# *TR 2004/D25 - Income tax: capital gains: meaning of the words 'absolutely entitled to a CGT asset as against the trustee of a trust' as used in Parts 3-1 and 3-3 of the Income Tax Assessment Act 1997*

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The Tax Office is consulting with Treasury in relation to absolute entitlement and in particular the problem areas of joint and multiple beneficiaries, and the trustee`s indemnity. TR 2004/D25 will not be finalised while this consultation is occurring. TR 2004/D25 will not be withdrawn and still represents the Tax Office view of the law.

Generated on: 27 November 2026, 12:28:41 AM

# Draft Taxation Ruling

# Income tax: capital gains: meaning of the words 'absolutely entitled to a CGT asset as against the trustee of a trust' as used in Parts 3-1 and 3-3 of the *Income Tax Assessment Act 1997*

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***Preamble***

*This document is a draft for industry and professional comment. As such, it represents the preliminary, though considered views of the Australian Taxation Office. This draft may not be relied on by taxpayers and practitioners as it is not a ruling for the purposes of Part IVAAA of the* ***Taxation Administration Act 1953****. It is only final Taxation Rulings that represent authoritative statements by the Australian Taxation Office.*

## What this Ruling is about

1. This ruling explains the circumstances in which a beneficiary of a trust is considered to be absolutely entitled to a CGT asset of the trust as against its trustee.

2. Broadly, an absolutely entitled beneficiary (rather than the trustee) is treated as the relevant taxpayer in respect of the asset for the purposes of the capital gains tax (CGT) provisions.

### Class of persons/arrangement

3. This Ruling only applies in determining whether a beneficiary is absolutely entitled to a trust asset as against the trustee for the purposes of the CGT provisions in Parts 3-1 and 3-3 of the *Income Tax Assessment Act 1997* (ITAA 1997).

4. References in this Ruling to an 'absolutely entitled' beneficiary are to be read as references to a beneficiary who satisfies the criteria for absolute entitlement as that phrase is used in the CGT provisions.

#### *Unit trusts*

5. This Ruling does not apply to a unit holder in a unit trust in respect of assets of the trust. The scheme of the ITAA 1997 is to treat a unit as the relevant asset for capital gains purposes rather than any asset of the trust, even if the unit holder has an interest in the trust property at general law (see Taxation Determination TD 2000/32). Therefore, the holder of all the units in a unit trust is not subject to the general treatment that applies to those who are absolutely entitled for

CGT purposes to the assets of a trust. See Explanation paragraphs 134 to 135.

***Superannuation funds***

6. This Ruling also does not apply to a member of a superannuation fund in respect of assets held by the fund. There is an extensive statutory regime governing the taxation of superannuation funds, the payment of benefits by funds and the taxation of those benefits in the hands of a recipient. It is considered that the entitlement of a member to benefits is governed entirely by that statutory regime and for that reason an entitlement to the fund's assets can never arise under the CGT provisions. Therefore, a member of a superannuation fund is not treated as if they are absolutely entitled for CGT purposes to the assets of the fund or to assets held in the member's account. See Explanation paragraphs 136 to 139.

# Date of effect

7. It is proposed that when the final Ruling issues, it will apply both before and after its date of issue. However, the final Ruling 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 final Ruling (see paragraphs 21 and 22 of Taxation Ruling TR 92/20).

# Ruling

8. The main CGT provisions to which the concept of absolute entitlement is relevant apply if a beneficiary is (or becomes) absolutely entitled to a CGT asset of the trust as against the trustee (disregarding any legal disability): see section 106-50 and CGT event E5 in section 104-75.

9. The provisions apply separately to each beneficiary and asset of the trust. They require absolute entitlement to the whole of a CGT asset of the trust. While a beneficiary's interest in the trust, or in the trust property, may also be a CGT asset as that term is defined in section 108-5, neither is the CGT asset to which the relevant provisions refer.

**Core principle**

10. The core principle underpinning the concept of absolute entitlement in the CGT provisions is the ability of a beneficiary, who has a vested and indefeasible interest in the entire trust asset, to call for the asset to be transferred to them or to be transferred at their direction. This derives from the rule in *Saunders v. Vautier* applied in

the context of the CGT provisions (see Explanation paragraphs 41 to 50). The relevant test of absolute entitlement is not whether the trust is a bare trust (see Explanation paragraphs 33 to 40).

### *Rule in Saunders v. Vautier*

11. Under the rule in *Saunders v. Vautier*, the courts do not regard as effective a direction from the settlor of the trust that purports to delay the beneficiary's full enjoyment of an asset. However, if there is some basis upon which a trustee can legitimately resist the beneficiary's call for an asset, then the beneficiary will not be absolutely entitled as against the trustee to it.

## Core principle: implications and consequences

12. Paragraphs 13 to 19 outline some general implications and consequences of the core principle.

### *Persons who cannot be absolutely entitled*

13. The following persons cannot be absolutely entitled because they do not have an interest in the trust's assets:

- an object of a discretionary trust prior to any exercise of the trustee's discretion in their favour (see Explanation paragraph 71), and
- a beneficiary of a deceased estate prior to the completion of its administration (see Explanation paragraph 72).

14. Also, a beneficiary with an interest in the trust's assets cannot be absolutely entitled if that interest is contingent or defeasible (see Explanation paragraphs 73 to 75).

### *Factors which do not prevent absolute entitlement*

15. Paragraphs 16 to 19 set out circumstances which do not prevent absolute entitlement.

#### *Trustee*

16. A beneficiary can be absolutely entitled to an asset even though they hold their interests in it as trustee for one or more others (see Explanation paragraph 61).

*Security*

17. The fact that there is a mortgage, encumbrance or other charge over the asset in favour of a third party does not of itself prevent a beneficiary being absolutely entitled to the asset as against the trustee (see Explanation paragraphs 62 to 63).

*Trustee's lien*

18. The existence of a trustee's lien to enforce a right of indemnity against a trust asset will not prevent a beneficiary being absolutely entitled to the asset (see Explanation paragraphs 64 to 65).

*Legal disability*

19. The fact that the beneficiary cannot give the trustee a good discharge for any asset transferred to them because they are suffering a legal disability (for example infancy or insanity) will not prevent the beneficiary being absolutely entitled. Absolute entitlement for CGT purposes is determined ignoring any legal disability (see Explanation paragraphs 66 to 68).

## Core principle: applying it in practice

20. The most straight forward application of the core principle is one where a single beneficiary has all the interests in the trust asset. Generally, a beneficiary will not be absolutely entitled to a trust asset if one or more other beneficiaries also have an interest in it.

### *One beneficiary with all the interests in a trust asset*

21. A beneficiary has all the interests in a trust asset if no other beneficiary has an interest in the asset (even if the trust has other beneficiaries).

22. Such a beneficiary will be absolutely entitled to that asset as against the trustee for the purposes of the CGT provisions if the beneficiary can (ignoring any legal disability) terminate the trust in respect of that asset by directing the trustee to transfer the asset to them or to transfer it at their direction (see Explanation paragraphs 76 to 79).

### *More than one beneficiary with interests in a trust asset*

23. If there is more than one beneficiary with interests in the trust asset, then it will usually not be possible for any one beneficiary to call for the asset to be transferred to them or to be transferred at their direction. This is because their entitlement is not to the entire asset.

24. There is, however, a particular circumstance where such a beneficiary can be considered absolutely entitled to a specific number of the trust assets for CGT purposes. This circumstance is where:

- the assets are fungible;
- the beneficiary is entitled against the trustee to have their interest in those assets satisfied by a distribution or allocation in their favour of a specific number of them; and
- there is a very clear understanding on the part of all the relevant parties that the beneficiary is entitled, to the exclusion of the other beneficiaries, to that specific number of the trust's assets.

25. Because the assets are fungible, it does not matter that the beneficiaries cannot point to *particular* assets as belonging to them. It is sufficient in these circumstances that they can point to a specific number of assets as belonging to them. See Explanation paragraphs 80-126

### Tracing absolute entitlement through a chain of trusts

26. If there is a chain of trusts (for example, the beneficiary of the head trust holds their interest on a sub trust for others) then the CGT provisions require absolute entitlement to be tested at the level of each trust in the chain.

