IS THE COMMISSIONER RIGHT TO NOT SEEK SPECIAL LEAVE OF THE HIGH COURT TO APPEAL AGAINST THE FULL FEDERAL COURT’S DECISION IN MURDOCH?

MAHESWARAN SRIDARAN*

The Commissioner did not seek special leave of the High Court to appeal against the Full Federal Court’s decision in Murdoch v Commissioner of Taxation. This article argues that the Commissioner must have sought such special leave. The taxpayer (Dame Elisabeth Murdoch) was a life tenant of certain trusts, and was the sole income beneficiary of those trusts. Her son, Mr Rupert Murdoch, was the sole remainderman of those trusts. The principal assets of those trusts were shares in Cruden Investments Pty Ltd, a company which owned shares in companies of the News Group. Mr Rupert Murdoch was, at all times, the chief executive officer of companies of the News group. The taxpayer contended that, if those trusts’ investments had been more ‘balanced’, she would have been entitled to greater income by way of periodic distributions from those trusts, as the current investment policy of those trusts resulted in greater capital growth of the assets of those trusts (not greater growth in the income of those trusts), which accrued to the exclusive benefit of the remainderman (and not the taxpayer). She, accordingly, claimed from the trustees of those trusts (which included Mr Rupert Murdoch) and the remainderman compensation to remedy that deficiency. The trustees of those trusts and the remainderman did not accept that claim, but reached a compromise under which the taxpayer was paid compensation, in a single lump sum, by those trusts of some $85 million. Those trusts raised that amount through proceeds of an equal amount from a court-approved reduction of share capital by Cruden Investments Pty Ltd encompassing the shares in that company owned by those trusts. The Commissioner assessed the taxpayer to income tax on that lump sum on the basis that it was her income. The taxpayer appealed against that assessment to the Administrative Appeals Tribunal, which held for the Commissioner. The taxpayer appealed that holding to the Full Federal Court, which unanimously overturned it. The decision of the Full Federal Court was that the lump sum received by the taxpayer was a capital gain (and not income). That was so because, the Full Federal Court seems to have reasoned that the taxpayer’s claim was for an accounting by the remainderman to the taxpayer of an actual capital gain made by the remainderman and held by the remainderman under a constructive trust for the benefit of the taxpayer. This article argues that the Full Federal Court erred in holding so, as it failed to draw the proper conclusion upon applying the relevant law to the facts.

* Maheswaran Sridaran teaches tax law at Macquarie University, Sydney. The opinions expressed in this article are exclusively his. He may be reached at m.sridaran@ozemail.com.au.
I INTRODUCTION

This article considers the developments in the *Murdoch* case\(^1\) where, in particular, the Commissioner did not seek special leave of the High Court to appeal against the Full Federal Court’s decision in *Murdoch v Commissioner of Taxation* (‘*Murdoch’).\(^2\) This article argues that the Commissioner should have sought such special leave.

II FACTS

The facts set out below are as ascertained from the decisions of the Administrative Appeals Tribunal (‘the AAT’) and the Full Federal Court. Where facts which were considered relevant could not be ascertained from those decisions, it has been stated so below.

A The terms of the trusts

The taxpayer was Dame Elisabeth Murdoch, wife of late Sir Keith Murdoch and mother of Mr Rupert Murdoch. In 1936 and 1937, Sir Keith established eight inter vivo trusts (‘the trusts’), of which one or more of his eldest three children (including Mr Rupert Murdoch) or their children were remaindermen (remaindermen are those beneficiaries of a trust who are entitled to the assets of the trust upon the death of those beneficiaries of the trust who are life tenants). Of the trusts, the taxpayer was a life tenant, and, accordingly, for her life, either the sole income beneficiary or one of the income beneficiaries together with one or more of those children of Sir Keith. (A life tenant is a beneficiary of a trust who is entitled to benefit from the assets of the trust only while that beneficiary remains alive.)

The terms of the trusts as to the distribution of income were substantially similar. Those terms typically read:

The trustee shall hold the trust fund IN TRUST to pay the income arising therefrom to the wife for life for her own use and benefit absolutely and upon the death of the wife IN TRUST as to both the capital and income of the Trust Fund for the son conditionally upon his attaining the age of twenty-five years.

The trustee of the trusts, until 1983, was The Trustees Executors and Agency Company Ltd. In 1983, that company was replaced as trustee by the taxpayer, Mr Rupert Murdoch and Mr Jack Kennedy. In 1991, the taxpayer and Mr Jack Kennedy were replaced as trustees by Actraint No 119 Pty Ltd, whose shareholders and directors were the taxpayer and Mr Jack Kennedy.

On 8 November 1991, a Reorganisation Agreement was entered into between, among others, the taxpayer, Actraint No 119 Pty Ltd and Mr Rupert Murdoch. Under that agreement, the taxpayer surrendered her life interests in the trusts except for her life interests in four of those trusts in which Mr Rupert Murdoch was the sole remainderman (those four trusts are, in this article, referred

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\(^1\) *Murdoch v Commissioner of Taxation* [2008] FCAFC 86 (28 May 2008) (‘*Murdoch’).

During the life of Sir Keith and since his death, the principal assets of the trusts were shares in Cruden Investments Pty Ltd, a company which owned shares in News Ltd until 1979, and, from then, in News Corporation Ltd, which became the ultimate parent of News Ltd. Mr Rupert Murdoch was, at all times, the chief executive officer of the two latter companies and all other companies of the News Group.

