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Preface – Editors' Note

We have taken the unusual step of writing an editorial note for this edition of the *eJTR* because it is a commemorative issue to honour the contribution to Australian tax made by our late colleague John Raneri. John had a passion for tax law that was unmatched, he had an eye for detail that made him stand out amongst practitioners and academics and he was, simply, meticulous in his tax practice and research. As an academic, John was what we sometimes call 'a black letter lawyer'. He had an eye for the technical detail of the legislation that few others have. This skill as well as John's many other qualities are sadly missed at Atax.

The papers that have been chosen for this issue are selected by reason of the interest John would have shown in thei

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Eulogy

Farewell to my fallen friend

JOHN CHARLES RANERI

14 July 1957 – 20 July 2005

by Bob Deutsch

It was in 1990 that I was sitting in my office at the city law firm Mallesons Stephen Jacques overlooking the harbour when I was buzzed by my secretary – "there's a fellow on the phone for you – the name's Raneri, John Raneri and he says he knows

was sure I'd never met him and still he acted like we knew each other well. y thing is - so did I!

less to say with such a formidable Curriculum Vitae we did employ John and we ne the best of friends from that moment on.

certifiably insane (like myself and about a third of today's audience) was a major paper which recognised many complex tax issues in the operation of Australia's international tax rules. Many of the issues John raised were specifically addressed in subsequent legislation that was passed by Parliament.

John then spent three years with Mallesons as a senior tax lawyer before joining us at Atax. Like myself, John had a need to combine his practical work with his passion for teaching. Perhaps this is one of the reasons we understood each other so well.

and I have special memories of a wonderful night sharing religious practices and one filled with much joy, goodwill and laughter.

During the last troubled five years John bore his illness with unbelievable courage and

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Refocusing on Fundamental Principles of Stamp Duty

Bill Cannon and Peter Edmundson*

Abstract
This article refocuses on the fundamental principles of Stamp Duty in the context of the rewrite of stamp duty and tax reform. The article traces the course of these changes through the States in Australia and carefully tracks changes to heads of duty such as lease duty, duty on hire of goods, duty on quoted marketable securities, on business assets etc. The article notes an increasing emphasis on dealings in land and the greater role of land rich duty in the tax base. It examines the constitutional validity of land rich duty as well as flagging the validity of anti-avoidance measures that purport to operate outside of the jurisdiction of a State. The article finally reflects on the pursuit of uniformity amongst the State jurisdictions and expresses

the aim of "the achievement of a new national tax system, including the elimination of a number of existing inefficient taxes which are impeding economic activity".[7]

Under the Intergovernmental Agreement, the States and Territories agreed to abolish stamp duties on quoted marketable securities by 1 July 2001.[8] All jurisdictions have abolished this duty and financial institutions duty (if previously imposed). It was also agreed that the tax, or similar taxes, would not be reintroduced in the future. Obligations in relation to some other heads of stamp duty are more vague. It was agreed that the Ministerial Council, a body formed to oversee the operation of the Intergovernmental Agreement,[9] would:

> by 2005 review the need for retention of stamp duty on non-residential conveyances; leases; mortgages, debentures, bonds and other loan securities; credit arrangements, instalment purchase arrangements and rental arrangements; and on cheques, bills of exchange, promissory notes; and unquoted marketable securities.[10]

The response of various governments to the "review" of these taxes has not been uniform. The Commonwealth has expressed the view that the States and Territories are obliged to abolish these taxes. It has stated:

> The reason for agreeing to a review of these taxes, rather than setting a firm date for their abolition, reflected uncertainty in 1999 about when GST revenue would be sufficient to fund their abolition. It was understood that if GST revenue proved to be sufficient at the time of the review, the states would abolish these stamp duties.[11]

number of the "review" taxes.[16] Finally, following intense and public political pressure,[17] New South Wales announced the removal of a number of the taxes.[18]

Differences in terminology and application of various taxes make generalisations difficult. However, most jurisdictions have abolished or will abolish mortgage duty (see Table 1 below), duty on leases of real property (see Table 2 below), duty in relation to the hire of goods[19] (see Table 3 below), duty on marketable securities that are not quoted on a recognised stock exchange (see Table 4 below), and duty on the conveyance of business assets other than real property (see Table 5 below). The abolition of various taxes on credit arrangements, bills of exchange, cheques and promissory notes has also been announced.[20]

TABLE 1: CHANGES TO MORTGAGE DUTY

JURISDICTION	CHANGES
NSW	Mortgage duty will be phased out by being reduced by 50% from 1 January 20010 with complete abolition from 1 January 2011: see New South Wales, *Budget Paper No 2 Budget Statement 2006-07*

TABLE 2: CHANGES TO LEASE DUTY

JURISDICTION	**CHANGES**
NSW	Lease duty will be abolished from 1 January 2008: New South Wales, *Budget Paper No 2 Budget Statement 2006-07*, p 8-17.
VIC	Abolished from 26 April 2001: *State Taxation Acts (Taxation Reform Implementation) Act 2001*

TABLE 4: CHANGES TO DUTY ON UNQUOTED MARKETABLE SECURITIES

JURISDICTION	**CHANGES**
NSW	To be abolished on 1 January 2009: New South Wales, *Budget Paper No 2 Budget Statement 2006-07*, p 8-17.
VIC	Abolished from July 2002: *Duties Act 2000* (Vic) s7 (3A).
QLD	To be abolished from 1 January 2007: see Queensland Government, *State Budget 2005-06 Budget Strategy and Outlook Budget Paper No 2*, p81.
WA	Duty on unquoted shares was abolished from 1 January 2004.
SA	To be halved by 1 July 2009 with complete abolition on 1 July 2010: see RevenueSA, *Stamp Duties Circular No 255: State Budget 2005-2006.*
TAS	Duty on marketable securities was abolished on 1 July 2002: *Revenue Legislation (Miscellaneous Amendments) Act 2002* (Tas) s5.
ACT	To be abolished by 1 July 2010: Australian Capital Territory, *2005-06 Budget Paper No. 3: Overview,* p81.
NT	Abolished from 1 July 2006. Northern Territory, *Fiscal and Economic Outlook 2005-06 Budget Paper No.2*, p64.

TABLE 5: CHANGES TO DUTY ON SALE OF BUSINESS ASSETS (OTHER THAN REAL PROPERTY)

JURISDICTION	**CHANGES**
NSW	Duty to be abolished on 1 July 2012: New South Wales, *Budget Paper No 2 Budget Statement 2006-07*, p 8-17.
VIC	Duty not charged on business assets (although attempts have been made to build the value of goodwill into the value of real property).
QLD	Duty to be reduced by 50% on 1 January 2010 and removed completely on 1 January 2011: see Queensland Government, *State Budget 2005-06 Budget Strategy and Outlook Budget Paper No 2*, p81.

subject to the existence of a sufficient territorial nexus with the law-making jurisdiction.[28] The operation of this requirement is described in the context of taxation in *Broken Hill South Ltd v Commissioner of Taxation (NSW)* (1937) 56 CLR 337 where it is stated (at 375):

> The power to make laws for the peace, order and good government of a State does not enable the State Parliament to impose by reference to some act, matter or thing occurring outside the State a liability upon a person unconnected with the State whether by domicile, residence or otherwise. But it is within the competence of the State legislature to make any fact, circumstance, occurrence or thing in or connected with the territory the occasion of the imposition upon any person concerned therein of a liability to taxation or of any other liability. It is also within the competence of the legislature to base the imposition of liability on no more than the relation of the person to the territory. The relation may consist in presence within the territory, residence, domicile, carrying on business there, or even remoter connections.

When applying the limitation in the context of taxation it is important to recognise that not only must there be some form of territorial nexus, but the matter that forms the basis of this nexus must be relevant to the imposition of the tax.[29] Questions of degree may be relevant in finding a sufficient nexus but, once a sufficient nexus is found, the legislature is not limited in its powers to an exercise of power that is proportionate to the degree of such nexus.[30]

The refocus of stamp duties on dealings involving real property invites a few comments on these principles. Clearly, if a State or Territory imposes duty on the transfer or conveyance of land in that State or Territory, there will be sufficient territorial nexus.[31] This will be the case regardless of the place of residence of the vendor or purchaser. However, in relation to less direct dealings involving land the matter is far from clear. The most serious constitutional difficulties arise in the context of "land-rich duty" such as that imposed under Chapter 4A of the *Duties Act 1997* (NSW).

In general terms, land rich duty is imposed on the transfer of shares in an unlisted company that holds land (whether directly or through intermediate entities). It may also be imposed on the transfer of units of a unit trust where land is held on trust. Thresholds may apply in respect of both the extent of the interest held or transferred[32] and the extent of real property held by the company or trustee (in its capacity as trustee of the relevant unit trust).[33] Duty is payable not on the value of the share or unit transferred, but based on a proportion of the unencumbered value of the land holdings

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comments of the High Court in *Union Steamship Company of Australia Pty Limited v King* (1988) 166 CLR 1 at 14.

[28] *Broken Hill South Ltd v Commissioner of Taxation (NSW)* (1937) 56 CLR 337 at 375; *Union Steamship Company of Australia Pty Limited v King* (1988) 166 CLR 1 at 14. It may be that this territorial limitation stems from the description of the States' and Territories' powers or it may flow from "the federal structure of which each State is a part": *Mobil Oil Australia Pty Limited v Victoria* (2002) 211 CLR 1 at 34.

[29] *Broken Hill South Ltd v Commissioner of Taxation (NSW)* (1937) 56 CLR 337 at 375.

[30] Ibid.

[31] See *Johnson v CSD* [1956] AC 331 at 352.

[32] See, for example, the definition of "significant interests" in the *Duties Act 1997* (NSW) s163D.

