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Gift and loan back arrangements with SMSFs - A Tax Office Warning

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A previous article in this Bulletin (reported at 2022 WTB 25 [489]) explored recent developments in relation to the asset protection strategy often referred to as a 'gift and loan back' arrangement.

The arrangement (and various iterations of it) has arguably had a chequered history, and often seen branding developed to conveniently label the steps involved, for example:

- Beta Strategy (which was the subject of a failed patent application in the case of Grant v Commissioner of Patents [2006] FCAFC 120);
- Legacy Protection Strategy;
- Secured loan arrangement;
- Synthetic transfer;
- Capital protection strategy using a lineal descendent or bloodline trust;
- 100% security strategy - to protect your assets from thieves such as the tax man (see Ed Burton and his 'Diamond Inner Circle Coaching and Mastermind Alliance' as part of the 'Vital Link Financial Education' Group circa 2004).

Gift and loan back arrangements

Recently, another productised version of the arrangement has gained the attention of the Tax Office.

Branded as the 'Vestey Trust' or the 'Master Wealth Control Package', the arrangement is promoted as part of a wider property and investment offering that promises advice on 'how to locate and invest in undervalued property, undertaking property developments, locating undervalued businesses, renovating for profit and how to secure and grow your wealth'.

As with all the various versions, or brands, of a gift and loan back arrangement, the key components appear to be driven by managing asset protection that would be otherwise problematic due to related tax and stamp duty asset transfer costs.

That is, in broad terms, the owner of an asset gifts an amount equal to their equity in the asset to a family trust (or low risk spouse). The family trust then lends an amount of money to the owner and takes a secured mortgage over the property or registers a security interest on the Personal Property Securities Register over the personal assets of the individual the protection is intended for.

Implemented correctly, the gift and loan back approach ensures there are no CGT or stamp duty consequences to achieving asset protection, subject to the claw back rules under the bankruptcy regime and various state based property or conveyancing acts.

Tax Office Warning

Now the Tax Office, in a pre-Christmas trust related release (continuing an, apparent, tradition of late December trust related releases - including in recent years announcements on trust splitting and trust vesting) has flagged material concerns with the strategy in relation to SMSFs.

Titled 'SMSFs and schemes involving asset protection' the Tax Office confirms that as a threshold issue the arrangement is unnecessary because the superannuation system already protects SMSF assets from creditors.

This fundamentally important observation is supported with a number of further comments focused on the likely superannuation related compliance risks, for example that the arrangement may:

- result in the giving of a ‘charge’ over, or in relation to, a fund asset by the SMSF trustee;
- involve the ‘borrowing’ of money by the SMSF trustee;
- expose fund assets to unnecessary risk if it is unclear who owns them;
- cause the fund to be maintained in a way that doesn’t comply with the sole purpose test;
- cause SMSF money to be used for costs related to asset protection arrangements entered into by members to protect their personal or business assets; which is prohibited because these expenses are not incurred in running the SMSF.

Based on publicly available information there is no doubt that each of the concerns set out by the Tax Office are correct and likely to be applicable to any gift and loan back arrangement involving an SMSF.

Other potential issues

For arrangements not involving SMSFs, despite the case featured in the previous article (namely Re Permewan No 2 [2022] QSC 114), appropriately implemented gift and loan back arrangements appear to be a valid and revenue effective asset protection strategy. This said, there are a myriad of potential issues that always need to be considered, for example:

- care should always be taken to ensure that the trust which will make the secured loan does not itself conduct risky activities (for example, run a business).
- while the arrangement can be entered into without registering a mortgage, if this step is not taken, the trust that has made the loan will simply be an unsecured creditor.
- the impact of the arrangement in relation to potentially accessing the small business tax concessions should always be carefully considered, because while a family home should be

excluded from the $6 million test, a secured loan will generally be included if the trust is an affiliate or 'connected entity' under the Tax Act (which will typically be the case).

- to the extent that a third party financier already has a mortgage over the property, they will generally require a deed of priority securing that lending (to whatever level it may be from time to time) as a first priority before the trust's second mortgage.
- the provisions of the Tax Act under subdivision EA need to be considered. While there has been some significant dilution of the circumstances where subdivision EA will apply given the Tax Office's approach to UPEs, in some situations it remains potentially relevant. In particular, the second 'tranche' of the gift and loan back arrangement involving a loan out of a trust can be problematic if at the time the loan is made, there was an unpaid distribution to a corporate beneficiary.

Promissory notes

Finally, a key aspect in the Re Permewan No. 2 case related to the (argued) ineffectiveness of the promissory notes. The decision in Turner v O'Bryan-Turner [2021] NSWSC 5 provides further context of some of the key issues in this regard. In a factual matrix where the promissory notes were blank as to the dollar amount and had no date for repayment at the date of issue to the payee, the court confirmed:

- A promissory note must specify either that it is payable on demand, or at some future time.
- If a future date is nominated, then it has been held that the specified time must be capable of being determined with certainty or at a fixed date (see Williamson v Rider [1963] 1 QB 89).
- Therefore, a purported note specifying that payment was to be made 'on or before' a specified date will be invalid.
- There is however an unresolved question as to whether a note which specifies a date on which the maker must repay the principal, but thereby confers on the maker a discretion to make payments from time to time prior to that date, is a 'promissory note' for the purposes of the Bills of Exchange Act.
- This aspect was not resolved in Turner as there was no date set for repayment on the face of the purported note, and therefore strictly the issue did not need to be considered.
- To be valid, a note must be sum certain - by definition, a promissory note is an instrument, the contents of which consists substantially of a promise to pay a definite sum of money, and of nothing else.
- Given the notes in Turner when executed contained no sum, they failed to comply with the statutory requirements and were therefore invalid on this basis alone, without the need to resolve the issues around the date for repayment.