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Notes for in-house CPD – Cartland Law

RE: **Section 100A – Some Unresolved Issues**

DATE: **17 February 2023**

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1. Three recent decisions of the Federal Court about section 100A, and the ATO's issue of a ruling and of a "practical compliance guide", necessitate us revisiting where taxpayers now stand. The court decisions are :
   (a) *Guardian AIT Pty Ltd* –
      (i) trial before Logan J, 2021 ATC ¶20-813;
      (ii) Full Federal Court appeal, 2023 ATC ¶20-850;
   (b) *BBlood Enterprises Pty Ltd* 2022 ATC ¶20-840 (Thawley J), (appeal pending).
2. The Commissioner issued:
   (a) a public binding ruling, TR 2022/4, "Income tax: section 100A reimbursement agreements" on 8 December 2022;
   (b) a "Practical Compliance Guideline" PCG 2022/2 entitled "Section 100A reimbursement agreements – ATO compliance approach".
3. I have noted 3 matters that remain unresolved, but doubtless there are more:
   (a) Thawley J's comments about period of review;
   (b) Whether the tax avoidance purpose must be determined by an analysis similar to the Part IVA procedure of testing an alternative postulate; and
   (c) Whether the beneficiary need be party to an alleged "reimbursement agreement".
4. *Grandview Private Trust Co Ltd v Wen-Young Wong* [2022] UKPC 47 (8 December 2022) at [122] mentions the continuing controversy of "whether the exercise of a fiduciary power for an improper purpose renders the exercise void or voidable", mentioning *Pitt v Holt* [2013] 2 AC 108, [62]. The United Kingdom Supreme Court, in the latter case, noticed that there was Court of Appeal authority "that a fraudulent appointment is void rather than voidable". The critical question in Australia now is whether, after *Commissioner of Taxation v Carter* (2022) 96 ALJR 325 this distinction is meaningful for income tax purposes.

1 Period of Review

5. Notoriously, section 100A gives the Commissioner an unlimited period of review under section 170 of the *Income Tax Assessment Act 1936*. The words in section 170(10), which precede the table containing reference to section 100A (at item 17) are as follows:

> *Nothing in this section prevents the amendment, at any time, of an assessment for the purpose of giving effect to any of the provisions of this Act set out in this table.*

6. But words to that effect – albeit in subsection (10AA) - have been read down by the Full Federal Court: *Metlife Insurance Ltd* (2008) 170 FCR 584, [29].

7. Thawley J did not resolve the issue of whether the reasoning in *Metlife* could be applied to section 170(10), in *BBlood* at [61]-[69].

8. Nevertheless, note that the reasoning in *Metlife*[1] was that similar words governing 170(10AA) were "not designed to allow for oversight by the Commissioner, but [were] designed to address new facts after the original assessment, and which could occur at any time, enlivening the operation of … [the section in question]".

9. The argument is thus left open that the unlimited amendment period apparently conferred by section 170(10) in relation to section 100A actually only addresses particular circumstances, such as those exampled in *Metlife*.

2 Determining the Tax Avoidance Criteria

10. Section 100A(8) is a subsection which limits the width of the meaning of "reimbursement agreement" given by subsection (7). Relevantly, subsection (8) requires us to read down the meaning of "reimbursement agreement" so as not to include:

> *... a reference to an agreement that was not entered into for the purpose, or for purposes that included the purpose, of securing that a person who, if the agreement had not been entered into, would have been liable to pay income tax in respect of a year of income would not be liable to pay income tax in respect of that year of income or would be liable to pay less income tax in respect of that year of income than that person would have been liable to pay if the agreement had not been entered into.*

11. This is the so-called "tax avoidance purpose" required under section 100A.

12. The ruling, TR 2022/4, paragraph 22 says:

> *For there to be a tax reduction purpose, it is not necessary that an alternative postulate be established so as to identify a specific amount of tax that would be avoided by an identified person.*

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1 See *Metlife* at [29].

13. More interesting however is the supporting footnote.[2] Footnote 14 relies on *BBlood* at paragraphs [161]-[168]. However the footnote then mentions Logan J's decision in *Guardian*, which appears to be to the contrary.

