TD 2001/26 - Income tax: capital gains: what are the capital gains tax consequences for a beneficiary of a discretionary trust who renounces their interest in the trust?

Taxation Determination

Income tax: capital gains: what are the capital gains tax consequences for a beneficiary of a discretionary trust who renounces their interest in the trust?

Preamble

The number, subject heading, date of effect and paragraphs 1 to 8 and 13 to 15 of the Taxation Determination are a 'public ruling' for the purposes of Part IVAAA of the ***Taxation Administration Act 1953*** *and are legally binding on the Commissioner. The remainder of the Determination is administratively binding on the Commissioner. Taxation Rulings TR 92/1 and TR 97/16 together explain how a Determination is legally or administratively binding.*

Date of Effect

This Determination applies to years commencing both before and after its date of issue. However, the Determination does not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of the Determination (see paragraphs 21 and 22 of Taxation Ruling TR 92/20).

1. A renunciation by a beneficiary of an interest in a discretionary trust (the interest being a CGT asset) would give rise to CGT event C2 for the beneficiary because it is an abandonment, surrender or forfeiture of the interest (section 104-25 of the *Income Tax Assessment Act 1997* ('ITAA 1997')).

2. A beneficiary of a discretionary trust who has no interest in either the assets or the income of the trust before the exercise of any discretion by the trustee as to the allocation of those assets or income can renounce their interest in the trust. In these circumstances, however, any capital gain the beneficiary makes from the renunciation of an interest acquired on or after 20 September 1985 is likely to be nil because its cost base is likely to be nil and the market value of the interest at the time of the renunciation would generally be nil. A capital gain or capital loss made on an interest acquired before 20 September 1985 is disregarded: subsection 104-25(5).

3. A discretionary beneficiary may or may not receive any capital proceeds for renouncing their interest in the discretionary trust. Whether or not capital proceeds are received, the beneficiary will need to determine the market value of the interest under section 116-30 of the ITAA 1997 at the time of the renunciation of the interest. A capital gain may arise if the market value exceeds the cost base of their trust interest.

4. If a beneficiary of a discretionary trust has an interest in either the assets or the income of the trust before or after the exercise of any discretion by the trustee as to the allocation of those assets or income (for example a beneficiary with a default interest) they can also renounce their interest in the trust. In these circumstances, however, a capital gain is more likely to be made by the beneficiary from the renunciation of an interest acquired on or after 20 September 1985 because its cost base is likely to be nil and the interest at the time of the renunciation may have some significant value. Whether the default beneficiary's interest has any substantial value or not will need to be determined on a case by case basis depending in each case on the terms of the particular trust and its purpose, the past history of distributions made by the trustee in favour of the default beneficiary and all the other circumstances of the particular case.

Background

5. The *Social Security Act 1991* and the *Veterans Entitlements Act 1986* ('Social Security Acts') have been amended by the *Social Security and Veterans' Entitlements Legislation Amendment (Private Trusts and Private Companies – Integrity of Means Testing) Act 2000*. The amendments, which will affect social security payments from 1 January 2002, provide for the income and assets of private trusts to be attributed to controlling individuals for the purposes of the means testing provisions of the Social Security Acts.

6. An affected beneficiary of a discretionary trust may wish to renounce their interest in the trust. If the beneficiary renounces their interest before 1 January 2002, the Department of Family and Community Services ('FaCS') has advised that the beneficiary may avoid the gifting rules within the means testing provisions of the Social Security Acts that will generally apply on and after this date. If the beneficiary renounces their interest on or after 1 January 2002, FaCS has advised that it is likely that the gifting rules will apply.

7. The ATO has been asked to provide guidance on the CGT consequences of a renunciation of the interest in the discretionary trust by the beneficiary in these types of cases.

8. According to the *Macquarie Dictionary* in its third edition, the word 'renounce' means 'to give up or put aside voluntarily'. The word 'renounce' may be used in the sense of a disclaimer or abandonment which results in either a refusal to accept a benefit or extinguishment, without replacement, of an interest held by someone: see the High Court of Australia decision in *MSP Nominees Pty Ltd & Anor v. Commissioner of Stamps (SA)* (1999) 42 ATR 833; 99 ATC 4937. *Re Gulbenkian's Settlements (No. 2) Stephens & Anor v. Maun & Ors* [1970] Ch 408 involved a valid renunciation or disclaimer of an interest in a discretionary trust by a discretionary object. The renunciation operated as an extinguishment of the interest on and from the date of the renunciation.

