PCG 2016/16 - Fixed entitlements and fixed trusts

Practical Compliance Guideline

PCG 2016/16

Fixed entitlements and fixed trusts

Relying on this Guideline

This Practical Compliance Guideline sets out a practical administration approach to assist taxpayers in complying with relevant tax laws. Provided you follow this guideline in good faith, the Commissioner will administer the law in accordance with this approach.

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What this Guideline is about

1. This Guideline outlines the factors the Commissioner will consider when deciding whether to exercise the discretion[1] to treat an interest in the income or capital of a trust as being a fixed entitlement. This can result in a trust being treated as a fixed trust under the trust loss provisions and is also relevant when applying other provisions in the tax legislation which rely on the concept of 'fixed entitlement' (listed in **Attachment A** of this Guideline).[2]

2. In practice, it may be difficult for many trusts to satisfy the definition of 'fixed trust' unless the Commissioner exercises his discretion to treat the beneficiaries' interests as fixed entitlements.

3. This Guideline also outlines (at **Attachment B**) a safe harbour compliance approach for trustees of certain trusts that allows them to manage the trust's tax affairs as if the Commissioner had exercised the discretion to treat beneficiaries as having fixed entitlements to income and capital of the trust.

4. This Guideline does not apply:

- For the purposes of the 'non-arm's length income' rules in section 295-550 of the *Income Tax Assessment Act 1997* (ITAA 1997) or the 'special income' rules in the former section 273 of the ITAA 1936. The Commissioner's view of the concept of fixed entitlement in those provisions is explained in Taxation Ruling TR 2006/7 *Income tax: special income derived by a complying superannuation fund, a complying approved deposit fund or a pooled superannuation trust in relation to the year of income*.
- For the purposes of applying former subsection 160APHL(14) of the ITAA 1936 (about the holding period rule for franking credits).
- To a trust that is an attribution managed investment trust (AMIT) within the meaning of section 276-10 of the ITAA 1997. An AMIT is treated as being a fixed trust, and its members are treated as having fixed entitlements to its income and capital.[3]

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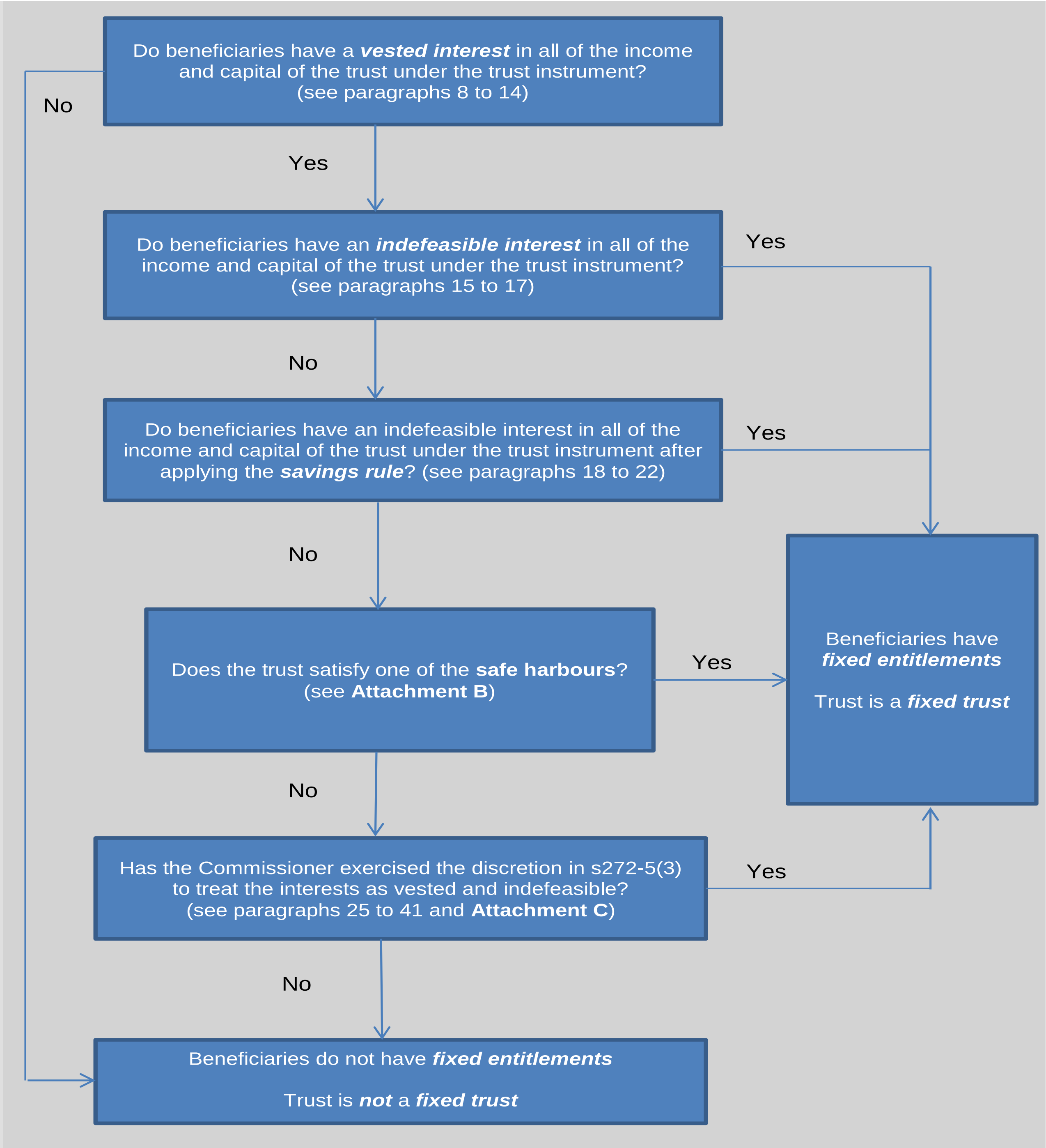
[1] Subsection 272-5(3) of Schedule 2F to the *Income Tax Assessment Act 1936* (ITAA 1936).
[2] The trust loss provisions are contained in Schedule 2F to the ITAA 1936. In this Practical Compliance Guideline, all legislative references are to Schedule 2F to the ITAA 1936 unless otherwise indicated.
[3] Paragraph 276-55(a) of the ITAA 1997.

