IT 2664 - Income tax: capital gains and losses: the transfer of assets to beneficiaries in deceased estates

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This ruling contains references to repealed provisions, some of which may have been rewritten. The ruling still has effect. Paragraph 32 in TR 2006/10 provides further guidance on the status and binding effect of public rulings where the law has been repealed or repealed and rewritten. The legislative references at the end of the ruling indicate the repealed provisions and, where applicable, the rewritten provisions.

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TAXATION RULING IT 2664

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FOI INDEX DETAIL

Reference no.	Subject refs:	Legislative refs:
I 1012992	**CAPITAL GAINS**	**160J**
	DECEASED ESTATES	**160X**
	DIRECT TRANSMISSION	**160ZZC**
	PRINCIPAL RESIDENCE	**160ZZQ**
	TESTAMENTARY OPTIONS	
	TRANSFER OF ASSETS	

OTHER RULINGS ON THIS TOPIC:

TITLE: INCOME TAX: CAPITAL GAINS AND LOSSES: THE TRANSFER OF ASSETS TO BENEFICIARIES IN DECEASED ESTATES

NOTE: . Income Tax Rulings do not have the force of law.

. Each decision made by the Australian Taxation Office is made on the merit of each individual case having regard to any relevant Ruling.

PREAMBLE

This Ruling considers whether there is a "disposal" of an asset for the purposes of the capital gains and capital losses ("CGT") provisions of the Income Tax Assessment Act 1936 if the executor of a will (or the administrator of a deceased estate) transfers an estate asset, owned by the deceased when that person died, to a beneficiary in four different situations:

(i) Where the asset is specifically given to the beneficiary by the will or a court order under testator's family maintenance or family provision legislation (paragraphs 16-18).

(ii) Where the asset is sold during the administration of the estate to the beneficiary under the executor's (or administrator's) power to sell assets (paragraphs 19-21).

(iii) Where the asset is appropriated in or towards satisfaction of the beneficiary's entitlement to a monetary legacy or a share of the estate (paragraphs 22-27).

(iv) Where the asset is bought by the grantee of a testamentary option (that is, an option given by a deceased person by will to a grantee to purchase property forming part of the deceased estate) who exercised the option (paragraphs 28-32).

2. The Ruling also addresses whether there is a "disposal" where an estate asset, owned by the deceased when that person died, is transmitted directly to a beneficiary of the deceased estate i.e., without the executor or administrator first obtaining ownership of the asset and then transferring it to the beneficiary (paragraphs 33-34).

3. Another issue considered in the Ruling is whether a taxpayer acquires a dwelling as a beneficiary for the purposes of the CGT sole or principal residence exemption in section 160ZZQ where the asset in situation (iii) above is a dwelling (paragraphs 35-36).

BACKGROUND

4. The death of the owner of an asset generally does not constitute the disposal of that asset for the purposes of CGT (subsection 160X(2)). Subject to special provisions in the law which apply where an asset passes to a tax-advantaged beneficiary (section 160Y), the mere fact of a person's death therefore has no CGT consequences to the deceased's estate. This is the case whether the date of death occurred before, on or after 20 September 1985.

5. Where a person died before 20 September 1985, any asset that formed part of the deceased's estate and passed to the deceased's legal personal representative or to a beneficiary is deemed to have been acquired by the representative or beneficiary before 20 September 1985 (subsection 160X(4)). Consequently, the CGT provisions will not apply to any later disposal of such an asset by the legal personal representative or beneficiary. To determine whether an asset that formed part of the estate of the deceased person has passed to the representative or to a beneficiary, it is necessary to look to section 160J, which is set out below at paragraphs 9 and 10.

6. However, there may be CGT consequences for the deceased's legal personal representative or a beneficiary in the estate where the deceased died on or after 20 September 1985. In that case, where an asset that formed part of a deceased's estate passes to the legal personal representative or to a beneficiary, the asset is deemed by subsection 160X(5) to have been acquired by the representative or the beneficiary on the date of the deceased's death. A capital gain may therefore accrue, or a capital loss may be incurred, on any later disposal of the asset by the representative or beneficiary if the deceased died on or after 20 September 1985.

7. To determine whether a capital gain accrues or a capital loss is incurred in the circumstances considered in paragraph 6, an

asset acquired by the deceased after 19 September 1985 is deemed to have been acquired by the legal personal representative or beneficiary for a consideration equal to the relevant cost base of the asset in the hands of the deceased immediately before his or her death (paragraph 160X(5)(b)). However, if the asset was acquired by the deceased before 20 September 1985, it is deemed to have been acquired by the representative or beneficiary for a consideration equal to the market value at the date of the deceased's death (paragraph 160X(5)(a)).