The terms of the trusts as to the trustees’ investment powers were substantially similar. Those terms typically read:

Any funds in the hands of the Trustees for investment shall during the life of the Settlor be invested in such securities bonds stocks debentures or other investments as the Settlor shall in his absolute discretion direct and the Trustees shall if and whenever so directed by the Settlor sell and dispose of or otherwise realize any particular securities bonds stocks shares debentures or other investments in which the Trust Fund or any part thereof is for the time being invested and shall for the purposes of any such realization if so directed by the Settlor take or join in taking any steps to wind up any company of or in which the Trustees hold stocks shares or debentures as part of the Trust Fund and from and after the death of the Settlor the Trustees shall either continue to hold any of then existing investments or at their discretion shall call in and convert the same into money and with the like discretion invest the money arising thereby or otherwise in their hands for investment in the names of the Trustees upon some one or more of the securities authorized by any Statute for the time being in force in any State of the Commonwealth of Australia authorizing the investment by Trustees of Trust Funds or upon the shares or debentures of any public industrial company which has been carrying on business in Australia for at least three years and which has paid up capital of not less than One hundred thousand pounds. During the life of the Settlor the Trustees shall not be entitled to call for a transfer into their own names of any of the property comprised in the said Trust Fund (whether as a result of investment or otherwise) which shall be in the name of the Settlor and such property shall unless the Settlor otherwise elects be left in his name.

Advice of Mr D Heydon QC and Wyatt Company Pty Ltd), a firm of consulting actuaries

About April 1994, advice was sought from Mr D Heydon QC on whether the taxpayer has a valid claim against the trustees of the trusts due to the investment policy adopted by those trustees with respect to the trusts. That advice was sought by a solicitor who had acted for Mr Rupert Murdoch from the late 1970s to the late 1990s. It is not known whether that advice was sought (by that solicitor from Mr Heydon) on behalf of the taxpayer, Mr Rupert Murdoch, or both. That solicitor’s evidence included a memorandum he received from lawyers from overseas, which read:

If Dame Elisabeth has a valid claim under Australian Law with respect to the ‘Power to Contain Conversion’, because she was not receiving a fair
current return, Rupert would be obligated to act together with the other trustee and correct the situation by making a distribution to Dame Elisabeth. A distribution of this type made by the trustees to bring the trust into compliance with Australian law would not be construed to be a gift made by Rupert under United States law.3

Around the same time, advice was sought (it is not known by whom, and on whose behalf that advice was sought) from Wyatt Company Pty Ltd (‘Wyatt’), a firm of consulting actuaries, to supplement the matter on which Mr Heydon’s advice was sought. In June 1994, Mr Heydon provided the first of two written opinions (‘the first opinion’). That opinion was based on instructions given to Mr Heydon to the effect:

- that the dividend yield of those companies in which the trusts held an interest thorough the trusts’ ownership of shares in Cruden Investments Pty Ltd which were public companies had ‘been very low relative to the earnings of blue chip shares in industrial companies quoted on the Stock Exchange, though there has been a considerable rise in the value of those shares’;4 and
- that ‘the result had been that Dame Elisabeth Murdoch has received much less income in virtue of her life interest than she would have done had the Trust Fund been differently invested’.5

In the first opinion, Mr Heydon addressed whether the taxpayer can sustain a claim on the authority of Howe v Lord Dartmouth6 and Re Earl of Chesterfield’s Trusts,7 and concluded that she cannot. He then, in the first opinion, addressed whether the trustees of the trusts had breached their duty owed to the taxpayer (in her capacity as a life tenant of the trusts) by their failure to exercise the powers of investment conferred on them in a manner so as ‘to hold the balance properly between capital and income’.8 With respect to that issue, Mr Heydon reached the following conclusion:

Whether the various trustees are liable for breach of trust to Dame Elisabeth Murdoch is thus a difficult question. If they were, the quantum of compensation for that breach may be hard to calculate but in principle it would be the difference between what the income of the assets could have been had they been invested in a mix of blue chip shares and other authorized investments producing a reasonable income, and what Dame Elisabeth actually received.9

He concluded that, if there had been such a breach of duty by the trustees, a court ‘might recognize a charge over the remainder interests to benefit the tenant for life to the extent to which she was disadvantaged’,10 and:

Alternatively, on the reasoning in paragraph 254 [of Scott on Trusts (4th edition)], a court might hold that there was a constructive trust which could be vindicated by a sale of the property subject to the constructive

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5 Above n 4, para 14.
6 (1802) 7 Ves 137.
7 (1883) 24 Ch D 643.
9 Above n 8, para 14.
10 Above n 8, para 14.
trust (or, on the earlier analysis, subject to the charge): the proceeds of the sale could then be applied partly to compensate the tenant for life for past losses and thereafter reinvested on more appropriate securities.\footnote{Murdoch [2007] AATA 1791, para 14.}

If the facts, on investigation, turned out to be of the type indicated above there would be good prospects that the breach of duty by the trustees, and by Mr Murdoch as beneficiary-trustee in particular, could lead to the remedy indicated—a Court-ordered sale of the shares with a view first to compensating Dame Elisabeth Murdoch for past breaches, and then reinvestment of the fund in appropriate assets so as to achieve for the future a proper balance between the interests of those interested in income and those interested in capital.\footnote{Above n 11.}

The instructions upon which the first opinion was based, it later transpired, were deficient as the distributions of income received by the taxpayer from the trusts were ‘well in excess of the gross income [which] could have been received had a “typical” investment policy been applied’. That was so as accretion (due to bonus issues of shares or otherwise) to the quantity of shares in those companies in which the trusts held an interest thorough the trusts’ ownership of shares in Cruden Investments Pty Ltd did cause the absolute amount of dividends received in respect of those shares to substantially increase, though the dividend yield of those shares was relatively low. Accordingly, Mr Heydon was requested to provide a second written opinion.

In the meantime, in July 1994, Wyatt provided a report which concluded: ‘[I]n all periods the accumulated value of the actual gross income received from [the trusts] is well in excess of the gross income we estimate could have been received had a ‘typical’ investment policy been applied since mid 1952 instead of the actual investment policy.’ It reached that conclusion because, over those periods, though the dividend yield of shares in companies of the News group had been relatively low, the absolute amount of dividends received by a shareholder who owned a quantity of those shares as at the beginning of those periods had substantially increased due to an accretion (as a result of bonus issues of shares or otherwise) to that quantity of shares owned.

In October 1994, Wyatt provided a further report which dealt with only the subject trusts. That report concluded that, as at certain dates specified in it, in the subject trusts, the value of the taxpayer’s interests (as the life tenant) was significantly less than the value of Mr Rupert Murdoch’s interests (as the remainderman) due to the investment policy followed by the trustees of those trusts not being ‘typical’.

