Draft Taxation Ruling

Income tax: Trust vesting – amending the vesting date and consequences of a trust vesting

Contents Para

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Summary – what this draft Ruling is about

1. This draft Ruling explains the Commissioner's views about amending the trust's vesting date and the income tax consequences of the passing of a trust vesting date.

2. When a trust vests, all of the interests in the trust as to income and capital become vested in interest and possession.

3. The income tax consequences that arise on, and after, the vesting of a trust depend on the terms of the deed. Vesting of itself may, but need not, cause a CGT event to happen.

Definitions

4. In this draft Ruling, unless context otherwise requires:

- **Net income** means the net income of a trust estate under subsection 95(1) of the *Income Tax Assessment Act 1936* (ITAA 1936) calculated as the total assessable income of the trust estate as if the trustee were a resident taxpayer less all allowable deductions (except certain deductions identified in the provision).

- **Income of the trust estate** means the income of the trust estate as that expression is used in Division 6 of Part III of the ITAA 1936.[1]
- A trust **vests** at the time all the interests in the trust property become vested in interest and possession.
- A trust's **vesting date** is the day on which the trust vests (the day on which the interests in the trust become vested).
- **Takers on vesting** means those beneficiaries that, under the deed, hold a fixed interest in the capital (and income thereon) after the trust vests.

Ruling

Amending a trust's vesting date

5. A trust deed will nearly always specify a date on which the interests in the trust vest and contain a clause which specifies the consequence of that date being reached (for example, that the property is to be held from that date for the takers on vesting in equal shares absolutely). This is to ensure that the rule against perpetuities is not breached. The date is commonly labelled in the deed as the 'Vesting Date' or 'Termination Date'.

6. Prior to a trust's vesting, it may be possible for the trustee[2] or a Court[3] to postpone the vesting of the trust by nominating a later date as the new vesting date.

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[1] The Commissioner's understanding of the meaning of 'income of the trust estate' is explained in Taxation Ruling TR 2012/D1 *Income tax: meaning of 'income of the trust estate' in Division 6 of Part III of the Income Tax Assessment Act 1936 and related provisions*.

[2] Pursuant to a proper exercise of a valid power under the deed. Determining whether the trustee has the power to amend the deed to change the vesting date requires a careful consideration of the terms of the trust deed. For example, although a trustee may have a general power to amend the deed, there may also be specific exclusions from the scope of that power. The power might also be limited to permitting the trustee to bring forward the date on which the trusts vests and not permit extending that date.

[3] Where a trust deed does not provide the trustee with a power to extend the vesting date, an application to the Court may be necessary. In every State and Territory, the Court has a statutory power to vary a trust deed in particular circumstances: section 81 of the *Trustee Act 1925* (ACT); section 81 of the *Trustee Act 1925* (NSW); section 94 of the *Trusts Act 1973* (Qld); section 59C of the *Trustee Act 1936* (SA); section 47 of the *Trustee Act 1898* (Tas); section 63 of the *Trustee Act 1958* (Vic); section 89 of the *Trustees 1962 Act* (WA); section 50A of the Trustee Act (NT).

7. However once the vesting date has passed, the trust has vested and this is no longer possible. Specifically, once the trust has vested, the interests in the trust property become fixed at law. This result cannot be avoided by the parties continuing to carry on as though the trust had not vested or by a purported exercise of a power to vary the deed.[4]

8. Further, the Commissioner understands it is unlikely that a Court would extend a vesting date once the interests of beneficiaries in the trust have vested,[5] as this would involve defeating the fixed beneficial interests of the takers on vesting.

Consequences of a trust vesting

9. Though it is common to speak of a trust's vesting, it is the interests of the beneficiaries in the property of the trust that vest on the vesting date.

