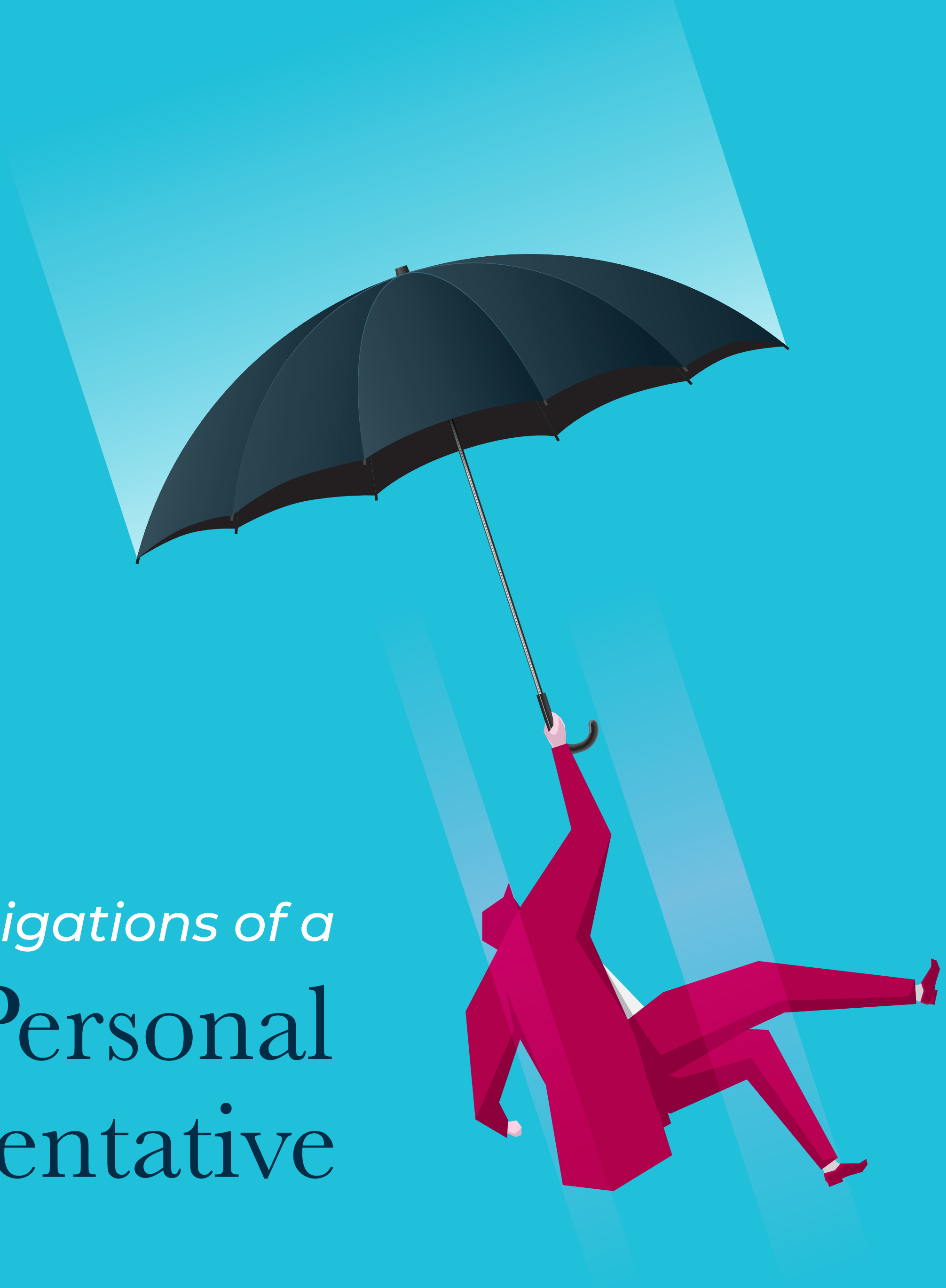

The Tax Obligations of a

Legal Personal Representative

BNR PARTNERS
ESTATE & TRUST TAXATION SPECIALISTS

Contents

The information in this publication is current as at 1 July 2024.

