Death and income tax – some discrete issues: part 1

by Ian Raspin, CTA, Managing Director,
Lyn Freshwater, Senior Tax Consultant, and
Mark Morris, FTI, Senior Tax Counsel,
BNR Partners

This is part 1 of a two-part series dealing with some standalone issues about tax and deceased estates. This article discusses some of the factors that a legal personal representative should consider when deciding whether to hold or sell shares that the deceased owned. Relevant factors might include, for example, the tax residency of the estate and the beneficiaries. Part 1 also considers some of the advantages that testamentary discretionary trusts offer over those created inter vivos. For example, trustees of testamentary trusts are generally assessed at lower tax rates than trustees of inter vivos trusts and importantly have access to the CGT discount. Further, the higher tax rates that apply to a minor's unearned income do not apply to income from a testamentary trust, although, as noted, new rules are proposed which restrict this benefit to income from assets that the deceased person who created the trust owned.

Introduction

Deceased estate taxation is becoming increasingly complex for many reasons, including the likelihood of international elements and changes occurring (or proposed) in this area from both legislators and the ATO. The size of many estates is also much larger than in past generations, with a vast transfer of intergenerational wealth expected in the next decade.[1]

This two-part series examines some discrete factual scenarios and issues that commonly arise in a succession planning context or in the administration of the estate of a deceased person or testamentary trust. The facts and issues below have been identified by practitioners. From the perspective of a legal personal representative (LPR) or trustee, it is important to understand where tax liabilities lie in order to ensure that those liabilities do not have to be met from the LPR's own funds.

The material in this article is current as at 20 January 2020, and deals only with income tax (including CGT) issues.

Distributing or selling the deceased's share portfolio: tax implications

There is no simple answer to the question: should the deceased's share portfolio be distributed or sold? Non-tax factors will usually be relevant, such as whether residuary beneficiaries want the shares or the cash. Tax implications will depend on a range of factors, including the tax residence of the LPR, the tax residence of the beneficiaries and the types of shares involved.

If the deceased was, and everyone involved in the estate is, a resident/s of Australia and the LPR distributes shares that the deceased owned to a beneficiary, the main implication is that tax is deferred until the beneficiary sells the shares. That is, under CGT "death" roll-over,[2] the beneficiary inherits the deceased's cost base,[3] and any capital gain from the sale of the shares is included as part of the beneficiary's net capital gain in the year that a contract is entered into to sell them.[4]

Alternatively, if the LPR sells the shares, the capital gain would be included in the net income of the estate. Whether tax is paid by the LPR or a beneficiary of the estate will depend on whether there is any trust income and whether beneficiaries are presently entitled to it (or specifically entitled to capital gains or franked distributions).

Usually, until administration is complete, beneficiaries are not presently entitled to income of the estate, in which case the LPR will be taxed on trust net income under s 99 of the *Income Tax Assessment Act 1936* (Cth) (ITAA36).[5] Section 99 rates are basically individual marginal tax rates, with a tax-free threshold for the first three years, and may be more tax favourable than if beneficiaries were assessed. However, an LPR can, during the administration of an estate, determine to make beneficiaries presently entitled to particular amounts of income (or specifically entitled to franked dividends[6]). There may be advantages in doing this, for example, if the beneficiary is a charity that is a gift-deductible recipient.

It is assumed above that the share portfolio is in listed companies or at least those that the deceased did not control.

Sometimes, the deceased will have held shares in a resident private family company, and perhaps a 100% or controlling interest. In this case, the LPR may have to consider selling the shares or winding-up (liquidating) the company by having the company sell its assets and distributing the proceeds or making an in specie distribution of the assets.

A sale and distribution approach may yield taxable gains for the company in respect of revenue assets such as trading stock and post-CGT acquired assets. Franked dividends can be paid and offset by the LPR (and any excess franking credits refunded if the LPR is taxed under s 99), whether distributions are made before or after liquidation commences.

Where the deceased's shares were pre-CGT, and taken to be acquired for market value at the date of death, pre-liquidation dividends paid to non-corporate LPRs will not affect the reduced cost base of the shares,[7] allowing for potential

capital losses to be obtained for offset against estate gains (if any).

