The Tax Institute

Private Business Tax Retreat

Section 99B and the Temple of Doom

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1. Introduction – Trouble

> Indiana Jones: We're in trouble!
>
> Willie: Trouble? What kind of trouble?
>
> Indiana Jones: It's a long story. Better hurry up or you won't get to hear it.

Deep in the mountainous depths of the taxation of trusts lives an integrity provision, which until recently, was rarely disturbed. However, the ATO have resurrected s 99B of the *Income Tax Assessment Act 1936* (**ITAA 1936**)[1] from its slumber. It is ugly and mean-spirited, frightening even to the most seasoned advisor in its potential breadth.

Section 99B is a provision that was introduced in 1979[2] to remedy a perceived deficiency in the way Division 6 operated. It does its work, if triggered, by making an amount received from a trust taxable when the amount is not otherwise caught by the "standard" trust rules involving present entitlement or is not an amount that has been taxed in some other way. In that context, s 99B could be described as a simple (to the extent tax and simple can coexist), noble, and well-intentioned provision.

However, after nearly 45 years, it is a section that is the subject of renewed interest by the Commissioner. These days it seems, the Commissioner is willing to apply s 99B to fact patterns that many might not have otherwise thought fell within the scope of the provision, or was assessable as a general proposition (ie, that gift from a relative).

The limited jurisprudence on the provision combined with the fact that the provision was enacted well before many other provisions relevant to the taxation of trusts means the application of s 99B remains highly uncertain.

There is no short story version of this paper and, as you'll find, once the layers are peeled back, the complexity unveils itself and the façade of simplicity dissipates.

The ATO is developing a draft compliance approach "to explain when it will apply compliance resource to review distributions from non-resident trusts to beneficiaries", including in relation to distributions from non-resident deceased estates and on record keeping.[3] In light of the lack of jurisprudence, this is no easy task, but it is hoped that the guidance will assist advisors in applying the provision.

We pose a number of questions, some of which we will answer in the course of our presentation. But the renewed interest means the advisor better hurry up and listen to this story because:

> I keep telling you, you listen to me more, you live longer.

[1] Unless stated otherwise, all provisions referred to in this document are references to the ITAA 1936.
[2] Incidentally, around the same time as s 100A and both provision ultimately passed Parliament at the same time.
[3] ATO, "Private Groups Stewardship Group key messages 23 November 2023", https://www.ato.gov.au/about-ato/consultation/in-detail/stewardship-groups-key-messages/private-groups-stewardship-group/private-groups-stewardship-group-key-messages-23-november-2023, accessed on 19 January 2024

2. Section 99B – The Statutory Framework

Section 99B(1) operates to include in a resident beneficiary's assessable income an amount, being property of a trust estate, which is paid to, or applied for the benefit of, the beneficiary. Section 99B(1) provides:

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

2.1 Section 99C – applied for the benefit of

Section 99C addresses the circumstances in which an amount shall be taken to have been applied for the benefit of a beneficiary for the purposes of s 99B. Sub-sections (1) and (2) of s 99C provide:

> Determining whether property is applied for benefit of beneficiary
>
> (1) In determining for the purposes of section 99B whether any amount has been applied for the benefit of a beneficiary of a trust estate, regard shall be had to all benefits that have accrued at any time to the beneficiary (whether or not the beneficiary had rights at law or in equity in or to those benefits) as a result of the derivation of, or in relation to, that amount, irrespective of the nature or form of the benefits.
>
> (2) Without limiting the generality of subsection (1), an amount shall be taken, for the purposes of section 99B, to have been applied for the benefit of a beneficiary if:
>
> (a) whether by re-investment, accumulation, capitalization or otherwise, and whether directly or indirectly, the amount has been so dealt with that it will, at a future time, and whether in the form of income or not, enure for the benefit of the beneficiary;
>
> (b) the derivation of the amount has operated to increase the value to the beneficiary of any property or rights of any kind held by or for the benefit of the beneficiary;
>
> (c) the beneficiary has received or become entitled to receive any benefit (including a loan or a repayment, in whole or in part, of a loan, or any other payment of any kind) provided directly or indirectly out of that amount or out of property or money that was available for the purpose by reason of the derivation of the amount;
>
> (d) the beneficiary has power, by means of the exercise by the beneficiary of any power of appointment or revocation or otherwise, to obtain, whether with or without the consent of any other person, the beneficial enjoyment of the amount; or
>
> (e) the beneficiary has directly or indirectly assigned to another person his or her interest in the amount or is able, in any manner whatsoever, and whether directly or indirectly, to control the application of that interest.

2.2 Section 99B(2) – reducing the s 99B(1) amount

Once an amount is captured by s 99B(1) it is included in a resident beneficiary's assessable income, unless the amount so included is "reduced" by s 99B(2). Subsection 99B(2) specifies six circumstances, which, if they apply, reduce the amount captured by s 99B(1). It provides:

> The amount that, but for this subsection, would be included in the assessable income of a beneficiary of a trust estate under subsection (1) by reason that an amount, being property of the trust estate, was paid to, or applied for the benefit of, the beneficiary shall be reduced by so much (if any) of the amount, as represents:
>
> (a) corpus of the trust estate (except to the extent to which it is attributable to amounts derived by the trust estate that, if they had been derived by a taxpayer being a resident, would have been included in the assessable income of that taxpayer of a year of income);
>
> (b) an amount that, if it had been derived by a taxpayer being a resident, would not have been included in the assessable income ofthat taxpayer of a year of income;
>
> (ba) an amount that is non-assessable non-exempt income of the beneficiary because of section 802-17 of the Income Tax Assessment Act 1997;
>
> (c) an amount:
>
> (i) that is or has been included in the assessable income of the beneficiary in pursuance of section 97; or
>
> (ii) in respect of which the trustee of the trust estate is or has been assessed and liable to pay tax in pursuance of section 98, 99 or 99A; or
>
> (iii) that is reasonably attributable to a part of the net income of another trust estate in respect of which the trustee of the other trust estate is assessed and is liable to pay tax under subsection 98(4);
>
> (d) an amount that is or has been included in the assessable income of any taxpayer (other than a company) under section 102AAZD; or
>
> (e) if the beneficiary is a company-an amount that is or has been included in the assessable income of the beneficiary under section 102AAZD.

3. A touch of history

The Explanatory Memorandum to the *Income Tax Assessment Bill (No. 5) 1978* (**EM**) set out the rationale for the enactment of s 99B, as being:[4]

> … designed to overcome a High Court decision that the existing trust provisions in Division 6 of the Income Tax Assessment Act ("the Principal Act") only have application to Australian source income of trusts. As the law now stands, Australian residents can defer or escape completely, the payment of tax on foreign source income accumulated in trusts for their benefit.

The High Court decision referred to in the EM is *Union Fidelity Trustee Co. of Australia Ltd v F.C. of T* (**Union Fidelity**).[5] At the time, the term "the net income of the trust estate" was defined in s 95 to mean:

> … "net income of a trust estate" means the total assessable income of the trust estate calculated under this Act as if the trustee were a taxpayer in respect of that income, less all allowable deductions, except the concessional deductions and except also, in respect of any beneficiary who has no beneficial interst in the corpus of the trust estate, or in respect of any life tenant, the deduction of such of the losses of previous years as are required to be met out of corpus.

That definition, as it was then drafted, required consideration of s 25(1), which at the time provided:

> The assessable income of a taxpayer shall include –
>
> (a) where the taxpayer is a resident – the gross income derived directly or indrectly from all sources whether in or out of Australia; and
>
> (b) where the taxpayer is a non-resident – the gross income derived directly or indirectly from all sources in Australia,
>
> which is not exempt income.

In Union Fidelity, it was held that, in calculating the net income of a trust estate for the purposes of Div 6 of the ITAA 1936 (as it was then drafted), only income from sources in Australia could be taken into account. However, income of a trust estate from foreign sources could not be taxed under that Division as it was derived. As stated by Barwick CJ (emphasis added):[6]

> The effect of the definition of the net income of the trust estate in sec. 95 is that the provisions of the Act are to be applied to the actual income of the trust estate as if it were the income of an individual deriving it. From the actual income of the trust estate there is abstracted all sums which can be seen to be assessable income. **For the purpose of this abstraction or computation the only fact which is relevantly known is that the trustee, as a taxpayer, has derived the income**. The residence of the trustees, or of any one of them, if there be more than one cannot afford a reason for varying the net amount of the income of the trust estate according to the accident of the trustee's residence in the year of tax. Its irrelevance is emphasised when the possibility of diverse residences of several trustees is contemplated.
>
> Income for the relevant purposes of the Act falls into one of two categories — that which is derived from an Australian source and that which is not derived from an Australian source. The

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[4] Explanatory Memorandum to the *Income Tax Assessment Amendment Bill (No.5) 1978*, 1.
[5] (1969) 119 CLR 177.
[6] *Union Fidelity Trustee Co. of Australia Ltd v F.C. of T* (1969) 119 CLR 177, 181.

> scheme of the Act is to bring to tax both kinds of income where the taxpayer deriving it is a resident of Australia but to bring to tax only income of the former kind where the taxpayer is not a resident of Australia. **It is therefore clear to my mind that if nothing is known as to the residence of a taxpayer the only income which can certainly be said to be assessable income is the income** derived **by the taxpayer from an Australian source**. Unless it is known that he is a resident, it cannot be said that any other income is to be included in his assessable income.

In Barwick CJ's view, in calculating the amount the beneficiary is required to include in their assessable income pursuant to s 97, being his share of the net income of the trust estate, that amount would not vary according to the residency of the beneficiary.[7] Barwick CJ stated (emphasis added):

> In applying the provisions of Div. 6 a clear distinction must be maintained between the position of a person who is entitled to receive a share of the estate and one who has been paid the amount of it. When a beneficiary has been paid his share of the income of the estate in respect of a tax year he no longer satisfies the description of a beneficiary who is entitled to a share of the net income of the estate for that year. Thus, if at the close of the taxation year the appropriate share of the income of the trust estate has been already paid to the beneficiary who before the payment was merely entitled to it, the amount so paid to the beneficiary as his share of that income will form part of his assessable income by virtue of sec. 26(b) and not, in my opinion, by reason of sec. 97.
>
> The purpose of these three sections in Div. 6, sec. 97, 98 and 99, it seems to **me, is to anticipate the receipt by a beneficiary of the share of the trust income upon the receipt of which, whatever his residence, he would be liable to tax: and to bring the share of that income to tax before it is received by a beneficiary**. The beneficiary under sec. 97 must include in the assessable income money which he has not received but which in the year of income he is entitled to receive as his share of the net income of the estate. In the case of a beneficiary under disability but entitled to his share the trustee is to pay the tax, it being assumed that the beneficiary will not receive it in that year of tax because of legal disability, and in the case of sec. 99 as there is nobody at present entitled to receive the amount to which that section applies, the trustee will be required presently to pay tax upon that amount. Where a beneficiary at the conclusion of a year of tax is still entitled to a share of income and, conformably to sec. 97, includes the amount of that share which he has not received in his assessable income for that year, he will not be liable to tax upon the money he subsequently receives as that share any more than a person who has rendered his return of income on a credit basis is liable to pay tax upon the actual receipt of the money which he has already brought to account in computing income upon a credit basis. For the same reason, when the trustee has paid tax under sec. 98, the subsequent receipt of the share of income by the person who was formerly under disability will not attract tax by reason of that receipt. The same will also be true of the person who ultimately becomes entitled to and receives income of the estate which has fallen within sec. 99 and on which the trustees have paid tax in pursuance of that section.

