Trust deed amendments - life after Clark’s case

Presentation to QLS succession seminar

November 2013

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1. INTRODUCTION

In this paper I have been asked to consider some practical issues in relation to variation of trusts particularly in a ‘post Clark’ environment.

There are numerous different types of trust but, for the purpose of this paper, I will largely confine my comments to variations of discretionary trust deeds as these are the most commonly used trust structure.

Two key features of discretionary trusts are that they are likely to continue for a long period of time and they provide substantial flexibility not only to the client who establishes the trust but to those who might take control of it after the death of the founder. It is therefore important that trustees have wide powers of variation to ensure that the original founders and future controllers have the required level of flexibility to deal with changing circumstances over the life of the trust – but with some checks and balances.

Since the High Court decision in *Bamford* our firm has reviewed literally thousands of trust deeds and it has been quite surprising to find the number of different types of trust deed that are in circulation.

In this paper I will initially consider some issues in relation to whether there is an effective power of amendment and the procedures that should be followed when exercising that power and then consider some specific issues, particularly whether changes to a discretionary trust deed are likely to trigger a resettlement.

For a more comprehensive coverage of issues that need to be considered when varying trusts in the ‘post Clark environment’, I refer you to an excellent paper prepared by Andrew O’Bryan, William Moore and Kay Papadopolous from Hall & Wilcox.

2. CHECK THE POWER OF VARIATION

Later in the paper I will consider some technical issues which may limit the trustee’s power to amend the trust deed but, even where it is clear that there is an effective power of variation, it is still very important to ensure that the provisions of the trust deed governing how that power should be exercised must be followed.

While there are many different types of trust deed in circulation, many of these have clearly been based on an original precedent and have significant similarities. The danger when working with a trust deed which appears to be familiar is that it is easy to fall into the trap of thinking you know what the provisions of the deed will say (based on familiarity with similar deeds).

However, on a closer reading you may find there are particular provisions that have subtle differences to what you expect. The variation clauses in examples 1 and 2 later in this paper provide a good illustration of this point.

Therefore, even if you are familiar with the style of trust deed you are working with, it is critical that you read the variation provisions carefully before implementing any amendment.

While the procedures for varying a trust will often be reasonably clear, it is important to always check the trust deed to ensure the correct procedure is followed. For example, you need to check the provisions of the deed to ascertain:

- does the power of variation extend to all provisions in the deed (including schedules) or only limited provisions;
- who has the power to make the change (e.g. the trustee or appointor);

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1 Commissioner of taxation v Bamford [2010] HCA 10
2 Varying trusts after Clark – The Tax Institute, Victorian Division, 13 March 2013
• the procedures for variation (e.g. by deed, minute or notice in writing);

• whether it is necessary to obtain the consent of any party such as the appointor or guardian; and

• whether there are any specific restrictions on the power of variation (e.g. prohibiting amendment of certain clauses).

A failure to comply with procedural requirements may result in a purported variation being ineffective as illustrated by the decisions in *Re Cavill Hotels Pty Ltd.* and *Idlecroft v Commissioner of Taxation.*

In *Cavill* the trust deed empowered the trustee to vary the provisions of the second schedule to the deed ‘by adding the name of any person’ and also ‘by deleting the name of any Capital Beneficiary’.

The trustee purported to vary the deed by deleting various categories of beneficiaries (e.g. a group described as ‘Family Beneficiaries’).

The court held that the variation was invalid because, to effectively remove a beneficiary, the deed of variation had to refer to the beneficiary by name not by reference to a class of eligible beneficiaries. Williams J had this to say:

… the power to vary the beneficiaries was strictly and severely limited. The trust could not be varied ‘in any manner whatsoever’;… the only power the trustee had was to delete ‘the name’ of any beneficiary. …in the circumstances of this case that could not be done by merely identifying the categories of continuing beneficiaries.\(^5\)

In *Idlecroft* the trust deed provided that the principal could appoint additional beneficiaries. The trustee was a company and the principal was a director of the trustee.

The trustee purported to appoint an additional beneficiary by a nomination under the company’s seal which was countersigned by the principal but in his capacity as director. Spender J held that the fact the principal signed the nomination of beneficiary as a director did not constitute an appointment by him as principal.\(^6\)

### 3. IS THE PROPOSED AMENDMENT WITHIN THE POWER OF VARIATION

The first step in determining whether a proposed amendment is within the power of variation (if there is one) is to carefully read the variation clause to ascertain what provisions of the deed may be amended.

As indicated above, there are many varieties of trust deed in circulation, and the wording of the common variation powers can be significantly (or subtly) different. Some examples of common wording for variation clauses in trust deed are as follows:

**Example 1**

The Trustee may by Deed revoke add to release or vary all or any of the Trusts declared or any Trusts declared by any variation, alteration or addition made from time to time and may by the same or any other Deed declare any new or other trusts or powers concerning the Trust Fund but so that the Trustee shall not have any power to revoke add to or vary any of the Trusts so that the Settlor may acquire a beneficial interest in the Trust Fund or any part of it nor to effect [sic] the beneficial entitlement of any Beneficiary to any amount applied for him prior to the date of revocation or alteration and any other person or persons upon whom any power or powers so conferred on him or them. Upon this exercise of any release and revocation pursuant to this clause the power so released and revoked shall be absolutely and irrevocably determined.