27. If there is absolute entitlement in respect of each trust in the chain then the beneficiary of the sub trust would be entitled to obtain the sub trust's interest in the head trust and, if they did, then they would also be entitled to obtain the assets of the head trust. Having followed absolute entitlement through each trust in the chain it can be said then that for the purpose of the CGT provisions the beneficiary of the sub trust is absolutely entitled to the assets of the head trust (see Explanation paragraphs 127 to 132).

### Examples

28. Refer to the examples at the end of the ruling (paragraphs 149 to 179).

# Explanation

29. The concept of 'absolute entitlement' is used in a number of different contexts in Parts 3-1 and 3-3 (the CGT provisions), each of which requires a determination as to whether a beneficiary is *absolutely entitled to a CGT asset as against the trustee of a trust (disregarding any legal disability)*.

30. Broadly, the provisions dealing with capital gains and losses treat an absolutely entitled beneficiary as the relevant taxpayer in respect of the asset. This means that if a CGT event happens in relation to the asset, the beneficiary (and not the trustee) is responsible for any resulting capital gain or loss. It also means that a CGT event will generally be triggered when a beneficiary becomes absolutely entitled. The main CGT provisions to which the concept of absolute entitlement is relevant are discussed in more detail at paragraphs 141 to 148.

31. The statutory expression 'absolute entitlement' was taken from the UK capital gains legislation. However, the UK definition was not reproduced in the Australian legislation. The concept of absolute entitlement is based on the rule in *Saunders v. Vautier* though the application of that rule must be viewed in the context of the Australian CGT provisions.

32. The rest of the Explanation part of this Ruling discusses:

- whether 'bare trust' is the test (paragraphs 33 to 40);
- the rule in *Saunders v. Vautier* (paragraphs 41 to 50);
- the rule in *Saunders v. Vautier* in the context of the CGT provisions (paragraphs 51 to 68);
- the requirements of absolute entitlement (paragraphs 69 to 75);
- the implications for a beneficiary who has all the interests in the relevant trust asset (paragraphs 76 to 79);
- the implications for a beneficiary if one or more other beneficiaries also have an interest in the trust asset (paragraphs 80 to 126);
- tracing absolute entitlement through a chain of trusts (paragraphs 127 to 132);
- persons to which this Ruling does not apply (paragraphs 133 to 139); and
- the CGT provisions for which absolute entitlement is relevant (paragraphs 140 to 148).

### Bare trust is not the test

33. It is considered that the test of absolute entitlement is based on whether the beneficiary can direct the trustee to transfer the trust property to them or at their direction. While the existence of a bare trust may be a good indicator that a beneficiary of the trust is absolutely entitled, it is not necessary to establish that the trust is a bare trust in order to establish absolute entitlement. Likewise, the existence of a bare trust does not lead automatically to the conclusion that a beneficiary of the trust is absolutely entitled.

34. We take the same view in respect of an equivalent provision in the *Income Tax Assessment Act 1936* (ITAA 1936), section 160V, which contained a reference to 'bare trust' in its heading. A heading to a section of the ITAA 1936 is not part of the Act: see subsection 13(3) of the *Acts Interpretation Act 1901*. Given that the provision itself contained no indication that it should be limited to a bare trust, the heading should not be invoked to limit its operation. The reference to 'bare trust' was omitted when the provision was rewritten and inserted into the ITAA 1997 as section 106-50. Nothing would appear to turn on this omission. (Note that section 950-100 of the ITAA 1997 ensures that section headings *do* form part of that Act.)

35. It is said that a bare trust is one where the trustee has no active duties to perform. Gummow J said in *Herdegen v. Federal Commissioner of Taxation* (1988) 84 ALR 271 at 281:

> Today the usually accepted meaning of 'bare' trust is a trust under which the trustee or trustees hold property without any interest therein, other than that existing by reason of the office and the legal title as trustee, and without any duty or further duty to perform, except to convey it upon demand to the beneficiary or beneficiaries or as directed by them, for example, on sale to a third party.

36. While a beneficiary in these circumstances may be absolutely entitled, the existence or otherwise of a bare trust is not considered the appropriate test because it focuses on the duties of the trustee or trustees rather than on the ability of the beneficiary to direct the trustee. While the two are obviously linked, the focus on the duties of the trustee produces a slightly different emphasis which, if used as the test, would distort the result in some cases.

37. Take for example a trust for the maintenance and advancement of a child until they attain the age of 25. When the child attains their majority they can, if of sound mind, call for the capital without waiting to turn 25. This is essentially what happened in *Saunders v. Vautier* (discussed further at paragraphs 41 to 50).

38. However, Gummow J in *Herdegen v. Federal Commissioner of Taxation* says the trustee of such a trust has active duties and that the trust is therefore not a bare trust. He said ((1988) 84 ALR 271 at 282) that a trustee's obligations with respect to maintenance and advancement go beyond those of guarding the property prior to conveyance to the beneficiary. He said that while a trustee retains active duties of the type involved in a trust for maintenance and advancement 'it would not be, in modern times, an apt use of language to describe him as a 'bare' trustee'.

39. So there are circumstances where a beneficiary can direct the trustee in respect of the trust property, and therefore be considered absolutely entitled to that property, despite the trustee having active duties to perform in the absence of such direction.

40. Also, the existence of a bare trust does not automatically mean a beneficiary of the trust is absolutely entitled. There may be multiple beneficiaries with interests in the trust property in which case other factors need to be considered. It may be that despite the trust

being a bare trust, no one beneficiary is absolutely entitled to the trust property.

### The rule in *Saunders v. Vautier*

41. The principle invoked in the case of *Saunders v. Vautier* was that if a sole beneficiary's interest in the trust property is vested and indefeasible and they are of age then they can put an end to the trust by directing the trustees to transfer the trust property to them or at their direction, even though the trust deed contains a contrary intention. The basis of the principle is that a beneficiary is entitled now to that which will be theirs eventually anyway: *Saunders v. Vautier* (1841) 4 BEAV 115; 49 ER 282.

42. In *Saunders v. Vautier*, the testator left assets to be held on trust to accumulate income from those assets for his beneficiary (his great-nephew), the accumulated income and the assets to be transferred to the beneficiary when he attained the age of 25. However, when the beneficiary attained the age of 21 (the then age of majority in England) he sought to have the whole of the income and assets transferred to him. Despite the directions contained in the will, it was held that the beneficiary had an absolute indefeasible interest in the legacy, there being no gift over in the event of his failing to attain the age of 25. The beneficiary was therefore entitled to the fund.

43. The Master of the Rolls, Lord Langdale, said at p 116:

> I think that principle has been repeatedly acted upon; and where a legacy is directed to accumulate for a certain period, or where the payment is postponed the legatee, if he has an absolute indefeasible interest in the legacy, is not bound to wait until the expiration of that period.

44. When the case came before Lord Cottenham L.C. he said in reference to the assets and the accumulation, and after noting that there was no gift over, 'I am clearly of the opinion that he is **entitled** to it': see Cr. & Ph. 24 at p 248; 41 ER 482 (emphasis added).

45. Other directions contained in a will or trust instrument can be overridden by a sole beneficiary with an absolute, vested and indefeasible interest in the trust property. For example, if money is left to a beneficiary under a will for the purchase of an asset, the beneficiary can demand the money instead of the asset. Likewise, if an asset is held on trust with instructions that it be sold and the proceeds invested for a beneficiary absolutely, then the beneficiary can demand the asset rather than the money.

46. In other words a beneficiary will be absolutely entitled to trust property if there is no other person with an interest in that property. Lord Davey said in *Wharton v. Masterman* [1895] AC 186 at 198; [1895-9] All ER 687 at 691:

> The principle is this: that where there is an absolute vested gift made payable at a future event, with direction to accumulate the

> income in the meantime, and pay it with the principal, the court will not enforce the trust for accumulation in which no person has any interest but the legatee, or (in other words) the court holds that a legatee may put an end to an accumulation which is exclusively for his benefit….There is no condition precedent to happen or to be performed in order to perfect the title of the legatees, and there is no other person who has any interest in the execution of the trust for the accumulation, or who can complain of its non-execution.

