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The scope of section 99B and implications for Australian beneficiaries

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1. Introduction

More millionaires have migrated to Australia in the last 20 years than (almost) any other country in the world. This is in addition to returning expats, inheritors and beneficiaries of overseas wealthy families.

It is shocking for these clients to learn that close to half their funds could be wiped out by Australian tax. The application of section 99B is often met with disbelief by clients. It has the potential to capture amounts which a lay person might otherwise consider to be tax-free.

I say this because section 99B applies at the point an amount of trust property is paid or applied for the benefit of an Australian resident beneficiary. However, the source of the amount could be foreign income derived by a foreign trustee while the beneficiary was a non-resident (even decades ago).

In addition to the primary tax (and if relevant, interest and penalties), there is also the potential for "throwback interest" which has a punitive impact on the unwary beneficiary.

Despite having been introduced 45 years ago, its interpretation and scope is not always fully understood. In today's environment, it can apply to common situations, such as:

- Previous foreign employment earnings
- Pre-migration wealth
- Foreign gifts and inheritance
- Inter-generational wealth transfers

This paper explores the scope of section 99B and useful strategies to manage the implications for Australian resident high net wealth individuals and wealthy families. This includes accounting treatment, record keeping and other practical and technical considerations.

Unless otherwise stated, all legislative references are to the *Income Tax Assessment Act 1997* (**ITAA1997**) or the *Income Tax Assessment Act 1936* (**ITAA1936**) and all amounts in Australian currency (**AUD**).

2. Origin story

Like all good heroes and villains, section 99B has an interesting origin story.

In 1969, the High Court in *Union Fidelity Trustee Co of Australia Ltd v Federal Commissioner of Taxation* (**Union Fidelity**) determined that Division 6, as it was then written, did not capture foreign sourced income.

This was problematic as the foreign sourced income of a foreign trustee could escape Australian tax unless it was paid as income to the Australian resident beneficiary.[1] The trust income could also be tax-free or lightly taxed in the source jurisdiction.

This loophole was identified in the 1975 Asprey Report.[2]

To combat this, from 1 July 1978, section 99B (and its side kick section 99C) was introduced by *Income Tax Assessment Amendment Bill (No. 5) 1978* (the **1978 Bill**) to capture the accumulated untaxed income of foreign trusts.

Along with a re-write of Division 6, the 1978 Bill formed the basis for the current 'modern' system of taxing trusts – which, along with some further modernisation, band-aid fixes, and an attribution regime, consists of:

- The trust's tax law income ('net income') is calculated on the basis the trustee was a hypothetical resident, referred to as the "residency assumption" (i.e. worldwide income).

- A resident trust estate is one where at *any time* during the year of income *a* trustee of the trust was a resident of Australia, or the central management and control of the trust was in Australia.

- Where a beneficiary was 'presently entitled' or 'deemed presently entitled'[3] to a 'share' of the income of the trust estate (accounting or distributable income), then its 'share' of the trust's tax income[4] is included in the beneficiary's assessable income and taxed at the beneficiary's tax rate[5] – with an apportionment of source for periods of non-tax residency.

- Where there was no present entitlement to all or part of the trust income, the trustee is taxed at a flat 47% on the trust's tax law income. A foreign trustee is only taxed on the trust's Australian sourced income – but not on its foreign sourced income (hence the need for section 99B).

- Section 99B operates as a "catch-all" for **all** trusts with a carve-out for amounts not previously subject to tax, or exempt, under the provisions above (or taxed under the transferor trust attribution regime).

So, when unleased, section 99B had the potential to apply to both foreign and resident trusts[6].

[1] The trust income could be accumulated and later paid to the Australian beneficiary as a non-assessable amount, such as trust corpus. Former sections 26(b) and 25(1) would capture ordinary income paid to a beneficiary.
[2] Taxation Review Committee report to the Parliament of Australia on 31 January 1975.
[3] Under sections 95(A) or section 101 for discretionary trusts.
[4] Also a share of the trust's exempt or non-assessable non-exempt income.
[5] Trustee taxation arises for minor beneficiaries ('under a legal disability') and foreign beneficiaries (or foreign trustee beneficiaries) with credit mechanisms for the beneficiary.
[6] Although it can apply to both, the focus of this paper is the more common scenario of a foreign trust

In 1991 the ‘extreme width’ of section 99B was recognised by Justice Hill’s judgment in *Traknew Holdings Pty Ltd v Federal Commissioner of Taxation* 91 ATC 4272. As such, it is sometimes stated that section 99B should be limited to the legislative purpose for its enactment (i.e. accumulated foreign income of a foreign trust).

In 2011 concerns regarding section 99B were raised in the Treasury discussion paper “Modernising the taxation of trust income — options for reform”, in particular the uncertainty from the “expansive wording” of section 99B and its application to resident trusts.

In 2011 the ATO released ATO ID 2011/93 which outline that under:

“ … section 99B of the ITAA 1936, and by inference from subsection 102AAM(5) of the ITAA 1936, that there is no apportionment of the amount included in assessable income by reference to the residency status of the beneficiary as at the time the income was derived by the trust. Rather, the only explicit condition concerning residency is that the beneficiary be a resident at some time during the year of income in which the trust property is paid to them or applied for their benefit.”

In 2012, *Howard v Commissioner of Taxation* [2012] FCAFC 149 considered section 99B where there was a share buy-back and a successive distribution through interposed foreign trusts to an Australian resident.

In 2017, the ATO finalised two tax determinations (being TD 2017/24 and TD 2017/23) which addressed the interaction of section 95(1) net income and section 855-10, with the conclusion that capital gains from a foreign trust are caught to the beneficiary under section 99B and are not eligible for the CGT discount nor offset against capital losses in the beneficiary’s hands.

In 2019 the burden of proof in relation to section 99B was addressed in *Campbell v Commissioner of Taxation* [2019] AATA 2043.

In 2021 the ATO released Taxpayer Alert 2021/1 Disguising undeclared foreign income as gifts or loans from related overseas entities, which briefly discussed section 99B amongst other provisions.

The ATO’s website (last modified on 1 December 2021) contained guidance on section 99B which outlined three simple questions:[7]

- *Whether you are a beneficiary of the foreign trust.*
- *Where the foreign trust obtained the money. This will assist in determining the source of the money.*
- *Why the money was paid to you; for example, is it payment for services, a gift, a distribution, or a loan. This will assist in understanding the nature of the payment.*

The 8 June 2023 key messages from the ATO’s Private Group Stewardship Group stated there would be practical guidance issued on section 99B.

And here we are today!

[7] https://www.ato.gov.au/General/Trusts/In-detail/Distributions/Receiving-payments-or-assets-from-foreign-trusts/#

3. The gateway: section 99B (1)

Section 99B (1) operates as a 'basic rule' to include an amount in a beneficiary's 'assessable income':

Receipt of trust income not previously subject to tax

(1) 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.

