THE TRUST CONDUIT PRINCIPLE: A FOUNDATIONLESS THEORY?

By David Schabe[*]

This article re-evaluates the jurisprudential foundations of one of the long-accepted basic principles of the Australian income taxation of trusts − the "trust conduit principle". According to that "principle", an amount distributed by the trustee to a beneficiary retains, in the beneficiary's hands, the specific character (eg, as dividend or interest income) that it had in the trustee's hands.

This article demonstrates that:

(1) there is no sound jurisprudential foundation for such a general "trust conduit principle";

(2) the cases usually cited as authority for such a general principle have been wrongly interpreted; and

(3) the circumstances when such a proposition holds true are much more limited than is widely thought

1. INTRODUCTION

The "trust conduit principle" that an amount distributed by the trustee to a beneficiary retains, in the beneficiary's hands, the specific character[1] it had in the trustee's hands, has long been accepted as a basic principle of Australian income taxation of trusts. It is this "principle" that enables a trustee of a discretionary trust to "stream" trust income of a specific character to a particular beneficiary or beneficiaries of that discretionary trust so as to achieve the most tax effective result (that is, minimise the tax payable on that trust income).

The trust conduit principle has widespread acceptance. Numerous texts[2] support the principle. Even the Commissioner of Taxation demonstrates a belief in the principle through a number of rulings.[3] But is this acceptance correct and valid at law?

This article evaluates the trust conduit principle. It examines whether there is a sound jurisprudential foundation for such a general trust conduit principle and it examines the circumstances when an amount distributed by the trustee to a beneficiary does retain, in the beneficiary's hands, the specific character it had in the trustee's hands. This examination takes the form of a chronological analysis of the key cases from Australia, Canada, New Zealand, and the United Kingdom,[4] which are cited as authority for the trust conduit principle. As part of that analysis, the subsequent cases that have referred to, or had an impact upon, those key cases also are considered. This article demonstrates that there is no sound jurisprudential foundation for such a general trust conduit principle, the cases usually cited as authority for such a general principle have been wrongly interpreted, and the circumstances when such a proposition holds true are much more limited than is widely thought.

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[1] For example, as dividend or interest income.

[2] R Woellner. T Vella, L Burns, S Barkoczy and R Krever, *1999 Australian Taxation Law* (9th ed, 1999) ¶20-030; *CCH Electronic Tax Library CD-ROM* (CD No 38 2/99) Commentary − ITAA 1936 & others, ¶902-900; CCH Tax Editors, *1999 Australian Master Tax Guide* (30th ed. 1999) ¶6080; H Hodgson, *Law and Taxation of Trusts* (1996) 81; *ATP Tax Resource Library CD-ROM* (January/February 1999) Australian Tax Practice Commentary, [6/550] & [97/21]; and RL Deutsch & Others, *Australian Tax Handbook 1999* (1999) [30 065].

[3] See *Taxation Ruling* IT 2328, para 13; *Taxation Ruling* IT 2466, para 4; *Taxation Ruling* IT 2680, paras 16-20; and *Taxation Ruling* TR 92/13, paras 4, 5, 11 & 16.

[4] Including *Syme v C of T (Vic)* (1914) 18 CLR 519; *Baker v Archer-Shee* [1927] AC 844; *Pan-American Trust Co v Minister of National Revenue* [1949] Ex C R 265; *Charles v FC of T* (1954) 90 CLR 598; and *FC of T v Tadcaster Pty Ltd* 82 ATC 4316.

2. IN THE BEGINNING THERE WAS *SYME V C OF T (VIC)*

Of the cases most cited as authority for a general trust conduit principle, *Syme v C of T (Vic)*[5] is the oldest. Strictly it was an appeal from the decision of the Full Court of the Supreme Court of Victoria to the Privy Council, but as the Privy Council noted,[6] it was in effect an appeal from the High Court's decision in *Webb v Syme*.[7]

The proprietor of a newspaper publishing concern known as the "Age business", died leaving a will under which the residue of his estate (which consisted principally of the Age business) was given to trustees. The trustees were to, and did, carry on the business once the debts of the testator's estate were cleared. Out of the income of the residuary estate an annuity was to be paid, certain capital sums set aside, and the residue income divided equally among five beneficiaries (of which the appellant was one).

The question was whether the appellant's one-fifth share of the residue income during the 1910 tax year was assessable to income tax as "income derived by any person from personal exertion" or as "income derived by any person from the produce of property" within the meaning of those terms in the *Income Tax Act 1895* and the *Income Tax Act 1896 (Vic)*."Income derived by any person from personal exertion" was defined to include "all income arising or accruing from any trade carried on in Victoria although the income has not arisen or accrued or been ... derived ... from the taxpayer's own personal exertion or trade". "Trade" was defined to include every business. "Income derived by any person from the produce of property" was defined as "all income derived in or from Victoria and not derived from personal exertion". The Commissioner of Taxes had assessed the appellant under the "income derived by any person from the produce of property" head, which was subject to double the rate of tax charged on "income derived by any person from personal exertion".

The Privy Council[8] held that the portion of the appellant's one-fifth share of the residue income during the relevant year that was attributable to the business, was "income arising or accruing from any trade carried on in Victoria" and therefore was "income derived by any person from personal exertion" rather than "income derived by any person from the produce of property".

The Privy Council's judgment, which was delivered by Lord Sumner, stated:

> In saying 'any trade carried on in Victoria' the definition does not say by whom such trade is carried on. The amending section enlarges 'personal exertion' and extends it to trade carried on by vicarious exertion without stating the legal relationship between the real and the vicarious trader, or defining the capacity in which the business must be carried on by the latter ... Again, the Act does not say for whom the trade is carried on. When a trade is carried on by trustees there is no doubt that they carry it on for the beneficiaries and not for themselves, save in so far as their remuneration is provided for by law or by the trust deed. ... [T]he definition of 'income derived from personal exertion' is wide enough to cover the present case. What the appellant gets is 'income arising ... from a trade carried on in Victoria' by trustees, for the benefit of himself and others, entitled equally with him, 'although the same has not accrued ... from his own personal exertion' in his capacity as such a beneficiary.[9]

To this point, the Privy Council's judgment clearly was based on statutory interpretation rather than any general trust conduit principle. Later, however, the Privy Council stated:

[5] (1914) 18 CLR 519 ("*Syme*").
[6] Ibid 520.
[7] (1910) 10 CLR 482.
[8] Lord Dunedin. Lord Atkinson, Lord Sumner and Sir Joshua Williams.
[9] (1914) 18 CLR 519, 522-523.