5. Law Administration Practice Statement PS LA 2002/11 *Issues concerning fixed entitlements to a share of the income or capital of a trust* continues to instruct ATO officers about how to ensure that such issues are decided consistently.

Structure of this Guideline

6. The structure of this Guideline is represented in the following flowchart which outlines the process for determining if beneficiaries have fixed entitlements to all of the income and capital of a trust.

Determining whether beneficiaries have fixed entitlements to all of the income and capital of the trust



Date of effect

7. When finalised, this Guideline will apply both before and after the date of issue.

Fixed entitlements under subsection 272-5(1)

8. The concept of a 'fixed entitlement' is central to the trust loss provisions.[4] It is used to determine whether a trust is a fixed trust, whether a trust's beneficiaries have maintained the requisite proportion of ownership, and for tracing direct and indirect entitlements.

9. A beneficiary will have a fixed entitlement to a share of the income or capital of the trust if, under a trust instrument, their interest in the income or capital is vested and indefeasible.[5]

10. A trust is a fixed trust if the beneficiaries have fixed entitlements to all of the income and capital of the trust.[6]

Under a trust instrument

11. For these purposes, the Commissioner accepts that a 'trust instrument' includes a deed or constitution as supported by documentation such as a Product Disclosure Statement, Investment Memorandum or other document that modifies or supplements the terms of the trust set out in the deed or constitution.

12. The beneficiaries of a trust[7] that does not have a 'trust instrument' are not capable of having fixed entitlements in the absence of the exercise of the Commissioner's discretion. Trustees of such trusts cannot rely on the safe harbour compliance approach in managing the trust's tax affairs.

Vested interests

13. In terms of the concept of 'fixed entitlement', an interest is 'vested' if it is vested in interest or vested in possession.[8] An interest is vested in possession when it gives its holder a right of present enjoyment, whereas an interest is vested in interest if it gives its holder a present right to future enjoyment.

14. The mere object of a discretionary trust does not have a vested interest in, and therefore does not have a fixed entitlement to, either the income or capital of the trust.[9]

Indefeasible interests

15. An interest is defeasible if it can be defeated by the actions of one or more persons or by the occurrence of one or more subsequent events. An interest of a default beneficiary in the income or capital of the trust is an example of a defeasible interest.

