The Tax Summit

Session 4.1: Intergenerational change - Trusts

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1. Overview

Often discretionary trust structures are used during a client's life to build up their wealth, operate their business and provide asset protection and tax strategies. The issue which we commonly see in practice is that multiple assets are accumulated in one trust and there may come a time when the client will want to separate out particular assets. This may for various reasons including:

- to implement a succession plan, where the intention is for control of different assets are to pass to different children;
- a change in the family dynamic where beneficiaries may want to go their separate ways;
- asset protection, that is avoiding the domino affect where the risks associated with particular activities carried on by the trustee may expose other assets of the trust.

When implementing the succession plan, there needs to be consideration in respect to:

- who will control particular assets which are held in the trust;
- which assets may need to be moved out of the trust;
- who will control the trust and if there are multiple controllers, are there appropriate control mechanisms to ensure that each party obtains their share of equity and trust income;
- whether the trustee has made an FTE or IEE, and if so, what impact will that have on distributions in the future.

If moving assets out of a trust, then as with any transaction, before proceeding it is necessary to consider a number of factors including:

- how the transaction is to be implemented, for example:
    - transferring the asset(s) to an individual or entity for consideration;
    - making an 'in specie' distribution to a beneficiary;
- what are the tax issues, including:
    - whether the trustee can reduce or disregard any capital gain under:
        - any roll-overs (for example the small business restructure roll-over); or
        - the small business CGT concessions;
    - making enquiries as to whether the trustee has made an FTE or IEE, in which case care must be taken to ensure that distributions are not made to individuals or entities outside the family group of the test individual;
- what are the duty and GST issues;
- ticking off on the commercial issues including dealing with financiers;
- the terms of the trust deed, including:

- does the trustee have the power to implement the transaction (for example, any consents which are required, power to make interim capital distributions or power to make ‘in specie’ distributions);
- has the trust already vested – which may mean that the trustee does not have any discretion as to who can receive distributions;
- who are the beneficiaries;
- how to deal with any gain, including getting the trustee resolutions correct:
  - how is ‘trust income’ to be defined;
  - does the trustee have the power to make interim capital distributions;
  - making sure that the trustee has small business CGT concession stakeholders if the trustee is applying the small business 15 year exemption or small business retirement exemption;
  - making sure that a beneficiary is made specifically entitled to the net financial benefit of a capital gain if streaming;

As is apparent there are so many boxes to tick before pushing the button to implement any succession plan (including the transfer of assets). In particular if a transfer is an internal restructure there will not be any cash to pay the tax if things go wrong and:

- particular concessions which were being relied on to deal with the capital gain are not available; and/or
- the net capital gain is taxed in the hands of the wrong beneficiary.

Planning for succession early and reviewing the plan regularly is particularly important as it allows for issues to be identified and therefore clients can implement measures during their lifetime rather than leaving things to chance for the next generation to sort out or fight over.

It will be important for advisers to regularly review their client’s structures to ensure that their succession plan is current. As is quite often the case circumstances change and assets are purchased and sold which means that the structure that the client started out with or decisions in relation to particular assets are no longer appropriate.

In this paper, a reference to the ‘1997 Tax Act’ means the Income Tax Assessment Act 1997 (Cth); and ‘1936 Tax Act’ means the Income Tax Assessment Act 1936 (Cth).

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2. Trusts, trust deeds and trustee decisions

2.1 What is a Valid Trust?

A trust exists where a person (trustee) has the legal ownership of property (trust property) which is held for the benefit of beneficiaries .

2.1.1 Essential elements

The essential elements of a trust as outlined in Jacobs Law of Trusts in Australia are:[1]

- there must be property capable of being held on trust;
- there must be an individual or corporate trustee in existence who has "an obligation to deal with the trust property in accordance with the terms of the trust";
- there must be beneficiaries or an identifiable class of beneficiaries;
- the terms of the trust must be certain.

Generally, the terms of the trust will be evidenced by a trust deed or similar instrument. Provided that the essential elements of a trust are present, generally it will not matter if some of the formalities involved in preparing or signing the trust deed have been overlooked. It will however be important to show:

- certainty of intention that the trust property was to be held on trust (intention to create a trust);
- certainty of the trust property; and
- certainty as to the beneficiaries.

Aileen Pty Ltd v One Hawker Holdings Pty Ltd[2] provides a good illustration of this.

In that case the settler did not pay the settlement sum to the trustee and the settlor's signature on the deed was forged. The court considered it was sufficient that the trust deed had been signed by the trustee who held land which was subject to the trust. Land was transferred to the trustee after the signing of the trust deed. An ABN for the trust was applied for. A bank account was opened and funds were borrowed in the name of the trustee as trustee for the trust. The Court was satisfied that the individual intended to transfer land to the trustee upon trust for the beneficiaries upon the terms set out in the trust deed.

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[1] 8th Edition at [1-04] to [1-10]
[2] [2006] VSC 135.

However, in the case of *Re Lauer; Corby v Lyttleton*[3] the Court held that a trust had not come into existence

Facts

- The deceased and the defendant were friends. He had been appointed as her attorney under an enduring power of attorney.

- The deceased asked the defendant to organise a family trust for her. To save costs, the defendant decided to copy and amend the 'family trust' of his friend.

- He then organised for the deed to be signed by himself and the deceased showing the date on the cover page as 24 September 2002. On 16 October 2002, a bank account was opened in the name of "The Elizabeth Lauer Family Trust" with the deceased described as the trustee. The account was subsequently changed to "George Nagy [the defendant] in Trust for the Elizabeth Lauer Family Trust'. Money was deposited and withdrawn from the trust account, relevantly approximately $104,000 was deposited in 2005.

- At a VCAT hearing in 2009 a copy of the trust deed was provided in which page 10 of the trust deed was missing.

- Five versions of the Trust Deed were presented to the Court (none of them were original versions):
  - Defendants version:
    - The cover page cited date as 24 September 2002, the 'Settlor' as Q.P. Williams, the 'Trustee' as George Nagy and it contained the words "Deed of Trust" and "The Elizabeth Lauer Family Trust"
    - Pages one to nine had consistent font.
    - Page 10 was drafted in different font. It listed three schedules. The first schedule identified Queenie Patricia Williams as the 'Settlor' and George Nagy as the 'Trustee'. The second schedule listed the 'Beneficiary' as Bernard Lyle Wright, Markus Rashie, Bettina Lauer, George Nagy, Anna Nagy. Schedule three contained the words "The Lauer Family Trust'.
    - Page 11 of the deed contained the signing clauses. It contained two signing clauses, one for the "Common seal of Elizabeth Lauer" and another for 'the said trustee'. The common seal of Elizabeth Lauer is said to be affixed 'pursuant to a resolution of the Board of Directors'. To the right of the first signing clause was a circular stamp in blue ink, bearing the words 'The Common Seal' of the 'Elizabeth Lauer Family Trust', and four signatures. The first signature was that of the deceased. The defendant's sister-in-law had signed twice, one signature next to the text "Director'. The sister-in-law said that she attended and witnessed the signature of the deceased and the defendant. She only signed one document. The second witness, Mr Graff was not present at that time. In relation to the signing clause for the 'said Trustee', the defendant signed as well as his sister-in-law and Mr Graff.
  - Mr Morehead's version (previous lawyer of the defendant) – same as the defendant's version.
  - Roberts Beckwith's version (which was discovered in the 2009 VCAT file when they acted for the executors of the deceased in relation to the administration of the estate) – cover page and pages one to nine were identical to the defendant's version. Page 10 was different in that the formatting of the text in clauses were different. Four schedules rather than three schedules were identified. Both the settlor and beneficiaries had changed. The settlor was identified as 'Kim Michod' and the 'Beneficiary' as 'Bernard Lyle Wright, Markus Rashle, Bettina Lauer'. The third schedule identified the 'income beneficiary' as 'my Trustee George Nagy' and the fourth schedule noted the name of the trust as the "Elizabeth Lauer Family Trust'. Page 11 was different in that Mr Graff's signature did not appear.

[3] [2017] VSC 728.

- VCAT's version – pages one to ten the same as the defendants. This deed contained two pages identified as page 11. One of the page 11s, had an execution clause for the common seal of Elizabeth Lauer, but had no seal affixed. Beside the clause was the deceased's signature and adjacent to the word 'Director' was a signature that does not appear on the defendant's version. Adjacent to the execution clause for the trustee was the signature of the defendant. The second page 11 was the same as the page 11 contained in Roberts Beckwith's version.
- CBA's (bank) version – Pages one to nine were the same as the defendants. Page 10 was missing. Page 11 was different to the defendant's version in that only one signature of Elizabeth Lauer appears, no stamps have been affixed to the clauses and there were no signatures of witnesses.
- Further, all the deeds referred to a fifth schedule in clause 1(e) – none of the versions contained a 'fifth schedule'.

The Court held that the trust had not come into existence:

- The settlor did not sign the deed.
- There was no evidence the settled sum of $500 was ever given by the settlor to the trustee.
- The beneficiaries were not sufficiently defined in the trust deed.

> 103 Having regard to the 'three certainties' of trust creation and the evidence, it is apparent that there are two key points in time in which a trust may have been created: 2002, when the original deed was signed by the deceased and the defendant; and 2005, when funds were deposited into the Trust Account, particularly the amount of $104 104.52.
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> *Did a trust come into existence in 2002?*
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> 104 Two obstacles in particular preclude a conclusion that a trust was created in 2002. First, the relevant intention to create a trust is that of the settlor. Although at times courts have recognised that the intentions of others may have greater relevance, and have consequently inferred that a nominal settlor has adopted the intentions of others, such cases have surrounded applications for rectification of trust instruments and have involved at least some evidence of the intention of the settlor. Here, the absence of evidence regarding the intention of the settlor cannot be overlooked. The named settlor in the defendant's version of the deed, Ms Queenie Williams, did not execute the deed and as such, there is no evidence manifesting her intention to create a trust. Moreover, it is not possible to find that she may have adopted the intentions of others.
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> 105 It can be accepted, however, that the terms of the defendant's version of the deed and the signatures of the deceased and the defendant, support a finding that in 2002 the deceased and the defendant manifested an intention to create a trust. The submissions of the plaintiffs invite the Court to consider the surrounding evidence, and conclude that the actions of the deceased may otherwise be explained as the deceased seeking to appoint the defendant as the 'trustee' of her affairs, reflecting his appointment as her attorney. There is a degree of discord, however, between such an approach and the approach of the High Court in *Byrnes v Kendle*. Here, the terms of the defendant's version of the deed, as signed by the deceased and the defendant, adopt the explicit language 'upon trust'. As such, it is unnecessary to look for inferences drawn from the surrounding circumstances. Even if this course is taken, based upon the trust not necessarily having to be manifest in writing and the ambiguities in the terms of the deed, particularly the unusual execution by the deceased and lack of execution by the settlor, the Court's finding as to the manifest intentions of the deceased and the defendant would not change. The facts upon which the plaintiffs rely in this regard are:
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> (a) the written agreement of 1 April 2002 in which the deceased referred to the defendant as 'my Trustee', relating to expenses incurred in caring for the deceased; and
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> (b) the deceased signing the CBA authority dated 16 October 2002 as 'Trustee' of the Trust Account.
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> 106 These facts, however, do not outweigh the existence and language of the trust deed. Moreover, the deceased had already executed a formal instrument to assist the defendant in managing her affairs, namely, the power of attorney. Consequently, the evidence overall still manifests an intention of the deceased and the defendant to create a trust. That said, it is evident that in the absence of the intentions of a settlor in 2002, those of the deceased and the defendant assume limited relevance.

107 The second factor that prevents the finding that the Trust was created in 2002 is the absence of evidence of subject matter. Property is referred to in the defendant's version of the deed in both the recitals, and cl 1(d). The former states that upon execution the settlor will pay the sum of $500 to the trustee to be held upon trust. The latter defines 'Trust Property' broadly as including, inter alia, not only the $500, but 'all monies investments or property paid or transferred to or otherwise acquired by the Trustee and accepted by it as additions to the property'. There is no evidence, however, that $500 was ever transferred by the settlor. Indeed, other than the reference to that sum, there is no evidence of any property to which trust obligations could be affixed in 2002. As such, while the Court accepts that in 2002 the defendant and the deceased sought to establish a trust by the name of the Elizabeth Lauer Family Trust, no trust was created.

Did a trust come into existence in 2005?

108 The only property identified in the evidence before the Court to which trustee obligations may have attached relates to the funds in the Trust Account. The earliest statement of account indicates that on 17 December 2004 the Trust Account held $4694, and approximately one month later, it received a deposit of $104 104.

109 The defendant asserts that he accepted money into the Trust Account as trustee. However, little is known regarding the origin of these funds. The Court is invited to infer that: the $104 104 came from the deceased's share of the proceeds of sale of the Eastbourne Road property; the deceased transferred the funds to the Trust Account; and, an express trust was created by this transfer. Moreover, the deceased and the defendant were bound by the terms of the defendant's version of the deed as signed in 2002, which then applied to the newly created trust.

110 As the submissions of the defendant focus upon the creation of a trust, the Court can put to one side the possibility that the Trust Account funds were an 'addition' or 'accretion' to the settlement of $500 that failed in 2002. Instead, analysis turns to whether the transfer of funds into the Trust Account in 2005 created a trust. On the issue of an intention to create a trust, as there is no explicit language in evidence regarding the transfers, an intention must be inferred from the nature of the transaction, other language used by the parties and the circumstances attending the parties' relationships. Here, for the reasons stated by the defendant, the Court is prepared to accept that the $104 104 originated from the sale of the deceased's interest in the Eastbourne Road property. While it can also be accepted that depositing funds into a trust account is a particularly significant manifestation of an intention to create a trust, evidence surrounding who transferred the funds and the circumstances in which the transfers occurred is lacking. Unlike in *Harpur v Levy*, contemporaneous documents are almost entirely absent. In circumstances where the deceased was dealing with a considerable asset which, as indicated by her last will in 2002, she had intended to devise to the defendant, in the absence of such evidence the Court cannot infer that it was the deceased who transferred the money.

111 Further, the submissions of the defendant require inferences to be drawn as to certainty of objects. It is asserted that the relevant funds were to be held on trust on the terms of the defendant's version of the deed. While the authorities identified by the defendant suggest that the deceased and the defendant may be bound by the terms of the defendant's version of the deed, this does not lead to the conclusion that the obligations contained therein are automatically annexed to the property identified in 2005. The only link between the defendant's version of the deed and the property later identified is the Trust Account. In my view, this alone is not enough to support the requisite inferences. The circumstances are distinct, for example, from those in *La Housse v Counsel*, as there:

(a) the initial trusts came into existence;

(b) the funds were transferred into the trust accounts by the trustee of the earlier trusts; and

(c) contemporaneous evidence was adduced, both written and oral, manifesting an intention of the trustee that the beneficiaries of the later trusts were the same as those of the earlier trusts.

112 Ultimately, on the evidence of the funds in the Trust Account alone, albeit funds realised from the sale of the Eastbourne Road property, the Court cannot conclude that the funds were transferred by the deceased to be held on trust on the terms of the defendant's version of the deed. To draw such inferences would be verging upon speculation, which, as touched on by Gummow and Hayne JJ in Byrnes v Kendle is particularly inappropriate when potentially creating property rights enforceable against third parties.

113 As such, the answer to the first question is 'yes'; that is, a trust by the name of the Elizabeth Lauer Family Trust failed to come into existence.

2.1.2 Formalities not adhered to

Unfortunately, it is common to see trust deeds that have not been properly signed or that the settlement moneys or cheques are not banked by the trust. Although these look like minor deficiencies, the failure to properly settle a trust can have unintended consequences, especially for a client's estate planning.

While a failure to comply with formalities will rarely result in a court determining that the trust is invalid (provided that there is evidence of the three 'certainties'), it is obviously better if the there is a properly signed trust deed for the trust.

Financiers in particular tend to take a quite pedantic approach when reviewing trust documents and, if they consider there is a defect, the client is usually left with no option but to take remedial action to address the lender's concerns rather than have a debate with the lender's lawyers as to whether technical errors impact on the existence or operation of the trust.

Tips to ensure a trust is properly established

- Trust deed: Use a well drafted and comprehensive trust deed that contains all the necessary trust formalities and is easy to understand.
- Signing: Make sure that the settlor and trustee properly sign the trust deed and it is properly witnessed.
- Settlement sum**:** Ensure the settlor provides the settlement sum (usually a nominal amount) and deposit this into the trust's bank account as soon as it is established (even if you do not need a bank account for another reason).

2.1.3 Rectifying mistakes in a trust deed

It is also not uncommon for trust deeds to contain mistakes. Such mistakes are commonly resolved by a deed signed by the parties to the trust deed rectifying the mistake.

However, in *FC of T v Trustee for the Michael Hayes Family Trust*[4] which involved a tax dispute, the Court was required to consider whether a mistake could be rectified against the Commissioner.

Facts

- MJH Fixed Trust was established in February 2010.
- The schedule to the trust deed of the MJH Fixed Trust identified the second absolute beneficiary as 'Grawlex Pty Ltd as trustee for the MJH Fund'.
- However, Grawlex had been replaced as trustee of the MJH Fund by Ragem Pty Ltd on 1 July 2007.
- The settlor and the trustee of the MJH Fixed Trust signed a Deed of Rectification rectifying the error with effect from the date of the establishment of the MJH Fixed Trust.

Decision (Steward J with Griffiths and Derrington JJ in agreement)

- The mistake could be rectified by the principle of construction

  33. The learned primary judge decided at [61] that the reference to Grawlex as the Second Absolute Beneficiary "made no sense". I also respectfully agree with that observation. However, I think that this case is not really concerned with ambiguity in an instrument (whether patent or latent). In my view, this is a case about mistake. The

[4] [2019] FCAFC 226.

parties mistakenly referred to Grawlex instead of Ragem. This is a mistake which can be cured by construing the reference to Grawlex to be a reference to the correct trustee of the MJH Superannuation Fund, namely Ragem.

34. The correction of obvious errors by an application of the ordinary principles of construction is well known……

37. I note the expression of the test as involving two conditions which must be satisfied, namely:

(1) that the literal meaning of the contractual words is an absurdity; and

(2) that it is self-evident what the objective intention is to be taken to have been.

The level of satisfaction about these matters must be “high”.

- In relation to the Deed of Rectification, the Court found that whilst legally binding between the parties, it was not binding on the Commissioner as it could not retrospectively change or alter taxable facts. However, it could be used as evidence of the mistake that had been made and the identity of the trustee.

49. Thirdly, whilst the Deed of Rectification here may be legally efficacious as between the parties to it, including, perhaps, as between the trustee and the beneficiaries, it cannot bind the Commissioner. The Commissioner can only assess taxpayers by applying the 1936 and 1997 Acts to the “taxable facts” which apply in each year of income, to use the language of Barwick C.J. in Bailey v Federal Commissioner of Taxation (1977) 136 CLR 214. The Deed of Rectification, executed in 2018, in and of itself cannot change or alter those taxable facts.

51. Whilst the Deed of Rectification cannot bind the Commissioner, it was received into evidence, and, in my view, was otherwise able to be relied upon by the taxpayer as evidence of the mistake that had been made about the identity of the trustee of the MJH Superannuation Fund.

2.2 Lost trust deeds

2.2.1 Importance of the trust deed

If the trust deed cannot be located, then the trustee may not be able to administer the trust with certainty. For example:

- What are the powers and obligations of the trustee?
- Who are the beneficiaries?
- Who is the appointor?
- How can the terms of the trust be varied?
- What is the vesting date?

It is also a breach of the duties of a trustee which include:[5]

- being acquainted with the terms of the trust; and
- to adhere to and carry out the terms of the trust.

Uncertainty as to the terms of the trust deed, may create issues with the beneficiaries, the Australian Taxation Office and financiers.

Clients should regularly make sure that they know where their original documents are – or address these issues as soon as they realise they are a problem.

[5] Jacobs’ Law of Trusts in Australia 8th Edition, paragraphs [17-01] and [17-03].

2.2.2 Where to look for the original or a copy?

Approach third parties, for example lawyers, previous accountants, banks, individuals associated with the trust to determine whether they have the original or a signed copy.

In some States, the trust deed may have been lodged with the titles office if the trust holds real property.

If the provider of the deed and the date the trust was settled can be determined with accuracy, the provider can be approached for a copy of their template terms used at the time the trust was established or they may have a copy of the unsigned deed. If relying on the template terms, the trustee may also consider applying to the ATO that this approach will not result in a resettlement of the trust.

2.2.3 Options

Do nothing

Risks

- Uncertainty as to how to administer the trust.
- Potential issues with financiers, beneficiaries and the ATO.
- Providing evidence that there was a trust.

Confirm the terms of the trust

- Requires evidence of the terms of the trust
  - Copy of a signed deed
  - Copy of an unsigned deed
  - Service provider’s template
- If possible, have the settlor and trustee sign the deed of confirmation
- Risks - potential issues with financiers, beneficiaries and the ATO.

Seek the direction of the Court

- Protection for the trustee
- There is a high threshold to reach in terms of establishing that sufficient enquiries to substantiate the terms of the trust have been made.
- Expensive

Court decisions

In *Barp Nominees Pty Ltd,*[6] the Court was satisfied that there were two family trusts set up at the same time and that they mirrored each other with the only differences being the beneficiaries and the persons who controlled the trusts.

Facts

- Two trusts were established in 1974 by the parents for the families of their two children, Giselda Sandrin and Clelia Cisera. The trust deed for the Sandin trust had been lost. The trust deed for the Cisera trust was in existence.

- The daughter of Giselda Sandrin remembered her mother (who was elderly at the time) showing her the trust deed for the Sandrin trust. She recalled that Sandin trust deed was dated 1974 and that the trustee was Barp Nominees Pty Ltd. Her mother pointed out her name [the daughter's name] and the mother's name as beneficiaries.

Decision

- The Court held that Barp Nominees (the trustee) was justified in managing and administering the trust estate known as the Sandrin Family Trust which was established in 1974 pursuant to the terms annexed and marked 'A' to the orders.

Sutton v NRS(J) Pty Ltd[7] is a decision by the NSW Supreme Court which dealt with a situation where the original trust deed could not be located, but the parties had a photocopy of the signed deed.

Facts

- A discretionary trust was established in 1972. The trust was practically dormant for approximately 30 years, holding only the settlement sum. In 2007, the trust was re-activated.

- In June 2007, in accordance with the terms of the deed, there was a change of trustee. The three individual trustees were replaced with three separate companies.

- Shortly after the change of trustee, the Trust acquired a rather large investment portfolio.

- The portfolio generated income which was distributed to the beneficiaries of the Trust in accordance with the terms of the trust deed.

- Accountants were retained from 2009 to prepare tax returns for the trust.

- The issue arose because a bank requested to see the original trust deed. The bank needed to satisfy itself that the originating documents for the Trust were in order, referred to as the "Knowing your Client" obligations. This required them to inspect the original deed documents. This was not possible because the original deed for the trust could not be found. They were only provided with a photocopy of the original deed.

- Because they could not be provided the original deed, the bank froze the bank account for the Trust.

[6] [2016] NSWSC 990
[7] [2020] NSWSC 826.

The application

- An application was made to the Court requesting an order that the photocopy the trustees had was a true copy of the original deed.

- The court did not grant this specific order that the parties sought, rather it gave a direction to the trustees that it was appropriate for them to treat the photocopy of the deed they had as a true copy of the original deed and to administer the trust according to that copy.

The decision

- The copy being relied on was a copy of the signed deed – therefore no need to provide that the formal requirements had been complied with. This was compared to the case of Re Thompson [2015] VSC 370 where the parties were relying on an unsigned copy of an originating trust deed.

- The existence of a second photocopy was also relied on by the Court to support the conclusion that the photocopy is indeed a copy of the original which is now lost.

- The court ordered that "The trustees of the trust settled by Frederick Walter Sutton by Deed of Trust dated 23 October 1972 are justified in administering the trust on the basis that the document annexed to this order and marked "A" is a true copy of that Deed."

In *Application of South Melbourne Continental Pty Ltd,*[8] the Court dismissed an application where the plaintiff sort a declaration for the reconstruction of a lost trust deed and order for the trustee to enter transactions and approve past transactions of the trustee. Although the provider of the trust deed was known there was uncertainty as to who was the Settlor, what the settlement sum was and who were the appointor, guardian, and named beneficiaries of the trust. The Court was also not satisfied that all reasonable efforts were made to locate the trust deed.

> 41 The evidence provided by the plaintiff in support of the relief sought highlights the substantial gaps in the relevant information and facts required to enable the deed to be reconstructed. The plaintiff has not provided clear and convincing proof as to the contents of the lost trust deed. There is no means of verifying Mr Totos' recollection as to the information required for the completion of the schedule to the precedent trust deed, such as the guardian, the appointor, the principal or other beneficiaries, the settlor or the date of the trust. Notably, Mr Totos was very young at the time that the deed was settled in 1984 and under the guidance of his father. In such circumstances, only so much weight can be given to his evidence without corroboration. It is notable that Mr Totos' mother and the extended Totos family are not mentioned as beneficiaries, as would be usual in the type of family trust that has been described by Mr Totos and Mr Moses, and where distributions were made to his mother.
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> 42 The limited number of financial statements provide some secondary evidence of the trust but the usual secondary evidence that might assist the Court, such as the complete sets of the accounts for the trust, completed tax returns and various transactions for the trust over the years, are not in evidence. Notably, the financial statements provided relate to the period after it was discovered that the trust deed was lost, yet Mr Totos deposes that since that time the trust has been administered in accordance with the terms of the precedent trust deed. The evidence as to the searches undertaken is limited in its utility and the evidence of the activities of the trust over the years is sparse. The evidence of the Family Court orders are insufficient for the presumption of regularity to be applied in respect of the trust.
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> 43 The Court is not satisfied that all reasonable efforts to locate the trust deed have been carried out or that evidence of its existence is incapable of being procured, particularly where Mr Moses' evidence suggests that it is likely that four original deeds were executed in 1984.
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> 44 As stated, the plaintiff's originating motion also seeks orders confirming the power of the trustee to effect the relevant transactions, as defined, alternatively, the power to enter into the proposed transactions, alternatively, orders approving the relevant transactions dating back to 1984. The evidence of the proposed transactions is mostly secondary evidence and is not verified by any documentary evidence, with limited evidence provided for the detail of the transactions undertaken by the trust over the past 35 years.

[8] [2018] VSC 398.

Application *of M & L Richardson Pty Ltd*:[9]

Facts

- The Trust had been administered for a number of years in accordance with an unsigned trust deed.
- The original trust deed could not be found.
- The trustee sought advice that it would be justified in administering the Trust in accordance with the unsigned trust deed.
- The service provider provided evidence that it had established a trust in accordance with the unsigned copy.
- There was evidence that the Trust had operated a bank account for many years. There was evidence from the bank that it would not have allowed a bank account to be opened without having seen at least a copy of the signed trust deed.

Decision

- The application was successful. The Court was satisfied that the Trust has been administered in accordance with the unsigned copy of the deed and the terms of the Trust were clearly and convincingly established through the 'continuous administration of the Trust in accordance with the identified unexecuted copy of the trust deed'.

2.3 Check to make sure that distributions are made to eligible beneficiaries

2.3.1 Need to READ THE DEED and take care when establishing the trust

Assistance of the Court to rectify the deed

Wilstead No. 5 Pty Ltd v Smyth[10]

Facts

- In August 1988 the trust deed was signed for the Bowen Family Trust.
- The primary beneficiaries were described to mean 'the children of the persons referred to in the Schedule hereto (clause 1.1).
- The primary beneficiaries were listed in the Schedule as "Robert Evan Bowen and Venetia Kitson Bowen and the children of Robert Evan Bowen and Venetia Kitson Bowen.
- The general beneficiaries included the parents of the primary beneficiaries however excluded the guardian and the appointor unless they were specifically included as a primary beneficiary in clause 1.1.
- The Guardian and Appointor was Robert Evan Bowen.

[9] [2021] NSWSC 105
[10] [2020] VSC 651.

- This meant that Robert Bowen was not a beneficiary of the trust.
- The trustee had been distributing to Robert for many years.

Decision

- Based on the evidence of the Settlor and Robert Bowen, the Court was satisfied that it was always intended to include Robert, his wife and their future children as beneficiaries and that the Trust Deed did not reflect the actual common intention at the time of creating the Trust. This was because of the inclusion of the words ‘the children of the’ in clause 1.1.
- The Court also noted that distributions were made to Robert Bowen as though he was a primary beneficiary.
- The Court ordered that the Trust Deed be rectified by deleting the words ‘children of the’ in clause 1.1 resulting in the primary beneficiaries being ‘persons referred to in the Schedule hereto’.

Benaroon Pty Ltd v Larmar & Ors[11]

Facts

- The Larmar Family Trust was established on 3 March 1977, with Benaroon as the trustee. Earl Larmar and his former wife, Suzanne Larmar, were the original directors of Benaroon.
- The trustee had made distributions to Earl, Suzanne and Margaret (Earl’s current wife).
- The beneficiaries included the children of Earl Larmar. Neither Earl nor his wives were named as beneficiaries.
- Clause 3(a)(i) of the deed gave the trustee the power and discretion, before 30 June each year, to”

> Pay the whole or any par of the net income …. To all or any one or more of the Beneficiaries or the spouse of the Beneficiaries or such of the issue of the Beneficiaries or the spouses of the issue of the Beneficiaries s shall then be living as the trustee in its absolute discretion determines;

Issue

- Neither Earl nor his wives were beneficiaries.
- An application was made to the Court seeking orders that the trust deed be rectified by including Earl Larmar and trusts and companies as beneficiaries.

Decision

- The issue considered was whether the trust deed was capable of being rectified. Martin J confirmed the approach to be taken at [8]:

> [8] Both parties accepted, as do I, that for a trust deed to be rectified:
>
> … there must be clear and convincing evidence that at the time the trust deed was executed the trustee and the settlor had an actual intention as to the effect which the deed was intended to create which was different from the effect which the instrument did have in a clearly identified way … . It must be demonstrated with clarity that the parties had a sufficiently precise intention that the court can determine both the substance and the detail of the precise variation to be made to the wording of the instrument …

[11] [2018] QSC 274

Who may seek rectification?

- In determining who could seek rectification, Martin J discussed that rectification is to be sought by the settlor. The settlor of the Larmar Family Trust was, Earl Reeves, a client of Mr Larmar.

- Mr Reeves deposed that at the time the trust was created he did not understand the role of the settlor and only signed the document to become settlor because it was given to him by Mr Larmar, his accountant.

- As such, Mr Reeves had no separate intentions regarding the structure of the trust. Mr Reeves intentions were whatever Mr Larmar decided. The applicant therefore had the settlor's consent to bring the application.

What was intended?

- Mr Larmar gave evidence that he intended the trust to be for the benefit of himself, his spouse, his children, grandchildren and the usual remaining beneficiaries.

- He explained that the deed did not name him as a beneficiary due his secretary using a precedent trust deed to construct the document.

Is there clear and convincing evidence?

- Martin J accepted that Suzanne intended to establish a family trust for the benefit of Mr Larmar, herself and their family. There was no evidence of the interests either Suzanne or Mr Larmar were to have under the trust. Nor was it clear that Suzanne intended future spouses of Mr Larmar to become beneficiaries.

