24 Februrary 2020

The Department of Treasury
Ms Maryanne Mrakovcic
Deputy Secretary, Revenue Group
Treasury Building
Langton Crescent
PARKES ACT 2600

Also by email: maryanne.mrakovcic@treasury.gov.au

Dear Ms Mrakovcic,

Amend Section 102AG(2)(d)(ii) of the ITAA 36

We the Society of Trust & Estate Practitioners Australia Pty Limited (STEP Australia) represent professionals from across Australia who are specialists in trusts, estate planning and in supporting the needs of families (young and old, wealthy and modest). The objective of a STEP Professional is to advance the interests of families across generations. This often involves us in identifying issues of relative importance to families and bringing these to the attention of those who can make a positive difference. This is the purpose of this submission.

STEP Australia's membership includes lawyers, accountants, financial wealth advisors and trustee company professionals from across Australia; our members bring a multi-disciplinary approach to the benefit of their clients. It is this unique multi-disciplinary approach that supports this submission.

STEP is concerned with a tax law that operates differently across Australia according to where a person lived, died and the location of their wealth. The problem arises from an unintended clash that may have had a sound policy perspective in years past but with greater modern mobility has become out of date and very unworkable.

There is confusion, complexity, risk of errors and costs to the persons who are in genuine grief circumstances. Below is a simple solution that will maintain the original policy, 'legalise' a decades old work-a-round that has been applied by the Australian Taxation Office (ATO) and restore consistent law across Australia.

Section 102AG(2)(d)(ii) of the ITAA 36 allows a parent to permanently dedicate a part of an inheritance to the benefit of children of a deceased and recognise the income as excepted income that bears ordinary taxation. That applies to the extent the income amount:

'*(d)* *is derived by the trustee of the trust estate from the investment of any property: …*

> *(ii)* *that was transferred to the trustee for the benefit of the beneficiary by another person out of property that devolved upon that other person from the estate of a deceased person and was so transferred within 3 years after the date of the death of the deceased person;'*

Trusts established under this 3 year rule are commonly described as 'de facto testamentary trusts' or 'post mortem trusts'. Conditions which need to be met include:

1. the transfer must be within 3 years of death;
2. it must originate from what the person inherited from the estate of the deceased; and
3. the transfer must be permanently in favour of the child beneficiaries who *must* acquire the property when the trust ends[1].

The amount to be transferred is limited by section 102AG(7) ITAA 36. Very broadly this is limited to what the minor child or children would have obtained had the deceased died intestate (without a will). To see where the problem arises it is necessary to consider the intestacy rules across Australia.

In Queensland, South Australia, the Australian Capital Territory, the Northern Territory and Western Australia[2] the spouse and children share the deceased spouse's estate on intestacy. But the precise amounts vary among these.

In NSW, Victoria and Tasmania there is no amount arising on an intestacy for children of the relationship between the surviving spouse and the deceased. In these states the surviving spouse inherits 100% of the deceased's estate on intestacy[3].

A single Federal tax law has significantly different operation and potential across Australia, based on where people lived and died.

Greater anomalies exist, for example, in NSW, Victoria and Tasmania *step children* of the deceased may benefit on an intestacy[4] such that a surviving partner can permanently transfer funds to a post mortem trust for step children but not for children born of them and their deceased partner!

For instance in NSW, under section 113 of the *Succession Act 2006* (NSW) the surviving spouse inherits the intestate's personal effects, a statutory legacy (this is a CPI indexed statutory amount - around $476,551 if the deceased died in say April 2019[5]) and half of the remaining residuary estate. The step-children inherit the balance of the residuary estate in equal shares[6].

A single Federal tax law has significantly different operation and potential across Australia, based on family and marital relationships.

There is a potential inherent discrimination that is, to say the least uncertain and confusing. The intestacy laws of an Indigenous deceased have regard to and are dependent upon the laws, customs, traditions and practices of the community or group to whom the deceased recognised[7].

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[1] the capital requirement in section 102AG(2A) applies

[2] Part 3 of the *Succession Act 1981* (Qld), section 72G of the *Administration and Probate Act 1919* (SA), section 49 of the *Administration and Probate Act 1929* (ACT), section 66 of the *Administration and Probate Act* (NT) and section 14 of the *Administration Act* 1903 (WA).