16. Powers in modern trust instruments which cause a beneficiary's interests to be defeasible include:

- Broad powers to amend the trust instrument.[10]

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[4] It is also central to the 'secondary provisions' listed at Attachment A.
[5] See subsection 272-5(1).
[6] Section 272-65.
[7] Including, for example, a trust described as a 'bare trust'.
[8] Paragraphs 13.4 – 13.6 of the Explanatory Memorandum to the Taxation Laws Amendment (Trust Loss and Other Deductions) Bill 1997.
[9] *Gartside v. Inland Revenue Commissioners* [1968] AC 553 at 617 to 618 per Lord Wilberforce.

- Powers to issue new units after the trust is settled, or to redeem existing units.[11]
- A power to reclassify existing units so that they do not all have equal rights to receive the income and capital of the trust.
- A power to classify receipts as being on income or capital account where the units that have been issued do not all have the same rights to receive the income and capital of the trust.
- A power to appoint a beneficiary's interest in the income or capital of the trust to another beneficiary.
- A power to settle or appoint any part of the corpus of the trust to a new trust with different beneficiaries.
- A power to enforce the forfeiture or cancellation of partly paid units due to the non-payment of a call except where such partly paid units would be void *ab initio*.

17. For the purposes of working out whether all beneficial interests have the same rights to receive the income and capital of the trust (sometimes referred to as establishing whether or not there are different classes of interests in the trust), the Commissioner will disregard the following factors which may otherwise result in a different conclusion:[12]

- fees or charges imposed by the trustee in relation to the beneficial interests
- issue price and redemption price of the beneficial interests (provided that the savings rule in subsection 272-5(2) is satisfied as explained below), and
- exposure of the beneficial interests to foreign exchange gains and losses.

Satisfaction of the 'savings rule' in subsection 272-5(2)

18. The mere fact that a trustee has power to redeem units in a unit trust, or issue further units, for an appropriate value, being:

- where the units are listed for quotation in the official list of an approved stock exchange – the same price as other units are offered for sale on that exchange at the time of the redemption or issue, or
- where the units are not so listed – a price determined on the basis of the net asset value of the unit trust at the time of the redemption or issue according to Australian accounting principles

does not mean that unit holders' interests in the income or capital of the unit trust are defeasible.[13] For the purposes of this Guideline, this is referred to as the 'savings rule'.

[10] The Federal Court has held that a power of the trustee or manager to amend the constitution of the trust results in the beneficiaries' interests being defeasible and, consequently, the trust being a non-fixed trust – see *Colonial First State Investments Ltd v. Commissioner of Taxation* [2011] FCA 16; (2011) 192 FCR 298; 81 ATR 772; 2011 ATC 20-235 at [94] – [106].

[11] In this Guideline the term 'units' also refers to other beneficial interests in a trust, however described.

[12] This approach is consistent with the approach taken in subsection 276-15(2) of the ITAA 1997 in relation to AMITs.

[13] Subsection 272-5(2).

19. The Commissioner considers that the savings rule is satisfied where further units may be issued[14] or existing units redeemed[15] in any of the following situations:

- for a price based on a market value[16] of the assets and liabilities of the trust which has been determined by a licensed valuer
- for a price based on a market value of the assets and liabilities of the trust which has not been determined by a licensed valuer, but which nevertheless is accurate
- for a price determined by reference to a value of the trust which is sufficiently close to its net asset value (allowing an adjustment for transaction costs)
- for a price determined by reference to a value of the trust which is sufficiently close to its net asset value (allowing an adjustment for transaction costs), including where accrued distributions are excluded from the net asset value based on a 'unit day's pricing model'
- for a price based on the volume weighted average price (VWAP) of the units, or
- in accordance with ASIC Corporations (Managed investment product consideration) Instrument 2015/847, ASIC Class Order [CO 13/655] and ASIC Class Order [CO 13/657] (if relevant), or any other ASIC guidance or relief on the same subject.

Reference to units includes interests in percentage shares

20. The Commissioner considers that a reference to 'units' in the savings rule includes a class of vested interest which can be expressed as being a beneficial interest in a percentage share of the total income or capital of the trust. The interest must also be capable of being measured as a percentage of the total beneficial interest in the income or capital of the trust enjoyed by the holders of that same class of interest in the trust.

Reference to Australian accounting principles

21. The reference to 'Australian accounting principles'[17] means the accounting standards, statements of accounting concepts or authoritative pronouncements of the Australian Accounting Standards Board, as applicable to the trust that seeks to satisfy the requirements of the savings rule.

Partly paid units

22. Partly paid units are capable of satisfying the savings rule. In this regard, the relevant price per unit should be adjusted to reflect the proportion of the paid up amount.

