Game over for trust splitting? The ATO embraces Revisionist History

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The ATO has released its views on trust splitting in Draft Taxation Determination (TD 2018/D3), reported at 2018 WTB 30 [990].

There are a range of concerns with TD 2018/D3 for all trust advisers. A summary of the key issues is set out below.

Examples

The factual matrix provided in TD 2018/D3 is very specific and lists a number of line items that may, or may not, be a part of a trust splitting arrangement. Many of the arrangements we have seen historically have involved a change of trustee in relation to specific assets and few or none of the other features listed in the draft ruling (for instance, no changes to the appointors, right of indemnity or range of beneficiaries).

For TD 2018/D3 to be credible, it will be imperative that more examples are included highlighting the range of potential trust splits, and in turn, highlighting the types of trust splitting arrangements that will *not* give rise to any CGT consequences.

For example, the ATO appears to place significant weight on issues such as varying the trustee's right of indemnity and adjusting the range of potential beneficiaries together with a decision to change appointorship.

It is well settled law (and the ATO has long accepted - for instance, in the withdrawn Statement of Principles on Trust Resettlements and subsequently in TD 2012/21) that each of these changes in isolation do not cause any CGT event to arise. ***It is therefore critical to highlight what combination of changes, in the ATO's view, amount to a resettlement***.

Flawed assumptions

Unfortunately, in concluding that trust splitting will cause CGT event E1, it appears the ATO has ignored most case law and legislation in the area, and indeed its most recent private ruling, as reported at 2016 WTB 6 [144], and earlier private rulings.

Arguably, TD 2018/D3 turns entirely on an assumption that, without any analysis, concludes how a court may respond to the application of an aggrieved beneficiary of a discretionary trust the subject of a trust splitting arrangement.

The assumption is unfortunately fundamentally flawed in at least 3 areas:

Despite a virtually identical factual scenario, TD 2018/D3 assumes that in 1 instance, the court will be resistant to an application, and yet in another instance, will support an application. There is no authority provided for either conclusion.

More fundamentally, the paragraphs are based on a significant misunderstanding of the law in this area. There is substantive and longstanding case law confirming that the beneficiary of a discretionary trust does not have a proprietary interest in the trust assets and their rights against the trustee are limited. In particular, while a beneficiary has a right to proper administration and a right to be considered in relation to distributions of income or capital, a discretionary beneficiary does not have any legal or equitable right to distributions. ***TD 2018/D3 completely ignores this position***.

Finally, TD 2018/D3 fails to acknowledge that the mere amendment of a range of potential beneficiaries is highly unlikely to of itself cause a resettlement (as acknowledged by the ATO in TD 2012/21). Therefore, if a trust splitting arrangement takes place, and as part of the arrangement, the range of beneficiaries of the split trust is narrowed, then the conclusions in the abovementioned paragraphs are irrelevant.

Furthermore, ***the conclusions in TD 2018/D3 are such that it would mean every single change of trustee or even a change of appointor (or principal) of a family trust would be liable to trigger (if the ATO felt the arrangement was not usual") CGT event E1 – a clearly unsustainable position***. In particular, the logic of

the ATO would imply that at any time the trustee of a trust is changed, it automatically means that the new trustee (and their family) would benefit from the trust to the exclusion of the old trustee (and their family) and that a court would with certainty intervene if ever requested by a disgruntled beneficiary.

Frustratingly TD 2018/D3 also contains long winded paragraphs, unsupported with any authority. Some of these statements are indeed arguably irrelevant to the subject matter. See for example the entire section under the heading "Settlement of assets on terms of a different trust" - and in particular the sweeping generalisations at paragraph 28 about "practical problems" with trust splits. ***At what point did "practical problems" become a key factor in triggering CGT events?***

Resettlement?

Similarly, the ATO essentially ignores both High Court and Full Federal Court authority in decisions such as *FCT v Commercial Nominees of Australia Ltd* (2001) 47 ATR 220 ("Commercial Nominees") and *FCT v Clark* (2011) 190 FCR 206 ("Clark") when making conclusions in TD 2018/D3 about resettlement.

In particular, both *Commercial Nominees* and *Clark* acknowledged that it is completely expected that over the life of an 80-year discretionary trust, there will be changes, at times significant changes, in relation to the conduct of the trust. This is reflective of a continuing trust.

Indeed, given current life expectancies of humans, it would be impossible not to have fundamental changes to the make-up of a trust over an 80-year period.

It appears that TD 2018/D3 is implicitly predicated on a belief that, despite superior court authority, a separate set of rules apply to discretionary trusts as compared to unit trusts and superannuation funds.

