



# ***TR 2017/D10 - Income tax: Trust vesting - amending the vesting date and consequences of a trust vesting***

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## Draft Taxation Ruling

# Income tax: Trust vesting – amending the vesting date and consequences of a trust vesting

Contents	Para
<b>PROPOSED LEGALLY BINDING SECTION:</b>	
<b>Summary – what this draft Ruling is about</b>	<b>1</b>
<b>Definitions</b>	<b>4</b>
<b>Ruling</b>	<b>5</b>
<b>Date of effect</b>	<b>43</b>
<b>NOT LEGALLY BINDING SECTION:</b>	
<b>Appendix 1:</b>	
<i>Alternative views</i>	<b>44</b>
<b>Appendix 2:</b>	
<i>Your comments</i>	<b>49</b>
<b>Appendix 3:</b>	
<i>Detailed contents list</i>	<b>51</b>

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## Summary – what this draft Ruling is about

1. This draft Ruling explains the Commissioner’s views about amending the trust’s vesting date and the income tax consequences of the passing of a trust vesting date.
2. When a trust vests, all of the interests in the trust as to income and capital become vested in interest and possession.
3. The income tax consequences that arise on, and after, the vesting of a trust depend on the terms of the deed. Vesting of itself may, but need not, cause a CGT event to happen.

## Definitions

4. In this draft Ruling, unless context otherwise requires:
  - **Net income** means the net income of a trust estate under subsection 95(1) of the *Income Tax Assessment Act 1936* (ITAA 1936) calculated as the total assessable income of the trust estate as if the trustee were a resident taxpayer less all allowable deductions (except certain deductions identified in the provision).

- **Income of the trust estate** means the income of the trust estate as that expression is used in Division 6 of Part III of the ITAA 1936.<sup>1</sup>
- A trust **vests** at the time all the interests in the trust property become vested in interest and possession.
- A trust's **vesting date** is the day on which the trust vests (the day on which the interests in the trust become vested).
- **Takers on vesting** means those beneficiaries that, under the deed, hold a fixed interest in the capital (and income thereon) after the trust vests.

## Ruling

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### Amending a trust's vesting date

5. A trust deed will nearly always specify a date on which the interests in the trust vest and contain a clause which specifies the consequence of that date being reached (for example, that the property is to be held from that date for the takers on vesting in equal shares absolutely). This is to ensure that the rule against perpetuities is not breached. The date is commonly labelled in the deed as the 'Vesting Date' or 'Termination Date'.

6. Prior to a trust's vesting, it may be possible for the trustee<sup>2</sup> or a Court<sup>3</sup> to postpone the vesting of the trust by nominating a later date as the new vesting date.

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<sup>1</sup> The Commissioner's understanding of the meaning of 'income of the trust estate' is explained in Taxation Ruling TR 2012/D1 *Income tax: meaning of 'income of the trust estate' in Division 6 of Part III of the Income Tax Assessment Act 1936 and related provisions*.

<sup>2</sup> Pursuant to a proper exercise of a valid power under the deed. Determining whether the trustee has the power to amend the deed to change the vesting date requires a careful consideration of the terms of the trust deed. For example, although a trustee may have a general power to amend the deed, there may also be specific exclusions from the scope of that power. The power might also be limited to permitting the trustee to bring forward the date on which the trusts vests and not permit extending that date.

<sup>3</sup> Where a trust deed does not provide the trustee with a power to extend the vesting date, an application to the Court may be necessary. In every State and Territory, the Court has a statutory power to vary a trust deed in particular circumstances: section 81 of the *Trustee Act 1925* (ACT); section 81 of the *Trustee Act 1925* (NSW); section 94 of the *Trusts Act 1973* (Qld); section 59C of the *Trustee Act 1936* (SA); section 47 of the *Trustee Act 1898* (Tas); section 63 of the *Trustee Act 1958* (Vic); section 89 of the *Trustees 1962 Act* (WA); section 50A of the *Trustee Act* (NT).

7. However once the vesting date has passed, the trust has vested and this is no longer possible. Specifically, once the trust has vested, the interests in the trust property become fixed at law. This result cannot be avoided by the parties continuing to carry on as though the trust had not vested or by a purported exercise of a power to vary the deed.<sup>4</sup>

8. Further, the Commissioner understands it is unlikely that a Court would extend a vesting date once the interests of beneficiaries in the trust have vested,<sup>5</sup> as this would involve defeating the fixed beneficial interests of the takers on vesting.

### **Consequences of a trust vesting**

9. Though it is common to speak of a trust's vesting, it is the interests of the beneficiaries in the property of the trust that vest on the vesting date.

10. On a trust's vesting date, the interests in the property of the trust become vested in interest and possession. In the case of a discretionary trust, from the time the trust vests a trustee no longer has any discretionary power to appoint the income or capital of the trust, rather it holds the trust property for the absolute benefit of those beneficiaries specified as the takers on vesting.<sup>6</sup>

11. In itself, the vesting of beneficial interests in a trust, even if described as a 'Termination Date', does **not** ordinarily cause the trust to come to an end<sup>7</sup>, nor cause a new trust to arise. Vesting does not mean trust property must be transferred to the takers on vesting on the vesting date, nor that the trust must be wound up either immediately or within a reasonable period (although the deed may require these events to occur after vesting).<sup>8</sup>

12. A trust deed may, or may not, specifically envisage or provide for an ongoing relationship between the trustee and takers on vesting after the trust has vested. In any case, where a trustee continues to hold property for takers on vesting, although the nature of the trust relationship does change, the underlying trust relationship continues.<sup>9</sup>

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<sup>4</sup> This is because, on the vesting day, the beneficiaries' interests vest immediately and entitle those takers on vesting to possession, and it would be inconsistent for the trustee to retain any power to defeat those interests: *Clay & Ors v. James & Ors* [2001] WASC 18 at [6], [18]; *Hancock v. Rinehart* [2015] NSWSC 646 at [128].

<sup>5</sup> *Re Dion Investments* (2014) 87 NSWLR 753 at [48].

<sup>6</sup> *Hancock v. Rinehart* [2015] NSWSC 646 at [128]; *Clay & Ors v James & Ors* [2001] WASC 18 at [6].

<sup>7</sup> *Clay & Ors v. James & Ors* [2001] WASC 18 at [11].

<sup>8</sup> Examples of trusts continuing following vesting and trusts being wound up include *Clay & Ors v. James & Ors* [2001] WASC 18 at [6] and [11] (trust being wound up), and *Hancock v. Rinehart* [2015] NSWSC 646 (trust continuing).

<sup>9</sup> However, there may be circumstances where the property of a trust is resettled on a new trust by the takers on vesting.

## ***CGT consequences of trust vesting***

13. Determining whether or not a CGT event happens on vesting requires a close consideration of the effect of vesting as specified in the deed. This will include consideration of the effect of vesting on the nature of beneficial interests in the trust and the nature of the property<sup>10</sup> held on trust.

14. It may be the case that no CGT event happens by reason alone of the trust's vesting. But events occurring post-vesting may cause a CGT event to happen.

### *CGT event E1: creation of a new trust*<sup>11</sup>

15. A trust vesting of itself does not ordinarily cause the trust to come to an end and settle property on the terms of a new trust.<sup>12</sup> As such CGT event E1 need not happen merely because a trust has vested.

16. Circumstances might, however, occur in which the parties to a trust relationship subsequently act in a manner that results in a new trust being created by declaration or settlement so as to cause CGT event E1 to happen. See example 4 of this draft Ruling.

17. If CGT event E1 happens and a trust is created over the assets, the trustee of the new trust is taken to acquire each asset when the trust is created and the first element of each asset's cost base is its market value.

### *CGT event E5: beneficiary becoming absolutely entitled*<sup>13</sup>

18. The vesting of a trust may result in the takers on vesting becoming absolutely entitled as against the trustee to CGT assets of the trust, depending on what those CGT assets are and the particular interests of the takers on vesting.

19. The Commissioner's view of when a beneficiary becomes absolutely entitled and when CGT event E5 happens is explained in draft Taxation Ruling TR 2004/D25 *Income tax: capital gains: meaning of the words 'absolutely entitled to a CGT asset as against the trustee of a trust' as used in Parts 3-1 and 3-3 of the Income Tax Assessment Act 1997*.

20. In certain cases CGT event E7 may happen (for example upon actual distribution of CGT assets to beneficiaries), but it will not happen to the extent the beneficiaries are already absolutely entitled to the CGT assets as against the trustee.<sup>14</sup>

<sup>10</sup> See paragraphs 18 to 20 of this draft Ruling on CGT event E5.

<sup>11</sup> Section 104-47 of the *Income Tax Assessment Act 1997* (ITAA 1997).

<sup>12</sup> *Clay & Ors v James & Ors* [2001] WASC 18 at [11].

<sup>13</sup> Section 104-70 of the ITAA 1997.

<sup>14</sup> Section 106-50 of the ITAA 1997.

***Taxation of trust net income after the vesting date***

21. In the year in which vesting occurs, different beneficiaries may be presently entitled to income of the trust estate derived before, as opposed to after, the vesting date. For example, in the case of a discretionary trust, a trustee may, pre-vesting, exercise their discretion to appoint income of the trust estate derived before the vesting date (pre-vesting income) among those entitled to benefit under the trust.<sup>15</sup> By contrast, present entitlement to the income of the trust estate derived post-vesting (post-vesting income) will be held by the takers on vesting (usually in proportion to their vested interests in the property of the trust). This needs to be taken into account in identifying each beneficiary's share of the trust estate's income for the year which, in turn, determines their share of the net income of the trust for that year.<sup>16</sup>

**Note:** The Commissioner will accept an allocation of income of the trust estate into pre-vesting and post-vesting income of the trust estate in the year in which vesting occurs that is done on a fair and reasonable basis having regard to all of the relevant circumstances.<sup>17</sup> See example 5 of this draft Ruling.

22. In the following income years, the takers on vesting will usually have a fixed entitlement to the income of the trust estate and be assessable on their corresponding share of the net income. If all of the income of the trust will flow to the takers on vesting according to their entitlement, none of the net income will fall to be assessed to the trustee.<sup>18</sup>

23. A payment or other purported distribution of income or capital by a trustee post-vesting that is not consistent with the vested beneficiaries' fixed interests is void or otherwise not effective.<sup>19,20</sup>

24. Section 101 and subsection 95A(1) of the ITAA 1936 have no application to deem a beneficiary to be presently entitled where the trustee purports to make an appointment or payment that is inconsistent with the fixed interests of the takers on vesting.

***Examples******Example 1 – ineffective amendment of vesting date***

25. *The deed of the Smith Discretionary Trust expressly states that the trust will vest on 30 June 2018 or on such earlier date as the*

<sup>15</sup> Those same beneficiaries will then be presently entitled to any income that arises in the following years from the investment of any unpaid present entitlement from a pre-vesting year (that is, rather than the takers on vesting).

<sup>16</sup> *FCT v. Phillip Bamford & Ors; Phillip Bamford & Anor v. FCT* [2010] HCA 10; 2010 ATC 20-170; (2010) 75 ATR 1.