In October 1994, Mr Heydon provided a second written opinion (‘the second opinion’). In it, he advised (reproduced below exactly as set out in the Full Federal Court’s decision, except the interpolations in italics):

(a) ‘the disparity now appearing between the relative position of the income beneficiary under the actual [investment] policy and the relative position of the income beneficiary under the notional [investment] policy, if it resulted wholly or partly from breaches of trust by the trustees, can be described as analogous to overpayment of one beneficiary at the expense of another within the principles discussed on pages 20-21 of [the first opinion]’;
(b) the problem referred to in para (a) ‘is also a problem which may be the result of the trustee/remainderman having had goals which made investment policy adopted desirable, and having persuaded the other trustees (at least since 1983 and perhaps earlier) of the merits of that policy, or not having intervened with them to change it;

(c) if the evidence in contested litigation supported this view, the principles discussed on pages 22-23 of the first opinion ‘may operate not merely to permit an action for breach of trust against the trustees, but to create a charge in the nature of a constructive trust over the interest of the remainderman in the capital, being a charge capable of being enforced by sale’;

(d) there was ‘a real possibility that the adoption of the [investment] policy was at various points a breach of trust induced by the remainderman’ with the consequence that it would need to be ‘accounted for by him and held by him in trust for the other beneficiaries, even though the gain could not have been made by lawful means, and even though the conduct in question has caused the other beneficiaries to be better off than they otherwise would have been: Phipps v Boardman [1967] 2 AC 46’;

(e) the analysis in the Wyatt Report ‘shows that the gain made by the trustee/remainderman is, on his assumptions, $193m for the first two [subject trusts] and $83m for the other two;

(f) in the circumstances it would not be unreasonable for the applicant [that is, the taxpayer] to seek to settle the potential dispute in relation to the subject trusts on terms involving the payment to the applicant of $85 million or a transfer of assets of that value in consideration for her giving a release of all claims against the trustee/remainderman for the past breaches of trust and consenting to the maintenance by the trustees of the current investment policy.

The taxpayer was advised (presumably, by the solicitor who instructed Mr Heydon), on the basis of the second opinion (of Mr Heydon) and the report by Wyatt (presumably, of October 1994), she was entitled to make a claim on the capital of those trusts. That advice to her, however, did not state that she had ‘any right to claim for loss of income’. Moreover, the taxpayer ‘did not believe that any decision of the trustees caused [her] to lose income’. The taxpayer and the entities that had been the trustees of the subject trusts (Mr Rupert Murdoch, Mr Jack Kennedy and Actraint No 119 Pty Ltd) entered into a Deed of Release and Agreement (‘the settlement deed’) on 28 November 1994.

C The settlement deed

The settlement deed did contain the following recitals:

I. The trustees of the Trusts from time to time since the death of the Settlor have followed an investment policy of investing the funds the subject of the Trusts almost exclusively in shares in companies, Cruden Investments Pty Ltd (‘Cruden Investments’) and Cruden Holdings Pty Ltd, which are not authorized trustee investments under Australian legislation relating to trustees (such investment policy being referred to below as the ‘Investment Policy’).
J. Dame Elisabeth has claimed that:
(i) the pursuit of the Investment Policy by the trustees of the Trusts:
   • has not given rise to any exceptional increase in income of the Trusts but has greatly increased the value of the corpus of the Trusts; and
   • involved significant risk for the beneficiaries of the Trusts, which risk was not properly rewarded in the case of Dame Elisabeth to the extent she only had an income interest under the Trusts;
(ii) in pursuing the Investment Policy, the trustees of the Trusts from time to time have since the death of the Settlor breached their trust duties to Dame Elisabeth as a life tenant;
(iii) Mr Murdoch, a man generally regarded as being of outstanding ability and force of personality with an extraordinary record of business success, as a trustee of the Trusts and the holder of the whole of the remainder interests in the Subject Trusts, had substantial responsibility for such breaches of trust since May 1983 because he was pursuing goals not properly goals of the Trusts, but which goals required the Investment Policy to be pursued and inter alia had the effect of improving Mr Murdoch’s financial position as beneficiary in remainder under the Subject Trusts; and
(iv) that in the premises, a constructive trust has arisen in respect of eighty percent or more of the beneficial interest in the assets of the Subject Trusts, constituting the advantage to Mr Murdoch of the Investment Policy having been pursued in lieu of a more appropriate investment policy, and/or Dame Elisabeth has the benefit of a charge over the assets of the Subject Trusts which Dame Elisabeth is not entitled to be paid as income of the Subject Trusts accompanied by a right to have sufficient of the corpus of the Subject Trusts sold to compensate Dame Elisabeth for the breach of trust and/or to ensure the benefit of such advantage is made over to her and does not flow to Mr Murdoch.

K. The Current Trustees (including Mr Murdoch) and Mr Kennedy do not, and Mr Murdoch as beneficiary in remainder under the Subject Trusts does not, admit any such breach of trust or the existence of any such constructive trust, or charge, or right of sale. With a view to avoiding unnecessary disputation and any need for litigation, however, the Current Trustees (including Mr Murdoch) and Mr Murdoch as such beneficiary in remainder are desirous of compromising the claims made by Dame Elisabeth.

L. It has therefore been agreed that Dame Elisabeth, as the life tenant under the Subject Trusts, having shared in the risk of investing in the investments of the Subject Trusts, and in consideration of her releasing:
(i) The Current Trustees and the former trustees under the Trusts from any claims by her against them for breach of trust or
otherwise in relation to following the Investment Policy in relation to the investments of the funds of the Subject Trusts and of the other of the Trusts; and

(ii) The assets of the Subject Trusts and the other of the Trusts (being assets which Dame Elisabeth is not entitled to be paid as income of the Trusts) from any claims Dame Elisabeth has or may have upon or in respect of them other than her right to be paid a proportion of the undistributed current income and the future income of the Subject Trusts and any interest she may have in the capital and income of the other of the Trusts, should be entitled to the following:

(iii) that the ordinary shares in Cruden Investments (‘the Cruden Investments shares’) comprising the assets of the Subject Trusts should be in whole or in part realized (by way of sale of some of such shares or partial return of capital on all of such shares) to raise $85,087,176 in Australian currency; and

(iv) that the $85,087,176 be paid to Dame Elisabeth or as she may direct as the absolute property of Dame Elisabeth to deal with as she in a her full and complete discretion may determine.

