

TR 2006/4 - Income tax: capital gains: meaning of the words 'the beneficiaries and terms of both trusts are the same' in paragraphs 104-55(5)(b) and 104-60(5)(b) of the Income Tax Assessment Act 1997

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! On the 31st October 2008 the Assistant Treasurer, Chris Bowen MP, announced that the Government intends to change the law to remove the capital gains tax (CGT) trust cloning exception to CGT events E1 and E2. The proposed amendments will apply to CGT events happening on or after 1 November 2008. If enacted, the amendments will affect the application of this ruling. For further information please refer to New Legislation on the Tax Office website at www.ato.gov.au.

! This document has changed over time. This is a consolidated version of the ruling which was published on *28 June 2006*



Taxation Ruling

Income tax: capital gains: meaning of the words ‘the beneficiaries and terms of both trusts are the same’ in paragraphs 104-55(5)(b) and 104-60(5)(b) of the *Income Tax Assessment Act 1997*

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

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What this Ruling is about

1. This Ruling explains the circumstances in which the beneficiaries and terms of two trusts are considered to be the same for the purpose of applying an exception to CGT events E1 and E2.

2. CGT event E1 happens if a trust is created over a CGT asset. CGT event E2 happens if a CGT asset is transferred to an existing trust. However, these events do not happen if the asset is transferred to the trust from another trust and the beneficiaries and terms of both trusts are the same: see paragraphs 104-55(5)(b) and 104-60(5)(b) of the *Income Tax Assessment Act 1997* (ITAA 1997).

3. For ease of reference, this Ruling refers to both exceptions as ‘the exception’ unless otherwise indicated. It also refers to the trust that held the asset originally as the ‘original’ trust and to the trust that obtains the asset on transfer as the ‘new’ trust. The asset itself is referred to as the ‘transferred asset’.

Ruling

4. There are two conditions, and both must be met, for the exception to apply. The conditions are that the beneficiaries and terms of the original trust and the new trust are the same.

5. These conditions must be met at the time the asset is transferred. But given that the asset is transferred from the original trust to the new trust, the comparison that must be made is between the original trust immediately before the asset is transferred and the new trust immediately after the asset is transferred.

General principles

6. That the beneficiaries and terms of both trusts must be the same is an explicit requirement of paragraphs 104-55(5)(b) and 104-60(5)(b) of the ITAA 1997. Even differences that might be considered minor will prevent application of the exception. It is noted that the requirement is stated in terms of the two *trusts*, and not in terms of the *asset* transferred.

7. It will be difficult to satisfy the exception if one or both trusts are not in writing. Assuming both trusts are in writing, then, in order to satisfy the exception, both trust deeds must have exactly the same meaning and effect. So it will be necessary to first establish the meaning and effect of the trust deed for the original trust and to then ensure that meaning and effect is the same in the deed for the new trust.

8. The meaning and effect of a trust deed is a reference to its strict legal meaning which must be determined using the rules generally applied by the courts in interpreting trust deeds.

9. As stated, the test is whether the two deeds have the same meaning and effect. Meeting this requirement is not simply a matter of ensuring that both deeds are worded identically. In some cases the meaning and effect of the deeds will not be the same even though they are worded identically (see Examples 9 to 12). In other cases the meaning and effect of both deeds will be the same even though the deeds are worded differently (see Example 13).

10. How these principles apply in the context of *beneficiaries* is discussed in paragraphs 11 to 15 of this Ruling. How they apply in the context of *terms* is discussed in paragraphs 16 to 25 of this Ruling.

Beneficiaries

11. The reference to 'beneficiaries' in this context includes a class of beneficiaries, the objects and potential beneficiaries of a discretionary trust, a default beneficiary and the members and pensioners of a superannuation fund. It is noted that it is the beneficiaries of the trusts, rather than of the transferred asset, that have to be the same.

12. It also means the 'direct' (rather than 'indirect') beneficiaries. Therefore, the direct beneficiaries of the new trust must be the same as the direct beneficiaries of the original trust.

13. The exception is not satisfied if the indirect or ultimate beneficiaries of each trust are the same but the direct beneficiaries are not.

14. A person acting in the capacity of trustee may be a direct beneficiary.

15. But the exception is not satisfied if a person is a beneficiary of both trusts but in different capacities. For example, if they are a beneficiary of one trust in their individual capacity and of the other in a trustee capacity.

Terms

16. The terms of a trust include those set out in the trust deed and those implied by statute and the general law. They include the powers, duties and discretions of the trustee and of any appointor or guardian. They also include a power to amend the trust terms.

17. The terms of both trusts must be the same. Therefore, the new trust must contain all the terms contained in the original trust and no others.

18. Whether the terms of the two trusts have the same meaning and effect will be a question of fact to be determined on a case by case basis. The factors discussed in paragraphs 19 to 25 of this Ruling are relevant in making that determination.

Trustees, appointors, guardians

19. The trustees do not have to be the same. But if one trust has an appointor or a person who fulfils that role (whether or not so called), then the other trust must have an appointor or similar. Also, if both trusts have an appointor, then the identity of the appointor, and their successors, must be the same for both trusts. The identity of any guardians and protectors must also be the same.

Beneficiaries' rights and entitlements

20. Each beneficiary must have the same rights, entitlements and interests in the new trust (including rights, entitlements and interests, if any, as to the income and corpus) which they had in the original trust. This includes, but is not limited to, direct interests in the trust assets and rights to benefit from those assets.

Vesting and termination dates

21. Clauses in a trust deed which concern the time at which interests in a trust are to vest, or the time at which a trust is to terminate, are terms of the trust and must therefore be the same for both trusts.

State laws

22. The same state laws must govern each trust. For example, if the original trust is governed by the state laws of New South Wales then the new trust must also be governed by the state laws of New South Wales.

Family trust and interposed entity elections

23. If one trust has made a family trust election or an interposed entity election, then the other trust must have made the same type of election. If the elections are family trust elections, then each election must specify the same individual (that is, the same 'test' individual). If the elections are interposed entity elections, then each election must be in respect of the same family trust election and each must specify the family group of the individual specified in the family trust election.

24. Therefore, the exception will not be satisfied if, for example, the original trust has made a family trust election and the new trust has not, or if both trusts have made family trust elections specifying different 'test' individuals, or if one trust has made a family trust election and the other has made an interposed entity election.

