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Via email: testamentarytrusts@treasury.gov.au

Dear Sir/Madam

Thank you for the opportunity to comment on the exposure draft legislation for the proposed amendment to section 102AG of the *Income Tax Assessment Act 1936*. All legislative references in our submission are to that Act unless otherwise indicated

BNR Partners has specialized in the taxation of deceased estates since 2000. We provide advice and other tax compliance services to legal practitioners and licensed trustee companies involved in the administration of deceased estates and testamentary trusts across Australia. We handle in excess of 5000 estate matters annually and our firm was recently named as the mid-size accountancy firm of the year at the 14th Annual Global Private Client awards of the Society of Tax and Estate Practitioners (STEP) in London.

We offer the following comments on the draft legislation and explanatory memorandum and would be more than happy to discuss them further with you if that would be of assistance.

- We observe that the paragraph 102AG(2)(a) has always had a different focus from paragraphs 102AG(2)(c) and (d). That is, the former has looked simply to the creation of the trust, the latter to particular property of the trust. The proposed amendment will more closely align paragraph (a) with the operation of paragraphs (c) and (d). Should paragraph (e) also be amended so that it refers to accumulations of capital for the purposes of those other paragraphs?

- Paragraph 1.12 of the EM notes that the effect of subsection 102AA(4) is that a reference to property of a particular kind (such as that which forms part of a deceased estate) includes such property as represents that property. However that provision relies on the Commissioner determining that certain property represents other property. Will the ATO publish a Law Companion Ruling outlining the factors that the Commissioner will take into account in this regard?

  In a simple case where, for example, the trustee sells shares that the deceased owned and acquires replacement shares with the proceeds, it is clear that the new shares should be regarded as representative of the original shares. However it becomes more difficult if the trustee assumes liabilities that the deceased had in respect of particular assets or the trustee borrows against the deceased's assets.

- Paragraph 1.14 of the EM discusses the requirement that property be transferred to the trust from the estate of a deceased person.

We appreciate that is not appropriate to limit the relevant property to that which the deceased owned as this would not include example life insurance or superannuation proceeds that are paid to the estate. Specific inclusions would be required for these types of amounts.

However, we wonder if the object of the amendment can be defeated simply by injecting assets into an estate rather than the testamentary trust. See for example the arrangement described in edited private ruling 1051240543983, where the assets of an existing *inter-vivos* trust were converted to assets of a trust created by a will. If it were possible for those assets to find their way into an estate and then into the testamentary trust (rather than directly into the trust) the effect of the measure might be able to be defeated.

[In the private ruling, the ATO determined that the existing anti-avoidance rules in Division 6AA could not apply to the unilateral actions of a trustee.]

Secondly, in relation to this paragraph, what does 'transferred to the trust' mean? If the LPR is also the trustee of the testamentary trust, there would not necessarily be a transfer (at least of legal title).

We assume that the reference to a beneficiary includes someone who falls within the scope of a widely-drawn beneficiary clause of the type used commonly in discretionary trusts and is not limited to people who are named specifically as beneficiaries. Perhaps this could be clarified in the EM.

Finally, is it envisaged that more than one estate can transfer estate assets into one testamentary trust? For example, husband died and assets went into a testamentary trust. A few years later, the wife died and her assets were transferred into the same trust in order to minimize compliance and administration costs.

- Paragraph 1.15 and 1.16 of the EM refer to new provisions which again rely on the Commissioner forming an opinion as to whether amounts represent accumulations of income or capital from property that formed part of a deceased estate. The examples in the Draft EM are very simple. Will the Commissioner publish further guidance in relation to the nature of the records that are required to be kept where a trust holds mixed funds. It seems that over time significant tracing will be required. In this regard, the issue is not unlike that which arose in the context of the application of section 99B in the recent case of *Campbell v Commissioner of Taxation*[1]. For example, would the Commissioner require that capital losses be offset against capital gains that are accumulated in the same way that they are applied for tax purposes.

- Example 1.1 simplistically assumes that the assessable income from dividends is the same as the trust net income (that is, there are no deductions). This will generally not be the case. How are deductions/expenses to be allocated if they relate to both excepted and non-excepted income? Will the law contain deduction/expense allocation rules or will the Commissioner produce an LCG on this question?

- Should there be a *de minimis* exception so that extensive tracing exercises are not required when any income from 'injected assets' is less than a percentage of the value of the deceased estate net assets (for example, 10%) and a set amount (say $10,000)?

- Paragraph 1.18 notes that the amendments apply in relation to assets acquired by or transferred to the trustee on or after 1 July 2019? How does the provision apply for example if an entitlement to an amount had been created in the trust prior to that date but it is not paid until after that?

[1] [2019] AATA 2043

- For compliance saving reasons it may be preferable for an amount to which say paragraph 102AG(2)(d) applies be held within a trust that was created by a will. Can you confirm that the excepted trust income of a trust created by a will also includes income from assets referred to in other paragraphs that also give rise to excepted trust income, assuming that the beneficiaries are the same?

- In terms of providing further guidance perhaps you might consider how the provision will apply in the following situations:

  - The deceased died with outstanding loans which the trust takes over. The loan payments are funded via investment income.

  - The trustee borrows money as part of its investment strategy to grow the corpus.

  - The trustee pays maintenance expenses on behalf of the testamentary trust as the only asset is a property that a minor beneficiary is living in. The trustee recoups the 'loan' after the property is sold.

Should you wish to discuss further, please do not hesitate to contact Lyn Freshwater Senior Tax Consultant of our office, or the undersigned.

Yours sincerely

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Managing Director
BNR Partners