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Where the Guardian appeal was won and lost

TAX

The court's decision highlighted the differences between s100A and Part IVA.

By Jeremy Makowski•08 February 2023•6 minute read

The facts

Guardian AIT Pty Ltd was the trustee of the Australian Investment Trust (AIT), a discretionary trust of which Mr Springer was the "principal". AIT Corporate Services Pty Ltd (AITCS) was incorporated with all its shares held by Guardian and was then appointed as a corporate beneficiary of AIT.

Broadly, in each of the 2012 and 2013 income years:

- Guardian as trustee of the AIT made AITCS presently entitled to income which was not physically paid thereby creating an unpaid present entitlement (UPE).
- AITCS drew part of the UPE to fund its tax liability and then declared a fully franked dividend back to AIT, which was paid by offsetting the balance of the UPE.
- AIT then appointed the income comprising the fully franked dividend to Mr Springer, a non-resident individual (and no further tax was payable).

The Commissioner assessed Guardian as trustee for the AIT under s100A and s99A and in the alternative made determinations under Part IVA and assessed Mr Springer. The primary judge found that neither s100A nor Part IVA applied. The Commissioner appealed to the Full Federal Court submitting that s100A applied to the 2013 year and that Part IVA applied to the 2012 and 2013 years.

The full court decision

S100A (2013 year)

The Full Federal Court held that an s100A reimbursement agreement (which includes any agreement arrangement or understanding, whether formal or informal, express or implied) need not be binding or enforceable. However, it must reflect a common intention, or consensus at least, between two parties at or prior to the time by which the beneficiary is made presently entitled to the net income of the trust.[1]

By contrast, a mere "expectation" that an arrangement will be entered into after the creation of the present entitlement is not sufficient for s100A.[2]

The Court held that the evidence was insufficient to find the existence of an actual or imputed (subjective) reimbursement agreement at or prior to the date of the resolution by which AITCS was made presently entitled. Mr Springer's assent to the agreement could not be inferred from the practice of following the advice of Pitcher Partners because that advice was never communicated to Mr Springer on or before the date of the resolution. Given the subjective nature of s100A, there is limited scope for attributing the intention of the tax adviser to the relevant entities unless the evidence shows the advisor was an authorised representative (which it did not).[3]

Given this finding, there was no need to consider s100A any further, and so we were left without any further guidance on the meaning of the phrase "ordinary commercial or family dealing".

Part IVA (2012 and 2013)

Broadly, the Part IVA schemes alleged by the Commissioner were similar to the facts as outlined above.

Tax benefit

The Commissioner's position was that absent the scheme, Guardian would have appointed (unfranked) income directly to Mr Springer, who would have therefore been assessed at a higher rate of tax, which the Full Court accepted.

The Full Court rejected the primary judge's finding that a direct distribution would not be made to Mr Springer (but instead amounts would remain with AITCS or AIT) because those findings were inconsistent with:[4]

- Mr Springer's concern about leaving funds in a bank account over which he had no control;
- AIT's history of never accumulating income; and
- The actual fact that AITCS was not used as a vehicle for wealth accumulation or asset protection.

Additionally, given the legislative amendments following the case of RCI,[5] the Full Court observed that it was not open for the primary judge to have regard to the higher Australian income tax cost when rejecting the Commissioner's alternative postulate/counterfactual as not being "economically justifiable".[6]

Dominant purposes

Unlike s100A, Part IVA does not concern itself with subjective states of mind but rather it is to be determined objectively by reference to specified criteria. Therefore, it was not relevant whether Mr Springer subjectively turned his mind to a payment of a dividend by AITCS at the time of its present entitlement or whether a recommendation was discussed.[7]

Importantly, unlike the 2012 income year, which was the product of an "evolving set of circumstances"[8] (and so lacked the requisite dominant purpose), in 2013 the objective circumstances would have given rise to an expectation in an objective, reasonable observer that AITCS's UPE would be cleared out in the same way it was in 2012 as part of the implementation of an existing and settled strategy.[9]

Take away

Part IVA and s100A cases are often going to be decided on the particular facts, which the taxpayer has the burden of proving.

S100A requires a subjective agreement (as defined) at the time the beneficiary is made to be presently entitled to the income. Unfortunately, the Court did not provide any further guidance on s100A and it remains to be seen whether the Commissioner will update Taxation Ruling TR 2022/4 to reflect the limited ability to infer the existence of a reimbursement agreement.

The Full Court affirmed that s177CB(4)(b) precludes the taking into account of the higher Australian tax burden when determining what might reasonably be expected to have happened had the scheme not been carried out. Non-resident beneficiaries of discretionary trusts will need to be mindful of Part IVA in circumstances where they are to receive fully franked dividends.

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[1] At [108].

[2] At [111].

[3] At [124].

[4] At [160], [170] and [175].

[5] *RCI Pty Limited v Commissioner of Taxation* [2011] FCAFC 104.

[6] At [174].

[7] At [193].

[8] At [223]

[9] At [223].