WHO PAYS THE TAX ON AN ESTATE'S INCOME?

Correctly identifying who will pay the tax on any income derived by an estate is determined by a number of factors, including if a beneficiary is presently entitled to trust income, under a legal disability, or if the estate is fully administered.

The Commissioner of Taxation sets out his position on the present entitlement of income during an estate administration in *Taxation Ruling IT 2622*. This ruling is based upon the High Court findings in *FCT v Whiting (1943) 68 CLR 199*, where the court held that the beneficiary of a deceased estate cannot be presently entitled to the income of the estate until the estate has been fully administered.

Justices Latham and Williams stated that:

"… until an estate has been fully administered by payment or provision for the payment of funeral and testamentary expense, death duties, debts, annuities and legacies and the amount of the residue thereby ascertained, the income of the residuary estate is the income of the executors and not of the residuary beneficiaries."

In essence, during the estate administration it is not really possible to determine the residual of the estate and accordingly any claim by beneficiaries in either the corpus or income may be defeated by another party lodging a claim against the estate. Hence, the executor is taxed on the income during the administration of the estate.

In *IT 2622* the commissioner identifies three distinct stages of the administration of an estate post the granting of probate;

STAGE	INCOME TREATMENT
Initial Stage	The net income of the estate is used to apply to reduce debts such as the testator's outstanding accounts, and funeral expenses etc.
Intermediate Stage	At this point, the executor may have identified that part of the estate is not required to pay debts etc. and may decide to pay an interim distribution to beneficiaries
Final Stage	All debts are paid for in full and income is available for distribution to beneficiaries.

INITIAL STAGE

During this stage no beneficiary will be deemed as presently entitled to the income of the estate and accordingly all income must be assessed against the executor. An estate has access to standard adult marginal tax rates for a period of up to three years from date of death. This includes the $18,200 tax free threshold.

INTERMEDIATE STAGE

It is not unusual during the estate administration that an executor may identify that part of the net income of the estate will not be required to meet the estate's debts and obligations. In these situations, the executor sometimes elects to make an interim distribution to beneficiaries. IT 2622 clearly states that where this occurs, the beneficiaries will be held as presently entitled to the proportion of trust income to the extent that is actually paid to them, or paid on their behalf.

This could include for example the payment of rent on behalf of a beneficiary in accordance with the terms of a will.

FINAL STAGE

Where an estate has been fully administered, the beneficiaries will be deemed as presently entitled to the income and corpus, as they will be deemed to have an indefeasible and absolute vested interest within the estate. This applies even if the executor has not yet physically transferred all the entitlements to the beneficiaries. Essentially these assets are then deemed to be held on trust on their behalf.

FINAL YEAR OF ADMINISTRATION

It has been a long standing practice of the ATO to permit an apportionment of income between the executor and beneficiaries in the year that the estate is fully administered.

Present entitlement is ordinarily determined on the last day of the income year (I.e. 30th June) and a beneficiary would ordinarily be assessed on their proportion of trust income for the full financial year. For the above apportionment rules to apply, it is therefore a requirement that adequate evidence of the income derived during these periods is maintained to support how it was apportioned. The ATO has made it clear that it will not accept income being apportioned merely based on time.

DERIVED INCOME	ASSESSMENT
Income derived in the period between the beginning of the income year and the day administration was completed.	Assessed in the hands of the executor or administrator under section 99 of the Act.
Income derived in the period between the day administration was completed and the end of the income year.	Assessed to the beneficiaries presently entitled to the income in the manner require by section 97 or 98 of the Act.

It should be noted, that where a beneficiary is under a legal disability, that the executor will be assessed on the beneficiary's share of the trusts' income. Legal disability includes minors, bankrupts and people with legal incapacity due to mental conditions.

TESTAMENTARY TRUSTS

Where a testamentary trust has an income beneficiary, the beneficiary will be deemed as presently entitled to the trusts' income and accordingly be responsible for the taxation. However when an income beneficiary has a legal disability, then the trustee will be required to pay tax on their behalf.

When an income beneficiary has passed away and the assets are to be transferred to the remainder beneficiaries, then the remainder beneficiaries would be deemed to have become presently entitled to income and corpus as at the date of death of the life tenant, and will be personally assessed on same. It should be noted that any assets acquired by the trustee post the death of the initial testator would also be deemed to have been disposed of at this date, and that the remainder beneficiaries would also be assessable on any associated capital gain.

BNR PARTNERS
ESTATE & TRUST TAXATION SPECIALISTS

PO Box 1337
Waverley Gardens, Vic 3170
estates@bnrpartners.com.au
32/830 Princess Highway
Springvale VIC 3171
www.bnrpartners.com.au

Melbourne	03 9781 6800
Adelaide	08 7221 9750
Brisbane	07 2101 5390
Perth	08 6323 5480
Sydney	02 9131 4270