COMMISSIONER OF TAXATION OF THE COMMONWEALTH OF AUSTRALIA...... APPELLANT;
RESPONDENT,

AND

BAMFORD AND OTHERS.. .... RESPONDENTS.
APPLICANTS,

BAMFORD AND ANOTHER............................ APPELLANTS;
APPLICANTS,

AND

COMMISSIONER OF TAXATION OF THE COMMONWEALTH OF AUSTRALIA AND ANOTHER.. RESPONDENTS.
RESPONDENT AND APPLICANT,

[2010] HCA 10

ON APPEAL FROM THE FEDERAL COURT OF AUSTRALIA

HC of A
2010

March 2, 3, 30 2010

French CJ, Gummow, Hayne, Heydon and Crennan JJ

Income Tax (Cth) — Income — Trust estate — Assessable income of beneficiary — Share of net income of trust estate — Calculation of share — Whether specific amount or proportionate part — Capital gains — Treatment by trustee as distributable income — Relevance for assessment — Income Tax Assessment Act 1936 (Cth), ss 95-99A.

Section 97(1)(a)(i) of the *Income Tax Assessment Act 1936* (Cth) provided (subject to an exception that is not material) that, where a beneficiary of a trust estate who was not under any legal disability was presently entitled to a share of the income of the trust estate, the assessable income of the beneficiary should include so much of that share of the net income of the trust estate as was attributable to a period when the beneficiary was a resident. Section 95(1) defined "net income", in relation to a trust estate, to mean the total assessable income of the trust estate calculated under the Act as if the trustee were a taxpayer in respect of that income and were a resident, less all allowable deductions (except certain deductions which are not material).

Held, (1) that a capital gain which was treated by a trustee, under the terms of a trust deed, as income available for distribution and was distributed to beneficiaries presently entitled should be included in the assessable income of those beneficiaries. The "income of a trust estate" in s 97(1) was to be understood as income according to the general law of trusts.

(2) That the expression in s 97(1)(a)(i) "that share of the net income of the trust estate" referred to the proportion of the distributable income of the trust estate ascertained by the trustee according to appropriate accounting principles and the trust instrument.

Zeta Force Pty Ltd v Federal Commissioner of Taxation (1998) 84 FCR 70 at 74-75, approved.

Decision of the Federal Court of Australia (Full Court): *Bamford v Federal Commissioner of Taxation* (2009) 176 FCR 250, affirmed.

APPEALS from the Federal Court of Australia.

A trust was established by deed dated 9 February 1995 of which P & D Bamford Enterprises Pty Ltd was trustee. The "Eligible Beneficiaries" included Mr P J Bamford, his wife Mrs D L Bamford, their children, and such other persons, trusts or companies or charities as the trustee appointed to be beneficiaries. The trustee appointed Narconon Anzo Inc and the Church of Scientology Inc. Clause 3(a) of the deed required the trustee to stand possessed of the Trust Fund and the income thereof in trust for all of such one or more exclusively of the others of the Eligible Beneficiaries and in such shares or proportions as the Trustees should revocably or irrevocably appoint from time to time before a certain date (the "Closing Date"). Clause 4 provided that in default of and subject to any determination under cl 3 the trustee should stand possessed of (a) the income of the Trust Fund during the Trust Period (i) to hold the income arising in any year, or such part of it as the trustee determined, for such one or more to the exclusion of the others of the Eligible Beneficiaries and in such proportions or manner as the trustee in its absolute discretion from time to time but on or prior to 30 June in any year determined; (ii) subject to the exercise of that power to accumulate the whole or part of the income that was not paid or applied during such period as was permissible by law; (iii) subject to (i) and (ii) until a certain date to pay or distribute the whole of the income or such part as was not paid or applied by the end of a year for [sic] all or such one or more to the exclusion of the others of the Eligible Beneficiaries in such proportions as the trustee by the end of the year in its absolute discretion determined; (b) of the capital (i) for such of the children of Mr Bamford as were living at the Closing Date as tenants in common in equal shares with substitutional gifts for the children of any child who died before the Closing Date equally per stirpes; (ii) if any of the capital did not vest under (i) for such of the Eligible Beneficiaries as were living at the Closing Date as tenants in common in equal shares; (iii) if the capital did not vest under (i) or (ii) for such charitable purposes as the trustee determined. Clause 4(e) empowered the trustee in its discretion in making any payment determination or application of income or capital to determine and identify which income or capital or which part of the income or capital or which class of income or capital (whether by reference to source nature or otherwise) of the Trust Fund was the subject of any particular determination and provided that the income or capital was to be treated for all purposes as being paid,

applied, set aside or accumulated, as the case may be, from the income or capital or part or class thereof so identified. Neither "income" nor "capital" was defined, but by cl 7(n) the trustee was given power to determine in its absolute discretion whether any receipt, profit or gain or payment, loss or outgoing or any sum of money or investment was to be treated as being on income or capital account. If it failed to make a determination, or to the extent to which it failed to do so prior to the end of a year, the income of the Trust Fund for that year was to be calculated in the same manner as the net income of the trust estate was to be calculated under the provisions of the *Income Tax Assessment Act 1936* (Cth).

On 30 June 2000 the trustee determined that "the income" for the year ended 30 June 2000 be allocated "in the following proportions": the first $643 to a named child of Mr and Mrs Bamford, the next $643 to another named child, the next $12,500 to Narconon Anzo Inc, the next $105,000 to the Church of Scientology Inc, the next $68,000 to Mr and Mrs Bamford in equal shares, and the balance to the Church of Scientology Inc. The trustee determined pursuant to cl 7(n) that certain outgoings of $191,701 be treated as expenses and wrongly treated them as allowable deductions in calculating the net income of the trust estate for the purposes of s 97(1) of the 1936 Act. The total income for distribution and the net income of the trust under s 95 was shown as $187,530. After the distribution to the children, Narconon Anzo Inc and the Church of Scientology Inc, there was only sufficient income to distribute $33,872 to each of Mr and Mrs Bamford. The Commissioner assessed Mr and Mrs Bamford by calculating the ratio which the actual distributions of $33,872 bore to $187,530 and then applied that ratio to the disallowed deduction of $191,701. The amount so calculated of $34,624 was then included in the assessable income of each of Mr and Mrs Bamford. The taxpayers objected to the assessments on the ground that "that share" in the opening words of s 97(1), where a beneficiary's present entitlement was to a proportionate part of the income of a trust estate, meant that proportionate part of that income, or, where the present entitlement was to a specified amount, that specified amount.

On 30 June 2002 the trustee determined that "the net income" for the year ended 30 June 2002 be distributed to Mr and Mrs Bamford, the first $60,000, including capital gain, shared equally; to the Church of Scientology Inc, the balance. The capital gain referred to $29,227 (half of $58,454) which arose from the sale of certain real estate. The Trustee made no express determination under cl 7(n) that the capital gain was to be treated as being on income account but in objection and appeal proceedings it was accepted that the trustee had treated the capital gain as income available for distribution. The Commissioner assessed the trustee on the footing that the capital gain was not to be included in "the income of the trust estate" for the purposes of s 97(1) because it was not income according to ordinary concepts and hence

that the trustee was liable to be assessed under s 99A. The trustee objected to the assessment.

The three objections were disallowed and on review the Administrative Appeals Tribunal (J Block Deputy President and G D Walker Deputy President) affirmed the assessments. The taxpayers appealed from the decisions of the Tribunal to the Federal Court of Australia. The appeal was heard by a Full Court (Emmett, Stone and Perram JJ) pursuant to s 44(3) of the *Administrative Appeals Tribunal Act 1975* (Cth). The appeal relating to the 2000 tax year was dismissed; the appeal relating to the 2002 year was allowed and the matter was ordered to be remitted to the Tribunal to be reconsidered and determined (1). The taxpayers and the Commissioner appealed to the High Court in respect of parts of the order of the Federal Court by special leave granted by French CJ and Heydon J.

A H Slater QC (with him *R L Seiden* and *I S Young*), for Mr and Mrs Bamford in the beneficiaries' appeal and the trustee in the Commissioner's appeal.