[33] See, for example, the definition of "land rich" in the *Duties Act 1997* (NSW) s163B.

of the company or trustee.[34] The tax was introduced as an "anti-avoidance" measure[35] to prevent the minimisation of duty by the sale of land-holding entities rather than the land itself.[36]

Land rich duty is not inherently problematic in relation to territorial nexus. However, there are potential difficulties where a State or Territory seeks to impose duty on the sale of shares in a land-holding company where the company was not incorporated in the taxing jurisdiction and neither transferor nor transferee has a connection with that jurisdiction. The holding of property in a jurisdiction clearly provides sufficient territorial nexus to tax the property holder on a dealing with an interest in that property. However, in the situation contemplated, the person being taxed (the

It was held by Rich, Dixon and McTiernan JJ that the provision went beyond the powers of the New South Wales legislature.[41] In a separate judgment Starke J agreed with this conclusion.[42] The majority stated that the provision in question:

> assumes to tax the share as property out of the jurisdiction, but does so because of the existence of the company's business within the jurisdiction. In doing so, it adopts a connection which is too remote to entitle its enactment to the description a law 'for the peace, welfare, and good government of New South Wales'.[43]

By analogy it could be argued that land-rich duty provisions may go beyond the capacity of the States and Territories to tax. Indeed, this has been described by Hill as "quite a respectable argument".[44] Before any firmer conclusion could be drawn on the issue it is worth considering three further matters.

First, and probably of least significance overall, the decision in *Millar* was not unanimous. In a joint, dissenting judgment Gavan Duffy CJ and Evatt J found that there was a sufficient territorial nexus to support the legislation.[45] Second, there are some differences between land rich duty and the tax considered in *Millar*. In *Millar*, the legislature sought to impose tax on the full value of the share. However, the various land-rich regimes impose duty based on a value that represents a proportion of the value of land held. In *Millar*, Rich, Dixon and McTiernan JJ stated:

> Let it be assumed that, in so far as the shareholder obtains an actual advantage from the possession by the company of property in New South Wales, that advantage may be taxed by the State. It may be the case that the Legislature can disregard the legal character of the relation between the

well outside tax, and in many instances has been in obiter, it is stated by the High Court:

> The requirement for a relevant connexion between the circumstances on which the legislation operates and the State should be liberally applied and… even a remote and general connexion between the subject-matter of the legislation and the State will suffice.[49]

These comments have been reinforced in the recent High Court case of *Mobil Oil Australia Pty Limited v Victoria*.[50]. Justice Kirby has stated that the High Court in the 20th century "adopted rules of growing ambit" in relation to the States' powers to legislate with extra-territorial effect[51] and that it would be rare to succeed in a challenge of a State or Territory's law-making power on this basis.[52] However, it is clear that the difficult question of whether there is a sufficient "real connection" remains.[53]

The validity of land rich duty is not put beyond doubt by *Millar*. It may be that the High Court would hold that the measures are constitutional because the valuation for taxation purposes based on land in the taxing jurisdiction provides a sufficiently "real connection". However, the matter is far from settled and ripe for litigation. In particular, there must be questions about the validity of the provisions where the putative land rich entity has no real interest in land in a particular state but is merely the object of a discretionary trust. In such a situation the entity may be deemed to own the land entirely despite having no real interest in it.[54] This would seem to divorce further the subject matter of land rich duty and the connection with a particular State or Territory.

If it is found that the provisions are not valid in certain contexts, then this raises the possibility of structuring acquisitions in a manner that may avoid land rich duty. In turn, this raises the difficult issue of the scope of an individual jurisdiction's anti-avoidance measures (if any) to apply to activities deliberately undertaken outside the jurisdiction in order to avoid duty.

ANTI AVOIDANCE PROVISIONS IN STAMP DUTY LEGISLATION

As noted by the late Justice Graham Hill in a paper titled "Countering Avoidance of Stamp Duty" presented by His Honour at the Fifth Annual State's Taxation Conference conducted by the Taxation Institute of Australia:[55]

> Of the various state taxes enacted in Australia perhaps the most Tc( )ta.8(papr5(e))6..9(f)-in (ac0.3303 0)-4.

> tax, and because it largely piggy-backs upon the group tax provisions of the income tax law, avoidance is somewhat easier to detect than avoidance in stamp duty…
>
> There is an initial difficulty in defining what is meant by avoidance in the field of stamp duty. Perhaps that is why it has not been uniform throughout Australia for state legislatures to adopt general anti-avoidance provisions. Two examples suffice.
>
> Traditionally, stamp duty has been a tax on instruments and not transactions although this principle has been much eroded over the past fifty years. It is a corollary of the principle that if a transaction could be carried out without an instrument, no duty would be payable. It is a nice point whether it would have been stamp duty avoidance not to document a transaction so that no liability to duty would arise.

His Honour goes on to note that the various state Parliaments thought such an arrangement did involve avoidance when brewery interests worth many millions of dollars were sold in this manner, resulting in amendments to the legislation to ensure that similar transactions were brought to duty notwithstanding that no dutiable instrument is brought into existence.

Notwithstanding the expansion of the ambit of stamp duty legislation to require tax to be paid on some transactions as well as instruments, the tax remained a stamp duty as transactions are generally taxed by the imposition of an obligation to make out and lodge for stamping a return which generally is deemed to be the instrument effecting the transaction.

The second example given by His Honour relate

Transactions which could potentially reduce the value of land being transferred for example would include: the grant of an option where the option exercise price is low compared to the value of the land; the grant of a long term lease at a premium with less than market value rent payable over the term; and the grant of a life interest. However, it is arguable that in each case as the rights of the lessee, holder of the life interest or option holder (assuming the option is specifically enforceable) would constitute interests in land, the existence of the option, lease or life interest would not be said to be made "in respect of the dutiable property" being the reversion, remainder interest or property the subject of the option. However, as the section and similar predecessor sections were introduced to specifically cover these types of arrangements, it seems that the section would operate in these cases unless the Commissioner is satisfied in terms of subsections (2) and (3).[56]

Another specific anti-avoidance provision inserted in Duties legislation is designed to counter splitting of transactions to prevent advantage being taken of lower rates of duty applying to transactions having lower values or to reduce the transaction value below the threshold for imposition of duty.[57] Similar provisions exist allowing aggregation of acquisitions of interests in land rich entities, not only by related entities but, for example in New South Wales, also by persons who acquire interests under transactions that:

> together form, evidence, give effect to or arise from what is substantially one arrangement between the acquirers…[58]

Despite the expansion of the scope of application of stamp duty legislation to require duty to be paid on transactions as well as instruments and, despite specific amendments being introduced to counter perceived avoidance of duty, taxpayers

(a) the transaction (and steps making it up) is pre-ordained; and

(b) the interposed steps have no commercial purpose but rather, can be regarded as having been interposed solely for the purpose of minimising tax (which would have been payable if such steps had not been interposed.)

The doctrine of fiscal nullity has been applied to stamp duty cases in both the United Kingdom,[60] and Hong Kong.[61]

In a number of Australian cases, the High Court[62] and the Western Australian Supreme Court[63] have considered whether the doctrine should be applied to the facts before them. Each decided that it should not. In *Ashwick (Vic) (No 4) Pty Limited v Comptroller of Stamps (Vic)*[64] the High Court did not however rule out the possible application of fiscal nullity to Australian stamp duties in the future should an appropriate transaction arise.

It is likely that specific anti-avoidance measures such as aggregation provisions and mechanisms designed to prevent the manipulation of dutiable value will continue to have a role to play in reinforcing duty on dealings in land. It is also likely that despite such specific provisions there will be perceived need for general anti-avoidance mechanisms. In jurisdictions with a general anti-avoidance rule it is unlikely that fiscal nullity will have a role to play. However, in other jurisdictions the possibility of the acceptance of the doctrine should not be ignored.

H

right to so tax the transaction (or part of it.) It also suggests that changes to stamp duties have distracted from any significant effort in the pursuit of uniformity between the States and Territories. The narrowing of

The Promoter Penalty Provisions

The objects of the Promoter Penalty Provisions are set out in Section 290-5. It provides that:

> The objects of this Division are:
>
> (a) to deter the promotion of tax avoidance *schemes and tax evasion schemes; and
>
> (b) to deter the implementation of schemes that have been promoted on the basis of conformity with a *product ruling in a way that is materially different from that described in the product ruling.

A number of the concerns that were expressed with respect to the original proposal have been addressed. Those that have not studied the Promoter Penalty Provisions

Long has it been necessary to differentiate between tax avoidance and tax evasion. Often drawing the line between the two has been difficult even if the difference is accepted as being the legality or otherwise of the arrangement. Frequently the boundary between avoidance and evasion has been in the eye of the beholder. The Promoter Penalty Provisions introduce the new concept of "*a*tax exploitation scheme*". It is to those who promote "**tax exploitation schemes*" that the Promoter Penalty Provisions are directed.

Definition

A "**tax exploitation scheme*" is defined in Section 290-65. It provides that:

> **290-65 Meaning of tax exploitation scheme**
>
> (1) A *scheme is a **tax exploitation scheme** if, at the time of the conduct mentioned in subsection 290-50(1):
>
> (a) one of the conditions is satisfied:
>
> (i) if the scheme has been implemented – it is reasonable to conclude that an entity that (alone or with others) entered into or carried out the scheme did so with the sole or dominant purpose of that entity or another entity getting a *scheme benefit from the scheme;
>
> (ii) if the scheme has not been implemented – it is reasonable to conclude that, if any entity (alone or with others) had entered into or carried out the scheme, it would have done so with the sole or dominant purpose of that entity or another entity getting a scheme benefit from the scheme; and
>
> (b) one of these conditions is satisfied:
>
> (i) if the scheme has been implemented – it is not *reasonably arguable that the scheme benefit is available at law;
>
> (ii) if the scheme has not been implemented – it is not reasonably arguable that the scheme benefit would be available at law if the scheme were implemented
>
> Note: The condition in paragraph (b) would not be satisfied if the implementation of the scheme for all participants were in accordance with binding advice given by or on behalf of the Commissioner of Taxation (for example, if that implementation were in accordance with a public ruling under this Act, or all participants had private rulings under this Act and that implementation were in accordance with those rulings).
>
> (2) In deciding whether it is *reasonably arguable that a *scheme benefit would be available at law, take into account any thing that the Commissioner can do under a *taxation law.
>
> Example: The Commissioner may cancel a tax benefit obtained by a taxpayer in connection with a scheme under Section 177F of the Income Tax Assessment Act 1936.

