THE TAX INSTITUTE

NSW 11th Annual Tax Forum

Practical Issues with Trusts: Session A

24-25 May 2018
Sofitel Wentworth Sydney

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1 Introduction

This paper deals with trusts and their beneficiaries that are taxed principally under Division 6 of the *Income Tax Assessment Act 1936* ('ITAA1936'), which applies primarily to private trusts and beneficiaries of private trusts.

Many of the changes that have occurred in the private trust landscape in the last 12 months have occurred as a result of the publication of ATO views on various topics and case law. While there have not been large changes, like those seen when the 2011 amendments occurred to tax law to allow streaming of capital gains and franked distributions, the small changes, in combination with the complex rules applying to trusts generally, make it hard to advise on private trust transactions without there being both a refresher and an update.

What follows is an update on recent changes, and a refresher on some relevant issues:

- A Division 6 rewrite
- Division 7A and UPEs
- Section 100A – reimbursement agreements
- The consequences of vesting
- Trustee resolutions
- Bamford amendments
- Trust resettlements
- 99B and foreign capital gains
- Time limits for trustee assessments

2 Division 6 rewrite

On 29 June 2011 Royal Assent was given to the *Tax Laws Amendment (2011 Measures No 5) Act 2011*. The Act gave effect to 'interim' changes to the taxation of trust income to introduce the streaming measures, allowing for streaming of capital gains and franked distributions, and to two new anti-avoidance rules, a 'pay or notify' rule and a 'benchmark' rule.

The streaming provisions were introduced in some haste towards the end of the 2011 financial year after only a brief period of consultation. The potential for there to be unintended consequences of the provisions was recognised by the then Assistant Treasurer, Bill Shorten, in his second reading speech:

> The government is aware that due to the short timeframe involved in developing these amendments, there may be scope for unintended consequences. The operation of these amendments will therefore be closely monitored and if unintended consequences are identified, the government will act to remedy these consequences retrospectively where appropriate.

Treasury in the last few years were given a remit to rewrite the tax law provision dealing with the taxation of trusts, and consultation has occurred over how the new laws might apply[1], but so far, no changes have been made.

The 2018-19 Federal Budget did not reveal any funds set aside for a trust tax law rewrite.

Labor policy was released on 30 July 2017[2] to the effect that, if elected, the Labor party will reform the taxation of trusts so that beneficiaries that are over the age of 18 will be taxed at a minimum rate of 30%. The policy announcement also included the following points:

> Labor's changes are about making sure trusts serve their true purpose – not as a tax minimisation tool.
>
> This policy is well targeted to address tax minimisation and artificial income splitting. These reforms will not affect 98 per cent of taxpayers in Australia.
>
> Under Labor, individuals and businesses can continue to make use of trusts – and trusts will not be taxed liked companies.
>
> Labor's policy only applies to discretionary trusts. Non-discretionary trusts – such as special disability trusts, deceased states and fixed trusts – will not be affected by this change.
>
> Labor's policy will also not apply to farm trusts and charitable trusts.

What has not appeared as part of Labor's plan is a wholesale rewrite of Division 6 and associated provisions, but this may be possible if Treasury are tasked with implementing the 30% tax rate proposed. With a Federal election potentially occurring between August 2018 and May 2019 we will cannot have immediate certainty as to what tax policy will apply to trusts and their beneficiaries.

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[1] https://treasury.gov.au/consultation/modernising-the-taxation-of-trust-income-options-for-reform/

[2] http://www.billshorten.com.au/media_release_a_fairer_tax_system_for_all_australians_sunday_30_july_2017 and https://d3n8a8pro7vhmx.cloudfront.net/australianlaborparty/pages/7652/attachments/original/1501324995/170729_Shorten_Trusts_Fact_Sheet_FINAL.PDF?1501324995

Until there is a re-write some of the possible unintended consequences or anomalies introduced by the streaming measures will continue:

- Capital gains on non-TAP assets being taxable to foreign beneficiaries of a resident trust;
- Distributions from trusts with capital gains and revenue losses;
- Franking credits being lost on some distributions in disputes over what amounts to distributable income; and
- The impact of capital appointments on later capital gains.

2.1 Capital gains on non-TAP assets

Prior to the implementation of the streaming measures, when a beneficiary was assessed on their share of a trust's capital gain under section 97(1) of ITAA1936 the operation of the law was relatively straight forward.

A resident would include in their assessable income their share of the trust's net income for the period in which they were a resident, and a non-resident would only include their share of Australian sourced income.

A capital gain made by a trustee on a foreign asset should not be considered to be Australian sourced income[3]. A non-resident would ordinarily not pay tax on a capital gain made on a foreign asset by the trustee of an Australian resident trust, and the trustee would not be required to pay tax on their behalf.

Once the streaming measures became law however in the 2011 year, capital gains are no longer assessable under section 97(1) but are instead included in a person's assessable income through subdivision 115-C of the *Income Tax Assessment Act 1997* ('ITAA1997') and the CGT provisions. This means that when a trustee of an Australian resident trust makes a gain on a CGT asset and appoints the gain to a foreign resident they have a capital gain to be reported in Australia regardless of where the asset was located or whether the gain was Australian or foreign sourced.

From 12 December 2006, where a CGT event occurs to a CGT asset a non-resident has been able to disregard the capital gain that would otherwise be reportable where the CGT event did not occur to taxable Australian property. The relevant section, section 855-10 of ITAA1997, provides:

> Disregard a *capital gain or *capital loss from a *CGT event if:
>
> (a) you are a foreign resident, or the trustee of a *foreign trust for CGT purposes, just before the CGT event happens; and
>
> (b) the CGT event happens in relation to a *CGT asset that is not *taxable Australian property.

The section allows a foreign resident to disregard a gain on Australian property to the extent that that property is not taxable Australian property ('TAP'), for instance where the asset disposed of is a share

[3] The ATO appear to accept this in their analysis in ATO ID 2010/54 which is stated to be the ATO view prior to the implementation of the streaming measures.

in a company or a unit in a trust that is not an indirect Australian real property interest (broadly where the market value of any Australian real property held is 50% or less of the asset holdings or where the interests or where the interests of the non-resident and their associates in the 2 years prior to the CGT event are less than 10%).

While there is a specific exemption for a beneficiary of a fixed trust from recognising gains on property that are not taxable Australian property (in section 855-40) the streaming changes have resulted in a foreign resident being subject to a much broader exemption.

This section arguably still allows a foreign resident to disregard capital gains made on foreign assets, as they are unlikely to be taxable Australian property (unless they are indirect Australian real property interests). This view would rely on the capital gain or loss that the beneficiary is ultimately assessed on being 'from a CGT event' that happened 'in relation to a CGT asset that is not taxable Australian property' as required by the section.

The ATO view is that the law should not be interpreted as providing for such an exception, and their view is contained in ATO ID 2007/60, which was published after section 855-10 was introduced. At that time however, an amount was only covered by CGT rules in Division 115 where an amount was included in assessable income for a foreign resident where there was an Australian source.

The Explanatory Memorandum to the *Tax Laws Amendment (2011 Measures No 5) Act 2011*[4] does not indicate any manifest intention that Government intended to change the treatment of capital gains for foreign residents so that a view that favours continuation of the rules prior to that time, such as that set out above in relation to section 855-40 may be preferred.

An issue with such an interpretation however is that it would exempt from taxation Australian sourced capital gains on non-TAP assets distributed to non-residents, that were taxable to foreign residents prior to the streaming measures being introduced.

It is hoped that the position in relation to non-Australian sourced gains be clarified through retrospective legislation or through use of the ATO's remedial power.

2.2 Capital gains and revenue losses

Prior to the implementation of the streaming measures, where a trust had a capital gain, but an overall revenue loss, the way that a beneficiary's share of the net income of the trust was handled in such a way that the beneficiary effectively included in their assessable income the capital gain, and their share of the revenue loss.

This meant that if the beneficiary concerned had capital losses in their own right, that these capital losses could be used to offset capital gains, so that they were 'distributed' the benefit of the revenue losses.

For example, in a trust with a capital gain of $100 (non-discountable) and a $30 revenue loss, a beneficiary would have included $100 in their capital gains method statement and had a deduction of

[4] http://parlinfo.aph.gov.au/parlInfo/search/display/display.w3p;query=Id%3A%22legislation%2Fbillhome%2Fr4593%22

$50. If the beneficiary that was distributed this amount had a capital loss of $100 available to them, then they would ultimately have no capital gain to include in their assessable income, but an income tax deduction of $30 to offset against their assessable income.

