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WEEKLY TAX BULLETIN
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Tax Office Wins Big in attack on related party service fees

by Matthew Burgess, Director, View Legal

In any small to medium sized business (SME) - and indeed much larger businesses, the gap between a purest approach to legal documentation and commercial reality is often significant.

Where third parties are involved (for example on the breakdown of personal or business relationships) or where an event of incapacity or death occurs, the higher order consequences of limited legal documentation can be material - and often unsolvable without incurring significant cost.

In contrast, between related parties in closely held groups, it has been argued that a lack of formal documentation may not be of particular detriment, even where the legitimacy of arrangements is challenged by the Tax Office.

The key arguments in this regard in recent times were captured in the decision in S.*N.A Group Pty Ltd v Commissioner of Taxation* [2025] FCA 240 one step the business owners have endured in a protracted Tax Office audit and court proceedings.

In essence the case involved a business that had evolved from start up to a nationwide operation (Coronis Real Estate Group).

Following a restructure driven by asset protection objectives, multiple entities combined to run the various aspects of the overall business (with operating entities separated from asset owning entities), and based on accounting advice, service agreements implemented with service fees charged.

The Tax Office took issue with the arrangements as a form of profit stripping, highlighting aspects of the factual matrix such as the following (with the decision in the initial case confirmed in brackets):

(a) due to an administrative error, the extension of the original license agreements on termination was not documented in writing, and extended orally by one of the directors of each relevant entity (which the court accepted as valid);

(b) a director claimed in material that a particular trust was in existence, when it was not (a fact that the court held was an oversight that was trusting and careless but not dishonest);

(c) the accountant had no contemporaneous record of the methodology used in calculating the advice as to what a reasonable service fee would be in any given year (which the court accepted was likely less than ideal, although of itself of no particular import, noting that the court (and the Tax Office) should not be concerned with the provision of management consultancy advice).

The 2025 decision rejected all aspects of the Tax Office attack and held that the arrangements were effective and valid.

In the February 2026 full federal court appeal decision of *Commissioner of Taxation v S.N.A Group Pty Ltd* [2026] FCAFC 10, the conclusions from the initial judgement were unanimously reversed.

The critical reasons emphasised by the full court were as follows in confirming that there was 'insufficient evidence of an objective manifestation of mutual assent' between the related parties to enter into contract for the payment of service fees.

1. As a threshold issue, the full court held that even between related parties, all the elements of a valid contract need to exist before service fees can be validly charged for tax purposes. In particular:

(a) the formation of a contract and identification of its terms turns upon what the words and conduct of the putative contracting parties would be reasonably understood to have conveyed to reasonable people in the position of those parties, not upon the actual subjective intention of those parties (see *Equuscorp Pty Ltd v Glengallan Investments Pty Ltd* [2004] HCA 55;

(b) evidence about subjective intentions or understandings is not relevant to determining whether a contract exists (see *Ermogenous v Greek Orthodox Community of SA Inc* [2002] HCA 8);

(c) the conduct of the parties, viewed in light of the surrounding circumstances, can show a tacit understanding or agreement, however in such a case, the conduct of the parties must be capable of proving all the essential elements and terms of an express contract (see *Integrated Computer Services at 11,117; Vroon BV v Foster's Brewing Group Ltd* [1994] 2 VR 32);

(d) it is not sufficient that the conduct be consistent with what is asserted as being the existence and terms of a binding agreement - rather the evidence must positively indicate that both parties considered themselves bound by the purported agreement (see *Industrial Rollformers Pty Ltd v Ingersoll-Rand (Australia) Ltd* [2001] NSWCA 11);

(e) the circumstances in which a contract will be inferred by conduct are rare. This is not a statement of a legal principle, but rather a reflection of the difficulty, in the absence of a communication of offer and acceptance, of demonstrating to the satisfaction of a court that reasonable people in the position of the parties would understand from their conduct that there was mutual assent to contract on clear identifiable terms (see *Danbol Pty Ltd v Swiss Re International SE* [2020] VSCA 274).

