



***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?***

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This document has been finalised by [TD 2017/24](#).

 There is a Compendium for this document: [TD 2017/24EC](#) .



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## Draft Taxation Determination

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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?

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### Ruling

1. No. The amount included in the beneficiary's assessable income under subsection 99B(1) of the ITAA 1936 is not treated as a capital gain for capital loss offset or CGT discount purposes.

### Example

2. *In June 2014, the trustee of a foreign trust for CGT purposes<sup>1</sup> sells shares in an Australian public company that it had owned for five years. The trustee makes \$50,000 capital gains in total. The shares are not taxable Australian property.<sup>2</sup>*

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<sup>1</sup> A foreign trust for CGT purposes is defined in subsection 995-1(1) of the *Income Tax Assessment Act 1997* (ITAA 1997) as a trust that is not a resident trust for CGT purposes. A resident trust for CGT purposes is also defined in subsection 995-1(1).

<sup>2</sup> Taxable Australian property is defined in section 855-15 of the ITAA 1997.

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3. *In August 2016, the trustee distributes an amount attributable to the capital gains to Erin, a resident of Australia. Erin has a \$40,000 net capital loss that she has carried forward from the 2013 income year.*
4. *The capital gains are not taken into account in calculating the trust's net income for the 2014 income year: section 855-10 of the ITAA 1997.*
5. *Erin must include the entire \$50,000 in her assessable income under section 99B of the ITAA 1936. She cannot reduce the amount by her net capital loss or by the 50% CGT discount.*

## **Date of effect**

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

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**Commissioner of Taxation**

30 November 2016

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## Appendix 1 – Explanation

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

### Part 3-1 – capital gains

7. As explained in draft Tax Determination 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?* the trustee of a foreign trust for CGT purposes disregards a capital gain from a CGT event happening to a CGT asset which is not taxable Australian property. It follows that such an amount is not included in the net income of the trust.<sup>3</sup> Further, it is not treated as a ‘capital gain’ of the trust’s beneficiaries and no additional amounts are included in the assessable income of the trustee under Subdivision 115-C of the ITAA 1997.<sup>4</sup>

8. Depending on the terms of the particular trust deed (and the trustee’s actions pursuant to it), the amount attributable to the gain may be treated as income or corpus of the trust for trust law purposes.

### Section 99B

9. An amount attributable to the capital gain may nonetheless be assessable to the beneficiary under subsection 99B(1) of the ITAA 1936.<sup>5</sup>

10. Subject to subsection 99B(2) of the ITAA 1936, subsection 99B(1) requires a beneficiary to include in their assessable income an amount of trust property that is paid to, or applied for their benefit, provided the beneficiary was resident at any time during the income year in which the payment or application was made.<sup>6</sup>

11. The amount made assessable by subsection 99B(1) of the ITAA 1936 does not have the character of a capital gain for Australian tax purposes, nor is there any linkage between subsection 99B(1) and Subdivision 115-C of the ITAA 1997.

12. Subsection 99B(2) of the ITAA 1936 excludes certain amounts from the scope of section 99B. Most relevantly:

- Paragraph 99B(2)(a) of the ITAA 1936 excludes an amount representing corpus of the trust estate, except to the extent to which it is attributable to amounts derived by the trust estate that, if they had been derived by ‘a taxpayer being a resident’, would have been included in the assessable income of that taxpayer for a year of income.

<sup>3</sup> As defined in subsection 95(1) of the ITAA 1936.

<sup>4</sup> See subsection 115-210(1) of the ITAA 1997.

<sup>5</sup> If amounts are included in the assessable income of a beneficiary under section 99B of the ITAA 1936, that beneficiary may also be liable to pay interest under section 102AAM of the ITAA 1936.

<sup>6</sup> Section 99C of the ITAA 1936 contains rules for determining whether an amount has been paid or applied for the benefit of a beneficiary for the purposes of section 99B.

- Paragraph 99B(2)(b) of the ITAA 1936 excludes an amount that, if it had been derived by a taxpayer being a resident, would not have been included in the assessable income of that taxpayer of a year of income.

### **Hypothetical taxpayer – Commissioner’s view**

13. Paragraphs 99B(2)(a) and (b) of the ITAA 1936 posit a ‘hypothetical taxpayer’ who is a resident, but do not otherwise specify characteristics of that taxpayer. In the Commissioner’s view, it cannot be assumed that this hypothetical taxpayer has other characteristics; for example, that it is an entity eligible for the CGT discount.

14. Paragraph 99B(2)(a) of the ITAA 1936 refers to an amount derived by ‘the trust estate’, but then hypothesises a scenario in which that amount was derived by ‘a taxpayer being a resident’. It is evident from this language that the hypothetical taxpayer is not the trustee of the trust, but an entirely separate, fictional entity. There is support for this approach in *Howard v. Federal Commissioner of Taxation* [2012] FCAFC 149 where the Full Federal Court observed that the ‘hypothesis posited is that the amount received by the [Esparto] trust estate was derived by a resident taxpayer’, which was relevantly different from the actual characteristics of that trust and its trustee.<sup>7</sup>

15. Moreover, paragraph 99B(2)(b) of the ITAA 1936 identifies the hypothetical taxpayer without reference to any trustee.

16. Both paragraph 99B(2)(a) and 99B(2)(b) of the ITAA 1936 employ the indefinite article ‘a’ to identify a non-specific taxpayer deriving the amount in a non-specific year of income. This indicates that the hypothesis in these provisions is concerned with non-resident taxpayers generally, rather than a particular trustee or beneficiary. Nor do those paragraphs refer to any particular category of taxpayer.

