Law Council
OF AUSTRALIA

Draft Taxation Determination TD 2026/D1

Australian Taxation Office

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Contents

Acknowledgements 2
Introduction 3
Testamentary trusts are established under the deceased's will 4
Deceased estate and testamentary trust: no change in legal source 4
The proper scope of *Whitby* 4
Rights of occupation under testamentary trusts 5
Amendments made under a power to amend 6
Purposive interpretation of item 2(b) 6
Trustee discretions and source of legal authority 7
Contemporary estate planning practice and absence of tax mischief 9
Lack of guidance and transitional concerns 9
Recasting Example 5 10
Appendix 1 11
Transitional provisions 11
Conclusion 12
About the Law Council of Australia 13

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- the Law Society of New South Wales;
- the National Elder Law and Succession Law Committee; and
- the Taxation Committee of its Business Law Section

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Introduction

1. The Law Council welcomes the opportunity to provide this submission on the Draft Taxation Determination TD 2026/D1 (**Draft TD**), about the meaning of the phrase "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* (Cth) (**ITAA**).

2. We broadly accept the Commissioner's approach to the operation of subsection 118-195(1) of the ITAA and acknowledge the importance of clarity and consistency in the administration of the main residence exemption in the context of deceased estates. The Draft TD usefully articulates the Commissioner's views on the interaction between estate administration and rights of occupation, and will assist practitioners in understanding the ATO's intended compliance approach.

3. However, we have concerns with the position adopted in the Draft TD insofar as it purports to draw a strict distinction between rights arising under a deceased's will and rights arising under a testamentary trust established by that will. This distinction is not supported by orthodox trust law principles, does not reflect the proper legal character of testamentary trusts, and gives rise to arbitrary and unintended outcomes.

4. The operative question under item 2(b) of column 3 of the table in subsection 118-195(1) of the ITAA is whether the relevant right of occupation derives from the terms of the deceased's will. Debates about the sequencing of estate administration and the trustee's subsequent fiduciary obligations are conceptually distinct and do not change the legal source of that right. Further, rights under a testamentary trust do not arise from a separate testamentary trust deed. Rather, these rights are all rights arising under the will.

5. If the concerns we have identified in relation to the Draft TD are not addressed, the result is likely to be the exclusion of commonplace and orthodox testamentary arrangements from the operation of subsection 118-195(1), producing outcomes that turn on drafting form rather than substantive testamentary intention. Estates in which a dwelling continues to be occupied consistently as provided for in the deceased's will may nonetheless be denied access to the main residence exemption, exposing beneficiaries to unexpected capital gains tax (**CGT**) liabilities and increasing pressure to dispose of dwellings earlier than intended. This would introduce uncertainty into estate planning and administration, encourage defensive drafting to guard against technical risk, and generate avoidable disputes at the margins of what constitutes a qualifying right. More broadly, it would narrow the practical operation of the provision in a manner that may not reflect its underlying purpose, while diminishing predictability for executors and trustees administering deceased estates.

6. We would welcome further engagement in the development of the Draft TD.

Testamentary trusts are established under the deceased's will

7. A testamentary trust is not constituted by a separate or independent instrument to a will. It is a legal structure created solely and entirely by the deceased's will and has no existence, operation or legal authority outside that will. All powers, discretions, rights and entitlements exercisable by a trustee of a testamentary trust derive exclusively from the will itself. Where a will 'annexes' or incorporates terms governing the administration or operation of a testamentary trust, those terms nonetheless form part of the will and are not a separate instrument. In our view, paragraphs 33 to 36 of the Draft TD do not reflect the way in which discretionary testamentary trust arrangements are set up in a will.

8. The fact that the enjoyment of trust property may be postponed until after administration of the estate does not alter the legal source of the trust or the legal source of the right to occupy. Equity recognises that a trust may be created to take effect upon death without necessarily being testamentary in nature. However, where a trust is created by a will, the will remains the source of authority.