As a result of the streaming measures however where you receive a distribution of a capital gain, or a franked distribution (excluding the franking credits) and the amount of the capital gain or franked distribution is less than your proportionate share of the net income of the trust, the amount of your capital gains or franked distributions is reduced to that proportionate share of the net income.

The main way that this change in the law can lead to practical difficulties is where distributions are made to entities with capital losses, or where discounted gains are given to corporate entities, as applying the law in the former way will lead to an incorrect outcome that could result in tax, penalties and interest being payable.

2.3 Franking credits

It is possible that even after reading a trust deed and determining that you consider that there is 'income of the trust estate' according to the trust deed, that franked distributions may not flow through a trust where a specific entitlement is not created.

A beneficiary is assessed on a franked distribution under section 207-35 of ITAA1997, to the extent that they have an attributable franked distribution under section 207-37 (subsection 207-35(4)).

The attributable franked distribution then depends upon whether someone is specifically entitled, or whether they have simply received a share of the income of a trust estate, as this determines their share of a franked distribution under section 207-55.

Where a trustee receives a franked distribution and passes it on to a beneficiary, the share of the franked distribution will be determined under item 3 of the table in section 207-55.

This share of the franked distribution determines the share of a franking credit for a beneficiary under section 207-57.

This item treats your share as the amount of the franked distribution you are specifically entitled to, or if there is an amount that no beneficiary is specifically entitled to, the beneficiary's 'adjusted Division 6 percentage of the income of the trust' for the relevant income year.

To work out your adjusted Division 6 percentage you need to refer to section 95 of ITAA1936 that defines that term to mean:

> **adjusted Division 6 percentage**, of an entity that is a beneficiary or trustee of a trust estate, means the entity's Division 6 percentage of the income of the trust estate calculated on the assumption that the amount of a capital gain or franked distribution to which any beneficiary or the trustee of the trust estate is specifically entitled were disregarded in working out the income of the trust estate.

Thus your adjusted Division 6 percentage requires that you determine what the 'income of the trust estate' actually is. The ATO view on what the expression 'income of the trust estate' means is still contained in the draft ruling TR 2012/D1.

That ruling states in part:

> 13. Notwithstanding how a particular trust deed may define income, the 'income of the trust estate' for Division 6 purposes must therefore be represented by a net accretion to the trust estate for the relevant period. In effect, the statutory context places a cap on what the income of the trust estate may be for Division 6 purposes. Specifically, for these purposes, the income of a trust estate for an income year cannot be more than the sum of:
>
> - the accretions to the trust estate (whether accretions of property, including cash, or value) for that year;
> - less any accretions to the trust estate for that year which have not been allocated, pursuant to the general law of trusts (as that may be affected by the particular trust instrument), to income [and therefore cannot be distributed as income]; and
> - less any depletions to the trust estate (whether depletions of property, including cash, or value) for that year which, pursuant to the general law of trusts (as that may be affected by the particular trust instrument), have been allocated as being chargeable against income.

Also:

> 16. Where, for trust purposes, a trust's distributable income is equated with its net income, notional income amounts may form part of the distributable income of a trust estate only to the extent that they are matched by notional expense amounts, for example, deductions for depreciation which may exceed any depletion of the trust estate…

In a situation where there the income of a trust estate does not represent a 'net accretion to the trust estate' for the relevant financial year it is possible the ATO will take the view that:

1. There is no income of the trust estate, so that,
2. The adjusted Division 6 percentage is nil, with the effect that,
3. The beneficiary has no share of the franked distribution, so that further,
4. There is no attributable franked distribution for the beneficiary, and
5. As a result, there is no share of the franking credit that the beneficiary is entitled to.

Consider the position where a trust has received a distribution of $70 with a $30 franking credit attached and has also received rental income of $50 whilst having depreciation claims of $120, in a situation where the trust adopts tax law as its definition of income.

The tax law income would be $30.

The ATO would consider that the franking credit could only be included in income of the trust estate to the extent that it is matched by depreciation that is matched by depreciation claims that exceed the real reduction in the value of the trust property for the income year.

Such a situation means deep consideration needs to be given to what might occur whenever the amount of the tax law income is equal to, or less than, the amount of the franking credits within the trust.

2.4 The impact of capital appointments on later capital gains

A beneficiary who is specifically entitled to a capital gain must include, effectively, their share of a capital gain as being their capital gain for the purposes of the method statement in section 102 of ITAA1997. This is done by the provision of subdivision 115-C.

Whether a beneficiary is specifically entitled to an amount of a capital gain is determined by section 115-228, that sets out that the amount they are specifically entitled to is calculated as:

$$^{*}\text{Capital gain} \times \frac{\text{Share of net financial benefit}}{\text{Net financial benefit}}$$

The terms 'share of net financial benefit' and 'net financial benefit' are defined as:

> **net financial benefit** means an amount equal to the *financial benefit that is referable to the capital gain (after any application by the trustee of losses, to the extent that the application is consistent with the application of capital losses against the capital gain in accordance with the method statement in subsection 102-5(1)).
>
> **share of net financial benefit** means an amount equal to the *financial benefit that, in accordance with the terms of the trust:
>
> (a) the beneficiary has received, or can be reasonably expected to receive; and
>
> (b) is referable to the *capital gain (after application by the trustee of any losses, to the extent that the application is consistent with the application of capital losses against the capital gain in accordance with the method statement in subsection 102-5(1)); and
>
> (c) is recorded, in its character as referable to the capital gain, in the accounts or records of the trust no later than 2 months after the end of the income year.
>
> Note: A trustee of a trust estate that makes a choice under section 115-230 is taken to be specifically entitled to a capital gain.
>
> (2) To avoid doubt, for the purposes of subsection (1), something is done in accordance with the terms of the trust if it is done in accordance with:
>
> (a) the exercise of a power conferred by the terms of the trust; or
>
> (b) the terms of the trust deed (if any), and the terms applicable to the trust because of the operation of legislation, the common law or the rules of equity.
>
> (3) For the purposes of this section, in calculating the amount of the *capital gain, disregard sections 112-20 and 116-30 (Market value substitution rule) to the extent that those sections have the effect of increasing the amount of the capital gain.

While it does not often occur, sometimes a trustee will make a distribution of an amount referrable to a capital gain on an asset prior to the asset being disposed of, in the writer's experience, this is often considered as part of dealing with trust assets on relationship breakdown.

Where a distribution is made, that is referable to a gain on an asset, this may have the consequence of creating a specific entitlement to some part of a gain that emerges when the asset is later sold. This can lead to anomalies such as:

- A person that considered they received a capital payment from a discretionary trust that was effectively tax-free (as CGT event E4 does not apply[5]) could later be subject to taxation;
- A person has been excluded as a beneficiary before the capital gain arise; and
- Where that person passes away or ceases to exist it is not clear what the taxation impact would be.

The position that a capital gain can 'follow' an earlier appointment of capital was outlined in example 2.3 to the Explanatory Memorandum concerning the streaming provisions.

[5] TD 2003/28.

3 Division 7A and UPEs

It had been hoped that the Federal Government might make changes to Division 7A from 1 July 2018 in line with the recommendations by the Board of Taxation, but the recent Budget made it clear that such changes are being deferred by 12 months to 1 July 2019, which will be after the next Federal election.

The Budget did however highlight a change to Division 7A from 1 July 2019 in relation to UPEs, to make a UPE owed to a corporate beneficiary and immediate Division 7A loan from the corporate beneficiary to the trust (trustee).

The proposed change highlights the benefits currently available to trusts using corporate beneficiaries over the position of a company paying tax on the same profits in its own right, in terms of Division 7A.

Where a private company makes a profit and lends an amount to a shareholder or associate of a shareholder the borrower and the company have until the earlier of the lodgement time and the due date for lodgement for the return for the year I which the loan is made to either repay the amount or bring it under a complying loan agreement to prevent there from being a deemed unfranked dividend. If a complying loan agreement is put in place the first loan repayment is then due on the 30 June following the loan agreement being put in place.

For example, a loan made in 2017 to a shareholder or associate would need to be repaid or brought under a complying loan agreement by the lodgement time for the company's 2017 tax return. The first loan repayment would then be due by 30 June 2018.