Beneficiaries' appeal: In the phrases "a share of the income of the trust estate" and "that share of the net income" in s 97 of the *Income Tax Assessment Act 1936* (Cth), "share" means "the interest directed by the terms of the trust". The amount included in assessable income by s 97(1)(a)(i) as "that share of the net income of the trust estate" is calculated by applying the terms of the trust to the amount of "net income" fixed under s 95. The Full Court erred in holding that "that share" in s 97(1) refers to the proportion of the net income of the trust estate equal to the proportion that the income to which the beneficiary is presently entitled bears to the income that has been distributed during the year or remains available for distribution at its end. Section 97(1) is to be read as an entirety and its meaning requires reference to context which includes its general purpose and policy and the mischief it was designed to remedy. The mischief identified in ss 26(1) and 27(2) of the *Income Tax Assessment Act 1915* (Cth) was cured by a legislative scheme designed to secure payment of tax on the whole of the net income of a trust estate and to allocate liability among the trustee and beneficiaries according to the extent of present entitlement (2). [HAYNE J. The hinge about which the earlier provisions turned was "trustee"; might s 96 be seen as the central provision of Div 6?] Section 96 is no more significant in the legislative scheme than the provisions of ss 97, 98 and 99.] The assumption behind s 97 was that the person who derives the income should be in a

(1) *Bamford v Federal Commissioner of Taxation* (2009) 176 FCR 250.

(2) *Tindal v Federal Commissioner of Taxation* (1946) 72 CLR 608 at 618; *Federal Commissioner of Taxation v Belford* (1952) 88 CLR 589 at 606; *Union-Fidelity Trustee Co of Australia Ltd v Federal Commissioner of Taxation* (1969) 119 CLR 177 at 187.

position to pay the tax out of the income (3). The implicit assumption was that the fund of trust income to a share of which a beneficiary could become "presently entitled" was coextensive with what "the trustee [would be] liable to pay tax in respect of". The language both measures liability by reference to net distributable income and assumes that the individual interest to which the beneficiary is presently entitled is in a net amount calculated in substantially the same way as the "net income" defined by s 95. That assumption was appropriate to the legal and social context in 1915 when trustees received income from a narrow range of investments which was readily identifiable as detached money in which beneficiaries had an equitable proprietary interest. Two changes occurred which have led to material disparities between income ascertained for the purpose of settling rights of beneficiaries and s 95 net income: various amounts not treated as income between life tenant and remaindermen, such as capital gains, have been included in assessable income and hence s 95 net income; and the conduct of businesses by trustees has become normal in Australian commerce. Where there is a disparity between distributable income and s 95 net income the underlying assumption of *Whiting's* case (4) is falsified. If the net income is greater than the distributable income, liability to tax on the excess will fall either on the beneficiaries, even though not entitled to distributions from which the tax might be paid, or on the trustee who must pay the tax out of corpus at the expense of the remaindermen. If the net income is less than the distributable income, either the beneficiaries or the trustee (on account of corpus) will be taxed on a lesser amount than is received or retained. No construction of s 97 wholly escapes an anomalous result when there is such a disparity. Section 97 should be construed to accord with the general purpose and policy of the Act, that income tax should be borne by those who enjoy the gains or income on which it is imposed and, in relation to Div 6, that all of the net income of a trust estate should be subjected to tax. That is achieved by aligning "income of the trust estate" with "net income" on which by s 97 tax is imposed and by construing "a share of the income of the trust estate" and "that share of the net income" to bring the tax burden into alignment with entitlement to distributions. The ordinary meaning of "share" is "the part or portion (of something) which is allotted or belongs to an individual, when distribution is made among a number" (5). The connotation of "share" in the chapeau to s 97(1) and para (a)(i) is the interest directed by the terms of the trust. The hypothetical "as if" in para (a)(i) is mandated by the requirement that the "share" in the "income of the trust estate" is to be applied to the net income. In the case of a gift of income to members of a class "in equal shares", the denotation of "share" may be

(3) *Federal Commissioner of Taxation v Whiting* (1943) 69 CLR 199 at 214-215.
(4) (1943) 68 CLR 199 at 215.
(5) *Oxford English Dictionary*, 2nd ed (1989), 1a; *Doe d Clift v Birkhead* (1849) 4 Exch 110 at 125 [154 ER 1145 at 1151].

a fractional interest; but neither fraction, ratio, nor proportion (nor the amount produced by application of a fraction) is the connotation of "share" in the Act. In such a case the directed fraction is the specification, in the terms of the trust, of the beneficiary's share, and so application of the fraction is the method by which in the events of the income year the beneficiary's share is to be quantified. The interest in income may be fixed in a different way, eg, as a specified annuity or even an amount. In such a case, while the connotation of "share" in "share of the income" is constant, as the interest in the trust income defined by the terms of the trust, its denotation in "share of the income" is the result of applying the terms of the trust to the trust income, yielding the right to receive that specified amount. The connotation of "share" is not "fraction", ratio or proportion and is not the fraction or ratio which the specified sum adventitiously bears to whatever happens to be the total income for the year. The beneficiary's right does not depend on the amount of the total income as it would if "share" meant fraction. It is the entitlement to the specified sum. While the denotation of a beneficiary's share may vary from a proportion of the whole to an annuity to a fixed sum, the connotation of "share" must be constant. The meaning of "share of the income of the trust estate" which most sensibly remains constant across a range of potential entitlements to trust income is "interest in the income of the trust estate pursuant to the terms of the trust". Two other constructions of "share" in s 97 have been advanced. One – the "quantum" view – construes it to mean the monetary amount to which the beneficiary is entitled, so that the same monetary amount is the beneficiary's share of the net income; an excess of net income is taxed to the trustee as a share of net income to which no beneficiary is entitled, while a shortfall simply reduces the tax burden. This view has not found judicial or academic support, and should be rejected. The second – the "proportional view" – construes "share of the income" in respect of a beneficiary as meaning simply the fraction or ratio which in the event the amount to which the beneficiary is entitled bears to the total income, so that the fraction or ratio so derived is applied to the net income to ascertain "that share" assessable to the beneficiary. That view was adopted by the Full Court. Where by the terms of the trust each beneficiary is entitled to a fractional or proportional share (or one is entitled to all) of "the income", the connotation for which the appellants contend produces the same result as the respondent's contention. In all the cases in which the meaning of "share" in s 97 has been considered the reasoning has proceeded on the premise that the interests of beneficiaries in the income of the trust estate were fractional, or that there was only one entitled beneficiary (6). In each other case the

(6) See *Davis v Federal Commissioner of Taxation* (1989) 20 ATR 548 at 575-577; 86 ALR 195 at 229-231; 89 ATC 4,377 at 4,402-4,404; *Richardson v Federal Commissioner of Taxation* (1997) 80 FCR 58; *Zeta Force Pty Ltd v Federal Commissioner of Taxation* (1998) 84 FCR 70 at 72-73; *Cajkusic v Federal

entitlement in trust law was assumed to be sole or proportional (7). This is the first appeal calling for the construction of s 97 where entitlements under the terms of the trust are partly to fixed amounts and partly to proportions of the balance of the income. Where the entitlements of some beneficiaries are fixed and those of others are proportional or residual the competing constructions produce different results. The appellants' construction consistently imposes the burden of tax on the discrepancy on the beneficiaries who enjoy the balance of the income in a manner as close to being rational as the departure from reality imposed by a deeming provision permits. The respondent's construction produces for beneficiaries entitled to fixed income tax results which vary dramatically according to the total amount of trust income. In reaching a construction which best accords with the policy and purpose of the legislation, one ascribing to "share" in "the share of the income" a meaning which rests on the basis of entitlements to income is preferable to one which rests on the caprice of numbers in the calculation of fractions.

Commissioner's appeal: The issue concerns "presently entitled to a share of the income of the trust estate" in s 97. The s 95 "net income" of the present trust estate was calculated by including a net capital gain: exclusion of that amount would have meant that there was no "income of the trust estate" to which any beneficiary was presently entitled. We submit that (a) the subject matter of entitlement to a share, in "presently entitled to a share of the income of the trust estate", is that which, as a matter of trust law as applied to the terms of the trust, is distributable to entitled beneficiaries as the annual yield of the trust estate; (b) the notion of income according to ordinary concepts is one of tax law, not a trust law concept governing entitlements of beneficiaries; (c) it is present entitlement which is the measure by which liability to assessment upon the "net income" as defined by s 95 is imposed; and (d) while there is a substantial overlap between the subject matter of present entitlement for s 97, and "assessable income" for s 6-5, the two concepts are not congruent. The Commissioner contends that "presently entitled to a share of the income of the trust estate" should be severed into two parts to be construed in isolation and that "the income of the trust estate" should be construed first and apart from its context. The trustee submits that (a) the relevant context is that it is the extent of present entitlement to "the income" which

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Commissioner of Taxation (2006) 155 FCR 430 at 436.