Example

9. *Since 1986, the Jeller family has held farming land in a discretionary trust, Jeller Family Trust. Their private company, Jeller Rural Industries Pty Limited, operates the farming enterprise. Lloyd is the appointor and trustee of the trust. Lloyd, his wife Sue, and their son Paul and his two children, are the beneficiaries of the trust. Sue is the default beneficiary under the terms of the trust. Lloyd and Sue hold the two directors' shares in the company, and Paul holds all other shares. For some years Lloyd, as trustee, has ensured that Paul receives the bulk of the income of the trust. There is no pattern of distributions from the trust in favour of Sue as default beneficiary. Lloyd and Sue each supplement their income with an age pension.*

10. *From 1 January 2002 Lloyd and Sue would, because of the operation of the new private trust and companies legislation under the assets tests of the Social Security Acts, lose their entitlement to the age pension. They decide to preserve their pensions and hand over control of the trust and company to Paul. Lloyd and Sue enter into the following arrangements to meet the requirements of a genuine resignation for social security purposes.*

(a) *In September 2001, Lloyd and Sue each renounce their interests in the Jeller Family Trust by the following renunciation declaration [see Note 4]:*

'I [Lloyd Jeller]/[Sue Jeller] renounce my interest in the Jeller Family Trust and my entitlement to any further benefits from the Jeller Family Trust, whether those benefits be income or capital or of any other nature. I request that the trustee of the Jeller Family Trust recognise my request that I receive no further benefits from the Jeller Family Trust and furthermore recognise that this renunciation of my beneficial interest in the Jeller Family Trust is irrevocable';

(b) *Lloyd resigns as trustee and appointor of the Jeller Family Trust, Paul is appointed trustee and appointor and Lloyd and Sue provide Centrelink with a written declaration that they will not exert any control over or benefit directly or indirectly in any way from the Jeller Family Trust;*

(c) *Lloyd and Sue sell their shares in Jeller Rural Industries Pty Limited for an amount equal to their market value.*

11. *Lloyd and Sue receive advice from Centrelink that these transactions are sufficient to satisfy the requirements of a genuine resignation for social security purposes. Centrelink also advise Lloyd and Sue that they will monitor whether Lloyd and Sue continue to act consistently with these undertakings.*

12. Lloyd and Sue make no capital gain or capital loss on renouncing their interests in the trust. Sue's default interest in the trust (which has a nil cost base) is considered on the particular facts to have a nil market value in terms of section 116-30 at the time of the renunciation of the interest. Nor do Lloyd and Sue make any capital gain or capital loss on the changes of trustee and appointor. Lloyd and Sue may make a capital gain on the sale of their shares in Jeller Industries Pty Ltd if the market value of the shares is greater than their cost base. It is possible that assets of Jeller Industries Pty Ltd which were pre-CGT assets before Lloyd and Sue sold their shares in the company stop being pre-CGT assets when the sales occurred because of the operation of Subdivision 149-B of the ITAA 1997.

Note 1:

13. A renunciation by a discretionary beneficiary would not normally have any CGT consequences for the trustee or for the trust. However, an amendment to the trust deed to exclude a beneficiary from the discretionary trust may result in the creation of a new trust with CGT event E1 (about creating a trust over a CGT asset) happening: see section 104-55 of the ITAA 1997. For further discussion on what constitutes the creation of a new trust refer to the statement of principles applied by the ATO titled 'Changes to trusts leading to the creation of a new trust estate' which issued on 9 June 1999 (see www.ato.gov.au).

Note 2:

14. A mere change of trustee has no CGT consequences.

Note 3:

15. CGT event H2 in section 104-155 of the ITAA 1997 (about receipts for events relating to CGT assets) could apply if a beneficiary receives money or other consideration because of the renunciation of their interest. However, the effect of the ordering rules in section 102-25 of the ITAA 1997 Act is that CGT event C2 applies rather than CGT event H2.

Note 4:

16. The renunciation declaration used in the Example is provided only for the purposes of the Example. You should seek advice on the form of any renunciation declaration you intend to make because it is not appropriate for the Commissioner to express any opinion about the terms which should be used in a renunciation declaration.

Commissioner of Taxation
31 October 2001

Previous draft:
Previously released in draft form as TD 2001/D7

Subject references:
- abandonment
- capital gain
- capital proceeds
- CGT event
- CGT event C2
- CGT event E1
- CGT event H2
- creation of a new trust
- discretionary beneficiary
- discretionary trust
- forfeiture
- interest
- interest in a trust
- market value
- means testing
- renounce
- renunciation
- renunciation by discretionary beneficiary
- surrender
- trust

Legislative references:
- ITAA 1997 102-25
- ITAA 1997 104-25
- ITAA 1997 104-25(5)
- ITAA 1997 104-55
- ITAA 1997 104-155
- ITAA 1997 116-30
- ITAA 1997 Subdivision 149-B
- Social Security Act 1991
- Social Security and Veterans' Entitlements Legislation Amendment (Private Trusts and Private Companies – Integrity of Means Testing) Act 2000
- Veterans Entitlements Act 1986

Case references:
- *MSP Nominees Pty Ltd & Anor v. Commissioner of Stamps (SA)* (1999) 42 ATR 833; 99 ATC 4937
- *Re Gulbenkian's Settlements (No. 2) Stephens & Anor v. Maun & Ors* [1970] Ch 408

ATO references:
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