The following things do not have to be the same

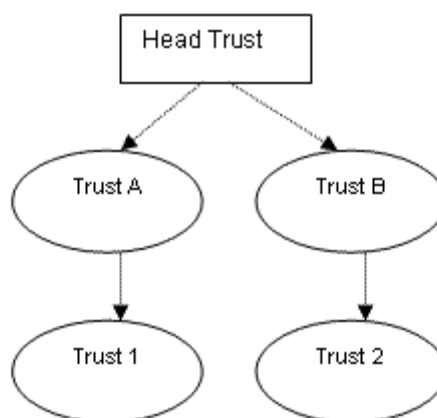
25. As stated in paragraph 19 of this Ruling, the trustees of the two trusts do not have to be the same. The two trusts also need not have the same:

- name;
- commencement or establishment date;
- settlor; or
- trust property (except that the transferred asset must be an asset of both trusts, though obviously not at the same time).

Examples

Example 1: direct beneficiaries

26. Assume the following trust structure. The terms of each trust are the same. X Co is the trustee of both Trust A and Trust B. The beneficiaries of Head Trust are individuals.



27. It is proposed to transfer the assets of Trust A (other than its interest in Trust 1) to Head Trust.

28. The exception does not apply because the beneficiaries of Trust A and Head Trust are not the same. Even though the ultimate beneficiaries of both trusts are the same (that is, the individual beneficiaries of Head Trust) their direct beneficiaries are not the same (because the beneficiary of Trust A is Head Trust and the beneficiaries of Head Trust are individuals).

29. Therefore, CGT event E2 will happen when the assets of Trust A are transferred to Head Trust.

Example 2: direct beneficiaries – capacity

30. Assume the same facts as Example 1, except that it is instead proposed to transfer the assets of Trust 1 to Trust 2.

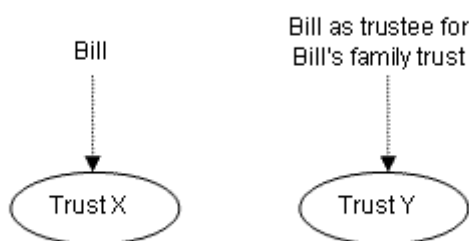
31. Again, the exception does not apply because the beneficiaries of Trust 1 and Trust 2 are not the same. Even though their ultimate beneficiaries are the same (that is, the individual beneficiaries of Head Trust) their direct beneficiaries are not the same (because the direct beneficiary of Trust 1 is X Co as trustee for Trust A and the direct beneficiary of Trust 2 is X Co as trustee for Trust B).

32. Also, even though X Co is the beneficiary of both Trust 1 and Trust 2, X Co is acting in a different capacity in respect of each trust. In each capacity in which a person does things, the person is taken to be a different entity for income tax purposes.

33. Therefore, CGT event E2 will happen when the assets of Trust 1 are transferred to Trust 2.

Example 3: capacity

34. Bill is the only beneficiary of Trust X. Bill in his capacity as trustee for his family trust is the only beneficiary of Trust Y.



35. It is proposed to transfer the assets of Trust X to Trust Y.

36. The exception does not apply because the beneficiary of each trust is not the same. Bill in his individual capacity (as beneficiary of Trust X) is a different entity for income tax purposes from Bill in his trustee capacity (as beneficiary of Trust Y).

37. Therefore, CGT event E2 will happen when the assets of Trust X are transferred to Trust Y.

Example 4: discretionary trusts – objects

38. It is proposed to transfer an asset from a family discretionary trust (the original trust) to another family discretionary trust (the new trust).

39. The objects of the original trust are the settlor's two sons. The objects of the new trust are the settlor's three daughters.

40. The exception does not apply because the beneficiaries (that is, objects) of the two trusts are not the same. Therefore, CGT event E2 will happen when an asset is transferred from the original trust to the new trust.

Example 5: discretionary trusts – death of an object

41. It is proposed to transfer an asset of a family discretionary trust (the original trust) to another family discretionary trust (the new trust).

42. The trust deed for the original trust lists the settlor's three children as the only discretionary objects of the trust. One of the children has since died. No other beneficiaries or objects have been appointed.

43. The exception will apply if the only beneficiaries of the new trust are the remaining two children (provided the terms of the two trusts are the same).

Example 6: transfer from a unit trust to a discretionary trust

44. It is proposed to transfer some of the assets of a unit trust to a family discretionary trust. The only unit holders of the unit trust are Mr and Mrs Smith and their three children. They are also the only objects of the family discretionary trust.

45. As the terms of the two trusts are different, including the nature of the beneficiaries' interests in the transferred asset, the exception does not apply. Therefore, CGT event E2 will happen when assets are transferred from the unit trust to the discretionary trust.

Example 7: discretionary trusts – establishment date and trustee

46. A family discretionary trust (the original trust) was established in 1990. Its trustee is Bill Smith and its beneficiaries are Bill's two children – Michael and Julie. The trust property is two residential rental properties.

47. The trustee of the original trust changes to a corporate trustee of which Michael is the sole director and shareholder. A new family discretionary trust (the new trust) is established with a corporate trustee of which Julie is the sole director and shareholder.

48. In all other respects the terms of the new trust and the original trust are the same. Michael and Julie are the only beneficiaries of the new trust. Their interests in the new trust are the same as in the original trust.

49. It is proposed to transfer one of the rental properties to the new trust. As the beneficiaries and terms of the two trusts (other than the establishment date and trustee) are the same, the exception applies to the transfer. Therefore, CGT event E2 will not happen when the assets are transferred from the original trust to the new trust.

Example 8: discretionary trusts – appointors

50. Assume the same facts as for Example 7, except that, prior to the transfer, Michael becomes the appointor of the original trust and Julie the appointor of the new trust.

51. The exception does not apply in this case because the appointors are not the same. Therefore CGT event E2 will happen when one of the rental properties is transferred from the original trust to the new trust.

Example 9: terms must have same effect – appointors

52. The original trust was settled in 1980. The appointor named in the trust deed died in 1989. The deed gives the trustee the power to name a new appointor but this power has not been exercised.

53. So while the original trust deed establishes the position of appointor, there is currently no person occupying that position. That is, the original trust does not have an appointor – merely the possibility of one.

54. Therefore, in order for the exception to apply to an asset transfer to a new trust, there must also be no person occupying the position of appointor in respect of the new trust. And the person who has the power to name an appointer in respect of the original trust must also have that power in respect of the new trust.

