

Trusts tax litigation



THE ATO'S COMPLIANCE PROGRAM WILL REQUIRE PRACTITIONERS TO CONFRONT DIFFICULT TRUST TECHNICAL AND DISPUTE STRATEGIC ISSUES.

"You got to know when to hold em,
know when to fold em,
Know when to walk away
and know when to run..."¹

INTRODUCTION

The Australian Tax Office (ATO) is reviewing trust distributions and will seek judicial clarification of numerous trust issues during 2009. Practitioners may be forgiven for thinking some of these trust issues are clearly settled.

During 2009, practitioners are likely to receive ATO questionnaires, information requests, technical position papers and possibly have their trustee and beneficiary clients subject to audits, adverse tax assessments, objection proceedings and (if unfortunate enough) litigation.

This article discusses selected issues that practitioners ought to consider for their trustee and beneficiary clients subject to ATO compliance activities.²

Legislative references are to the *Income Tax Assessment Act 1936 (ITAA36)*, the *Income Tax Assessment Act 1997 (ITAA97)* and the *Taxation Administration Act 1953 (TAA53)*.

DISPUTED TRUST ISSUES

Compliance program

The ATO is reviewing the reporting of capital gains on disposals, utilisation of capital losses and the application of the small business concessions and is reviewing trust distributions and beneficiary returns to check that distributions have been correctly disclosed and will escalate appropriate cases to audit.³ The ATO is seeking judicial

clarification of a number of trust issues, but will not conduct active compliance activities pending clarification. However, if a review otherwise identifies these trust issues, the trust issues will be actioned.⁴ Trust cloning activities will also be reviewed.⁵

Accordingly, the ATO review activities are likely to increase disputes and litigation surrounding trusts.

Trust issues

A number of actual or perceived uncertainties continue to exist in the construction of Division 6, Part III ITAA36 (Div 6), including:

1. the source and nature of the undefined term "income of the trust estate" in s 97 ITAA36;
2. the power to classify and reclassify capital receipts as "income of the trust estate" for the purposes of s 97 ITAA36 expressly in the trust instrument or by exercise of the trustee's discretion;
3. the power to classify, reclassify and to allocate expenses against income or capital receipts when determining the amount of "income of the trust estate" for the purposes of s 97 ITAA36;
4. the power to defer recoupment of carried forward losses in determining the amount of "income of the trust estate" for the purposes of s 97 ITAA36;
5. the application of the quantum approach or proportionate approach to the meaning of "share of the income of the trust estate" in s 97 ITAA36;
6. the power to stream tax attributes and notional tax amounts to beneficiaries; and
7. the time at which "present entitlement" to a share of the income of the trust

estate" for the purposes of s 97 ITAA36 is created expressly in the trust instrument or by exercise of the trustee's discretion.

Some commentators and the ATO assert different views about the correct interpretation of these trust issues and of the authorities. Particularly, debate ensues whether statements in a particular case are binding (*ratio decidendi*) or non-binding (*obiter dicta*) on the ATO. Arguably until the High Court determines a matter by binding statement then commentators or the ATO have latitude to continue the debate regardless of the mounting weight of Federal Court and Full Federal Court authority. Accordingly, judicial clarification of these trust issues will be painstakingly slow and *ad hoc*.

Income definition trust issues

Section 97 ITAA36 states:

97 Beneficiary not under any legal disability

(1) ...Where a beneficiary of a trust estate who ...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

"Income" or "income of a trust estate" in s 97 ITAA36 could be interpreted as:

- ordinary income (being only income according to ordinary concepts);
- assessable income (being income according to ordinary concepts and other amounts deemed income by revenue law); or

■ trust law income (being ordinary income and other amounts deemed income by trust law).

Parsons⁶ contends that income for revenue law purposes means either ordinary income or assessable income. As s 95 ITAA36 contains a definition of “net income” which is equivalent to taxable income, the traditional view is that income in s 97 ITAA36 must be ordinary income or assessable income.

Whether income is ordinary income, assessable income or trust law income is arguably at the centre of the analysis whether income of a trust estate is a gross or net amount. *Totledge*⁷ held that income was the net amount legally available to be distributed to the beneficiaries. This focuses the interpretation of income on trust law concepts and the legal rights of beneficiaries.

As an extension of this, *Zeta Force*,⁸ *Richardson*⁹ and *Cajkusic*¹⁰ have unambiguously interpreted income to mean trust law income.

The adoption of trust law income permits the trust instrument, expressly or by exercise of the trustee’s discretion for the purpose of determining the amount of income available for appointment to the beneficiaries, to classify and reclassify a capital receipt as income and to classify, reclassify and to allocate expenses against income or capital receipts.

