

Trust earnings taxed at highest rate

Money

I am interested in testamentary trusts and understand that, under the proposed changes, income distributed from a discretionary testamentary trust will be subject to a minimum tax rate of 30 per cent, regardless of the beneficiary's personal tax rate.

What is unclear to me is how income retained within the trust will be treated. My understanding is that, under the current rules, undistributed trust income is generally taxed at the top marginal rate plus the Medicare levy. Will retained income in a testamentary trust continue to be taxed this way under the proposed changes, or are different rules expected to apply?

The short answer is yes. Income retained in a trust is generally taxed at the top marginal rate, currently 47 per cent including the Medicare levy. That applies to both family trusts and testamentary trusts, the latter being trusts created under a will.

Estate planning solicitor Rachael Rofe, who has met with Treasury on this issue, says the proposed 30 per cent minimum tax applies only to income dis-

tributed to beneficiaries, not income retained in the trust. Retained income would continue to be taxed at 47 per cent.

If the proposed changes proceed and income is distributed to an individual beneficiary, the trustee would pay tax at 30 per cent and the beneficiary would receive a credit for the tax already paid. If their personal tax rate is higher than 30 per cent, they would pay the difference. If it is lower, there would be no refund.

That is the curious part. Although the measure has been described as targeting wealthy Australians, the additional tax burden falls mainly on low-income earners whose marginal tax rate is below 30 per cent. Company beneficiaries are potentially worse off again, as they would receive no credit for the 30 per cent tax already paid by the trustee.

It's early days yet, as the legislation has not yet been released. Regardless of any proposed tax changes, testamentary trusts remain an important estate planning tool for protecting inheritances from relationship breakdown, bankruptcy and creditors.

You have advised readers who intend to keep assets bey-

ond June 30, 2027, to obtain a professional valuation around that date. I've already entered a reminder in my Google Calendar, but I have two questions.

First, what does the ATO regard as a professional valuation? Would a detailed valuation from a real estate agent be acceptable, or would I need to engage a licensed valuer? Second, how close to June 30 should the valuation be obtained? Is there an acceptable timeframe before or after that date?

This is an area where the Tax Office largely relies on self-assessment, so you should ultimately be guided by your accountant. My understanding is that, for most residential properties, a detailed written appraisal from an experienced real estate agent should be sufficient, provided it is well documented and capable of being substantiated if ever questioned by the ATO.

The valuation should reflect the property's market value as at June 30, 2027. In practice, there is no need to rush out and obtain it on that exact day. Provided the valuation is prepared shortly after then and clearly states the market value

at that date, it should generally achieve the objective.

One additional point: keep copies of the valuation, supporting sales evidence and any correspondence. Records have a habit of disappearing over time, and good documentation could prove invaluable years later if the property is eventually sold and the ATO asks how the value was determined. Having said that, don't panic, as registered valuers can provide historical valuations.

I bought a unit off the plan about five years ago and moved into it when construction was completed in 2023. It has been my principal place of residence ever since, but I am now considering moving out and renting it as an investment property. I still owe about \$600,000 on the mortgage.

How would the proposed Budget changes to capital gains tax affect me if I convert the unit to an investment property? Would the outcome be different if I move out and start renting it before June 30, 2027, rather than after that date? What issues should I be considering before making this decision?

The negative gearing restrictions announced in the Budget apply only to properties purchased after Budget night - May 12, 2026.

As you acquired this property before that date, those rules should not affect you. When the unit becomes a rental property, you should continue to be able to claim all deductible ex-

penses, including interest on the mortgage, against your taxable income. Because the property has been your principal place of residence since you acquired it, you may also be able to take advantage of the six-year absence rule. This allows you to move out, rent the property, and still treat it as your principal place of residence for capital gains tax purposes for up to six years, provided you do not nominate another property as your principal residence during that period.

That gives you a valuable opportunity. For the next six years, you could own an asset that is not only eligible for negative gearing benefits but may also be sold free of capital gains tax. In effect, you would have an investment property that continues to enjoy principal residence CGT treatment, provided the relevant conditions are met.

We have a portfolio of shares that we would like to leave equally to our two children. What is the best way to structure this, and are there any strategies that could help minimise unnecessary capital gains tax for them in the future?

Your first step should be to have a meaningful discussion with your children to find out whether they would prefer to inherit shares or cash. The answer may be different for each child, depending on their individual circumstances and financial goals.

As you move into retirement and your taxable income falls, it

may be possible to progressively sell some shares and realise capital gains at a lower tax cost. The proceeds could then be left as cash to the child who prefers cash rather than shares.

If both children are happy to receive shares, remember that death does not trigger capital gains tax. Instead, the tax liability generally passes to the beneficiaries. They will only pay CGT if and when they decide to sell the shares, and the amount of tax payable will depend on their personal circumstances at that time.

Often, simply leaving the shares to them may be the most straightforward and tax-effective strategy, particularly if they intend to hold the investments for the long term.

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Money inside a trust is still going to incur the highest tax rate. Illustration: Simon Letch