PRACTITIONER ARTICLES

[1193]

Final Trust Vesting Ruling - is that it?

- by Matthew Burgess, Director, View Legal

As reported at 2018 WTB 35 [1149], the ATO has now issued its ruling in relation to trust vesting with Draft Taxation Ruling ("TR") 2017/D10 now finalised as TR 2018/6.

As also reported at 2018 WTB 36 [1160], the ATO has published details of its administrative approach.

In theory, the combination of these publications, after what is understood to be the extensive industry consultation, should be the definitive statement of all key issues with trust vesting. Arguably for many trust specialists however, it is difficult to instead not be asking "is that it" from the ATO on trust vesting?

Some history

Previous detailed comments on Draft TR 2017/D10 may have been lost in the Christmas rush (see 2017 WTB 52 [1797]) – the draft ruling having been issued less than 2 weeks before Christmas 2017.

One interesting aspect of the recent history in relation to the ATO's approach to trust vesting not addressed by this previous article involves the trust at the centre of the (in)famous Rinehart dispute.

Given what has been disclosed publicly, there are many who believe that Ms Rinehart successfully obtained a private ruling from the ATO in relation to whether there were any CGT consequences of the trust vesting when Ms Rinehart's youngest child turned 25.

While it cannot be certain, it appears that Private Ruling Authorisation number 1012254771092 ("Ruling") relates to the Rinehart matter.

The Ruling carefully considers whether CGT event E5 occurs on the vesting of a trust. CGT event E5 is said by the ATO to occur when a beneficiary becomes "absolutely entitled" to a CGT asset of the trust as against the trustee.

The ruling then goes on to explore in some detail the broad position that the ATO adopts in these areas based on Draft TR 2004/D25 **("Absolute Entitlement Ruling").**

The ATO confirms that while the Absolute Entitlement Ruling remains in draft, so long as it is not withdrawn, it does represent its view of the law.

Based on the analysis of the Absolute Entitlement Ruling, the (so-called) Rinehart Ruling concludes that because no beneficiary was able to call for any 1 or more of the assets to be transferred to them, they were not entitled to any assets as against the trustee, and therefore, CGT event E5 did not occur on the vesting of the trust.

In many respects, the Rinehart Ruling appears to heavily inform what is now TR 2018/6.

In combination, TR 2018/6 and the Rinehart Ruling make it clear that the ATO explicitly acknowledges that the vesting of a trust will not, by itself, result in any CGT event in many circumstances.

Absolute Entitlement Ruling and Draft TR 2017/D10

One key and often raised concern with Draft TR 2017/D10 was that it did not adequately explain the reasons for concluding that CGT event E5 will or will not occur on the vesting of a trust in different circumstances.

While Draft TR 2017/D10 was broadly consistent with the ATO's position in the Absolute Entitlement Ruling, the correctness of a number of points in the Absolute Entitlement Ruling are the subject of significant conjecture, perhaps none more so than the ramifications of the trustee's entitlement to sell trust assets to satisfy its right of indemnity out of trust assets.

This point was tested in the decision of FCT v Oswal [2012] FCA 1507 ("Oswal"), reported at 2013 WTB 2 [58].

Oswal(from which the High Court refused special leave to hear an appeal) was not mentioned in Draft TR 2017/D10 and is also not mentioned in TR 2018/6.

Example 7 of Draft TR 2017/D10 concluded that where a trust vests with a sole capital beneficiary, that beneficiary becomes absolutely entitled to the trust assets and CGT event E5 occurs; the exact opposite conclusion to that reached in Oswal.

In particular, in Oswal, Justice Edmonds found that CGT event E5 could not arise, because the beneficiaries could not become absolutely entitled to trust assets where the trustee had a lien over the assets in respect of its right to be indemnified for trust liabilities out of trust assets.

Adopting the Federal Court's view in Oswal, it seems the beneficiaries of a discretionary trust (even if there is a sole capital beneficiary) can never be absolutely entitled against a trustee when a trust simply vests, as the trustee will always have a common law right of indemnity out of trust assets, able to be satisfied via an equitable lien.

Instead of these conflicting outcomes being addressed specifically in TR 2018/6, all references to the Absolute Entitlement Ruling have instead been deleted and example 7 amended to essentially avoid the issue.

Other changes to Draft TR 2017/D10

Despite what we understand to be feedback made to the ATO on Draft TR 2017/D10 for a range of issues to be addressed before the ruling was finalised, it appears that the abovementioned change to Example 7 (and a consequential amendment of Example 6) is the only substantive change in TR 2018/6.

Arguably the only other change of note was to adjust wording to highlight that the ability to extend a vesting day will turn almost entirely on the power in the trust instrument (assuming an application to court is not made) – in other words, abide by the "read the deed" mantra. A critical point no doubt, however hardly indicative of a robust consideration of industry feedback.

Unanswered questions

What this means practically is that a range of important trust vesting questions remain unanswered.

In particular, TR 2018/6 does not attempt to even acknowledge (nor address) issues such as:

- In what situations will a power of variation be deemed to be too narrow to allow an extension of a vesting date?
- If a power of variation expressly permits retrospective amendments, why will this not allow a vesting date to be extended after it has passed (TR 2018/6 is blunt in its view that a trust vesting date can never be extended once it has passed)?
- If there are no default beneficiaries and a trust vests without the trustee being aware, will the trustee of the trust be taxed on all income and capital gains derived (at the top marginal rate, with no CGT discount) pending the assets of the trust being distributed?
- Alternatively, if there are no default beneficiaries, does the ATO instead believe that the assets of the trust pass on a resulting trust to the settlor?
- Whether the position in Private Ruling Authorisation number 1012191260298 is still accepted as correct – in that ruling, the ATO confirmed that where a bare trust that owned shares in a pre-CGT company had made all distributions of income to the same person when the trust vested to that same person, the beneficial interest was not taken to have changed. In other words, the vesting of the trust did not change the majority underlying interests in the company's assets for the purposes of the application of Div 149 of the ITAA 1997.
- Can a trustee resolve to amend the jurisdiction of a trust to South Australia, and thus have any vesting date essentially abolished?
- If an individual default beneficiary of a vested trust dies before the trustee distributes the assets to them, do those assets pass in accordance with their will, without tax consequence due to Div 128 of the ITAA 1997?
- What approach will the ATO have in relation to lost trust deeds, where it is impossible to confirm the date of vesting?

Conclusion

As we concluded in relation to Draft TR 2017/D10, TR 2018/6 should be welcomed as it does provide some clarity to the ATO's views in relation to trust vesting.

This said, the reality is that some of the most important questions in relation to the tax consequence of trust vesting remain unanswered.

Hence the question will rightly be posed by many specialist trust advisers – "is that it?"