10. On a trust's vesting date, the interests in the property of the trust become vested in interest and possession. In the case of a discretionary trust, from the time the trust vests a trustee no longer has any discretionary power to appoint the income or capital of the trust, rather it holds the trust property for the absolute benefit of those beneficiaries specified as the takers on vesting.[6]

11. In itself, the vesting of beneficial interests in a trust, even if described as a 'Termination Date', does **not** ordinarily cause the trust to come to an end[7], nor cause a new trust to arise. Vesting does not mean trust property must be transferred to the takers on vesting on the vesting date, nor that the trust must be wound up either immediately or within a reasonable period (although the deed may require these events to occur after vesting).[8]

12. A trust deed may, or may not, specifically envisage or provide for an ongoing relationship between the trustee and takers on vesting after the trust has vested. In any case, where a trustee continues to hold property for takers on vesting, although the nature of the trust relationship does change, the underlying trust relationship continues.[9]

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[4] This is because, on the vesting day, the beneficiaries' interests vest immediately and entitle those takers on vesting to possession, and it would be inconsistent for the trustee to retain any power to defeat those interests: *Clay & Ors v. James & Ors* [2001] WASCA 18 at [6], [18]; *Hancock v. Rinehart* [2015] NSWSC 646 at [128].

[5] *Re Dion Investments* (2014) 87 NSWLR 753 at [48].

[6] *Hancock v. Rinehart* [2015] NSWSC 646 at [128]; *Clay & Ors v James & Ors* [2001] WASC 18 at [6].

[7] *Clay & Ors v. James & Ors* [2001] WASC 18 at [11].

[8] Examples of trusts continuing following vesting and trusts being wound up include *Clay & Ors v. James & Ors* [2001] WASCA 18 at [6] and [11] (trust being wound up), and *Hancock v. Rinehart* [2015] NSWSC 646 (trust continuing).

[9] However, there may be circumstances where the property of a trust is resettled on a new trust by the takers on vesting.

CGT consequences of trust vesting

13. Determining whether or not a CGT event happens on vesting requires a close consideration of the effect of vesting as specified in the deed. This will include consideration of the effect of vesting on the nature of beneficial interests in the trust and the nature of the property[10] held on trust.

14. It may be the case that no CGT event happens by reason alone of the trust's vesting. But events occurring post-vesting may cause a CGT event to happen.

CGT event E1: creation of a new trust[11]

15. A trust vesting of itself does not ordinarily cause the trust to come to an end and settle property on the terms of a new trust.[12] As such CGT event E1 need not happen merely because a trust has vested.

16. Circumstances might, however, occur in which the parties to a trust relationship subsequently act in a manner that results in a new trust being created by declaration or settlement so as to cause CGT event E1 to happen. See example 4 of this draft Ruling.

17. If CGT event E1 happens and a trust is created over the assets, the trustee of the new trust is taken to acquire each asset when the trust is created and the first element of each asset's cost base is its market value.

CGT event E5: beneficiary becoming absolutely entitled[13]

18. The vesting of a trust may result in the takers on vesting becoming absolutely entitled as against the trustee to CGT assets of the trust, depending on what those CGT assets are and the particular interests of the takers on vesting.

19. The Commissioner's view of when a beneficiary becomes absolutely entitled and when CGT event E5 happens is explained in draft Taxation Ruling TR 2004/D25 *Income tax: capital gains: meaning of the words 'absolutely entitled to a CGT asset as against the trustee of a trust' as used in Parts 3-1 and 3-3 of the Income Tax Assessment Act 1997*.

20. In certain cases CGT event E7 may happen (for example upon actual distribution of CGT assets to beneficiaries), but it will not happen to the extent the beneficiaries are already absolutely entitled to the CGT assets as against the trustee.[14]

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[10] See paragraphs 18 to 20 of this draft Ruling on CGT event E5.
[11] Section 104-47 of the *Income Tax Assessment Act 1997* (ITAA 1997).
[12] *Clay & Ors v James & Ors* [2001] WASC 18 at [11].
[13] Section 104-70 of the ITAA 1997.
[14] Section 106-50 of the ITAA 1997.