The heading of section 99B (which forms part of the Tax Act under section 950-100(1)) clearly states its objective to capture a receipt of untaxed trust income. There is no mention of foreign trustee nor foreign sourced accumulated earnings.

For section 99B to be enlivened, trust property needs to be paid to or applied for the benefit of a resident beneficiary:

3.1 An amount of trust property of the trust estate

It is the 'property' which is the subject of the trust relationship which is the relevant starting point for the enquiry.

'Property' (unlike 'CGT asset') is not defined for tax purposes. Its ordinary meaning is something which is capable of ownership, whether real or personal, tangible or intangible.[8] The section therefore applies to more than a payment or application of money, but to any application of a trust asset.

Perhaps "property of the trust estate" can be contrasted to "income of the trust estate" which is the 'surplus' income or 'distributable' income ascertained by the trustee according to appropriate accounting principles and the trust instrument.[9] Therefore, its target is (prima facie) accumulated trust income.

There is no enquiry as to the nature or character of the 'property'- whether it is "income", "net income", gains, reserves, corpus or some other amount for accounting, tax or trust law purposes.

Nor is no enquire of the source or situs of the relevant property.

There is no enquire of the residence of the trust, the trustee or any other reference to domicile, settlor, transferor, controller or grantor.

In addition, the term 'trust estate' is also not defined for tax purposes. The term "trustee" has an extended definition in section 6(1) for tax purposes. However, for Division 6 purposes it generally applies where legal ownership of assets is vested in a person with some proprietary right by which the income arises, even though they may not be a trustee in the 'proper sense' (e.g. executors and deceased estates but not liquidators).[10]

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[8] Osborn's concise law dictionary, 10th edition.
[9] See High Court decision in Bamford's case and *Zeta Force Pty Ltd v Commissioner of Taxation*.
[10] See *FCT v Australian Building Systems Pty Ltd (in Liq)* (2015) 102 ATR 359.

Finally, the word ‘amount’ implies that the property being paid or applied must be quantified in some sense. There is no guidance on how this is to be measured or valued.

An amount of monies paid (including expenditure or cost) may be easily quantifiable, but the giving of property, or a non-cash benefit might be its market value.[11] There is no mention of an ‘arm’s length dealing’.

This raises some interesting questions where the property is a loan or an intangible benefit under section 99C (see later discussion).

If the amount is in foreign currency, then it would be translated into Australian currency[12] when the amount is included in assessable income (on the basis it is statutory income outside of the CGT provisions).[13]

Section 10-5 of the ITAA 1997 lists section 99B amounts as ‘statutory income'.

3.2 Is paid to or applied for the benefit of

“Paid” is not generally defined in the Tax Act (although it may be defined for some purposes, such as dividends or for withholding tax purposes).

The composite expression, “paid *to*” implies a direct receipt of funds by the beneficiary.

“Applied for the benefit *of*” is similarity not defined in the Tax Act. It may imply an indirect payment, where the amount is dealt with by the trustee in some other way by which the beneficiary could benefit. It could include a payment to a third party, payment in satisfaction of an amount owed (entitlement) by the beneficiary, payment at the direction of the beneficiary or a crediting of an amount to the beneficiary account with the trustee.

Section 99C expands the meaning of “applied for the benefit of a beneficiary of the trust estate”.

3.3 A beneficiary of the trust estate

For section 99B to apply, it appears the recipient of the trust property must be an actual beneficiary of the trust estate. Accordingly, someone who is not a beneficiary of the trust under the deed may not be caught under section 99B.

A beneficiary for tax purposes, is generally accepted to be a person entitled to due administration by trustee. That is, a mere object rather and some who is presently entitled.[14]

The interest of the beneficiary in the trust is also not explored in section 99B(1) - only that the property is paid to or applied for their benefit.

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[11] Which for tax purposes is usually its ordinary meaning as affected by Subdivision 960-S (section 995-1). Section 21 may have limited application as a dealing within the context of section 99B is unlikely to involve ‘consideration’. Section 103-5 deals with amounts under the CGT rules.
[12] Section 960-50(1).
[13] Section 960-50(6) Item 7.
[14] See *Kafataris v DCT* (2008) 73 AT 531 and *Yazbek v FCT* (2013) 88 ATR 792

The wording also seems to imply that the payment or application of the trust property must actually benefit (betterment) the person, in their capacity as a beneficiary of the trust.

There is no express wording in the section to that effect (as there is for shareholders / creditors in the section 6(1) definition of a 'dividend') and under section 99C it appears it could apply in broader situations.

3.4 Who was a resident at any time during a year of income

The jurisdictional nexus in section 99B is that the recipient beneficiary is an Australian tax resident 'at *any* time' during an income year.

The 'income year' means the period of 12 months beginning on 1 July[15] unless the Commissioner allows a substituted accounting period (SAP).[16] It is unlikely the Commissioner would allow a SAP for an individual as their circumstances would not be outside the "ordinary run" (see PSLA 2007/21).

3.5 The assessable income of the beneficiary shall include that amount

Once the requisite connection between the payment or application of trust property and a resident beneficiary has been made, the 'amount' of trust property is included in the beneficiary's assessable income.

Section 99B operates on an assessment basis and so the assessable amount is included in the beneficiary's tax return. Given the trustee is a foreign entity, a trustee withholding mechanism would be impractical.

The amount is taxed at the beneficiary's marginal tax rate (assuming the beneficiary is not tax exempt) including any entitlement to the tax-free threshold (or pro-rata) and Medicare levy, etc.

3.6 Subject to section (2)

Section 99B(2) includes a number of items which reduce the amount included in the resident beneficiary's assessable income under section 99B(1) (see later discussion).

Interestingly, as it is the amount of the payment (property) which is included in the beneficiary's assessable income under section 99B(1), then in the context of capital gains, it would be the payment of the capital proceeds which would be caught, not the net gain – if it were not for the reductions under section 99B(2).

[15] Section 995-1.
[16] Section 18.

3.7 Planning considerations under section 99B (1)

There are a number of planning considerations that arise around section 99B(1):

1. Is it a trust?

Firstly, it is necessary to consider whether the foreign entity is a 'trust' for Australian tax law purposes (e.g. such as a foreign Foundation under civil law).

This will depend on the entity's constituting documents (whether a deed, regulations or articles of association, etc) and how the entity is recognised under the foreign law.[17]

In general, where the legal ownership of the assets vests in one entity, with an obligation to hold the assets for the benefit of another entity, then the entity is likely to be a trust for Australian tax purposes.

2. Location, location, location

It is very easy for a foreign trust to become a resident.

However, the location of the trustee or the trust's central management may not be of assistance. Payments from the accumulated income of the now resident trust would still be captured under section 99B(1).