Published by BNR Partners Pty Ltd ABN 85 354 278 697
32/830 Princes Highway, Springvale VIC 3171
Phone (03) 9781 6800
bnrpartners.com.au

Introduction

The role of executor or administrator of a deceased estate is a time-honoured one, usually accepted by a family member, friend or trusted adviser to honour the wishes of a deceased person (where there is a Will) or to give effect to relevant intestacy laws (in other cases).

However, an intending executor or administrator (legal personal representative or LPR) should be aware of the tax responsibilities and risks associated with performing that role. In particular, an LPR is responsible for ensuring that the deceased person's tax responsibilities (that is, prior to their death) as well as those of that person's estate have been met. A person's deceased estate is regarded as a separate tax entity and will require its own tax file number (TFN) if tax returns need to be lodged or a private ruling is to be sought.

Dealing with the ATO

The ATO has published a lot of information on its website to assist LPRs meet their tax obligations.[1] Some key points are discussed below.

Notify the ATO officially of deceased's death

An LPR should officially notify the ATO that they are managing the deceased's tax affairs. The ATO website[2] contains information about how to notify them and the supporting documentation they require.

The ATO indicates that it can take up to 28 days to update a deceased person's records after they receive the notification.

Once the ATO is notified of someone's death, they will not allow the deceased's former tax representative or anyone who held a power of attorney to access the deceased's ATO records. [This does not prevent the former representative or attorney from providing information that they hold to the LPR.]

The ATO will not issue any tax refunds to the deceased person's estate until they have received an official notification of their death.

Accessing a deceased person's tax information

To prepare any outstanding tax returns for the deceased person, an LPR may need to obtain information from the ATO. [As noted above, the person's former accountant will no longer have access to the deceased's ATO records.]

The ATO will provide information about the deceased's tax position to an LPR but only if they have obtained a grant of probate or letters of administration. Alternatively, similar information can be provided by the ATO to the LPR's duly appointed tax agent or legal practitioner. But again, this information will only be provided if the LPR has obtained a grant of probate or letters of administration.

[1] ATO website use Quick Code QC23846
[2] ATO website use Quick Code QC49903

Income tax obligations of an LPR in respect of the deceased person's tax affairs

Once probate or letters of administration has been granted to an LPR, the LPR effectively stands in the shoes of the deceased person as far as that person's tax affairs are concerned.[3]

This means that the LPR must lodge any income tax returns (or other documents) that the deceased person was required to lodge, including a tax return for the part of the income year that ended when the person died.

If the LPR fails to lodge a tax return or other document that was required to be lodged, they can be subject to the same penalties that would have applied to the deceased person.

The LPR is liable to pay the deceased's income tax (and other amounts such as penalties and interest) up to the value of the deceased's assets that came into the LPR's hands (or should have done).

It is therefore very important that the LPR understands the full extent of those liabilities before distributing any estate assets – otherwise the LPR may have to pay any tax shortfall from their own assets. We have seen cases where an LPR has been in danger of losing their own home because they distributed estate assets before paying all tax-related amounts.

Example

Barry accepted the role of executor of the estate of his friend Bruce.

Barry lodged all of Bruce's outstanding tax returns. He paid all of the assessments on time. Barry then distributed the residue of the estate to a number of charities.

Some time later, Barry received a notice requiring him as executor to pay a significant amount of interest charge (it was equivalent to twice the amount of tax he had paid on behalf of Bruce).

Barry is a pensioner and his only asset of any value is his home. The outstanding interest is equivalent to approximately one third of the value of his home.

Barry sought remission of the interest charge from the ATO but was refused.

[3]An LPR who has not obtained probate or letters of administration is not made personally liable for the deceased person's outstanding tax-related liabilities. A different collection mechanism applies under sections 260-145 and 260-150 of Schedule 1 to the Taxation Administration Act 1953 (TAA).

Income tax obligations of an LPR in respect of the tax affairs of the deceased's estate

A deceased person's estate is a separate tax entity from the deceased individual.

If the estate has tax obligations, then the LPR must apply for a different TFN from that of the deceased.

For tax purposes, an LPR is treated as a trustee, and the estate that they are administering is treated as a trust estate. This means that the LPR will have to lodge trust tax returns for the deceased estate.

Tax returns will not be necessary for a resident deceased estate for an income year if:

- the net income[4] is less than the tax-free threshold (currently $18,200)
- the deceased person died less than 3 years before the end of the income year
- no beneficiary is presently entitled to a share of the income of the estate, and
- there are no non-resident beneficiaries.

