The Tax Institute

Member webinar series

Trusts — 10 things people get wrong

Presented at the Member Webinar Series on 29 October 2024

Adrian “the Taxinator” Cartland
Cartland Law

© Adrian Cartland 2024
Disclaimer: The material and opinions in this paper are those of the author and not those of The Tax Institute. The Tax Institute did not review the contents of this paper and does not have any view as to its accuracy. The material and opinions in the paper should not be used or treated as professional advice and readers should rely on their own enquiries in making any decisions concerning their own interests.
Liability limited by a scheme approved under professional standards legislation.

Contents

1. Acknowledgement and Thanks 4

2. Overview 5

2.1 The Basic Case 5

2.2 Ten Things I Hate 5

3. Division 6 7

4. Trust Distributions in Equity 12

4.1 Presently Entitled – Whiting 12

4.2 Preliminary Issues with Present Entitlement 12

4.2.1 Reconciliation of *Whiting* and *Harmer* Formulations 13

4.3 Accounting Issues 13

4.4 Definition of Income 15

4.4.1 Re Spanish Prospecting Co Ltd 15

4.4.2 Income Can Include Accounting Revaluations – *Clark v Inglis* 16

4.5 Conventional View of Presently Entitled 16

4.5.1 *Fischer v Nemeske* –French CJ and Bell J 17

4.5.1 Fischer v Nemeske - Gageler 21

4.5.1 Fischer v Nemeske – Kiefel 23

4.5.2 Fischer v Nemeske – Gordon J 24

4.5.3 North P in Ward 27

4.5.4 McCarthy J in Ward 28

4.5.1 Turner J in Ward 29

4.5.2 E47 30

4.5.3 Tindon v Adams 31

4.5.4 Corporate Initiatives 32

4.5.5 Oswal 33

4.5.1 Cajkusic 34

4.5.2 Chianti 34

4.5.3 Buckle 36

4.5.4 CTP Custodian 37

4.6 TR 2004/D25 – Absolute Entitlement 38

4.6.1 Farmsworth 39

4.6.2 Bendel 39

4.6.3 White v Shortall 42

5. Corpus Distribution 43

5.1.1 Distribution of Assets 43

5.1.2 Distribution of Reserve Account 43

5.1.3 Entitlement to an Asset 44

5.1.4 Distribution of Bill of Exchange 44

6. The Meaning of “Pay” 46

6.1 Bank Accounts Are Not Money 46

6.2 “Legal tender” 47

6.3 Payment By Non-Legal Tender 48

6.4 Issues with Legal Tender 51

6.5 Payment By Promissory Note 51

6.6 Payment “Of” vs “By Way Of” a Trust Distribution – Fixing Present Entitlement and Bricks 52

1. Acknowledgement and Thanks

I would like to acknowledge and thank my friend and mentor Dr Campbell Rankine for his guidance on the ideas that are presented in this paper. Although I have written this paper, I attribute all of the ideas to Dr Rankine and our many hundreds of hours of discussion and exploration of these topics. To the extent that any material is my own, it is merely a small extension to the intellectual framework that he has set out.

I would also like to thank Isaac Syengo of Cartland Law for his assistance in compiling this paper.

© Adrian Cartland 2024

2. Overview

What is a distribution? For a discretionary trust it is the use of a trustee's power. It can also occur by a default power. The trustee has something and they distribute it to the beneficiary. How do they do that? The usual set of terms are "pay apply or set aside". Each of these has different meanings.

I will go through both “pay” and “apply”:

There is an overlay of tax law upon trust law. They are intertwined. Some of the trust laws that I will examine do not have a clear answer. That is part of what makes it interesting. There is an overlay of tax law upon trust law. They are intertwined. Some of the trust laws that I will examine do not have a clear answer; That is part of what makes it interesting. The more you look at a complex topic the more you see in it. This also means that the view presented in this paper may not be my final view and I reserve the right to update that upon further consideration. This is especially because many issues are the subject of current litigation, in particular, *Bendel and Commissioner of Taxation*.[1]

There are also conflicting judgements, around a somewhat amorphous area of law. One reason for this is that judges decide their particular matter, and do not necessarily fully consider matters that are not before them.

Where we start is in s97 which provides that a trustee is not taxed upon income where there is a beneficiary presently entitled to that income. In order to properly understand s97 and Division 6 we must therefore explore the concept of present entitlement in equity.

2.1 The Basic Case

The issue is that many of the formulations and assumptions come from a simple accounting case, but issues arise when complexities are added into it:

Consider a simple example where Adam holds Greenacre on trust absolutely for Ben Adam farms Greenacre and uses cash accounting. All of the transactions occur in physical cash. Adam as trustee has no debts. At the end of each day Adam diligently updates the books of the trust in regard to every transaction. On 30th June Adam sits in his farmhouse with a pile of money on the kitchen table and knows that that represents the profit for Greenacre for the past 12 months. Ben sits at the kitchen table with Adam and is shown the profit. It seems clear to me that Ben would be able to demand payment of the income in this situation and would be presently entitled to it;

Considering the *Harmer v Federal Commissioner of Taxation*[2] formulation the interest of Ben is vested by reason of being the sole and uncontested beneficiary. Ben has a right to demand possession of the income. Therefore, Ben is vested in both interest and possession of the income. The amount of the income is known by both Adam and Ben and therefore Ben has an immediate right to demand payment of the income.

2.2 Ten Things I Hate

When these variables are changed there can be a difference in position though. These changes are the 10 things that I hate about trust distributions:

[1] [2023] AATA 3074 (28 September 2023) (Deputy F D O’Loughlin Kc P).
[2] [1991] HCA 51; 173 CLR 264.

1. The accounting basis: accruals instead of cash;
2. The passing of the knowledge from trustee to beneficiary about the amount to which the beneficiary is entitled;
3. Whether the trustee has present or potential liabilities;
4. Whether the trustee (as a company) may have Corporations Act remedies against the distribution could unwind it;
5. Whether the trust has carried forward losses or negative net assets;
6. Whether the trust deed requires that income should be proved to exist;
7. How the income of the trust is measured;
8. If the trust deed requires that the income be set aside on a separate trust;
9. If there is some property being distributed that cannot be identified; and
10. If the amount is required to be paid.

© Adrian Cartland 2024

3. Division 6

The High Court in *FCT v Bamford*[3] set out a helpful manner of approaching Division 6, starting with the shifting of taxation of a trust away from the trustee unless no beneficiary was presently entitled:

> The primary provision remains s96. 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."
>
> […]
>
> [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 income the Commissioner was empowered to assess the trustee (s 102).

We then proceed to s97, which is the gateway to the Division. it brings in the definition of net income under s95(1):

- It makes assessable the beneficiary of the trust estate on that net income, provided other circumstances are met; and
- Incorporates the equitable principles of present entitlement and vested in interest and possession.

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):
>
> " 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

[3] [2010] HCA 10.

> 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."

The Court then picked up from *Zeta Force Pty Ltd v Commissioner of Taxation*[4] the meaning of "net income of the trust estate"

> "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 par (a)(i) has the meaning given it by s 95(1) - taxable income as opposed to distributable income. The words 'that share' in par (a)(i) refer back to the word 'share' in the 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."

The uncertainties clarified in *Bamford* are as follows:

- First, it seeks to categorise capital receipts as constituting the 'income of the trust estate';
- Second, it reclassifies expenses against certain categories of income and capital in the determination of what constitutes the 'income of the trust estate';
- Third, the division is not clear about the extent of the power of a trustee to stream tax attributes and the notional tax amounts to beneficiaries of the trust estate; and
- The division does not clearly state when the present entitlements to the share of the income of the trust income are created;

The High Court in *Commissioner of Taxation v Carter*[5] expands on s97 and sets out the timing requirement as well as the lack of necessity for there to be an actual payment of those amounts.

---

4 [1998] FCA ATC 4681; 98 ATC 4681; 39 ATR 277.
5 [2022] HCA 10.

> The phrase "is presently entitled to a share of the income of the trust estate" in s 97(1) is expressed in the present tense. It is directed to the position existing immediately before the end of the income year for the stated purpose of identifying the beneficiaries who are to be assessed with the income of the trust – namely, those beneficiaries of the trust who, as well as having an interest in the income of the trust which is vested both in interest and in possession, have a present legal right to demand and receive payment of the income.
>
> In some cases, the two limbs of "presently entitled" recognised in Bamford will overlap. For present purposes, the relevant criterion in s 97(1) is the present legal right of the beneficiary to demand and receive payment of a share of the distributable income of a trust estate. The criterion for liability looks to the right to receive an amount of distributable income, not the receipt. That position is expressly reinforced in s 95A(1) – enacted in response to the decision of this Court in *Union-Fidelity Trustee Co of Australia Ltd v Federal Commissioner of Taxation*6 – which makes clear that a present entitlement of a beneficiary under s 97(1) does not depend upon receipt of the income. Section 95A(1) was enacted to ensure that a present entitlement retains its character as such even if the income has been "paid to, or applied for the benefit of, the beneficiary". Indeed, there may be a right to demand payment even though the trustee does not have funds available to pay it.

The deemed present entitlement in s95A is worth exploring further

It is not clear as to the reason for the enactment of s95A. In *Harmer* counsel for the Commissioner argued that the provisions were enacted due to the States' Trustee Acts providing for the accumulation during minority of so much of the trust income of infant beneficiaries as is not expended on their maintenance. The infant beneficiary would not be presently entitled and without s95A(2) the trustee would be assessable most likely under 99A. As Hill J pointed out there is no explanation for s95A(2) is given in either the explanatory memorandum or second reading speech on the introduction of the amendments to parliament;

Subsequent cases have discussed the deemed present entitlement. For example in *Re Peter Dwight v Commissioner of Taxation*,[7] the main issue was whether or not a beneficiary was presently entitled to the interest derived from a fund held by a trustee as security for costs for which the plaintiff of the case may become later liable. Hill J:

- again considered 95A(2) and found difficulty in a case where funds were vested in a beneficiary, but subject to a charge in favour of another person;
- stated to avoid difficulty it could be conceded that present entitlement in the ordinary sense is not applicable, but 95A(2) applies to deem present entitlement;
- found that the plaintiff had a vested and indefeasible interest in the security funds and further stated that it may be assumed that the requirement that a beneficiary have a vested and indefeasible interest in the income is different from the requirement that the beneficiary have a present entitlement to the income;
- the difference being:
    - a present fixed right of future enjoyment where the estate is said to be vested in interest; and

[6] [1969] HCA 36; 119 CLR 177; 69 ATC 4084.
[7] [1992] FCA 178.

© Adrian Cartland 2024

    - a present right to present to present enjoyment where the asset is said to be vested in possession;

- concluded saying that notwithstanding that it is subject to a security interest in another the mere existence of a lien or charge over the asset or property does not convert an interest otherwise vested and indefeasible into one that is vested but defeasible;

- from this case, 'indefeasible' refers to a case where the beneficiary's interest may be brought to an end by the exercise of a power, but not by potential for the exercise of a security by a creditor;

- these may be instances of defeasibility, but not exhaustive of the circumstances in which an interest may be defeated;

In *Walsh Bay Developments Pty Ltd v Commissioner of Taxation*[8] the Court stated a defeasible interest is an interest that is defeated by the operation of a subsequent condition. An indefeasible interest is one not subject to any condition whereas a defeasible interest was on which was liable to be divested by a supervening event. The most likely conclusion is that it is difficult to avoid that the failure of a plaintiff to discharge a costs order made in favour of the defendant would be a supervening event. Accordingly in *Dwight*, the Court should have not found (without s95A(2)) a present entitlement in the defendant to income. A security interest would not defeat a present entitlement is a difficult conclusion to accept where the beneficiary has the right to demand income regardless of the security claim.

In *Trustees of Estate Mortgage Fighting Fund Trust v Federal Commissioner of Taxation*:[9]

- Hill J again considered the issue of 95A(2) and stated that because the intervention of the Court would have been necessary before a beneficiary could demand payment of income no present entitlement would arise based on the formulation in *FCT v Whiting;*[10]

- there were no present claims against the trustees, but the terms of the trust deed prevented the beneficiary from claiming an immediate payment of income;

- the trust was established to fund litigation, this provided a defence for the trustees to resist a claim for payment to the beneficiaries, because doing this would deny the trustee the funds necessary to conduct the litigation;

- Hill J found that despite the defences the interests of the beneficiary were vested and indefeasible;

- the right to demand payment was not subject to any condition;

the ongoing issue with 95A(2) lies in the finding of an indefeasible interest, this can be difficult based for the reasons that I will set out later

There is a further important deeming in s101 in the case of discretionary trusts. This only operates where the trustee has exercised their discretion and so does not apply to the default distributions seen in *Commissioner of Taxation v Carter & Ors*.[11]

---

[8] [1995] FCA 428 (27 June 1995); 31 ATR 15.
[9] [2000] FCA 981; 102 FCR 15.
[10] (1943) 68 CLR 199.
[11] [2022] HCA 10.

© Adrian Cartland 2024

However s101 only applies to the amount “paid” or “applied” to the beneficiary.

In *Carter*, the High Court stated as follows:

> The phrase "is presently entitled to a share of the income of the trust” in section 97 is expressed in the present tense. It is directed to the position existing immediately before the end of the income year.
>
> The fact that s 97(1) is directed to identifying the legal right of the beneficiary immediately prior to the end of the year of income is important. In relation to each trust estate, once the beneficiaries with those rights are identified, it permits the balance of s 97(1) to operate and, consistently with the stated purpose of Div 6, provides for those beneficiaries to be assessed on a share of the net income of the trust estate based on their present entitlement to a share of the income of the trust estate. As this Court recognised in Bamford, the beneficiaries may be presently entitled immediately before the end of the income year "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".
>
> Put in different terms, the taxation liability of the beneficiaries is determined by ascertaining the proportion of the distributable income of the trust estate to which each beneficiary is presently entitled at that point in time – just prior to midnight at the end of the year of income – and then applying that proportion to the "net income of the trust estate". That has practical significance. The stepped process in s 97(1) identifies the beneficiaries who are to be assessed at the end of the income year, permits the "net income of the trust estate" to be determined for that income year in the usual way and then enables the quantum of tax payable by the beneficiary to be calculated and subsequently assessed[17].
>
> The other relevant criteria in s 97(1) – that a beneficiary is not under any legal disability and is a resident – reinforce the conclusion that a beneficiary's present entitlement is determined immediately before the end of the income year. Those criteria, ascertained during and at the end of the income year, are conditions or circumstances which cannot be altered by facts and matters subsequent to the relevant income year. Moreover, ss 98, 99 and 99A also operate by reference to facts, events and legal relationships in existence at the end of the income year[18], which cannot be altered after the end of the income year.

