The Tax Institute

13 June 2024

Ms Kirsten Fish
Second Commissioner
Law Design & Practice
Australian Taxation Office

By email: Kirsten.Fish@ato.gov.au

Dear Kirsten,

Issues in tax administration for estates

The Tax Institute writes to the Australian Taxation Office (**ATO**) to highlight some key areas of concern that arise during the administration of an estate and the ongoing needs of taxpayers and their advisers that we consider would benefit from ATO guidance and support.

The concerns raised in our submission are based on feedback from our members. These include legal professionals, tax agents and other practitioners who manage these issues for their clients and deal with the ATO through the administration of an estate. Members of the Society of Trust and Estate Practitioners Australia Limited (**STEP**) have assisted in preparing this submission and we understand that STEP Australia has provided its endorsement to this submission. A number of STEP's members are also members of The Tax Institute.

Of note, we consider that there are several aspects of the ATO's administrative approach that would benefit from amendment, clarification, or further consultation. These include, but are not limited to:

- amending the forms used in the notification process and providing an online portal to ensure timeliness and the adequate protection of taxpayer information;
- clarifying the ATO's approach to voluntary disclosures for estate administrators who are lodging the deceased's overdue tax returns; and
- allowing legal practitioners from the same firm to certify copies of documents needed by the ATO in relation to the estate of the deceased.

This will ensure that tax and legal practitioners and legal personal representatives (**LPRs**) are supported to efficiently manage deceased estates.

Our members have also noted the need for updated and new guidance from the ATO regarding several key issues. This includes, but is not limited to, guidance on the ATO's views regarding:

- present entitlement for deceased estates;
- whether certain amounts are taxable under the withholding tax (**WHT**) regime;

- the application of section 99A of the *Income Tax Assessment Act 1936* (Cth) (**ITAA 1936**);
- the correct tax outcome in a 'double death' scenario – that is, where a beneficiary of an estate passes away prior to the administration of the first estate and their estate subsequently receives assets of the first estate.
- the appropriate tax treatment when a beneficiary pays for an asset (or part of an asset) from a deceased's estate;
- the treatment of capital gains and losses made by foreign LPRs; and
- family trust elections (**FTEs**) involving testamentary trusts.

Further details are contained in **Appendix A**.

Appendix B contains real-life examples provided by our members of problems in this field experienced in practice. The issues mainly relate to estates dealing with a deceased's lack of historic tax compliance that gives rise to significant difficulties and exposures for LPRs and their tax and legal advisers.

[redacted]

We look forward to working with the ATO in relation to the matters outlined in our submission. To arrange a workshop, or to discuss any aspect of our submission, please contact our Senior Counsel – Tax & Legal, Julie Abdalla, on (02) 8223 0058.

The Tax Institute is the leading forum for the tax community in Australia. We are committed to shaping the future of the tax profession and the continuous improvement of the tax system for the benefit of all. In this regard, The Tax Institute seeks to influence tax and revenue policy at the highest level with a view to achieving a better Australian tax system for all.

Yours faithfully,

Scott Treatt
Chief Executive Officer

Todd Want
President

APPENDIX A

We have set out below our detailed comments and observations for your consideration. All legislative references are to the ITAA 1936, unless otherwise indicated.

Administration and engagement concerns

Feedback from our members has raised several concerns and suggestions regarding the ATO's administrative approach to issues concerning the administration of estates. These are discussed in detail below.

Support for tax practitioners

Feedback from our members indicates that there is often a perceived lack of support by ATO staff when they are managing certain difficulties in the self-assessment environment. We acknowledge that the experiences of tax practitioners are likely to vary in practice. We consider that many of these challenges arise due to a shortage of ATO guidance in key areas. Guidance on these issues (discussed in detail below) would ease the burden on tax practitioners and improve the quality of their dealings with the ATO, and the time taken to administer an estate.

Due to the nature of managing estates, and the associated liabilities, tax practitioners need clear ATO guidance that they can rely on and apply to their clients' circumstances. LPRs are responsible for administering an estate and are required to follow strict guidelines regarding the scope of their actions. LPRs may also be held personally liable in respect of issues the ATO may raise after the estate has been distributed. This is markedly different to other areas of our tax system and, in our view, is a key reason why advice and certainty is needed in this area.

Consultation on key issues

We consider that the ATO should undertake thorough consultation on the areas where guidance is needed. It is important for the ATO to consult with industry to determine what matters are important and should be subject to consultation. Basing the need for advice on other metrics only available to the ATO, such as the number of private binding rulings (**PBRs**) on specific issues, may not accurately represent the needs of taxpayers, tax practitioners and LPRs.

