

JOINT SUBMISSION BY

**Chartered Accountants Australia and New Zealand, The Tax Institute,
Institute of Public Accountants, CPA Australia
and Taxpayers Australia**

Draft Taxation Ruling TR 2017/D10

Income tax: Trust vesting - amending the vesting date and consequences of a trust vesting

Date: 26 February 2018

The Professional Bodies welcome the opportunity to comment on Draft Taxation Ruling TR 2017/D10 ("the Draft Ruling").

GENERAL COMMENTS

1. The Professional Bodies welcome the ATO's confirmation that, subject to the terms of the particular deed, the vesting of a trust will not, in itself, cause the trust to come to an end and the assets of the trust to be settled on the terms of a new trust.
2. However, the Professional Bodies have a number of concerns, outlined below, and we request that the Commissioner take these into consideration in finalising the Draft Ruling.

SPECIFIC COMMENTS

When would a Court extend the vesting date?

3. The Draft Ruling expresses the view (at paragraph 11 and 12) that, prior to a trust's vesting, a Court may be prepared to extend the vesting date but that once the vesting date has passed this would no longer be possible.
4. However, that view appears to be at odds with the comments at paragraph 13 – that is, that the Commissioner understand that it would be unlikely that a Court would extend the vesting date once the vesting date has passed. The Professional Bodies would ask that the Commissioner review these paragraphs and clarify his views in this respect.

Vesting and CGT Event E5

5. In paragraph 23 of the Draft Ruling, the Commissioner observes that the vesting of a trust may result in the takers in default becoming absolutely entitled to the CGT assets of the trust. Reference is then made to Taxation Ruling 2004/D25 for the Commissioner's views on the meaning of absolutely entitled.
6. A note to TR 2004/D25 indicates that that ruling would not be finalised until consultation with Treasury in relation to absolute entitlement and in particular the problem areas of joint and multiple beneficiaries was complete. The Professional Bodies are concerned that in the more than 13 years that have elapsed since TR 2004/D25 was released these consultations have not progressed sufficiently to enable the ruling to be finalised. Further, if the difficulties around which consultation occurred could not be resolved, we believe that it is inappropriate that TR 2004/D25 be cited in support of the final version of the Draft Ruling.

Does the trust deed provide a power to extend the vesting date?

7. A critical issue underlying much of the discussion in the Draft Ruling is whether the terms of a trust deed provide the trustee with the power to extend the vesting date. Example 1 (paragraph 30) provides a clear example of when that power does not exist. The Professional Bodies recommend that further examples be provided to assist practitioners.

Approach to lost deeds

8. The Draft Ruling has been prepared on the basis that the vesting date of the trust can be determined. The Professional Bodies recommend that the final version of the Draft Ruling explain what Commissioner's position where the trust deed cannot be found: that is, if the terms of the trust are unknown.

Can a power to extend the vesting date be exercised retrospectively?

9. The Draft Ruling expresses the view (paragraph 12) that once the vesting date of a trust is passed it is not possible for the trustee to extend the vesting date and further, that it is unlikely that a Court would do so.
10. These comments are based on the content of the legal advice annexed to the Draft Ruling. That advice was provided in the context of a particular trust deed. Conceivably, a different result might obtain under a differently worded trust deed; for example, where the power of variation contemplates retrospective amendment and the deed does not include a provision equivalent to clause 16(c).
11. In this respect, the Professional Bodies draw the Commissioner's attention to the decision of the Supreme Court of Western Australia in *Graham Australia Pty Ltd v Perpetual Trustees WA Ltd* (1989) 1 WAR 65. The issue before the Court in that case was whether it was open to amend the provisions of a trust deed dealing with the redemption of units after certain unit holders had initiated the redemption process. The amending deed, if effective, reduced the price at which the units would be redeemed.
12. One of the arguments raised by the redeeming unit holders was that an amendment that sought to affect accrued rights was invalid and of no effect. The Court unanimously rejected this argument. In the course of his judgment, Chief Justice Malcolm observed¹:

If, upon the proper construction of the contract, the power of amendment includes a power to amend so as to defeat accrued rights, an amendment made in the bona fide exercise of the power will be valid and binding in accordance with its terms.

13. While the circumstances of that case are different, the Professional Bodies submit that it supports the proposition that the answer to the question of whether a power to extend the vesting date can be exercised retrospectively must be, that it depends on the terms of the particular trust deed. The Professional Bodies request that this issue be specifically addressed in the final Ruling.

