

HIGH COURT OF AUSTRALIA

KIEFEL CJ,
BELL, GAGELER, KEANE, NETTLE, GORDON AND EDELMAN JJ

Matter No B60/2017

THE COMMISSIONER OF TAXATION OF THE
COMMONWEALTH OF AUSTRALIA APPELLANT

AND

MARTIN ANDREW THOMAS RESPONDENT

Matter No B61/2017

THE COMMISSIONER OF TAXATION OF THE
COMMONWEALTH OF AUSTRALIA APPELLANT

AND

MARTIN ANDREW PTY LTD RESPONDENT

Matter No B62/2017

THE COMMISSIONER OF TAXATION OF THE
COMMONWEALTH OF AUSTRALIA APPELLANT

AND

THOMAS NOMINEES PTY LTD RESPONDENT

Matter No B63/2017

THE COMMISSIONER OF TAXATION OF THE
COMMONWEALTH OF AUSTRALIA APPELLANT

AND

MARTIN ANDREW THOMAS RESPONDENT

Federal Commissioner of Taxation v Thomas
Federal Commissioner of Taxation v Martin Andrew Pty Ltd
Federal Commissioner of Taxation v Thomas Nominees Pty Ltd
Federal Commissioner of Taxation v Thomas
[2018] HCA 31
8 August 2018
B60/2017, B61/2017, B62/2017 & B63/2017

ORDER

Matter No B60/2017

1. *The appeal be allowed in respect of the income years ending 30 June 2006, 30 June 2007 and 30 June 2008.*
2. *The cross-appeal be dismissed.*
3. *Set aside order 1 of the Full Court of the Federal Court of Australia made on 12 April 2017 in Matter No QUD72/2016 and orders 1, 2, 3 and 4 of that Court made on 3 August 2017 in Matter No QUD72/2016, and in their place make the following orders:*
 - (a) *the appeal be allowed in part;*
 - (b) *the cross-appeal be allowed;*
 - (c) *the objection decisions in respect of the income years ending 30 June 2006, 30 June 2007 and 30 June 2008 be remitted to the Commissioner of Taxation of the Commonwealth of Australia for determination in accordance with the reasons of this Court;*
 - (d) *the objection decision in respect of the income year ending 30 June 2009 be remitted to the Commissioner of Taxation of the Commonwealth of Australia for determination in accordance with the orders of Greenwood J made on 26 November 2015 in Matter No QUD274/2012 and otherwise in accordance with the law.*
4. *The respondent pay the appellant's costs of the appeal except for those costs that relate to the determination of the matters concerning the income year ending 30 June 2009.*

3.

5. *The appellant pay the respondent's costs of the appeal insofar as those costs relate to the determination of the matters concerning the income year ending 30 June 2009.*

Matter No B61/2017

1. *The appeal be allowed.*
2. *Set aside order 1 of the Full Court of the Federal Court of Australia made on 12 April 2017 in Matter No QUD78/2016 and orders 1, 2, 3 and 4 of that Court made on 3 August 2017 in Matter No QUD78/2016, and in their place make the following orders:*
 - (a) *the appeal be dismissed;*
 - (b) *the cross-appeal be allowed;*
 - (c) *the objection decision in respect of the income year ending 30 June 2008 be remitted to the Commissioner of Taxation of the Commonwealth of Australia for determination in accordance with the reasons of this Court.*
3. *The respondent pay the appellant's costs of the appeal.*

Matter No B62/2017

1. *The appeal be dismissed.*
2. *The appellant pay the respondent's costs.*

Matter No B63/2017

1. *The appeal be dismissed.*
2. *The appellant pay the respondent's costs.*

On appeal from the Federal Court of Australia

Representation

J T Gleeson SC and P A Looney QC with J A Watson and C M Pierce for the appellants (instructed by Australian Government Solicitor)

F L Harrison QC and M L Robertson QC for the respondents (instructed by Hopgood Ganim Lawyers)

S P Donaghue QC, Solicitor-General of the Commonwealth with K E Foley and R A Minson for the Attorney-General of the Commonwealth, intervening in B60/2017 and B61/2017 (instructed by Australian Government Solicitor)

P J Dunning QC, Solicitor-General of the State of Queensland with D E F Chesterman for the Attorney-General of the State of Queensland, intervening in B60/2017 and B61/2017 (instructed by Crown Solicitor (Qld))

Notice: This copy of the Court's Reasons for Judgment is subject to formal revision prior to publication in the Commonwealth Law Reports.

CATCHWORDS

Federal Commissioner of Taxation v Thomas

Federal Commissioner of Taxation v Martin Andrew Pty Ltd

Federal Commissioner of Taxation v Thomas Nominees Pty Ltd

Federal Commissioner of Taxation v Thomas

Taxation – Division 207 in Pt 3-6 of *Income Tax Assessment Act* 1997 (Cth) – Where trustee passed resolutions purporting to distribute franking credits to beneficiaries of trust separately from and in different proportions to income comprising franked distributions – Where directions made by Supreme Court of Queensland pursuant to s 96 of *Trusts Act* 1973 (Q) concerning the resolutions – Whether directions determined against Commissioner of Taxation the application of Div 207.

Words and phrases – "deemed assessment", "determine conclusively", "directions", "franked distribution", "franking credit", "imputation credit", "income tax return", "judicial advice", "notice of amended assessment", "notionally allocated", "streaming", "tax offset".

Income Tax Assessment Act 1936 (Cth), ss 95, 97.

Income Tax Assessment Act 1997 (Cth), Div 207.

Taxation Administration Act 1953 (Cth), Pt IVC.

Trusts Act 1973 (Q), s 96.

1 KIEFEL CJ, BELL, KEANE, NETTLE, GORDON AND EDELMAN JJ. These appeals, arising out of proceedings in the Federal Court of Australia under Pt IVC of the *Taxation Administration Act* 1953 (Cth) ("the TAA"), concern the receipt of distributions that had been franked within the meaning of Div 207 in Pt 3-6 of the *Income Tax Assessment Act* 1997 (Cth) ("the 1997 Act").

2 In the 2006 to 2008 years of income¹, the trustee of the Thomas Investment Trust ("the Trust"), Thomas Nominees Pty Ltd ("the Trustee"), received franked distributions within the meaning of Div 207 of the 1997 Act. In each of those years, the Trustee passed two relevantly identical resolutions, described respectively as the "Net Income Resolution" and the "Franking Credit Resolution". Those resolutions sought to distribute, or stream, the franking credits between beneficiaries of the Trust separately from, and in different proportions to, the income comprising the franked distributions. In these appeals, the assumption which underpinned the resolutions – that franking credits could be distributed separately from, and in different proportions to, the income comprising the franked distributions – was referred to as the "Bifurcation Assumption".

3 The income tax returns for the Trustee and the beneficiaries of the Trust were prepared, and lodged with the Commissioner, on the basis that the Bifurcation Assumption was legally effective under Div 207. Then, in 2010, the Trustee made an application to the Supreme Court of Queensland under s 96 of the *Trusts Act* 1973 (Q) for, and successfully obtained, "directions" that the Trustee, by those resolutions, could give, and had given, effect to the Bifurcation Assumption ("the State Proceedings")².

4 In this Court, the Trustee and two beneficiaries of the Trust – Mr Martin Thomas ("Mr Thomas") and Martin Andrew Pty Ltd ("MAPL") (collectively, "the taxpayers") – accepted that the Bifurcation Assumption was legally ineffective under Div 207 in Pt 3-6 of the 1997 Act.