Distributing in liquidation has the advantage that gains on pre-CGT assets of the company are not taxable dividends,[8] although the amounts will still constitute capital proceeds for the purposes of CGT event G1[9] or CGT event C2 on the ending of the shares. Often, however, the benefits of tax deferral from simply allowing shares in the portfolio of the deceased to pass to the resident beneficiaries will outweigh other considerations.

Assets passing to foreign resident beneficiary

If shares that are non-taxable Australian property (non-TAP) assets owned by a resident deceased person pass[10] to a foreign resident beneficiary (rather than being sold by the LPR), the usual CGT roll-over for death does not apply. (Shares will generally be non-TAP,[11] but if they are in "land rich" companies, they may be taxable Australian property (TAP).[12])

Instead, CGT event K3[13] happens so that the gain inherent in the non-TAP asset on death does not fall out of the Australian tax net.[14]

CGT event K3 happens immediately prior to the death of the deceased, with the result that any gain or loss is included in the deceased's date of death income tax return (see the Appendix at the end of this article). A capital gain from CGT event K3 will arise if the market value of the relevant asset when the deceased died is more than its cost base at that time. A capital loss is made if that market value is less than the asset's reduced cost base.

In a recent matter that the authors came across, a legal practice had overlooked the application of CGT event K3 that resulted in a $60,000 tax liability. As all of the assets had been transferred to beneficiaries overseas, there were no funds left in Australia to pay the tax. As LPRs, the practitioners were liable to pay the tax.

Asset sold and proceeds paid to foreign resident beneficiaries

TD 2019/D7 indicates that, following the streaming amendments which apply for the 2011 and later income years, foreign resident beneficiaries cannot disregard their share of a resident trust capital gain (from the sale of TAP or non-TAP assets) on the basis that the capital gain was sourced outside Australia.

Section 115-220 ITAA97 now assesses the trustee on a foreign resident beneficiary's share of a trust capital gain (without regard to the rules in Div 6 of Pt III ITAA36 whereby foreign residents are assessed only on amounts attributable to sources in Australia).

Prior to the streaming rules, only those gains that were made assessable under Div 6 were treated as relevant gains for the purposes of the rules in Subdiv 115-C ITAA97. Section 115-215(6) then ensured that the amount was not assessed twice (by excluding the "Division 6" capital gains). The ATO's view in relation to the operation of the provisions prior to the streaming amendments is set out in ID 2010/54 and ID 2010/55.

Example

Andy is a resident of Australia. He owns his own home (subject to mortgage) and shares in numerous listed companies in Australia and overseas.

Andy passed away on 1 April 2017. Under his will, Andy left his estate to his three children in equal shares. One of his children (Janelle) resides in Switzerland.

His executors (the children in Australia) sell some of the foreign company shares on 28 June 2017 in order to pay out the mortgage. The estate has a net capital gain of $99,000 for the 2017 income year. Although the administration is not completed, the executors make each of the beneficiaries specifically entitled to $33,000 of trust capital gains for that year.

Janelle's share of the gains from the sale of shares on foreign stock exchanges cannot be disregarded on the basis that those gains were sourced outside Australia. (The LPR will be assessed under s 115-220 ITAA97 on her behalf.)

Previously, the gains from the shares bought and sold on foreign stock exchanges would not have formed part of Janelle's share of net income on the basis that those gains were sourced outside of Australia and so there was no amount in respect of which Subdiv 115-C could operate.

Further, in TD 2019/D6, the ATO takes the view that a foreign resident beneficiary of a non-fixed trust cannot disregard their share of a trust gain from non-TAP assets under s 855-10 ITAA97.[15] On this view, gains from non-TAP trust assets can only be disregarded by beneficiaries of fixed trusts under s 855-40.

If this is correct, the ATO suggests, at para 21 of TD 2019/D7, that the only possible way around this for foreign-sourced non-TAP gains may be for the trustee to accumulate rather than distribute, have the trustee assessed under s 99 (or 99A) ITAA36, distribute to the non-resident beneficiary, and claim a refund under s 99D ITAA36. This is very messy and cumbersome, especially for deceased estates.

The following example shows how there may be a better way in the context of a deceased estate, and it would also deal with non-TAP gains that were not foreign-sourced.

Example

Continuing from the previous example, Janelle cannot disregard her share of the capital gains under s 855-10 ITAA97 on the basis that the gains are from non-TAP assets. The ATO's view is that the exception only applies to gains that Janelle makes in her own right, not through a trust.

