COMMENT

SECTIONS 99 AND 99A OF THE INCOME TAX ASSESSMENT ACT 1936: THEIR PAST AND PRESENT ROLES, AND A SUGGESTED FUTURE ROLE

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Section 99A of the Income Tax Assessment Act 1936 (Cth), as amended, has been the subject of recent legislative reform.[1] The section was originally enacted in 1964, following the recommendations made by the Ligertwood Committee in 1961. The Committee noted:

> 710. We are informed that increasingly in recent years, there has been a loss of revenue arising from the deliberate use of trusts as a tax-avoiding device. The amount settled under a trust may be a purely nominal amount, but this is of little consequence as it does not stop the settlements from acquiring substantial assets. The assets may be bought on a small deposit with the balance to be paid out of future income. The vendor is generally the parent of the children in whose favour the settlements were created, and he is appointed trustee. Thus, a father could sell his business to a partnership consisting of the several trusts created. The income of the business, formerly assessed to the parent, would thereupon become split several ways and assessed to the trustee at much lower rates of tax. As trustee, the parent would retain control of the business . . .
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> 711. [I]n the interests of the Revenue and of taxpayers generally, remedial action should be taken. The objective should be to assess family trusts of the type now under discussion at a rate designed to result in payment of a tax equal to that which would have been payable if the person originally in receipt of the trust income, had continued to receive it.[2]

The solution to the problem, as the Committee saw it, was to tighten up section 102. With this end in view the Committee recommended that section 102 be amended so as

(a) to apply to minor unmarried relatives instead of to minor unmarried children only;

(b) to include contingent trusts where the income is capable of accumulation for the benefit of the minor unmarried relatives; and

(c) to aggregate, for certain purposes, multiple trusts for minor unmarried relatives.

The Committee also recommended the insertion of a new section 99A which was to impose a tax rate of 50 per cent on trust deeds whereunder the settlor retained the right to vary the terms in favour of unmarried relatives under the age of 21 years. These details were not followed.

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1 Income Tax Assessment Amendment Act (No. 2) 1977 (Cth).

2 (1961) Parl. Pap. No. 100, paras 710, 711.

Instead, the existing section 99 was amended and a new section 99A was enacted. Section 99 applies only if the Commissioner considers it unreasonable for section 99A to apply.[3] Where section 99A is applied, the trustee is to be assessed on the net trust income or part thereof at the current special rate.[4] If, instead, section 99 is applied, the trustee is to be assessed on the net trust income or part thereof, as if it were the income of an individual and not subject to any deductions.

The enactment of these sections (section 99A in particular) caused considerable concern and was the subject of a constitutional challenge in *Giris Pty Ltd* v. *Federal Commissioner of Taxation*.[5] The challenge was based on two grounds. (1) That the sections did not amount to a law with respect to taxation within the meaning of section 51(ii) of the Constitution, because they prescribed no rule at all and that the sections created what was virtually an authority in the Commissioner to create a rule; that by the use of the sections more favourably towards the citizens of one State rather than those of another, the Commissioner could discriminate between the States. (2) That the sections imposed an "incontestable tax" the imposition of which the taxpayer could not challenge and the validity of which the court could not examine.

Despite some disquietude,[6] the High Court held that, nonetheless, the subject matter of the law was taxation and that the provisions made a rule with respect to that matter; that section 99A did not make the application of sections 99 and 99A depend on the will of the Commissioner instead of the will of Parliament, and that so long as there existed a right of appeal it could not be said that the provisions imposed an "incontestable tax".

The two sections apply only where there is no beneficiary presently entitled. It is important, therefore, to know when a beneficiary is presently entitled. The cases of *Federal Commissioner of Taxation* v. *Whiting*[7] and *Taylor and another* v. *Federal Commissioner of Taxation*[8] provide a useful starting point. In *Whiting's* case, the deceased estate was during the relevant year still in the course of being administered by executors. Some debts and liabilities of the estate together with certain legacies and an annuity were yet to be paid. The residuary estate, therefore, had not yet been ascertained. But the executors, regarding it as certain that there would be a residue, credited by book entries certain amounts of income to the residuary beneficiaries in the proportions in which the will entitled them to the

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[3] The question has arisen whether s. 99 could apply by default or whether the Commissioner is under a positive obligation to form an opinion whether it would be unreasonable for s. 99A to apply and therefore, that s. 99 should apply. Barwick C.J. in *Giris'* case (1969) 119 C.L.R. 365 was of the opinion that the Commissioner must form the opinion and that s. 99 could not apply by default. Contra Kitto J. in *Perron's* case (1973) 128 C.L.R. 595. Stephen J. in *Perron's* case held that s. 99 could apply by default, but in the later case of *Duggan* v. *Federal Commissioner of Taxation* (1973) 129 C.L.R. 365 he followed the views of Barwick C.J. as expressed in *Giris'* case. The better view, it is submitted, is that taking into account the factor of judicial review by the courts, the Commissioner is bound to form the opinion as required under the section for either s. 99A or s. 99 to apply.