The ATO rejects these authorities and the ability to reclassify capital as income for trust law income purposes as being inconsistent with *ANZ Savings Bank*¹¹ and *Totledge*¹² or merely non-binding *obiter*.¹³ Some commentators criticise reliance on these cases which are considered to be applied by the ATO out of context.

Trust law requires the allocation of income expenses against income¹⁴ and capital expenses against capital¹⁵ and mutual-hybrid expenses to be apportioned against income and capital with the initial expense allocated to capital and a portion of that capital recouped from future income.¹⁶ However, the trust instrument can provide alternate allocation of expenses.

*Carver v Duncan*¹⁷ arguably requires the allocation of income expenses against income and capital expenses against capital on the basis that the terms of the trust instrument are irrelevant in the

allocation, because the trust instrument cannot alter the nature of those expenses when determining the amount of income, but merely authorises the trustee to defray the expense from income or capital.¹⁸

If the ATO is correct that income is ordinary income and not trust law income, then it is likely that *Carver v Duncan* is correct and the trust instrument is irrelevant in determining the proper allocation of expenses.

The Full Federal Court Appeal in *Bamford*¹⁹ may provide some guidance, but is unlikely to settle this trust issue. If the trust issue is considered by the High Court the authorities of *Zeta Force*, *Richardson* and *Cajkusic* may be over-ruled.

Generally losses in one year must be made up out of profits of subsequent years and not out of the capital of the trust in order to preserve the property for the capital beneficiary.²⁰ However, the trust instrument may grant the power to the trustee not to use subsequent profits to recoup past losses.²¹ *Raftland*²² limited this principle founded upon *Upton v Brown* to trusts with successive estates so that the rule does not apply generally to all trusts unless there are successive income and capital beneficiaries, and more particularly does not apply to a unit trust with a single class of units.

Accordingly, there continues to be uncertainty regarding the concept of income of a trust estate for s 97 ITAA36 purposes²³ which may alter the amount of income available for appointment to the beneficiaries and the potential for an adverse assessment arising from an ATO review.

Proportionate and quantum approach trust issue

The references to “share of the income of the trust estate” and “share of the net income of the trust estate” in s 97 ITAA36 may be interpreted as meaning a proportion or a specific amount.

Despite the weight of authorities including *Davis*,²⁴ *Dwight*,²⁵ *Prestige Motors*,²⁶ *Richard Walter*,²⁷ *Richardson*,²⁸ *Prestige Motors*,²⁹ *Zeta Force*³⁰ and *Richardson*³¹ there is still some uncertainty regarding whether the proportionate approach is the preferred approach.

The ATO has stated it will generally apply the proportionate approach, but pending judicial clarification, the ATO will

raise alternative assessments under the quantum approach.³²

Accordingly, there continues to be uncertainty regarding the application of the proportionate approach to s 97 ITAA36³³ which may alter the amount of net income to which a beneficiary is liable to tax and the potential for an adverse assessment arising from an ATO review.

Streaming trust issue

*Baker v Archer-Shee*³⁴ held that income from stock and shares retained its character when passing through a trustee to a beneficiary provided the beneficiary has a beneficial interest in the property of the trust. *Archer-Shee v Garland*³⁵ concerned the same trust, but in respect of the subsequent years. The taxpayer provided evidence that the beneficiary under the trust did not have a beneficial interest in the assets of the trust. The court held that the distribution to the beneficiary lost its character as income from stock and shares and was simple trust income arising from the chose in action of the beneficiary.

Charles,³⁶ *Syme*³⁷ and *Tadcaster*³⁸ are traditionally cited as authority that the character of income or capital flows through the trust to the beneficiaries. However, this principle will arguably not apply where the beneficiary does not have a beneficial interest in the assets of the trust. Where there is no such beneficial interest what is distributed is income or capital in a generic sense, not, for example, dividend income or discounted capital gain.³⁹

The ATO has recognised the statutory flow through nature of capital gains,⁴⁰ dividend income,⁴¹ dividend, interest and royalty income⁴² and foreign tax credits.⁴³ The basis of the flow through arguably differs based on source of income or capital and the nature of the beneficiary’s interest in the assets of the trust.⁴⁴

In respect of capital gains, the correctness of IT 2328 (withdrawn 28 May 2008) that the conduit theory of streaming applied to capital gains was doubted by commentators.⁴⁵ The ATO referred to the conduit theory in TR 2005/23 and explained that the conduit theory does not apply to capital gains Div 115-C ITAA97.⁴⁶

If the ATO is correct that income of the trust estate is ordinary income and the proportionate approach applies, then the

beneficiaries in receipt of the ordinary income of the trust estate will include in assessable income a proportionate amount of the capital gain and it is not possible to stream the capital gain to other beneficiaries for tax purposes.

