TR 98/4 - Income tax: child maintenance trust arrangements

Taxation Ruling
Income tax: child maintenance trust arrangements

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*This Ruling, to the extent that it is capable of being a 'public ruling' in terms of Part IVAAA of the **Taxation Administration Act 1953**, is a public ruling for the purposes of that Part. Taxation Rulings TR 92/1 and TR 97/16 together explain when a Ruling is a public ruling and how it is binding on the Commissioner.*

What this Ruling is about

Class of person/arrangement

1. Children of families that have broken down may have entitlements under, or receive distributions from, a child maintenance trust ('CMT') arrangement. This Ruling considers whether and in what circumstances such entitlements or distributions may be 'excepted trust income' under subparagraph 102AG(2)(c)(viii) of the *Income Tax Assessment Act 1936* ('the Act').

2. A CMT arrangement is a means to pay contributions to the maintenance of a child where there has been a family breakdown. The amount of these contributions is usually agreed as satisfying the obligations of a parent to maintain the child. CMT arrangements distribute income to the child from a trust or from a series of trusts and other entities.

3. The Ruling does not concern CMT arrangements entered into to provide entitlements or make distributions to minor beneficiaries who are excepted persons under section 102AC of the Act; 'excepted persons' include minors engaged in a full-time occupation, disabled minors and double orphans (with provisos in each case).

4. Many of the explanations of subparagraph 102AG(2)(c)(viii) are based on reasoning for subparagraph 102AE(2)(b)(viii), which is in similar terms.

Cross reference of provisions

5. Section 51-50 of the *Income Tax Assessment Act 1997* ('the 1997 Act'), to which this Ruling refers, expresses the same ideas as paragraph 23(l) of the Act.

Ruling

6. The income of a child's trustee under a CMT arrangement is intended to be excepted trust income under Division 6AA. If it is excepted trust income, it is not taxed at the higher rates imposed by the *Income Tax Rates Act 1986* on minors receiving income under income splitting arrangements.

7. Subparagraph 102AG(2)(c)(viii) provides that amounts included in the assessable income of a trust estate are excepted trust income in relation to a child, to the extent they are derived by the trustee of the trust estate from investing any property transferred to the trustee for the benefit of the child, as the result of a family breakdown. Amounts qualifying as excepted trust income are assessable to the trustee and are taxed at normal rates. In relation to a beneficiary who is a minor, they would include both undistributed income to which the minor beneficiary of the CMT is presently entitled and income that the trustee has paid to or for the benefit of the minor beneficiary.

8. If the amounts are included in the income of the child, under section 97 or 100 (that is, where the child is not under a legal disability or derives income from other sources, respectively), they are excepted assessable income under paragraph 102AE(2)(e) and likewise subject to tax at normal rates in the hands of the child.

9. When CMT income is **not** excepted trust income, subsection 102AG(1) applies Division 6AA to the entitlements or distributions and they are taxed at higher rates. This also occurs where the entitlements or distributions are 'eligible assessable income' for the purposes of subsection 102AE(1); if they are not excepted trust income under subparagraph 102AG(2)(c)(viii), they are not excepted assessable income under paragraph 102AE(2)(e) because they then answer the description in subsection 102AE(4) of income to which Division 6AA applies.

10. Income derived by the trustee of a CMT is **not** excepted trust income under subparagraph 102AG(2)(c)(viii) in any one of five situations:

(a) it does not derive from the investment of property transferred beneficially to the child (**situation 1)**;

(b) it does not derive from the investment of property at all by the trustee (**situation 2**);

(c) the property has not been transferred beneficially to the child as the result of a family breakdown (**situation 3**);

(d) it derives from the investment of property, but exceeds an arm's length return on the investment of the property (**situation 4**); or

(e) it is derived as a result of an agreement entered into or carried out to secure the assessable income as excepted trust income (**situation 5**).

11. In **situation 1**, income does not derive from the investment of property transferred beneficially to the child where, under the terms of the trust, the child will not acquire the trust property, or will acquire it only as trustee, when the trust ends. Express provisions reinforce this rule with effect for income derived on or after 7 March 1994. Examples include cases where:

- no property is transferred to the trustee;
- the trust property will or may (perhaps as a matter of discretion) go to someone other than the child; and
- the trustee is denied any power to deal with the property in the interests of the child.

12. In **situation 2**, income does not derive from the investment of property by the trustee. For example, a CMT may receive distributions from a trust or other entity derived neither from loans nor subscriptions of any kind that the CMT has made to the trust or other entity; the distributions cannot be excepted trust income. Nor does income necessarily come from investments by a CMT merely because it is conditional on those investments having been made. On the other hand, property may be taken to be invested, even where the trustee does not realise the property and reinvest the proceeds, such as where a trustee:

- receives a portfolio of shares and decides to retain them;
- receives a rental property and retains it, or
- only realises and reinvests property at term.

The proceeds of licensing a patent or copyright transferred beneficially to a child may be taken to be derived from the investment of property; so may the proceeds of a business transferred beneficially to the child or set up by the child's trustee using property transferred beneficially to the child.

13. In **situation 3**, the property has not been transferred beneficially to the child as the result of a family breakdown. Where two people are living as spouses, there may have been no breakdown of a family relationship; neither spouse may be a parent of the infant beneficiary; no person may have a legal obligation, because of the family breakdown, to do any particular thing for the benefit of either spouse

or for the child; or the property may not be transferred to meet such an obligation. Where there is no domestic relationship between two people living as spouses, there may be no legal obligation (because the child's parents never lived as spouses) for any person to do any particular thing for the benefit of either spouse or for the child; or the property may not be transferred to meet such an obligation.

14. In **situation 4**, the income derives from the investment of property, but exceeds an arm's length return on the investment of the property. This is the case, for instance:

- wherever only nominal property is transferred to the CMT, but substantial amounts of income flow to the trustee by way of distributions from a discretionary trust of which the CMT is a beneficiary and to which the CMT has lent its property;
- where the CMT subscribes a nominal amount for units in a unit trust, which receives income by way of distributions from a discretionary trust; the excess over an arm's length rate of return on the amount subscribed to the unit trust is not excepted trust income; and
- where the trustee's share of partnership income from any share of such income transferred to the trustee, or from any partnership entered by the trustee with property transferred to the trustee, is only excepted income up to an arm's length share of the partnership income.

Annuity income can only be excepted up to the amount of income an arm's length annuity purchased with the same property would produce.