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3 \(^{[1998]}\) 1 Qd R 396.

4 2004 ATC 4845

5 At 402

6 at 4854
Example 2

The Trustee **may by Deed revoke add to release or vary all or any of the trusts or powers hereinbefore declared** or any trusts or powers declared by any variation, alteration or addition made hereto from time to time and may by the same or any other Deed declare any new or other trusts or powers concerning the Trust Fund or part or parts thereof but so that the Trustee shall not have any power to revoke add to or vary any of the trusts or powers hereof so that the Settlor or the Trustee may acquire a beneficial interest in the Trust Fund or any part thereof nor to affect the beneficial entitlement of any Beneficiary to any amount applied for him prior to the date of revocation or alteration and any other person or persons upon whom any power is conferred by this Trust may release and revoke any power or powers so conferred on him or them PROVIDED ALWAYS that no such addition variation or amendment shall be made whereby the Settlor or the Trustee may acquire a beneficial interest in the Income or capital of the Trust or any part thereof. Upon the exercise of any release and any revocation pursuant to this clause the power or trust so released and revoked shall be absolutely and irrevocably determined. The expression ‘trusts or powers’ where used in this sub-clause shall be deemed to include all the provisions of this Trust Deed or of any other Deed varying or altering or adding to such Trust Deed

Example 3

The Trustee may revoke, delete or vary all or any of the trusts, powers **or provisions declared or included in this deed** and may at the same time declare or include any new or other trusts, powers or provisions concerning the Fund

The first clause was found in the deed considered in Jenkins v Ellett\(^7\) which is dealt with in more detail later in this paper.

The clause in the second example is slightly different to that in the deed for Jenkins v Ellett but the differences are material, in particular because of the further words that ‘define’ the expression ‘trust or powers’ as including all of the provisions of the deed. Many deeds that have a variation clause similar to this also contain a further interpretive provision that stipulates the ‘deed’ includes the schedules to the deeds.

The third example provides more flexibility again because it not only permits the trustee to vary the trusts or powers contained in the deed, but makes it clear that the trustee can vary any ‘provisions declared or included’ in the deed.

Notwithstanding that the variation power in a trust deed may appear to provide complete discretion to the trustee as to how they exercise the power of amendment, there are still some restrictions on the power.

- In exercising the powers of amendment the trustee is required to act honestly and in good faith for proper purposes and upon relevant considerations in the interests of the beneficiaries and the trust estate as a whole.\(^8\)
- Also equity will not permit a trust power to be used for an object which is extraneous to and in conflict with the objects of the trust.\(^9\)
- In addition, some authorities suggest that a variation which destroys the ‘substratum’ of the trust, will be invalid.\(^10\)

Many of the decisions in relation to these restrictions on the trustee’s power of amendment (particularly in the context of whether the amendment destroys the substratum) involve superannuation and pension fund deeds, where there is a quite specific purpose (or substratum) for which the trust is established.

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\(^7\) [2007] QSC 154

\(^8\) KCA Super Pty Ltd at trustee of the superannuation fund known as KCA Super (No 2) [2011] NSWSC 130 and Re Brockbank [1948] 1 CH 206

\(^9\) Dwyer v Ross 34 FCR 463 (at page 467) and Vatcher v Paull [1915] AC 372

\(^10\) Re Ball’s settlement [1968] 1 WLR 899, Re Dyer [1935] VLR 273
The Queensland case of *Jenkins v Ellett* illustrates the difficulties that arise with a restrictive power of amendment.

The original appointor was George Jenkins who was also a trustee along with Luciano Menniti. Part 9 of the schedule to the deed provided that, on George’s death, his executor became the appointor.

In 1999, George used his power as appointor to remove Luciano as trustee, and replaced him with Joyce Ellett. Then, he and Joyce (as trustees) purported to amend the deed to appoint Joyce as appointor in place of George. George died in 2002 and his executor (his granddaughter Georgina) purported to exercise her power as appointor to appoint herself and her brother Peter as trustees.

The variation clause in that deed is reproduced in example 1 above.

The question was whether the 1999 deed appointing Joyce Ellett was valid.

Douglas J held that the variation power did not authorise an amendment to the definition of ‘Principal’ in the schedule to the deed for a number of reasons.

- Although, the deed defined the term ‘this Trust’ to mean ‘the trust constituted by and comprised in this Deed and the Schedule’, the variation clause, when specifying what could be varied, did not refer to ‘this Trust’ but instead referred to ‘any of the Trusts declared’.

- His Honour found this latter expression to be a reference back to the declaration of trust in clause 2 of the deed and reasoned that, if the drafters had intended to extend the variation power to include the schedules to the deed, they could have simply referred to ‘this Trust’ in the variation clause.

- His Honour also placed weight on the fact that the appointor’s power to remove the trustee was ‘designed to ensure that control of the trust [would] remain with the significant intended beneficiary, here George Jenkins, and after him his spouse or his executor’. This power could be sidestepped by the trustee if the variation power extended to allow the trustee to remove the appointor. To do this would be ‘akin to destroying the substratum of the deed’.

