

AUSTRALIAN TAX ADVISER

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In This Issue

Section 1 – Professional Developments.....	1
Testamentary and Unit Trusts and Estate Planning	1
¶4.1 The two primary categories of trusts	1
¶4.2 The three subcategories of trusts	1
¶4.3 Parties to a trust estate	2
¶4.4 Taxation of trusts.....	4
¶4.5 Use of trusts in tax planning.....	4
¶4.6 UPEs and testamentary trusts.....	5
Section 2 – Professional Currency.....	8
Bills and Legislation	8
¶4.7 GST changes.....	8
¶4.8 Payments systems reform	10
¶4.9 Aged Care amending Bill consequential amendments.....	10
¶4.10 Splitting of spousal super balances.....	10
¶4.11 Strengthening Financial Systems Bill.....	11
¶4.12 Qualified GloBE tax jurisdictions.....	12
¶4.13 Global and domestic minimum tax: Draft legislative instrument	12
¶4.14 Hardship relief extended	13
¶4.15 Simplified GST Accounting Method for government entities	14

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AUSTRALIAN TAX ADVISER

Issue 2602 / August 2025

In This Issue

Cases and Decisions	14
¶4.16 Proceedings against an unregistered tax preparer	14
¶4.17 Medical expenses deductibility rejected	14
¶4.18 Input tax credit claim denied due to four-year limit	15
Rulings and Guidelines	17
¶4.19 Effective Life Determinations	17
¶4.20 PAYG withholding variations	17
¶4.21 Critical Minerals Production Tax Incentive eligibility	18
¶4.22 GST on second-hand goods	18
¶4.23 Adjustment note extension for certain utility providers	19
¶4.24 Updates from the Tax Ombudsman	19
¶4.25 ATO fact sheet on GIC and SIC	20
¶4.26 Determinations	21
¶4.27 Corporate Plans released	21
¶4.28 From the ATO website	22
State Taxes	26
¶4.29 Victoria	26
Section 3 – Questions and Answers	31
¶4.30 Trust distribution and losses	31
¶4.31 FBT – luxury car benefit	33
¶4.32 Self-education expenses	34
¶4.33 Deceased estate taxation	35
¶4.34 GST – adjustment following cessation of registration	36
¶4.35 Travel expenses	38
¶4.36 Death benefit	38
¶4.37 Commercial debt forgiveness	39

Section 1 – Professional Developments

TESTAMENTARY AND UNIT TRUSTS AND ESTATE PLANNING

From the number of questions that this service has received recently, it appears that the use of trusts in general (and testamentary trusts in particular) have been exercising the minds of our members. It is perhaps apposite to provide some analysis of trusts generally to acquaint readers with the potential issues arising from the use of trusts in tax and estate planning.

Trusts fall into two categories and three subcategories, so understanding these basic tenets is important when deciding how to use a trust structure or even whether to use one at all.

¶4.1 The two primary categories of trusts

Trusts generally fall into two main categories: *inter vivos* trusts and *testamentary* trusts. Without getting too bogged down in the legal niceties, an *inter vivos* trust is essentially a trust that is created by a living settlor (or unit holder in the case of a *unit* trust or a *hybrid* unit trust). We'll discuss *unit* trusts and *hybrid unit* trusts under the **subcategories** below. A *testamentary* trust on the other hand, is a trust that is formed upon the death of the settlor in accordance with the deceased testator's wishes.

¶4.2 The three subcategories of trusts

The discretionary trust

The most commonly used trust structure is the discretionary trust, but it is rare to find one where the trustee is given an unfettered discretion. Discretionary trusts are those under which the trustee has free rein in everything that has to do with the function of the trust, such as to whom distributions are made, how those distributions are to be funded (i.e. out of revenue or capital) and even whether a distribution is made at all.

Given the unfettered nature of the discretion granted to the trustee, these trusts are usually accompanied by a 'letter of wishes' outlining the creator's preference as to how the trust is to be administered. It is important to note that a letter of wishes is *not* binding on the trustee, but it is fair to say that most (if not all) trustees would take account of these letters in making any decisions concerning the trust.