Opinion

Family trust tax changes come with one huge risk

The case for changes to family trust taxes is strong, especially if they result in simplifying things. But there's a big catch.

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Last week, Treasurer Jim Chalmers opened the door to tax reform, promising an overhaul of Australia's tax system. And family trusts are squarely in the picture.

Treasury is expected to propose higher taxes on trusts to help fund the government's income tax cuts [https://www.afr.com/policy/tax-and-super/family-trusts-and-electric-vehicles-in-tax-review-spotlight-20250619-p5m8q0]. The rationale is straightforward: about 1.7 million people received close to $60 billion from trusts last year. Treasury sees this as generous and a growing point of revenue leakage.

Family trust tax changes are on the agenda for Treasurer Jim Chalmers. **Tim Beor**

But the real opportunity is more nuanced. Reforming the tax treatment of trusts to simplify an increasingly complex system – rather than just to raise revenue – would be a worthwhile outcome.

Go too far, however, and we risk pushing investment, talent, and wealth offshore.

How are family trusts currently taxed and used?

Let's start with the basics. A trust arises where a party (the trustee) holds assets for the benefit of others (the beneficiaries).

For tax purposes, trusts are generally treated as flow-through vehicles: income is taxed in the hands of the beneficiaries at their marginal tax rate, not the trust itself.

If the trustee is taxed, it usually means something has gone wrong – and the default tax rate is a punitive 47 per cent.

That's why calls to "increase tax on family trusts" are misleading. What's really under consideration is increasing the tax on the income flowing through trusts to beneficiaries.

There are almost 1 million family trusts in Australia, and they are used by families, professionals, small businesses and farmers for asset protection, succession planning and income streaming.

While some are used aggressively, many are simply a practical way of navigating a system riddled with structural distortions.

Those distortions stem from our lopsided tax rate structure: individuals are taxed at up to 47 per cent, companies at up to 30 per cent, and discounted capital gains at a maximum effective rate of 23.5 per cent. Tax minimisation flourishes in the gaps.

Family trusts are discretionary trusts that offer flexibility to stream different types of income and gains to different beneficiaries.

Capital gains, for example, are typically distributed to adult individuals (to access the CGT discount of 50 per cent), while dividend or interest income might be directed to a company within the family group to access the corporate rate.

This isn't exotic or aggressive tax planning – it's how much of the country's private wealth operates.

What might genuine family trust tax reform look like?

One option Treasury might be considering is to apply a flat tax rate to trust distributions, say 25 or 30 per cent, as a way to neutralise income-splitting benefits and reduce complexity. It's not a new idea.

Labor's ill-fated 2019 election platform included a 30 per cent minimum tax on distributions to individuals from discretionary trusts. While carve-outs were proposed for farms and charities, key terms were undefined, which added complexity to the landscape rather than resolving it.

Another suggestion is to tax trusts like companies. In fact, our tax laws already contain a species of trust taxed as a company (although in practice, most trusts are structured in such a way as to prevent this).

The Howard government floated taxing trusts like companies in 1998, and the Ralph Review supported it in 1999. However, draft legislation was shelved in 2002 after the Board of Taxation warned of technical and practical problems.

The Henry Review revisited the idea in 2010, but stopped short of endorsing it, noting that it would be poorly targeted and could disadvantage trusts not used for income splitting.

Still, the idea deserves fresh attention. Fifteen years on, trust tax laws have become so complex that families now need an army of lawyers and accountants just to attempt compliance, and even then, shifting Australian Taxation Office interpretations [https://www.afr.com/wealth/tax/1b-family-trusts-dispute-may-be-headed-to-the-high-court-20250319-p5lkoq] make certainty elusive.

Taxing trusts as companies – at a flat 25 or 30 per cent tax rate – would narrow arbitrage opportunities and, more importantly, offer the chance to simplify vast swathes of trust tax law.

The income distribution rules, the trust loss provisions, the family trust election regime [https://www.afr.com/policy/tax-and-super/family-trust-blitz-threatens-financial-ruin-as-ato-goes-back-decades-20250429-p5lv2p], the private company deemed dividend rules in Division 7A and other trust anti-avoidance rules could all be radically streamlined, if not scrapped entirely.

That alone might be worth the price of reform. The compliance burden of family trust taxation is immense – not just for advisers, but for the ATO, the courts, and the families caught in the middle, even when they are trying to do the right thing.

Get it right or risk the flight of capital

But here's the catch: no trust reform will succeed unless the top personal tax rate is also reduced.

As long as the 47 per cent top marginal rate remains so far above company and capital gains rates, new anti-avoidance rules will simply follow the old ones.

Flattening the difference between those tax rates is the only way to truly defuse the incentive for income streaming and entity arbitrage.

And whatever it does, the government must tread carefully. Wealthy families are already rattled. The proposed super tax on unrealised gains has many looking offshore [https://www.afr.com/policy/tax-and-super/ato-puts-wealthy-families-on-notice-over-3m-super-tax-20250530-p5m3ha].

Australia's trust tax rules are overdue for simplification, and there is a real opportunity here. But reform should be about integrity and coherence, not just revenue or headlines.

Push too hard on trusts, and we risk an exodus of capital – and people – to more favourable tax regimes like Singapore, Dubai or Italy, where the rules are simpler and the welcome warmer.

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