1 These appeals initially concerned the income years ending 30 June 2006 to 30 June 2009 (inclusive). The appellant, the Commissioner, abandoned his appeals concerning the 2009 year (part of Matter No B60 and Matter No B62) and penalties (Matter No B63).

2 *Thomas Nominees Pty Ltd v Thomas* (2010) 80 ATR 828 at 838-839 [50]-[52].

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2.

5 The principal issue in this Court was whether, in the Pt IVC proceedings, the Full Court of the Federal Court was correct in holding that it was bound by the decision in *Executor Trustee and Agency Co of South Australia Ltd v Deputy Federal Commissioner of Taxes (SA)*³ to conclude that the "directions"⁴ (in the form of declarations) given by the Supreme Court of Queensland determined conclusively, against the Commissioner, the application of Div 207 to those franked distributions – in other words, that the "directions" determined the rights of the beneficiaries against the Trustee in such a way that Div 207 would operate consistently with the Bifurcation Assumption. The Commissioner submitted that the Full Court of the Federal Court was in error in holding that the Court was so bound. That submission should be accepted.

6 If neither the Federal Court in the Pt IVC proceedings, nor the Commissioner, were bound by the "directions" of the Supreme Court of Queensland (and they were not), then the next issue concerned the proper construction of the resolutions and the application of Div 207 to those resolutions. Having abandoned reliance on the Bifurcation Assumption, in this Court the taxpayers sought to uphold an alternative construction of the resolutions adopted by the Full Court of the Federal Court – one in which franked distributions were "notionally allocated" to match the purported, and separate, distribution of the franking credits. As will be explained, the Commissioner's submission that this alternative construction of the resolutions was flawed should be accepted.

7 By notices of contention, the taxpayers sought to raise three further issues – estoppel by convention, rectification of the resolutions and a denial of procedural fairness. Each of those grounds should be dismissed.

8 The Commissioner's appeals in relation to the 2006 to 2008 income years should be allowed.

Division 207 in Pt 3.6

9 The Bifurcation Assumption involves the notion that franking credits are discrete items of income that may be dealt with or disposed of as if they were property under the general law. That notion is contrary to the proper

3 (1939) 62 CLR 545; [1939] HCA 35.

4 ss 96 and 97 of the Trusts Act.

3.

understanding of Pt 3.6. Franking credits are a creature of its provisions; their existence and significance depend on those provisions.

10 Part 3.6 of the 1997 Act creates an imputation system which sets out the effects of receiving a "franked distribution". The Part creates a distinction between *franked distributions* and *franking credits*, the latter being "on"⁵ or attached to the franked distribution. Under the Part, when a corporate tax entity⁶ distributes profits on which income tax has already been paid, the corporate tax entity *may* impute credits for that tax by "franking" the relevant distribution⁷.

11 As a general rule⁸, a member of a corporate tax entity will be taxed on the full amount of the franked distribution and the attached franking credits but will be entitled to an imputation credit, a tax offset, equal to the franking credit on the distribution included in that member's assessable income for the tax already paid by the corporate tax entity⁹.

12 That general rule is modified where the distribution is made to a trustee¹⁰. In that situation, subdiv 207-B creates a system¹¹ which notionally allocates the franking credits in the same proportions as the beneficiaries' share in the franked distributions. This is the significance of the statutory reference to "notional allocation". That reference is not, as the taxpayers' argument would have it, an indication that a trustee may effect such an allocation of franking credits as it may choose in order to achieve an effect inconsistent with the provisions of Div 207.

5 See, eg, ss 207-5(1)(a), 207-5(3), 207-5(4), 207-10 and 207-35(1) of the 1997 Act.

6 See the definition of "corporate tax entity" in ss 995-1(1) and 960-115 of the 1997 Act.

7 ss 200-5 and 200-10 of the 1997 Act.

8 ss 200-10, 200-35, 207-5(1), 207-35, 207-45 and 207-50 to 207-57 of the 1997 Act.

9 The tax offsets available under Div 207 are subject to the refundable tax offset rules: Div 67 of the 1997 Act.

10 subdiv 207-B of the 1997 Act.

11 ss 207-5, 207-25, 207-35, 207-45 and 207-50 to 207-57 of the 1997 Act.

Kiefel CJ
Bell J
Keane J
Nettle J
Gordon J
Edelman J

4.

13 The beneficiaries' share in the franked distributions, in turn, depends on how the beneficiaries share in the income of the trust under s 97 of the *Income Tax Assessment Act 1936* (Cth) ("the 1936 Act")¹². Subdivision 207-B ensures that the beneficiary of the trust income receives the benefit of the franked distribution to the extent that the franked distribution is received through a trust.

14 The system comprises four steps: first, where a franked distribution is made or flows indirectly to a trustee, the assessable income of the trust for that year includes the amount of franking credits on the distribution¹³; second, it is necessary to identify whether any of the franked distribution flows indirectly to a beneficiary of the trust¹⁴; third, if any of the franked distribution flows indirectly to a beneficiary of the trust, it is necessary to identify if the beneficiary has assessable income attributable to all or a part of the franked distribution¹⁵; and, fourth, if so, the beneficiary's assessable income will include a franking credit amount equal to its share of the franking credit on the franked distribution¹⁶.

15 In respect of the fourth step, s 207-55 seeks to ensure that the amount of a franked distribution made to a trustee is allocated notionally amongst the beneficiaries who derive benefits from that distribution and that the allocation corresponds with the way in which those benefits were derived. Its sub-sections provide the mechanisms to achieve that objective. Section 207-55(2) provides that the amount notionally allocated, described as a *share* of the franked distribution, does not have to be received by the beneficiary. The table in s 207-55(3) provides the method for determining the share amount – relevantly, the beneficiary's share of the trust's net income for the relevant income year¹⁷, usually calculated as a percentage of the trust's net income.

12 Read with s 95 of the 1936 Act.

13 s 95 of the 1936 Act and s 207-35(1)(a), (2) and (3) of the 1997 Act.

14 s 97(1)(a) of the 1936 Act and ss 207-35(3)(c), 207-50(3) and 207-55 of the 1997 Act.

15 s 207-35(3)(d) of the 1997 Act.

16 ss 207-35(3), 207-45, 207-55 and 207-57 of the 1997 Act.

17 See also s 207-50(3)(b) of the 1997 Act and ss 95 and 97(1)(a) of the 1936 Act.

5.

16 What is clear from this stepped approach (and particularly from the fourth stage) is that the statutory notional allocation of *franking credits* to beneficiaries follows the proportions which have been established with respect to their notional sharing in *franked distributions* at the earlier stages.

17 So long as a trust deed confers power on a trustee to apply classes of income of the trust estate to particular beneficiaries to the exclusion of other beneficiaries (or differentially among beneficiaries), Div 207 recognises that a trustee may stream the franked distribution (or any part of it) to one beneficiary and the other income to another beneficiary¹⁸. However, Div 207 does not treat franking credits as a separate source of income capable of being dealt with, and distributed, separately from the franked distribution to which they are attached. The scheme's objective in relation to trusts is to ensure that a beneficiary of a trust will have notionally attributed to it that proportion of the franked distributions received by the trustee that is referable to the amount of the net income distributed to the beneficiary while, at the same time, ensuring that the beneficiary obtains the benefit of the franking credits to the extent of those franked distributions. The franking credits are on¹⁹, or attached to, the franked distribution.

