

THE TAX OBLIGATIONS OF A LEGAL PERSONAL REPRESENTATIVE

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BNR was the 2019/20 global winner of 'mid-sized accounting firm of the year' in the prestigious Society of Trust and Estate Practitioners private client awards in London.

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INTRODUCTION

A person's appointment as the Legal Personal Representative (LPR) of a deceased estate is often seen as a time-honoured role where a family relative or trusted adviser ensures that the deceased's testamentary wishes are given effect.

However, in reality this fiduciary role also carries with it an array of responsibilities and risks which should be considered before any person agrees to be the executor or administrator of a deceased estate.

In particular, individuals accepting the role of the LPR of a deceased estate must recognise that they are liable for the deceased's outstanding tax liabilities to the extent of the deceased's assets that come into their hands.

This is because once the Letters of Administration or Probate are granted, the tax law will treat the LPR as that deceased person under section 260-140(2) of Schedule 1 of the *Taxation Administration Act (1953)* (the TAA (1953)).

That is, the LPR effectively stands in the shoes of the deceased for the purposes of discharging any of the deceased's outstanding tax liabilities to the ATO.

Accordingly, where the deceased's assets have been distributed and there are no funds left in the estate to discharge such liabilities, the LPR will have to meet the debts from their own assets.

Given this significant potential exposure this paper seeks to:

- Identify when an LPR may become personally liable for the outstanding tax liabilities of the deceased as at the date of death;
- Explain why an LPR should only consider distributing assets to beneficiaries after the period of the Commissioner's ability to amend assessments of the deceased has expired;
- Highlight the Commissioner's administrative concession under *Practical Compliance Guideline PCG 2018/4* which provides an LPR with greater certainty that smaller and less complex estates can be wound up without triggering a liability from the LPR's assets for the pre-death tax obligations of the deceased;
- List other practical strategies an LPR should consider taking in order to mitigate any potential tax exposure; and
- Explore the merits of an LPR making voluntary disclosure of any unpaid tax liabilities of the deceased to the ATO to crystallise any outstanding income tax liabilities and therefore reduce the LPR's potential exposure to possible tax liabilities.

Each of these key considerations is discussed further below.

While the focus of this paper is on outstanding income tax liabilities an LPR may inherit from a deceased person, it should be noted that the LPR is also required to lodge any other outstanding business activity statements or instalment activity statements and remit any unpaid Goods and Services Tax (GST), Pay-As-You-Go Instalments or other taxes owed to the Commissioner of Taxation up to the date of death of the deceased.

Moreover, the LPR will have a personal liability in respect of any liability arising in respect of the period after death (i.e. the deceased estate). Where an estate continues to operate a business of the deceased who had traded in their own right, the LPR will be required to obtain a new Australian Business Number (ABN) and GST registration in the name of the estate to ensure that the LPR will be able to apply the rollover provisions of section 138-17 of the *A New Tax System (Goods and Services Tax) Act (1999)* in continuing to carry on the business for GST purposes. Similarly, the LPR will be required to make an election under section 70-105(3) of the *Income Tax Assessment Act (1997)* (the ITAA (1997)) to ensure that any trading stock acquired by the LPR in their representative capacity is not regarded as being a disposal of trading stock at its market value outside the ordinary course of business.

The contents of this paper are current as at 18 October 2018.

1. INCOME TAX LIABILITIES OF A LEGAL PERSONAL REPRESENTATIVE

1.1 BACKGROUND

As the LPR stands in the shoes of the deceased the LPR is required to lodge a final income tax return up to the date of death of the deceased, and any other outstanding income tax returns of the deceased, under sections 260-140(3)(a) and (b) of the TAA (1953).

In lodging such returns, the LPR can make all the elections and choices that the deceased would have been able to make in respect of such returns under section 260-140(2) of the TAA (1953).

Conversely, if the LPR determines that there is no obligation or need to lodge an income tax return the LPR should lodge a Non-Lodgment Advice with the ATO.

Following the lodgment of such returns (or notices) the LPR will then be liable for any income tax assessed in their representative capacity as the trustee of the deceased estate including any penalty or general interest charge that may be payable under section 260-140(3)(c) of the TAA (1953).

Essentially, section 260-140(3)(c) provides the Commissioner of Taxation with the same rights of recovery against the LPR in respect of any outstanding tax liability that he would have had against the deceased.

Accordingly, it would be advisable that the LPR ensures that the ATO issue a notice of assessment (or are taken to have issued a nil assessment) before any of the assets of the estate are distributed to beneficiaries to ensure that sufficient monies are retained by the estate to fund the payment of any assessed income tax liabilities.

Where a decision is made to make an interim distribution part-way through an estate's administration, it is critical that prior to making such a distribution, the LPR ensure they assess and make adequate provision to meet all tax obligations. *Taxation Ruling IT 2622* clearly sets out the Commissioner's position on the stages of estate administration including the requirement that the LPR must provide for all debts relating to the period prior to death and for debts incurred in administering the estate before the completion of the estate's administration.

