Draft PCG 2017/D12 – at last some clarity for legal personal representatives of deceased estates?

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As reported at 2017 WTB 29 [1014], Draft Practical Compliance Guideline 2017/D12 (**Draft PCG 2017/D12**) contains guidance from the ATO in relation to the liability of an executor or legal personal representative (**LPR**) of a deceased estate for the deceased's tax debts.

Background

Historically, the leading decision in this area has been seen as the case of *Barkworth Olives Management Ltd v DCT* [2010] QCA 80; (2010) 78 ATR 827 (**Barkworth**).

Broadly, *Barkworth* acknowledged that, subject to some limitations (such as the application of s 99A of the ITAA 1936), the trustee of a trust has a right of indemnity for trust tax debts and under s 254 of the ITAA 1936 is generally not personally liable for those debts.

In the context of a deceased estate, this means the LPR will generally not be personally liable for the deceased's tax debts.

Personal liability will however arise (to a maximum of the original assets in the estate) where the assets of the estate have been fully distributed, or distributed to an extent that means there are still unsatisfied tax debts outstanding.

In contrast, if a tax debt arises during the course of the administration of the deceased estate, the LPR can automatically be personally liable, regardless of the assets in the estate.

Importantly, beneficiaries of deceased estates can never be liable for the tax debts of the deceased, unless there has been fraud or evasion.

Historically, where an LPR was concerned that there may be taxes they might ultimately be personally liable for, best practice was to obtain clearance from the ATO that there were no outstanding tax liabilities. However, the ATO no longer issues letters of clearance.

Therefore, if there are genuine concerns that the ATO may audit the estate, then the conservative approach is generally for the LPR to retain sufficient assets to cover any possible tax liability for either 2 or 4 years (depending the nature of assets in the estate and therefore the potential audit period) following the lodgment of the final tax return for the deceased estate.

Practically, in this type of situation, it therefore means that the estate can only be fully administered and final lodgments made to the ATO after the 2 or 4-year period has lapsed. This is because until the final notice of assessment has been received by the LPR (listing no outstanding amounts owing by the estate), they are not relieved of personal liability.

This conclusion also relies on the assumption that there is no fraud or evasion involved, as if there is, the ATO is not restricted by time limits on the ability to issue amended assessments.

Draft PCG 2017/D12 - Overview

Draft PCG 2017/D12 is broadly consistent with the approach outlined above, although (as is often the case with this style of release from the ATO) ***there are some important caveats***.

In particular, the draft guideline outlines the circumstances where the LPR will be treated as having notice of a claim or potential claim by the ATO, which could result in personal liability should the assets of the estate be distributed without leaving sufficient funds to discharge the ATO claim.

The ATO adopts the view that the LPR will have a notice of the claim (or potential claim) where:

- the deceased had amounts owing to the ATO at the date of their death (including any additions to those amounts such as interest);
- the deceased had an outstanding assessment from an income tax return which had been lodged but not yet assessed by the ATO;
- the ATO notifies the LPR within 6 months of the lodgment of the deceased's last return that it intends to review the deceased person's tax affairs; or
- further assets come into the hands of the LPR after what was thought to be completion of the estate's administration (the ATO takes the view that the identification of further assets might suggest the deceased's income was understated previously).

In each of the above circumstances, the LPR should take a conservative approach and delay the distribution of some or all of the estate assets, until the estate's potential tax exposure can be quantified.

'Smaller and less complex estates'

Arguably the most significant caveat with Draft PCG 2017/D12 is that ***it is expressly stated to only apply to 'smaller and less complex estates'***.

Assuming an estate satisfies the concept of being 'smaller and less complex', Draft PCG 2017/D12 confirms the basis on which a wind up can proceed without concern that the LPR's personal assets may be exposed to a claim by the ATO.

In particular, the following elements *must all be present*:

- in the 4 years before their death, the deceased did not carry on a business or receive distributions from a trust;
- the estate assets consist solely of shares or interests in widely held entities (such as public companies), superannuation death benefits, Australian real property, cash and personal assets;
- the total market value of the estate assets was less than $5 million;
- none of the circumstances outlined earlier in this article where the LPR is deemed to have notice of the claim (or potential claim) arise;
- the LPR acted reasonably in lodging the deceased person's outstanding returns; and
- the ATO has not given the LPR notice that it intends to examine the deceased person's tax affairs within 6 months from the date of lodgment of the last outstanding return.

One related issue

One related issue not specially addressed by Draft PCG 2017/D12 is how long a deceased estate can remain in 'administration mode', following someone's death. It is assumed that this is because the ATO has confirmed its broad position in this regard via taxation ruling IT 2622.

Assuming there are no complications with the deceased estate due to, for example, a challenge against a will, it is generally the case that the ATO accepts a maximum period of 3 years for an estate to be administered.

The administration of an estate, from the ATO's perspective, involves the ultimate distribution of assets to beneficiaries if there is no formal testamentary trust under a will, or the distribution of assets to a testamentary trust if the deceased has incorporated that into their will.

This effectively means that for the purposes of the excepted trust income rules (these are the rules that allow children to be treated as adults for tax purposes, see for example our article reported at 2015 WTB 40 [1475]), all wills contain a form of testamentary trust.

It is important to note that while the ATO allows a maximum of 3 years, often it will in fact expect that the deceased estate is administered within 12 months from the date of death, and therefore may deny access to the excepted trust income provisions despite the fact that the estate has not in fact been fully administered.

Conclusion

As a result of Draft PCG 2017/D12 (and assuming the draft guidelines are issued in final form on broadly similar terms), it should be possible for smaller and simpler estates to be wound up in a shorter period of time, without the LPR creating personal exposure in relation to tax debts.

While the draft guidelines are a welcome initiative in a fast growing area for many adviser practices, they also highlight that where clarity is most needed - that is larger and more complex estates - significant risks remain for LPRs.

Any person currently an LPR, or considering accepting an LPR role, in situations outside the scope of Draft PCG 2017/D12, should continue to proceed with caution in relation to tax debts.