It followed from the decision of Union Fidelity that:

a. the residence of both the trustee and the beneficiary of a trust estate was irrelevant for the purposes of Division 6 as it was then drafted;

[7] *Union Fidelity Trustee Co. of Australia Ltd v F.C. of T* (1969) 119 CLR 177, 182.

b. the source of the income derived was relevant in calculating amounts under Division 6, but only Australian-source income was included in calculating “the net income of a trust estate”; and

c. non-Australian source income of a trust estate would be assessable, but only when that “income” was distributed to a beneficiary if the beneficiary was a resident.

The practical effect of Union Fidelity was that foreign-source income of a trust estate could be accumulated in the trust without liability to tax arising to either the trustee or the beneficiary unless and until such time as the income was distributed to a resident beneficiary. Income accumulated under most trust deeds then forms the capital of the trust estate. Accordingly, any distributions of that previously accumulated income would not be assessable to a beneficiary if subsequently distributed to that beneficiary because the subsequent distribution would not be a distribution of income, but rather, a distribution of capital.

To overcome the problems raised in *Union Fidelity*, substantial amendments were made to Division 6 by Income Tax Assessment Amendment Bill (No 5) 1978 (**1978 Bill**). The 1978 Bill made the following changes:

a. the definition of ‘net income’ of a trust estate (that is, the trust’s tax law income) was changed to be calculated on the basis that the trustee was a resident of Australia, so as to capture it’s worldwide income;

d. a resident trust estate was defined to mean one where at any time during the year of income, a trustee was either a resident of Australia, or the central management or control of the trust was in Australia;

e. the trustee was brought to tax on the income of the trust estate to which no beneficiary was presently entitled (whether that income was from Australian or foreign sources);

f. s 99B was introduced to capture “*an amount paid to an Australian beneficiary out of income from foreign sources that has been accumulated in a non-resident trust estate (and would not have been taxed while the income accumulated)*”.[8]

In addition, there were changes to the provisions relating to the taxation of non-resident trustees on income from sources in Australia (some substantive, but some which were intended to make the existing law clearer).

3.1 Context and purpose of s 99B(1)

On the face of it, s 99B is relatively straightfoward. However, in complex fact patterns, questions may arise as to the meaning of certain terms used in that provision. Section 99B was inserted in a very different tax landscape. For example, s 99B was introduced in a period where capital was not subject to tax. Its age means there are textual uncertainties and a consideration of both context and purpose are important in understanding the operation of s 99B. Indeed, as Hill J stated in *Re Traknew Holdings Pty Ltd v Commissioner of Taxation*[9] (**Traknew Holdings**), the historical context is critical to understanding the purpose of s 99B(1) and how it operates.

[8] Explanatory Memorandum to the *Income Tax Assessment Amendment Bill (No.5) 1978*, 4.
[9] [1991] 21 ATR 1478, 1492 (*Traknew Holdings*).

As a result of the amendments to Division 6 made by the 1978 Bill, the provisions now operate to apply to trustees and beneficiaries in relation to the net income of the trust estate.[10] That is, Div 6:[11]

a. assesses beneficiaries on a share of the net income of the trust estate based on their present entitlements to a share of the income of the trust estate; and

b. assesses the trustee directly on any share of the net income to the extent there is a portion of income to which no beneficiary is presently entitled; and

c. as a collection mechanism, assesses the trustee in respect of some beneficiaries, such as non-residents or those under a legal disability.

Properly understood, Div 6 was not intended to, and does not apply to persons other than beneficiaries or trustees.

The detailed statutory scheme and the legislative history of s 99B(1) is outlined in the EM, its associated second reading speech made by Mr Howard (the then Federal Treasurer) (the **Second Reading Speech**) and the report by the Taxation Review Committee dated 31 January 1975 (the **Asprey Committee Report**) (together, the **Extrinsic Materials**). These Extrinsic Materials summarise the historical context of s 99B.

The EM states [emphasis added]:

> Proposed section 99B will require the inclusion in a beneficiary's assessable income of amounts paid to or applied during a year for **the benefit of a resident beneficiary** where that **amount represents trust income** of a class which is taxable in Australia but which has not previously been subject to Australian tax in the hands of either that beneficiary or the trustee. It will normally apply where **accumulated foreign-source income** of a non-resident trust estate (or of a resident trust estate that previously was not able to be taxed in Australia in light of the Union Fidelity decision) **is distributed to a resident beneficiary**.
>
> **Sub-section (1) of proposed section 99B**, which is subject to the important qualifications expressed in section (2), **sets out the basic general rule that where** during a year of income **a beneficiary** who was a resident at any time during the year is **paid a distribution from a trust estate or has an amount of trust property applied for his benefit**, that amount is to be included in the assessable income of the beneficiary.

By way of further explanation regarding the purpose for the enactment of s 99B, Mr Howard in the Second Reading Speech states [emphasis added]:

> The second group of measures contained in the Bill is designed to limit opportunities to avoid tax on income from an **ex-Australian source** that is derived through a trust or a partnership. These measures were foreshadowed in my statement on 8 June 1978, and as indicated then, will apply for the 1978-79 income year. **The need for these amendments arose out of a High Court decision to the effect that the trust provisions of the income tax do not apply to income of a trust that is derived from a foreign source.** The **Asprey Committee described this result as 'unacceptable'** because it means that Australian residents can defer-or even escape completely tax on foreign source income that is accumulated for their benefit.
>
> The basic thrust of the proposed provisions is to ensure that both Australian and foreign source **trust income to which an Australian resident beneficiary is presently entitled** in the year of

[10] Refer to ITAA 1936 s 95AAA.
[11] Ibid.

> **income will be taxed under the trust provisions** to the beneficiary or, if the beneficiary is under a legal disability, such as infancy, to the trustee.
>
> **Provisions are also included to ensure that a resident beneficiary is taxed on <u>foreign source income</u> that had first been accumulated but was later paid or applied for the beneficiary's benefit.** These provisions will apply if the income was not taxed in Australia while accumulating in a trust estate that is not a resident trust estate and would have been taxable to a resident beneficiary had he or she been presently entitled to it when it was derived by the trustee. The provisions include rules designed to prevent a beneficiary escaping tax on a technicality that an amount or benefit is not received as income.

Relevantly, the Asprey Committee Report,[12] which is mentioned in the Second Reading Speech, discussed the need for a provision such as s 99B following the Union Fidelity decision.[13] In that report, it was said [emphasis added]:[14]

> The provisions of Division 6 are not in their terms founded on any basis of jurisdiction. **There is judicial opinion that those provisions of Division 6 depending on the notion of net income of a trust estate apply only to income having an Australian source.**
>
> A number of consequences follow:
>
> (a) Even though the trustee is an Australian resident, foreign-source income to which a non-resident is entitled through a trust is not subject to Australian tax.
>
> (b) Even though the trustee is an Australian resident, foreign-source income accumulating in a trust is not subject to Australian tax.
>
> (c) Foreign-source income to which an Australian resident is entitled through a trust may be subject to Australian tax in his hands but only when he receives that income: entitlement to receive is not a derivation.
>
> (d) Even though foreign-source income has been paid to an Australian resident, it is arguable that it is still not taxable in his hands if it has previously been accumulated by the trust or retained for him because he was under a disability. The argument would be that he has received, not income, but an amount paid to him in satisfaction of his interest in the trust.
>
> (e) When instead of paying it to him, the trustee has applied foreign-source income for the benefit of a beneficiary, the application may not give rise to a receipt within the meaning in (c) so as to constitute a derivation of income by the beneficiary.
>
> **All except the first of these consequences involve some escape from or deferral of Australian tax, which the Committee considers unacceptable.** Australia should assert a wider jurisdiction to tax income moving through a trust intermediary and Division 6 should be adapted to apply to any such income in relation to which jurisdiction is asserted. The following proposals are made:
>
> (a) Where an Australian resident beneficiary is presently entitled to foreign-source income derived by a trust estate, that income should be subject to tax in his hands, in the same manner as Australian-source income is taxed under the present Division 6.

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[12] Asprey K.W., Parsons, Ross Waite, Australian Commonwealth Taxation Review Committee (Full Report, 31 January 1975).
[13] *Re Traknew Holdings Pty Ltd v Commissioner of Taxation* [1991] FCA 129 at [60].
[14] At [15.54] to [15.62].

Present entitlement for this purpose will include deemed entitlement arising from a payment or application for the benefit of the beneficiary.

(b) Where an Australian resident beneficiary receives a distribution from income of a trust estate that has been accumulated, and the income has not been subject to Australian tax in the hands of the trustee, it should be taxed in the hands of the beneficiary.

(c) Where income is accumulating, and the trustee is an Australian resident, or for other reasons the trust is to be regarded as an Australian trust, the income should be subject to Australian tax in the hands of the trustee. If subsequently such income is distributed to a non-resident beneficiary, there ought to be an appropriate refund of Australian tax. If, on the other hand, it is distributed to an Australian resident there will be no further tax on the income in the hands of the beneficiary.

The implementing of these proposals will require extensions to the scheme in Division 6. Net income of the trust estate should include foreign-source income. An Australian resident beneficiary presently entitled, or deemed to be presently entitled, to that income would be taxed in the same manner as any beneficiary is now subject to tax in respect of Australian-source income. A non-resident beneficiary would of course be exempt in respect of foreign-source income. **Accumulating foreign-source income would be subject to Australian tax in the hands of the trustee where the trust is an Australian one. A distribution from accumulated foreign source income that has not been previously subject to Australian tax would be taxed to an Australian resident beneficiary receiving it.** A distribution to a non-resident from accumulated foreign-source income of an Australian trust would not be subject to Australian tax in the hands of the beneficiary and there would be a refund of Australian tax imposed on that income.

It will be necessary, to a greater extent than at present, to distinguish in the trustee's accounts between Australian-source and foreign source income. There will be a question whether the character of a beneficiary's entitlement, or the character of a distribution made to him, is to be determined by the law or by an appropriation by the trustee. If the trustee's action governs, he may be able to limit Australian tax by the appropriation of foreign-source income to a non-resident beneficiary. Alternatively, the law could provide a formula by which any income, for purposes of the tax liability of a beneficiary, will include Australian-source and foreign-source elements in proportions reflecting the amounts of these elements held in the trustee's accounts.

The Extrinsic Materials referred to above establish that s 99B is designed to extend the existing scheme in Div 6 to capture foreign source income of trusts only insofar as such income is distributed to an Australian beneficiary in that capacity. These Extrinsic Materials make it abundantly clear that the purpose of s 99B is not to modify the way in which the existing trust provisions in Div 6 operate other than to capture a beneficiary's receipt of trust income that is foreign sourced (as it would not otherwise have been caught). In the same way that the primary taxing provisions in Div 6 direct attention to 'trust estates'[15] (which essentially involves a relationship between a trustee, a beneficiary, and trust property, and an obligation conferred on the trustee to deal with the property in a certain manner for the benefit of the beneficiary[16]), so does s 99B.

[15] See *FCT v Commercial Nominees of Australia Ltd* (1999) 167 ALR 147 at [11] and *Bamford v COT* (2009) 176 FCR 250 at [2].
[16] See JD Heydon and M J Leeming Jacob's Law of Trusts (7th edition, 2006), LexisNexis Butterworths, Sydney, pp 3-5.

3.2 Guidance on s 99B

Despite being enacted nearly 45 years ago, there has been little judicial consideration of s 99B.