(7) eg, *Peabody v Federal Commissioner of Taxation* (1992) 24 ATR 58; [1992] ATC 4,585; *Richard Walter Pty Ltd v Federal Commissioner of Taxation* (1995) 31 ATR 95; 95 ATC 4,440; *Grollo Nominees Pty Ltd v Federal Commissioner of Taxation* (1997) 73 FCR 452; *Federal Commissioner of Taxation v Prestige Motors Pty Ltd* (1998) 82 FCR 195; *Hart v Federal Commissioner of Taxation* (2003) 131 FCR 203 at 205; *Kajewski v Federal Commissioner of Taxation* (2003) 52 ATR 455 at 457; [2003] ATC 4,375 at 4,376; *Pearson v Federal Commissioner of Taxation* (2006) 64 ATR 109 at 112-113; 232 ALR 55 at 57.

identifies the "share" by reference to which s 97(1)(a) makes beneficiaries assessable on s 95 "net income"; (b) the expression should be construed as a whole and in context: the emphasis is on "presently entitled" as the relevant criterion and not on "income"; (c) "income" is not an independent criterion of liability but is the subject matter of the (entitlement) criterion. Construed in that context, the subject matter of "present entitlement" is what is detached from the trust estate so that the life tenant, or beneficiaries entitled to annual distributions of the yield of the estate, may become presently entitled to demand payment. The notion of an annual yield or income is fundamental to the legislative scheme: see ss 3-5, 4-10 and 6-5(2). The 1918 amendments of the *Income Tax Assessment Act* substituted entitlement to distribution for the 1915 provisions because the 1915 scheme, resting on a reduction of the tax imposed on the trustee proportionate to the distributions made, left income not distributed in the year taxable to the trustee at a higher rate than that imposed on beneficiaries entitled to the income but not yet in receipt of it. The requirement of present entitlement secured that the beneficiary was not taxed on, and the trustee did not escape tax in respect of, amounts the beneficiary was entitled to receive in future or on a contingency (8). Where a business was properly conducted by a trustee a life tenant was ordinarily entitled to receive only what the trustee prudently determined was available for distribution (9). An entitlement to a share of profits arose only when accounts disclosing them were or ought to have been taken (10). Hence income was identifiable as detached money in the hands of the trustee and present entitlement was the right to demand payment. The conduct of businesses by means of a trust has become an accepted phenomenon here. In the absence of express directions in the trust instrument the present entitlement principles developed for income beneficiaries continued to apply but it is now common for entitlement to be confined to calculated income: income to which beneficiaries are entitled is detached from the trust fund for distribution (11). Where the issue arises under a statute, the statutory language must be construed in its context (12). But where the statute adopts as its criterion the terms of the trust, as s 97(1) does, the operation of the trust is imported and becomes the statutory criterion. The criterion in s 97(1) is a single compound criterion: "presently entitled to a share of the income of the trust estate." The words "presently entitled", not "income", are the significant integer in specifying on what a beneficiary may be assessed. The extent of that

(8) *Whiting's* case (1943) 68 CLR 199 at 215-216, 219-220; cf at 207.

(9) *Thornley v Boyd* (1925) 36 CLR 526 at 536; *Ritchie v Trustees Executors & Agency Co Ltd* (1951) 84 CLR 553 at 583.

(10) *In re Cox's Trusts* (1878) 9 Ch D 159 at 162; *In re Moore* [1956] VLR 132 at 133.

(11) *McBride v Hudson* (1962) 107 CLR 604 at 624.

(12) *Bartlam v Union Trustee Co of Australia Ltd* (1946) 72 CLR 549 at 561; *Union Trustee Co of Australia Ltd v Bartlam* (1948) 76 CLR 492 at 492-498; [1948] AC 495 at 505.

present entitlement is not limited by abstract conceptions developed for other purposes. A beneficiary is presently entitled to an amount which he can call upon the trustee to have immediately paid to him. The Commissioner's submissions confuse the concepts of "income of the trust estate" (which may be subject to the present entitlement of a beneficiary) and "net income of the trust estate" (as defined by s 95). Though the concept of "income" in Australian income tax statutes has its origins in the rules developed as to the inferred intentions of settlors for life interests and remainders the meaning of the term in trust law is not constrained by its meaning in income tax law. The phrase "income of the trust estate" refers to an entitlement under the terms of the trust. The extent of that entitlement becomes the statutory criterion. There was no issue in *Federal Commissioner of Taxation v Totledge Pty Ltd* (13) or *Federal Commissioner of Taxation v Harmer* (14) about the character of the trustee's receipt. *Federal Commissioner of Taxation v ANZ Savings Bank Ltd* (15) was not concerned with whether a trust deed could for tax purposes convert income into capital or vice versa. *Cajkusic v Federal Commissioner of Taxation* (16) rejected a submission that income for s 97 purposes cannot be governed by the trust deed. Section 97 was not amended when capital gains tax was introduced. The Act supposes that a capital gain is part of the income of the trust estate which the beneficiary to whom it is allocated, and who is entitled to a s 115-215(6) deduction, may be required to include in his assessable income. The Commissioner's alternative submission that the income of the trust estate means all amounts in the hands of the trustee that are treated as income for taxation purposes confuses the scope of tax income (scil s 25 gross income, s 6-5 ordinary income, and s 6-10 statutory income) with the scope of trust income to which beneficiaries can be entitled and overlooks the consequences of disallowed deductions for real expenses.

J T Gleeson SC (with him *T P Murphy* SC and *K J Deards*), for the Commissioner.

Commissioner's appeal: To be "income of the trust estate" within s 97 an amount must be income according to ordinary concepts in the hands of the trustee. Amounts which are not income of that kind but which are assessable (and hence are included in the net income of the trust estate under s 95) only by reason of express statutory provisions are not part of the "income of the trust estate". The meaning of "income of the trust estate" is unaffected by terms of the trust instrument, or by decisions of the trustee under it, such provisions and decisions being relevant only to fixing entitlements between the trustee and beneficiaries, and between the beneficiaries. Accordingly, if an

(13) (1980) 60 FLR 149; 12 ATR 830; 40 ALR 385; 82 ATC 4,168.
(14) (1991) 173 CLR 264.
(15) (1998) 194 CLR 328.
(16) (2006) 155 FCR 430 at 436.

amount in the hands of the trustee bears the character of capital, it is not part of the "income of the trust estate" within s 97(1). If there is "income of the trust estate", the provisions of the trust instrument, and lawful decisions made by the trustee, together with general principles of trust law, are relevant in determining whether one or more of the beneficiaries are "presently entitled" to that income (s 97(1)). Once the relevant beneficiaries' present entitlements have been established, their respective "shares" of the income are determined on a proportionate basis. Such shares are then applied by s 97(1)(a) to the net income of the trust estate (under s 95) to determine how much becomes assessable income of each beneficiary. So much of the net income that is not assessed to a beneficiary under s 97 (or the trustee under s 98) is assessed to the trustee under s 99A (or in a limited range of cases under s 99).

In elaboration of the above: A trust estate is not a legal person to which tax is assessed but is a conglomerate of assets by which income is generated. That income is assessed to either beneficiaries or to the trustee. In both cases the amount assessed is calculated by reference to the "net income" of the trust estate which is defined by s 95 and is calculated by reference to a statutory hypothesis that the trustee is a taxpayer in respect of the assessable income of the trust estate. The first step required by s 97 is to determine whether an amount constitutes "income" of the trust estate. One must consider its character in the hands of the trustee. The trustee does not receive it beneficially but is treated as a hypothetical taxpayer in respect of the income for the purpose of characterising the amount, just as it is for calculating the "net income" (17). Whether an amount has the character of "income" depends on its quality in the hands of the recipient. The trust instrument only fixes the entitlement of a beneficiary to an amount: it is relevant to whether a beneficiary can be described as being "presently entitled" to a particular amount but not to whether that amount is "income of a trust estate" for s 97. It was held in *Totledge's* case that a present entitlement was a right to demand and receive payment of what retains the character of trust income after the full working of trust law. The phrase "income of the trust estate", in the absence of a separate statutory definition, should bear its natural legal meaning (18). The trust law meaning of "income" has influenced the development of its tax law meaning, but the word now has its own meaning in tax law which broadly flows from the concept of income in accordance with the ordinary concepts and usages of mankind (19). "Income of the trust estate" is not defined. But s 97(1)(a) provides that the amount of the

(17) *Federal Commissioner of Taxation v Totledge* (1980) 60 FLR 149; 12 ATR 830; 40 ALR 385; 82 ATC 4,168; *Harmer v Federal Commissioner of Taxation* (1991) 173 CLR 264 at 271.