The settlement deed did contain the following operative provisions:

2 LIFE TENANT RELEASES, AUTHORITIES AND REQUESTS

2.1 Subject to the other provisions of this deed, Dame Elisabeth, in her capacity as the Life Tenant, hereby releases and discharges each other party hereto from any claims, proceedings, obligations to account and other liabilities for or in relation to (including without limitation any loss arising to or profit of or other benefit to any other party hereto in respect of) any or all of the following which, had this deed not been entered into, such party would have had against such other party as the case may be:

(a) the pursuit of the Investment Policy in relation to the investment of the funds of the Trusts and the failure of the Trustees at any time and from time to time to consider pursuing another policy or otherwise to realize, convert and reinvest the funds of the subject of the Trusts or to consider doing so;

(b) any breach by the Trustees of the duties owed by the Trustees to the beneficiaries under the Trusts;

(c) any right of action, whether at law or in equity, Dame Elisabeth has or may have against Mr Murdoch as a beneficiary of any of the Trusts in relation to any of above; and

(d) any right of action Dame Elisabeth has or may have upon or in respect of Trust assets other than her right to be paid a proportion of the undistributed current income and the future income of the Subject Trusts and any interest she has or may have in the corpus or income of the other of the Trusts according to the express terms of the documents creating or recording the terms of the Trust.

2.2 Dame Elisabeth hereby authorizes and requests the Trustees to continue to carry on the Investment Policy and undertakes not to bring any claims or proceedings against any of the Trustees in respect thereof.

3 TRUSTEE UNDERTAKINGS

The Current Trustees hereby undertake:
(a) promptly to raise the Settlement Amount by selling some of the
Cruden Investments shares or participating in a reduction and
return of capital by Cruden Investments on and in respect the
Cruden Investments Shares; and
(b) to pay to Dame Elisabeth the Settlement Sum on the Settlement
Date.

4 REMAINDERMAN REQUEST AND AUTHORITY

Mr Murdoch, as the beneficiary in remainder under the Subject Trusts,
requests and authorizes the Current Trustees to observe and perform
their undertakings in clause 3 hereof.

In the settlement deed, the expression ‘Settlement Sum’, as referred to in
clause 3 (b) reproduced above, was defined to mean $85,087,186 in Australian
currency.

D Consequences of entry into the settlement deed

On 28 November 1994, which was the date the settlement deed was
entered into, in terms of that deed, the taxpayer was paid, as a lump sum,
$85,087,176 (‘lump sum settlement’) by cheque. That payment was made by the
trustees of the subject trusts.

On the same date on which that payment was made to the taxpayer, she
transferred approximately a third of which she so received to a trust that was
associated with her. That trust used some of the money so received by it to make
gifts to family members and charity, and it converted the remainder of that money
to foreign currency ‘for the purpose of making a gift to Mr K R Murdoch’.
It was contemplated in the settlement deed that the payment of the lump sum
settlement was to be met by the trustees of the subject trusts realizing those trusts’
shares in Cruden Investments Pty Ltd. The trustees of the subject trusts met that
payment through proceeds of an equal amount from a court-approved reduction of
share capital by Cruden Investments Pty Ltd. The shares in that company owned
by the trustees of the subject trusts which were encompassed by that capital
reduction had been acquired by them before 20 September 1985.

The Commissioner assessed the taxpayer to income tax, for the year ended
30 June 1995, on the basis that the lump settlement received by her either was
income of hers or was otherwise assessable income hers because it was a capital
gain. The taxpayer appealed against that assessment to the AAT, which held that
the lump settlement received by her was income of hers. Given that holding, the
AAT did not consider the Commissioner’s alternative contention that the lump
sum settlement received by the taxpayer was otherwise assessable income of hers
because it was a capital gain (but not a distribution of capital to the taxpayer
representing a capital gain that must be ignored because it arose from the
happening of CGT events A1 or C2 to CGT assets acquired by the trusts before 20
September 1985).

The taxpayer appealed that decision of the AAT to the Full Federal Court,
which unanimously overturned that decision, holding that the lump settlement
received by the taxpayer was not her income. Before the Full Federal Court, the
Commissioner did not press his alternative contention that the lump sum
settlement received by the taxpayer was otherwise assessable income to her
because it was a capital gain (but not a distribution of capital to the taxpayer
representing a capital gain that must be ignored because it arose from the happening of CGT events A1 or C2 to CGT assets acquired by the trusts before 20 September 1985).

III THE LEGISLATIVE PROVISIONS RELEVANT TO MURDOCH

The legislative provisions relevant to imposing income tax on trusts and beneficiaries of trusts are contained in Division 6 of Part III of the Income Tax Assessment Act 1936 (Cth). So far as relevant to Murdoch, essentially, the effect of those legislative provisions was as follows.

A trust must, for each income year, determine its “net income”, which is equal to the total assessable income (including capital gains which are not ignored for purposes of income tax) of the trust minus the total of allowable deductions, as if the trustee of the trust were a taxpayer. Where, for an income year, a beneficiary of a trust was “presently entitled” to a share of the net income of the trust, the assessable income of the beneficiary will include that share of net income, on which, therefore, income tax will be payable by the beneficiary, and not the trustee of the trust.

If, for an income year, a beneficiary of a trust was not “presently entitled” to a share of the net income of the trust, with respect to that share of net income, income tax will be payable by the trustee of the trust, and not any beneficiary of the trust. To be “presently entitled” to a share of net income of the trust, as held by the High Court in a number of cases, the beneficiary must have an indefeasible, absolutely vested, beneficial interest in possession in that share of net income, and that share of net income must be legally available for distribution to the beneficiary by the trust. The character of the net income of a trust to which a beneficiary of that trust is “presently entitled” is the same character that net income had when it was derived by the trust.