If, however, the gain was made in the year that the administration was completed, Janelle may be able to disregard her share of the trust capital gain under s 855-40 ITAA97. At the time she is taken to have made

Example (cont)

that gain (the end of the relevant income year), the trust is a fixed trust rather than a non-fixed trust.

Janelle would be well-advised to ask for a private ruling to confirm that the trust was a fixed trust.[16]

(Note that the situation would be the same for ASX-listed shares as they are also usually non-TAP assets.)

When the LPR is a foreign resident

For tax purposes, an LPR is treated as a trustee, and a deceased estate is treated as a trust estate. There are different tax rules that apply depending on whether or not the trust estate is a resident trust estate.

Where the LPR of an estate is a foreign resident, the estate will generally not be a resident trust estate for taxation purposes even though the deceased may have been an Australian tax resident.

This has several tax consequences; this article only considers those relating to capital gains.

Capital gains and losses made by the LPR of a foreign trust from assets that are non-TAP will not be included in the net income of the estate. This would include, for example, shares in most ASX-listed entities, foreign shares and foreign land. The ATO takes the view in TD 2017/23 that s 855-10 ITAA97 overrides the requirement in s 95(1) ITAA36 that the net income of a trust be calculated on the basis that the trustee was a resident taxpayer.

Example

Bob Builder resided in Australia throughout his life. When he died, he had an extensive portfolio of ASX-listed company shares.

Bob's will appointed his son Boris as his LPR. Boris has resided in London for many years. Boris, as LPR, sold the shares and made capital gains totalling $5m.

As the estate is not a resident trust estate and the shares are not TAP, the gains from the shares are not included in the net income of the estate and so no liability arises.

Alternatively, if Boris had been a resident of Australia, the estate would be a resident trust estate and the gains would have been included in the estate net income. If there were no beneficiaries presently entitled to trust income, Boris, as LPR, would be assessed under s 99 ITAA36 on those capital gains (reduced by the 50% CGT discount where applicable).

Subsequent distribution to resident beneficiary

The ATO takes the view in TD 2017/24 that an amount attributable to a non-TAP gain of a foreign trust will be assessable under s 99B ITAA36 if it is later distributed to a resident beneficiary.[17]

Section 99B(1) includes in a beneficiary's assessable income an amount (being property of a trust) that is paid to, or applied for the benefit of, the beneficiary[18] if they were a resident at any time during the income year. (Section 99B does not apply if the beneficiary is a foreign resident for the entire income year in which the distribution is paid.)

There are exceptions to the application of s 99B.[19] Perhaps the most important exception is for a distribution of trust corpus.[20] However, that exception does not apply to so much of a corpus distribution that would have been assessable had it been derived by a resident taxpayer.

Accordingly, TD 2017/24 takes the view that a distribution from corpus that is attributable to a capital gain does not fall within the corpus exception.

Further, TD 2017/24 takes the view that the amount made assessable by s 99B(1) ITAA36 does not have the character of a capital gain for Australian tax purposes, nor is there any linkage between s 99B(1) and Subdiv 115-C. This means that an amount which is included in assessable income under s 99B cannot be reduced by a capital loss or the CGT discount.

Example

Continuing from the previous example, assume that Boris, as LPR, distributes an amount attributable to the $5m gain to his sister Doris who is a tax resident of Australia.

Doris must include the entire distribution of $5m in her assessable income under s 99B. She cannot reduce the amount by her net capital loss or by the CGT discount.

(Note that the situation would be different if Doris was a foreign resident because s 99B only applies to distributions to Australian resident beneficiaries.)

The recent case of *Campbell v FCT*[21] highlights the importance of maintaining records at the level of detail necessary to establish that the corpus exception applies.

Finally, if an amount is assessable under s 99B ITAA36, an interest charge may also be imposed under s 102AAM ITAA36 (there is an interest charge exception for amounts distributed from a deceased estate within three years of the date of death[22]).

Should a testamentary trust for the grandchildren be set up for tax purposes?

The answer to the question of whether a testamentary trust for grandchildren should be set up for tax purposes, as with most things in tax, is that it may or it may not be, depending on all the circumstances. (It is assumed that, in this context, tax means income tax, including tax on capital gains.)

It is important at the outset to appreciate that there is no single type of testamentary trust. A testamentary trust, like one created inter vivos, may be purely discretionary, may confer contingent interests on the grandchildren which vest on their attaining their majority, may be a trust with successive interests (for example, to the testator's children for life with the remainder to the grandchildren), or may be some other type of trust.

