neglected their estate planning for the past 10 years.

Peter and Susan have three adult children, two are now married with young children of their own and the third is single. One child is currently experiencing marriage difficulties.

Peter and Susan are concerned that their children may lose their inheritance in a divorce.

Peter and Susan were advised to include Testamentary Discretionary Trusts in their Wills for the benefit of each of their children. Discretionary Trusts can assist in protecting their children's inheritance from matrimonial breakdown and bankruptcy.

Peter and Susan died in a car accident before they implemented the recommended changes to their Wills. At the time of their death, their daughter was in the process of separating from her husband and their single son was in financial difficulties after his business failed.

Unfortunately because Peter and Susan left their estate to their children in their personal names, their son's inheritance fell into the hands of his creditors and their daughter's inheritance formed part of the matrimonial assets when her and her estranged husband finally sorted out their finances.

Benefits of a Testamentary Discretionary Trust

- Asset Protection
- Income Splitting
- Income Streaming
- Generational Wealth Management (providing for future generations of the one family)

Asset Protection

A Testamentary Discretionary Trust can protect the assets which a beneficiary inherits should they find themselves:

- in financial difficulties (bankrupt); or
- involved in a property settlement because of a relationship breakdown.

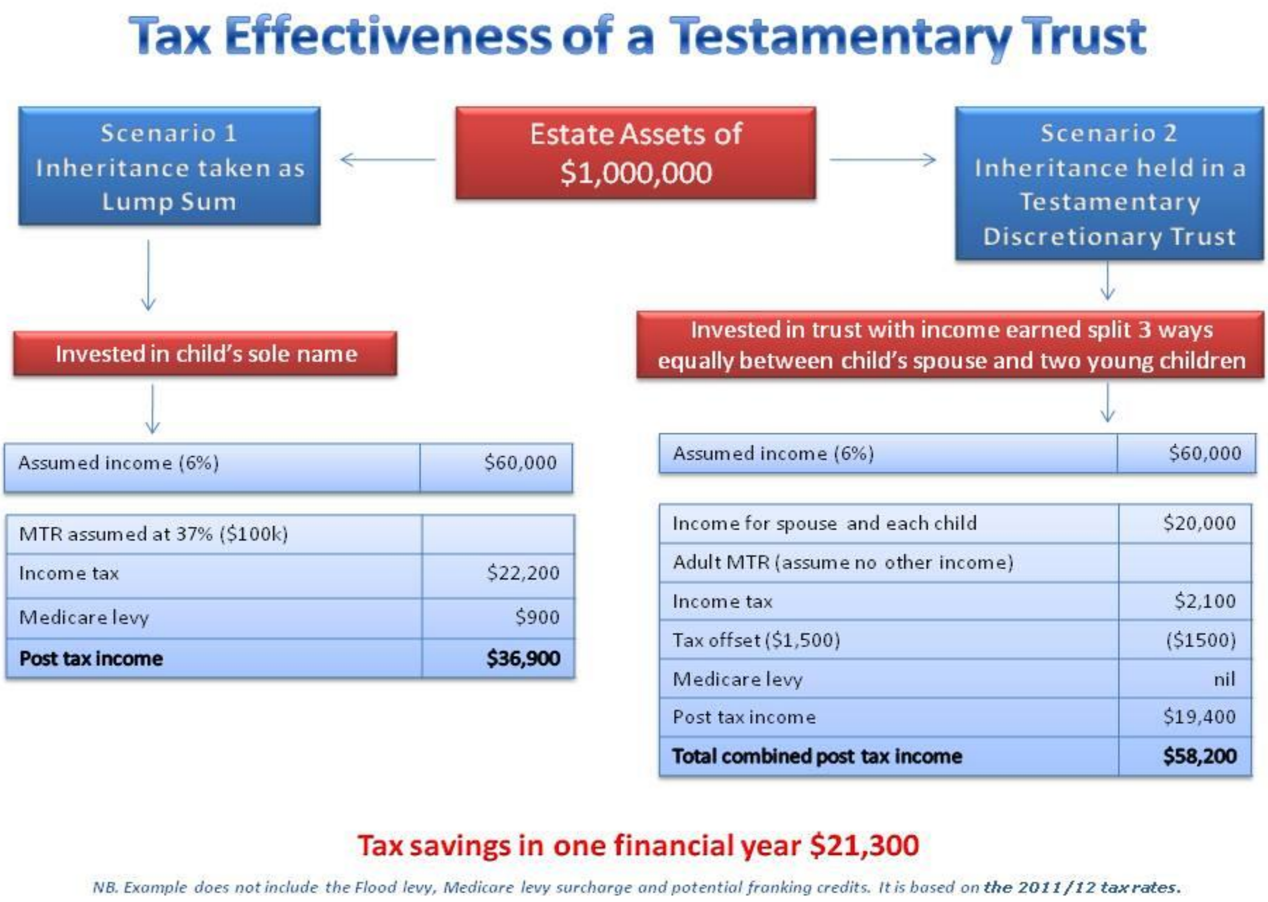
This type of trust can also protect the interests of a vulnerable beneficiary, for example beneficiaries with a disability, a gambling problem or a drug addiction.

The separation between the legal owner and beneficial owner of the trust assets allows for this protection to exist.

NB. There are limitations to the effectiveness of a Testamentary Discretionary Trust, please contact us to discuss your personal circumstances.

Income Splitting

It is the income splitting capability of a TDT which makes this structure so attractive. Unlike family discretionary trusts, Testamentary Discretionary Trusts provide a favourable tax position when paying income distributions to a minor (child under 18). This is because a minor beneficiary of a testamentary trust is taxed as an adult. This means that a minor beneficiary is entitled to receive the $6,000 tax free threshold and the standard adult tax rates thereafter. This can be compared to a minor of an inter vivos discretionary trust (a trust created during one's lifetime) who is only entitled to $416 tax free and any income above this amount is taxed at penalty tax rates. *The diagram below sets out an example of the potential tax savings when income is distributed from a Testamentary Discretionary Trust between two or more beneficiaries rather than the estate assets being invested in the beneficiary's name and he or she paying tax on the entire income generated.*



Income Streaming

Income streaming is the ability to pay different classes of income to different beneficiaries. For example paying the fully franked dividend received on BHP shares to Beneficiary A and paying the rental income from an investment property to Beneficiary B.

This gives the trustee the greatest flexibility when it comes to distributing income to the beneficiaries, it also allows for a more tax effective trust.

Tom and Kerry

Tom is 57 and Kerry 55 they have 2 adult children. They currently have one granddaughter and their youngest son is expecting his first child in November. Both their daughter and son are happily married and have plans for more children. Their son James runs his own business and Tom and Kerry are concerned that if something were to go wrong all of their hard earned wealth could be lost to potential creditors.

Tom and Kerry decided that Wills incorporating Testamentary Discretionary Trusts suited their circumstances perfectly. They were attracted to the potential tax savings their children could make through splitting the income generated by their trust with their spouse and children. They saw this as an opportunity to assist their children in the future, as it would provide their children in the short term with additional income every year which could then be used towards the grandchildren's school fees or a holiday. And in the long term provide their children with adequate asset protection. This was particularly important given James' business interests.

Please contact us to discuss how Testamentary Discretionary Trusts can work for you.