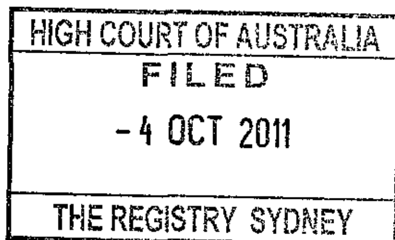
IN THE HIGH COURT OF AUSTRALIA
SYDNEY REGISTRY

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

RESPONDENTS' SUBMISSIONS

Part I: Internet publication

1. These submissions are in a form suitable for publication on the internet.

Part II: Issues

2. Whether the questions of statutory construction posed by the Commissioner arise at all on the facts as found by the Administrative Appeals Tribunal (the "AAT").

10 3. Whether the test to be applied pursuant to s50-60 of the *Income Tax Assessment Act* 1997 is quantitative or qualitative in nature.

4. Whether the intentions of the trustees of a fund are relevant in determining whether the fund has been "applied for the purposes for which it was established".

Part III: Section 78B of the *Judiciary Act* 1903 (Cth)

5. The respondents certify that they have considered whether any notice should be given to the Attorneys-General in compliance with s78B of the *Judiciary Act* 1903 (Cth) and have concluded that no such notice need be given.

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Part IV: Contested facts

A. Overview

6. There can be no contested facts in this appeal. By virtue of s44 of the *Administrative Appeals Tribunal Act* 1975, the Commissioner is bound to accept all of the findings of fact made by the AAT.

7. Yet, the Commissioner's appeal comprises two questions of statutory construction that are premised entirely upon facts that were expressly rejected by the AAT – namely, that certain monies belonging to the Fund were applied for non-charitable purposes.[1]

8. In his submissions, the Commissioner simply assumes that three particular transactions "were an application of the income or capital of the Fund to private purposes",[2] in spite of direct findings by the AAT to the contrary.

9. Thus, the Commissioner contended in the AAT (and assumes in this appeal) that the deposit of Fund monies into the accountant's trust account, pursuant to an arrangement whereby the accountant's practice retained all interest earned on those monies, was an application of part of the Fund for the purpose of the accountant and his practice, rather than for the purpose of the Fund.[3] The AAT rejected this contention and found that the deposit of Fund monies into the accountant's trust account was for the purpose of facilitating the investment and growth of the Fund.[4]

10. This was a finding of fact (or conclusion of fact) by the AAT, and cannot be disturbed on appeal.

11. Likewise, the Commissioner contended in the AAT (and assumes in this appeal) that the accountant's maladministration of his trust account was relevantly attributable to the trustees, with the result that part of the Fund had been applied for the benefit of other clients of the accountant.[5] The AAT rejected this contention and found that

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[1] Appellant's Submissions, para. 2 ("...where part of the fund is applied for another purpose and not for public charitable purposes") and para. 3 ("...where part of the fund is intentionally applied for other purposes that are not public charitable purposes...").
[2] Appellant's Submissions, para. 56.
[3] [2008] AATA 275 at [58].
[4] [2008] AATA 275 at [64].
[5] [2008] AATA 275 at [94].

there was simply no evidence that the trustees had authorised, condoned, suspected or even contemplated the irregularities in the accountant's trust account.[6]

12. This was also a finding of fact by the AAT, and cannot be disturbed on appeal.

13. Finally, the Commissioner contended in the AAT (and assumes in this appeal) that the interest offset transaction was an application of part of the Fund for the personal benefit of the trustees, rather than for the purpose of the Fund.[7] The AAT rejected this contention and found that the interest offset transaction was for the benefit of the Fund.[8]

14. Once again, this was a finding of fact (or conclusion of fact) by the AAT, and cannot
10 be disturbed on appeal.

B. <u>Background</u>

15. The Commissioner's statement of facts leaves out the following relevant facts:

- The trustees relied on the accountant's professional skills, paternal devotion and similar philanthropic motivations.[9]

- The growth of the Fund to date is almost exclusively attributable to the personal generosity of the accountant.[10]

- Between December 2003 and August 2007, the Fund distributed a total of $293,914.55 to numerous charitable causes,[11] including HELP International Inc., an organisation which conducts a program for orphaned and underprivileged
20 children in Bangladesh.[12]

- The Commissioner's submissions before the AAT explicitly disavowed any intention to suggest that either the trustees or the accountant knowingly set out to misapply the Fund's funds.[13]

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[6] [2008] AATA 275 at [95].
[7] [2008] AATA 275 at [101].
[8] [2008] AATA 275 at [105].
[9] [2008] AATA 275 at [95].
[10] [2008] AATA 275 at [6] & [53].
[11] [2008] AATA 275 at [54], [55] & Table attached to Decision.
[12] [2008] AATA 275 at [12].
[13] [2008] AATA 275 at [52].

