

Practical Tax Issues in Succession Matters

PRESENTED BY ANMOL KAURAH

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Practical Tax Issues in Succession Matters

Planning, Administration and Disputes

Anmol Kaurah
Nexia Canberra

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Your Presenter



Anmol Kaurah

UK & Australian Tax Advisor | Estate Tax Advisor | Nexia Canberra

Practice Areas

- Australian taxation advice for individuals, private clients, trusts and businesses.
- Deceased estate tax compliance, inherited assets and CGT on death.
- Testamentary trusts, family trusts and business succession.
- Estate tax residency, foreign beneficiaries and UK/Australian matters.

Today's Session

01 Estate Planning And Will Drafting

02 Estate Administration & Disputes

03 Questions

Housekeeping

- The comments today are general in nature. Specific client matters will still need to be considered on their own facts.
- Feel free to ask questions as we go. We'll also leave around 10 minutes at the end for questions and discussion.

Estate Planning: Key Tax Considerations

Anmol Kaurah
Nexia Canberra

CGT on Death – Estate Planning Considerations

- Australia has no general inheritance tax. However, the CGT consequences of assets passing under a will can materially affect the value beneficiaries ultimately receive.
- Under Division 128, capital gains and losses are generally disregarded on death, and assets can ordinarily pass through the executor to beneficiaries without an immediate CGT liability.
- Division 128 generally defers CGT rather than eliminating it. An executor's sale of an estate asset will ordinarily bring any capital gain or loss into account, whereas a qualifying in-specie transfer to a beneficiary generally preserves the CGT rollover and inherited cost base.
- When preparing a will, consider the nature of each asset, its cost base and the intended beneficiary's tax residency. Exceptions such as CGT event K3 can trigger tax on death, while assets of similar market value may produce different after-tax outcomes.

CGT Event K3

- CGT event K3 is an exception to the ordinary treatment on death. It can trigger a capital gain or loss in the deceased's final tax return, even though the asset has not been sold.
- K3 may apply where a CGT asset passes to a tax-exempt entity, a complying superannuation trustee or a foreign-resident beneficiary, subject to certain exceptions.
- For foreign-resident beneficiaries, K3 applies where the deceased was an Australian resident immediately before death and the asset is not taxable Australian property in the beneficiary's hands.
- For example, leaving ordinary shares to a child living overseas may trigger K3. The beneficiary's tax residency and the nature of the assets being gifted should be considered when preparing the will.

Inherited Asset Cost Bases

The first element of the cost base of a CGT asset in the hands of a LPR or beneficiary is as follows:

Asset	First element of cost base
Deceased acquired the asset before 20 September 1985	Market value at death
Post-CGT dwelling that was the deceased's main residence immediately before death, was not then income-producing, and the deceased was not an excluded foreign resident	Market value at death
Deceased was a foreign resident immediately before death and the asset was not taxable Australian property	Market value at death
If none of the above apply (i.e., listed shares purchased after 20 September 1985)	Deceased's original cost base

Testamentary Trusts

- Testamentary trusts provide flexibility in how inherited assets and income are managed and distributed, particularly where beneficiaries are minors.
- Under section 102AG of the ITAA 1936, qualifying income derived from estate assets may be treated as excepted trust income. This allows distributions to minors to be taxed at ordinary individual rates rather than the higher rates generally applicable to minors.
- The concession does not apply to all income earned by a testamentary trust. Income from unrelated assets subsequently introduced into the trust will generally not qualify under subsection 102AG(2AA).
- When preparing a will, consider the intended beneficiaries, trustee powers and assets that will fund the trust. The source of trust assets should also be documented to support the intended tax treatment.

Overseas Assets, Beneficiaries and Foreign Wills

- Identify overseas property, investments and bank accounts when preparing a will. Foreign succession laws, probate requirements and inheritance or estate taxes may apply in addition to Australian obligations.
- An Australian will may cover overseas assets, but this does not necessarily remove the need for probate, administration or legal advice in the relevant foreign jurisdiction.
- Where separate wills are used for overseas assets, they should be carefully coordinated to avoid conflicting gifts, unintended revocation or complications during estate administration.
- Confirm the tax residency of executors and beneficiaries before finalising appointments and gifts. This can affect Australian CGT, the estate's tax residency and potential foreign tax liabilities.

Executor Appointments and Estate Tax Residency

- Estate residency is often overlooked during administration, but it can materially change how the estate is taxed. A deceased estate is treated as a trust estate for Australian tax purposes.
- A trust estate will be an Australian resident trust estate for income tax and capital gains tax purposes if a trustee (legal personal representative) of the trust estate was a resident at any time during the year of income or the central management and control of the trust estate was in Australia at any point during the year of income.
- Why does this matter?