This inquiry will however be relevant from an administrative perspective and for dealing with current year trust income under section 97 or 99A. Additionally, the transferor trust rules cease to have practical effect once the trust estate is a resident (i.e. attributable income is 0).[18]

Similarly, the location of the trust assets would not matter. Australian sourced income and taxable Australian property (**TAP**) of a foreign trustee falls within Division 6 or the withholding provisions (with some exceptions).

It is only the location of the beneficiary that is important for section 99B purposes (see later for resident transferors).

3. Timing is everything – inbound beneficiaries

Section 99B can have no application where the beneficiary is not an Australian tax resident for the entire income year.

Proactive advice and dealing with trust payments and property in the year ended 30 June before the beneficiary becomes an Australian tax resident is a simple solution.

Leaving a 12-month (full income year) buffer between payment and establishing an Australian footprint is an easy safeguard – given there is no bright line threshold under the 'resides test'.

[17] For further discussion, see Neil Brydges, Australian residents, foreign trusts and foreign funds – The New Black! (2019) The Taxation Institute, including the four elements of a trust (Harmer's case), *Mulherin v FCT* (Liechtenstein Foundation) and various private rulings
[18] Section 102AAU(2).

4. Leave the country - Outbound residents and transitory beneficiaries

Another solution might be to simply leave the country 12 months (a full income year) before an 'impending' foreign trust payment (subject to the application of section 99C).

This, of course, is easier said than done and comes with extreme caution.

The resides test is a question of fact and degree and a 'continuing association with Australia' will be unhelpful.

The domicile and the 183-day tests require that you have established a permanent or have a usual place of abode (respectively) outside Australia - both require the Commissioner be satisfied that this is in fact the case.[19]

Tax residency is easy to make and hard to break.

5. Love can be taxing: temporary residents

A taxpayer on a temporary Australian visa who does not have an Australia spouse would not be assessable on foreign sourced ordinary income and statutory income derived[20] when they were a temporary resident (except for remuneration and personal services income).

Source tracing for section 99B is provided by section 6B(2A)(a)(ii) which considers that 'for the purposes of this Act'[21] an amount of income derived by a person shall be deemed to be income derived from a particular source if the person derived the amount of income as a beneficiary of a trust estate and the amount of income can be attributed, directly or indirectly, to income derived from that source (or to an amount deemed by this section to be income derived from a source).

Accordingly, section 99B amounts should be non-assessable non-exempt income of a temporary resident (assuming they are not from an Australian source).

The transferor trust rules are also 'switched off' for temporary residents (section 786-970).

6. Can a double tax agreement (DTA) help?

Where a trustee is a dual tax resident, then a DTA[22] is likely to allocate residency to the jurisdiction in which the trust has its 'place of effective management'. This may provide some insight as to how the trust should be administered for tax purposes from an Australian perspective. However, it is the beneficiary who is taxed under section 99B and not the trustee.

Where the Australian beneficiary is a dual tax resident but a foreign resident for DTA purposes then relief might be available.

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[19] Notwithstanding that the Commissioner expects you to self-assess.
[20] Statutory amounts can be 'derived' see *Allen (Trustee), in the matter of Allen's Asphalt Staff Superannuation Fund v Commissioner of Taxation* [2011] FCAFC 118 and *SCCASP Holdings Pty Ltd as trustee for the H&R Super Fund v Commissioner of Taxation* [2013] FCAFC 45.
[21] *Gibb v FCT* (1966) 118 CLR 628, this means both ordinary and statutory income.
[22] Assuming a trust is a 'person' covered by the DTA. Also, the multi-lateral instrument should be considered also (e.g. optional article 3 that deals with transparent entities to access treaty benefits).

Trust distributions are likely to be covered under the "other income" article in the DTA[23] when considering trust distributions. Under the OECD model tax convention, exclusive taxing rights is given to the State of residence.

So, a resident under Australia's domestic laws, but a foreign resident for DTA purposes is likely to escape the impact of section 99B.

However, an Australia resident for DTA purposes, is likely to have no such luck and instead would look for relief from double tax by tax credit.

Section 3(4) of the *International Tax Agreements Act 1953* also deems source look-through for trust income.

7. Foreign currency

As an amount of statutory income (but not a capital gain) an amount under section 99B denominated in foreign currency is converted for tax purposes to the equivalent Australian currency at the exchange rate at the time of receipt or 'required to be included in your income'.[24]

If an entitlement arises prior to satisfaction, or the amount remains in foreign currency, then a foreign currency realisation event or a CGT event may arise.

A foreign trust is not able to make a functional currency election under subdivision 960-D (unless it is a transferor trust or has a CGT event from an interest in indirect Australian real property).

8. Tax rates

For a resident individual, it makes no difference if they are taxed under section 97 or section 99B as both apply resident marginal tax rates.

For a company beneficiary, it will depend on whether the amount is referable (either directly or indirectly) to the 'base rate entity passive income' of the foreign trustee.

Accumulated trust income captured under section 99B should not be 'excepted trust income' for the purposes of Division 6AA so would be taxed at punitive rates to minor beneficiaries.

9. Read the deed

Reading the deed (assuming you can access a copy in English) to understand whether the recipient is actually a beneficiary, and the ability to receive the trust amounts will be relevant. If someone is not a beneficiary or not entitled to receive an amount as a beneficiary (e.g. breach of trust), then section 99B might not apply.

For the purposes of the reductions in section 99B(2) or the timing under section 99C the nature of the beneficiary's interest and their entitlements to trust income or corpus will be relevant.

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[23] Noting that some articles look at the person 'beneficially owner'.
[24] 960-50(6) Item 7 in the table.

10. Period of amendment

The usual four-year time limit appears to apply for section 99B purposes, subject to there being no fraud or evasion.

11. Rulings and voluntary disclosure

If an assessable amount under section 99B has been overlooked, a voluntary disclosure should be prepared to mitigate the risk of penalties. If there is uncertainty on the application of section 99B, then a ruling may be beneficial.

Practically, amounts caught under section 99B would be brought to the Commissioner's attention by data matching information with Australian Transaction Reports and Analysis Centre.

4. The escape door: section 99B (2)

The extreme breadth of section 99B (1) is reined in by section 99B(2):

(2) The amount that, but for this subsection, would be included in the assessable income of a beneficiary of a trust estate under subsection (1) by reason that an amount, being property of the trust estate, was paid to, or applied for the benefit of, the beneficiary shall be reduced by so much (if any) of the amount, as represents:

> *(a) 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);*
>
> *(b) an amount that, if it had been derived by a taxpayer being a resident, would not have been included in the assessable income of that taxpayer of a year of income;*
>
> *(ba) an amount that is non-assessable non-exempt income of the beneficiary because of section 802- 17 of the Income Tax Assessment Act 1997 ;*
>
> *(c) an amount:*
>
>> *(i) that is or has been included in the assessable income of the beneficiary in pursuance of section 97; or*
>>
>> *(ii) in respect of which the trustee of the trust estate is or has been assessed and liable to pay tax in pursuance of section 98, 99 or 99A; or*
>>
>> *(iii) that is reasonably attributable to a part of the net income of another trust estate in respect of which the trustee of the other trust estate is assessed and is liable to pay tax under subsection 98(4);*
>
> *(d) an amount that is or has been included in the assessable income of any taxpayer (other than a company) under section 102AAZD; or*
>
> *(e) if the beneficiary is a company--an amount that is or has been included in the assessable income of the beneficiary under section 102AAZD.*

(2A) An amount that is not included in a beneficiary's assessable income because of paragraph (2)(d) or (e) is not assessable income and is not exempt income.

