TD 2017/24EC - Compendium

Public advice and guidance compendium – TD 2017/24

This is a compendium of responses to the issues raised by external parties to draft Taxation Determination TD 2016/D5 *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 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?*

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

Summary of issues raised and responses

Issue No.	Issue raised	ATO Response/Action taken
1	**Statutory context and legislative purpose of section 99B indicate approach is wrong** The tax outcome that an Australian beneficiary receiving a capital gain through a trust cannot benefit from the CGT discount or use capital losses is not consistent with the appropriate policy outcome. Hill J in *Traknew Holdings Pty Ltd v. FCT* 91 ATC 4272 noted the purpose and historical context in which section 99B *of the Income Tax Assessment Act 1936* (ITAA 1936) is to be understood. That is, income accumulated offshore in a tax-free form was not subject to tax when distributed to a resident beneficiary. Hill J noted that in some cases, the extreme width of the provision might require it to be read down. The Full Federal Court in *Howard* re-affirmed the view that section 99B was introduced as a 'catch-all' provision, with residual effect after the primary operation of section 97 of the ITAA 1936. That is, where Australian resident investors are taxed on a present entitlement basis, section 99B has no residual operation. Section 99B was never enacted to deal with distribution of capital gains, but was enacted to deal with distributions of foreign-sourced	The first comment does not explain why the policy outcome is not appropriate, it merely asserts that it is not. That is, it takes as given that an outcome where discount or capital loss offset is available is 'appropriate' and the alternative inappropriate. Where amounts are not included in the subsection 95(1) net income, for example, by the operation of section 855-10 of the *Income Tax Assessment Act 1997* (ITAA 1997), the normal assessing provisions of Division 6, including section 97 cannot operate to appropriately tax them. Section 99B will apply to bring these amounts to tax and appropriately operate as a catch all provision. If section 99B did not apply, the amounts could escape taxation altogether. We consider that the approach in the determination is not inconsistent with the legislative intention behind section 99B. While the section was introduced before the CGT provisions, its focus is on taxing distributions from non-resident trusts that have not been assessed. One reason that amounts may not be assessed is because of the operation of section 855-10 of the ITAA 1997. In *Traknew*, Hill J's comments were dicta, and the factual

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	income not previously subject to tax in Australia. Coupled with the principles of statutory construction most recently outlined in *Commissioner of Taxation v. Unit Trend Services Pty Ltd* (2013) 250 CLR 523, the Commissioner's view cannot be sustained.	circumstances under consideration were far removed from those to which section 99B were primarily directed. The scenario there was not in relation to foreign income. The absence of entitlement to CGT discount for section 99B amounts has long been recognised – see paragraph 6.17 of the February 2003 Board of Taxation Report to the Treasurer, *International Taxation*.
2	**Section 99B should not apply to capital gains distributed in the year of derivation** It is not clear from the *Example* whether the same approach would apply if the amount was distributed in the same year as the shares were sold. Capital gains derived by foreign trusts in respect of non-taxable Australian property and distributed in the year of derivation to Australian resident beneficiaries should be assessed on a present entitlement basis to such beneficiaries, for example, under section 97 of the ITAA 1936 and the associated provisions of Subdivision 115-C of the ITAA 1997. It therefore follows that the exception in subparagraph 99B(2)(c)(i) of the ITAA 1936 operates to exclude the relevant amount from being assessed under section 99B. Section 99B was introduced in 1979 as part of the suite of amendments made to Division 6 after the *Union Fidelity* decision. The Explanatory Memorandum stated that section 99B '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'. Where the relevant capital gain is distributed in the year of derivation and is not accumulated, the case should not fall within the	Changes have been made to paragraphs 2, 3 and 4 to remove the timing references as they are not relevant to the issue. As noted above, because capital gains from non-TAP assets are excluded from a foreign trust's net income in the year that they are made, they cannot be assessed to a beneficiary under the general rules in Division 6 in that year. That is so whether or not the gains are distributed currently. While the EM said that section 99B would generally apply where amounts had been accumulated, it is not limited to that case, though no interest may be payable.