Where a trust makes a profit in the same circumstances, distributes the profits to a corporate beneficiary, leaving the amount unpaid, to prevent there from being a deemed dividend, the timeline becomes:

- The UPE becomes a loan at the earlier of the time that the trust tax return is due or lodged for the year in which the UPE was created;
- The loan must be repaid or brought under a complying loan agreement by the earlier of the time that the company tax return is due or lodged for the year in which the loan was made.

The first loan repayment would be due on the 30 June following the loan agreement being put in place.

For example, a trust that distributes to a corporate beneficiary in 2017 would need to repay the amount or bring it under a complying loan agreement by the lodgement time for the company's 2018 tax return. The first loan repayment would be due on 30 June 2019.

The difference between the two is that the Division 7A loan does not begin to be serviced in the trust/corporate beneficiary scenario until a year later.

This is presumably the tax advantage that will be taken away by the Budget change, but that will only apply from 1 July 2019, meaning that using corporate beneficiaries in the short term will still provide a timing advantage.

As well as there being a timing advantage in using a corporate beneficiary, it is still the case that putting a UPE on sub-trust provides more flexibility, and potentially an even greater timing advantage in terms of tax.

In PSLA 2010/4, the ATO outline that rather than treating an amount as being subject to Division 7A as a loan, it is possible to treat the amount as either, effectively, a 7-year or 10-year interest only loan:

> The trustee may, in its capacity as the trustee of the main trust and the sub-trust, decide to put the funds representing the UPE on a [7-year or 10-year] interest only loan between the sub-trust and the main trust.

In their guidance on the requirements for 'investment agreements' the ATO state that the agreement should set out[6]:

> PS LA 2010/4 requires an investment agreement to be legally binding. However, it also states that the document evidencing that legally binding agreement may be prepared as part of the tax return working papers.
>
> The agreement need not be professionally prepared and is not the same as a Division 7A complying loan agreement. You may, however, choose to engage a professional to prepare the agreement where you believe it is appropriate to do so.
>
> We will consider a document containing the following to be sufficient evidence of a legally binding loan agreement between the main trust and the sub-trust:
>
> a. the names of the parties
>
> b. the loan terms, including
>
> i. the amount of the loan
>
> ii. the date the loan amount is drawn
>
> iii. the requirement to repay the principal amount of the loan
>
> iv. the period of the loan
>
> v. the interest rate payable on the loan
>
> vi. interest payment to be made annually on the last day of the income year
>
> c. that the parties named have agreed to the terms
>
> d. when the agreement was made, for example, the date it was signed or executed.

Care should be taken in drafting such an agreement, in particular, where it is a facility agreement, it is only likely wanted to apply where the amount from the time that the trust return is lodged or due for the year in which the UPE is created, so that interest only needs to be charged from this time.

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[6] https://www.ato.gov.au/business/private-company-benefits---division-7a-dividends/in-detail/fact-sheets/division-7a---unpaid-present-entitlement/?page=8 retrieved 20 May 2015

Although the ATO appear to content to refer to the agreement as a 'loan agreement' it may be preferable to style the agreement as something else, such as a 'retention agreement' or 'sub-trust agreement' to avoid the suggestion later that the amount is in fact a loan.

The ATO include in their guidance on what the form of the agreement might be, where in their execution section they say the document should be executed where the corporate beneficiary is referred to as 'Privco':

> Signed by the trustee of the PrivCo Sub-trust and DiscFamily Trust

It appears to be their view, and it is the writer's view, that the agreement should be executed by the trustee of the trust owing the UPE amount, and the trustee of the trust owing the UPE as trustee of the sub-trust for the corporate beneficiary – that is, the document is executed only by the trustee of the main trust, but in two capacities.

The benefits of using a sub-trust are that there is no need to pay down the loan until the end of the term, but there is flexibility to pay it down earlier. This should be contrasted with the position for an ordinary Division 7A loan where the penalty for not making the minimum annual repayment is a potential deemed unfranked dividend. It is still possible to pay down a Division 7A loan early. As it is often the case though that Division 7A loans are serviced by setting off franked distributions the sub-trust arrangement allows any top-up tax payable on such a distribution to be deferred.

There are three disadvantages in using a sub-trust arrangement however:

- Interest begins to be calculated from the time that the sub-trust agreement is in place, whilst under Division 7A an amount might be paid back interest free if repayment is made before the lodgement time for the year in which the loan was made.
- Clients might not understand the arrangement or might not prepare themselves to repay the interest only loan at the end of the term.
- The Commissioner's view is that a sub-trust arrangement still sees a loan from the trust (trustee) to a shareholder or associate of a shareholder being potentially subject to the deemed dividend rules in subdivision EA of Division 7A.

4 Section 100A and reimbursement agreements

In July 2014 the ATO released a factsheet regarding the application of section 100A of ITAA1936 concerning 'reimbursement agreements'[7].

In the writer's experience the ATO focus on the application of section 100A has increased following the release of that factsheet. Anecdotally, up to that time, section 100A was commonly looked to be applied where distributions were made to foreign beneficiaries that remain unpaid. Now the provision is being considered in relation to domestic arrangements, and in circumstances where arrangements are of the 'common or garden variety' sort.

There are a number of problems with section 100A that need to be confronted by practitioners:

1. The provision has an open-ended period for amendment of assessment where it applies. This means that the ATO could review now an otherwise out of time period and raise an assessment.
2. A reimbursement agreement will only exist where it was entered into for a purpose, or for purposes that include, '… securing that a person who, if the agreement had not been entered into, would have been liable to pay income tax in respect of a year of income would not be liable to pay income tax in respect of that year of income or would be liable to pay less income tax in respect of that year of income than that person would have been liable to pay if the agreement had not been entered into'[8]. It is not clear whether this is a subjective or objective test.
3. A reimbursement agreement will not be taken to exist where the '…agreement, arrangement or understanding entered into in the course of ordinary family or commercial dealing.[9]' It is not clear however what an ordinary family or commercial dealing is.

The potential, as set out below, for the section to apply to a situation where a discretionary trust trustee distributes to adult children (distributions to minors usually do not trigger the operation of the provision[10]) and then 'mum and dad' get the benefit of the distribution, means that practitioner need to be very careful when advising their clients on making distributions at year-end.

The inclusion in the recent Federal budget of a measure to ensure that a family trust that distributes to another family trust where the income 'comes back' gets taxed at the top marginal rate plus medicare levy also seems unnecessary given the potential operation of section 100A.

[7] https://www.ato.gov.au/General/Trusts/In-detail/Technical-issues/Trust-taxation---reimbursement-agreement/
[8] Section 100A(8).
[9] Section 100A(13).
[10] Section 100A(1)(a).

4.1 Summary of ATO factsheet

The ATO considers that a reimbursement agreement generally involves making someone presently entitled to distributable income of a trust in circumstances where both:

- someone else actually benefits from that income, and
- a purpose of a party to the agreement is obtaining a tax benefit.

However, the ATO in their factsheet note that arrangements involving 'ordinary family or commercial dealings' are excluded from the definition of a reimbursement agreement.

The ATO quite correctly point out that there is no definition of an ordinary family or commercial dealing. The ATO do however set out that they will not consider an agreement to be part of an ordinary family dealing merely because all parties are part of the same family group.

Where section 100A applies the beneficiary that would otherwise be taken to be presently entitled to income is taken not to be so entitled, with the consequence that no-one is taken to be presently entitled to that share of trust income, so that instead the net income referrable to the income is assessable to the trustee at section 99A rates.

The provision does not apply where it is a person under a legal disability (such as a minor) that is presently entitled.

The ATO has an unlimited period of review to apply section 100A.

In the 'Questions and answers' part of the guide the ATO set out their view on the interaction between Division 7A and section 100A, noting that both could apply to an arrangement where there is a loan, payment or forgiveness results in a deemed dividend. They state that where a loan from a trust is put on Division 7A terms, without more, they would consider the loan an ordinary commercial dealing. They also state that the Commissioner will not devote 'compliance resources' to the application of section 100A where amounts are retained a trust for working capital pre-16 December 2009 and will 'not generally seek to devote compliance resources' to considering whether post-16 December 2009 UPEs result in the application of section 100A.

The ATO set out four examples in their facts sheets of where section 100A might, or might not be applied (examples 2 – 4 with example 1 being an example of the operation of the section).