- Mr Larmar's secretary did not give evidence as to what she was told about who, if anyone, was to be a capital beneficiary or an income beneficiary or a default beneficiary. She did not give evidence concerning whether the trust deed was to include future spouses of Mr Larmar.

- Another trust produced by the applicant contained significant differences to the Larmar Family Trust and did not support the applicant's case.

Outcome

- The application was dismissed due to the uncertainty of the available evidence.

- Martin J at [32] noted that 'clear and convincing' evidence was lacking and that in the absence of any contemporaneous writing, there was nothing to support Mr Larmar's assertions.

- Further the applicant sought only to add Mr Larmar as a beneficiary. Martin J determined that even if the trust were to be rectified on the available evidence, Suzanne would also need to be named as a beneficiary.

Who is included as a 'spouse'?

"Spouse" – Is it defined? Does it include de-facto spouses and former spouses?

For example:

- When ABC Trust was established the 'wife' was nominated as the primary beneficiary.

- The husband and wife divorced. The trust is controlled by the husband.

- Beneficiary includes the spouse of the primary beneficiary.
- Distributions have been made to the husband.
- Issues:
  - Does the deed have a definition of 'spouse'?
  - Does 'spouse' include former spouses?

Is a deceased estate a beneficiary?

If the trust deed defines a class of beneficiary to be 'the trustee of any trust in which the eligible beneficiaries include a person or company that is also a beneficiary of this trust" the issue is whether a deceased estate will be included in this class.

Until a deceased estate is administered, there is no specific property capable of constituting the subject property of any trust.[12]

Therefore, for an estate to be included as a beneficiary prior to administration, the class will need to include 'the legal personal representative of a beneficiary'.

2.3.2 Adding and removing beneficiaries

The procedures for varying a trust or adding or removing beneficiaries will usually be reasonably clear, but it is important to always check the trust deed to ensure the correct procedure is followed.

Important issues that need to be checked are:

- who has the power to make the change (for example, the trustee or appointor);
- the procedures for variation (for example, by deed, minute or notice in writing); and
- whether it is necessary to obtain the consent of any party (for example, an appointor or guardian).

A failure to comply with the procedural requirements for the appointment or removal of beneficiaries may result in the purported removal or appointment being void.[13]

- In *Idlecroft* the trust deed of one of the trusts considered in the judgement provided that the principal could appoint additional beneficiaries. The trustee was a company and the principal was a director of the trustee.
- The trustee purported to appoint an additional beneficiary by a nomination under the company's seal which was countersigned by the principal but in his capacity as director. Spender J held that the fact the principal signed the nomination of beneficiary as a director did not constitute an appointment by him as principal.[14]

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[12] *Re Estate of Stagliano* [2025] VSC 39

[13] *Idlecroft v Commissioner of Taxation* 2004 ATC 4845, *Re Cavill Hotels Pty Ltd* [1998] 1 Qd R 396.

[14] 2004 ATC 4845 at 4854

2.4 Exercise of Trustee Discretion

If the trustee has determined to exercise its discretion, it is important that the trustee does so properly and carries out (and documents) a process for informing themselves of the decision to be made. Otherwise, the trustee risks their actions being criticised, and their decision being reviewed by the court.[15]

We know that, generally, a trustee does not need to give reasons for their decision.

Where the trustee declines to provide reasons for the decision, provided the decision has not been made in bad faith or with ulterior purpose, the court is not able to review the trustee's decision.[16]

This however does not mean that the trustee can simply make a discretionary decision without properly informing themselves of certain things.

The court will review a trustee's decision if:[17]

- there was a failure of the trustee to act honestly and in good faith;
- the trustee failed to give genuine consideration to the decision;
- the discretion was not exercised with due consideration for its proper purpose; and
- the trustee's reasons (if given) were not sound.

If a trustee's decision is disputed, the trustee must be able to provide evidence that the trustee made proper enquiries to obtain the relevant information to inform the trustee of the decision to be made.

The actions of the trustee in *Re Marsella*[18] are clear examples of the trustee of a self-managed superannuation fund breaching their duty when exercising the discretion to pay a death benefit. In that case the Court found the trustee:

- not understanding duties to consider the other eligible beneficiaries
- either ignorance of, or had deliberately, mischaracterised the true circumstances
- denied her conflict of interest in being a trustee and eligible beneficiary
- wrongly concluded the discretionary decision allowed the trustees decision without a genuine consideration of the trustee's duty to exercise the power in good faith
- had not tried to resolve these issues by seeking proper advice.

The duty of the trustee to properly inform themselves is higher for a trustee of a superannuation fund.[19] However, there are some lessons to be taken away for trusts.

When a dispute arises about the exercise of discretion, the court's role is to look at the:

- inquiries made by the trustee;
- information the trustee had available;

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15 See *Re Marsella; Marsella v Wareham (No 2)* [2019] VSC 65 (*Re Marsella*) and *Wareham v Marsella* [2020] VSCA 92.

16 *Karger v Paul* [1984] VR 161.
17 Ibid.
18 *Re Marsella* [2019] VSC 65.
19 *Finch v Telstra Super Pty Ltd* [2010] HCA 36.

- trustee's reasons for exercising discretion; and
- manner in which the discretion was exercised.

It is not the Court's role to assess the fairness or reasonableness of the trustee's decision. However, the trustee's decision itself may form part of the evidence to prove the discretion was not properly exercised.[20]

***Owies v JJE Nominees Pty Ltd*[21]**

Facts

- John and Eva (husband and wife) operated the Owies Family Trust in the 1970s.
- John and Eva's three children, Michael, Deborah and Paul were named as the Primary Beneficiaries.
    - The Primary Beneficiaries were default beneficiaries.
    - There was a broad class of general beneficiaries based on relationship to Primary Beneficiaries.
    - However, the Primary Beneficiaries did not have kids of own so actually reasonably narrow group of eligible beneficiaries
    - The trustee was a corporate trustee:
    - John and Eva were directors until their deaths, which were
        - Eva in 2018.
        - John in 2020.
    - Michael and Paul were appointed directors 1998 and removed in 2013.
    - Michael and Paul did not participate in trust administration while directors.
    - Michael was appointed director again in 2019 and had a greater participation in the administration of the trust.
- The total value of the trust's assets at the time of the of the judgement was $23 million.
- Historically, the trust distributions were made as follows:
    - 2011 – 2018
        - 40% John
        - 40% Michael
        - 20% Eva
    - 2019
        - 100% John as to income
        - capital distribution of real estate to Deborah.

[20] *Re Marsella* [2019] VSC 65
[21] *Owies v JJE Nominees Pty Ltd* [2022] VSCA 142

- There was some estrangement between family:
    - Paul lived overseas for a period but generally had good relationship with parents
    - Deborah had strained relationship with both parents.
    - Michael was the golden child. He also had a strained relationship with his siblings (Deborah more so).

Issues

The issues on appeal were:

- whether the trial judge erred in finding that the trustee gave real and genuine consideration to the position of Paul and Deborah and that the trustee did have sufficient information as to their circumstances for the 2017 distribution;
- no real and genuine consideration was given to the 2019 distribution, and that this 100% distribution to John was so ‘grotesque’ it showed a miscarriage of the trustee’s discretion;
- the appropriate relief for the years where the trustee had breached its duty was to set aside the distributions on the basis that they were void or invalid and order that the trustee pay the applicant each an amount reflecting one third of the total income for each of these years; and
- whether the trial judge erred in refusing to remove the trustee.

Decision

- The Court acknowledged that although clause 17 of the trust deed imports a very wide discretion on the Trustee in exercising their power, there are still boundaries on Trustee’s conduct.
- The Court cited *Scott v National Trust for Places of Historic Interest or Natural Beauty* [1998] 2 All ER 705 in which Walker J provided that Trustees must always:[22]
    - act in good faith;
    - act responsibly;
    - act reasonably; and
    - inform themselves of relevant matters before making a decision.
- The Court provided that the trustees are also required to give real and genuine consideration. The Court considered *Karger v Paul [1984] VR 161* (Karger) and provided that the content of this duty includes the trustee actively exercising their discretion and turning their mind to whether or not to exercise their discretion. The Court provided that the duty could also be expressed as requiring the trustee to not act ‘irresponsibly, capriciously or wantonly’.[23]
- The Court considered *Wareham v Marsella* (2020) 61 VR 262 and the elements to consider when determining whether a trustee has failed to give real and genuine:[24]
    - that are the relevant matters the trustee must consider;

[22] Ibid at [82].
[23] Ibid at [86].
[24] Ibid at [90].

- what standard of review should the Court adopt in determining whether there was non-compliance; and

- what was the consequence of the trustee's failure to give real and genuine consideration.

- Importantly, the starting point is an analysis of the terms of the trust to determine the nature and purpose of the trust.[25]

- In this case, the Court concluded that the class of beneficiaries is not large and the beneficiaries remain closely linked to the three Owies children (who did not have children of their own). The Court also stated it was implied by the terms that of the trust that the trustee should remain informed of the circumstances of the relevant beneficiaries.

  This may be distinguishable of the particular facts of the case given that the relevant class of beneficiaries was quite narrow.

- The Court considered the following factors in order to determine whether the trustee had properly discharged its duty:

  - the trustee made no enquiries of Paul and Deborah;

  - mere contact between Paul and his parents was not sufficient to infer that the trustee was sufficiently informed of Paul's circumstances; and

  - the limited information received in 2017 regarding Deborah's circumstances was not sufficient to be adequately informed of her circumstances after not receiving any information in the two previous years.

- The applicants bore the onus of proof to demonstrate that the trustee did not make a real and genuine consideration. The Court also acknowledged that the trustee is not required to give reasons. However, the Court concluded that based on the above evidence, the Court was satisfied that the trustee, 'was not informed to an extent that enabled it to make a genuine decision'.[26]

- The Court also referenced the decision to distribute 100% of the income to John (who was in his 90s, had other financial resources and relatively low living expenses) as further evidence of a failure to exercise real and genuine consideration for the position of the applicants.

- The applicants sought payment by the trustee for one third of the annual income flowing from the breach of trust for failure to give real and genuine consideration to Paul and Deborah's position.

- The Court provided that the consequence of the trustee's breach of trust does not make the distributions void, rather they are voidable on application by the applicants to set-aside the distribution. However, the applicants failed to seek an order to set-aside the distribution, consequently, the distributions were not set-aside.[27]

- The final ground of appeal was the applicants' submission that the trial judge erred in failing to remove the trustee from their position.

- The Court of Appeal identified two principles it must address:[28]

  - First, the principles to adopt when dealing with the question of whether a trustee should be removed; and

[25] Ibid at [110].
[26] Ibid at [119].
[27] Ibid at [140].
[28] Ibid at [152].

    - Secondly, acknowledging the decision of the primary judge to remove or not remove a trustee is discretionary and on appeal the decision of the primary judge should be given especial weight.[29]

- The primary judge had correctly identified the principles on the first question, that is jurisdiction to remove a trustee should be exercised with regard to:[30]

    - the interest of the beneficiaries;
    - the security of the trust property;
    - an efficient and satisfactory execution of the trust; and
    - a faithful and sound exercise of the powers conferred on the trustee.

- However, the Court acknowledge that:[31]

> It would be unrealistic however, in the context of many family trusts, to ignore the fact that the trustee will often be imbued with the vagaries of the family dynamic, its antagonists and alliances. **Impartiality does not require the trustee to bring a blank slate to the exercise of powers**. [Emphasis added]

- The Court upheld the ground of appeal for the following reasons:

    - the trustee has failed to act impartially;
    - the trustee failed to give real and genuine consideration to the applicants;
    - the relationship between the beneficiaries and the trustee are damaged beyond repair; and
    - it is not in the best interests of the beneficiaries for the trustee to remain.

- Consequently, the Court ordered that the trustee should be removed, and an independent trustee be appointed.

[29] Ibid citing *Miller v Cameron* (1936) 54 CLR 572 at [152].
[30] Ibid citing *Miller v Cameron* (1936) 54 CLR 572 at [153].
[31] Ibid at [154].

3. What provisions should be included in trust deeds

There are some specific provisions which should be considered to be included in trust deeds to deal with changes in taxation law.

The most important point to remember, READ THE DEED.

3.1 Trustee's discretion to determine how trust income is calculated

Following the decision in *Commissioner of Taxation v Bamford,*[32] it is now accepted that a trustee may have the power to determine what amounts will be regarded as being received or paid on revenue or capital account for the purpose of determining the 'distributable income' of the trust.

The basis on which the trustee determines the distributable income does not have to be consistent with tax or accounting principles.

However, the trustee only has discretion if the deed allows it. If the deed does not contain a power to determine what will be income or capital, the distributable income will be determined in accordance with trust law principles. If the deed has a fixed definition of income the trustee has no discretion to adopt a different approach.

The trust deed should:

- contain a definition of trust income (so that trust law principles do not automatically apply);
- give the trustee discretion to adopt an alternative concept of income where appropriate; and
- include a general power allowing the trustee to determine what amounts are received or paid on capital or revenue account each year.

It is also important that income distribution resolutions are drafted in a way that reflects the provisions in the deed. We often see income distribution resolutions that do not reflect the provisions of the trust deed. For example, it is not uncommon to see resolutions where the trustee purports to distribute the accounting income of the trust whereas the trust deed provides that the trust income is equal to 'net income' as defined in section 95 of the 1936 Tax Act, or vice versa.

This can result in significant problems. For example, it may mean that not all trust income is picked up resulting in default assessments to the default beneficiaries or the trustee (under section 99A).

The most common approach is for the deed to define the net income of the trust as being equal to 'net income' determined under section 95 of the 1936 Tax Act.

There is merit in this approach (provided the trustee has the discretion to adopt a different concept of income if appropriate) but it is also important to exclude 'notional amounts' from the section 95 concept of net income for this approach to work in practice.

[32] [2010] HCA 10.

Exclude 'Notional amounts' being included in the definition of net income

The danger of having a definition which equates trust income with section 95 'net income' is that the net income determined under section 95 will often include 'notional amounts' that are not actually received by the trustee (e.g. franking credits attached to fully franked dividends and deemed dividends under Division 7A).

For example, if a trust receives a fully franked dividend of $70,000 the section 95 'net income' will be $100,000 (being the dividend ($70,000) plus the franking credit attaching to the dividend of $30,000).

While the taxable income will therefore be $100,000, the only amount available to the trustee for the purpose of making distributions to beneficiaries is $70,000.

The best approach in our view is to provide that the net income of the trust will be equivalent to section 95 net income excluding any notional amounts (while allowing the trustee a discretion to adopt some alternative concept).

The Commissioner has also made it clear that, in its view, notional amounts such as franking credits cannot be taken into account in calculating the distributable income of the trust.[33]

Including notional amounts in distributable income may also result in significant non-tax related problems if there are disputes in the future about the effect of previous trust distributions and whether beneficiaries are entitled to call for payment of these notional amounts.

These potential problems are illustrated by the decision in *Thomas Nominees Pty Ltd v Thomas*[34]. In that case the trustee had purported to include franking credits in trust income and to separately distribute those franking credits. The trustee applied to the court for directions as to whether the franking credits were in fact available for distribution. The Queensland Supreme Court initially held that the franking credits could be included in distributable income but this approach was rejected by the Federal Court in *Thomas v Commissioner of Taxation*[35] where Greenwood J said:

> The franking credits, however, were not income of the trust. They could not be streamed.[36]

3.2 Allow the trustee to make distributions from gross income to preserve franking credits

A beneficiary is only entitled to claim the benefit of imputation credits attaching to a franked dividend, to the extent the beneficiary is presently entitled to a share of the trust income under section 97.[37]

The concept of "present entitlement" is not defined in the legislation, but the authorities establish that, in order for a beneficiary to be presently entitled to a share of the income of the trust estate, that beneficiary must have an indefeasible and absolutely vested interest in the income **and must be able to demand immediate payment of their share of the income from the trustee**.[38]

The difficulty where the trust estate has positive "net income" under section 95 only because the net income includes imputation credits, is that, while there may be an amount of 'net income' that is subject to tax, this is a notional amount which cannot be distributed to a beneficiary and therefore they cannot be presently entitled to it.

[33] TR 2012/D1 at paragraph 15
[34] [2010] QSC 417
[35] [2015] FCA 968
[36] At [493]
[37] section 207-50 - 1997 Act.
[38] *Harmer* at page 5004.

The view of the Commissioner is that, if there is no income available for distribution in a year then there is no amount to which a beneficiary can be presently entitled under section 97, even though the trust itself may have a positive "net income" under section 95 because of the requirement to gross up the imputation credit.[39]

One option that may allow the trustee to pass on imputation credits even where the trust has no distributable net income is to include a provision in the trust deed allowing the trustee to make distributions out of gross income (e.g. by treating some expenses as being on capital account).

Section 97 only requires that the beneficiary is entitled to a share of the "income" and not the net income of the trust estate. This distinction was pointed out by Kitto J in *Union Fidelity Trustee Co of Australia* Ltd v *FCT*.[40]

Therefore, if the trustee has the power to make distributions out of the gross income (before calculating the distributable net income) it is at least arguable that the beneficiaries are still entitled to a share of the trust "income" under section 97 and would in turn be required to include the same proportion of section 95 "net income" (i.e. the imputation amount) in their assessable income.

It should be noted however that the Commissioner may take issue with such an approach given the statement in TR 2012/D1 that the 'income of the trust estate' must be 'represented by a net accretion to the trust estate'[41].

3.3 Ensure that the deed has streaming provisions

Trust deeds must have an adequate 'attribution' clause allowing the trustee to differentiate between different categories of income and capital and to allow the trustee to distribute these different categories to beneficiaries in disproportionate shares.

If the trust deed does not have an adequate attribution clause – in respect of both income and capital – then it will not be possible to stream capital gains and franked dividends.

The explanatory memorandum that accompanied the legislation that introduced the streaming measures made it clear that trusts could only stream capital gains and franked dividends if the trust deed contained express provisions allowing this. In particular, paragraph 2.35 of the EM contained the following statement.

2.35 These amendments ensure that where a trustee has a power to stream under the terms of the trust, the streaming will be effective for tax purposes. These amendments do not in any way *give* trustees a power to stream where they do not already have the power to do so.

Taxpayers are unlikely to have any issues in applying the statutory streaming provisions if there is an express clause in the deed along the following lines:

> In determining the net income or making any determination to distribute or accumulate net income, the Trustee may:
>
> (a) identify an amount by reference to its character or description in the Tax Acts;
>
> (b) account separately for that amount; and
>
> (c) make a determination to pay, apply, transfer or set aside or accumulate in respect of the whole or part of that amount.

[39] Taxation Ruling TR 92/13 at paragraph 17
[40] 119 CLR 177.
[41] At [13]

Is it possible to stream classes of income other than capital gains and franked dividends?

- Prior to the decision in Bamford, the Commissioner view was that it was possible to stream different types of income to particular beneficiaries provided the deed had an adequate attribution clause42.

- However, as a result of the decision in *FCT v Greenhatch*,[43] it is now clear that, apart from the statutory exceptions, income derived by a trust does not retain its character when distributed to beneficiaries.

3.4 Importance of trustee resolutions

The requirements to ensure that trustees make valid resolutions to distribute income (and capital) under the Tax Acts and in many trust deeds are quite technical.

In particular with the specific requirements of the streaming provisions it will be necessary to ensure that taxpayers adopt a more technical approach in dealing with issues relating to distribution and taxation of trust income and capital gains.

Getting the distributions correct will be particularly important for those years in which the small business CGT concessions are claimed due to the increase in audit risk and therefore high level of scrutiny.

The time to determine who is presently entitled to the income of the trust is at midnight on 30 June of the relevant year. Where a beneficiary is presently entitled to a share of the income of the trust at that time, they will include in their assessable income that share of the net income. A disclaimer after 30 June which purports to disclaim a beneficiary's interest in the trust income prior to 30 June is not effective to exclude that amount in the beneficiary's assessable income.[44].

Suggested approach for trust distribution minutes

Template or precedent minutes should be used with caution.

- The better approach is to have a document that identifies the issues that need to be considered each year and to use the document more as a 'prompt sheet' than a precedent.

- The approach we recommend is as follows:

  - The distribution resolution should record whether the trust deed has a definition of income and whether the trustee has a discretion to apply that definition or adopt some other concept of income.

  - If the trustee has a discretion, the resolution should state what concept of income is being adopted for the year in question.

  - The resolution should identify the capital gains or franked dividends and the 'net financial benefit' from those gains or dividends (or how the net financial benefit will be calculated).

  - There should be separate resolutions in relation to capital gains and franked dividends if the trustee wants to stream these to specific beneficiaries.

  - Have a separate resolution distributing the balance of trust income after taking into account specific distributions of capital gains and franked dividends.

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[42] Taxation Ruling TR 92/13 – paragraph 4
[43] [2012] FCAFC 84
[44] *FC of T v Carter* [2022] HCA 10

Timing of distribution resolutions

- The streaming provisions require that for the purposes of streaming:
  - distributions to make beneficiaries 'specifically entitled' to capital gains must be in place by 31 August; and
  - distributions to make beneficiaries 'specifically entitled' to franked dividends must be in place 30 June.

  Resolutions made after these dates will be ineffective - resulting in capital gains and franked dividends being allocated to beneficiaries who receive other income on a proportionate basis.

- Need to check the trust deed – may require that trustee must exercise its discretion by an earlier date (for example 28 June).
- For the purpose of determining who is a 'significant individual' or 'CGT concession stakeholder' for the small business CGT concessions under Division 152, the distributions must be made during the year.

  This is because in determining an entities small business participation percentage you look at the lowest percentage of all income and capital distributions made during the year.

  Therefore it is imperative that distributions are done by 30 June.

- Subject to the terms of the deed, it is not necessary that the clients hold a formal meeting to pass the distribution resolution nor that a minute is signed by the relevant date.
  - What is required is that the trustee can establish that the trustees/directors had effectively resolved how the amounts would be distributed.
  - This could be evidenced by the fact that the accountant provided tax planning advice pre-30 June and the tax returns are submitted on a basis that is consistent with that advice.
  - It is acceptable for the clients to sign a minute confirming a distribution resolution after the date of the resolution – they are simply recording a prior resolution.
  - If a minute of a meeting is signed, then the ATO may then require evidence that the meeting was held.
  - If the minute simply records that a resolution was made without a formal meeting the same evidentiary issues do not arise.
  - The terms of the trust deed should be reviewed to determine whether any consents are required to make a valid resolution.
- Examples of distributions of income which have failed because there was no evidence that the resolutions took place
  - *The Trustee for the Whitby Trust and Commissioner of Taxation (Taxation)*[45]
    - The minutes of the meeting for the years 2011 to 2014 indicated that the meeting was held on 30 June of each year.
    - The minutes did not record who was in attendance at the meeting. The Constitution of the trustee company required is the number determined by the directors otherwise the quorum is two.
    - There was no evidence that the meetings talk place.

[45] [2019] AATA 5637 (23 December 2019)

- The distributions required the consent of the guardian (there was no evidence of the consent).

- *The Trustee for Goldenville Family trust A/C Xiangming Huang and Commissioner of Taxation (Taxation)*[46]

    - Wife (who could not speak English) was the sole director of the trustee company.

    - Minutes of meetings for the 2015, 2016 and 207 were purposed to have been made on 30 June of each of the years.

    - In one year, the husband said he estimated an amount which was to be distributed to his sister (this estimated amount was exactly the same amount in the finalised income tax return).

    - In one year there were three different minutes signed (one of the signatures was very different to the others).

3.5 Power to make interim capital distributions including from asset revaluation reserve

It will be important that the trustee has the power to make interim capital distributions.

- This will allow the trustee to distribute capital to the beneficiaries prior to the vesting of the trust.

- Also, to effectively stream capital gains, the beneficiary needs to be specifically entitled to the gross capital gain. If a section 95 concept of trust income is adopted, an interim capital distribution will also be required.

It is quite common for trustees of private trusts to seek to revalue assets in order to be able to make interim capital distributions to beneficiaries.

There are a number of circumstances where this can be a useful strategy. For example, if a beneficiary of a discretionary trust wants to exit, the payment of an interim capital distribution to them rather than selling or distributing assets can be very advantageous as it will not attract duty and the beneficiary will also generally not be subject to any capital gains tax on the distribution.[47]

While this strategy of making interim distributions from a revaluation reserve has been reasonably common, there has been some uncertainty about exactly how effective this was for trust law purposes.

This issue has been considered in the High Court decision of *Fischer v Nemeske.*[48]

Facts

- The only asset of the Nemes Family Trust consisted of shares in another company.

- In 1994 the trustee (Nemeske Pty Ltd) revalued those shares (to $3,904,300) and credited that amount to an asset revaluation reserve.

- Shortly after, the trustee resolved to make a distribution out of the asset revaluation reserve to Mr and Mrs Nemes (two of the Specified Beneficiaries of the trust).

[46] [2025] ARTA 1355 (13 August 2025)
[47] Section 99B(2) of the 1936 Tax Act and Taxation Determination TD 2003/28.
[48] [2016] HCA 11.

- No amount was paid to Mr and Mrs Nemies. The amount of $3,904,300 was credited to them in the trust's accounts and the trustee granted a charge over the shares in favour of Mr and Mrs Nemes securing the payment of the distribution amount.
- Mrs Nemes died in November 2010 and Mr Nemes passed away in September 2011.
- In Mr Nemes' Will he effectively transferred control of the trust to 'the Fischers' and the residuary estate to other beneficiaries.
- The Fischers argued that the purported distribution of capital out of the revaluation reserve was ineffective and that the trust had no existing obligation to pay the amount of the purported distribution to the estate (with the consequence that the value of the residue was substantially diminished).

The High Court held (by a majority of three to two) that the resolutions to create a revaluation reserve and then make a distribution from that reserve were effective and that the trustee owed $3,904,300 to Mr Nemes's estate.

However, the majority decision did not establish any general principle that interim distributions of capital from a trust revaluation reserve would always be effective.

Rather the decision makes it clear that the efficacy of the distribution will be dependent on the terms of the trust deed and the resolution purporting to make the distribution. Each of the judges delivered a separate judgement and these provide some guidelines for practitioners who are asked to advise on or implement interim capital distributions.

The first issue is that the trustee must have power to revalue trust assets. The trust acts in the various states allow for this but subject to restrictions. For example, in Queensland, a trustee has a general power to carry out a valuation of trust assets.[49] However, where the trustee is not personally qualified to value the property, they must consult a 'duly qualified person'.

In our view, it is preferable if there is a specific power in the trust deed that allows the trustee to revalue trust assets at the complete discretion of the trustee.

This power must be wide enough to also allow the trustee to make a distribution from a revaluation reserve and create a binding obligation to pay the beneficiaries notwithstanding that no money or other property is actually distributed or set aside for the benefit of those beneficiaries.

A significant factor in the decisions of some of the majority was that the trust deed gave the trustee a power to 'advance' capital to beneficiaries and we therefore recommend that trust deeds should include a specific power to 'advance' as well as 'distribute' capital.

The judgements also illustrate that it will be critical that any resolution purporting to make a capital distribution from a revaluation reserve is carefully drafted to ensure that the terms of the resolution are consistent with the powers of the trustee under the deed. In her dissenting judgment, Kiefel J appeared to accept that it may have been possible for the trustee to make an effective 'advance' of capital relying on the powers in the trust deed but said that:

> Neither the terms of the Resolution nor the entries in the accounts reflect an application under a power of advancement of the property and the Shares representing the capital of the trust.

> She also indicated that while it;

> …may be accepted … that an effective exercise of (the power to make an interim distribution) does not depend upon there being cash in the trustee's hands … . However, for a conclusion that capital was applied there should be a corresponding reduction in the capital of the trust..

[49] s 51 *Trusts Act 1973* (Qld).

3.6 Amending trust deeds

A discretionary trust deed should provide flexibility for the clients to vary the deed to deal with changes in their circumstances or in legislation effecting the trust.

Therefore, unless there are specific reasons to limit the scope of the variation power, the amendment clause should be as wide as possible.

It is also imperative when amending a trust deed to carefully read the deed to ensure that the powers are wide enough and that any procedures in the deed are followed. For example, advisers need to check the provisions of the deed to ascertain:

- whether the power of variation allows amendments of all provisions in the deed (including schedules) or only limited provisions;
- who has the power to make the change (e.g. the trustee or appointor);
- the procedures for variation (e.g. by deed, minute or notice in writing);
- whether it is necessary to obtain the consent of any party such as the appointor or guardian; and
- whether there are any specific restrictions on the power of variation (e.g. prohibiting amendment of certain clauses).

A failure to comply with procedural requirements may result in a purported variation being ineffective as illustrated by the decisions in *Re Cavill Hotels Pty Ltd*[50] and *Idlecroft v Commissioner of Taxation*.[51]

In Cavill the trust deed empowered the trustee to vary the provisions of the second schedule to the deed 'by adding the name of any person' and also 'by deleting the name of any Capital Beneficiary'. The trustee purported to vary the deed by deleting various categories of beneficiaries (e.g. a group described as 'Family Beneficiaries').

The court held that the variation was invalid because, to effectively remove a beneficiary, the deed of variation had to refer to the beneficiary by name not by reference to a class of eligible beneficiaries. Williams J had this to say:

> … the power to vary the beneficiaries was strictly and severely limited. The trust could not be varied "in any manner whatsoever";… the only power the trustee had was to delete "the name" of any beneficiary. …in the circumstances of this case that could not be done by merely identifying the categories of continuing beneficiaries.[52]

3.6.1 Is the proposed amendment within the scope of the power of variation?

There are many varieties of trust deed in circulation, and the wording of the common variation powers can be significantly (or subtly) different. Some examples of common wording for variation clauses in trust deeds are as follows:

Example 1

The Trustee **may by Deed revoke add to release or vary all or any of the Trusts declared** or any Trusts declared by any variation, alteration or addition made from time to time and may by the same or any other Deed declare any new or other trusts or powers concerning the Trust Fund but so that the Trustee shall not have any power to revoke add to or vary any of the Trusts so that the Settlor may acquire a beneficial interest in the Trust Fund or any part of it nor to effect [sic] the

[50] [1998] 1 Qd R 396.
[51] 2004 ATC 4845.
[52] At 402.

beneficial entitlement of any Beneficiary to any amount applied for him prior to the date of revocation or alteration and any other person or persons upon whom any power or powers so conferred on him or them. Upon this exercise of any release and revocation pursuant to this clause the power so released and revoked shall be absolutely and irrevocably determined.

Example 2

The Trustee **may by Deed revoke add to release or vary all or any of the trusts or powers hereinbefore declared** or any trusts or powers declared by any variation, alteration or addition made hereto from time to time and may by the same or any other Deed declare any new or other trusts or powers concerning the Trust Fund or part or parts thereof but so that the Trustee shall not have any power to revoke add to or vary any of the trusts or powers hereof so that the Settlor or the Trustee may acquire a beneficial interest in the Trust Fund or any part thereof nor to affect the beneficial entitlement of any Beneficiary to any amount applied for him prior to the date of revocation or alteration and any other person or persons upon whom any power is conferred by this Trust may release and revoke any power or powers so conferred on him or them PROVIDED ALWAYS that no such addition variation or amendment shall be made whereby the Settlor or the Trustee may acquire a beneficial interest in the Income or capital of the Trust or any part thereof. Upon the exercise of any release and any revocation pursuant to this clause the power or trust so released and revoked shall be absolutely and irrevocably determined. **The expression "trusts or powers" where used in this sub-clause shall be deemed to include all the provisions of this Trust Deed or of any other Deed varying or altering or adding to such Trust Deed**

The first example was the variation clause in the deed considered in *Jenkins v Ellett*[53] where the facts were as follows.

