TechKnow Podcast – July 2026 – ***These are taxing times***

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Synopsis

More than two months after being announced in this year's Federal Budget, tax changes continue to be the focus of many conversations in the financial advice industry. In this episode of TechKnow, host Bryan Ashenden takes a look at some of the changes that were made to the legislation as it progressed through Parliament, as well as looking further at the negative gearing changes that take effect from 1 July 2027. Bryan also looks deeper into a recently released consultation paper concerning upcoming changes to the taxation of discretionary trusts.

Transcript

More than two months later, tax changes announced in this year's Federal Budget continue to be the focus of many conversations in the financial advice industry, from what the impact of the announced changes were, to the amendments made to secure passage of the first tranche of reforms, and questions over what is still to come.

Hello, and welcome to TechKnow, a podcast series brought to you by BT Technical Services. My name is Bryan Ashenden, and I have the pleasure of leading the BT Technical Services team – a group of professionals dedicated to helping you as advisers work through strategy options for your clients.

In out last TechKnow podcast, we explored how the Budget announcements potentially made superannuation appear even better for wealth accumulation towards retirement, despite the introduction of Division 296 from 1 July. We also then started looking in a little more detail around the Budget tax announcements that had been introduced into Parliament, at that time, particularly those around capital gains tax.

In this TechKnow podcast we will take a look at some of the changes that were made to the legislation as it progressed through Parliament, as well as look further at the negative gearing changes that take effect from 1 July 2027, and a recent consultation paper released concerning the changes to the taxation of discretionary trusts from 1 July 2028.

So let's start with capital gains tax. In our last podcast we talked about how from 1 July 2027 capital gains will fall into one of four categories, being:

- Deferred non-residential capital gains;
- Deferred residential capital gains;
- Non-residential capital gains; or
- Residential capital gains.

This categorisation gives rise to two issues requiring resolution – first, is it a deferred capital gain or not, and secondly, is it a residential or non-residential capital gain.

The first of these is relatively straight forward, although not without its complications. A capital gain will be a deferred capital gain if the asset was purchased before 1 July 2027, but after 19 September 1985 – that is, it is not a pre-CGT asset. These assets will be deemed to have been sold on 30 June 2027 for their market value and reacquired for the same value as at 1 July 2027.

Any capital gain to that point is calculated, and provided the asset is actually held for at least 12 months – ignoring the deemed sale and reacquisition – will be eligible for discounting, even if not owned for 12 months as at 30 June 2027. Whilst eligible for discounting, the discounting will not take place until the asset is actually sold in the future, at which point the notional gain calculated to 30 June 2027 will be realised and subject to potential taxation.

Gains that don't meet the definition of a deferred capital gain are essentially non-deferred gains, and represent the growth in asset values from 1 July 2027. These gains are subject to the indexation method for calculating the assessable amount of a capital gain, and can arise in one of 3 ways.

The first is simply an asset purchased on or after 1 July 2027. If owned for at least 12 months since its date of purchase, it will then have indexation applied to the original cost of the asset, which would reduce the amount of assessable gain. If the asset has fallen in value from its original non-indexed cost, then a capital loss will arise. If the asset is sold for more than its original cost, but less than then indexed cost base, there will be no assessable capital gain and no capital loss on the asset.

The second way a non-deferred or indexed gain may arise is for those assets that were purchased before 1 July 2027, but after 19 September 1985 that were subject to the deemed sale and reacquisition on 1 July 2027. Any growth in the value of the asset from its value on 1 July 2027 falls into the indexation regime, and provided the asset has actually been owned for more than 12 months at the time of its sale, indexation will apply. This is the case even if the asset is sold within 12 months of 1 July 2027.

