New law clarifies minor tax testamentary trust income

A minor pays tax at adult marginal rates on income received from a testamentary trust. The new law seeks to stop non-estate assets making their way into those trusts in order to increase that income and access those marginal rates.

In the 2018-19 Budget, the Government announced that it will implement an integrity measure to improve the taxation of testamentary trusts.

Currently, income received by minors from testamentary trusts is taxed at normal adult rates rather than the higher tax rates that generally apply to minors. However, some taxpayers are able to inappropriately obtain the benefit of this lower tax rate by injecting assets unrelated to the deceased estate into the testamentary trust.

The new law will clarify that minors will be taxed at adult marginal tax rates only in respect of income a testamentary trust generates from assets of the deceased estate, or the proceeds of the disposal or investment of these assets.

Division 6AA and section 13 of the Income Tax Rates Act 1986 impose higher tax rates on minors1 as a specific tax integrity measure to deny most minors a tax advantage from receiving income that might flow from income-splitting arrangements. In broad terms, the rules discourage the diversion of income from adults to minors.

One exception to Division 6AA and section 13 imposing higher tax rates on minors is assessable income resulting from an entitlement to income from a testamentary trust. This income is a type of 'excepted trust income' that is generally taxed at ordinary rates.

The existing law does not specify that the assessable income of the testamentary trust be derived from assets of the deceased estate (or assets representing assets of the deceased estate). As a result, assets unrelated to a deceased estate that are injected into a testamentary trust may, subject to anti-avoidance rules, generate excepted trust income that is not subject to the higher tax rates on minors.

This allows some taxpayers to inappropriately obtain the benefit of concessional tax treatment.

The proposed law will clarify that excepted trust income of the testamentary trust must be derived from assets transferred to the testamentary trust from the deceased estate or from the accumulation of such income.

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