- The original Principal was George Jenkins who was also a trustee along with Luciano Menniti.
- Part 9 of the schedule to the deed provided that, on George's death, his executor became the Principal.
- In 1999, George used his power as Principal to remove Luciano as trustee, and replaced him with Joyce Ellett.
- Then, he and Joyce (as trustees) purported to amend the deed to appoint Joyce as Principal in place of George.

The question was whether the 1999 deed appointing Joyce Ellett as Principal was valid. Douglas J held that the variation power did not authorise an amendment to the definition of 'Principal' in the schedule to the deed for a number of reasons.

- Although, the deed defined the term 'this Trust' to mean 'the trust constituted by and comprised in this Deed and the Schedule', the variation clause, when specifying what could be varied, did not refer to 'this Trust' but instead referred to 'the Trusts declared'.
- His Honour held that the purported change of Principal was not a variation of 'the Trusts declared' and was invalid.

A similar outcome occurred in *Mecanti v Mercanti*.[54] The deed in that case permitted the trustee to 'revoke add or vary all or any of the trusts hereinbefore provided…'. The court held that the identity of the appointor was not 'any of the trusts hereinbefore provided' and therefore a variation deed purporting to change the appointor was not valid.

In *Re Owies Family Trust*,[55] the trust deed was varied to change the appointor and guardian from the parents to one of their children. The variation power allowed the trustee to 'revoke add or vary all or any of the trusts hereinbefore limited' and to 'declare any new or other trusts or powers'. The court held that the variation deed purporting to change the appointor was not valid.

[53] [2007] QSC 154.
[54] [2015] WASC 297.
[55] [2020] VSC 716.

The clause in the second example is slightly different to that in the deed for *Jenkins v Ellett* but the differences are material, in particular because of the further words that ‘define’ the expression ‘trust or powers’ as including all of the provisions of the deed.

Many deeds that have a variation clause similar to this also contain a further interpretive provision that stipulates the ‘deed’ includes the schedules attached to the deed – which is desirable.

Our view is that an amendment clause that is similar to example 3 below is to be preferred as it makes it clear that the trustee can vary all provisions of the deed, including the schedules.

Example 3

The Trustee may revoke, delete or vary all or any of the trusts, powers or provisions declared or included in this deed (including the schedules) and may at the same time declare or include any new or other trusts, powers or provisions concerning the Fund.

How far can you go without triggering a resettlement?

When varying a trust deed, it is important to consider the broader duty and tax implications and particularly whether the proposed variation might trigger a resettlement.

However, the risk of a variation of trust or change in beneficiaries triggering a resettlement is substantially reduced as a consequence of the decision in *Commissioner of Taxation v Clark*[56] and the subsequent release of Taxation Determination TD 2012/21.

Prior to these developments there was a good deal of confusion about what constituted a resettlement – or at least what the Commissioner considered was a resettlement. In *Buzza v Controller of Stamps* (Vic)[57] Dixon J unhelpfully said, “it is notoriously difficult to define a settlement, but that does not mean that it is difficult to recognise one.”[58]

The High Court decision in *FCT v Commercial Nominees of Australia Ltd*[59] should have clarified the position but it concerned changes to the deed for a superannuation fund and the Commissioner initially refused to accept that the principles outlined in *Commercial Nominees* applied to other trusts.

In *Commercial Nominees* the High Court considered that, notwithstanding the quite dramatic changes that were made to the trust deed and the structure of the superannuation fund, the original fund “did not come to an end” but continued as the same entity.

The fact that the original trust deed provided the trustee with the power to make the changes was a significant factor in the Federal Court decision which was appealed to the High Court.[60]

In *Clark*, the Federal Court (both at first instance[61] and on appeal) indicated that the principles enunciated in *Commercial Nominees* are not confined to superannuation funds and are equally applicable to other trusts. Importantly, all members of the Full Court followed the approach of the High Court in *Commercial Nominees*.

[56] [2011] FCAFC 5.
[57] [1951] 83 CLR 286.
[58] Ibid at 300.
[59] 2001 ATC 4336.
[60] 99 ATC 5115 at 5124.
[61] [2009] FCA 1401.

Dowsett J cited the following passage from the High Court decision in *Commercial Nominees* as summarising the correct approach in determining whether there is a resettlement:[62]

> "The three main indicia of continuity for the purposes of Pt IX 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."

The Commissioner subsequently issued Taxation Determination TD 2012/21 which can be summarised as follows:

- The previous approach of the Commissioner 'is not sustainable'.
- The principles in *Commercial Nominees* are relevant in determining whether there is a resettlement of an existing trust.
- An amendment will not trigger a resettlement unless the variation of the trust 'causes the existing trust to terminate and a new trust to arise for trust law purposes.
- *Clark* 'is authority for the proposition that, assuming there is some continuity of property and membership of the trust, an amendment of the trust that is made in proper exercise of a power of amendment contained under the deed will not have the result of terminating the trust, irrespective of the extent of the amendments so made so long as the amendments are properly supported by the power'.[63]
- However, there may be some instances where, although a variation to a trust deed does not result in a resettlement, the change may result in some assets being held on a different trust. *Commissioner of State Revenue v Lam and Kym Pty Ltd*[64] and *Oswal v Commissioner of Taxation*[65] illustrate how this might occur.

Therefore, provided that a proposed amendment is within the powers under the deed and there is continuity of at least some of the three essential elements of the trust (as specified in *Commercial Nominees)* it is unlikely that a variation will trigger a resettlement for tax purposes.

3.6.2 Can you amend a troublesome variation clause?

A question that often arises where there is a restriction in the power of variation, is whether the deed can be amended to remove that restriction. While the answer to this question will often depend upon exactly what is the nature of the restriction that is imposed and the scope of the power of variation, the general principle appears to be that a power of variation will not generally allow an amendment removing a restriction on the exercise of that variation power.[66]

The scope of powers of amendment in trust deeds is discussed in *Thomas on Powers*.[67] In that text the author makes the following comments:

> It does not follow, of course that the power of amendment itself can be amended in this way. Indeed, it is probably the case that there is an implied (albeit rebuttable) presumption, in the absence of an expressed direction to that effect, that a power of amendment (like any other kind of power) cannot be used to extend its own scope or amend its own terms.[68]

[62] [2011] FCAFC 5 at [34]
[63] At [21]
[64] [2004] VSCA 204.
[65] [2013] FCA 745.
[66] *Equity and Trust in Australia*, GE Dal Pont and DRC Chalmers, 4th Edition, 2007 at p641.
[67] 1st Edition, 1998.
[68] at 585 to 586.

A power given to a trustee under a deed can only be exercised for the purpose for which it is given and not an ulterior purpose. If the trustee attempts to exercise that power for an ulterior purpose, this may constitute a fraud on the power which means the variation would be void. This is a long-standing principle of trust law and is outlined in the House of Lords decision in *Duke of Portland v Topham:*[69]

> [The donee of the power] shall at the time of exercise of that power, and for any purpose for which it is used, act with good faith and sincerity, and with an entire and single view as to the real purpose and object of the power and not for the purpose of accomplishing or carrying into effect any bye or sinister object (I mean sinister in the sense of its being beyond the purpose and intent of the power) which he may desire to effect in the exercise of the power.

In determining the purpose of the exercise of a power, the court will have regard not just to the terms of the power in the deed but also the surrounding circumstances and practical effect of the exercise of the power.[70]

3.6.3 Application to the Court

The various Trusts Acts[71] provide the Court with the power to amend the deed where the deed does not have an appropriate variation power.

Re EM McPherson Settlement[72] which considered an application for amendments to a trust deed (extending the vesting date, widening the class of beneficiaries, power to create sub-trusts, the power to stream income, power as to how the trustee could determine the income of the trust and a general power of amendment) under section 63 and 63A of the Trustee Act (Vic) provides a summary of the principles which the Court consider.

17. Section 63A empowers the Court to authorise an ‘arrangement’ varying or revoking all or any of the trusts, on behalf of any person with an interest under trusts who are not capable of consenting. Powers of this nature have been regarded as providing a statutory extension to the rule in Saunders v Vautier. That principle is to the effect that beneficiaries who are sui juris (ie have full capacity) and together absolutely entitled to the trust property, may exercise their proprietary rights, notwithstanding the terms on which the trust was settled, to call for the trust property.

19 In Perpetual Trustees Victoria Ltd v Barns, the Victorian Court of Appeal considered a trustee’s application for an order under s 63A approving a variation to a trust on behalf of the trust’s only beneficiary, who lacked capacity to consent. The Court noted that s 63A requires the Court to be satisfied of two things, first that the arrangement would be for the benefit of the relevant person; and if so, whether that arrangement is by its nature a proper and fair one. The Court gave the following guidance as to the considerations involved: In determining whether an order under s 63A(1)(a) should have been made and now should be made, the court must first be satisfied that the arrangement was and is both for [the beneficiary’s] benefit and a fair and proper one overall. It must take into account the purpose of the trusts and the intention of the testator. The court should engage in a ‘businesslike consideration of the arrangement, including the total amounts of the advantages which the various parties obtain, and their bargaining strength’.

20. In Re Perenna Nominees Pty Ltd, McMillan J referred to Barns, and also summarised the effect of other authorities as to the principles relevant for the Court in considering whether to exercise the power in s 63A, as follows:

(a) Whether the arrangement would be for the benefit of the beneficiaries who are unable to supply consent. In this regard, it has been noted that benefit is not restricted to financial benefit and can encompass other non-financial benefits, such as social, familial, moral or educational benefits.

(b) Whether the arrangement is by its nature a fair and proper one overall, taking into account the particular advantages which the various parties will gain from the arrangement, and their respective bargaining strength.

(c) Whether the arrangement is consistent with the purpose of the trust and the testator’s intention in establishing it.

[69] (1864) 11 HL CAS 32 at 54; 11 ER 1242 at 1251.
[70] *Re Burton* [1955] CH 82.
[71] Section 94 Trusts Act 1973 (Qld), section 63 Trustee Act 1958 (Vic), section 81 Trustee Act 1925 (NSW), section 47 Trustee Act 1898 (Tas), section 89 Trustees Act 1963 (WA), section 59C of the Trustee Act 1936 (SA), section 81 Trustee Act (ACT), section 50A Trustee Act (NT)
[72] [2024] VSC 744

The Court approval each of the requested amendments. However did not approve the general power of amendment [at 198 to 204]

> The Trustee acknowledged that the only authority dealing with an application under s 63A for approval of a variation of a trust deed to introduce a general power of amendment was *Re the Alan Synman Family Trust*, in which the variation was not approved.
>
> The Trustee submitted:
>
> > [T]he current case should be determined on its own fact and the general power of amendment should be permitted. There have been proposals around for quite some time to change the legislative provisions dealing with the taxation of trusts. It would be beneficial to current and unborn beneficiaries for the Trustee to have a general power of amendment to deal with any future law changes in that respect. Similarly, if the Trustee needs to borrow then it would also be beneficial to those current and unborn beneficiaries for the Trust to be able to meet any financier's requirements in terms of administrative powers or provisions that might need to be included in the Trust Deed. These are not matters that would be detrimental to any potential unborn beneficiaries.
>
> When the difficulty of the Court being satisfied that every exercise of a general power of amendment would be for the benefit of Relevant Beneficiaries was raised with counsel for the Trustee it was submitted that it was possible to be so satisfied because in order to exercise the power of amendment:
>
> > the trustee has to act in good faith, exercise the power for proper purposes, it is a fiduciary power. So the trustee cannot, for example, use the power to let's say just benefit one beneficiary, because that would not be a proper exercise of the power.
>
> It was submitted that the Trustee was an independent trustee and that any inappropriate exercise of power by the Trustee could be addressed by an application to the Court by the beneficiaries affected. The Deed also contained limitations in cl 10(1) on the persons who could be appointed a trustee, and in particular provided that neither a beneficiary, nor 'any company in which a Beneficiary has a controlling interest, or in respect of which any beneficiaries or two or more have de facto control or power and direction' could be trustee. In submissions filed following the hearing, the Trustee also submitted that the proposed power of amendment could be varied to provide that 'no amendment could be made to cl 10(1) of the Deed, or to otherwise cause or permit such persons as outlined in cl 10(1) of the Deed as a Trustee of the Settlement'
>
> The Contradictor submitted that the Court should not approve the variation to introduce a general power of amendment, based on the rationale identified by Ginnane J in Re Alan Synman Family Trust. She submitted that this Court should follow that decision unless persuaded that the decision was plainly wrong, and that there was nothing put forward to explain why the ratio in that case does not apply.
>
> The Contradictor submitted that also considering this aspect of the application on its own facts and circumstances, it was not possible to determine whether the variations which may be made pursuant to a general power would be for the benefit of relevant beneficiaries, nor whether it would be a fair and proper arrangement for those persons. The Trustee's fiduciary responsibilities would not be an answer to that question. Finally the Contradictor noted that the proposed general power of amendment only preserves vested rights prior to any amendment, which would not protect any interests of the Relevant Beneficiaries who do not have any vested entitlements.
>
> *Consideration — it is not possible to conclude that it would be to the benefit of minor and unborn beneficiaries to approve a general power of amendment*
>
> Authorities establish that the power in s 63 of the Trustee Act does not extend to the authorisation of an amendment to a trust instrument to enable the trustee to vary the terms of the trust. The component of the application relating to approval of a general power of amendment must, therefore, be dismissed.

4. Trusts and planning for succession

4.1 Planning considerations

It will be important for clients to carefully consider the family succession of assets. In particular, it will be important to consider:

- whether there are particular assets which will pass to different children (this is particularly relevant when some children work in the business);
- whether some or all the assets will pass to children during the client's lifetime or on death;
- whether there will be inequity between the value of the assets transferred to the children and whether that needs to be dealt with;
- family dynamics – can the children work together;
- whether there are amounts owing to and from entities which will pass to particular children and how will they be dealt with;
- whether there are vital assets used by entities (for example premises) where the premises will pass to different children then those who will obtain control of the entities (in which case there will need to be a lease put in place);
- whether there may be an estate challenge.

Whilst some clients would rather not consider these issues (as it is too difficult to deal with their children and in any case, it will not be their problem), not dealing with these issues early may lead to considerable angst and costly legal challenges between family members later.

The benefits of considering these issues allows for careful planning around:

- whether it will be necessary to restructure the ownership of the assets to enable different assets to pass to different children;
- managing taxation and duty issues;
- managing the commercial aspects if control of particular properties are transferred during the lifetime of the client; and
- managing the risk of an estate challenge.

Whenever a client is looking at acquiring new assets or selling assets it is always important to consider which is the appropriate entity to acquire the asset in and what impact that may have on the client's succession plan.

If the property or clients are in New South Wales, the notional estate provisions in Part 3.3 of the *Succession Act 2006 (NSW)* will need to be considered. That is, transaction could be clawed back if they have occurred within three years of death.

4.2 Dealing with assets held in a trust

Often discretionary trust structures will be used during a client's life to hold the assets and possibly to operate the business. However, this will need careful consideration when it comes to the succession plan as the discretionary trust structure may not achieve the client's intention or be suitable in the circumstances due to the family dynamics.

It may be necessary to deal with the assets in the trusts to leave different of assets to different beneficiaries.

When implementing the succession plan, there will need to be a review of the client's structure including whether the assets are held in individual names or in entities.

For those assets held in trusts there needs to be consideration in respect to:

- who will control particular assets which are held in the trust;
- which assets may need to be moved out of the trust;
- who will control the trust and if there are multiple controllers, are there appropriate control mechanisms to ensure that each party obtains their share of equity and trust income;
- whether there are amounts owing to and by the trust which need to be dealt with;
- whether the trustee has made an FTE or IEE, and if so, what impact will that have on distributions in the future.

If moving assets out of a trust, then as with any transaction, before proceeding it is necessary to consider a number of factors including:

- how the transaction is to be implemented, for example:
  - transferring the asset(s) to an individual or entity for consideration;
  - making an 'in specie' distribution to a beneficiary;
- what are the tax issues, including:
  - whether the trustee can reduce or disregard any capital gain under:
    - any roll-overs (for example the small business restructure roll-over); or
    - the small business CGT concessions;
  - making enquiries as to whether the trustee has made an FTE or IEE, in which case care must be taken to ensure that distributions are not made to individuals or entities outside the family group of the test individual.

5. Discretionary Trusts – dealing with assets and control

The major issues for clients acquiring assets in discretionary trusts is that when it comes to passing control of the assets or giving children a fixed interest in the assets:

- the assets do not form part of the estate and therefore assets held in trusts cannot pass under the terms of the Will;
- beneficiaries do not have a fixed interest in the income or capital; and
- whoever gets to control the trustee or the power to remove and appoint trustees will effectively control the trust's assets.

Strategies, such as trust splitting (or the former trust cloning exemption) may have been used where it is necessary to leave different classes of assets (such as business assets) to different beneficiaries.

From a tax perspective, it will be necessary to consider whether this will trigger either:

- CGT event E1 – where a trust is created over a CGT asset by declaration or settlement;
- CGT event E2 – where a CGT asset is transferred to a trust; or
- CGT event A1 – where there is a disposal of a CGT asset.

Note: Neither of the above events occur merely because of a change of trustee.

5.1 Trust splitting

The objective of a trust splitting is to separate assets in a single trust into separate asset pools to allow for designated beneficiaries to take control of the different asset pools.

In order to achieve a trust split the trust deed must allow the trustee to vest the legal title to assets in the trust in a new trustee.

A new trustee is appointed to hold the assets under the terms of the existing trust. This will allow different people (who control the relevant trustee) to control the relevant assets.

However, to avoid any CGT consequences, it is essential that a new trust is not created over the assets by way of declaration or settlement (that is, CGT event E1 is not triggered).

The Commissioner's view as to whether a 'trust split' will result in the creation of a new trust is contained in Taxation Determination TD 2019/14. The Taxation Determination outlines common features of a 'trust split' and provides an example of when separating control of assets would result in the creation of a new trust (Example 1) and when it would not (Example 2)

Features of a trust split (paragraph 2 of TD 2019/4)

2. A trust split in this sense will exhibit all or most of the following features:

- The trustee of an existing trust is removed as trustee of part/some of the trust assets and a new trustee is appointed to hold those assets.
- Control of the original trustee is changed such that control passes to a subset of the beneficiaries of the original trust. The new trustee is controlled by a different subset of beneficiaries.
- A different appointor is appointed in respect of the part of the fund held by the new trustee, the control of the new appointor aligned with the control of the new trustee.
- The rights of indemnity of the trustees are segregated such that each trustee can only be indemnified out of the assets held by that trustee.
- The expectation is that the new trustee will exercise its powers in respect of the assets it holds independently of the original trustee to benefit one subset of beneficiaries to the exclusion of others. The original trustee is also expected to exercise its powers in respect of the assets held by it independently of the new trustee to benefit instead a different subset again to the exclusion of others. This is so whether the range of beneficiaries that can benefit from particular assets is expressly limited.
- The rights, obligations and powers of the trustees and beneficiaries remain governed by the one deed.
- The original trustee and new trustee keep separate books of account.
- The new trustee may also seek to apply for a new tax file number and/or Australian business number, and commence to lodge a separate return in respect of the income derived from the assets it holds.

The Commissioner notes that a resettlement is different to a trust split. The former occurs where the original trust comes to an end whereas in relation to a trust split, a new trust is separated or carved out of the original trust fund.

The Commissioner refers to the decisions of the Full Federal Court in *Aussiegolfa Pty Ltd (Trustee) v Commissioner of Taxation* (*Aussiegolfa*) and the Supreme Court of South Australia in *Dyda P/L & Anor v Commissioner of State Taxation* (*Dyda*).

38. In *Aussiegolfa*, the Full Federal Court considered whether a class of units in a unit trust (the DomaCom Fund) were units held on a separate and distinct trust. Of note for present purposes, Steward J made the following observations from his analysis of a number of court decisions from Australia and the UK:[73]

I derive the following general propositions from the foregoing survey of statutory language, context and purpose, as well as from the authorities:

(a) first, that the word "trust" in s 70E(2)(a) (of Part 8 of the *Superannuation Industry (Supervision) Act 1993* which contains the in-house asset rules applying to regulated superannuation funds) is apt to refer to a singular continuing relationship of trust with the possibility of multiple and changing beneficiaries, in respect of multiple and changing items of property;

(b) secondly, that within that singular relationship there may be created sub-funds which may not constitute separate and distinct trusts;

(c) thirdly, the creation of a sub-fund would probably constitute a new or separate relationship of trust where there was, to use the language of Hoffmann J, a segregation of assets, the appointment of a new trustee, and the exhaustion, by the terms of the sub-fund, of the beneficial interest in the property of the fund;

[73] [2018] FCAFC 122 at [206]

(d) fourthly, the creation of a sub-fund would probably not constitute a separate and distinct relationship of trust where the fund remained subject to the provisions of the original settlement and its property remained available, whether contingently or otherwise, to be deployed for the trust's original purposes, or to use the language of Lord Wilberforce, to "fall back into the rest of the settled property";

(e) fifthly, a key consideration would be whether the other beneficiaries, who were not members of the new sub-fund, could be said to enjoy, whether contingently or otherwise, an equitable interest in, or equitable rights over, the assets or income of the sub-fund. Conversely, it will be relevant to determine whether the members of the sub-fund had, whether contingently or otherwise, an equitable interest in, or equitable rights over, the other assets or income of the original trust. Asking such questions will assist in determining whether the terms of issue of the sub-fund had segregated the sub-fund from the original trust;

(f) finally, the question as to whether a given sub-fund is a separate trust turns upon a close analysis of the terms governing that sub-fund. Those terms will reveal the intentions of the parties. Each case will, as Edmonds J has emphasised, need to be judged on its particular facts.

39. The Court concluded that the holders of the units in the sub-fund that was at the centre of the dispute in *Aussiegolfa* did not have any rights or interests in any other part of the DomaCom Fund and that a separate trust had been created.

40. The arrangement considered by the Supreme Court of South Australia in *Dyda* has similarities to the trust splitting arrangements considered in this Determination. The Court in *Dyda* considered whether a series of steps to transfer control of real property to the Dyda group gave rise to a stamp duty liability. The land in question was held in a unit trust, the Woodville Property Trust. Units in this trust were held by two family trusts, the Meeuwissen Family Trust and the Young Family Trust.

41. The transfer of the control of the real property was effected through a series of steps.

(a) First Dyda was appointed as trustee of the part of the trust assets of the Woodville Property Trust which comprised the real property. This part of the trust was to be known as the Burleigh Avenue Trust.

(b) The trust deed was amended to allow for a new type of units, funding units, which could receive income in priority to all existing units.

(c) Dyda in its capacity as trustee of the Burleigh Avenue Trust issued to Dyda in its capacity as trustee of the Burleigh Avenue Trust No 4 one funding unit.

(d) Dyda Nominees was appointed as trustee to part of the Meeuwissen Family Trust comprising one ordinary unit in the Burleigh Avenue Trust. This was henceforth known as the Burleigh Avenue Trust No. 2.

(e) John Dyda was made guardian and appointor of the Burleigh Avenue Trust No. 2.

(f) Similarly, Dyda Nominees was appointed as trustee to part of the Young Family Trust comprising one ordinary unit in the Burleigh Avenue Trust. This was henceforth known as the Burleigh Avenue Trust No. 3.

(g) John Dyda was also made guardian and appointor of the Burleigh Avenue Trust No. 3.

42. The appellants argued that the transactions implemented did not involve the conferring of a benefit in relation to the trust property in any form, that is, 'nothing was conferred on anybody as nothing additional was done to create in any person rights apart from the rights that existed under the existing discretionary trusts'.

43. Stanley J rejected the argument of the appellants, concluding.

The appointment of Dyda Nominees as trustee of the Burleigh Avenue Trust No. 2 and No. 3, was in each case, effectively the resettlement of the units under a new trust rather than the appointment of a new trustee to existing trusts. The requisite continuity of the trust did not exist.

The continuity of trusts was broken because of the transfer of control of these two discretionary trusts to the Dyda group, which occurred on 8 March 2007. This was achieved by the appointment of Dyda Nominees as the trustee, and by the appointment of John Dyda as the appointor and guardian under the trusts. In his capacity as guardian, John Dyda could control the distributions of some income and of all of the capital of the trusts. A member of the class of potential beneficiaries of the trusts who was not a member of the Dyda group could not realistically expect ever again to receive any distributions under the trusts. This conclusion is reinforced by the granting of indemnities. Accordingly, Dyda Nominees acquired an absolute interest in the ordinary units.

Settlement of assets on terms of a different trust

45. The appointment of an additional trustee to an existing trust fund would not, without more, give rise to an E1 event. The usual position applying to a trust with multiple trustees is that the trustees share one office of trustee and must act unanimously in respect of the assets of the fund.

47. A trust split as defined for the purposes of this Determination is directed to achieving a functional separation in the operation of the trust. The intent is that those who control and can benefit from the part of the trust corpus that is transferred to the new trustee will be different from those who control and benefit from the remaining assets held by the original trustee. In these arrangements, the existing trustee is removed as trustee in respect of some of the assets of the existing trust estate and a new trustee is appointed to hold those assets. The intended result is that the existing trustee will no longer have fiduciary obligations in respect of the transferred assets, and no entitlement to indemnification out of those assets for expenses incurred after the introduction of the new trustee. Likewise, the new trustee will have no fiduciary obligations in respect of the assets retained by the pre-existing trustee, nor any rights to be indemnified out of those assets. As a consequence, each particular trustee's obligations and powers relate to particular assets only. Further, in relation to the assets it holds, each trustee exercises its powers independently of the other and is solely responsible for the manner in which those powers are exercised.

48. These factors lead to the conclusion that there is no longer one trust fund over all of the assets. Instead, there are two distinct trust funds which are both administratively and legally separated.

49. In addition, given the intended separation of trustee obligations and powers, attempts to administer a 'split' trust as a single trust fund would encounter immediate practical problems. Each trustee will only receive the income derived from the assets it holds and is only able to seek to make good its right to be indemnified from those assets, and only for expenses properly incurred in carrying out its trust duties. The parties typically intend that each trustee individually calculates the income of the trust that arises from the assets it holds and individually determines how that income is to be dealt with. As such, a trustee of a loss-making fund would have no surplus income available for distribution but rather a loss intended to be carried forward and recouped only against future income (if any) of that fund, with the full surplus income in the other trust fund remaining available for distribution by the trustee of that trust fund.

50. Finally, although the range of beneficiaries and the terms of the trust deed may be consistent between both trust funds at the time that the new trustee is appointed, the terms of the trust instrument do not prevent the instrument being varied by each trustee individually as it relates to the assets it holds. Through the exercise of such powers it is conceivable that the range of beneficiaries, the trust terms and even the vesting date applicable to the individual funds may be caused to differ. This fact again points to there no longer being a single trust fund.

51. A useful check on this analysis can be obtained by considering the result of a potential challenge by an aggrieved beneficiary to an exercise of a trustee discretion after the implementation of a trust split.

52. While the identity of those entitled to benefit from the original trust as a whole, as set out in the trust deed, may remain unaltered in the course of the implementation of the trust split, in exercising its discretionary power of appointment, each trustee must give real and genuine consideration to how, and in respect of whom, the power should be exercised, having regard to the purpose for which the discretion has been conferred.

53. In ascertaining the purposes for which the discretionary powers of appointment have been vested in each trustee, a court could be expected to have regard to extrinsic evidence as to the reasons for, or object of, the reorganisation, as well as the circumstances surrounding the reorganisation, in construing the scope of the powers and discretions vested in each trustee under the trust deed. This is so notwithstanding that on their face, the trustee discretions conferred by the trust deed are wholly unfettered.

By declaration or settlement

56. The second element necessary for CGT event E1 to happen is that the creation of the trust is by declaration or settlement.

57. A trust is created by declaration within the meaning of subsection 104-55(1) when it is created by words or conduct sufficient to demonstrate an intention to create an express trust over property. Where a trust split is implemented by executing a deed of variation, or similar document, the terms of the agreement will demonstrate an express intention to hold the transferred assets subject to the terms of the trust deed. This suffices to create a trust over those assets by declaration.

58. A trust is created by settlement when property is vested in a trustee for the benefit of others. A trust split involves a transfer of existing trust property to, and the vesting of this property in, a new trustee for the benefit of others. Therefore, there is the creation of a trust by settlement.

59. In short, a trust split involves the creation of a new trust by declaration and/or settlement, and CGT event E1 happens when that new trust is created.

Example 1 - separating the control of some of the assets of an existing trust that results in creation of a new trust

5. *The Star Trust is a discretionary trust that was settled in 1980 to benefit John Smith and his family members being his spouse, children, grandchildren and their lineal descendants. John has two children from his first marriage - Ben and Holly Smith. He has two children with his second spouse, Jane Smith.*

6. *The trustee of the Star Trust is Star Trustee Pty Ltd (Star Trustee). The trust deed gives the trustee the absolute discretion to appoint income to any one or more of the beneficiaries.*

7. *The assets of Star Trust are 300 shares in Sun Pty Ltd.*

8. *John Smith passed away in 2010. Since his death, Star Trustee has been controlled by Jane and Ben. Jane and Ben are also the current appointors in respect of the whole trust.*

9. *Since John's death, there has been conflict between the children from his first marriage, and Jane and her children.*

10. *To allow the two branches of John's family some level of autonomy and limit the amount of interaction required between them, Star Trustee varies the trust deed pursuant to a power of amendment, and deeds of appointment are executed to implement a trust split as follows:*

(a) A new company owned and controlled by Jane is created, Moon Trustee Pty Ltd (Moon Trustee).

(b) Ownership and control of Star Trustee is changed such that control of this company is now held by Ben and Holly.

(c) Star Trustee is removed as trustee of 100 shares and Moon Trustee is appointed as trustee of those shares in its place.

(d) In accordance with the deeds executed, the remaining 200 shares held by Star Trustee are designated as the corpus of the Star Trust and the 100 shares to be transferred to Moon Trustee are referred to as the corpus of the Moon Trust.

(e) Jane resigns as appointor in respect of the Star Trust and is appointed as appointor in respect of the Moon Trust.

(f) Star Trustee's rights of indemnity are limited so that it can only look to the assets that remain in its control to satisfy its rights to be indemnified (200 shares in Sun Pty Ltd).

(g) Moon Trustee's rights of indemnity are similarly limited to the assets that are in its control (100 shares in Sun Pty Ltd).

(h) Legal ownership of 100 shares in Sun Pty Ltd is transferred from Star Trustee to Moon Trustee.

