



## Draft Taxation Determination

Income tax: will a trust split arrangement of the type described in this draft Determination cause a new trust to be settled over some but not all assets of the original trust with the result that CGT event E1 in subsection 104-55(1) of the *Income Tax Assessment Act 1997* happens?

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### Arrangements this draft Determination covers

1. There are many forms of arrangement which can be described as a trust split. For the purposes of this draft Determination, 'trust split' refers to an arrangement where the parties to an existing trust functionally split the operation of the trust so that some trust assets are controlled by and held for the benefit of one class of beneficiaries, and other trust assets are controlled and held for the benefit of others.<sup>1</sup> A trust split usually involves a discretionary trust that is part of a family group. A common reason given for splitting the trust is to allow different parts of the family group to have autonomous control of their own part of the trust fund.
2. A trust split in this sense will exhibit all or most of the features below.
  - The trustee of an existing trust is removed as trustee of part/some of the trust assets and a new trustee is appointed to hold those assets.
  - Control of the original trustee is changed such that control passes to a subset of the beneficiaries of the original trust. The new trustee is controlled by a different subset of beneficiaries.
  - Different appointors are appointed for each trustee.
  - The rights of indemnity of the trustees are segregated such that each trustee can only be indemnified out of the assets held by that trustee.

<sup>1</sup> This is one sense in which the term 'trust split' is commonly used.

- The expectation is that the new trustee will exercise its powers in respect of the assets it holds independently of the original trustee to benefit the subset to the exclusion of others. The original trustee will also exercise its powers in respect of the assets held by it independently of the new trustee to benefit a different subset again to the exclusion of others. This is so whether the range of beneficiaries that can benefit from particular assets is expressly limited.
  - The rights, obligations and powers of the trustees and beneficiaries remain governed by the one deed.
  - The original trustee and new trustee keep separate books of account.
3. It is assumed in this draft Determination that the steps needed to implement the trust split arrangement are able to be achieved at law, including by amendment of the trust deed as necessary, without bringing the whole trust to an end for trust law purposes and thereby resettling the trust.

### **Ruling**

4. Yes. A trust split as described in this draft Determination will result in the creation of a trust by declaration or settlement as the trustee has new personal obligations and new rights have been annexed to property. This will cause CGT event E1 in subsection 104-55(1) of the *Income Tax Assessment Act 1997* (ITAA 1997)<sup>2</sup> to happen.

### **Example: new trustee appointed over some of the property of an existing trust**

5. *The Star Trust is a discretionary trust that was settled in 1980 to benefit John Smith and his family members being his spouse, children, grandchildren and their lineal descendants. John has two children from his first marriage: Ben and Holly Smith. He has two children with his second spouse, Jane Smith.*
6. *The trustee of the Star Trust is Star Trustee Pty Ltd (Star Trustee). The trust deed gives the trustee the absolute discretion to appoint income to any one or more of the beneficiaries.*
7. *The assets of the Trust are 300 shares in Sun Pty Ltd.*
8. *John Smith passed away in 2010. Since his death, Star Trustee has been controlled by Jane and Ben. Jane and Ben are also the current appointors of the trust.*
9. *Also since his death, there has been conflict between the children from John's first marriage, and Jane and her children.*
10. *To allow the two branches of John's family some level of autonomy and limit the amount of interaction required between them, Star Trustee varies the trust deed pursuant to a power of amendment, and deeds of appointment are executed to implement a trust split as follows.*
- *A new company owned and controlled by Jane is created, Moon Trustee Pty Ltd (Moon Trustee).*
  - *Ownership and control of Star Trustee is changed such that control of this company is now held by Ben and Holly.*

<sup>2</sup> All legislative references are to the ITAA 1997, unless otherwise specified.