Example 10: terms must have same effect – appointors

55. It is proposed to transfer an asset of a family discretionary trust (the original trust) to another family discretionary trust (the new trust).

56. The original trust was settled in 1990. The trust deed for the original trust says the settlor of the trust is the appointor of the trust. The settlor died in 1997. The trust deed does not provide a facility for any other person to be named as appointor.

57. The new trust was settled in January 2005. The trust deed for the new trust is worded identically to that for the original trust and therefore contains the same term that the settlor is its appointor. The settlor of the new trust is still alive.

58. The terms of the new trust are not the same as the original trust because the new trust has an appointor but the original trust does not. The original trust does not have an appointor because the person who had originally occupied that position has since died and no new appointor has been named. However, because the new trust was settled later by a different person who is still alive, and was worded identically to the original trust, the new trust has an appointor.

59. Therefore, CGT event E2 will happen when the asset is transferred from the original trust to the new trust.

60. However, the exception would have been satisfied (provided the beneficiaries and other terms are the same) if the clause about appointors had not been included in the new trust.

Example 11: terms must have same effect – appointors

61. Assume the same facts as for Example 10, except that on the death of the settlor of the original trust the trust deed provided that the settlor's son automatically assumed the position of appointor of the original trust.

62. In that case, the exception would be satisfied if the settlor's son was also the appointor of the new trust and the beneficiaries and other terms are the same (including terms if any about the circumstances in which a successor appointor can be named).

Example 12: terms must have same effect – vesting dates

63. It is proposed to transfer an asset of a family discretionary trust (the original trust) to another family discretionary trust (the new trust).

64. The original trust was established on 1 July 1990 with a vesting date of 80 years from its commencement date. The new trust is established in 2000 and the exact words used to describe the vesting date of the original trust are used to describe the vesting date of the new trust.

65. The terms of the new trust are not the same as the terms of the original trust. As the two trusts have been established at different times, the words '80 years from the commencement date' have a different meaning and effect in each trust.

66. Therefore, CGT event E2 will happen when the asset is transferred from the original trust to the discretionary trust.

67. However, the exception would be satisfied (provided the beneficiaries and the other terms are the same) if the vesting date for the new trust is 30 June 2070 or 80 years from 1 July 1990.

Example 13: terms must have same effect – investment powers

68. The original trust deed provides for the trustee to borrow monies from any bank or credit union or other lending institution. The reference to a credit union was omitted from the deed for the new trust which simply provides for the trustee to borrow from any bank or other lending institution.

69. It seems reasonable to assume in this context that a credit union would be regarded as a lending institution. On that basis, both trust deeds effectively provide for the trustee to borrow from a credit union. Therefore, in this regard, the two trust deeds have the same meaning and effect for the purpose of determining whether the exception applies.

Example 14: terms must be the same

70. It is proposed to transfer a rental property from one fixed trust (the original trust) to another fixed trust (the new trust). The two trusts have the same beneficiaries.

71. In addition to managing the rental property, the original trust carries on a business. Therefore, its trust deed contains special trustee powers and duties that relate only to that business activity and to the business assets.

72. The new trust does not carry on a business and it is intended that it hold only passive assets. Therefore, the trust deed for the new trust does not contain any powers and duties relevant to conducting a business.

73. The terms of the two trusts are not the same. Therefore, CGT event E2 will happen when the rental property is transferred from the original trust to the new trust.

Example 15: same beneficiaries

74. The original trust holds various mining and banking shares. The settlor's sons, Matthew and Timmy, have all of the income and capital interests (in equal proportions) in the mining shares. The settlor's daughters, Madeline and Sophie, have all the income and capital interests (in equal proportions) in the banking shares.

75. It is proposed to transfer the banking shares to a new trust. Madeline and Sophie will be the only beneficiaries of the new trust and they will continue to have the same rights and entitlements in respect of the banking shares as they had when those shares were held by the original trust.

76. The beneficiaries of the two trusts are not the same. The beneficiaries of the original trust (just before the transfer of the banking shares) are Matthew, Timmy, Madeline and Sophie. The beneficiaries of the new trust (just after the transfer) are Madeline and Sophie.

77. Therefore, CGT event E2 will happen when the banking shares are transferred to the new trust.

Example 16: same beneficiaries and terms

78. Assume the same facts as the previous example except that Matthew and Timmy are also named in the trust deed of the new trust as beneficiaries and that in all other respects the two trust deeds are the same.

79. The exception applies and therefore CGT event E2 will not happen when the banking shares are transferred to the new trust.

80. The outcome is different from the previous example because in this case the terms of the trusts (including the beneficiaries' interests) are the same, even though the trust property representing those interests is not the same.

Example 17: terms – superannuation fund

81. The assets of an industry superannuation fund (the transferor fund) will be transferred to the trustee of another superannuation fund (the successor fund) under Regulation 6.29 of the Superannuation Industry (Supervision) Regulations 1994 which permits the transfer of a member's benefits to a successor fund.

82. The successor fund is an already existing fund with several sub-funds. The assets of the transferor fund and its members will comprise another sub-fund within the successor fund.

83. The trust deed of the successor fund contains a clause giving the trustee of the successor fund certain powers and duties that are needed because the successor fund is comprised of several sub-funds. For example, the trustee of the successor fund can make adjustments between the sub-funds if tax attributes attributable to the assets of one sub-fund have reduced the liabilities of another sub-fund. The trust deed for the transferor fund does not contain such a clause. In all other respects the terms of the two trusts are the same.

84. In order to determine whether the exception applies, the beneficiaries and terms of the transferor fund must be compared with the successor fund.

85. The exception does not apply because the beneficiaries of the two trusts are not the same. The beneficiaries of the transferor fund (just before the transfer) are all the members of that fund. The beneficiaries of the successor fund (just after the transfer) are all the members of the various sub-funds comprised in the successor fund.

86. In any event, the deed of the successor fund contains a clause that is relevant to the transferred assets (the tax adjustment clause) that does not appear in the deed of the transferor fund. Therefore, the terms are not the same.

87. Therefore, CGT event E2 will happen when the assets of the transferor fund are transferred to the successor fund.

Example 18: self managed superannuation funds

88. Donna, Chris and Syd are the only members of the Twilight Self Managed Superannuation Fund (the original fund). They have \$100, \$200, and \$500 respectively standing to the credit of their account within the fund. The assets of the fund consist of land with a market value of \$500 and cash.