(i) No changes are made to the range of beneficiaries in favour of whom either trustee can exercise its power of appointment. However, the expectation is that Moon Trustee will hold 100 of the Sun Pty Ltd shares for the benefit of Jane and her children to the exclusion of Ben and Holly, and conversely Star *Trustee will hold the remaining 200 Sun Pty Ltd shares for the benefit of Ben and Holly to the exclusion of Jane and her children.*

11. *The arrangement puts in place a complete segregation of the obligations, powers and rights of the trustees attached to the different assets they respectively hold. Each trustee has a separately identifiable parcel of trust property to which their separate trust obligations (and rights, as trustee) attach, comprising separate trust funds. The separation of the trust estates is expected to be borne out by the exercise of the respective trustee's powers.*

12. *For these reasons, the trust split causes new rights and obligations to be created over the shares transferred to Moon Trustee. These new rights and obligations amount to the creation of a new trust over those shares. The new trust is created by settlement in respect of the transferred shares causing CGT event E1 to happen.*

Example 2 - separating the control of some of the assets of an existing trust that does not result in creation of a new trust

13. *The Kingdom Family Trust is a discretionary trust settled in 1970 for the benefit of Ian King and his family members - his wife Maria and his children Katarina and Laura. Ian King is the current appointor of the Kingdom Family Trust.*

14. *The trustee of the Kingdom Family Trust is Emperor Pty Ltd (Emperor), a company jointly owned by Ian and Maria. Together with their daughters, Ian and Maria are also the directors of Emperor.*

15. *The Kingdom Family Trust is in the business of property development and the operation of retirement villages. Ian is 70 years old and wishes to reduce his involvement in the family's business activities.*

16. *Ian and Maria King decide that now is an appropriate time for greater responsibility for the administration of the Kingdom Family Trust to be placed on Laura who is currently taking increased responsibility for the property development business. To facilitate the desired succession planning goal, the trust deed is amended to:*

(a) *allow for the appointment of additional trustees in respect of some of the assets of the trust fund*

(b) *allow for separate appointors in respect of the different parts of the trust fund*

(c) *provide that in making a determination about how to distribute the net income of the trust fund for a particular accounting period, each trustee of any separate part/s of the trust fund must take into account the losses incurred by the other parts of the trust fund and expenses of the trust as a whole*

(d) *require all trustees to act together in respect of decisions which one trustee reasonably believes requires agreement of all trustees including but not limited to*

(i) *selection of an accountant for preparation of the trust tax return*

(ii) *incurring joint expenses*

(iii) *amending the trust deed*

(iv) *determining an earlier vesting date for the trust, and*

(e) *give* each *trustee recourse to all of the trust assets where the assets held by that trustee are insufficient to fully satisfy its right to be indemnified.*

17. *A Deed of Appointment was subsequently executed appointing Rainbow Pty Ltd (Rainbow) as an additional trustee over all assets relating to the property development business of the Kingdom Family Trust. Laura and Ian King are the directors and shareholders of Rainbow. Emperor is removed as trustee over all assets relating to the property development business.*

18. *The identity of those who control Emperor remains unchanged.*

19. *Laura is appointed as appointor in respect of that part of the trust fund that Rainbow holds as trustee and Ian King resigns from that role. Ian King remains appointor in respect of the remainder of the trust fund (being the assets Emperor continues to hold).*

20. *Both parts of the trust fund continue to be governed by the terms of the original trust deed as amended.*

21. *The range of potential beneficiaries entitled to benefit from the trust as a whole does not change.*

22. *Each trustee keeps separate accounts in respect of the assets they hold, but the results are consolidated for the entire trust fund and a single tax return is prepared for the Kingdom Family Trust as a whole.*

23. *Considering all the elements of the arrangement, it cannot be concluded that the assets transferred to Rainbow have been subjected to new personal obligations and new rights annexed to that property. The Kingdom Family Trust continues as one trust, albeit with two trustees, each separate trustee assuming primary responsibility in respect of a specified portion of the trust fund. The preconditions to subsection 104-55(1) are not satisfied and implementation of the arrangement does not cause CGT event E1 to happen.*

24. *Example 2 is illustrative of a scenario that is not a 'trust split' as described in this Determination.*

What were the particular features in Example 2 (which did not trigger CGT event E1)?

- The trustee in making a determination about how to distribute the net income of the trust fund for a particular accounting period in respect to the separate parts of the trust fund had to take into account the losses incurred by the other parts of the trust fund and expenses of the trust as a whole.
- The trustees were required to act together in respect of decisions which one trustee reasonably believes requires agreement of all trustees including but not limited to
    - selection of an accountant for preparation of the trust tax return
    - incurring joint expenses
    - amending the trust deed
    - determining an earlier vesting date for the trust.

- Each trustee had a right of indemnity out of all of the trust's assets. That is, it is not limited to one part of the trust fund.
- Both parts of the trust fund continue to be governed by the terms of the original trust deed as amended.
- The range of potential beneficiaries entitled to benefit from the trust as a whole did not change.
- Although separate accounts were kept in respect of the assets held in the separate parts, the results are consolidated for the entire trust fund.
- One tax return is prepared for the trust.

Private Binding Ruling Authorisation number 1051902419908 issued 29 October 2021 (Commissioner's view was that CGT event E1 not triggered)

Background

The Children's Trust

The Children's Trust was constituted by Deed. Individuals that are not beneficiaries of the Children's Trust are the Trustees of the Children's Trust (Existing Trustees). The Existing Trustees are both residents of Australia. The Trust was created by the settlement of the sum of ten dollars ($10) by the Settlor on the Trustee.

The Children's Trust is a discretionary trust allowing for the appointment of the income and capital of the trust to a class of persons described in the deed as the Income Beneficiaries and Capital Beneficiaries (they are the same) on the terms and conditions set out in the Deed.

The Trust Fund means the settlement fund ($10) and any money paid and other property transferred to the Trustee and accepted as additions to the Trust Fund and all or part of any investments and property representing the Trust Fund.

The beneficiaries of the Children's Trust are the children of an individual (the Parent). The Parent is not an Existing Trustee.

The Parent recently died and at the time of their death they were not a resident of Australia for tax purposes.

The children of the Parent are called the Designated Persons in the Deed and are Income and Capital Beneficiaries. Also included in the definition of Income Beneficiaries and Capital Beneficiaries are other individuals and entities including (in summary):

- each child of the Designated Person;
- any trust in which any of the Designated Persons or their children are present or future beneficiaries;
- any corporation in which any shares or capital is beneficially owned by any of the foregoing;
- any unit trust in which any of the units is or will be held by the Trustee upon the trusts set out in the Deed or is beneficially owned by any of the foregoing;
- a University; and
- any person, corporation or association whom the Trustee considers worthy of funds either for charitable, educational benevolent and similar purposes.

The Parent was the Appointor of the Trust during their lifetime but pursuant to their Will had nominated their spouse as the Appointor.

The Trustees may at any time prior to the Vesting Day determine to pay out or apply the capital of the Trust Fund or any part of it to or for the benefit of any one or more of the Capital Beneficiaries in such proportions and in such manner as it thinks fit.

Any distribution could be done in specie.

The Appointor's consent was required to amend the deed.

The assets of the Children's Trust were primarily shares in private companies connected to businesses conducted principally by the Parent's family but also included shares in various public companies listed on the ASX.

The primary income of the Children's Trust is dividends received from its investments in these companies. It also receives dividends from its holdings in the ASX listed shares and small amounts of interest and capital gains.

The Trustee made a family trust election in a previous financial year and the Parent is the specified individual.

The proposed transactions

The proposed transaction is part of the succession plan of the Parent.

A part of the fund will be distributed to the eldest children of the Parent having regard to their age and position and circumstances in life. This step will occur first and prior to the appointment of the new trustees.

The remaining part of the of the fund is to be split into three parts.

It is expected the first part will provide for some of the Parent's children. These are children with a former spouse. It was the Parent's intent that a distinct part of the fund be available at some point to provide for these children. It is possible that the Existing Trustees may become the new Appointors of this part.

The second part is expected to provide primarily for children of the Parent and their Spouse. It is expected that their Spouse will remain the Appointor of that part.

The third part is to be held for more general application. It is possible that the Existing Trustees may become the new Appointors of that part.

The range of potential beneficiaries entitled to benefit from the trust fund as a whole will not change.

Three new companies will be incorporated in Australia, each to act as the new trustee of one of the three parts (New Trustees). The three parts are referred to as Children's Trust Part 1 (first part), the Children's Trust Part 2 (second part) and the Children's Trust Part 3 (third part).

The Existing Trustees will become the directors and shareholders of each of the New Trustees. Directors will have equal rights in respect of decision making.

The Parent's spouse may be appointed as an additional director of the New Trustee for the Children's Trust Part 2.

The accounting and tax reporting for all three parts will be on a consolidated basis.

Proposed Deed of Variation #1

The following changes are proposed pursuant to the proposed/draft Deed of Variation #1.

A new clause will define "Trust Deed" to mean "this deed constituting the Children's Trust as modified, added to or varied from time to time".

The clauses dealing with the power to appoint new trustees will include express powers to appoint a new trustee of parts of the property of the Trust, as follows:

Clause

The Appointor may by a written document:

- at any time appoint an additional trustee or trustee with an existing trustee or trustees of the whole or any part of the trust fund;
- at any time appoint a new trustee or trustees to be a trustee or trustees in place of a trustee or trustees of the whole or any part of the Trust Fund;
- at any time remove a trustee or trustees of the whole or any part of the Trust Fund.

Clause A

The Appointor may exercise the foregoing power to appoint or remove a trustee or trustees of the Trust Fund or any part of the Trust Fund whether or not such part shall be held on the same trust or trusts distinct from any other part of the Trust Fund.

Clause B

The Appointor:

- may appoint a single trustee in place of existing trustees of the whole or any part of the Trust Fund;
- remove a trustee of the whole or any part of the Trust Fund notwithstanding that may leave a single trustee of such whole or part of the Trust Fund.
- is not required to ensure that there is more than one trustee of the Trust Fund or any part thereof at any time notwithstanding the numbers of trustees that were originally appointed was more than one.

Clause C

The Appointor may on any appointment of a trustee or trustees of a part of the Trust Fund declare:

- that the trustee or trustees of such part of the Trust Fund must in making a determination about how to distribute net income of the Trust Fund for a particular Accounting Period take into account the losses incurred by other parts of the Trust Fund and expenses of the Trust as a whole in the same proportions as the value of that part bears to the value of the whole of the Trust;
- that all trustees of any parts of the Trust Fund must act together in preparing a single set of financial statements and tax returns of the Trust.
- that all trustees of any parts of the Trust Fund must act together in respect of decisions which one of them reasonably believes requires agreement of all of them in connection with the Trust including but not limited to:
  - (a) selection of an accountant for preparation of the financial statements and tax returns of the Trust;
  - (b) incurring joint expenses of the Trust, which unless otherwise agreed are to be shared in the same proportion as the value of each part of the Trust Fund bears to the value of the Trust;
  - (c) amending the Trust Deed;
  - (d) the day that is to be the Vesting Day of the Trust as permitted by clause 2.15(a); and
- Subject to clause D, that the trustee or trustees of each part of the Trust Fund have full recourse to all of the assets of the Trust where the assets held by the trustee or trustees of a part are insufficient to fully satisfy its right to be indemnified out of such part of the Trust Fund.

Clause D

Where the last part of clause C applies, the right of recourse shall be borne by the other parts of the Trust Fund in the same proportion as the value of each such part of the Trust Fund bears to the value of the Trust at the time of such recourse.

Clause E

The Appointor may for the purposes of clause C in any appointment of a trustee simply declare that clause C applies to such part without setting out its terms.

Clause F

The Appointor of any part of the Trust Fund, may with the written consent of the trustee or trustees of all parts of the Trust Fund declare that clause C no longer applies to such part.

Clauses are to be replaced to enable an appointor to be appointed in respect of part of the Trust Fund, for example the Deed will provide that the Appointor will include:

(a) Any person nominated in writing as appointor, whether in respect of the Trust Fund or any part thereof that is then held by a separate trustee or trustees, by the Appointor of the Trust Fund or in respect of a separate part the Appointor of that separate part;

A clause which allows the Trustee to appoint a trustee in any country and transfer part of the Trust Fund to that trustee will be varied to:

With the written consent of the Appointor, appoint a trustee or trustees in any country and to vest (where the law permits) or require the Trustee to transfer any part of the Trust Fund to that trustee or trustees.

Clause F in paragraph 37 above of the Proposed Deed of Variation is included to provide greater flexibility. The appointor and/or the trustees may at some stage in the future wish to separate or de-aggregate from the requirements in the proposed clauses C that the trustees act together. Clause F is intended to facilitate that de-aggregation.

Proposed Deeds of Appointment of New Trustee of Part of the Children's Trust

The background to each draft/proposed Deed of Appointment of New Trustee of Part of the Children's Trust (Deed of Appointment)states that:

D. The Appointor in exercise of the powers vested in [them] by [clauses in Proposed Deed of Variation] is desirous of appointing the New Trustee to be the Trustee in substitution for the Existing Trustees of that part of the Trust Fund described in the Schedule which is to be held on and subject to the same trusts and powers and provisions as the whole of the assets of the Trust Fund are currently subject (that part of the Trust Fund is for the purpose of identification only to be hereafter known as the Children's Trust Part (Appropriate Part Number To Be Inserted)

Each such Deed of Appointment provides (in summary):

- that the Appointor appoints the New Trustee to be the Trustee of the property described in the Schedule and hereafter to be known as the Children's Trust Part (appropriate part number is to be referred to);
- the New Trustee consents to the appointment (clause 2);
- that the Appointor declares and directs that all the estate and interest of the Existing Trustees in those parts of the property described in the Schedule shall vest in the New Trustee upon the trusts affecting the same respectively by virtue of the Trust Deed as varied (Vesting Declaration - clause 3);
- the Existing Trustees agree to transfer to the New Trustee all other investments and property as described in the Schedule to be held by the New Trustees (clause 4);
- the Appointor and the New Trustee agree and declare that the New Trustee shall hold the property vested in it by virtue of the vesting declaration and also the said property being transferred to it upon the trusts and with and subject to the trusts powers and provisions declared and contained in the Deed as varied and subject to such of the said trusts powers and provisions as are now subsisting and capable of taking effect;
- the New Trustee hereby indemnifies and agrees to keep indemnified the Existing Trustees from and against the debts and obligations described in the Schedule (if any) to the extent of the assets of the Trust vested in it by virtue of the Vesting Declaration and also the said property being transferred to it.

- that the Appointor declares, pursuant to clause E, that Clause C of the Deed as varied applies to the Children's Trust Part (appropriate part number is to be referred to).

Each such Deed of Appointment may provide:

The Appointor in exercise of the power of appointing a separate Appointor vested in [them] by clause [xx] of the Trust Deed as varied in respect of the Children's Trust Part [appropriate part number to be inserted] appoints [X] to be the Appointor in [their] place in respect of the Children's Trust Part [appropriate part number to be inserted].

The inclusion of the above provision in any Deed is subject to the matters described above at paragraphs 27 and 29.

Deed of Variation of Trust 20XX#2

This Deed of Variation of Trust 20XX#2 provides for the variation of clauses that provides for maintaining, classification and allocation of income to one or more separate accounts and permits the Trustee to stream income and capital (from a class, source or category), in its character, to a beneficiary.

Intended transfer of assets

The assets remaining after distributions to the eldest children will be divided between each of the three parts held by the New Trustees. Principally these will be the shares held in the private family companies.

Reasons for Decision

CGT event E1 will not happen: In order to determine whether CGT event E1 happens, it is necessary to consider whether the proposed steps would have the effect of creating a trust over a CGT asset by declaration or settlement (subsection 104-55(1)).

The question under consideration is not whether the Children's Trust will come to an end, but whether the assets transferred to the New Trustees are settled on a new trust fund that is separate and distinct from the existing Children's Trust.

The proposed arrangements are distinguishable from the trust splitting arrangements of the kind described in TD 2019/14.

Although each of the three parts of the fund will have a new and distinct corporate trustee these trustees will all be bound by the terms of proposed new clauses of the Deed that:

- requires all trustees to act together in respect of decisions that one trustee reasonably believes requires agreement of all the trustees, including selecting an accountant to prepare the tax return, incurring joint expenses, amending the trust deed; and changing the vesting date;

- requires the trustees of each part, when making decisions to distribute the net income of the fund, to take account of the losses incurred by the other parts of the trust fund and expenses of the trust as a whole;

- gives each trustee recourse to all of the trust assets where the assets held by that trustee are insufficient to fully satisfy its right to be indemnified.

Further, the tax reporting and accounting for all three parts will be on a consolidated basis.

Considering these elements together with the other elements of the proposed arrangement and the circumstances prevailing at the time that these arrangements will be entered into, it cannot be concluded that the assets to be transferred to the New Trustees have been subjected to a new charter of personal obligations and rights.

We conclude that the Children's Trust will continue as one trust albeit with three separate trustees in respect of the three parts of the trust fund.

Consequently, the elements of subsection 104-55(1) will not be satisfied and CGT event E1 will not happen.

CGT event A1 will not happen: CGT event A1 happens if you dispose of a CGT asset (section 104-10 of the ITAA 1997).

Subsection 104-10(2) provides that 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. A change of ownership does not occur if you stop being the legal owner of the asset but continue to be its beneficial owner. Further, as stated in the note to subsection (2), a change in the trustee of a trust does not constitute a change in the entity that is the trustee of the trust. This means that CGT event A1 will not happen merely because of a change in the trustee.

In this case, when the CGT assets are transferred to the New Trustees there will be a change in the ownership of those assets at law (that is, another legal entity will have the legal rights to deal with the assets subject to the terms of the Children's Trust). However, as concluded above, the assets are still held under the same trust albeit by three new trustees in respect of the three parts of the trust fund. There is no change in the entity that is the trustee of the trust for tax purposes and thus no change in ownership of the nature required under subsection 104-10(2). Therefore, CGT Event A1 will not happen.

CGT event E2 will not happen: CGT event E2 happens if you transfer a CGT asset to an existing trust (section 104-60 of the ITAA 1997).

As concluded above, the assets will continue to be held under the same trust albeit by three new trustees in respect of the three parts of the trust fund. There is no transfer of assets to an existing trust. Therefore, CGT Event E2 will not happen.

CGT event H2 will not happen: CGT event H2 will only apply to an event where no other CGT event has been applied. It happens if an act, transaction or event occurs in relation to a CGT asset that you own and the act, transaction or event does not result in an adjustment being made to the asset's cost base or reduced cost base: section 104-155 of the ITAA 1997.

We have concluded that the Children's Trust will continue as one trust albeit with three separate trustees in respect of the three parts of the trust fund. None of the parts will be made subject to a separate charter of rights and obligations. Therefore, we conclude that no relevant act, transaction or event has happened in relation to a CGT asset. Therefore, CGT Event H2 will not happen.

The consequences of a trust split resulting in CGT event E1 occurring is as follows:

- The trustee has a capital gain if the capital proceeds from the creation are more than the asset's cost base or a capital loss if the capital proceeds are less than the asset's reduced case bae.
- CGT event E1 occurs when the trust over the asset is created.

  Note: CGT event E1 does not happen merely because of a change in the trustee.

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- Consequence of a trust split

If CGT event E1 is triggered	If CGT event E1 is not triggered
New trust created	One trust
Trustee has a capital gain/capital loss in relation the CGT asset based on the market value of the asset less the cost base at the time the trust over the asset is created	No CGT issues
Each trust calculates its trust income without consideration of the other trust. No need to take into consideration trust losses from the other trust	Need to take into account losses incurred by each part of the trust
Trustee's right of indemnity can be limited to each part of the trust fund.	Trustee's right of indemnity cannot be limited to a particular part of trust fund.
Separate tax returns, TFNs and FTEs	One tax return, one TFN and one FTE

5.2 Former Trust cloning exemption

A trust cloning exemption applied to events which occurred prior to 1 November 2008

- CGT event E1 and E2 did not happen if an asset is transferred from one trust to another and the beneficiaries and terms of both trusts were the same (former sections 104-55(5)(b) and 104-60(5)(b) of the 1997 Tax Act).

- *Taxation Ruling* TR 2006/4 (which has now been withdrawn) provided a list of requirements which needed to be satisfied for the terms of both trusts to be considered the same. At paragraph 19 it listed the differences which were allowable, being, the trustees, trust name, commencement date, settlor and trust property (other than that the transferred assets must have an asset of both trusts, though not at the same time).

This strategy allowed clients to:

- separate assets held in one discretionary trust to one or more discretionary trusts; and

- later appoint different controllers to each of the discretionary trusts,

without triggering any CGT implications.

An example:

- The Smith Family Trust holds a parcel of ASX listed shares and a residential property.
- Mr Smith would like his eldest child to receive the benefit of the shares, and his younger child to receive the benefit of the residential property.
- The Smith Family Trust is cloned, and we now have the Smith Family Trust No 2 the terms of which are identical to the terms of the original Smith Family Trust with the same trustee.
- The residential property is declared to be vested on the terms of the Smith Family Trust No 2.
- A change of trustee is completed for the Smith Family Trust No 2.
- The succession plan then passes control of the original Smith Family Trust to the eldest child, and control of the Smith Family Trust No 2 to the youngest child.

Although the trust cloning exemption for tax purposes is no longer available, moving assets out of one trust to another may not have adverse taxation implications where:

- the assets are pre-CGT or there would be minimal capital gain implications; and
- clients can access other CGT concessions such as small business concessions or other roll-overs.

5.3 Passing control of a trust

Clients with what may be considered as even moderate wealth will often have assets held in a discretionary trust structure. Whilst this may be suitable for their personal circumstances during their life, often there will be reasons why leaving assets in a discretionary trust to a number of children or other beneficiaries will not be suitable.

To transfer the control of a trust it is necessary to look at the both the succession of the trustee (and shares in a corporate trustee) and the appointor (also commonly referred to as a principal or guardian).

This can be achieved through a myriad of strategies. Commonly we will either see the succession of the controlling roles passed through the Will or by varying the terms of the trust deed.

Regardless of whether control is being passed through the Will or a variation to the trust deed, it is absolutely necessary to read and understand the:

- deed establishing the trust and any varying deeds;
- constitution for a corporate trustee, and voting rights attached to the shares; and
- client’s Will and how the shares in any corporate trustee are dealt with as well as any power of appointment.

Depending on the client’s strategy and the level of risk of an estate dispute, sometimes it will be preferable to pass control outside the terms of the Will.

Dealing with shares in corporate trustee

If the client has a corporate trustee, the client needs to plan for the succession of ownership of the shares, and how the appointment of directors will work.

Whilst shares in a company that acts only as trustee have no inherent value, whoever owns the shares generally have control of the corporate trustee trust as they will generally have the power to appoint the directors and it is the directors who effectively exercise the trustee discretions.

For a straightforward succession plan, it may be a matter of gifting the shares in the corporate trustee to the people intended to take on the role as trustee. However, an advisor and the client also need to consider:

- where more than one person is receiving the shares, will they all have the power to appoint a director of the corporate trustee? If no one has a majority shareholding how can we ensure the persons intended to act as directors can get appointed?

- will the shareholding need to be split to accommodate the number of new shareholders?

Even if the control of the client's shares in the corporate trustee is adequately dealt with under the Will, it is also necessary to consider the provisions in the constitution for appointing directors. The majority of constitutions follow the Corporations Act replaceable rule[74] that a majority of members eligible to vote at a general meeting is required to appoint a director.

However, gifting shares in a trustee company under a Will may not provide a certain outcome if the Will is challenged in a family provision action[75] because, while they may only have a nominal value, the shares will still be assets in the estate and a court may order that those shares (and therefore control of the trust) should be transferred to alternate beneficiaries.

There are a number of alternative strategies that allow the voting rights attaching to shares in the trustee company to be transferred to the intended controllers of the trust, and therefore avoiding the risk of shares being subject to an estate dispute.

One option is for the client to transfer their interest in the shares to the proposed controllers as joint tenants. The shares will then pass to the survivor automatically outside of the Will[76].

This strategy may not be suitable for various reasons, including:

- The client may lose a degree of control by being a joint owner. To ensure the client maintains the control of the voting rights attaching to the share it will be necessary to ensure that the client's name appears first on the share certificate as under most company constitutions this will entitle them to exercise the vote, as well as considering whether the constitution should be updated to allow that while the client is alive they are the only joint holder with the right to exercise a vote.

- If the client later changes their succession strategy and no longer intends the joint tenant to receive control after the client's death, it may be difficult to remove them as a joint shareholder.

- The need to review the strategy if the joint tenant pre-deceases the client.

[74] see section 201G of the *Corporations Act 2001.*
[75] E.g. Part 4 *Succession Act 1981* (Qld).
[76] However in New South Wales assets held as joint tenants may be subject to a notional estate order under part 3.3 of the *Succession Act 2006* (NSW).

An alternative option is to issue special class shares and vary the company constitution to allow control of the corporate trustee to pass automatically on the client's death outside of the Will.

By way of example:

- The client holds ordinary shares in the corporate trustee.
- The corporate trustee issues special class redeemable shares (A class shares) to the people whom are intended to control the trust on the client's death.
- The special class shares are issued as redeemable, so that if the client's strategy changes in the future the shares can be redeemed.
- The company constitution is varied to provide that:
    - while the client is alive, the A class shares have no voting rights;
    - on the client's death, the rights attaching to the ordinary shares are extinguished; and
    - on the client's death, the A class shares become the only shares with voting rights.

If implementing a strategy like this, it is important to consider whether there are any duty consequences of dealing with the shares in a corporate trustee.

Role of appointor/principal

Most (but not all) trust deeds stipulate that a designated person has the power to remove a trustee and appoint a replacement. This person is commonly referred to as an appointor or principal.

Dealing with the shares in the corporate trustee is only part of the succession plan for a discretionary trust. You will also need to look at the appointor role in order to complete the transfer of control.

It is necessary to review the terms of the trust deed carefully to understand how the power of appointment works for that trust. In particular, check the provisions of the trust deed to ascertain whether the initial appointor can nominate a replacement and the procedures that must be followed.

If the existing provisions in the trust deed are not adequate to allow the power to be passed to another person, then the trust deed will need to be varied to accommodate the client's wishes.

Many deeds allow the appointor to nominate a replacement in their Will and stipulate that, if no replacement is appointed, the executors of a deceased appointor will take over that role.

If there is a material risk of a challenge to the Will, it may be prudent to ensure that the role of appointor can pass to the designated controllers independently of the Will.

Again, this may require an amendment to the trust deed. For example, the deed could be amended to allow for a successor appointer but on the basis that the successor did not become an appointor until the existing appointor dies. The power of appointment could be drafted further to allow for a cascade of successors.

Another common variation will be to allow the client's children to be nominated to become an appointor on reaching a certain age, or the children automatically deemed to become the appointers at a certain age.

Alternatively the client may prefer that this power of appointment of new trustees ‘dies’ with the client so that the strategy of gifting the shares in the trustee company to the designated controllers cannot be defeated by a change of trustee.

Control of discretions following death

A dilemma facing clients whose preference is for their family trust to continue after their death is how to ensure that their children (or other beneficiaries) receive ‘their share’ of the trust income and assets given that no beneficiary has a defined interest in the trust.

Statement of wishes

A strategy commonly adopted is to leave the shares in the corporate trustee to the persons named as executors and leave a statement of wishes as to how the client wants those persons to exercise the trustee discretions.

There are several problems with of this approach.

- The statement of wishes is not binding and beneficiaries who are not happy with how the directors of the trustee are exercising their powers have limited rights to object.
- There may be some basis for beneficiaries to challenge decisions of trustees that clearly deviate from the statement of wishes as individuals who have an interest in a trust estate have the standing to apply to the Court to review decisions of the trustee.[77] However, this is not ideal.
- If the clients rely solely on a statement of wishes, a further problem is that none of the beneficiaries can require the trustee to distribute ‘their share’ of the trust assets if they wish to terminate their involvement in the trust.

Creating fixed entitlements in discretionary trust

Before any amendment of the trust deed to give designated beneficiaries a vested interest in either income or capital is undertaken, there will need to be consideration as to whether this will be considered a resettlement of the trust.

However, it is possible in many cases to achieve a reasonable degree of certainty without triggering duty or tax consequences by making complementary amendments to the trust deed and the constitution of the corporate trustee.

While the appropriate strategy will depend on individual circumstances and the terms of each trust deed, an approach along the following lines will be available in most cases.

Firstly amend the trust deed to:

- identify the children (or other persons) the clients want to ultimately benefit from the trust (designated beneficiaries);
- provide that the designated beneficiaries may request the trustee to distribute ‘their share’ of the trust capital at any time after a specified date or event (eg. the death of the clients) and require the trustee to consider this request; and

[77] Section 8 *Trusts Act 1973* (Qld)

- vary the amendment provisions so that these 'estate planning amendments' cannot be deleted or varied after the death of the clients.

In addition to amending the trust deed, the constitution of the corporate trustee should be amended to:

- ensure the designated beneficiaries will be entitled to nominate a director to the board of the trustee after the death of the clients;
- provide that the director representing the interest of each designated beneficiary has the power to determine how that beneficiary's 'share' of trust income will be distributed; and
- provide that, if a designated beneficiary makes a request to the trustee to distribute 'their share' of trust capital, the designated beneficiary (or their nominee director) will effectively have 51% of the votes at the meeting of directors which considers this request.

As part of this overall strategy, the clients should ensure their shares in the trustee company are left to the designated beneficiaries in equal shares. It may be necessary to implement a share split now to ensure that there are sufficient shares on issue to allow for this.

This strategy will allow the designated beneficiaries to control the distribution of 'their share' of trust income and terminate their involvement without having to rely on the agreement of their co-beneficiaries.

The changes to the constitution of the corporate trustee will not have any duty consequences. However, the duty consequences will need to be considered when dealing with the shares in the corporate trustee.

Entrenching Estate Planning Restrictions

While clients and advisers are becoming more aware of the need to insert restrictions and controls on the way in which trustee discretions can be exercised after the death of the principals, one aspect which seems to be commonly overlooked is that most discretionary trust deeds allow a wide flexibility to amend the deed.

Unless these powers of amendment are restricted, then the control mechanisms a client puts in place before their death may be unwound after they pass away.

For example, if the trust deed is amended to stipulate that non-family members can never take a capital distribution or to restrict the trustee from making distributions to family members who are in a relationship but do not have a financial agreement, it is imperative that these restrictions cannot be removed or modified by subsequent amendments.

If the control mechanisms have been built into the trustee constitution, then it will also be necessary to ensure that that company cannot be removed as trustee (or at least not without the unanimous consent of all shareholders and directors in the trustee company).

5.4 Amounts owing by the trustee to the clients

Any amounts owing by the trustee to individuals will form part of the individual's estate. How these amounts are to be dealt with will need to be considered, particularly if the individuals who will benefit under the Will are different to those who will control the trust.

The following issues which will need to be considered is:

- Should the loan form part of the estate of the client or should it be released?

- If the loan does form part of the estate, then what are the terms of the loan repayments?

Examples of strategies which may be implemented are as follows:

- Where the client wants the ability to call on the loan during their lifetime, but do not want the loan to form part of the estate:
  - The client assigns the loan (by way of gift) to a new trust (Loan Trust).
  - Clients control the trustee and are the appointors of the Loan Trust, but on their death, the children who will take the benefit of the loan become the appointor.
- Where the clients want the loan to form part of the estate:
  - The clients enter into a loan agreement with the trustee.
  - Careful consideration is required in relation to the repayment terms.

