Wealth Investing Federal budget

How Labor is killing family trusts – starting with the bucket company

A calculated tweak in the budget papers is set to push the effective tax rate on bucket companies to a punishing 51 per cent, higher than the top marginal rate.

The bucket company will become highly tax inefficient from July 1, 2028. **Bethany Rae**

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Buried in the budget papers is a revelation that Labor plans to impose a minimum effective tax rate of 51 per cent on distributions from discretionary trusts to so-called bucket companies.

The move is aimed squarely at the hundreds of thousands of people who use such strategies to split income with their families – to a non-working spouse or university-age child, for example – to reduce tax. The budget papers argue that it is unfair because it is a strategy not available to ordinary income earners.

The tax, which can end up being as high as 63 per cent in some circumstances, effectively destroys the popular structure by taxing it out of existence and ends a major reason to have a discretionary trust, many of which are family trusts.

"The bucket company is dead," estate planning lawyer Rachael Rofe says, and users of such trusts will have a three-year "rollover relief" window starting July 1, 2027, to restructure.

Paul Ashworth, the managing partner of wealth advice business Cameron Harrison, shares that view: "The bucket company is being abolished by stealth," he says. In fact, Ashworth believes the ramifications are even more far-reaching, with the 51 per cent rate representing "punishment pricing" designed to neuter trust use more broadly.

With Labor's disdain for trusts well known, he says the party's broader plot is to force people to move their wealth out of trusts and into companies, where there are greater requirements for reporting and transparency.

Memes have started popping up on social media for those with an interest in these things, depicting the horror scenario for bucket companies.

"It is herding family enterprises out of trust deeds and into the Corporations Act, where ASIC, director duties and public reporting do the surveillance that Division 7A and the Bendel decision no longer reliably deliver," Ashworth says.

"Eighty thousand bucket companies, $4.5 billion over five years, and a generation of family businesses pushed under ASIC's gaze – all while Canberra insists it is merely closing a loophole salary earners cannot use."

Trust arrangements are hideously complex, and there's a lot to unpack in Ashworth's comments. Let's start by explaining what a bucket company is.

Also known as a corporate beneficiary, a bucket company "catches" income that is not distributed to human beneficiaries of a trust.

It might be the case that all trust beneficiaries (usually members of an extended family group) are on marginal tax rates of 47 per cent (the top rate), so it is more beneficial to stream any leftover income in a given year to the bucket company.

Cameron Harrison managing partner Paul Ashworth says the budget measure is an example of "punishment pricing". **Louise Kennerley**

Not only is that profit taxed comparatively lightly at the corporate rate of 30 per cent, but the money also remains inside the family group to be re-invested or saved.

"In strong years, this caps the family's overall tax rate well below the top marginal rate that would apply if all income flowed personally," says Scott Quinlan, the principal of Solace Financial.

"In weaker years, the family draws franked dividends from the accumulated company reserves to supplement income, paying tax at their marginal rate net of the 30 per cent franking credit. The structure smooths income, builds a business reserve, provides asset protection and produces a steady tax outcome."

The flexibility that the trust-and-bucket company structure gives to defer tax has been a key attraction for them, but it has also drawn criticism that it gives unfair advantages to richer people – a point the government made explicit in the budget papers on Tuesday.

Double taxation might just be a nasty byproduct of budget trust changes

"This gives rise to fairness concerns as distributions are often made between family members and other beneficiaries to take advantage of lower tax rates," the government said in the budget papers.

But the budget measures mean distributions will now be double taxed – first at the new trust floor of 30 per cent and then at the 30 per cent corporate tax rate.

The budget papers say the change is necessary to prevent people from bypassing the 30 per cent minimum tax via refundable credits.

So while individual trust beneficiaries will get a non-refundable credit for that 30 per cent by the trust, any money paid to a company by a discretionary trust won't get any credit, refundable or not, from distributions from a trust.

Todd Want, tax services partner at William Buck, says by not allowing bucket companies to get any credit for the tax paid by a trust, the government is probably trying to stop the possibility of that bucket company "paying" a credit back to a trust beneficiary on a lower tax rate than 30 per cent and therefore bypassing the minimum 30 per cent tax rate.

