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CGT Hotspots in Restructuring Trusts in Estate Planning

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Written by:

Sam Campbell
Associate, Sladen Legal

Rob Jeremiah
Principal, Sladen Legal

Will Monotti
Lawyer, Sladen Legal

Ashleigh Eynaud
Graduate Lawyer, Sladen Legal

Presented by:

Rob Jeremiah
Principal, Sladen Legal

Sladen Legal
Level 5, 707 Collins Street
Melbourne 3008
Victoria Australia

DX 30970
Stock Exchange

PO Box 633
Collins Street West
Victoria 8007

T +61 3 9620 9399
F +61 3 9620 9288

sladen.com.au

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1. Introduction

1.1 There are significant tax issues, especially in relation to possible capital gains tax (**CGT**) liabilities, which should be considered whenever a client intends to restructure a trust. This is particularly the case in the restructuring of entities, particularly trusts, in a family group.

1.2 From the program for this event, this paper will consider the CGT perspective of:

- Structuring trust deeds to minimise CGT problems;
- Creation and extinguishment of rights – a CGT checklist;
- Assignment of loan accounts and unpaid present entitlements (**UPE**);
- CGT event C2 – when a taxpayer's ownership of an intangible asset ends;
- CGT event D1 – when a taxpayer creates a contractual or other legal right in an entity;
- Promising never to make a claim and disclaimers – is this tax effective?;
- Removing beneficiaries as discretionary objects – tax position explained;
- Reimbursement agreements and s100A tax issues; and
- Changing trustee or appointor – tax impact.

1.3 When advising clients there is always a conflict between the twin agendas of control and asset protection. There are always a number of often competing factors that should be considered in relation to estate planning and restructuring. More often than not, as tax professionals, we will emphasise the asset protection benefits of estate planning structures, advising clients on things like relative tax benefit, business/family succession and risks relating to relationship breakdowns. This usually involves careful consideration of the right combination and balance between those persons who are trustees, directors, shareholders, appointors and beneficiaries and choosing those who to fulfil these roles very carefully.

1.4 Taking into account all of these concerns, if a client instructs to restructure a trust in order to concentrate the practical control of that trust in one individual, there are a number of ways in which this can be achieved. Prior to the implementation of the instructions however, the related tax risks should always be considered to ensure any restructure does not bring about unforeseen and unintended tax consequences.

2. Structuring trust deeds to minimise CGT problems

2.1 From fundamental principles, a trust is an obligation on the legal owner of property to deal with that property for the benefit of beneficiaries. The objects of a discretionary trust, commonly known as beneficiaries, do not have any legal or proprietary right or equitable entitlement to any trust asset or share of trust assets. The only right a beneficiary has is the equitable right to due administration of the trust by the trustee and to be considered by the trustee as a potential object of distributions of income or capital or powers which the trustee may exercise in relation to the trust, including such powers as may be present under the deed to make loans to beneficiaries.[1]

2.2 The terms of a trust are those expressed in the trust deed. The trustee of a discretionary trust has the discretion to pay or apply income to or for the benefit of specified beneficiaries and a beneficiary in whose favour the trustee exercises such a discretion is deemed to be presently entitled to the amount paid to the beneficiary or applied for the beneficiary's benefit.[2] Where a beneficiary of a trust who is not under any legal disability is presently entitled to a share of the income of the trust estate, their assessable income shall include that share of the net income of the trust estate[3]. Where there is a share of the income of the trust estate to which no beneficiary is presently entitled, the trustee is assessable.[4]

2.3 The amount of the taxable or net income of a trust is to be assessed on either the trustee or the beneficiary to the extent the beneficiary is presently entitled to a share of the income of the trust.[5]

[1] *Gartside v Income Revenue Commissioners* [1968] AC 553
[2] section 101, *Income Tax Assessment Act 1936* (**ITAA 1936**)
[3] section 97, ITAA 1936
[4] sections 99, 99A, ITAA 1936
[5] section 95, ITAA 1936

2.4 It is essential in determining whether a beneficiary is to become presently entitled, that the terms of the trust deed and the factual circumstances of the intended distribution be considered. A beneficiary will be presently entitled to a share of the income of the trust estate if, and only if, the beneficiary has:

2.4.1 an interest in the income which is both vested in interest and in possession; and
2.4.2 a right to demand immediate payment of the trust income.[6]

2.5 Further, capital gains made or franked distributions received by a trust will be effectively streamed to a beneficiary(s), to the extent the beneficiary(s) become specifically entitled to an amount of the capital gain or franked distribution of the trust. For a beneficiary to be specifically entitled to an amount of a capital gain or franked distribution:

2.5.1 the beneficiary must have received or be reasonably expected to receive an amount that is referrable to the capital gain or franked distribution – this would, in the normal course, be reflected by the trustee of the trust providing for or resolving that the amount be appointed or streamed to the beneficiary; and

2.5.2 the entitlement must be recorded in its character as an amount referrable to that capital gain or franked distribution in the accounts or records of the trust.

2.6 A beneficiary of a trust will have a share of a capital gain that is the sum of:

2.6.1 the amount of the capital gain to which the beneficiary is specifically entitled; and

2.6.2 if there is an amount of the capital gain to which no beneficiary of the trust is specifically entitled and to which the trustee is not specifically entitled, that amount multiplied by the beneficiary's adjusted Division 6 percentage of the income of the trust for the relevant income year.[7]

2.7 The 'adjusted Division 6 percentage' of a beneficiary means the entity's Division 6 percentage of the income of the trust calculated on the assumption that the amount of a capital gain or franked distribution to which any beneficiary is specifically entitled were disregarded in working out the income of the trust estate.[8]

2.8 For a beneficiary the 'Division 6 percentage' of the income of the trust is equal to the share (expressed as a percentage) of the income of the trust to which the beneficiary is presently entitled. Where the income of the trust is nil, a beneficiary has a Division 6 percentage of the income of the trust of 0%.[9]

2.9 For example, where a beneficiary is presently entitled to half the capital proceeds from the sale of an asset by a trust then the beneficiary will generally be specifically entitled to half of the capital gain realised on the sale.[10]

2.10 A beneficiary's share of a franking credit on a franked distribution is the amount notionally allocated to that entity as a share of that credit (whether or not they receive any of that credit or distribution), calculated by multiplying the amount of the franking credit on the franked distribution by the beneficiaries share of the franked distribution divided by the amount of the franked distribution.[11]

2.11 For example, where a beneficiary is entitled to a portion of the franking credit on a franked distribution the beneficiary will generally be specifically entitled to an amount being the franked distribution multiplied by their percentage share of the net financial benefit.[12]

[6] *FCT v Harmer & Ors* (1990) 94 ALR 541
[7] section 115-227, *Income Tax Assessment Act 1997* (**ITAA 1997**)
[8] Definition of 'adjusted Division 6 percentage', section 95(1), ITAA 1936
[9] Definition of 'Division 6 percentage', section 95(1), ITAA 1936
[10] section 115-228, ITAA 1997
[11] section 207-57, ITAA 1997
[12] section 207-58, ITAA 1997

2.12 After the High Court decision in *Bamford,*[13] it continues to be important to ensure that a trust deed includes an express power to deal with the streaming of income and capital. Although both the *Income Tax Assessment Act 1936* (**ITAA 1936**) and *Income Tax Assessment Act 1997* (**ITAA 1997**) provide for the concept of a specific entitlement of a beneficiary(s), the effective creation of a right fora beneficiary to receive a benefit from a trust will continue to be dependent upon the right being created in accordance with the terms of its trust deed. This is based on the assumption, under the terms of the trust deed, that the right will only be created upon the exercise of a power or discretion of the trustee. It will always be vitally important to ensure in each income year that the trustee or in the case of a corporate trustee its directors resolve to create entitlements to the income and realised capital gains of the trust in accordance with these terms. If the necessary power is included in the trust deed this will most usually be effected by the trustee as a resolution determining the income of the trust (which may or may not include capital gains) and then appointing/distributing that income. If it does not include capital gains, those capital gains go to beneficiaries. As noted above, for the amount of any franked dividends included in the income of a trust and any capital gains made by it to be included in the assessable income of a beneficiary under the appointments of income/capital gains the beneficiaries must be specifically entitled to that income/capital gain(s).

