Please click here if you are having problems viewing this email

WEEKLY TAX BULLETIN

www.thomsonreuters.com.au/tax

THOMSON REUTERS WEEKLY TAX BULLETIN

Issue 17, 30 APRIL 2021

In this issue

PRACTITIONER ARTICLES

[340] Ex-spouses attacking trust assets - *by Matthew Burgess, Director, View Legal*

TAX PRACTICE UPDATE

[341] Professional bodies respond to allocation of profits draft guidelines
[342] Amendments to support small business insolvency reform: Exposure drafts
[343] Taxation revenue in 2019-20 down by 1.4%
[344] ATO's "Online services for business" now operational
[345] 62-year-old man charged for alleged illegal phoenixing: ATO
[346] ATO website updates

RULINGS AND GUIDELINES

[347] Class and Product Rulings (fuel tax credit records), Addendum (ASC grants)

▲Return to Top

Copyright. You are subscribed with the email address [email].
Private and confidential information for the use of the subscriber under Thomson Reuters General Terms and Conditions - Australia.

PRACTITIONER ARTICLES

[340] Ex-spouses attacking trust assets

- by Matthew Burgess, Director, View Legal

Many previous articles in WTB have explored how trusts are considered in family law matters.

The decision in *Balken & Vyner* [2020] FamCA 955 provides another example of the approach the courts take in relation to family trusts.

Factual matrix

Broadly, the factual matrix was as follows.

- A couple, both previously married, had a period of perhaps a few years as *de factos* prior to their marriage (there was a debate as to when a *de facto* relationship may have started).
- The couple were married 6 years.
- The majority of the asset pool was owned via trusts.
- The majority of the trusts were created by, and the assets held via them contributed by, the husband's father (who died shortly before the couple married).

There was significant disagreement between the spouses on almost every substantive issue before the Court, including the overall value of all assets, with the wife's estimate ($63 million), more than double the husband's ($31 million).

Control of trusts

Specifically, in relation to the level of control of the trusts the husband had (and therefore in turn the ability for the Court to apportion assets held via the trusts to benefit the wife), the following key comments were made.

- The husband was not the sole appointor of key trusts, nor the sole director or shareholder of the trustee companies.
- The husband's father had left a Letter of Wishes addressed to the directors and shareholders of the trustee company setting out his instructions.
- There were independent directors of the trustee companies and these persons were also appointors. The directors held regular meetings and exercised their discretion in relation to the income and capital of the trusts in accordance with the Letter of Wishes and there was no evidence which suggested that they would not continue to do so.

The accepted evidence was that the directors of the trustee had always acted, and would likely continue to act, in accordance with the wishes (an extract the decision provides of the Letter of Wishes is set out below).

This meant the husband had a present entitlement to 40% of the income and 40% of the capital, however only on the trusts vesting, as opposed to the 100% immediate entitlement to all income and capital of the trusts suggested by the wife.

The Court confirmed the evidence clearly demonstrated that the husband did not control the trusts, nor could he use the assets of the trusts for his own purposes.

In particular, there were regular meetings of the directors of the trustee companies and the husband reported to those meetings and was required to account to the other trustees and justify his actions.

To the extent the husband was responsible for the day-to-day management, an independent director (a consultant to the group) reviewed the accounts and queried the husband about particular transactions. The husband was required to justify his actions to the other directors (which included a partner at a law firm) and ultimately to the beneficiaries.

The evidence also demonstrated that if the husband received more than he was entitled to, according to the terms

of the Letter of Wishes, any amount over and above was debited against his loan account and he was either required to repay those amounts or paid interest on any loan account balance.

Ultimately the asset pool was decided to be in the region of $35 million, which effectively excluded a number of assets held in the trusts due to the practical limitation on the husband's potential entitlements imposed by the Letter of Wishes.

The husband suggested an 85%-15% split in his favour. The wife suggested 65%-35% in the husband's favour.

In a detailed balancing of the contributions, the Court made a primary allocation of 77.5%-22.5% in favour of the husband, with a further adjustment to benefit the wife, making the final allocation 75%-25% in favour of the husband.

Letter of Wishes

In relation to the Letter of Wishes, a warning - the significant emphasis placed on the Letter of Wishes and the fact that the Court held that the trustee directors essentially considered themselves bound by it should be considered in light of wider trust principles.

For example, the potential tax and stamp duty consequences of the Letter of Wishes perhaps causing the various trusts to be amended were not explored.

Furthermore, the rules against trustee's fettering their discretion were ignored.

As confirmed in the decision of *Dagenmont Pty Ltd v Lugton* [2007] QSC 272, there is a general prohibition on a trustee fettering its discretion, namely "trustees cannot fetter the future exercise of powers vested in trustees ... any fetter is of no effect. Trustees need to be properly informed of all relevant matters at the time they come to exercise their relevant power".

Similarly, the questions of whether the trustee directors were otherwise discharging the 3 key obligations on a trustee exercising a discretion were not explored, namely:

- to do so in good faith;
- upon a real and genuine consideration (a requirement that is so obvious that it is often not mentioned); and
- in accordance with the purpose for which the discretion was conferred.

The Letter of Wishes provided as follows.

