Worrells Brisbane CBD Conference

9 June 2022

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I want to give you some insights you won't have got elsewhere. That's the value of these Worrell's seminars.

I will cover some aspects of *Carter*, of section 100A, and of some welcome news about UPEs.

I also need to cover very recent developments in structuring, which are not in the news yet. There was an attack on a "gift and loan-back" structure, in the Supreme Court last month. It's time to talk briefly about the future of those transactions.

But I need to set the scene, first.

The policy scene

The Australian reports this morning that the Treasury Secretary yesterday spoke of a leaky tax system.

Mr Kennedy is reported to have identified:

> *"costly tax concessions, including superannuation, and tax minimisation ploys, such as family trusts, as areas ripe for reform".*[1]

The same story ran on the front page of the *Australian Financial Review* this morning.[2]

Trust taxation is back with Treasury, given the previous government's reaction to reportage in the same newspaper by Mr Gottliebsen at the start of the election

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1 Tom Dusevic & Patrick Commins, "Plug leaky tax system: Treasury", *The Australian*, published online 8 June 2022. I have read the published version of the speech to the Australian Business Economists on 8 June 2022, and the written version online does not deal with these matters specifically. As usual, one must check against delivery, and the reporters were best placed to do so.

2 John Kehoe, "Prudent budget repair needed", *Australian Financial Review* 9 June 2022, p.1

campaign. He wrote about the *Carter* decision of the High Court.[3] And about section 100A.[4]

Assistant Treasurer, Michael Sukkar, was forced to issue a press release on 7 April recognising that "trusts are a legitimate and important way for families … to manage their financial affairs".[5]

He welcomed the ATO backing off retrospective application of its draft ruling and draft Practical compliance guide on section 100A.

He signalled consideration of legislative amendments, to fix *Carter*, but his government was not returned.

So it is clear trust taxation is back on the agenda at Treasury, and has become politicised.

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3 Robert Gottliebsen, "Families' double blow: rising rates, ATO trap", *The Australian* 4 May 2022; and "High Court tax ruling to haunt Morrison government", *The Australian* 6 April 2022; and "How the Morrison government can fix the ATO" *The Australian* 7 April 2022

4 Robert Gottliebsen, "ATO to unleash carnage is Labor wins election", *The Australian* 19 April 2022

5 Press release, "Certainty and stability for family trusts" 7 April 2022

My reality check for you is this – last direct policy consultation I did with Treasury involved a discussion with one of Australia's best, young population economists. I doubt the chap could spell 'trust', though.

Engaging with Treasury is not always productive, so do not assume we can get reasonable results.

It is also plain ATO has been told to raise money again. we know that from the return of debt-collecting activities in March.

In my view, the continually extended reach of time-consuming reviews of increasingly smaller businesses will find serious issues with their structures. Trusts are complex, and the ATO will raise revenue there.

Section 100A

There are 5 key requirements (largely quoting from a presentation by the TTI recently):[6]

- A beneficiary has a present entitlement (PE) to trust income – note must not be under a legal disability
- PE arose under a reimbursement agreements (RA)
- A benefit is provided to someone other that the beneficiary
- The 'agreement' is not entered into in the course of 'ordinary family of commercial dealing'
- RA was entered into for a purpose of reducing income tax.

6 The Tax Institute, web presentation, "100A – Practical Guidance and Pre-June 30 Planning", 2022

The recent case, *Guardian,* emphasised the idea that the PE must arise under the RA. This was a special set of facts. The matter is on appeal.[7]

The debate has FIRSTLY been around the exceptions to the definition to 'agreement'.

That definition that feeds into the definition of 'reimbursement agreement'.

The exception in the definition of "agreement" is for "an agreement, arrangement or understanding entered into in the course of ordinary family or commercial dealing": subs100A(13).

SECONDLY, the debate has been around the separate exception from the definition of "agreement" -mfor an agreement not entered into for the purpose of reducing income tax: subs100A(8).

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7 *Guardian AIT Pty Ltd v FCT* 2022 ATC 20-813 (Logan J, 21 December 2021)

Specifically, as to this second debate, thenquestion is whether you can be excluded on the basis of "ordinary family or commercial dealing", if there was a tax avoidance purpose under subs(13): or whether you only consider absence of a tax avoidance purpose as a separate test under subs(8).

The drafting as separate subsections supports absence of tax avoidance purpose being a separate exclusion.

See Mark West's paper in *Taxation in Australia* this month.[8]

An awful lot has been written about the first of those exclusions.

Can I just give a reality check on the conversation. *Halliwell* is a decision of a good NZ High Court[9] judge, back in the 1970s.

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8 Mark West "Section 100A and tax purpose" (2022) 56(11) *Taxation in Australia* 701-713

9 In those days, the present "High Court" of NZ was called the NZ 'Supreme Court'. Confusingly, the ultimate appellate court in NZ is now called the 'Supreme Court'.