15. In s**ituation 5**, the income is derived as a result of an agreement entered into or carried out to secure the assessable income as excepted trust income. An example occurs where distributions from an existing discretionary trust are made, or could be made, directly to a child, but following a family breakdown, distributions are made instead from the discretionary trust to a CMT which is then established, or to a unit trust or other entity in which the CMT has an interest. Another example is where income is to be paid, and a trustee receives property but must use it only in the purchase of an annuity producing income of the agreed amount.

16. In each of these cases, the entitlements or distributions of income are subject to the higher rates of tax that apply to amounts to which Division 6AA applies. The tax-free threshold for the entitlements or distributions is only $416 for a full year of income, and is clawed back from higher distributions, so that the rates of tax generally represent the top marginal rate of tax applicable to individuals. (The low income rebate may also be available.)

Date of effect

17. This Ruling applies to years 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 a settlement of a dispute agreed to before the date of issue of the Ruling (see paragraphs 21 and 22 of Taxation Ruling TR 92/20).

18. If a taxpayer has a private ruling that is inconsistent with this Ruling, then this Ruling only applies to entitlements of, or distributions made to, that taxpayer after the date of this Ruling, unless the taxpayer asks that it apply (subject to any limitations imposed by statute) to earlier income years.

Explanations

How do CMT arrangements operate?

19. A CMT is a trust set up to provide support for a child (or children). Most commonly, CMT arrangements are put in place where there is an obligation to provide maintenance for the child, and income under the CMT to which the child is presently entitled or that is distributed to the child is taken to satisfy that obligation. A CMT arrangement is more likely to be made where the person who would otherwise be obliged to provide maintenance payments for the child faces high marginal or average tax rates on his or her own income, or where the maintenance payments would not be exempt from income tax under section 51-50 of the 1997 Act. In these cases, there may be a considerable income tax reduction by the use of a CMT arrangement.

20. Income flowing to, or for the benefit of, a child under a CMT arrangement is generally not exempt from income tax under section 51-50 of the 1997 Act as a maintenance payment. This is because the income does not flow in the form of periodic payments made by, or attributable to payments made by, the parent (or spouse, or former spouse, of the parent) of the child. The maintenance that would otherwise have had to be paid to, or for the benefit of, the child would generally have been exempt from income tax under section 51-50. Where the income flowing under the CMT arrangement is relatively small, and is the only income of the child, the income tax payable by the child is not great. However, the marginal tax rate that the child faces where other income is derived, for example from after-school or holiday employment, may be much higher.

21. Agreements that income flowing under a CMT arrangement would reduce maintenance obligations have generally been embodied in consent orders made by the Family Court of Australia, whether under family law or by way of departure orders under child support law. Despite their substitution of before-tax income for after-tax income, these agreements generally provide that a dollar of income under the CMT arrangement fully satisfies the obligation to provide a dollar of tax-exempt maintenance income. Some commentators have claimed that CMT arrangements have nevertheless allowed the payment of more or of more certain income for the support of children.

22. A common structure of such arrangements is as follows:

- a trust - the CMT - is established, with minor beneficiaries for whom a parent has maintenance obligations, in circumstances of family breakdown;
- a unit trust without significant assets is established, in which the CMT comes to hold units, perhaps by transfer of the units, by purchase of the units for a nominal amount, or by subscription of a nominal amount for units;
- the unit trust is made a beneficiary of a discretionary trust, which generally is already in existence;
- the discretionary trust derives income from business or investment activities of the parent who has the maintenance obligations, or with which that parent is associated;
- income sufficient to meet the maintenance obligations of the parent who has those obligations is distributed to the unit trust by the discretionary trust;
- the income of the unit trust is in turn distributed to the CMT, from which it is made available for support of the children;
- commonly the income to which each child beneficiary is entitled in a year of income does not exceed the amount of the standard tax-free threshold for a resident (currently $5,400) and in any case the full benefit of that threshold is available for each child beneficiary; and
- the income diverted to the CMT satisfies the maintenance obligation of the parent.

23. These features are common, but not essential. For instance, a company or partnership may sometimes take the place of the unit trust described above. In very simple cases, the CMT itself may receive discretionary distributions of income directly. And the rule that the

income of the CMT is taken to satisfy a parent's maintenance obligations is a practical one, unrelated to any feature of Division 6AA. While CMT arrangements without this feature are less likely, Division 6AA affects them in the same ways and to the same extent as other CMT arrangements.

24. Not all arrangements designed to satisfy what would otherwise be an obligation to pay maintenance for a child fit the general description above. Some CMT arrangements transfer substantial property to a trustee beneficially for the child, and the trustee invests this property to derive an arm's length rate of income for the child under the arrangement. To that extent, an arrangement normally results in excepted trust income being derived and is not affected by this Ruling.

Provisions of Division 6AA

25. Division 6AA of the Act was inserted in Part III to deny minors any possible tax advantage from receiving income that might flow from income splitting arrangements. It applies to minors - people who are under 18 years of age on the last day of the year of income - unless they are excepted persons. Before 1 July 1993, excepted persons included married persons, but from that date excepted persons have been essentially limited to those minors in a full-time occupation (that does not include work between sessions of full-time study), minors who are disabled or receive certain kinds of disability assistance, and certain double orphans.

26. Some kinds of income are excepted if earned at no more than arm's length rates. These kinds of income include the child's employment income or business income, and income from a testamentary trust. Excepted income also includes income from the investment of property transferred to or beneficially to the child in any of several defined circumstances (including by the reinvestment of excepted income itself). One of the circumstances in which property may be transferred to, or beneficially to, a child so that income from its investment may be excepted income is where the property is transferred as a result of a family breakdown. CMT arrangements rely on this provision (in subparagraph 102AE(2)(b)(viii) and subparagraph 102AG(2)(c)(viii)), being applicable to the child's own property or to property transferred to the child's trustee respectively.

27. The provision does not sanction income splitting; it acknowledges that family breakdown is one of a range of circumstances that may compel the transfer of property to or beneficially to a child, and so provides that a child's return from the investment of such property ought not (up to arm's length rates, and in

general) be taxed at higher rates. This is the reason why the provision is not concerned with whether the income satisfies or reduces an obligation to maintain the child. Division 6AA has no application to those maintenance payments that are exempt from income tax under paragraph 23(l).

28. Section 102AE, which deals with income of persons, and section 102AG, which deals with incomes of trust estates, are cognate provisions in most respects, applying with necessary changes the same rules expressed in as nearly as possible the same words to the cases where income is directly that of the minor or is that of a trustee for the minor. Therefore, the Parliament must have meant the effect of one provision to be as nearly the same as that of the other provision as the context permits. For that reason, some parts of the explanation of this Ruling compare the effects of the two sections in particular respects.