In summary, court and tribunal consideration of s 99B has been limited to:

a. *Traknew Holdings* in which Hill J stated, in obiter, that s 99B can only be understood in its historical context, including by reference to the comments made by the Asprey Committee. He also suggested that in some cases, the extreme width of s 99B might require it to be read down (discussed further at section 6.1).

b. *Howard v COT*[17] (**Howard's Case**) in which the Full Federal Court re-afirmed Hill J's view that s 99B was introduced as a "catch-all" provision, with residual effect after the primary operation of s 97 of the ITAA 1936. That is, where Australian resident beneficiaries are taxed on a present entitlement basis, s 99B has no residual operation. Howard's case considered the application of s 99B(2)(a) (discussed further below at section 6.1.1).

c. *Campbell v Commissioner of Taxation* (**Campbell**) in which the Tribunal held that the taxpayer failed to discharge its onus of proof in establishing that s 99B(2)(a) applied (discussed further below at section 8).[18]

The Commissioner has also provided his views on the provision in various forms, such as private rulings, ATO IDs, Tax Determinations and Taxpayer Alerts. In summary, the ATO's interpretive decisions and guidance are as follows:

a. ATO ID 2004/691 - Assessability of lump sum payment received by resident beneficiary of a non-resident trust from foreign life assurance policy held by the trust (see section 6.2);

b. ATO ID 2011/93 – Application of section 99B of the Income Tax Assessment Act 1936 when accumulated foreign source income is paid to an Australian resident beneficiary who was a non-resident when the trustee derived the income (see section 4.3);

c. ATO ID 2010/211 - Is an amount taken to be 'included in the assessable income of any taxpayer' under section 102AAZD of the ITAA 1936 even though the taxpayer has not included the amount in their income tax return? (see section 6.4);

d. ATO ID 2004/66 – Assessability of payment of accumulated foreign-source income of a non resident trust to a resident taxpayer (see section 6.1);

e. TD 2017/23 - Income tax: does the residency assumption in subsection 95(1) of the Income Tax Assessment Act 1936 (ITAA 1936) apply for the purpose of section 855-10 of the Income Tax Assessment Act 1997 (ITAA 1997), which disregards certain capital gains of a trust which is a foreign trust for CGT purposes? (see section 6.1.2); and

f. TD 2017/24 - Income tax: where an amount included in a beneficiary's assessable income under subsection 99B(1) of the Income Tax Assessment Act 1936 (ITAA 1936) had its origins in a capital gain from non-taxable Australian property (**non-TAP**) of a foreign trust, can the beneficiary offset capital losses or a carry-forward net capital loss ('capital loss offset') or access the CGT discount in relation to the amount? (see section 6.1.2).

[17] *Howard v FCT* [2012] FCAFC 149.
[18] [2019] AATA 2043.

We delve deeper into these decisions and the ATO guidance material in the pages that follow.

In addition to the ATO guidance listed above, the Commissioner also released TA 2021/2 - Disguising undeclared foreign income as gifts or loans from related overseas entities. While that Taxpayer Alert does not provide any relevant examples directly on s 99B (none of the examples refer to trusts), the Commissioner does say:

> 22. We are concerned that Australian-resident taxpayers are entering into these arrangements to attempt to avoid or evade Australian tax on their foreign assessable income
>
> …
>
> 24. More specifically, we are concerned that:
>
> ….
>
> • taxpayers have not declared all their statutory income, such as amounts assessable … under section 99B …

Further, in discussing genuine gifts and loans, the Commissioner states:

> While outside the scope of this Alert, care should still be taken in relation to genuine gifts or loans received in these circumstances as there may be Australian tax consequences – for example, section 99B may apply if the amounts are paid by or through trusts.

4. Section 99B(1) – the assessing provision

Section 99B(1) provides [emphasis added]:

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

Accordingly, in order for s 99B(1) to apply there must be:

a. a trust; and

b. an amount being property of a trust estate;

c. paid to or applied for the benefit of;

d. a beneficiary of the trust estate who was a resident at any time during the year of income in which the amount was paid.

"*Trust estate*", "*an amount*", "*property*" and "*property of a trust estate*" are not defined in s 99B.

4.1 Trust estate

The first thing to consider is that there must be a "*trust estate*".

In Aussiegolfa Pty Ltd,[19] Steward J reminded us what the word trust means at law:

> The term 'trust' refers to the legal relationship created – inter vivos or on death – by a person, the settlor, when assets have been placed under the control of the trustee for the benefit of a beneficiary or for a specified purpose.

Elsewhere he said, "*a trust is not an entity… it is a relationship governing the basis upon which property is held.*"[20] Another way of putting it, is as follows:[21]

> A trust is an equitable obligation, binding a person (who is called a trustee) to deal with property over which he has control (which is called trust property), for the benefit of persons (who are called the beneficiaries or cestuis que trust) of whom he may himself be one, and any of whom may enforce the obligation.

Accordingly, there are four essential elements of a trust relationship:[22]

a. a trustee must hold a legal or equitable interest in the trust property;

b. the trust property must be property capable of being held on trust;

[19] [2018] FCAFC 122, [189].
[20] [2018] FCAFC 122, [188].
[21] *Law of Trusts and Trustees*, 12th ed, p 3, which was cited with approval by Cohen J in *Re Marshall's Will Trusts* (1945) Ch 217, at p 219, and by Romer LJ in *Green v Russell* (1959) 2 QB 226, at p 241. For some judicial attempts at definition, see *Wilson v Lord Bury* (1880) 5 QBD 518, per Brett LJ at pp 630 — 631; *Sturt v Mellish* (1743) 2 ER 765 per Lord Hardwicke; and *Re Scott* (1948) SASR 193, per Mayo J at p 196.
[22] *Harmer v FCT* 89 ATC 5180.

c. there must be one or more beneficiaries other than the trustee;

d. the trustee has a personal obligation to deal with the trust property for the benefit of the beneficiaries, and that obligation is also annexed to the property.

This paper does not focus on the different types of trusts we may encounter in practice, and proceeds on the presumption that this gateway element is satisfied. However, something should be said, albeit briefly, about certain entities found in civil law countries, which do not perfectly fit our model of a trust.

Whether Stiftungs, Foundations and other foreign trust-like structures are a trust for Australian tax law purposes will depend on a full analysis of the rights, powers and relationship set out in the relevant constituent documents.

Australian courts have often grappled with whether Stiftungs, Foundations and other trust-like structures from civil law countries are in fact a trust because those jurisdictions:[23]

> struggle to come to grips with the concept that there can be separate legal and equitable interests in property. They have been brought up in a system divided conceptually into the law of persons, the law of obligations, the law of property and actions - their Roman law inheritance.

Because s 99B(1) is directed primarily, or some would argue solely, at foreign trusts, it is important that one considers whether the vehicle, from which the distribution is being made, is able to be categorised as a trust under our general law. If it cannot be, s 99B simply won't apply.

Whether it is a civil law country or a common law country, consideration must also be given to the nature of other types of entities and whether they themselves qualify as trusts, for example, foreign superannuation (or pension) funds, deceased estates, life insurance funds and so on.

4.2 An amount being property of a trust estate

The phrase "*an amount*" is clarified in the body of s 99B(1) as being, not just any amount, but an amount which is "*property of the trust estate*". However, neither s 99B(1) nor any other provision in the *Income Tax Assessment Acts* define or provide any guidance as to when "*an amount*" can be properly characterised as "property of the trust estate".

In *Kennon v Spry*,[24] Gummow and Hayne JJ stated:

> The term "property" is not a term of art with one specific and precise meaning. It is always necessary to pay close attention to any statutory context in which the term is used. In particular it is, of course, necessary to have regard to the subject-matter, scope and purpose of the relevant statute.

In considering the subject matter, Lockhart J stated in *The Commissioner of Taxation v Walsh* (emphasis added):[25]

> The term "trust estate" is not defined in the [1936] Assessment Act. It is generally taken to mean the **estate which is vested in a trustee, that is the trust property**. In my view this is the meaning of the term in Divisions 5 and 6.

[23] Leeming, "Translating Overseas Trusts into the Australian Legal System" (2014) 88 *ALJ* 169.
[24] (2008) 238 CLR 366 at [89].
[25] [1983] FCA 140, [13]

Accordingly, the phrase "*property of a trust estate*" can only be understood by understanding the nature of a trust.

As set out in the proceeding section about "*trusts*", something will only be "*trust property*" (or "*property of a trust estate*" to use the language of s 99B) if that property:

a. is held by the trustee; and

b. the trustee has a personal obligation in relation to that property.

In that context, property held by a trustee can include a possible interest in real and personal property, choses in action or possession, money, and the right to receive payment.

However, the relevant inquiry must be to "*an amount, being property of a trust estate*". At the very least, the reference to "*an amount*" suggests that the property paid to a beneficiary must, at least, be quantifiable. There remains an open question about whether "*an amount*" can be interpreted to include a non-cash benefit. Certainly, the intent of the provisions was to capture accumulated income of the trust estate, which may suggest that provision is only intended to capture cash benefits paid to, or applied for the benefit of, a beneficiary. However, clearly the terms "property" and "money" carry their own precise meaning, and so any suggestion that an amount be interpreted as being restricted to cash, is tenuous at best. This seems to be reinforced by s 99C(2)(c) which specifically refers to "property or money".

Assuming then that "*an amount*" includes non-cash benefits, would the provision only apply in respect of an in-specie distribution of assets? Or could it include the use of trust property? There is certainly nothing in s 99B which equates to the language of s 109CA which deems a payment to have occurred where there is use of company property for the purposes of Division 7A (although perhaps an argument might be made that an application of trust property includes the use of that property). And if "an amount" includes non-cash benefits, what value is given to the property? Section 99B contains no prescribed rules, but one would assume the ordinary market value rules would apply.

A further question also arises as to when something ceases to be "*property of a trust estate*" for the purposes of s 99B. In our view, a plain, unequivocal, reading of s 99B requires that at the time the relevant amount is paid to, or applied for the benefit of, a beneficiary, the amount must be property of the trust estate. If the trustee does not hold a legal or equitable interest in the property, and does not have personal obligations to deal with the property for the benefit of the beneficiary, at the time so paid or applied, the amount cannot be said to be property of a trust estate for the purpose of s 99B.

4.3 Paid to or applied for the benefit of

There are two situations anticipated by s 99B. They are where:

a. an amount of trust property is paid to a beneficiary; and

b. an amount of trust property is applied for the benefit of a beneficiary.

In the first situation anticipated by s 99B, an amount meeting the description of "*property of a trust estate*" would be paid to a beneficiary. That is, the relevant amount would be provided directly to the beneficiary.

For example, assume that a trust has derived $100 of foreign sourced interest income which has been accumulated by the trustee and now forms part of the accumulated income (also referred to as capital) of the trust estate. To the extent that the trustee makes a distribution to an Australian resident beneficiary that is attributable to that $100 accumulated foreign-sourced interest income, then, subject to the exceptions in s 99B(2), s 99B(1) operates to include that entire amount in the beneficiary's assessable income.

But what about an amount paid by the trustee at the direction of someone else. For example, assume beneficiary A, a resident beneficiary, is made presently entitled to Australian source income[26] from a non-resident trust estate. That beneficiary of course would be taxed in accordance with s 97. But what if beneficiary A said to the trustee, "*please don't pay me, I want you to transfer the money I have been made presently entitled to, to beneficiary B*" (perhaps beneficiary A owes beneficiary B money, or perhaps beneficiary A wants to gift an amount to beneficiary B). Is the payment made by the trustee to beneficiary B captured by s 99B(1)? In our view no. Section 99B(1) only applies where "an amount, being property of the trust estate" is paid to a beneficiary of the trust estate. On the facts, the amount being paid to beneficiary B is not trust property (it ceased to be trust property when beneficiary A was made presently entitled to the income), and it is not being paid to beneficiary B in their capacity as a beneficiary. It is merely being paid to beneficiary B at the direction of beneficiary A.

Section 99B(1) also anticipates a second situation, being one where the property itself is not paid to the beneficiary, but that amount is nonetheless dealt with in such a way that the benefits associated with the relevant trust property accrue to a beneficiary. This situation is informed by the phrase "*applied for the benefit of*" in s 99B(1). Advisors of trusts will be familiar with the concept of "*applied*", as, after all, most trust deeds provide the trustee to "*pay, apply and set aside*" trust income.