    For example, on the death of the clients, should the outstanding balance become payable immediately (which may cause cashflow issues) or is it to be paid over a particular period commencing on the death of the clients.

Releasing loans

If releasing loans of an entity which has made a FTE or IEE, make sure that the individual or entity is in the 'family group' of the relevant test individual, otherwise there will be family trust distribution tax issues.

5.5 Beware of the Vesting Date

5.5.1 Vesting Period

The common law rule known as the 'rule against perpetuities' prevents trust property from being held in trusts for a limitless number of years. This also applies where a distribution of income or capital is made by a trust (original trust) to another trust (recipient trust) if the recipient trust has a vesting date later than the original trust.

> The common law rule and its operation were summarised by the Privy Council in Air Jamaica Limited v Charlton [1999] 1 WLR 1399 at 1408-1409:
>
> ... no interest is valid unless it must vest, if it vest at all, within a period of a life in being, the date of the gift plus 21 years. The rule is applied remorselessly. A gift is defeated if, by any possibility, however remote, it may vest outside the perpetuity period. It is not saved by the fact that, in the event, it vests inside the period....

To address the complexity of the common law rule, the States and Territories have enacted legislation modifying or abolishing the rule.

South Australia has completely abolished the rule.

In all States and Territories (other than South Australia), the maximum period for which property may be held on trust is:

- 80 years[78] (including Queensland up to 31 July 2025); and
- 125 years (from 1 August 2025 for Queensland) [79]

Generally, the vesting date will be defined in the deed with reference to the date which is 80 years from the date of the establishment of the trust (or an earlier date). However, it will be important to review the terms of the deed as the vesting date may be a period less than the maximum period allowed (for example 20, 25, 40 years), once a particular person reaches a particular age or refer to the death of a beneficiary.

Most deeds will allow the trustee to change the vesting date of the trust provided that the date is not later than the 80 years.

It will be important to be aware of the vesting date of a trust as:

- there may be unintended consequences if the vesting date has passed; and
- the appointment of trust income or part of a trust fund of a trust (original trust) in favour of another trust (recipient trust) will breach the rule against perpetuity if the recipient trust has a vesting date later than the original trust (subject to the 'wait and see' rule)
- some trust deeds prohibit the appointment of income and capital to a recipient trust if the vesting date of the recipient trust has a later vesting date than the original trust.

"Wait and see' rule

As mentioned above, under the common law rule, **the disposition of an interest is void if**, at the date of creation, it **could by any possibility vest outside the perpetuity period**.

Each of the States and Territories (other than South Australia who has abolished the rule against perpetuities) have saving provisions which allow dispositions that might vest outside the period to remain valid if there is still a chance of vesting within the period (wait and see rule)[80].

If it becomes certain that the interest will not vest within the period the disposition is taken to be void.

Nemesis Australia Pty Ltd v Commissioner of Taxation[81]

> 41. At common law and under s 210, the ``wait and see'' rule is designed to enable the Court to look at what actually occurs before the expiry of the perpetuity period and the circumstances as they have unfolded in order to determine whether there has been a vesting within the perpetuity period. If, in fact, the interest is vested prior to the expiry of the perpetuity period, notwithstanding that a longer period is provided for in the trust deed, the trust may be valid. The trust would then not infringe the rule against perpetuities. Accordingly Section 210 was introduced to remedy what was seen as a deficiency in the common law rule, namely, that the common law was concerned with possible or hypothetical, and not actual, events. Under the common law rule, the disposition of an interest is void if, at the date of creation, it could by any possibility vest outside the perpetuity period. This rule was criticised by the Queensland Law Reform Commission because it may in fact happen that, at the time at which the question of validity is contested, the contingencies have already been satisfied within the perpetuity period.

[78] Section 209 of the Property Law Act 1974 (Qld); section 7 of the Perpetuities Act 1984 (NSW); section 5 Perpetuities and Accumulations Act 1968 (Vic); section 101 Perpetuities and Accumulations Act 1968 (WA); section 6 Perpetuities and Accumulations Act 1992 (Tas); section 8 Perpetuities *and Accumulations Act 1985* (ACT); section 187 *Law of Property Act 2000* (NT)
[79] Section 201 of the Property Law Act 2023 (Qld)
[80] Section 210 of the Property Law Act 2023 (Qld); section 9 of the Perpetuities Act 1984 (NSW); section 6 Perpetuities and Accumulations Act 1968 (Vic); section 103 Perpetuities and Accumulations Act 1968 (WA); section 9 Perpetuities and Accumulations Act 1992 (Tas); section 9 Perpetuities *and Accumulations Act 1985* (ACT); section 190 *Law of Property Act 2000* (NT)
[81] [2005] FCA 1273

43. Under the "wait and see" rule, one waits to see whether the event happens within the perpetuity period. If it does, it is a valid exercise and, if it does not, it is invalid. The Commissioner submits that if the "wait and see" rule applied in the present circumstances, the perpetuity period of 80 years would be meaningless because, on this approach, every discretionary trust, even one expressed to be for 100 years, would be valid for at least 80 of those years. Accordingly, since a new trust could be set up before the end of the 80 year period providing for a distribution within a further 80 years, the trust property could be rolled over indefinitely.

44. In the present case, it is, in my view, possible that the trustee of each trust might **not** exercise the discretion conferred by the other trust deeds to advance the vesting date to a date within the perpetuity period as set out in the SHFT Deed. It can therefore be said that the interest disposed of **might** not become vested until too remote a time. However, s 210 also provides that where a disposition might be void on the basis that it might not become vested until too remote a time, the disposition must be treated as valid until such time as it is **established** that the vesting **must** occur after the end of the perpetuity period, as if the disposition were not subject to the restriction. Therefore, in my view, s 210 operates to validate a disposition and anything done in relation to the interest disposed of by way of the application of intermediate income.

45. The intention of the wait and see rule is to avoid the draconian consequences which otherwise flow from the rigid application of the rule against perpetuities. It applies in the present case because under each of the relevant trust deeds the trustees possess a discretionary power **to advance** the vesting date. The definition of "vesting date" in each of the deeds includes a provision that the expression "vesting date" shall mean the specified date or an **earlier** date nominated by the trustees in their sole and unfettered discretion. Such power includes the nomination of an earlier date within the 80 year period under the SHFT Deed.

46. Until the expiration of the 80 year period provided for in the SHFT Deed, it is not possible to say that the vesting **must** occur after the end of the original 80 year period. Accordingly, everything done within that period is valid.

47. Consequently, in the present case, any possible breach of the rule against perpetuities within the perpetuity period specified in the SHFT deed must be treated as a valid disposition. For this reason, the submission advanced for the Commissioner must fail. In my view, the integers of s 210 are made out in the present case, namely:

    - The interest disposed of under the SHFT **might** not become vested until too remote a time; and
    - That disposition must be treated until such time as **it becomes established that the vesting must** occur outside the perpetuity period **as if the disposition were not subject to the rule**.

48. Both these integers having been satisfied in this case, the rule against perpetuities has no application and the dispositions are not nullities. Accordingly, the Commissioner's basis of claim must fail.

Where the 'wait and see' rule applies the distribution from the original trust only becomes void where the recipient trust fails to distribute to a beneficiary before the vesting date of the original trust.

This means that:

- if the original trust distributes income or capital to the recipient trust with a later vesting date then provided that the recipient trust distributes the income or capital to a beneficiary prior to vesting date of the original trust then the distribution will not be void (even if the recipient trust vests later than the original trust).
- if the original trust distributes income or capital to the recipient trust with a later vesting date then if the recipient trust does not the income or distribute the capital to a beneficiary prior to vesting date of the original trust then the distribution will be void and the distribution will go to the default beneficiaries of the original trust.

Example (Not a South Australian trust):

- Trust A (established on 1 January 2020 with a vesting date of 31 December 2100), distributes to Trust B (which has a vesting date of 31 December 2120).

- The distribution would be void but for the 'wait and see' rule.
- This does not mean that Trust B must necessarily vest before Trust A.
- Provided that under the terms of Trust B, there is the power to bring forward the vesting date) and provided that the distribution has been distributed out of Trust B (or any other trust) before 31 December 2100, the distribution will not be void.

5.5.2 Bringing forward the vesting date and terminating the trust

If clients want to terminate a trust, the first step is to carefully review the trust deed to determine the circumstances in which the trust must or can be terminated and the procedures (if any) outlined in the trust deed for termination.

For example, the trustee will generally have a discretion to bring forward the vesting date or to make interim capital distributions.

The actual procedures to wind up most trusts will usually be quite simple. There are no formal requirements for dissolution or winding-up of a trust as is the case with a company (in which case the Corporations Act provisions apply).

Generally, all that is required is for the trustee to pass resolutions determining to vest the trust and to distribute the trust capital in accordance with the terms of the trust deed.

The trustee will generally have a discretion as to how the trust capital will be distributed, but failing to exercise that discretion, the trust capital will be held for the benefit of the 'default capital beneficiaries'.

Capital Gains Tax and General Income Tax Issues

There are a number of CGT events, which may be relevant if a trust is terminated or the trustee makes a distribution of trust property (whether as an interim capital distribution or a final distribution on termination).

The events which may be relevant are:

- Event A1 – disposal of a CGT asset.
- Event E4 – capital payment for trust interest.
- Event E5 – beneficiary becoming entitled to a trust asset.
- Event E6 – disposal to a beneficiary to end an income right.
- Event E7 – disposal to a beneficiary to end capital interest.
- Event K6 – disposal of an interest in a trust which is a pre-CGT asset where the post CGT assets of the trust represent more than 75% of its net assets at the time of the CGT event.

While there are a number of different CGT events which may be applicable to transactions occurring in the course of a trust termination, it is only the event which is "most specific" to the transaction in question which applies.[82]

[82] s102-25(1) of the 1997 Tax Act.

Interim Capital Distributions

If the trustee disposes of a trust asset to a third party and makes an interim capital distribution to beneficiaries out of the proceeds, CGT Event A1 will occur as there is a disposal of the asset.

The capital gains implications for the trustee will be determined in the normal way.

If the trust is a discretionary trust, the beneficiary will not derive any net capital gain or ordinary income as a result of the interim capital distribution.

While section 99B(1) of the 1936 Tax Act provides that any amounts distributed to or for the benefit of a beneficiary of a trust estate will be included in the assessable income of that beneficiary, section 99B(2) excludes distributions of “corpus of the trust estate”.

In addition, the Commissioner accepted in *Taxation Determination* TD 2003/28 that CGT event E4 (capital payment in respect of a trust interest) does not apply to interim capital distributions to beneficiaries of a discretionary trust irrespective of whether they are discretionary or default beneficiaries.

In the determination, the Commissioner indicates that “CGT event E4 does not happen in the circumstances (of a capital distribution to a discretionary or default beneficiary) because a mere object or default beneficiary is not considered to have an “interest in the trust” of the nature or character required in paragraph 104-70(1)(a) of the 1997 Tax Act.”

The application of CGT event E4 is more complex in the case of a unit trust or a hybrid trust where beneficiaries have some fixed entitlement, which qualifies as an “interest”.

The basic rule is that the amount distributed to the unit holder/beneficiary in respect of their interest will reduce the cost base of that interest if the distribution is less than the cost base and the beneficiary will make a capital gain if the amount of the distribution exceeds the cost base of their interest in the trust.83

That part of the interim capital distribution, which represents the non-assessable portion of a capital gain made by the trustee because of the application of Division 115 of the 1997 Tax Act, will be excluded from the operation of CGT event E4 if the beneficiary would be entitled to claim the full 50% discount under division 115.

Where the beneficiary would not be entitled to claim the full benefit of Division 115 discount (e.g. companies and superannuation funds or beneficiaries with losses), the extent to which the capital distribution is excluded from the operation of CGT event E4 is adjusted to reflect that reduced entitlement.84

A capital distribution to a unit holder or beneficiary with a fixed interest will also be disregarded under CGT event E4 to the extent that the amount distributed represents an exempt amount under section 152-125 (the fifteen year exemption).

In Specie Distributions

In circumstances where the trustee makes a determination to distribute a particular trust asset to a beneficiary (as opposed to realising the trust assets and distributing cash), the relevant event will be CGT event E5 (for a discretionary trust) or E7 (where the beneficiary has units or a fixed interest).

[83] s104-70(6)) and s104-70(4) of the 1997 Tax Act.
[84] s104-71(4) of the 1997 Tax Act

In those circumstances, the consequences for the trustee will be much the same as under the CGT event A1 in that the trustee will make a capital gain if the market value of the asset at the time of the event is more than its cost base (assuming that the asset is a post-CGT asset).

The consequences for the beneficiary will depend upon whether the beneficiary has an interest in the trust and whether the beneficiary acquired that interest for consideration.

As the Commissioner accepts that beneficiaries of discretionary trusts do not have an "interest" in the trust,[85] there will generally be no consequences for the beneficiaries who become absolutely entitled to a trust asset of a discretionary trust.

However, there may be consequences for a unit holder in a unit trust or a beneficiary who has a defined interest in a fixed or hybrid trust.

In those circumstances, the beneficiary will make a capital gain if the market value of the asset to which they become entitled exceeds the cost base of their interest in the trust.[86]

However, any capital gain or loss will be disregarded if the beneficiary acquired its interest in the trust "for no expenditure".[87]

5.5.3 What happens if the vesting date has passed?

Subject to the terms of the trust deed, it may be possible to extend the vesting date, however the Commissioner's view in *Taxation Ruling* 2018/6, is that this must occur prior to the vesting date. If the trust deed does not contain a power to allow for the vesting date to be extended, it is possible to make an application to the Court for the vesting date to be extended.

The Commissioner's view is that the CGT event E1 does not happen by amending the vesting date through the valid exercise of a power in a trust deed or by the approval of the Court.[88]

What happens on the vesting date – TR 2018/6?

- The Commissioner's views are outlined in TR 2018/6. In summary, subject to the terms of the deed, the trust may not come to an end, however the trustee no longer has discretionary powers to appoint the income or capital of the trust. That is, following the vesting date, the income and capital will be held for the benefit of the default beneficiaries.

- Trust law consequences of a trust vesting:

  12. On a trust's vesting date, the interests in the property of the trust become vested in interest and possession. In the case of a discretionary trust, **from the time the trust vests the trustee no longer has any discretionary power to appoint the income or capital of the trust**. Rather it holds the trust property for the absolute benefit of those beneficiaries specified as the takers on vesting.

  13. The vesting of beneficial interests in a trust, even if described as a 'Termination Date', does **not** ordinarily cause the trust to come to an end, nor cause a new trust to arise. Vesting does not mean trust property must be transferred to the takers on vesting on the vesting date, or that the trust must be wound up either immediately or within a reasonable period (although the deed may require these events to occur after vesting).

[85] Taxation Determination TD 2003/28
[86] s104-75(5) of the 1997 Tax Act
[87] s104-85(6) of the 1997 Tax Act
[88] Taxation Ruling TR 2018/6 at paragraph 10.

14. Further, where a trustee continues to hold property for takers on vesting, **the property is held on the same trust as existed pre-vesting**; albeit the nature of the trust relationship changes.

Example 6 - discretion as to takers on vesting not exercised

41. The trust deed for the Turner Family Trust provided that the trust would vest on 1 January 2015. It also provided that, unless the trustee resolved to distribute the trust capital to particular beneficiaries before the vesting date, the trustee would hold the trust property absolutely for one or more persons chosen at the discretion of the trustee from a class of listed beneficiaries prior to the trust vesting. In the absence of the exercise of that discretion, the trustee would hold the trust property absolutely and solely for Jim.

42. On 1 January 2015 (the vesting date), the trustee had not exercised their discretion to nominate any taker on vesting from the class of listed beneficiaries. Accordingly, the trustee would hold the trust property absolutely and solely for Jim.

CGT consequences of trust vesting

15. Determining whether or not a CGT event happens on vesting requires a close consideration of the deed. This will include consideration of the effect of vesting on the beneficial interests in the trust, and the nature of the property held on trust.

16. It may be the case that no CGT event happens by reason alone of the trust's vesting. But events occurring post-vesting may cause a CGT event to happen subsequently.

CGT event E1 - creation of a new trust

17. The vesting of a trust, of itself, does not ordinarily cause the trust to come to an end and its property to settle on the terms of a new trust. As such CGT event E1 need not happen merely because a trust has vested.

18. Circumstances might, however, occur in which the parties to a trust relationship subsequently act in a manner that results in a new trust being created by declaration or settlement so as to cause CGT event E1 to happen. See Example 4 of this Ruling.

19. If CGT event E1 happens and a trust is created over the assets, the trustee of the new trust is taken to acquire each asset when the trust is created and the first element of each asset's cost base is its market value.

Example 4 - purported extension after vesting date

34. A discretionary trust holding several rental properties had a vesting date of 30 September 2016.

35. On 1 June 2017, the trustee became aware that the vesting date had passed and, with the acquiescence of the takers on vesting, continued to manage the trust as if the trust had not vested. On 29 June 2017, the trustee executed a deed of extension that purported to extend the trust's vesting date to 30 September 2057.

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

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

CGT event E5 - beneficiary becoming absolutely entitled

20. The vesting of a trust may result in the takers on vesting becoming absolutely entitled as against the trustee to CGT assets of the trust, depending on the particular interests of the takers on vesting.

CGT event E7 - disposal to beneficiary to end capital interest

21. Post-vesting, CGT event E7 may happen (for example, upon actual distribution of CGT assets to beneficiaries), but it will not happen to the extent the beneficiaries are already absolutely entitled to the CGT assets as against the trustee.

Taxation of trust net income after the vesting date

22. In the year in which vesting occurs, different beneficiaries may be presently entitled to income of the trust estate derived before, as opposed to after, the vesting date. For example, in the case of a discretionary trust, a trustee may, pre-vesting, exercise their discretion to appoint income of the trust estate derived before the vesting date (pre-vesting income) among those entitled to benefit under the trust. By contrast, present entitlement to the income of the trust estate derived post-vesting on the vested property (post-vesting income) will be held by the takers on vesting (usually in proportion to their vested interests in the property of the trust). This needs to be taken into account in identifying each beneficiary's share of the trust estate's income for that year which, in turn, determines their share of the net income of the trust for the year.

Note: The Commissioner will accept an allocation of income of the trust estate into pre-vesting and post-vesting income of the trust estate in the year in which vesting occurs that is done on a fair and reasonable basis having regard to all of the relevant circumstances. See Example 5 of this Ruling.

Example 5 - present entitlement for income year in which trust vests

37. The Atkins Family Trust has a vesting date of 1 January 2017. The relevant clauses of the trust allow the trustee to determine income of the trust estate for the period before the vesting date, and distribute that income to one or more discretionary beneficiaries. On 31 December 2016, the trustee resolved to distribute all of the income up to the vesting date to Andrew.

38. The trust deed further provided that, on the vesting date, the trustee was to hold the trust property in equal shares for Andrew and Edward.

39. For the 2016-17 income year, each of Andrew and Edward is assessable on the share of the net income that relates to their share of the total income of the trust estate for the year.

40. The nature of the Atkins Family Trust's income ($100) is such that it is derived evenly across the 2016-17 income year. As such, it would be fair and reasonable to conclude that Andrew is presently entitled to $75 of the income of the trust estate for the year, being all of the income derived before the vesting date ($50) and half of the income derived after vesting date ($25) and Edward is presently entitled to $25 of the remaining income for the year, being half of the income derived after vesting date ($25).

23. In the following income years, the takers on vesting will usually have a fixed entitlement to the income of the trust estate and be assessable on their corresponding share of the net income. Because all of the income of the trust will flow to a beneficiary post-vesting according to their entitlement, none of the net income will fall to be assessed to the trustee.

24. A payment or other purported distribution of income or capital by a trustee post-vesting that is not consistent with the vested beneficiaries' fixed interests is in breach of trust and void or otherwise not effective.

25. Section 101 and subsection 95A(1) of the ITAA 1936 have no application to deem a beneficiary to be presently entitled where the trustee purports to make an appointment or payment that is inconsistent with the fixed interests of the *takers on vesting.*

Does the beneficiary become 'absolutely entitled' to the trust's assets?

The issue of whether a beneficiary is or has become 'absolutely entitled' to a trust's assets 'as against a trustee' has been considered in a number of cases. (*Kafataris v The Deputy Commissioner of Taxation* [2008] FCA 1454 (**Kafataris**), *Oswal v Commissioner of Taxation* [2013] FCA 745 (**Oswal**) and *Taras Nominees Pty Ltd as Trustee for the Burnley Street Trust v Commissioner of Taxation of the Commonwealth of Australia* [2014] FCA 1).

The general principle established by the cases is that a beneficiary will be absolutely entitled to a trust asset as against the trustee where 'the beneficiary of a trust has a vested, indefeasible and absolute entitlement in trust property and is entitled to require the trustee to deal with the trust property as the beneficiary directs' [Kafataris at paragraph 6]).

This statement was also adopted by the court in Oswal [at paragraph 68] and Taras Nominees [at paragraph 118].

It is common for default beneficiaries to have a vested and indefeasible interest in their share of the net assets of the trust on the vesting date, however they do not generally have an absolute entitlement to any of the specific assets held by the trustee.

In Kafataris, the Court held that the existence of a power of sale and the trustee's right of indemnity meant that the beneficiaries could not be absolutely entitled to trust assets as against the trustee.

However, the issue will be that the trustee will no longer have any discretion as to who may be presently entitled to the trust income.

Following the Kafataris decision the ATO issued a Decision Impact Statement in which it stated that Lindgren J's reasoning confirmed the Commissioner's approach to what is meant by absolute entitlement (in TR 2004/D25).

> We consider that the approach taken by Lindgren J aligns with the 'core principle' adopted in the ruling at paragraph 10. 'The core principle underpinning the concept of absolute entitlement in the CGT provisions is the ability of a beneficiary, who has a vested and indefeasible interest in the entire trust asset, to call for the asset to be transferred to them or to be transferred at their direction' aligns with his Honour's approach expressed at paragraph 61 of the judgment: "the expression 'absolutely entitled to the asset as against the trustee' ... as the beneficiary directs." to the construction of the exception to CGT Event E1.
>
> Additionally, his Honour made some conclusions not expressed in the draft ruling. These are:
>
> - The existence of a power of sale by the trustee in respect of an asset is inconsistent with absolute entitlement by a beneficiary to the asset as against the trustee;
>
> - A provision in the instrument of trust denying a beneficiary any interest in any particular asset of a trust is inconsistent with absolute entitlement by a beneficiary to any of the assets of the trust.
>
> These conclusions are not inconsistent with our draft ruling and we accept that they are correct.

***Drafting Taxation Ruling* TR 2004/D25**

The Commissioner's view in relation to absolute entitlement is outlined in *Drafting Taxation Ruling* TR 2004/D25:

> 10. The core principle underpinning the concept of absolute entitlement in the CGT provisions is the ability of a beneficiary, who has a vested and indefeasible interest in the entire trust asset, to call for the asset to be transferred to them or to be transferred at their direction. This derives from the rule in *Saunders v. Vautier* applied in the context of the CGT provision
>
> 41. The principle invoked in the case of *Saunders v. Vautier* was that if a sole beneficiary's interest in the trust property is vested and indefeasible and they are of age then they can put an end to the trust by directing the trustees to transfer the trust property to them or at their direction, even though the trust deed contains a contrary intention. The basis of the principle is that a beneficiary is entitled now to that which will be theirs eventually anyway: *Saunders v. Vautier* (1841) 4 BEAV 115; 49 ER 282.

TR 2004/D25 sets out circumstances which do not prevent absolute entitlement [paragraphs 16 to 19]. These are:

- A beneficiary can be absolutely entitled to an asset even though they hold their interests in it as trustee for one or more others.

- The fact that there is a mortgage, encumbrance or other charge over the asset in favour of a third party does not of itself prevent a beneficiary being absolutely entitled to the asset as against the trustee.

- The existence of a trustee's lien to enforce a right of indemnity against a trust asset will not prevent a beneficiary being absolutely entitled to the asset.

- The fact that the beneficiary cannot give the trustee a good discharge for any asset transferred to them because they are suffering a legal disability (for example infancy or insanity) will not prevent the beneficiary being absolutely entitled. Absolute entitlement for CGT purposes is determined ignoring any legal disability.

- Core principles

> 20. The most straight forward application of the core principle is one where a single beneficiary has all the interests in the trust asset. Generally, a beneficiary will not be absolutely entitled to a trust asset if one or more other beneficiaries also have an interest in it.
>
> *One beneficiary with all the interests in a trust asset*
>
> 21. A beneficiary has all the interests in a trust asset if no other beneficiary has an interest in the asset (even if the trust has other beneficiaries).
>
> 22. Such a beneficiary will be absolutely entitled to that asset as against the trustee for the purposes of the CGT provisions if the beneficiary can (ignoring any legal disability) terminate the trust in respect of that asset by directing the trustee to transfer the asset to them or to transfer it at their direction (see Explanation paragraphs 76 to 79).
>
> *More than one beneficiary with interests in a trust asset*
>
> 23. If there is more than one beneficiary with interests in the trust asset, then it will usually not be possible for any one beneficiary to call for the asset to be transferred to them or to be transferred at their direction. This is because their entitlement is not to the entire asset.
>
> 24. There is, however, a particular circumstance where such a beneficiary can be considered absolutely entitled to a specific number of the trust assets for CGT purposes. This circumstance is where:
>
> · the assets are fungible;
>
> · the beneficiary is entitled against the trustee to have their interest in those assets satisfied by a distribution or allocation in their favour of a specific number of them; and
>
> · there is a very clear understanding on the part of all the relevant parties that the beneficiary is entitled, to the exclusion of the other beneficiaries, to that specific number of the trust's assets.
>
> 25. Because the assets are fungible, it does not matter that the beneficiaries cannot point to particular assets as belonging to them. It is sufficient in these circumstances that they can point to a specific number of assets as belonging to them.

Can the vesting date be extended after the 'vesting date'?

This question was considered by the Victorian Supreme Court in Re McGowan & Valentini Trusts.[89]

Facts as they apply to this question

- Two trusts were created by separate deeds dated 14 February 1977 (**1977 Deeds**) by Giuseppe Valentini and Norma Valentini for the children. One for their daughter Anna, being the Anna McGowan Trust and the other their son Peter being the Peter Valentini Trust.

- On 23 June 1991 further deeds were signed (**1991 Deeds**) to amend the 1977 Deeds with the effect of 'widening the class of discretionary beneficiaries and extending the vesting date'. These were signed by the settlor, trustee and each Anna in respect of the Anna McGowan Trust and Peter in respect of the Peter Valentini Trust.

[89] [2021] VSC 154.

- At the date of signing of the 1991 Deeds, the terms of the 1977 Deeds provided that the property of the trusts had already vested absolutely in Anna and Peter.
- Over time further properties were acquired.

The Court was asked to determine whether the legal effect of the 1991 Deeds to validly amend the 1997 Deeds and continue the two trusts on the same trusts or was the effect of the 1991 Deeds and/or subsequent conduct of the trustee to create new trusts over the trust property of the two trusts (New Trusts)?

- Firstly, the Court considered whether the vesting of the trust property resulted in a continuation of the 1977 Deeds or alternatively created New Trusts.

> 105 In my view, there is nothing in the language used in the 1977 Deeds that would prevent the continuation of the Trusts beyond the date of vesting pending the winding up of the Trusts. While it may be a breach of an obligation imposed by the trust deeds not to wind up the Trusts upon vesting of the trust property, nobody in this proceeding is suggesting that the Trustee failed, in breach of trust, to wind up the Trusts. Moreover, as will be seen, the Original Beneficiaries of the Trusts who were each of full age and capacity actively consented to the continuation of the Trusts and, indeed, to their subsequent amendment.
>
> 110 The amendment power contained in the 1977 Deeds was set out in clause 8 of each deed, as follows:
>
> Either the Trustee or the person or persons who for the time being have power to appoint new or additional trustees hereof may at any time or times alter vary rescind or add to in any way all or any of the trusts provisions or conditions herein contained and in particular and without derogating from the generality of the foregoing provisions by declaring in favour of any other issue of the said Giuseppe Valentini in addition to or in substitution for the Original Beneficiary any other trusts of the Trust Fund and the income thereof.
>
> PROVIDED that every such alteration variation rescission or addition shall be by deed executed by the person or persons making the same and if not made by the Trustee shall be delivered to the Trustee before it shall take effect.
>
> <u>AND PROVIDED FURTHER</u> that no such alteration variation rescission or addition shall have any force or effect if it would have the result of vesting in the Settlor or the Trustee or either of them any beneficial interest in the Trust Fund or the income therefrom.
>
>> 111 In summary, the power to amend:
>>
>> (a) could be exercised ‘at any time or times’;
>>
>> (b) was to ‘alter vary rescind or add to [...] all or any of the trusts provisions or conditions’ and to do so ‘in any way’;
>>
>> (c) specifically included a power to declare ‘any other trusts of the Trust Fund and the income thereof’ in favour of ‘any other issue of [...] Giuseppe [...] in addition to [...] the Original Beneficiary’; and
>>
>> (d) was limited only in that it had to be implemented by a deed and not confer any beneficial interest upon the Settlor or Trustee.

- Secondly, the Court considered whether the amendments under the 1991 Deeds resulted in the continuation of the trusts or created New Trusts.

> 122 First, purely as a matter of construction of the very wide power of amendment contained in the 1977 Deeds, I see no reason to find that any of the amendments and variations contained in the 1991 Deeds go beyond the scope of the amendment power.
>
> 128 Compared to those expressed in the 1977 Deeds, the Trusts expressed in the 1991 Deeds are of the same nature, benefit the same family (albeit a wider class) and appear to be directed to the same purpose. Although the 1991 Deeds broaden the discretionary nature of the Trusts and expand the class of potential beneficiaries to, in the main, a broader range of relatives and their controlled entities, nonetheless the Trusts had some discretionary elements and existed to benefit Anna and Peter and their relatives. I therefore accept the plaintiffs’ argument that

the substratum of the Trusts has not been destroyed by the amendment. Put another way, having regard to the nature of the Trusts and the circumstances in which they were made, the changes effected by the 1991 Deeds may reasonably be considered to be within the contemplation of the parties to the 1977 Deeds at the time they were made. Further, the 1991 amendment fell within the scope of the amendment power in the 1977 Deeds having regard to its evident purpose of affording maximum flexibility to the Trustee to amend the deeds in the interests of the Original Beneficiaries.

129 Finally, and relatedly, it is necessary to differentiate between a purported amendment which results in the continuation of the original trusts, on the one hand, and an amendment which in fact creates new trusts, on the other. The plaintiffs relied upon a number of taxation cases to submit that for a new trust to not be created by amendments to a trust there needed to be continuity of: the trust property, the beneficiaries and the constitution of the trust. Essentially, one must look at whether the trust continues in existence. Where the trust deed contains a power of amendment and that power is validly exercised then, so long as there is sufficient degree of continuity of the elements mentioned, the amended trust will not result in a new trust.

130 The plaintiffs submitted in this case that the amendments in the 1991 Deeds were validly made pursuant to a power of amendment, there was continuity of trust assets and of some beneficiaries and the 1991 Deeds made reference to and sought to continue the Trusts so that there was some continuity in their constitution. As a result, the plaintiffs submitted, there was no resettlement of the trust assets upon new trusts but, instead, the Trusts continued as amended.