> It does not follow when the appellant receives the cheque for his share ... that the connection between his income and the newspaper business is lost. There is no difficulty, either in fact or in theory, in keeping the 'Age business' apart from the other businesses, all the businesses apart from those concerns the income of which is the produce of property. The Commissioner's argument conceived the fund out of which the appellant is paid, as a reservoir fed by various streams descending from sundry sources and blending their waters in one basin, out of which they flow indistinguishably and indissolubly. With all respect to the learned Judges, the majority in the High Court of Australia in *Webb v Syme*, who adopted this figurative way of putting a very plain set of facts, their Lordships are only able to regard this argument as fallacious. There is no question here of showing whence the sovereigns came in the first instance which were ultimately paid to the appellant ... and there is no doubt whatever that the appellant's £17,025 17s 3d comes from the 'Age business' ... and is his solely because under his father's will they are carried on for him and the other members of the family. *What was the produce of personal exertion in the trustee's 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.*[10] (emphasis added)

This passage might appear to be authority for the establishment of a general trust conduit principle (at least in the context of a fixed trust - as in the facts). It cannot, however, be treated as such given the last sentence, which clearly demonstrates that what is being said in that passage is being said in the context of the particular statutory interpretation question being considered. It is not stating a general principle. Waters neatly concurs in the following terms that *Syme* is simply an authority on a very specific question of statutory interpretation and did not establish any general trust conduit principle:

> *Syme v. Commissioner of Taxes* ... is but the highlight of a consistent line of Commonwealth and South African authority, stretching from the year 1897 until the most recent Canadian decision in 1960, which holds that where a taxing statute refers to "income derived from" property, the interposition of trustees between the property and the trust beneficiaries does not prevent the beneficiaries from saying that their income is still derived from the property.[11]

Indeed:

> ... "derived from" are words which do not require the courts to distinguish between the legal interest of the trustees, and the equitable interest of the beneficiaries.[12]

Subsequent cases have treated *Syme* as limited to its particular statutory words and not as a basis for a general trust conduit principle. In *Tindal v FC of T*,[13] for example, the High Court quietly and simply distinguished *Syme* on the meaning of "income from personal exertion" and "income from property". By the time of *Tindal*, new income tax legislation, the *Income Tax Assessment Act 1936 (Cth)* ("ITAA36"), had been enacted and the definitions of those terms differed from those considered in *Syme*. Only two of the five High Court judges in *Tindal* saw fit to mention *Syme*. Of *Syme*, Starke J simply said, "*Syme v Commissioner of Taxes (Vic)* is distinguishable on the words of the Act"[14] and Dixon J said:

> *Syme v Commissioner of Taxes (Vic)* is inapplicable because, no doubt with that decision in mind, the draftsman of the

[10] Ibid 525-526.
[11] DWM Waters, "The Nature of the Trust Beneficiary's Interest" (1967) 45 *Can Bar Rev* 219, 234.
[12] Ibid 235.
[13] (1946) 72 CLR 608 ("*Tindal*").
[14] Ibid 625.

> definition introduced the words "carried on by the taxpayer" after the words "proceeds of any business." The taxpayer did not carry on the business. She was a beneficiary, not a partner. Her trustee did carry on the business, that is as a partner. The second question should, therefore be answered that it is all income from property.[15]

In *Archer-Shee v Garland*,[16] Lord Buckmaster (with whom Lord Warrington agreed) provided further confirmation that the reasoning in *Syme* is not of general application, but is authority on a very specific and limited question of statutory interpretation. Lord Buckmaster expressed that notion in the following terms:

> The case of *Syme v Commissioner of Taxes* again is no assistance. The tax was there assessed upon income "derived by any person from personal exertion," and this was by the statute declared to include "income arising or accruing from any trade" although not arising from the taxpayer's own personal exertion or trade. Under the provisions of a will, trustees carried on a business and paid the appellant one-fifth of the profits, and on these the tax was held duly assessed under the provisions already quoted. It is rarely profitable to attempt the interpretation of one statute by another, and in this case the mere comparison of the language shows it to be useless.[17]

Further, if *Syme* were the basis for a general trust conduit principle, one would expect that subsequent cases would, at the very least, mention *Syme*. To the contrary, *Syme* is not mentioned in three of the cases most cited as authority for a general trust conduit principle: *Baker v Archer-Shee*,[18] *Pan-American Trust Co v Minister of National Revenue*,[19] and *Charles v FC of T*.[20]

3. THEN CAME *BAKER V ARCHER-SHEE*

Given that *Syme*, when carefully considered, is not good authority for a general trust conduit principle, is such a principle to be found in *Baker* − the next case after *Syme* and another of the cases most cited as authority for a general trust conduit principle?

Baker was an appeal to the House of Lords from the decision of the Court of Appeal. A testator, who was a citizen of the United States of America, left the residue of his estate in trust for his daughter during her life. The trust fund consisted of foreign government securities, foreign stocks and shares, and other foreign property. The trustee, a company incorporated and resident in New York, paid such of the sums they received as they considered to be income, after deducting expenses, to the order of the daughter at a New York bank. No part of the income was remitted to the United Kingdom.

The question was whether the respondent, the daughter's husband, who was resident in the United Kingdom, should be assessed to income tax on the full amount of the income of the trust. The respondent (rather than the testator's daughter) was assessed because, in the UK, until 1990/91, a husband's income was deemed to include his wife's income if the couple were living together. It is only since 1990/91 that, in the UK, a husband and wife have been taxed as individuals.

More specifically, the question was whether the sums paid to the testator's daughter in New York, and not remitted to the UK, were income from "possessions out of the United Kingdom other than stocks, shares, or rents" within the terms of Sch D, Case V (2) of the *Income Tax Act 1918 (UK)*. If that were the case, the respondent would not be taxed on those sums because, under that provision, tax was

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[15] Ibid 629-630.
[16] [1931] AC 212 ("*Garland*").
[17] Ibid 220.
[18] [1927] AC 844 ("*Baker*"). It is particularly interesting that *Syme* is not mentioned in *Baker* given that:
(1) Viscount Sumner and Lord Atkinson sat in both *Syme* and *Baker*; and
(2) Viscount Sumner delivered the Privy Council's judgment in *Syme* (then Lord Sumner) and yet was in the minority in *Baker*!
[19] [1949] Ex C R 265 ("*Pan-American*").
[20] (1954) 90 CLR 598 ("*Charles*").