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	ambit of section 99B.	
3	**Hypothetical taxpayer test – problems with Commissioner's view** The Commissioner cites the *Union Fidelity* case as authority for his view that the hypothetical taxpayer posited by paragraphs 99B(2)(a) and 99B(2)(b) of the ITAA 1936 is a non-specific taxpayer. This reliance is misplaced. Barwick CJ said: 'The effect of the definition of net income of the trust estate in s.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.' appear to negate the contention that the hypothetical taxpayer has no characteristics other than being a resident. The Union Fidelity Case contradicts the Commissioner's position and requires that the enquiry under paragraphs 99B(2)(a) and 99B(2)(b) to be made on the basis that the hypothetical taxpayer were an individual. The words in paragraph 99B(2)(a) are similar to those in subsection 95(1) of the ITAA 1936 which requires trustees to assume that they are a hypothetical resident taxpayer in calculating their net income. If the trust's characteristics as a trust were not imputed to the hypothetical taxpayer in subsection 95(1), the trust could not assert that any capital gain was eligible as a discount capital gain under section 115-10 of the ITAA 1997 as the hypothetical taxpayer would not be an individual, a complying superannuation entity, or a trust. Alternatively, section 115-10 is the more specific provision with respect to the calculation of net capital gains, thus overriding the lack of characteristics other than residency in the hypothetical taxpayer in calculating subsection 95(1) net income. An analogous interpretive approach to paragraph 99B(2)(a) should be applied in	While Barwick CJ referred to an individual, Kitto and Menzies JJ referred to a person. We do not think that any definitive point can be taken from this, and particularly not in the sense that an individual taxpayer would be entitled to CGT discount under tax laws enacted decades later. Section 95 was amended as a result of *Union Fidelity* to include a residency requirement for the hypothetical taxpayer; the amendment not requiring the hypothetical taxpayer to also be an individual. Changes have been made to paragraph 17 to address this point. There is a different statutory context to the hypothetical taxpayer test in subsection 95(1). It is clear the subsection 95(1) test is to be applied to the actual trust estate and that the only matters to be assumed are residence and that the trust was a taxpayer. On this basis there is a clear link to section 115-10 which provides a trust with access to the discount. In the case of the section 99B hypothetical taxpayer test, the trust is hypothetical not actual. It is not a question of more specific, it's a question of whether it can apply at all. Further, it cannot provide characteristics that are otherwise absent in the hypothetical test in section 99B for example, of an actual trust or individual. To the contrary, all that we know about a hypothetical resident is that their capital gains would be included in their net capital gain which in turn would be assessable to a resident taxpayer. The other matters that is, application of capital losses or CGT discount don't prevent the determination of an assessable amount for a hypothetical resident taxpayer for the purpose of subsection 99B(1).

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	support of Alternative View 1. It can’t be concluded that the CGT provisions would make the capital gain assessable. Rather section 102-5 of the ITAA 1997 includes the taxpayer’s net capital gain in assessable income. To calculate a net capital gain a range of other things would need to be known including the taxpayer’s losses and how they were applied against gains. As was the case in Union Fidelity, if nothing is known as to these matters, it cannot be the case that the amount will be included in the hypothetical taxpayer’s assessable income.	
4	**Inconsistency with broader policy intent** The ATO ‘s proposed view in the tax determination is inconsistent with broader policy objectives relating to achieving comparable tax treatment between direct and indirect investment, particularly outbound investment of resident collective investment vehicles (CIVs), including managed investment trusts (MITs) and Australian superannuation funds. It is recommended the ATO works with industry and Treasury to ensure Australian investors investing via a managed investment trust (MIT) receive the same CGT outcome whether the MIT invests directly in foreign assets or indirectly via a foreign trust. Until such time as a law fix, the ATO should consider an administrative or compliance approach and/or the possible application of the Commissioner’s remedial power.	There is no evidence that the legislative intention is to provide comparable tax treatment between direct and indirect investment. The absence of entitlement to CGT discount for section 99B of the ITAA 1936 amounts has long been recognised. See paragraph 6.17 of the February 2003 Board of Taxation Report to the Treasurer, *International Taxation*. The matter does not satisfy the Remedial Power criteria. The issue has been drawn to the attention of Treasury.
5	**Character retention** The hypothesis posited by both paragraphs 99B(2)(a) and 99B(2)(b) of the ITAA 1936 is similar and preserves or retains the character of ‘the amount’ under consideration – thus, the capital gain derived by the trustee is assumed to have been derived by the hypothetical resident taxpayer – see *Howard v. FCT* [2012] FCAFC 149 at [48].	There is nothing in section 99B of the ITAA 1936 that gives a character to the payment in the hands of the beneficiary (other than its character as a previously assessed amount). It is clear that Subdivision 115-C of the ITAA 1997 can only apply in relation to amounts attributable to capital gains included in the net income of a trust. As outlined in Taxation Determination

