# *ATO releases practical guidance on fixed trusts*

*19 September 2017*

## *In brief*

On 13 September 2017, the Commissioner of Taxation (the Commissioner) released Practical Compliance Guideline PCG 2016/16 (the Guideline), regarding fixed entitlements and fixed trusts. The Guideline provides long awaited guidance on factors the Commissioner will consider when deciding whether to exercise his discretion to treat an interest in the income or capital of a trust as being a 'fixed entitlement', a key factor in a trust meeting the requirement to be a 'fixed trust' for tax purposes. Being treated as a 'fixed trust' has important tax implications, including the ability to carry forward and utilise tax losses from year to year. The Guideline also includes a 'safe harbour compliance approach', which certain trusts can rely on without having to seek the exercise of the Commissioner's discretion in relation to fixed trust status.

## *In detail*

The question of whether a trust is a 'fixed trust' for tax purposes has been a longstanding issue. It was brought into sharper focus in 2011, following the Colonial First State Investments Ltd[1] case and the ATO's Decision Impact Statement that followed. There has been a concern that it may be difficult for most trusts to satisfy the 'fixed trust' definition without the Commissioner exercising his discretion to treat beneficiaries' interests in the trust as 'vested and indefeasible'. The fixed trust status of a trust can have far reaching tax implications, from the ability to carry forward tax losses and to distribute franking credits, to various capital gains tax related concessions. A list of provisions that directly or indirectly rely upon fixed entitlement and/or fixed trust status is set out in Attachment A to the PCG.

For many widely held managed investment trusts, the introduction of the Attribution Managed Investment Trust (AMIT) regime has removed the need to consider this issue on a go forward basis. Trusts that are eligible for, and elect to apply, the AMIT regime are deemed to be fixed trusts for tax purposes, and their members are treated as having fixed entitlements to its income and capital. Accordingly, the issues dealt with in this Guideline should only be relevant for trusts that are not AMITs.

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[1] *Colonial first State Investments Ltd v Commissioner of Taxation* [2011] FCA 16

Also, the Guideline cannot be applied in relation to the 'non-arm's length income' rules, or certain aspects of the holding period rule.

This Guideline was first issued in draft in October 2016. Since that time, it has been significantly re-written in consultation with industry to its current form, which includes a safe harbour compliance approach in addition to a non-exhaustive list of factors the Commissioner will consider when determining whether to exercise his discretion to treat a trust as a fixed trust. Below, we highlight some of the key features of the new Guideline.

### *The Commissioner's safe harbour compliance approach*

The Commissioner has stated in the Guideline that a trust that falls into one of the categories outlined below "can manage its tax affairs as if the Commissioner had exercised the discretion to treat the beneficiaries as having a fixed entitlement to the income and capital of the trust ....".

This means that, other than ensuring that a trust satisfies the relevant conditions of the category relied upon, the Commissioner will not allocate compliance resources to determine whether beneficiaries have fixed entitlements in cases where one of the categories below is met. This is a welcome development as it should increase certainty for many trusts as to their fixed trust status without the need to approach the Commissioner for exercise of his discretion.

However, the Commissioner indicates that the safe harbours can only be satisfied in respect of 'known facts'.  An example is provided of a proposed scrip for scrip rollover, where if the trustees require certainty as to the fixed trust status of the trusts before the transaction proceeds, they would need to seek a ruling as to whether fixed entitlements will exist at the relevant time, and request the Commissioner to exercise his discretion if the beneficiaries interests at the future date are not fixed entitlements.

### *Which trusts are eligible for the safe harbour?*

| Type of Trust | Overview of conditions that must be satisfied to access the safe harbour |
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| Listed trust | The trust's units are listed for quotation on the official list of an approved stock exchange. |
| Registered managed investment scheme | • The trust is a registered managed investment scheme (MIS) under the *Corporations Act 2001*.<br>• The trustee, Responsible Entity or manager has complied with all of the requirements of Chapter 5C of the *Corporations Act 2001*, and any applicable ASIC relief.<br>• All beneficial interests have the same rights to receive the income and capital of the trust*. |
| Widely held trust that satisfies licensing requirements | • The members of the trust are all widely held, as prescribed in the Guideline.<br>• The trust is not required to be registered under the Corporations Act 2001, but is operated or managed by an Australian financial services licensee or authorised representative.<br>• All beneficial interests have the same rights to receive the income and capital of the trust*. |
| Unregistered managed investment scheme that satisfies licensing requirements | • The trust is an unregistered MIS, and is operated or managed by an Australian financial services licensee or authorised representative.<br>• The trust has a trust instrument, and all interests in the trust income and capital are 'vested' and can be expressed as a percentage of the total income and capital of the trusts. The trust |

