

New 'death tax' on family trusts to squeeze inheritances for thousands

Australia has no death tax, yet the 2026 budget proposes measures that estate planning lawyers say will achieve much the same result for ordinary grieving families, writes Noel Whittaker.

Noel Whittaker

Don't miss out on the headlines from Noel Whittaker. Followed categories will be added to My News.

Death tax is the hot topic of the moment, but it means different things depending on where you live.

In Britain, for example, estates above £325,000 face inheritance tax of 40 per cent, subject to various concessions and exemptions.

Australia does not have death duties, estate taxes or inheritance taxes. But for years our tax system has achieved much the same result by other means, and the 2026 budget proposes another layer. None of these measures is a death tax in the traditional sense. Collectively, however, they take an ever-larger slice of what people leave behind.

The best-known example is superannuation left to a non-dependent. Leave your super to someone outside the ATO's definition of a dependent and death benefits tax of up to 15 per cent applies to the taxable component, rising to 30 per cent on life insurance proceeds held inside super. These taxes are deducted before payment, so families often only discover them when administering the estate.

The budget also proposes changes targeting testamentary trusts. A testamentary trust is created under your will, so an inheritance is managed for a beneficiary rather than paid directly to them. Most families should consider one, not for tax reasons but for protection against divorce, creditors, poor decisions, family disputes, or an eighteen-year-old who is not ready to inherit outright.

A testamentary trust also allows the trustee to distribute income earned on an inheritance among beneficiaries on lower tax rates. That can sound like clever tax planning, but look at who often benefits: a child still at school, a young adult not yet earning, or a relative living with a disability.



Labor's hidden death tax will hit families at their most vulnerable.

Unlike a family trust created during life, a testamentary trust allows income distributed to a child under 18 to be taxed at ordinary adult rates, with up to \$22,000 a year effectively tax-free rather than at punitive rates that can reach 47 per cent. For a child whose parent has died, that seems entirely appropriate.

The budget proposes to change that. From July 1, 2028, income distributed from a testamentary trust would be taxed at a minimum of 30 per cent, regardless of the recipient's personal tax rate. Presented as a crackdown on income splitting, the measure will mainly affect beneficiaries whose tax rate would otherwise be below 30 per cent. Many advisers expected a broad exemption for children, but current indications are that relief will be limited to "vulnerable" minors.

The law has always distinguished between trusts created during life and those created on death. A family trust may be used for tax planning. A testamentary trust is different. It is created because someone has died, and another person must exercise the judgment they no longer can. The concession recognises that role. The proposed 30 per cent minimum tax does not.

Estate planning lawyer Rachael Rofe, founder of Rofe + Co, is blunt about who will be affected.

"These are not necessarily the wealthy," she says. "They are students, spouses caring for children, young adults just starting out, and children not yet earning. They are the very people the estate plan was designed to protect."

The government has suggested fixed testamentary trusts as an alternative, exempting them from the proposed new tax. But a fixed trust requires you to decide, on the day you sign your will, exactly how much each beneficiary is entitled to receive and in what proportions for the life of the trust.

In effect, you are being asked to predict their circumstances decades into the future. You cannot know which beneficiary may end up in a difficult marriage, run into financial trouble, develop a dependency, or simply need more protection than another. A fixed entitlement is also there for all to see, including lawyers, creditors and former spouses, making it more vulnerable to the very risks the trust was designed to guard against.

A discretionary trustee can respond to events as they unfold, delaying or redirecting distributions to help keep an inheritance beyond the reach of beneficiaries who cannot manage it themselves, and others who would try to claim it. That flexibility is the whole point of a testamentary trust, and it is precisely what a fixed trust removes. The proposed legislation is drafted with a narrow focus on tax collection and little apparent consideration of the broader consequences for ordinary families.

None of this makes discretionary testamentary trusts redundant. They remain valuable for asset protection, control and flexibility, and the proposal touches none of that. So the smart move is to build the option into your will now. That does not mean your family must use it. your executor can choose whether to use it based on the law and each beneficiary's circumstances at the time of inheritance.

What you cannot do is add one after death. Put it in, and your family keeps the option open. Leave it out, and the door is closed.

The proposed testamentary trust changes are not the only example of tax policy spilling into estate planning.

The dreaded Division 296 is another example. The tax on super earnings increases once balances exceed \$3 million and rises again for balances above \$10 million. The catch is where the bill lands: if your super passes directly to one person under a binding nomination but the Division 296 liability falls to the estate, the person who gets the super may not be the one who pays the tax. The money can go one way, and the tax bill another. That is not just a tax problem: it is a family fight waiting to happen.

With all the moving parts, Rofe's advice is to get the order right.

“Good estate planning starts with the goals: getting the right assets to the right people, in the right structure, with the least chance of a fight. The will, super nominations, tax consequences and family dynamics must be considered together. That is where the real planning happens,” she says.

We do not call any of this a death duty, but the effect can be much the same. Some budget measures, including the proposed CGT and negative gearing changes, are still before parliament, and the final shape of the testamentary trust rules remains uncertain. But estate planning does not have time to wait.

Whatever happens to the tax rules, the will, super nominations and structures that protect an inheritance can all be reviewed now. The job is to keep calm and review the plan while you can. Once you’re gone, your family has to live with whatever you left behind.

More Coverage



[The capital gains tax strategy that could save you thousands](#)



[‘Crushing blow’: The aged care crisis Australia chose not to fix](#)