14. The footnote does not mention the case to which both Logan & Thawley JJ respectively referred, *East Finchley*, a decision of Hill J, (1989) 90 ALR 457, 474 from about line 15. Referring to section 100A(8), and the required purpose, Hill J says:

> *It requires the hypothesis to be formulated as to what income tax <u>would</u> become payable if the relevant agreement had not been entered into. Since the relevant agreement requires the payment of monies to be made by some person, generally the beneficiary (in this case the payment clearly relied upon was a payment by the beneficiary to the trustee) it seems to me to be a matter of necessity that the relevant reimbursement agreement could only have been entered into where the beneficiary is in fact a party.*

15. Logan J refers to the first part of that passage at [158], saying that nothing in *Prestige Motors, Idlecroft*, or *Raftland* "calls into question the correctness of that observation". Logan J noted the force of the word "would", as just carrying "its ordinary English meaning". Logan J then said at [160]:

> *Insofar as anything more need be stated as to what s 100A(8) requires, it was stated by Hill J in East Finchley.*

16. On the other hand, in *BBlood* Thawley J rejected a construction of section 100A(8) that took a lead from Part IVA, the latter requiring identification of an alternative postulate. At paragraph [156] Thawley J said:

> *Section 100A does not operate by a mechanism which makes the identification of a specific amount of tax avoided a necessary component of identifying a 'tax avoidance' purpose.*

17. And Thawley J followed this through with specific findings against the need for there to be particular amounts of tax payable by some person, apart from the reimbursement agreement, needing to be found as facts. Refer [162]-[166].

18. Footnote 14 in the ruling simply notes, as was correct at date of issue of the ruling, that both *Guardian* and *BBlood* were subject to Full Federal Court appeal, but:

    (a) On my reading, the Full Court in *Guardian* did not determine this issue; and

    (b) The appeal in *BBlood* has not been determined.

3 Parties to "Reimbursement Agreement"

19. The definition of "agreement" in section 100A(13) invites some width of interpretation:

> ***agreement*** *means any agreement, arrangement or understanding, whether formal or informal, whether express or implied and whether or not enforceable, or intended to be enforceable, by legal proceedings, but does not*

[2] And see para [190] of the ruling.

> *include an agreement, arrangement or understanding entered into in the course of ordinary family or commercial dealing.*
>
> *Note: Section 960-255 of the Income Tax Assessment Act 1997 may be relevant to determining family relationships for the purposes of the definition of* ***agreement.***

20. In the quote from *East Finchley* (above, paragraph 16), the last sentence is to the effect that a reimbursement agreement could only have been entered into "where the beneficiary is in fact a party".[3]

21. Ruling TR 2022/4 paragraph 16, to the contrary, says that "neither the presently entitled beneficiary nor the trustee needs to necessarily be a party to the agreement or even be in existence when the agreement is made", citing *Idlecroft* (2005) 144 FCR 501. The Full Court said in that case at [41] that the definition "does not require a beneficiary to be a party to any arrangement or understanding".

22. But in light of the Full Court's decision in *Guardian*, paragraph [111], this will need to be revisited.

23. Specifically, the Full Court in *Guardian* picks up that quote from *East Finchley.* The Full Court also quotes a later reference in that decision (at page 475) to the practical necessity that the beneficiary also be a party. Hill J said, in part:

> *I have great difficulty in conceiving in the context of s 100a of the Act, how an arrangement to which that section applies could be constituted by the directors of a trustee company alone or for that matter by them and the trustee without the beneficiary being also a party. This will certainly be the case where the so called "reimbursement agreement" is one requiring payment by the beneficiary to the trustee.*

24. This aspect of the ruling now looks doubtful.

4 Relevance of "fraud on a power"

25. I begin with a point of terminology. What we have historically called "fraud on a power" is now termed the "proper purpose test". The old terminology incorrectly directed attention to concepts of fraud, and the new terminology directs us to questions of construction of the deed, and whether the purported exercise of a power was for a purpose permitted by the grant of that power. As the Privy Council said in *Grandview* at [56], the proper purpose rule, previously referred to as "fraud on a power" is "not confined to cases involving some reprehensible conduct on the part of a trustee or other fiduciary but extends to any case where a fiduciary power is used for a purpose not falling within the purposes for which the power has been conferred, even though the trustee may have acted in good faith and genuinely with a view to benefiting the beneficiaries". The Privy Council encourages us to discard the historical language, and use the term "proper purpose rule".

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[3] (1989) 90 ALR 457, 474 about lines 23-24.

26. It is certainly the case that historically an exercise of a power for an improper purpose was referred to as being void. There is authority in England and Australia supporting that. In Australia, see *Re Co-operative Development Funds of Australia Ltd (No.3)*.[4]

27. In England see Farwell, *A Concise Treatise on Powers* (3rd Edition) page 457 Chapter X, and citing *Aleyn v Belchier* (1758) 28 ER 634 for the proposition – "A person having a limited power, must exercise it *bona fide* for the end designed; otherwise the execution is corrupt and void …"

28. More recently, see *Cloutte v Storey* [1911] 1 Ch 18.

29. *Cloutte* is described in *Pitt v Holt*, [62], as problematic and liable to be revisited in future. But *Cloutte* stands for the proposition that "[a]ny questions of a fraud on the power would be for equity only": page 31. Thus if someone had obtained the legal estate to property, a purchaser for value without notice of that legal estate would have a good defence. But where an appointment operated only in equity, the distinction between an appointment which is void or voidable is of lesser moment: at page 30. Farwell LJ, delivering the judgment of the Court of Appeal, says at pages 30-31:

> *The purchasers appeal and contend that they are purchasers for value without notice, that the appointments are not void but voidable, and ought not to be set aside against them. Now the power in this case is equitable only; ie, it has no direct operation on the legal interest and could not have been enforced or challenged in any common law Court; the trustees in whom the legal title is vested must have transferred the property in order to give legal effect to the appointments. In such a case the difference between void and voidable is of little, if any, importance. Equity administers the trusts of the settlement and has regard only to equitable interests and equities: the appointments operate only in equity and are mandates to the trustees as to the mode of dealing with the legal title: there is nothing to be set aside or delivered up to be destroyed before effect can be given to the rights of the parties, because the Court has all the materials in its own hands and deals with the parties according to their rights in equity only. It would be otherwise if the power enabled dealings directly affecting the legal estate – eg, if … the settled property was real estate conveyed to the use of such of the children as the parents should by deed appoint: the common law would inquire only whether the appointee was a child and whether the deed was duly executed in accordance with the power, and if these questions were answered in the affirmative would hold the execution valid.*

30. Thus, David Maclean, in his Australian book *Trusts and Powers* summarises the position at page 124:

> *Appointments in fraud of an equitable power, namely one which does not operate to pass a legal estate or interest, are void. Appointments in fraud of a power which passes a legal estate are voidable.*
>
> *A purchaser who obtains the legal estate for value from the appointee of a fraudulent appointment without notice is unaffected by the fraud.*

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[4] (1978) 3 ACLR 437, 452 *et seq.* (Sangster J, SASC)

> *The purchaser of an equitable interest from an appointee is not protected by being a purchaser for value without notice.*[5]

31. The reason that I mention the "proper purpose test" is that it has always been considered improper in that sense to purport to appoint property to an object, where the real end is that some other person should benefit. Examples can be multiplied, but a simple instance might be an appointment in favour of a beneficiary where the beneficiary separately and personally owed a debt to the trustee, on the understanding that the beneficiary would use the appointment to repay the personal debt to the trustee.

32. It seems to me that the kinds of instances set out in the explanatory memorandum when section 100A was introduced involve trustees purporting to appoint income in favour of people and entities who were not, ultimately, meant to benefit, or meant to benefit in any substantial way. That looks, on the face of it, to be done for an improper purpose.

33. If the money is not actually paid, then it would appear that the unpaid object had a right in equity to have the trustee account to the unpaid object.

34. But if the appointment was invalid, in the sense that equity looks upon it as not made, then presumably the amount is treated as not validly appointed, and may go in a different direction, for example to a default beneficiary. Or it might go to some other beneficiary, depending on how the distribution minute was drafted.

35. A note of caution is necessary because of *Carter* (2022) 96 ALJR 325, particularly [22]:

> *Put in different terms, the taxation liability of the beneficiaries is determined by ascertaining the proportion of the distributable income of the trust estate to which each beneficiary is presently entitled at that point in time – just prior to midnight at the end of the year of income – and then applying that proportion to the "net income of the trust estate". That has practical significance. The stepped process in section 97(1) identifies the beneficiaries who are to be assessed at the end of the income year, permits the "net income of the trust estate" to be determined for that income year in the usual way and then enables the quantum of tax payable by the beneficiary to be calculated and subsequently assessed.*

36. The majority judgment, having mentioned the possibility of unfairness in this approach, goes on to say at [26]:

> *Similarly, here, the construction which has been adopted means that a beneficiary might be presently entitled at the end of an income year but be unaware of it. That unfairness arises because Division 6, and section 97(1) in particular, is drafted to tax a beneficiary by reference to present entitlement, not receipt.*

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[5] Some limited protection is conferred where the appointee was not less than 25 years of age and the purchase was for money or money's worth without notice of the fraud or of circumstances from which the fraud might have been discovered if reasonable enquiries had been made. This is a statutory intervention according to legislation in New South Wales, Victoria, Queensland and Western Australia, as at date of publication Maclean's book. In Queensland, see section 204 of the *Property Law Act 1974 (Qd).* This looks like something to add to the list, for any review of the *Law of Property Act 1936 (SA).*

37. *Carter* is authority for the proposition that, in Australia, and in construing and applying Division 6 of Part III of the *Income Tax Assessment Act 1936*, later, valid disclaimer of an entitlement to income, even if valid as against the trustee, did not disturb the position as at just before midnight on 30 June of the year of income concerned.

38. The concept of a void appointment of income is different from attempting to disclaim an appointment of income. But *Carter* may indicate that the job is ahead of someone, who contends that an appointment, the subject of an alleged reimbursement agreement, is void, leading to non-application of section 100A by reason of the legal invalidity of the purported appointment of income.

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