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Draft Taxation Determination

Income tax: is the source concept in Division 6 of Part III of the *Income Tax Assessment Act 1936* relevant in determining whether a non-resident beneficiary of a resident trust (or trustee for them) is assessed on an amount of trust capital gain arising under Subdivision 115-C of the *Income Tax Assessment Act 1997*?

❶ Relying on this draft Determination

This publication is a draft for public comment. It represents the Commissioner's preliminary view on how a relevant provision could apply.

If this draft Determination applies to you and you rely on it reasonably and in good faith, you will not have to pay any interest or penalties in respect of the matters covered, if the draft Determination turns out to be incorrect and you underpay your tax as a result. However, you may still have to pay the correct amount of tax.

Ruling

1. No. The source concept in Division 6 of Part III of the *Income Tax Assessment Act 1936* (ITAA 1936) is not relevant in determining whether an amount of trust capital gain is assessable to the non-resident beneficiary¹ or trustee.² The same view applies in relation to a non-resident beneficiary's share of 'taxable Australian property' (TAP)³ gains of a non-resident trust and a trustee's share of a capital gain to which section 115-222 ITAA 1997⁴ applies.

2. In this draft Determination⁵, the phrase 'source concept' refers to the limitation in Division 6 on the assessment of non-residents (or trustees) to amounts 'attributable to sources in Australia'.⁶

3. This Determination does not deal with the application of Australia's double taxation agreements.

Note: Draft Taxation Determination TD 2019/D6 *Income tax: does Subdivision 855-A (or subsection 768-915(1)) of the Income Tax Assessment Act 1997 disregard a capital gain*

¹ See section 115-215 of the *Income Tax Assessment Act 1997* (ITAA 1997), and sections 95AAB and 95AAC of the ITAA 1936.

² See section 115-220 of the ITAA 1997 and sections 95AAC and 98 of the ITAA 1936.

³ See section 855-15 of the ITAA 1997 for when a CGT asset is TAP.

⁴ All legislative references are to the ITAA 1997 unless otherwise indicated.

⁵ All further references to 'this Determination' refer to the Determination as it will read when finalised. Note that this Determination will not take effect until finalised.

⁶ See for example, paragraphs 98A(1)(b) and 98(2)(e) of the ITAA 1936.

that a foreign resident (or temporary resident) beneficiary of a resident non-fixed trust makes because of subsection 115-215(3)? deals with the related issue of how Division 855 applies to a non-resident beneficiary's share of a trust capital gain.

Example 1

4. *The OZ Trust is a resident non-fixed trust estate. The trustee of the trust holds shares in a land-rich Australian company (LandCo) and shares in an Australian company that owns no taxable Australian property (OtherCo). The trustee sells all the shares by contract executed in the United Kingdom in the 2014 income year and makes non-discount capital gains totalling \$70,000 and \$30,000 respectively.*

5. *Pursuant to the trust deed, the trustee resolves to treat the gains as income of the trust for that year. There is no other trust income. The trustee further resolves to make Edward, a non-resident beneficiary who is not under a legal disability, presently entitled to 100% of the trust income.*

6. *The trustee is assessed under section 98 of the ITAA 1936 on the \$100,000 of trust capital gains attributable to Edward. The source concept in subsection 98(2A) of the ITAA 1936 has no application in relation to these capital gains as section 115-220 increases the amount assessable to the trustee under section 98 without regard to those conditions.*

7. *Capital gains totalling \$100,000 are included in the calculation of Edward's net capital gain for the income year.⁷ However, Edward is entitled to a refundable tax offset for the tax the trustee paid on his behalf under subsection 98A(2) of the ITAA 1936.*

8. *The same outcome would arise if the trustee did not treat the gains as income but Edward was made specifically entitled to the amounts of capital gains.*

Example 2

9. *If the trust had instead been a fixed trust, Edward may be able to access the exemption in section 855-40 to disregard the capital gain of \$30,000 in relation to the shares in OtherCo.*

Date of effect

10. Subject to paragraph 11 of this Determination, when the final Determination is issued, it will apply to capital gains taken into account in working out the net income of a trust estate under section 95 of the ITAA 1936 (disregarding Division 6E of Part III of the ITAA 1936) for the 2019–20 income year and later income years. 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 76 of Taxation Ruling TR 2006/10 *Public Rulings*).

11. For the 2018–19 and earlier income years, the Commissioner will not seek to disturb approaches taken for capital gains from non-TAP assets of the trust which are consistent with the source principles present in the pre-2011 streaming legislation. This is provided that such approaches are not artificial or contrived to manipulate the source of

⁷ Section 115-215 and section 102-5.

the gain or otherwise have a dominant purpose of tax avoidance, and that the non-resident beneficiary has a genuine entitlement to, and is intended to benefit from, the capital gain.

Commissioner of Taxation
30 August 2019

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.*

12. The capital gains and losses of a resident trust are determined without regard to whether they arise from TAP, or whether the trust has non-resident beneficiaries. Any net capital gain is included in the trust’s net income for the income year, calculated in accordance with subsection 95(1) of the ITAA 1936.

13. For each capital gain of the trust, Subdivision 115-C treats a beneficiary (whether or not the beneficiary is a non-resident) as having an extra capital gain worked out according to section 115-215. That capital gain is taken into account in calculating the beneficiary’s net capital gain for the income year in accordance with the method statement in subsection 102-5(1).

14. For the 2011 and later income years, section 115-220 assesses the trustee under section 98 of the ITAA 1936 on the trust’s capital gain attributed to the non-resident beneficiary.⁸ The attributable gain is worked out by reference to a non-resident beneficiary’s share of the trust’s capital gain, including where the share arises from a specific entitlement to the gain.⁹ Section 115-220 does not test whether the beneficiary’s attributable gain satisfies the conditions in section 98 of the ITAA 1936.¹⁰ Rather, it increases the amount assessable to the trustee under section 98 without regard to those conditions.