<sup>17</sup> Under Division 6 of Part III of the ITAA 1936, as modified by Division 6E.

<sup>18</sup> Under section 99A or section 99 of the ITAA 1936.

<sup>19</sup> *Turner v. Turner* [1984] 1 Ch 100 at 111.

<sup>20</sup> Such trustee has breached their duty to obey the trust deed: *Greig v. McGregor; Re Hay's Settlement Trusts* [1982] 1 WLR 202 at 210.

*trustee nominates. While the trustee has broad powers to amend the deed, those powers expressly exclude any changes that affect the definition of the vesting date, and so prevent an extension of the date.*

26. *Without more (for example, a court order having the effect of changing the vesting date), a purported amendment by the trustee to extend the trust's vesting date will be ineffective, and the trust will continue to vest on 30 June 2018.*

#### *Example 2 – ignorance of vesting date by trustee and beneficiaries*

27. *A discretionary trust was established to lease property to a company that operates a medical practice. Under the deed, on vesting the trustee holds the property for the takers on vesting as tenants in common in equal shares. The vesting date is defined to be 1 November 2014.*

28. *The trustee, unaware of the provisions of the deed regarding vesting, continued to make discretionary distributions of income to beneficiaries after 1 November 2014. The beneficiaries of the trust, also unaware of the relevant provisions of the deed, did not challenge the actions of the trustee.*

29. *As the trust vested on 1 November 2014 by operation of the deed, the trustee's purported exercise of discretionary powers to appoint income after this date was not within the trustee's powers and was ineffective. The income of the trust post-vesting was instead beneficially owned in equal shares by the takers on vesting.*

30. *Those takers on vesting are presently entitled to the income of the trust ineffectively appointed, and assessable on their respective shares of the net income of the trust.*

#### *Example 3 – realisation, and extension of vesting date*

31. *Assume the same facts as in Example 1, except the trustee properly executed a deed extending the vesting date on 30 October 2014 (supported by a power in the deed). Assume further that the amended vesting date (1 November 2064) did not cause a breach of the rule against perpetuities.*

32. *The effect of the amendment is to change the vesting date of the trust to 1 November 2064. As a result, the trustee retains the power to make discretionary distributions of income and capital until that time.*

#### *Example 4 – purported extension after vesting date*

33. *A discretionary trust holding several rental properties had a vesting date of 30 September 2016.*

34. *On 1 June 2017, the trustee became aware that the vesting date had passed and, with the acquiescence of the takers on vesting,*

*continued to manage the trust as if the trust had not vested. On 29 June 2017, the trustee executed a deed of extension that purported to extend the trust's vesting date to 30 September 2057.*

35. *The subsequent execution of a deed of extension is void and ineffective to change a vesting date that has already passed. Any power of the trustee to extend the vesting date ceased on 30 September 2016.*

**Note:** If, once it is realised that the deed of extension is ineffective to change the trust's vesting date, all of the takers on vesting agree that the trust assets should continue to be held on a new trust on the same terms as the original trust, and this was effective to create such a new trust over the assets by declaration or settlement, CGT event E1 would happen in relation to trust assets.

*Example 5 – present entitlement for income year in which trust vests*

36. *The Atkins Family Trust has a vesting date of 1 January 2017. The relevant clauses of the trust allow the trustee to determine income of the trust estate for the period before the vesting date, and distribute that income to one or more discretionary beneficiaries. On 31 December 2016, the trustee resolved to distribute all of the income up to the vesting date to Andrew.*

37. *The trust deed further provided that, on the vesting date, the trustee was to hold the trust property in equal shares for Andrew and Edward.*

38. *For the 2016-17 income year, each of Andrew and Edward is assessable on the share of the net income that relates to their share of the total income of the trust estate for the year.*

**Note:** The nature of the Atkins Family Trust's income (\$100) is such that it is derived evenly across the 2016-17 income year. As such, it is fair and reasonable to conclude that Andrew is presently entitled to \$75 of the income of the trust estate for the year (being all of the income derived before the vesting date, \$50, and half of the income derived after vesting date, \$25) and Edward is presently entitled to \$25 of the remaining income for the year (being half of the income derived after vesting date, \$25).

*Example 6 – no absolute entitlement*

39. *The trust deed for the Robin Family Trust provided that the trust would vest on 1 August 2014. The deed further provided that unless the trustee resolved to distribute the trust capital, (a rental property) to particular beneficiaries before the vesting date, the trustee would hold the trust property for Jenny and Josh jointly in equal shares.*

40. *On 1 August 2014 (the vesting date), the interests of Jenny and Josh in the trust vest: their interests become vested and indefeasible. However, they did not become absolutely entitled to the*



*rental property as against the trustee for the purposes of CGT event E5 as that test requires that a beneficiary be entitled to the whole of the CGT asset owned by the trustee.*

#### *Example 7 – absolute entitlement*

41. *The trust deed for the Ho Family Trust provided that the trust would vest on 1 August 2014. It further provided that unless the trustee resolved to distribute the trust capital to particular beneficiaries, before the vesting date, the trustee would hold the trust property absolutely and solely for Lu.*

42. *On 1 August 2014 (the vesting date), Lu has a vested and indefeasible interest in the trust property. In addition, he has become absolutely entitled to the trust assets as against the trustee causing CGT event E5 to happen.*

## **Date of effect**

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43. When the final Ruling is issued, it is proposed to apply both before and after its date of issue. However, the Ruling will not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the Ruling (see paragraphs 75 to 76 of Taxation Ruling TR 2006/10).

## **Appendix 1 – Alternative views**

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**❶** *This Appendix sets out alternative views and explains why they are not supported by the Commissioner. It does not form part of the binding public ruling.*

### **Extending the vesting date by implication**

44. It has been contended that continued behaviour by both the trustee and beneficiaries of a trust, in a way that is consistent with the terms of the trust as they existed prior to its vesting date, may be sufficient to extend the trust's vesting date.

45. For example, a trustee purports to appoint income of the trust estate, in accordance with a discretionary power of appointment contained in the trust deed, to beneficiaries that are not the takers on vesting, and the beneficiaries are said to have accepted tacitly those distributions. It is purported that such behaviour implicitly invokes a power of amendment within the trust deed to retrospectively extend the trust's vesting date.

46. We do not accept this view.

47. Neither a mistaken assumption that discretionary powers of appointment continue to apply after a trust's vesting date, nor ignorance of the vesting date having occurred, can alter the legal and equitable rights of parties that are established by the terms of the trust.

48. Depending on the facts and circumstances of a particular case, it may be that conduct of the kind considered in the alternative view gives rise to certain equitable remedies or defences in favour of the trustee or an overpaid beneficiary. It may also be that such conduct amounts to a gift from one beneficiary to another beneficiary, or a resettlement of the trust if all potential beneficiaries are involved in the arrangement.

## Appendix 2 – Your comments

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49. You are invited to comment on this draft Ruling, including the proposed date of effect. Please forward your comments to the contact officer by the due date.

50. A compendium of comments is prepared for the consideration of the relevant Rulings Panel or relevant tax officers. An edited version (names and identifying information removed) of the compendium of comments will also be prepared to:

- provide responses to persons providing comments, and
- be published on the ATO website at [www.ato.gov.au](http://www.ato.gov.au).

Please advise if you do not want your comments included in the edited version of the compendium.

**Due date:** 16 February 2018

**Contact officer:** Richard Mold

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## **Appendix 3 – Detailed contents list**

51. The following is a detailed contents list for this draft Ruling:

	<b>Paragraph</b>
<b>Summary – what this draft Ruling is about</b>	<b>1</b>
<b>Definitions</b>	<b>4</b>
<b>Ruling</b>	<b>5</b>
Amending a trust’s vesting date	5
Consequences of a trust vesting	9
<i>CGT consequences of trust vesting</i>	13
<i>CGT event E1: creation of a new trust</i>	15
<i>CGT event E5: beneficiary becoming absolutely entitled</i>	18
<i>Taxation of trust net income after the vesting date</i>	21
<i>Examples</i>	25
<i>Example 1 – ineffective amendment of vesting date</i>	25
<i>Example 2 – ignorance of vesting date by trustee and beneficiaries</i>	27
<i>Example 3 – realisation, and extension of vesting date</i>	31
<i>Example 4 – purported extension after vesting date</i>	33
<i>Example 5 – present entitlement for income year in which trust vests</i>	37
<i>Example 6 – no absolute entitlement</i>	39
<i>Example 7 – absolute entitlement</i>	41
<b>Date of effect</b>	<b>43</b>
<b>Appendix 1 – Alternative views</b>	<b>44</b>
Extending the vesting date by implication	44
<b>Appendix 2 – Your comments</b>	<b>49</b>
<b>Appendix 3 – Detailed contents list</b>	<b>51</b>

## References

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*Previous draft:*

Not previously issued as a draft

*Related Rulings/Determinations:*

TR 2004/D25; TR 2006/10;  
TR 2012/D1

*Legislative references:*

- ITAA 1936
- ITAA 1936 Div 6 Pt III
- ITAA 1936 Div 6E
- ITAA 1936 95(1)
- ITAA 1936 95A(1)
- ITAA 1936 99
- ITAA 1936 99A
- ITAA 1936 101
- ITAA 1997
- ITAA 1997 Pt 3-1
- ITAA 1997 Pt 3-3
- ITAA 1997 104-47
- ITAA 1997 104-70
- ITAA 1997 106-50
- Trustee Act 1925 (ACT) 81
- Trustee Act 1925 (NSW) 81
- Trustee Act (NT) 50A
- Trusts Act 1973 (Qld) 94
- Trustee Act 1936 (SA) 59C
- Trustee Act 1898 (Tas) 47
- Trustee Act 1958 (Vic) 63
- Trustees 1962 Act (WA) 89
- 75 ATR 1; [2010] HCA 10; (2010) 84 ALJR 266; (2010) 264 ALR 436; 2010 ATC 20-170; [2010] ALMD 5415; [2010] ALMD 5416; [2010] ALMD 5419; (2010) 240 CLR 481; (2010) 5 ASTLR 174
- Clay & Ors v. James & Ors [2001] WASC 18
- Re Dion Investments Pty Ltd - [2014] NSWCA 367; (2014) 87 NSWLR 753; [2015] ALMD 3041; (2014) 11 ASTLR 574; (2014) 10 BFRA 15
- Re Hay's Settlement Trusts - [1982] 1 WLR 202; [1981] 3 All ER 786; (1981) 125 Sol J 866
- Hancock and Another v. Rinehart and Others - (2015) 106 ACSR 207; [2015] NSWSC 646; (2015) 13 ASTLR 1; [2017] ALMD 1113; [2017] ALMD 1030; [2017] ALMD 1033; [2017] ALMD 1034; [2017] ALMD 1035; [2017] ALMD 1036; [2017] ALMD 1038; [2017] ALMD 1039; [2017] ALMD 1041
- Turner v. Turner [1984] 1 Ch 100

*Cases relied on:*

- Federal Commissioner of Taxation v. Bamford - (2010)
- 

ATO references

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Income tax ~~ Trusts ~~ Other

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## RE: ADVICE CONCERNING THE VESTING OF TRUSTS

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### MEMORANDUM OF ADVICE

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1. The Commissioner has recently observed a number of cases in which a taxpayer asserts that a trust continues to function on the same terms, despite the stated vesting date having passed and other requirements of the relevant vesting clauses in the trust deed not having been complied with. It has also been argued that a trustee may exercise a power to vary the vesting date of the trust, after that date has passed.
2. We are instructed to advise on the likely merits of such arguments, and as to the general legal and equitable effects of a stated vesting date passing, including in circumstances where the vesting date passes without the knowledge or realisation of the trustee or beneficiary or beneficiaries.
3. Our instructions proceed by providing a sample fact pattern, which concerns a particular deed and then asking a series of questions that arise from that fact pattern.
4. The advice will therefore first outline the facts relevant to the particular Trust, and after considering the general principles that seem to us to apply, will turn to consider the specific questions on which our opinion is sought.

