



CR 2004/134 - Income tax: capital gains: amendment of trust deed: possibility of resettlement of Trust: AXA - Growth & Income Fund

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Class Ruling

Income tax: capital gains: amendment of trust deed: possibility of resettlement of Trust: AXA – Growth & Income Fund

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Preamble

*The number, subject heading, **What this Class Ruling is about** (including **Tax law(s)**, **Class of persons** and **Qualifications** sections), **Date of effect**, **Arrangement** and **Ruling** parts of this document are a 'public ruling' in terms of Part IVAAA of the **Taxation Administration Act 1953**. CR 2001/1 explains Class Rulings and 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 Class Ruling is about

1. This Ruling sets out the Commissioner's opinion on the way in which the 'tax law(s)' identified below apply to the defined class of persons, who take part in the arrangement to which this Ruling relates.

Tax law(s)

2. The tax laws dealt with in this Ruling are:

- subsection 6(1) of the *Income Tax Assessment Act 1936* (ITAA 1936);
- sections 102-5 and 102-20 of the *Income Tax Assessment Act 1997* (ITAA 1997);
- section 104-10 of the ITAA 1997 (capital gains tax (CGT) event A1 – disposal of a CGT asset);
- section 104-25 of the ITAA 1997 (CGT event C2 – ownership of an intangible CGT asset comes to an end);
- section 104-55 of the ITAA 1997 (CGT event E1 – creation of a trust over a CGT asset);
- section 104-60 of the ITAA 1997 (CGT event E2 – transfer of a CGT asset to a trust);
- section 104-70 of the ITAA 1997 (CGT event E4 – capital payment for a trust interest);
- section 104-75 of the ITAA 1997 (CGT event E5 – a beneficiary becomes entitled to a trust asset);

- section 104-80 of the ITAA 1997 (CGT event E6 – disposal to beneficiary to end income right);
- section 104-90 of the ITAA 1997 (CGT event E8 – disposal by beneficiary of capital interest);
- section 136-10 of the ITAA 1997; and
- section 136-25 of the ITAA 1997.

Class of persons

3. The class of persons to which this Ruling applies is:
- the unitholders for the time being of the Growth & Income Fund as constituted by deed dated 21 January 1986 (the Trust) who are either residents of Australia as defined in subsection 6(1) of the ITAA 1936 or who are non-resident but subject to capital gains tax under the provisions of sections 136-10 and 136-25 of the ITAA 1997; and
 - the Responsible Entity (trustee) of the Trust.

Qualifications

4. The Commissioner makes this Ruling based on the precise arrangement identified in this Ruling.
5. The class of persons defined in this Ruling may rely on its contents provided the arrangement actually carried out is carried out in accordance with the arrangement described in paragraphs 9 to 53.
6. If the arrangement actually carried out is materially different from the arrangement that is described in this Ruling, then:
- this Ruling has no binding effect on the Commissioner because the arrangement entered into is not the arrangement on which the Commissioner has ruled; and
 - this Ruling may be withdrawn or modified.
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Date of effect

8. This Ruling applies to the years of income ended 30 June 2004, 2005 and 2006.

Arrangement

9. The arrangement that is the subject of the Ruling is described below. This description is based on the following documents:

- Application for Class Ruling dated 30 June 2003 in relation to the amendment of the deed of trust of the Growth & Income Fund;
- The deed of trust incorporating the proposed amendments in 'marked-up' form (Appendix 1 of the application);
- A Statement of Facts in relation to the arrangement (Appendix 2 of the application);
- The short-form prospectus for the Trust dated 12 September 2002; and
- A letter dated 5 August 2004 in relation to the arrangement and unit-pricing methodology.

The Statement of Facts as provided by the applicant is set out below.

Background

10. National Mutual Funds Management Ltd. (NMFML) is the Responsible Entity of the Growth & Income Fund (Trust) within the meaning of the *Corporations Act 2001*.

11. The Trust is an unlisted registered managed investment scheme under Chapter 5C of the Corporations Act, regulated by the Australian Securities and Investments Commission.

12. The Trust has only one class of unitholders and each unitholder has an interest in both the income and capital of the Trust.

13. The Trust has approximately 418 retail investors.

14. The Constitution of the Trust distinguishes between the 'income' of the Trust and realised capital gains arising from disposal of the assets of the Trust ('realised gains').

