TAXATION TREATMENT OF PUBLIC UNIT TRUSTS

by K.R. Wilson.*

An important financial development in recent times has been the rapid increase in growth of public unit trusts. This can be explained largely by the fact that such trusts provide an effective means of pooling the resources of individuals, and indeed smaller institutions, so that they may together obtain the investment advantages available to large institutions. To take the so-called 'property trusts' as an example, it can be readily seen that they provide an ideal vehicle to mobilize the vast amounts of capital necessary to engage in modern property development. But these trusts also offer to their investors important taxation advantages through 'gearing' and long-term investment strategies. As a common feature, 'managed trusts' (or 'growth' trusts) offer to investors a return largely, or even wholly, from increases in the value of trust properties — a prima facie capital gain not subject to income tax. In most cases expenses associated with the trust properties, in particular interest on monies borrowed to acquire them, are sufficient to offset substantially, if not wholly, rental income — the concept of 'gearing'.

The basic principle of the property trusts (both fixed and growth), as with various other varieties of unit trust such as cash management, share management and so on, is that a unit trust is constituted by the vesting of property (either in the form of cash or investments) in a Trustee who is bound by a trust deed to deal with it as directed by Managers. A unit trust is normally constituted by a trust deed made between a management company (the Manager) and a corporate trustee (the Trustee) for the benefit of beneficiaries (the Unitholders) whose participation in the trust is evidenced by the issue of unit certificates.[1] A unitholder takes an equitable interest in all the trust property held by the trustee for the time being, subject to the terms of the trust deed. Thus, the unit trust is like any other trust and the trustee has the same duties and obligations and is subject to the same liabilities as apply to any other trusts. A unit trust may be a 'fixed' trust or a 'managed' or 'growth' trust. A fixed trust comprises a set portfolio of investments, variable only in exceptional circumstances, and the unitholders depend primarily on the income produced by those investments to gain short to medium term returns. A managed trust or growth trust gives the trustee comprehensive powers to vary, at his discretion, the nature and mix of investments. It is that latter type of public unit trust which therefore seeks to provide short to medium term returns to its investors through sale of the trust assets themselves, and it is the type of trust with which this article is largely concerned.

The unit trust differs from a partnership in that, unlike the latter, the unit trust lacks any contractually created association between its unitholders, who have no rights or obligations to each other[2] and have no control over assets. Any contractual association between unitholders[3] could create a difficulty in that the Commissioner of Taxation may regard the

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1. M. Day and P. Harris, *Unit Trusts — The Law and Practice* — (1974) at 12.
2. *Smith* v. *Anderson* (1880) 15 Ch.D. 247.
3. See H.A.J. Ford, 'Unit Trusts', 23 *M.L.R.* 129.

trust as an unincorporated association and assess it as a company[4] with the attendant company tax rate of 46%. The unit trust differs also from a company in that a limited company may not reduce its issued share capital except in compliance with the conditions prescribed by statute (including confirmation of the reduction by the Court). This means in practice that if an investor is the holder of shares in a company, he cannot realise his investment by requiring the company to repurchase his shares.[5] Thus a Stock Exchange listing is necessary if a ready market for those shares is desired. By contrast, a trust can overcome that difficulty by providing a mechanism in the trust deed to allow the investor to realise his investment by selling units back to the trust. A further distinction between a unit trust and a company is that the former is not a separate legal entity like the latter but its unitholders do have a beneficial interest in the trust property, whereas members of a company have no such interest in the company's assets. Further, all the unitholders of a unit trust, if *sui juris* and together entitled to the whole beneficial interest under the trust, may at any time bring the trust to an end and require the proceeds of sale of the trust property to be distributed to them pro rata to their holdings in satisfaction of their rights under the trust.[6] The members of a company have no such right except indirectly by making an application to the court to wind up the company and distribute assets remaining after satisfaction of debts.[7] As Dixon C.J., Kitto and Taylor JJ. stated in *Charles v. F.C. of T.*[4]:—

> A share confers upon the holder no legal or equitable interest in the assets of the company; it is a separate piece of property; and if a portion of the company's assets is distributed among the shareholders the question whether it comes to them as income or as capital depends upon whether the corpus of their property (their shares) remains intact despite the distribution. But a unit under the trust deed before us confers a proprietary interest in all the property which for the time being is subject to the trust of the deed : *Baker* v. *Archer Shee* [1927] AC 884; so that the question whether monies distributed to unitholders under the trust form part of their income or of their capital must be answered by considering the character of those monies in the hands of the trustees before the distribution is made.[8]

In this article it is proposed to examine some aspects of taxation law which apply, or may apply, to managed public unit trusts and their unitholders under the following heads:

1. general taxation liability of trust beneficiaries for payments received;
2. particular taxation liability of trust beneficiaries under the 'capital gains' provisions of the Income Tax Assessment Act 1936, as amended (hereinafter referred to as the Act);
3. taxation liability of the trustee;
4. taxation liability where net income of a trust (as internally calculated) exceeds net income calculated pursuant to the Act, and the converse situation.