4. Trust Distributions in Equity

4.1 Presently Entitled – Whiting

The starting point is the formulation of present entitlement found in *Whiting*:

> The words "presently entitled to a share of the income" refer to a right to income "presently" existing—i.e., a right of such a kind that a beneficiary may demand payment of the income from the trustee, or that, within the meaning of s. 19 of the Act, the trustee may properly reinvest, accumulate, capitalize, carry to any reserve, sinking fund or insurance fund however designated or otherwise deal with it as he directs or on his behalf.
>
> A beneficiary who has a vested right to income (as in this case) but who may never receive any payment by reason of such right, is entitled to income, but cannot be said to be "presently entitled" as distinct from merely "entitled." Indeed, it is difficult to see how he can be entitled at all to income which must be applied in satisfaction of some prior claim.
>
> Thus, in order to ascertain whether such a present right exists, it is necessary to look at the state of the administration of the trust estate.
>
> Numerous authorities, many of which are collected in the recent decision of this Court in *Robertson v. Deputy Federal Commissioner of Land Tax*,[12] have established that until an estate has been fully administered by payment or provision for the payment of funeral and testamentary expenses, death duties, debts, annuities, and legacies and the amount of the residue thereby ascertained, the income of the residuary estate is the income of the executors and not of the residuary beneficiaries.

I shall now examine a number of issues with the *Whiting* formulation of present entitlement.

4.2 Preliminary Issues with Present Entitlement

What we can determine from this is formulation is that the beneficiary must have a vested right to income. As we will shortly turn to, this is somewhat problematic in of itself, as “income” is not property. A better way of putting this formulation is that there is a present right to demand an amount “equal to” the amount determined to be the income of trust.[13]

It is often considered that *Harmer* restated the *Whiting* formation for present entitlement more precisely. However, that is not necessarily the case.[14]

The *Harmer* formulation is as follows:

> The parties are agreed that the cases […] establish that a beneficiary is "presently entitled" to a share of the income of a trust estate if, but only if:
>
> (a) the beneficiary has an interest in the income which is both vested in interest and vested in possession; and

[12] [1941] HCA 40 (08 December 1941); 65 CLR 338.
[13] Rankine PhD pg 29
[14] Rankine PhD pge 37

(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.

4.2.1 Reconciliation of *Whiting* and *Harmer* Formulations

This is explained by Dr Campbell Rankine[15]

> "[Harmer] is not at all consistent with the High Court decision in *Whiting* since the reasoning in *Whiting* acknowledges that present entitlement would be satisfied if the interest was vested in interest and possession, and if the discussion above on the first of the difficulties is correct, then this was surely the position in *Harmer* since the rights were not created on the publication of the court's decision in the case. That the person ultimately found to be presently entitled to the income had claims that were disputed by other claimants could not, of itself, defeat the claim properly made by the successful claimant. To illustrate: a presently entitled interest could be denied to a beneficiary who clearly has it, if another person makes an allegation that he or she should have it instead. Under the High Court logic in *Harmer* the mere allegation would be enough to deny a present entitlement in the rightful owner. It is difficult to see that this proposition is correct.
>
> The explanation for the differences between Harmer and Whiting may lie in the reasoning of Hill J in *Dwight*. As explained by Hill J, the present entitlement will not arise under s 97 even where there is an indefeasible vesting in interest and possession if the interests of the beneficiary are subject to a condition. In the comments appearing in the passage in Whiting […], the reference to a beneficiary who may never receive the payment by reason of the right must be taken as a reference to the conclusion where the trust income must be applied in satisfaction of some prior claim, is a description of the very condition which Hill J refers to in *Dwight*.
>
> It is on this basis that *Whiting* and *Harmer* can be reconciled, for an indefeasible vesting of the interest and in the vesting of an interest in possession that is subject to a condition could lead to the explanation of the second limb of Harmer as one that applies only when the condition is satisfied. In this, *Dwight* contains the key to unlocking the apparent difference in Formulation of *Whiting* and *Harmer*." [Footnotes omitted]

4.3 Accounting Issues

The basis for accounting immediately creates difficulties in ascertaining the amount to which the beneficiary will be entitled. Where there is an amount incurred but it is not immediately known or will be calculated later then there will be no equitable present entitlement until that is calculated. If there is depreciation, and under the accounting rules for the trust the trustee has that depreciation reduce the net income of the trust then until that depreciation is calculated then the net income of the trust cannot be known.

Another example is long service leave. *D & R Commercial Pty Ltd v Flood*[16] dealt with long service leave and annual leave. If a person could forfeit their leave then there would be no deduction until it is no longer contingent as it is not "incurred". Similarly, in *Nilsen Development laboratories Pty Ltd v*

[15] The Disutility of Assessing Trust Beneficiaries, Dr Campbell Rankine PhD Thesis, 2009 at 38
[16] [2002] NSWIRComm 88; 113 IR 344.

Federal Commissioner of Taxation,[17] the long service leave was not "incurred" until the employees either took the leave entitlements or ceased employment.

In Coles Meyer this was explained

> Flood therefore stands as authority for the proposition that a liability must presently be existing in order to be ``incurred'' within the meaning of s. 51(1).
>
> So much was accepted in Nilsen Development Laboratories Pty. Ltd. & Ors v. FC of T , [33] 81 ATC 4031; (1980-1981) 144 C.L.R. 616. which held that the amounts provided in the taxpayer's accounts to meet employees' long service leave entitlements were not outgoings ``incurred'' within the meaning of s. 51(1) because there was no liability to make payment until the employees either took the leave entitlements or ceased employment. The decisions in Flood and Nilsen proceed on the footing that the Court, in determining entitlement to a deduction under s. 51(1), accepted the legal or jurisprudential analysis rather than the commercial view as the correct one. [34] ibid., at ATC p. 4039; CLR p. 631, citing Deane J. in the Federal Court FC of T v Nilsen Development Laboratories Pty Ltd & Ors ; Nilsen Development Laboratories Pty Ltd & Ors v FC of T 79 ATC 4520 , at p. 4527; (1979) 27 A.L.R. 239 , at p. 249 . In other words, the Court concluded that the liability was the ordinary liability to pay wages to an employee in respect of a period of employment in preference to the commercial view that the liability was a progressive one, being part of the cost of labour employed from day to day. Subsequently, in Arthur Murray (NSW) Pty. Ltd. v. FC of T; FC of T v Arthur Murray (NSW) Pty Ltd , Barwick C.J., Kitto and Taylor JJ. said of Flood : [35] […] .
>
> ``The Court there held that, while commercial and accountancy practice may assist in ascertaining the true nature and incidence of an item as a step towards determining whether the item answers the test laid down in the Act for allowable deductions, it cannot be substituted for the test.''

If the trust was accounting under ordinary accounting principles, it would account for the long service leave as a deduction. However that contingency is not an allowable tax deduction.

There is a separate matter as to how distributions occur when there is a difference between accounting, trust and tax law income.

Here were are concerned with whether this creates a present entitlement to that income under trust law.

Where an amount is not income, the trustee cannot make the beneficiary presently entitled to it. Another possibility is if the amount is some property, in which case the trustee may distribute. But for the trustee to attempt to distribute an amount that it does not recognise would be an excessive execution of its power.

Also, in this example of long service leave, it is impossible to know whether the employee will take leave or cease their employment in that financial year until after the end of the financial year. The employee could resign at 11:59pm on 30th June, and therefore make the amount of long service leave "incurred" in that income year. Until that opportunity has passed the amount of income is not ascertainable.

---

[17] [1981] HCA 6 (10 February 1981); 144 CLR 616; 55 ALJR 161; 81 ATC 4031; 11 ATR 505.

To the extent of that uncertainty there cannot be present entitlement.

In *Australian Oil Exploration Ltd v Lachberg*,[18] the High Court held that there cannot be a distribution of capital profits unless there is an accretion to paid up capital. However that was a decision of company law and there is no such restriction in trust law. Although of course it would be a breach of trust to make a distribution that is greater than the trust's net assets. Because that would be a breach of trust then it would be defeasible and that possibility of defeasance would prevent the present entitlement.

If there are accumulated losses but there are some assets then there is the possibility of making distributions from specific accounts. So if there was a credit account for pigs, and debit of the sheep account, could make a distribution out of the pigs account.

This general rule, as well as the possibility of sidestepping it through the trust instrument, was set out in *The Commissioner of Taxation of the Commonwealth of Australia v Cajkusic & Ors:*[19]

> The rule in Upton v Browne (1884) 26 Ch D 588 […] was applicable. That is, losses in one year must, in the absence of any contrary direction in the trust instrument, be made up out of profits of subsequent years and not out of capital so that there can be no profits properly distributable in cash until all past losses are paid. In the present case, therefore, the distributable net income of the Trust for the year ended 30 June 1998 was negative and none of the beneficiaries was presently entitled to anything. The consequence is, in our view, that the liability for tax on the s 95 'net income' falls wholly on Intex under s 99A of the 1936 Act.

If the trust has negative net assets it will be difficult to create present entitlement at all past the trustee's right of indemnity, or create an entitlement to one or more assets of the trust, at least in equity.

4.4 Definition of Income

4.4.1 Re Spanish Prospecting Co Ltd

The concept of income comprises no more than the difference between the increase in net assets between one period and the next:[20] Hence, a beneficiary could never, strictly speaking, be entitled to income or profits. Instead, it is treated as a compendious way of saying that the beneficiaries are entitled to property of the trust equal in an amount or magnitude to the trust property changes. In this, the expression is taken to mean that the beneficiary is entitled to assets and property (indeed, if there be any) of the trust equal in amount to the income derived during the period of which they are said to be ***presently entitled***;

Even this description does not suffice for there may be no trust property at all. Instead, the income may be manifested by a reduction in liabilities where there were no assets at the commencement of the accounting period;

Income is no more than the measurement of a change in net assets over an accounting period. See for example *Re Spanish Prospecting Company Ltd,* [21] where Fletcher Moulton LJ stated:

---

[18] [1958] 101 CLR 119.
[19] [2007] HCATrans 157.
[20] See *FCT v Slater Holdings (No. 2) Pty Ltd*. [1984] 156 CLR 447; 56 ALR 306.
[21] [1911] 1 Ch 92 at 98.

© Adrian Cartland 2024

"'profits' implies a comparison between the states of business at two specific dates usually separated by an interval of a year. The fundamental meaning is the amount of gain made by the business during the year. This can only be ascertained by comparison of the assets of the business at the two dates."

4.4.2 Income Can Include Accounting Revaluations – *Clark v Inglis*

In *Clark v Inglis*[22] it was considered whether movements in the value of investments could be lawfully treated as income.

> The cross-defendants asserted that unrealised gain on the investments could not be characterised as income.
>
> While I accept that authorities from the field of income tax law are not irrelevant on this question, they are also not decisive; moreover, the proviso contained in clause 6(f), set out above, demonstrates that the Trustee's treatment of income and capital in the Trust accounts did not have to accord with its treatment for income tax purposes.
>
> I do not accept that it cannot be said that a profit has been made (or 'incurred', for the purposes of clause 10 of the Trust Deed), just because it has not been realised. Comparison of the value of the assets of an entity at the end of the relevant period with their value at the beginning of that period is one well-recognised means of ascertaining profit [*Re Spanish Prospecting Co Limited* [1911] 1 Ch 92, 98; *QBE Insurance Group v ASIC* (1992) 38 FCR 270, 284-5 [53]
>
> What is income for the purposes of Div 6 is a question principally for the trust deed: Commissioner *of Taxation v Bamford* [2010] HCA 10; 246 ALR 436.
>
> Whilst it can be accepted that the notion of profit is different from income, I cannot agree with the submission that the trust deed and the law do not permit unrealised increases in value of investments to be treated as income.

4.5 Conventional View of Presently Entitled

To understand the effect of a resolution to make a beneficiary presently entitled to a sum, with a clear separation from the gloss placed by Division 6, it is important to examine *Fischer* in depth.

The case is important for a number of reasons:

- First, it draws together a number of cases that consider how income is applied to the benefit of beneficiaries
- Second, it is High Court authority on the matter, and so is binding (although precisely what it is authority for and what is the majority is worth examining)
- Third, it brings together the issues in trust law and accounting that have been ever present and ever problematic with earlier iterations of trust distributions

The background to the matter is the decision in *Fischer v Nemeske Pty Ltd*.[23] In this case, the trustee of the discretionary trust the Nemes Family Trust was the owner of some valuable shares in Aladdin

[22] [2010] NSWCA 144; 5 ASTLR 570.
[23] [2016] HCA 11; 257 CLR 615.

Pty Ltd. The value of the shares was recorded in an “Asset Revaluation Reserve” by journal entry and this amount was resolved to be distributed to Mr and Mrs Nemes. Upon the death of Mr and Mrs Nemes the control of Nemeske passed to the Fischers, and their residuary estate to other beneficiaries. The Fischers sought to deny the effectiveness of the resolution that denuded a large value from the Nemes Family Trust

4.5.1 *Fischer v Nemeske* –French CJ and Bell J

There seemed to be general agreement between the parties and the various Judges that the resolutions were problematic. Indeed, there was an agreement to read into the resolution several words:

> “The parties agreed at trial that […] The resolution of 23 September 1994 should be construed as written in the Minutes with the last sentence to read[15]:
>
> "*An amount equal to the entire reserve* ... to be distributed to [Mr and Mrs Nemes] as joint tenants."

All that can be distributed is “*an amount equal to*” the reserve, because the reserve itself is a mere accounting concept; it is not property that can be distributed.

So too does this apply to distributions of income: all that can ever be distributed is “*an amount equal to*” the income.

Many trust deeds have a clause that requires that where income is distributed that income must be “set aside on a separate trust” until paid. This is discussed more particularly in *Tindon v Adams,*[24] *Bendel* and *Chianti* below. That income cannot ever be set aside. All of the judgements, and the parties to *Fischer v Nemeske* implicitly agree on that. We will see that there is disagreement as to whether “*an amount equal to*” income should be set aside and how that must be effected.

An important factual matter is that there was no debt in the Nemes Family Trust. Therefore, the issues of the trustee’s right of indemnity did not need to be considered.