(3) In paragraphs (2)(d) and (e):

***"company"** means a company other than a company in the capacity of a trustee.*

Subsection (2) makes it clear that it is intended to reduce the ‘amount’ assessable under subsection (1).

This limits the amounts initially caught under section 99B which may have otherwise been tax-free or subject to Australian tax.

The reduction is ‘by so much of the amount, as represents’ the listed exclusions. This implies some type of quantifiable ‘trust-law’ tracing, attribution or sourcing is required.

How exact the sourcing needs to be is unclear (e.g. to its 'origin'), especially where trust funds have been intermingled and reinvested over many years. Presumably, it may not need to be exact, provided that it has been correctly accounted for in the books of the trust.

It is noted that the term "attributable" is used for the corpus reduction and "reasonably attributable" when tracing through a trust for section 98(4) amounts.

4.1 Corpus reduction

Represents corpus of the trust estate

'Corpus of the trust estate' is not defined in the Tax Act. Its ordinary meaning is the 'capital of a fund, as contrasted with the income'.[25] Depending on the terms of the trust deed, it could constitute the initial settled sum, voluntary transfers and income not distributed but accumulated by the trustee.

For the reduction under section 99B(2)(a), it must be capable of being appointed to the capital beneficiaries under the terms of the trust instrument and in conformity with trust law.

Quantifying the amount of corpus and whether 'so much of' a distribution is 'represented' by corpus, might be a system of accounting or bookkeeping with debits and credits in the books of the trust. This will not always be the case, as not all entries will impact the equity section of the balance sheet (especially under section 99C).

Similar concepts can be found in relation to section 47[26] where the Archer Brother's principle is relied upon to determine the extent to which a liquidators' distributions 'represents' income or a loss of paid-up capital (see TD 95/10).

Comparably, the section 6(1) definition of a 'dividend' is explicit when it states that an 'amount of value debited against an amount standing to the credit of the share capital account of the company' is not a dividend.

The amount of corpus and any subsequent debits would be calculated in foreign currency and only the final assessable amount of the distribution converted to AUD.

Except to the extent to which it is attributable to amounts otherwise assessable to a hypothetical resident

To avoid foreign trusts accumulating income as trust capital and distributing it as tax-free trust corpus under the above reduction, a 'parenthetic exclusion' is provided for amounts which would have been assessable if they had been derived by a hypothetical resident.

This includes amounts which are assessable income for tax purposes but capital for trust law purposes (such as a deemed dividend under a share buy-back[27] or a liquidator's distribution under section 47).

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[25] Osborn's concise law dictionary, 10th edition.
[26] 'to the extent to which [distributions] represent income …. replace loss of paid-up share capital'.
[27] *Howard v Federal Commissioner of Taxation* [2012] FCAFC 149.

In *Howard's case*, there was a chain of trusts and a distribution from the vesting of one trust to another, which was not automatically an amount of corpus. Section 99B was required to be applied at each layer of trust from the level of the deepest trust and cascade through successive trusts[28] back up to the original trust (genuine) resident taxpayer[29].

A hypothetical resident taxpayer

Both *Howard's case* and *Union Fidelity* support a view that the hypothetical taxpayer is not the trustee, nor the beneficiary,[30] but 'a' separate entirely fictional or abstract entity (especially in light of the diverse range of taxpayers, such as application of CGT discount, losses, etc).

That is, ignore the 'taxpayer attributes' of both the trustee and the beneficiary.

For income, the Commissioner may simply look at whether the income is of 'a class' that would 'ordinarily' be assessable to a resident taxpayer. How far this goes is not known. If an amount of income could only be derived by a trustee or individual and not company, then the hypothesis must logically assume it's a natural person taxpayer.

Whether the 'amount' needs to be calculated in accordance with Australian tax rules is not clear. Section 99B refers to 'an amount being derived' and the gross concept of 'assessable income' rather than to a 'net' amount.

Practically, for an amount to be paid to a beneficiary, it would be the net (cash) amount after actual expenses and losses[31] that would be available for distribution (i.e. a reduction to available corpus or debt). However, this would depend on the actual context (e.g. a payment of net rental to beneficiary compared to an application of gross rent towards the beneficiary's expenses). Notional expenses might simply mean there is more cash or corpus available for distribution.

For capital gains, the approach is more interesting. Both section 99B(2)(a) and 99B(2)(b) refer to a hypothetical taxpayer (see below).

4.2 Otherwise not assessable income reduction

For amounts which are not added to corpus, a further reduction is available under section 99B(2)(b) where an amount would have been non-assessable income to a hypothetical resident taxpayer.

This could include amounts which result in an accretion to the trust (say a 'reserve') but not assessable income for tax purposes, such as a debt forgiveness amount, release of an unpaid present entitlement or the excess of accounting income[32] over net income.

It would also include pre-CGT gains / reserves and the cost base amount from a capital gain (noting that section 99B(1) would initially include the entire capital proceeds as assessable income).

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[28] Including simple trusts, such as nominee arrangements.
[29] A similar approach was taken in the context of a series of section 47 liquidation in *Brewing Investments Ltd.*
[30] Otherwise, it might be argued at the time the amount was assessable to a resident trustee under 99A and therefore not assessable to the beneficiary.
[31] The *Sole Luna* case dealt with the application of the statutory fiction of a foreign trust's 'net income' under section 95 (where there were foreign exchange losses) as the first step in sections 97 – 99A (but not 99B).
[32] Which could be affected by the application of certain accounting principles and standards.

A hypothetical resident taxpayer – capital gains

It would appear that the hypothetical resident taxpayer approach should allow 'asset attributes' when quantifying, calculating or computing capital gains or other amounts for tax purposes (e.g. capital allowances) in order to quantify the 'amount'. This would include acquisition dates, proceeds, cost base, pre-CGT status.

Presumably, this means the assessable/non-assessable amount is calculated under Australia's tax rules, including the application of the market value substitution rule[33] in calculating the cost base of the asset held by the foreign trustee.

Current and prior year capital losses are available to taxpayers 'generally' in working out their net gain, and therefore assessable income (amount) under section 102-5.

Section 99B was written prior to the introduction of capital gains and never updated. The explanatory memorandum to the 1978 Bill (the **1978 EM**) acknowledges that capital gains remain tax-free under section 99B.

