



# ***TD 2024/9 - Income tax: factors taken into account in applying paragraphs 99B(2)(a) and (b) of the Income Tax Assessment Act 1936***

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 There is a Compendium for this document: **TD 2024/9EC** .



Status: **legally binding**

## Taxation Determination

# Income tax: factors taken into account in applying paragraphs 99B(2)(a) and (b) of the *Income Tax Assessment Act 1936*

### **❶ Relying on this Determination**

This publication (excluding appendix) is a public ruling for the purposes of the *Taxation Administration Act 1953*.

If this Determination applies to you, and you correctly rely on it, we will apply the law to you in the way set out in this Determination. That is, you will not pay any more tax or penalties or interest in respect of the matters covered by this Determination.

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### **What this Determination is about**

1. Paragraphs 99B(2)(a) and (b) of the *Income Tax Assessment Act 1936* operate to reduce the amount of trust property paid to, or applied for the benefit of, a beneficiary of a trust who is an Australian resident (referred to in this Determination as an Australian

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beneficiary), assessed under subsection 99B(1). The reductions under those paragraphs depend upon specific tests, referred to in this Determination as the hypothetical resident taxpayer tests.

2. This Determination sets out our view on the relevance of the following in applying the hypothetical resident taxpayer tests:

- characteristics of the hypothetical taxpayer, other than residency
- in determining whether an amount would be assessable, the circumstances that gave rise to the relevant amount, and
- how the property paid or applied to the Australian beneficiary became a trust asset (that is, the source of the amount paid or applied).

3. All legislative references in this Determination are to the *Income Tax Assessment Act 1936*, unless otherwise indicated.

### **Ruling**

4. For the purposes of the hypothetical resident taxpayer tests, the only characteristic of the hypothetical taxpayer is that they are an Australian resident.

5. Further, in applying the hypothetical resident taxpayer tests to determine whether or not an amount would be assessed in the hands of the hypothetical resident taxpayer, it is necessary to consider the circumstances that gave rise to the relevant amount.

6. Determining whether a distribution represents an amount which is 'attributable to' amounts which would be assessed in the hands of a hypothetical resident taxpayer for the purposes of paragraph 99B(2)(a) or whether an amount 'represents' an amount that would not have been assessable if derived by the hypothetical resident taxpayer for the purposes of paragraph 99B(2)(b) involves considering how the amount became an asset of the trust.

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### **Example 1 – capital asset acquired before 20 September 1985**

7. *A non-resident trust estate is settled in 1982, with land in New Zealand. In 2024, the trustee disposes of the land and makes a capital distribution to an Australian beneficiary.*

8. *The distribution received by the Australian beneficiary is attributable to, or represents, the proceeds derived by the trust estate on the sale of trust property. In determining, for the purposes of the hypothetical resident taxpayer tests, whether the proceeds would have been included in the assessable income of the hypothetical resident taxpayer, consideration is given to the fact that the asset disposed of was land<sup>1</sup> and was acquired before 20 September 1985.*

9. *The capital gains tax (CGT) provisions<sup>2</sup> disregard a capital gain in these circumstances for all taxpayers, meaning that no part of the proceeds would have been included in the assessable income of the hypothetical resident taxpayer. No part of the*

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<sup>1</sup> If the asset was pre-CGT shares in a company, rather than land, the outcome may be different, after considering CGT event K6.

<sup>2</sup> Section 104-10 of the *Income Tax Assessment Act 1997* (ITAA 1997). Note other CGT provisions affect the capital gain calculation (for example, section 118-20 of the ITAA 1997 may reduce a capital gain if an amount is assessable or exempt by a provision outside of Part 3-1 of the ITAA 1997 because of the CGT event prior to being disregarded).