Accordingly, there continues to be uncertainty regarding the ability to stream classes of income under s 97 ITAA36⁴⁷ which may alter the amount of net income to which a beneficiary is liable to tax and the potential for an adverse assessment arising from an ATO review.

Reasonably arguable position (RAP)

The uniform penalty provisions apply to statements made, returns lodged and schemes entered into from 1 July 2000.⁴⁸

Where a taxpayer adopts an interpretation of a tax law that is “reasonably arguable” (which is subsequently found to be incorrect) the taxpayer may be obliged to pay any unpaid tax and interest on that tax; however, penalties should not be imposed on that unpaid tax.⁴⁹

A matter is “reasonably arguable” if it would be concluded in the circumstances, having regard to relevant authorities, that what is argued for is about as likely to be correct as incorrect (or more likely to be correct than incorrect).

The ATO has discussed reasonably arguable position in TR 94/5 (withdrawn 14 May 2008) and replaced by MT 2008/2 (12 November 2008). Although it is not necessary to prepare a written RAP at the time of taking a particular position, it is often advisable to do so, which will ensure that the trustee and the beneficiaries can demonstrate reasonable care in preparing their tax returns.⁵⁰

With regard to the above authorities, it is likely that the trustee and the beneficiaries will have a RAP in respect of these uncertain trust issues pending further judicial clarification.

LIABILITY TO TAX

Structure of Division 6

Under Div 6:

1. a beneficiary not under a legal disability includes in the beneficiary’s assessable income a share of the net income of the trust estate to which the beneficiary is

presently entitled (s 97 ITAA36) and is liable to tax at the beneficiary’s tax rate;

2. a beneficiary under a legal disability, deemed to be presently entitled to a share of income under s 95A(2) ITAA36 or is non-resident or trustee of a non-resident trust estate includes in the beneficiary’s assessable income a share of the net income of the trust estate to which the beneficiary is presently entitled (s 98 ITAA36) and the trustee is liable to tax at the beneficiary’s tax rate with an offset for the non-resident beneficiary if the non-resident beneficiary has paid tax (ss 98A or 99B ITAA36); or
3. the trustee includes in the trustee’s assessable income that part of the net income of the trust estate not subject to taxation to a beneficiary (s 99A ITAA36) and is liable to tax at 46.5%, unless the ATO determines to apply progressive tax rates (s 99 ITAA36).

A beneficiary will be presently entitled to a share of income where:

1. the beneficiary has a vested, indefeasible and currently existing legal right to demand or direct payment but for the legal disability;⁵¹
2. the beneficiary has received the income so the present entitlement under s 95A(1) ITAA36 despite it arguably being discharged before year’s end;⁵²
3. the income was applied for the benefit of the beneficiary under s 95A(2) ITAA36;⁵³ or
4. the income was applied for the benefit of the beneficiary of a discretionary trust under s 101 ITAA36.

Present entitlement usually arises by an appointment in the trustee’s minutes to one or more beneficiaries out of a class of potential beneficiaries.⁵⁴

If a valid appointment is not made, a modern trust deed usually automatically appoints the income to the default beneficiary⁵⁵ or accumulates the income so no beneficiary is presently entitled to the income and the income is added to corpus. Present entitlement can be deemed to arise where paid in fact to or applied in fact for the benefit of the beneficiary whether or not supported by a trustee’s minute.⁵⁶

Part IVA ITAA36 permits the ATO to reconstruct a transaction based on a reasonable counterfactual.

Invalid appointments

The validity of an appointment can be impugned through various irregularities including:

1. failure to pass the resolution and prepare the minutes in time such as by the end of each accounting period or within such reasonable time as required by the trust instrument⁵⁷ or on or before 31 August following the end of the accounting period;⁵⁸
2. the recipient not being a beneficiary entitled to an appointment under the trust instrument because the beneficiary was not validly appointed under a nomination,⁵⁹ did not satisfy the ownership requirements to be an eligible company or eligible trust,⁶⁰ was excluded because the distribution to the eligible trust would breach the perpetuity period,⁶¹ or was excluded from the class under settlor or notional settlor exclusions in the trust instrument;
3. the appointment not being effective because the consent of a third party (such as the appointor) was not obtained;
4. the appointment being a sham distribution;⁶² or
5. present entitlement to an amount being denied as a s 100A ITAA36 reimbursement agreement.

Ineffective minutes

Ineffective minutes are an easy method for the ATO to dispute a distribution and embarrass the practitioner in front of the client for leverage in the negotiating process.