However, the phrase "*applied for the benefit of*" is not specifically defined for the purposes of s 99B(1) or for any other purpose of the *Income Tax Assessment Acts*. The phrase "*applied for the benefit of*" in s 99B(1) must therefore be construed in its context, and requires that its meaning be informed by the express language of s 99C, introduced to complement s 99B, and the legislative history of both provisions. Section 99C and "*applied for the benefit of*" is discussed further in Section 5.

4.4 A beneficiary who was a resident at any time during the year

Section 99B will operate where the beneficiary was a resident at any time during the year of income. Depending on the character of the beneficiary entity, this will require reference to the relevant tests of residence. There may also be the possibility that the beneficiary is a dual resident and a double tax agreement (**DTA**) could allocate sole residence to another state. The payment may then be treated as "*other income*" taxable only in the other contracting state by the relevant article in the DTA.

In determining whether you are dealing with a beneficiary, careful consideration must be given to the terms of the trust deed and any amendments made to the deed. Where you have a named beneficiary who is made presently entitled to income of the trust estate, this requirement will be obvious. However, complex fact patterns can raise questions as to the meaning of "*to a beneficiary of the trust estate*". For example, is the phrase "*to a beneficiary*" a reference to an entity receiving an amount from the trust estate in their capacity as such? Or is the mere fact that the entity is a beneficiary sufficient to enliven s 99B(1)? What is the status of a "*beneficiary*" under a discretionary trust if the word is used to refer to the object of a mere power of appointment who is not also a taker in default of appointment?[27]

[26] Yes, we mean Australian sourced and not foreign sourced income.

[27] Although see *Kafataris v The Deputy Commissioner of Taxation* [2008] FCA 1454 and *Yazbek v Commissioner of Taxation* [2013] FCA 39.

If the beneficiary is an individual and qualifies as a temporary resident, his or her statutory income will be non-assessable non-exempt income if it is from a foreign source (subject to a few exceptions). Accordingly, s 99B(1) amounts, being statutory income,[28] will not be assessable to a temporary resident if such a distribution is from foreign sources. In addition to there being private rulings confirming this view,[29] in response to the Commissioner being asked about the application of s 99B to temporary residents in the drafting of TD 2017/24, the Commissioner stated:[30]

> Section 99B will not apply to assess a beneficiary who was a temporary resident (or a non-resident) for the whole of the relevant income year on an amount that is not attributable to an Australian source.

However, where a beneficiary is changing residence into or out of Australia during the course of an income year, it will be important to ensure that no payment or application from the trust estate is made during the year of change. This is because the section operates on a payment to a beneficiary during a year of income that the beneficiary is a resident *at any time*.

As the Commissioner makes clear in ATO ID 2011/93, s 99B does not provide any mechanism for apportionment of income derived by the trust estate in relation to a period where the relevant beneficiary was a non-resident, if the payment is made in the year in which they are a resident.[31] The Commissioner states:

> The trust property paid to the resident beneficiary is attributable to foreign source interest derived by the trust. As interest income would have been assessable had it been derived by a resident taxpayer, and as the interest income has not been included in the assessable income of the beneficiary under section 97 of the ITAA 1936 or been assessed to either the trustee of the trust or the trustee of another trust under Division 6 of Part III of the ITAA 1936, none of the exclusions in subsection 99B(2) of the ITAA 1936 applies to reduce the amount included in the assessable income of the beneficiary.
>
> A question arises however whether the non-resident status of the beneficiary for the period in which the interest was derived by the trust estate in any way alters the outcome under the provision.
>
> It is clear from the language of section 99B of the ITAA 1936, and by inference from subsection 102AAM(5) of the ITAA 1936, that there is no apportionment of the amount included in assessable income by reference to the residency status of the beneficiary as at the time the income was derived by the trust. Rather, the only explicit condition concerning residency is that the beneficiary be a resident at some time during the year of income in which the trust property is paid to them or applied for their benefit.
>
> Since the beneficiary satisfies the residency requirement during the relevant year of income and as none of the exclusions in subsection 99B(2) of the ITAA 1936 applies, the entire amount of the payment is included in the beneficiary’s assessable income under subsection 99B(1) of the ITAA 1936.

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[28] ITAA 1997, s 10-5.
[29] See also Private Ruling 1051910296871.
[30] ATO, Public advice and guidance compendium - TD 2017/24, p 8.
[31] See also EPA 1051974789666.

4.5 Residence of the trust estate

Section 99B is, overtly, silent in relation to the residence of the trust estate. In Traknew Holdings, the Federal Court considered the operation of s 260 to a trust stripping arrangement involving resident trust estates. At first instance, the Tribunal held that the arrangement entered into was void under s 260, and as a result, but without providing any reasons, assessable under s 99B(1) or s 25(1).

On appeal, the Federal Court agreed that s 260 applied to strike down the scheme, but held that once so struck down, s 101 applied to deem the beneficiary to be presently entitled to an amount, which brought into operation s 97. Accordingly, it was not necessary for the Federal Court to consider the operation of s 99B. However, Justice Hill did make a number of comments in obiter about the operation of s 99B. Specifically, Hill J stated:

> The application of s. 99B also presents difficulty. Literally, the section is capable of applying in the circumstances of the present case. However, the section was not enacted to render assessable payments or applications to the benefit of discretionary beneficiaries. Such payments or applications were already made assessable income by force of s. 97 alone or in combination with s. 101, leaving aside a case where s. 98 applies but the presently entitled beneficiary is under a legal disability where the trustee is assessable.
>
> The provisions of s. 99B can only be understood in their historical context. The need for some such provision was discussed by the Taxation Review Committee (the Asprey Committee) in its report of 31 January 1975. The problem exposed by cases such as Union Fidelity Trustee Co. of Australia Ltd v FC of T 69 ATC 4084; 119 CLR 177 was that ss. 99 and 99A had no application where accumulated income was derived from a source outside Australia. If the trust income was accumulated and became capital, its subsequent receipt by a beneficiary was neither assessable income under ss. 25 or 26(b). Section 99B together with s 99C and 99D were introduced into the Act by the Income Tax Assessment Act (No 5) 1978. As the Explanatory Memorandum circulated with that Act discloses to deal:
>
>> "... primarily with the receipt by resident beneficiaries of distributions from non resident trust estates of previously untaxed foreign sourced income."
>
> The Explanatory Memorandum makes the following relevant comments on s. 99B:
>
>> "The proposed section 99B will require the inclusion in a beneficiary's assessable income of amounts paid to or applied during a year of income for the benefit of a resident beneficiary where that amount represents trust income of a class which is taxable in Australia but which has not previously been subject to Australian tax in the hands of either the beneficiary or the trustee. It will normally apply where accumulated foreign sourced income of a non resident (or of a resident trust estate that previously was not able to be taxed in Australia in the light of the Union Fidelity decision) is distributed to a resident beneficiary."
>
> It is not necessary to decide for the purposes of the present case whether the extreme width of s. 99B and associated sections require it to be read down having regard to the obvious legislative purpose in enacting it.

While s 99B(1) itself does not expressly confine its application to a non-resident trust estate, there may be a basis for s 99B being read down to only apply to non-resident trust estates, and the type of resident trust estates specifically referred to in the EM (namely those resident trusts which had, in accordance with the principles in Union Fidelity, accumulated foreign source income). As we will see in section 6, s 99B(2)(a) and (b) pose a question of whether amounts would have been taxable if the amounts were derived by a hypothetical resident taxpayer. Those provisions, and the third conditional question they pose, arguably, make no sense if the relevant amount was, in fact, derived by a resident trust estate. And s 102AAM, which can only apply if s 99B applies, specifically references non-resident trust estates, both within the provision itself and also in the heading which states "*payment of interest by taxpayer on distributions from certain non-resident trust estates*". Notwithstanding that over 30 years has passed since the decision of Traknew Holdings, whether s 99B should be construed as only applying to the trusts referred to in the EM has not been considered by another Court.

At various times, the Commissioner has, it seems at least in footnotes, agreed that s 99B ought only to apply to trusts that are or were non-residents. For example, in TR 2018/7, the Commissioner sets out his views on how the taxation laws apply to employee remuneration trust (**ERT**) arrangements that operate outside the employee share scheme rules in Division 83A of the ITAA 1997. At footnote 72, the Commissioner states:

> While subsection 99B(1) of the ITAA 1936 provides that certain property of a trust estate paid to, or applied for the benefit of, a resident beneficiary, is assessable to the beneficiary, it does not apply unless the ERT is or was a non-resident trust estate. Accordingly, neither it, nor the exception to it in subparagraph 99B(2)(c)(ii) of the ITAA 1936 (concerning amounts previously assessed to the trustee), generally applies to the ERT arrangements described in this Ruling.

In TD 2017/26, the Commissioner considers "*when a dividend equivalent payment is assessable to an employee as remuneration*" when paid to an Australian resident participant of an employee share scheme and a beneficiary of a trust. At footnote 14, the Commissioner states (in almost identical words to the footnote in TR 2018/7):

> While subsection 99B(1) of the ITAA 1936 provides that certain property of a trust estate paid to, or applied for the benefit of, a resident beneficiary, is assessable to the beneficiary, it does not apply unless the trust is or was a non-resident trust estate. Accordingly, neither it, nor the exception to it in subparagraph 99B(2)(c)(ii) of the ITAA 1936 (concerning amounts previously assessed to the trustee), generally applies to the trust described in this Determination. See also Hill J's comments in *Traknew Holdings Pty Ltd v. FC of T 91* ATC 4272 at 4284; (1991) 21 ATR 1478 at 1492.

But could the Commissioner resile from that position? As stated by our Senior Partner, Mark Leibler AC:[32]

> The Commissioner could, if so inclined, change his mind tomorrow and, subject to the time limits imposed by s 170 of the 1936 Act, commence issuing amended assessments on the basis of a literal reading of s 99B. This would be a major reversal and many taxpayers could find themselves adversely impacted by the Commissioner's change of position.
>
> Those taxpayers might have otherwise been fully compliant and quite legitimately adopted an interpretation which not only appears to be consistent with the law, but is also consistent with the Commissioner's position over many years. Even so, they would have no protection if the Commissioner suddenly shifted his approach and their only recourse would be long and expensive litigation under pt IVC.

[32] Mark Leibler AC, "Tax and the Rule of Law", Melbourne University Law Review Vol 46(2) 548, 551 (advance).

4.6 Section 99B(1) and foreign income tax offsets (FITO)

The rules governing FITOs are set out in Division 770. The general rule to qualify for a FITO for a year of income is that the taxpayer must have paid foreign income tax on an amount that is included in its assessable income for that year.[33]

So assuming s 99B(1) applies, can the beneficiary get a FITO for tax paid in another country by that beneficiary?

The Commissioner has considered the application of FITOs for tax paid by the beneficiary in EPR 1051944051591, EPR 1051974789666 and EPR 1052066313919.

In EPR 1051944051591, the Commissioner considered the application of s 99B to amounts paid by US foreign superannuation funds. The Commissioner held that s 99B(1) would apply to withdrawals from the funds, except to the extent it was reduced by s 99B(2)(a). The Commissioner held that employer and employee contributions to the funds were considered corpus, and s 99B(2)(a) applied. In relation to prior withdrawals, the facts stated that the taxpayer "*incurred an 'early withdrawal penalty' as a 10% additional tax on early distributions*" and "*filed a US Federal Income tax return in the 20XX-XX income year and received a refund for the tax paid on the combined withdrawals*". The taxpayer was considering making further withdrawals from the fund. Relevantly, the questions asked in EPR 1051944051591 are:

> Are you entitled to a FITO for the US taxes paid on the part of the withdrawal corresponding to:
>
> (a) employer contributions to the plan?
>
> (b) employee contributions to the plan?
>
> (c) annual earnings accumulated in your account that are, or were, assessable in Australia in the current or previous tax year?
>
> (d) any other amounts?

