

***TD 2017/20 - Income tax: is a person who is not a beneficiary of the trust capable of having a distribution made to them for the purposes of section 272-60 of Schedule 2F to the Income Tax Assessment Act 1936 ?***

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## Taxation Determination

**Income tax: is a person who is not a beneficiary of the trust capable of having a distribution made to them for the purposes of section 272-60 of Schedule 2F to the *Income Tax Assessment Act 1936*?**

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This publication (excluding appendices) 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. Yes. A person who is not a beneficiary of the trust is capable of receiving a distribution for the purposes of section 272-60 of Schedule 2F to the *Income Tax Assessment Act 1936* (ITAA 1936).<sup>1</sup>
2. Where a person who is not a beneficiary receives a benefit from a transaction of the kind described in paragraphs 272-60(1)(a) to (e) (a 'distribution transaction'), that benefit is a distribution to the extent that its amount or value exceeds the amount or value of any consideration given in return.<sup>2</sup>
3. In this context, the term 'consideration' is considered to have a broad meaning. It extends beyond contractual consideration to include any value passing to the trustee which 'moves' the relevant transaction.<sup>3</sup>

**Note:** Paragraph 20 of this Determination explains the Commissioner's approach to working out the amount or value of consideration for distribution transactions that are an ordinary incident of a business carried on by a trust and on arm's length terms.

<sup>1</sup> All legislative references in this Determination are to Schedule 2F to the ITAA 1936, unless otherwise indicated.

<sup>2</sup> Subsection 272-60(2).

<sup>3</sup> *Chief Commissioner of State Revenue (NSW) v. Dick Smith Electronics Holdings Pty Ltd* (2005) 221 CLR 496, 517-8; *Archibald Howie Pty Ltd v. Commissioner of Stamp Duties (NSW)* [1948] 77 CLR 143, 152.

## **Date of effect**

4. The Commissioner has previously expressed the view that the extended meaning of 'distribution' in section 272-60 does not apply to writing-off a trade debt where the debtor is not a beneficiary of the trust.<sup>4</sup> Accordingly, this Determination will not apply to distribution transactions which have begun to be carried out on or before 7 June 2017.

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**Commissioner of Taxation**

[Date of issue]

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<sup>4</sup> ATO Interpretative Decision ATO ID 2012/12 *Trust Losses: whether the writing off of a trade debt by a trustee constitutes a distribution to the debtor* (withdrawn, 8 June 2017).

## Appendix 1 – Explanation

**❶** *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.*

**Note:** This Determination explains the Commissioner's view of the meaning of 'distributes' in section 272-60 in relation to trusts and beneficiaries. However, to the extent that it is relevant, the view applies equally to companies and shareholders, and to partnerships and partners.

5. The trust loss measures<sup>5</sup> are designed to prevent the transfer of the tax benefit from deducting tax losses, bad debts and debt/equity swap losses to persons who did not bear the economic loss at the time it was incurred by the trustee.

6. Broadly speaking, a trust that has made a family trust election is an 'excepted trust'<sup>6</sup> and excluded from the measures that restrict the use of tax losses and other deductions. However, family trust distribution tax (FTDT) is imposed on a trustee of a family trust, or certain interposed trusts, partnerships or companies, that confers a present entitlement on, or distributes income or capital to, an entity that is not a member of the family group of the individual specified in the family trust election (FTE).<sup>7</sup>

**Note:** The meaning of 'distributes' in section 272-60 is also relevant for the pattern of distributions test in Subdivision 269-D.

### Primary definition of 'distributes'

7. In this context, section 272-45 provides that a trustee 'distributes' income or capital of the trust to a beneficiary, if it:

- (a) pays or credits the income or capital in the form of money to the person; or
  - (b) transfers the income or capital in the form of property to the person; or
  - (c) reinvests or otherwise deals with the income or capital on behalf of the person or in accordance with the directions of the person; or
  - (d) applies the income or capital for the benefit of the person;
- in the person's capacity as a beneficiary of the trust.