18 As the taxpayers now accept, the Bifurcation Assumption – the proposition that franking credits could be distributed separately from, and in different proportions to, the income comprising the franked distributions – was wrong.

19 It is against that statutory framework that the terms of the Deed, and the actions of the Trustee, are to be considered.

Facts

The Trust

20 The Trust was established by a Deed, subsequently amended by a number of deeds poll. Mr Thomas was the sole shareholder and director of MAPL. Mr Thomas and his mother were directors and equal shareholders of the Trustee.

18 See the example at s 207-35(3).

19 See, eg, ss 207-5(1)(a), 207-5(3), 207-5(4), 207-10 and 207-35(1) of the 1997 Act.

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Nettle J
Gordon J
Edelman J

6.

21 Clause 4(1) of the Deed (as amended) gave the Trustee an "absolute and uncontrolled discretion" to apply the income of the Trust property. Under cl 4(2), the Trustee was permitted to record identified categories of *income* separately in the Trust's books of account. The identified categories included dividends which were fully franked, which were unfranked, to which a foreign tax credit attached, or to which "any other separately identifiable taxation consequence or benefit" attached.

22 Clause 4(3) went on to provide that the Trustee could identify, separately record and maintain, in the books of account and records of the Trust, income having, or in respect of which there was attached, individual or unique characteristics other than as referred to in cl 4(2), as the Trustee by resolution determined.

23 Next, consistent with s 207-35 in Div 207 of the 1997 Act, cl 4(4)(a) permitted differential distribution of the whole or any part of the *income* between beneficiaries – commonly referred to as "streaming". The Deed did not, because it could not, treat franking credits as income. However, the Deed did, as s 207-35 provides, contemplate that franked distributions could be streamed between beneficiaries in different proportions to the other income of the Trust.

24 Finally, cl 4(5) provided that expenses and outgoings of the Trust, at the discretion of the Trustee, could be differentially allocated against, and deducted from, categories of income. The Trustee did not purport to act under cl 4(5).

Franked distributions and resolutions

25 As noted earlier, in each of the 2006 to 2008 income years, the Trustee passed the resolutions, under cl 4 of the Deed, which were described by the taxpayers as "dual net income distribution resolutions".

26 Each resolution purported to apply the net income of the Trust for the benefit of Mr Thomas and MAPL but in a different way. Apart from the year and the proportions, the resolutions for the 2006 year set out below were typical of the resolutions passed in each of the income years in dispute.

Kiefel	CJ
Bell	J
Keane	J
Nettle	J
Gordon	J
Edelman	J

7.

27

The Net Income Resolution was in these terms:

TRUST INCOME DISTRIBUTION: Resolved pursuant to the powers vested in the trustee under the [Deed] establishing the abovenamed trust fund that *the net income of the trust fund for the financial year ended 30 JUNE 2006 be applied for the benefit of the beneficiaries listed hereunder by credit to accounts maintained by the trustee for them.*

<u>BENEFICIARY</u>	<u>PROPORTION</u>
[Mr Thomas]	THE FIRST \$21,600
[MAPL]	THE BALANCE

Should the Commissioner of Taxation disallow any amount as a deduction or take any action that would have the effect of creating undistributed net income in the trust as at 30 JUNE 2006 then such net income shall be deemed to be distributed on 30 JUNE 2006 to the abovenamed beneficiaries in proportions as stated above, except where there is a remainder nomination then this amount shall be distributed to that person. (emphasis added)

28

The Franking Credit Resolution was in these terms:

TRUST INCOME DISTRIBUTION: Resolved pursuant to the powers vested in the trustee under the [Deed] establishing the abovenamed trust fund that *the net income of the trust fund for the financial year ended 30 JUNE 2006 be applied for the benefit of the beneficiaries listed hereunder by credit to accounts maintained by the trustee for them.*

<u>BENEFICIARY</u>	<u>PROPORTION</u>	
[Mr Thomas]	FRANKING CREDITS	\$2,416,217.92
	TFN WITHHELD	\$17,502.00
[MAPL]	FRANKING CREDITS	\$228,900.38
	FOREIGN TAX CREDITS	\$4,267.42

Should the Commissioner of Taxation disallow any amount as a deduction or take any action that would have the effect of creating undistributed net income in the trust as at 30 JUNE 2006 then such net income shall be deemed to be distributed on 30 JUNE 2006 to the abovenamed beneficiaries in proportions as stated above, except where there is a remainder nomination then this amount shall be distributed to that person. (emphasis added)

Kiefel CJ
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 Edelman J

8.

29 The Trust's income tax returns, prepared and lodged on the basis that the Bifurcation Assumption was effective, disclosed the following distributions:

	2006	2007	2008
Section 95 net income	\$798,826	\$1,839,635	\$142,651
Distributions to Mr Thomas :			
Share of non PP income	\$21,600	\$4,615	\$50
Franking credits	\$2,416,218	\$4,765,353	\$1,030,839
TFN withheld	\$17,502	-	-
Distributions to MAPL :			
Share of non PP income	\$763,149	\$1,822,307	\$138,109
Franking credits	\$228,900	\$548,488	\$42,780
Attributed foreign income	\$125	\$0	-
Other foreign income	\$13,952	\$12,713	\$4,492
Foreign tax credits	\$4,267	\$1,821	\$1,185

30 The result sought to be achieved each year by the resolutions, and reflected in the tax returns, was not in dispute. As the taxpayers submitted to the primary judge in the Pt IVC proceedings, by the passing of the "dual net income distribution resolutions", the Trustee endeavoured to ensure that all trust income was distributed to avoid the operation of s 99A of the 1936 Act and to ensure that the distribution occurred in a way that maximised the refundable tax offsets available only to Mr Thomas.

31 There were two steps. First, in relation to the non-primary production income (which included the franked distributions), the Trustee sought to allocate, or "stream", the income between beneficiaries to attract the most favourable marginal tax rates. In the 2006 year, that required Mr Thomas to receive an amount (just \$21,600) that, together with his other income, kept his average tax rate at 30 per cent. The balance (some \$763,149) was then streamed to MAPL, which had a tax rate of 30 per cent.

32 The second step involved the franking credits. The objective was different. As a corporate entity, MAPL could not receive a cash refund from the Commissioner²⁰. If MAPL received franking credits over and above an amount

20 s 67-25(1D) of the 1997 Act.

9.

that would effectively reduce its tax to nil, the franking credits would be wasted. However, Mr Thomas, as an individual, *could* get a refund for excess franking credits²¹. It was for that reason that the bulk of the franking credits were sought to be distributed to Mr Thomas (in the 2006 year, \$2,416,218), rather than to MAPL (in the 2006 year, \$228,900).

33 The income tax returns lodged by the Trustee, Mr Thomas and MAPL produced deemed assessments under s 166A of the 1936 Act. The Commissioner subsequently gave notice of an audit and expressed concern over the correctness of the Bifurcation Assumption.

State Proceedings

34 After the Commissioner had given notice of intention to conduct an audit, but before the Commissioner issued amended assessments, the Trustee applied pursuant to s 96 of the Trusts Act, by Originating Application to the Supreme Court of Queensland, for judicial advice in the form of directions. The Trustee sought directions "as to the construction of the [Trustee's] resolutions to distribute net income comprising, inter alia, of franking credits for the income tax years 30 June 2005 to 30 June 2008" and, unusually, also sought in the same Originating Application "[e]quitable rectification, if required, of the [Trustee's] resolutions to distribute net income comprising, inter alia, franking credits for the income tax years 30 June 2005 to 30 June 2008 and/or of clause 4(1) of the trust deed for the [Trust] (as amended)"²².