There should be no problem in identifying a "*

different conclusions in *Hart's Case*. Particularly is this so given the roles played by Gleeson CJ and the late Hill J in the development of Part IVA.[3]

Presumably the "*sole or dominant purpose*" requirement is the same as that in Part IVA. That is purpose will be a matter of objective determination rather than the subjective motives of the promoter. However the EM at paragraph 3.55 refers to the penalty provisions in the TAA 1953 rather than Part IVA. It states that:

> The purpose tests in paragraph 290-65(1)(a) is modelled on the tests that apply to taxpayers in the scheme penalty provisions in subsection 284-145(1) of Schedule 1 to the TAA 1953.

For there to be a "**tax exploitation scheme*" there must be a purpose of "*getting a* scheme benefit from the *scheme*"**. "***Scheme benefit*" is defined in Section 284-150(1). It provides that:

> An entity gets a "**scheme benefit**" from a *scheme if:
>
> (a) a *tax-related liability of the entity for an accounting period is, or could reasonably be expected to be, less than it would be apart from the scheme or a part of the scheme;

It may be reasonable to conclude that by the time the Promoter Penalty Provisions have come into play it will be clear that there is a "**scheme*". Also it may be clear that there is "*a *scheme benefit*

> with a cattle breeding project involving a number of companies associated with an accountant …

In *Vincent's Case* the Full Federal Court went on to note at 4645 that:

> … there was a critical finding of fact made by the learned primary Judge that Ms Vincent was not carrying on a business

and then held at 4758 that:

> In our view once the conclusion is reached that Ms Vincent did not carry on a business it followed that the costs that were necessarily incurred to produce the six calves promised was an outgoing of capital and simply not deductible.

Was there a reasonable prospect of success in obtaining the tax deductions promised from the cattle breeding project in which Ms Vincent participated? If so, then such a project now would have the potential to come within the Promoter Penalty Regime. However if the inept way that the project was implemented meant that there was no reasonable prospect of there being a reduction to Ms Vincent's tax liability it would appear that the Promoter Penalty Regime would not apply to such a "*scheme*".

The apparent requirement of a reasonable prospect for success in reducing a tax liability is considered further at paragraphs 2.19 and 2.20 as far as tax avoidance schemes are concerned.

As with Part IVA, under the Promoter Penalty Provisions it may be less clear that the "*sole or dominant purpose*" was to obtain the "**scheme benefit*". However even if that can be demonstrated there is a further condition to be satisfied before the Promoter Penalty Regime will apply.

Not reasonably arguable

Under Section 290-65(2)(b) the Promoter Penalty Provisions will not apply unless "*it is not *reasonably arguable that the scheme benefit is available at law*". The Un6.4(ti1.8( )98e)-4 0.8( )5.82(i)-2..5( )5.8 eSew1ond

(d) A *public ruling.

A cynical view of the ATO interpretation of what constitutes "**reasonably arguable*" might be summed up as "*you would not be facing promoter penalties if what you had done was reasonably arguable*". However a more measured view of what constitutes "*reasonably arguable*" is set out in Taxation Ruling TR 94/5.

arguable would depend on its relative strength when compared with the Commissioner's and other possible treatments. In other words, taxpayers should take particular note of the Commissioner's views on the correct operation of the law as expressed in a Public Ruling, but may adopt alternative treatments provided there are sound reasons for doing so;

been met and to have the Commissioner's decision on the objection reviewed by the AAT or the Federal Court;

(i) a taxpayer will only be liable for penalty for not having a reasonably arguable position where the shortfall caused by the position taken is greater than the higher of $10,000 or 1% of the tax that would have been payable on the basis of the taxpayer's return;

Also it should be noted that in considering whether for the purpose of Section 290-65(2) it is "**reasonably arguable that a *scheme benefit would be available at law*", it is necessary to consider whether such a benefit could be cancelled by the Commissioner by applying Part IVA. This is stated specifically in the Example in Section 290-65(2).

Nugatory legislation?

If paragraph 2.6 correctly states the Section 284(150)(1) requirement that the "*scheme*" must have a reasonable prospect for success, how does this fit with the Section 290-65(2)(b) exclusion if the position taken in a "*scheme*" is "**reasonably arguable*". Does it render the Promoter Penalty Regime nugatory? Alternatively will the Promoter Penalty Regime apply only when the reasonable prospect for success falls short of "*reasonably arguable*"? If so, it may leave a very narrow band of operation.

If and when the Promoter Penalty Regime falls for consideration by the Federal Court there is the intriguing prospect of Counsel arguing that it was "*reasonably to be expected*" that the scheme would reduce the tax liability but that the position taken by the scheme was not "**reasonably arguable*". This might require the use of doublethink. George Orwell defined doublethink as:

> … the power of holding two contradictory beliefs in one's mind simultaneously, and accepting both of them.[4]

On reflection that is the daily currency of Counsel.

Potential application of Part IVA

Of some concern is an implication in the EM that there needs to be a judicial split decision on Part IVA with respect to the relevant scheme for it to have been

of a "**tax exploitation scheme*" requires consideration of what was "**reasonably arguable*" "*at the time of the conduct*" of the "**promoter*".

Indeed determining what is "**reasonably arguable*" by reference to subsequent events, is contrary to what is stated in the opening sentence in paragraph 3.66 of the EM. It states that:

> When examining what is reasonably arguable **at the time of the promoter's conduct**, the Federal Court may take into account anything that the

(c) having regard to all relevant matters, it is reasonable to conclude that the entity has had a substantial role in respect of that marketing or encouragement.

(2) However, an entity is not a **promoter** of a *tax exploitation scheme merely because the entity provides advice about the *scheme.

(3) An employee is not to be taken to have had a substantial role in respect of that marketing or encouragement merely because the employee distributes information or material prepared by another entity.

It should be noted that to be a "**promoter*" there has to be marketing or encouragement of the "**scheme*" which potentially generates income. Moreover the role of the marketing and encouragement has to be "*substantial*".

Leaving aside for the moment the specific exclusion in Section 290-60(2) for providing tax advice, paragraph 3.44 of the EM seeks to differentiate between a "**promoter*" and a professional adviser. It states that:

> Scheme promoters generally undertake promotional activities to earn higher financial rewards than would be available for providing independent and objective tax advice. Those scheme profits constitute consideration received from the marketing or encouragement of a tax exploitation scheme and help to establish that any entity is a promoter.

At this point most tax practitioners may well feel that it is crystal clear that they fall outside the definition of a "**promoter*" and hence that they need have no further concern about the potential application of the Promoter Penalty Provisions to their activities. Consideration below of the exclusion with respect to the provision of tax advice suggests that it may not be quite so clear cut.

Tax advice exclusion

Section 290-60(2) excludes from the definition of "**promoter*" situations where an "*entity provides tax advice about the scheme*". This would appear to be making explicit what paragraph 3.44 of the EM quoted above suggests is implicit in the basic definition of "**promoter*".

The tax advice exclusion is explained in the EM as follows:

3.49 An entity is not a promoter merely because they provide advice about the scheme. As a result, financial planners, tax agents, accountants, legal practitioners and others are not promoters merely because they provide advice about a tax exploitation scheme, even if that advice provides alternative ways to structure a transaction, or sets out the tax risks of the alternatives. [Schedule 3, item 1, subsection 290-60(2)]

3.50 The civil penalty regime is not intended to inhibit the provision of independent and objective tax advice, including advice regarding tax planning. Advisers who advise on tax planning arrangements, even those who advise favourably on a scheme later found to be a tax exploitation scheme, are not at risk of civil penalty to the extent that they have merely provided independent, objective advice to clients.

The comfort to be gleaned from the statements in paragraphs 3.49 and 3.50 of the EM may be illusory. This is because Section 290-60(2) requires advice to be given "*about the *scheme*". It would appear that there has to be a pre existing scheme with respect to which the tax professional is requested to opine on its efficacy. Indeed paragraph 3.49 of the EM repeats the statutory requirement that the provision of advice be

"*about the scheme*". The Section 290-60(2) exclusion does not appear to extend to advice given which includes the development of "*the scheme*".

The conclusion which can be drawn is that proactive advice to a client may be regarded as promoting a "**tax exploitation scheme*". Indeed Example 3.1 in paragraph 3.50 of the EM suggests that is the case. It is that:

> **Example 3.1: When are tax advisers at risk of being promoters?**
>
> A partner (Graeme) in a major accounting firm approaches a high wealth client (Matthew) to advise him on an arrangement to minimise his tax liability by moving taxable income to an offshore tax haven.
>
> The tax haven arrangement was initially developed by another partner (Brett) for another of the firm's clients and the firm decided it should offer similar arrangements to other clients in similar circumstances.
>
> Brett receives a fixed percentage of the fee obtained by other accountants in

company or a trust, perhaps even involving a superannuation fund. Also there may be options about the level of gearing etc. Does the advice regarding the appropriate structure to be used, level of gearing etc fall within the exclusion? It might be thought that it does. As is set out in paragraph 3.49 of the EM, advisers:

> *are not promoters merely because they provide advice about a tax exploitation scheme, even if that advice provides* ***alternative*** *ways to structure a transaction* (emphasis added).

Unfortunately, as noted above, Section 290-60(2) and the EM are dealing with a pre existing "**scheme*" not the development of a "**scheme*".

Perhaps if a client states that they are proposing to buy the business personally the adviser will not be a "**promoter*" if they suggest that instead the acquisition should be made by a trust. Maybe. Even so that may not mean that the Promoter Penalty Regime could not impinge upon what may be regarded within the tax profession as normal advice.

Where will the tax adviser stand if they achieve what is often discussed, and seldom

Where does that leave the diligent proactive tax partner? Clearly he has a potential conflict of interest and may no longer be able to act for the client. The ATO auditor may regard that as a satisfactory outcome. The diligent proactive tax partner and his client may not. Indeed outside the ATO it may not be an anticipated outcome of introducing the Promoter Penalty Regime. Hopefully it is not an intended potential outcome.