8. Where an asset that formed part of a deceased person's estate passes to a legal personal representative, and the asset later passes to a beneficiary in the estate, its passing to the beneficiary is deemed not to be a disposal of the asset by the representative for CGT purposes (paragraph 160X(3)(a)).

9. By paragraph 160J(a), a reference to an asset of a deceased's estate passing to the deceased's legal personal representative is a reference to an asset that formed part of the estate coming into the ownership of a person as the executor of the will or as the administrator of the deceased's estate.

10. Paragraph 160J(b) explains that in the CGT provisions:

> "a reference to an asset that formed part of the estate of a deceased person passing to a beneficiary in that estate is a reference to an asset that formed part of the estate of the deceased person coming into the ownership of a person as a beneficiary -
>
> (i) under the will of the deceased person, or under that will as varied by an order of a court; or
>
> (ii) by operation of law as a result of the intestacy of the deceased person, or by operation of law as a result of that intestacy as the operation of the law is varied by an order of a court,
>
> whether the asset was transmitted directly to that person or was transferred to that person by the executor of the will, or by the administrator of the estate, of the deceased person."

11. Direct transmission may occur if a legal personal representative decides that title in an asset should be transmitted to a beneficiary even though title in that asset has not first been transferred to the representative. In some States, for example, real property may be transmitted directly to the beneficiary in these circumstances (e.g. see section 93 of the Real Property Act 1900 (NSW), section 32 of the Real Property Act 1877 (Qld). Similarly, under section 1091 of the Corporations Act 1989 shares or debentures of a deceased estate may be transferred to a beneficiary without the legal personal representative being registered as the holder. Furthermore, in practice, in the case of small estates, estate assets of small value are often

transferred directly to beneficiaries without probate or letters of administration being obtained.

12. Section 160ZZQ provides an exemption from CGT on certain disposals of dwellings. For example, where a dwelling was the sole or principal residence of a deceased person, the taxpayer acquired the dwelling as a beneficiary in the estate of the deceased person and the dwelling was disposed of within 12 months of the deceased's death (subsection 160ZZQ(14)). Subsection 160ZZQ(6) explains that in the section the expression "a taxpayer having acquired a dwelling as a beneficiary in the estate of a deceased person" is a reference to a taxpayer having acquired a dwelling in the circumstances set out above in subparagraphs 160J(b)(i)and(ii).

13. The State and Territory legislation that governs the administration of deceased estates gives the legal personal representative the power to appropriate assets from the estate in or towards the satisfaction of the interest of the beneficiary in that estate. For example, see section 46 of the Trustee Act 1925 (NSW); section 46 of the Administration and Probate Act 1958 (Vic) and section 31 of the Trustee Act 1958 (Vic). The appropriation of property under such a power is subject to any contrary intention expressed in the will and generally requires the consent of the beneficiary. It is also usual for a will expressly to give the executor the power to distribute assets of the estate "in specie".

14. In this context the expression "in specie" means "in its own form and essence, and not in its equivalent" (Roger Bird, Osborn's Concise Law Dictionary (7th Edition), Sweet & Maxwell, 1983).

15. Usually a will expressly gives the executor the power to sell assets of the estate. A power of sale may also be implied from the terms of the will.

RULING

Where an asset is specifically given to a beneficiary by the will or a court order

16. Where an asset is transferred by an executor of a will to a beneficiary and that asset was specifically bequeathed or devised to the beneficiary in the will (or transferred by an order under testator's family maintenance or family provision legislation), the asset comes into the ownership of the relevant person "as a beneficiary under the will of the deceased person" (paragraph 160J(b)). Consequently, an asset that formed part of the estate of a deceased person "passes to a beneficiary in that estate" and, by virtue of paragraph 160X(3)(a), the executor has not disposed of the asset. The position is the same whether the gift in issue is a devise or a specific, general, demonstrative or residuary legacy.

17. Because the asset has passed to the beneficiary in the deceased estate, subsection 160X(5) operates - in a situation where the deceased person died on or after 20 September 1985 - to deem the asset to have been acquired :

(a) by the beneficiary on the date of the deceased's death; and

(b) for an amount equal to:

(i) its market value as at the date of death - if the asset was acquired by the deceased before 20 September 1985 (paragraph 160X(5)(a)); or

(ii) the amount that would have been its cost base, indexed cost base or reduced cost base to the deceased - if the asset was acquired by the deceased on or after 20 September 1985 (paragraph 160X(5)(b) and subsection 160X(6)).

18. A capital gain may accrue to, or a capital loss may be incurred by, the beneficiary on any later disposal of the asset by the beneficiary.