The Commissioner can also assess the LPR if there is a failure to lodge a final income tax return up to the date of death (or any other required income tax return) under section 260-140(4) of the TAA (1953). Accordingly, an LPR is not able to avoid their responsibilities as trustee of the deceased estate by simply not lodging outstanding income tax returns as the ATO may issue a default assessment in such circumstances.

It is also important to recognise that where probate or letters of administration are not granted within 6 months of the date of death of the deceased, the Commissioner may determine the outstanding tax liabilities of the deceased pursuant to section 260-145 of the TAA (1953). In these circumstances, section 260-140 will not apply as would be the case in Queensland where assets automatically vest with the LPR where the deceased leaves a will.

1.2 LPR'S LIABILITY

As discussed, an LPR's liability as a trustee of a deceased estate is a personal liability of the LPR rather than being a liability of the deceased. However, an LPR's liability up to the date of death of the deceased is considered to be a representative liability and will therefore be limited to the value of the assets that should have come into the hands of the LPR.

However, it is well established that the amount of such a tax liability cannot exceed the value of the deceased's assets which form the property of the deceased estate, provided no distribution of the assets of the estate have been distributed to beneficiaries.

The rationale for such a view is that the LPR is only appointed after the deceased had derived such taxable income and therefore will not have had an opportunity to provide for such a tax liability before that time (see *Barkworth Olives Management Limited v DFC of T* (2010) ATC 20-172; *Stapleton v FCT* (1955) 93 CLR 603).

Essentially, an LPR is assessed on any outstanding tax assessed in respect of the deceased's income tax returns as the LPR stands in the shoes of the deceased under section 260-140 of the TAA (1953), and will therefore be liable to pay the tax payable on the taxable income derived by that deceased individual in respect of such returns calculated at the applicable marginal tax rate.

Accordingly, an LPR should take great care in collecting all the assets of the deceased to ensure that sufficient funds are retained to pay any outstanding tax debts as well as any other liabilities.

Such a tax liability will rank equally with all other liabilities to the extent that the deceased passed away on or after 1 July 2000.

In practice, some assets of the deceased will not come into the hands of the LPR. This is particularly true for smaller estates where a main residence passes to a surviving joint tenant, a life insurance policy is payable to a specified dependant or when superannuation benefits are paid directly to a dependant of the deceased member rather than to the estate. All other assets owned directly by the deceased which pass to the LPR should nonetheless be set aside as they may be required to fund the payment of any outstanding tax liability of the deceased.

Accordingly, the personal assets of the LPR can be quarantined from any prospective tax liability up to the point that no distributions of estate assets have been made to beneficiaries. Where an estate's debts exceed the value of its assets, the estate will be insolvent and should be administered in accordance with the Bankruptcy legislation or provisions in the relevant State or Territory legislation dealing with insolvent estates.

However, section 254(1)(e) of the ITAA (1936) also provides that the trustee is personally liable for the tax payable on any monies that come to the LPR in their representative capacity which has been retained or should have been retained by the LPR in respect of income derived by the estate.

Hence, there is a risk that an LPR will not comply with section 254(1)(e) if the trustee fails to recognise that tax 'should' have been retained from income received by the deceased estate and subsequently distributes assets of the estate to beneficiaries without being aware of this exposure.

Given this potential tax liability it is therefore appropriate that any LPR act conservatively in ensuring that any estate property is not distributed to beneficiaries where there is any doubt or concern that there may be potential tax liabilities up to the date of death of the deceased.

To mitigate this risk the LPR should make appropriate queries to ensure that all potential tax liabilities have been identified including making contact with the ATO where a return has been lodged but not assessed to ensure that there are no tax liabilities which the trustee needs to account for.

This is especially important as the ATO will anticipate that the LPR would have had notice of any outstanding claim that may be made in respect of outstanding tax liabilities since the LPR stood in the shoes of the deceased in preparing the outstanding returns and would therefore be expected to have a reasonable understanding of any prospective tax claims that could be made by the ATO.

Accordingly, an LPR must proceed with caution before distributing any assets of the estate to beneficiaries especially as it was held in *Deputy Commissioner of Taxation v Brown (1958) 100 CLR 32* that the Commissioner cannot recover tax from a beneficiary once the estate's assets have been distributed by the LPR. This effectively means that the only avenue available to the ATO to collect such outstanding tax is to recover that amount from the LPR.

2. LIABILITY IN RESPECT OF PRIOR YEAR ASSESSMENTS

The LPR's prospective personal liability will not only extend to the assessment of income tax returns that were outstanding at the time of the deceased's death but also to any amended assessments that may be issued after their appointment in respect of prior year assessments of the deceased.

Accordingly, the LPR must be alert to the risk that further tax may be assessed in respect of prior year assessments issued to the deceased subject to restrictions on the amendment of assessments set out under section 170 of the ITAA (1936).