As such, a gain may retain its pre-CGT status for one asset under section 99B (as an 'asset attribute') but would not get the benefits of the non-assessable component of the CGT discount for another asset (as it is a 'taxpayer attribute').

Section 95 and Division 855

A further complication arises for current year capital gains of the foreign trust.

Ordinary, where an Australian beneficiary is presently entitled to a trust's capital gain - which is included in its 'net income' by way of the residency assumption in section 95(1) - then section 97 and the CGT rules would operate to allow the CGT discount to the beneficiary.

In the Commissioner's view in TD 2017/23, under the rules of statutory interpretation where there is conflict between general and specific provisions, the specific provision prevails – being that section 855-10 prevails over the residency assumption in section 95(1) and non-TAP gains are excluded from the trust net income.

Accordingly, such amounts do not flow to the beneficiary under section 115-215 (or the trustee in sections 115-220 or 115-222) and are instead included in the beneficiary's assessable income under section 99B without the benefit of the CGT discount or capital losses (see TD 2017/24).

4.3 Conduit Foreign Income (CFI) flow-through reduction

Non-assessable non-exempt CFI amounts received by an Australian trust from an Australian company can flow through the trust to a foreign beneficiary tax-free (section 802-17). Therefore they are excluded from section 99B (1) by section 99B (2).

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[33] See private ruling 1051970330207 regarding shares under a demutualisation and private ruling 1051910296871 for an inherited investment linked life assurance bond.

CFI is non-assessable foreign income of an Australian company which is unfranked and declared to be CFI in the company's distribution statements on or before the day of distribution. It is free of Australian corporate tax and dividend withholding where its final destination (including through a chain of interposed trusts) is a foreign resident beneficiary.

It would seem that a non-portfolio dividend via a foreign trust to an Australian corporate beneficiary may not be caught under section 99B where the conditions in section 768-5(2) are met (see also TD 2017/22).

4.4 Assessable to <u>the</u> beneficiary under section 97 or to <u>the</u> trust under section 98, 99, 99A or 98(4) reductions

Section 99B(2)(c) is what gives section 99B its residual operation as it carves out amounts dealt with under sections 97, 98 and 98(4) (where there is present entitlement) and section 99 and 99A where there is not a present entitlement.

This means that where, under the terms of the trust deed, it is possible to create a present entitlement to the annual income of the trust estate (year it is derived) then the aforementioned section should take primacy[34] (with the exception of non-TAP capital gains discussed above).

It is interesting to note that the subsection dealing with section 97 only requires that the amount "is or has been included" in <u>the</u> beneficiary's assessable income, not that the beneficiary has paid tax on it (or that another person has been taxed).

Whereas the requirement under the other subsections, is that the amount "is or has been assessed and liable to pay tax" (by the trustee). This may be relevant where the four-year period of amendment has expired.

4.5 Assessable under transferor trust reduction

Where an amount has been assessed under the transferor trust rules, then the amount should not be taxed again under section 99B.

As such, where the payment or application under section 99B can be sourced back to an amount of 'attributable income' assessable to a resident transferor ('attributable taxpayer'), then the section 99B amount is reduced accordingly.

Very broadly, a transfer of property or services by an Australian resident (directly or indirectly) to a foreign discretionary trust is generally caught in the transferor trust rules, unless it was in the ordinary course of carrying on business and under an arm's length transaction.

The attributable income of a foreign trust in an unlisted country is the trust's net income and only Eligible Designated Concessional Income[35] (EDCI) for foreign trusts in listed countries[36].

[34] The framework of Division 6 gives priority to section 97 only by reason of section 99B(2)(c)(i).
[35] See section 317 and Regulation 17 of the Income Tax Assessment (1936 Act) Regulation 2015.
[36] See section 320 of the ITAA1936.

It is possible that mismatches could arise between the assessable amount under the transferor trust rules and for section 99B purposes.

4.6 Planning considerations under section 99B (2)

There are a number of planning points that arise around section 99B(2):

12. Financial accounts and burden of proof

Sourcing or tracing the payment to tax-free corpus or a non-assessable amount may initially start with a good set of accounts with appropriate debits and credits and dissection of the amounts in the equity section.

It is not unusual for foreign trusts not to maintain financial accounts, so a forensic reconstruction of historical data (if possible) may be required.

Other documents, such as the requirements of the trust deed (including whether the beneficiary can be entitled to corpus) and trustee resolutions will also be important to support the accounting treatment adopted.

Accounting and trustee requirements in the foreign jurisdiction may also impact the records.

Corroborating verbal evidence by knowledgeable parties could also be helpful in the absence of other or contradictory documents (see *Campbell's case*). An uncooperative foreign trustee would make things difficult.

If maintained in a foreign language, the information should be translated and maintained in English.

Finally, as a practical matter, where the annual income of the trust has been applied against expenses of the trust and the remaining trust net income has historically been paid to or for the beneficiaries, then it may be implied that a residual payment could only have been sourced from corpus.

13. Migrate the trust to Australia

Migrating the trust to Australia means each CGT asset of the trust is deemed to be acquired, at that time, for their market value (except for pre-CGT assets and TAP).

As such, section 99B should not apply to the uplift in cost base amount when the assets are realised. The hypothetical resident taxpayer is now an actual resident taxpayer, and the amount when derived is not assessable to that resident taxpayer.

Where section 97 applies instead, the CGT discount should similarly be available (with the 12 months starting from the time the trust became resident).

This assumes that the trust is not already a 'controlled foreign trust' under section 342(a) which can have broad application and might be a trap if not read closely.

A 122-A rollover of the trust assets to a resident company could also be available.

Finally, the ignores any foreign exit taxes or on-going tax implications in the foreign jurisdiction.

14. Is some else assessable under the transferor trust rules?

Given the breadth of the transferor trust rules, it is possible that another taxpayer (or in another income year) was assessable on the amount. Under section 99B(2)(d) the amount has to be 'included in the assessable income of *any* taxpayer'.

Given the breadth of the transferor trust rules, it might be more likely that they apply before section 99B.

15. Death of the transferor

Where a transferor dies, it does not appear that the trust income is attributed to their deceased estate. Section 99B might instead apply to those amounts from such trusts.

16. Post marital and family relief foreign trusts

Non-resident family trusts (post marital and family relief trusts) which are excluded from the transferor trust rules require that the beneficiaries are foreign residents and therefore would fall outside section 99B (which requires a resident beneficiary).

17. Pre-residency trusts (migrant transferors)

An individual who first became an Australian resident after 12 April 1989 will not be subject to the transferor trust measures if they transferred property or services to a non-resident trust estate before becoming a resident and they were not in a position to control the trust estate. Section 99B might instead apply to those amounts from such trusts.

18. Offshore estates and testamentary trusts

Transfers from a resident deceased according to the directions in the deceased's will, codicil or court order (but not by testamentary trustee discretion) are excluded from the transferor trust rules (section 102AAL). Section 99B might instead apply to those amounts from such trusts.

