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Dear Ms Jablanovic

ATO consultation on deceased estates' draft Determination

The Tax Institute welcomes the opportunity to make a submission to the Australian Taxation Office (ATO) in relation to the consultation on draft [TD 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* (ITAA 1997) (draft Determination).

Summary of position

The Tax Institute is concerned that aspects of the draft Determination are inconsistent with existing laws and practice. In particular, the comments in paragraphs 31-33 of the draft Determination which state that a right to occupy a dwelling under a testamentary trust cannot satisfy the requirement in item 2(b) of column 3 of the table in subsection 118-195(1) of the ITAA 1997, because such a right does not arise under the deceased's will.

The Tax Institute considers that:

1. this conclusion is inconsistent with the law and cannot be maintained by the terms of the relevant statute. We recommend that the Commissioner reconsider paragraphs 31–33 and clarify that a right to occupy expressly conferred by a will, but administered through a testamentary trust established by that will, will satisfy of the relevant provisions of subsection 118-195(1) of the ITAA 1997;
2. given the widespread use of testamentary trusts in Australian estate planning, the issues raised in paragraphs 31–33 are likely to cause great disruption and uncertainty, which warrants careful reconsideration to ensure that the final Determination is correct and promotes the fair administration of the tax system;
3. if the current approach is maintained, it will create a differential treatment of testamentary trusts under section 118-195 of the ITAA 1977 compared to Division 128 of the ITAA 1997, for no clear policy reason or statutory basis;
4. given the Commissioner's view in the draft Determination that court ordered variations to a will do satisfy the provisions in question, this might result in taxpayers having greater recourse to the courts to rectify this issue, increasing costs, unnecessarily consuming the courts' time, and raising issues of unfairness for those who cannot afford such an option.

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Where an ATO legal interpretation is likely to be highly disruptive and represents a change or overturning of a longstanding practice, it should only proceed after an appropriate case has been tested in the courts.

At a minimum, if a revised interpretation is to be adopted, appropriate transitional or grandfathering arrangements should be implemented.

Our detailed response and recommendations to improve the draft Determination are contained in **Appendix A**.

The Tax Institute is the leading forum for the tax community in Australia. We are committed to shaping the future of the tax profession and the continuous improvement of the tax system for the benefit of all. In this regard, The Tax Institute seeks to influence tax and revenue policy at the highest level with a view to achieving a better Australian tax system for all.

If you would like to discuss any of the above, please contact our Tax Counsel, John Storey, on (03) 9603 2003.

Yours faithfully,

Julie Abdalla

Head of Tax & Legal

Tim Sandow

President

APPENDIX A

We have set out below our detailed comments and observations on the draft Determination for your consideration.

Preliminary comments on the draft Determination

The Tax Institute acknowledges that draft TD 2026/D1 provides useful clarification of the Commissioner's view on the meaning of the phrase '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 ITAA 1997.

In particular, the confirmation that a mere private arrangement between beneficiaries will not satisfy item 2(b) is broadly consistent with the text of section 118-195 and with the Commissioner's long-standing position that the right must arise from the testamentary instrument itself.

However, paragraphs 31–33 of the draft Determination propose an interpretation of the interaction between a deceased's will and a testamentary trust that appears to depart from established administrative practice and accepted succession law principles. We consider that this aspect of the draft Determination is inconsistent with the law.

The Tax Institute strongly encourages the ATO to consider alternative pathways to merely issuing updated public advice and guidance when changing long-standing views. We consider that the ATO should pursue test case options to obtain the court's interpretation of the interaction between a deceased's will and a testamentary trust, rather than solely relying on the Determination. Alternatively, we consider that additional public advice and guidance, such as practical compliance guidelines, would be valuable to assist taxpayers to understand the ATO's compliance approach to these issues.

Construction of the phrase 'under the deceased's will'

Statutory context

Item 2(b) of column 3 of the table in subsection 118-195(1) of the ITAA 1997 allows the main residence exemption (**MRE**) to apply where:

- a dwelling passes to a beneficiary; and
- from the deceased's death until disposal, the dwelling was the main residence of an individual who had a 'right to occupy the dwelling under the deceased's will'.

The phrase 'under the deceased's will' is not defined in Division 118 or elsewhere in the ITAA 1997. Accordingly, its meaning must be ascertained by reference to:

- the text of section 118-195;
- its context within Division 118;
- the operation of Division 128 (about assets of deceased persons); and
- ordinary principles of statutory construction.

Division 128 establishes the capital gains tax (**CGT**) framework for assets passing from a deceased to their legal personal representative (**LPR**) and ultimately to beneficiaries. The Division recognises that assets may pass:

- directly to beneficiaries; or
- via a testamentary trust established by the will.

The legislative architecture therefore contemplates that a testamentary trust is one mechanism by which a will operates to pass assets and confer rights.