35 It is necessary to describe in a little detail what happened in the State Proceedings.

36 Mr Thomas and MAPL, as the relevant beneficiaries, were joined as respondents to the State Proceedings but played no active part in the proceedings²³. The other beneficiaries of the Trust were apparently made aware of the State Proceedings, obtained independent legal advice about the

21 s 67-25 of the 1997 Act.

22 cf *Macedonian Orthodox Community Church St Petka Inc v His Eminence Petar Diocesan Bishop of Macedonian Orthodox Diocese of Australia and New Zealand* (2008) 237 CLR 66 at 91-92 [64]-[65]; [2008] HCA 42.

23 *Thomas Nominees Pty Ltd v Thomas* (2010) 80 ATR 828 at 831 [10].

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Nettle J
Gordon J
Edelman J

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proceedings and supported the proceedings²⁴. The Commissioner was given notice of the State Proceedings but told the Trustee's solicitors that he was neither a necessary nor an appropriate party. The Trustee did not seek to join the Commissioner as a party to the State Proceedings.

37 In the State Proceedings, Applegarth J found that, under Div 207 of the 1997 Act, the Bifurcation Assumption was correct in law, that the Trustee intended to make a bifurcated distribution of franking credits between beneficiaries and that the resolutions gave effect to that intention²⁵. His Honour indicated that had he reached the conclusion that the Trustee did not document the resolutions to give effect to the Bifurcation Assumption, he would have ordered that the resolutions be rectified to reflect it²⁶. The terms of any rectified resolution or resolutions were not identified.

38 After reasons for judgment were handed down, Senior Counsel for the Trustee prepared and filed minutes of proposed orders. The Commissioner was not given notice of the contents of the proposed orders or given notice that the orders would extend to include declarations of rights, as opposed to directions that the Trustee would be justified in acting on.

39 Applegarth J made the declarations and orders sought ("the directions") as follows:

- "1. The court directs [the Trustee] under s 96 of the *Trusts Act* 1973 (Qld), and declares, that:
 - (a) on the proper construction of the *Income Tax Assessment Act* 1997 (Cth), franking credits in respect of a franked distribution made to the trustee of a trust confer a financial advantage which falls to be dealt with by the trustee of that trust; and
 - (b) on the proper construction of the trust deed for the [Trust] and of the *resolutions* of the directors of [the Trustee] for the

24 *Thomas Nominees Pty Ltd v Thomas* (2010) 80 ATR 828 at 831 [10].

25 *Thomas Nominees Pty Ltd v Thomas* (2010) 80 ATR 828 at 838-839 [50]-[52].

26 *Thomas Nominees Pty Ltd v Thomas* (2010) 80 ATR 828 at 839 [53]-[54].

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 Bell J
 Keane J
 Nettle J
 Gordon J
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11.

years ended 30 June 2005 to 2008, *those resolutions were effective to:*

- (i) allocate to the following beneficiaries in the following amounts the benefits pertaining to the franking credits; and
- (ii) entitle those beneficiaries to those benefits in the proportions which those amounts bear, each to the other:

<u>Date of Resolution</u>	<u>[Mr Thomas]</u>	<u>[MAPL]</u>
30 June 2005	\$282,631.49	\$17,860.51
30 June 2006	\$2,416,217.92	\$228,900.38
30 June 2007	\$4,765,353.11	\$548,488.89
30 June 2008	\$1,030,838.70	\$42,780.30;

- (iii) confer on each of those beneficiaries respectively a vested and indefeasible interest in possession in a share of the distributable income that is consistent with the above allocation to those beneficiaries of the benefits pertaining to the franking credits;
- (iv) distribute all the distributable income of the Trust in each year among the above beneficiaries *in accordance with those resolutions.*

- 2. The court orders that the application for equitable rectification of those resolutions be dismissed." (emphasis added)

40

Paragraph 1(a) is a direction and declaration that, on the proper construction of the 1997 Act, franking credits in respect of a franked distribution made to the trustee of a trust confer a financial advantage which falls to be dealt with by the trustee of that trust. Paragraph 1(a) is general in nature. That paragraph reflects and records the flawed Bifurcation Assumption that, under the 1997 Act, franking credits can be distributed or streamed between beneficiaries *separately from*, and in different proportions to, the income comprising the franked distributions.

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12.

41 The following paragraphs of the directions proceed from, and build on, that flawed Bifurcation Assumption. Paragraphs 1(b)(i) and (ii) construe the Deed and the resolutions for, relevantly, the 2006 to 2008 income years and declare that the resolutions were effective to allocate to Mr Thomas and MAPL benefits pertaining to the franking credits in the amounts and proportions set out in par 1(b)(ii). Paragraph 1(b)(iii) declares that the resolutions were effective to confer on Mr Thomas and MAPL a vested and indefeasible interest in possession in a share of the distributable income consistent with the allocation to each of them of the benefits pertaining to the franking credits set out in the schedule in par 1(b)(ii). Finally, par 1(b)(iv) declares that the resolutions were effective to distribute all of the distributable income of the Trust in each year among the beneficiaries in accordance with "those resolutions". The relationship between the directions and the resolutions is clear. The directions purport to give effect to *both* resolutions, despite the fact that the resolutions are contradictory in terms.

42 The taxpayers' contention that par 1(b)(iii) was not, as a matter of construction or reasoning, dependent upon the Bifurcation Assumption must be rejected. Hence, the taxpayers' contention that the Full Court of the Federal Court was correct to conclude that par 1(b)(iii) of the directions could be divorced from the balance of the directions also should be rejected. Indeed, to adopt that approach would impermissibly alter the meaning of the directions contrary to the express terms of the directions and the reasoning of Applegarth J.

43 It will be necessary to return to consider the directions and, in particular, the argument that the Full Court of the Federal Court was bound by *Executor Trustee* to conclude that the directions determined conclusively against the Commissioner the application of Div 207 to the franked distributions in issue. Before doing that, reference should be made to the issue of the relevant income tax assessments and the subsequent commencement of the Pt IVC proceedings.

Audit and Amended Assessments

44 The Commissioner completed his audit in 2011. Notices of Amended Assessment were issued to, amongst others, Mr Thomas in relation to the 2006 to 2008 income years and MAPL in relation to the 2008 income year. Each lodged objections in relation to those assessments and, in May 2012, the Commissioner issued further Notices of Amended Assessment to Mr Thomas and MAPL ("the Amended Assessments"). Relevantly, Mr Thomas and MAPL challenged the Commissioner's Amended Assessment objection decisions

concerning the primary tax for the 2006 to 2008 income years and filed appeals pursuant to s 14ZZ in Pt IVC of the TAA in the Federal Court.

Part IVC proceedings

45 In the Pt IVC proceedings, the principal issues raised by the Amended Assessments were the legal effectiveness of the Bifurcation Assumption and, in turn, how Div 207 operated upon the resolutions purporting to "stream" the franking credits between Mr Thomas and MAPL.

46 The taxpayers contended that *Executor Trustee* required that the orders of Applegarth J conclusively determined the rights of Mr Thomas and MAPL, as beneficiaries, against the Trustee such that the Commissioner and the Court were bound by them, even if the result was wrong in law. The primary judge, Greenwood J, concluded that *Executor Trustee* did not bind the Commissioner or the Court. His Honour found that the Bifurcation Assumption was flawed in law and held that the appeals against the objection decisions should be dismissed.