Deceased estate and testamentary trust: no change in legal source

9. The Draft TD proceeds on the basis that a deceased estate arises upon death whereas a testamentary trust arises only after the estate has been administered.[1] That distinction reflects a difference in fiduciary function and timing, not a difference in legal source.

10. In *Commissioner of Stamp Duties (Qld) v Livingston* (1964) 112 CLR 12, the Privy Council held that beneficiaries of an unadministered estate have no proprietary interest in specific estate assets, but they do have a valuable chose in action: the right to require due administration of the estate in accordance with the will. Only once the executor has completed administration and assented to the vesting of assets does the executor hold those assets in the capacity of trustee.

11. That transition is a shift in fiduciary role and the incidents of holding property. It does not involve the creation of a new legal instrument or a new source of authority. The will remains the governing instrument throughout.

12. Similarly, Griffith CJ's reasoning in *Glenn v Federal Commissioner of Land Tax* (1915) 20 CLR 490 at 498 (approved in *CPT Custodian Pty Ltd v Commissioner of State Revenue* (2005) 224 CLR 98 at 10) demonstrates that, where beneficial enjoyment is postponed, the trustee may for a time hold the entire estate subject to the will's directions. Deferral of enjoyment does not imply non-existence of the trust; it reflects the structure mandated by the will.

The proper scope of *Whitby*

13. The Draft TD relies upon *Whitby and Secretary, Department of Social Services (Social services second review)* [2019] AATA 246 (***Whitby***) as supporting the proposition that no testamentary trust exists until estate administration is complete and relevant assets are transferred. With respect, *Whitby* does not establish that

[1] Draft Taxation Determination, 6 [32].

proposition. *Whitby* describes the orthodox succession law position as to when estate assets cease to be estate property and become trust property in the sense of being held following assent or transfer. It explains why beneficiaries lack equitable proprietary interests in specific estate assets during administration.

14. *Whitby* does not determine:

    - when a trust is created in equity;
    - whether a testamentary trust can exist but be unconstituted or incompletely funded; or
    - the character of rights or income for taxation purposes.

15. The Draft TD therefore overextends *Whitby* by collapsing the existence of a trust into the vesting of trust property. That collapse is inconsistent with long-standing trust authority, which distinguishes between the creation of equitable obligations and the later constitution or funding of trust property. The existence of a testamentary trust depends upon the terms of the will. The vesting or assent of particular assets affects proprietary interests in those assets, but not the source of the trust obligations.

Rights of occupation under testamentary trusts

16. Once these distinctions are maintained, a right to occupy a dwelling that arises pursuant to the terms of a testamentary trust is, in substance and law, a right conferred under the deceased's will.

17. During administration, a beneficiary's interest is limited to a chose in action to require proper administration in accordance with the will. Once administration is complete and the relevant property is assented to vest in the trustee, the trustee holds legal title subject to the equitable obligations imposed by the will. As the High Court observed in *DKLR Holding Co. Ltd (No 2) Pty Limited v Commissioner of Stamp Duties (NSW)* (1982) 149 CLR 431, a beneficiary's equitable interest arises because the trustee's obligations are annexed to the trust property.[2]

18. In practice, a deceased's will may create a right to occupy a dwelling in a number of orthodox and well-established ways, including:

    - a specific devise of a residence to a trustee to hold on trust for a beneficiary with a right of occupation;
    - a direction that a residence forming part of the residue be held on trust subject to a right of occupation;
    - a gift of a residence together with other assets to be held on trust, with a direction that the named beneficiary may occupy the residence; or
    - the inclusion of the residence within the residue of a broader testamentary trust, coupled with an express right of occupation.

19. In each of these cases, the trust is established by the will, the residence is held pursuant to the will, and the right to occupy arises solely by force of the will. There is no principled basis upon which these common drafting structures can be

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[2] *DKLR Holding Co. Ltd (No 2) Pty. Limited v Commissioner of Stamp Duties* (NSW) (1982) 149 CLR 431, [8].

distinguished for the purposes of item 2(b). These drafting techniques differ only in form. In each case, the trustee's title and powers, and the beneficiary's personal right to occupy, derive from the terms of the will; the right is therefore conferred under the will.