Property transferred to the trustee for the benefit of the beneficiary

29. Income may be excepted income under subparagraphs 102AE(2)(b)(viii) or 102AG(2)(c)(viii) where it is derived from the investment of property transferred to the minor, or transferred to a trustee for the benefit of the minor, respectively, as the result of a family breakdown. If a CMT arrangement is to take advantage of these provisions, the property must be transferred to the trustee for the benefit of the minor.

30. In some cases, no property is transferred to the trustee at all. The facts of *Case U202* 87 ATC 1129; *AAT Case 134* (1987) 18 ATR 3974 provide an illustration. In that case, following the dissolution of a marriage and as part of an agreement resolving issues of property and maintenance, the trustee of an existing discretionary trust in favour of the children and their parents entered into a binding agreement to exercise its discretion to a defined extent in favour of the children. The agreement resulted from a family breakdown but it transferred no property to the trustee for the benefit of the children, or to the children themselves. Accordingly, the AAT found that the income allocated to the children by the trustee was not 'excepted trust income' by virtue of the then subparagraph 102AG(2)(c)(viii).

31. In many CMT arrangements, existing fixed, discretionary and unit trusts are adapted after a family breakdown for their new purpose. When this occurs, and property has been transferred before the family breakdown, there may be no transfer of property to the trustee of the CMT **as a result of** the family breakdown, and so no possibility that the income is excepted trust income in terms of subparagraph 102AG(2)(c)(viii). The facts of *Case U202* also illustrate this.

32. In other cases, property is not transferred to the trustee for the benefit of the child. For income derived on or after 7 March 1994, subsection 102AG(2A) provides that those provisions of section 102AG that except income from the investment of property transferred to a trustee for the benefit of a child do not apply unless the property is transferred beneficially to the child.

33. Accordingly, the child must, under the terms of the trust, acquire the trust property other than as a trustee when the trust ends. Moreover, the property must pass into the child's estate, should the child die before the trust ends. However, the trust property can be applied for the child's benefit during the trust; for example, in the most extreme case, the trust property can be applied to acquire a term annuity for the child. In such cases, the trust property may be reduced over the period of the trust, but the child is still to acquire any trust property remaining when the trust ends.

34. Under some CMT arrangements, substantial property is transferred to a trustee, it is invested at arm's length or to derive no more than an arm's length rate of return, and the child is to receive the income from the investment. However, on completion of the arrangement - for example, when the child ceases full-time education, or when maintenance obligations for the child cease - the property is to pass to someone other than the child, usually the person with an obligation to maintain the child, or to a nominee of that person. This may be expressly provided for, or may occur as a matter of discretion.

35. The arrangements described in the previous paragraph do not produce excepted trust income. For income derived on or after 7 March 1994, subsection 102AG(2A) makes it clear that such arrangements are not within subparagraph 102AG(2)(c)(viii). The explanatory memorandum to Taxation Laws Amendment Bill (No 4) 1994, which introduced the provision, described it as a clarification of the existing law. So the introduction of subsection 102AG(2A) does not support any inference that the law was previously of a different effect.

36. Subsection 102AG(2A) did not apply for income derived in or after the year of income ended 30 June 1980, but before 7 March 1994. We consider that paragraph 102AG(2)(c) nevertheless required income to be derived by the trustee from the investment of property transferred to the trustee for the benefit of the child. In the context of Division 6AA, the property had to be transferred beneficially for the child. As a result, CMT arrangements under which property would or could pass beneficially to someone else, did not produce excepted trust income from the investment of that property.

37. Subparagraph 102AG(2)(c)(viii) has the same effect whether income was derived before or after 7 March 1994. Any child who is

the beneficiary of a CMT arrangement must derive income from the investment of property transferred beneficially to that child. The child must have an absolute vested interest in the property from the inception of the trust. Where several children are beneficiaries of the same CMT, each child must have an absolute beneficial interest in its own part of the trust property. That part of the trust property is the child's and must form part of the child's estate in the event of the child's death before the trust ends. If part of a child's share of a trust is advanced to the child during the trust, then that child's property is reduced and so is the capacity of the trust to produce excepted income of that child.

38. Where, however, a trust also includes property to which a child is not beneficially entitled, we accept the application of that property to or for the benefit of the child does not reduce the child's property in the trust or the capacity of the trust to produce excepted income for the child from the child's part of the trust property.

39. The operative provisions of paragraphs 102AE(2)(b) and 102AG(2)(c) have always been in the same terms and intended to be read identically. The explanatory memorandum to the Bill introducing the provisions made this clear, by not giving paragraph 102AG(2)(c) an explanation independent from the explanation of paragraph 102AE(2)(b). The fundamental requirement of paragraph 102AE(2)(c) is that property be transferred to the child; the corresponding implication for the case of a trustee is that property be transferred beneficially to the child. The words of paragraph 102AG(2)(c) reasonably bear that meaning by requiring that the property transferred be for the benefit of the child and this means it must be beneficially the child's property. It does not mean a transfer that has some benefit for the child, as it occurs where only the income from the property is to benefit the child.

40. This view is supported by comparing paragraphs 102AE(2)(c) and 102AG(2)(d), on the one hand, and paragraph 102AG(2)(a) on the other. Both sections 102AE and 102AG provide for exception of income from the investment of property transferred to a child, or to a trustee for the benefit of a child, from a deceased estate or (within three years of the death) from someone's legacy from a deceased estate. If paragraph 102AG(2)(d) is limited to income from the investment of property transferred beneficially to the child, by words essentially similar to those of paragraph 102AG(2)(c), then paragraph 102AG(2)(a) is necessary because paragraph 102AG(2)(a) excepts a child's income from a testamentary trust, regardless of whether the child has any interest in the property. But if the words of paragraph 102AG(2)(c) extend to cases where the transfer to the trustee, but not the asset itself, would benefit the child, then so do the words of paragraph 102AG(2)(d). That makes paragraph 102AG(2)(a)

unnecessary - a construction ordinary statutory interpretation rejects if it can.