- *Star Trustee is removed as trustee of 100 shares and Moon Trustee is appointed as trustee of those shares in its place.*
- *In accordance with the deeds executed, the remaining 200 shares held by Star Trustee are designated as the corpus of the Star Trust and the 100 shares to be transferred to Moon Trustee are referred to as the corpus of the Moon Trust.*
- *Jane resigns as appointor of Star Trustee and is appointed as appointor of Moon Trustee.*
- *Star Trustee's rights of indemnity are limited so that it can only look to the assets that remain in its control to satisfy its rights to be indemnified (200 shares in Sun Pty Ltd).*
- *Moon Trustee's rights of indemnity are similarly limited to the assets that are in its control (100 shares in Sun Pty Ltd).*
- *Legal ownership of 100 shares in Sun Pty Ltd is transferred from Star Trustee to Moon Trustee.*
- *No changes are made to the range of beneficiaries in favour of whom either trustee can exercise its power of appointment. However, the expectation is Moon Trustee will hold 100 Sun Pty Ltd shares for the benefit of Jane and her children to the exclusion of Ben and Holly, and conversely Star Trustee will hold 200 Sun Pty Ltd shares for the benefit of Ben and Holly to the exclusion of Jane and her children.*

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

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

#### **Date of effect**

13. When the final Determination is issued, it is proposed to apply both before and after its date of issue. However, the Determination will not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the Determination (see paragraphs 75 to 76 of Taxation Ruling TR 2006/10 *Public Rulings*).

## Appendix 1 – Explanation

**① This Appendix is provided as information to help you understand how the Commissioner’s preliminary view has been reached. It does not form part of the proposed binding public ruling.**

14. CGT event E1 happens when a trust is created over a CGT asset by declaration or settlement.<sup>3</sup> The CGT event happens at the point in time the trust is created.<sup>4</sup>

15. There is no case law dealing directly with the tax implications of an arrangement of the type described in this draft Determination as a ‘trust split’.

16. The phrase ‘you create a trust over a CGT asset’ is to be understood by reference to the general law of trusts.<sup>5</sup> This directs attention to the fundamental nature of a ‘trust’ over an asset and what is involved in ‘creating’ one.

17. Academically, a trust has been described as:

- ‘An obligation enforceable in equity which rests on a person (the trustee) as the owner of some specific property (the trust property) to deal with that property for the benefit of a certain person (the beneficiary) or persons ...’.<sup>6</sup>
- ‘A relation between the trustee and beneficiary in respect of certain property... which arises when the owner of a legal or equitable interest in property is bound by an obligation recognised by and enforced in equity to hold that interest for the benefit of others’.<sup>7</sup>

18. In *DKLR Holding Co (No 2) Pty Ltd v. Commissioner of Stamp Duties*<sup>8</sup>, Hope JA described the ‘very nature of a trust’ in terms of a personal obligation of a trustee annexed to property to hold the property for the benefit of another. Hope JA emphasised that both elements were necessary for the existence of a trust: a personal obligation not annexed to property is insufficient to constitute a trust and, conversely, a right annexed to property but without any concomitant personal obligation is likewise insufficient.

19. Each description highlights the dual character of a trust, comprising both personal obligations of a trustee and concomitant rights of the beneficiaries annexed to the trust property. In order to ‘create’ a trust there must be a creation of both elements of a trust; that is, a creation of personal obligations and a creation of rights annexed to property.

20. In *FC of T v. Commercial Nominees Australia Ltd*<sup>9</sup>, the Full Federal Court noted that the use of the term ‘trust estate’ and ‘fund’<sup>10</sup>:

...must be taken to refer to the conglomeration of property in respect of which trust obligations and corresponding rights exist from time to time. Putting it another way, a trust estate or a superannuation fund will be that property the ownership of which is divided between trustee and beneficiary....

21. While concerned with the tax impact of certain changes to an existing trust, the decisions in *FC of T v. Commercial Nominees of Australia Ltd*<sup>11</sup> (*Commercial Nominees*)

<sup>3</sup> Subsection 104-55(1).

<sup>4</sup> Subsection 104-55(2).

<sup>5</sup> *FC of T v. Bamford* (2010) 240 CLR 481 at [36].

