Inheritance Tax in Australia

Most developed countries across the world levy some form of inheritance or estate tax against the value of a deceased estate. While the colloquial term "death duties" is used interchangeably in some countries, there are distinct differences between the two taxes. Specifically, a beneficiary of a deceased estate pays "inheritance tax", whereas "estate tax" is levied against the estate during probate and before bequests are distributed. Australia does not currently have either tax, but a beneficiary still needs to be aware of the financial complications that arise from inheriting assets. This article explains the history of inheritance tax in Australia and the taxes that do apply to inherited assets.

International Inheritance Tax

Inheritance tax varies significantly according to the succession law of the specific country. Japan has the highest inheritance tax at 55%, followed by South Korea at 50%, France at 45%, with the UK and the US at 40%. To ensure that there is some parity in the tax assessment, most countries have a sliding scale of tax depending on the value of the deceased estate. For instance, a US estate is only taxed at 40% if the total value of the assets is over $11 million. In the UK, on the other hand, the 40% inheritance tax applies to any estate worth more than £325,000.

Inheritance tax in Australia

Until 1979, Australia had both state and federal inheritance taxes. These tax rates were progressive and calculated on the total value of the deceased estate. While a high "exemption threshold" limited the impact on smaller estates, the taxes were particularly unpopular with rural farmers and small business owners who felt that the tax hindered business succession. Queensland abolished inheritance taxes in the 1970s in an attempt to attract new residents. Soon after, the federal government followed suit and eliminated inheritance tax nationally. All assets of a deceased estate, including property, shares and cash, became exempt from direct tax.

Tax Implications of Inheritance

Each beneficiary under a will has a responsibility to ensure that they pay the required tax on the inheritance. It must be stressed that if the beneficiary's financial position changes after an inheritance then they may be subject to standard taxes on earned interest and capital gains. For instance, if a beneficiary is gifted a share portfolio they must pay all applicable taxes on generated earnings. Similarly, there are tax implications for additional income and capital gains attendant on the sale of any assets.

Capital Gains

A beneficiary must pay income tax on earned income from an asset, and when they sell an inherited asset, they may have to pay capital gains tax on the proceeds. For instance, if a beneficiary inherits a house, and rents it out for a period of time, then that revenue stream must be included on a tax return as income. When the beneficiary eventually sells the asset, they will have to pay capital gains tax.

Superannuation Assets

When someone who has invested in a superannuation fund passes away and they have made out aBinding Death Benefit Nomination, the proceeds of the fund go directly to the nominee. A beneficiary who inherits a testator's superannuation may have to pay taxes on those funds.

A surviving spouse does not pay tax on their deceased partner's superannuation, but the same exemption does not apply to nondependents. At least some part of a super death benefit is likely to be taxed depending on:

- Whether the beneficiary is a dependent according to taxation law;
- Whether the benefit is paid in a lump sum or in an income stream;
- Whether the super is taxable or tax-free, and whether the super fund has paid tax on the taxable component; and
- The age of the beneficiary and the deceased when they passed away for the purposes of ncome streams.

The future

There is no doubt that the absence of inheritance taxes in Australia has concentrated wealth in a relatively small number of families. There have been some calls for reintroducing some form of inheritance tax, but it is unlikely to be a politically popular move.

The rules and obligations that apply to bequests differ if the recipient is not an Australian resident or is legally defined as disabled. A beneficiary should also be aware that other taxes may apply if the testator was an overseas resident with property in another country.

It is important that a testator and his or her beneficiaries understand not onlyproperty inheritance law but also the tax implications on any bequests contained in a will. Careful estate planning can minimise, if not eliminate, the chance of a beneficiary having to pay tax on their inheritance. Consulting a wills and estates solicitor from Armstrong Legal will ensure that you have the best advice available for your case. Please contact or call us on 1300 038 223 to chat with one of our experienced solicitors.

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