


# ***PCG 2016/D16 - Fixed trusts***

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## Fixed trusts

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### Relying on this draft Guideline

This Practical Compliance Guideline is a draft for consultation purposes only. When the final Guideline issues, it will have the following preamble:

*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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Table of Contents	Paragraph
What this draft Guideline is about	1
Date of effect	4
Fixed entitlements	5
Discretion to treat interest as fixed entitlement	12
<i>Circumstances in which the interest is capable of not vesting or being defeated</i>	14
<i>The likelihood of the entitlement not vesting or the defeasance happening</i>	16
<i>The nature of the trust</i>	18
<i>Other factors</i>	19
Summary table	20
Attachment A	Page 9
Your comments	21

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### What this draft Guideline is about

1. This draft Guideline outlines the factors that the Commissioner will consider when deciding whether to exercise the discretion<sup>1</sup> to treat an entitlement as being a fixed entitlement, which results in a trust being treated as a fixed trust under the trust loss provisions.<sup>2</sup> The Commissioner must determine whether to exercise this discretion on a case-by-case basis. This draft Guideline provides taxpayers with greater certainty about when the Commissioner will exercise this discretion.

2. Attachment A to this draft Guideline provides a list of provisions affected by the meaning of 'fixed entitlement' in section 272-5.

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<sup>1</sup> Subsection 272-5(3) of Schedule 2F of the *Income Tax Assessment Act 1936* (ITAA 1936).

<sup>2</sup> The trust loss provisions are contained in Schedule 2F to the ITAA 1936. In this draft Practical Compliance Guideline, all legislative references are to Schedule 2F to the ITAA 1936 unless otherwise indicated.

3. This draft 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 circumstances is set out 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*.

#### Date of effect

4. When finalised, this draft Guideline will apply both before and after date of issue.

#### Fixed entitlements

5. The concept of a 'fixed entitlement' is central to the trust loss provisions. It is used to determine whether a trust is a fixed trust, whether a trust has maintained ownership and control, and for tracing direct and indirect entitlements. In particular, a trust will be a fixed trust if the beneficiaries hold fixed entitlements to all of the income and capital of the trust.<sup>3</sup>

6. For a beneficiary's interest in a trust to constitute a fixed entitlement to income or capital of the trust, the beneficiary's interest must be vested and indefeasible.<sup>4</sup>

7. For an interest to be fixed, it must be capable of measurement. Therefore, the mere object of a discretionary trust would not have an interest that the Commissioner would be capable of considering to be a fixed entitlement.<sup>5</sup>

8. An interest will generally be indefeasible if it cannot be defeated by the actions of one or more persons or by the occurrence of one or more subsequent events.

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

- Powers to amend the trust instrument – 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.<sup>6</sup>
- Powers to issue or redeem units – however, the tax law specifically ignores the ability to issue new units or redeem units for an appropriate value, being<sup>7</sup>:
  - (where the units are listed for quotation of an approved stock exchange) – the same price as other units are offered on that exchange at the time of 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 issue.
- Powers to issue units of different classes or a power to reclassify units.
- Powers to stream income or capital (especially by having a power to issue units of different classes and a power for the trustee to classify receipts as being on income or capital account).

<sup>3</sup> Section 272-65. A trust will also be a fixed trust if it is an Attribution Managed Investment Trust within the meaning of section 276-10 of the ITAA 1997 (in which case it will be deemed to be a fixed trust having members with fixed entitlements to its income and capital: See paragraph 276-55(a) of the ITAA 1997).

<sup>4</sup> See section 272-5.

<sup>5</sup> *Gartside v. Inland Revenue Commissioner* [1968] AC 553 per Lord Wilberforce at 618.

<sup>6</sup> *Colonial First State Investments Ltd v Commissioner of Taxation* [2011] FCA 16; (2011) 192 FCR 298; 81 ATR 772; 2011 ATC 20-235.

<sup>7</sup> Subsection 272-5(2).

10. 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 being vested and indefeasible.

11. This draft Guideline provides taxpayers with greater certainty about when the Commissioner will exercise this discretion.

### **Discretion to treat interest as fixed entitlement**

12. In deciding whether or not to exercise this discretion, the Commissioner must consider<sup>8</sup>:

- 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.

13. The Commissioner will also consider any other relevant factors.

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

14. 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
- the significance of those circumstances, and
- whether any preconditions or caveats affect those circumstances such that defeasance is unlikely.

15. This includes having regard to:

- any person who is capable of altering the beneficiary's interest
- the nature of their relationship to the beneficiary, and
- any limitation on their capability to so alter that interest.

### **The likelihood of the entitlement not vesting or the defeasance happening**

16. 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.

17. Where the trustee or trust manager 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.

### **The nature of the trust**

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

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<sup>8</sup> Subsection 272-5(3).

- fiduciary responsibilities are placed on the trustee via legislation, most commonly as a registered managed investment scheme (MIS) in 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<sup>9</sup>
- commitments are made in Product Disclosure Statements to exercise powers in a particular (restrictive and/or non-adverse) way, or
- 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.

