HIGH COURT OF AUSTRALIA

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Details of Filing

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IN THE HIGH COURT OF AUSTRALIA
SYDNEY REGISTRY

ON APPEAL FROM THE FULL COURT OF
THE FEDERAL COURT OF AUSTRALIA

BETWEEN: **COMMISSIONER OF TAXATION**
Appellant

10

and

NATALIE CARTER
First Respondent

ALISHA CARATTI
Second Respondent

NICOLE CARATTI
20 Third Respondent

APPELLANT'S SUBMISSIONS

PART I: CERTIFICATION

1. It is certified that these submissions are in a form suitable for publication on the internet.

PART II: ISSUES

2. If a beneficiary with a present entitlement to a share in the distributable income of a trust at the close of an income year disclaims that entitlement after the income year, does the beneficiary cease, at all times relevant to the assessment of tax for that income year, to have been "presently entitled" to the distribution within the meaning of s 97 of the *Income Tax Assessment Act 1936* (Cth) (**ITAA 1936**).

PART III: SECTION 78B

3. The Commissioner has considered whether a notice under s 78B of the *Judiciary Act 1903* (Cth) is required, and does not consider that such a notice is necessary.

PART IV: JUDGMENTS BELOW

4. *Carter v Federal Commissioner of Taxation* [2020] FCAFC 150.
5. *Re The Trustee for the Whitby Trust & Ors and Commissioner of Taxation* [2019] AATA 5637.

PART V: FACTUAL BACKGROUND

6. The factual background can be shortly stated.
7. The Whitby Trust was settled on 27 July 2005: CAB 92 [57].
8. The respondents, as children of Allen Bruce Caratti, were "Primary Beneficiaries" and "General Beneficiaries" of the trust: ABFM 9 (definitions of "Primary Beneficiaries" and "General Beneficiaries") (Whitby Trust T docs at 155-156); CAB 92 [58].
9. Clause 3.7 of the Trust Deed stated (CAB 92 [60]):

> If in relation to any Accounting Period, the Trustee has made no effective determination pursuant to the preceding provisions of this clause in respect to any part of the income of that Accounting Period immediately prior to the end of the last day of that Accounting Period, then the Trustee shall hold that income in trust successively for the persons who are living or existing on the last day of that Accounting Period and who are successively described in clauses 4.1 to 4.5 (inclusive) as though that last day of the relevant Accounting period were the Vesting Day.

10. Clause 4.2 relevantly referred to "such of the Primary Beneficiaries as shall be living at the Vesting Day as tenants in common in equal shares": ABFM 19.
11. The "Accounting Period" was the period of twelve months expiring on 30 June of each year: ABFM 9 (definition of "Accounting Period").

12. On 17 April 2014, the Commissioner issued amended assessments to each of the respondents for the 2011 to 2013 income tax years. On 4 June 2014, the respondents executed deeds of disclaimer for those years referred to below as the **First Disclaimers**. The Commissioner (wrongly) accepted the First Disclaimers were effective as to the 2011-2013 income years: CAB 92-93 [61]-[64]. The 2011- 2013 income years are not in issue in this appeal.

13. As at 30 June 2014, the trustee had not made an effective determination under clause 3 of the Trust Deed for that Accounting Period.[1] As a result, the respondents became entitled, under cl 3.7, to the income from the year ending 30 June 2014.

14. Following an audit, on 27 October 2015, the Commissioner issued assessments to the respondents for the income year ended 30 June 2014: CAB 93 [65].

15. On 3 and 4 November 2015, the respondents executed deeds of disclaimer in respect of their default distributions for the year ending 30 June 2014: CAB 93 [66]. Those disclaimers, which were described below as the **Second Disclaimers**, were ineffective: CAB 55 [131]; CAB 104-105 [94]-[98].

16. On 30 September 2016, the respondents executed further disclaimers (described below as the **Third Disclaimers**): CAB 94-95 [70]. The Third Disclaimers were, if effective as disclaimers, sufficiently broad to disclaim the relevant trust distribution.

17. The Administrative Appeals Tribunal (constituted by O'Loughlin DP) held that the Third Disclaimers were ineffective because they were made after the respondents, with knowledge, had failed to disclaim and had accepted the gifts: CAB 55-56 [132]-[134].

18. The respondents appealed to the Federal Court, inter alia against the Tribunal's finding that the Third Disclaimers were ineffective: CAB 70. By Notice of Contention, the Commissioner contended that the Third Disclaimers, even if effective at general law to disclaim the gift, did not retrospectively disapply s 97 of the ITAA 1936.

19. On appeal, the Full Court held that the Third Disclaimers were effective: CAB 92-104 [57]-[93].

20. The Full Court dismissed the Commissioner's contention: CAB 106-112 [100]-[111]. The Full Court's reasoning appears at CAB 111-112 [109]-[110]. Two propositions emerge from those paragraphs as central to the Full Court's reasoning. First, that a disclaimer

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[1] An argument that there had been an effective determination was rejected below: CAB 80-92 [44]-[56].

operates at general law to extinguish a beneficiary's entitlement to trust income ab initio. Its effect is that the beneficiary must be treated as never having been entitled to the income for the purposes of s 97 in respect of the relevant income year. Thus, it was determinative against the Commissioner in the application of s 97 to the beneficiary ([109]). Second, there was nothing in s 97 to indicate that a beneficiary's liability was to be determined once and for all at the end of the income year by reference to the legal relationships then in existence ([110]).

21. The Commissioner's case is these propositions are based on misunderstandings of s 97 of the ITAA 1936 and the effect of a disclaimer at general law.

22. By special leave to appeal granted on 16 April 2021, the Commissioner now appeals to this Court.

PART VI: ARGUMENT

Introduction

23. This case involves the interaction between revenue laws and principles of the general law. In such a case, it is necessary to construe the revenue laws, to understand what taxable facts they operate on and the circumstances in which they are intended to render a person liable to tax. It is also necessary to understand the precise legal effects of the applicable general law doctrine, relevantly, to understand the extent to which it is retroactive.