<sup>6</sup> Ford and Lee *Principles of the Law of Trusts* at [1.010].

<sup>7</sup> *Jacobs Law of Trusts* (8<sup>th</sup> ed at [1-01]).

<sup>8</sup> [1980] 1 NSWLR 510 at 518–519.

<sup>9</sup> [1999] FCA 1455.

<sup>10</sup> As the term is defined and used in Part IX of the *Income Tax Assessment Act 1936*.

and *FC of T v. Clark (Clark)*<sup>12</sup> are of minimal assistance in considering the tax implications of a trust split. In those cases the legal question before the court went to whether an existing trust had come to an end such that the assets of the original trust were now held on a different trust. The joint judgment in *Commercial Nominees* concluded:

...The trusts under which the fund operated in 1994-95 were constituted by the original trust deed in 1988 as varied by the exercise, in 1993, of a power of amendment. The property the subject of the trusts did not alter at the time the amendments took effect. Persons who were the members of the fund before the amendments remained the members of the fund after the amendments. The fund, both before and after the amendments, was administered as a single fund, and treated in that way by the regulatory authority.

The eligible entity established in 1988 did not come to an end in 1993, and it did not divide into two eligible entities...<sup>13</sup>

22. Similarly in *Clark*, Edmonds and Gordon JJ in their joint judgment noted that it was significant that ‘the Commissioner never contended, either before the primary judge or on the appeals, that there was a cessation in the continuum of trust property such as to leave it open to find that the trust estate as originally constituted had come to an end’.<sup>14</sup> Their Honours concluded:

When the High Court in *Commercial Nominees* spoke of trust property and membership as providing two of the indicia for the continued existence of the eligible entity or trust estate, the Court was not suggesting that there had to be a strict or even partial identity of property for the first and objects for the second. It was speaking more generally: that there had to be a continuum of the property and membership, which could be identified at any time, even if different from time to time; and without severance of one or both **leading to the termination of the trust in question**. In the present case, the Commissioner never contended, nor on the evidence could he, that there was a severance in the continuum of trust property and objects of the CU trust. Their identity changed from time to time, but not their continuum.<sup>15</sup>

23. The trust splitting arrangements considered in this draft Determination can be contrasted with the matters considered in *Commercial Nominees* and *Clark*. The question posed by a trust split is not whether the original trust has come to an end. Rather, the question is whether the assets transferred to the new trustee are settled on a new trust fund that has been separated from (or carved out of) the original trust fund.<sup>16</sup> A similar point is made in TD 2012/21<sup>17</sup> at paragraph 11 where it is observed that the effect of a change to the terms of a trust pursuant to the valid exercise of a power contained within the trust’s constituent document might be such as to lead to a particular asset being subject to a separate charter of rights and obligations which gives rise to the conclusion that that asset has been settled on terms of a different trust.<sup>18</sup>

<sup>11</sup> *FC of T v. Commercial Nominees of Australia Ltd* (1999) 43 ATR 42 (FCAFC); (2001) 47 ATR 220 (HC).

<sup>12</sup> *FC of T v. Clark* (2011) 190 FCR 206.

<sup>13</sup> *Commercial Nominees* at [36–37] (emphasis added).

<sup>14</sup> *Clark* at [53].

<sup>15</sup> *Clark* at [87] (emphasis added).

<sup>16</sup> See for example *C of SR (Vic) v. Lam and Kym Pty Ltd* (2004) 10 VR 420; *Oswal v. FC of T* [2013] FCA 745.

<sup>17</sup> Taxation Determination TD 2012/21 *Income tax: does CGT event E1 or E2 in sections 104–55 or 104–60 of the Income Tax Assessment Act 1997 happen if the terms of a trust are changed pursuant to a valid exercise of a power contained within the trust’s constituent document, or varied with the approval of a relevant court?*

<sup>18</sup> See also paragraphs 11 and 27 to 29 of TD 2012/21.

