# Making the most of special disability trusts

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# Contents


| | |
|---|---|
| Introduction | 3 |
| Who can be principal beneficiary of a SDT? | 3 |
| What is a Special Disability Trust? | 3 |
| Who can donate? | 3 |
| Social Security benefits | 3 |
| Example: Deprivation rules and succession planning | 4 |
| Concession for the Principal Beneficiary | 5 |
| Tax Advantages | 5 |
| Example | 5 |
| Payments for accommodation and reasonable care needs | 6 |
| Setting up and Administration | 6 |
| Investment Strategy | 7 |
| Comparing family trusts and special disability trusts | 7 |

Special Disability Trusts (SDT) fund the care and accommodation of a severely disabled person. Previously, their restrictive nature meant they were not widely used. With the changing nature of the rules surrounding SDTs, it's important to reconsider whether SDTs are worthwhile.

## Introduction

Special disability trusts (SDTs) have come a long way since their inception in September 2006. Certain tax concessions were introduced and some rules relaxed in the last few years to make SDTs more attractive. These measures can make SDTs a worthwhile alternative or complement family trusts and superannuation, especially for severely disabled persons and their immediate family members who benefit from Centrelink age or DVA service pensions.

## Who can be principal beneficiary of an SDT?

A person must be severely disabled to qualify as an SDT principal beneficiary (PB). A 'severely disabled person' is a person:

- Who can't work for more than seven hours a week
- Whose disability makes the person eligible for a Centrelink disability or DVA invalidity pension or the Invalidity Income Support Supplement, and either:
  - Whose sole carer (if the person has one) qualifies for a Carer Payment or Carer Allowance or
  - Who receives care in a Government funded facility, institution or group home.

A disabled child (aged less than 16) is eligible if their carer is covered by a Disability Care Load Assessment (child) Determination with an 'intense' rating and a care professional certifies that the child needs at least six months of personal care that must be provided by a certain number of persons.

## What is a Special Disability Trust?

An SDT is a special purpose trust set up solely to provide for the accommodation and care needs of a disabled person - the PB. SDTs have concessional social security and tax treatment and are subject to stricter rules. Most of these rules are incorporated in the SDT deed. A Model Trust Deed can be found on the Department of Social Services website here.

A disabled person can only have one SDT and must be the sole beneficiary (PB) of the trust. If SDT assets are exhausted or the law requires that the trust ends (e.g. State laws may state that trusts can only exist for a certain number of years) the SDT will also cease.

An SDT loses its concessional status once the PB dies. Any residual assets can then become available for other beneficiaries.

## Who can donate?

Donations may be made by anyone except the principal beneficiary or their spouse. The exception to this rule is where the donations are sourced from a bequest under a Will or a superannuation death benefit paid to the PB, and the donation is made within three years of receipt.

**Planning point:**
Where a young parent wishes to provide for a disabled child and there is a lack of funding, death cover can be purchased and insurance proceeds can be left to the estate. The Will can then stipulate that these proceeds are to be paid into an SDT for the benefit of that child.

Couples considering establishing an SDT for a remaining spouse should one of them pass away, should identify assets to be allocated for this purpose and must leave these to the surviving spouse through their Will. Only assets owned by the deceased spouse or as tenants-in-common (rather than joint tenants) can be passed via a Will. If superannuation is to be transferred to a spouse's SDT on the member's death, it is important that the beneficiary nomination for the PB is up to date and valid.

The downside of donating to an SDT is that the gift is unconditional – meaning donors cannot impose any conditions on their donations. As long as the trust has SDT status, no amounts can be paid or loaned to any family member.

**Planning point:**
It is important that donors consider their own financial security when donating assets to an SDT.

## Social security benefits

The social security benefits of an SDT are available only to the principal beneficiary and 'immediate family members' who seek or receive the age pension or DVA service pension. 'Immediate family members' include parents, legal guardians, grandparents and siblings.

Immediate relatives of Age or DVA pension age can donate to the SDT without deprivation rules applying, provided that their combined donations to the SDT do not exceed $500,000. This concession can reduce their own Centrelink/DVA assessable assets and potentially increase their pension entitlements. Any amount over the $500,000 limit will be subject to deprivation rules.