#### **The Trust Deed**

##### *Terms of the trust*

5. The Trust is a private discretionary trust settled by deed on 1 January 1980.
6. Clause 2 is a declaration of trust by the settlor. Clause 3 (read with clause 4) established the trust as a “discretionary trust”<sup>1</sup> and provided in relevant part as follows:
  - 3(a) The Trustee shall in each Accounting Period or as soon as practicable thereafter determine the nett income of the Fund and in particular all expenses paid or payable by the Trustee as described in Clause 7(h) hereof.
  - 3(b) The Trustee may at any time prior to the expiration of each Accounting Period until the Vesting Day determine with respect to all or any part or parts of the nett income of the Trust Fund for such Accounting Period to do all or any of the following –
    - (i) To pay apply or set aside the same for any one or more of the General Beneficiaries living or in existence at the time of the determination.
    - (ii) To accumulate the same.

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<sup>1</sup> As to the meaning of “discretionary trust”, *Chief Commissioner of Stamp Duties v Buckle* (1998) 192 CLR 226 [8], [9].

- 3(c) ... (iv) The Trustee shall have a complete discretion as to the making of any determination and shall not be bound to assign any reason thereof.
- 3(e) The Trustees shall hold so much of the nett income of the Trust Fund for each Accounting Period as shall not be the subject of a determination effectively made at or prior to the end of such Accounting Period pursuant to Paragraph (b) of this Clause upon the same trusts as are declared in paragraphs (a) (b) and (c) of Clause 4 hereof in respect of the Trust Fund as though the last day of such Accounting Period were the Vesting Day.
- 3(f) Any amount set aside for any person being on the General Beneficiaries and any amount held by the Trustees in trust for any person pursuant to Paragraph (e) of this clause shall not form any part of the Trust Fund as defined in Clause 1(e) hereof but upon setting aside or becoming subject to such trust (as the case may be) shall be thenceforth held by the Trustees as a separate Trust Fund on trust for such person absolutely with power to the Trustees pending payment over thereof to such person to invest or apply or deal with such fund or any resulting income therefrom or any part thereof in the manner provided for in Clause 6(d) hereof.

7. However, the trust just described had a finite life. By clause 4 of the trust deed, “as from the Vesting Day”, the trust estate was to be held on trust “for” such of the General Beneficiaries (and in such proportions) as the trustee may appoint in writing prior to the Vesting Day and, absent such a determination, in trust for certain other identified beneficiaries in the proportions set out in the clause.

8. Clause 4 is an important clause, and provides as follows (emphasis added):

AS from the Vesting Day the Trustees shall stand possessed of the Trust Fund and the income thereof in trust for such of the General Beneficiaries for such interests and in such proportions and for one to the exclusion of the other or others as the Trustee may by instrument in writing revocable or irrevocable before the Vesting Day appoint provided always that the Trustee shall not without such consent revoke any revocable appointment and in default of and subject to any such appointment.

- (a) If one Specified Beneficiary is named or described in the Schedule in trust for such Specified Beneficiary absolutely if he survives the Vesting Day and where two or more Specified Beneficiaries are so named or described in trust for such of the Specified Beneficiaries who survive the Vesting Day as tenants in common in equal shares which such deceased Specified Beneficiary would have received had he or she survived to the Vesting Day and the children of any deceased child (who dies before the Vesting Day) or any such Specified Beneficiary shall take (and in turn the descendants of any such children who dies before the Vesting Day shall take the share calculated per stirpes which that deceased would have taken) as tenants in common in equal shares the share which such deceased child would have received had he or she survived to the Vesting Day.
- (b) If any Specified Beneficiary is named or described in the Schedule and if the Trust Fund is not disposed of by the last preceding paragraph in trust for the brothers and sisters then living of the Specified Beneficiary as tenants in common in equal shares provided that the children (if any) of a deceased brother or sister shall take as tenants in common in equal shares the share which such deceased brother or sister would have received had he or she survived to the Vesting Day and the children of any deceased child (who dies before the Vesting Day) of any such brother or sister shall take (and in turn the descendants of any of such children who die before the Vesting Day shall take the share calculated per stirpes which the deceased would have taken) as tenants in common in equal shares the share which such deceased child would have taken had he or she survived the Vesting Day.



(c) If the events which happen or if for any reason whatsoever any part or parts of the Trust Fund shall not be effectively or validly disposed of by the Trusts declared by this Deed or by any Deed from time to time in force varying altering or adding to such trusts the Trustee shall stand possessed of such part or parts of the Trust Fund as aforesaid for the next-of-kin (but not including any person from time to time being the Settlor, any of the Trustees hereof or any parent or grandparent of the Specified Beneficiary) of the Specified Beneficiary if one only is named or described in the Schedule and if more than one then in trust for the next-of-kin (but not including any person from time to time being the Settlor any of the Trustees hereof or any parent or grandparent of a Specified Beneficiary unless specifically included in the Schedule as a Specified Beneficiary) of the last to die of the Specified Beneficiaries who in either case are living when the said part or parts of the Trust Fund falls or fall into possession as tenants in common in equal shares absolutely.

9. As will appear, in our opinion the effect of clause 4 is that, upon the happening of the Vesting Day, the trust ceased being a discretionary trust and became a fixed trust. That occurred automatically and by operation of clause 4 itself. Henceforth the interests of the former discretionary objects (the “General Beneficiaries”) no longer comprised an equitable right to compel due administration of the trust, and became instead an interest in the trust estate vested in possession, and that could properly be described as absolute and unconditional. The trustee’s duty altered to a correlative extent, changing from a duty to properly consider whether to distribute the net income of the trust in accordance with the discretionary power of appointment (clause 3), to a duty to hold the whole of the capital and income for the benefit of the relevant beneficiaries.

10. When did the Vesting Day occur? Clause 1(c) defines Vesting Day in the following terms:

...the first to occur of the following dates namely –

- (i) The day specified in the Schedule as the Vesting Day.
- (ii) The date being twenty-one (21) years after the death of the last survivor of the descendants now living of his Late Majesty George VI.
- (iii) Such other date as may be fixed for [sic] the Trustee as the Vesting Day whether by Deed or Memorandum in writing or oral declaration recorded in the Minutes of the Trustee.

11. The day specified in the Schedule as the Vesting Day is the “21<sup>st</sup> anniversary of the date of the Trust Deed”. That date was 1 January 2001.

12. In addition to the specific power to amend the Vesting Day (clause 1(c)(iii)), the trust deed gives the trustee a power to amend any provision of the deed (clause 16). That clause is said to be exhaustive of the trustee’s power of amendment (clause 25).

13. Clause 16 provides as follows (emphasis added):<sup>2</sup>

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<sup>2</sup> Cf. *Commissioner of Stamp Duties v Buckle* (1998) 192 CLR 226 at [17], which indicates that a similarly worded clause was before the High Court in that case, though the Court did not have to consider the present problem.

The Trustee for the time being may at any time and from time to time by Deeds revoke add to or vary all or any of the provisions of this Deed or any previous revocation addition or alteration but so that...

- (c) The same [*i.e.*, *any variation*] shall not affect the beneficial entitlement to any amount set aside for any beneficiary or otherwise affect any interest which has vested prior to the date of variation, alteration or addition.

14. The whole of the deed is to be construed so that the various clauses are consistent the one with the other. In our opinion, when clause 1(c)(iii), 16(c) and 25 are read together, it is apparent that clause 1(c)(iii) is intended to comprehend a case where the trustee alters the Vesting Day before the Vesting Day would otherwise arrive, for it would otherwise conflict with the clear words of clause 16(c).
15. Finally, it may be noted that in addition to certain named persons, and their children, the class of discretionary objects includes trusts or companies in which those persons are interested and that are nominated by the trustee from time to time (clause 1(d)(2)(v)).

*Performance of the Trust – ignorance of vesting on 1 January 2001*

16. We are instructed that neither the trustee nor the beneficiaries were aware that on 1 January 2001 the rights of the parties changed in the manner set out in clause 4, or that 1 January 2001 was the day described as the Vesting Day in the trust deed.
17. The trustee has not acted on the basis that on and from 1 January 2001 it was the trustee of a fixed trust on the terms set out in clause 4. The trust income has not been distributed in a manner consistent with the ownership rights fixed by clause 4.
18. Instead, from 1 January 2001 until the present time, the trustee has continued to administer the trust as if the Vesting Day had not passed, including by purporting to exercise its discretionary powers to distribute the net income of the trust estate. The trustee has purported to distribute the net income as it sees fit, and in a manner not consistent with the trusts created by clause 4.

*Deed of Variation executed 31 March 2014 purporting to extend the Vesting Day*

19. On 31 March 2014 the trustee executed a deed in which the trustee describes the terms on which the trustee has at all times continued to manage the income and capital of the trust (clause 4 of the Deed of Variation), and by which the trustee purports to extend the trust's Vesting Day to 2030 (clauses 5 and 6 of the Deed of Variation).
20. In that Deed of Variation it is stated that the trustee had recently become aware of the passing of the Vesting Day (see Recital B).

*Taxpayer's submission*

21. We are instructed that the trustee and beneficiaries assert that the same trust continues on its original terms (except insofar as the definition of the Vesting Day is concerned) because the very fact that the trustee and beneficiaries have acted as if the trust were continuing is evidence that there was an implied exercise of the power to extend the Vesting Day. For the reasons set out below, we consider that argument to be wrong.
22. It is also asserted that no CGT event occurred on the Vesting Day, because the trust did not vest. Whilst we consider that the trust did vest on the Vesting Day, we are not asked to advise whether the taxpayer is correct that no CGT event occurred, and do not do so.

**What happened when the Vesting Day arrived on 1 January 2001?**

23. We will first consider the position that obtained before 1 January 2001, and then the position that obtained after that day.

