IN THE HIGH COURT OF AUSTRALIA
SYDNEY REGISTRY

No S284 of 2011

BETWEEN

THE COMMISSIONER OF TAXATION OF THE COMMONWEALTH OF AUSTRALIA

Appellant

and

GRAHAM BARGWANNA & MELINDA BARGWANNA AS TRUSTEES OF THE KALOS METRON CHARITABLE TRUST

Respondents

APPELLANT'S SUBMISSIONS IN REPLY

1 This reply is in a form suitable for publication on the Internet.

Issues identified by the respondents

2 The appellant does not accept that the third issue identified by the respondents can arise for consideration in this appeal. It is not a matter raised by any of the grounds in the appellant's Notice of Appeal, and nor is it raised by the respondents' Notice of Cross-Appeal. Consequently, paragraphs 52 to 65 of the Respondents' Submissions ("RS") are irrelevant to this appeal and to the respondent's cross-appeal.

Facts

3 Contrary to RS[8], the Tribunal did not make a finding of fact that there was no application of the income or capital of the Fund to private purposes. The findings relied on by the respondent are either legal conclusions or are findings of fact that are consistent with the appellant's submission.

4 With respect to the payment of interest on the trust account monies to the accountant:

(a) the first sentence of the extract at RS[19] is a legal conclusion as to which facts are relevant to assessing the purpose for which funds were applied. The fact that "the purpose of the Trustees in allowing the accountant to be responsible

Filed on behalf of the appellant
Address for service:
Maddocks
Level 21, Angel Place
123 Pitt Street
[5748150: 8666383_1]Sydney NSW 2000

Tel: (02) 8223 4100
Fax: (02) 8223 4161
DX 1353 Sydney
Ref: Mr Peter Poulos
Email: peter.poulos@maddocks.com.au

for maintaining [the Fund's] accounting records was to facilitate the growth of the Trust fund"[1] is not inconsistent at all with the proposition that the payment of the trust account interest to the accountant was an application of the income of the fund to a private purpose;

(b) the Respondents do not, and cannot, take issue with the underlying fact that the interest on the trust account was diverted to the accountant. Nor is any issue taken with the fact that the diversion was deliberate in the sense that it was not accidental or inadvertent;

(c) there is no evidence, and nor is there any finding of fact below, to support the proposition put by the Respondents (at RS[21]) that the interest was made in payment of an "expense" incurred by the Trustees in connection with the administration of the Fund. No such expense can be identified, much less its quantum or when it was incurred.

With respect to the accounting irregularities in the accountant's trust account:

(a) there is no issue as to the "accountant's apparent failure to apply the funds in his trust bank account exclusively for the benefit of the persons entitled to them"[2], giving rise to "the accountant's acknowledgement of his obligation to compensate to compensate [the Fund] for his irregular administration"[3]. The respondents acknowledge that there were irregularities (RS[26]);

(b) it does not matter that the Funds monies were never "deliberately utilised" for loans to other persons, or that the trustees did not condone the irregularities[4]. The appellant's case is predicated on the proposition that the misapplication of the Fund was not deliberate in the sense that the trustees or the accountant were conscious that the (admitted) application was in breach of trust;

---

[1] [2008] AATA 275 at [64]
[2] [2008] AATA 275 at [96]
[3] [2008] AATA 275 at [96]
[4] RS[26]

(c) the reference to the compensatory interest arising from the debit balances being less than $1,000[5] is misleading. The interest calculation undertaken by the accountant was calculated on a flawed assumption, and the accountant conceded it would have been more if that assumption were corrected.[7]

6 With respect to the interest offset account:

(a) the appellant does not allege that the interest offset transaction was an "egregious self-dealing" by the trustees (RS[27]). He accepts that while the trustees deliberately withdrew monies from the interest offset account they did not intend the shortfall that arose in that account[8], and nor did they appreciate that they were conferring a benefit upon themselves in breach of trust;

(b) The respondents do not, and cannot, take issue with the fact that the trustees withdrew amounts from the interest offset account to which the Fund was entitled and used those amounts for their own private purposes[9]. In relying on those facts, the appellant does not in any way contradict the finding by the Tribunal that the transfer to the interest offset account "was clearly *conceived* as a benefit to [the Fund]"[10] or that "the transaction *as proposed* was an ordinary investment"[11] (emphasis added).