Donations by immediate relatives made up to 5 years before reaching age pension age will be included in the $500,000 limit. Donations before this period are excluded from the limit.

When the PB dies the SDT loses its concessional status. The SDT trust deed may provide for residual assets to be paid to the donors or other residual beneficiaries. However if donations were made under the concessional $500,000 limit within the last 5 years, donors must receive a residual amount proportional to their donations, otherwise the deprivation rules will apply for the remainder of the five year period.

The example below shows how concessions are applied.

## Example: Deprivation rules and succession planning

Karen is 80 years old and receives a small amount of age pension (asset tested). Her daughter Marianne (aged 59) has two children, Mary and Kurt. Kurt had an accident and is severely disabled. Kurt's partner is his carer and receives the Carer Payment and Carer Allowance.

Marianne wants to ensure that if anything happened to her, there are enough funds to take care of Kurt's needs. She sets up an SDT and donates $400,000. The donation doesn't fall within the $500,000 limit as it is not made within 5 years of Marianne attaining age pension age.

Three years later Karen and Marianne discuss how assets in the SDT can be increased. Karen believes she doesn't need $600,000 of her funds and Kurt can have these.

Karen's options could be to:

- Leave Kurt $600,000 in her Will with instructions to place the funds into Kurt's SDT. The amount won't be captured under deprivation.
- Donate the $600,000 to the SDT. The first $500,000 will not be caught under the deprivation rules, $10,000 will be disregarded (as a gift) and the remaining $90,000 will be assessed as an asset and deemed by Centrelink[1] for the next 5 years *or*
- Donate $500,000 to the SDT and provide in her Will that $100,000 be placed in the SDT when she passes away. With this option no deprivation will apply.

The $500,000 donation (2nd and 3rd options) will not be a 'deprived asset' for Centrelink purposes and will reduce Karen's assets as assessed by Centrelink. It is possible that Karen may receive a higher amount of Age Pension if her pension entitlement is calculated under the assets test. Karen ends up choosing the last option.

Marianne (now aged 64) adds another $100,000 to the SDT. This amount will be subject to deprivation rules when Marianne applies for the age pension three years later. It will be assessed and deemed for the first two years after Marianne reaches age pension age. Any donation she or another immediate family member may make will no longer be exempt from deprivation as Karen has used up the $500,000 limit for exempt donations. This $500,000 limit is not indexed.

Kurt dies within 3 years after Karen made her donation of $500,000. At that time, the trust's assets are valued at $600,000 and the trust loses its SDT status. Karen's proportionate share of residual assets is $240,000 (40% of $1,000,000 in total contributed). If it is paid back to her, the deprivation rules will not apply. However if she nominates her granddaughter Mary to receive her portion of residual assets, the amount will be caught by the deprivation rules for two years. Marianne must also receive a certain portion of residual assets so that deprivation rules don't apply when she applies for the age pension.

**Planning point:**
The donor's choice of either taking their proportion of residual assets on the termination of the trust, having it paid to their deceased estate, or nominating another person to receive it, may depend on their own financial position, life expectancy, or their intentions of giving it away altogether. This choice can impact the donor's age pension benefits or the residual beneficiary's eligibility for government support (if any).

## Concession for the Principal Beneficiary

In most cases a severely disabled person will have minimal assets and income because of the person's limited ability to earn and save, therefore immediate family members usually have to provide for them, using their own assets and income (after tax is paid).

A severely disabled person may receive additional government support via a Centrelink disability support pension, a DVA invalidity pension or supplement, subject to eligibility under the assets and income test.

While fixed entitlements in any trust assets are attributed to a beneficiary, the first $862,750 (indexed in 2026/27) of assets held in an SDT and all SDT income are exempt from social security and DVA means tests. This means that a PB can hold all of his or her assets valued at up to $1,462,750 (single non-homeowner as at 1/7/2026) in an SDT and potentially receive the full disability support pension. In addition, the PB can receive additional income up to the income free area and still receive the full disability support pension.

