

2026 taxation changes to testamentary trusts: what NSW families need to know

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The 2026 Federal Budget announced significant changes to the taxation of Trusts in Australia and NSW, where all income in a discretionary trust will be subject to a base tax of 30 per cent. As at 18 June 2026 the Federal Government clarified that certain types of discretionary testamentary trusts will be exempt from the proposed 30 per cent minimum tax on other discretionary trusts.

This clarification has significant impacts for estate planning, and families who intend to use testamentary trusts in their Will as part of their succession planning. For many people preparing or updating their Will, testamentary trusts remain one of the most effective estate planning tools available.

What is a testamentary trust?

A Testamentary Trust is a trust established under a Will that only comes into existence upon the death of the Will maker.

This is distinguished from a typical family trust or inter vivos discretionary trust, which are created by someone during their lifetime.

Rather than assets passing directly to beneficiaries, assets are held within a trust and managed by a trustee selected by the Will maker for the benefit of one or more beneficiaries.

Testamentary Trusts are commonly used to:

- Protect assets from relationship breakdowns and creditors.

- Provide flexibility in distributing income and capital.
- Protect vulnerable beneficiaries or those who may be financially inexperienced.
- Assist with tax planning across multiple generations.
- Preserve family wealth.

They remain important estate planning tools.

What did the 2026 federal budget propose for discretionary trusts?

The Federal Government announced a proposal to introduce a 30 per cent minimum tax on income generated from assets owned in discretionary trusts from 1 July 2028.

Under the proposal, trustees of discretionary trusts would be required to pay a minimum rate of tax of 30 per cent on taxable income. Beneficiaries would generally receive tax credits for tax already paid by the trustee, but would not receive a refund if their marginal tax rate was less than 30 per cent.

The announcement did not confirm whether the changes would apply to all trusts, or whether discretionary testamentary trusts would be different.

The Government's June 2026 clarification

As at 18 June 2026, the Government clarified in a further announcement that discretionary testamentary trusts arising from deceased estates will not be subject to the proposed 30 per cent minimum tax, provided the trust is for ‘genuine testamentary purposes’.

This means that distributions to individuals and charities from testamentary trusts established under a Will should continue to receive the taxation treatment that has previously applied. Distributions from testamentary trusts to companies or other trusts may still be subject to the proposed minimum 30 per cent tax.

The exemption recognises that testamentary trusts are fundamentally different from family discretionary trusts established during a person's lifetime. They are generally used for succession planning, asset protection and family wealth preservation rather than tax minimisation.

Why testamentary trusts matter

One of the most significant benefits of a testamentary trust is the unique taxation treatment available to minor beneficiaries.

Ordinarily, children receiving income that they have not earned themselves, such as trust distributions, are subject to very high tax rates which are designed to discourage income splitting.

However, income derived from assets inherited through a qualifying testamentary trust is generally treated as "excepted trust income". This means children can access ordinary adult marginal tax rates rather than the higher rates.

For families with children or grandchildren, this can produce substantial long term tax savings.

Asset protection benefits of testamentary trusts remain unchanged

The recent Budget debate has highlighted that taxation is only one reason people establish testamentary trusts.

Many clients are more concerned with protecting inheritances than minimising tax.

A properly drafted testamentary trust can assist in protecting inherited assets from:

- Bankruptcy;
- Risks experienced by business owners or directors of a company;
- Family law separations and disputes;
- claims from creditors; and
- Financial mismanagement.

This is often particularly important where beneficiaries are business owners, professionals or directors of companies exposed to litigation risks, or individuals in unstable family relationships.

The asset protection benefits of testamentary trusts still remained relevant irrespective of the Budget announcements.

What should families do now?

Although the Government has announced that certain discretionary testamentary trusts will be exempt from some of the proposed trust tax measures, as at June 2026 the actual legislation does not yet exist and has not yet been drafted.

Depending on the legislation once drafted, it is possible that the terms of Wills that include testamentary trusts will require variation by the Will maker to narrow the purpose of the trust to ‘genuine testamentary purposes’. What constitutes ‘genuine testamentary purposes’ is not yet understood, but it may require the removal of certain classes of beneficiaries (such as companies and other trusts).

Tax law can change and the details of the reforms will continue to evolve before commencement.

For this reason, the current expectations could be subject to change. For persons considering their estate planning, it is important to consider:

- Whether your current Will appropriately addresses your intentions.
- Whether your beneficiaries would benefit from asset protection.
- Whether introducing the flexibility for your beneficiaries to choose whether they use a trust would be beneficial.
- Whether your estate planning arrangements remain suitable for your family circumstances.
- Whether your or your beneficiary's business, investment or family structure creates additional succession planning risks.

Should you still include a testamentary trust in your will?

Testamentary trusts continue to offer significant advantages in relation to tax planning, asset protection and flexibility.

Every family is different, however, and the suitability of a testamentary trust depends on your assets, beneficiaries and long-term objectives.

How E&A Lawyers can help

At E&A Lawyers, we are highly experienced and regularly advise individuals and families throughout the Northern Beaches and New South Wales on testamentary trust wills, estate planning and succession strategies.

If you are reviewing your Will following the 2026 Federal Budget, or would like to understand whether a testamentary trust is appropriate for your circumstances, our team can provide tailored advice to help ensure your estate plan remains effective, tax conscious and aligned with your family's needs.

Contacting E&A Lawyers

For more information or to arrange a consultation with a lawyer, you can call or email us.

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Note: This article is general information only and does not constitute legal or taxation advice. Tax laws and proposed reforms may change. You should obtain professional advice regarding your specific circumstances before making decisions about your estate planning arrangements.

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