TRUST RESETTLEMENT:

THE LAW AND ATO'S STATEMENT OF PRINCIPLE

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ABSTRACT

The fact that trust resettlement could have income tax implications is nothing new. This issue has been around for a long time; yet, it is an area where the application of the law to real life facts remains unclear. For years, an embargo was imposed on private rulings in relation to trust resettlement issue while the ATO formulates and considers its position. This position finally emerged in the form of the Statement of Principles on the creation of a new trust. A test case (ie. *Commercial Nominees*) has also been mounted by the ATO. It subsequently lost the case; and consequently, the Statement of Principles was "revised", but its position remains the same.

The Commissioner's general position is that there is a trust resettlement (in the sense of creation of a new trust) where there is a fundamental change to the rights or obligations of the beneficiaries of the trust. This general proposition is consistent with the prevailing legal jurisprudence. Unfortunately, this proposition says very little; the Statement of Principles has failed to provide any further guidance in terms of its application to real life facts. Indeed, the gloss that the Statement of Principles placed on some issues tends to compound the uncertainties in this area of law. Further, the Commissioner's attempt to quarantine the scope of the seemingly unfavourable *Commercial Nominees* case is arguably highly dubious. The better view seems to be that the legal framework supporting and illustrating the reasoning adopted in that case is consistent with the prevailing legal jurisprudence in relation to variation of trust in both Australia and overseas. The approach illustrated by *Commercial Nominees* is equally applicable to trust in general.

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INTRODUCTION

Variations to a trust deed are very common in practice, yet the taxation consequences flowing from such activities are not well defined. Variation to a trust deed ranges from the administrative type changes, such as the inclusion of procedurals steps to account for trust income in a certain way, through to changes that impact upon the trust property and/ or the rights or obligations of the beneficiaries. The consequences also range from the nothing in the former case to the potentially adverse resettlement scenario that may arise from the latter. The boundary between the two cases is where the uncertainty is. Essentially, what changes amount to a resettlement? Fundamental that this issue is, but the jurisprudence remains unclear.

In recent times, a Statement of Principles has been issued by the Australian Taxation Office (ATO) on this very issue. This Statement of Principles has been "revised" following the outcome of the High Court decision in *Commercial Nominees*[1], a test case mounted by the ATO to clarify the law in this area. Despite the seemingly contrary position espoused by the Statement of Principles as compared to the High Court decision, the Commissioner's position remains unchanged in the "revised" version. Instead, the Commissioner seeks to restrict the application of *Commercial Nominees* to superannuation fund. Is this appropriate? What is the legal position concerning resettlement now? This paper examines the development of the law concerning this issue; particularly how it could apply to income tax issues, and in so doing, considers the position adopted by the Commissioner in the Statement of Principles.

The structure of this paper is as follows. First, the relevance of this notion called "trust resettlement" to income taxation issues is outlined to establish the context of subsequent discussions. Second, the technical meanings of settlement and resettlement is considered based on case laws analysis. This part seeks to identify the prevailing approach adopted by the Courts in respect of this issue, and in particular, the implications for income tax issues. The general thrust of the ATO's position is also considered along the way. Then, in the final section of this paper, some of the examples in the Statement of Principles are examined and some of the loose threads in the previous section are pulled together.

[1] The case was heard in the first instance in the AAT, and known as *case 22/98* [1998] ATC 282, (1998) 41 ATR 1077; then it was appealed to the Federal court of Australia, *FCT v Commercial Nominees of Australia Ltd* (1999) 167 ALR 147. Finally, the case found itself in the High Court, *FCT v Commercial Nominees of Australia Limited* (2001) 47 ATR 220.

RESETTLEMENT IN THE GRAND SCHEME OF TAXATION OF TRUST

The issue of resettlement often goes hand-in-hand with discussion about variation to a trust deed. Resettlement is an archaic terminology that is often cited, but arguably much less understood. Before considering the technical meaning of the term, it is instructive to briefly consider the practical sense of the term; in particular, the income tax implications associated with this phenomenon called resettlement.

Tax Implications of Trust Resettlement

A resettlement of trust may give rise to various tax consequences to the trustee, including: capital gains tax, ability to recoup tax losses (revenue or capital), depreciation balancing changes adjustments, foreign tax credits, trading stocks.[2] In addition, there may also be consequences to the beneficiaries as well. Two main areas are outlined here:

(i) Capital gains tax

(ii) Tax losses

Capital Gain Tax

The presence or the possibility of resettlement often raises the concern that there will be some capital gains tax liability. It is important to clarify the relationship between resettlement and CGT liability. For CGT purposes, the concern is whether the arrangement triggered a "CGT Event", and hence, leads to the inclusion of a capital gain in the taxpayer's assessable income. A particularly relevant CGT Event in the context of variation of trust is CGT Event E1. This occurs where, among other conditions, there is a "creation of a trust over a CGT asset by declaration or *settlement*" (emphasis added).[3] Sub-section 104-55(5) further provides that CGT Event E1 does not happen if:

(a) the person is the sole beneficiary of the trust and:

  (i) the person is absolutely entitled to the asset as against the trustee (disregarding any legal disability); and

  (ii) the trust is not a unit trust; or

[2] These are recognised in *A Platform for Consultation*, paragraph 22.48 on p491.

[3] Sub-section 104-55(1) of ITAA 1997.

(b) the trust is created by transferring the asset from another trust, and the beneficiaries and the terms of both trusts are the same.[4]

Resettlement *per se* does *not* give rise to a CGT liability, whereas it may give rise to a liability under Stamp Duties legislation.[5] By itself, it does not mean much. This is not suggesting that the notion of settlement is irrelevant. It is merely one of the factors that need to be considered, albeit admittedly one of the more important one. Resettlement signifies nothing more than a possible situation where CGT Event E1 may arise. The other conditions in the provisions need to be considered. For there to be an income tax liability *all* conditions for a particular CGT Event need also be satisfied.[6]

There is also a subtle distinction between a resettlement and CGT Event E1.[7] E1 focuses upon whether there is a creation of a new trust, whereas resettlement concerns naturally on resettlement. These two concepts are not identical; for example, the vesting of a unit trust followed by the creation of a new unit trust is not a resettlement as such. Indeed, the creation of new trust need not results in a resettlement; but where there is a resettlement, a new trust always arises.

It has been argued that the notion of resettlement may be "inapposite" to fixed or unit trusts.[8] At issue are the two alternative levels upon which CGT could apply – at the trustee level, or, at the unit holders level. For example, variation of rights attached to units is *prima facie* a change to the interest of the unit holders, not the trust fund. If so, why should there be a resettlement of the trust property and give rise to CGT at the trust level? Indeed, which Event is relevant – A1, C2 or E1 to E9?

Although there are little doubt that the CGT Event E1 would apply to the creation of a trust over asset already subject to a trust; for example, where a trustee of an existing trust holds an asset on trust and creates a new trust over those same assets.[9] There are a number of instances where this will not be the case:

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[4] In relation to (b) one is entitled to ask when are two trusts the same? *See A & G Lamattina & Sons Pty Ltd. v C* 33 ATR 535; wherein the argument that the trusts were the same was rejected.

[5] This is particularly the case under the old stamp duties legislation where the imposition of duty turns on the notion of "settlement"; cf. Under the rewritten statutes, such as the *Duties Act 1997* (NSW), the imposition of duty is based largely on the more concrete notion of "transfer".

[6] Refer to exception under sub-section 104-55(5).

[7] Moshinsky, A. 'Consequences of a Termination' (1999) 34 TIA 126.

[8] Moshinsky, A., *op. cit.*

[9] Cathro, G. 'Variation of Discretionary Trust' (1996) 25 ATRev 40.

- Where there is only one beneficiary who is absolutely entitled to the asset as against the trustee (except where the trust is an unit trust).[10]
- Where the assets are transferred from another trust and the beneficiaries and terms of both trusts are identical.[11] This would seem to suggest that changes to the trust deed would not have Event E1 consequence so long that there is no change to the beneficiaries and the terms of the trust. Does this exception only apply where the benefit and term are *absolutely* the same? Alternatively, is there a threshold?
- Any capital gains arising from Event E1 may be nominal if the logic in *Buckle's Case*[12] applies. In that case, the trustee's right of indemnity is taken into consideration and the present value of the interest is calculated taking into account the fact, where applicable, that the interest is capable of being defeated.

Tax Losses

The second main issue that often arise with resettlement concerns the ability to carry forward tax losses. It is interesting that there are no references to "resettlement" in the tax loss provisions. The notion of resettlement becomes relevant insofar that a resettlement impact upon the continuity of the trust. That is, technically, the test for carry forward of tax losses turns on the continuity of the trust rather than resettlement *per se*. This point is well emphasised by the both the Full Federal Court and the High Court in *Commercial Nominees*:[13]

> "Whether or not the changes wrought by the Amending Deed mean that the Amending Deed effected a resettlement for stamp duty purposes is not to the point. The question is whether the Trustee was entitled, under sections 79E(3) and 80(2) to treat the losses for the 1989 and 1990 income years as deductions from the assessable income of the Fund in the 1995 year of income."

[10] Subsection 104-55(5)(a). Ie. Event E1 does not apply to the creation of bare trust. This essentially is an application of the principle in *Saunders v Vautier* (1841) 49 ER 282. Refer to also to footnote 24.

In relation to the notion of "absolute entitlement" see paper by Momsen, J. (1990).

[11] Subsection 104-44(5)(b).

[12] *CSD (NSW) v Buckle* 98 ATC 4097.

