


IT 2622 - Income tax : present entitlement during the stages of administration of deceased estates

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TAXATION RULING NO IT 2622

INCOME TAX: PRESENT ENTITLEMENT DURING THE STAGES OF
ADMINISTRATION OF DECEASED ESTATES

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PREAMBLE

This Ruling considers the income tax liabilities of executors or administrators and of beneficiaries under the estates of deceased persons during the stages of administration of deceased estates.

2. On the death of a taxpayer, the property of the deceased taxpayer passes to his or her estate, legal control over which is exercised by an executor or administrator. The executor or administrator, in effect, steps into the shoes of the deceased and winds up the deceased's personal affairs. An executor of a deceased person who leaves a will must obtain probate of the will. This is the official proving of the will and provides the executor with authority to deal with the estate. When probate has been granted, the executor is free to call up the deceased's assets and liabilities, and pay the debts, funeral and testamentary expenses. After these matters have been attended to, the executor distributes the property of the deceased to the beneficiaries of the estate.

3. A fiduciary obligation is assumed by the executor or administrator, on the death of a taxpayer, in favour of the beneficiaries of the estate. At that time, beneficiaries of the estate have no interest in the assets of the estate, although they do have a beneficial right to see that the estate is properly administered.

4. Even though a will may provide beneficiaries with absolute and indefeasible interests in the capital or income of an estate, under State laws those interests cannot crystallize until probate has been granted. A will may direct an executor to make an immediate distribution to beneficiaries after the granting of probate or it may establish a testamentary trust in

which income of the estate is to be applied in favour of certain beneficiaries for their lives and distribution of the capital of the estate is deferred for some time in the future. Where a deferred distribution is designated, a second fiduciary obligation arises - that of testamentary trustee.

5. Even where a will does not envisage the creation of a testamentary trust, the executor must assume a trustee's fiduciary capacity for some period after death. The responsibilities of the executor are similar to, though legally separate and distinct from, those of a testamentary trustee. The estate represents a legal entity or relationship quite separate from the testamentary trust. In practice it is only in rare cases that two different persons assume the roles of executor and testamentary trustee and, for income tax purposes, the estate and the testamentary trust are treated as one and the same. In fact, the term "trustee" is defined in subsection 6(1) of the Income Tax Assessment Act 1936 ("the Act") to include persons acting as executors or administrators.

6. The stages of administration of the estate of a deceased person may be illustrated as follows:

DATE OF DEATH

STAGES OF ADMINISTRATION

1. Burial of deceased.
2. Executor appointed by will or administrator appointed by Court.
3. Probate applied for and granted by Court.

PERIOD
OF
ADMINISTRATION

4. Assets vest in executor who pays debts and testamentary expenses:
 - . Initial stage - net income of estate is applied to reduce debts, etc.
 - . Intermediate stage - part of the net income of estate that is not required to pay debts, etc., may be paid to beneficiaries.
 - . Final stage - debts, etc., are paid or provided for in full and net income of estate is available for distribution.

ADMINISTRATION OF ESTATE
IS COMPLETE

RULING

Assessability of Income of a Deceased Estate

7. In a deceased estate, whether a beneficiary is presently entitled to a share of the income of a trust estate for the

purposes of Division 6 of Part III of the Act depends on:

- (a) The stage reached in the administration of the deceased estate.
- (b) The terms of the deceased's will or codicil, trust law and principles enunciated and orders made by the Courts.
- (c) Whether any discretionary payments have been made to the beneficiary by the executor or trustee.

8. Division 6 requires the ascertainment of the "net income" of the trust estate as defined in subsection 95(1) of the Act. The net income of the trust is then assessed to the beneficiary or to the trustee depending on whether the beneficiary is presently entitled to income of the trust estate or is under a legal disability.

9. Beneficiaries cannot enjoy present entitlement to income derived by a deceased estate during the administration of the estate. Income of a deceased estate in income years before the administration of the estate is complete, is the income of the executors or administrators and is not income of the beneficiaries. During the initial stage of the administration (as described in paragraph 6 above) no beneficiary is presently entitled to the income derived.

10. The leading Australian case on present entitlement under a trust arising during the course of administration of an estate is the decision of the High Court of Australia in *FCT v. Whiting* (1943) 68 CLR 199; 7 ATD 179. The Court held that a beneficiary of a deceased estate cannot be presently entitled to the income of the estate until the estate has been fully administered.

11. In their joint judgment, Latham C J and Williams J stated (CLR at 216; ATD at 184), that numerous authorities had established that:

".... until an estate has been fully administered by payment or provision for the payment of funeral and testamentary expenses, 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."

12. And later their Honours added (CLR at 216; ATD at 184):

"The only part of an estate which can be made available to satisfy the claims of the beneficiaries is that part which remains after the funeral and testamentary expenses, death duties and debts have been paid or provided for, if necessary out of the whole estate, including any income earned by the estate during the period of realization."

