



TD 2017/24 - Income tax: where an amount included in a beneficiary's assessable income under subsection 99B(1) of the Income Tax Assessment Act 1936 (ITAA 1936) had its origins in a capital gain from non-taxable Australian property of a foreign trust, can the beneficiary offset capital losses or a carry-forward net capital loss ('capital loss offset') or access the CGT discount in relation to the amount?

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Taxation Determination

Income tax: where an amount included in a beneficiary's assessable income under subsection 99B(1) of the *Income Tax Assessment Act 1936* (ITAA 1936) had its origins in a capital gain from non-taxable Australian property of a foreign trust, can the beneficiary offset capital losses or a carry-forward net capital loss ('capital loss offset') or access the CGT discount in relation to the amount?

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Ruling

1. No. The amount included in the beneficiary's assessable income under subsection 99B(1)¹ is not treated as a capital gain for capital loss offset or CGT discount purposes.

¹ All references are to the *Income Tax Assessment Act 1936* (ITAA 1936) unless otherwise indicated.

Example

2. *The trustee of a foreign trust for CGT purposes² sells shares in an Australian public company that it had owned for five years. The shares are not taxable Australian property.³*
3. *The trustee makes \$50,000 capital gains from the share sale but these are not relevant in calculating the trust's net income.*
4. *The trustee distributes an amount attributable to the capital gains to Erin, a resident of Australia. Erin has a \$40,000 net capital loss that she has carried forward.*
5. *Erin must include the entire \$50,000 in her assessable income under section 99B. She cannot reduce the amount by her net capital loss or by the CGT discount.*

Date of effect

6. This Determination applies to years of income commencing both before and after 13 December 2017. However, this Determination will not apply to taxpayers to the extent that it conflicts with the terms of a settlement of a dispute agreed to before the date of issue of this Determination (see paragraphs 75 and 76 of Taxation Ruling TR 2006/10). However see paragraph 29 of this Determination which sets out the Commissioner's compliance approach.

Commissioner of Taxation
13 December 2017

² A foreign trust for CGT purposes is defined in subsection 995-1(1) of the *Income Tax Assessment Act 1997* (ITAA 1997) as a trust that is not a resident trust for CGT purposes. A resident trust for CGT purposes is also defined in subsection 995-1(1) of the ITAA 1997.

³ Taxable Australian property is defined in section 855-15 of the ITAA 1997.

Appendix 1 – Explanation

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

Treatment of trust capital gains

7. The trustee of a foreign trust for CGT purposes does not include in the net income of the trust⁴ a capital gain from a CGT event happening to a CGT asset which is not taxable Australian property.⁵ Further, the amount is not treated as a capital gain of the trust's beneficiaries and no additional amounts are included in the assessable income of the trustee under Subdivision 115-C of the ITAA 1997.⁶

8. Depending on the terms of the particular trust deed (and the trustee's actions pursuant to it), the amount attributable to the gain may be treated as income or corpus of the trust for trust law purposes.

Section 99B

9. An amount attributable to the capital gain may nonetheless be assessable to the beneficiary under subsection 99B(1).⁷

10. Subject to subsection 99B(2), subsection 99B(1) requires a beneficiary to include in their assessable income an amount of trust property that is paid to, or applied for their benefit, provided the beneficiary was resident at any time during the income year in which the payment or application was made.⁸

11. The amount made assessable by subsection 99B(1) does not have the character of a capital gain for Australian tax purposes, nor is there any linkage between subsection 99B(1) and Subdivision 115-C of the ITAA 1997.

12. Subsection 99B(2) excludes certain amounts from the scope of subsection 99B(1). Most relevantly:

- paragraph 99B(2)(a) excludes an amount representing corpus of the trust estate, except to the extent to which it is attributable to amounts derived by the trust estate that, if they had been derived by 'a taxpayer being a resident', would have been included in the assessable income of that taxpayer for a year of income, and
- paragraph 99B(2)(b) excludes an amount that, if it had been derived by a taxpayer being a resident, would not have been included in the assessable income of that taxpayer of a year of income.

⁴ As defined in subsection 95(1).