Whether a testamentary trust is separate from the will

Paragraphs 31–33 of the draft Determination state that the reference to ‘will’ in item 2(b) does not extend to a testamentary trust, on the basis that:

- a deceased estate and a testamentary trust are distinct; and
- the trustee of a testamentary trust performs a different function from an executor.

While it is correct that the executor and trustee have different legal roles, this does not resolve the interpretive question.

A testamentary trust does not arise independently of the will. It is constituted by the will and derives its authority from it. The trust is the mechanism through which the testamentary intentions expressed in the will are implemented. In that sense, the rights conferred under the trust are rights conferred pursuant to, and by force of, the will.

The interpretive question is therefore not whether the estate and the trust are conceptually distinct legal relationships, but whether a right that arises through the machinery of a testamentary trust established by the will can properly be said to arise ‘under the deceased’s will’.

We consider that a purposive interpretation supports that conclusion.

Interaction with Division 128 and established practice

Administrative treatment of testamentary trusts

Law Administration Practice Statement [PS LA 2003/12](#) provides that the Commissioner will treat the trustee of a testamentary trust in the same manner as an LPR for the purposes of Division 128. This administrative approach recognises that a testamentary trust is an extension of the testamentary disposition and part of the process by which the deceased’s assets devolve.

This treatment has been fundamental to the CGT roll-over framework applying to deceased estates. It reflects a coherent reading of Division 128, which does not distinguish between assets passing directly to a beneficiary and assets passing via a testamentary trust created by the will.

If, for the purposes of section 118-195, a strict separation is drawn between the will and the testamentary trust, an inconsistency may arise within the broader legislative scheme governing deceased estates. This inconsistency would complicate the administration of deceased estates and alone may put into question the ATO’s stated approach in the draft Determination.

Rights conferred through a testamentary trust

It is common for a will to:

- establish a testamentary trust; and
- confer on a specified beneficiary a life interest or right to reside in a dwelling held on that trust.

In such circumstances, the trustee does not create the right. Rather, the trustee's obligation is to administer the trust in accordance with the will's terms. The beneficiary's right to occupy is sourced in the will, even though it is enjoyed through the structure of the trust.

The draft Determination appears to proceed on the basis that a right granted 'under a testamentary trust deed' is not granted 'under the deceased's will'. However, in the testamentary context, the 'trust deed' is typically not a separate instrument executed independently of the will; it is constituted by the will itself.

We consider that greater precision is required in the final Determination to distinguish between:

- a right created by an independent post-death arrangement; and
- a right expressly conferred by the will but administered through a testamentary trust structure.

Replacement dwellings and continuity of occupation

Many wills confer on trustees powers to:

- sell a dwelling;
- acquire a replacement dwelling; and
- allow the life tenant to occupy the replacement dwelling.

Historically, it has been accepted by the Commissioner — including through private binding rulings — that where a will grants a continuing right of occupation and the trustee exercises powers under the will to replace the dwelling, the MRE under section 118-195 can continue to apply.

The draft Determination does not expressly address this scenario. If the Commissioner's view is that the right must attach only to the original dwelling owned at the time of death, this would have significant practical implications and may not reflect the substance of the testamentary intention.

We recommend that the final Determination clarify that where:

- the will confers a right to reside; and
- the trustee exercises powers under the will to replace the dwelling;

the right to occupy the replacement dwelling may continue to be regarded as arising 'under the deceased's will' for the purposes of item 2(b).

Court orders and scope of item 2(b)

The draft Determination indicates that a right to occupy arising under a court order may satisfy item 2(b). This appears to represent an expansion of scope compared to the Commissioner's long-standing view that item 2(b) does not operate in the same manner as section 128-20 (which expressly recognises certain variations by deed of arrangement or court order).

If court-ordered rights are to be recognised for the purposes of section 118-195, the legislative basis for that position should be clearly articulated. It would also be appropriate to explain how this position is reconciled with the Commissioner's historical approach that the right must arise from the will itself.

From a system-perspective, we note that, reliance on court processes may introduce practical inequities, as not all beneficiaries will have the financial capacity or resources to seek such orders.

Impact on existing estate plans

The interpretation proposed in paragraphs 31–33 has the potential to affect a substantial number of existing testamentary trusts currently operating in reliance on established practice.

Estate planning arrangements have been structured for many years on the basis that:

- a right to reside granted through a testamentary trust established by the will can satisfy section 118-195; and
- Division 128 roll-over relief applies coherently to assets devolved through that structure.

If the Commissioner intends to adopt a revised interpretation that departs from that position, we consider that transitional arrangements or grandfathering provisions should be implemented to protect existing testamentary trusts established prior to the finalisation of the Determination.

Certainty and stability in estate taxation are critical, given that wills are executed years — and often decades — before they take effect.