13. Until the estate of a testator has been fully administered and the net residue ascertained, a residuary beneficiary has no proprietary interest in any specific investment forming part of the estate or in the income from any such investment. Both corpus and income are the property of the executors or administrators: Lord Sudeley v. Attorney-General [1897] A.C. 11; Dr Barnardo's Homes National Incorporated Association v. Commissioners for Special Purposes [1921] 2 A.C. 1. See also Pajels v. MacDonald (1936) 54 CLR 519 at 526; Corbett v. I.R.C. (1937) 4 All E.R. 700 at 707 and C.S.D. (Qld) v. Livingston (1964) 112 CLR 12.

14. During the intermediate stage of administration of a deceased estate (as described in paragraph 6 above), the point may be reached where it is apparent to the executor that part of the net income of the estate will not be required to either pay or provide for debts, etc. The executor in this situation might in exercise of the executor's discretion, in fact, pay some of the income to, or on behalf of, the beneficiaries. The beneficiaries in this situation will be presently entitled to the income to the extent of the amounts actually paid to them or actually paid on their behalf. The fact that the estate has not been fully administered does not prevent the beneficiaries in this situation from being presently entitled to the income actually paid to, or on behalf of, the beneficiaries.

Income Derived After Administration of Estate is Complete

15. Where residue of the estate has been ascertained and the estate has been fully administered, residuary beneficiaries enjoy present entitlement to income derived by the estate. As Lord Cave said in the Dr Barnardo's Homes case (A.C. at 10):

"When the personal estate of a testator has been fully administered by his executors and the net residue ascertained, the residuary legatee is entitled to have the residue, as so ascertained, with any accrued income transferred and paid to him."

16. The administration of the estate does not have to reach the stage where the estate is wound up for beneficiaries to enjoy present entitlement to the income of the estate. Once the executor has provided for all debts incurred by the deceased before his or her death and for debts incurred in administering the estate (e.g. funeral expenses) and provided for distributions of specific assets or legacies, it will be possible to ascertain the residue with

certainty, even though the executor may not have actually made all the transfers necessary to satisfy these demands on the estate.

Where the Estate is Fully Administered During an Income Year

17. Where the administration of a deceased estate is completed during the course of an income year, the longstanding practice

of this Office is to raise assessments on the basis that beneficiaries who are not under any legal disability should bear tax, under section 97 of the Act, on their shares of the net income of the estate for that year to which they are presently entitled. If a beneficiary is under a legal disability the relevant share of the net income of the estate would be assessed in the manner required by section 98 of the Act.

18. Statutory authority for this course is to be found in sections 95, 97 and 98 of the Act. Under these provisions, beneficiaries are not assessed directly on their shares of the income of an estate. The first step, required by section 95, is that the "net income of the trust estate" for the income year concerned is calculated in the manner laid down by that section. Section 97 then provides that where any beneficiary not under a legal disability is presently entitled to a share of the income of the trust estate, that share of "the net income of the trust estate" (i.e. the share of the amount calculated in the manner laid down in section 95) shall be included in his or her assessable income. Similar reasoning applies if the case is one to which section 98 applies.

19. The "net income of the trust estate" and whether any beneficiary is presently entitled to a share of income of the estate are determined on the last day of the financial year. As Chief Justice Barwick said in *Union Fidelity Trustee Co. of Australia v. FCT* (1969) 119 CLR 177 at 182; 69 ATC 4084 at 4087; 1 ATR 200 at 202:

"The time as at which to determine the assessable income of a taxpayer is in general the concluding day of the taxation year. There is no provision which takes the calculation under s.95 in that respect out of the general scheme of the Act."

This approach is also supported by the decision in *FCT v. Galland* 86 ATC 4885; (1986) 18 ATR 33.

20. This means that, on the last day of the income year, provided a beneficiary has become presently entitled to a share of the income of the trust estate on or before that day, the beneficiary is assessable on that share of the "net income of the trust estate" calculated in accordance with section 95 of the Act. The calculation required by section 95 includes in the "net income of the trust estate" the assessable income derived by the trust estate for the whole of the income year concerned.

21. It has also been the longstanding practice of this Office, however, to accept an apportionment in the income year in which the estate is fully administered. Where the executors and beneficiaries

are able to demonstrate, through the striking of accounts at the completion of administration, the actual amounts of income derived in the periods before and after the day on which the estate was fully administered, an apportionment may be made as follows:

- . Income derived in the period - Assessed in the hands of the
between the beginning of executors or administrators
the income year and the under section 99 of the Act.
day administration was
completed.

- . Income derived in the period - Assessed to the
between the day administration beneficiaries presently
was completed and the end of entitled to the income in
the income year. the manner required by
section 97 or 98 of the Act.

22. There must be evidence of the income derived during these periods and apportionment of the net income of the trust estate in this manner must be requested by the taxpayers concerned, i.e., the executor or administrator and the beneficiaries. This Office would not accept an apportionment of the income derived by the estate for the whole income year concerned into the two periods merely on a time basis.

23. One exception to this alternative course of apportionment is that, if an executor or administrator does in fact pay part of the income of the estate to a beneficiary before the estate is fully administered (i.e. during the first of the periods mentioned in paragraph 21 above), the beneficiary would be assessed on the basis that he or she was presently entitled to that income. This also accords with paragraph 14 above.

COMMISSIONER OF TAXATION
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