15. NMFM wishes to change the way it administers the Trust. The application for a Class Ruling relates to proposed changes to simplify the basis for making distributions of income and realised gains to unitholders of the Trust:

- (a) from a unit days model in respect of income to a pro-rata model; and
- (b) from a daily allocation model in respect of realised gains to a pro-rata model (collectively referred to as the 'proposed changes').

16. NMFM intends to make the proposed changes on and from 1 July 2003.

17. NMFM's reasons for wishing to simplify the allocation methods it currently uses are:

- (a) elements of the current distribution mechanism are complicated to administer and difficult for unitholders to understand;
- (b) NMFM believes a simpler model would be more attractive to investors and ensure investors continue to have the advantage of the benefits of scale which are available if funds under management are maintained at a reasonable level;
- (c) NMFM is part of the AXA Group of companies and the proposed changes will promote consistency for similar products within the AXA Group; and
- (d) a desire to reflect current business and commercial practice.

18. This Statement of Facts should be read in conjunction with the application for Class Ruling dated 30 June 2003. Capitalised terms in this Statement of Facts are defined in the Constitution for the Trust contained in the application for Class Ruling.

General summary of the unit days and the pro-rata methods of income allocation

19. The fundamental feature for a unit days trust is that the value of a unit ('unit price') in the trust excludes the current income of the trust. This is because unitholders in the trust have, in effect on a daily basis, in respect of each unit a separate entitlement to the income of the trust.

20. Another design feature of a unit days trust is to provide redeeming unitholders with a separate entitlement to current income of the trust for units redeemed during the distribution period. That is, the redemption proceeds for a unit days unit will comprise the unit price at that time and the redeeming unit holder's income entitlement in respect of the number of the days that the unit was on issue in the distribution period.

21. In contrast, under a pro-rata trust the current income of the trust will be 'rolled-up' in the unit price for pricing purposes. The pro-rata method of income allocation enables new investors to acquire a 'participation interest' in the current income of the trust by paying a unit price which includes a proportional share of the current income of the Trust.

22. Unitholders in the pro-rata trust become entitled to the income of the trust only at the end of the distribution period in proportion to the units they hold at that time. However, their unit price during the distribution period will reflect their proportion of the current income of the trust.

Determination of the unit price under the Constitution of the Trust

23. Under the Constitution, the unit price is a function of the Current Value of the Trust (see clauses 4.1 and 6.1 of the Constitution).

24. The Current Value is based on a concept known as Net Asset Value (see definition of 'Current Value' in clause 26.1).

25. The Net Asset Value, in turn, is based on the value of the Assets calculated under clause 8 of the Constitution (see definition of 'Net Asset Value' in clause 26.1).

26. These Assets include property and include the income of the Trust (see definition of 'Asset' in clause 26.1).

27. Under the Constitution NMFm may determine the appropriate valuation method for each item of Asset.

28. Consistent with the fundamental design feature of a unit days trust, the provisions of the Trust operate in such a way so as to enable NMFm to determine the unit price by excluding from the Net Asset Value of the Trust any amount attributable to income of the Trust.

29. After the proposed changes the unit price for a unit will include amounts attributable to the income of the Trust (see proposed changes to the definition of 'Current Value' in clause 26.1). However, it is not anticipated that as a result of the proposed changes to the Constitution, NMFm would alter its valuation methodology. This is because under the pro-rata allocation methodology, the Distributable Amount of the Trust (see definition of 'Distributable Amount' contained in clause 26.1 of the Constitution) will only be distributed at the end of the relevant distribution period. On this basis, the current methodology used by NMFm in determining the value of the items of 'Asset', being 'income of the trust', 'cash' and 'right to income' will be consistent with the method that will be used in determining the unit price after the proposed changes take effect.

Method of determination and allocation of the 'income' of the Trust

30. As indicated above, the Constitution distinguishes between the 'income' of the Trust and realised gains arising from disposal of Trust assets. Under the Constitution, the Distributable Amount represents the 'income' of the Trust.

31. The Distributable Amount for the Trust is determined by NMFMM on a daily accruals basis.

32. The Constitution confers an 'Income Entitlement' calculated by reference to the Distributable Amount in respect of both a unit that is redeemed during a distribution period and a unit that is on issue at the end of the period.

33. The redemption Income Entitlement for a redeemed unit is a pro rata share of the Distributable Amount of the Trust for the relevant period (less the aggregate Income Entitlements for units previously redeemed in the period) on the basis of the aggregate number of days that the redeemed unit has been on issue in the period.