Moreover, if during the administration of the estate the LPR becomes aware during the relevant amendment period that there were material errors or omissions in prior year tax returns of the deceased, it is prudent for the LPR in their representative capacity to request amended assessments in the same way that any other taxpayer would voluntarily disclose such adjustments in order to reduce any penalties that may be imposed.

This would particularly apply to prior year adjustments where the ATO has issued an amended assessment, and it would be reasonable for the LPR to expect that the ATO to also amend earlier prior year assessments where an error or omission is effectively repeated over multiple years.

Such vigilance is desirable as the LPR will wish to ensure that any tax issues are appropriately disclosed and quantified to the ATO to ensure that their own potential tax exposure is minimised before any property of the estate is distributed to beneficiaries.

2.1 TIME LIMITS ON AMENDMENTS

Broadly, there are 3 major time periods in respect of which a notice of assessment can be amended in respect of a deceased individual under section 170 of the ITAA (1936) being either 2 or 4 years after the day on which the Commissioner gave that individual a notice of assessment, or a period of indefinite duration where the Commissioner believes that there has been fraud or evasion in respect of a prior year assessment.

Each of these 3 scenarios are discussed below:

2.1.1 2-YEAR TIME LIMIT

Item 1 of section 170(1) of the ITAA (1936) allows the Commissioner to amend an assessment for an individual within 2 years after the day on which the Commissioner gave notice of the assessment to the individual, and that person was either not carrying on a business or was a sole trader that would otherwise qualify to be a small business entity.

Very broadly, a small business entity for these purposes is defined under section 328-110(1) of the ITAA (1997) to mean an entity which carried on a business in the relevant year whose aggregated turnover was below a certain threshold which is less than \$10 million from the year ended 30 June 2017 (and less than \$2 million for earlier years).

This 2-year amendment period would also apply to an individual who was a partner in a partnership or a beneficiary of a trust where the partnership or trust was itself a small business entity.

For these purposes the Federal Court held in *Yazbek v FCT (2013) FCA 39* that a 'beneficiary' means any person for whose benefit a trust estate is administered who is entitled to enforce the trustee's obligation to administer the trust in accordance with the trust deed, rather than merely those beneficiaries who have an actual interest in the trust income or property. Accordingly, an object of a discretionary trust will be subject to the 2-year amendment period provided the trust itself satisfies the requirements of being a small business entity.

Given the breadth of individuals covered by Item 1 the amendment period for most deceased individuals would predominantly be capped to the above 2-year time limit provided a notice of assessment has issued (or has been deemed to have been issued) to the deceased.

However, it is always important to recognise that this 2-year time limit is subject to other provisions under section 170 which could extend the amendment period to either 4 years or an indefinite period in certain circumstances.

2.1.2 4-YEAR TIME LIMIT

Item 4 of section 170 (1) of the ITAA (1936) may extend the amendment period to 4 years after the day on which the Commissioner gave a notice of assessment to the deceased individual in certain circumstances.

Firstly, the 4-year amendment period will apply if the deceased was carrying on a business and was not a small business entity in the year(s) in issue.

This also extends to a partner in a partnership where the partnership was not a small business entity for the relevant tax year.

For example, if the deceased individual had been a partner in a partnership carrying on a business which had an annual turnover of \$10 million or more for the year ended 30 June 2018 that individual would be subject to a 4-year amendment period under Item 4 assuming that person had passed on during the year ended 30 June 2018.

Similarly, the 4-year amendment period will apply to a beneficiary of a trust which is not a small business entity.

As discussed, following the Federal Court's decision in *Yazbek v FCT (2013) FCA 39* a beneficiary includes an object of a discretionary trust for the purposes of amending assessments under section 170(1) of the ITAA (1936) and is not merely limited to those beneficiaries who are assessed on a share of the net income of a trust.

Thus, any object of a discretionary trust will be subject to a 4-year amendment period where the relevant trust is not a small business entity in the relevant year because it either exceeds the applicable aggregated turnover threshold or is not carrying on a business (e.g. investment trusts).

Secondly, the extended 4-year amendment period will apply where it is reasonable for the Commissioner to conclude that a person entered into or carried out a scheme (either alone or with others) for the sole or dominant purpose of obtaining a tax benefit under a scheme as set out under section 284-150 of Schedule 1 of the TAA (1953).

2.1.3 NO TIME LIMIT

Item 5 of section 170 of the ITAA (1936) provides that the Commissioner may amend an assessment at any time if the Commissioner believes that there has been fraud or evasion.

The issue as to whether there has been fraud or evasion in respect of an earlier year is determined according to the facts and circumstances which existed in the year in which the alleged fraud or evasion is taken to have occurred.

Unfortunately, the terms fraud and evasion are not specifically defined under the income tax legislation. Accordingly, it may be difficult in practice to determine whether fraud or evasion exists in respect of a prior year assessment.

However, as a very broad observation, fraud may be regarded as an act akin to obtaining financial advantage by deception, whilst evasion appears to be an intentional underpayment of tax by deliberately omitting assessable income or over claiming deductions.

