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Keeping it in the family

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Queensland Bar

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Contents

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1. Overview

This brief paper deals with two issues which have cropped up in recent practice:

- what the recent cases about “gift and loan back” tell us. I will suggest at this stage that those cases tell us nothing conclusive, but rather indicate pressure points with such arrangements; and

- debt collecting by tax authorities by suing relatives of the taxpayer, to undo “gifts”, made to the relatives; and

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2. Gift and loan back cases

2.1 Attempt to patent

We knew there was something special about gift and loan back arrangements when we saw the report of *Application by Grant* (2004) 62 IPR 143. Mr Grant had applied for an innovation patent. The first claim in the patent, subject to a proposed amendment of that claim, was as follows:

> "1. An asset protection method for protecting an asset owned by an owner, the method comprising the steps of:
>
> (a) establishing a trust having a trustee,
>
> (b) the owner making a gift of a sum of money to the trust,
>
> (c) the trustee making a loan of said sum of money from the trust to the owner, and
>
> (d) the trustee securing the loan by taking a charge for said sum of money over the asset."

The decision of the Deputy Commissioner of Patents, which was important at the time, notes that an aspect of the invention was "that it does not entail the application of any 'natural' law. The present invention resides in the 'discovery' that the effects of certain laws can be avoided by the pre-emptive taking of appropriate steps in accordance with other laws".

Apparently, the Queensland Law Society had lodged an objection to the issue of a certificate of examination. There had been a deal of correspondence including claims that the method, the subject of application for patent, had already been referred to in seminars.

The Deputy Commissioner of Patents decided that the claims of the patent under consideration did not involve "any discovery of a law of nature, or involving the application of technology is some form or other to perform the process". Rather the Deputy Commissioner characterised the discovery as relating to the laws of Australia. It was said that "the state of affairs was already present in the laws of Australia". The Deputy Commissioner revoked the innovation patent.

This was apparently not the end of matters, because the Deputy Commissioner of Patents also mentioned the existence of other filings. Nevertheless I have heard nothing more of this claim.

The evidence filed by those opposing indicated that seminars had been given in 2002 referring to something that was contended to be a similar method, and that a newsletter had been published by a Brisbane firm also indicating this method in 2002. Without that evidence to hand, it is not possible to say anything of the merits of that evidence.

2.2 More recent cases

There have been two 2021 cases about application of methods like that referred to in Mr Grant's application for patent:

- *Turner v O'Bryan-Turner*; and
- *Re Permewan*.

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The latter case appeared to be at an early stage, and I deal with that first.

2.3 *Permewan*[1]

This is a decision of Davis J of the Queensland Supreme Court on an application to remove Mr JS Permewan as executor of the estate of the late Ms PV Permewan, his mother.

The evidence recited by Davis J indicated that the deceased had three children including the executor.

Davis J considered that the effect of the deceased's Will was "to transfer the entire estate of [the deceased] either to [the executor] or to Zalerina as trustee of the Lotus Trust in circumstances where [the executor] controls Zalerina": paragraph 8.

It is important to understand the limits of this decision. The applicant was one of the two daughters of the deceased, and she sought removal of Mr Permewan, her brother, as executor of the estate of the deceased.

Thus the decision does not deal closely with the merits of the transaction that the applicant daughter sought to have considered by a replacement administrator of the deceased's estate. The applicant did not need to show that the transaction was invalid. It assisted her case that her brother saw no need for the transaction to be litigated except in the context of family provision proceedings.[2]

There was evidence that the executor saw the applicant in a poor light, such that Davis J said that the evidence did not "inspire confidence that he will act honestly and in accordance with his obligations as trustee and executor": paragraph 34.

These are the kinds of matters which in fact were quite relevant to the decision made by Davis J to remove Mr Permewan as executor and appoint a lawyer as administrator of the estate.

That having been said, we should now examine the transaction of interest, that the applicant sought to have further investigated. Davis J describes the transaction as follows.

Seventeen months before her death, the deceased made a statutory declaration that she intended that certain payments by her, including those by a Bearer Promissory Note to the trustee of the Lotus Trust, were to be "by way of gift".

On the same day she signed a "Bearer Promissory Note" under which she promised to pay the bearer the sum of $3 million.

On the same day, but this time on behalf of the trustee of the Lotus Trust, she signed a receipt "as a gift".

Thus far, the deceased has by promissory note promised to pay $3 million to bearer, being the trustee of the discretionary trust which has accepted the promissory note as a gift.