[13] *Comr of Taxation v Commercial Nominees of Australia* (1999) 43 ATR 42; 99 ATC 5115

Similarly, the High Court itself said the issue is whether "by reason of changes in the nature of the fund, the taxpayer in the earlier years was not the same taxpayer as in the year of income."[14]

A final observation here is that there is a distinction between resettlement and when an existing trust comes to an end.[15] A resettlement does not mean a trust has came to an end; nor does the fact that a trust has came to an end means that there is a resettlement! It is simply not correct that the notion of a trust estate coming to an end has a particular tax law meaning. Typically, a trust estate comes to an end when the legal and beneficial interests of the trust estate are vested in the same persons, or, when the trust property ceases to be subjected to the trust. A resettlement could involve the settlement of *part* or *all* of the trust assets of an existing trust. By contrast, an existing trust comes to an end only if the *whole* of the trust fund is settled upon a new trust. Although a new trust is created in both cases, only in the latter case did the original trust estate comes to an end. If the original trust did not come to an end, its continuity means that it could carry forward tax losses.

Practical Meaning of Resettlement

Often a lot of significance is place on the notion of "resettlement". The common usage of the term gives resettlement almost a magical quality. It is taken to give rise to income tax liability almost as a matter of fact. Clearly, it does not; at least not in the income tax context. Despite the importance that is seemingly attributed to resettlement, it is somewhat surprising to observe that resettlement *per se* do not give rise to any direct income tax consequences. There are no provisions within the *Income Tax Assessment Act 1936* and *Income Tax Assessment Act 1997* that turns solely on the notion of resettlement. Not that it is irrelevant and has no tax implication; the point here is that, regardless whether there is a resettlement, it is not determinative of the tax consequences.

It is also useful to note the subtle distinction between resettlement, an existing trust coming to an end and the creation of a new trust. This distinction is significant in analysing the income tax implications. For instance, CGT consequences will arise in both cases; but the ability to carry forward losses will only be affected if the trust comes to an end. That is, resettlement may not necessarily result in the loss of ability to carry forward tax losses, unless the resettlement also results in the existing trust coming to an end.

[14] Paragraph 13

[15] Moshinsky, A. 'Trust Resettlement' (1999) 3 Tax Specialist 126.

In a sense, "resettlement" as a word may be regarded as an anachronistic concept, one whose legacy relates more to stamp duty than income taxation. In terms of usage it seems that references to resettlement merely flags a situation whereby certain tax consequences may flow. That is, "resettlement" is used nowadays as a convenient term to refer to the creation of a new trust, either where a trust comes to a end and a new trust arise in its place, or, where a new trust arise without the original trust coming to an end. This is consistent with the ATO usage of the term in its Statement of Principles. This practical meaning is a shorthand way of alluding to the fact there may be significant tax consequences if this thing called "resettlement" happen – especially, the loss of carried forward losses and the happening of CGT Event E1.

CREATION AND ENDING OF TRUST

With the income tax consequences turning on the creation of a new trust or a trust coming to an end, the important question to consider is: when exactly does this situation occur? This section considers the legal jurisprudence on this matter.

Notwithstanding that resettlement *per se* is not determinative of the income tax issue, the general law understanding of resettlement provides guidance as to whether there is a new trust or whether a trust has came to an end. After all, it is widely accepted that tax legislation takes the law as it finds it.[16] Hence, Principless established by the case laws in relation to settlement and resettlement are entirely relevant here. One caveat is that stamp duty cases often turns upon the existence or not of a "settlement", whereas this is not the case for income tax purpose. These cases are certainly not concern about when an amended trust has such different obligations from the pre-amendment trust that it can be called a new trust.[17] Whereas CGT Event E1 for instance is concern about the creation of a trust by means of a declaration or settlement.

This difference in focus is important for two reasons. First, multiple trusts could arise under one settlement, either simultaneously or in succession.[18] Second, a trust can be created by means other than by a settlement. A declaration of trust, for example, does not necessarily entail a settlement. In a sense, the concept of a "settlement" operates to limit the scope of section 104-55(1). For example, a constructive trust could arises in particular circumstances without a declaration of trust or a settlement, meaning that the creation of such a trust would not trigger the operation of CGT Event E1.

[16] The ATO's Statement of Principle has accepted as much.

[17] Moshinsky, A. 'Trust Resettlement' (1999) 3 Tax Specialist 126.

[18] Australian Tax Practice, *Commentaries on the 1997 Act*.

The Meaning of Settlement

The inquiry into the legal meaning of settlement begins with the classic statement of Griffith CJ in *Davidson v Chirnside*:[19]

> "In my opinion any instrument, which on its face purports to be a charter of future rights and obligations with respect to the property comprised in it, and which contains limitations as are ordinarily contained in settlements, is a settlement or agreement to settle within the meaning of the Schedule, whether those rights could have been established allunde or not."

In another classic case *The Commissioner of Stamp Duties (Qld) v Hopkins*, Rich J stated the following:[20]

> "In order that a document may constitute a settlement, it is essential (subject to any artificial meaning which may be attributed to the word by statute) that it should at least operate or contribute to cause property, in the sense of some right or interest of a proprietary nature, to become, either at law or in equity, vested in some person or devoted to some charitable purpose."

Dixon J in the same case stated that:[21]

> "An instrument is a settlement because it creates trusts and contains limitations which restrict or affect alienation and transmission, according to the course provided by law for estates in fee simple or a full ownership ..."

The indicia of settlement is further spelt out by Dixon J in *Buzza's* case, where he said:[22]

> "The creation of new trusts, the inclusion of trusts to persons in succession and the restriction in all the trust upon the enjoyment which would arise from full ownership market the instrument out as a settlement."

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[19] (1908) 7 CLR 324 at 340.

[20] (1945) 71 CLR 351 at 367.

[21] (1945) 71 CLR 351 at 378.

[22] (1951) 83 CLR 286 at 300. These indicia were based upon the UK case of *Massereene v Commissioners of Inland Revenue* [1900] 2 IR 138, where it was said that (at 146):

> "It is essential to such an instrument that there shall be: (1) such free property, by which I mean property which then is not, according to our jurisprudence, subject to the trusts in question; (2) a settlor who either is, or appears on the face of the instrument to be, competent to subject that free property to trusts which until the execution of the instrument, did not bind it, and (3) an imposition by the instrument of such trusts upon such property."

From these traditional stamp duty cases a settlement is an instrument that defines or creates a trust and that set limits or restrictions upon the manner in which trust property will pass to beneficiaries. In other words some typical "indicators" are:[23]

- the limitation of estates in succession;
- the imposition of restriction of full enjoyment of the rights of ownership and the beneficial interests created or declared by the instrument;
- the conferring of powers of management and of administration of the subject property.

In the absence of such key features, a settlement does not exist under general law.

A point to note is that the mere presence of a trust does not mean there is a settlement. A bare trust,[24] for example, would probably not be a settlement for the simple reason that there is no limitation on the passage of the property to beneficiaries. Indeed, depending on the precise terms, even a fixed trust may not be a settlement.[25] Thus, for there to be a settlement in the required sense, the trust that is created at least has to be more than a bare trust.[26]

The Meaning of Resettlement

For obvious reason "resettlement" is conceptually related to settlement. In broad terms, a resettlement is where there is a new "settlement" of the trust property of an original settlement. The real issue, in the context of variation of trust deed, is when is there a new settlement of existing trust property or assets. This is the source of much uncertainty. Megarry VC's said in *Re Ball's Settlement Trusts* that there is resettlement:[27]

> "If an arrangement changes the whole substratum of the trust, then it may well be that it cannot be regarded merely as varying the trust."

[23] These are as outlined by Mclnerney J in *Scott v Comptroller of Stamps (Vic)* [1967] VR 122 at 146. Refer to *Scott's* Case for a comprehensive review of the authorities.

[24] A bare trust is a trust where the trustee has no active duties to perform, and merely holds onto the property on behalf of the beneficiaries. Technically, it is a trust where there is a sole beneficiary who is absolutely entitled as against the trustee (disregarding any legal disability).

[25] See Moshinsky, A. 'Trust Resettlement' (1999) December 3 Tax Specialist 126 at p126.

[26] See Robertson, M. 'Trusts - Why The Commissioner Is Right!' (1999) October 3 Tax Specialist 74, *Buzza v CS (Vic)* (1951) 83 CLR 286, *IRC v Hamilton –Russell* [1943] All ER, *Herdegen v FCT* (1988) 20 ATR 24.

[27] [1968] 1WLR 899 at 905

The question then becomes what changes to a trust will be so substantial as to alter the whole substratum of the trust. The jurisprudence concerning this issue are examined below.

Charter of Rights Approach

An examination of the jurisprudence on resettlement must commenced with the so called Charter of Right approach. Its origin can be traced to Griffiths CJ's observation in *Davidson v Chirnside*[28] concerning the meaning of "settlement", in which he stated that the instrument needs to be a "charter of future rights and obligations in respect to the property comprised in it". [29] From this statement, a strong form of this approach is that *any* variation to the Charter of Rights under the existing trust will comprise a resettlement. That is, any changes to the rights and entitlements of beneficiaries are sufficient to result in a resettlement.

The argument for this strict approach is the High Court implicit rejection of older authorities, notable *Wiseman v Collector of Imposts*[30] and *Re Strachan*[31], that requires there to be variation to the beneficial interest in the underlying trust property before there is a resettlement. In *Davidson*, following the testator's instruction, the trust fund under his will were transferred from the trustee appointed under the will to some other trustee whereby they are to hold the trust fund upon the same trust as expressed by the will. The instrument effecting this change expressly provided that there are no alternation or creation of beneficial interests in the trust. The High Court held that the transfer resulted in a resettlement. This conclusion is taken to be a rejection of the requirement to have a change in beneficial interest.

However, whether *Davidson* in fact did reject such older authorities are debatable.[32] The above interpretation seems too narrow. The better view is that there is no specific rejection of the beneficial interest argument. On the contrary, Griffiths CJ noted in the same sentence that a settlement must contain "such limitations as are ordinarily contained

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[28] *Op. Cit.*

[29] At 340-1. Refer to page 7 for full quote.

[30] (1896) 21 VLR 743. In *Wiseman*, several equitable tenants in common of various properties want to rationalise their property holdings. The agreed process involves transfer of some properties to a trustee to facilitate division among the several parties to the agreement. No new interests were created as a result of this agreement. Madden CJ held at 747 that "... Before a transaction can be regarded as a settlement within the meaning of the Schedule it must create a beneficial interest in some person in whom it did not previously exist."