However, more recent cases have questioned whether there is an implied restriction on a trustee’s power of amendment to preserve the substratum of the trust (particularly for general trusts rather than specific purpose trusts such as superannuation funds).\(^\text{11}\)

The reduced importance of the concept of a substratum of the trust is illustrated by the comments of the Court of Appeal in *Kearns v Hill*\(^\text{12}\). *In that case*, the court doubted that there was any general presumption that a settlor of a trust intended a power of amendment to be limited so as not to effect ‘the main structure of the trust’.\(^\text{13}\)

The court also said that a power to amend ‘any provision’ in the deed should not be read down.\(^\text{14}\)

Mahoney JA said that:

…I do not think that any limitation should be placed on the generality of the power of variation by reasons of the fact as referred to in the cases cited.\(^\text{15}\)

The Court of Appeal in *Kearns v Hill* also indicated that a discretionary family trust is in a class of trusts that is:

.. designed to deal with the disposal of family assets in such a way that the trustees are furnished with the most ample powers of management and disposition of the settled fund coupled with maximum flexibility in

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\(^\text{12}\) (1990) 21 NSWLR 107

\(^\text{13}\) *Kearns v Hill* at 108 (Mahoney JA) and also 110-111 Per Mergher J, Clark JA agreeing

\(^\text{14}\) *Kearns v Hill* at 110 (Mergher J, Clark JA agreeing)

\(^\text{15}\) At 108
the use of those powers, so as to accommodate the settled fund to a merging and ever changing economic and revenue considerations.\textsuperscript{16}

4. WILL THE AMENDMENT TRIGGER A RESETTLEMENT?

What is a resettlement anyway?

When varying a trust deed it is important to consider the broader duty and tax implications.

The risk of a variation of trust or change in beneficiaries triggering a resettlement is substantially reduced as a consequence of the decision in \textit{Commissioner of Taxation v Clark}\textsuperscript{17} and the subsequent release of Taxation Determination TD 2012/21.

Prior to these developments there was a good deal of confusion about what constituted a resettlement – or at least what the Commission of Taxation considered was a resettlement.

In \textit{Buzza v Controller of Stamps (Vic)}\textsuperscript{18} Dixon J unhelpfully said, ‘it is notoriously difficult to define a settlement, but that does not mean that it is difficult to recognise one.’\textsuperscript{19}

\textit{Chief Commissioner of Stamp Duties (NSW) v Buckle}\textsuperscript{20} provided some guidance. In that case, the trust deed provided that, if the trustee did not distribute all trust capital before the termination of the trust, two named ‘default beneficiaries’ would be entitled to the undistributed capital in equal shares. This interest of the default beneficiaries was contingent on the trustee not exercising its discretion to distribute the capital to other beneficiaries prior to the termination date.

The trust deed was varied to provide that, if the default provision was triggered, one of the beneficiaries would receive two-thirds of the capital and the other would get the remaining one third.

The High Court considered that this change was not enough to constitute a ‘resettlement’ of the entire fund. A significant reason for the Court’s decision was that the trust was a discretionary trust and the rights of the default beneficiaries which were varied could only be described as beneficial interests in a very limited sense, because of the overriding discretion of the trustee to distribute income and capital to other parties.

The High Court decision in \textit{FCT v Commercial Nominees of Australia Ltd}\textsuperscript{21} should have clarified the position but it concerned changes to the trust deed for a superannuation fund and the Commissioner of Taxation initially refused to accept that the principles outlined in \textit{Commercial Nominees} applied to other trusts.

In \textit{Commercial Nominees} the High Court:

\begin{itemize}
  \item acknowledged there were differences between a normal trust fund and a superannuation fund, but pointed out that the fundamental question was one of ‘continuity’ (i.e. did the original fund continue in existence despite the changes); and
  \item considered that, notwithstanding the quite dramatic changes that were made to the trust deed and the structure of the superannuation fund, the original fund ‘did not come to an end’ but that continued as the same entity.
\end{itemize}

The fact that the original trust deed provided the trustee with the power to make the changes was also a significant factor in the Federal Court decision which was appealed to the High Court.\textsuperscript{22}

\textsuperscript{16} At 109
\textsuperscript{17} [2011] FCAFC 5
\textsuperscript{18} [1951] 83 CLR 286
\textsuperscript{19} Ibid at 300
\textsuperscript{20} 98 ATC 4097
\textsuperscript{21} 2001 ATC 4336
\textsuperscript{22} 99 ATC 5115 at 5124
The ATO issued revised a ‘Statement of Principles’ in 2001 (following the decision in *Commercial Nominees*) which outlined the circumstances in which the ATO would treat changes to an existing trust as triggering a resettlement. This Statement of Principles refused to accept that the principles in *Commercial Nominees* would apply to general trusts and indicated that some relatively minor changes might trigger a resettlement in some circumstances (e.g. an amendment to the definition of trust income in some cases).