For clarity, what this mean is that an asset owned for more than 12 months, but less than 12 months before 1 July 2027 and less than 12 months post 1 July 2027 still attracts the benefits of discounting and indexation – which is the right result. For example, if an asset was originally purchased in December 2026 for $10,000, sold in February 2028 for $15,000, and was valued at $12,000 on 1 July 2027, there will be a deferred capital gain arising on 30 June 2027 for $2,000 and non-deferred gain (before indexation) of $3,000 in February 2028. Even though the asset was only owned for 7 months prior to the deemed disposal and reacquisition at 1 July 2027, it will have been actually owned for 15 months when sold in February 2028. As a result, the deferred capital gain of $2,000 can be discounted by 50% when brought to account as part of the 2027/28 tax return. Similarly, the $3,000 gain arising post 1 July 2027 will actually be reduced by any indexation benefits from the September quarter of 2027 to the March quarter of 2028 as the asset has been owned for more than 12 months overall, even though it will have been within the new indexation regime for only 8 months.

The third way that an asset will be in the indexation regime is if it is a pre-CGT asset – that is, an asset acquired prior to 19 September 1985. Probably one of the more controversial measures, from 1 July 2027 “pre-CGT” assets will essentially cease to exist, with these assets deemed to have been acquired at their market value as at 1 July 2027, and gains accruing from that point in time will be subject to taxation in the future. Of course, these assets will have already been held more than 12 months, so indexation benefits apply immediately without the need to wait another 12 months for that to apply.

Now I know I said that the distinction between deferred and non-deferred gains is relatively straight forward, and hopefully I haven’t complicated it with my explanation, but in the most simple terms, a deferred gain occurs where you already own an asset at the time the new legislation commences on 1 July 2027. There are also some other complications, where CGT discounting can actually remain available in certain situations, but we won’t have time to delve into the details of those in today’s podcast.

The second distinction for gains, whether deferred or not, relates to the distinction between residential and non-residential gains. It is a relatively simple distinction, simply requiring a determination of whether a gain is in relation to a residential dwelling. If it doesn’t meet that requirement, then it is a non-residential capital gain.

So, what is a residential capital gain? First off, the capital gain needs to arise in relation to an asset that is a residential dwelling. A residential dwelling is broadly defined as a dwelling (which whilst not specifically defined as such, means something used to live in), but more specifically for the purposes of the CGT changes does not include a caravan, mobile tiny home, other mobile home, a boat, education accommodation, or other dwellings that are run for business purposes, such as hotels, motels etc.

Where the property has been used for mixed purposes – ie some residential and some non-residential, an apportionment of the capital gain is also made.

Applying these broad principles then allows for all capital gains to be categorised between the 4 alternatives described.

Whilst the distinction between deferred and non-deferred gains may make sense, because of the change in calculation methodology, why is the distinction between residential and non-residential important?

The first reason is that there is still the potential for new residential dwellings to still attract CGT discounting even if acquired post 1 July 2027. A new residential dwelling will be defined via a separate legislative instrument that is still to be made, but is expected to cover newly built housing, rather than existing properties – designed to act as an incentive for housing stock to increase.

The second reason for the distinction between residential and non-residential gains is tied to the changes around negative gearing. For that, don't go anywhere as we will pause for a short break now and then come back to discuss this, and the changes to discretionary trusts, in more detail.

<<BT Panorama ad break>>

Welcome back to our TechKnow podcast, looking further into the major tax changes announced in this year's Federal Budget.

Before the break I alluded to the changes around negative gearing. In essence, the changes are, again, relatively simple. From 1 July 2027, for residential dwellings acquired on or the Budget announcement on 12 May 2026, if a negative gearing loss arises, that loss is quarantined and can't be offset against other income.

Again, though, there are a few nuances that need to be understood.

Firstly, the quarantining approach does not cover residential dwellings acquired before the announcement. Full negative gearing continues to apply in these situations as it does today with no changes.

Secondly, the quarantining approach does not apply to new residential dwellings. This is the same definition as applies for CGT purposes, so broadly relates to the construction of new housing, rather than existing housing stock – but we await final details for full clarification.

Also, the quarantining applies on a class of assets basis, rather than asset by asset. So, if a client had two residential dwellings that these new rules apply to, with one negatively geared and the other positively geared, the negative gearing loss on the first property can reduce the assessable income on the second property. It also does not matter if the positively geared property was grandfathered – that is acquired pre the Budget announcement – and the negatively geared property was acquired post Budget. If they are both residential dwellings, then they fall into the same asset class and losses can offset income. It is only if there is a net loss after any offsetting that a quarantined amount arises.