Appeal to the Full Court of the Federal Court

47 The taxpayers successfully appealed to the Full Court of the Federal Court (Pagone J, Dowsett J and Perram J agreeing). Pagone J accepted that Div 207 did not operate to permit the Bifurcation Assumption. However, his Honour held that *Executor Trustee* required that although the Commissioner was not bound, or may not be bound, by the construction of Div 207 adopted in par 1(a) of the directions, the Court was bound by par 1(b)(iii) of the directions and that it followed that the taxpayers' appeals should be allowed.

48 That is, Pagone J accepted that the Commissioner was not bound by the construction of Div 207 adopted by Applegarth J, but stated that the relevant question was whether Applegarth J's orders "relevantly determined conclusively the rights of the beneficiaries as against the trustee in such a way that Div 207 would operate as the taxpayers contended"²⁷. After stating that Applegarth J's declaration in par 1(b)(iii) was perhaps surprising in its terms, Pagone J held that par 1(b)(iii) of the directions conclusively determined the beneficiaries'

27 *Thomas v Federal Commissioner of Taxation* (2017) 105 ATR 413 at 427 [25].

Kiefel CJ
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respective shares of the Trust's net income for the years covered by the directions²⁸.

49 In relation to the 2009 year of income (which was then in issue), Pagone J adopted the alternative construction of the resolutions²⁹, which has been described earlier in these reasons³⁰.

50 Dowsett J and Perram J agreed. Perram J held that Applegarth J's orders were valid and binding (apparently binding generally and without limitation) until set aside³¹.

Executor Trustee

51 In addressing the principal issue in this Court – whether, in the Pt IVC proceedings, the Full Court of the Federal Court was correct in holding that it was bound by *Executor Trustee*³² to conclude that the directions determined conclusively, against the Commissioner, the application of Div 207 to the franked distributions – it is necessary to consider the decision in *Executor Trustee*. As these reasons will explain, the Full Court of the Federal Court misunderstood and misapplied *Executor Trustee*.

52 In *Executor Trustee*, a testator had left directions for the application of his estate. The trustee applied to the Supreme Court of South Australia for, and was granted, directions as to the application of the estate³³. Dixon J described the orders made by the Supreme Court in the following terms³⁴:

28 *Thomas v Federal Commissioner of Taxation* (2017) 105 ATR 413 at 428 [27].

29 *Thomas v Federal Commissioner of Taxation* (2017) 105 ATR 413 at 428-430 [28]-[29].

30 See [6] above.

31 *Thomas v Federal Commissioner of Taxation* (2017) 105 ATR 413 at 415 [3].

32 (1939) 62 CLR 545.

33 *Executor Trustee* (1939) 62 CLR 545 at 556-557.

34 *Executor Trustee* (1939) 62 CLR 545 at 570.

"The orders define the interests of the six beneficiaries. It is true that they do not purport to give new interests and that in law they operate only as declarations determining, as between trustee and beneficiary, the interests otherwise existing, that is, arising under the will. *But it is none the less true that the beneficiaries can, after the making of the orders, have no interest in the land inconsistent with the orders.*" (emphasis added)

53

Contrary to those orders and declarations, the trustee, who had been a party to the earlier proceedings³⁵, sought to depart from those orders by claiming six deductions under the *Land Tax Assessment Act 1910* (Cth) on the footing that the six beneficiaries were *joint* owners of certain land, as persons entitled to its income in the will³⁶. The High Court held that the order of the Supreme Court had declared the position³⁷. As Latham CJ stated³⁸:

"The order of the Supreme Court is certainly *conclusive in relation to the rights inter se of the parties to the proceedings in which it was made*. It could have been challenged upon appeal, but so long as it stands, the rights of the annuitants to receive income from the trustee are the rights declared in the order – no more and no less. *There is no means whatever whereby either the trustee or the annuitants can, as a matter of right, vary those rights ...*

The question which arises in this appeal *depends entirely upon the rights of the annuitants against the trustee*. Those rights have been defined by a court of competent jurisdiction in a manner which excludes the definition of them now preferred by the annuitants – or any other definition inconsistent with the order of the court. The commissioner is entitled to take, and must take, interests in land as he finds them". (emphasis added)

35 *Executor Trustee* (1939) 62 CLR 545 at 561.

36 *Executor Trustee* (1939) 62 CLR 545 at 558.

37 *Executor Trustee* (1939) 62 CLR 545 at 559, 561, 570.

38 *Executor Trustee* (1939) 62 CLR 545 at 561.

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54 *Executor Trustee* is authority for the proposition that the general law rights of trustee and beneficiary *inter se*, to the extent that they are defined³⁹ by a decision made in duly constituted proceedings, are defined as against the Commissioner unless the decision is set aside⁴⁰. In *Executor Trustee*, the earlier proceedings had determined rights *inter se*. There was no question of *res judicata* or of issue estoppel, and the separate declaration did not generate rights *in rem* against third parties⁴¹. And, importantly, the earlier proceedings did *not* determine the application of the taxation law to those rights.

55 It follows that *Executor Trustee* is *not* authority for the proposition that the Commissioner, or a court under Pt IVC⁴², should determine the application of the taxing acts otherwise than according to law. "When the revenue authorities come to impose a tax in relation to such rights [defined by order of the court], they must ... take them as they in fact actually exist *between the parties*"⁴³ (emphasis added). But directions made under the equivalent of s 96 of the Trusts Act do not bind the Commissioner in the *application of the taxation laws*.

56 The Full Court of the Federal Court was wrong to conclude that it was bound by *Executor Trustee* to hold that the directions in the State Proceedings determined conclusively, against the Commissioner, the application of Div 207 to the franked distributions.

57 In these appeals, that conclusion is reinforced by the following facts and matters. First, the State Proceedings, under s 96 of the Trusts Act, had the primary function of providing advice to the Trustee respecting the management

39 *Executor Trustee* (1939) 62 CLR 545 at 562.

40 *Executor Trustee* (1939) 62 CLR 545 at 563.

41 *Executor Trustee* (1939) 62 CLR 545 at 562-563, 570.

42 See, eg, *Deputy Federal Commissioner of Taxation v Brown* (1958) 100 CLR 32 at 39; [1958] HCA 2; *FJ Bloemen Pty Ltd v Federal Commissioner of Taxation* (1981) 147 CLR 360 at 375-376, 378; [1981] HCA 27; *Deputy Commissioner of Taxation v Moorebank Pty Ltd* (1988) 165 CLR 55 at 67; [1988] HCA 29; *Deputy Commissioner of Taxation v Broadbeach Properties Pty Ltd* (2008) 237 CLR 473 at 495-496 [57]; [2008] HCA 41.

43 *Executor Trustee* (1939) 62 CLR 545 at 562.

or administration of the Trust⁴⁴. It is a procedure which, if adopted, not only protects a trustee from later complaint that he or she should have acted otherwise but also protects the trustee from personal liability for costs incurred⁴⁵. The question for the Supreme Court of Queensland under s 96 of the Trusts Act concerned the management and administration of the Trust. It was no part of proceedings under s 96 of the Trusts Act for the Court to decide how the taxing acts operate. And that conclusion is reinforced by two separate but interrelated facts: there was no contradictor in the State Proceedings; and the Commissioner was not a party to those proceedings. Not being party to the State Proceedings, the Commissioner was not bound by any orders made in those proceedings about the operation of the taxing acts⁴⁶. The nature and course of the State Proceedings necessarily determined the limited nature and effect of the directions.

