

Ruling Compendium – TD 2012/11

This is a compendium of responses to the issues raised by external parties to draft TD 2012/D2 – Income tax: capital gains: for the purposes of paragraph 115-228(1)(a) of the *Income Tax Assessment Act 1997*, can a beneficiary of a trust estate be reasonably expected to receive a share of the net financial benefit referable to a capital gain made by the trust estate in an income year if the fact that the capital gain was made is not established until after the end of the income year?

This compendium of comments has been edited to maintain the anonymity of entities that commented on the draft ruling.

Summary of issues raised and responses

Issue No.	Issue raised	Tax Office Response/Action taken
1	Irrevocability of a trustee resolution not essential for an expected outcome to be reliably based	
	<p>Paragraph 5 of example 1 refers to the deed providing that trustee resolutions are irrevocable. This implies that the fact that a trustee resolution may be revoked in the future means that it is not possible to reasonably expect that a beneficiary will receive a net financial benefit at a later date. Irrevocability is not necessary for an expected outcome to be reliably based - the fact that a valid resolution has been made means that it is not (to use the language in paragraph 28 of the Draft Determination) 'unreasonable, irrational or absurd' to expect that a beneficiary will receive something in due course.</p> <p>A similar issue arises in paragraph 29 of the draft Determination implying that a reasonable expectation may only be founded in an irrevocable resolution of the trustee.</p>	<p>It is agreed that the revocability of a resolution does not mean that the resolution cannot found a reasonable expectation in terms of the specific entitlement rules.</p> <p>Paragraphs 5 and 29 have been changed in the final Determination to delete this reference.</p> <p>However, if in relevant situations the facts suggest that a resolution is <i>likely</i> to be revoked (if indeed this is even permitted under the deed), an expectation of receiving the relevant benefits may be unreasonable. But such situations are not readily envisaged and the Commissioner would therefore expect them to be unusual. [For example, if a resolution is only able to be revoked in unusual or exceptional circumstances, it would be unusual to expect this to happen.]</p> <p>A statement to this effect has been included in the explanation, but as the situation is expected to be unusual, no separate example on this point has been included.</p>

2	Issues with examples	
	<p>Example 1 - The final determination should clarify that, if the relevant CGT asset is subsequently disposed of under a different contract (for example, a contract entered into in the year ended 30 June 2014 - 'contract A') then, depending on the powers contained under the trust deed and the wording of the trustee resolution made by the trustee of the Bottomley Trust before 31 August 2012, Potts Pty Ltd may be reasonably expected to receive a share of the net financial benefit referable to the capital gain arising from contract A under the resolution made before 31 August 2012.</p> <p>For example, if the trustee resolution made by the trustee of the Bottomley Trust resolves to distribute to Potts Pty Ltd before 31 August 2012 all of the net financial benefit referable to any capital gain arising on the disposal of the shares, but does not specify the income year in which the capital gain arises and makes no reference to the contract entered into in November 2011, then Potts Pty Ltd may be specifically entitled to any capital gain resulting from the disposal of the CGT asset under contract A.</p>	<p>The example has been changed so that the trustee resolution refers to any capital gain arising on the disposal of the shares rather than to the disposal under the particular contract of sale. A note has been added to confirm that the resolution referred to in the example would create a specific entitlement to the capital gain (if any) arising on any disposal of the shares (including, for example, if the contract entered into in November 2011 does not complete, but a subsequent contract does).</p>
	<p>Example 2 - The Draft Determination does address the situation where the trust deed does <u>not</u> have a default beneficiary clause. That is, can a beneficiary be made specifically entitled to a capital gain within 2 months after 30 June of the relevant income year if the relevant trust deed:</p> <ul style="list-style-type: none">(a) defines the income of the trust as section 95(1) net income;(b) does <u>not</u> have a default beneficiary clause; and(c) requires the trustee to appoint the income of the trust by 30 June in any given year? <p>For clarity, the ATO is asked to provide its view on whether a beneficiary can be made specifically entitled to a capital gain within 2 months after 30 June of the relevant income year in such a case.</p>	<p>A note has been added to confirm that in the absence of a default beneficiary clause, the resolution (not itself specifying whether it was a resolution to distribute income or capital) would be effective to create a reasonable expectation of Chelsea receiving that amount, if the undistributed income was capitalised (forming part of the trust estate) at 30 June and the trustee had a power to distribute capital.</p> <p>Alternatively, if the deed was silent about what happens to undistributed income at 30 June (that is, there was no default beneficiary clause and no accumulation clause), the resolution may be a distribution of income in August, effective to create a reasonable expectation of receiving the financial benefit referable to any capital gain. Such a resolution would not however be effective for section 97 purposes more generally. So as to avoid any possible confusion on this point, and because it would seem unusual for a trustee to only deal with a capital gain component of income separately to and / or at a later time to any other dealings with its income, a separate example on this point was not included in the Final Determination.</p>

	<p>Example 3 - The following sentence should be removed from paragraph 13 in the Draft Determination: "The trustee has no power to vary the terms of the trust." This sentence infers that the existence of this power can be problematic with respect to determining whether a particular beneficiary could be reasonably expected to receive a share of the net financial benefit referable to a capital gain. Nearly all trusts have such a power. The existence of such a power should not be relevant, unless and until it is exercised, with respect to making the relevant determination. Further, until such time as the trustee exercises the power to vary the terms of the trust (if such a power exists in the trust deed), the beneficiary in the example should have a reasonable expectation of receiving the net financial benefit of the capital gain. Therefore, to ensure no undue inference arises, this sentence should be removed.</p>	<p>To avoid any inference that the existence of a power to vary the terms of the trust affects whether a beneficiary satisfies the 'reasonable expectation' test, this sentence has been removed from the final determination. However, as with the likelihood of resolutions being revoked (discussed above at issue 1), if a capital beneficiary's rights under the deed are <i>likely</i> to be varied before a gain is realised, those circumstances may prevent the deed founding a reasonable expectation of the capital beneficiary receiving the relevant gain. However, the Commissioner would expect that such circumstances would be unusual. A statement to this effect has been included in the explanation, but as the situation is expected to be unusual, no separate example on this point has been included.</p>
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