Decision impact statement

Commissioner of Taxation v Carter

Court citation(s):	[2022] HCA 10
Venue:	High Court of Australia
Venue reference no:	S62/2021
Judge names:	Gageler, Gordon, Edelman, Steward and Gleeson JJ
Judgment date:	6 April 2022
Appeals on foot:	No
Decision outcome:	Favourable to the Commissioner

Impacted advice

- ATO Interpretative Decision ATO ID 2010/85 *Trust income: disclaimer of an entitlement to trust income*

The Commissioner has withdrawn this ATO ID and will also update relevant website guidance to reflect the view of the High Court.

Summary

This Decision impact statement outlines the ATO's response to *Commissioner of Taxation v Carter* [2022] HCA 10.

The main issue in this case was the taxation of gains from the sale of properties held in a trust. The question for the High Court was whether the default beneficiaries who were entitled to those gains under the deed remained liable to tax despite validly disclaiming their right to those gains after year end.

All legislative references in this Decision impact statement are to the *Income Tax Assessment Act 1936*.

Brief summary of facts

The Commissioner had determined that in each of the years in issue (2010–11 to 2013–14), the Whitby Trust had earned income from the development and sale of certain property.

By the end of each of the relevant income years, some or all of the income of the Whitby Trust was not subject to an effective determination by the trustee (Whitby Land Company Pty Ltd). Under the trust deed, any such income was to be held on trust in equal shares for the 5 children of Mr Caratti (the default beneficiaries).

The assessments

The core trust taxation rules are contained in Division 6 of Pt III. Key provisions within that Division are sections 97 and 99A. Under section 97, a beneficiary who is presently entitled to a share of the income of a trust for a particular year includes in their assessable income that share of the trust's net (taxable) income for that year. Where a share of the income of a trust is income to which no beneficiary is presently entitled, the trustee is assessed on that share of the trust's net (taxable) income under section 99A.

The Commissioner raised alternative assessments against:

- Whitby Land Company Pty Ltd as trustee of the Whitby Trust; these were section 99A assessments, and
- the default beneficiaries; of the 5 takers in default (Christina Caratti, Natalie Carter, Alisha Caratti, Nicole Caratti and Benjamin Caratti), Benjamin was a minor at the relevant time and the trustee was assessed on his behalf in a representative capacity under section 98 on his 20% share of the net income. The other default beneficiaries were assessed on their respective shares under section 97.

The default beneficiaries subsequently executed a series of disclaimers in respect of their default entitlements. In particular, the third (and final) disclaimers were expressed broadly to disclaim any and all rights and interests conferred by the deed to any income.[1]

Administrative Appeals Tribunal proceedings

The trustee and the 4 default beneficiaries of age challenged the Commissioner's decision to disallow objections against the assessments for the 2010–11 to 2012–13 years (for the trustee) and the 2013–14 year (for those default beneficiaries).[2]

The quantum of the income being brought to tax in the relevant years was not disputed by the litigants; rather, they disputed who was properly assessable on that income.[3]

In a decision handed down on 23 December 2019, the Tribunal (constituted by DP O'Loughlin) affirmed each of the Commissioner's relevant objection decisions. As to the default beneficiaries of age, the Tribunal concluded that none of the disclaimers executed were effective at general law. On that basis, the Tribunal did not need to express views on whether the disclaimers would have worked to disapply section 97 had they been effective.

Federal Court proceedings

Three of the 4 default beneficiaries of age (but not Christina Caratti, nor the trustee of the Whitby Trust) appealed the Tribunal's decision to the Federal Court. The appeal was heard by the Full Court.[4]

In a decision handed down on 17 August 2020, the Court concluded (contrary to the Tribunal's decision) that the third disclaimers executed by the Caratti daughters were effective at general law to disclaim the entirety of their default interests, Further, the Court concluded that for section 97 purposes, the daughters were (as a result of the disclaimers) not presently entitled to income within the meaning of section 97 as at 30 June 2014 – in other words, that the disclaimers were retrospectively effective for

[1] The first disclaimers were expressed to relate specifically to the income derived in the 2010–11 to 2012–13 income years and the second specifically to the income derived in the 2013–14 income year.

[2] The Commissioner had earlier, in error, allowed the daughters' objections against their 2010–11 to 2012–13 year assessments on the basis of a view that they had effectively disclaimed their entitlements to the income of the trust estate in those years. Before the Tribunal, the Commissioner acknowledged his error and, while accepting he was bound by the error for the 2010–11 to 2012–13 years, maintained that the error could not also bind his approach to the 2013–14 year.

[3] *The Trustee for the Whitby Trust and Commissioner of Taxation* [2019] AATA 5637 at [2].

[4] *Carter v Commissioner of Taxation* [2020] FCAFC 150.

tax purposes. Therefore, section 97 did not apply to assess the Caratti daughters on any share of the trust's net (taxable) income.

High Court proceedings

On 23 April 2021, the High Court (Gageler, Edelman and Gleeson JJ) granted the Commissioner special leave to appeal. The grounds of appeal solely concerned the discrete issue of whether a valid (legally effective) disclaimer executed by a default beneficiary has the effect of retrospectively avoiding the application of section 97.

The High Court, constituted by Gageler, Gordon, Edelman, Steward and Gleeson JJ, heard the appeal on 9 November 2021.

On 6 April 2022, the High Court unanimously allowed the Commissioner's appeal with Gageler, Gordon, Steward and Gleeson JJ delivering a joint judgment in favour of the Commissioner and Edelman J, in agreement, writing separately.

Issues decided by the High Court

The High Court emphasised that the resolution of this case turned on the proper construction of Division 6 and, in particular, the time at which a beneficiary must be presently entitled to income of a trust to engage section 97.