In example 2 the ATO posit an arrangement where a corporate beneficiary is made entitled to income, and the resulting UPE is put under a complying Division 7A loan agreement, or complying sub-trust arrangement. The funds are retained in the trust to allow the trustee to use the funds as working capital for a business. The ATO state they would not consider this arrangement (in the absence of other factors) to be a reimbursement agreement.

Example 3 concerns a testamentary trust where income is to be accumulated for the benefit of, but not paid to, one beneficiary. The ATO accept that such an arrangement, without more, even if the beneficiary is an adult, would not result in a reimbursement agreement.

Example 4 involves a discretionary trust controlled by one beneficiary distributing money to other resident beneficiaries, but only paying enough money to them to fund the tax and retaining the balance in the trust. After several years the trustee makes a loan on commercial terms to the

controller of the trust, where principal and interest is payable. The ATO again say that, without more, there would be no reimbursement agreement.

Example 5 is of the 'perpetual motion machine' where a trustee distributes to a corporate beneficiary in which it owns all of the shares. The UPE from year one is discharged by way of set-off against a dividend which gets declared by the company to the trustee in year 2 before the UPE can become a loan. That dividend is then distributed back to the company and the process is repeated.

4.2 Comments on operation of 100A give the factsheet

In a 'Lets Talk Tax' Live Chat, a transcript of which is available on the ATO website[11] Assistant Deputy Commissioner Bruce Collins and Deputy Commissioner Tim Dyce were recorded as saying:

> We recently issued the Fact Sheet on section 100A, which we developed in a co-design process with the tax profession. We are getting some requests for further guidance, but our ability to provide such guidance is limited, given the fact-specific nature of section 100A. We are looking particularly at questions around the exclusion for 'ordinary family or commercial dealings', so there may be scope for litigation on these type of issues at some point.

It is the 'ordinary family or commercial dealings' exception that is of most interest in understanding the ATO position on section 100A. Technically, the expression is of interest because a reimbursement agreement is defined in subsection 100A(7) as being an 'agreement, whether entered into before or after the commencement of this section, that provides for the payment of money or the transfer of property to, or the provision of services or other benefits for, a person or persons other than the beneficiary or the beneficiary and another person or other persons.' The term 'agreement' is then defined in subsection 100A(13) as (emphasis added):

> ***agreement*** means any agreement, arrangement or understanding, whether formal or informal, whether express or implied and whether or not enforceable, or intended to be enforceable, by legal proceedings, **but does not include an agreement, arrangement or understanding entered into in the course of ordinary family or commercial dealing**.

The decided cases where section 100A has been applied do not provide much assistance in determining when an ordinary family or commercial dealing will be taken to have occurred.

- In *Raftland Pty Ltd as Trustee of the Raftland Trust v C of T*[12] a loss trust was introduced into a structure and some $2.85 million was distributed to the loss trust, with only some $250,000 being paid as a fee for the acquisition of the loss trust. The dealing was found at first instance not to be a commercial dealing, but the artificiality of the case (with Kirby J considering the arrangements a sham) means not much assistance can be gained in determining what is a commercial dealing.

[11] https://s3-ap-southeast-2.amazonaws.com/ehq-production-australia/59cb9da507a4f584e6a8f65ec352b71d91bb089c/documents/attachments/000/017/979/original/Transcript.pdf?1416440925

[12] [2008] HCA 21

- From *Idlecroft Pty Limited v Commissioner of Taxation*[13] we learn that for section 100A to apply it is not necessary for the beneficiary to be a party to the reimbursement agreement[14]. In this case, in general terms, Idlecroft Pty Limited was the trustee of a trust that arranged to minimise the tax payable on the income it earned by distributing to a loss company, Westside Commerce Centre Pty Ltd (WCC) as a result of a joint venture agreement that it had entered into with WCC. Only 12% of what was distributed to WCC was paid to it. It was conceded between the parties that the joint venture agreement constituted a 'reimbursement agreement' for the purposes of section 100A. Again because of the contrived nature of the facts, little can be gained from the decision as to what might be an ordinary commercial dealing.
- In *Commissioner of Taxation v Prestige Motors Pty Limited*[15], in broad outline, there was a sale of a business from Prestige Motors to the trustee of a unit trust that was owned in large part by a loss company. Prestige Motors then became the trustee of that trust and it gained control over the foreign entity that had funded the losses. The profits that were previously earned by Prestige Motors would now flow to the loss company unit holder, and the foreign entity as interest on loans. Although the step of paying interest from the unit trust to the foreign entity in this case might have been considered to be an ordinary commercial dealing, 'The question posed by s 100A, especially subs (13), is whether the agreement was entered into in the course of ordinary commercial dealing, not whether a particular element in a transaction implemented pursuant to that agreement could be so characterised.'
- In *Case X40*[16] the tax-free amount of $585 (for a non-resident beneficiary) was distributed to 126 non-resident beneficiaries, where the Tribunal member considered the clear understanding was that the amounts would be loaned back to the trustee. Again, nothing of use can be gained from this case in attempting to define an ordinary commercial dealing.

In none of the above cases were the transactions considered to be ordinary family dealings. While the possibility of litigation means that there may be some interpretation of the expression, it is hoped that the ATO might be inclined to consider publishing something on a more 'middle of the road' example.

For instance, if distributions from a family discretionary trust are made to husband and wife equally, but the husband uses most of the funds to pay down personal debt – will that be an ordinary family dealing?

If a family discretionary trust distributes amounts to adult children, pays sufficient to the children to fund their tax, and then loans amounts interest free to the parents, would the ATO seek to apply section 100A? Their factsheet suggest that they would.

It is submitted that the above two examples, and many like them, occur regularly in the client bases of most practitioners and the ATO's current guidance gives no indication as to what stance the ATO may adopt. Given the open-ended nature of section 100A and the lack of clear guidance the writer would recommend that practitioners make their clients aware of the potential operation of the provision when advising on year-end distributions.

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[13] [2005] FCAFC 141

[14] Which was reinforced in the first instance in *Raftland*

[15] (1998) 82 FCR 195

[16] 90 ATC 342

5 The consequences of vesting

Vesting of a trust may be planned or unplanned. A planned vesting will afford the trustee to obtain advice on the potential tax issues on vesting, while an unplanned vesting will occur when the vesting date or time has passed, and practitioner is asked to advise on the consequence of what has already occurred.

In the case of an intentional vesting of a discretionary trust it could be expected from a tax perspective, that to the extent that assets are passed to a beneficiary that either CGT event A1 or E5 (absolute entitlement) would occur, with the consequence that there could be a gain or loss for the trustee.

For the beneficiary, CGT event E5 will not have consequences for them on its own if they acquired their interest in the trust for no consideration.

The specific entitlement rules together with the general operation of Division 6 would however likely result in them paying tax on any capital gain made by the trustee to the exclusion of the trustee.

The vesting would have duty consequences only if there is dutiable property in the hands of the trustee that is then the subject of a dutiable transaction such as a transfer. If there was duty paid on the creation of the trust over property and that property or the proceeds of reinvestment from the disposal of such property is passed out in accordance with the terms of the trust there is the potential for duty relief in NSW[17].

If the time at which the trust will vest has been planned for, the result should be much the same as an intentional vesting even if nothing is done to bring forward the time for vesting.

Where the time at which the trust has come and gone, without any planning however, consideration needs to be given to what the consequence of this would be.

If the terms of the trust provided that at the vesting date the trustee would hold property in trust for default beneficiaries, that would be what would have occurred on the vesting date. If the trust instrument did not provide the trustee with any powers past the vesting date, the trustee is unlikely to have any powers beyond administrative ones, or those conveyed by statute, as its obligation under most deeds would be merely to hold the trust property on trust for default beneficiaries. The trust would effectively become a fixed trust in favour of the default beneficiaries.

What has now been the subject of multiple papers[18] is that if a trust vests, and there is no actual transfer of property so that CGT event A1 or E5 clearly occur, it will be the case that CGT event A1 does not occur, and CGT event E5 may not occur. There appear to be no other relevant CGT event to consider other than CGT event E5 in working out whether an 'unplanned' vesting will have unforeseen tax consequences.

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[17] Section 57, *Duties Act 1997* (NSW) provides for only $50 in duty for such a transfer if the CCOSR is satisfied that certain conditions are met.