24. The starting point, then, is the proper construction of the revenue laws. Section 97 of the ITAA 1936 relevantly applies where a beneficiary has a present legal right to demand and receive payment of a share of the distributable income of a trust estate. The relevant taxable fact is the *right* to receive an amount of distributable income, not its receipt. Nor does the receipt of trust income determine the *quantum* of tax payable. That is determined by ascertaining the proportion of the distributable income of the trust estate to which the beneficiary is presently entitled and applying that proportion to the "net income of the trust estate" (as defined in s 95). The relevant taxable fact – the *right* to receive an amount of distributable income – crystallizes at midnight at the end of each financial year (relevantly 30 June). At that time, income tax is levied by s 7 of the ***Income Tax Act*** *1986* (Cth) upon which a taxpayer owes a present legal obligation to pay the tax levied that matures into a debt due upon assessment: *Commissioner of Taxation v* ***H*** (2010) 188 FCR 440 at [17], [39] and [43]-[44]; see also *Commissioner of Taxation v* ***Jones*** (1999) 86 FCR 282 at [18]. Taxpayers do not have a unilateral right subsequently to vary that present legal obligation.

25. The next issue is the effect of a disclaimer at general law. Critically, a disclaimer does not render a gift void ab initio for all purposes, in all respects and against all persons. A disclaimer *may* render void ab initio any transfer of property. However, it does not render void ab initio the *right* of the beneficiary, at all times up to the disclaimer, to demand and receive the gifted property.

26. In this case, the respondents were "presently entitled" to the amounts the subject of the default distributions. At all times up to the disclaimers, the beneficiaries had a right to demand and receive payment of those distributions. The disclaimers did not retroactively extinguish that right. And that right was sufficient to give rise to a present entitlement within the meaning of s 97.

27. Further, even if the disclaimers *did* render *any* rights held by the respondents void ab initio as between the respondents and the trustee, they did not operate to affect the application of s 97 at the time it applied, namely, 30 June 2014. Nor did they extinguish or vary the present legal obligation which had arisen on 1 July 2014 under the *Income Tax Act*.

The correct approach

28. The basis of the Full Court's decision is the proposition that disclaimers operate to render void ("extinguishes") a beneficiary's entitlement to a share in the distributable income of a trust ab initio for all purposes (CAB 112 [109]).

29. Questions as to the legal effect of the "voiding" of a transaction or decision arise in various areas of the law. The issue sometimes arises in public law, eg when assessing the extent to which jurisdictional error invalidates exercises of public power: eg *Oakey Coal Action Alliance Inc v New Acland Coal Pty Ltd* (2021) 95 ALJR 128; *Minister for Immigration and Border Protection v SZMTA* (2019) 264 CLR 421; *Hossain v Minister for Immigration and Border Protection* (2018) 264 CLR 123. The issue also arises where there is an intersection between public and private law, eg when assessing the extent to which illegality invalidates a contract: eg ***Gnych*** *v Polish Club Ltd* (2015) 255 CLR 414.

30. In these contexts, this Court has repeatedly cautioned that care must be exercised in using words such as "void". As the Court said in *State of NSW v* ***Kable*** (2013) 252 CLR 118 at [21]-[22]:

> [21] 'It is necessary to exercise great care in using words like "void", "voidable", "irregularity" and "nullity" in connection with the issues that arise in this matter. Each word was used in Mr Kable's argument in this appeal to state a conclusion about the legal effect of the order of Levine J. More often than not, each word was used in a way which expressly or impliedly sought to

> convey a meaning identified by its opposition to another word (void versus voidable, nullity versus irregularity). Used in that way, each of the words, void, voidable, nullity and irregularity, suggests that the whole of the relevant universe can be divided between two realms whose borders are sharply defined and completely closed. None is used in a way which admits (or readily appears to admit) of the possibility that the legal effect to be given to an act affected by some want of power may require a more elaborate description which takes account not only of *who* may complain about the want of power, but also of what *remedy* may be given in response to the complaint.

31. At [22] in *Kable* the Court quoted with approval the observation of HWR Wade, made in the context of administrative actions, that there was no "such thing as voidness in an absolute sense, for the whole question is, void against whom".[2]

32. In the passage from *Minister for Immigration v Bhardwaj* (2002) 209 CLR 597 to which this Court also referred in *Kable* at [22], Gaudron and Gummow JJ said (at [46]):

> In our view, it is neither necessary nor helpful to describe erroneous administrative decisions as ''void'', ''voidable'', ''invalid'', ''vitiated'' or, even, as ''nullities''. To categorise decisions in that way tends to ignore the fact that the real issue is whether the rights and liabilities of the individual to whom the decision relates are as specified in that decision. And, perhaps more importantly, it overlooks the fact that an administrative decision has only such force and effect as is given to it by the law pursuant to which it was made.

33. Further, as Gageler J observed in *Kable*, an invalid exercise of power "remains at all times a thing in fact" which has an existence and is capable of having legal consequences: at [52]. His Honour also observed in *Gnych* that a transaction may be only partly void, eg it may be void only to the extent of unenforceability and as against some persons: at [65]. And, as Dixon J said in ***Posner*** *v Collector for Inter-State Destitute Persons (Vict)* (1946) 74 CLR 461 at 483, it is "only as a result of the construction placed upon a statute" that a decision "can be considered so entirely and absolutely devoid of legal effect for every purpose as to be described accurately as a nullity".

34. A number of important, and presently relevant, points flow from the Court's jurisprudence on voidness.

35. First, to speak of a transaction as "void" (or "extinguish[ed] … ab initio") is to conceal assumptions as to the *extent* of voidness and the *persons against whom* the transaction is void: *Bhardwaj* at [46].

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[2] "Unlawful Administrative Action: Void or Voidable" (1967) 83 *LQR* 449 at 512.