## Tax Advantages

In addition to social security benefits there are also tax concessions for SDTs. Donations by family members to an SDT is an income splitting strategy as income from these assets used for the PB's benefit would be otherwise taxed at the donor's marginal tax rate. With an SDT the PB's tax free threshold and generally lower marginal tax rate can be utilised.

### Example

Craig and Anna, both in their 50s, pay tax at the highest marginal tax rate. They generally spend $20,000 on the care and needs of their severely disabled daughter Katrina (aged 30). This means they have to earn $37,736 before tax (tax paid at 47.0% is $17,736) to fund this expense. The couple could transfer $838,578 to an SDT in which case the income (assuming a 4.5% pa return) of $37,736 would be taxed at Katrina's marginal rate. The table below shows the benefit of the strategy:

| Income source | Craig & Anna | Special Disability Trust |
|---|---|---|
| Gross Income | $37,736 | $37,736 |
| Tax & ML less LITO (2026/27) | ($17,736) | ($2,997) |
| Net cash flow after tax | $20,000 | $34,739 |

Restrictions on how SDT income and assets can be spent income mean that income may not always be expended. Unlike normal trusts where unallocated income is taxed at the highest marginal tax rate all SDT income is taxed at the PB's marginal tax rate including income retained in the trust. A PB who is a minor is taxed at adult rates as he or she will be considered an 'excepted person.'

Any capital gains when donating an asset to an SDT is disregarded. The asset's cost base in the SDT is reset to its market value at the time of transfer. This concession makes it easier for family members to provide for a disabled person without incurring additional tax.

**Planning point:**
SDTs can accept cash and asset donations. A donor may choose to donate assets in specie to an SDT. By doing this they can disregard any capital gains on the transfer. The SDT trustee/s can then dispose of the asset using the new cost base.

An SDT may hold a beneficiary's main residence as a Centrelink exempt asset as well as up to $862,750 in investments. The residence also attracts the CGT main residence exemption. A trustee or recipient of the PB's home can dispose of the home within two years of the PB's death without incurring a capital gain. This concession can be a tax effective estate planning tool for families who wish to provide for the PB during their lifetime and leave residual SDT assets to their other beneficiaries (eg other children, grandchildren).

Donors should also take into account that social security/ DVA deprivation rules may apply if they survive the PB and give up their proportionate share of residual assets to other family members.

## Payments for accommodation and reasonable care needs

SDT assets and income must be used primarily for the PB's care and accommodation needs.

Examples of accommodation expenses include accommodation charges or bonds paid to an eligible care facility, the purchase of (including acquisition costs), or rent paid for the PB's accommodation. A property cannot be purchased or rented from an immediate family member. If the PB does not live in the property held in the SDT and it is rented out at market value, the rent received must only be spent for the benefit of the PB. The SDT can pay for approved maintenance costs (except to an immediate family member).

Some examples of care expenses include the costs of membership of a private health fund, dental and medical expenses, approved therapy (including alternative therapy), specialised food, communication, mobility and personal aids/modifications, professional care, and case management as is reasonable in relation to the PB's disability.

From 1 January 2011 discretionary spending for the PB's other expenses was allowed, capped to a certain amount. These include food, toiletries, leisure, vehicle maintenance, and vehicle related expenses other than those needed due to the PB's disability. Housekeeping and capital improvements to the PB's home may also be funded under this category. Total discretionary spending is limited to $15,250 pa (2026/27 indexed).

**Planning point:**
Because of the annual limit on using SDT assets for discretionary spending it is important that other funds are available outside of the SDT for these purposes.

Immediate family members cannot receive any payments or benefits either directly or indirectly from the SDT. Any services family members provide including professional services, cannot be paid for by the SDT.

To ensure these rules are followed, the SDT is subject to reporting requirements. Trustees must provide annual financial statements to Centrelink or DVA. These statements will include details of trust disbursements. The SDT must also submit to an audit if requested.

## Setting up and Administration

Legal and tax advice must be sought when setting up an SDT, or any trust for that matter. Family trusts can be more flexible compared to SDTs as there are no restrictions on how distributions can be spent and there can be more than one beneficiary (subject to trust deed provisions). In addition, there are other rules that SDTs need to comply with. However, where an SDT can provide certainty and protection for assets intended for the PB in addition to tax and social security benefits, an SDT may be warranted.