*Position up to 1 January 2001*

24. Until such time as the applicable Accounting Period comes to an end, or the trustee decides to appoint the net income of the trust,<sup>3</sup> no discretionary object can be certain that they will receive some or any of the available net income earned during an Accounting Period, either by appointment (viz. clause 3(b)(i), 3(c)) or by accumulation (clause 3(b)(ii), 3(e),(f)). That is because for so long as an appointment has not been made in favour of a particular trust object, it remains possible that the whole of the net income will be appointed to some other member or members of the class of objects, up until the Accounting Period comes to an end.
25. Further, the class of objects in respect of which an appointment may be made is capable of expanding from time to time, and will do so upon the birth of children of certain named beneficiaries, or upon the trustee making a nomination of the kind contemplated by clause 1(d)(2)(v) of the deed.
26. The class of objects is also capable of narrowing over time, and will do so upon the death of General Beneficiaries who are natural persons, or by a beneficiary nominated pursuant to clause 1(d)(2)(v) ceasing to exist, or its ownership changing in a way that brings the entity outside the scope of that clause.
27. In these circumstances, in our opinion, until 1 January 2001, the Trust had the following features:<sup>4</sup>

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<sup>3</sup> That is, the trustee appoints all of the net income, so that it is certain whether the subject beneficiary will take or not, or appoints some part of it to the subject beneficiary, so that it is known affirmatively that he or she will take.

<sup>4</sup> Lynton Tucker et al, *Lewin on Trusts* 19<sup>th</sup> edn (2015) [1-061] (hereafter, "*Lewin*"); *Queensland Trustees Limited v Commissioner of Stamp Duties* (1952) 88 CLR 54 at 62-3; *Gartside v Inland*

- (a) Subject to one exception,<sup>5</sup> the discretionary objects existing from time to time (viz. the class of persons and entities meeting the description “General Beneficiaries”) had no vested interest in the trust income, and no right to a definable part of the trust income, unless and until the trustee either (i) made a valid appointment of a part of the net trust income earned during the Accounting Period (viz. before the end of the Accounting Period, and pursuant to clause 3(b)(i)&(c)), or (ii) did not do so, and so accumulated all or part of the net income in respect of an Accounting Period (clause 3(b)(ii)&(e), (f));
- (b) The discretionary objects obtained a vested (and indefeasible) interest in the net income of the trust in respect of an Accounting Period upon a valid appointment made by the trustee, and the particular persons who took and the extent of their interest are the persons and interests determined by the trustee in its appointment;
- (c) The discretionary objects also obtained a vested (and indefeasible) interest in the income of the trust in respect of an Accounting Period if at the end of the Accounting Period part of the net income had not been appointed, and the extent of that interest, and the particular objects who took, are those fixed by the terms of clause 4(a), (b) and (c) (see clause 3(e), providing for accumulation of unallocated net income<sup>6</sup>);
- (d) Prior to the end of the Accounting Period and the making of an appointment, the interests of the trust objects included a right to be considered for the exercise of the trustee’s discretion, and a right to compel the due administration of the trust;
- (e) The obligation of the trustee was to determine the net income of the trust in each Accounting Period (clause 3(a)), and during each Accounting Period to properly consider whether to exercise the discretion conferred by the instrument of trust, to appoint all or part of the net income to none, one or more than one members the class of discretionary objects existing from time to time, or to instead permit the net income to accumulate and be vested on the terms of clause 4(a) to (c);

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*Revenue Commissioner* [1967] AC 553 at 617; *Commissioner of Stamp Duties v Buckle* (1998) 192 CLR 226 at [16], [21]-[25], [37]; *Kennon v Spry* (2008) 238 CLR 366 at [160]-[162]; *Cmr of Taxation v Ramsden* (2005) 58 ATR 485 at [5], [35], [36] (Full Fed Ct) (considering a discretionary trust in similar or identical terms to the trust under consideration).

<sup>5</sup> There is authority that at the start of each Accounting Period, the beneficiaries enjoyed a vested but defeasible interest in income that might come to them by accumulation pursuant to clause 3(e) (and noting that clause 3(e) differs from clause 4 because survival is not expressly identified as a condition of taking): *Cmr of Taxation v Ramsden* (2005) 58 ATR 485 at [37] – [40] (Full Fed Ct); also, Thomas & Hudson, *The Law of Trusts* 2<sup>nd</sup> edn (2010) [13.21]; also note 8 below. The discretionary objects were, however, not presently entitled to that income, for they had no present legal right to demand and receive payment of any sum. An indefeasible interest (and a present entitlement) only arose at the end of the Accounting Period, and then in relation to any net income not appointed.

<sup>6</sup> Discretionary trusts having this feature are sometimes called “non-exhaustive” discretionary trusts: eg. Thomas & Hudson, *The Law of Trusts* 2<sup>nd</sup> edn (2010) [13.14].

- (f) As to trust capital, the discretionary objects existing from time to time had no vested interest in the capital, for the reason that their interest depended upon the future contingency that they were alive or (as to artificial persons) continued to exist or qualify as General Beneficiaries as at 1 January 2001.<sup>7</sup>
28. In the foregoing discussion, the term “vested interest” refers to an interest in property that is not subject to any condition precedent, and is to be distinguished from a merely contingent interest, which will not vest unless and until some uncertain requirement (other than merely the determination of a prior interest) is satisfied.<sup>8</sup>
29. In the context of estates in land, and sometimes also intangible property (which is incapable of being possessed), interests that are vested are often divided into those said to be “vested in possession” and interests that are merely “vested in interest”. The former is an interest conferring an immediate right to present enjoyment of property (viz. by possession or other means of enjoyment<sup>9</sup>), whilst the latter confers a present right to future enjoyment of property (viz. a present right to possession or other means of enjoying the property at a future time).<sup>10</sup> So, in a trust of land for A for his life and upon A’s death for B, the life tenant A has an interest vested in possession, whereas the remainder-man B has an interest vested in interest only, and that will become an interest vested in possession upon A’s death.<sup>11</sup>
30. The conclusion that the discretionary objects of the Trust had no fixed proprietary interest in the income or capital of the trust, whether vested in interest or in possession (subject to the proviso at note 5 above), matches the position that often (but not always<sup>12</sup>) obtains for the object of a discretionary trust. Indeed, the interest of members

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<sup>7</sup> As to this last point, *Commissioner of Stamp Duties v Buckle* (1998) 192 CLR 226 at [21]-[25].

<sup>8</sup> *Lewin* at [1-048], [1-055]; *Glenn v Federal Commissioner of Land Tax* (1915) 20 CLR 490, 496 (Griffith CJ); *Dwight v FCT* (1992) ATR 236, 249 L4 (Hill J); *Walsh Bay Developments Pty Ltd v FCT* (1995) 31 ATR 15, 27 L14-25 (Full Fed Ct). A distinction is also sometimes drawn between a “contingent” interest (which does not vest until a future event) and a vested interest that is capable of being divested by some subsequent event. The latter is usually called a “defeasible” interest: *Dwight’s case* at 249 L5-10; *Walsh Bay* at 27 L40-43; for discussion, *Lewin* at [1-049] to [1-051]; also [1-052] to [1-054]. The distinction between a vested interest that is indefeasible and a vested interest that is defeasible, is therefore that in the latter but not the former case, the interest may be lost by the happening of some future event: eg. *Walsh Bay* at 27 L33-39.

<sup>9</sup> Where the property is not tangible, “present enjoyment” connotes the right to deal with the property as the true owner; for example, by directing how funds held by another are to be paid.

<sup>10</sup> *Lewin* at [1-048]. A leading authority on the point is *Glenn v Federal Commissioner of Land Tax* (1915) 20 CLR 490, 496, where Griffith CJ observed that “an estate is vested when there is an immediate fixed right of present or future enjoyment, is vested in possession when there exists a right of present enjoyment, and is vested in interest when there is a present fixed right of future enjoyment” (quoting with approval from Charles Fearn, *Essay on the Learning of Contingent Remainders and Executory Devises*, 10<sup>th</sup> edn (1844), perhaps from page 26); followed eg. *Dwight v FCT* (1992) ATR 236, 248 L45-50 (Hill J); *Walsh Bay Developments Pty Ltd v FCT* (1995) 31 ATR 15, 27 (Full Fed Ct).

<sup>11</sup> *Walsh Bay Developments Pty Ltd v FCT* (1995) 31 ATR 15, 27 L6-14 (Full Fed Ct).

<sup>12</sup> See eg. *Queensland Trustees Limited v. Commissioner of Stamp Duties* (1952) 88 CLR 54 at 62-3, and *Commissioner of Stamp Duties v Buckle* (1998) 192 CLR 226 at [22], and note 5 above.

of a class of objects under an ordinary discretionary trust has been described as a “discretionary interest”.<sup>13</sup>

*Position on and from the Vesting Day of 1 January 2001*

31. When a discretionary trust is expressed to continue for a defined period of time, as is often the case in order to protect against the rule against perpetuities, the consequences of the relevant date passing will in each case depend upon the terms of the particular trust.
32. For this Trust, the consequences of the Vesting Day passing are set out in clause 4, the terms of which were set out above.
33. Assuming that no instrument of appointment was executed by the trustee in the manner contemplated by the third, fourth and fifth lines of clause 4, and that the only Specified Beneficiaries are those whose names appear in the Schedule at page 24 of the trust deed, and that those persons survived to 1 January 2001, then in our opinion, on and from 1 January 2001, the capital and income of the trust estate is to be held on trust for two named beneficiaries “as tenants in common in equal shares”. So much is apparent from the terms of clause 4(a) of the Trust deed, lines 4 and 5 of which (“...*in trust for* ...”) require the trustee to hold the available trust estate existing as at 1 January 2001, for the benefit of the two identified trust beneficiaries, as tenants in common in equal shares.
34. For these reasons, in our opinion, from 1 January 2001 onwards, the trustee ceased to hold the trust estate pursuant to a discretionary trust, and held it on the terms of a fixed trust. The incidents of the new fixed trust are considered next.
35. From the Vesting Day onward, the trust beneficiaries obtained a vested interest in the trust estate. That interest was vested in interest and possession as to capital, and as to income earned and available for distribution from time to time (and with some rights as well in respect of the gross income earned). The distributable income may well be different in amount to the taxable income of the trust.<sup>14</sup> The position was otherwise prior to vesting, for the trustee was entitled to distribute only part or all of the taxable income of the trust (see the definition of “nett income” in clause 1(k)).
36. It may be noted, also, that after the Vesting Day the beneficiaries’ right to income earned from time to time is an incident of his or her ownership of the trust capital (equitable title to the assets extending to ownership of its fruits), and does not derive from the exercise of a power of appointment on the part of the trustee, as was the case prior to the vesting.

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<sup>13</sup> Lewin at [1-061].

<sup>14</sup> *Cmr of Taxation v Bamford* (2010) 240 CLR 481, 507-8; *Thomas v Cmr of Taxation (Cth)* [2015] FCA 968, [97]-[99].