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*distribution is assessed under subsection 99B(1) because the liability is reduced in full under paragraphs 99B(2)(a) or (b).*

**Example 2 – distribution from a non-resident deceased estate**

10. *Following the death of a non-resident in 2023, the non-resident executor<sup>3</sup> of the deceased's estate disposes of United Kingdom listed shares which had been acquired by the deceased on 1 September 1991. The executor makes a capital distribution of proceeds from that share sale to an Australian beneficiary in accordance with the deceased's will.*

11. *The distribution received by the Australian beneficiary is attributable to, or represents, the proceeds from the sale of the shares. Therefore, it is the proceeds that are the relevant amount tested under the hypothetical resident taxpayer tests. The vesting of the shares in the executor is a relevant circumstance giving rise to the proceeds. The cost base of the shares in those circumstances is the cost base deemed by Division 128 of the ITAA 1997. In determining, for the purposes of the hypothetical resident taxpayer tests, whether and to what extent the proceeds of sale would have been included in the assessable income of the hypothetical resident taxpayer, regard is had to the cost base deemed under Division 128 of the ITAA 1997.<sup>4</sup>*

12. *The distribution is assessed under subsection 99B(1), reduced only under paragraphs 99B(2)(a) or (b) by an amount equal to the cost base of the shares. The distribution is not reduced by an amount equal to the gain.*

**Example 3 – CGT discount not available to hypothetical resident taxpayer**

13. *A distribution to an Australian beneficiary from a non-resident trust represents, or is attributable to, the sale of trust property which has been held for many years.*

14. *In applying the hypothetical resident taxpayer tests to determine whether the proceeds would be included in the assessable income of the hypothetical resident taxpayer, the only relevant characteristic of the hypothetical resident taxpayer is their status as an Australian resident.*

15. *This means that the CGT discount cannot be taken into account to reduce the amount which may be included in the assessable income of a hypothetical resident taxpayer.<sup>5</sup>*

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<sup>3</sup> References to legal personal representative in Division 128 of the ITAA 1997 include to an executor – see subsection 995-1(1) of the ITAA 1997.

<sup>4</sup> The cost base for the purposes of the hypothetical resident taxpayer tests will depend on the residency status of the deceased. The first element of the cost base of the shares will generally be deemed to be equal to the deceased's cost base (per table item 1 of subsection 128-15(4) of the ITAA 1997), though there are some exceptions. For example, the first element of the cost base will instead be the market value of the shares on the date of death if the deceased is a non-resident (per table item 3A of subsection 128-15(4) of the ITAA 1997) or if the shares were acquired prior to 20 September 1985 (per table item 4 of subsection 128-15(4) of the ITAA 1997).

<sup>5</sup> See Taxation Determination 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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**Date of effect**

16. This Determination applies to arrangements 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 76 of Taxation Ruling TR 2006/10 *Public Rulings*).

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**Commissioner of Taxation**

27 November 2024

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## Appendix – Explanation

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**❶** *This Explanation 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.*

### Section 99B

17. Subject to subsection 99B(2), subsection 99B(1) requires an Australian beneficiary to include in their assessable income an amount of trust property that is paid to, or applied for their benefit<sup>6</sup>, provided the Australian beneficiary was resident at any time during the income year in which the payment or application was made.<sup>7</sup>

18. Subsection 99B(2) reduces the amount included in assessable income under subsection 99B(1) by:

- for paragraph 99B(2)(a) – so much of the amount as represents 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
- for paragraph 99B(2)(b) – so much of the amount as represents 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.

### Corpus for paragraph 99B(2)(a)

19. Corpus, in the context in which it is used in section 99B and Division 6 more broadly refers to trust capital which is represented by the assets of the trust, excluding income which has not been accumulated. In determining whether an amount distributed represents corpus, for the purposes of paragraph 99B(2)(a), regard is had to the trust property distributed. The accounting records of the trust may assist in evidencing this but are not determinative of what the amount represents.

20. Accumulated income is included in corpus, but it will be corpus which is attributable to amounts which would be included in assessable income if derived by a hypothetical resident taxpayer. Accordingly the amount assessed under subsection 99B(1) will not be reduced by an amount attributable to accumulated income under paragraph 99B(2)(a).<sup>8</sup>

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### Example 4 – corpus and asset revaluation reserve

21. *A non-resident trust is settled in 2000 with land.*

22. *By 2023, the land has increased in value and the trustee reflects the unrealised gain in an asset revaluation reserve. The trustee distributes funds from cash reserves to an Australian beneficiary. The trustee advises the Australian beneficiary that the*

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<sup>6</sup> 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.

