RESETTLEMENTS, VESTING, AND APPLYING TO COURT TO AMEND A TRUST DEED WHERE THE DEED HAS NO POWER TO AMEND

Introduction

1. Taxation Rulings are binding on the Commissioner (s357-60 TAA 1953) but not the taxpayer, who may rely on the law if it is more favourable than the Ruling (s357-70 TAA 1953).

2. Two Taxation Rulings are particularly relevant where an application is made to a court to amend a trust deed that does not have a power to amend, or the power is insufficient to make the amendment desired[1].

3. Taxation Ruling TR 2018/6 deals with the tax consequences of a trust vesting. Taxation Determination TD 2012/21 deals with "resettlements" (where the old trust ceases and a new trust is created), and where particular trust assets are held only for particular beneficiaries[2].

4. Often where an application is made to amend a trust deed where there is no power to amend in the deed, it is because the trust may be going to vest soon, and it is perceived that there will be disadvantageous CGT consequences of vesting i.e. that the post-CGT assets of the trust will be deemed to be disposed of by the trustee, and that pre-CGT assets will be turned into post-CGT assets[3]. A recent example of such an application was before Parker J in *Cisera v Cisera* [2023] NSWSC 1507 (5 Dec 2023)("*Cisera*")[4].

5. Other applications may be made because the class of beneficiaries of the trust is perceived to be too narrow, meaning that there is less flexibility than desired in who may benefit from the trust. A recent example of such an application was before Lyons JA in *Re The Pickering Family Trusts* [2024] VSC 5 (24 Jan 2024)("*Pickering*")[5].

6. In *Cisera*, there was also an application to extend the class of beneficiaries, although there was considerable focus on, even if the class was not extended, the extension of the vesting date by what was likely to be 30 years, would have the effect that different beneficiaries would be likely to take on vesting then, than would be the case if the vesting was imminent.

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[1] *Mercanti v Mercanti* [2015] WASCA 206; *Jenkins v Ellett* [2007] QSC 154. Most recently, in *Re Owies Family Trust* [2020] VSC 716 there was the issue whether the power to amend the trust deed was validly exercised to amend the guardians and appointors under the trust deed. It was held that the amendments were invalid, and the issue was not appealed in *Owies v JJE Nominees Pty Ltd* [2022] VSCA 142.

[2] For valuable commentary at the time the determination issued, see Andrew O'Bryan, "Varying Trusts after Clark", TTI Victorian Div, 13 March 2013.

[3] Further, the prior tax losses may not carry forward.

[4] Commentary on *Cisera* before *Pickering* was handed down, has been provided by Matthew Burgess, **"**Using court applications to remedy tax risks with trust deeds", Thomson Reuters Weekly Tax Bulletin at [931] 20 Dec 2023.

[5] Commentary on *Pickering* made without mentioning *Cisera*, has been provided by *William Moore et al, "*The Pickering Family Trusts: no variation power ... no options? All is not lost", Thomson Reuters Weekly Tax Bulletin at [75] 9 Feb 2024.*Pickering* has now been followed in *Re Gengoulf-Smith Family Trust* [2024] VSC 189 at [24] again without referring to *Cisera*.

7. The applications were made under like provisions of the NSW and Victorian Trustee Acts, s86A and s63A respectively. However, the outcomes were completely different, and the latter case did not refer to the former.

8. The judgement in *Cisera*, was interim in nature, as the applicant was invited to cause a "contradictor" to be appointed, but failed to do so by the next directions (8 Dec 2023), with the result that the application was struck out, rather than dismissed on its merits: *Cisera v Cisera* (No 2) [2023] NSWSC 1531.

9. In *Cisera*, the applicants referred to adverse CGT consequences of the imminent vesting, but the judgement does not refer to the above Taxation Rulings[6]. After detailed analysis of the case law on resettlements as against minor variations, Parker J thought the effect of extending the vesting date and expansion of the class of beneficiaries, would result in a resettlement of the trust, with the same perceived adverse CGT consequences as vesting occurring, such that at the time of the interim judgement, there was no utility in granting the application.