37. Looking next at the powers and discretions of the trustee after the Vesting Day, from 1 January 2001, the trustee ceased to have both the power of appointment conferred by clause 3, and the special power or right conferred by the fourth and fifth lines of clause 4. The trustee may, instead, properly deal with the trust capital and income only in a manner consistent with the ownership interests of the two beneficiaries.<sup>15</sup>
38. Equally, in our opinion, on and from 1 January 2001 the trustee will become subject to the ordinary duties of a trustee of a private fixed trust, to safeguard the trust estate, and to deal with it only on the terms of the trust.

*Consequence of mistaken distributions of trust income after the Vesting Day*

39. The distinctive feature of the fact pattern now being considered is that the trustee continues to believe that the discretionary trust continues, when in fact that trust has ceased to apply, and has been replaced by a new fixed trust on quite different terms.
40. What are the rights and obligations of the trustee and beneficiary in such a case? The simplest case involves the actual payment of money by the trustee, to one beneficiary, in an amount that exceeds what that beneficiary was in fact entitled to under the terms of the fixed trust: for example, if the trustee were to pay all of the net income to one beneficiary in the mistaken belief that it still enjoyed a discretionary power of appointment. In fact, all other things being equal, the trustee should have either paid half of the distributable income to each beneficiary or accumulated the income in its own hands (recording it as an accumulation owned equally by both *cestui que trust*).
41. If the trustee were to overpay one beneficiary in this way, then in our opinion:<sup>16</sup>
- (a) that payment would be unauthorised;
  - (b) the payment would therefore be in breach of trust;
  - (c) the trustee would be obliged to reinstate the trust estate to the extent of the overpayment, by recourse to its own separate assets;
  - (d) the trustee would, however, be entitled to recoup the overpayment out of any trust capital or income remaining in, or coming into, the trustee's hands, to which the overpaid beneficiary would be entitled;<sup>17</sup>
  - (e) the overpaid beneficiary will ordinarily be obliged to reimburse the trustee for the overpayment;

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<sup>15</sup> See also *Hancock v Rinehart* (2015) 106 ACSR 207 at [128].

<sup>16</sup> See generally, *Lewin*, chapter 42.

<sup>17</sup> *Lewin* [42-007].

- (f) the underpaid beneficiary's equitable interest in the misapplied fund will persist (the overpaid beneficiary being a volunteer), and that interest may be traced into the hands of the overpaid beneficiary, but it is generally only the trustee who has the right to sue to vindicate this proprietary interest, the injured beneficiary's right being to compel the trustee to sue (the entitlement to a derivative action being very limited);
  - (g) insofar as the personal *re Diplock* remedy is available,<sup>18</sup> the underpaid beneficiary is also entitled to recover the overpayment directly from the overpaid beneficiary, but only after first exhausting his or her rights against the trustee;
  - (h) to the extent that the underpaid beneficiary can establish that he or she has suffered loss by reason of the overpayment, the trustee will probably be obliged to pay equitable compensation for breach of trust, to make good that loss.
42. The matrix of obligations just described is adapted to undoing the unauthorised overpayment. The payment itself took effect not because of a power of disposition given by the instrument of trust (which indeed gave no right to make the payment), but was instead effective because the trustee's ownership of legal title to the trust fund carries with it a power to pay trust income away. If what the trustee had done to appoint the income falls short of actual payment (or other disposition effective at common law), and would instead be capable of taking effect only in equity, in our opinion that conduct is of no effect at all, if not authorised by the trust. The position is quite unlike the exercise of an actual power of appointment in a manner having unintended fiscal or other consequences.<sup>19</sup> In the fact-pattern being considered, the trustee lacks any power at all to make the disposition, for the power of appointment formerly reposed in him has, since the vesting date, been taken away. Insofar as the language of "void" and "voidable" is to be employed, in our opinion it is plain that the purported disposition is properly described as void and not voidable.<sup>20</sup>
43. The underpaid beneficiary could not ratify the trustee's breach of trust in the sense of giving authority to appoint income where none otherwise existed. However, in our opinion he or she could validly agree to the overpaid beneficiary retaining the overpaid monies and to release the trustee from any claim arising from the mistake.

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<sup>18</sup> It remains unclear whether the claim is available in the case of an *inter vivos* trust. In Queensland the doubt has been removed by section 109 of the *Trusts Act 1973* (Qld). See further, *Lewin* [42-014].

<sup>19</sup> A fact pattern the subject of extensive consideration in the English courts, under the rubric of the so-called rule in *Hastings-Bass*, and culminating in *Pitt v Holt* [2013] 2 AC 108. In that case, the Supreme Court confirmed that the mistaken exercise of a power of appointment makes the disposition voidable not void (at [43], [93]).

<sup>20</sup> "The purported exercise of a discretionary power on the part of trustees will be void if what is done is not within the scope of the power" (*Pitt v Holt* [2012] Ch 132 at [96] per Lloyd LJ (CA), cited with apparent approval but on a different point in *Hancock v Rinehart* (2015) 106 ACSR 207, [68] (Sup Ct NSW)). See also the reasoning in *Comr of Taxation v Ramsden* (2005) 58 ATR 485 at [77]-[78] (Full Fed Ct), which should apply *a fortiori* to the position that obtains following a vesting of the trust.



44. Where:

- (a) a trust has vested in accordance with its terms with the effect that an interest which is vested in interest and vested in possession arises in the underpaid beneficiary;
- (b) the trust property which is the subject of the underpaid beneficiary's interest is wrongly paid to the overpaid beneficiary (that is, there has been actual payment in cash, or by means of an inter-bank transfer);
- (c) the underpaid beneficiary subsequently agrees to the overpaid beneficiary retaining the overpaid sum and releasing the trustee from any liability for the breach of trust;<sup>21</sup> then

the correct legal characterisation of the action of the underpaid beneficiary is, in our opinion, a gift of the overpaid sum made by the underpaid beneficiary to the overpaid beneficiary.

45. We consider that this is likely to be correct characterisation of the fact pattern for the following reasons. In the posited scenario, when the mistaken trustee made the overpayment, legal title to the overpaid monies passed to the overpaid beneficiary.<sup>22</sup> However, prior to the agreement and release referred to in 44(c) above, the underpaid beneficiary held an equitable interest in the overpaid monies that arose on and from the time the overpayment was made. For his part, on and from the moment the overpaid monies were received, the overpaid beneficiary held those funds on trust for the underpaid beneficiary, and enjoyed no equitable proprietary interest in them. On the assumption that the overpaid monies remained traceably identified in the hands of the overpaid beneficiary at the date of the agreement and release, following the agreement and release referred to 44(c) above, the overpaid beneficiary had a complete title to the overpaid monies, and the underpaid beneficiary retained none. No consideration has been provided by the overpaid beneficiary. In the result, the proper characterisation of the effect of the agreement and release on the facts posited is, in our opinion, that of a gift by the underpaid beneficiary, of his or her equitable interest in the overpaid sum, to the overpaid beneficiary. We do not consider that the arrangement can be characterised as one where the settlor (or the trustee) has made the gift, or where the gift has come merely from the trust estate itself,<sup>23</sup> for that characterisation does not sufficiently reflect

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<sup>21</sup> As to which, see further L Tucker et al. *Lewin on Trusts* 19<sup>th</sup> edn (2015) at [39-107] to [39-111], [39-122], [45-003].

<sup>22</sup> Viz. legal title to the notes and coins paid over in the case of a cash payment, or, in the case of payment by inter-bank transfer, legal ownership of the chose in action arising (where the bank account had a zero balance, or was in debit in an amount less than the sum paid, prior to the payment), or increased (where the bank account was in credit prior to the payment), by means of the overpayment.

<sup>23</sup> Cf. a simple release of a beneficiary's interest in a trust, which might in other contexts take effect as a resulting trust in favour of the settlor: *In re Guinness Settlement* [1966] 1 WLR 1335 (Ch D, Goff J).

the circumstance that, before the arrangement being discussed, beneficial ownership of the overpaid sum rested with underpaid beneficiary.

46. What of the circumstance where, at the time of the agreement and release, there remains no traceably identifiable product of the overpaid monies in the hands of the overpaid beneficiary; for example, because the funds were paid into an overdrawn bank account, or were all spent in a way that left no *corpus* over which equitable title might be asserted? In that scenario, the effect of the agreement and release<sup>24</sup> will be to extinguish the personal obligation in the overpaid beneficiary to repay the overpaid sum to the trustee, the trustee's right to recover the overpayment, and the other rights and obligations arising by operation of law to undo the consequence of the unauthorised payment, and which are summarised in paragraph [41] above. The language of "gift" fits less comfortably in this scenario, for the reason that, unlike the fact-pattern just discussed (where the money or its product remains identifiable in the hands of the overpaid beneficiary), the overpaid beneficiary has not acquired a new proprietary interest that is equal to the interest given up by the underpaid beneficiary.
47. It is, however, apparent that the overpaid beneficiary has obtained new rights of value, and the underpaid beneficiary has lost accrued rights of value. The overpaid beneficiary is no longer indebted to the trustee in the amount of the overpayment. The underpaid beneficiary no longer has enforceable claims in respect of the overpayment (*viz.* to require the trustee to reinstate the trust fund in the amount of the overpayment by recourse to his own assets, or requiring him to recover the overpayment from the overpaid beneficiary, or, insofar as such a claim may be available, against the overpaid beneficiary directly, by way of a *re Diplock* claim). Looked at in terms of the effect of the rearrangement of rights following the contemplated agreement and release, the overpaid beneficiary has received a gift of the overpaid sums, and has done so by reason of the agreement and release. Whether the putative donor is to be regarded as the underpaid beneficiary, or the settlor or trustee himself, might conceivably turn upon the particular circumstances of the case, but it would seem to us likely that in most cases, the donor will be the underpaid beneficiary, for the net effect of the arrangement is that his entitlement to and in the trust estate (howsoever enforceable) is reduced, and that of the overpaid beneficiary is *pro tanto* increased.

**Did the conduct of the trustee and beneficiaries from 2 January 2001 to 30 March 2014 extend the Vesting Day (because the fact that the trustee and beneficiaries have acted as if the trust were continuing is evidence that there was an implied exercise of the power to extend the Vesting Day)?**

48. In our respectful opinion the argument just noted is plainly wrong. The fact that after 1 January 2001 the trustee and beneficiaries continued to conduct their affairs on the

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<sup>24</sup> It might in theory be necessary for the trustee to join in any agreement in order to effectively extinguish the right to claim back the overpaid sum, for that right is at least in some respects, vested not in the underpaid beneficiary, but in the trustee himself.

footing that the discretionary trust continued in force (being ignorant of the change effected by clause 4) does not have the consequence that the Vesting Date is extended. Clause 4 was self-executing and was triggered by the effluxion of time. The consequences effected by the clause occurred automatically on 1 January 2001, and irrespective of the knowledge or intention of the trustee and beneficiaries (each of whom had anyway effectively pre-agreed to the regime imposed by clause 4 by consenting to be bound by the trust deed).