Most unit trust deeds provide that unitholders are presently entitled to the trust income.[9] For the purposes of this article it will be assumed that this is the case.[10]

1. General Taxation Liability of Beneficiaries

In the majority of cases, provided the net income of the trust (using that expression here to mean 'taxable income' of the trust) for each income year is distributed in full to the unitholders, it will be they who bear the taxation liability for that income rather than the

4. Income Tax Assessment Act, 1936, as amended, extended definition of company in s.6(1).
5. Save by court order, e.g. under Companies (Qld) Code S.320(2)(f).
6. *Saunders* v. *Vautier* (1841) 4 Beav. 115.
7. E.g. under Companies (Qld)Code S364(l)(j) on the grounds that it is just and equitable.
8. (1953-54) 90 C.L.R. 598 at 609.
9. As to the general meaning of this see *Whiting* v. *F.C. of T.* (1943) 68 C.L.R. 199 and *Taylor* v. *F.C. of T.* (1970) 119 C.L.R. 444.
10. S.99A of the Act provides for the situation where no beneficiary is presently entitled.

trustee. Section 95(1) of the Act defines 'net income' as the total assessable income of the trust estate, calculated as if the trustee were a resident taxpayer, less all allowable deductions except concessional deductions and deductions in respect of income equalization deposits. Special provision is also made in respect of life tenants and beneficiaries with no beneficial interest in corpus.

In *Syme* v. *Commissioner of Taxation (Vic.)*[11] Lord Sumner said:

> What was the produce of personal exertion in the trustees' hands till they part with it does not in the instant of transfer suffer a change, and become the produce of property and not of personal exertion, as it passes to the hands of the cestui que trust.

It is apparent from this passage that taxation of monies distributed to unitholders in a unit trust would depend upon the character of those monies in the hands of the trustees prior to distribution. This proposition is clearly supported by the High Court in *Charles* v. *F.C. of T.*,[12] in the passage earlier quoted from that case. Thus, if a distribution is one of income profits derived by the trust, it will constitute income in the hands of the recipient unitholder and be prima facie assessable under s.25(1) of the Act. On the other hand, if a distribution is one of capital profits it will not be assessable under s.25(1) but may be assessable under the 'capital gains' provisions of the Act. In those cases where a distribution is comprised of both income and capital elements, it will be necessary to apportion it according to its component parts in order to ascertain that portion of it which constitutes assessable income under s.25(1) of the Act. In this case it would seem that the onus lies on the taxpayer to satisfy the Commissioner that such a distribution is not one made up entirely of income profits, and to demonstrate the appropriate proportions.

It is not proposed here to discuss the types of activities in which a unit trust may engage so as to make capital profits and those types which will produce income profits. In the vast majority of cases the nature of profits derived will be determined according to the ordinary concepts of income and capital. As the High Court has indicated in *Colonial Mutual Life Assurance Society Ltd* v. *F.C. of T.* [13] this question must be determined 'in accordance with the ordinary usages and concepts of mankind, except in so far as the Act states or indicates an intention that receipts which are not income in ordinary parlance are to be treated as income'. It is important to note, however, that if the unit trust can be said to be in the 'business' of buying, selling or developing assets then what is prima facie a capital profit will in fact be held to be an income profit. Income from business is in the terminology of the Act, a subdivision of income from personal exertion. That is, the definition in s.6(1) of the latter phenomonen encompasses 'the proceeds of any business carried on alone or in partnership'. There is no definition of business in the Act, and no satisfactory definition provided by other means. In the event of an argument as to whether or not a certain transaction amounts to generating 'proceeds of business' rather than a prima facie capital gain, the court can only look to the circumstances for evidence of indicia which might resolve the matter. There are many cases which focus upon the issue of whether a business is being carried on; a classic instance is *California Copper Syndicate* v. *Harris.*[14] Lord Justice Clerk in that case makes clear the importance of making the correct characterization of a transaction:

> ... Where the owner of an ordinary investment chooses to realize it, and obtains a greater price for it than he originally acquired it at, the enhanced price is not profit ... assessable to income tax. But it is equally well established that enhanced values obtained from realization or conversion of securities may be so assessable, where what is done is not merely a realization or change of investment, but an act

11. [1914] A.C. 1013.
12. *Supra* n.8.
13. (1946) 73 C.L.R. at 615.
14. (1904) 5 T.C. 159.

done in what is truly the carrying on, or carrying out of a business. The simplest case is that of a person or association of persons buying and selling lands or securities speculatively, in order to make gain, dealing in such investments as a business, and thereby seeking to make profits.

In *London Australia Investment Co Ltd* v. *F.C. of T.* [15] the taxpayer was a company incorporated in New South Wales with the principal object under its memorandum of association of carrying on the business of an investment trust company, and it did conduct such a business, but did not carry on any business in Australia other than investment in Australian companies with a view to the production of an income from dividends. The policy followed by the taxpayer was to invest in a number of shares in listed public companies in Australia from which it could be expected that the taxpayer could immediately or within a reasonable time obtain a consistent dividend yield of four percent or better. In order to maintain such a desired consistent yield, it was advisable, if not indeed necessary, from time to time to realize such shares as, by reason of changes in market value or dividends paid, ceased to provide a yield of four per cent or better. With that purpose in view, it was another special matter of policy followed by the taxpayer that the shares so acquired should be readily marketable so that they could be disposed of in the event that a change of investment became necessary or desirable. Although in the case of such investment-switching sales of shares an excess over the price originally paid could be obtained, this was not a result sought by the taxpayer for its own sake. The taxpayer's articles of association precluded the use of any such excess for the payment of dividends to shareholders; sums so obtained had to be held in an equalization account designed to protect the invested capital, and from this account amounts could be carried, in the discretion of the directors of the company, to a capital reserve. Dividends were payable only out of the income derived from dividends on shares held by the taxpayer. Apart from these investment-switching sales of shares, the taxpayer did not purchase or otherwise acquire shares in order to make a profit by the resale thereof.