Different tax outcomes may attach to these different arrangements or, even if the same tax is payable, the analysis or mechanism may be different.

Another significant point to note is that, while tax minimisation is almost always an important consideration in the choice of a structure to handle the assets of the deceased, there are almost always non-tax considerations which are equally (if not more) important. For example:

– a testamentary trust may be put in place so that the testator can effect some degree of control over the assets after death (for example, by using a discretionary testamentary trust with appointers etc);
– there may be strong asset protection aims involved so that the assets are not regarded as those of the grandchildren (or other beneficiaries) for bankruptcy or family law reasons, for example, if the grandchildren are of age and subject to risks in their business or professional undertakings; and
– one testamentary trust (as opposed to several) may not be the best structure to deal with situations other than where it is intended that the residue should simply be shared between the grandchildren on their attaining majority, that is, differences of opinion may arise about the management of the trust when the grandchildren are older and have families of their own. In circumstances where the grandchildren seek to split the trust into separate trusts, other tax issues may arise.

Having said that, it is true that testamentary trusts can offer some significant tax benefits (both in terms of annual income and capital gains) over other arrangements (for example, leaving assets directly to children who could then provide as they wished for the grandchildren).

The following analysis assumes that the trust and the grandchildren are Australian residents. More complex considerations may arise if this is not the case. For example, if the beneficiaries are foreign residents and it is proposed that the trust will hold non-TAP assets other than those owned by the deceased, there may be advantages in using a fixed trust (rather than a discretionary trust) to access the relief in s 855-40 ITAA97 when such assets are distributed to the beneficiaries.

The main tax advantages to using a testamentary trust include:

– the ability to secure favourable tax rates under s 99 ITAA36, including access to the CGT discount (where there are not presently entitled beneficiaries to all of the income);
– the ability to access exceptions to Div 6AA of Pt III ITAA36 (sometimes called "children's tax"), in particular, where income is used for the maintenance and education of infant beneficiaries; and
– the CGT concessions that may be availed of when assets actually pass to the beneficiaries (for example, on their coming of age or at some later point).

These tax advantages are considered in more detail below.

Access to s 99 progressive individual rates

Testamentary trusts are, broadly speaking, subject to many of the same tax rules as other trusts (such as present entitlement to trust income, and the determination of trust net income) in Div 6 of Pt III ITAA36. However, there are some special considerations that may provide testamentary trusts with tax rate advantages over inter vivos trusts (especially when accumulating income) or compared with top marginal tax rates applying to individuals (as direct beneficiaries).

In the case of a testamentary trust where the interests of minor grandchildren have not yet become vested (that is, the income is accumulated absent an amount being applied for their benefit, such as for their education), much of the net income will fall to be assessed to the trustee.

Many people do not appreciate that, strictly, the penal rates (top marginal tax rate plus Medicare) that apply to assessments under s 99A ITAA36 apply to all trusts, including testamentary trusts, unless the Commissioner determines that it would be unreasonable to apply them having regard to some narrow exceptions. One exception is a trust resulting from a will, codicil etc.[23] This is not limited to the deceased estate (a trust for tax purposes, although not at general law), but also includes a testamentary trust.

If the exception applies, s 99 ITAA36 applies rather than s 99A. Broadly, the trustee is taxed on the income as if an individual (at progressive rates). However, the trustee is not entitled to the tax-free threshold.

It is sometimes thought that the special rates that apply within three years of death (which include a tax-free threshold of $18,200) can apply to a testamentary trust. They cannot, even if the testamentary trust arises within the three years. The special rates can only be applied to the estate of a deceased person (that is, while it is under administration).[24]

> *"... testamentary trusts offer some significant benefits ... over other arrangements ..."*

Avoiding Div 6AA ITAA36 consequences

Prima facie, a minor's assessable income over $416[25] from trusts is taxed at the top marginal rate (even to the extent of effectively taxing the $416 if it is exceeded), and this has been the case since 1979. But there are important exceptions for "excepted income", including income of a trust estate that resulted from a will.[26] This exception is itself subject to some specific anti-avoidance rules.