In *Clark*, the Federal Court (both at first instance and on appeal) indicated that the principles enunciated in *Commercial Nominees* are not confined to superannuation funds and are equally applicable to other trusts. Importantly, all members of the Full Court followed the approach of the High Court in *Commercial Nominees*.

Dowsett J cited the following passage from the High Court decision in *Commercial Nominees* as summarising the correct approach in determining whether there is a resettlement:

> ‘The three main indicia of continuity for the purposes of Pt IX are the constitution of the trusts under which the fund (if a trust fund) operated, the trust property, and membership. Changes in one or more of those matters must be such as to terminate the existence of the eligible entity, or to produce the result that it does not derive the income in question, to destroy the necessary continuity.’

Edmonds and Gordon JJ cited the same passage.

**Implications of a resettlement**

Prior to the introduction of capital gains tax, the main concern was that a variation of trust that triggered a resettlement would result in stamp duty consequences because there was a specific head of ‘settlement duty’ under the previous Stamp Duties Act. Therefore many of the older cases on trust resettlements relate to duty issues.

A trust resettlement is no longer a specific dutiable event in Queensland but a variation that triggers a resettlement may still involve some duty issues, which are considered later in this paper.

Since the introduction of the capital gains provisions in 1985 the main consequence of triggering a resettlement is that this will result in the occurrence of CGT event E1 because the effect of a resettlement is that the original trust is terminated and a new trust is created.

The consequence of CGT event E1 occurring is that the CGT assets in the original trust will effectively be deemed to be transferred to the newly created trust at market value. This will either result in pre-CGT assets becoming post-CGT assets (with a market value cost base) or will trigger a capital gain equal to the difference between the market value and the cost base of post-CGT assets held in the trust. Obviously the consequences where there are substantial post-CGT assets in the trust can be very significant.

**ATO position post Clark**

The ATO has now issued Taxation Determination TD 2012/21 which can be summarised as follows:

- The approach set out in the original Statement of Principles ‘is not sustainable’.
- Neither CGT event E1 nor CGT event E2 happens unless the variation of the trust ‘causes the existing trust to terminate and a new trust to arise for trust law purposes’.
- *Clark* ‘is authority for the proposition that assuming there is some continuity of property and membership of the trust, an amendment of the trust that is made in proper exercise of a power of amendment contained under the deed will not have the result of terminating the trust,

23 [2009] FCA 1401
24 [2011] FCAFC 5 at paragraph 34
25 at paragraph 77 of their joint judgement
irrespective of the extent of the amendments so made so long as the amendments are properly supported by the power’.  

- The principles in *Commercial Nominees* are relevant in determining whether CGT event E1 or E2 happens as a result of changes to the terms of an existing trust (i.e. whether a resettlement occurs).

- However there may be some instances where, although a variation to a trust deed does not result in a resettlement, the change may result in some assets being held on a different trust. *Commissioner of State Revenue v Lam and Kym Pty Ltd* and *Oswal v Commissioner of Taxation* illustrate how this might occur.

Taxpayers can rely on this Taxation Determination and therefore, provided that a proposed amendment is within the powers under the deed and there is some continuity of at least some of the three essential elements of the trust as specified in *Commercial Nominees* it is unlikely that a variation will trigger a resettlement for tax purposes.

However, because the consequences of triggering a resettlement can be very significant it may be prudent to apply for a private ruling if there is any doubt about the scope of the variation power or the trust assets have substantial unrealised capital gains.

This is particularly relevant where the change is being made for some purpose unrelated to tax issues (e.g. estate planning).

### A tale of four rulings

The extent of the change in the ATO position on what constitutes a resettlement since the decision in *Clark* can be illustrated by considering several private rulings that my firm has obtained over the last few years (some prior to and some subsequent to the decision in *Clark*).

The first of these private rulings (60189) involved a family trust established by the parents with their three sons as the primary/default beneficiaries. The parents had entered into an arrangement with one of their sons where he was paid a large capital amount in consideration of him agreeing to relinquish his interest in the estate of the parents and also the family trust.

To shore up this arrangement the clients proposed to vary the trust deed to remove that son as a primary/default beneficiary. A ruling request was lodged submitting that the change did not affect the continuity of the trust deed, trust assets or eligible class of beneficiaries and was within the trustee’s powers (based on the principles in *Commercial Nominees*).

The ATO ruled that the removal of one of the three primary/default beneficiaries would result in the occurrence of CGT event E1 and a deemed disposal of all CGT assets.

The facts in Ruling 94501 were that the eligible beneficiaries under a discretionary trust deed were the nominated principal and her children (excluding adopted children) and lineal descendants. The client proposed to amend the trust deed to expand the class of eligible beneficiaries by including adopted children and expanding the class of relatives who would be eligible (e.g. to include grandparents, sibling, nephews, nieces etc.).

The ATO (relying on the Statement of Principles) ruled that these changes would ‘change the beneficial class by adding a class of beneficiaries not intended by the settlor’ and would therefore trigger a resettlement and CGT event E1.

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27 Paragraph 21
28 [2004] VSCA 204
29 [2013] FCA 745
30 Private Rulings Nos. 60189, 1012224602151, 94501 and 1011717756470
The proposed change under consideration in Private Ruling 1011717756470 was also one which involved a relatively minor change to the trust deed but which the ATO ruled would trigger a resettlement.