In consequence of the pursuit of its investment policy, the taxpayer bought and sold shares on a considerable scale from the time of its commencement in 1957. In the relevant tax years 1967, 1968, and 1969, there was a large surplus on realization because of very substantial investment-switching sales, principally because of considerable increases in market values in those years of certain of the shares in the taxpayer's investment portfolio, which increases, because of the consequential fall in yield, caused the taxpayer to sell the shares concerned.

It was held by the High Court, by Gibbs and Jacobs JJ., Barwick C.J. dissenting, that the primary judge was correct in his finding that the sums concerned formed part of the income of a business carried on by the taxpayer.

Gibbs J.[16] referred to the test in *Californian Copper Syndicate* v. *Harris*[17] and said that in the case of an investment company carrying on a business, if sales of shares are acts done in what is truly the carrying on of an investment business the profits will be taxable just as they would have been if the business had been that of banking or insurance. The taxpayer systematically sold its shares at a profit for the purpose of increasing the dividend yield of its investments, and such sales were normal operations in the course of carrying on the business of investing for profit; the sales were not of the nature of mere realizations or changes of investments.

Jacobs J.[18] held that although a frequent activity of acquisition and resale does not necessarily constitute a business, this was evidence from which it could be inferred that

15. (1977-78) 138 C.L.R. 106
16. *Ibid.* at 116.
17. *Supra* n.14.
18. *Supra* n.15 at 129.

there was a business in that respect. The taxpayer's investment policy envisaged regular and frequent sales of the shares acquired, and, in pursuance of that policy, investment-switching sales had thus been conducted on a very large scale. It was no answer to say that if the share prices did not fall proportionately to a lowered dividend, so that a lowered return on market price would be currently received, the investment policy would require sale, even at a loss. The taxpayer's dealings took place on a market which was regarded by the taxpayer as having growth potential; a rising, not a falling market was expected, and it was on that expectation that the investment policy was based. The sums in question therefore represented income within the meaning of s.25(1) of the Act.

In *F.C. of T.* v. *Whitfords Beach Pty Ltd*[19] the High Court again examined the taxation ramifications of large-scale property sales and development. The facts of that case, though complex, are well known and it is not proposed to set them out here; they are fully detailed in the judgment of Wilson J.[20] The Commissioner had contended that profits from the scheme carried out by the taxpayer were assessable as income under s.25(1) of the Act; a majority (Gibbs C.J., Mason and Wilson JJ.) held that contention to be correct. In view of the doubts created by this decision as to the scale of activity necessary to 'cause' realization of capital assets to be regarded as the carrying on of a business there can be no hard and fast rules as to potential circumstances in which the trading activities of a unit trust may give rise to 'capital' distributions being held assessable in the hands of the recipient under s.25(1) of the Act. Given the views expressed by Gibbs C.J., Mason and Wilson JJ. in the High Court in *Whitfords Beach* and those expressed by Deane J. in the Federal Court hearing of that case,[21] it seems that a majority of the present High Court would require perhaps less 'activity' than was required in some of the earlier cases such as *McClelland*[22] or *Scottish Australian Mining*.[23] If all the cases agree on one thing however, it is that each case must be decided according to its own facts, and no hard and fast rule can be applied.

2. Capital Gains Provisions

Where a unit trust sold trust investments within twelve months of the date of purchase, s.26AAA of the Act would apply to render any profits from such sale assessable income and therefore on the principle of *Charles* v. *F.C. of T.*,[24] any distribution of such profits would be taxable in the hands of the recipient unitholder. Given that a trustee is unlikely to take such action unless in the most exceptional circumstances, it will be s.25A of the Act that causes concern. This section was inserted in 1984, replacing the old s.26(a) and introducing new provisions principally connected with the 'first limb' of the old section. The new provisions are lengthy and it is not proposed to set them out here. Section 25A(1) is couched in exactly the same terms as the old s.26(a).

The 'first limb' of s.25A) (1) includes in a taxpayer's assessable income profit 'arising from the sale by the taxpayer of any property acquired by him for the purpose of profit-making by sale . . .' In *F.C. of T.* v. *Whitford's Beach Pty Ltd*[25] it was not, and could not be, argued that the taxpayer was assessable under such a provision because it was shares that had been acquired and land that had been sold; for the first limb to operate there must

19. (1982) 56 A.L.J.R. 240.
20. *Ibid.* at 252.
21. (1979) 44 A.L.R. 312.
22. *McClelland* v. *F.C. of T.* (1970) 120 C.L.R. 487.
23. *Scottish Australian Mining Co Ltd* v. *F.C. of T.* (1950) 81 C.L.R. 188. Gibbs C.J. in *Whitford's Beach* does not actually criticize the decision in *Scottish Australian Mining* — *quaere* whether he may be said to have tacitly approved it.
24. *Supra* n.8.
25. *Supra* n.19.