Amendments made under a power to amend

20. The Draft TD draws, in our view, a proper distinction between a right of occupation granted "under a will" and a right granted under a separate agreement.

21. The above analysis does not deny that a will may confer a power to vary the terms governing a testamentary trust. Where a right of occupation is created by the exercise of that variation power, the right arises under the instrument effecting the amendment rather than under the will itself. In that circumstance, the right is properly characterised as arising under a separate and distinct instrument and may not constitute a testamentary disposition for the purposes of item 2(b). That distinction preserves coherence between the statutory requirement that the right arise "under the deceased's will" and orthodox trust law principles. Where a right of occupation first arises on exercise of a post-testamentary variation power, it is properly characterised as arising under the amending instrument rather than under the will.

Purposive interpretation of item 2(b)

22. Item 2(b) is directed to giving effect to testamentary intentions relating to occupation of a dwelling following death. Testamentary trusts are a primary and orthodox mechanism by which those intentions are expressed, and form part of the legal structure by which a deceased estate is administered and given effect. Property held on the terms of a testamentary trust is held pursuant to, and by force of, the will itself. Excluding rights that arise through testamentary trusts frustrates the evident legislative purpose and produces outcomes that depend not on substance or intent, but on the drafting structure chosen.

23. If Parliament had intended to exclude testamentary trusts from the operation of subsection 118-195(1), it would have been necessary to do so expressly, either by carving out testamentary trusts notwithstanding that they are established under a will, or by limiting the provision to specific proprietary interests: for example, life estates. No such limitation appears in the legislation. Nor does subsection 118-195(1)(a), in referring to a dwelling held by the trustee of a "deceased estate", draw any distinction between the period of active administration and the subsequent holding of estate property on the trusts declared by the will. The executor or trustee holds the property throughout pursuant to the testamentary trusts; the character of that holding does not cease to be that of a deceased estate merely because the will directs that the property be retained on ongoing trust. It would require clear words to exclude such orthodox testamentary arrangements from the provision's operation, and no such words appear.

24. The fact that a right to occupy may only be capable of practical enjoyment following administration of the estate does not alter its legal source. All testamentary gifts and rights are necessarily subject to estate administration. Conditioning the application of item 2(b) on the absence of intervening administration would render the provision internally incoherent and incapable of practical operation.

25. A right to occupy cannot arise in the absence of a legal source. Where such a right exists following death, and where the only instrument conferring authority is the deceased's will, the right can only sensibly be characterised as arising under that will.

26. Judicial authority has long recognised that testamentary trust provisions are construed using principles applicable to wills, with ambiguities resolved by reference to testamentary intention. Courts consistently treat testamentary trusts as integral components of the will, not as freestanding instruments. Courts have treated "under" in taxing statutes as meaning "in accordance with", "pursuant to" and "by virtue of",[3] and have explained that a right is "under the will" when it is given by the terms of that instrument;[4] applied here, a right of occupation in the will itself creates or compels that it is conferred "under the will". In the absence of legislative definition, this common law precedent must inform the ordinary meaning of "under the deceased's will".

27. Properly framed, the sole statutory question is whether the right to occupy is "under the deceased's will". The issue to be properly addressed by the Draft TD is not whether a testamentary trust is equivalent to a deceased estate as a matter of trust law taxonomy. Rather, the sole statutory question posed by item 2(b) of column 3 of subsection 118-195(1) is whether the relevant right to occupy is "under the deceased's will". Framing the inquiry by reference to distinctions between estate administration and trust administration misdirects attention away from the statutory text, and risks substituting form for substance.

Trustee discretions and source of legal authority

28. Where the will confers only a broad, unconstrained discretion and does not identify the intended occupant, we acknowledge the Commissioner's narrower construction that the right arises by virtue of the discretionary act. However, where the will itself names the intended occupant, or sets criteria that functionally fix who may occupy with the trustee's role limited to implementation, the right remains one conferred under the will. That the party exercising that discretion is the trustee of a testamentary trust (and not the executor of a will) does not sever the connection between the right conferred and the will under which that discretion exists.