<sup>7</sup> 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.

<sup>8</sup> To the extent a distribution represents accumulated income in respect of which the trustee of the trust estate is or has been assessed and liable to pay tax pursuant to section 99 or 99A, paragraph 99B(2)(c)(ii) may instead apply to reduce the amount otherwise taxed under subsection 99B(1).

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*distribution is corpus and provides the Australian beneficiary with a copy of the trust financial statements showing the distribution was recorded as being from the asset revaluation account.*

23. *The asset revaluation reserve is not a separate asset of the trust and merely reflects and records the value of the trust assets for accounting purposes. The fact that the trustee debited the asset revaluation reserve does not mean that the distribution represents the land and therefore corpus. The distribution will still represent corpus to the extent the cash reserves do not include current year income. Whether any of the amount will be subject to tax under subsection 99B(1) will depend on what the cash reserves which funded the distribution are attributable to.*

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### **The hypothetical resident taxpayer tests**

24. Paragraphs 99B(2)(a) and (b) require a hypothesis to be posited in order to determine if an amount distributed to an Australian beneficiary is assessable under subsection 99B(1). The hypothesis, posited for paragraph 99B(2)(a), is that the amounts derived by the trustee were, instead, derived by a hypothetical resident taxpayer. The question premised on this hypothesis is whether the amounts would be included in the assessable income of that hypothetical resident taxpayer. This was articulated by the Full Federal Court in *Howard v Commissioner of Taxation* [2012] FCAFC 149 (*Howard*) as<sup>9</sup>:

... The excision requires the positing of a hypothesis and the posing of a question premised on that hypothesis. The hypothesis posited is that the amount received by the Esparto Trust estate was derived by a resident taxpayer; the question posed on its assumption is whether that resident taxpayer would have been required to include the amounts it received as assessable income.

25. Paragraph 99B(2)(b) similarly enquires whether the amount paid or applied for the benefit of the Australian beneficiary represents an amount that, if it had been derived by a hypothetical resident taxpayer, would not be included in the assessable income of that taxpayer.

26. The hypothetical resident taxpayer tests raise 2 questions:

- In posing the hypothesis, what characteristics are ascribed to the hypothetical taxpayer, other than residency?
- In answering the question as to whether amounts would or would not be included in the assessable income of that taxpayer, is it relevant to take into account the circumstances giving rise to the amount?

### **Characteristics of the hypothetical resident taxpayer**

27. The hypothesis posited under paragraphs 99B(2)(a) and (b) involves an assumption that the amount held or derived by the trust estate was instead held or derived by a resident taxpayer. That resident taxpayer is a separate fictional entity.

28. Paragraphs 99B(2)(a) and (b) adopt the indefinite article 'a' to identify a non-specific taxpayer deriving the amount in a non-specific year of income. Neither paragraph refers to any particular category of taxpayer (such as an individual, trust or a

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<sup>9</sup> At [37].

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company) indicating that the marginal tax rates or other specific taxing characteristics of specific types of taxpayer are irrelevant for the purposes of applying the hypothesis.

29. Therefore, the characteristics of the hypothetical resident taxpayer are limited to residence in Australia only. This is clear from the text in paragraphs 99B(2)(a) and (b). No other characteristics can be assumed.

30. A similar issue arose in *Union Fidelity Trustee Co (Aust) Ltd v Commissioner of Taxation (Cth)* [1969] HCA 36. In that case, the High Court considered the 'individual' hypothesis arising under section 99 (as it was worded at that time) and the 'taxpayer' hypothesis under section 95 (net income definition) which at that time did not specify a further hypothesis of Australian residence. Barwick CJ and Kitto J (with whom Windeyer J agreed) did not have regard to the 'actual' residence status of the trustee preferring instead to have regard to only that which had been hypothesised (a taxpayer) (emphasis added)<sup>10</sup>:

... For the purpose of this abstraction or computation [under section 95] **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 emphasized when the possibility of diverse residences of several trustees is contemplated.