58 Second, read as a whole, the directions were made on the basis that the Bifurcation Assumption, a question about how the *taxing acts* operate, was correct in law. That question was not a question suitable for determination in proceedings advising a trustee about how the trustee could lawfully administer the trust. At its highest, the advice given could only protect the trustee from later complaint⁴⁷. And the answer given to the question was incorrect.

59 Third, as the Commissioner submitted and as the preceding analysis of the directions demonstrates, the construction which the Full Court of the Federal Court placed on par 1(b)(iii) of the directions, when divorced from the balance of the directions, altered the meaning of the directions. Contrary to the approach adopted by the Full Court of the Federal Court, it was impermissible for the Court to pick out one sub-paragraph of the directions, par 1(b)(iii), and treat that sub-paragraph as somehow binding the Court, while at the same time ignoring par 1(a), which recorded and adopted the Bifurcation Assumption.

60 Finally, as the taxpayers conceded in argument, if the Bifurcation Assumption underpinned par 1(b)(iii) of the directions (and it did), then the Court was not bound by *Executor Trustee* to conclude that the directions (or one

44 See *Macedonian* (2008) 237 CLR 66 at 86 [45], 89 [58], 91-92 [64]-[65].

45 s 97 of the Trusts Act; *Macedonian* (2008) 237 CLR 66 at 86 [45], 92 [65].

46 *Executor Trustee* (1939) 62 CLR 545 at 562-563, 570.

47 See s 97 of the Trusts Act.

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sub-paragraph of the directions) determined conclusively against the Commissioner the application of Div 207 to the franked distributions. This is because, for the reasons explained earlier, the Commissioner and the Federal Court in proceedings under Pt IVC were each required to determine the taxation issues according to law.

61 The Attorney-General of the Commonwealth and the Attorney-General of the State of Queensland intervened to provide submissions concerning s 118 of the Constitution and the requirement in s 118 that "[f]ull faith and credit ... be given, throughout the Commonwealth to the laws, the public Acts and records, and the judicial proceedings of every State". The nature and scope of the State Proceedings and the directions having been identified, no issue concerning s 118 of the Constitution⁴⁸ arises for determination. Section 118 does not alter, or add to, the effect of the directions.

Alternative construction of the resolutions and the application of Div 207

62 The taxpayers contended that the resolutions in the 2006 to 2008 income years, properly construed, were effective in their terms to achieve the alternative construction adopted by the Full Court of the Federal Court.

63 Pagone J explained the alternative construction, in the context of the 2009 year, as follows⁴⁹:

"The terms of the two resolutions taken together only make sense if construed as conferring upon Mr Thomas, as a share of the trust's net income covered by s 97(1)(a) of the [1936 Act] in the 2009 year, so much of the [T]rust's net income for that year as would see him receive the benefit of franking credits in the amount stated in the franking credit distribution resolution notwithstanding that the amount of income purportedly distributed to him in the 2009 year was \$16,000 and to MAPL \$157,143."

64 His Honour noted that the alternative construction fitted uneasily with the words of the resolutions but stated that the construction was consistent with the

48 Or s 185 of the *Evidence Act* 1995 (Cth).

49 *Thomas v Federal Commissioner of Taxation* (2017) 105 ATR 413 at 430 [29].

intention of the Trustee reflected in the mind of the person drafting the resolutions.

65 As the Commissioner submitted, this alternative construction is contrary to the terms of the resolutions, and inconsistent with the bifurcated returns and the Trustee's intention⁵⁰.

66 As has been seen, there were two resolutions – the Net Income Resolution and the Franking Credit Resolution. The Net Income Resolution, in its terms, pooled all the income of the Trust and treated it on the same basis, with the result that the whole of the income of the Trust was distributed to Mr Thomas and MAPL. There was no attempt to stream or allocate the franked distributions to one beneficiary and the rest of the income to the other.

67 Division 207 sets out the effects, for tax, of the beneficiaries having received that income when, in each year, the income included the receipt by the trustee of franked distributions⁵¹. First, each beneficiary, for that income year, has an amount, described as a "share of the trust's net income for that income year [being the net income of the trust under s 95 of the 1936 Act] that is covered by [s] 97(1)(a) of the [1936 Act]"⁵². The task is to work out the amount notionally allocated to each beneficiary, as their share of the franked distributions, as was taken into account in working out each beneficiary's share of the trust's net income under s 97(1)(a) of the 1936 Act. Here, the Net Income Resolution allocated between the beneficiaries the whole of the net income for the purposes of s 97(1)(a) in the proportions consistent with the amounts stated in the resolutions. In the 2006 year, the proportions were the first \$21,600 of the net income to Mr Thomas and the balance to MAPL. There was no dispute that the net income of the Trust for that year was \$798,826 and that the proportions were approximately 2.7 per cent for Mr Thomas and 97.3 per cent for MAPL.

68 Next, s 207-55(3), operating with s 207-50(3)(b)(i), notionally allocated the franked distributions between Mr Thomas and MAPL in those same proportions. The franking credits were attached to, or on, the franked distributions.

50 See [30]-[32] above.

51 s 207-50(3)(a) of the 1997 Act.

52 s 207-50(3)(b)(i) of the 1997 Act.

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69 Third, s 207-57 then effected a statutory allocation of the franking credits (\$2,645,118) between those beneficiaries in the same proportions with the result that, in the 2006 year, \$71,418 was allocated to Mr Thomas and \$2,573,700 was allocated to MAPL.

70 As a result, there was no other income on which the second resolution – the Franking Credit Resolution – could operate. The Net Income Resolution had allocated all of the net income among the beneficiaries and there was simply no net income left over that was capable of being dealt with by the Franking Credit Resolution. Moreover, the Franking Credit Resolution, in its terms, was based on the Bifurcation Assumption, which the taxpayers accept is legally ineffective. That is, the Franking Credit Resolution seeks to have the Trustee, contrary to the 1997 Act (and the Deed), apply the franking credits as some kind of income (and they are not) separately from the franked distributions to which they are attached.

71 Moreover, it is not possible to read the two resolutions as a single composite resolution. Indeed, even if, as the Full Court of the Federal Court suggested, it was possible to take the two resolutions together, on their proper construction they fail to achieve a distribution of so much of the net income in each year such that Mr Thomas would receive the benefit of the franking credits stated in the Franking Credit Resolution. The 2006 year is illustrative of the problem. In the Net Income Resolution, only \$21,600 of the net income was distributed to Mr Thomas. That amount of income was never sufficient to match the \$2,416,218 of franking credits listed against Mr Thomas' name in the Franking Credit Resolution. The Net Income Resolution was considerably short.

72 The taxpayers' contention, in substance, that the Franking Credit Resolution is the resolution to be given primacy and that the Net Income Resolution is to be read as if, by some process of construction or amendment, the amount of net income distributed to Mr Thomas was increased from \$21,600 to match the \$2,416,218 of franking credits listed against Mr Thomas' name in the Franking Credit Resolution, is not only contrary to the express terms of the Net Income Resolution, it is contrary to law. A resolution of a company is a formal decision of the board of directors of the company recording a binding corporate action which must meet certain specific requirements⁵³. It is a

53 See s 248G of the *Corporations Act 2001* (Cth); *Gillfillan v Australian Securities and Investments Commission* (2012) 92 ACSR 460 at 464 [5]-[11].

collective resolution of the board of the company and it binds the company. If it is to be amended, then it is a matter for the collective resolution of the board of the company.