49. In any event, as will appear, in our opinion, after 1 January 2001 there was no power to extend the Vesting Date conferred by the trust deed. There was, therefore, no power of extension to be exercised by the trustee and beneficiaries, either expressly or by implication from their conduct.
50. It should be added, for completeness, that we have considered the argument expressed in the paper “Vesting of Trust Deeds” (30<sup>th</sup> National Convention of the Tax Institute, March 2015) (at 5.1.7) that is briefed and to which those instructing us have referred. We respectfully consider this argument to be wrong, and that the reasoning in *Cajkusic v Cmr of Taxation* [2006] FCAFC 164; (2006) 155 FCR 430 at [20] on which the paper relies, does not support the argument advanced.

#### **Did the Deed of Variation executed on 31 March 2014 alter the Vesting Day to 2030?**

51. In our opinion, the instrument of variation did not alter the Vesting Day for the following reasons.
52. The power to amend the trust deed is set out in clause 16 (and see also clause 25). Clause 16 provides as follows (emphasis added):
  16. THE Trustee for the time being may at any time and from time to time by Deeds revoke add to or vary all or any of the provisions of this Deed or any previous revocation addition or alternation but so that –
    - (a) Any law against perpetuities is not thereby infringed.
    - (b) The same shall not be in favour of or form benefit of or result in any benefit to any person from time to time being the Settlor or Trustees or any of them except a person named or described in the Schedule as a Specified Beneficiary but shall be for the benefit of all or any one or more of the General Beneficiaries or the next-of-kin of any of them or the next-of-kin of the Specified Beneficiary or Specified Beneficiaries or any of them. For the purpose of this clause “next-of-kin” shall be taken to be the persons who would be the next-of-kin of all or any one or more of the General Beneficiaries or Specified Beneficiaries or Specified Beneficiary (as the case may be) if such person or persons had died on the date of exercise of the power given by this Clause 16.
    - (c) The same shall not affect the beneficial entitlement to any amount set aside for any beneficiary or otherwise affect any interest which has vested prior to the date of the variation, alteration or addition.

53. In our opinion, the effect of clause 16(c) is that the trustee does *not* have a power or authority to revoke add to or vary any provision of the trust deed to the extent doing so would “affect” any interest which has “vested” prior to the date of the purported variation, alteration or addition. For the reasons explained earlier, in our opinion clause 1(c)(iii) should be construed consistently with clause 16(c), and so read as permitting alteration of the Vesting Day only before the trust in fact vests.
54. The effect of clause 4 was to vest new proprietary interests in the trust beneficiaries, on and from 1 January 2001, in the manner previously discussed.
55. Accordingly, in our opinion, on and from 1 January 2001, the trust deed became incapable of being altered by the trustee in a way that would “affect” the interests so vested.
56. The question arising is whether varying the Vesting Day would have that effect.
57. In our opinion, the answer is, plainly “yes”. After 1 January 2001, purporting to alter the Vesting Day to some later point in time “affected” an interest which has “vested” prior to the date of the purported variation, within the meaning of clause 16(c). That is because purporting to alter the Vesting Date to some later date necessarily required the beneficiaries’ interest in the trust estate, which vested on 1 January 2001, to be transformed into a contingent, discretionary interest of the kind enjoyed by a discretionary object (para [27] above).
58. For these reasons, in our opinion, on and from 1 January 2001 the trustee had no power to extend the Vesting Day, and the Deed of Variation executed by the trustee on 31 March 2014 was not effective to alter the Vesting Day to 2030 or to any other date.
59. We would add that, in our opinion, even if the trust deed did not contain a clause in the terms of 16(c), it would be a surprising construction of the instrument for it to be interpreted as giving a power to the trustee to retrospectively alter the vested beneficial interests of the *cestui que trust*: which seems to us to be a necessary consequence of a subsequent alteration of the vesting date.
60. On that construction of the deed, from the vesting date the beneficiaries would have particular proprietary interests, but the trustee could at a later date retrospectively alter those proprietary interests, transforming them as from the date of their creation, into merely discretionary interests (and correspondingly enlarging the trustee’s own powers). In our opinion a court would be reluctant to find that that was the presumed intention of the settlor. It is not only that the retrospective alteration of rights of property is conceptually difficult, but the practical consequences include the prospect that transfers of capital or payments of income that were valid when made could become invalid and in breach of trust; tax might be levied and paid on a basis

subsequently falsified; and conduct which was lawful when engaged in could become retrospectively unlawful (and vice versa). The advice will return to this point again, in considering questions 3 and 8(f).

### Particular questions

61. We now turn to consider the specific questions on which our opinion is sought.
62. Questions 1 to 7 will be set out first:
  1. What is the legal or equitable effect of the Vesting Day happening, specifically in relation to:
    - a. the interests of those defined to take on vesting? Do the interests of a capital beneficiary become vested in interest and in possession immediately at the time the Vesting Day arrives?
    - b. the rights, powers and obligations of a trustee, for example:
      - i. any discretionary powers of appointment
      - ii. the general power to amend the terms of the trust deed
      - iii. the specific power to change the Vesting Day.
    - c. the continued existence of the trust relationship, for example:
      - i. does the same trust relationship continue to exist as between the trustee and beneficiaries?
      - ii. does a new trust relationship arise upon vesting as between the trustee and beneficiaries?
      - iii. if a new trust relationship arises, does that mean the original trust has come to an end for trust law purposes and if so at what point in time did the original trust come to an end?
      - iv. are there any principles of general application that can be stated in relation to (a), (b) or (c)?
  2. Was the execution of the Deed of Extension effective to change the Vesting Day?
  3. In what circumstances, if any, might a trustee conceivably be capable of changing a Vesting Day after the original Vesting Day has passed?
  4. Is it open for a court to extend the vesting date of a trust after the original date has passed and, if so, in what circumstances would this be contemplated?
  5. What are the trustee's duties regarding the winding up of a trust after it has vested, particularly if the deed is silent on this point? For example, if the deed provides for the trustee to hold the trust fund on trust for the beneficiaries entitled on vesting, does the trustee nonetheless have a duty to distribute all of the trust fund as soon as practicable after the Vesting Day?
  6. In relation to the purported appointment of income of the trust estate after the Vesting Day to beneficiaries in a way that is not consistent with the beneficiaries' respective entitlements post-vesting as set out in clause 4 of the deed:
    - a. what is the legal or equitable effect of the purported application?

- b. are there any principles of general application that can be stated in relation to similar purported distributions of income after a Vesting Day (including, whether or not the level of trustee knowledge or competence is relevant)?
  - c. what are the assessment consequences (in accordance with Division 6 of Part III of the *Income Tax Assessment Act 1936* (ITAA 1936)) for any appointee?
  - d. What ability do the capital beneficiaries have to challenge the appointment of income? If the capital beneficiaries do not seek to challenge the appointment within a reasonable period, what impact does this have on whether the trust vested?
7. What are the capital gains tax (CGT) consequences in respect of CGT event E1 in section 104-55 of the ITAA 1936 of the trust vesting for the trustee and the beneficiaries?

63. In our opinion, the answers to each of those questions are as follows.

64. In relation to question 1:

- (a) As to 1(a): the interests of those defined to take on vesting became vested in accordance with and by operation of clause 4. On the assumption that at 1 January 2001 the two named beneficiaries survived and had no issue (and there were no other discretionary objects), the whole of the trust estate existing as at 1 January 2001 that had been subject to the former discretionary trust, became vested in them as tenants in common in equal shares. Both beneficiaries were capital and income beneficiaries as at 1 January 2001. Their interests in the trust capital and income available for distribution from time to time became vested in interest and in possession. Moreover, their interest was in our opinion, absolute and unconditional.
- (b) As to 1(b):
  - (i) the discretionary powers of appointment of the trustee ceased on and from 1 January 2001. After that time they were effectively “spent”<sup>25</sup>;
  - (ii) the general power to amend the terms of the trust deed continued in the same terms on and from 1 January 2001, however, the effect of the transformation of the former discretionary trust into a fixed trust is that, by operation of clause 16(c), the entitlement of the trustee to alter the terms of the trust was, in a practical sense, significantly diminished;
  - (iii) the power to change the Vesting Day ceased on 1 January 2001.
- (c) As to 1(c):

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<sup>25</sup> Adopting the language used in *Cmr of Taxation v Ramsden* (2005) 58 ATR 485 at [78] (Full Fed Ct), considering the position after the end of the Accounting Period, in respect of income earned during that period.

- (i) the same trust relationship does not continue to exist as between the trustee and the beneficiaries. On and from 1 January 2001 the trust relationship was transformed from that existing under a discretionary trust to the relationship obtaining in a fixed trust (the details of which were noted at [27], [30], [33]-[38] above);
- (ii) yes, a new trust relationship arises upon vesting;
- (iii) it is difficult to answer question 1(c)(iii) because there exists ambiguity in the terms “original trust” and “for trust law purposes”. In our opinion it is not the case that the original trust has come to an end for trust law purposes, if the “trust” means the trust relationship described in the instrument of trust. That trust has not come to an end.<sup>26</sup> What has occurred is a change in the relationship between trustee and beneficiary that was anticipated by, and occurred in accordance with, the terms of the trust.<sup>27</sup> It is difficult to see why this process should be characterised as “the original trust coming to an end for trust law purposes”, rather than being described as a rearrangement of the parties’ rights and obligations in accordance with the terms of the trust;
- (iv) the principle of general application that can be stated in relation to question 1 (a), (b) and (c), is that in each case it is important to have regard to the terms of the particular trust, for the reason that it is this that governs what will occur upon the arrival of a vesting day, and whether the trust purports to allow the vesting day to be extended after the trust has vested.

Whilst any general principles not anchored in a particular fact pattern must be treated with care, in our opinion it is also the case that in general, the mere fact that trustees and beneficiaries may continue to conduct themselves on the mistaken assumption that the former discretionary trust continues to apply, cannot alter the true legal and equitable rights of the parties, as established by the terms of the trust. The conduct might give rise to defences of waiver or acquiescence or laches in favour of the mistaken trustee, or the overpaid beneficiary, in a suit between them. As well, in some cases the conduct might be construed as an agreement whereby a gift has been made to the overpaid beneficiary in the amount of the overpayment (para [43] and [44] above). However, in our opinion, conduct carried on in ignorance of the fact that the trust has vested is, in principle, not capable of having the effect that the vesting day is to be regarded as

<sup>26</sup> Cf. *FCT v Clark* (2011) 190 FCR 206 at [76], [82] (Full Ct).

<sup>27</sup> Also, *Fischer v Nemeske Pty Ltd* [2016] HCA 11 at [96]-[98] per Gaegler J (change in beneficial ownership upon trustee’s exercise of power of advancement to be regarded as anticipated by and written into the trust instrument).

having been postponed or extended (for example, to such time as the true position becomes known to the parties<sup>28</sup>).

