Case Study

Mervyn and Betty - Married, 76 and 72

Mervyn and Betty are in their seventies, with three adult children and 6 grandchildren, aged between 6 months and 17. They have retired and worked hard to self fund their retirement. They are now living comfortably off of the income generated from their superannuation, without needing to reduce the capital of $3 million. Mervyn and Betty also jointly own their house, which they have lived in for thirty years and own outright. The house is valued at approximately $1 million.

Mervyn and Betty have not updated their wills in some time, but they believe that they will continue to achieve their objectives – to give their assets to their children and grandchildren. Their wills do just this, bequeathing each of their estates to each other and then to their children and (if their children die leaving children of their own) to their grandchildren. There are no testamentary trusts created through their wills. The absence of testamentary trusts in their wills does not affect the way that their estate flows to their children and grandchildren, but it will affect the benefit that their children can obtain as a result. In looking at the consequences, we assume that the total estate which is to be distributed between the children is $4.2 million, once everything is taken into consideration.

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Case Study

Jimmy and John

Mervyn and Betty's eldest child is Jimmy. He is a doctor earning $300,000 per annum ($183,053 net) and his partner John is a teacher earning $50,000 per annum ($41,453 net). They have no children and live in a $900,000 apartment owned by John for asset protection reasons but which has a mortgage of $300,000 over it.

In the absence of a testamentary trust, Jimmy would take the full $1.3 million into his name. He gifts
$300,000 to John to enable John to repay the mortgage but is unable to effectively transfer the remainder of the funds to John to split the revenue. Thus, assuming a return of 7%, Jimmy will have an increase in his income of $70,000 ($35,700 net).

If Mervyn and Betty had included a testamentary trust in their wills, Jimmy would have been able to use $300,000 to pay off the mortgage on the apartment and then stream the $70,000 income to John on an annual basis. The net difference to Jimmy and John as a couple would be $8,100 per annum.

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Elizabeth and Michael

Mervyn and Betty's second child is Elizabeth. She is a lawyer, but currently on maternity leave looking after her six month old twins. She and her husband Michael have two other children, aged 3 and 6.
Michael is an accountant for a company, earning $90,000 ($66,953 net) and Elizabeth intends to go back to work 3 days a week when the twins are one, earning $70,000 ($54,303 net). Elizabeth and Michael live in a house which they own jointly, worth $1.2 million, on which they owe $700,000.

In the absence of a testamentary trust, Elizabeth would take the full $1.3 million into her name. She uses $700,000 to pay off the mortgage and invests the remaining $600,000, earning 7% per annum. Once she returns from maternity leave, this will increase her income by $42,000 per annum ($26,070 net).

If Mervyn and Betty had included a testamentary trust in their wills, Elizabeth would have been able to use $700,000 to pay of the mortgage on the house and then keep the remaining $600,000 in the trust, where it could still earn $42,000 per annum. However, in the testamentary trust, she can stream the income to her children, utilising their full tax free threshold of $18,200. Thus, this income would result in $42,000 per annum net until the children begin working, a difference to Michael and Elizabeth of $15,930 per annum.

$15,930 per annum

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Case Study

Luke

Mervyn and Betty's youngest child is Luke, a plumber earning $65,000 per annum ($51,053 net). He
is divorced and has two children aged 14 and 17, whom he co-parents with his ex-wife. He rents a house which accommodates him and the children, as well as having sufficient storage for his tools and equipment.

In the absence of a testamentary trust, Luke would take the full $1.3 million into his name. Although he considers buying a house, he chooses to invest it, earning 7% per annum. This increases his income by $91,000 ($56,160 net). It also exposes the whole of that amount to litigation if he were to be sued by one of his customers.

If Mervyn and Betty had included a testamentary trust in their wills, Luke would have been able to keep $1.3 million in the trust, where it could still earn $91,000 per annum. However, in the testamentary trust, he can stream the income to his children, utilising their full tax free threshold of $18,200. Thus, this income would result in $77,144 per annum net until the children begin working, a difference to Luke of $20,984 per annum. This outcome, structured properly, could also protect the trust fund from liability if Luke were to be sued by a customer.

$20,984 per annum

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