36. Secondly, a decision may be void for some purposes, but not others. Voidness for some purposes or in some respects does not entail "invalidity for all purposes": *Kable* at [22]. The transaction remains a thing in fact, and can have legal consequences: *Kable* at [52]. And the transaction may be void against some persons, but not against all persons: *Kable* at [21]; *Gnych* at [65]. As Leeming JA said in *CCSR v* ***Smeaton*** *Grange Holdings Pty Ltd* (2017) 106 ATR 151 at [6] "it is one thing for private parties to agree that their legal relations are to be taken to have been conducted on a particular basis, and for that agreement to have retrospective effect as between themselves", but "[i]t is an entirely different thing for parties by their private agreement to alter with retrospective effect their relations with a third party". *A fortiori*, where that asserted retrospective effect is to expunge accrued tax liabilities arising on the taxable facts as they existed at the relevant time.

37. Thirdly, where it is said that a transaction is "void" so that it is not picked up by a statute, it is always necessary to consider the construction of the statute said to pick up (or not pick up) the transaction; or, in other words, the extent to which the statute recognizes the "voiding" of the transaction: *Posner* at 483; see also *Smeaton* at [4], [39].

38. In light of these principles, the Commissioner submits that the correct approach in a case such as the present is as follows.

39. The Court should first consider the construction and operation of those revenue laws said to pick up and give effect to the default distribution.

40. The Court should second consider the effect, at general law, of a disclaimer.

41. Finally, the Court should ask whether, in light of the effect of a disclaimer at general law, a disclaimer is effective wholly to disapply s 97.

42. These submissions turn now to addressing these questions.

The meaning and operation of the revenue laws

Section 97(1) of the ITAA 1936: history and key principles

43. Section 97(1) of the ITAA 1936 relevantly states:

> 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) so much of that share of the net income of the trust estate as is attributable to a period when the beneficiary was not a resident and is also attributable to sources in Australia …

44. At the outset, it should be observed that the relevant taxable fact which enlivens s 97(1) is that a beneficiary "is presently entitled to a share of the income of the trust estate". However, the amount included in the beneficiary's assessable income is not the quantum of that share of the *income*. Rather, the amount included in a beneficiary's assessable income is an amount of the "net income" of the trust estate (a concept defined in s 95(1)). As *Commissioner of Taxation of the Commonwealth of Australia v* ***Bamford*** (2010) 240 CLR 481 at [45] shows, that is distinct from the "income" referred to in the chapeau. That amount is ascertained by application to the net income of the beneficiary's proportionate present entitlement to the "income of the trust estate" referred to in the chapeau.

45. The critical issue in this case is the meaning and operation of the words in the chapeau, namely, "presently entitled to a share of the income of the trust estate". In order to understand the meaning of those words, it is convenient to note some matters of statutory history and also the key authorities on that expression and its statutory predecessors.

46. The statutory history starts with the *Income Tax Assessment Act 1915* (Cth) (No 34 of 1915) (**the 1915 Act**). The scheme of the 1915 Act was to include in assessable income beneficial interests in income derived under (inter alia) any instrument of trust (s 14(c)) *and* to tax income derived by a person as trustee as if the trustee were beneficially entitled to it (s 26(1)). The taxation of the trustee was subject to a proportionate deduction from total tax assessed (not from assessable income) equal to the proportion that the income of the trust which had been distributed to beneficiaries bore to the whole of the income (s 27(2)). This deduction reduced, but did not eliminate, the potential for double taxation, particularly in the case of undistributed income. Further, by making the deduction one from the tax assessed and not from assessable income, the trustee's marginal rate of tax was maximized.

47. The perceived unfairness in the operation of the 1915 Act led to the replacement of s 26 and s 27 of the 1915 Act by s 26 of the *Income Tax Assessment Act 1918* (No 18 of 1918) (**the 1918 Act**). The effect of s 26 was, relevantly, to include in the assessable income of a beneficiary who was "presently entitled" to a share in the income of the trust estate, their "individual interest in the income of the trust estate", after allowing all deductions save one, and to relieve the trustee of tax on those amounts. The 1918 Act thus introduced the concept of "present entitlement". It was said that the section operated to deem the income of the trust estate "to have been distributed where there were beneficiaries entitled to receive it or

have it credited as income".[3] Section 14(c) was not amended by the 1918 Act. Section 26 of the 1918 Act was re-enacted as s 31 of the *Income Tax Assessment Act 1922* (Cth) (Act No 37 of 1922) with only immaterial additions.

48. The *Income Tax Assessment Act 1936* (Cth) (No 27 of 1936) enacted, as section 97(1), the following:

> Where any beneficiary is presently entitled to a share of the income of a trust estate and is not under any legal disability, his assessable income shall include that share of the net income of the trust estate.

49. Section 97(1) – which is the ancestor of the current s 97 – copied the language of present entitlement from the 1918 Act. Importantly, it introduced the concept of "net income of the trust estate" and designated that as the object the relevant share of which was included in a beneficiary's assessable income. That concept was defined in s 95.

50. While it has been observed that Division 6 of the ITAA 1936 as enacted reflected the general principle previously embodied in s 31 of the 1922 Act that the persons entitled to receive and retain trust income were the persons who should pay tax in respect of it,[4] that should not obscure the fact that Division 6 differed from its predecessors in that what it brought to tax were amounts of the "net income of the trust estate" as defined and not the "income of the trust estate". Those were always apt to be different: *Bamford* at [17].

51. The construction of s 97 of the ITAA 1936 was considered by this Court in *Federal Commissioner of Taxation v* ***Whiting*** (1942) 68 CLR 199. At 215-216, Latham CJ and Williams J observed:

> 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 …

52. At 219 of *Whiting*, Starke J approved the proposition that "all that is necessary in order to attract liability to [the beneficiary] and to divert it from [the] executor or trustee, is that he should be presently entitled to income of the estate … It is not necessary that he should have received his share of the income".