**Settlement of assets on terms of a different trust?**

24. The appointment of an additional trustee to an existing trust fund would not, without more, give rise to an E1 event. The usual position applying to a trust with multiple trustees is that the trustees share one office of trustee and must act unanimously in respect of the assets of the fund.<sup>19</sup>

25. The steps involved in the arrangement discussed in this draft Determination can be contrasted with the mere appointment of an additional trustee.

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

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

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

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

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

<sup>19</sup> See for example *Beath v. Kousal* [2010] VSC 24 at [18]-[19].

31. While the classes of beneficiaries may remain constant after the trust split as a matter of form, in the exercise of the discretionary power of appointment reposed in it, each trustee must give real and genuine consideration to how, and in respect of whom, the power should be exercised, having regard to the purpose for which the discretion has been conferred.<sup>20</sup>

32. In ascertaining the purposes for which the discretionary powers of appointment have been vested in each trustee, a court could be expected to have regard to extrinsic evidence as to the reasons for or object of the re-organisation, as well as the circumstances surrounding the re-organisation, in construing the scope of the powers and discretions vested in each trustee under the trust deed. This is so notwithstanding that on their face, the trustee discretions conferred by the deed are wholly unfettered.<sup>21</sup>

33. These circumstances lead to the conclusion that the trust powers and discretions vested in the original and new trustee have purposes distinct from each other, notwithstanding that they are contained within the same trust deed and are on identical terms. These distinct purposes could be expected to be recognised and given effect to by a court in the event that a disappointed beneficiary attempted to raise an action against a trustee. Returning to the example in paragraphs 5 – 12 of this draft Determination:

- (a) *Assume the Moon Trustee thenceforth distributed all the income from the 100 Sun Pty Ltd shares to Jane. The parties' intent is that post the transfer of the 100 Sun Pty Ltd shares to Moon Trustee, those shares will be held for the benefit of Jane and her children and Moon Trustee would accordingly only make distributions of income derived from those shares between Jane and her children. Any challenge by Ben or Holly of the Moon Trustee's decision to only distribute to Jane would be contrary to this intent and it might be expected such a challenge would fail.*
- (b) *Assume instead the Moon Trustee thenceforth distributed all the income from the 100 Sun Pty Ltd shares to Ben or Holly. This would be inconsistent with the parties' intent that post the transfer of the 100 Sun Pty Ltd shares to Moon Trustee, Moon Trustee would hold those shares (and the income derived from those shares) for the benefit of Jane and her children and not for the benefit of Ben or Holly. As such, Jane would have a basis to challenge the trustee's actions and such a challenge might be expected to succeed.<sup>22</sup>*

34. *These expected outcomes are consistent with the conclusion that, in transferring the 100 Sun Pty Ltd shares to Moon Trustee, those shares are subject to a new charter of rights and obligations: that those shares have been settled on terms of a new trust to be held for the exclusive benefit of Jane and her children.*

<sup>20</sup> *Edge v. Pensions Ombudsman* [1998] Ch 512 at 533F-G; *Attorney-General for the Commonwealth v. Breckler* (1999) 197 CLR 83 at 99–100.

<sup>21</sup> Use of extrinsic evidence of this type is permissible at law: *Byrnes v. Kendle* (2011) 243 CLR 253, 275 [59]; *Schmidt v. Rosewood Trust Ltd* [2003] 2 AC 709, [31]; *Karger v. Paul* [1984] VR 161, 175; *Hartigan Nominees Pty Ltd v. Rydge* (1992) 29 NSWLR 405, 427–431.

<sup>22</sup> Of course as Jane is the designated appointor for the Moon Trust, if Moon Trustee were to act in this way it would also be expected Jane would exercise her powers as appointor to remove the trustee and replace it with an entity that would respect the intention of the parties in 'splitting' the trust.

