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Draft Taxation Determination

Income tax: does Subdivision 855-A (or subsection 768-915(1)) of the *Income Tax Assessment Act 1997* disregard a capital gain that a foreign resident (or temporary resident) beneficiary of a resident non-fixed trust makes because of subsection 115-215(3)?

❶ Relying on this draft Determination

This publication is a draft for public comment. It represents the Commissioner's preliminary view on how a relevant provision could apply.

If this draft Determination applies to you and you rely on it reasonably and in good faith, you will not have to pay any interest or penalties in respect of the matters covered, if the draft Determination turns out to be incorrect and you underpay your tax as a result. However, you may still have to pay the correct amount of tax.

Ruling

1. No. Section 855-40 of the *Income Tax Assessment Act 1997* (ITAA 1997)¹ only disregards a capital gain that a foreign resident beneficiary makes because of subsection 115-215(3) if the trust is a fixed trust. Section 855-10 (or subsection 768-915(1)) does not disregard a capital gain that a foreign resident (or temporary resident) beneficiary of a resident trust makes because of subsection 115-215(3).
2. This draft Determination² does not deal with the application of Australia's double tax agreements.

Example

3. *During the 2016 income year, the trustee of a resident discretionary trust derived income from a business.*
4. *The trustee also made non-discount capital gains from the sale of 5,000 listed shares that it had owned for less than 12 months. The shares were not 'taxable Australian property' (TAP).³*
5. *The trustee resolved to make a foreign resident beneficiary presently entitled to all of the trust income (in this case, the business income).*

¹ All legislative references are to the ITAA 1997 unless otherwise indicated.

² All further references to 'this Determination' refer to the Determination as it will read when finalised. Note that this Determination will not take effect until finalised.

³ See section 855-15 for when a CGT asset is TAP.

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6. *On these facts, as there was no beneficiary specifically entitled to any of the trust gains, all of the gains will be attributable to the foreign resident beneficiary.*
7. *Section 115-220 will operate so that the trustee is assessed under subsection 98(3) of the Income Tax Assessment Act 1936 (ITAA 1936) on the beneficiary's attributable capital gain.*
8. *The foreign resident beneficiary is also taken to have made capital gains under subsection 115-215(3). The beneficiary will receive a refundable tax offset under subsection 98A(2) of the ITAA 1936 for tax paid by the trustee.*
9. *As the trust is not a fixed trust, section 855-40 does not apply to disregard the foreign resident beneficiary's capital gain attributable to the non-TAP trust assets. Nor does section 855-10 apply to disregard the capital gain which the foreign resident beneficiary is taken by Subdivision 115-C to have made.*

Date of effect

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

Commissioner of Taxation
30 August 2019

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.***

Extra capital gains: section 115-215

11. If a trust's net income⁴ includes a net capital gain, subsection 115-215(3) may treat a beneficiary as having *extra capital gains* (that is, in addition to those that the beneficiary has made directly) which are included in the calculation of their net capital gain under the method statement in subsection 102-5(1).

12. Subsection 115-215(4A) makes it clear that the beneficiary is taken to have made these capital gains even though no CGT event has happened directly to the beneficiary.

Foreign resident beneficiary exemption where there is a fixed trust: section 855-40

13. Section 855-40 disregards a capital gain that a foreign resident beneficiary of a *fixed* trust is taken to have made as a result of a CGT event happening to a CGT asset of that trust if, at the time of the event, the CGT asset was not TAP of the trust.⁵ The purpose of the provision is to provide comparable treatment to that which would have been available had the beneficiary directly owned the trust assets. It is apparent from the enactment that comparable treatment was not thought to be warranted in the case of a non-fixed trust.⁶

14. There is a clear policy justification for limiting relief to capital gains where beneficiaries have interests in fixed trusts. Prior to the changes made by the *New International Tax Arrangements (Managed Funds and Other Measures) Act 2005*, foreign resident beneficiaries of resident trust estates received no relief in relation to trust capital gains attributed to them⁷, even though some gains would not have been subject to CGT if they had held the assets directly. This was so, whether the resident trust estate was fixed or not.⁸

15. The rule now reflected in section 855-40 (and originally in section 768-605 in Subdivision 768-H) was one of a number of changes aimed at removing tax impediments that discouraged foreign residents from investing in Australian trusts. In particular, the reform aimed to improve the international competitiveness of Australia's managed funds

⁴ As defined in subsection 95(1) of the ITAA 1936.

⁵ Section 855-40 also applies to disregard capital gains ultimately taken to be made by a foreign beneficiary through a chain of fixed trusts where the CGT event happens to a non-TAP CGT asset of the first-tier fixed trust.

⁶ See subsection 855-40(1).

⁷ Unless the beneficiary was absolutely entitled to the CGT asset as against the trustee – see section 106-50.

⁸ Under the predecessor provisions in the ITAA 1936, the interaction between former sections 160L and 160T left open no argument that non-resident beneficiaries could obtain exemption in relation to capital gains made by trustees of resident trust estates. There is no evidence that any change to this outcome was intended to have been made by the Tax Law Improvement Project rewrite in 1998, or by the subsequent enactment of Subdivision 115-C in 1999 which treated beneficiaries as having capital gains. Prior to 1999, capital gains treatment was afforded to beneficiaries by administrative practice: see paragraphs 12 to 16 of Taxation Ruling IT 2328 *Income tax: capital gains provision: interpretation and operation* (now withdrawn).

industry. The Explanatory Memorandum to the New International Tax Arrangements (Managed Funds and Other Measures) Bill 2004 provided⁹:

These amendments apply to foreign residents that have interests in managed funds (or other fixed trusts) whose assets are without the necessary connection with Australia.