[3] Section 70K of the *Administration and Probate Act 1958* (Vic), section 112 of the *Succession Act 2006* (NSW) and section 13 of the *Intestacy Act 2010* (Tas).

[4] Section 14 of the *Intestacy Act 2010* (Tas), section 70L of the *Administration and Probate Act 1958* (Vic) and section 113 of the *Succession Act 2006* (NSW).

[5] The statutory legacy amount is defined in section 106 of the *Succession Act 2006 (NSW)* and contains the CPI indexation formula.

[6] Section 127 of the *Succession Act 2006* (NSW).

[7] Refer for example to section 133 of the *Succession Act 2006* (NSW)

Whilst this may suggest greater scope for Indigenous persons of NSW, there is no clarity as to whom the provisions may apply and how much!

A single Federal tax law has significantly different operation between Indigenous and non-Indigenous Australians and lacks clarity where it may apply.

Private international law determines the succession laws that apply on intestacy. A deceased's moveable property is subject to the law of the deceased's domicile at their death. Their immoveable property (such as land) is subject to the law of where it is situated. In modern Australia person is likely to have assets and property in multiple Australian jurisdictions.

There is a need in investigate the law of each asset which can only lead to complexity, cost, confusion and the risk of error. Take for example public company Australian Stock Exchange listed shares. These are thought to be national but are in fact subject to State or Territory laws under which they are registered or worse, a foreign law of another country or multiple countries!

The cost of the investigation can be prohibitive and therefore only of benefit to the wealthy who are motivated to 'forum shop' and obtain multiple rights of estate administration.

A single Federal tax law has significantly different operation according to each and every asset of a deceased estate.

Superannuation is enjoyed by millions of Australians and from a death benefit perspective affects many more millions. It can be part of an estate or paid direct. Where does this sit in the context of section 102AG? Nowhere; it is not mentioned. But if it is part of the estate the post mortem trust may be adopted in Queensland, South Australia, the Australian Capital Territory, the Northern Territory and Western Australia. But if it is not part of the estate?

The ATO has adopted a pragmatic approach that relies on an old Canberra Income Tax Circular Memorandum 884 which was released following the introduction of Division 6AA in 1980. Now withdrawn, the CITCM has been quoted by the ATO in several Private & Binding Ruling Requests[8] to the effect that superannuation derived directly by a spouse will be treated as having come to them from the estate of a deceased and therefore the person can create the post mortem trust.

This results in a situation where the spouse of those who lived and died in Queensland, South Australia, the Australian Capital Territory, the Northern Territory or Western Australia may create the post mortem trust that is able to comply with section 102AG, unless the law of the superannuation fund may be NSW, Victoria or Tasmania. But what about multiple superannuation interests? And what if the person is Indigenous? And anyway, who knows about this, there is no clarity in the law, just a pragmatic ATO approach that relies on a CITCM that is almost 40 years old and is no longer published.

[8] Private & Binding Ruling Authorisation Number 1012994963374. The concept has been expressed by the ATO in other ruling requests without any mention of CITCM 884, see for example Private & Binding Ruling Authorisation Number 1051187537572.

A single Federal tax law has significantly different operation according to who knows how to find the hidden rules.

Where it can apply, which is not entirely clear, the post mortem trust cannot be established from a grandparent or other person's will or intestacy because in those situations the minor child would not have an interest in the grandparent's intestate estate[9].

This issue is ripe for reform and modernisation. With minor variation, the problems outlined above will be corrected. The suggested fix to section 102AG is expressed below. Complementary changes can be made to section 102AE(c)(ii).

> '*(d) is derived by the trustee of the trust estate from the investment of any property:*
>
> *…*
>
> *(ii) that was transferred to the trustee for the benefit of a child, children or grandchildren of the deceased person by another person out of up to half of any property that devolved upon that other person from the estate or from superannuation of a deceased person and was so transferred within 3 years after the date of the death of the deceased person;*'

If you would like to discuss any of the above, please contact Peter Bobbin TEP, STEP Australia Chair on +61 2 9895 9370 or David Marks QC, STEP Australia Policy Committee Member on +61 7 3236 5477.

Yours sincerely

Peter Bobbin

Chair of STEP Australia

cc. Michael Sukkar, Assistant Treasurer

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[9] Katerina Peiros, 'Estate proceeds trusts: benefits for families' Taxation in Australia Vol 51(4) October 2016 at 223.