Alternative view 1

41. Some commentators have put a contrary view, suggesting that income is excepted when it comes from property transferred to a trustee, where the transfer to the trustee benefits the child, even if the child has no interest in the property. That view is based on paragraph 102AG(2)(c) without reference to the rest of the provisions, particularly paragraph 102AE(2)(b). In our opinion, this view would remove the effect of the 'arm's length' rules limiting the extent of excepted income (subsections 102AE(6) and 102AG(3)) for cases where a trustee is employed (though not for cases where property is directly that of the child). If a child's income through a trustee could be excepted, although it does not come from the child's property, the requirement that the income come from the investment of the property is inexplicable. So is limiting the child's own, direct excepted income to that from investment of the child's own property. Yet these provisions operate consistently and coherently between paragraphs 102AE(2)(b) and 102AG(2)(c) if they are read, correctly, as requiring income to come from the investment of what is beneficially the child's property.

Alternative view 2

42. Some commentators claim that subsection 102AG(8) supports the view that the law did not require property transferred to a trustee to be beneficially that of the child. This is on the basis that the provision takes property to be transferred for the benefit of beneficiaries, where their entitlement to the income from the property is subject to a discretion. However, the provision has a sensible application, consistent with the requirement that property be transferred beneficially to the child. Without the provision, it could be argued that, although the property was beneficially that of a child, any discretion in the allocation of income would mean that the transfer of the property to the trustee was not (or, perhaps, part of the property was not) for the benefit of the child. The provision clearly prevents that argument from being maintained.

43. Both sections 102AE and 102AG are, and are meant to be, apportioning provisions. If property is transferred to a child in some form of joint ownership, or to a trustee beneficially for a child and other beneficiaries, the arm's-length and other *features of the provisions clearly apply because of the child's interest in the property. On the same basis, the explanatory material for subsection 102AG(8) and early commentary on that subsection described the subsection as operating to allocate income from any source proportionately to all discretionary income beneficiaries of such income. This view of the operation of the provision does not support any argument that the underlying property is not required to be beneficially that of the child.*

Alternative view 3

44. The AAT, in Case 44/95 *95 ATC 387;* AAT Case 10,321 *(1995) 31 ATR 1131, held that an amount was transferred for the benefit of a child where the child was absolutely entitled to all income from investing the amount during her minority, whether that amount was paid or accumulated, and was one of a group of potential discretionary beneficiaries of the corpus once she turned eighteen. The careful decision of the Tribunal is entitled to respect, but the terms of the decision show that the Tribunal was not referred to the detailed arguments for and against the view that the law required property to be beneficially that of the child; for instance neither party referred to subsection 102AG(8) at all (ATC at 392; ATR at 1137). The Tribunal was not given the benefit even of the detailed arguments that were already canvassed in* Butterworths Weekly Tax Bulletin 1995 *at items [2] and [3]. In the circumstances, while the ATO accepts that the view favoured by the Tribunal is clearly arguable, it would be appropriate to have this issue tested in a case where the competing arguments could be squarely put to a Court. Consideration would be given to assisting a litigant in such a case under the Test Case Litigation Program for Tax Law Clarification, administered by the ATO.*

Alternative view 4

45. Some commentators have suggested that the requirement that property be beneficially that of the child means that no effective trusts for children can survive the majority of the youngest beneficiary This is because of the rule in Saunders v. Vautier *(1841) 4 Beav 115 that where all possible beneficiaries are competent to do so they can agree to wind up and distribute the assets of a trust among themselves. This view is clearly incorrect. The requirement that the property be beneficially that of the child does not preclude the use of mechanisms, such as* *the presence of discretionary income beneficiaries, that ensure the trust has its intended term. See, for example,* In the Estate of Lee; Perpetual Trustee Company (Canberra) Ltd v. Rasker and Others *(1986) 84 FLR 268.*

46. Some CMT arrangements include the purported transfer of property to a child's trustee, conditional on the trustee immediately retransferring the property in a specified way. A common requirement is for the property to be exchanged for an annuity, to end when maintenance obligations end, payable by the parent whose maintenance obligations will be reduced by the annuity payments or by some third party, perhaps associated with the parent. Where property is 'transferred' to a trustee in this way, the trustee never has control of the property in the sense of being able to make any decision regarding its disposition, and has no real powers of ownership over the property. If the property can be said to be transferred to the trustee at all, it cannot be said to be transferred to the trustee for the benefit of the child, or beneficially for the child. The trustee does not have any power to deal with the property in accordance with the trust or the interests of the child.

Income from the investment of property

47. Income may be excepted income under subparagraphs 102AE(2)(b)(viii) or 102AG(2)(c)(viii) where it is derived from the investment of property transferred to the minor, or transferred to a trustee for the benefit of the minor, respectively, as the result of a family breakdown. So in CMT arrangements the income must come from the investment of property.

48. Paragraphs 102AG(2)(c) and 102AE(2)(b) are cognate paragraphs, having the same effect for trust cases as for cases where property is transferred directly to a child. The narrow trust law meaning of investment is not the sense in which the term is used in either paragraph and the broad ordinary meaning of investment applies.

49. It could be burdensome and unnecessary for a trustee, or a child, having regard to the meaning of investment under trust law principles, to realise any property and reinvest the proceeds. The property may already be in an income-producing form with which the child or the trustee is satisfied; be held in the form in which it was transferred to the trustee for the child; or the property may have been realised and reinvested. (One comment on the draft of this Ruling suggested that income would have to come from the actual property transferred to be excepted income, as otherwise it would come from the investment of some other property.) The ATO makes no distinctions, recognising

that income can come from investing property in any of these situations.

50. Although not completely free from doubt, the ATO accepts that if property comprising a patent or copyright is transferred beneficially to a child, the proceeds of licensing the patent or copyright are properly treated as income from investment of the patent or copyright. Similarly, if the child or the trustee develops a patent or copyright by employing property transferred beneficially to the child, the proceeds of licensing are income from investment of the transferred property used to develop the patent or copyright. The ATO also accepts that (in the rare cases where a trust authorises such action by a trustee) annuity income purchased with property transferred beneficially to a child may be income from the investment of the property with which it is purchased, despite the technical argument that the property has not been invested but merely exchanged for a right to an income. (The joint judgment of Mason ACJ, Wilson, Brennan, Deane and Dawson JJ in *FC of T v. The Myer Emporium Ltd* (1987) 163 CLR 199; 87 ATC 4363 observed CLR at 218; ATC at 4,371:

> 'Annuity payments are not derived from the money paid for the annuity; they are derived solely from the annuity contract.'

It does not follow that the annuity payments are not the proceeds of investing the purchase price of the annuity, for the purposes of Division 6AA.)