47. It should be noted that the principle is concerned with whether a beneficiary has the ability to terminate the trust in respect of the asset, and not whether the beneficiary actually terminates the trust, or even whether they seek to terminate it.

48. The principle from *Saunders v. Vautier* has been extended over the years such that it also applies if there is more than one beneficiary with an interest in the trust property, even if the several interests are not all immediate but are successive, provided all of the beneficiaries consent to bringing the trust to an end, see *Jacobs' Law of Trusts in Australia*, 6th edn, Butterworths, Australia at p 2308. It has even been said that the objects of a discretionary trust fund can join together to terminate the trust: see *Sir Moses Montefoire Jewish Home v. Howell & Co (No 7) Pty Ltd* [1984] 2 NSWLR 406.

49. As such:

> The rule derived from [*Saunders v. Vautier*] may be stated as follows: if all the beneficiaries are sui juris and are collectively possessed of the entire beneficial interest, and are in unanimous agreement, they can terminate the express trust and subsequently instruct the trustee to deal with the trust property as they choose.[1]

50. However there can be exceptions even in the case where a single beneficiary holds all the beneficial interests. In *Re Kirkland (A Bankrupt); Official Trustee in Bankruptcy v. Kirkland and anor, 25 July 1997*, for example, the rule was unable to be invoked against the trustee of a superannuation fund because the effect would have been inconsistent with the objects of the relevant statutory regime.

### The CGT provisions

51. The rule in *Saunders v. Vautier* must be viewed in the context of the CGT provisions. Those provisions, and the scheme established by them, set the parameters within which the concept of absolute entitlement is invoked for CGT purposes. In some important respects they modify the application of the rule in *Saunders v. Vautier* – most notably in the way in which it applies if there is more than one beneficiary with an interest in the trust asset.

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[1] *Law of Trusts*, Marks and Baxt, CCH, Sydney, 1981, p 97.

### *To which CGT asset do the provisions refer?*

52. The CGT provisions dealing with absolute entitlement refer to a CGT asset of the trust – that is, to trust property. An interest in the trust, or in the trust property, may also be a CGT asset as that term is defined in section 108-5 of the ITAA 1997, but neither of them is a CGT asset to which the absolute entitlement provisions refer.[2] The absolute entitlement provisions are concerned with establishing whether it is appropriate to look through the trust and to regard the beneficiary as the relevant taxpayer in respect of the underlying property of the trust. In this context it is clear that the reference is to a CGT asset of the trust, of which the trustee is the owner.

53. In any event, while an interest in a trust, or in a trust asset, may be a CGT asset, that interest is clearly an asset **of the beneficiary**. The only asset to which a beneficiary could be absolutely entitled 'as against the trustee' is an asset **of the trustee**.

54. Therefore, the requirements for absolute entitlement within the context of the CGT provisions cannot be satisfied if there are multiple beneficiaries in respect of a single asset such as land. While each beneficiary may have an interest in, and therefore be entitled to, a share of the land, the asset to which the provisions refer is the land and no beneficiary in this case is entitled to the whole of it.

55. Even if the asset to which the provisions refer is a beneficiary's undivided share in the land (and, as discussed, we do not agree that it is), the beneficiary could not insist upon having that undivided share transferred to them. To do so may prejudice the other beneficiaries because the sale of the remaining undivided share may not realise the same amount as if the whole of the land had been sold and the proceeds distributed: see *Re: Horsnaill* [1909] 1 Ch 631 and *Wilson v. Wilson* (1950) 51 SR (NSW) 91.

### *Do the provisions address beneficiaries separately or collectively?*

56. The CGT provisions work out the capital gains or losses made by individual taxpayers in respect of their CGT assets. Consistent with that scheme the absolute entitlement provisions are also concerned with whether 'you', that is a single beneficiary, are absolutely entitled. Given this context, it is considered that the normal rule of statutory interpretation (contained in paragraph 23(b) of the *Acts Interpretation Act 1901*) that words in the singular number include the plural does not apply. That rule does not apply if a contrary intention appears. The CGT provisions exhibit a contrary intention.

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[2] Note that section 160V(1) of the ITAA 1936 referred to 'an asset held by a person as trustee for another person who is absolutely entitled to the asset as against the trustee.....' while section 106-50 of the ITAA 1997 states that '..you are absolutely entitled to a CGT asset as against the trustee...'. No change in meaning is effected by the rewording (section 1-3 of the ITAA 1997).

57. Therefore, unlike the rule in *Saunders v. Vautier*, the test is not whether the beneficiaries can together agree to end the trust, but rather whether a particular beneficiary can terminate the trust, or at least terminate the trust in respect of a particular trust asset.

58. It is for this reason that a beneficiary of a trust will have difficulty in establishing the requirements for absolute entitlement to an asset of the trustee if one or more other beneficiaries of the trust also has an interest in that asset. See further the discussion under the heading 'More than one beneficiary with interests in a trust asset' (paragraphs 80 to 126).

59. If the provisions were viewed as addressing beneficiaries collectively, those provisions would be very difficult, if not impossible, to administer. For example, if the mere fact that the objects of a discretionary trust can join together to end the trust were sufficient to make each object absolutely entitled, to what, given the existence of the trustee's discretion, would each object be absolutely entitled? This difficulty with the 'collective' approach lends further support to the 'separate' beneficiary approach.

### *As against the trustee*

60. The CGT provisions require the beneficiary to be absolutely entitled to the asset as against the *trustee* and not as against the whole world.

#### *A trustee can be absolutely entitled*

61. Therefore, a beneficiary who holds their interest in a trust (the head trust) on behalf of others, that is, in their capacity as trustee of another trust (the sub trust) may be absolutely entitled to an asset of the head trust even though they could never be absolutely entitled to the asset as against the beneficiaries of the sub trust. That is, a trustee can be absolutely entitled to an asset even though their interest in the asset is held not for their own benefit but for the benefit of others, see *Hoare Trustees v. Gardner (HM Inspector of Taxes)* 52 TC 53.

#### *A security does not prevent absolute entitlement*

62. On the same basis, it is considered that the existence of a mortgage, encumbrance or other charge over the asset in favour of a third party with no interest in the trust does not of itself prevent a beneficiary being absolutely entitled to the asset as against the trustee. This is because the existence of such a charge does not prevent the trustee from 'stepping aside' and, for example, transferring the asset to the beneficiary subject to the charge. That is, such a charge does not affect the beneficiary's relationship with the trustee.

63. The position of a sole beneficiary who has all the interests in a trust asset that is subject to a mortgage can be contrasted with that of a remainderman whose interest in the trust asset is subject to the interest of the life tenant. The remainderman will not be absolutely entitled until the death of the life tenant or the surrender by the life tenant of their interest. Until then the remainderman cannot demand the transfer of the whole of the asset to them because such a transfer would defeat the interest of the life tenant. On the other hand, a beneficiary with all the interests in a trust asset can be absolutely entitled to the asset despite it being subject to a mortgage. The asset can be transferred to the beneficiary subject to the mortgage.

*A trustee's lien does not prevent absolute entitlement*

64. The existence of a trustee's lien to enforce a right of indemnity against a trust asset will also not prevent a beneficiary being absolutely entitled to that asset. The rights of beneficiaries are always subject to the rights of the trustee to be indemnified for outgoings. However, the existence of a trustee's right to be indemnified should not be viewed as diluting or erasing any rights held by the beneficiaries. It just means that the beneficiaries can only exercise their rights subject to the rights of a trustee to be indemnified.

65. The UK provision acknowledges the rights of trustees to be indemnified in that it talks about a beneficiary being absolutely entitled subject only to satisfying these rights of the trustee. However, some support for the view that the UK provision is in this regard simply a restatement of the general laws can be found in *Hoare Trustees v. Gardner (HM Inspector of Taxes)* where Brightman J said ([1979] 1 Ch 10 at 14-15):

> In my judgement this paragraph was not intended to produce any fundamental change of meaning, but merely to spell out the meaning so as to clarify the position where, for example, the trustee has a lien which might be technically sufficient to preclude the potential recipient from asserting a right to absolute entitlement.