(18) *Federal Commissioner of Taxation v W E Fuller Pty Ltd* (1959) 101 CLR 403 at 413.

(19) *Federal Commissioner of Taxation v Montgomery* (1999) 198 CLR 639 at 661.

net income to be assessed to the beneficiaries is determined by reference to the "income" of the trust estate, not to defined terms such as its assessable income, net income or exempt income. The concept of income is fundamental to the operation of the 1936 and the 1997 Acts and forms an element of the defined terms. The term "income" has been construed to be income according to ordinary concepts unless the statutory context has required otherwise (20). The fact that "income of the trust estate" in s 97 is not defined but "net income of the trust estate" is defined by s 95 indicates an intention to adopt the concept of ordinary income in the former. *Executor Trustee and Agency Co of South Australia Ltd v Federal Commissioner of Taxation (Pearson's Case)* (21), which might suggest otherwise, concerned a differently phrased predecessor to s 97. The phrase "income of the trust estate" in s 97 was not amended when Pt IIIA – dealing with the comprehensive taxation of capital gains – was introduced in 1986. One can infer that no change was thought necessary because "income of the trust estate" did not include capital gains. Section 254 of the 1936 Act, which before 1986 made a trustee answerable as taxpayer for the doing of things required by the 1936 Act in respect of "income" derived as trustee, was amended to include the words "or any profits or gains of a capital nature" after the word "income". If "income" had included capital gains in the context of the taxation of trust income there would have been no need for that amendment. The definition of "taxpayer" in s 6 was expanded to take account of capital profits. The contention that "income of the trust estate" in s 97 means income according to ordinary concepts in the hands of the trustee is supported by *Totledge's* case (22) and *Federal Commissioner of Taxation v ANZ Savings Bank Ltd* (23). [GUMMOW J. Is not "presently entitled to a share of the income of a trust estate" a composite phrase which should not be chopped up? It is the product of going through some steps in trust law, amongst other things.] The first step concerns the tax concept of income according to ordinary concepts received by the trustee. [GUMMOW J. At that stage there is an intrusion of trust law.] Section 95 deals with a statutory concept of net income. *Cajkusic v Federal Commissioner of Taxation* (24) decided that expenses that were not deductible in determining the "net income" of the trust estate under s 95 were to be taken into account in determining whether there was any "income of the trust estate" to which the beneficiaries could be presently entitled. Hence there was no "income of the trust estate" to which the beneficiaries could be presently entitled and the whole of the net income was assessable to the trustee. It was accepted that there was

(20) eg, *Gibbs v Commissioner of Taxation* (1966) 118 CLR 628, which concerned s 47A of the 1936 Act.
(21) (1932) 48 CLR 26.
(22) (1980) 60 FLR 149; 12 ATR 830; 40 ALR 385; 82 ATC 4,168.
(23) (1998) 194 CLR 328 at 337.
(24) (2006) 155 FCR 430.

income according to ordinary concepts in the hands of the trustee, and it had to be decided whether the beneficiaries' present entitlement was to be determined before or after deductions properly made for trust law, but not tax purposes, reduced the income to which they could become presently entitled to nil. The Court in *Cajkusic's* case misunderstood the judgment of Gleeson CJ in the *ANZ Savings Bank* case (25) in stating that it was wrong to look at the trust deed for s 97 purposes to turn income into capital.

There is no policy or assumption underlying Div 6 or s 97 that, as a general rule, liability for tax in respect of the income of a trust estate should correspond to the enjoyment of that income. First, none of the approaches to the construction of "income of the trust estate" in s 97 adopted by the Full Federal Court or advocated in this appeal would give effect to such a policy. Every approach in certain circumstances would give rise to a liability to tax on amounts in excess of the amount to which a beneficiary is entitled. Secondly, Div 6 is directed to a simpler policy of ensuring that trust income is either taxed to a trustee (ss 98, 99, 99A) or a beneficiary (s 97): *Tindal's* case (26). The legislative history and extrinsic materials for the introduction of s 97 do not disclose any consideration before the enactment of Div 6 given to potential disparity between the income of the trust estate and the amount to be taxed. No policy consideration appears to have been given to whether beneficiaries should be assessed on amounts commensurate with their entitlements. The primary concern of Parliament since the 1915 Act has been to ensure that trust income is brought to tax in someone's hands, irrespective of whether it can be identified as belonging to a particular person, and to ensure that trust income is brought to tax in the year in which it is derived, is taxed at a beneficiary's marginal rate if it is income to which a beneficiary is presently entitled, and is taxed at the top marginal rate if it is accumulated.

The legislative history is as follows. The approach of the 1915 Act was to assess the trustee on the whole income of the trust, with a proportionate reduction based on income actually distributed. Beneficiaries were assessed on their "beneficial interests" in income derived under any instrument of trust. Amendments were made in 1918 so that, like Div 6, the "income of the trust estate" was taxed either to the trustee or to a beneficiary who was "presently entitled" to a share of that income. Such a beneficiary was assessed on his "individual interest" in the income of the trust estate that would have been taxable if the trustee were liable to pay the tax in respect of that income. The 1918 amendments were directed to a concern that it was inequitable that undistributed income of a trust estate be taxed at the trustee's marginal rate rather than the (possibly) lower rate applicable to a

(25) (1998) 194 CLR 328.
(26) (1946) 72 CLR 608 at 618.

beneficiary who is entitled to receive it. The 1922 Act which consolidated and amended the 1915 Act, essentially replicated in s 31 the provision as amended in 1918. It was amended in 1930 to ensure that beneficiaries who had no beneficial interest in the corpus of the estate did not get the benefit of prior year losses of the trustee in the calculation of the income of the trust estate if the trustee were liable to pay the tax in respect of the income. That amendment was intended to prevent life tenants from escaping tax by taking the benefit of prior year trading losses charged against corpus of a trust estate. Division 6 of the 1936 Act replaced s 31 of the 1922 Act. It broke up s 31 into a number of provisions, and introduced the concept of "net income of a trust estate" (ss 95 and 97), while retaining the original concept of "income of a trust estate" (s 97). Nothing in the Explantory Memorandum to the *Income Tax Assessment Bill 1935* or the reports of the Royal Commission on Taxation preceding the 1936 Act shed any light on why s 97 was so drafted. There are various amendments to Div 6 since 1936, but the relevant provisions are not materially different from those enacted in 1936 except in two respects. First, s 99A did not appear in the original Div 6. In 1936, the liability of a trustee to pay tax in respect of the "net income" of the trust estate was governed wholly by s 99. Rather than a trustee being liable to tax in respect of that part of the "net income" that is not otherwise assessed to a beneficiary under s 97 or to a trustee in respect of a beneficiary under s 98, the original s 99 made a trustee assessable where there was "a part of the income of a trust estate" to which no beneficiary "was presently entitled". In those circumstances the trustee would be assessed on "that part of that net income". Secondly, the rate at which trustees are assessed to pay tax has changed. The introduction of s 99A in 1964 meant that, unless the Commissioner exercised his discretion to apply s 99, a trustee was liable to tax where no beneficiary was presently entitled at a special flat rate. The purpose of that amendment was to provide "a basis for imposing a special rate of tax on the accumulated income of certain trust estates" (27).

If, contrary to our submission, there is a policy underlying Div 6 that liability for tax on income of a trust estate should reflect or otherwise correspond with the enjoyment of that income, it would follow that "income of the trust estate" would be better construed to mean that which is treated as income in the hands of the trustee for income tax purposes. Hence, a capital profit would be "income of the trust estate" within s 97 but for the reason (contrary to the beneficiaries' argument) it is statutory income of the trust estate by reason of ss 102-5(1) and 104-10 of the 1997 Act. This alternative, a construction of "income of the trust estate" in s 97 as referring to all amounts in the trustee's hands that are treated as income for taxation

(27) Explanatory Memorandum to the *Income Tax and Social Services Contribution Assessment Bill (No 3) 1964*, p 80.

purposes, would cover income shown in the diagram in s 6-1 as "ordinary income" and "statutory income". It would ensure that trustees were not liable to pay tax in respect of statutory income to which beneficiaries are presently entitled and limit the burden of taxation on beneficiaries to the taxable amounts to which they are presently entitled and tax any excess of net income to the trustee under s 99 or s 99A, thus securing the payment of tax on the whole of the net income. It would also allow net capital gains to be dealt with by s 97 in the same way as ordinary income, and would ensure that subdiv 115-C of the 1997 Act treats beneficiaries as having made capital gains to the extent of their entitlement to capital gains reflected in the "net income", with the consequence that those gains may be discounted. It is consistent with the original 1936 ss 99 and 96. In *Union-Fidelity Trustee of Australia Ltd v Federal Commissioner of Taxation* (28) Kitto J said "[t]he operation of [ss 97, 98 and 99] is only to provide for the taxation of 'the net income of the trust estate', the need to do so being a consequence of the provision in s 96 that, except as provided, a trustee shall not be liable to pay tax upon that income". If the function of s 96 is to make it clear that Div 6 is an exclusive code for the taxation of trustees, it ought to apply to all kinds of income liable to be taxed as "net income" under Div 6. The alternative construction would also sit comfortably with *Resch v Federal Commissioner of Taxation* (29).