In answer to those questions, the Commissioner stated:

> (a) No.
>
> (b) No.
>
> (c) Not applicable, as annual earnings are not assessable when accumulated.
>
> (d) Yes, to the extent the tax is payable in respect of the assessable amount.

His detailed reasons stated:

> Section 770-10 provides that a FITO can be claimed for foreign income tax paid by a taxpayer in respect of an amount that is included in their assessable income.
>
> Foreign income tax is a tax imposed by a law other than an Australian law, on income, profits or gains. The taxpayer must have paid the foreign income tax before an offset is available. A taxpayer is deemed to have paid the foreign income tax if the foreign income tax has been withheld from the income at its source.

[33] ITAA 1997, s 770-10.

> You state that the Internal Revenue Code Section 72(t) describes the ‘early withdrawal penalty’ as a 10% additional tax on early distributions.
>
> If the foreign income tax has been paid on an amount that is part non-assessable non-exempt income and part assessable income for the income year, only a proportionate share of the foreign income tax paid (the share that corresponds to the part that is assessable income) will count towards the tax offset.
>
> Article 22 (paragraph (2)) of the US Convention provides that Australia will allow a credit for US tax (other than US tax imposed solely by reason of citizenship or by an election by an individual under US domestic law to be taxed as a resident of the US) on income derived by a resident of Australia from sources in the US.
>
> In your case, you will be entitled to claim a FITO that corresponds to the foreign tax paid on the proportion of the withdrawals from Fund A and Fund B that are included in your assessable income.

The rulings listed seem to suggest that where the beneficiary pays foreign tax, or can be deemed to have paid the foreign tax, a beneficiary taxed under s 99B(1) is entitled to a FITO.

5. Section 99C – determining whether property is applied for the benefit of a beneficiary

The title of s 99C, *"[d]etermining whether property is applied for the benefit of beneficiary*", illumes that it is a section concerned with the application of the phrase "*applied for the benefit of*" as used in s 99B(1). Section 99C(1) is drafted in broad general terms. The language of s 99C(1) indicates that the enquiry into whether an amount has been "*applied for the benefit of*" a beneficiary is a wide-ranging enquiry into all benefits that have accrued to the beneficiary, seemingly irrespective of their nature or form. However, as we mentioned in section 4, the drafting of s 99B(1) must be kept in one's mind when determining the scope of s 99C.

Section 99C(1) is supplemented by s 99C(2) which sets out five specific situations in which trust property would be considered to have been applied for the benefit of a beneficiary, including situations where the use of, or a dealing with, the trust property, or its mere derivation, results in a direct or indirect benefit to the beneficiary. Subsection 99C(2) is said not to limit the generality of s 99C(1).[34] However, s 99C must be contained by the meaning of s 99B(1). Accordingly, the relevant amount applied for the benefit of a beneficiary must still be an amount of trust property.

Although concerned with specific situations, the drafting of s 99C(2) also employs broad language. For example, various paragraphs use the word "*indirect*". Section 99C also contains no express limitation which would confine its operation to tax avoidance arrangements of the kind referred to by the Treasurer in his Second Reading Speech or where a beneficiary escapes the operation of s 99B as a result of "*artificial means*".[35] Section 99C and, in particular, the paragraphs of s 99C(2), are drafted in such a manner that potentially have a very wide operation. Thus, the section can give rise to considerable difficulty in practice.

A relatively simple application of s 99C was considered by the Commissioner in EPR 1052059680727. In that Ruling, the Commissioner considered the application of s 99B where a foreign trust made a loan to an Australian resident beneficiary on arm's length terms. Section 99C(2)(c) specifically contemplates that an amount will be applied for the benefit of a beneficiary where there is "*a loan or a repayment, in whole or in part, of a loan*". Accordingly, the Commissioner held that, provided the loan was a genuine loan (that is, there was the necessary obligation to repay), the amount loaned was "*captured by s 99C as an amount that was applied for your benefit*". In addition, the Commissioner stated:[36]

> Paragraph 99C(2)(c) does not distinguish between different types of loans, including whether they are made on arm's length terms. All that matters is that it is in fact a loan.
>
> …
>
> Subsection 99C(1) provides that regard shall be had to all benefits that have accrued at any time to the beneficiary. In this regard, the application of section 99B in a particular income year is not affected by:
>
> - the passage of time between benefits being provided
> - the provision of different benefits to the beneficiary

[34] Explanatory Memorandum, Income Tax Assessment Amendment Bill (No 5) 1978, 28.
[35] Ibid.
[36] Private Ruling 1052059680727.

- whether there is a series of transactions resulting in indirect benefits.

However, consider what happens when the loan is repaid and whether s 59-30 of the ITAA 1997 could apply.

While the relevantly straightforward scenario in that EPR is a clear application of s 99B(1) and s 99C, the real questions begin when the factual scenarios become more complicated. For example, whilst s 99B will generally not be applicable in relation to amounts that have already attracted the operation of ss 97, 98, 99 or 99A (although this is discussed in more detail in section 6.3 below), s 99B does not cease to be applicable in relation to a particular amount merely because the amount has already been subjected to tax pursuant to s 99B itself in the hands of a particular beneficiary. The concern here is that, on a plain reading of its terms, s 99B (in conjunction with s 99C) could, arguably, result in multiple beneficiaries being subject to tax in relation to the same amount of trust property. Consider the below fact pattern.

Example A

Assume that a non-resident trust estate derives a net income of $10,000, all of which is attributable to sources out of Australia. The income is derived in respect of the year ended 30 June 2022 and is accumulated. Accordingly, the trustee will not be liable to be assessed under either ss 99 or 99A. Assume that A, B, C, D and E are resident beneficiaries. During the year ended 30 June 2023, the following transactions occur:

a. On 1 August 2022, the trustee lends to A the sum of $10,000 (representing the net income of $10,000 derived during the previous year).

b. On 2 August 2022, A uses the said sum of $10,000 to repay a debt of $10,000 owed to B.

c. On 31 January 2023, A repays the loan of $10,000 to the trustee and the trustee then lends that same sum to C.

d. On 3 March 2023, C repays the loan of $10,000 to the trustee and the trustee forthwith applies that sum of $10,000 by way of deposit on the purchase by the trustee of a home. The trustee permits D to reside in the home rent free as from 1 May 2023.

e. On 1 June 2023, the trustee grants a mortgage over the home to secure a borrowing of $10,000 which sum is provided by way of loan to E.

A literal reading of ss 99B and 99C are such that the Commissioner might be justified in assessing each of A, B, C, D and E to tax on the sum of $10,000 in respect of the year ended on 30 June 2023. Indeed, one cannot rule out the possibility that successive applications by way of loan of the same amount representing the same income derived by the trust to the one beneficiary in successive years of income will be liable to tax in the hands of that beneficiary on each occasion upon which a loan is made.

Sections 99B and 99C also make no attempt to quantify the benefit enjoyed by a particular beneficiary. No matter how slight the benefit conferred upon the beneficiary, the whole amount can be said to be “applied for the benefit” and assessed to tax pursuant to s 99B. A loan of $10,000 for a period of two days to a beneficiary is placed in the same category as a gift or advancement to the beneficiary of the sum of $10,000 with no strings attached.

6. Section 99B(2): Reducing the s 99B(1) amount – finding the mystical stone

In essence, the exceptions to s 99B(2) operate to exclude certain amounts from the assessable income of a beneficiary that would otherwise be included under s 99B(1). The EM offers some guidance as to the intent of s 99B(2), providing that (emphasis added):[37]

> Proposed sub-section (1) **modifies** this general rule [as contained in sub-s 99B(1)] and will have the effect that the amount to be included in assessable income under sub-section (1) is not to include anything that represents either –
>
> - corpus of the trust estate, but an amount will not be taken to represent corpus to the extent that it is attributable to income derived by the trust estate which would have been subject to tax had it been derived by a resident taxpayer (paragraph (a)) or
> - amounts – such as capital gains, or ex-Australian income taxed abroad and exempt from tax under section 23(q) of the Principal Act – that would not be included in assessable income if derived by a resident taxpayer (paragraph (b)); or
> - amounts that have been or will be liable to tax in the hands of the beneficiary under section 97 of the Principal Act or in the hands of the trustee under sections 98,99 or 99A of that Act, whether or not (e.g., because the income is below a minimum amount) the amount has actually borne tax in the hands of the beneficiary or trustee (paragraph (c)).

There remains some uncertainty with respect to the operation of s 99B(2) and some traps that one should be familiar with. While we will work through most of the limbs of s 99B(2) separately, one issue that arises for all paragraphs is that s 99B(2) also omits to provide any guidance as to how one determines whether an amount "*represents*" one of the excluded categories listed in s 99B(2). Unlike some other provisions in the *Income Tax Assessment Acts*, s 99B(2) does not require the relevant amount to be credited or debited, or recorded in any particular way. The provision simply states that the amount included by s 99B(1) "*shall be reduced by so much (if any) of the amount, as represents*" one of the six categories. What is clear, however, is that it must be an amount which is trust property.

So how is one required to determine whether an amount represents one of the excluded categories? Can the trustee make arbitrary appropriations, or is one to be confined to a strict process of tracing? Must a trustee make a determination at the time the amount is distributed as to what it represents? Is it necessary to have accounts kept for each specific fund or profit similar to the Archer Brother's principle for liquidator's distributions?[38]

The Asprey Committee Report did raise this as a potential problem:[39]

> It will be necessary, to a greater extent than at present, to distinguish in the trustee's accounts between Australian-source and foreign-source income. There will be a question whether the character of a beneficiary's entitlement, or the character of a distribution made to him, is to be determined by the law or by an appropriation by the trustee. If the trustee's action governs, he may be able to limit Australian tax by the appropriation of foreign-source income to a non-resident beneficiary. Alternatively, the law could provide a formula by which any income, for

[37] Explanatory Memorandum, Income Tax Assessment Amendment Bill (No 5) 1978, 28.
[38] TD 95/10.
[39] Asprey Committee Report, [15.61].

> purposes of the tax liability of a beneficiary, will include Australian-source and foreign-source elements in proportions reflecting the amounts of these elements held in the trustee's accounts.

Notwithstanding that warning, when s 99B(1) was inserted there was no formula to govern the process and no guidance or commentary has since been provided which would give advisors (and trustees) any guidance on this.

Example B – tracing and the corpus exception

In the context of the corpus exclusion (see s 99B(2)(a)), let us assume the following.

A trust is settled with $1 million and the accounts record:

Asset	**Liability**
Cash $1,000,000	
	Equity
	Settled capital $1,000,000

The trustee of the trust acquires shares in Bank of Nova Scotia for $1,000,000 which pays an annual dividend of $43,000 (at a yield of 4.3%).The trustee of the trust accumulates this income.

The accounts of the trust now record:

Asset	**Liability**
Cash $43,000	
Shares $1,000,000	**Equity**
	Settled capital $1,000,000
	Accumulated income $43,000

The trustee resolves to make a capital distribution of $43,000 to beneficiary A (an Australian resident) and appropriates this distribution out of the settled capital. Will the capital distribution of $43,000 fall within the exception in s 99B(2)(a)?

6.1 Corpus – s 99B(2)(a)

Section 99B(2)(a) provides that s 99B(1) will not apply to an amount that is:

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

The *Income Tax Assessment Acts* do not provide a definition of "*corpus of the trust estate*". The general meaning of corpus of a trust estate is the corpus, capital or principal of that trust estate, being something, which is not income of the trust estate, as determined according to trust law.[40] Trust

[40] *Encyclopaedic Australian Legal Dictionary.*

income only becomes part of the corpus of the trust or part of the trust fund if and to the extent that it is accumulated.[41]

The Commissioner has taken the view in some private rulings that the term "corpus" is something which is opposed to income and in doing so quotes the following dictionary definition:[42]

> The Macquarie Dictionary (Online edition 2019) defines 'corpus' to mean a 'principal or capital sum, as opposed to interest or income'.

