Being wilful and reckless with trust deeds: not a winning tax planning strategy

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Regularly in this *Bulletin* I have recited the 'read the deed' mantra.

A previous article of mine in this *Bulletin* (see 'Changing trustees of trusts - Simple in theory ... not so simple in practice', at 2017 WTB 6 [160]) explored some of the fundamental issues to be aware of with the 'simple' concept of changing the trustee of a trust.

Last year's decision in *Advanced Holdings Pty Limited as trustee for The Demian Trust v FCT* [2020] FCA 1479 provided a stark example of a range of issues, centred on a purported change of trustee.

Factual matrix

The key difficulties with the documentation before the court included:

- the deed required that the principal first remove the trustee if the principal was wanting to appoint a new trustee;
- the documentation did not support an argument that the principal did in fact remove the incumbent trustee;
- furthermore, the documentation failed to effectively evidence the trustee itself resigning and also did not comply with the written notice of intention to resign mandated by the trust deed as needing to be given 2 months before any trustee resignation;
- while there was a 'Notice of Removal of Trustee' signed by a director of the trustee company, as this was signed in the director's personal capacity and not as a director, it was held to be invalid;
- the 'Notice of Removal of Trustee' document was also not a valid reliance on the principal powers as the notice was drafted on the assumption that the trustee had in fact already resigned;
- the signed 'Deed of Retirement and Appointment of Trustee' also referred to the minutes of the previous trustee company being tabled at the meeting of the directors of the (purported) new trustee company, and yet no such minutes could be produced to the court;
- separately, the documentation that was available was further undermined by the fact that the accountants for the trust produced and backdated documents (leaving an email trail confirming their conduct) in an attempt to create the impression that the change of trustee had in fact occurred many years earlier;
- there were also allegations (that the court decided it did not need to resolve) that the backdated documents had been further doctored from the actual documents signed in an attempt to create the desired tax outcome.

Initial decision

Based on the factual matrix, the court concluded that the argued change of trusteeship was ineffective.

One of the consequences of the failed change of trusteeship was that the, purported, new trustee was unable to demonstrate that one of the assets it was owner of (being units in a unit trust) were in fact held on trust.

This meant that the potentially concessional tax treatment on distributions from the unit trust were instead taxed in the company in its own right.

Appeal decision

A number of key issues were explored in more detail in the appeal decision of *Advanced Holdings Pty Limited as Trustee for The Demian Trust v FCT* [2021] FCAFC 135, handed down on 4 August 2021, and reported at 2021 WTB 32 [747].

While the appeal case essentially confirmed the original decision, a number of other key comments were made in relation to the way in which trusts are managed (at least for tax purposes), as set out below.

As a general rule, a court should give effect to the objective intention sought to be achieved where the words of an instrument allow that intention to be given effect, however the court cannot give effect to any intention which is not expressed or plainly implied in the language of the document, as to do otherwise would be to engage impermissibly in 'gratuitous, groundless, fanciful implication' (see *Fell v Fell* [1922] HCA 55).

To the extent of any ambiguity in the terms of a document, the court should construe the clause so that the operation of the trust is advanced (see *Re Baden's Deed Trust* [1969] 2 Ch 388).

In the case here where a claimed 'implied removal' of a trustee lacked these essential words that pertained to what the court referred to as 'a straightforward concept' was held to be fundamental and prevented any favourable interpretation for the taxpayer. Any interpretation other than that demanded by the words of the document (ie an appointment, but no retirement, of trustee) meant the court would have needed to cross a line from simple construction into rectification.

Statutory provisions (such as under s 251A(6) of the *Corporations Act 2001*, which provides that a minute of meeting properly recorded and signed is evidence of the proceeding to which it relates, unless the contrary is proved) do not mean such a minute is automatically conclusive evidence of happenings at a meeting unless the contrary is proved. Whether the contrary is proved must be judged on the whole of the evidence. If the evidence establishes that an event recorded in a minute did not occur, the fact of its recording in the minute has no effect (see *Australian Securities and Investments Commission v Macdonald (No 11)* [2009] NSWSC 287).

Thus, where there are other findings of fact firmly adverse to the quality of corporate management by a director, a court is not obliged to accept at face value and for all purposes, the existence and efficacy of challenged underlying transactions referred to in a company minute.

The court acknowledged that this reality may present a sobering bookkeeping reminder to directors of small companies. This said, it was also confirmed that the evidentiary rules established under the statutory provisions are not intended to circumvent the need to establish the efficacy of all the underlying transactions recorded in a company's minutes in all cases. In this case, the underlying transactions were squarely in issue and their efficacy open to being doubted.

Finally, given there was evidence that the taxpayer was aware his accountant had prepared backdated documents and his wilful and reckless inattention to the correctness of the relevant tax returns, the court confirmed that the penalties imposed (of 75% of the tax shortfall amount, further increased by 20%) were appropriate. This conclusion was further reinforced by the fact that the taxpayer's advisers also took steps to prevent or obstruct the Tax Office.

Conclusion (yet again) - always start by reading the deed

As explained regularly in this *Bulletin*, given the range of significantly adverse consequences that can result where a purported change to a trust is subsequently found to be invalid, advisers should proactively invest in processes and systems to minimise the risk of such an outcome.

Invariably, best practice dictates that the starting point must be to read the trust deed.

However, the 'strategy' of backdating documents (regardless of how described) will always be inappropriate.