[31] (1902) 28 VLR 118.

[32] As noted by ATP Commentators in the Commentaries on the *Income Tax Assessment Act 1997*.

in settlements",[33] and that "in the present case the rights under the two instruments are by no means identical".[34] The inference here is that Griffiths CJ has not necessarily rejected the proposition that there must be some change in beneficial interests by the relevant instrument; what he did reject is the broad requirement in *Wiseman* that a change in beneficial interest will result in a resettlement. Higgins J in the same case agreed that the dictum in *Wiseman* might be too broad. Likewise, Barton and O'Connor JJ concurred with Griffiths CJ.

Subsequent cases have further ameliorated the apparent harshness of the strong form Charter of Right approach. For instance in *Wedge v Acting Comptroller of Stamps (Vic)*[35], although the High Court distinguished *Davidson* despite the similarities of the two cases, the Courts indicated that a variation to beneficial interests in the subject property was a crucial element. Rich ACJ observed at 79:

> "The subject instrument contains no disposition or agreement to dispose of property belonging to the appellant but is merely an acknowledgment or recognition that he is not the absolute owner of the property comprised in the instrument and preserved other trusts or rights affecting it. *No new beneficial interest is created* in favour of the appellant or anybody else, and the property remains subject to the same trusts as it did before the instrument was executed." (emphasis added)

Likewise, Williams J held at 82 that:

> "[h]e and the widow, as the only persons interested in the property, were entitled to call upon the trustee to transfer it according to their directions. As a result of the transfer he only *acquired the same beneficial interest* in the property as he already had under the will ... His undertaking was a mere recognition of existing trusts." (emphasis added)

In *Comr of Stamp Duties (Qld) v Hopkins*[36], the High Court again noted the importance of a change of beneficial interests for there to be a settlement. It follows from the statement

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[33] At 341.

[34] At 340.

[35] (1940) 64 CLR 75. Here, a testator had left a part of his estate, including a house, to his widow for the remainder of her life or for the duration of her widowhood. The remainder of this estate was to fall into the residuary estate. The testator's only son was the sole residuary beneficiary. To enable the son to obtain the use of the house before the termination of the widow's estate, the widow and her son agreed that the trustee of the deceased estate should transfer the house to the son, who would hold the house upon the same trusts expressed in the will.

[36] (1945) 71 CLR 351.

regarding settlement by Dixon J and Rich J, quoted previously,[37] that the integral elements of a settlement are: the vesting of some proprietary rights or interests and imposing some limitation thereon. More recently, the requirement that there be a variation of the beneficial interests in trust property was endorsed by McInerney J in *Scott v Comptroller of Stamps (Vic)*[38].

Whist the outcome of *Davidson* may have suggested that changes in beneficial ownership is irrelevant to the existence of a settlement, the better view appears to be that, although a variation or creation of beneficial interests is not the sole indicia of a settlement, it is nevertheless a significant factor. In other words, resettlement should at least involve some changes to the beneficial interests in some form of property.[39]

The trend of case authorities seem to be that the strong form charter of right approach has gave way to an approach that takes a broader and more pragmatic view of the change in determining whether there is a new trust. It then becomes a question of degree that requires analysis of the circumstances. This trend is further explored below. Anyhow, an important consideration is whether there is any disposition of beneficial interests in the trust.

Commercial Nominees

The Courts rarely have the opportunities to consider resettlement in the context of income tax issue; but in recent years, the now famous *Commercial Nominees* have provided such a chance.[40] The judicial saga stretched from the AAT, the Full Federal Court to the Hight Court.[41]

In *Commercial Nominees*, a superannuation fund was established by Control Data Australia Pty Limited (subsequently renamed as the Miden Group) during the 1988 income year. The fund was set up as defined benefit fund to provide benefits to employees of Control Data and its related companies. The dispute arouse from amendments made to the trust deed in November 1992. As part of the amendment a new trustee was appointed, a new set of governing rules were adopted, the fund were changed from a defined benefit to an accumulation fund, resulting in amendments to the

[37] Refer to page 7.

[38] [1967] VR 122.

[39] This is also the view of a learned commentator. Refer to Hill, D. *Stamp Duties* (2nd ed), Law Book Company, Sydney.

[40] Although it has been observed by some that the Courts have missed the opportunities to clarify the uncertainties in the jurisprudence in this area. See Collins, P. and Kyle, T. 'High Court Misses Opportunity To Clarify Resettlement Question' (1998) 36 LSJ 34.

[41] Refer to footnote 1 for citation of these cases.

contribution provisions and the rules defining members' benefits, a professional management company was appointed as administrator, and employers unrelated to Control Data was allowed to join as participating employers. Also, three classes of members were created: A class members (representing the original Control Data employees who were still in the fund), B class members (those who became members in the period just prior to the amending deed being executed) and C class members (employees of new participating employers).

The fund had incurred losses in 1989 and 1990 amounting to $11,285,876. It sought to carry forward losses in the 1995 income year. The Commissioner disallowed the carrying forward of this loss on two grounds. First, the effect of the deed of amendment was to transfer the assets of the fund from one trustee to another under new trusts, resulting in a resettlement, and as a result the Commissioner content that the original trust has been extinguished and a new trust created in its place. In the alternative, the Commissioner argued that the effect of the amendment deed was to create a new fund that co-existed with the old fund. The new trust would not be able to claim the losses incurred by the old fund.

In first instance, in the AAT,[42] Deputy President McMahon held that the "fund in the 1995 year was the same fund that incurred losses in the 1989 and 1990 year"[43] and accordingly, the losses could be set off against the income of 1995 year. This conclusion is not, by itself, of great interest; the reasoning McMahon used is. In the course of his judgment, McMahon focused considerably on the nature of the trust in question – namely the characteristic of a superannuation fund. He highlighted the difference between a classic trust and a superannuation fund by referring to the Canadian decision of *Hockin v Bank of British Columbia*[44]. Importantly, he noted that a superannuation fund is "not an immutable and completely constituted closed trust for specified beneficiaries… but rather an accommodating, open trust to provide a range of pension benefits to fluctuating groups of beneficiaries in a range of circumstances."[45] His discussion tended to focus on the purpose for which the trust fund was created. In particular, he observed in relation to the superannuation fund in question:

- the beneficial interests in the fund remained substantially unchanged;
- the original trust deed allowed the trustee to accept members from outside of the Miden group of companies; and

[42] *Case 22/*98 98 ATC 282; 41 ATR 1077

[43] 41 ATR 1077 at 1090.

[44] (1990) 71 DLR (4th) 11.

[45] 41 ATR 1077 at 1087.

- the purpose of the fund was not altered by the variations to the trust.

This resulted in his conclusion that no new beneficial interests were created "which represent a substantial departure from the principal features of the original deed" and that the accrued rights of employees "under the original deed are preserved".[46] Consequently, it was held that the original fund has not been terminated and hence there is a continuity of the fund.

In the Full Federal Court, the joint decision of Lee, Emmett and Gyles JJ held that the rights of members under the new trust deed were not significantly different from those that had existed under the original deed. Again, there seems to be a overriding emphasis on the purpose of the trust in question; in this case, the purpose is one and the same before and after the amendment: to administer the fund for the benefit of the employees of Control Data and its subsidiaries. Consequently, as with McMahon, it was held that the fund was able to carry forward the tax losses.

The High Court affirmed the Full Federal Court and the AAT decisions by deciding that there was a continuity of the trust. It could be argued that the outcome of the *Commercial Nominees* case is that the High Court has effectively rejected the ATO's Statement of Principles, because it held that there was a continuance of the trust despite the substantial changes made to the trust deed; this conclusion contradicted ATO's resettlement argument that the original trust estate has came to an end because of the amendments, or, that a new trust estate has been created. The outcome begs the question: if given the very dramatic changes made to the deed, the Court still find that there is sufficient continuity of the trust, it stood to reason that the Courts considered that the beneficial interests have essentially been preserved. Consequently, applying the logic of the charter of right case authority, it could be argued that there is no resettlement here either as there are no disposition of beneficial interest.

The ATO disagreed; it sought to distinguish the *Commercial Nominees* case by restricting its operation to superannuation fund cases. This turns of event is ironic as this was a test case brought on by the ATO to clarify the issues.

Two questions call for consideration at this point. First, this focus by the courts on "purpose" have gave rise to the suggestion that a purposive approach should be adopted in addressing resettlement issue in respect of certain trust referred to as purpose trust.[47] What exactly is this approach? Second, to what extent is the ATO's attempt to confine

[46] 41 ATR 1077 at 1088 and 1089.

[47] ATP commentaries on the *Income Tax Assessment Act 1997*.

the *Commercial Nominees* decision to superannuation fund case valid? These two related aspects are considered next.

Superannuation Fund: New Specie, New Rules?

The ATO seeks to limit the implication of *Commercial Nominees* by arguing that it is restricted to superannuation fund cases. The logic behind this argument appears to be as follows:

1. The AAT, the Full Federal Court, and the High Court all placed emphasise on the fact that the trust in question is a superannuation fund, which has particular and unique characteristic that can be distinguished from other trusts.[48] That is, it is said to be a class of trust known as "purpose trust".

2. The High Court made the statement that "…in applying Part IX of the Act, the legal commercial incidents of superannuation funds, and the interrelationship between the Assessment Act and SIS Act, must be taken into account."[49] The inference from this statement is that resettlement or continuity of trust at general law is not at issue. McMahon J stated likewise that the resettlement concept is irrelevant in this case.[50]

3. Consequently, the principle espoused in the case have no application beyond superannuation fund case.[51]

In essence, the argument is that superannuation fund is different, and hence, this decision cannot act as a precedent for other trust. Whether this is valid seems a moot point. Uncertainties would remain pending future resolution by the Courts. Nonetheless, it is submitted here that the position adopted by the ATO is dubious, and that the *Commercial Nominees* case is relevant to other trust as well.