Where an asset is sold to a beneficiary under a power of sale

19. Where a legal personal representative, under a power of sale, sells an asset to a person who happens to be a beneficiary, that asset does not, in the words of paragraph 160J(b), "com[e] into the ownership of a person as a beneficiary under the will... or by operation of law as a result of the intestacy of the deceased person". The buyer acquires the asset as a purchaser, not in the capacity of a beneficiary. It follows that paragraph 160X(3)(a) does not apply and that there is a disposal of the asset by the representative to the beneficiary.

20. Where the deceased died on or after 20 September 1985, a capital gain may accrue to, or a capital loss may be incurred by:

(a) the legal personal representative on disposing of the asset to the beneficiary; and

(b) the beneficiary on any later disposal of the asset by the beneficiary.

21. Where the deceased died before 20 September 1985, the CGT provisions do not apply to the sale by the legal personal representative to the beneficiary because the representative is deemed to have acquired the asset before that date (subsection 160X(4)). However, the CGT provisions apply to any later disposal by the beneficiary, provided that the sale contract between the representative and the beneficiary was entered into on or after 20 September 1985, because subsection 160X(4) does not apply to the sale to the beneficiary.

Where an asset is appropriated in or towards satisfaction of a beneficiary's entitlement

22. The expressions "under the will of the deceased person" and "by operation of law as a result of the intestacy" in paragraph 160J(b) should not be narrowly construed.

23. The words "under the will" in paragraph 160J(b) do not mean only "in strict conformity with the will", "expressly by force of the will" or "by virtue of the will". Rather, those words have a meaning akin to "in pursuance of the will" or "under the authority of the will": Evans v. Friemann (1981) 53 FLR 229 at 238. The broad meaning of "under the will" can be contrasted with an expression such as "under and in conformity with the trusts contained in the will" (which appears in paragraph 73(1)(f) of the Stamp Duties Act 1920 (NSW)).

24. The expression "by operation of law as a result of the intestacy of the deceased person" does not mean only "by virtue of intestacy law giving a specific entitlement". The expression includes "by the exercise of an administrator's statutory powers such as the appropriation of assets".

25. Where there is no specific bequest or devise but an executor of a will distributes an asset in specie to a beneficiary in or towards satisfaction of that beneficiary's entitlement in the will (e.g. to a share of residue) that asset comes into ownership of the person "as a beneficiary under the will". Consequently, paragraph 160X(3)(a) applies and the distribution is not a disposal by the executor for CGT purposes.

26. Similarly, where the administrator of a deceased estate distributes an asset in specie to a beneficiary in or towards satisfaction of that person's entitlement under the intestacy law, the asset comes into the ownership of the person "as a beneficiary by operation of law ... as a result of the intestacy of the deceased person". It follows that the distribution is within paragraph 160X(3)(a) and is not a disposal by the administrator for CGT purposes.

27. Subsection 160X(5) operates in each of the situations in paragraphs 25 and 26 in broadly the same manner as explained in paragraph 17. In essence, where the deceased died on or after 20 September 1985 a capital gain may accrue to, or a capital loss may be incurred by, the beneficiary on any later disposal of the asset by the beneficiary.

Where an asset is bought by a grantee of a testamentary option exercised by the grantee

28. A deceased person may by his or her will give to a person (in this Ruling referred to as "a grantee") a right to purchase property that forms part of the estate. If that option to purchase is exercised by the grantee, the grant of the option and the purchase transaction "shall be treated as a single

transaction"(subsections 160ZZC(7) and 160ZZC(8)). Accordingly, the exercise of the option is not treated as the disposal of the option for CGT purposes.

29. Whether there is a disposal of an asset, for CGT purposes, where the grantee exercises the option and the executor transfers the property to the grantee, depends on whether the property comes into the ownership of the grantee "as a beneficiary under the will of the deceased person" in terms of paragraph 160J(b). In this situation, on the exercise of the option, a contract of sale would be entered into with the grantee as the purchaser of the property.

30. This Office accepts that the asset comes into the ownership of the grantee "under the will of the deceased" within the broad meaning of that term set out in paragraph 23. However, the property comes into the ownership of the grantee as a purchaser, not as a beneficiary. Therefore, paragraph 160X(3)(a) does not apply and there is a disposal of the property by the executor to the grantee.

31. Where the deceased died on or after 20 September 1985, capital gain may accrue to, or a capital loss may be incurred by:

(a) the executor on disposing of the property to the grantee; and

(b) the grantee on any later disposal of the property by the grantee.

