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Tax and estate planning - a timely reminder

by Matthew Burgess, Director, View Legal (3 June 2022)

In the estate planning arena there are many debatably unique outcomes that have developed from the interplay of tax legislation and case law over time.

Arguably one of the most unusual however is the exception to the rule that a willmaker can only regulate the transfer of assets they personally own under a will.

In particular, in certain situations the standard position that assets of a company are not something individual shareholders have the authority to regulate under their will has been overruled.

Recent decision

The decision in Wheatley v Lakshmanan [2022] NSWSC 583 ("Wheatley") provides a detailed analysis of the key rules in this area.

At the heart of the factual matrix in this case was a clause in a will that purported to gift to a child of the willmaker, unencumbered, a commercial property - with a further direction that the property 'be placed into a trust or superannuation fund of (the child's) choice'.

The relevant property however was owned by a company that the willmaker was at all material times (i.e. both at the date of the making the will and at the date of death) the sole shareholder.

In confirming that the purported gift of the property was ineffective the court stated:

- the general position is that a willmaker cannot bequeath something that they do not own;
- it may be that where a willmaker conveys to the executor a direction to reduce into possession an asset not owned by the willmaker, and the executor is armed by the willmaker with the power to get the asset (eg by directing that all relevant assets are to be held on trust under the estate) they will be bound to do so - and then deal with the asset as directed by the will (see Re O'Callaghan [1972] VR 248 ("O'Callaghan"));
- that is, if there is the conferral of power upon executors to deal with shares in a company that owns the assets in question as if they were beneficial owners, coupled with express gifts under the will, this can give rise to an implication that the trustee was required to use the shares of the company to ensure the assets of the company are transferred as set out in the will;
- this said, the court commented that it may also be that the earlier cases such as O'Callaghan were in fact decided incorrectly - a point the court did not need to resolve on the basis that in the will in Wheatley, the requisite power was not granted to the executor of the will in any event;
- the key reason for suggesting that the previous cases may be wrong at law is that they are vague in clarifying how exactly an executor exercising rights as a shareholder can cause the relevant company to divest itself of the assets purportedly bequeathed. That is, the shareholders do not

manage the company’s affairs; rather the directors do and a court should not construe a will in a manner that would or might place the directors in a position where their statutory duties as directors are in conflict with the willmaker's intentions, based on a conflation of ownership with management (or day-to-day conduct) of a company.

Tax interplay

Ultimately, while the aggrieved beneficiary was granted a cash settlement pursuant to a court order as part of a family provision application, this amount was significantly less than the value of the property in question; and was also arguably partially reduced by a tax bill that the estate had to bear. The potential tax liability was said to be in the region of $1M.

Relying on advice of a specialist tax adviser the court made the following observations:

- the estate, for tax purposes, would be deemed to be a trust under section 6(1) of the Tax Act;
- any payment of any amount by the company to the executor of the estate would be a dividend assessable under section 44 or under Division 7A of the Tax Act - and, if the moneys were paid to the executor who then used them to pay the purported gift under the will, the recipient of the gift would be subject to income tax on a flow through basis;
- if instead the company distributed to the estate and no particular beneficiary was eligible to receive those moneys, then the trustee would be taxed (at the highest marginal rate) under section 99A of the Tax Act;
- an argument that the payment by the company to the beneficiary as a form of notional estate order would not constitute a deemed dividend had been rejected by the Tax Office in a private ruling issued before the trial - the Tax Office instead determining that the payment would in fact be treated as a deemed dividend under Division 7A;
- although not expressly stated in the decision, it seems likely that the relevant private binding ruling in this regard is Authorisation Number 1051799201069. This ruling references Taxation ruling TR 2014/5 (Income Tax: matrimonial property proceedings and payments of money or transfers of property by a private company to a shareholder (or their associate)) in concluding that the reasoning from a family law perspective also applies in the succession law setting, and as such, the requirement in section 109J(b) of the Tax Act to access an exemption from the deemed dividend regime is not satisfied;
- the use of the word in the gift provision of the will 'unencumbered' was held to be intended to be in its common parlance - that is referring to mortgages or charges secured on the property – not the embedded tax liability. Thus, any income tax liability should be largely ignored by the court in determining the appropriate provision to be made for the aggrieved beneficiary. This conclusion was reinforced by the fact that the tax liability only arose subsequent to the sale of the property, on the distribution of the proceeds of sale - and furthermore the purported gift was held to be invalid in any event.

Conclusion

The interplay of tax and estate planning should never be underestimated. However so too should advisers understand the core principles of corporation laws and the fact that individuals personally owning shares in a company generally does not create any right to dispose of the assets of the company under a will.

Furthermore, as the court also observed in Wheatley, there is a risk that tax issues can 'overtake' common sense during estate litigation. Specifically in Wheatley this contributed to high levels of legal and accounting costs - which the court stated it was inclined to place a significant cap on in terms of what the estate would be liable to pay for.