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Retaining Pre-CGT assets owned via trusts – Clarity at last(?)

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Division 149 of the 1997 Tax Act is an anti-avoidance provision aimed at preventing access to tax free disposals of assets otherwise assumed to have been acquired before 20 September 1985.

Broadly Division 149 applies most commonly where a company has acquired assets prior to 20 September 1985, however at a later date there is a change of 50% or more of the underlying ownership of the assets evidenced by a change of 50% or more of the shares in the company.

One aspect of Division 149 that is often overlooked is the application of the provisions to assets held by trustees of family discretionary trusts

Historically, it has arguably been the case that the Tax Office has considered itself bound, at least administratively of the clear explanation of the way in which the rules operate as it set out in Taxation Ruling IT 2340, being 'Income tax: Capital gains: deemed acquisition of assets by a taxpayer after 19 September 1985 where a change occurs in the underlying ownership of assets acquired by the taxpayer on or before that date' (the relevant extracts of which, as quoted in the decision) are set out at the end of this article).

In the case of XLZH and Commissioner of Taxation (Taxation)[2025] ARTA 2154 however, the Tax Office sort - unsuccessfully - to agitate arguments arguably contrary to its own position adopted in Taxation Ruling IT 2340.

At the heart of the factual matrix there was a discretionary trust settled in 1977, which in turn founded a business in 1979.

The business maintained its pre-capital gains tax (CGT) status in 1988, when rolled over to a wholly owned company, under what is (now) referred to as a Division 122A rollover (being at the time, a 160ZZN rollover). Relevantly, a key party was the 'nominator' (or the appointor) of the trust and via this role they held the sole authority to determine who was to be appointed as a beneficiary of the trust; however could not nominate themself.

The Tax Office argued that a prior appointment in 2011 as a beneficiary of the trust of a company (the shares in which were owned by a related trust, which trust the nominator was a potential beneficiary of) automatically triggered Division 149 – meaning that the shares in the trading company automatically lost their pre-CGT status.

The taxpayer argued however that, on review of the pattern of trust distributions, there had not been a change of 50% or more of the ultimate owners.

The shares in the company that operated the business were sold by the trust in 2019, for $100M.
In holding the shares had retained their pre-CGT status, the tribunal confirmed:

1. It is incontrovertible that, at law, no beneficiary is entitled to income or capital of a discretionary trust until the trustee exercises their discretion to distribute income or to make an appointment of capital to that beneficiary (see Gartside v Inland Revenue Commissioners [1968] 1 All ER 121).

2. That is, an object of the discretionary trust, has no legal or beneficial interest but only the right to due consideration and due administration of the trust (see Kennon v Spry(2008) 238 CLR 366 and Swishette Pty Ltd v ACCC (2017) 149 FCR 483).

3. Thus, a beneficiary of a discretionary trust does not hold an interest in any asset of the trust or in the ordinary income derived from the asset until the trustee's discretion is exercised.

4. While superficially this means it would not be possible to satisfy a test which traces beneficial interests in the assets of a discretionary trust, for the purposes of Division 149 the 'ultimate owners' in the case of an asset of a discretionary trust are deemed to have interests in the trust's assets akin to ownership interests - that is, the statutory provisions adopt a non-technical meaning of the phrase (and the Tax Office adopts the same approach in IT 2340).

5. Section 149-30(2) is an entirely concessional provision as evident from its statutory context and language and, therefore, it 'should be construed beneficially (and) to give the most complete remedy', particularly where (as is the case here) the provisions are extraordinarily difficult to apply in certain circumstances (see Eichmann v Commissioner of Taxation [2020] FCAFC 155).

6. The principle that '[n]o clause, sentence or word shall prove superfluous, void, or insignificant, if by any other construction they may all be made useful and pertinent' was also held to be relevant (see The Commonwealth v Baume (1905) 2 CLR 405).

7. Despite technical arguments that may have undermined whether the Tax Office was in fact administratively bound by IT 2340 (including that it was issued before formal rulings were introduced and considered the 1936 version of Division 149 (namely section 160ZZS)), there was no argument submitted suggesting IT 2340 did not continue to bind the Tax Office. Therefore, suggestions by the Tax Office that actual distributions could be ignored in determining whether Division 149 had been triggered were rejected.

8. Ultimately, as highlighted by schedules of distribution patterns provided by the taxpayer, the tribunal was satisfied that at no time did the nominator receive 50% or more of the income referable to dividends on the shares in the pre-CGT company - and thus, the trust was always held for the benefit of the same majority group of ultimate owners and in turn retained its pre-CGT status at the date of the CGT event.

Extracts from IT 2340: 'Income tax: Capital gains: deemed acquisition of assets by a taxpayer after 19 September 1985 where a change occurs in the underlying ownership of assets acquired by the taxpayer on or before that date'

5. In relation to what are generally referred to as discretionary trusts, i.e., family trusts, the trustees of which have discretionary powers as to the distribution of trust income or property to beneficiaries, in considering the question of whether majority underlying interests have been maintained in the assets of the trust it will be relevant to take into account the way in which the discretionary powers of the trustees

are in fact exercised.

6. Where a trustee continues to administer a trust for the benefit of members of a particular family, for example, it will not bring section 160ZZS into application merely because distributions to family members who are beneficiaries are made in such amounts and to such of those beneficiaries as the trustee determines in the exercise of his discretion.

7. In such a case the Commissioner would, in terms of sub-section 160ZZS(1), find it reasonable to assume that for all practical purposes the majority underlying interests in the trust assets have not changed. That is consistent with the role of the section to close potential avenues for avoidance of tax in cases where there is a substantial change in underlying ownership of assets and the legislative guidance contained in Subdivision G of Division 3 of Part III of the Act. On that basis, trust assets acquired by the trustee before 20 September 1985 would remain outside the scope of the capital gains and losses provisions of the Act.

8. On the other hand where, by the exercise of a trustee's discretionary powers to appoint beneficiaries or by amendment of the trust deed, there is in practical effect a change of 50% or more in the underlying interests in the trust assets - such as where the members of a new family are substituted as recipients of distributions from the trust in place of persons who were formerly the object of such distributions - the section would have its intended application as described.