[18] See for instance Professor Gordon Cooper's 'A trust primer: Beyond the usual issues' NSW Tax Symposium, October 2014 or Michael Butler's 'Vesting Trust Deeds' from the 30th National Convention 2015, amongst others.

CGT event E5, as mentioned above, occurs when a beneficiary becomes 'absolutely entitled' as against a trustee in relation to a CGT asset. For the trustee there is a capital gain if the market value of the asset is more than its cost base, and there is a capital loss if the market value is less than the asset's reduced cost base. Any gain or loss is disregarded if the asset is a pre-CGT asset. A beneficiary makes a capital gain or loss if the market value of the asset is more than the cost base of the beneficiary's interest in the trust capital to the extent it relates to the asset and can make a capital loss on the same basis. If the beneficiary paid no consideration for their interest, acquired their interest pre-CGT of if the capital gain or loss for the trustee could be disregarded under the rules applying to special disability trusts and main residences, then the beneficiary disregards the capital gain.

For CGT event E5 to apply at all, there must be absolute entitlement. The ATO set out their preliminary views on the meaning of this term some time ago, in TR 2004/D25. They have not yet finalised that view. Their view, which can be relied upon as protection against penalties only, is that a beneficiary cannot be absolutely entitled as against a trustee in relation to a particular asset if more than one beneficiary has an interest in that asset. Thus, ordinarily, if there is more than one default beneficiary, on the ATO's view CGT event E5 will not occur because no one beneficiary would become absolutely entitled to an asset on the vesting date where the vesting was unplanned. The ATO depart from this view though where the assets of the trust are fungible and:

> the beneficiary is entitled against the trustee to have their interest in those assets satisfied by a distribution or allocation in their favour of a specific number of them; and
>
> there is a very clear understanding on the part of all the relevant parties that the beneficiary is entitled, to the exclusion of the other beneficiaries, to that specific number of the trust's assets.

On the basis of the ATO's draft views, on an unplanned vesting, while their may be assets that are both fungible and divisible, unless there is a clear understanding between the beneficiaries as to who is entitled to what, there will be no absolute entitlement and so no trigger for CGT event E5. In an unplanned vesting it is hard to conceive of how there could be such a clear understanding except in the most unusual of circumstances, say, where there was an agreement between the default beneficiaries before the trust vested.

As well as it being the Commissioner's view that there is unlikely to be absolute entitlement, the decisions in *CPT Custodian*[19], and in *Oswal*[20] mean that on the current state of the law, it should be possible in most cases to conclude that absolute entitlement does not occur merely because the vesting date has passed.

[19] *CPT Custodian Pty Ltd v Commissioner of State Revenue* [2005] HCA 53 concerning a trustee's right of indemnity

[20] *Oswal v Commissioner of Taxation* [2013] FCA 745 concerning a power of sale preventing E5 from occurring and a right of lien also preventing absolute entitlement

5.1 ATO draft ruling on vesting

In late 2017 the ATO released draft Taxation Ruling TR 2017/D10 concerning what occurs on a trust vesting. The ruling also overs whether the vesting date for a trust can be amended and the consequences of the vesting of the trust.

5.1.1 Amending the vesting date

The draft ruling provides that the Commissioner accepts that changing the vesting date of a trust can postpone the vesting date of the trust, assuming there is a power in the trust deed to do so, as long as the decision to postpone the vesting date is made prior to the vesting date. The Commissioner does not accept that a vesting date can be extended after it has passed.

The Commissioner notes that here is a view that the vesting date can be extended by the trustee and the beneficiaries behaving in a way that is consistent with the terms of the trust prior to the vesting date. The Commissioner does not accept this view.

5.1.2 Trust law consequences of trust vesting

In the drafting ruling, the Commissioner notes that upon the passing of the vesting day for a trust, the trust does not automatically come to an end. Rather, on that day the property of the trust is to be held on the terms specified in the trust deed and the trust continues until formally wound up. What vests is the interest in the trust property, rather than the trust property.

For a discretionary trust, from the vesting date the trustee no longer retains discretionary powers to distribute income or capital of the trust but rather holds it for the absolute benefit of the takers-in-default, or such other appointed persons, upon vesting. The Commissioner notes that he will accept an allocation of income of the trust into pre-vesting and post-vesting income in the year in which vesting occurs so long as it is done on a fair and reasonable basis having regard to all of the relevant circumstances.

The Commissioner expressly accepts the vesting of the trust does not ordinarily cause the trust to come to an and does not cause a new trust to be created.

5.1.3 Tax consequences of trust vesting

As no 'new' trust is created upon the vesting date having passed, the Commissioner accepts that CGT event E1 generally does not occur, but the ruling includes an example where he considers it does:

> Example 4 - purported extension after vesting date
>
> 33. A discretionary trust holding several rental properties had a vesting date of 30 September 2016.
>
> 34. On 1 June 2017, the trustee became aware that the vesting date had passed and, with the acquiescence of the takers on vesting, continued to manage the trust as if the trust had not vested. On 29 June 2017, the trustee executed a deed of extension that purported to extend the trust's vesting date to 30 September 2057.

35. The subsequent execution of a deed of extension is void and ineffective to change a vesting date that has already passed. Any power of the trustee to extend the vesting date ceased on 30 September 2016.

Note: If, once it is realised that the deed of extension is ineffective to change the trust's vesting date, all of the takers on vesting agree that the trust assets should continue to be held on a new trust on the same terms as the original trust, and this was effective to create such a new trust over the assets by declaration or settlement, CGT event E1 would happen in relation to trust assets.

The Commissioner considers that CGT event E5 may happen if a beneficiary has become absolutely entitled to an asset of the trust and refers to his draft *Taxation Ruling* TR 2004/D25 (discussed above) for his view as to when a is beneficiary absolutely entitled to an asset as against the trustee.

CGT event E7 (disposal to a beneficiary to end a capital interest, except where the trust is a unit trust or a trust to which Division 128 applies) may happen upon the actual distribution of assets to the beneficiaries, to the extent that they are not already absolutely entitled, however this event does not apply if the beneficiary acquired the interest for no consideration – note that there would be gain for the trustee on E7 occurring to the extent that the market value of property is more than its cost base.

5.1.4 Taxation of trust net income after vesting

From the vesting date, the Commissioner notes that the takers on vesting, being either the takers-in-default or those persons whom the trustee has determining to entitled to the trust fund on vesting, will be presently entitled to the income from the vesting date. Any distribution of income or capital to any other person he states will be ineffective.

6 Trustee resolutions

Each year tax advisers are asked to assist their clients in preparing resolutions, minutes or other documents to distribute (appoint) the income of a trust, usually in a tax effective manner.

While the principles around distributing income are well settled, in the last year there was an unusual decision in relation to a contingent resolution (*Lewski*[21]).

The most practical tips that can be given in relation to preparing documents concerning the distribution of income are:

1. Read the deed:
    a. Check that the trust has not already vested
    b. Work out what the income is and whether the trustee needs to do anything to determine the income
    c. Work out whether the person you want to benefit is a beneficiary
    d. Check to see whether anyone's consent is needed before the distribution will be effective
    e. Check to see whether there is a date that the trustee needs to make their decision before (it may not be 30 June)
2. Do not use a pro-forma minute that has been prepared for another trust deed, it will likely lead you into error
3. Work out whether you are going to stream franked distributions or capital gains, and if so, address these at the start of the document
    a. If you are streaming capital gains remember it is the gross gain (i.e. pre-discount) that needs to be streamed
    b. If you are streaming franked distributions remember it is the amount of the dividends (net of franking credits) less directly relevant expenditure that needs to be streamed
4. Work out whether you are going to distribute dollar amounts or percentages
5. Make sure that the document is done within the time-frame required by the trust deed and tax law

6.1 Resolutions

A beneficiary of a trust is only taxed to the exclusion of the trustee (except in limited cases such as where the beneficiary is non-resident, under a legal disability, etc.) where the beneficiary is presently entitled to a share of the income of the trust estate for the purposes of subsection 97(1).

A beneficiary is made presently entitled to income through the terms of a trust instrument, which may require a decision to be made by the trustee, often referred to as a resolution, although it may take the form of a minute, list or notice depending upon the requirements of the trust instrument.