8. The meaning of 'distributes' in the context of company distributions to shareholders and partnership distributions to partners are separately defined.<sup>8</sup>

### Extended definition of 'distributes'

9. In addition to the primary definition of 'distributes' in relation to each kind of entity, other types of distributions that a company, partnership or trust may make, are defined in the following terms in subsection 272-60(1):

A company, partnership or trust (an **entity**) also **distributes** income or capital to a person in circumstances not covered by sections 272-45, 272-50 or 272-55 if it:

<sup>5</sup> Schedule 2F to the ITAA 1936.

<sup>6</sup> Section 272-100.

<sup>7</sup> Sections 271-15 (family trust), 271-20 (interposed trust), 271-25 (interposed partnership) and 271-30 (interposed company).

<sup>8</sup> Sections 272-50 (companies) and 272-55 (partnerships).

- (a) pays (including by way of a loan) or credits money of the entity to the person, or reinvests such money for the person; or
- (b) transfers property of the entity to, or allows use of property of the entity by, the person; or
- (c) deals with money or property of the entity for or on behalf of the person or as the person directs; or
- (d) applies money or property of the entity for the benefit of the person; or
- (e) extinguishes, forgives, releases or waives a debt or other liability owed by the person to the entity.

10. In relation to trusts, the only additional kinds of transaction included within the extended meaning of 'distributes' are those in paragraph (e).<sup>9</sup>

11. However, the use of the adverb 'also' in the phrase '[a] company, partnership or trust...also distributes income or capital to a person...' is clearly intended to extend that meaning of 'distributes' to encompass transactions not included within the primary definition of 'distributes' in relation to each kind of entity.<sup>10</sup>

12. Significantly, in the context of trust distributions, the application of the extended definition is not limited by reference to the capacity of the person to whom the distribution is made. In this regard, the extended definition may be contrasted with the primary definition, which is specifically confined to distributions to a person in their 'capacity as a beneficiary of the trust'.<sup>11</sup>

13. It might be argued that the omission of a reference to the person's capacity in the extended definition does no more than extend the meaning of 'distributes' to include benefits given to a beneficiary, but otherwise than in that capacity. That is, it does not extend the meaning to include benefits given to persons who are not beneficiaries of the trust.

14. However, a payment by a trustee which is genuinely in respect of services rendered or property provided by a beneficiary is no more readily characterised as a 'distribution' to the beneficiary in the ordinary sense than a payment made to a non-beneficiary.

15. In addition, a view which limited the extended definition to beneficiaries would render that definition substantially redundant in the circumstances described in this Determination, given the significant overlap between the kinds of transaction described in the primary and extended definitions.<sup>12</sup>

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<sup>9</sup> There is a similar overlap with the kinds of transaction within the meaning of 'distributes' in sections 272-50 and 272-55.

<sup>10</sup> Paragraphs 9.37 and 15.13 of the Explanatory Memorandum to the Taxation Laws Amendment (Trust Loss and Other Deductions) Bill 1997 describe the definition of 'distributes' in subsection 272-60(1) as being 'an extended meaning' and 'an expanded definition' of 'distributes'.

<sup>11</sup> Similarly, sections 272-50 and 272-55 are limited to distributions to persons in their capacity as shareholders and partners, respectively.

<sup>12</sup> Pearce, DC and Geddes, RS 2014, *Statutory interpretation in Australia*, 8th edn, Butterworths, Australia at [2.26] and [2.36].

16. More broadly, a restrictive interpretation of the extended definition would frustrate the effective operation of the trust loss measures by allowing the trustee of a family trust to confer a benefit on a person who is not a beneficiary of the trust without being liable to pay FTDT.<sup>13</sup>

17. The above considerations indicate that the unqualified reference to 'distributes...to a person' in the extended definition includes distributions (as defined) to persons who are not beneficiaries of the trust.<sup>14</sup> This interpretation is consistent with the language, context and purpose of the primary and extended definitions. It gives full effect to the words used, enabling the provisions to apply on a consistent rather than conflicting basis.<sup>15</sup>

### **Consideration given in return for distribution**

18. The interpretation in this Determination is further supported by subsection 272-60(2), which provides that an amount is only a distribution within the extended meaning of 'distributes' to the extent that it exceeds the amount or value of any consideration given in return for the benefit described. The existence of this provision confirms that the extended definition in subsection 272-60(1) is capable of applying to transactions which would not be 'distributions' in the ordinary sense.