For example, a large proportion of PBRs appear to be in relation to the exercise of the Commissioner's discretion, especially the Commissioner's discretion in relation to the period for disposal of a main residence under section 118-195 of the *Income Tax Assessment Act 1997* (**ITAA 1997**). Although the ATO released guidance on this issue in Practical Compliance Guideline PCG 2019/5, there are other pressing issues that remain unaddressed. We consider it important for the ATO to work with the profession and industry, and undertake a process to prioritise and discuss technical issues with practitioners, and the need for guidance products. This is consistent with Recommendation 1 of the Inspector General of Taxation and Taxation Ombudsman's (**IGTO's**) 2020 report titled 'Death and Taxes – An Investigation into ATO Systems and Processes for dealing with Deceased Estates' (**2020 Report**).

Notification process

The requirements around notification of a deceased person and obtaining an estate tax file number (**TFN**) are a key contributor to delays in the process. Notification needs to be in writing and requires the attachment of certified copies of the death certificate, will and probate. We consider that the need for all of these documents should be reviewed when probate is obtained. The will forms part of the probate document and is only issued if the Court is satisfied that the deceased person has in fact died. As a result, we do not consider it necessary to request all documents if the process for obtaining a will requires those other documents.

Feedback from our members indicates that the ATO often advises that it has not received a written notification. Rectification of this requires a duplication of effort on the part of the person seeking to lodge the form. Some members have also raised concerns about the security of personal information if it is sent to the ATO but unable to be located as an LPR completing the notification of death form must provide their own TFN, date of birth, and other identifying details.

We consider that LPRs should have a dedicated portal to ensure that their information stays secure while providing for a more streamlined notification process. We understand that public trustees and trustee companies have access to an electronic notification system through the Online Service for Business (Day 1 notification forms). This could be expanded to all estates. Alternatively, the ATO should consider linking its information gathering capabilities to the Australian Death Notification Service, identify probate directly from registries, or expanding the scope and operability of the Online Services for Agents (**OSfA**).

A dedicated online portal to replace paper communications will also ensure more timely service. Feedback from our members indicates that paper communication is slow, and mail routinely gets delayed or misplaced. This is a security risk for the LPR and can often lead to delayed processing times. Some members have reported turnaround times taking up to 4 months instead of 28 days.

Certifications

Feedback from our members suggests a perceived resistance on the part of the ATO with respect to certification being done by members of the same law firm who drafted the will or submitted a probate application. This requires administrators of estates to seek certification from unrelated parties, resulting in inconvenient outcomes and unnecessary costs being incurred.

The Tax Institute is of the view that members of the same firm undertaking the certification is not a high-risk activity and should not result in a conflict of interest. Solicitors are required to act in accordance with the Australian Solicitors Conduct Rules (**ASCR**), which requires solicitors to ensure there is no conflict of duty concerning current clients.[1]

[1] ACSR, rule 11.

Voluntary disclosures

Some practitioners have historically lodged voluntary disclosures with the ATO to obtain sign off for situations where there is a need to ensure that both the tax agent and LPR are not making false declarations in light of matters to be signed on the lodgement of a tax return. For deceased estates in particular, this is a live issue as even after substantial time and expense spent on reconstruction, there is often no one able to conclusively attest to the completeness of a tax return. In recent times, some members report that this avenue of voluntary disclosure is no longer available.

This appears to represent an operational change in the way that the ATO approaches some matters, and the circumstances in which the ATO will accept a voluntary disclosure. The change in approach has in some cases resulted in:

- undue delay of estate administration;
- threats to executors of removal, leading to tying up of judicial time; and
- diminution of estates due to continued need for adviser intervention and legal challenges.

We consider that it is important to ensure that the ATO effectively communicates its current, and any changes to its, administrative approach regarding the voluntary disclosure process. If there has not been a change in approach, we consider that the ATO should ensure that estate administrators have a clear pathway to have these issues resolved.

See **Appendix B** below for real-life examples provided by our members outlining the impact of these issues in practice.

Other administrative approaches

Based on feedback from our members, there perceived concerns with the ATO's administrative approaches to specific issues and processes concerning estate administration.

A primary concern is the length of time taken to resolve issues. Some members have noted that the turnaround time for a PBR application can be much longer than the timeframes provided by the ATO. For example, members have reported timeframes up to:

- approximately 6 weeks (rather than 14 days) for an ATO Officer to make initial contact; and
- the entire ruling process, from application to outcome, generally taking approximately 3 to 4 months for what is perceived to be a simple matter, with complex matters often taking more than 12 months.

