

Pros and cons in leaving estate to family trust

Inheritance

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Testamentary discretionary trusts are the “new black” in wills, with many solicitors recommending them thanks to tax benefits and protection from kids’ estranged spouses. Where there is a family trust, however, an alternative is to give the estate to that trust.

A testamentary discretionary trust is a discretionary trust set up in a will. It differs from the main type of discretionary trust that is set up by a trust deed while the beneficiaries are still alive. This latter type is called an “inter vivos trust” by lawyers and a “family trust” by everyone else.

Family trusts are set up for income splitting and asset protection of the family, particularly the key individual. Testamentary trusts are designed to protect the assets of the beneficiaries under the will and to allow minors (the deceased’s children and or grandchildren) to access favourable tax treatment on distributions.

One possible strategy is to give the estate to your family trust. Indeed, many people who already have a family trust ask why they can’t do precisely that. There are pros and cons.

Benefits

■ The family trust is already in place so the administrative issues relating to the establishment of the testamentary trust after you die are much simpler.

■ The trust already caters for the family members so you don’t have to be specific about the possible beneficiaries in your will, though there may be an issue if you want to cut a family trust beneficiary out of your will.

■ Most people have a private company as the trustee of their family trust with the spouses as the directors and the least financially vulnerable of the spouses as the shareholder. If your spouse is still alive when you die, the passing of control of the trust is easy. In fact, there is no passing of control – the surviving spouse simply continues to control the trust.

■ Much of your wealth is already

contained in the trust, so there’s no need to transfer it thereby ensuring there will be no capital gains tax or transfer duty issues.

■ There is no need to set out the very lengthy trust provisions in your will as they are already in the trust deed of the family trust.

■ If the family trust that has existed for years before your passing is eventually taken over by your children it cannot be argued by any claimant that the trust was set up as a sham or a simple tax avoidance strategy.

■ In addition, the single family trust that services all your children also prevents the argument by one child’s creditor that it is simply a sham vehicle controlled by that child.

One word of caution. There is a view that the tax benefits for minors can’t be accessed if you gift the estate to the family trust. The matter has not been judicially determined.

Generally, it is believed that the gift from your estate can be held in a separate division of the family trust to have the tax benefits that flow from a testamentary trust apply to those estate assets even though the pre-existing trust assets are excluded from those benefits.

Risks

■ The single, biggest downside is that existing creditors of the family trust will have access to the inheritance once it is put into the family trust. Don’t do it if there is any chance that the family trust will have material liabilities.

■ For as long as they operate the family trust, your children will know all about each other’s financial position.

Contrast that to a testamentary trust for each child where there will be no sharing of assets or management.

■ Finally, separation of the trust assets can be complex if the children want to close the trust or part of it. Different children will likely have different financial circumstances and aims. Some will want to hold, maybe develop, and others will want to sell, cut and run. One client told me: “If they can’t agree, then wind the whole bloody thing up and they can just get whatever’s left.” ■

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Family trusts are set up for income splitting and asset protection.
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