Estate Tax Residency Continued

- Australian tax resident estates are taxed on their worldwide income and gains. A non-resident estate is generally taxed in Australia on Australian-sourced income and gains from taxable Australian property.
- Appointing an Australian resident executor for a foreign estate may bring foreign income or gains within the Australian tax net.
- Conversely, if a non-resident is appointed as executor of an estate of a deceased Australian resident, and central management and control of the estate is exercised overseas, Australian-sourced income and gains may also be exposed to tax in the foreign jurisdiction.
- Key takeaway - estate practitioners should be cautious where executor residency does not align with the deceased's residency, the asset base or the intended place of administration.

Superannuation Death Benefits – Estate Planning

- Superannuation does not automatically form part of the deceased's estate or pass under their will. Payment is governed by the fund's rules and any effective death benefit nomination.
- A member may nominate eligible dependants or their legal personal representative, allowing the death benefit to be paid directly to beneficiaries or through the deceased estate.
- A valid binding death benefit nomination generally directs the trustee as to who receives the benefit. Without an effective binding nomination, the trustee may retain discretion over payment.
- When preparing a will, review the fund's governing rules, nomination validity and expiry, and intended beneficiaries to ensure the superannuation arrangements align with the broader estate plan.

Taxation of Superannuation Death Benefits

- The definition of a dependant differs for superannuation and tax purposes. An adult child may be eligible to receive a death benefit without qualifying as a dependant for tax purposes.
- Tax dependants generally include a spouse or former spouse, children under 18, and individuals who were financially dependent on or in an interdependency relationship with the deceased.
- A lump sum death benefit paid to a tax dependant is generally tax-free. An independent adult child may be taxed on the taxable component, although the tax-free component remains exempt.
- Where superannuation is paid through the deceased estate, the tax treatment depends on which beneficiaries have benefited, or are expected to benefit, from the payment. Payment through the estate does not automatically eliminate the tax liability.

Small-Business CGT and Succession Planning

- Where a deceased owned business assets, company shares or trust interests, the small-business CGT concessions may reduce or eliminate CGT on a subsequent disposal by the estate or beneficiaries.
- Under section 152-80 of the ITAA 1997, the executor or beneficiary may access concessions the deceased would have qualified for had the asset been disposed of immediately before death.
- The relevant CGT event must generally occur within two years of death, although the Commissioner may allow a longer period.
- Eligibility depends on the deceased's circumstances and the particular asset, including the active asset and small-business requirements. The availability of concessions should be reviewed before any sale is agreed.

Recent Tax Reforms Relevant to Estate Planning

- From 1 July 2027, CPI-based cost-base indexation will replace the 50% CGT discount for gains accruing from that date. Gains accrued before 1 July 2027 will continue to be treated under the existing rules.
- For pre-CGT assets, gains accrued before 1 July 2027 will remain exempt. Gains accruing from that date will be subject to the new CGT rules when the asset is subsequently disposed of.
- The federal budget reforms also introduce a 30% minimum tax on relevant capital gains from 1 July 2027. August 2026 draft legislation proposes excluding certain gains distributed through deceased estates and genuine testamentary trusts from this minimum tax.
- Separately, a 30% minimum tax on discretionary trusts is proposed from 1 July 2028. Current draft legislation proposes excluding deceased estates and genuine discretionary testamentary trusts.

Tax Reforms: Practical Estate Planning Considerations

- Clients should obtain and retain market valuations as at 30 June 2027 for all CGT assets affected by the changes. This will be particularly important for property, private company shares and business interests.
- When preparing wills, consider whether executors have sufficient flexibility to obtain valuations and tax advice, meet associated costs and manage the disposal of estate assets.
- Consultation on the August and September 2026 draft legislation has now closed. Further legislation is expected to clarify the transitional CGT rules and proposed concessions for deceased estates and testamentary trusts. Estate plans should be reviewed once the final legislation is released.

Estate Administration & Disputes

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Estate Tax Compliance

- The executor or LPR is responsible for addressing the deceased's outstanding tax obligations, including any overdue returns and unpaid tax liabilities.
- A final “date of death” tax return may be required for income earned from 1 July to the date of death.
- Income and capital gains arising after death are dealt with separately. The estate may require its own TFN and annual trust tax returns.
- For the first three income years, eligible deceased estates generally access ordinary individual tax rates and the tax-free threshold on income assessed to the trustee. Less favourable rates apply thereafter.
- Before making final distributions, executors should ensure outstanding tax obligations are addressed and sufficient funds retained for any remaining liabilities. Premature distributions may expose executors to personal liability.