"computed only on the full amount of the actual sums annually received in the United Kingdom."

The House of Lords held by a 3:2 majority (Lord Atkinson, Lord Wrenbury and Lord Carson; Viscount Sumner and Lord Blanesburgh dissenting) that:

> ... the daughter was specifically entitled under the will in equity during her life to the interest and dividends of the securities, stocks, and shares comprised in the trust fund, and that consequently her husband was assessable under Case IV (1) and Case V (1) to income tax in respect thereof (except such, if any, as were shown to be "foreign possessions other than stocks, shares and rents") whether such interest and dividends were remitted to the United Kingdom or not.[21]

After pointing out that the estate had been fully administered and that the Trust Company of New York was subsequently appointed, and held the relevant funds, as trustees, Lord Wrenbury (with whom Lord Atkinson agreed) concluded that:

> Under Mr. Pell's will Lady Archer-Shee (if American law is the same as English law) is, in my opinion, as a matter of construction of the will, entitled in equity specifically during her life to the dividends upon the stocks.[22]
>
> Her right is not to a balance sum, but to the dividends subject to deductions [for the trustee's commission, expenses and American tax on the dividends] ...
>
> The statute itself provides for deduction of income tax (see Sch D, Cases IV and V); the commission payable to the Trust Company is a debt due from the beneficiary to the trustee — neither the one nor the other is relevant to the title of the beneficiary as distinguished from the amount which the beneficiary is entitled to receive by virtue of her title.[23]

Lord Carson (the other member of the majority) also concluded that once the residue became specifically ascertained, as a matter of construction of the will, Lady Archer-Shee was:

> ... sole beneficial owner of the interest and dividends of all the securities, stocks and shares forming part of the trust fund therein settled and was entitled to receive and did receive such interests and dividends.[24]

Lord Carson importantly did, however, qualify his conclusion by stating that:

> Had the residue been still undetermined or had the share to which Lady Archer-Shee was entitled been a proportion only of the income or profits of the residue other questions would, no doubt, arise.[25]

On the other hand, Viscount Sumner strongly dissented. He concluded that:

> Lady Archer-Shee ... does not, for income tax purposes, in my view own and is not entitled to any of the stocks, shares, securities or real property that form part of the New York trust estate. These belong to the trustee company, to whom also the annual payments made in respect of them, by way of rent, interest or dividends, "arise", "accrue" and "belong".[26]

Viscount Sumner's reasoning for that conclusion is summarised in the following passage:

> In the present case it happens that the settlement is in the simplest form. There is only one tenant for life and, during her life, there is no other object of the trust to be considered. We hear of no matters in which

[21] [1927] AC 844.
[22] Ibid 866.
[23] Ibid 866-867.
[24] Ibid 870.
[25] Ibid 869.
[26] Ibid 856.

> a conflict between income and capital and their respective interests has arisen, nor of any business carried on by the trustee, as to which the more complex case of trading profits would replace the plain case of dividends paid. *If there had been annuitants with a prior right to be paid or several beneficiaries entitled to share in the income; if there had been reversioners, who could claim that part of the annual receipts were in the nature of accretions to capital; if there was a trust for accumulation or a power to vary the amounts payable from time to time as between minors, the impracticability of saying that any or all of the beneficiaries entitled to income owned the whole or any part of that income from the moment it became payable was paid and to the full extent of the amount paid, would be evident.* ... The trustee may in his discretion pay one beneficiary out of the money collected from a security, another out of a payment of rent, and a third out of the profits of a business. He may, on the other hand, if he thinks fit, pay everything received into one account and then draw on that account generally in favour of each beneficiary. In either case it is plain that no specific dividend or interest payment "belongs" in any proper sense of the word to any particular beneficiary ... Similarly, by appropriation of payments in the trust bank account, the source out of which any given payment was made can be calculated. Neither process shows anything material to the nature of the beneficiary's right. They both go only to the measure and discharge of it in money.[27] (emphasis added)

Note the italicised portion of that passage, which accords with the qualification made by Lord Carson in the majority. Given Lord Carson's qualification, the case can only stand for a very narrow proposition. As Waters neatly expresses it:

> When the judgments of the majority are examined, it will be found that there was complete unanimity for only one proposition. Namely that when there is a constituted trust fund, and only one beneficiary entitled to all the income which arises from the fund, that beneficiary is entitled subject to deductions properly made by the trustee, to all the dividends and interest arising.[28]

That view accords with the way that subsequent cases have interpreted *Baker*.

4. *BAKER V ARCHER-SHEE* HAS BEEN NARROWLY INTERPRETED

In *Reid's Trustees v IRC*,[29] the judges of the Scottish Court of Session adopted a narrow interpretation of the decision in *Baker*, which is consistent with Waters' view. Lord Sands, whose approach was representative of that taken by the judges in the case, commented upon *Baker* in the following terms:

> Notwithstanding the narrowness of the majority, the decision is of course binding upon us, as is any implication which necessarily underlies it. But otherwise *dicta* of any of the noble Lords in the majority, though entitled to the greatest respect, are not conclusive.[30]
>
> The *dicta* which might be founded upon ... as indicating that a trust may be regarded as a mere agency or conduit pipe, are strictly limited to the case where the circumstances are similar, viz., where there is one beneficiary and the estate is already realised and duly invested.[31]

Subsequently in *Garland*,[32] the House of Lords was called upon to consider *Baker* when Archer-Shee appealed against further assessments to

[27] Ibid 853-854.
[28] Waters, above n 11, 260.
[29] (1929) 14 TC 512 (*"Reid's Trustees"*).
[30] Ibid 528.
[31] Ibid 529.
[32] [1931] AC 212.

income tax made upon him in respect of the same income for the three succeeding years, but this time:

> ... expert evidence was adduced as to the law of the United States to the effect that under that law the wife had no estate or interest in the securities, stocks or shares, but that her sole right was to compel the trustees to discharge their duties under the will.[33]

The House of Lords held unanimously that as a result of that evidence, the income was assessable under Case V (2) only to the extent to which that income was remitted to the UK. Of importance is that several of the Law Lords considered what comprised the ratio decidendi of *Baker*. Viscount Dunedin considered that:

> ... the ratio decidendi very clearly appears by comparing the judgment of Viscount Sumner, who was in the minority, with the majority judgment which prevailed. Viscount Sumner thought that the specific property in the stocks, shares, securities, and other investments which formed the trust fund, was in the hands of the trustees, and that accordingly what the beneficiary in this country got was what came to her from a foreign possession − namely, her right to get the trustees to make payment to her of the balance of the income. That view was rejected by the majority on the view that *there was in the beneficiary a specific equitable interest in each and every one of the stocks, shares, etc, which formed the trust fund*[34] (emphasis added)

Similarly, Lord Tomlin considered that:

I do not think it can be doubted that the majority of your Lordships' House in [*Baker*] founded themselves upon the view that according to English law (with which, in that case, American law was assumed to be identical) the appellant's wife had a property interest in the income arising from the securities, stocks and shares constituting the American trust, and that *but for the existence of that supposed property interest the decision would have been different*.[35] (emphasis added)

Those quotes (particularly the italicised parts) strongly support a narrow interpretation of the ratio of *Baker*.