[14] Including units issued in connection with the exercise of options or rights issued by the trustee or manager. The trading of options, rights or derivatives not connected to the issue of units by the trustee or manager is not relevant for the purposes of the savings rule.
[15] Subsection 272-5(2) will also apply to a 'redemption like' event such as a forfeiture and cancellation.
[16] Refer to the ATO publication, *Market valuation for taxation purposes* (NAT 72508) for further information.
[17] Paragraph 272-5(2)(d).

Safe harbour – Compliance approach

23. The trustee of a trust described in **Attachment B** can manage the trust's tax affairs as if the Commissioner has exercised the discretion to treat the beneficiaries as having fixed entitlements to the income and capital of the trust.

24. The 'safe harbours' in this Guideline can only be satisfied in relation to known facts. A trustee that requires certainty as to whether or not the beneficiaries of the trust have fixed entitlements in relation to a future time must request the exercise of the Commissioner's discretion.

Discretion to treat an interest as a fixed entitlement in subsection 272-5(3)

25. Where a trust is not a fixed trust, because all of the beneficiaries' interests in the income and capital of the trust are not fixed entitlements, and the trust does not satisfy the requirements for a 'safe harbour' in this Guideline, the trustee may request that the Commissioner exercise the discretion to treat beneficiaries' interests as being vested and indefeasible.

Note: the Commissioner is not able to exercise the discretion in relation to:

- *the mere objects of a discretionary trust – they do not have vested interests in the income or capital of the trust under a trust instrument, or*
- *an interest of a default beneficiary – although it may be a vested, proprietary interest in a trust, it is defeasible because the trustee may resolve to appoint the income or capital to another beneficiary.*[18]

26. A trust can both rely on the savings rule in relation to some trustee powers in a trust instrument (the power to issue or redeem units), and request that the Commissioner exercise the discretion in the context of other powers that may defeat a beneficiary's interest (such as in relation to a power to amend).

27. In deciding whether or not to exercise the discretion, the Commissioner must consider:[19]

- the circumstances in which the interest is capable of not vesting or being defeated
- the likelihood of the interest not vesting or being defeated, and
- the nature of the trust.

28. The Commissioner will also consider factors relevant in the context of the trust loss rules.

Circumstances in which the interest is capable of not vesting or being defeated

29. When examining the *circumstances* in which a beneficiary's interest is capable of not vesting or being defeated, the Commissioner will have regard to any factor that may affect the defeasance of any beneficiary's interest, including:

- the number of circumstances of potential defeasance, and
- the significance of those circumstances.

30. This includes having regard to:

- any person who is capable of altering the beneficiary's interest

[18] See *Queensland Trustees Ltd v. Commissioner of Stamp Duties (Queensland)* (1952) 88 CLR 54 at 63.
[19] Subsection 272-5(3).

- the nature of their relationship to the beneficiary, and
- any limitation on their capability to so alter that interest.

The likelihood of the interest not vesting or the defeasance happening

31. When considering the *likelihood* of the interest not vesting or being defeated, the Commissioner must form a view as to the probability that the contingency or defeasance will happen. Where the likelihood of the contingency or event of defeasance occurring is low, this will weigh towards a favourable exercise of the discretion.

32. Where the trustee or manager of the trust has a particular power to defeat a beneficiary's interest, it is relevant to consider how often, if at all, they have exercised that power over a relevant period.

33. Any preconditions or caveats that affect the likelihood of a beneficiary's interest not vesting or being defeated are also relevant.

The nature of the trust

34. The *nature of the trust* refers to its basic legal characteristics and its economic function, both actual and intended. The ability of the trustee or manager of the trust to adversely affect the interests of beneficiaries could be limited where:

- additional responsibilities are placed on the trustee by legislation, most commonly as a registered managed investment scheme under Chapter 5C of the *Corporations Act 2001*
- contractual restrictions limit the trust manager's access to trust assets
- the trust is subject to industry regulations, licensing or registration requirements, which are legally enforceable, such as the Australian Securities Exchange (ASX) Listing Rules which are enforceable against listed entities and their associates[20]
- commitments are made in a Product Disclosure Statement, Investment Memorandum or other document to exercise powers in a particular (restrictive and/or non-adverse) way
- the trust deed restricts the ability of the trustee to issue and redeem units at anything other than market value or other values approximating net asset value, or
- the unanimous (100%) approval of the beneficiaries is required prior to the exercise of a power capable of defeating a beneficiary's interest by the trustee or manager.

