


TD 2001/D7 - Income tax: capital gains: what are the capital gains tax consequences for a beneficiary of a discretionary trust who renounces their interest in the trust?

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This document has been finalised by TD 2001/26.

Draft Taxation Determination

Income tax: capital gains: what are the capital gains tax consequences for a beneficiary of a discretionary trust who renounces their interest in the trust?

Preamble

Draft Taxation Determinations (DTDs) present the preliminary, though considered, views of the Australian Taxation Office. DTDs should not be relied on; only final Taxation Determinations represent authoritative statements by the Australian Taxation Office.

1. A renunciation by a beneficiary of an interest in a discretionary trust would give rise to a CGT event C2 for the beneficiary, being an abandonment, surrender or forfeiture of the interest (section 104-25 of the *Income Tax Assessment Act 1997* ('ITAA 1997')).
2. A beneficiary of a discretionary trust who has no interest in either the assets or the income of the trust before the exercise of any discretion by the trustee as to the allocation of those assets or income can renounce their interest in the trust. In these circumstances, however, a capital gain is unlikely to be made by the beneficiary from the renunciation of an interest acquired on or after 20 September 1985 because the market value of the interest at the time of the renunciation would generally be nil. A capital gain or capital loss made on an interest acquired before 20 September 1985 is disregarded: subsection 104-25(5).
3. If a beneficiary of a discretionary trust has an interest in either the assets or the income of the trust before or after the exercise of any discretion by the trustee as to the allocation of those assets or income (for example a beneficiary with a default interest) they can also renounce their interest in the trust. In these circumstances, however, a capital gain is more likely to be made by the beneficiary from the renunciation of an interest acquired on or after 20 September 1985 because the interest at the time of the renunciation may have some significant value.

Background

4. The *Social Security Act 1991* and the *Veterans Entitlements Act 1986* ('Social Security Acts') have been amended by the *Social Security and Veterans' Entitlements Legislation Amendment (Private Trusts and Private Companies – Integrity of Means Testing) Act 2000*. The amendments, which will affect Social Security payments from 1 January 2002, provide for the income and assets of private trusts to be attributed to controlling individuals for the purposes of the means testing provisions of the Social Security Acts.

5. An affected beneficiary of a discretionary trust may wish to renounce their interest in the trust. If the beneficiary renounces their interest on or after 1 January 2002, the Department of Family and Community Services ('FaCS') has advised that it is likely that the gifting rules within the means testing provisions of the Social Security Acts will apply.
6. The ATO has been asked to provide guidance on the CGT consequences of a renunciation of the interest in the discretionary trust by the beneficiary in these types of cases.

Explanation

7. The meaning of the term 'renounce' was considered by the High Court of Australia in *MSP Nominees Pty Ltd & Anor v. Commissioner of Stamps (SA)* (1999) 42 ATR 833; 99 ATC 4937 where the Full Court said (ATR at 841; ATC at 4943):

“‘Renounce’ may be used here in the sense of a disclaimer or abandonment which results in either refusal to accept a benefit (See *FC of T v. Cornell* (1946) 8 ATD 184 at 188-9; 73 CLR 394 at 401-2; Crago, ‘Principles of Disclaimer of Gifts’, (1999) 28 *University of Western Australia Law Review* 65) or extinguishment, without replacement, of an interest held by one party ...’

8. A discretionary beneficiary may not receive any capital proceeds for renouncing their interest in the discretionary trust. In these circumstances, as well as where capital proceeds are received, the beneficiary will need to determine the market value of the interest under section 116-30 of the ITAA 1997 at the time of the renunciation of the interest. A capital gain may arise if the market value exceeds the cost base of their trust interest.

Example

9. *Since 1986, the Jeller family has held farming land in a discretionary trust, Jeller Family Trust, operating the farming enterprise through a private company, Jeller Rural Industries Pty Limited. Lloyd is the appointor and trustee of the trust. Lloyd, his wife Sue, and their son Paul and his two children, are the beneficiaries of the trust. Lloyd and Sue hold the two directors' shares in the company, and Paul holds 49 C Class shares. For some years Lloyd and Sue have ensured that Paul receives the bulk of the company's dividends and the income of the trust. Lloyd and Sue each supplement their income with an age pension.*
10. *From 1 January 2002 Lloyd and Sue would, because of the operation of the new private trust and companies legislation under the assets tests of the Social Security Acts, lose their entitlement to the age pension. They decide to preserve their pensions and hand over control of the trust and company to Paul who has been running the farm for the past ten years. Lloyd and Sue enter into the following arrangements to meet the requirements of a genuine resignation for social security purposes.*

- (a) *In September 2001, Lloyd and Sue each renounce their interests in the Jeller Family Trust by the following renunciation declaration:*

'I [Lloyd Jeller]/[Sue Jeller] do hereby renounce my entitlement to any further benefits from the Jeller Family Trust, whether those benefits be income or capital or of any other nature. I request that the trustee of the Jeller Family Trust recognise my request that I receive no further benefits from the Jeller Family Trust and furthermore recognise that this renunciation of my beneficial interest in the Jeller Family Trust is irrevocable';

- (b) *Lloyd resigns as trustee and appointor of the Jeller Family Trust and Paul is appointed trustee and appointor;*

- (c) *Lloyd and Sue sell their shares in Jeller Rural Industries Pty Limited for an amount equal to their market value. (A capital gain may arise if the market value of the shares is greater than their cost base).*

11. *Lloyd and Sue receive advice from Centrelink that these transactions are sufficient to satisfy the requirements of the Social Security Acts. Centrelink also advise Lloyd and Sue that they will monitor whether Lloyd and Sue continue to act consistently with these undertakings.*

Note 1:

12. A renunciation by a discretionary beneficiary would not normally have any CGT consequences for the trustee or for the trust. However, an amendment to the trust deed to exclude a beneficiary from the discretionary trust may result in the creation of a new trust. For further discussion on what constitutes the creation of a new trust refer to the statement of principles applied by the ATO titled 'Changes to trusts leading to the creation of a new trust estate' which issued on 9 June 1999 (see www.ato.gov.au).

Note 2:

13. A mere change of trustee has no CGT consequences.

Note 3:

14. The renunciation declaration used in the Example is provided only for the purposes of the Example. You may wish to seek advice on the form of any renunciation declaration you intend to make.

Your comments

15. We invite you to comment on this draft Taxation Determination. We are allowing 2 weeks for comments before we finalise the Determination. If you want your comments considered, please provide them to us within this period.

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Commissioner of Taxation

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Previous draft:

Not previously issued in draft form

Related Rulings:

Australian Taxation Office Statement of Principles: 'Changes to trusts leading to the creation of a new trust estate' issued on 9 June 1999.

Subject references:

- abandonment

- capital gain
- capital proceeds
- CGT event
- CGT event C2
- creation of a new trust
- discretionary beneficiary
- discretionary trust
- forfeiture
- interest
- interest in a trust
- market value
- means testing
- renounce
- renunciation
- renunciation by discretionary beneficiary
- surrender
- trust

Legislative references:

- ITAA 1997 104-25
- ITAA 1997 104-25(5)
- ITAA 1997 116-30
- Social Security Act 1991
- Social Security and Veterans' Entitlements Legislation Amendment (Private Trusts and Private Companies – Integrity of Means Testing) Act 2000
- Veterans Entitlements Act 1986

Case references:

MSP Nominees Pty Ltd & Anor v. Commissioner of Stamps (SA) (1999) 42 ATR 833; 99 ATC 4937

ATO references:

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