Who's liable to pay tax on income of a deceased estate

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It's a common misconception that as long as the deceased estate is kept open, the income derived by a deceased estate is always assessable to the estate for tax purposes. Where the beneficiaries of a deceased estate are on a high marginal tax rate, this view can lead to delaying the distribution of the estate's assets so that the estate's income can be taxed at a lower tax rate.

However, depending on the administration stage of the deceased estate, the estate income may be taxed in the hands of a beneficiary who is presently entitled even if the estate is kept open and the estate's assets are yet to be distributed.

"Present entitlement" is a critical element to determine how an estate's income is taxed. This article looks at present entitlement during the stages of administration of deceased estates and who is liable to pay tax on the estate's net income.

This article also looks at a high level when a beneficiary's interest in a deceased estate becomes an assessable asset for Centrelink purposes.

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What is a deceased estate?

A deceased estate is a trust which is a relationship between a trustee and beneficiaries. The trustee is required to administer the trust property in the best interests of the beneficiaries.

A deceased estate is made up of:

1) **The trust property** which typically can include:
   - assets solely held under the name of the deceased or the deceased's share of an asset held as tenants in common. Assets that are held as joint tenants, by a private company or trust will not form part of the deceased estate;
   - the deceased's super death benefit where the estate is nominated to receive the funds, or in the absence of a valid death benefit nomination, where the trustee of the super fund decides to pay the death benefit to the estate;
   - a life insurance policy owned by the deceased that does not list a nominated beneficiary, and the insurance proceeds are paid directly to the deceased estate.
2) **Beneficiaries**:
   - Where a valid Will exists, beneficiaries are those normally named in the Will of the deceased person.
   - Where the deceased died without a valid Will, the beneficiaries are identified based on the rules of intestacy that apply in the relevant state or territory.
3) **The trustee**. For income tax purposes, the legal personal representative (LPR) of a deceased estate is the trustee of the deceased estate who is entitled to deal with the assets of the deceased person.
   - The LPR is usually the executor appointed by the deceased's Will; or
   - If the deceased died without a valid Will or the nominated executor is unable to discharge their duties, the LPR is the administrator of the deceased estate appointed by the Court.

LPR's duties in managing the deceased's tax affairs

Unless the deceased person left minimal assets, the LPR would be required to apply for a grant of probate, or Letters of Administration for an intestate estate.

Once the grant is approved by the Court, the executor or administrator is considered the authorised LPR by the ATO. The LPR has:

- full authority to manage the deceased's tax affairs
- unrestricted access to ATO-held information and assets of the estate

Once approved by the ATO to be the authorised LPR, the executor or the administrator is required to fulfil tax obligations including:

1) **Lodge a final tax return for the deceased person**

   This is called a 'date of death' tax return which is the deceased's last individual tax return. It covers the income derived by the deceased in the year of death from 1 July up to the date of death.

   The LPR is also required to lodge any outstanding prior year tax returns.

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Where the deceased individual made personal super contributions with an intention to deduct the contributions but did not give a valid notice of intent to claim deduction in the approved form to the super fund prior to death, the notice can be given by the agent on behalf of the person, including a LPR of the deceased estate. The usual timeframe and conditions for lodging a valid notice apply.

Once the super fund has acknowledged the receipt of a valid notice, the LPR can claim a deduction for the deceased's personal contributions in the date of death tax return.

2) Lodge trust tax returns for the deceased estate

Upon death the title to the assets of the deceased (that can form part of the deceased estate) vests in the LPR.

The LPR is required to apply for a trust tax file number (TFN) for the deceased estate. This TFN fis different from the deceased individual's TFN or the TFN for a testamentary trust (if such a trust is established under the terms of the deceased's Will and continues after the deceased estate is finalised).

Finalising a deceased estate typically takes 6 to 12 months but can take longer. Trust returns may need to be lodged each year until the estate is finalised.

Trust returns are used to:

- report the income of the deceased estate received after the person's death, such as rent, dividends, interests or net capital gains. The deceased estate may also receive a super death benefit payment, business or employment income or death benefit employment termination payment that may be assessable income in the deceased estate
- claim any tax refund or franking credits owed to the deceased estate.