53. In 1946, in ***Tindal*** *v The Federal Commissioner of Taxation* (1946) CLR 608, a question as to the construction of s 97(1) came before the High Court on a case stated. At 618, Latham CJ stated:

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[3] House of Representatives, Income Tax Assessment Bill, Second Reading Speech (Wednesday, 1 May 1918) (William Watt, Acting Prime Minister and Treasurer).

[4] *Harmer v Federal Commissioner of Taxation* (1989) 20 ATR 1461 at 1466 (French J).

> In order to answer the question it is necessary to decide (1) whether, upon the true construction of s.97 of the Act, the assessable income of a beneficiary includes a share of the net income of a trust estate independently of actual receipt of that income by the beneficiary …
>
> As to the first question I am of opinion that, when s.97 applies, the result is that the assessable income of a beneficiary does include his share of the net income of the trust estate, whether or not that income is paid to him. Otherwise, the section would produce no effect in relation to assessment or payment of tax. Sections 95-99 are designed, in my opinion, to secure payment of tax upon the whole of the net income of a trust estate, either from a beneficiary or the trustee, whether or not that income is paid over to or on account of the beneficiary.

54. His Honour was in dissent in *Tindal*, but the other members of the Court did not controvert the proposition stated at 618, and it has been applied subsequently.[5]

55. In ***Union Fidelity*** *Trustee Co of Australia Ltd v Federal Commissioner of Taxation* (1969) 119 CLR 177 at 182, Barwick CJ drew a distinction between the position of a beneficiary who, at the close of the tax year, was entitled to receive a share of the income of the trust estate and one who had been paid it. The Chief Justice went on to observe that a beneficiary who had been paid their share of the income of the estate in respect of a tax year at or before the close of a tax year was not at the close of the tax year presently entitled to it and thus was not taxable under s 97, but under s 26(b) (the successor to s 14(c) of the 1915 Act).

56. In 1979, the ITAA 1936 was amended by the *Income Tax Assessment Amendment Act 1979* (Cth) (No 12 of 1979 (**the 1979 Act**)). The 1979 Act repealed the existing s 97 and replaced it with the text which (subject to some presently irrelevant exceptions) it retains today.

57. The 1979 Act also enacted s 95A. Section 95A(1) as introduced by the 1979 Act stated:

> For the purposes of this Act, where a beneficiary of a trust estate is presently entitled to any income of the trust estate, the beneficiary shall be taken to continue to be presently entitled to that income notwithstanding that the income is paid to, or applied for the benefit of, the beneficiary.

58. Additionally, the 1979 Act introduced s 26(b)(i)-(ii) into the ITAA 1936 which removed from the assessable income under s 26(b) amounts assessable to a beneficiary or trustee under Division 6. Accordingly, ss 95A(1) and 26(b)(i)-(ii) effectively reversed the observations of Barwick CJ in *Union Fidelity* concerning the position of a beneficiary of a trust estate who at or before the close of the tax year, had been paid their share of the income

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[5] See, eg, *Leighton v Federal Commissioner of Taxation* (2010) 80 ATR 567 (Gordon J) at [29(5)] ("Sections 95-99 were designed to secure payment of tax upon the whole of the net income of a trust estate, either from a beneficiary or the trustee, whether or not that income was paid over to or on account of the beneficiary"); *Re Thorpe Nominees Pty Ltd v The Commissioner of Taxation of the Commonwealth of Australia* (1988) 19 ATR 1834; [1988] FCA 387 at [33] (Lockhart, Sheppard and Burchett JJ).

of the trust estate. However, they confirmed the broader point made by the Chief Justice in *Union Fidelity;* namely, that a present entitlement enlivening the application of s 97 to a beneficiary was distinct from receipt and was determined at the close of the relevant tax year.

59. The 1979 Act also amended the definition of "net income" in s 95(1) to overcome the decision in *Union Fidelity* by introducing an assumption that the trustee was a resident. The definition of "net income", as originally enacted and as amended in 1979, further divorces the operation of s 97(1) from the actual receipt of trust income by a beneficiary. The quantum of the amount included in the assessable income of a beneficiary under s 97(1) is a share of the "net income" (as defined in s 95(1)) determined by reference to the beneficiary's proportionate share of the "income of the trust estate". That share of the "net income" may differ from (and be greater than) the share of trust income to which the beneficiary is presently entitled which, in turn, may differ from (and be greater than) the amount in fact received by the beneficiary.

60. In 1980 the *Income Tax Laws Amendment Act 1980* (Cth) (No 19 of 1980) introduced s 95A(2) into the ITAA 1936 deeming a beneficiary with vested and indefeasible interest in the income of a trust estate, but who was not presently entitled to it, to be presently entitled to that income. Where it applies, s 95A(2) deems a beneficiary to have a present entitlement if they have a non-contingent interest in the income of the trust estate which cannot be brought to an end and whether or not they can call for the payment at the close of the year.[6] Section 95A(2) further confirmed the separation of the concept of "present entitlement" to the income of the trust estate from the receipt of trust income.

61. In *Federal Commissioner of Taxation v* ***Totledge*** *Pty Ltd* (1982) 12 ATR 830, a decision which was later cited with approval in *Bamford*, the Full Court of the Federal Court (Bowen CJ, Deane and Fitzgerald JJ) stated that s 97(1) applied where there was "a present vested right to demand and receive payment" of income: at 839. The focus is on the right to demand payment, not actual payment.

62. The current authoritative articulation of the meaning of present entitlement (leaving aside deemed present entitlement under s 95A(2)) was stated in ***Harmer*** *v Federal Commissioner of Taxation* (1991) 173 CLR 264 at 271 and *Bamford* at [28], namely, a beneficiary is presently entitled if and only if:

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6 *Dwight v Commissioner of Taxation* (1992) 37 FCR 178 at 191-192 (Hill J).

(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** … (emphasis added)

63. The emphasised passages identify three key points. First, the taxable fact is the *right* to demand and receive. Secondly, there is a temporal focus, namely, "the end of the relevant year of income". And, third, whether or not the trustee has funds available for payment is irrelevant, thereby underscoring that the taxable fact is not receipt.