Other contextual factors

35. Having regard to the subject matter, scope and purpose of the trust loss rules, it is relevant for the Commissioner to consider whether the exercise of the discretion would allow a person to obtain a tax benefit from a trust claiming a deduction for a tax loss, bad debt deduction or debt/equity swap deduction when the person did not bear the economic loss incurred by the trust.

[20] Sections 793C and 1101B of the *Corporations Act 2001.*

36. The concept of a fixed entitlement is central to the operation of the trust loss rules, the purpose of which is to prevent the transfer of the tax benefit of those losses or deductions. The tax benefit of a loss is transferred when a person who did not bear the economic loss at the time it was incurred by the trust obtains a benefit from the trust being able to deduct the loss.[21]

37. Because the discretion to treat beneficiaries' interests as being a fixed entitlement is part of the trust loss rules, and because of the resultant consequences of being treated as a fixed trust, these contextual factors are also relevant even when the reason for requesting that the Commissioner exercise the discretion is related to one of the other legislative provisions listed in **Attachment A**.

Factors influencing the exercise of the Commissioner's discretion

38. **Attachment C** to this Guideline contains a non-exhaustive list of the factors that the Commissioner will consider when deciding whether or not to exercise the discretion.

39. In each case the Commissioner will weigh up all factors (favourable and unfavourable) in the context of the facts and circumstances of the case. The presence of more favourable factors will increase the likelihood that the Commissioner will exercise the discretion.

40. However, a single power in a trust instrument may pose such a serious threat to beneficiaries' interests that, in the absence of any mitigating factors, the Commissioner will not exercise the discretion.

41. Conversely, the absence of some or all of the favourable factors described in **Attachment C** does not necessarily preclude the exercise of the discretion.

Examples

42. The following examples illustrate the application of the savings rule and how the Commissioner would consider the exercise of the discretion in various situations.

Example 1: savings rule applies

43. *The interests in the income and capital of a trust are defeasible only because the trustee may issue or redeem units for a price determined on the basis of the net asset value of the trust. The savings rule will apply in this circumstance to ensure that the beneficiaries' interests are not defeasible, and are fixed entitlements.*

Example 2: savings rule applies

44. *The trustee of a trust issues units for a price that is higher than a price determined on the basis of the net asset value of the trust. The higher price is attributable to transaction costs associated with the issue of the units. The savings rule will apply in this circumstance to ensure that the beneficiaries' interests are not defeasible and are fixed entitlements.*

[21] See paragraphs 3.1, 6.6, 13.1 and 13.2 of the Explanatory Memorandum to the Taxation Laws Amendment (Trust Loss and Other Deductions) Bill 1997.

Example 3: savings rule and a safe harbour apply

45. *If, in relation to the trust in Example 1, the trustee also had an unlimited power to amend the trust deed, the beneficiaries' interests would be defeasible and would not constitute fixed entitlements. However, if the requirements of one of the safe harbours in the compliance approach in* ***Attachment B*** *are satisfied, the trustee can manage the trust's tax affairs as if the Commissioner has exercised the discretion to treat the beneficiaries as having fixed entitlements to the income and capital of the trust.*

Example 4: savings rule does not apply but a safe harbour applies

46. *The beneficiaries' interests in the trust are not fixed entitlements, and the savings rule does not apply, because the trustee may issue or redeem units for a price not determined on the basis of the net asset value of the trust. If the requirements of one of the safe harbours in the compliance approach in* ***Attachment B*** *are satisfied, the trustee can manage the trust's tax affairs as if the Commissioner has exercised the discretion to treat the beneficiaries as having fixed entitlements to the income and capital of the trust.*

Example 5: exchange of interests in a trust under Subdivision 124-M of the ITAA 1997

47. *Two trustees are contemplating a transaction whereby all of the units in one trust (the selling trust) will be acquired by the trustee of the other trust (the acquiring trust) in return for new units in the acquiring trust. The scrip for scrip roll-over provisions require that entities have fixed entitlements to all of the income and capital of each trust immediately before, during and immediately after the exchange of units.*

48. *The beneficiaries' interests in the selling trust are not fixed entitlements, and because of the prospective nature of the proposed transaction, the safe harbours in the compliance approach cannot be relied upon.*