***Ignore any legal disability***

66. The concept of absolute entitlement as it is used in the CGT provisions differs from the rule in *Saunders v. Vautier* in that it is to be determined ignoring any legal disability. In other words, if the only thing that prevents a beneficiary from being absolutely entitled under the rule in *Saunders v. Vautier* is their legal disability, then they will be absolutely entitled for the purposes of the CGT provisions.

67. In the absence of this qualification a minor or a person who suffered some other legal disability such as mental incapacity would not be absolutely entitled for these purposes. This is because they would be prevented from calling for the trust property by virtue of their inability to give the trustee a good discharge in respect of the property.

68. Ignoring legal disability ensures that there is no taxing point in respect of a person's assets if they commence to suffer a legal disability or when they are freed from their disability. It also means that the main residence exemption can, if relevant, be satisfied during the period of the disability.

## Requirements of absolute entitlement

69. On the basis of the previous discussion, the following are regarded as key factors which must be present in order for a beneficiary to establish absolute entitlement to an asset.

### *Beneficiary must have an interest in the trust assets*

70. Clearly a trustee would only be obliged to satisfy a demand from a beneficiary with an interest in the trust asset. Therefore, the beneficiary must have an interest in the relevant asset in order to be considered absolutely entitled to it for CGT purposes.

#### *Discretionary trusts*

71. Because an object of a discretionary trust does not have an interest in the trust assets, they cannot be considered absolutely entitled to any of the trust assets prior to the exercise of the trustee's discretion in their favour.

#### *Deceased estates*

72. A beneficiary of a deceased estate does not have an interest in any asset of the estate (and therefore cannot be considered absolutely entitled to any of the estate's assets) until the administration of the estate is complete. That is, until the assets of the estate have been called in and the deceased's debts and liabilities have been paid, see *Commissioner of Stamp Duties (Qld) v. Livingston* [1965] AC 694; [1964] 3 All ER 692.

### *Beneficiary's interests must be vested and indefeasible*

73. The interest a beneficiary has in the trust asset or assets must be vested in possession and indefeasible. A trustee would only be obliged to satisfy a demand from a beneficiary with such an interest.

74. A vested interest is one that is bound to take effect in possession at some time and is not contingent upon an event occurring that may or may not take place. A beneficiary's interest in an asset is vested in possession if they have the right to immediate possession or enjoyment of it.

75. Also, the interest must not be able to be defeated by the actions of any person or the occurrence of any subsequent event. For example, if the class of potential beneficiaries has not yet closed then a beneficiary's interest is capable of being defeated, at least in part, by the admission of new beneficiaries to the class. Another example is if assets are held on trust for X should X attain the age of 25, but if X does not attain 25, then the assets are to pass to Y. This is referred to as a 'gift over' and its existence means that X's interest will be defeated if he does not attain 25.

### One beneficiary with all the interests in a trust asset

76. A beneficiary is a sole beneficiary in respect of a trust asset if no other beneficiary has an interest in the asset. This was the actual situation in *Saunders v. Vautier*. It is the situation most clearly contemplated in the context of the CGT provisions and for this reason the way in which those provisions apply to a sole beneficiary can be simply stated.

77. A beneficiary is *not* the sole beneficiary in respect of a trust asset if, for example, they have all the income interests in respect of the asset, but one or more other beneficiaries are entitled to the asset itself or accretions to capital in respect of it. That is, if there are separate income and capital beneficiaries in respect of the asset, no one beneficiary holds all of the interests in the asset. This is so even if there is one beneficiary with all of the income interests and one with all of the capital interests.

78. Because a sole beneficiary in respect of an asset has the totality of the beneficial interests in the asset, they automatically satisfy the requirement (discussed in paragraph 73) that their interest in the asset be vested in possession and indefeasible. Therefore, a sole beneficiary in respect of a trust asset will be absolutely entitled to that asset as against the trustee if the beneficiary can (ignoring any legal disability) terminate the trust in respect of that asset by directing the trustee to transfer the asset to them or to transfer it at their direction.

79. A sole beneficiary will be entitled to terminate the trust in respect of an asset provided there are no legal impediments to the beneficiary's obtaining immediate possession and enjoyment of the asset. A direction by the settlor of the trust that the beneficiary's enjoyment of an asset be delayed is not an effective impediment. Of greater standing are legislative impediments such as those which prevent the distribution of retirement savings assets prior to retirement and which it is considered the courts would enforce.

**More than one beneficiary with interests in a trust asset**

80. It is evident from the preceding discussion that a beneficiary will have difficulty in establishing that they are absolutely entitled to a trust asset for CGT purposes if one or more other beneficiaries also have an interest in the asset. In the UK capital gains legislation, this problem is addressed, at least in part, by making direct reference to 'two or more persons who are or would be jointly so entitled'. There is no such reference in the Australian CGT provisions and the circumstances in which such a beneficiary may be considered absolutely entitled under those provisions are therefore very limited.

81. The fact that under the rule in *Saunders v. Vautier* multiple beneficiaries may together terminate the trust is of no assistance to such beneficiaries wanting to establish absolute entitlement for the purposes of the Australian CGT provisions. As already discussed, those provisions require a single beneficiary to be absolutely entitled to the whole of a trust asset, whereas the entitlement of a beneficiary who shares their interest with others will generally be to a share of each trust asset.

82. It is also true that equity may permit a beneficiary who has an interest in trust assets along with one or more others to have that interest satisfied by a distribution to the beneficiary of entire assets (provided the assets are readily divisible and the distribution can be made without prejudice to the other beneficiaries). While a beneficiary's ability to have their interest satisfied is necessary in order to establish absolute entitlement for CGT purposes, it is not, of itself, sufficient. This is because it is not possible for the beneficiary, prior to the distribution or sale, to show that they are entitled to any *particular* assets.

83. The importance for the CGT provisions of establishing whether or not there is an absolutely entitled beneficiary prior to the distribution of assets is confirmed by CGT event E5 in section 104-75 of the ITAA 1997. That event may happen when a beneficiary becomes absolutely entitled to a trust asset – that is, before the receipt of the asset by the beneficiary or any other dealing with the asset by the trustee. Therefore, it is necessary to know at all times during the existence of a trust, and in respect of each of the trust's assets, whether there is an absolutely entitled beneficiary.

84. A beneficiary with a vested and indefeasible interest in trust assets where one or more others also have an interest in those assets will nonetheless be considered absolutely entitled to a specific number of the trust's assets if the three factors listed below are also present.

85. First, the assets must be fungible, at least to the extent to which a person would reasonably be expected to be indifferent to the replacement of any one asset with another.

86. Secondly, it must be the case that equity would permit the beneficiary to have their interest in all those assets satisfied by a distribution or allocation in their favour of a specific number of them.

87. Thirdly, there must be a very clear understanding on the part of all the relevant parties that the beneficiary is entitled, to the exclusion of the other beneficiaries, to a specific number of the trust's assets.

88. If these factors are present, then the beneficiary will be considered absolutely entitled to that specific number of the trust's assets for CGT purposes. Because the assets are fungible it does not matter that the beneficiaries cannot point to particular assets as belonging to them. It is sufficient that they can point to a specific number of assets as belonging to them, even though it is impossible to say exactly which ones.

89. The factors are further explained in the following paragraphs (up to and including paragraph 126).

### Multiple beneficiaries: assets must be fungible

90. Where more than one beneficiary has an interest in the trust assets, absolute entitlement can only be established if the assets are fungible.

91. If the assets are not fungible, but more than one beneficiary has an interest in them, then that is the clearest possible indication that, under the terms of the trust, individual beneficiaries are not entitled to particular assets to the exclusion of others. That is, if each asset is unique, but the trust does not clearly set out which beneficiary is to get which asset, this indicates an intention that each beneficiary is in fact to have an interest in each of the assets.