Accordingly, if a trust made a capital gain which is ignored for purposes of income tax (such as, say, a capital gain made from the happening of CGT event A1 or CGT event C2 to assets acquired by the trust before 20 September 1985), and if, in the income year in which that capital gain is made, a beneficiary of the trust becomes “presently entitled” to that capital gain, it will remain a capital gain that is ignored for purposes of income tax in the hands of that beneficiary. As outlined earlier, in Murdoch, at the Full Federal Court, it was not contended by the taxpayer that the lump sum received by her was a capital gain that is ignored for purposes of income tax, nor did the Commissioner contend that lump sum was a capital gain that was not ignored for purposes of income tax, which was thus assessable income of the taxpayer.

In Murdoch, at the Full Federal Court, it was not contended by the Commissioner or the taxpayer that the lump sum received by the taxpayer from the trusts was a distribution by the trusts to the taxpayer of “net income” of the

13 Income Tax Assessment Act 1936 (Cth) s 95 (1).
14 Income Tax Assessment Act 1936 (Cth) s 97.
15 Income Tax Assessment Act 1936 (Cth) ss 99 and 99A.
16 FC of T v Whiting (1943) 68 CLR 199; Taylor & another v FC of T (1970) 70 ATC 4026; Union Fidelity Trustee Co of Australia & another v FC of T (1969) 69 ATC 4084; Taxation Ruling IT 2622.
17 Charles v FC of T (1954) 90 CLR 598.
trusts. Accordingly, whether the taxpayer was “presently entitled” to the lump sum in question did not become germane, though, clearly, that lump sum did not remain receivable, but rather had been received, by the taxpayer. Murdoch did not turn on the proper interpretation of any of the legislative provisions canvassed above, as there was no controversy over their application. Rather, Murdoch turned on a most basic issue which the common law has grappled with on innumerable occasions, time and time again: that is, whether a lump sum received by a taxpayer is, in her hands, income or capital. Reaching the correct answer to that issue required the proper application of judicial principle, as gleaned from case law, to the facts of the case.

IV FULL FEDERAL COURT’S ANALYSIS

The decision of the Full Federal Court, in Murdoch, was a unanimous one, which held that the lump sum settlement of $85,087,176 received by the taxpayer was not her assessable income. The essential reasons as to why it held so are contained in the following two paragraphs of its judgment:

It is common ground that where a taxpayer provides consideration in the form of a release of a claim, the consideration, that is to say, the release ‘will ordinarily supply the touchstone for ascertaining whether the receipt is on revenue account or not’: Federal Coke Co Pty Ltd v Federal Commissioner of Taxation (1977) 15 ALR 449 at 472 per Brennan J; Allied Mills Industries Pty Ltd v Federal Commissioner of Taxation (1989) 20 FCR 288 at 309.18

We do not think that the Lump Sum [that is, the lump sum settlement received by the taxpayer] was compensation for the release of a claimed entitlement to that which would have been assessable income: cf Federal Commissioner of Taxation v Dixon (1952) 86 CLR 540; Federal Commissioner of Taxation v Myer Emporium Ltd (1987) 163 CLR 199; Federal Commissioner of Taxation v Rowe (1997) 187 CLR 266 at 276.19

The point that the Full Federal Court makes in the first of those two paragraphs is unexceptionable. That point is whether the lump sum settlement received by the taxpayer is assessable income to her must be determined with reference to the substance of the release granted by her, as she received the lump sum settlement in return for granting that release. The point that it makes in the second of those two paragraphs, however, is not, which is an issue that, therefore, merits close scrutiny if one were to argue, as this article does, that the decision of the Full Federal Court, in Murdoch, was wrong.

What, then, was the substance of the release granted by the taxpayer? Given the point it made in the first of those two paragraphs, the Full Federal Court must have necessarily answered that question with close regard to the terms of the settlement deed. It, however, most remarkably, failed to do so, which was a fatal deficiency. The best that the Full Federal Court did, in that respect, is represented by the following passages in its judgment:

In Phipps v Boardman, the House of Lords applied a principle that it had recognized in Regal (Hastings) Ltd v Gulliver [1942] 1 All ER 378 … In summary, that line of authority is to the effect that a trustee or other

19 Above n 18, para 13.
A fiduciary is accountable for a profit he or she made from a breach of fiduciary duty, even though the profit is one that the beneficiary to whom the trustee or other fiduciary is liable to account could not have made.\footnote{20} The rule recognized in \textit{Phipps v Boardman} has been accepted as forming part of the law in Australia. \footnote{21} In his second opinion, Mr Heydon QC thought the principle recognized in \textit{Phipps v Boardman} was arguably applicable to the circumstances of Mr Murdoch’s dealings with the trust estate. Mr Murdoch clearly stood in a fiduciary relationship to the applicant. If the applicant could prove the matters recited in paras (i), (ii) and (iii) of Recital J of the Settlement Deed, a \textit{Phipps v Boardman} claim for an accounting would be made out. \footnote{22}

The Commissioner relies on the reference to the applicant’s status as Life Tenant in the Settlement Deed but we do not think this is to the point. That reference merely explains the basis of the existence of the fiduciary duty. What the applicant would have received would have been a sum representing the profit or gain made by Mr Murdoch, notwithstanding that she had no entitlement to it under the terms of the trust.\footnote{23} We say nothing about the likelihood of success of the claim that the applicant made: it is not disputed that she made it, and it is not disputed that it is the character of that claim and its notional fruits that determine whether the Lump Sum (being the consideration for release of that claim) was income derived by the applicant.\footnote{24}

In our respectful opinion, the Tribunal erred in failing to characterize properly the character of the claim that the applicant gave up and, therefore, the character (income or not) of the Lump Sum that she received for giving it up. \textit{The applicant’s claim was to an accounting for a capital profit or gain made by Mr Murdoch and to an entitlement to a constructive trust over the assets of the trust estate, and she was paid the Lump Sum in satisfaction of those claims.} The Lump Sum was not income.\footnote{25} [emphasis added.]

If the Full Federal Court’s decision is to be tenable, its conclusion in the penultimate sentence in the last of the paragraphs quoted just above, a sentence which has been highlighted in italics, must necessarily be supportable with reference to the terms of the settlement deed. It, however, cannot be, for the reasons canvassed below.

