

# ALERT

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## Case Note: *Commissioner of Taxation v Bargwanna*

The High Court of Australia sent a strong message to trustees concerning how funds of a charitable trust must be applied, when it handed down the decision *Commissioner of Taxation v Bargwanna* [2012] HCA 11 on 29 March 2012.

The respondents, a husband and wife, were trustees of a trust. The deed establishing the trust provided that the trustees were to hold the trust fund in trust for charitable purposes. The respondents distributed just under \$300,000 of the trust fund to a number of charities.

The respondents had applied for endorsement by the Australian Tax Office that the trust was a charitable trust and was accordingly an entity exempt from income tax pursuant to Division 50 of Part 2-15 of the *Income Tax Assessment Act 1997 (ITAA 1997)*.

Division 50 of the ITAA 1997 requires that in order for a trust to be exempt from income tax:

1. it must be endorsed as exempt by the Commissioner of Taxation (**the Commissioner**);
2. it must be established for charitable purposes; and
3. the application of the trust fund must be applied for the purposes for which the trust was established.

The Commissioner claimed that the trustees had failed to satisfy the third requirement, and therefore that they should not be endorsed as exempt, contending that between 2002 and 2007 there had been a number of applications of the trust fund which were not for the purposes for which it was established.

The court held that the general principles of trust law obliged the respondents, as trustees, to strictly conform to and carry out the terms of the deed and that the respondents were under a duty to keep the trust fund distinct from other property.

The terms of the deed conferred widely expressed powers of investment on the respondents. However, the court stated that such broadly expressed discretion is still subject to the requirement that the trust fund was to be held and applied for public charitable purposes. The court found there were three circumstances where the trust fund was not applied for those purposes.

Firstly, the money comprising the trust fund was held in two bank accounts, including the trust bank account maintained by the principal benefactor of the trust, Mr Craik. Interest generated by this account was not credited to charities but rather to a separate bank account used for the purpose of defraying the cost of



maintaining the trust account (Mr Craik described it as his *'practice account'*). The AAT held at first instance that this was a *'standard arrangement'* with clients that the interest was foregone by them. The respondents typically acted on Mr Craik's recommendations and did not authorise or have knowledge of the various accounting irregularities surrounding Mr Craik's account.

Secondly, the respondents, in their personal capacities, obtained a home loan. As partial consideration for the loan, a sum of \$210,000 was transferred by the respondents into a non-interest bearing account maintained by the respondents in their personal capacity, where the trust monies were mixed with their personal funds. This account was used to offset interest owing on the loan. While the respondents made payments into the account from other sources, the total sum withdrawn exceeded those amounts.

Thirdly, because the deed did not explicitly provide for the power to intermingle funds, and because the money paid into Mr Craik's account and the respondents' interest offset account was mixed with money held by the respective parties personally and on behalf of other, the trust fund was not applied for public charitable purposes.

The High Court found that even if it was considered that the trust money was administered *'substantially in accordance'* with the terms of the trust deed, this was insufficient. The majority stated that the term *'applied'* is not to be understood as meaning *'substantially applied'* or *'on the whole, applied'*. The intermingling of funds, the failure of the respondents to obtain interest on trust money and the use of the interest offset account was not referable to the carrying out of the charitable purposes for which the deed provided. Accordingly, the High Court upheld the Commissioner's refusal to endorse the trust as exempt from having to pay income tax under Division 50 of the ITAA 1997.

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