2.13 Therefore, in structuring trust deeds, the first step is to ensure you have streaming clauses under the deed including the streaming of capital gains and franked distributions. However, to reiterate, in order for the trustee to validly stream capital gains and franked distributions to a specific beneficiary(s) those beneficiaries must have a specific entitlement.

2.14 Whenever any amendment or variations of a trust deed are being contemplated, it is important to consider whether those changes may result in a resettlement of the trust. When drafting a trust deed, it is also important to ensure its terms provide for future succession of control of the trust to pass as may be intended. Whether it be of an individual or corporate trustee(s), appointor(s) and/or (including the addition or exclusion of) beneficiary(s). Care should always be taken that any variation to the terms of the deed of the trust do not result in the existing trust being terminated and a new trust arising. For trust law purposes that is a resettlement, thus effecting the disposal of a CGT asset and, a consequent capital gain (or capital loss, as the case may be). Variations or amendments to a trust deed could include extending the vesting date of a trust, including and/or excluding beneficiaries and amendments relating to notional settlor exclusion.

2.15 If the trust has a corporate trustee, this would also involve ensuring the terms of the constitution of the corporate trustee company reflect the clients' intentions in relation to any change of directors or shareholders. The use of corporate trustees and/or corporate appointors may provide an effective vehicle for the change of control under the constitution of the corporate entity. By ensuring that the ownership of shares in the corporate entity can be transferred to the desired person or entity (such as providing for standard provisions allowing for transmission of shares on bankruptcy, incapacity or death) and/or ensuring there are adequate provisions for the appointment of directors (such as allowing the corporate trustee to be a single director company).

2.16 Since the application of the Commissioner of Taxation (**Commissioner**) for special leave to appeal to the High Court, the Full Federal Court decision of *Clark*[14] was refused,[15] the Commissioner has accepted that his then existing views on what could amount to a resettlement of a trust were incorrect, these views were then withdrawn.[16] In his previous view, the Commissioner was of the opinion that possible changes which may result in a new trust being created includes: any change in beneficial interest in trust property, a new class of beneficial interests (whether introduced or altered) and changes to the terms of the trust or right or obligations of the trustee. The Commissioner said that whether any new trusts were created would also depend upon consideration of the terms of the original trust, powers of the trustee and whether the essential nature and character of the original trust relationship had

[13] *Bamford v FCT* (2010) 240 CLR 481

[14] *Commissioner of Taxation v David Clark; Commissioner of Taxation v Helen Clark* [2011] FCAFC 5

[15] ATO, *Decision Impact Statement, Commission of Taxation v David Clark; Commissioner of Taxation v Helen Clark [2011] FCAFC 5*, DIS QUD 1 of 2010, issued 2 December 2011

[16] These previously held views were contained in 'ATO, Creation of a new trust – Statement of Principles August 2001' (**Statement**). The Statement was withdrawn by the Commissioner on 20 April 2012.

fundamentally changed.

2.17 It is now beyond doubt that amendments made to a trust deed pursuant to and in accordance with the power of amendment contained in the deed will not effect a resettlement and therefore not trigger a CGT event (unless any such changes destroy the necessary continuity of the essential features of the trust).[17] In *Clark*, quoting the reasoning in the High Court decision of *Commercial Nominees,*[18] which dealt with the continuity of a trust estate in relation to a superannuation fund, the majority (Edmonds and Gordon JJ) found (at para [77]):

> "***[55]****…* [t]*he three main indicia of continuity [for the purposes the former taxing regime for superannuation funds] are* **the constitution of the trusts** *under which the fund (if a trust fund) operated,* ***the trust property****, and* ***membership****.* ***Changes in one or more of those matters must be such as to terminate the existence of the eligible entity, or to produce the result that it does not derive the income in question****, to destroy the necessary continuity*."

And further, again quoting *Commercial Nominees* (at para [78]):

> "***[56] So long as any amendment of the trust obligations relating to such trust property is made in accordance with any power conferred by the instrument creating the obligations, and continuity of the property that is the subject of trust obligation is established, there will be identity of the 'taxpayer' for the purposes of s 278 and ss 79E(3) and 80(2), notwithstanding any amendment of the trust obligation and any change in the property itself***."
>
> [emphasis added by Edmonds and Gordon JJ]

And finally, in conclusion (at para [87]):

> "[w]*hen the High Court in Commercial Nominees spoke about trust property and membership as providing two of the indicia for the continued existence of the ... trust estate, the Court was not suggesting that there had to be a strict or even partial identity of property for the first and objects for the second. It was speaking more generally: that there had to be a continuum of property and membership, which could be identified at any time, even if different from time to time; and without severance of one or both leading to the termination of the trust in question...*"

2.18 Accordingly and firstly any variation of a trust deed should only be undertaken after a thorough review of its terms including the terms of any power of variation. In many older deeds the power of variation may often be limited to the power to vary the terms relating to the trust fund. This will give rise to difficulties where it is desired and intended to appoint a new appointor to the trust. If the power of variation is limited in such a way; the position of appointor being a 'power' as opposed to a 'trust' may mean the scope of the relevant amendment or variation power may not extend to any change of appointor. A change of appointor can only be validly made if it is done pursuant to a specific power to do so.[19] Where a power of amendment is subject to any restrictions or limitations those restrictions must themselves be complied with and cannot be amended by the exercise of the power.

2.19 Therefore, the second step in structuring trust deeds is to ensure that you have sufficient provision/s allowing for requisite scope to both add and remove beneficiaries and make such other variations to the trust, including succession of the trustee and appointor, as may be considered appropriate.

2.20 Even if the proposed amendment is within power this will not completely negate the risk of there being CGT consequences.

2.21 CGT event E1 happens if a trust is created over a CGT asset by declaration or settlement.[20] Even if no capital proceeds are received on account of a resettlement the client may still be

[17] See also, Taxation Determination, TD 2012/21
[18] *Federal Commissioner of Taxation v Commercial Nominees* (2001) 75 ALJR 1172
[19] *Jenkins v Ellett* [2007] QSC 154
[20] subsection 104-55(1), ITAA 1997

deemed to have made a capital gain at that date if the market value of the assets the subject of the declaration exceeds their cost base.[21]

2.22 In the Federal Court decision of *Oswal,*[22] the Court found that the trustee's exercise of a special power of appointment in respect of the trust corpus for the absolute benefit of some of the beneficiaries of the trust was a declaration of trust and settlement that triggered CGT event E1. The Court concluded this was so because even where a trustee does not have a beneficial interest in certain property the trustee can still declare that the property is held on a separate trust. A settlement of trust property can still occur even where the settlement is contemplated under a power granted to the trustee under the existing trust.[23]

2.23 The third step in structuring trust deeds is to ensure that the trustee follows the terms of the trust deed in seeking to make distributions of income or capital under the deed to a beneficiary or beneficiaries of the trust. *Oswal* stands as a lesson that the potential tax implications of any resolution need to be carefully considered before the resolution is made.

2.24 The Trustee Acts of each State and Territory may empower the Court by order to amend a trust deed where the trustee under the terms of the deed is not authorised to effect the desired variation. Care needs to be taken to consider the terms of the trust deed itself, the extent and application of the relevant statutory provisions and whether the change intended will breach those provisions. For example, it has been found in NSW courts[24] that section 81 of the NSW Trustee Act, which deals with the courts power to make orders to allow for effective management of the trust, does not extend to the power to amend a trusts terms where an existing amendment clause does not exist as section 81 only concerns a power to vary or supplement the terms of the trust derived from the trust deed. This is contrary to the more expansive position taken by the court in Victoria on its power to amend the terms of a trust deed under sections 63 and 63A of the Victorian Trustee Act.[25]

2.25 It is always easier to provide for a change of control in the terms of the trust deed on establishment of the trust rather than after the fact when any variation, not otherwise allowable, may, even if it were achievable, inevitably have some complications and difficulties attached to it.