Taxation of trust net income after the vesting date

21. In the year in which vesting occurs, different beneficiaries may be presently entitled to income of the trust estate derived before, as opposed to after, the vesting date. For example, in the case of a discretionary trust, a trustee may, pre-vesting, exercise their discretion to appoint income of the trust estate derived before the vesting date (pre-vesting income) among those entitled to benefit under the trust.[15] By contrast, present entitlement to the income of the trust estate derived post-vesting (post-vesting income) will be held by the takers on vesting (usually in proportion to their vested interests in the property of the trust). This needs to be taken into account in identifying each beneficiary's share of the trust estate's income for the year which, in turn, determines their share of the net income of the trust for that year.[16]

Note: The Commissioner will accept an allocation of income of the trust estate into pre-vesting and post-vesting income of the trust estate in the year in which vesting occurs that is done on a fair and reasonable basis having regard to all of the relevant circumstances.[17] See example 5 of this draft Ruling.

22. In the following income years, the takers on vesting will usually have a fixed entitlement to the income of the trust estate and be assessable on their corresponding share of the net income. If all of the income of the trust will flow to the takers on vesting according to their entitlement, none of the net income will fall to be assessed to the trustee.[18]

23. A payment or other purported distribution of income or capital by a trustee post-vesting that is not consistent with the vested beneficiaries' fixed interests is void or otherwise not effective.[19,20]

24. Section 101 and subsection 95A(1) of the ITAA 1936 have no application to deem a beneficiary to be presently entitled where the trustee purports to make an appointment or payment that is inconsistent with the fixed interests of the takers on vesting.

Examples

Example 1 – ineffective amendment of vesting date

25. The deed of the Smith Discretionary Trust expressly states that the trust will vest on 30 June 2018 or on such earlier date as the

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[15] Those same beneficiaries will then be presently entitled to any income that arises in the following years from the investment of any unpaid present entitlement from a pre-vesting year (that is, rather than the takers on vesting).
[16] *FCT v. Phillip Bamford & Ors; Phillip Bamford & Anor v. FCT* [2010] HCA 10; 2010 ATC 20-170; (2010) 75 ATR 1.
[17] Under Division 6 of Part III of the ITAA 1936, as modified by Division 6E.
[18] Under section 99A or section 99 of the ITAA 1936.
[19] *Turner v. Turner* [1984] 1 Ch 100 at 111.
[20] Such trustee has breached their duty to obey the trust deed: *Greig v. McGregor; Re Hay's Settlement Trusts* [1982] 1 WLR 202 at 210.

trustee nominates. While the trustee has broad powers to amend the deed, those powers expressly exclude any changes that affect the definition of the vesting date, and so prevent an extension of the date.

26. *Without more (for example, a court order having the effect of changing the vesting date), a purported amendment by the trustee to extend the trust's vesting date will be ineffective, and the trust will continue to vest on 30 June 2018.*

Example 2 – ignorance of vesting date by trustee and beneficiaries

27. *A discretionary trust was established to lease property to a company that operates a medical practice. Under the deed, on vesting the trustee holds the property for the takers on vesting as tenants in common in equal shares. The vesting date is defined to be 1 November 2014.*

28. *The trustee, unaware of the provisions of the deed regarding vesting, continued to make discretionary distributions of income to beneficiaries after 1 November 2014. The beneficiaries of the trust, also unaware of the relevant provisions of the deed, did not challenge the actions of the trustee.*

29. *As the trust vested on 1 November 2014 by operation of the deed, the trustee's purported exercise of discretionary powers to appoint income after this date was not within the trustee's powers and was ineffective. The income of the trust post-vesting was instead beneficially owned in equal shares by the takers on vesting.*

30. *Those takers on vesting are presently entitled to the income of the trust ineffectively appointed, and assessable on their respective shares of the net income of the trust.*