64. Two important points arise from this review of the legislative history and the authorities.

65. The first is that s 97(1) is not concerned with whether or not a beneficiary has in fact received income. The section is concerned with the existence of an entitlement in the beneficiary. As *Harmer* and *Bamford* make clear, there may be an entitlement even though the trustee does not even have funds available to pay it.

66. The second point is that (leaving aside cases of deemed present entitlement under s 95A(2)) the entitlement with which s 97(1) is concerned is a right to demand and receive payment of the income – or, put another way, a right to call for the trust distribution.

The levying of tax

67. Section 5(1) of the *Income Tax Act* states that "[i]ncome tax is imposed in accordance with this Act and at the relevant rates declared by the *Income Tax Rates Act 1986*".

68. Section 7 of the *Income Tax Act* states:

> The tax imposed by subsection 5(1) is levied, and shall be paid, for the financial year commencing on 1 July 1986 and for all subsequent financial years until the Parliament otherwise provides.

69. The effect of ss 5 and 7 of the *Income Tax Act* is to give rise to what has been called a "present legal obligation" to pay the levied tax: *H* at [44]. As the Court said at [43] of *H*:

> [I]ncome tax is imposed by the *Income Tax Act* (s 5(1)) at the rates declared by the *Income Tax Rates Act 1986* (Cth). The income tax so imposed is levied by s 7 of the *Income Tax Act*, which also requires it to be paid for the relevant financial year. The obligation to pay income tax so imposed arises by operation of the *Income Tax Act* itself and not by the issue of a notice of assessment.

70. This reflects the more general principle that, under the income tax laws, income tax is computed and knowable as at the end of a financial year. As Hill, Sackville and Hely JJ said in *Jones* at [18]-[19], after referring to the *Income Tax Act* (at [16]):

> There is no doubt that the scheme of the legislation contemplates that income tax is an annual tax to be computed by reference to the taxable income, that is to say the

> assessable income less allowable deductions of the year of income which ends on 30 June or on the last day of the substituted accounting period. It is no doubt also true to say that one can never know on any day during the financial year, except on the last moment of the last day of the year, what a taxpayer's taxable income or allowable deductions for the year of income will be. …
>
> The income tax which is levied is to be assessed in accordance with the Assessment Act. …

71. In a case like the present, the effect of the *Income Tax Act* and s 97 of the ITAA 1936 is, at the end of a financial year, to levy tax on income, which income includes amounts by reason of s 97(1). And, tax having been levied, the beneficiaries have a present legal obligation to pay the taxed amount to the Commonwealth. That obligation is then given concrete application as a debt due and payable by the completion of the process of assessment: *Batagol v Federal Commissioner of Taxation* (1963) 109 CLR 243 at 252.

72. Nothing in the *Income Tax Act* contemplates that the present legal obligation arising at the end of the financial year may be affected by the unilateral conduct of the taxpayer after the end of the financial year. Much less after the end of the financial year *and* after an assessment. Were it otherwise, the unilateral conduct of a taxpayer would "change the operation of the legislation", something which the Court below expressly disavowed: CAB 112 [110].[7]

73. This is true *a fortiori* when an amount has been brought to tax by reason of s 97. The purpose of s 97 is to render a beneficiary liable to tax where the beneficiary has a present entitlement at the end of the relevant income year, whether or not the beneficiary in fact receives any amount from the trust. So, as Barwick CJ explained in *Union Fidelity*, one tests the question of present entitlement "at the close of the taxation year" (at 182) and "at the conclusion of the tax year" (at 183). Where a beneficiary has such a present entitlement at that time that present entitlement is then used to determine the relevant "share" of the "net income of the trust estate" on which s 97 taxes the beneficiary. Once that occurs the concept of present entitlement has "served its purpose".[8] Whether that present entitlement is subsequently satisfied (by payment) or released (by disclaimer) is irrelevant to the operation of s 97. Contrastingly, receipt of trust income by a beneficiary *is* taxed by s 99B, if it is not a receipt

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7 See analogously *Rowe v Federal Commissioner of Taxation* (1982) 13 ATR 110 at 113 (Deane, Fisher and Davies JJ); *Federal Commissioner of Taxation v Trustee for the Michael Hayes Family Trust* (2019) 273 FCR 567 at [49] (Steward J; Griffiths and Derrington JJ agreeing); *Smeaton* at [9], [21]-[22] (Leeming JA) at [146] (Sackville AJA).

8 *Zeta Force Pty Limited v Federal Commissioner of Taxation* (1998) 84 FCR 70 at 75 (Sundberg J), quoted with approval in *Bamford* at [45].

in respect of which an amount has been included in a beneficiary's assessable income under s 97 (s 99B(2)(c)(i)).

74. The very expression "is **presently** entitled" directs attention to a temporal question. *When* is one to be presently entitled? There *must* be a temporal dimension to the statutory question because the question is one of entitlement, not actual receipt, and entitlement will typically but not always precede receipt. The use of the present tense in s 97 suggests the section is speaking to an entitlement existing during the relevant income year: see *Smeaton* at [136].

75. There are further textual and contextual indications within s 97 and Division 6 that the taxable facts enlivening s 97's operation are determined at a point in time, being during or at the end of the relevant income year. Thus, when s 97(1) directs attention to whether a beneficiary is under a legal disability (eg, a minor) or is a resident (see s 97(1)(a)(i) and s 97(2)(a)(i) and (b)(i)) it is necessarily directing attention to facts which can only be ascertained during or at the end of the relevant income year. It is unlikely some of the taxable facts on which s 97 turns (viz., absence of a legal disability and residency) would be determined during or at the end of the relevant income year, but others (viz., present entitlement) could be subject to fluctuation and retrospective alteration after the close of the relevant income year by the unilateral action of a taxpayer. Other provisions of Division 6 similarly expressly direct attention to the state of a trust estate at the end of an income year for particular purposes (see s 95AB(1) and (3)).