Such a belief is unsustainable in the context of both High Court and Full Federal Court authority and in the context of the ATO's own publications. ***It is similarly unsustainable that steps as simple as changing an appointor, trustee and the potential range of beneficiaries could be said to amount to a resettlement.***

This conclusion is further reinforced by a failure in TD 2018/D3 to coherently address why the specific tax exemption available for discretionary trusts on a change of trusteeship, that being the rollover relief available under s 104-10 of the ITAA 1997, can be ignored.

Nor is the requirement under s 102-25 of the ITAA 1997 mentioned – that is, that if there are multiple potential tax events, the most specific must apply.

Aside from the specific exemption for changes of trustee, applying the principles from *Commercial Nominees*, *Clark* and TD 2012/21, ***it is clear that at law that a change in the terms of any trust (ie including a discretionary trust) pursuant to the exercise of an existing power will not result in the termination or establishment of a new trust***.

Therefore, the example provided in TD 2018/D3 that the proposed amendment to appoint separate appointors and trustees of the sub-trust, pursuant to an express power under the trust deed allowing the appointments to be made, is incorrect.

In a sentence, none of the changes in the example in TD 2018/D3 give rise to a separate charter of rights and obligations so substantive that could give rise to the conclusion that assets have been settled on terms of a different trust.

Case law

In some instances, TD 2018/D3 refers to the decision in*Commissioner of State Revenue v Lam and Kym Pty Ltd* [2004] VSCA 204 ("Lam & Kym"), however reference to this decision is not helpful to the ATO's arguments.

In particular:

- *Lam & Kym* involved an express declaration of trust over specific assets, which does not appear to be the case in the factual scenario considered in TD 2018/D3;
- In any event, *Lam & Kym* was a Victorian Supreme Court case which has been largely superseded by the High Court in *Clark;* and
- *Clark* confirmed, as acknowledged by the ATO in TD 2012/21, that a variation of a trust by the trustee in accordance with an express power in the trust instrument can generally not result in the establishment of a new trust.

Furthermore, while the case of *Oswal v FCT* [2013] FCA 745 ("Oswal") is referenced, it again is not helpful to the position that the ATO is trying to sustain as *Oswal* specifically related to assets being held for the benefit of 1 beneficiary of a trust – in our experience, it is never the case that a trust split occurs in the manner that is analogous to the *Oswal* decision.

The ATO reaches the quite extraordinary conclusions without any supporting argument in relation to the case law or legislation in this area that despite an identical trust instrument applying, there are somehow circumstances that lead to the conclusion that the trust powers of the split trust are suddenly distinct.

Even relying on the well-known legal principle from the 1997 film "The Castle" ("it's the vibe") would fail to support such a conclusion. Indeed, there would appear to be no legislation or case law which would support the conclusion reached.

The ATO also concludes that trust splitting occurs by declaration of trust, without any attempt to justify its conclusion. This is another concerning assumption given that in our experience, we are unaware of any trust splitting that takes place in a manner other than by way of a change of trusteeship.

To argue that a change of trusteeship amounts to a declaration of trust over assets is nonsensical – the whole commercial framework of the change of trusteeship is that the existing trust remains in place and there is simply a change in the legal owner of the trust assets, with that trustee however being completely bound by the terms of the original trust instrument.

Furthermore, to reach these conclusions, again without any reference to the legislative position outlined above and the specific CGT exemption available for changes of trusteeship, is inappropriate.

Retrospective

The ATO states that the ruling is to apply on both a retrospective and prospective basis.

To issue a ruling with retrospective effect when there have been positive rulings issued by the ATO over an extended period is arguably irresponsible and will likely cause unnecessary and significant taxpayer and industry backlash.

Conclusion

As noted above, there are private rulings previously published by the ATO (as recently as 2016) confirming that trust splitting arrangements on similar terms did not constitute an E1 event.

It is extremely concerning that the ATO is purporting to now retrospectively change its approach to a longstanding, and tax benign, arrangement.

At a minimum, there should be an explanation as to why the position adopted by the ATO historically has been abandoned and not considered relevant.

TD 2018/D3 also fails to explain why the change in approach by the ATO was not implemented when the trust cloning exemption was abolished for discretionary trusts by the Government without warning on 31 October 2008.

Trust splitting was extremely prevalent at the time of the removal of the trust cloning rollover relief.

Indeed, a cursory level of research would have demonstrated that leading tax specialists recommended trust splitting as the preferred approach to trust cloning for years before and after 2008 due to its effectiveness from a stamp duty perspective in some States.

Ultimately, there is a material risk that TD 2018/D3 will cause significant damage to the reputation of the ATO for failing to address these issues 10 years ago, if it truly felt an argument that trust cloning and trust splitting was essentially the same was sustainable. As Malcolm Gladwell might ask, is TD 2018/D3 another example of the ATO unilaterally embracing its own version of Revisionist History?