In "*A New Relationship with the tax profession*" the new Commissioner, Michael D'Ascenzo, made some comments about the application of the Promoter Penalty Regime. He said:

> The promoter penalty legislation is aimed at eliminating unscrupulous operators who peddle unsustainable arrangements to the detriment of both the taxpayers and ethical advisers.
>
> However, in achieving this objective we need to ensure that it does not unduly impact in an unintended way.
>
> Accordingly, the ATO is committed to work with the NTLG to ensure that in practice this does not occur.
>
> Even in the formative stage of this measure, we have agreed to co-design some important aspects of the administration of the measure, including the types of cases that should come under ATO focus and the governance

(4) The Commissioner must not make an application under section 290-50 in relation to an entity's involvement in a *tax exploitation scheme more than 4 years after the entity last engaged in conduct that resulted in the entity or another entity being a *promoter of the tax exploitation scheme.

(5) The Commissioner must not make an application under section 290-50 in relation to an entity's involvement in a *scheme that has been promoted on the basis of conformity with a *product ruling more than 4 years after the entity last engaged in conduct in relation to implementation of the scheme.

(6) However, the limitation in subsection (4) or (5) does not apply to a *scheme involving tax evasion.

- Recommendations 9.1 and 9.2 - prescribing an accruals basis for financial assets and liabilities, with a mark-to-market election.[7]

The government has broadly followed this division of topic areas, with legislation being developed in three tranches. Legislation dealing with the demarcation between debt and equity was introduced in the first tranch,[8] with these provisions being classification provisions not dealing with the consequences of the distinction between a debt and equity instrument. In the second tranch, provisions were enacted to deal with foreign currency transactions,[9] providing conversion rules and taxation treatment for gains and losses on foreign currency.

The remaining areas awaiting legislation involved hedging and taxation of gains and losses on financial arrangements and, while these areas were to be initially dealt with separately, they have now been combined and constitute the third arm of the legislative regime, encapsulated in TOFA 3 & 4. The Exposure Draft of the proposed provisions was publicly released in December 2005 and it is this Exposure Draft which is the subject of examination in this analysis.

The analysis in the paper examines the scope of the regime and aspects of the tax calculat Tw[(pe)-5e

to be incurred a liability must be "... presently incurred and due though not yet discharged."[15] In the view of the court, the "… critical question is whether, within the

on the Australian tax base, would again be outside the realm of influence of Australian legislative authorities.

Ultimately these latter concerns would appear to have prevailed, as the TOFA 3 & 4 draft provisions create a separate legislative regime, albeit one which does have some interaction and harmonisation with the accounting standards.

Principles based drafting

A notable feature of the Exposure Draft legislation is the appearance of yet another drafting style in taxation legislation. Current legislation is replete with examples of changes in drafting style, from very prescriptive and narrow black-letter law drafting, to the broad all-encompassing approach evident in some of the anti-avoidance provisions.

encompassed in the provision of finance and shifting of risk did not necessarily emanate from contracts.[35] While recognising that a financial arrangement for tax purposes would typically be constituted by a contract, the wider tax definition reflected a concern that a contractual basis would not be sufficient to mirror the substance of arrangements in all circumstances.[36] A further argument raised against adopting the accounting definition arose from the non-comprehensive coverage of the accounting standards, with not all entities being required to prepare accounts based on the AIFRS standards.[37]

In addition to the differences with accounting, a further contrast may be drawn between different treatment within the tax provisions themselves. In particular a contrast may be identified between the scope of the TOFA proposals and the scope of existing legislative provisions dealing with financing arrangements. In the first tranch of the TOFA provisions, dealing with the debt/equity classification, the test for a debt

other taxation provisions. The rationale appears to be to ensure that arrangements developed in the future would still be encompassed within this broad definition.

The inherent difficulty with the approach taken of defining financial arrangements widely, and then providing specific exclusions from the regime, is that unless there is a specific legislative exclusion provided, an arrangement is caught regardless of whether this had been the intention. The burden is thus created for ongoing legislative amendments to provide for additional carve-outs as these are identified.

A number of specific exclusions are identified in the Exposure Draft, although many of these remain ill-defined and it is expected that there will be further development in relation to the exclusions. Exceptions from financial arrangements are provided in the Exposure Draft for:

- non-derivates held for longer than 12 months where the consideration is not money or money equivalent;[45]
- individuals, or entities with turnover less than $20,000,000, where the financial arrangement is for not more than 12 months and the implicit interest rate does not differ by more than 1.5% from the actual rate;[46]
- equity interests;[47]
- interests in partnerships or trusts;[48]
- life insurance policies;[49]
-

- determining the quantum of the gain or loss to be recognised, this determination being a function of the timing.

Under the proposals, these issues are related in that both the timing of recognition and the calculation of the gain or loss to be recognised will broadly be functions of the methodology adopted. The proposals offer a number of methodologies, depending on certain conditions being satisfied, with the methods potentially available being:

- a realisation basis;
- an accruals basis;
- an elective fair value method;
- an elective retranslation method; and
- an elective hedge accounting method.

It is not intended that these different recognition models would all be available in all circumstances, so taxpayers are not being offered an unfettered freedom to choose any particular method. Also, the methods would not be mutually exclusive as, in particular circumstances, there may be two or more of the methods applying to a single financial arrangement either at any particular time, or over the life of the financial arrangement.

In addition to these methodologies, there is a discretion for the Commissioner to allow for the use of financial accounting records for tax purposes where threshold conditions are met.

If none of the elective methods has been chosen then recognition of gains and losses will be on a realisation and/or accruals basis.

The conditions for, and operation of, each of the methodologies is outlined below.

REALISATION BASIS

Realisation of a financial arrangement occurs when the whole or part of the financial arrangement ceases to be held, or something of economic value is received or provided, or the time for this occurs.[62] There may be a disposal, or ceasing to hold, a financial arrangement either through the expiry of rights or obligations, the transfer of rights or obligations, or the assignment of rights or obligations. If there is an expiry, transfer or assignment of part of a financial arrangement this would constitute a part disposal.

The realisation method is intended to have operation both as a fall-back when other methods are not applicable and as a residual method when another method had applied to the financial arrangement.

The realisation basis would be seen as the base method to apply in recognising gains and losses from a financial arrangement when none of the other methods would be appropriate. This would be the case, for example, with a cash basis taxpayer who had not made an election for an alternative method and was not required to account on an accruals basis. If no gain or loss had been previously recognised on the financial arrangement, the quantum of the gain or loss on realisation would be the total gain or

[62] Proposed s 230-25 item 4.

loss on the financial arrangement. This would be the case if there had been no prior accruals recognition of a gain or lo

gain (loss) would be reasonably certain. If the probability of a gain (loss) was relatively low, the gain (loss) would not be reasonably likely and the realisation basis would apply.

The difficulty with this explanation is that the reasonably likely test is explained in terms of a 'relatively certain' return or a 'relatively low probability', with these terms themselves lacking the precision and certainty required if taxpayers are to have a clear understanding of when the accruals basis is to apply. While it may be difficult to provide this certainty by way of a prescribed

Conditions for the fair value election to be available are designed to ensure the integrity of the accounting information on which the tax gain or loss will be based. These conditions requiring:[73]

- the accounts for the income year must be audited under the requirements of Chap 2M of the *Corporations Act*, or a foreign equivalent; and
- the financial asset or liability must be required to be classified in the accounts as at fair value through profit and loss, this requirement arising from application of AASB 139, or a foreign equivalent accounting standard.[74]

If the financial instrument for accounting purposes comprises the whole of the financial arrangement for tax purposes, then the fair value election will apply to the whole of the financial arrangement and no other tax-timing mechanism will apply. However if the financial instrument for accounting purposes does not comprise the whole financial arrangement for tax purposes, then the fair value election applies to

instruments without a quoted price in an active market or whose fair value cannot be reliably measured.

In determining fair value for tax purposes no definition is provided, with the suggestion[76] being that reliance may be placed on the definition and guidance in AASB 139, which defines fair value in terms of the amount for exchange or settlement between knowledgeable willing parties in an arm's length transaction.[77]

RETRANSLATION ELECTION

A further elective method is available[78] in relation to foreign exchange retranslation, the intention again being to align the tax treatment of gains and losses from rate changes on foreign exchange with the accounting treatment for these amounts. The election is restricted in its scope to foreign currency gains and losses arising from exchange rate movements and is thus different to the fair value election which would recognise gains and losses attributable to all variables. Because this election applies only to exchange mall tn-ttshs

which are recognised in profit and loss, the exchange component of gains or losses will also be recognised in profit and loss. For non-monetary items recognised in equity and monetary items forming part of a net investment in a foreign operation, the currency gain or loss will be recognised in equity and for these cases the taxation retranslation election would not be available.

HEDGING ELECTION

As noted earlier in the discussion, the definition of financial arrangements for tax purposes is designed to capture not only arrangements for the provision of finance, but also arrangements dealing with the shifting and allocation of risk, as occurs under hedging arrangements. While bringing hedging within the regime, the proposals do allow for an elective method[80]

A derivative financial arrangement is itself a defined term, being a financial arrangement whose value changes in response to a specified variable and where there is generally no requirement for a net investment.[85]

This definition of a derivative aligns with the accounting definition. To be classified as a hedging instrument under accounting standard AASB 139 the instrument must be a designated derivative or designated non-derivative financial asset or liability whose fair value or cash flows are expected to offset changes in fair value or cash flows of a designated hedged item. The standard defines a derivative as being a financial instrument:[86]

- whose value changes in response to changes in some other variable, such as interest rates, commodity prices, foreign exchange rates, or other variable;
- which requires no initial net investment; and
- which is settled at a future time.

As becomes apparent from these tax and accounting definitions, the defined meaning for tax purposes appears to effectively reproduce the accounting definition, the requirements of which must also be met for the financial arrangement to be a derivative financial arrangement. While this may appear as an unnecessary duplication, it is understandable in terms of Treasury's concern not to compromise the integrity of the tax system or the tax base, while simultaneously creating some harmony between tax and accounting. Becoming reliant on accounting rules that are not part of the statutory regime and which may be subject to subsequent interpretation or amendment by outside organisations, may be seen as potentially jeopardising the integrity of the tax regime.