An attractive starting point is to consider the plurality of French CJ and Bell J. Together with Gageler J they upheld the effectiveness of the corpus distribution.

It was argued that the distribution created a vested and indefeasible interest, and that it followed that there was a debt enforceable at law.

While often called a beneficiary of a trust, an object is a mere ‘potential’ beneficiary of the trust. The beneficiaries claimed that the distribution vested an interest in the trust property in them. This amount could then be called upon, and once so called would become a debt.

> In the result Mr and Mrs Nemes became creditors of the Trust rather than discretionary objects. As creditors they had the ability, at any time, to call on the Trustee to repay the debt; a result which conferred a "benefit" on them

In the absence of calling upon the trustee to pay the vested interest the obligation of the trustee would be to continue to hold the property the subject of the trust.

---

[24] [2006] VCS 172 (19 May 2006) (Hargrave J).

The plurality held that not only was there an unconditional vested interest, they held that that gave rise to an action for money had and received: a debt at law. That is, both an equitable interest and a legal interest.

They held this on the basis that where a trustee appropriates a sum for the benefit of a beneficiary, the trustee holds it as receiver.

> 16. It was submitted for the executors that the combination of the Trustee's resolution of 23 September 1994 and the entry in the accounts of the Trust for the period ending 30 September 1994 created an unconditional vested equitable interest and a debt enforceable at law owing by the Trustee to Mr and Mrs Nemes. It is a long established proposition that no action at common law for money had and received lies against a trustee in respect of its equitable obligations even if those obligations extend to the payment of money. The same authorities which established that proposition also established the proposition that a trustee can end a trust with respect to capital or income in whole or in part and create a creditor/debtor relationship with a beneficiary. In Edwards v Lowndes,25 Lord Campbell CJ said:
>
> "If ... the trustee, by appropriating a sum as payable to the cestui que trust, or otherwise, admits that he holds it to be paid to the cestui que trust, and for his use, the character of the relation between the parties is changed; and the trustee does not hold it as a trustee properly so called, but as a receiver for the plaintiff's use".
>
> The general proposition was set out in the third edition of Bullen and Leake's Precedents of Pleadings:26
>
> "A trustee who has received trust-money is accountable for it to the cestui que trust in the Court of Chancery, but in the courts of law he is treated for most purposes as the absolute owner, and no action can in general be maintained by the cestui que trust against him to recover trust money. ... If, however, he admits to the cestui que trust that he holds such money as the money of the cestui que trust to be accounted for to the latter, he is debarred from setting up his character of trustee, and becomes liable at law to the cestui que trust for money received to his use."

It is a rather strange thing to rely upon *Edwards v Lowndes* because although the proposition quoted is correct, the decision in the case was strictly that "*in the absence of a specific appropriation of a part of the fund to the plaintiff, no action at law lay*". That is, that in order to maintain an action at law, a specific part of the fund must be appropriated. The plurality however did not find that a specific appropriation had been made.

They do raise an important point that a debt is created when the admission is made to the beneficiary that an amount is held for them. It was considered that this admission was made by the book entries made in consequence of the resolution.

There was a consideration that

> It is true that North P in Ward made a distinction between an advance of capital and an advance of income. In so doing he accepted a submission, not essential to his reasoning, that it was of the very essence of the exercise of the power of advancement with respect to a capital sum that

[25] (1852) 1 E1 & B181; 118 ER 357.
[26] The Hon Sir William Blair, Lord Daniel Brennan QC, The Rt. Hon. Sir Robin Jacob and The Hon. Sir Brian Langstaff, *Bullen & Leake & Jacob's Precendents of Pleadings* (Sweet & Maxwell, 2022)

> the capital sum so advanced ceased to form part of the trust property. In that respect he relied upon Pilkington, which involved a resettlement of part of the trust fund.

The passage in question from Ward is the following.

> Ward North P
>
> Mr. Orr, I think, quite rightly submitted that this case, dealing as it does with a different section, was only of limited relevancy but he relied on it as authority for his submission that in the case of a capital advancement at all events, the fund so advanced must be taken right out of the trust estate and devoted to the benefit of some person who holds it clear of the limiting trusts of the settlement under which the power of advancement is exercised. I have no doubt that that is true in the case of an advance of a capital sum for it is of the very essence of the exercise of the power that the capital sum so advanced ceases to form part of the trust property but I do not regard Pilkington's case as any authority for the view that in the case of income which is the fruit of the trust property, the same considerations apply

This is quite an interesting passage as it sets up a difference in treatment between distributions of income and capital, in that a capital distribution (under the view of North P) is made by identifying and separating the fund advanced, but income can be advanced in another manner.

The plurality in *Fischer* continued:

> However, Pilkington and therefore Ward should not be taken as limiting the means by which an advance and application of capital can be effected pursuant to a specific provision such as cl 4(b). More particularly, they should not be taken as excluding from the ambit of the power of advancement the creation of a creditor/debtor relationship between trustee and beneficiary by the creation of a vested, absolute equitable interest in capital realisable by an action for money had and received or otherwise. Indeed, so much was recognised by the dissentient in Ward, Turner J, who held that an application could be achieved by the creation of a creditor/debtor relationship between the trustee and the specified beneficiaries

If the creation of a creditor/debtor relationship relies upon the appropriation of a sum, as there was in *Edwards v Knowles* then this accords both with *Pilkington* and *Ward*. However, it does mean that for a capital distribution there must be an asset identified and separated in order for there to be a creditor/debtor relationship created. It seems that a logical step has simply been skipped over here.

Further, Turner J in *Ward* considers the proposition that an amount can be *applied* by the creation of a debtor-creditor relationship. He does not strictly accept that it could be, although perhaps does so by implication. He considers that in the absence of contract, there must be a deed creating the debt – as it is otherwise unsupported by consideration.

> was a debtor-creditor relationship created as between trustee and beneficiaries? Such a relationship can be created in law by contract, by quasi-contract, by judgment, by Statute or other legislative process, or as the result of a trust.
>
> Neither can it be said that there is perceptible in this case any other of the prerequisite origins of debt, which in the absence of judgment, contract, quasi-contract or some legislative process cannot arise by mere acknowledgment unless by deed.

The manner that Turner J considers that a debtor-creditor relationship might be created it quite at odds with the propositions of the plurality.

The plurality continues and endorses the reasoning in *Chainti*:

© Adrian Cartland 2024

> *In Chianti Pty Ltd v Leume Pty Ltd*, Buss JA, with whom Martin CJ and Pullin JA agreed, referred to *Vestey* and *Ward* and concluded that distribution resolutions coupled with account entries constituted an admission by a trustee of an obligation to pay the money distributed on demand.

The distribution in *Chianti* was an income distribution. The reasoning so far seems to be setting out a difference between capital and income distributions. However, there is then a jump back to merging the treatment of income and capital:

> Barrett JA, in the present case, referred to *Vestey*, *Ward* and *Chianti* as authority for the proposition that a resolution deliberately arrived at and recorded can of itself be sufficient to effect an immediate vesting of a specific part of the trust income. That general proposition may be accepted as also applicable to capital.

If a distribution of income and capital have the same requirements, and it is the resolution coupled with the recording of that resolution in the accounts that vests an interest in a specific part of the trust fund, then present entitlement can only occur once the resolution to distribute an amount has been recorded in the books of account of the trust. This can only occur once the accounts have been completed, which means that it can only be done for a year after the 30th of June.

An amount could be distributed prior to the end of financial year, but if the trustee distributes a sum greater than is available then that would be an excessive execution of the trustees power and would be subject to defeasance as a breach of trust.

There is then a strange mischaracterisation of *Vestey, Ward* and *Chianti* as “resettlement” cases. This seems to be a confusion with *Pilkington*, which was a resettlement case. Instead, these cases were about the application of income.

> It may be accepted that each of *Vestey*, *Ward* and *Chianti* involved resettlements of actual property held on trust and that, as the Fischers contended, none was authority for the proposition that a power to "apply" trust capital could be exercised without altering the beneficial ownership of the property the subject of the advancement. As already observed, those cases are not authorities for the proposition that the mechanisms by which an advance and application can be achieved are limited to an immediate resettlement of trust property.

None of those cases were authority for the proposition that a power to "apply" trust capital could be exercised without altering the beneficial ownership of the property the subject of the advancement, because none of them were strictly about trust capital. Instead, they were income cases. This is somewhat of a confusing characterisation, and seems to be a conflation of income and capital. Perhaps the way of reconciling these comments is that income and capital are to be treated the same.

This begs the question as to what precisely is a resettlement of income?

Their Honours conclude that a debt to be satisfied out of the property of the trust was how the application and advance was made:

> On the face of it the creation of a debt to be satisfied out of the property of the Trust was a means of effecting an advance and application of the capital of the Trust. The provision of a covenant to pay the debt supported the advance and application thus made.
>
> …
>
> The resolution and the entry in the accounts by creating a creditor/debtor relationship constituted an advance and application

4.5.1 Fischer v Nemeske - Gageler

The other Judgement in the majority is Gageler J. But his reasoning didn't necessarily accord with French CJ and Bell J.

To start with, His Honour is a succinct description of the nature of "apply" and how it relates to both capital and income and vests an interest when an amount is applied.

> The power, relevantly, is to "apply" any part or parts of the whole of the capital or income of the Trust Funds so as to bring forward the benefit of part or parts of the Trust Funds in respect of which any beneficial interest would otherwise remain future and contingent.

He then analyses *Vestey* and *Ward*, and avoids mischaracterising them as "resettlement" cases.

> Once it is accepted – as it was in *In re Baron Vestey's Settlement; Lloyds Bank Ltd v O'Meara* and in *Commissioner of Inland Revenue v Ward*– that a trustee can "apply" trust property to the advancement of a specified beneficiary by resolving to allocate trust property unconditionally and irrevocably to the benefit of that beneficiary, it is difficult to see any reason in principle why such an unconditional and irrevocable allocation of trust property must take the form of an alteration of the beneficial ownership of one or more specific trust assets. The allocations in each of those cases were of specified proportions of a single monetary amount which stood to the credit of a bank account which the trustee held as trust property at the time of the resolution. The allocations were held to be sufficient to result in the specified beneficiaries to whom the allocations were made each obtaining an immediate absolute beneficial entitlement to the sums so allocated. It appears that the sums in question in the first case were soon afterwards paid into separate bank accounts, but that fact does not appear to have been treated as relevant to the holding. The sums in question in the second case were not paid into separate accounts for many years.
>
> […]
>
> In neither of those cases was there any suggestion that the trustee's exercise of the power to apply trust property involved a resettlement of trust property so as to result in the creation of a new trust.

Instead of resettling sums, His Honour considers that *Vestey* and *Ward* resolved to allocate a portion of trust property. And they did so through a resolution in relation to income.

He specifically considers that it is not necessary that the sums do not need to be separated from the rest of the trust fund.

But how much money was there in those bank accounts? Given that there are trading trusts, there is not a final amount of property known until termination of the trust.

North P in *Ward* consider that the sums in the bank accounts in *Vestey* may not be representative of the income available, but then reasons that the facts in *Vestey* are not before the Court in *Ward* and so not suitable for re-litigation.

> Mr. Orr's next submission was that as the declaration of the respondent was made two days before the date which had been adopted by the respondent over a period of years for the preparation of the yearly accounts of the trust, the trustee was in no position to determine what

> income was available for distribution or accumulation until 31 March 1963, for losses might have been sustained in the succeeding two days which might have resulted in no income being available for that year. It is quite true that trustees must exercise their discretion as and when the income becomes available for they have no power to bind themselves for the future: see Snell's *Principles of Equity,* 26th Ed., p. 149, citing
>
> *Re Vestey's Settlement* ; *Lloyds Bank Ltd.* v. *O'Meara* (1950) 2 All E.R. 891 , at p. 895 , which contains a passage in the judgment which was not reported in the authorised reports ((1951) Ch. 209). There is, in my opinion, no substance in this submission either, for surely it was a matter for the trustee to determine what income was presently available and there is nothing before this Court which would justify the conclusion that the income purported to be allocated was not presently available.

This quite properly raises the accounting problem of not being able to know the funds available for distribution until the end of the financial year, but side-steps the issue.

But Turner J in *Ward* places a different view on *Vestey* – that the distribution was not in relation to an incalculable income, but instead was a distribution of the cash that the trustees in *Vestey* held in bank accounts

> The essential differences between that case and the one before us appear to me to be, first, that the income with which the trustees purported to deal by resolution in *Vestey's case* was in the hands of the trustees in the form of cash, and that it was *this cash* which was in terms dealt with by the resolutions which were held to amount to ``applications''. If reference is made to the report in the *All England Reports,* in which the facts are set out in rather more detail than in the official Reports, it will be seen at p. 894 that at the meeting of 2 February 1949 what was dealt with was ``the income which had *come to the hands of the trustees for the half year* '' and that there was ``a total sum of £ 63,375 *in hand* '', of which the trustees decided to allocate £ 47,000 for *immediate distribution.* This fact seems to me completely to take *Vestey's case* out of the train of reasoning that I have adopted in this for in that case there was a sum in money in hand part of which was designated as the subject of the trust effected by the resolution.

Turner J get past this issue of a distribution of income by pointing out that *Vestey* distributed the asset that was the cash that had come into the hands of the trustees. That was a knowable and definable amount.

But it does not appear that Gageler J was referring to the reconciliation that Turner J applied.

Gageler J also does not say that there *was* a bare trust created by the resolutions of Nemeske Pty Ltd, but instead draws an analogy. That is, because there can be a debt where there is a bare trust means that it is not inconsistent with a trust to have a debt arise. But His Honour does point to particular assets, and not an amorphous measurement of income.

> That the <u>common law cause of action can arise</u> where the trustee holds the <u>relevant assets</u> on a <u>bare trust</u> is alone sufficient to demonstrate that the coming into existence of the common law cause of action is <u>not inconsistent with the continuing existence of a trust</u> under which the trustee remains subject to fiduciary and other duties of a trustee for so long as the trustee's absolute equitable obligation to pay the admitted sum of money to the admitted beneficiary remains unperformed. Obligations of a trustee which exist by virtue only of that office, having been described as applicable to a bare trustee, include the obligation "to get the trust property in, protect it, and vindicate the rights attaching to it". There can be no reason in principle why the

> availability of the common law action should be excluded in circumstances where some or all of those obligations are spelt out in the terms of settlement.