76. Two key observations arise from these textual and contextual observations. First, the question of whether there are taxable facts which enliven s 97(1) – and relevantly the beneficiary's present entitlement – is to be asked and answered at the end of the relevant income year. Secondly, if s 97(1) is enlivened, and an amount is included in the beneficiary's assessable income and the beneficiary (as a result) has taxable income on which tax is levied, there is then a present legal obligation to pay that tax. These observations furnish the basis in principle for the High Court's observation in *Harmer* at 271 that the question posed by s 97 "must be answered … during the tax years".[9]

The effect of a disclaimer at general law

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[9] See also *Colonial First State Investments Ltd v Federal Commissioner of Taxation* (2011) 192 FCR 298 at [24] (Stone J).

77. In civil law systems, a gift is generally ineffective until the donee assents.[10] The common law could have developed that way. Indeed, in 1886, Lord Halsbury LC observed that "[i]f the matter were to be discussed now for the first time, I think it might well be doubted whether the assent of the donee was not a preliminary to the actual passing of the property".[11]

78. However, as Lord Halsbury indicated, the common law took a different course. In ***Butler*** *and Baker's Case* (1590) 3 Co Rep 26b-27a; [1591] 76 ER 684 at 689, it was said in respect of gifts that "the [gifted] goods and chattels are in the donee presently, before notice or agreement". A century later, in ***Thompson*** *v Leach* (1690) 2 Ventris 198; 86 ER 391, Ventris J held that "conveyances work immediately upon the execution of them" and "immediately vest the estate in the party without any express consent": at 203, 394. Subsequently, in ***Siggers*** *v Evans* (1855) 5 E&B 367; 119 ER 518, after reviewing the authorities, Lord Campbell CJ held at 382, 524, that even in respect of "onerous trusts", the "estate would pass subject to the trustee choosing afterwards to disclaim".

79. The course taken by the common law was in tension with another principle of the common law, namely, that "[i]t requires the assent of both minds to make a gift as it does to make a contract": *Hill v Wilson* (1873) LR 8 Ch App 888 at 896, adopted in *Matthews v Matthews* (1913) 17 CLR 8 at 20. If assent is necessary to effect a gift, how does title pass prior to assent, or even knowledge, of the donee?

80. That tension was resolved, to an extent, by founding the principle that a gift vests in a donee immediately by reason of a strong presumption of law that the donee assents. In *Thompson*, Ventris J said[12] "the assent of a party that takes, is implied in all conveyances, and this is by intendment of law, which is as strong as the expression of the party, till the contrary appears". His Honour rooted that presumption on three rationales: (i) a "strong intendment of law, that … no man can be supposed to be unwilling to that which is for his advantage"; (ii) that "it would seem incongruous and absurd, that when a conveyance is completely executed on the grantor's part, yet notwithstanding the estate should continue in him"; and (iii) the "third and principal reason", being "to prevent the uncertainty of the freehold … because that it would be very hard and inconvenient that a man should be driven to bring

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10 Crago, "Principles of Disclaimer of Gifts" (1999) 28 *Western Australian Law Review* 65 at 67; ***Standing*** *v Bowring* (1886) 31 Ch D 282 at 290 (Lindley LJ).

11 *Standing* at 286.

12 At 202; 394.

his praecipe or real action first against the grantor, and after he had proceeded in it a considerable time, it should abate by the transferring of the freehold to a stranger, by reason of his agreement to some conveyance made before the writ brought".[13] In *Matthews v Matthews* (1913) 17 CLR 8 at 43, Isaacs and Powers JJ described this as a "presumption of acceptance", referring to Lindley LJ's[14] foundation of that presumption "on human nature; a man may be fairly presumed to assent to that to which he in all probability would assent if the opportunity of assenting were given him".[15]

81. What, then, is the effect of a disclaimer of a gift? In civil law systems, the answer to that question is straightforward: the gift is ineffective until assent, and a disclaimer manifests dissent. The answer is not so straightforward in the common law system: if title passes before assent, to what extent can and does a subsequent disclaimer undo that which has already occurred?

82. The courts have grappled with this question on several occasions.

83. In *Townson v Tickel* (1819) 3 B & Ald. 31; 106 ER 575, Bayley J said of a disclaimer:[16]

> It seems to me that the effect of that is, that the estate never was in him at all. For I consider the devise to be nothing more than an offer which the devisee may accept or refuse, and if he refuses, he is in the same situation as if the offer had never been made.

84. It might be thought from *Townson* that a disclaimer *does* operate to void the gift ab initio for all purposes. Nevertheless, the law developed differently.

85. The issue arose again in ***Mallott*** *v Wilson* [1903] 2 Ch 494, where Byrne J referred at 501 to a statement in *Sheppard's Touchstones* to the effect that "[f]rom the moment there is evidence of disagreement, then in construction of law the grant is void ab initio, as if no grant had been made: and in intendment of law the freehold never passed from the grantor". His Honour did not wholeheartedly embrace that proposition, instead saying at 501:

> I felt somewhat embarrassed by the use of the expression "void ab initio"; but I am satisfied now that the true meaning is that, **not in regard to all persons and for all purposes is the case to be treated as though the legal estate had never passed**, but that as regards the trustee and the person to whom the grant was made, he is, in respect of his liabilities, his burdens, and his rights, in exactly the same position as though no conveyance had ever been made to him. (emphasis added)

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13 At 203-204; 394

14 In *London v County Banking Co Case* (1888) 21 QBD 535 at 542

15 See also Barton ACJ at 20-21; *Townson v Tickel* (1819) 3 B &Ald. 31, 36, 37; 106 ER 575, 577

16 at 38; 577; see also at 37; 577 Abbott CJ describing the disclaimer as "hav[ing] the effect of making the devise with respect to him null and void"

86. In *Mallott*, the issue concerned the effect of a disclaimer of office by a named trustee of a trust. His Honour held that the disclaimer "did not destroy the trust" but revested the settlor with the result that the "settlor … subsequently became trustee" by reason of the disclaimer. *Mallott* stands for the proposition that a disclaimer does not render the gift void ab initio for all purposes and against all persons.