[4] Which is 60 per cent.

[5] (1969) 119 C.L.R. 365.

[6] *Id., per* Barwick C. J. at 372, *per* Menzies J. at 381, *per* Owen J. at 387.

[7] (1943) 68 C.L.R. 199.

[8] (1969) 119 C.L.R. 444.

residuary estate. It was an amount so credited to a beneficiary that arose for decision in that case. Rich J. in the first instance thought that since, on the true construction of the will, the beneficiary had a vested interest in possession in the income of the estate generally and not an interest in expectancy, the beneficiary was presently entitled to the income that had been appropriated to him. The members of the Full Court, on appeal, unanimously set aside that part of the judgment of Rich J.: Latham C.J. and Williams J., reasoning by analogy with sections 97 and 98, reached the following conclusion:

> A beneficiary who has a vested right to income (as in this case) but who may never receive any payment by reason of such right, is entitled to income, but cannot be said to be 'presently entitled' as distinct from merely 'entitled'. Indeed, it is difficult to see how he can be entitled at all to income which must be applied in satisfaction of some prior claim.[9]

According to their Honours then, "present entitlement" meant, in addition to a vested interest, the right to obtain immediate payment. Starke J. in a separate judgment said that a beneficiary was not presently entitled to income unless it could be established that there was income, and that the beneficiary was entitled to obtain payment thereof from the trustee.

In *Taylor's* case, there were three infant children each of whom was indefeasibly entitled to the income and capital of the trust. Under each settlement the income arising from the trust fund was to be employed (from the date of settlement until the attainment by the son of the age of 21 years or his prior death) for the benefit of the son's maintenance, education and advancement with a gift over to the son's estate in the event of death. Upon an appeal against an assessment under section 99A, Kitto J. held the beneficiaries to be presently entitled to the whole of the income of the trust estates but as the beneficiaries were under a legal disability due to their minority, the trustees were to be assessed under section 98.[10]

His Honour went on to conclude that "present entitlement" referred to an interest in possession in an amount legally available for distribution, which the beneficiary could demand to be paid if not for his legal disability. The Commissioner for his part relied on the joint judgment of Latham C. J. and Williams J. in *Whiting's* case that "present entitlement" meant the right to obtain immediate payment. It was therefore necessary for Kitto J., sitting as a single judge, to explain away the above statement in the joint judgment:

> The point of difference between Rich J. and the Full Court was, therefore, the former thought that a beneficiary is "presently entitled" to the income produced by the trust estate if under the trust instrument he is "presently entitled to income of the estate" whatever be the stage that administration has reached, while the Full Court considered that a beneficiary is not "presently entitled" to any income of the trust estate unless the administration has reached such a point that an amount of income has become identifiable as being the subject of a present interest in possession vested in him by the trust instrument.

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[9] (1943) 68 C.L.R. 199, 216.
[10] (1969) 119 C.L.R. 444, 448-449. Note 6 *supra*.

> When their Honours spoke of the beneficiary having a right to obtain immediate payment, they could not have been referring to his legal capacity to give a discharge for the payment. Having regard to the point of difference from Rich J. to which they were addressing themselves, I think it is clear that they were holding only that an admittedly vested interest in possession in the income of an estate does not make the beneficiary "presently entitled" to any income which is not yet distributable, and so is not yet specifically caught by the beneficiary's interest.[11]

In both *Whiting's* case and *Taylor's* case the beneficiaries had a vested interest, the difference being that in *Taylor* the beneficiary was also held to be presently entitled to his interest. A beneficiary however could be presently entitled to an interest in a trust even though his interest in the trust itself is contingent. This is provided for in section 101 which states that where a trustee pursuant to a discretion vested in him to pay or apply the income of a trust estate to or for the benefit of specified beneficiaries exercises that discretion, the beneficiary in whose favour the discretion is exercised is deemed to be presently entitled to such amount.[12] There is a payment or application within the meaning of section 101 where an amount is paid into a beneficiary's savings bank account even though the funds are immediately lent back to the trusts. An actual payment or application, however, is not necessary for a beneficiary to be presently entitled. In certain circumstances the mere crediting of an amount would be sufficient. Thus, where an amount, pursuant to a resolution, is credited in the books of the trust estate for the benefit of a beneficiary, such amount would be treated as having been applied to the benefit of the beneficiaries.[13] Furthermore, a definite monetary amount need not be credited in the books of account. A reference to a percentage share would be sufficient if a distinct amount could be later ascertained from the accounts of the trust.[14]

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[11] *Id.*, 451.