C. Payment of trust account interest to the accountant's practice

16. In his submissions, the Commissioner assumes without explanation that the payment to the accountant's practice of interest earned on Fund monies held in the accountant's trust account was an application of the Fund for private purposes.[14]

17. The background to this transaction is as follows:

- The accountant has been responsible for the administration of the Fund's funds and maintaining its accounting records. Typically the funds have been paid into the accountant's practice trust account.[15]

- The accountant maintains ledger accounts for clients on whose behalf he holds funds, including the Fund. The ledger accounts record both balances held in the trust bank account and some other investments, such as term deposits, made on behalf of clients.[16]

- While the accountant's trust bank account is interest bearing, the accountant has a standard arrangement with all of his clients whereby they agree to forego interest on their funds. Interest earned by the trust account is then credited to the accountant's practice account as a means of defraying the costs of maintaining the trust bank account and its related accounting requirements.[17]

18. The Commissioner accepted below that the interest waiver arrangement was a standard feature of the accountant's dealings with his clients, and was conceived as a practical means of defraying the cost of administering the trust bank account and its related client ledger accounts.[18]

19. The AAT rejected the Commissioner's contention that this arrangement constituted an application of Fund monies for the benefit of the accountant, rather than for charitable purposes:

> "I do not accept the Commissioner's contention that the fact the trustees allowed the accountant to administer [the Trust's] accounting records through

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[14] Appellant's Submissions, para. 12.
[15] [2008] AATA 275 at [56].
[16] [2008] AATA 275 at [56].
[17] [2008] AATA 275 at [56].
[18] [2008] AATA 275 at [58].

> his practice trust bank account relevantly informs an assessment of the purpose for which [the Fund's] funds were applied. ... The characteristic practice of the trustees and the accountant, throughout the period after 1999 was to invest [the Funds's] funds in shares, term deposits and loans. The Trustees' purpose in allowing the accountant to be responsible for maintaining [the Fund's] accounting records was to facilitate the investment and growth of the Trust fund."[19]

20. The Commissioner does not dispute that facilitating the investment and growth of the Fund is a charitable purpose.

10 21. It should be noted that cl. 8 of the Trust Deed provides that:

> "The expenses in connection with the administration of this Trust including the remuneration and charges of the Trustees hereinafter provided for and of the investment and re-investment of any part of the Trust Fund and the collection of income and other sums derivable therefrom shall be charged against the income of the Trust Fund..."

Accordingly, the arrangement that the trustees had with the accountant – whereby he retained any interest earned on Fund monies held in his trust account in lieu of charging fees for administering the Fund's assets and maintaining its accounting records – was specifically authorised by the Trust Deed.

20 22. With respect to the figure of $108,825 in Fund monies held on deposit in the accountant's trust account as at 30 June 2006,[20] the following should be noted:

(a) this figure includes interest earned by the Fund from the interest offset account transaction in the sum of $25,744;[21]

(b) the accountant paid the Fund interest on that sum of $25,744 (being the interest income that the accountant caused the Fund to forego as a result of his mismanagement of the interest offset account);[22] and

(c) $16,395.25 in charitable distributions on behalf of the Fund were made from the accountant's trust account in the three months immediately following 30 June 2006.[23]

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[19] [2008] AATA 275 at [64].
[20] Appellant's Submissions, para. 13.
[21] [2008] AATA 275 at [99] (see Table).
[22] [2008] AATA 275 at [100].
[23] [2008] AATA 275 at [55] and Appeal Book [ ].

23. With respect to the figure of $135,818 in Fund monies held on deposit in the accountant's trust account as at 30 June 2007,[24] the following should be noted:

    (a) this figure includes interest earned by the Fund from the interest offset account transaction in the sum of $36,706;[25]

    (b) the accountant paid the Fund interest on that sum of $36,706 (being the interest income that the accountant caused the Fund to forego as a result of his mismanagement of the interest offset account);[26] and

    (c) $63,450 in charitable distributions on behalf of the Fund were made from the accountant's trust account in the two months immediately following 30 June 2007.[27]

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D. <u>Accounting irregularities in the accountant's trust account</u>

24. Throughout the period 1 July 2000 to 30 June 2007, some of the accountant's client trust account ledgers, which the accountant maintained in his MYOB accounting software application, periodically recorded debit balances.[28]

25. The Commissioner assumes, again without explanation, that because Fund monies were held in the accountant's trust account during this period, some of the Fund's monies were applied for the benefit of other clients.[29]

26. The AAT made the following findings of fact in respect of the debit balances in the accountant's trust account:

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- The debit balances that appeared during the period prior to May 2004 are of no real significance.[30]

- The net interest calculated to be due to the Fund over the period 1 July 2003 to 30 June 2007 as a result of the debit balances was less than $1,000. On 12 October 2007, the accountant compensated the Fund for that interest loss.[31]

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[24] Appellant's Submissions, para. 13.
[25] [2008] AATA 275 at [99] (see Table).
[26] [2008] AATA 275 at [100].
[27] [2008] AATA 275 at [55] Appeal Book [ ].
[28] [2008] AATA 275 at [65].
[29] Appellant's Submissions, para. 10.
[30] [2008] AATA 275 at [74].