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[1] [2021] QSC 151

[2] At paragraph 27. This seemed to be putting the cart before the horse, because it is conventional to determine the size of the estate before determining any application for further provision from the estate. The court even resists running the equity proceeding at the same time as the family provision trial.

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Also on that day, the deceased, as sole director of the trustee company, resolved:

- to note receipt of the bearer promissory note for $3 million from herself by way of a gift of capital to the trustee to be held on trust;
- to acknowledge receipt of the bearer promissory note by execution of the bearer promissory note;
- to lend the money gifted by that bearer promissory note back to herself, (ie in her personal capacity);
- that such loan be repayable on demand and secured by mortgage over real property acceptable to the trustee company;
- to execute a loan agreement and mortgage security to effect the above resolutions.

A loan agreement was signed that day between the deceased and the trustee of the Lotus Trust. The loan agreement refers to the trustee lending money to the deceased. It contained a covenant for provision of security over a nominated property, as and when required by the lender. She was also to give on demand a security interest over shares in a company.

It would seem that on the same day the deceased signed a "Security Deed" providing for a mortgage over the land and over the shares in question. A mortgage over the land was executed about a month later and was registered.

Also, on the critical day when all the other documents such as the Bearer Promissory Note were signed, the deceased gave a receipt in favour of the trustee as follows (referring to the promissory note):

> "Received by Prudence Veronica Permewan on 18 April 2018 as a loan and cancelled by her because of the merger of the right to be paid and the obligation to pay."

Davis J describes the above as follows at paragraph 24:

> "By this series of extraordinary documents:
>
> 1. Prudence purports to gift, through the provision of the promissory note, $3 million to the Lotus Trust. This is despite the fact that Prudence clearly did not have $3 million in cash and would have to liquidate all of her assets to pay it.
> 2. The Lotus Trust has loaned $3 million to Prudence. This is despite the fact that the Lotus Trust clearly did not have $3 million in cash to loan to Prudence.
> 3. To secure the loan, so as to give effect to the gift evidenced by the promissory note, Prudence mortgaged or otherwise charged her assets.
> 4. The result of the transactions is that Prudence, who before these transactions had assets worth net $3 million, now has a debt of that amount to the Lotus Trust secured over her assets."

The applicant submitted that there should be an inquiry into the transactions, and that:

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- The "Promissory Note" was not a promissory note as defined in the *Bills of Exchange Act*. It thus did not have legal effect as a promissory note. However, I do not have the submissions to hand and the issue identified by counsel is not clear to the reader of the judgment.[3]

- That no gift had been perfected and that there was no consideration supporting a promise to pay $3 million to the Lotus Trust.

- That the transactions were a sham.

I can only emphasise again that Davis J did not consider in any detail the merits of the arguments being put by the applicant about the veracity of the transactions in question. His Honour said at paragraph 45:

> "[The solicitor advocate for the executor] seemingly accepts that questions arise as to the effect of the *inter vivos* transactions. He continually submitted to me that those questions could be litigated in the family provision applications … In the passage above he concedes that [the executor] is not considering the validity of the promissory note. The fact that [the executor] is not considering whether action should be taken to relieve the estate of the $3 million debt is the very point upon which Mr Morris QC relies in his submissions for the removal of [the executor] …"

In short, it was the failure of the executor to contemplate investigation of the transaction, rather than any detailed consideration of the merits of the transaction, that led Davis J to remove the executor and appoint an independent administrator.

Nevertheless, we do now have an outline of the transactions in question, and the critique of those transactions by the Applicant, as a resource in considering these matters in future.

2.4 Turner v O'Bryan-Turner

Turner v O'Bryan-Turner[4] is a very lengthy case. There were a number of issues not presently relevant. I concentrate on the "gift and loan back" transaction.

2.4.1 Retention of evidence, gathering evidence

The case turns much on the evidence that was gathered.

Putting on an affidavit of a one-sided conversation with an elderly gentleman, where the gentleman's responses are not recorded (except by exception), is unlikely to be of assistance where the issue is, not some technical question about the law of promissory notes or mortgages, but rather whether the gentleman was effectively advised about a transaction that appeared to be much to his disadvantage.

[3] I gather there may have been issues raised about the validity of the promissory note, based on an earlier case (below).
[4] [2021] NSWSC 5

2.4.2 The transaction in 2010

I will omit much of the detail, and anything to do with claims about matters not related to the "gift and loan back" transaction.

Mr John Turner had latterly lost capacity and was living in a nursing home. There was dispute about the extent of his assets.

The transactions in 2010 began with the establishment of two discretionary trusts as an element of asset protection planning.