[12] Section 101 is only a deeming section. The beneficiary's liability will have to be determined elsewhere under the Code; ss 26(b), 97 and 98. Barwick C.J. in *The Union Fidelity Trustee Co.* v. *Federal Commissioner of Taxation* (1969) 119 C.L.R. 177 held that Division 6 only anticipates income; where income has been actually received (that is paid, applied or credited), the section applicable is 26(b).

[13] *73 A.T.C. Case E47; Commissioner of Inland Revenue (New Zealand)* v. *Ward* 69 A.T.C. 6050. *Contra* the New Zealand Supreme Court decision of *Montgomerie* v. *Commissioner of Inland Revenue (N.Z.)* XIV A.T.D. 102 *per* Barraclough C. J.

[14] In *73 A.T.C. Case E47* the Board, relying on *Ward's* case, laid down the following propositions: (1) A declaration, resolution or whatever of the trustee will amount to an application if it is immediately and irrevocably effective to vest a specific portion of the income of the year in the beneficiary so that his contingent interest in the trust income becomes an absolute interest in the income allotted to him. (2) It is immaterial whether the income is immediately used for the benefit of the beneficiary and it is sufficient if it is allocated to him in terms which make the part of the income so allocated the separate property of the beneficiary. (3) The fact that a specific sum is not named (as in *Ward's* case, the Savings Bank interest was not) is immaterial provided that the distinct sum in question is or becomes ascertainable from the trust accounts. (4) It is not correct to say that a resolution should not be regarded as applying income unless it acted as a declaration of trust imposing a new trust on the trustee in favour of the beneficiaries or created a debtor-creditor relationship between them. The rights of the beneficiaries do not arise out of debt or contract but of the trusts created by the deed of trust.

Section 99A is not a dispensing power and its operation does not depend on an application by the taxpayer. These two propositions follow from the decision in *Perron* v. *Federal Commissioner of Taxation*.[15] The facts there were that of a total sum in excess of $326,000 the trustee distributed $4,000 to beneficiaries and accumulated the rest. The Commissioner formed the opinion that it would be unreasonable for section 99A to apply and assessed $322,000 at the personal rates applicable under section 99. The taxpayer argued that the Commissioner should have applied section 99A instead of section 99 since section 99A(2) was a dispensing power which the Commissioner could not properly employ against the interest of the taxpayer so as to increase rather than reduce the rate of tax payable on the income of the trust estate. To do so, argued the taxpayer, was inconsistent with the notion of a dispensing power. Stephen J., holding against the taxpayer, said:

> [T]he instrument for prevention of tax avoidance which section 99A represents becomes, on one view, ineffective and, on another, unnecessary once the income of a trust estate is so large as to attract under section 99 a rate of tax greater than 50 per cent.
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> In such a case there is no work to be performed by section 99A. . . . To do otherwise would be to confer upon trust estates with large incomes a concessional rate of tax not available to equally large incomes when derived by individuals or by those types of trust which are altogether excluded from the application of section 99A, being trusts resulting from a will or codicil, or from an intestacy or from orders under testator's family maintenance legislation. . . .[16]

The second argument of the taxpayer that the power conferred upon the Commissioner by section 99A(2) was one which should be exercised upon an application in that behalf by the taxpayer was also rejected by his Honour for the same reasons as the first.

In exercising his discretion whether to apply section 99A instead of section 99, the Commissioner is required by section 99A(3) to take into consideration (1) the circumstances and conditions in which the property was acquired or transferred to the trust estate, (2) any special rights or privileges attached to such property, and (3) the income derived by the trust estate from such property. According to the Taxation Department's practice, stated in Public Information Bulletin No. 4 (April 1965), the discretion will be exercised in favour of the taxpayer if property, or cash to acquire property, is given to the trustee by the settlors. The discretion will not generally be exercised in favour of the taxpayer where the property which is the subject matter of the trust is sold to the trustee by the settlor and the purchase price is to be paid for in instalments from the income of the trust estate. The Information Bulletin goes on to say that in the case of a loan, repayable on demand, the Taxation Department will need to be satisfied that income will not be used at any time to repay the loan for the discretion to be exercised in favour of the taxpayer. Where the trustee is a member of a business partnership and the beneficiary is under 16 years of age, the discretion will not be exercised generally. Nor will it

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15 (1973) 128 C.L.R. 595. As the rate applicable under s. 99A is the same as the maximum rate applicable under s. 99, this case is of historical significance only.