- The trust account ledger maintained by the accountant demonstrated that the Fund's monies were never deliberately utilised for loans to either the accountant, the trustees or third parties, for the purpose of attempting to "regularise" any of the debit balance irregularities that occurred within the accountant's MYOB ledgers.[32]

- In reality, the accountant's trust ledger accounts showed that there was no occasion when Fund monies were advanced to other trust ledger accounts in connection with any of the evident accounting irregularities. There was no occasion when Fund monies were deposited into the trust bank account in
10 connection with any such irregularity.[33]

- There was simply no evidence that the trustees authorised, condoned, suspected or even contemplated, the kinds of accounting irregularities the evidence revealed. The accountant himself bore the entire personal culpability for them. His conduct in endeavouring to compensate the Fund acknowledged that culpability and his consequential liability to the trustees.[34]

- The question of the application of the Fund's monies should properly be determined by the conduct of the trustees themselves. They were not implicated in the accountant's apparent failure to apply the funds in his trust bank account exclusively for the benefit of each of the persons entitled to them.[35]

20 **E. <u>The interest offset account</u>**

27. In his submissions, the Commissioner attempts to portray the interest offset transaction as an egregious self-dealing by the trustees for their own benefit.[36]

28. This is wholly contrary to the findings of fact made by the AAT.

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[31] [2008] AATA 275 at [82].
[32] [2008] AATA 275 at [86].
[33] [2008] AATA 275 at [90].
[34] [2008] AATA 275 at [95].
[35] [2008] AATA 275 at [96].
[36] Appellant's Submissions, para. 14.

29. The background to the interest offset transaction was as follows:

- In March 2004, the trustees obtained a home loan from the National Australia Bank on standard commercial terms, including the provision of mortgage security.[37]

- There was an interest offset account ("IOA") associated with the trustees' loan account. Any monies held on deposit in the IOA earned interest from the bank at the same rate that interest accrued on the trustees' home loan.[38]

- The trustees arranged for $210,000 of Fund monies to be deposited into the IOA on the basis that the trustees would incur an interest obligation to the Fund in substitution for their mortgage interest obligation to the bank.[39]

- In this way, the Fund would earn interest at a greater rate than it would have received on an ordinary term deposit.[40]

30. The Commissioner accepted below that the underlying intention of the interest offset transaction was to benefit the Fund by generating an interest income for it.[41]

31. During its first 6 months of operation, the IOA held between $230,000 and $248,000 – i.e. between $20,000 and $38,000 more than the $210,000 deposited by the Fund.[42] The accountant treated these additional amounts as a prepayment of interest by the trustees.[43]

32. The accountant later told the trustees that they could withdraw funds from the IOA for their own use, and that he would arrange for the payment of interest.[44] The trustees subsequently withdrew all of the "prepaid interest" from the IOA. In doing so, however, the trustees also inadvertently withdrew $4,849 of the Fund's principal.[45]

[37] [2008] AATA 275 at [97].
[38] [2008] AATA 275 at [97].
[39] [2008] AATA 275 at [97].
[40] [2008] AATA 275 at [97].
[41] [2008] AATA 275 at [101].
[42] [2008] AATA 275 at [98].
[43] [2008] AATA 275 at [99].
[44] [2008] AATA 275 at [99].
[45] [2008] AATA 275 at [98], [99] (see Table) and [105].

33. At the end of each financial year, the accountant credited the Fund's subaccount ledger in his trust account with the interest earned by the Fund on the monies it had deposited in the IOA.[46] At the same time, in order to ensure that his trust account balanced, the accountant should have made a journal transfer of funds from his own subaccount within the trust account to the Fund's subaccount – as he ultimately did on 30 June 2007.[47] However, the accountant failed to make any such journal transfer until 30 June 2007.

34. The AAT found that the interest offset transaction, as proposed, was for the benefit of the Fund:

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> "The interest offset transaction was clearly conceived as a benefit to [the Fund] and provided it with the opportunity to achieve an increased rate of interest over that which it might otherwise obtain. The arrangement as proposed, which need not have involved the trustees having direct personal access to [the Fund's] deposit account, would have had substantially the same effect, save for the increased interest rate, as a term deposit with the bank. **In these circumstances the transaction as proposed was an ordinary investment transaction for the benefit of the trust and was a proper application of its funds consistent with the trust purposes.**"[48] (Emphasis added.)