10. Parker J did not refer in *Cisera* to *FCT v. Clark* [2011] FCAFC 5 or *FCT v. Commercial Nominees of Australia Ltd* [2001] HCA 33, relied on by the Commissioner in TD 2012/21 in his analysis of resettlement, but did refer to many other cases and the history of the application of the court's power to approve amendments. The question thus arises, as to whether TD 2012/21 is more favourable to taxpayers than the law, upon which taxpayers can rely, or whether Parker J's analysis does not in fact survive the decisions in *Clark* and *Commercial Nominees*.

11. In contrast to *Cisera*, Lyons JA in *Pickering* approved an expansion of the class of beneficiaries of two related family trusts, without referring to any issue of whether the expansion might cause a resettlement and hence a potential tax problem.

TD 2012/21

12. The TD followed the Commissioner's loss in *Clark*'s case. At the same time as the TD issued, he withdrew his so-called "Creation of a new trust - Statement of Principles" on resettlements, originally issued in 1999, and amended in 2001 after he lost the *Commercial Nominees* case, to say nothing in *Commercial Nominees* (being his test case), affected his "Principles" as *Commercial Nominees* dealt with a super fund, not an ordinary trust!

13. Whilst the ATO have removed the "Statement of Principles" from its website, I have a record of some of what it contains, e.g:

[6] Another case where both rulings would have been relevant, but were not referred to, was *Re McGowan & Valentini Trusts* [2021] VSC 154

Changes potentially leading to a new trust can arise by several means, including variations under a power in the deed and a variation by agreement among the beneficiaries. Listed below are some of the changes which raise the question of whether a new trust has been created.

- *any change in beneficial interests in trust property;*
- *a new class of beneficial interest (whether introduced or altered);*
- *a possible redefinition of the beneficiary class;*
- *changes in the terms of the trust or the rights or obligations of the trustee;*
- *changes in the nature or features of trust property;*
- *additions of property which could amount to a new and separate settlement;*
- *depletion of the trust property;*
- *a change in the termination date of the trust;*
- *a change to the trust that is not contemplated by the terms of the original trust;*
- *a change in the essential nature and purpose of the trust; and/or*
- *a merger of two or more trusts or a splitting of a trust into two or more trusts.*

Depending on their nature and extent, and their combination with other indicia, these changes may amount to a mere variation of a continuing trust, or alternatively to a fundamental change in the essential nature and character of the trust relationship. In this second case, the original trust is brought to an end and/or a new trust created.

Whether a new trust is created will depend, among other things, on the terms of the original trust, and on the powers of the trustee. The original intentions of the settlor must be considered in determining whether a new trust has been created. There may be different trigger points/tests for different types of trusts. (underlining added)

14. The decisions in *Clark* and *Commercial Nominees* were to the effect that provided there is sufficient "continuity" in the trust, there would not be a resettlement.

15. In *Commercial Nominees* it was said at [36]:

> As the Full Court, and the Administrative Appeals Tribunal held, the question is one of continuity, to be considered in the context of a superannuation fund which, of its nature, may be expected to undergo change. The question is whether the eligible entity which derived the taxable income in the year ended 30 June 1995 is a different entity from the eligible entity that incurred losses in the earlier years. If, as the appellant contends, it is a different entity, there is a question as to what happened to the original entity. The three main indicia of continuity for the purposes of Pt IX are the constitution of the trusts under which the fund (if a trust fund) operated, the trust property, and membership. Changes in one or more of those matters must be such as to terminate the existence of the eligible entity, or to produce the result that it does not derive the income in question, to destroy the necessary continuity. The trusts under which the fund operated in 1994-1995 were constituted by the original trust deed in 1988 as varied by the exercise, in 1993, of a power of amendment. The property the subject of the trusts did not alter at the time the amendments took effect. Persons who were members of the fund before the amendments remained members of the fund after the amendments. The fund, both before and after the amendments, was administered as a single fund, and treated in that way by the regulatory authority.

