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Converting water into wine (or family trusts into fixed trusts) is way cool

by Matthew Burgess, Director, View Legal

For a myriad of structuring issues, one issue that appears to be raised more regularly is whether it is possible to convert a family discretionary trust into a fixed trust.

This issue was considered some years ago by the Tax Office in Private Ruling Authorisation Number: 1012991136582.

Broadly the factual matrix was as follows –

1. a 'standard' family trust held an asset;
2. the trust had a widely crafted power of variation;
3. he trustee resolved to make a capital distribution of the balance in the unrealised capital profits account to certain beneficiaries, with this amount left unpaid (ie meaning it was a debt owed by the trust to the beneficiaries);
4. by agreement there was then a conversion of the debts (and some other outstanding loans) to equity such that each of the relevant beneficiaries had a certain percentage of 'equity' in the trust;
5. relying on the power to vary, the trustee then amended the terms of the trust deed to convert it into a fixed unit trust.

After analysing the provisions of its Tax Determination in relation to resettlements (namely TD2012/21, the Tax Office confirms that so long as the amendments are within the powers of the trust deed, the continuity of the trust will be maintained for trust law purposes.

This is because the ultimate beneficiaries of the trust after the proposed amendments would be the individuals who were the objects of the trust before the variation. The fact that the extent of the interests of the beneficiaries in the trust change as a result of the variation was seen as irrelevant.

Therefore, the amendments to the terms of the trust did not trigger capital gains tax (CGT) event E1 or CGT event E2, being the 'resettlement' CGT events.

CGT event E1 happens if a trust is created over a CGT asset by declaration or settlement.

CGT event E2 happens if a CGT asset is transferred to an existing trust.

The Tax Office further confirmed that CGT event E5 was not triggered by the conversion of a family trust to a fixed trust.

CGT event E5 happens if a beneficiary becomes absolutely entitled to a CGT asset of a trust as against the trustee despite any legal disability of the beneficiary.

CGT event E5 does not however happen if the trust is a unit trust and thus this exemption was held to apply here.

The Tax Office also confirmed that there are no other CGT events that happened when the family trust was converted into a unit trust. This is because the amendments were within the trustee's powers contained in the trust instrument. This means that the continuity of the trust was maintained for trust law purposes.

A similar conclusion was reached by the Tax Office in Private Ruling Authorisation Number 1051886979078.