35. The AAT further found that, in spite of the irregularities involved in the operation of the IOA, the interest offset transaction remained a transaction for the benefit of the Fund:

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> "The question whether the irregularities involved in the operation of the Interest offset account warrant the conclusion that the fund was applied for extraneous purposes has to be answered in the light of the whole of the circumstances. **Those circumstances include the fact that from the outset the trustees accepted an interest obligation in relation to the whole of [the Fund's] deposit amount, and that this was intended to advantage [the Fund] by earning interest at a higher rate. They also include both the subsequent accrual of interest, and its payment by the accountant.** In addition, the evidence establishes that although the male trustee's withdrawals from the interest offset account contributed to a temporary shortfall in the balance of [the Fund's] deposit, that shortfall was unintended and later remedied by the accountant. **These circumstances justify the conclusion that the interest offset transaction was in the nature of an ordinary commercial investment for the benefit of the trust fund itself.** It is, in my opinion, in a similar category to the loan transactions commented upon approvingly by Taylor J in

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[46] [2008] AATA 275 at [99].
[47] [2008] AATA 275 at [100].
[48] [2008] AATA 275 at [104].

Driclad Pty Ltd v Federal Commissioner of Taxation (1966-1968) 121 CLR 45 at 61-62."[49] (Emphasis added.)

36. It should be noted that the accountant compensated the Fund for the interest it lost as a result of his mismanagement of the IOA.[50]

Part V: Legislation

37. The appellant's statement of applicable statutes is accepted.

Part VI: Argument

38. The respondents' principal position in this appeal is that the questions of statutory construction posed by the Commissioner simply do not arise, in light of the AAT's
10 findings that no Fund monies were applied for non-charitable purposes.

39. Should the Court find against the respondents on this issue, the questions of statutory construction posed by the Commissioner are addressed below.

A. Application of the fund as a whole

40. The Commissioner makes two fundamental errors in his first argument regarding the construction of s50-60:

(i) he treats the statutory test as a quantitative, rather than a qualitative, test; and

(ii) he equates a breach of trust with an application of the fund for non-charitable purposes.

Each of these errors is dealt with below.

20 (i) The test to be applied pursuant to s50-60 is qualitative

41. The Full Court held that the statutory test to be applied pursuant to section 50-60 was a qualitative one:

- "The relevant question seems to be whether, having regard to the whole administration of the relevant fund, it is to be concluded that it 'is applied' to the relevant charitable purpose."[51]

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[49] [2008] AATA 275 at [105].
[50] [2008] AATA 275 at [100].

- "Each transaction had to be analyzed in the context of the administration of the Fund as a whole."[52]

- "As we understand it, his Honour [the primary judge] found non-compliance with s50-60 upon the basis of the interest set-off question and the trust account question, treating the Trustees' explanations as being irrelevant, and without regard to the administration of the Fund as a whole. That approach was erroneous. Those transactions had to be assessed in the light of the wider conduct of the fund, including the subjective evidence from those who acted in its administration."[53]

10 42. This approach is entirely consistent with High Court authority on the issue. For example, in *Mahoney v C of T* (1965) 39 ALJR 62, Owen J explained the statutory test provided by s23(*j*) of the *Income Tax Assessment Act* 1936 as follows:

- "There remains a further matter which the appellants must establish affirmatively. Was the fund, during the years in question, being applied for the purpose for which it was established, that is to say for the purpose of benefiting employees? In considering that question I think it is permissible to look at the circumstances leading up to the establishment of the fund, the terms of the deed under which it was managed and controlled, the use made of the powers and discretions conferred by the deed, **the extent to which employees received benefits from the fund and the extent to which it was used to benefit persons who were not employees.** Nor is the inquiry limited, in my opinion, to an investigation of the manner in which the fund was applied during the particular years of income with which these appeals are concerned since the purposes for which it was used in other years may throw light on **the question whether** during the years ending 30th June, 1957 and 1958, **the fund was in a real sense being applied for the purposes of benefiting employees.**"[54] (Emphasis added)

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- "**When all the circumstances are considered,** I am left with a strong impression that throughout its existence the fund was being applied for the benefit of the company rather than for the benefit of its employees."[55]

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43. Not only is the Commissioner's "one strike and you're out" approach incompatible with a consideration of "all the circumstances", as espoused by Owen J, it entirely ignores the distinction between ends, means and consequences:

"The distinction is between ends, means and consequences. The ends must be exclusively charitable. But if the non-charitable benefits are merely the means

[51] (2010) 191 FCR 184 at [69].
[52] (2010) 191 FCR 184 at [71].
[53] (2010) 191 FCR 184 at [72].
[54] 39 ALJR at 63 RHC.3-6.
[55] 39 ALJR at 64 LHC.7-8.