87. The issue arose again in *In re* ***Parsons****; Parsons v Attorney-General* [1943] 1 Ch 12. In *Parsons*, the donee, a legatee, had disclaimed. The issue was whether, despite the disclaimer, the donee remained someone who, prior to the disclaimer, was "competent to dispose" of the gifted property within the meaning of ss 5(2) and 22(2)(a) of the *Finance Act 1894* (UK). The answer to that question affected the imposition of estate duty. The concept of "competent to dispose" included the capacity to make the property your own by taking it: at 15. It was argued for the trustees that the disclaimer "made the gift void ab initio", with the result that "the husband never was 'competent to dispose' of the stock although he was until the disclaimer": at 13. It was argued for the Attorney-General that the gift was "more than a mere offer and would be better described as conferring a binding option": at 14. The Court rejected the trustees' contention, holding that disclaimer did not mean that "the competence must be treated in law as not having existed" (at 16) and that the donee "was, as Mr Stamp [for the Attorney-General] put it, in a position not unlike that of a person with a binding option" and was therefore, despite the disclaimer, a person "competent to dispose" of the property at all times: at 17.

88. *Parsons* stands for two propositions. The first is that a donee, prior to actual assent, is in a position akin to the beneficiary of a binding option; that is, has the right to call for the transfer of the gifted property.[17] The second is that, even after disclaimer, a donee may be said to have had, at all material times, rights to the gifted property. In *Parsons*, those rights were sufficient to be described as a competency to dispose of the property. The similarity to the concept of present entitlement may be observed.

89. The issue arose again in ***Re Stratton's Disclaimer*** [1958] Ch 42. Like *Parsons*, *Re Stratton's Disclaimer* also concerned the incidence of estate duty. The beneficiary had disclaimed. The issue was whether, despite the disclaimer, the beneficiary had at all material times a "right" enforceable against the gifted property within the meaning of s 45 of the

[17] A characterisation approved by Brooking J in *Perpetual Executors and Trustees Association of Australia Ltd v Commissioner of Probate Duties* [1981] VR 91 at 101-102 and by McGarvie J in *JW Broomhead (Vic) Pty Limited v JW Broomhead Pty Limited* [1985] VR 891 at 930-931.

Finance Act 1940 (UK). The plaintiffs/beneficiaries contended that the effect of a disclaimer was to establish "that the presumption of assent to the gift originally made by the law was wrong and was *always* wrong, that is, that the presumption of assent was negatived ab initio and not from the date of disclaimer", so that there was no "right". The Court of Appeal rejected that "extreme position" as going beyond anything in the previous cases and as inconsistent with *Parsons* (at 52) and, holding at 54:

> [A] disclaiming legatee or devisee has between the testator's death and the moment of disclaimer a right in respect of the legacy or devise, in that he is, during that period, entitled to call upon the executors to pay or transfer to him the subject-matter of the bequest or devise in due course of administration. It is none the less a right because it is defeasible by the beneficiary's own act of disclaimer. That merely means that he is free to choose whether to avail himself of it or not until such time as he has either unequivocally disclaimed or unequivocally accepted the gift. If he disclaims, then he avoids the gift, and with it the concomitant right, **but that does not alter the fact that down to the moment of disclaimer he did have the right and would still have had it if he had not disclaimed**. [emphasis added]

90. *Re **Paradise** Motor Co Ltd* [1968] 2 All ER 625; [1968] 1 WLR 1125, the decision referred to by the Full Court at [109] below, was decided approximately a decade after *Re Stratton's Disclaimer*. The issue of the effect of disclaimer arose in *Paradise* because there was a question as to whether a disclaimer effected a "disposition": if it did, it was necessary to be in writing and signed for the purposes of s 53(2) of the *Law of Property Act 1952* (UK). The Court of Appeal answered that question "no", saying: "the short answer to this is that a disclaimer operates by way of avoidance and not by way of disposition".[18]

91. The brevity with which the conclusion in *Paradise* was expressed has been criticised: *Meagher, Gummow and Lehane's Equity Doctrines and Remedies* (2015, 5th ed), p321 [7.250]. The ultimate result in *Paradise* is no longer correct in most Australian jurisdictions, because property laws deem disclaimers to be dispositions.[19]

92. It is, however, unnecessary to decide whether *Paradise* is correct in what it actually says. This is because the present case is not concerned with whether there was a "disposition" of the distributed amount; it is concerned only with whether there was a present entitlement to it. Importantly, *Paradise* cannot be read as overturning the principles stated in *Parsons* and

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18 [1968] 1 WLR 1125 at 1143.

19 *Property Law Act 1969* (WA) s 34(1)(c); see also *Conveyancing Act 1919* (NSW) s 23C(1)(c); *Property Law Act* 1958 (Vic) s 53(1)(c); *Property Law Act 1974* (Qld) s 11(1)(c); *Law of Property Act 1936* (SA) s 29(1)(c); *Conveyancing and Law of Property Act 1884* (TAS) s 60(2)(c); *Civil Law (Property) Act 2006* (ACT) s 201(4); *Law of Property Act 2000* (NT) s 10(1)(c).

Re Stratton's Disclaimer. Their Honours did not say they were, and in fact referred to *Re Stratton's Disclaimer*: at 1143B-c. Moreover, *Paradise* is readily reconciled with *Parsons* and *Re Stratton's Disclaimer*: the former stands for no more than that a disclaimer avoids the transfer of title; the latter stand for the proposition that a disclaimer does not avoid, ab initio, the right to demand and receive the gift. Nothing in *Paradise* stands for the proposition that a disclaimer voids ab initio a gift for all purposes and the Full Court was in error at [109] in thinking it did.

