Theme 4: Legal structures, professional privilege

Trusts and Tax Integrity Risks: Assessing the Potential of s100A *ITAA36*, and a Critique of the Full Federal Court's Approach in *Guardian*

Dr Sonali Walpola (Australian National University)

Section 100A of the *Income Tax Assessment Act* 1936 (ITAA36) is an important integrity measure in the trusts arena. The provision was introduced in 1979 with the intention that it overturn schemes that have the broad purpose of allowing income derived by trusts to be passed on to beneficiaries in a tax-free form. More specifically, section 100A is activated where a beneficiary is made presently entitled to trust income in circumstances where the economic benefits relating to the present entitlement are enjoyed by another party. Where s100A applies, the relevant trust income is taxed to the trustee at the highest personal rate. For most of its history, the Australian Taxation Office (ATO) did not actively use s100A to address trust tax avoidance, and the case law on s100A is modest. However, in the last few years, s100A ITAA36 has attracted considerable attention. The Commissioner of Taxation released detailed guidance on s100A in 2022, and has relied on s100A in recent litigation—in *BBlood Enterprises Pty Ltd v Commissioner of Taxation* [2022] FCA 1112 (*BBlood*), where the Commissioner was successful (currently on appeal to the Full Federal Court) and *Commissioner of Taxation v Guardian AIT Pty Ltd* [2023] FCAFC 3 (*Guardian*), where the Commissioner was unsuccessful (at least on s100A). This paper examines the scope and operation of s100A ITAA36, with a focus on how Federal Court and High Court judges have approached the provision. It is centrally argued that the Full Federal Court's approach to s100A in *Guardian* is overly narrow, and in fact untenable in light of the (only) High Court decision on s100A—which remarkably, was not cited or discussed.

In 2022, the Commissioner successfully invoked s100A before Thawley J in *BBlood*. The case involved egregious tax avoidance, with trust controllers attempting to exploit differences in the meaning of trust income under the trust deed (which did not include capital gains) and trust income for tax law purposes (which includes net capital gains) to extract economic benefits in a tax-free form. The type of scenario in *BBlood* was documented in ATO materials for some time as something that 'attracts attention.' *BBlood* is a very strong case, and does not really test the limits of s100A ITAA36.

Guardian has represented far greater challenges for the Commissioner. The trust (AIT) was controlled by Mr Springer (a non-resident), and the advisors involved acted according to his instructions. The tax avoidance issues focussed on the dealings between the trustee (Guardian) and a corporate beneficiary (AITCS) of the trust. Importantly, the trustee owned all of the shares in AITCS. The incorporation of AITCS, and its inclusion among the eligible class of beneficiaries (some years before the tax controversy), had been originally done to minimise Springer's business risks rather than to obtain tax benefits. However, in the income years of relevance, there were obvious tax advantages achieved by the course of dealing between the trustee and beneficiary. AITCS was made presently entitled to trust income, but this present entitlement was never paid. AITCS later relied on its (unpaid) present entitlement to discharge its tax liability, and then declared a franked dividend to the trustee to fully clear its present entitlement. The benefit of this franked dividend was ultimately passed onto Springer, who did not pay any further tax on the substantial dividend as his non-resident status meant the franked dividend was non-assessable non-exempt income. At first instance, Logan J held that s100A ITAA36 failed due to the application of the 'ordinary family or commercial dealing' exclusion in s100A(13) ITAA36. Logan J evidently placed controlling emphasis on the original (non-

tax related) motives in incorporating AITCS and including it as a beneficiary. On appeal, the Commissioner challenged the first instance decision in relation to only one of the income years, when the arrangement in question was repeated. The Full Federal Court considered that s100A ITAA36 did not apply (for different reasons to the trial judge), but held that the Commissioner could successfully rely on the general anti-avoidance provision (s177D ITAA36, Part IVA). As to s100A ITAA36, the Full Court held that the beneficiary's present entitlement did not arise out of a reimbursement agreement. In reaching this conclusion, Hespe J (with whom the other judges agreed) emphasised that there needs to be an understanding or consensus between at least two parties, and relied on the decision of Hill J in *East Finchley Pty Ltd v Federal Commissioner of Taxation* (1989) ALR 457 ('*East Finchley*'), to hold that it is also necessary that the beneficiary be a party to the agreement where the alleged agreement involves payment by the beneficiary. These alleged requirements were held not to be met.