16 *Id.*, 599.

be exercised where shares in a private company held by a trustee are of a special class having special rights or privileges attaching to them. The discretion will generally be exercised in favour of the taxpayer where—(a) the trust estate consists of a savings bank account held in trust by a person for his children or grandchildren; (b) the trust estate is created under a court order, for example, on the award of compensation for injuries; and (c) in the case of bankrupt estates.

The courts will not interfere with the exercise of the discretion by the Commissioner unless the circumstances indicate such discretion to have been improperly exercised.[17] The courts have consistently held that they will not substitute their decision for that of the Commissioner; the Board of Review, however, is empowered to do so under section 193 of the Income Tax Assessment Act.[18] The Board of Review, as its decisions indicate, has pursued an independent line on this question. Thus, in *15 C.T.B.R. (N.S.) Case 28, 69 A.T.C. Case A50,* Mr Thompson set out a number of propositions at paragraph 24 which he considered to be proper and convenient in determining how the discretion should be exercised:

(1) The Revenue should be protected against tax avoidance devices.

(2) The interests of taxpayers generally should be protected.

(3) The right of the subject to make legitimate and reasonable arrangements relating to family and business matters should be protected.

(4) Arrangements which are for the good of the public generally should not be discouraged.

(5) Trusts which arise out of the exercise of a public duty should not be penalized.[19]

In the same case,[20] Mr Davies, having examined the judgment of the High Court in *Giris'* case, went on to say:

> Trusts . . . are also a means of achieving fiscal objectives, a means of avoiding or lessening the burden of tax. The 50% rate of tax falling on section 99A trusts should not be imposed where it would unreasonably restrict the achievement of legitimate non-fiscal, social, family or business ends. On the other hand, it is the rate of tax applicable to those trusts which seek to lessen the burden of taxation. In cases where trusts are used as instruments to achieve both fiscal and non-fiscal ends—and competent draftsmen properly keep taxation laws in mind when preparing documents which affect a client's property and income—a decision must be reached, on the facts of each particular case as to which should prevail on the balance, the interests

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[17] See generally, Sappideen "The Control of the Commissioner's Discretionary Power under the Income Tax Assessment Act 1936-1974" (1977) 13 *U. W. Austl. L. Rev.* 135. For an instance where the Commissioner was found to have exercised his discretion under s. 99A improperly, see *Duggan* v. *Federal Commissioner of Taxation* (1973) 129 C.L.R. 365.

[18] Sappideen "The Control of the Commissioner's Discretionary Power", note 17 *supra.*

[19] See also *15 C.T.B.R. (N.S.) case 114,* where at para. 11 of his decision Mr Thompson says that s. 99A is not an emasculated version of s. 260.

[20] (1965) 119 C.L.R. 365.

> of the Revenue or the legitimate interests of the beneficiaries under the trust.[21]

Because of this power of review in the hands of the Board of Review, and because the Board could substitute its decision for that of the Commissioner, the Commissioner's power under sections 99 and 99A could by no means be said to be an arbitrary power. The fact is that it is a closely regulated power.

Prior to the amendments proposed under the Income Tax Assessment Amendment Act (No. 2) 1977, section 99A had no application to accumulation trusts created by will or codicil and had no work to perform where the applicable tax rate exceeded 50 per cent. The amendments remove both anomalies. The exclusion of trusts created by will or codicil from the application of section 99A has been taken away because of its widespread abuse by the creation of multiple "shell" trusts. To quote from the Treasurer's speech on the Second Reading of the Amendment Bill:

> Some family groups, few in number I am pleased to say, have arranged for unrelated aged people who are expected not to live for any length of time, and who have little in the assets of their own, to set up multiple "shell" trusts under a will for the benefit of members of the sponsor family.
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> On the death of the aged person, the family channels income into these trusts which, because they qualify as deceased estates, are outside the scope of the special rate of tax under section 99A. Effective for the 1977-78 and subsequent years such trusts will be dealt with by bringing deceased estates within the scope of section 99A.[22]

The increasing of the applicable rate under section 99A to 60 per cent (which is the maximum personal rate applicable under the Act) provides it with a function to perform where the applicable personal rate is below this amount. Where the applicable personal rate is 60 per cent it has no deterrent effect.