Post *Garland,* there were several more decisions that narrowly interpreted and distinguished *Baker* (as in *Reid's Trustees*).

In *Executor Trustee and Agency Co of South Australia Ltd v DFC of T (SA),*[36] Latham CJ (the only judge in that case to consider *Baker*) narrowly interpreted and distinguished *Baker*. It is clear that Latham CJ considered *Baker* (and the so-called trust conduit principle) inapplicable to a discretionary trust. Certain persons were entitled to annuities of fixed amounts out of the income of the testator's residuary estate. The trustee was entitled to accumulate any unapplied surplus income and distribute the same at its discretion. Forty years after the testator's death, all life interests in the land in the estate had ceased and only six of the annuitants were still alive. For the year ended 30 June 1938, the trustee paid the whole of the net income from the trust real estate to the six surviving annuitants, first, in payment of their annuities, and, secondly, in exercise of its discretion to pay the surplus income to the surviving annuitants. The trustee, having been assessed in its representative capacity to land tax in respect of the land in the estate, claimed a deduction of £5000 from the unimproved value of the land in respect of each of the six annuitants in purported reliance on s 38(7) of the *Land Tax Assessment Act 1910 (Cth),* which stated:

> Where, under a settlement made before [1 July 1910] ... or a will of a testator who died before that day, the beneficial interest in any land or in the income therefrom is for the

[33] Ibid.
[34] Ibid 221.
[35] Ibid 222.
[36] (1939) 62 CLR 545.

> time being shared among a number of persons ... [there could be £5000 deducted from the unimproved value of the land in respect of each such person].

The High Court unanimously held that the trustee was not entitled to the benefit of s 38(7) of that Act.

Latham CJ distinguished *Baker* on the following basis:

> Here the will gives a power to accumulate and accordingly to withhold income, and, when the power to accumulate ceased by reason of the *Thellusson Act*, the beneficiaries could not, under the will as interpreted by the second order of the Supreme Court, obtain any income beyond the fixed annuities unless the trustee exercised a discretion in their favour. This fact, which, as I have already said, prevents the beneficiaries from being "owners" within the meaning of the Act, provides also a reply to any argument based upon *Baker v Archer-Shee*. In view of the fact that such a discretion exists, and that the exercise of it is interposed between the receipt of rents and profits of the land by the trustee and the payment of income to the beneficiaries, it seems to me to be impossible to hold that the latter are entitled specifically to the rents and profits.[37]

Although they did not consider *Baker*,[38] Starke and McTiernan JJ[39] used similar reasoning to Latham CJ to hold that the beneficiaries were not entitled to the income from the land, the subject of the trust, even though between them they received the whole of the income from the trust. Their reasoning, like that of Latham CJ, demonstrates a repudiation of a trust conduit principle in the context of a discretionary trust.

In *Re Young; Trustees Executors and Agency Co Ltd v Young*,[40] *Baker* was again narrowly interpreted. Martin J (of the Victorian Supreme Court), after referring to the qualifications of Lords Carson and Blanesburgh in *Baker* regarding where there was more than one person entitled to the residuary income, stated:

> I do not consider that any of the speeches delivered in *Baker v Archer-Shee* warrant the deduction that, where there are a number of persons entitled to share in the residue of an estate, any one of them has an equitable interest in the actual assets forming part of the trust fund, even assuming that there has been full administration.[41]

Five years later, in *Stannus & Anor v Commissioner of Stamp Duties*,[42] the New Zealand Court of Appeal (3:1) strongly supported the narrow interpretation of *Baker*. In the leading majority judgment, Callan J (with whom Kennedy J agreed) stated that the majority in *Baker* held that:

> Under English law the sole life tenant of a residuary estate, which has been finally ascertained and settled, is entitled in equity specifically during her life to the dividends upon the stocks in which such residuary estate is for the time being invested. ... [and that] the sole life tenant of an ascertained residuary trust fund has some form of specific interest or property in the particular assets of which such residuary trust fund for the time being consists.[43]

Callan J went on to distinguish *Baker* on the (now familiar) basis that:

> In *Baker v Archer-Shee* there was, in the events which had happened, only one life tenant solely entitled to the whole of the income. Here there are two sisters ... equally

[37] Ibid 557-558.
[38] Ibid 566.
[39] Ibid 571-572.
[40] [1942] VLR 4 ("*Young*").
[41] Ibid 8.
[42] [1947] NZLR 1 ("*Stannus*").
[43] Ibid 24.

> entitled for their respective lives to share the income from an ascertained but unapportioned residuary trust fund. ... There is a sense in which a sole life tenant is a specific owner, but it has no application when the income is divisible among more than one.[44]

Finlay J, the other member of the majority in *Stannus*, employed similar reasoning to that of Callan J. Finlay J too concluded that the principle in *Baker* was applicable "where there is only one *cestui que trust*."[45]

Around this time, there was first instance support in England for a slightly more broad interpretation of *Baker.* In a very short judgment in *Nelson v Adamson*,[46] Lawrence J (of the King's Bench Division) considered *Baker* in the context of a non-discretionary trust with an annuity as first charge on trust income, and the remaining income payable to a sole life tenant. He was of the view that it was held in *Baker*:

> ... that the interposition of a trustee does not prevent the income of *the cestui que trust* arising, within the meaning of the Income Tax Acts, from the stocks and shares held by the trustee,[47] (emphasis added)

and concluded that:

> ... the residue still arises from the stocks and shares within the meaning of the Income Tax Acts, and no more arises from the trust than in the case where there is no annuity.[48]