65. In relation to question 2: the execution of the Deed of Extension was not effective to change the Vesting Day, for the reasons explained earlier.
66. As to question 3: We are not presently able to see in what circumstances a trustee might conceivably be capable of changing a vesting day after the original vesting day had passed.
67. Some of the practical difficulties that would flow from an *ex post facto* changing of the vesting date were noted earlier (para [60] above). If clause 16(c) of the Trust had provided instead that the trustee could, after the Vesting Day, by instrument in writing fix a new and later Vesting Day, consideration would have to be given to what were the parties' true rights when the Vesting Day arrived. If this new clause 16(c) was capable of taking effect according to its terms, then from 1 January 2001, the trust beneficiaries would own the trust estate as tenants in common, but only defeasibly, subject to a power in the trustee to retrospectively extinguish that title and to replace it with a discretionary interest (and to correspondingly increase the trustee's powers and discretions). In such a case the beneficiaries' right to receive and retain income or other trust property after the vesting date would be uncertain, because that right would be conditional upon the trustee not subsequently altering the vesting date. No beneficiary would be able to safely deal with any income or other trust property received after the vesting date, for the receipt would be pregnant with the risk that it could subsequently become unauthorised and improper. Consideration might also have to be given to the effect of such a clause on the rule against perpetuities.
68. In relation to question 4: in our opinion, in general a Court has no power to extend the vesting date for a trust after its expiration. A court has no power at general law to alter or amend the terms of a trust instrument: *Re Dion Investments* (2014) 87 NSWLR 753 (CA) at [48]. A number of authorities had held that the power of the Court in provisions such as s81 of the *Trustee Act 1925* (NSW) to confer on trustees power to effect (inter alia) a "transaction" which was, in the opinion of the Court, expedient but could not be effected by reason of a lack of power of the trustee, authorised the Court to empower the trustee to amend the trust deed by extending the vesting date: see eg., *Stein v Sybmore Holdings Pty Limited* (2006) 64 ATR 325 at [45]-[46], *Barry v Borlas Pty Limited* [2012] NSWSC 831. A like position was reached in relation to analogous provisions in other states: see *Re Arthur Brady Family Trust; Re Trekmore Trading Trust* [2014] QSC 244 (concerning s94 of the *Trusts Act 1973* (Qld)).

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<sup>28</sup> Uncertainty as to when the new vesting day is said to be is another practical difficulty in the way of the proposition that unwittingly carrying on the old discretionary trust is capable of extending the vesting day.



69. However, in our opinion, since the decision of the Court of Appeal in *Re Dion*, the earlier decisions that had held that s81 of the *Trustee Act 1925* (NSW) authorised a Court to empower a trustee to amend a trust deed by extending the vesting date, must be taken to have been disapproved. The effect of the Court of Appeal’s decision is that the reference to “transaction” in s81 of the *Trustee Act* does not include an amendment of a trust deed, except to the extent it is a procedural step to effect a specific dealing (at [94]-[96]). In the circumstance currently under consideration, there is no specific dealing for which a procedural step requires amending the trust deed to effect the dealing. As presently instructed, we find it difficult to imagine a scenario in which altering the vesting date after the trust has vested according to its terms, would be a procedural step to effect a specific dealing.
70. In our opinion, the same result will likely obtain in other States in relation to provisions analogous to s81 of the *Trustee Act 1925* (NSW). This is so despite some differences in the wording of those provisions, and despite first instance decisions to the contrary pre-dating *Re Dion*. Thus, while the Court of Appeal in *Re Dion* adverted to some differences between s81 of the *Trustee Act* (NSW) and s94 of the *Trusts Act 1973* (Qld) considered in *Re Arthur Brady Family Trust* (at [84]), in *Hancock v Rinehart* [2015] NSWSC 646; (2015) 106 ACSR 207 at [186]-[183] Brereton J applied the conclusion in *Re Dion* to s89 of the *Trustees Act 1962* (WA) (set out at [181]), which is in substantially identical terms to s94 of the *Trusts Act 1973* (Qld) (see at [182]). We are reinforced in our view by the statement appearing in *Jacobs Law of Trusts* (8<sup>th</sup> Ed, 2016) at [17-06]. The learned authors there state, with reference to *Re Dion* and *Hancock v Rinehart*, the following general proposition in relation to all of the provisions in Australian jurisdictions that follow the form of s57 of the *Trustees Act 1925* (UK):
- “Apart from making adjustments to the terms of the trust or the rights of beneficiaries which are incidental to or consequential on the advantageous dealing, the court has no power to vary the trust”.
71. In relation to question 5: in our opinion, unless there exists a clause in the trust deed providing for the trust to be “wound up” following vesting, or an immediate distribution is plainly contemplated by other terms of the deed, the trustee ought not to have a duty to wind up the trust after it has vested, by distributing all of the trust fund as soon as practicable after the Vesting Day.
72. Those instructing us have drawn attention to the reasons of Justice Anderson in *Clay v. James* [2001] WASCA 18 at [6] and [11]. In our respectful opinion those passages should be understood in the light of the particular trust deed before the court. It is apparent that the learned judge considered that clause 2 of the trust deed had the effect that upon the expiration of the “Trust Period” the duty of the trustee was to pay the amount of the trust fund in accordance with the settlement and otherwise to take all steps necessary to wind up the trust: at [6]. In our opinion whilst that may (or may not)

be the correct interpretation of clause 2 of the deed before the court, the decision is not authority that in a fact pattern of the kind currently being considered, there is usually an implied obligation on the trustee to distribute the trust fund or to otherwise wind up the trust once it has vested.

73. So, for example, in relation to the Trust under consideration, the trust deed provides in clause 4 that upon the Vesting Day, if there are two surviving Specified Beneficiaries, then the trustee is henceforth to hold the trust estate for each of them as tenants in common in equal shares. In our opinion there is nothing in clause 4 that implies that the trustee must thereafter distribute the trust fund and so bring the trust to an end. Rather, in our opinion, the working assumption of clause 4 is that the trustee is obliged to continue to hold the fund on the trusts there set out. An implied obligation to distribute the fund to the beneficiaries would be a significant limitation upon the trust, and an important obligation upon the trustee. In our opinion, if this was the intention of the settlor, it could be expected to be made clear.
74. The instrument is also to be read as a whole, and if the other terms of the trust indicated that the trustee was required to distribute the fund upon vesting, it might be that a term to that effect could properly be implied. However, in our opinion, the terms of the Trust deed tell against that construction. By clause 6, whilst some of the trustee's discretionary powers are expressed to *not* survive vesting (for example, the power to lend trust money to the beneficiaries (clause 6(a)), and the power given by clause 7(x)), other powers contain no such temporal limitation, and this includes the trustee's power of investment (clause 7(a)). The juxtaposition of these two types of clause, the one limited to the period prior to vesting, and the other apparently intended to survive vesting, tends to suggest that the presumed intention of the settlor was that the trust would continue after the Vesting Day.
75. In relation to question 6(a): assuming that the incorrect appointment of income has been made by mistake, and has been accompanied by a payment of money, then:
  - (a) the payment has the character of a payment by a trustee that is not authorised by the trust deed and which was also made by mistake;
  - (b) the payment is effective at common law in that legal title to the money paid will pass, but its economic effect will be reversed by the overpaid beneficiary coming to owe a debt imposed by law to the trustee (*viz.* because he or she will be amenable to a claim by the trustee for money had and received, as money paid by mistake);
  - (c) the payment is ineffective in equity, in the sense that all other things being equal, the equitable title in the underpaid beneficiary will persist in the hands of the overpaid beneficiary and is enforceable at the suit of the trustee, and the trustee will also obtain (in our view) a personal equitable claim for repayment.

76. A further discussion of the rights of the parties *inter se* is set out at paragraph [41] above.
77. In relation to question 6(b): the principles of general application are, in our opinion, those principles that are to be applied to any unauthorised and mistaken distribution by a trustee to a beneficiary.
78. The level of trustee knowledge or competence is, in our opinion, irrelevant to whether the trust has vested. If the trustee is in fact aware of or negligent as to the misapplication of trust money, that might be relevant to the extent of the beneficiaries' claims against the trustee, and to the availability of a defence of the kind established by section 76 of the *Trusts Act 1973* (Qld) (whereby a trustee who establishes that he has acted honestly and reasonably and ought fairly to be excused may be relieved from liability).
79. As to question 6(c), and at the risk of restating matters familiar to those instructing us:
- (a) Section 97(1) of the ITAA 1936 provides as follows (emphasis added):
- 97 Beneficiary not under any legal disability**
- (1) 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; and...
- (b) Section 95 defines “net income of the trust estate” as that term appears in section 97(1), and essentially to mean taxable income.
- (c) The “income of the trust estate” in section 97 means the distributable income of the trust estate ascertained by the trustee (applying the general law of trusts), determined according to appropriate accounting principles taking account of relevantly applicable presumptions (if any) about receipts, outgoings and losses, and the terms of the trust instrument, measured in respect of distinct income years.<sup>29</sup>
- (d) Section 97 therefore imposes tax upon a notional sum calculated in accordance with the statutory formulae there set out. The formulae is whatever is the

<sup>29</sup> *Zeta Force Pty Ltd v Commissioner of Taxation (Cth)* (1998) 89 FCR 70, 74-5 (Sundberg J); *Cmr of Taxation v Bamford* (2010) 240 CLR 481, 507-08; *Thomas v Cmr of Taxation (Cth)* [2015] FCA 968, [90]-[92].

proportion of the (distributable) income of the trust that the beneficiary is presently entitled to, tax is payable on that same proportion of the trust's net (taxable) income.<sup>30</sup> Accordingly, as has been explained:<sup>31</sup>

“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.”

(e) A trust beneficiary is presently entitled to a share of the income of the trust estate if (and only if) the beneficiary has an interest in the income which is both vested in interest and vested in possession, and 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.<sup>32</sup>

(f) Section 101 of the ITAA 1936 provides as follows:<sup>33</sup>

For the purposes of this Act, where a trustee has a discretion to pay or apply income of a trust estate to or for the benefit of specified beneficiaries, a beneficiary in whose favour the trustee exercises the trustee's discretion shall be deemed to be presently entitled to the amount paid to the beneficiary or applied for the beneficiary's benefit by the trustee in the exercise of that discretion.

(g) It will be assumed that none of the relevant income represented a capital gain engaging Subdivision 115-C.

(h) A valid appointment of income under clause 3(b) would have given the recipient beneficiary an immediate, vested and indefeasible interest in and to the income appointed to him (see clause 3(c)(i), (f) of the trust deed),<sup>34</sup> making him

<sup>30</sup> *Cmr of Taxation v Bamford* (2010) 240 CLR 481, 507-8.

<sup>31</sup> *Zeta Force Pty Ltd v Commissioner of Taxation (Cth)* (1998) 89 FCR 70, 75 (Sundberg J), approved *Cmr of Taxation v Bamford* (2010) 240 CLR 481 at [45].

<sup>32</sup> *FCT v Totledge Pty Ltd* (1982) 40 ALR 385, 393, 394, 396 (Full Federal Court); *Cmr of Taxation v Bamford* (2010) 240 CLR 481, 505, 506. See also *Taylor v Commissioner of Taxation of the Cth of Australia* (1970) 119 CLR 444, 449, 451-452; *Harmer v FCT* (1991) 173 CLR 264, 271; *Cameron v Jeffress* [2014] NSWSC 702, [35]; *Thomas v Cmr of Taxation (Cth)* [2015] FCA 968, [95]-[99].