Section 99A, of course, has no application where the beneficiary is presently entitled. Where the beneficiary is presently entitled but under a legal disability the trustee is assessed on behalf of the beneficiary at the personal rate applicable on that amount. The assessment under section 98 is often the result of amounts received under a discretionary trust under section 101. Some inequity would seem to arise in assessing amounts paid, applied or credited for the maintenance, benefit or advancement of minor beneficiaries at the personal rates applicable to such amounts. Where these amounts have been directly expended by the parent no deduction will be allowed as they will be treated as expenditures of a private or domestic nature. The fact that the tax consequences could be altered by the interposition of a trust instrument seems to highlight a deficiency in this area of the law. Similar inequity, in the area of partnership income taxation is avoided by section 94 which deems partners under 16 years of age as having no real and effective control over their share of partnership income. Section 102 was originally intended to be a parallel provision applicable

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21 See also *73 A.T.C. Case E 21,* Mr Donovan at paragraph (a) of his decision.
22 H. R. Deb., 20 October 1977, 2272.

to trust estates. The section, as intended, applies to trusts where the creator retains the right to confer a beneficial interest on himself or where the beneficiaries are his minor, unmarried children. But this has proved to be a trap only for the unwary. It has been held not to apply to trusts created by a person other than the parent even though it is the parent who actually funds the trust with income-earning assets.[23] If the progressive tax base is to have any significance, and if tax equity is to have any meaning, reform in this area would seem to be long-overdue. Division 6 as existing tends to favour the affluent and the initiated. Successful tax planning is dependent on income-producing assets that can be alienated away from the donor without the donor being taxed. As income from personal exertion cannot be alienated without it having been first derived by the person whose efforts resulted in that income being earned, it rules out salary and wages income and leaves in only income derived from property.[24]

This abuse has to some extent been recognised under the proposed amendments. Thus, where the beneficiary is presently entitled but under 16 years of age, the amount exempted from tax is limited to $1,040 instead of the $3,750 otherwise made available to individual taxpayers. This falls short of being an effective anti-avoidance measure. It affects only the middle income earner and leaves untouched the wealthy. Recognising the problem much more fully, the Ligertwood Committee had as far back as 1961, recommended that the province of section 102 be extended to apply to all trusts created for the benefit of unmarried minor relatives. This recommendation does of course fail to bring within section 102 trusts created by persons other than a relative of the beneficiary, as, for example, trusts created by an employee for the benefit of the employer's minor, unmarried children. Therefore, little would have been achieved by such an amendment. Considering the difficulty of definition, and drawing inspiration from parallel sections such as section 99A and section 94, it is suggested that sections 99 and 99A be suitably amended to extend also to trust estates where the beneficiaries are unmarried minors.[25] Any

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[23] *Truesdale* v. *Federal Commissioner of Taxation* (1969) 120 C.L.R. 353. Knowledge of this loophole existed before 1969 (see Ligertwood Committee Report, 1961, para. 709). In 1965, however, Woodhouse J. had held in the New Zealand Supreme Court case of *Tucker* v. *Commissioner of Inland Revenue* [1965] N.Z.L.R. 1027, that where a trust created by one person was funded by another person, a further trust resulted. This decision spurred the Commissioner to litigate the matter in *Truesdale's* case. S. 102(1)(b) has also been held inapplicable to trusts created by parents where the interest of the beneficiary is contingent: *Hobbs* v. *Federal Commissioner of Taxation* (1957) 98 C.L.R. 151.

[24] *8 C.T.B.R. (N.S.) Case 1; Kelly* v. *Inland Revenue Commissioner (New Zealand)* 1 A.T.R. 380; *Bolton* v. *Federal Commissioner of Taxation* (1964) 9 A.I.T.R. 385. But see the decision of Rath J. in *Everett* v. *Federal Commissioner of Taxation*, New South Wales Supreme Court 77 A.T.C. 4478; 8 A.T.R. 1, where his Honour upheld as valid an assignment of a solicitor's partnership interest to his wife who held a practising certificate but was not a partner in the firm.

[25] Under the amendments, beneficiaries to whom s. 98 are applicable and who are under 16 years of age are exempted from tax only on the first $1,040 instead of the first $3,750 generally available to taxpayers.

resulting hardship should be alleviated by the proper use of the discretion vested in these two sections.[26] This proposal would require the repeal of section 26(b). It would also require the repeal of section 98 or a limiting of its application to instances where the beneficiary is over 16 but under under 18 years of age—18 years being the age of majority.

[26] Ss 99 and 99A, as pointed out in this paper, have not turned out to be the sledge hammer it was feared they would be. Judicial review by the courts and the existence of the power of review by the Board of Review together with the Board's power to substitute its own decisions for those of the Commissioner have proved to be adequate and effective checks against the power of the Commissioner. See Sappideen, "The Control of the Commissioner's Discretionary Power", note 17 *supra*.