3) Finalise tax affairs

The LPR needs to check that all tax obligations are provided for before making a final distribution of the deceased's property.

It is important to note that the LPR is liable to pay any outstanding tax-related liabilities of a deceased person, up to the value of the deceased estate's assets. Where the LPR prematurely distributes the estate's assets, the LPR may need to personally meet these outstanding liabilities. [1]

Present entitlement determines who's liable to pay tax

"Present entitlement" is a critical element under Division 6 of the Income Tax Assessment Act 1936 (ITAA 1936) to determine how the net income of a trust is taxed.

For tax law purposes a deceased estate is a trust (administered by the executor or administrator) and therefore Division 6 applies. This means that:

- The estate's income to which no beneficiary is presently entitled is assessed to the LPR (ie executor or administrator) at a tax rate that is applicable to the deceased estate.
- The estate's income to which a beneficiary is presently entitled is taxed at the beneficiary's marginal tax rate.

Present entitlement during stages of administration of deceased estate

"Present entitlement" is not defined in the tax law. The High Court has considered the meaning of "present entitlement" in a number of leading cases (*Whiting; Taylor;* etc.) and held that on a high level, a beneficiary is presently entitled to income of a deceased estate if they have:

- an indefeasible, absolutely vested interest in the income – in other words, they have a claim or interest in the income that cannot be defeated by another person; and
- the right to demand immediate payment of the income – this means a beneficiary can be presently entitled even though they may not have actually received the income.

In a deceased estate, whether a beneficiary is presently entitled to a share of the income of a trust estate for tax law purposes (ie Division 6 of the ITAA 1936) depends on[2]:

(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.

[1] PCG 2018/4 Income tax – liability of legal personal representative of a deceased person

[2] Taxation Ruling IT 2622, paragraph 7

(c) Whether any discretionary payments have been made to the beneficiary by the executor or administrator.

The ATO in its tax ruling IT 2622, paragraph 6, expressed that there are three stages during a deceased estate's administration once assets vest in executor.

1) **Initial stage**

   This is the period where the LPR applies the net income of the estate to reduce debts and pay funeral or testamentary expenses.

   At this stage it is not possible to ascertain the net residue in the deceased estate and beneficiaries cannot be presently entitled to income in the deceased estate.

   The net income of the estate is assessed to the LPR.

2) **Intermediate stage**

   During this stage, the point may be reached where it is apparent to the LPR that part of the net income of the estate will not be required to either pay or provide for debts, etc. The LPR in this situation might exercise their discretion to make an interim distribution to the beneficiaries.

   The ATO stated[3] that 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 a beneficiary in this situation from being presently entitled to the income actually paid to them.

   During this stage, beneficiaries cannot however be presently entitled to estate's income not actually paid to them or paid on their behalf.

3) Final stage

   During this stage all debts are paid or provided for in full and net income of the estate is available for distribution. The administration is complete, and beneficiaries are presently entitled to income derived by the estate.

   The ATO states that 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.

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Beneficiaries generally cannot be presently entitled to income of a deceased estate until it has been fully administered (finalised).

However, if any income is distributed to a beneficiary by the LPR before the estate is fully administered, the beneficiary is considered to be presently entitled to the income.

Income derived after the administration is complete is taxed at the marginal tax rates of the presently entitled beneficiaries. This is the case even if the LPR is yet to distribute the residue estate to the eligible beneficiaries.

How estate income is reported and assessed

Income of the trust estate to which no beneficiary is presently entitled

The trustee of the deceased estate (ie the executor or administrator) is liable to pay tax on the estate's net income to which no beneficiary is presently entitled (ie during the first stage and intermediate stage before the administration is complete).

The LPR is required to include the income in the trust tax return and is responsible for paying any tax on this amount.

Normally a trustee who is assessed on the net income of a trust (eg. Discretionary trust where no

[3] Taxation Ruling IT 2622, paragraph 14

beneficiary is presently entitled) pays tax at the top marginal tax rate (currently 45% plus 2% Medicare levy where applicable).