19. In the context of the trust loss measures, and having regard to the language used in the legislation, it is considered that this limitation on the extended definition is designed to ensure that genuine commercial dealings do not inappropriately give rise to a liability to pay FTDT.

#### *Consideration for a distribution made as an ordinary incident of business on arm's length terms*

20. The amount or value of consideration given for a distribution transaction is a question of fact. However, in practice the Commissioner will infer that the amount or value of a benefit provided to a person does not exceed the amount or value of consideration given in return where the relevant transaction:

- occurs on arm's length terms, and
- is an ordinary incident of a business being carried on by the trust.<sup>16</sup>

### **Examples**

#### ***Example 1 – various business-related transactions***

21. *The Rhino Family Trust is a discretionary trust. It has made an FTE and Paul Rhino is the specified individual.*

<sup>13</sup> Specifically, on that limited interpretation, FTDT would not apply to a distribution made to a person outside of the family group (who was not a beneficiary), and the family trust would retain the ability to deduct its tax losses.

<sup>14</sup> Similarly, it will encompass distributions to persons who are not shareholders or partners of relevant companies and partnerships (respectively).

<sup>15</sup> *Project Blue Sky Inc v. Australian Broadcasting Authority* (1998) 194 CLR 355, 381-382; [1998] HCA 28, 69-71; *Alcan (NT) Alumina Pty Ltd v. Commissioner of Territory Revenue* (2009) 239 CLR 27; (2009) 73 ATR 256; 2009 ATC 20-134; [2009] HCA 41, 47.

<sup>16</sup> The same inference will be drawn in relation to distribution transactions entered into by companies and partnerships.

22. *The trust operates a commercial café and a separate catering business.*
23. *The trust employs Paul Rhino, his wife Jane and 20 other employees (who are not members of the family group) in the two businesses.*
24. *Jennifer is a delivery driver in the catering business. She is permitted to take the trust's delivery van home after late afternoon deliveries.*
25. *Zara is a book-keeper. As there is no office space at the business premises, the trust has given Zara a laptop to facilitate her working from home.*
26. *Roberto, the chef, recently celebrated his 10 year anniversary working at the café. Paul and Jane (as trustees) gave Roberto a cash bonus for his years of service.*
27. *Every Friday the café gives a free coffee to the first customer that correctly answers a trivia question written on the café blackboard.*
28. *The trust conducts each of these four transactions on arm's length terms.*
29. *Each is the giving of a benefit as described in the extended meaning of 'distributes' in subsection 272-60(1) and none of the employees nor the customer contributes directly to the cost of these transactions.*
30. *However, in each case it will be inferred that the amount or value of the benefit provided by the trust does not exceed the amount or value of consideration given in return. Each transaction is on arm's length terms and is an ordinary incident of a business that the trust carries on. None is a disguised distribution of trust property outside of the family group.*

**Note:** As each benefit to the employees is not taken to be a distribution, the trust may need to consider whether any such benefit is a fringe benefit.<sup>17</sup>

### **Example 2 – use of holiday home, not an incident of a business**

31. *The Wonder Family Trust has made an FTE and Diana Prince is the specified individual. The trust owns a holiday home. The holiday home is used by Diana's friends, for no consideration, for four weeks in the year.*
32. *This transaction is not on arm's length terms nor an ordinary incident of a business being carried on by the trust. As no consideration is given in return for the use of the property, the full value of that use is a distribution within the extended meaning of 'distributes'.*

### **Example 3 – interest-free loans by a business**

33. *The Phantom Family Trust has made an FTE and Kit Walker is the specified individual. The trust carries on a commercial retail business which sells goods to customers at market value. At no extra cost, a customer can request the business's 'no repayment for 12 months' deal. This results in an interest-free loan from the trust to a customer for a year.*

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<sup>17</sup> An amount on which FTDT had been paid is not a fringe benefit: paragraph (q) of the definition of 'fringe benefit' in subsection 136(1) of the *Fringe Benefits Tax Assessment Act 1986*.

