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Testamentary trusts facilitate smoother estate planning

By Matthew Burgess and Elissa Etheridge

The need for effective structuring of business and personal assets has been brought into sharp focus for farming families in the past few years and, more recently, as a side-effect of the global financial crisis. As a result, more effective estate planning strategies have developed. Current strategies allow individuals to achieve a high level of flexibility in the distribution of an estate while still maintaining a high level of asset protection and tax effectiveness.

Fundamental changes to the taxation regime, the vast amounts of wealth accumulated within superannuation funds and the increasing tendency for both business and personal relationships to be relatively short-term as opposed to lifelong have also been driving factors in the revolution of traditional estate planning methods.

A significant factor to note in the changing face of estate planning is the transfer of wealth from Australia's Baby Boomer generation. Statistically, this segment of the population is by far the wealthiest and best educated in Australia's history and, consequently, far more sophisticated estate planning strategies have been developed in order to minimise the ability for wealth to be attacked by creditors, former spouses, business associates and (in some instances) disgruntled beneficiaries. It is this generation that makes up a significant proportion of Australia's rural property owners.

Of particular relevance to managing the protection and distribution of the underlying wealth of an individual's estate are complex will arrangements incorporating testamentary trust structures. Testamentary trusts are trusts contained in a person's will which come into existence at the time of the person's death.

Testamentary trusts are structured to provide a person (or people) with ultimate control of the trust and the discretion to distribute the income and capital of the estate to a broad range of beneficiaries.

Testamentary trusts can be structured so as to ensure that only a willmaker's lineal descendants can benefit from the trust. This type of trust is also known as a Lineal Descendant Trust (LDT). Separate LDTs can be established under the one will for different beneficiaries.

Asset protection

LDT structures allow for tax-effective income distribution and a high level of asset protection. For example, if an estate is left under

Matthew Burgess says a Lineal Descendant Trust allows for tax effective income distribution and a high level of asset protection.

a will to an individual absolutely (that is, not a LDT), it is their personal property in their own name. This means the property can be jeopardised by the individual's personal circumstances or financial position and will be exposed to creditors and matrimonial breakdowns.

In contrast, if the property is left via a LDT then the individuals can receive the benefit of the assets without those assets being in the individual's own name. A level of protection is therefore usually afforded to the assets against bankruptcy, litigation and divorce and the division of matrimonial assets.

Tax planning

LDTs also allow for very effective tax planning. Distributing income to minors is an effective income splitting mechanism and tax minimisation strategy. In particular, tax legislation permits LDTs to make income distributions to minors at adult tax rates rather than the tax penalty rate of 66% (which is the rate usually imposed on family trust distributions to minors).

This means up to $14,000 can be distributed to each minor beneficiary each year free of tax. Table 1 highlights the taxation benefits of distributions to children or grandchildren under the age of 18 via a LDT compared to distributions from a family trust

In conjunction with comprehensive wills (incorporating LDTs), additional structures are now being utilised to ensure both on-farm and off-farm wealth passes efficiently to the intended recipients and that the transfer takes place at the intended time. Often, the desire to ensure a suitable tax outcome needs to be balanced against a desire to ensure assets are protected from family disputes, spendthrift beneficiaries and creditors in deciding on an estate plan.

Table 1: Comparison of tax benefits of distribution to children between a Lineal Descendant Trust and a family trust

	LDT	Family trust
Tax treatment of minors	Distributions to minors are taxed at adult rates	Distributions to minors are taxed at penalty rates – that is, higher than adult rates
Tax-free limits of payments to minors	The tax-free limit is $14,000	The tax-free limit is $2667

Some of the other techniques which have developed in recent years to achieve appropriate asset protection levels include:

- binding death benefit nominations in relation to superannuation entitlements to ensure distribution of superannuation benefits cannot be challenged or altered;
- pre- and post-death trust arrangements, again often structured to limit the ability to access lump sum capital amounts;

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- special-purpose structures that utilise independent or professional management teams to administer and control wealth transfers; and
- structured agreements between family members regulating the manner in which wealth is to be divided in the event of a relationship breakdown, such as the new financial agreements available pre, post or during a marital or de facto relationship.

Where there is more than one ultimate beneficiary it is not unusual to implement a variety of different strategies to ensure the circumstances of each beneficiary are appropriately provided for and to achieve an efficient tax outcome.

The difficulty, however, is that in many estate planning exercises for farming families, serious attempts to devise and implement a plan are often not made until some trigger event stimulates action. Often the triggering event is itself an issue that may jeopardise the ability to implement appropriate strategies – for example, financial or matrimonial misfortune or life-threatening illness.

Given that the first wave of the Baby Boomer generation is now already 60, it is likely that the increased importance placed in recent years on appropriately structuring intergenerational farming wealth transfers will continue to intensify.

Find out more:

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