The feedback concerning the time taken for PBRs is broadly consistent with feedback from members across other business lines. We appreciate that federal funding for the ATO is often provided on a taskforce basis to achieve specific outcomes. However, we consider that the ATO should seek more funding to assist with the development and provision of PBRs and other guidance. Alternatively, we also consider that the ATO should prioritise providing widely needed advice on a one-to-many basis to reduce the pressure on ATO staff responding to PBR requests.

Our members have also noted other concerns regarding the ATO's approach to estate administration. We consider that these should be aired as part of consultation with the profession regarding estate administration. Such other concerns include:

- a perceived growing unwillingness on behalf of the ATO to settle matters and issue default assessments (see examples in **Appendix B** for further details);
- a perceived growing lack of confidence with the ATO's early engagement processes, exacerbated by a lack of clarity regarding the appropriate ATO contact for estate administration issues;
- the need for clear and more frequent communication regarding the ATO's debt collect policy – we note that the ATO's receivables policy for deceased estates after the withdrawal of Practice Statement Law Administration PSLA 2008/13 in 2013 is contained in in Practice Statement Law Administration PSLA 2018/4 and may not be well understood by LPRs and tax practitioners;
- the need to review and correct the deceased estate form and data package to ensure it is contemporaneous, accessible through OSfA, and includes the relevant fields (such as the nomination of a tax agent); and
- the need for a forum to raise issues that require timely legislative correction, with many options not progressing despite consultation and debate, including matters canvased in the discussion papers issued by the Treasury in May 2011 and June 2012 concerning the interaction between CGT and deceased estates; and
- addressing outstanding issues from the IGTO's 2020 report.

ATO guidance

We consider that new and updated ATO guidance on a range of issues would assist taxpayers and tax practitioners better manage estate administration issues. These are discussed in further detail below.

Present entitlement for deceased estates

We consider that Taxation Ruling IT 2622 (**IT 2622**), which sets out the fundamental analysis of who is presently entitled to income during the stages of administration of an estate and is a fundamental issue in estate administration, should be updated to reflect recent law change and commercial practice.[2]

[2] We understand that this was originally a priority item for the ATO. At The Tax Institute's Death and Taxes Conference in 2022, representatives from the ATO stated that the update for IT 2622 was imminent. However, this has since not progressed. We consider that this should be a priority issue for the ATO.

Feedback from our members indicates that there is a growing trend of beneficiaries, who are deductible gift recipients (**DGRs**), looking to maximise the extent of their testamentary gifts by threatening legal action against LPRs and their advisers who diminish the estate by paying tax unnecessarily. Updating and refreshing IT 2622 could help to address this issue by reminding LPRs to consider whether the stage has been reached during the estate administration when the charity can be made presently entitled to some of the trust income (or specifically entitled to capital gains or franked dividends). To the extent that the beneficiaries can be made so entitled, there may be a legitimate tax saving for the LPR. Furthermore, while an LPR may not be taxable because they can access franking credits to reduce tax that is otherwise payable, the charity would be entitled to a full refund of franking credits on dividends to which they were specifically entitled. The example below demonstrates this.

> **Example**
> Phoebe leaves her entire estate to her preferred charity (which is also a DGR). Her LPR sells the estate assets and makes capital gains totalling $2.5 million (after the application of the CGT discount).
>
> The estate administration is ongoing and the LPR does not consider making the charity specifically entitled to the capital gains. The LPR is assessed on the capital gain under section 99 and pays tax on the $2.5 million (almost $1.1million).
>
> However, if the LPR had waited during the administration to deal with the asset and transfer it to the charity, no tax would have been payable.

Section 99A

Feedback from our members indicates that there is a reliance on the Commissioner's discretion not to apply section 99A to tax estate trustees. If the discretion is not exercised, the trustee will be assessed at the highest marginal tax rate and, more significantly, will be denied the benefit of the CGT discount. We consider that it would be useful for the Commissioner to publish a PCG about the circumstances in which he may refuse to exercise this discretion.

[redacted]

Withholding tax

We also consider that ATO guidance should be provided to determine whether a foreign LPR who is assessable on Australian interest or dividends, is assessable under the WHT regime or by assessment. Although it may be considered that the withholding rules apply to exempt the income, as it was in the past, feedback from our members suggests that there has been inconsistent applications of this approach.

For example, in an objection matter, the ATO took the view that paragraph 128B(3)(d) applied so that the trustee was assessed under section 99. We consider it important to ensure that the correct outcome is reached in all cases, consistently.