Beneficiaries' appeal: Division 6 of Pt III is designed to secure payment of tax upon the whole of the net income of a trust estate, either from a beneficiary or the trustee, whether or not that amount is paid over to or on account of the beneficiary. To be assessed under s 97 a beneficiary must be "presently entitled" to at least some of the income of the trust estate. The share of the "net income" upon which a beneficiary will be assessed will be that proportion of the "net income" that the beneficiary's present entitlement to the income of the trust estate bears to the distributable income of the trust estate. The phrase "that share" in s 97 has a fixed and singular meaning which applies regardless of how a beneficiary's entitlement may be expressed by the trust deed or in a determination by the trustee. The meaning of "that share" is "proportion" not "part" or "portion".

The two principal approaches to the construction of "that share" in s 97 have been the "quantum" and the "proportionate" approach. We contend for the proportionate. The beneficiaries contend for a third approach which turns on the prescription of entitlement of the relevant beneficiaries ascertained from the terms of the trust and decisions under the trust instrument. The balance of present authority has adopted the proportionate approach. The beneficiaries' novel approach has not been considered in any previous case. The differences between

(28) (1969) 119 CLR 177 at 188.
(29) (1941) 66 CLR 198 at 210, 213, 224.

the two principal views are set out in *Federal Commissioner of Taxation v Pilnara Pty Ltd* (30). Under the proportionate approach, one must first determine whether any of the distributable income is the subject of present entitlement in a beneficiary and then include in the assessable income of that beneficiary the whole of the appropriate proportion of the "net income" of the trust estate. If there are beneficiaries entitled to the whole of the "income of the trust estate", the whole of the "net income" will be taxed in their hands. By contrast the quantum view would include in a beneficiary's assessable income only so much of the "net income" of the trust estate as he was entitled to and assess any other part to the trustee as income to which no beneficiary is presently entitled. Where the "net income" of the trust estate exceeds the "income of the trust estate", on the proportionate view s 97 may assess a beneficiary on amounts he neither did nor could receive while, on the quantum view, the excess net income would be taxed under s 99A. The proportionate approach has been held to be correct (31). Hence the meaning of "share" in ss 95 and 97 read in context is "proportion" rather than "amount" or "part". Section 97 requires one to ascertain "the share of the income of the trust estate" to which the beneficiary is presently entitled and to apply "that share" to the "net income" of the trust estate. The process is a careful and deliberate instruction to calculate the amount to be assessed to the beneficiary. It is not a single step process akin to that in s 31 of the 1922 Act. Section 101 does not demand a different conclusion. The reference there to an "amount" is not inconsistent with "share" in s 97 meaning "proportion". Section 101 deems a beneficiary to be presently entitled to an amount and s 97 operates by reference to the proportion that amount bears to the total income of the trust estate.

While the beneficiaries do not advance the quantum approach as such, their connotation and denotation argument has the result that in some circumstances it becomes a quantum approach. There is a fundamental problem with the quantum approach. Where the income of a trust estate exceeds the net income of that estate, the proportionate approach would require that the share of the net income included in the assessable incomes of the presently entitled beneficiaries is the proportion each present entitlement bears to the distributable income of the trust estate. A strict quantum approach provides no basis for determining the shares of net income. Further, if "share" means the fixed amount determined by the present entitlement, the shares of the beneficiaries in the net income might exceed the actual net income. The beneficiaries' construction departs too far from the language of s 97(1). It substitutes, as the integer against which the present

(30) (1995) 96 FCR 82 at 102.

(31) *Davis v Federal Commissioner of Taxation* (1989) 20 ATR 548 at 576-577; 86 ALR 195 at 230-231; 89 ATC 4,377 at 4,403-4,404; *Zeta Force Pty Ltd v Federal Commissioner of Taxation* (1998) 84 FCR 70 at 74-83; *Cajkusic v Federal Commissioner of Taxation* (2006) 155 FCR 430 at 436.

entitlement to a "share" is to be ascertained, the s 95 "net income" for the statutory integer "income of the trust estate". Section 97(1)(a) proceeds on the basis that a relevant "share" has already been ascertained by applying the opening words of s 97(1), by reference to "income of the trust estate", which then has to be applied to "net income". The beneficiaries contend that in their construction the connotation of "share" is constant, but what is constant there is the source of the meaning of the word (the trust deed or a determination by the trustee) rather than its conceptual meaning. That meaning varies between "proportion", "specified amount" and "the balance", depending on how the entitlement of the relevant beneficiaries is expressed in the deed or in a determination by the trustee. These are not different examples of the denotation of "share"; they fix different meanings to the word. The variable meaning of "share" would also permit tax effective manipulation. The beneficiaries contend for a hybrid approach which combines the proportionate approach, where a beneficiary's entitlement is expressed as a proportion, a quantum approach, where it is expressed as a fixed amount, and a "balance" approach, where the entitlement is to the balance remaining after fixed entitlements are satisfied. It suffers from the flaws inherent in each approach. The principal problem of the quantum approach – that it does not provide a basis for determining the shares of the net income where the distributable income of the trust exceeds the net income – is not resolved by the hybrid approach. Nor does the beneficiaries' construction deal with the problem raised by the proportionate approach in particular circumstances. Like that approach, the construction will give rise to the assessment of beneficiaries to tax on income they have not received where entitlements are fractional or proportionate. Further, the construction will cause a beneficiary entitled to the balance of income remaining after the satisfaction of fixed entitlements to be assessed on any excess of net over distributable income. This can give rise to a more serious anomaly than any arising on the proportionate approach. It would result in an assessment of a beneficiary who is notionally entitled to the balance of the distributable income after specific appointments have been made in circumstances where in fact there was no residual income to be appointed. Even where a beneficiary appointed the balance of income does become entitled to a distribution (ie because there was residual income), there is no reason why taxing such a beneficiary on the excess net income is more rational than taxing the excess to all beneficiaries who are presently entitled, in proportion to their entitlements. The proportionate approach maintains a relationship between receipt and tax burden, at least on a percentage basis. Where the beneficiary entitled to the balance of income is not in fact entitled to receive any distribution, the beneficiaries' construction would give no meaning to "is presently

entitled" in s 97. The adoption of a hybrid approach to s 97 in *Richardson v Federal Commissioner of Taxation* (32) was wrong.

The purpose of Div 6, to secure payment of tax on the whole of the net income of a trust estate, either from a beneficiary or the trustee, whether or not that amount is paid to or for the beneficiary (33) is achieved by the Full Court's construction of s 97. There is no underlying assumption that liability for trust estate income should correspond to its enjoyment (34). The legislative history does not support that assumption even if it may have been assumed that distributable income will correspond with net income. Observations in *Whiting's* case (35) were directed to present entitlement.

If, contrary to our submission there is such an underlying policy of Div 6, neither the Full Court's construction of s 97 (for which we contend) nor the beneficiaries' construction is consistent with it; for a consistent interpretation then to be adopted, one would need to construe "income of the trust estate" so as to refer to all amounts in the hands of the trustee that are treated as income for taxation purposes; and the words "that share" of the income of the trust estate are taken to be a reference to so much of the "income of the trust estate" to which the beneficiary is presently entitled, as is reflected in "net income" as defined. That alternative interpretation would (a) assess all of the "net income" of the trust estate to the beneficiaries and/or the trustee; (b) give effect to each element of s 97(1)(a); (c) unlike the quantum approach, provide a basis for determining the "share" of net income where the "income of the trust estate", and the beneficiaries' fixed entitlements to it, exceed the "net income"; (d) limit the amount to be included in the assessable income of a beneficiary to the amount to which he is presently entitled; (e) assess any excess of the "net income" of the trust estate over the "income of the trust estate" to the trustee. This alternative construction of "that share" differs from the quantum approach in that it is capable of allocating shares of net income where the "income of the trust estate" is more than the "net income". It does so by including in the assessable income of the beneficiary the share of "net income" that reflects the share of income to which the beneficiary is presently entitled. If the alternative construction is correct, s 97 would not operate to include the excess of net income over distributable income ($191,701) in the income of any beneficiary here because, while reflected in "net income", no part was reflected in the "income of the trust estate" to which a beneficiary was presently entitled. The excess would be assessed to the trustee under s 99A.