In arguing that a superannuation fund is in a class of its own, the ATO is perhaps not alone. The treatment of a superannuation fund as a distinct "new specie of trust" has support from other jurisdictions, notably the United Kingdom.[52] The development of the

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[48] Refer to above on page 11.

[49] (2001) 47 ATR 220 at 226.

[50] 41 ATR 1077 at 1089.

[51] The ATO is not alone in drawing this inference. Other commentators make similar remarks. See for example, Davis, N. 'Resettlements- Commercial Nominees' (2001) 12 Australian Superannuation Law Bulletin 101, and Ingram, P & Drew, L. 'Discretionary Trusts & Resettlement' (2001) 36 TIA 261.

[52] Refer to Chareneka, S. 'Legal Darwinism: the Evolution of a New Trust Species' (2000) 11 Insurance L J 120 for an overview of the cases in this regard. The author in that article claimed that the treatment of superannuation fund as a new specie of trust has been well advanced. However, it seems that this position may be doubted.

law in such foreign jurisdiction has established that, although trust principle continues to operate, they apply in a modify form to cater for the particular or unique relationship inherent with a superannuation fund. The argument is that a superannuation fund is a "purpose trust"– in particular, one with the purpose of providing superannuation benefit. Reliance was placed often on the *Hochin* case noted above.[53]

However, on closer analysis, *Hockin* is not as authoritative as has been suggested. The proposition in *Hockin* that a pension fund is a purpose trust has been soundly rejected by the more recent case of *Schmidt v Air Products Canada Ltd*[54]. Cory J in that case said thus:[55]

> "Trusts for a purpose is a rare species…The pension trust is much more akin to the classic trust than to the trust for a purpose. I agreed with the following comments of the Pension Commission of Ontario in *Arrowhead Metals Ltd v Royal Trust Co* (March 26, 1992), unreported, at pp 13-15, cited by Adams J in *Bathgate v National Hockey league Pension Society* (1992) 11 PR (3d) 449 at 510:
>
> > "Purpose trusts are trusts for which there is no beneficiary; that is, they are trusts where no person has an equitable entitlement to the trust funds. Funds are deposited in trust in order to see that particular purpose is filled: people may benefit, but only indirectly…."
>
> … A pension trust is a "classic" or "true" trust and not mere trust for a purpose."

The fate of the *Hockin's* proposition is finally sealed when that case came before the British Columbia Court of Appeal for a second time in 1995,[56] where the Court reversed its 1990 decision and clearly abandoned the notion of the purpose trust, and applied the principle noted in the *Air Products* case.

This reaffirmed Sir Robert Megarry VC's views in *Cowan v Scargill*[57] that a pension is not different to any other trust:[58]

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[53] In Australia, *Hockin* has been followed by Waddell CJ in *Lock v Westpac Banking Corporation* (1991) 25 NSWLR 593, and by Santow J in *Uncle v Parker, Warner and Millott* (unreported, NSW Supreme Court, 22 August 1994). See also *Mettoy Pension trustee Ltd v Evans* [1990] 1 WLR 1587.

[54] (1994) 2 SCR 611.

[55] (1994) 2 SCR 611 at 640.

[56] *Hockin v Bank of British Columbia* (1995) BCJ 688.

[57] [1985] 1 Ch 270.

> "I can see no reason for holding that different principles apply to pension fund trusts from those which apply to other trusts. Of course, these are many provisions in pension schemes which are not to be found in private trusts, and to these the general law of trust will be subordinated. But subject to that, I think that the trusts of pension funds are subject to the same rules as other trusts."

In Australia, the above approach has been adopted by Beach J in the Victoria case of *Asea Brown Boveri Superannuation Fund v Asea Brown Boveri*[59]. Thus, it seems that the notion that a superannuation fund is a purpose trust is itself an extinct specie! It follows that if superannuation fund is not a distinct category of trust, then principle established in case, such as *Commercial Nominees*, involving superannuation fund could equally apply to other trust.

A Context Oriented Approach

The Charter of Right approach noted above is well established on the basis of stamp duty authorities, but it is submitted that, whilst the Charter of Right approach is still relevant, an overarching consideration is the context and nature of the trust in question.

The judges in the Full Federal Court decision have made it clear that the existence of resettlement or not for stamp duty purposes is not determinative of the income tax consequences. In coming to the conclusion that the tax losses can be carried forward, their Honours focused upon the requirements of the tax losses provisions, the then sections 79E and 80. The determinative factor here is the continuity of the trust. It is worthwhile to quote the following passage from the judgment at length here:[60]

> "In order to determine whether losses of particular trust property are allowable as a deduction from income ... it will be necessary to establish some degree of continuity of the trust property or corpus that earns the income from the income year of loss to the year of income. It will also be necessary to establish continuity of the regime or trust obligations affecting the property in the sense that, while amendment of those obligations might occur, any amendment must be in accordance with the terms of the original trust.

[58] [1985] 1 Ch 270 at 290.

[59] [1999] 1 VR 144.

[60] [1999] FC A 1455, paragraphs 55 to 57.

> So long as any amendment of the trust obligations relating to such trust property is made in accordance with any power conferred by the instrument creating the obligation, and continuity of the property that is the subject of trust obligations is established, there will be identity of the 'taxpayer' notwithstanding any amendment of the trust obligation and any change in the property itself.
>
> In the present case, there has been continuity of the regime regulating the Fund. The amendment that took place in 1993 was in accordance with the provisions of the Original Trust Deed. Further, it is a straightforward matter to trace the continuity of the property that has been the subject of that regime since the 1989 and 1990 income years. Accordingly, there has been sufficient continuity of the Fund from the 1989 and 1990 income years to the 1995 income year. The change of name in 1990 and the change of rules from time to time did not interfere with the continuity of the fund that was established in 1988."

From this, it can be observed that the underlying framework adopted by the Court is one based upon the nature and context of the trust arrangement and tax issue at hand. In the *Commercial Nominees* case, as the main question is one concern with the ability to carry forward tax losses, the relevant tax loss provisions of the income tax legislation took on importance. Moreover, as the context here involves a superannuation fund, the Court also considered the features, law and commercial practice associated with it. The focus on purpose in the judgment should not be overemphasised in this regard; purpose is but an additional factor that the Courts has considered because this case involves a superannuation fund. The ATO single-minded preoccupation with its resettlement argument has also been rejected. All this is supportive of the fact that the Courts do not look at the issue in a vacuum. Thus, the High Court said:[61]

> "… 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…" (emphasis added)

It is submitted that this framework may be generalised to other trust. The *Commercial Nominees* decision should not be seen as a once off case whose application is confined within the sphere of superannuation fund as the ATO would like to argue. The better view is that *Commercial Nominees* is an application of the general framework that the Court will use in addressing variation of trust issues. Indeed, it may well be that the three

[61] (2001) 47 ATR 220 at 227.

indicia of continuity identified by the High Court in *Commercial Nominees* – constitution of the trust, trust property, and membership – are equally applicable to other trust with suitable modification if required.

UK Authorities

An approach that stresses the context and nature of the trust is also consistent with the development of jurisprudence in other jurisdiction, especially the UK. A number of UK cases on the meaning of settlement are particularly relevant in this regard. These cases concern the exercise of a power of appointment whereby certain trust property are appointed or appropriated to the beneficiary. The issue is whether the property has been taken out of the original trust and into a new one, or, continues to be held on trust under the original trust estate.

Since Lord Wilberforce's statement in *Roome v Edwards (Inspector of Taxes)*[62] has been cited and applied in subsequent cases, notably in *Bond (Inspector of Taxes) v Pickford*[63] and *Swires (Inspector of Taxes) v Renton*[64], it is thus useful to quote it in full here:[65]

> "There are a number of obvious indicia which may help to show whether a settlement, or a settlement separate from another settlement, exists. One might expect to find separate and defined property; separate trusts; and separate trustees. One might also expect to find a separate disposition bringing the separate settlement into existence. These indicia may be helpful, but they are not decisive. For example, a single disposition, eg a will with a single set of trustees, may create what are clearly separate settlements, relating to different properties, in favour of different beneficiaries, and conversely separate trusts may arise in what is clearly a single settlement, eg when the settled property is divided into shares. There are so many possible combinations of fact that even where these indicia or some of them are present, the answer may be doubtful, and may depend on an appreciation of them as a whole."

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[62] [1982] AC 279.

[63] [1983] STC 517.

[64] [1991] STC 490.

[65] At 292- 293. Similarly, Brightman J in *Hart (Inspector of Taxes) v Briscoe* [1978] STC 89 at 105 also stated that:

> "In my judgment, the question whether a disposition which exercises a fiduciary power is to be viewed as a separate settlement, or as part of a single fiduciary arrangement headed by the disposition which created the power, must be answered in the context of the circumstances of the particular case."

Lord Wilberforce continues by indicating how the question is to be determined:[66]

> "Since 'settlement' and 'trusts' are legal terms, which are also used by business men or laymen in a business or practical sense, I think that the question whether a particular set of facts amounts to a settlement should be approached by asking what a person, with knowledge of the legal context of the word under established doctrine and applying this knowledge in a practical and commonsense manner to the facts under examination, would conclude."

His Lordship identified "two fairly typical cases":

1. Where the trust contain power to appoint a part or proportion of the trust property to beneficiaries, with or without appointment of separate trustee. In this case, there should be no separate settlement as it is established doctrine that the trusts declared by a document exercising a special power of appointment are to be read into the original settlement: *Muir v Muir*[67]. This would especially be the case where the provisions of the original settlement continue to apply.

2. Where there is a power to appoint and appropriate a part or portion of the trust property to beneficiaries and to settle it for their benefit. This would likely result in a conclusion that a new trust estate has been created, especially if a complete new set of trust was declared as to the appropriated property, and if it could be said that the terms of the original settlement ceased to apply to it.

Slade LJ in *Bond (Inspector of Taxes) v Pickford*[68], referred to these cases as a "power in the narrower form" and "power in the wider form". Slade LJ also observed that:[69]

> "as a matter of trust law trustees, who are given a discretionary power to direct which of the beneficiaries shall take the trust property and for what interests, do not have the power thereby to remove assets from the original settlement, by subjecting them to the trusts of a separate settlement, unless the instrument which gave them the power expressly or by necessary implication authorises them so to do…

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[66] At 292 to 293.

