Lewski v Commissioner of Taxation -

Decision impact statement

Lewski v Commissioner of Taxation

Court citation(s):	[2017] FCAFC 145
Venue:	Federal Court
Venue reference no:	VID 1496 of 2016
Judge/AAT member name(s):	Perram, Pagone and Moshinsky JJ
Judgment date:	18 September 2017
Appeals on foot:	No
Decision outcome:	Unfavourable

Impacted advice

ATO ID 2010/85
TD 2012/22

The ATO is reviewing the impact of this decision on related advice and guidance products.

Précis

Outlines the ATO's response to this case which concerned, among other things, the calculation and assessment of trust net income.

Brief summary of facts

The Commissioner determined that certain tax losses were not available in working out the net income of the ACE No 4 Trust (the ACE Trust) and the Arjod Trading Trust (the Arjod Trust) for the income years ended 30 June 2006 and 30 June 2007, respectively. The tax losses of the ACE Trust arose from deductions that the trustees claimed were incurred under contracts entered into on 30 June 1999. The Commissioner considered that the amounts had not been so incurred.

The taxpayer was a beneficiary of both trusts at all relevant times.

On 14 May 2013, the Commissioner issued amended assessments to the taxpayer for the income years ended 30 June 2006 and 30 June 2007 on the basis that she was presently entitled to a share of the income of the ACE Trust (2006) and the Arjod Trust (2007) and thus was assessable on that share of net income (as adjusted) under subsection 97(1) of the *Income Tax Assessment Act 1936* (ITAA 1936).

The trustee resolutions appointing the income of each trust were similarly worded and consisted of two parts.

- Firstly, under a ‘distribution of income’ resolution each trustee resolved to pay, apply and set aside the ‘income’ of the trust. In the 2006 year, the taxpayer was made entitled to 100% of the income of the ACE Trust. In the 2007 year, to the extent that the Arjod Trust had income in excess of $3.5m, she was made entitled to that excess. The trust income was, in each case, determined to include all amounts (including capital gains) taken into account in calculating the net income of the trust.

- Secondly, each trustee also resolved that should the Commissioner disallow a deduction or include an amount as assessable income of the trust, there would be a deemed distribution of such amounts to a corporate beneficiary (the 'variation of income' resolution).

On the 5 July 2013, the taxpayer objected to the amended assessments and those objections were determined on 9 July 2015. The taxpayer purported to disclaim her entitlements in the ACE and Arjod Trusts on 15 December 2015, some three months after she had initiated proceedings in the AAT.

The Commissioner was successful before the Tribunal (*TVKS and Commissioner of Taxation* [2016] AATA 1010 (Forgie DP)). The taxpayer appealed to the Federal Court. The appeal was heard by the Full Court.

Issues decided by the court

The issues before the Court included:

a) whether amounts payable under certain contracts were incurred on 30 June 1999 by the trustee of the ACE Trust (Incurred Issue), and

b) whether the trustee resolutions created in the taxpayer a present entitlement to income of the trusts as at 30 June (Trust Resolution Issue).

Depending on the view taken in respect of the previous issues and whether leave was granted to the taxpayer to raise new grounds, the following issues also arose:

c) whether the taxpayer had effectively disclaimed her entitlements under the trusts by executing the deeds of disclaimer (Disclaimer Issue), and

d) whether a resolution made by the trustee of the ACE Trust with respect to the 2006 year to distribute 'income' rather than the 'net income' (defined in the deed to mean the tax net income) was authorised by the trust deed or was made *ultra vires* (*Ultra Vires* Issue).

The Tribunal had refused the taxpayer leave under section 14ZZK of the *Taxation Administration Act 1953* (TAA) to argue the disclaimer and ultra vires issues.

Incurred Issue
The Court found that the relevant amounts were incurred for the purposes of subsection 8-1(1) of the *Income Tax Assessment Act 1997* (ITAA 1997) upon the execution of the contracts on 30 June 1999 rather than on 31 October 1999 (the 'Settlement Date' / 'Completion Date'). Accordingly, those amounts properly contributed to tax losses that were carried forward from the 1999 year and were available to reduce the net income of the ACE Trust in 2006.

Trust Resolution Issue
The Court first considered whether the 'variation of income' resolutions were authorised by the trust deeds. The Court 'incline[d] to the view' that it was open to the trustees of each trust to distribute all or part of the net income of the trusts on alternative bases.

The Court rejected the Commissioner's position that the distribution and variation of income resolutions should be read as separate and sequential as a matter of construction such that the variation of income resolution had no work to do because all of the income had been dealt with by the distribution resolution.

In the Court's view the resolutions were interdependent with the result that the taxpayer's trust law entitlement to income under the distribution resolution was contingent, since it depended on the occurrence of an event that may or may not take place (namely the disallowance of a deduction or the inclusion of additional assessable income). If the Commissioner included an additional amount in the trust's assessable income, that amount (as trust income) went to another entity, not the taxpayer. Consequently, although the resolutions created an income entitlement in the taxpayer for trust purposes, the taxpayer did not have a vested and indefeasible interest in any income of the trusts as at 30 June and therefore was not presently entitled to any trust income for the purposes of subsection 97(1) of the ITAA 1936.

If the 'variation of income' resolution was not validly made, the Court considered that the result for the taxpayer would be unchanged because the variation of income resolution could not be severed from the distribution resolution. That is, the interdependence of the two resolutions would cause both to fail, with the consequence that the taxpayer had no vested and indefeasible interest in any income of the trusts as at 30 June.