Alternative view 5

> *51. The meaning of 'investment' in the context of a trust is restricted by long-standing principles of trust law. If those principles limited the meaning of 'investment' for the purposes of paragraph 102AG(2)(c), it could be argued that any property other than money transferred to a trustee for a child would have to be realised and the proceeds reinvested, or income would not be the product of investment, and so dividends on shares transferred to a trustee for a child could not be excepted income. A loan without security would not be an investment, and so interest on it could not be excepted income (see* Khoo Tek Keong v. Ch'ng Joo Tuan Neoh *[1934] AC 529). The purchase of a home for the child to live in (with its caregivers) would not be an investment but for enabling legislation (*In the Will of Sherriff *[1971] 2 NSWLR 438;* Re Peczenik's Settlement Trusts *[1964] 1 WLR 720;* In re Power: Public Trustee v. Hastings *[1947] Ch 572), and so the rent paid by the child's family to live there could not be excepted income. However, these principles cannot apply, as they would mean that the effect of paragraph*

102AG(2)(c) was very different from the effect of paragraph 102AE(2)(b).

52. Apart from the restrictions of trust law, 'investment' is not a term of art.

> *'Money employed as capital in a business is, in popular language, money invested in a business; money used for the purchase of negotiable instruments is an investment; so also money lent upon a bond or other personal security; so money deposited with a bank or other financial institution at interest.'*

*(*The Commissioner of Taxes v. The Australian Mutual Provident Society *(1902) 22 NZLR 445 (CA) per Edwards J at 457). To invest is 'to lay out money in the acquisition of some species of property' (*Inland Revenue Commissioners v. Rolls-Royce Ltd *[1944] 2 All ER 340 per Macnaghten J at 341) and an investment is made 'in the purchase of some property from which interest or profit is expected and which property is purchased in order to be held for the sake of the income which it will yield' (*Re Wragg; Wragg v. Palmer *[1919] 2 Ch 58 at 65). Outside a trust context, even the purchase of a life policy of an investment kind is investment (*Re Lilly's Will Trusts; Public Trustee v. Johnstone *[1948] 2 All ER 906 per Harman J at 907).*

*53. Even so, at general law, the courts have said some things are not investments. For example, the income earned from licensing patents to one's own inventions has been held not to be income from investment (*Inland Revenue Commissioners v. Rolls-Royce Ltd *[1944] 2 All ER 340), and not all income-producing property is an investment; thus, fees for the use of one's productive plant have been held not to be income from investment (*Tootal Broadhurst Lee Co Ltd v. Inland Revenue Commissioners *[1949] 1 All ER 261 (HL)). Licensing copyright, or the use of a fictional character, has been held not to produce income from investment (*Electric and Musical Industries Ltd v. Inland Revenue Commissioners *[1950] 2 All ER 261 (HL);* Noddy Subsidiary Rights Co Ltd v. Inland Revenue Commissioners *[1966] 3 All ER 459; [1967] 1 WLR 1).*

54. The ATO does not accept that these cases are applicable in interpreting paragraphs 102AG(2)(c) and 102AE(2)(b) of the Act; they related to tax provisions that taxed income from investment on different terms from income from carrying on a business, employment or other activities. Thus, in deciding whether excess profits tax applied, the House of Lords did not *deny that money embarked in a business was invested, but had to decide whether it was invested apart from the business and so produced earnings irrelevant to the application of the excess profits tax to the profits of the business. Investments in petroleum companies with Belgian and Romanian activities were irrelevant to excess profits tax in* Gas Lighting Improvement Co Ltd v. Commissioners of Inland Revenue *[1923] AC 723; but they would have come from investment in the petroleum refining and distribution business, in the wider sense, whatever the outcome. The excess profits tax required a distinction between property actively employed in carrying on a business and property invested by the business in an outside security, as the court explained in* Tootal*, following* Gas Lighting*, above. Division 6AA requires no such distinction.*

55. If investment requires the acquisition of property, annuities can be said not to be the proceeds of an investment, for they do not involve the acquisition of property that can be described as an asset, but instead only the giving up of an asset in return for an income stream, a view supported by the High Court in FC of T v. The Myer Emporium Ltd *(1987) 163 CLR 199; 87 ATC 4363. This view has some support from the authorities on testamentary annuities, where an annuitant is not generally entitled to a settled sum in place of the annuity unless the testator directs the purchase of the annuity out of the estate, or dedicates a fund from which the annuity is to be purchased, or the annuity is in substance perpetual beyond the life of the first annuitant.*

56. The question is a difficult one, but if paragraphs 102AG(2)(c) and 102AE(2)(b) are to be read as cognate provisions in the various ways outlined in this Ruling, the ATO does not accept that these principles exclude the proceeds of an annuity from being regarded as income from investment of property for the purposes of the paragraphs. As Harman J explained in dicta in Re Lilly's Will Trusts; Public Trustee v. Johnstone *[1948] 2 All ER 906 at 907, in the special context of testamentary trusts:*

> *' ... a man who put out his money to buy himself a policy to return a sum, whether at 65 or at his death, was investing money, and that the proceeds would properly be called an investment. I have no doubt that is so ...'*

Similarly, the same person putting out money to buy, not a single lump sum payable at 65 or at death, but an annual income (fixed or indexed) for life or for some lesser term, may properly be said to invest money, and the proceeds are properly

> *the proceeds of investment. A different view would mean, for instance, that property transferred to or beneficially to a child in substitution for any entitlement to maintenance and used to buy an annuity payable while the child is a minor, or perhaps for a longer time allowing for tertiary study, would attract Division 6AA where an investment preserving the property would not. Yet courts, in Australia and elsewhere, commonly assess the value of property that substitutes for a maintenance obligation as the property that would purchase an annuity equal to the maintenance for which the property is a substitute, and ending when the maintenance obligation would end.*

57. In some circumstances, income does not come from an investment although it is channelled through that investment. For example, suppose the trustee of a discretionary trust is authorised to make distributions to objects including a child, or any trust benefiting the child. If property is transferred to the trustee for the child, and invested by subscription for units in a unit trust, income from further investment by the unit trust that the unit trust allocates to the child's trustee is income from investment of the property transferred to the trustee. But a distribution by the discretionary trust directly to the child's trustee would not be income from investment of the property transferred to the trustee. Neither would a distribution to the unit trust in which the property was invested.

58. *Case 44/95* 95 ATC 387; *AAT Case 10,321* (1995) 31 ATR 1131, illustrates this point; '(t)he discretionary distribution by the B Trust to the C Unit Trust was, in one sense, a windfall gain unrelated to any investment' (per B H Pascoe at ATC 392, ATR 1136). In that case, there was no connection between the possibility of the discretionary distribution and any investment by the trustee for the child. The Tribunal was not considering a case where, for example, a loan was made without interest but with an entitlement to be considered for a discretionary distribution from the trust to which the loan was made. On the view expressed by the Tribunal, only income received from the use of the money subscribed to the unit trust could be income from investment of the money transferred to the CMT and subscribed to the unit trust.