Casey J was taken to more liberal single-Judge Australian authority, but said:

> *I accept that the net income has been accumulated in the trust and used to acquire further assets, and that it is usual family dealing for income and assets to be built up in such a trust. But in New Zealand, the Courts have firmly rejected the method of income splitting or contrived deductions resulting in tax saving, as ``ordinary family dealings'', in achieving this object. (I note that in three Australian decisions discussed in 51 A.L.J. 215 the Supreme Courts in Tasmania and South Australia seem ready to take a rather more liberal view of family dealings involving a redistribution of assets. The cases are Peacock v. F.C. of T. 76 ATC 4375 decided by Nettlefold J. in Tasmania; Bayly v. F.C. of T. 77 ATC 4045 and Jones v. F.C. of T. 77 ATC 4058, both decided by Bray C.J. in South Australia.)*

The ATO will be attempting to push the envelope back toward this less liberal view of the world.

And we can see, from this NZ case that reasonable minds can differ about what constitutes an ordinary family dealing.

Specific arrangements ATO does not like

ATO issued 3 documents about s100A on 23 February.

Rather than doing the kind of technical bleating we have seen over the last 3 months, it is more useful to look at the stuff ATO really does not like, and see if we can derive any conclusions from those arrangements.

I should warn there is a fair bit more that ATO is highly suspicious of, but we'll concentrate on the highest risk stuff today.

TA 2022/1 is about a scheme purportedly to benefit the non-minor children of a family.

While resolutions appoint income their way, taking them just under the $180,000 threshold for top marginal rates.

But the money is actually paid to the parents or applied against a beneficiary loan account:[10]

- *The parties contend that the entitlements are paid or applied in this manner because -*

  - the Children are required to repay their Parents for expenses incurred in relation to their upbringing or while they were minors (for example, school fees, school uniform costs or their share of the family holidays)

  - the Children are required to pay or repay their Parents amounts to meet their share of family costs for the current year in excess of amounts it would reasonably be expected an adult child would meet for their personal living expenses while they remain living at home or otherwise supported to some extent by their Parents (those amounts being, for example, a reasonable rate for their board, lodgings or rent if living away from home, or car expenses), or

  - there is an agreement that the Parents will manage the pooled family members' entitlements from the Trust for the benefit of the family members.

- *There is no expectation or understanding that the Children's income they derive from sources other than the Trust distributions will be used to either repay their Parents for expenses incurred when they were a minor or pay more than their reasonable share of the household expenditures, or be placed in a pool to be managed by the Parents for the benefit of the family members.*

ATO say there is often no evidence of an obligation to repay anything, and often the children do not know of

[10] TA 2022/1, para 4

the beneficial entitlement, nor of it being applied against expenses.

The sting in this is the mention of promoter penalty provisions. This could be terminal for a registered tax agent, and is a controversial clause in this TA. But the TA was not out for consultation.

[Comments about current matters, implementation, need for legal advice]

Red zone arrangement in PCG 2022/D1 include –

- Adult children gift back their entitlements, for example to parents. This looks like the TA 2022/1
- Payments that are returned to the trust as assessable income – for example, paying to a corporate beneficiary, which is "taxed", but returns the amount as a fully-franked dividend. This is cycled through in year 2 as a

distribution of a fully franked dividend to the corporate beneficiary.

- Schemes involving issue of units at an over-value, to absorb a UPE, especially where the unit trust allows unilateral issues of units to the unitholders to absorb such UPEs
- Games with the definition of "income", which follow from *Bamford.* So distributable income may be $10, but carry with it $100 of net income of the trust estate.
- Losses.

This is not the end of the matter, as the ATO claims to want to look at anything that is not plain vanilla.

But looking at the Red Zone arrangements – there is a difference between economic reality, and the purported tax reality, and thus an element of contrivance.

Carter – disclaimer

The HCA upheld the ATO's argument that disclaimer of a PE was not to be given retroactive force under Australian income tax laws.

This was justified it was said, in Carter v Commissioner of Taxation [2022] HCA 8. See at [24]:

> *"It would give rise to uncertainty in the identification of the beneficiaries presently entitled to a share of the income of a trust estate and the subsequent assessment of those beneficiaries. On the respondents' construction, whether a beneficiary was presently entitled to a share of the income of a trust estate may not be resolved for a substantial period of time and, in some cases, such as the present, for years. The uncertainties that would arise, and which would apply with equal force to the Commissioner, trustees, beneficiaries and perhaps even settlors, would also not be fair, convenient or efficient."*

So the default beneficiaries can be sued to bankruptcy on the basis of efficiency. Of course perhaps there is some way they

can extract money from the trust or their family. But none is assured in most cases.

Gift and loan back transactions

However, I start with something hot off the press, in estate planning and insolvency.

Last month Cooper J heard a case called *Permewan*, about a gift and loan back transaction.

The case gained some attention last year, when Davis J expressed his surprise about the transaction.[11] But it was up to the parties whether they would test if the structure worked.

In that case, the transaction essentially denuded a $3m estate of value, making family provision claims by relatives problematic.