"They seem to have gone with a pretty solid stick to say: 'We do not want that happening. And in fact, we're going to be pretty brutal to try and make it very unattractive to distribute to a corporate beneficiary ... by just completely denying that credit'," he said.

"It's deliberate. It's a very calculated reference to non-refundable credits being available to beneficiaries other than corporate beneficiaries," said Clint Harding, the head of Arnold Bloch Leibler's Sydney taxation practice. "You either infer from that the corporate beneficiaries will get a refundable credit, which is clearly not going to happen, or they get no credit."

To facilitate what is expected to be a mass migration of wealth, family groups will be able to wind up their discretionary trusts and move assets into different ownership structures without triggering tax penalties for three years from mid-2027.

Plus, the government has announced exemptions for "fixed" trusts, superannuation funds and farmers.

Returning to the detail of Ashworth's comments, Division 7A is an anti-avoidance provision designed to stop business owners from accessing company profits tax-free. The "Bendel decision" relates to a High Court case involving questions over whether "unpaid present entitlements" – income a trust owes to a bucket company but hasn't yet paid – should be treated as a loan. The budget proposal imposes a 30 per cent tax floor regardless of the court's final word.

To understand how much more tax will be paid on $100 of earnings distributed from a trust, let's look at the hypothetical case of Keith, his K Trust family trust and Keithly Co, his hypothetical bucket company.

Currently, if K Trust earns $100 and distributes it to Keithly Co, Keithly pays 30 per cent corporate tax, leaving $70 in earnings. Normally, it would retain those earnings, but say it paid a franked dividend to Keith of $70. In this case, Keith would pay "top-up" tax of $17 because he is on the top marginal rate. That means the total tax on that $100 in earnings would be $47 – the same as if the money were paid to Keith himself.

But come July 1, 2028, the government's tax rate will climb substantially.

When K Trust earns $100, it will then only pay $70 to Keithly Co. Keithly Co will pay its 30 per cent tax on that income, which amounts to $21. So that $100 will have $51 in tax paid on it, not $30 as it is now.

"The bucket company is dead," estate lawyer Rachael Rofe.

"An effective rate of roughly 51 per cent before personal tax sits above the top personal marginal rate of nearly every developed nation, surpassed only by Finland, Japan and Denmark," Quinlan said.

"It is a punishing outcome for what has been one of the most widely used legitimate tax planning structures in the country. The government has effectively rendered the strategy self-defeating without needing to legislate against it directly."

But it gets even worse.

Budget 2026 changes mean trust payments could be taxed at 63pc in some cases

If Keithly Co then pays a franked dividend to Keith of $51. Keith will be liable for top-up tax of $12.39. The total tax paid on that $100 will now be $63.39.

That means the tax rate under such a scenario will be 63 per cent. Australia has not had a top marginal tax rate that high since the Fraser government cut it from 65 per cent in the late 1970s.

Taxing income twice in this way would contradict long-established conventions. Australia even has more than 40 treaties with countries to avoid double taxation – the taxing of the same income twice for residents with foreign income or foreign residents with Australian income.

"For all intents and purposes, a bucket company is just no longer tax effective ... if anything, it is probably one of the most tax ineffective beneficiaries now to receive a distribution from a trust," Rofe says.

Jeff Garrett, legal practice director at Attwood Marshall Lawyers, and other lawyers, doubt that the government has thought through the full ramifications of the change.

"Why would you muck around with something as fundamental as that?" asks Jeff Garrett legal practice director at Attwood Marshall Lawyers. "Everyone knows the rules. Everyone knows this is how we do it. If you change all of that unexpectedly, it puts a dent in people's confidence, and it's not a good look," said Garrett.

"Trusts have been in place for a long time, he said, and people have embraced that and use it in their overall structuring and their estate planning. Once you start messing with that, it could also have ramifications for estate planning. There might be a few unexpected outcomes that the tax boffins may not have really thought about."

Even before the prospect of double taxation on family trust distributions emerged, Natalie Claughton, the tax director at Stannards was already concerned about the lack of consultation on the proposal for a minimum 30 per cent tax rate on trusts.

"This is a significant concern given the complexity of trusts and the impact it will have on many taxpayers. It will also potentially make the system more complex than it is currently," Claughton said.

"Any trust reform will need to carefully consider the impact on rules for specific industries to ensure it doesn't penalise these taxpayers."

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