Minutes may be ineffective due to failure to pass the resolution on or before 30 June or 31 August following the end of the accounting period, failure to comply with the trust deed or constitution requirements to effect the meeting, failure to sign or date the minute or by inappropriately drafted resolutions that are ambiguous or incomplete.

Logically, it must be effective before 30 June each year. Whether the resolution that is created post 30 June can be effective for the year ended 30 June is unclear.

Arguably, without an express requirement that the trustee create the present

entitlement on or before 30 June, the trustee may have the power to create the present entitlement at 30 June after 30 June. Where the default position under a trust instrument is to accumulate income, an income appointment clause that operates a reasonable time after 30 June but is expressed as effective 30 June may provide greater flexibility and represent the reality of trust minutes that are frequently prepared after 30 June (and often after 31 August). If *Pearson*⁶³ is correct and the present entitlement must be actually made rather than effective before the end of 30 June, then the accumulation default position will apply with no additional adverse consequences.

ceased due to death or divorce (such as a step child of a spouse) so the person no longer falls within the class of beneficiaries;

5. a corporate beneficiary or trust beneficiary has ceased to be a beneficiary because a relationship established by share or unit holding has ceased upon the disposal of the share or interest so the company or trust no longer falls within the class of beneficiaries.⁶⁶

Accordingly, because of the uniqueness of each trust deed or changes in circumstance, a person that has received a distribution may not be a beneficiary and the purported distribution is of no effect.⁶⁷

of a beneficiary on certain trust distributions that are effectively diverted to a third party. The section applies where a present entitlement otherwise vests in a beneficiary or where the beneficiary has been paid or had an amount applied for the benefit of the beneficiary arising directly or indirectly out of a reimbursement agreement. As no present entitlement, payment or applied benefit exists for the purposes of s 97 ITAA 1936, the trustee of the trust is taxed under s 99A ITAA 36 at the 46.5% rate.

Section 100A ITAA36 is most obviously applicable to trust stripping arrangements⁷⁰ and loss trust injection arrangements,⁷¹ although other arrangements may be caught. A reimbursement agreement may arise by the payment of money, including by way of a loan or by release, failure to demand or to postpone payment of a debt, the transfer of property, including a chose in action or legal or equitable estate, interest, right or power in or over property or the provision of services or other benefits to or for a person other than the beneficiary or for a group of person including the beneficiary.

To be a reimbursement agreement the agreement must be entered into for the purpose or for purposes that include the purpose of securing that the liability to income tax of any person in respect of any year of income is reduced or eliminated. The phrase “whenever entered into” in the definition of reimbursement agreement means that the reimbursement agreement can arise before, at the same time or after the creation of the present entitlement. Accordingly, the provision has wide application.

The agreement is not a reimbursement agreement if the wider context of the arrangement constitutes ordinary family or commercial dealings. What constitutes ordinary family or commercial dealings will often be disputed. Accordingly, the exemption is often difficult to apply in practice.

Default distribution

Where at the end of 30 June there has not been an effective appointment at the trustee’s discretion, most modern trust instruments provide a default appointment of income. A default appointment may be to accumulate the income (not to create a present entitlement so s 99A

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However, a provision that permits a present entitlement appointment to be made after 30 June but is effective before the end of 30 June can actually be made before 30 June (for those conservative practitioners) but retains the argument on any dispute with the ATO that a later appointment is still effective.

Recipient not a beneficiary

A person may not be a beneficiary⁶⁴ because:

1. the person does not fall within the class of beneficiaries as defined in a particular trust instrument;
2. the person is within a class of precluded beneficiaries as defined in a particular trust instrument (such as a notional settlor, the trustee or a trust with a vesting day later than the distributing trust);
3. the precondition of nomination as a beneficiary in writing (such as by the appointor) has not been obtained;⁶⁵
4. the beneficiary has ceased to be a beneficiary because a relationship established by birth or marriage has

Sham distribution

A sham distribution arises where the parties do not have a common intention to give effect to the distribution so the distribution does not have substantive as opposed to apparent legal effect.⁶⁸

The precise operation of the principles of sham distribution is arguably unclear. Kirby, J in *Raftland* detailed the history, comparative international analysis and the content of Australian sham analysis in an extensive judgment. However, the majority of the High Court simply reverted to the analysis of Keifel, J in the original Federal Court decision with a much limited analysis of sham.

Accordingly, where the distribution is made to a beneficiary but the payment is to or for the benefit of another, then this discordance between the legal rights of the beneficiary and payment or the enforcement of those legal rights may allow the ATO to allege sham.⁶⁹

Reimbursement agreement

Section 100A ITAA 1936 is an anti-avoidance provision that cancels the taxation

ITAA36 applies) or to specifically provide a default appointment to a specified class of beneficiaries (called a default beneficiary). A default beneficiary is a beneficiary of a trust that takes the trust fund subject to any exercise of a mere power of appointment by the trustee in favour of other beneficiaries. *Pearson*⁷² well illustrates the issue.