131 In my opinion the plaintiffs' submissions ought to be accepted. I have already found that, despite the vesting of trust assets, the power of amendment under the 1977 Deeds remained available for the Trustee to exercise and did not become void or stand cancelled. The power of amendment was broad and, on its proper construction, permitted the variations (including to the class of beneficiaries) contained in the 1991 Deeds. The amendment was made in conformity with and promoted the purposes of the Trusts. The substratum of the Trusts was not destroyed but, rather, the 1991 Deeds expanded upon and varied elements which already existed in the Trusts. And, finally, there is sufficient continuity in the trust assets, beneficiaries and constitution of the trusts such that the trusts under the 1991 Deeds should properly be seen as the continuation of the Trusts.

6. Discretionary Trusts – transferring assets

6.1 Planning

Sometimes it will be necessary to move assets out of a trust to achieve the client's succession plan. This will generally involve considering the following issues.

- Will the transfer be directly to an individual or another entity?
  - If it is to another entity, who will control that entity?
  - Will control pass now or sometime in the future?
- Is it intended that the recipient pay for the property?
  - If the trustee has made a FTE or IEE then you will need to ensure that the property is transferred at market value or the transferee is in the 'family group' of the test individual. If the transferee is another trust, the trust will need to make an FTE in respect of the same test individual or make an IEE to be in the family group of the test individual.

    Note, a 'distribution' for the purpose of Schedule 2F of the 1936 Tax Act includes a transfer of property at less than market value. If the trustee has made a FTE or IEE and there is a distribution to an individual or entity outside the family group, then the trustee and the directors of the trustee company will be jointly and severally liable for family trust distribution tax.

    This is considered in further detail in this paper, however before implementing any transaction it will be important to ascertain whether the trustee has made an FTE or IEE.
  - If the trustee will derive a net capital gain to which it intends to stream to a particular beneficiary there will need to be consideration paid. This is because the market substitution rule does not apply when making a beneficiary specifically entitled to the net financial benefits of the capital gain.
  - If the trustee will be claiming the small business retirement exemption in relation to the CGT concession stakeholder there will need to be consideration. This is because section 152-325 of the 1997 Tax Act requires the trustee to make a payment of the 'retirement exemption' amount.
- If the recipient will pay for the property, how will it be paid?
  - Will it be paid on the transfer?
  - Will it be paid under the terms of a loan agreement as part of a succession plan?
  - Will the loan be gifted by way of assignment to the individual who will control the property?

The trustee will need to consider what the tax implications are for the trust on the transfer of the property. Depending on how the transfer of property occurs, the more likely CGT events for the trustee will be either:

- CGT event A1 – where there is a disposal of a CGT asset; or
- CGT event E1 – where a trust is created over a CGT asset by declaration or settlement; or
- CGT event E2 – where a CGT asset is transferred to an existing trust.

  Note: Neither of the above events occur merely because of a change of trustee.

While there may be more than one CGT events which may be applicable to the transactions it is only the event which is "most specific" to the transaction in question which applies.90

Regardless of which of these CGT events is triggered, the trustee will have a:

- capital gain if the capital proceeds is more than the cost base; or
- capital loss if the capital proceeds are less than the cost base.[91]

  The market substitution rule will apply in determining the capital proceeds if the parties are not dealing at arm's length or there is no consideration paid for the property.[92]

The trustee will then need to consider whether some or all of the capital gain can be disregarded.

- In particular:
  - Whether the property was purchased by the trustee pre-CGT.

    It will be important to identify whether Division 149 of the 1997 Tax Act [about change in underlying ownership] has occurred. If this is the case then there may be a capital gain to deal with.
  - Whether the small business CGT concessions under Division 152 of the 1997 Tax Act are available.
  - Whether the small business restructure roll-over under Subdivision 328-G of the 1997 Tax Act is available.

    Note, that the Commissioner's view is that succession planning is not a 'genuine restructure of an ongoing business' for the small business restructure roll-over under Subdivision 328-G of the 1997 Tax Act.
- If applying the small business CGT concessions the trustee will need to consider which concessions can be accessed. If the small business 15 year exemption or small business retirement exemption is being applied, the requirement that the trust has a CGT concession stakeholder will need to be satisfied.

  These issues are discussed in further detail in this paper.

There will also need to be consideration about how the capital gain will be dealt with in the hands of the beneficiaries, in particular if the net capital gain will be streamed to particular beneficiaries.

[90] s102-25(1) of the 1997 Tax Act.
[91] Section 104-55(3) for CGT event E1; section 104-60(3) for CGT event E2 or section 104-10(4) for CGT event A1
[92] Section 116-30 Transfer the property for consideration of the 1997 Tax Act

Considering the terms of the trust deed will be important. In particular:

- Dealing with the property and/or gain. Does the trustee have the following powers:
  - Ability to stream capital gains.
  - Flexibility on how to determine ‘trust income’.
  - Ability to make interim capital distributions (including out of revaluation reserves).
  - Ability to make in specie distributions.
  - Ability to hold trust property in its capacity as trustee for another trust (trust cloning)
- Who are the beneficiaries and has the trustee made a FTE or IEE?
- Whether there are any consent requirements under the terms of the trust deed before making capital distributions
- Make sure the vesting date of the trust has not passed without anyone becoming aware.

The next issue will be, how the transfer of assets will occur?

- Transfer the assets for consideration
- Distribute the assets as an ‘in specie’ distribution.

6.2 Transfer the assets for consideration

The trustee may transfer assets to an individual or another entity. This would trigger CGT event A1 for the trust. The trust will have a capital gain equal to the difference between the capital proceeds and the cost base of the asset.

For example:

- ABC Pty Ltd as trustee for the Smith Family Trust holds two parcels of land, Parcel A and Parcel B.
- Bob Smith has two sons, Jack and John. Bob would like Jack to receive the benefit of Parcel A and John to receive the benefit of Parcel B.
- Smith Family Trust has made an FTE in relation to Bob.
- Smith Family Trust transfers Parcel B to Smith Family Trust No 2 for an amount equal to market value of $1,000,000.

Issues:

- Smith Family Trust will have a capital gain equal to the difference between the market value and the cost base of Parcel B.
- As Smith Family Trust has made a family trust election in relation to Bob, either:
  - the consideration for the transfer will need to be at market value; or
  - Smith Family Trust No 2 will need to make a FTE in relation to Bob Smith or IEE to be part of Bob’s family group.

In this example, Smith Family Trust No 2 will pay market value therefore Smith Family Trust No 2 does not need to make an FTE in relation to Bob.

- Need to consider how to deal with the capital gain in Smith Family Trust?
  - Will the small business 15 year exemption or small business retirement exemption be used?

    If so, Smith Family Trust will need to satisfy the CGT concession stakeholder requirements.
  - Will there be a net capital gain remaining? If so, need to consider whether the capital gain will be streamed.

    To stream the net capital gain, the relevant beneficiaries will need to be made specifically entitled to the gross capital gain (after applying capital losses).

    This is discussed later in the paper in the chapter ‘Dealing with the capital gain – getting the trustee resolution correct’.
  - If the restructure is part of an asset protection strategy, the small business restructure rollover could be considered. If this were the case, both trusts would need to make an FTE with the same test individual.

How will the capital gain be treated in the accounts of Smith Family Trust?

- As outlined above, for tax purposes (‘Tax World’), there will be CGT implications on the transfer of the property.
- How the capital gain is treated in the accounts of Smith Family Trust will depend on how the trustee determines ‘trust income’. Effectively if a receipt does not form part of ‘trust income’ it will form part of the capital of the trust. The accounts (‘Accounting World’) should reflect how the capital gain is treated under the terms of the trust deed (‘Trust World’).
- How ‘trust income’ is defined will become important when preparing the trustee resolution dealing the trust income and capital for the purpose of determining whether:
  - the trust has a CGT concession stakeholder if the small business 15 year exemption or retirement exemptions are being accessed; and
  - the trustee has effectively made particular beneficiaries specifically entitled to the net financial benefit of the capital gain (that is, because both the taxable and non taxable component of the capital gain must be dealt with).
- Recording the capital gain in the accounts
  - If the trustee defines trust income on the basis of a ‘section 95’ concept, then the net capital gain will be included in ‘trust income’ and the non taxable component of the capital gain will form part of the capital of the trust fund.
  - If the gross capital gain is included as trust income, it would be reflected in the profit and loss account.
- Following on the example: The consideration which Smith Family Trust No 2 will pay Smith Family Trust will be $1,000,000. Assuming Parcel B has a cost base of $200,000, Smith Family Trust will have a capital gain of $800,000. It applies the 50% general discount (to reduce the capital gain to $400,000), small business 50% reduction (to further reduce the capital gain to $200,000) and retirement exemption

of $200,000 for Bob (reducing the capital gain to nil). Assume Smith Family Trust does not have any other income.

- Bob will need to be a CGT concession stakeholder of Smith Family Trust, therefore must receive at least 20% of all income and capital distributions made by the Smith Family Trust for the year of the CGT event.
- The net capital gain will be nil provided Bob is a CGT concession stakeholder and the small business retirement exemption can be applied.
- Therefore the terms of the trust deed must reviewed to determine:
  - How 'trust income' is defined and whether the trustee has a discretion to adopt a different basis of calculation.
  - If a 'section 95' concept is adopted then the 'trust income' will be nil and the capital gain will form part of the capital of the trust.
  - This means that Smith Family Trust will need to make a capital distribution to Bob to ensure that he is a CGT concession stakeholder for the year.

    If this is the case, the trust deed must give the trustee the power to make interim capital distributions.
  - If the trust deed does not have the power to make interim capital distributions but the trustee has a discretion as to how to determine 'trust income', the gross capital gain could be included as 'trust income'.

6.3 In Specie Distributions

In circumstances where the trustee of a discretionary trust makes a determination to distribute a particular trust asset to a beneficiary (as opposed to realising the trust assets and distributing cash), the relevant event will be CGT event E5.

In those circumstances, the consequences for the trustee will be much the same as under the CGT event A1 in that the trustee will make a capital gain if the market value of the asset at the time of the event is more than its cost base[93] (unless the asset is a pre-CGT asset in which case any capital gain or capital loss is disregarded[94]).

The consequences for the beneficiary will depend upon whether the beneficiary has an interest in the trust and whether the beneficiary acquired that interest for consideration.

- The beneficiary will make a capital gain if the market value of the asset to which they become entitled exceeds the cost base of their interest in the trust.[95]
- As the Commissioner accepts that beneficiaries of discretionary trusts do not have an 'interest' in the trust,[96] there will generally be no consequences for the beneficiaries who become absolutely entitled to a trust asset of a discretionary trust.

[93] Section 104-75(3) of the 1997 Tax Act
[94] Section 104-75(4) of the 1997 Tax Act
[95] s104-75(5) of the 1997 Tax Act
[96] Taxation Determination TD 2003/28

- In any case, any capital gain or loss will be disregarded if the beneficiary acquired its interest in the trust 'for no expenditure'.[97]

Going back to our example:

- ABC Pty Ltd as trustee for the Smith Family Trust holds two parcels of land, Parcel A and Parcel B.
- Smith Family Trust has made an FTE in relation to Bob.
- The Smith Family Trust makes an in specie distribution to Smith Family Trust No 2 of Parcel B.

Issues:

- Smith Family Trust will have a capital gain equal to the difference between the market value and the cost base of Parcel B.
- As Smith Family Trust has made a family trust election in relation to Bob, Smith Family Trust No 2 will need to make a FTE in relation to Bob or IEE to be part of Bob's family group.
- Need to consider how to deal with the capital gain in Smith Family Trust?
  - The same issues outlined above will apply.
  - The issue will be that Smith Family Trust No 2 will have received a capital distribution of Parcel B, therefore care would need to be taken to ensure that the Smith Family Trust has a CGT concession stakeholder (which may create an issue if Smith Family Trust No 2 does not receive 'trust income' from Smith Family Trust).

    This is explained later in this paper, but the issue will be that if Smith Family Trust has 'trust income' and Smith Family Trust No 2 receives 100% of the capital of the trust but none of the 'trust income', its small business participation percentage will be nil.
  - Also, if there is a net capital gain, then the Smith Family Trust No 2 would have been specifically entitlement to the net financial benefit of the capital gain.

How will the capital gain be treated in the accounts of Smith Family Trust?

- As outlined above, for tax purposes ('Tax World'), there will be CGT implications on the transfer of the property.
- For accounting purposes there is not a gain as no consideration was paid for the asset. Therefore it would not be able to form part of 'distributable income' on the basis that there is not an amount to which a beneficiary can demand payment.

[97] s104-85(6) of the 1997 Tax Act

The further issue with an 'in specie' distribution is that it may result in a deficit to the accounts of the trust.

Smith Family Trust	
Before distribution:	
Assets	
Property A	$800,000
Property B	$200,000
Assets	$1,000,000
Liabilities	
UPE to Bob	$ 799,990
Loan	$ 200,000
Liabilities	$ 999,990
Net Assets	*$ 10*
Trust Fund	
Settlement Sum	$ 10
After distribution:	
Assets	
Property A	*$800,000*
Property B	*$ 0*
Assets	*$800,000*
Liabilities	
UPE to Bob	$ 799,990
Loan	$ 200,000
Liabilities	$ 999,990
Net Assets	$(199,990)
Trust Fund	
Settlement Sum	$ 10
Capital distribution	$(200,000)
Deficit	$(199,990)

Smith Family Trust No 2	
Assets	
Cash	*$ 10*
Property B	*$1,000,000*
Assets	*$1,000,010*
Trust Fund	
Settlement Sum	*$ 10*
Capital	*$1,000,000*
Trust Funds	*$1,000,010*

Issue: Can the assets of the trust be revalued to deal with the deficit in trust funds?

Possibly a better way is to transfer the property to Smith Family Trust No 2 for market value ($1,000,000).

- No requirement to make an FTE in relation to Bob.
- This would result in Smith Family Trust No 2 owing Smith Family Trust $1,000,000.
- Smith Family Trust makes a capital distribution to Bob of $800,000.
- The loan owing by Smith Family Trust No 2 would be assigned to Bob to pay capital distribution and part of UPE owing to Bob.
- The means that Smith Family Trust No 2 would owe Bob $1,000,000.

Smith *Family Trust*	
Before distribution:	
Assets	
Property A	*$800,000*
Property B	*$200,000*
Assets	*$1,000,000*
Liabilities	
UPE to Bob	*$ 799,990*
Loan	*$ 200,000*
Liabilities	*$ 999,990*
Net Assets	*$ 10*
Trust Fund	
Settlement Sum	*$ 10*

After distribution:

Assets	
Property A	*$800,000*
Property B	*$ 0*
Assets	*$800,000*
Liabilities	
UPE to Bob	*$ 599,990*
Loan	*$ 200,000*
Liabilities	*$ 799,990*
Net Assets	*$ 10*
Trust Fund	
Settlement Sum	*$ 10*

Smith Family Trust No 2

Assets	
Cash	*$ 10*
Property B	*$1,000,000*
Assets	*$1,000,010*
Liabilities	
Loan to Bob	*$ 1,000,000*
Liabilities	*$ 1,000,000*
Net Assets	*$ 10*
Trust Fund	
Settlement Sum	*$ 10*

7. Small business CGT concessions re transfer of assets

7.1 Introduction

Provided that clients satisfy the basic tests to access the small business CGT concessions, they may choose to reduce any capital gain happening in relation to their CGT assets (after applying the 50% general discount if applicable) by:

- 50% under the small business 50% reduction (Subdivision 152-C); and/or
- applying the small business retirement exemption for its CGT concession stakeholders (Subdivision 152-D); and/or
- applying the small business roll-over (Subdivision 152-E).

Alternatively, provided that the basic tests to access the small business CGT concessions as well as the requirements for the 15-year exemption (under Subdivision 152-B) are satisfied any capital gain will be disregarded.

7.2 Basic conditions for accessing the small business concessions

To access any of the small business CGT concessions, the taxpayer must meet the basic requirements of Subdivision 152-A. These are (section 152-10):

- One of the following applies:
  - The taxpayer and its connected entities and affiliates have $6 million or less in net value of assets just before the CGT event (**NAT**).
  - The taxpayer is a CGT small business entity for the income year.
  - The asset is used by an affiliate or connected entity which is a CGT small business entity for the income year.
  - The taxpayer is a partner in a partnership, the partnership is a CGT small business entity for the income year and the CGT asset is an asset of the partnership.
  - The asset is owned by the taxpayer which is a partner and used by a CGT small business entity partnership in carrying on a business.
- The CGT asset must meet the active asset test.
- If the CGT asset is a share in a company or interest in a trust:
  - there must be a significant individual just before the CGT event and the shareholder or unitholder claiming the concession must be a CGT concession stakeholder in the company or trust; or

    - CGT concession stakeholders have a 90% interest in the entity which owns the shares or interest in the trust.

- There are additional requirements if CGT asset is a share in a company or interest in a trust including:

    - The company or trust must satisfy Nat or be a CGT small business entity (based on modified tests).

    - The active asset test must be satisfied (based on modified tests).

7.3 Applying the small business concessions

7.3.1 Small business 15-year exemption (subdivision 152-B)

To claim the small business 15-year exemption it is necessary that:

- the taxpayer satisfies the basic conditions;

- the taxpayer must have owned the CGT asset for at least 15 years;

- if:

    - the asset is owned by a company or trust; or

    - the asset is a share in a company or interest in a trust, then

  that company or trust:

    - must have had a significant individual for at least 15 years (subject to some exceptions about trusts with losses); and

    - must have a CGT concession stakeholder just before the CGT event; and

- the taxpayer who owns the asset or the CGT concession stakeholder just before the CGT event if the taxpayer is a company or trust must be:

    - 55 years or over just before the CGT event and the CGT event happens ‘in connection with their retirement’; or

    - permanently incapacitated.

If the requirements for the small business 15-year exemption are satisfied, the taxpayer disregards the capital gain.

What does 'in connection with retirement' mean?

The issue when transferring assets as part of a retirement plan to the next generation is whether the 15 year exemption can be claimed where there is no actual proceeds paid (or less than market value).

The legislation does not define what 'in connection with your retirement' means.

ATO publication Advanced Guide to Capital Gains Tax Concessions for Small Business

> Whether a CGT event happens in connection with an individual's retirement depends on the particular circumstances of each case. There would need to be at least a significant reduction in the number of hours the individual works or a significant change in the nature of their present activities to be regarded as a retirement. However it is not necessary for there to be a permanent and everlasting retirement from the workforce.
>
> The following are given as examples:
>
> A small business operator, over 55 years old, sells his business. Under the terms of the sale, he agrees to be employed by the new owner for a few hours each week for two years. The sale of the business would be in connection with the small business operator's retirement. He has permanently or indefinitely ceased being self-employed and has commenced gainful employment on a much reduced scale with another party, although still performing similar activities.
>
> A small business operator and spouse are both pharmacists, are both over 55 years old and carry on business through two pharmacies. They sell one (and make a capital gain) and, accordingly, reduce their working hours from 60 hours a week each to 45 and 35 hours a week respectively. There has been some change to their present activities in terms of hours worked and location – but there has not been a significant reduction in the number of hours or a significant change in the nature of their activities; therefore, there has been no 'retirement'.
>
> If, on the other hand, one spouse reduced their hours to nil (stopped working), there would be a significant reduction in the number of hours that spouse was engaged in the business activities. Therefore the sale would be in connection with the retirement of that spouse.

In private rulings (for example Authorisation number 1052266077554) the Commissioner accepts that it is not necessary for there to be a permanent and everlasting retirement from the workforce.

> However, there would need to be at least a significant reduction in the number of hours worked or a significant change in the nature of the activities to be regarded as a retirement for the purposes of paragraph 152105(d)(i)

Where clients are ceasing or reducing their involvement in the business, generally this will be satisfied.

The Explanatory Memorandum to New Business Tax System (Capital Gains Tax) Bill 1999 which introduced the small business CGT concessions indicates that there are 'capital proceeds to fund retirement'.

- Paragraph 1.68 of the Explanatory Memorandum provides:

  > One of the requirements of this concession for an individual small business taxpayer is that they must be either permanently incapacitated at the time of the CGT event, or at least 55 years old and **using the capital proceeds for their retirement**.
  >
  > [Emphasis added]

  Note: Section 152-105(d)(i) does not require that the capital proceeds are used for a taxpayer's retirement.

- If there are no proceeds received on the transfer of the assets there is a risk that the ATO will consider that the transfer of the assets will not be in 'connection with' the client's retirement.
- The concern is that there are a number of private ruling quoting paragraph 1.68 of the explanatory memorandum (about using proceeds for retirement). For example, in private ruling authorisation

number 1052294374162 the following comments were made in relation to the meaning of ‘in connection with retirement”.

> The Explanatory Memorandum (EM) to the New Business Tax System (Capital Gains Tax) Bill 1999 makes the following comments about the requirement to be permanently incapacitated or retiring as one of the conditions for the concession:
>
> '1.68 One of the requirements of this concession for an individual small business taxpayer is that they must be either permanently incapacitated at the time of the CGT event, or at least 55 years old and using the capital proceeds for their retirement.'
>
> This wording would suggest that the funds arising from the disposal of the asset must predominantly be intended to fund the retirement of the individual (whether or not supplemented by other monies).
>
> It would similarly follow that where the funds are intended to be employed in a manner other than funding the individual's retirement (for example the acquisition of a new business that the individual will have an active role in, or the gifting of the monies, or the investment of the monies within the trust for the benefit of family members generally at the Trustee's discretion) then the test will not be satisfied.

In private ruling authorisation number 1052294374162, the words ‘funds arising from the disposal of the asset’ are used. However, the explanatory memorandum uses the words ‘capital proceeds’. If the parties are not dealing with each other at arms length, then the capital gains provisions deems ‘capital proceeds’ to be the market value of the asset, not the funds received.

7.3.2 Small business 50% reduction (subdivision 152-C)

If the taxpayer satisfies the basic tests, it may choose to apply the small business 50% reduction (section 152-30).

This is applied after the general discount in Division 115 is applied (if applicable).

Provided the requirements of Division 115 are satisfied, the general discount applies automatically after applying capital losses.

The taxpayer has the choice not to apply the small business 50% reduction.

However, if the small business 50% reduction is applied, it must be applied after the general discount in Division 115 is applied.

7.3.3 Small Business Retirement Exemption (subdivision 152-D)

Where the taxpayer is a trust

- To access the retirement exemption, the trust must have a significant individual just before the CGT event (section 152-305(2)).
- The small business retirement exemption allows the r trust to pay up to $500,000 to or for the benefit of its CGT concession stakeholders (section 152-315(5)).
- However, the r trust must ensure that the payment of the retirement exemption to the individual will not result in them exceeding their lifetime limit of $500,000.
- The trust must make the choice to use the retirement exemption in writing by the time it lodges its income tax return for the year in which the CGT event occurs (section 103-25 and 152-315(4)).

Note, it is the taxpayer who has the capital gain which chooses to apply the retirement exemption, not the CGT concession stakeholder.

- It must nominate who its CGT concession stakeholders are and what percentage of the small business retirement exemption it is applying to each.
- It must make the payment no later than within seven days of making the choice (section 152-325(4)).
- If the CGT concession stakeholder to whom the retirement exemption is applied is at least 55 years when the choice is made, the payment must be paid to the CGT concession stakeholder.
- If the CGT concession stakeholder to whom the retirement exemption is applied is not at least 55 years when the choice is made, the payment must be paid into a complying superannuation fund (section 152-325(7)).
- A CGT Cap Election Form must be given to the superannuation at or before the contribution is made to the superannuation fund, otherwise the contribution is treated as a non-concessional contribution (section 292-100).

8. Small business restructure roll-over

8.1 Introduction

- The small business restructure roll-overs (SBRRs) which are contained in Subdivision 328-G of the 1997 Tax Act applies to:
  - transfers of assets subject to the capital gains provisions (CGT assets) where the CGT event occurs on or after 1 July 2016;
  - transfers of depreciating assets, where the balancing adjustment event occurs on or after 1 July 2016; and
  - transfers of trading stock or revenue assets where the transfer occurs on or after 1 July 2016.
- The purpose of the SBRRs as stated in the Explanatory Memorandum to the Tax Laws amendment (Small Business Restructure Roll-over) Bill 2016 (SBRR EM) which introduced the changes is as follows.
  - To provide greater flexibility for small business owners to change the legal structure of their businesses.
  - To make it easier for small business owners to restructure by allowing them to defer gains or losses that would otherwise be realised when business assets are transferred from one entity to another as part of a genuine restructure.
- There are a number of requirements which need to be satisfied to access the SBRRs including the requirement that the transaction is part of a "genuine restructure of an ongoing business".
- If all of the requirements are satisfied, then to access the SBRRs both the transferor and transferee must choose to apply Subdivision 328-G to the assets which are transferred. The choice to apply Subdivision 328-G is made on an asset by asset basis. This means that clients may choose the SBRRs in relation to only some of the assets transferred and other concessions or roll-overs to other assets.
- The SBRRs are an alternative to the concessions and/or roll-overs which are currently available. Examples of these are as follows.
  - For CGT assets
    - Division 152 of the 1997 Tax Act (small business CGT concessions);
    - Subdivision 122-A of the 1997 Tax Act (transfers of CGT assets from individuals or trustees to a wholly-owned company); and
    - Subdivision 122-B of the 1997 Tax Act (transfers of CGT assets from a partnership to a wholly owned company); and
    - Subdivision 124-N of the 1997 Tax Act (transfers of CGT assets from a unit trust to a company); and
  - Division 40 or Subdivision 328-D of the 1997 Tax Act for depreciating assets.
- The SBRRs have extended the assets and transfers to which roll-over relief was previously available. These include transfers of:
  - trading stock (without the requirement of retaining a 25% interest);
  - revenue assets;
  - assets regardless of the type of entity (for example, it is possibly to apply the SBRRs to transfers from a company to another company, to individuals, to partnerships and to trusts).

- However, before undertaking a restructure to access the SBRRs:
  - care will be required to ensure that all of the requirements are satisfied;
  - a comparison between the consequences of applying the SBRRs and other roll-overs will need to be considered to determine which is the best option for the client; and
  - other 'non income tax' considerations, such as duty and GST will need to be considered.

8.2 Requirements to be satisfied to access the SBRRs

- The requirements to access the SBRRs are contained in section 328-430 of the 1997 Tax Act.
  Note: The SBRRs are not available if the transferor or the transferee is either an exempt entity or a complying superannuation fund[98].

Summary of requirements

	Requirement
Requirement 1	Genuine restructure of an ongoing business ▪ Genuine restructure ▪ Safe harbour rule
Requirement 2	Both transferor and transferee must satisfy small business entity (SBE) requirement ▪ Be a SBE ▪ Be 'connected to' or have an 'affiliate' which is a SBE ▪ Be a partner in a partnership which is a SBE
Requirement 3	Active asset at time of the transfer If the SBE is a 'connected entity', 'affiliate' or partnership – then the asset must be being used by the SBE

Requirement 4	▪ No change in ultimate economic ownership
	  ▪ Trace through to individual owners
	  ▪ Special rule for discretionary trusts

Requirement 5	Both transferor and transferee must be Australian residents for tax purposes
Requirement 6	Both transferor and transferee must choose to apply the SBRRs

Requirement 1: Genuine restructure of an ongoing business

- The transaction must be or be part of, a genuine restructure of an ongoing business99.
- The two key issues with this first requirement are as follows:

[98] Section 328-430(2) of the 1997 Tax Act
[99] Section 328-430(1)(a) of the 1997 Tax Act

    - There must be a restructure of a business. This indicates that the SBRRs only apply to the transfer of business assets and not the transfer of shares or units.
    - The transaction is or is part of a 'genuine restructure of an ongoing business'.
- The 'genuine restructure of an ongoing business' requirement can be satisfied in one of two ways:
    - The satisfaction of the 'safe harbour rule' in section 328-435 of the 1997 Tax Act.

      However, even where the 'safe harbour rule' is met, the application of Part IVA of 1936 Tax Act would still need to be considered.
    - The transaction is or is part of a 'genuine restructure'.

      Whether this is satisfied will be a question of fact having regard to all of the circumstances.

What is the 'safe harbour rule'?

- The 'safe harbour rule' as contained in section 328-435 of the 1997 Tax Act is follows:

    A transaction is or is a part of a genuine restructure of an ongoing business if, in the **three year period** after the transaction takes effect:

    - there is no change in ultimate economic ownership of any of the significant assets of the business (other than trading stock) that were transferred under the transaction; and
    - those significant assets continue to be active assets; and
    - there is no significant **or material use of those significant assets for private purposes**.
- The major issue for clients is that they will not know whether the 'safe harbour rule' is satisfied until three years after the transaction occurs.
- Even if the 'safe harbour rule' is satisfied, clients will still need to consider the application of Part IVA.
- *Law Companion Guidelines* LCG 2016/3 provides an example (Example 10) where the safe harbour rule may be satisfied, however the application of Part IVA would need to be considered. The example given is as follows:

  A sole trader wants to sell his business to the father of his sister's husband. The sole trader transfers the business assets to a trust which makes a family trust election specifying the sole trader's sister as the test individual. After the transfer the father manages the business and the trustee distributes the trust income and capital to him and his family.

  Part IVA of the 1936 Tax Act would need to be considered.

What is a 'genuine restructure of an ongoing business'?

- Even if the safe harbour rule cannot be satisfied, the first requirement will be met if the transaction is a 'genuine restructure'.
- Guidance as to what is a 'genuine restructure of an ongoing business' can be obtained from the SBRR EM and Law Companion Guidelines LCG 2016/3.
- SBRR EM
    - The SBRR EM states:[100]

      The genuine restructure principle distinguishes genuine restructures from artificial or inappropriately tax-driven schemes. This acknowledges that while tax considerations are significant factors in small business structuring, a minority of taxpayers and advisers may try to manipulate the operation of a 'black letter' provision of the tax law to achieve an inappropriate or uneconomic tax outcome.

[100] at paragraph 1.20

- The SBRR EM[101] provides the following factors that would indicate a genuine restructure of an ongoing business.
  - It is a bona fide commercial arrangement undertaken to enhance business efficiency.
  - The business continues to operate following the transfer, through a different entity structure but under the same ultimate economic ownership.
  - The transferred assets continue to be used in the business.
  - The restructure results in a structure likely to have been adopted had the business owners obtained appropriate professional advice when setting up the business.
  - The restructure is not artificial or unduly tax driven.
  - It is not a divestment or preliminary step to facilitate the economic realisation of assets.
- *Law Companion Guideline* LCG 2016/3
  - The purpose of LCG 2016/3 is to provide guidance as to the meaning of 'genuine restructure of an ongoing business' for the purpose of accessing the SBRRs.
  - Features of a 'genuine restructure of an ongoing business'

    LCG 2016/3 lists a number of features which would indicate that a transaction is, or is part of, a 'genuine restructure of an ongoing business'. These are as follows:[102]
    - It is a bona fide commercial arrangement undertaken in a real and honest sense to:
      - facilitate growth, innovation and diversification;
      - adapt to changed conditions, or
      - reduce administrative burdens, compliance costs and/or cash flow impediments.
    - It is authentically restructuring the way in which the business is conducted as opposed to a 'divestment' or preliminary step to facilitate the economic realisation of assets.
    - The economic ownership of the business and its restructured assets is maintained.
    - The small business owners continue to operate the business through a different legal structure. For example, there is:
      - continued use of the transferred assets as active assets of the business;
      - continuity of employment of key personnel; and
      - continuity of production, supplies, sales or services.
    - It results in a structure likely to have been adopted had the small business owners obtained appropriate professional advice when setting up the business.
  - Taxation considerations may factor in restructuring[103]
    - The Commissioner acknowledges that tax considerations are factors that can be taken into account under a genuine small business restructure. For example, a sole trader subject to the highest marginal rate moving to a company structure to access the lower corporate tax rate.
    - However, this is not without limits. There are concerns where the restructure is contrived or unduly tax driven in the sense that it achieves a tax outcome that does not reflect the economic reality or creates an outcome that would, but for the SBRR, ordinarily attract other integrity measures in the law. For example, a restructure directed at eliminating an impending or existing

[101] at paragraph 1.22
[102] at paragraph 7
[103] at paragraphs 8 and 9

tax liability, would indicate that a restructure is not a 'genuine restructure of an ongoing business'.