16. In *Clark*, the majority quoted the passage above and concluded:

> 87. ….. When the High Court in *Commercial Nominees* spoke of trust property and membership as providing two of the indicia for the continued existence of the eligible entity or trust estate, the Court was not suggesting that there had to be a strict or even partial identity of property for the first and objects for the second. It was speaking more generally: that there had to be a continuum of property and membership, which could be identified at any time, even if different from time to time; and without severance of one or both leading to the termination of the trust in question. In the present case, the Commissioner never contended, nor on the evidence could he, that there was a severance in the continuum of trust property and objects of the CU Trust. Their identity changed from time to time, but not their continuum.
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> 88. Such an approach is consistent with the position at general law in relation to the four essential indicia of the existence of a trust: the trustee, trust property, the beneficiary and an equitable obligation annexed to the trust property: JD Heydon & MJ Leeming: *Jacobs' Law of Trusts in Australia* (2006) 7th ed, at [104] – [110]. In *Commercial Nominees* both the Full Court, at [49] of its reasons, and the High Court, at [35] of its reasons, pointed out that there was nothing in Pt IX, nor in the 1936 Act generally, which imposed some statutory requirement of continuity for determining when there is a sufficient identity of the trusts involved. With respect, the same applies in the case of Div 6 of Pt III of the 1936 Act.

17. The High Court refused special leave to appeal.

18. Neither case used the expression, "substratum", as such (broadly, the foundational purpose of the trust).

19. The concept of the purpose of a non-charitable trust is somewhat fraught as strictly, only charitable trusts can exist only for a purpose. Non-charitable trusts exist for beneficiaries.

20. In *Cisera*, it was said at [115]:

> There appears to be a recognition in the English authorities that where the trust involves an asset of a special character, such as a historic home, that may affect the characterisation of the nature or "substratum" of the trust: see *Lewin on Trusts* at [53-059]. Against that background, the decision in *Wyndham* may have been influenced by a perception that the "substratum" of the trust involved maintaining the family connection with Petworth. But that could hardly be a factor in the present case.

21. It is unfortunate that Parker J was apparently not referred to the Privy Council decision in *Grand View Private Trust Co Ltd & Anor v Wen-Young Wong & Ors (Bermuda)* [2022] UKPC 47 (8 Dec 2022) which while not binding on Parker J, would have assisted his Honour come to grips with the "substratum" authorities his Honour sought to deal with.

22. True it is in *Commercial Nominees*, dealing with superannuation funds, it might be said that the "substratum" of such trusts, is to provide superannuation benefits for their members (beneficiaries).

23. Further, *Clark*'s case concerned a unit trust, in which it would be expected that unitholders would change from time to time.

24. In the case of family discretionary trusts, it might be said that the "substratum" of such a trust is to provide benefits for a particular family, such that if the beneficiaries were changed to be exclusively for another family, the "substratum" would arguably change[7].

25. However, whether TD 2012/21 is more beneficial to the taxpayer than the law actually provides, might only apply to the Examples provided in the TD, because the introductory part of the ruling says: "neither CGT event E1 nor CGT event E2 … happens unless…

> [a] *the change causes the existing trust to terminate and a new trust to arise for trust law purposes" i.e. a resettlement*, or
>
> [b] "the effect of the change or court approved variation is such as to lead to a particular asset being subject to a separate charter of rights and obligations such as to give rise to the conclusion that that asset has been settled on terms of a different trust." (*italics* added)

26. In relation to (a), it is worthy of note that CGT event E1 can only happen by a "declaration[8] or settlement[9]" of trust.

27. In relation to (b), the Commissioner's ruling on "trust splits" (TD 2019/14) notes that under a trust split some assets of the trust continue on the existing trust, and some assets are held on a new trust, so that there is not a "resettlement" as such[10].

28. So, the Examples in the ruling of adding and removing general beneficiaries or extending the vesting date may provide protection that they will not be treated by the ATO as a "resettlement", will not help if the changes to the trust deed are not exactly as in the Examples, because the ruling is still effectively saying if there is a resettlement and it isn't covered expressly by the Examples, there may be a problem.

29. Interestingly, TD 2019/14 reaches the conclusion that the appointment of different trustees and appointors in relation to specified property will not be enough to be "trust splitting" but where those trustees' indemnity to restricted to only the specified property[11], there will be the separate charter of rights and obligations to which (b) above applies.

30. By corollary, this may indirectly confirm that the Commissioner view may be that changing appointors will not result in a resettlement.

31. The Full Federal Court in *Bellinz v FCT* [1998] FCA 615 warns us that a public ruling will only protect the taxpayer to the extent that what they are doing is on "all fours" with the ruling.

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[7] Op Cit O'Bryan at p13.