[67] 1943 AC 468.

[68] [1983] STC 517.

[69] At 522 to 523.

> Thus, there is in my opinion a crucial distinction to be drawn between (a) powers to alter the presently operative trusts of a settlement which expressly or by necessary implication authorise the trustees to remove assets altogether from the original settlement (without rendering any person absolutely beneficially entitled to them) and (b) powers of this nature which do not confer on the trustees such authority."

Consequently, Slade LJ considered that "it is essential to examine the nature of the powers which the trustees were purporting to exercise, both in order to see whether they were acting *intra vires* …[and] it seems clear from Lord Wilberforce's speech that the intention of the parties, viewed objectively, is a relevant consideration in this context".

In other words, no indicia are decisive; the question really turns on the facts and circumstances of the case as "[t]here can be many variations on these cases each of which will have to be judged on its facts."[70] In making this determination, the standard is one that a person with the requisite legal knowledge would make by applying his or her knowledge to the facts in a practical and common sense manner. That is, the analysis should not be too technical. The intention of the parties could also be relevant. Further, the nature and terms of the trust need to be considered in deciding whether there is a power to remove the trust property from the trust in the first instance. A distinction is drawn between power to appoint capital to the beneficiaries or to appropriate corpus to their benefit, and power that permits the trustee to remove the trust property from the original trust settlement. An exercise of power in the former case is taken to be part of the first trust, and will be read into the original settlement, and hence, there is no new trust. Whereas, an exercise of power in the latter category will likely result in a creation of a new trust, especially if the factual circumstance support the conclusion that trust property has been removed or disposed of by the trustee.

There is little reason why the authorities established by these UK cases should not be applied in Australia. These cases consider settlement in the context of UK capital gains tax legislation. The fact that Australian CGT legislation is modelled upon UK law should give it some precedential value at the very least. The focus of these cases on the context and nature are also consistent with the approach adopted in the *Commercial Nominees* case. It is thus curious that whilst the ATO's Statement of Principe acknowledged the existence of such authorities, it almost single-handedly dismissed them. A commentator has noted that the ATO dismissal of these cases is a "spurious" one.[71]

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[70] [1982] AC 279 at 293.

[71] Ingram, P. 'Companies and Trust', Conference Paper, Taxation Institute of Australia, 27 March 2001.

Settlement Under Event E1

If the better view is to base the examination upon the context and nature of the situation, what does the context of CGT Event E1 says about the issue of settlement?

An argument could be raised that CGT Event E1 is intended to be very broad. An exception in s104-55(5)(b) provides that Event E1 does *not* apply where there is a transfer of an asset from one trustee to a second trustee on the basis that the second trustee is to hold the asset for the same beneficiaries and upon the same trusts that existed before the transfer. This exception implied that the operative provision of section 104-55(1) would be triggered by virtually *any* variation to an existing trust. This interpretation is supported by the relevant extrinsic materials. The Explanatory Memorandum to the Bill introducing its predecessor stated:[72]

> "A further exception applies where there is a settlement of an asset to a trustee to hold on terms of an existing trust where the only change that occurs is a change of trustee. The effect of this exception is that where property is transferred from one trustee to another to be held under the same trust arrangements without any change at all in the trust arrangements including the interest of each beneficiary in the trust income and assets, there will be no change of ownership for CGT purposes."

It seems clear that the EM regards a mere change of a trustee constitutes the creation of a new trust by settlement. It is because of this that it was considered necessary to specifically state that the mere change of a trustee would not trigger a disposal for the purposes of the original CGT provisions. This would tend to support the strong form Charter of Right approach.

Whist this is a possible interpretation of the statute, it is submitted that such a strict application of the Charter of Right approach is inconsistent with the prevailing authorities. This interpretation can readily be rebutted in practice. It may be contended that that section 104-55(5)(b) was inserted as a fail-safe measure, and therefore should not be construed as restricting the general law meaning of "settlement" in s 104-55(1). Further, the explanatory memorandum may not be sufficient to displace the general law understanding of "settlement" as there is no indication that there is an intention to replace the general law meaning with a statutory one. Finally, it is open to a court to reject the relevance of the explanatory memorandum upon the grounds that the threshold tests

[72] Explanatory Memorandum to *Taxation Laws Amendment Act (No 2) 1994* (Cth) (Act 82 of 1994), introducing the old section 160M(3A).

expressed in s 15AB of the *Acts Interpretation Act 1901 (Cth)* are not satisfied in this case in that the meaning of section 104-55 is clear.

Discretionary Trusts: Objects and Takers- in - Default

The application of resettlement rules to a change in beneficiaries of discretionary trust has shifted over the years.[73] The traditional view, one that has been adopted by the state revenue authorities (in their rulings),[74] is that the addition of a discretionary object would not result in a resettlement, whereas the additional of a takers-in-default would. This view stems from the notion, as established in cases like *Hopkins,* that for there to be a resettlement at least some change to the "beneficial interest" in the trust property are required. Since a discretionary object do not have a proprietary interest in the trust, should such an object be added to the trust, no interest of a proprietary nature can be regarded as having vested in that person. By contrast, the addition of a takers in defaults would result in such a change to the beneficial interest. Whilst this distinction may have some support in the past, at least up until the 1950's, the better view is that this distinction is a false one.[75]

In Australia, the proposition that a discretionary object is different to a takers-in-default can be traced to the High Court case of *Queensland Trustees v Commissioner of Stamp Duties (Qld)*[76]. Over the years, the judicial authorities supporting the *Queensland Trustees* have been eroded. The story commenced with the 1950s case of *Baker v Archer-Shee*[77], which held that a beneficiary of a trust owned the trust property in equity; the beneficiary has right *in rem*, rather than just right *in personam*. The implication of this decision for discretionary trust is that such a trust would be regarded as invalid unless all the "beneficial owner" is capable of being identified. This is known as the certainty of object test.[78] Since the trustee owed no duty to the object of appointment, there is no way to identify with any certainty the beneficiaries of the trust, and hence, the trust failed! Consequently, the beneficial owner must be the takers in default in that the object of a mere power had nothing other than an expectation that the trustee may or may not

[73] Discretionary trust may be defined for this purpose as a trust where the beneficiary do not have a fixed or defined entitlements to the income or capital of the trust fund. That is, it does not have a vested and indefeasible interest in the trust. See further, Rooke, K. "Fixed and Non-Fixed Trusts", Mallesons Stephen Jaques, November 2000.

[74] Eg. Under the old NSW *Stamp Duty Ruling SD 45*.

[75] See Robertson, M. 'Trusts - Why The Commissioner Is Right!' (1999) October 3 Tax Specialist 74.

[76] (1952) 88 CLR 54.

[77] [1932] AC 844.

[78] See *Inland Revenue Commissioners v Broadway Cottages Trust* [1954] 1Ch 20.

exercise its discretion in its favour. The distinction between the two classes of beneficiaries thus arises.

By the mid 1960s the *in personam* view have started to make a come back, beginning with *Commissioner of Stamp Duties (Queensland) v Livingston* [1965] AC 694,[79] where it was said that the need for both equitable and legal owners of property is a fallacy. Subsequently in *Gartside v Commissioner for Inland Revenue*[80] it was held that the rights of a beneficiary in a discretionary trust were *in personam*.[81] It was held that whilst a discretionary object has no interest over the whole or part of the trust, it does have a chose in action to compel due administration,[82] meaning that a discretionary object could be owed a fiduciary duties without owning portion of the trust property. (cf *Baker v archer-Shee*). That is, the object of a mere power were owned a fiduciary duties if the trustee were the holder of the power. In *Re Gulbenkian*[83], Lord Reid again stated that trustee owed fiduciary duties to object of a mere power. This position is supported by latter cases like *Lutheran Church of Australia v Farmners' Cooperative Executors and Trustees Limited*[84], and in *Turner v Turner*[85] and *Andco Nominees Pty Ltd v Lestato Pty Ltd*.[86] From these cases, especially the last one, a necessary inference is that a takers-in-default is just another discretionary object.[87] In retrospect, the distinction between object and taker in default seem to be an artificial one.[88]

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[79] See Robertson, M., *op. cit.* at page 79.

[80] [1968] AC 579.

[81] See also *Re Goldsworthy* (1982) 3 All ER 808.

[82] In technical terms, a discretionary object 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. Whereas a taker in default has a vested interest in the trust fund subject to any exercise of a power of appointment by the trustee.

[83] [1970] AC 508.

[84] (1970) 121 CLR 628 at 352:

> "A discretionary power, given to a trustee as such, to act or not to act in a specified manner imposes a duty on the trustee at least to consider the matter and to decide deliberately whether or not to exercise the power."

[85] [1984] Ch 100, at 109-110:

> "When a discretionary power is given to trustees they come under certain fiduciary duties…"

[86] (1995) 126 FLR 404, at 429-310:

> "it is well established that a trustee under a discretionary trust with a mere power, had a duty to consider its exercise from time to time and that, in the event of the trust failing to do so, either the takers-in-default of appointment, or the discretionary objects, has standing to complain."

[87] See Robertson, M., *op. cit.*, *McPhail v Doulton* [1971] AC 424 provides further support for this.

[88] Ironically, the dissenting judge in *Baker v Archer-Shee* expressed the same view in the subsequent case of *Adamson v Attorney-General* [1933] AC 257 at 270.

In the recent High Court case of *Buckle*[89], the *in personam* view was unanimously supported. This case is authority for the view that a change in the interests of default beneficiaries (from contingent to vested) does not give rise to a resettlement of the trust Fund.[90] The position now is that the distinction between object and takers-in-default is non-existent.[91] This is not saying that the addition or removal of beneficial (whether in respect of discretionary objects or takers-in-default) will not result in resettlement. This case merely establishes that resettlement does not depends on whether the beneficiary added is a discretionary object or takers-in-default.