Where a default appointment or accumulation is to occur, the trust instrument should clearly specify the date and time by which any appointment or accumulation is to occur. Interpretation of particular default appointment or accumulation clauses is often difficult. *BRK (Bris) P/L*⁷³ and *Ramsden*⁷⁴ illustrate the difficulties.

BRK (Bris) P/L applied a literal interpretation of the trust instrument and since the trust instrument did not specify that the default appointment provision operated before the end of the accounting period, a default beneficiary present entitlement was not created within the accounting period. Conversely *Ramsden* disagreed with *BRK (Bris) P/L* and considered that the entitlement of the default beneficiaries became indefeasible at year end and so became presently entitled at that time. On appeal by the ATO, the Full Federal Court in *Ramsden*⁷⁵ held that the cases cited by Spender J (the judge at first instance) did not establish a general principle and was dependent on the construction of the relevant trust instrument.

Accordingly, there is some uncertainty regarding the operation of default distribution clauses unless the trust instrument is extremely clear that the default appointment occurs immediately before the end of 30 June.

Alternate assessment

Depending on how the present entitlement arises different beneficiaries may be liable to tax. To avoid assessing the wrong person, the ATO will usually issue multiple assessments to different persons on alternate basis. The ATO is entitled to issue more than one assessment in respect of the same amount to different taxpayers provided the ATO is bona fide of the view that each assessment could be correct at law.⁷⁶ However, the ATO will have to elect to enforce only one assessment.⁷⁷

Assessments

The ATO generally has four years to amend an assessment. However, the ATO has six years to amend an assessment when Part IVA ITAA36 applies and an unlimited amendment period in the case of fraud or evasion⁷⁸ or to give effect to s 100A ITAA36.⁷⁹

A “no tax payable assessment” for the 2004-05 and later income years is an

of objection or appeal proceedings being unresolved.⁸⁴ While there had been some uncertainty regarding whether a statutory demand could be stayed or set aside on a winding up application, the law has been settled that the statutory demand will not be set aside.⁸⁵ Accordingly, it is vital that taxpayers negotiate deferral of enforcement proceedings pending resolution of the objection and appeal proceedings.

“ Involvement of specialist tax litigators ... at an early time in the dispute process will assist in the negotiation, settlement and running of any potential tax litigation. ”

assessment so time limitations apply. For earlier years, “a no tax payable assessment” was not an assessment so no time limitation applied.⁸⁰ Transitional rules apply. Unless the trustee has accumulated some income for the period before the 2004-05 income year, the time period for an assessment would not have commenced running so the ATO is able to issue an assessment regardless of the lapse of time.

Accordingly, there may be circumstances when the trustee or the beneficiary may defend an assessment because the ATO was out of time to issue the relevant assessment.

Some uncertainty arose regarding the circumstances under which the ATO can amend a CGT assessment more than four years after the original assessment. However, on appeal the court held that the four year period could only be extended where new evidence arose after the assessment, not merely a new interpretation of the evidence.⁸¹

The ability to challenge an assessment concurrently under judicial review or Part IVC TAA53 has recently been clarified with Part IVC TAA53 having priority.⁸² Accordingly, a taxpayer’s litigation options have arguably been reduced.

The amount of an assessment is a debt due and payable to the ATO under statutory presumptions⁸³ and the debt can be enforced regardless

Exercise of the Trustee’s Indemnity

The ATO may obtain judgment against the trustee (for example under s 99A ITAA36). The extent to which the ATO can enforce the judgment against the trust estate or the beneficiaries of the trust requires consideration.

The trustee has a statutory and common law⁸⁶ right of indemnity out of the trust estate. If the trust estate is insufficient to satisfy the indemnity, the trustee has a right of indemnity against a sole beneficiary not under a legal disability or all of the beneficiaries if none are under any legal disability in respect of the excess liability, unless the trust instrument, contract or equitable estoppel excludes the liability.⁸⁷

It is unclear whether the statutory and common law rights of indemnity out of the trust estate can be excluded by the trust instrument or contract. *Kemtron Industries*⁸⁸ expressed the view that the indemnity was probably incapable of exclusion⁸⁹ while *RWG Management*⁹⁰ expressed the opposite view. The indemnity out of the trust estate cannot be excluded in Queensland.⁹¹ The trustee’s indemnity against the beneficiaries can be excluded by the trust instrument or contract.⁹²

Most modern trust instruments exclude the indemnity against the beneficiaries or the indemnity is inapplicable because

the discretionary class of beneficiaries is not closed or has beneficiaries under a legal disability.