49. *Accordingly, before entering into the transaction, the trustee of the selling trust applies to the Commissioner for a ruling in relation to whether the requirements of scrip for scrip roll-over will be satisfied, including whether fixed entitlements will exist at a future date. The trustee asks the Commissioner to exercise the discretion if the beneficiaries' interests at the future date are not fixed entitlements.*

Attachment A – Other provisions

50. Other provisions that, directly or indirectly, rely upon the meaning of 'fixed entitlement' in section 272-5

Income Tax Assessment Act 1936	
Schedule 2F	Trust loss provisions
section 102UC	Trustee beneficiary reporting
sections 160APA; 160APHD	Franking of dividends
Income Tax Assessment Act 1997	
section 104-72	CGT event E4 and trusts
section 115-50	Discount capital gains
section 115-110	Foreign or temporary residents – individuals with trust gains
section 116-35	Capital proceeds – market value substitution rule
section 118-510	CGT and venture capital
section 124-781	Capital gains and scrip-for-scrip rollover
Subdivision 165-F	Company tax losses – ownership of a company by non-fixed trusts
section 170-265	Company as a member of a linked group
section 328-440	Small business restructure roll-over – ultimate economic ownership of a non-fixed trust
section 415-20	Designated infrastructure entity
section 703-40	Consolidation: treating entities held through non-fixed trusts as wholly-owned subsidiaries
section 707-325	Consolidation: modified market value of an entity becoming a member of a consolidated group
section 713-50	Consolidation: determining destination of distribution by non-fixed trust
section 719-35	Consolidation: treating entities held through non-fixed trusts as wholly owned subsidiaries
section 725-65	Direct value shifting: cause of the value shift
section 727-110	Indirect value shifting: common ownership nexus test
sections 727-360; 727-365; 727-400; 727-410	Indirect value shifting: control, common ownership and ultimate stake tests
section 855-40	Capital gains or losses of foreign residents
A New Tax System (Goods and Services Tax) Regulations 1999	
Regulations 48-10.01 and 48-10.03A	Approval of GST groups
Schedule 1 to the *Taxation Administration Act 1953*	
section 45-287	Trust income included in instalment income of a beneficiary

Attachment B – Compliance approach – safe harbours

Safe harbour – Administration

51. The trustee of a trust that satisfies the conditions for one of the categories below can manage its tax affairs as if the Commissioner had exercised the discretion to treat the beneficiaries as having a fixed entitlement to the income and capital of the trust for the purposes of section 272-5.

52. Accordingly, other than ensuring that a trust satisfies the relevant conditions of the category relied upon, the Commissioner will not allocate compliance resources to determine whether beneficiaries have fixed entitlements in cases where one of the categories below is met. A safe harbour only has application during the period in which the conditions for the relevant category are satisfied. A trustee that requires certainty as to whether or not the beneficiaries of the trust have fixed entitlements in relation to a future time must request the exercise of the Commissioner's discretion.

53. Taxpayers should maintain relevant records that support their claim that they meet the relevant conditions being relied on.

Safe harbour – Conditions

54. To qualify for access to a safe harbour, a trust must, at all relevant times, satisfy the conditions of one of the categories below:

(1) Listed trusts

The trust's units are listed for quotation in the official list of an approved stock exchange (as defined in subsection 995-1(1) of the ITAA 1997 and Regulation 995-1.05 of, and Schedule 5 to, the *Income Tax Assessment Regulations 1997*). This includes depository and nominee arrangements in relation to such units.

(2) Registered managed investment schemes that are trusts

The trust complies with all of the following conditions:

- it is a 'registered scheme' as defined in subsection 995-1(1) of the ITAA 1997 (that is, a managed investment scheme that is registered under section 601EB of the *Corporations Act 2001*)
- the trustee, Responsible Entity, manager or other controller has complied with all of the requirements of Chapter 5C of the *Corporations Act 2001*, and any applicable ASIC relief (for example, authorising issuing units at a discount), and
- all beneficial interests have the same rights to receive the income and capital of the trust (see paragraph 17 of this Guideline).

(3) Certain widely held trusts that satisfy licensing requirements

The trust complies with all of the following conditions:

- either:
  - the only members of the trust are entities that are covered by subsection 275-20(4) of the ITAA 1997, Investor Directed Portfolio Services ('IDPS' – as defined in ASIC Class Order [CO 13/763]) or 'IDPS-like schemes' (as defined in ASIC Class Order [CO 13/762]); or

- the only members of the trust are entities that are managed investment trusts in relation to the income year because of subsection 275-10(2), and

- the trust is covered by section 275-15 of the ITAA 1997 (it is not required to be registered in accordance with section 601ED of the *Corporations Act 2001*)
- the trust satisfies the licensing requirements in section 275-35 of the ITAA 1997, and
- all beneficial interests have the same rights to receive the income and capital of the trust (see paragraph 17 of this Guideline).