2.2 DEFERRING ADMINISTRATION OF THE ESTATE

Given the breadth of the above amendment periods it may be prudent for an LPR to defer the distribution of the assets of the deceased to beneficiaries until the relevant amendment period has expired to ensure that the payment of any potential tax liability can be funded from the property of the estate.

Pragmatically this would obviously be most feasible where the LPR believes it likely that the 2-year time limitation period under Item 1 of section 170 applies to the deceased's circumstances.

However, an LPR also needs to bear in mind that the ATO will regard the LPR as having notice of a potential claim against the estate if they are aware that the taxpayer has any understated taxable income for a prior year which may be the subject of a future amended assessment issued by the ATO.

Accordingly, in order to shield themselves from such a contingency an LPR should disclose any material irregularity which comes to their attention and request an amended assessment if it can be reasonably concluded that a prior year assessment may issue within the review period and the tax liability of the deceased has been understated.

By contrast, where the LPR has no reason to believe that there are any outstanding tax liabilities after making reasonable inquiries, and the LPR has advertised for creditors in accordance with the applicable State or Territory legislation, it is much less likely that the LPR will be exposed to any tax risk following any subsequent distribution of assets to beneficiaries. In support of such an argument reliance can be placed on the High Court decision in *Taylor v Deputy Commissioner of Taxation* (1969) 123 CLR 206.

The above processes will of course become more important where there are material irregularities which have resulted in the deceased obtaining a tax benefit under a scheme for the purposes of section 285-150 of the TAA (1953) which will trigger a 4-year amendment period.

Needless to say, where the LPR is concerned that the deceased may have engaged in activities which constitute fraud or evasion the LPR should seek specialist advice or contact the ATO to ensure that such concerns are addressed and their own risks quarantined.

3. ADMINISTRATIVE CONCESSION – PCG 2018/4

Following extensive consultation with stakeholders, the ATO has issued Practical Compliance Guideline PCG 2018/4 to provide the LPR's of certain smaller and less complex deceased estates with greater certainty as to when they will be regarded as having notice of a claim by the ATO in determining when to distribute assets to estate beneficiaries.

The purpose of this administrative concession is to strike a balance between appropriately protecting the revenue and allowing the executors and administrators of certain deceased estates to have greater confidence that they can distribute assets of the estate to beneficiaries without compromising their own position.

Whilst it needs to be recognised that a Practical Compliance Guideline is not a binding public ruling it nonetheless provides detailed practical guidance on how the law will generally be administered by the ATO. Accordingly, the issue of the PCG 2018/4 should be welcomed as a positive initiative since it is likely to reduce complexity for the great bulk of conventional deceased estates in determining the deceased's outstanding tax liabilities up to the period of the death of the deceased.

3.1 ELIGIBILITY TO RELY ON PCG 2018/4

Pursuant to paragraph 6 of PCG 2018/4 the Guideline will apply to an executor who has been granted probate of the deceased's will, or an administrator who has obtained letters of administration of the deceased estate, provided the following criteria is met:

- (a) in the 4 years before their death the deceased did not carry on a business and was not assessable on a share of the net income of a discretionary trust and was not a member of a self-managed superannuation fund (SMSF);
- (b) the estate assets consist only of public company shares or other interests in widely held entities, death benefit superannuation, Australian real property and cash and personal assets such as cars and jewellery; and
- (c) the total market value of the estate assets at the date of death was less than \$5 million and none of the estate assets are intended to pass to a foreign resident, a tax-exempt entity or a complying superannuation entity.

Clearly the LPR of many small and less complicated estates will be able to readily satisfy all these conditions and will therefore be able to choose whether or not to rely on the Guideline in distributing the deceased's assets.

However, it should be noted that each of the above three conditions must be fully satisfied before reliance can be placed on the Guideline.

Accordingly, an LPR of a deceased estate will not be able to rely on the Guideline in any of the following circumstances:

- the deceased carried on a business in the 4 years prior to their death;
- the deceased was assessable on a share of net income of a discretionary trust in the 4 years prior to their death;
- the deceased was a member of an SMSF in the 4 years prior to their death;
- the deceased held equity interests in unlisted private companies or other non-widely held entities;
- the deceased owned real property located outside Australia;
- the total market value of the estate assets at the date of death was \$5 million or more; and
- any of the estate's assets were intended to pass to a foreign resident, a tax-exempt entity or a complying superannuation entity, (in which case it will be necessary to separately consider whether CGT event K3 under section 104-215 of the ITAA (1997) has any application to such asset transfers).

The LPR of some estates potentially eligible to apply the Guideline may consider getting a valuation to confirm that they meet the \$5 million market value eligibility threshold if they hold significant eligible assets whose market value is not significantly below the \$5 million valuation threshold.

