BNR PARTNERS

... specialising in the taxation of Estates and Trusts

When is a Tax Return required?

Perhaps the easiest way to assess this, is to ask if this was your own personal financial affairs would you have an obligation to lodge an income tax return? The Deceased has fundamentally the same requirements to lodge a return as any individual taxpayer.

Both a date of death and estate returns are eligible for the same tax free threshold (currently $18,200). It should be noted that whilst an estate return has access to this tax free threshold, it does lose the tax free threshold after a period of three years, but still has access to progressive marginal tax rates.

The fundamental questions are really as follows:

- Did the Deceased or the Estate pay, or have tax withheld?
- Is the taxable income above $18,200?
- Was the taxpayer conducting a business?

The first question is an important one. If the taxpayer has either paid or had tax withheld, and has income above the tax free threshold, the Estate could be eligible for a tax refund or potentially have a tax liability. Generally, if a taxpayer has paid tax in any form, then it is a fair indication that the executor may have an income tax obligation to consider.

As noted above, both the Deceased and Estate are treated by the ITAA as separate taxpayers and accordingly both are entitled to the full tax free threshold in the year of death. The Act does not pro rata this entitlement, so both the Returns would be eligible to the full $18,200 tax free threshold. Moreover, that Estate Returns are specifically excluded from the Medicare levy of 1.5% on any undistributed income. s. 215(s) of ITAA 1936.

A taxpayer who was in business has an automatic obligation to lodge a Tax Return regardless of the income levels of the business, and this would include if the business was trading at a loss. It is important to note that this obligation does not include business income generated from either a private trust or company, but rather relates to business income generated from trading as either a sole trader or as a partner of a partnership. Trust distributions and private company dividends would however be included when assessing if a taxpayer had an obligation to lodge an Income Tax Return.

Date of Death Return

This Return is required to be prepared for the period from the beginning of the taxpayer's financial year (normally the 1st of July) to their respective date of death. Any income earned during this period should be reviewed to determine if the taxpayer has any tax obligations, i.e. their income for the period is greater than $18,200.

If the LPR determines that there is no obligation or need to lodge an Income Tax Return, then they should lodge a Non-Lodgement Advice with the ATO. Both this form and the date of death return (sometimes referred to as 'the Final Return') are the medium to advise the ATO that the taxpayer is now deceased and that no further returns are required.

The LPR should also ensure that they determine any outstanding tax obligations the Deceased had at their date of death, and appropriately address these at this time.

Deceased Estate Return

This Return aligns itself with the administration period of the Estate and as noted above is the responsibility of the LPR/Executor, who must determine if the Estate has or will have any tax obligations, and then ensure that these obligations are met.

If the Estate does have tax obligations, then the LPR must apply for a separate tax file number (TFN) to that of the Deceased. We note that the ATO has indicated on their website that an estate return is required if the Estate has derived any income during the year.

The ITAA provides for a deceased estate to be taxed using standard adult marginal rates for a period up to three years. The Commissioner does however have the ability to remove this concession if it is believed that the estate administration is being unnecessarily delayed; in particular to take advantage of lower marginal rates than beneficiaries may be subject to within their own names.

It is worth noting that taxpayers in receipt of fully franked dividends could be eligible for a refund of the associated franking credits even if their income did not reach the tax free threshold. We have seen this at times missed by both the taxpayer and subsequently the LPR. It can easily accumulate in size to thousands of dollars of missed tax refunds.

Should I lodge anyway?

There are two schools of thought when it comes deciding to lodge an Income Tax Return, and neither is technically incorrect, so this should be decided on a case by case basis.

In Australia income tax is assessed on a self-assessment basis, meaning the Commissioner ordinarily accepts at face value the details of the return lodged, but does have the right to undertake an audit on any return. This right to undertake an audit is limited by the ITAA in s.170(1) to either a 2 year or 4 year period.

This means that as such, once a return is lodged, the clock physically starts ticking and when this time period elapses any errors or unintended omissions within the return are essentially quarantined. The two year amendment period generally relates to taxpayers with more basic affairs such as salary and wages, bank interest and dividends. Whereas in situations where a taxpayer is conducting a business, holds a rental property or is a beneficiary of trust income, then this audit period will be extended to 4 years.

Given the uncertainty of the Executor's personal responsibility of income tax after an estate has been distributed, we see a number of executors opt to avail themselves of the protection of this quarantined period by physically lodging a return even when the income is below the tax free threshold. It would be fair to say that from our observations, the industry would appear to be equally split between lodging or not lodging in these cases. There is an argument that the estate should not be unnecessarily burdened with the cost of preparing unnecessary tax returns, but equally an argument that it is hard to recover funds from beneficiaries to meet subsequent tax debts after the Estate has been distributed.

Finally it should be noted, that in the case of fraud or tax evasion that the Commissioner has an unlimited time frame in which to amend Returns.