(4) Unregistered managed investment schemes that satisfy licensing requirements

The trust complies with all of the following conditions:

- it is a managed investment scheme (as defined in section 9 of the *Corporations Act 2001*)
- the trust is covered by section 275-15 of the ITAA 1997 (it is not required to be registered in accordance with section 601ED of the *Corporations Act 2001*)
- the trust satisfies the licensing requirements in section 275-35 of the ITAA 1997
- the trust must have a trust instrument
- all beneficial interests in the income and capital of the trust are vested
- all beneficial interests have the same rights to receive the income and capital of the trust (see paragraph 17 of this Guideline)
- all beneficial interests in the income and capital of the trust can be expressed as a percentage of the total income and capital of the trust, and
- the trust is not a discretionary trust or a trust with default income or capital beneficiaries – that is, no beneficial interest in the income or capital of the trust is capable of being defeated, partly or wholly, by the exercise of a power of appointment of income or capital by the trustee or other donee.

(5) Specific single interest holder trusts

The trust complies with all of the following conditions:

- the trust must have a trust instrument
- all beneficial interests in the income and capital of the trust are vested
- all beneficial interests have the same rights to receive the income and capital of the trust (see paragraph 17 of this Guideline)

- all beneficial interests in the income and capital of the trust can be expressed as a percentage of the total income and capital of the trust
- the trust is not a discretionary trust or a trust with default income or capital beneficiaries – that is, no beneficial interest in the income or capital of the trust is capable of being defeated, partly or wholly, by the exercise of a power of appointment of income or capital by the trustee or other donee
- one of the following types of entity holds all of the interests, directly or indirectly, in the trust and has the right to receive all of the income and capital of the trust, directly or indirectly, for their own benefit (that is, excluding a nominee, custodian or agent)
  - (a) an individual
  - (b) a trust that satisfies category 1 above (a listed trust)
  - (c) a trust that satisfies category 2 above (a registered managed investment scheme), and
- an arrangement has not been entered into which would result in:
  - (a) section 272-35 having application
  - (b) the trafficking of the tax benefit of a tax loss, bad debt deduction or debt/equity swap deduction, or
  - (c) fraud or evasion.

(6) Other trusts

The trust complies with all of the following conditions:

- the trust must have a trust instrument
- all beneficial interests in the income and capital of the trust are vested
- all beneficial interests have the same rights to receive the income and capital of the trust (see paragraph 17 of this Guideline)
- all beneficial interests in the income and capital of the trust can be expressed as a percentage of the total income and capital of the trust
- the trust is not a discretionary trust or a trust with default income or capital beneficiaries – that is, no beneficial interest in the income or capital of the trust is capable of being defeated, partly or wholly, by the exercise of a power of appointment of income or capital by the trustee or other donee

- a trustee or manager has never exercised a power capable of defeating a beneficiary's interest to defeat a beneficiary's interest in the income or capital of the trust,[22] and
- an arrangement has not been entered into which would result in:

  (a) section 272-35 having application

  (b) the trafficking of the tax benefit of a tax loss, bad debt deduction or debt/equity swap deduction, or

  (c) fraud or evasion.

[22] An issue or redemption of units which satisfy subsection 272-5(2) does not constitute the defeat of a beneficiary's interest for these purposes.

Attachment C – Relevant factors in the exercise of the Commissioner's discretion to treat an interest in a trust as being a fixed entitlement