3. Creation and extinguishment of rights – a CGT checklist

3.1 In relation to relevant CGT events under division 104 of the ITAA 1997, subdivision 104-C relates to those CGT events involving assets coming to an end ('C' events), subdivision 104-D to those CGT events where CGT assets are brought into existence ('D' events) and subdivision 104-E to those CGT events involving trusts ('E' events).

3.2 Where more than one CGT event may have occurred, the CGT event that will apply is the one that is the most specific to the taxpayer's situation.[26] A taxpayer will only make a capital gain (or capital loss) if a CGT event happens, with such gain or loss being made at the time of the event.[27]

3.3 Where there may have been either the creation or extinguishment of rights under a trust, the factors to be considered include:

3.3.1 ***What are the terms of the trust deed and the factual circumstances surrounding those rights that are to be created or extinguished?***

3.3.2 ***Who are the beneficiaries of the trust under the trust deed including any provisions excluding notional settlors as beneficiaries?***

[21] subsection 104-55(3), ITAA 1997
[22] *Oswal v FCT* [2013] FCA 745
[23] *Oswal* at paras [42] – [54], [55] – [60]; The Applicant subsequently sought leave to appeal Federal Court's decision in this case, however their application was refused (Oswal v Commissioner of Taxation [2014] FCA 812)
[24] *Re Dion Investments Pty Ltd* [2014] NSWCA 367; *Paloto Pty Ltd v Herro* [2015] NSWSC 445
[25] *Re Plator Nominees* [2012] VSC 284; *Re the Alan Synman Family Trust* [2013] VSC 364
[26] subsection 102-25(1), ITAA 1997
[27] subsection 102-20(1), ITAA 1997

3.3.3 ***What provisions of the trust deed provide for the distribution/appointment of income and capital by the trustee to the beneficiaries of the trust?***

- In determining whether a beneficiary is presently entitled to a share of the income of the trust, consideration must be given to the terms of the trust deed.
- Consider also, are there provisions providing for the streaming of capital gains and/or franked distributions?
- Comparing the terms of the trust deed to the intended distribution/appointment of income, has the beneficiary become specifically entitled to an amount of the income of the trust (including capital gains) for the relevant income period?

3.3.4 ***What is the nature and the scope of the amendment/variation provision(s) under the trust deed?***

- Does the trust deed provide the trustee with the requisite scope to do certain things such as adding and removing beneficiaries, providing for other variations such as the succession of the trustee and/or appointor or extending the vesting date of the trust (CGT event E5 would not occur if vesting date extended under a power of the trust)?
- What are the limitations, if any, to these provisions?
- Is there a risk any proposed amendment/variation of the trust deed may result in a resettlement of the trust (CGT event E1)?
- If a proposed amendment/variation is outside the terms of the trust deed, is there any scope under the relevant State (or Territory) Trustee Act to amend the terms of the trust deed to bring about the desired outcome?

3.3.4. ***What are the rights in the trust to be created or extinguished?***

- Do they relate to the appointor, the trustee or the beneficiary(s) of the trust?
- If so, query, subject to amendments being made in accordance with the terms of the trust deed, whether there are any tax (CGT) consequences at all?
- If those rights relate to either the appointor or trustee, and any proposed change of their rights is acted on pursuant to a power of amendment or variation under the trust deed, what if any will be the CGT consequences by reason of the change of these rights (refer below)?

3.3.5 ***Where there has been a change or extinguishment of rights in relation to a beneficiary, what are the CGT implications of this change?***

- Is the right a CGT asset?
- As a result of the change or extinguishment of these rights, is there more than one CGT asset that needs to be considered?
- As a result of the change, has there been the occurrence of a CGT event – such as CGT event C2 (taxpayer's ownership of an intangible CGT asset ends because it has been redeemed/satisfied/surrendered) or D1 (taxpayer creates contractual or other legal/equitable rights in another entity)?
- If more than one CGT has occurred, what is the most specific event?
- What is the cost base of the relevant CGT asset just prior to the CGT event?
- What are the capital proceeds on disposal of the CGT asset as a result of the CGT event?
- As a result of disposal of the CGT asset, has there been any capital gain?
- Any CGT implications for the trustee as a result of disposal of the CGT asset?

4. Assignment of loan accounts and UPEs

4.1 An assignment or effectual transfer of a loan account or UPE could be made:

4.1.1 to effect a gift;
4.1.2 by repayment in order to set off against a debit loan in the trust in which the assignor has the UPE; or

4.1.3 in consideration of the transfer of an asset or payment of money.

4.2 A UPE is created upon the trustee of a trust making a determination, pursuant to the terms of the relevant trust deed, to appoint (distribute) income or capital to a beneficiary of the trust.

4.3 Most usually upon the creation of a UPE the beneficiary in whose favour it has been created will have an immediate right to call upon the trustee of the trust, in which the UPE then exists, to pay the UPE in part or in full.

4.4 A UPE, being a right held by a beneficiary of a trust to call for immediate payment of a specific amount, will be enforceable in equity and is proprietary in nature. Accordingly it will be a CGT asset.[28]

4.5 When a beneficiary becomes presently entitled to a share of income of a trust estate, a UPE comes into existence, at which point CGT event D1 occurs.[29]

4.6 Most commonly a UPE is satisfied or discharged by payment from the trustee. Upon satisfaction or discharge of a UPE by payment, will CGT even C2 occur? For CGT event C2 to occur all that is necessary is that the ownership of the asset by the taxpayer is at an end. It would seem therefore that upon the discharge of a chose in action (such as a UPE) by payment, CGT event C2 will occur.

4.7 In Private Rulings, the Commissioner has expressed the view that it is appropriate to look-through the legal rights incidentally created pursuant to the UPE and either discharged or satisfied when the legal rights so created are facilitating what is the ‘real’ transaction, being the distribution of income from a trust to a beneficiary.[30] The Commissioner finds support for this view in the Full Federal Court decision of *Dulux Holdings.*[31] In this case, the Court found a discharge of a chose in action by performance of a contract was not a disposal ‘under a contract’ for the purposes of the then section 160U of the ITAA 1936. In relation to a UPE, on its creation, CGT event D1 occurs. When the UPE is discharged, satisfied or ends, CGT event C2 occurs. The look-through approach validated by the Commissioner would look-through the legal rights incidentally created or discharged by the discharge/satisfaction/ending of the UPE to the real transaction, being the distribution of income from the trust to the beneficiary.[32]

4.8 It is also not uncommon for a UPE to be effectively disposed of by conversion to a loan by agreement between the beneficiary entitled to the UPE and the trustee of the trust in which it has been created. It is a fundamental premise for a loan to be made that there must be an advance of money.

4.9 For the process of the conversion of a UPE to a loan to occur there must be an advance or deemed advance of the amount of the loan from the beneficiary to the trustee. The steps for such a conversion are as follows:

4.9.1 The beneficiary disposes of the UPE in consideration of the amount of the UPE in full. From a CGT perspective, this disposal will either trigger CGT event A1 or C2; and

4.9.2 The beneficiary then advances the amount of the loan to the trustee; or

4.9.3 The UPE is satisfied or discharged by the conversion being effected in form of an acknowledgement of a debt by the trustee in favour of the beneficiary for an amount equal to the amount of the UPE.

4.10 These transactions can be effected under a written or oral agreement between the beneficiary and the trustee (including where relevant an acknowledgement by the trustee). Journal entries should then be made in the financial accounts of the trust to correctly reflect the transactions.