(32) (1997) 80 FCR 58.
(33) *Tindal's* case (1946) 72 CLR 608 at 618.
(34) *Zeta Force Pty Ltd v Federal Commissioner of Taxation* (1998) 84 FCR 70 at 82.
(35) (1943) 68 CLR 199 at 215.

The beneficiaries filed submitting appearances in the Commissioner's appeal and the trustee filed a submitting appearance in the beneficiaries' appeal.

A H Slater QC, in reply. In *Totledge's* case (36), it was recognised that a beneficiary may have an interest in income received by a trustee which equity will protect without having a present entitlement to receive it.

Cur adv vult

30 March 2010

THE COURT delivered the following written judgment: —

1 These appeals are brought from the Full Court of the Federal Court (Emmett, Stone and Perram JJ) (37) and have been heard together. They concern the operation with respect to the income tax years of 2000 (the taxpayers' appeal) and 2002 (the Commissioner's appeal) of the provisions of Div 6 of Pt III of the *Income Tax Assessment Act 1936* (Cth) (the 1936 Act). Division 6 is headed "Trust income" and comprises ss 95-102. There is no relevant difference in the text of Div 6 as it stood in 2000 and 2002.

2 It is appropriate at this stage to note that s 97(1) applies where "a beneficiary of a trust estate … is presently entitled to a share of the income of the trust estate" and that, if so, the assessable income of the beneficiary includes "that share of the net income of the trust estate".

3 For the reasons which follow each appeal should be dismissed.

The facts

4 The facts are not in dispute and were fully detailed by Emmett J (38). It is sufficient to state what follows.

5 P & D Bamford Enterprises Pty Ltd (the Trustee) is the second respondent in the taxpayers' appeal and the third respondent in the Commissioner's appeal. By deed of settlement made 9 February 1995 it was trustee of the trusts of the settlement established by that deed (the Deed). Mr and Mrs Bamford were among the class of "Eligible Beneficiaries" defined in cl 1(d). So also was Church of Scientology Inc (the Church). Mr and Mrs Bamford were directors and employees of the Trustee. They are the appellants in the taxpayers' appeal, and first and second respondents in the Commissioner's appeal.

6 The Deed provided that, as to "the income arising from the Trust Fund" (as defined in cl 1(n)), the Trustee was to hold it for such of the Eligible Beneficiaries as it selected under a provision in cl 4. This clause was of a kind found in what are commonly called "discretionary

(36) (1980) 60 FLR 149 at 157-158; 12 ATR 830 at 837; 40 ALR 385 at 393; 82 ATC 4,168 at 4,173-4,174.

(37) *Bamford v Federal Commissioner of Taxation* (2009) 176 FCR 250.

(38) (2009) 176 FCR 250 at 253-257.

trusts". Clause 7(n) empowered the Trustee to determine whether any receipt "is or is not to be treated as being on income or capital account".

The 2002 year of income

7 In respect of the 2002 year of income, the subject of the Commissioner's appeal, it was common ground that the Trustee treated as income available for distribution the net capital gain of $29,227 arising from the sale of certain real property in which the Trustee had held a half share. That capital gain was divided equally and included in the distribution made to Mr and Mrs Bamford by the Trustee. Mr and Mrs Bamford each lodged a tax return for the 2002 year in accordance with that distribution (39).

8 However, the Commissioner considered that the capital gain was not included in "the income of the trust estate" of which s 97(1) speaks, with the result that there was no income of the trust estate to which s 97(1) could apply and that the Trustee itself was to be assessed under s 99A of the 1936 Act.

9 In this Court the Commissioner submits, contrary to the decision of the Full Court, that "the income of the trust estate" did not include this amount. This is said to be so because, while available for distribution in accordance with the Deed, the capital gain amount was not, in the sense of the 1936 Act, "income according to ordinary concepts".

10 On the second day of the hearing of the appeals the Commissioner made it clear that he accepts that the appeal should be dismissed if "the income of the trust estate" within the meaning of s 97(1) includes "statutory income" such as capital gains which are brought in as "assessable income".

The 2000 year of income

11 In respect of the 2000 year, the subject of the taxpayers' appeal, the state of affairs giving rise to the dispute is more complex. Shortly put, the issue of construction concerns the application of the phrase "that share" in s 97(1) in circumstances where the entitlement of beneficiaries is not to fixed proportions of the income of the trust estate but, as to some beneficiaries, to specific amounts and, as to another beneficiary, to the residue.

12 The Trustee determined under the Deed that the income for the year ended 30 June 2000 be distributed, as to consecutive amounts of $643 each to a child of Mr and Mrs Bamford, the next $12,500 to Narconon Anzo Inc, the next $106,000 to the Church, the next $68,000 to Mr and Mrs Bamford in equal shares, and the balance to the Church. The Trustee determined pursuant to cl 7(n) of the Deed that certain outgoings be treated as expenses and, in error, treated them as allowable deductions in computing the net income of the trust estate for the purposes of s 97(1). This was shown as $187,530.

(39) (2009) 176 FCR 250 at 256-257.

13 Upon making the distributions in the above sequence, there was insufficient remaining to provide the $68,000 to Mr and Mrs Bamford, and no balance to go to the Church. There remained $67,744, which was distributed equally between Mr and Mrs Bamford (ie each received $33,872).

14 Rather than being merely $187,530, the net income of the trust estate included the non-deductible outgoings of $191,701. The Commissioner assessed Mr and Mrs Bamford by calculating the ratio which the actual distributions of $33,872 bore to the total of $187,530, and then applied that ratio to the excess of the net income addition of $191,701 over the distributable income. The Commissioner included the product of that calculation ($34,624) in the assessable income of each of the taxpayers. The taxpayers (contrary to the decision of the Full Court) contend that their share of the net income of the trust estate and thus the amounts included in their assessable incomes should have been ascertained as if the terms of the Deed, including the effect of any exercise of power of appointment over income, applied to the calculation of that "net income".

15 The difference between the parties' submissions may be illustrated as follows. Upon the taxpayers' case, if there were trust income of $300,000 and net income of $180,000 and a beneficiary with an annuity of $100,000, the beneficiary's assessable income would be fixed at $100,000. Upon the Commissioner's case, the beneficiary's assessable income would not be fixed at $100,000 but would be the same one-third proportion (ie $60,000).

Trust law and income tax law

16 Before turning to consider further the relevant provisions of the 1936 Act, the following points of a general nature should be made respecting the intersection between the statute and the law of trusts.

17 First, both sides in argument on the present appeals accepted that whichever of the competing constructions of Div 6 were accepted examples could readily be given of apparent unfairness in the resulting administration of the legislation; it is more than twenty years since Hill J observed that "the scheme of Div 6 calls out for legislative clarification, especially since the insertion into [the 1936 Act] of provisions taxing capital gains as assessable income" (40). Secondly, as Stone and Perram JJ emphasised (41) in the Full Court, the distinction between income and capital in trust law was a product of the administration of successive equitable estates with the balancing in particular of the concern of those with life interests in the receipt of income and those with remainder interests in the conservation and augmentation of capital. Thirdly, the "rules" which were developed in Chancery regarding apportionment between capital and income of

(40) *Davis v Federal Commissioner of Taxation* (1989) 20 ATR 548 at 576; 86 ALR 195 at 230; 89 ATC 4,377 at 4,403.
(41) (2009) 176 FCR 250 at 265.

receipts and outgoings and losses largely took the form of presumptions which would yield to provision made in the trust instrument (42). Fourthly, against this background it was to be expected that the treatment of receipts and outgoings by a trustee would not necessarily correspond with that in a taxing statute such as the 1936 Act. Fifthly, the degree to which a revenue statute adopts or qualifies or supplants the general understanding of terms with a particular application in property law will be a matter of statutory construction, but bearing in mind the caution expressed by Lord Wilberforce in *Gartside v Inland Revenue Commissioners* (43) that the transfer from one context to another may breed confusion.