There was a concern about claims that might be made by Mr John Turner's second wife.

The trustee of the two trusts was a company of which John and one of his sons, Nick, were the only directors and shareholders.

Under each of the trusts, John, Nick, and Nick's sister of the whole blood, Sara (children by John's first wife) were the nominated principals. This gave them certain powers about distributing capital and income.

Ward CJ in Eq describes what happened, at paragraph 15:

> "John signed what are described as two promissory notes in favour of the trustee of those trusts … those notes together totalling around $2.5 million (that being said to be around about 90% of the value of the Trundle Properties at the time) … John executed statutory declarations at that time to the effect that all payments by him by promissory notes to the trustee were by way of gift. ..[A]t the time that the notes were signed, there was no amount specified in them and there was no fixed date for repayment."

Ward CJ in Eq continues:

> "16. John and [the trustee company] then entered into loan agreements whereby [the trustee company] in effect lent to John the $2.5 million that John had just 'gifted' to [the trustee company] under the promissory notes; and those two loans were secured by way of unregistered (and unstamped) mortgages … John then proceeded to cancel those promissory notes.
>
> 17. The consequence of the 2010 Transaction … was that, unless disturbed, [the trustee company] thus had the benefit of security over the Trundle Properties and would, at some point in time, be able to obtain what was then estimated to be approximately 90% of the value of the Trundle Properties. The purpose of the 2010 Transaction was unashamedly to protect John's farming assets from a potential claim by his then *de facto*, Wendy, …"

I cannot do justice to this lengthy decision by Ward CJ in Eq in the space of a conference paper.

But note the warning signs observed by her Honour.

The first warning sign in any estate planning matter is that a relative makes the appointment with the solicitor.[5] That is what is recorded as having happened here.

[5] At [46].

Secondly, the concern expressed about danger to the property apparently emanated from others in the family, not John.[6] The transaction was initiated because of concerns originating from them.

Thirdly, secrecy from other family members is telling.[7]

This is not conclusive of anything. It does put the experienced estate planning practitioner on guard, to ensure that the person who has to make decisions about property is independently and properly advised.

How is the person protected? By independent advice. There is no point in giving such advice unless it is recorded and can be given in evidence.

Thus the next point is the evidence about a discussion concerning the proposed trusts and the proposed gift and loan back transaction.

- The designated note-taker had lost his note pad.[8]
- The principal of the law firm gave a lengthy explanation of the proposed transactions to John, in the presence of Nick (his son) and the employed solicitor.
- The explanation was described by the employed solicitor as a "standard" "presentation".[9]
- The detailed explanation appears in the affidavit of the principal of the law firm.
- Critically, the principal records that "he did not recall any issue arising in the course of the meeting to suggest that John did not understand what he was saying".[10]

Ward CJ in Eq points out that simply putting on evidence that the gentleman concerned said nothing to indicate that he did not understand the transactions; did not appear to be perplexed; did not ask questions; and simply responded when questioned to the effect that John understood:[11]

> "… seems to me to be an inadequate basis on which to test whether John had any real understanding of the complex structure there being put forward".

No formal written advice was later tendered to John.[12]

Her Honour was concerned that there was no independent legal advice.[13] There was no formal letter of advice.[14] The costs agreement was signed by both John and Nick, which raises an issue about the provision of "independent" legal advice to John.[15]

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[6] At [43]-[44].
[7] At [57]
[8] At [53]
[9] At [57].
[10] At [60].
[11] At [60].
[12] At [67].
[13] At [67].
[14] At [67]
[15] At [75].

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Experienced estate planning solicitors are conscious of the heavy burden of providing advice. Her Honour quotes from the judgment of Kirby P in *Stivactas v Michaletos (No. 2)*:[16]

> "However, where advice is given, it must be both independent and effective for the purpose of enlivening the client's appreciation of the transaction, its legal effects and the alternatives (if any) which are open to the client …
>
> The fatal flaw in the procedures put in place by the appellant, to guard against just the kind of challenge which later eventuated, was the inability of the independent solicitor to establish that he sufficiently drew to the respondent's attention, so that she understood, precisely what she was doing, the alternatives which were available to her in law to effect her wishes, the comparative advantages of those alternatives and that she nonetheless preferred to transfer her properties to the appellant."

I now turn to those brief matters which were dispositive of the invalidity of the "gift and loan back" structure employed here. I will do so briefly, despite the very long judgment canvassing the arguments.