In my view Gageler J holds that it is necessary for an application to be in relation to some specifically identifiable assets. This is more in line with Turner J in *Ward* and the judgements of Kiefel J and Gorden J. What his view adds as a unique gloss in *Fischer* is that the specific assets can be the *totality* of the trust fund, and that there is a calculable vested interest in those assets. In my view, this seems to be quite reconcilable to *White v Shortall* which resolved the identification of trust assets for fungibles by giving a proportionate interest in the undivided whole.

> On and from the making of the resolution, the Trustee continued to hold such trust assets as might from time to time comprise the Trust Funds subject to an immediate unconditional obligation on the part of the Trustee to account to Mr and Mrs Nemes

4.5.1 Fischer v Nemeske – Kiefel

Kiefel J considered that for the capital to be applied, and the corpus distribution to be effective, there needed to be some identified property that was set aside.

She distinguishes *Vestey* on the basis that the property the subject of the distribution was identified, namely an amount of cash

> It will be observed that in *Vestey's Settlement* the power being exercised was identified, as was the property the subject of its exercise.

In relation to *Ward* Her Honour considered that the allocations made trusts of separate property

> North P went on to say that it "is sufficient if it is allocated to them in terms which makes the parts of the income so allocated the separate property of each infant". In this case, it is not possible to say that it was intended that Mr and Mrs Nemes were to become absolutely entitled to any property of the Trust.

But it is unclear how *Ward* and the facts in *Fischer* are truly distinguished, given that income is not property, and *Ward* was not about the amounts of cash in the bank account but was instead about the income.

Her Honour sets out her position that there must be a separate trust with identifiable assets in order for there to be an application and that the absence of a separate trust means that there is not the basis for giving rise to a debt.

> No new trust
>
> When the trustee in Ward made the declaration and recorded the application of the funds in the accounts of the trust, the monies were effectively taken from the existing trust and the trustee thereafter held them on a new trust for the infant beneficiaries. McCarthy J in Ward, who agreed with North P, made an observation to this effect, and noted that this was hardly an unusual occurrence in the administration of trusts.

> The position which obtained in Vestey's Settlement after the exercise of the power of advancement may be viewed in the same way. When the trustees retained the monies, the monies were impressed with a new trust in favour of the infant beneficiaries. The point to be made is that the monies were no longer part of the original trust to be dealt with according to its terms.
>
> Such a circumstance may be contrasted with that which prevailed in this case. There is no suggestion that the Trustee held the sum of $3,904,300 on trust for Mr and Mrs Nemes. It was common ground that there was no resettlement following the Resolution.

In my view this is an incorrect characterisation of *Vestey* and *Ward*, although the I respectfully agree with Her Honour's overall position that there must be a separate trust and that resolution by Nemeske Pty Ltd did not properly create a new trust.

In Her Honours view the resolution was ineffective, and therefore neither created an equitable interest, nor gave rise to a debt.

> The most that can be said about the Resolution is that it sought to create the appearance of a distribution of something out of the Trust, but that something was not property. The Trustee cannot be taken by the Resolution to have intended to set aside, allocate or otherwise "apply" Trust property. Rather, it was intended at all times that the whole of the property of the Trust continue to be owned by it
>
> […]
>
> the admission by the Trustee that the monies were due might provide a basis for an action for money had and received, but only if the Trustee had otherwise completed what was required under the Trust.
>
> Neither *Pardoe v Price* nor *Roxborough v Rothmans* suggest that an admission of this kind has the effect of creating a debt which did not otherwise exist. A trustee would be entitled to defend the action for money had and received. Whilst the trustee's admission would be evidence against it, the trustee could rebut it by showing that there were in fact no monies owed.

4.5.2 Fischer v Nemeske – Gordon J

The dissent of Gordon J considers that the asset revaluation reserve is a mere accounting entry and is not in of itself property

> The 1994 Resolution purported to deal with "the asset revaluation reserve" and to distribute "the entire reserve if any". But the asset revaluation reserve was not "part of" "the capital or income of the Trust Funds"
>
> The "asset revaluation reserve" was an accounting entry which recorded, in the accounts of the Trust, an unrealised accretion in the value of the Shares at a particular point in time.

Her Honour considered that an unrealised gain is capable of being income, but then distinguished *Clark v Inglis*

> The Court of Appeal, in reliance on *Clark v Inglis*, stated that "it must be accepted that an unrealized gain on revaluation is capable of being 'income' as referred to in clause 4(b)". That statement should not be accepted. As counsel for the Executors correctly submitted, *Clark v Inglis* was no more than an example where an advance was made by a trustee under the terms

> of a particular deed and which was effected by (and capable of being effected by) a loan back. The discretionary trust there was distinguishable from the Trust here in crucial respects.
>
> First, the trustee of the discretionary trust was given a binding discretion to determine whether any property or moneys held by it constituted capital or income.
>
> Second, there was no direction which required income and profits to be paid, transferred or handed over to any beneficiary.
>
> Third, the terms of the trust deed were in other respects significantly different. This appeal is about the terms of this Deed and the 1994 Resolution. *Clark v Inglis* may be put to one side.

I do not find these reasons for distinguishing particularly compelling.

First, the ability of the trustee in *Clark v Inglis* to determine what constitutes income was certainly present, but that aspect of the trust deed was simply not considered in *Fischer*. It is unclear what powers may or may not have been present for the trustee.

Second, there was no direction requiring income or profits to be paid in either *Fischer* or *Clark v Inglis*. Instead, *Fischer* is concerned with “apply”, and not “pay”.

Third, the trust differences are not readily apparent to me. Of course perhaps upon greater explanation the differences might be more compelling.

Notwithstanding this, Her Honour’s reasoning on how the power of advancement or application in the Nemes Family Trust might be exercises is insightful

> The power of advancement might be exercised by moving the property to a new trust (a resettlement of part of the trust for the benefit of one or more named objects) or by simply transferring the property directly to the beneficiary without the process of cash advancement and sale. But whatever mechanism is adopted, the power operates by altering the proprietary interests in the property advanced so that the property is no longer property of the trust. It involves more than a notional "earmarking" of property for specific beneficiaries.

Given that there was no resettlement of any part of the trust fund, there was no amount applied, nor was there an amount paid:

> What then was advanced (ie removed) from the corpus of the Trust Funds so that it could be paid or applied? The answer is nothing. As noted earlier, the assets of the Trust (the Shares) remained unaffected by the 1994 Resolution. The Shares continued to be held on the terms of the original settlement under the Deed. The Trustee, exercising the power of advancement, did not purport to confer on Mr and Mrs Nemes any interest in any of the Trust Funds.
>
> What is necessary is that the resolution effects an immediate vesting of absolute title to some property held on trust in a beneficiary. The 1994 Resolution did not do that. And simply crediting amounts to a beneficiary in the Trust's accounts was not sufficient to effect an immediate vesting of a specific part of the capital or income of the Trust Funds. The power to advance in cl 4(b) was not exercised because no part of the Trust Funds was separated from the corpus of the Trust to be paid or applied.
>
> …

> The power to apply was not exercised because there was no change in the beneficial ownership of any asset of the Trust. The asset revaluation reserve, or the accretion in value of the Shares, was never an asset of the Trust.

Her Honour then picks upon an important trust law requirement of certainty of subject matter – the need to identify the trust property that is resettled to effect the distribution. If there is an entitlement to an amount of shares equal to the monetary sum distributed then because of the potential fluctuation of the value of the shares the amount

> Even if the Trustee had purported to effect the distribution by a resettlement – settling a new trust for Mr and Mrs Nemes absolutely for $3,904,300 worth of the Shares – that trust would fail for want of certainty of subject matter. The value of the Shares necessarily fluctuated. The money value alone would be an insufficiently certain criterion to identify what specific portion of the Shares was held on the new trust.
>
> …
>
> It is then necessary to address the propositions that "income may be 'applied' by a process of crediting" it to a beneficiary and that a resolution to "apply" trust income by crediting it effects "an immediate vesting of a specific part of the trust income" in the beneficiary. Those propositions do not assist in the resolution of this appeal.
>
> First, as seen earlier, <u>there was no income the subject of the 1994 Resolution</u> and no distribution or advancement of income. Second, the cases cited by the Court of Appeal to support those propositions are not authority for them.

That Gordon J found that there was no income of the trust because the resolution failed to create income due to its defective execution leaves open the possibility that had there been income then there would have been an effective advancement of that income and a creation of an interest in the trust property of an amount equal to that income distribution. Such a position would be consistent with the reasoning of Gageler J, and therefore the difference in their positions is merely whether the resolution of Nemeske Pty Ltd was effective, and that they would otherwise treat a valid (or invalid) distribution of income or capital in the same manner and with the same effect.

Her Honour also presents what is in my view a more favoured view of *Vestey*, and a view which is more in line with the view of *Vestey* put forward by Turner J in *Ward*

> *In re Baron Vestey's Settlement; Lloyds Bank Ltd v O'Meara* is authority for the proposition that a trustee can "apply" the income or capital of a discretionary trust by resolving to vest the absolute beneficial ownership of property held on trust in one or more of the discretionary objects of the trust. Vestey is not authority for the more general proposition that a trustee can "apply" income (or capital) simply by crediting it to a beneficiary in the accounts of a trust.
>
> […]
>
> A sum of money was held "in hand" by the trustees. The trustees resolved that a specified proportion of that sum "shall belong" to certain beneficiaries

What is curious is that (respectfully) I believe Her Honour comes to an incorrect view of what occurred in *Ward*. What she describes is more in line with what the dissentient Turner J in *Ward* said was necessary to occur, rather than the position of North P

> In *Commissioner of Inland Revenue v Ward*, North P of the New Zealand Court of Appeal held that a resolution that certain money should "be held for the credit of" four children in equal

> shares effected by book entries in the trust accounts was an effective exercise of a power to "apply" trust income. However, in reaching that conclusion, North P held that the effect of the resolution was to make the money "the separate property" of each child. In other words, the income was "applied" when it ceased to be held under the prior trust and became the absolute property of each child.

Her Honour then groups *Vestey, Ward* and *Chianti* together as being cases that all separated out a trust asset in order to create a vested and indefeasible interest in the title to those assets, and thus support an action for money had and received. Although I do not agree that this is a proper characterisation of *Ward* and *Chianti*, this is in my opinion overall a more preferred view of how to achieve absolute title.

> As will be apparent, the fundamental difference between *Vestey*, *Ward* and *Chianti* and the present appeal is that whereas in those three cases absolute title to trust assets was transferred or vested,
>
> …
>
> Second, a beneficiary may maintain an action for money had and received against a trustee only where there remains nothing for the trustee to do except to pay over the money to the beneficiary and the trustee admits itself to be indebted to the beneficiary. But, in this appeal, the first limb was absent because the 1994 Resolution did not vest any asset of the Trust in Mr and Mrs Nemes

4.5.3 North P in Ward

It is worth considering the judgement of *Ward* itself, given the conflicting view that have been presented about its facts in the various judgements in *Fischer*.

North P does not consider that there was some amount separated out for the beneficiaries, instead there was merely a credit to the beneficiaries' accounts for the amount of income so distributed.

> The trustee's declaration was carried into effect in the books of the trust but the appropriate entries were not made until after 31 March 1963. No part of the income credited to the four children was, however, paid to them until some years later when the amounts standing to their credit in the books of the trust were paid into separate Post Office accounts.

The sole question was whether that distribution was sufficient for that amount of income to be applied to the beneficiaries

> the sole question which this Court is called upon to determine on this appeal is whether as a matter of law the steps taken by the respondent were sufficient to enable her successfully to contend that her children were deemed to be entitled in possession to the receipt of the amount paid to them or applied for their benefit during the income year.

It is unclear if there was a conflation in the submissions that "pay" and "apply" should be read as almost synonymous. That is, an amount may not be "applied" unless it is "paid". That seems to take away meaning from "apply". That does not seem to be the understanding of the submissions by Turner J, and it is perhaps this view of the submissions that causes the position of North P

> third submission which, in my opinion, goes to the heart of the case. He contended that on the admitted facts the trustee neither paid nor applied the income in question to or for the advancement or benefit of the children […] The substance of his argument was that the word ``apply'' read in its context required the trustee to take the positive step of there and then applying the income for the benefit of the children and that it was an insufficient exercise of her discretionary power to make a declaration followed by the crediting of the income to the children in the books of the trust. In short, as nothing was paid out of the trust the income had been retained in the trust and not applied

Perhaps the reason for taking this view was the comments in *Montgomerie* which found that because there had not been a payment there was not an application of trust income

> No part of the income derived by the trustee in the year in question was paid out for the maintenance of the beneficiaries and the whole of it still remained in the bank account of the trust. In these circumstances, the Commissioner took the view that the income ``was not also income derived by any beneficiary"

It is better to see "apply" as being closer to "set aside". That is a position that is more consistent with *Vestey*. North P then correctly rejects the interpretation of "apply" as being synonymous to "pay". But it does not necessarily follow that a need for something more than simply crediting the books is necessary for an application. It would be entirely consistent to require that an amount is set aside in order for their to be an application.

His Honour concluded that a specific portion of the income of the trust was vested in interest, even though it was not paid out. It can be seen that there is no notion of resettlement of any part of the trust fund.

> The declaration of the trustee in exercise of the power conferred on her by sec. 40 of the Trustee Act 1956 did have the effect of immediately vesting a specific portion of the income in the year ending 31 March 1963 in her four children and that in result there was a change in title from a contingent interest to an absolute interest in the sums allotted to them. […] Once the trustee made her declaration the sums allotted to her children, although not immediately paid out to them, became their absolute property and would form part of their individual estates in the event of their death under the age of 21 years. In my opinion then the conclusion reached by the English Court of Appeal in *Vestey's* case is to be preferred to the more limited approach which found favour with Barrowclough C.J. in *Montgomerie's* case.

4.5.4 McCarthy J in Ward

McCarthy J approaches the issues of timing in the application of income, noting that the crediting of the accounts occurred subsequent to the end of the financial year. The trust must have been operating on a cash basis and had its accounts completed before the end of the financial year as the determination two days before the end of the financial year specifies the net income of the trust. Presumably there was to be no trading on the next two days. This was a sheep farm (it was a New Zealand case after all) and so there may have been possible to determine that there would be no further sales of sheep, or payment of expenses. His Honour considers (in agreement with Turner J) that the subsequent entry in the accounts was not a part of what was the disposition of income. It i

> the application, if it is to qualify, must be effective by the close of the tax year. But, of course, the subsequent entry in the estate accounts is some confirmation that the step taken by the trustee on 29 March 1963 was intended by her to be an effective disposition of income, income to which

© Adrian Cartland 2024

> at that point of time the particular children had no vested rights in possession; their interests in capital and income were contingent.
>
> […]
>
> The power to `pay or apply' is sufficiently exercised by a resolution of the trustees allocating money (or property) to a beneficiary.''

