The Law Society OF NEW SOUTH WALES

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By email: Nathan.MacDonald@lawcouncil.au

Dear Dr Popple,

ATO DRAFT TAX DETERMINATION – INCOME TAX: DECEASED ESTATES – MEANING OF 'RIGHT TO OCCUPY THE DWELLING UNDER THE DECEASED'S WILL'

Thank you for the opportunity to contribute to the Law Council's submission to the consultation of the Australian Taxation Office (**ATO**) on the draft Tax Determination 2026/D1 – Income tax: deceased estates – meaning of "right to occupy the dwelling under the deceased's will" in item 2(b) of column 3 of the table in subsection 118-195(1) of the *Income Tax Assessment Act 1997* (Cth) (**ITAA**) (**TD**). The Law Society's Elder Law, Capacity and Succession and Business Law Committees contributed to this submission.

The TD is relevant to individual beneficiaries and trustees of a deceased estate who have an ownership interest in a dwelling acquired from a deceased estate. It intends to clarify when an individual has a "right to occupy a dwelling under the deceased's will", which is relevant in determining whether the beneficiary or trustee of the deceased estate is entitled to the capital gains tax (**CGT**) main residence exemption when a CGT event happens to their ownership interest in the dwelling.[1]

Under subsection 118-195(1) of the ITAA (emphasis added):

> A *capital gain or *capital loss you make from a *CGT event that happens in relation to a *dwelling or your *ownership interest in it is disregarded if:
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> (a) you are an individual and the interest *passed to you as a beneficiary in a deceased estate, or you owned it as the trustee of a deceased estate; and
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> (b) **at least one of the items in column 2 and at least one of the items in column 3 of the table are satisfied**; and
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> (c) the deceased was not an *excluded foreign resident just before the deceased's death.

[1] Australian Taxation Office, draft Tax Determination TD 2026/D1, paragraph 2: https://www.ato.gov.au/law/view/document?docid=DXT/TD2026D1/NAT/ATO/00001.

Beneficiary or trustee of deceased estate acquiring interest		
Item	**One of these items is satisfied**	**And also one of these items**
1	the deceased *acquired the *ownership interest *on or after* 20 September 1985 and the *dwelling was the deceased's main residence just before the deceased's death and was not then being used for the *purpose of producing assessable income	your *ownership interest ends within 2 years of the deceased's death, or within a longer period allowed by the Commissioner
2	the deceased *acquired the *ownership interest before 20 September 1985	the *dwelling was, from the deceased's death until your *ownership interest ends, the main residence of one or more of: (a) the spouse of the deceased immediately before the death (except a spouse who was living permanently separately and apart from the deceased); or **(b) an individual who had a right to occupy the dwelling under the deceased's will**; or (c) if the *CGT event was brought about by the individual to whom the *ownership interest *passed as a beneficiary—that individual

Deceased estate and testamentary trust (paragraphs 31-36)

Wills and testamentary trust deed

The Commissioner's view in the draft TD is that the deceased's will is "separate and distinct" from a testamentary trust, such that the rights granted under a testamentary trust deed are not rights granted under the deceased's will for the purposes of item 2(b). We note that the TD cites the High Court's explanation in *Wilson v Federal Commissioner of Land Tax*[2] that "under the will" means "under the terms of the will".

In our view, in denying that the CGT exemption under subsection 118-195(1) applies to wills that have a gift which operates as a trust, the draft TD represents a departure from the CGT concessions that have otherwise been available in respect of deceased estates. We support the alternative view under paragraphs 38 to 40 of the TD, making further observations in relation to that in this submission.

In our view, the references in paragraph 3 of the draft TD to "testamentary trust deeds" give rise to a misunderstanding in law that a testamentary trust is somehow separate from the will. Testamentary trusts can

[2] [1916] HCA 16.

only be established under the terms of a will. The terms of a testamentary trust are a gift in a will, that is, they are embedded in the will rather than separate and distinct from the will.

There are many instances where the wording of the trust within the will can only be understood because of defined terms contained in parts of the will and not within the trust itself. Further, there are instances where powers applicable to the administering of various gifts in the will apply to all of the gifts with no separate powers that are only applicable to the trust (which is one of those gifts).

The fact that various steps are taken by an executor (or administrator), and other steps may be taken by the trustee of a gift in the will, does not mean that the latter is not within the terms of the will. Wills may contain separate appointments, including separate executorships for segments of the estate. In such matters, the key consideration in law is that the terms of the will are carried out (as opposed to what executor/s takes a particular action).

Part of the misunderstanding about what are described as testamentary trusts is a lack of recognition of the wide variety of trusts to which this term of convenience can be applied. A simple and long-standing example of a testamentary trust (which also may or may not actually name the beneficiaries) is as follows:

> *I give [describe the extent of estate the subject of the gift] to such of my children as survive me and attain the age of 25 if more than one equally.*

More recent testamentary trusts are often discretionary and may be capable of lasting for the length of the relevant perpetuity period. However, in contrast to the TD, we do not consider that the length of time that a testamentary trust may subsist means that one set of CGT rules applies to such a trust that may only last for a particular period of time that may be regarded as reasonably short, and a different set of CGT rules applies to such a trust that may last for a longer period of time.