4.11 Clearly though in the case of an assignment of a UPE, it is the Commissioner’s view, CGT event A1 occurs as it cannot be said that any such assignment was to facilitate the distribution

[28] subsection 108-5(1), ITAA 1997
[29] section 104-35, ITAA 1997
[30] ATO Private Rulings Number 1012648073225; 1012571177732
[31] *FC of T v Dulux Holdings Pty Ltd & Orica Ltd* [2001] FCA 1344
[32] ATO Private Ruling Number 1012648073225

of income from the trustee to a beneficiary.[33] Subject to compliance with the relevant legislation in each jurisdiction it is possible for a legal owner of an equitable interest to make a complete and perfect gift of that interest. For example, the Victorian *Property Law Act 1958* provides an assignment of a chose in action must be made absolutely and in writing and involve the transfer of all rights of the assignor in the chose in action.[34] As such, in the author's view, the Commissioner's view is correct on the basis that CGT event A1 requires there to be a change of legal ownership of the asset, including the beneficial ownership. A valid statutory assignment of a UPE would trigger CGT event A1.[35]

4.12 When quantifying CGT, the first question for consideration, upon the discharge of a UPE by payment from the trustee or release or surrender by the beneficiary (in which event CGT event C2 will happen) or assignment by the beneficiary (in which event CGT event A1 will happen), what is the cost base of the UPE?

4.13 The first element of the cost base is the total of the money paid (or required to be paid) and the market value of any other property you gave (or are required to give) in acquiring the CGT asset.[36]

4.14 In relation to this issue, the Commissioner takes the view that as prior to the creation of the UPE the beneficiary never had any legal right to payment of the amount of the UPE against the trustee, the UPE not being a debt. The amount of the UPE cannot be said to have been given (or required to be paid) to the trustee, by the beneficiary, to acquire the equitable right to demand and receive payment.[37] Upon a beneficiary becoming presently entitled to an amount from a trust estate, they will have an equitable right to that amount but not, without more, as a result of any debtor-creditor relationship.[38] As referred to later, the rights arising under a present entitlement could, in certain circumstances, crystallise into an equitable debt (such as, in the case of a UPE, the beneficiary calls for payment of their entitlement) but the right that comes into existence on creation of the present entitlement is not a debt.[39]

4.15 Under the market value substitution rule if you do not incur any expenditure to acquire a CGT asset, the first element of the cost base of the asset will be its market value. Except where CGT event D1 occurs or the acquisition results from another entity doing something that did not constitute a CGT event occurring.[40] CGT event D1 occurs upon the creation of a UPE and accordingly its market value will not be substituted as the first element of the cost base. The cost base of the UPE will only comprise any expenditure incurred by the beneficiary in whose favour it has been created. A further exception to the market value substitution rule may apply to the assignment of the UPE having been made without payment (or the giving of anything) and the right not having been acquired by way of any assignment from another entity.[41]

4.16 The capital proceeds from a CGT event are the total of the money a person received (or is entitled to receive) in respect of the event happening and the market value of the other property the person received (or is entitled to receive) in respect of the event happening.[42] Where there is no consideration for the assignment of a UPE the assignor will be taken to have received the market value of the CGT asset that is the subject of the assignment.[43]

4.17 Usually, the market value of a UPE at the time of a CGT event in respect of it will be the face value of the UPE. However where the UPE comprises an interest in specific assets of the trust (for example where funds specifically held for the beneficiary entitled to the UPE have been applied or invested by the trustee for the for the benefit of the beneficiary) the market value of the UPE may be more than its amount on creation.[44] In this instance, it is necessary to consider whether CGT event E5 happens. CGT event E5 occurs if a beneficiary of a trust

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[33] ATO Private Ruling Number 1012571177732
[34] Section 134, Property Law Act (Vic)
[35] Subsection 104-10(2), ITAA 1997
[36] Subsection 110-25(2), ITAA 1997
[37] ATO Private Ruling Number 1012571177732; 1012557133149
[38] Taxation Ruling, TR 2010/3 at para [34]
[39] *Commissioner of Inland Revenue v Ward* (1969 1 ATR 287 at 313
[40] Subsections 112-20(1)(a), (a)(i), (a)(ii) ITAA 1997
[41] Item 1, subsection 112-20(3), ITAA 1997; ATO Private Ruling Number 101257177732
[42] Subsection 116-20(1), ITAA 1997
[43] Subsection 116-30(1), ITAA 1997
[44] ATO Private Ruling Number 1012571177732

becomes absolutely entitled to an asset of the trust as against the trustee of the trust.[45] Once a beneficiary becomes absolutely entitled to an asset against a trustee, the asset will be treated as an asset of the beneficiary and all acts of the trustee were acts of the beneficiary.[46] This means, for example, any subsequent distribution to the beneficiary would not have CGT consequences.

4.18 Section 118-20 of the ITAA 1997 seeks to prevent double taxation by reducing the capital gain a taxpayer makes from a CGT event, if because of the event an amount is included in their assessable income or exempt income in any income year.[47] This section operates to reduce a capital gain made from a CGT event by an amount included in the assessable income or exempt income of a taxpayer in relation to a CGT asset as if the amount were so included. This is because the CGT event would also be taken into account in working out the amount of a capital gain made by the taxpayer.[48]

4.19 In relation to UPEs, section 118-20 will apply to the extent that, in respect of an assignment of a UPE, an amount has been included in the assessable income of the assignor beneficiary. Therefore, any capital gain made by the beneficiary upon the waiver or assignment of that UPE will be reduced by those amounts that may have been included in the beneficiary's assessable income under section 118-20 on the UPE's creation.[49]

4.20 Where no amount was included in the taxpayer's assessable income as a result of the creation of a UPE, such as the UPE arising from the distribution of a non-assessable amount of capital to the beneficiary for no consideration, then section 118-20 will have no application.

What are the CGT implications if a beneficiary waives or forgives a trustee's obligation to pay a UPE?

4.21 Although outside the scope of this paper, whilst a UPE as an equitable obligation does not constitute a debt under common law, the Commissioner has expressed the view that the release of the obligation to pay a UPE to a distribution from the income of a trust may be considered a payment under section 109C of the ITAA 1997. Thereby being a 'financial benefit' to an entity and a deemed dividend under Division 7A.[50] Needless to say, this view is contentious.

Does Division 245 have potential application to treat the waiver or forgiveness of an amount of a UPE to be a forgiven debt for the purposes of the Division?

4.22 Section 245-1 of ITAA 1997 treats a creditor who forgives a commercial debt as having made a gain. As a result, the Division offsets the forgiven debt amount against the amounts that could otherwise reduce your taxable income or later income years including tax losses or net capital losses, capital allowances and similar deductions and the cost base of CGT assets.[51]

4.23 However, this is dependent upon whether the UPE is, in fact, a debt. It is an equitable debt but not a debt under common law. As a result, any release by a beneficiary of their equitable right to the UPE will not be a forgiveness of a debt by that beneficiary. Division 245 will not apply.

4.24 What if the trustee is unable to pay a distribution to a corporate beneficiary which remains a UPE? How is a beneficiary, who may otherwise have been originally assessable in relation to the trust distribution under section 97 of the ITAA 1997, to treat the non-payment of this amount?

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[45] Subsection 104-75(1), ITAA 1997
[46] Section 106-50, ITAA 1997
[47] Section 118-20, ITAA 1997
[48] Subsection 118-20(1A), ITAA 1997
[49] ATO Private Ruling Number 1012571177732
[50] Sections 109C, 109F, ITAA 1997; Draft Taxation Determination, TD 2015/D4 (Note: since the writing and presentation of this article, TD 2015/D4 has now been finalised and released by the ATO as TD 2015/20); see also, Taxation Ruling, TR 2010/3 at paras [95] – [106]
[51] Section 245-105, ITAA 1997

4.25 Subsection 25-35 of the ITAA 1997 provides:

> "*You can deduct a debt (or part of a debt) that you write off as bad in the income year if:*
> *(a) it was included in your assessable income for the income year or for an earlier income year; or*
> *(b) it is in respect of money that you lent in the ordinary course of your *business of lending money*."