92. In those circumstances, absolute entitlement cannot be established, unless all parties (that is, the trustee and the beneficiaries) agree that a particular asset or assets be set aside for each beneficiary to the exclusion of the others. If that happens, the beneficiaries may be regarded as having become absolutely entitled (but only from that time) to the asset or assets that it is agreed should be set aside for them such that CGT event E5 happens. But of course the basis of that absolute entitlement is the straight forward notion of a sole beneficiary in respect of each asset.

#### *When are assets fungible?*

93. Assets are fungible if each asset matches the same description such that one asset can be replaced with another. Assets are fungible if they are of the same type (for example, shares in the same company and with the same characteristics).

94. The test is not an extreme one. Assets within the class need not be exactly identical and in this regard it is enough that a beneficiary might reasonably be expected to be indifferent between them. For example, in the case of shares, the mere fact that each share is allocated a unique number in the company's share register is not enough to prevent those shares being treated as fungible.

Therefore, shares in a listed public company can be fungible. However, land would rarely be fungible because each parcel of land is unique.

### *Fungible assets form a separate asset class*

95. Fungible assets form a separate class for the purpose of determining the number and type of assets to which each beneficiary is regarded as being absolutely entitled.

96. For example, if the trust property consists of 1,000 listed public company shares and 800 of them are in Co A and 200 are in Co B, then the Co A shares form one asset class and the Co B shares form another. If there are two beneficiaries and under the terms of the trust each is entitled to one-half of the total number of shares, and assuming the other conditions are met, each beneficiary will be absolutely entitled to 400 Co A share and 100 Co B shares.

## Multiple beneficiaries: beneficiary's right to have their interest satisfied

97. A beneficiary with a vested and indefeasible interest in trust property will be entitled to have that interest satisfied (though, as discussed, this right is not by itself sufficient to establish absolute entitlement). The general rule is set out in *Snell's Principles of Equity* 30th edn, Sweet & Maxwell, London, 2000 at p 266:

> The general rule is that a person who is indefeasibly entitled to a share in divisible property is entitled to have his share transferred to him, unless there is some good reason to the contrary, as where division *in specie* of trust property would give one beneficiary a disproportionate advantage. The general rule applies even if the property is held on trust for sale with a power to postpone sale and the transfer would diminish the value of the other shares. It is otherwise if it is land that is thus held.

### *Beneficiaries' interests must be concurrent*

98. The beneficiaries' interests in the trust assets must be concurrent or what Jacobs' Law of Trusts describes as 'immediate'. That is, their interests cannot be successive, see *Kidson (Inspector of Taxes) v. Macdonald and anor* [1974] STC 54; [1974] 1 All ER 849.

99. If there are multiple beneficiaries with successive interests, for example a life tenant and remainderman, then neither beneficiary can, under the 'general rule' quoted in paragraph 97, demand satisfaction of their 'share' of the trust estate. Similarly if there are separate income and capital beneficiaries in respect of an asset, no one beneficiary is entitled to call for the asset in satisfaction of their interest because that would defeat the interests of the other beneficiary.

### *Assets must be conveniently divisible*

100. Assets must be conveniently divisible in order for a trustee to satisfy a demand from a beneficiary that their share be satisfied by the transfer of an asset of the trust (or its allocation in favour of the beneficiary). This condition must be applied separately in respect of each class of fungible assets.

101. Two possible situations may arise. There may be multiple beneficiaries in respect of a single asset (such as land) or there may be multiple beneficiaries in respect of multiple assets (such as shares).

#### *One asset*

102. First, if there is only one asset in the asset class, then the test of fungibility is not satisfied because there is no other asset that could replace it. In any event, if the asset is not divisible, it is impossible, *from the asset*, to satisfy the claims of a beneficiary with a shared interest.

103. Even where division is possible, difficulties will arise if the asset cannot be divided without prejudice to the other beneficiaries. In *Manfred v. Maddrell and Others* (1950) 51 SR NSW 95 Sugerman J said at p 97:

> Thus, where real estate is held on trust for sale and division of the proceeds, one of several beneficiaries has no right to a transfer of his undivided share, because the remaining undivided shares will not fetch their full proportion of the proceeds of sale of the entire estate and so the other beneficiaries are prejudiced. A mortgage debt is not conveniently divisible into shares. Other forms of personal property, which, without attempting an exhaustive or conclusive definition, may be broadly described as fungibles or things which possess all the relevant characteristics of fungibles, do not present the same difficulties, for example, shares in companies or government securities.

104. Even if the asset can be physically divided without prejudice, the asset received by each beneficiary will be a different asset from that which was originally in the trust. Therefore, absolute entitlement can also not be established in these circumstances because the CGT provisions require absolute entitlement to a CGT asset of the trust.

#### *Multiple assets*

105. Even if there are multiple assets, it may be that they cannot be conveniently divided. For example, if the trust property comprises four shares in a private company but there are five beneficiaries with an interest in those shares, then the shares cannot be conveniently divided between the beneficiaries.

106. Similarly, if there are six equal beneficiaries and six quite disparate assets (a caravan, a boat, a car etc), it would not be the typical case that satisfaction of an interest could be made by

transferring one of the assets because of the variation in their values. However if the asset mix is appropriately divisible, the beneficiary can, in the absence of prejudice to other interest holders, insist that their entitlement be met by the transfer of assets currently within the trust rather than accepting a cash equivalent (*Hyman v. Permanent Trustee Co of NSW Ltd* (1914) 14 SR (NSW) 348).

107. So where there is, on trust, a group of fungible assets (an asset class) and the assets are conveniently divisible between the beneficiaries, and there is no prejudice to other interest holders, a beneficiary may be able to demand a certain number of those assets in satisfaction of their partial interest in each and every asset within that class.

### *Distribution must not cause prejudice*

108. In short, the courts will not permit one beneficiary to terminate the trust in respect of an asset if to do so would defeat the interests of other beneficiaries or in any way prejudice those interests. The extent to which the trust property can be conveniently divided between the beneficiaries is relevant in this context. In *Manfred v. Maddrell* Sugerman J said ((1950) 51 SR NSW 95 at 97) in discussing a beneficiary's right to income from a trust fund:

> It may be true that there is for some purposes a difference between a right to a third of the entire income of a fund and a right to the income of a third of that fund. But the cases which have been cited show that the question of making a distribution out of a fund or portion of a fund, so that a beneficiary entitled to what is in form or in substance an immediate, absolute and indefeasible interest may have the present enjoyment of his share, is governed by practical considerations and, in particular, by considerations of convenience of division and of the risk of prejudice to other beneficiaries.

109. Therefore, it is considered that the courts will not permit a beneficiary to take their share if to do so would prejudice the other beneficiaries. Having said that assets which are fungible or bear the characteristics of fungibles can be easily divided, Sugerman J said at p 97:

> Even as to these, there may be special circumstances in particular cases such that division would be inconvenient or detrimental to the other beneficiaries. The Courts have not thought it necessary to define those circumstances, and there is no need to do so here since no special circumstances of this kind are suggested.

110. The difficulty then is in determining whether there are special circumstances that prevent the division of the trust property. This will depend on the facts and circumstances in each case. Shares or units in publicly listed entities are generally considered capable of convenient division without prejudice to other beneficiaries (assuming they are of the same asset class). Traditionally the assets which are cited as presenting the greatest difficulties (aside from land which is discussed above) are private company shares and mortgage debts.

111. In *Re Marshall* [1914] 1 Ch 192, a beneficiary with a one-quarter interest in the assets of a deceased estate was entitled to have transferred to them sufficient shares to satisfy that interest even though the trustee had the power to postpone the sale of the shares for so long as they should in their absolute discretion consider proper. The rights of an absolute owner to demand and take their fraction of the shares were said to prevail over the right of the trustees to postpone their sale.

112. In *Re Sandeman's Will Trusts* [1937] 1 All ER 368 and *Re Weiner's Will Trust* [1956] 2 All ER 482, beneficiaries were held able to receive their entitlement to private company shares even though that meant that the trustees lost their controlling interest in the company. In *Re Sandeman's Will Trusts*, Clauson J, having noted that the courts had been careful never to define in precise terms the special circumstances that would prevent a beneficiary obtaining their share, said at 373:

> … there is no fact, at the present moment, which seems to show that the interests of anybody concerned in the trust will be in the slightest degree prejudiced by the proper division being made – in other words by the shares to which the plaintiffs are entitled being handed over to them.