Although the statutory context is somewhat different, the approach taken by the Court is considered to inform the appropriate approach to be taken in the context of section 99B.

31. The Full Federal Court's approach to characterising the hypothetical resident taxpayer in *Howard* at [37–42] recognised, in relation to paragraph 99B(2)(a), that the hypothetical taxpayer is a separate fictional entity and that the hypothesis differs from the actual fact, which is that there was an amount derived by a trustee of a non-resident trust.

32. Given the only relevant characteristic of the hypothetical resident taxpayer is their status as an Australian resident, concessions such as the CGT discount available under Division 115 of the ITAA 1997 are not taken into account when determining whether an amount would or would not be included in the assessable income of the hypothetical resident taxpayer. This is because the CGT discount is not available to all resident taxpayers and is only available to specific classes of resident taxpayers.<sup>11</sup> Similarly other concessions such as the small business concession or the concession afforded to an executor under section 118-195 of the ITAA 1997 are not taken into account.

### ***Circumstances giving rise to the amount***

33. In order to determine whether an amount would be included in the assessable income of a hypothetical resident, it is relevant to consider the circumstances giving rise to that amount.

34. It is relevant and necessary to consider at least certain facts about the amount being tested which could form part of the circumstances of the hypothesised derivation. Without importing some facts, it is not possible to make an assessment as to whether, or what part of, that amount a hypothetical resident taxpayer would be assessed on.

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<sup>10</sup> [1969] HCA 36; 119 CLR 177 at [181], per Barwick CJ.

<sup>11</sup> TD 2017/24.



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35. The Full Federal Court in *Howard* considered the hypothesis (in relation to paragraph 99B(2)(a)) and characterisation of amounts.<sup>12</sup> It was observed that<sup>13</sup>:

.... Each application of s 99B(2)(a) leads to a hypothetical question about whether the amounts received by the trust estate would have been assessable income if they had been earned by a resident taxpayer. Once an answer to that question is known at the level of the deepest trust the answer cascades back up to the original (genuine) resident taxpayer.

...

Once that is understood the question simply becomes whether the amounts received by the Juris Trust estate from Esparto Ltd would have been assessable income had it been (as it certainly was not) a resident taxpayer.

What amounts did it receive? It received the proceeds of a share buy-back which occurred when Esparto Ltd purchased its own shares back from the trustee of the Juris Trust....

36. The amount received by the resident beneficiary in *Howard* involved a distribution received through a chain of trusts (from the Juris Trust to the Esparto Trust to Mr Howard). The Full Federal Court considered the operation of the hypothetical resident taxpayer test in respect of each distribution. Determining the circumstances giving rise to the amount was straightforward due to there being only one significant, identifiable transaction for each trust. In relation to the distribution made by the Esparto Trust, the Full Federal Court considered the relevant circumstances and attributes included that the amount was a capital distribution from a non-resident trust, the Juris Trust. A distribution from a non-resident trust could be assessable in the hands of a hypothetical resident taxpayer by the (further) operation of section 99B. For that purpose, when considering the distribution made by the Juris Trust, the fact that the distribution comprised proceeds from an off-market share buy-back received by the Juris Trust was relevant in determining whether those proceeds would be assessable in the hands of a hypothetical resident taxpayer.

37. If the relevant amount being tested under the hypothetical resident taxpayer tests in paragraphs 99B(2)(a) or (b) is the proceeds of realisation of a capital asset of the trustee of the trust, the acquisition of the asset by the trustee and its sale are relevant circumstances in determining whether the proceeds would be assessable to a hypothetical resident taxpayer.<sup>14</sup> The tax attributes of that capital asset at the time of initial acquisition (including its cost base) are relevant for the purpose of the hypothetical resident taxpayer tests as they allow the tests to work. The attributes enable the calculation of a capital gain as contemplated by section 102-22 of the ITAA 1997 giving rise to an amount under Division 102 of the ITAA 1997 that would be assessed to the taxpayer.