⁵ See Taxation Determination TD 2017/23 *Income tax: does the residency assumption in subsection 95(1) of the Income Tax Assessment Act 1936 (ITAA 1936) apply for the purpose of section 855-10 of the Income Tax Assessment Act 1997 (ITAA 1997), which disregards certain capital gains of a trust which is a foreign trust for CGT purposes?*

⁶ See subsection 115-210(1) of the ITAA 1997.

⁷ If amounts are included in the assessable income of a beneficiary under section 99B, that beneficiary may also be liable to pay interest under section 102AAM.

⁸ Section 99C contains rules for determining whether an amount has been paid or applied for the benefit of a beneficiary for the purposes of section 99B.

Hypothetical taxpayer – Commissioner’s view

13. Paragraphs 99B(2)(a) and 99B(2)(b) posit a ‘hypothetical taxpayer’ who is a resident, but do not otherwise specify characteristics of that taxpayer. In the Commissioner’s view, it cannot be assumed that this hypothetical taxpayer has other characteristics; for example, that it is an entity eligible for the CGT discount.
14. Paragraph 99B(2)(a) refers to an amount derived by ‘the trust estate’, but then hypothesises a scenario in which that amount was derived by ‘a taxpayer being a resident’. It is evident from this language that the hypothetical taxpayer is not the trustee of the trust, but an entirely separate, fictional entity. There is support for this approach in *Howard v. Federal Commissioner of Taxation*⁹ where the Full Federal Court observed that the ‘hypothesis posited is that the amount received by the [Esparto] trust estate was derived by a resident taxpayer’, which was relevantly different from the actual characteristics of that trust and its trustee.¹⁰
15. Moreover, paragraph 99B(2)(b) identifies the hypothetical taxpayer without reference to any trustee.
16. Both paragraphs 99B(2)(a) and 99B(2)(b) employ the indefinite article ‘a’ to identify a non-specific taxpayer deriving the amount in a non-specific year of income. This indicates that the hypothesis in these provisions is concerned with resident taxpayers generally, rather than a particular trustee or beneficiary. Nor do those paragraphs refer to any particular category of taxpayer.
17. A similar issue arose in *Union Fidelity Trustee Company of Australia Limited v. Federal Commissioner of Taxation*.¹¹ In that case the High Court considered the ‘taxpayer’ hypotheses arising under the then section 99 and section 95 (net income definition) which did not specify a further hypothesis of Australian residence. Barwick CJ and Kitto J (with whom Windeyer J agreed) were both disinclined to have regard to the ‘actual’ residence status of the trustee preferring instead to have regard to only that which had been hypothesised (a taxpayer):
- For the purpose of this abstraction or computation the only fact which is relevantly known is that the trustee, as a taxpayer, has derived the income. The residence of the trustees, or of any one of them, if there be more than one cannot afford a reason for varying the net amount of the income of the trust estate according to the accident of the trustee’s residence in the year of tax. Its irrelevance is emphasised when the possibility of diverse residences of several trustees is contemplated.¹²
18. Although the statutory context is somewhat different, the approach taken in this matter is considered to inform the appropriate approach to be taken in the context of section 99B.
19. If the position were otherwise, section 99B would effectively enable corporate beneficiaries to benefit from the CGT discount, contrary to the intention of Subdivisions 115-A and 115-C of the ITAA 1997. Under such an approach, a resident company would obtain a greater benefit investing through a foreign trust, or a chain of trusts including a foreign trust, than if it had invested in the underlying asset through a resident trust.
20. It follows that an amount which is included in assessable income under section 99B cannot be reduced by a capital loss offset or the CGT discount.

⁹ [2012] FCAFC 149.

¹⁰ See *Howard v. Federal Commissioner of Taxation* [2012] FCAFC 149 at [37], see also [41] and [42].

¹¹ (1969) 119 CLR 177.

¹² (1969) 119 CLR 177, Barwick CJ at 181.

21. However, section 99B will not bring to tax amounts attributable to capital gains that would be disregarded by any resident taxpayer, for example, gains from life insurance policies under section 118-300 of the ITAA 1997.

Appendix 2 – Alternative views

❶ *This Appendix sets out alternative views and explains why they are not supported by the Commissioner. It does not form part of the binding public ruling.*

Hypothetical taxpayer – alternative view 1

22. An alternative view to the Commissioner's is that the distributing entity's status as a trust is relevant to the hypothetical taxpayer test. On this view, the amount made assessable by subsection 99B(1) would not include an amount attributable to the CGT discount.