113. *Lloyds Bank v. Duker* [1987] 1 WLR 1324 is one case in which special circumstances were found to exist which prevented the distribution of private company shares to a beneficiary in satisfaction of their interest in the assets of a deceased estate. In the circumstances it was found that such a distribution would prejudice the other beneficiaries.

114. In that case the deceased's will provided for the division of the residuary estate, which comprised 999 shares in a private company, among named beneficiaries in certain shares. The only other share on issue in the company was already held by his wife. She called for the executor to transfer to her 574 of the shares being the number of shares representing her entitlement of 46/80ths of the estate. Other beneficiaries objected. After making the request, the wife died and an action to give effect to the wife's request was brought by her executor, Mr Duker.

115. The general rule was acknowledged – that is, a person entitled to an aliquot share of an estate is entitled to insist on a corresponding part of the estate property being distributed to him intact if it is readily divisible, rather than the whole property being sold and the proceeds distributed. However, it was held that because a majority shareholding was worth considerably more per share than the minority holdings, a transfer of 574 shares would in fact amount to more than 46/80ths of the estate. Therefore, the trustee was obliged to sell all the shares on the open market and distribute the proceeds in accordance with the proportions specified in the will.

116. In the course of his judgement John Mowbray Q.C. said he was unable to obtain much assistance from the authorities discussed previously because in those cases there was no discrepancy between

share numbers and share values as in this case. He said at 1330-1331:

> I can, though, get some help from another general principle. I mean the principle that trustees are bound to hold an even hand among their beneficiaries, and not favour one as against another, stated for instance in Snell's Principles of Equity, 28th ed., p. 255. Of course Mr Duker must have a larger part than the other beneficiaries. But if he takes 46/80ths of the shares he will be favoured beyond what Mr Smith intended, because his shares will each be worth more than the others. The trustees' duty to hold an even hand seems to indicate that they should sell all 999 shares instead.

### Multiple beneficiaries: specific number of assets held for each beneficiary

117. As discussed, the ability of a beneficiary to demand a number of trust assets in satisfaction of their interest, and the obligation of the trustee to meet that demand, is necessary, but not sufficient, to establish absolute entitlement for CGT purposes. There must also be a clear understanding on the part of all the relevant parties that, despite the shared interests, a specific number of assets of a clearly defined asset class are held for each beneficiary to the exclusion of the other beneficiaries.

118. Shared interests in trust assets may exist despite a requirement, contained for example in the trust deed, that a specific number of assets be held exclusively for each of the beneficiaries, if the assets are fungible. If specific assets are not identified as being in respect of particular beneficiaries, then arguably each beneficiary necessarily retains an interest in each asset even in the face of a contrary instruction in the trust deed.

119. The kinds of situations in which there might be shared interests fall into the following two categories:

- where the assets cannot be separately identified, so it is impossible to match a particular asset with a particular beneficiary (for example, shares in a listed public company), or
- where the high level of homogeneity between the assets suggests that the matching of beneficiaries with assets would be a mere formality (for example, new cars of the same make and model).

120. However, in the second case if there are three such cars and three beneficiaries and the trust deed provides that each beneficiary is entitled to a car and the trustee marks which car is set aside for each beneficiary, then absolute entitlement will easily be established. In that case there is only one beneficiary with an interest in each asset and the problems associated with multiple beneficiaries do not arise. Of course in these kinds of cases, where particular assets are set aside for particular beneficiaries, absolute entitlement can arise irrespective of the kinds of assets involved.

### *Evidentiary requirements*

121. The fact that a specific number of fungible assets of a single asset class are held for each beneficiary must be consistent with any trust instrument and be evidenced by a contemporaneous written record, made by the trustee, of the number held for each beneficiary. However, where there is a trust instrument, and its terms unambiguously indicate a specific number of assets are for each beneficiary, then the trust instrument will be sufficient evidence of the number held for each beneficiary.

122. The requirement that there be a record of allocation means that when the trustee deals with a recorded asset, whether by distribution or otherwise (or there is any other occurrence that has CGT consequences such as an adjustment to the assets' cost base) they will specify which beneficiary's assets were the subject of that dealing. That is, it will be clear which beneficiary's asset was the subject of the dealing.

123. The records must be in writing. There is no prescribed form in which they must be made. The only requirement is that they clearly state the number of assets of an asset class to which a particular beneficiary is entitled for their own benefit to the exclusion of the other beneficiaries and, if applicable, the CGT attributes of each such asset.

124. Because the relevant situation is one where there are both shared interests and the holding of a specific number of assets for each beneficiary, a written record of allocation by the trustee (or a clear unambiguous trust instrument) is required. The record serves as confirmation that the trust is administered on the basis that a specific number of assets are held for each beneficiary, rather than on the basis of the shared interests. In the absence of such evidence it is considered that absolute entitlement is not established, regardless of the terms of the trust instrument.

125. In the absence of a record of asset allocation it would be reasonable to conclude that shared interests in the trust assets, by their very nature, prevent absolute entitlement. For example, if there are three assets and three beneficiaries who the trust deed says are to share equally in the assets, no one beneficiary is absolutely entitled to an asset unless the trustee has also recorded an allocation.

126. As this record of allocation is the final requirement for absolute entitlement, the making of the record may, if all of the other requirements for absolute entitlement are established, cause the beneficiaries named in the record to become absolutely entitled to the number of assets that the record shows as theirs. If it does, then CGT event E5 in section 104-75 of the ITAA 1997 will happen. In some circumstances, this event will trigger a taxing point for both the trustees and the beneficiaries.

### Tracing absolute entitlement through a chain of trusts

127. The fact that the beneficiary of the trust (the head trust) is acting in the capacity of trustee of another trust (the sub trust) does not prevent their being absolutely entitled to the assets of the head trust. The question is whether absolute entitlement can be traced further through the chain so that the beneficiary of the sub trust can also be said to be absolutely entitled to the assets of the head trust.

128. *Jacobs' Law of Trusts* suggests at p. 699 that it is unlikely that the beneficiaries of the sub trust would be able to invoke the rule in *Saunders v. Vautier* against the trustee of the head trust by demanding a transfer of the property of the head trust to them:

> …difficulties may arise with sub-trusts. A sub-trust will arise if A, a beneficiary under a trust, declares himself trustee of it for B under a trust imposing active duties on A; the head trustee will owe his duties to A who will continue to hold a beneficial interest and A will owe distinct duties to B who will also acquire a beneficial interest. Even if B's interest be vested absolutely and B be sui juris, there will not be between B and the head trustee the precise co-incidence of right and duty necessary to B to invoke the rule in Saunders v. Vautier and require a conveyance of the legal title to him.

129. Jacobs' suggests that that outcome may be different if A does not have active duties. However, regardless of whether the trustee of the sub trust has active duties it is considered that the better view is that the CGT provisions require absolute entitlement to be tested at the level of each trust in the chain.

130. The purpose of applying those absolute entitlement provisions is to determine whether it is appropriate to 'look through' a trust and consider the beneficiary as the appropriate taxpayer in respect of the trust property. Given that context, it is inappropriate to adopt a look through approach *before* applying the provisions.

131. Therefore, while the practical effect may be that the beneficiary of the sub trust could obtain the property of the head trust, and therefore be regarded as absolutely entitled to it, that position can only be reached within the context of the CGT provisions by an application of the provisions to each successive trust in the chain.

132. For example, if there was absolute entitlement in respect of each trust in the chain, then the beneficiary of the sub trust would be entitled to obtain the sub trust's interest in the head trust and, if they did, then they would also be entitled to obtain the assets of the head trust. Having followed absolute entitlement through each trust in the chain it can then be said that for the purpose of the CGT provisions the beneficiary is absolutely entitled to the assets of the head trust. Tracing would be more difficult where there were multiple beneficiaries and assets.

### Class of persons to which this Ruling applies

133. This ruling does not apply to a unit holder in a unit trust in respect of assets of the trust. It also does not apply to a member of a superannuation fund in respect of assets of the fund.