In addition, the Guideline does not apply where probate or letters of administration has not been obtained as would be the case in Queensland where assets automatically vest with the deceased's LPR where the deceased leaves a will. In these circumstances, the LPR will not be made personally liable for the deceased's outstanding tax liabilities as section 260-140 of the TAA (1953) does not apply. Instead the Commissioner of Taxation may collect the deceased's outstanding tax liabilities under section 260-145 of the TAA (1953).

The Guideline applies from the date it was issued as a finalised Practical Compliance Guideline being 22 August 2018. However the ATO has confirmed that it will be reviewed from time to time under the ATO's standard review process to ensure the currency and relevance of its contents.

3.2 SCOPE OF ADMINISTRATIVE CONCESSION

The Guideline recognises that an LPR may have an outstanding tax-related liability in respect of estates subject to the Guideline if the LPR distributed the estate's assets when there was a notice of claim (or potential claim) by the ATO.

Such notice of claim may take the form of tax debts outstanding at the date of the deceased's death, returns which have been lodged but not assessed at the time of the deceased's death and any tax liabilities arising in respect of returns which have not been lodged up to the date of death.

However, paragraph 13 of the Guideline provides that the ATO will not treat an LPR as having notice of any further potential ATO claim relating to returns the LPR lodged (or advised were not necessary) if:

- the LPR acted reasonably in lodging all of the deceased's outstanding returns (or advising the ATO that they were not necessary); and
- the ATO has not given the LPR notice that it intends to examine the deceased person's taxation affairs within 6 months from the lodgment (or advice of non-lodgment) of the last of the deceased's outstanding returns.

Accordingly, where the LPR has acted reasonably in ensuring that the deceased's 'final' income tax return up to the date of death has been lodged (as well as any other outstanding income tax returns), and has provided the appropriate advertised notice to creditors, the LPR will be able to potentially distribute the assets of the estate within 6 months from the lodgment of the last of any such returns or provided notice that a return is not required, unless the ATO gives the LPR notice that it intends to examine the deceased's taxation affairs during this 6 month period.

Example – Straight forward small estate (Paragraphs 16-17 of PCG 2018/4)

Alfred died on 1 June, 2017. Bill was appointed executor of Alfred's will. He obtained probate of it in July 2017. Alfred's estate consists of his main residence, shares in publicly listed companies and money in a bank account. The collective value of the estate is less than \$1 million. Up until his death, Alfred had been receiving a pension. Alfred had advised the ATO in 2012 that he was not required to lodge further returns.

Based on all of the information available to him, Bill determines that no return is necessary for the period from 1 July 2016 to 1 June 2017. Bill lodged a Return Not Necessary (RNN) Advice with the ATO on 31 October 2017. If the ATO does not notify Bill that it intends to review Alfred's tax affairs by 30 April 2018 (6 months from the time Bill lodged his RNN advice), the ATO will treat Bill as not having notice of any claim relating to Alfred's estate. Bill can distribute the estate to beneficiaries without risk of personal liability.

However, an LPR will not be able to rely on this 6-month review period where the LPR becomes aware (or should reasonably have become aware) of any material irregularity in a prior year return. In such a case the ATO will treat the LPR as having notice of the claim to the extent of the irregularity identified. However, such an irregularity will not result in a notice of claim if the LPR brings that irregularity promptly to the attention the ATO in writing (e.g. the LPR lodges a request for an amended assessment), and the ATO does not issue an amended assessment or indicate that it intends to review the irregularity identified within 6 months of the ATO being notified of that irregularity.

Example - Material tax irregularity identified by the LPR (Paragraphs 18-25 of PCG 2018/4)

Peter died on 12 December 2016. Jill was appointed executrix of his will. She obtained probate in January 2017.

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 2015-2016 year and the final period to Peter's date of death.

In preparing those returns, Jill discovered the Peter had never returned rental income from a property that he had owned in Sydney since 2010. Jill included rental income from that property in the returns for the 2016 income year (\$20,000) and the period to Peter's date of death (\$10,000). She lodged both returns on 3 March 2017. 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 2017, 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 2017, Jill published a Notice of Intended Distribution (under State succession laws) for claims to be made within 30 days. On 4 August 2017, Jill distributed the remaining assets of the estate.

On 20 October 2017, the ATO wrote to Jill advising that Peter's assessments for the 2014 and 2015 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 2014 and 2015 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.

Alternatively, where the ATO has decided to review or examine the affairs of the deceased upon being notified of such an irregularity, it has advised in the Guideline that it will promptly amend relevant returns where a tax liability is identified. Such a process will also help expedite the administration of the deceased estate and ensure that tax liabilities are identified prior to any distribution of estate assets to beneficiaries.

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. The underpinning rationale of this qualification to the above 6-month review period is that such assets may have previously generated assessable income which should have been included in any outstanding income tax returns of the deceased. Such an omission is unlikely to occur if the LPR makes reasonable enquiries of the deceased's tax affairs including consulting with the deceased's tax agent.

Example - Further assets identified (Paragraphs 27-29 of PCG 2018/4)

Vincent died on 26 November 2016. 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 consist 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 2016 to 26 November 2016 because Vincent's income was below the tax-free threshold. Six months after advising the ATO that no return was necessary, Ben proceeded to distribute the estate's assets.