4.26 The Commissioner has published a draft view[52] setting out the position that a beneficiary in this situation is not entitled to a deduction under section 25-35 for the UPE for the amount of the entitlement is not included in the beneficiary's income, rather it is used to determine the amount, if any, of the net income of the trust.[53] The Commissioner's rationale is the UPE is not included in the assessable income of the beneficiary but rather the beneficiary is assessed on the amount of their entitlement; that is the amount of their share of the income of the estate to which the beneficiary is presently entitled.[54]

4.27 The position on the application of section 25-35 of the ITAA 1997 to a beneficiary who has written off a UPE was considered in the Administrative Appeals Tribunal (**AAT**) decision in *Pope.*[55] In *Pope*, the Commissioner argued that whilst the amount written off by the taxpayer was a debt that it was not the UPE. Rather, it was the outstanding balance owed to the taxpayer by way of the balance of a loan account in his favour which therefore had an entirely different character to the money included in his assessable income for the relevant period and thereby was not deductible under section 25-35. In this case, the AAT agreed with the Commissioner's argument, finding:

> "…*What, relevantly, was included in Mr Pope's assessable income in those years had as its source the share of the trust income to which he became presently entitled. What was written off was of an entirely different character; it was an investment Mr Pope chose to make in the business of the Trust*."[56]

Where does this leave a beneficiary with an UPE that cannot be paid by the trustee of a trust?

4.28 Upon the waiver of a debt by a beneficiary in favour of the trustee where no consideration is received for the waiver, the beneficiary will be taken to have received an amount equal to the market value of the debt at the time of its disposal.[57] For CGT purposes, in these circumstances, the trustee of the trust is considered to not have an asset and therefore when the beneficiary waives the debt, the trustee of the trust does not dispose of an asset and does not make either a capital gain or capital loss.[58]

4.29 The amount of a loan account, being a chose in action comprising an account recording the granting of a loan and the credit to and debit from that account (**Loan**), is clearly a CGT asset.[59] Where a CGT asset is disposed of, CGT event A1 will happen. Where a CGT asset is transferred to an existing trust, CGT E2 will happen.[60] As to which event would be the most specific where a loan account is assigned would need to be considered in light of the relevant circumstances[61]. Where the trustee assigns those debts owed to them to another trust and that trust is connected to the first trust and the parties are not dealing with each other at arm's length the Commissioner's view is the most specific CGT event would be CGT event E2 and not CGT event A1.[62]

4.30 Where no capital proceeds are received in respect of a CGT event then the taxpayer is taken to

[52] TD 2015/D5
[53] TD 2015/D5, para [1]
[54] TD 2015/D5, paras [12] – [13]
[55] *Pope v FCT* [2014] AATA 532
[56] *Pope*, at para [20]
[57] TD 2
[58] TD 3
[59] Section 108-5, ITAA 1997
[60] Subsections 104-10(1), 104-60(2), ITAA 1997
[61] Subsection 102-25(1), ITAA 1997
[62] ATO Private Ruling Number 1012648073225; *Healy v FCT* [2012] FCA 269

have received the market value of the CGT asset the subject of the event.[63] The market value of a loan account to be assigned would be the amount of principal payable at the time of the assignment. The cost base of a loan account will generally be the amount of the loan.[64] This would be the amount of the principal due under each Loan to the trustee. The capital gain on the assignment of a loan account would be the sum received, or to be received, in respect of the outstanding loan.[65]

4.31 In considering the assignment of a loan account, care should also be taken in relation to circumstances where the rate of interest of a loan is at a premium or discount compared to the market rate for the relevant loan. The result, the capital proceeds of the assigned loan account may be more than the face value of the sum received, or to be received in respect of the outstanding loan and thereby increase or reduce any potential capital gains.

5. CGT event C2 – when taxpayer's ownership of an intangible asset ends

5.1 CGT event C2 occurs, as follows:[66]

> "(1) ***CGT event C2*** *happens if your ownership of an intangible CGT asset ends by the asset:*
> - *(a) being redeemed or cancelled; or*
> - *(b) being released, discharged or satisfied; or*
> - *(c) expiring; or*
> - *(d) being abandoned, surrendered or forfeited; or*
> - *(e) if the asset is an option – being exercised; or*
> - *(f) if the asset is a convertible interest – being converted.*
>
> *(2) The time of the event is:*
> - *(a) when you enter into the contract that results in the asset ending; or*
> - *(b) if there is no contract – when the asset ends.*
>
> *(3) You make a **capital gain** if the capital proceeds from the ending are more than the asset's cost base. You make a **capital loss** if those capital proceeds are less than the asset's reduced cost base."*

5.2 CGT event C2 only occurs in relation to the ending of ownership of an 'intangible CGT asset'. As CGT event C2 occurs when a CGT asset effectively comes to an end there is no acquisition by another person at that time. Of significance will be the timing of when a person's ownership of the CGT asset has ended and whether that will result in the crystallisation of a capital loss or a capital gain. Where a beneficiary's interest in a UPE ends, such as by assignment of the UPE to another party or the amount of a UPE being paid, CGT event C2 may occur.

5.3 In the view of the Commissioner the renunciation by a beneficiary of an interest in a discretionary trust, being a CGT asset, would give rise to a CGT event C2 as the beneficiary is abandoning, surrendering or forfeiting their interest within the meaning of subsection 104-25(1)(d) of the ITAA 1997. However the Commissioner also notes renunciation by a beneficiary, who has no interest in either the assets or the income of the trust, of their interest in a discretionary trust prior to the exercise of any discretion by the trustee, would likely result in nil capital gain because the cost base of such an interest is likely to be nil. Also the market value of the interest at the time of the renunciation would also generally be nil.[67]

5.4 If a beneficiary has an interest in either the assets or the income of the trust either before or after the trustee's exercise of any discretion whilst the cost base of the interest is still likely to be nil at the time of renunciation the capital proceeds (the market value of the interest) may result in a capital gain. For beneficiaries whose interests comprise an entitlement to a share of

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[63] Subsection 116-30(1), ITAA 1997; TD 2
[64] Subsection 110-25(2), ITAA 1997
[65] Subsection 110-25(2), ITAA 1997
[66] Section 104-25, ITAA 1997
[67] section 116-30, ITAA 1997; TD 2001/26

the assets of a trust on default of appointment (for example prior to the vesting date of the trust), the market value, at the time of the renunciation would necessarily be ascertained. If the default interest did have a market value in excess of its cost base, on renunciation a capital gain would arise.[68]

But to the extent the default interest related to the income of the trust on renunciation section 118-20 of the ITAA 1997 may protect the beneficiary entitled to the default interest from CGT by negating any capital gain that would otherwise be made. Section 118-20 would only afford protection in respect of a default interest in the capital of a trust to the extent the amount of the default interest was included in the assessable income of the beneficiary.

5.5 In Private Rulings, the Commissioner has expressed the view that rather than relying upon section 118-20 to prevent double taxation of trust distributions that the 'look-through' approach be applied. As discussed previously in this paper (in relation to the application of *Dulux*), this approach is to look-through CGT event C2 (and any capital gain that may result) to determine whether rights have been incidentally discharged or satisfied to merely facilitate the distribution of income from the trustee to the beneficiary.[69]

6. CGT event D1 – when a taxpayer creates a contractual or other legal right in an entity

6.1 CGT event D1 occurs:[70]

> "*(1)* ***CGT event D1*** *happens if you create a contractual right or other legal or equitable right in another entity*."
>
> *(2) The time of the event is when you enter into the contract or create the other right.*
>
> *(3) You make a* ***capital gain*** *if the capital proceeds from creating the right are more than the incidental costs you incurred that relate to the event. You make a capital loss if those capital proceeds are less*…"

6.2 CGT event D1 may occur whenever contractual or other rights of the kind specified in section 104-35 of the ITAA 1997 are created even where the rights form part of a larger agreement. This would potentially necessitate for each particular right that has been created to be considered and dealt with separately. Often, there may be difficulty in assessing what (if any) value is attributable to specific rights. For there to be a capital gain, the capital proceeds relating to the creation of the specific right must be more than the incidental costs incurred in relation to the relevant CGT event. To reiterate, a taxpayer will make a capital gain under CGT event D1 where the capital proceeds from creating the right are more than the incidental costs incurred in relation to its creation.[71]

6.3 There are a number of exemptions where CGT event D1 does not happen, including where the right/s require a person to do something that is another CGT event that happens to them (subsection 104-35(5)(b), ITAA 1997).