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|---|---|
| | is not a discretionary trust or a trust with default income or capital beneficiaries.<br>● All beneficial interests have the same rights to receive the income and capital of the trust*. |
| Specific single interest holder trust | ● The trust has a trust instrument, all interests in the trust income and capital are 'vested' and can be expressed as a percentage of the total income and capital of the trusts.<br>● The trust is not a discretionary trust or a trust with default income or capital beneficiaries.<br>● All the interests in the trust are held directly or indirectly, and for their own benefit, by an individual, listed trust or registered managed investment scheme.<br>● All beneficial interests have the same rights to receive the income and capital of the trust*.<br>● The trust meets certain anti-avoidance criteria. |
| Other trust | ● The trust has a trust instrument, all interests in the trust income and capital are 'vested' and can be expressed as a percentage of the total income and capital of the trusts. The trust is not a discretionary trust or a trust with default income or capital beneficiaries.<br>● A trustee or manager has never exercised a power capable of defeating a beneficiary's interest in the income or capital of the trust.<br>● All beneficial interests have the same rights to receive the income and capital of the trust*.<br>● The trust meets certain anti-avoidance criteria. |

* For the purposes of making this determination, the following factors will be disregarded:
(i) differences in obligations as to fees and charges
(ii) issue and redemption price of the beneficial interests (provided that the savings rule in subsection 272-5(2) of ITAA 1936 is satisfied (as discussed in the Guideline)
(iii) exposure of the beneficial interests to foreign exchange gains and losses.

### *Factors relevant for exercising the Commissioner's discretion*

Where a trust does not satisfy the conditions to access the safe harbour, it still has recourse to request the Commissioner to exercise his discretion to treat the trust as a fixed trust for tax purposes. The Guideline provides an overview of the factors the Commissioner will consider when deciding whether or not to exercise his discretion, and whether these factors weigh in favour of the exercise of his discretion, or against it.

| Examples of factors favourable to the exercise of the Commissioner's discretion |
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| A trustee or manager has never exercised a power capable of defeating a beneficiary's interest in the trust. |
| Commitments are made in unit holder agreements, Product Disclosure Statements or other documents that the trustee or manager will not exercise a power capable of defeating a beneficiary's interest at all, or in a way that is adverse to the rights of beneficiaries to receive the income and capital of the trust. |
| All beneficiaries have the same rights to receive the income and capital of the trust. |
| The trust instrument can only be amended with the unanimous (100 per cent) approval of all the beneficiaries, or, where it can be amended without the unanimous approval of beneficiaries, the approval percentage calculated on the current interest or unit holdings of beneficiaries effectively means that all beneficiaries must approve any amendment. |
| The trustee or manager deals with the beneficiaries on an arm's length basis |
| The trust is governed by a foreign law that is similar to Chapter 5C of the *Corporations Act 2001*. |
| **Examples of factors adverse to the exercise of the Commissioner's discretion** |
| A trustee or manager exercises a power to defeat beneficiaries' interests in the income or capital of the trust however, it is noted that:<br>● the nature of the power that is exercised will be important, for example, compulsorily redeeming units where a unit holder's stake is less than a minimum specified in the trust instrument, and the unit holder receives the redemption price of those units, is unlikely to preclude the exercise of the discretion; and<br>● where external factors (such as those in the Global Financial Crisis) temporarily affect the ability of the trustee or manager to fund distributions or redemptions, this is unlikely to preclude the exercise of the discretion (for example, a temporary wholesale freezing or deferral of interests). |
| There are significantly different beneficiaries of the trust in an income year for which an entity seeks to have a fixed entitlement, compared to the beneficiaries of the trust in the income year(s) in which the trust made a tax loss, or incurred a bad debt deduction or debt/equity swap deduction. |
| An arrangement has been entered into which would result in a specific anti avoidance rule regarding fixed entitlements being triggered, the trafficking of the tax benefit of a tax loss, bad debt deduction or debt/equity swap deduction, or fraud or evasion. |

## The takeaway

The finalisation of this Guideline is a welcome development for trustees and beneficiaries where fixed trust status will continue to be an issue as they are not eligible to, or choose not to, elect into the AMIT regime. The introduction of the safe harbour should reduce uncertainty, but it will be critical that those seeking to rely on this concession maintain records to support their claim that they meet the relevant conditions to access the safe harbour, and monitor their eligibility on an ongoing basis.

## *Let's talk*

For a deeper discussion of how these issues might affect your business, please contact:


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