Example 3 – realisation, and extension of vesting date

31. *Assume the same facts as in Example 1, except the trustee properly executed a deed extending the vesting date on 30 October 2014 (supported by a power in the deed). Assume further that the amended vesting date (1 November 2064) did not cause a breach of the rule against perpetuities.*

32. *The effect of the amendment is to change the vesting date of the trust to 1 November 2064. As a result, the trustee retains the power to make discretionary distributions of income and capital until that time.*

Example 4 – purported extension after vesting date

33. *A discretionary trust holding several rental properties had a vesting date of 30 September 2016.*

34. *On 1 June 2017, the trustee became aware that the vesting date had passed and, with the acquiescence of the takers on vesting,*

continued to manage the trust as if the trust had not vested. On 29 June 2017, the trustee executed a deed of extension that purported to extend the trust's vesting date to 30 September 2057.

35. *The subsequent execution of a deed of extension is void and ineffective to change a vesting date that has already passed. Any power of the trustee to extend the vesting date ceased on 30 September 2016.*

Note: If, once it is realised that the deed of extension is ineffective to change the trust's vesting date, all of the takers on vesting agree that the trust assets should continue to be held on a new trust on the same terms as the original trust, and this was effective to create such a new trust over the assets by declaration or settlement, CGT event E1 would happen in relation to trust assets.

Example 5 – present entitlement for income year in which trust vests

36. *The Atkins Family Trust has a vesting date of 1 January 2017. The relevant clauses of the trust allow the trustee to determine income of the trust estate for the period before the vesting date, and distribute that income to one or more discretionary beneficiaries. On 31 December 2016, the trustee resolved to distribute all of the income up to the vesting date to Andrew.*

37. *The trust deed further provided that, on the vesting date, the trustee was to hold the trust property in equal shares for Andrew and Edward.*

38. *For the 2016-17 income year, each of Andrew and Edward is assessable on the share of the net income that relates to their share of the total income of the trust estate for the year.*

Note: The nature of the Atkins Family Trust's income ($100) is such that it is derived evenly across the 2016-17 income year. As such, it is fair and reasonable to conclude that Andrew is presently entitled to $75 of the income of the trust estate for the year (being all of the income derived before the vesting date, $50, and half of the income derived after vesting date, $25) and Edward is presently entitled to $25 of the remaining income for the year (being half of the income derived after vesting date, $25).

Example 6 – no absolute entitlement

39. *The trust deed for the Robin Family Trust provided that the trust would vest on 1 August 2014. The deed further provided that unless the trustee resolved to distribute the trust capital, (a rental property) to particular beneficiaries before the vesting date, the trustee would hold the trust property for Jenny and Josh jointly in equal shares.*

40. *On 1 August 2014 (the vesting date), the interests of Jenny and Josh in the trust vest: their interests become vested and indefeasible. However, they did not become absolutely entitled to the*

rental property as against the trustee for the purposes of CGT event E5 as that test requires that a beneficiary be entitled to the whole of the CGT asset owned by the trustee.

Example 7 – absolute entitlement

41. *The trust deed for the Ho Family Trust provided that the trust would vest on 1 August 2014. It further provided that unless the trustee resolved to distribute the trust capital to particular beneficiaries, before the vesting date, the trustee would hold the trust property absolutely and solely for Lu.*

42. *On 1 August 2014 (the vesting date), Lu has a vested and indefeasible interest in the trust property. In addition, he has become absolutely entitled to the trust assets as against the trustee causing CGT event E5 to happen.*

Date of effect

43. When the final Ruling is issued, it is proposed to apply both before and after its date of issue. However, the Ruling will not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the Ruling (see paragraphs 75 to 76 of Taxation Ruling TR 2006/10).

Commissioner of Taxation
13 December 2017

Appendix 1 – Alternative views

This Appendix sets out alternative views and explains why they are not supported by the Commissioner. It does not form part of the binding public ruling.