Underlying what is expressed in the draft TD seems to be the notion that a testamentary trust is in some way removed from the will, which is its only source. In our view, that cannot be correct. We also disagree with the view in the TD that "a testamentary trust arises only after the deceased estate has been administered", as the terms of the will may include a clause such as "each trust established under this Will is deemed to be established on my death". In any event, as noted above, a testamentary trust is just another gift in a will.

We consider that a clause in a will granting a right to occupy a dwelling to an individual (whether named in the testamentary trust) is a decision made "under the will". In the same way, an individual who receives the right to occupy the dwelling under a testamentary trust, which exists only because of a will, satisfies item 2(b) of column 3 of the table in subsection 118-195(1) of the ITAA. Accordingly, the beneficiary or trustee of the deceased estate (depending upon who is entitled to the dwelling on the cessation of the right to occupy) would be entitled to the CGT main residence exemption when a CGT event happens to the individual's ownership interest in the dwelling.

"Under the deceased's will"

The TD cites *Caratti v Commissioner of State Revenue*[3] (***Caratti***) to support the view that "rights granted pursuant to a pre-testamentary or post-testamentary agreement did not amount to a right granted under the terms of the deceased's will".[4] In that case, the deceased's will did not expressly name the appellant, who was a beneficiary under the testamentary trust, as having a right to use the property as a place of residence.

We note that *Caratti* is a Western Australian decision concerning exemptions under the *Land Tax Assessment Act 2002* (WA), rather than federal CGT. In our view, it is an inappropriate case to rely on in relation to CGT

[3] [2017] WASVA 128.
[4] Paragraph 14.

where the outcome is determined by reference to other legislation in different terms. The requirement under the section 22 of the WA Act for an individual who "has a right under the will to use the property as a place of residence" to be "identified in the will" is distinct from subsection 118-195(1) of ITAA's requirement for "an individual who had a right to occupy the dwelling under the deceased's will", namely, that the ITAA does not require the individual to be "identified in the will". Selection of an occupant of real estate under the terms of the will is just that – "under the terms of the will". A contrary conclusion only follows if the terms of the will, in some manner, can be said *not* to include the trust. However, necessarily, it is the words of the will that constitute the trust because it has no other source.

In our view, this means that what is set out in paragraphs 15 to 17 of the TD cannot be accepted as a correct expression of the CGT position. The footnote to paragraph 16 referring to the brief judgment in the 1915 High Court decision in *Thomson v Deputy Federal Commissioner of Land Tax for Tasmania*[5] does not assist. Not only was that decision dependent upon the construction of state land tax legislation, but the parties had also entered into a deed.

Where the will names the individual with a right to residence and also establishes a testamentary trust

If the Commissioner maintains the position that a testamentary trust is separate to the will, we suggest clarification should be given about whether the CGT main residence exemption applies in circumstances where the will itself expressly names the individuals with a right to occupy the dwelling, not subject to the discretion of the trustee. This includes where beneficiaries under the testamentary trust are entitled to the dwelling after the cessation of the limited right to occupy.

Appendix 1 – Alternative views

We make the following comments on the TD's views of the alternative views.

Paragraph 38 describes the alternative view on the basis that a testamentary trust is equivalent to a deceased estate. In our view, this expression is misdirected, because what is occurring is that the deceased estate is disposed of in various ways in accordance with the will, one gift of which is expressed in terms of a trust. It is not equivalent to a deceased estate – it is a gift of part of the deceased estate.

Paragraph 39 refers to a right to occupy which might arise under the terms of a testamentary trust as being tantamount to being granted under the deceased will. We do not agree with the view, given that it is actually given under the terms of the will itself, and not in some equivalent document.

Paragraphs 40 and 41 of the TD are set out as follows:

> 40. Moreover, the alternative view contends that an individual does not need to be specifically named in the deceased's will (or testamentary trust deed) as having a right to occupy the dwelling; it is sufficient if the executor or trustee of the deceased estate has a discretion to grant a right to occupy the dwelling to any individual. Proponents of this view argue that the words in item 2(b) do not impose a requirement for an individual to be specifically named in the deceased's will as having a right to occupy the dwelling.
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> 41. We do not agree with this alternative view.

In our view, however, the alternative is sound given that, if the right to occupy the dwelling is granted to an individual by a trustee pursuant to a broad discretion contained in the will, taking this step is simply giving effect to the terms of the will.

[5] [1915] HCA 4.

Transitional provisions

The date of effect of the TD is proposed to "apply to years of income commencing both before and after its date of issue".

In our view, as a matter of principle, the TD should provide a transitional period so that the TD only applies to wills made two years after the date of its coming into effect, particularly as it represents a significant departure from current practice.

Conclusion

In our view, it follows from the above that paragraphs 31 to 36 are incorrect. As noted above, paragraph 37 is also objectionable in proposing retrospective operation. Accordingly, we consider that, given there has been no change in the legislation or common law, the TD should be redrafted to reflect the current position in respect of CGT concessions that have been available in respect of deceased estates.

If you have any queries about the items above, or would like further information, please contact Mimi Lee, Policy Lawyer, on 02 9926 0174 or mimi.lee@lawsociety.com.au.

Yours sincerely,

Ronan MacSweeney
President