Factors favourable to the exercise of the Commissioner's discretion

55. The Commissioner regards the following factors favourably when deciding whether to exercise the discretion:

- a trustee or manager has never exercised a power capable of defeating a beneficiary's interest to defeat a beneficiary's interest in the income or capital of the trust
- commitments are made in unit holder agreements, Product Disclosure Statements or other documents with legal consequences that the trustee or manager will not exercise a power capable of defeating a beneficiary's interest at all, or in a way that is adverse to the rights of beneficiaries to receive the income and capital of the trust
- all beneficiaries have the same rights to receive the income and capital of the trust
- the trust instrument can only be amended with the unanimous (100%) approval of all the beneficiaries
- although the trust instrument can be amended without the unanimous approval of beneficiaries, the approval percentage calculated on the current interest or unit holdings of beneficiaries effectively means that all beneficiaries must approve any amendment (for example, where the approval of 75% of unit holders is required to make the amendment and the smallest unit holding is more than 25% of the units)
- the trust instrument has been amended in accordance with section 601GC of the *Corporations Act 2001* (so as to assist with the efficient administration of the trust) but no beneficial interests in the income and capital of the trust are adversely affected
- the beneficiaries whose rights to receive the income and capital of the trust have been adversely affected by the exercise of a power capable of defeating a beneficiary's interest have explicitly consented to that specific act (such as upon the redemption of the interests of an employee not covered by the savings rule upon the cessation of employment)
- the trustee or manager deals with the beneficiaries of the trust on an arm's length basis
- the trust is governed by a foreign law that is similar to Chapter 5C of the *Corporations Act 2001*, and
- the trust would satisfy the basic and specific conditions (as applicable to the type of trust) for access to a safe harbour.

Factors adverse to the exercise of the Commissioner's discretion

56. The Commissioner regards the following factors unfavourably when deciding whether to exercise the discretion:

- a trustee or manager exercises a power to defeat beneficiaries' interests in the income or capital of the trust, however:
  - the nature of the power that is exercised will be important, for example, compulsorily redeeming units where a unit holder's stake is less than a minimum specified in the trust instrument, and the unit

holder receives the redemption price of those units, is unlikely to preclude the exercise of the discretion

- where external factors (such as those in the Global Financial Crisis) temporarily affect the ability of the trustee or manager to fund distributions or redemptions, this is unlikely to preclude the exercise of the discretion (for example, a temporary wholesale freezing or deferral of interests)

- there are significantly different beneficiaries of the trust in an income year for which an entity seeks to have a fixed entitlement, than the beneficiaries of the trust in the income year(s) in which the trust made a tax loss, or incurred a bad debt deduction or debt/equity swap deduction
- an arrangement has been entered into which would result in:
  - (a) section 272-35 having application
  - (b) the trafficking of the tax benefit of a tax loss, bad debt deduction or debt/equity swap deduction, or
  - (c) fraud or evasion.

Commissioner of Taxation
13 September 2017

References

ATOlaw topic(s)	Income tax ~~ Trusts ~~ Other
Legislative references	ITAA 1936 ITAA 1936 102UC ITAA 1936 160APA ITAA 1936 160APHD ITAA 1936 160APHDL(14) ITAA 1936 273 ITAA 1936 Sch 2F ITAA 1936 Sch 2F 272-5 ITAA 1936 Sch 2F 272-5(1) ITAA 1936 Sch 2F 272-5(2) ITAA 1936 Sch 2F 272-5(2)(d) ITAA 1936 Sch 2F 272-5(3) ITAA 1936 Sch 2F 272-35 ITAA 1936 Sch 2F 272-65 ITAA 1936 Sch 2F 275-10(2) ITAA 1997 ITAA 1997 104-72 ITAA 1997 115-50 ITAA 1997 115-110 ITAA 1997 116-35 ITAA 1997 118-510 ITAA 1997 Subdiv 124-M ITAA 1997 124-781

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Previous Practical Compliance Guidelines	PCG 2016/D16
Related Rulings/Determinations	TR 2006/7
Case references	Colonial First State Investments Ltd v. Federal Commissioner of Taxation - [2011] FCA 16; 2011 ATC 20-235; (2011) 192 FCR 298; [2011] ALMD 4786; [2011] ALMD 4787; [2011] ALMD 4788; (2011) 81 ATR 772; (2011) 6 ASTLR 50 Gartside v. Inland Revenue Commissioners [1968] AC 553; [1968] 1 All ER 121; [1968] 2 WLR 277; [1967] TR 309 Queensland Trustees Ltd v. Commissioner of Stamp Duties (Queensland) (1952) 88 CLR 54
Other references	ASIC Corporations (Managed investment product consideration) Instrument 2015/847 ASIC Class Order CO 13/655

	ASIC Class Order CO 13/657 ASIC Class Order CO 13/762 ASIC Class Order CO 13/763 Market valuation for taxation purposes (NAT 72508) Explanatory Memorandum to the Taxation Laws Amendment (Trust Loss and Other Deductions) Bill 1997 Law Administration Practice Statement PS LA 2002/11
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