89. Syd would like to start his own fund. As a result the Better Days Self Managed Superannuation Fund (the new fund) is established. Donna, Chris and Syd are the only members of the new fund. The land is transferred from the old fund to the new fund and Donna, Chris and Syd have \$1, \$1 and \$500 respectively standing to the credit of their account within the fund. (Syd's account in the old fund is reduced to zero.)

90. The terms of the two funds are not the same because the member entitlements of Donna and Chris in the new fund (just after the asset transfer) are not the same as in the old fund (just before the asset transfer).

Example 19: family trust elections

91. It is proposed to transfer an asset held by a family discretionary trust (the original trust) to another family discretionary trust (the new trust).

92. The trustee of the original trust has made a family trust election specifying an individual (the test individual) whose family group is to be taken into account in relation to the election. However, the test individual has since died.

93. As a result, it is not possible for the trustee of the new trust to make a family trust election specifying the same test individual as that specified in the election made by the trustee for the original trust.

94. Therefore, the exception does not apply and CGT event E2 will happen when the asset is transferred from the original trust to the new trust.

Date of effect

95. This Ruling applies to years of income commencing both before and after its date of issue. However, the Ruling does 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 Ruling.

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.*

96. CGT event E1 happens if a trust is created over a CGT asset. CGT event E2 happens if a CGT asset is transferred to an existing trust. However, these events do not happen if the asset is transferred to the trust from another trust and the beneficiaries and terms of both trusts are the same: paragraphs 104-55(5)(b) and 104-60(5)(b).

97. The exception ensures no CGT event happens if an asset is transferred from one trust to another and the beneficiaries and terms of both trusts are identical. Essentially it ensures that a transfer of assets between two trusts that have the same beneficiaries and terms is treated in the same way as a change of trustee of a single trust: indeed, these two scenarios could be regarded as merely variations of each other. It complements paragraph 104-10(2)(b) of the ITAA 1997 which says there is no change of ownership merely because of a change of trustee.

98. This is confirmed by paragraph 6.14 of the Explanatory Memorandum to the Tax Laws Amendment Bill (No. 2) 1994 which introduced the exception into the *Income Tax Assessment Act 1936* (ITAA 1936):

A further exception applies where there is a settlement of an asset to a trustee to hold on terms of an existing trust where the only change that occurs is a change of trustee. The effect of this exception is that where property is transferred from one trustee to another to be held under the same trust arrangements **without any change at all** in the trust arrangements including the interest of each beneficiary in the trust income and assets, there will be no change of ownership for CGT purposes. [Our emphasis.]

Comparison with the ITAA 1936

99. The equivalent provision in the ITAA 1936 was subparagraph 160M(3)(a)(ii). That provision required the beneficiaries and terms to be 'identical' whereas the current provisions in the ITAA 1997 require them to be 'the same'. Despite this difference in wording, there is no difference in meaning. The *Shorter Oxford Dictionary*¹ defines identical to mean:

1. The same; the very same. ... 2. Agreeing entirely in material, constitution, properties, qualities, or meaning...

¹ 1973, Oxford University Press, Clarendon.

100. Also, subparagraph 160M(3)(a)(ii) says the terms of the trusts that must be identical include the interest of each beneficiary in the income and corpus of the trusts. On the other hand, the ITAA 1997 provisions simply refer to the terms of the trusts having to be the same and do not contain a specific reference to the beneficiaries' interests in income and corpus.

101. Again, it is considered that the difference in wording does not change the meaning. As the terms of a trust clearly include the interest each beneficiary has in income and corpus (assuming the trust is of a type where the beneficiaries have such interests), it follows that these interests must also be the same in order to satisfy the ITAA 1997 exception.

102. It is noted that there is no requirement that there be beneficiaries with an interest in income and corpus. Therefore, the exception can apply to an asset transfer between discretionary trusts. But if there are beneficiaries with an interest in income and or corpus then those interests must be the same (see further the discussion at paragraphs 158 to 161 of this Ruling).

What must be the same?

103. The exception, if it applies, prevents a CGT event happening in respect of the transferred asset only. However, in order for the exception to apply, the beneficiaries and terms of each trust, and therefore in respect of all of the property of each trust, must be the same.

The same means identical

104. In order for the exception to apply, the beneficiaries and terms of the two trusts must be the 'same', that is, identical. The *Shorter Oxford Dictionary* defines the 'same' as:

I. ... 2. Identical with what has been indicated.... II. In modified senses. 1. Exactly agreeing *in* (amount, quality, etc.). Of a person: Unchanged in character, condition of health etc.

105. In short, there can be *no* difference in the beneficiaries and terms of the two trusts. It means there can be no change from the original trust to the new trust – not even one that may be regarded as unimportant. Even terms that are purely administrative and in the nature of 'housekeeping' must be the same.

106. This is consistent with the outcome if the exception applies. That is, where the exception applies, nothing has happened; therefore, no CGT event should happen. There is also no change in the acquisition date or in the cost base and reduced cost base of the transferred asset. (See Taxation Determination TD 2004/14.)

107. Therefore, this outcome only applies if there is also no change in the trusts. They must be identical. Only the trustee may change. In applying the exception it is important to bear in mind that it is not a form of rollover relief directed to relieving the CGT consequences of a change in circumstances where that change, though real, is not such as to warrant a taxing point. But rather it is recognition that in the absence of any substantive change at all it would be inappropriate for a CGT event to happen in the first place.

108. Further support for this view can be found in the extract from the Explanatory Memorandum quoted in paragraph 98 of this Ruling. It refers to the exception applying where property is transferred from one trustee to another to be held 'on the same trust arrangements **without any change at all** in the trust arrangements'.

109. However, this does not mean that the two trust deeds must be worded identically. Rather, it requires that the two deeds have exactly the same meaning and effect.

110. What 'the same' means in the context of *beneficiaries* is discussed in paragraphs 120 to 137 of this Ruling. What it means in the context of *terms* is discussed in paragraphs 138 to 187 of this Ruling.

Time at which conditions must be met

111. CGT event E1 happens when the trust over the asset is created. The exception in paragraph 104-55(5)(b) of the ITAA 1997 applies if the trust is created by *transferring* the asset from another trust (and the beneficiaries and terms of both trusts are the same). CGT event E2 happens when an asset is *transferred* to an existing trust. The exception in paragraph 104-60(5)(b) applies if the asset is transferred from another trust (and the beneficiaries and terms of both trusts are the same). It seems clear then that the conditions must be met at the transfer time.