#### *Unit trusts*

134. Even though a unit holder in a unit trust may, depending on the terms of the trust, have an interest in the property of the trust (see *Charles v. FCT* (1954) 90 CLR 598) they are not subject to the treatment that otherwise applies to a person who is absolutely entitled to any asset of the trust for CGT purposes. This is because the scheme of the CGT provisions is to treat the units in the trust as the relevant asset rather than any interest the unit holder might have in the underlying property of the trust (see Taxation Determination TD 2000/32). Therefore, the concept of absolute entitlement is not relevant to the holder of a unit in a unit trust in respect of the assets of the trust. It is for this reason that this Ruling does not apply to them.

*Unit trusts: alternative view*

135. The alternative view is that a unit holder can be absolutely entitled – provisions such as subparagraphs 104-55(5)(a)(ii) and 104-60(5)(a)(ii) seem to recognise that possibility – and so should be afforded the associated treatment. However, such an outcome would be contrary to the general scheme of the CGT provisions as it could result in a beneficiary holding two assets for CGT purposes (the units and the underlying trust asset) which represent the one thing. The statutory scheme is to treat that interest as being represented by the units on the basis that the units are also assets and, importantly, assets that are traded and that are treated as discrete investment vehicles. It is noted that section 108-5 of the ITAA 1997 specifically identifies units in a unit trust as examples of CGT assets.

#### *Superannuation funds*

136. Anomalies may arise if, for example, the sole member of a self managed superannuation fund is taken to be absolutely entitled to the assets of the fund for CGT purposes.

137. Firstly, a complying superannuation fund is taxed at a concessional tax rate on income generated by the fund, including a net capital gain made by the fund. Were a member of the fund taxed on the basis that the member was absolutely entitled to the fund's assets, then capital gains in respect of those assets would be taken into account in working out the member's net capital gain that would be taxed at the member's marginal tax rate. That outcome is inconsistent with the policy objectives underpinning the taxation of superannuation funds.

138. Secondly, CGT event E5 (see section 104-75 of the ITAA 1997) happens when a beneficiary *becomes* absolutely entitled to a trust asset. Were the concept of absolute entitlement relevant to superannuation funds, then, depending on the structure of the fund, a member may trigger CGT event E5, for example, on termination of their employment or on turning 65. It may be that any capital gain or loss made by the member will be disregarded under section 118-305 of the ITAA 1997, but that provision does not apply to the trustee of the fund. If CGT event E5 happened, the trustee would make a capital gain or loss. This would introduce an additional taxing point that is outside the superannuation regime and is in addition to any tax imposed under that regime on the member in respect of any benefit when it is actually received by the member.

139. We take the view that the legislative scheme that regulates the taxation of superannuation funds, the payment of benefits by those funds and the taxation of those benefits is a complete code in respect of those matters. This does not mean that the CGT provisions cannot apply if a CGT event happens to an asset of a superannuation fund. It simply means that the CGT concept about the entitlement of a beneficiary to trust assets does not apply. Therefore, a member of a superannuation fund is not treated as if they are absolutely entitled for CGT purposes to the assets of the fund or to assets held in the member's account. We take this view regardless of whether the member has met a condition of release for the payment of benefits under the *Superannuation Industry (Supervision) Regulations 1994*.

### CGT provisions for which absolute entitlement is relevant

140. There are provisions that apply to a beneficiary that is already absolutely entitled and, consistent with an absolutely entitled beneficiary (rather than the trustee) being treated as the relevant taxpayer in respect of an asset to which they are entitled, a CGT event may happen at the point when a beneficiary becomes absolutely entitled. The main CGT provisions within this scheme are discussed below.

#### *Beneficiary is already absolutely entitled*

141. A beneficiary that is absolutely entitled to a CGT asset as against the trustee will be the relevant taxpayer if a CGT event happens to the asset. This is the effect of section 106-50 of the ITAA 1997 which provides that an act done by a trustee in relation to an asset is taken to have been done by a beneficiary that is absolutely entitled to the asset.

142. Therefore, the beneficiary (and not the trustee) will be required to account for any capital gain or loss that arises on disposal of the asset in the calculation of their net capital gain or net capital loss and hence their taxable income. This is so regardless of whether the beneficiary has always been absolutely entitled to the asset or they became absolutely entitled to it at some time after the trust commenced.

143. Because the beneficiary is the relevant taxpayer, and the capital gain or loss is included in the beneficiary's income calculations, it is not included in the net income of the trust under section 95 of the ITAA 1936.

144. Also, no CGT event happens when the legal title in an asset to which a beneficiary is absolutely entitled as against the trustee is transferred to the beneficiary.

### *Beneficiary becomes absolutely entitled*

145. CGT event E5 in section 104-75 happens when a beneficiary becomes absolutely entitled to a CGT asset of a trust as against the trustee. However, this event does not happen if the trust is a unit trust or the trust is a deceased estate and the asset was owned by the deceased just before they died (see Division 128 and Taxation Determination TD 93/35).

146. Because absolute entitlement is determined ignoring any legal disability, CGT even E5 will not happen, for example, when a minor reaches the age of majority or a person recovers from a mental illness.

147. A beneficiary that becomes absolutely entitled to a share as against the trustee is entitled to roll-over relief if the trustee obtained scrip-for-scrip roll-over relief following the demutualisation of an insurance company, see section 126-190 of the ITAA 1997. This ensures that the beneficiary inherits the benefit of the roll-over previously obtained by the trustee (that is, that the benefit of the roll-over for the trustee is not 'undone' by the beneficiary becoming absolutely entitled).

148. CGT events E1 and E2 in sections 104-55 and 104-60 (which can happen when an asset is transferred to a trust) do not happen if the transferor is the sole beneficiary of the trust and is absolutely entitled as against the trustee to the asset they transferred, provided the trust is not a unit trust.

# Examples

**Example 1: defeasible interest**

149. In her will Mary directed that her bank shares be held on trust for her daughter Megan until she reached 25 years, but if Megan were to die before that time, the shares were to be transferred to Mary's nephew, Peter.

150. When Mary died, Megan was aged 17 years. The existence of the gift over in favour of Peter should Megan not reach 25 years, means that Megan's interest in the trust assets is defeasible. Therefore, until Megan turns 25 she is not absolutely entitled to the shares. The trustee (and not Megan) is the relevant taxpayer in respect of any capital gain or loss made on the disposal of the shares.

151. When Megan turns 25, she will become absolutely entitled to the shares and Megan (and not the trustee) will be the relevant taxpayer in respect of any capital gain or loss made on their disposal. Because the trust is a testamentary trust, CGT event E5 will not happen when Megan becomes absolutely entitled to shares Mary owned just before she died. However, CGT event E5 will happen if Megan becomes absolutely entitled to any shares acquired by the trustee after Mary's death.

**Example 2: sole beneficiary**

152. In his will Paul made provision for specific bequests to each of his grandchildren with the rest and residue of his estate to go to his wife, Christine.

153. Paul dies. After payment of Paul's debts and the specific bequests, the residue consists of cash, 500 shares in a listed public company and a holiday unit on the coast. Once the residue is ascertained, Christine is absolutely entitled to it and Christine (and not the trustee) will be the relevant taxpayer if the shares and unit are sold, even if Christine never obtains legal title in the assets. Again, because the trust is a testamentary trust, CGT event E5 will not happen when Christine becomes absolutely entitled.

**Example 3: multiple beneficiaries**

154. Assume the same facts as for Example 2, except that Paul's wife Christine has predeceased him and as a result he leaves the rest and residue of his estate to his two daughters, Marie and Clare. Assume also that the will makes it clear that Marie and Clare are each entitled to half the total number of shares each, half the cash and a half share in the holiday unit.

155. The shares are fungible. The will is clear that Marie and Clare are each absolutely entitled to 250 shares.

156. Therefore, if Marie directs the trustee to sell her shares and pay her the cash, Marie (and not the trustee) will be the relevant taxpayer in respect of the resulting capital gain. If Clare directs that her shares be transferred to her, she will be the relevant taxpayer if she later disposes of them.