Excepted trust income is taxed at adult marginal rates with a tax-free threshold so, effectively, $18,200 is tax-free in most cases for minor grandchildren.[27] For example, if there are five such grandchildren, $91,000 can be freed from tax. As the tax-free threshold is not available under s 99 ITAA36 for a trustee of a testamentary trust, there may well be tax advantages associated with making sure that the grandchildren derive assessable income from the trust, as opposed to it being accumulated. This sort of arrangement can be very tax effective — parents can spend "untaxed" money on children (maintenance/education), whereas normally they would be paying this out of after-tax income.

For completeness, it should be noted that, even if a testamentary trust has not been set up in favour of grandchildren (for example, where the testator has left the

property to a child directly, leaving it up to that child to make some provision for the grandchildren), it may still be possible to obtain the relief under Div 6AA of Pt III ITAA36 that would have been available for a testamentary trust in favour of the grandchildren.

This requires gifting or transferring the estate assets into an inter vivos trust. However, the requirements are very specific, including requirements as to timing which must be within three years of the date of death.[28] Where an inter vivos trust is involved, the CGT and stamp duty implications may not be the same.

Adding assets and related income to the testamentary trust

So far, it has been assumed that the concessions have been sought for assets of, and income from assets of, the deceased person. Significant opportunities may be available (subject to some announced proposed amendments) if the concessions can be obtained in relation to other assets and income — often referred to as "after-acquired" property and the income derived from such property.

The first question is, can it be done? If the terms of the trust do not permit such contributions to be received by the trustee (and there is no power of amendment to change this), it probably cannot be done as there would be a new and different trust created even if it were on the same terms.

If it can be done, case law[29] makes it clear that the exemption from the Div 6AA rates is not limited to income from assets that the deceased had. This is a significant loophole in the existing law which effectively allows income from non-estate assets to be favourably treated. It is not a loophole that the authors recommend exploiting, nor in their experience one that is used by the general legal/accounting community or listed trustee companies. In any event, the ability to take advantage of it has now been curtailed by a proposed change to the law (see below).

Budget announcement to address loophole

The 2018-19 federal Budget included a proposed integrity measure to deny excepted trust income status from 1 July 2019 to income derived from introduced estate property, such as gifts or borrowings. These changes have not yet been enacted, but legislation has been introduced.[30] The amendments will apply to assets acquired by or transferred to a testamentary trust on or after 1 July 2019. However, income derived from assets acquired or transferred before that date and distributed to minors will not be affected. There are also rules to prevent the addition of new entities to the class of beneficiaries for the deceased estate.

Existing anti-avoidance measures

There are already anti-avoidance measures which apply Div 6AA tax to income derived by a minor beneficiary from a testamentary trust where effectively value is injected. This is where:

- the income is derived from an arrangement or a transaction that is not arm's length, eg where estate property is exchanged at overvalue;[31] or
- the income is derived from an arrangement entered into or carried out for a purpose of securing the tax concession. It need not be a dominant purpose — just not incidental. This is a low bar to trip over.[32]

CGT reliefs

Assets of deceased at death

On a literal reading of the tax law, the so-called "death" roll-over in Div 128 ITAA97 may not apply when testamentary trust assets pass to beneficiaries. This is because the relief applies to an LPR, which technically does not include a trustee of a testamentary trust arising from a will. However, the ATO has long administered the law on the basis that it does include a person acting in that capacity, but only in respect of trust assets that were owned by the deceased at the time of death.[33]

Government announcement to address

In the 2011-12 federal Budget, the then government announced that it would legislate the Commissioner's practice of allowing Div 128 ITAA97 to apply to assets coming out of testamentary trusts to beneficiaries. It also said that it would rewrite the deceased estate provisions with a principled approach, and make some minor technical amendments.

Again, in the 2012-13 federal Budget, the then government announced that this legislation would proceed, and that a series of minor amendments would be made to the measure (for example, to reduce compliance costs from the change, modifying application dates, and extending the integrity provisions to assets subject to survivorship).

However, on 14 December 2013, the then government announced that these changes would no longer be proceeded with, resulting in some continuing uncertainty. There is a small degree of risk that, absent legislative change, the Commissioner may change his view or a case may come before the courts where the law is interpreted strictly.