For the year in which the individual died, two income tax returns may be required – that is, one for the deceased up to the time of their death, and the other for the estate covering the balance of the income year (1 July – 30 June).

Example

Henry died on 4 February 2023. A tax return may be necessary in respect of income he derived for the period from 1 July 2022 to 4 February 2023.

Another return may be necessary for the estate for income derived from 5 February 2024 to 30 June 2023.

The earlier that these returns are lodged the earlier relevant amendment periods will expire.

The way in which tax is paid by a trust is complicated. Depending on the facts, it may be payable by the LPR in that capacity or by a beneficiary.

[4] 'Net income' is defined in subsection 95(1) of the ITAA 1936. Essentially it is the amount that would be the taxable income of the trust if the trustee was a resident taxpayer.

Liabilities from amended assessments

An LPR should be alert to the fact that their tax exposure extends to amounts that may arise from an amendment of one of the deceased's income tax assessments or that of the estate. So, it is important to know when an assessment can be amended.

In Australia, income tax is assessed on a self-assessment basis. This means that the Commissioner ordinarily accepts at face value the details in tax returns as lodged, but has the right to review an assessment. This right is usually limited to either a two or four-year period. [Although in the case of fraud or tax evasion, the Commissioner has an unlimited time period in which to amend an assessment.]

The two-year amendment period applies unless:

- the taxpayer carried on a business (other than a small business) either alone or in partnership, or
- was a beneficiary of a trust that was not a small business entity.

Once an assessment (including a nil assessment) is issued, the amendment period in respect of that assessment starts. When the amendment period for a particular assessment has expired, the assessment cannot be generally altered.

It is also important to understand that the ATO has an unlimited period within which to raise an original assessment. So, for example, if no return was ever lodged to trigger the making of an assessment, the Commissioner can review the taxpayer's tax position at any time.[5]

Deferring administration of the estate

Some LPRs who are unsure about the accuracy of the deceased's income tax returns or that of the estate defer the distribution of estate assets until the relevant amendment period has expired. This ensures that any potential tax liability can be funded from the estate assets.

But from a practical perspective an estate cannot remain unadministered indefinitely. There is a tension between the LPRs duties to administer the estate as soon as possible and avoiding a personal exposure to tax from a possible amendment.

Administrative concession in respect of pre-death tax position – PCG 2018/4

The ATO has issued Practical Compliance Guideline PCG 2018/4 to provide LPRs of less complex deceased estates with greater certainty in relation to their potential liability from an amended assessment of the deceased individual. [The PCG does not apply in respect of potential liabilities the LPR may have from the estate.]

The main effect of the PCG is that an LPR may no longer have to delay the distribution of estate assets until the expiration of a relevant amendment period, to avoid a personal liability from an amended assessment of the deceased.

The PCG applies if:

- the total market value of the estate assets at the deceased's date of death is less than $10 million
- none of the estate assets are intended to pass to a foreign resident, a complying superannuation entity or a tax-exempt entity that is not also a deductible gift recipient (DGR)

[5] Lodging a return not necessary notice does not result in a nil assessment being issued.

- the estate assets consist only of Australian real property, public company shares or other interests in widely held entities, cash or cash investments, personal effects and superannuation death benefits, and
- in the four years before their death the deceased did not carry on a business, was not assessable on a share of the net income of a trust and was not a member of a self-managed superannuation fund.

If the PCG applies, the ATO will treat the LPR as not having notice of an amount owing in respect of an amendment if:

- for returns lodged by the deceased – the LPR brings any material irregularity to the attention of the ATO in writing (for example, by requesting an amendment) and the ATO does not within 6 months issue an amended assessment (or advise that it intends to undertake a review).

Example

Peter died on 12 December 2019. Jill was appointed executrix of his Will. She obtained probate in January 2020.

In the course of discharging her duties as executrix, Jill confirmed with the ATO that Peter had lodged all of his income tax returns other than the returns for the 2018-2019 year and the final period to Peter's date of death.

In preparing those returns, Jill discovered that Peter had never returned rental income from a property that he had owned in Sydney since 2013. Jill included rental income from that property in the returns for the 2019 income year ($20,000) and the period to Peter's date of death ($10,000). She lodged both returns on 3 March 2020. Jill did not seek to amend any of Peter's earlier year assessments or otherwise bring the irregularities to the ATO's attention.