For the tax hedging election to be available there is an additional requirement that the taxpayer record details of the hedge, the required details describing the hedging financial arrangement, the purpose of the hedge and nature of the risk being hedged, the hedged item and details of how the effectiveness of the hedge will be assessed.[87] In relation to the effectiveness of the hedge, the proposals require that:[88]

- the hedging of the risk must be expected to be highly effective;
- the forecast risk must be highly probable;
- the market values of both the hedged item and the hedging financial arrangement must be able to be reliably measured; and
-

discretion to accept the use of financial accounts for some tax purposes. As explained in the Explanatory Material, the purpose behind the discretion is to provide enhanced flexibility and lower compliance and administration costs, by allowing the use of financial accounts rather than recalculating gains and losses under disparate tax rules.[93] Because the discretion is granting the taxpayer a concession, exercise of the discretion requires satisfying a number of conditions, which include:[94]

- financial records audited under Chap 2M of the *Corporations Act*, of a foreign equivalent;
- the fair value election and retranslation election must apply in relation to the financial statements; and
- the hedging election must apply.

Additionally the Commissioner must be satisfied that there is not a substantial difference between the accounting calculation and the tax calculation that would otherwise apply in determining the gain or loss on the financial arrangement.

The provision for the Commissioner to be able to accept the accounting formulation as representative of the tax position must be welcomed, although there are concerns that arise in relation to the discretion.

The proposal suggests that in determining to exercise the discretion the Commissioner should have regard to factors such as the cost of complying with and of administering, the provisions and any other relevant matter. While it is appreciated that a definitive list of factors to consider may not be feasible, it may have been seen as more helpful if the provision could have identified the range of factors to which the Commissioner should have regard in considering the exercise of the discretion. Such a specification

CONCLUDING REMARKS

It is understandable that the revenue authorities would be reluctant to link tax outcomes automatically to accounting outcomes in relation to taxing financial arrangements. As noted in the Explanatory Material, this reluctance reflects, in part, the different objectives and functions of

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Testamentary Trusts: Not Just "Another" Trust?

Arlene Macdonald*

Abstract
This article examines the use of testamentary trusts and the implications of the taxation of trust rules for such trusts. It looks at the advantages and disadvantages of creating a testamentary trust in the Will as distinct from leaving property to existing inter vivos trusts and deals with the rule against the delegation of testamentary power still existing in some States. It identifies difficulties associated with planning and amending such trusts. It identifies difficulties that may result in a new trust being created and identifies Capital Gains Tax issues arising from cloning or splitting trusts. The article also considers what it terms "after death trusts" and Capital Gains Tax issues arising fr
with many aspects peculiar to testamentary trusts that do not apply to trusts inter vivos.

INTRODUCTION

There was a young lad named Bill
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wandering too far from the central topic into other fascinating and linked topics
with death and trusts and tax or some combination of all three.

There is no need to leave property to a trustee to hold that property on trust for
more beneficiaries, the true recipients of your largesse. Where the choice is m
leave property in trust, that trust can be created in the Will, with the gift bei
settled property or it can be left to a trustee of an existing trust which will alread
other property (at least the settled sum).

Testamentary trusts have many uses but that doesn't mean they are always a
thing. Where the trust is properly created with trustworthy appointors and tru
including successors - carefully chosen, a testamentary trust allows flexibi
directing financial resources to those most in need (such as vulnerable adult chi

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or withholding those resources where they would be at risk to creditors, ex-spouses, and wastage by those children and grandchldren who think money is for spending! It

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can also be used as part of the plan to divide property and control among different family members and their descendants. Ther

Young J considered the rule against the delegation of testamentary power at length in dealing with a gfit to a typical discretionary trust. He summarised the position in New South Wales (NSW)[11] (at 586):

> In summary, reducing the foregoing to their simplest form, the position as to the rule against delegation of will-making powers is as follows:
>
> 1. The rule is part of the law of New South Wales.
>
> 2. A person will not exercise the power personally where a power is given to an executor or some third person to choose the persons who are to benefit from the testator's bounty.
>
> 3. There are exceptions to that rule in the case of powers of appointment including powers of appointment where there is a trust to exercise the power in favour of: (a) charitable purposes; (b) powers where the appointor can appoint to himself or herself so that the interest conferred is equivalent to ownership; and (c) special powers where the class of persons who can be benefited is defined with sufficient precision.
>
> 4. It is not a breach of the rule to give property by will [to] a pre-existing trust or to constitute a trust which is sufficiently constituted according to the rules of certainty in trust law.
>
> 5. There is a further apparent exception where secret or half-secret trusts are used.

The case was argued on the basis that a gift to a typical discretionary trust meant it was possible for the trustee to add as beneficiaries almost the whole world with the exception of the limited specified ineligible beneficiaries. Without agreeing that was the case, Young J said (at 584):

> How then does the rule against delegation apply where the will sets up a trust? Usually, the rule does not apply at all. Thus, if a testator leaves property to the executor to convey it to the trustees for the Barristers' Sailing Club, that will be the end of the matter…. A testator clearly has power to leave his or her property to a trust without infringing the rule against delegation, provided that the trust is for a person or a defined class of persons or is a valid charitable trust.

By giving to the trustee, the testator has fully exercised his testamentary power so a challenge is not expected there. Of possible interest to the reader, he also warns (at 586-7):

> During argument, I remarked that the discretionary trust set up in the instant case was one which makes a judge in equity in 1997 wonder why equity courts are bothering with this sort of trust at all. Trusts, and at an earlier time, uses, were enforced by courts of equity because it was against the conscience of the holder of the legal estate not to carry out the promise that had been made to hold the property concerned on the trust expressed in the instrument. However, where the trustee can virtually designate who is to be the beneficiary, this ground has no validity at all. When one sees that discretionary trusts are used for the anti-social purpose of minimising taxation or defeating the rights of wives (see, eg, Re Davidson and Davidson

[11] The decision of Young J was affirmed on appeal: (1998) 45 NSWLR 300. The conclusions expressed by him represent the law in SA (per Besanko J in *Lines v Lines* [2003] SASC 173 at [36]).

> (No 2) [1994] FLC ¶92-469), there does not seem to be any reason in conscience why a court of equity should take any notice of them at all. Counsel were surprised that any judge should take this view and accordingly I announced during the argument that I would not seek to develop it in this case, but I believe that the message should be put abroad that the time may well have come where equity will have to reconsider its attitude to enforcing this sort of trust.

We have been warned!

Common benefits of testamentary trusts

The main benefit of a testamentary trust compared to the ordinary inter vivos trust is the income tax concession for minors who are taxed as adults with the benefit of the tax free threshold which in the current year results in up to $10,000 being tax free per minor.[12]

Another advantage of the testamentary trust is that as it does not come into effect until death and until then the testator owns the property, the testator can vary it to his or her heart's content until death (by Will or codicil). The testator can change the beneficiaries, trustees, powers, property etc. Also the testator can manipulate what property remains to be dealt with in his or her Will. Property can be transferred absolutely before death or to an inter vivos trust or left for the Will to deal with it.

Confusion in use of term "testamentary trust"

At one level, all deceased estates are for a time at least, "testamentary trusts". On death, the assets of the deceased vest in the executor (if there is one who is willing to act). It is a common myth that the assets don't vest until probate is granted to the executor or administrator by the Court.[13] In SA, at least this isn't correct. Some assets (but not land) can be transferred without probate.

The executor[14] has duties of a trustee to administer the estate (ie to pay all debts including tax bills, funeral expenses and to distribute the bequests). It is only when administration is complete (ie all debts paid or assets have been set aside by the executor to pay them) that the beneficiaries become absolutely entitled to any assets or their share of cash (if there are no further trusts created) and the assets and/or cash are distributed to the beneficiaries.

This is the "estate during administration" and is as much a trust (relationship) as any other. The beneficiaries at this stage have no right to anything except proper administration. It is during this period that unhappy or omitted beneficiaries should make any relevant application for variation of the Will under the Family Provision legislation of the particular State or territory. There is a very limited time allowed for an aggrieved beneficiary to make an application for obvious reasons although the Court may extend the time if it considers it appropriate.

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[12] Sec 102AG(2)(a). See later discussion.

[13] For example see IT 2622 at [2] and see the recent (27.6.06) ATO Guide called "Managing the tax affairs of someone who has died" on ATO website.

[14] *Executor and executrix* are the male and female forms of the term given to the person who is named as executor/executrix of the Will. *Administrator* is the term where the Court appoints a person to administer the deceased estate in the absence of a valid executor. In the CGT provisions, all of these are referred to as the *Legal Personal Representative* (s995-1 ITAA 1997).

Where a testamentary gift is left to an ex

Assume a life interest is created in the Will. If it is over specified assets such as named shares or real estate, when does the life tenant "enter" into that tenancy? What if it is a life interest over the residuary estate? Does the life tenancy commence when the debts and expenses are paid or at an earlier time, when the executor has set aside sufficient assets or cash to pay them?

The ATO explains its view is that the trust will commence at the completion of the administration of the estate or at earliest when the trustee first pays income:

> …where it is apparent to the executor that part of the net income of the estate will not be required to either pay or provide for debts, etc. The executor in this situation might in exercise of the executor's discretion, in fact, pay some of the income to, or on behalf of, the beneficiaries. The beneficiaries in this situation will be presently entitled to the income to the extent of the amounts actually paid to them or actually paid on their behalf. The fact that the estate has not been fully administered does not prevent the beneficiaries in this situation from being presently entitled to the income actually paid to, or on behalf of, the beneficiaries.[18]

Varying the terms of the a testamentary trust –how far can you go

The subtitle of this article is 'not just "another" trust'? The question for us then isn't about varying trusts in general[19] but whether there is anything peculiar or simply different about varying testamentary trusts.

The general tax issue is whether the variation of the trust which is allowed under the specific trust deed, has the result of ending this trust and creating a new one (or to be more accurate, does it cause the trustee to have new obligations such that it is a new

(1) The Supreme Court may, on the application of a trustee, or of any person who has a vested, future, or contingent interest in property held on trust—

(a) vary or revoke all or any of the trusts; or

(b) where trusts are revoked—

(i) distribute the trust property in such manner as the Court considers just; or

(ii) resettle the trust property upon such trusts as the Court thinks fit; or

(c) enlarge or otherwise vary the powers of the trustees to manage or administer the trust property.