Rather than focusing on whether there is a change in beneficial interest, a learned writer suggested that a resettlement of trust property occurs where the variation imposes a new "dispositive duty" on the trustee in respect of the property or its income. In the case of the addition of beneficiary, resettlement only arises where the trustee "has a new fiduciary duty annexed to the trust property; the duty to consider that new beneficiary."[92] It is this fiduciary duty that makes a difference in respect of the various variations.

This approach seems logical and is consistent with the authorities. From Dixon J statement in *Hopkins*, it was argued that the test is whether a new fiduciary duty in respect of property has been imposed on a person which affects that person's right of ownership.[93] Similarly, Griffiths J in *Davidson v Chirnside*, is saying the same thing in the sense that it requires a comparison of the obligation of the trustee before and after the variation and determine whether those obligations are new obligation.[94] Consequently, because the addition of a discretionary object means that the trustee has a new fiduciary duty imposed on it, a new trust arise. The fiduciary duty being the need to consider disposing the trust property to the beneficiary to the exclusion of other. By the same logic, the removal of a discretionary object would not result in a resettlement as there is no new fiduciary duty imposed on the trustee. Instead, fiduciary duty has merely been removed from the trustee (as a result of the removal of the discretionary object).

A New Trust Over What?

Even if a new trust is found to have been created, an issue arise concerning the property over which the trust has been created. There are two broad possibilities. The creation of a

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[89] (1998) 37 ATR 393.

[90] See Collins, P. and Kyle, T. 'High Court Misses Opportunity To Clarify Resettlement Question' (1998) 36 LSJ 34.

[91] The NSW Office of State Revenue confirms as much in its revenue ruling *DUT 017*.

[92] Robertson, M., *op. cit.* at 75.

[93] Robertson, M., *op. cit.* at 84.

[94] Robertson, M., *op. cit.*, at 84.

trust over the trust asset or property (whether some or all of it); alternatively, the trust could have been created over the beneficial interests in the trust assets. This issue is relevant to the determination of the value of the assets that has been settled or re-settled into the trust, and hence, dovetail directly into the calculation of the capital gains amount under CGT Event E1. This is not an issue that the Courts have the opportunities to consider in the income tax arena.

A review of a few stamp duties cases point to some conflicting treatment in this area. In the case of *Long v Comptroller of Stamps*[95], Mr Long left a property on trust for his wife and three children. The wife was entitled to one-third of the income, and the balance to his children equally. The corpus of the trust was to be divided among the children after the widow's death or upon her remarriage. The trustee with the consent of the widow and the children appropriated one-third of the assets of the trust to provide for the widow's right to one-third of the income, and appropriated the balance of assets to the children so that they became entitle to the specific asset. The Court held that there was a resettlement of the entire trust assets as the variation made changes to the beneficial interest that is not contemplated by the deed, such that, amongst others, the children is entitled to the corpus at an earlier date and remove a right from the widow to occupy the property free of charge. Similarly, in *Buzza v Comptroller of Stamps (Vic)*[96], a case with similar facts, Dixon J refused to regard the variation as a mere resettlement of the beneficiary's interests in the trust asset; rather, he held that there is a resettlement of the entire trust assets.

However, in the more recent *Buckle's* case[97], both Kirby P and Sheller JA agreed that it was the future defeasible interests of the beneficiaries that are resettled, rather than the trust asset as such.[98] In *Buckle*, an amendment was made to the default provisions in the trust Deed of the Buckle Family Discretionary Trust. Prior to the amendment, the Deed provided that in default of the exercise of the trustee's power of appointment, the balance of the trust fund was to be held for "such of the children as were living at the end of the year in question and, if more than one, in equal shares as tenants in common per stirpes".[99] The general effect of the relevant provision of the trust deed was that the interests of Mr. Buckle's children were contingent on them being alive at the date of

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[95] [1964] VR 796.

[96] (1951) 83 CLR 286 at 300 to 301.

[97] (1996) 96 ATC 4098.

[98] Although strictly, Kirby P view is by way of an obiter dicta. The other judge Powell JA held that there was a resettlement of the entire trust assets. The argument either way, as Kirby P admits, is finely balanced. Refer to comment by Zipfinger, F. 'Stamp Duty on Resettlement. *CCSD (NSW) v Buckle & Ors'* (1996) 34 LSJ 24.

[99] *CSD (NSW) v Buckle* 98 ATC 4097 at para 5.

distribution. It is also a contingent interest that could be displaced by the exercise by the trustee of the power of appointment in favour of others.[100] The amendment to the default provision provided that if the trustee failed to make an appointment the trustee was "to hold the Trust Fund for the children in the following shares as tenants in common: JMJ- one third; WJB- two thirds." Consequentially, their interests were no longer contingent but vested; but nevertheless, could still be displaced if and when the trustee exercise the power of appointment.

The distinguishing characteristic that may explain the difference is the nature of power exercised by the trustees and the manner in which the power is being exercised.[101] This explanation is consistent with the UK CGT cases[102] noted previously that endorses the context and nature approach. Indeed, the view expressed by the Courts in *Buckle* suggests that there may be no resettlement where the changes were contemplated by the original deed of settlement; and likewise, in *Commercial Nominees* the fact that the amendment was made within power and was consistent with the statutory framework were regraded as significant. This means effectively that where a new trust arises from the exercise of a power conferred by the original trust, the trust so created are read into the original trust such that it is regarded as part of the original trust. In this regard, it has been argued in relation to the old provision in ITAA36 that a new trust has not been created where a trustee exercise a power of appointment, unless it is clear that the trust assets have been completely taken out of the original trust and placed in a new trust.[103]

Finally, the Court's observation regarding the values that should be attached to this interest is noteworthy. The High Court was of the view that the value of such interest, at least in the *Buckle's* case, is likely to be negligible after taking into account the trustee's right of indemnity and the nature of the interest transferred.[104] If this logic is applied to determine the value of the proceeds for CGT purposes, this would mean that there could only be nominal capital gains in many cases!

Summary

The fact that creation of a trust is such a contentious and uncertain issue is largely attributable to this very construct called a trust. Unlike a corporate entity, whose death is

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[100] *CSD (NSW) v Buckle* 98 ATC 4097 at para 21.

[101] See Cathro, G. 'Variation of Discretionary Trust' (1996) 25 ATRev 40.

[102] Cases such as *Roome & Deane v Edwards* 57 TC 359, *Bond (HM Inspector of Taxes) v Pickford* (1983) 57 TC 301, *Swires (HM Inspector of Taxes) v Renton* [1991] BTC 313.

[103] Refer to Cathro, G., *op. cit.* at p42 to 44.

[104] "These were vested interests in a technical sense.... However, their present value had to reflect the vicissitudes which were the essential element of the structure created by the deed of settlement." [Para40]

governed by formal procedural requirements under the *Corporations Act*; a trust ceases to exist through the almost "silent" operation of trust law – it exists one day, and gone the next without much need, if any, for procedural steps. This makes the termination and creation of a trust much harder to recognise. To personify the situation: how much is necessary to "kill" the trust and "rebirth" another one from its ashes?

The case authorities suggest that a resettlement (in the sense of creation of a new trust) refers to situation where changes to a trust are such that the future rights and obligations of the parties to the trust deed have been modified beyond a certain threshold degree. Where there is no change to the future rights and obligations of the parties to the trust deed, then no resettlement issue should arise; however, a positive answer does not mean that there is a resettlement! The precise degree varied from case to case. Perhaps because of this, recent authorities all endorse a pragmatic framework that looks to the context and nature of the trust arrangement and that focuses upon the precise tax issue in question. It is no longer an analysis based purely on an examination of the Charter of Right between the trust parties. Whilst changes to the beneficial interests and/ or relationship is still a requirement, the case laws have made it clear that the degree of changes required need to be flexible and sensitive to the nature and context of the trust arrangement. In this regard, the terms of the original trust deed is relevant, as is the fact that commercial practices and other legislative provisions impinge on the particular trust arrangement.[105]

In *Commercial Nominees,* the fact that the issue concerns the ability to carry forward tax losses by a superannuation fund causes the Court to focus on the continuity of the trust and to examine the purpose and terms of the trust in determining whether there is such continuity. It is submitted that this is but an application of the approach outlined above, rather than a separate rule that only apply to a "purpose trust" (which it is not on the basis of the above noted UK authorities). The approach adopted in *Commercial Nominees* is consistent with the general framework in recent case laws in Australia and overseas, especially the UK. Consequently, this general framework does and can have application to other trusts. It is significant that a superannuation fund is still a trust, and hence, existing trust law principle regarding variation of trust continues to apply to it. Likewise, principle established in relation to superannuation fund cases could also have relevance to other trust.[106]

A few points about trust principles can be noted. First, resettlement will only arise where the requisite power is conferred upon the trustee, where the power is exercised in a *bona fide* manner for the benefit of the beneficiary and where the rule against perpetuity is

[105] For example, as is the case in the *Commercial Nominees* case.

[106] See Carey, A. 'Commissioner Must Rethink Trust Resettlement' (2000) 34 TIA 352.

satisfied.[107] If the purported variation exceeds the requisite power, or is exercised for an improper purpose, then the resettlement (if any) is invalid; and accordingly, nothing happen and there is no tax consequence. In *Commercial Nominees*, all the judges in the various Courts have made comments to this effect; and, in particular, have observed that the original deed contained broad power of amendment and that the amendments were all within power.

Overall, the Court was prepared to take a far more pragmatic, dynamic and broader approach than is seem to be the case under the ATO's Statement of Principles.

ATO STATEMENT OF PRINCIPLES

For many years, the ATO has been considering its position in relation to trust resettlement. During this time, an embargo has been imposed on private rulings seeking clarification on the subject of resettlement. This plus the lack of judicial guidance in this field has created an atmosphere of uncertainties: variation to trust that needs to occur in the meantime is often done with the possibilities that a taxation time bomb may have been created. It has always been the hoped that the ATO will clarify the issue and make this area of law more certain.