59. In cases where the trustee for a child gets property only on condition that the trustee applies it in a certain way, it may be that the income the trustee receives on applying the property is not income from the investment of property. Depending on the circumstances, the income may be clearly independent of the property and its application; it may be essentially an inducement to the trustee to deal with a piece of property according to the condition. In that case, the trustee's income could not be, to that extent, excepted income.

Transfer of property as a result of a family breakdown

60. To qualify under subparagraphs 102AG(2)(c)(viii) or 102AE(2)(b)(viii), income must be from the investment of property transferred beneficially to a child 'as the result of a family breakdown'. *Taxation Laws Amendment Act (No 4) 1994* introduced these words, retrospectively to the original date of effect of Division 6AA. New section 102AGA explains their meaning and resolves a possible defect in the original words of the legislation, which could have made the paragraphs largely ineffective.

61. The original words referred to income from the investment of property transferred beneficially to a child pursuant to a decree or order of dissolution or annulment of marriage, or pursuant to a decree or order of judicial separation or a similar decree or order. For decrees obtained in Australia after the repeal of the *Matrimonial Causes Act 1959*, there could be no operation of the 'judicial separation' wording (*Case V105* 88 ATC 678; *AAT Case 4480* (1988) 19 ATR 3678). The draft of this Ruling put forward for discussion the view that the 'dissolution or annulment' wording was so inconsistent with the course of action under the *Family Law Act 1975* that it would also have no operation for decrees obtained in Australia after the repeal of the *Matrimonial Causes Act 1959*, confining the paragraphs to operation in respect of decrees obtained under the *Matrimonial Causes Act 1959*, its State predecessors, or laws of other countries. Parliament acted to clarify its intent.

62. Section 102AGA provides for two sorts of family breakdown. First, someone who lives with another person as their spouse on a genuine domestic basis may cease to do so (the 'marriage breakdown' case). Second, two parents may never live together as spouses on a genuine domestic basis after their child is born (the 'other relationship' case). The two sorts of family breakdown are not mutually exclusive; there may be cases where a particular breakdown answers both descriptions, for a particular child or children. Both sorts may lead to the transfer of property beneficially to a child, and to exception of the child's income from investing the property. The laws applying to both sorts of breakdown are very similar.

63. In the 'marriage breakdown' case, where two people were married or in a de facto relationship, the first condition for the application of paragraphs 102AG(2)(c)(viii) and 102AE(2)(b)(viii) is that one of the two people ceases to live with the other on a genuine domestic basis as their spouse. This does not require the two people to divorce, if they are married. So, for instance, a marriage may be taken to have broken down even if the two people do not intend to divorce (perhaps for religious reasons), or even if they cannot divorce

(perhaps because they are not legally married, or the necessary grounds for divorce cannot be established yet).

64. The second condition is that the child to whom, beneficially, property is to pass must be the child of at least one of the two people. This is not confined to natural children. An adoptive child, a step-child, or a child who is under the legal custody or guardianship of a person is the child of that person. And it is not confined to children who are the children of both people.

65. The third condition is that some sort of order, determination or assessment is made because the two people have ceased to live together on a genuine domestic basis as spouses, and the order, determination or assessment renders someone liable to do something for the benefit of the child or either of the people. The order, determination or assessment could be administrative or judicial, and involve maintenance, property, or other benefits for either spouse, the child, or any of them. This is not confined to obligations to maintain the child, or transfer property to the child. The person who has this obligation need not be either spouse; for instance, the trustee of a family trust, or a family company, might come under obligations.

66. Finally, someone must transfer property beneficially to the child to give effect to the obligation to do what has to be done for either spouse or the child. This is not just a transfer of property by the person with the obligation; the transfer of property could be made by someone else, such as a relative or friend of a spouse having the obligation. The transfer of property beneficially to the child need not be the obligation, as long as the transfer gives effect to or discharges the obligation; for instance, a transfer of property to a child could satisfy an obligation to transfer property to a spouse.

67. In the 'other relationship' case, where a child is born to parents who are not living together as spouses at the time, the child to whom property is to pass beneficially must be the child of both parents. This does not include children or step-children of only one of the two people, because such children could be taken to be children of both only because of a marriage or de-facto marriage between the two people. Similarly, there is no need to consider adoptive children or children under the legal custody or guardianship of either or both people, as these could be taken to be children of both people only because of their marriage or defacto marriage. All those cases are dealt with under the 'marriage breakdown' case.

68. With the 'other relationship' case, there has to be some sort of order, determination or assessment made because the two parents do not live together on a genuine domestic basis as spouses, which renders someone liable to do something for the benefit of the child or either of the parents. This includes orders such as affiliation orders.

The order, determination or assessment could be administrative or judicial, and involve maintenance, property, or other benefits for either parent, the child, or any of them that are not confined to obligations to maintain the child or transfer property to the child. The person who has this obligation need not be either parent; for instance, the trustee of a family trust, or a family company, might come under obligations.

69. Finally, someone must transfer property beneficially to the child to give effect to the obligation to do what has to be done for either parent or the child. This is not just a transfer of property by the person who has to do the thing; the transfer of property could be made by someone else, such as a relative or friend of a parent having the obligation. The transfer of property beneficially to the child need not be the obligation, as long as the transfer gives effect to or discharges the obligation; for instance, a transfer of property to a child could satisfy an obligation to transfer property to a parent.

70. The tests are worded widely, because they cover the breakdown of marriages and defacto marriages and also parental obligations having no marriage context at all. In any of these cases, State or Commonwealth law, past or present, and the law of other countries, could have led to an obligation arising from the family breakdown that has been met or discharged by transferring property beneficially to a child. If that child is deriving income to which Division 6AA applies, subparagraphs 102AG(2)(c)(viii) and 102AE(2)(b)(viii) should be equally applicable, wherever the family breakdown happened and whatever the obligations that were met or discharged. The words of the tests are intended to cover not only obligations imposed in judicial proceedings but also obligations imposed administratively or by operation of law, and certainly include child support obligations.

71. However, there are circumstances in which the tests are not satisfied. Most commonly, this would be because property was not transferred beneficially to a child in giving effect to or discharging any legal obligation. Such cases are likely to be rare. Certainly, in CMT arrangements the transfer of property is usually designed to meet or discharge maintenance obligations, and often to reduce or satisfy obligations to transfer property to a parent or spouse.