## **By declaration or settlement?**

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

36. A trust is created by declaration within the meaning of subsection 104-55(1) when it is created by words or conduct sufficient to demonstrate an intention to create an express trust over property.<sup>23</sup> Where a trust split is implemented by executing a deed of variation, or similar document, the terms of the agreement will demonstrate an express intention to hold the transferred assets subject to the terms of the trust deed, which is sufficient to create a trust over those assets by declaration.

37. A trust is created by settlement when property is vested in a trustee for the benefit of others.<sup>24</sup> A trust split involves a transfer of existing trust property to, and the vesting of this property in, a new trustee for the benefit of others. There will therefore be the creation of a trust by settlement.

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

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<sup>23</sup> *Kafataris v. DC of T* (2015) 243 FCR 291 at [26] (*Kafataris*).

<sup>24</sup> *Taras Nominees Pty Ltd v. FC of T* (2015) 228 FCR 418 at [5]; *Kafataris* at [31].



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## **Appendix 2 – Your comments**

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39. You are invited to comment on this draft Determination including the proposed date of effect. Please forward your comments to the contact officer by the due date.

40. A compendium of comments is prepared for the consideration of the relevant Public Advice and Guidance Panel or relevant tax officers. An edited version (names and identifying information removed) of the compendium of comments will also be prepared to:

- provide responses to persons providing comments
- be published on the ATO website at [www.ato.gov.au/law](http://www.ato.gov.au/law)

Please advise if you do not want your comments included in the edited version of the compendium.

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## References

*Previous draft:*

Not previously issued as a draft

*Related Rulings/Determinations:*

TR 2006/10; TD 2012/21

*Previous interpretative decisions:*

ATO ID 2009/86

*Legislative references:*

- ITAA 1936
- ITAA 1936 Pt IX
- ITAA 1997
- ITAA 1997 104-55(1)
- ITAA 1997 104-55(2)

*Cases relied on:*

- Attorney-General (Cth) v. Breckler - (17 June 1999) - (1999) 197 CLR 83; (1999) 42 ATR 313
- Byrnes v. Kendle - [2011] HCA 26; (2011) 243 CLR 253
- Commissioner of State Revenue (Vic) v. Lam and Kym Pty Ltd [2004] VSCA 204; 2004 ATC 5058; (2004) 58 ATR 60
- Federal Commissioner of Taxation v. Commercial Nominees of Australia Ltd [2001] HCA 33; (2001) 47 ATR 220; 2001 ATC 4336
- DKLR Holding Co (No 2) Pty Ltd v. Commissioner of Stamp Duties (NSW) - (2 June 1980) - [1980] 1 NSWLR 510; (1980) 10 ATR 942; 80 ATC 4279

- Edge v. Pensions Ombudsman - [1998] Ch 512
- Federal Commissioner of Taxation v. Bamford - (30 March 2010) - (2010) 75 ATR 1; [2010] HCA 10; 2010 ATC 20-170; [2010] 240 CLR 481
- Federal Commissioner of Taxation v. Clark - (21 January 2011) - 2011 ATC 20-236; (2011) 190 FCR 206; (2011) 79 ATR 550
- Federal Commissioner of Taxation v. Commercial Nominees of Australia Ltd - (22 October 1999) - [1999] FCA 1455; 99 ATC 5115; (1999) 43 ATR 42
- Kafataris and Another v. Deputy Commissioner of Taxation - (20 August 2015) - 2015 ATC 20-523; [2015] FCA 874; (2015) 243 FCR 291
- Oswal and Others v. Federal Commissioner of Taxation - [2013] FCA 745; 2013 ATC 20-403; 2013 ATC 20-403; (2013) 96 ATR 68
- Taras Nominees Pty Ltd v. Federal Commissioner of Taxation 2015 ATC 20-483; (2015) 228 FCR 418; (2015) 96 ATR 1

*Other references:*

- Ford and Lee, Principles of the Law of Trusts, 2<sup>nd</sup> edition, Sweet & Maxwell Ltd, 1990
- Heydon JD and Leeming MJ, Jacobs' Law of Trusts in Australia, 8<sup>th</sup> edn

**ATO references**

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