Consequences if no taker in default

14. The Commissioner comments at paragraph 15 of the Draft Ruling that "*from the time the trust vests a trustee ... holds the trust property for the absolute benefit of those beneficiaries specified as the takers on vesting*". The Professional Bodies request that the Draft Ruling address the position if the identity of the takers in default is at the discretion of the trustee.

¹ (1989) 1 WAR 65 at 85.

15. We also request that the Commissioner address the retrospectivity point in relation to this issue: that is, the question of whether the power to identify the takers in default can be exercised after vesting date depends on the terms of the particular trust deed.

Consequences if taker in default dies after vesting date but prior to distribution

16. The Commissioner comments at paragraph 12 of the Draft Ruling that “*once the trust has vested, the interests in the trust property become fixed at law*”. The Professional Bodies understand that comment to imply that a taker in default would have an interest in each of the CGT assets of the trust at the vesting date. The Professional Bodies request that the Commissioner confirm that Division 128 would apply in relation to the taker in default’s interest in each of the assets where the taker in default dies before those assets are transferred by the trustee.

Vesting year income

17. Example 5 (paragraph 41) provides a simple example of the implications of vesting on the entitlement to income of the vesting year: one where the trustee exercises the power to distribute the pre-vesting income of the trust prior to the vesting date. It is implicit in the comments at paragraphs 15 and 26 that the Commissioner understands that the trustee’s power to distribute pre-vesting income ceases on vesting date. If that is the Commissioner’s understanding, the Professional Bodies recommend that it be made explicit.
18. We also request that the Commissioner address the retrospectivity point in relation to this issue: that is, the question of whether the power to distribute pre-vesting date income can be exercised after vesting date depends on the terms of the particular trust deed. The Professional Bodies request that the final Ruling address trustee’s power to distribute pre-vesting income where that is provided for in the deed.

Tax treatment of overpaid & underpaid beneficiaries

19. The legal advice annexed to the Draft Ruling outlines (at paragraph 79) the taxation consequences of income distributions made after the vesting day as follows:
- h. *A valid appointment of income under clause 3(b) would have given the recipient beneficiary an immediate, vested and indefeasible interest in and to the income appointed to him (see clause 3(c)(i), (f) of the trust deed), making him absolutely entitled to the sum appointed, and also presently entitled to a share of the income of the trust estate in the proportion appointed, within the meaning of section 97 of the ITAA 1936. (Also, upon the expiration of an Accounting Period in which some part of the net income remained undistributed, beneficiaries taking by accumulation pursuant to clause 3(e) would have become presently entitled at the end of the Accounting Period to the income accumulated in their favour.)*
 - i. *But the purported appointment by the trustee was in fact made without authority, for the reason that the discretionary power of appointment in clause 3(b) was no longer conferred on the trustee, and the trust deed does not contain any other power permitting the trustee to distribute the income in the manner attempted.*
 - j. *The consequence in our opinion is that the purported appointment of income was not effective to vest any interest in the nominated beneficiary, and was not effective to make the beneficiary presently entitled to any part of the income sought to be applied or set aside or paid.*
 - k. *The true position was that the two beneficiaries were entitled to the income of the trust as tenants in common in equal shares (making the assumption set out earlier). The share of the income of the trust estate enjoyed by each beneficiary was therefore one half each.*

l. Accordingly, for each year of income after 1 January 2001, each beneficiary was assessable to tax upon one half of the net income of the trust estate, irrespective of the sum that was paid, set aside or applied by the trustee in the purported exercise of the power of appointment.

20. Subject to the issues raised in this submission, the Professional Bodies agree with these conclusions on the fact pattern considered.
21. Obviously, if the error is discovered early, amendments to assessments of underpaid and overpaid beneficiaries could be made within relevant amendment periods. However, it is likely that amendments may be out of time for some years. The Professional Bodies request that the final version of the ruling explain the Commissioner's position with respect to amendments.
22. A consequential issue not addressed in the legal advice or Draft Ruling is the CGT implications for the underpaid beneficiary if, as the legal advice describes it, the 'equitable right in the misapplied funds' is abandoned. The Professional Bodies would understand that that right would be a CGT asset and that the CGT cost base in that asset would be nil as there would be no amount paid for the right and the market value substitution rule would not operate². We would recommend that the final version of the Draft Ruling address this aspect.

Application Date

23. Given the complexity associated with this matter, the Professional Bodies recommend that the Tax Ruling apply prospectively from the date it is issued in final form.

² Item 1 in the table in section 112-20(3) of the Income Tax Assessment Act 1997.