38. Tax attributes of the asset are determined at the time it is acquired by the trust estate for the purposes of the hypothetical resident taxpayer test. Therefore, actions taken by the trustee or things that happen to the trustee after acquiring an asset are not relevant. For example, the ongoing ownership structure or residency status of a trust that owns the capital asset is not a circumstance giving rise to the amount.

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#### **Example 5 – circumstances giving rise to the amount**

39. *An Australian beneficiary receives a payment from the trustee of a non-resident trust that is attributable to the proceeds from disposal of a capital asset. The capital asset*

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<sup>12</sup> The High Court did not make any specific findings on this issue in *Howard v Commissioner of Taxation* [2014] HCA 21.

<sup>13</sup> *Howard* at [41–43]

<sup>14</sup> For example, a relevant circumstance is whether the capital asset had vested in the trust as executor of a deceased estate.

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*was acquired by the trustee in 2000 with funds settled upon the trust at the time the trust estate was established.*

40. *For the purposes of the hypothetical resident taxpayer tests, the circumstances giving rise to the proceeds are the acquisition and subsequent disposal of a capital asset.*

41. *The acquisition date of the asset (being after 20 September 1985) and the cost base of the asset are relevant tax attributes of the asset disposed of for the purposes of the hypothesis.*

42. *The amount (if any) by which the capital proceeds exceed the cost base represents a gain which would be assessable income under Division 102 to a hypothetical resident taxpayer. Accordingly, the distribution is assessed under subsection 99B(1), reduced only under paragraphs 99B(2)(a) or (b) by an amount equal to the cost base of the asset. The distribution is not reduced by an amount equal to the gain.*

### **Example 6 – settled sums and gifted assets**

43. *A non-resident trust is settled in 1995 with commercial land and cash. In 2000, the trust estate is gifted a residential property by a non-resident as an accretion to the corpus of the trust.*

44. *The trustee disposes of the commercial land and the residential property. The trustee distributes the proceeds from those disposals to an Australian beneficiary.*

45. *The distribution represents, and is attributable to, the proceeds of sale of the trust assets. For the purposes of the hypothetical resident taxpayer tests, the acquisition and disposal of the properties is relevant as is the cost base determined under Divisions 110 and 112 of the ITAA 1997 (being the market value of those assets on the date of their acquisition by the trust estate).*

46. *The distribution is assessed under subsection 99B(1), reduced only under paragraphs 99B(2)(a) or (b) by an amount equal to the cost base of the assets. The distribution is not reduced by an amount equal to the gain.*

### **Example 7 – change in residence of trust not relevant**

47. *A non-resident trust is established in 1999. The settled property comprises shares in a Canadian company. The beneficiaries of the trust include the trustee's child who is an Australian resident.*

48. *On 28 June 2019, the trustee resigns and appoints an Australian resident trustee. As the trust became an Australian resident, section 855-50 of the ITAA 1997 operates to give the Canadian shares a cost base equivalent to the market value on the date of change in residency. In 2020, the trustee sells the shares and distributes all proceeds to the Australian beneficiary.*

49. *The distribution represents, and is attributable to, the proceeds of sale of the shares. For the purposes of the hypothetical resident taxpayer tests, the acquisition and disposal of the shares is relevant and the cost base of the shares at the time they were acquired is a relevant tax attribute. The change in residence of the trust is not relevant.*

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50. *The distribution is assessed under subsection 99B(1), reduced only under paragraphs 99B(2)(a) or (b) by an amount equal to the cost base of the shares (at the time of their acquisition).<sup>15</sup> The distribution is not reduced by an amount equal to the gain (calculated using that same cost base).*

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#### **Source of the distribution**

51. Paragraphs 99B(2)(a) and (b) require a determination of what the relevant amount received by the Australian beneficiary represents and is attributable to. That involves looking beyond the distribution by the trustee to consider how the trust property became a trust asset.