73 The net income distributed to Mr Thomas in the 2006 year was \$21,600, not some greater amount. Moreover, the alternative construction does *not* give effect to the intention of the Trustee when the two resolutions were passed in each of the 2006 to 2008 years of income⁵⁴. The Trustee endeavoured to ensure that all trust income was distributed to avoid the operation of s 99A of the 1936 Act and to ensure that the distribution occurred in a way that maximised the refundable tax offsets available only to Mr Thomas, whilst at the same time minimising Mr Thomas' tax rate. That was the intention, although as the taxpayers now accept, that was legally ineffective under Div 207. The alternative construction is not open factually or legally and it should be rejected.

Notices of contention

74 The taxpayers sought to raise three further issues by way of notices of contention: estoppel by convention, rectification and a denial of procedural fairness. Each contention should be dismissed.

Estoppel by convention

75 The taxpayers contended that because the Trustee and the relevant beneficiaries of the Trust were all present when the resolutions were passed, and then acquiesced in the tax returns being lodged with the Commissioner, the rights between the beneficiaries were fixed by the actions of the Trustee and the Commissioner was estopped by convention from administering the taxing acts according to law and, instead, had to "assess in accordance with those rights".

76 That contention is flawed. Estoppel by convention is founded on the conduct of relations between identified parties on an agreed or assumed state of facts which the parties are estopped from denying⁵⁵. The immediate difficulty for

54 See [30]-[32] above.

55 *Con-Stan Industries of Australia Pty Ltd v Norwich Winterthur Insurance (Australia) Ltd* (1986) 160 CLR 226 at 244; [1986] HCA 14. See also *Fischer v Nemeske Pty Ltd* (2016) 257 CLR 615 at 647 [87], 675 [196]; [2016] HCA 11.

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the taxpayers was and remains that the Commissioner was not a party to⁵⁶ and played no part in the adoption of⁵⁷ either aspect of the alleged assumption – the making of the resolutions or the lodging of the income tax returns.

77 Moreover, the justice of an estoppel would not permit parties to create a private arrangement which produced an outcome contrary to law or produced an outcome which required a statutory officer to administer the taxing statutes⁵⁸ other than according to law. That was, in substance, the effect of the taxpayers' contention. That contention was flawed: the Commissioner is obliged to administer the taxing statutes according to law.

Rectification

78 If the Court did not accept that it was bound by the construction of the resolutions adopted by Applegarth J in the Supreme Court of Queensland, the taxpayers sought rectification of the resolutions.

79 As counsel for the taxpayers conceded in argument before this Court, as the taxpayers' application for rectification of the resolutions had been dismissed by Applegarth J, the taxpayers were bound by that decision, and the taxpayers could not now seek to raise that issue in these proceedings. That concession was properly made and is a complete answer to the question of rectification of the resolutions. The other difficulties with the application for rectification are unnecessary to address.

Denial of procedural fairness

80 As noted earlier, s 207-55 of the 1997 Act seeks to ensure that the amount of a franked distribution made to a trustee is allocated notionally amongst the beneficiaries who derive benefits from that distribution and that the allocation corresponds with the way in which those benefits were derived. Its sub-sections provide the mechanisms to achieve that objective. Section 207-55(2) provides that the amount notionally allocated, described as a *share* of the franked

56 *Con-Stan* (1986) 160 CLR 226 at 244.

57 *Grundt v Great Boulder Pty Gold Mines Ltd* (1937) 59 CLR 641 at 675; [1937] HCA 58.

58 ss 3A and 4 of the TAA and s 8 of the 1936 Act.

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distribution, does not have to be received by the beneficiary. The table in s 207-55(3) provides the method for determining the share amount⁵⁹. No other step is necessary.

81 It was common ground that the additional step imposed by the primary judge – that evidence be adduced of how much of the amount of the franked distributions was taken into account *by the Trustee* in working out the particular beneficiary's share of the s 95 net income – was not the subject of submissions from the parties.

82 By the parties' respective appeals to the Full Court of the Federal Court, that legal question was before that Court. Any denial of procedural fairness was therefore addressed by those appeals and is no longer operative. To the extent that the taxpayers sought to have the proceedings remitted to the primary judge to adduce further evidence in relation to the actual distributions of income that were made in the 2006 to 2008 income years, that application should be rejected. An application by the taxpayers to the primary judge for leave to reopen to adduce that evidence was refused. If the taxpayers wished to raise that issue in this Court, they should have sought leave to file a cross-appeal. No such cross-appeal was filed.

Conclusion and orders

83 For those reasons, the following orders should be made:

Matter No B60/2017

1. The appeal be allowed in respect of the income years ending 30 June 2006, 30 June 2007 and 30 June 2008.
2. The cross-appeal be dismissed.
3. Set aside order 1 of the Full Court of the Federal Court of Australia made on 12 April 2017 in Matter No QUD72/2016 and orders 1, 2, 3 and 4 of that Court made on 3 August 2017 in Matter No QUD72/2016, and in their place make the following orders:
 - (a) the appeal be allowed in part;

⁵⁹ See also s 207-50(3)(b) of the 1997 Act and ss 95 and 97(1)(a) of the 1936 Act.

Kiefel CJ
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- (b) the cross-appeal be allowed;
 - (c) the objection decisions in respect of the income years ending 30 June 2006, 30 June 2007 and 30 June 2008 be remitted to the Commissioner of Taxation of the Commonwealth of Australia for determination in accordance with the reasons of this Court;
 - (d) the objection decision in respect of the income year ending 30 June 2009 be remitted to the Commissioner of Taxation of the Commonwealth of Australia for determination in accordance with the orders of Greenwood J made on 26 November 2015 in Matter No QUD274/2012 and otherwise in accordance with the law.
4. The respondent pay the appellant's costs of the appeal except for those costs that relate to the determination of the matters concerning the income year ending 30 June 2009.
5. The appellant pay the respondent's costs of the appeal insofar as those costs relate to the determination of the matters concerning the income year ending 30 June 2009.

Matter No B61/2017

1. The appeal be allowed.
2. Set aside order 1 of the Full Court of the Federal Court of Australia made on 12 April 2017 in Matter No QUD78/2016 and orders 1, 2, 3 and 4 of that Court made on 3 August 2017 in Matter No QUD78/2016, and in their place make the following orders:
- (a) the appeal be dismissed;
 - (b) the cross-appeal be allowed;
 - (c) the objection decision in respect of the income year ending 30 June 2008 be remitted to the Commissioner of Taxation of the Commonwealth of Australia for determination in accordance with the reasons of this Court.
3. The respondent pay the appellant's costs of the appeal.

Kiefel *CJ*
Bell *J*
Keane *J*
Nettle *J*
Gordon *J*
Edelman *J*

25.

Matter No B62/2017

1. The appeal be dismissed.
2. The appellant pay the respondent's costs.

Matter No B63/2017

1. The appeal be dismissed.
2. The appellant pay the respondent's costs.

84 GAGELER J. Tax lawyers often speak of "taxable facts"⁶⁰. They mean by that expression to refer to more than just facts. They mean by it to refer to the combination of events that have occurred and legal consequences of events that have occurred on which a taxing statute fixes to impose a taxation liability or to confer a taxation benefit.