Whilst Lawrence J's view of the ratio in *Baker* is consistent with the narrow interpretation of *Baker*, his application of that ratio to the facts of the case before him is not. By applying *Baker* in the context of a trust with an annuity as first charge on trust income, with the remaining income payable to a sole life tenant, it is submitted that Lawrence J fell into error by interpreting *Baker* more broadly than had previous cases. Indeed, this view is supported by Callan J in *Stannus*. After considering *Re Young* and *Nelson v Adamson*, Callan J concluded that:

> [I]f and so far as *Nelson v Adamson* imports a conclusion as to the general law different from that of Martin J in *Re Young; Trustees Executors and Agency Co Ltd v Young*, then the view of Martin J should be preferred.[49]

5. *PAN-AMERICAN TRUST CO V MINISTER OF NATIONAL REVENUE* − THE NEXT MAJOR CASE

Two years after *Stannus* came *Pan-American* − another of the cases most cited as authority for a general trust conduit principle. In that case, Thorson P (at first instance in the Canadian Exchequer Court) applied *Baker* in the context of a trust with a sole beneficiary. More specifically the facts were that, after the outbreak of the second world war, a Swiss company incorporated the appellant in Canada and thereafter the dividends from two Canadian subsidiaries, instead of being paid to the Swiss company, were paid to the appellant which credited them to the Swiss company and paid them into a separate bank trust account. After citing *Baker* and *Garland*, Thorson P concluded:

> When the dividends were paid to the appellant and credited by it to the Swiss company the latter became the beneficial owner of such dividends and entitled to the amounts thereof in their character as dividends and not as income received or accruing from a Canadian estate or trust. ... In my opinion, the intervention of the appellant as trustee for the Swiss company did not cause the amounts received by it to

[44] Ibid.
[45] Ibid 38.
[46] [1941] 2 KB 12.
[47] Ibid 16.
[48] Ibid 16-17.
[49] [1947] NZLR 1, 26.

> lose their character as tax exempt dividends ...[50]

The result in that case raises no great controversy given the simple nature of that trust[51] and the fact that there was a sole beneficiary. The various cases referred to above, which had narrowly interpreted *Baker*, were not cited by Thorson P, but that is perhaps not surprising given that the facts in *Pan-American* fitted squarely into the narrow interpretation of *Baker*. It is for these simple reasons that *Pan-American* is not authority for a general trust conduit principle.

It was in this state of play that the High Court of Australia handed down its decision in *Charles* — the Australian case most cited as authority for a general trust conduit principle.

6. ENTER *CHARLES V FC OF T* – ANOTHER MISCONSTRUED CASE

The High Court[52] described the background to that case as follows:

> The appeal concerns an amount of £390, portion of a sum of £830 which the appellant received in the relevant year as a certificate holder in ... the Second Provident Unit Trust. ... The ... £390 ... came partly from profits which had been made on realizations of capital investments of the Trust, and partly from the proceeds of sale of "rights" in respect of new share issues which had arisen in respect of shares held as capital investments of the Trust. Both parties to the appeal attached significance to the distinction between the [£390 and £430] amounts in respect of source, the appellant contending that the £390 was in his hands a receipt of a capital nature and not liable to be included in the computation of his assessable income, and the commissioner contending that the £390 was profits of a business, or (alternatively) profits arising from the carrying on or carrying out of a profit-making undertaking or scheme within the meaning of s 26(a) of the ... [ITAA36], and accordingly possessed from the beginning, and continued to have when it reached the hands of the appellant, the character of income from personal exertion ...
>
> The beneficial interest in the trust fund was originally divided into 1700 units ... The trustees were to retain the trust fund in trust for the certificate holders ... A holder of 3,000 units or any exact multiple of 3,000 units was given a right to exchange his units for cash and securities, or securities only, forming a proportionate part of the trust fund ... and upon its determination the trust fund was to be distributed in specie or cash amongst the certificate holders in proportion to their respective unit-holdings.[53]

The High Court held that the sum in question should be excluded from the taxpayer's assessable income. Based on the evidence accepted by the Taxation Board of Review, the High Court concluded that the case could not:

> ... be treated as one in which beneficiaries receive from trustees profits made by the sale of property acquired for the purpose of profit-making by sale.[54]

Most importantly, for current purposes, was the following statement in the High Court's judgment:

> [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*; so that the question whether moneys distributed to unit holders under the trust

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[50] [1949] Ex CR 265, 273.

[51] Indeed, in *Fraser v The Queen* 95 DTC 5684, the Canadian Federal Court of Appeal was of the view that *Pan-American* involved a "bare" trust (that is, the trustee had no active duties to perform besides conveying the dividends to the beneficiary when instructed to do so).

[52] Dixon CJ, and Kitto and Taylor JJ.

[53] (1954) 90 CLR 598, 604-606.

[54] Ibid 610.

> form part of their income or of their capital must be answered by considering the character of those moneys in the hands of the trustees before the distribution is made.[55]

The first important point to make about that statement is that there is no reasoning given by the High Court as to why *Baker* was applicable to this case. Given the abundance of authority supporting a narrow interpretation of *Baker*, it might be argued that that the High Court was wrong in concluding that *Baker* was applicable. However, one can perhaps understand why the analogy with *Baker* is drawn in respect of each of the unit holders in this particular case, given that the High Court makes it very clear that what it is saying is in the context of the particular unit trust deed, which makes it clear by its terms that each unit holder under that trust had at all times a proprietary interest in all the trust property. That does not, however, establish *Charles* as authority for a general trust conduit principle applicable to all trusts. For example, *Charles* cannot be read as authority for a trust conduit principle in respect of any trust (eg, a discretionary trust) under which individual beneficiaries do not have proprietary interests in trust property at all times that they are beneficiaries of that trust.

Another important point about *Charles*, which seems to have been generally overlooked, is that the High Court did not address the question whether an amount distributed by the trustee to a beneficiary retains in that beneficiary's hands the specific character (eg, as dividend or interest income) that the amount had in the trustee's hands. The High Court held, in the particular circumstances of the case, that an amount that had a capital nature in the trustee's hands retained that capital nature in the beneficiary's hands. In other words, the very general character of income or capital was retained in the circumstances. *Charles* is thus also not authority for a general trust conduit principle that suggests such specific characteristics of an income amount are retained.

Only a year after *Charles*, the Supreme Court of Canada considered a case with many similarities to *Charles*. In *Minister of National Revenue v Trans-Canada Investment Corporation Ltd*,[56] the respondent invested funds in the purchase of certificates evidencing undivided interests in "trust units", which represented blocks of shares in "underlying companies". In due course the respondent received its share of the returns on the trust units.