Finally, it is important to remember that the quarantining rules do not apply to commercial property investments, nor do they apply to any other non-residential investments, such as shares.

And the changes do not apply to superannuation funds, so that if an SMSF owned a negatively geared residential dwelling, the quarantining rules do not apply. It is important on this note to mention that as part of gaining agreement from the Australian Greens party to successful pass this package of reforms through Parliament, the Government agreed to remove the ability of superannuation funds to enter into limited recourse borrowing arrangements (or LRBAs) to acquire residential property. This ban will take full effect from 10 August, so the chances of any new residential investments being acquired in a SMSF with negative gearing will be severely limited in any event.

If there is a quarantined amount, then subject to one very important exception, that quarantined amount is carried forward to the next income year and could be used to offset gains from residential dwellings in the next income year. If any amount still remains unused, or the overall loss has grown, that will collectively be a new quarantined amount.

The one exception though, that I just alluded to, is a very important exception to be aware of. If a residential dwelling is sold in the income year that a quarantined amount arises, that quarantined amount will be used to reduce the assessable capital gains from those residential capital gains. If this exhausts all the quarantined amount, there will be none left to carry forward to the next income year. If any remains, then it is carried forward as a quarantined loss to use in the following income year's tax calculations.

This offsetting though of residential capital gains is important, as the loss is first used to offset any deferred residential capital gains. There is no choice to offset against non-deferred residential gains first. The result where this is applied is that clients only gain half the benefit of the quarantined loss, as it is applied against the deferred capital gain, which may be eligible for CGT discounting, but before the CGT discount is actually applied.

The third significant area of tax reform announced in the Federal Budget was around the taxation of discretionary trusts, with changes to apply from 1 July 2028. Broadly, the change, which also is subject to some exceptions, will operate to impose a 30% tax on distributions from a discretionary trust. Where the distribution is paid to an individual or non-corporate beneficiary, the recipient will receive a non-refundable tax offset for the tax paid by the trustee.

There are some exceptions to the 30% tax at the trustee level, which include where the distributable income is primary production income, and where the discretionary trust is a deceased estate, a charitable trust or a special disability trust.

Whilst a deceased estate was stated on Budget night to be excluded from the measures, the approach for discretionary testamentary trusts is slightly different. On Budget night it was announced that distributions from a testamentary trust that existed at the time of the announcement would be excluded – in essence grandfathering those testamentary trust arrangements – but that exemption would not apply to testamentary trusts established after that time. In other words, any clients that had included provisions for the establishment of a testamentary trust as part of their Will and future estate planning arrangements would be captured by the 30% tax rule.

However, the Government has recently announced a change to this position, providing a broad exemption from the 30% tax for testamentary trusts into the future provided the trust has been established for genuine testamentary purposes.

It is not clear what is meant by “genuine testamentary purposes”, although a recent consultation paper from Treasury on the design of the measure does indicate that factors for determining this question would include that the income can only come from assets of the deceased estate. On this point, it is assumed that those assets from the deceased estate can be sold and new assets purchased and the exemption would remain. Considering that many testamentary trusts are established cash from areas such as superannuation death benefits, to require the exact same assets to always be held would give rise to absurd result, and it would be expected that income from those assets that is reinvested, rather than distributed, would also be exempt.

Also, the consultation paper states that income from other assets injected into the same trust after Budget night would be subject to the 30% minimum tax, and from 1 July 2028, the testamentary trust can only benefit individuals and income tax-exempt entities, which would cover charities.

Where the minimum 30% tax is to be imposed, it is imposed on the trustee, with the trustee determining to which distributions the 30% minimum tax is applied. In other words, the trustee is determining if the payment comprises primary production income, testamentary income etc that removes the need to withhold any tax. They will then need to report this to the ATO, as well as to the beneficiary who will need this information to complete their own tax return.