be common identity between what is bought and what is sold.[26] Section 25A(2) will now operate to deem shares in a private company, or an interest in a partnership or private trust estate sold after 23 August 1983, to have been acquired for the purpose of profit-making by sale in circumstances where, at the time of sale, the company, partnership or trustee, as the case may be, held property which had been acquired for the purpose of profit-making by sale. The sub-section also applies where the sale of the shares or interest carries with it the effective disposal of an indirect interest in property acquired by another company, partnership or trust. It will not apply, however, where the property held by the company, partnership or trust is 'excepted property' i.e. trading stock or depreciable plant. Section 25A(3) vests in the Commissioner a discretion not to invoke s.25A(2) subject to the matters therein set out. Section 25A(4) will include in the assessable income of a taxpayer profits from the sale of bonus shares or rights, where bonus shares or rights are issued by a company after 23 August 1983, as a result of the taxpayer holding shares in a company which were acquired for the purpose of profit-making by sale. Section 25A(5) will, in certain circumstances deem a transferee of property under a transfer after 23 August 1983 to have acquired the property for the purpose of profit-making by sale where the transferor of the property had acquired the property for that purpose, for example where the transferee acquired it as a result of a bequest or devise (as in *McClelland* v. *F.C. of T.*[27]) or as an unsolicited gift (as in *F.C. of T.* v. *N.F. Williams*[28]). Thus it will no longer be necessary as in the first limb of S.26(a) for there to be an acquisition of property by means of some positive act of the taxpayer's own volition. Section 25A(6) is designed to make clear that there need not be strict legal identity between property acquired by a taxpayer for resale at a profit and the property actually sold by the taxpayer for s.25A(1) to apply.

One problem with the former s.26(a) was that the 'profit' to be assessable was not defined in the Act. It was only mentioned in s.26(a) as 'profit arising from etc. . . .' so that there could be argument as to the amount of profit to be assessed. Sub-section (9) of s.25A provides that the income of the taxpayer is to include so much of the proceeds of sale as the Commissioner considers appropriate having regard to the factors specified in sub-section (10). J. Mannix in a recent article criticizes this wide discretion given to the Commissioner and states:

> The recent amendments to Section 26(A) [sic] dealing with property bought for resale at a profit again give the Commissioner enormous discretion. Sub-section (9) of the new Section 25A provides that the income of the taxpayer is to include as much of the proceeds of sale as the Commissioner considers appropriate. One practical consequence of these provisions is that the taxpayer is effectively denied a right of appeal where he disagrees with the Commissioner's assessment. Where the exercise of discretion by the Commissioner is challenged, the taxpayer must take it to a Board of Review, since a Court has no power to review such decisions. Delays before Boards of Review are up to eight years and growing. The present legislation forces taxpayers to pay what the Commissioner considers they ought to pay, and if they disagree they must join the queue to be heard before a Board of Review, probably some time in the 1990's.[29]

It should be noted that, whilst it is generally true that the taxpayer is obliged to challenge an exercise of the Commissioner's discretion in the Board of Review, there are certain limited circumstances in which a court would have jurisdiction to deal with the matter. In

26. *Ibid.* per Gibbs C.J. at 244. See also *Steinberg* v. *F.C. of T.* (1975) 134 C.L.R. 640, per Gibbs J. at 695.
27. *Supra* n.22.
28. 72 A.T.C. 488.
29. Business Review Weekly, June 16-22, 1984 at 129.

Avon Downs Pty Ltd v. *F.C. of T.*[30] Dixon J. set out the circumstances under which a court can intervene. Briefly these are:—

(a) If the Commissioner does not address himself to the question formulated by the section;
(b) If the conclusion is in some way affected by a mistake in law;
(c) If the Commissioner considers extraneous reasons or matters;
(d) If the Commissioner has excluded a factor which would have determined the matter.[31]

It seems that even if the Commissioner, as is common, does not disclose reasons, a Court may still intervene where it is able to conclude that the Commissioner's decision is founded on some misconception having regard to the available evidence.[32]

It is not proposed to discuss further the possibilities which clearly arise from the granting of such a discretion in terms of future amendments to the Act, which may well be increasingly based on the vesting of a discretion in the Commissioner.

In relation specifically to property growth trusts, the Commissioner has indicated (in December 1982[33]) that property intended to be held in the 'longer term' i.e. more than ten years, where the trustee's powers to buy and sell property 'do not permit too much scope', will not give rise to profits on sale being regarded as assessable when distributed to unitholders. Conversely, the 'shorter term' property growth trusts, i.e. those with sales in less than ten years, will provide 'strong grounds' for the conclusion that the trust properties were acquired for re-sale at a profit, thus making the profits assessable under the first limb of s.25A(1). As with *Charles Case,*[34] the difficulty will be one of proof, here as to the intended 'prospective life' of the trust concerned. No doubt much reliance will be placed on statements contained in the relevant prospectus, particularly when the trust deed itself is uncertain or ambiguous on the matter.

A device which has been recently employed by property growth trusts in order to avoid possible assessments under s.25A(1) is to revalue trust properties after a certain period and distribute the increased value to unitholders via bonus units. This it would seem *prima facie* escapes the 'capital gain' provisions of the Act; it should be noted that s.25A(2) speaks of 'private trusts' and does not seem to apply to public unit trusts. A private trust is defined in s.25A(12)(c) of the Act as:—

> a trust estate other than a unit trust the units in which are listed for quotation in the official list of a stock exchange in Australia or elsewhere or are ordinarily available for subscription or purchase by the public.[35]

Thus, the mere issue of bonus units to a unitholder of the trust does not of itself create any taxation liability. Regard must be had, however, to the position of the unitholder when he wishes to dispose of his units for cash. If a unitholder cashes in or sells the original units which he has purchased then any profits made on such sale or cashing in will be assessable if:

(a) the units were not held for more than 12 months (S.26AAA);
(b) the units were acquired by the taxpayer for resale at a profit or as part of a profit making undertaking or scheme (S.25A(1)); or

30. (1949) 4 A.I.T.R. 195 at 211-12.
31. See also *Kolotex Hosiery (Australia) Pty Ltd* v. *F.C. of T.* (1975) 5 A.T.R. 206 per Barwick C.J. at 211.
32. See further K.W. Ryan 'Curbing the Commissioner's Discretionary Powers', *Butterworth's Tax Essays*, Volume 1.
33. Taxation Ruling No. IT 2004.
34. *Supra* n.8.
35. Compare the definition of private company in s25A(12)(b) which refers to a company whose shares are not listed on the stock exchange and the broader definition of 'company' in s103A(2) of the Act. The exceptions to the latter in S.103A(3) and (3A) should be noted, subject to subs.(3B) and (5) of that section.