The issue was whether the respondent was "entitled to deduct from its income the amount so received as dividends received by it from the underlying companies under s 27(1)(a) of the *Income Tax Act* 1948 (Can)"[57] which applied "where a corporation received a dividend from a [non-exempt] corporation that was resident in Canada."

By a 3:2 majority, the Supreme Court of Canada held that the respondent was entitled to the deduction provided by s 27(1)(a). Although none of the majority judges cited *Baker*, both Locke J and Cartwright J (with whom Fauteux J agreed) agreed with the reasons for judgment given by Cameron J in the Exchequer Court. Cameron J had stated that:

> At the time of the semi-annual distribution of income, a registered owner of the certificate was furnished with a statement showing precisely the shares held by the trustee in respect of each "Trust Unit."
>
> It is also shown that the Trustee took meticulous care to ensure that the stocks in the "underlying companies" represented in each "Trust Unit" were kept separate from all others. When dividends were received, they were immediately placed in a special Series "B" Trust Account and all distributions made, whether to registered owners or to those holding bearer certificates, were paid out of that account.

[55] Ibid 609.
[56] [1955] 5 DLR 576 ("*Trans-Canada Investment Corp*").
[57] Ibid 577.

> From these facts, and particularly because [the respondent] could at any time demand that the Trustee deliver to him his proper proportion of the shares in the "underlying companies," it seems to me that the holder of the Series "B" certificate was, in fact, the beneficial owner of the basic shares represented thereby. ... The number of shares to which he was entitled in each company was fixed at the time he purchased the certificates, remained the same throughout, and he was entitled to physical possession thereof, upon demand.
>
> Under these circumstances I do not think that the amounts which the appellant received were other than dividends from the "underlying companies." The majority decision of the House of Lords in *Archer-Shee v Baker* strongly supports that view.[58]
>
> Reference may also be made to *Pan-American Trust Company v MNR*, in which the President of this Court considered the first *Archer-Shee* case and followed the principles therein laid down. Reference may also be made to ... *Nelson v Adamson*; and to *Syme v Commissioner of Taxes*.[59]

Locke J agreed with Cameron J that the respondent was "the beneficial owner of these shares"[60] and Locke J was:

> ... quite unable to understand how the character of these moneys became changed through the intervention of the trustee or by the fact that by agreement it was entitled to make the deductions I have mentioned before paying over the amount to the respondent.[61]

Cartwright J relevantly considered that:

> ... in applying the words of the section to the facts of the case the question to be answered is not, from whose hand did the appellant receive actual payment of the sum of $737.62, but rather, of what did such sum consist, and, in my opinion, the reasons of [Cameron J] make it clear that the answer to such question is that it consisted of dividends of the sort described in the [section] and that the *mere* interposition of a trustee between the dividend-paying companies and the beneficial owner of the shares did not change the character of such sum. The finding of [Cameron J] that the appellant was the beneficial owner of shares in the underlying companies was not questioned before us.[62] (emphasis added)

It is obvious that Cameron J and the majority Supreme Court judges were heavily influenced by the fact that the respondent was, under the terms of the particular trust, the beneficial owner of the particular shares in respect of which the dividends in question were paid. Thus, in respect of those particular shares, there was a strong similarity between the position of the respondent and the position of Lady Archer-Shee in *Baker*. But, as it was similarly demonstrated in the context of *Charles*, because it is not always possible to point to such continuous beneficial ownership of particular trust property by a particular beneficiary of that trust (particularly in the context of a discretionary trust), *Trans-Canada Investment Corp* is also not authority for a general trust conduit principle.

7. ONLY PASSING REFERENCES AFTER *CHARLES* AND *TRANS-CANADA INVESTMENT CORP*

Since 1955, there have been only passing references by individual judges to the various cases mentioned in relation to the circumstances when the trust conduit proposition (that an amount distributed by the trustee to a beneficiary retains, in the beneficiary's hands, the specific character it had in the trustee's hands) holds true.

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58 [1953] Ex CR 292, 296-297.
59 Ibid 298.
60 [1955] 5 DLR 576, 586.
61 Ibid 588.
62 Ibid.

In *Livingston v Commissioner of Stamp Duties (Qld)*,[63] Fullagar J said of *Baker* "[i]t may be that applications in later cases of the view of the majority in that case have been based on a misunderstanding of that view".[64] Whilst the decision of the High Court was overturned on appeal in the Privy Council, it is submitted that what Fullagar J (in the majority) had to say about *Baker* remains valid since:

(1) it was said in the context of discussing the situation where there is an ascertained trust fund, rather than an unadministered estate (as was the case in Livingston);

(2) the Privy Council did not discuss *Baker*; and

(3) as Waters notes:

> The decision of the Privy Council is expressly based on the facts of the case, an unadministered estate. So that the case says nothing, expressly or impliedly, as to the law where the trust fund is ascertained.[65]

Having said that Fullagar J's statement about *Baker* is still valid, it is of limited assistance in the current context given that Fullagar J does not specify what are the "later cases" that may have been based on a misunderstanding of the majority view in *Baker*.

In *Shortt & Quinn v Minister of National Revenue*,[66] Thurlow J (of the Exchequer Court of Canada) cited *Syme, Baker* and *Trans-Canada Investment Corp.* In that case, half the net income of a trust was payable to each of two beneficiaries. Included in the assets of the trust was a business, which was carried on by the trustee. The question was whether the share of the net income of that business that was credited to each of the two beneficiaries was "income from the carrying on of a business" within the terms of the relevant provision. Thurlow J relevantly stated:

> While ... the determination of the amount of the business earnings available for distribution as income was left to the trustee, the making of such a determination could not change the nature of the amount as income from the carrying on of a business [citing *Syme, Baker* and *Trans-Canada Investment Corp*]. And the immediate right of the appellants to the sum when determined was not dependent upon any further act or determination by the trustee to pay it. Accordingly, the factual situation, as I view it, is one wherein the income in question was income from the carrying on by the trustee of a business which was vested in him as trustee for the appellants and others, but wherein the net income from such business, as determined by the trustee, belonged entirely to the appellants.[67]

Thurlow J went on to apply similar reasoning to that used in *Syme* to the effect that the income in question was "income from the carrying on of a business" because the section did not specify that the business had to be carried on by the taxpayer. Thus, it is obvious that this case also is not authority for a general trust conduit principle, but is simply another example of the "income derived from" type of reasoning used in *Syme*.

