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Tax Effective Wills

Most people when they make a Will provide for their assets to be given directly to their intended beneficiaries by way of a standard Will (eg: I give my estate to my children in equal shares). The problem with leaving assets direct to beneficiaries in this way is that the assets become the legal property of that beneficiary and as such:

1. may be seized by creditors if the beneficiary is in financial difficulty or bankrupt;
2. may be at risk from spouses or de facto spouses of the beneficiary in the event of divorce or separation; and
3. any income generated from the assets will be treated as taxable income of the beneficiary in addition to that beneficiary's other taxable income.

Rather than giving your assets direct to a beneficiary in the above way, a more effective way is to leave your assets to beneficiaries by way of a Testamentary Discretionary Trust (TDT) established in your Will.

What is a TDT?

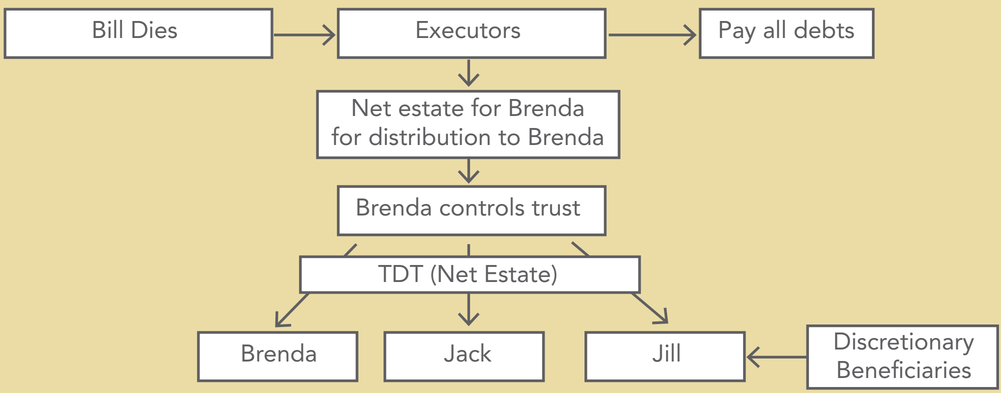
A TDT is a discretionary trust:

- Established in a Will;
- Which comes into existence when the person making the Will dies.

The purpose of a TDT is to give the intended beneficiary control over their inheritance without actually receiving legal title to it. In other words, the beneficiary's inheritance is owned by the Trust and the beneficiary has effective control over what happens with the assets of the trust.

The potential or "discretionary" beneficiaries of the TDT would normally be a wide range of people related to the beneficiary who has control of the Trust.

Example: Bill is married to Brenda and they have 2 children, Jack and Jill. Bill dies. Rather than leaving his estate direct to Brenda through a standard Will, Bill leaves his estate to Brenda through a Tax Effective Will incorporating a TDT. Bill's executors will pay all debts and estate expenses and the net estate would be distributed to a TDT which Brenda controls for the benefit of her family, as shown in the following diagram:



The advantages of this are three-fold.

ASSET PROTECTION

The assets in the TDT are not owned by Brenda and therefore cannot be claimed by creditors or the Trustee in Bankruptcy if Brenda gets into financial trouble or goes bankrupt.

FAMILY LAW CLAIM

If the estate was left direct to Brenda through a standard Will and she subsequently re-married or commenced a de-facto relationship, the assets would be at risk in the event of a subsequent divorce or separation from future spouses or defacto spouses. Assets held in a properly structured TDT can have some level of protection against claims from future spouses or defacto spouses, especially if combined with a provisoe which requires Brenda to enter into a pre-nuptial agreement with any future spouse.

TAX MINIMISATION

Like ordinary family trusts, the TDT provides greater flexibility to split income of the Trust between discretionary beneficiaries. Unlike family trusts however, income allocated to beneficiaries under 18 years of age through a TDT are taxed at normal marginal rates and not at the penalty tax rate as for most family trusts.

Say for example:

- Brenda has an income of $40,000.00 per year;
- Jack and Jill are 4 and 6 years old; and
- the inheritance left by Bill will create an annual income of $20,000.00 per year.

Brenda has control of the Trust and can apply the trust funds towards anything from real estate to her childrens' education. It is up to Brenda as to who should receive the income and capital from the Trust.

You can set up more than one TDT in your Will and so you can set up one TDT for each of your children.

It is important to avoid unwanted TDTs and therefore we ensure that the beneficiary effectively has a choice whether to receive their inheritance directly or through a TDT.

Examples

If Bill had left his estate directly to Brenda through a standard Will, her tax position after his death would be as follows:

		Annual Income	Tax payable
Brenda	Wage	$40,000	
	Inheritance	$20,000	
	Total	$60,000	$12,600

If Bill leaves his inheritance to Brenda by way of a Tax Effective Will however, Brenda can distribute all the income from the TDT to Jack and Jill and the situation would be as follows:

		Annual Income	Tax payable
Brenda	Wage	$40,000	$ 6,600
Jack	Inheritance	$10,000	$ 600
Jill	Inheritance	$10,000	$ 600
	Total	$60,000	$ 7,800

From the above fairly modest example, the tax saving is $4,800.00 per year.

Properly drafted, TDTs have many advantages. If you believe a TDT would benefit your family, please contact Paul McHugh on 07 5443 1566 for a professional assessment.