\section*{V WHY THE FULL FEDERAL COURT’S ANALYSIS IS NOT THE BEST}

The Full Federal Court’s analysis, and its decision, can be critiqued as not the best on the ground that the Full Federal Court erred in drawing the proper conclusion upon applying the relevant law to the facts. The AAT, as to the

\footnotesize{20} Above n 18, para 15.
\footnotesize{21} Above n 18, para 23.
\footnotesize{22} Above n 18, para 24.
\footnotesize{23} Above n 18, para 25.
\footnotesize{24} Above n 18, para 26.
\footnotesize{25} Above n 18, para 27.
question of what was the substance of the release granted by the taxpayer, concluded:

The types of claim or obligation specified in the release related to:
1. The investment policy and the trustees’ failure to pursue another policy;
2. Breach of the trustees’ duties to beneficiaries;
3. Rights of action as a beneficiary;
4. Rights of action in respect of assets other than the right to current and future income and any interest the taxpayer may have in corpus or income.

Categories 1 to 3 could only relate to the income paid to the taxpayer. Although category 4 contemplates rights in assets or corpus, the trust deed did not confer any such rights other than to secure her rights to income.\textsuperscript{26}

The claims enumerated as 1 to 4 in that passage exactly correspond to the claims enumerated as (a) to (d) in clause 2.1 of the settlement deed, a clause which has been quoted earlier. The conclusion reached by the AAT as to the effect of those claims, as noted in the last paragraph of that passage, is correct, and was decisive to the AAT’s holding that the lump sum settlement received by the taxpayer was income of hers. Most surprisingly, the Full Federal Court did not analyse as to why that conclusion of the AAT was, in the view of the Full Federal Court, wrong. As will be evident from the passages of the judgment of the Full Federal Court quoted earlier, all that the Full Federal Court said in that respect was:

[i]n our respectful opinion, the Tribunal erred in failing to characterize properly the character of the claim that the applicant gave up and, therefore, the character (income or not) of the Lump Sum that she received for giving it up.\textsuperscript{27}

Soon after that statement, the Full Federal Court proceeded to conclude, which also will be evident from the passages of its judgment quoted earlier:

The applicant’s claim was to an accounting for a capital profit or gain made by Mr Murdoch and to an entitlement to a constructive trust over the assets of the trust estate, and she was paid the Lump Sum in satisfaction of those claims.\textsuperscript{28}

As to how the Full Federal Court reached that conclusion with regard to the terms of the settlement deed, and particularly with regard to the claims enumerated as (a) to (d) in clause 2.1 of the settlement deed (quoted earlier), cannot be discerned from its judgment, which is a fatal deficiency. What, in that respect, the Full Federal Court did say (as quoted earlier) was the following, which, though, does not explain how it reached that conclusion:

In his second opinion, Mr Heydon QC thought the principle recognized in \textit{Phipps v Boardman} was arguably applicable to the circumstances of Mr Murdoch’s dealings with the trust estate. Mr Murdoch clearly stood in a fiduciary relationship to the applicant. If the applicant could prove the matters recited in paras (i), (ii) and (iii) of Recital J of the Settlement

\textsuperscript{26} Murdoch [2007] AATA 1791, para 25.
\textsuperscript{27} Murdoch [2008] FCAFC 86, para 27.
\textsuperscript{28} Above n 27, para 27.
Deed, a *Phipps v Boardman* claim for an accounting would be made out.

That passage can be given effect to only in the context of clause 2.1 (c) of the settlement deed, a clause to which recital J (iii) of that deed relates. The essence of that clause 2.1 (c) is that, as one beneficiary of a trust, Mr Rupert Murdoch owed a fiduciary duty to the taxpayer, who was another beneficiary of the same trust, and that there had been a breach of that duty. That duty, of course, is owed to the taxpayer in her capacity as a beneficiary of that trust, a status which is necessarily determined according to the terms of that trust. In accordance with those terms, the taxpayer was a life tenant of the trust with an entitlement to only distributions from that trust of its income (not capital).

The breach of that duty by Mr Rupert Murdoch, it follows, was a breach whose consequence was that the taxpayer was denied the receipt of distributions of income to which she was otherwise entitled from that trust (as she had no entitlement to anything else, including capital, from that trust). Any compensation that she receives (in a lump sum or otherwise) for that breach must, accordingly, in her hands, necessarily bear the character of income.

Here that entitlement to compensation, in the circumstances, may well be measured as what amount of capital profit Mr Rupert Murdoch, in his capacity as the sole remainderman of that trust, may be entitled to, by way of a capital distribution from that trust to him. That distribution, if indeed made by that trust to Mr Rupert Murdoch, will, in his hands, be a capital (not income) receipt. This, however, has no bearing in determining the proper character, in the taxpayer’s hands, of the compensation which the taxpayer received, pursuant to that entitlement, for a breach of a duty owed to the taxpayer in terms of that trust.

In summary, therefore, the Full Federal Court erred as it misapprehended what was, in fact, merely the method of measurement of the compensation received by the taxpayer to be determinative of the character of that compensation in the hands of the taxpayer. What was truly determinative of that character was, as noted earlier, the substance of the release granted by the taxpayer. That release, in terms of clause 2.1 (c) of the settlement deed, is that of a claim of the taxpayer in her capacity as a life tenant of that trust with an entitlement to only distributions of income (not capital) made by that trust.

VI CRITICAL ASPECTS OF THE AAT’S ANALYSIS NOT ADDRESSED IN THE FULL FEDERAL COURT’S DECISION

As noted earlier, the AAT, in addressing the question of what was the substance of the release granted by the taxpayer, did so with proper regard to the exact terms of the settlement deed, something which the Full Federal Court did not. The AAT also, relative to the Full Federal Court, more extensively, and more critically, evaluated the advice contained in the first opinion and the second opinion (provided by Mr Heydon QC), as canvassed below. The AAT did so despite its concession thus as to that advice of Mr Heydon:

It is not readily apparent why the barrister’s opinion is pertinent to the resolution of the issues before me. However, there was no objection to the tendering of the two opinions and the parties made reference to them.

