

# High Court decision

## Income test: property trust

READ v COMMONWEALTH OF AUSTRALIA

High Court of Australia

Decided: 2 June 1988 by

Mason C.J., Brennan, Deane, Toohey and Gaudron JJ.

This was an appeal against the decision of the Federal Court in *Secretary to DSS v Read* (1987) 38 SSR 484. The Federal Court had allowed an appeal from the AAT's decision in *Read* (1986) 33 SSR 420, and decided that extra units in a property trust, credited to a pensioner following a revaluation of the trust's assets, were 'income' for the purposes of the age pension income test.

### The legislation

At the time of the original DSS decision, 'income' was defined in s.18(1) of the *Social Security Act* as meaning -

'personal earnings, moneys, valuable consideration or profits earned, derived or received by that person for the person's own use or benefit by any means from any source whatsoever, within or outside Australia . . .'

[The definition was subsequently re-enacted in s.6(1) of the Act; and, from 27 October 1986, the additional words, 'whether of a capital nature or not', were added to the definition after the word 'profits'. The High Court did not consider the amended version of s.6(1); but the justices approached the earlier definition on the basis that it included capital profits. Accordingly, this decision appears to be directly applicable to the current definition - now in s.3(1).]

### The property trust

The property trust, in which Read had purchased units, operated under a trust deed. The deed provided that the trust's income from property investments was not to be distributed to unit holders but transferred to the trust's capital fund. The trust's investments were to be revalued every 3 years. If this revaluation showed an increase in value, additional units were to be created and issued to unit holders. A unit holder could call on the trustees to buy any of her or his units on 28 days' notice.

The unit's assets were revalued in 1984; and, because this showed an increase in value, extra units were issued to Read. The DSS treated the value of those additional units as Read's income.

### The majority opinion

Mason C.J., Deane and Gaudron JJ. said that the additional units credited to Read were 'valuable consideration'

because they were 'capable of being valued in money terms'. But, they said, it was not possible to regard Read as having 'earned, derived or received' that 'valuable consideration'.

The justices said that the issue of the additional units to Read (and the other unit holders) did not affect her proportionate beneficial interest in the trust's assets. If Read were to sell the additional units she would surrender a part of her previous interest in the trust. It followed that 'the additional units cannot be said to represent a separate item of property or a separate interest in the Trust.' The issue of the additional units was -

'an adjusting mechanism for formally recognizing or reflecting the alteration in current value of the appellant's proportionate beneficial interest in the trust vis-a-vis other unit holders.'

(Mason C.J., Deane and Gaudron JJ., pp.6-7)

The three justices then turned to the question whether the additional units were a 'profit' within the definition of 'income'. They approached this question on the assumption that the words 'profits earned derived or received' in the pre-1986 definition of 'income' were wide enough to include capital profits. They observed:

'In our opinion a mere increase in the value of an asset does not amount to a capital profit. A profit connotes an actual capital gain and not mere potential to achieve a gain. Until a gain is realized it is not "earned, derived or received". A capital gain is not realized when an item of capital which has increased in value is ventured, either in whole or in part, in a transaction which returns that increase in value.'

(Mason C.J., Deane and Gaudron JJ., p.9)

After quoting from a decision of the U.S. Supreme Court, *Eisner v Macomber* (1920) 252 U.S. 189, the three justices concluded:

'As the only relevant gain which is identifiable by reference to the additional units issued to the appellant is an unrealized capital gain, the additional units do not constitute a profit within the definition of "income" in s.18 of the Act as it stood in May 1984.'

(Mason C.J., Deane and Gaudron JJ., p.10)

It followed that the additional units issued to Read were not 'income' as defined by the *Social Security Act* in 1984, they said.

### The minority opinion

Brennan and Toohey JJ. dissented. Brennan J. observed that the definition of 'income' in the former s.18 and present s.3 of the *Social Security Act* -

'is couched in the widest terms presumably to ensure that public expenditure is directed to those who stand in actual need of the periodic support which income-related pensions provide. The definition is wide enough to em-

brace receipts of a capital nature as well as receipts of income . . .'

(Brennan J., p.12)

Brennan J. rejected an argument that the definition should be read down because otherwise occasional receipts of capital, such as for the sale of a house or a car, would affect a person's pension. He said that, under the *Social Security Act*, a receipt of 'income' was relevant to the determination of a rate of pension only if it -

'related in some way to a period; an isolated receipt of what is, by ordinary notions, a capital sum cannot affect "the annual rate of income".'

Brennan J. continued that it was 'entirely consistent with the scheme' for determining the rate of pension -

'to include within a pensioner's "income" receipts of moneys etc. to which a pensioner becomes entitled periodically, even though the entitlement depends on an increment in, or in the value of, a capital asset. Such receipts may well be regarded as available to a pensioner to defray the recurrent expenses ordinarily met out of income.'

(Brennan J., p.14)

He pointed out that the definition of 'income' in the Act was to be 'construed in its unique context' and that decisions on the meaning of 'income' in other legislation and from other jurisdictions should be used with care.

After examining the terms of the trust deed, Brennan J. said that the additional units allocated to Read in 1984 were a periodic addition to her units and were convertible into money on giving 28 days' notice to the trust managers. They fell within the definition of 'income', because they were a periodic allocation of additional units, convertible into money: they were therefore 'valuable consideration . . . received by' Read for her 'own use or benefit'. Moreover, the additional units 'might properly be regarded as a yield on the investment made by [Read]': Brennan J., p.21.

Toohey J. agreed with Brennan J.

### Formal decision

The High court allowed the appeal against the decision of the Federal Court.

[P.H.]