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		TD 2016/D4 *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?*, capital gains from non-TAP assets are not included in the net income of a foreign trust. Further if a payment could be regarded as a capital gain, one would have expected that section 115-215 of the ITAA 1997 (prior to the 2011 amendments) would have referred to section 99B of the ITAA 1936.
6	**Support for Alternative views** The hypothetical taxpayer tests in paragraphs 99B(2)(a) and 99B(2)(b) of the ITAA 1936 should be applied incorporating the characteristics of trustee and beneficiary where appropriate per Alternative View 1 and 2. Support for this view can be found in paragraph 41 of the decision in *Howard v. Federal Commissioner of Taxation,* where the successive application of section 99B of the ITAA 1936 through levels of foreign trusts indicates that the characteristic of the Juris Trust estate as trustee, and the Esparto Trust estate as both trustee and beneficiary is imputed into the application of paragraph 99B(2)(a). Absent this inference, it would not be possible to apply section 99B to the distribution received by the Esparto Trust estate (assuming that it was a resident) from the Juris Trust estate, as section 99B only applies to amounts paid by a trust to a beneficiary of the trust.	While it is clear that the payment has to be from a trust to a beneficiary, for section 99B to apply, it does not follow that this must be determinative of the character of the hypothetical taxpayer.
7	**Support for Alternative View 2- Characteristics of the beneficiary are imputed to the hypothetical taxpayer** This view results in appropriate amounts of assessable income in the beneficiary's hands. For example, a resident individual	Noted but not accepted for the reasons outlined in the Determination. Noted. However, the matter does not satisfy the Remedial Power criteria.

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	beneficiary receiving a distribution out of trust corpus representing a previously accumulated capital gain should be assessable on the same amount that they would have been assessable on had they made the capital gain personally. Section 99B of the ITAA 1997 has not been amended in any significant manner since its introduction, despite subsequent dramatic changes to the income tax law, including the introduction of the CGT regime in 1985 and the CGT discount for certain entities in 1999. Section 99B in its current form is not flexible enough to allow for consistent and cohesive interaction with various other provisions of the tax law. If the only impediment to adopting Alternative View 2 is a single limited circumstance in which it gives rise to an inappropriate result, and in lieu of a broader review of Division 6 of the ITAA 1997, this may be a matter to which the Commissioner could seek to apply his statutory remedial power.	
8	The draft taxation determinations TD 2016/D4 and TD 2016/D5 appear to jump to the conclusion that on distribution of a non-TAP capital gain of a foreign trust to an Australian resident, section 99B may apply to include the full amount in the beneficiary's assessable income. This is where the reasoning in the *Examples* seem incomplete and the facts unclear. For example, TD 2016/D4 refers to a discretionary trust whilst TD 2016/D5 simply refers to a foreign trust. Neither ruling refers to the beneficiary being presently entitled to the trust income.	The reference to a 'discretionary' trust in the *Example* in TD 2016/D4 has been removed, as the trust's status as either a fixed trust, or non-fixed trust is irrelevant. The 'present entitlement' of a beneficiary to such amounts is also irrelevant in the circumstances described because the gains are not included in the trust's net income.
9	The ruling does not refer to CGT event E4, presumably because it takes the view that subsection 99B(1) of the ITAA 1936 makes the payment assessable or because the rulings are dealing with discretionary trusts. However there are difficulties with the reasoning supporting the application of section 99B. If section 99B did not apply and if the trust was a unit trust, CGT event E4 would	CGT event E4 will only apply to payments of non-assessable amounts. CGT event E4 can have no application if an amount is made assessable by section 99B. While we take the view that subsection 99B(1) is likely to apply in most cases, there may be other exceptions that are relevant to its application or a Double Tax Agreement may give taxing rights to