157. However, neither Marie nor Clare is absolutely entitled to the holiday unit. Neither is entitled to have the unit transferred to them because to do so would defeat the interest of the other. Also, Clare cannot direct that a half share in the unit be transferred to her because that would prejudice Marie in that sale of the remaining half is unlikely to raise the same amount as if the whole unit had been sold and the proceeds split. Likewise, Marie cannot direct that a half share in the unit be sold and the proceeds distributed to her.

158. Therefore, in order to satisfy Marie and Clare's interests in the estate, the trustee must either sell the unit and distribute the proceeds to Marie and Clare or transfer the unit to Marie and Clare jointly. The trustee will be the relevant taxpayer in respect of any capital gain or loss made if the trustee sells the unit. Any capital gain or loss made on the transfer of the unit to Marie and Clare will be disregarded (see subsection 128-15(3) of the ITAA 1997) but Marie and Clare will be the relevant taxpayers in respect of a subsequent sale of the unit by them.

**Example 4: multiple beneficiaries**

159. Under his will, a deceased person left 900 shares in a listed public company to be held on trust for his daughter Caroline and his grand-daughter Sophie (aged 3 years).

160. Under the will it was clear that the deceased intended that Caroline was to receive 600 shares and Sophie 300 shares. That is, it was clearly not the deceased person's intent that Caroline was to have a two thirds interest, and Sophie a one third interest, in all 900 shares. Further, the deceased instructed that Sophie's shares were to be held on trust for her, and the income from them was to be accumulated, until she reached 18 years.

161. Once all of the deceased's assets had been called in and debts paid, the administration of the estate was complete and the shares passed to the executor in their capacity as trustee. Later, the trustee arranged for 300 shares to participate in the company's dividend reinvestment plan. The trustee created records indicating that the reinvestment shares were Sophie's. Dividend income received on the balance of the shares (600) was paid to Caroline.

162. On completion of the administration of the estate, Caroline is absolutely entitled to 600 shares. Sophie is absolutely entitled to 300 shares, plus the shares acquired under the dividend reinvestment plan, even though she cannot call for her shares until she turns 18. This is because a legal disability is ignored in determining absolute entitlement for the purpose of the CGT provisions.

**Example 5: multiple beneficiaries**

163. Assume the same facts as for Example 4. The trustee sold 200 of Caroline's shares and 100 of Sophie's shares and noted the accounts accordingly. Caroline and Sophie included the resulting gains on the sale of their shares in their own income tax returns.

164. Under a power contained in the will, and with the consent of Caroline and Sophie, the trustee acquired a small business, the assets of which were to be held on trust for Caroline and Sophie on the same terms and conditions as the shares had been held. Neither Caroline nor Sophie is absolutely entitled to the goodwill of the business – there is a single asset and two beneficiaries so neither is absolutely entitled to the whole asset as required by the CGT provisions.

**Example 6: life tenant and remainder**

165. Aman settled shares on trust. The trust deed directed that income from the shares was to be paid to Aman's wife Salome during her life and, on her death, the shares were to be held for Aman's daughter, Medina. Neither Salome nor Medina is absolutely entitled to the shares. Because their interests are successive, the shares are not held for either of them alone. They cannot be transferred to either of them because to do so would defeat the interests of the other.

**Example 7: life tenant and remainder**

166. Assume the same facts as for Example 6. Several years later Salome surrendered her life interest because she wanted Medina to receive the income. On surrender of the life interest, Medina becomes absolutely entitled to the shares.

167. CGT event C2 happens when Salome surrenders her right to income under the trust. That right is a CGT asset which ends when surrendered. Salome is the relevant taxpayer in respect of this event.

168. CGT event E5 also happens when Medina becomes absolutely entitled as a result of the surrender. Generally both the trustee and the beneficiary (Medina) would make a capital gain or loss as a result of CGT event E5 happening. However, any gain or loss made by Medina will be disregarded because she acquired her interest in the trust for no expenditure, see paragraph 104-75(6)(a) of the ITAA 1997. Also, Medina (and not the trustee) will be the relevant taxpayer if the shares are subsequently sold by the trustee.

**Example 8: multiple beneficiaries (no absolute entitlement)**

169. Augustus settled shares in a listed public company on trust for his two daughters as tenants in common in equal shares.

170. Notwithstanding that the shares may be fungible and that each daughter may be able to demand that her interest be satisfied

by a distribution *in specie* of one half of the number of shares to her, neither daughter is absolutely entitled. The reason is that under the trust it is clear that the settlor intends that each daughter has an interest in each share. Therefore, any capital gain or loss made by the trustee in respect of the shares will be included in the net income of the trust.

**Example 9: multiple beneficiaries (no absolute entitlement)**

171. Assume the same facts as for Example 8, except that the trust instrument simply said that the shares were to be held on trust for the two daughters equally. Further, the trustee 'turned over' the shares a number of times. That is, in accordance with their powers under the trust instrument, the trustee sold the shares and bought others, and then sold the new shares and bought further shares. All resulting capital gains and losses were taken into account in working out the net income of the trust and assessments were issued to the daughters in accordance with Division 6 of the ITAA 1936.

172. It is not clear from the terms of the trust instrument whether or not the settlor intended that one half of the total number of shares be set aside for each of the daughters exclusively. Certainly equity would be prepared to satisfy the interest each daughter has in the trust by a distribution *in specie* of sufficient shares to satisfy her interest. But more is required in order to establish absolute entitlement.

173. Because the trustee has not recorded a specific number of assets as being held for each beneficiary, neither daughter is absolutely entitled. Accordingly, the trustee has correctly taken capital gains and losses into account in working out the net income of the trust.

**Example 10: multiple beneficiaries (no absolute entitlement)**

174. Assets were settled on trust for the benefit of the settlor's children, Lazo and Slavka. The trust deed provided that Lazo and Slavka are to share equally in the income and capital of the trust. The subsequent sale and purchase of trust assets was recorded by the trustee in a single set of accounts. Capital gains and losses made on asset sales have been included in the net income of the trust and assessments have been issued to Lazo and Slavka in accordance with Division 6 of the ITAA 1936.

175. The instruction in the trust deed that Lazo and Slavka are to 'share equally' does not make it clear whether or not specific assets are to be held for each of Lazo and Slavka. Because the trustee has not recorded a specific number of assets as being held for each beneficiary, Lazo and Slavka are not absolutely entitled to any of the trust's assets. Accordingly, the trustee has correctly taken capital gains and losses into account in working out the net income of the trust.

**Example 11: self managed superannuation fund**

176. Bill contributes to his own self-managed superannuation fund. He transfers some shares to the fund which he had previously purchased in his own name. Bill is the only member of the fund.

177. The transfer of the shares from Bill to the fund will cause CGT event E2 to happen. The exception to CGT event E2 that applies if the transferor of assets to a trust is the sole beneficiary of the trust and is absolutely entitled to the assets does not apply in the case of a transfer of an asset to a superannuation fund.

**Example 12: chain of trusts**

178. Martin is the sole beneficiary of Trust A, which in turn has an interest in Trust B along with several other beneficiaries. Trust B owns one asset, an office building. Each beneficiary of Trust B each has an interest in the office building in proportion to their original cash contributions to Trust B which funded the purchase of the building.

179. Martin is absolutely entitled to the assets of Trust A, including the interest that Trust A has in the office building. But Trust A is not absolutely entitled to the office building (because Trust B has several beneficiaries and only one asset). Therefore, while Martin is absolutely entitled to the asset held by Trust A (that is, the whole of Trust A's interest in the office building) he is not absolutely entitled to the asset held by Trust B (that is, the office building).

# Your comments

180. We invite you to comment on this draft Taxation Ruling. Please forward your comments to the contact officer by the due date.

**Due date:** **11 February 2005**

**Contact officer details have been removed.**

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**Commissioner of Taxation**
15 December 2004

*Previous draft:*

Not previously issued as a draft

*Related Rulings/Determinations:*

TR 92/20; TR 92/90; TD 93/35; TD 94/31; TD 2000/32; TD 2004/3; TD 58

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NO: 2003/11324
ISSN: 1039-0731