[8] As to which see *Oswal v FCT* [2013] FCA 745 at [40]-[54].

[9] As to which see *Oswa*l at [55]–[60]; Also see *Taras Nominees Pty Ltd as Trustee for the Burnley Street Trust v FCT* [2015] FCAFC 4 at [5] ff.

[10] TD 2022/11 relating to unpaid present entitlements in the Div 7A context says that where an entitlement is put on "sub-trust" permitted by the deed, for the exclusive use of the corporate beneficiary, that will be a separate trust. Also see PCG 2017/13. There is no discussion in the TD as to whether this may be a "resettlement". Criticism of Commissioner's approach in to treating unpaid present entitlements as "financial accommodation" implicit in TD 2022/11 as contained in *Bendel and the Commissioner of Taxation* [2023] AATA 3074 (on appeal) did not extend to the Commissioner's treatment of sub-trusts. Nor did the "sub-trust" found to exist in *Aussiegolfa v FCT* [2018] FCAFC 122 prompt any discussion of "resettlement".

[11] It is noteworthy that the Full Court in *Clark*'s case at [82] made observations that the limitation of trustee's indemnity in that case was not a factor pointing to a resettlement, and referred to *Buckle*'s case.

32. In relation to changing takers-in-default of capital from those who have a right to be considered to a vested interest, the decision in *Chief Commissioner of Stamp Duties v Buckle* [1998] HCA 4, is authority that this will not cause a resettlement, that is, in the stamp duties context of that case, whether there was a conveyance of the whole of the$4M gross assets of the trust, when the net assets were negligible. The High Court said that the amendment converted persons who were in the case of person who could take on vesting, from having a mere right to be considered, to person who had a vested interest subject to divestment. The value of what was conveyed was the value of the net assets discounted by the time it would potentially take before the takers-in-default where likely to take.

33. Query if the takers-in-default were changed to different people altogether.

Stamp Duty

33. The analysis under the duties legislation is also illustrative of when there will be a "resettlement".

34. The Duties Regulations 2022 (26 August 2022) under the Duties Act 1997 (NSW), expressly make a change to take takers-in-default out of being a potentially dutiable transaction viz, (a) a change in default beneficial interests under a discretionary trust, including the following— (i) a change to the default beneficial interests of the default beneficiaries, (ii) the addition or removal of a default beneficiary.

35. This change seems to have legislated Revenue NSW's practice immediately before the change. That practice was contained in DUT 017v2 (issued Nov 2022 effective 19 May 2022):

DUT 017v2

Preamble …

2. Prior to the decision of the *High Court in Chief Commissioner of Stamp Duties v Buckle* (1998) 37 ATR 393, some variations to trusts were assessed under the Stamp Duties Act 1920 to ad valorem duty as conveyances of property. In the Buckle decision, the High Court found that a deed that varied the terms of a discretionary trust was not a resettlement of the trust fund as a whole.
…
3. There are generally two types of beneficiaries under a discretionary trust: takers in default, and discretionary objects. A taker in default has a vested interest in the trust fund subject to any exercise of a power of appointment by the trustee. However, a discretionary object, as such, has neither a vested nor contingent interest in the fund, but has a chose in action involving a right to call for the due administration of the discretionary trust.

Ruling …

Is the variation of a discretionary trust a 'dutiable transaction'?

8. Under section 8 and the Dictionary of the *Duties Act*, a 'transfer' includes an assignment or exchange of dutiable property. The word 'transfer' has a wide meaning but, unlike the definition of 'conveyance' in section 65 of the *Stamp Duties Act 1920,* it does not cover cases

where dutiable property is vested in a person without being divested from some person who previously owned it. In *Coles Myer Limited v Commissioner of State Revenue (1998)* 98 ATC 4537, the Victorian Court of Appeal held (at 4546-7) that a 'transfer' is essentially bilateral in nature. A transfer requires at least that the transferee should, at the end of the transaction, have substantially the same right or interest in the subject matter as did the transferor before the transfer took place.