Double death scenario

Feedback from our members indicates that there is confusion in the market about how the law applies in a double death scenario. That is, when a beneficiary of an estate passes away after the death of the testator, but before the finalisation of the estate of the first deceased. In part, the confusion may arise from contradictory approaches taken in PBRs. We consider that a public ruling would provide all taxpayers and tax practitioners a better understanding of the ATO's view. It will also ensure consistency across PBRs and engagement activities.

[redacted]

Beneficiary pays for asset

The Tax Institute is of the view that the ATO should provide the Commissioner's view regarding how the law applies when a beneficiary pays money to an LPR to ensure the transfer of an estate asset. For example, this may occur where the beneficiary's estate entitlement is less than the value of the asset. We consider that the correct outcome results in a part sale of the property by the LPR. However, this view may not be recognised or applied throughout the profession. The Commissioner's view on this issue would provide clarity and ensure consistent outcomes.

[redacted]

Capital gains and losses by foreign legal professional representatives

Capital gains and losses made by the LPR of a foreign trust (where the LPR is a foreign resident) from assets that are not taxable Australian property (**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 Taxation Determination TD 2017/23 that section 855-10 of the ITAA 1997 overrides the requirement in subsection 95(1) that the net income of a trust be calculated on the basis that the trustee was a resident taxpayer. However, distributions of gains from non-TAP assets to resident beneficiaries can trigger section 99B of the ITAA 1936 (see Taxation Determination TD 2017/24). Further, these amounts are not regarded as capital gains (so the CGT discount cannot be applied, nor can capital losses be offset). We consider that guidance on this issue will better assist foreign LPRs assist their Australian obligations.

Other issues

We consider that ATO guidance should also be provided regarding:

- whether there is more than one deceased estate (and/or trust for tax purposes) when a person dies and has an LPR appointed in more than one jurisdiction because the deceased had property in those jurisdictions;

- the tax outcome when an asset passes under a deed of arrangement for the purposes of section 128-20 of the ITAA 1997;[3]
- the appropriate treatment of income under section 102AG and excepted trust income under Division 6AAA of Part III that flows to, and may be invested by, a testamentary trust; and
- the ATO's expectations of an LPR in undertaking a process of income reconstruction, particularly where relevant record holders such as banks may only hold records for limited years – this could include advice about how to make a voluntary disclosure to the ATO to ensure a timely resolution.

Testamentary trusts with independent trustees

Based on feedback from our members, we understand that it is common for individuals to establish testamentary trusts under their wills, where they appoint independent trustees rather than family members. Examples of independent trustees include the individual's legal and financial advisers or a registered trustee company. If the assets that are held in the testamentary trust include shares in companies that have made interposed entity elections (**IEEs**), or which have substantial franking credits, there are two potentially serious consequences:

- if the testamentary trust receives a franked dividend, it will not be able to receive the benefit of the franking credits unless the trust can make a FTE;[4]
- if the testamentary trust cannot make an IEE, family trust distributions tax will be payable on any dividends paid from a company that has made an IEE.

A trust cannot make an FTE or IEE unless it passes the 'family control test' at the end of the specified year. Broadly, a trust will pass the 'family control test' if it meets the requirements set out in section 272-87 of Schedule 2F to the ITAA 1936. Of note, subsection 272-87(2) of Schedule 2F to the ITAA 1936 sets out a list of requirements for 'control' of the testamentary trust, of which one must be met, that are required to be satisfied by the 'group'. The group consists of:[5]

- the individual (**primary individual**) who is specified in the FTE, or in the case of the IEE, who is specified in the FTE to which the IEE will relate;
- one or more members of the primary individual's family; or
- the primary individual and one or more of the members of the primary individual's family.

Further, paragraph 272-87(1)(b) of Schedule 2F to the ITAA 1936 states that requirements in paragraphs 272-87(2)(a) to (e) of Schedule 2F to the ITAA 1936 will be satisfied in relation to a group consisting of:

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[3] We note that this view was provided by the ATO in Taxation Ruling TR 2006/14, a broader ruling concerning life and remainder interests. However, we consider that this view would benefit from being placed in a standalone guidance product.

[4] We note that this outcome is based on the assumption that legislation introducing the holding period requirements, as announced by the former Government on 13 May 2008, is implemented in the ITAA 1997 with retrospective effect as announced in 2008.

[5] Paragraph 272-87(1)(a) of Schedule 2F to the ITAA 1936.

- a person or persons being, the primary individual and/or members of the primary individual's family; **and**
- one or more legal or financial advisers to the primary individual or to a member of the primary individual's family.

As the individual which is chosen as a primary individual for an FTE must be a member of the 'family' to allow for distributions to pass to family members, a testamentary trust with an independent controller will generally not meet the relevant requirements. Instead, these types of testamentary trusts will need to rely on paragraph 272-87(1)(b) of Schedule 2F to the ITAA 1936.