or the incidental consequences of carrying out the charitable purposes and are not ends in themselves, charitable status is not lost."[56]

44. Thus, the Commissioner points to the fact that monies of the Fund held in the accountant's trust account earned interest for the accountant's practice, and says that this is not an application for charitable purposes. However, when viewed in light of the whole administration of the Fund – in particular, the fact that the trustees' purpose in allowing the accountant to administer the Fund's accounts through his trust account was to facilitate the investment and growth of the Fund, and that the characteristic practice of the trustees and the accountant was to invest the Fund's funds in shares,
10 term deposits and loans – it can be seen that any interest earned by the accountant's practice was merely an incidental consequence of the administration of the Fund:

> "Trustees of a charitable trust may be authorised to charge their own fees and expenses to the trust without causing the loss of the trust's charitable status. It cannot be said to be a purpose of the trust to enable the trustees to charge fees and expenses; such expenditure may be justified only if it helps to further the trust's charitable purpose, and may accordingly be classified as ancillary to that purpose."[57]

45. Likewise, the purpose of depositing Fund monies into the IOA was not to relieve the trustees of their obligation to pay interest to the bank on their home loan, but to allow
20 the Fund to earn interest at a higher rate than could be obtained in a term deposit account. It was merely an incidental consequence of the transaction that the trustees would be relieved of their obligation to pay interest to the bank – that obligation having been replaced with a corresponding obligation to pay interest to the Fund instead.

46. If it be accepted that the test required by s50-60 is qualitative rather than quantitative, then the AAT's conclusion that the Fund was applied for charitable purposes is not appellable:

> "...where the facts found are capable of falling within or without the description used in the statute, the decision which side of the line they fall on
30 will be a decision of fact and not law. Such a decision will generally involve

[56] *Re Crown Forestry Rental Trust; Latimer v Commissioner of Inland Revenue* [2004] 4 All ER 558 at 569.4 per Lord Millett.
[57] 4 All ER 558 at 568.10-569.1.

weight being given to one or other element of the facts and so involve matters of degree."[58]

47. Finally, the Commissioner's submission that s50-60 should not be given a liberal construction[59] is inimical to the judgment of the High Court in *Ryland v FCT*:

> "Thus I find no need to insert either the word 'exclusively' or 'chiefly' into the section in order to effect the legislative intention. Charity being involved, generosity rather than pedantry is called for in the construction of the section; so long as the predominant purpose of the fund is to afford relief to persons in Australia and there is no specific intention to include persons out of Australia within the scope of the gift, the fact that consistently with the language of the gift, relief might possibly be given out of the fund to persons not in Australia, will not in my opinion prevent the gift from qualifying for exemption from duty."[60]

Ryland was applied by Gyles J in *Trustees of the Indigenous Barristers' Trust v Commissioner of Taxation* (2003) 127 FCR 63 at 89 (para. 40).

(ii) <u>A breach of trust is not necessarily an application of a fund for extraneous purposes</u>

48. In his submissions, the Commissioner equates a breach of trust with an application of a fund for non-charitable purposes:

- "That requirement fails to be satisfied if there is a single or discrete breach of trust."[61]
- "The statutory task is an enquiry into how the assets of the fund are being applied, and where there is a breach of trust, one concludes that the assets of the fund are not being applied to the relevant fund purposes."[62]

Section 50-60, however, makes no mention of the words "breach of trust". The only (relevant) question raised by the section is whether a fund has been applied for the purposes for which it was established – in this case, public charitable purposes.

49. There are many situations in which a breach of trust would not amount to an application of a fund for non-charitable purposes. For example, the constituent deed of a charitable trust might stipulate that trust monies are not to be lent other than on the security of a first mortgage. If the trustees proceeded to lend trust monies to an

[58] *Sharp Corporation of Australia Pty Ltd v Collector of Customs* (1995) 59 FCR 6 at 16 per Hill J.
[59] Appellant's Submissions, paras. 41-42.
[60] (1973) 128 CLR 404 at 411 (per Barwick CJ).
[61] Appellant's Submissions, para. 36.
[62] Appellant's Submissions, para. 45.

arm's length borrower on the security of a second mortgage, in circumstances where (i) a favourable interest rate was being offered and (ii) the trustees considered that the second mortgage provided adequate security, and if the loan was ultimately repaid in full together with interest, there would be little basis for a court to find that the fund had been applied for non-charitable purposes.