2.4.3 Invalid promissory notes

The promissory notes, when executed, contained no sum. Therefore, they could not comply with the statutory requirement for a valid promissory note.[17]

Also, when signed, they contained nothing on their face allowing you to work out "any date for repayment, discretionary or otherwise".[18] So they failed a second statutory test.

There were further issues as to whether the maker of a note could authorise another person to fill in matters.

In my view, if you are going into a scheme which may result in litigation, it is probably best not fall back on such arguments. I leave them to one side. Suffice to say that her Honour found that, "whether the promissory notes were here later filled in or indorsed (whether personally or otherwise), they remained invalid as promissory notes".[19]

2.4.4 Unstamped mortgages

A further issue affected the mortgages. To save stamp duty, John accepted advice that the documents be held "in escrow", to be fully executed and delivered should events require the mortgages to be perfected.

Her Honour did not agree with the reasoning about delaying the impact of New South Wales stamp duty.

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[16] [1994] ANZ ConvR 252 at 254
[17] At [343].
[18] At [341].
[19] At [363].

Although this can only now be of historical interest, given the abolition of stamp duty on mortgages in most places, I mention it as again indicating that the stamp duty saving (as it was thought to be) added an extra layer of complexity in something which proved to be litigious.[20]

2.4.5 Defending claims of UI and UB

I now briefly turn to issues concerning undue influence and unconscionable bargains.

What I have indicated above about the way in which John and Nick jointly engaged the solicitors shows that some care must be taken.

To rebut the allegation of undue influence, Nick had to show affirmatively that John received independent, competent and sufficient legal (or other) advice (though the lack of such advice is not strictly determinative).[21] Her Honour said at [393]:

> "Here, to maintain the impugned transactions, Nick must show affirmatively that John knew what he was doing at the time of the transaction, in the sense that he understood its effect and the significance of that transaction in relation to himself; and that it was done at the incidence of John's own free and independent will. It is in this context that the adequacy of the advice provided … becomes particularly relevant … I hasten to add that it is not necessary here to entertain debate as to whether the advice was negligently given or otherwise nor to enter into debate as to the duty of care owed by solicitors when giving advice preparatory to entry into a client relationship or during what here seems to have been little more than a marketing presentation …"

Her Honour found, on the evidence that had been presented to her, that John did not receive advice as to the potential implications for him in the relevant way.[22]

Her Honour found that there "was a sufficient relationship of dependency by John upon Nick … at around the time of the 15 April 2010 meeting, and the subsequent execution of the 2010 Transaction Documents, to give rise to the presumption of undue influence …". Thus the evidence about the advice given to John did not overcome that presumption of undue influence. Her Honour was minded to set aside those transactions.[23]

Her Honour was also minded to find that the transactions in question should be set aside on the basis of unconscionable conduct. Again, the evidence as to the advice given to John was material. The difference between undue influence and unconscionable conduct need not be explored here, but the experienced estate planning lawyer will be alive to the differences in the doctrines, and the need for independent and proper advice both to be given and available to be put into evidence.[24]

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[20] See for example at [366].
[21] At [392].
[22] At [394]
[23] At [388] and [396].
[24] At [401].

2.4.6 Summary

The evidence showed that incomplete promissory notes had been given, which did not comply with the *Bills of Exchange Act* and were thus invalid.

Reliance on other arguments for the validity of those documents added to the complications in the case. The lesson from that is that matters which may become contentious should be handled in the simplest way, not relying on additional arguments for validity.

Secondly, care is taken over transactions like this, when:

- The purpose of the transaction is to denude an estate.
- There may well be litigation.
- The transactions involve a person who, whatever the their perceived qualities when you meet them, will be coloured by one side as being vulnerable.
- The red flags for an estate planning lawyer should include anybody who is apparently vulnerable, ill, or old; anyone who is brought to the lawyer by a relative; and anyone intending to enter into a transaction which, on its face, appears to be seriously against that person's interests.

I am not saying that a solicitor cannot act in those circumstances.

But the solicitor must expect to give an account of the advice given to the person. Notes must be preserved. If the solicitor will have difficulty providing independent advice, the person entering into the transactions should be sent away to another adviser. Entering into a joint engagement between the donor and someone who could benefit, even indirectly, is a red flag.

Doubtless those involved in the transactions described by Ward CJ in Eq will have their own views about the outcome of the case. We must be conscious that the decision here is governed by the evidence that could be presented, after many years.