It is relevant to mention also *FC of T v Angus*.[68] That case provides further support against the existence of a general trust conduit principle.

The taxpayer in that case, an Australian resident, was entitled under a testamentary trust to a life interest in one-third of the income of the trust fund, which consisted of shares in a company incorporated and resident in Singapore. Those shares remained registered in the name of the testator after his death. Pursuant to a direction given by the trustees, who resided in Singapore, to the company, one-third of the amount of dividends declared by the company was paid directly by the

[63] (1960) 107 CLR 411.
[64] Ibid 436.
[65] Waters, above n 11, 273.
[66] 60 DTC 1056.
[67] Ibid 1058.
[68] (1961) 105 CLR 489.

company to the taxpayer instead of being paid to the trustees and then by the trustees to the taxpayer. At first the taxpayer lodged an income tax return in Singapore in which the amount she received was returned as dividends received from a Singaporean company. Later the Singapore taxing authorities were informed that the amount should have been returned as income from a trust estate, but they replied that it made no difference. The taxpayer claimed that, for the purposes of her Australian income tax liability, her one-third share of the income of the trust estate was exempt income pursuant to s 23(q) of the ITAA36.

The High Court unanimously held that s 23(q) did exempt from tax income received by a beneficiary from a trust estate which otherwise falls within its terms.

Of current relevance are consistent statements by the judges that the amount in the taxpayer's hands was income from a trust estate and not dividend income. Dixon CJ considered that "she ought not to be regarded as a shareholder receiving dividends but as a beneficiary of a trust"[69] and later noted that the income was "received by her in the character of ... income to which she was entitled under the trusts the executors or trustees were bound to administer."[70] Fullagar J noted that "[t]he income received by her was not dividend income, but income of a trust estate."[71] Kitto J considered it "necessary to recognize that ... what she received was in her hands part of the income of the trust estate and not dividends paid to a shareholder"[72] and Menzies J likewise commented that the income concerned was "strictly the share of the income of a trust fund ... albeit it was taxed in the way in which it was returned (that is, as dividends) rather than as a share of the income of a trust."[73]

Twenty years later in *IRC v Berrill*,[74] Vinelott J (of the English Chancery Division) cited *Baker* for the proposition that:

> Under English law *a* beneficiary entitled to the income of trust property under a trust instrument which contains no power of accumulation is entitled to the income of each asset comprised in the trust property; each asset constitutes a separate source of income.[75] (emphasis added)

Again, those comments accord with the narrow interpretation of *Baker*. Further, and even more interestingly, Vinelott J then expressed the view (which accords with the already expressed argument) that:

> If, on the other hand, a beneficiary has no right to receive income but is paid income (or a sum which for tax purposes falls to be treated as income) in the exercise of a discretion, the exercise of the discretion constitutes a new source of income.[76]

Shortly thereafter came *FC of T v Tadcaster Pty Ltd*[77] − one of the cases cited in *Taxation Ruling* TR 92/13 as authority for a general trust conduit principle.

The taxpayer in that case (a resident private company) declared a dividend in favour of its two shareholders, who held their shares as bare trustees for a Dutch private company. The amount of the dividend, less withholding tax deducted, was paid or credited to the Dutch company. The Commissioner claimed that part of the dividend was a "prescribed dividend" as defined in s 103AA of the ITAA36 − being a dividend derived by a non-resident private company and paid by a resident private company. The taxpayer argued that "what

[69] Ibid 501.
[70] Ibid 502.
[71] Ibid 506.
[72] Ibid 515.
[73] Ibid 519.
[74] [1981] 1 WLR 1449.
[75] Ibid 1460.
[76] Ibid.
[77] 82 ATC 4316.

[the Dutch company] derived was income that came to it by virtue of the trust in its favour and not a dividend that came to it by way of payment from the taxpayer."[78]

In holding in favour of the Commissioner, Brinsden J (of the Supreme Court of Western Australia) stated:

> There is a consistent line of Commonwealth and South African authority from the year 1897 which holds that where a taxing statute refers to "income derived from" property, the interposition of trustees between the property and the trust beneficiaries does not prevent the beneficiaries from saying that their income is still derived from the property ... It is unnecessary for me to set out all these cases but particular reference is made to *Syme v FC of T* ... and *Baker v Archer-Shee* ... and particularly Lord Carson at p 870.[79]

It is obvious that this case also is not authority for a general trust conduit principle, but is simply yet another example of the "income derived from" type of reasoning used in *Syme*. Just as it was critical to the Privy Council's decision in *Syme* that the relevant legislation there did not specify that the business had to be carried on by the taxpayer, it was critical to Brinsden J's decision "that the section does not expressly state that the paying company must pay the dividend direct to the company which derives the dividend."[80] In any event, as there was only one beneficiary entitled to the trust income, the case fits within the narrow interpretation of *Baker*.

Subsequently, in *Read v Commonwealth*,[81] Brennan J cited *Charles* in the context of considering the trust deed of a commercial unit trust under which each unit holder had:

> ... a beneficial interest in the assets of the Trust, a right to have the trusts executed in accordance with the Deed, and a right to proportionate distribution of the proceeds representing the assets of the trust fund upon termination of the Trust. The extent of a unit holder's beneficial interest at any given time is that proportion which his or her units bear to the total number of units issued.[82]

Brennan J considered that:

> Statute apart, a distribution of a capital profit in the hands of a Trustee would be capital in the hands of a unit holder, for the character of the moneys distributed in the hands of the unit holder would correspond with the character which those moneys bore in the hands of the Trustee: *Charles v Federal Commissioner of Taxation.*[83]

This statement does not take *Charles* any further than the statements in *Charles* itself. Thus, for the reasons earlier expressed as to why *Charles* is not authority for a general trust conduit principle, Brennan J's statement is also not authority for such a principle.

The most recent judicial statements concerning the "transparency" of trusts are to be found in the English case of *Memec plc v IRC.*[84] Statements in that case very clearly support the non-applicability of any trust conduit principle in the case of discretionary trusts. In the context of considering whether a German "silent partnership" was:

> ... transparent in the sense that dividends paid by the trading subsidiaries [to the silent partnership of which the taxpayer was the "silent partner"] were paid (under the partnership agreement and to the extent there specified) to [the taxpayer]"[85]

[78] Ibid 4319.
[79] Ibid.
[80] Ibid 4320.
[81] (1988) 167 CLR 57.
[82] Ibid 61-62.
[83] Ibid 72.
[84] [1996] BTC 590 (ChD) and [1998] BTC 251 (CA).
[85] [1996] BTC 590, 597.