In *Chianti* it is considered that the entry into the books of account is a necessary step in order to communicate the debt. Perhaps in *Ward* the resolution to distribute income was communicated to the children beneficiaries, particularly since McCarthy J finds that the resolution itself was effective to make the present entitlement.

> And so I believe that *Vestey's* case is authority for the proposition that in circumstances such as those of this present case a resolution deliberately arrived at and recorded is sufficient of itself to make an infant beneficiary entitled to the amount covered by the resolution, and is therefore an application of income

In a further departure from *Chianti* His Honour rejects that a debtor-creditor relationship is created.

> I believe, too, that it is misleading to speak of debtor-creditor relationship. The rights of the beneficiaries here do not arise out of debt or contract. They arise out of the trusts created by the deed, and the beneficiaries are entitled to invoke the powers of the court by reason of a new title ``consisting of the exercise of the trustees' discretion in the infant's favour''.

4.5.1 Turner J in Ward

Rather than attempting to distinguish “apply” from “pay” as North P did, Turner J sets out that there is clearly no payment and that only question is whether there is an application of the income. He also sets out the importance of having any application occur before the end of the financial year. Accordingly, if the entry into the accounts is the thing that perfects the entitlement (which was not considered) then it could not retrospectively create an application before the end of the financial year.

> It is not argued that anything that happened after the execution of the memorandum could improve the position from the taxpayer's point of view, for the purpose of deciding the incidence of tax under sec. 155, for what was done subsequently was done outside the income year. Nor was it argued, at least with any force, that the effect of the memorandum was to constitute payment of the moneys - they remained, as before, in the hands of the trustee, part of a mixed investment, not even represented in toto by a sum of liquid cash, and I cannot think that it can possibly be contended in this case that what was done before 31 March constituted payment to them. But did it constitute application for the benefit of the beneficiaries?

Turner J sets out an critical concession in argument, that the creation of a debtor-creditor relationship or a separate trust is necessary for an application of income. Hi Honour later reasons that absent contract the debt can only arise through the creation of a separate trust

> conceded in argument by Mr. McKay, for respondent, that the document of 29 March could be regarded as ``applying'' the income referred to in it only if it were operative either (a) to create a debtor-creditor relationship between the trustee and the specified beneficiaries or (b) as a

> declaration of trust imposing a trust on the former in favour of the latter; and that the matter must be judged immediately upon the execution of the document.
>
> […]
>
> Such a [debtor-creditor] relationship can be created in law by contract, by quasi-contract, by judgment, by Statute or other legislative process, or as the result of a trust.

Thus, Turner J considers whether a trust has been created, and finds that it fails for certainty of subject matter. This position creates quite consistent position on trust law as to how a trust or beneficial interest is to be created. His Honour finds that therefore the effect of the resolution is record of intention to apply the amounts at a future time,

> was argued by Mr. Orr, for the Commissioner, that the operative words used - ``... do hereby determine that the income shall be disposed of... to be held for the credit of...'' - were insufficient to declare with sufficient clarity and certainty that a trust was being created. There is much, I think, to be said for accepting this submission, the effect of which would be to reduce the effect of the document so as to make it no more than a record of the intention of the trustee to apply, at some time in the future, perhaps when liquid funds were sufficient, the income referred to in it
>
> But there is one such essential requirement which is not met in this case, and this in my opinion is fatal to the contention that a valid declaration of trust can be found in the document. This essential requirement is the designation of the trust property. One of the classic ``three certainties'' which must necessarily characterise, without exception, the creation of every valid trust is certainty in the property made the subject of the trust. The principle is sufficiently set out in Halsbury's Laws of England, 3rd Ed., Vol. 38, at pp. 834-5, and it is so well known that it seems superfluous to cite authority for it.
>
> It is necessary in this case, as in every case, to be able to point with exactitude to the assets made subject to the new trust, and equally to be assured that other assets were not made so subject - otherwise it would be impossible to say whether any later dealing with any of the old trust property was a breach of the new trust or not, or whether, if some of the assets in the hands of the declarant were later lost, what was lost was the trust property under the new trust or not. If, for instance, in the present case, the bank had failed, would the old trust or the new have been the loser?

A matter that I am informed was raised during oral argument was that it was examined whether sheep, as trading stock, could be separated out as certain subject matter. Certainty this was a manner of separating out assets that was effective for the Biblical Jacob (Genesis 30:32) who took as his wages the “*speckled and spotted sheep and every black lamb, and the spotted and speckled among the goats*”.

4.5.2 E47

The Majority in *Ward* was applied in Australia in the case *E47* because the deeming provisions in s101 of the *ITAA 36* were equivalent to the deeming provisions in New Zealand. Hence, notwithstanding issues in present entitlement, if an amount is paid or applied there will be deemed present entitlement

> It was held by the Court (North P., and McCarthy J., Turner J. dissenting) that the declaration did amount to an application within the relevant provisions. This decision is of course of very high persuasive authority, and it is not strictly necessary to say more than that it applies in our opinion

> to the facts proved in this case, there being no significant point of difference between the provisions of the proviso to sec. 155 of the New Zealand legislation and sec. 101 of the Income Tax Assessment Act

The consideration of paying expenses on behalf of the beneficiary, seems to me to be a more robust and classical explanation of “apply”, which coupled with setting aside a sum for the beneficiary is in my view to be preferred. In my view that is also supported by Kiefel, Gegeler and Gordan JJ in their respective judgements in *Fischer*. Of course this raises the spectre of whether the entirety of the income can reasonably be paid or applied during an income year given that it is unlikely to be known, especially the trust is accounting on an accruals basis. To the extent that there is an amount of tax law income that is not distributed then there would be a proportionate distribution as per *Bamford* below.

> If he has free income during the year he can make a payment to a beneficiary, or make an application of money for his benefit, as by paying school fees, medical expenses or whatever. If however payment during the year is inconvenient or impossible, the question arises of the sum that may be paid or applied for the purposes of sec. 101 at a time, before 30 June when the trust accounts have not been finalised.

The Member held that a resolution to vest income will constitute an application, and then imported the following interpretations of *Ward*:

> First, a declaration, resolution or whatever of the trustee will amount to an application if it is immediately and irrevocably effective to vest a specific portion of the income of the year in the beneficiary so that his contingent interest in the trust income becomes an absolute interest in the income allotted to him.
>
> Second, it is immaterial whether the income is immediately used for the benefit of the beneficiary and it is sufficient if it is allocated to him in terms which makes the part of the income so allocated the separate property of the beneficiary.
>
> Third, the fact that a specific sum is not named (as in *Ward's* case the Savings Bank interest was not) is immaterial provided that the distinct sum in question is or becomes ascertainable from the trust accounts.
>
> Fourth, it is not correct to say that a resolution should not be regarded as applying income unless it acted as a declaration of trust imposing a new trust on the trustee in favour of the beneficiaries or created a debtor-creditor relationship between them.

Finally, it was considered that a debtor-creditor relationship arises from the vesting in interest which creates a bare trust.

> as far as the creation of a debtor-creditor relationship is concerned the rights of the beneficiaries do not arise out of debt or contract but out of the trusts created by the deed of trust

4.5.3 Tindon v Adams

Tindon v Adams [2006] VSC 172 the principles in *Ward* and *E47* were taken to a rather confusing place, in that the Court accepted a sub-trust over income in a unit trust. The relevant clause was a common one:

© Adrian Cartland 2024

> "Any amount set aside for any Unitholder pursuant to any provision of this Clause of this Deed or deemed to be held on trust pursuant to clause 13.8 shall not form part of the Trust Fund but shall upon the setting aside be held by the Trustee as a separate trust fund in trust for such Unitholder with power in the Trustee pending payment over to such Unitholder to invest or apply or deal with such separate fund or other resulting income or any part in any of the investments authorised by the Deed in respect of the Trust Fund."

The Court held that the effect of this clause was that "*there were constituted two separate trusts under which the trustee held one-half of the amount of the 2005 net income of the Delprop Trust upon trust for each of the unitholders"*.

Another clause provided that "the only rights (if any) of indemnity of the Trustee or any creditor of the Trustee shall be limited to recourse to the assets of the Trust Fund". The Court held that this limited the trustee's right of indemnity and excluded assets set aside and held on sub-trust.

Although the trust had positive net assets, there was no assets marshalled for the payment of the income, nor was there sufficient liquid assets to meet the calls for the distribution of income and the other current liabilities of the trust. It is unclear to me what assets precisely form part of the sub-trust. Surely it must fail as considered by Turner J in *Ward* and Gordon J in *Fischer*.

Given that there was this purported sub-trust the Court then considered that this gave rise to a debtor-creditor relationship.

> The authorities establish that financial statements (including the balance sheet and the notes to the accounts) can constitute an acknowledgement of debt, and that individual creditors comprised in the aggregate sums shown in the financial statements can be identified by extrinsic evidence, where the financial statements have been received by the creditor who sues in reliance on them.
>
> In the present case, I am of the opinion that the financial statements of the SJRF Trust and the evidence of Stephen Frederick Ryan, which I have mentioned at [27] - [30] and [32] above, when considered in the context of the relevant factual and legal background including cl 3.5 of the SJRF Trust deed and the resolutions, constitute admissions by the appellant that the distributed amounts were owing by the appellant to the respondent, for the purposes of the principle referred to in Gummow J's reasons in *Roxborough*.

4.5.4 Corporate Initiatives

Similar clauses requiring that sums be set-aside until paid were in the trust deeds in both *Corporate Initiatives* and *Oswal*. This clause purports to create a sub-trust of the kind envisaged in the Option 1 and Option 2 of TD 2022/11. In Paragraph 71 of that ruling the Commissioner correctly points to *Corporate Initiatives*[27] which determined that "*where a beneficiary has a UPE, the beneficiary does not have a proprietary right in any assets of the trust and the trustee would be free to deal with the trust assets for trust purposes*";

However, in neither case did the Court consider, nor was it necessary to consider, whether such a trust existed:

[27] *Corporate Initiatives Pty Ltd v Commissioner Of Taxation [2005]* FCAFC 62

- *Corporate Initiatives* was concerned with the effects of the distributions of income to a loss entity;[28]
- The "Sub-Trust" definition in the trust deed in *Corporate Initiatives* merely concerned a trust that was a beneficiary of a further trust, in order to determine eligible beneficiaries;
- *Oswal* was concerned with a distribution of an asset, and not income;

4.5.5 Oswal

Although *Oswal* is about a distribution of a capital asset, rather than income, there is reasonable authority to consider that the tests for both capital and income distribution are the same as in *Fischer*. The test for absolute entitlement by creating a vested an indefeasible interest is the same

> The term "absolutely entitled" is not defined in the ITAA 1997; nor is the expression "absolutely entitled to a CGT asset of a trust … as against the trustee". […] "the expression 'absolutely entitled to the asset as against the trustee' in subs (5) of 104-55 and s 104-60 of the Act is intended to describe a situation in which the beneficiary of a trust has a vested, indefeasible and absolute entitlement in trust property and is entitled to require the trustee to deal with the trust properly as the beneficiary directs".

There is an impediment on creating a vested an indefeasible interest: the trustee's right of indemnity. While that right of indemnity is unsatisfied, the interests will be defeasible in favour of the trustee

> The Trustee would be entitled to rely on this statutory power of sale to sell the Burrup Holdings shares notwithstanding that the new trust created over them by the 13 March 2007 resolution was for the absolute benefit of Mr and Mrs Oswal. In this sense, their interests in the shares while absolute were defeasible. It follows that on the test adopted by Lindgren J in Kafataris and embraced by both parties in this case, Mr and Mrs Oswal were not absolutely entitled to the Burrup Holdings shares, the subject of the 13 March 2007 resolution, as against the Trustee; it further follows that CGT event E5 did not happen in the 2007 income year.

The trustee can of course abandon their right of indemnity in relation to a particular asset by transferring it to the beneficiary.

> Had there been an outright transfer of the shares to Mr and Mrs Oswal in their individual capacities in consequence of the resolution, one may more readily discern an intention on the part of the Trustee to release or abandon any right of indemnity that attached to the shares as part of the Burrup Trust prior to the resolution. For example, in Burns v Leda Holdings Pty Ltd, Dowsett J proceeded on the basis that the transfer or distribution by a trustee to the beneficiaries of the entirety of the trust funds, without any reservation in respect of the right to indemnity, operated as a release or waiver of the trustee's right of indemnity.

But while the asset remains held by the trustee, its right of indemnity still applies, and therefore prevents a vesting of interest and hence absolute entitlement.

---

[28] Criticisms of the case are in any event set out in the article by *A H Slater QC, 'Unit trusts: Law and Lore'* (2006) 35 Australian Tax Review 185, 196

© Adrian Cartland 2024

> I have no doubt that a Court faced with the prospect that the assets of the Fund may not be sufficient to satisfy and discharge all liabilities properly incurred by the Trustee in the administration of the Burrup Trust, would not allow the Trustee to defeat the claims of creditors by repudiating an entitlement to be indemnified out of the shares in Burrup Holdings on the ground that the appointment worked a release, abandonment or waiver of that right.
>
> […]
>
> For these reasons, I am of the view that the Trustee's lien in respect of its right of indemnity continues to attach to the shares in Burrup Holdings subsequent to the making of the 13 March 2007 resolution; for that reason Mr and Mrs Oswal did not become, in consequence of the resolution, absolutely entitled to those shares as against the Trustee; and therefore that CGT event E5 did not happen in the 2007 income year.

4.5.1 Cajkusic

The Court in *Cajkusic* , comprising Kiefel, Sundberg and Edmonds JJ raises the issue of the defeasance of present entitlement by virtue of the trustee's right of indemnity.

> In the circumstances, it is not necessary to consider the second of the applicants' arguments at [15] supra, namely, that Intex's right of indemnity and exoneration as trustee precluded any beneficiary having any entitlement to any income of the Trust for the 1998 year.
>
> However, in passing we would merely observe that this submission, which appears to have its origin in what fell from the High Court in CPT Custodians Pty Ltd (previously t/as Sandhurst Nominees (Vic) Ltd [2005] HCA 53; (2005) 221 ALR 196 at [49] – [51], conflates two totally different concepts – present entitlement to an amount equal to the income of the fund (not to any particular asset vested in the trustee) on the one hand and the trustee's right to resort to such assets to meet liabilities on the other. This latter right of the trustee would not seem to impact on the beneficiary's present entitlement.