50. A breach of trust is simply one of the circumstances that a court must take into account in determining whether or not a fund is applied for the purposes for which it was established:

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> "Like other trustees they must of course conduct the business of the fund in the interests of present and future employees with the same care which a prudent, honest man of business would exercise if he were investing money for the benefit of those for whom he felt bound to provide or those who have claims upon him... If they fail to do so, that is a relevant circumstance in considering whether in fact the fund is being applied for the benefit of employees."[63]

51. Even though the interest offset transaction was technically a breach of trust, the AAT found that the arrangement need not have involved the trustees having direct personal access to the monies of the Fund held in the IOA.[64] Thus, the breach of trust involved did not mean that the interest offset transaction was an application of Fund monies for the personal benefit of the trustees.

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B. <u>Intention to apply the Fund</u>

52. The Commissioner argues that the intention of the trustees is entirely irrelevant to the statutory test posed by s50-60:

> "Whether a fund is applied to its constituent purpose is to be determined from what the fund actually did, not by reference to the understanding of the trustees or administrators of the fund."[65]

53. This argument was correctly rejected by the Full Court:

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> "The Trustees are, after all, charged with the administration of the Fund. It is for them to decide how it should be administered and, in particular, how its assets should be invested and eventually disbursed. A particular appropriation may, prima facie, not be for a relevant purpose. However there is always the

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63 *Mahoney v C of T* (1965) 39 ALJR 62 at 63.9-64.1 per Owen J
64 [2008] AATA 275 at [104].
65 Appellant's Submissions, para. 55.

possibility of an explanation which justifies it. Trustees are not infrequently called upon to justify their conduct and do so by reference to the purposes which they have sought to achieve. Exercise of a trustee's powers frequently involves questions of judgment. When judgment is questioned, assessment of intention may be relevant. Actual intention may also be relevant to the overall assessment of whether the Fund is being applied for the relevant charitable purposes."[66]

54. The relevant definitions of the word "apply" in the Oxford English Dictionary are:

(i) "to put to a special use or purpose; to devote, appropriate to"; and

10 (ii) "to put to use; to employ, spend, dispose of".

Both of these definitions involve intention. Something cannot be "applied" without there being a corresponding intention to apply it.

55. Furthermore, the word "for" in s50-60 of *ITAA* 1997 (*"is applied <u>for</u> the purposes"*) itself connotes intention. <u>See</u> *Herald & Weekly Times Limited v FCT* (1932) 48 CLR 113 at 123.5 (*"The principal relation is expressed by the word 'for', which is indicative of the object or purpose of the taxpayer in incurring the expenses claimed by him as a deduction."*)

56. In order to determine the purposes for which the Fund was applied, the relevant intention to consider is that of the trustees. This is because, pursuant to the terms of

20 the Trust Deed, the power to apply the Fund has been granted only to the trustees.

57. Let us assume that the trustees gave a stockbroker $1,000 of Fund monies and instructed the stockbroker to purchase shares on behalf of the Fund. If the stockbroker then misappropriated the $1,000 and gambled it all away, it could not be said that the Fund was applied for the purposes of gambling. Rather, the Fund was applied for the purposes of investment at the time that the trustees gave the $1,000 to the stockbroker with instructions to purchase shares. Although <u>monies</u> belonging to the Fund have been applied for gambling purposes, the Fund itself has not. <u>See</u> *Trustees, Executors and Agency Co. Limited v FCT* (1917) 23 CLR 576 at 587, where a distinction is drawn between the income of a fund and the fund itself.

[66] (2010) 191 FCR 184 at [71].

58. Similarly, the accounting irregularities in the accountant's management of his trust account cannot constitute a misapplication of the Fund in circumstances where the trustees did not authorise, condone, suspect or even contemplate the kinds of accounting irregularities which the evidence revealed. See also *Inland Revenue Commissioners v Helen Slater Charitable Trust Limited* [1982] 1 Ch 49, 60G-H.

59. Furthermore, it is not always possible to determine whether a fund is being applied for the purposes for which it was established simply by looking at where the money ends up. In many cases, the Court will have to consider why the money has ended up where it is. This was the approach laid down by the High Court in respect of the
10 statutory predecessors to s50-60 of the 1997 Act.

60. In *Trustees, Executors and Agency Co. Limited v FCT* (1917) 23 CLR 576, the High Court considered s11(1)(f) of the *Income Tax Assessment Act* 1915-1916, which exempted from income tax:

> *"...the income of a fund established by any will or instrument of trust for public charitable purposes if the Commissioner is satisfied that* ***the fund is being applied by the trustees to public charitable purposes.*** *"* (Emphasis added)

Isaacs J held (at p. 587):

> "...if a fund were established to purchase radium for free curative purposes, and if it were found that (say) £20,000 were required as a minimum,
20 but the fund could accumulate only at the rate of £5,000 a year, and the Commissioner were satisfied that each year's income was deposited in a bank **for the special purpose of** getting together £20,000, and buying the radium, he could well say he was satisfied the fund was **'being applied' to the charitable purpose**. ... 'Being applied' is as true of the first step in the process as of the last. The Commissioner, in examining the facts, can judge of the reality of the first step, and of its actual standing as carrying out the provisions of the trust." (Emphasis added)

In other words, a deposit of £5,000 into a bank account, viewed in isolation, indicates nothing about whether a fund is being applied for charitable purposes. In order to
30 determine the issue, it is necessary to examine the trustees' intentions.