72. Because section 102AGA is fully retrospective, the original limitation of the provisions against defacto marriages and unmarried parenthood does not affect any past or present CMT arrangements.

Arm's length rate of income

73. Subsections 102AG(3) and 102AE(6) are cognate provisions that allow income as excepted assessable income only so far as the income does not exceed the amount that would have been derived had

the income been derived on an arm's length basis. Where any two or more of the parties to the derivation of excepted trust income, or parties to any act or transaction directly or indirectly connected with the derivation of excepted trust income, were not dealing with each other at arm's length, the excepted trust income is reduced to what it would have been had the parties been dealing with each other at arm's length. *Taxation Laws Amendment Act (No 4) 1994* clarified the provisions, but their operation was not altered, merely confirmed: see the explanatory memorandum to the Bill for that Act.

74. In their application to subparagraphs 102AG(2)(c)(viii) and 102AE(2)(b)(viii), subsections 102AG(3) and 102AE(6) apply to the derivation of income from investment of property and to any act or transaction directly or indirectly connected to the derivation of the income.

Alternative view 6

> *75. Arguments have been put forward that parties to a family breakdown or a resulting CMT are dealing at arm's length in relation to the transfer of property beneficially to the child, or in relation to the setting of a rate of maintenance for the child. Therefore, it is claimed, any income from investment of the property transferred into the CMT arrangement, however it is derived and at whatever rate, is income to which subsections 102AG(3) and 102AE(6) cannot apply. This is not so. The fact that parties are dealing at arm's length in settling an amount of property to be transferred, or in settling a rate of maintenance, does not establish that they are dealing at arm's length in relation to the return on investment of property transferred into a CMT. In fact, a known maintenance obligation often explains the payment of income representing more than an arm's length return on the investment of a child's property.*

76. Subsection 102AG(3) applies where higher than arm's length rates of income are paid in relation to the investment of property transferred beneficially to a child. In the case of a CMT holding a unit in a unit trust, for example, the relevant question in determining the arm's length return is how much return would be expected if all parties were dealing at arm's length in relation to the return on the unit. For instance, if there was only a nominal amount of property subscribed for the unit, the arm's length income for the unit is nominal or zero. Any greater return would attract the operation of subsection 102AG(3). Similarly, if property were invested in an annuity to be paid by a parent, the income under the annuity should not exceed the range of income under annuities available at the same cost and on the same terms from commercial providers of annuities. Extraordinary

terms in an annuity from a non-arm's length source may suggest that the income exceeds an arm's length rate of return.

77. Subsections 102AG(3) and 102AE(6) apply to any parties to any act or transaction connected even indirectly to the derivation of excepted income; they are not limited to dealings between the party deriving the excepted income and the party from whom that income is derived. Take, for example, the trustee of a CMT investing in a unit trust that acquires a company in partnership with someone else. The law requires:

- the unit trust to deal at arm's length with its partner over the distribution of partnership income or derive no more than an arm's length share of that income;
- the partners to deal at arm's length with the company over the dividends they take, or to take no more than arm's length dividends; and
- the company to deal at arm's length in earning its profits, or to make no more than arm's length profits. If dividends on profits exceed arm's length amounts, the excepted income derived by the CMT has to be recalculated.

78. The subsections ensure that, for the purposes of subparagraphs 102AG(2)(c)(viii) and 102AE(2)(b)(viii), substantial property has to be transferred to ground any substantial amount of excepted income. They limit income, where parties do not deal at arm's length in relation to the income, to what it would have been if they had dealt at arm's length. But the tax law does not require parties to deal at arm's length. For example, a lender at arm's length would not allow the interest on a loan to be a matter of discretion. But if a CMT, or a related entity, made loans on that basis, so much of the interest as did not exceed arm's length interest could still be excepted income.

79. The parties to the derivation of excepted income, or to an act or transaction connected even indirectly with the derivation of excepted income, may be at arm's length. This is not sufficient; they must deal with each other at arm's length, that is, as arm's length parties would normally do, so that their dealing has an outcome that is the result of normal bargaining (see *The Trustee for the Estate of the late A W Furse No 5 Will Trust v. FC of T* 91 ATC 4007; (1990) 21 ATR 1123 and *Granby Pty Ltd v. FC of T* 95 ATC 4240; (1995) 30 ATR 400). It has been suggested that even if they are not at arm's length, subsections 102AG(3) and 102AE(6) do not apply if they deal on an arm's length basis, a view that has some support in the authorities. Another view would be that the subsections apply where parties are not at arm's length, but where they do deal on an arm's length basis the income is necessarily what it would have been between parties dealing

on that basis. On either view, if parties are dealing only on an arm's length basis in relation to the derivation of excepted income and any even indirectly related acts or transactions, subsections 102AG(3) and 102AE(6) do not reduce the amount of the excepted income.

80. *Case 44/95; AAT Case 10,321* provides an illustration of the effect of subsection 102AG(3). It applied the former, rather than the current, wording of the subsection, but its conclusions do not turn on any difference from the current words. In the case, a discretionary trust that antedated any CMT arrangement and included contingent beneficiaries associated with a partner in a professional firm, made distributions to a unit trust set up under a CMT arrangement. The AAT rejected the claim that, because the trustee of the discretionary trust acted properly in discharging its fiduciary obligations, the payment to the unit trust of the CMT arrangement was the result of an arm's length dealing. The AAT found that the distributions were made according to the wishes of the partner, whose maintenance obligations were to be reduced under the CMT arrangement. In the circumstances, the distribution to the unit trust of the CMT arrangement was an action connected to the derivation of income by the CMT, and parties including the trustee and the partner were not dealing at arm's length in relation to that action.

81. A distribution by the discretionary trust to, or directly for the benefit of, the child might have been made at arm's length. (Of course, such a distribution would not have represented the income from investment of any property transferred to or beneficially to the child.) Whatever the status of such distributions, a distribution by the discretionary trust to a CMT unit trust, whether for reasons known only to the partner or to support excepted income status when the distribution flows through the CMT arrangement, was not the result of an arm's length dealing. At arm's length, no such distribution would have been made, according to the Tribunal.

82. Under the current wording of subsections 102AG(3) and 102AE(6), distributions by a discretionary trust could be acts or transactions at least indirectly connected to the derivation of excepted income by a CMT, where the discretionary distributions are to flow to the CMT (whether through a unit trust, as dividends of a company, or in some other way). Similarly, the addition of a contingent beneficiary of a discretionary trust of a CMT, or some other trust or entity from or through which the CMT might derive income, could be regarded as indirectly connected acts or transactions. Any excepted income under the CMT is reduced to what it would have been had all parties to these acts or transactions been dealing at arm's length.