<sup>33</sup> And see *Thomas v Cmr of Taxation (Cth)* [2015] FCA 968 at [87], [88], [98].

<sup>34</sup> Unless the income proved, at the end of the accounting period, to not exist: see clause 3(c)(i); also, *Comr Inland Revenue v Ward* [1970] NZLR 1, 28, 30 (CA). Although clause 3(f) says that a separate trust is created where sums are “set aside”, whereas clause 3(b)(ii) speaks of “pay apply or set aside”, in our opinion a separate trust is probably also created if the trustee validly appoints income by “applying” it. The exercise by a trustee of a power to appoint assets so as to make the beneficiary absolutely entitled will remove the assets from the original trust, even absent an express authority to do so: *Bond (HM Inspector of Taxes) v Pickford* [1983] STC 517, 522E-J, 523A (CA) per Slade LJ. Equally, if a beneficiary does become absolutely entitled following an appointment in his favour, a separate trust should exist over the appointed assets: *Swires (HM Inspector of Taxes) v Renton* [1991] STC 490; (1991) 64 TC 315, 319E-H (first instance), 328G (Hoffmann J, sitting in the Ch D); cf. *Fischer v Nemeske Pty Ltd* [2016] HCA 11 [96]-[98] per Gageler J (change in beneficial ownership after appointment by exercise of power of advancement to be regarded as anticipated by and written into the trust instrument).

absolutely entitled to the sum appointed,<sup>35</sup> and also presently entitled to a share of the income of the trust estate in the proportion appointed, within the meaning of section 97 of the ITAA 1936.<sup>36</sup> (Also, upon the expiration of an Accounting Period in which some part of the net income remained undistributed, beneficiaries taking by accumulation pursuant to clause 3(e) would have become presently entitled at the end of the Accounting Period to the income accumulated in their favour.<sup>37</sup>)

- (i) But the purported appointment by the trustee was in fact made without authority, for the reason that the discretionary power of appointment in clause 3(b) was no longer conferred on the trustee, and the trust deed does not contain any other power permitting the trustee to distribute the income in the manner attempted.<sup>38</sup>
- (j) The consequence in our opinion is that the purported appointment of income was not effective to vest any interest in the nominated beneficiary,<sup>39</sup> and was not effective to make the beneficiary presently entitled to any part of the income sought to be applied or set aside or paid.
- (k) The true position was that the two beneficiaries were entitled to the income of the trust as tenants in common in equal shares (making the assumption set out earlier). The share of the income of the trust estate enjoyed by each beneficiary was therefore one half each.
- (l) Accordingly, for each year of income after 1 January 2001, each beneficiary was assessable to tax upon one half of the net income of the trust estate,<sup>40</sup> irrespective of the sum that was paid, set aside or applied by the trustee in the purported exercise of the power of appointment.<sup>41</sup>

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<sup>35</sup> See previous note. Also, *Fischer v Nemeske Pty Ltd* [2016] HCA 11 (considering a power of advancement given to a discretionary trustee) at [31], [49], [63]-[73], [91], [93], [96]-[98], [104], [170]-[179].

<sup>36</sup> *FCT v Bamford* (2010) 240 CLR 481, 505, 506; s 101 of the ITAA 1936.

<sup>37</sup> *Cmr of Taxation v Ramsden* (2005) 58 ATR 485 at [68] (Full Fed Ct).

<sup>38</sup> Contrast *Fischer v Nemeske Pty Ltd* [2016] HCA 11 (power of advancement authorised trustee's conduct though not actually referred to by the trustee). For the avoidance of doubt, in our opinion it is difficult to see how the statutory power of advancement given to a trustee (eg section 60, 62 of the *Trusts Act* 1973 (Qld), assuming it applied to the Trust) could authorise the mistaken appointments presently being considered, not least because the trustee has purported to make them from income not capital.

<sup>39</sup> Unless the trustee appoints income by paying money to the beneficiary, in notes and coins, or by cheque or other interbank transfer. There, of course, legal title to cash (the notes and coins) or the chose in action (the increased credit balance in the payee's account) becomes vested in the beneficiary, but he or she will be compelled to hold that title on trust to the extent of the other beneficiary's interest in the money, and remains as well under a personal obligation to refund the overpayment to the trustee. In our opinion the beneficiary in such a case does not obtain a vested or indefeasible interest in the money paid, and is not presently entitled to those monies within the meaning of section 97, unless he or she would otherwise be presently entitled by reason of the ordinary operation of the fixed trust then in force.

<sup>40</sup> Putting to one side the circumstance that the trust may have vested in the middle of a year of income.

<sup>41</sup> See also *Cmr of Taxation v Ramsden* (2005) 58 ATR 485 at [73]-[75] (Full Fed Ct).

80. As to question 6(d):
- (a) the capital beneficiaries will have a right to challenge incorrect appointments of income after the trust has vested;
  - (b) whether or not the capital beneficiaries seek to challenge the incorrect appointment of income within a reasonable period should in our opinion have no impact on whether the trust has vested.
81. Question 7 concerns the capital gains tax consequences in respect of CGT event E1 in section 104-55 of the ITAA 1936. For the reasons explained earlier, our preliminary view is that the transformation of the trust from a discretionary to a fixed trust, by operation of the trust deed itself, does not involve the creation of a trust over a CGT asset by declaration or settlement, if the key inquiry is whether there has been continuity of the trust of the kind discussed in *FCT v Clark* (2011) 190 FCR 206 (Full Ct) or whether the original trust has instead terminated. We would wish to consider this issue further before coming to a final view, and would be pleased to do so in a subsequent advice if required.
82. We are also asked the following further questions:
8. General advice is sought on whether any aspect of your advice relating to questions 1 to 7 is impacted by, or dependent on:
- (a) whether the trust is completely discretionary as to entitlements to income and capital, non-discretionary as to both income and capital, or a hybrid?
  - (b) whether the same beneficiaries are entitled to trust income and corpus during the life of the trust and upon vesting?
  - (c) the existence of a power in the trustee to vary the beneficiaries (or class of beneficiaries) who are entitled to income and/or capital of the trust?
  - (d) a requirement in the deed that the capital of the trust be *paid or transferred* to the relevant beneficiaries on vesting (as opposed to the trustee *standing possessed in trust* for them as at that time)?
  - (e) whether, before the Vesting Day, the trustee executed a deed to extend the time at which the trust vested which was conditional on an event that may occur after the original Vesting Day?
  - (f) whether or not the trustee and beneficiaries are in agreement as to the purported extension of the vesting day? If yes, does the agreement need to be reached with all beneficiaries (including those outside the class entitled to trust corpus and income on vesting), or only those entitled to take on vesting?
83. Our opinion in relation to these further questions is as follows:
- (a) As to questions 8(a) to (c): We cannot immediately see why this should make a relevant difference, but would be happy to address any particular questions that those instructing me wish to be considered.

- (b) As to question 8(d): the effect of a clause of this kind is that the trustee will hold the trust estate on a bare trust after vesting,<sup>42</sup> but otherwise we cannot immediately see what relevant difference this should make. Again, we will be pleased to address any particular questions that may arise in relation to this point.
- (c) As to question 8(e): in our opinion because of the conceptual and practical problems that would arise if the deed was construed as being capable of being engaged after vesting (discussed earlier), a deed of this kind would be effective up until the original Vesting Day, but if the condition precedent to the variation of the date did not occur by the Vesting Day, then the trust should vest on the Vesting Day, and the deed of extension should be construed as ceasing to be engaged from that point onward. Of course, in principle a conditional deed of extension of this kind could be expressed in words that made plain that the vesting date was to change if the condition occurred after the original vesting date. However, a clause of this kind would give rise to the significant difficulties noted earlier in the advice: see para [60], [67] above.<sup>43</sup>
- (d) As to question 8(f): in our opinion if the trustees and beneficiaries all agreed after the Vesting Day to extend the Vesting Day, and this agreement was evidenced by some outward manifestation, it is possible that this conduct will be construed as manifesting an intention to henceforth (for the future) resettle the fixed trust as a discretionary trust.<sup>44</sup> We are doubtful that a trustee and beneficiary can validly agree, after the event, to cause a fixed trust vested pursuant to the terms of a valid trust deed, to retrospectively become a discretionary trust as from the date of vesting.

In the general law, the retrospective revesting of title is typically associated with cases where a disposition of property has been impaired by a defect in the consent of the disponent. If the defect is sufficiently significant, the laws permit the transferor to re-vest title by electing to rescind the transaction, and in a number of respects the revesting is said to occur retrospectively.<sup>45</sup> But the fact pattern now being considered is quite different. There is no defect in the consent of the settlor of the discretionary trust deed. We are doubtful that after the trust has vested in

<sup>42</sup> As to the meaning of “bare trust”, *Herdegen v FCT* (1988) 84 ALR 271, 281 (Gummow J); *Byrnes v Kendle* (2011) 243 CLR 253, 264-5; *Fischer v Nemeske Pty Ltd* [2016] HCA 11 [107] (Gageler J).

<sup>43</sup> For a discussion of retrospective amendments to trusts (and arguing that this may in some circumstances be possible), Thomas & Hudson, *The Law of Trusts* 2<sup>nd</sup> edn (2010) [24.58] – [24.61].

<sup>44</sup> For an express trust to arise, it is necessary for there to have been some outward manifestation of intention. An uncommunicated and therefore purely subjective intention or agreement is not sufficient: *Byrnes v Kendle* (2011) 243 CLR 253, 274-5, 277 [65]. In cases of doubt, all of the relevant circumstances are to be taken into account in ascertaining whether an intention to create a trust existed: *Byrnes v Kendle* (2011) 243 CLR 253, [54]-[55]; see also *Walsh Bay Developments Pty Ltd v FCT* (1995) 31 ATR 15, 22 L29-30 (Full Fed Ct); *Korda v Australian Executor Trustees (SA) Ltd* [2014] VSCA 65, [242]-[247]; (2015) 255 CLR 62 at [3], [7] (French CJ), [108] (Gageler J); also, [204], [208] per Keane J (courts do not strain to find an intention to create a trust).

<sup>45</sup> Eg. D O’Sullivan et al, *The Law of Rescission*, 2<sup>nd</sup> edn, [13.29] - [13.31].

accordance with its terms, the trustee and beneficiaries are competent to retrospectively undo those consequences.

Further, we are aware of no power, either under the general law, or pursuant to statute, by which a Court may effectively undo a valid vesting of a trust pursuant to its terms, and cause the trust to revert to being a discretionary trust. Any such power would seem to involve, at the very least, a power to retrospectively vary the terms of the trust. The decision in *Re Dion Investments* (2014) 87 NSWLR 753 (CA) would appear to preclude the power to vary the terms of the trust at all; *a fortiori* to do so retrospectively.

84. We advise accordingly.

**Dominic O’Sullivan QC**

**Michael O’Meara**

31 October 2016