The trust deed was a typical discretionary trust deed that included a wide range of beneficiaries and allowed the trustee full discretion in relation to distributions of income and capital. For estate planning reasons the client wanted to impose some restrictions on the trustee’s ability to make capital distributions to non-family members by inserting provisions which effectively precluded distributions of capital other than to the primary beneficiaries and their lineal descendants.

The ATO considered the change would result in a resettlement. This ruling request was lodged after the decision at first instance in Clark but while it was still subject to appeal to the Full Federal Court.

However, in subsequent private ruling 1012224602151 the ATO position was dramatically different.

In that case the trust deed had restrictive provisions both in relation to the eligible class of beneficiaries and amendments which could be made to the deed. In addition, although the deed was only established in 1976, the vesting date was nominated as 13 May 2021.

The clients wanted to amend the trust deed by;

- extending the vesting date to 2055 (to avoid triggering an automatic CGT event in 2021);
- allowing the trustee to make interim distributions of capital; and
- inserting a ‘trust cloning’ power to allow the trustee to declare that some assets in the trust would be held on the terms of a different trust.

The proposed extension of the vesting date was not permitted under the power of variation in the trust deed and therefore, subject to obtaining a favourable private ruling, the clients proposed to apply to the court for approval to make that change.

These changes were quite significant (particularly in relation to the relatively minor changes referred to in the previous three private rulings). However the ATO determined that these changes would not trigger a resettlement and accepted that the relevant test to be applied in determining whether there was a resettlement was to determine whether there had been a continuity of the trust estate by reference to the trust’s constituent documents and property and the identity of the eligible class of beneficiaries.

5. **DUTY IMPLICATIONS**

A trust resettlement is no longer a specific dutiable event under the *Duties Act 2001*.

Adding or removing discretionary beneficiaries is also not a dutiable transaction but adding or removing a default beneficiary will trigger a trust acquisition or trust surrender and may have duty consequences.\(^{31}\)

However, the addition or removal of a default beneficiary will be exempt from duty if the trust has been established and maintained primarily for the benefit of the members of a particular family and the person acquiring or surrendering the trust interest is a member of that family group.\(^{32}\)

A trust will be regarded as being established and maintained primarily for the benefit of a particular family group if:

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\(^{31}\) Sections 55 – 57  
\(^{32}\) Section 118
the primary beneficiaries (defined as being persons who are ‘the first takers in default of an appointment for capital by the trustee of the trust’) consist only of members of that family group or a ‘family company’; \(^{33}\) and

the takers in default of appointment for capital consist only of members of the family group or a family company.\(^ {34}\)

In most cases it will relatively easy to determine whether the trust meets the requirements for this exemption and whether any changes to default beneficiaries will trigger duty consequences.

While a trust resettlement is not a specific dutiable transaction, if a resettlement does in fact occur this will involve the termination of an existing trust and creation of a new trust and the creation and termination of trusts of dutiable property are dutiable transaction.\(^ {35}\)

If there is a trust resettlement and the default beneficiaries remain the same, the trust creation arising from the resettlement will generally not be subject to duty as a result of section 53(2) which provides that a trust creation only arises where a party previously held property on trust and starts to hold the property on a new trust if the default beneficiaries are different.

I have been unable to find any definitive authority of commentary on the application of section 54 (trust terminations) but in my view it is arguable that, even though a change that triggers a trust resettlement will (by definition) involve the termination of a previously existing trust, this will not satisfy the requirements for a trust termination under section 54 because the same party will generally continue to hold the property as trustee of a trust (albeit a different one).

Section 54 provides that there will be a dutiable termination of a trust only where a person ‘having held the property as trustee, starts to hold the property other than as trustee’.

Therefore it is arguable that there is no trust termination provided the party continues to hold the property in a trustee capacity rather than beneficially.

The explanatory notes to the Bill that introduced the Duties Act indicate that the focus of the section ‘is on a change in the capacity in which a person holds dutiable property, namely from trustee to non-trustee’.

The CCH Queensland Duties Commentary also indicates that the application of section 54 ‘appears to be where the trustee is also a beneficiary and the vesting of property upon the termination of the trust involves the trustee retaining title of property’. \(^ {36}\)

6. COMMON VARIATION ISSUES

Can you amend a troublesome variation clause?

A question that often arises where there is a restriction in the power of variation, is whether the deed can be amended to remove that restriction. While the answer to this question will often depend upon exactly what is the nature of the restriction that is imposed and the scope of the power of variation, the general principle appears to be that a power of variation will not generally allow an amendment removing a restriction on the exercise of that variation power.\(^ {37}\)

One argument as to why such a restriction should not be capable of amendment is that the trustee has a primary obligation to adhere to the terms of the trust deed.\(^ {38}\)

\(^{33}\) Section 118(3)
\(^{34}\) Schedule 6 – Duties Act 2001
\(^{35}\) Section 9(1)(h)
\(^{36}\) at paragraph 30-230.
\(^{38}\) O’Brien, Moore and Papadopolous, Varying trusts after Clark, Tax Institute, Victorian Division, 13 March 2013 at 14
There is also a general principle that it is not permissible to do indirectly what is prohibited directly.\(^{39}\)

The scope of powers of amendment in trust deeds is discussed in *Thomas on Powers*.\(^{40}\) In that text the author makes the following comments:

> It does not follow, of course that the power of amendment itself can be amended in this way. Indeed, it is probably the case that there is an implied (albeit rebuttable) presumption, in the absence of an expressed direction to that effect, that a power of amendment (like any other kind of power) cannot be used to extend its own scope or amend its own terms.\(^{41}\)

There are also a number of authorities involving amendments to superannuation and pension deeds which suggest that the power of variation cannot be used to remove restrictions on that power.