(c) the taxpayer carries on the business of buying and selling securities (S.25(1)).

Some promoters of property growth trusts state that receipts from the disposition of bonus units will not be assessable income in the hands of the recipient, however L.A. Cook, in his article 'Property Growth Trusts'[36] suggests such statements have a doubtful legal basis. It would appear that the author accepts the proposition that the mere issue of bonus units does not render any amounts assessable but he asserts that the disposition of such units could give rise to taxation liability. Cook asserts that such disposition will not be assessable under s.26AAA because the bonus units have not been purchased. Additionally the first limb of s.25A(1) would not apply as it is doubtful as to whether the units have been acquired within the meaning of that section (compare s.25A(4) dealing with bonus *shares*). He asserts, however, that disposal may be assessable under the second limb of s.25A(1) being part of an 'undertaking or scheme'. The 'second limb' of s.25A(1) includes in a taxpayer's assessable income profit arising '. . . from the carrying on or carrying out of any profit making undertaking or scheme'. Support for this proposition, Cook says, is to be found in the High Court decision of *McRae* v. *F.C. of T.*[37]. In that case a Dr Stephens owned a block of flats valued at 35,000 pounds but worth considerably more (60,000 pounds) if held under company title. Dr Stephens lent his six children 35,000 pounds. The children became the sole shareholders in a company specially incorporated for the purpose of acquiring the block of flats from Dr Stephens for 35,000 pounds. The block of flats was revalued to 61,000 pounds and exempt bonus shares were issued out of the revaluation profits. The articles of the company were then altered to divide the shares into twenty-seven groups, each group entitling the holder to a particular flat. The groups of shares were owned by the children as tenants in common and subsequently a number of the groups of shares were sold at a profit. It was held that the children, notwithstanding their passive role in the arrangements, were engaged in a profit-making scheme in terms of s.26(a) and that the dividend satisfied by the issue of fully paid bonus shares was not deductible as part of the cost of the scheme.

Despite the overlap of the former s.26(a) and s.25(1) revealed in the judgments in *F.C. of T.* v. *Whitford's Beach Pty Ltd*[38] the majority of the High Court decided that the second limb of S.26(a) is to apply only to situations not caught by s.25(1) as carrying on a business. In some cases courts have compared the concept of carrying on a business in s.25(1) with an implied concept of a 'business deal'[39] or 'commercial dealing'[40] in the second limb of the former section 26(a). Such distinctions tend to blur the boundaries of each provision. Gibbs C.J. in *Whitford's Beach* makes it clear that in his view the second limb does not catch profits arising from mere realization of an asset;[41] in other words, it does not constitute a true 'capital gains tax' in the wider sense. Mason J. agreed on this point, requiring that there be activity in the nature of a 'business deal'.[42] Nonetheless, as Mason J. points, out the extent of operation of the second limb of s.25A(1) will be entirely dependent on the breadth of definition of the concept of income for the purposes of s.25(1), the latter provision operating in preference to the former. His Honour says:

> It is possible that the second limb applies when the taxpayer's activities amount to more than the mere realization of an asset but do not constitute the carrying on of a business because they lack the characteristics of repetition or recurrence.[43]

36. *Taxation in Australia,* Nov 83, 531.
37. (1969) 121 C.L.R. 266.
38. *Supra* n.19.
39. *Supra* n.22.
40. *A. L. Hamblin* v. *F.C. of T.* (1974) 130 C.L.R. 159.
41. *Supra* n.19 at 249.
42. *Ibid.* at 251.
43. *Ibid.*

It is submitted that Mason J. correctly states the ambit of the second limb of s.25A(1), and that largely the other members of the majority in *Whitfords Beach* would be in agreement with him. Given, as suggested earlier in this article, the High Court trend towards a broader scope of definition of 'income' under s.25(1) in relation to the carrying on of a business, it would seem that for the immediate future the ambit of the second limb of s.25A(1) will be restricted.

Although there is no definition of 'scheme' or 'undertaking' in the Act these words were discussed in *Steinberg* v. *F.C. of T.*[44] The High Court differed in its interpretation. Barwick C.J. was of the opinion that there must be an identifiable specific scheme existing at the date of the acquisition of the property which is to be used to execute the scheme to make a profit. A scheme of realization of an asset not contemplated at the time of its acquisition but subsequently conceived and formulated, is according to his Honour not a scheme within the second limb of s.26(a). Gibbs J. took another view that:

> . . . schemes may be precise or vague; every detail may be arranged in advance, or the working out of the plan may be left for decision in the light of circumstances as they arise. It is no objection to a plan that it allows room for manoeuvre. When property is bought with the purpose of making a profit in the easiest or most advantageous way that may present itself, and the taxpayer adopts one of the many alternatives that his plan leaves open, thereby returning himself a profit, he will rightly be said to be carrying on a profit-making scheme.[45]

Stephen J. agreed with Gibbs J. and held that only rarely can it be said of a scheme for the acquisition of assets for profit making simply by their resale that a frustration of the planned mode of disposal, followed nevertheless by a profitable disposal, results in there being no scheme capable of attracting s.25A(1) but only in a realization of a capital asset.