18 Finally, there is the difficulty that while the general provisions in ss 17 and 19 of the 1936 Act (44) speak of income derived by a "person" and a trustee will answer that description, the trust itself, in the absence of special provision in the legislation, will not be a separate entity with the distinct character of a taxpayer.

19 Writing of the provisions of the 1936 Act dealing with trusts and companies as they stood in 1958 Professor Ford said that looking at "a trust in the abstract" there appeared to be two methods by which it could be dealt with in the scheme of income taxation (45). He continued (46):

> "First, the trust could be treated as a separate entity and the income of the trust as a whole could be assessed as one unit. Under this approach no regard would be had to the income which beneficiaries under the trust derive from other sources. The rate of tax would be that appropriate to the total taxable income of the trust and the trustees would be assessed in respect of that income. If a trust were treated as a tax entity in this way its position would, in a broad sense, be like that of a company. In fact, not only is tax assessed and paid on the taxable income of a company but in addition, dividends paid by the company to its shareholders are, in general, taxed as part of the income of each shareholder. The suggested analogy between a trust treated as a tax entity and a company is a broad one, and is not intended to imply that similar double taxation should operate when trust income is distributed to beneficiaries."

20 However, Professor Ford went on to write that wherever possible the 1936 Act adopted in Div 6 of Pt III what he described as the second approach for a scheme of income taxation. This was as follows:

(42) *Jacobs' Law of Trusts in Australia*, 7th ed (2006), p 485 [1952].
(43) [1968] AC 553 at 617.
(44) Now rendered into "plain English" by the "Core provisions" in Pt 1-3 of the *Income Tax Assessment Act 1997* (Cth).
(45) Ford, "Income and Estate Taxation Affecting Trusts", *Melbourne University Law Review*, vol 1 (1958) 419, at p 420.
(46) Ford, "Income and Estate Taxation Affecting Trusts", *Melbourne University Law Review*, vol 1 (1958) 419, at p 420.

> "[T]he trust could be treated as a mere conduit through which the beneficiaries under the trust receive income. Under this approach the income received by each beneficiary would be aggregated with his income from other sources and tax would be assessed against the beneficiary on that aggregated income at the rate appropriate thereto."

21 This second approach was implemented by Div 6.

The provisions of Div 6

22 The primary provision remains s 96. This states: "Except as provided in this Act, a trustee shall not be liable as trustee to pay income tax upon *the income of the trust estate*." (Emphasis added.)

23 Section 96 had its immediate predecessor in s 31 of the *Income Tax Assessment Act 1922* (Cth), which in turn had been preceded by s 26 of the *Income Tax Assessment Act 1915* (Cth) (47). The Court was taken to the text of this and earlier federal and Victorian legislation (48) respecting the taxation of trust income, but it provides no immediate assistance in the construction of Div 6 for the purposes of the present appeals.

24 The structure of Div 6 as first enacted was as follows. Special provision was made in s 98 for assessment of and payment by the trustee where a beneficiary was presently entitled to "a share of the income of a trust estate" but under a legal disability. Further, where no beneficiary was presently entitled the trustee was to be assessed and liable to pay (s 99); s 99 is now subject to s 99A. Finally, in the case of revocable trusts whereby the person creating the trust had the power to acquire a beneficial interest in the income derived during the year of income the Commissioner was empowered to assess the trustee (s 102).

25 A central provision was s 97. It is upon the construction of this provision, as it stood in the 2000 and 2002 income tax years after amendments to Div 6 over the years, that these appeals turn. As enacted s 97 stated:

> "(1) Where any beneficiary is presently entitled to a share of the income of a trust estate and is not under any legal disability, his assessable income shall include that share of the net income of the trust estate.
>
> (2) The exempt income of any such beneficiary shall include his individual interest in the exempt income of the trust estate, except to the extent to which that exempt income is taken into account in calculating the net income of the trust estate."

26 Section 97(1) in its current form substitutes for "income of a trust estate" the phrase "income of the trust estate". The two phrases appear

(47) Inserted by *Income Tax Assessment Act 1918* (Cth), s 21.

(48) Including s 12(1)(d) of the *Income Tax Act 1896* (Vic). This rendered the trustee liable, as a taxpayer, in respect of income earned, derived or received by the trustee where no other person was "presently entitled" to it and the trustee was "in actual receipt" of it.

throughout Div 6 (in both its original form and its current form) but are not defined. The expression "net income" when used in Div 6 in relation to a trust estate is defined in s 95(1). The relationship, in the construction of s 97(1), between the terms "the income of the trust estate" and "the net income of the trust estate" gives rise to difficulties some of which require resolution in these appeals.

27 The term "trust estate" appears throughout Div 6 and is attached to the term "trustee", but not defined. Nor is the term "beneficiary". However, the term "trustee" is defined in s 6(1) in terms that take the reader immediately beyond a realm limited to the trusts of a settlement or testamentary trust.

28 The definition of "trustee" in s 6(1) is as follows:

> "*trustee* in addition to every person appointed or constituted trustee by act of parties, by order, or declaration of a court, or by operation of law, includes:
>
> (a) an executor or administrator, guardian, committee, receiver, or liquidator; and
>
> (b) every person having or taking upon himself the administration or control of income affected by any express or implied trust, or acting in any fiduciary capacity, or having the possession, control or management of the income of a person under any legal or other disability."

In considering this definition it is important to note that it is said in s 6(1) to apply "unless the contrary intention appears". Thus, it is not to be assumed that every person or entity which answers the statutory definition will be a trustee for the purposes of Div 6 of Pt III. The opening words of the definition speak of a trustee in the ordinary sense of a person who holds property on trust while paras (a) and (b) include persons in whom trust property is not vested. For example, a liquidator, although identified in para (a), is not a trustee of a trust estate in any ordinary sense (49).

29 Nevertheless, the reach of Div 6 beyond settlements and testamentary trusts is illustrated by three decisions of this Court. The official receiver of the estate of a bankrupt was taxed under Div 6 in *Official Receiver v Federal Commissioner of Taxation (Fox's Case)* (50). In *Harmer v Federal Commissioner of Taxation* (51) Div 6 applied to moneys paid into the Supreme Court of Western Australia where no claimant had any vested interest in them; it was sufficient to attract Div 6 that the effect of the relevant West Australian legislation and Rules of Court was that the moneys were held upon trust for statutory purposes.

(49) *Federal Commissioner of Taxation v Linter Textiles Australia Ltd (In liq)* (2005) 220 CLR 592.
(50) (1956) 96 CLR 370 at 383-384.
(51) (1991) 173 CLR 264.

30 On the other hand, in *Registrar of Accident Compensation Tribunal v Federal Commissioner of Taxation* (52) the majority in this Court held that the Registrar was a trustee "pure and simple" (53) of awards of compensation required by Victorian legislation to be paid into a fund under control of the Registrar. The trusts were for the benefit of those entitled to the compensation moneys, as individual beneficiaries, notwithstanding that the trusts arose under the legislation, rather than as a result of the acts of individuals (54). The result was that interest then earned was income of trust estates to which Div 6 applied.

31 Division 6 is now drawn to distinguish between a trust estate which is "a resident trust estate" and "a non-resident trust estate" in relation to the relevant year of income (s 95(2), (3)). Nothing turns on that distinction for these appeals, which, it is accepted, concern resident trust estates. Section 97 is now expressed to be subject to the "closely held trust" provisions of Div 6D (ss 102UA-102UV). The purpose of Div 6D is to provide the Commissioner with information respecting the "ultimate beneficiaries" of certain net income and tax-preferred amounts (s 102UA(1)). A "tax-preferred amount" includes "income of the trust that is not included in its assessable income in working out its net income" (s 102UI).

32 If a "net capital gain", as defined in s 995-1(1) of the *Income Tax Assessment Act 1997* (Cth) (the 1997 Act), is made it will be taken into account in computing the net income of the trust estate within the meaning of s 95(1) of the 1936 Act as part of the assessable income, which is defined by reference to Div 6 of the 1997 Act (55). Special rules found in Subdiv 115-C of the 1997 Act then may allow beneficiaries to reduce their liability by their available capital losses and unapplied net capital losses.

33 So far as is presently relevant s 97(1) reads:

"Subject to Division 6D, where a beneficiary of a trust estate who is not under any legal disability is presently entitled to *a share of the income of the trust estate*:

(a) the assessable income of the beneficiary shall include:

(i) so much of *that share of the net income of the trust estate* as is attributable to a period when the beneficiary was a resident; and

(ii) …

(b) …"

(Emphasis added.)