83. A discretionary trust holding part of a partner's interest in a firm, or a similar commercial interest in a company, would not make any

arm's length distribution other than a distribution to the partner or interested shareholder. All its distributions would be to that person. A non-arm's length arrangement would be evident where particular amounts are distributed in particular periods as that person desires. The addition of further contingent beneficiaries would also ordinarily result from a non-arm's length arrangement. Distributions to benefit CMT arrangements would normally exceed any arm's length distribution.

Agreement for the purpose of securing that assessable income be excepted trust income

84. Income is not excepted income if it results, directly or indirectly, from an agreement entered into or carried out for purposes including that the income be excepted income (subsections 102AG(4) and 102AE(7)). However, if the purpose of having the income excepted is no more than merely incidental to setting up legitimate arrangements to satisfy an obligation to provide for the maintenance of a child, then the purpose is disregarded and the income may still be excepted (subsections 102AG(5) and 102AE(8)).

85. Subsections 102AG(4) and 102AE(7) do not apply where income results only from ordinary commercial agreements, made for ordinary commercial reasons, even though parties to those agreements were aware that the resulting income would be excepted income (per Williams J in *FC of T v. Bill Wissler (Agencies) Pty Ltd* 85 ATC 4626 at 4631-4632). Therefore, the subsections clearly do not mean that Division 6AA applies whenever someone transferring property beneficially to a child, or investing that property, is aware that income from the investment would be excepted income.

86. In what circumstances is the purpose of having income be excepted income more than merely incidental? One illustration is provided by *Case 44/95*; *AAT Case 10,321* where income from an existing discretionary trust was to be routed through new CMT arrangements to a child. As the discretionary trust already existed, it could have distributed income directly to the child or the trustee for the child; but had it done so, the income would not have been even arguably excepted and would have been taxed at the higher rates applicable under Division 6AA. In those circumstances, the agreements under which the child's trustee took units in a unit trust, the unit trust was made a contingent beneficiary of the discretionary trust, and distributions were made by the discretionary trust to the unit trust, all had the purpose of securing that income flowing from the discretionary trust, through the unit trust, to the child's trustee would be excepted income.

Alternative view 7

> *87. That decision has been criticised by some commentators. The main criticism has been that the purpose of the arrangements was to provide amounts that would support a child, and therefore any purpose of ensuring that the amounts would be excepted income was necessarily merely incidental. On this view, if subsections 102AG(4) and 102AE(7) ever applied, they could only do so in cases where income was not really intended to benefit a child at all - cases to which Division 6AA would not apply in the first place. Such an interpretation of the law cannot be correct.*
>
> *88.* Case 44/95; AAT Case 10,321 *does not suggest that subsection 102AG(4) applies whenever a trustee's income under an agreement is expected to be excepted. It identifies a case in which agreements had a more than incidental purpose of making income excepted. For example, subsection 102AG(4) applies where discretionary distributions of income that would not be excepted if made to a child's trustee are routed, perhaps through a unit trust or partnership, so as to give them the character of excepted income.*

89. Another illustration of the application of these provisions is the transfer of property on condition that a trustee for a child use the property only to purchase an annuity. Suppose the person seeking to reduce maintenance obligations by a CMT arrangement transfers property to a trustee for the child, but on terms that the trustee must give the property back in exchange for an annuity at a rate and on terms which reduce the maintenance obligation. This is no different in substance from the facts of *Case U202*. In that case, following a family breakdown, the trustee of an existing discretionary trust limited its discretion by agreeing to distribute certain minimum amounts of income for the benefit of children in each year. Those distributions were not excepted income. The requirement that property be exchanged for an annuity to produce income is imposed, and the agreement to pay the annuity is made, substantially for the purpose of ensuring that the amount that is to be paid is given the character of excepted income. The same amount could easily be paid without transferring the property to the child's trustee and requiring it to be returned immediately.

90. A trustee for a child may use property transferred beneficially to the child to buy an annuity, payable only over the same period for which someone is obliged to maintain the child. That period may last while the child is a minor, or perhaps may extend to a period of full-time tertiary study. If the income of the child's trustee from the

investment of property reduces what would otherwise be the maintenance obligations of that person towards the child, and the annuity does not substantially exceed the amount of those obligations, then the trustee may be giving up the benefit of the property for no advantage to the child. Once the maintenance obligation is over and the annuity ends there will be no property remaining, yet the trustee could have invested the property in a way that would preserve it for the child without reducing the amount available to maintain the child. Such cases are unlikely to be at arm's length. Where they arise, it is likely there is an agreement for the purpose of converting an amount equal to the maintenance obligation into excepted income, and that subsection 102AG(4) applies. On the other hand, where the income of the child's trustee does not reduce any obligation to pay maintenance, perhaps because the property was transferred beneficially to the child in satisfaction of any maintenance obligation, the child may benefit from higher income under an annuity at the cost of preserved property. A trustee might choose an annuity in the interests of the child.

Alternative view 8

91. A counter to this view is that subsections 102AG(4) and 102AE(7) only apply where the amount agreed to be made into excepted income would otherwise be paid as assessable income. In CMT cases, where the income of the child's trustee is meant to satisfy what would otherwise be someone's obligation to maintain the child, it has been suggested that any amounts would not flow through the arrangement at all if they were not excepted income, but would simply be paid as exempt maintenance payments under section 51-50 of the 1997 Act. The ATO does not accept this view. There is no reason to assume that if payments did not flow as excepted income maintenance would have been paid at all, or that maintenance would have met the requirements of section 51-50, particularly since the maintenance payer would not have diverted income or divested assets to make the payments. In CMT cases, it is reasonable to suppose that, but for the agreement, the same income would have flowed through the arrangement but in another form. In the discretionary trust distribution cases discussed above, the discretionary trust distribution is the income that had to be converted into excepted income. In the annuity cases, the income would have flowed with no transfer of property to the trustee and no purchase of an annuity at all. In both sorts of case, that part of the income of the child's trustee was the subject of conversion into an arguably excepted form.

Commissioner of Taxation

18 March 1998

ISSN 1039 - 0731

ATO references
NO 98/1025-1
96/4513-6
96/1060-0
BO

Previously released in draft form as TR 94/D8

Price $2.90

FOI index detail
reference number
I 1017370

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