The trust's creditors (but not the personal creditors of the trustee) have the right of subrogation to the trustee's rights of exoneration against the trust estate and the beneficiaries.⁹³ The trust's creditors can enforce the indemnity to obtain payment from the trust estate and beneficiaries. If the trustee withdraws from the trust estate and in breach of trust disburses the money, the trust's creditor's may lose their right of subrogation against the trust estate and the beneficiaries retaining only a personal liability against the trustee.⁹⁴

Accordingly, the ATO may theoretically be precluded from enforcing the judgment against the trust estate or the beneficiaries where the trustee has in breach of trust disbursed the proceeds referable to the tax, although the ATO would retain a personal action against the trustee.

The trustee may have distributed or disbursed the trust estate to the beneficiaries or third parties. Upon the bankruptcy or insolvency of the trustee, the ATO may obtain control of the trust. The ATO may seek to set aside and reclaim the distributed or disbursed money placing the trust estate back in funds to pay the liability.

Where the distribution or disbursement is in breach of trust, the trust estate (through the current or substitute trustee) may have an entitlement to recovery of the disbursed assets or money against the trustee or beneficiary personally and any recipient with knowledge of the breach or recipient who acquired under an undervalue transaction by an action in tracing.⁹⁵ *In specie* disbursement of assets can be traced at common law and disbursement of money can be traced in equity.⁹⁶

There are limitations on tracing, particularly where the recipient was a mere volunteer and had mixed the receipts with other money and incorporated into other assets,⁹⁷ used the money to pay off an unsecured loan⁹⁸ or used the money to pay off an overdraft or overdrawn account.⁹⁹

Accordingly, it is seldom an effective strategy to abandon the trust assets to the ATO and assume that the ATO cannot trace assets and distributions to claw back assets to satisfy an adverse assessment.

Disclaimer

A beneficiary by appointment¹⁰⁰ or by default¹⁰¹ can disclaim an interest in the distribution retrospectively if the beneficiary disclaims all the relevant interest¹⁰² and has not effectively accepted the present entitlement such as by effluxion of time.¹⁰³

A beneficiary by appointment of income for an income year can disclaim the appointment for that income year, but can accept future appointments of income in later income years. A default beneficiary must disclaim the interest as a beneficiary in the entire trust fund.¹⁰⁴

Whether a disclaimer has been made within a reasonable time was considered in *AAT Case*.¹⁰⁵

CONCLUSION

ATO compliance activities for trustees are set to increase in 2009 which will require practitioners to confront difficult trust technical and dispute strategic issues.

If trust disputes with the ATO escalate, practitioners may also be faced with litigation. Involvement of specialist tax litigators and tax barristers at an early time in the dispute process will assist in the negotiation, settlement and running of any potential tax litigation.

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Reference notes:

- 1 *Kenny Rogers, The Gambler* (United Artists, 1978).
- 2 For a detailed analysis of tax litigation principles see Inspector General of Tax, "Review of Tax Office management of Part IVC litigation", 28 April 2006, PSLA 2007/2, PSLA 2007/5 and Code of Settlement Practice, PSLA 2007/12, PSLA 2007/17-19 and PSLA 2007/23.
- 3 ATO Compliance Program 2008-9 at 25.
- 4 ATO Compliance Program 2008-9 at 29.
- 5 ATO Compliance Program 2008-9 at 40.
- 6 R. Parsons, *Income Taxation in Australia, Principles of Income, Deductibility and Tax Accounting*, University of Sydney Library, electronic format, 2001 at [1.30].
- 7 *FCT v Totledge P/L* (1982) 12 ATR 830.
- 8 *Zeta Force P/L v FCT* (1998) 39 ATR 277 at 282.
- 9 *Richardson v FCT* (2001) 46 ATR 285 (FC); (2001) 48 ATR 101 at [30] (FFC).
- 10 *Cajkusic v FCT* (2006) 62 ATR 1.091 (AAT); (2006) 64 ATR 676; (FFC).
- 11 *FCT v ANZ Savings Bank Ltd* (1997) 36 ATR 230 (FFC), (1998) 39 ATR 419 (HC).
- 12 *FCT v Totledge P/L* (1982) 12 ATR 830.
- 13 *Cajkusic Decision Impact Statement* (VID 279/2006).
- 14 *In re Dawes* [1954] VLR 76 at 79.