9. In Buckle, although it could be said that prior to the variation, the trustee was the 'owner' of the assets then comprised in the trust fund, the variation by the trustee did not transfer those assets. The beneficiaries acquired vested interests in the trust fund as takers in default, but these interests were not vested in the trustee prior to the variation. Consequently, there was a vesting rather than a transfer of the property, and such a vesting is not a dutiable transaction under then section 8 of the Act. Since 19 May 2022, a variation of trust which vests an interest in dutiable property can be a dutiable transaction under section 8(1)(b)(ix) of the Act as a "change in beneficial ownership" (as defined in section 8(3)).
10. For the same reasons, where the trustee by an amending deed adds to the class of existing takers in default, the deed does not effect any transfer of property from the trustee to the new taker in default. Furthermore, there is no transfer of property from the existing takers in default to the new taker in default because the purported transferors (the existing takers in default) are not parties to the transaction whereby the interest is vested in the purported transferee (the new taker in default).

Is the property in a variation of a discretionary trust 'dutiable property'?

12. Clearly, the interest of a discretionary object under a discretionary trust is not dutiable property under paragraph (l) of section 11. Such a beneficiary has the right to compel the due administration of the trust (an equitable chose in action) but has no vested or contingent proprietary interest in the trust fund or in the assets (including any dutiable property) which from time to time comprise the trust fund. Accordingly, an amending variation or supplemental deed that merely adds to or subtracts from the class of discretionary objects (whether or not the trust also has takers in default) does not affect dutiable property and is not liable to duty under the Act.
13. It is not clear from the decision in Buckle whether the interest of a taker in default can be regarded as dutiable property under paragraph (l) of section 11 (an interest in any dutiable property listed in section 11). While takers in default have a vested or contingent interest in the trust fund, the High Court in Buckle emphasised that this interest was distinct from the assets (including any dutiable property) which may comprise the trust fund from time to time. Revenue NSW takes the view that the interest of a taker in default is dutiable property to the extent that the trust fund comprises dutiable property.
14. However, the High Court in Buckle indicated that the present value of such interests 'had to reflect the vicissitudes which were an essential element of the structure' of the discretionary trust. Therefore, the unencumbered value of the interest of a taker in default is to be determined after taking into account:
    a. the extent to which the trustee (or any other person) can, by exercising powers conferred under the trust deed, affect or defeat the interests of the takers in default; and
    b. whether the interest is contingent on the taker in default being alive on the distribution date.

    Consequently, the unencumbered value of the interest of a taker in default will, in most cases, be minimal. This will be so even before taking into account whether the trust has any liabilities

for which the trustee is indemnified and that would have the effect of depleting or exhausting the funds available for distribution.

Summary - discretionary trusts

16. The following variations to discretionary trusts are not dutiable transactions over dutiable property, or not treated as a dutiable transaction and will not be liable to duty:
    a. a variation that adds a beneficiary to, or deletes a beneficiary from, the class of persons who are takers in default;
    b. a variation that adds a beneficiary to, or deletes a beneficiary from, the class of persons who are discretionary objects
    c. a variation that varies the interests inter se of beneficiaries without altering the identity of beneficiaries; and
    d. a variation that merely inserts or amends administrative powers without vesting any interest of the beneficiaries in the trust property.

36. Before the Duties Act 1997, the Revenue NSW position was in SD 45 (1986):

Revenue Ruling No. SD45

Variations of Discretionary Trusts

Preamble

There are two types of beneficiary under a discretionary trust: takers in default of appointment and discretionary objects.

A taker in default of appointment takes the trust fund subject to any exercise of a mere power of appointment by the trustee. His interest is referred to as a defeasible interest or a vested interest subject to divestment.

No discretionary object, as such, has a vested or contingent interest in the fund.

Each discretionary object has a chose in action carrying with it, or involving, a right to call for the due administration of the discretionary trust: see Gartside v IRC (1968) AC 553, 617-618….

Questions have arisen concerning the stamp duty obligations attaching to instruments effecting variations to discretionary trusts where, for example, amendments involve the addition or deletion of a beneficiary. The following situations arise:

(i) where the trustee has a "mere power' i.e. the trustee holds the trust property on trust for persons in default of that power being exercised;

(ii) where the trustee has a "trust power" i.e. there are no persons designated to take in default, only discretionary objects (with the trustee duty bound to exercise the power).