29. The Draft TD cites *Caratti v Commissioner of State Revenue*[5] (***Caratti***) to support the view that "rights granted pursuant to a pre-testamentary or post-testamentary agreement did not amount to a right granted under the terms of the deceased's will".[6]

30. We note that *Caratti* is a Western Australian decision concerning exemptions under the *Land Tax Assessment Act 2002* (WA), rather than federal CGT. In our view, it is an inappropriate case to rely on in relation to CGT where the outcomes are determined by reference to other legislation in different terms. The requirement under section 22 of the *Land Tax Assessment Act 2002* (WA) for an individual who "has a right under the will to use the property as a place of residence" to be "identified

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3 *Energy Resources of Aust Ltd v Commissioner of Taxation* [2003] FCA 26 at [37]. Also referenced in the Draft Taxation Determination, 3 [12].

4 *Wilson v Federal Commissioner of Land Tax* [1916] HCA 16 at 238 and 244. Also referenced in the Draft Taxation Determination, 3 [13].

5 [2017] WASVA 128.

6 Draft Taxation Determination, 3-4 [14].

in the will" is distinct from subsection 118-195(1) of the ITAA's requirement for "an individual who had a right to occupy the dwelling under the deceased's will", namely, that the ITAA does not require the individual to be "identified in the will". Selection of an occupant of real estate under the terms of the will is just that—"under the terms of the will". A contrary conclusion would arise only if the terms of the will could, in some way, be said *not* to include the trust. However, the trust necessarily derives from—and is constituted by—the words of the will, as it has no other source.

31. In our view, this means that what is set out in paragraphs 15 to 17 of the Draft TD cannot be accepted as a correct expression of the CGT position. The footnote to paragraph 16 referring to the judgement in the 1915 High Court decision in *Thomson v Deputy Federal Commissioner of Land Tax for Tasmania*[7] does not assist. Not only was that decision dependent upon the construction of state land tax legislation, but the parties had also entered into a deed.

32. We invite the ATO, in finalising the Draft TD, to reconsider the approach and drafting of these paragraphs. At a minimum, where paragraph 15 of the Draft TD narrows the Commissioner's view to "an individual specifically named in the will", we suggest adding the words "or an individual who fulfills some tightly circumscribed criteria set out in the will".

33. If the Commissioner maintains the position that a testamentary trust is separate to the will, we suggest clarification should be given about whether the CGT main residence exemption applies in circumstances where the will itself expressly names the individuals with a right to occupy the dwelling, not subject to the discretion of the trustee. This includes where beneficiaries under the testamentary trust are entitled to the dwelling after the cessation of the limited right to occupy.

34. The Draft TD appears to proceed on the assumption that rights arising under testamentary trusts are necessarily contingent upon the exercise of trustee discretion. That assumption is incorrect. Not uncommonly under the terms of testamentary trusts, the right to occupy is a fixed entitlement created immediately by the will, with the trustee having no discretion as to whether the right exists, but merely an obligation to administer it. In these instances, the right to occupy exists independently of any discretionary decision and solely by operation of the will itself. This two-tier analysis—distinguishing fixed or effectively fixed rights from bare discretions—preserves coherence while respecting the Commissioner's legitimate concerns about unconstrained discretionary powers.

35. The Draft TD itself acknowledges that a testamentary trust is established by the will and that the trustee's powers and obligations are sourced entirely from that instrument. Having accepted those propositions, it is internally inconsistent to conclude that a right conferred pursuant to the exercise of those powers does not arise under the will.

36. The approach adopted in the Draft TD would result in estates with identical testamentary intent being treated differently for tax purposes, solely because of the structural form chosen to give effect to that intent. This creates arbitrary and inequitable outcomes notwithstanding identical substantive rights, and penalises

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[7] [1915] HCA 4.

common, conservative and non-tax-driven estate planning practices. Importantly, where the will names the intended occupant, or sets tight criteria that effectively fix who may occupy, the arbitrary outcomes are most acute: the testator has done everything within their power to identify the beneficiary, yet the right is treated as not arising "under the will".