112. However, it is also clear, given the nature of the exception, that the transfer time encompasses the time immediately before and after the transfer. Otherwise it would not be possible to apply or satisfy the conditions of the exception. Therefore, it is necessary to compare the beneficiaries and terms of the original trust immediately before the transfer with the beneficiaries and terms of the new trust immediately after the transfer.

Evidence to be taken into account

113. An examination of the beneficiaries and terms of each trust as amended or varied must be undertaken to see if the exception applies. If the original trust has been amended by one or more deeds, it is sufficient that the new trust be established under one deed that reflects the terms of the original trust as amended.

114. If no trust deeds exist, then the circumstances surrounding the creation of the trusts, including the intentions of the settlor and the behaviour of the relevant parties (for example, settlor, trustee and beneficiaries) must be examined.

115. However, if one or both trusts are not in writing, it would be difficult to establish the requirements for the exception. Because it is difficult to precisely determine the terms of an oral trust, it follows that it would be difficult to determine whether they are the same as those of another trust.

116. A variation of a trust that occurs before or after the time the conditions must be met is not relevant in determining whether the exception applies. However the variation of the trust may have resettlement implications and the general anti-avoidance provisions in Part IVA of the ITAA 1936 may be relevant where a conclusion can be reached that a relevant person made a variation or did some other thing for the dominant purpose of gaining a tax benefit.

Link to resettlement principles

117. A variation of any trust may constitute a resettlement of the trust: see further the ATO Statement of Principles regarding trust resettlements.² If the resettlement itself causes CGT event E1 or E2 to happen, then it would in theory be necessary to determine whether the exception applies. However, it is most unlikely that the exception would apply in a resettlement case. For a change in the trust relationship to amount to a resettlement it would usually, if not invariably, be necessary for there to be an alteration to the beneficiaries or terms of the trust, and most likely to both.

Link to value shifting rules

118. There is no requirement in the exception that the asset be transferred to the new trust for market value consideration. However, the transfer of an asset from one trust to another for less than market value consideration may attract the application of the value shifting rules in Part 3-95 of the ITAA 1997.

119. For example, the transfer of an asset from a 'fixed trust' (the original trust) to another trust for less than the asset's market value may cause a corresponding reduction in the market value of interests held by beneficiaries in the original trust. In that case, the indirect value shifting rules in Division 727 of the ITAA 1997 may apply to prevent the asset transfer being used to generate a loss on the subsequent disposal of beneficiaries' interests in the original trust.

² See *Creation of a new trust – Statement of Principles August 2001*.

The same beneficiaries

120. Each trust must have precisely the same beneficiaries.

121. The term 'beneficiary' is not defined for the purpose of the exception and must therefore be construed having regard to its general meaning and the context in which it is used.

122. A beneficiary is a person who is entitled to enforce the trust against the trustee. That is, a person with a right to see that the trust is administered in accordance with its terms and to seek relief from a court exercising equitable jurisdiction if it is not.

123. The reference to beneficiaries includes a class of beneficiaries, the objects of a discretionary trust, a default beneficiary and members and pensioners of a superannuation fund.

124. The need for precision in describing the beneficiaries of each trust is highlighted by AAT case [2004] AATA 1041.³ The tribunal held in that case that the equivalent exception in the ITAA 1936 did not apply because the beneficiaries of each trust were not 'identical'. While children of named individuals were beneficiaries of both trusts, the transferor trust defined child or children to include an adopted or step child or children but that definition was omitted from the trust deed of the transferee trust.

Beneficiary at the transfer time

125. The beneficiaries of the new trust must be exactly the same as the beneficiaries of the original trust. This requires a comparison to be made between the beneficiaries of the original trust just before the asset is transferred to the new trust and the beneficiaries of the new trust just after the asset transfer.

126. Making this comparison, and determining whether the exception is satisfied, involves different considerations depending on whether the beneficiaries are specifically named persons or whether they have been defined by reference to a class. An example of a class of beneficiaries is all the children of the settlor living as at a prescribed date. Other examples, commonly found in discretionary trust deeds, are any shareholder of a company in which one of the named beneficiaries owns shares or any institution, body or organisation having objects which are charitable at law.

³ 2004 ATC 220; 57 ATR 1149.

Beneficiary at the transfer time: specifically named

127. The beneficiaries of the original trust just before the transfer time do not include a person who was specifically named or appointed as a beneficiary but has ceased to be a beneficiary of the original trust for any reason, including because they have renounced their rights under the trust or because they were the object of a discretionary trust but have since died. In order for the exception to apply, such persons should not be named as beneficiaries of the new trust. See Example 5.

128. Likewise the beneficiaries of the original trust do include a person who has, for any reason and by any means, become a beneficiary since the commencement of the trust and is still a beneficiary just before the transfer time. Therefore, a person who has been appointed as a beneficiary of the original trust after its commencement and who is still a beneficiary of the trust just before the transfer time must also be named a beneficiary of the new trust in order for the exception to apply.

129. Also, for example, the interest a beneficiary has in a fixed trust may, on the death of the beneficiary (the deceased), pass to a beneficiary of the deceased's estate. If that 'replacement' beneficiary is a beneficiary of the original trust just before the transfer time, they will also need to be a beneficiary of the new trust for the exception to apply.

Beneficiary at the transfer time: class of beneficiaries

130. A reference to a class of beneficiaries avoids the need to specifically name or identify particular members of the class in the trust deed. Therefore, the beneficiaries of both trusts are the same if both refer to the same class of beneficiaries.

131. However, any original members of the class who had effectively renounced their rights under the original trust would need to be excluded from the beneficiary class as described in the new trust.

Direct beneficiaries

132. As there are no specific tracing rules, the reference to beneficiaries means direct beneficiaries. The exception is not satisfied if the ultimate (that is, indirect) beneficiaries are the same but the direct beneficiaries are not. *Jacobs' Law of Trusts in Australia*⁴ at page 699 in discussing the rule in *Saunders v. Vautier* (1841) Cr & Ph 240; 49 ER 282 says:

A sub-trust will arise if A, a beneficiary under a trust, declares himself trustee of it for B under a trust imposing active duties on A; the head trustee will owe his duties to A who will continue to hold a beneficial interest and A will owe distinct duties to B who will also acquire a beneficial interest. Even if B's interest be vested absolutely and B be sui juris, there will not be between B and the head trustee the precise co-incidence of right and duty necessary to B to invoke the rule in *Saunders v. Vautier* and require a conveyance of the legal title to him.