Assets acquired by the trustee after the death of the deceased

The Commissioner's view is that Div 128 ITAA97 does not happen in relation to "after-acquired" property of a testamentary trust. It is therefore possible that relevant CGT events (for example, CGT event E5 to CGT event E7, which are excluded for Div 128 cases) may throw up taxable capital gains when beneficiaries become absolutely entitled to those assets (CGT event E5)[34] or they are transferred to beneficiaries who are not absolutely entitled to them (CGT event E7).[35] Although these CGT events can operate at both the trustee level and the beneficiary level, usually the beneficiary has not paid for their interest or acquired it by assignment, so any gain or loss at the beneficiary level is disregarded.

The detailed operation of these provisions is beyond the scope of this discussion, but suffice to say that, in the Commissioner's view outlined in TR 2004/D25, absolute entitlement (CGT event E5) does not arise for indivisible property such as land where there are multiple beneficiaries. Moreover, notwithstanding what the Commissioner says in TR 2004/D25, it probably does not strictly arise for divisible "fungible" property like shares either — for several reasons, including that beneficiaries cannot point to particular shares that they are absolutely entitled to, or the shares may rarely

betruly fungible (eg if they have different cost bases or dates of acquisition). This means that, provided there are multiple beneficiaries ("grandchildren"), trust capital gains can be deferred at least until actual distribution or transfer of almost all assets, unless an earlier taxing point is sought consistent with the ruling for "fungible" assets.

Life estates

Where testamentary trusts are established using life estates (so that a surviving spouse or child derives a constant income during their life, with the residue being held for the grandchildren), more complex CGT outcomes can arise, and these are discussed in detail in TR 2006/14.

In general terms, while the creation of the testamentary trust may trigger CGT event E1,[36] Div 128 ITAA97 avoids any adverse consequences in respect of assets of the deceased. Further, on death of the life tenant, CGT event C2[37] happens to the life tenant but any gain or loss is disregarded under Div 128.

The positions of the remainder beneficiaries and trustee have to be considered. The death of the life tenant may result in remainder beneficiaries becoming absolutely entitled (normally triggering CGT event E5); if not, the actual transfer of the asset by the trustee would normally trigger CGT event E7. However, in relation to assets of the deceased, CGT events E5 and E7 do not happen.

It is not entirely clear whether, strictly, other CGT events (such as CGT event A1[38]) could happen in relation to the deceased's assets. On one view, the specific exclusion to the normal trust CGT events having been met suggests that no other CGT event should be regarded as happening. Even if that is not correct, the trustee would seem to be protected by the Commissioner's administrative approach whereby the trustee is treated as if it were an LPR for Div 128 purposes. The position of the remainder beneficiaries is even less clear, but it has never been suggested by the ATO that a beneficiary receiving assets of the deceased for Div 128 purposes has any capital gain or capital loss on the ending of their interest, for example, pursuant to CGT event C2.

Different outcomes may arise in relation to "after-acquired" property, if there is any.

Mere right of occupancy

Sometimes the use of a mere right of occupancy of a marital home (without a full life estate) will be enough to confer the intended benefit for a surviving spouse or another person without the above more complex implications. Stamp duty liability may also be averted, which may not be the case for life estates. Also, the main residence exception can be preserved where the spouse or a person with a right to reside under the will occupies the dwelling.

Conclusion

This concludes part 1 of the two-part series on discrete facts and tax issues related to deceased estate administration. Part 2 will look at main residence issues and whether a challenge to the will can result in upfront CGT for a deceased estate.

Ian Raspin, CTA
Managing Director
BNR Partners

Lyn Freshwater
Senior Tax Consultant
BNR Partners

Mark Morris, FTI
Senior Tax Counsel
BNR Partners

This article is an edited and updated version of "Death and taxes – some discrete issues" presented at The Tax Institute's Tasmanian State Convention held in Launceston on 17 to 18 October 2019.

Appendix

An issue arises when the estate administration process exceeds the period available to amend the deceased person's assessment for their final return. The amendment periods permitted under s 170 ITAA36 are generally capped at either two or four years after an assessment notice has been issued, depending particularly on whether the deceased was involved in a business that was not a small business. Accordingly, it is not possible to generally amend an assessment to include any omitted capital gain arising under CGT event K3 in the deceased's date of death return after these time periods have elapsed.