19. Foreign deceased estate – distribution of assets existing at the date of death

Whether a deceased estate is a foreign trust does not depend on the residency status of the deceased but rather the residency status of the executor(s) and the place of central management and control of the administration.

Theoretically, an Australian resident could create a foreign deceased estate when they die if the executor of their will is overseas, although the usual CGT cost base rules and CGT event K3 should still apply.

When a foreign person dies, their assets at the time of death form part of the corpus of the trust at their market value, so cash or assets sourced from these amounts should be tax-free to the Australian beneficiaries – although another view could be that a hypothetical resident would acquire the assets of a foreign resident deceased at their market value (apart from TAP).

For in-specie distributions, the beneficiary should obtain a market value cost base in AUD on the date of death of the deceased, with the acquisition date for the CGT discount back dated to the time the foreign deceased acquired the asset (section 115-30(1) item 4 of the table).

Finally, it does not appear that a tax credit should be available from the payment of foreign inheritance / estate taxes (see section770-10 and 770-15).

20. Foreign deceased estate – accumulation during administration

Income or realised gains (in excess of the market value on death) accumulated during the administration period, where a present entitlement cannot yet be created in favour of a beneficiary (see IT 2622) would be assessable to a resident beneficiary under section 99B when later paid.

Modifications may arise for gains on assets such as collectibles, personal use assets, motor vehicles, trading stock and main residence.

21. Foreign pension, provident or retirement funds – lump sum withdrawal of foreign employment earnings

Where the foreign fund does not meet the definition of 'foreign superannuation fund' in section 995-1, a lump sum payment will be dealt with under section 99B[37] rather than Subdivision 305-B of the ITAA1997.

Subdivision 305-B allows a lump sum withdrawal from a foreign superannuation fund to be tax-free (and, if you choose, eligible to be contributed as a non-concession contribution to an Australian superannuation fund) within 6 months of establishing Australian tax residency. After that time, the 'applicable fund earnings' are assessable to the individual – from the time they became a resident (i.e., 'grandfathered').

Many foreign funds may not qualify for this as they allow withdrawals for purposes other than retirement, invalidity or death (such as education, home ownership, emigration, medical expenses, college tuition, funeral expenses) and therefore do not meet the 'sole purpose test'[38] [39].

Post-tax contributions to the fund would constitute corpus and earnings on that corpus withdrawn as a lump sum assessable under section 99B. Deferred pre-tax contributions may not be tax-free corpus.

Rollovers from one foreign fund to another foreign fund, at the direction of the beneficiary (or as 'beneficial owner'), would be applied for the benefit of the beneficiary and therefore caught under section 99B at the time of the rollover.

The decision to withdraw a lump sum amount may also depend on foreign taxes on withdrawal and foreign inheritance tax exemption for foreign domiciled persons.

As a foreign fund is not a 'complying superannuation plan', lump sum death benefits paid to a dependent would not be tax-free under Subdivision 302-B.

22. Foreign life insurance, life assurance, insurance bonds and endowment policies

Lump sum payments (including reversionary bonuses)[40] under foreign life insurance policy,[41] assurance policy or an insurance bond can be distributions from a foreign trust. Similar rules to the above apply if considering whether the fund is a foreign superannuation fund.

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[37] Assuming the former Foreign Investment Fund rules did not tax the amount already (section 23AK).
[38] See *Scott v Commissioner of Taxation of the Commonwealth (No. 2)* (1966) 10 AITR 290 and *Mahoney v Federal Commissioner of Taxation* (1967) 41 ALJR 232, *Barker v Federal Commissioner of Taxation* 2015 ATC 10-399.
[39] See for example in private ruling 1051618374747.
[40] See 15-75 of the ITAA1997.
[41] See definition of 'life policy' in section 995-1 and section 9 of the *Life Insurance Act 1995.*

Such payments are not ordinary income and dealt with as statutory income under section 26AH of the ITAA1936 (see also IT 2504 and IT 2346), except where the policy was held for more than 10 years.

Section 118-300 and 118-305 of the ITA1997 also disregards capital gains or losses made from a CGT event happening in relation to an interest under an insurance policy or capital amount from a foreign superannuation fund.

As these amounts would not be assessable to a hypothetical resident taxpayer, then they would be 'carved out' of section 99B.

5. Broadening the net: section 99C

The Asprey Report recognised that in some cases, instead of paying amounts to the beneficiary the trustee may apply the foreign source income for the benefit of the beneficiary and the application may not give rise to a receipt of an entitlement so as to constitute a derivation of income by the beneficiary.

The 1978 EM explains that "section 99C is complementary to section 99B and is designed to ensure that a beneficiary will not escape the provisions of section 99B where indirect or artificial means are used to provide the beneficiary with the benefit of accumulated trust income".

5.1 The general rule

Subsection (1) is the general rule that states:

Determining whether property is applied for benefit of beneficiary

(1) In determining for the purposes of section 99B whether any amount has been applied for the benefit of a beneficiary of a trust estate, regard shall be had to all benefits that have accrued at any time to the beneficiary (whether or not the beneficiary had rights at law or in equity in or to those benefits) as a result of the derivation of, or in relation to, that amount, irrespective of the nature or form of the benefits.

This rule (or guidance to 'determining') is incredibly broad. It appears that a connection is required between the derivation (or sourcing) of an amount and its accrued benefit for a specific identifiable beneficiary.

Subsection (2) reinforces the general rule above by setting out a number of situations where an amount is deemed to having been applied for the benefit of the beneficiary under subsection (1).

The Commissioner has observed[42] that section 99C(1) provides that regard should be had to all benefits that have accrued at any time to the beneficiary and therefore the application of an amount in a particular income year is not affected by:

- The passage of time between benefits being provided
- The provision of different benefits to the beneficiary
- Whether there is a series of transactions resulting in indirect benefits.

5.2 Specific examples

The examples are listed as follows:

(2) Without limiting the generality of subsection (1), an amount shall be taken, for the purposes of section 99B, to have been applied for the benefit of a beneficiary if:

> *(a) whether by re-investment, accumulation, capitalization or otherwise, and whether directly or indirectly, the amount has been so dealt with that it will, at a future time, and whether in the form of income or not, enure for the benefit of the beneficiary;*

[42] Private ruling 1052059680727.