- 15 *In re Farnham's Settlement* [1904] 2 Ch 561, *In re Cross* [1943] VLR 38; *In re Wentworth* (1915) 15 SR (NSW) 384.
- 16 *Watson v Little* (1921) 38 WN (NSW) 143; *Re Grant* [1933] VLT 263.
- 17 *Carver v Duncan* [1985] 1 BTC 248 (House of Lords).
- 18 Although the author considers Lord Diplock's dissenting judgment reasons more compelling.
- 19 *Bamford v FCT* (2008) 70 ATR 199 heard on 24 November 2008 and 25 November 2008 by Emmett, Stone and Perram, JJ, with judgment reserved at the time of writing this article.
- 20 *Upton v Brown* (1884) 26 Ch D 588; *Re Reynolds* [1942] VLR 158.
- 21 *Re Mountain* [1934] NZLR 399; *Re Nairn* [1935] NZLR 134.
- 22 *Raftland P/L v FCT* (2008) 68 ATR 170.
- 23 For a more detailed discussion refer to R. Jorgensen, "Continuing controversy post Cajkusic", *Taxation in Australia*, Vol. 42 No. 6, December/January 2007 at 249 and R. Jorgensen, "Continuing controversy post Cajkusic", *Taxation in Australia*, Vol. 42 No. 10, May 2008 at 594; AH Slater, QC, "The nature of income: the intersection of tax, legal and accounting concepts", (2007) 26 AT Rev 138.
- 24 *Davis v FCT* (1989) 20 ATR 548 at 576.
- 25 *Dwight v FCT* (1992) 23 ATR 236.
- 26 *FCT v Prestige Motors P/L* (1994) 28 ATR 336.
- 27 *Richard Walter P/L v FCT* (1985) 31 ATR 95.
- 28 *Richardson v FCT* (1997) 37 ATR 452.
- 29 *FCT v Prestige Motors P/L* (1998) 38 ATR 568.
- 30 *Zeta Force P/L v FCT* (1998) 39 ATR 277 at 282.
- 31 *Richardson v FCT* (2001) 46 ATR 285 (FC).
- 32 *National Tax Liaison Group minutes of 4 June 1998 and 5 March 1998 and PSLA 2005/1 at [26] - [28]*.
- 33 For a more detailed discussion refer to M. Blissenden, "Taxation of trust income under Div 6: A reflection on Justice Hill's contribution", (2006) 35 AT Rev 262.
- 34 *Baker v Archer-Shee* [1927] AC 844.
- 35 *Archer-Shee v Garland* [1931] AC 212.
- 36 *Charles v FCT* [1953-1954] 90 CLR 598, 609.
- 37 *Syme v C of T(Vic)* (1914) 18 CLR 519.
- 38 *FCT v Tadcaster Pty. Ltd.* (1982) 13 ATR 245 at 249.
- 39 *FCT v Angus* [1960] 105 CLR 489; G Longhouse "Maintaining Identity: The Conduit Theory of the Taxation of Trust Income", *The Tax Specialist*, Vol 2/3, February 1999 at 132.
- 40 *IT 2328* (Withdrawn 28 May 2008).
- 41 *TR 92/13*.
- 42 *IT 2680*.
- 43 *IT 2555*.
- 44 *TR 93/12*.
- 45 *TIA Writers*, "Tax Tips: Trusts - flow through of capital gains", *Taxation in Australia*, 36/1, July 2001, pages 16-19.
- 46 *TR 2005/23 at [145]*.
- 47 For a more detailed discussion refer to M. Blissenden, "Taxation of trust income under Div 6: A reflection on Justice Hill's contribution", (2006) 35 AT Rev 262.
- 48 *Part 4-25 TAA53*.
- 49 *Section 284-75(2) TAA53*.
- 50 *MT 2008/1* (12 November 2008) at [39] - [41].
- 51 *FCT v Whiting* (1943) 68 CLR 199 at 214-216; *Taylor v FCT* 70 ATC 4026 at 4029-4030; *Sacks v Gridiger* 90 ATC 4299 at 4304-4305.
- 52 *Union Fidelity Co of Australia Ltd c FCT* (1969) 119 CLR 177 at 182.
- 53 *Dwight v FCT* 92 ATC 4192 at 4202-4203.
- 54 *FCT v Belford* (1952) 88 CLR 589 at 607.