[21] *Lewski v Commissioner of Taxation* [2017] FCAFC 145

A minute could be done after a meeting of trustees, or of directors of a corporate trustee, but you need to be aware that the *Corporations Act 2001*[22] requires a minute book that records minutes within 1 month, but only requires that they are signed within a reasonable amount of time of the meeting or a resolution being passed. A company's constitution may also set out requirements for written records. Failing to keep timely minutes may lead someone to infer that the documents have been back-dated.

It may be possible under a trust deed for a decision to be made without there being a written document, but this can cause evidentiary concerns about when the decision is/was made.

6.2 Timing

Although the tax legislation silent on when the present entitlement must be created, case law indicates that to create a present entitlement to income it is necessary to create that entitlement prior to the end of an income year[23]:

> Present entitlement to the income must arise, if at all, at the latest by the end of the year of income.

Although there is not requirement under trust law for an entitlement to income of the trust estate to arise prior to the end of an income year for a person to be entitled to that income, it appears to be generally accepted by most practitioners, and required by the ATO that the present entitlement be created prior to the end of an income year.

In some trust deeds there is a requirement that the decision to appoint the income of the trust estate prior to the end of the income year (for instance, that the decision be made by 28 or 29 June) and if that is a requirement of the trust deed it must be met.

Under the streaming provisions there is a requirement that where a decision is made to stream franked distributions that this is recorded in writing in the accounts or records of the trust on or prior to 30 June – this means that when streaming such amounts it is not possible to sign a minute of meeting after 30 June recording a pre-30 June decision without having some other record of the decision made on or prior to 30 June.

The streaming provisions do not require, by contrast, any decision to be recorded in the accounts or records for capital gains that are streamed until 31 August following financial year-end.

6.3 Content

The following points, which are likely to be uncontentious, can be made about the content of a resolution recording the appointment of income. It is noted that some resolutions, following the decision in *Bamford* and the streaming measures being introduced have ended up being quite 'long-form'. Although such resolutions can assist in showing that the proper clauses of the deed have been considered and that they are present in the deed, in practice using a long form distribution is fraught with difficulty. Experience has shown that some practitioners will adopt a standard long-form

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[22] Section 251A.

[23] *Trustees of the Estate Mortgage Fighting Fund Trust v FC of T* 2000 ATC 4525.

resolution without considering whether it fits within the terms of a particular deed, or whether it is appropriate to the circumstances. This has caused the trustee to do things that it is not empowered to do under the trust instrument such as determining income to be tax law income.

The points below should be considered a minimum requirement. The ATO have published a checklist which contains some of these points[24].

- It should be clear who has made the decision and that person should be the person empowered to make the decision under the trust deed.
- If there is someone that needs to consent to the appointments made in the record of the decision it should be clear that the consent has been obtained (for instance a guardian or appointor may need to provide prior written consent – and that consent should be obtained).
- It should be clear what decision was that was made in relation to income of the trust estate, and preferably the decision should use the terminology used in the trust deed to define income that is being dealt with in the distribution minute[25].
- The distributions should be to beneficiaries that are permitted to be distributed to under the trust deed.
- If streaming is intended to occur, streaming should occur first in the order of what the trustee has resolved – it is not possible to stream a capital gain or franked distribution as part of a 'balance' amount.
- It should be clear what each beneficiary is entitled to, either in dollar amount, percentage amount, or formula.
- Unless percentages are being used consider when setting out amounts in dollar terms 'the first $X, the second $Y, etc.' so that if the income of the trustee estate is determined to be a different amount, who has benefited from the distribution of income is clear.
- Unless percentages are being used, consider having a 'balance' beneficiary. If you attempt to stream classes of income other than capital gains or franked distributions you may have a potential argument with the ATO over whether such streaming can occur.

6.4 Contingent resolutions

In TD 2012/22 the Commissioner makes clear his view that a resolution that attempts to deal with income that was not thought to exist at the time the resolution was made will fail. His example 6 is an includes a resolution which has commonly been made in the past:

> On 30 June 2011, the trustee resolved to distribute the income of the trust equally between two individual beneficiaries, Daisy and Rose. The trustee further resolved that should the Commissioner later include any amount in the assessable income of the trust, the amount so included is deemed to be distributed on 30 June to Bouquet Pty Ltd.

[24] https://www.ato.gov.au/printfriendly.aspx?url=/General/Trusts/In-detail/Trust-tax-time-toolkit/Resolutions-checklist/

[25] In *Lewski* a failure to use the terminology in the deed did not invalidate the distribution.

The Commissioner's position is that on 30 June 2011 there is no amount that the company, Bouquet Pty Ltd, could be seen to be entitled, as all of the income entitlements had been allocated between the two individual beneficiaries.

The Commissioner maintains that the same outcome would arise in Example 7 where the facts are different. In that case the trustee thought the trust income, which was equated with section 95 net income, was $100,000. The trustee allocated $50,000 each to Daisy and Rose. The trustee tried further to resolve that:

> should the Commissioner later include any amount in the assessable income of the trust, the amount so included is deemed to be distributed on 30 June to Bouquet Pty Ltd

The Commissioner's view is that such a resolution could not take an increase in assessable income to the company, Bouquet Pty Ltd, as the company's entitlement was contingent upon the Commissioner determining the income to be different than that thought to be the amount determined by the Commissioner. Present entitlement does not exist where the entitlement is contingent. The outcome should be different however where rather than making the distribution conditional upon the Commissioner later including an amount, the trustee had merely resolved that 'the balance will be distributed to Bouquet Pty Ltd'. Such a resolution is merely contingent on there being such income, in the same way that the distribution to the other beneficiaries, Daisy and Rose, is contingent upon there being sufficient income to be distributed to them.[26]

The Commissioner's position in relation to a contingent resolution appears to be correct. In *Lewski* resolutions were passed which in part provided the following:

Distribution of trust income:	It was resolved to pay, apply and set aside the income of the trust, as defined in the deed, for the year ending 30 June 2006 to or for the benefit of the beneficiaries in the manner and of the type as allowed under the deed such that the assessable income for taxation purposes of each beneficiary (and the class of assessable income from which their respective entitlements are appointed) is:	
	Beneficiary	Amount
	Roslyn Lewski	100% of income
Variation of income:	It was resolved that should the Commissioner of Taxation disallow any amount as a deduction or include any amount in the assessable income of the trust, and not distribute that amount so disallowed as a deduction, or so include in the assessable income in accordance with the above appropriation, such amount or amounts are to be deemed to be distributed on 30 June 2006 in the following manner:	
	Beneficiary	Amount
	Australian Commercial Underwriting Pty Ltd	100% of income

[26] See the discussion on contingencies and their impact on present entitlement in Bernard Marks, *Trusts & Estates Taxation and Practice,* 2nd Edn, 26-145.

The Tribunal at first instance in *Lewski* considered the above resolutions could be read as distinct and sequential so that the first resolution could validly appoint income to Mrs Lewski, even though the contingent resolution could fail, as the Tribunal considered occurred as it was contingent. The Full Federal Court however considered such an approach artificial. Rather, the Court noted, the resolutions were interdependent resolutions made at the same time, set out in a single document and signed by a sole director and accordingly, should be interpreted together. The Court considered that the resolutions were clearly contingent if read together. Accordingly, Mrs Lewski was not presently entitled as it was not possible for someone to be presently entitled where there was a contingency in place.

Care should be taken when trying to draft resolutions for contingencies, where those contingencies might, where they can only be fulfilled after the end of a year of income, defeat present entitlement.

7 Bamford amendments

After the decision in *Bamford v Commissioner of Taxation*[27] many practitioners took the opportunity to make 'Bamford' amendments to trust deeds.

The decision in *Bamford* did confirm the position that the term 'income of the trust estate' where it appears in section 97(1) of ITAA1936 refers to the income as defined in the deed. The Commissioner has his own views on what the terms means, as set out in TR 2012/D1 as noted above. It does appear clear from the *Bamford* decision that the deed does not do all the work in determining what the income of a trust is, as the High Court quoted in its judgement from Sundberg J in Zeta Force, where he said:

> The words 'income of the trust estate' in the opening part of s 97(1) refer to distributable income, that is to say income ascertained by the trustee according to appropriate accounting principles and the trust instrument. That the words have this meaning is confirmed by the use elsewhere in Div 6 of the contrasting expression 'net income of the trust estate'. The beneficiary's 'share' is his share of the distributable income.