6.4 When selling a business, it may be that a number of different rights are disposed of, including goodwill. A CGT asset may include goodwill or an interest in goodwill.[72] When used in relation to the CGT regime under the ITAA 1997, 'goodwill' has the meaning it bears under general law. It is the legal definition of 'goodwill' rather than its accounting and business definition which applies.[73]

What implications does this have for restructuring of a trust or control of its assets, including business assets?

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[68] Subsection 116-30(3), ITAA 1997
[69] ATO Private Rulings Number 1012571177732; 1012648073225
[70] Section 104-35, ITAA 1997
[71] subsection 104-35(3), ITAA 1997
[72] subsection 108-5(2), ITAA 1997
[73] *FC of T v Murry* [1998] HCA 42 at paras [12] – [22]

6.5 It may provide for an opportunity for a taxpayer to transfer business operations into a new entity without triggering any CGT consequences but also offering asset protection benefits for the entity that owns the asset/s to grant a licence to the new entity to operate the business.

6.6 The Commissioner has accepted the position that it is possible to licence goodwill in a business. Whilst CGT event D1 would happen on creation of the contractual rights under any licence, where the taxpayer does not receive or is not entitled to receive any money as a result of CGT event D1 occurring, a capital gain would not result from the grant of the licence.[74]

6.7 The new entity may be entitled to future income for the term of any licence (and therefore property for the purpose of the CGT regime)[75] however any such property received will not be in respect of CGT event D1.[76]

6.8 Under the licence the licensor would continue to hold legal ownership of the licensed asset and the licensee would conduct the day-to-day operations of the business and be entitled to its profit without a CGT liability being incurred. A further benefit is the grant of a licence to conduct/operate a business may well preserve the pre-CGT status of the goodwill of the business.

7. Promising never to make a claim and disclaimers – is this tax effective?

Promises to never make a claim

7.1 A beneficiary(s) of a trust may execute a deed of release and indemnity as a way of releasing the trustee from all claims, actions, proceedings, accounts, costs, damages, entitlements, demands and other amounts whatsoever that they may be entitled to as against the trustee and in respect of the administration of the trust. This could include a disclaimer from trust distributions.

Why would a disclaimer be implemented?

7.2 A beneficiary of a trust may wish to disclaim their interest in the trust for:

7.2.1 personal or family reasons (acceptance of a distribution might trigger a family dispute);
7.2.2 possible bankruptcy concerns; and
7.2.3 relationship breakdown concerns.

7.3 There may also be financial reasons for wishing to disclaim an interest in a trust, including ensuring an unwanted capital gain is not derived. If there are unwanted capital gains tax outcomes of receiving a gift from an inter vivos discretionary trust, for example, a beneficiary may wish to disclaim their interest. The Full Federal Court decision of *Ramsden,*[77] a landmark decision in relation to disclaimers, looked at whether a group of beneficiaries to a trust had successfully disclaimed their interests to the extent that they were able to avoid income tax liability for the receipt of income from the trust in a particular income year.

7.4 Where a CGT asset owned by a deceased just before dying devolves to the deceased's legal personal representative or passes to the deceased's estate, any capital gain or capital loss made by the legal personal representative is disregarded.[78] In this regard, the Commissioner has a long-standing administrative practice of treating a trustee of a testamentary trust in the same way as a legal personal representative is treated for the purpose of Division 128 of the ITAA 1997.[79]

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[74] Subsection 116-30(3), ITAA 1997
[75] Subsection 116-20(1)(b), ITAA 1997
[76] ATO ID 2003/517
[77] *Federal Commissioner of Taxation v Ramsden* [2005] FCAFC 39
[78] Subsection 128-15(3), ITAA 1997
[79] And in particular, subsection 128-15(3), ITAA 1997; PS LA 2003/12

Ramsden's case and the validity of disclaimers

7.5 Upon being informed of an entitlement to any part of the income of a trust, a beneficiary may wish to disclaim that entitlement.

7.6 Notwithstanding that it is helpful to formalise a disclaimer in a written document, it is not compulsory to do so. Any disclaimer of an interest in a trust by a beneficiary must be made to the trustee of that trust. For a disclaimer to be valid, it must be supported by some evidence that the beneficiary is disclaiming their interest. Silence or otherwise passive behaviour will not suffice.[80]

7.7 In the seminal High Court decision of *Cornell*, Latham CJ noted the following:[81]

> "*A devise, however, being prima facie for the devisee's benefit, he is supposed to assent to it, until he does some act to show his dissent. The law presumes that he will assent until the contrary be proved; when the contrary, however, is proved, it shows that he never did assent to the devise, and, consequently, that the estate never was in him*."

7.8 A crucial aspect of *Ramsden* was the determination that any gift disclaimed by a trust beneficiary must be of the gift in its entirety. The four applicants in *Ramsden* were the default beneficiaries of the Steve Hart Family Trust (**SHFT**), a discretionary trust. From the minutes of a meeting of directors of the trustee company, the trustee purportedly distributed an amount of $429,000 to a trust known as the Adcock Practice Trust during the financial year ending 30 June 1996. It was held, however, that the Adcock Practice Trust did not fall into the category of a beneficiary of the SHFT for that financial year, nor could it be appointed as a beneficiary. With the distribution failing, it was the view of the Commissioner of Taxation that the amount of $429,000 had been distributed to the default beneficiaries (split four ways, $107,250 each).

7.9 The issue for the court was whether disclaimers entered into by the default beneficiaries a number of years after receiving the assessments from the ATO were effective in validly disclaiming the distributions. Ultimately, it was held that they were not.

7.10 The issue was not that the disclaimers were retrospective. In *Ramsden*, Lee, Merkel and Hely JJ stated the following:[82]

> "*Until disclaimer, a beneficiary's entitlement to income under a trust is operative for the purposes of s 97 of ITAA from the moment it arises notwithstanding that the beneficiary has no knowledge of it (Federal Commissioner of Taxation v Vegners (1989) 89 ATC 5274; (1991) 91 ATC 4213 at 4215). A beneficiary may disclaim an entitlement on its coming to his or her knowledge. At law an effective disclaimer operates retrospectively, and not merely from the time of disclaimer*."

7.11 The Commissioner has accepted the retrospective operation of a valid disclaimer:[83]

> "*If a discretionary beneficiary repudiates a benefit of the trust when he or she becomes aware of his or her entitlement, such a disclaimer would have a retroactive effect and the transfer of property would be void ab initio. The trust probably revests in the trustee and, in effect, it never passes from the trustee*".

7.12 The failure of the disclaimers in *Ramsden* was due essentially to two factors: one, that the disclaimers had purported to only disclaim part of the distribution, and two, because the disclaimers had not, within a reasonable time of becoming aware of the distribution, disclaimed it.