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29 Above n 27, para 24.
Nevertheless, it is for me to determine whether the lump sum paid under the deed was received as capital or income. The opinions do provide some evidence of the circumstances surrounding the execution of the deed. However, they cannot assist in construing the deed in the absence of supporting evidence and submissions.\textsuperscript{30}

That concession of the AAT is entirely correct. The AAT observed:

The passages in the Queen Counsel’s first opinion suggest that any remedy for breach of trust flowing from improper exercise of the power of investment would reflect lost income. In that I think he was right.\textsuperscript{31}

The passages of the first opinion that the AAT refers to in that observation must be the following paragraphs (of the first opinion), which were quoted earlier:

Whether the various trustees are liable for breach of trust to Dame Elisabeth Murdoch is thus a difficult question. If they were, the quantum of compensation for that breach may be hard to calculate but in principle it would be the difference what the income of the assets could have been had they been invested in a mix of blue chip shares and other authorized investments producing a reasonable income, and what Dame Elisabeth actually received.\textsuperscript{32}

Alternatively, on the reasoning in paragraph 254 [of Scott on Trusts (4\textsuperscript{th} edition)], a court might hold that there was a constructive trust which could be vindicated by a sale of the property subject to the constructive trust (or, on the earlier analysis, subject to the charge): the proceeds of the sale could then be applied partly to compensate the tenant for loss for past losses and thereafter reinvested on more appropriate securities.\textsuperscript{33}

The first of those two paragraphs describes the compensation the taxpayer is entitled to as the quantum of the income that she ought to have received from the trusts by way of distributions to her, but which she did not receive. The second of those two paragraphs describes the compensation the taxpayer is entitled to as recompense for “past losses”. Both of those descriptions are consistent with the conclusion the AAT reached “that any remedy for breach of trust flowing from improper exercise of the power of investment would reflect lost income”.

Last, the AAT offered a most tenable analysis of why \textit{Phipps v Boardman} does not apply in \textit{Murdoch}, an analysis which the Full Federal Court did not attempt to refute, which it must have, as it overturned the decision of the AAT in \textit{Murdoch}. This analysis of the AAT was described by it in the following terms:

It is, accordingly, easy to posit a case in which a person acquires shares which are impressed with a charge or constructive trust because of the person’s fiduciary relationship. But that is a very long way from the present matter. The conduct prescribed in \textit{Boardman} and similar cases is the taking of an asset by a fiduciary which is in reality a trust asset. What is said here is that the trust funds should have been invested in different assets. The remedy in a \textit{Boardman} case is imposing a charge or constructive trust upon assets of the fiduciary in favour of the trust. Here, the remedy was the imposition of a charge or constructive trust on the trust assets in favour of a beneficiary. In \textit{Boardman} no question of the

\textsuperscript{30} \textit{Murdoch} [2007] AATA 1791, para 17.
\textsuperscript{31} Above n 30, para 35.
\textsuperscript{32} Above n 30, para 14.
\textsuperscript{33} Above n 30, para 14.
entitlement of the beneficiary to the benefit of a charge or constructive trust arose. The ‘beneficiary’ of the charge or trust was the original trust and not a beneficiary; certainly not a beneficiary with only a life interest in income. The statement that Boardman leads to a charge or trust over assets needs to be seen in this context. Obviously, that will be the case when an asset held by a fiduciary belongs to a trust. The fiduciary will be a bare trustee for the trust. The trust imposed will be a separate trust arising by operation of law and will not be some manifestation of the existing trust. When the assets subject to that separate trust are transferred to the original trust, they will become part of the original trust’s assets, subject to that trust’s terms.

It follows that Boardman does not assist the taxpayer. First, the conduct giving rise to the charge or trust is quite different. Secondly, no question of a charge or trust directly in favour of a beneficiary [sic: the word ‘beneficiary’ should perhaps have been ‘trust’] arises.

As will be evident from the passages of the Full Federal Court’s judgment quoted earlier, reliance on Phipps v Boardman was absolutely crucial to the holding the Full Federal Court reached in its decision. That being so, it is pivotal that the Full Federal Court refuted the analysis of the AAT as to why Phipps v Boardman does not apply in Murdoch, as described by the AAT in the passages quoted just above. The Full Federal Court, in its judgment, did not refute so, which is a fatal deficiency.

VII CAN THE FULL FEDERAL COURT’S DECISION BE JUSTIFIED BY AN ANALYSIS NOT ARTICULATED IN ITS JUDGMENT?

One may argue that the Full Federal Court’s decision can be justified by an analysis not articulated in its judgment. One could conceive two such possible analyses, the first of which is as follows.

The lump sum which the trusts paid the taxpayer was equal to the proceeds realized from by the trusts from the happening of CGT event A1 (that is, the disposal of a CGT asset) or CGT event C2 (that is, the redemption or cancellation of an intangible CGT asset) to assets acquired by the trusts before 20 September 1985. Any capital gain made by the trusts from those CGT events, accordingly, is ignored for purposes of income tax. Any distribution of those capital gains by the trusts to the taxpayer in the income year in which those CGT events happened (as the taxpayer is presently entitled in that income year to those capital gains) is also, accordingly, ignored for purposes of income tax in the hands of the taxpayer.

In the author’s view, this analysis is not tenable in the context of the case since in terms of the trusts all that the taxpayer was entitled to from the trusts was income (and not capital). Therefore, the trusts could never have distributed to the taxpayer any capital gains, as, by their very nature, capital gains (though they may be assessable income) can never be income. This conclusion is consistent with the position that, in Murdoch, at the Full Federal Court, it was not contended by the Commissioner or the taxpayer that the lump sum received by the taxpayer from the trusts was a distribution by the trusts to the taxpayer of “net income” (which includes capital gains not ignored for purposes of income tax) of the trusts.