This problem is known to regulators and was proposed to be addressed by amendment. The proposed amendment was designed to capture any gain or loss from CGT event K3 in either the estate or testamentary trust tax return at the date of transfer, albeit at market value at the date of death of the testator. Subsequently, the government announced, on 15 December 2013 as part of its "announced but unenacted measures" review, that it was not proceeding with the measure. As it currently stands, if CGT event K3 happens after the amendment period of two or four years has expired, it is essentially a tax-free gain because an amendment of a prior year assessment is statute barred. However, the general anti-avoidance provisions in Pt IVA ITAA36 may need to be considered if this eventuality is planned.

References

1 A recent study in the United States indicates that millennials in that country are expected to inherit $68t from their baby-boomer parents by 2030. See www.cnbc.com/2020/01/16/receiving-an-inheritance-four-things-experts-say-you-should-know.html.

2 Div 128 of the *Income Tax Assessment Act 1997* (Cth) (ITAA97).

3 If the shares were pre-CGT shares of the deceased, they are acquired at the date of death and have an acquisition cost equal to their market value at that death. See item 4 of the table in s 128-15(4) ITAA97.

4 S 104-10(3) ITAA97.

5 Sch 10 to the *Income Tax Rates Act 1986* (Cth).

6 IT 2622.

7 S 110-55(7) ITAA97.

8 S 47(1) and (1A) ITAA36.

9 S 104-135 ITAA97.

10 Note that the ATO takes the view in TD 2004/3 that an asset will "pass" to the beneficiary of a deceased estate when the beneficiary becomes absolutely entitled to the asset as against the estate's trustee (whether or not the asset is later transmitted or transferred to the beneficiary). In the authors' opinion, this view is contestable as it can reasonably be argued that "pass" in this context means "given to" — had the legislature intended the test to be absolute entitlement, it could easily have done so.

11 "Taxable Australian property" is defined in s 855-15 ITAA97. It includes mostly land in Australia, and certain indirect interests in land.

12 Section 855-25 ITAA97 sets out when an indirect real property interest will be TAP.

13 S 104-215 ITAA97.

14 That is, foreign residents are only subject to tax on TAP assets.

15 In the ATO's view, s 855-10 only applies to a foreign resident entity that makes a capital gain from a CGT event happening to them. A capital gain that a beneficiary of a trust is taken to make under Subdiv 115-C is not from a CGT event happening to them; rather, it happened to the trustee. See TD 2019/D6.

16 It may be difficult for many trusts to satisfy the definition of "fixed trust" unless the Commissioner exercises his discretion to treat the beneficiaries' interests as fixed entitlements. PCG 2016/16 outlines the factors that the Commissioner will take into account when exercising that discretion. It also provides a safe-harbour compliance approach for trustees of certain trusts that allows them to manage the trust's tax affairs as if the Commissioner had exercised the discretion to treat beneficiaries as having fixed entitlements to income and capital of the trust.

17 In the Boris example, where the trust was resident, the application of s 99 would mean that there would be no subsequent application of s 99B on distribution to a resident beneficiary, and it is evident that some trusts proposing to make such distributions would be much better off if they had been resident trusts for tax purposes. The appointment of a resident LPR would usually be enough to achieve this outcome.

18 Section 99C ITAA36 sets out when an amount will be taken to have been applied for the benefit of a beneficiary.

19 S 99B(2) ITAA36.

20 S 99B(2)(a) ITAA36.

21 [2019] AATA 2043.

22 S 102AAM(1B) ITAA36.

23 S 99A(2) ITAA36.

24 Div 6AA of Pt III ITAA36; and para (1)(b) in Pt I of Sch 10 to the *Income Tax Rates Act 1986*.

25 Subdiv C of Pt II of the *Income Tax Rates Act 1986*.

26 S 102AG(2) ITAA36.

27 The assessments are made to the trustee under s 98 ITAA36 to facilitate collection of tax. The beneficiaries may also be assessable under s 100 ITAA36 but will be entitled to a credit for the tax paid by the trustee.

28 S 102AG(2)(d)(ii) ITAA36.

29 *The Trustee for the Estate of the late AW Furse No. 5 Will Trust v FCT* (1990) 21 ATR 1123.

30 Treasury Laws Amendment (2019 Measures No. 3) Bill 2019, introduced on 5 December 2019.

31 S 102AG(3) ITAA36.

32 S 102AG(4) ITAA36.

33 PS LA 2003/12; and TR 2006/14.

34 S 104-75 ITAA97.

35 S 104-85 ITAA97.

36 S 104-55 ITAA97.

37 S 104-25 ITAA97.

38 S 104-10 ITAA97.