Robert Walker J (of the Chancery Division) considered "by way of analogy"[86] whether a trust was "transparent". After referring to *Baker* and *Garland*, Robert Walker J stated:

> Under an English trust with an interest in possession the life tenant has an equitable interest in the trust property and the trust income as it comes into the trustee's hands, even though the trustees have a lien on capital and accruing income for their expenses. Such a trust is transparent for income tax purposes. A discretionary trust, on the other hand, is not transparent. No beneficiary is entitled unless and until the trustees exercise their discretion in his or her favour, and the trustees' exercise of discretion is regarded as having (in Lord Asquith's words) independent vitality and creating a new source of income, although the effect of this may be tempered by specific enactment ... or extra-statutory concession ... Similarly the rights of an annuitant under a trust are regarded as a source of income distinct from that of the underlying trust investments.[87]
>
> Transparency is normally associated with a situation where the ultimate recipient of the income in question has a beneficial interest in it from the start, and moreover the income is not transmuted at some intermediate stage by the need for the trustees to exercise a discretion or by its being packaged so as to reach the ultimate recipient in the form of a fixed annuity.[88]

On appeal, the Court of Appeal affirmed Robert Walker J's decision and refused leave to appeal to the House of Lords. The judgments of the members of the Court of Appeal do not contradict Robert Walker J's statements about the "transparency" of trusts. Peter Gibson LJ (with whom Henry LJ agreed) relevantly noted that Robert Walker J:

> ... made a comment at p 603 on the distinction between a life tenant under an English trust and a beneficiary under an English discretionary trust, there being transparency in the case of the former but, the judge said, not in the case of the latter[89]

and that "this distinction was supported by the Crown but disputed by [the taxpayer]",[90] but regrettably considered it "not necessary for the purposes of this appeal to resolve the dispute."[91]

The other member of the Court of Appeal in that case, Sir Christopher Staughton, also did not take the matter any further. He simply stated:

> There is authority that, for tax purposes, an intermediary can in certain circumstances be disregarded. Indeed that must be the case where the intermediary is a mere agent or messenger, such as the post office or a bank. A wider application of the doctrine can be seen in the contrasted cases of Baker [citing *Baker* and *Garland*].[92]

8. THE PRINCIPLES FROM THE CASES

Having reviewed all the relevant precedents in Australia, Canada, New Zealand, and the United Kingdom, since *Syme* on the question of whether there is a general trust conduit principle, the following relevant principles can be extracted from all those cases:

(1) There is no general principle that an amount distributed by the trustee of a trust to a beneficiary of that trust retains in that beneficiary's hands the specific characteristics that the amount had in the trustee's hands.

[86] Ibid 603.
[87] Ibid.
[88] Ibid 605.
[89] [1998] BTC 251, 257.
[90] Ibid.
[91] Ibid.
[92] Ibid 263.

(2) Further, there is no sound authority for the proposition that, statute apart, where:

(a) there is more than one beneficiary entitled to the income from trust property under a trust; and

(b) the trustee keeps such trust records and accounts that demonstrate that an amount came from the income from particular trust property,

an amount of such income will retain in that beneficiary's hands the specific characteristics that the amount had in the trustee's hands.

(3) *Baker* is authority that, statute apart, where:

(a) there is one beneficiary entitled to the income from trust property (without the exercise of a discretion in that beneficiary's favour) under a trust with no power of accumulation given to the trustee; and

(b) the trustee keeps such trust records and accounts that demonstrate that the relevant amount came from the income of particular trust property,

an amount of such income will retain in that beneficiary's hands the specific characteristics that the amount had in the trustee's hands unless, under the terms of that trust or the trust law of the relevant jurisdiction:

(i) the trustee is required to mix the different types of trust income and then distribute the "blended" income to that beneficiary; or

(ii) that beneficiary does not have a proprietary interest in the trust property.

(4) *Trans-Canada Investment Corp* is authority (at least in Canada) that, statute apart, where:

(a) there is more than one beneficiary entitled to the income from trust property (without the exercise of a discretion in those beneficiaries' favours) under a trust with no power of accumulation given to the trustee;

(b) a particular beneficiary is, under the terms of the trust, specifically entitled to the income from particular trust property; and

(c) the trustee keeps such trust records and accounts that demonstrate that the relevant amount came from the income from that particular trust property,

an amount of such income will retain in that beneficiary's hands the specific characteristics that the amount had in the trustee's hands unless, under the terms of that trust or the trust law of the relevant jurisdiction:

(i) the trustee is required to mix the different types of trust income and then distribute the "blended" income to that beneficiary; or

(ii) that beneficiary does not have a proprietary interest in the trust property.

(5) Statute apart, where an object of a trust becomes entitled to income of that trust pursuant to the exercise of a discretion in that object's favour, then an amount of such income will not retain in that object's hands the specific characteristics that the amount had in the trustee's hands. In such circumstances, the exercise of the discretion creates a new source of income.

(6) Statute apart, the rights of an annuitant under a trust are a source of income distinct from the source or sources from which that annuity is paid. That is why an annuity has an income nature even if paid out of trust capital.

(7) In the context of a specific tax provision, the question whether an amount distributed by the trustee of a trust to a beneficiary of that trust does retain in that beneficiary's hands the specific characteristics that the amount had in the trustee's hands is determined by discerning whether that specific provision expressly or impliedly allows, or excludes, such character retention.

(8) A tax provision that utilises the phrase "derived from [a particular character of property or

activity]" (or something similar) would seem to allow an amount distributed by the trustee of a trust to a beneficiary of that trust to be regarded as retaining in that beneficiary's hands the specific characteristics that the amount is demonstrated (through relevant trust records and accounts) to have had in the trustee's hands.

9. CONCLUSION

It will be evident that the above principles differ significantly from the propositions widely believed to come from the cases. Indeed, it should be evident that the circumstances when the trust conduit principle holds true are much more limited than is widely thought. Of particular significance is the conclusion that, unless there is a specific contrary statutory intention, the trust conduit principle does not hold true in the context of a discretionary trust even where the trustee keeps separate accounts for different types of trust income and purports to allocate different types of income to particular objects or classes of objects. The Commissioner's views in the various rulings mentioned, to the effect that such character retention does generally occur in such circumstances, should be regarded as being not in accordance with the case law. It seems that the widespread, but erroneous, acceptance of a general trust conduit principle is a classic example of the old adage that something false said often enough may eventually be accepted as true.

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