### **Other factors**

19. The Commissioner will also consider *other relevant factors* including the purpose for which the discretion is being considered. For example, 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 or debt deduction when the person did not bear the economic loss incurred by the trust.

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<sup>9</sup> Sections 793C and 1101B of the *Corporations Act 2001*.

## Summary table

20. The following table contains examples of how the Commissioner is likely to consider relevant circumstances in determining whether to treat a trust as a fixed trust under subsection 272-5(3). These circumstances are not considered in isolation but, rather, in the context of the facts and circumstances of each case.

Circumstances	Limitations or qualifications (which go to the likelihood of the circumstance happening and/or the nature of the trust)	Impact on exercise of discretion	Examples
Units in a trust are listed on the official list of an approved stock exchange	Both the trust and the approved stock exchange are subject to the <i>Corporations Act 2001</i> .	It would only be in exceptional circumstances that the Commissioner would not exercise the discretion.	1. A unit trust has its units listed on the official list of the ASX.
Unlisted unit trusts (this may include a registered or an unregistered MIS for the purposes of the <i>Corporations Act 2001</i> ) with a single class of units on issue	Units may be issued and redeemed provided the price is set at a value that does not unduly favour or prejudice particular unit holders, and it is done in the best interests of all unit holders and complies with any relevant ASIC relief. Further, no amendment has been made to the trust's constitution that has the effect of significantly defeating a beneficiary's interest in the income or capital of the trust.	Favourable impact	2. The trust is an unregistered MIS and is managed by an Australian Financial Services Licence (AFSL) holder. It has a single class of units on issue. Units of the Trust may be redeemed at a price that is sufficiently close to the price determined on the basis of the trust's net asset value. The trustee has never exercised the power granted to amend the constitution that has the effect of significantly defeating a beneficiary's interest in the income or capital of the trust.
A power conferred on the trustee to issue new units / interests or add	New units can only be issued for a value based on market value.	Neutral impact	3. Under the trust deed of a private unit trust, further units must be issued at market value. The fact that the market value does not have to be ascertained by a licensed valuer is not of itself an impediment to treating the trust as a fixed trust. However, it may be an impediment were there an indication that the trustee has or may itself determine market value otherwise than as an

Circumstances	Limitations or qualifications (which go to the likelihood of the circumstance happening and/or the nature of the trust)	Impact on exercise of discretion	Examples
new beneficiaries			<p>honest assessment of that value.</p> <p>4. Under the trust deed of a private unit trust, further units can be issued for a price determined by reference to a value of the trust which is sufficiently close to its net asset value.</p>
	The power conferred on the trustee to issue new units of the same class for a value not based on market value is subject to regulatory controls.	Neutral impact	5. A responsible entity of a MIS has power under the constitution to issue further units of the same class at a price discounted up to 10% of the trading price. The responsible entity of the MIS is obliged under section 601FC of the <i>Corporations Act 2001</i> to act in the best interests of the members and treat members holding interests of the same class equally.
	The power to issue additional units/interests or add new beneficiaries for a value not based on market value is limited in a way that sufficiently protects members' interests.	Neutral impact	<p>6. Under the trust deed, a trustee of a private unit trust is conferred with a power to issue additional units/interests only where all of the unitholders/beneficiaries agree to the issue and issue price.</p> <p>7. The responsible entity of a MIS issues a product disclosure statement (PDS) which states that it will not issue any further units without approval of 100% of unit holders.</p>
A power of redemption over units/interests conferred on the trustee or manager	No limitation	Unfavourable impact	8. A power granted to the trustee to compulsorily redeem units or interests without requiring the consent of unit holders or beneficiaries, and at a price to be determined solely at the discretion of the trustee.
	Insufficient limitation	Unfavourable impact	9. The trustee of a private unit trust has the unfettered power to redeem units at a value between 90% and 150% of the market value of those units.
	Units can only be redeemed for a value based on market value.	Neutral impact	<p>10. Under the trust deed of a private unit trust, the units can be redeemed for a price determined by reference to a value of the trust which is sufficiently close to its net asset value.</p> <p>11. See also Example 3.</p>