> *(b) the derivation of the amount has operated to increase the value to the beneficiary of any property or rights of any kind held by or for the benefit of the beneficiary;*
>
> *(c) the beneficiary has received or become entitled to receive any benefit (including a loan or a repayment, in whole or in part, of a loan, or any other payment of any kind) provided directly or indirectly out of that amount or out of property or money that was available for the purpose by reason of the derivation of the amount;*
>
> *(d) the beneficiary has power, by means of the exercise by the beneficiary of any power of appointment or revocation or otherwise, to obtain, whether with or without the consent of any other person, the beneficial enjoyment of the amount; or*
>
> *(e) the beneficiary has directly or indirectly assigned to another person his or her interest in the amount or is able, in any manner whatsoever, and whether directly or indirectly, to control the application of that interest.*

The 1978 EM lists the following as examples[43] (or deemed amounts) or descriptions of the nature and form of benefits as having been applies for the benefit of a beneficiary of the trust estate:

- The amount will in any form enure for the beneficiary's benefit
- The derivation of the amount increases the value of the beneficiary's property
- The beneficiary receives a loan or other benefit provided out of the amount
- The beneficiary has power to obtain the beneficial enjoyment of the amount; and
- The beneficiary assigns his interest in the amount, or able to control its application

Section 99C(2) is explored in the situations below.

5.3 Planning considerations under section 99C

23. What interest does the beneficiary have?

A present entitlement to current year trust income by a resident beneficiary would be dealt with under section 97. Therefore, section 99C is directed at interests which are less than a present entitlement for a resident beneficiary.

Possibly, different outcomes may arise if the interest to trust income or capital is vested in possession or vested in interest and whether that interest is defeasible or indefeasible. If the entitlement is contingent or defeasible, it seems unusual to say the amounts 'accrue' or 'enure' to a beneficiary.

A purely discretionary object of a trust should not be caught under the general rule merely by the accumulation and reinvestment of income by the foreign trustee.

A trust would be akin to an Australian discretionary trust where, under the deed, there is trustee discretion as to when any payments from the trust fund will be made, how it will be distributed between the named beneficiaries (or class of beneficiaries) and how much the payment will be.

24. Debt forgiveness and release of UPEs

Where a foreign trustee releases a beneficiary from a debt (or an Unpaid Present Entitlement (UPE)), the forgiven amount may be caught under 99C(2). However, section 99B(2) might operate

[43] Modelled on the former section 24H of the ITAA1936.

to reduce the assessable amount as being sourced from either non-assessable trust income or corpus.

25. Loans, payments, repayments and source of finance

It sounds unusual that a loan might be a 'benefit' under section 99C(2)(c) given there is a corresponding obligation by the beneficiary to pay back the funds.

Understandably, this would make sense for a 'non-genuine'[44] loan that is never intended to be repaid (i.e., it is in substance a 'disguised' trust distribution).

For an interest-free or low interest loan, it might be argued that the 'benefit' to the beneficiary is only the interest component and this is the amount that should be caught under section 99C(2). However, there is no such guidance in the provisions or the 1978 EM, so it appears the entire loan principal may be assessable.[45]

Even if the loan is on genuine 'arm's length' terms, the Commissioner is still of the view that the entire amount of principal is assessable under section 99B.[46] The Commissioner relies on the 1978 EM to support this view (notwithstanding the 1978 EM also states that section 99C is intended to apply to "indirect or artificial means").

It is difficult to reconcile the concept that an 'arm's length dealing'[47] by a trustee with a beneficiary (in a different capacity) where there is commercial consideration provided[48], is being 'applied' 'for the benefit' of a 'beneficiary'.

It also seems punitive when compared to section 99B's corporate siblings, in Division 7A and section 47A, which at least exclude section 109N complying loans or 'arm's length' loans respectively.

Section 99C(2)(c) also extends to any payments and even, repayments of loans owed by the trustee to the beneficiary. As such, loans (or prior trust entitlements) owed to the beneficiary by the foreign trust should be repaid prior to establishing Australian tax residency.

If the loans from the trust are sourced from non-assessable corpus or other debt, then a reduction might be available under section 99B(2). However, the ATO takes the view that once the corpus exception has been claimed for the loan it is no longer available for other applications under section 99B(1) payments.[49]

This is interesting from an accounting perspective as the accounting entries for advancing and repayment of the loan (Dr Loan Receivable / Cr Cash) would never impact the equity section of the balance sheet. Presumably, under this logic, a repayment of the loan (Dr Cash / Cr Loan Receivable) would 'make-good' the corpus amount or be treated as a 'non-assessable amount'.

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[44] For ATO guidance on evidencing 'genuine loans' see https://www.ato.gov.au/Business/Privately-owned-and-wealthy-groups/Tax-governance/Tax-governance-guide-for-privately-owned-groups/Gifts-or-loans-from-related-overseas-entities/#
[45] See private ruling 1051830400148.
[46] Private ruling 1052059680727.
[47] Possibly excluded under the transferor trust rules.
[48] In the event the supply was connected with the indirect tax zone (e.g. goods imported on a non-FOB basis) it may be in the course of furtherance of an enterprise (see GSTD 2009/1).
[49] Private ruling 1052059680727.

26. Back-to-back amounts

Section 99C(2)(c) uses the expression 'the beneficiary has received … any benefit[50] (including … any other payment of any kind) … provided *directly or indirectly* out of *that* amount …

One view is that this expression would trace a loan or payment made from the foreign trust to an interposed foreign beneficiary who on-lends, pays or gifts[51] the amount to an Australian (target) entity (who would also have to be a beneficiary under the trust deed). This makes sense in an artificial arrangement.

Another view might be that it is not a tracing of the recipients, but rather a tracing of the source of the amount (property or money).

Arguably, if the first amount from the trust is *genuinely* applied for the benefit of that beneficiary, then the enquiry should end there (in fact section 99B(1) would catch the payment and section 99C would not be required). If that beneficiary independently chooses to apply those funds for a subsequent purpose (e.g. for an Australian relative), then this should not change the nature of the trust payment.

Foreign gift tax and taxes paid by the foreign beneficiary should be considered.

27. Beneficial enjoyment of trust property

If the beneficiary 'has the power' to obtain the 'beneficial enjoyment' of an amount, then this could also be caught under 99C(2)(d). In this example, 'amount' presumably refers to the beneficial enjoyment of some trust property or income.

How this amount is quantified or valued in order to be included in the beneficiary's tax return is unclear (i.e., is it the entire value of the property or just the 'annual' enjoyment). The payment of consideration, or offsetting of expenses, does not appear to reduce the 'amount' and may even add to the trust's accumulated income.

28. Assignment of a trust interest

If an Australian resident has an interest in the trust which they assign to a foreign beneficiary (who would not be caught under section 99B), then section 99C(2)(e) would capture it (so could CGT event E8 or A1).

29. In-specie distributions

In addition to section 99B applying to an in-specie distributions from a foreign trust to a resident beneficiary, CGT events E4 to E8 (and may be even CGT events A1, C2 and H2) could also apply in relation to the beneficiary's interest in the trust, giving rise to a further (discountable) CGT event.

The anti-overlap rule in 118-20 should reduce the gain on the basis that 'because of the event' (being the trust payment and its impact on the trust interest) the gain is assessable income under another provision of the Tax Act (i.e. section 99B).