Taxation of Estate Income

- Income earned after death, including rent, interest, dividends and taxable capital gains, is generally reported by the estate during administration.
- During the initial stages of administration, the executor is generally assessed on estate income because beneficiaries are not yet presently entitled to it.
- As administration progresses, beneficiaries may become presently entitled to estate income and taxed on their respective shares. This can occur before the estate is fully administered where income is distributed to beneficiaries.
- Before making distributions, executors should consider when beneficiaries become presently entitled, their tax residency and whether any ongoing testamentary trust needs to be dealt with separately.

Successive Deaths During Estate Administration

- A “double death” arises where a beneficiary dies before an inherited asset has passed to them. For example, a husband leaves his solely owned home to his wife, who dies before his estate has been fully administered.
- Where the first beneficiary never became the owner of the asset, the Division 128 CGT rollover may not apply when the second estate distributes it. This can trigger an unexpected CGT liability and potentially affect the main residence exemption.
- The ATO is developing guidance on these circumstances, including when an asset is considered to have passed to a beneficiary. The Law Council has challenged aspects of the ATO's proposed approach to ownership and probate.
- Where successive deaths occur, executors should establish when the asset passed, whether the first beneficiary acquired ownership and the CGT consequences of selling or distributing it. These issues should be resolved before transferring assets between estates.

Main Residence Exemption for Deceased Estates

- Section 118-195 can provide a full CGT exemption where the deceased acquired the dwelling before 20 September 1985, or acquired it later and it was their main residence immediately before death and was not being used to produce income.
- The exemption generally requires the dwelling to be disposed of within two years of death, or to remain the main residence of a qualifying spouse, beneficiary or individual with a right to occupy under the will.
- Where the conditions for a full exemption are not met, a partial exemption may be available under section 118-200.
- Executors should confirm the deceased's acquisition and occupancy history, how the property will be used after death and the proposed disposal date before proceeding with a sale or distribution.

Two-Year Disposal Rule and Extensions

- To qualify for the two-year main residence CGT exemption, settlement of the property sale must generally occur within two years of death. Signing a sale contract before the deadline is not sufficient.
- The Commissioner may extend the two-year period where circumstances beyond the executor's control have delayed the sale, such as estate disputes, complex estate administration or unexpected settlement delays. PCG 2019/5 provides a conditional safe harbour of up to 18 additional months.
- Executors should diarise the deadline, progress the sale promptly and document any delays. Waiting for improved market conditions, undertaking unnecessary renovations or prolonged inactivity will generally weigh against an extension.

Rights to Occupy Under a Will & TD 2026/D1

- A will may grant an individual the right to occupy the family home while preserving it for other beneficiaries. How this right is structured can affect the CGT outcome.
- Under section 118-195, the full CGT exemption may extend beyond two years where the dwelling remains the main residence of an individual with a qualifying right under the will until disposal.
- Under draft TD 2026/D1, the ATO considers that a right to occupy must be expressly granted by the will to a specifically named individual. Informal permission or a right granted later through trustee discretion would generally not qualify.

Rights to Occupy Under a Will & TD 2026/D1 Continued

- The ATO also considers that rights arising through a testamentary trust do not qualify. Professional bodies have challenged this interpretation, arguing that rights conferred through a trust established by the will can still arise under the will itself. The determination remains in draft.
- When preparing wills, consider clearly identifying who has the right to occupy the property and how long that right will last. Particular care and tax advice are needed where occupation rights arise through testamentary trusts or depend on trustee discretion.

Estate Disputes: Tax Issues Before Settlement

- Family provision orders can change how estate assets are distributed without necessarily triggering CGT. Where an asset passes under a will varied by court order, the ordinary Division 128 rollover can generally continue to apply.
- Deeds of family arrangement may also preserve the rollover, provided they settle a claim to participate in the estate and any consideration is limited to giving up claims over other estate CGT assets. Private buyouts require separate consideration.
- For example, where two siblings inherit a Canberra property equally and one pays the other to acquire the entire property, ACT conveyance duty may apply to the additional 50% interest. The CGT consequences depend on how the transaction is structured.
- Estate disputes do not suspend ATO obligations. Outstanding returns, audits and tax debts must still be addressed, and failure to lodge can result in default assessments. Executors should establish the tax liabilities and retain sufficient funds before making distributions.

Questions?