7.13 The default beneficiaries in *Ramsden* attempted to disclaim only the entitlement resulting from the failed distribution to the Adcock Practice Trust in the income year ending 30 June 1996, in lieu of the whole distribution. In general terms, the nature of a gift given to a trust beneficiary

[80] *Townson v Tickell* (1819) 106 ER 575.
[81] *Federal Commissioner of Taxation v Cornell* (1946) 73 CLR 394 at 401
[82] *Ramsden*, at para [30]
[83] Taxation Ruling IT 2651, particularly at para [12]

will depend on the way the trust deed is termed. In *Ramsden*, the court was able to distinguish between the entitlements received by default and by discretionary beneficiaries pursuant to provisions of the trust deed. The interest of a default beneficiary in the trust was to be characterised as a single entitlement, whereas each distribution of trust income to a discretionary beneficiary in any given accounting year was to be deemed a separate and discrete entitlement. This meant that any disclaimer by a default beneficiary of the trust had to be of the interest in the trust in its entirety, meaning that the claimants in *Ramsden* could not effectively disclaim only their interest in the income of the trust for the income year ended 30 June 1996.[84]

7.14 From Ramsden the CGT benefit to a beneficiary disclaiming their (whole) interest in a discretionary trust is that at law, the beneficiary is treated as if they had never held the interest disclaimed at all, for any successful disclaimer acts retrospectively. Therefore, where there is a disclaimer of a beneficiary's interest, any value otherwise attributable to that interest would be nil as it would be treated as never having existed.

7.15 Further, any disclaimer must be prompt to ensure validity. In Ramsden the disclaimers were not made for a number of years, and the court described the period between the receipt of the ATO's notices and the disclaimers as being "well in excess of a reasonable period".[85] Any beneficiaries wishing to disclaim an entitlement resulting from a distribution from a trust should therefore do so as practicable after they have become aware of the entitlement being created.

8. Removing beneficiaries as discretionary objects – tax position explained

8.1 By definition, a discretionary trust is a trust with a special power of appointment, being that the beneficiaries are not determined at the moment of creation of the trust, but only upon each occasion that the trustee in its absolute discretion exercises the special powers.

8.2 Arguably therefore a discretionary trust does not have "beneficiaries" in the traditional sense, the term 'beneficiary' defined in the context of a beneficiary whose interests together aggregate the beneficial ownership of the trust property. A discretionary trust usually provides for a class of persons, described in wide terms, who are the objects of a power to appoint either income or corpus or both to selected members of the class.

8.3 What then are the rights of a beneficiary under a discretionary trust?

Do these objects of powers have any rights?

8.4 Beneficiaries of a discretionary trust do not have a proprietary legal or equitable interest in the trust fund. They do not have any beneficial interest in rights the trust property, and they are not persons for whose benefit the trust property is held by the trustee. At the highest they are members of a class of persons for the benefit of some one or more of whom the trustee may in due course hold property if it so determines.[86] They are also *potential* beneficiaries. In terms accepted by French CJ in the High Court decision of *Spry*:[87]

> "*no object of such a trust has any fixed or vested entitlement, and the trustee is not obliged to distribute to anyone; the default distribution gives the default beneficiary no more than a contingent remainder*."

8.5 And in the words of Gummow and Hayne JJ in the same case:[88]

> "*the word 'beneficiary' is inapt insofar as it suggests the existence of any beneficial interest; such a person is 'an eligible object' of the trust*."

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[84] This judgment followed the similar conclusion reached in the case of *Case X30* (1990) 90 ATC 287.
[85] *Federal Commissioner of Taxation v Ramsden* [2005] FCAFC 39 [60].
[86] *Ramsden* at para 36
[87] *Kennon v Spry* (2008) 238 CLR 366 at 389
[88] *Spry* at 408

8.6 In relation to a discretionary beneficiary renouncing their interest in a trust, the applicable CGT event is CGT event C2.

8.7 The Commissioner is of the view[89] that a renunciation by a beneficiary of an interest in a discretionary trust (the interest being a CGT asset) would give rise to CGT event C2 for the beneficiary because it is an abandonment, surrender or forfeiture of the interest.

8.8 In these circumstances however, any capital gain the beneficiary makes from the renunciation of an interest acquired on or after 20 September 1985 is likely to be nil because its cost base is likely to be nil and the market value of the interest at the time of the renunciation would generally be nil.[90]

8.9 This position differs if the beneficiary of a discretionary trust has an interest in either the assets or the income of the trust before or after the exercise of any discretion by the trustee (for example, where a specific interest, such as a UPE, is created in the trust for the benefit of a beneficiary).

8.10 In these circumstances, a capital gain is more likely to be made by the beneficiary because the cost base of the interest is likely to be nil and the interest at the time of the renunciation may have some value. It is the Commissioner's view that this question should be considered on a case by case basis. The answer will be dependent upon the terms of the particular trust,its purpose and the past history of distributions made by the trustee in favour of the default beneficiary, etc.[91] As noted earlier, a beneficiary of a discretionary trust only holds an equitable right to due administration of the trust by the trustee and to be considered by the trustee as a potential object of distributions of income or capital under powers which the trustee may exercise in relation to the trust.[92]

8.11 In TD 2001/26 the Commissioner expresses the view that a renunciation by a discretionary beneficiary of their interest in a discretionary trust would not normally have any CGT consequences for the trustee or the trust. However, it is important to note that an amendment to the trust deed to exclude a beneficiary from the discretionary trust, may result in the creation of a new trust with the flow on consequences in relation to CGT event E1 being triggered.[93]

8.12 Further in the view of the Commissioner CGT event E4 does not occur if a trustee of a discretionary trust makes a payment of a non-assessable amount to a mere object (discretionary beneficiary) in respect of their interest in the trust. Nor does it happen in respect of a default beneficiary (as discussed above) if the interest was not acquired for consideration or by way of assignment.[94]

8.13 This is because a mere object or default beneficiary is not considered to have an "interest in the trust" of the nature or character required under subsection 104-70(a) of the ITAA 1997.[95] The meaning to be given to the words "interest in the trust" depends on the context in which they are used. Generally, the interest in the trust is one that is akin to the interest that a unit holder has in a unit trust. The interest that is contemplated is one in which a taxpayer invests.[96]

9. Reimbursement agreements and s100A tax issues

9.1 Section 100A of the ITAA 1936 is an anti-avoidance measure under which the assessable income of the trustee of a trust will include certain net income of the trust to which by application of the section no beneficiary or beneficiaries of the trust are treated as being presently entitled. Where section 100A is found to apply, sections 99 and 99A of the ITAA 1936 operate to assess the trustee of the trust to tax on that income.

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[89] Taxation Determination, TD 2001/26
[90] TD 2001/26 at para 2.
[91] TD 2001/26 at para 2, 4
[92] *Gartside*
[93] TD 2001/26 para 13; *Clark*
[94] Taxation Determination, TD 2003/28 paras 1(a), (b).
[95] TD 2003/28 para 3
[96] TD 2003/28 para 4.

9.2 The policy intent of section 100A is to avoid the income of a trust being streamed to a taxpayer in an attempt to reduce the tax that would otherwise be payable on that income.

9.3 A reimbursement agreement is defined broadly to include any agreement, arrangement or understanding, either, formal or informal, express or implied, but does not include an agreement, arrangement or understanding entered into in the course of ordinary family or commercial dealings.[97]

9.4 To be a reimbursement agreement, the agreement must be entered into for the purpose, or for purposes that include securing that any person not be liable or be liable for a reduced amount of income tax.[98]

9.5 The potential breadth of section 100A of the ITAA 1936 is illustrated by the Full Federal Court decision of *Presige Motors.*[99] In this case, a profitable business owned by a company was sold to a trust in the same group. An unrelated company, which was insolvent with significant tax losses was later appointed as a beneficiary of the trust. The group acquired the loans made to this unrelated company via a Singaporean based entity. The unrelated entity claimed a deduction for interest payable on the loans. The nature of the arrangement enabled the trust to pay significantly less tax than would otherwise have been the case by way of offsetting income distributions from the trust against the carry forward losses and interest on the loans. Units in the trust were then issued to the Singaporean based entity without income tax. In this case, the court found that section 100A did have application and the trustee was assessable to tax under section 99A of the ITAA 1936.