In 2019, 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 2017 year and four 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.

4. PRACTICAL STRATEGIES TO MITIGATE AN LPR'S EXPOSURE

Historically, an LPR was able to write to the Commissioner of Taxation seeking what was known as a 'Tax Clearance letter' which essentially enabled them to distribute the corpus of an estate without fear of being subject to unexpected tax liabilities. That practice changed with the introduction of self-assessment. The ATO approach to collection of taxes from an LPR was then outlined in versions of Chapter 32 of the ATO Receivables Policy. With the withdrawal of the Receivables Policy there has been significant uncertainty as to when LPRs will be held personally liable for outstanding tax liabilities associated with their administration of an estate.

It is for this reason that LPRs must exercise care when managing the taxation affairs of any estate.

Some prudent steps that could be practically implemented to mitigate an LPR's risk of exposure in respect of outstanding tax liabilities of a deceased estate include the following:

- Ensure that a full review of the deceased's tax history is undertaken, and that any outstanding income tax returns or other tax obligations are both identified and appropriately addressed prior to distributing assets of an estate. This would include ensuring that all related tax, interest and penalties are paid in full;
- Set aside part of the estate's assets to fund the payment of any outstanding tax liabilities if it is necessary to distribute some of the estate's assets prior to finalising the administration of the estate. As best practice, many professional executors not only put aside assets to fund the payment of outstanding liabilities but also retain additional funds as a buffer to finance the payment on any unanticipated estate liabilities or where there is any uncertainty regarding the specific amount of the liabilities. The amount of such a provision can later be distributed to beneficiaries as a final distribution if it is not required to be called upon;
- File a non-lodgment advice form with the ATO if it is determined that there is no requirement to lodge an income tax return in respect of the deceased's income tax affairs up to the date of death;
- Contact the ATO directly if there is any uncertainty exists around a taxpayer's affairs. The ATO records and tracks all correspondence and calls they receive from taxpayers, so at the very least such communications would demonstrate that the LPR has made an effort to try and ensure that the deceased's taxation affairs were adequately addressed;
- Comply with all legislative requirements concerning the publication of advertised notices to creditors as required under applicable State or Territory legislation;
- 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;
- Contact the ATO if it is not possible to locate the deceased's Tax File Number (TFN). The LPR can request in writing to be provided with the deceased's personal details, and request the ATO to provide the TFN and details of any outstanding tax obligations; and

- Liaise with the deceased's tax agent to obtain a summary of outstanding income tax returns and obligations which can be downloaded from the ATO's Tax Agent Portal. From the 2007 year onwards, ATO pre-filling reports are also available from the Tax Agent Portal which contain details of income the deceased had derived each year. These pre-filling reports are not necessarily a comprehensive or fully accurate summary of all of the taxpayer's affairs. Accordingly, whilst often a very useful source of information it is not recommended that an LPR purely rely on such reports alone as they may not contain all of the required tax data especially in relation to income earned.

5. MERITS OF MAKING VOLUNTARY DISCLOSURES

Whilst implementing the above steps will often allow an LPR to effectively address any outstanding tax liabilities, an LPR may encounter situations where there is considerable uncertainty regarding the deceased's tax affairs usually because of missing data or tax records.

This is especially problematical where the deceased derived offshore foreign income which is assessable in Australia or where they owned CGT assets that are located outside Australia.

Accordingly, the LPR may broadly believe that there is some contingent tax liability in respect of undeclared income but may not feel there is sufficient certainty about the precise amount of such an exposure.

In these circumstances there is considerable merit in the LPR contacting the ATO to voluntarily disclose the information held by the LPR to see if the ATO could access information that has either been lost or inadvertently destroyed.

This is beneficial as the ATO will not only be able to access its own records but increasingly has access to information provided or exchanged with other revenue authorities.

Once such information has been collated the LPR may be able to work with their advisers and the ATO in reconstructing transactions so that they can crystallise the amount of the deceased's outstanding tax liabilities, and therefore more readily distribute the assets of the estate to beneficiaries thereby providing peace of mind to the LPR.

Apart from providing certainty to all parties the ATO would also typically reduce the amount of penalties that would otherwise apply where voluntary disclosures are made.

Two recent client experiences illustrate the benefits of making voluntary disclosures to the ATO.

In the first case the deceased was a Veterans Affairs pensioner who passed away in the 2017 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.

However, it transpired that the deceased had not lodged an Australian income tax return upon his return to live in Australia in the 1999 tax year.

As the information disclosed on the available pre-filling reports obtained from the tax agent omitted much of the income actually derived by the deceased, it was not possible to accurately calculate such assessable income especially where some of the capital supporting such foreign income had been repatriated back to Australia at some point during the 18-year period of non-compliance.