85 Most often, taxable facts are independent of and antecedent to their taxation consequences. That is because, most often, a taxing statute will operate upon "the result of a taxpayer's activities as it finds them"⁶¹.

86 *Executor Trustee and Agency Co of South Australia Ltd v Deputy Federal Commissioner of Taxes (SA)*⁶² was concerned with identification, on an appeal against an assessment, of taxable facts of that independent and antecedent nature.

87 The taxpayer in *Executor Trustee* was the trustee of the unsold residue of land devised by a will. The taxpayer claimed certain deductions from land tax. The taxing statute permitted those deductions only if the remaining beneficiaries under the will were each "entitled to ... the income" from the land⁶³. The Commissioner disallowed the deductions by the taxpayer in assessing the taxpayer to land tax. The taxpayer appealed against the assessment. The appeal was to the High Court in its original jurisdiction. The taxpayer argued on the appeal that the will, properly construed, gave each of the remaining beneficiaries a life interest in the income from the land held on trust.

88 The difficulty for the taxpayer was that, nearly twenty years before the tax year to which the assessment related, the Full Court of the Supreme Court of South Australia had construed the will differently in a proceeding to which the trustee and all persons having an apparent interest in the will had been parties. The Supreme Court had made an order which, in effect, declared that the will on its proper construction conferred on the remaining beneficiaries no entitlement to any of the income of the trust but only an ability to receive income from the trust as a result of the exercise of discretion on the part of the trustee. No party had appealed that declaration. The trustee had acted consistently with the declaration

60 Eg *Bailey v Federal Commissioner of Taxation* (1977) 136 CLR 214 at 217; [1977] HCA 11.

61 *Magna Alloys and Research Pty Ltd v Federal Commissioner of Taxation* (1980) 33 ALR 213 at 222, 233, quoting *Tweddle v Federal Commissioner of Taxation* (1942) 180 CLR 1 at 7; [1942] HCA 40.

62 (1939) 62 CLR 545; [1939] HCA 35.

63 See *Executor Trustee and Agency Co of South Australia Ltd v Deputy Federal Commissioner of Taxes (SA)* (1939) 62 CLR 545 at 558.

in exercising discretion to distribute trust income over the ensuing years, including in the tax year to which the assessment related.

89 On a case stated for the consideration of the Full Court of the High Court in the appeal against the assessment, no member of the Full Court accepted the taxpayer's argument based on the construction of the will. Four of the five members rejected the argument for the reason that the argument contradicted the legal effect of the will as declared by the order of the Supreme Court. The explanations given by three of those four members were terse.

90 The explanation given by Latham CJ as to why the order of the Supreme Court of South Australia was to be treated on the appeal against the assessment as establishing the entitlements of the remaining beneficiaries under the will was more expansive. For present purposes, that explanation is instructive. His Honour's explanation was substantially as follows.

91 Except in relation to evasive arrangements, which the taxing statute in question itself rendered void against the Commissioner, the Commissioner was obliged in the administration of the taxing statute to take interests in land and in income from land as the Commissioner found them. The order made by the Supreme Court of South Australia might have been challenged on appeal. If made collusively or fraudulently, the order might in the alternative have been able to be set aside on the application of the Commissioner in the original jurisdiction of the Supreme Court. For so long as the order stood, however, such rights as the beneficiaries had, against the trustee and against other persons potentially interested, to receive income from the trust were "the rights declared in the order – no more and no less"⁶⁴.

92 The explanation continued⁶⁵:

"This view of the effect of the order does not treat it as an order *in rem*. The order really has the same kind of effect as the will it interprets. The will plus the order (that is, the will as interpreted by the order) is the foundation and only support of the rights in relation to which alone the commissioner can properly assess taxation. Perhaps the will 'ought' to have been different. Perhaps the order 'ought' to have been different. The first proposition is irrelevant and, for material purposes, is meaningless. I describe the second proposition in the same way."

93 Put in other words, whether the Supreme Court of South Australia had been "right" or "wrong" in its construction of the will, the Supreme Court had in

64 (1939) 62 CLR 545 at 561.

65 (1939) 62 CLR 545 at 562.

fact made an order which operated under the general law finally to determine the legal entitlements of the beneficiaries as between them, the trustee and all other persons who had an apparent interest in the will. The legal entitlements of the beneficiaries under the will, as declared in the order made by the Supreme Court, were the taxable facts on which the taxing statute operated.

94 Turning from that case to this one, the order made by Applegarth J in the Supreme Court of Queensland purported on its face to be more than mere directions to the Trustee. The order purported on its face to be also a declaration, made in the general jurisdiction of that Court, which determined the legal entitlements of Mr Thomas and MAPL flowing from the Net Income Resolution and the Franking Credit Resolution having regard to the proper construction of those resolutions and to the proper construction of the deed which established the Trust. For my own part, I see no reason to treat the order otherwise.

95 Like the order of the Supreme Court of South Australia considered in *Executor Trustee*, the order of the Supreme Court of Queensland has not been challenged on appeal and has not been set aside in the original jurisdiction of that Court on the ground of fraud or collusion. Had the order done no more than to determine the general law rights of Mr Thomas and MAPL which flowed from the Net Income Resolution and the Franking Credit Resolution, the present case would to my mind be indistinguishable from *Executor Trustee*. But, had the order done only that, it would have been a different order.

96 The taxpayers' invitation to take one sub-paragraph of the order (sub-par 1(b)(iii)) and to treat that sub-paragraph alone as declaring the respective rights of Mr Thomas and MAPL to a specified franked income stream is an invitation to treat that sub-paragraph of the order as saying something that it does not say. The order must be read as a whole and in light of the reasons for judgment of Applegarth J to which the order was drafted to give effect. Neither in form nor in substance can the sub-paragraph be severed from par (a) and from the preceding sub-paragraphs of par (b). The order as a whole is concerned with the respective rights of Mr Thomas and MAPL to franking credits.

97 To my mind, the essential difference between the order of the Supreme Court of Queensland and the order of the Supreme Court of South Australia considered in *Executor Trustee* lies in the subject matters with which those orders deal. Unlike the subject matter of the order in *Executor Trustee*, the subject matter of the order in the present case is not a taxable fact which exists independently of and antecedently to the operation of the relevant taxing statute. The subject matter of the order – franking credits – exists neither in nature nor under the general law. The subject matter has no existence other than through the operation of a taxing statute, specifically Div 207 in Pt 3-6 of the 1997 Act.

98 Irrespective of whether the order of the Supreme Court of Queensland is right or wrong in its understanding of the operation and effect of the taxing

statute, that order can have no effect on the operation of the taxing statute or on the administration of that statute. In the event, the Supreme Court order is wrong, because it was based on the erroneous Bifurcation Assumption. The critical point, however, is that the Supreme Court order is simply irrelevant to the making of the assessments and is simply irrelevant to the determination of any question of fact or of law arising on the appeals against the objection decisions under Pt IVC of the TAA.

99 As Greenwood J correctly recognised at first instance, the jurisdiction and duty of the Federal Court on the appeals against the objection decisions was to determine for itself all contested questions of fact and law which bore on the taxation consequences of the Net Income Resolution and the Franking Credit Resolution⁶⁶.

100 Subject to those observations, I agree with the reasoning of the plurality and join in the orders proposed.

66 *Thomas v Federal Commissioner of Taxation* (2015) 101 ATR 576 at 644 [446].