34 The phrase "the net income of the trust estate" is to be read with the definition in s 95(1):

(52) (1993) 178 CLR 145.
(53) (1993) 178 CLR 145 at 171.
(54) (1993) 178 CLR 145 at 170.
(55) See s 6(1) of the 1936 Act (definition of "assessable income") and ss 6-10 and 102-5 of the 1997 Act.

> "*net income*, in relation to a trust estate, means the total assessable income of the trust estate calculated under this Act as if the trustee were a taxpayer in respect of that income and were a resident, less all allowable deductions, except deductions under Division 16C or Schedule 2G and except also, in respect of any beneficiary who has no beneficial interest in the corpus of the trust estate, or in respect of any life tenant, the deductions allowable under Division 36 of the *Income Tax Assessment Act 1997* in respect of such of the tax losses of previous years as are required to be met out of corpus."

35 On the other hand, and as already remarked, the expression "the income of the trust estate" which appears both in s 97 and in the basic provision of s 96 is not defined. This poses the first construction issue, that in the Commissioner's appeal.

"The net income of the trust estate" and "the income of the trust estate"

36 The very juxtaposition within s 97(1) of the defined expression "net income of the trust estate" and the undefined expression "the income of the trust estate" suggests that the latter has a content found in the general law of trusts, upon which Div 6 then operates.

37 The opening words of s 97(1) speak of "a beneficiary of a trust estate" who is "presently entitled to a share of the income of the trust estate". The language of present entitlement is that of the general law of trusts, but adapted to the operation of the 1936 Act upon distinct years of income. The effect of the authorities dealing with the phrase "presently entitled" was considered in *Harmer v Federal Commissioner of Taxation* (56), where it was accepted that a beneficiary would be so entitled if, and only if,

> "(a) the beneficiary has an interest in the income which is both vested in interest and vested in possession; and (b) the beneficiary has a present legal right to demand and receive payment of the income, whether or not the precise entitlement can be ascertained before the end of the relevant year of income and whether or not the trustee has the funds available for immediate payment."

The elaboration of those propositions that may be called for in the application of s 98 (being the elaboration to which Kitto J adverted in *Taylor v Federal Commissioner of Taxation* (57)) need not be examined in this matter.

38 The identification in s 97(1) of "a trust estate" of which there is "a beneficiary" also bespeaks the general law of trusts. It is true that s 97(1) must be read with s 96. This is addressed to "a trustee", and the effect of the decisions to which reference has been made is that there may be a trustee of a trust created by the operation of a legislative

(56) (1991) 173 CLR 264 at 271.
(57) (1970) 119 CLR 444 at 451-452.

regime not by settlement inter vivos or testamentary disposition. Nevertheless, there must be a "trust estate".

39 Further, the phrase "presently entitled to a share of the income" directs attention to the processes in trust administration by which the share is identified and entitlement established. The relevant operation of those principles, supported by a review of the authorities, was described as follows by Bowen CJ, Deane and Fitzgerald JJ in *Federal Commissioner of Taxation v Totledge Pty Ltd* (58). Their Honours said:

> "A beneficiary under a trust who is entitled to income will ordinarily only be entitled to receive actual payment of the appropriate share of surplus or distributable income: the trustee will be entitled and obliged to meet revenue outgoings from income before distributing to a life tenant or other beneficiary entitled to income. Indeed, circumstances may well exist in which a trustee is entitled and obliged to devote the whole of gross income in paying revenue expenses with the consequence that the beneficiary entitled to income may have no entitlement to receive any payment at all. This does not, however, mean that a life tenant or other beneficiary entitled to income in a trust estate has no beneficial interest in the gross income as it is derived. He is entitled to receive an account of it from the trustee and to be paid his share of what remains of it after payment of, or provision for, the trustee's proper costs, expenses and outgoings."

40 Reliance was placed by the Commissioner upon a passage in *Federal Commissioner of Taxation v Australia and New Zealand Savings Bank Ltd* (59). There was, however, in that case no submission to the effect that the trust deed could operate to treat as capital receipts what otherwise might have been included as income of the trust estate. This is apparent from the argument in the Full Court of the Federal Court in that case (60), and the argument there, as in this Court, was, as the Trustee submitted in this appeal, upon other issues.

41 Finally, the Commissioner only partially invoked the operation of the 1936 Act to give content to the expression "income of the trust estate", and would exclude "statutory income", which is not income according to ordinary concepts. The lack of consistency which this involves tells against the submission.

42 The result is that the Commissioner's appeal should be dismissed. There remains the second construction issue. The resolution of that issue is sequential to that of the first issue.

(58) (1982) 60 FLR 149 at 157-158; 12 ATR 830 at 837; 40 ALR 385 at 393; 82 ATC 4,168 at 4,173-4,174.

(59) (1998) 194 CLR 328 at 337 [15].

(60) *Australia and New Zealand Savings Bank Ltd v Federal Commissioner of Taxation [No 2]* (1997) 75 FCR 25 at 32.

"That share"

43 The second question of construction is presented by the presence in para (a)(i) of s 97(1) of the phrase "that share", which links the preceding identification of present entitlement to "a share" of the income of the trust estate to the defined expression "the net income of the trust estate". On its face the section may appear to postulate the same share of two subject matters which do not correspond.

44 Emmett J referred to the submissions by Mr and Mrs Bamford that where the entitlement of a beneficiary is to a specified amount, as in the present case, and not to a proportionate part, the word "share" means that amount and that this is because "share" reflects the particular method for determination of entitlement to trust income (61). His Honour continued (62):

> "Mr and Mrs Bamford say that, where there is a disparity between the net income of the trust estate and the distributable income, entitlement to which is governed by the trust instrument, the amount in respect of which each beneficiary is assessable must be calculated as if the terms of the trust instrument and any relevant appointment operated upon the amount of the net income of the trust estate as if it were the distributable income. They say that such a result accords with the concept that the liability to tax upon income should follow from the distribution of income according to the terms of the trust."

These submissions were correctly rejected.

45 The resolution of the second issue of construction is to be found in the analysis by Sundberg J in *Zeta Force Pty Ltd v Federal Commissioner of Taxation* (63). His Honour dealt with the first issue of construction to the same effect as that just explained, saying:

> "The words 'income of the trust estate' in the opening part of s 97(1) refer to distributable income, that is to say income ascertained by the trustee according to appropriate accounting principles and the trust instrument. That the words have this meaning is confirmed by the use elsewhere in Div 6 of the contrasting expression 'net income of the trust estate'. The beneficiary's 'share' is his share of the distributable income."

Sundberg J then continued:

> "Having identified the share of the distributable income to which the beneficiary is presently entitled, s 97(1) requires one to ascertain 'that share of the net income of the trust estate'. That share is included in the beneficiary's assessable income. The expression 'net income of the trust estate' in para (a)(i) has the meaning given it by s 95(1) – taxable income as opposed to distributable income. The words 'that share' in para (a)(i) refer back to the word 'share' in the

(61) (2009) 176 FCR 250 at 259.
(62) (2009) 176 FCR 250 at 259.
(63) (1998) 84 FCR 70 at 74-75.

expression 'a share of the income of the trust estate', and indicate that the same share is to be applied to an income amount calculated according to a different formula (taxable income as opposed to distributable income). Since the income amount may differ according to which formula is applied, the natural meaning to give to 'share' where it appears for the second time is 'proportion' rather than 'part' or 'portion'. When Parliament wanted to convey the latter meaning, as it did in ss 99 and 99A, it used the word 'part'.

The contrast between the expressions 'share of the income of the trust estate' and 'that share of the net income of the trust estate' shows that the draftsman has sought to relate the concept of present entitlement to distributable income, and not to taxable income, which is, after all, an artificial tax amount. Once the share of the distributable income to which the beneficiary is presently entitled is worked out, the notion of present entitlement has served its purpose, and the beneficiary is to be taxed on that share (or proportion) of the taxable income of the trust estate."

46 That analysis should be accepted. It follows that the taxpayers' appeal should be dismissed.

Orders

47 Each appeal should be dismissed. No costs orders were made in the Federal Court, there being an agreement between the parties respecting costs (64), and no costs orders should be made in this Court.

In each matter, the appeal is dismissed.

Solicitor for the Commissioner, *Australian Government Solicitor*.

Solicitors for the beneficiaries and trustee, *Robert Richards & Associates*.

JDM

(64) (2009) 176 FCR 250 at 265.