Why Children Should Pay For Their Parents' Wills

The benefits of wills which have full discretionary testamentary trust provisions

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Issue #03/2021

EXAMPLE 1 – ESTATE OF $555,000: SAVING OF NEARLY $55,000 AFTER 6 YEARS!

Jane, a widow, passed away leaving Mary, her only child, as the main beneficiary under her Will.

Jane's only major asset was her house, valued at $555,000.

Mary is single with 2 minor children: Fred and Sam.

Mary kept Jane's house for 6 years and then sold it.

The net annual profit from renting out Jane's house (i.e. rent less expenses), was $20,000, a modest 3.6% p.a. return on investment.

The value of Jane's house increased by $50,000 in that period, less than 2% p.a., resulting in an assessable capital gain of $25,000.

Mary earned a salary of $120,000 p.a. for the last 6 years.

If Jane's Will **did *not* have** full Testamentary Discretionary Trust provisions, she would pay an extra **$56,550.00** in tax:

(a) Mary would have earned an extra $20,000 per annum in taxable income for 5 years, making her taxable income $140,000 per annum.

(b) Tax at 39%; (37% + 2% Medicare Levy) would have been payable on that extra income, namely, **$7,800** per year.

(c) In year 6, she would also earn an additional $25,000 from the capital gain on sale of the house, for a total of **$165,000** assessable income.

(d) Extra tax paid in year 6 would be **$17,550**.

(e) For the 6 year period, on extra taxable income of **$145,000** and non-taxable income of **$25,000**, Mary would have paid **$56,550.00** in extra tax.

(f) The balance for Mary is **$113,450**.

However, Jane ***did have*** a Will with full Testamentary Discretionary Trust provisions, and she left her entire estate to her Executor, to hold it according to those trust provisions, with Mary as the Primary Beneficiary and Fred and Sam as general beneficiaries, so consequently, the family would pay **only $1,806.00** in extra tax, **a saving of $54,744.00**:

(a) The testamentary trust made profits of $20,000 per annum for the first 5 years and assessable income of $45,000 in year 6 because of the capital gain.

(b) That profit was able to be distributed among all the beneficiaries of the trust, in Mary's discretion, so she distributed half each to Fred and Sam:

  (i) $10,000 in income each in years 1 to 5; and

  (ii) $22,500 each in year 6.

(c) The income was spent by Mary on their support, advancement, maintenance, education and benefit.

(d) Fred and Sam are taxed as adults because the trust is a testamentary trust,

(e) The income they receive does not exceed the tax-free threshold of $18,200 in years 1 to 5, and barely exceeds it in year 6, with only $903.00 in tax payable by each of them in year 6.

(f) The result is a very substantial tax savings of **$54,744.00** over the 6 years, as per the table below.

(g) Mary's family pays only **$1,806.00** extra in tax during the 6 year period, and so they pocket **$168,194.00** out of the **$170,000** in extra income!

The benefits are greater if the estate assets are invested more favourably.

		Years 1–5 (each year)	Total for the first 5 years	Year 6	Total for 6 Years
	Mary's Assessable Income	$120,000.00	$600,000.00	$120,000.00	$720,000.00
	Tax Payable	$33,147.00.00	$165,735.00	$33,147.00	$198.882.00
	Rental Income	$20,000.00	$100,000.00	$20,000.00	$120,000.00
	Capital Gains Income (@ 50%)	-	-	$25,000.00	$25,000.00
Simple Will	Total Income for Mary	$140,000.00	$700,000.00	$165,000.00	$865,000.00
	Total Tax payable by Mary	**$40,947.00**	**$204,735.00**	**$50,697.00**	**$255,432.00**
	Extra Tax Paid	**$7,800.00**	**$39,000.00**	**$17,550.00**	**$56,550.00**
Will with Full Discretionary Trust Provisions	Mary's Assessable Income	$120,000.00	$600,000.00	$120,000.00	$720,000.00
	Taxable Income: Fred & Sam	$10,000.00	$50,000.00	$22,500.00	$72,500.00
	Tax for Mary	$33,147.00	$165,735.00	$33,147.00	$198.882.00
	Tax for Fred & Sam	$0.00	$0.00	$903.00	$903.00
	Total Tax Paid	**$33,147.00**	**$165,735.00**	**$33,147.00**	**$200,688.00**
	Tax Savings	**$7,800.00**	**$39,000.00**	**$17,550.00**	**$54,744.00**