For example, in *UEB Industries Ltd v Brabant*\(^{42}\) Cook P (with whom the majority agreed) held that the power of amendment in the deed did not extend to removing a restriction on the exercise of that power.

These superannuation cases need to be considered in the context that superannuation and pension deeds are a special class of trust funds which are different from traditional trusts because they are based on a contract between the employer, trustee and employees.\(^{43}\)

**Income definitions and attribution clauses**

As mentioned previously in this paper, many trust deeds have been updated following the decision in *Bamford*.\(^{44}\) The effect of the decision in *Bamford* was that the High Court confirmed that when determining the ‘net income of the trust estate’ for the purposes of section 97 of the *Income Tax Assessment Act 1936*, the relevant trust income was determined in accordance with the provisions of the trust deed and may well be different to the ‘net income’ of the trust estate as defined in section 95 of the Act or under accounting concepts.

The significance of this is that the liability of beneficiaries to pay tax on their share of the taxable ‘net income’ of the trust estate (under section 95) is dependent upon their proportionate share of their entitlement to the section 97 income (commonly referred to as distributable income).

Therefore, it is important that trustees have the power under the trust deed to determines an appropriate concept of distributable income so as to achieve the appropriate tax outcomes on a year to year basis. The general approach adopted (but by no means a universal one), is to define the trust income as being equal to the section 95 net income of the trust (i.e. determined as if the trust estate was a separate taxpayer) but also to allow the trustee some discretion to adopt a different concept of income if that is appropriate.

However, because it is essential that beneficiaries are ‘presently entitled’ to a share of the distributable income (determined under section 97) the better view is that a definition of income which ties the trust income to section 95 net income, should exclude any ‘notional amounts’ which might be included in the taxable income of the trust.

The best example of such notional amounts are franking credits which flow with fully franked dividends paid to the trust.

The reason for this is that while notional amounts increase the amount of the taxable income of the trust, they do not represent amounts which are actually available for distribution and therefore no beneficiary can be presently entitled to those amounts. Including notional amounts in distributable income where no person can be presently entitled may lead to the trustee being subject to a section 99A assessment on undistributed income (which would be taxed at top marginal rates).

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\(^{39}\) A H Slater QC Amendment of Trust Instruments. STEP on-line publication, November 2009

\(^{40}\) 1st Edition, 1998

\(^{41}\) at 585 to 586

\(^{42}\) (1995) 1 NZSC 40, 341

\(^{43}\) Lock v Westpac Banking Corporation (1991) 25 NSWLR 593

\(^{44}\) Commissioner of Taxation v Bamford [2010] HCA 10
Following the decision in *Bamford* many deeds have been reviewed to align the trust income with section 95 net income but excluding notional amounts.

The now withdrawn Statement of Principles specifically considered whether amendments along these lines might trigger a resettlement. The view of the ATO was that inserting or varying an income definition would not generally trigger a resettlement but there may be an issue if there are different capital and income beneficiaries because, inserting or amending a definition so that the trustee has a discretion to treat receipts on capital account as if they were income and vice versa, might significantly alter the rights of the capital and income beneficiaries.

Based on the views expressed by the ATO in Taxation Determination TD 2012/21, it now appear to unlikely that changes to the income definition (even where there were different income and capital beneficiaries) would trigger a resettlement.

However, it is important not to focus solely on the tax outcomes of a particular change. Where there are in fact different income and capital beneficiaries, you need to consider carefully whether an amendment which purports to allow the trustee to re-characterise capital receipts as income or vice versa is appropriate.

A related amendment which is commonly made to deeds (particularly older deeds) is to include an attribution clause which allows the trustee to segregate different types of income and to stream different categories to particular beneficiaries (particularly capital gains and franked dividends).

Attribution clauses are common in trust deeds established after the introduction of the capital gains and imputation provisions but the need for such clauses is now imperative if a trustee is to take advantage of the streaming measures introduced in the *Tax Laws Amendment (2011) Measures No. 5 (Act)* 2011.

The explanatory memorandum to the legislation introducing the streaming measures made it very clear that the amended provisions do not empower the trustee to stream different categories of income and only have operation to ensure that 'where a trustee has a power to stream under the terms of the trust', the streaming will be effective for tax purposes.45

In my view, the insertion of an attribution clause where one does not already exist is highly unlikely to trigger any resettlement consequences because the amendment does not in any way detract from the continuity of the three essential trust elements and nor does it alter the substantive rights of beneficiaries. It merely empowers the trustee to characterise amounts distributed to the beneficiaries in a particular way and does not impact on the actual amounts that the beneficiaries receive.