In the context of s 99B(1) specifically, the AAT in Campbell suggests that the term "corpus" is synonymous with the principal of the trust estate.[43] Most trust deeds enable the trustee to retain and capitalise income. Accordingly, accumulated income will often form part of the "corpus of the trust estate".

However, even if an amount is "*corpus of a trust estate*", there is an excision from s 99B(2)(a), being "*except to the extent to which it is attributable to amounts derived by the trust estate that, if they had been derived by a taxpayer being a resident, would have been included in the assessable income of that taxpayer of a year of income*". In other words, to the extent that the relevant corpus amount would have been taxable to a hypothetical resident taxpayer, s 99B(2)(a) will not apply.

Following on from our discussion about accumulated income in the preceding paragraph, accumulated interest income which has been capitalised by a trust would be assessable to a hypothetical resident taxpayer in the year in which that income is derived. In ATO ID 2004/66, the Commissioner considered the question of whether a resident taxpayer is assessable on the payment of accumulated foreign source income of a non-resident trust estate under s 99B(1). The Commissioner held that it was. However, the facts set out in ATO ID 2004/66 are curious. They are stated as being:

> The taxpayer was a resident of Australia during the year of income.
>
> The taxpayer was presently entitled to a share of the foreign-source income of the non-resident trust prior to becoming a resident of Australia.
>
> This income was accumulated in the trust and the taxpayer was subsequently paid several amounts from this accumulation after the taxpayer became a resident of Australia.
>
> These amounts had not previously been subject to tax in Australia.
>
> These amounts are amounts that would be included in assessable income of a resident taxpayer if they were derived by that resident taxpayer.

It is not clear how a trust can accumulate a present entitlement. It may be able to retain the amount of the present entitlement in the trust, or on a sub-trust, until such time as the beneficiary calls on the entitlement. However, it cannot both accumulate, and make a beneficiary presently entitled to, the same amount.

It appears to us that it would be arguable that such an amount when ultimately paid to the beneficiary should not be taxed under s 99B(1) because:

a. s 99B(1) doesn't apply because the amount paid to the beneficiary is no longer trust property; or

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[41] see *Garside v IRC* [1968] AC 553 at 614.
[42] EPR 1051974789666; see also EPA 1052000770694.
[43] *Campbell*, [31].

b. the s 99B(1) amount ought to be reduced under s 99B(2)(a), for example, the trust deed might specify that the amount set aside for the beneficiary is to be held on a separate trust, in which case the amount in question will be corpus and would not be assessable to a hypothetical resident taxpayer; or

c. the s 99B(1) amount ought to be reduced under s 99B(2)(b), because the amount of the uncalled entitlement when paid is merely facilitating the real transaction – being the distribution of income from a trust to a beneficiary – which would not ordinarily be taxable to a hypothetical resident taxpayer.

6.1.1 Howard's Case and the hypothetical taxpayer

The application of s 99B(2)(a) was considered in Howard's Case.[44] Howard's Case involved amounts received by Mr Howard, an Australian tax resident, from a non-resident trust estate, the Esparto Trust. There was no dispute in the case that the amounts received by Mr Howard were part of the corpus of the Esparto Trust estate. Accordingly, the first part of s 99B(2)(a) was engaged. The question for the court involved the second part of s 99B(2)(a), the "*parenthitical excision to that subsection*" which provides the "*positing of a hypothesis and the posing of a question premised on that hypothesis*".[45] In the circumstances of the case, the hypothetical question was whether the Esparto Trust would have been assessable on the amounts it received as a beneficiary from another trust, the Juris Trust.

Accordingly, in determining whether s 99B(2)(a) applied to Mr Howard, the Court had to consider, "*[m]aintaining in one's mind (as best one can) that one is to treat the Esparto Trust estate as a resident taxpayer this second layer trust requires one, once more, to apply the provisions of s 99B(2)(a).*"[46] In other words, the Court had to consider whether the amount received by the Esparto Trust from the Juris Trust fit within the parenthetical exception. This required an analysis of the source of the funds received from the Juris Trust. As stated by the Court, "*[t]he trustee of the Juris Trust received non-trust distributions from another Jersey company called Esparto Ltd*" which were "*the proceeds of a share buy-back which occurred when Esparto Ltd purchased its own shares back from the trustee of the Juris Trust.*"[47] In asking the question whether a hypothetical resident taxpayer would have been assessed on the amount received by the Juris Trust as a result of the buy-back, consideration needed to be given to the application of s 159GZZZP(1), which has the effect of deeming the proceeds of the share buy back to be a dividend paid out of profits. Those amounts were, if received by a taxpayer who was a resident, assessable income under s 44(1), and, as a result, would have been assessable to that taxpayer. Accordingly, the distribution received by the Juris Trust, which in turn was received by the Esparto Trust, was not excluded by the corpus exception in s 99B(2)(a).

As stated by the Court, "*[a]lthough the process of conjoining Mr Howard to the amounts paid by Esparto Ltd seems complicated, in reality it is not.*"[48] Section 99B(2)(a) will simply apply as many times as there are interposed layers of trusts. Each application of s 99B(2)(a) leads to a hypothetical question about whether the amounts received by the trust estate would have been assessable income if they had been earned by a resident taxpayer. "*Once an answer to that question is known at the*

[44] [2012] FCAFC 149.
[45] *Howard v FCT* [2012] FCAFC 149, [37].
[46] *Howard v FCT* [2012] FCAFC 149, [38].
[47] *Howard v FCT* [2012] FCAFC 149, [39] and [43].
[48] *Howard v FCT* [2012] FCAFC 149, [41].

level of the deepest trust the answer cascades back up to the original (genuine) resident taxpayer..."[49] The Court concluded:[50]

> To unpick that slightly: if the Juris Trust estate had been a resident taxpayer and the amounts received by it had been assessable income, then the amounts received by the Esparto Trust, although corpus, would have fallen within the parenthetic excision in s 99B(2)(a) and would have been assessable income in its hands. This, in turn, provides the affirmative answer to the question posed by s 99B(2)(a) as to whether the amounts received by the Esparto Trust estate would have been assessable income on the hypothesis that the Esparto Trust estate was a resident taxpayer. But it is that answer on that hypothesis which applies to Mr Howard himself. What is revealed therefore is not complexity but repetition.
>
> Once that is understood the question simply becomes whether the amounts received by the Juris Trust estate from Esparto Ltd would have been assessable income had it been (as it certainly was not) a resident taxpayer.

It should be noted however that *Howard's Case* involved a factual scenario of interposed trusts. There may be a very different outcome if, for example, there was a non-resident individual interposed between the trusts.

6.1.2 TD 2017/23 and TD 2017/24 – non-TAP capital gains made by foreign trusts and distributed to resident beneficiaries

On 13 December 2017, the Commissioner finalised Taxation Determination 2017/23 (TD 2017/23) and Taxation Determination 2017/24 (TD 2017/24). The finalised Taxation Determinations were originally released in draft form in November 2016 and set out the Commissioner's view in relation to capital gains made on non-TAP by foreign trusts.

TD 2017/23

In TD 2017/23, the Commissioner takes the position that s 855-10 of the ITAA 1997 overrides the deeming provision in s 95 of the ITAA 1936 and in calculating the net income of a non-resident trust you disregard any capital gains (or, indeed, losses) made on non-TAP. This means that a capital gain made by a foreign trustee on a non-TAP asset is not included in the trust's net income.

The Commissioner then takes the view that because of this interpretation, s 115-215 of the ITAA 1997 will not apply to treat beneficiaries of the trust as having a capital gain (or loss) in respect of the trustee's CGT event. In addition, the trustee will not be assessed on the capital gain (or loss) pursuant to ss 115-220 or 115-222 of the ITAA 1997. At first blush, that seems to be an excellent result for a beneficiary, at least in respect of capital gains.

But the Commissioner continues [emphasis added]:

> **…although the capital gains are not included in the net income in the year they are made, section 99B of the ITAA 1936 may apply** to assess a beneficiary if amounts attributable to gains are paid or applied for the benefit of the beneficiary.

[49] *Howard v FCT* [2012] FCAFC 149, [41].
[50] *Howard v FCT* [2012] FCAFC 149, [41]-[42].

That view, which is set out in detail in TD 2017/24, is dealt with further below.

The example given by the Commissioner in TD 2017/23 illustrates his view on these matters:[51]

> The Kiwi Trust was established in New Zealand. The trust is a foreign trust for CGT purposes as the trustee company is incorporated in New Zealand and the trust is centrally managed and controlled there. The trustee can appoint income and capital of the trust to a range of beneficiaries, some of whom are resident in Australia.
>
> The trustee invests in shares in Australian companies that are not 'taxable Australian property'. The trustee sells some of those shares.
>
> As the trust is a foreign trust for CGT purposes and the shares are not 'taxable Australian property', no capital gains or losses from the sale will be reflected in the net income of the trust under subsection 95(1) of the ITAA 1936. Accordingly, Subdivision 115-C of the 1997 Act will not treat the trust's beneficiaries (or the trustee) as having capital gains in respect of the sale.
>
> The trustee distributes an amount attributable to the gain to a beneficiary resident in Australia. Section 99B of the ITAA 1936 may then apply to include an amount in the beneficiary's assessable income.

The basis for the Commissioner's view is that s 95(1) is a general provision, and s 855-10 is more specific to capital gains made by trustees of foreign trusts for CGT purposes. Accordingly, in the Commissioner's view, he regards s 855-10 as prevailing over the assumption in s 95(1).

TD 2017/24

As stated above, although the amount of a capital gain is excluded from the calculation of a foreign trust's net income, the Commissioner's view is that s 99B may apply.

Specifically, it is the Commissioner's view that amounts made assessable by s 99B(1) do not retain the character they may have had in the hands of the trustee and, therefore, to the extent s 99B includes an amount as assessable income that is referrable to a capital gain made by a trust, it does not retain the character as a capital gain. Further, the Commissioner's view is that there is no linkage between s 99B(1) and Sub-division 115-C of the ITAA 1997.

The Commissioner posits the view that ss 99B(2)(a) and 99B(2)(b) apply to a hypothetical taxpayer who is a resident, but without any other specific characteristics (for example, the hypothetical taxpayer is not provided with the characteristic of being an individual which would entitle it to the 50% CGT discount). What that means is that, in the Commissioner's view, an amount that is included in the assessable income of a taxpayer pursuant to s 99B(1) cannot be reduced by capital losses or the CGT discount. However, s 99B(1) will not apply to a beneficiary if any resident taxpayer could have disregarded the gain.

The Commissioner provides the following example:[52]

> The trustee of a foreign trust for CGT purposes sells shares in an Australian public company that it had owned for five years. The shares are not taxable Australian property.

[51] TD 2017/23, [3]-[6].
[52] TD 2017/24, [2]-[5] (references omitted).

> The trustee makes $50,000 capital gains from the share sale but these are not relevant in calculating the trust's net income.
>
> The trustee distributes an amount attributable to the capital gains to Erin, a resident of Australia. Erin has a $40,000 net capital loss that she has carried forward.
>
> Erin must include the entire $50,000 in her assessable income under section 99B. She cannot reduce the amount by her net capital loss or by the CGT discount.

The Commissioner sets out the following alternative views:

a. that the hypothetical taxpayer is assumed to be a resident with the same characteristics as the trustee; and

b. that the hypothetical taxpayer is assumed to be a resident with the same characteristics as the beneficiary who received the relevant amount.