It is unclear why the trustee's right of indemnity is separated from present entitlement, unless present entitlement for income is treated separate to present entitlement to a capital asset.

When Kiefel J later considers trust distributions as part of the High Court in *Fischer* Her Honour considered that the income distributions in *Ward* created separate trusts of property. If there was such a trust created, surely it would be important that it is not defeasible by the trustee's right of indemnity. I struggle to reconcile *Cajkusic* with *Fischer*.

4.5.2 Chianti

In *Chianti* an unpaid trust distribution was called upon by the beneficiary. Similar to *Tindon v Adams* (below), *Corporate Initiatives* and *Oswal* there the trust deed required that that amount be set aside on a separate trust until paid. Besides the difficulties in trust law in creating a separate trust over income, a further difficulty arises: that the failure of the trustee to comply with that requirement may constitute a breach of the trustee's obligations. Therefore not only are such clauses in trust deeds ineffectual, they are problematic for the trustee who will evidently fail to comply with them unless perhaps some amount of cash is placed aside as occurred in *Vestey*.

© Adrian Cartland 2024

> It is established, by the financial statements of the SJRF Trust and the evidence of Stephen Frederick Ryan (a director of the appellant) that, in apparent breach of cl 3.5 of the SJRF Trust deed, the amounts distributed to the respondent were not held by the appellant as a separate trust fund. Further, it is established, by that evidence, that the appellant did not invest the distributed amounts pursuant to cl 3.5 and cl 5(e) and in consequence no income was derived from those amounts.
>
> […]
>
> (a) In par 9, the appellant as trustee of the SJRF Trust made distributions, from time to time, to the beneficiaries of that trust 'by payment or by setting aside amounts in account for the beneficiaries'.
>
> (b) In par 11, the amounts set aside were set aside 'on the basis that [the appellant] retained complete discretion as to when these amounts would be paid to [the relevant beneficiaries], and that [the relevant beneficiaries] would not be entitled to call upon or demand payment without the approval of [the appellant]'.
>
> The 'basis', as alleged in par 11, on which the distributed amounts were supposedly set aside, is not authorised by the SJRF Trust deed and, in any event, the so-called 'basis' is not referred to in the resolutions, the financial statements or any other documents produced by or on behalf of the appellant.

The Court had jurisdiction to hear a legal action, and not an equitable action, and so rather than consider an equitable claim for a vested interest in property that had been set aside, the question was whether an action for money had a received could be maintained.

> With respect to express trusts it was settled by 1852, when *Edwards v Lowndes* ((1852) 1 El & Bl 81 at 89 […]) was decided, that it was only at the stage when there remains nothing to the trustee to execute except the payment over of money to the beneficiary, or the trustee admits the debt, that an action for money had and received might lie at the suit of the beneficiary against the trustee; in other respects, in the courts of law the trustee was treated as the absolute owner and the beneficiary's remedy was exclusively in a court of equity which might give effect to equitable set-offs and other equitable defences available to the trustee. The trust which had not been wholly performed was treated as analogous to the "open" contract, that is to say, one not discharged (footnote omitted); at that earlier stage, the action for money had and received did not lie .

In relation to whether there was a debt creaed, the Court considering McCarty J's comments in *Ward* that there is no debtor-creditor relationship the Court, and then a finding in *Eurasian Holdings* that a trust distribution did not create a debt.

> In *Euroasian Holdings Pty Ltd v Ron Diamond Plumbing* (in liq) (1996) 64 FCR 147, [the Court found that the distribution] did not bring about the relationship between the applicant and respondent of debtor and creditor. Whether or not the respondent may have been 'presently entitled' for the purposes of the Income Tax Assessment Act 1936 (Cth), it seems to be the position that rights of the respondent were enforceable in equity only.

These cases were distinguished on the basis that they did not consider the line of authority that holds that a trustee who has no further duties is liable for an action for money had and received

> In *Ward* and *Euroasian Holdings* no reference was made to Edwards v Lowndes or any of the other cases in the line of authority referred to in Meagher, Gummow & Lehane's, Equity Doctrines & Remedies (4th ed, 2002) or in Gummow J's reasons in Roxborough.

It followed that because there was the bare trust (although it was unclear what precisely the assets were) that there was a vested interest

> The respondent's interest in the distributed amounts was not subject to any contingency or condition which might defeat its entitlement. Rather, the respondent's interest in the distributed amounts was vested in interest and possession.

Because of the admission of the debt in the accounts, there was a basis for a legal action for money had and received.

> 68 In my opinion, if, when the District Court action was commenced (that is, 18 January 2005), there remained nothing for the appellant to execute in respect of the trust on which it held the amounts distributed to the respondent, except the payment of those amounts to the respondent; or if, when the District Court action was commenced, the appellant had admitted the existence of a debt owing to the respondent on account of the distributed amounts in question, then the respondent was entitled to recover those amounts from the appellant by an action for money had and received.

One matter that was not considered (as it was not relevant) was <u>when</u> the interest vested and when the legal action for money had and received was enlivened. Given the need for the admission that occurs in the accounts, it seems that this could only occur <u>after</u> the publication of the accounts of trust. This creates difficulty for creating a present entitlement before 30th June.

4.5.3 Buckle

The dismissal of the trustee's right of indemnity in *Cajkusic* was done in reference to *CTP Custodian*. But that case followed *Buckle*, which is the authority for the extent of trustee's right of indemnity. The right of the beneficiaries is to what remains of the trust assets after the right of indemnity has been satisfied.

> 48. Until the right to reimbursement or exoneration has been satisfied, "it is impossible to say what the trust fund is". The entitlement of the beneficiaries in respect of the assets held by the trustee which constitutes the "property" to which the beneficiaries are entitled in equity is to be distinguished from the assets themselves. The entitlement of the beneficiaries is confined to so much of those assets as is available after the liabilities in question have been discharged or provision has been made for them. To the extent that the assets held by the trustee are subject to their application to reimburse or exonerate the trustee, they are not "trust assets" or "trust property" in the sense that they are held solely upon trusts imposing fiduciary duties which bind the trustee in favour of the beneficiaries.

More that that, the trustee holds a beneficial interest in the trust assets. The indemnity takes priority over the claims of the beneficiaries.

> 49. The entitlement to reimbursement and exoneration was identified by Lindley LJ as "the price paid by cestuis que trust for the gratuitous and onerous services of trustees". The right of the trustee has been described as a first charge upon the assets vested in the trustee, as one upon

> the "trust assets", and as conferring upon the trustee an "interest in the trust property [which] amounts to a proprietary interest".
>
> 50. However, the starting point in the class of case under consideration is that the assets held by the trustee are "no longer property held solely in the interests of the beneficiaries of the trust". The term "trust assets" may be used to identify those held by the trustee upon the terms of the trust, but, in respect of such assets, there exist the respective proprietary rights, in order of priority, of the trustee and the beneficiaries. The interests of the beneficiaries are not "encumbered" by the trustee's right of exoneration or reimbursement. Rather, the trustee's right to exoneration or recoupment "takes priority over the rights in or in reference to the assets of beneficiaries or others who stand in that situation". A court of equity may authorise the sale of assets held by the trustee so as to satisfy the right to reimbursement or exoneration. In that sense, there is an equitable charge over the "trust assets" which may be enforced in the same way as any other equitable charge[39]. However, the enforcement of the charge is an exercise of the prior rights conferred upon the trustee as a necessary incident of the office of trustee. It is not a security interest or right which has been created, whether consensually or by operation of law, over the interests of the beneficiaries so as to encumber them in the sense required by s 66(1) of the Act. In valuing the interests of beneficiaries which are conveyed by an instrument, there is no encumbrance which the Act requires to be disregarded.
>
> Accordingly, we agree with the following treatment of the matter by Sheller JA:
> "If it be right, as in my opinion it is, that the trustee has a beneficial interest in the trust assets to the extent of its right to be indemnified out of those assets against personal liabilities incurred in the performance of the trust and that interest will be preferred to the beneficial interests of the cestuis que trust, the consequence is that the interest conveyed has no value. This does not depend in any way upon treating the interest as encumbered. It flows from the fact that the trustee has a preferred beneficial interest in the trust fund."

That the trustee's right of indemnity would prevent present entitlement was expressly set out in *Whiting*. Repeating the quote above for convenience of reference

> Indeed, it is difficult to see how he can be entitled at all to income which must be applied in satisfaction of some prior claim: […] until an estate has been fully administered by payment or provision for the payment of funeral and testamentary expenses, death duties, debts, annuities, and legacies and the amount of the residue thereby ascertained, <u>the income of the residuary estate is the income of the executors</u> and not of the residuary beneficiaries.

4.5.4 CTP Custodian

Even where the is a single beneficiary of the trust, when there is still an unsatisfied right of indemnity the beneficiary will not be able to call for the assets until that right is satisfied. The amount of the trust fund is not able to be determined until the satisfaction of that indemnity

> There is a further consideration. The facts of the present cases do not, in any event, answer the modern formulation of the rule in Saunders v Vautier, stated as follows in Thomas on Powers:
> "Under the rule in Saunders v Vautier, an adult beneficiary (or a number of adult beneficiaries acting together) who has (or between them have) an absolute, vested and indefeasible interest in the capital and income of property may at any time require the transfer of the property to him

> (or them) and may terminate any accumulation."
> […]
>
> the rule in Saunders v Vautier could not apply if, by reason of the charging of legacies on the fund and accumulations, the persons seeking to put an end to the accumulations were "only entitled to an undetermined and uncertain surplus (if any) which might be left of the fund after payment of the legacies".
>
> In the present case, the unsatisfied trustees' right of indemnity was expressed as an actual liability in each of the relevant accounts at each 31 December date and rendered applicable the sense of the above words of Lord Davey. Until satisfaction of rights of reimbursement or exoneration, it was impossible to say what the trust fund in question was.

4.6 TR 2004/D25 – Absolute Entitlement

In view of the above discussion, I find it difficult to follow the ATO's position on absolute entitlement.

> A trustee's lien does not prevent absolute entitlement
>
> 64. The existence of a trustee's lien to enforce a right of indemnity against a trust asset will also not prevent a beneficiary being absolutely entitled to that asset. The rights of beneficiaries are always subject to the rights of the trustee to be indemnified for outgoings. However, the existence of a trustee's right to be indemnified should not be viewed as diluting or erasing any rights held by the beneficiaries. It just means that the beneficiaries can only exercise their rights subject to the rights of a trustee to be indemnified.
>
> 84. A beneficiary with a vested and indefeasible interest in trust assets where one or more others also have an interest in those assets will nonetheless be considered absolutely entitled to a specific number of the trust's assets if the three factors listed below are also present.
>
> 85. First, the assets must be fungible, at least to the extent to which a person would reasonably be expected to be indifferent to the replacement of any one asset with another.
>
> 86. Secondly, it must be the case that equity would permit the beneficiary to have their interest in all those assets satisfied by a distribution or allocation in their favour of a specific number of them.
>
> 87. Thirdly, there must be a very clear understanding on the part of all the relevant parties that the beneficiary is entitled, to the exclusion of the other beneficiaries, to a specific number of the trust's assets.
>
> 88. If these factors are present, then the beneficiary will be considered absolutely entitled to that specific number of the trust's assets for CGT purposes. Because the assets are fungible it does not matter that the beneficiaries cannot point to particular assets as belonging to them. It is sufficient that they can point to a specific number of assets as belonging to them, even though it is impossible to say exactly which ones.

The only way that this can be considered correct is if it is reduced to a meaningless position. That is, if the trustee's right of indemnity is satisfied then the beneficiary will have a vested and indefeasible interest in the trust assets, or in the assets that are not marshalled to the trustee.

4.6.1 Farmsworth

An analogy can be drawn between the creation of present entitlement when the amount is not fixed, and the derivation of income when the amount is not fixed. In *Farnsworth* there was an estimate provided for a mass of fruit that would be sold. When the fruit was actually sold there could be a greater or lesser amount actually paid. This is analogous to the income of a trust estate that is not properly determined as at 30th June due to one or more of the issues that I have raised earlier in this paper – accruals accounting, unknown property, trustees right of indemnity etc.

> The amount of 648 pounds in the present case was not a debt owed by any person to the taxpayer. It represented only an estimate of what the taxpayer would probably be paid if the mass of fruit were all sold and paid for. Accordingly, in my opinion, this amount should not be included as if it were a debt owed to the taxpayer.

Of course this analogy, and the material present so far does not prevent present entitlement from occurring at all – provided that the trust does not last in perpetuity it will eventually vest and present entitlement will be created and the income and capital will be paid or applied for the beneficiaries. However that may not create a desired tax treatment.

> I hesitate in the present case to lay down any proposition of universal application about anticipated dividends from pools of primary products. But it does seem to me that the natural solution of a case like the present, which is a simple case, is to ascertain the taxable income of the taxpayer on the basis of receipts and outgoings. After all, as was remarked by Mr. Gibson, who dissented in the Board of Review, the payments were not "got or obtained" by the taxpayer before she received them. He said that the payments were undoubtedly assessable income derived by the taxpayer at, but not before, the respective times when the payments were received; they were required to be made to her under the rules adopted by the contract but the amounts and the times of the payments were at the discretion of the packers concerned. I agree in this view.

4.6.2 Bendel

Bendel is an interesting case, and promises more interest because (at the time of writing) it is under appeal by the Commissioner. The part of *Bendel* that receives the most reporting is its analysis of the history and purpose of Division 7A and what is intended to constitute a loan based on statutory interpretation principles. In my view those arguments were neither persuasive (one way or the other) nor interesting. This is because legislation is ripe for legislative amendment, whereas the nature of trust rights and relationships endures and develops.

In my view, the interesting part of *Bendel* were its trust law analysis, which tie together many of the matters raised in this paper.

First, after considering the analysis of Div 6 as set out in *Carter* and present entitlement that is created under s97 it was noted that it was not a deemed present entitlement that is the source of the beneficiaries rights deriving from distributions of trust income. Instead the rights flow from trust law.

