When is a tax return required?

If you are administering a deceased estate, you may need to lodge:

- one or more individual income tax returns for the deceased person; and
- one or more trust income tax returns for the estate of that person.

For the year in which the individual died, two 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 year. In that year, both the deceased person and their LPR (Legal Personal Representative) are entitled to a full tax-free threshold (this is not pro-rated). The tax-free threshold is currently $18,200.

For example
Henry died on 4 February 2019. A return may be necessary in respect of income he derived for the period from 1 July 2018 to 4 February 2019.

Returns for deceased individuals

Generally an income tax return will not be required for a year (including the final period to date of death), where the deceased person's taxable income was below the tax-free threshold.

There are some circumstances where a return should be lodged even though the deceased's income was below the tax-free threshold:

- *if the deceased carried on business as a sole trader or in partnership - the ATO requires a return even if the business made a loss*
- *if tax was withheld from the deceased's income - this ensures that the tax is refunded to the estate, and*
- *if the deceased had an entitlement to franking credits - this ensures that those credits are paid to the estate. (Alternatively, these can be obtained by lodgement of an Application for Franking Credit Refund form).*

We have seen this missed by both the taxpayer and subsequently the LPR. It can easily amount to thousands of dollars of missed tax refunds.

If you determine that there is no need to lodge a return, you should lodge a Non-Lodgement Advice with the ATO.

This form (or the final return) lets the ATO know that the taxpayer is now deceased, and that they should not expect further returns. The LPR is also obligated to notify the ATO of the death of the taxpayer by lodging a Notification of Deceased Person form.

Returns for deceased estates

Trust returns will not be necessary for an estate for the first three years if:

- the net income of the estate (effectively its taxable income) is below the tax-free threshold
- there is no beneficiary presently entitled to income of the estate, and
- there are no non-resident beneficiaries of the estate.

Income Tax Ruling IT 2622 contains more information about present entitlement during the administration of an estate.

However even if the net income is below the threshold, returns should be lodged in those circumstances described for the deceased's returns.

If the estate does have tax obligations, then the LPR must apply for a separate tax file number (TFN) from that of the deceased.

To the extent that an LPR is assessable, they are generally taxed using standard adult marginal rates for a period of up to three years (although they are not required to pay Medicare Levy).

After that time, the LPR loses the benefit of the tax-free threshold but is otherwise still subject to progressive marginal tax rates.

The Commissioner does however have the ability to remove this concession for example where the estate administration has been delayed or tax avoidance is involved. In this case, the LPR will be assessed at the top marginal rate (and any CGT discount denied).

Should I lodge anyway?

There are two schools of thought when it comes to deciding whether to lodge an income tax return even though it is not actually required. 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 returns lodged, but does have the right to review an assessment. This right is limited to either a two or four year period.

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 is issued, the clock starts ticking so that when the amendment period elapses, any errors or unintended omissions are essentially quarantined.

But if no assessment is issued (generally because no return is lodged), there is no time period within which the ATO must review a person's tax affairs. The ATO does not issue an assessment to an LPR if an estate return has been lodged showing that the LPR had no liability. However the ATO has adopted a practice not to review the LPR's position after 2 or 4 years from lodgement – see Law Administration Practice Statement PSLA 2015/2.

Given the LPR's personal liability for income tax after an estate has been distributed, we see a number of them opt to avail themselves of the protection of this quarantined period by 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 appears 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 tax returns if they are not required, but equally an argument that it is hard to recover funds from beneficiaries to meet subsequent tax debts after the estate has been distributed.

To facilitate the administration of smaller and less complex estates, the ATO has published Practical Compliance Guideline PCG 2018/4. It applies only in relation to returns for the deceased individual (not the estate). If it applies, an LPR may get a similar level of protection after 6 months from lodging all of the deceased's returns or advising the ATO that they were not necessary.

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 assessments.

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