The treatment under this measure can result in changed after tax results, compared to the position that exists today, and will depend on the marginal tax position of individual beneficiaries, who are entitled to non-refundable tax offsets, or to companies who are not entitled to these offsets.

Using an example of a discretionary trust with $10,000 available for distribution. Assuming the beneficiary is not in an exempt class, the trustee will be liable to withhold 30% tax, or $3,000, and then distributes the remaining $7,000 to the beneficiary.

If this went to an individual on the highest marginal tax rate, the beneficiary includes the $10,000 trust allocation in their tax return (even though they only received $7,000 cash) and their tax would be calculated as $4,700 on that amount. They are then entitled to utilise the $3,000 non-refundable tax offset, to reduce their personal tax liability down to $1,700, meaning they have $5,300 cash left after tax. This is no different to the position that exists today under current law.

If, however, the distribution was made to a beneficiary on a nil tax rate with no other taxable income, their personal tax liability on the $10,000 trust allocation would be nil. Whilst the non-refundable tax offset exists, they have no liability to offset it against. Nor do they get a refund of the unused amount of that offset. So they are left with $7,000 cash after tax, and are $3,000 worse off compared to the existing rules.

If the distribution went to a company, the company is assessed at the corporate tax rate on the $10,000 allocation. Assuming the standard corporate tax rate of 30% applied, this would be a $3,000 tax liability that remains, and there is no non-refundable tax offset available to corporate beneficiaries, leaving the company with $4,000 after tax. The company could potentially then use those funds to pay franked dividends out to shareholders, but assuming there are no other funds available to the company to pay the dividend, the largest fully franked dividend they could pay would be $4,000, with $1,714 of imputation credits attached. If paid to shareholder on a nil tax rate, the shareholder would receive a refund of the imputation credits, but the overall tax paid on the $10,000 available for distribution from the trust initially is now $4,286 (an effective rate of almost 43%, with the shareholder having $5,714 cash – compared to $7,000 if it came direct from the discretionary trust under the new rules, or $10,000 under existing rules.

If the dividend was instead paid to a shareholder on the highest marginal rate, the shareholder would have a $972 tax liability after allowing for the imputation benefit, leaving them with $3,028 after all taxes paid – an effective tax rate of almost 70% on the initial $10,000 available for distribution from the trust.

As these examples show, there are distinct changes to the tax treatment of distributions from discretionary trusts under these new proposed rules, unless the beneficiary or trust income falls into a class exempted from the new minimum tax rules.

Now, noting that these changes are potentially significant, and the fact that there are a number of legitimate structures set up currently that utilise discretionary trusts, such as many small businesses, the Government has proposed that there will be rollover relief provided for a three year period from 1 July 2027, to allow taxpayers to restructure their affairs – ie potentially exit from discretionary trusts – without triggering a tax liability at the time. The existing consultation paper is exploring questions and options to make this happen, and we will provide an update in a future TechKnow podcast once more information is available.

Well, that's about all we have time for in this podcast.

Just a reminder, if you have any questions about the content of today's podcast, or other advice strategy questions in general, and you are a registered adviser with BT Panorama, you can contact our BT Technical Services team via the BT Panorama mobile app. To call, simply open the app, head to the contact us section, and navigate to the option to initiate a call with BT technical services. Or you can simply email the team at technical@btfinancialgroup.com.

And don't forget to join us for our fortnightly BT Academy Webinar series where we talk all things regulatory and technical. Our next webinar will be held at midday AET on Wednesday, 29 July 2026 when Matt Manning, one of BT's Technical Services consultants will talk more about two elements of this podcast – capital gains tax and negative gearing. That session will cover the legislated changes to capital gains tax and negative gearing and the key changes, who is impacted, and use case studies to illustrate the strategic considerations required to best advise your clients.

To register for that session, simply head to www.bt.com.au/professional and navigate to the Events and Webinars section within BT Academy. You can also explore previous some of our previous webinars that are available on demand and quality for CPD points if originally held within the last 12 months.

Once again, thanks for joining us today. Until next time, bye for now.