> Courts have frequently been called upon to determine whether a beneficiary is presently entitled to a share of the income of the trust estate. Carter's case is an example. It is said that the s 97 condition is satisfied if, but 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

[…]

These comments were the part of a formulation of a question as to when the s 97 threshold condition is to be tested, and whether events post that time could change taxable facts or assessment outcomes. These comments were not an analysis of the nature of rights created when trust income is distributed.

In understanding the nature of a distribution of income, we are brought back to the distribution of capital in *Fischer* and in particular Gageler J

Gageler J's analysis in Fischer v Nemeske [54] is more to the point. His honour was addressing the nature of entitlements created when discretionary vesting powers were exercised. There he said:

96. Once it is accepted – as it was in In re Baron Vestey's Settlement (121) and in Commissioner of Inland Revenue (NZ) v Ward (122) – that a trustee can 'apply' trust property to the advancement of a specified beneficiary by resolving to allocate trust property unconditionally and irrevocably to the benefit of that beneficiary, it is difficult to see any reason in principle why such an unconditional and irrevocable allocation of trust property must take the form of an alteration of the beneficial ownership of one or more specific trust assets.

The taxpayer argued that the income was held on a separate trust, and therefore s109D(3) did not apply. That the income is held on a separate trust is difficult to maintain for a number of reasons.

- Under the reasoning of North P in *Ward* the income is simply applied without a separate trust being created
- For *Vestey* to apply there must be some determination of the cash proceeds available for application
- If there is a separate trust like in *Pilkington*, or the reasoning of Turner J in *Ward* or Gordon J and Kiefel J in *Fischer* considered was required then there must be some property set aside. There was not. In particular, income is not property

In circumstances where an 'entitlement to some part of a fund of property that is held on trust [is] not … reflected in an absolute beneficial entitlement to the whole or some part of any specific asset within that fund', as is the case presently, the beneficiary's interest in the income of the trust is thus 'an equitable obligation' on and of the trustee. That equitable obligation reflecting the beneficiary's interest in the income of the trust is not property the trustee owns or controls. Income is not property.

[…]

In the present circumstances, where it is not possible to identify any asset or property held on any separate trust as conventionally understood, notwithstanding the acceptance of the parties that a separate trust was created, what was created upon passing resolutions to distribute Gleewin's income was a right or entitlement for the beneficiary coupled with the corresponding obligation of the trustee of a nature contemplated by what Gageler J said in Fischer v Nemeske.

Accordingly, the Tribunal does not accept contentions that a separate trust in fact arose in any conventional sense that had the effect of discharging or replacing the obligation to pay

> entitlements to income. Those entitlements to be paid shares of Gleewin's income continued to exist.

All that remained was an entitlement to be paid income. Following the reasoning of Gageler J this entitlement does not necessitate that it is held on a separate trust.

What seems to be overlooked though is that not only does the taxpayer (correctly) fail on the submission that there is a separate trust, but that under the reasoning of Gageler J if there is a present entitlement then there is a common law action available for money had and received. That is, provided that the distribution has been communicated to the beneficiary (per *Chianti*), a debt will arise. In my view this brings the unpaid distribution clearly within s109D(3).

It does not appear to me that the Commissioner has argued that there is an action for money had and received. Given that *Fischer* has clearly been raised, perhaps this avenue will be pursued at the appeal.

If there is a view that the Commissioner would espouse, it would seem to be the view of French CJ and Bell J for the reason that they consider that the application of income was *by way* of creating a debt. That is, that a debt is created and that debt is what creates an application. This would mean that a distribution must fall within the ambit of s109D(3) for it to be a valid distribution.

In my view the *ratio* of *Fischer* is to be found across the other three judgements, and that those are to be preferred. That is, there must be some trust created and asset separated for there to be an entitlement to that asset, and Gageler J thought that that could be done without separating that asset from the remainder of the trust fund. However, I must concede that there are issues with the reasoning, as I have set out earlier.

If the taxpayer in *Bendel* was able to show on the facts that an amount had been set aside (like in *Pilkington*) and that there was accordingly a separate trust for those amounts, rather than assist in bringing the taxpayer out of s109D(3) it would in my view be fatal. That is, all five Justices in *Fischer* considered that such a separation of assets would support an action for money had and received and thus would be a debt enforceable at law.

There is a way out of such a bind for the taxpayer, where there is money set aside in a separate trust. And that is by the trustee's right of indemnity. As see in *Oswal* this will prevent absolute entitlement and hence a debt. It is unclear what the status of the trustee's right of indemnity is in *Bendel*, although there are expenses for PAYG and tax debts so presumably it is both trading and incurring liabilities.

The corollary of the trustee's right of indemnity preventing an debt would also be that there may not have been present entitlement in the first place, except for deemed present entitlement. This may be a far worse consequence than deemed dividends under Division 7A.

A final interesting issue raised in *Bendel* is the issue of fungible property

> 'where the subject matter of a trust is a defined part of fungible property to which the settlor holds title, an issue may arise as to whether that subject matter is sufficiently certain to constitute trust property…

4.6.3 White v Shortall

White v Shortall rejected the (much criticised) approach taken by Dillon LJ in *Hunter v Moss*. In *White v Shortall* the parties entered into a contract whereby (amongst other things) the defendant was to declare a trust over a total holding of 1,500,000 shares such that the claimant would acquire an equitable interest in 222,000 of those shares. The argument was raised that, like *Hunter v Moss*, a distinct trust could take effect over just the 222,000 shares. There had been no segregation of those shares from the entire 1,500,000 shareholding. The court upheld the validity of the trust but explicitly disavowed the rationale in *Hunter v Moss*. Instead, the inference which the court took from the facts was that a single trust took effect over the entire holding of 1,500,000 shares such that the trustees had a power to elect which 222,000 shares out of that entire shareholding were to be treated as being held for the claimant. This avoided the problem of certainty of subject matter because the trust took effect over the identified fund of 1,500,000 shares, but there no need to segregate out 222,000 shares under a separate trust if the trustees were to have a power to split off that number of shares from the valid trust fund. Therefore, the claimant had an equitable interest in the large trust equal to 222,000 shares and the defendant was deemed to have an equitable interest in the remaining shares.

This triggers CGT over the entirety of the shares in question and is overall a terrible tax outcome.

5. Corpus Distribution

A corpus distribution is, as the name implies, a distribution of some part of the corpus of the trust to a beneficiary. The purpose would be to distribute assets so that they are in the hands of the testator before their death:

5.1.1 Distribution of Assets

The starting point should be the distribution of an asset:

The asset should first be identified;

The trustee of the inter-vivos trust then resolves to distribute the asset to the testator;

The asset is then transferred to the testator, or held absolutely for them until transfer;

For a discretionary trust this will generally trigger ***CGT Event E5*** and thus will trigger a liability for CGT on the difference between the ***cost base*** of the asset and its present market value;

There is a Stamp Duty exemption available in **s71(5)(f)** for a transfer from a discretionary trust to a natural person who is an object of that trust;

There is the obvious difficulty that the benefits of the inter-vivos trust are now lost in relation to that asset, particularly flexibility of income distributions and asset protection; and

Sometimes the most simple strategies are the most appropriate, and if the CGT can be dealt with then this may be a suitable option;

5.1.2 Distribution of Reserve Account

Another method is to make a distribution of a part of the corpus to a beneficiary that is attributable to a particular account of the trust:

Some trusts will have a “gift reserve” or “equity reserve” that is attributable to amounts that have been settled on or gifted to the inter-vivos trust;

If there is not a suitable account to distribute from, a common method is to revalue one or more assets of the inter-vivos trust and then credit the amount of that revaluation to a reserve account, commonly a “revaluation reserve”;

A reserve account is not a particular asset of the trust in of itself, and is simply an accounting record. The importance of this will be returned to;

The reserve account is then distributed to the beneficiary. I will go through the mechanisms and consequences of this below;

Distributing a reserve account was commonly used as a Division 7A avoidance strategy when distributions were made to a company beneficiary prior to the introduction in 206 of s 109T, a 109XA and s 109XB of the *Income Tax Assessment Act 1936* (Cth). We are not making distributions to a corporate beneficiary and need not be concerned with these. Of course if the inter-vivos trust has received payments that are attributable to company s109T, which traces payments across entities, may be enlivened. But that is beyond the scope of this paper;

5.1.3 Entitlement to an Asset

In my view, the issues raised by Gordon J can be remedied in a distribution of a revaluation reserve by distributing a particular asset:

One example would be for the trustee to draw out in physical cash a portion of the money and make the beneficiaries presently entitled to it. Depending on the monetary figure, it may not be a feasible option;

Another option would be for the trustee to draw a bank cheque payable to itself, which it then indorses on to the beneficiaries as it makes it corpus distribution. When the trustee holds the bank cheque, the cheque would be an asset of the trust whose face value is equal to its market value and its acquisition cost and would therefore be an asset that the trustee could create a present entitlement over by way of distribution;

The Trustee then effects that distribution by indorsing it on to the beneficiary and passing it to them. This would be the simplest method of effecting this transaction, however, even though this is built upon hundreds of years of banking law in my experience this is too complex for banks to understand, and they are unlikely to give you such a bank cheque;

5.1.4 Distribution of Bill of Exchange

If the bank drew the cheque improperly the distribution would be ineffective. It is for this reason I typically recommend a set of transactions whereby bills of exchange are passed around between the parties and presented in return for bank cheques;

Steps

Prior to the transaction taking place the Trustee draws minutes noting the corpus revaluation;

Step 1

In step 1 the following occurs:

The Drawer enters into an agreement with the Drawee;

The Drawer agrees with the Trustee that in exchange for the Drawer agreeing to pay the Bill of Exchange to the Trustee the Trustee will pay the Drawer a set figure by way of a Bank Cheque;

A Bill of Exchange is drawn and executed; and

The Trustee draws minutes setting out the terms of the agreement;

Step 2

Now holding the Bank Cheque, the drawer can satisfy their obligations under the Bill Facility Agreement and pay the Drawee the same figure as above. This does not destroy the value of the Bill of Exchange which may be prescribed by the bearer to the drawee who will then pay the figure to the bearer;

Step 3

The Trustee then makes a distribution of corpus to the Drawer. This distribution is affected by transferring the Bill of Exchange to the Drawer. The trustee then draws minutes noting the distribution of the set figure out of the Trust;

Step 4

Now holding the Bill of Exchange, the drawer presents the Bill of Exchange to the Drawee who is obliged to pay the face value of the Bill of Exchange to the bearer of the Bill. To satisfy this obligation the Drawee then passes the Bank Cheque to the Drawer satisfying their obligations under the Bill Facility Agreement;

Step 5

The Drawee now holds the Bill of Exchange which no longer has any function.

In relation to this transaction ***CGT Event E5*** event is triggered.[29] However, no CGT is payable because the cost base of the bill is equal to its face value;

An example of the distribution of a bill of exchange occurs in PBR 1011455641741, and the Commissioner consider that the distribution did not trigger income tax or CGT for the beneficiaries.

[29] See 26.28.

6. The Meaning of "Pay"

One example of this is the nature of money. What is brought to mind when we consider money is the physical coins and notes that we are familiar with. Economically, physical currency represents only a small percentage of the total money supply in an economy. Most transactions are completed with a transfer of a derivative of money, including electronic interbank transfers, records into ledgers, and instruments such as cheques, bonds, promissory notes and bills of exchange. In many cases, the law will regard these are money, but this is not always the case. Importantly, the legal nature of these money derivatives are quite different to chattel money, and this is commonly overlooked. For example, a bank account is a contract between a banker and customer and a payment from one bank account to another is a chain of contractual relationships rather than a simple movement of cash. Whether electronic money is exactly the same as chattel money is important for many legal relationships including trust declarations and distributions, contractual relations and the timing of taxing events and obligations. Often, any record of monetary assets is treated as being a pile of chattel money, and this creates difficulty. When considered properly Courts realise that a bank account is a separate legal right and property, and the amount of electronic money recorded against that right is not an asset that can be divided or assigned.

6.1 Bank Accounts Are Not Money

For example in *R v Preddy [1996] AC 815* the House of Lords considered whether a transfer of money from one account to another constituted a transfer of ownership of a thing, being money (in relation to whether the accused had obtained money by deception by transferring it between accounts). The conclusion was that there was no transfer of underlying property because the only property in question was the contracts between banker and customer, which were unaffected (even though their account balance was reduced).

Foley v Hill (1848)[30] Lord Cottenham said:

Money, when paid into a bank, ceases altogether to be the money of the [customer]…it is then the money of the banker, who is bound to return an equivalent by paying a similar sum to that deposited with him when he is asked for it. The money paid into the banker's [sic], is money known by the [customer] to be placed there for the purposes of being under the control of the banker; it is the banker's money; he is known to deal with it as his own; he makes what profit of it he can, which profit he retains to himself….[31]

A further elaboration of this position was this:

The money placed in the custody of the banker is, to all intents and purposes, the money of the banker, to do with it as he pleases; he is guilty of no breach of trust of employing it; he is not answerable to the [customer] if he puts it into jeopardy, if he engages in hazardous speculation; he is not bound to keep it or deal with it as the property of his [customer], but he is of course answerable for the amount, because he has contracted, having received that money, to repay the [customer], when demanded, a sum equivalent to that paid into his hands.[32]

---

* Associate Professor, University of Western Australia School of Law

[30] *Foley v Hill* (1848) 2 HLC, 9ER 1002

[31] Ibid at 1006

[32] Ibid at 1005-1006

But in many cases the Court will simply gloss over that distinction, for example in *Re Vestey's Settlement; Lloyds Bank Ltd v O'Meara* (1951) Ch.D 209 where the Court referred to the funds that were set aside as being in 'cash' where in fact they were rights under a bank account. This flows into judicial misunderstanding of the nature of, payment, application, and money derivatives including ledger entries, interbank transfers, promissory note and bills of exchange (for example in *Messenger Press Proprietary Limited v Commissioner of Taxation* [2012] FCA 756 and the cases which have relied upon it). *Mann and Proctor on the Legal Aspect of Money* consider various theories for what constitutes money, in particular the State Theory (which holds that money is the coins and notes issues by the State), Community Theory (eg *Moss v Hancock* which holds that money is that which is accepted by the community as money) and Institution Theory (which holds that money is that which is accepted by institutions like the Central Bank as money). The different theories produce different answers to what constitutes money, and what type of property different monetary assets are..

But when we turn to some of the cases that are at the heart of present consideration such as Vestey and Ward this aspect is overlooked and the bank accounts are treated as if they are simply piles of physical notes and coins that can be readily identified and divided. The nature of money and how is it paid is worthy of a paper at least as long as the present discussion and so I will put this anomaly to one side and treat bank money the same as legal tender for present purposes.