15. In other words, the effect of section 115-220 is merely to make the amount drawn from Subdivision 115-C, without regard to source, both assessable and taxable to the trustee under section 98 of the ITAA 1936. This applies even if there is no other amount (based on the Division 6E net income) assessable to the trustee.¹¹

16. Similarly, the conditions in subsection 98A(1) of the ITAA 1936 have no application to determine the beneficiary’s capital gains, as this is done by section 115-215 and other provisions within Subdivision 115-C.

17. Division 6E of Part III of the ITAA 1936¹² prevents double taxation by ensuring capital gain amounts are disregarded in determining the trust income and net income that may be assessed through the ordinary operation of Division 6 of the ITAA 1936.

18. Prior to the 2011 income year, trust capital gains were assessed having regard to the combined operation of Subdivision 115-C and Division 6 of the ITAA 1936, including the ‘source concept’. This was the result of section 115-215 considering whether a beneficiary had assessable income under subsection 98A(1) of the ITAA 1936 (which had regard to source), and if so, including additional gains in the beneficiary’s net capital gain calculation.

⁸ See subsection 115-220(2). In some cases, the trustee is assessed on double the amount of the trust capital gains attributed to the beneficiary.

⁹ See sections 115-227 and 115-228 for how to determine a beneficiary’s share of a trust capital gain and any specific entitlement. The insertion of section 95AAB of the ITAA 1936 means that beneficiaries may still receive a credit for related tax paid by the trustee under the normal operation of Division 6 (subsection 98A(2) or section 98B of the ITAA 1936).

¹⁰ Including paragraph 98(2A)(d) of the ITAA 1936.

¹¹ Subsection 115-220(3).

¹² Sections 102UX and 102UY of the ITAA 1936.

19. The position for the 2011 and later years is consistent with that which applies in respect of capital gains of non-residents from direct investments. While paragraph 6-10(5)(a) requires non-residents to include only Australian sourced statutory income in their assessable income, paragraph 6-10(5)(b) also includes other statutory income where a provision assesses this on some basis other than it having an Australian source. The Explanatory Memorandum to the Income Tax Assessment Bill 1996 and the Income Tax (Consequential Amendments) Bill 1996¹³ says in relation to this provision that there are limited cases where an amount is assessed on a specifically expressed basis, and provides the following example:

... the capital gains and losses provisions bring to account gains and losses on the disposal of a 'taxable Australian asset' rather than on Australian-sourced capital gains and losses).

20. While rules outside of Subdivision 115-C allow some non-resident beneficiaries to disregard some trust capital gains, this is based on the concept of TAP rather than the source concept in Division 6 of the ITAA 1936. For example, section 855-40 disregards a capital gain made by a foreign resident beneficiary of a *fixed trust* that is attributable to a CGT event happening to an asset (or interest in an asset) which is not TAP; and provides an equivalent treatment to the trustee.

21. It is noted that the source concept is relevant to the application of section 99D of the ITAA 1936, which in some cases can provide a non-resident beneficiary with a refund of tax paid by the trustee under section 99A of the ITAA 1936 on income from non-Australian sources. Section 99D could potentially apply to all or part of a capital gain that is asserted to have a foreign source. Importantly, any entitlement under subsection 99D(1) is subject to the discretion of the Commissioner under subsection 99D(2) to refuse a refund where there was a purpose of enabling the beneficiary to obtain the refund of tax. The Commissioner would carefully consider the requirements of subsection 99D(1) and the operation of subsection 99D(2) in a case where a non-resident beneficiary seeks a refund under section 99D in respect of a distribution which the beneficiary asserts is attributable to a capital gain.

¹³ See Chapter 4, Parts A and B.

Appendix 2 – Your comments

22. You are invited to comment on this draft Determination, including the proposed date of effect. Please forward your comments to the contact officer by the due date.

23. A compendium of comments is 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
- be published on **ato.gov.au**

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

Due date: 27 September 2019
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References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 2006/10; TD 2019/D6

Legislative references:

- ITAA 1936
- ITAA 1936 Pt III Div 6
- ITAA 1936 Pt III Div 6E
- ITAA 1936 95
- ITAA 1936 95(1)
- ITAA 1936 95AAB
- ITAA 1936 95AAC
- ITAA 1936 98
- ITAA 1936 98(2)(e)
- ITAA 1936 98A
- ITAA 1936 98A(1)
- ITAA 1936 98A(1)(b)
- ITAA 1936 98A(2)
- ITAA 1936 98(2A)
- ITAA 1936 98(2A)(d)
- ITAA 1936 98B
- ITAA 1936 99A
- ITAA 1936 99D
- ITAA 1936 99D(1)

- ITAA 1936 99D(2)
- ITAA 1936 102UX
- ITAA 1936 102UY
- ITAA 1997
- ITAA 1997 6-10(5)(a)
- ITAA 1997 6-10(5)(b)
- ITAA 1997 102-5
- ITAA 1997 102-5(1)
- ITAA 1997 Subdiv 115-C
- ITAA 1997 115-215
- ITAA 1997 115-220
- ITAA 1997 115-220(2)
- ITAA 1997 115-220(3)
- ITAA 1997 115-222
- ITAA 1997 115-225
- ITAA 1997 115-227
- ITAA 1997 115-228
- ITAA 1997 Div 855
- ITAA 1997 855-15
- ITAA 1997 855-40

Other references:

- Explanatory Memorandum to the Income Tax Assessment Bill 1996 and the Income Tax (Consequential Amendments) Bill 1996

ATO references

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