34. The excess of the Distributable Amount of the Trust for a Distribution Period over the aggregate Income Entitlements for units redeemed in the Distribution Period is allocated to unitholders who hold units on issue at the end of a Distribution Period on the basis of the aggregate number of days the units were on issue in the period.

Impact of proposed changes to the Constitution on the method of determining and allocating the Distributable Amount

35. As a result of the proposed changes to the Constitution, the method of determining the Distributable Amount for the Trust will not change.

36. In relation to allocation of the Distributable Amount, under the proposed changes, at the end of a Distribution Period, the Distributable Amount is allocated on the basis of the number of units held by each unit holder on the last day of the Distribution Period. There will be no separate entitlement to Distributable Amount for redeeming unitholders as their unit price would already reflect an amount on account of the current income of the Trust.

Method of determination and allocation of the 'realised gains' of the Trust

37. The realised gains of the Trust for each day are represented by the Daily Net Gain of the Trust.

38. The provisions in the Trust in respect of realised gains are 'daily proportionate' provisions. They operate as follows.

39. Broadly, the daily proportionate provisions operate by calculating on a daily basis a Unit Gain (or loss), being a pro-rata share of the Daily Net Gain (or loss) determined in accordance with the number of units on issue each day. At the end of a Distribution Period NMFAM allocates to each unit that has been on issue at any time in the period the Net Realised Gains of the Trust pro-rata in accordance with the Aggregate Unit Gain for the unit as it bears to the sum of the Aggregate Unit Gains for all units on issue at any time in the Distribution Period.

40. The unit price of a unit in the Trust includes the realised gains of the Trust. In relation to unit holders who redeem some or all of their units during a Distribution Period, the Net Realised Gains Entitlement for the redeemed unit is included as part of the redemption price of the unit. The entitlement is satisfied by payment of the redemption price in respect of the unit.

41. To the extent that a unit holder who holds units on the last day of a Distribution Period, acquired some or all of its units during the period, the unit holder will receive a Capital Compensatory Amount to ensure that the Net Realised Gains of the Trust (net of the aggregate redeemed Unit Gain Entitlements for all units redeemed in the period) is distributed effectively pro-rata among all unit holders who hold units on the last day of the period.

Impact of proposed changes to the Constitution on the determination of the Net Realised Gains and method of allocation

42. As a result of the proposed changes to the Constitution, the method of determining the Net Realised Gains for the Trust will not change.

43. In relation to allocation of the Net Realised Gains, under the proposed changes, at the end of a Distribution Period, the Net Realised Gains are allocated pro rata on the basis of the number of units held by each unit holder on the last day of the Distribution Period. As such, no further Capital Compensatory Amount is required to be paid.

Assessment of economic benefits that are provided to a unit days unit and a pro-rata unit

What are the economic benefits that arise in relation to a unit in a trust?

44. Under the Constitution, each unit in the Trust confers an equal undivided interest in the income and capital of the Trust.

45. Under a pro-rata trust, prior to the end of a distribution period, the unit price represents the interest conferred by the unit in the 'income' and 'capital' of the trust. At the end of a distribution period, the pro-rata income entitlement in respect of a unit represents the

interest conferred by the unit in the 'income' of the trust and the unit price will represent the interest in the 'capital' of the trust.

46. Under a unit days trust, the unit price represents the interest conferred by a unit in the 'capital' of the trust and the unit days income entitlement in respect of the unit represents the interest conferred by that unit in the 'income' of the trust.

47. The economic 'benefit' that arises in respect of a unit at a particular time reflects the cumulative impact of both the income entitlement in respect of the unit and its unit price at that time.

Assessment of comparative economic benefits of a unit in a 'unit days trust' and a 'pro-rata trust'

48. There will be no material difference in relation to the economic benefit that arises for the holder of:

- (a) a unit which is on issue pursuant to the terms of the Trust immediately before the proposed changes take effect ('Unit Days Unit'); and
- (b) a unit which is on issue pursuant to the terms of the Trust immediately after the proposed changes take effect ('Pro-Rata Unit').

49. A material difference is a difference in economic benefit where the economic benefit that accrues to a unit under the Pro-Rata methodology varies by more than one percent from the economic benefit that would otherwise accrue to that unit under the Unit Days methodology.

50. The assessment of the economic benefit that arises in relation to a Unit Days Unit and a Pro-Rata Unit is based on:

- (a) the periodic nature of distributions in the Trust;
- (b) the level of income distributions;
- (c) the Trust generating for the relevant assessment period equivalent rates of investment returns on the Trust's portfolios similar to the Trust's experience in the 5 years prior to the date of this Statement;
- (d) the relative size of the Trust;
- (e) the anticipated levels of redemptions and issues of units for a day are based on the normal operation of the Trust in accordance with its experience in the 5 years prior to the date of this Statement; and
- (f) consistent with current AXA business practice, any returns of capital to investors will be reinvested in the Trust.