61. In *Mahoney v Commissioner of Taxation of the Commonwealth* (1965) 39 ALJR 62, Owen J stated in relation to s23(*j*) of the 1936 Act:

- "The words in s. 23 (*j*) 'is being applied' must, as Isaacs J. said in *Trustees, Executors and Agency Co. Ltd.* [citation omitted], be given some elasticity and, because over a particular period no benefits are conferred upon employees out of a fund established for the purpose of benefiting them, it does not follow that the fund has not been applied for their benefit during that period. There may have been no necessity to call upon it. **Those controlling its operations may, in the exercise of a proper discretion, have thought it desirable in the interests of employees to build up the fund so that greater benefits would become available at a later stage.**" [at p. 63, RHC.6 (emphasis added)]

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- "**It may also have been considered [by the trustees/appellants]** that after March 1959, when the assessments under appeal were issued, it would be wise to await events. These are matters to be taken into consideration in favour of the case put on behalf of the appellants." [at p. 64, LHC.5 (emphasis added)]

Thus, the subjective thoughts and considerations of the trustees are relevant to the court's determination of whether the fund is being applied for the purpose for which it was established.

62. On appeal (*Mahony v Commissioner of Taxation of the Commonwealth* (1967) 41 ALJR 232), the conclusions of Taylor J are expressed in terms of the intentions of the trustees/appellants:

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- "I have no doubt that the appellants, in making this loan, were not acting in the interests of the fund and that **it was made to serve the business interests of the company and Wren.**" [at p. 236, LHC.7 (emphasis added)]

- "In the circumstances it seems to me impossible to doubt that **this loan also was made merely to serve the business interests of the company and Wren.**" [at p. 236, RHC.8 (emphasis added)]

- "The loans which were made were not made **with the interests of the fund in mind** and, in my view, **were not made in the bona fide exercise** of the powers of investment which the deed conferred." [at p. 237, LHC.1 (emphasis added)]

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- "Further...the fund was allowed to languish in the appellants' current account. **An explanation was offered for this last circumstance but I find it most unconvincing.** The correct conclusion is, in my view, that **the fund was allowed to remain in the current account to serve the interests of the company** and at no time can it be said to have been applied for the purpose for which it was established. If it were necessary to say so I should, having regard to all the circumstances of the case, say that **it was the intention of the company that the fund should not be administered in accordance with the deed and that the appellants concurred in carrying this intention into effect.**" [at p. 237, LHC.2 (emphasis added)]

In contrast to the position in *Mahony*, the explanations offered by the trustees and the accountant in respect of the impugned transactions in the instant case were all accepted by the AAT.

63. In *Compton v FCT* (1966) 116 CLR 233, *Driclad Pty Limited v FCT* (1968) 121 CLR 45 and *Rollason v FCT* (1966) 121 CLR 60, the High Court again expressed the view that the intention of the trustees is relevant in determining whether a fund is being applied for the purpose for which it was established (pursuant to s23(*j*)(i) of the 1936 Act):

- "Although the deed did not contemplate the establishment of a fund for the benefit of all of the employees of the company as such its fundamental purpose was the establishment of a fund for the benefit of such of its employees as should be nominated as members of the fund. But the evidence establishes beyond question that during the relevant period no attempt was made to give effect to this purpose; indeed, it appears clearly enough that **at all relevant times it was the intention of the four directors and for that matter, of the trustees, that no such attempt should be made. In these circumstances I find it impossible to say that during the relevant income years the fund was being applied for the purpose for which it was established.**" [*Compton* at p. 239 per Taylor J (emphasis added)]

- "...the manner in which the fund was administered may be thought to raise a corresponding question, namely **whether the purpose which governed the application of the fund throughout the relevant years** was not rather the purpose of benefiting the Comptons as individuals than the purpose of providing them with superannuation as employees." [*Compton* at pp. 246-247 per Kitto J (emphasis added)]