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	presumably apply and the beneficiary making an E4 capital gain would be entitled to CGT discounting and able to use capital losses against it. Thus the section 99B reasoning is critical. It should be noted that the rulings do not say the amount will be assessed by subsection 99B(1), rather they say that the amount may be included.	another country.
10	Private Ruling 1012694430183 takes the position that the trust is the hypothetical resident taxpayer. This amounts to a U-turn as contemplated in PSLA 2011/27.	A record in the *Register of private binding rulings* is not intended to provide advice, nor does it set out our general administrative practice. A decision in relation to a single case is not of itself sufficient to demonstrate that the ATO has facilitated or contributed to the development of particular views by taxpayers generally or an industry practice. We note that there are other edited versions that take different views, consistent with those expressed in the tax determination. However, recognising the absence of any earlier public advice or guidance that clearly set out the ATO's views on the issue, the Commissioner does not propose to devote compliance resources to apply the view in the tax determination to distributions received or already assessed in income years ending before the issue of the determination (see Appendix 3).
11	In relation to TD2016/D4, section 99B of the ITAA 1936 is referred to as a source in relation to the inclusion of an amount, being in the case discussed, a capital gain in a beneficiary's assessable income. However this reasoning ignores paragraph 99B 2(b) which says that the amount shall be reduced by so much of the amount as represents an amount that, if it had been derived by a taxpayer	We do not agree that it can be assumed for the purposes of paragraph 99B(2)(b) that the hypothetical taxpayer is eligible for discount. We also do not agree that the legislation provides tax symmetry for direct holdings of assets by residents, and assets held in foreign trusts where gains are distributed to residents.

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	being a resident, would not have been included in the assessable income of that taxpayer of a year of income. The 50% discount in relation to a capital gain made on an asset held for greater than one year would surely be an example covered by paragraph 99B(2)(b). Therefore if a non-resident trust had sold an apartment which it had held for over a year and distributed the capital gain to an Australian resident, the resident should surely be entitled to the discount on the gain. If an Australian resident purchases an apartment in London and then sells it after a few years the capital gains tax discount would be available. If instead, money to purchase the apartment was lent or gifted and the trusts sells it after a few years and distributes the gain to the Australian resident beneficiary he should still be eligible for the discount.	
12	**Temporary Residents** The draft determinations do not address the treatment that would apply if the beneficiaries are temporary residents. Section 768-910 of the ITAA 1997 ensures that a temporary resident is not assessed on ordinary income or statutory income (other than a net capital gain) that is derived directly or indirectly from a foreign source if the taxpayer is a temporary resident when the amount is derived. Sections 768-960 and 768-970 of the ITAA 1997 deal specifically with the application of the controlled foreign company rules and transferor trust rules, but there does not appear to be a specific provision dealing with the application of section 99B of the ITAA 1936 to temporary residents. The view in the draft taxation determination is that amounts	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 someone is a resident for part of the relevant year and a temporary resident for part of the same year, section 99B may apply. This is consistent with the approach taken where a foreign resident becomes a resident: see ATO ID 2011/93 *Income Tax 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.*

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	assessed under section 99B would not be treated as a capital gain. A temporary resident beneficiary of a foreign trust should not be assessed under section 99B if the distribution they receive represents a capital gain that has a foreign source. The practical application of the draft taxation determination could be improved by additional comments and/or examples which deal specifically with whether section 768-910 can apply to amounts that would otherwise be assessable under section 99B, and explaining the circumstances in which section 768-910 would apply. This is particularly relevant for beneficiaries who are residents of Australia but are citizens of New Zealand, as it is common for these individuals to continue to be classified as temporary residents for an extended period of time. Interestingly, the example in TD 2016/D4 deals with a NZ resident trust. If the exemption in section 768-910 can apply, further guidance would also be required in determining whether a capital gain made by a foreign trust has an Australian source or a foreign source. We understand that the ATO is currently drafting a separate Draft Taxation Determination dealing with this issue.	
13	Paragraph 11 of TD 2016/D5 states that a section 99B of the ITAA 1936 amount does not have the character of a capital gain and suggests a disregarded capital gain is not excluded by subsection 99B(2). Presumably it is not the purpose of section 99B to override specific (and subsequent) CGT exemptions (such as that provided for life policies under Item 3 of the Table in subsection 118-300(1) of the ITAA 1997) in respect of life policies held by trustees, and the flow-on exemption for beneficiaries of that trust under subsection 118-300(1A)). It would be valuable to taxpayers and tax advisors alike, if the ‘final’	We do not seek to bring to tax under section 99B amounts attributable to capital gains that would be disregarded by any resident taxpayer, for example, gains from life insurance policies. Changes have been made – see paragraph 21.

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	TDs made it clear that CGT exemptions that would apply to resident taxpayers are not disregarded when applying section 99B.	
14	In paragraph 16 of Appendix 1 it says ‘This indicated that the hypothesis in these provisions is concerned with non-resident taxpayers generally, rather than a particular trustee or beneficiary’. Should this have been ‘concerned with resident taxpayers generally’, which seems to make more sense in the context of paragraphs 99B(2)(a) and 99B(2)(b) of the ITAA 1936?	Agree. Changes have been made to paragraph 16.