The ATO has finally released its first Statement of Principles on resettlement on 9 June 1999. At that time, the Full Federal Court was still to determine the outcome of the appeal in *Case 22/98* 98 ATC 282 (ie. *Commercial Nominees* case). This fact was acknowledged in the first Statement of Principles:

> "We expect to obtain a better understanding of the law in this area (i.e., superannuation) from the Full Federal Court's decision."

Now that the High Court has handed down its judgment on this case, it is somewhat ironic that, having obtained a "better understanding of the law", the ATO now seeks to distinguish this case and restrict its application to superannuation fund in its "revised" Statement of Principles.[108]

Previous discussion in this paper has shown that the ATO's attempt to quarantine *Commecial Nominees* may be questioned.[109] The following examines further some of the principles adopted (to the extent that these principles can be discerned from the general statement) and the examples cited by the ATO.

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[107] Moshinsky, A. 'Trust Resettlement' (1999) 3 Tax Specialist 126.

[108] This revised version was released on 29 August 2001

[109] See discussion on this issue above on page 14.

General Principle Adopted by the ATO

The Statement of Principles states that:

> "It is a change in the essential nature and character of the original trust relationship which creates a new trust…"

The requirement that there be a "fundamental change to the trust relationship" is exceptionally broad and vague. This position is difficult to fault. As a general proposition, this requirement is consistent with the legal jurisprudence. It flows from the notion that a "trust estate" for tax purpose, especially as the term is used in Division 6 of the 1936 Act, refers to the relationship between a party with the equitable interest (ie. the beneficiaries) and another party with the legal title (ie. the trustee) whereby the latter owes the former certain fiduciary duties and the former has certain rights and obligation in respect of the latter. It defines a relationship. Changes that are so significant that it redefines the essence of that relationship would necessarily give rise to a new relationship, and hence, a new trust arises. This is consistent with the *Re Ball Settlement Trust* statement that there be a "change to the whole substratum of the trust."

This fact has always been clear; the uncertainties and the big question that is left unanswered by the ATO is what amounts to a change to the essential nature and character of the original trust relationship?

Has the ATO Achieve its Aim?

In the Statement of Principles, the ATO stated that its aim is to "clarify when changes to a trust are such that, for income tax purposes, one trust estate comes to an end to be replaced by another."

It is submitted that the ATO has failed to achieve this aim. The Statement confirms the common sense and well accepted principle in the area; but failed to provide any guidance in relation to areas of contention and uncertainties. It confirms, for instance, that changes to members of an existing identified class of beneficiaries will not result in a new trust. It confirms that changes to terms that are merely administrative and "housekeeping" matters would not be a resettlement. This is no more than a restatement of common understanding. It failed to consider or provide more concrete guidance regarding changes in the grey area, such as changes that varies the beneficiary's entitlement in the capital and/or income of the trust, the additional or removal of beneficiary from a trust,[110]

[110] The removal of beneficial became a very pressing and serious issue following changes to the social security rules (as a result of amendment under the *Social security and Veterans' Entitlements Legislation*

changes that give the trustee power to accumulate income.[111] Changes that are regarded as affecting the essential nature and character of the trust relationship have not been made any clearer.

The ATO identified the following as situations where a new trust *may* arise:

- 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.

Unhelpfully, the ATO continues by stating that, depending on their nature and extent, terms of the original trust, the power of the trustee as well as 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. This guide is really no guide; it says nothing. The only conclusion is that the ATO has adopted a very broad approach such that *any* variation could result in a resettlement, subject to the fact of the situation. The following statement regarding unit trust is interesting as it reveals the potential breadth of ATO's approach:

> "A 'standard' investment unit trust is varied to create and issue a new class of units. Such variations may not only create a new beneficiary group (the holders of the new class) but also may lead to an express or effective change in the rights attaching to the pre-existing class or classes, for instance

Amendment (Private Trusts and Private Companies- Integrity of Means Testing) Act 2000). Refer to further comments below.

[111] Changes to give trustee power to accumulate income was a very significant issue for awhile during the time of the proposed entity tax regime. The suggestion then was that trust deed may need to be changed to enable the trustee to accumulate income in situation where the trust is taxed like a company.

> through introducing a competing claim on the proceeds of the trust fund. The overall result may be a redefinition of the trustee's obligations to the beneficiaries and hence the trust relationship, resulting in the creation of a new trust estate."

On the one hand, the general approach adopted by the ATO may be consistent with the legal jurisprudence insofar that the approach requires a consideration of the context and nature of the situation. However, at the same time, it seems ironic that the ATO wants to curtail the potentially revenue negative implication that this approach may create by seeking to deny or confine the application of authorities, such as the *Commercial Nominees* case and the UK cases. Thus, not only did the Statement of Principles not clarify the legal position, it arguably adds more confusion and uncertainties to this area of law.

The fact that the Statement of Principles is not a public binding ruling do not assist either. It did say that the ATO's undertaking in the Taxpayer Charter concerning ATO publication would also apply to the Statement. This arguably does not mean much given the extremely vague principles noted therein.[112]

Further, note that the Statement of Principles is not the be all and end all proposition. Even where there is a continuing trust in accordance with the Statement of Principles, the changes could still have tax consequences, such as the occurrence of CGT Event K6.[113]

Commissioner's Examples

In the Statement of Principles, the ATO seeks to provide guidance by way of example through five broad scenarios. Whilst these are simple cases, they are nonetheless interesting to examine here. If nothing else, they help shed some light upon ATO's approach in relation to such issues. Although the extent that they can be relied upon because of their questionable basis remain to be tested in practice.[114]

Addition or Removal of Beneficiaries

This is perhaps one of the most common changes to trust deeds in practice. This is also one that is more likely to raise resettlement issues because such changes directly impact upon the trust relationship. The general position of the ATO is that "changes amounting

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[112] Given that the extent of reliance that can be placed on ATO taxation ruling may be doubted following *Bellinz v FCT* (1998) 38 ATR 350 and (1998) 39 ATR 198, the weight of the Statement of Principle would arguably be much weaker.

[113] Petersson, G. 'ATO Unsettles Trusts' [1999] inTAX 8.

[114] See Moshinsky, A. 'Consequences of a Termination' (1999) 34 TIA 126.

to a redefinition of the membership class or classes would terminate the original trust", whereas "changes in membership of a continuing class" would not. The ATO will, in general, accept that there is a change in membership of a continuing class where two conditions are satisfied:

(i) An already existing power to nominate new beneficiaries is only exercisable under the terms of the trust in favour of a clearly defined group which it could be reasonably inferred that the trust was intended to benefit; and

(ii) It can be shown from the deed and surrounding circumstances that the actual objective purpose or theme of the trust was to benefit that wider group.

Example 5.1.2 is an instance where this condition is satisfied. The outcome is that a discretionary trust that has a power vested in the trustee to appoint beneficiaries from a particular class of persons dose not cause a resettlement on the appointment of one of the person within that class as an additional beneficiary. This may be contrasted with Example 5.1.3 where a family discretionary trust contains a power to nominate new beneficiaries that is not restricted to members of the family group or their associates. If the power is exercised to nominate persons from a completely different family group, the ATO would regard that there is a resettlement. There are arguably little difference in substance between these two examples, apart from the scope of the power of appointment. ATO's reasoning seems to base on the objective of the trust – that the original trust deed did not intend to benefit this new class of beneficiary!

The focus on the purpose or essential nature of the trust is even more apparent in the next two examples cited by the ATO. In Example 5.1.5 the ATO does not consider that there is a resettlement where there is a transfer of all the units from the existing unitholder to a single new unitholder in a trust, even if accompanied by a change in control of the shares in the trustee. This is in substance identical to Example 5.1.3, except that the trust in that case is a discretionary trust.[115] The explanation offered by the ATO is that the purpose of the trust in the latter example is to benefit a particular family group, whereas in the former example, the purpose is to benefit those who have subscribe units from time to time.

Whilst this observation by the ATO may be correct in certain cases, it is dangerous to over-generalise this statement to all cases. Indeed, adopting the prevailing approach of the Courts, it is necessary to examine the context and nature of the trust arrangement in question to determine whether there is such a purpose and the exact nature of the trust

[115] See Davis, N. 'Resettlements- Commercial Nominees' (2001) 12 Australian Superannuation Law Bulletin 101.

relationship. Granted that the ATO may be adopting this approach, but this has not been made clear in its examples.

Turning to Example 5.1.6. The ATO approach here could be a concern. Here a 'standard' investment unit trust is varied to create and issue a new class of units. The ATO's view is that a new trust estate has been created because the new class of unit represent a new beneficiary group and the rights attaching to the existing class of beneficiaries have also been altered through the introduction of competing claims. This is particularly problematic because such changes are common in practice, particularly in the current era when investments are held through public unit trusts; and in order to raise additional capital, the trustee issues preferred units that may, after a period, convert into ordinary units.[116] The ATO did not cite any authorities for this view. However, the ATO's view may be explained by the "dispositive" argument noted previously:[117] since the new class of units introduce a new fiduciary duty on the trustee to consider, a new trust arises.

The guideline provided by the ATO and the examples cited are arguably of little real use in the tough case. A notable example is the need to remove a beneficiary from a trust following recent amendment to the mean testing rule for social securities purposes.[118] It is not immediately apparent from the Statement of Principles that the removal of a beneficiary in such an instance would result in resettlement. Yet, it is submitted that argument from recent case law seems clear that the mere removal of beneficial should not result in a resettlement.[119] If the mere removal of beneficiary is unclear under the Statement of Principles, what happen in more complex (but not unusual) cases where additional beneficiary may need to be added as part of the change? The ATO refusal to commit themselves is most unhelpful.[120]

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[116] Johnson, J. 'Commissioner Reissues Statement of Principles on Trust Resettlement' (2001) 75 Law Inst J 37.

[117] See page 22 above.

[118] See footnote 110.

[119] See above discussion on variation to discretionary object and taker-in-default on page 22.