However, the Commissioner disregards both of these alternative views. Accordingly, the Commissioner's view is that when considering the hypothetical taxpayer for the purposes of s 99B(2)(a) (and also s 99B(2)(b)), it is a hypothetical resident taxpayer but without any other characteristics.

The Commissioner does state, however, that he will not devote compliance resources to the enforcement of his view in relation to distributions received and already assessed in income years ending before the issue of the TD 2017/24. However, if the Commissioner was asked to amend an assessment, or required to state a view such as in a private ruling or in submissions in litigation, the Commissioner would act consistently with his views in TD 2017/24.

6.1.3 Calculating and quantifying amounts

While the Commissioner has issued his guidance which indicates that the hypothetical taxpayer is a resident but with no other characteristics, the Commissioner has not issued guidance in relation to what attributes of assets can be considered when determining what amount would not be assessable to the hypothetical resident taxpayer. For example, if the relevant amount is referrable to the disposal of a pre-CGT asset, is the hypothetical gain also disregarded for the hypothetical resident taxpayer? Do you use the same cost base for that asset? What if the relevant asset was acquired by the trust while it was a non-resident, but it later became a resident trust estate so that special cost base rules in Division 855 of the ITAA 1997 apply – does the hypothetical resident taxpayer apply those rules?

What about deceased foreign estates – does the hypothetical resident taxpayer take into account the market value at the date of death for assets held by the deceased (which would all be corpus of the deceased estate)? Or alternatively, let's assume the deceased foreign estate comprised of shares in Google. If the executor sold those shares and distributed the cash, how might the analysis under s 99B(2)(a) work? That is, would the hypothetical resident taxpayer assume that Division 128 of the ITAA 1997 applied to give the Google shares a market value cost base such that there is no hypothetical capital gain that would be assessable and, therefore, the cash distribution comes within the exception of s 99B(2)(a) as well?

In EPR 1051970330207, the Commissioner considered the application of s 99B(2) in relation to distributions by a foreign trust to a resident beneficiary of various amounts. In relation to one of those amounts, a foreign trustee received a number of shares as part of the demutualisation of a company. The EPR stated *"[t]hese shares are deemed to have a capital cost base of AUD $XX.XX per share.*"

The shares were then sold. The trustee was considering distributing amounts to a resident beneficiary, including an amount referrable to the deemed cost base of the shares. The EPR asked the question:

> Will s.99B(2) of the ITAA 1936 apply to exclude the distribution of the original deemed cost base of the shares acquired as a result of the demutualisation of a company on where the funds are distributed by the Trustee of the Trust to the Taxpayer?

The Commissioner's answer, without providing reasons, was yes. That is, when the amount referrable to the deemed cost base of the shares was distributed, s 99B(2) applied to exclude the distribution to a resident beneficiary of the original deemed cost base of the shares. It is not clear from the facts, nor the analysis as to how the deemed cost base came to be and why the Commissioner took the view that the deemed component of the cost base was excluded from s 99B(1) because of s 99B(2)(a). However, this ruling potentially raises interesting questions in other contexts such as where a foreign trust becomes an Australian resident trust and gets a market value cost base in its non-TAP on the date it commences residency.[53] Is there an argument that the deemed cost base, because of s 855-50, should also fall within the exception of s 99B(2)(a)?

6.1.4 Section 99C and the corpus exclusion

In some cases it will be readily apparent that an amount applied for the benefit of a beneficiary can be from the corpus of the trust estate and, therefore, fall within the exception in s 99B(2)(a). However, in other cases, it will be less clear, for example, when the trustee makes a loan.

We discussed EPR 1052059680727 in Section 5. In summary, that ruling considered an arm's length loan made by a foreign trust to a resident beneficiary. The facts stated that the loan would be made either from original corpus of the foreign trust, or accumulated income of the foreign trust. The Commissioner stated that (emphasis added):

> …the loan to be made to you may include an amount that represents the corpus of the foreign trust. Amounts that represent earnings of the foreign trust are not corpus. Therefore, paragraph 99B(2)(a) of the ITAA 1936 applies to you so that:
>
> (a) the proportion of the loan to you that represents amounts previously deposited to the foreign trust to settle it or to achieve its purpose is excluded from your assessable income, and
>
> (b) the proportion of the loan to you that represents earnings of the foreign trust (from the commencement date of the foreign trust) is included in your assessable income because the foreign trust earnings are amounts that are not taken to represent corpus; the earnings are attributable to income derived by the foreign trust, which would have been subject to tax had the earnings been derived by a resident taxpayer.
>
> **It is important to note that when the corpus exception has been claimed in relation to a loan, that corpus is no longer available for the purposes of claiming the corpus exception for other applications of subsection 99B(1) to payments from the trust.**

Accordingly, in that Ruling the Commissioner appears to accept that there can be an apportionment of an amount where it comes from both original corpus, and accumulated income. However, the Commissioner's comment in relation to the last paragraph is interesting. While we understand why the corpus exception might not be available in relation to the payment of any other amount while the loan

[53] ITAA 1997, s 855-50.

is advanced, it is not clear why, if the loan is ultimately repaid, that the corpus exception would not be available again in relation to that principal returned.

Notwithstanding the above, the idea that a loan can represent corpus of a trust estate raises an ongoing uncertainty with respect to how one determines what is corpus of the trust estate. As mentioned above, is the relevant amount in question evidenced by the way in which the accounts are prepared (akin to the Archer Brothers principle) or is one required to trace the actual source of the funds distributed? If the former, it seems difficult to understand how a loan would represent corpus of the trust estate, since the relevant accounting entries may not affect the equity side of the balance sheet. This then raises questions in relation to other amounts that might be applied for the benefit of an Australian beneficiary.

6.2 Otherwise not assessable – s 99B(2)(b)

Section 99B(2)(b) provides a s 99B(1) amount will be reduced by "*an amount that, if it had been derived by a taxpayer being a resident, would not have been included in the assessable income of that taxpayer of a year of income.*"

There is limited guidance on s 99B(2)(b), although some of the principles that were raised in *Howard's Case* are likely to be influential and the Commissioner's views in relation to the characteristics of the hypothetical taxpayer are set out in TD 2017/23 and TD 2017/24 (discussed above). Although the Commissioner's guidance on the hypothetical resident taxpayer is reasonably clear, the same issues regarding the attributes of assets, or the application of tax rules that do not apply equally in relation to all taxpayers at all times, also arise under s 99B(2)(b). See also our comments at section 6.1.3.

The Commissioner has issued guidance in relation to s 99B(2)(b) and foreign life assurance policies, which is summarised below.

6.2.1 ATO ID 2004/691

The Commissioner has issued ATO ID 2004/691 in relation to the application of s 99B(2)(b) in relation to an amount paid from a foreign life assurance policy.

Issue

Is a bonus received by a resident beneficiary of a non-resident trust from a foreign life assurance policy held by the trust, included in assessable income under s 99B?

Decision

No. A bonus received by a resident beneficiary of a non-resident trust from a foreign life assurance policy held by the trust, is not included in assessable income under s 99B.

As the amount was paid more than 10 years after the commencement of the risk under the policy, the lump sum payment received by the taxpayer from the life assurance policy held by the non-resident trust would not have been included in the taxpayer's assessable income under s 26AH of the ITAA 1936 had the taxpayer held the policy directly. Further, as a bonus is not ordinary income (see

Taxation Ruling IT 2504), the bonus would not be included in the taxpayer's assessable income under s 6-5(2) ITAA 1997 had the taxpayer held the policy directly.

Therefore, s 99B(2)(b) will apply to exclude the lump sum payment from the taxpayer's assessable income.

6.3 Sections 97, 98, 99, 99A and 98(4) – s 99B(2)(c)

Subsection 99B(2)(c) provides a s 99B(1) amount is reduced by:

> an amount:
>
> (i) that is or has been included in the assessable income of the beneficiary in pursuance of section 97; or
>
> (ii) in respect of which the trustee of the trust estate is or has been assessed and liable to pay tax in pursuance of section 98, 99 or 99A; or
>
> (iii) that is reasonably attributable to a part of the net income of another trust estate in respect of which the trustee of the other trust estate is assessed and is liable to pay tax under subsection 98(4);

The general proposition in relation to s 99B(2)(c) should be that if the amount has otherwise been taken into account under Division 6, it ought not be assessable under s 99B(1). However, the precise wording of s 99B(2)(c) needs to be carefully considered.

For example, s 99B(2)(c)(i) excludes from the application of s 99B(1) an amount that is or has been included in the assessable income of "*the beneficiary*" in pursuance of s 97. The form of the exclusion from the application of s 99B, as set forth in s 99B(2)(c)(i), gives rise to serious concern in that it is limited to an amount included in the assessable income of **the** beneficiary. The reference to the beneficiary would appear to confine the availability of the exclusion to cases where the beneficiary for the benefit of whom the relevant amount is applied is the same as the beneficiary assessed under s 97. If this be the case, and if we return to example A (see above section 5), then the fact that an amount of income has been assessed in the hands of beneficiary A pursuant to s 97, would not prevent that same amount being assessed in the hands of beneficiaries B, C, D, and E pursuant to s 99B(1), provided that it can be demonstrated that the relevant amount has been successively applied for the benefit of those beneficiaries in the manner indicated in s 99C.

It may be possible to argue, however, that the foregoing problems, which relate to the ambit of the exclusion under s 99B(2)(c)(i), arise only if the relevant amount is deemed to have been applied for the benefit of a beneficiary (say, beneficiary B) pursuant to s 99B in the same year that the amount was derived by the trustee and allocated to a different beneficiary (beneficiary A). Section 99B can only apply in relation to an amount being property of a trust estate which is applied for the benefit of a beneficiary of that trust estate. A typical form of discretionary trust deed provides that any amount set aside for any beneficiary shall cease to form part of the trust fund and upon such setting aside shall subsequently be held by the trustee on a separate trust for such person absolutely. Take an example where both A and B are beneficiaries of a discretionary trust. During the 2022 financial year, the sum of $10,000 is set aside for beneficiary A but not physically paid in cash. Pursuant to the terms of the trust, that amount is deemed to be held on separate trust for beneficiary A. Any application of that sum of $10,000 in favour of beneficiary B during the following income year should not be within s 99B because the sum of $10,000 so applied will not comprise property of a trust estate of which beneficiary B is a beneficiary. The sum of $10,000 will, at the relevant time it is applied for the benefit of beneficiary B, be held by the trustee on a separate trust for A absolutely.

Further to the above, s 99B(2)(c)(ii) excludes from the application of s 99B an amount in respect of which the trustee of the trust estate is or has been assessed and liable to pay tax in pursuance of ss 98, 99 or 99A. Those sections provide that the trustee is liable to be assessed in relation to the net income of a trust estate which, subject to certain qualifications, is arrived at only after subtracting from assessable income all allowable deductions: see s 95.

Similar to s 99B(2)(c)(i), the article before trustee of the trust estate is “the”. Does that mean s 99B(2)(c)(ii) is precluded from applying in circumstances where a trustee which has been assessed and paid tax under one of the relevant provisions is replaced by a new trustee? While the article before the object is the same in the two sub-paragraphs, there is a difference between sub-paragraphs (i) and (ii) in that (i) makes no reference to whether tax has been paid under s 97, whereas sub-paragraph (ii) requires that the trustee of the trust estate “*is or has been assessed and liable to pay tax…*” in pursuance of s 98, 99 or 99A.

Example C

Assume a trust estate has carry-forward losses of $10,000 as at 30 June 2022. During the year ended 30 June 2023 the trustee derives a total net income of $5,000. In view of the availability of the losses of $10,000 the net income of the trust estate will be nil and, accordingly, neither the trustee nor any beneficiary will be liable to be assessed or to pay tax. If that be the case, then s 99B(2)(c) would not have the effect of excluding the amount of $5,000 from the reach of s 99B – there is no beneficiary taxed pursuant to s 97, and the trustee is not assessed and liable to tax pursuant to ss 98, 99 or 99A.

