TD 96/D17 - Income tax: can a company satisfy the requirements of section 80A or section 80E of the Income Tax Assessment Act 1936 if 50% or more of its shares are held by the trustee(s) of a discretionary trust(s)?

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This document has been finalised by TD 2000/27.

Generated on: 29 November 2026, 03:17:44 AM

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Draft Taxation Determination

Income tax: can a company satisfy the requirements of section 80A or section 80E of the *Income Tax Assessment Act 1936* if 50% or more of its shares are held by the trustee(s) of a discretionary trust(s)?

1. Under the existing law, if the trustee(s) of a discretionary trust(s) holds shares carrying between them 50% or more of the voting, dividend and capital rights in a company in the year in which a loss was incurred, and the trustee continues to hold those shares in the year of income, the company cannot satisfy the continuity of beneficial ownership test in subsection 80A(1) of the *Income Tax Assessment Act 1936* (the Act).

2. This is because the shares are not beneficially owned by any persons: see *Gartside and Another v. Inland Revenue Commissioners* [1968] 1 All ER 121 and *Re Weir's Settlement MacPherson and Another v. Inland Revenue Commissioners* [1970] 1 All ER 297, which provide authority for the proposition that beneficiaries of a discretionary trust do not have any interest, either individually or collectively, in the property or income of a trust estate.

3. Several alternative arguments have been raised in relation to this issue. Firstly, it has been argued that the comments of Menzies J in *Franklin's Selfserve Pty Ltd v. FC of T* (1970) 125 CLR 52; 70 ATC 4079; (1970) 1 ATR 673 provide judicial support for the proposition that a 'broad brush' approach to the concept of beneficial ownership should be adopted. In that case, his Honour was not persuaded that liquidation, of itself, deprives the company in liquidation of the beneficial holding of its shares. He noted at CLR 70; ATC 4089; ATR 686 that the function of the liquidator is prescribed by:

> '... elaborate statutory provisions for bringing about the result for which the statute provides. The matter is not left to the application of general law relating to trustees and cestuis que trust.'

4. The circumstances of that case did not require his Honour to consider the issue of beneficial ownership in the context of a discretionary trust. Consequently, his comments do not necessarily provide any guidance in relation to the situation where relevant interests are held by the trustee of a discretionary trust.

5. Neither, in our view, does the decision of the Administrative Appeals Tribunal (AAT) in *Case 29/96* 96 ATC 330; *AAT Case 10,898* (1996) 32 ATR 1259 necessarily provide any assistance in relation to that issue. The AAT was considering a specific provision that requires a direct or indirect 'beneficial interest' rather than beneficial ownership. Furthermore, it was not necessary for the AAT members to decide whether the discretionary beneficiaries had a beneficial interest in the trust property. In fact, the members appear to acknowledge that the term 'beneficial interest' may be 'construed so as to be confined to an **absolute** interest in possession or a present entitlement in relation to a trust': see ATC 341; ATR 1270 (emphasis added).

6. Secondly, it has been argued that, where the trustee of a discretionary trust holds shares in a holding company which itself owns shares in the operating subsidiary (the loss company), the proposed ATO approach would have no impact on any tax losses of the operating company, as a 'person' (the holding company) is the beneficial owner of the shares in the loss company. We do not accept this argument because, in our view, it is quite clear that the tracing provisions in subsection 80A(3) can be applied in lieu of subsection (1) if the Commissioner considers that it is reasonable to do so: see subsection 80A(2).

7. Thirdly, it has been argued that, if the default beneficiaries have remained the same, then there has been the requisite continuity of beneficial ownership. We do not accept this argument. Although a default beneficiary may have a vested interest in the corpus of a discretionary trust, nevertheless, that interest is defeasible upon the exercise of the power of appointment by the trustee: see *Lutheran Church of Australia South Australia District Incorporated v. Farmers' Co-operative Executors and Trustees Limited and Others* (1970) 121 CLR 628 at 653-4. We consider that the better view is that, to satisfy the beneficial ownership test in subsection 80A(1), there must be a vested and indefeasible interest in 50% or more of the shares of a company in the year of income and the year in which the loss is incurred.

8. In our view, it follows that, in a situation where a majority of shares in a company continue to be held by the trustee of a discretionary trust so that it is not possible to determine the person(s) who beneficially owns shares for the purposes of subsection 80A(1), there is no scope for the operation of section 80E, because it is not possible to assert that there has been a change in beneficial ownership.

9. Nevertheless, in the past, it is likely that there have been situations where the rules prescribed by subsection 80A were applied by the ATO in a way that reflects the outcomes which are achieved in relation to section 160ZZS: see Taxation Rulings IT 2340 and IT 2361. Indeed, in at least one public statement by the ATO, we expressed support for the broader interpretation of section 80A.

10. The Government has announced its intention to amend the law so that, where any of the relevant interests in a company are held, directly or indirectly, by a family trust (as defined for the purposes of the trust loss measures), the trustee of the family trust will be taken to own beneficially those interests as an individual for its own benefit for the purposes of the continuity of beneficial ownership test.

11. The law will also be amended so that, where 50% or more of the relevant interests in a company are held by a trustee of a discretionary trust that is not a family trust, losses can be deducted by the company provided certain conditions are met. Full details are contained in Attachment B of Treasurer's Press Release No 79 of 20 August 1996.

12. The proposed changes to the law will operate for losses incurred in the 1996-97 and subsequent years of income. However, the amendments will not resolve the issue in relation to earlier years of income.

13. In the light of these changes, and having regard to Taxation Ruling TR 92/20, it is proposed that, for losses incurred in the 1995-96 or earlier years of income, the continuity of beneficial ownership test will be interpreted consistently with the broad principles that have been adopted in relation to section 160ZZS. For section 80A, this means that the onus will be on the taxpayer to show, for example, that:

- the trustee has administered the trust for the benefit of members of a particular family at all times during the relevant years of income; and
- the trustee has not exercised discretionary powers to appoint beneficiaries or amend the trust deed, the practical result of which was to effect a change of 50% or more in the underlying interests in the trust assets.

14. However, in applying those principles, the level of proof required to show that, in a practical sense, the continuity of beneficial ownership test can be satisfied would be higher, for

example, in the case of complex arrangements involving non-resident trusts situated in tax havens than would otherwise be the case. In those cases, we might also require information regarding the activities of the trust to ensure that there has been no change, for all practical purposes, in majority underlying interests, and that there has been compliance with other provisions of the law.

Commissioner of Taxation
13 November 1996

FOI INDEX DETAIL: Reference No.

Related Determinations:

Related Rulings: IT 2340; IT 2361; TR 92/20

Subject Ref: carry forward losses; discretionary trusts

Legislative Ref: ITAA 80A; ITAA 80A(1); ITAA 80A(2); ITAA 80A(3); ITAA 80E; ITAA 160ZZS

Case Ref: Franklin's Selfserve Pty Ltd v. FC of T (1970) 125 CLR 52; 70 ATC 4079; (1970) 1 ATR 673; Gartside and Another v. Inland Revenue Commissioners [1968] 1 All ER 121; Lutheran Church of Australia South Australia District Incorporated v. Farmers' Co-operative Executors and Trustees Limited and Others (1970) 121 CLR 628; Re Weir's Settlement MacPherson and Another v. Inland Revenue Commissioners [1970] 1 All ER 297; Case 29/96 96 ATC 330; AAT Case 10,898 (1996) 32 ATR 1259

ATO Ref: NAT 96/4951-4; NAT 96/10889-3

ISSN 1038 - 8982