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A new death tax to start the year (TD 2026/D1)

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The Tax Office has released Draft TD 2026/D1 - Income tax: deceased estates - meaning of 'right to occupy the dwelling under the deceased's will' in item 2(b) of column 3 of the table in subsection 118-195(1) of the Income Tax Assessment Act 1997 (reported at 2026 WTB 4 [46]).

In the main, TD 2026/D1 is a helpful summary of the key rules in this area.

However, at least in relation to the approach concerning testamentary trusts (TTs), TD 2026/D1 is arguably misguided.

Relevantly, in relation to TTs, the Tax Office states as follows:

Deceased estate and testamentary trust

31. For the purposes of item 2(b), the reference to the term 'will' is, properly construed, a reference to the deceased's will only and does not extend to a testamentary trust.

32. In other words, the deceased's will is considered to be separate and distinct from a testamentary trust.[14] Broadly, this is because:

☐ a deceased estate is created upon the death of the deceased, whereas a testamentary trust arises only after the deceased estate has been administered

☐ the role of a trustee of a testamentary trust is to hold the trust property, carry out the terms of the trust deed and deal with the beneficiaries' proprietary interests, whereas the role of an executor is to preserve the deceased's assets, pay the deceased's debts and administer the estate.

33. Accordingly, rights granted under a testamentary trust deed are not rights granted under the deceased's will for the purposes of item 2(b).

34. Therefore, an individual will not have a right to occupy the dwelling under the deceased's will for the purposes of item 2(b) in situations where:

☐ an individual is specifically named in a testamentary trust deed as having a right to occupy the dwelling, or

☐ the testamentary trust deed provides the trustee of the deceased estate with a discretion to grant a right to occupy the dwelling to any individual.

Observations in relation to testamentary trusts

In relation to the abovementioned conclusions concerning TTs, Draft TD 2026/D1 arguably:



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1. Overlooks that a TT is not a separate instrument, but a legal structure created solely by the will. All powers, rights and entitlements under a TT originate in the will itself, meaning any right granted through the TT is can only be a right conferred under the will.
2. Fails to recognise that there is no basis on which a TT can be established unless it is 'under the deceased's will', hence the extensive additional legislative provisions that, in limited circumstances, provide limited access to the excepted trust income rules for inter vivos trusts. Clearly there is no basis on which these post death inter vivos trusts can satisfy any aspect of subsection 118-195.
3. Assumes a conceptual divide between the estate administration phase and trust administration phase but does not address that this distinction is functional only. The will remains the governing instrument throughout, and the administrative transition from executor to trustee merely reflects a change in fiduciary role, not a change in the legal source of authority.
4. Does not engage with the legislative purpose of Item 2(b), which is to give effect to rights arising from the deceased's testamentary intentions. TTs are a primary vehicle for expressing those intentions, and excluding rights arising through them would create artificial distinctions inconsistent with a purposive interpretation.
5. In this regard, there is a failure to interpret the legislation correctly, as TTs are clearly only ever established 'under the deceased's will'. Therefore, if it was intended to prevent TTs from accessing subsection 118-195, the legislation would need to either:
 - ☐ Specifically list TTs as being unable to access the concession, despite being established 'under the deceased's will'; or
 - ☐ Specifically limit the concession to life estates and rights to occupy and no other arrangements established 'under the deceased's will'.
6. Overlooks the long standing judicial approach that interprets TT provisions using principles applicable to wills. Courts consistently resolve ambiguities in TTs by reference to testamentary intention, confirming that these trusts are treated as integral components of the will rather than freestanding instruments.
7. Assumes a separation between rights granted under the will and rights arising under the TT, without recognising that trustee discretions and beneficiary entitlements in a TT are sourced solely from the will. Even where a TT trustee exercises a discretionary power, the legal authority for that exercise is still conferred by the will.
8. Fails to recognise that excluding rights arising through TTs would treat estates with identical testamentary intent differently solely because of the structural form chosen. This creates arbitrary and unfair outcomes that penalise benign, common and conservative estate planning practices.



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9. Does not address that contemporary wills routinely incorporate TTs as part of a single, coherent holistic estate planning structure. The TT is embedded within, and operates as part of, the testamentary scheme set out in the will. Treating it as separate mischaracterises its function and the way such instruments are drafted. This aspect is particularly egregious in the context that there is no tax mischief achieved by granting a right to occupy via a TT; rather in practice the dominant drivers for the approach are exclusively estate planning and asset protection related, such as:

- ☐ Blended families;
- ☐ At risk individuals (mental or physical incapacity, substance abuse, gambling addictions, business owners);
- ☐ Orphaned children;
- ☐ Serial monogamists;
- ☐ Grandparents providing for grandchildren.

10. Does not provide guidance on a right to occupy granted to a specifically named individual under the terms of a TT, as distinct from cases where the trustee merely holds a general discretionary power to grant a right to occupy.

11. Does not provide guidance on a right to occupy granted to individuals who are identifiable as members of a class but not specifically named. For example, a right to occupy to the Primary Beneficiaries (in the order that the beneficiaries are listed in that defined term) of the TT.

12. Provides an unhelpful and misleading example (example 5) in relation to TTs, in particular:

- ☐ States that 'Probate is granted for both the will and testamentary trust deed' - probate is only ever granted in relation to the will (which may or may not include a TT);
- ☐ States that the only asset in the estate is the house, which is specifically gifted to an individual (meaning the TT fails, as it receives no assets);
- ☐ Suggests that the TT somehow continues to exist and then in turn has rights to make resolutions in relation to an asset not held via the TT.

13. Fails to address any of a range of key questions if taxpayers choose to accept the 2026 arguments of the Tax Office in relation to TTs on legislation that has been in existence for decades, for example:

- ☐ How should rights to occupy under wills with TTs be treated where the willmaker died before 2026;
- ☐ How should rights to occupy under wills with TTs be treated where the willmaker made their will before 2026, however is alive and has testamentary capacity;



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□ How should rights to occupy under wills with TTs be treated where the willmaker made their will before 2026, however is alive and has lost testamentary capacity.