(2) In any proceedings under this section the interests of all actual and potential beneficiaries of the trust must be represented, and the Court may appoint counsel to represent the interests of any class of beneficiaries who are at the date of the proceedings unborn or unascertained.

(3) Before the Court exercises its powers under this section, the Court must be satisfied—

(a) that the application to the court is not substantially motivated by a desire to avoid, or reduce the incidence of tax; and

(b) that the proposed exercise of powers would be in the

CGT result, it would almost certainly sever the connection with the deceased's Will (the concession applies only to a trust estate that resulted from a will) which gives the tax concession for income distributed to minors and so destroy the benefit which underpins the very reason for having a testamentary trust. (See 2.5 below for further discussion on this tax concession).

When does a testamentary trust end?

The testamentary trust ends like other trusts. If a life interest, it ends when the person whose life is to be counted, dies or when the person with the interest assigns or surrenders it. If a discretionary trust, it ends when the trust deed says so (when the trust vests by one of the actions provided for in the Will, such as distribution of the property to the various beneficiaries or by declaration by the trustee that the trust has vested) or the Court makes an order vesting the trust. It can also end by accident if there is no trust property.

Adding corpus to a testamentary trust

This is a current hot topic. There are some who consider property can be added to a testamentary trust and they read certain comments in articles and papers in support.[20] I am not convinced these comments go as far as some say and there may be more than a hint of wishful thinking on the part of proponents of this view. My view is even where you can add property; you can't obtain the minor's concessionary tax rates from the income produced by the added corpus.

Assume the testamentary trust is in existence, and assume the Will provides that the trustee may accept gifts.[21] Exactly what are we asking and why? If it is simply whether we can add property, the answer is yes. Subject to claw back provisions in bankruptcy law and the reach of the Family Court in property proceedings, that property should be safe from attack by creditors in the trust.

The starting point is what is this testamentary trust there for? If the answer is asset protection of some type, then assuming the trustee can accept new property to hold under the same trusts, assets can be added to that trust and be as protected as the other assets. To the extent that the trust is to split income then again, that also can be done. Here the trust is similar to the typical inter vivos discretionary trust

However, where the trust has income tax advantages of income distribution to minors, I assume our concern is to ensure that those tax advantages are maintained. As this is the major use of testamentary trusts as distinct from inter vivos trusts, the question really is "can you add corpus to a testamentary trust while maintaining the tax advantages of income distribution to minors?"

Can you add property and get the minor's tax concession from its income?

Minors who are beneficiaries of the trust can receive income from assets transferred into the trust and from any substituted or grown assets eg by borrowing, investment, sale and purchase etc. The original assets given to the trust may be viewed as the

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[20] For example, see *TIA Trusts Workbook* 2006 at 11.1.2 and Daniel Smedley *Establishing New Trust as part of succession Planning,* paper presented at the Taxation Institute of Australia's *13th National Intensive Retreat*, Noosa, 2005.

[21] If there is no specific power in the Will that allows the trustee to accept a gift of property, it is difficult to see how such property can be accepted by the trustee to be held on the same trust. If there is a power of variation, presumably the power can be added.

"seed assets" and they can vary. The benefit of the testamentary trust is not confined to the assets owned by the deceased or by the deceased estate during administration but that does not mean that other added assets will give rise to income that can be treated concessionally.

Assume the testamentary trust is to predominantly allow Betsy to distribute income among her 2 youngest children and 2 grandchildren (who are all under 18). The trust derives income of $30,000 pa. Betsy has just read in the *Wealth* pages of *The Australian* that minors can get up to $10,000 each tax free this year (taking into account the tax free threshold and the low income offset). She asks if she can transfer property to the trust (or ask her brother to do so) to earn an additional $10,000 and so distribute this as tax free income?

102AG(4) [Agreement to secure income excepted trust income]

Subsection (2) does not apply in relation to assessable income derived by a trustee directly or indirectly under or as a result of an agreement that was entered into or carried out by any person (whether before or after the commencement of this subsection) for the purpose, or for purposes that included the purpose, of securing that that assessable income would be excepted trust income.

breakdown, income from certain trust income from personal injury damages and post-death trusts.

Saving tax with a "second chance/post death/post-mortem trust"[27]
Dianna can transfer shares or investment property or money[28] left to her by Charles to a trust in which Wilma is a beneficiary. Income derived by the trustee from that property can be distributed to Wilma in a tax effective manner by using the provisions in sec 102AG(2)(d)(ii).

> 102AG(2) [Excepted trust income]
>
> Subject to this section, an amount included in the assessable income of a trust estate is excepted trust income in relation to a beneficiary of the trust estate to the extent to which the amount:
>
> (d) is derived by the trustee of the trust estate from the investment of any property: ;
>
> (ii) that was transferred to the trustee for the benefit of the beneficiary by another person out of property that devolved upon that other person from the estate of a deceased person and was so transferred within 3 years after the

must be an absolute right according to the terms of the trust and not depend on the discretion of the trustee. Strictly read, the provision requires the preservation of the actual property transferred! The requirement surely means that she must have the absolute right and the actual act of acquiring it isn't required. If it were, what do you do when 16 years after the trust has commenced and all the income has been taxed concessionally, Wilma disclaims her interest in the property?

6. And don't forget that if the property transferred is a CGT asset and there is a capital gain, then CGT will be payable due to the transfer and the funds will need to be found from other sources. Transferring money, if money was inherited, avoids this problem.[29]

Practical matters

1. The gift of property from a testamentary beneficiary to the trustee must be within 3 years of the death of testator.
2. It is done by transfer after inheritance and does not require and should not involve any variation to the Will or renunciation of interests.
3. The usual CGT and stamp duty implications result from this transfer of property to a trust.
4. The trust for Wilma need not be a stand alone trust but for practical reasons including the need for special terms such

usual adult rates. If distributing only to adults the testator doesn't need a testamentary trust and an inter vivos trust can be used.

Income splitting
As with inter vivos discretionary trusts, any testamentary trust with the discretionary power to appoint the income to different beneficiaries can split the income among beneficiaries with mixed tax rates to reduce the overall tax liability. This combined with the children's tax break gives testamentary trusts a unique benefit where there are children.

Franking credits problems
For the beneficiaries of a testamentary trust to be entitled to franking credits, the trustee will generally need to make a Family Trust Election (FTE). This won't have the effect of reducing the scope of beneficiaries where we are dealing with simple life interests because only one person (the life tenant) is entitled to distributions of income.

If it is life interest with discretion to pay income to others then a FTE may restrict the tax effective distribution of the income where the life tenant is not a parent, spouse or child of the deceased. It sometimes happens that the life interest is left to a friend.

Example
Mrs Danvers was Arthur's nurse and close friend in the final years of his life and she is the life tenant of Arthur's estate. Arthur left an adult child, Rebecca and 5 grandchildren. Rebecca takes in remainder. Under Arthur's Will, the trustee can distribute income to the children and grandchildren with the consent of Mrs Danvers (who likes Rebecca).

Arthur is dead and so cannot be named as the test individual. If Mrs Danvers is named as test individual, the distributions of income to Rebecca or the grandchildren will attract family trust distribution tax (FTDT) (at maximum rates). If Rebecca is named as test individual, the distributions of income to Mrs Danvers will attract FTDT (at maximum rates). Furthermore Rebecca or Mrs Danvers (as appropriate) will not be entitled to franking credits.

> 'The "family" of an individual (the "test individual") consists of all of the following (if applicable):
>
> (a) any parent, grandparent, brother, sister, nephew, niece, child, or child of a child, of:
>
> (i) the test individual; or
>
> (ii) the test individual's spouse;
>
> (b) the spouse of the test individual or of anyone who is a member of the test individual's family because of paragraph (a).[30]

Without a FTE, there was no entitlement to franking credits for the life tenant (or anyone else) from shares acquired post 31 December 1997[31] until the retrospective amendments were announced in March this year.[32] So, although franking credits will be allowed to a life tenant who has a vested right to the income but not the capital (the

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[30] 272-95 Schedule 2F ITAA 1936.
[31] ATOID 2002/122.
[32] Minister for Revenue Press Statement No 010 20.3.06.

usual case), where there is any element of discretion (where the right to income is not vested), a FTE (with the possible problems of naming a test individual) will still be necessary.

Note that the income tax concessions given to the executor as trustee of estate during the administration of the estate are not tax issues concerning testamentary trusts (because of our earlier agreed meaning of the term *testamentary trust*).

Commencement of the trust

Each testamentary trust is a separate trust and needs to be treated as such for tax purposes, including lodging of tax returns. For more detail on the ATO's requirements, see IT 2622.

CGT ISSUES FOR TESTAMENTARY TRUSTS

Commencement of the trust

There is no CGT liability on the transfer of any asset from the executor to the trustee or when the executor starts holding the property as the trustee of the particular testamentary trust. This is due to sec 128-15.[33]

Cloning or Splitting

Assume a single testamentary trust exists and the deceased's children are all adults with at least one having a burning desire to control his/her "own share". Assuming the trust contains the right of the trustee to vary the terms; can you clone or split the trust as you may do for an inter vivos trust in some cases?

Cloning

The first step in cloning is to establish a new trust with "identical terms" to the testamentary trust. Can this be done where the trust to be cloned was set up in a Will? TR 2006/4, deals with the ATO's view of the circumstances in which the beneficiaries and terms of two trusts are considered to be the same for the purpose of applying an exception to CGT event E2.

The following do not have to be the same:[34]

- the trustees;
- name;
- commencement or establishment date;
- settlor; or
- trust property (except that the transferred asset must be an asset of both trusts, though obviously not at the same time).

However, the appointor, if any, has to be the same. The ATO is also of the view that if a FTE was made in one, it must be made with the same test individual in the other. Therefore, it may be difficult to achieve the desired separation of control by cloning.

[33] Confirmed in PS LA 2003/12.
[34] [25].

Splitting
Assuming splitting is effective in actually separating the assets and the different trustee's indemnities,[35] there is nothing in particular which makes it more or less difficult to split a testamentary trust.