23. Under this view, the hypothetical taxpayer is an assumed resident with the characteristics of a trustee. Support for this view might be drawn from the fact that paragraph 99B(2)(a) adopts the perspective of a trustee in identifying an amount which represents corpus of the trust or is attributable to income derived by the trust.¹³

24. The Commissioner does not agree with this view, for the reasons set out in paragraphs 14 to 20 of this Determination. This view is not considered to have sufficient regard to the language in paragraph 99B(2)(a), which distinguishes between the trust estate in question and 'a taxpayer' which is assumed to be a resident.

Hypothetical taxpayer – alternative view 2

25. A further alternative view to the Commissioner's is that the beneficiary's status is relevant to the hypothetical taxpayer test.

26. In support of this view, it is argued that subsection 99B(2) is specific in its reference to the amounts to be included in assessable income. Further, it is argued that a hypothetical taxpayer should be taken to have some characteristics which are relevant to determine tax outcomes, and that the most logical characteristics to assign are those which apply to the actual taxpayer under consideration.

27. It is further argued that, under this alternative view, an amount made assessable by subsection 99B(1) would not be reduced by reference to the CGT discount in circumstances where, for example, the beneficiary was a company. It is said that this approach better reflects the policy that companies should not benefit from the CGT discount.

28. While this may be the result where a company is a direct beneficiary of a foreign trust, it would not be so where a company holds its interest in a foreign trust through an Australian trust. That is, on this approach, the trustee of the Australian trust would be the relevant hypothetical taxpayer and would be entitled to the CGT discount when working out the amount made assessable by section 99B to be included in its net income. If a corporate beneficiary was assessable on that part of the net income, there is nothing which would require it to gross-up the amount.

The Commissioner does not agree with this view for this reason, and the reasons outlined in paragraphs 14 to 20 of this Determination.

¹³ See *Howard v. Federal Commissioner of Taxation* [2012] FCAFC 149 at [38].

Appendix 3 – Compliance approach

❶ *This Appendix sets out a practical administration approach to assist taxpayers in complying with relevant tax laws. Provided you follow the advice in this appendix in good faith and consistently with the ruling section, the Commissioner will administer the law in accordance with this approach.*

29. The Commissioner will not devote compliance resources to enforce this view in relation to distributions received or already assessed in income years ending before the issue of this Determination. However, if the Commissioner is asked to amend an assessment, or required to state a view (for example in a private ruling or in submissions in a litigation matter), the Commissioner will act consistently with the views set out in this Determination.

References

Previous draft:

TD 2016/D5

Related Rulings/Determinations:

TR 2006/10; TD 2017/23

Legislative references:

- ITAA 1936
- ITAA 1936 95
- ITAA 1936 95(1)
- ITAA 1936 99
- ITAA 1936 99B
- ITAA 1936 99B(1)
- ITAA 1936 99B(2)
- ITAA 1936 99B(2)(a)
- ITAA 1936 99B(2)(b)
- ITAA 1936 99C
- ITAA 1936 102AAM
- ITAA 1997

- ITAA 1997 Subdiv 115-A
- ITAA 1997 Subdiv 115-C
- ITAA 1997 115-210(1)
- ITAA 1997 118-300
- ITAA 1997 855-10
- ITAA 1997 855-15
- ITAA 1997 995-1(1)

Cases relied on:

- Howard v. Federal Commissioner of Taxation [2012] FCAFC 149; 2012 ATC 20-355; (2012) 206 FCR 329; (2012) 91 ATR 89
- Union-Fidelity Trustee Co (Aust) Ltd v. Federal Commissioner of Taxation (1969) 119 CLR 177; (1969) 43 ALJR 313; (1969) 1 ATR 200; 69 ATC 4084; [1969] HCA 36

ATO references

NO: 1-9I4ZAKV

ISSN: 2205-6211

BSL: TCN

ATOlaw topic: Income tax ~~ Trusts ~~ Trust income ~~ Specific entitlement – capital
Income tax ~~ Capital gains tax ~~ Discount capital gains
International issues ~~ Non-resident Australian income ~~ Trust distributions
International issues ~~ Residency and source ~~ Assessable income

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