17. A similar issue arose in *Union Fidelity Trustee Company of Australia Limited v. Federal Commissioner of Taxation* (1969) 119 CLR 177. In that case the High Court considered the ‘taxpayer’ hypotheses arising under the then section 99 and section 95 (net income definition) which did not specify a further hypothesis of Australian residence. Barwick CJ and Kitto J (with whom Windeyer J agreed) were both disinclined to have regard to the ‘actual’ residence status of the trustee preferring instead to have regard to only that which had been hypothesised (a taxpayer):

The effect of the definition of the net income of the trust estate in sec. 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. From the actual income of the trust estate there is abstracted all sums which can be seen to be assessable income. For the purpose of this abstraction or computation the only fact which is relevantly known is that the trustee, as a taxpayer, has derived the income. The residence of the trustees, or of any one of them, if there be more than one cannot afford a reason for varying the net amount of the income of the trust estate according to the accident of the trustee’s residence in the year of tax. Its irrelevance is emphasised when the possibility of diverse residences of several trustees is contemplated.<sup>8</sup>

18. Although the statutory context is somewhat different, the approach taken in this matter is considered to inform the appropriate approach to be taken in the context of section 99B of the ITAA 1936.

<sup>7</sup> See *Howard v. Federal Commissioner of Taxation* [2012] FCAFC 149 at [37]. See also [41] and [42].

<sup>8</sup> at CLR 178.

19. If the position were otherwise, section 99B of the ITAA 1936 would effectively enable corporate beneficiaries to benefit from the CGT discount, contrary to the intention of Subdivision 115-A of the ITAA 1997. Under such an approach, a resident company would obtain a greater benefit investing through a foreign trust, or a chain of trusts including a foreign trust, than if it had invested in the underlying asset directly.

20. It follows that an amount which is included in assessable income under section 99B of the ITAA 1936 cannot be reduced by capital loss offset or the CGT discount.

## Appendix 2 – Alternative views

**❶** *This Appendix sets out alternative views and explains why they are not supported by the Commissioner. It does not form part of the proposed binding public ruling.*

### Hypothetical taxpayer – alternative view 1

21. An alternative view to the Commissioner's is that the distributing entity's status as a trust is relevant to the hypothetical taxpayer test. On this view, the amount made assessable by subsection 99B(1) of the ITAA 1936 would not include an amount attributable to the CGT discount.

22. Under this view, the hypothetical taxpayer is an assumed resident with the characteristics of a trustee. Support for this view might be drawn from the fact that paragraph 99B(1)(a) of the ITAA 1936 adopts the perspective of a trustee in identifying an amount which represents corpus of the trust or is attributable to income derived by the trust.<sup>9</sup>

23. The Commissioner does not agree with this view, for the reasons set out in paragraphs 14 to 20 of this draft Determination. This view is not considered to have sufficient regard to the language in paragraph 99B(2)(a) of the ITAA 1936, which distinguishes between the trust estate in question and 'a taxpayer' which is assumed to be a resident.

### Hypothetical taxpayer – alternative view 2

24. A further alternative view to the Commissioner's is that the beneficiary's status is relevant to the hypothetical taxpayer test.

25. In support of this view, it is argued that subsection 99B(2) of the ITAA 1936 is specific in its reference to the amounts to be included in assessable income. Further, it is argued that a hypothetical taxpayer should be taken to have some characteristics which are relevant to determine tax outcomes; and that the most logical characteristics to assign are those which apply to the actual taxpayer under consideration.

26. It is further argued that, under this alternative view, an amount made assessable by subsection 99B(1) of the ITAA 1936 would not be reduced by reference to the CGT discount in circumstances where, for example, the beneficiary was a company. It is said that this approach better reflects the policy that companies should not benefit from the CGT discount.

27. While this may be the result where a company is a direct beneficiary of a foreign trust, it would not be so where a company holds its interest in a foreign trust through an Australian trust. That is, on this approach, the trustee of the Australian trust would be the relevant hypothetical taxpayer and would be entitled to the CGT discount when working out the amount made assessable by section 99B of the ITAA 1936 to be included in its net income. If a corporate beneficiary was assessable on that part of the net income, there is nothing which would require it to gross-up the amount.

28. The Commissioner does not agree with this view for this reason, and the reasons outlined in paragraphs 15 to 20 of this draft Determination.

<sup>9</sup> See *Howard v. Federal Commissioner of Taxation* [2012] FCAFC 149 at [38].

## **Appendix 3 – Your comments**

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29. Please forward your comments to the contact officer by the due date.

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

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

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

**Due date:** 3 March 2017

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## References

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*Previous draft:*

Not previously issued as a draft

*Related Rulings/Determinations:*

TR 2006/10; TD 2016/D4

*Legislative references:*

- ITAA 1936
- ITAA 1936 95
- ITAA 1936 95(1)
- ITAA 1936 99
- ITAA 1936 99B
- ITAA 1936 99B(1)
- ITAA 1936 99B(2)
- ITAA 1936 99B(2)(a)
- ITAA 1936 99B(2)(b)
- ITAA 1936 99C
- ITAA 1936 102AAM
- ITAA 1997

- ITAA 1997 Subdiv 115-A
- ITAA 1997 Subdiv 115-C
- ITAA 1997 115-210(1)
- ITAA 1997 855-10
- ITAA 1997 855-15
- ITAA 1997 995-1(1)

*Cases relied on:*

- Howard v. Federal Commissioner of Taxation [2012] FCAFC 149; (2012) 2012 ATC 20-355; (2012) 206 FCR 329; (2012) 91 ATR 89
- Union-Fidelity Trustee Co (Aust) Ltd v. Federal Commissioner of Taxation (1969) 119 CLR 177; (1969) 43 ALJR 313; (1969) 1 ATR 200; (1969) 69 ATC 4084; [1969] HCA 36

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ATO references

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