6.4 The transferor trust rules – s 99B(2)(d) and (e)

Section 99B(2)(d) and (e) effectivley provide that where amounts have been assessed under the transferor trust rules, they ought not to be taxed again under s 99B(1).

The Commissioner has released issued ATO ID 2010/211 on the application of s 99B(2)(d), which is summarised below, although with a twist in that it considers a nuanced issue of whether the exception still applies where the assessable amount has not been returned in the taxpayer’s tax return. As a general comment, there is no reason why the same position could not be adopted by a beneficiary seeking to apply s 99B(2)(c)(i) (default or otherwise) that was presently entitled to income of the trust but failed, for one reason or another, to report such an amount in their tax return.

6.4.1 ATO ID 2010/211

Issue

For the purpose of s 99B(2)(d), is an amount taken to be “*included in the assessable income of any taxpayer*” under s 102AAZD even though the taxpayer has not included the amount in their income tax return?

Decision

Yes. The amount is taken to be included in the assessable income of the taxpayer under s 102AAZD even though the amount has not been included in the taxpayer's tax return for the purpose of s 99B(2)(d).

Section 99B(1) includes as assessable income of a beneficiary an amount paid to, or applied for the benefit of, the beneficiary of a trust estate.

However, s 99B(2)(d) excludes an amount "*that is or has been included in the assessable income of any taxpayer (other than a company) under section 102AAZD*". An amount is assessable under s 102AAZD even though it was not included in the income tax return of the transferor and the Commissioner is out of time to amend the taxpayer's assessment.

The amount is therefore excluded from being assessed to the beneficiary under s 99B(1) by s 99B(2)(d).

7. Section 102AAM interest

Division 6AAA of the ITAA 1936 is titled "*[s]pecial provisions relating to non-resident trust estates etc*".

Section 102AAM is a provision of Div 6AAA, the function of which is to impose an interest charge in respect of an amount included in a taxpayer's assessable income pursuant to s 99B(1). It is titled "*[p]ayment of interest by taxpayer on distributions from certain non-resident trust estates*".

The purpose was described in the Explanatory Memorandum to the *Taxation Laws Amendment (Foreign Income) Bill 1990* in the following terms:

> The purpose of section 102AAM is to set out the circumstances in which additional tax, in the nature of an interest charge, is to be imposed on certain distributions received by a resident beneficiary from a non-resident trust estate and to provide rules for calculating the amount of the interest charge. The additional tax in the nature of the interest charge is to be formally imposed by a separate Act.
>
> Subsection 102AAM(l) is designed to identify those distributions from a non-resident trust estate that will attract the interest charge.
>
> The interest charge will apply in relation to an amount that is included in the assessable income of a taxpayer of the 1990-91 year of income or a subsequent year of income (referred to as the 'current year of income") under section 99B of the Principal Act (paragraph 102AAM(l)(a)). In broad terms, section 99B includes in the assessable income of a beneficiary of a trust estate who was a resident at any time in a year of income certain amounts, being property of a trust estate, that are paid to, or applied for the benefit of, that beneficiary in the year of income but had not previously been subject to tax in Australia either in the hands of the trustee or of the beneficiary. The effect of this paragraph and the amendment of section 99B by clause 16 will be that the interest charge will generally apply only in relation to distributions of accumulated trust income by a non-resident trust estate to a resident beneficiary where the accumulated income had not previously been subject to the transferor tax measures.

The interest charge calculated under s 102AAM is intended to be a sanction to compensate the Australian revenue for the deferral of Australian tax on any accumulated income which was not taxed in the year it was derived because it had a foreign source, was derived by a non-resident trust estate, and no resident beneficiary was made presently entitled to the income.

The interest charge applies to non-listed country trust estates, and listed country trust estates if the amount is considered to be eligible designated concession income of that listed country trust estate.[54] While s 99B does not specifically refer to the residence of the trust estate, s 102AAM makes it very clear that it is only dealing with a "*non-resident trust estate*". But what, then, about a non-resident trust estate which has become a resident trust estate? In some situations, s 102AAM will still apply where the income being distributed was derived during a period that the resident trust was a non-resident. However, in other circumstances, s 102AAM may have no application.

The interest charge is calculated for the period determined under s 102AAM(5)(a). That provision provides that interest is to be calculated:

> (a) in respect of the period commencing at whichever of the following times is the latest:

[54] Section 102AAM(1)(b).

> (i) the beginning of the first year of income of the taxpayer that begins after the end of the non-resident trust's year of income;
>
> (ii) the beginning of the year of income of the taxpayer commencing on 1 July 1990;
>
> (iii) if the taxpayer is a natural person (other than a natural person in the capacity of a trustee) who first commenced to be a resident of Australia at a time (in this subparagraph called the first residence time) on or after 1 July 1990 — the beginning of the year of income of the taxpayer next following the year of income of the taxpayer in which the first residence time occurred;
>
> and ending at the end of the assessment year of income; …

The interest is calculated on an amount determined by the following formula:[55]

> (distributed amount × applicable rate of tax) – foreign tax credit

The rate of tax applied differs depending on whether the relevant beneficiary is a company or not and is calculated in accordance with ss 102AAM(10) and 102AAM(10A). In the case of beneficiaries that are not companies, the rate is the maximum individual tax rate, whereas for companies (not acting as trustees) it is the corporate tax rate.

While the provision refers to itself as interest, in truth, it is more akin to a tax. Full self-assessment taxpayers are required, if s 99B(1) applies, to include the amount of interest in their return for the year of income.[56] Companies and SMSFs, for example, are specifically defined as being full self-assessment taxpayers. Accordingly, tax returns for those types of entities will have a section to include the 102AAM charge. Individuals, however, are not defined as being full self-assessment taxpayers, and so interestingly there is no section in their tax returns to include the 102AAM charge.[57] This raises an interesting question about how the Commissioner administers this in practice, and whether an individual is able to (under the legislation) self-assess a 102AAM charge.

This interest payment is not specifically deductible to the taxpayer and the Commissioner does not have a specific power to remit the interest amount calculated on s 102AAM.

Importantly, where s 102AAM applies, the interest charge cannot exceed the difference between the amount distributed to the beneficiary and the amount of tax that is payable on that amount.[58] In other words, while the Commissioner could collect the whole amount of the distribution received, he cannot collect more than the amount of the distribution (ignoring penalties and SIC/GIC). The impact of s 102AAM is substantial and can add considerably to the tax costs of receiving the trust distribution that is assessable pursuant to s 99B(1).

[55] Section 102AAM(2).
[56] Section 102AAM(13A).
[57] Section 102AAM(12).
[58] Section 102AAM(6).

8. Managing s 99B audits – why they can feel like an ambush while crossing a rope bridge

> The problem with this case is the amount of paperwork, and a lot of it … goes up blind [alleys], you know.[59]

Some may be familiar with the anguish expressed in the above quote from the taxpayer's accountant in *Campbell*. This recent case illustrates the importance of getting the paperwork right as well as highlighting important technical and compliance issues for Australian resident beneficiaries of foreign trusts.

Whilst there is no specific Australian requirement for the trustees to keep income and capital accounts, the onus of proof will always be on the taxpayer to demonstrate the source of any distribution and so thought must be given as to the evidential requirements necessary to discharge such an onus.

In *Campbell*, the Australian taxpayer failed to prove that distributions she received from a New Zealand trust were 'corpus' of the trust estate that should have been excluded from default assessments issued to the taxpayer by the Commissioner. The taxpayer's accountant argued before the Tribunal that there was an original corpus amount of $3 million, which should have been protected from the operation of s 99B(1) by a reduction because of s 99B(2)(a).[60] However, the taxpayer's New Zealand accountants had originally provided financial statements showing all of the trust capital was accumulated income - which meant that any capital distributions to her would be subject to tax under s 99B(2)(a). The New Zealand accountants provided revised financial statements, showing an increased amount of original corpus and reduced amount of accumulated income, which the Tribunal was not prepared to accept.

The problem for the taxpayer in *Campbell* was that, for the purposes of discharging the burden of proof, there were inadequate records of the New Zealand trust. The trust accounts and minutes provided were inconsistent and therefore unreliable. There were no witness statements lodged and no witnesses called, and therefore no reliable evidence that could allow the Tribunal to conclude that any of the amounts the Australian resident beneficiary received could be traced back to amounts that would have been excluded under s 99B.[61] The Tribunal commented that one would expect to see a resolution in the trust minutes recording the distribution of capital to a beneficiary (as had happened in previous years).

Campbell highlights the difficulties that can be faced by Australian beneficiaries of foreign trusts. Even where there are trust records, those records may be inadequate to allow the beneficiary to prepare their income tax return or to challenge an assessment issued by the Commissioner. This is somewhat exacerbated under Australian tax legislation, which places the onus on the taxpayer to prove an assessment, or amended assessment, is excessive. Further, in some instances, the taxpayer must also prove the correct amount of the assessment or amended assessment.

In light of cases like *Campbell*, trustees of foreign trusts should ensure that they keep records that enable the Australian resident beneficiaries to meet their tax reporting obligations. This would include records that clearly delineate the income and capital of the trust – such records being necessary for

[59] [2019] AATA 2043, [72].
[60] In paragraph 99B(2)(a) of the ITAA 1936.
[61] Paragraph 99B(2)(a) of the ITAA 1936.

beneficiaries seeking to substantiate their Australian tax position, which may include proving that they have a nil tax liability.

Practically, the most important part of managing s 99B issues is to gather the relevant evidence from the get-go. It is not uncommon to see that:

a. financial statements for a foreign trust are not kept to the level of detail necessary to help Australian resident beneficiaries deal with their s 99B issues; and/or

b. no source documents are kept for the amounts originally received by the trust.

In these circumstances, it is necessary to:

a. gather evidence from individuals with knowledge of how the trust was established, funded and operated; and

b. gather whatever supporting documents are available that may corroborate the individuals' evidence.

9. Conclusion

> Shaman of Mayport: Now you see the power of the rock you bring back.
>
> Indiana Jones: Yes. I understand its power now.

As we stated in our introduction, when s 99B was introduced in 1978, it was intended to capture the lacuna identified in *Union Fidelity*. Accordingly, its purpose was to make an amount of foreign sourced income received from a trust taxable to a resident beneficiary if that amount was not otherwise caught by the "standard" trust rules involving present entitlements, or if it was not taxed in some other way. That premise sounds simple enough.

But unfortunately Indiana Jones and The Temple of Doom and s 99B have much in common. Like the film, the provision can be messy, brutal, angry and unpleasant.

As this paper has demonstrated, the potential breadth of the provision, and how it interacts with other provisions of the Income *Tax Assessment Acts* introduced after s 99B, remains uncertain. This is unsurprising given comments made by Mr A. P. Webb, Q.C. and Dr I. C. F. Spry, QC in the Financial Review on 20 February 1979. That letter pointed to a number of problems with respect to the 1978 Bill (which was echoed by others at the time) which led them to conclude that "*it is impossible to avoid the conclusion that the provisions of the Bill have not been given sufficient consideration or scrutiny and that it should not be proceeded with in its current form*". Ultimately that recommendation was ignored.

What this paper has shown is that Mr Webb and Dr Spry's comments remain as true today as what they did back then, except for the fact that we now have a further unacceptable provision in the form of s 102AAM. The provisions, particularly when applied together, have the potential to result in outcomes that are simply unacceptable and for this reason it is now time that they are rewritten so they are fit for purpose.

Sections 99B and 102AAM should be to taxpayers, what snakes are to Indiana Jones.