**Changes affecting appointor/principal**

Changes to a trust deed that involve a replacement or termination of the role of an appointor or principal or remove provisions in the deed which require the trustee to obtain the prior consent of a person holding such an office may be problematical – depending on the terms of the trust deed.

In some cases, the provisions of the trust deed will say that the appointor or principal (or person holding similar roles) may be removed with their consent or that their powers may be varied with their consent in which case there is no issue in amending the deed provided the consent is obtained. However if the deed requires that the consent is given in advance it has been suggested that the requirement for the consent to be provided in advance cannot be waived and that a subsequent consent will not suffice 46.

The position becomes somewhat more difficult where the trust deed is silent as to whether a person who holds a position such as principal or appointor can be removed without consent or whether restrictions in the deed which require their consent for the exercise of particular powers (for example, the power of a variation) can be removed from the deed under the general power of variation.

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45 Paragraph 2.35 of Explanatory Memorandum to Tax Laws Amendment (2011 Measures No. 5) Bill 2011.
46 AH Slater QC Step Paper on amendment of trust instruments at page 5.
I have previously referred to *Jenkins v Ellett* where there was an unsuccessful attempt to amend the deed to replace the principal. An alternative submission put on behalf of Ms Jenkins in that case was that even if the variation was beyond the trustee’s power of amendment, it was still valid because the principal was able to disclaim or release his powers pursuant to section 205(1) of the *Property Law Act 1974* (Qld).

That section provides as follows:

> 205. Disclaimers etc. of powers

A person to whom any power, whether or not coupled with an interest, is given, may by deed disclaim, release or contract not to exercise the power, and after such disclaimer release or contract shall not be capable of exercising or joining in the exercise of the power.

The provision in section 205(1) is qualified by section 205(4) which reads as follows:

(4) This section –

(a) **does not apply to a power coupled with a duty**; and

(b) applies to a power created by an instrument coming into operation whether before or after the commencement of this Act.

There is a question of whether the power vested in an appointor is ‘coupled with a duty’ as referred to in section 205(4) – in which case the ability to disclaim under section 205(1) would not be available.

In *Rayner and Ors v NJ Sheaffe Pty Ltd and Ors*[^7] Lindgren AJ considered that the power of appointment of a trustee is a fiduciary power. His Honour cited Jacobs, Law of Trust in Australia[^48] which text in turn referred to decisions in *Re Newen*[^49] and *Re Skeats’ settlement*[^50].

If the appointor is in fact a fiduciary then the power of removal and appointment of a trustee would be ‘coupled with a duty’ which means that the person would not be able to rely on section 205 to execute a disclaimer of their powers.

**Extending the vesting date**

It is surprising how many trust deeds have a relatively short vesting period rather than adopting the 80 year period allowed under the *Property Law Act 1974* or the ‘life in being’ concept under the traditional rule against perpetuities.

If a trust with significant assets vests this will result in the occurrence of one or more CGT events. If the trust assets automatically vest in particular beneficiaries this will trigger CGT event E5[^51]. If the trustee exercises a discretion to make capital distributions to the eligible class of beneficiaries this will result in either CGT event A1[^52] or CGT event E7[^53] which has the potential to create a significant tax problem.

This is one of the issues that has triggered the very public dispute between members of the Rinehart family in relation to the trusts established by Lang Hancock for his grandchildren which had a relatively short vesting period.

It will often be possible to amend the trust deed by extending the vesting date (up to the maximum period permitted without infringing the rule against perpetuities) but difficulties arise where the deed

[^7]: [2010] NSWSC 810
[^48]: Seventh Ed 2006 at paragraph [1512]
[^49]: [1894] 2 CH 297 at 308
[^50]: (1889) 42 CHD 522
[^51]: Section 104-75
[^52]: Section 104-10
[^53]: Section 104-85
either has no power of variation or the power of variation does not permit the extension of the vesting date. In those cases it will be necessary to make application to the court to extend the date.

There are a number of authorities that confirm an extension of the vesting date for a trust will not trigger a resettlement\(^{54}\).

It is interesting to note that in many of these decisions the purpose of extending the vesting date was to avoid triggering capital gains tax liabilities as a result of the early vesting of the trust. In *Thomson v Thomson and Whitme*\(^{55}\) the court posed the question whether it should refuse to exercise its discretion to approve a proposed trust amendment where a result of that amendment would be the reduction of tax and concluded that:

> It would be absolutely wrong that this court, if it has power to resettle these funds, should be deterred from exercising that power on some ground of public policy of this kind. The proposed variation will preserve for the benefit of the beneficiary some of the funds which would otherwise be paid away in tax; and I cannot see that express power given to the court…ought to be abandoned for that consideration.\(^{56}\)

In its Statement of Principles on resettlements the ATO specifically considered whether extending the vesting date would trigger a resettlement and indicated that ‘the ATO will accept that in most circumstances the mere extension of the term of a trust is consistent with a continuing trust estate’. The ATO will reach this conclusion when:

- 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.

