


TD 95/D12 - Income tax: can section 36A of the Income Tax Assessment Act 1936 apply if:(a) a sole trader who owns the trading assets of a business transfers the assets to a partnership comprising the sole trader and a trustee of a discretionary trust; and (b) the partnership of the sole trader and the trustee, in turn, transfers the assets to the trustee?

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This document has been finalised by TD 96/3.

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Draft Taxation Determination

Income tax: can section 36A of the *Income Tax Assessment Act 1936* apply if:

- (a) a sole trader who owns the trading assets of a business transfers the assets to a partnership comprising the sole trader and a trustee of a discretionary trust; and**
- (b) the partnership of the sole trader and the trustee, in turn, transfers the assets to the trustee?**

1. Yes, but only if the agreement between the parties under paragraph 36A(2)(d) is not made ineffective by other subsections of section 36A, for example, subsection 36A(8).

2. Subsection 36A(1) can apply in respect of each transfer. For the purposes of subsection 36A(1), the sole trader who transfers the assets to the partnership ('the first transfer') owned the assets before the change in their ownership and has an interest (being an undivided fractional interest, as a partner) in the assets after the change. On the partners of the partnership transferring the assets to the trustee ('the second transfer'), the trustee is one of the persons who legally owned the assets before the change and the trustee has a legal interest in the assets after the change. The result is the same whether or not the trustee is the same person as the sole trader who originally owned the assets.

3. Turning to subsection 36A(2), the sole trader in the first transfer owned the assets before the change and holds, after the change, an interest in the assets of a value equal to 25% or more of the value of the assets. In the second transfer, the trustee is one of the persons who owned the assets before the change and the trustee holds, after the change, an interest in the assets of a value equal to 25% or more of the value of the assets. Paragraph 36A(2)(b) is satisfied in each transfer and, subject to the other requirements of subsection 36A(2) also being satisfied, the subsection can apply to each transfer.

4. Paragraph 36A(2)(d) requires that the person(s) who owned the assets before the change together with the person(s) who owned the assets after the change agree that the subsection apply in respect of the assets (paragraph 36A(2)(d)). Are discretionary beneficiaries under the discretionary trust, for the purposes of paragraph 36A(2)(d), persons who in each transfer owned the assets and who must agree to the application of subsection 36A(2)?

5. We are prepared to accept for the purposes of paragraph 36A(2)(d) that the discretionary beneficiaries are not persons who owned the assets either before or after the change. In each transfer, it suffices if the sole trader and the trustee of the discretionary trust sign the agreement. If the view taken in *Gartside v. Inland Revenue Commissioners* [1968] AC 553; [1968] 1 All ER 121

and *Re Goldsworthy* [1969] VR 843 is adopted, the discretionary beneficiaries would have no proprietary interest in the trading assets. They would therefore not be persons who owned the assets for the purposes of subsection 36A(2). If, on the other hand, the trustee of the discretionary trust is bound to distribute the whole of the trust assets among the discretionary beneficiaries then, based on the view taken in *Queensland Trustees Ltd v. Commissioner of Stamp Duties (Qld)* (1952) 88 CLR 54, the discretionary beneficiaries would seem to have a beneficial interest in the trust assets but the interest could be divested on the exercise of the trustee's discretion. We think, even on this view, that there is sufficient doubt whether the discretionary beneficiaries may truly be said to be persons who **owned** the assets for us not to insist on their agreeing that subsection 36A(2) shall apply in respect of the assets.

6. Other subsections in section 36A operate in certain circumstances to preclude the application of subsection 36A(2): see subsections 36A(5), 36A(6), 36A(7) and 36A(8). [Where these subsections refer to a 'notice' given under paragraph 36A(2)(d), it is necessary to read an 'agreement' under paragraph 36A(2)(d) to ensure that these subsections operate as intended]. Subsection 36A(8) is the most likely provision to apply in the present case.

7. Subsection 36A(8) makes a paragraph 36A(2)(d) agreement ineffective if:

- (a) the change in ownership of, or in the interests in, property (other than a chose in action) has occurred otherwise than in the course of ordinary family or commercial dealing; and
- (b) the consideration received or receivable in connection with the change substantially exceeds the consideration that might reasonably be expected to have been received or receivable if the value of the property before the change had been the value applicable if the agreement had been effective.

8. We consider that the two transfers are unlikely to be held by a court to have been done in the course of ordinary family or commercial dealing especially if they are done as part of a single prearranged plan of action. Whether the consideration in connection with the change substantially exceeds the consideration that might reasonably be expected to have been received or receivable in the terms envisaged in paragraph 36A(8)(d) depends on the facts of each particular case: see for example *Income Taxation in Australia*, Prof R W Parsons, paragraph 14.82.

Definition:

The expression 'trading assets' is used in this Taxation Determination to mean assets of a business (being trading stock, standing or growing crops, crop-stools or trees which have been planted and tended for the purpose of sale).

Commissioner of Taxation

30/08/95

FOI INDEX DETAIL: Reference No.

Related TRs and TDs: TD 95/D10; TD 95/D11; TD 95/D13

Subject Ref: beneficial interest; beneficiary; discretionary trust; disposal; ownership; trading stock; trustee; undivided fractional interest

Legislative Ref: ITAA 36A(1); ITAA 36A(2); ITAA 36A(5); ITAA 36A(6); ITAA 36A(7); ITAA 36A(8)

Case Ref: *Gartside v. Inland Revenue Commissioners* [1968] AC 553; [1968] 1 All ER 121; *Re Goldsworthy* [1969] VR. 843; *Queensland Trustees Ltd v. Commissioner of Stamp Duties (Qld)* (1952) 88 CLR 54

ATO Ref: TDUMG 94/1; TOW54: NAT 95/6458-6