# *TD 94/D68 - Income tax: can subsection 36A(2) of the Income Tax Assessment Act 1936 apply to ascribe a value, other than market value, on the transfer to a discretionary trust of trading stock, standing or growing crops, crop stools or trees which have been planted and tended for the purpose of sale?*

Taxation Determination **TD 94/D68**



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# Draft Taxation Determination

## Income tax: can subsection 36A(2) of the *Income Tax Assessment Act 1936* apply to ascribe a value, other than market value, on the transfer to a discretionary trust of trading stock, standing or growing crops, crop stools or trees which have been planted and tended for the purpose of sale?

1. No. The conditions contained in paragraphs 36A(2)(a), (b) and (d) would not be met where a discretionary trust acquires trading stock, standing or growing crops, crop stools or trees which have been planted and tended for the purpose of sale in this Determination called 'trading stock'.

2. Section 36A was introduced as a result of the decision in *Rose v. FC of T* (1951) 84 CLR 118. It extends the operation of section 36 where trading stock of a business is disposed of, but partial ownership is retained by the former proprietor of the trading stock.

3. Subsection 36A(1) applies to a change in the ownership of, or the interest of a person or persons in, trading stock where the change does not involve a complete disposal, in the ordinary course of business, by the person or persons who owned or possessed interests before the change.

4. Where subsection 36A(1) applies, and the conditions of subsection 36A(2) are also met, the parties to the change are able to adopt a value other than market value for the deemed disposal of trading stock. This is a variation of the position where section 36 or subsection 36A(1) applies as paragraph 36(8)(a) prescribes market value as a value to be adopted with such deemed disposals.

6. Subsection 36A(2) prescribes certain conditions that have to be met. These conditions are:

(a) the property becomes an asset of a business carried on by the person or persons who owned or had an interest in the property after the change;
(b) continuity of at least 25% of the prior ownership, interest or interests, is maintained after the change;
(c) the value of the property ascertained under paragraph 36(8)(a), that is, the market value, is greater than the value of the stock for tax purposes at the time of the disposal if the disposal had not taken place;
(d) all persons who owned or had an interest in the property before and after the change agree that subsection 36A(2) is to apply to them.

7. With a discretionary trust, the trustee has legal ownership of the trust property and carries on the trust business in a fiduciary relationship with the beneficial owner of the property - the beneficiary or beneficiaries. Even though the trading stock would be an asset of a business being

carried on, that business is not being carried on by the beneficial owner. Therefore the condition contained in paragraph 36A(2)(a) would not be met.

8. Likewise, in a discretionary trust, the trustee has the legal or equitable ownership of the trading stock whilst a beneficiary has a beneficial interest in all of the trust fund. The interest is an expectancy until the trustee exercises his/her discretion in favour of a beneficiary or beneficiaries. When the discretion is exercised the beneficiary or beneficiaries have a vested interest in the trust income or property. Until the trustee's discretion is exercised, the interest of the beneficiary or beneficiaries is neither vested nor contingent in the trust fund (*Gartside v. Inland Revenue Commissioners* [1968] AC 553; [1968] 1 All ER 121; *Re Goldsworthy* [1969] VR 843); the only right is to have the trust duly administered.

9. Even though the beneficiary or beneficiaries have a beneficial interest in all of the trust fund which includes the trading stock, they could not satisfy the condition contained in paragraph 36A(2)(b) as it could not be said that any one, or more of them, had any specific fractional interest in at least 25% of the trading stock at the time it was acquired by the trust. This is because a trustee may exercise his/her discretion for the benefit of one of the beneficiaries to the exclusion of the other beneficiaries. Alternatively, the trustee may not exercise his/her discretion in favour of any of the beneficiaries.

10. Furthermore, paragraph 36A(2)(d) could not apply as the interest of the beneficiary or beneficiaries would not be vested until such time as the trustee's discretion is exercised in favour of the beneficiary or beneficiaries. They therefore could not agree, at the time the trust acquired the trading stock, that the section is to apply to them.

*Example*

*Fred Jersey owns a grazing business in North West Queensland. Fred transfers his business to a family discretionary trust which he is the trustee of and also a beneficiary in.*

*Subsection 36A(1) would apply to the disposal of the trading stock by Fred to the discretionary trust. Such trading stock would be deemed to have been disposed of at market value under paragraph 36(8)(a). Subsection 36A(2) would not apply to the change of ownership or interests in the trading stock to deem the disposal to be at a value other than market value as the conditions in the subsection would not be met.*

**Commissioner of Taxation**
16/6/94

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Subject Ref: trading stock; disposal; legal ownership; beneficial interest; discretionary trust; trustee, beneficiary

Legislative Ref: ITAA 36; ITAA 36(8)(a); ITAA 36A; ITAA 36A(1); ITAA 36A(2); ITAA36A(2)(b); ITAA36A(2)(d)

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