A Warning: Something that *may* impact the effectiveness of these is that ignoring the interposition of the testamentary trust between the executor and the beneficiary of the Will may really rest on the ATO's practical indulgence which can be withdrawn. When the trustee of the testamentary trust distributes assets owned by the deceased to a beneficiary, the ATO has had a long-standing administrative practice of treating the trustee of a testamentary trust in the same way that a legal personal representative is treated for the purposes of Division 128 of the ITAA 1997, in particular subsection 128-15(3).[36]

Paying the CGT
The Government has announced it will amend the CGT provisions[37] to enable the CGT liability arising from a CGT event happening to a trust asset to be paid by the trustee of a testamentary trust where a presently entitled income beneficiary will not obtain the benefit of the capital gain.[38] The trustee can make the choice on a beneficiary-by-beneficiary basis and this is intended to ensure the trustee is not assessed on part of the capital gain in circumstances where no tax would have been paid on the gain by the income beneficiary, for instance where the income beneficiary is an exempt entity or a foreign resident. The amendments are intended to apply to the P gain.

(and spouse) in their own names? If it is merely the family home and some small investments, is there any need for the expense and comparative complexity of a testamentary discretionary trust?

The answer may be the testamentary trust is primarily to deal with superannuation or

of appointment. Where the executor is appointed by the testator does the executor have any duty to bring all property he can into the deceased estate?[46]

It is also common knowledge that the testator cannot control the assets in the inter vivos family trust except through control of appointor and/or trustee but is this true?

First of all, where the trust deed expressly provides that where the appointor dies, they may appoint a successor in their Will or in the absence of this, the executor of their Will is the appointor.

It is common knowledge that this is the only way the testator can have some control – by controlling the appointor and so indirectly having control over the distribution of the trust assets and income (if the appointor and trustee know what the testator wants eg by a non binding statement of wishes). However, this may not be correct.

I was recently introduced to the concept of "fail-over trusts". The concept as I understand it is to allow a direction from the testator to the trustee of the inter vivos family discretionary trust (ie direct control) over the trust's assets and income.

Assume the typical family discretionary trust (which typically includes as objects, trusts in which any of the individual objects are also objects) is varied to acknowledge the existence of a sub trust called the Fail-over Trust (which needs to be separately created at about the same time) and the introduction of a requirement that the Trustee obey any Direction left in the Will of the Appointor.[47]

Assume the Will provides a Direction to distribute specified income and/or capital to named or identifiable beneficiaries (of the family trust). The concept of the 'fail-over trust' is introduced into the inter vivos deed (by variation of its terms but assuming such a trust is already an object to the trust) to take the income subject to the testator's direction in the Will if obeying the demand from the Will is inappropriate for tax reasons eg due to a Family Trust Election, the distribution would attract the Family Trust Distribution Tax.

The idea of a fail-over trust could be considered in cases where the testator wants to direct distribution of income and/or capital, eg to ensure the assets over which he had control in life but didn't own are shared among the beneficiaries as he likes.

Obviously, if this control can be exercised, this could make it more attractive to put most assets into the family trust and in effect divide all controlled assets at death. The aim is to direct the trustee of the family trust to distribute certain income and/or capital from the grave.

So although assets of the family trust don't pass through the Will, real control of them may!

Checklist for planning where assets go on death

This is simply one blank checklist which gives a range of matters that should be considered. It only deals with the questions we have been considering. You may have your own or wish to use this as a basis for yours.

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[46] This is a raised in *Aileen Pty Ltd v One Hawker Holdings Pty Ltd* [2006] VSC 135 at [52].

[47] This should not be a resettlement as the beneficiaries are not varied and these powers do not change the nature of the trust obligations etc.

1. ASSETS THAT DON'T PASS THROUGH WILL

Asset	MV $	Anticipated CGT or income tax	Beneficiary

Asset	MV $	Anticipated CGT or income tax	Beneficiary
Home	400	None	Joint tenant-Melanie
Assets in first family trust	200	n/r	Expect all children to share overall, 1st wife will be trustee when Julian dies
Superannuation[49]	300		Minor child or other dependant for tax benefits

2. ASSETS THAT PASS THROUGH WILL

Asset	MV $	Anticipated CGT or income tax	Preferred beneficiary
Superannuation[50]	300	It depends on who gets it	Minor child or other dependant for tax benefits
Shares	110	10 CGT	-
Investment property	500	100 CGT	-

3. BENEFICIARY

Name	Under 18/For how long	Assets at risk to creditors, ex spouse	Assets need protection from benefici

What will the testamentary trust achieve for Beneficiary 1?

Children's tax break while under 18. This may also mean that Melanie needs less from the life interest (ie fewer assets may be needed to give her sufficient income)

What will the testamentary trust achieve for Beneficiary 2?

Children's tax break while under 18

What will the testamentary trust achieve for Beneficiary 3?

Maximum protection from property distribution in case of divorce(s)

Children's tax break for grandchildren/great grandchildren under 18

What will the testamentary trust achieve for Beneficiary 4?

Maximum protection from losing assets in professional negligence claim

What will the testamentary trust achieve for Beneficiary 5?

Maximum protection from losing assets in professional negligence claim

Children's tax break for grandchildren/great grandchildren under 18

What will the testamentary trust achieve for Beneficiary 6?

In this case, life interest in either investment property or some or all shares not discretionary trust

5. Assuming separate trusts in each case, who should be trustee/appointor and why? These are not fixed or "right" answers but indicate what should be considered

Name	**Appointor**	**Trustees**	**Comment**
1. Michael	2 or 3 of Liz, Joan and Oscar	Melanie	Assuming Mum will be good. If not her and all siblings or just them alone or just Joan.
2. Joseph	Liz, Joan and Oscar[51]	Liz, Joan and Oscar	What will happen when he is 18 or 25?
3. Liz	Joan and Oscar	Joseph, Joan and Oscar	Not in control herself to protect from loss on divorce or to manipulative lover.
4. Joan	Joan	Joan	Do you assume Joan will remove herself as appointor and trustee if any risk arises (eg she becomes aware of a will r 47c4 11.1( )-191(isf7.6(o)-.5(z, J63.

			sensible siblings are joint trustees with him.
6. Melanie	No	Don't want her to get more assets.	Don't want her to get more assets.

Consider if these choices -which might look good on paper- will nevertheless cause family problems especially if Oscar or Melanie think they are being patronized.

Ask whether all the trusts except the life interest will have the same beneficiaries in effect (ie siblings, their children).So for example the Liz trust would have Liz as primary beneficiary, her spouse, children, grandchildren (all appropriately defined), associated companies, trusts and charities as objects.

Finally, do all you can to get this reviewed at least in 5-6 years? Joseph is nearly 18 - should he be given some responsibility at 18 or 21 eg as a joint trustee of his own trust? Has Oscar stopped drinking and gambling? You don't want to think about the possibility that Joan has gone off the rails partly due to the major responsibility she has taken on to keep the family happy.

DRAFTING ISSUES

Drafting the trust

Assume a testamentary trust is thought to be a good thing in a particular case.

It goes without saying that the testamentary trust(s) and the rest of the Will should be clearly set out, preferably in reasonably plain language and be able to be understood by the testator, executor, appointors, trustees and potential beneficiaries (some of whom may be young or not particularly well educated or not sophisticated in dealing with trusts or finances).

Should the Will be drafted to give the executor the power to decide whether to provide any property for it (ie to start it) or should some conditions be included in the Will.

One option is to add a pro forma modified discretionary trust to the Will creating one or more testamentary trusts. A *pro forma trust* is eminently suitable for a *pro forma client* eg happily married once with children, any married children are happily

Once you have decided what priorities can be best satisfied by a testamentary trust, then it should be drafted to provide for that priority (or with a range of aims).

- Is the trust to be set up whatever age the children (and so is a trust for the grandchildren as well) or is the gift absolute if child is over 18 or 21 or 30 or whatever?
- When trust is to end and rights of trustee to end earlier (including by distribution of all income and capital so there is no trust property left) - this may require consent of spouse or some beneficiaries.
- Definitions especially for meaning of spouse and child (to give maximum f

of certain assets is fine). Leaving the full decision to the executor may otherwise result in the trusts being ineffective.

Superannuation and tax benefits

This article is not dealing with death benefits from superannuation policies except to make these simple points:

1. Whether or not to pay the superannuation benefits into a testamentary trust is one of the last decisions in planning what to do with them.
2. If a superannuation payment is made to a trustee its 'death benefit' tax concession is generally lost. However, the ATO considers that a payment made to the trustee of a trust set up to benefit a single dependant of a deceased person will maintain this concession. Provided the benefit is paid to or for the benefit of dependant of the deceased person, it will be exempt from tax.[54] It needs to be noted this interpretation is based on the dependant having an absolute entitlement to the income (ie is the sole beneficiary and any income on death would form part of the dependant's estate).
3. To be sure the benefit of the ATO view is obtained, there needs to be separate testamentary trust for each dependant and the superannuation payment paid to the separate trusts. These trusts cannot be discretionary as to appointment of the income although accumulation could be allowed as long as the dependant is entitled to any accumulation in due course.

CURRENT ISSUES WITH LIFE INTERESTS AND CGT

Update on ruling on life interests

In late November 2006, the ATO issued its final ruling on the topic TR 2006/14. The most significant result relevant to this article is that the ATO has changed its view from the draft ruling on the cost base of the life tenant. The result is that the life tenant has a market value cost base (instead of a nil cost base). This solution to the complexities of the law gives some relief to the life tenant and in many cases will give complete relief where the value of the life interest has decreased. Where the value of the life interest has increased (because the value of the property has increased), the best result continues to be that no CGT is payable if the surrender is made before administration of the deceased estate is completed or where the life tenant does what comes naturally to us all one day.

The relevant extracts follow (my emphasis):

> 25. The first element of the cost base and reduced cost base of an equitable life or remainder interest is the sum of any money and the market value of any property given to acquire it: subsection 110-25(2).
>
> 26. If, as is generally the case, no money or property is given to acquire an equitable life or remainder interest, section 112-20 provides that the first element of the cost base and reduced cost base of the interest **is its market value at the time it was acquired**.
>
> 27. However a market value cost base cannot be obtained for an equitable life interest that arose other than as a result of someone's death) if:
>
> nothing is actually paid or given to acquire it; and

[54] ATOIDs 2001/751 and 2002/155.