An SDT may be set up as an inter vivos trust or as a testamentary trust. The SDT trust deed must contain the necessary clauses which must be adhered to by the trustee in order for the trust to maintain its concessional status. Trustees must understand their responsibilities and have the expertise and time to properly administer the trust.

The SDT must have either a Trustee Corporation, a professional trustee (eg a lawyer) or at least two individual trustees or directors of a corporate trustee. Generally, individual trustees or directors of a corporate trustee are family members or friends. The PB and the settlor cannot be the SDT appointor, trustee or director of the corporate trustee.

Only certain persons can be trustees or directors of the corporate trustee. These persons must be Australian residents who have not been convicted of an offence against the Social Security Act 1991 or the Veterans' Entitlements Act, or dishonesty under any Australian Commonwealth, State, Territory or foreign country and must not be disqualified persons under *the Corporations Act 2001*.

A trustee corporation, professional trustee, or individual trustees, with the exception of an immediate family member, can be remunerated for their services.

**Planning point:**
The cost of a professional trustee or the availability of persons willing to take on the responsibilities of trustee is an important consideration, as a breach of the rules can cause the trust to lose its concessional status.

Alternative appointors and/or trustees should also be considered.

Another consideration in opting for an SDT is the cost of setting up and running the trust.

These must be considered in relation to any social security and tax benefits that can be derived by both the PB and donors. The value and complexity of SDT investments may also impact the cost effectiveness of the strategy.

## Investment Strategy

Trustees are required to formulate and implement an investment strategy – very similar to requirements for SMSFs – taking into consideration the PB's needs and circumstances. It is therefore very important that trustees consult with the PB's primary caregiver regarding the short to long-term needs of the PB so that enough liquidity is available to meet these costs. The trustee should consider risk in relation to the investment returns sought for the fund, diversification, the expected cash flow, tax and other liabilities of the SDT.

An SDT is prohibited from renting or acquiring property or any life interest in property from an immediate family member. In addition, unlike superannuation funds, SDTs are not allowed to borrow at all.

## Comparing family trusts and special disability trusts

While generally family trusts are more tax effective vehicles, SDTs provide more certainty that particular assets and income are set aside for the severely disabled relative. Unlike family trusts where the trustee has discretion on the allocation of trust assets and income, an SDT's assets are solely for the benefit of the PB while the PB is alive. The following chart compares the differences between family trusts and SDTs.

| | Family trust | Special disability trust |
|---|---|---|
| Tax on income | MTR of recipient<br>Minor tax rates for a child unless child is an excepted person<br>Undistributed income at highest MTR | MTR (including minor child) |
| Capital gains tax discount | 50% discount | 50% discount |
| Access to distributions | Can be paid to any eligible income beneficiary<br>Can be spent on anything | Limited to PB's accommodation and care expenses + up to $15,250 pa discretionary spending |
| Centrelink/DVA assets test | Amount of fixed entitlement to trust assets is assessed | Main residence + first $862,750 assets are exempt |
| Centrelink/DVA income test | Income the beneficiary is entitled to is assessed | Nil |
| CGT on transfer of assets to trust/SDT | Yes<br>Trust cost base = market value at acquisition + transfer costs | Disregarded<br>SDT cost base = market value at acquisition + transfer costs |
| Sale of property or life interest in property by immediate relative to trust | Yes | No |
| Main residence exemption | No | Yes |
| Deprivation for age/DVA pension donors | Not if controlled; assets and income are attributed<br>Yes if not controlled | First $500,000 of total donations from immediate pensioner family members are exempt |
| Residual beneficiary | Yes | Yes |

It is important to set aside amounts to be used for the PB's other expenses outside of the SDT, as the SDT has a limited capacity to pay for these. The disability support pension (if it is received) can be used for this purpose. Otherwise the PB may also hold investments personally, be a beneficiary of a discretionary family trust or have their own superannuation subject to meeting a condition of release.

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