"Income

After the death of the father of the husband, the net income of the Trusts for each accounting period shall be:

Distributed and paid as to:

1. 40% to the husband (or as he may direct)

2. 20% to the father's daughter (or as she may direct); and

Distributed and set aside to:

3. 30% to the children of the father's daughter as tenants-in-common in equal shares; and

4. 10% to the husband's children as tenants-in-common in equal shares

Until each of father's grandchildren attain the age of 24 years, sufficient funds shall be made available from thei respective entitlements above to pay for their education expenses.

Capital

After the death of the father and upon vesting of the Trusts, the balance of the capital, assets, income and othe entitlements arising in respect of the Trusts, if any, after taking into account all liabilities of the Trusts will be helc and applied as to:

(i) 40% to the husband (or as he may direct);

(ii) 20% to the father's daughter (or as she may direct);

(iii) 30% to the children of the father's daughter as tenants in common in equal shares; and

(iv) 10% to the husband's children as tenants in common in equal shares.

Notwithstanding any of the provisions in this Letter of Wishes, the Trustees may at any time make funds availabl to any of the beneficiaries named in this Letter of Wishes either by way of distribution of net income or advance o capital or loan to the relevant beneficiary if, in the majority opinion of the directors of the Trustees, the relevan beneficiary has reasonable cause to require assistance.

Any such payment shall be treated as a payment on account of (and not in addition to) the beneficiary' entitlements under the above paragraphs (as the case may require).

In the event that any of the beneficiaries named in this Letter of Wishes predecease the father or survive the fathe but do not reach their full entitlements hereunder leaving a child or children then such of those children as shal attain the age of 21 years (and if more than one as tenants-in-common in equal shares) will take the entitlemen which his or her or their parent would otherwise have taken.

This letter merely reflects the wishes of the father. It does not seek to impose any legal or binding obligations upor the Trustees except insofar as it is within the discretion of the Trustees to comply with such wishes and insofar a the Trustees as prepared to do so.

The Letter of Wishes is to be taken into account by all of the shareholders and directors from time to time of th Trustees and any successors in the offices of trustees or of Appointors and Guardians of the Trusts, in th administration of the Trusts and the exercise of the Trustees' discretions in applying any income or capital of th Trusts after the death of the father.

If at any time any difference of opinion of exists in relation to the commission or omission or any act or an decisions, determination or consent to be made or given by the Executors under this Letter of Wishes, then unles otherwise indicated the majority opinion of the Executors shall prevail."

Conclusion

Ultimately the decision in *Balken & Vyner* [2020] FamCA 955 provides a further reminder that appropriatel structured and administered trusts can achieve asset protection objectives from a family law perspective.

Critically however, in achieving asset protection objectives, potential tax, stamp duty and trust law

issues may cause unintended and undesirable consequences.

Acknowledgement

Thank you to Clifford Hughes CTA, Principal, Clifford Hughes & Associates for his insights in relation to the case featured in this article.

▲Return to Top

TAX PRACTICE UPDATE

[341] Professional bodies respond to allocation of profits draft guidelines

The professional bodies have released their joint submission to Draft Practical Compliance Guideline ***PCG 2021/D2*** ("Draft"). It makes for some interesting reading. Chartered Accountants ANZ has also released its separate additional submission.

Background

On 1 March 2021, the ATO finally released the long-awaited Draft, which sets out the ATO's proposed compliance approach to the allocation of professional firm profits and also provides a risk assessment framework to assist individual professional practitioners to self-assess their risk. Details can be found at 2021 WTB 9 [171].

However, by way of reminder, the Draft applies to arrangements that have a genuine commercial basis (including in relation to how profits are distributed) and do not include any high-risk features. Draft PCG 2021/D2 refers to the genuine commercial requirement as "Gateway 1" and the no high-risk features requirement as "Gateway 2".

- ***Gateway 1 - sound commercial rationale:*** The first gateway is that there must be sound commercial rationale for entering into, and operating, the arrangement or structure.
- ***Gateway 2 - arrangement must not contain "high-risk features":*** The second gateway is that the arrangement must not contain certain "high-risk features".

Taxpayers who satisfy these gateways can self-assess their compliance risk. Those who do not will need to engage with the ATO before seeking to apply Draft PCG 2021/D2.

The ATO's draft risk assessment methodology comprises 3 risk zones - low (green), moderate (amber) and high (red) - for assessing a profit allocation arrangement. The applicable risk zone is determined by combining the scores obtained for each of three risk assessment factors.

Taking a step back, it can be seen that the Draft is aimed at arrangements where an "individual professional practitioner" (IPP) redirects their share of the income from a professional practice (or a portion thereof) to an associated entity or entities - such as a trust, company or family member - where that has the effect of reducing the IPP's tax liability (because the recipient entity has a lower tax rate). Among others, the proposed rules can affect the accounting, architectural, engineering, financial services, legal and medical professions.

Relevantly, in December 2017, the ATO suspended its guidelines on the risks surrounding the allocation of profits within professional firms. The concern is that arrangements which would have previously been considered "low risk" will now fall into the "high risk" category.

In other words, its potential impact should not be underestimated. This perhaps explains the fairly blunt and direct language of the professional bodies, as set out below. It is also worth keeping in mind the timeframe. The Draft