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. Following consultation with the ATO, who undertook additional internal searches for data, the parties were able to reach an agreed position, enabling the LPR to finalise the administration of the estate without being exposed to residual tax risks. This collaboration resulted in annual assessable income ranging from \$45,000 to \$150,000 per annum, and the collection of a significant amount of tax.

The second case involved an Australian pensioner who passed away at 89 years of age.

As at the date of death of the deceased the estate included a property located in the United Kingdom as well as a local residence and cash funds.

The LPR subsequently discovered that the property in the United Kingdom had been income producing for 7 years prior to the deceased's death, and that such rental income had never been declared in any of the deceased's Australian income tax returns during this period. Moreover, the deceased's Australian accountant had not been apprised of the existence of the overseas rental property, and therefore did not have any details concerning the net rental income derived during this period.

After the LPR obtained the necessary net rental income information from the UK, the LPR contacted the ATO to voluntarily disclose the omission of such foreign source rental income, in order to enable the LPR to finalise the estate administration, including the claiming of foreign tax credits and the management of associated interest and penalties.

Whilst obviously the LPR would seek to independently obtain all required data in order to ensure that the deceased's tax liabilities were appropriately quantified it should be borne in mind that all parties including the ATO are keen to ensure that the tax affairs of deceased persons and the administration of their estates are finalised as accurately and expeditiously as possible.

Essentially, making such voluntary disclosure enables the LPR to crystallise income tax obligations in difficult circumstances. This also reduces the amount of resources that the ATO would otherwise have to independently deploy to locate and identify omitted income although much of this work will be increasingly automated in the future.

Accordingly, making voluntary disclosure to the ATO should be one of the possible strategies that an LPR should consider in finalising the administration of an estate.

6. SUMMARY

Whilst this paper has understandably focused on tax risks faced by LPRs distributing the assets of an estate it is worthwhile remembering that there are a variety of strategies which can mitigate such exposures.

For those that are acutely risk averse there may be merit in deferring any distribution until after the relevant amendment period has expired. However, we recognise that such a strategy is usually commercially unpalatable especially given the need to distribute estates to beneficiaries following a period of bereavement.

As discussed, many practical steps can be methodically undertaken to correctly ascertain and calculate any of the deceased's outstanding tax liabilities.

In addition, where there is uncertainty, experienced practitioners are available to help LPRs navigate their tax risks.

Importantly, where there is a lack of reliable and detailed documentation the ATO can also be approached to work collaboratively in finalising the tax position which will provide reassurance to both LPRs and their advisers that the tax liability of the deceased can be accurately determined.

In this context the ATO is to be applauded for the issue of PCG 2018/4 which has the potential capacity to significantly streamline the administration of smaller and less complex deceased estates whilst ensuring that any of the deceased's tax liabilities owed as at the date of death are appropriately remitted to the ATO.

It is our understanding that PCG 2018/4 is intended by the ATO to be the first step in a process, where, subject to the successful application of the Guideline, consideration may be given to potentially expanding its scope.

As a profession we are keen to build on this initiative and over time would be keen to support other administrative strategies where a suitable balance can be struck between accelerating the administration of an estate whilst protecting the LPR and the broader community by ensuring that any of the deceased's outstanding taxes are efficiently collected.

HOW CAN BNR PARTNERS ASSIST ?

BNR Partners are recognised nationally as experts in the field of deceased estate and trust taxation matters. We have one of the only dedicated teams of professionally qualified Accountants in the country who specialise in this niche and often complex area; an area we have practiced in since 2000. We work directly with Wills & Estate/Succession Law Practitioners and Trustee Companies across Australia providing reliable specialist estate and trust taxation services and advice, from the preparation of simple to complex estate income tax returns to letters of advice on more complex estate taxation matters.

By partnering with our team, legal practitioners and LPRs alike are assured that they are dealing with a dedicated team of accountants who understand the idiosyncrasies of this field of taxation, and equally as important, who understand the terminology and fundamental legal principles of estate administration.

Our service offerings include:

Date of Death Tax Return

BNR Partners can assist LPRs in preparing and lodging the deceased's final income tax return and any outstanding prior years' tax returns. We assist to ensure that the deceased's outstanding tax obligations are completed prior to the finalisation of the estate administration.

Deceased Estate and Testamentary Trust Tax Returns

The BNR Partners tax team specialises in preparing estate and testamentary trust tax returns. We have the experience in preparing tax returns of estates under administration from initial stage to final administration.

Our team is also familiar with the nuances of preparing tax returns for testamentary trusts, including trusts with life tenants, special disability trusts, testamentary discretionary trusts, minors trusts, superannuation proceed trusts and testamentary charitable trusts.

Our services also include the preparation of beneficiary tax statements on your firm's stationery. Alternatively, we can distribute the beneficiary statements on your behalf. BNR Partners can also manage the process of obtaining a tax file number for a deceased estate, a testamentary trust or other entities.

Obtain a Tax History Report

As it is the LPR's responsibility to manage any outstanding tax obligations, it is essential that you obtain an understanding of the tax affairs of the deceased. To assist you with this, BNR Partners can provide a summary of the deceased's tax return history and any outstanding obligations.