[120] In this regard, one commentator has noted that:

> "Indeed, the ATO seems to have gone out of its way to avoid reaching any conclusion on that matter, other than to say a unilateral renunciation by a beneficiary is not a resettlement, which probably only confirms most practitioners' understanding in any event."

See Ingram, P & Drew, L. 'Discretionary Trusts & Resettlement' (2001) 36 TIA 261.

The ATO refusal to commit themselves is even more apparent in *Taxation Determination TD 2001/26*. This determination deals directly with the social security issue, yet, the most critical issue of removal of a beneficiary by renunciation is addressed by a vague comment in a footnote that merely refers back to the very general Statement of Principle!

Extending the Term or Duration of the Trust

The ATO accepts that in most cases an extension of the term of the trust will not affect the continuity of the trust estate, or, give rise to a new trust estate. The ATO has indicated that this will be the case where the following three factors are present:

- The trust deed confers an express power to alter the termination date;
- The deed and the surrounding circumstances do not indicate that a particular trust period was a fundamental feature of the particular trust relationship; and
- Other accompanying circumstances do not indicate a fundamental change to the trust.

The position adopted by the ATO here appears sensible, but may be a bit guarded, which is not surprising coming from a revenue authority. Whilst it is technically possible, and there could be instances where the duration is a "fundamental feature" of the trust relationship, Examples 5.2.1 and 5.2.3 cited by the ATO are arguably a rarity in practice. A fixed period of time is rarely critical to the trust relationship. Further, two remarks can be made about the authority, *Re Holmden's Settlement Trusts*,[121] cited by the ATO. It is correct that there are conflicts in opinion between the various law Lords as to whether a new trust has been created. However, the majority concurred that the extension of the duration of the trust did not create a new trust. The minority view that a new trust has been created did not turn on the fact that the duration of the trust has been extended, rather, the reason was that the original trust arrangement has came to an end as a result of changes to the interest of the parties.

Changes in Trust Property

The ATO's approach regarding a change in trust property is similar to the extension of the trust duration. A mere change or addition to the trust property will generally not result in a creation of a new trust estate, unless the trust in question has a specific subject matter. The more specific the subject matter, the more likely that there will be a creation of a new trust if the property is changed. Again, both the "terms of the trust and the purpose inferred from the surrounding circumstances" are relevant in making this determination.

Except for the really specific trust – for example, a trust establish for only property A and where there is a change to property B– in the majority of cases changes or addition to trust property should not give rise to any resettlement issue. This is consistent with the

[121] [1968] 1 All ER 148.

principle established in *Truesdale v FCT*[122], which held that the addition of property to a trust established with a nominal settlement does not amount to a creation of a new trust in respect of the later contributed property. It is interesting that the ATO stressed in the Statement of Principles that this principle is decided in the context of section 102 of the 1936 Act, and hence, hinting that it may not apply elsewhere. However, the ATO continues by stating that it should also apply to other trust estate "in comparable circumstances". Such seemingly contradictory statement is most unfortunate as it tends to cloud the issues.

It seems from the Statement of Principles that the ATO is concerned about the situation where dormant or inactive trust with negligible assets are "revived" or "reactivated" at a subsequent point in time. The ATO is not concern with the case where the trust is controlled by a particular group or family; the concern arises where the control or "ownership" of such a trust is effectively changed. In particular, their concern is with the situation where the trust, though dormant, have significant tax losses; and by shifting the control or ownership, the losses could effectively be transferred and used by another taxpayer. The ATO is probably alluding to the possibility under the current system whereby it is technically possible to shift the ownership/ control of a discretionary trust without triggering a CGT Event (other than those associated with a resettlement).[123]

If the concern is with the trafficking of tax losses, it is submitted that the better way to address the issue is through specific tax losses measures rather than indirectly through resettlement.[124] Indeed, the ATO's approach is arguably dubious. It is not clear what the legislative or case law basis behind the ATO's approach is. The passage of ownership of a trust (whether one with substantial asset or nominal assets) from one party to another party should not result in the creation of a new trust estate in the vast majority of cases (if at all). That is, the control of a trust does not change the trust relationship; there is neither change to the beneficial interest, nor change in the fiduciary duties of the trustee.

Changes of Trustee

The possibility that a change in trustee will give rise to a resettlement or creation of a new trust estate is remote in the extreme. Indeed, it seems somewhat illogical to suggest

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[122] 70 ATC 4056.

[123] A very simple example of how this may occur is where the trustee of the discretionary trust is changed to one that is effectively controlled by the new owner. This new trustee can then make distribution to the new owner (and depending on the definition of the scope of the discretionary objects, there may be no need to amend the deed further to specifically add the new owner as a discretionary object.)

[124] Similarly, if the concern is wit value shifting, resettlement is arguably a clumsy way to deal with the issue. The recently introduced general value shifting measure is arguably a better approach. See *New Business Tax System (Consolidation, Value Shifting, Demergers and Other Measures) Bill 2002*.

that the appointment or removal of the trustee will bring the trust to an end, or, create a new trust; the process merely changes the person in whom the trust obligation is vested. That this possibility is even raise in the Statement of Principles is puzzling. Again, the concern of the ATO seems to be with the scenario noted above where the ownership/ control of the trust estate is changed without triggering any tax consequences. A change of trustee or control of the trustee is an obvious way to do this. No case law or legislation currently says that a change in the control of the trustee will result in that trust coming to an end, or, that a new trust estate arise from it.

On a slightly related point, the ATO stated that: "If the trustee remains the same, it would dispose of the trust property in its capacity as trustee of one trust estate, and reacquire it as trustee of another." There is no legislative backing for this statement; a learned author referred to this as a "pure invention". There is no disposal of the property. A mere change in the capacity in which property is held does not involve any disposal.[125]

Changes to the Terms of the Trust

The range of changes possible is limitless. Given the vague ATO's position, it is thus not surprising that this area is still full of uncertainties. ATO could have done more to provide a clearer guideline in this area. Instead, the ATO simply made broad policy statement.

Take, for example, the conversion of a trust to a unit trust arrangement referred to in the Statement of Principles.[126] The ATO's view is that this will generally result in the creation of a new trust. Is this necessarily so? It is submitted that the analysis should proceed first by asking: what income tax issue are being considered? It is important that the analysis flows from criteria that give rise to the tax consequences in question, not some general statement that leave the issue hanging in mid-air.

If the question concerns tax losses, the focus of the analysis is on whether there is a continuity of the trust. Here, the fact that a new trust may or may have been created is beside the point; the creation of a new trust does not mean that the original trust has ceased, and hence, it says nothing about the continuity of the original trust. This is the very approach that the Courts in *Commercial Nominees* are adopting. The focus is on the continuity of the trust.

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[125] *Suncorp Insurance & Finance v Commissioner of Stamp Duties* 97 ATC 4826; *Glennon v FCT* (1972) 127 CLR 503, 507.

[126] Ie. Example 5.5.1, where "the deed of a fixed trust is converted to substitute interests in the trust property for units and to allow the trustee to issue and redeem units."

If the question concerns capital gains tax, especially CGT Event E1, the focus is on whether there arise a settlement of the property of the original trust or some other property. In addressing this question, it is correct that the relationship between the beneficiary and the trustee needs to be considered; but this is only one aspect that needs to be considered. As noted above, whilst it is true that there must at least be some change to the beneficial ownership, this fact alone is not determinative.

In both instance, it is very important to consider the context and nature of the change in light of the particular circumstances and facts of the scenario. Generic statement and approach is likely to be misleading in this regard.

Further, as one author suggested, the creation of fiduciary power may be relevant. If so, it is hard to see how a mere conversion of a trust to a unit trust create any additional fiduciary power on the part of the trustee; either way, the trustee needs to consider whether to make the distribution to the beneficiary, whether they are mere objects or unitholders. Indeed, by unitising the trust, it may be argued that the class or number of beneficiaries that the trustee needs to exercise fiduciary power has reduced rather than increase.

CONCLUSION

The law concerning the termination of trust or the creation of a trust following changes to an existing trust arrangement has never been clear in the past, and remains unclear. The ATO's Statement of Principles achieves nothing in this regard. No additional clarity of the issue can be gleaned from it; in fact, it arguably adds to the confusion by putting a gloss over some of the issues, and by adopting a position on certain areas that seems at odd with the prevailing jurisprudence. It is fitting here to quote from the final report of the Review of Business Taxation: *A Tax System Resigned*:[127]

> "An existing trust may cease and a new trust may be created as a result of changes to a trust deed, changes to the substance or nature of a beneficiary's interest in the trust or changes to the operation of a trust. Such changes can give rise to the resettlement of a trust for some legal purposes. However, neither trust law nor taxation law is clear about exactly what changes to a trust deed constitute the creation of a new trust."

Notwithstanding the inherent uncertainties that persist in this domain, it is submitted that the following framework of analysis can be distilled from the prevailing authorities. This framework can be used to address the taxation implications associated with variation of

[127] At page 479.

trust. First, it is necessary to determine precisely the taxation issues that are at stake. Is it a CGT issue, tax loss issue or some other issue? One point that is clear from *Commercial Nominees* is that the legal analysis must be driven by the income tax issues under consideration. Resettlement is not a determinative factor by itself. For instance, in the case of CGT, the question is whether there is a CGT Event; and in relation to tax losses, the question is whether there is a continuity of the trust.

The next phase of the analysis calls for an examination of the changes (if any) to the beneficial ownership, interest, rights or obligations of any parties to the trust relationship. If there is no change, then it is most likely that no new trust would have been created. If there is a change, resettlement may still not arise. The issue here turns upon the extent of the changes in light of the circumstances of the particular situation. A broad and pragmatic approach is favoured by the authorities. In this regard, the nature and context of the trust arrangement needs to be considered; in particular, in determining what facts are relevant and the weight to be placed upon those facts. It is also necessary to consider basic trust law principles such as whether the variation is within power, or, whether it is exercised in *bona fde* manner for benefit of beneficiary. Equally important is the taxation issue identified in the first phase of the analysis: this issue set the stage for the evaluation of these facts within the context and nature of the trust arrangement.

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