In *F.C. of T.* v. *Whitfords Beach Pty Ltd*[46] Murphy J. was of the view that it was not necessary, for a case to come under the second limb of s.25A(1), that the scheme must have been contemplated when the asset was acquired.

From the principle in *Charles Case*[47] it can be seen that any activity engaged in by a unit trust which results in profits being made that are caught under s.26AAA or s.25A will cause those profits to be assessable income in the hands of the recipient unitholder when distributed. In the case of sales of trust units themselves a taxation liability in the unitholder may also arise. Cook submits that where the units in a property growth trust attract either capital growth or both income and capital growth it will be necessary to hold onto original units and bonus units for a considerable period of time to evidence an intention that they are purchased as an investment. He concludes that in the light of the Commissioner's ruling[48] bonus units, as well as original units, should be retained for ten years to avoid any operation of s.25A(1).[49] There seems, however, little justification for applying the principles of such a general ruling to the sale of original and bonus units. It is submitted that the merits of each case must be examined in the light of current circumstances and legislation.

Finally under this head, mention should be made of the practice of portfolio-splitting in order to avoid the operation of s.25(1) and s.25A(1) at least in respect of portion of the trust portfolio of investments. This device is most common amongst the share management trusts, which lend themselves most readily to the concept.

44. *Supra* n.26.
45. *Ibid* at 700.
46. *Supra* n.19.
47. *Supra* n.8
48. *Supra* n.33.
49. *Supra* n.36.

In *Charles* v. *F.C. of T.*[49A] the Commissioner argued that profits were assessable as profits from a business or alternatively profits arising from the carrying out of a profit making undertaking or scheme within the meaning of s.26(a). The Full High Court when deciding against the Commissioner stated:

> According to that evidence the money in question arose, not (as in the cases cited) from transactions forming incidents in the conduct of a business or a profit making scheme, but from transactions effected in the course of performing a fiduciary duty to preserve for beneficiaries as far as practicable the assets comprising the trust fund and any increments in the value of those assets which might appear from time to time to be in jeopardy.[50]

In order to utilize the principle contained in this passage, many share trusts now divide their portfolios into two — one branch containing long-term investments and one containing speculative investments acknowledged to be subject to taxation on profits. Whilst share trust managers may be able to argue that the sale of shares in a falling market is merely to protect their unitholders' investment, it will be a more difficult matter in a rising market. Jacobs J. in *London Australia Investment Co* v. *F.C. of T.*[51] stated that the taxpayer's dealings took place on a market having growth potential; a rising not a falling market was expected and it was on that situation that the investment policy was based. The sums in question therefore represented income within the meaning of s.25(1) of the Act. However in *Chamber of Manufacturers Insurance Ltd* v. *F.C.of T.*[52] the Federal Court has recently held that an insurance company, assessable on profits from sale of investments under s.25(1), could have escaped some liability by creating separate funds, one 'reserve' fund and one 'investment' fund. As the Full Court said:

> Even in a case such as the present, the position might have been different had the taxpayer maintained two quite separate funds — the first acknowledged as a reserve fund and demonstrably sufficient to meet claims and expenses in all reasonably foreseeable contingencies — the second categorised and dealt with as an investment fund. Whether profits from the sale of investments in the second fund were taxable would depend upon factors unrelated to insurance such as those referred to in the *London Australia Investment Co case.*[53]

3. Taxation Liability of the Trustee

As previously stated, most unit trust deeds provide that unitholders are presently entitled to the trust income. So long as the net income (using that word here to mean 'taxable' income) of the Trust for each income year is distributed in full to the unitholders, the only liability of the trustee will be that imposed pursuant to s.98 of the Act in respect of distributions to non-resident unitholders. There will be no liability on the trustee in respect of that part of the net income applicable to resident unitholders, save in two specific cases referred to below.

Where a beneficiary is presently entitled to a share of trust income, and is a non-resident at the end of the year of income, the trustee is liable to pay tax in respect of so much of that share as is attributable to a period when the beneficiary was a resident, whatever the source. In respect of any period when the beneficiary was not a resident, only income attributable to Australian sources is taxable. In all other cases, that is where the presently entitled beneficiary is a resident at the end of the income year, s.97 of the Act will apply and his

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49A. *Supra* n.8.
50. *Ibid.* at 612
51. *Supra* n.15.
52. 84 A.T.C. 4315.
53. *Ibid.* at 4318.

share of the trust income will form part of his own assessable income. It should be noted that s.95A(2) of the Act deems a person having a vested and indefeasible interest in the income of a trust estate who is not yet presently entitled to be, for the purposes of the Act, presently entitled to his share of such income. In the case of a non-resident person who comes under s.95A(2), s.98(2) of the Act states that, provided he is a natural person not under a legal disability, the trustee shall be liable to pay tax on that beneficiary's share in the trust estate referred to above subject to no deduction other than concessional deductions allowable to the beneficiary. This provision also applies to residents coming under s.95A(2).

Section 98(3) of the Act deals with corporate beneficiaries, providing that in respect of those who are non-resident and presently entitled the trustee shall be liable to pay tax on that beneficiary's share referred to above at a special rate of tax declared by Parliament, currently the company tax rate. This provision does not apply to bodies exempt from tax under s.23 of the Act or under a regulation made under the International Organizations (Privileges and Immunities) Act 1963.