The statutory construction of section 97

The High Court observed that the criterion for liability in Division 6 turns on the right to receive an amount of distributable income, not its receipt.[5]

The High Court accepted the Commissioner's submission that a beneficiary's liability is based on 'present entitlement', which turns on the facts existing at the time immediately before the end of the income year.[6] In line with the well-known authorities of *Bamford*[7], *Harmer*[8] and *Zeta Force*[9], the High Court confirmed that beneficiaries are to be assessed on their share of the trust's net (taxable) income based on their present entitlement to a share of the trust income immediately before the end of the relevant income year.

The High Court emphatically rejected the respondents' contention that the phrase 'presently entitled' should have regard to later events that would disentitle the beneficiary.

The majority decision concluded that[10]:

> … the question of the "present entitlement" of a beneficiary to income of a trust must be tested and examined "at the close of the taxation year" …, not some reasonable period of time after the end of the taxation year.

This was similarly expressed by Edelman J[11]:

> A "present entitlement" to a share of the income of the trust estate in s 97(1) is an entitlement at the "present" time of the determination, being the end of the relevant financial year, whether or not that entitlement is later the subject of defeasance by a disclaimer.

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[5] *Commissioner of Taxation v Carter* [2022] HCA 10 (*Carter – High Court*) at [20].
[6] *Carter – High Court* at [17], [19], [25] and [33].
[7] *Commissioner of Taxation v Bamford* [2010] HCA 10.
[8] *Harmer v Commissioner of Taxation* [1991] HCA 51.
[9] *Zeta Force Pty Ltd v The Commissioner of Taxation of the Commonwealth of Australia* [1998] FCA 728.
[10] *Carter – High Court* at [25].
[11] *Carter – High Court* at [33].

The High Court observed that the competing construction (put by the respondents) was '… contrary to the text of s 97(1) and the object and purpose of Div 6', adding[12]:

> It would give rise to uncertainty in the identification of the beneficiaries presently entitled to a share of the income of a trust estate and the subsequent assessment of those beneficiaries. … The uncertainties that would arise, and which would apply with equal force to the Commissioner, trustees, beneficiaries and perhaps even settlors, would also not be fair, convenient or efficient.

While the majority did acknowledge that unfairness can arise where a beneficiary is not aware of its entitlement to trust income, their Honours noted that this is a function of the operation of Division 6 and the fact that subsection 97(1) is drafted to tax a beneficiary by reference to present entitlement not receipt. The High Court noted that this is similar to the apparent unfairness identified in *Bamford*, the High Court in that case recognising that this arises because subsection 97(1) taxes a beneficiary on a share of the trust's net income, not the distributable income to which they are entitled, and does so regardless of whether distributable income is received.[13]

ATO view of decision

The High Court decision settles an important practical question as to how trust income is to be brought to tax when relevant trust entitlements are disclaimed in a legally effective manner[14] sometime after financial year end.

It tells us that such disclaimers do not disturb what would otherwise be the tax result. Beneficiaries who have an interest in, or entitlement to, trust income should now take this into account if they were otherwise considering not accepting that interest or entitlement and instead looking to disclaim it.

Implications for impacted advice or guidance

ATO Interpretative Decision ATO ID 2010/85 *Trust income: disclaimer of an entitlement to trust income* expressed the view derived from earlier authority that a beneficiary who has validly disclaimed an entitlement to trust income is not presently entitled to a share of the income of the trust estate for the purposes of section 97.

The Commissioner has withdrawn this ATO ID and will also update relevant website guidance to reflect the view of the High Court.

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[12] *Carter – High Court* at [24].

[13] *Carter – High Court* at [26].

[14] Whether a disclaimer is effective turns on the general law. An effective disclaimer requires repudiation of the entirety of the gift, the repudiation must be done within a reasonable period of the donee becoming aware of the gift and without the benefit of the gift already having been accepted (see *Commissioner of Taxation of the Commonwealth of Australia v Ramsden* [2005] FCAFC 39 and *Lewski v Commissioner of Taxation* [2017] FCAFC 145).

Comments

We invite you to advise us if you feel this decision has consequences we have not identified or if you consider there is specific guidance that needs to be added to our existing public advice and guidance on the issues covered by this case. Please forward your comments to the contact officer.

Date issued: 10 June 2022

Contact officer details have been removed as the comments period has expired

Legislative references

Income Tax Assessment Act 1936
Div 6 Pt III
95A
96
97
98
99
99A

Case references

Carter v Commissioner of Taxation [2020] FCAFC 150; 279 FCR 83; 2020 ATC 20-760; 112 ATR 493
Commissioner of Taxation v Bamford [2010] HCA 10; 240 CLR 481; 84 ALJR 266; 75 ATR 1; 2010 ATC 20-170
Commissioner of Taxation of the Commonwealth of Australia v Ramsden [2005] FCAFC 39; 2005 ATC 4136; 58 ATR 485
Harmer v Commissioner of Taxation [1991] HCA 51; 173 CLR 264; 22 ATR 725; 91 ATC 5000; 66 ALJR 89
Lewski v Federal Commissioner of Taxation [2017] FCAFC 171; 254 FCR 14; 106 ATR 566; 2017 ATC 20-630
The Trustee for the Whitby Trust v Commissioner of Taxation [2019] AATA 5637; 111 ATR 177
Zeta Force Pty Ltd v The Commissioner of Taxation of the Commonwealth of Australia [1998] FCA 728; 84 FCR 70; 98 ATC 4681; 39 ATR 277

Other references

ATO ID 2010/85 (withdrawn)