93. Summing up, the key conclusions are these. A disclaimer operates to refute the legal presumption of assent to a gift. It thereby operates to prevent the perfection of the transfer of title contemplated by the gift. A disclaimer does not, however, operate to invalidate the gift for all purposes and against all persons. In particular, a disclaimer does not operate to void, invalidate or retrospectively extinguish the right to demand and receive the gift, which exists at all times up to the disclaimer: *Parsons*; *Re Strattons.*

The resolution of the issue in the proceedings

94. Having regard to the general principles set out above, the appeal should be upheld on three, alternative and independently sufficient bases.

95. ***First***, the relevant taxable fact on which s 97(1) operates is the existence of a present entitlement in a beneficiary *not* the receipt of actual amounts: *Whiting* at 215-216, 219; *Tindal* at 618; *Union Fidelity* at 182; *Harmer* at 271; *Bamford* at [28]. There is a present entitlement in the relevant sense if the beneficiary has a **right** to demand and receive payment of the amount: *Harmer* at 271; *Bamford* at [28]; *Totledge* at 839. At general law, a disclaimer does not operate retrospectively to extinguish the beneficiary's right, at all times up to disclaimer, to demand and receive the gift: *Re Stratton's Disclaimer*; *Parsons*. A disclaimer operates to release that right and the correlative obligations of the trustee,[20] not to void it ab initio. The Full Court erred by holding (or assuming) to the contrary. At all material times, including after the Third Disclaimers, it has remained correct to say that at the end of 30 June 2014, the respondents had a right to demand and receive payment of the default distributions. That was a present entitlement within the meaning of s 97(1).

96. ***Secondly***, s 97(1), properly construed, requires the question of whether the taxable facts which enliven the inclusion of amounts in assessable income to be asked and answered at a

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[20] See *Re Gulbenkian (No 2)* [1970] Ch 408 at 418B (recording the argument of Templeman QC) and at 418G (Plowman J). See also, *Smeaton* at [119] (Sackville AJA, quoting *Lewin on Trusts*).

particular time, relevantly, the end of the year of income: *Union Fidelity* at 182, 183; *Harmer* at 271. The answer to the question of present entitlement, if asked and answered at the end of 30 June 2014, was that the respondents were presently entitled to a share of the income of the trust. The subsequent disclaimer did not and could not affect that.

97. ***Thirdly***, tax was levied on the respondents at midnight on 30 June 2014: *Income Tax Act* s 7. Upon tax being levied, there arose a present legal obligation between the respondents and the Commonwealth: *H* at [17], [39] and [43]-[44]. The quantum of that present legal obligation included amounts that were brought to tax, at midnight on 30 June 2014, by reason of the operation of s 97(1) of the ITAA 1936 and which found concrete application in an assessment made in October 2015. That present legal obligation having arisen, it was beyond the power of the beneficiaries, acting alone, to vary or extinguish it. The Third Disclaimers occurred in September 2016. Whether or not they were effective to vary the inter se rights of the trustee and beneficiaries, they were not effective to "retrospectively expunge"[21] the rights of the Commissioner as against the beneficiaries which had accrued at midnight 30 June 2014 and which matured as a debt due and payable by an assessment in October 2015.

98. This outcome serves a salutary purpose. It ensures a beneficiary cannot avoid tax by disclaiming, perhaps many years after the relevant events (or, as here, after being audited and assessed). That the beneficiary might ultimately not receive the trust income to which it was entitled is no reason to reject this outcome. For reasons set out above, the whole purpose of s 97 (and its statutory ancestor) is to tax by reference to entitlement, not actual receipt. If the beneficiary apprehends an onerous tax liability, the beneficiary can always elect not to disclaim (or, put another way, to affirm). If the receipt is insufficient for the beneficiary's tax liability that is because that liability is determined by reference to the "net income" of the trust estate, not the distributable income,[22] and not because of a deficiency in the principles attending the legal effect of the disclaimer.

99. Moreover, if a retrospective disclaimer after the end of the income year expunges a present entitlement as at the end of the year for the purposes of s 97, that carries with it the possible consequence that other beneficiaries (eg default beneficiaries whose entitlements are enlivened by the disclaimer) or the trustee (where there is no other beneficiary presently

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21 *Smeaton* at [146] (Sackville AJA).

22 *Bamford* at [17]-[18].

entitled) will find themselves visited with unexpected and belated tax liabilities. The outcome for which the Commissioner contends avoids this potentially destabilizing effect on the operation of Division 6.

100. On any or all of these bases, the respondents were, at all material times, presently entitled to the amounts the subject of the default distributions under the Whitby Trust Deed. The Third Disclaimers did not change that position.

PART VII: ORDERS

101. Appeal allowed.

102. Set aside orders 1 and 2 of the Full Court of the Federal Court dated 10 September 2020 and, in their place, order that the appeal is dismissed.

PART VIII: ESTIMATE

103. The Commissioner estimates he will require 1.5 hours to present his oral argument.

Dated: 3 June 2021



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ANNEXURE A

List of statutory provisions referred to in submissions

Legislation and Regulations

1. *Income Tax Act 1986* (Cth) (current), ss 5, 7.
2. *Income Tax Assessment Act 1915* (Cth) (No. 34 of 1915) (as enacted), ss 14, 26, 27.
3. *Income Tax Assessment Act 1918* (Cth) (No. 18 of 1918) (as enacted), s 21.
4. *Income Tax Assessment Act 1922* (Cth) (No. 37 of 1922) (as enacted), s 31.
5. *Income Tax Assessment Act 1936* (Cth) (current), ss 95, 95A, 97, 99B.
6. *Income Tax Assessment Act 1936* (Cth) (No. 27 of 1936) (as enacted), ss 95, 97.
7. *Income Tax Assessment Amendment Act 1979* (Cth) (No. 12 of 1979) (as enacted), ss 5, 11.
8. *Income Tax Laws Amendment Act 1980* (Cth) (No. 19 of 1980) (as enacted), s 9.
9. *Judiciary Act 1903* (Cth) (current), s 78B.