52. If the distribution is made from the proceeds of sale of an asset which was settled upon the trust, the distribution will represent and be attributable to the sale proceeds of that asset. However, if a trustee acquires a capital asset with accumulated income not previously subject to tax in Australia, the amount received by the Australian beneficiary will represent or be attributable to amounts which would be included in the assessable income of the hypothetical resident taxpayer because that is the ultimate source of the distribution.

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#### **Example 8 – capital asset acquired using interest income**

53. *In the income year ending 30 June 2000, the trustee of a non-resident trust earns a substantial sum of interest income from a lending arrangement. On 1 September 2001, it uses \$350,000 of that interest income to acquire a capital asset. The trustee disposes of the capital asset on 15 July 2010 for \$300,000. On 30 June 2015, the trustee distributes those capital proceeds to an Australian beneficiary.*

54. *For the purposes of the hypothetical resident taxpayer tests, in determining whether the relevant amount represents, or is attributable to, an amount which would be assessed to a hypothetical resident, it is necessary to look behind the disposal of the capital asset and identify how the asset which gave rise to the relevant amount became a trust asset.*

55. *No part of the proceeds would be assessable to a hypothetical resident taxpayer (as the asset was realised for a capital loss), but the asset was acquired using interest income which would ordinarily be assessable income of a resident taxpayer.*

56. *The distribution of corpus represents, and is attributable to, interest income which is an amount which would be assessable to a hypothetical resident taxpayer. The distribution will be assessed under subsection 99B(1) without reduction by paragraphs 99B(2)(a) or (b).*

57. *If the capital asset was not acquired using interest income and was instead property settled on the trust, the relevant amount would be attributable to the capital proceeds.*

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<sup>15</sup> The Australian beneficiary will also be assessed on the capital gain (calculated using the uplifted cost base deemed by section 855-50 of the ITAA 1997) under Subdivision 115-C of the ITAA 1997. However, paragraph 99B(2)(c) will apply to reduce the subsection 99B(1) liability by the amount already taxed to the beneficiary (or trustee).

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## References

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*Previous draft:*

TD 2024/D2

*Related Rulings/Determinations:*

TD 2017/24; TR 2006/10

*Legislative references:*

- ITAA 1936 Div 6
- ITAA 1936 99
- ITAA 1936 99A
- ITAA 1936 99B
- ITAA 1936 99B(1)
- ITAA 1936 99B(2)
- ITAA 1936 99B(2)(a)
- ITAA 1936 99B(2)(b)
- ITAA 1936 99B(2)(c)
- ITAA 1936 99B(2)(c)(ii)
- ITAA 1936 99C
- ITAA 1936 102AAM
- ITAA 1997 Part 3-1
- ITAA 1997 Div 102
- ITAA 1997 102-22
- ITAA 1997 104-10
- ITAA 1997 Div 110

- ITAA 1997 Div 112
- ITAA 1997 Div 115
- ITAA 1997 Subdiv 115-C
- ITAA 1997 118-20
- ITAA 1997 118-195
- ITAA 1997 Div 128
- ITAA 1997 128-15(4)
- ITAA 1997 855-50
- ITAA 1997 995-1(1)

*Cases relied on:*

- Howard v Federal Commissioner of Taxation [2012] FCAFC 149; 206 FCR 329; 2012 ATC 20-355; 91 ATR 89
- Howard v Commissioner of Taxation [2014] HCA 21; 253 CLR 83; 2014 ATC 20-457; 92 ATR 38
- Union Fidelity Trustee Co (Aust) Ltd v Commissioner of Taxation (Cth) [1969] HCA 36; 119 CLR 177; 69 ATC 4084; 1 ATR 200; 43 ALJR 313

*Other references:*

PCG 2024/3

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ATO references

NO: 1-S4B9KWI

ISSN: 2205-6211

BSL: PW

ATOlaw topic: Income tax ~~ Trusts ~~ Trust income ~~ Taxed as income of individual - section 99

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