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Example 2 – ESTATE OF $990,000: SAVINGS OF OVER $100,000 AFTER 6 YEARS!

John, a widower, passed away leaving Rita, his only child, as the main beneficiary under his Will.

John's major asset was his super worth $990,000.

Rita is married to Richard, with 2 minor children: Julie and Kate.

Rita invested the superannuation proceeds for 6 years and then sold the investment, to reinvest. For 6 years, the net annual profit from the investment was $39,600, a 4% p.a. return on investment.

Rita earned a salary of $100,000 p.a. during the last 6 years but her husband, Richard, did not work during that time.

The investment increased in value by $70,000 during that period.

If John had had a Will ***without*** full Testamentary Discretionary Trust provisions, similarly to example 1, Rita would have:

(a) earned an extra $39,600 p.a.;

(b) paid an extra $15,444.00 p.a. in tax for the first 5 years; and

(c) paid an extra $25,194.00 in tax in the 6th year, because of the sale of the investment.

However, John did have a Will ***with*** full Testamentary Discretionary Trust provisions.

He left his entire estate to his Executor to hold for Rita on the terms of those trust provision:

(a) the testamentary trust makes a profit of $60,000 p.a. in the first 5 years;

(b) that profit can be distributed between Rita, Richard and their 2 minor children; and

(c) the minor children are also taxed as adults.

Because John left the superannuation proceeds to Rita on Testamentary Discretionary Trust, Rita was able to distribute the trust's income, including income from the $70,000 capital gain, to the general beneficiaries of the trust:

(a) Richard, who is not earning any other income; and

(b) their minor children , who are taxed as adults, rather than at the higher rate normally paid by minors,

and the family only paid a total of only **$1,400** in tax, for a saving of **$102,114.00**. The calculations are shown in the table below.

Again, the benefits are greater if the estate assets are invested more favourably.

		Years 1 – 5 (each year)	**Total for the first 5 years**	**Year 6**	**Total for 6 Years**
Simple Will	Rita's Assessable Income	$100,000.00	$500,000.00	$100,000.00	$600,000.00
	Tax Payable	$25,347.00	126,735.00	$25,347.00	152,082.00
	Rental Income	$39,600.00	$198,000.00	$39,600.00	$237,600.00
	Assessable Income from the Capital Gain (@ 50%)	-	-	$35,000	$35,000.00
	Total Income for Rita	$139,600.00	$698,000.00	$174,600.00	$872,600.00
	Total Tax payable by Rita	**$40,791.00**	**$203,955.00**	**$54,441.00**	**$258,396.00**
	Extra Tax Paid	**$7,800.00**	**$39,000.00**	**$7,800.00**	**$46,800.00**
Will with Full Discretionary Trust Provisions	Rita's Assessable Income	$100,000.00	$500,000.00	$100,000.00	$600,000.00
	Taxable Income for Each of Rita's Husband and Children	$13,200.00	$66,000.00	$24,866.67	$90,866.67
	Tax for Rita	$25,347.00	$126,735.00	$25,347.00	$152,082.00
	Tax for Each of Rita's Husband and Children	$0	$0	$1,400.00	$1,400.00
	Total Tax Paid	**$25,347.00**	**$126,735.00**	**$29,547.00**	**$156,282.00**
Rita's Tax Savings		**$15,444.00**	**$77,220.00**	**$24,894.00**	**$102,114.00**