Case Study

Jack and Jill - Married, 34 and 33

Jack and Jill are married and have three children aged 5, 3 and 1. They own a house together which is valued at $800,000. They have also taken out a $500,000 mortgage over the house. Jack's annual salary is $120,000 (net $85,253) while Jill has an annual salary of $50,000 (net $41,453). Both Jack and Jill have wills and they have worked with their financial advisor to effect life insurance to the value of $1.5 Million and $1 Million respectively.

Using a simple will

Jill dies and in her will leaves everything to her husband Jack without the use of a testamentary trust. If Jack uses half Jill's estate to pay off the outstanding mortgage on the house this will leave Jack with $500,000.

To ensure a maximum future return on the remaining funds, Jack decides that it would be sensible to invest the funds at a rate of 7% per annum generating an annual income of $35,000.
Where there is no testamentary trust in place, the $35,000 will be taxed in Jack's hands at Jack's full tax rate. At current rates, that would mean that he would have a net income of $106,603, a total increase of $21,350 annually.

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Case Study

Jill's testamentary trust

Now assume that Jill in her will leaves here estate to Jack via a testamentary trust. The trust establishes Jack as the trustee and primary beneficiary with Jack and Jill's children also beneficiaries.
A key benefit of including a testamentary trust in your will is that it allows any income, capital gains and franked dividends derived from the estate to be distributed to the beneficiaries of the trust in the most tax efficient way.

Therefore if Jack generates an additional annual income of $35,000 from investing the trust funds at a rate of 7% per annum, by splitting the income, benefits can be distributed between the children and Jack so that there would be no tax payable on the $35,000. This would be done by ensuring that no distribution to any one beneficiary was greater than the minimum tax free threshold of $18,200, which they are entitled to even though they are minors because the trust is a testamentary trust, rather than a standard discretionary trust.

$13,650 per annum

By structuring their estates in this way, the family would be $13,650 better off per year until the children begin earning their own income. This extra money can be taken into consideration when calculating insurance needs and may therefore be able to reduce premium costs during Jack and Jill's lives as well.

Jack's testamentary trust

If Jack were to die, then a similar calculation would show that Jill would generate additional income of $70,000 per annum by the same method. Without a testamentary trust in place, this would result in a net increase of $43,800. With a testamentary trust in place, this would result in a net increase of $67,571.59 – a $23,772 better result annually for the family.

$23,772 per annum

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