Contemporary estate planning practice and absence of tax mischief

37. Modern wills routinely incorporate testamentary trusts as part of a single, coherent estate planning framework. Testamentary trusts are frequently employed for reasons unrelated to tax outcomes, including asset protection, succession planning and the management of complex family arrangements.

38. In particular, rights of occupation conferred through testamentary trusts are commonly used to address circumstances involving blended families, serial relationships, and the need to provide stable housing while preserving capital for future beneficiaries. They are also a well-established mechanism for protecting individuals who may be at risk due to mental or physical incapacity, substance abuse, gambling addiction, or other vulnerabilities. Similar considerations arise where provision is made for orphaned children or where grandparents seek to provide long-term housing security for grandchildren while retaining appropriate control over the underlying asset.

39. In these contexts, the use of a testamentary trust, rather than an outright gift or a proprietary life interest, reflects careful and orthodox estate planning directed to protection, stability and intergenerational fairness. The right to occupy is typically personal, non-transferable and incapable of commercial exploitation.

40. There is no identifiable tax avoidance or deferral outcome achieved by granting a right to occupy through a testamentary trust rather than directly under a will. The Commissioner's approach does not address any discernible tax mischief, but instead disadvantages arrangements adopted for legitimate estate planning and asset protection purposes.

Lack of guidance and transitional concerns

41. The Draft TD does not provide guidance on a number of practical and material issues, including:

    - rights to occupy granted to specifically named individuals under the terms of a testamentary trust;
    - rights to occupy granted to identifiable members of a class; and
    - the treatment of discretionary powers to grant a right of occupation, as distinct from fixed rights.

42. Further, the Draft TD does not address significant transitional questions, including how the Commissioner proposes to treat:

- wills containing testamentary trusts where the deceased died prior to the issue of the Draft TD;
- wills executed prior to 2026 where the testator remains alive and has testamentary capacity; and
- wills executed prior to 2026 where the testator is alive but has since lost testamentary capacity.

43. Given that section 118-195 has operated for decades, during which time the ATO has acknowledged distinctions between rights conferred directly under a will and powers exercised under a testamentary trust, but has not treated those distinctions as determinative (where the terms of the testamentary trust do not identify or name a beneficiary entitled to occupy the dwelling), and has administered the provision without identifying any associated tax mischief, the absence of clear transitional guidance creates uncertainty and compliance risk for taxpayers and advisers.

44. The Draft TD appears to proceed on the basis that its interpretation will apply without any grandfathering of prior arrangements. This raises particular concern for estates and families who have structured testamentary arrangements on the reasonable assumption that a trustee's power under a testamentary discretionary trust to grant a right of occupation to a specifically named beneficiary was sufficient for the purposes of section 118-195, provided the other criteria of that section were met.

45. The Draft TD does not address how such arrangements would be treated, notwithstanding that the right of occupation is clearly contemplated, identified and intended by the will at the time of death.

46. More broadly, the Draft TD gives rise to uncertainty as to whether the Commissioner considers that no testamentary discretionary trust can ever satisfy item 2(b), regardless of how clearly the will identifies the intended occupant or how tightly the trustee's powers are constrained. If that is the intended position, it represents a significant departure from historical understanding and practice and underscores the need for clear transitional guidance.

Recasting Example 5

47. Example 5 in the Draft TD could be recast to avoid internal inconsistency, and to illustrate the operative principles coherently.

- Scenario A: the will gifts the residence into a testamentary trust and expressly grants a fixed right of occupation to a named individual for a defined period, after which the property is to be sold or retained on stated terms. On the Commissioner's current approach, this would still be treated as not "under the will", a result difficult to reconcile with item 2(b) given that the will itself creates and compels the right.

- Scenario B: the will gifts the residence into a testamentary trust and confers a broad discretion on the trustee to grant a right of occupation to any person,

without naming or effectively identifying the intended occupant. We acknowledge this may fall outside item 2(b) on the Commissioner's view.