Extraordinarily, the Full Court in *Guardian* does not once discuss or cite the only High Court decision on s100A, *Raftland Pty Ltd v Commissioner of Taxation* [2008] HCA 21 ('*Raftland*'). I argue this is a serious omission as a consideration of *Raftland* could have led to different conclusions on the interpretation and application of s100A in *Guardian*. Importantly, in *Raftland*, the High Court (which fully agreed with Justice Kiefel's careful judgment at first instance) upheld a purposive, liberal approach to establishing s100A elements and there was no exacting enquiry (or any enquiry) in that case to identify the parties to the reimbursement agreement. Further, in endorsing Justice Kiefel's decision, the High Court in *Raftland* also approved of *Idlecroft* (*Idlecroft Pty Ltd and Ors v Commissioner of Taxation* [2005] FCAFC 141) where the Full Federal Court held that a beneficiary did *not* need to be a party to the reimbursement agreement and confined Justice Hill's view in *East Finchley* to its facts. *Idlecroft*, although directly on point, was not discussed or cited in *Guardian*, and represents a further serious omission. And while Part IVA was successfully used in *Guardian*, prior case law shows that s100A is the more robust anti-avoidance mechanism because it is not hindered by problems that have beset Part IVA including establishing a dominant tax avoidant purpose.

What Is Behind Business Structures? Reasons for Business Structure Recommendations

Dr Barbara Trad (Griffith University)

A fundamental decision in starting a business is the choice of a business structure. While this choice can have long-term implications for business operations, there is a paucity of Australian research on this topic. The business structure decision can have important ramifications for internal and external governance issues, liability exposure, ability to raise equity finance, tax liability, management roles and responsibilities, and tax compliance costs. If an inappropriate business structure is initially chosen, this may impose legacy issues, as it may be difficult, or cost prohibitive, to later alter the business structure. The differing tax treatment of business structures may constitute an incentive for investors to adopt suboptimal business structures to conduct their operations, resulting in economic costs for businesses, and the nation. From a policy perspective, there may also be concerns about business structures being used inappropriately, such as for phoenix activities, as well as in facilitating aggressive tax planning.

Business structures are often discussed in isolation, whether they be sole traders, partnerships, companies, or trusts. It has been reported that there is a trend for advisors to recommend to Australian small and medium enterprises (SMEs) a combination of business structures for the one business operation, with companies and discretionary trusts featuring prominently. However, this fact alone provides little insight into the underlying reasons for the business structure recommendations. Despite the significance of SMEs to the Australian economy there is little empirical evidence about the reasons for SMEs adopting a combination of structures. This research provides a comprehensive analysis of the underlying reasons for the recommendations of business structures by Australian SME advisors.

This research employs an experimental case study design to provide detailed insights into what SME advisors are trying to achieve for their clients. These case studies are 12 different business scenarios and each of these scenarios is either a new or established business. The case studies were complimented with in-depth interviews, which consisted of structured, semi-structured and open-ended questions. Forty eight SME advisors (accountants & lawyers) were interviewed across Australia. The findings may provide policy makers with deeper insights into the use of the business structures in Australia. The analysis demonstrates that enhanced tax outcomes and asset protection are core attributes that advisors are seeking to achieve for their clients.

Really Under Pressure? The Federal Commissioner of Taxation, Legal Professional Privilege and the Provision of Australian Legal Profession Legislation that Dare not Speak their Name

Mr Eu-Jin Teo (University of Melbourne)

Taxation and legal professional privilege have a long history. (Indeed, it appears that one of the earliest cases to involve a claim of the privilege, *Berd v Lovelace* [1577] Cary 62, arose in a tax context.) In recent times, however, and consistent with what would seem to be an emerging trend amongst regulators internationally, the Australian Taxation Office ('the ATO') has been bellicose in its opposition to claims of legal professional privilege. The ATO has insisted that legal practitioners who, in its view, make unfounded privilege claims, leave themselves open to sanction for breaching their obligation to comply with the Federal Commissioner of Taxation's ('the Commissioner's') coercive information-gathering powers (which, the ATO accepts, are subject to legal professional privilege).

What seems to have not quite received the same attention, though, are some of the prohibitions that might constrain the ATO itself in the exercise of its powers in this regard. For instance, s 39 of the *Legal Profession Uniform Law* provides that: 'A person must not cause or induce or attempt to cause or induce a law practice or a legal practitioner associate of a law practice to contravene this Law, the Uniform Rules or other professional obligations.'

This paper discusses the potential relevance of s 39 (and its equivalents in Australian jurisdictions that have not adopted the *Uniform Law*, for example, ss 143 and 159 of the *Legal Profession Act 2007* (Qld)) to the Commissioner and to agents or officers of the Commissioner. Conduct by the executive vis-à-vis s 39, a provision yet to be judicially considered, likely raises broad rule of law concerns, quite apart from the general issue of Crown immunity (the *Legal Profession Uniform Law* does not purport to bind the Crown in any of its capacities). The potential application of the section to the Crown in right of the Commonwealth raises further issues in relation to intergovernmental immunity and s 109.

While pursuing the hardly objectionable objective that the legally 'correct' amount of tax be paid, it would appear, on balance, that well-meaning but overzealous ATO officers could potentially expose themselves to criminal culpability if they seek to pressure practitioners in relation to claims of legal professional privilege, contrary to s 39 and its equivalents. In this regard, what practical impact, if any, the ATO's most recently adopted *Legal Professional Privilege Protocol* will have, remains to be seen.