Bamford amendments generally involve a trust deed being reviewed, and amended where possible to:

1. Ensure that the income definition is what is wanted by the practitioner
2. Ensure that there is flexibility to vary the definition of income if that is what is wanted
3. Ensure that the trustee does not need to determine what income is by the end of the financial year if this is what is wanted
4. Ensure that the trustee can stream different classes of income – particularly franked distributions net of directly relevant expenses and capital gains
5. Ensure that where the trustee needs other powers these are present

Arguably, there is no need to make an amendment to most deeds to 'take advantage' of the Bamford decision. The decision itself did not confer the ability on a trustee to stream classes of income, that was the effect of the streaming legislation. As well almost all deeds give trustees power in relation to income, and while they may not define that term, this would only result in income meaning what income means according to ordinary concepts.

The writer is generally loath to amend a trust deed except to cater for a particular circumstance, though there are real merits in making Bamford amendments:

1. They can lead to a standardised definition of income across the deeds managed by one practice, reducing the likelihood that a minute or resolution will be prepared incorrectly;
2. They can remove the need (if the amendment does this) for a decision to be made earlier than 30 June for distributions;
3. They can provide for standardised streaming provisions to make drafting a minute or resolution easier.

[27] [2010] HCA 10

8 Trust resettlements

Following the decision in *Federal Commissioner of Taxation v. Clark and Anor*[28] and the High Court's refusal to grant the Commissioner leave to appeal that decision it is reasonably well settled that most amendments to a trust deed, done in accordance with an amendment power found within the deed will not 'resettle' the trust for income tax purposes. That is, they will not result in CGT events E1 or E2 occurring.

The Commissioner's determination, TD 2012/21, issued after *Clark* sets out the ATO that changes to a trust that fall short of a termination of the existing trust, or the creation of a 'new charter of rights and obligations' over particular assets will not trigger CGT events E1 or E2.

The examples in the determination of changes that would not amount to a resettlement are:

- Using a power of amendment to remove or add beneficiaries;
- Changing a trustee's investment powers to allow investment in land;
- Changing the definition of income and adding a streaming power and extending the vesting date.

The example of the creation of a new charter of rights and obligations so that there would be a resettlement involves a trustee amending a trust deed so that it will hold a particular asset on trust for only one beneficiary. The example in the determination sets out:

> Example 4: settling of trust asset on new trust
>
> 11. The Hedgerow Trust is a discretionary trust the class of objects of which consists of a large number of entities associated with the Buttercup family. Under its terms, the trustee has a wide range of powers including the power to declare that particular assets of the trust are to be held exclusively for one or more of the trust objects to the exclusion of the other objects of the trust. In exercise of this power, the trustee declares that one of several assets forming part of the corpus of the trust - asset 1 - was henceforth held exclusively in trust for one of the objects, Mr Badger (subject to the trustee's other powers, such as its power of sale). One month later the trustee makes a second declaration to similar effect in favour of Mr Badger in respect of one of the remaining assets of the Hedgerow Trust (asset 2). While the respective declarations do not terminate the Hedgerow Trust, the effect of the declarations is that assets 1 and 2 are no longer held on that trust. Rather, the trust obligations attaching to those assets have changed in a manner consistent with a conclusion that the assets have commenced to be held on the terms of a separate trust for the benefit of Mr Badger as sole beneficiary. As a result, CGT event E1 happens when the separate trust for the benefit of Mr Badger is created over asset 1. CGT Event E2 happens when asset 2 is also transferred to that separate trust.

It is reasonably clear that holding a particular asset on trust for one beneficiary would cause a CGT event to occur, though this is likely to be CGT E5 (absolute entitlement).

The Commissioner's fuller reasoning in relation to the creation of a new charter of rights and obligations provides:

> 28. In Commissioner *of State Revenue v. Lam & Kym Pty Ltd* [2004] VSCA 204; 2004 ATC 5058; (2004) 58 ATR 60 the Supreme Court of Victoria considered a scenario in which by deed of settlement a trustee stood possessed of a fund on discretionary trust for two classes of objects (the Primary Beneficiaries and the Discretionary Beneficiaries).

[28] [2011] FCAFC 5

> By deed poll the trust was amended giving the trustee the power to transfer the whole or any portion of the fund to or for the advancement of any of the Discretionary Beneficiaries. The trustee subsequently executed an instrument in which it declared that it 'hereafter held separately in trust' particular real estate for certain beneficiaries. Nettle JA (with whom Vincent JA and Hansen AJA agreed) held that the exercise of the power of appointment had the result of the real estate being held on separate trust.

While the decision of the Court in the case referred to was that a new trust was created, the provision of the law they were applying required, section 64A(3) of the *Stamp Act 1958* (Vic), provided:

> **(3)** Where-
>
> (a) real property is vested in a person; and
>
> (b) the real property becomes subject to a trust for another by reason of a declaration of trust by that person-
>
> the person shall, not later than 14 days after the real property becomes subject to the trust-
>
> (c) furnish to the Comptroller of Stamps a statement in the prescribed form accompanied by a statutory declaration setting out the prescribed particulars; and
>
> (d) pay the Comptroller of Stamps as stamp duty on the statement a sum equal to the amount of stamp duty that would have been payable if the real property had been conveyed by an instrument of conveyance from the person to the other.

The provision requires a declaration of trust.

The declaration concerned provided:

> The Trustee hereby declares that the property described in Certificate of Title Volume 9516, Folio 732 known as 28 Main Street, Box Hill is hereafter held separately in trust for the Primary Beneficiaries named in the Trust Deed and for the Primary Beneficiaries and their parents, children, grandchildren, uncles, aunts, brothers, sister, nieces, nephews and the spouses of any of those person[s] as Discretionary Beneficiaries to the exclusion of all other beneficiaries of the Huynh Family Trust (including any beneficiary that the Trustee may otherwise nominate under Clauses 1(a)(2)(iii), (v) or (vi) of the Trust Deed) but otherwise upon the same trusts and subject to the same powers and condition[s] and for the same period as are set out in the Trust Deed.

The declaration concerned clearly fitted the definition of a declaration, that being clear on its face.

What it not clear in the context of the Commissioner's position in his TD is whether something short of a declaration, where a trustee in accordance with its existing powers, determines that it will hold an asset for only certain beneficiaries is either a creation of a trust by declaration or settlement (CGT event E1). It could not be a transfer to an existing trust, as there is no existing trust to transfer the asset to (as opposed to the two-step process in the ATO example).

Still, it would be prudent in any situation where a trust deed is being amended, to consider whether what is done might vary the trust relationship in such a way that the Commissioner may want to pursue a *Lam & Kym* style resettlement argument.

9 Section 99B determinations

On 13 December 2017 the Commissioner issued two tax determinations relating to the tax treatment of capital gains made by a foreign trust from assets that are not taxable Australian property. The combined effect of the two determinations is that a capital gain, made by a non-resident trust, in relation to property that is not TAP, will not be treated as a capital gain when received by an Australian resident beneficiary.

TD 2017/23 provides that the assumption in section 95 of the ITAA1936, to be applied in determining the net income of a trust estate, that the trustee is a resident taxpayer, does not apply to the operation of Division 855 to capital gains made from a CGT asset that is not taxation Australian property. The effect of this is that Division 855 operates so that the trustee of a foreign trust disregards a capital gain made from a CGT asset that is not TAP. As a result, neither the beneficiaries nor the trustee will be assessed on the capital gain under Division 115 of ITAA1997. That is, the amount will not be treated as a capital gain.

TD 2017/24 then provides that where an amount of a capital gain made by a foreign trust from a CGT asset that is not taxable Australian property is included in a beneficiary's assessable income, it will be under section 99B of ITAA1936, which taxes the amount as statutory income.

Although amounts are not assessable under section 99B where they are:

> corpus of the trust estate (except to the extent to which it is attributable to amounts derived by the trust estate that, if they had been derived by a taxpayer being a resident, would have been included in the assessable income of that taxpayer of a year of income)

The Commissioner's view is that you cannot in the above 'hypothetical taxpayer' situation, posit that the taxpayer as a resident would have been eligible for the CGT general discount, which would render some amount (possibly 50%) of any gain not taxable.

Part of the Commissioner's explanation for this position is that to consider that the hypothetical taxpayer was a resident would allow a resident company to benefit from the CGT discount.

The beneficiary cannot, because the amount is assessed as statutory income and not capital gains, apply capital losses or carry-forward net capital losses to the amount, and cannot reduce the amount under the CGT general discount.