48. We invite the ATO, in finalising the TD, to include clear examples that clarify the Commissioner's approach, noting that, in our view, identifying the intended occupant may include reference to a category of people (for example, any child of the deceased person).

Appendix 1

49. Paragraph 38 of the Draft TD describes the alternative view on the basis that a testamentary trust is equivalent to a deceased estate. In our view, this expression is misdirected, because what is occurring is that the deceased estate is disposed of in various ways in accordance with the will, one gift of which is expressed in terms of a trust. It is not equivalent to a deceased estate—it is a gift of part of the deceased estate.

50. Paragraph 39 refers to a right to occupy which might arise under the terms of a testamentary trust as being tantamount to being granted under the deceased will for the purposes of item 2(b). We do not agree with this view, as it is actually given under the terms of the will itself, and not in some equivalent document.

51. Paragraphs 40 and 41 of the Draft TD are set out as follows:

> *40. Moreover, the alternative view contends that an individual does not need to be specifically named in the deceased's will (or testamentary trust deed) as having a right to occupy the dwelling; it is sufficient if the executor or trustee of the deceased estate has a discretion to grant a right to occupy the dwelling to any individual. Proponents of this view argue that the words in item 2(b) do not impose a requirement for an individual to be specifically named in the deceased's will as having a right to occupy the dwelling.*
>
> *41. We do not agree with this alternative view.*

52. In our view, however, the alternative is sound given that, if the right to occupy the dwelling is granted to an individual by a trustee pursuant to a broad discretion contained in the will, taking this step is simply giving effect to the terms of the will.

Transitional provisions

53. The date of effect of the Draft TD is proposed to "apply to years of income commencing both before and after its date of issue".[8]

54. In our view, as a matter of principle, the Draft TD should provide a transitional period so that it only applies to wills made two years after the date of its coming into effect, particularly as it—in its current form—represents a significant departure from current practice.

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[8] Draft Taxation Determination, 7 [37].

55. Concessions should also be made for individuals who may be unable to amend their wills to take into account a new TD—for example, individuals who no longer have decision-making capacity.

Conclusion

56. While the Law Council supports the Commissioner's objective of providing clarity in this area, we submit that the Draft TD:

- promotes a supposition, unsupported by law and equity, that because an estate and a testamentary trust are separate and distinct structures, they arise under different legal sources (instead of a single legal source, being the deceased's will);
- adopts a construction of item 2(b) that conflates the vesting of trust property with the existence of a testamentary trust; and
- at times, misapplies the authorities relied upon.

57. We respectfully urge the Commissioner to reconsider the distinction drawn between deceased estates and testamentary trusts, and to recognise that rights to occupy arising under a testamentary trust are, properly characterised, rights conferred under the deceased's will for the purposes of subsection 118-195(1), and to revise the Draft TD accordingly.

About the Law Council of Australia

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The Law Council advises governments, courts, and federal agencies on ways in which the law and the justice system can be improved for the benefit of the community. The Law Council also represents the Australian legal profession overseas, and maintains close relationships with legal professional bodies throughout the world. The Law Council was established in 1933, and represents its constituent bodies:

- the Australian Capital Territory Bar Association;
- the Law Society of the Australian Capital Territory;
- the New South Wales Bar Association;
- the Law Society of New South Wales;
- the Northern Territory Bar Association;
- the Law Society Northern Territory;
- the Bar Association of Queensland;
- the Queensland Law Society
- the South Australian Bar Association;
- the Law Society of South Australia;
- the Tasmanian Bar;
- the Law Society of Tasmania;
- the Victorian Bar Incorporated;
- the Law Institute of Victoria;
- the Western Australian Bar Association;
- the Law Society of Western Australia; and
- Law Firms Australia.

Through these bodies, the Law Council represents more than 110,000 Australian lawyers.

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- Mr Justin Stewart-Rattray, Executive Member
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The Chief Executive Officer of the Law Council is Dr James Popple.

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