- "Nor, in my view, does the evidence indicate that the fund was, as is suggested, being used for the benefit of the contributing companies or, that during the relevant periods, it was not being applied for the purpose for which it was established. The investments in question were within the investment powers of the trustees and, to my mind, it was immaterial whether the funds were invested in this or some other manner. It may be true that the moneys, when lent, we [*sic*] used by the companies in their respective businesses but it is erroneous to say that the evidence reveals that the trustees were not applying the fund for the purpose for which it was established but, rather, for the benefit of the companies concerned. I do not say that if it could be shown that the trustees, in exercising their powers of investment, **were applying the fund in derogation of, or, so as to defeat**, the rights of employees in the fund as constituted, the conclusion would not follow that the fund was not being applied for the purpose for which it was established. But there is nothing to suggest that this was so in this case." [*Rollason* at 61-62 per Taylor J (emphasis added)]

64. In *Bray v FCT* (1978) 140 CLR 560, Jacobs J discussed the relevance of the trustees' intentions in the context of a similar statutory test – namely, whether a fund was being "maintained" exclusively for charitable purposes pursuant to s78(1)(a) of the 1936 Act:

- "Although the trust can be described as a 'purpose' trust it does not follow that the purpose referred to in s. 78(1)(a) can be exhaustively found in the declared beneficial objects. It is necessary also to take into account the powers conferred or duties imposed upon the trustees in order to see whether in the circumstances of the case the instrument in its form and its manner of operation as a result of decisions by the trustees discloses that what might ordinarily be an administrative power operates in fact as a purpose of the maintenance of the fund in the manner in which it is in fact maintained. What is apparently and ordinarily a power may be seen to operate as a purpose if it has an operation other than ancillary to the conferring of benefits upon the objects of the trust. One example will suffice. Assume an instrument of trust which gives power to employ a manager irrespective of the size of the fund to be managed. If the affairs of the trust are so conducted by the trustees under the instrument of trust that the income of the fund is absorbed by the salary of the manager the conclusion would be open that the fund maintained under the instrument of trust was not being maintained exclusively for the purpose of providing benefits to the objects. **That conclusion would the more easily be drawn if the exercise of the power by the trustees was not wholly motivated by a wish to promote the best interests of the beneficial objects of the trust.**" [at pp. 577-8 (emphasis added]

- "The question is whether the inclusion of the power to retain property followed by the exercise of that power in the manner in which it was exercised shows that the fund was established or maintained with a purpose that the shares given to the fund by the founder would be retained in the form in which they were received **whether or not the trustees were of the opinion that the retention of the shares was the best way of achieving a purpose of providing money, property or benefits to or for the specified beneficial objects.**" [at p. 578 (emphasis added)]

- "If it be correct that the fund was established upon the gift of the shares, then the decision of the trustees to exercise the power to accept the transfer of shares and to exercise the power to retain them **for reasons other than the exclusive benefit of the objects of the trust** means that the trustees exercised their powers in such a way as to achieve a result or effect other than that of exclusively providing benefits to the declared objects of the trust." [at pp. 578-9 (emphasis added]

65. Thus, to use Jacobs J's hypothetical, while the conclusion would be open that a fund was not being maintained exclusively for charitable purposes if the whole of the income of the fund was absorbed by the salary of the manager in a particular year,

nevertheless, if the trustees gave evidence that they had plans to dramatically grow the fund for the benefit of its beneficiaries – and therefore had good reason to employ an experienced, but expensive, manager to achieve that goal – it would clearly be open to the Court to conclude that the fund was being maintained exclusively for charitable purposes. Cf. *Trustees, Executors and Agency Co.* (1917) 23 CLR at 587 (quoted above).

Part VII: Argument on cross-appeal

66. The Full Court ordered that the matter be remitted to the AAT for further consideration, in light of the Full Court's finding (at [74]) that:

10 "There appears to be no point at which the Tribunal addressed all of the evidence to determine whether or not the Fund, as a whole, was being applied to the relevant charitable purpose. As there has been no consideration of the proper question, the matter should be remitted to the Tribunal."

67. It is submitted that the Full Court erred in remitting the matter to the AAT, in view of the following paragraphs of the AAT's decision: paras. 2, 4, 9, 12, 32, 33, 34, 35, 36, 38, 39, 40, 45, 46, 47, 49, 50, 51, 53, 55, 64, 84, 85, 86, 89, 91, 96, 104 and 105.

68. In light of the above paragraphs, it is not clear what further consideration the AAT could give to the question of whether the Fund, as a whole, was being applied to the relevant charitable purpose.

20 69. The respondents seek the following orders in respect of their cross-appeal:

(i) Application for special leave to cross-appeal granted and cross-appeal allowed.

(ii) Vary order 3 of the orders of the Full Court to read:

"The orders made by the trial judge on 12 June 2009 be set aside; and, in lieu thereof, order that the appeal be dismissed."

Dated: 4 October 2011

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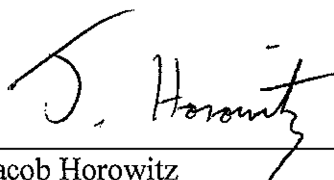

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