- Factors which tend to indicate that a restructure is not a 'genuine restructure of an ongoing business'

  The following factors indicate that the restructure is not a ‘genuine restructure of an ongoing business’:[104]

  - Where the restructure is a preliminary step to facilitate the economic realisation of assets, or takes place in the course of a winding down to transfer wealth between generations.
  - Where the restructure effects an extraction of wealth from the assets of the business (including accumulated profits) for personal investment or consumption or otherwise designed for use outside of the business.
  - Where artificial losses are created or there is a bringing forward of their recognition.
  - The restructure effects a permanent non-recognition of gain or the creation of artificial timing advantages.
  - There are other tax outcomes that do not reflect economic reality.
- Examples
  - LCG 2016/3 provides a number of examples which may indicate the transaction is or is not a ‘genuine restructure of an ongoing business’.
    - Examples 1 to 4 are examples whose features indicate that the restructure is a ‘genuine restructure of an ongoing business’.
      - Example 1: Restructuring from an individual to a discretionary trust for asset protection reasons and due to the growth of the business.
      - Example 2: Restructuring from a discretionary trust to a company to allow for shares to be issued to key employees.
      - Example 3: Restructuring from a partnership to a company to allow for new capital to be injected into the business.
      - Example 4: Restructuring from a company to an individual to simplify the business affairs.

        Note: If there is a change in ownership of the entities or if any of the assets cease to be active assets within three years, the client will need to show that at the time the transaction occurred, it was not part of a plan to divest the assets.
    - Examples 5 to 7 are examples whose features indicate that the restructure is not a ‘genuine restructure of an ongoing business’.
      - Example 5: A company transfers business assets to the shareholders as prospective purchasers do not want to acquire the shares in the company. After 12 months of the transaction, the shareholder disposes of the businesses assets to the purchasers. The shareholders obtain the 50% general discount.
      - Example 6: A company operates two separate businesses. The shareholder (father) is looking to retire and pass control of the businesses to his sons (one business each). The company transfers one business to another company which is owned by the father.

[104104] at paragraph 10

Within three years the father transfers his shares in the first company to one of his sons and the shares in the second company to his other son.

- Example 7: A business is operated through a trust which has unpaid income distributions owing to a company. The trust transfers the assets to the company in satisfaction of the unpaid income distributions. The company then transfers the business assets to another trust who then sells the assets to a third party.

- The transaction may be a genuine restructure if the trust transfers the assets to the company in satisfaction of the unpaid income distributions and the business continued to be operated in the company (Example 8).

- Example 9 is an example of the application of 'significant assets' and the 'safe harbour rule'.

  Example 9: A sole trader transfers the business assets and premises to a company. The premises (in terms of value compared to the other business assets) is a significant asset of the business. Twelve months after the transaction occurs, the sole trader finalises her matrimonial property settlement and transfers the premises to her former partner and begins operating the business online.

  As the premises are a significant asset, the sole trader cannot rely on the 'safe harbour rule' even though the company continues to carry on the business. The transaction may still be a 'genuine restructure' though.

Can the SBRR be used for succession planning?

- As outlined above, the Commissioner's view [at paragraph 10 of LCG 2016/3] is that a transaction will not be 'genuine restructure of an ongoing business' if it takes place in the course of a winding down to transfer wealth between generations.
- Example 6: Succession planning

  Facts

  53. Nick owns all the shares in Holding Co a company that operates two restaurants, Fish and Chips. Nick has two sons and is looking to retire.

  54. Nick causes the company to transfer the active assets relating to Fish restaurant to Gone Fish Inc., a newly incorporated company that he also owns. The SBRR is claimed.

  55. Sometime later, but within three years, Nick retires and disposes of the shares in the Holding Co (which now holds the active assets of Chips only) to his first son and the shares in the new company to his other son, so that each of them can run their own restaurants separately. Nick cedes control to his sons as a result of his plan to retire.

- Therefore, if the purpose of the restructure is to facilitate succession planning, then the transfer is unlikely to be part of a genuine restructure of an ongoing business.
- The issue therefore is whether the client can apply the 'safe harbour' rule. Although there may not be a change in the economic ownership for three years, the Commissioner may apply Part IVA.

  Example 10: Anti-avoidance rules may have application

  Facts

  88. Leor operates his small business as a sole trader. Samuel approaches Leor, wishing to acquire his business. One of Samuel's sons is married to Leor's sister.

  89. Leor and Samuel enter into an agreement to sell the business.

90. Leor transfers the active assets relating to his business to a newly established discretionary trust where Leor is one of the beneficiaries.

91. To satisfy the 'genuine restructure of an ongoing business' condition, the trustee relies on the 'safe harbour rule' where no significant assets, apart from trading stock, are disposed of, or used for private purposes, for a three year period.

92. To satisfy the 'ultimate economic ownership test', the trustee relies on the 'alternative ultimate economic test' where the family trust election is made specifying Leor's sister is the primary individual.

93. The SBRR is claimed.

94. After the transfer, Samuel starts managing and expanding the business where its service, managements and personnel change materially. The trustee distributes its trust income and capital to Samuel and his family.

Relevant considerations

95. Although all the requirements for the SBRR to apply might be met, the arrangement is contrived and is undertaken as a step in the economic realisation of Leor's business, as well as wealth transfer to Samuel's family members.

Conclusion

96. The anti-avoidance rules would need to be carefully considered for their application to the arrangement.

- This then raises the question as to whether the Commissioner will apply Part IVA where the intention is that the ownership and control will remain with the client until they are ready to pass control either during their lifetime or under their Will (but as part of a long term succession plan strategy).
- PRB 1051659884980 (issued 1 May 2020) indicates that the ‘genuine restructure’ requirement may not be satisfied but the ‘safe harbour’ concession may be satisfied.

  Relevant facts and circumstances

  - You are an Australian resident company for income tax purposes.
  - You hold a number of parcels of farming land.
  - The land has been used in farming businesses.
  - Your shares are currently owned by siblings following the death of their parents.
  - You are proposing to transfer the land to the family trusts of the siblings such that each trust will own 100% of the respective property.
  - Each party of the transfer is a CGT small business entity or connected with a CGT small business entity.

  Application to the circumstances: In your case it is not considered that proposed restructure will be a genuine restructure for the purposes of the small business restructure rollover. The proposed restructure is designed to split the assets between the shareholders in the company and will create distinct businesses. Your situation is comparable to example 6 in LCR 2016/3. While the transfers in your case have occurred after the death of the shareholders, the main purpose of the proposed restructure is to enable a tax-effective inter-generational transfer of wealth. Consequently, the transaction won't be a genuine restructure for the purposes of section 328-430 of the ITAA 1997.

  However, provided that in the three years after the transaction occurs:

  · there is no change in ultimate economic ownership of any of the significant assets of the business that were transferred under the transaction; and

  · those significant assets continue to be active assets; and

- there is no significant or material use of those significant assets for private purposes.

the safe harbour rule will apply and the transaction will be deemed to be part of a genuine restructure under section 328-435 of the ITAA 1997.

Conclusion: Based on the facts the provided, the transfer of the land will be part of a genuine restructure under the safe harbour provision, each party to the transfer is either a small business entity or connected with a small business entity, the transaction does not have the effect of changing the ultimate economic ownership, the residency requirements will be met, and the transferor and each transferee will elect to use the rollover. Consequently, the transfer of the land will satisfy the requirements of the Small Business Restructure Rollover in accordance with Subdivision 328-G of the ITAA 1997.

- It may be prudent to obtain a private binding ruling.

Requirement 2: Small business entity

- Both the transferor and transferee must be one or more of the following:[105]
  - Be a small business entity for the income year during which the transfer occurred.
  - An entity which has an affiliate that is a small business entity for the year in which the transfer occurred.
  - An entity which is connected with an entity that is a small business entity for the year in which the transfer occurred.
  - Be a partner in a partnership that is a small business entity for the year in which the transfer occurred.
- What is a small business entity?

  An entity is a small business entity[106] for an income year if it:
  - carries on business in the income year; and
  - at least one of the following applies.
    - It has an aggregated turnover of less than $10 million[107] for the income year (worked out at the end of the year).
    - It carried on business in the previous year and had an aggregated turnover of less than $10 million for the previous income year.
    - Its aggregated turnover for the current year is likely to be less than $10 million (provided that if it carried on business for the previous two years its aggregated turnover for those two years was not $10 million or more).

Requirement 3: Active asset requirement

- At the time the transfer takes effect, the CGT asset (other than a depreciating asset) must be:
  - an active asset of the transferor and the transferee; and
  - if under Requirement 2 above:
    - the ‘small business entity’ was an affiliate or connected entity of the transferor and/or the transferee, then the affiliate or connected entity (as the case may be) must be using the asset in carrying on its business; and
    - a party to the transaction was a partner in a partnership that was a small business entity, then the asset must be an interest in an asset of the partnership and be used by the partnership in carrying on its business.

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[105] Section 328-430(1)(b) of the 1997 Tax Act
[S]as defined in section 328-110 of the 1997 Tax Act
[107] From 1 July 2016

- Note: The asset only needs to be an 'active asset' at the time the transfer occurs, it does not have to be an active asset for at least half the time the asset is owned.

- What is an active asset?

  A CGT asset is an active asset if at that time:

  - the taxpayer owns the asset (whether the asset is tangible or intangible) and it is used, or held ready for use, in the course of carrying on a business that is carried on (whether alone or in partnership) by either the taxpayer, the taxpayer's affiliate or another entity that is connected with the taxpayer;
  - if the asset is an intangible asset – the taxpayer owns it and it is inherently connected with a business that is carried on (whether alone or in partnership) by the taxpayer, the taxpayer's affiliate or another entity that is connected with the taxpayer.[108]

- Note: some assets cannot be active assets, being:

  - financial instruments (such as loans, debentures, bonds, promissory notes, futures contracts, forward contracts, currency swap contracts and a right or option in respect of a share, security, loan or contract); or
  - assets where the main use is to derive rent, interest or royalties.[109]

- Shares or interests in a trust

  Although shares in a company that is an Australian resident at that time or interests in a trust that is a resident trust for CGT purposes for the income year may be active assets provided that at least 80% of the market value of all of the assets of the company or trust are active assets,[110] transfers of shares and trust interests are unlikely to be eligible to access the SBRRs because:

  - the roll-over applies to the restructure of a business not the shareholding; and
  - the 'small business entity' requirement (Requirement 2 above) is unlikely to be satisfied.

- Examples

  - Examples of transactions where Requirement 3 is satisfied:

    - Sam Jones carries on business and is a small business entity (SBE). Sam transfers the business assets to ABC Trust who will use the assets in carrying on its business and will be a SBE for the year.
    - Requirement 3 is satisfied as:

      - Sam and ABC Trust are both SBEs.
      - At the time of the transfer the business assets are active assets.

    - Sally Brown is a SBE who uses business assets including the premises in carrying on her business. Sally transfers the business assets excluding the premises to Brown Pty Ltd. Sally transfers the premises to Brown Trust who is connected to Brown Pty Ltd. Brown Pty Ltd who will be a SBE for the year will use the premises in carrying on its business.

      Requirement 3 is satisfied in relation to the business assets transferred to Brown Pty Ltd as:

      - Sally and Brown Pty Ltd are both SBEs.
      - At the time of the transfer, the business assets are active assets.

      Requirement 3 is satisfied in relation to the business premises as:

      - Sally is a SBE.
      - Brown Trust is connected with Brown Pty Ltd who is a SBE.

[108] Section 152-40(1) of the 1997 Tax Act
[109] Section 152-40(4) of the 1997 Tax Act
[110] Section 152-40(3) of the 1997 Tax Act

- At the time of the transfer the business premises:
  - are an active asset of Sally; and
  - are an active asset of Brown Trust and are used by Brown Pty Ltd (a connected entity) in carrying on its business.
- Example of a transaction where Requirement 3 is not satisfied:

  Brian Smith (who is not a SBE) owns 100% of the shares in Smith Pty Ltd. Brian transfers the shares in Smith Pty Ltd to Smith Trust. Smith Pty Ltd is a SBE. The shares are active assets as they satisfy the 80% test.

  - Requirement 3 is not satisfied as although the shares are active assets and Brian is connected with Smith Pty Ltd who is a SBE, the shares are not used by Smith Pty Ltd in carrying on its business.
  - Even if Brian and Smith Trust were both SBEs, it is questionable whether Requirement 1 (about the restructure of an ongoing business) is satisfied. This is because the business is still being carried on by Smith Pty Ltd.

Requirement 4: No change in ultimate economic ownership of the assets

- The transaction must not have the effect of materially changing:
  - which individual has, or which individuals have, the ultimate economic ownership of the assets; and
  - if there is more than one such individual – each such individual's share of that ultimate economic ownership.[111]
- Who are the ultimate economic owners?

  The ultimate economic owners of an asset are those individuals who directly or indirectly own the asset. This allows a 'look through' test where assets are owned by entities or the interests in the assets or entity which owns the assets are held by non-individuals.

  If there is more than one individual owner, then that individual's proportionate interest cannot materially change.

  Examples:

  - If mum and dad as equal partners own an asset which is transferred to a company, then mum and dad must each own 50% of the shares in the company.
  - If mum, dad and their son as equal partners own an asset which is transferred to a company, mum, dad and son must each own one-third of the shares. That is, the proportion of shares which they hold (and the rights attaching to those shares) must be the same as their proportionate interest in the partnership asset.
- Special rule for discretionary trusts[112]
  - If an asset or interest in an entity is owned by a discretionary trust then it will not be possible to trace through to individual owners as the beneficiaries will only have a contingent interest in the trust. Therefore there is special rule where the transferor and/or transferee is a non-fixed trust.
  - In relation to accessing the SBRRs, a transaction does not have the effect of changing the ultimate economic ownership of an asset, or an individual's share of that ultimate economic ownership, if all of the following are satisfied:
  - Criteria One:
    - Either or both of the following applies

[111] Section 328-430(1)(c) of the 1997 Tax Act
[112] Section 328-440 of the 1997 Tax Act

- Just before the transaction took effect, the asset was included in the property of a non-fixed trust that had made a family trust election (FTE).
- Just after the transaction took effect, the asset was included in the property of a non-fixed trust that had made a FTE.

- Note: This means that either the transferor or transferee (or both) must be a trust which has made a FTE.

- Criteria Two

  Every individual who, just before the transfer took effect, had the ultimate economic ownership of the asset was a member of the family group (within the meaning of Schedule 2F of the 1936 Tax Act) of the individual specified in the FTE.

- Criteria Three

  Every individual who, just after the transfer takes effect, has the ultimate economic ownership of the asset is a member of that family group.

- What is a non-fixed trust?
  - A trust is a non-fixed trust if it is not a fixed trust.[113]
  - A trust will be a fixed trust only "if persons have fixed entitlements to all of the income and capital of the trust".[114]
  - Beneficiaries will have fixed entitlements to the income and capital of a trust if, under a trust instrument they have "a vested and indefeasible interest" in a share of the income and/or capital115 .
  - Discretionary trusts will be non-fixed trusts and therefore to satisfy requirement 3 of the SBRR will need to make a FTE.
  - It is unlikely that a non-fixed unit trust with unrelated unitholders will be able to satisfy the requirement of making a FTE as it:
    - may not satisfy the 'family control' test in order to make a FTE; and
    - is generally impractical for any trust with unrelated beneficiaries to make a FTE as this will limit who can receive distributions from the trust without the trustee incurring family trust distribution tax.

- Who is part of the family group?
  - To meet both criteria two and three, the individual beneficiaries of the trusts who are a party to the transaction can only consist of individuals who are part of the family group of the individual specified in the FTEs (that is, the test individual).
  - 'Family Group'[116]

    A member of the test individual's family is a member of the test individual's family group.
  - The 'family'[117] of a test individual consists of the test individual and all of the following:
    - any parent, grandparent, brother or sister of the test individual or the test individual's spouse;[118]
    - any nephew, niece or child119 of the test individual or the test individual's spouse;

[113] Section 272-70 of Schedule 2F of the 1936 Tax Act
[114] Section 272-65 of Schedule 2F of the 1936 Tax Act
[115] s272-5(1) of Schedule 2F of the 1936 Tax Act
[116] Section 272-90 of Schedule 2F of the 1936 Tax Act
[117] Section 272-95(1) of Schedule 2F of the 1936 Tax Act
[118] Spouse is defined in section 995-1(1) of the 1997 Tax Act and includes same sex couples
[119] Child is defined in section 995-1(1) of the 1997 Tax Act to also include the individual's adopted child, stepchild or ex-nuptual child and a child of the individual's spouse.

    - any lineal descendant of a nephew, niece or child of the test individual or the test individual's spouse;
    - the spouse of the test individual or of anyone who is a member of the test individual's family because of the above paragraphs.

- Note:
  - A person does not cease to be a family member merely because of the death of any other family member.
  - An adopted child, step-child or ex-nuptual child of a person is taken to be a lineal descendant of that person for the purposes of determining the lineal descendants of that person or any other person.
  - The following former family members are members of the test individual's family group.
    - A person who was a spouse of either the test individual or of a member of the test individual's family before a breakdown in the marriage or relationship.
    - A person:
      - who was the spouse of either the test individual or of a member of the test individual's family before the death of the test individual or of a member of the test individual's family; and who is now the spouse of a person who is not a member of the primary individual's family; and
      - a person who was a child of the spouse of either the test individual or of a member of the test individual's family before a breakdown in the marriage or relationship of the primary individual or the member of the primary individual's family.
- Issues in relation to the 'special rule' for discretionary trusts
  - Criteria two and three above require that, just before and just after the transfer takes effect, every individual who had the ultimate economic ownership of the asset is a member of the family group of the test individual.
  - The purpose of having the 'special rule' for discretionary trusts is that it is not possible to identify individuals who have the 'ultimate economic ownership' of the asset.
  - Although it is clearly not the intention, on a strict reading of the legislation, this means that if the transferor or transferee (or both) are trusts, then criteria two and three cannot be satisfied.
  - Only individual beneficiaries who are members of the family group can have the ultimate economic ownership of the asset.
    - Aunts, uncles and cousins of a test individual are not part of the 'family' group (as defined in Schedule 2F of the 1936 Tax Act.
    - As the class of beneficiaries under the terms of most discretionary trusts are quite wide it will be important to review the terms of the deeds to determine who are the 'beneficiaries' and whether they are part of the family group.
  - Where the aunts, uncles and cousins of the 'test individual' are beneficiaries under the terms of the deed, does that mean that the deeds will need to be amended to exclude them as beneficiaries as they are not part of the 'family group'?
  - Tip: The terms of the trusts who are parties to the transactions could be amended so that whilst a FTE is in force, any person who is not a member of the family group of the test individual is excluded as a beneficiary. As there are adverse tax consequences of distributing outside the family group (in the form of family trust distribution tax [FTDT]), this would eliminate the risk of the trustee inadvertently triggering FTDT by distributing outside the family group and overcome the uncertainty as to whether only individuals who are members of the family group can be beneficiaries.

- Examples of transactions involving trusts where the special rule may be satisfied:
  - Transfer from Sam Jones (individual) to ABC Trust provided that:
    - ABC Trust makes a FTE;
    - Sam Jones must be in the ‘family group’ of the test individual specified in the FTE; and
    - only individuals who are in the ‘family group’ of the test individual are the individual beneficiaries of ABC Trust.
  - Transfer from DEF Pty Ltd (which is owned 100% by Sam Jones) to ABC Trust provided that:
    - ABC Trust makes a FTE;
    - Sam Jones must be in the ‘family group’ of the test individual specified in the FTE; and
    - only individuals who are in the ‘family group’ of the test individual are the individual beneficiaries of ABC Trust.
  - Transfer from XYZ Pty Ltd (which is owned 100% by Jones Trust) to ABC Trust provided that:
    - Jones Trust makes a FTE;
    - ABC Trust makes a FTE with the same test individual as Jones Trust because all of the ultimate owners before and after the transaction must be in the same family group; and
    - in relation to individual beneficiaries – only individual who are in the ‘family group’ of the test individuals are the individual beneficiaries of ABC Trust.
  - Transfer from Smith Pty Ltd (of which Bob and Julie Smith own the ordinary shares and their son Tom owns a discretionary dividend share) to Smith Trust provided that:
    - Smith Trust makes a FTE;
    - Bob, Julie and Tom must be in the ‘family group’ of the test individual specified in the FTE;; and
    - in relation to individual beneficiaries – only individual who are in the ‘family group’ of the test individuals are the individual beneficiaries of Smith Trust.
  - Transfer from Jones Trust to ABC Trust provided that:
    - Jones Trust makes a FTE;
    - ABC Trust makes a FTE with the same test individual as Jones Trust because all of the ultimate owners before and after the transaction must be in the same family group; and
    - in relation to individual beneficiaries – only individuals who are in the ‘family group’ of the test individual are the individual beneficiaries of ABC Trust.
- Examples of transactions involving trusts where the special rule will not or may not be satisfied:
  - Transfer from Sam Jones and his uncle Bob Jones (individual) to ABC Trust if ABC Trust makes a FTE with Sam Jones as the test individual.
    - This is because Bob Jones (Sam’s uncle) will not be part of Sam’s family group.
    - If however, ABC Trust made a FTE with Bob Jones as the test individual, then the special rule will be satisfied as Sam (Bob’s nephew) is in his family group.
    - If ABC Trust makes a FTE with Bob as the test individual, then care will need to be taken as any distributions will need to be in relation to Bob’s family group, otherwise the trustee of the ABC Trust will be subject to family trust distribution tax.
  - Transfer from ABC Pty Ltd (which is owned by ABC Trust) to DEF Pty Ltd (which is owned by DEF Trust).
    - In this case Requirement 3 cannot be satisfied as the ultimate economic ownership cannot be traced through to individuals.

- The special rule relating to discretionary trusts will not apply as in this case, although both trusts may have made a FTE with the same test individual, the transfer is between two companies. For the 'special rule' to apply, either the transferor or transferee (or both) must be a trust which has made a FTE.

Requirement 5: Residency

- Transferor and transferee must be Australian residents. If the transferor or transferee is a partnership, then at least one of the partners must be an Australian resident.

Requirement 6: Choice

- Both transferor and transferee must choose to apply the roll-over in relation to the assets transferred under the transaction other than depreciating assets.
- If a depreciating asset is transferred then, provided all the SBRR requirements are satisfied, roll-over applies automatically to the depreciating assets.[120]

  Note: The choice to apply the SBRRs does not need to be made in relation to all assets transferred.
- How do the transferor and transferee make the choice?

  Division 328-G is silent as to how or when the transferor and transferee must make the choice to apply the roll-over. Therefore it would be prudent that prior to the lodgement of their tax returns both the transferor and transferee have written evidence as to which assets they have chosen to apply the SBRRs to.

8.3 Consequences of making the choice in relation to particular assets

- Direct consequences of transfer ignored
  - Except as provided for under Subdivision 328-G, a transfer of an asset has no direct consequences under the income tax law provided that the SBRR is applied to the asset.
  - Issues:
    - Must be a 'direct' consequence.
    - Only applies to 'income tax law'. Therefore still need to consider GST, FBT and duty.
  - This means that any income tax consequences (including Division 7A issues are ignored) provided that they are as a direct result of the transfer of the asset.
  - Examples of direct consequences:
    - ABC Pty Ltd transfers the business premises which have a market value of $1 million to ABC Trust for nil consideration. All of the SBRR requirements are satisfied.
    - ABC Pty Ltd would ordinarily have a capital gain on the transfer of the business premises.
  - However the capital gain is disregarded as the capital gain is a direct result of the transfer of the premises.

    ABC Trust would ordinarily have a deemed unfranked dividend of $1 million to include in its assessable income (as the transfer of the premises will be a Division 7A payment).
  - However the unfranked dividend is ignored as the dividend was a direct result of the transfer of the premises.
- Transferee acquires the assets for its 'roll-over cost' or adjustable value in relation to depreciating assets.

  What is an asset's roll-over cost?

The roll-over cost will depend on the type of assets being transferred. These are summarised below

[120] Item 8 of section 40-340(1) of the 1997 Tax Act

Type of asset	Roll-over cost (other than depreciating assets)	Depreciating assets
CGT assets (other than trading stock, revenue assets or depreciating assets)	The transferor's cost base just before the transfer takes effect.	
Trading stock	The amount equal to: • the cost of the item for the transferor; or • the value of the item under Division 70 for the transferor if the transferor held the item as trading stock at the start of the income year.	
Revenue asset	The amount which would not give rise to the transferor making a profit or loss on the transfer.	
Depreciating assets		Transferor's adjustable value (written down value). Transferee also adopts transferor's method of depreciation and rate

  - Note: In most cases where there is a disposal of all of the stock as part of a sale of the business, the market value of the stock will be equal to its cost. One of the exceptions will be the transfer of livestock where in most cases the market value of the stock is considerably higher than the cost reflected in the livestock trading account (particularly as a result of natural increase of cattle being reflected at the cost prescribed by the regulations, being $20).
  - This means that primary production clients who want to transfer livestock have to retain at least a 25% interest in the livestock in order to choose to transfer the livestock at cost under Division 70 of the 1997 Tax Act. At a later point, the remaining 25% interest in the livestock could then be transferred. This is generally known as the 'double shuffle'.
- Under the SBRRs it may be possible to transfer livestock without any income tax consequences.
- Cost base of shares or units if part of consideration
  - Where shares or units are part of the consideration, then the roll-over cost of assets plus the adjustable value of depreciating assets form part of the cost base of the shares or units.
  - The cost base is reduced if the shares or units are only part of the consideration.

    Example: Tom transfers business assets to ABC Pty Ltd in exchange for shares in ABC Pty Ltd plus $200,000. The roll-over cost of the assets plus adjustable value of the depreciating assets is $800,000.

    The cost base of the shares which Tom receives in ABC Pty Ltd will be $600,000 (being the $800,000 less the consideration of $200,000 received).

- Pre-CGT assets retain status
  - Pre-CGT assets which are transferred retain their pre-CGT status.
  - Note: If pre-CGT assets are transferred to a company, although the assets retain their pre-CGT status, the legislation is silent as to the treatment of any shares issued in the company as consideration. This means that the shares do not appear to be taken to have been acquired pre-CGT even if the transferred assets are taken to have been acquired pre-CGT.
  - If pre-CGT assets are being transferred to a company, clients should consider applying roll-over relief under Subdivision 122-A or Subdivision 122-B as the shares will be taken to be pre-CGT assets if the assets being transferred are pre-CGT assets (or to the extent that the assets transferred are pre-CGT assets).
- 50% general discount under Division 115
  - For the purpose of the 50% general discount, the asset is acquired on the date it is acquired for CGT purposes (generally contract date) for determining whether it has been held at least 12 months.
  - Unlike other roll-overs, there are no deeming rules.

Interaction with the small business CGT concessions

- Small business roll-over under Subdivision 152-E of the 1997 Tax Act
  - If the transferred asset was a small business replacement roll-over asset under Division 152 of the 1997 Tax Act in the hands of the transferor, then the transferee is taken to have made the choice for the purpose of CGT events J2, J5 and J6.
  - This means that if the transferor had acquired a replacement asset which it transfers under the SBRR's then:
    - if the replacement asset ceases to be an active asset of the transferee, CGT event J2 will occur for the transferee;
    - if the replacement asset is not an active asset of the transferee at the end of the replacement period, CGT event J5 will occur for the transferee;
    - if the cost base of the replacement asset is less than the amount chosen by the transferor to disregard under the small business roll-over, CGT event J6 will occur for the transferee.
  - Example
    - ABC Pty Ltd acquired goodwill as a small business replacement asset in the 2010 year. In the 2017 year it transferred the goodwill to ABC Trust. The SBRRs requirements were satisfied.
    - ABC Pty Ltd disregards the CGT event J2 which would have occurred as the goodwill ceased to be an active asset of ABC Pty Ltd.
    - ABC Trust is taken to have made the choice to apply the small business roll-over and therefore when the asset ceases to be an active asset of ABC Trust, CGT event J2 will occur for ABC Trust.
- Small business 15 year exemption under Subdivision 152-B of the 1997 Tax Act
  - For the purpose of the small business 15 year exemption, in determining whether the asset has been owned for at least 15 years just before the CGT event, the transferee is taken to have acquired the asset when the transferor acquired it.
  - Generally, unless an asset is acquired which satisfies the requirements for a roll-over under Subdivision 124-B (about an asset being compulsorily acquired, lost or destroyed) or Subdivision 126-A (about marriage or relationship breakdowns), then for the 15 year exemption, a taxpayer's period of ownership commences when they become the owner.
- Capital losses on shares and units may be disregarded
  - If membership interests are affected by the transfer of assets under the SBRRs, then any capital loss which arises from a CGT event in relation to that membership interest is disregarded except to the

extent that the entity can demonstrate that the loss is attributable to something other than the transaction.

- Example

  Tom owns 100% of the shares in ABC Pty Ltd. The shares have a cost base of $100,000. ABC Pty Ltd transfers its only asset to ABC Trust for nil consideration under the SBRRs. After the transfer ABC Pty Ltd's equity is reduced to nil and is wound up. This means that Tom will not receive any return on his shares and will have a capital loss of $100,000 as a result of CGT event C2 occurring when ABC Pty Ltd is deregistered.

  Tom will disregard the capital loss on his shares as the capital loss would be attributable to the fact that the asset was transferred for nil consideration under the SBRRs.

9. SBCGT concessions versus SBRR

Assuming that the requirements are satisfied, a decision will need to be made as to whether to apply the SBRRs or in particular the small business CGT concessions under Division 152 of the 1997 Tax Act. Although both of the concessions are for the benefit of small business, there are differences in the requirements to access the concessions and also the implications of choosing the concessions.

In particular, the SBRRs may be attractive if:

- the asset is a pre-CGT asset (particularly where the transferor is a company);
- the asset is livestock.

One major benefit of the small business CGT concessions for post-CGT assets is that the transferee will obtain an uplift in the cost base of the asset.

Also, although any income tax implications may be ignored under the SBRRs, other implications of the transactions will need to be considered, in particular GST and duty.