> it is not acquired by way of assignment from another entity.
>
> (See item 1 in the table in subsection 112-20(3).)
>
> 28. Note that for the purpose of paragraph 112-20(1)(a), **equitable life and remainder interests are considered to have been acquired as the result of CGT event E1 happening. That is, a market value acquisition cost is not denied** on the basis that the interests resulted from CGT event D1 happening or no CGT event at all happening.

The problem:

The problem is the massive CGT on the surrender of a life interest in CGT assets such as investments when the life interest ends other than through the death of the life tenant. This is particularly unfair where the life tenant does not receive anything for

Capital proceeds	96 (in this case this is real)
Less cost base	nil
Capital gain	96
CGT, say 25%[59]	**$24**

In this case, Ryan is in the same position except he has paid Rosie to end the trust early. Ryan gets $120 worth of shares for $80. Does he have his father's entire cost base of $20 as well as the $80 he paid? Why not?

Life interest ended 5 years after death by in specie transfer of shares owned by deceased

This becomes very interesting. Where Rosie ends her right to income by receiving an in specie distribution CGT event E6 would have occurred with the result that, as the shares being transferred are shares that were owned by Robert at death (and so are covered by Div 128), E6 does not apply. Rosie receives the shares as if gifted in the Will and any CGT liability is rolled over. CGT event E6 provides:

> SECTION 104-80 Disposal to beneficiary to end income right: CGT event E6
>
> 104-80(1)
>
> CGT event E6 happens if the trustee of a trust (except a unit trust or a trust to which Division 128 applies) *disposes of a *CGT asset of the trust to a beneficiary in satisfaction of the beneficiary's right, or part of it, to receive *ordinary income or *statutory income from the trust.
>
> 104-80(2)
>
> The time of the event is when the disposal occurs.
>
> Trustee makes a capital gain or loss
>
> 104-80(3)
>
> The trustee makes a capital gain if the *market value of the asset (at the time of the disposal) is more than its *cost base. It makes a capital loss if that market value is less than the asset's *reduced cost base.
>
> Exception for trustee
>
> 104-80(4)
>
> A *capital gain or *capital loss the trustee makes is disregarded if it *acquired the asset before 20 September 1985.
>
> Beneficiary makes a capital gain or loss
>
> 104-80(5)
>
> The beneficiary makes a capital gain if the *market value of the asset (at the time of the disposal) is more than the *cost base of the right, or the part of it. The beneficiary makes a capital loss if that market value is less than the *reduced cost base of the right or part.
>
> Note:
>
> If the beneficiary did not pay anything for the right, the market value substitution rule does not apply: see section 112-20.]

[59] Supra.

Exception for beneficiary

104-80(6)

A *capital gain or *capital loss the beneficiary makes is disregarded if it

happening in relation to the parts of the land transferred to Hector's daughters.

166. The exceptions for trusts to which Division 128 applies have no relevance in this case because the land is not passing to the beneficiaries in terms of section 128-20. That is, the interests in the land are not passing under the will nor are they passing under a deed of family of family arrangement entered into to settle a claim to participate in the estate.

167. The trustee of the testamentary trust and Hector's wife may make a capital gain or capital loss from CGT event E6 happening. Depending on the application of Division 6 of Part III of the ITAA 1936, and on section 118-20 and subsection 118-20(1A) of the ITAA 1997, any capital gain made by Hector's wife may be reduced to the extent of amounts referable to the trustee's capital gain included in her assessable income under Division 6 (see also PS LA 2005/1 (GA)).

168. The trustee of the testamentary trust may make a capital gain or capital loss from CGT event E7 happening in relation to the parts of the land used to satisfy the interests of the daughters in the trust. CGT event E7 also happens on the ending of the capital beneficiaries trust interests. Because the daughters did not pay anything for their interests, or

beware of stamp duty![62] Ryan simply receives the shares when the executor is able to transfer them to him as if gifted absolutely in the Will.

Deed of Family Arrangement
Ryan was on active duty in Iraq when his father died. He returns to Australia and goes bush for 12 months to get over the experience. By this stage Rosie has started to receive the dividends. He then considers his bequest. He is most unhappy with his father's Will and is given bona fide written advice that he has a valid claim under the relevant family provisions statute in his State or Territory and even though he is out of time to lodge a claim, he also has grounds to obtain an extension of time.[63] He informs the executor and his mother and they enter into a Deed of Family Arrangement to settle his claim.

The deed ends the life interest and divides the shares 80:20. The CGT consequences are as set out above in 8.1.2 and are as if the agreed split was left in the Will.

Results summarised

Action	She receives	Her CGT	She keeps	Out of pocket
Gift to Rosie	96	20	76	
Ends 5 yrs for no consideration	-	24	-	24
Ends on Rosie's death	-	-	-	-
Ends 5 yrs for mv consideration	96	24	72	
Ends for shares owned at death UNCLEAR	96	20 (deferred until she sells)	76	-
Ends for combination of cash and death shares UNCLEAR	96	??	??	-
Disclaims shortly after Robert's death	-	-	-	-
Deed of Family Arrangement to settle dispute	96	20 (deferred until she sells)	76	

Some possible solutions: What can the adviser do?

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[62] Eg 71AA Stamp duty act 1923 (SA); 42 Duties Act 2000(Vic).
[63] 128-20(1)(d) ITAA 1997 and see ATOID 2003/107.

and the money or securities or the proceeds of the sale calling in and conversion are not by statute or in equity considered as land.

(6) This section applies only and if and as far as a contrary intention is not expressed in the instrument, if any, creating the trust, and shall have

eg in PS LA 2003/12 (also concerning Div 128) and eg TR 95/35 which was necessarily to make CGT on compensation receipts work at all!

In PS LA 2003/12, the ATO states:

> Although this is a difficult issue, particularly given the wording in section 128-15 of the ITAA 1997, it is open to the Commissioner to follow a long-standing practice that promotes the policy intent of the provisions and that might be adopted by a court.[67]

The following explains why there is no loss to the revenue.

1) Shares sold by remainder on death of life tenant-

Assuming Rosie dies while still entitled to the life interest, she will have no CGT liability on the acquiring or ending of her life interest.

Ryan then inherits the capital assets with a cost base of $20 (as Robert had). Assume he sells them all. Assuming the value hasn't decreased, then the capital proceeds that Robert would have obtained and paid tax on will now be "included" in Ryan's gain and the "above CGT" will then be paid.

That is the usual case. All that has happened is the CGT on the shares owned by Robert is deferred until his capital beneficiary disposes of them. This is the point of the CGT death concessions in Div 128.

2) Life tenancy surrendered for no consideration-

Assume instead, Rosie ends the life interest when it has a market value of $50. She asks for and receives nothing.

The effect of the ending is that Ryan's interest is accelerated so he inherits the capital assets with a cost base of $20 (as Robert had). Assume he sells them all. Again all that has happened is the CGT on the shares owned by Robert is deferred until his capital beneficiary disposes of them. Robert does not gain except by either being able to sell the shares sooner than Robert and God intended which is a benefit to the Revenue as it gets the deferred CGT earlier. There is no loss to the Revenue in ordinary income tax––whoever holds the rights to the income from the shares will be paying income tax on the income derived.

3) Life tenancy surrendered for mv consideration-

Ryan pays $50,000. Rosie receives it and surrenders her ine eu0.0027 Tcuo3.5( )c60h(in)6 rea[(has har)(shs)

The relevant parts of sec 110-25(2) are set out below so you can check my claim. In summary, the cost base rules deal with amounts incurred etc. in acquiring the asset. If Ryan spent the money for a reason other than acquiring the asset (ie the shares), the cost base rules don't apply.

5 elements of the cost base -

> 110-25(2)
>
> The first element is the total of:
>
> (a) the money you paid, or are required to pay, in respect of *acquiring it; and
>
> (b) the *market value of any other property you gave, or are required to give, in respect of acquiring it (worked out as at the time of the acquisition).
>
> [Note 1: There are special rules for working out when you are required to pay money or give other property: see section 103-15.]
>
> [Note 2: This element is replaced with another amount in many situations: see Division 112.]
>
> 110-25(3)
>
> The second element is the *incidental costs you incurred. These costs can include giving property: see section 103-5.
>
> [Note: There is one situation to do with options in which the incidental costs relating to the CGT event are modified: see section 112-85.]
>
> 110-25(4)
>
> The third element is the costs of owning the *CGT asset you incurred (but only if you *acquired the asset after 20 August 1991). These costs include:

A. CGT event D1 happening on acquisition of life interest;;
B. Robert or someone else doing something that did not constitute a CGT event happening; or
C. Rosie did not deal at arm's length with Robert or whoever she acquired the life interest from.[68]

The arguments are as follows:

A

whether she was dealing with them at arm's length or not. Furthermore, and as a further illustration of how impossible it is to use the general CGT provisions with assets held on death, it is also likely that **in fact** Rosie did not deal with Robert at all – she may have no knowledge of the life interest until after his death. Even if she was aware, this is surely not the type of "dealing" that the CGT provisions are meant to tax.

Another (almost) solved CGT problem for life tenants

A life tenant of an active testamentary trust is the sole income beneficiary and is presently entitled to the income pursuant to the Will. The result is that any CGT liability arising from the sale of trust assets (such as shares) also flows to the life

base but there is CGT on the balance of the deemed consideration which is a bonus to the Revenue (caused by the early ending of the life interest).

She "sells" her life interest. If she accepts shares, then Ryan only acquires the shares left over. If Ryan funds this out of his funds, then he acquires all the shares.

Comment on "solutions"

These ideas are offered as just that - ideas! I release these balloons of hot air in the hope one of them will be found to hold a better answer than the current position for the life tenant especially one who wishes to be generous and let the remainder beneficiaries receive their inheritance early.

CONCLUSION

There once was a man named Flowers
Whose wealth was from building showers
He made his own Will
The silly old dill
So "gave" all of his assets to lawyers

Well, after reading all of this, do you think testamentary trusts are just another trust?