On 4 April 2020, the ATO issued notices of assessment relating to the returns that Jill had lodged. Jill paid those assessments out of the estate's assets.

On 1 July 2020, Jill published a Notice of Intended Distribution (under State succession laws) for claims to be made within 30 days. On 4 August 2020, Jill distributed the remaining assets of the estate.

On 20 October 2020, the ATO wrote to Jill advising that Peter's assessments for the 2017 and 2018 years were being reviewed because of the non-reporting of rental income.

Jill had become aware of a material irregularity for those income years because she discovered that Peter had not included rental income in his returns.

Jill will be personally liable for any outstanding tax liabilities resulting from the amendment of Peter's 2017 and 2018 income tax assessments. Jill cannot avoid liability on the basis that she had no notice of it.

If Jill had brought the prior year irregularities to the ATO's attention when she lodged the outstanding returns Jill would not be personally liable because the ATO did not advise her within 6 months that it was intending to review the assessments.

- for returns lodged by the LPR – the LPR acted reasonably in lodging the returns or advising they were not necessary and the ATO has not notified the LPR that it intends to review the deceased's taxation affairs within 6 months of the last lodgement.

  'Acting reasonably' means exercising sound judgment or good sense and requires an LPR to act with a degree of prudence. An LPR who abdicates responsibility and relies in blind faith on their co-LPR, a solicitor, accountant or other person is not considered to be acting reasonably. Reliance on relevant written professional advice that they have sought about a particular matter may, however, be a relevant factor in establishing that an LPR has acted reasonably.

Example

Bill died on 31 August 2020. probate of his Will was obtained on 30 October 2020.

At the time he died, Bill had lodged his 2019-2020 and all earlier income tax returns.

Bill's LPR determines, reasonably, that no return is necessary for the period from 1 July 2020 to 31 August 2020 and advises the ATO of this on 30 November 2020. The LPR was not aware of any material irregularity in returns lodged by Bill.

If by 1 June 2021, the ATO does not advise the LPR that Bill's tax affairs are being reviewed, the LPR can distribute the estate without risk of personal liability.

However, if the LPR failed to advise the ATO that Bill's final return was not necessary, the ATO could seek to amend Bill's assessments until the relevant amendment periods expire.

Finally, if further assets come into the hands of an LPR after what was thought to be the completion of the estate's administration, the ATO will treat the LPR as having notice of a potential claim by the ATO.

Example

Vincent died on 26 November 2019. Ben was appointed executor of Vincent's Will and obtained probate. To the best of Ben's knowledge, the assets included in Vincent's estate consisted of his main residence, a number of rental properties that Vincent acquired using his superannuation lump sum, and some money in a bank account. Based on all of the information available to him including tax returns for earlier years, Ben determined that no return was necessary for the period from 1 July 2019 to 26 November 2019 because Vincent's income was below the tax-free threshold. 6 months after advising the ATO that no return was necessary, Ben proceeded to distribute the estate's assets.

In 2022, the ATO receives information that Vincent owned further assets, the income from which was not disclosed by Vincent or Ben (due to Ben not knowing of their existence).

The ATO issues amended assessments for the 2020 year and 4 preceding income years. The ATO is not bound by this Guideline to refrain from issuing an assessment/amended assessment to reflect the income from the further assets. The ATO will seek to recover tax related liabilities from Ben up to the value of the further assets that come into Ben's hands as LPR.

Practical strategies to mitigate an LPR's tax risk

Obtain a private ruling

In the administration of many estates, questions often arise as to how the law applies to the particular facts of the estate.

An LPR might therefore choose to obtain a private ruling from the ATO about how it considers the law applies rather than to risk the ATO coming to a view as part of a later review of the estate's tax affairs after the estate assets have been distributed.

However, failure to follow a private ruling may be taken into account by the ATO, for example in determining penalties as part of a later review whether the rulee has taken reasonable care.

A rulee is not bound to apply a ruling. However, failure to follow a private ruling may be taken into account, for example, in deciding whether they have taken reasonable care in determining penalties as part of any later review was undertaken by the ATO.[6]

Other material published by the ATO (apart from a public ruling) does not protect taxpayers from payment of any tax shortfall but they may be protected from penalties and interest. So, for example if the ATO changes its view about information published on its website, a taxpayer who has previously relied on that information could be liable to pay any tax shortfall.