This can be an issue as, in many circumstances, the 'group' will consist wholly of individuals who are not family members. Even if at least one member is the primary individual or members of their family, the controlling group must also consist of one or more legal or financial advisers to the primary individual or to a member of the primary individual's family.

However, the exemption for legal and accounting advisers will not apply in many cases because, while the independent trustees may have provided legal or financial advice to the testator, they will often not be advisers to surviving family members. The exemption will also not be available if the independent trustee is a registered trustee company or a trusted business partner or acquaintance. There is also uncertainty regarding whether 'financial advisers' for the purposes of paragraph 272-87(1)(b) of Schedule 2F to the ITAA 1936 includes accountants or individuals who were previously financial advisors or legal advisers but have since retired from their profession.

As a result, we consider that the Commissioner should provide guidance regarding the operation and applicability of the FTE and IEE rules in relation to testamentary trusts with independent trustees. This includes guidance about what a 'financial adviser' is for the purposes of paragraph 272-87(1)(b) of Schedule 2F to the ITAA 1936.

APPENDIX B

Examples

Our sanitised examples below, based on the experiences of our members, are intended to highlight common issues that arise for LPRs and tax practitioners when managing the estates of deceased who have not lodged tax returns for many years. LPRs and tax practitioners may attempt to rectify the non-lodgements, however, face administrative challenges, including:

- difficulties in obtaining a TFN;
- being unable to sign tax return declarations because factual gaps make it practically difficult to declare that all the information is true; and
- challenges when making voluntary disclosures to the ATO and unsuccessfully requesting default assessments.

Example 1 – Foreign asset and income reconstruction

An Australian deceased owned overseas assets. The deceased's estranged child is the executor and has limited knowledge of the deceased's affairs.

The executor undertook extensive work to identify and quantify the overseas assets of the estate, including hiring foreign advisers and translators to then translate advice into English. Extensive work was done to reconstruct income of the deceased based on available information.

Income estimates were provided to the ATO as a voluntary disclosure on the basis that the executor cannot sign tax returns, as she is not in a position to declare that they are 'true and correct.' Signing the declaration with the current level of knowledge the executor had may result in the executor making a false statement, and the tax agents meeting their professional tax agent obligations regarding the lodgment of the returns.

A voluntary disclosure was sought to allow the ATO to review the basis of the calculations and accept them, either by unilaterally issuing default assessments, or accepting that returns be lodged on the assumption of unknown facts but best efforts.

The executor has at all times sought to comply with all obligations, has gone to great lengths and expense to do so, and is seeking to wind up the estate. The executor is now at threat of action to be removed and is under immense stress.

The voluntary disclosure was lodged in January 2023 and is yet to be resolved. The ATO has stated that the tax returns are required to be lodged, refusing to engage on the issue of the necessary disclaimers or potential (albeit not intended) exposure for liability for false declarations.

Example 2 – Foreign deceased, resident estate, historical Australian rental income

The first point of contact with the ATO was via a voluntary disclosure in September 2022. The matter related in part to previously unknown rental income of the deceased (a foreign taxpayer) dating back to 1981.

Due to the lack of any evidentiary basis, rental income was reported on an assumed full occupancy/nil deductions basis, using known market values and extrapolated market yield.

In November 2022, the ATO advised that the voluntary disclosure could not be actioned as the deceased had never lodged tax returns. The purpose of the voluntary disclosure had been to demonstrate the income reconstructions and seek advice from the ATO as to whether they accepted the position before the lodgement of over 30 years of tax returns (which would have likely been at great administrative burden on the ATO staff). We note that the executor was attempting to rectify in good faith the affairs of a historically non-compliant taxpayer.

The ATO advised that a letter would be forthcoming. No such letter was received and the tax agent has been unable to identify what the letter would have contained. We note that the ATO staff member's choice to send a letter by mail seemed unusual when electronic communication was available and was being used.

Following this, the ATO requested that the foreign (Singaporean) Letters of Administration should be resealed. However, this was not possible. In December 2022, the ATO stated that no action could be taken until the tax returns were lodged. On 4 January 2023, the ATO again requested the that the Singaporean Letters of Administration be resealed.

On 13 January 2023, confirmation was received that the deceased had no records at the ATO, that the agent should obtain a TFN, and that resealed probate/letters of administration were not required to consider the voluntary disclosure.

On 20 February 2023, a new case officer was assigned to the voluntary disclosure. That officer provided a workable proposal in respect of the deceased's tax affairs, approximately seven months after original engagement.