32. Where the deceased died before 20 September 1985, the CGT provisions do not apply to the sale by the legal personal representative to the grantee because the representative is deemed to have acquired the asset before that date (subsection 160X(4)). However, the CGT provisions apply to any later disposal by the grantee, provided that the sale contract between the representative and the grantee was entered into on or after 20 September 1985, because subsection 160X(4) does not apply to the sale to the grantee.

Direct transmission of an asset to a beneficiary

33. If, in the administration of a deceased estate, an estate asset owned by a deceased person when that person died comes into the ownership of a person as a beneficiary under the deceased's will by being transmitted directly to the beneficiary, the asset passes to the beneficiary in terms of paragraph 160J(b). The asset would not be disposed of by the legal personal representative to the beneficiary because the representative never became the owner of the asset.

34. Subsection 160X(5) operates in the situation considered in paragraph 33 in the same broad manner as explained in paragraph 17. In essence, where the deceased died on or after 20 September 1985, a capital gain may accrue to, or a capital loss may be

incurred by, the beneficiary on any later disposal of the asset by the beneficiary.

Appropriation of the deceased's principal residence in or towards satisfaction of a beneficiary's entitlement

35. Whether a beneficiary "acquire[s] a dwelling as a beneficiary in the estate of a deceased person" for the purposes of section 160ZZQ in these circumstances turns on the construction of the expressions "under the will of the deceased person" and "by operation of law as a result of the intestacy". Whether a distribution in specie of an asset satisfies these words is considered above in paragraphs 22 to 26. It follows from those paragraphs that a distribution in specie of a dwelling by a legal personal representative of a deceased person to a beneficiary results in that beneficiary acquiring the dwelling "under the will of the deceased person" or "by operation of law as a result of an intestacy".

36. Thus, where a legal personal representative appropriates a dwelling to a beneficiary in or towards satisfaction of that person's entitlement, the beneficiary has "acquired the dwelling as a beneficiary in the deceased estate" for the purposes of section 160ZZQ. Subject to the other requirements of section 160ZZQ being satisfied, the dwelling would be excluded from the operation of the CGT provisions.

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TABLE 1: WHERE A PERSON DIED ON OR AFTER 20 SEPTEMBER 1985

The following table summarises the CGT consequences where a person died on or after 20 September 1985 and an asset of the deceased's estate, owned by the deceased when that person died, is transferred to a beneficiary in that estate.

	WHERE ASSET TRANSFERRED BY LEGAL PERSONAL REPRESENTATIVE (L.P.R.) TO BENEFICIARY					
	Date acquired by L.P.R.	Deemed acquisition consideration to L.P.R.	Whether disposal by L.P.R.	Whether CGT applies to transfer by L.P.R. to beneficiary	Date acquired by beneficiary	Whether applies t subseque disposal benefici
. Asset specifically given to beneficiary by will or court order	Date of death	If asset was acquired by deceased before 20.9.85, market value. Otherwise, cost base, indexed cost base or reduced cost base (as case may require) to deceased at date of death.	NO	NO	Date of Death	YES
. Asset sold to a beneficiary under a power of sale	Date of death		YES	YES	Date of sale contract	YES
. Asset appropriated in or towards satisfaction of the beneficiary's entitlement	Date of death		NO	NO	Date of death	YES
. Asset bought by grantee of testamentary option who exercised the option	Date of death		YES	YES	Date of sale contract	YES

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TABLE 2: WHERE A PERSON DIED BEFORE 20 SEPTEMBER 1985

This table summarises the CGT consequences where a person died before 20 September 1985 and an asset of a deceased estate, owned by the deceased when that person died, is transferred to a beneficiary in that estate.

	WHERE ASSET TRANSFERRED BY LEGAL PERSONAL REPRESENTATIVE (L.P.R.) TO BENEFICIARY					
	Date acquired by L.P.R.	Deemed acquisition consideration to L.P.R.	Whether disposal by L.P.R.	Whether CGT applies to transfer by L.P.R. to beneficiary	Date acquired by beneficiary	Whether applies t subsequ disposal benefici
. Asset specifically given to beneficiary by will or court order	Before 20.9.85	-----	Not Relevant	NO	Before 20.9.85	NO
. Asset sold to a beneficiary under a power of sale	Before 20.9.85	-----	Not Relevant	NO	Date of sale contract	YES, if a after 19. Otherwi
. Asset appropriated in or towards satisfaction of the beneficiary's entitlement	Before 20.9.85	-----	Not Relevant	NO	Before 20.9.85	NO
. Asset bought by grantee of testamentary option who exercised the option	Before 20.9.85	----	Not Relevant	NO	Date of sale contract	YES, if a after 19. Otherwi