Given that statement in the Statement of Principles and the more definitive statements in TD 2012/21 it is unlikely the ATO would now argue that a trust variation which extends the vesting date and which is within the variation powers in the deed would trigger a resettlement.

However, the views in TD 2012/21 are subject to the caveat that the changes made are within the scope of the variation power in the deed.

Therefore, if it is necessary to apply to the court to approve an extension of the vesting date because this is not permitted under the deed, it may be prudent to apply for a private ruling.

### 7. CAN YOU ‘TOP UP’ A TESTAMENTARY TRUST WITH INTER VIVOS GIFTS

Unearned income of children under 18 is generally taxed at the top marginal rate pursuant to the provisions of division 6AA of the *Income Tax Assessment Act 1936* (except for the first $416). However, there are some categories of trust income (excepted trust income) to which the unearned income provisions do not apply. These categories of excepted trusts are set out in section 102AG.

Perhaps the most common category of excepted trust income is ‘assessable income of a trust estate that resulted from…a Will’.\(^{57}\)

A strategy that is sometimes proposed to ‘leverage up’ the benefit of this exception for testamentary trusts is to create a trust under a Will and then ‘top up’ the trust fund after the death of the testator either by contributing further capital or borrowing.

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\(^{54}\) *Re Holmden’s Settlement Trust [1968] 1 All ER 148*, *Stein v Sybmore Holdings Pty Ltd [2006] NSWSC 1004*, *Re Plator Nominees [2012] VSC 284* and *Thomas Hare Investments Ltd v Hare [2012] VSC 200*

\(^{55}\) [1954] P 384

\(^{56}\) 393-394

\(^{57}\) Section 102AG(2)
This can provide significant benefits by generating a substantially higher level of ‘excepted trust income’, which can be distributed to minors but taxed at normal rates.

There are several questions that arise in relation to such strategies. The first is whether the income generated as a result of ‘topping up’ the testamentary trust is ‘excepted trust income’ within the meaning of section 102AG and the second is whether the arrangement might be caught by Part IVA.

The position in relation to the first issue seems reasonably clear. The requirement in section 102AG(2)(a) is simply that the assessable income is:

- income of a trust estate;
- that resulted from a Will.

There is no requirement that the income must be derived from assets which formed part of the estate. This can be contrasted with the provisions in relation to ‘post death’ testamentary trusts’ which require that the income is derived from the investment of property ‘that devolved for the benefit of the beneficiary (who creates the trust) from the estate of the deceased person’.58

This was confirmed in the Federal Court decision of Trustee for the Estate of Furse No. 5 Will Trust v Commissioner of Taxation.59

That case involved a testamentary trust created under a Will made in July 1974, where a number of trusts were created each with capital of $1.00. The testator died within three months of making the Will.

After the date of death a new trustee was appointed and that entity borrowed a small amount of money which it invested in units in a unit trust (which appears to have operated as the service trust for a firm of solicitors).

The ATO argued in the appeal to the Federal Court that the income derived by the trustee was not assessable income of a trust estate that ‘resulted from a Will’. Hill J had no hesitation in rejecting this submission and made the following points:

- All that is necessary for income of a testamentary trust to be excepted trust income is that the trust estate was created by Will – it is not necessary to make any inquiry as to the character of the income (apart from the arm’s length test).
- The argument that the income must be sourced from assets of the estate is not supported by the wording of the provisions of division 6AA.
- As a result, His Honour determined that, notwithstanding that the income was generated as a result of funds borrowed and invested by the trustee after the death of the testator, it was still income of a trust estate that resulted from the Will.

The second issue is whether Part IVA might apply to such arrangements. In Furse, the Commissioner did not appear to raise a Part IVA argument which is a little surprising given the testator made a Will shortly before his death in which he created a number of testamentary trusts all with nominal capital and new parties took over control of the trust shortly after his death.

However, in circumstances where there is no ‘artificiality’ and the trustees have a testamentary trust created in the normal fashion, choose to borrow further funds or accept contributions of capital, the Part IVA risk should be low.

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58 Section 102AG(2)(d).
59 BC 9003685.
8. CONCLUSION

The message I think one can take from the issues canvassed in this paper is that the question of whether a particular variation to a trust is within the powers in the deed can be quite problematical.

If there is any doubt as to whether a proposed variation is permitted under the terms of the deed, the prudent course may be to seek approval of the court as significant complications can arise if a trustee acts on the assumption that a variation is effective only to subsequently find that this is not the case.

For example, a variation adding beneficiaries may lead the trustee to make income distributions to those purported new beneficiaries over a period of time. If the ATO subsequently argues that the variation appointing the beneficiaries was ineffective, the income distributions would also be ineffective which could lead amended assessments either to the default beneficiaries or to the trustee (under section 99A).

On the other hand, the good news is that, if the amendment is within the amendment power in the deed, it is highly unlikely that the amendment will trigger a resettlement. This adds a substantial degree of certainty in this area.

This paper is only intended as a general overview of issues relevant to the topic and is not legal advice. If there are any matters you would like us to advise you on in relation to this paper, please let us know.