Letter of Advice

On the pending closure of an estate or testamentary trust, BNR Partners can prepare and provide LPRs or trustees with a letter of advice which acts as a tax clearance prior to the final distribution of the estate or trust. The letter outlines outstanding tax obligations (if any), and gives comfort to the LPR or trustee that the tax issues have been reviewed by a tax professional specialising in this domain.

Private Binding Ruling (PBR)

With the variety of estate taxation complexities and uncertainties that exist, it is often in the best interest of the estate and the LPR to seek a private binding ruling as to how the Commissioner would assess a given arrangement or situation. This is increasingly important where there is uncertainty in relation to tax treatment so as to provide the LPR with certainty on how to report certain events, so as to manage their exposure to personal liability for income tax post the distribution of an estate's corpus.

Voluntary Disclosures

BNR Partners regularly manage voluntary disclosures directly with the ATO on behalf of LPRs where uncertainty exists as to the tax history of the deceased, or where there are retrospective compliance issues that the LPR needs to address prior to distributing the estate's corpus, but is unable for any number of reasons to finalise.

Charitable Trusts

We can manage the registration process for testamentary charitable trust endorsements with the appropriate regulatory bodies such as the ATO and ACNC, prepare their annual financial reports, plus complete and lodge business activity statements and franking credit refund applications.

Withholding Tax Obligations

LPRs and trustees are responsible for the withholding and submission of tax for foreign beneficiaries, or when a beneficiary fails to quote their tax file number to the trustee. We can assist in both the registration process and the calculations of the correct withholding tax amount.

Specialised Tax Advice

BNR Partners also provides written opinions on more complex taxation matters where there is uncertainty on the interpretation of taxation legislation in relation to deceased estates and testamentary trusts, or when tax planning is recommended during the Will preparation process. We can also prepare and lodge private binding ruling requests on your client's behalf.

Private Company, Trusts and Self-Managed Superannuation Funds

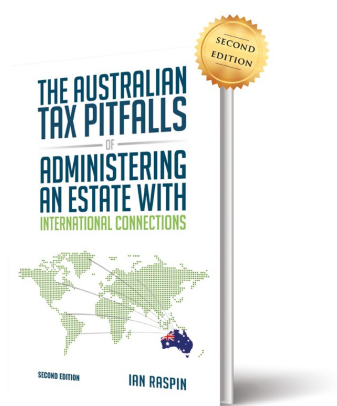
Although not estate assets, many people die leaving behind private companies, trusts and self-managed superannuation funds which will need to be attended to. Both our estates and trusts or business services teams can assist with the preparation of financial reports and income tax returns. In addition, we are often engaged by LPRs to provide an independent review of financial reports prepared by the deceased's accountant.

Seminars / In-house Training

Our team has presented at numerous seminars and in-house client training sessions across the country. We would be happy to discuss with you how we may be able to assist with your training needs.

PUBLICATIONS

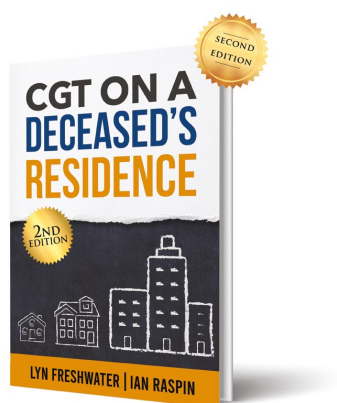
Available for purchase at bnrpartners.com.au



The Australian TAX PITFALLS **of Administering an Estate with** **INTERNATIONAL CONNECTIONS**

Australian Estate Practitioners are increasingly being confronted with estates that contain the complexities of offshore assets or residents.

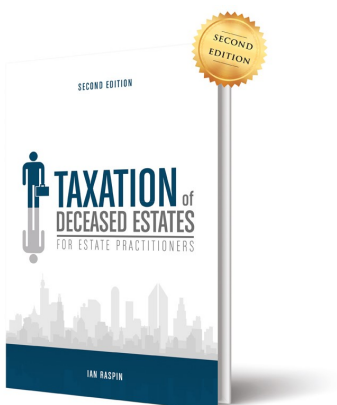
The information in this publication provides practitioners with the fundamental tools necessary to understand the Australian tax implications of the tax residency status of beneficiaries, the deceased, and that of a personal legal representative.



CGT ON A DECEASED'S RESIDENCE *... a tax minefield*

One of the largest assets of a typical deceased estate is often the principal place of residence. What is often inadvertently overlooked is that the sale of the residence may trigger a number of Capital Gains Tax issues for the estate.

The book explores this minefield and gives clear guidance on how to handle this issue.



TAXATION of DECEASED ESTATES **for ESTATE PRACTITIONERS**

The book provides the answer to key questions such as the tax responsibilities of executors and when a tax return is required.

It addresses a number of fundamental estate taxation issues such as capital gains tax, superannuation proceeds and the concepts of present entitlement.



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