Make a voluntary disclosure to the ATO

An LPR may have considerable difficulty determining the deceased's tax position because of missing data or tax records. That is, although the LPR may believe there is an outstanding tax liability in respect of undeclared income they don't have the information needed to establish the amount of the liability.

In our experience, this situation often arises where the deceased derived foreign income or owned CGT assets located outside of Australia or where a foreign resident owned property in Australia but failed to declare rental income.

If the LPR makes a voluntary disclosure to the ATO, they may be able to come to an agreement as to the extent of the deceased person's tax liabilities. Apart from providing certainty to the LPR, the ATO would also typically reduce the amount of penalties that would otherwise apply where voluntary disclosures are made.

Example

The deceased was a Veterans Affairs pensioner who passed away in the 2020 tax year.

On his death the LPR identified assets comprising a $500,000 share portfolio, a $50,000 overseas bank account and a $1.2 million investment fund in Singapore.

It transpired that the deceased had not lodged an Australian income tax return since returning to live in Australia in the 2002 tax year.

After significant effort had been made to reconstruct the income derived by the deceased, a voluntary disclosure was made to the ATO given the LPRs inability to locate the remaining information. The ATO undertook additional data searches and the parties were able to reach an agreed position. This collaboration resulted in annual assessable income ranging from $45,000 to $150,000 per annum and the payment of a significant amount of tax.

[6] section 357-65 of Schedule 1 to the TAA

Other

- Obtain an indemnity from all beneficiaries prior to finalising the distribution of the estate. It goes without saying that there are pitfalls in this practice especially if the beneficiary does not have any assets when the LPR comes to invoke the indemnity. Nonetheless this is sensible housekeeping.
- Alternatively an LPR may hold back payment of an amount that may be needed to pay tax.

Record keeping

An LPR has record keeping obligations to consider both for CGT and general tax purposes.

If the deceased has not kept cost base records for their assets or the records cannot be located, the LPR must reconstruct them. For assets that are transferred to beneficiaries, these become the beneficaries' cost base records.

Records must also be retained (generally for five years) and penalties can apply for failure to do so.[7]

How can BNR Partners assist?

BNR has a team of professionally qualified accountants and tax consultants who specialise in the taxation of deceased estates. We work exclusively with the legal profession and trustee companies across Australia and by direct appointment from Supreme Courts.

If you would like assistance from us, please discuss this with your legal advisor and arrange for a referral to be made to us. By partnering with us, you can be assured that you are dealing with a team that understands the idiosyncrasies of this field of taxation as well as the fundamental legal principles of estate administration.

Our service offering includes:

- Tax review and tax history reports
- Managing ATO administrative processes - including TFN applications
- Preparation of tax returns and financial statements
- Letters of advice
- Private ruling applications
- Voluntary disclosures
- Penalty and interest charge remissions

[7] See for example Division 121 of the ITAA 1997 and section 262A of the ITAA 1936

Our values

Expert

We are defined by our deep knowledge. Being deliberately niche in our focus allows us to develop a level of mastery that is second to none. We thrive in finding pathways through the maze of complexity that surrounds estate taxation. We know our greatest strength is to be curious, reflective, and adaptive to change.

Relationships Rule

Whether it is working with each other, or our many external stakeholders, our mindset is always how we add value to those we are engaged with. Our role as an advisor is grounded in the simple delight of 'being of service'. Empathy, active listening, a desire for achieving equitable solutions and growing together sits at the heart of every relationship.

Shapers

We revel in translating our expertise and knowledge into how estate taxation law is interpreted and developed. We know we are performing when we are invited into the conversations which are shaping the future in our domain. To be at the table requires our minds to be at the forefront of technical acumen and practical application.

Passionate

We share a hunger to be the best in our field. We are energised by creating an environment that is unique with talent and values the contributions of our people. We have a natural nurturing instinct that invites every one of us to shine. Collaboration and teamwork allow us to punch above our weight.

Contact Us

MELBOURNE: (03) 9781 6800
ADELAIDE: (08) 7221 9750
BRISBANE: (07) 2101 5390
PERTH: (08) 6323 5480
SYDNEY: (02) 9131 4270

PO Box 1337 Waverley Gardens VIC 3170

estates@bnrpartners.com.au | bnrpartners.com.au

BNR PARTNERS
ESTATE & TRUST TAXATION SPECIALISTS