

TD 2009/19 - Income tax: does a taker in default of trust capital have an 'interest in the trust capital' for the purposes of CGT event E8 in section 104-90 of the Income Tax Assessment Act 1997?

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Taxation Determination

Income tax: does a taker in default of trust capital have an 'interest in the trust capital' for the purposes of CGT event E8 in section 104-90 of the *Income Tax Assessment Act 1997*?

❶ This publication provides you with the following level of protection:

This publication (excluding appendixes) is a public ruling for the purposes of the *Taxation Administration Act 1953*.

A public ruling is an expression of the Commissioner's opinion about the way in which a relevant provision applies, or would apply, to entities generally or to a class of entities in relation to a particular scheme or a class of schemes.

If you rely on this ruling, the Commissioner must apply the law to you in the way set out in the ruling (unless the Commissioner is satisfied that the ruling is incorrect and disadvantages you, in which case the law may be applied to you in a way that is more favourable for you – provided the Commissioner is not prevented from doing so by a time limit imposed by the law). You will be protected from having to pay any underpaid tax, penalty or interest in respect of the matters covered by this ruling if it turns out that it does not correctly state how the relevant provision applies to you.

Ruling

1. No. A taker in default of trust capital does not have an 'interest in the trust capital' of the kind contemplated by CGT event E8 in section 104-90 of the *Income Tax Assessment Act 1997* (ITAA 1997)¹.
2. Having regard to the provisions of sections 104-90, 104-95 and 104-100, only those interests which constitute a vested and indefeasible interest in a share of the trust capital fall within the scope of CGT event E8. The interest of a taker in default of the trust capital is defeasible because the trustee may resolve to appoint the capital to another beneficiary.

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

Example

3. *The ABC trust is established with the trust deed conferring discretionary powers of appointment of income and capital on the trustee for the benefit of several discretionary objects. Under the deed, Tom is named as the taker in default who on the termination date will take any trust capital that has not been appointed. Tom has not given any money or property to acquire his interest in the trust capital. Tom subsequently disposes of his interest in the trust capital to a third party and receives negligible capital proceeds equal to the market value of the interest.*

4. *CGT event E8 does not happen upon the disposal of Tom's interest as the interest does not constitute a vested and indefeasible interest in the trust capital. However, the disposal of the interest by Tom will result in CGT event A1 happening unless one of the exceptions to that event applies.*

Date of effect

5. This Determination applies to years of income commencing both before and after its date of issue. However, this Determination will not apply to taxpayers to the extent that it conflicts with the terms of a settlement of a dispute agreed to before the date of issue of this Determination (see paragraphs 75 and 76 of Taxation Ruling TR 2006/10).

Commissioner of Taxation

7 October 2009

Appendix 1 – Explanation

① *This Appendix is provided as information to help you understand how the Commissioner's view has been reached. It does not form part of the binding public ruling.*

Explanation

6. CGT event E8 happens if a beneficiary under a trust (except a unit trust or a trust to which Division 128 applies) disposes of their interest in the trust capital. However, the event does not happen if the beneficiary gave any money or property to acquire the interest or if the interest was acquired by way of assignment.

7. In determining whether a beneficiary has a requisite interest in a trust, the courts have held that the meaning to be given to the word 'interest' will depend on the context in which it is used; see for example *Leedale v. Lewis* [1982] 3 All ER 808; *Gartside v. Inland Revenue Commissioners* [1968] 1 All ER 121; [1968] AC 553 and *Craig v. Federal Commissioner of Taxation* (1945) 70 CLR 441, particularly at 454.

8. Thus the meaning to be given to the words 'interest in the trust capital' in subsection 104-90(1) must be determined having regard to all of the provisions which relate to CGT event E8, particularly sections 104-95 and 104-100 which provide for the calculation of any gain or loss from the event.

9. A beneficiary's capital gain (or loss) from CGT event E8 is calculated by deducting, from the capital proceeds from the disposal of the trust interest, the beneficiary's share of the amount worked out under the method statement in section 104-95 (or, in the case of a loss, under the method statement in section 104-100). The calculation under the method statement involves adding the cost bases (or reduced cost bases) of the post-CGT trust assets, the market values of the pre-CGT trust assets and the amount of money in the trust, and subtracting from that result any liabilities of the trust.

10. Effectively the provisions operate as if the beneficiary had disposed of 'their share' of the net assets of the trust. There is no meaningful sense in which a taker in default can be regarded as having a share of the trust assets, given that their interest in the trust capital may be defeased by the trustee appointing it to other beneficiaries.

11. It is reasonable to infer that where a methodology attributes the full cost base of the trust assets (or a relevant share of it) to a beneficiary's interest in the trust capital then that event is intended to apply only in respect of an interest that is both vested and indefeasible.

12. However the interest need not be one which is vested in possession. Taxation Ruling TR 2006/14 makes it clear that CGT event E8 can apply to a remainder interest² (which is only vested in interest).

13. Because the interest which a taker in default has in the trust capital is defeasible³ it is not considered to be an interest of the kind to which CGT event E8 applies. However the disposal of the interest will result in CGT event A1 happening unless one of the exceptions to that event applies.

² Paragraphs 73 – 81.

³ The interest of a default beneficiary has been held to constitute a vested, but defeasible, proprietary interest in a trust (see *Queensland Trustees v. Commissioner of Stamp Duties (Queensland)* (1952) 88 CLR 54 at page 63).

References

Previous draft:

TD 2009/D3

Related Rulings/Determinations:

TR 2006/10; TR 2006/14

Subject references:

- capital gains tax
- CGT events E1-E9 - trusts
- discretionary trusts
- trusts
- trust beneficiaries

Legislative references:

- ITAA 1997
- ITAA 1997 104-90

- ITAA 1997 104-90(1)

- ITAA 1997 104-95
- ITAA 1997 104-100
- ITAA 1997 Div 128
- TAA 1953

Case references:

- Craig v. Federal Commissioner of Taxation (1945) 70 CLR 441
- Gartside v. Inland Revenue Commissioners [1968] 1 All ER 121; [1968] AC 553
- Leedale v. Lewis [1982] 3 All ER 808
- Queensland Trustees v. Commissioner of Stamp Duties (Queensland) (1952) 88 CLR 54

ATO references

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Income Tax ~~ Capital Gains Tax ~~ CGT events E1 to E9 - trusts
Income Tax ~~ Entity specific matters ~~ trusts