The second of those two analyses is as follows. The lump sum received by the taxpayer was not, in fact, received from the trusts but, rather, from the
remainderman. That is, the trusts made capital gains which are ignored for purposes of income tax from the happening of CGT event A1 (that is, the disposal of a CGT asset) or CGT event C2 (that is, the redemption or cancellation of an intangible CGT asset) to assets acquired by the trusts before 20 September 1985. The trusts then distributed to the remainderman those capital gains, which retained their character, in the hands of the remainderman, as capital gains which are ignored for purposes of income tax. The remainderman thereafter used those capital gains to pay to the taxpayer the lump sum in question.

This analysis, of course, is premised on the terms of the trusts permitting a distribution (albeit a distribution of capital, not income) by the trusts to the remainderman during the lifetime of the life tenant (that is, the taxpayer). One has to assume that the terms of the trusts so permitted, since there is no reliable basis to discern the relevant terms of the trusts.

This too, is an analysis which is not tenable in the context, for the following reasons (which have been explained earlier). The remainderman (Mr Rupert Murdoch) can become obligated to make the payment of the lump sum to the taxpayer only in the context of clause 2.1 (c) of the settlement deed, a clause to which recital J (iii) of that deed relates. The essence of that clause 2.1 (c) is that, as one beneficiary of a trust, Mr Rupert Murdoch owed a fiduciary duty to the taxpayer, who was another beneficiary of the same trust, and that there had been a breach of that duty. That duty, of course, is owed to the taxpayer in her capacity as a beneficiary of that trust, a status which is necessarily determined according to the terms of that trust. In accordance with those terms, the taxpayer was a life tenant of the trust with an entitlement to only distributions from that trust of its income (not capital).

The breach of that duty by Mr Rupert Murdoch, therefore, it follows was a breach whose consequence was that the taxpayer was denied the receipt of distributions of income to which she was otherwise entitled from that trust (as she had no entitlement to anything else, including capital, from that trust). Any compensation that the taxpayer receives (in a lump sum or otherwise) for that breach must, accordingly, in her hands, necessarily bear the character of income.

The taxpayer’s entitlement to compensation, in the circumstances, may well be measured as what amount of capital profit Mr Rupert Murdoch, in his capacity as the sole remainderman of that trust, may be entitled to by way of a capital distribution from that trust to him. This has no bearing in determining the proper character, in the taxpayer’s hands, of the compensation which the taxpayer received, pursuant to that entitlement, for a breach of a duty owed to her in terms of that trust.

VIII POLICY IMPLICATIONS OF MURDOCH

Since 1976, the High Court will hear an appeal only after it has granted special leave to hear that appeal. It has been reported that the High Court only grants special leave to hear an appeal against a decision of the Full Federal Court with respect to questions of federal tax law in ‘exceptional cases’. 34 Nevertheless,
in reality the High Court frequently grants special leave to hear appeals against decisions of the Full Federal Court on questions of income tax.\textsuperscript{35}

There is no basis to reliably discern why the Commissioner decided not to seek special leave of the High Court to appeal against the Full Federal Court’s decision in Murdoch. The only authoritative pronouncement in that respect which one can have reference to is the Decision Impact Statement on Murdoch issued by the Australian Taxation Office, which is referred to in footnote 2. That Decision Impact Statement, however, sheds no light on why the Commissioner decided not to seek such special leave of the High Court.

Murdoch turned on whether a lump sum of as much as $85,087,176 was income (or capital) of an individual (not a large corporate entity). The income tax at stake, therefore, was, by no means, insignificant. The Commissioner rightly decided that the taxpayer’s contention that lump sum was capital was one which should be adjudicated. Furthermore, the AAT, in a decision reasoned with considerable discipline, held for the Commissioner. The fact that the decision of the Full Federal Court, unanimous though it was, overturned the decision of the AAT cannot, in the circumstances, support a conclusion that the Commissioner could, therefore, have resigned to the position that there was no merit in contesting the Full Federal Court’s decision. That is especially so as the Full Federal Court’s decision, as argued in this article, is not supported by an analysis that comprehensively refutes the analysis that underpinned the decision of the AAT.

Murdoch evinces a need to strengthen the controls applicable to the conduct of the Commissioner. It is submitted that legislative or administrative controls must be instituted which require the Commissioner to explain, through public pronouncement, his reasons for not seeking special leave of the High Court to appeal a decision of the Full Federal Court (such as in Murdoch). Such controls will enhance the proper discharging of accountability by the Commissioner, in his capacity as the holder of a very significant public office.

IX CONCLUSION

So far as can be discerned from the decision of the Full Federal Court, the Commissioner’s submissions to it seemingly did include exactly the analysis articulated in this article. That analysis is, as noted earlier, not dissimilar to the analysis upon which the AAT reached its decision that the lump sum settlement received by the taxpayer rightly was her income.

For the reasons canvassed in this article, the Full Federal Court erred in Murdoch in deciding that the lump sum settlement received by the taxpayer was not her income. It erred so as it failed to draw the proper conclusion upon applying the relevant law to the facts. That failure is manifested in two fatal deficiencies in the Full Federal Court’s decision:

- First, it cannot be discerned from the Full Federal Court’s judgment as to how it reached, with regard to the terms of the settlement deed, and particularly with regard to the claims enumerated as (a) to (d) in clause 2.1 of the settlement deed, the conclusion that the taxpayer’s ‘claim was to an

\textsuperscript{35} The Hon Justice Michael Kirby, ‘Hubris contained: why a separate Australian Tax Court should be rejected’ (2007) 42(3) Taxation in Australia 161.
accounting for a capital profit or gain made by Mr Murdoch and to an entitlement to a constructive trust over the assets of the trust estate, and she was paid the Lump Sum in satisfaction of those claims’.

- Second, the Full Federal Court, in its judgment, failed to refute the analysis of the AAT as to why *Phipps v Boardman* does not apply in *Murdoch*.

  The Commissioner, accordingly, should have sought special leave of the High Court to appeal against the Full Federal Court’s decision in *Murdoch*. The Commissioner has erred in not seeking such special leave.

  In the author’s view, legislative or administrative controls must be instituted which require the Commissioner to explain, through public pronouncement, his reasons for not seeking special leave of the High Court to appeal a decision of the Full Federal Court (such as in *Murdoch*). Compliance with such controls will enhance the proper discharging of accountability by the Commissioner, in his capacity as the holder of a very significant public office.