34. The benefit of the interest-free loan is a distribution transaction. However, in the circumstances it will be inferred that the amount or value of the interest-free loan does not exceed the amount or value of consideration given in return. The interest-free loan is on arm's length terms and is an ordinary incident of a retail business carried on by the trust.

**Example 4 – entertainment expense for arm's length clients of a business**

35. The Jules Family Trust has made an FTE and Ms Julie Slipig is the specified individual. The trust carries on a business. The trust spends approximately \$200,000 per year on entertaining arm's length clients of the business (the expense is non-deductible).

36. The benefit of the entertainment provided is a distribution transaction. However, in the circumstances it will be inferred that the value of the entertainment provided by the trustee does not exceed the amount or value of consideration given in return. The entertainment is provided on arm's length terms and is an ordinary incident of a business that the trust carries on.

**Example 5 – discounted fees for services provided by a business**

37. The Super Consulting Family Trust has made an FTE and Mr Clark Kent is the specified individual. In respect of one particular transaction, the trust provided \$200,000 worth of services to a client (based on the trust's standard consultation rate). The trust bills the client for the services. The client subsequently requests that the trust reconsider the price charged due to their longstanding relationship. As an act of goodwill, the trust discounts the fee by \$25,000.

38. The \$25,000 reduction is a distribution transaction. However, it will be inferred that the value of the services provided does not exceed the amount of value of consideration given in return. The reduced fee, although less than would be payable at the trust's standard rate, is nonetheless genuine consideration for the services provided and agreed upon as a result of an arm's length dealing. The discounted fee is provided on arm's length terms and is an ordinary incident of the business that the trust carries on.

**Example 6 – written-off bad trade debts**

39. The Greener Family Trust has made an FTE and Mr Bruce Banner is the specified individual. The trust operates as an industrial property trust and writes-off a bad trade debt owed by a debtor who is not a beneficiary of the trust.

40. The mere writing-off of a debt does not cause the debt to be extinguished, forgiven, released or waived.<sup>18</sup> It is therefore, of itself, not a distribution transaction.

41. However, to the extent that a debt has, on a bona fide assessment (based on sound commercial considerations) gone bad, the debt is of no value. Accordingly, the value of the distribution transaction that is a genuine extinguishment, forgiveness, release or waiver of a bad debt is nil. Because nothing of value is transferred or given by the trust to the debtor and commensurate consideration (nil) has been given in return by the debtor, a genuine extinguishment, forgiveness, release or waiver of a bad debt is not within the extended meaning of 'distributes'.

<sup>18</sup> For the purposes of paragraph 272-60(1)(e).



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## References

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*Previous draft:*

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*Related Rulings/Determinations:*

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*Previous interpretative decisions:*

ATO ID 2012/12

*Legislative references:*

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- ITAA 1936
- ITAA 1936 Sch 2F Subd 269-D
- ITAA 1936 Sch 2F 271-15
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- ITAA 1936 Sch 2F 271-25
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- ITAA 1936 Sch 2F 272-45
- ITAA 1936 Sch 2F 272-50
- ITAA 1936 Sch 2F 272-55
- ITAA 1936 Sch 2F 272-60
- ITAA 1936 Sch 2F 272-60(1)
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- ITAA 1936 Sch 2F 272-60(1)(c)
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- ITAA 1936 Sch 2F 272-60(1)(e)
- ITAA 1936 Sch 2F 272-60(2)
- ITAA 1936 Sch 2F 272-100
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*Cases relied on:*

- Alcan (NT) Alumina Pty Ltd v. Commissioner of Territory Revenue – (30 September 2009) – (2009) 73 ATR 256; [2009] HCA 41; (2009) 83 ALJR 1152; 2009 ATC 20-134; (2009) 260 ALR 1; (2009) 239 CLR 27; [2010] ALMD 481; [2010] ALMD 482; [2010] ALMD 511
- Archibald Howie Pty Ltd v. Commissioner of Stamp Duties (NSW) [1948] HCA 28; 77 CLR 143
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*Other references:*

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- Explanatory Memorandum to the Taxation Laws Amendment (Trust Loss and Other Deductions) Bill 1997.

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