...

These amendments are not confined to foreign residents with interests in widely held unit trusts. The amendments will apply to interests in closely held trusts and trusts that are not unit trusts. This is to ensure the benefits of the measures apply as widely as possible, irrespective of the trust arrangements through which the foreign resident invests. However, the trust in which the foreign resident has invested and all relevant trusts in the chain must meet the definition of 'fixed trust' in the *Income Tax Assessment Act 1997* (ITAA 1997). ... This is important to the integrity of the amendments.

16. It is evident that the focus was on a foreign resident 'investing' and bringing funds into Australia, and this does not occur with the object of a non-fixed or discretionary trust.

General foreign resident exemption: section 855-10

17. Subsection 855-10(1) provides that a foreign resident can disregard a capital gain or capital loss *from* a CGT event if the event happens in relation to a CGT asset that is not TAP.

18. It has been suggested that this 'general' exemption provision disregards a capital gain or capital loss which a foreign resident beneficiary of a trust is taken to have made as a result of a CGT event happening to non-TAP assets of the trust.

19. However, a capital gain that a foreign resident beneficiary makes because of the operation of subsection 115-215(3) is not a capital gain *from* a CGT event that happens to the beneficiary. Rather, such an event happens to the trustee. While subsection 855-10(1) does not expressly provide that the relevant CGT event must happen 'to' the foreign resident, this is an inference which may be drawn from the statutory context.

20. In particular, the presence of a specific rule in section 855-40 enabling beneficiaries of fixed trusts to disregard certain trust capital gains is a strong indicator that beneficiaries of non-fixed trusts are not catered for by section 855-10.

21. If subsection 855-10(1) could disregard trust capital gains attributed to foreign resident beneficiaries, it would on its terms do so without regard to whether the trust was a fixed trust or a non-fixed trust, rendering that aspect of section 855-40 redundant. The statutory context strongly suggests that the intention is for foreign resident beneficiaries of fixed trusts to have capital gains or losses disregarded in appropriate cases, but not foreign resident beneficiaries of non-fixed trusts. Such an intention is consistent with the policy considerations set out in paragraphs 7 and 8 of this Determination.

22. Section 855-40 only disregards capital gains arising through a chain of fixed trusts in circumstances where each trust is a fixed trust. The purpose of these detailed rules would be frustrated if they could be bypassed through the application of section 855-10.

⁹ See paragraphs 1.9 and 1.12.

General temporary resident exemption: section 768-915

23. Section 768-915 operates to disregard a capital gain or capital loss made by a temporary resident if the temporary resident was a non-resident. However there is no counterpart in the provision to section 855-40. Therefore gains which a temporary resident is taken to make under Subdivision 115-C cannot be disregarded whether the trust is a fixed trust or non-fixed trust.

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.***

24. An alternative view is that section 855-10 can disregard a capital gain or loss that a foreign resident beneficiary makes indirectly from a non-TAP asset of a non-fixed trust (that is, as a result of the application of subsection 115-215(3)).

25. It is argued in support of this view that the Commissioner's view requires words to be read into section 855-10. That is, it requires the words 'that happens to you' to be read into the chapeau to subsection 855-10(1) after 'CGT event'.

26. Alternatively, it is argued that the Commissioner is unduly relying on the maxim *expressio unius est exclusio alterius* in the inference being drawn from the presence of section 855-40.

27. Another basis for the view is that, with the introduction of Division 855, it was contemplated that foreign residents would only ever be subject to tax on gains that came from TAP, without qualification as to whether the gains were made directly, or through, trusts. This is said to be so despite the re-enactment in Division 855 of specific provisions relating to fixed trusts from Subdivision 768-H.

28. The Commissioner considers that when the provisions are read as a whole and in context, and having regard to the way the provisions have developed over time, the better view of the law is that section 855-10 cannot be interpreted to apply to beneficiaries of non-fixed trusts. If section 855-10 were interpreted to disregard capital gains or losses for *any* foreign residents, including foreign beneficiaries of non-fixed trusts, it would render section 855-40 redundant.

Appendix 3 – Your comments

29. You are invited to comment on this draft Determination. 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 **ato.gov.au**

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

Due date: 27 September 2019
Contact officer: Karen Rooke
Email address: Karen.Rooke@ato.gov.au
Telephone: (02) 9374 1059

References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

IT 2328 (Withdrawn); TR 2006/10;
TD 2019/D7

Legislative references:

- ITAA 1936
- ITAA 1936 95(1)
- ITAA 1936 98(3)
- ITAA 1936 98A(2)
- ITAA 1936 160L
- ITAA 1936 160T
- ITAA 1997
- ITAA 1997 102-5(1)
- ITAA 1997 106-50
- ITAA 1997 Subdiv 115-C
- ITAA 1997 115-215
- ITAA 1997 115-215(3)

- ITAA 1997 115-215(4A)
- ITAA 1997 115-220
- ITAA 1997 Subdiv 768-H
- ITAA 1997 768-605
- ITAA 1997 768-915
- ITAA 1997 768-915(1)
- ITAA 1997 Div 855
- ITAA 1997 Subdiv 855-A
- ITAA 1997 855-10
- ITAA 1997 855-10(1)
- ITAA 1997 855-15
- ITAA 1997 855-40
- ITAA 1997 855-40(1)

Other references:

- Explanatory Memorandum to the New International Tax Arrangements (Managed Funds and Other Measures) Bill 2004

ATO references

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