133. Therefore, the exception will not apply, for example, if one trust (head trust) owns all the interests in another trust (subsidiary trust) and an asset is transferred from the subsidiary to the head trust. In those circumstances CGT event E5 or E7 will happen.

134. A person acting in the capacity of trustee may be a direct beneficiary.

135. However, the exception is not satisfied if an entity is a direct beneficiary of both trusts but is acting in a different capacity in respect of each trust. See further the discussion in paragraphs 136 to 137 of this Ruling.

Persons acting in different capacities

136. In each capacity in which a person does things they are taken to be a different entity for income tax purposes: subsection 960-100(3) of the ITAA 1997. Therefore, the exception is not satisfied if a person is a direct beneficiary of both the original and the new trusts but is acting in a different capacity in respect of each trust. In that case, the person is a different entity for income tax purposes in respect of each trust and therefore a different beneficiary in respect of each trust. See Examples 2 and 3.

137. The same outcome would follow in circumstances where the same person is a direct beneficiary of both the original and new trusts, but in each case holds as trustee for beneficiaries of different sub-trusts. This is so whether the beneficiaries of those sub-trusts are the same or different, or can sue in their own names the trustee of the head trusts. In each case, the trustee (of the sub-trusts) holds in a different capacity in respect of each sub-trust, and is therefore a different 'beneficiary' in respect of the original and new trusts.

⁴ 6th edn, Butterworths, Australia.

The same terms

138. All terms are taken into account, even those that are administrative in nature.

139. The new trust must contain all the same terms as the original trust and cannot contain any additional terms. The exception will not apply if, for example, the new trust deed contains terms that were not present in the old trust deed. Likewise, the exception will not apply if terms in the original trust deed are omitted from the new trust deed. See Examples 14 and 17.

140. While it is not necessary that the new trust use precisely the same words in expressing its terms as were used in the original trust, their meaning and effect must be the same as those of the original trust. In fact, in some cases the meaning and effect of the deeds will *not* be the same even though they are worded identically (see Examples 9 to 12). But in other cases the meaning and effect of both deeds will be the same even though they are worded differently (see Example 13).

141. Therefore, in drafting a new trust deed for the purpose of taking advantage of the exception, it will be necessary firstly understand the meaning and effect of the original trust deed. This must be done taking into account the circumstances that exist at the time of the proposed asset transfer. It will then be necessary to ensure that whatever meaning and effect is ascribed to the original trust deed is reproduced in the new trust deed.

142. In determining whether the terms of two trusts have the same effect, the language used in a deed must be construed strictly according to its proper legal meaning. That is, the rules used by the courts in interpreting trust deeds must also be used for the purpose of determining whether the conditions for the exception are satisfied.

143. Any term defined in one trust deed must have the same meaning in the other deed.

144. Whether or not the terms of two trusts are the same is a question of fact to be established on a case by case basis. The evidence discussed in paragraphs 152 to 187 of this Ruling must be taken into account.

145. If it is not possible to reproduce the terms of the original trust, for example, if this is prevented as a result of legislative changes to the rules under which a trust of that type operates, then the exception cannot apply.

What are the terms of a trust?

146. In the context of the exception it is considered that the expression 'terms' should be given its widest possible meaning. For example, the power to vary a trust is considered to be a term of the trust.

147. The *Shorter Oxford Dictionary* defines 'terms' as:

Conditions or stipulations limiting what is proposed to be granted or done....Standing, footing, mutual relation between two persons or parties...Condition, state, situation, position, circumstances...

148. The terms of a trust include those set out in the trust deed and those implied by statute and the general law. They govern the powers, duties and discretions of the trustee and the relationship between the trustee and the beneficiaries. The terms also govern the powers, duties and discretions of others who have a role in respect of the trust such as an appointor or guardian, and their relationship with the trustee and beneficiaries.

149. Given that the terms of a trust govern the relationship between the relevant parties, it follows that the terms of a trust also include provisions stipulating the identity of those parties, not merely those which determine their powers or obligations. For example, the identity of the beneficiaries, trustee, appointor and guardian are terms of the trust. Beneficiaries are referred to specifically in the provision and they have already been discussed in paragraphs 120 to 137 of this Ruling.

150. Although a provision providing who shall be the trustee might otherwise be regarded as a term of the trust, it is clear from the statutory context that a mere change in the identity of the trustee is not an alteration of the terms of the trust in the sense contemplated by the exception. The exception is intended to apply, and does apply, if the trustees are different (provided everything else is the same).

151. However, there is no such argument available in respect of the appointor and guardian. Therefore, since provisions stipulating their identity are terms of the trust, their identity must be the same as between the original and the new trust. This is further discussed in paragraphs 152 to 157 of this Ruling.

Appointors and guardians

152. Trust deeds (particularly those of discretionary trusts) commonly include a provision governing the occasion and manner of the appointment of new trustees. The donee of this power is generally referred to as the 'appointor'. The appointor may also have the power to remove any trustee for any reason. *Halsbury's Laws of Australia*⁵ states:

This vests the appointor with considerable influence over the management of the trust, for he or she can appoint trustees who are most likely to manage the trust in the manner desired by the appointor.

⁵ Vol 27, Butterworths, Sydney, at 430-3250.

153. The 'considerable influence' exerted by the appointor means they are often seen as the 'controller' of the trust. Indeed, the identity of the appointor is as important, practically speaking, as the identity of the beneficiaries or trustee. The identity of the appointor is considered a term of the trust. Therefore, if the original trust has an appointor then, in order for the exception to apply, the new trust must have the same appointor. The potential successors of each appointor must also be the same.

154. The existence or otherwise of an appointor is also a term of the trust. Therefore, the exception will not apply if one of the trusts has an appointor and the other does not.

155. The Commissioner takes the same view in respect of any person granted the sorts of powers referred to in paragraph 152 of this Ruling, regardless of whether they are accorded the title of 'appointor'. Therefore if, for example, the trustee of the original trust has the powers of an appointor (whether in their capacity as trustee or otherwise), they must have those same powers of an appointor under the new trust.