Leave to raise new grounds Issue
Ultimately it was unnecessary for the Court to determine whether the Tribunal was wrong to decline to permit the taxpayer to rely on grounds other than those raised in the objection. The Court expressed doubt that the Commissioner's inability to raise an assessment against, or recover from, another taxpayer should weigh heavily in the decision not to grant leave. The Court observed that this would seem ordinarily to be outside the range of considerations for the grant of leave. The Court also observed that it was difficult to see how the Commissioner was prejudiced by the introduction of the new contention in relation to the *Ultra Vires* issue, as the taxpayer raised it several months prior to the Tribunal hearing.

Disclaimer Issue
Although it was not necessary to decide the matter, the Court observed that the taxpayer had not validly disclaimed her trust entitlements due to the passage of time that had elapsed between her becoming aware of them and the date of the purported disclaimer.

In that regard, the taxpayer was taken to have gained knowledge of her entitlements when her 'agent' did. The Court noted that it was open for the Tribunal to find that the taxpayer had given 'unfettered' authority to her husband to handle all of her financial affairs and act as her agent in relation to them. As her husband participated in the making of the resolutions that created the taxpayer's entitlements, the taxpayer had knowledge of them from the 2006 and 2007 years.

Ultra Vires Issue
When read in context with the trust deed and the previous resolutions, the correct construction of the 'distribution of income' resolution was that the trustee's intention in dealing with 'income' under the resolutions was to distribute the 'net income' of the trust. Where there is the possibility of two constructions, one of which results in validity and the other invalidity, the Court considered it in accordance with established principle that the construction which preserves validity is to be preferred.

ATO view of decision

In relation to the 'variation of income' resolution issue, it was open to the Court to find that the taxpayer was not presently entitled at 30 June 2006 and 30 June 2007 to any trust income as a matter of construction of the relevant resolutions and deeds. The decision highlights that trustee resolutions may not produce the results that were anticipated at the time they were made. We anticipate that in contested cases involving ‘variation of income’ resolutions we will have to raise a number of alternative assessments to deal with the range of possible interpretations of the relevant deed and resolutions.

The ATO considers that the inability to issue an assessment against another taxpayer may be a relevant consideration for the grant of leave to raise new grounds of objection under sections 14ZZK and 14ZZO of the TAA. In appropriate cases we will continue to argue against the grant of leave where it is considered that there is a relevant prejudice to the Commissioner.

The ATO will seek to test the position about the consequence of a valid disclaimer in other cases.

Implications for impacted advice or guidance

We are considering the changes that may need to be made to Taxation Determination TD 2012/22 (in particular Examples 6 and 7) in light of the decision regarding the ‘variation of income’ resolution. Outcomes may vary depending on whether income entitlements are expressed as a percentage share or a specific amount and also whether a variation resolution seeks to deal with both decreases and increases by the Commissioner.

Having determined the proper construction of the resolutions before it, the Court did not go on to identify how it considered the net income fell to be assessed. We think that where a resolution is a valid exercise of a trustee’s power to deal with income under the deed but operates to create an entitlement for trust purposes that is not vested and indefeasible as at year end, there will be no scope for a default beneficiary clause to operate. The result would seem to be an assessment of the trustee under section 99A of the ITAA 1936.

We will consult with practitioners on any changes to the Determination.

Comments

We invite you to advise us if you feel this decision has consequences we have not identified or if a precedential decision such as a Public Ruling or an ATO ID requires reconsideration or amendment. Please forward your comments to the contact officer.

Date issued:	14 December 2017
Due date:	2 February 2018
Contact officer:	Contact officer details have been removed as the comments period has expired.

Legislative references

Income Tax Assessment Act 1997
8-1(1)

Income Tax Assessment Act 1936
95
97(1)
99A

Taxation Administration Act 1953
14ZZK
14ZZO

Case references

Aon Risk Services Australia Pty Ltd v Australian National University
[2009] HCA 27
(2009) 239 CLR 253

BRK (Bris) Pty Ltd v Federal Commissioner of Taxation
(2001) 46 ATR 347

Commissioner of Taxation (Cth) v CityLink Melbourne Ltd
[2006] HCA 35
(2006) 228 CLR 1

Commissioner of Taxation v Raymor (NSW) Pty Ltd
(1990) 24 FCR 90

Commissioner of Taxation v Woolcombers (WA) Pty Ltd
(1993) 47 FCR 561

Federal Commissioner of Taxation v Malouf
[2009] FCAFC 44
(2009) 174 FCR 581

Federal Commissioner of Taxation v Ramsden
[2005] FCAFC 39
(2005) 58 ATR 485

JW Broomhead (Vic) Pty Ltd (in liq) v JW Broomhead Pty Ltd
[1985] VR 891

Lighthouse Philatelics Pty Ltd v Commissioner of Taxation
(1991) 32 FCR 148

Nemesis Australia Pty Ltd v Commissioner of Taxation
[2005] FCA 1273
(2005) 150 FCR 152

Ramsden v Federal Commissioner of Taxation
[2004] FCA 632
(2004) 56 ATR 42

TVKS and Commissioner of Taxation
[2016] AATA 1010

Walsh Bay Developments Pty Ltd v Federal Commissioner of Taxation
(1995) 130 ALR 415

Whitlock v Brew
[1968] HCA 71
(1968) 118 CLR 445