51. The assessment is made of the economic benefit that arises for a unit over time.

52. Paragraph [48] is based on assessing the economic benefit that arises in respect of a Pro-Rata Unit and a Unit Days Unit taking into account the historical experiences of the Trust including growth rate and level of applications and redemptions. It is possible that extraneous circumstances (such as the level of redemptions and applications) different to that experienced by the Trust in the 5 years prior to the date of this Statement may lead to differences in the value of economic benefit that arise for a Unit Days Unit and a Pro-Rata Unit. However, based on the measures available to NMFM under the Constitution for the proper administration of the Trust, the potential impact of such extraneous circumstances would be reduced to a level which is not material.

Confirmation of Changes

53. NMFM has confirmed that the changes as proposed have taken place.

Ruling

54. The CGT events described at paragraph 2 did not occur in relation to the class of persons to which this Ruling applies when the amendments were made to the trust deed, as the Commissioner considers that the amendments do not amount to the termination of a trust and the creation of a new trust in respect of the Growth & Income Fund.

Explanation

55. This is a ruling on the income tax effect of the amendments as described in the application to the deed of trust current as at the date of the application. The amendments to the deed including those relating to the pricing of units are subject to the *Corporations Act 2001*, in particular Chapter 5C of that Act. This Ruling should not be taken as implying any view as to whether the Corporations Act has been complied with.

56. Amendment to the constitution of a trust may alter the nature and character of the trust relationship to such an extent that for the purposes of trust law the previous trust has come to an end and a new trust has been created. In such circumstances a resettlement is said to have taken place in respect of all or only part of the assets of the original trust. The effect at common law of such a resettlement is that there has been a disposal of the trust assets, and as such is likely to have capital gains tax consequences. Specifically, a capital gain could accrue to a beneficiary as a result of the occurrence of various capital gains tax events. This capital gain would form part of the beneficiary's assessable income for tax purposes unless the

beneficiary had other capital losses against which the gain could be netted off.

57. The Commissioner of Taxation issued a Statement of Principles on 29 August 2001 (the Statement) to provide guidance on when the Commissioner will treat changes as giving rise to a new trust estate. The Statement does not cover all possibilities or circumstances of every taxpayer. The answer to whether alterations to trusts, taken together, result in terminations and creations of trust estates will generally flow from establishing whether the essential character and nature of the original trust relationship has fundamentally changed.

58. The amendments to the trust deed as described in the application result in procedural changes. These changes do not fail the indicia of continuity of the trust as set out in paragraph 4 of the Statement.

59. The Commissioner does not consider that the changes to the terms of the trust as described in the application result in a fundamental change to the essential nature and character of the original trust relationship. It is the view of the Commissioner that the changes do not disturb the continuity of the Growth & Income Fund.

Detailed contents list

60. Below is a detailed contents list for this Class Ruling:

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Commissioner of Taxation

1 December 2004

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| <i>Previous draft:</i> | - Corporations Act 2001 Ch 5C |
| Not previously issued as a draft | - ITAA 1936 6(1) |
| | - ITAA 1997 102-5 |
| <i>Related Rulings/Determinations:</i> | - ITAA 1997 102-20 |
| CR 2001/1; TR 92/1; TR 97/16 | - ITAA 1997 104-10 |
| | - ITAA 1997 104-25 |
| <i>Subject references:</i> | - ITAA 1997 104-55 |
| - capital gains tax | - ITAA 1997 104-60 |
| - CGT event A1 | - ITAA 1997 104-70 |
| - CGT event C2 | - ITAA 1997 104-75 |
| - CGT events E1& E2 | - ITAA 1997 104-80 |
| - CGT events E4-E6 inclusive | - ITAA 1997 104-90 |
| - CGT event E8 | - ITAA 1997 136-10 |
| - present entitlement | - ITAA 1997 136-25 |
| - trusts | - TAA 1953 Pt IVAAA |
| - trust resettlements | |
| - unit trusts | <i>Other references:</i> |
| - unitholders | - Creation of a new trust – |
| | Statement of Principles August |
| <i>Legislative references:</i> | 2001 |
| - Copyright Act 1968 | |
| - Corporations Act 2001 | |

ATO references

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