Extending the vesting date by implication

44. It has been contended that continued behaviour by both the trustee and beneficiaries of a trust, in a way that is consistent with the terms of the trust as they existed prior to its vesting date, may be sufficient to extend the trust's vesting date.

45. For example, a trustee purports to appoint income of the trust estate, in accordance with a discretionary power of appointment contained in the trust deed, to beneficiaries that are not the takers on vesting, and the beneficiaries are said to have accepted tacitly those distributions. It is purported that such behaviour implicitly invokes a power of amendment within the trust deed to retrospectively extend the trust's vesting date.

46. We do not accept this view.

47. Neither a mistaken assumption that discretionary powers of appointment continue to apply after a trust's vesting date, nor ignorance of the vesting date having occurred, can alter the legal and equitable rights of parties that are established by the terms of the trust.

48. Depending on the facts and circumstances of a particular case, it may be that conduct of the kind considered in the alternative view gives rise to certain equitable remedies or defences in favour of the trustee or an overpaid beneficiary. It may also be that such conduct amounts to a gift from one beneficiary to another beneficiary, or a resettlement of the trust if all potential beneficiaries are involved in the arrangement.

Appendix 2 – Your comments

49. You are invited to comment on this draft Ruling, including the proposed date of effect. Please forward your comments to the contact officer by the due date.

50. A compendium of comments is prepared for the consideration of the relevant Rulings Panel or relevant tax officers. An edited version (names and identifying information removed) of the compendium of comments will also be prepared to:

- provide responses to persons providing comments, and
- be published on the ATO website at www.ato.gov.au.

Please advise if you do not want your comments included in the edited version of the compendium.

Due date: **16 February 2018**

Contact officer: **Richard Mold**

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Appendix 3 – Detailed contents list

51. The following is a detailed contents list for this draft Ruling:

References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 2004/D25; TR 2006/10;
TR 2012/D1

Legislative references:

- ITAA 1936
- ITAA 1936 Div 6 Pt III
- ITAA 1936 Div 6E
- ITAA 1936 95(1)
- ITAA 1936 95A(1)
- ITAA 1936 99
- ITAA 1936 99A
- ITAA 1936 101
- ITAA 1997
- ITAA 1997 Pt 3-1
- ITAA 1997 Pt 3-3
- ITAA 1997 104-47
- ITAA 1997 104-70
- ITAA 1997 106-50
- Trustee Act 1925 (ACT) 81
- Trustee Act 1925 (NSW) 81
- Trustee Act (NT) 50A
- Trusts Act 1973 (Qld) 94
- Trustee Act 1936 (SA) 59C
- Trustee Act 1898 (Tas) 47
- Trustee Act 1958 (Vic) 63
- Trustees 1962 Act (WA) 89

Cases relied on:

- Federal Commissioner of Taxation v. Bamford - (2010) 75 ATR 1; [2010] HCA 10; (2010) 84 ALJR 266; (2010) 264 ALR 436; 2010 ATC 20-170; [2010] ALMD 5415; [2010] ALMD 5416; [2010] ALMD 5419; (2010) 240 CLR 481; (2010) 5 ASTLR 174
- Clay & Ors v. James & Ors [2001] WASC 18
- Re Dion Investments Pty Ltd - [2014] NSWCA 367; (2014) 87 NSWLR 753; [2015] ALMD 3041; (2014) 11 ASTLR 574; (2014) 10 BFRA 15
- Re Hay's Settlement Trusts - [1982] 1 WLR 202; [1981] 3 All ER 786; (1981) 125 Sol J 866
- Hancock and Another v. Rinehart and Others - (2015) 106 ACSR 207; [2015] NSWSC 646; (2015) 13 ASTLR 1; [2017] ALMD 1113; [2017] ALMD 1030; [2017] ALMD 1033; [2017] ALMD 1034; [2017] ALMD 1035; [2017] ALMD 1036; [2017] ALMD 1038; [2017] ALMD 1039; [2017] ALMD 1041
- Turner v. Turner [1984] 1 Ch 100

ATO references

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