- 55 *A default beneficiary is a beneficiary of a trust that takes the trust fund subject to any exercise of a mere power of appointment by the trustee in favour of other beneficiaries.*
- 56 *CIR (NZ) v Ward* [1970] NZLR 1.
- 57 *BRK (Bris) P/L v FCT* (2001) 46 ATR 436.
- 58 *IT 328 and IT 329*; PSLA 2005/1 (GA).
- 59 *Idlecroft P/L v FCT* (2005) 60 ATR 224 paras 47 and 49 and *BRK (Bris) P/L v FCT* (2001) 46 ATR 436 para 14; *In re Gulbenkian's Settlements* [1970] AC 508 at 518; *In re Hays Settlement Trusts* [1982] 1 WLR 202 at 210.
- 60 *Ramsden v FCT* 2004 ATC 4659 at [25].
- 61 *Pilkinton v IRC* [1964 AC 612; *Ramsden v FCT* 2004 ATC 4659 at [25]; *Nemises Australia P/L v FCT* 2005 ATC 4881.
- 62 *Raftland P/L v FCT* (2008) 68 ATR 170.
- 63 *Pearson v FCT* (2006) 64 ATR 109.
- 64 Neil Mathison "Discretionary Trusts – problems with beneficiaries" *Taxation in Australia* Vol. 39 No. 4 October 2004.
- 65 *Idlecroft v FCT* 2004 ATC 4845.
- 66 *BRK (Bris) P/L v FCT* (2001) 46 ATR 436.
- 67 *Idlecroft P/L v FCT* (2005) 60 ATR 224.
- 68 *Equuscorp P/L v Glengallan Investments P/L* (2004) 218 CLR 471; *Raftland v FCT* (2007) 68 ATR 170.
- 69 See R Speed, "High Court lets the 'sham' genie out of the bottle", 27 *Weekly Tax Bulletin* [11092].
- 70 *Idlecroft P/L v FCT* (2005) 60 ATR 224.
- 71 *Raftland P/L v FCT* (2008) 68 ATR 170.
- 72 *Pearson v FCT* (2006) 64 ATR 109.
- 73 *BRK (Bris) P/L v FCT* (2001) 46 ATR 436.
- 74 *Ramsden v FCT* (2004) 56 ATR 42.
- 75 *FCT v Ramsden* (2005) 58 ATR 485 at [70].
- 76 *Briglia v FCT* 2000 ATC 4247; PSLA 2006/7.
- 77 PSLA 2005/24 at [124] and [131].
- 78 Consider PSLA 2008/6.
- 79 Section 170(10) (item 17) ITAA36.
- 80 *Batagol v FCT* (1963) 109 CLR 243, *FCT v Ryan* 2000 ATC 4079.
- 81 *Metlife Insurance Ltd v FCT* (2008) 70 ATR 125 (FC); (2008) 70 ATR 364 (FFC).
- 82 *FCT v Futuris Corporation Ltd* [2008] HCA 32.
- 83 Section 208 ITAA36.
- 84 Section 218 ITAA36.
- 85 *DCT v Broadbeach Properties P/L* [2008] HCA 41.
- 86 *CSD (NSW) v Buckle* (1998) 192 CLR 226 at 247.
- 87 *Hardoon v Bellios* [1901] AC 118 at 124 and 127.
- 88 *Kemtron Industries P/L v CSD (Qld)* [1984] 1 Qd R 576 at 585.
- 89 Supporting statements that the indemnity is inseparable or a necessary incident of the trustee's office can be found in *Re Exhall Coal Company Ltd* (1866) 35 Beav 449 at 463; 55 ER 970 at 972; *CSD (NSW) v Buckle* (1998) 192 CLR 226 at 247.
- 90 *RWG Management P/L v CCA* [1985] VR 385 at 395.
- 91 ss. 65 and 72 *Trusts Act* 1973 (QLD).
- 92 *Hardoon v Bellios* [1901] AC 118 at 127.
- 93 *Ron Kingham Real Estate P/L v Edgar* [1999] 2 Qd R 439 at 440, 443-444 and 446; cf *Belar P/L (in liq) v Mahaffey* [2000] 1 Qd R 477 at 487-488.
- 94 *In re Johnson* (1880) 15 Ch D 548; at 552.
- 95 *Taylor v Palmer* (1815) 3 M&S 562 at 575; 105 ER 721 at 726.
- 96 *In re Diplock* [1948] Ch 465 at 520.
- 97 *In re Diplock* [1948] Ch 465 at 520.
- 98 Cf *Boscawen v Bajwa* [1996] 1 WLR 328.
- 99 *In re Goldcorp Exchange Ltd* [1995] 1 AC 74 at 105; *Bishopsgate Investment Management Ltd (in liq) v Homan* [1995] Ch 211.
- 100 *FCT v Cornell* (1946) 73 CLR 394 at 401-402; Case X30 90 ATC 287 at 294-295.
- 101 *Ramsden v FCT* 2005 ATC 4136.
- 102 *Pearson v FCT* 2005 ATC 4119.
- 103 *Nguyen v FCT* 99 ATC 2211; *Ramsden v FCT* 2005 ATC 4136.
- 104 *Ramsden v FCT* 2005 ATC 4136.
- 105 *AAT Case* [2008] AATA 927 (*McCabe*, SM 13 October 2008).