Davis J described the steps taken by the deceased 17 months before her death (emphasis added):

11 [2021] QSC 151

[14] On 18 April 2018, some 17 months before Prudence's death, she swore a statutory declaration in these terms:

> *1. It is my intention that all payments whether in cash, by cheque or Bearer Promissory Notes or otherwise, that I make from myself to the trustee of the Lotus Trust being a trust constituted by Deed dated 14 February 2011 are by way of gift unless otherwise recorded in writing.*

[15] On the same day, Prudence signed a document headed "Bearer Promissory Note No 1". That document was in these terms:

> *Prudence Veronica Permewan promises to pay to the bearer of this Bearer Promissory Note the sum of $3,000,000.00.*

[16] On the same day, this time on behalf of Zalerina, she signed a receipt. The receipt concerns the promissory note. It is in these terms:

> *Received by Zalerina Pty Ltd ACN 623 050 055 as trustee for the Lotus Trust on 18 April 2018 as a gift.*

[17] Therefore, Prudence has, by the promissory note, promised to pay $3 million to "the bearer" who is Zalerina who has accepted the promissory note "as a gift".

[18] Also on 18 April 2018, Zalerina, by its sole director Prudence, resolved as follows:

IT WAS NOTED that:

A. A Bearer Promissory Note in the amount of $3,000,000.00 has been received from Prudence Veronica Permewan by way of gift of capital to the Trustee of the Trust to be held upon the terms of the Trust.

IT WAS RESOLVED:

1. To acknowledge receipt of the Bearer Promissory Note by execution of the Bearer Promissory Note.

2. To lend the money gifted by Bearer Promissory Note to Prudence Veronica Permewan.

3. That such loan be repayable on demand and secured by way of Mortgage over real property acceptable to the Trustee.

4. To execute a Loan Agreement and Mortgage security documents to effect these Resolutions.

[19] A loan agreement was entered into, again on 18 April 2018, between Prudence and Zalerina. The loan agreement was executed by Prudence on her own behalf as well as on behalf of Zalerina. By that loan agreement, Prudence was loaned $3 million by Zalerina as trustee for the Lotus Trust.

[20] The loan agreement then provides as follows:

4. Security

4.1 The Borrower shall, when required by the Lender, execute and deliver to the Lender such documents evidencing the Security (if any) as required by the Lender.

4.2 If the Lender requires the Borrower to enter into a separate deed granting the Lender a security interest, then the parties agree that this document is a Transaction Document.

[21] The term "security" is defined for the purposes of the loan agreement as:

Security

1. Mortgage over the Borrower's interest in the property located at 354-358 Hauton Road, Burpengary, Queensland more particularly described as Lot 3 on Registered Plan 210,938 on Title Reference 16957106

2. Security interest over all shares in Orion Investments (Qld) Pty Ltd ACN 082 774 650 held by the Borrower

[22] A further document, styled "Security Deed", was also entered into which provided for a mortgage over the Burpengary property and a charge over the shares in Orion. On 20 May 2019, a mortgage over the Burpengary property was executed by Prudence and that has since been registered.

[23] Again on 18 April 2018, Prudence signed a further receipt in these terms:

> *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.*

[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.***

> *[25] These transactions have a direct impact upon Donna and Marla because they effectively obliterate the fund upon which provision for them could be made.*

I am not involved in that case. The court record shows it was heard over 4 days in May, and judgment reserved. Talk around the profession is that all substantial issues have been resolved by agreement of the parties, during the course of the trial – it seems to have been stood down at some stage for negotiations.

But the matter is listed for judgment tomorrow morning. I understand the remaining issue is – costs.

But since one side presses for indemnity costs, Cooper J may have to get into the merits or the conduct of the litigation, so far as relevant to that issue.

This follows the same law firm's gift and loan-back transaction being examined by the NSW Supreme Court in 2021. The case is *Turner v O'Bryan-Turner* [2021]

NSWSC 5; BC202100058. Ward CJ in Eq. hosed out the transaction in various ways.

Do these transactions remain viable?

The critique by Ward CJ in Eq was fairly specific to the implementation. Those issues could be overcome, and indeed the "legal technology" employed in Queensland has improved over the 12 years since that transaction.

I gather there are some implementation issue raised in the *Permewan* litigation, also. But we may never find out for sure.

Absent those issues, there are pervasive issues that must be considered and mitigated.

There is risk of prosecution under the *Bankruptcy Act 1966*, section 266(3). No one really wants to be locked up for 5 years sharing a potty with their client.

Also, the *Statute of Elizabeth*,[12] and voidable transaction provisions under the *Bankruptcy Act*, are pretty effective at negating attempts at defeating creditors. The trustee in bankruptcy has to be funded, sometimes, but most claims settle.

A problem particularly in Queensland is that relatives attempting to gain a jump over other relatives, in a future estate claim, will often be conflicted. There are general law conflicts rules, but in Queensland we also have a statutory presumption of undue influence under the *Powers of Attorney Act.* People forget they are attorneys, and do not appreciate how potent this Act is.

DW Marks QC

9 June 2022

12 Section 228 of the *Property Law Act 1974 (Qd)*