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[50] Benefits from a trustee to a beneficiary, would be non-assessable non-exempt income if they are fringe benefits under section 23L of the ITAA1936.
[51] For ATO guidance on evidencing 'genuine gifts' see https://www.ato.gov.au/Business/Privately-owned-and-wealthy-groups/Tax-governance/Tax-governance-guide-for-privately-owned-groups/Gifts-or-loans-from-related-overseas-entities/#

6. Throwback interest

To compensate for the deferral of tax on amounts accumulated by a foreign trustee, an amount included in the beneficiary's assessable income under section 99B is subject to an interest charge where the amount was derived from profits in a year where the:

- Trust was a resident in a listed country[52] – income was eligible designated concession income[53]
- Trust was a resident in an unlisted country – income was not subject to (full) tax

Amounts that cannot be proven otherwise are deemed to be EDCI (102AAM(1A)(a)).

The interest accrues on the amount of the section 99B distribution grossed up for any foreign tax credits, under the following formula:

Amount on which interest is payable = *(Distributed amount × applicable rate of tax)* - *foreign income tax offset*

The applicable tax rate is the general company tax rate (non-BRE) in the year of distribution or the maximum marginal tax rate of any other taxpayer.

The interest charge accrues from the start of the year following the income derivation[54] to the end of the income year in which the amount was included in the beneficiary's assessable income.

The current interest rate is the General Interest Charge under section 8AAD of the TAA 1953 less seven percentage points (i.e. the base interest rate, being the RBA's published 90 day average yield Bank Accepted Bill).

The relevant interest rate depends on the relevant period:

Period	
From 14 September 2006	applicable rate under section 8AAD of the *Taxation Administration Act 1953*
from 1 July 1999 until 14 September 2006,	rate applying under section 214A of the ITAA 1936
from 1 July 1994 until 30 June 1999	rate applying under section 214A of the ITAA 1936 less four (4) percentage points
before 1 July 1994	the rate applying under section 10 of the *Taxation (Interest on overpayments) Act 1983*

[52] See section 320 of the ITAA1936.
[53] See section 317 and Regulation 17 of the Income Tax Assessment (1936 Act) Regulation 2015.
[54] Or from the 1990/91 year for amounts accumulated before then.

30. Foreign deceased estate – interest charge 102AAM

Distributions from deceased estates to beneficiaries within 3 years of death are excluded from the interest charge. It does not appear a testamentary trust will qualify for this exception.

31. Deductibility of interest charge

A tax deduction to neutralise the impact of the throwback interest does not appear to be available. Section 8-1 may be of no assistance as the interest was not incurred “in” gaining or producing your assessable income.

Section 25-5 for tax related expenses only provides a deduction for GIC, being a charged worked out under Part IIA of the TAA (see section 995-1) where the above charge is calculated under 102AAM (with reference to the GIC provisions).

7. Foreign income tax offsets

Division 770 allows a gross-up and tax credit (up to the FITO limit) for foreign taxes appropriately levied and paid by you on amounts included in your assessable income. A DTA may also allow a credit or exemption.

Section 770-130 deems you to have paid an amount of foreign tax 'in respect' of a taxed amount that is all or part of an amount included in your ordinary or statutory income where the amount is:

(a) Paid by another entity under an arrangement with you or under the law relating to the foreign income tax

An arrangement could be an amount paid by your representative, by a partner in a partnership or a trustee on behalf of a beneficiary or a spouse (apportioned as appropriate).

Alternatively, it could be where a foreign law requires payment on your behalf such as deduction or withholding.

In both cases, it is the taxpayer that bears the economic burden of the foreign tax (i.e., it's the tax liability of the taxpayer) and a material connection or nexus is require between the amount of included in your assessable income and the foreign tax.

This is the case for 'flow-through' entities (or by election) but not for non-flow through entities, such as a company paying underlying corporate tax in its own right or a foreign pension fund (see TR 2005/3(W)).

In addition to apportionment, the words 'in respect of' allow a slicing of foreign income tax for conduit or flow-through entities such as trusts or partnerships

(b) Beneficiaries of trust estate

Where the foreign tax is not paid by the trust itself, the character and source of the income (via section 6B) flow through the trust to the beneficiary. This could be whether the trust income is subject to deduction or tax paid by an earlier trust. For example, withholding taxes by a company on a dividend paid to a trust.

Generally, an unlimited amendment period applies to give effect to Division 770.

32. FITO mismatches

Although conceptually a credit should be allowed for amounts assessable under section 99B, it may be the case that a FITO is not available where:

- The trust is not considered flow-though in the foreign jurisdiction and taxed in its own right
- The foreign jurisdiction taxes another taxpayer, such as a grantor or another beneficiary
- A nexus (or evidence) cannot be established between the foreign income and the tax paid
- It is Australian withholding tax on Australian income taxes to a foreign trustee or beneficiary
- The tax is not on income (e.g. inheritance or gift tax)

In this case, only tax relief by deduction might available (i.e., the net after-tax amount is taxed in Australia).

8. Other considerations

8.1 Section 102

It is not unusual for a foreign trust to be revocable by the person that established it or established it for the purpose of a minor beneficiary. Section 102 gives the Commissioner the power to tax the trustee (and not the beneficiary) on the trust's net income to the extent it is not included in the 'creators' assessable income. This rule excludes foreign income derived during the periods the creator was a foreign resident. Section 99B could capture such amounts later paid to a resident beneficiary (assuming the person can benefit under the trust deed).

8.2 Section 100A

Section 100A does not look at the residency of the trustee or the beneficiary. It is an anti-avoidance provision that *taxes a trustee* under section 99A where a present entitlement arises to an adult beneficiary, but a benefit has been provided to someone other than (or jointly to) the beneficiary.

Section 99B *taxes the beneficiary* where the benefit is actually paid or applied to a resident beneficiary and the amount has not been taxed to the trustee. As such, the two provisions are in some respects inverse.

Section 100A also requires a 'tax reduction purpose' where as section 99B is self-executing. That is, no tax avoidance or tax reduction purpose is necessary for section 99B to operate. Nor is there an exclusion in section 99B for 'ordinary commercial dealings'.

8.3 Family trust elections

A foreign trust could make a family trust election, for example, to satisfy the continuity of ownership test of an Australian loss company. Where this arises, the Commissioner can give notice to the foreign trust to collect information about its distributions to both resident and foreign resident beneficiaries.

9. Conclusion

Section 99B was clearly written for a different time and place. In its historical context, it was meant to apply to Australian residents that benefitted from accumulating tax-free income in a foreign trust.

The existence of throwback interest implies the Australian beneficiary had some role to play in accumulating the income offshore.

It operates without regard to a commercial or family purpose and penalises common, legitimate and in some cases, even arm’s length arrangements of former foreign residents and Australian beneficiaries of overseas relatives.

In a today’s globalised environment, it seems out of place (an ‘overreach’) and once a person has established tax residency, there may be little that can be done to reverse the impact of section 99B.

Be prepared.