156. Some trust deeds appoint a guardian or protector. Their powers depend on the trust instrument but can be very wide and can include the power to direct the trustee on the exercise of their powers. The guardian or protector may also have power to remove and appoint trustees. They may be used to ensure that the trust is administered in accordance with the original wishes of the settlor.

157. Again, the identity of the guardian or protector (and their potential successors) is a term of the trust, as is their existence or otherwise.

Beneficiaries' rights and entitlements

158. The rights, entitlements and interests each beneficiary has in the new trust (including rights, entitlements and interests, if any, as to the income and corpus) must be the same as in the original trust.

159. Therefore, the exception is not satisfied if, for example, an asset is transferred from one unit trust to another and the beneficiaries of both trusts are the same but, for Trust 1, X Co has 25% of the units and Y Co has 75% and, for Trust 2, X Co has 35% of the units and Y Co has 65%.

160. The nature of a beneficiary's rights, entitlements and interests will vary depending on the terms of the trust and the legislation governing the trust. A beneficiary may have a direct interest in trust assets. Alternatively, they may have a right to benefit from the asset rather than an interest in the asset itself, or their rights may be prescribed more broadly such as the entitlement of a member of a superannuation fund to be paid retirement benefits.

161. Therefore, the exception is also not satisfied if, for example, both trusts are self-managed superannuation funds and the rights, entitlements or interests of some or all of the members under the new fund are different from those they had under the original fund.

Vesting and termination dates: general

162. The date on which interests in a trust are to vest, or the date on which a trust is to terminate, is a term of the trust and must therefore be the same for both trusts.

163. The requirement that interests in property vest in interest within a certain time is generally referred to as the rule against perpetuities or, more appropriately, as the rule against remoteness of vesting.⁶ A vesting or termination clause may be used to ensure a trust does not breach this rule.⁷

164. Under the general law, the rule against remoteness of vesting provided that in order to be validly created, an interest in property, if not vested at its creation, must vest, if it vests at all, not later than 21 years after the termination of a life or lives in being at the date of the creation of the interest (the perpetuity period).⁸

165. The perpetuity period and other aspects of the rule against the remoteness of vesting have been fundamentally modified by state legislation. Other than for South Australia and the Northern Territory, those modifications apply to settlements that take effect after the date prescribed by the legislation so settlements prior to the relevant prescribed date continue to be governed by the general law.

166. In some states the settlor now has the option of adopting a perpetuity period not exceeding 80 years from the date of the settlement instead of the common law 'lives in being' (Queensland, Tasmania, Victoria and Western Australia). In other states the 80 year period replaces the general law period (Australian Capital Territory and New South Wales). In South Australia the perpetuity period has been abolished altogether (though after 80 years a court can order the vesting of any remaining unvested interests).

167. In the states where the perpetuity period still applies, a 'wait-and-see-rule' has been introduced. The rule provides that interests which would previously have been void from the outset because they might vest outside the perpetuity period are now valid until it is certain that the vesting must occur, if at all, outside the perpetuity period.

⁶ *Jacobs' Law of Trusts in Australia*, 6th Edition, Butterworths, Sydney, at p. 157.

⁷ It is noted that the rule against perpetuities or remoteness of vesting does not apply to the trust of a superannuation entity: section 343 of the *Superannuation Industry (Supervision) Act 1993*.

⁸ *Jacobs' Law of Trusts in Australia*, 6th Edition, Butterworths, Sydney, at p. 158.

168. Because the state laws governing each trust will be the same (see paragraph 175 of this Ruling) it will never be the case that the trusts are governed by different state modifications to the perpetuity period.

169. Despite these or any other statutory modification, it is considered that the conditions for the exception can only be satisfied if the vesting or termination date of the new trust is expressed so as to have the same meaning and effect as the relevant term of the original trust.

Vesting and termination dates: examples

170. The trust deed may specify a vesting or termination date that reflects the wishes of the settlor or a period may be specified that is measured from the commencement of the trust. The trustee may also be given a power or discretion to specify an earlier date in writing.

171. If the original trust specifies an actual date then the new trust must contain the same clause with the same date in order for the exception to apply.

172. If the original trust specifies a maximum period (for example, 80 years) within which trust interests must vest or the trust must end that is measured from the commencement of the trust, the exception will not be satisfied if the new trust contains the same clause and the new trust was established on a different date from the original trust.

173. In that case, the two clauses do not have the same meaning and effect. In order to satisfy the exception, the relevant period for the new trust would need to be measured in a manner which ensures it ends at the same time as the relevant period for the original trust (see Example 12).

174. If the original trust can vest or end on a date specified by the trustee, then in order to satisfy the exception the trustee of the new trust must have exactly the same discretion, exercisable in the same circumstances and the same manner.

State laws

175. The terms of a trust include those implied by statute. Given that different terms may be implied depending upon the state jurisdiction in which the trust was established, the same state laws must govern each trust.

Family trust and interposed entity elections

176. The original trust may have made a family trust or interposed entity election. In order for the exception to apply, the new trust must have made the same type of election in respect of the same test individual (if the election is a family trust election) or in respect of the same family group specified in the same family trust election (if the election is an interposed entity election). Likewise, the exception will not apply if the new trust has made an election but the original trust has not, or if the trusts have made elections in respect of a different individual and family group.

177. One consequence of making the election is that conferring present entitlement to, or a distribution of, the income or capital of the trust is subject to the provisions of Schedule 2F to the ITAA 1936. Broadly, family trust distribution tax is payable if the conferral or distribution is to a person outside the family group in respect of which the election was made.

178. The election binds the trustee and imposes upon them an obligation in respect of the trust and its property, namely the obligation to pay family trust distribution tax if they confer or distribute the trust property upon or to persons outside the relevant family group. The trust, and in a sense its property, are impressed with the conditions that attach to, and the consequences that flow from, its conferral or a distribution outside the family group (as set out in Schedule 2F).

179. Essentially those things become part of the terms and conditions under which the trust operates. They are therefore considered terms of the trust for the purpose of determining whether the exception applies. Their nature is such that the only way they can be replicated by another trust is by that other trust making an appropriate election, in accordance with Schedule 2F, in respect of the same family group.

180. Therefore, both trusts must have made the same type of election in respect of the same family group. The exception will not be satisfied if one trust has made a family election in respect of a family group and the other trust makes an interposed entity election, albeit in respect of that same family group.