Section 98(4) of the Act provides for the most numerous category of non-residents, natural persons not coming under s.95A(2) and under no legal disability; in this case the trustee is liable to pay tax on their share referred to above on the same terms as set out in s.98(2).

In the case of non-resident beneficiaries under a legal disability, s.98(1) of the Act operates to make the trustee liable to pay tax on their share referred to above in the same terms as set out in s.98(2); s.98(1) also applies to resident beneficiaries under a legal disability.

It should be noted that s.98(3) and (4) apply only where the beneficiary is a non-resident at the end of the year of income, and only in respect of trust income paid to the beneficiary (or applied for his benefit) on or after 18 May 1983. They do not apply where the beneficiary is a beneficiary in the capacity of trustee of another trust estate, nor in cases involving income equalization deposits.[54] In all of these cases, the beneficiary continues to be assessable under s.97. Further, s.98(4) does not apply where the trustee would have been assessable under s.98(1) or (2), that is, where the non-resident beneficiary is under a legal disability or is a natural person deemed to be presently entitled under s.95A(2).

A non-resident beneficiary on whose behalf a trustee has been assessed under s.98(3) or (4), is also taxed on the particular trust income: s.98A(1) A credit is then allowed in the assessment of the beneficiary for the tax paid by the trustee: s.98A(2). Where the tax paid by the trustee exceeds the tax assessed to the beneficiary, the difference is refunded to the beneficiary. This arrangement provides a means by which recourse can be had to the beneficiary if the tax cannot be collected from the trustee. It also ensures that the beneficiary retains all the tax advantages that the beneficiary would have if assessed directly under s.97. For example, any averaging rebate of tax in respect of primary production income is not allowable to the trustee, but is allowable to the beneficiary by virtue of s.98A(1).

Division 6B of the Act also sets out particular circumstances in which the income of a public unit trust will be assessed in the trustee's hands, in this case as well as in the hands of recipient unitholders. The provisions of Division 6B (ss 102D to 102L) were inserted to overcome what was described by the then Treasurer, Mr Howard, as the 'developing practice for public companies to transfer income earning assets to unit trusts so as to eliminate company tax on the income from those assets'.[55] *Prima facie*, companies when transferring certain assets (e.g. office buildings or shopping centres) to their public unit trusts could attract the provisions of Division 6B notwithstanding that the legislation was not intended to cover this type of situation. In the House of Representatives, in the second

54. Neither is trust income consisting of dividends or interest subject to withholding tax affected by the new provisions. This would be of particular significance to share trusts.
55. Explanatory memorandum to Income Tax Laws Amendment Bill (No 3) 1981.

reading speech the then Minister for Business and Consumer Affairs, Mr Moore, made the following comments on the legislation:

> The main concern of the government in this respect is to prevent ad hoc erosion of the so called classical system of company taxation through the use of unit trusts by public companies . . .[56]

Nevertheless, a public unit trust which, as part of a re-arrangement of a company group, acquires property or a business from a company and otherwise falls within Division 6B of the Act is treated by that Division as a public company; if the unit trust was established on or before 11 July 1982, Division 6B first applies in relation to the year of income that commences on 1 July 1983 and in all other cases first applies in relation to the year of income that commenced on 1 July 1980. A unit trust which falls within Division 6B of the Act is called a 'corporate unit trust'. The net income of such a unit trust is taxed at the company rate of tax (46%) and distributions to unitholders are assessable but rebateable in the case of a unitholder which is either a company or another unit trust within Division 6B. A unit trust will be a corporate unit trust in relation to a year of income if it is both an 'eligible unit trust' and a 'public unit trust' in relation to that year, and is either a resident unit trust in relation to that year or was a corporate unit trust in relation to a prior year. The definition of a public unit trust for the purposes of Division 6B is to be found in s.102G(1) of the Act. This provides that a unit trust is a public unit trust in relation to a year of income if, at any time during that year of income:

(a) any of the units in the unit trust were listed for quotation in the Official List of a stock exchange in Australia or elsewhere;
(b) any of the units in the unit trust were offered to the public; or
(c) the units in the unit trust were held by not fewer than fifty persons.

A unit trust will not, generally, be a public unit trust if twenty or fewer persons hold seventy-five per cent or more of the beneficial interests in the income or property of the trust — s.102G(3).[57]

Thus, most if not all of the property growth trusts, share management trusts, equity trusts and other managed trusts currently offered to investors would be covered by this definition.

The definition of an eligible unit trust for the purposes of Division 6B is to be found in s.102F of the Act. A unit trust will be an 'eligible unit trust' in relation to a year of income if at any time property formerly owned by, or a business formerly owned by, or a business formerly carried on by, a company (or an associate) became property of, or a business carried on by, the unit trust in pursuance of an arrangement that is a 'prescribed arrangement' in relation to that company. An arrangement will be a 'prescribed arrangement' in relation to a company if under the arrangement a shareholder in the company is by reason of his being such shareholder, given a preference or advantage in relation to the allocation or acquisition of units in the unit trust[58] and the unit trust was so structured or the income so dealt with in relation to any year of income that the Commissioner considers that if the definition of public unit trust applied in relation to the year, the unit trust would be a public unit trust (s.102E). Corporate property developers, in order to avoid having their relationship with a unit trust classified as a prescribed arrangement, and thus to avoid the trust being classified as an eligible unit trust and in turn a corporate unit trust, often request the Commissioner of Taxation's opinion on the matter.