(c) The reference in RS[32] to an inadvertent withdrawal of $4,849 gives a misleading impression of the extent of the shortfall, which in fact totalled $40,954 (see AS[15]). Furthermore, the trustees decided to keep the arrangement in place, with the interest posted monthly to the trust ledger[12].

Argument

7 It is not clear why the respondents describe the construction preferred by the Full Court as "qualitative" while the construction contended for by the appellant is "quantitative":

---

[5] RS[26], second dot point
[7] [2008] AATA 275 at [83]; (2009) 72 ATR 963 at [20]
[8] see Appellant's Submissions at [16] ("AS[16]")
[9] [2008] AATA 275 at [103] and [105]
[10] [2008] AATA 275 at [104]
[11] Ibid
[12] [2008] AATA 275 at [100]

RS[40]-[47]. The basis for that distinction is not developed by the respondents. If the statutory question turned on the significance of the applications here in the context of the size of the Fund, then given the quantum of the misapplications,[13] the Fund would fail to satisfy section 50-60.

8 The distinction sought to be made by the respondents between "ends, means and consequences" (RS[43]) in reliance on what was said by Owen J in *Re Crown Forestry Rental Trust; Latimer v Commissioner of Inland Revenue*[14] is not a distinction that arises on the facts as found. None of the admitted misapplications relied on by the appellant can properly be characterised as "merely the means or the incidental consequences of carrying out the charitable purpose" [15] of the Fund. In particular, the interest on the trust account to which the Fund was entitled (incorrectly described by the respondents as "interest earned by the accountant's practice": RS[44]) was not merely an incidental consequence of the administration of the Fund. The interest was not diverted to the accountant in reimbursement of any particular fee or expense.

9 Furthermore, the shortfall in the interest offset account is still a misapplication of the monies of the Fund even though it arose in relation to a transaction that was intended to confer a benefit on the Fund (cf RS[45]).

10 The respondents' submissions in this respect fail to engage with the first issue identified by the appellant, namely that an application of trust funds may be intentional even if the relevant trustee or administrator lacks an appreciation that the application is in breach of trust, and in fact entered into the transaction in the hope that the Fund would obtain a benefit. So much is illustrated by the example given at RS[57]. In the present case the trustees not only conferred absolute authority on the accountant to deal with the Fund's assets, they had full knowledge of and participated in one of the misapplications (the interest offset transaction). A better analogy would be where the trustees give the stockbroker $1,000 in trust monies, in full knowledge that the stockbroker intends to gamble the funds, but without an appreciation that to do so constitutes a breach of trust. The failure to appreciate that an application of funds may be intentional even where

[13] See paragraphs 5(c) and 6(c) above. The quantum of the interest on the trust account monies paid to the accountant was never quantified (but see [2008] AATA 275 at [60]).
[14] [2004] 4 All ER 558
[15] Ibid

there is no appreciation that the application is in breach was, with respect, the reason why the Full Court fell into error (see AS[53]-[56]).

11 It is not clear what assistance the respondents gain from the Tribunal's finding that the interest offset account arrangement "*need not* have involved the trustees having direct personal access to the monies of the Fund"[16] (emphasis added). The fact is that in the event, the trustees did access those monies and did apply them to their own personal expenses[17]. With respect, the respondents' submission that there was no application of Fund monies for the personal benefit of the trustees (RS[51]) is wrong. Whether the trustees *were aware* that the withdrawals made from the interest offset account were in breach of trust is another matter.

12 The respondents' attempt to distinguish the monies belonging to the Fund from the Fund itself (RS[57]) is contradicted by the reasons of the Full Court (which the respondents otherwise seek to support): "it may be accepted that ... it is the application of Fund assets, both capital and income, which is to be considered"[18].

Cross-appeal

13 The appellant submits that special leave to cross-appeal should not be granted. The respondent has made no submission as to why special leave should be granted, and the appellant contends that no question of general importance arises from the cross-appeal.

14 In any event, the Full Court made no error in remitting the matter to the Tribunal. As the Full Court explained in its reasons of 17 February 2011, while the reasons of the Tribunal were extensive, the Tribunal approached the enquiry on a different construction of section 50-60[19].

Dated: 11 October 2011

David Bennett Elizabeth Collins Kristen Deards

[16] [2008] AATA 275 at [104]
[17] [2008] AATA 275 at [103] and [105]
[18] (2010) 191 FCR 184 at [70]
[19] par [7]