The broad principles adopted by the Chief Commissioner of Stamp Duties in determining liability to stamp duty may be summarised as follows:

(a) where trustees have a mere power and the instrument of variation adds or deletes a beneficiary to the class of persons who are takers in default of exercise of that power, the instrument will be liable to ad valorem duty as a "conveyance", since the takers in default have an interest in property which is vested, though subject to divestment by the exercise of the trustees' powers;

(b) where trustees have a mere power and the instrument of variation adds or deletes a beneficiary of the class of persons who are discretionary objects the instrument will not attract ad valorem duty, since the discretionary objects have no interest vested or contingent in the trust fund. Restated, the objects of the power have the same interest (consisting of the right to have their entitlements protected by a court of equity and a right to take and enjoy whatever part of the income or corpus the trustees choose to give them) before and after the instrument of variation. In this case, the only difference arising from the instrument of variation is that the size of the class of potential beneficiaries has been altered;

(c) where trustees have a trust power an instrument of variation of beneficiaries will not attract ad valorem duty since it merely adds or deletes discretionary objects, and the same analysis as is set out in (b) above applies.

37. Interestingly, the current position in Victoria is different to the current position in NSW. The SRO website says:

Variation of a discretionary trust

Duty may apply to a variation of the terms and beneficiaries of a discretionary trust holding dutiable property.

Duty will apply to a variation that is so significant that it severs the continuity of the trust and results in a declaration of trust or a change in beneficial ownership of the dutiable property of the trust.

Whether a variation to a discretionary trust results in duty can only be determined on a case-by-case basis taking into account all facts and circumstances, the terms of the relevant discretionary trust deed, and the nature and extent of the variations.

Generally, the Commissioner considers that a dutiable transaction may arise where a variation to a discretionary trust has the effect of:

- creating beneficial interests in persons in whom those interests did not exist previously
- changing all the default beneficiaries/takers in default of that discretionary trust
- significantly changing the interests of beneficiaries between themselves.

In these cases, duty at general rates would apply based on the value of the property held by the trust.

The Commissioner also accepts that certain variations will not give rise to a dutiable transaction, such as:

- minor variation to the administrative provisions of a trust, such as the trustee's power to operate bank accounts, borrow money, keep records and pay expenses
- the addition or deletion of discretionary objects to and from a class of persons under a discretionary trust provided that the trustee of that trust has the pre-existing authority to do so under the terms of the trust.

38. The SRO in Victoria withdrew the ruling dealing with this issue on 30 June 2001 (SD-062) and has not issued a replacement ruling, so their statement on the website above is their only current guidance.

Revenue Rulings SD-062 (replacing SD-030)

Preamble

> To date, Victoria, like South Australia, has adopted the position set down by the Taxation Appeals Board in 1982 (*Case 25 CTBR (NS) VTB Case 1)* that a change of discretionary objects does constitute a resettlement of a trust. Accordingly, duty has been payable under Heading IX of the Third Schedule of the Act to the sum of $200.
>
> That position has now been reviewed and a decision has been made to alter the current policy….

Ruling

> Where there is a change in takers in default of a trust, there is a resettlement which is dutiable under Heading IX of the Third Schedule of the Act.
>
> Where there is merely a change in discretionary objects, such a change will not constitute a resettlement. Accordingly, duty under Heading IX of the Third Schedule of the Act will not be payable.

<u>TR 2018/6</u>

39. Broadly, the ruling disavows a CGT event arising simply because the vesting date of a discretionary trust has arrived. Rather it says that the trust can continue if property is not distributed to beneficiaries, but with the result that the trustee no longer has any discretion, and the income of the trust will then follow the proportions that the capital beneficiaries share in the capital.

40. However, it is expressly stated that if particular assets are from the vesting date, held for particular beneficiaries, pursuant to a power of the trust, CGT event E1 will occur.

41. If this ruling is correct, it may mean that the representation to the courts that dreadful CGT consequences will necessarily follow if the court does not extend the vesting date, are overstated.

42. That advisors held the view before TR 2018/6 that simply because the vesting date had arrived, did not mean there was a CGT event, was alluded to sensationally in *Hancock v Reinhart* [2015]

NSWSC 646 (at [223]; [232]), where it was held that Pricewaterhouse Coopers had been manipulated to change their opinion that no CGT event occurred on vesting.

Barrister

Melbourne

2 May 2024