Where the trust is a deceased estate, the ATO can exercise its discretion (under section 99A of the ITAA 1936) to apply a concessional tax scale under section 99 of the ITAA 1936 in relation to the estate's net income, where no beneficiary is presently entitled as follows:

- During the first 3 income years
  The concessional tax rate during the first 3 income years is the same as the individual income tax rates with the benefit of the full tax-free threshold (currently $18,200).

  In most cases, the first income year is not a full financial year as it commences from the day following the date of death and ends on 30 June of that same income year. Nevertheless, the full tax-free threshold of $18,200 is available.

- **Fourth income year and later**

  For deceased estates that continue to be administered beyond the third income year, the below tax rates apply to the estate's income where no beneficiary is presently entitled in the fourth income year and later. Effectively the tax-free threshold is reduced from $18,200 to $416:

Tax rates 2024-25

Deceased estate taxable income (no present entitlement)	Tax rates
$0 - $416	Nil
$417 - $611	50% of the excess over $416
$612 - $45,000	$97.76 plus 16% of the excess over $611. If the deceased estate income exceeds $611, the entire amount from $0 will be taxed at the rate of 16%.
$45,001 - $135,000	$7,200 plus 30% of the excess over $45,000
$135,001 - $190,000	$34,200 plus 37% of excess over $135,000
$190,001 and over	$54,550 plus 45% of the excess over $190,000

- **Medicare levy**

  The executor or administrator is not liable to pay the Medicare levy on estate income to which no beneficiary is presently entitled[4].

  In contrast, a trustee of other types of trusts is liable to pay the Medicare levy on such income.

- **Tax offsets**

  Deceased estates do not get the benefit of tax offsets such as low-income tax offset.

  However, any franking credits from franked distributions or credit for TFN amounts withheld from interest, dividends or unit trust distributions are available to reduce the tax liabilities and any excess can be refunded to the deceased estate.

Income of the trust estate to which beneficiary is presently entitled

As discussed above, a beneficiary can become presently entitled to a share of the net income in the deceased estate if:

- the administration of the deceased estate is complete, or
- the beneficiary receives an interim distribution before the administration is complete.

Such income is taxed at the beneficiary's marginal tax rate. However, depending on the beneficiary's tax residency status and whether they are under a legal disability, how the tax is paid can be different:

- If the beneficiary is a tax resident and is not under a legal disability, the beneficiary is responsible for including their share of the net income in their own tax return and paying any tax owning (section 97 of the ITAA 1936).
- If the beneficiary is under a legal disability (eg under 18 years of age at the end of the tax year,

[4] Section 251S (1) (c) of the ITAA 1936

bankrupt or mentally incapacitated), the LPR needs to include the beneficiary's share of the net income in the trust tax return and pay tax on the beneficiary's behalf at the beneficiary's marginal tax rates (section 98 of the ITAA 1936).

  - As the beneficiary is presently entitled to the trust income, Medicare levy and Medicare levy surcharge can apply.
  - The LPR is entitled to any tax offsets to which the beneficiary would be entitled, such as the low-income and low-and-middle income tax offsets.

- If the beneficiary is a non-resident for tax purposes at the end of the tax year, the LPR needs to include the beneficiary's share of the net income in the trust return and pay tax on the beneficiary's behalf (section 98 of the ITAA 1936).
  - Non-resident tax rates apply to income that would be assessable to the non-resident beneficiary. Tax paid on the non-resident's behalf by the LPR is not a final tax, instead it's a refundable tax credit when the non-resident lodges their Australian tax return.
  - Medicare levy is not payable.
  - The LPR is required to withhold tax from certain income such as interest, unfranked dividends and royalties and pay the withheld amount to the ATO. The withholding tax is a final tax.

Exceptions to the rule – certain types of income paid to the deceased estate

Super death benefit paid to the deceased estate

Where a deceased super death benefit is paid to the deceased estate, the trustee of the super fund is not required to withhold any tax.

It is then the responsibility of the LPR of the deceased estate to pay tax on the taxable component of any death benefit amount used to benefit a non-tax dependant beneficiary.