181. Also, if the original trust has made a family trust or interposed entity election, but the new trust has not, and the transfer of the asset to the new trust is a distribution, then the original trust may be liable for family trust distribution tax: Division 271 of Schedule 2F. This would be in addition to CGT event E2 happening in respect of the transfer (because in that case the exception would not apply).

182. In this regard it is noted that 'distribution' is defined widely to include transferring property to an entity to the extent the entity has not given consideration in return: section 272-60 of Schedule 2F.

The following things do not have to be the same

183. It is considered that these things are not terms of a trust and therefore do not have to be the same as between the original and new trusts:

- the trust names;
- the commencement or establishment dates;
- the settlor of the trusts; and
- the trust property.

184. Clearly, the name by which a trust is known is not a term of the trust. In any event, the exception applies if there are two separate and distinct trusts (Taxation Determination TD 2004/14). It is very likely that two separate trusts will have two different names.

185. The requirement is that the beneficiaries and terms of the two trusts be the same at the transfer time. When they were established or commenced to be the same is irrelevant. The relevant time is the transfer time. As the exception clearly contemplates a transfer of property between two separate trusts it is possible that the two trusts have been established at different times.

186. In any event, if the new trust is established after the original trust, it will be impossible for their commencement or establishments dates to be the same. Likewise the settlor of the original trust may have died since its establishment meaning it is impossible for them to settle the new trust.

187. As for the trust property, the very nature of the exception makes it clear that the property of the two trusts will not be the same. That is, the exception contemplates the transfer of an asset from one trust to another so it is impossible at any given time for both trusts to have the same property. Also, the new trust must have property for it to be an existing trust just before the time of transfer, and this property cannot be property of the old trust. The exception does not require that all of the property of the old trust be transferred to the new 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 binding public ruling.*

The same terms

188. The Ruling says that in the context of the exception the expression ‘terms’ should be given its widest possible meaning and that all aspects of the trust arrangements must be the same for both trusts in order for the exception to apply. Support for this can be found in the extract from the Explanatory Memorandum quoted at paragraph 98 of this Ruling. It makes clear that the exception only applies if there is no change at all in the trust arrangements, other than the identity of the trustee.

189. This approach underpins the views in this Ruling concerning the identity of appointors (and guardians) and the making of family trust and interposed entity elections. Strong alternative views to those of the Commissioner have been put, and they are discussed in detail below.

190. It has been argued that the ‘terms of the trust’ have a well-established and more limited meaning, and it is not permissible to draw a wider meaning of them in the context of the exception.

191. On one view, the ‘terms of a trust’ are determined by the trust’s settlor (as augmented or varied by relevant trustee legislation) and the duty of the trustee is to strictly adhere to, and carry out, those terms.⁹ Therefore, the ultimate test of whether terms are the same is whether the trustee’s actions are authorised by the terms or whether the trustee needs the approval of the beneficiaries or a court in order to deviate from them.

The same terms: appointors and guardians

192. The Ruling says that if the original trust has an appointor, then the new trust must have the same appointor in order for the exception to apply. That is, the identity of an appointor of a trust is a term of the trust. The same view is taken in respect of guardians.

193. An alternative view is that the identity of an appointor or guardian is *not* necessarily a term of the trust. While the terms of a trust include any powers, duties or discretions granted an appointor or guardian under the trust deed, the terms of a trust do not necessarily include the identity of such persons.

⁹ *Jacobs Law of Trusts in Australia*, 6th Edition, Butterworths, Sydney, at p. 419

194. The ultimate test is whether the trustee's actions are authorised by the terms or whether the trustee needs the approval of the beneficiaries or a court in order to deviate from them. Therefore, the identity of an appointor or guardian is not necessarily a term of the trust.

195. For example, if the trust deed says a named person, and nobody else, is to be the appointor or guardian, then the identity of that person is a term of the trust. But if the trust provides a mechanism for replacing the named person, then this could happen without breaching (and in fact in accordance with) the terms of the trust. On that basis, the exception can apply if the trusts have different appointors provided both have been appointed in accordance with the terms of the trust.

196. Also, if the identity of appointors and guardians are terms of the trust, then the identity of other relevant persons such as trustees and beneficiaries must also be terms of the trust. But that is not supported by the statutory context within which the expression 'terms of the trust' is used. It is used in the context of an exception which is clearly intended to apply in circumstances where the identity of the trustee changes. And the fact that the identity of the beneficiaries must be the same is separately and specifically provided for which implies that the identity of the beneficiaries is not a matter covered by 'the terms of the trust'. On that basis, the identity of an appointor or guardian is not a term of the trust either.

197. However, these alternative views do not accord with the purpose or object underlying the exception. An appointor or guardian is a person of considerable influence who is generally viewed as the effective controller of the trust. If the alternative view is accepted, then the exception could be used to change the identity of the person who effectively controls an asset without triggering a CGT taxing point. The exception is designed to prevent a CGT taxing point where there is a change in the trustee in respect of the asset but no other change at all in the trust arrangements. Therefore, the Commissioner prefers the view that the identity of an appointor is a term of the trust for the purpose of applying the exception.

The same terms: family trust and interposed entity elections

198. The Ruling says if one trust has made a family trust or interposed entity election, then the other trust must have made the same type of election in order for the exception to apply. That is, the making of such an election is a term of the trust.

199. An alternative view is that a family trust or interposed entity election is *not* a term of the trust. They are simply a feature of the tax laws. A trustee can choose to make such an election and, if they do, certain tax consequences will flow. But making a valid election does not make the election a term of the trust.

200. However, this alternative view does not accord with the purpose or object underlying the exceptions. In particular, adopting that view would mean that the exception could, in effect, be used to facilitate the revocation of an election. This would be contrary to the scheme of the relevant provisions which provide that the ability to revoke a family trust election is extremely limited (subsection 272-80(6) of Schedule 2F to the ITAA 1936) and that an interposed entity election is unable to be revoked in any circumstances. Therefore, the Commissioner prefers the view that the making of a family trust or interposed entity election is a term of the trust for the purpose of applying the exception.

Appendix 3 – Detailed contents list

201. The following is a detailed contents list for this Ruling:

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References

Previous draft:

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Related Rulings/Determinations:

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Subject references:

- beneficiaries
- capital gains
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- trust assets
- trust beneficiaries
- trust deeds
- trust distributions
- trust documentation
- trust losses
- trust resettlements
- trustee companies
- trusts
- trustees
- unit trusts

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