2. Ultimately therefore, the objective theory of contract demands an 'outward manifestation or communication by words and (or) conduct of a mutual assent to contract on particular terms. The private thoughts or intentions of the parties are not relevant and cannot outwardly manifest or communicate to reasonable people in the position of the parties a mutual intention to contract on particular terms'.

3. On the evidence in this case, it was held that there was no binding agreement that could be inferred between the parties (in the context that the original written agreements had ended many years earlier), with the four specific issues for this conclusion summarised below.

4. First, there was no direct evidence of any communications between the natural persons who were the directors of the taxpayers and trustees of the relevant trust of an accepted liability on the part of the taxpayers to pay a fair and reasonable fee for use of the trust assets before the taxpayers transferred the alleged service fee amounts each year.

5. Second, there was:

(a) no direct evidence of any communications of an accepted liability on the part of the taxpayers to pay the return claimed to be required by the service trust; and

(b) inconsistent evidence regarding the benchmarking for the required ‘return’.

6. Third, there was no evidence that the related parties had communicated or shown any outward manifestation to either the internal nor external accounting functions, that there was an agreed obligation based on mutual consent before the end of each year to pay a reasonable service fee; and no accounts reflected this claim - despite the obligation on the parties to keep written financial records that correctly recorded and explained their transactions and

financial position and performance to enable true and fair financial statements to be prepared and audited (see section 286(1) of the Corporations Act).

7. Fourth, the contemporaneous conduct of the parties on the transfer of amounts was inconsistent with payment of 'service fees' in accordance with a pre-existing agreement or understanding to pay a fair and reasonable service fee, in particular:

(a) all financial records were prepared on the mistaken assumption that the lapsed agreements remained binding and operative;

(b) the related parties were unaware of the manner in which the payments were coded or labelled in the financial records and took no steps to ensure the coding reflected existing contractual liabilities at the time the payments were made;

(c) there was no objective communication between the related parties of an agreed liability to pay a coherent and consistent 'fair and reasonable (service) fee' or any methodology for use of intellectual property - indeed, the evidence was the opposite, with the payments instead being of 'incoherent, inconsistent and seemingly random amounts from relevant year to relevant year', despite the claimed use of the same, or similar, intellectual property each year;

(d) there was material miscoding in relation to claimed service fees which was held to be 'inexplicable' - although even if there had been integrity in this regard it was confirmed that accounts of themselves cannot establish that payments are made for or on account of 'a fair and reasonable (service) fee';

(e) although GST was 'charged' on the amounts coded as 'service fees' no GST tax invoices were rendered, indicating that there may not have been a taxable supply - which was also 'inconsistent with an objective outward manifestation or communication' between the related parties of the existence and acceptance of a contractual liability to pay a service fee (see section 29-10 of A New Tax System (Goods and Services Tax) Act 1999 (Cth)).

8. Ultimately:

(a) the uncommunicated subjective thoughts or intentions of related parties provided 'no foundation for inferring the existence of a contract', particularly where there did not even seem to have been a request for the trust to provide any services;

(b) the subjective view of the parties 'that the amounts recorded as service fees in the taxpayers' financial statements were fair and reasonable' provided no foundation for inferring the existence of a contract given there was no outward manifestations or communication of those thoughts;

(c) the mere making of payments and assigning codes to the payments in the financial records was insufficient evidence from which to infer a request for the provision of services or assets or agreement to pay a fair and reasonable (service) fee - particularly when the codes in fact evidenced a mistaken assumption that the lapsed agreements remained operative;

(d) given there was no coherence or consistency with respect to the payments made in each relevant year, the mere fact that payments were made and these were within the range of an arm's-length fee for use of the assets was also insufficient evidence from which to infer the existence of a contract.

Pending the outcome of the special leave application to the High Court, the decision of the Court of Appeal provides a stark reminder to advisers and business owners alike of the risks of poorly implemented contractual arrangements.