It should be noted though that even if a company were to receive the benefit of a discounted capital gain in such a situation, that this would not automatically mean that such an amount could be provided tax-free to a shareholder or associate.

This should be contrasted to the position where a trust is a resident trust for CGT purposes, where a gain on a non-TAP asset would be taxed as a capital gain.

The Commissioner states the following in relation to his position:

> 29. The Commissioner will not devote compliance resources to enforce this view in relation to distributions received or already assessed in income years ending before the issue of this Determination. However, if the Commissioner is

> asked to amend an assessment, or required to state a view (for example in a private ruling or in submissions in a litigation matter), the Commissioner will act consistently with the views set out in this Determination.

Two observations can be made about the position set out in the determinations and on section 99B generally:

- The drafting of section 99B catches more distributions than would be expected to be caught; and
- The recent confirmation of the law on the residence of companies may result in a discretionary trust being resident where it might previously not have been considered such.

The drafting issue in section 99B is that is it applies:

> Where, at any time during a year of income, an amount, being property of a trust estate, is paid to, or applied for the benefit of, a beneficiary of the trust estate who was a resident at any time during the year of income, the assessable income of the beneficiary of the year of income shall, subject to subsection (2), include that amount.

Where you could ordinarily expect that income derived by a person while a non-resident from a foreign trust would not result in Australian tax implications, if a person is a resident at any point in time during the year an amount is received, applied for their benefit, or loaned to them[29], then it may result in an assessable amount under section 99B.

For a trust that is not a unit trust, the trust estate will be a resident trust for CGT purposes if the trustee is an Australian resident, or the central management and control of the trust is in Australia. In the litigation that culminated in *Bywater Investments Limited & Ors v. Commissioner of Taxation; Hua Wang Bank Berhad v. Commissioner of Taxation* [2016] HCA 45 it was confirmed that in relation to a company '… a company is resident where its real business is carried on, and its real business is carried on where the central management and control abides …'[30]. This may result in what might otherwise have been considered to be a non-resident trust being treated as an Australian resident trust where central management and control of the trustee abides in Australia.

[29] Section 99C(2)(c).

[30] *Hua Wang Bank Berhad v Commissioner of Taxation* [2014] FCA 1392 at 393

10 Time limits for amendments

There are time limits in tax law that prevent the Commissioner from amending an assessment once it is issued. Those time limits usually run to 2 to 4 years depending upon the tax characteristics of the taxpayer concerned, and the nature of the tax adjustment. The time limits operate to provide certainty to both taxpayers and Government about the tax position resulting from an assessment.

The time limits in relation to trustees that lodge returns but that do not receive assessments operate in an unusual way.

Currently the definition of assessment includes:

> (d) for a taxpayer that is the trustee of a trust estate (other than a trustee to which paragraph (b) or (c) applies or the trustee of a complying superannuation fund, a non-complying superannuation fund, a complying approved deposit fund, a non-complying approved deposit fund or a pooled superannuation trust)--the ascertainment:
>
> (i) of so much of the net income of the trust estate as is net income in respect of which the trustee is liable to pay tax (or that there is no net income in respect of which the trustee is so liable); and
>
> (ii) of the tax payable on that net income (or that no tax is payable); and
>
> (iii) of the total of a taxpayer's tax offset refunds for a year of income (or that the taxpayer can get no such refunds for the year of income);

The definition of an assessment includes what occurs when the Commissioner determines that there is no tax payable by the trustee on the net income of a trust estate following lodgement of the return.

Although there is an 'assessment' when the Commissioner determines there is no tax payable by a trustee, the provisions dealing with amendment of assessments rely on counting from the time that the Commissioner 'gives notice of the assessment…' to a taxpayer. It is not the Commissioner's practice to issue assessments to trustees when returns are lodged, so that the time limits in subsection 170(1) of ITAA1936 cannot begin to run[31].

The ATO issued Practice Statement Law Administration *PS LA 2015/2* in February 2015 which guides ATO staff to limit the time within which they will issue an assessment to the trustee of a trust, to ensure that trustees are subject to, broadly, a similar period of review as other taxpayers.

The net income of a trust is ordinarily assessed to the beneficiaries. A trustee may, however, be issued with an assessment and taxed in certain instances, for example in respect of a non-resident beneficiary or where no beneficiary is presently entitled to the trust's income.

The ATO considers that the existing of an unlimited time to review the assessment made when the return is lodged is inconsistent with the outcome contemplated by the *Report Aspects of Income Tax Self Assessment,* that all taxpayers returning a nil liability should have a limited period of review.

[31] PSLA 2015/2 paragraph 1

Accordingly, the ATO states that its practice will be to limit the review period for trustees to the following time periods:

- four years after the relevant trust tax return was lodged; or
- two years after lodgment of a return for the 2014 or a later income year, if the trust is a small business entity for that year[32] and none of the qualifications in item 3 of the table in subsection 170(1) apply.

The ATO states that the time limits above will not apply where:

- the trustee has not lodged a trust return for the relevant income year;
- the Commissioner is of the opinion that there has been fraud or evasion;
- an extended or unlimited amendment period would apply; or
- the time limit has been extended by agreement with the trustee.

The following examples, of the application of the above time limits and exceptions, are included in the Practice Statement.

Example 1 - time limit for raising an original trustee assessment

The 2010 income tax return for the Oak Family Trust was lodged on 9 May 2011. The trust was not a small business entity for the 2010 income year. An audit of the trust reveals that some of the trust net income should be assessed to the trustee under section 99A. The time limit for review has not been extended by agreement with the trustee. An assessment should be issued to the trustee by 9 May 2015.

Example 2 - multiple trustee assessments

A trust return for the Cedar Family Trust was lodged on 9 May 2011. The trust was not a small business entity for that income year. An assessment is issued to the trustee under section 98 on 30 June 2011. As a result of audit activities, the Commissioner considers the trustee should instead be assessed under section 99A. The time limit for review has not been extended by agreement with the trustee. The section 99A assessment must be made by 9 May 2015 and is an original, not an amended, assessment.

Similarly, if the result of the audit was that the trustee was assessable under section 98 in respect of a different beneficiary, then that assessment should also be issued by 9 May 2015.

Example 3 - time limits do not apply - unlimited amendment period

A beneficiary has been assessed under section 97 on all of the net income of a trust for the 2008 year. As a result of some compliance action taken by the ATO, it was established that the beneficiary's entitlement to trust income arose out of a reimbursement agreement. Consequently the net income is assessable to the trustee under section 100A. Under subsection 170(10) the ATO has an unlimited time to assess a present entitlement arising from reimbursement agreement. Accordingly, there is no time limit for issuing an amended assessment in this instance, however the ATO states that its officers should endeavour to do so as soon as practicable.

Example 4 - extension of time limits

[32] Note that for 2017 and later years this is a $10 million turnover test.

> A trust's taxation affairs are being reviewed. However, due to the complexity of the arrangements, the ATO does not expect to complete the review before the end of the abovementioned time limits. The ATO obtains the trustee's agreement to extend the relevant time limit by a further six months. The ATO has until 14 November 2014 to issue a trustee assessment/s (if required), unless it negotiates further time.
>
> Example 5 - extended timeframes
>
> The 2009 return for the Pine Family Trust lodged on 9 May 2010 indicates that all of the net income is assessable to an individual beneficiary. That beneficiary's assessment is issued on 6 June 2010.
>
> On 1 June 2014, the beneficiary requests an amendment on the basis that the trustee's resolution appointing income was invalid. The default beneficiary (a minor) was instead presently entitled to all the income and the trustee should have been assessed under section 98 on all of the net income. The ATO officer should escalate the case to an SES officer who, having regard to all of the facts, will determine in consultation with the trustee a period within which an assessment is to issue.

The last example can be seen of someone potentially 'gaming' the system, in that they have waited until after the trustee would ordinarily be out of time to be assessed based on the practice statement, but the individual is within time, so that it might be inferred that the arrangement is a deliberate attempt to prevent the Commissioner from collecting tax – hence the need for the ATO officer to escalate the case.

That the Commissioner has decided to deal with the issue of limiting the time period for amending the assessment of a trustee in this way, by issuing administrative, and therefore non-binding guidance to his officers, leaves it more open to an officer to determine to issue an amended assessment in a position where this might not occur if an original assessment had been issued. That such a practice exists without an original assessment being issued is however positive in that it provides for certainty in relation to tax positions.

