



# WEEKLY TAX BULLETIN

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## Absolute entitlement: and why 2022 should be the year for some certainty

- by *Matthew Burgess, Director, View Legal*

The meaning of the term "absolutely entitled" for CGT purposes continues to be the subject of significant contention and debate. This is perhaps best evidenced by the ongoing failure of the ATO to issue a final version of Taxation Ruling TR 2004/D25 (2004 is not a typo!).

A key aspect of the rules for absolute entitlement relates to the ability of an absolutely entitled beneficiary to access the CGT main residence exemption.

### **Mingos decision**

One case that considers in passing the concept of absolute entitlement in the context of an (argued to be) main residence, owned by a family trust is *Mingos v FCT* [2019] FCA 834: see 2019 WTB 26 [850].

It should be noted that the taxpayer appealed to the Full Federal Court in *Mingos v FCT* [2019] FCAFC 211: see 2019 WTB 51 [1600]. The Full Court unanimously held that the primary judge's findings proceeded logically from the evidence and were the product of "compelling logic". There was no basis for overturning them and the appeal was dismissed. The commentary below therefore references the views of the Federal Court at first instance ("Mingos").

Broadly, the case involved a house owned by a family trust that a taxpayer was attempting to access the CGT main residence exemption for – by arguing he was absolutely entitled to the asset. The taxpayer failed however to produce any real evidence that the house was owned via a "sub-trust" under the family trust of which he was the sole absolutely entitled beneficiary.

The Court did make some interesting observations about what the tax position would have been had there been evidence supporting the argument.

In summary the Court confirmed the following.

- When CGT event A1 happens, the capital gain is made by the person who disposes of the asset (s 104-10 of ITAA 1997).
- This result is subject only to a statutory exception for an absolutely entitled beneficiary.
- This exception relevantly provides that from just after the time an entity becomes absolutely entitled to a CGT asset as against the trustee of a trust (disregarding any legal disability), the asset is treated as being the entity's asset (instead of being an asset of the trust). Thus an act done in relation to the asset by the trustee (is treated) as if the act had been done by the entity (instead of by the trustee).

- A beneficiary will be held to be absolutely entitled to an asset as against the trustee of a trust if the beneficiary has a vested, indefeasible and absolute entitlement in the trust asset, and is entitled to require the trustee to deal with the trust asset as the beneficiary directs. A potential beneficiary of a discretionary trust will not be absolutely entitled to an asset of the trust.
- Where the asset in question is a main residence, even where absolute entitlement is shown to exist, the evidence must support the fact that it was used by the absolutely entitled beneficiary as their main residence. For example, there must be evidence such as the property being listed as the taxpayer's place of residence on the electoral roll, listed with main roads department as the address at which the taxpayer's car was garaged and all utilities attributable to the residence must be invoiced to that address.
- A legal right to occupy a property can also give rise to a CGT exemption under the main residence provisions (ie s 118-130 of ITAA 1997). This said, even where such a right is demonstrated, it is the disposal of that right, not the disposal of the property, which creates entitlement to the CGT relief.

## **Ludwig decision**

While not directly relevant to the issues before the Court, the recent decision in *Ludwig v Jeffrey (No 4)* [2021] NSWCA 256 ("Ludwig") provides some further helpful guidance in relation to absolute entitlement.

In *Ludwig*, relevantly, the trustee of a trust had applied to the ATO for a private ruling on the question of whether it would be liable to pay CGT on the sale of a property held on trust for the benefit of certain beneficiaries in accordance with Pts 3-1 and 3-3 of the ITAA 1997.

As quoted in the decision, the ATO confirmed no CGT would be payable, with the following context provided.

- On acquisition of the property, the trustee agreed to have their name on the title as joint tenants in equal shares with the beneficiaries to assist them with obtaining finance.
- The property was always used for main residence purposes by the beneficiaries and was never used for investment purposes.
- The trustee at no stage contributed any funds towards the property.
- The entirety of the purchase price of the property, the stamp duty payable, all fees, interest and principal repayments in respect of any loans secured by any mortgage over the property were paid at all times by the beneficiaries, who also paid all outgoings, utility expenses, repairs, maintenance expenses, land taxes and council rates.
- Therefore, the trustee had no beneficial ownership of the property and was not liable to pay CGT upon the sale of the property. Indeed there was no CGT payable by the beneficiaries either, as the main residence exemption was available (as the beneficial owners of the property lived there).
- An individual can be a legal owner but have no beneficial ownership in an asset. That is, an entity may hold a legal ownership interest in property for another individual in trust. In these cases, it is the beneficial owner that will have a CGT event upon sale of a CGT asset.
- A beneficial owner is the person or entity who is beneficially entitled to the income and proceeds from the asset.
- The ATO considers that where the beneficial ownership and the legal ownership are not the same, there must be evidence that the legal owner holds the property on a trust for the beneficial owner. That is, there must be a valid trust over the property confirming that the equitable owner is the party entitled to benefit from the property.

## Observations

Generally it seems accepted that if the only thing that is preventing a beneficiary from being absolutely entitled under the rule in *Saunders v Vautier* (1841) 49 ER 282 is their legal disability (eg, being under the age of 18), then they will be absolutely entitled for the purposes of the CGT provisions.

Given 2022 will see the 18th anniversary of the release of TR 2004/D25, perhaps there would be some symmetry in it being "absolutely" finalised over the next 12 months.