9.6 In considering the restructure of a trust, the Commissioner has, and may, seek to apply section 100A to longstanding UPEs. For example where a UPE has been created in favour of a person, the amount of the UPE has been retained in the trust and then subsequently at the request of the trustee it has been paid to another person, such as a person with a higher marginal tax rate being a relative of the person in favour of whom the UPE has never been created.

9.7 In any trust restructure involving family groups and the possible application of section 100A, it is important to consider whether the ordinary family or commercial dealing exception would apply. *Prestige Motors* also considered the nature and extent of this test, considering the application of this test the court said the following:[100]

> "*The wording of the exclusion in s 100A(13) derives from the judgment of Lord Denning, on behalf of the Privy Council, in Newton & Ors v FC of T (1958) 11 ATD 442 at 445; (1958) 98 CLR 1 at 8. There his Lordship, in discussing s 260 of the ITAA, contrasted an arrangement implemented in a particular way to avoid tax with ``transactions that are capable of explanation by reference to ordinary business or family dealing''.*
>
> *There is a danger that, when words used in a judgment are translated into the legislation, the change of context may alter the meaning of the words from that which they originally bore. It is clear from both the judgment of the Privy Council and from the language of the High Court on the same case (FC of T v Newton (1957) 96 CLR 578) that s 260 was regarded as involving a dichotomy. A transaction was either stamped as one entered into to avoid tax or as one about which it could be predicted that it was entered into in the course of ordinary family or commercial dealing. In the former case the transaction was caught by s 260; in the latter case it was outside the section. We do not need to decide in the present case whether s 100A imports a similar dichotomy. In particular we do not need to decide whether if an agreement is shown to have been ``entered into in the course of ordinary commercial dealing'', the operation of s 100A is spent, regardless of whether the commercial purpose was subsidiary to the purpose of tax avoidance. In our view, none of the transactions was entered into in the course of ordinary commercial dealing.*

[97] Subsection 100A(13), ITAA 1936
[98] Subsection 100A(8), ITAA 1936
[99] *FC of T v Prestige Motors Pty Limited as trustee of the Prestige Toyota Trust* (1998) 98 ATC 4241
[100] *Prestige Motors* at 4262

We have already referred to Prestige's submission that the reimbursement agreement relating to the RLAV transaction was entered into in the course of ordinary commercial dealing. Mr Bloom contended that the agreement should be seen, for the purpose of s 100A of the ITAA, as no more than an agreement for the transfer of the Business from Perron Investments to LSP, as the original trustee of the new trust. If the agreement went no further than this, it might well be characterised as an ordinary family or commercial dealing. But the difficulty with Prestige's submission has already been identified. It focuses on one element in the RLAV transaction, namely, the sale of the Business by Prestige to LSP as trustee of the Trust. But the reimbursement agreement contemplated, inter alia, that LSP would be replaced as trustee by Prestige, which would carry on the Business in its new capacity; that units in the Trust would be issued to RLAV; that distributions of Trust income would be made to RLAV; that those distributions would be partly offset against tax losses and partly used to pay interest to Cholmondeley (with some moneys being paid to Century Finance); and that Cholmondeley would act in accordance with the wishes of the Perron interests. The transaction, or series of transactions, contemplated by the agreement was very different from a straightforward sale of a business by one entity within a group to another."

9.8 In *Prestige Motors*, the court draws a clear distinction in considering the purpose of the alleged reimbursement agreement; whether it was entered into in order to avoid tax or in the course of ordinary family or commercial dealings. If the purpose of the agreement was the latter then arguably it would not fit within the definition of 'reimbursement agreement' for the purpose of section 100A.

9.9 Where a family group operating various businesses and investments through different entities is seeking to restructure the ownership of the assets of a trust within the group. It is difficult to envisage in what circumstances section 100A could be found to have application if from the relevant evidence it was clear the intention was to do no more than implement the restructure.

10. Changing trustee or appointor – tax impact

Change of Trustee

10.1 Only a legal person can owe a debt and be sued for it. A trust is not a legal person, it is a fiduciary relationship subject to which property is held. It is the trustee of a trust, being a legal person that can incur legal obligations such as debts and other liabilities for the purposes of the trust. Therefore for tax purposes, it is the trustees who are personally liable for tax debts assessed to them on behalf of a trust.[101]

10.2 Generally, a change in trustee does not incur a potential taxation liability. Section 104-10 ITAA 1997 provides:

"*(1) CGT event A1 happens if you *dispose of a *CGT asset.*
*(2) You dispose of a *CGT asset if a change of ownership occurs from you to another entity, whether because of some act or event or by operation of law. However, a change of ownership does not occur if you stop being the legal owner of the asset but continue to be its beneficial owner.*

Note: a change in the trustee of a trust does not constitute a change in the entity that is the trustee of the trust (see subsection 960-100(2)). This means that CGT event A1 will not happen merely because of a change in the trustee."

10.3 Therefore when the assets of a trust are transferred from a retiring or removed trustee to a new trustee, because the change of trustee does not result in a change in beneficial ownership only in legal ownership, there would not be any CGT implications from the change.

10.4 If however, the circumstances surrounding the change of trustee has caused a resettlement (the creation of a new trust) there may be tax consequences. This is because a deemed

[101] PS LA 2012/2: Change of trustee, paras 13, 2

disposal will have occurred from the retired or removed trustee to the new trustee of both the legal and beneficial interests in the trust property. To reiterate from *Clark*, a change of trustee effected pursuant to the terms of the trust deed of the trust is unlikely to result in the creation of a new trust.

10.5 Whilst generally a change in trustee will not by itself have any tax consequences, the question may arise as to which trustee, retired or new, of the trust will bear any tax-related liability – did the change occur before or after the time at which the tax-related liability for the trust arose? This issue has practical implications in terms of identifying the trustee to whom a notice of assessment should be issued and the form that the notice should take.[102]

10.6 The trustee at the end of the income year or tax period is the entity that has the tax-related liability equivalent to section 255-1 of Schedule 1 to the *Taxation Administration Act 1953* for income tax or GST for that period.[103] This is the case even if there has been a change of trustee during, or after, the relevant period.[104]

10.7 This was affirmed in a recent decision of the AAT[105] in which a new trustee was held personally liable for payment of the GST debt of the trust because she was the trustee at the time the debt crystallised (ie. at the end of the quarterly tax period).

Change of Appointor

10.8 The appointor of a trust generally has the power to remove and appoint trustees. Arguably the appointor is the ultimate controller of a discretionary trust. The role of appointor is most often created and an appointment made for asset protection and appropriate estate planning purposes.

10.9 Whilst the role of an appointor is different to that of a trustee, the taxation outcome of a change of appointor is akin in nature to a change of trustee.

10.10 The Commissioner has confirmed this view by stating that the resignation of the original appointor is considered to be procedural in nature, and when implemented on its own does not result in a resettlement of the trust. The changes amount to a variation of a continuing trust with the original trust maintaining the same trust purpose or theme.[106]

10.11 The role of the appointor is not the subject of the trusts of the trust, it is a role or office. Consequently a change in the appointor cannot effect the resettlement of a trust.

11. Conclusion

11.1 It remains incumbent on all practitioners working in this area to ensure a thorough and careful analysis is undertaken in every instance involving the creation and/or extinguishment of any rights in relation to a trust, especially in the manner in which UPEs are dealt with. The adoption of this practice will ensure that no unintended tax consequences occur as a result, particularly those rights concerning beneficiaries of the trust.

11.2 To the unwary, there can be significant, unintended consequences as a result of the assignment of UPEs arising from capital distributions. These need to be fully and properly considered in any trust planning or restructuring.

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[102] PS LA 2012/2: Change of trustee, paras 2, 3
[103] Meaning a pecuniary liability to the Commonwealth arising directly under taxation law.
[104] PS LA 2012/2 at para 7.
[105] *Anderson v Commissioner of Taxation* [2015] AATA 167
[106] ATO Private Ruling Number 1011616699832