Major differences between the requirements to access SBRRs and small business CGT concessions

Consequences	SBRRs	Small business CGT concessions
Transferor	Disregard tax consequences on CGT assets, revenue assets, depreciating assets and trading stock including Division 7A implications where the transferor is a company.	Only applies to CGT assets. Can choose to apply small business CGT concessions. For retirement exemption – need to pay into superannuation if 55 years of age.
Transferee	Acquires assets for their rollover cost (no uplift in cost base) Retains pre-CGT status For 15 year exemption - asset deemed to be acquired when transferor acquired it	Acquires asset for its cost base (Uplift in cost base) Asset becomes post-CGT asset For 15 year exemption – assets acquired when transferee becomes the owner (resets the 15 year time)

Requirements	SBRRs	Small business CGT concessions
Genuine restructure of an ongoing business	Needs to be satisfied (Business assets)	Not a requirement (Business assets or shares or units)
Small business entity	Needs to be satisfied	Alternative test to the $6 million net asset test
Active asset	Needs to be satisfied at the time the transaction occurs	Needs to be satisfied for at least: • Half of time commencing when the asset is acquired and ending just before the CGT event; or

Requirements	SBRRs	Small business CGT concessions
		• 7.5 years if the asset is owned at least 15 years
Economic ownership	Needs to be satisfied	Not a requirement
Residency	Needs to be satisfied	Not a requirement
Choice	Both transferor and transferee must choose	Only transferor taxpayer to make the choice

10. Family trust elections and succession issues

10.1 Introduction

If distributions are being made from a trust or entity which has made an FTE or IEE as a part of the succession planning, then to avoid family trust distributions tax, either:

- the distribution (if a transfer of assets) must occur at market value; or
- the entity to which the distribution is made must be part of the family group of the individual specified in the FTE or IEE.

Forgiving loans will be a ‘distribution’, therefore if releasing loans of an entity which has made a FTE or IEE, make sure that the individual or entity is in the ‘family group’ of the relevant test individual, otherwise there will be family trust distribution tax issues.

Once a trust has made a valid FTE (and assuming that it cannot be revoked), careful planning may be required to allow for maximum flexibility for the next generation when deciding to whom that trust may make distributions without being subject to family trust distribution tax.

In addition, if assets are passes to a testamentary trust which may need to make an FTE to pass on franking credits, that testamentary trust must be able to satisfy the ‘family control’ test at the end of the year.

10.2 Making a family trust election[121]

A trustee may make a FTE that it will be a ‘family trust’ at all times after the beginning of a specified year.

The election must be in writing and in the approved form.

The election must specify an individual (“test individual”) as the individual whose family group is to be taken into account in relation to the election.

ATO Interpretative Decision ATO ID 2014/3 – the test individual must be alive when the FTE is made.

If the trust does not pass the family control test at the end of the specified income year, the trustee must not make the election.

> The ATO website states
>
> The income year specified in the FTE must have ended before the FTE is made. This is because an FTE can only be made if the trust passes the family control test at the end of the specified income year.

The ‘specified year’ can be a year earlier than the one in which the FTE is made provided that at all times from the beginning of the ‘specified year’ until 30 June in the income year before the one during the election is made:

- the trust passes the ‘family control test’; and
- any distributions of income or capital of the trust have only been made members of the ‘test individual’s’ family group.

> The specified year cannot be a year earlier than the 2005 year.

Once a FTE has been made, it can only be varied or revoked in limited circumstances.

10.3 Making an interposed entity election[122]

If a company, partnership or trust makes an IEE in respect of the trust which has made a FTE, that company, partnership or trust will be included in the ‘family group’ of the test individual specified in the FTE.

[121] Section 272-80 of Schedule 2F of the 1936 Tax Act
[122] Section 272-85 of Schedule 2F of the 1936 Tax Act

This means that the trust which has made the FTE can distribute to that company, partnership or trust.

The election must be in writing and in the approved form.

The company, partnership of trust must pass the family control test at the end of the specified income year.

The 'specified year' can be a year earlier than the one in which the IEE is made provided that at all times from the beginning of the 'specified year' until 30 June in the income year before the one during the election is made:

- the company, partnership or trust passes the 'family control test'; and
- any distributions of income or capital of the trust have only been made members of the 'test individual's' family group.

Once an IEE has been made, it can only be revoked in limited circumstances.

An IEE is still in force even if the trust in respect of which the relevant IEE was made ceases to exist (ATO Interpretative Decision ATO ID 2013/21)

The company, partners or trustee must not make an IEE to be included in the family group of the individual specified in the FTE in respect of more than one trust, unless the individual specified in each FTE is the same.

However, you can disregard an IEE which has been revoked.

10.4 Passing the 'family control test'

10.4.1 Trusts

A trust cannot make a FTE or IEE unless it passes the 'family control test' at the end of the specified year.

A trust passes the 'family control test' if any one of the following are satisfied:[123]

a) the 'group' has the power to obtain beneficial enjoyment (directly or indirectly) of the capital or income of the trust; or

b) the group is able (directly or indirectly) to control the application of the capital or income of the trust; or

c) the group is capable, under a scheme, of gaining the beneficial enjoyment in paragraph (a) or the control in paragraph (b); or

d) the trustee of the trust is accustomed, under an obligation or might reasonably be expected, to act in accordance with the directions or wishes of the group; or

e) the group can remove or appoint the trustee of the trust; or

f) the group has more than a 50% stake in the income or capital of the trust; or

g) persons in the group are the only persons who, under the terms of the trust, can obtain the beneficial enjoyment of the income and capital of the trust.

[123] Section 272-87(2) of Schedule 2F of the 1936 Tax Act

Who is the 'group'?

The 'group' consists of:

- the individual (test individual) who is specified in the FTE, or in the case of the IEE, who is specified in the FTE to which the IEE will relate; or
- one or more members of the test individual's family; or
- the test individual and one or more of the members of the test individual's family.

The requirement in any paragraphs (a) to (e) above is satisfied in relation to a group consisting of:

- a person or persons being, the test individual and/or members of the test individual's family; and
- one or more legal or financial advisers to the test individual or to a member of the test individual's family.

NOTE: To satisfy the 'family control test' there will need to be at least one individual who is the test individual or members of the test individual's family.

If independent persons are used:

- must ensure that one of the 'family control tests' can be satisfied; and
- to be part of the 'group' for determining the control test, they must be legal or financial advisers.

The requirement in paragraph (f) above is satisfied in relation to a group consisting of the trustees of one or more family trusts, provided the test individual is specified in the FTE of each of those family trusts and/or a person or persons being, the test individual and/or members of the test individual's family.

10.4.2 Companies and partnerships

A company or partnership in respect of which an IEE is proposed to be made passes the family control test if a group consisting of:[124]

- the individual who is specified in the FTE in relation to the IEE; and/or
- one or members of the test individual family; and/or
- the trustees of one or more family trusts, provided the individual is specified in the FTE of each of those family trusts

have between them, directly or indirectly, and for their own benefit, fixed entitlements to a greater than 50% share of the income or a greater than 50% share of the capital of the company or partnership.

10.5 Family and Family Group

Understanding who is part of the 'family' and family group' is important in determining whether the 'family control test' is satisfied and also who can receive distributions without triggering family trust distributions tax.

[124] Section 272-87(3) of Schedule 2F of the 1936 Tax Act

10.5.1 'Family' of the test individual

The 'family'[125] of a test individual consists of the test individual and all of the following:

- any parent, grandparent, brother or sister of the test individual or the test individual's spouse;
- any nephew, niece or child or the test individual or the test individual's spouse;
- any lineal descendant of a nephew, niece or child of the test individual or the test individual's spouse;
- the spouse of the test individual or of anyone who is a member of the test individual's family because of the above paragraphs.

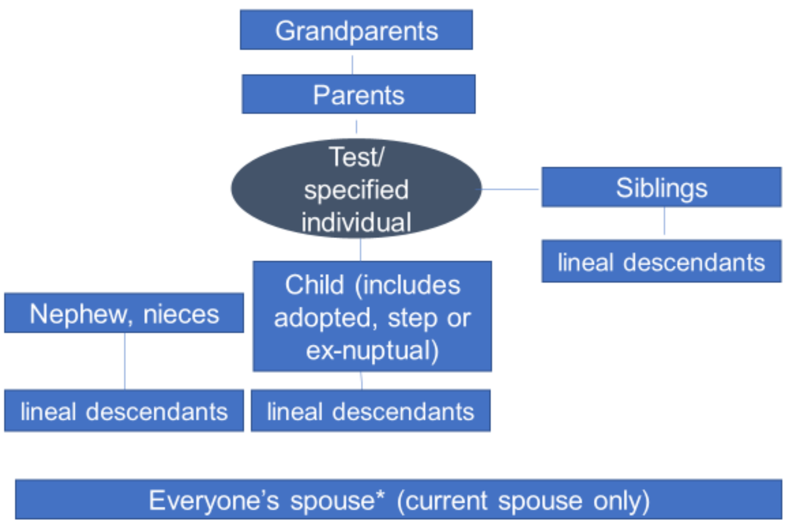
  'Spouse' is defined in section 995-1(1) of the 1997 Act and includes same sex couples.

  'Child' is defined in section 995(1) of the 1997 Act to also include the individual's adopted child, stepchild or ex-nuptual child and a child of the individual's spouse.

A person does not cease to be a family member merely because of the death of any other family member.

An adopted child, step-child or ex-nuptual child of a person is taken to be a lineal descendant of that person for the purposes of determining the lineal descendants of that person or any other person.

Who are members of the 'family'? (Section 272-95)



10.5.2 'Family Group'[126]

The section states whether a person is a member of the family group of the test individual in relation to a conferral of a present entitlement to, or a distribution of, income or capital of a company, partnership or trust, upon or to the person.

- A member of the test individual's family is a member of the test individual's family group in relation to the conferral or distribution.
- The following former family members in relation to the conferral or distribution.

[125] Section 272-95(1) of Schedule 2F of the 1936 Tax Act
[126] Section 272-90 of Schedule 2F of the 1936 Tax Act

- A person who was a spouse of either the test individual or of a member of the test individual’s family before a breakdown in the marriage or relationship.

- A person:

  - who was the spouse of either the test individual or of a member of the test individual’s family before the death of the test individual or of a member of the test individual’s family; and

  - who is now the spouse of a person who is not a member of the primary individual’s family; and

  - a person who was a child of the spouse of either the test individual or of a member of the test individual’s family before a breakdown in the marriage of relationship of the primary individual or the member of the primary individual’s family.

- A trust in respect of which the FTE was made is a member of the test individual’s family group in relation to the conferral or distribution.
- A trust with the same test individual specified in its FTE is a member of the test individual’s family group in relation to the conferral or distribution.
- A company, partnership or trust is a member of the test individual’s family group in relation to the conferral or distribution if:
  - the company, partnership or trust has made an IEE to that effect; and
  - the election is in force when the conferral takes place or the distribution is made.
- A company, partnership or trust is a member of the test individual’s family group in relation to the conferral or distribution if:
  - the test individual; and/or
  - one or members of the test individual’s family; and/or
  - the trustees of one or more family trusts, provided the primary individual is specified in the FTE of each of those family trusts;

  have fixed entitlements directly or indirectly, and for their own benefit, to all of the income and capital of the company, partnership or trust.
- A fund, authority or institution in Australia covered by Subdivision 30-B of the 1997 Act (about recipients for gift recipients).
- An institution, hospital, trustee, society, association, club or fund, all of whose income is exempt under:

- section 50-5 (charity, education and science);
- section 50-10 (community service);
- Items 6.1 or 6.2 of section 50-30 (public hospital or hospital carried on by a society or association);
- Items 9.1 or 9.2 of section 50-45 (sports, culture and recreation).

10.5.3 Fixed entitlements to a share of income or capital

Fixed entitlements to the income and capital of a trust[127]

Beneficiaries will have fixed entitlements to the income and capital of a trust if, under a trust instrument they have “a vested and indefeasible interest” in a share of the income and/or capital[128] .

Fixed entitlement to a share of income or capital of a company[129]

If a shareholder in a company holds shares carrying the right to receive:

- some or all of the dividends that may be paid by the company, the shareholder has a fixed entitlement to a share of the income of the company equal to the percentage of the total dividends represented by the dividends that the shareholder has a right to receive; and
- the whole or part of any distribution of the paid-up share capital of the company in the event of any return of capital to shareholders, the shareholder has a fixed entitlement to a share of the capital of the company equal to the percentage of the total distribution represented by the amount that the shareholder has a right to receive.

Private Binding Ruling Authorisation number 1051714149928 – company had different class shares which had equal capital rights but discretionary dividend rights. All shares were held by the test individual and members of the test individual’s family.

31. Fixed entitlement to a share of income or capital of a company is outlined in subsections 272-10(1) and 272-10(2) of Schedule 2F of the ITAA 1936. Individually, Taxpayer A, Taxpayer B, Taxpayer C and Taxpayer D do not hold shares that have a right to receive some or all of the dividends of Company A because the dividends may, with the exercise of the discretion, be paid to one or more of the other classes of shares to the exclusion of their shares, as outlined in Clause X.Y of the company Constitution.

32. Collectively, all of the dividends must be paid to members of Taxpayer A's family, however, for the purposes of subsections 272-10(1) and 272-10(2) each of the shareholders' entitlements must be fixed (giving them a right to a share of dividends equal to a percentage of the total dividends) and then taken together all of the shareholders who satisfy (a) to (c) in subsection 272-90(5) should add up to all of the income and capital of the company (100%).

[127] Section 272-5(1) of Schedule 2F of the 1936 Tax Act
[128] Section 272-5(1) of Schedule 2F of the 1936 Tax Act
[129] Section 272-10 of Schedule 2F of the 1936 Tax Act

Fixed entitlement to a share of income or capital of a partnership[130]

If under a partnership agreement, a partnership is entitlement to a share of income that the partnership derives from time to time, or of the capital of the partnership and the share is not able to be varied, the partner has a fixed entitlement to that share of the income or capital.

If a partner does not have a fixed entitlement to income or capital of the partnership, only because the partner's share is able to be varied, the Commissioner does have a discretion to treat the partners has having a fixed entitlement having regard to:

- the circumstances in which the share is able to be varied;
- the likelihood of the variation happening; and
- the nature of the partnership.

Fixed entitlement to share of income or capital indirectly

A person holds a fixed entitlement to a share of the income or capital of a company, partnership or trust indirectly if the person holds the entitlement indirectly through fixed entitlements to shares of the income or capital, respectively, of interposed companies, partnerships or trusts.131

Additional special cases of fixed entitlements held directly or indirectly

- Section 272-30 also affects references to a person or individual having, directly or indirectly, a fixed entitlement to a share of the income or capital of a company, partnership of trust (other than in sections 269-75(b)(ii) or 272-25) at a particular time (test time).
- Section 272-30 will not affect a reference to a person or individual having a fixed entitlement where the phrase 'directly or indirectly' is not used.
- If at the test time a family trust has, directly or indirectly, a fixed entitlement to a share of the income or capital of the main entity, it is treated as if it and the fixed entitlement as an individual and for the individual's own benefit.

Fixed entitlement on death

If, immediately before an individual dies, he or she has a fixed entitlement to a share of the income or capital of a trust, partnership or company directly or indirectly, and for his or her own benefit, the individual is taken to continue to have the entitlement for so long as:

- It is held by someone as trustee of the individual's estate; or
- It is held by someone who received it as a beneficiary of the estate (s 272-40).

10.6 Distributions of income or capital

This applies in relation to determining whether 'distributions' have been made outside of the family group and also whether the pattern of distribution test is satisfied.

10.6.1 Trust distribution to a beneficiary[132]

A trust distributes income or capital to a person if it:

- pays or credits the income or capital in the form of money to the person;
- transfers the income or capital in the form of property to the person; or

[130] Section 272-15 of Schedule 2F of the 1936 Tax Act
[131] Section 272-20 of Schedule 2F of the 1936 Tax Act
[132] Section 272-45 of Schedule 2F of the 1936 Tax Act

- reinvests or otherwise deals with the income or capital on behalf of the person or in accordance with the directions of the person; or
- applies the income or capital for the benefit of the person;

in the person's capacity as a beneficiary of the trust.

10.6.2 Company distribution to a shareholder[133]

A company distributes income of the company to a person if the company pays a dividend or non-share dividend to the person.

A company distributes capital of the company to a person if:

- it pays or credits money, or transfers property, of the company to the person, where the amount paid or credited, or the amount or value of the property, is debited against an amount standing to the credit of the share capital account of the company; and
- the payment, crediting or transfer is not the payment of the dividend.

A company distributes capital of the company to a person if the company makes a non-share capital return to the person.

10.6.3 Partnership distribution to a partner[134]

A partnership distributes income or capital of the partnership to a person if it:

- pays or credits the income or capital in the form of money to the person; or
- transfers the income or capital in the form of property to the person; or
- reinvests or otherwise deals with the income or capital on behalf of the person or in accordance with the directions of the person; or
- applies the income or capital for the benefit of the person;

in the person's capacity as a partner in the partnership.

10.6.4 Other distributions of income and capital[135]

A company, partnership or trust also *distributes income or capital to a person* if it:

- pays (including by way of a loan) or credits money of the entity to the person, or reinvestments such money for the person; or
- transfers property of the entity to, or allows use of the property of the entity by, the person; or
- deals with money or property of the entity for or on behalf of the person or as the person directs; or
- applies money or property of the entity for the benefit of the person; or
- extinguishes, forgives, releases or waives a debt or other liability owed by the person to the entity (section 272-60(1)).

However, section 272-60(1) only applies if, and to the extent that:

- the amount paid, credited, reinvested or applied, the value of the property transferred or the value of the other thing done; exceeds

[133] Section 272-50 of Schedule 2F of the 1936 Tax Act
[134] Section 272-55 of Schedule 2F of the 1936 Tax Act
[135] Section 272-60 of Schedule 2F of the 1936 Tax Act

- the amount or value of any consideration given in return.

Each thing that is a distribution because of section 272-60(1) is a distribution of income unless it is clear that the money or property concerned was capital, or that the debt or liability was attributable to capital, of the entity.

Taxation Determination TD 2017/20 [at paragraph 17]

> …. the unqualified reference to 'distributes…to a person' in the extended definition [that is, section 272-60] includes distributions (as defined) to persons who are not beneficiaries of the trust.

10.6.5 Distribute indirectly[136]

A trust distributes income or capital indirectly to an individual if it distributes the income or capital to a company, partnership or trust (the first interposed entity) interposed between the trust and the individual and:

- the first interposed entity distributes to the individual an amount or property attributable to the income or capital; or
- another company, partnership or trust (the final interposed entity) distributes to the individual an amount or property that is attributable to the income or capital as a result of:
  - the distribution of an amount or property attributable to the income or capital to the final interposed entity by the first interposed entity; or
  - successive distributions of amounts or property attributable to the income or capital to and by any companies, partnerships or trusts interposed between the first interposed entity and the final interposed entity.

Examples

- *ATO* Interpretative *Decision* ATO ID 2004/162

  Issue: Is the trustee of a family trust liable for Family Trust Distribution Tax (FTDT) pursuant to section 271-15 of Schedule 2F to the *Income Tax Assessment Act 1936* (ITAA 1936) on a payment made in respect of the redemption of units, where the amount paid exceeds the value of any consideration given in return?

  Decision: Yes. The trustee of a family trust is liable for FTDT pursuant to Division 271 of Schedule 2F to the ITAA 1936 to the extent that the payment made in respect of the redemption exceeds the value of any consideration given in return.

  Reasons for Decision: The redemption of units in a unit trust would be a distribution pursuant to subsection 272-60(1) of Schedule 2F to the ITAA 1936. Section 272-60 gives an extended meaning of distributions of income and capital.

- ABC Family Trust (who is controlled by Tom and Jane Smith) and has made an FTE owns shares in XYZ Pty Ltd. Tom and Jane want to bring their son Jack into the company. ABC Family Trust gifts 50% of its shares to ABC Jr Family Trust.

  The transfer of shares at less than market value will be considered to be a distribution for the purpose of section 272-60(1).

- DEF Pty Ltd
  - DEF Pty Ltd has made an IEE in relation to the DEF Family Trust. DEF Family Trust sells its shares to a third party, Unfortunate Family Trust. DEF Pty Ltd pays dividends to Unfortunate Family Trust.

    The dividends will be distributions (section 272-50).

[136] Section 272-63 of Schedule 2F of the 1936 Tax Act

- The client now realises that DEF Pty Ltd has made an IEE, but is out of time to revoke the IEE. DEF Pty Ltd decides to transfer the business assets to NewCo Pty Ltd (the shares of which are owned by Unfortunate Family Trust) for $50,000 (however, the market value of business assets is $1 million.

  The transfer of the business assets will be a distribution ($950,000) (section 272-60).

- DEF Pty Ltd forgives the $50,000 owed by NewCo Pty Ltd for the transfer of the business assets.

  The release of the debt will be a distribution ($50,000) (section 272-60).

10.7 Family trust distribution tax

10.7.1 Trusts which have made a FTE[137]

If:

- a trustee makes a FTE in relation to a trust; and
- at any time while the election is in force, the trust confers a present entitlement to, or distributes, income or capital of the trust:
  - upon or to a person who is neither the individual specified in the FTE nor a member of the individual's family group in relation to the conferral or distribution; or
  - upon or to the individual specified in the FTE or a member of the individual's family group, where that person is the trustee of a trust, that is not included in the individual's family group in relation to the conferral or distribution; then

if:

- the trustee is an individual – the trustee is liable to family trust distribution tax on the amount or value of the income or capital to which the entitlement relates, or that is distributed; or
- the trustee is a company - the trustee, together with each person who was a director of the company at the time of the conferral or distribution is jointly and severally liable to family trust distribution tax on the amount or value of the income or capital to which the entitlement relates, or that is distributed.

10.7.2 Trusts which have made an IEE[138]

If:

- a trustee makes an IEE for the trust to be included in the family group of the individual specified in a FTE; and
- at any time while the election is in force, the trust confers a present entitlement to, or distributes, income or capital of the trust:
  - upon or to a person who is neither the individual specified in the FTE nor a member of the individual's family group in relation to the conferral or distribution; or
  - upon or to the individual specified in the FTE or a member of the individual's family group, where that person is the trustee of a trust, that is not included in the individual's family group in relation to the conferral or distribution; then

[137] Section 271-15 of Schedule 2F of the 1936 Tax Act
[138] Section 271-20 of Schedule 2F of the 1936 Tax Act

if:

- the trustee is an individual – the trustee is liable to family trust distribution tax on the amount or value of the income or capital to which the entitlement relates, or that is distributed; or
- the trustee is a company - the trustee, together with each person who was a director of the company at the time of the conferral or distribution is jointly and severally liable to family trust distribution tax on the amount or value of the income or capital to which the entitlement relates, or that is distributed.

10.7.3 Partnerships which have made an IEE[139]

If:

- the partners in a partnership make an IEE for the partnership to be included in the family group of the individual specified in a FTE; and
- at any time while the election is in force, the partnership confers a present entitlement to, or distributes, income or capital:
  - upon or to a person who is neither the individual specified in the FTE nor a member of the individual's family group in relation to the conferral or distribution; or
  - upon or to the individual specified in the FTE or a member of the individual's family group, where that person is the trustee of a trust, that is not included in the individual's family group in relation to the conferral or distribution; then

  the partners, together with each person who at the time of the conferral or distribution was a director of any partners that was company is jointly and severally liable to family trust distribution tax on the amount or value of the income or capital to which the entitlement relates, or that is distributed.

10.7.4 Companies which have made an IEE[140]

If:

- a company makes a IEE for the company to be included in the family group of the individual specified in a FTE; and
- at any time while the election is in force, the company confers a present entitlement to, or distributes, income or capital of the company:
  - upon or to a person who is neither the individual specified in the FTE nor a member of the individual's family group in relation to the conferral or distribution; or
  - upon or to the individual specified in the FTE or a member of the individual's family group, where that person is the trustee of a trust, that is not included in the individual's family group in relation to the conferral or distribution; then

the company, together with each person who was a director of the company at the time of the conferral or distribution, is jointly and severally liable to family trust distribution tax on the amount or value of the income or capital to which the entitlement relates, or that is distributed.

[139] Section 271-25 of Schedule 2F of the 1936 Tax Act
[140] Section 271-30 of Schedule 2F of the 1936 Tax Act

10.7.5 Payment of family trust distribution tax[141]

Family trust distribution tax is due and payable:

- in the case where the conferral or distribution was made before the day on which the election was made – at the end of 21 days after the day on which the election was made; and
- in any other case – at the end of 21 days after the day on which the conferral or distribution was made.

If any of the family trust distribution tax remains unpaid 60 days after the day by which it is due to be paid, the person is liable to pay general interest charge.

As it is a debt there is no time limit on when the family trust distribution tax is payable (and interest will continue to accumulate on any unpaid amount). That is, it is not subject to a review period.

10.7.6 Implication for the recipient

If:

- a family trust distribution tax (the tax payable) becomes payable on the amount or value of income or capital of the company, partnership or trust; and
- a payment (the tax payment amount) of the whole or part of the tax payable is made; and
- the whole or part of the amount or value of the income or capital is included in the assessable income of the company, partnership or trust or of any other person;

the *amount* included in the assessable income is reduced by the amount worked out using the following formula:

Tax payment amount/tax payable x original assessment amount.[142]

A further issue is that if a trustee who has made a FTE makes a distribution to a beneficiary which is outside the family group and that distribution has franking credits attached:

- the trustee will be liable for family trust distribution tax;
- the beneficiary will not include the distribution is their assessable income; and
- no one will be entitled to a tax offset for the franking credits.

For example:

- The trustee received franked dividends from XZY Pty Ltd of $75,000 with franking credits of $25,000.
- The trustee distributes the franked dividends to ABC Bucket Co Pty Ltd. ABC Bucket Co Pty Ltd is not part of the family group of the test individual.
- The trustee (and directors) will be jointly and severally liable for family trust distribution tax of $35,250 (47% x $75,000).
- ABC Bucket Co Pty Ltd does not include the $75,000 in its assessable income but also does not receive the benefit of the franking credit.
- However, ABC Bucket Co Pty Ltd has received accounting income of $75,000 which will need to be paid out to shareholders at some point (without the benefit of the franking credits).
- How much tax is being paid on the original $100,000 from XYZ Pty Ltd?

[141] Section 271-75 of Schedule 2F of the 1936 Tax Act
[142] Section 271-105 of Schedule 2F of the 1936 Tax Act

- XYZ Pty Ltd paid tax of $25,000 on the original $100,000 (being $100,000 x 25%). It then paid the fully franked dividend of $75,000 to the trustee.

- The trustee then paid family trust distribution tax of $35,250 (being 47% x $75,000).

- The shareholders of ABC Bucket Co Pty Ltd pay tax on the $75,000 unfranked dividend, being $35,250 (assuming 47%).

- Total tax is $95,500 ($25,000 plus $35,250 plus $35,250). That is, 95.5% of $100,000.

10.7.7 Reversing the family trust distribution tax

If the entity who has made the FTE or IEE has made a distribution outside of the family group, but the recipient can put in place a valid FTE or IEE (and therefore become part of the family group of the relevant entity) specifying the year in which the distribution was received, then the family trust distribution tax is reversed (ATO publication on Family trusts - concessions).

10.8 FTEs and passing control of trusts

Where a trustee has made an FTE in relation to a particular individual, the entities to which distributions can be made is limited. This is particularly the case when control of trusts are passed to the next generation who may then want to make distributions to corporate entities which the control.

The issue is compounded because:

- the test individual cannot be changed as a result of the death of that individual; and
- a trustee can only make a FTE in relation to someone who is alive.

To overcome this issue, a strategy may be to establish trusts and have the trustee make FTE's in relation to the test individual of the existing trust with the FTE. Control of these trusts will pass to the individuals who will control the existing trust.

- Example:
  - Background
    - Brian and Louise have a trust which holds the farming land and conducts the primary production operations.
    - Their intention is that, on the death of the survivor, their children, Michael and John will jointly control the trust and the anticipation is that both Michael and John will want to establish corporate beneficiaries which can receive income distributions from this trust.
    - The trust has made a FTE with Brian as the test individual.
    - There may be a problem if corporate beneficiaries are established after the death of Brian and the trust makes income distributions to those corporate beneficiaries.
  - Issue
    - As each of the trust has made a FTE in relation to Brian, this will restrict all future distributions to:
      - individuals who are part of Brian's family;

        - trusts that have made IEE's in relation to the relevant trust;
        - companies that are wholly owned by individuals who are part of Brian's family (but there cannot be any discretionary shares);
        - companies that are wholly owned by trusts that have made a FTE with Brian as the test individual; or
        - companies that have made an IEE to be part of Brian's family group.
    - If a company is established after Brian's death with the shares held by a trust that has not made an FTE while Brian was alive, that company will not be able to make an IEE because it will not satisfy the 'control test' in section 272-87(3) of Schedule 2F of the 1936 Tax Act, which requires that:
        - Brian; and
        - members of Brian's family; and
        - trusts which have made an FTE with Brian as the test individual
        - must between them have fixed entitled to more than 50% of the income or capital of the company.
    - This means that if Michael and John want to distribute to corporate beneficiaries after Brian's death, the shareholders of those companies can only be:
        - trusts which made a FTE with Brian as the test individual; or
        - individuals who were part of Brian's family.
    - A trust can only make a FTE in relation to an individual who is alive at the time the election is made.
- Possible solution (before the death of Brian)
    - Brian and Louise could establish trusts while Brian is alive (New Trusts) which make FTE's with Brian as the test individual.

      Note: The ATO's view is that the trustee cannot make a FTE unless it passes the 'family control test' at the end of the year.
    - The New Trusts and any future companies in which they hold shares will be in Brian's family group because they will;
        - have made FTEs with Brian as the test individual; or
        - be wholly owned by trusts that have made FTEs in relation to Brian.
    - After Brian's death, the trustee of the trust could then distribute to:
        - the New Trusts; or
        - corporate beneficiaries in which the New Trusts own all shares.

    - It is not necessary that these corporate beneficiaries are in existence prior to Brian's death.

- Possible solution (after the death of Brian)
    - Michael and John could each establish a company which have shares which have:
        - rights to 100% of the capital and voting held by individuals (who are part of Brian's family); and
        - rights to 100% of the income held by a trust of which they are the test individual.

      For example, Michael's company could be established with him owning shares which have 100% of capital and voting rights and his trust (Michael Trust) will own shares which have 100% of the income rights.

      John's company could be established with him owning shares which have 100% of capital and voting rights and his trust (John Trust) will own shares which have 100% of the income rights.

    - Michael's company and John's company could make an IEE in relation to each of the trusts of which Brian is the test individual that make distributions to the relevant companies. The companies can do this as members of Brian's family own more than 50% of the rights to capital.
    - Michael Trust and John Trust will need to make an IEE in relation to each of the trusts which distribute to the relevant companies. Otherwise the relevant companies will be liable to family trust distributions tax on the dividends to the trusts. They will also need to make FTE's to pass on the franking credits. For example, Michael could be the test individual of the Michal Trust and John the test individual of the John Trust.
    - Michael Trust will need to ensure that distributions are only make to entities within both Brian's and Michael's family group.
    - John Trust will need to ensure that distributions are only make to entities within both Brian's and John's family group.