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3. Debt collecting – undoing "gifts"

Fundamental to our practice in this area is *Re Associated Electronic Services Pty Ltd*, a decision of the Full Court of Queensland. Delivering that judgment, Gibbs J said:[25]

> "The question remains whether the agreement that the dividend be treated as paid and that the amount of it be lent to the company discharged the company's liability to pay the dividend. There can be an accord and satisfaction where a debtor's promise, rather than the performance of his promise, is accepted in satisfaction of the original cause of action. … In the present case however the agreement between the parties was unsupported by consideration and was not binding. The only promise by the company that can be spelled out of the agreement was a promise to repay the amount … on request. A loan of money repayable on request creates an immediate debt. … But the declaration of the dividend had already created a debt immediately payable by the company to the appellant. … The position of the parties after the agreement had been concluded and the entries had been made in the books was exactly the same as it had been before; all they had done was to give a new label to an existing debt. The company did no more than promise to do something that it was already bound to do, and such a promise was no consideration for the alleged contract."

That was in a case where there was an attempt to re-characterise an amount (showing in the books as a declared but unpaid dividend) as a loan, so that the shareholders were not deferred to other unsecured creditors in the winding up. The shareholders were unsuccessful in that attempt. I say that this is fundamental because it shows that some care must be taken, and some understanding of the law applicable to each of the kinds of transactions under discussion must be applied.

3.1 Whether loan or gift

The proof of whether a payment by one person to another is a loan differs between Australia, on the one hand, and England and New Zealand on the other hand. In Australia we follow what I submit is the principled position that there must be proof of a promise to repay. It is not sufficient (as it is in England and New Zealand) merely to prove payment of an amount. The English case is *Seldon v Davidson* [1968] 1 WLR 1083. In Australia, there are two intermediate appellate decisions, one of which is binding, *Alexiadis v Zirpiadis*.[26] But see the New South Wales Court of Appeal, albeit *obiter dicta*, which is *Gray v Gray*.[27] The position in New Zealand, following the UK position, is spelt out in *Re Matthews*.[28]

Pannam, *The Law of Money Lenders in Australia and New Zealand*, 1965, Lawbook Company, defines a loan:[29]

> A loan of money may be defined, in general terms, as a simple contract whereby one person ("the lender") pays or agrees to pay a sum of money in consideration of a promise by another person ("the borrower") to repay the money upon demand or at a fixed date.

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[25] [1965] QdR 36, 41.4-41.8.
[26] (2013) 302 ALR 148
[27] (2004) 12 BPR 22, 755
[28] [1993] 2 NZLR 91
[29] At p.6

A good definition of "gift" is found in *Federal Commissioner of Taxation v McPhail*.[30] The High Court emphasises the need for a transfer of property, and that it be done voluntarily and without valuable consideration. There must be no advantage of a material character conferred on the donor.

3.2 Presumption of advancement

Whether something is a gift, rather than a loan, can also be addressed through the prism of presumption such as the presumption of advancement by a parent in favour of a child, or by a husband in favour of a wife. The former is seen in the recent New Zealand High Court decision of *Comins v The Public Trust*, per Mallon J. It points out that the essential feature was the contemporaneous evidence, rather than what was done later.[31]

In fact, that case was determined without application of the presumption of advancement in favour of the child, simply on the basis of the contemporaneous evidence.

There has been recent litigation in the Federal Court of Australia about whether there was a resulting trust in favour of a husband, arising from dealings with land which benefited a wife. *Commissioner of Taxation v Bosanac*[32] shows that the presumption of advancement operates "unless 'rebutted' by evidence": at [2]. The presumption was "developed as a result of Courts of equity drawing an inference, from the type of relationship, that the gift was intended as an 'advancement'": [4].

Then at [5], "the presumption of advancement has particular significance where there is little evidence relevant to establishing the intention of the donor or where the Court is unable to reach a positive satisfaction on the issue from the evidence adduced".

But the presumption of advancement "does not preclude an examination of the actual relationship between the parties, or of other facts relevant to the intention at the time of the transaction, when it comes to the question whether the evidence rebuts the presumption": [6].

The presumption is "liable to be displaced or rebutted by evidence, including the circumstances of the particular transaction": [11].

Worryingly, the mere evidence that Mr Bosanac took on a very substantial liability in respect of the property in question appeared to sway the Full Court that he intended to acquire a corresponding beneficial interest in the property: [21]-[22].

This is a concerning development, because that evidence appears very slight indeed, and almost puts the presumption of advancement at nought here.

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Chambers

15 February 2022

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[30] (1968) 117 CLR 111
[31] [2021] NZHC 1172 at [22]-[23] and [26]
[32] [2021] FCAFC 158

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