Circumstances	Limitations or qualifications (which go to the likelihood of the circumstance happening and/or the nature of the trust)	Impact on exercise of discretion	Examples
	Redemption for a value not based on market value is subject to regulatory controls.	Neutral impact	12. A listed unit trust, where the trustee has the power to sell or redeem unmarketable parcels of units, but is subject to ASX Listing Rule 15.13 which requires it to effectively or adequately compensate unitholders in relation to the sale or divestment of such small holdings.
	The power of redemption for a value not based on market value is limited in a way that sufficiently protects the members' interests.	Neutral impact	13. Under the trust deed, the trustee is conferred with a power to redeem units/interests only where all of the unitholders/beneficiaries agree to the redemption and redemption price. 14. In a widely held trust without concentrated real or potential control, the trustee is conferred with a power to redeem units/interests only where the redemption price is approved by a special resolution of at least 75% of members.
A power of the trustee to amend the terms of the trust	No limitation, but the power has not been used over the relevant period.	Neutral impact	15. The trust made losses in the years ended 30 June 2008 to 30 June 2012. The losses were fully deducted during the years ended 30 June 2013 and 30 June 2014. Although the trustee had a wide and unfettered power to amend the terms of the trust, this power was not used during the period relevant for determining whether the losses could be utilised.
	The power to amend the terms of the trust is effectively fettered such that the trustee is not able to introduce powers that reduce the unitholders'/beneficiaries' entitlements.	Neutral impact	16. A trustee is conferred with a power to amend the terms of the trust provided that the amendment does not adversely affect beneficiaries' rights. 17. The trust deed provides a wide power for the trustee to alter the terms of the deed provided that 100% of beneficiaries agree to the change. 18. All of the units/interests are held by three individuals and the trust deed provides that the deed can be amended subject to obtaining agreement from at least 75% of unitholders/beneficiaries. There is nothing to indicate one or more of the three individuals may be unduly influenced by another. In this case, the unitholders/beneficiaries must unanimously agree to reach the 75% threshold. This reduces the likelihood that defeasance will occur while the unit holding remains the same.



Circumstances	Limitations or qualifications (which go to the likelihood of the circumstance happening and/or the nature of the trust)	Impact on exercise of discretion	Examples
	The power to amend the terms of the trust is subject to additional regulatory controls.	Neutral impact	<p>19. The Responsible Entity of a registered MIS is conferred with an unfettered power to amend the constitution. However, the Responsible Entity is subject to section 601FC of the <i>Corporations Act 2001</i> which requires it to act in the best interests of the unit holders. Further, section 601GC of the <i>Corporations Act 2001</i> provides that the constitution of the MIS may only be modified by special resolution or by the responsible entity if it reasonably considers the change will not adversely affect members' rights.</p> <p>20. The trust is an unregistered MIS with a large number of unrelated sophisticated investors and managed by an AFSL holder. The trustee has a wide power to amend the constitution subject to approval of 75% of unit holders by special resolution. It is considered that the beneficiaries' interests are sufficiently protected so as to reduce the likelihood that they would be adversely affected by a change to the constitution.</p>
The powers conferred on the trustee under the trust deed which may give rise to streaming of income and capital	If no such powers have been (or are expected to be) exercised by the trustee.	Neutral impact	<p>21. The trust deed confers on the trustee a range of powers including the power to:</p> <ul style="list-style-type: none"> <li>(i) issue units/interests of different classes;</li> <li>(ii) redeem units/interests;</li> <li>(iii) reclassify units/interests into different classes;</li> <li>(iv) decide the classification of any amount as being on income or capital account; and</li> <li>(v) accumulate income. The trustee has never exercised such powers and the PDS or a similar statement makes it clear that the trustee will not exercise those powers.</li> </ul>

## Attachment A

<b><i>Income Tax Assessment Act 1936</i></b>	
Schedule 2F	Trust loss provisions
Section 102UC	Trustee beneficiary reporting
Sections 160APA; 160APHD	Franking of dividends
<b><i>Income Tax Assessment Act 1997</i></b>	
Section 104-72	Capital gains tax 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	Capital gains tax and venture capital
Section 124-781	Capital gains tax 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 207-128	Franked distributions – reinvestment choice
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
<b><i>A New Tax System (Goods and Services Tax) Regulations 1999</i></b>	
Regulations 48-10.01 and 48 10.03A	Approval of GST groups
<b><i>Schedule 1 to the Taxation Administration Act 1953</i></b>	
Section 45-287	Trust income included in instalment income of a beneficiary

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**Commissioner of Taxation**

26 October 2016

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## Your comments

21. You are invited to comment on this draft Practical Compliance Guideline including the proposed date of effect. Please forward your comments to the contact officer by the due date.

**Due date:** 23 November 2016  
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## References

ATOlaw topic(s)	Income tax ~~ Trusts ~~ Other
Legislative references	ITAA 1936 ITAA 1936 273 ITAA 1936 Sch 2F ITAA 1936 Sch 2F 272-5 ITAA 1936 Sch 2F 272-5(2) ITAA 1936 Sch 2F 272-5(3) ITAA 1936 Sch 2F 272-65 ITAA 1997 ITAA 1997 276-10 ITAA 1997 276-55(a) ITAA 1997 295-550 Corporations Act 2001 Corporations Act 2001 Chapter 5C Corporations Act 2001 601FC Corporations Act 2001 601GC Corporations Act 2001 793C Corporations Act 2001 1101B
Related Rulings/Determinations	TR 2006/7
Case references	<i>Colonial First State Investments Ltd v. Commissioner of Taxation</i> [2011] FCA 16; (2011) 192 FCR 298; 2011 ATC 20-235; (2011) 81 ATR 772  <i>Gartside v. Inland Revenue Commissioners</i> [1968] AC 553; [1968] 1 All ER 121; [1968] 2 WLR 277; [1967] TR 309
ATO references	1-6H13K90
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