The taxable component of the super death benefit that is paid to a non-tax dependant is part of the assessable income of the deceased estate. A maximum tax rate of 15% applies to taxed element and 30% untaxed element.

However, for tax law purposes, the benefit is taken to be income in the trust to which no beneficiary is presently entitled, which means Medicare Levy is not payable when the death benefit is paid from the deceased estate to a non-tax dependant.

The LPR must deduct tax from the taxable component of the lump sum before paying the death benefit to a non-tax dependant beneficiary. The beneficiary does not need to declare this income in their tax return, hence no increase in their assessable and taxable income.

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There could be tax benefits for a non-tax dependant to receive a lump sum super death benefit via the deceased estate rather than directly through the super fund. For example:

- Medicare levy is not payable
- The beneficiary is not required to include the taxable component of the death benefit in their assessable income. Therefore, the lump sum payment will not have flow-on effects on the individual beneficiary's tax, super and social security position.

However, tax savings are only one aspect of super estate planning. Other factors must be considered to determine an estate planning strategy that can work best for a client, such as:

- Potential uncertainties in the deceased estate.
- There may be a delay in receiving the death benefit payment through the deceased estate.
- Costs associated with managing the deceased estate such as accounting fees.

Please refer to our FirstTech strategic update article – **tax on super death benefits paid to estate vs beneficiary** for further details.

Death benefit employment termination payment paid to the deceased estate

Where the deceased's employer pays a death benefit employment termination payment (ETP) to the LPR of the deceased estate, the LPR pays tax on the death benefit ETP in the same way it would if the payment were made to a dependant or non-dependant directly.

However, for tax law purposes, the benefit is taken to be income to which no beneficiary is presently entitled and therefore Medicare Levy is not payable by the LPR.

When the beneficiary receives the payment from the deceased estate, the payment is not assessable income in the hands of the beneficiary.

Please refer to chapter 3 of our FirstTech **employment termination guide** for further details.

Payments for work or services

Payments for work or services, including outstanding wages and bonuses accrued before the death of the employee may be paid to the LPR of the deceased estate. These payments are included in the assessable income of the deceased estate rather than being included in the deceased's date of death return.

Such amounts received by the LPR that would have been assessable income in the hands of the deceased person if it had been received by them during their lifetime, are deemed to be income in the estate to which no beneficiary is presently entitled[5].

Payments for unused annual and long service leave

Payments for unused annual leave and long service leave are tax-free and not included in the assessable income of the deceased estate[6]. In this case, the employer is also not required to withhold tax from the leave payments, and they are not included on the employee's PAYG summary.

Where a payment for a period that the employee had been on annual leave or sick leave is not paid until after the date of death, these amounts are included in the assessable income of the estate[7].

Centrelink considerations

A frequently asked question is:

When does a beneficiary's interest in a deceased estate become an assessable asset for Centrelink purposes? Is it the case that as long as the assets are kept in the deceased estate, they will not be assessed against the beneficiary for social security purposes?

Centrelink applies a similar 'present entitlement' concept and a beneficiary's interest in a deceased estate is exempt from the assets test until it is:

- received, OR
  able to be received.

Deceased assets attributed to a beneficiary within 12 months of the death

Centrelink acknowledges that it can take some time to finalise an estate.

Where an asset of an estate is distributed to a beneficiary within 12 months after the date of death of the testator, Centrelink generally only assesses an asset against a beneficiary from the date the asset is transferred into the beneficiary's name by the LPR of the deceased estate.

Deceased assets attributed to a beneficiary outside 12 months of the death

If the estate has not been distributed 12 months after the death of the testator, Centrelink will investigate to determine:

- what is preventing the estate from being finalised, AND
- whether the reasons are within the Centrelink's client's control.

If the Centrelink client has contributed to the delay, the interest in the deceased estate is regarded as being able to be received even if the assets are yet to be distributed out of the deceased estate.

[5] Section 101A
[6] Section 101A(2) of the ITAA 1936
[7] ATO ID 2002/1049

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