56. Votes and Proceedings of the House of Representatives 23 September 1981, Hansard p.1682.
57. The discretions given to the Commissioner by ss.102G(4) and 102G(6) should be noted however.
58. Section 102E(1)(a) refers to an arrangement whereby '. . . a shareholder in the Company was, by reason of being a shareholder in the Company, to be granted a right or an option to acquire either directly or indirectly through any interposed companies or trusts a unit or units in the unit trust'.

One example is that of a particular trust which states in its prospectus under the heading 'Taxation of the Trust and its Unit Holders':

> In our opinion, and according to advice received from the Commissioner of Taxation, the trust is not a trust to which Division 6B of the Act applies. The advice given by the Commissioner of Taxation is subject to the reservation usually given regarding expressions of opinion in advance of any assessment.
>
> Nevertheless, it will be the actual arrangements which the Commissioner will examine in the application of Division 6B and many arrangements would require careful structuring in order to escape the net of Division 6B, notwithstanding that it was not intended to catch them in the first place.[59]

4. **Accounting Provisions**

It is not uncommon for the net income of a trust estate as determined for trust purposes to exceed the net income of the trust estate calculated for taxation purposes in accordance with s.95 of the Act. This may occur, for example, due to factors such as investment allowances and trading stock valuations reducing the latter. The Commissioner currently takes the view that where taxable income is less than the accounting income, distributions to unitholders in excess of the taxable income will not constitute assessable income in their hands.

It should be observed that an excess of net income for trust purposes over net income calculated in accordance with s.95 is not within the operation of any of ss.97, 98, 99 or 99A of Division 6, since those sections only provide for the assessment of the net income of the trust estate calculated in accordance with s.95. Division 6 seems the exclusive source of liability of a trustee in respect of the income of a trust estate and, consequently, the trustee could never be assessable on an excess of the kind referred to.

It would seem, however, that if applied strictly and in accordance with its terms, one of the sections in Division 6 may in some circumstances require an excess of the net income for trust purposes over the net income for income tax purposes to be included in the assessable income of a beneficiary. The particular section which it is necessary to consider is s.99B which applies to assessments in respect of income of the year of income that commenced on 1 July 1978 and in respect of income of all subsequent years of income. Section 99B provides that a beneficiary is assessable in certain circumstances on an amount, being property of the trust estate, that is paid to him or applied for his benefit (or is deemed, by s.99C, to have been applied for his benefit).

By virtue of s.99B(1) an amount, being property of a trust estate, paid to, or applied for the benefit of, a beneficiary of a trust estate is assessable income of the beneficiary if he is a resident of Australia at any time during the year of income, save to the extent, if any, to which the amount represents an amount specified in subs. 2. Thus, apart from subs. 2 of s.99B, an excess of the net income for trust purposes over that for taxation purposes would, by virtue of subs. 1 of s.99B, be assessable to a beneficiary in the year in which it is paid to him or applied for his benefit if he is a resident at any time during the year. It is suggested that anomalous results could flow from the application of this section, and the Commissioner seems content to ignore it in this context.

Due to factors such as depreciation on plant calculated at rates higher than those allowed by the Commissioner, the converse situation wherein net income of the trust estate for tax purposes exceeds net income for internal purposes also occurs. The question whether such excess is assessable to the beneficiary or is assessable to the trustee gives rise to considerable difficulty. The question has not directly arisen for decision by a Court, although there are

59. It may be noted that a trustee is not taxed personally but in the capacity of trustee, and s.254 of the Act authorises him to retain funds sufficient to pay the tax in question and indemnifies him in respect thereof.

judicial dicta which are of relevance; the matter also has been considered on a number of occasions by Boards of Review which have expressed conflicting views. It is not proposed to discuss the various court and board decisions in relation to this matter.

There is agreement that this area of uncertainty is undesirable and that amendments to the Act should be made in accordance with the recommendations made by the Asprey Committee.[60] It is understood that this matter is at present under consideration and a nationwide assessor's guide to 'trusts' (available under the Freedom of Information Act 1982) will be issued which will result in a uniform practice being adopted by all branches of the Taxation Office. The current practice of the Deputy Commissioner in Queensland is to allow any excess to be distributed to the beneficiaries in accordance with unit entitlement.

5. Conclusion

As the rapid growth in size and popularity of public unit trusts is a recent phenomenon, the law relating to their taxation position and that of their beneficiaries can be said to be in a development phase. Guidelines for operation of these types of trusts are gradually being issued as both the National Companies and Securities Commission and the various State corporate affairs offices take an increasing interest in regulation of the industry in response to perceived community needs. Nevertheless it remains true that no section or division of the Income Tax Assessment Act has been introduced to deal generally with the public unit trust; Division 6B is of a most specific nature. Further, the Commissioner of Taxation has done little by way of ruling to clarify the position of such trusts. Whilst it is true that public unit trusts are currently being dealt with under existing provisions of the Act to a satisfactory extent, there remain many areas (such as the concept of 'business' under s.25(1)) which may require particular treatment to adapt them more efficiently to the needs and responsibilities of this new industry. Any proposal to alter the capital gain provisions of the Act would also need to take account of the special needs of these trusts, as significant effects on the finance market may follow any extension of the operation of these sections.

It can be foreseen that the taxation treatment of public unit trusts will be in a state of flux for some years to come.

60. *Report of the Taxation Review Committee* 31 January 1975.