Payment will not be complete or timely unless it is in cash or the equivalent, which will be an unconditional right to cash, unless contrary indication in contractual documents, statutory rules or established commercial custom or usage exist. [33]

Section 8(1) of the *Currency Act 1965* (Cth) provides that the monetary unit, or unit of currency, of Australia is the dollar.[34]

Currency is the notes and coins issued under the authority of Australian statute, principially, the Reserve Bank of Australia Act 1956 (which prints notes) and the Currency Act 1965 (that deals with coins). By the force of law, currency is sufficient to meet a financial obligation.

6.2 “Legal tender”

Australian currency is legal tender in Australia. Legal tender is a concept whereby the offering of legal tender to meet a financial obligation is, in the eyes of the law, sufficient to extinguish that obligation.

All payments to meet a financial obligation must be make in legal tender unless the parties agree otherwise. Thus, when purchasing a home, a purchaser is legally able to pay the purchase price in folding notes and physical cents.[35] This is legal tender and is sufficient to meet the purchase price. Of course this is highly impractical and therefore the parties agree that the purchase price may be met by the tender of a bank cheque. As will be discussed, a cheque (and other bills of exchange) are money but not legal tender (because a creditor is not obligated under the law to accept a cheque). In the absence of agreement, a creditor does not need to accept a cheque and can demand legal tender.

[33] *A/S Awilco of Oslo v Fulvia SpA di Navigazione of Cagliari (The Chikuma)* [1981] 1 WLR 314 (HL) payment did not earn interest immediately.

[34] Section 9(1) provides that all contracts, instruments and transactions “relating to money, or involving the payment of, or liability to pay, money” shall be “made, executed, entered into or done” in Australian currency unless made according to the currency of some other country.

[35] Seasoned lawyers will recall the times when settlements occurred not at the Land Titles Office but at banks where the purchaser’s bank officer would literally hand over a bag of cash to the bank officer of the vendor.

© Adrian Cartland 2024

There are ‘limits’ on legal tender. 5 cent coins can only be used to meet financial obligations not exceeding $5 (section 16 of the Currency Act).

6.3 Payment By Non-Legal Tender

A creditor can waive his or her right to be paid in legal tender if the creditor asks for payment by cheque or some other means.[36] Absent of such a request, a tender of payment by cheque or other negotiable instrument does not satisfy the requirements of payment by legal tender. A cheque or other negotiable instrument is money but is not legal tender and is not sufficient to make a payment that extinguishes a financial obligation.

Tender by cheque, other negotiable instrument or other means may be provided for by contract or by statute (such as for the purchase of a home, car or business). In *George v Cluning* (1979) 53 ALJR 767; the High Court held that, on a proper assessment of the facts and proper construction of the option contract in question, payment could be done by the optionee’s personal cheque. Mason J with whom Aickin J agreed, said at 62:

The practice of giving and accepting personal cheques in payment of debts and liabilities is now so widespread that there is a general expectation on the part of persons making payments that a personal cheque … will be accepted unless the payee objects before or at the time of receipt that the cheque does not constitute legal tender.

In the Victorian Supreme Court case of *Mobil Oil Australia Limited v. Caulfield Tyre Service Pty Ltd* [1984] V.R. 440 (before Young C.J.), the status of a bill of exchange as a payment instrument and the obligations of the person to whom the bill is 'addressed' were considered. In the course of delivering his judgment in that case, the Chief Justice referred favourably to observations on the character of a Bill of Exchange made in several UK cases. These references include:

...the bona fide holder for value of a bill of exchange is entitled, save in truly exceptional circumstances, on its maturity, to have it treated as cash... (Cebora S. N. C. v. S. I. P . (Industrial Products) Ltd . [1976] 1 Lloyd's Rep. 271)

Bills of exchange are treated as cash, and unless there are exceptional circumstances where there is an action between the immediate parties to a bill of exchange judgment will not be held up by virtue of a counterclaim by the defendant and execution will not be stayed. (Cebora S. N. C. v. S. I. P . (Industrial Products) Ltd . [1976] 1 Lloyd's Rep. 271)

When one person buys goods from another ... He may demand payment in cash; but if the buyer cannot provide this at once, he may agree to take bills of exchange payable at future dates. These are taken as equivalent to deferred instalments of cash. (Nova (Jersey) Knit Ltd. V. Kammgarn Spinnerei G.m.b.H .[1977] 2 All E.R. 463)

Lamshed

In *Re Lamshed* (deceased) a father gave 8,000 pound to his daughter and her husband, for the purpose of enabling them to buy a dairy property. He filed a gift duty return in connection with the gift,

[36] *Cubitt v Gamble* (1919) 35 TLR 223.

in which he showed two gifts of 4,000 pound each, one to his daughter and one to her husband. The father died intestate. With respect to the monies being a declaration of trust the Court said:

Lamshed from time to time deposited sums of money in a savings bank in trust accounts. In respect of each account he made a declaration that he constituted himself a trustee of the moneys in the account for a person named in the declaration. There was no direct communication by Lamshed to any of the persons named in the declarations that he had opened trust accounts for them, although he had from time to time indicated that he was making some provision of that nature for some of the beneficiaries.

Lamshed drew interest which accrued on the accounts and showed it in his income tax return as income. He also from time to time made withdrawals from some of the accounts and also made deposits.

The court held that Lamshed had constituted himself a trustee of the amounts deposited in the accounts for the named beneficiaries, but not in respect of the interest accruing on the accounts. They also stated that the withdrawals from the accounts were breaches of trust, but where there were subsequent deposits after withdrawals, the subsequent deposits should be regarded as making good, pro tanto, the deficiencies.

Joliffe

In *Joliffe*[37] a man opened a bank account in his name as trustee for his wife as a trust account and deposited his own money in it. Upon the death of his wife he withdrew the balance of the account and appropriated it as his own. The Commissioner of Stamp Duty claimed estate duty on the money as part as Mrs Joliffe's estate. Mr Joliffe argued that no trust existed because no trust had ever been intended. His evidence was that he had applied the money for his own purposes and that the purpose of opening the account was to avoid his creditors. The High Court agreed with Mr Joliffe finding that:

"it is obviously essential to the creation of a trust, that there should be the intention of creating a trust, and therefore if upon a consideration of all the circumstances the Court is of opinion that the settlor did not mean to create a trust, the Court will not impute a trust where none was in fact contemplated"

Kauter v Hilton

In *Kauter v Hilton*[38] a man promised to leave his niece money in trust accounts. He had not included his in his Will, saying, in effect, that she would be better off if he put money into trust accounts while he was alive. A number of passbook accounts were opened in his name. I each case he gave the niece the passbook. Withdrawals could not be made from the accounts without presenting the passbook. The High Court held that an irrevocable trust of the moneys in the account on their deposit, although the beneficial ownership of the amounts was postponed until the man's death.

Overdraft Accounts

There is a big difference between one bank account in overdraft of $300 and two bank accounts, one in credit of $200 and the other in overdraft $500. Although these will often be aggregated in financial statements, the trust implications are different. In the first instance there will not be any positive assets

[37] *Commissioner of Stamp Duties (Qld) v Joliffe* (1920) 28 CLR 178
[38] *Kauter v Hilton* (1953) 90 CLR 86

to declare trust over (other than the right to deposit monies with the bank. The assignment of that right will be dealt with later). In the second case it is possible to declare a trust over the account with the positive balance of $200.

Parkview

Parkview Qld Pty Ltd v Commonwealth Bank of Australia [2013] NSWCA 422 concerned whether a trust arose in relation to a building contract that required one party to set aside monies in a 'retention account'. Fortia was obliged to retain monies that it drew down from the bank's progress payments to pay the developer Parkview. The amounts that Fortia was entitled to draw down, it did not. It had the ability to draw that amount down from the bank.

Was there a constructive trust with the bank as trustee over the undrawn amounts? There was valuable consideration to bind the conscience of Fortia to establish a trust

The second formulation was that Fortia had the right to draw down the balance of its facility, that it could have declared itself a trustee of that chose in action, that the Bank was in the position of control of those monies, in the sense that it could make those monies available, and was therefore to be regarded as a trustee de son tort. The argument is subtle; it was expressed by Mr Parker SC as follows:

> "The other way in which we put it is that it is possible to see that as an asset ... it's a chose in action where Fortia has the right to draw it down. Now, there's no difficulty with being a trustee of a promise. Fortia could have declared itself trustee of that right, and the trustee would have been required to draw those monies down. If BankWest has in effect assumed the position of being the trustee or looking after the security, we would say that BankWest was in a position of control over those monies, 'control' in the sense that it was able to make those monies available."

However, Fortia did not declare itself trustee of that chose in action.

> "There is no doubt that a contractual right can be held on trust. As Lord Shaw said in Lord Strathcona Steamship Co Ltd v Dominion Coal Co Ltd [1926] AC 108 at 124, "There can be a trust of a chattel or of a chose in action, or of a right or obligation under an ordinary legal contract, just as much as a trust of land."

There is nothing in the evidence to suggest that Fortia did in fact declare itself, …, a trustee of the right,…

In addition, the bank was not able to be a *trustee de son tort* because it did not control over the asset.

"The right Fortia had to draw down funds was a right against the Bank … The Bank did not have "control" in the relevant sense over that chose in action; to the contrary, the Bank was the person against whom that chose in action could be vindicated"

There may be a tracing remedy if funds the subject to a trust are dispersed..[39]

[39] *Associated Alloys Pty Ltd v ACN 001 452 106 Pty Ltd [2000] HCA 25; 202 CLR 588*

6.4 Issues with Legal Tender

If legal tender is proffered which are Australian notes and coins, that must be accepted in discharge of debt.[40] Any other method of satisfaction does not need to be accepted, however, it can be accepted as payment. Notably, this includes bank money because bank money is a chose in action between banker and customer.[41]

Successive federal governments have attempted to prevent and dissuade the use of legal tender in many situations, something that has accelerated since the COVID-19 pandemic. In 2019, a bill was introduced to Parliament which aimed to ban all cash transactions over $10,000.[42] While this was eventually abandoned, since **1st July 2022**, AUSTRAC has required all reporting entities to submit a Threshold Transaction Report ("TTR") for transfers of legal tender above $10,000 and to submit a Suspicious Matter Report ("SMR") for transactions suspected of being structured to avoid a TTR being submitted.[43]

6.5 Payment By Promissory Note

Any requirement for payment using legal tender can not be taken as literally meaning "only payment in money, bills or other legal tender".[44] Precedent shows that courts are eager to find that an obligation to complete a transaction in legal tender has been waived and there has been an agreement to pay by another method which is deemed equally acceptable.[45]

Any other method of payment decided upon between the parties is a chose in action,[46] that is an enforceable right and must be consented to by the parties.[47] A person is not bound to accept Promissory Note as this is not legal tender but accepted it in any case based on the commercial context of this transaction.

The parties may agree on many forms of payment, commonly this would be through bank cheque, solicitors' cheque or electronic funds transfer ("EFT").[48] All of these are examples of methods of payments that aren't legal tender. A bank cheque and one from a solicitor's trust account are variations of promissory notes and achieve the same thing.[49] A promissory note or bank cheque or bill of exchange or solicitors trust cheque all constitute payment the moment they are received.[50]

If these instruments are not honoured when presented then there is a deeming that they were never paid,[51]

---

[40] *Currency Act 1965 (Cth)* s 16 and *Reserve Bank Act 1959 (Cth)* s 36
[41] *Foley v Hill (1848)* 2 HLC 28 at 36
[42] *Currency (Restrictions on the Use of Cash) Bill 2019* (Cth)
[43] *Anti-Money Laundering and Counter-Terrorism Financing Act 2006* (Cth) s 43
[44] *Federal Mogul Asbestos Personal Injury Trust v Federal Modul Ltd* [2014] EWHC 2002 (Comm).
[45] *Quality Publications Australia Pty Limited v Commissioner of Taxation* [2012] FCA 256 at 48
[46] *Torkington v Magee* [*1902*] 2KB 427 at 430
[47] *Stirling Properties Ltd v Yerba Pty Ltd* [1987] 73 ACTR 1.
[48] *Ibid*.
[49] *Commercial Banking Co. of Sydney Ltd v. Mann* (1961) A.C.1,7.
[50] *Sidney Raper Pty Ltd v Commonwealth* Trading [1975] 2 NSWLR 227.
[51] *Liwszyc v Commissioner of Taxation* [2014] FCA 112, at para 157.

© Adrian Cartland 2024

When a promissory note is presented there is no further documentation created. It is not usual to create a document showing the promissory note has been presented so there is no missing document. The transaction is simply completed.

The legislation requires that presentment of the promissory note occurs, not that possession of it still exists.[52]

As promissory notes constitute payment they are used in commercial transactions as an alternative to shifting large amounts of cash.[53]

6.6 Payment "Of" vs "By Way Of" a Trust Distribution – Fixing Present Entitlement and Bricks

Entitlements to the income of the trust could be paid by way of promissory note, or something else agreed between the trustee and beneficiary. The distribution would at that moment be discharged, even though the promissory note would be presented later.

But there is an alternative, and that is to make the trust distribution *by way of* a payment. This would involve making a beneficiary entitled to some specific asset, and that represents a payment for the income of the trust for that financial year. This is an analogous to *Vestey* making the beneficiaries entitled to some cash before the end of the financial year.

Given that there has been a payment of that asset (such as a bill of exchange – a promissory note is not choate until passed from the drawer to the drawee and so is merely paper until that time) the trustee's rights of indemnity will be discharged in relation to that distributed asset, and the earlier issues relating to vesting an interest should be met – the amount is known and is in the hands of the beneficiary.

Should the tax net income be an amount that is different from the amount distributed (quite likely given the accounts will be done later) then the proportionate distribution of tax net income per *Bamford* will apply.

The asset could in theory be anything properly identifiable, such as a brick. In reference to the ability to make a trust distribution by way of an asset, a couple of years ago for his birthday (as a joke) I gave Campbell a brick. Engraved on the brick was the words that this represents a trust distribution of the Cartland Family Trust for $1,000,000. Should that not have been a fictitious joke, upon accepting that brick he would have become liable for the tax on that distribution (on whatever the tax net income was).

- End-

[52] *Bill of Exchange Act 1909* (Cth) Part IV.
[53] *The Brimnes* [1973] 1 WLR 386, 400.