TD 2009/D3 - Income tax: does a taker in default of trust capital have an 'interest in the trust capital' for the purposes of CGT event E8 in section 104-90 of the Income Tax Assessment Act 1997?

Draft Taxation Determination

Income tax: does a taker in default of trust capital have an 'interest in the trust capital' for the purposes of CGT event E8 in section 104-90 of the *Income Tax Assessment Act 1997*?

This publication provides you with the following level of protection:

This publication is a draft for public comment. It represents the Commissioner's preliminary view about the way in which a relevant taxation provision applies, or would apply to entities generally or to a class of entities in relation to a particular scheme or a class of schemes.

You can rely on this publication (excluding appendixes) to provide you with protection from interest and penalties in the following way. If a statement turns out to be incorrect and you underpay your tax as a result, you will not have to pay a penalty. Nor will you have to pay interest on the underpayment provided you reasonably relied on the publication in good faith. However, even if you don't have to pay a penalty or interest, you will have to pay the correct amount of tax provided the time limits under the law allow it.

Ruling

1. No. A taker in default of trust capital does not have an 'interest in the trust capital' of the kind contemplated by CGT event E8 in section 104-90 of the *Income Tax Assessment Act 1997* (ITAA 1997).

2. Having regard to the provisions of sections 104-90, 104-95 and 104-100 of the ITAA 1997, only those interests which constitute a vested and indefeasible interest in a share of the trust capital fall within the scope of CGT event E8. The interest of a taker in default of the trust capital is defeasible because the trustee may resolve to appoint the capital to another beneficiary.

Example

3. *The ABC trust is established with the trust deed conferring discretionary powers of appointment of income and capital on the trustee for the benefit of several discretionary objects. Under the deed, Tom is named as the taker in default who on the termination date will take any trust capital that has not been appointed. Tom has not given any money or property to acquire his interest in the trust capital. Tom subsequently disposes of his interest in the trust capital to a third party and receives negligible capital proceeds equal to the market value of the interest.*

4. *CGT event E8 does not happen upon the disposal of Tom's interest as the interest does not constitute a vested and indefeasible interest in the trust capital. However, Tom may make a capital gain or capital loss under CGT event A1 in section 104-10 of the ITAA 1997 as a result of the disposal.*

Date of effect

5. When the final Determination is issued, it is proposed to apply both before and after its date of issue. However, the Determination will not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the Determination (see paragraphs 75 to 77 of Taxation Ruling TR 2006/10).

Commissioner of Taxation
8 July 2009

Appendix 1 – Explanation

This Appendix is provided as information to help you understand how the Commissioner's preliminary view has been reached. It does not form part of the proposed binding public ruling.

Explanation

6. CGT event E8 happens if a beneficiary under a trust (except a unit trust or a trust to which Division 128 of the ITAA 1997 applies) disposes of their interest in the trust capital. However, the event does not happen if the beneficiary gave any money or property to acquire the interest or if the interest was acquired by way of assignment.

7. In determining whether a beneficiary has a requisite interest in a trust, the courts have held that the meaning to be given to the word 'interest' will depend on the context in which it is used; see for example *Leedale v. Lewis* [1982] 3 All ER 808; *Gartside v. IRC* [1968] AC 553 and *Craig v. Federal Commissioner of Taxation* (1945) 70 CLR 441, particularly at 454.

8. Thus the meaning to be given to the words 'interest in the trust capital' in subsection 104-90(1) of the ITAA 1997 must be determined having regard to all of the provisions which relate to CGT event E8, particularly sections 104-95 and 104-100 of the ITAA 1997 which provide for the calculation of any gain or loss from the event.

9. Broadly, a beneficiary's capital gain (or loss) from CGT event E8 is calculated by deducting, from the capital proceeds from the disposal of the trust interest, the beneficiary's share of an amount which is worked out by adding the cost bases (or reduced cost bases) of the post-CGT trust assets, the market values of the pre-CGT trust assets and the amount of money in the trust, and subtracting any liabilities of the trust.

10. Effectively the provision operates as if the beneficiary had disposed of 'their share' of the net assets of the trust. There is no meaningful sense in which a taker in default can be regarded as having a share of the trust assets, given that their interest in the trust capital may be defeased by the trustee appointing it to other beneficiaries.

11. It is reasonable to infer that where a methodology attributes the full cost base of the trust assets (or a relevant share of it) to a beneficiary's interest in the trust capital then that event is intended to apply only in respect of an interest that is both vested and indefeasible.

12. However the interest need not be one which is vested in possession. Taxation Ruling TR 2006/14 makes it clear that CGT event E8 can apply to a remainder interest.

13. Because the interest which a taker in default has in the trust capital is not vested and indefeasible it is not considered to be an interest of the kind to which CGT event E8 applies.

Appendix 2 – Your comments

14. You are invited to comment on this draft Determination. Please forward your comments to the contact officer by the due date.

15. A compendium of comments is also prepared for the consideration of the relevant Rulings Panel or relevant tax officers. An edited version (names and identifying information removed) of the compendium of comments will also be prepared to:

- provide responses to persons providing comments; and
- publish on the Tax Office website at www.ato.gov.au.

Please advise if you do not want your comments included in the edited version of the compendium.

Due date:	**7 August 2009**
Contact officer:	**David Mennie**
Email address:	**David.Mennie@ato.gov.au**
Telephone:	**(07) 3213 5197**
Facsimile:	**(07) 3213 5971**
Address:	**Australian Taxation Office**
	GPO Box 9977
	Brisbane 4001

References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 2006/10; TR 2006/14

Subject references:

- capital gains tax
- CGT events E1-E9 – trusts
- discretionary trusts
- trusts
- trust beneficiaries

Legislative references:

- ITAA 1997 104-10
- ITAA 1997 104-90
- ITAA 1997 104-90(1)
- ITAA 1997 104-95
- ITAA 1997 104-100
- ITAA 1997 Div 128

Case references:

- Craig v. Federal Commissioner of Taxation (1945) 70 CLR 441
- Gartside v. IRC [1968] AC 553
- Leedale v. Lewis [1982] 3 All ER 808

ATO references

NO:	2009/3470
ISSN:	1038-8982
ATOlaw topic:	Income Tax ~~ Capital Gains Tax ~~ CGT event A1 - disposal of a CGT asset Income Tax ~~ Capital Gains Tax ~~ CGT events E1 to E9 - trusts Income Tax ~~ Entity specific matters ~~ trusts